

MINUTES OF THE HOUSE COMMITTEE ON TAXATION

The meeting was called to order by Chairman Edmonds at 9:00 a.m. on March 7, 2002 in Room 519-S of the Capitol.

All members were present except: Representative Howell, excused  
Representative Kirk, excused  
Representative Vickery, excused

Committee staff present: Chris Courtwright, Legislative Research Department  
April Holman, Legislative Research Department  
Don Hayward, Revisor  
Winnie Crapson, Secretary

Conferrees appearing before the Committee: Steve Richards, Secretary of Revenue

Others Attending: See attached list.

By unanimous consent bill will be introduced as requested by Representative Pyle concerning licensing of child care facilities where certain individuals lived or worked. [HB 3016 - Prohibiting licensing or registering child care facilities when persons who committed certain crimes reside or work at facility.]

**Hearing was opened continuing from February 13 on  
HB 2706 - Taxpayer Fairness Act of 2002**

Steve Richards, Secretary of Revenue, expressed appreciation for the opportunity to appear before the Committee and presented written testimony in opposition to **HB 2706 (Attachment #1)** with specific reference to issues raised in the earlier hearing. Page 3 provided a diagram of the cycle of the collection process at the present time. At any point in time the taxpayer can raise the question of the validity of the debt. Short of not collecting, the need is to help the taxpayers while maintaining the integrity of the data. He said the received date for the payment continues to be the most critical issue on farm returns and the system is being enhanced to delay issuance of estimated penalty letters to farmers to resolve those problems.

Secretary Richards said when a closure letter is requested by a taxpayer or practitioner, one is issued. Over 100,000 closure letters have been issued this year to taxpayers and preparers. Practitioners file 62% of individual income tax returns. He reported that fiscal impacts put a lot of collection efforts on hold. The current compliance initiatives have generated the collection of \$48 million.

He described the dilemma of trying to address concerns raised by the practitioners with the resources available. He believes the answer is a virtual taxpayer assistance center that would be on-line in a secure internet architecture similar to programs accepted for banking information.

A Committee member commented that the process in the Department of Revenue has improved greatly since 1997 and commented that suggestions on a virtual assistance center are a recognition that there are still some issues that need to be dealt with.

Mr. Richards was questioned about his objection to the suggestion that the Department be required to communicate with the professional representative of the taxpayer. He said when a taxpayer provides such authorization by checking the box provided, that account is handled with that authorized representative, whether an attorney or CPA, and their access to information has never been denied.

Secretary Richards said he believes on individual returns information should be provided directly to the taxpayer, but if a representative has been authorized, they are not restricting that information. The Department will work with either the taxpayer or their designated representative. He thinks it is difficult to put into statutes circumstances under which they deal with the taxpayer and those circumstances where they deal with the paid preparer. As demonstrated in his explanation of the notification processes, if notification goes to a preparer who does not notify the taxpayer and no communication is received, a warrant may be issued and when the sheriff serves it, it may be the first time the taxpayer is aware of that debt. The Secretary said sending all correspondence to a paid preparer with the taxpayer not getting any of it gives him concern as a public policy.

## CONTINUATION SHEET

It has been suggested the information be mailed to both parties, but duplicate notices would be very expensive and would create a very costly administrative process to capture information about the paid preparer that they do not currently have. Such information is not on the form and it would have to be captured when the form is processed. The Department receives more than 900,000 returns from paid preparers each year and a significant number have the box checked "talk to my paid preparer". It may be H&R Block and they are not sure the taxpayer wants them to talk to H&R Block or to another preparer. There is no assurance that the taxpayer was not dissatisfied with the service received and, for whatever reason, had hired a different preparer another year.

Secretary Richards suggested many problems in understanding changes in accounts could be solved with a virtual on-line system taxpayers or their representatives could access for data. Committee members commended the idea of a virtual system and suggested a cost-benefit analysis be done. When asked if it would be cost saving, the Secretary said he believed it would be a great feature providing taxpayers access to lots of information and would answer some concerns raised by the CPAs by providing information they have requested. Funds have not been requested for such a project. He is not aware of any states with such a system although some companies have them. The last component of the integrated technology was bringing in corporate income tax. As resources become available small excise taxes are being brought into the environment.

Committee members described problems with the automated phone system. Secretary Richards said this week the Department has been receiving 1200 to 1400 calls a day and with the automated system they are able to answer 90% of them. Without it they could probably process in the area of 25% area. [Further information on automated phone system use was presented by Secretary Richards March 14.]

