

Approved: Feb. 2, 2000
Date

MINUTES OF THE HOUSE TAXATION COMMITTEE.

The meeting was called to order by Chairperson Wagle at 9:00 a.m. on January 19, 2000, in Room 519-S of the Capitol.

All members were present except: Rep. Howell - excused

Those attending from the Tax, Judicial and Transportation Budget Committee:

Rep. J. Peterson
Rep. Hermes
Rep. Nichols

Committee staff present: April Holman, Legislative Research Department
Don Hayward, Revisor of Statutes
Shirley Sicilian, Department of Revenue
Ann Deitcher, Committee Secretary

Conferees appearing before the committee: Karla Pierce, Secretary of Department of Revenue

The Chair introduced Janet Stubbs of the Kansas Building Industry Association who requested the introduction of a bill regarding excise tax. This would establish guidelines that the local unit of government would have to follow in order to implement an excise tax.

The Chair recommended passage of this bill and it was seconded by Representative Tomlinson. The bill passed on a voice vote.

Representative Aurand moved that a bill be adopted regarding hotel services exempting certain sales of hotel rental services that would only apply to federal employees. Representative Minor seconded the motion which carried on a voice vote.

The Chair introduced the Bi-States Cultural Tax which is up for renewal. It was seconded by Representative Johnston and passed on a voice vote.

The Chair then recognized Secretary Karla Pierce of the Department of Revenue who gave a briefing to the Committee on the State of the Department of Revenue Tax Operations. (Attachment 1).

The Secretary said they thought it would be wise to go back prior to Project 2000 to explain just why they'd made the choices that were made. She referred to the first box on page 3.

She said that overall what was going on in 1995 was that the entire process didn't focus on the customer, the taxpayer, at all. The other thing that was going on in 1995 was the compliance initiative. They had very aggressive audit techniques. Appeals took five to seven weeks.

Secretary Pierce reminded the Committee of the 1996 article in CFO Magazine that ranked Kansas right at the top as having a tax climate that was not favorable to business. Tax practitioners and attorneys could shop around for their favorite tax specialist in the department and they could get the answer they wanted.

She said that typically those answers were locked away in a file drawer so no one else knew where they were so there was no way to apply policy consistently across the board. Very little effort was made to locate additional taxpayers and accounts receivables were several years behind the collections process when they actually occurred. Looking for a way to solve these problems they decided the solution was Project 2000.

CONTINUATION SHEET

They had failed in several attempts in the early 1980's to put in a satisfactory tax system so they knew that the Legislature wasn't going to give them funding to rebuild the Department of Revenue. Thus, they came up with an innovative funding mechanism which was to pay for these improvements from the improved benefits that were generated by making the changes.

The Department of Revenue did an analysis and at the end of the fiscal year, after the shortfall was accounted for, they found they'd underestimated fiscal notes from the tax relief by \$10 million. There was some acceleration of refund processing that occurred in June of around \$10 million that probably would have occurred in July in prior years. The consensus estimate deviation which is what they changed in November, was between \$35 and \$48 million. This means that in May of 1998 they revised the estimate after the \$117 million tax reductions down to \$1.684 billion for an income tax. The actual receipts in FY99 were \$1.695 million more than they said they would collect in May 1998.

Secretary Pierce went on to explain that they didn't stay with the May 1998 consensus estimate because when they put out withholding tax tables in July of 1998, they doubled up on the reductions because they needed to annualize the reduction and withholding tax to account for the reduction in the law. Many businesses must not have put those in because withholding continues at a higher rate than it was going on the prior year. That was the indication that the Revenue Department thought the economy was growing faster than it really was. The other thing was the estimated tax law said that if you pay the same amount of tax that you paid last year, you don't get an estimate penalty. People did not adjust their estimated payment. They still came in very high in January. What happened was that the withholding and the estimated were coming at such a rate that they thought they should increase the November estimate.

In April, with the delays in refund processing, they didn't realize there were still that many more yet to come, they didn't know they would be paying all that money back out in April and May after the April estimate. So they didn't adjust it that much in April. The data just wasn't available when they were making those up.

Representative Vickrey asked if they were paying interest on refunds. Secretary Pierce said they were.

