

REPORT HIGHLIGHTS
 PERFORMANCE AUDIT

Subject

The Collections Division collects taxes from those who have not paid after receiving written request for payment. In fiscal year 2004, the Division collected approximately \$242 million.

Our Conclusions

The Division should improve its matching program for identifying debtor wages and develop similar matching programs with banks and the State Lottery.

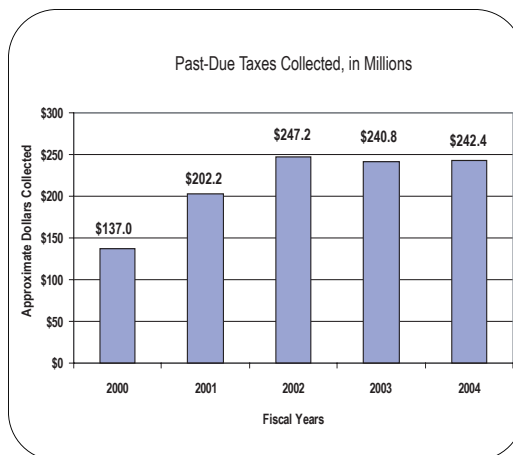
- ◆ The Division should also periodically evaluate its debtor profiling for effectiveness, and identify and review cases prior to their statute of limitations.
- ◆ The Division should ask for greater authority to accept credit cards as well as to mandate payment plans using automatic withdrawals.



2005

Expanding Matching Programs Could Improve Collections

The Collections Division helps ensure that the State receives the tax monies owed to it. During fiscal years 2000 to 2004, the Division's annual collections and staff increased by approximately 80 percent. Additionally, the average collected in fiscal year 2004, approximately \$1.4 million per collector FTE, was virtually the same as it was in fiscal year 2000.



Enforcement actions—The Division contacts taxpayers by phone, mail, or in person to arrange for payment of the taxes they owe. If a resolution cannot be reached, collectors can levy or seize wages, bank accounts, and tax refunds. They may also seize real and personal property or put liens on real property.

An important step in taking enforcement actions is identifying the taxpayer's assets. The Division makes use of automated matching and levy programs to locate and seize the assets. These programs involve a computerized comparison of delinquent taxpayers'



accounts to employment and other computerized records.

Expand wage matching and levy—In 1997, the Division began a matching program in cooperation with the Department of Economic Security (DES). As part of the unemployment insurance program, DES receives employment information from all Arizona employers. The Division matches its list of delinquent taxpayers against this information to identify the taxpayers' employers. The Division's computer then automatically generates a wage levy on the taxpayers' wages.

However, the wage matching program can be expanded and improved in at least three ways:

1. **Match against more accounts**—In one June 2005 weekly match attempt, the Division excluded about 12,000 out of the 84,000 delinquent accounts from matching because they contained confidential federal tax information. However, according to the Internal Revenue Service (IRS), the Division can take actions to change the status of the information from federal to state so that more of these accounts can be used in matching.
2. **Match against a second database**—DES has another employment database that is used for child support enforcement. This

database is more current than the unemployment insurance database, but the Division will need statutory authority to match against it.

- 3. Send cases to the next enforcement step more quickly**—An account is currently kept in the automated wage matching program, without benefit of an active collector, for a 60-day period. This allows for multiple attempts to locate debtor wages. However, in many cases it would be difficult for new matches to be made after the first attempt. This suggests cases should be sent more quickly to the next step, such as identifying and levying bank accounts.

Develop additional automated bank matching—The Division currently sends, on a case-by-case basis, the names of specific delinquent taxpayers to Arizona banks. The banks must then check their records to see if each taxpayer is an account holder. This is a time-consuming, costly process for both the Division and the banks. A better process would be an automated match with the banks. However, this would require additional legislative authority. The banks already perform an automated match with DES' child support enforcement program.

The Department's new computer system will also help in bank matching. This new system is being implemented as a part of the Business Reengineering/Integrated Tax System (BRITS) project, which involves the Department working with a private contractor, Accenture, to reengineer its core business processes and organizational structure. The new computer system will be able to capture information about where taxpayers have bank accounts from information that it

receives when a taxpayer pays by check or electronically. This information could then be used for automated bank levies of delinquent taxes.

Intercepting federal refunds—The Division participates in the federal refund off-set program. The Division can intercept a federal refund for delinquent taxes. This program is a little more complicated in that the Division must give 60 days' notice to allow the taxpayer time to make payment arrangements before the refund is used to pay the delinquent state tax.

Since the federal refund off-set program's inception in fiscal year 2003, the Division has collected more than \$5 million from this program.

