



Study to Serve Governor's Management Review Commission

Operational Review of Tax Delinquency and Related Revenue Administration Issues

November 16, 1990

GOVERNOR'S MANAGEMENT REVIEW COMMISSION

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GOVERNOR'S MANAGEMENT REVIEW COMMISSION

OPERATIONAL REVIEW OF

TAX DELINQUENCY

AND

RELATED REVENUE ADMINISTRATION ISSUES

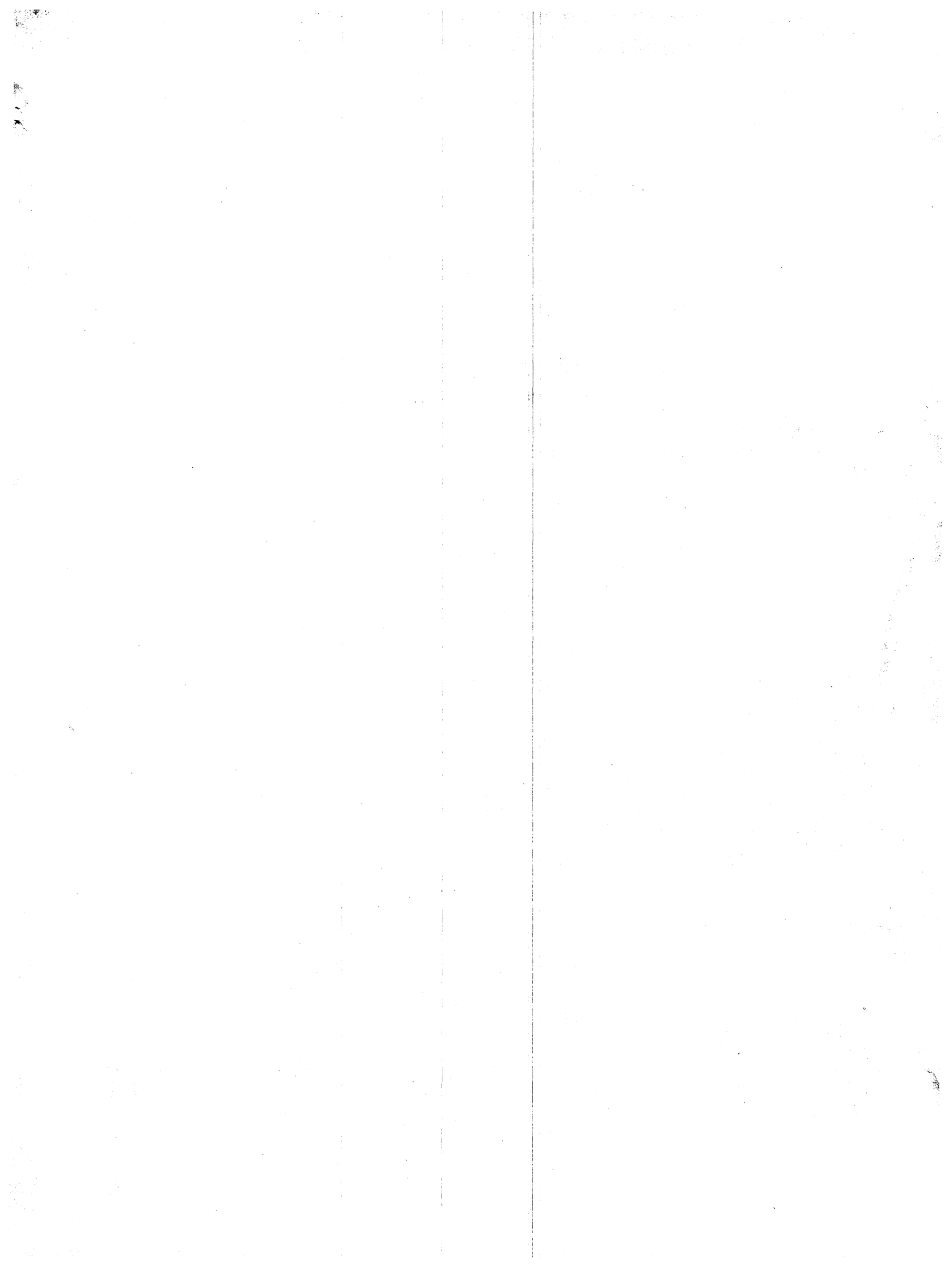
OBJECTIVE:

The objective of this review by the Governor's Management Review Commission was to quantify the state's Tax Delinquency - that portion of the total tax effort which is officially labeled as an "unremitted liability", and to clarify its composition, collectibility and the effectiveness of measures being taken to collect it.

INTRODUCTION:

Tax collection efforts in the State of New Jersey are the responsibility of the Treasury Department's Division of Taxation. Records indicate that 95-98% of all taxes due are collected with little or no manual collection intervention (Exhibit A). The 2-5% balance of taxes due, the tax delinquency, which has averaged about \$325 million a year over the last five years, is where the Division of Taxation spends much of its resources. This is also the area that has been the target of repeated questioning.

At issue is the size of this delinquency, its collectibility, the rate of collection, and the type, intensity and reasonableness of the collection efforts. This examination seeks to provide answers to these and related questions and to offer insight into the complexity of this issue.



METHODOLOGY:

This review of tax delinquencies was a cooperative effort of the New Jersey Society of Certified Public Accountants, the staff of the Governor's Management Review Commission and staff of the Office of Management and Budget (OMB). The Commission especially wants to recognize the assistance of the New Jersey Society of Certified Public Accountants (NJSCPA), John Kelly, President, and Robert Garrity, Executive Director.

The primary NJSCPA (the Society) participants included Bernard Gingras, CPA (Gingras, Collister & Co.) who served as Chairman of the Society's task force, Patrick J. Deo, CPA (Albanese, Deo & Co), Michael Lefanto, CPA (Chazotte, Lefanto & Co.), Robert Mathers, CPA (R.D. Hunter & Co), Henry Murphy, CPA (KPMG Peat Marwick), and Alan J Preis, CPA (Deloitte & Touche).

Robert Preston, Daniel Swantko and Edward Maute of OMB contributed to the collection and analysis of the data. Coordinating these various efforts for the Commission was Paul Finocchio (GMRC).

The review of the tax delinquency issue could not have been accomplished without the cooperation of many staff at the Division of Taxation. The Commission acknowledges the assistance of Chief of Staff James DiEleuterio, Jr. and Administrative Analyst Steven Csogi.

The methodology consisted of the collection, assimilation and analysis of many Division of Taxation generated reports, a series of meetings and interviews with Taxation staff and the research and review of other supporting materials including those furnished to the Commission by the Office of the State Auditor.

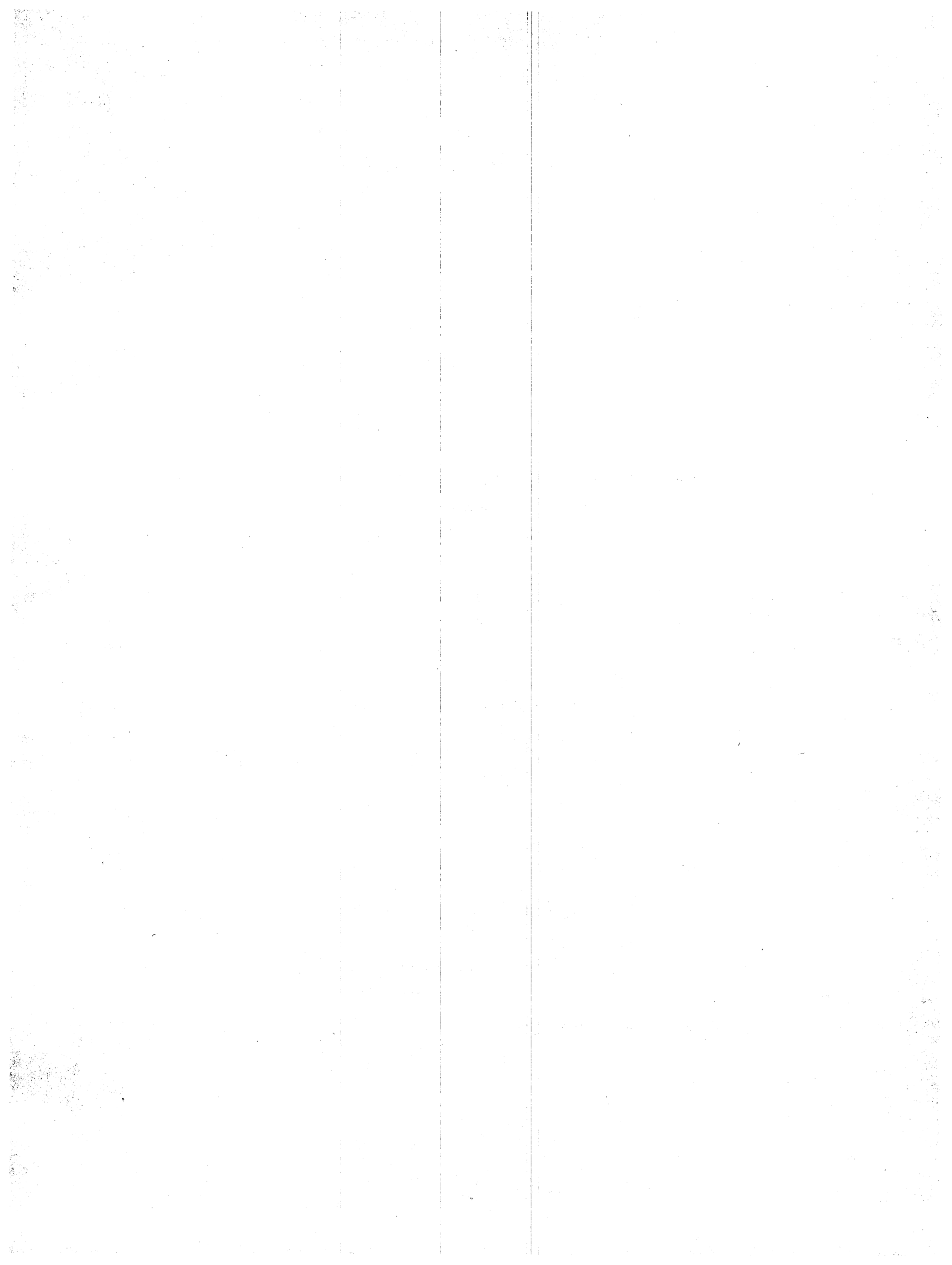
The report was initially developed as two stand-alone documents which were principally authored by Bernard Gingras (NJSCPA) and Dan Swantko (OMB). It was then agreed to issue a joint report and Paul Finocchio of the Commission staff provided the final edit to this cooperative effort. Both the Society and the Commission agree with and support the report and its recommendations.

The Tax Delinquency: A Clarification

The State of New Jersey's current \$400 million tax delinquency has been viewed by some as the panacea for the state's budget crisis. This analysis attempts to clarify the nature and complexity of these delinquencies and the managed effort which goes into collecting them. The report demonstrates that while improvements in delinquency collection are possible these delinquencies do not represent windfall profits. Rather, delinquent tax collections are a normal function of the Division of Taxation and the anticipated revenues generated by these collections are already budgeted. Finally, the analysis offers a series of recommendations to improve the collection of delinquent taxes and the public confidence in the equity of the collection of taxes.

The Nature of Unremitted Liabilities

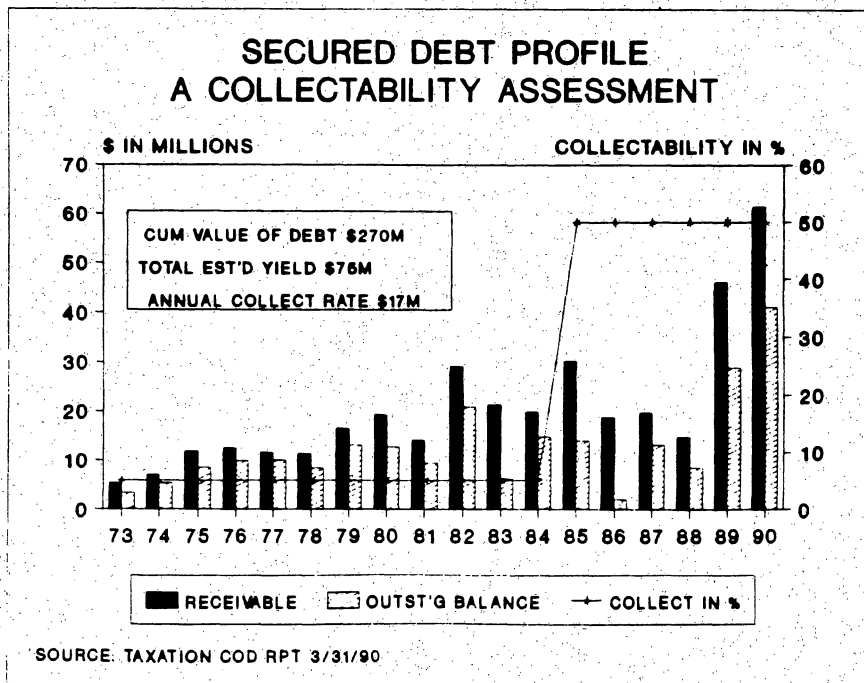
Unpaid taxes or unremitted liabilities take two "official" forms. A tax deficiency is the filing of a return with payment of less tax than actually due. A tax delinquency is the failure to file and to pay any taxes at all. Commonly however, and throughout this text, both of these types of unremitted liabilities are referred to as tax delinquencies. These tax delinquencies are a fact of life in the tax collection business as are bad debts in the private sector. Delinquencies result from the inability to pay, the desire not to pay or the inclination to pay less than that owed.

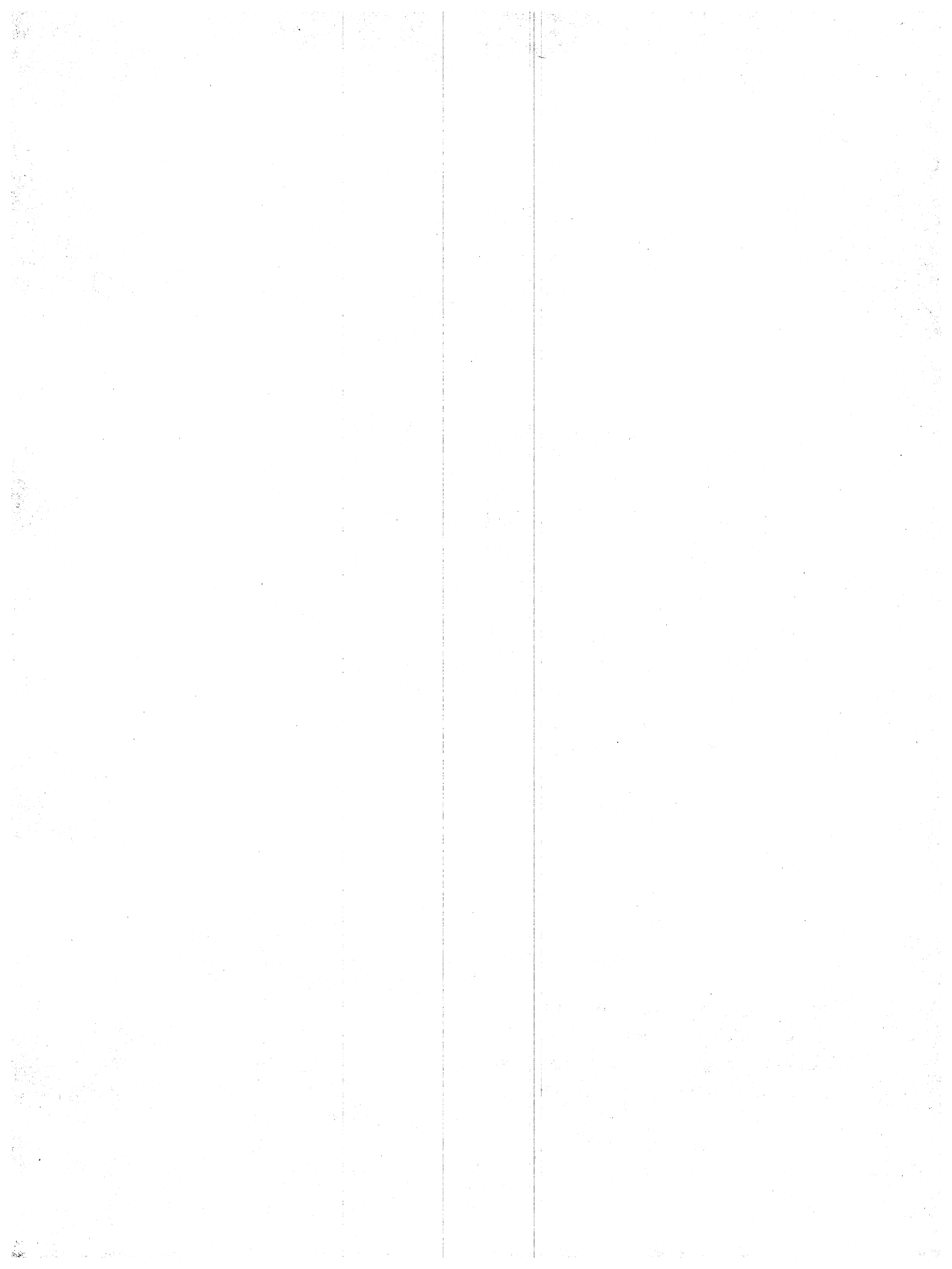


During any given collection year, delinquency information accumulates slowly as a result of the self-assessment nature of taxes. The amount owed and the identification of delinquent taxpayers is not known until after the filing or remittance period has passed. Taxation then begins the process to identify the delinquencies and initiate remedial actions.

The composition of the total tax delinquency is a mixture of both old and new debt. The \$400 million in fiscal year 1990, for instance, is composed of delinquencies which date back to 1973. This is because an unpaid debt secured by court remains "on the books" for 20 years and is renewable once before its statute of limitations expires. Unsecured types of delinquencies have no statute of limitations. The collectibility of a particular tax debt is often related to its age. The longer a debt remains on the books, the smaller is the likelihood of it ever being collected. As illustrated by Table 1, of all the court secured debt ordered prior to June of 1984, only 5% or about \$6.6 million is still considered to be collectible. Furthermore, the collection of these funds will likely be spread out over the next 10 to 20 years.

