



# **PERFORMANCE AUDIT REPORT**

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

**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.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U.S. Government Accountability Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. The standards also have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

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October 5, 2004

To: Members, Legislative Post Audit Committee

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This report contains the findings, conclusions, and recommendations 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.

The 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 any legislative committees, individual legislators, or other State officials.

Barbara J. Hinton  
Legislative Post Auditor

### Get the Big Picture

Read these Sections and Features:

1. **Executive Summary** - an overview of the questions we asked and the answers we found.
2. **Conclusion and Recommendations** - are referenced in the Executive Summary and appear in a box after each question in the report.
3. **Agency Response** - also referenced in the Executive Summary and is the last Appendix.

### Helpful Tools for Getting to the Detail

- In most cases, an “**At a Glance**” description of the agency or department appears within the first few pages of the main report.
- **Side Headings** point out key issues and findings.
- **Charts/Tables** may be found throughout the report, and help provide a picture of what we found.
- **Narrative text boxes** can highlight interesting information, or provide detailed examples of problems we found.
- **Appendices** may include additional supporting documentation, along with the audit **Scope Statement** and **Agency Response(s)**.

# 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.** *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.*

..... page 10

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

..... page 12

*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.** 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. .... page 14

**Question 1 Conclusion** ..... page 14

**Question 1 Recommendations** ..... page 15

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**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.** 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. .... page 18

**The longer delinquent taxes remain uncollected, the less likely they'll ever be paid.** 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. .... page 18

**Department records show that the amount of delinquent trust taxes owed has grown to \$195 million.** 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. .... page 18

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.** *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.*

..... page 20

**Our reviews identified several problems with the Department's effectiveness at collecting delinquent taxes.** *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:*

..... page 21

- *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.*

<b>Question 2 Conclusion</b>	.....	page 27
<b>Question 2 Recommendations</b>	.....	page 27
<b>APPENDIX A: Scope Statement</b>	.....	page 29
<b>APPENDIX B: Department of Revenue Collection Activity – Fiscal Year 2004</b>	.....	page 30
<b>APPENDIX C: Collection Process for Difference Risk Scores</b>	.....	page 31
<b>APPENDIX D: Agency Response</b>	.....	page 32

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.

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

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The Kansas Governmental Operations Accountability Law (K-GOAL) requires Legislative Post Audit to conduct a performance audit of specified State agencies each year. K-GOAL audits can help determine the necessity, propriety, and legality of the operations we review and evaluate, and can identify inefficient or ineffective operations. Through this process, the Legislature can, in the words of the Act, “retain and maintain appropriate and effective governmental operations, remediate defective governmental operations, and terminate inappropriate or obsolete governmental operations.”

The Legislative Post Audit Committee chose to focus this audit on the Department of Revenue’s efforts to collect “trust” taxes businesses collect from their customers. These include sales tax, liquor taxes, transient guest tax, retailer’s compensating use tax, and withholding taxes that are held from employees’ pay checks.

Legislative concerns stemmed from a performance audit we issued in April 2003 evaluating the Department’s procedures for ensuring that motor vehicle dealers are remitting to the State the sales taxes they collect from their customers. Among other things, we found that 4 of 7 small, used car dealerships we visited hadn’t remitted the taxes they’d collected for the time period we reviewed. We also found that 3 of these 4 dealers had long histories of not remitting the sales taxes they’d collected, yet the Department allowed them to continue selling cars and collecting taxes.

This performance audit answers the following questions:

- 1. Does the Department have effective procedures in place to identify when businesses aren’t paying the taxes they owe?**
- 2. Are the Department’s efforts to collect unpaid taxes effective?**

To answer these questions, we reviewed the Department’s practices for identifying businesses not registered with the Department to remit trust taxes and businesses delinquent in paying the taxes they’re registered for. We also reviewed the Department’s practices to collect delinquent taxes. We compared the Department’s practices against best practices and procedures we’d expect the Department to have in place, as well as to practices of other states. In addition, we surveyed city and county officials on their efforts to identify non-registered and businesses with delinquent taxes.

We also reviewed a sample of the Department's open cases of businesses with significant amounts of delinquent taxes to see whether the Department took timely and adequate actions to collect from these businesses. Finally, we reviewed the accounts receivable balances for the State's trust taxes to see how successful, over time, the Department's efforts have been to decrease the amounts due.

A copy of the scope statement for this audit approved by the Legislative Post Audit Committee is included in Appendix A.

In conducting this audit, we followed all applicable government auditing standards. Our findings begin on page 7, following a brief overview.

## 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***

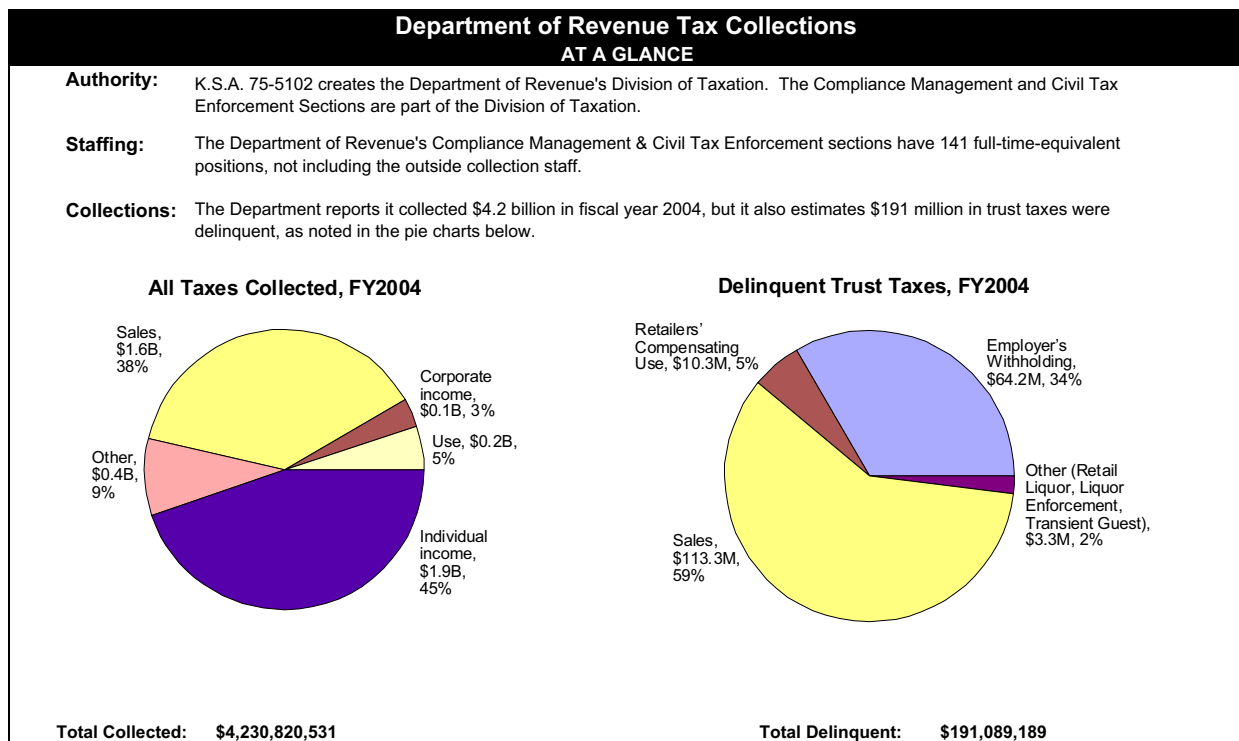
State and local governments levy a variety of taxes to fund their operations. People pay some of those taxes directly to the government—including property taxes and income taxes they owe above and beyond the amounts their employers withheld. But many other taxes—commonly referred to as “trust” taxes—are collected directly by a business. The major trust taxes in Kansas are shown in **Table OV-1**.

<b>Table OV-1 Kansas Trust Taxes and Amount Remitted in FY 2004</b>			
Type of Trust Tax	Requirements	Where the Tax Money Goes	Amount Remitted in FY 2004 (in millions)
<b>Retail Sales Tax</b>	Businesses are required to charge a 5.3% State sales tax (plus applicable city /county sales taxes) on the retail sale of tangible personal property and on certain services, and to remit it to the State. The State periodically sends the local sales tax moneys they receive to cities and counties.	95% of the State's sales tax goes to the State General Fund; 5% goes to the State Highway Fund	\$2,266
<b>Withholding Tax</b>	Most employers are required to withhold State and federal taxes from their employees' pay, and to remit it to the Kansas Department of Revenue or the Internal Revenue Service. The amount withheld depends on the employee's income.	State General Fund	\$1,621
<b>Retailer's Compensating Use Tax</b>	This is the same as retail sales tax, except it is levied on tangible personal property bought from an out-of-State retailer. If the property is subject to sales tax in another state, the buyer is supposed to pay the difference between the two states' tax rates <u>if</u> the other state's rate is lower than Kansas.	The State's retailer's compensating use tax goes to the State General Fund; 2% goes to the State Highway Fund	\$175.5
<b>Liquor Enforcement Tax</b>	Retailers, micro-breweries, and wineries are required to levy an 8% tax on the sale of liquor to consumers. Distributors are required to levy this tax when they sell liquor and cereal malt beverages to clubs, drinking establishments, and caterers.	State General Fund	\$40.3
<b>Liquor Drink Excise Tax</b>	Clubs, caterers, drinking establishments, and businesses with a temporary liquor license are required to levy a 10% tax on the sale of alcoholic liquor.	25% to State General Fund, 5% for a community alcoholism fund, & 70% to the originating city or county.	\$28.7
<b>Transient Guest Tax</b>	Cities and counties impose this tax on sleeping accommodations in any hotel, motel, or similar business. The State administers the tax on behalf of the cities and counties, and retains an administration fee equal to 2% of total taxes collected.	The State's administration fee goes to the State General Fund	\$21.1
Source: <u>Kansas Tax Facts</u> , 7 <sup>th</sup> edition, Kansas Legislative Research Department and Kansas Department of Revenue Office of Policy and Research (Amount Remitted)			

**Businesses that collect or withhold trust taxes are acting as fiduciaries for the State.** They are legally responsible for collecting and remitting those tax moneys to the State. As such, they must do the following:

- register with the Department of Revenue for **each** applicable trust tax. This registration establishes the business' tax account with the Department so the business can begin filing tax returns.
- file a return showing the amount actually collected. How often a business files a return depends on how much it collects. The frequency may vary from weekly to once a year.
- remit what they owe

This audit focused on the Department's efforts to collect delinquent trust taxes—those taxes that businesses don't voluntarily remit to the State when they owe them.

