



# **PERFORMANCE AUDIT REPORT**

**Tax Enforcement: A K-GOAL Audit Determining  
Whether the Department of Revenue Is Collecting  
Delinquent Trust Taxes Owed the State**

## ***Executive Summary*** ***with Conclusions and Recommendations***

**A Report to the Legislative Post Audit Committee  
By the Legislative Division of Post Audit  
State of Kansas  
October 2004**

# ***Legislative Post Audit Committee***

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## ***Legislative Division of Post Audit***

**THE LEGISLATIVE POST** Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$10 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by Legislative Post Audit helps provide that information.

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### **LEGISLATIVE DIVISION OF POST AUDIT**

800 SW Jackson  
Suite 1200  
Topeka, Kansas 66612-2212  
Telephone (785) 296-3792  
FAX (785) 296-4482  
E-mail: [LPA@lpa.state.ks.us](mailto:LPA@lpa.state.ks.us)  
Website:  
<http://kslegislature.org/postaudit>  
Barbara J. Hinton, Legislative Post Auditor

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LEGISLATURE OF KANSAS  
**LEGISLATIVE DIVISION OF POST AUDIT**

800 SOUTHWEST JACKSON STREET, SUITE 1200  
TOPEKA, KANSAS 66612-2212  
TELEPHONE (785) 296-3792  
FAX (785) 296-4482  
E-MAIL: lpa@lpa.state.ks.us

October 11, 2004

To: Members of the Kansas Legislature

This executive summary contains the findings and conclusions, together with a summary of our recommendations and the agency responses, from our completed performance audit, *Tax Enforcement: A K-GOAL Audit Determining Whether the Department of Revenue Is Collecting Delinquent Trust Taxes Owed the State*.

The report also contains appendices showing the collection activities during fiscal year 2004 for the Department of Revenue, and how the collection process is different for cases depending on a risk score assigned to the case.

This report includes several recommendations for the Department of Revenue, and one for the House or Senate Taxation Committee. We would be happy to discuss these recommendations or any other items in the report with you at your convenience.

If you would like a copy of the full audit report, please call our office and we will send you one right away.

A handwritten signature in black ink that reads "Barbara J. Hinton". The signature is fluid and cursive.

Barbara J. Hinton  
Legislative Post Auditor



# EXECUTIVE SUMMARY

LEGISLATIVE DIVISION OF POST AUDIT

## Overview of the State's Trust Taxes and Delinquent Collection Process

**Trust taxes are those taxes businesses collect or withhold on behalf of the State.** ..... page 3  
*State and local governments levy a variety of taxes to fund their operations. People pay some of those taxes directly to the government—including property taxes and income taxes. But many other taxes, commonly referred to as “trust” taxes, are collected or withheld directly by businesses, which are then required to send those taxes on to the State. The largest of these include sales, withholding, and retailer’s compensating use taxes.*

**Businesses that are delinquent on trust taxes are referred to the Department’s collections process.** ..... page 4  
*Those businesses may not file a return on time, may not remit the amount shown on the returns they do file, may bounce a check, or some combination of the three. The Department’s computer flags these cases for referral to the automated tax collection process, where they receive a series of progressively stringent computer-generated letters and computer-prompted attempts to call. If the business still doesn’t pay the delinquent trust taxes it owes, the Department can issue a tax warrant and take other steps such as bank levies, till taps, and garnishments.*

*Department staff handle most of these collection efforts, but if the debtor has out-of-state assets, can’t be located, or the amount of delinquent taxes is relatively small, the case may be handed over to a private collections company the Department contracts with.*

## Question 1: Does the Department of Revenue Have Effective Procedures in Place To Identify When Businesses Aren’t Paying the Taxes They Owe?

**We focused primarily on the Department’s procedures for identifying businesses that weren’t registered or filing returns.** ..... page 7  
*The agency has established a number of good practices for identifying businesses that should be registered with the Department but aren’t, and for determining when registered businesses aren’t filing timely tax returns or remitting the amount of taxed they owe. However, the Department has access to other information that it doesn’t always use that could help it gauge whether those businesses have filed returns and remitted the taxes they owe.*

**The Department could use information from other local and state agencies to help identify unregistered businesses.** ..... page 8  
*The Department makes a “tax-entity” list available on its web site to cities and counties so that, among other things, they can help identify other*

*businesses that are operating in their jurisdictions but aren't on that list. Despite the Department's promotion efforts, only 27% of the counties and 39% of the cities in Kansas that levy sales taxes have accessed that list. Increasing their use of that list could be a cost-effective way of identifying more tax evaders.*

*In addition, because many State agencies license, permit, inspect, or otherwise regulate some aspect of a variety of businesses, the Department should try to match its list registered businesses the lists those agencies maintain. To make this happen, agencies would need to collect the same identifying numbers for a businesses (such as an FEIN number) as the Department.*