TABLE 1



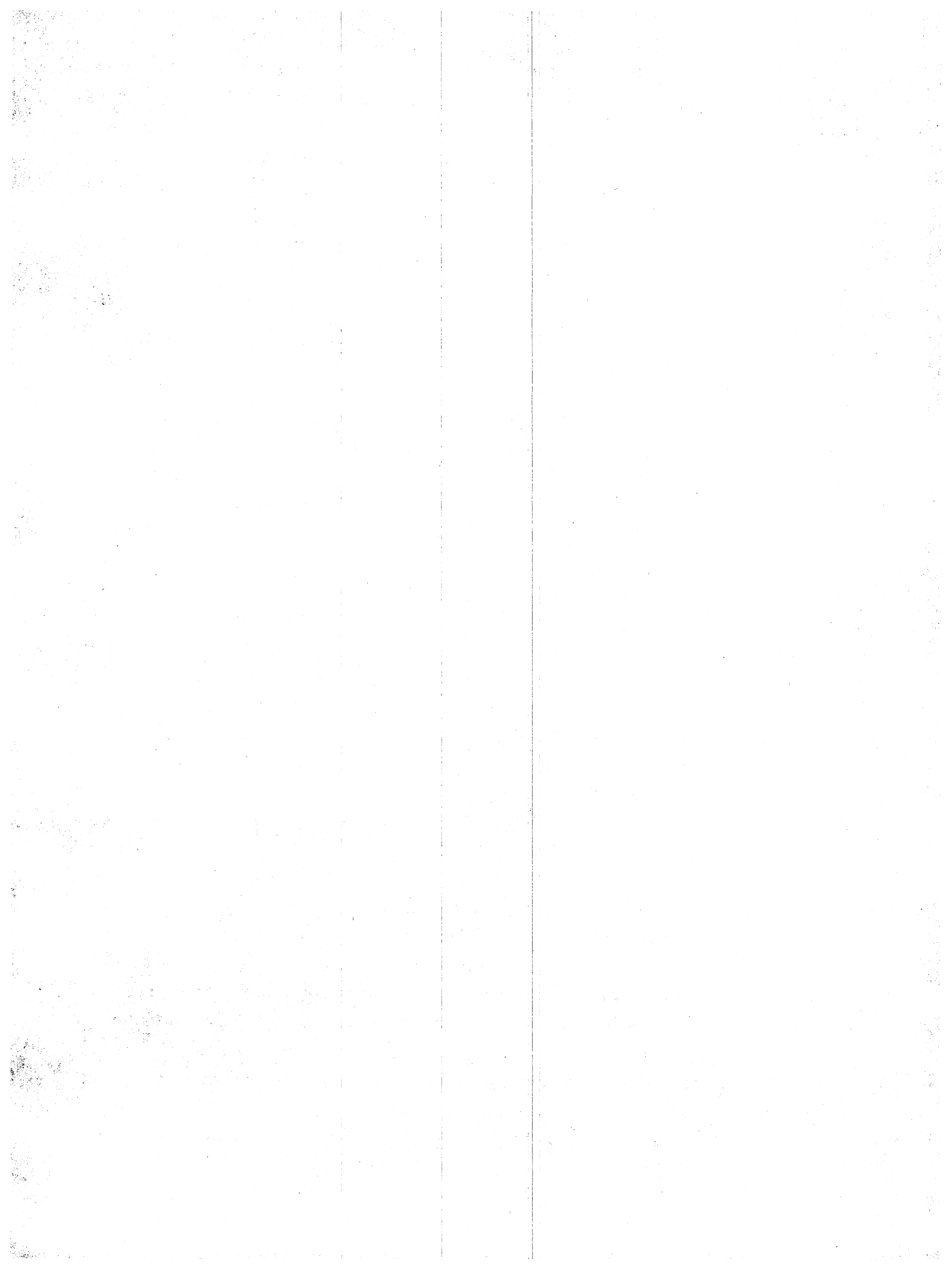


One consequence of tax receivables remaining on the books for long periods of time is that outstanding debt rolls forward every year, continuing to accrue interest and possible penalties, all without regard to its collectibility. This practice complicates the management of delinquent accounts and inflates the realistic value of delinquencies which can or ever will be collected. For instance, the current delinquency balance is composed of the collectible amount of outstanding debt balance which originated in all previous years, less the debt collected during the current period (on all of the old delinquent cases), plus current year delinquencies.

Despite the known uncollectibility of certain tax liabilities, the Division of Taxation does not yet have an official write-off policy. One presently in draft would create the equivalent of a "bad debt" account and remove outstanding tax liabilities from reporting status only. While this will help to report and clarify the value of the collectible delinquencies the Division of Taxation would still maintain significant delinquency amounts which are known to be uncollectable.

An even more vigorous approach consistent with private industry practices would involve a complete write-off of uncollectible debts. This type of a policy eliminates the further need to manage uncollectible cases and completely removes the impression of collectibility. It is worthy to note that implementation of a write-off policy will require strict procedural and internal control in order to protect the integrity of the Division's efforts. The question of a write off policy is a management and accounting one. Even with a write-off policy tax debts, by law, would still remain a legal obligation of the taxpayer (Exhibit B).

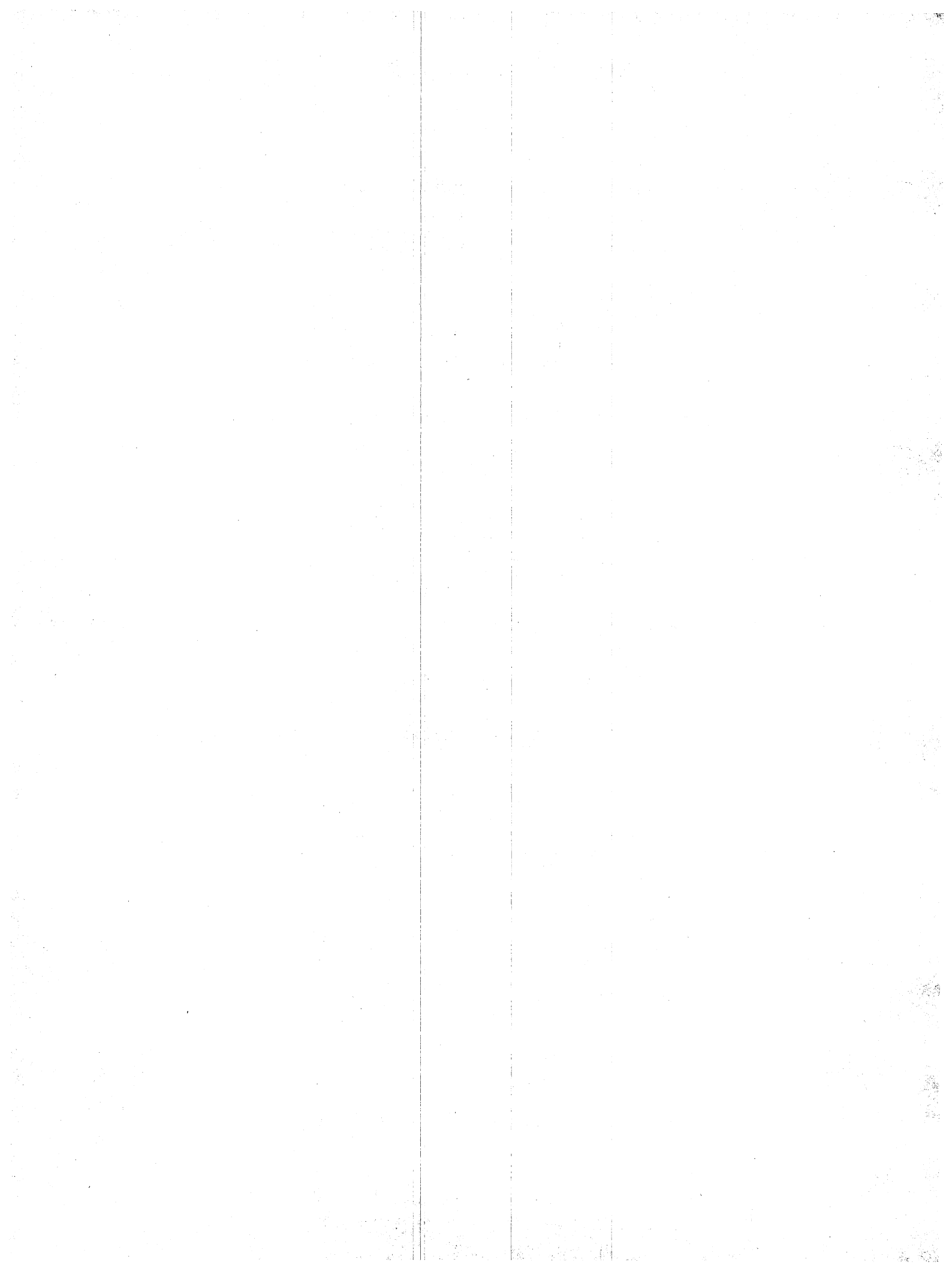
Tax delinquencies have not, in past practice, been recorded on the state's books (except in very specific and limited cases) but are maintained only within the Division. There are however indications that such centralized booking of these unremitted liabilities may be required in the future. Regardless of what the future holds, these receivables go back many years and are growing at an accelerated rate due to an increasing tax base and other economic conditions.



To summarize, the nature of New Jersey "unremitted tax liability" is influenced by a number of factors, among them being:

- the age of any given liability, the older the less collectible;
- the type of tax involved, those with withholding provisions increasing the predictability of collection;
- the timing and types of mechanisms being used to collect the tax; e.g., TACS (Taxation Automated Collection System) being very cost effective but of limited scope;
- the aggressiveness of the collection processes; e.g., Attorney General's intervention and criminal prosecutions being the costliest but most effective;
- the size of the tax due, the largest outstanding balances receiving the higher priority;
- the absence of a write-off policy;
- the staff resources which are available;
- the ability to develop and maintain state of the art technologies;
- the growth in the total taxable base; and
- the cooperation and/or ability of the taxpayer to pay.

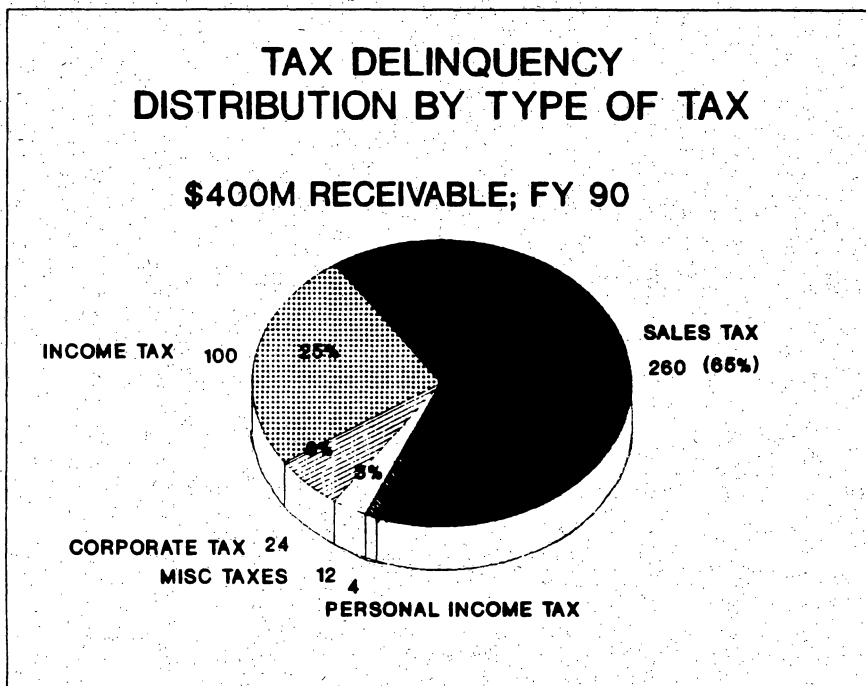
Of the influencing factors above, the most significant affecting New Jersey's tax receivable are the age and collectibility of the debts, the lack of a write-off policy, and the diminishing size of the field investigator staff. The elimination of uncollectible debts and improvements of collection resources will help the Division to more effectively focus its resources on collectible cases.



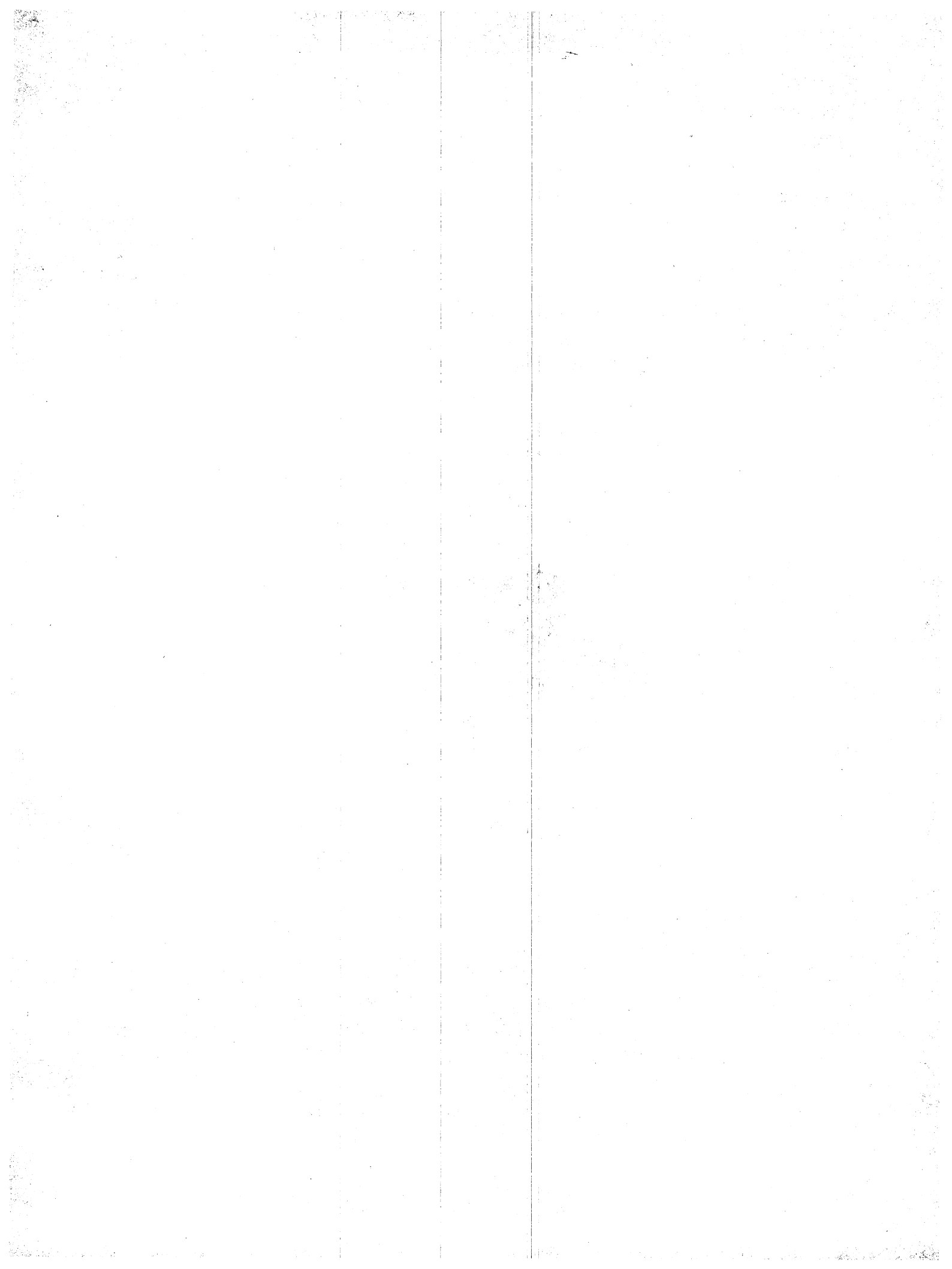
Composition of the Unremitted Liability

The composition of the unremitted liabilities by type of tax is shown in Table 2. The sales tax comprises some 65% or \$260 million of the total. The balance is composed of the income tax at 25% or \$100 million, corporate taxes at 6% or \$24 million and a variety of miscellaneous taxes.

TABLE 2

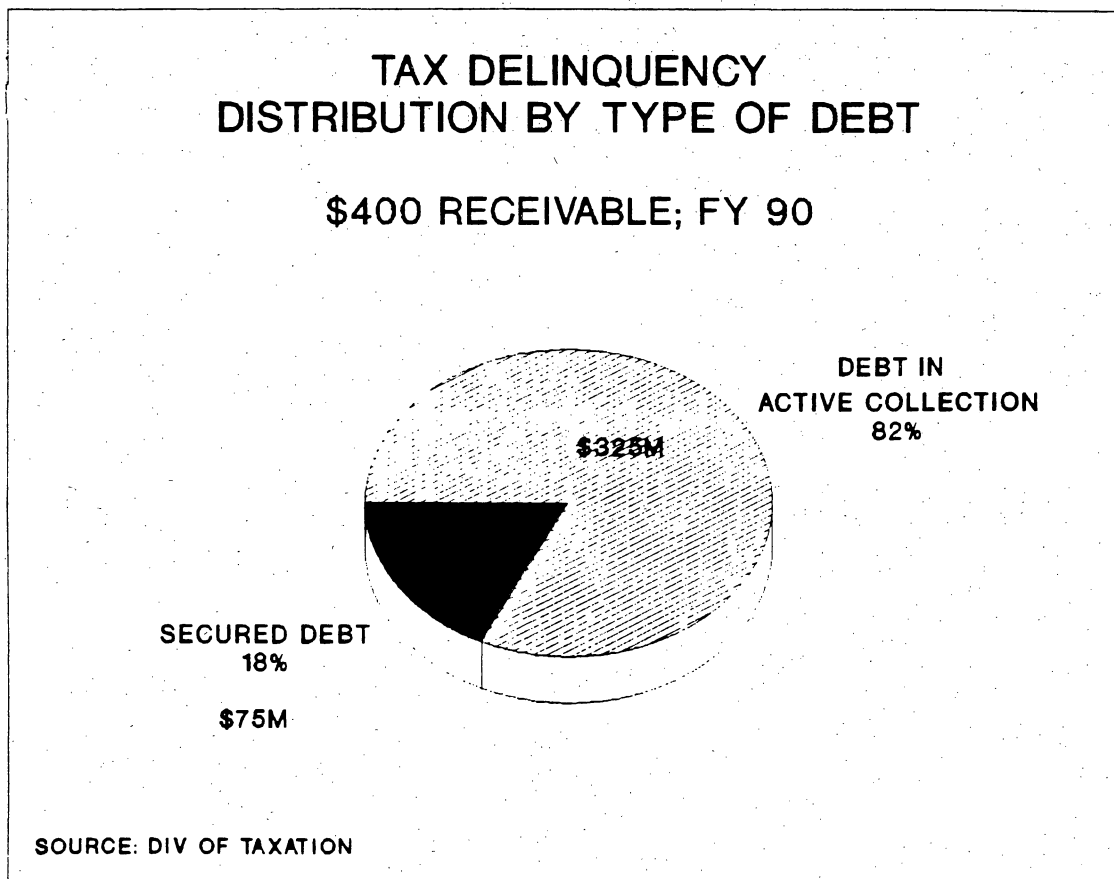


In 1985, the Division of Taxation developed a computer-based tax case tracking system with the acronym TULIPS, Taxation Unremitted Liability Inventory Plotting System. The system was developed to enhance the division's internal controls and the processing of delinquent or deficient tax cases. Through its review, the Commission found TULIPS and other taxation systems to be weak in their capability to provide proper management information reports. However, the design of TULIPS has provided the Division with an excellent case tracking system and the means to look at the unpaid tax pool by identifying where tax debt is in the process of collection.



Tax liabilities can be viewed in term of their stage of collection activity. The current \$400 million delinquency is displayed by type of debt in Table 3. Some 18% or \$75 million of the delinquency is in the form of "secured debt" i.e. court judgments have been filed against the debtors. The balance of \$325 million, 82% of the total, are tax cases under various active debt collection phases.