Last year the Department presented a proposal to the House Appropriations Committee indicating that if they got the requested resources they could collect \$48 million in the 2001-2002. At this point for 2001 they have collected between \$28-30 million, representing \$30 million of the \$48 million. In response to a question, Secretary Richards said he could not say without a detailed analysis how much of it represented 1997-1999 returns, simple returns, and itemized returns. A member of the Committee said he would like to know how many collections of less than \$75 were involved.

Secretary Richards said a problem with farm returns started in 1998 with the initial programming of the system. He said in recognition of what the system is not doing, a manual work around has been established until reprogramming after the tax season. Decisions made during the transition of Project 2000 contribute to problems he believes need to be worked through as partners and not as adversaries.

Committee members noted taxpayers sometimes pay penalties they do not owe because they are unable to get answers from the Department, questioning whether some of the money collected was never owed. Secretary Richards said everyone who receives one of these notices is encouraged to call and they receive thousands of calls a day. If they find it is a mistake, they correct it.

Members of the Committee provided examples of notices and correspondence that did not clearly describe the problems identified. One member said it would be helpful if notices indicated what the penalty is for, as Blue Cross Blue Shield does on refund checks and statements where codes are noted and can be checked on a list for the explanation. The Secretary said that would not be impossible to do but it would be very expensive. Texts of the letters are being revised to make them clearer and shorter.

Secretary Richards said that as a practical matter the problem of a closure letter is that it would say, "As of the date we issued this letter, this account had a zero balance." That doesn't mean that another adjustment might not be made tomorrow. The suggestion of the CPAs is that once you have issued a closure letter you could no longer adjust the account.

A Committee member said problems had been inherited problems and that Representatives usually hear exceptions—the person with a problem calls, but people delighted with an instant refund don't call.

Secretary Richards was asked if the initiative to move to technology with the integrated system had improved things and what the system had cost to date. He said he was not here during its development and can perhaps come with a fresh view. He believes the original estimate was just short of \$70 million and that it came in on budget. Although it has generated some of the concerns noted today, he believes it has been of tremendous benefit and has allowed the elimination of the backlog of correspondence in the last nine months and that without it the Department would be requesting more staff.

## CONTINUATION SHEET

In response to a question as to how he could characterize the transition as successful in view of the frustrations related by committee members, Secretary Richards said he believes that some of the frustration is caused because for a period of time during the transition letters giving taxpayers detail line-by-line were not being mailed. Now they get a bill and don't know why it was changed. An intense collection compliance initiative has now begun and taxpayers and paid preparers are getting notices they have not had for years. They are getting something that says "We think you owe us money," which raises a lot of apprehension and frustration. "It covers the 1999 period, why did it take so long to tell me?" All this information for those old years cannot be regenerated without stopping the system.

Secretary Richards was asked if a bonus had been paid to the company that provided the system and said that while it has been characterized as a "bonus", it was written into the first contract as an incentive that if it generated money there would be a bonus. Under the original contract, the amount of payment would be dictated by revenue growth. There was a long process with outside consultants to measure that revenue growth and a payment of about \$9.1 million was made. That bonus has disappeared. The company has been paid for doing more than was covered in the original contract. That list of the accomplishments and enhancements they put into the system totaled \$10 million.

With reference to his description of the constant need for revision and updating the automated system, Secretary Richards was asked if there is a budget account for that purpose and said he did not have the figure but an Information Services Group within the DOR maintains the system and provides enhancements as resources become available. Not only for tax collection but motor vehicle, alcoholic beverage control, and PVD are supported. The budget includes some in-house resources. The methodology for establishing priorities includes determining cost and where the best return is on enhancements.

In response to suggestion that costs for some revisions requested in **HB 2706** are already built in, Secretary Richards said they usually were not. The biggest cost is capturing taxpayer's name and address and phone number and there are great costs to re-program the imaging system to pick up those fields and put them into our automated system. Rapid implementation would mean costs for significant outside resources and he has serious concerns whether the goal could be met even if funding is provided. Based upon the changes that would be required in their business environment even if they quit doing everything else and used in-house resources it would be costly and although it could possibly be done in two years, he could not estimate the consequences of taking all the other things off the table. If they went to outside resources, it would be extremely expensive. He would like to work at identifying those things that would be beneficial to the taxpayer and the Department of Revenue.