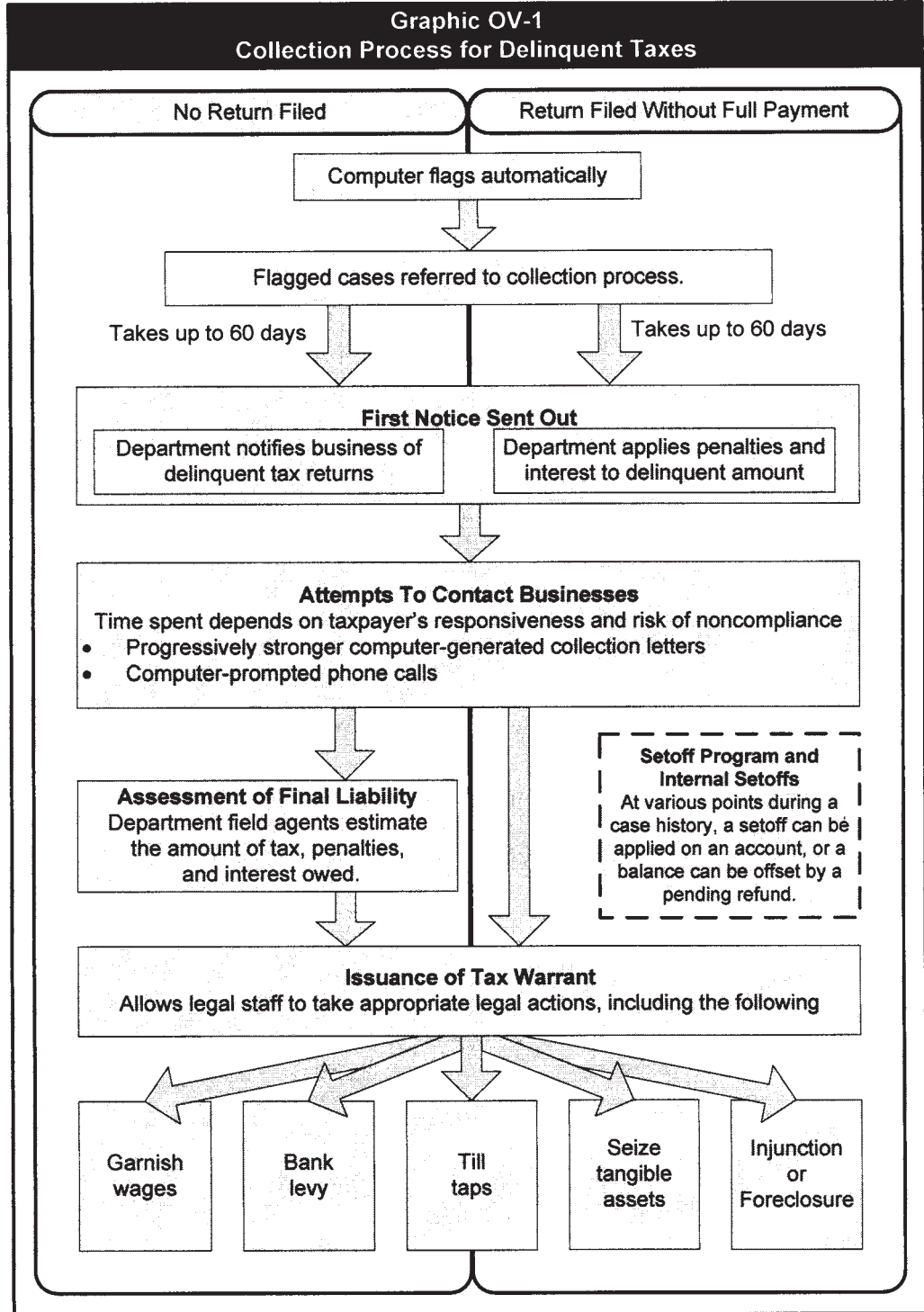


***Businesses That Are Delinquent on Their Taxes Are Referred to the Department's Collections Process***

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. As **Graphic OV-1** illustrates, that process is fairly complex. But in simple terms it involves the following:

- a series of computer-generated letters and computer-prompted attempts to call businesses to try to get them to voluntarily pay what they owe. The message in these letters and phone calls is progressively stringent. The Department will allow delinquent taxpayers to make payments under a payment plan, so long as they remain current on taxes owed.

- if the business doesn't voluntarily comply, the Department can take a series of administrative and legal actions. Before most of those actions can be taken, the Department must determine how much the taxpayer owes (for businesses that didn't file a return), and must file a tax warrant.



The major legal remedies the Department can take are described below:

- **Penalty and interest charges.** Businesses are charged interest on the known amount of delinquent tax, and can be charged penalties for failing to file returns or remit taxes. Penalty and interest amounts are calculated by the computer system and begin to be applied when the business becomes delinquent.
- **Set offs.** Using an internal set-off program, the Department will apply any refund a business is expected to receive for any tax against the delinquent amount owed the State. The Department also can send delinquent accounts to the State's centralized debt set-off program. This program matches information from debtors with State payments such as State employee payroll checks and State payments to vendors.
- **Filing tax warrants.** The Department can't pursue most legal actions until it files a tax warrant, which is a legal judgement issued to protect and secure the State's interest in a tax debt. The Department must file a tax warrant within three years from the date it receives a return without the proper payment, or from the date it makes a final liability assessment for businesses that didn't file a return.
- **Garnishing wages.** Wages can be held from a debtor's pay check to collect the delinquent tax amounts.
- **Till taps.** The Department's field agents can make an on-site visit to a business that operates with a cash register, and remove the cash that's in the register at the time.
- **Seize assets.** The Department can seize a business' liquid (cash) and tangible (equipment) assets.
- **Injunctions.** The Department can file a petition with the district court to prohibit a business from operating. Injunctions are used for sales tax and withholding tax delinquencies.
- **Foreclosure proceedings.** Enforcement of a tax lien that allows the Department to seize and sell the property of the business.
- **File claim in bankruptcy court.** When a business declares bankruptcy, the Department is required to stop all collection efforts. A tax claim is filed on behalf of the Department to secure its interest in the debt, but no other action occurs until the court resolves the bankruptcy claim.

Department staff handle most of these collection efforts, but in cases where 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?***

**ANSWER IN BRIEF:** *The Department has a number of good procedures for identifying businesses that should be registered with the Department but aren't, that are registered for some taxes but not all they should be, and that don't file returns when they should or don't remit the taxes they owe.*

*However, we found the Department could use additional information from other local and State agencies to try to identify unregistered businesses, could do more automated cross-checking, and should be using the information it collects from motor vehicle dealers to help identify dealers that may not be paying all the sales taxes they owe. These and other findings are discussed in the sections that follow.*

***We Focused Primarily On the Department's Procedures for Identifying Businesses That Weren't Registered Or Filing Returns***

A number of good practices exist for trying to identify when businesses aren't paying the taxes they owe. We focused on whether the Department had established good procedures in the following areas:

- **identifying businesses that should be registered with the Department but that aren't.** The procedures in this area cover two broad scenarios:
  - ▶ **identifying businesses that aren't registered at all**, even though they are operating and collecting sales or other trust taxes
  - ▶ **identifying businesses are aren't registered for all the trust taxes they should be registered for.** Once a business is registered for at least one tax, the Department can take other steps to determine whether it should be registered for other taxes.
- **identifying whether registered businesses are filing tax returns when they should, and are remitting the amounts they actually owe.** Generally, the Department has to rely on audits to determine the amount an individual or business actually owed in taxes. However, the Department has access to other internal information that can be used to help gauge whether those businesses have filed returns and remitted the taxes they owe.

Our review of the Department's procedures showed that, although it has established a number of good practices in each area, the Department can do more to help identify businesses that aren't paying the trust taxes they owe.

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***The Department Could Use Information from Other Local and State Agencies To Help Identify Unregistered Businesses***

As described below, the Department uses both its own staff and city and county officials to try to identify operating businesses that either are or should be collecting trust taxes, but that haven't registered with the Department:

- Field agents actively search for unregistered businesses. Although most field agents spend most of their time working with registered businesses that are delinquent in paying their taxes, they spend 5-10% of their time looking for unregistered businesses. Their work includes following-up on tips and canvassing businesses within an area to see whether they're registered. For example, field agents visit shopping malls at Christmas season to determine whether all stores are registered for sales and withholding taxes. In addition, two field agents are assigned to track and register special events—such as gun shows, fairs, and farmers' markets—where vendors may be transient or operate only a few times a year.
- The Department makes a “tax-entity” list available to cities and counties so that—among other things—they can help identify **other** businesses that are operating and should be on that list. Cities and counties have a vested interest in ensuring that businesses are registered to pay trust taxes and are paying all the taxes they owe. In fiscal year 2004, their share of the sales taxes remitted to the State was more than \$550 million. The Department generates a report that cities and counties can access over the Internet showing which businesses from their area are registered and what they owe and remitted in sales tax. A similar report is available on transient guest tax. Local officials can use this tax-entity list not only to identify businesses they know are operating but aren't on the list, but also to assess whether businesses' reported sales figures appear to be reasonable, given what local officials know about them.

We identified a number of other steps the Department could take to increase its chances of identifying unregistered businesses.

**The Department needs to work more actively with city and county officials to help identify unregistered businesses.** Soliciting the help of cities and counties is a cost-effective way for the Department to identify unregistered businesses. Despite the Department's promotion efforts, Department records show that only 27% of the counties and 39% of the cities in Kansas that levy sales taxes have accessed the business reports posted on the Department's website.

During this audit, we surveyed 90 city and county officials who have accessed these reports. Overall, many of the respondents had positive comments about the report and its usefulness. However, of the 53 who responded:

- **about one-fourth said they weren't using the report to try to identify businesses that aren't registered for—or might be under-reporting—the applicable trust taxes.** For example, one respondent said its focus had been on such things as identifying the top taxpayers in their county.