TABLE 3



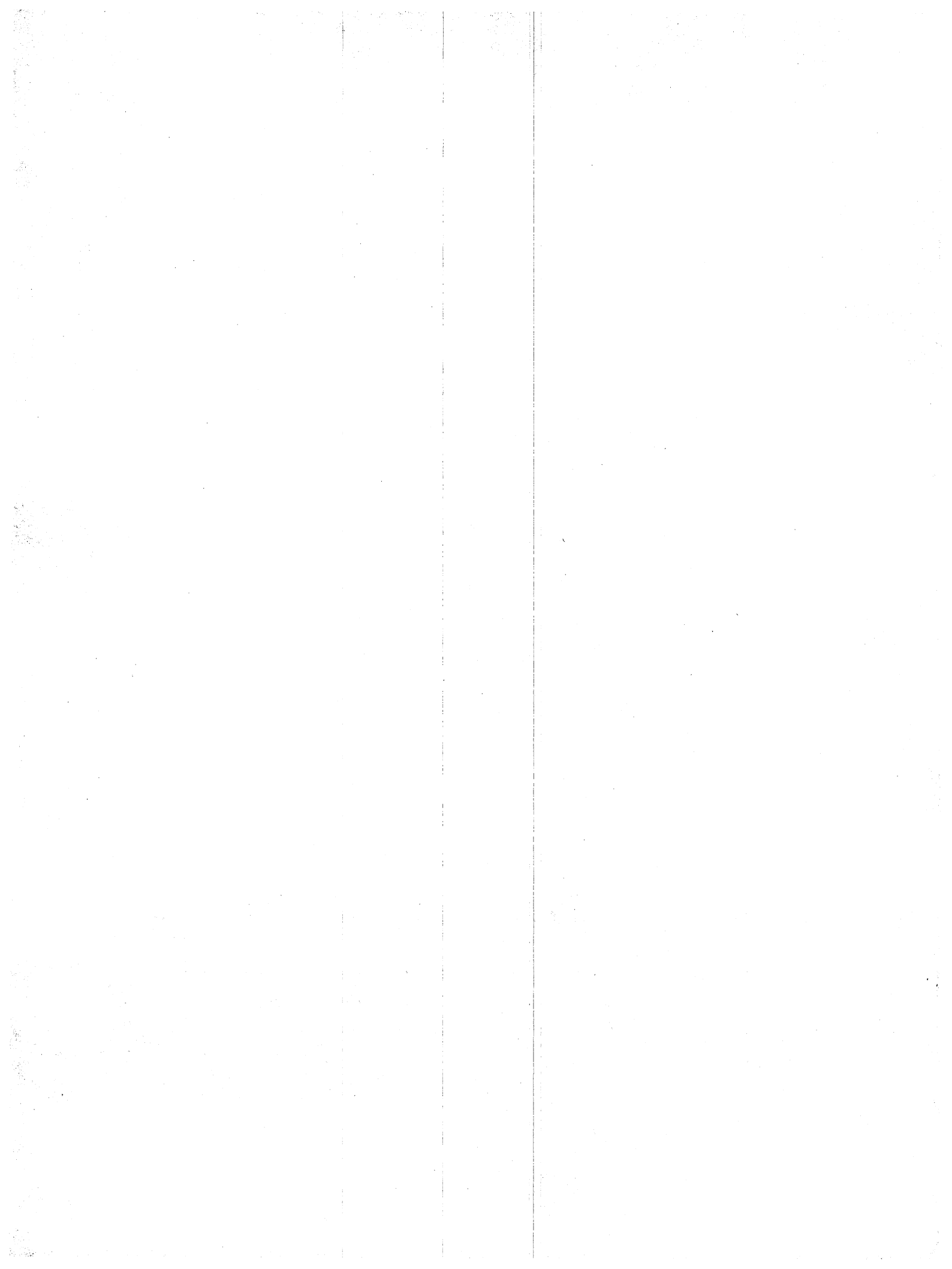


Exhibit C is a simplified flowchart of the processing steps for tax delinquencies. Its purpose is to show the case flow logic of the six major process steps within the TULIPS system. Briefly, each process is described as follows:

- cases in audit are those selected per criteria independent of the TULIPS system requirements and are entered into the collection mainstream after review and assessment;
- cases under appeal are those with taxpayer objections;
- cases in backlog are those cases which have not meet pre-established criteria which help to prioritize Taxation's case workload;
- cases in active collection are those under investigation, in pre-judgment, in the automated collection system (TACS) or otherwise being actively pursued;
- special actions are those active cases with special characteristics such as criminal elements which require intervention by the Attorney General; and
- unsecured backlogs are cases in which other collection actions have been exhausted and now court judgments are pursued.

Further supporting a look at the composition of the tax receivable are Tables 4, 5 and 6. Each of these tables focus around the detailed processing steps as defined by the TULIPS system.

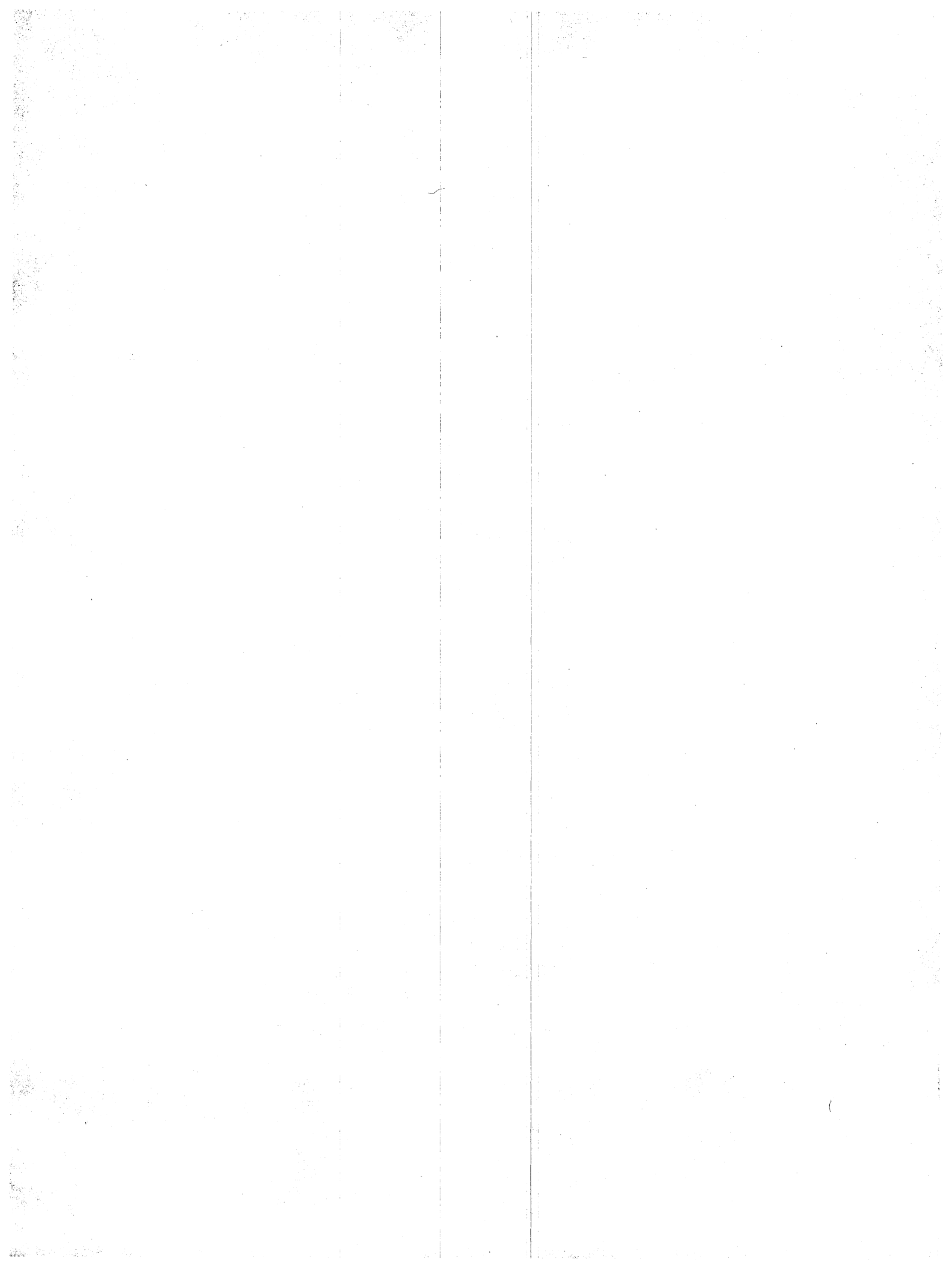


Table 4 identifies the value of the delinquencies within each of the six major processing areas of the active debt collection phase.

TABLE 4

COMPOSITION OF TAX DELINQUENCY BY DEBT COLLECTION ACTIVITY	
• SECURED DEBT	\$ 75 (COURT JUDGMENTS)
• DEBT IN ACTIVE COLLECTION	325 (COLLECTIONS IN PROCESS)

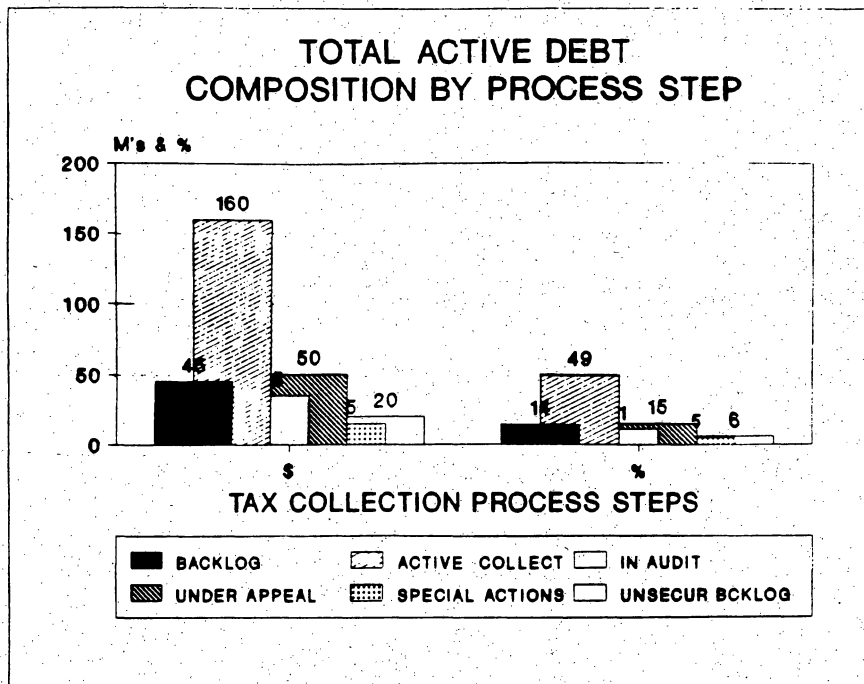
	\$400

ACTIVE DEBT COLLECTION PROCESS STEPS	
• BACKLOG	\$ 45
• COLLECTION	160
• IN AUDIT	35
• UNDER APPEAL	60
• SPECIAL ACTIONS	15
• UNSECURED BACKLOG	20

	\$ 325
• NOTE: DEBT COLLECTION STEPS ARE DEFINED IN TEXT OF ISSUE REPORT.	

Table 5 graphically depicts the value and percentage of each process function.

TABLE 5



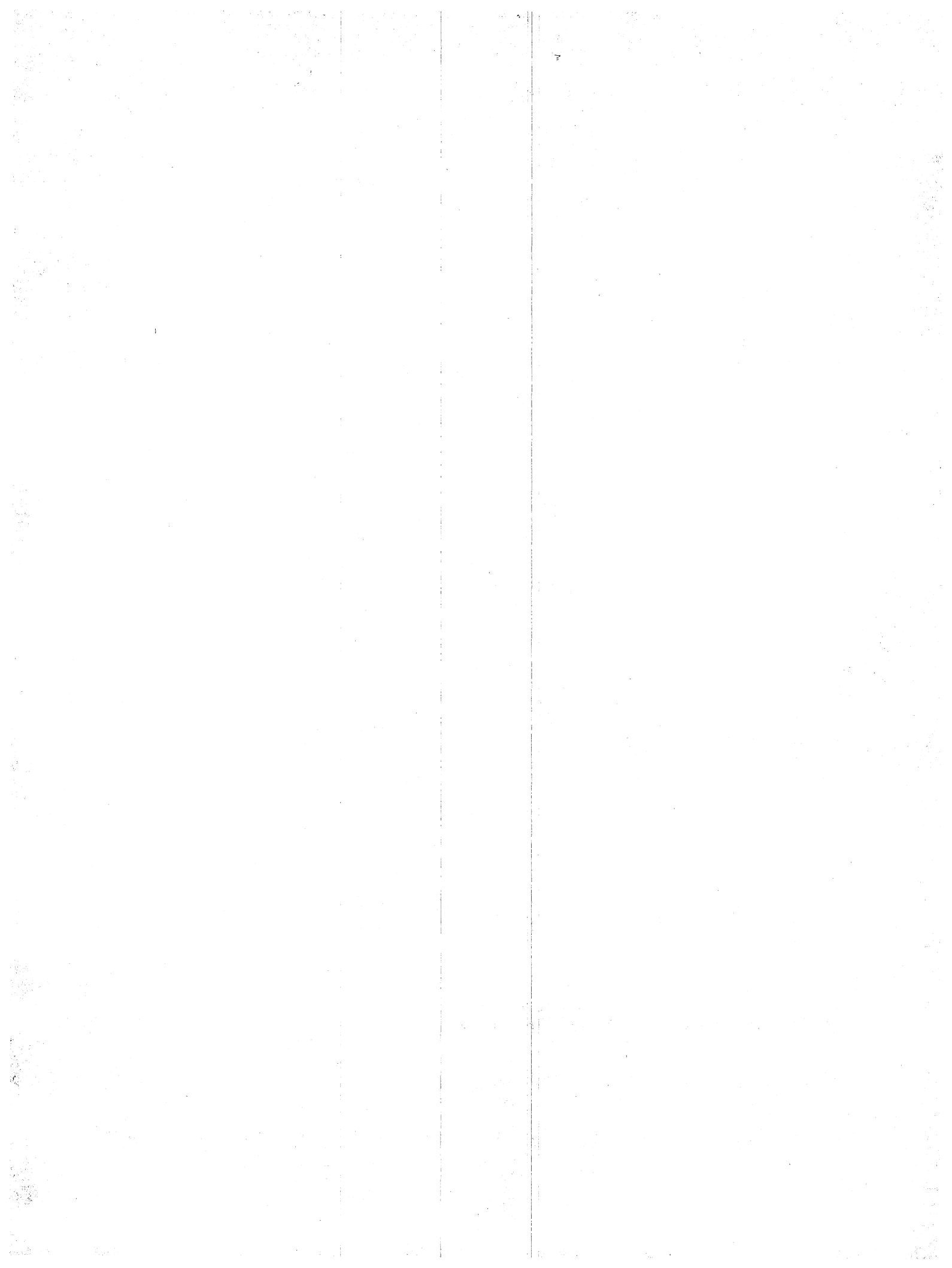
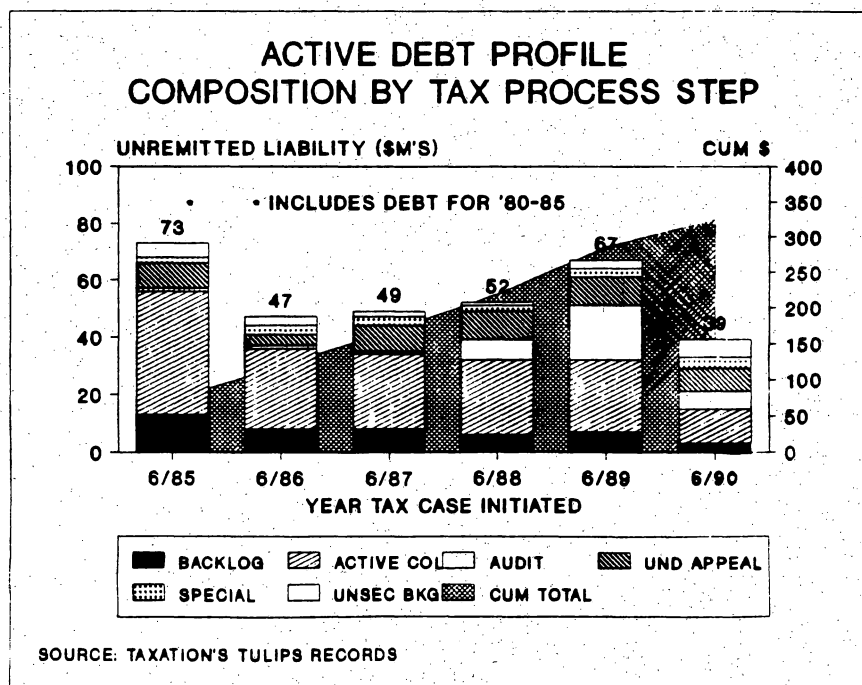


Table 6 profiles the age, process status and the amount of tax receivables in active debt collection as June 31, 1990. The following observations are noted:

- debt under active collection dates back to 1980;
- debt prior to 1986 has been folded into the 6/85 figure;
- cases under active collection is the largest area of collection activity, irrespective of when the case was initiated;
- cases under audit are appropriately concentrated in the most recent 3 years when collection rates are greatest; and
- fiscal year 1989 represents the most active collection period (\$67 million) and fiscal year 1990 the slowest (\$39 million) which reflects the slow and unique manner in which tax delinquencies evolve.

