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AGENCY REVIEW

DEPARTMENT OF REVENUE STATE TAX DEPARTMENT

AUDIT OVERVIEW

The Tax Department Has Increased Enforcement Efforts and Collections Through Advances in Technology and Internal Policies and Procedures



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EXECUTIVE SUMMARY

The Tax Department Has Increased Enforcement Efforts and Collections Through Advances in Technology and Internal Policies and Procedures.

In May 2006, the Legislative Auditor issued a Full Performance Evaluation on the Department of Revenue's Tax Department. This review stated that the Department was not using the full extent of its enforcement authority for business tax collections, causing the State to lose millions of dollars in potential revenue. The findings illustrated the Department's apparent reluctance to revoke, suspend, or refuse to renew business registration certificates as granted by West Virginia Code §11-12-5. This update focuses on the following:

- implementing the GenTax system,
- enforcing business registration certificate revocation and refusal to renew,
- requiring businesses to be in good standing as a condition of business registration renewal,
- promulgating rules for applying WVC §11-12-5, and
- addressing the centralization of payment plans.

The GenTax system implementation began in February 2006 and was completed in February 2010 at a cost of \$22.3 million.

The GenTax system implementation began in February 2006 and was completed in February 2010 at a cost of \$22.3 million. This system, containing both hardware and software, was purchased from Fast Enterprises. This process contained six individual rollouts with specific items contained in each. The Tax Commissioner provided the Legislative Auditor with information regarding efficiencies gained in the areas of electronic filing, refunds, data accuracy, and management information.

The 2006 report stated that the Department possessed an inherent reluctance to utilize the enforcement authority granted in WVC §11-12-5. In response to this finding and upon the implementation of GenTax, the Department issued new policies and procedures relating to the refusal to renew and revocation of business registration certificates as a means of enforcement. These new tools for enforcement, combined with an increased effort on behalf of the Department has resulted in increased revocation notices served and the creation of a new set of refusal-to-renew guidelines. **The Legislative Auditor recommends that the Department continue to increase focus on enforcement as a means of collecting delinquent taxes.**

The Department, using the new GenTax system, now uses a risk score system to determine a company's standing before renewing its business license. Risk scores are computed by the system using outstanding balance, specific transactions, timeliness of filing returns, collection history, and other factors as criteria. The current threshold for refusing the renewal of a business registration certificate is a risk score of 5,000.

The Legislative Auditor requested a list of all companies with an active business registration that were not in good standing with the Department to evaluate this process. From the list of 2,159 companies, a random sample of 327 was taken with a 5% margin of error and 95% confidence level. The data show that 270 or 83% of the sample were delinquent at the time of its most recent renewal. Twenty-seven (8%) had been officer assessed, 236 (72%) had a lien filed, 71 (22%) were on payment plans, and 277 (85%) had at least one missing return. The average delinquent balance at the time of the most recent renewal for the sample was \$12,402 while that number increased to \$13,667 by the time of the Legislative Auditor's analysis. Two hundred eighty-six (286) of the 327 companies analyzed possessed a risk score below the threshold of 5,000 with an average of 2,437. Thirty-one (31) companies had a risk score above 5,000 and accounted for \$2.57 million of the \$4.37 total delinquency for the sample. **Therefore, the Legislative Auditor recommends the Tax Department continue to refine the risk score analysis function provided by GenTax to reduce outstanding tax liabilities.**

At the time of the 2006 report, the Department collected \$82 million from its collection and enforcement efforts, which was a typical annual collection amount. As a result of the GenTax system and increased use of revocation and refusal-to-renew enforcement tools, collection of delinquent taxes increased to \$135 million in 2009 and is projected to reach \$150 million in 2010. The average yearly enforcement collections prior to the GenTax implementation for years 2002-2007 was \$88.2 million, while although only two years, the average for 2008 and 2009 equals \$130.7 million. **It should be noted that the initial investment of \$22 million for the GenTax system, has at least partially contributed to the increase in collections of nearly \$40 million.** At this point, it is proving to be a sound investment on the part of the Legislature.

The Department complied with the recommendation from the 2006 report stating that it should promulgate rules for applying WVC §11-12-5. The Department also developed a policy relating to the establishment of payment plans in response to the final recommendation of the 2006 report. This policy provides agents with guidelines for establishing payment agreements and is an attempt to limit the number established at regional offices as recommended. The Legislative Auditor is also satisfied with this resolution to the 2006 recommendation.

The Department, using the new GenTax system, now uses a risk score system to determine a company's standing before renewing its business license.

As a result of the GenTax system and increased use of revocation and refusal to renew enforcement tools, collection of delinquent taxes increased to \$135 million in 2009 and is projected to reach \$150 million in 2010.

Recommendations

1. *The Legislative Auditor recommends that the Department continue to increase focus on enforcement as a means of collecting delinquent taxes.*
2. *The Legislative Auditor recommends the Tax Department continue to refine the risk score analysis function provided by GenTax to provide the State with a valuable tool to reduce outstanding tax liabilities.*

OBJECTIVE, SCOPE & METHODOLOGY

The agency review of the West Virginia State Tax Department (Department) is authorized by the West Virginia Performance Review Act, specifically §4-10-8(b)3 of the West Virginia Code, as amended. This review was conducted in conjunction with the 2010 agency review of the Department of Revenue.

Objective

This review's objective is to inform the Legislature on the details of the new integrated tax system implemented by the Tax Department, and on progress toward recommendations made by the Legislative Auditor in a 2006 report.

Scope

This report is a limited scope performance update focusing solely on the Department's progress toward addressing the four recommendations made in the 2006 report and the implementation of the new tax system as it relates to business registration. The four recommendations to be updated are that the Department: utilize the enforcement authority granted in WVC §11-12-5, promulgate rules for applying WVC §11-12-5, establish policy and procedure to make the renewal of business licenses contingent on a company's good standing with the Department, and discontinue the practice of establishing payment agreements at regional offices. Information contained in this review is limited to 2006 to September, 2010, with the exception of historical Compliance Division collections data dating back to 2002.