- **comments from several respondents indicated they didn't know how to use the reports.** One survey respondent asked the Department to list businesses alphabetically on the report, even though this sorting process can be easily done using common computer software. Another respondent wanted the report to be more "user-friendly." Comments from some other respondents made suggested they didn't really know how to use the reports effectively.
- **a couple officials indicated they weren't willing to help ensure tax compliance.** For example, one respondent rhetorically asked, "Is it the city's responsibility to identify non-compliance?" Another commented that the reports were a "whistle blower program," and that the Department "should get out and audit."

We also noted that city and county officials that do regularly use these reports identify more businesses suspected of tax evasion. For instance, cities that match the tax entity report against their list of businesses with a local occupational or business license tended to refer more suspected unregistered businesses to the Department. Other cities that use the reports to identify trends in taxes collected over time also refer a higher number of businesses to the Department than those that don't do such a sophisticated type of analysis.

**The Department should try to match its list of registered businesses against lists that other State agencies maintain about businesses operating in Kansas.** Many State agencies license, permit, inspect, or otherwise regulate some aspect of a variety of businesses. By running those agencies' lists against its own database of taxpayers when possible, the Department could identify and follow-up on businesses that aren't registered with the Department. *Table I-1* shows some of those agencies.

<b>Table I-1</b> <b>Sources of Information Available Within the State that</b> <b>The Department of Revenue Could Use To Help Identify Unregistered Businesses</b>	
<b>State Agency/Licensing Board</b>	<b>Information That Could Be Used</b>
Department of Labor	Active businesses that pay unemployment insurance tax
Department of Health and Environment	Licensed businesses, including adult care homes, auto repair shops, hotels and other lodging establishments, child care facilities, dry cleaners, laundromats, gas stations, restaurants, and wood furniture manufacturers.
Animal Health Department	Licensed businesses, including companion animal dealers and breeders, pet shops, and livestock dealers.
Wildlife and Parks Department	Licensed bait and tackle shops
Board of Cosmetology	Licensed hair salons
Department of Agriculture	Businesses inspected by the Weights and Measures program. Licensed pesticide businesses, dairies, and meat processors.
Kansas Corporation Commission	Licensed motor carriers
State Fire Marshal	Licensed firework stands
Source: "Steps to Success", Kansas Department of Commerce	

One difficulty in matching this information is that agencies need to collect the same identifying numbers for a businesses as the Department. Although some of these agencies likely would have employer identification numbers in their databases, others would not. In these cases, the Department could try to match up business names, but that could be time-consuming and not very accurate. Over time, however, it could work with other agencies to have them collect businesses' employer identification numbers on their application or renewal materials, and enter those numbers in their databases.

**The Department should develop a more systematic process for handling the tips it receives from the public or other sources.** The Department receives tips on businesses suspected of tax evasion from a variety of sources, including the public, cities and counties, and other divisions within the Department. 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.

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***The Department Can Do More Automated Cross-Checking To Identify Businesses That Aren't Registered For All Applicable Taxes***

The Department uses a form of "tax clearance" to help ensure that certain businesses are registered for all applicable taxes, and that they are current on the taxes they owe before they can be licensed or allowed to do business with the State. Those businesses fall into two categories, as follows:

- **Businesses the Department licenses.** The Department performs tax clearances on motor vehicle dealers and businesses that sell liquor, both of which are required to collect various trust taxes.

Motor vehicle dealers must apply for a license with the Department's Division of Motor Vehicles. In January 2004, the Department began requiring them to be registered for all applicable taxes—and to be current on those taxes—before being issued a new or renewal license. The Division of Motor Vehicles sends these dealers' names to the Division of Taxation, which looks them up in the Department's main computer system to determine whether they are registered for and current on all sales, withholding, and income taxes. In addition, during the 2004 legislative session the Department sought and the Legislature passed legislation allowing the Department to revoke the license of any licensed dealer who wasn't current on sales and withholding taxes.

Businesses wanting to sell liquor in Kansas must apply for a liquor license with the Department's Division of Alcoholic Beverage Control. The Department requires these businesses to register for all applicable business taxes. A tax clearance check similar to the one performed for motor vehicle dealers also is performed on businesses

renewing their liquor license. However, liquor licensees are required to be current only on the liquor taxes they owe, not on all taxes. The Department's attempt to expand this requirement to all other taxes failed in the 2004 Legislature.

- **Businesses for which other State agencies request tax clearances.** Two State agencies voluntarily work with the Department to ensure that businesses they deal with are registered and current on all business taxes. The Department of Administration requires vendors wanting to do business with State agencies to receive a tax clearance, and the Kansas Lottery does the same with retailers that apply to sell lottery tickets. The agencies can do this under their statutory authority to perform background checks. Both agencies regularly give the Department a listing of businesses to be checked, and are notified in return whether the tax clearance for each business was approved or disapproved.

<b>Table I-2 Tax Clearances Performed on Vehicle Dealers, State Vendors, and Lottery Retailers (January to August 2004)</b>		
<b>Type of Business</b>	<b># of Tax Clearances Performed</b>	<b>Number Disapproved</b>
Motor Vehicle Dealers <sup>(a)</sup>	3,584	188
Liquor Establishments <sup>(b)</sup>	1,542	0
State Vendors	1,274	361
Lottery Retailers	135	36
(a) Represents the motor vehicle dealers from June 2004 to August 2004. The Department didn't maintain statistics of clearances done prior to this. (b) Represents liquor establishments renewing their license. Although the tax clearance for some establishments may have initially been disapproved, the businesses subsequently settled their tax debt (unless they were in bankruptcy or making payments on a Department agreed pay plan) in order to receive a license. Source: Department of Revenue		

For the agencies described above, *Table I-2* shows the number of tax clearances performed and disapproved. If the tax clearance is disapproved, the agency will deny the business a license or, in the case of the Department of Administration, not contract with the business. Two exceptions: when the business is in bankruptcy, or the business agrees to a payment plan with the Department of Revenue to pay off its tax debt.

**Expanding the number of businesses required to get a tax clearance before they can receive a license or permit to operate in Kansas would provide a greater incentive to delinquent businesses to pay off their tax debt.** The Department of Administration and the Kansas Lottery already have adopted tax clearance programs for the businesses they deal with. Missouri also has a voluntary program in which cities and counties can request tax clearances for businesses applying for local business licenses.

Tax clearances are a way of ensuring that businesses are registered for all applicable trust taxes, and of increasing the incentives for businesses to pay the delinquent taxes they owe. Expanding their use in Kansas would require a change in law to allow agencies to deny or revoke licenses or permits for tax non-compliance.

**The Department isn't routinely matching businesses that are registered for one tax against other taxes in its computer**

**systems.** The Department currently has two computer systems to manage all the taxes it collects. The taxes that bring in the most revenue—including income, sales, and withholding—are maintained in the newer system (called Astra Tax Processing, or ATP for short), while the smaller taxes—such as liquor, waste tire excise, and transient guest—are handled in the older legacy system.

In December 2003, the Department performed a one-time match between some of the businesses types registered in the legacy system and the businesses registered in the ATP system. That match was done as part of the plan to one day transfer all taxes onto the ATP computer system, and was designed to determine whether businesses had the same identifying numbers in both systems.

That match identified 41 businesses—17 tire companies and 24 liquor stores—that were on the legacy system but not on the ATP system. As of the start of this audit, 33 of those businesses either had been entered into the ATP system, or it was determined they were out of business. The Department hadn't followed up on the other eight. When it subsequently did, it found that all eight businesses had legitimate reasons for not being registered for the other taxes—such as having no employees to pay withholding tax for, or selling all tax-exempt goods (e.g., farm machinery). At our suggestion, the Department plans to match businesses registered for transient guest tax with those registered for sales and withholding taxes.

We also noted the Department doesn't do any matching between taxes within the ATP system—for example, to determine whether businesses registered for sales taxes also are registered for income or withholding taxes. Attempting to match (and explain the differences found for) all businesses in the ATP system may not be cost-effective, but targeting specific types of businesses potentially could be. For example, Missouri discovered that many veterinarians have begun to sell pet food and other items but hadn't registered for sales tax. Matching data within ATP may allow the Department to identify other similar situations.

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***The Department Needs To Improve Its Procedures For Determining Whether Registered Businesses Are Remitting The Trust Taxes They Owe***

The Department has to rely on audits to definitively identify the amount an individual or business actually owes in taxes. However, it has access to other information that can be used to help gauge whether those businesses have filed returns or remitted the taxes they owe. For example:

- the Department's computer system automatically flags registered businesses that don't file returns when they are due, or that don't pay the full amount owed. Businesses that are flagged are formally referred to the Department's tax collection system.
- employers submit an annual withholding tax return that summarizes the withholding payments for the year plus it accompanies the State's

copies of the W-2 forms. The Department uses this return to reconcile employers' withholding payments made during the year.

- State law requires liquor wholesalers to report to the Division of Alcohol Beverage Control on how much they sold to each retail liquor establishment. This information is then entered into the Department's liquor licensing database. The Division of Audit just recently started to electronically match this sales information from wholesalers to the amount of sales retailers reported on their tax returns. Retailers that have purchased much more alcohol than they reported in sales are referred for an audit.
- as noted above, the Department posts a report on the Internet that cities and counties can access showing which businesses from their area are registered and what their reported sales tax liability is. Local officials can use this list to help assess whether businesses' reported sales figures appear to be reasonable, given what they know about them.

**The Department isn't using the information it collects from motor vehicle dealers to help identify dealers that may not be paying all the sales taxes they owe.** In April 2003, we issued an audit that looked at the collection of taxes on motor vehicle sales. Among other things, we found the Department wasn't collecting certain information—including sale prices and taxes collected for the vehicles dealers sold—that could help it assess whether dealers were remitting the taxes they owed.

As we recommended, the Department has required motor vehicle dealers to submit monthly reports showing the amounts of individual sales made and taxes collected. However unlike with retail liquor establishments, the Department isn't using that information to match it 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 obtain sales tax return information from the Division of Taxation, and compare that information to the dealers' sales reports while conducting vehicle dealer inspections. However, a motor vehicle field agent we spoke with said that hasn't happened. Apparently, the two Divisions haven't implemented a process for sharing the information.

Having the Division of Motor Vehicles' field agents perform the match as part of their inspections would give the Department a cost-effective way of identifying whether dealers were significantly under-reporting the taxes they owed, and of selecting dealers for audit.

