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Compliance – The New Search for Balance

The Pendulum is Swinging Back: How the States are Reacting

*Presented by Laurie McGrath, John Vranna and Paul Panariello
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Finding Balance in Tax Administration

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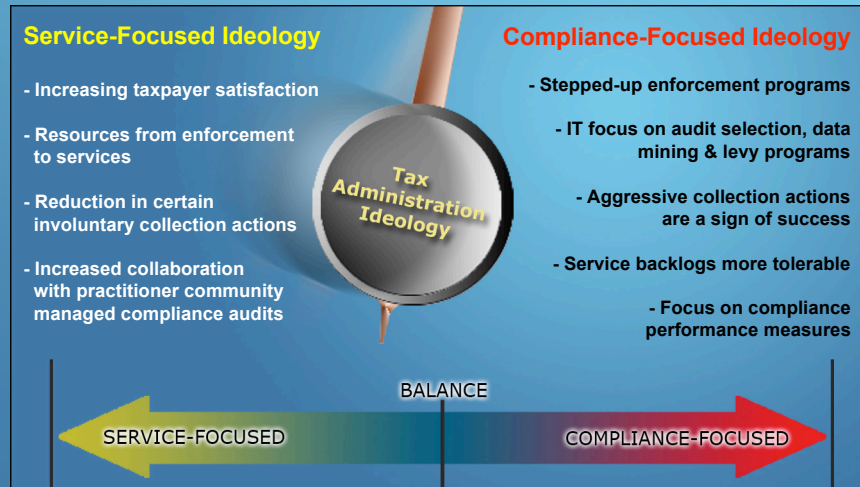
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Finding Balance in Tax Administration



Finding Balance in Tax Administration

- Increases in non-compliance and the resulting growth in the tax gap have two fundamental consequences:
 - Exacerbate already acute budget problems
 - Erode underlying fairness of a tax system
- Budget choices are limited, collecting more of what's already due, is part of the solution.

Finding Balance in Tax Administration

- The challenge is to re-focus on compliance without abandoning taxpayer service initiatives.
 - Both strategies improve compliance
 - The pendulum needs to swing, but not too far



How Concerned Should We Be?...

- Is the recent interest in compliance levels a long-term interest or short-term?
- Is our tax system becoming a truly voluntary tax system?
- Is the entire tax structure at risk without immediate corrective action?



We Should Be Very Concerned!

- We are facing a fundamental structural increase in non-compliance that can not be solved with traditional compliance methodologies.



SEVERE

HIGH

Issues Impacting Compliance - *Old History*

- Debtor prisons abolished in mid 1800s
- Capone convicted in 1930's for tax evasion



"The income tax law is a lot of bunk. The government can't collect legal taxes from illegal money."

--Attributed to Al Capone



Issues Impacting Compliance – 1980 - 2005

- IRS TCMP audits raise tax gap (15%) awareness
- Changes in economy

1980's

- Down economy, budget cuts
- 2001 tax gap rates show deterioration

2000's



1990's

- Congressional hearings lead to taxpayer bill of rights
- Shift to reduce auditors and increase service
- Repeal "Pay to Play"
- Y2K readiness
- E-commerce begins

Issues Impacting Compliance – Present

The current compliance challenge

- Globalization
- E-commerce
- A 20th century tax structure in a 21st century world
- A recipe for aggressive and creative tax planning

Issues Impacting Compliance – Present

Compliance challenges continued...

- Agencies are “outmanned”
- Increase in the aggressiveness and sophistication of tax sheltering activities.
- Identification of audit issues is becoming more challenging.

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Issues Impacting Compliance – Present



What are the implications of these trends?

- Compliance levels will erode
- Revenues will decrease

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Issues Impacting Compliance – Present

The good news:

- Government has demonstrated that it can be creative to address issues of tax administration.



Issues Impacting Compliance – Present

How states are responding

- Tax agencies have a long history of adapting.
- Examples of innovation are already coming online.
- Through continued collaboration the challenges can be overcome.

Let's look at some of the progress made today.

Issues Impacting Compliance – Present

“How states are responding” continued...



- Collections
 - Leveraging self-service opportunities
 - Implementing industrial strength case-management systems
 - Greater automation of collection activities
 - Applying decision-making analytical tools to better manage receivables



Issues Impacting Compliance – Present

“How states are responding” continued...

- Audit
 - Gaining comprehensive access to departmental data
 - Applying new data mining tools
 - Providing new audit desktop work tools to minimize clerical tasks
- Non-Filer Identification
 - New automated capabilities to identify and assess non-filers.