Methodology

The analysis for this review was conducted primarily through interviews with Department staff, information provided by the Department, and data collected on-site. On-site data collection included drawing relevant information from records contained in the GenTax system via Department provided computers and system access. The Legislative Auditor drew a sample from a list of 2,159 companies provided by the Department to conduct the business registration certificate renewal analysis. The sample of 327 was taken at a 5% margin of error and a confidence level of 95%. Every aspect of this review complied with

Generally Accepted Government Auditing Standards (GAGAS) as set forth by the Comptroller General of the United States of America.

ISSUE 1

The Tax Department Has Increased Enforcement Efforts and Collections Through Advances in Technology and Internal Policies and Procedures.

Issue Summary

This performance update's objective is to inform the Legislature on the details of the new integrated tax system implemented by the Tax Department, and on progress toward recommendations made by the Legislative Auditor in a 2006 report. The GenTax system was completed on-time at a final cost of \$22.3 million. This system has offered the Department increased efficiency in the areas of resource allocation, internet account management, refund processing, data accuracy, and management information. The Department, as recommended in the 2006 report, has increased its use of the enforcement authority granted in §11-12-5, the power for the Commissioner to revoke, suspend, or refuse renewal of business licenses. A risk score policy was recently implemented by the Department to use as a tool for deciding when to allow for business license renewal. While the current policy and threshold of 5,000 risk points is progress toward making good standing with the Department, a requirement for business license renewal, the criteria for developing an appropriate score and threshold should continue to be monitored. Whether as a product of one or many of the improvements to the Department, collections have increased nearly \$40 million from 2007 to 2009. The Legislative Auditor could not determine a sole reason for this increase and is of the opinion that it is a cumulative result of the improvements. The Department has also promulgated legislative rules for applying §11-12-5 and developed a policy for the establishment of payment plans, which satisfactorily address recommendations made in 2006.

The Legislative Auditor Issued a Report in May 2006 Stating That the Department Needed to Increase Its Enforcement Efforts, Promulgate Rules, and Address the Establishment of Payment Plans

In May 2006, the Legislative Auditor issued a Full Performance Evaluation on the Department of Revenue's Tax Department. This review stated that the Department was not using the full extent of its enforcement authority, causing the State to lose millions of dollars in

potential revenue. The findings illustrated the Department's apparent reluctance to revoke, suspend, or refuse to renew business registration certificates as granted by West Virginia Code §11-12-5. This code cite gives the Tax Commissioner the above authority if the registrant files a fraudulent application or renewal, refuses to file a return, refuses to pay any tax including trust taxes, abuses the privilege afforded to be exempt from payment, or fails to pay in full delinquent personal property taxes. It was also observed that it was not uncommon for the Department to renew Business Registration Certificates for companies that had large delinquencies as well as returns not filed, existing liens and warrants, and had not entered into a payment agreement.

The objective of this update is to report to the Legislature details of the recently completed upgrade to the West Virginia tax computer system as well as the Department's progress toward implementing recommendations made in the 2006 report. Specifically, beyond the system upgrade update, this update focuses on the following:

- implementing the GenTax system,
- enforcing business registration certificate revocation and refusal to renew,
- requiring businesses to be in good standing as a condition of business registration renewal,
- promulgating rules for applying WVC §11-12-5, and
- addressing the centralization of payment plans.

The Implementation of the GenTax Integrated Tax System Was Completed On-Time, at a Cost of \$22.3 Million, and Provides the Department Increased Efficiency

Numerous times throughout the agency's response to the 2006 report, technological limitations were cited as a reason for the findings. Also noted in the response was the purchase of a new computer system called GenTax that would help alleviate these problems in the future. In a presentation prepared for the August 11, 2010 meeting of the Joint Standing Committee on Finance, the Department gave an overview of the project. At the time, this particular product was being used by 14 states, 3 cities/counties, 3 Canadian provinces and 1 foreign nation.

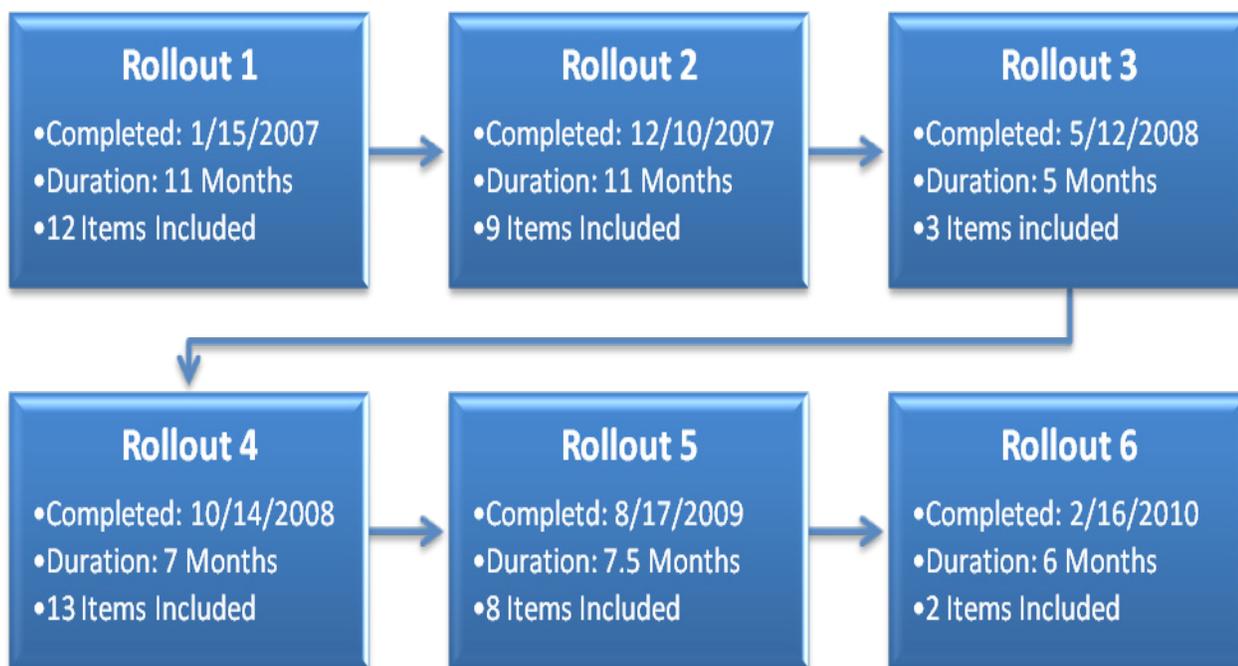
The findings illustrated the Department's apparent reluctance to revoke, suspend, or refuse to renew business registration certificates as granted by West Virginia Code §11-12-5.