Matching state vendors—From 1996 to 2000, the Division instituted a program to identify state vendors who owed taxes in order to intercept payments the State made to vendors to satisfy their tax debt. The program was inefficient because the vendor list included vendors who no longer contracted with the State. However, the Division has restarted this program using a list containing only current vendors. The Division should monitor results for a year to determine if the program should continue.

Intercepting lottery winnings—The Division also has an opportunity to conduct a matching program with the State Lottery. Using this match, the Division could levy lottery winnings before they are paid.

Recommendations

The Division should:

- Improve the automated wage match and levy by including more accounts, matching against another database, and sending cases to the next enforcement step more quickly.
- Request statutory authority to establish an automated financial institution data match and levy.
- Monitor results of the state vendor match program within 1 year.
- Establish a matching program with the State Lottery.

Division Can Improve Automated Collection Tools

The Division is taking a number of steps to modernize its collection practices, including developing debtor profiling.

Debtor profiling—Debtor profiling considers factors that indicate the likelihood that a debtor will pay the debt, such as payment history, current balance, and credit score.

Debtor profiling is used to direct stronger collection efforts toward those taxpayers who avoid payments. For example, a taxpayer who the Division determines is likely to pay would be sent an automated letter requesting payment. A taxpayer less likely to pay may be referred to a collector.

The Division worked with a private credit scoring firm to develop risk profiles. Profiling became fully operational for individual tax returns in November 2003 and for transaction privilege (i.e., sales tax) and withholding tax accounts in October 2004. Corporate tax accounts should follow in July 2006.

The Division should periodically evaluate automated profiling's effectiveness and revise it as necessary. The profiling does not consider the age of the tax debt, which may be important because it can become more difficult to collect as the debt becomes older.

Assigning cases more quickly—In January 2003, the Division expanded efforts to more quickly begin collections. Previously, taxpayers were sent several letters before they were referred for collection. Now, a new account under \$200 is sent one bill and final notice before the account is sent to collection.

Reviewing cases prior to statute of limitations expiration—The Division also needs to review cases in plenty of time before the statute of limitations expires. The Division has 6 years to collect a tax debt. The Office Collections section reviews old corporate and individual income tax cases just 90 days before the limitation period, while the Field Collections section is making the review 12 months before the expiration. Further, the Division is not reviewing old sales tax and withholding tax cases prior to their expiration.

Developing automated controls—The Division should ensure that the new computer system, which it is currently developing as a part of BRITS, has the necessary automated controls. The Division's old computer system has many automated controls to help ensure collectors follow policies when issuing liens, levies, and payment plans. For example, it automatically routes those cases requiring supervisory review. However, the new system does not yet have all of these automated controls.

Recommendations

The Division should:

- Regularly review and evaluate debtor profiling and revise as necessary.
- Ensure all tax types are reviewed, and in sufficient time, before the statute of limitations expires.
- Ensure the new computer system includes all needed automated controls.

Division Should Try To Provide More Options To Pay Tax Debts

The Division can take several steps to make it easier for taxpayers to pay their delinquent taxes.



Increase use of credit cards—The Division is developing the ability to accept credit cards for tax payments. Although the Legislature, in 2000 and 2001, authorized state agencies to accept credit cards, the Department of

Revenue is statutorily prohibited from paying any fees charged by credit card companies. Further, the use of credit cards was limited to only Web-based transactions. The Department has since identified banks that are willing to process the credit card transactions and charge the fees to the card holder. Now, it needs authority to accept credit cards over the counter and on mail-in forms.

Use automatic withdrawal—Although statute requires the Department to accept electronic funds transfers (EFT) for certain

businesses paying transaction privilege and withholding taxes, the Division does not have authority to mandate EFTs for tax debts. The IRS and other states use EFT to pay tax debts because it:

- Significantly reduces default rates on payment plans—California's default rate on personal income tax payment plans went from 40 percent to just 3 percent by requiring EFT. Arizona's default rate for individual and corporate income tax accounts is over 26 percent.
- Reduces the cost of mailing bills and processing checks.

Allow taxpayers to establish their own plans—The Division should also consider permitting low-risk taxpayers to set up their own payment plans through an automated telephone or Web-based system. A Virginia official reports that Virginia's system handles about 300 calls per day, and since inception the system has been used to set up over 47,000 plans totaling over \$50 million. Without this system, staff would have handled all these calls.

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A copy of the full report can be obtained by calling
(602) 553-0333



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Contact person for this report:
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Recommendations

The Division should:

- Seek statutory authority to accept credit card payments for any type of transaction.
- Consider seeking statutory authority to accept EFT for payment plans.
- Consider developing a telephone or Web-based system for low-risk taxpayers to set up their own payment plans.