*The Department also should develop a more systematic process for handling the tips it receives from the public or other sources. Such tips generally are directed to field agents, but aren't logged in centrally within the Department, and aren't tracked or documented so that management knows whether they were followed-up on, what the field agents found, and whether those findings might be applicable to other businesses or situations.*

**The Department can do more automated cross-checking to identify businesses that aren't registered for all applicable taxes.**

..... page 10

*The Department performs "tax clearance" checks to help ensure that the businesses it licenses—motor vehicle dealers and businesses that sell liquor—are registered for all applicable taxes and are current on all the taxes they owe before they can be licensed or allowed to operate in Kansas. It also performs these tax clearance checks for two other agencies: the Department of Administration for vendors wanting to do business with the State, and the Kansas Lottery for retailers wanting to sell lottery tickets. Expanding the number of businesses required to get a tax clearance check before they can receive a license or permit to operate would provide a greater incentive for delinquent businesses to pay off their tax debt.*

**The Department needs to improve its procedures for determining whether registered businesses are remitting the trust taxes they owe.**

..... page 12

*The Department has to rely on audits to definitively say how much an individual or business actually owes in taxes, but it has access to some internal information for motor vehicle dealers and liquor retailers that could help it gauge whether those businesses have significantly under-reported the taxes they owe. For example, the Department requires motor vehicle dealers to submit monthly reports showing the amounts of individual sales they made and taxes they collected. However, it isn't matching that information against the amount of sales taxes those dealers actually remit to the State.*

*Officials within the Division of Motor Vehicles told us the Department agreed motor vehicle field agents should compare sales tax returns to the sales reports received from dealers. However, a motor*

vehicle field agent we spoke with said that hasn't happened. Apparently, a satisfactory process for sharing information between the Divisions of Motor Vehicles and Taxation has not been implemented.

**Kansas is similar to other states in the ways it identifies unregistered and delinquent businesses.** ..... page 14  
*Like Kansas, Missouri sends tax-entity reports to its cities and counties. All three states we reviewed—California, Georgia, and Missouri—also have an automated system for identifying businesses that don't file returns when they are due, or that don't pay the full amount shown on the returns they do file. Some additional things the Department could do include establishing a hot line for receiving tips from the public, and making use of the "Dodge Report" to identify transient employers.*

**Question 1 Conclusion.** ..... page 14  
*Businesses that don't remit the trust taxes they owe should be of particular concern to State administrators and policy-makers. Besides increasing the tax burden on others, these businesses may be misappropriating the moneys they collected or withheld from their customers or employees for their own use. In such situations, businesses are in essence stealing money from the State and its citizens.*

*The Department's computer systems provide it with timely notification when registered businesses stop paying the trust taxes they owe. However, challenges remain in systematically identifying business that haven't registered for the trust taxes they are—or should be—collecting, as well as businesses that likely aren't remitting all the taxes they collect. The Department has taken a number of important steps through its attempts to involve local governments in identifying possible tax evaders, its use of tax clearances for entities it licenses, and internal cross-checking between taxes, but it can do more in each area. For its part, the Legislature can help by directing State agencies to participate in data matching efforts with the Department, and supporting broader use of tax clearance requirements for trust taxes.*

**Question 1 Recommendations.** ..... page 15  
*To help identify when registered or unregistered businesses are paying the trust taxes they owe, we recommended that the Department :*

- *do more to promote cities' and counties' use its "tax entity" report*
- *seek the authority to access licensing databases of other State agencies to match against its records*
- *establish a hot line phone number or web site for receiving tips about businesses suspected of tax evasion*
- *use the information it already collects to determine whether vehicle dealers are significantly under-reporting the sales tax they remit*

*We also recommended that the House or Senate Taxation Committees amend State law to give State agencies the authority to deny, suspend, or revoke a license if a business is not registered for all appropriate taxes or is delinquent on taxes owed.*

## Question 2: Are the Department's Efforts To Collect Unpaid Taxes Effective?

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**Most businesses voluntarily remit the trust taxes they owe.** ..... page 18  
*During fiscal year 2004, the Department of Revenue collected more than \$4 billion from the six trust taxes we examined during this audit. New debt of \$191 million was referred for collection activity during the same year.*

**The longer delinquent taxes remain uncollected, the less likely they'll ever be paid.** ..... page 18  
*Acting quickly to collect delinquent taxes increases the likelihood they'll be paid. Those chances diminish as time goes by because some businesses may file for bankruptcy or close down. In addition, the longer a business operates without remitting the taxes owed, the larger the unpaid balances become, and the more difficult it is to find the money to pay them.*

**Department records show that the amount of delinquent trust taxes owed has grown to \$195 million.** ..... page 18  
*Although the amount of new delinquent taxes in any one year is relatively small in comparison to overall tax collections, over time the estimated amounts of unpaid taxes and their associated penalties and interest have accumulated to a relative large sum of money. The balance of unpaid trust taxes, interest, and penalties has risen from \$151 million to \$195 million over the past five years.*