Numerous times throughout the agency's response to the 2006 report, technological limitations were cited as a reason for the findings.

GenTax is a commercial off-the-shelf computer system, containing both hardware and software, for which a \$22 million appropriation was provided in July 2005. A full cost breakdown can be found in Appendix B. The contract was awarded to Fast Enterprises LLC of Greenwood Village, Colorado, in December 2005 to implement GenTax beginning in February 2006. The 5-year contract covered the conversion of 42 taxes over a 4-year period via 6 phases, with specific items included in each phase. Figure 1 shows the six individual phases, duration, completion date, and number of items included. A full list of items covered in each phase can be seen in Appendix C.

GenTax is a commercial off-the-shelf computer system, containing both hardware and software, for which a \$22 million appropriation was provided in July 2005.

**Figure 1: GenTax Rollout Schedule
(Began February 2006)**



When afforded the opportunity to provide any additional efficiencies or inefficiencies the agency has experienced with the new GenTax system, the current Tax Commissioner identified that through studies, the Department found that modern tax agencies dedicated a majority of their resources to enforcement. He described a modest improvement in this area increasing by two percent and one percent the staff dedicated to enforcement and technology respectively. The Commissioner went on to express improvements in the areas of electronic filing, refunds, data accuracy, and management controls.

The Department's "MyTaxes" website became active in May 2008. This web presence allows taxpayers to manage accounts around the clock, e-file returns and amended returns, pay current and delinquent taxes electronically, make name and address changes, schedule payments, and view historical data for up to three years. Since its inception, 41,146 businesses have registered as compared to the previous application use of 5,100. To date, the Department has received 257,355 returns and scheduled 236,791 payments totaling \$1.81 billion in state revenue. This application is currently receiving 48 new signups daily.

Since the inception of the "My Taxes", 41,146 businesses have registered as compared to the previous application use of 5,100.

In the area of refunds, new system implementation has decreased the time needed to process both electronic and paper returns. Before the current system, returns took electronic and paper methods 22 days and 9 weeks respectively. This is compared to the now fully automated processing time of five days and seven weeks respectively. The new system also allows the Department to view the entire return, including detail of the refund such as check numbers, dates, etc.

Before the current system, returns took electronic and paper methods 22 days and 9 weeks respectively. This is compared to the now fully automated processing time of five days and seven weeks respectively.

Throughout the GenTax implementation, a series of rules were created by the Department to ensure payment accuracy and return information. This process creates work items in the system for any return failing these rules. From that point, an employee must review and correct any errors before any transaction will post to the taxpayer's account. The accuracy of data gained by this process aid the Department in properly storing correct data, billing statements, etc. These rules are under constant supervision by the Department for improvement and reduction in workload.

The management control efficiencies gained provide the Department with real-time information via 668 ad hoc queries. This information combined with 132 reports that can be generated and shared among management. The system also collects external data from taxpayers and internal data from employees regarding workload, work performed, refunds processed, etc.

The Department Has Increased the Extent to Which It Utilizes the Enforcement Authority Granted by §11-12-5

In 2006, the Legislative Auditor found that there was an inherent reluctance to use the revocation powers granted by WVC §11-12-5 as an

enforcement tool, but those efforts have since increased. At that time, the Department stated that this power should be used sparingly and putting companies out of business would provide no opportunity to operate and, thus, no hope of recouping the liability owed to the State. Workers' Compensation data were used by the Legislative Auditor to illustrate that revoking or refusing to renew a business license would often encourage compliance from this group. The Department states that it is continuing to increase the use of such tools.

Upon completion of the GenTax system, the Department adopted the "Compliance LBR Non-Renew Indicator and Letter" policy on April 8, 2010. No official non-renewal policy existed prior to this date, because programmatically stopping this issuance of licenses in the previous system would have been difficult. From the implementation of this policy to September 3, 2010, the Department has sent 806 refusal-to-renew letters. Of this total, 341 (42%) of the recipients were able to achieve good standing, and were issued a certificate. Businesses who continue to operate on an expired license are referred to the Criminal Investigations Division for action. As of September 3, 2010, 97 such instances have occurred. The remaining 368 companies are either out of business or currently being investigated as part of normal field work. Table 1 shows a breakdown of these outcomes.

From the implementation of the non-renewal policy to September 3, 2010, the Department has sent 806 refusal-to-renew letters. Of this total, 341 (42%) of the recipients were able to achieve good standing, and were issued a certificate.

Table 1	
Refusal to Renew Outcomes	
Achieved Good Standing	341
No Longer in Business	113
Under Follow-up Investigation	255
Referred to Criminal Investigation Division	97
Total	806
<i>Source: Tax Department Documents</i>	

Upon completion of the 2006 Full Performance Evaluation, the Department created policy and procedure for the revocation of business registration certificates on June 14, 2006. In correspondence with the Department, it was stated in part that:

The change in culture regarding revocations has been accomplished due to a change in policy prompted in part by recommendations included in the May 2006 full

performance audit.

The policy and procedure were revised on September 8, 2008 to reflect the inclusion of the GenTax system in this procedure.

The Department provided a list of 58 businesses that have been served revocation notices since the 2006 report. Seventeen (29%) of the companies served either paid in full, entered into a payment agreement, or executed an offer in compromise, thus keeping their business registration certificates. Twenty-two companies that were served this notice had their business license revoked by the Department. The remaining 19 have filed for bankruptcy, are still pending court decisions, or are either otherwise resolved or ongoing. The Department also provides that the 22 notices served thus far in 2010 have already surpassed the 2009 total of 21. Table 2 shows a breakdown of revocation notice outcomes since the 2006 report.