TABLE 6



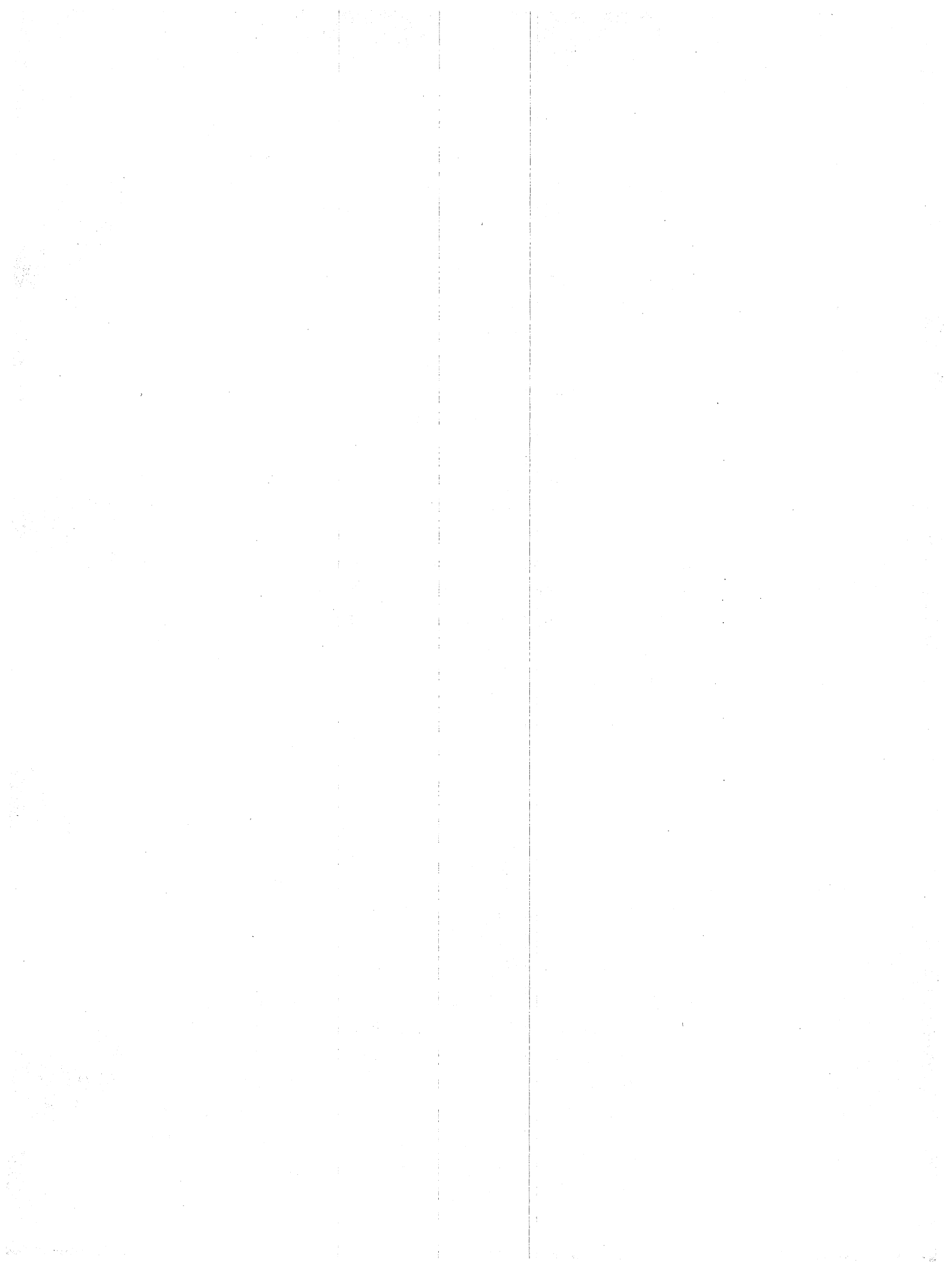


There are 294,000 cases in the active debt collection stages, some of which date back to 1980. Within this group however, 247,000 cases are currently in backlog status. Although backlog cases represent 84% of the entire active workload they account for only 14% of the delinquency amount. While these backlogs add to communications problems which need to be recognized, their low net value is a demonstration of the effectiveness of TULIPS to assist in proper case management. And, as in the case of secured debt, the active debt collection process has an element of uncollectibility to which a write-off procedure can apply.

Staffing Impact on Tax Collection Activity

In the early 1980's, management in Treasury/Division of Taxation made a conscious decision to trade off growth in staff for more investments in productive technological tools such as TULIPS. That is, investments in information processing systems were made which would return many times their initial cost in the form of better, faster and more accurate processing of tax activities. Many systems were developed (Exhibit D) under this policy and all have contributed to a processing capability which is far beyond that which existed only 6 or 7 years ago.

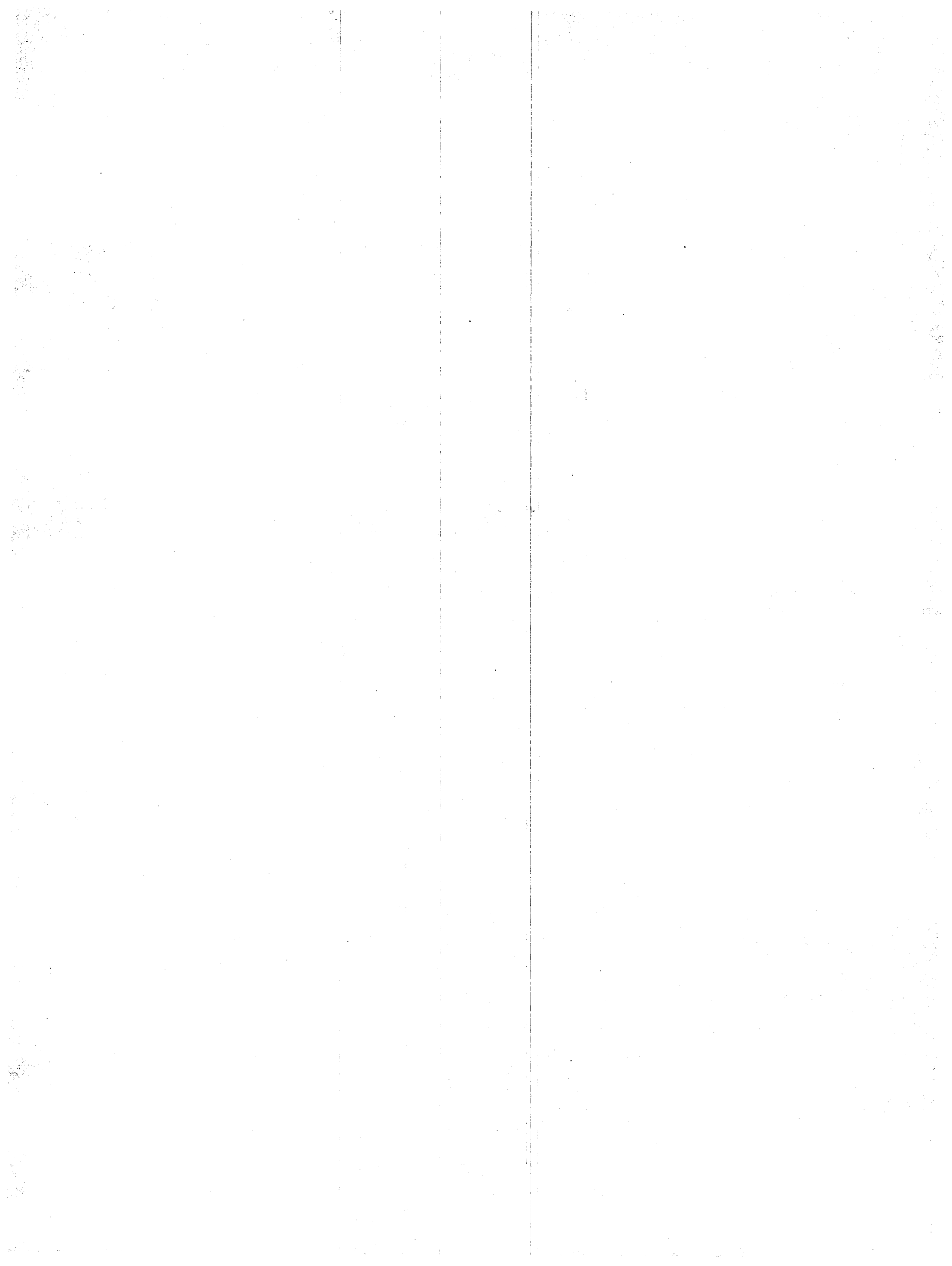
During this same period of time overall growth in the economy has multiplied tax-related workload by several times. Systems and staff support considered adequate only a few years ago are now stressed. In addition, the recent economic downturn and the resultant budget cutting measures have also taken their toll. From June 1988 to June 1990, filled positions in the division have dropped by 73 from 1,468 down to 1,395. Further affecting the division's tax processing capabilities have been hiring target decisions through which vacant but necessary positions have remained unfilled, irrespective of the function being performed.



The Division's Investigator titles, the first line of tax collection activity, have been hit hard by this sequence of circumstances. Since the recent staffing targets began in 1988, the division has lost the equivalent of 59 professional tax investigators; There were 26 vacant positions at the implementation of the target, 29 new vacancies as a result of attrition, and 4 staff who will retire by year end. The status of an additional 22 investigators, all of whom are eligible for retirement, will further exacerbate this situation. Based upon the division's experience, each investigator is valued at 10-12 times their salary or \$500,000 in tax revenues per year.

To combat this diminishing level of investigators, the division had prepared a plan to create paraprofessional titles to "take up the slack" in collection activities. These technical titles would be used to perform the many duties that did not require the level of expertise of investigators (e.g., inheritance box inventories, taxpayer services, phone collections via TACS) while at the same time freeing up experienced collection resources for especially productive field cases. It was estimated that 80 technical titles would be necessary to perform routine tax functions. This initiative was not supported in the budget process.

A view shared by both Taxation and the Society is that this Division, and in particular its tax collection areas, should be exempted from across the board staffing targets. Hiring targets generally result from revenue shortfalls and it seems contrary to sound business practice to add to this problem by reducing the collection arm of government. The State Auditor, in its report of October 12, 1990 on Selected Taxes, recommended that the Department of the Treasury consider increasing the audit and investigative staffing levels. While the Commission supports those concepts, it is not able to endorse them without further review. The Commission would encourage further debate and resolution of this issue.



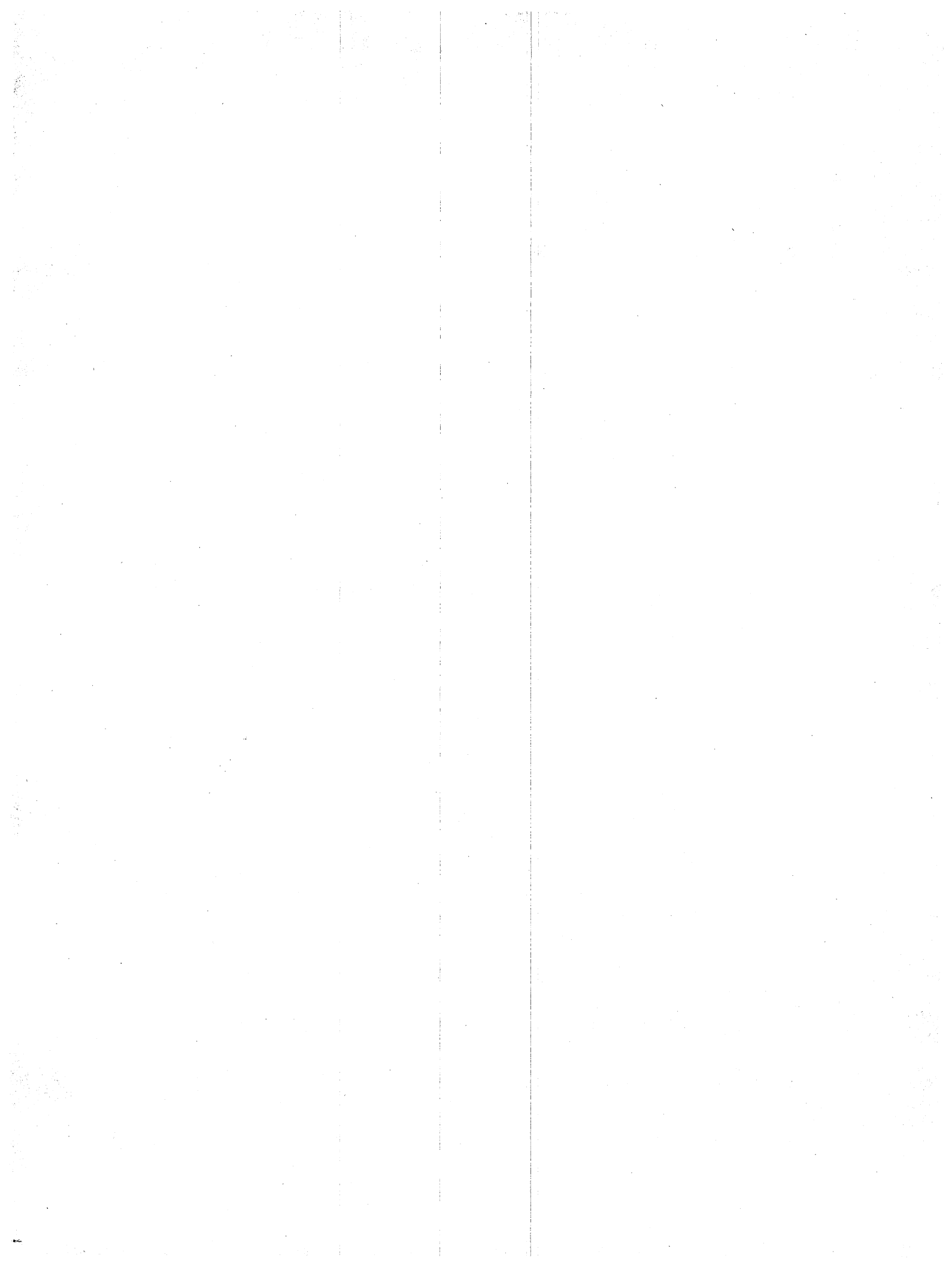
Summary Observations of the Tax Delinquency Issue

Table 7 displays the last 5 years of tax delinquency and collection history. The following observations and explanations are pertinent:

1. The value of tax delinquencies have been growing annually from some \$259 million at the end of fiscal year 1986 to the current \$400 million in 1990, a growth of 55% over the period. Excluded from the graph however, is the growth in the tax collection base over the same period, up some 62% from \$6.1 billion in 1986 to \$9.9 billion in 1990. After adjustment for this growth, the rate of delinquency has remained relatively constant at about 4% of the estimated annual tax revenues.

	<u>Estimated Tax Revenues*</u> <u>(Billions)</u>	<u>Tax Delinquency</u> <u>(Millions)</u>	<u>Delinquency as % of Base</u>
FY 1986	\$6.1	\$259	4.2%
FY 1987	\$7.7	\$287	3.7%
FY 1988	\$8.4	\$319	3.7%
FY 1989	\$9.5	\$354	3.7%
FY 1990	\$9.9	\$400	4.0%

* Source: Governor's Budget Messages, 1986-1990

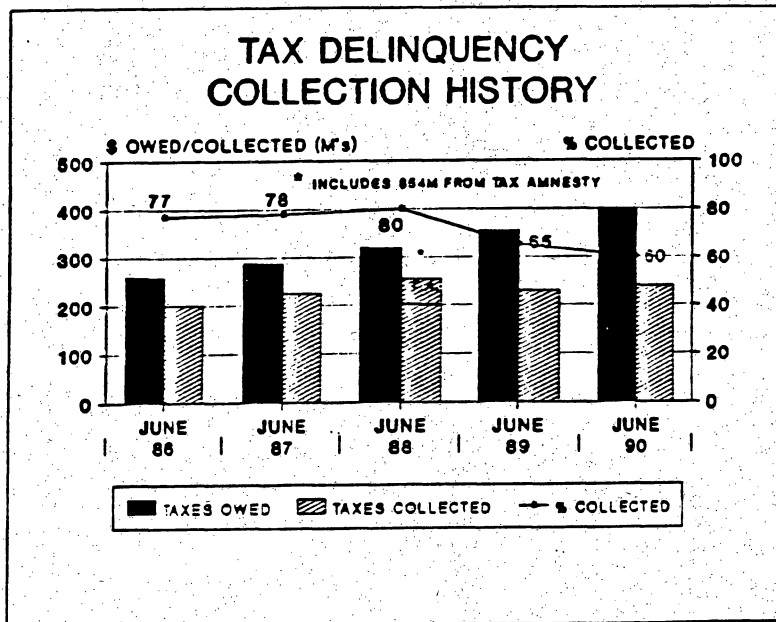


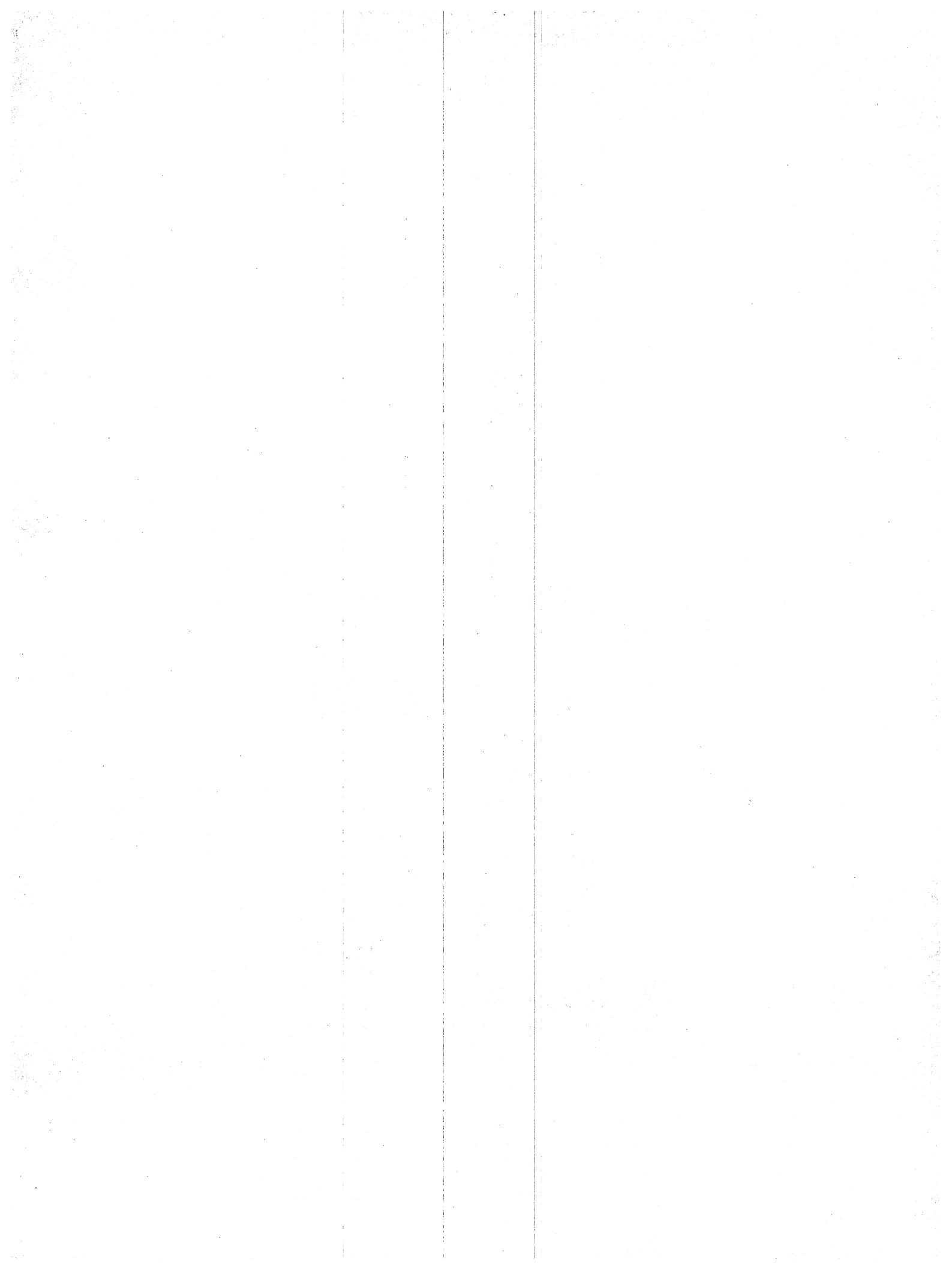
2. The effective collection rate has dropped from 77% in 1986 to an estimated rate of 60% in 1990. While this suggests a decreasingly effective collection process, included in these numbers are the steadily growing number of uncollectible cases. If the estimated \$130 million in delinquent but uncollectible accounts were eliminated in fiscal year 1990, the effective collection rate would be near 90%, with \$240 million collected out of a collectible pool of \$270 million.

3. Delinquent tax collections have remained relatively stable over the same 5 year period ranging from \$200 million collected in 1986 to \$240 million in 1990. As noted in Table 7, the tax amnesty program contributed \$53.8 million in unanticipated revenues to the fiscal year 1988 collection. NOTE: \$130 million of the total collection of \$183 million was anticipated and included in the fiscal year 1988 revenue estimates.