Secretary Richards believes the virtual on-line system he described would be mutually beneficial allowing the taxpayer to access information through the internet. He said that although he was not here during the system design, it is his understanding that virtual taxpayer system discussed today was not part of the project although it does lay a lot of groundwork for it. It does provide an integrated system but he does not believe it anticipated having taxpayer account information on an internet architecture.

A request was made that the Fiscal Note on **HB 2706** be refigured with reference to costs for work stations and programming.

Chairman Edmonds said Secretary Richards would be given the opportunity to continue his comments when he is scheduled to meet with the Committee on March 14.

**Hearing on HB 2706 was suspended until 9:00 a.m. March 14.**

The meeting adjourned at 9:54 a.m. Next meeting is March 12.



**STATE OF KANSAS**

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**Office of the Secretary**

**Testimony of Stephen S. Richards  
Before House Tax Committee  
HB 2706  
March 7, 2002**

Mr. Chairman and members of the Committee. At an earlier hearing, I provided a quick and brief overview of our concerns with the provisions of the HB 2706.

Today, I concentrate on the central themes aired at that hearing. I group them in four categories:

- (1) Concerns and complaints that focus on tax years 1997 through 1999.
- (2) Perception that taxpayers receive inadequate notice or explanation of tax adjustments, refunds, or balances due.
- (3) Processing of farm returns.
- (4) Appeals process.

**Billing and Collection**

Earlier testimony repeatedly pointed to problems with tax balances in tax years 1997 to 1999; years when the department experienced difficulty in processing returns associated with system conversion. These years contributed to the large accounts receivable balances that I told legislators about last year and to a large extent are the basis for our current collection activity. In reviewing specific issues surrounding these years, some of the data problems were ours; some were taxpayers, some practitioners. However, two points emerged; many cases need more information to correct any error and the focus remains on 1997-1999.

Taxpayers and preparers who hadn't heard from us during our transition to automated systems began receiving Kansas Department of Revenue (KDOR) correspondence requesting information to help improve our data integrity. Short of not collecting or correcting taxpayer returns for these years, KDOR needs help from practitioners and taxpayers to review these notices to help us maintain data integrity for the transition years. Before tax billing is released, we employ acceptable statistical sampling of all accounts. We don't simply send bills to taxpayers prior to review.

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While practitioners shared concerns about billings, they also told you that when they contacted a KDOR customer representative, the associates were friendly, professional and resolved the issues. When employees and taxpayers work together to resolve cases; data inconsistencies are identified and accuracy is improved. We will never have an error free system. Windows '98 was released with more than 10,000 bugs.

### **Cycle of correspondence**

Individual taxpayer accounts fall into two general broad categories: those who file returns with no accompanying payment of the tax due and individuals who file returns and payments that require adjustments by KDOR.

Taxpayers who file returns with no payments are provided seven different opportunities over four to five months to resolve their account. If payment is made at any point during the notification cycle, the taxpayer's account is cleared or if an appeal is filed, the collection process stops.

- 60 days after the return due date, taxpayers receive a consolidated tax bill, detailing tax, penalty and interest due for the tax period.
- 30 days later a written notice of delinquency is mailed.
- After another 15 days KDOR attempts to contact the taxpayer by telephone.
- If still unpaid, at day 60 a second written notice of delinquency is mailed.
- A second telephone contact is made after another 15 days.
- After 90 days, KDOR notifies taxpayers that legal action is pending. The notice advises that tax warrants may be filed or wages garnished.
- After 110 days delinquent, the account is referred to civil tax enforcement for warrant preparation.

Taxpayers who fall into the second category – those who file returns and payments that need to be adjusted by the revenue department – are subject to a slightly different cycle, yet afforded 170 days to resolve the account. As always, if payment is made or the account corrected the collection process stops and the taxpayer's account is cleared.

When an adjustment is made to a return, an adjustment letter, detailing line by line changes to the return, is mailed to the taxpayer.

- Taxpayers are allowed 60 days to contact KDOR or resolve the account before it is referred to the collection process.
- A similar notification process is followed beginning with the consolidated tax bill. These taxpayers have an additional 60 days to resolve the accounts.

Once an account is referred to civil tax enforcement for non-payment of tax, KDOR files a warrant with the appropriate district court. The district court forwards warrants to the county sheriff, who delivers or attempts to serve the taxpayer with the warrant. KDOR has no control over when the warrant is served. Remember that the department has notified these taxpayers on six separate occasions of the debt and that a warrant is pending, so taxpayers have received ample notice of tax liens.

