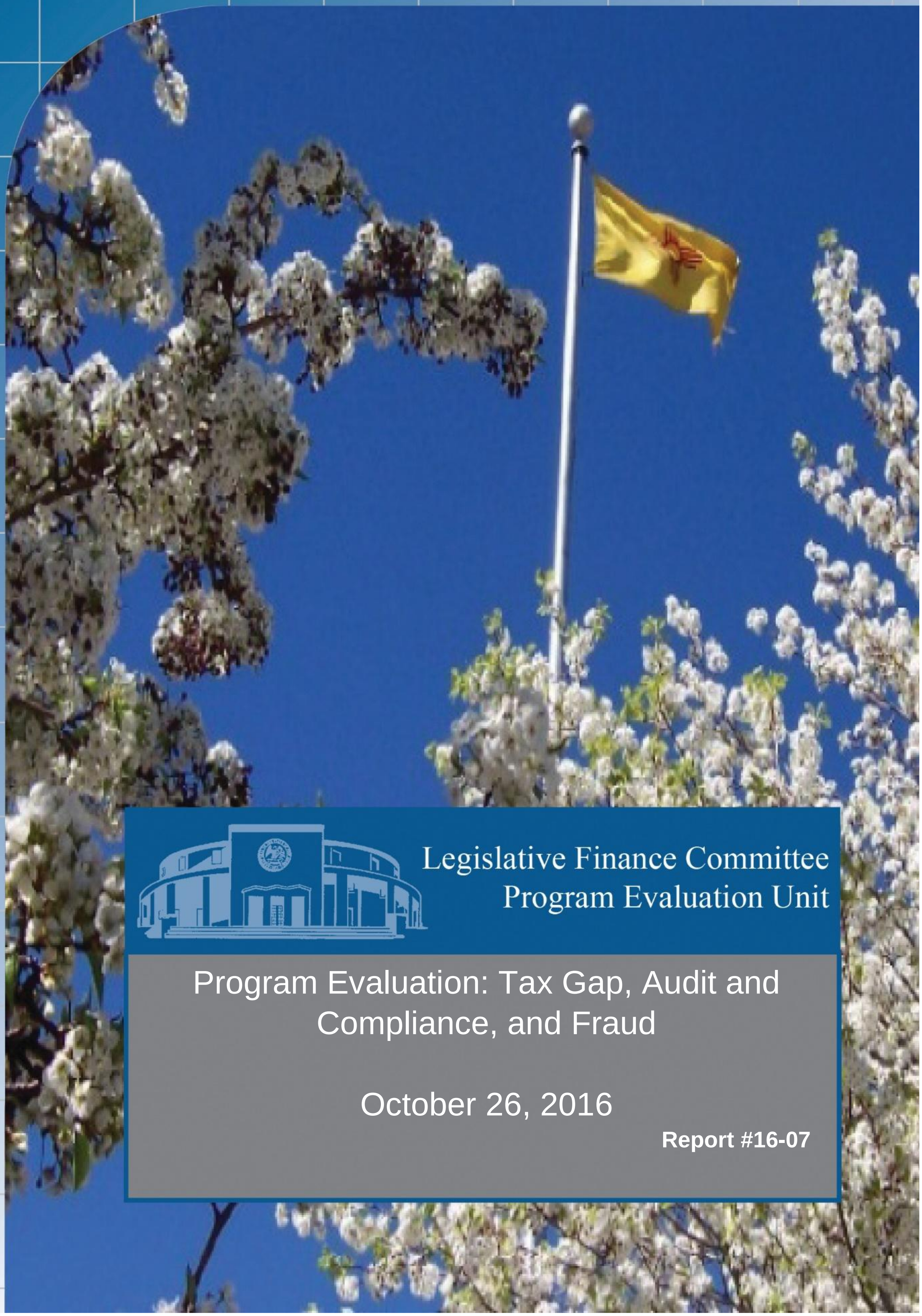

Legislative Finance Committee
Program Evaluation Unit

Program Evaluation: Tax Gap, Audit and Compliance, and Fraud

October 26, 2016

Report #16-07

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Taxation and Revenue Department Has Advanced Delinquent Tax Collection but the State Can Do More to Shrink the Tax Gap

Unanticipated general fund revenue declines, resulting mainly from the plunge in oil prices, created budget shortfalls totaling $1 billion over fiscal year 2016 (FY16) and FY17.