The amnesty program application period ran for a period of 90 days from September 10 to December 8, 1987. In addition to providing delinquent taxpayers an opportunity to satisfy long-standing tax obligations, the end of the amnesty period marked the introduction of new civil and criminal penalties and a more vigorous approach toward tax enforcement policies.

TABLE 7





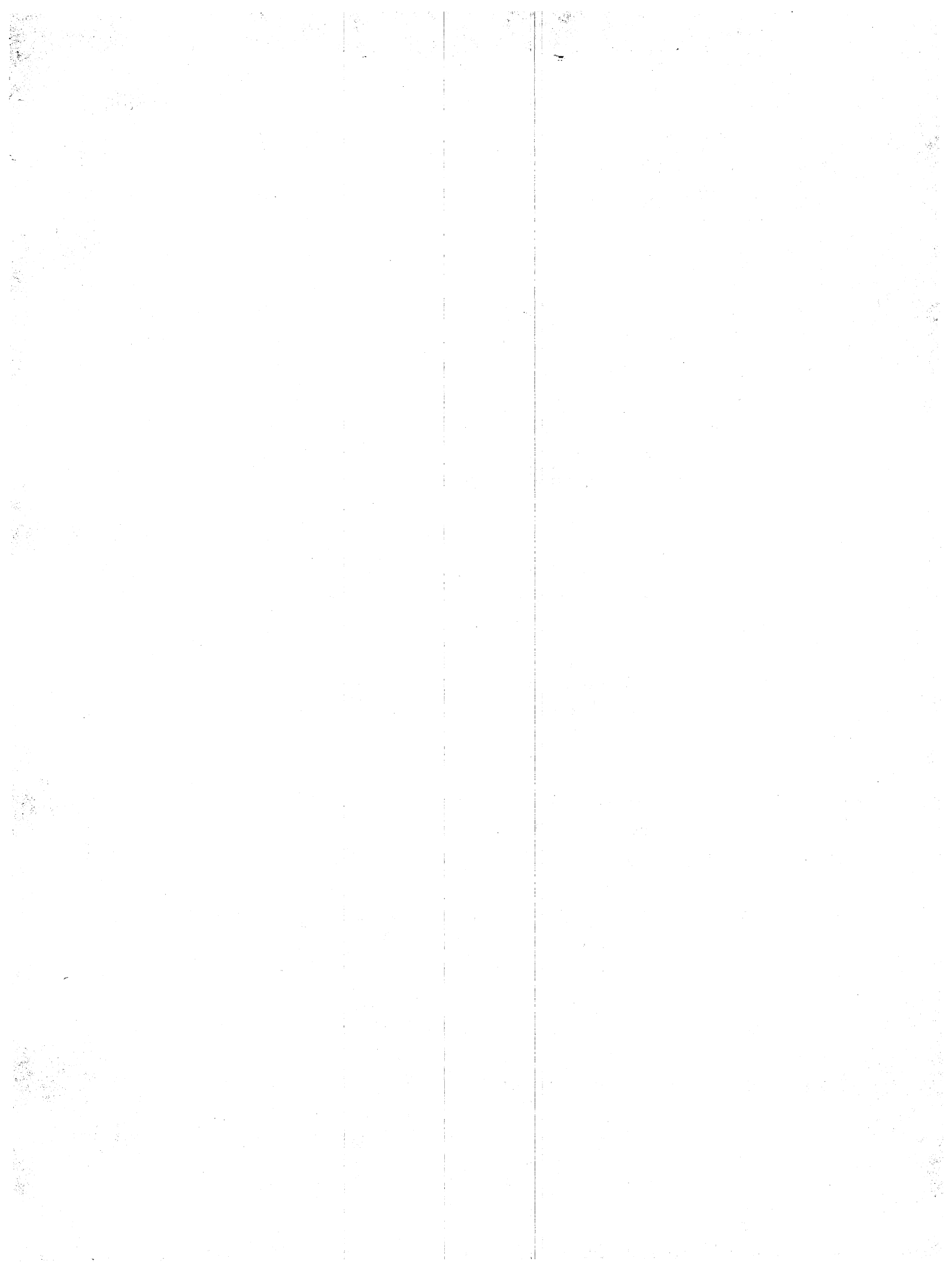
TAX INTEREST AND PENALTIES

As part of its review for this report the Society was asked to comment upon the appropriateness of New Jersey's interest and penalties charges for delinquent taxes. Generally, New Jersey currently charges interest rates that are 5% above the prime rate, adjusted quarterly. The penalty structure is basically 5% per month up to 25%. No interest is paid on refunds other than gross income tax. In reviewing other states the Society found that the only states with higher interest rates (at this time) are those who charge flat rates of 18%. Those states also pay interest, normally at 12% on refunds. Therefore, the Society believes that New Jersey's charges provide ample financial incentive to pay New Jersey debts.

There is a movement by some national organizations which support taxing authorities paying interest on refunds due as a measure to assure their prompt and timely processing. The rationale for such action is to provide equity in the tax rules and to encourage taxing authorities to utilize the need for these payments as a measure of their performance. The New Jersey Society of Certified Public Accountants supports this position.

There is however, some feeling within the NJSCPA that Taxation's delays in responding to tax correspondence may detract from the incentives provided by the interest charges. Additionally the Division is encouraged to continue implementing procedures which would expedite the penalty abatement process by removing the requirement for appeal. An improved process would assist in moving cases out of receivable and into collection.

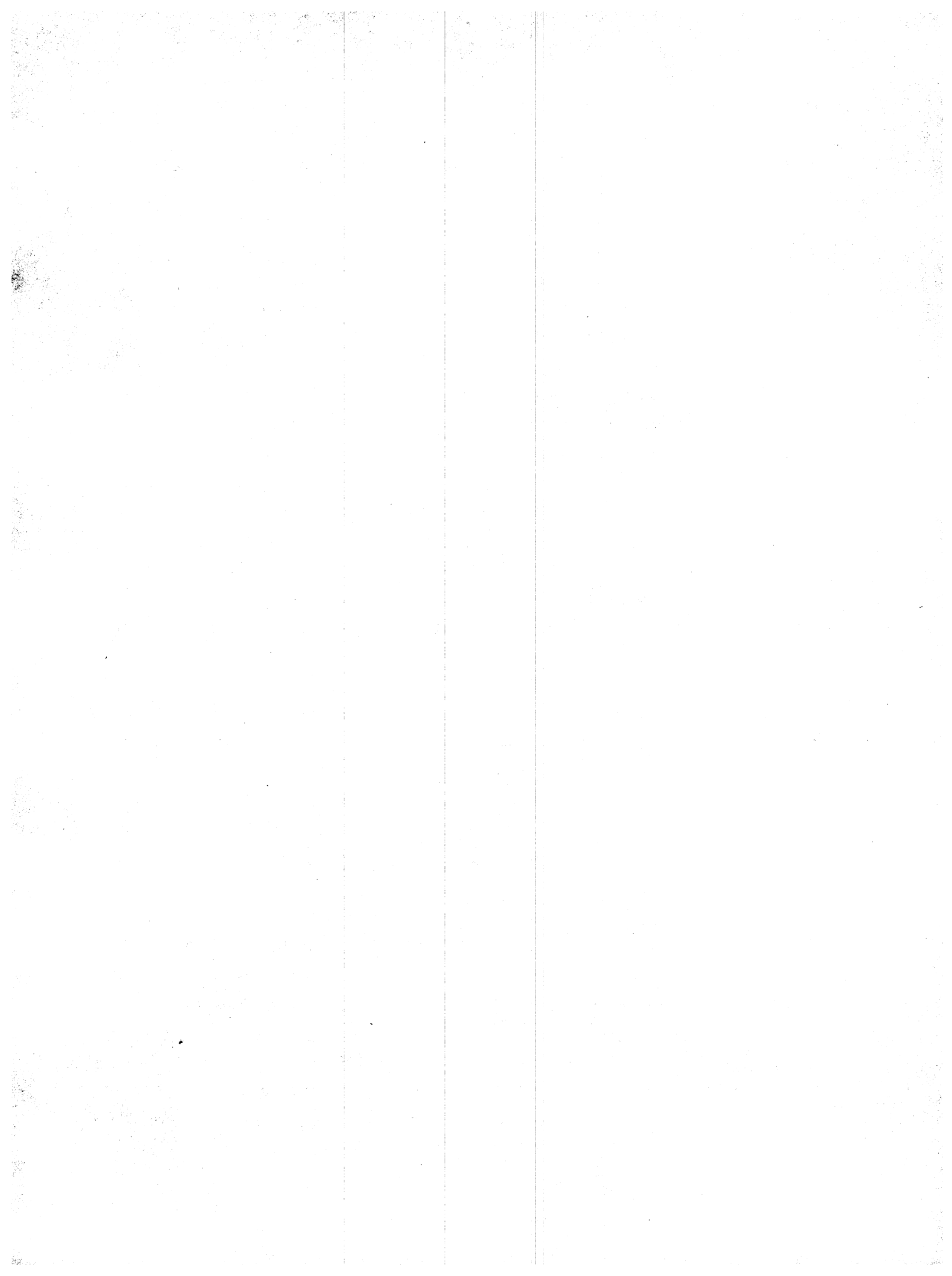
The Governor's Management Review Commission is not prepared to agree with the Society on the issue of refund interest although it supports the timely and efficient delivery of all tax services. Without studies of the fiscal impacts of such policy and without assurances of proper staffing at the Division the Commission believes that such a policy would not be in the best interest of the public as a whole.



CONCLUSIONS:

A number of conclusions can be drawn from this analysis of delinquent taxes and their collection. They are:

- The "tax receivable" is not a hidden source of tax revenues. It is an expected and managed consequence of tax collection.
- Tax delinquencies are growing along with the base of tax collections. This is a natural, understandable consequence of growth.
- The Division of Taxation is doing a creditable job of collecting delinquent taxes. Excluding uncollectibles, effective delinquency collection rates of 90% can be supported.
- Uncollectible taxes are beginning to seriously impair an accurate assessment of tax delinquencies. The implementation of an effective write-off policy would significantly lessen the incidence of faulty interpretations of the "tax receivable".
- Without action, staff attrition in the Division's investigator ranks may have negative consequences as experienced tax collection staff resources dwindle.
- The "TULIPS" system for tracking tax delinquencies is a major improvement over former methodologies. Further improvements in management systems modules would help to improve the aggregation, display and interpretation of performance data.
- The continued development of tax processing system enhancements to take advantage of technological advancements such as digitized imaging and electronic filing would be beneficial.



RECOMMENDATIONS:

The recommendations which follow are a derivative of the conclusions reached above. Additional documentation has been provided to further support the rationale around which the recommendations have been constructed:

Write-Off Policy

Recommendation:

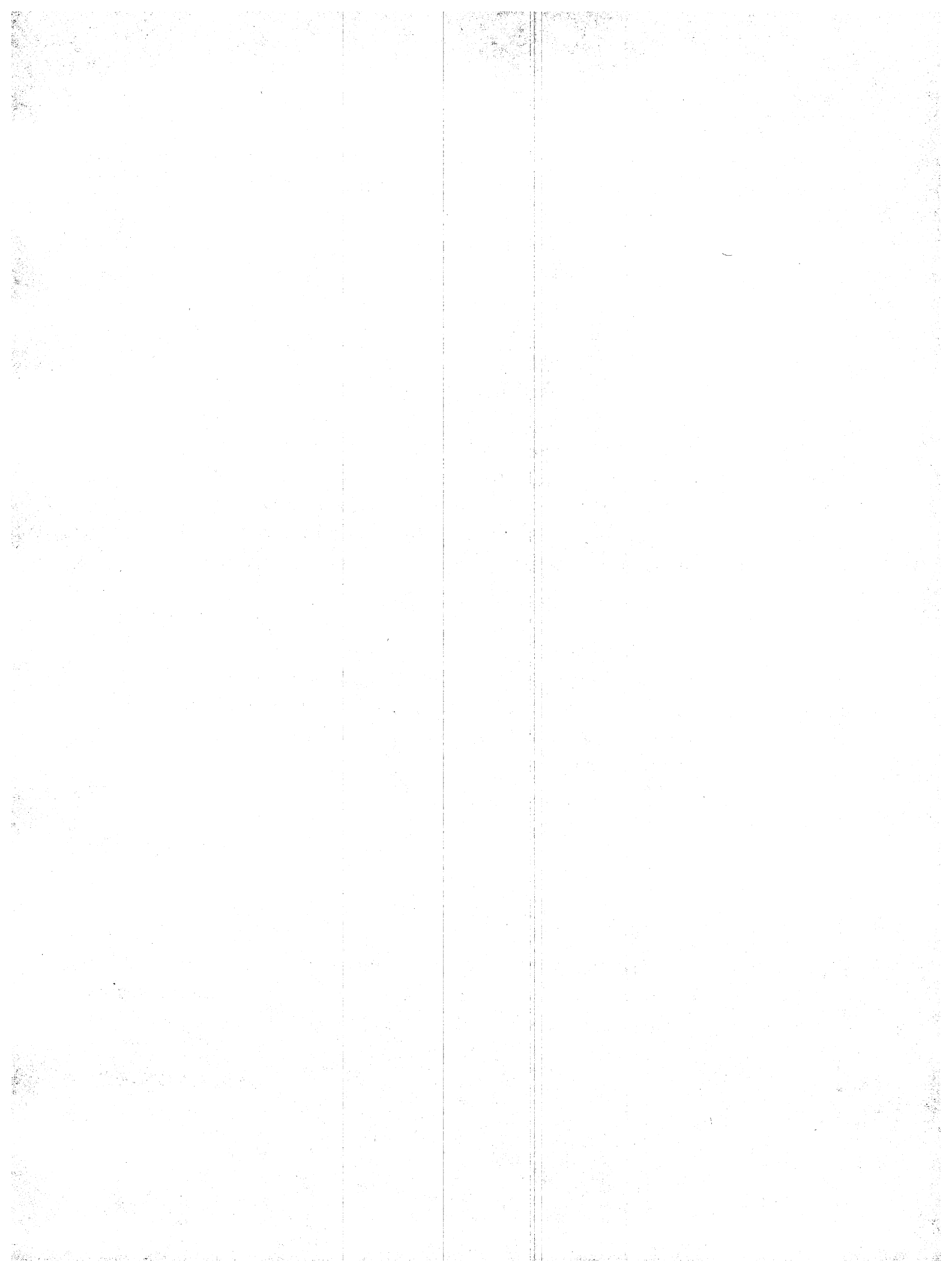
The Division of Taxation, in cooperation with the Director of Budget and Accounting, should develop and implement a write-off policy to purge the taxation reporting system of uncollectible debt.

Discussion:

Much has been said about the extent of uncollectible taxes in the present base of "unremitted liabilities". In the area of secured debt alone (Table 1), \$195 million of the \$270 million identified will never be collected. The continued existence of these known uncollectibles in the delinquent tax base seriously distorts the effectiveness of collection efforts as well as inflates the potential yield from delinquent accounts.

Fiscal Impact of a Write-Off Policy:

There is no fiscal impact expected from the implementation of the procedure. There is a payoff, however, in the proper valuing of the tax delinquencies and the removal of uncollectable cases from the management of the collection system. The administration of tax case monitoring would also be simplified.



Investigator Staff Attrition

Recommendation:

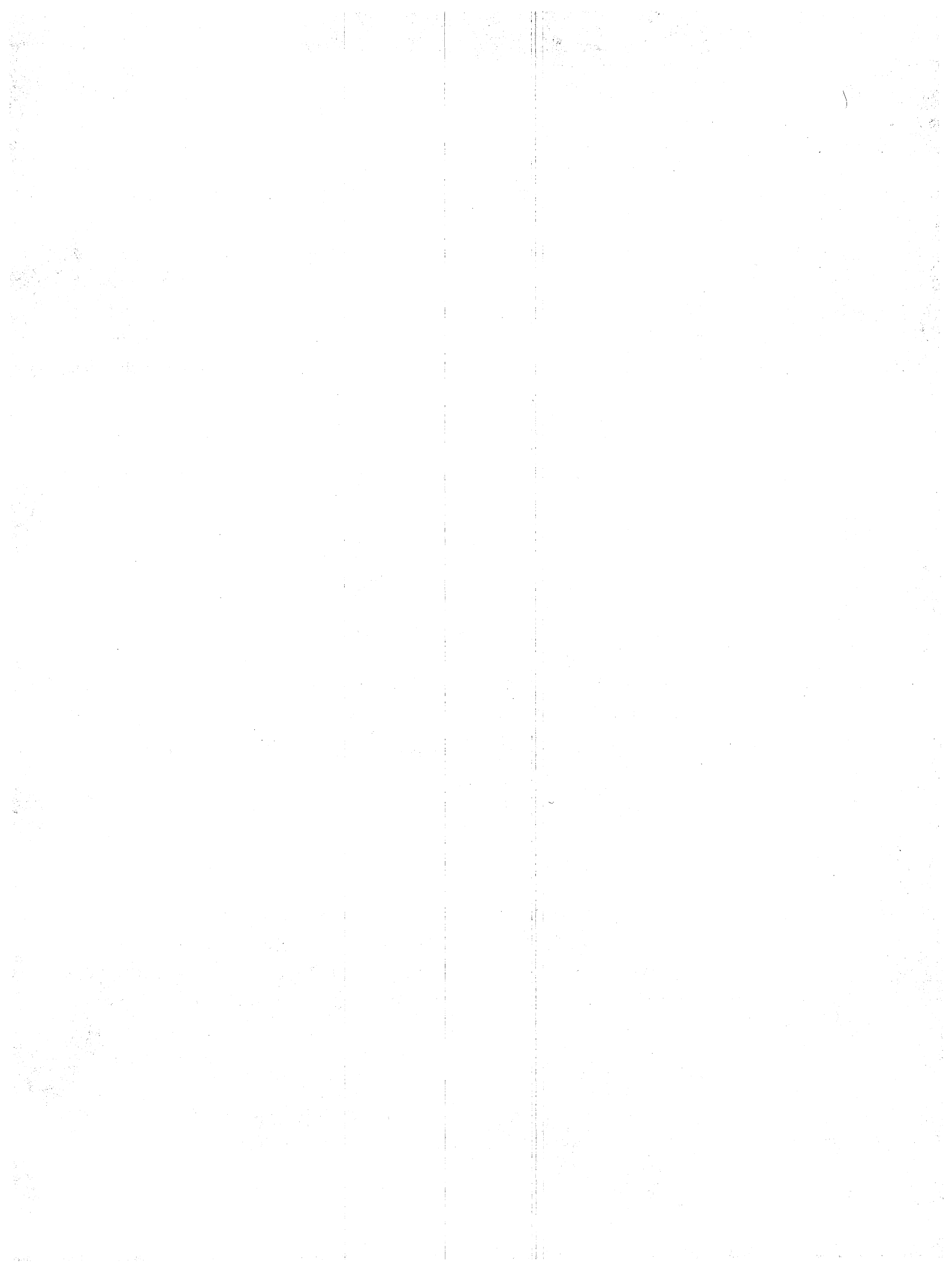
Steadily decreasing investigator resources are limiting revenue collections. A comprehensive review of taxation investigator requirements, technical assistant title plans and hiring target policies should be conducted. Staff should be supplemented as warranted.

Discussion:

The Special Procedures and Investigations Activity of the Division of Taxation is the focal point for delinquent tax collections in the state. It is in this unit that active enforcement activities begin and tax collection activities are especially productive. Three factors have limited the productivity of this unit:

1. High staff attrition rates;
2. Externally forced hiring policies; and
3. The inability to implement the creation of new paraprofessional job titles which would significantly enhance collection efforts.