***Kansas Is Similar To  
Other States in  
The Ways It Identifies  
Unregistered  
And Delinquent  
Businesses***

During this audit, we contacted officials from the Federation of Tax Administrators, the Multi-State Tax Commission, and from three states that we heard were doing innovative things in identifying such businesses—California, Missouri, and Georgia. The national associations didn't have any best-practice information, but Kansas' efforts for identifying unregistered and delinquent businesses generally were in-line with the other states'.

For example, like Kansas, Missouri sends tax-entity reports to its cities and counties. All three states 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. However, we did come across several practices that Kansas potentially could benefit from:

- **California uses a 1-800 number to receive tips from the public.** It has established a hot line for reporting tips on a business' suspected tax evasion. The tips are recorded and followed-up on. At one time, Kansas had a 1-800 number devoted to receiving tips, but Department officials said it was discontinued because of a lack of use. Such a number might be helpful again, however, given that the Department is planning to post the names of delinquent businesses with tax warrants issued on them on its Internet website. Officials from Georgia told us that having the delinquent businesses posted on their web page increased the number of tips it received from the public. Having an easy way to pass along tips to the Department would coincide with this effort.
- **Missouri uses third party information to help identify unregistered businesses.** Missouri uses a construction industry report called the "Dodge Report" to identify transient employers that may not be remitting withholding tax. Department officials said they used to receive this report at one time, but due to cost reduction, and the high expense of the report, it was discontinued.

***Conclusion*** 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.

***Recommendations***

1. To better use cities and counties as a cost-effective resource in identifying businesses suspected of not remitting sales or transient guest taxes, the Department of Revenue should do the following:
  - a. promote the use of its tax entity report among city and county officials, specifically targeting the members of the Kansas League of Municipalities, City Clerks/Municipal Finance Officers Association, Kansas Government Finance Officers Association, Kansas Association of Counties, and the Kansas County Treasurers Association.
  - b. track the success of the report in identifying non-registered and delinquent businesses, including the number of tips received, number of tips that prove to be valid, and the amount of delinquent taxes collected as a result. This information should be shared with city and county officials using the report.
  - c. develop and provide training to city and county officials on how to most effectively use the report. The training should include a list of best practices of cities and counties already using the report that have been successful in identifying businesses that are delinquent in paying the taxes they owe.
2. To help identify businesses operating in the State that aren't registered for all applicable taxes the Department should do the following:
  - a. seek the necessary authority to access the business licensing and permitting databases of other State agencies so that information can be used to match against the Department's tax records.
  - b. consider matching tax accounts within its ATP system for select types of businesses and industries that are more likely not to remit sales or withholding taxes even though they should. Businesses identified through the match as possibly not remitting either tax should be followed-up on by the Department's field agent staff.

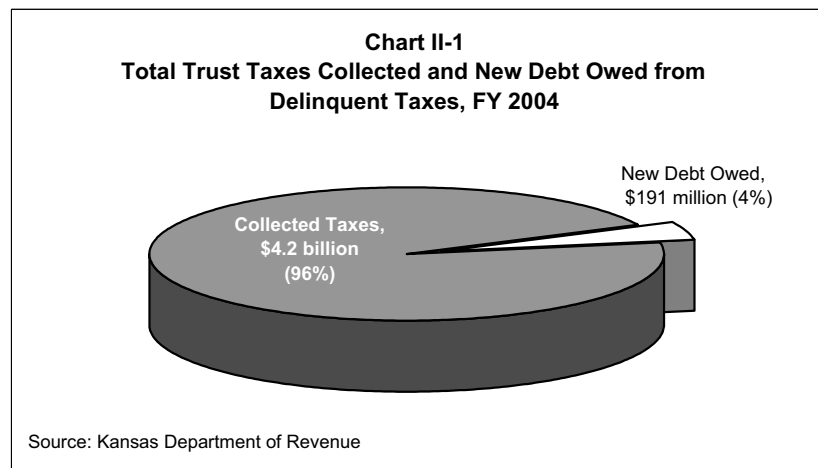
3. To help ensure that vehicle dealers remit all the sales tax they collect, the Department's Division of Taxation and Motor Vehicles should work together to implement the Division of Motor Vehicles' proposal to have its field agents match dealers' vehicle sales information to their sales tax return during inspections.
4. To ensure that the tips the Department receives about businesses suspected of tax evasion are investigated and followed-up on in a systematic manner, the Department should do the following:
  - a. offer and publicize a phone number or web site to receive tips from the public on businesses suspected of tax evasion. Tips received should be logged so that they may be assigned for investigation to Department staff.
  - b. develop written procedures on the handling of tips which should include directions on how tips are to be investigated and how the results of those investigations are reported to management staff.
5. To ensure that businesses regulated by the State are registered and current with all applicable trust taxes, the House or Senate Taxation Committee should amend State law to give State agencies the authority to deny, suspend, or revoke the license of any business that is not registered for all applicable State taxes or that is delinquent on its taxes.

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

**ANSWER IN BRIEF:** Although most business voluntarily remit the trust taxes they owe, the amount that becomes delinquent is not insignificant—about \$191 million in fiscal year 2004 was referred for collection activity. Department records show that the total amount of delinquent trust taxes owed has grown to \$195 million, although that amount is overstated because it includes artificially-high estimates and because the Department has only recently begun to write off some of its very old, uncollectible debt. The amount collected from delinquent accounts has increased in recent years, but we identified several problems with the Department's collection efforts, including delays in referring delinquent accounts into collections, lack of prompt actions to collect moneys, and lack of aggressive enforcement actions. Increasing the resources devoted to delinquent tax collection efforts would be cost-effective; in fiscal year 2004, the Department collected more than \$625,000 in delinquent taxes per full-time collections employee.

### ***Most Businesses Voluntarily Remit The Trust Taxes They Owe***

During fiscal year 2004, the Department of Revenue collected more than \$4 billion from the six trust taxes we examined during this audit. **Chart II-1** shows that about \$191 million in new debt—or 5% of the total—was referred for collection activity that year. The delinquency rates for that year ranged from 3.1% for liquor enforcement taxes, to 5.9% for retailer's compensating use taxes.



### ***The Longer Delinquent Taxes Remain Uncollected, The Less Likely It is They'll Be Paid***

When taxes first become delinquent, acting quickly to collect them increases the likelihood they'll be paid. Those chances diminish as time goes by. In some cases, 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.

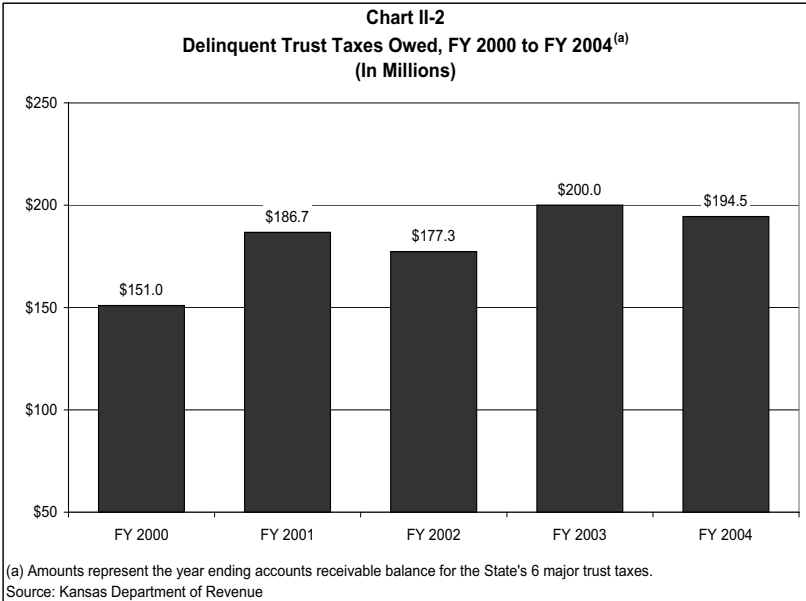
Table II-1 Age of Delinquent Sales Taxes in FY 2004 and Amount Collected			
Age of Delinquent Sales Taxes	Amount Owed	Amount Collected during FY 2004	% Collected
2003-2004	\$35.9	\$15.2	42.3%
2002	\$25.2	\$6.2	24.4%
2001	\$26.0	\$4.6	17.7%
1996-2000	\$58.2	\$8.4	14.5%
1991-1995	\$8.6	\$ .5	5.4%
1982-1990	\$1.8	\$.004	.2%

Source: "Establishing a New Methodology for Reporting Accounts Receivable," Kansas Department of Revenue - Internal Audit

A recent Department study showed that the chances of collecting delinquent sales taxes dropped nearly in half after the taxes had been delinquent for more than a year. This is demonstrated in *Table II-1*. A similar drop-off was true for withholding taxes as well.

**Department Records Show That the Amount of Delinquent Trust Taxes Owed Has Grown to \$195 Million**

Although the amount of new delinquent taxes in any one year is relatively small in comparison to overall tax collections that year, over time the estimated amounts of unpaid taxes and their associated penalties and interest have accumulated to a relative large sum of money. The Department’s accounts receivable records show that the balance of unpaid trust taxes, interest, and penalties has risen from \$151 million to \$195 million over the past five years—an increase of about 29%. That information is summarized in *Chart II-2*.



**That total amount of delinquent debt likely is overstated because the Department didn’t write-off any of the amounts it considered to be uncollectible during fiscal years 2000 and 2001.** When an agency decides a delinquent debt is no longer collectible, generally accepted accounting principles call for it to “write off” that amount. Doing so removes uncollectible debt from an agency’s accounting records, but doesn’t preclude the State from collecting at a later date.

**Table II-2  
Age of Accounts Receivable for the State's Trust Taxes  
FY 2004**

<b>Trust Tax</b>	<b>Less than a year</b>	<b>1-5 years</b>	<b>6-10 years</b>	<b>More than 10 years</b>
Sales	2%	60%	29%	9%
Withholding	2%	62%	27%	9%
Liquor Drink	2%	46%	36%	16%
Retailers' Compensating Use	4%	74%	16%	6%
Transient Guest	2%	68%	22%	8%
Liquor Enforcement	5%	40%	45%	10%
<b>Total \$ Amount (in millions)</b>	<b>\$3.6</b>	<b>\$117.8</b>	<b>\$56.0</b>	<b>\$17.2</b>
Source: Kansas Department of Revenue				

The Department didn't write off any uncollectible delinquent taxes in 2000 and 2001. It started doing so again in 2002, when it wrote off \$36 million in sales and retailers' compensating use taxes. As *Table II-2* shows, however, the Department still has approximately \$73 million of debt 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 for accounting for the transactions and adjustments that make up its delinquent tax balance.** In any year, an accounts receivable balance is determined by a beginning balance, the amount of new debt that comes in, the amount of debt collected, the amount written off, and the amount abated, forgiven, or otherwise adjusted during the year. What's left is the ending balance.