While seizure of business assets or threats of taking real property make good headlines; KDOR does not seize real property to collect individual income tax. The collection of a debt through liens or seizure of business property is the last resort.

### **Suggestion for written explanation of all refunds**

It has been suggested that we issue explanations of all refund checks. First, such notice would indicate that the taxpayer has overpaid his or her account. Secondly, to automatically include a letter of explanation with each refund check would cost in excess of \$900,000 for letters and postage.

The state issued 855,011 individual income and homestead refunds for tax season 2001 including 116,457 direct deposits. Since the Department of Administration issues paper refunds, significant changes would be required to accommodate an insert or attachment explaining the refund issuance. Direct deposits of refunds would trigger a separate mailing, a new processing procedure for such letters, and system enhancements.

### **History of farm return issues**

Concerns about KDOR's processing of farm returns appear to have begun in 1998. Past issues include programming the computer with the wrong deadline date and system non-recognition of the farmer check box. Both issues have been corrected.

Received date of payment continues to be the single most critical issue. If a farm return is filed without payment, an estimated penalty letter is automatically generated. The penalty is reversed when the payment posts with a received date of March 1 or earlier. To resolve the issue, KDOR is enhancing its system to delay the issuance of an estimated penalty letter until after farm returns and payment are due. Today, we must manually control these payment dates to avoid estimated penalty letters.

### **The appeals process**

In the Taxpayer Fairness Act of 1997, the informal appeal process was significantly improved to provide taxpayers a simpler and speedier process to resolve taxpayer disputes within 270 days. This process gives taxpayers an informal method to resolve accounts, appeal penalties, or challenge denied refund claims. The process also provides taxpayers a final determination by the department, a legal determination necessary to move the dispute to the Board of Tax Appeals.

The additional hearing and appeal process outlined in this bill, while focusing on collection activity, would not only impact the department's ability to collect a debt, but also preclude KDOR from issuing a final determination for years. This raises serious concerns about the statute of limitations and when appeals to BOTTA would be appropriate. This new hearing process would fail to bring closure to an account and "closure" was mentioned several times at the last hearing.

### **Closure letters to all taxpayers**

Practitioners are calling for the creation of closure letters on all accounts, mailed to both taxpayers and tax preparers. Last year, we issued 86,092 adjustment letters and 438,154 notices of tax due. Each notice would, at a minimum, qualify for some type of closure letter. This could extend to all 1.5 million individual taxpayers annually. I re-emphasize here that when a closure letter is requested, we issue one. We have issued more than 100,000 account closure letters to taxpayers and preparers this year.

Tax practitioners including large companies such as H & R Block and Jackson Hewitt file about 62 percent of all Kansas individual income tax returns – over 900,000. Under this bill, automatic closure letters would be sent to those large preparers who often operate only during income tax season and with temporary employees. Mailing unsolicited closure letters to all these large preparers companies for all their Kansas clients serves no purpose and is a waste of valuable resources.

I am reminded that during the implementation of Project 2000, practitioners approached the department requesting that the volume of correspondence be drastically reduced, as it was overwhelming.

#### **Fiscal impacts**

- Impacts to collections - \$27 million in FY03
- Administrative costs - \$5.1 million in contract programming
- Magnitude of provisions prohibit implementation by
- date of publication.

The real cost drivers of sending any correspondence automatically to practitioners are redesigning all our forms to place the tax preparer's name, address, phone numbers, prominently on the form and modifying our imaging systems to capture the additional information.