The impact of needed investigator resources go beyond the collection of unremitted taxes. Investigators are also required for further tax initiatives which have not been implemented to date because of staff shortages. Among these are sales tax losses from mail order sales, flea markets sales, trade or specialty shows, casual boat sales, high-ticket items sold along New Jersey borders and use taxes on construction material coming to this country from abroad. These examples represent areas of significant revenue loss.



The Commission supports a debate and further review of the broader issue related to staff reductions and across the board hiring targets within the Division of Taxation. From a practical viewpoint one would be hard pressed to disagree with the sentiment of the Society and others that the state must protect its revenue arm in order to deliver its services in other areas. On the other hand however, there are significant personnel and technological alternatives that need to be incorporated into the decision making process.

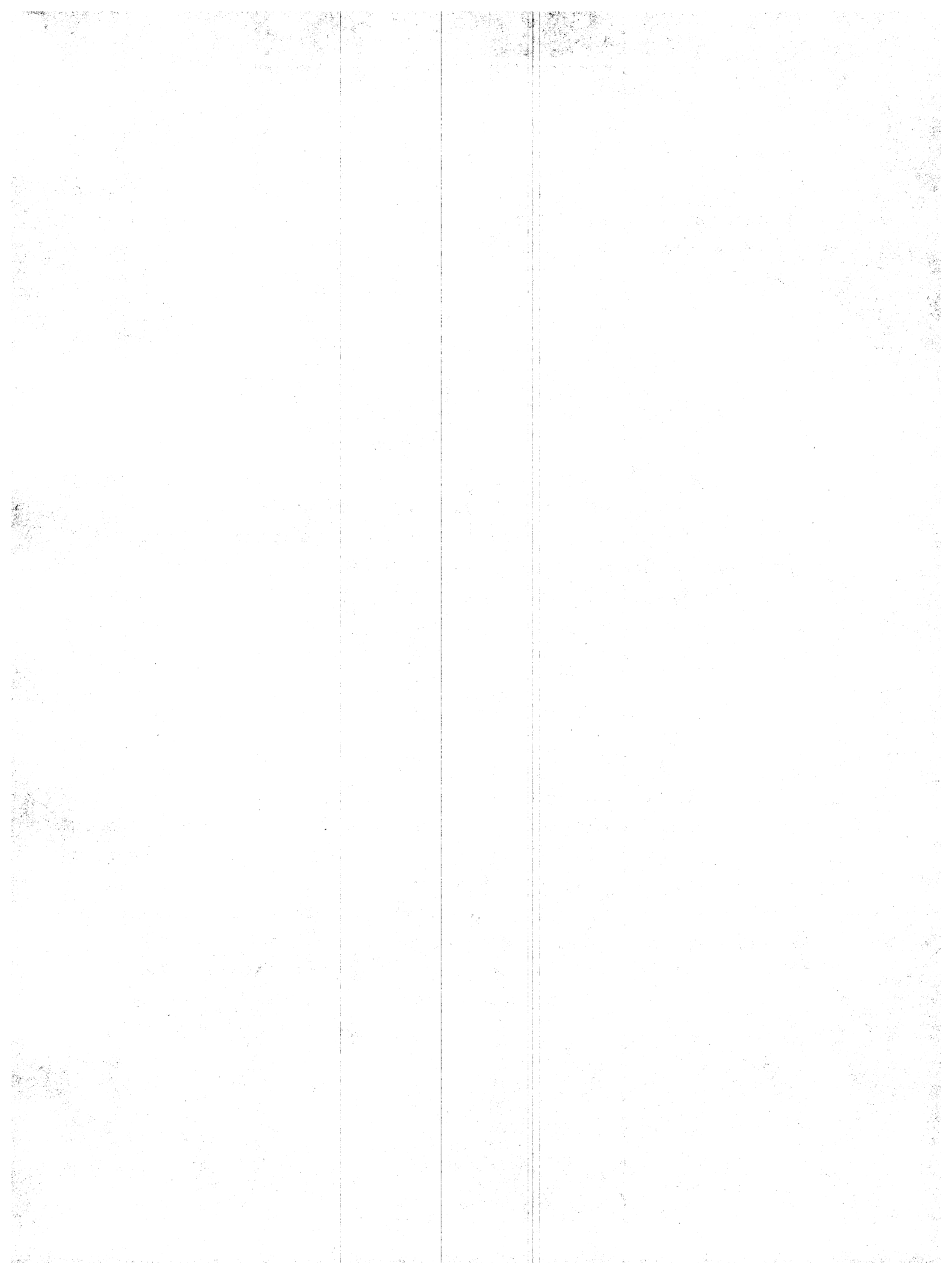
Fiscal Impact of Additional Collection Resources:

Based on the Division of Taxation's calculations, the net payback to the state from an investment in an additional 59 investigators and 80 technical assistants would approximate \$40 million annually. Total salary costs to effectuate this return have been estimated at \$3.4 million annually. This return does not include the area of new tax collection initiatives mentioned above which can yield several times this amount.

Privatization of Certain Collections

Recommendation:

Private sector collection alternatives represent a supplemental resource which the Division of Taxation, in cooperation with the Attorney General, should immediately pursue and implement on a pilot basis.



Discussion:

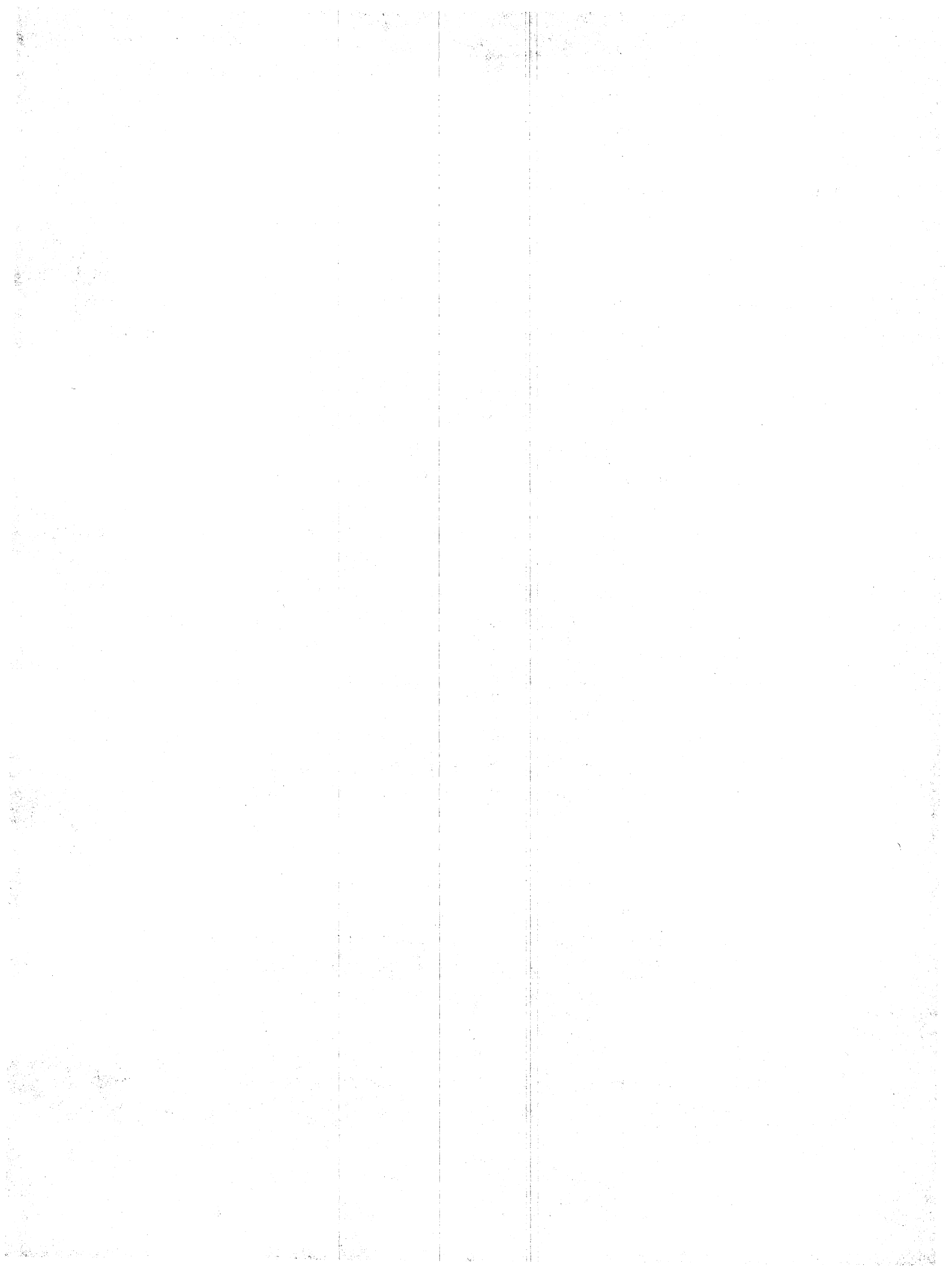
The issue of the utilization of private collection methods to augment division staff is not a new one. Initiatives along these lines have been attempted in the past but all have been thwarted by the following:

- The inherent confidentiality of tax information and the possible lack of authority to disclose such information;
- The questionable authority for the appropriation of funds to pay for these services; and
- The indeterminate level of informational support which would be required of the Division of Taxation to sustain private collection efforts.

Two different kinds of outside collection services are relevant and can be considered; the traditional collection agency service with expertise in generic collection procedures, and legal firms specializing in collecting on cases reduced to judgments. In either case, payment for services rendered could take the form of contingent fees, or a percentage of taxes collected.

Some states including New York and Missouri presently use private collection agencies to supplement the collection of delinquent taxes. While little information is available as to how these efforts are structured, they are being carried out within each state's statutory limits and apparently with some reasonable measure of effectiveness. Given the continuous depletion of the Division of Taxation's internal investigation resources, private resources may prove a viable alternative.

Implementation of a pilot project may require legislation and the subsequent modification of Taxation's internal procedures. Although such a pilot is seen as a supplement to internal collection methods it will require staff and administrative support. It is recommended that steps be taken to permit a supported test of this alternative collection method and that measures be developed to judge its success.



Fiscal Impact of Private Collection Agencies:

The potential yield from the use of collection agencies is indeterminate, but certainly promising. As Taxation's investigative resources have dropped, the Division has readjusted its selection criteria for case priority to insure that the productivity of its investigators remains high. This policy has had the effect of raising the number and value of unremitted liabilities in the backlog and has created more and larger opportunities for external collection sources.

Credit Bureau Access

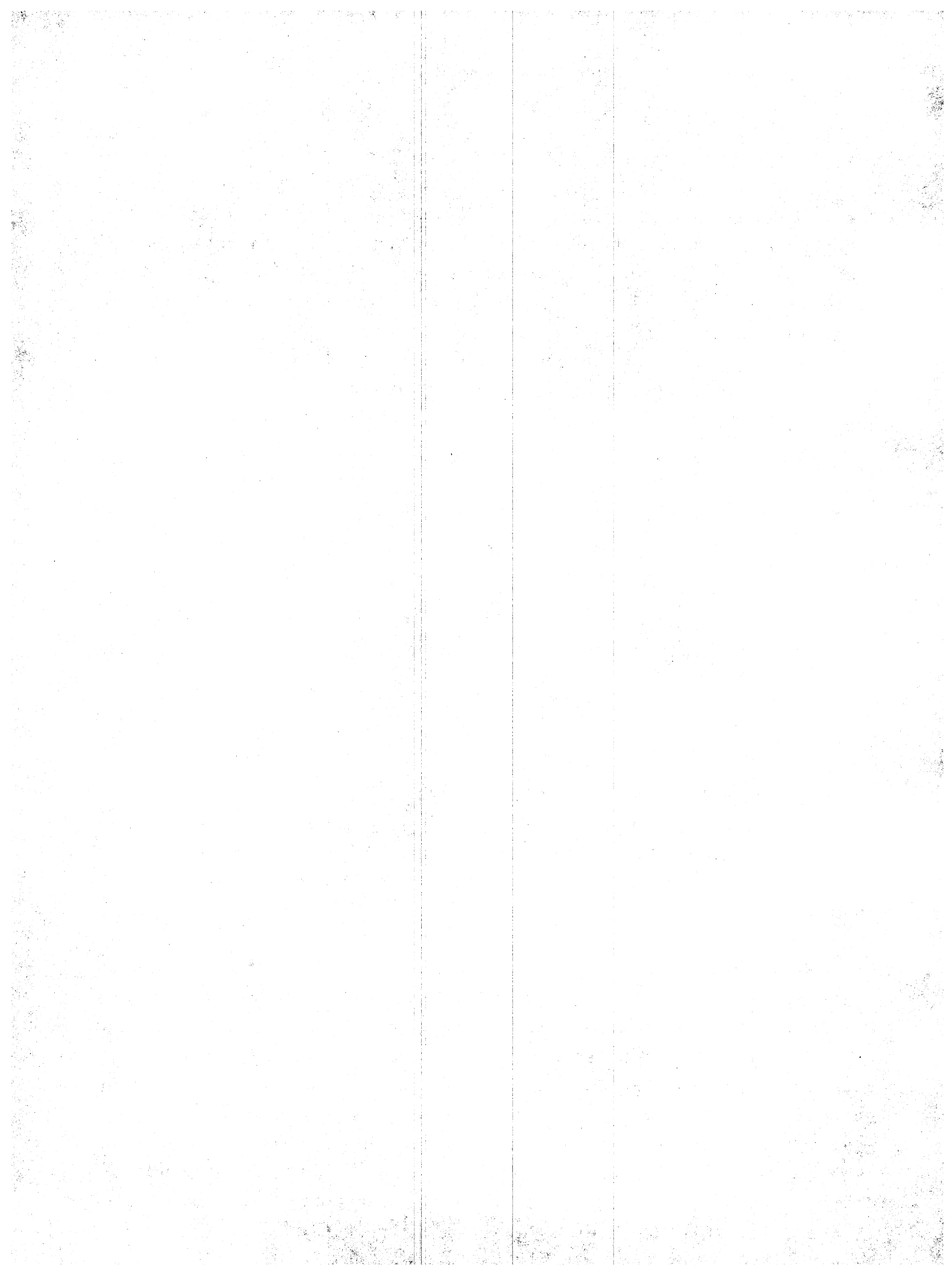
Recommendation:

Taxation should test the revenue potential from participation in the resources of credit bureau organizations with national networks such as TRW, RCA and others.

Discussion:

Although no endorsement is intended, TRW is an example of a national credit organization which maintains a comprehensive database of credit files on individuals and organizations throughout the country. Access to this database allows users to search and load information.

The TRW database includes thousands of user organizations some of which are public. Taxing authorities using the system include the California Franchise Tax Board, the States of Hawaii and Idaho and the Federal Internal Revenue Service (IRS). The IRS is said to have been accessing the TRW database for a long time while California has participated for some 6-7 years. The New Jersey Higher Education Assistance Authority, while not a taxing authority, also uses the TRW system for attempting to recover costs on defaulted student loans. The system is reported to be very effective as demonstrated by the California experience detailed in Exhibit E.

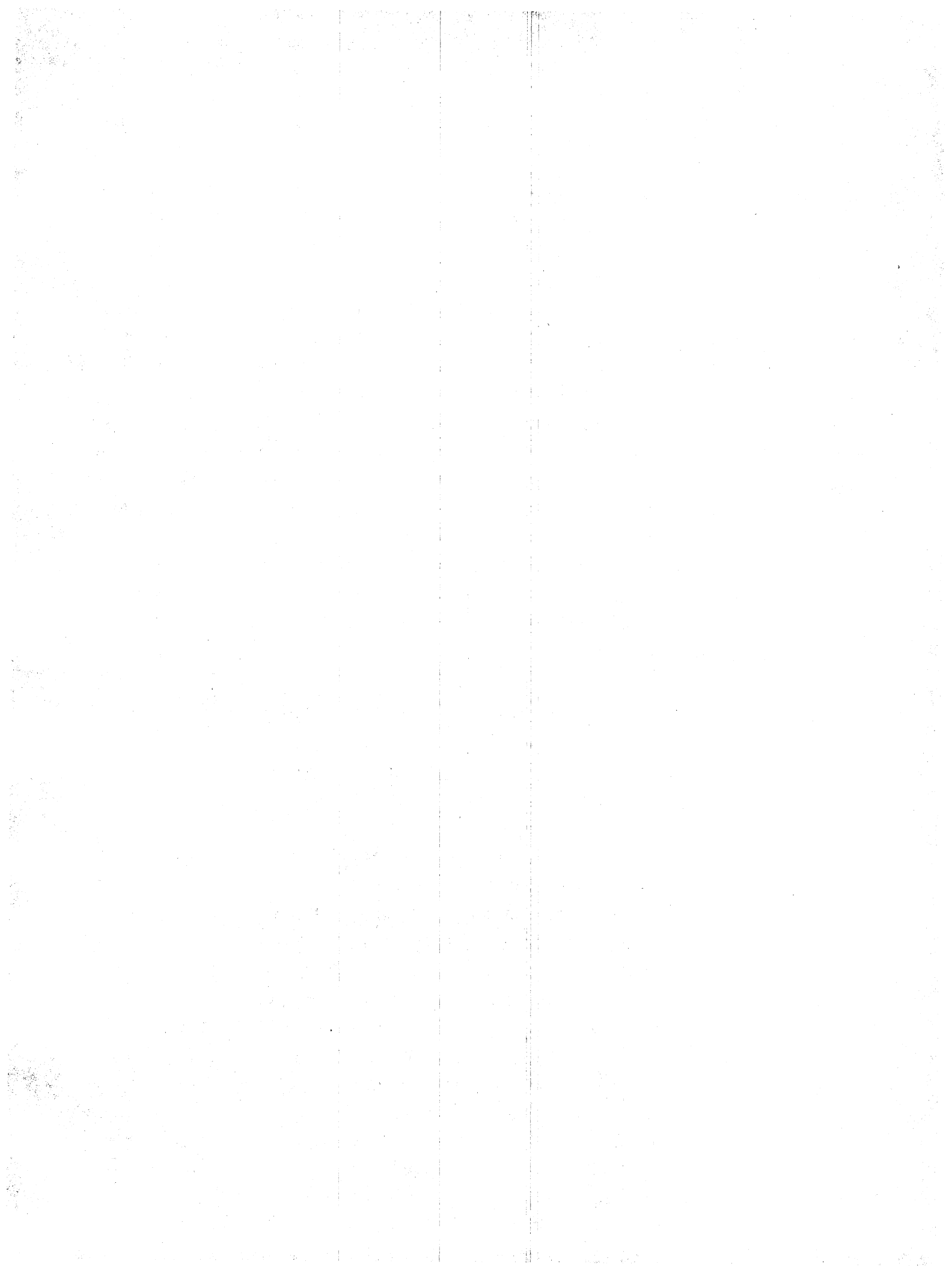


Use of a credit bureau takes either of two forms. The first is an active search, on a case by case basis, for asset data which was previously unreported and unaccessible. This approach does not reveal any taxpayer records to outside sources and is therefore least likely to compromise taxpayer confidentiality. It is this approach that is now in use in the State of California.