**Profile II-1  
Not All of the Delinquent Tax Balance Is Collectible**

For fiscal year 2004, the Department of Revenue's accounts receivable balance shows that businesses owe a total of \$195 million in delinquent trust taxes. That balance always will be somewhat overstated because it includes both estimates of taxes due, and amounts that ultimately are deemed to be uncollectible.

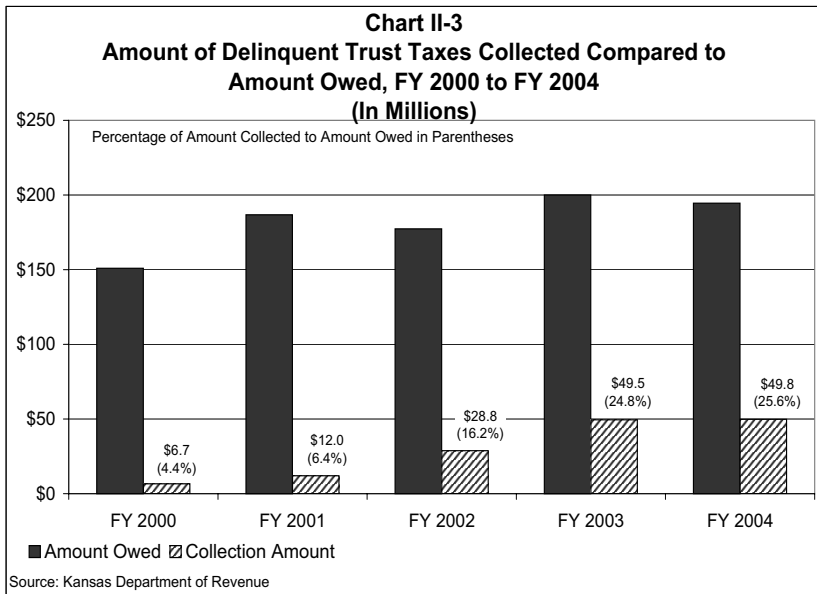
When a business doesn't file a tax return, the Department doesn't know how much in taxes it actually owes. In those cases, the Department has to estimate the amount owed. Those estimates typically are set at 125% of the highest amount the business could owe, based on how frequently it's required to file a return. The Department deliberately makes those estimates high to try to induce business owners to file returns proving they don't really owe that much. These estimates, along with the penalty and interest amounts associated with them, will tend to inflate the amounts some businesses actually owe and the amounts the Department reasonably can expect to collect.

In addition, accounts receivable balances always will include some amount of money that may never be collected because the business shuts down or is unable to pay. When an agency decides a delinquent debt is no longer collectible, generally accepted accounting principles say those amounts should be "written off." Doing so removes uncollectible debt from an agency's accounting records—to make it as accurate a depiction as possible of the amount of debt that's potentially collectible—but doesn't cancel the debtor's legal obligation or preclude the State from collecting at a later date.

For the delinquent trust taxes we reviewed, the Department couldn't reconcile its beginning and ending balances. Its collections are being recorded in the automated collections system, which isn't an accounting system. As a result, Department officials told us, not all transactions are recorded in that system, and those that are can be overridden and may not be entered consistently. After several weeks and considerable effort, the Department was able to come close to reconciling three of the trust taxes we were reviewing for fiscal year 2004, but still had to use several million dollars in figures not fully detailed in the collection system to make the balances fully reconcile. Officials said the transactions supporting these figures could be obtained from the accounting system, although it would be a lengthy process.

***The Amount the Department Has Collected from Delinquent Accounts Has Increased in Recent Years***

As **Chart II-3** shows, the amount of delinquent taxes collected has increased over the past five years, both in terms of actual dollars and as a percent of the average delinquent balance over the period.



In reviewing these figures, we noted the following:

- The percent of the delinquent balance collected in 2001 and 2002 is somewhat understated. If the Department had written off the delinquent taxes it considered to be uncollectible in 2000 and 2001 like it should have, the amounts shown as owed on the chart would have been smaller, and the percent collected would have been greater.
- The dollar amounts collected in 2000 and 2001 were relatively low because the Department wasn't carrying out many collection activities at that time. Department officials told us most of its collection efforts were put on hold while it was converting to a new computer system.
- The big increase in the amounts collected during fiscal year 2003 can be attributed in part to a big increase in staff devoted to the collections effort. The 2001 Legislature authorized 75 new positions

in response to the Department's promise that those staff would allow it to collect \$49 million in additional delinquent taxes—including income tax and other taxes not reviewed in this audit.

- Part of the amount collected during fiscal year 2004 was due to a tax amnesty program. Beginning in October 2003 and running for two months, the Department of Revenue offered a tax amnesty program that allowed delinquent taxpayers to forego penalties and interest on past-due accounts if they voluntarily paid the taxes they owed. Department officials told us this program netted \$8 million in delinquent sales taxes and \$2.3 million in delinquent withholding taxes.

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***Our Reviews Identified  
Several Problems With  
The Department's  
Effectiveness at  
Collecting  
Delinquent Taxes***

During this audit we reviewed the collections system the Department has established, the policies and procedures it has adopted for carrying out that system, and a sample of 40 delinquent accounts that had a balance due at the end of fiscal year 2004. Our sample focus was on active cases with larger balances due. That's because our April 2003 performance audit of motor vehicle taxes had shown that some vehicle dealers with chronic histories of delinquencies and large delinquent balances had been allowed to continue operating for years without any strong enforcement action being taken against them.

In this audit, we wanted to look at similar cases involving other types of businesses and trust taxes to see how quickly those cases had moved through the collections process, and whether the Department had taken appropriately aggressive enforcement actions against businesses that didn't voluntarily remit the trust taxes they owed. ***Profile II-2*** provides more information about our sample of cases.

**Profile II-2  
During This Audit We Reviewed 40 Delinquent Accounts That Had a  
Balance Due at the End of Fiscal Year 2004**

Our file sample was randomly selected from three groups—cases with very large balances, cases with moderate balances, and cases specifically delinquent on liquor taxes—and included the following:

- 8 cases with a balance greater than \$500,000
- 29 cases with a balance between \$10,000 and \$500,000
- 3 liquor tax cases with balances greater than \$3,000

Altogether, these delinquent accounts totaled \$7.6 million at the end of fiscal year 2004, including penalties and interest that had been assessed on the amounts owed or estimated. Most cases involved businesses that hadn't filed returns. Although many of these cases had been delinquent for some time, 11 came into the Department's collection system in 2002 or later.

The Department has collected about \$460,000 on these 40 delinquent accounts since 1998. Delinquent businesses paid more than \$400,000 voluntarily. The remaining \$60,000 was collected from bank levies and till taps, with most of that amount (\$53,000) coming from a single bank levy.

As described in the text, our focus in this audit was on active cases with larger balances due. It didn't include closed cases where the Department had successfully collected the delinquent amounts owed. Department staff were able to provide a list of all the collection activities taken in fiscal year 2004 relating to all tax types, not just the six trust taxes. That information is summarized in Appendix B.

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.

### Profile II-3

#### The Department Did Just About Everything Right in One Case in Our Sample

In July 2000, a club filed tax returns but didn't send in the full amount of sales and withholding taxes owed. Over the next 1½ years it continued to either file without payment or not file returns for sales, withholding and liquor taxes. This case was referred to the Department's automated collection system in March 2002. In June 2002 the business paid its delinquent liquor tax in full, along with penalty and interest. This amounted to almost \$7,500. The club still owed delinquent amounts for sales and withholding taxes. The business filed a petition to have all of the remaining tax debt abated, which was denied in July.

In August the Department sent "pre-seizure" letter to the club and "officer demand" letter to the club owner. In September it filed a tax warrant for \$21,400 on the known debt, and prepared a proposed tax liability assessment for those periods where a return hadn't been filed. Just five days after a tax warrant was filed, field agents went to the club and did a "till tap"—taking all the money that was in the cash register. That action netted the Department around \$2,600 to apply to the delinquent tax.

In October 2002, the Department issued a \$12,000 final tax liability assessment for the sales and withholding taxes the club owner hadn't filed a return for by that time. In January 2003, the Department discovered the business had closed. By March 2003, the Department had made a final tax liability assessment of almost \$4,000 for all the tax periods the club hadn't filed for or that hadn't been assessed previously. In July 2003, the Department referred this delinquent account to a third-party collection agency. There is no indication in the case file of any money recovered by the third-party collection agency.

**Under the Department's procedures, delinquent accounts are identified immediately, but most don't enter the collection system on a timely basis.** The sooner a business is notified that it is delinquent, the more likely it is that debt will be collected. Although some internal processing may be necessary before such accounts are referred to the automated collections system, those accounts should be referred as quickly as possible. That may not always happen:

- **Businesses with a known balance due may wait up to 60 days to enter the collection system.** Delinquent accounts can enter the collection system at various times. Cases within the legacy system can enter collections in two days; however, some cases with appeal rights don't enter for 60 days. In general, cases enter the system between 46-60 days after becoming delinquent, although some can be manually entered sooner by Department staff.

- **Some businesses that don't file a tax return may not be referred to the collections process for up to 120 days.** Beginning in fiscal year 2005, the Department decided it would only refer non-filers to its automated collections system once every quarter. Officials told us this delay has been built in because some returns actually may have been filed, but are being held up somewhere within the Department—such as in data entry or on a worklist. Before this change, the delay was up to 60 days. Officials said the new policy would save on printing and postage costs for sending out delinquency notices. Although some delay may be warranted, even 60 days for internal processing appears to be a very long time.

**Under the Department's current procedures, businesses that don't file a tax return receive the lowest priority in the Department's collections efforts.** Department officials told us some of those businesses may owe nothing or only a very small amount, and going after known debt amounts first is the best use of their resources. While some businesses that don't file a return have gone out of business, others still are in business and may end up owing significant amounts of unpaid taxes.