*The total amount of delinquent debt is likely overstated because the Department didn't write-off any of the amounts it considered to be uncollectible during fiscal years 2000 and 2001, and, approximately \$73 million of debt is still on the books that businesses have owed for six or more years. Those figures suggest additional amounts still need to be written off to make the accounts receivable balance more accurately reflect the amount of delinquent taxes likely to be collectible. We also noted the Department doesn't have a good system of accounting for the transactions and adjustments that make up its delinquent tax balance.*

**The amount the Department has collected from delinquent accounts has increased in recent years.** ..... page 20  
*That amount increased from less than \$7 million in fiscal year 2000 to \$50 million in fiscal year 2004. Factors affecting the amounts collected include a halt in most collections efforts during 2000 and 2001 to implement the new automated system, an addition of 75 new positions in 2001, and a tax amnesty program during 2003 that collected more than \$10 million in delinquent taxes.*

**Our reviews identified several problems with the Department's effectiveness at collecting delinquent taxes.** ..... page 21  
*A good system for collecting delinquent taxes should include such elements as making quick contact once a business becomes delinquent, maintaining regular contact until the debt is resolved, and using legal actions when necessary to bring a business into compliance. Although the Department clearly has established a collections process with these principles in mind, we identified several policies, procedures, or practices that minimize its effectiveness in collecting delinquent taxes:*

- *Delinquent accounts are identified immediately, but most don't enter the collection system on a timely basis. Some internal processing is necessary before such accounts are referred to the automated collections system, but those accounts should be referred as quickly as possible. Businesses with a known balance due may not be referred to the collection system for up to 60 days, and some businesses that don't file a tax return may not be referred for up to 120 days.*
- *Under current procedures, businesses that don't file a tax return receive the lowest priority in the Department's collection efforts. Some of these businesses may owe nothing or only a small amount because they've gone out of business, but others still are operating and can end up owing significant amounts of unpaid taxes. Determining whether businesses that don't file a return still are in operation—and more aggressively pursuing those that are— would appear to be a cost-effective use of those resources.*
- *For most of the cases we reviewed, the Department hadn't taken prompt action against businesses that were delinquent in filing returns and paying the trust taxes they owed. We reviewed 40 active cases involving delinquent trust taxes that had a balance as of the end of fiscal year 2004. We didn't review any closed cases. These 40 cases were on the Department's books as owing \$7.6 million in delinquent taxes, penalties, and interest as of the end of fiscal year 2004. Most of these cases fell into the two-year time period when the Department made no efforts to collect taxes from non-filers. We also noted that, under the Department's automated collection system, delinquent businesses may receive monthly bills, periodic letters, and phone call attempts for months or even years before moving forward in the collections process. For a typical case in our sample, it took the Department more than two years to make a final tax liability assessment, and more than seven additional months to file a tax warrant on these cases. Few legal actions can be taken until that tax warrant is filed. The Department also hadn't taken aggressive enforcement actions against most businesses in our sample.*

*Department officials told us that limited staff resources hampered their efforts in these areas. Our calculations showed that increasing the resources devoted to delinquent tax collection efforts would be cost-effective; almost \$627,000 in delinquent taxes was collected for every full-time employee involved in the delinquent tax collection process during fiscal year 2004.* ..... page 26

**Question 2 Conclusion.** *Although most businesses remit the trust taxes they owe to the Department on time, the amount of delinquent trust taxes that remains unpaid continues to grow. The longer delinquent taxes remain uncollected, the less likely it is the Department will be able to collect them. That's why it's essential for the Department to take timely and vigorous actions against businesses that don't voluntarily pay the trust* ..... page 27

*taxes they have collected from their customers or withheld from their employees within a reasonable period of time. The current process—which allows very lengthy times before the Department moves to involuntary collection efforts—provides little incentive for businesses intent on evading taxes to do otherwise. It also contributes to the estimated delinquent tax balance owed being greatly overstated. The Department may need additional staff resources to be able to respond more quickly to tax non-compliance*

**Question 2 Recommendations.** *To provide more complete and accurate information about the amount of delinquent taxes owed the State, we recommended that the Department write-off old debt that is not likely to be collected. To increase its chances of collecting delinquent taxes, we recommended that the Department reduce the amount of time it can take for a delinquent account to be referred to collections, more quickly determine whether businesses that don't file a return are still operating, make more timely assessments of final tax liability for delinquent businesses, issue tax warrants more quickly so that the Department can take other legal actions at a time when they are most likely to produce revenue, and determine what additional staff resources may be needed to accomplish these recommendations.* ..... page 27

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Collection Activity – Fiscal Year 2004** ..... page 30

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This audit was conducted by Lisa Hoopes, John Curran and Amy Thompson. Cindy Lash was the audit manager. If you need any additional information about the audit's findings, please contact Ms. Hoopes at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call us at (785) 296-3792, or contact us via the Internet at LPA@lpa.state.ks.us.