Representative Wilk asked how we were doing now against our estimates. Secretary Pierce said that as of the fiscal year-to-date, we are .4% or \$7 million behind where we thought we'd be. This is a \$5 growth over last year. Sales tax was down \$6 million in December but it was difficult to tell about sales tax until the end of January because you wouldn't know when people made their Christmas purchases. The December filing month is not due until January 25. Another thing that happened had to do with a large company that had just filed an amended return in January that will take up a lot of this shortfall. That was for November and should have been filed in December. Individual income tax was down \$867 thousand at the end of December so they feel it's right where they thought it would be. A couple of unusually large inheritance tax payments have come in recently that have offset some of the other things.

Representative Wilk asked for the final report to be submitted to the Tax Committee.

Representative Johnston asked how much the project cost and how much new money had gone into the State General Fund. The Secretary said the cost of the project was \$65 million. \$800 thousand has gone toward the State General Fund. The way the contract is set up is that the first \$45 million directly to the contractor. There's another \$10 million that is for the purchase of equipment and they pay out the other \$10 million that they owe AMS after they hit a revenue threshold of increased revenues of \$89 million and they share in that. The state has to benefit \$189 million in order for the contractor to be paid in full.

On the subject of errors in the booklet, the Secretary said that only 12% of the booklets had gone out with errors. This affected 600 people. As soon as error was discovered, new booklets were printed and sent out. They also contacted the preparers to inform them of the error.

Representative Johnston said he would like to see samples of some of the different types of letters they send out to people who have paid late, underpaid or overpaid or whatever other problems there were. He felt that since this was the Department's first contact with constituents, he was interested in what these letters looked like and what the wording was. Secretary Pierce said these would be provided.

CONTINUATION SHEET

The Chair asked if when the new system was set up, did AMS come in and do a review of our Kansas statutes so that we could take their system and apply it to our individual state law and make sure we were following our statutes. The Secretary said that they did.

Representative Nichols said that Post Audit had pointed out that other states had less reliance on automation and more reliance on manual involvement while the policy of this state is to have a little more reliance on automation versus manual involvement. He wondered if some of the glitches in the system could be traced back to the greater reliance on automation versus manual involvement and said he would like to better understand why that is the policy. Given some of the mistakes that happened last year, he wondered if the Department planned on altering that policy.

Secretary Pierce said they had added more manual review this year.

The meeting adjourned at 11:00 a.m. The next meeting is scheduled for Wednesday, January 20, 2000.

House Taxation Committee
Briefing on the State of KDOR
Tax Operations

January 19, 2000

Briefing Topics

- State of KDOR five years ago
- Key accomplishments over the last five years
- Project 2000 benefits
- Current state of KDOR 2000
- 2000 plan
- Proposed legislation recommended by LPA

House Taxation

Date 1/19/00

Attachment # 1

State of KDOR 1995

- Employee attitudes reflected their views that taxpayers were always trying to “cheat” the state
- Employees didn’t have the information to provide service on the phone which usually resulted in a call back
- Taxpayers had to call multiple areas to solve problems

State of KDOR 1995

- Only way to file a return was using paper forms
- Organized by tax type
 - Separate account numbers
 - Separate organizational units
 - Each with its own 20 year old system, that was not Y2K ready
- Managers performance measures rewarded those who passed work to other units

State Of KDOR 1995

- Compliance initiatives consisted of ---
 - Aggressive audit techniques
 - Appeals took 5 - 7 years to resolve
 - CFO Magazine ranked Kansas tax climate as “not favorable to business”
- Policies were not communicated to taxpayers and they were inconsistently applied to maximize revenue
- Spent little effort to identify businesses that should be collecting taxes

Project 2000 Concept

- Rethink and restructure KDOR operations to significantly enhance customer service with no new staff
- Innovative funding to mitigate project risk
- Project design included both fast track initiatives and a strategic blueprint of future operations implemented in phases
- Build a culture that supports continuous improvement

Selecting a Business Partner

- Legislation was passed in 1993- KSA 75-5147
- Request for Information completed in 1993
- Request for Proposal completed in 1994
- Proposal evaluation by over 30 staff members
- Site visits and reference checks
- Oral presentations - twice
- Negotiation and contract award made June 1995