In our sample, for example a vacuum repair shop stopped filing returns for sales and employee withholding taxes in February 2000. This was at the start of the two year period when the Department was not trying to collect from businesses that failed to file returns. In December 2003, the Department made a final liability assessment which totaled more than \$800,000 including penalties and interest. This business is currently in operation, and the notes in the case file state that the business owner was "cavalier" about the whole situation, and wondered how long it would take for the Department to catch up with him.

We recognize the Department has limited staff resources, but determining whether businesses that don't file a return still are in business—and more aggressively pursuing those that are—would appear to be a cost-effective use of those resources.

**For most cases in our sample, the Department hadn't taken prompt action against businesses that were delinquent in filing returns and paying the trust taxes they owed.** For our 40 delinquent accounts, here's what we saw:

- **Between 2000 and 2001, the Department made no collection efforts on businesses that hadn't filed a tax return.** Further, businesses that missed filing a tax return in 2000 weren't even referred to the collections process until late 2001 or 2002. This situation occurred during the two-year period while the new computerized tax collection system was being implemented. Department officials told us they needed to focus their limited resources on developing and preparing for the new system at the time. **Profile II-4** on the next page describes an account that was affected by this policy.

#### Profile II-4

### During a Two-Year Period, the Department Didn't Take Any Collection Actions Against Delinquent Businesses That Hadn't Filed a Return

A gas station stopped filing returns for sales and employee withholding taxes in February 1998. Between then and 2001, the Department's computerized collections system sent out 13 tax bills, but the business owner never responded. Normally even more tax bills might have been sent out, but between 2000 and 2001, the Department wasn't taking any collection actions against businesses that were delinquent in filing returns.

The Department didn't make a final liability assessment until January 2002. That assessment was for nearly \$500,000, which included estimated taxes, penalty, and interest for both trust taxes. The Department filed a tax warrant in February 2003, more than a year later. A tax warrant has to be filed before the Department can take any of the legal enforcement remedies available to it.

The Department was finally able to get ahold of the business owner in March 2003. There weren't any notes in the file regarding what transpired from the phone call. According to Department officials, the gas station closed in 2001, and it is unlikely that much of the debt would be collected.

- **Many cases in our sample churned within the automated tax collection system for years.** The Department's collections system is designed to automatically generate monthly tax bills, periodic letters, and prompts to staff to make telephone calls to businesses that are delinquent in filing returns or paying their taxes. Appendix C shows the differences in the collection process for cases that have a balance due and an assigned risk score. However, that system allows businesses to stay in this collections cycle for months or even years. We saw that happen with our sample of cases. In one case, for example, a business has been in this collections cycle for more than three years, has received 20 tax bills and 18 letters, but has made only a few payments. Overall, the 40 businesses in our sample received a total of 734 computer-generated tax bills and 162 letters from the time their cases were opened through August 2004.
- **For a typical case in our sample, it took 2.2 years for the Department to assess a final tax liability.** Until it makes a final assessment, the Department can't file a warrant and take the more aggressive enforcement actions available to it. That final liability calculation is based on estimates when the business fails to respond to Department's collection efforts. The business owner then has 60 days to appeal the final assessment by filing original returns.

As **Table II-3** shows, for the cases we reviewed it took between 7.4 months and six years for the Department to make a final assessment. Such delays reduce the chances of collecting the overdue amounts. For three of the cases in our sample, the Department didn't assess a final tax liability until after it knew they were closed. Once a business is closed, the Department can no longer recover moneys through such enforcement actions as bank levies or till taps.

**Table II-3  
Typical Amount of Time To Initiate  
Enforcement Actions for Cases Reviewed**

Sample Type	Making A Final Assessment (a)		Filing of a Tax Warrant After Final Assessment		First Legal Action Taken After Tax Warrant	
	Number of Days	Number of Cases	Number of Days	Number of Cases	Number of Days	Number of Cases
<b>Balance Over \$500,000</b> (8 cases)	1,196	7	301	4	7	1
<b>Balance Between \$10,000 and \$500,000</b> (29 cases)	806	20	219	8	129	4
<b>Liquor Cases With a Balance Over \$3,000</b> (3 cases)	528	1	185	1	No actions	0
<b>Total</b> 40 cases	806	28	221	13 <sup>(b)</sup>	7	5
<b>Range for All Cases</b>	7.4 months to 6 years		1 month to 2 years		1 day to 1 year	

(a) Days until final assessment is measured from the date the case entered collections.  
(b) Tax warrants filed on seven cases were excluded from the analysis because the cases had a known balance and didn't require a final assessment.

Source: LPA File Review

Department officials told us the computer had been set to automatically issue a final tax liability assessment after 999 days, if field staff hadn't been able to do one before that. They told us the current field staff of 24 would have to be at least doubled in order to make final assessments at the optimal time, about three months after the taxpayer stops filing returns.

**For a typical case in our sample, it took 7.4 months for the Department to file a tax warrant once it had assessed a final tax liability.** Filing a tax warrant secures the Department's claim to the debt and allows it to initiate more aggressive collection actions. Department officials told us this process could be delayed by up to four months while waiting for a business to appeal the final tax assessment, or for an officer to appeal his or her responsibility for the business' debt.

**The Department hadn't taken aggressive enforcement actions against most businesses in our sample.** Through its computer-automated tax collection process, the Department hopes that delinquent taxpayers will voluntarily come into compliance. However, when delinquent taxpayers aren't responsive to those automated collection efforts, the Department needs to take stronger and timely enforcement actions to try to recover the amounts owed. In our 40 sample cases, it didn't often do that, as follows:

- **Businesses continued in the automated collection cycle even when they generally didn't respond to bills or letters, or broke promises to pay.** As noted above, cases often churned within the automated collection system for years before being moved forward to other enforcement actions. That occurred even though most businesses continued to add more delinquent debt. In addition, five of the six businesses that set up payment plans with the Department defaulted on them. Because businesses can break three payment plans before they are moved forward for legal action, these businesses stayed in the automated system and continued to receive monthly bills and periodic letters. **Profile II-5** on the next page describes one case involving a broken payment plan.

- **The Department issued tax warrants for only 20 of the 40 cases in our sample.** Filing a tax warrant is the essential first step for pursuing other legal actions. For three cases in our sample that we could tell were closed, warrants weren't issued until after businesses had been closed for up to six months. For two other cases, a tax warrant has yet to be filed, and the Department was aware the businesses had closed five months and 1½ years ago.
- **The Department initiated legal enforcement actions in only 12 of our 40 sample cases.** In 10 cases, the Department performed bank levies and till taps that netted a total of \$60,000. Other actions taken included referring accounts to an outside collection agency, making a demand on an escrow bond, and filing a claim to secure the State's interest in a bankruptcy case.

Department officials told us enforcement actions often are difficult to execute because of a lack of financial information, or the fact that a business has no assets or has closed. If the Department's collection efforts in these cases had been more timely, however, it may be able to minimize these problems.

#### Profile II-5

#### **A Business That Breaks a Payment Plan Can Continue in the Automated Collection System For Years Without More Aggressive Enforcement Action Being Taken**

An amusement company became delinquent in September 1999 when it sent in a tax return but didn't send in the full amount of taxes it owed. The Department referred this amusement company to its automated collections system in January 2001, which over the next nine months sent four tax bills and three letters. The Department finally was able to contact the business in September 2001, and the business agreed to a payment plan for the remaining \$32 it owed. Prior to the plan, the company had made a \$288 payment. Under the plan, the business was required to remit all future returns and taxes owed. The following month, the amusement company didn't file its tax return, and broke the payment plan. Under Department policy, a business can break three payment plans before it is moved forward for legal action.

For the next 1½ years, the company didn't file any returns. The Department sent monthly bills and had some additional phone contact with the company owner during this time. In April 2003, more than two years after the company had entered collections, the Department issued a final tax liability assessment of almost \$12,000 for all returns not filed. It hasn't yet filed a tax warrant against this company, and nothing in the case file indicates the business has closed.

#### ***Increasing the Resources Devoted to Delinquent Tax Collection Efforts Would Be Cost-Effective***

Based on Department records for fiscal year 2004, we calculated that almost \$627,000 was collected for every full-time employee involved in collecting delinquent accounts for all types of taxes (not just trust taxes), and almost \$15 for every dollar spent by the collections unit as a whole. We used the total expenditures and staffing associated with the Compliance Management and Civil Tax Enforcement unit to calculate these dollar figures.

During this audit, Department staff repeatedly pointed to a lack of resources as the reason why it took so long to do things like issuing final assessments, or matching vehicle sales information with vehicle dealers'

tax returns. Because quick action can often make the difference between collecting money and not being about to collect, it is important that this function be adequately staffed to handle the workload it has.

A report presented to the Legislative Budget Committee in September 2004 showed that the Department had underspent its State General Fund appropriation for fiscal year 2004 by \$2.5 million, of which \$1.5 million was for salaries and wages. The Department's budget director indicated these funds were left over because there had been no internal request to increase the number of collections field staff, and the Department was being very conservative with its funds because it didn't want to have to lay off staff if there were additional budget cuts

The budget director also said salary moneys were underspent mostly from holding open vacant positions in the Division of Motor Vehicles, as well as clerical positions that processed paper tax returns. He said collections was one of three areas—along with audit and electronic filing—that had high priority for filling vacancies when they occurred.

***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 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 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.

***Recommendations***

1. To provide the Legislature and itself with more complete and accurate information about delinquent taxes owed to the State, the Department of Revenue should do the following:
  - a. take an aggressive stance on writing off old debt that is not likely to be collected. Writing off does not preclude the State from collecting those moneys should they become available at a later date; it simply removes uncollectible debt from the Department's accounting records.