The tax gap is generally defined as money legitimately owed to the state but not paid. Taxation and Revenue Department (TRD) is tasked with retrieving those tax dollars through the agency's Audit and Compliance Division (ACD) and Tax Fraud Investigations Division (TFID).

However, looking at the tax gap in the broadest view introduces tax policy areas where revenue leakages occur that are not directly under TRD's control. These options cover what could be collected under statutory changes. For example, the state forgoes hundreds of millions of dollars annually to targeted exemptions, credits, and refunds. While these policies intend to promote economic development and other goals, unintended consequences can occur due to poor policy design. The Legislature recently closed loopholes for two of the more costly tax credits.

By themselves, tax credits cost the state $1.3 billion in FY16.

This evaluation assessed the effectiveness and efficiency of TRD efforts to reduce the tax gap. Moreover, it overviews tax policy areas potentially contributing to lost revenues in a broader view of the tax gap.

A TRD 2013 tax gap analysis estimated the gap just under $600 million but the methodology, based on outside sources, boosts uncertainty in the absence of state-specific information. Furthermore, the projected $174 million that could be collected was overestimated and is likely nearer $70 million. Finally, the methodology minimizes or excludes other contributors to the tax gap, such as the cash economy and policy issues dealing with gross receipts tax on internet and catalog sales.

TRD has not performed a state-based tax gap analysis, a basic requirement to gauge dollars lost in the gap and monitor effectiveness of targeting taxpayer segments to improve compliance.

The Legislature appropriated $15 million from 2003 through 2009 in an aggressive effort to bolster ACD and TFID programs but more recent economic declines forced scaling funding back. Nevertheless, ACD collected $1 billion over the last five years. Despite progress, a 36 percent increase in yearend delinquent accounts indicates a slowdown in collection effectiveness. ACD could benefit most from an overhaul of its call center, where over half of delinquent collections take place.

This evaluation recommends the Revenue Stabilization & Tax Policy interim committee consider assessing complex tax gap dynamics and make recommendations on pursuing tax gap dollars. The Legislature should also consider reversing budget cuts to high return-on-investment divisions and implementing rigorous sunset reviews and periodic evaluations of tax policies. TRD should complete a state-based tax gap analysis, reassess staffing allocations, and adopt new compliance tools with legislative authorization.

From 2003, ACD increased collections going to the general fund by 200 percent.

KEY FINDINGS AND RECOMMENDATIONS

New Mexico is not deploying all tools to address the tax gap and collect additional revenues.

The Taxation and Revenue Department (TRD) has not performed a New Mexico tax gap analysis based on state-specific data and modeling. Using external sources for key assumptions, a 2013 TRD tax gap analysis estimated New Mexico's gross tax gap at $572 million. Applying the methodology to fiscal year 2016 (FY16) revenues produces a slightly higher gross tax gap of $635 million, of which about $70 million could be collected, or $52 million general fund.

However, this methodology likely understates the size of the state's gross tax gap and loss of potential revenues as it excludes various taxes. Furthermore, other states have taken aggressive actions on slowing revenue leakages due to internet commerce, the cash economy, and modern methods of skimming to underpay sales or gross receipts tax. So far New Mexico has not advanced on these fronts, offering options for the Legislature to pursue.

Tax expenditure design weaknesses impact state revenues much more than expected.