Key Accomplishments 1995

- Management retreat to establish vision
- Completed “Voice of Customer” analysis to use in the redesign of our operations
 - Friendly attitudes by associates
 - Simple forms in plain language
 - Consistent policy
 - Ensure everyone is paying their fair share
- Benchmarked Kansas businesses best practices
- Implemented a tax discovery program to locate unregistered taxpayers

Key Accomplishments 1996

- Implemented Tele-file and Tel-Assist to simplify the filing of personal income tax
- Upgraded the collections process by adding inbound and outbound phone automation
- Completed blueprint of future operations
- Designing, building and implementing the new operations
 - significantly modified the audit process to provide a problem resolution step prior to final assessment
 - implemented a new management process to measure and allocate resources focused on changing the culture

Key Accomplishments 1997

- Expanded Tele-file to all short form filers and added the refund status line
- Implemented the imaging of individual income tax returns
- Implemented the Taxpayer Fairness Act
 - published on the Internet a policy library to document Department's policy
 - implemented a user-friendly reconsideration process for tax assessments
- Implemented an automated fiscal note system

Key Accomplishments 1998

- Upgraded the imaging software
- Implemented an integrated case management system on the new technology (client-server) platform
- Implemented STRATA
 - an automated decision technology that allows us to bring the taxpayer back into compliance using the least intrusive method
- Implemented the integrated tax processing system for personal income, homestead and withholding taxes

Accomplishments 1999

- Implemented PC file for individual income taxpayers
- Implemented the requirements of the 1998 Tax Reduction Act by installing a modified version of the tax processing system
 - processed 28% more refunds with 14% less staff
 - didn't meet our goals for refund issuance or percentage of phone calls answered
- Implemented the audit and enforcement case management sub-system

1999 Accomplishments

- In September the management team developed a continuous improvement plan
 - Critical reflection based on experience
 - Promote electronic filing
 - Improve handling of paper returns
 - Improve customer education and communication
- Established a tax operations advisory council
 - Business and customer representatives
 - Review and monitor the implementation of the plan

Key Accomplishments 1999

- Implemented Phase I of the phone system plan
 - Interactive voice response system providing hold queues
- Implemented a new version of the tax processing system for sales and compensating use taxes in including significant upgrades to the income software
 - Completed over 54,000 hours of testing prior to implementation
 - Telefile for sales tax including ability to pay electronically
 - Rewrote many of the high volume letters to taxpayers
 - Improved data capture quality by increasing edits

Benefits of Project 2000

- Organizational change to service provider from tax police
- Integrated tax system provides extensive customer information and returns on-line
 - Customer segmentation provides a single point of contact
 - Compliance programs that bring taxpayers into compliance using the least intrusive method
- A modern technological foundation and business operations in which to provide high quality customer service
- \$65 million in additional revenue

Revenue Shortfall- Income Tax

- KDOR analysis shows the following
 - We underestimated fiscal notes from tax relief by \$10 million
 - Accelerated refund processing by \$10 million
 - Consensus estimate deviation due to WH and estimate payments was \$35- 48 million
- May 1998 revised estimate after \$117 million in tax reductions was \$1.684 billion
- Actual FY 99 receipts were \$1.695 billion

Current State of KDOR 2000

NEW

The New KDOR Team

- Staffing levels have declined
 - 40 retirements abolished
 - 1996 5% budget reduction impact of 35
- We are a team based environment
- Reassigned over 500 tax operations staff members to doing their work a new way
- We are doing more with less

2000 Plan

- Continuing to upgrade phone system
 - February 1 install toll free number (upon approval)
 - March 1 install new switch providing more efficient use of existing staff
- Begun processing 1999 forms
 - Telefile, PC file, paper
 - Four to six weeks ahead of last year in terms of system stability
 - Users have one year of experience

2000 Plan

- Enhancing the current operations
 - Adding corporation income tax to tax system
 - Adding e-taxation features to enhance service
 - Staff development to provide a single point of contact
 - Customer education unit supports changing requirements with out-reach programs
 - Continuing to improve customer correspondence

Request for Introduction of Legislation

- Legislative Post Audit recommends three areas of the statute that needs clarified
 - Request to file under extension
 - Proof of eligibility requirements for food sales refunds
 - Interest paid on amended refunds

Our Vision

- We will put the customer first every time
- Our performance will be the benchmark for the nation
- We will develop and sustain a team environment