Table 2	
Revocation Notice Outcomes	
Avoided Revocation	17
Revoked	22
Pending Court Decision	5
Filed Chapter 11 Bankruptcy	3
Other	11
Total	58
<i>Source: Tax Department Documents</i>	

The Legislative Auditor recognizes the increased effort on behalf of the Department to utilize the enforcement power granted in WVC §11-12-5 as recommended in the 2006 report. **The Legislative Auditor recommends that the Department continue to increase focus on enforcement as a means of collecting delinquent taxes.**

The Department Now Utilizes a Risk Score to Determine Whether Companies Should Be Issued a Business Registration Certificate

The 2006 report found that the Department was routinely renewing business registration certificates for companies that were not in

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good standing with the Department. This previous analysis focused on a sample of 159 companies that were scheduled to have their certificates revoked by the Workers Compensation Commission due to being on the Workers Compensation default list. Twenty-four of these companies were found to be delinquent with the Tax Department at the time of their most recent renewal. At the time, the Secretary of Revenue stated in the official response to the report that the process of determining a liability at the time of renewal was a manual process. Also, that the Business Registration Section consisted of only six employees and the necessary human resources were not present.

In an effort to ensure that businesses that do not meet certain criteria are not issued business registration certificates, the Department developed the “Compliance LBR Non-Renew Indicator and Letter” policy providing guidance for applying a non-renewal indicator to accounts in GenTax. This policy establishes the threshold of a 5,000 risk score as unacceptable to the Department, warranting non-renewal status. Also, when there is no quantified balance due but failure to file nine returns, of any duration, or more exists, the indicator is to be applied. The application of this indicator requires that a refusal to renew letter be sent to the taxpayer via certified mail.

Now that GenTax has been implemented and a threshold established, the Department utilizes the generated Risk Score to determine whether or not to renew a business registration certificate. GenTax uses a list of rules tied to a point system to assign a Risk Score. Criteria used to determine how many risk points are assigned to an account include:

- taxpayer balance,
- transactions,
- late filed returns,
- collection history, and
- other factors.

For example, a delinquent balance between \$1 and \$249 would assign 10 risk points to the account. The number of points assigned increases with the amount of the delinquent balance up to 25,000 risk points assigned for a \$250,000 delinquency. The other factors that can lead to an increased risk score are bad checks, duration of late filed returns, fraud, account type of tax delinquency, etc.

This policy establishes the threshold of a 5,000 risk score as unacceptable to the Department, warranting non-renewal status. Also, when there is no quantified balance due but failure to file nine returns, of any duration, or more exists, the indicator is to be applied.

For example, a delinquent balance between \$1 and \$249 would assign 10 risk points to the account. The number of points assigned increases with the amount of the delinquent balance up to 25,000 risk points assigned for a \$250,000 delinquency.

The Legislative Auditor Utilized a Sample of Currently Operating Delinquent Businesses to Examine the Future Application of the Risk Score System

In order to determine the Department's current practices regarding the renewal of business registration certificates and the future application of the risk score system, the Legislative Auditor requested a list of all businesses with an active business registration certificate that were not in good standing with the Department. From a list of 2,159 companies, a random sample of 327 was taken with a 5% margin of error and 95% confidence level. Using GenTax, the Legislative Auditor analyzed each account between August 30, 2010 and September 3, 2010, to determine its status at the time of renewal. To do this, the system was used to show the date of the most recent renewal. All liabilities accrued beyond that date were subtracted from the current balance to show the balance at the time of the business's most recent renewal. The current balance was also recorded to show whether the liability had grown since the most recent renewal. Other information collected was whether:

- the company had been officer assessed,
- a lien existed,
- a payment plan existed,
- at least one return had not been filed, and
- the company's current risk score.

Table 3 shows an analysis of the entire sample of 327 companies holding an active business registration certificate. The data show that 270 or 83% of the sample were delinquent at the time of their most recent renewal. Twenty-seven (8%) had been officer assessed, 236 (72%) had a lien filed, 71 (22%) were on payment plans, and 277 (85%) had at least one missing return. Seven companies were deemed not applicable to this analysis for reasons of bankruptcy proceedings, recent good standing

The data show that 270 or 83% of the sample were delinquent at the time of their most recent renewal.

status, ceased status, or non-renewal status with an audit in progress.

Table 3 Delinquent Businesses Holding an Active Business Registration - Sample										
	Delinquent at Renewal		Officer Assessed		Lien Exists		Payment Plan		Returns Not Filed	
Yes	270	83%	27	8%	236	72%	71	22%	277	85%
No	50	15%	293	90%	84	26%	249	76%	43	13%
N/A	7	2%	7	2%	7	2%	7	2%	7	2%

Source: Legislative Auditor's analysis of GenTax accounts.

Tables 4 and 5 show the balance and risk score information for the sample respectively. The average delinquent balance at the time of the most recent renewal for the sample was \$12,402 while that number increased to \$13,667 by the time of the Legislative Auditor's analysis. Also provided are the minimum, maximum, and median values for both the companies' balance at renewal and current balance. The total liability owed to the State for the sample stands at \$4.3 million. As discussed previously, business registration renewals are largely based on the assigned risk score of a company. For the sample, the average risk score of 2,437 lies below the non-renewal threshold of 5,000 established by the Department through GenTax. Two hundred eighty-six (286) of the 327 companies analyzed fall into this category.

The average delinquent balance at the time of the most recent renewal for the sample was \$12,402 while that number increased to \$13,667 by the time of the Legislative Auditor's analysis.