Various tax expenditures lack a well-defined purpose and eligibility criteria, clear outcome measurements, or timelines for review. Issues with tax policies have had a significant financial impact on the state's general fund via forgone revenue, and in some cases, as revenue paid for credits refunded to taxpayers. For this evaluation, LFC staff identified four tax policies currently in effect to show where potential policy weaknesses exist: the high-wage jobs tax credit, the healthcare practitioner deduction from gross receipts tax, the film production tax credit, and the corporate income tax rate reduction along with the single sales factor apportionment.

The evaluation found most of the selected tax expenditures could be strengthened in statute, and the Legislature closed loopholes for the two most costly credits during this last special session. There is also opportunity to increase the state's vetting and evaluation processes around tax expenditures to heighten clarity, accountability, and cost.

The Audit and Compliance Division collected $1 billion over the last five years but growing challenges threaten revenues.

The Legislature launched the latest large-scale effort to collect more delinquent taxes in 2003, expanding programs within TRD through 2009. Since the Great Recession, however, ACD has seen an ebb and flow in its operating budget and staff positions, beginning FY17 $3 million and 72 staff positions lower than its FY10 peak. Senate Bill 9 passed during the special session cuts an additional 5.5 percent in TRD's general fund appropriation as a solvency measure. As a consequent, ACD management trimmed expectations for this year's assessments by $70 million.

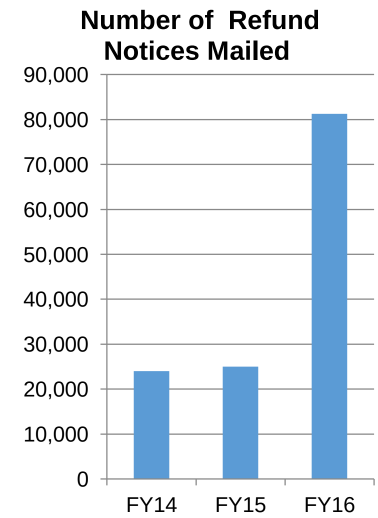
From inception of the initiative, ACD increased collections going to the general fund by 200 percent. The agency met or exceeded most targets associated with the initiative. Despite progress, a 36 percent increase in delinquent accounts since FY12 indicates a slowdown in collection effectiveness. Taxes owed but not paid have drifted up from $539 million in FY12 to over $730 million by the end of FY16. Primarily, collections have not kept pace with new assessments due to high budgeted vacancy rates and a tax code change that lengthened the period before a revenue agent can begin processing delinquent accounts by 60 days.

The call center's collection efforts have been hampered by both internal and imposed inefficiencies, including staffing issues, lack of expert management, ineffective business practices, and antiquated or nonoperational technology.

Developing a data warehouse increased assessments by 351 percent but has not been matched by an equal advancement in collections. Data warehousing has revolutionized the way taxing authorities track down missing tax dollars. By amassing data from many sources into one repository, TRD can compare data elements to identify discrepancies that might point to unintentional misreporting or actual tax fraud.

Data warehouse technology has driven huge efficiency gains but some weaknesses weigh against attaining full benefit.

Effectiveness of the data warehouse to produce quality leads cannot be determined with limited data. Additionally, TRD management presumes the data warehouse process adequately replaces all the traditional audit planning and performance tools. Thus, traditional tax gap, compliance rates, and audit coverage analyses are not performed.



Source: TRD

The process for detecting potential fraudulent 2015 personal income tax returns was hampered by a reactive approach to data breaches and a management decision to forgo an important control point to validate the data warehouse leads so the backlog could be reduced. Consequently, the process flagged over 80 thousand returns, an increase of over 200 percent from the prior year. The department now acknowledges data breaches today are not likely to produce tax fraud by the next day and is revamping the 2017 tax season process.

TRD could do more to bring in revenues but some options require legislation. Effective tax collection requires a broad array of strategies and tools to assess and recover monies due to the state. Additionally, enforcement actions targeting tax fraud with criminal intent can act as an effective deterrent to illegal activity.