Search access to such databases would provide a rich source of information on assets of delinquent New Jersey taxpayers, wherever they might reside. The ability to gain this information would be particularly valuable in helping to determine the collectibility of cases and support the write-offs of others.

An alternative use would involve loading the state's database of delinquent taxpayers onto that of a credit bureau's. In this instance, New Jersey's unremitted taxes become a part of the credit record of all pertinent files and routine credit checks for mortgage applications and the like are flagged and denied as unsatisfied debts to the state are revealed. Tax payment would then be required prior to further processing of these applications. THIS TYPE OF DATABASE USAGE IS SPECIFICALLY NOT RECOMMENDED. Any benefit which could be derived from this usage is significantly outweighed by the potential for credit damage based upon possible errors within Taxation's system's. THE COMMISSION AND THE SOCIETY APPROVE OF THE UTILIZATION OF THESE DATABASES FOR SEARCH PURPOSES ONLY.

The Division of Taxation does not presently access these types of databases. A ruling from the Attorney General was requested on this issue two years ago. A response must be demanded and participation, if appropriate, begun.



Fiscal Impact of Credit Bureau Access

The capital cost of implementing the TRW type searches would be very minimal and primarily consist of terminal and connection charges. The Division would then pay a user fee on a per inquiry basis. The payback, though not readily quantifiable is likely to be quite large. California has experienced a return of some 20 times the cost since beginning participation. There is no reason that New Jersey should expect any less. Participation therefore, could mean an additional \$3.0 million in revenue annually.

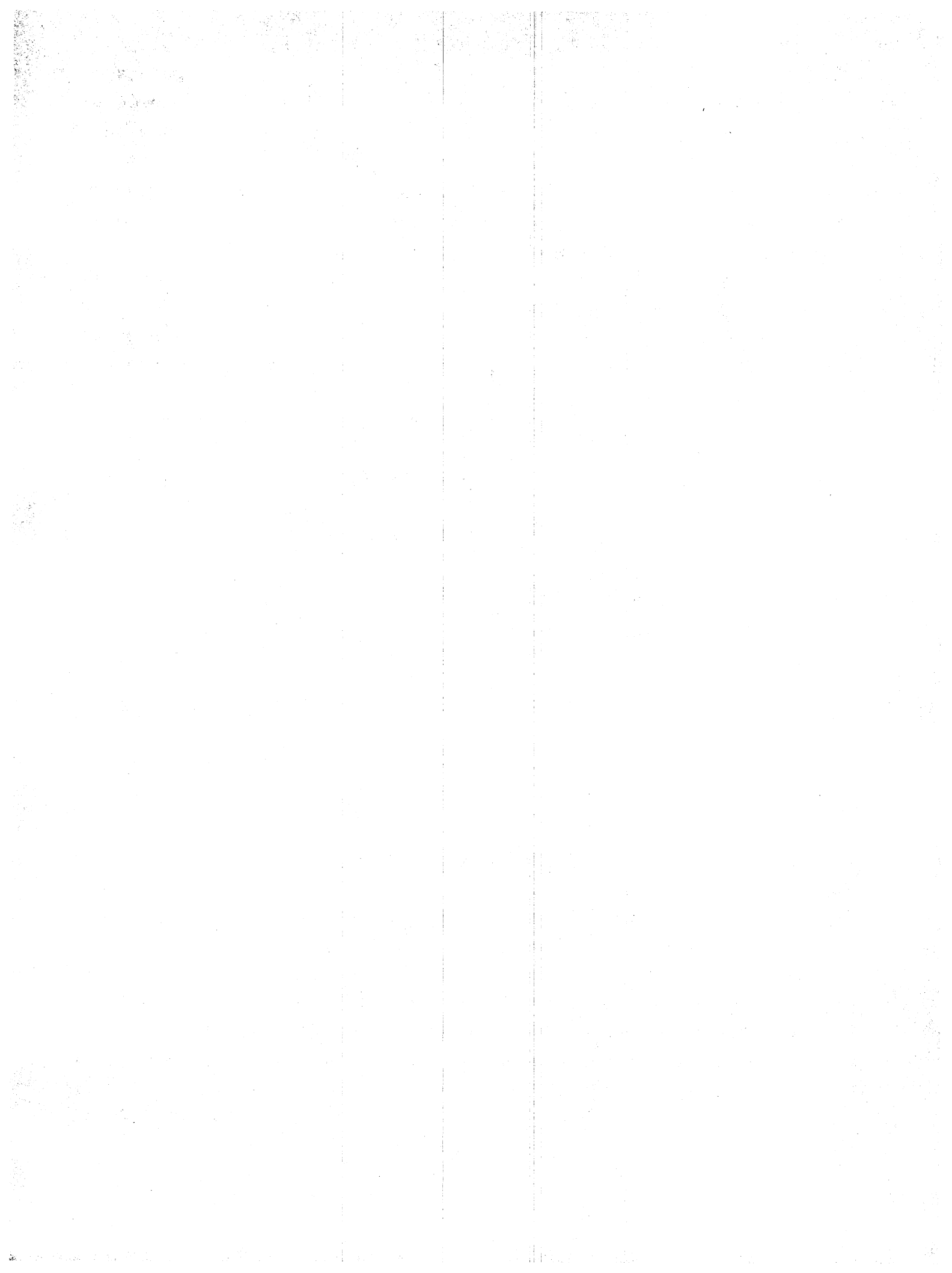
TULIPS Tools

Recommendation:

The management information systems module of the TULIPS system needs to be further developed in order to improve the quality and timeliness of information available to division and state management.

Discussion:

The TULIPS system (Taxation Unremitted Liability Inventory Plotting System) is but one of the many computer-based tools implemented by the Division of Taxation over the last 6 years. The intent of this and similar systems is to improve the effectiveness of internal tax processing capabilities as well as to reduce the labor intensity of these efforts. In general, the TULIPS system has accomplished both of these intended goals. The attendant management information systems module, however, is inadequate. It needs to be redesigned such that it can effectively and economically provide statistical, graphical and performance measurement data to division and state management. This is not the case at present. Costly, special procedures are now required to produce what should be routine, fundamental information. This situation should be corrected. It is recommended that a priority budget package be developed to address this need.



Fiscal Impact on TULIPS Management Module:

The cost of the development of an effective management information systems module is estimated at less than \$1 million. Whatever the cost, the inability of division and state management to take quick, correction action in situations dealing with hundreds of millions of dollars is a significant omission. A study to define user requirements, quantify costs and recommend the most desirable systems design approach to be taken is in order.

New Systems Development Efforts

Recommendation:

The Division of Taxation should continue the design and development of new tax processing systems to enhance productivity.

Discussion:

The Division of Taxation's success with systems development efforts have been mentioned previously and are identified in Exhibit L. The product of these efforts have made it possible for the division to cope with the workload demands of an ever-growing tax base. In part, the success of these efforts has been due to the advantage gained in applying new technologies to existing work requirements. Much more needs to be done, however, particularly to the front-end of the tax collection process where returns and remittances are still manually processed. These manual processes include everything from opening mail, extraction of the return and successive screening, batching, numbering and deposit processing functions.

These initial tax processing steps can be simplified via electronic alternatives. For example, many businesses are currently automated and are taking their electronic information, reducing it to paper and mailing such to the Division. Taxation then takes the paper return and key enters it to their electronic database.

Electronic filing has the capacity to reduce this unproductive paper processing while at the same time reducing the opportunity for key punch error. Other examples include the use of digital image processing techniques for capturing, storing and retrieving tax information; the electronic filing of tax returns which has huge potential in the move toward non-paper media; electronic funds transfer (EFT) techniques would enable the direct acceptance of tax payments; and broader applications of optical disk technology can further build on the base of knowledge already established.

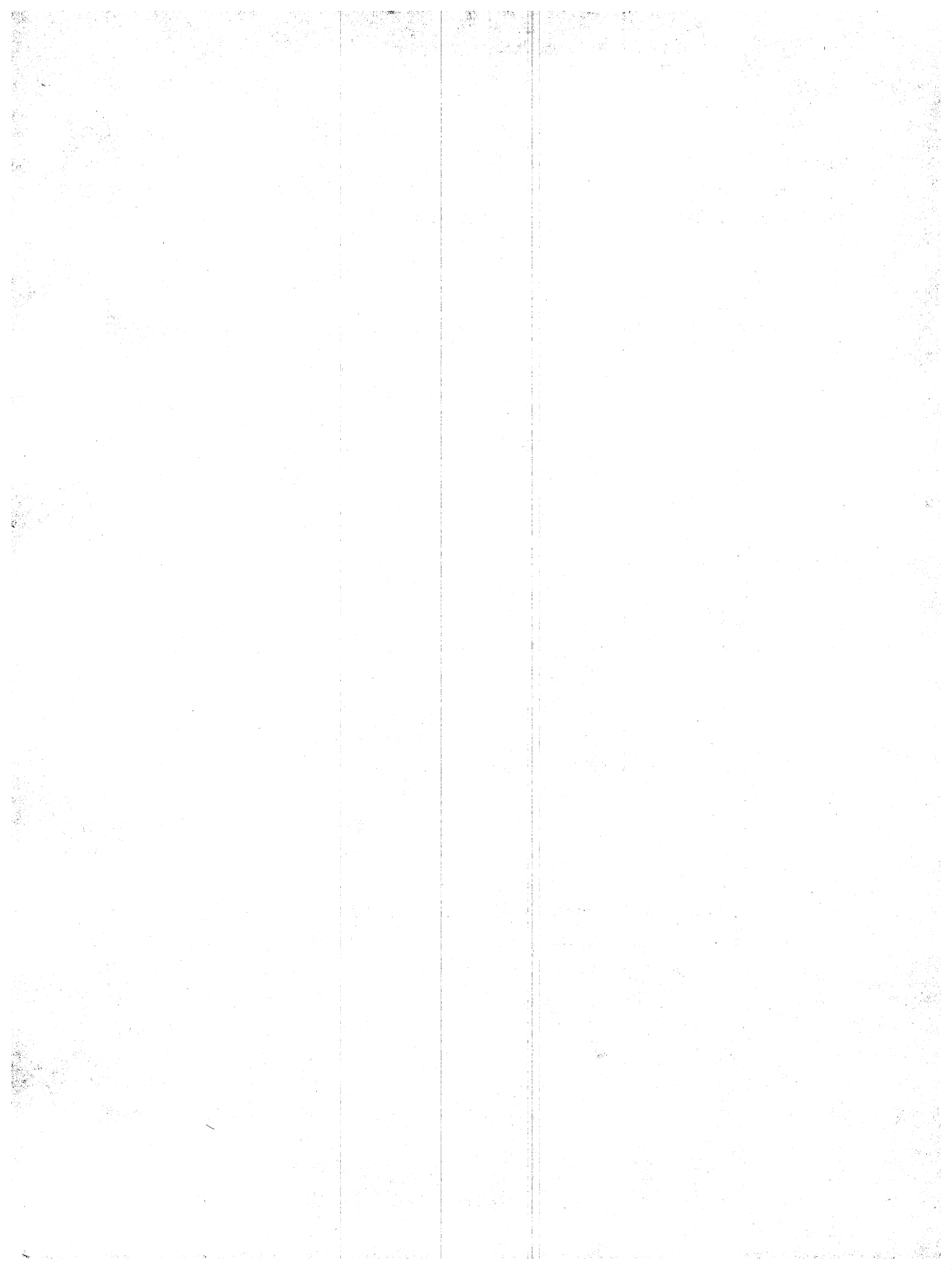
Fiscal Impact on New Systems Development

The division estimates that an aggressive program of innovation would cost approximately \$4.0 million over three years. Many advantages would result including cash flow improvements due to electronic funds transfer, improved taxpayer service as a result of quicker processing of returns, significant reduction in key punch errors and their eventual correction in the system. New systems would also allow the elimination of many front-end operations and the reduction of about half of the intermittent employees now supplementing permanent staff. The staff eliminations themselves would represent an annual savings of some \$3.0 million annually. A policy of continuous investment in improvements in tax processing methodologies would protect and enhance the tax collection capabilities established to date.

Taxpayer Ombudsman and Bill of Rights

Recommendation:

A focal point for taxpayer assistance and information, a Taxpayer Ombudsman, has emerged in various states. A review of the relative merits of such a position in New Jersey is recommended and should include full fiscal and organizational impacts.



Discussion:

Over the last few years, several states have taken the step of creating a position in state government called Taxpayer Ombudsman. The intent of doing so was to create a point of access for frustrated taxpayers in order to insure fair tax treatment under the law and to establish a point within state government through which grievances could be aired and differences resolved. Some of the specific responsibilities assumed by the Ombudsman of other states include:

- Investigate and facilitate the resolution of taxpayer complaints;
- Identify confusing forms, procedures laws or regulations;
- Develop taxpayer education programs;
- Stay enforcement actions which would result in irreparable harm; and
- Furnish each Taxpayer with a written statement of rights (A Taxpayer Bill of Rights).

Relative to a "Taxpayer Bill of Rights", such a document outlines the safeguards to taxpayers in their dealings with state tax agencies and generally establishes standards which governs the actions and the conduct of the taxing authorities. To date, five states have passed legislation which address taxpayer's rights and two others have provided for the same under administrative procedures (Exhibit F). The Internal Revenue Service has also adopted a Taxpayer Bill of Rights. The adoption of similar legislation in New Jersey could begin the process of building a better relationship with the taxpaying public as well as being an effective sounding board for the continuous self assessment of internal taxing policies and procedures. It is recommended that consideration be given to the creation of both an Ombudsman's Office and a "Taxpayer's Bill of Rights".



The Commission does however caution that the creation of such an office requires fiscal, personnel and systems support. There are also a number of organizational impacts upon Taxation and these should all be fully addressed in the review.

Fiscal Impact of Taxpayers Ombudsman:

No fiscal payback is anticipated from the implementation of this recommendation. Payback would take the form of improvement in the relationship between taxing authority and taxpayer.

Reporting of Tax Receivables

Recommendation:

The Division of Taxation should provide the Division of Budget and Accounting with its account receivable data as recommended by the State Auditor.

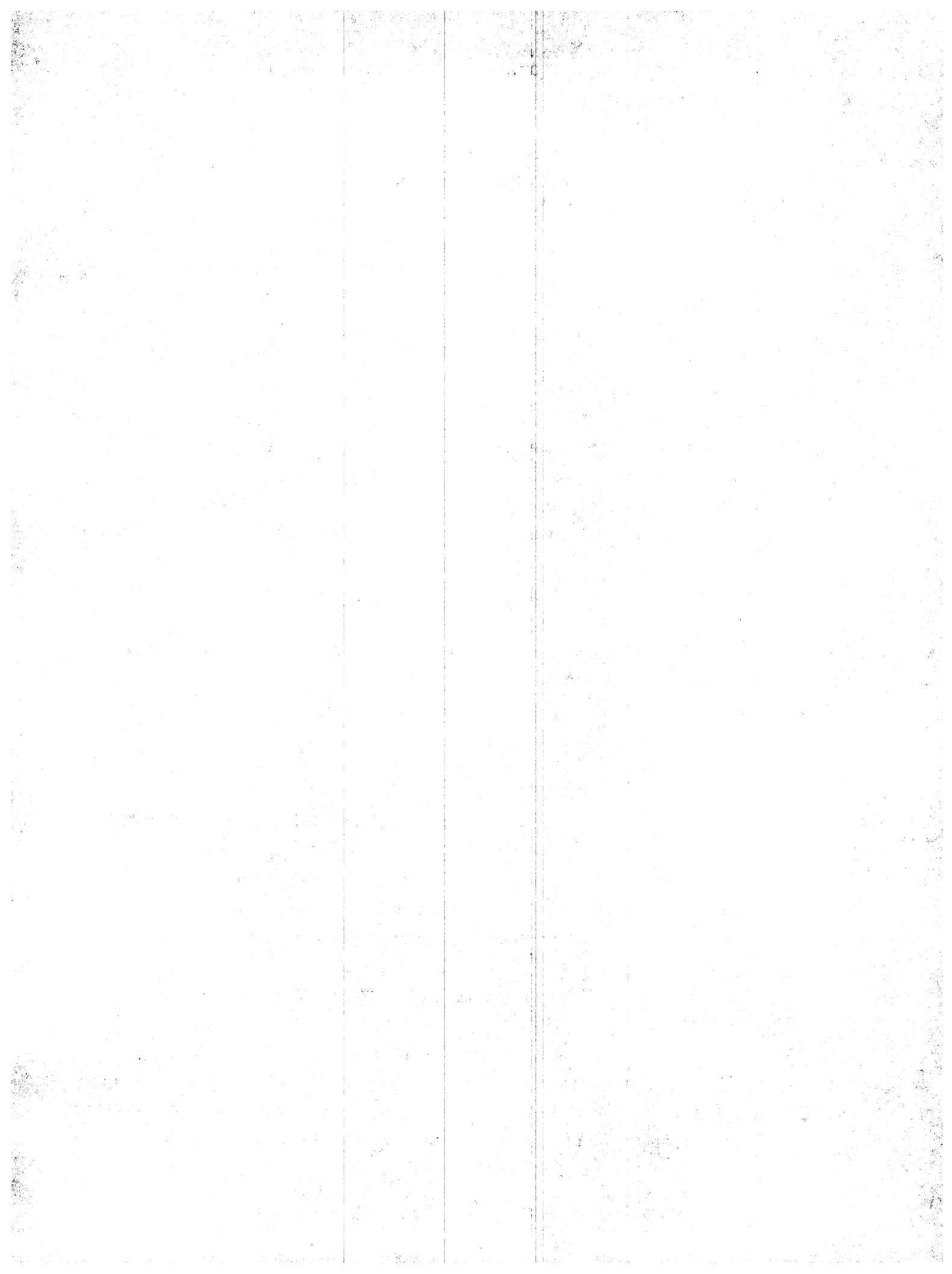
Discussion:

A recent finding by the Office of the State Auditor in its report on Selected Taxes (October 12, 1990) noted that the Division of Taxation has not on a timely basis informed the Division of Budget and Accounting of its fiscal year end amounts of taxes reported as due but not yet remitted. The failure to recognize receivables as assets understates revenue in the current year and overstates revenues in the subsequent years.

SUMMARY OF RECOMMENDATIONS

In summary, the Governor's Management Review Commission and the New Jersey Society of Certified Public Accountants recommends the following:

- The development and implementation of a write-off policy for uncollectible delinquencies. No fiscal impact will result.