Table 4 Balance Information - Sample		
	Balance at renewal	Current Balance
Minimum	\$ (307)	\$ (2,464)
Maximum	196,154	196,154
Average	12,402	13,667
Median	2,115	2,996
Total	\$ 3,968,511	\$ 4,373,501

Source: Legislative Auditor's analysis of GenTax accounts

Table 5 Risk Score Information - Sample		
Minimum		0
Maximum		21,000
Average		2,437
Median		1,400
Less Than 5,000	286	87%
5,000 or Greater	31	9%

Source: Legislative Auditor's analysis of GenTax accounts

The Legislative Auditor examined the two sub-groups as relates to risk score, those above and below the threshold of 5,000 risk points. The 286 entities that comprised the group with a risk score below the threshold produced a total delinquent balance of \$1.49 million at their

most recent renewal, which grew to \$1.8 million by the time of the Legislative Auditor's analysis beginning August 30, 2010. The average delinquencies for this group at their most recent renewal and at the time of analysis were \$5,211 and \$6,300 respectively. Comparatively, the group of 31 companies with a risk score of 5,000 or greater had accumulated a delinquency of \$2.47 million at the time of their most recent renewal. This total grew to \$2.57 million by the time of the Legislative Auditor's analysis. These averages were significantly higher than the preceding group at \$79,917 and \$82,940 respectively.

The Legislative Auditor provided the Compliance Division with a list of the 31 entities with a risk score of greater than 5,000 and requested the risk score at the time of the most recent renewal and additional detail. Twenty-two of the companies had a risk score exceeding the threshold at the time of their most recent renewal, yet most took place before the risk score policy had been implemented. Sixteen of the companies are still operating on a license that has yet to expire. Of these businesses, 10 have had a stop-renewal indicator placed on their account, 9 as a direct result of the Legislative Auditor's providing the Department with the opportunity to review these accounts. Twelve businesses have pending or signed payment agreements and one offer of compromise is pending approval. Seven companies have recently been issued a permanent business license as a result of agent error. At this time, the application of the stop renewal indicator is still a manual process. The Department is exploring the possibility to fully automate this process before the 2011 renewal season to improve the efficiency of this process. A list of the top ten balances for currently active delinquent business within the sample is shown in Table 6. The top 100 delinquent businesses overall within the state are contained in Appendix D.

Of these businesses, 10 have had a stop-renewal indicator placed on their account, 9 as a direct result of the Legislative Auditor's providing the Department with the opportunity to review these accounts.

The Department is exploring the possibility to fully automate this process before the 2011 renewal season to improve the efficiency of this process.

Table 6 Top 10 Delinquent Business - Sample			
	Balance at Renewal	Current Balance	Risk Score at Renewal*
Business 1	\$ 196,154	\$ 196,154	18,600
Business 2	191,445	191,348	18,500
Business 3	166,826	189,736	23,550
Business 4	181,259	182,190	18,850
Business 5	157,243	157,243	11,700
Business 6	145,073	145,298	5,200
Business 7	124,524	124,524	20,050
Business 8	111,518	111,518	11,400
Business 9	100,506	105,502	12,100
Business 10	99,047	100,270	11,300
Total	\$ 1,473,595	\$ 1,503,783	

Source: WV Tax Department
 *Most renewed prior to implementation of risk score policy

While it is imperative for the Compliance Division to pursue the most egregious offenders, it is also apparent that the companies who have yet to reach the risk score threshold for non-renewal of 5,000 are still accruing unpaid tax liability to the State. The Legislative Auditor recognizes that this is a new procedure, but it is also one that should be monitored to ensure the State is being proactive in minimizing the amount of unpaid taxes accrued by businesses. The Department should analyze not only the application of the risk score, but its composition as well. Given the flexible nature of these criteria, the Department may identify specific occurrences that warrant an increase or decrease in assigned risk points. This would allow the Department to use historical data to customize the risk score in a manner that best serves everyone. **Therefore, the Legislative Auditor recommends the Tax Department continue to refine the risk score analysis function provided by GenTax to provide the State with a valuable tool to reduce outstanding tax liabilities.**

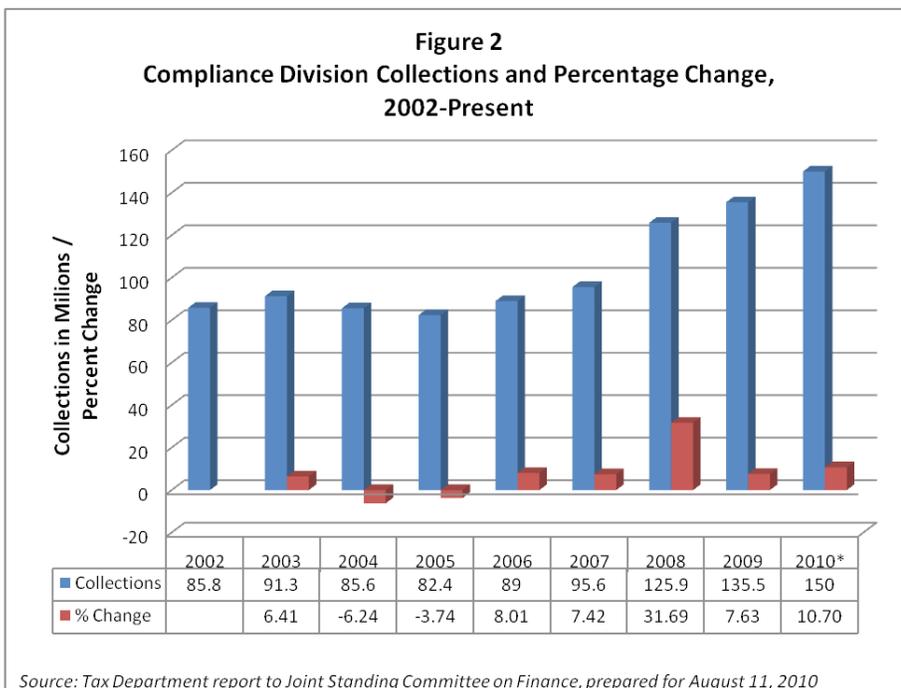
While it is imperative for the Compliance Division to pursue the most egregious offenders, it is also apparent that the companies who have yet to reach the risk score threshold for non-renewal of 5,000 are still accruing unpaid tax liability to the State.

The Department should analyze not only the application of the risk score, but its composition as well. Given the flexible nature of these criteria, the Department may identify specific occurrences that warrant an increase or decrease in assigned risk points.

