

Evaluating the State of State Tax Administration

Our 2016 tax panel explored the current condition of state tax administration, discussed practitioners' process and procedural concerns, and offered ideas to advance a strong ethic and system of voluntary compliance in Minnesota.

It's not a topic that makes political headlines or trends on Twitter, but efficient, sound, and equitable tax administration is an important tax policy issue in Minnesota. With rumblings of discontent among some tax practitioners in the air and the likelihood that several controversial legislative proposals offered last year to address some of their concerns will crop up again in 2017, the focus of our tax panel at this year's annual meeting explored the state of state tax administration and procedural protections for taxpayers.

As background for the discussion, the day began with a presentation of findings from MCFE's survey of state tax practitioners conducted late this summer. The survey gathered information on practitioners' experiences and opinions regarding the current state of state tax administration, the adequacy of current taxpayer supports, and the merits of nearly 30 potential new or enhanced procedural protections with precedents either at the national level or in other states. (Our findings will be published in a forthcoming Issue Brief). A distinguished panel of tax experts followed to discuss these and related issues moderated by state tax icon and former Federation of Tax Administrators executive director Harley Duncan. Panelists included Cynthia Bauerly, Commissioner of the Minnesota Department of Revenue; Doug Lindholm, President and CEO, Council on State Taxation (COST); Senator Ann Rest, Chair of the Minnesota Senate Tax Reform Division; and John James, former Department of Revenue Commissioner and "father" of Minnesota's original Taxpayer Bill of Rights (TBOR) efforts in 1990.

THE CURRENT LANDSCAPE

Panelists began by discussing the current landscape of state tax administration, how Minnesota is currently positioned, and how we arrived where we are today. Doug Lindholm highlighted Minnesota's performance on COST's scorecard of administrative practices, on which we continue to rank among national leaders in the quality of our statutory framework for tax administration. Lindholm emphasized that the COST scorecard focuses specifically on objective standards with respect to the existence of administrative infrastructure and its characteristics; it does not attempt to evaluate subjective issues pertaining to how states operate within that framework. Citing a recent example from another state, he noted evaluating objective standards and subjective behaviors and attitudes within state tax administration can yield very different results.

Commissioner Bauerly provided an overview of the state's investments in taxpayer supports and efforts to upgrade and improve various tax administration processes. Emphasizing that "every taxpayer who had an obligation under the law is our customer and is someone we need to serve," the challenge for the Department has always been to find ways to meet the needs and demands of all filer types, of all sizes, in all geographic areas of the state, for all the different taxes the state has with the limited resources it has available. Towards this end, the Department has placed a major effort on "plain language" initiatives, taxpayer guidance, tools, website improvements and related information initiatives to try to make tax administration as clear and taxpayer-friendly as possible and reduce the need for and level of direct contact with the department itself.

She continued by noting that outreach efforts in the form of in-person classes have been another area where the Department has made major investments. As one example, the number of sales and use tax classes the Department has offered has more than quintupled – from 20 to over 110 – since 2007. With respect to administrative processes, the Department has created audit quality assurance teams to assure consistency and identify areas where additional training may be needed. Audit follow up surveys provide the Department with feedback on the audit process itself and on how well the auditor educated the taxpayer on the process and laws as applied. Regarding expressed concerns about appeals timelines, she noted the Department has been working hard to reduce the backlog and progress has been made. In 2011, there were 140 outstanding appeals cases over two years old – an unacceptable turnaround time. That is now down to 15.

How does the current administrative landscape compare to the situations and circumstances 25 years ago which prompted the enactment of Minnesota's original TBOR? Former Revenue Commissioner John James argued the Department is now "light years ahead" on these issues; noting that much of what practitioners take for granted today didn't exist back then. The original TBOR effort was focused on establishing that infrastructure – an effort to "bring order out of chaos". Today, he claimed, our concerns are rooted in the procedural side: "fairness, understandability, and efficiency."

In several ways, he reflected, the landscape is the same now as it was then – best encapsulated by a genuine desire on behalf of both the Department and taxpayers to make the system work for everybody. But James asserted that the procedural world of today's state tax administration presents some new and significant challenges. It begins with numbers – many more business and resident taxpayers and 10% fewer departmental employees than in 1990. There is much more employee turnover at DOR and with it a loss of experience and expertise across tax types. To maximize returns on administrative investment, the department has chosen to organize staff – including legal staff – around tax type divisions. This has increased coordination of policy, process and education in tax areas; but has also likely led to increased frustration among tax professionals regarding their ability to access departmental attorneys. Globalization, degradation of IRS code and audit functions, and Congress' inability to "act rationally with respect to the federal tax system" all present additional obstacles for fair and efficient state tax administration. The key to tackling all these challenges, he contended, is stronger communication between the Department as an institution and practitioners. He argued a commissioner or assistant commissioner is in no position to fully understand the fine details and sources of frustration occurring in these highly complex areas.

Are legislators sensitive to these concerns and the ongoing needs of efficient tax administration? Senator Rest began by noting that the tax committees "jealously guard the idea we are the policy makers – the legislature and governor, not the Department. The Department does not make policy nor should they." Such arrogance, she continued, has not been on display here. Legislators do depend on the Department for expert advice on the administrative dimensions of any policy initiative. She noted that the one avenue the Department has to directly influence policy – its annual technical and policy bills – is limited to non-controversial material. If any committee member objects to any provision it's removed without further discussion.