- A comprehensive review of investigator and technical staffing requirements and supplement additions as required. The net fiscal impact of the recommendation is estimated at \$37 million.
- Development and implementation of a pilot project for the privatization of certain delinquent tax collection. The net impact of this recommendation is not quantifiable and is to be demonstrated by the pilot project.
- Utilization of credit information services, currently used by the IRS and other states, (for search only purposes) to assist in the collection of delinquencies and the rating of write-offs. The net impact of this recommendation is estimated at \$3.0 million annually.
- Enhancements to the management information components of TULIPS and other Taxation systems. The net fiscal impact of this recommendation is not quantifiable. Estimated cost of the enhancements is \$1.0 million.
- The design and development of new, state-of-the-art technologies to enhance revenue collection. The savings of this recommendation for staff alone is estimated at \$3.0 million annually. Estimated cost of the enhancements is \$4.0 million over 3 years.
- Review of the benefits and impacts of establishing an office of Taxpayer Ombudsman. The net fiscal impact of this recommendation is unknown but should be quantifiable through detailed study.
- The Division of Taxation should provide the Division of Budget and Accounting with its account receivable data as recommended by the State Auditor

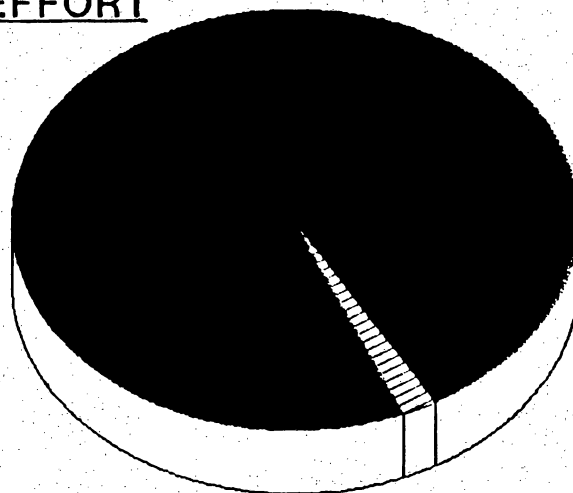
As quantifiable, the recommendations presented within the report and as summarized above have net benefit to the state of \$41 million.

TAX DELINQUENCY THE NORMAL COLLECTION CONDITION

TYPICAL COLLECTION EXPERIENCE

ROUTINE EFFORT

95-98%
(\$10-11B)



DELINQUENT EFFORTS

2-5%
(\$400M)

SOURCE: TAXATION RECORDS



STATE OF NEW JERSEY
DEPARTMENT OF THE TREASURY
OFFICE OF MANAGEMENT AND BUDGET
CN 221
TRENTON, NEW JERSEY 08625-0221

JIM FLORIO
GOVERNOR

DOUGLAS C. BERMAN
STATE TREASURER

RICHARD F. KEEVEY
DIRECTOR
AND STATE COMPTROLLER

TO: Paul Finocchio, Management Analyst
Office of the Governor
Governor's Management Review Commission

FROM: Stephen D. Rohrer, Manager *SDR*
Financial Reporting

DATE: August 14, 1990

SUBJECT: Delinquent Taxes

This is in response to your July 30 memorandum concerning delinquent taxes.

It is correct that receivables must be both measurable and available in order to be recorded in accordance with generally accepted accounting principles. At June 30, 1990, two receivables meeting this criteria from the Division of Taxation are being recorded; Cigarette Tax in the amount of \$17.9 million and Inheritance Tax in the amount of \$13.6 million. I have attached copies of the documentation received from the Division of Taxation as well as our input document.

Circular Letter 85-16 provides the procedures for all state agencies, including the Division of Taxation, to request the write off of uncollectable accounts receivable. Such write off, if approved, is for accounting purposes only and in no way absolves the debtor from liability.

Requests for write off of receivables are reviewed by the office of Russell R. Hart, Director of Fiscal and Resources, Department of the Treasury, CN 211, the successor agency to the Office of Financial Management stipulated in Circular Letter 85-16. Questions concerning historical requests and disposition thereof for the Division of Taxation should be directed to Mr. Hart.

If you have additional questions, please feel free to contact me.

bh

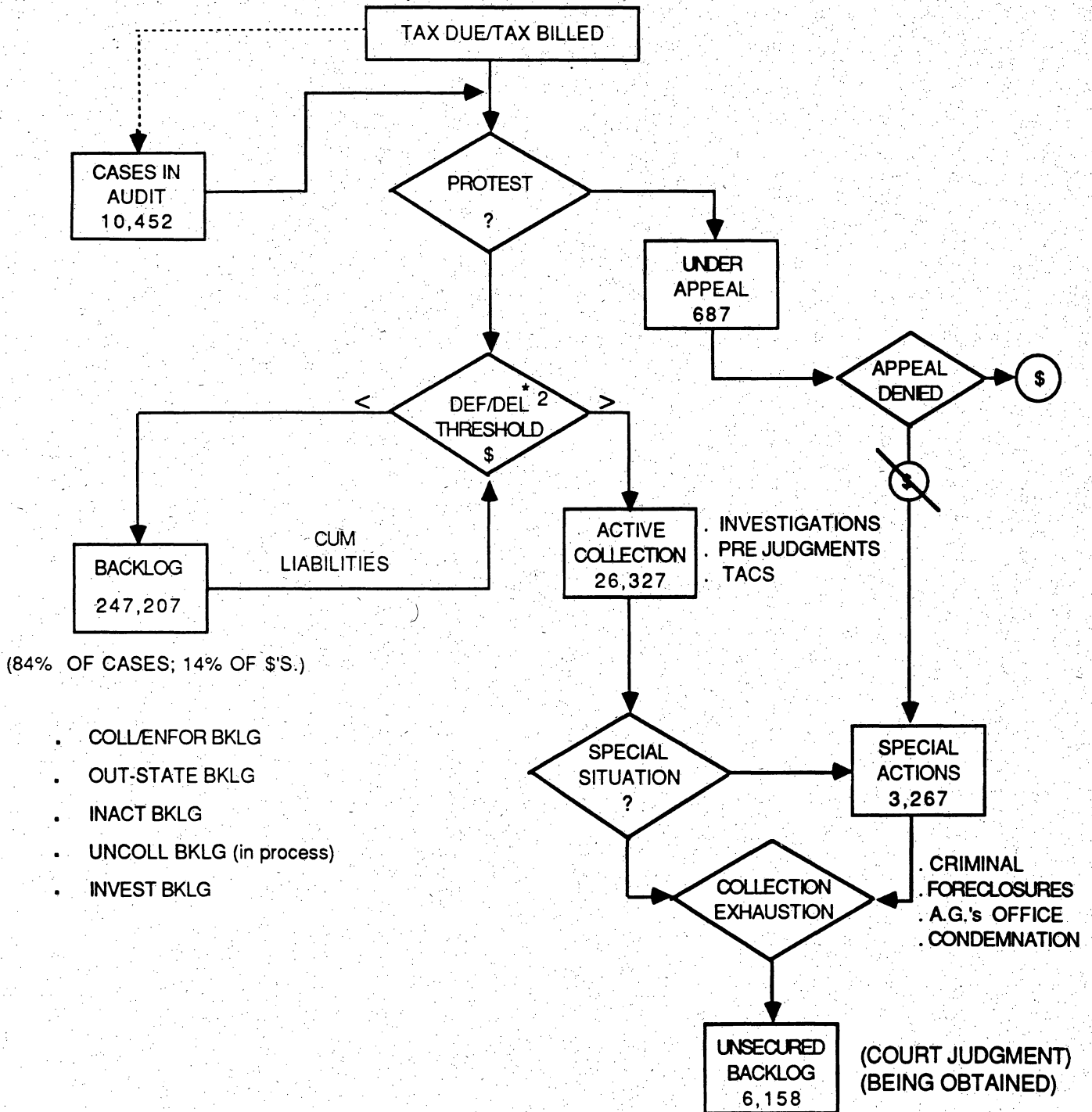
Attachments

c Richard F. Keevey
Francis C. Gatti, Jr.

GMRC 32

ACTIVE TAX CASES*¹

COLLECTION CASE FLOW



¹*294,098 CASES OUTSTANDING 8/31/90

²*TAX DEFICIENCY OR DELINQUENCY

Division of Taxation
Information Processing Systems

1. **Cash Receipts Accounting System (CRAS)** - Mechanized the division's deposit processing and cashbook accounting functions. Further enhancements have provided links between the New Jersey Financial Information System (NJFIS) and Electronic Funds Transfer (EFTS).
2. **Taxation Automated Contact System (TACS)** - Provides for the quick and economical contact of delinquent and deficient taxpayers by telephone. (Staffing of TACS work stations was one of the target applications of the paraprofessional initiative.)
3. **Taxation Unremitted Liability Inventory Plotting System (TULIPS)** - An internal case tracking system that virtually eliminates the need to manually create and track taxpayer cases throughout the division.
4. **Management Information System (MIS)** - System designed to capture relevant division-level performance data and facilitate its review and analysis. (It is this system which is in need of major redesign.)
5. **Generic Tax System (GENTS)** - Provides the division with a single method for administering all of the various taxes now in place. It replaces a outmoded tax-by-tax process that was particularly cumbersome.
6. **Tax Record Image Mechanization System (TRIMS)** - A high-volume, optical image storage-based device provides for the capture, storage and retrieval of tax documents with the speed, quality and accuracy not available formerly. Continuous refinements in the use of this new technology are planned.
7. **Wide Area Communication System (WACS)** - A system designed to provide high-speed telecommunications links among the three taxation facilities located in downtown Trenton. Reliance of new technologies (microwave and fiber optics) has reduced the amount of physical cabling usually involved and has significantly improved communications between the three tax processing facilities.
8. **TAX TALK** - An automated voice response system comprised of a series of pre-recorded messages. It was designed to assist taxpayers with general information as well as to provide answers to their often asked questions. An 800 toll-free number is provided.

CALIFORNIA CREDIT BUREAU USE

General Facts

- . California General State Fund Budget \$64B
- . Revenue Sources
 - . Personal and Corporate Income Tax Revenue.....\$35B
(Administered by the Franchise Tax Board)
 - . All Other Taxes and Fees.....\$29B
(Administered by State Board of Equalization)
 - . Delinquent taxes on Personal & Corporate Revenue...\$ 1.6B

Credit Bureau Facts

- . Credit Bureau Usage..... TRW, Trans Union, RCA, & Others
- . History of Usage 7 Years
- . Budget for Credit Bureau Service..... \$250,000
- . Staff Supporting Credit Searches..... 5 Clericals
- . Method of Use.....Using the social security number, the system searches the Credit Bureau files for assets of the delinquent taxpayer. No state records are turned over to the Credit Bureau. There were no confidentiality issues raised through this type of use.
- . # of Inquiries Annually..... >100,000
- . Matches to Inquiries..... 76%
- . Value of Collection Service..... 20:1 or approx \$5M annually

**TAXPAYER BILLS OF RIGHTS:
A COMPARISON OF STATE AND
FEDERAL PROVISIONS**



**Federation of Tax Administrators
444 North Capitol Street, N.W.
Washington, D.C. 20001**

Research Report No. 132

May 1990

TABLE 1 —

	<u>Arkansas</u>	<u>California¹</u>	<u>Hawaii</u>	<u>Illinois</u>	<u>Indiana</u>	<u>Kansas</u>	<u>Maryland</u>
Legislation	HB 1522	AB 2833 AB 2788	Policy	HB 1100 SB 1424	HB 1546	HB 2033	Policy
Effective date	12/11/89	1/1/89	9/1/89	1/1/90	10/30/89	7/1/89	1/1/89
Taxes covered²	All	*Sales & Use **All other	All	All	All	All	Income, Sales & Use, Admissions and Amusement, Motor Fuel, Alcohol & Tobacco
Ombudsman created	No	Yes	Yes	Yes	Yes	No	No
Annual report required	No	Yes	No	Yes	Yes	No	No
Agency employees not evaluated on basis of enforcement quotas	Yes	Yes	Yes	No	Yes	Yes	No
Taxpayer has right to:							
Record interviews	Yes	Yes*/No**	No	No	Yes	No	No
Installment plans	Yes	Yes*/No**	Yes	Yes	No	No	No
Agency advice	Yes	Yes	No	Yes	No	Yes	No
Representation	Yes	Yes	Yes	No	Yes	No	Yes
Sue	Yes	Yes	No	Yes	No	No	No
Attorney fees	No	Yes	No	Yes	No	Yes	No
Procedural instruction	Yes	No*/Yes**	Yes	No	No	Yes	Yes

¹ California enacted separate taxpayer bills of rights applicable, respectively to the Board of Equalization and the Franchise Tax Board. The provisions of these bills do have minor differences.

² "All" designates all taxes administered by the tax agency.

³ Preexisting condition.

* Board of Equalization

** Franchise Tax Board

STATE TAXPAYER BILLS OF RIGHTS

<u>Missouri</u>	<u>New York</u>	<u>New York City</u>	<u>Ohio</u>	<u>Oregon</u>	<u>South Carolina</u>	<u>South Dakota</u>	<u>Texas</u>
Policy	Policy	Policy	SB 147	HB 2209	SB 202	SB 44	Policy
11/1/89	12/5/89	10/30/89	1/1/90	10/3/89	1/1/90	7/1/90	9/1/88
Income, Sales & Use	All	All	Income, Sales & Use, Corp. Franchise, Pers. Property	All except Real Property and Personal Property	All	All except Inheritance Taxes	All
No	Yes	No	Yes	No	Yes	No	No
No	No	No	Yes	No	Yes	No	No
No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Yes	Yes	No	Yes	Yes	Yes	No	No
No	Yes ²	Yes	Yes	Yes	Yes	No	Yes
Yes	Yes ²	Yes	No	Yes	Yes	Yes	Yes
Yes	Yes	Yes	Yes	Yes	Yes	No	No
No	No	No	Yes	No	Yes	No	No
Yes	No	No	No	No	No	No	No
Yes	Yes	No	Yes	Yes	No	No	Yes

Table 2
State Taxpayer Bills of Rights
Unique Provisions

State	Other Provisions¹
Arkansas	<p>Taxpayer has the right to:</p> <ul style="list-style-type: none">• Full explanation of all actions by tax agent during an audit and during collection activities.• Request an administrative review of any proposed assessment of tax within 30 days of receipt of assessment.• Request a review by the Commissioner of an unfavorable administrative decision within 20 days of receipt of decision.• Appeal an unfavorable decision from the Commissioner to Chancery Court.• File an amended return for credit or an overpayment within three years of original filing date or two years from the date the tax was paid, whichever is later.
California	<p>Franchise Tax Board and Board of Equalization are required to:</p> <ul style="list-style-type: none">• Develop and implement a program to evaluate an employee's performance on contact with taxpayers.• Develop a plan to reduce the time required to resolve petitions and claims.• Refrain from knowingly authorizing, requiring, or conducting any investigation or surveillance for non-tax administration purposes.• Allow settlement of tax disputes of \$5,000 or less.• Notify taxpayer 60 days prior to suspension of a corporation's rights, privileges, and powers.• Grant taxpayer an extension of time to file a personal income tax return if the taxpayer indicates on the state extension request that timely deferral application for extension was filed and payment made.• Reimburse taxpayer for bank charges incurred due to an erroneous levy.
Hawaii	<p>Taxpayer has the right to:</p> <ul style="list-style-type: none">• Expect prompt responses to questions, freedom from red tape, and freedom from harassment or inappropriate contact.• Protection from unreasonable estimates of tax liabilities that are larger than previous tax liabilities.



State	Other Provisions ¹
	<ul style="list-style-type: none"> • Three-year statute of limitation on refunds. • Sign an agreement to allow an extension of the statute of limitation. • Meet with the auditor to discuss any disagreement with assessments. • Informal hearings with the Board of Review after filing an appeal. • A public hearing on all proposed administrative rules adopted under the Hawaii Administrative Procedure Act. • Look at personal tax records, including tax returns, audit files, and collection files. • Taxpayer information services.
Illinois	<p>Taxpayer has the right to:</p> <ul style="list-style-type: none"> • Receive an automatic extension if extension has been granted for filing of federal return.
Indiana	<p>Taxpayer has the right to:</p> <ul style="list-style-type: none"> • Not be investigated or surveyed unless these actions are related to the administration of an identified tax. • Have the time required to resolve appeals and claims for refunds reduced. • Have tax disputes of \$25,000 or less settled by Commissioner. • Receive notification of hearing results within 60 days.
Kansas	<p>Taxpayer has the right to:</p> <ul style="list-style-type: none"> • Not have a position maintained against him that is inconsistent with a prior written opinion that has not been rescinded.
Maryland	<p>Taxpayer has the right to:</p> <ul style="list-style-type: none"> • Free tax assistance and preparation at any branch of Comptroller's Office. • Inspect any record containing personal information held by Comptroller's Office. • Fair and courteous treatment under the law. • A copy of previous filing period tax return at no charge, when requested. • Know which records are needed to verify a return.



State	Other Provisions ¹
Missouri	<p data-bbox="336 334 663 363">Taxpayer has the right to:</p> <ul data-bbox="336 400 1394 1059" style="list-style-type: none"><li data-bbox="336 400 1394 463">• File an amended return for refund of overpayment within three years of original filing date or within two years from the date the tax was paid.<li data-bbox="336 495 1394 559">• Request a review by the Department of Revenue of any proposed assessment or refund claim.<li data-bbox="336 591 1394 655">• Seek a review of the Department's decision by the Administrative Hearing Commission.<li data-bbox="336 687 1394 751">• Take appeal of Administrative Hearing Commission's decision to state court system.<li data-bbox="336 783 938 812">• Three-year statute of limitations on billings.<li data-bbox="336 844 1394 874">• Petition for release of sales tax bond after five years of satisfactory tax compliance.<li data-bbox="336 906 1394 991">• Recover interest on an overpayment if overpayment is not refunded by the Department of Revenue within four months of the filing date of the return or the due date, whichever is later.<li data-bbox="336 1023 970 1059">• Taxpayer Assistance and Information Services.
New York	<p data-bbox="336 1098 1394 1183">Taxpayers provided a new administrative policy, applicable to most cases, limiting billings based on federal changes to three years from notification of the change by the IRS.</p>
New York City	<p data-bbox="336 1225 663 1255">Taxpayer has the right to:</p> <ul data-bbox="336 1287 1059 1385" style="list-style-type: none"><li data-bbox="336 1287 916 1317">• Receive information about tax exemptions.<li data-bbox="336 1349 1059 1385">• Professional treatment and fair application of the law.
Ohio	<p data-bbox="336 1417 663 1447">Taxpayer has the right to:</p> <ul data-bbox="336 1478 1394 1672" style="list-style-type: none"><li data-bbox="336 1478 1394 1672">• Request a written opinion from the tax commissioner. An "opinion of the Tax Commissioner" means an opinion issued under this section with respect to prospective tax liability. It does not include ordinary correspondence of the commissioner or a final determination of the commissioner arising from a request for administrative review of an assessment, a claim for refund, or an application for a pollution control or other certificate.
Oregon	<p data-bbox="336 1704 663 1734">Taxpayer has the right to:</p> <ul data-bbox="336 1766 1394 1832" style="list-style-type: none"><li data-bbox="336 1766 1394 1832">• Make certain types of appeals to the Small Claims Division of the Tax Court or the Department of Revenue.

State	Other Provisions ¹
South Carolina	<ul style="list-style-type: none"> • Appeal hearing decisions to Tax Court within 60 days of the date of the department's decision. • File refund claims up to three years after income tax return is filed or two years from the date tax or a portion of it was paid. <p>The Tax Commission shall not knowingly authorize, require, or conduct any investigation of, or surveillance over, any person for non-tax administration purposes.</p>
Texas	<p>Taxpayer has the right to:</p> <ul style="list-style-type: none"> • Freedom from red tape and harassment. • Receive a discount on specified taxes if reports and payments are early or timely. • Protection from unreasonable estimates of tax liabilities that exceed previous amounts. • Have all other collection actions exhausted before seizure of assets occur. • Challenge any tax liability. • Request review of any questionable assessment of penalty and interest. • The same statute of limitation on refunds as on assessments. • Have all proposed tax rules published for review in the <i>Texas Register</i>. • Taxpayer information services.

¹For the most part, the text has focused on the similarities and differences between the federal, state and state taxpayer bills of rights. However, legislative provisions or procedures in some states are unique to those states.