The department deploys most of the effective strategies for collecting delinquent debt but not all.

The primary strategy is to treat taxpayers fairly, providing due process that includes proper notices and dispute opportunities, which the agency does through its various statutory and procedural mandates. Of the 10 additional collection tools states use most often and are considered best practices, TRD employs seven.

Yet there are other effective tools TRD does not employ, such as internet posting of debtors. Additional authority to expand assets available for lien and levy processing – such as lottery winnings and unclaimed property – would allow taxpayers pay obligations without having to generate new cash. These options would require statutory authority.

Emerging best practices in debt management would require investing in up-to-date call systems to enable automation. For instance, while TRD provides online payments, extending this self-service capability to touch-tone phone would free up staff time while increasing collections.

The Tax Fraud Investigations Division (TFID) performance has been impacted by a focus on nontax issues and vacancies. Depressed outcomes for FY12 and FY14 are linked to a management directive to focus investigative resources on the Foreign National Licenses Program, which was a nontax initiative. While some states are expanding their investigative units to address the cash economy, New Mexico's has been shrinking. Almost 65 percent of pending cases logged for FY16 have not been assigned due to lack of resources.

Key Recommendations

The Legislature should consider:

Creating a non-partisan task force led by the Revenue Stabilization & Tax Policy interim committee to review the complex tax gap issues and make recommendations to the full Legislature for action;

Monitoring other state and NCSL efforts to solve the nexus issue regarding taxing online sales and consider legislation appropriate to New Mexico, while repealing Section 7-8-7.1 NMSA 1978, which bans TRD from collecting compensating tax from individuals for online and catalog sales;

Enacting legislation to accomplish the following:

- Outlaw sale of tax zapping mechanisms;
- Create a broad sunset review process for tax expenditures, with specific review cycles covering all tax policies;
- Require newly proposed tax expenditures be vetted through interim committees including the Revenue Stabilization and Tax Policy Committee and the Legislative Finance Committee where fiscal, legal, and general policy parameters can be reviewed and a recommendation developed;
- Reverse budget cuts to ACD programs with high return-on-investment results;
- Authorize internet posting of tax defrauder, additional license holds, and offsets for gambling, lottery winnings, and reclaimed property; and
- Prioritize resources in the Tax Fraud Investigation Division to address the underground economy based upon any interim committee recommendations having nonpartisan and business community support.

The Legislative Finance Committee should consider adopting:

A fiscal impact report form and process specific to tax expenditure bills, identifying if proposed legislation meets detailed criteria.

The Taxation and Revenue Department should:

Enlist University of New Mexico's Bureau of Business and Economic Research or New Mexico State University's Arrowhead Center in developing a broad-ranged, state-based tax gap analysis that also characterizes the state's cash economy;

Use the analyses to inform the Legislature on the most promising avenues to reclaim lost revenues by quantifying the costs and benefits;

Reassess resource allocation and redirect staffing to the audit and collection efforts with proven high rates of return;

Improve collections by filling vacancies, modernizing the call center, leveraging data warehouse capacity to aid collections, and requesting authorization to adopt additional collection tools; and

Fill Tax Fraud Investigation Division vacancies and pursue backlog of potential fraud cases.

