



## Legislative Fiscal Bureau

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

---

June, 2019

Joint Committee on Finance

Paper #625

### Expand Auditing Activity (Revenue -- Tax Administration)

[LFB 2019-21 Budget Summary: Page 367, #1]

---

#### CURRENT LAW

The Department of Revenue (DOR) is statutorily authorized to supervise, administer, and enforce state tax laws. Under this authority, DOR administers several auditing programs. In state fiscal year 2017-18, DOR's Audit Bureau issued audit assessments of \$520.3 million, of which \$236.3 million was collected by the Audit Bureau. An audit assessment is considered unpaid by the taxpayer after 72 days, at which point the assessment is transferred to DOR's Compliance Bureau as a delinquent tax bill. In 2017-18, DOR's Compliance Bureau collected delinquent tax revenues of \$254.3 million. The Audit Bureau's average front-line audit staffing level was 374 positions and the average staffing level of delinquent tax collection agents in the Compliance Bureau was 198 positions in 2017-18.

#### GOVERNOR

Provide \$3,215,100 in 2019-20 and \$3,834,300 in 2020-21 and 36.0 positions annually (24.0 project positions and 12.0 permanent positions) to increase auditing activity and to improve tax collections. The administration estimates the additional auditing activity would increase state tax collections by \$14,500,000 in 2019-20 and \$29,000,000 in 2020-21. The project positions would be authorized from October 1, 2019, through September 30, 2023.

#### DISCUSSION POINTS

1. According to the administration, the volume of new tax debts has increased steadily in recent years, and the resulting workload exceeds its current staffing levels. In addition, the administration notes that the U.S. Supreme Court decision in *Wayfair v. South Dakota* has increased

the number of sellers who are required to collect sales and use tax on sales in Wisconsin, which has expanded the number of out-of-state businesses that may be subject to audit. These factors have contributed to the request for additional nexus and out-of-state sales tax auditors described below.

2. The administration indicates that the 36 positions recommended by the Governor would be split between DOR's Audit Bureau (24) and Compliance Bureau (12). This paper provides an overview of DOR's Audit Bureau and Compliance Bureau and a subsequent analysis of the Governor's proposal.

### **Audit Bureau**

3. DOR's Audit Bureau staffing is configured so that each auditor focuses on a specific tax type. Front-line audit staffing in 2017-18 consisted of: (a) 98 individual income tax auditors; (b) 112 sales and use tax auditors, including 15 out-of-state sales tax auditors; (c) 85 corporate income/franchise tax auditors; (d) 12 excise tax auditors; (e) 17 out-of-state nexus auditors; (f) 29 pass-through entity auditors; (g) 12 income reconstruction auditors; and (h) nine program development and audit selection specialists.

4. Table 1 shows the average front-line audit staffing level, annual amount of audit assessments and collections, and amount sent to the Compliance Bureau as delinquent over the past eight fiscal years.

**TABLE 1**

#### **Audit Assessments and Collections: 2010-11 through 2017-18 (\$ in Millions)**

<u>Fiscal Year</u>	<u>Average Front-line Audit Staff</u>	<u>Audit Assessments</u>	<u>Assessment Per Auditor</u>	<u>Audit Collections</u>	<u>Average Collections Per Auditor</u>	<u>Amount Sent to Delinquent Collections*</u>
2010-11	283	\$329.1	\$1.16	\$255.8	\$0.90	\$63.2
2011-12	280	264.8	0.95	200.4	0.72	42.7
2012-13	278	231.6	0.83	170.4	0.61	34.5
2013-14	302	180.7	0.60	151.6	0.50	39.7
2014-15	291	254.1	0.87	176.2	0.61	38.9
2015-16	388	330.1	0.85	172.2	0.44	41.7
2016-17	374	382.3	1.02	247.2	0.66	54.4
2017-18	374	520.3	1.39	236.3	0.63	51.7

\*Amounts in this column include assessed amounts for audits posted during the fiscal year that became delinquent during the same fiscal year and were referred to the Compliance Bureau for collection. Beginning in 2016-17, the amounts that were actually collected as delinquent collections from assessments in the same fiscal year are reflected in this column.