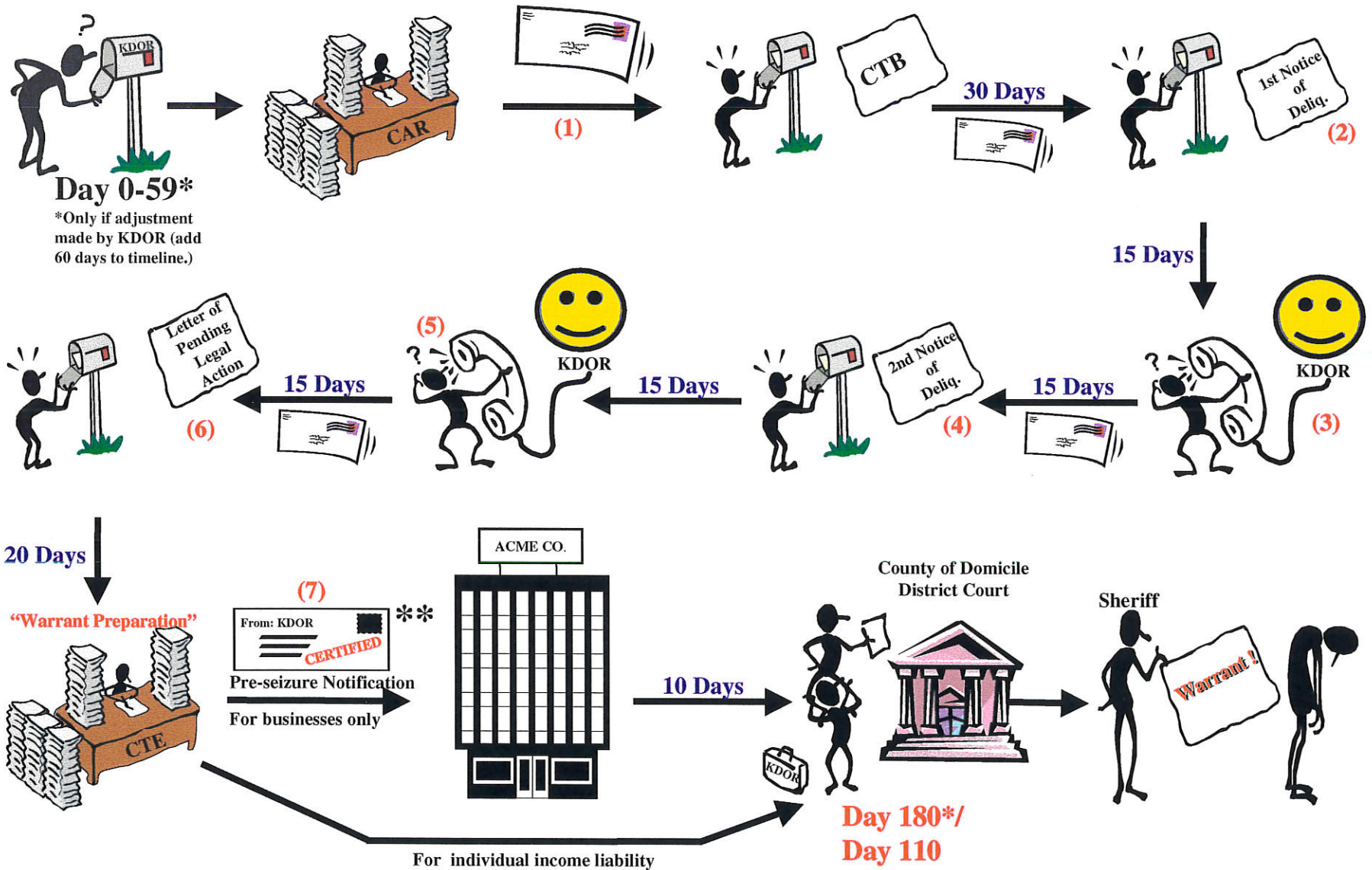
All the provisions in this bill carry a high implementation cost and a price and resource tag that would negatively impact our current compliance initiatives that are generating \$48 million in additional collections. We believe our current operations differ from those of the late 1990's. Cycle of correspondence provides taxpayers with information relative to their accounts. We provide closure letters when requested by taxpayers or practitioners. Revised appeal procedures allow taxpayers and tax representatives clear opportunity to challenge assessments. Finally, the current collection initiatives require clean up of prior year data. To assign additional FTE to personally review each account and to ask for new resources for this activity are imprudent uses of our resources.

CPAs want time-sensitive assurance that their million-plus client accounts are current and reflect valid unpaid taxes. The right answer is the development of a Virtual Taxpayer Assistance Center. This would be a conduit for taxpayers and authorized representatives to view tax account history, account changes, summaries of business accounts, refund status and provide payment options, online in a secure Internet architecture. This application resolves issues raised by CPAs, provides the citizens of Kansas with another electronic service and places Kansas on the leading edge in tax administration. We estimate the cost of design and implementation to be approximately \$ 820,000 and require 12-18 months for development. Your support and funding would provide this solution, a virtual solution that carries a significantly smaller cost and does not interfere with collection and compliance activities.

Mr. Chairman, I stand for questions.



# Account Resolution Notification Process



\*\* This step only done for business taxes