- b. extend its detailed reconciliations of delinquent taxes to all tax types, so that interested parties can see in detail what is happening with delinquent taxes.
2. Because the Department stands a better chance of collecting delinquent taxes the more quickly it acts, the Department should take a number of steps to speed up its processes, as follows:
  - a. reduce the amount of time an account waits to enter collections after it is identified as delinquent. Excluding accounts that have appeal rights, the Department should attempt to reduce this period to a maximum of 30 days for both accounts that have a balance due and accounts for which no return was filed.
  - b. quickly determining whether businesses that didn't file a return are still in operation and, regardless of whether the business is open or closed, make a timely assessment of final liability (the Department has indicated an ideal would be within 3 - 4 months of failure to file). Doing so would avoid inflating the accounts receivable balance with unrealistic estimates for closed businesses, and would allow the Department to take more timely legal actions against the owners of those businesses.
  - c. reduce the amount of time allowed for strictly voluntary compliance. Businesses that continue to operate with a balance due on trust taxes, or who don't file returns for those taxes, should be subject to a tax warrant much sooner than they are under the current system (for example, within 6 - 8 months), so the Department can take its other legal actions, such as till taps, bank levies, and garnishments, at a time when they are most likely to produce revenue.
  - d. determine the additional staff resources needed to process delinquent taxes in an active and timely manner, and make a request to the 2005 Legislature for those resources.

## **APPENDIX A Scope Statement**

This appendix contains the scope statement approved by the Legislative Post Audit Committee for this audit on April 27, 2004. The audit was requested by Representative John Edmonds.

### **Tax Enforcement: Determining Whether the Department of Revenue Is Collecting the Taxes Owed the State**

In April 2003 we issued a performance audit evaluating the Department of Revenue's procedures for ensuring that motor vehicle dealers are remitting to the State the sales taxes they collect from their customers. Among other things, we found that 4 of 7 small, used car dealerships we visited hadn't remitted the taxes they'd collected for the time period we reviewed. We also found that 3 of these 4 dealers had long histories of not remitting the sales taxes they'd collected, yet the Department allowed them to continue selling cars and collecting taxes. One of these dealers sold more than 500 vehicles during the past 5 years without filing sales tax returns, and owes the Department nearly \$500,000 in taxes, penalties, and interest since 1997.

Division of Taxation records also show there's currently about \$7 million in accounts receivable for about 500 vehicle dealers. We looked at a sample of 11 dealerships with some of the largest accounts receivable, and found that 7 of them had reported selling anywhere from 1 to 900 vehicles during 2002. These 7 dealers owe the State from \$22,000 to \$436,000 in taxes they collected from their customers.

These findings have raised legislative questions about whether similar weaknesses exist in the Department's efforts to collect sales or "trust" taxes that other businesses collect from their customers. A performance audit in this area would address the following questions:

- 1. Does the Department have effective procedures in place to identify when individuals or businesses aren't paying the taxes they owe?** To answer this question, we would select a sample of taxes that bring in the most money for the Department, and interview Department staff to determine what steps they take to identify businesses or individuals who likely owe those taxes but have failed to pay them. We would test those procedures to determine whether they were working as described. We also would find out from other states or officials from organizations like the Multi-State Tax Compact what types of procedures states generally use to identify failure to pay taxes, and assess whether there are additional techniques the Department should employ.
  
- 2. Are the Department's efforts to collect unpaid taxes effective?** To answer this question, we would interview Department officials and review any written procedures to identify what steps its staff are supposed to take when they have identified businesses or individuals that owe taxes to the Department. We would compare the steps the Department says it takes to good collection practices and to requirements for due process, and identify any weaknesses that may be present. For several types of taxes, we would review a sample of businesses or individuals that have collected and owe "trust" taxes to the Department to determine whether the Department followed its procedures and whether those procedures appeared to be effective in collecting the taxes owed. We would perform other testwork as needed.

**Estimated time to Complete:** 12-14 weeks

**APPENDIX B**  
**Department of Revenue Collection Activity - Fiscal Year 2004**

The cases reviewed during this audit included only active cases with large balances. This appendix contains information provided by the Department of Revenue regarding all collection activities, including number of cases closed, during fiscal year 2004. The information relates to all cases and all tax types, not just the six trust taxes reviewed in this audit.

**2004 Fiscal Year**

**Activity Data Extract – ASTRA Tax Management (ACM)**

The details provided in this report are directly extracted from the ASTRA Tax Management (ACM) system (does not include Legacy tax types not part of ACM). This extract is a snapshot of all case histories between July 01, 2003 and June 30, 2004, fiscal year 2004. Each detail is not attributable to any specific area of Compliance Enforcement, tax type, or ACM location code. Volumes are only measured in the form of counts of observation. To establish the beginning count of cases we took the ending count minus the opened cases plus the closed cases (ending -opened + closed). Some of the observations below only address activity at a TAP level rather than case level. These are noted as such.

**Case Closure FY 2004**

Case Count at July 01, 2003	197,669
Cases Opened in FY 2004	159,593
Cases Closed in FY 2004	198,169
Case Count at June 30, 2004	159,093

**Accounts Receivable Recovery FY 2004**

Compliance Enforcement Recovery Amount	\$95,291,180
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**Collection Activity**

New Case Referral to Debtor Setoff	79,680
New Case Referral to Treasury Offset *	10,797
Field Staff Visit (Case Level)	2,131
Legal Action Initiated on a Case level	12,566
Case Skiptraced	19,664
Return Filed by Taxpayer (from non-filer process)	111,756
Successful Setoff Through Debtor Setoff **	9,519
Successful Offset Through Treasury Offset **	6,568

**Case Level Customer Contact**

Outgoing Call and contact with Taxpayer	157,697
Incoming Call from Taxpayer *	207,916
Letter Sent to Taxpayer	440,731
Case notes Entered/Recording Action	138,727
Letter Received from Taxpayer	15,100
Office Visit by Taxpayer to KDOR	781

**Case Activity**

TAP Debt Adjustments	294,319
Case Demographic Data Changed	469,133
Payment Posted to a TAP	302,458
New TAP Received by ACM	374,342
Case Level Legal Action Released	14,770
Abatements (TAP Adjustment and Write Off)	157,125
Internal Offsets (TAP Level)	20,185
Internal Offsets Applied	72,287
Tax Assessments (TAP Level)	236,787
Correspondence Reviewed	47,961

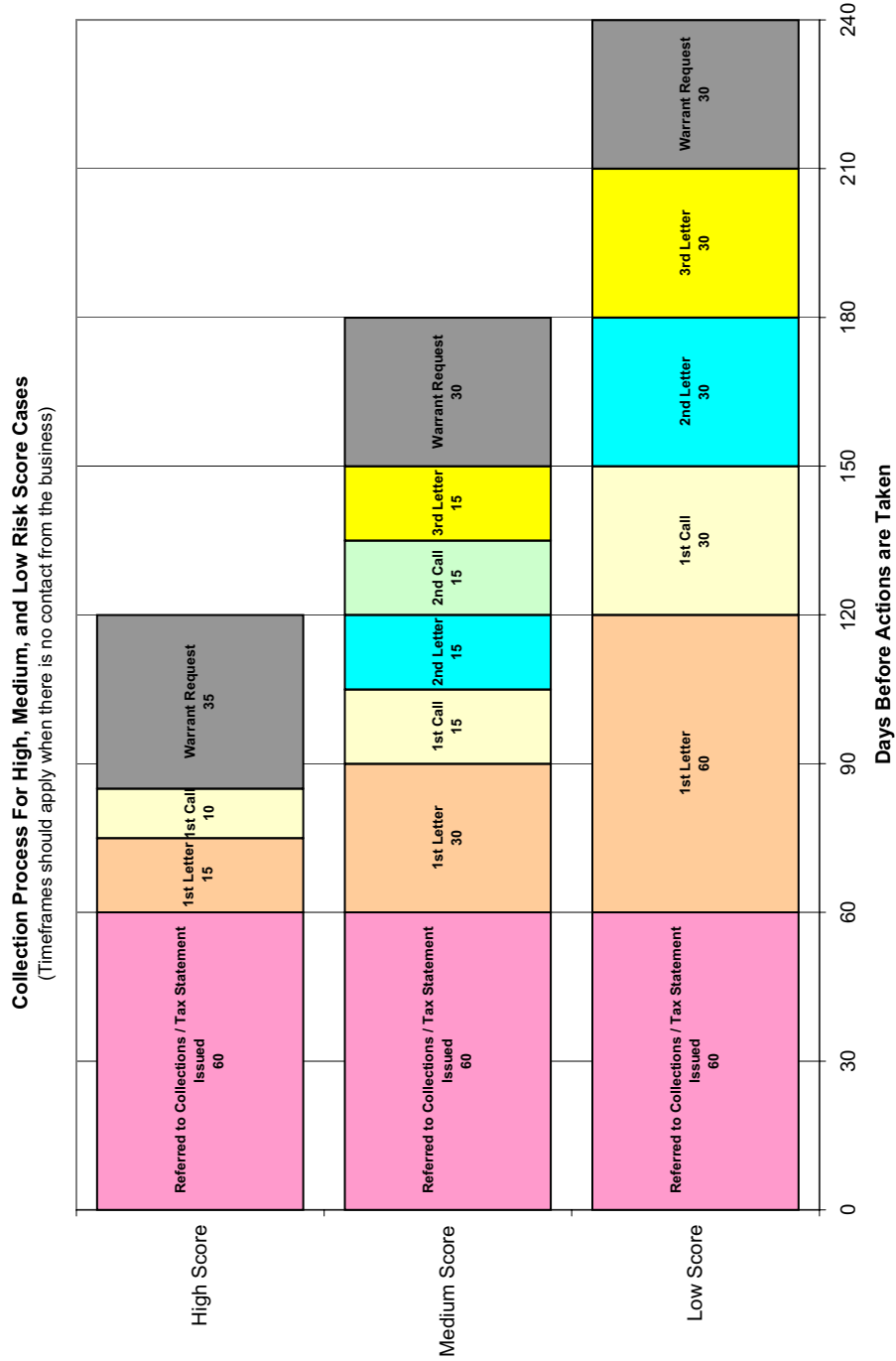
\*Figures established using internal reports.

\*\* Observations only, not related directly to TAP or Case.

## APPENDIX C

### Collection Process for Different Risk Scores

When businesses become delinquent and the Department knows the amount overdue (i.e., business that file a return but don't pay the full amount due), the computer system assigns the business a risk score based largely on the amount due and the business' previous payment history. The pattern of phone calls and collection letters the business subsequently receives depend on its assigned risk score. This appendix shows the difference in the Department of Revenue's collection process for cases that receive a low, medium, and high risk score.



## APPENDIX D

### Agency Response

On September 27, 2004, we provided copies of the draft audit report to the Department of Revenue. Its response is included as this Appendix.