5. As shown in Table 1, both audit assessments and collections declined from 2010-11 through 2013-14. Between 2013-14 and 2017-18, audit assessments have increased by 188% and audit collections have increased by 56%. Over this same period, the average amount assessed per auditor has more than doubled, while the average amount collected per auditor has increased by 26%. These per-auditor increases have followed increases in the number of front-line audit staff provided to DOR in 2013-15 (33 positions) and 2015-17 (87 positions). DOR indicates that the lower number of front-line auditors in 2016-17 and 2017-18 relative to 2015-16 represents vacant positions. However, the Department also notes that these vacant auditor positions will be filled in July, 2019.

6. Table 1 also demonstrates that audit assessments exceeded audit collections in each fiscal year. One reason for this is that approximately 10% of assessments are appealed and can potentially be reduced upon appeal. Another reason is that some of these assessments are not paid on time and thus become delinquent taxes owed. The payment of delinquent assessments is credited to the Compliance Bureau upon collection.

7. Tables 2 and 3 provide additional detail regarding DOR audit activity by tax type. Both tables show that corporate audits have historically generated the largest share of audit assessments and collections, followed by sales and use tax audits, nexus audits, individual income tax audits, excise tax audits, and other audits.

**TABLE 2**

**Audit Assessments by Tax Type: 2010-11 through 2017-18 (Millions)**

<u>Fiscal Year</u>	<u>Individual Income#</u>	<u>Sales and Use*</u>	<u>Corporate*#</u>	<u>Excise</u>	<u>Other</u>	<u>Total</u>
2010-11	\$40.8	\$78.8	\$200.1	\$5.2	\$4.2	\$329.1
2011-12	50.6	79.8	129.9	3.7	0.8	264.8
2012-13	40.3	75.8	112.3	2.7	0.5	231.6
2013-14	42.7	59.2	76.7	1.9	0.2	180.7
2014-15	53.8	74.8	121.0	2.9	1.6	254.1
2015-16	54.5	103.9	166.7	2.8	2.2	330.1
2016-17	52.6	112.0	213.2	3.5	1.0	382.3
2017-18	56.5	115.0	344.2	4.4	0.2	520.3

\*Nexus audit assessments are included in corporate income/franchise and sales and use tax collection data.

#Pass-through entity audit assessments are reflected in corporate income/franchise and individual income tax data.

**TABLE 3****Audit Collections by Tax Type: 2010-11 through 2017-18 (Millions)**

<u>Fiscal Year</u>	<u>Individual Income**</u>	<u>Sales and Use</u>	<u>Corporate**</u>	<u>Excise</u>	<u>Nexus*</u>	<u>Other</u>	<u>Total</u>
2010-11	\$14.2	\$50.2	\$185.3	\$1.4	-	\$4.7	\$255.8
2011-12	18.6	49.5	130.0	0.8	-	1.5	200.4
2012-13	10.5	61.1	97.0	1.5	-	0.3	170.4
2013-14	9.9	47.7	83.4	1.3	\$9.2	0.1	151.6
2014-15	18.1	44.7	98.8	2.9	10.3	1.4	176.2
2015-16	14.4	58.5	78.0	3.3	16.1	1.9	172.2
2016-17	16.6	66.4	132.2	3.3	28.0	0.7	247.2
2017-18	21.0	83.0	87.0	0.7	44.4	0.2	236.3

\*Nexus collections were included in "Other" tax types prior to 2013-14.

\*\*Pass-through entity collections included in individual income tax and corporate income/franchise collections were \$0.4 million in 2013-14, \$0.2 million in 2014-15, \$7.2 million in 2015-16, \$13.3 million in 2016-17, and \$12.4 million in 2017-18.

8. In the 2015-17 budget, 102 auditor positions, including 87 front-line staff positions, were provided to increase audit activities related to sales and use tax nexus investigation, corporate audits determining nexus and apportionment among combined group members, and audits of pass-through entities. Table 3 shows that much of the growth in overall audit collections between 2015-16 and 2017-18 is attributable to growth in collections from these tax types. DOR also notes that such collections through April, 2019, have more than doubled over similar collections in 2017-18, which the Department states is attributable to the activities of these 102 additional auditors.