BACKGROUND

General Fund Revenue Declines Created Budget Shortfalls Totaling over $1 billion

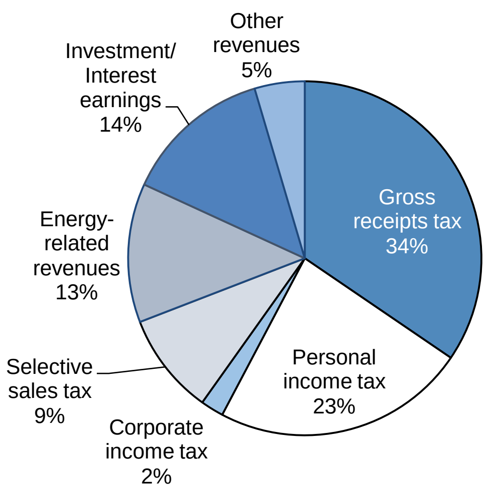
Changing economic conditions that were largely related to energy production and markets prompted New Mexico's Consensus Revenue Estimating Group (CREG), staffed by both legislative and executive economists, to revise forecasts downward twice during the last fiscal year. Ending fiscal year 2016 (FY16) recurring revenues of $5,672 million saw declines in almost every major tax category. Only selective sales taxes and investment earnings showed gains. While anticipating slight revenue improvement for FY17, the CREG outlook projects a budget deficit of about $460 million for the current fiscal year.

Table 1. Percent Change in General Fund Revenues FY15-FY16

Tax Program	% Change
Gross Receipts Tax	-6.6%
Net Personal Income Tax	-1.6%
Net Corporate Tax	-52.8%
Total Mineral Production Taxes	-35.4%
Total Rents & Royalties	-24.1%
Total Selective Sales Taxes	7.9%
Total Investment Earnings	9.6%
Total Recurring General Fund	-8.7%

Source: Fiscal Year 2016 General Fund Monthly Tracking, August 2016

Chart 1. Fiscal Year 2016 Revenue by Type
Amount: $5,672 million



Source: Fiscal Year 2016 General Fund Monthly Tracking, August 2016

The New Mexico Constitution requires the state maintain a balanced budget. The Legislature passed bills during the recent special session to achieve solvency by tapping reserves or other funds and reducing agency appropriations.

Table 2. Projected Budget Shortfalls
(in millions)

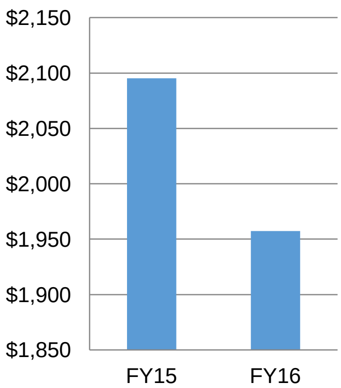
	FY16	FY17
Appropriations	$6,307.1	$6,229.6
Revenue*	$5,690.6	$5,770.4
Shortfall	($616.5)	($459.2)

*Includes nonrecurring revenue
Source: General Fund Financial Summary, August 2016

The Taxation and Revenue Department (TRD) administers most, but not all, revenue generating programs for New Mexico. The main objective of this evaluation was to assess the effectiveness of the department to help offset revenue declines by collecting taxes owed but not paid. Known as the "tax gap," accurately assessing taxes due and collecting on this debt offers a possible alternative to reducing budget deficits without the negative consequences associated with other measures. This evaluation focused on compliance with gross receipts tax (GRT) and income taxes as they account for the majority of state revenues.

The evaluation also covers key policy areas in an expanded view of lost revenues beyond current TRD operations.

Chart 2. GRT Revenue Comparison*



*FY 16 preliminary and unaudited
Source: Fiscal Year 2016 General Fund Monthly Tracking, August 2016

Gross receipts taxes account for a third of the state's general fund revenues

New Mexico taxes the privilege of doing business in the state, applying a gross receipts tax (GRT) on the total amount of money or other considerations (such as barter) a business receives for transactions occurring in the state. Unlike a sales tax, the tax liability belongs to the business rather than the consumer. However, in practice businesses usually pass along the cost to their customers. As compiled in Sections 7-9-1 through 7-9-115 NMSA 1978, the law presumes all transactions are taxable unless specifically exempted or reduced by statute.

Five types of transactions conducted in New Mexico are subject to GRT:

1. Sale of property;
2. Leasing or licensing property;
3. Granting a right to use a franchise;
4. Performance of services; and
5. Performance of services outside New Mexico when initial use of the product of research and development is intended to occur within the state.