Issues Impacting Compliance – *Future*

*Building blocks for Improved
Tax Compliance*



Strategic Planning

*Is your Organization positioned to
focus on today's Compliance Issues?*



Key Issues:

- Recruitment and Retention
 - Succession Planning
 - Identification of Noncompliant Taxpayers
 - Management of Delinquent Debts
 - Wise Investments in Technology
 - Defining Success
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Collaboration



“No one has a Monopoly on Good Ideas”

- Use of FTA: An essential Resource
 - Provides a forum for sharing ideas and evaluating your strengths and weaknesses
- Few Agencies can address all of today’s compliance issues alone
- Regardless of the issue, someone in this room has valuable information to share

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Personnel / Organization



Will you have in the talent to achieve your mission in the years ahead?

- Recruitment and Retention Challenges
- Retirement of Baby Boomers
- Succession Planning
- Compensation Packages
 - Do you need a new model?
 - Share success stories
- New emerging Skill Sets

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Legislative Agenda



“As Tax Administrators you do not control the Agenda”...But you can influence it!

- If you expect help from legislators they must understand the Issues
- Key Issues:
 - Implications of the changing economic world
 - E-Commerce
 - Globalization
- Must Provide Quality Information
 - Fiscal and Compliance Impacts
 - Impact on revenue and compliance on initiatives to standardize taxation across jurisdictions

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Technology



“Automation has largest revenue benefit potential and must continue to be focus – but there is a need now to shift from processing to data analytics”

- Integrated Tax Systems
 - Adjustments, multi-period audits
 - Accurate Billing
- Data Warehousing
- Risk Management Analysis Tools
- Desk & Field Innovations

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Technology – Data Warehousing

Step 1: Data aggregation



- Create “portfolios” (i.e., electronic duplicates) using
 - Federal
 - Other state
 - Local (county and town)
 - Third party (e.g., SEC)



- More data points leads to:
 - Being able to “Follow the money”
 - Better decisions
 - Reducing “false” positives

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Technology – Data Warehousing continued...

Step 2: Data Analytics



- Matching (taxpayers / relationships)
- Comparisons/Ratios/Calculations
- Patterns
- Scoring of based on rule sets
- Statistical / Risk scoring (more on this later)

Step 3: Case selection & integrated treatment scenarios

- Increase effectiveness and productivity
- Increase revenues
- Identify schemes
- Reduce cost and taxpayer burden

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Technology - Data Warehousing continued...

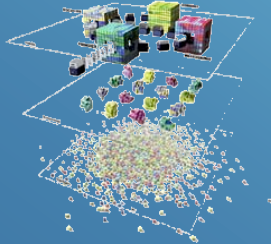


All Functions

- Non-registration
- Non-filing
- Desk audits
 - Automated differences
 - Correspondence
 - Self audits
- Field audits
- Collections
 - In-office
 - Field

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Technology – Risk Management: *Collections*



Apply the right action based on risk of non-payment

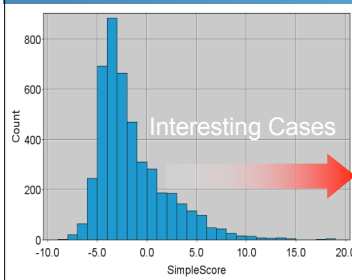
- Based on statistical analysis of past actions/results, future behavior predicted (e.g., payment within 90 or 180 days)
- Receivables are scored using predictive elements and treatment scenarios are set
- Increases in collections obtained by applying right strategy to each case with right resources

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Technology – Risk Management: *Audit*



Select the right audits based on probability of under reporting



- Models used to predict probability of under-reporting (e.g., next best yielding case considering audit complexity and potential for appeal)
- Models generally specific by tax type and involve ratios and deviations from norms

Technology – Desk Innovations



- Advancements in processing to calculate non-filed returns and bill
- Full automation of discrepancies based on external data
- Returns evaluated at time of processing for deviations from norm or from the industry averages or from past history
- Refund / EIC fraud detection based on predictive models

Technology – Field Innovations



- Hand-held collection devices
 - Case data
 - P&I update
 - Payment plans
 - GIS mapping/directions
 - T&E
- Auditor's workbenches
 - Data upload/download
 - E-worksheets, correspondence, policy
- UPC and/or RFID tag based audit's



Conclusion

We are seeing a fundamental transformation in the US economy. E-commerce is becoming a way of life, tax compliance must also transform itself as well. Plan with goals in mind using the right people, process and technology to maximize productivity and minimize costs



- Understand trends/impact
- Future success will be dependent on multi-pronged approach with an emphasis on collaboration and data analysis
- Enjoy the conference and visit with the vendors of many of these technologies