### **Compliance Bureau**

9. DOR's Compliance Bureau is responsible for collecting all delinquent taxes and providing taxpayer assistance and information. According to DOR, as of July, 2018, the Compliance Bureau's delinquent tax collection staff totals 200 positions, comprised of: (a) 42 field revenue agents; (b) 115 central revenue agents; (c) 13 special procedures revenue agents; (d) five support staff positions; (e) 18 supervisor positions; and (f) seven analysts, network coordinators, auditors, and trainers. The Bureau also provides collection services for state agencies, counties, and municipalities through the statewide debt collection program and the tax refund intercept program, which are described in a separate paper entitled "Collection Fees Under State Debt Collection Programs". Table 4 shows average delinquent tax agent staffing levels in the Compliance Bureau since 2010-11, as well as delinquent taxes collected by those positions.

**TABLE 4****Compliance Bureau Delinquent Tax Collections and Staffing Levels:  
2010-11 through 2017-18 (\$ in Millions)**

<u>Fiscal Year</u>	<u>Number of Agents</u>	<u>Delinquent Tax Collections</u>	<u>Collections per Agent</u>
2010-11	178	\$202.3	\$1.14
2011-12	142	193.3	1.36
2012-13	141	193.6	1.37
2013-14	168	194.2	1.16
2014-15	170	204.1	1.20
2015-16	171	216.6	1.27
2016-17	186	251.7	1.35
2017-18	198	254.3	1.28

10. Table 4 shows that delinquent tax collections were relatively stable between 2010-11 and 2014-15, then increased considerably in 2016-17 and 2017-18. DOR states this is primarily attributable to additional auditor positions and to a strong economy. Annual collections on a per-agent basis have been relatively stable, and have ranged from \$1.14 million to \$1.37 million over the last eight years. Table 5 shows the average outstanding delinquent tax balance, the amount of new bills referred to the Compliance Bureau, the amount of delinquent taxes collected, and the amount written off as uncollectible. The balance of other agency debt and total outstanding debt is also shown because DOR states that it cannot delineate the amount of delinquent tax bills written off from the amount of other agency debt written off.

**TABLE 5****Compliance Bureau Balance of Delinquent Debts:  
2010-11 through 2017-18 (Millions)**

<u>Fiscal Year</u>	<u>Delinquent Tax Balance</u>	<u>Other Agency Debts</u>	<u>Total Balance</u>	<u>New Tax Bills Added</u>	<u>Delinquent Taxes Collected</u>	<u>Delinquent Amounts Written off*</u>
2010-11	\$930.9	\$3.0	\$933.9	N/A	\$202.3	\$195.7
2011-12	968.5	29.7	998.2	\$424.0	193.3	126.5
2012-13	971.3	38.1	1,009.4	392.6	193.6	123.5
2013-14	975.5	46.9	1,022.4	412.5	194.2	122.0
2014-15	928.4	54.2	982.6	453.2	204.1	141.2
2015-16	950.4	71.9	1,022.3	633.1	216.6	129.4
2016-17	1,020.0	126.0	1,146.0	652.0	251.7	109.9
2017-18	1,037.6	219.6	1,257.2	573.9	254.3	96.9

\*Includes delinquent tax amounts and amounts owed other agencies.

11. Table 5 illustrates that the delinquent tax balance was generally stable from 2010-11 through 2015-16, then increased in the next two fiscal years. This trend is similar to growth in delinquent tax collections demonstrated in Table 4. DOR indicates the reason for recent growth in the delinquent tax balance is also related to increased auditing activity, which results in the identification of more taxes owed overall, some of which become delinquent.

12. Table 6 shows the estimated collectible amounts out of the total delinquent tax balance, and the percentage of taxes collected out of the collectible amounts. Each year, DOR estimates the amounts collectible using a method that is based on accounts in bankruptcy, deceased taxpayers, defunct corporations, and other amounts under consideration for write-off. On average, amounts collectible represent approximately 38% of the total delinquent tax balance over the last five fiscal years. The table also shows that the percentage of taxes collected out of the estimated collectible amounts has generally increased over the five-year period.