A transaction may qualify for a deduction per statute and is not taxable but is reportable to TRD. The organization must register and provide proof of deductions taken either by a nontaxable transaction certificate (NTTC) or other evidence approved by the Secretary. Exempt receipts are not only nontaxable, they are free from reporting. If all receipts are exempt, the organization is not required to register with the department unless it applies for a NTTC or must register or report for some other tax program, such as employee withholding.

GRT rates vary according to location, ranging from the state's 5.125 percent base rate up to a combined rate of 8.9375 percent with optional local taxes stacked on top. State, county, or municipal levies may also be included. Businesses remit their GRT on the combined reporting system (CRS-1) to TRD and the agency distributes the counties' and municipalities' portions to them.

Table 3. FY16 Estimated Personal Income Tax (PIT)*
(in millions)

Tax Program	Amount	Percent
Withholding	$1,192.1	70%
Final Settlements	$426.0	20%
Oil & Gas Withholding	$81.0	4.7%
Fiduciary	$7.0	0.4%
Total Gross PIT	$1,706.2	100%
Less: Refunds, distributions	($388.6)	
Net PIT	$1,317.6	
*June revenues are estimated		

Source: Fiscal Year 2016 General Fund Monthly Tracking, August 2016

Most personal income tax is collected through employer withholding

New Mexico residents, those residing in New Mexico at least 185 days (part-time residents), and nonresidents who work in the state or obtain income from property here must submit tax forms and payment to TRD by the federal due date or apply for an extension. Calculations for personal income tax (PIT) begin with the federal return and are adjusted up or down to accommodate state-specific rules. PIT rates range from 1.7 percent to 4.9 percent based on four income brackets. Filing status and exemption eligibility determine the final tax liability.

With a few exceptions, employers must withhold a portion of employees' wages for income taxes, which are subsequently credited against the employee's actual tax liability submitted on the PIT return. Remitters of oil and gas proceeds derived from New Mexico properties are also required to withhold taxes as well as pass-through entities for income of its owners, members, partners, and beneficiaries. Consequently, compliance rates for these income streams tend to be higher than for those with no withholding requirements or other third party reporting.

Section 6402(e) of the U.S. Tax Code allows TRD to participate in the Treasury offset program between the state and the Internal Revenue Service for taxes owed to either entity. Additionally, TRD collects debts for any outstanding liabilities due the department and transfers money to cover unpaid debt to several other programs from PIT overpayments prior to making a refund to the taxpayer:

- Past due child support
- Educational assistance loans
- Unemployment compensation
- Medical support
- Public assistance or supplemental nutrition assistance program overpayments
- Fines
- Worker's compensation fees
- Fees or costs owed to district, municipal, magistrate, or metro-politan courts
- Setoff of film loans against film production tax credit.

The IRS reported a 94 percent e-filing rate for the 2016 tax season.

Unless 100 percent e-filing rate is achieved, the resources, facilities, and legacy systems for paper processing will need to remain in place-reducing the savings.

Source: McKinsey & Company

Electronically filing tax returns is considered an industry best practice and most tax return preparers must e-file IRS returns. To achieve improved accuracy and efficiency, TRD encourages taxpayers to file their returns electronically using the online Taxpayer Access Point (TAP) or third party software. Over the last three years, voluntary compliance for e-filing personal income taxes hit a high of 92 percent for the 2014 tax year but has slipped slightly to 87 percent for 2015. TRD mandated e-filing for CRS submissions over $20,000 in 2010 and further refined its e-filing requirement to monthly submissions over $1,000.

The TRD performance measure tracking e-filing versus paper filing combines PIT and CRS returns into one metric that indicates 72 percent more returns are filed electronically than eight years ago but has likely leveled off to around 90 percent, which is the agency's performance goal.