However, Senator Rest could not recall a time where tax committees have ever paid much attention to the details of income and sales tax system administration. For example, she said, legislators don't hear a lot from the tax community on taxpayers' ability to navigate the sales tax system or other administratively complex taxes. In stark contrast, constituent feedback ensures that legislators are keenly attuned to and consumed by the details of property tax administration at the state and local levels.

DESIRING CLARITY, CONSISTENCY, AND CERTAINTY

Minnesota has high-quality infrastructure supporting tax administration, has made substantial investments in taxpayer supports, and has legislative bodies that take their responsibility for being the sole developers and gatekeepers of tax policy seriously. Despite this, practitioners responding to our survey identified several administrative issues and concerns on the minds of taxpayers. One key theme was significant frustration regarding a persistent environment of ambiguity and uncertainty within state administration that creates serious difficulties for voluntary compliance – particularly in the sales and use tax and income tax areas.

The problem respondents most often cited was an unwillingness to promulgate new regulations through the rulemaking process with input from the tax community. The publication and use of revenue notices (which, panelists noted, look like law but are only statements about the Department's interpretation of the law) is used instead as a less expensive, less cumbersome, more efficient way to provide guidance on administrative interpretation than formal administrative rulemaking. However, respondents communicated frustration with both the lack of revenue notices on important topics and a persistent lack of clarity/interpretive ambiguity within the revenue notices themselves, creating significant exposure for taxpayers.

When asked about this tension and what can be done about it, Commissioner Bauerly emphasized that if legislators or taxpayers don't agree with the Department's interpretation of the law, the law can be changed to clarify and refine lawmakers' intent and a revenue notice can be revoked and/or reissued. She noted a significant uptick in the number of revenue notices the Department has published recently compared to previous years. All revenue notices, she said, are shared with both tax committees for comment before publication, and the Department also uses informal processes to collect input from affected parties before releasing them. As a way to strengthen the desirable "opportunity for comment, obligation to respond" feature of formal rulemaking within a revenue notice framework, John James suggested that taxpayers take the initiative to draft revenue notices themselves and submit them to the Department for adoption.

Doug Lindholm cautioned that a "if we get it wrong we'll just revoke it" attitude toward revenue notices is disturbing because it creates a lack of certainty and predictability for business. He suggested stakeholders consider establishing a business advisory group as a sounding board for the Department. Based on his experience, however, he cautioned that such groups only succeed when there is a foundation of trust which allows departments to feel confident in exploring difficult interpretive areas and businesses to provide honest feedback. Moreover, he continued, the cultural issues influencing this topic must be addressed. There is too often a tendency to view the relationship between taxpayers and administrators as "us" versus "them" which is very different from the "customer" relationship which should be facilitated. Departments of revenue have to understand that because companies are competing in the marketplace and taxes are a cost of doing business, competitive issues – and not animosity toward the department – drive companies' tax decisions. If departmental staff feel companies are too aggressive in the many complex "gray areas" of tax administration, they should interpret this as a need to revisit the law itself and take the matter to the legislature, not internalize it as "they are trying to put one over on me."

Commissioner Bauerly echoed this concern noting the shift to a "customer focus" is a major departure for DOR. The Department operated under compliance initiatives for much of the recent past – adding auditors and collectors and booking the revenues it was expected they would bring in. Establishing a customer-focused relationship has been a challenge both for the Department and for businesses which for many years have been navigating this increased compliance activity. Senator Rest remarked that legislators have become rather jaded about compliance initiatives. Dong Lindholm argued aggressive compliance initiatives can have unintended long-term consequences on voluntary compliance.

How should we move forward? Harley Duncan asked each panelist to offer their key takeaway idea or recommendation. John James recommended the Department implement a technical advice process that can be used in audits so that legal staff can ensure the issue is properly framed factually in a cooperative effort by the tax administrator and the taxpayer. Senator Rest expressed a desire to have thorough hearings on tax policy administration in both the House and Senate. Doug Lindholm said not to forget to make continued investments in computer and systems support since systems glitches can wreak havoc with tax administration and undercut the painstaking efforts to improve taxpayer/departmental relationships. Commissioner Bauerly remarked that the Department has a lot more work to do in improving communication, noting that DOR already has policies and procedures addressing seven of the top ten recommendations survey respondents identified. She expressed strong interest in strengthening the lines of communication.

There is a lot at stake in keeping this conversation going and moving this agenda forward. Ensuring procedural fairness; easier-to-navigate audit, appeal, and collection processes; and greater clarity for the taxpayer all promote increased trust and faith in the tax system. That is especially needed among larger members of Minnesota's business community. Even though tax administration must be responsive to all taxpayers, greater acknowledgement of and responsiveness to administrative concerns that multistate and multinational businesses inevitably find themselves in because of their more complex tax situations would be a smart investment. That's true not just because of their tax contributions but also their role in Minnesota's economy overall. It's not favoritism, just wise tax administration.