Compliance Division Collections Increased Nearly \$40 Million from 2007 to 2009

At the time of the 2006 report, the Division collected \$82 million from its collection and enforcement efforts, which was a typical annual collection amount. As a result of the GenTax system and increased use of revocation and refusal-to-renew enforcement tools, collection of delinquent taxes increased to \$135 million in 2009 and is projected to reach \$150 million in 2010. Figure 2 shows the amount collected by the Compliance Division and percent change for years 2002 to present. The average yearly enforcement collections prior to the GenTax implementation for years 2002-2007 was \$88.2 million, while although only two years, the average for 2008 and 2009 equals \$130.7 million.

As a result of the GenTax system and increased use of revocation and refusal-to-renew enforcement tools, collection of delinquent taxes increased to \$135 million in 2009 and is projected to reach \$150 million in 2010.



It should be noted that the initial investment of \$22 million for the GenTax system, has at least partially contributed to the increase in collections of nearly \$40 million.

Because the Division has made several adjustments during the time period in which the increases in collections occurred, the Legislative Auditor could not identify any one as the sole reason. **It should be noted that the initial investment of \$22 million for the GenTax system, has at least partially contributed to the increase in collections of nearly \$40 million.** At this point, it is proving to be a sound investment on the part of the Legislature. The Division should continue to utilize the tools at its disposal to increase the collection of tax liability to the State.

The Department Has Promulgated Rules for Applying §11-12-5 of the West Virginia Code as Recommended.

The Legislative Auditor recommended in the May 2006 report that the Department promulgate rules for applying WVC §11-12-5. Filed on April 11, 2006 and effective May 1, 2006, Title 110 Series 12D is titled “Business Registration Certificate – Suspension, Cancellation, Refusal to Renew or Refusal to Issue for Failure to Pay Personal Property Taxes”. The scope of this rule states “This legislative rule explains and clarifies application of WVC §11-12-5, relating to the suspension, or refusal to renew, or issue, a business registration certificate.” **The Legislative Auditor finds that the Department is in compliance with this recommendation.**

The Compliance Division Has Developed a Policy for the Establishment of Payment Plans.

The final recommendation of the 2006 report stated that the Department should discontinue the practice of allowing payment plans to be established at regional offices and make all such agreements centralized. The concern regarding this activity was the lack of knowledge by the central office as to whether an agreement was in place. In some instances, the information had to be obtained from the regional offices.

In response to this recommendation, the Compliance Division attempted to limit the number of payment plans established at regional offices by developing a policy that provides guidelines for arranging these agreements. The policy outlines how to treat payment agreements based on their duration and also the amount of the liability. The four possible categories for business payment agreements are six-month payment agreements, twelve-month agreements, agreements in excess of twelve months, and agreements with liabilities in excess of \$10,000.

- Six-month payment agreements do not require a down payment and must be added to the GenTax system. Although, a formal agreement is not required if the Division has agreed not to file a lien for the liability. Instructions are then given as to which indicator to add to the system to prevent a lien from being filed.
- A twelve-month agreement requires a down payment to be remitted prior to the finalization of the plan. This payment is

In response to this recommendation, the Compliance Division attempted to limit the number of payment plans established at regional offices by developing a policy that provides guidelines for arranging these agreements.

recommended to be 25% of the balance, but the agent will have some discretion in this area. A formal agreement is to be prepared in all cases, signed by the taxpayer, and returned to the Division with the specified down payment prior to the agreement being granted.

- Payment agreements in excess of 12 months require the taxpayer to submit sufficient financial information to justify the extended terms. Also, additional forms and an income statement and balance sheet no older than three months are required. This information is then reviewed by the agent and the manager with monthly payments based on the financial documentation. The agreement stipulates that financial information is required yearly to determine if the taxpayer's ability to pay has changed. The recommended down payment is again 25% but does also allow some discretion in this area. Agreements between 12 and 48 months require review and signature of a single manager, while those exceeding 48 months must be reviewed by the Assistant Director.
- Agreements with a liability exceeding \$10,000 require a formal agreement to be prepared and a lien filed to protect the interest of the State. Even in cases where the agreement is less than six months.

All agreements for a duration exceeding six months require a lien to protect the interest of the State. The Division encourages agents to relay this information to the taxpayer in hope that it will encourage the negotiation of a payment plan of six months. The policy also outlines the terms and conditions of the payment agreement to be honored by the taxpayer and the State. In a letter to the Legislative Auditor, the Tax Commissioner stated:

We believe being able to negotiate and produce payment agreements while in the field, within the above stated guidelines, effectively facilitates the collection of delinquent taxes and allows the Tax Department to provide quality service to its customers.

All agreements for a duration exceeding six months require a lien to protect the interest of the State. The Division encourages agents to relay this information to the taxpayer in hope that it will encourage the negotiation of a payment plan of six months.

The Legislative Auditor is satisfied with the Department's resolution to the recommendation that all payment plans be centralized.

Conclusion

Since the Full Performance Evaluation issued in May 2006, the Tax Department has taken many steps to address the recommendations contained in the report. With the nearly \$40 million increase in collections, an argument can be made that the initial investment of \$22 million for the new GenTax system has already offered a significant return on investment. Also, the establishment of relevant policies and procedures and the utilization of the new tax system have provided the Department with criteria it can use to manage the state's taxpayers. It is, however, important that the Department continue to monitor and refine all aspects of the new system, policies, procedures, and measures. This will allow the Department to ensure it is best serving the State, by maximizing the collection of outstanding liabilities, and the taxpayer, by providing relevant and timely information.

With the nearly \$40 million increase in collections, an argument can be made that the initial investment of \$22 million for the new GenTax system has already offered a significant return on investment.