In their written response, agency officials indicated they intend to implement most of the report's recommendations, with some exceptions:

- **Question 1, Recommendation 1 (d)** – The Department contends the tax entity report available to cities and counties is straightforward and does not require further training.
- **Question 2, Recommendation 2 (a)** – The Department believes its current approach is more efficient. Officials said it saves time and costs involved with billing some accounts that would otherwise self cure, given an additional 30 days, and it also gives the Department time to use computer edits to ensure that billings and letters are based on accurate information.



# K A N S A S

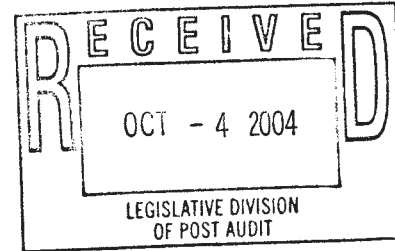
JOAN WAGNON, SECRETARY

DEPARTMENT OF REVENUE  
OFFICE OF THE SECRETARY

KATHLEEN SEBELIUS, GOVERNOR

October 4, 2004

Ms. Barbara Hinton,  
Legislative Post Auditor  
Legislative Division of Post Audit  
800 SW Jackson, Suite 1300  
Topeka, Kansas 66612



Dear Ms. Hinton:

Thank you for the opportunity to respond to the draft audit report, *Tax Enforcement: Determining Whether the Department of Revenue is Collecting the Taxes Owed the State*.

Collecting taxes is a difficult, complex, and frustrating function of government. Fortunately, the vast majority of Kansans pay their tax liability willingly and accurately. Yet with the numbers so large, even the small percentage owed by delinquent taxpayers can be a substantial sum. While we will never reach 100% compliance, we will not waver from our stated mission--to collect taxes fairly, cheerfully, accurately, and efficiently.

Beginning two years ago, we refocused the agency priorities on collecting overdue taxes. Since that time, we've recognized a substantial increase in collections of delinquent taxes, exceeding \$195 million in fiscal years 2003 and 2004 combined.

As recognized in the report, adding new positions to our Collections function was a big help. To use these positions effectively, we employ sound collection practices and operations. We regularly share best practice ideas with other states, and we believe our methodologies compare favorably. Our fully-automated collection system allows us to make efficient use of collection personnel.

Focusing attention on Appendix B in the report, it's important for the reader to appreciate the volume of collection activities performed by the Collection staff. During FY2004, we made almost 158,000 collection telephone calls and sent 440,000 collection letters to taxpayers. By identifying and contacting non-filers, we received 111,756 additional tax returns than we might not have otherwise received. As a result of these and other collection activities, we successfully closed over 198,000 cases, and collected over \$95 million in FY2004.

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To answer audit question 1, yes, the Department of Revenue has effective procedures in place to identify when businesses aren't paying the taxes they owe. When a registered business fails to file a tax return, that business is automatically referred to our collection process. That being said, we are always looking for ways to improve.

Specifically, we want to do more to find those businesses that are operating illegally, without properly registering with KDOR and remitting appropriate taxes. Unfortunately, tips, hotlines, and tax entity reports offer limited success. As pointed out in your report, we need statutory changes that would a) require state agencies to provide their licensee information to the Department of Revenue in a way that facilitates computer matching and b) require State agencies to deny, suspend, or revoke the license of any unregistered or delinquent taxpayer.

We have seen the success of this type of effort within our own Vehicle Dealer Licensing program. Beginning this year, no Vehicle Dealer is allowed to retain a valid license if they are delinquent in remitting taxes. This threat of license revocation is a powerful collection tool. Applying this practice in cooperation with State licensing agencies dramatically enhances our ability to identify non-filers and reduce the losses from those businesses who unlawfully confiscate tax collections for their own use. This could work in a similar fashion if municipalities would require retailer licenses.

As to Question 2, our efforts to collect unpaid taxes are effective, but greater effectiveness could be attained. We endorse the suggestion of acting more quickly and forcefully. However, we find ourselves constrained not by philosophy and procedure, but by resources. Our computer system effectively prioritizes delinquent accounts, focusing on high-risk and high-dollar deficiencies. But the frequency of collection tasks could be increased and the referral of cases could be expedited. With more field personnel, we could perform more on-site visits to determine whether non-filing businesses are still in operation. With more office collectors and attorneys, we could hasten the billing and telephone collection processes, so that accounts would move more quickly to hard core status and to the pursuit of assets through the court system.

Thank you for the analyses and recommendations contained in the audit report. This is an important issue, and we look forward to working with the Legislature to ensure that tax collections continue to increase and that tax compliance is both encouraged and assured.

## **Detailed Response to Recommendations.**

### **Recommendation 1-1.**

- a. The Department of Revenue agrees that cities and counties can be helpful in this regard. We very much appreciate the cities and counties that currently act as effective partners in identifying non-filers and non-registrants. We have promoted this program and will continue to do so. Local governments are aware of the potential benefits. Based on their own priorities and resources, some simply choose not to participate.
- b. Using this report provides an additional control over non-registrants. As it is designed to do, it is effective in isolated cases, identifying businesses that local government officials are aware of, that are not listed on the tax entity report. We will review the potential for summarizing the revenues gained through this process.

- c. We disagree. Increasing local tax revenues by collecting taxes due is the best incentive to encourage participation. There would be tremendous difficulties in attempting to calculate and segregate penalty and interest between the state and local units of government.
- d. The report is straightforward and does not require further training.

**Recommendation 1-2.**

- a. During the last two years, KDOR has worked to encourage state licensing agencies to share lists of licensees for use in matching programs to identify non-filers. We are currently working with ten different licensing agencies, including the Board of Accountancy, the Board of Cosmetology, the Dental Board and the Board of Nursing just to name a few. We would support a statutory change that would *require* agencies to share lists of licensees and to capture FEIN numbers, which provides an improvement over matching by name.

In 2004, the Department of Revenue supported HB 2776 and SB 468, which contained the aforementioned requirement. The bills were tabled and assigned to an interim committee for review.

Ideally, the legislature would require all entities licensed by the State to remain current in filing and paying state taxes as a condition of retaining their license. Failure to abide by the tax laws should result in automatic license forfeiture. Such a requirement would do more to improve the effectiveness of collection efforts than any change in practice or procedure that KDOR might undertake.

- b. KDOR already sends a consolidated tax bill to taxpayers and routinely offsets tax delinquencies against any pending refunds from other taxes. The exceptions are for minor taxes maintained on legacy accounting systems. We are planning to facilitate the required file matching as soon as programming priorities permit us to do so.

**Recommendation 1-3.**

In 2004, KDOR began requiring Motor Vehicle Dealers to remain current on all taxes as a condition of licensure. Now, delinquencies are dealt with swiftly and decisively, so that overdue taxes in this industry represent a very small problem. Dealer Licensing Inspectors have expanded their role in tax compliance. The inspector now compares total revenues from vehicle sales as reported on the Vehicle Sales report to the sales tax return for reasonableness. We believe this is a more cost-effective practice than capturing the detailed auto sales information from the reports of all dealers in the state.

**Recommendation 1-4.**

- a. KDOR discontinued its 1-800 phone number due to the cost of maintaining and manning this service. We plan to explore including a “tip” option on our website as a lower-cost alternative.
- b. We’ll develop a process for logging tips to document that all are worked and track results for evaluation by management.

**Recommendation 1-5.**

We agree wholeheartedly with this recommendation, as noted in our response to Recommendation 1-2.

### **Recommendation 2-1.**

- a. KDOR follows the statutory write-off practice as prescribed. However, this practice alone does not improve the accuracy of accounts receivable valuation and reporting, which is the intent of the recommendation. To be eligible for statutory write-off, an account must meet strict criteria, such as expiration of the statute of limitations, insolvency of the taxpayer, and/or anticipated collection costs exceeding the amount due. Every year, KDOR sends a voluminous list to the Board of Tax Appeals for approval of the write-off. In the interim, collection personnel code the accounts as "Uncollectable," to facilitate accurate valuation of accounts receivable and to discontinue collection activities for specific accounts.

Unfortunately, this process leaves most accounts on the books and valued at 100% of the tax assessment plus accumulated penalties and interest. This creates a substantial over-valuation of assets.

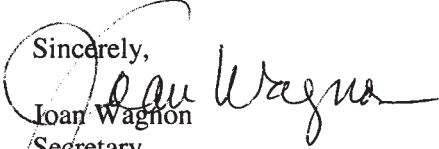
Instead, KDOR has developed an improved process for estimating the collectability of the accounts receivable for each tax type, taking into account the age of the accounts and the tax type. This practice, which is the approach favored by the Financial Accounting Standards Advisory Board, results in a more accurate estimate of accounts receivable values. Using this methodology, KDOR recently revalued its June 30, 2004 accounts receivable total from \$262 million to \$123 million.

- b. We agree with the intent of this recommendation. Achieving it will depend on our ability to shift I.T. resources from other priorities.

### **Recommendation 2-2.**

- a. We disagree. On the surface, initiating collection actions sooner for overdue or non-filing accounts seems obvious. However, we believe our current approach is more efficient. We mail non-filer letters once each quarter. This saves time and costs involved with billing some accounts that would otherwise self cure, given an additional 30 days. It also gives us time to use computer edits to ensure that billings and letters are based on accurate information. Currently, we prioritize and throttle the number of accounts entering collections so that we can manage the billing process and the incoming telephone calls that billings generate. We will certainly evaluate this recommendation carefully from a cost-benefit viewpoint and make a change if it appears beneficial.
- b. Before making this change, we need to conduct further study to be certain that devoting additional resources to non-filers is likely to generate greater collections than working on those with a documented debt. In September 2004, we referred 20,000 non-filed accounts into our collection system (accounts are now referred on a quarterly basis). Additional field positions would need to be authorized, hired, trained, and managed, as well, to provide on-site visits to non-filing businesses.
- c. We agree with the intent of advancing tax cases more quickly toward the filing of a tax warrant, for active cases. However, increasing the intensity on some accounts would necessitate either targeting fewer accounts or acquiring additional collection and attorney staff.
- d. We agree. We continue to pursue any automated approach that improves our efficiency and effectiveness.

- e. We agree. We intend to study this issue carefully and ask for the budgetary authority to expand collection staff for those positions that can best support our collection strategies.

Sincerely,  
  
Joan Wagnon  
Secretary