**TABLE 6**  
**Compliance Bureau Estimated Delinquent Tax Amounts**  
**Collectible and Percent Collected: 2013-14 through 2017-18 (\$ in Millions)**

<u>Fiscal Year</u>	<u>Tax Balance</u>	<u>Collectible Balance</u>	<u>Percent Collectible</u>	<u>Taxes Collected</u>	<u>Percent Collected</u>
2013-14	\$975.5	\$403.6	41.4%	\$194.2	48.1%
2014-15	928.4	361.0	38.9	204.1	56.5
2015-16	950.4	398.2	41.9	216.6	54.4
2016-17	1,020.0	304.2	29.8	251.7	82.7
2017-18	1,037.6	370.5	35.7	254.3	68.6

### **Proposed Additional Positions**

13. The Governor's request would provide 24 project positions to DOR in the Audit Bureau, and 12 permanent positions in the Compliance Bureau. The 24 project positions provided to the Audit Bureau would be comprised of 11 nexus-related project staff and 13 out-of-state sales tax audit project staff, and would be authorized from October 1, 2019, through September 30, 2023.

14. According to DOR, the proposed nexus-related project staff would conduct audits and investigations to find out-of-state businesses who are operating in Wisconsin and should be collecting and remitting Wisconsin taxes because of a presence (nexus) in the state, but are not. These positions would focus primarily on sales and corporate income/franchise tax audits. DOR also states that the proposed out-of-state sales tax project staff would audit businesses headquartered outside the state who are registered to collect sales tax and who remit the tax regularly.

15. Under state law, a project position is defined as a position which is normally funded for a temporary workload increase or for a planned undertaking which is not a regular function of the employing agency and which has an established probable date of termination. A project position may not exist for more than four years.

16. DOR indicates the Audit Bureau positions described below are being requested as project positions because this will provide the Department flexibility to review its staffing needs at the expiration of the positions to see if a future request is warranted and to what degree. In particular, DOR notes that the *Wayfair* decision will expand the number of out-of-state businesses that may be subject to audit, which could increase sales tax revenues, but the Department intends to evaluate the overall *Wayfair*-related revenue impact at the time the positions are due to expire. However, DOR and other state agencies can evaluate staffing needs and recommend deletion of permanent positions that are no longer needed in future budget submissions. In addition, the 38 audit and compliance project positions that were authorized in the 2017-19 budget are scheduled to expire on September 30, 2021. Based on the Governor's request for additional Audit Bureau positions, and considering the additional project auditor positions authorized in 2017-19, it is unclear why some portion of these project positions would not be needed on an ongoing basis. The Joint Finance Committee could choose to provide permanent positions, rather than project positions, if the Committee believes that the positions are needed on an ongoing basis (Alternative 2).

17. As stated above, the 38 project audit and compliance positions provided in the 2017-19 budget are set to expire on September 30, 2021. It should be noted that allowing these positions to expire is estimated to reduce general fund tax revenues by \$24.0 million in 2021-22 and \$32.0 million in 2022-23, offset partly by reduced GPR expenditures of approximately \$1.9 million in 2021-22 and \$2.5 million in 2022-23. Expiration of these positions would create a future commitment in the 2021-23 biennium (similarly, if the Committee adopted the Governor's request under the bill, the authorization of 24 project audit positions would create a future commitment in the 2023-25 biennium). The Committee could consider making the 38 project positions authorized in the 2017-19 budget permanent to avoid the structural deficit in the 2021-23 biennium caused by the expiration of these positions under current law (Alternative 3).

18. Alternatively, the Committee could choose to provide all positions being requested on a project basis, including the 12 permanent positions being requested in the Compliance Bureau. As noted, in the 2017-19 biennial budget, DOR was provided 20 project positions in the Compliance Bureau at the same time it was provided 18 project positions in the Audit Bureau. Similar justification was offered by the administration at that time as to why these positions were being requested as project rather than permanent positions. Namely, the administration indicated that project positions would afford it the flexibility to examine its staffing needs at the time the positions were due to expire. The Committee could consider authorizing all requested positions on a project basis (Alternative 4).