Table 4. PIT & CRS Paper versus Electronic Filing

PIT & CRS	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16
Paper	48.9%	45.5%	36.7%	17.9%	15.0%	10.0%	8.0%	11.9%
E-filed	51.1%	54.5%	63.3%	82.1%	85%	90%	92%	88.1%

Source: TRD

The tax gap reduces funds available to support governmental functions

The "tax gap" refers to the amount of tax liability imposed by existing law that is not paid voluntarily and timely. In addition to reducing revenue to fund government services, taxpayer noncompliance places a burden on those who pay accurately and erodes public confidence in the voluntary tax system.

"This is an alarming problem, affecting every state. It is, literally, systematic burglary of the taxpayer's money."

Source: Maryland Comptroller Peter Franchot

The Internal Revenue Service (IRS) estimates the national tax gap has ranged from 16 to 20 percent over the last 35 years. Its 2006 tax gap study, pointing to $450 billion in sidelined revenue, reignited state interest in defining and estimating the amount of these errant tax monies as states struggled with declining revenues nipped by the subsequent recession.

"Honest taxpayers pay nearly 20 percent more in taxes due to tax cheating."

Source: www.usgovinfo

In its April 2016 tax gap update, the IRS reiterated the challenges associated with estimating the tax gap using differing methodologies, *"The tax gap provides a rough gauge of the level of overall noncompliance and voluntary compliance…"*

Source: Tax Gap Estimates 2008-2010, IRS, April 2016

assumptions, and data sources. Additionally, the report notes other factors complicate the assessment over time, such as underlying economic conditions, changes in tax laws, changes in underlying behavior on the part of taxpayers and preparers, and shifts in the composition of economic activity toward those with differing compliance rates. In particular, the analysis notes the 2007-2009 recession and weak recovery that followed introduced enough uncertainty to conclude the gross tax gap compliance rate of 81.7 percent remains basically unchanged from the prior 2006 compliance estimate of 83.1 percent.

Main contributors to the tax gap include non-filing, underreporting, and underpayment. Underreporting, or not reporting the full amount of the tax liability on a timely filed return, remains the top contributor to the federal tax gap.

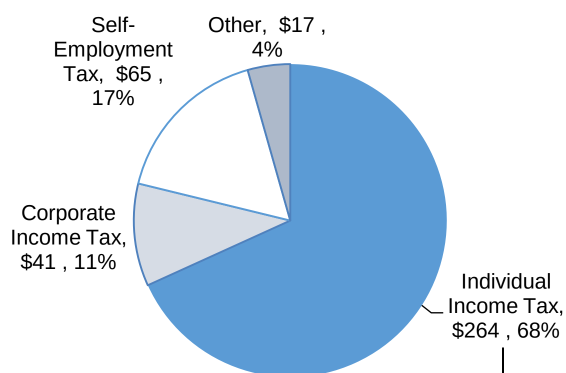
Figure 1. 2008-2010 IRS Tax Gap Estimates
(in billions)

Non-filing $32 + **Underreporting** $387 + **Under-Payment** $39 = **Gross Tax Gap** $458

Source: Internal Revenue Service (IRS)

This newer study aligns with prior tax gap analyses that have found most of the revenue gap arises from underreporting of nonwage income. In fact, over 40 percent of the total federal tax gap is attributed to underreported business income and self-employment tax, or $190 billion. Overstating deductions and credits accounted for 22 percent of the individual income tax underreporting.

Chart 3. Federal Underreporting Tax Gap - $387 Billion
(dollars in billions)



Breakdown of Individual Income Tax Gap

Business income	$125	47%
Non-business income	$64	24%
Credits	$40	15%
Income offsets	$19	7%
Other	$18	7%

Source: IRS

Definitions

Gross tax gap: Taxes owed under current law but not paid.

Compliance efforts: Efforts initiated to improve compliance and retrieve delinquent taxes.

Net tax gap: Amount remaining after deducting recovered monies due to current compliance efforts.

Voluntary Compliance Rate (VCR): ratio of taxes received according to tax code to estimated tax liability (associated with gross tax gap).