Recommendations

1. *The Legislative Auditor recommends that the Department continue to increase focus on enforcement as a means of collecting delinquent taxes.*
2. *The Legislative Auditor recommends the Tax Department continue to refine the risk score analysis function provided by GenTax to provide the State with a valuable tool to reduce outstanding tax liabilities.*

Appendix A: Transmittal Letter

WEST VIRGINIA LEGISLATURE *Performance Evaluation and Research Division*

Building 1, Room W-314
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0610
(304) 347-4890
(304) 347-4939 FAX



John Sylvia
Director

September 23, 2010

Craig A. Griffith, Acting Tax Commissioner
West Virginia State Tax Department
P.O. Box 11771
Charleston, West Virginia 25339-1771

Dear Commissioner Griffith:

This is to transmit a draft copy of the Performance Update of the Tax Division. This report is scheduled to be presented during the October 11-13, 2010 interim meeting of the Joint Committee on Government Operations and the Joint Committee on Government Organizations. We will inform you of the exact time and location once the information becomes available. It is expected that a representative from your agency be present at the meeting to orally respond to the report and answer any questions the committees may have.

Through correspondence with Director Oakes, the Legislative Auditor has requested additional information for inclusion in the final report regarding the top 100 currently active delinquent businesses and their risk score. The top 10, without the risk scores, are included in the body of this draft and the remainder are to be included as an appendix in the final report. An empty column is present for the pending risk scores. An updated copy of the report will be transmitted upon its completion.

If you would like to schedule an exit conference to discuss any concerns you may have with the report, please notify us between September 24, 2010 and September 29, 2010. We need your written response by noon on Friday, October 1, 2010, in order for it to be included in the final report. If your agency intends to distribute additional material to committee members at the meeting, please contact the House Government Organization staff at (304) 340-3192 by Thursday, October 7, 2010 to make arrangements.

We request that your personnel not disclose the report to anyone not affiliated with your agency. Thank you for your cooperation.

Sincerely,

Handwritten signature of John Sylvia in cursive script.
John Sylvia

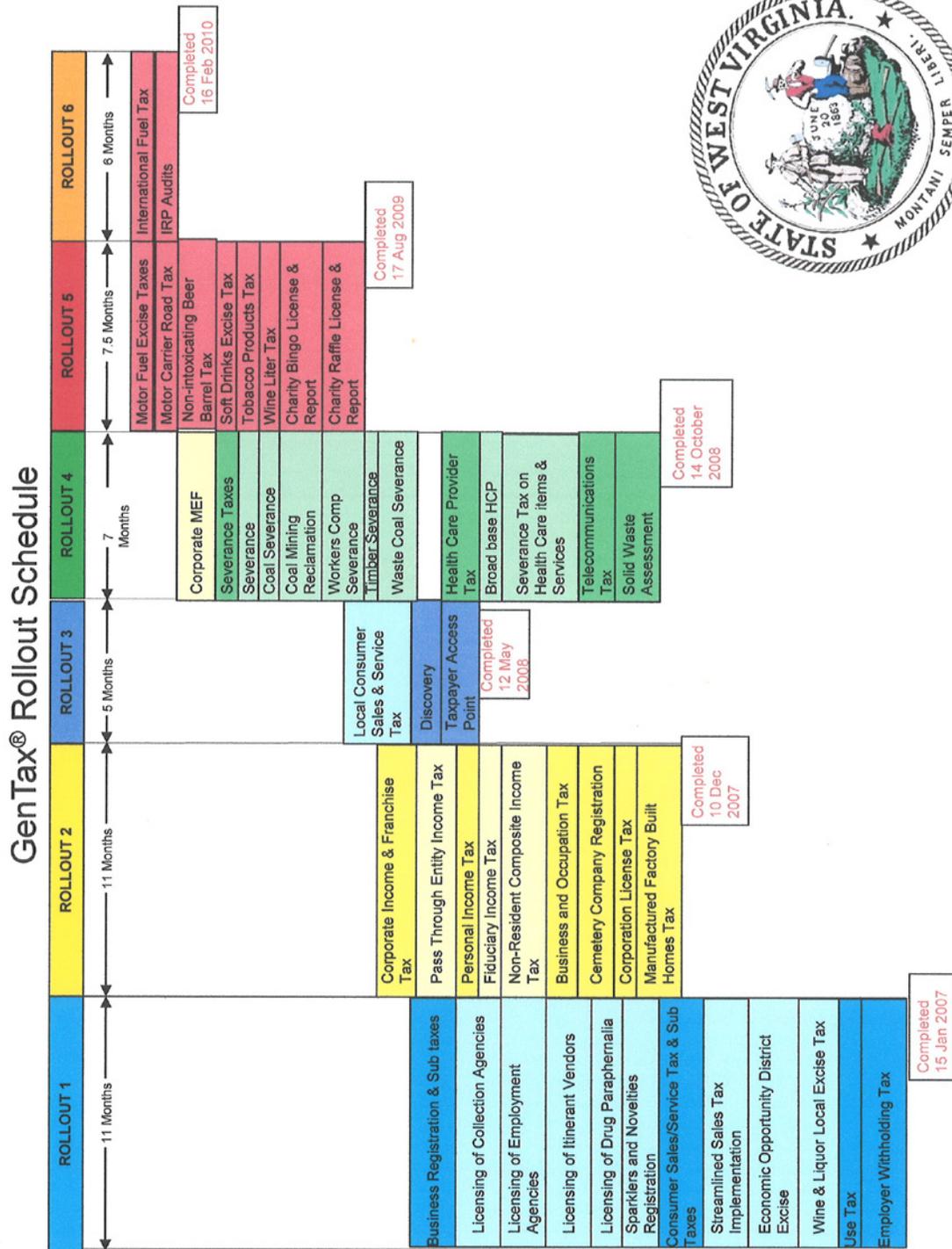
c: John Musgrave, Acting Secretary
Department of Revenue

Joint Committee on Government and Finance

Appendix B: GenTax Contract Cost Breakdown

Contract Costs	
Rollouts 1 - 5	
COTS software	\$3,000,000
Annual License/Maintenance 5 years @ \$600,000	\$3,000,000
Hardware	\$1,530,000
Implementation Services	\$13,500,000
Total	\$21,030,000
Rollout 6	
Implementation Services and Warranty Extension through February 2011	\$1,300,000
Total	\$1,300,000
Combined Costs	
Grand Total	\$22,330,000
<i>Source: Tax Department</i>	

Appendix C: GenTax Rollout Schedule



Appendix D: Top 100 Delinquent Companies Statewide (as of September 29, 2010)