19. The proposed 11 nexus-related project staff in the Audit Bureau would consist of eight nexus revenue auditors, two lead workers, and one revenue management supervisor to investigate businesses operating in Wisconsin but not filing or paying the applicable taxes. DOR estimates the 11 additional positions would increase revenues collected by the Audit Bureau by \$4.0 million in 2019-20 and \$8.0 million in 2020-21, or approximately \$1.0 million per front-line auditor on an annual basis. The administration's estimate for the amount of revenue generated per auditor is higher than the average amount of collections per auditor in the past several fiscal years, as shown in Table 1. However, DOR notes that the tax types the proposed nexus-related project staff would work on (primarily sales and corporate income/franchise taxes) typically generate more revenues than those generated from the auditing activities associated with other tax types. For example, average nexus-

related collections per front-line nexus auditor over the past three fiscal years were approximately \$1.74 million. For comparison, average individual income tax collections per associated front-line auditor in 2017-18 were approximately \$210,000.

20. The proposed 13 out-of-state sales tax audit project staff for the Audit Bureau would consist of 10 sales tax revenue auditors, one revenue management supervisor, and two computer audit sampling specialists to conduct additional sales tax audits of businesses headquartered outside Wisconsin. DOR indicates these positions would supplement the 15 front-line permanent positions currently conducting such audits that were authorized in the 2015-17 budget. DOR estimates these positions will increase revenues collected by the Audit Bureau by \$5.0 million in 2019-20 and \$10.0 million in 2020-21, or by \$1.0 million per front-line auditor on an annual basis. Again, these per-auditor amounts are higher than the average collections per auditor shown in Table 1. However, DOR states that these positions are associated with a tax type that generally produces greater revenues than other types. For example, in 2017-18, sales tax collections per associated front-line auditor were approximately \$740,000, while individual income tax collections per associated front-line auditor in 2017-18 were approximately \$210,000.

21. The 12 proposed permanent positions provided to the Compliance Bureau would consist of 11 Revenue Agents and one Revenue Agent Supervisor to investigate delinquent tax collections. The Department indicates these positions are necessary to address ongoing growth in the volume of new tax debts received by the Compliance Bureau. As noted previously, this growth has partially been spurred by increased auditing activity generating additional tax debts owed, some of which are not paid until delinquent. DOR indicates these additional tax debts represent an ongoing trend. The administration estimates these additional positions will generate delinquent tax collections of \$5.5 million in 2019-20 and \$11.0 million in 2020-21, or \$1.0 million per revenue agent on an annual basis. For comparison, the average delinquent collections per revenue agent over the past eight fiscal years were approximately \$1.27 million.

22. The administration's estimates for the amount of revenues generated per revenue agent and per front-line nexus auditor appear slightly low, while its estimate for revenues generated per sales tax auditor appears slightly high. On balance, the annual fiscal estimate of revenues generated by approving these positions appears reasonable.

## **ALTERNATIVES**

1. Adopt the Governor's recommendation to provide \$3,215,100 in 2019-20 and \$3,834,300 in 2020-21 and 36.0 positions annually (24.0 project positions and 12.0 permanent positions) to DOR to increase auditing activity and improve tax collections. Estimate increased state tax revenues of \$14,500,000 in 2019-20 and \$29,000,000 in 2020-21. The project positions would be authorized from October 1, 2019 through September 30, 2023.



ALT 1	Change to Base		Change to Bill	
	Funding	Positions	Funding	Positions
GPR	\$7,049,400	36.00	\$0	0.00
GPR-Tax	\$43,500,000			

2. Adopt Alternative 1, but provide permanent positions instead of project positions.

ALT 2	Change to Base		Change to Bill	
	Funding	Positions	Funding	Positions
GPR	\$7,049,400	36.00	\$0	0.00
GPR-Tax	\$43,500,000			

3. Authorize the 38.0 project audit and compliance positions provided in the 2017-19 budget on a permanent basis. This alternative would not have a fiscal effect in the 2019-21 biennium, but would reduce future commitments from the general fund in the 2021-23 biennium. This alternative can be adopted independent of any other alternative.

4. Adopt Alternative 1, but provide project positions instead of permanent positions.

ALT 4	Change to Base		Change to Bill	
	Funding	Positions	Funding	Positions
GPR	\$7,049,400	36.00	\$0	0.00
GPR-Tax	\$43,500,000			

5. Take no action.

ALT 5	Change to Base		Change to Bill	
	Funding	Positions	Funding	Positions
GPR	\$0	0.00	- \$7,049,400	- 36.00
GPR-Tax	\$0		- \$43,500,000	

Prepared by: Dan Spika