	Balance	Risk Score		Balance	Risk Score
Business 1	2,984,977.79	26,750		Business 51	298,971.72 28,700
Business 2	2,408,455.86	25,750		Business 52	298,677.08 1,450
Business 3	1,234,877.50	26,300		Business 53	295,738.36 25,250
Business 4	1,161,856.56	30,550		Business 54	279,252.91 26,400
Business 5	1,063,552.15	29,050		Business 55	277,042.32 26,250
Business 6	984,663.21	0		Business 56	272,728.21 29,950
Business 7	946,364.07	1,250		Business 57	269,898.58 26,800
Business 8	874,019.53	34,500		Business 58	262,207.74 40,850
Business 9	779,206.07	26,750		Business 59	256,902.31 26,750
Business 10	766,319.44	26,650		Business 60	256,229.78 20,000
Business 11	704,555.86	0		Business 61	255,005.27 26,550
Business 12	648,545.94	26,950		Business 62	249,041.90 26,100
Business 13	644,487.83	25,050		Business 63	245,986.84 26,150
Business 14	641,734.40	26,750		Business 64	239,904.51 19,200
Business 15	604,543.71	31,900		Business 65	238,245.25 19,900
Business 16	580,948.56	25,650		Business 66	233,970.49 19,350
Business 17	578,939.89	0		Business 67	232,882.46 20,050
Business 18	534,591.42	26,300		Business 68	231,896.80 18,600
Business 19	532,604.53	25,750		Business 69	228,946.03 0
Business 20	532,568.98	0		Business 70	227,077.08 1,800
Business 21	516,787.93	26,900		Business 71	226,303.37 23,150
Business 22	490,383.70	26,550		Business 72	226,026.09 19,600
Business 23	482,311.92	29,350		Business 73	222,329.80 19,550
Business 24	474,925.05	26,750		Business 74	221,656.19 21,650
Business 25	472,949.08	750		Business 75	220,470.48 32,100
Business 26	460,403.32	0		Business 76	219,851.27 20,600
Business 27	415,838.41	26,900		Business 77	214,530.88 0
Business 28	414,039.57	27,850		Business 78	214,399.47 20,650
Business 29	400,089.63	0		Business 79	212,620.76 0
Business 30	398,903.82	27,250		Business 80	210,081.94 19,050
Business 31	384,854.17	27,100		Business 81	208,558.12 19,800
Business 32	376,920.99	27,200		Business 82	208,376.83 18,500
Business 33	376,912.84	0		Business 83	206,584.21 20,550
Business 34	372,825.84	30,900		Business 84	203,846.52 22,200
Business 35	364,258.24	40,500		Business 85	202,423.44 20,150
Business 36	353,431.64	25,700		Business 86	202,163.65 19,450
Business 37	336,090.20	26,400		Business 87	202,016.36 0
Business 38	326,822.58	28,500		Business 88	201,004.53 18,800
Business 39	326,314.98	31,750		Business 89	195,761.22 18,650
Business 40	323,476.46	28,150		Business 90	195,553.36 18,700
Business 41	319,075.05	0		Business 91	193,584.92 18,050
Business 42	318,648.90	28,600		Business 92	192,285.62 18,600
Business 43	317,998.81	0		Business 93	190,957.39 21,150
Business 44	311,178.02	25,500		Business 94	189,604.54 50
Business 45	308,274.87	26,550		Business 95	184,471.46 21,300
Business 46	307,816.86	0		Business 96	171,384.89 19,500
Business 47	306,378.64	26,550		Business 97	170,964.49 19,600
Business 48	304,017.00	27,750		Business 98	165,619.82 29,200
Business 49	300,050.33	3,050		Business 99	164,593.89 19,100
Business 50	299,961.97	26,800		Business 100	164,240.93 0

Appendix E: Agency Response



Joe Manchin III
Governor

STATE OF WEST VIRGINIA
Department of Revenue
State Tax Department

Craig A. Griffith
State Tax Commissioner

September 29, 2010

John Sylvia, Director
Performance Evaluation and Research Division
Joint Committee on Government and Finance
Building 1, Room W-314
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0610

Dear Mr. Sylvia:

Thank you for providing me with a draft copy of the Performance Update (the "Update") of the Tax Division ("Tax"). In your cover letter you requested additional information for inclusion in the Legislative Auditor's final report regarding the top 100 currently active delinquent businesses and their corresponding risk scores. Enclosed you will find a list of the affected businesses so that you may finalize the Update. I have also enclosed the supplemental response that we discussed in our exit conference.

I am very pleased that the Legislative Auditor has recognized the great strides that Tax has made in our compliance and collection areas since the last Full Performance Evaluation in 2006 and in light of the recently completed installation of the GenTax integrated tax system. The Legislature's foresight in providing the initial investment in this system has given Tax the tools necessary to implement the recommendations contained in the 2006 report as well as increased the agency's ability to carry out its statutory mission in an effective, efficient, and equitable manner.

I would like to assure the Legislative Auditor and the Joint Standing Committee on Government Organization ("Joint Committee") that Tax will continue to focus on enforcement as a means of collecting taxes and will move forward with the refinement of the "risk score analysis" function used in GenTax.

I look forward to appearing before the Joint Committee during its October interim meeting to answer any questions that they may have.

TAX COMMISSIONER'S OFFICE
1001 LEE STREET, EAST, P.O. BOX 11771, CHARLESTON, WV 25339-1771
TELEPHONE (304) 558-0751
FAX (304) 558-8999

If you have any questions or require additional information, please do not hesitate to contact me.

Very truly yours,

A handwritten signature in blue ink, appearing to read "CAG", with a small flourish to the right.

Craig A. Griffith, Esq.
State Tax Commissioner

CAG/sgr
Enclosure

cc: John Musgrave, Acting Cabinet Secretary
Jason C. Pizatella, Deputy State Tax Commissioner



WEST VIRGINIA LEGISLATIVE AUDITOR

PERFORMANCE EVALUATION & RESEARCH DIVISION

Building 1, Room W-314, State Capitol Complex, Charleston, West Virginia 25305

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