Net Compliance Rate: ratio of all taxes received (after compliance actions) to estimated tax liability.

Only a small portion of the federal tax gap dollars will be collected. After anticipated enforcement actions and other late payments of $52 billion, or 11 percent of the total dollar gap value, the federal net tax gap falls to $406 billion. Accordingly, the estimated net compliance rate rose to 84 percent.

States' tax structures require additional analysis. State tax structures stretch beyond income taxes to include various other revenue streams. Sales taxes (or gross receipts tax) often contribute a significant portion to state coffers and must be considered in any state tax gap analysis where utilized. Other adjustments accommodate differing tax applications and nuances of tax code to generate reasonable assumptions underlying estimated tax liabilities. Finally, data sources also impact the reliability of such estimates. In particular, most intentional noncompliance remains hidden from view unless uncovered through indirect state enforcement efforts such as using data analytics or more direct methods such as sting operations.

"States more and more are relying on data analytics, data metrics. At least half and perhaps more have built data warehouses where they can collect data from all sorts of different places…so they can make inquiries against this data to find areas of noncompliance."

Source: Gale Garriott, Federation of Tax Administrators

Due to the complexity involved in analyzing tax gaps, limited resources, and the uncertainty associated with results, few states have generated estimates based on state-specific methodologies and data. Some apply the IRS voluntary compliance rate (VCR) or adapt other available state rates to circuitously gauge how much money remains a possible target. Table 5 summarizes selected state tax gap study results, indicating the VCR remained fairly consistent across state lines, around 86 percent for income taxes. Similarly, underreporting remained the main contributor.

Table 5. Key Baseline State Tax Gap Study Results

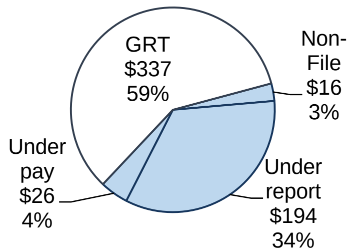
State	Tax Year	Methodology	Tax Program	Estimated VCR	Compliance Results	Estimated Tax Gap
California	2005	Based in part on IRS	PIT, CIT	86%	3%	11% (net)
Idaho	1994	Share-down of the federal income tax gap	PIT CIT	85%	5%	9.5% (net)
Minnesota	1994	Census-based method (subsequently found flawed)	PIT	89%	N/A	10.5% (gross)
Minnesota	2000	US Bureau of Economic Analysis Input-Output (I/O) account data	Sales & Use	90%	N/A	9.9% (gross)
New York	2002	Census-based method	PIT	86%	N/A	13.9% (gross)

Sources: State Tax Gap Studies, LFC Files

In general, identifying areas of noncompliance through tax gap studies help policymakers and management allocate resources as well as devise appropriate strategies to improve compliance and reduce the tax gap. Furthermore, generating a baseline and monitoring the gap over time yields insight into the effectiveness of those strategies to enhance VCR.

In 2013, Taxation and Revenue Department estimated the state's gross tax gap at $573 million. Taxation and Revenue Department (TRD) presented testimony to the Legislative Finance Committee (LFC) in August 2013 that set the gross income tax gap at $236 million and the gross receipts tax gap near $340 million. Rather than developing the estimates using state-specific data, TRD relied on the IRS for income tax calculations and the Minnesota sales and use tax gap study for gross receipts tax (GRT). Some adjustments were made to more closely mirror the state's tax structure. For example, the 2006 IRS voluntary compliance rate of 83 percent improved to 86 percent when non-

Chart 4. TRD 2013 Tax Gap Estimates
(dollars in millions)



Source: TRD

applicable tax categories were removed, such as FICA and self-employment tax. The resulting PIT profile, shaded blue in Chart 4, retains underreporting as the greatest PIT tax gap contributor.

The presentation combined net personal, corporate, and withholding tax revenues to estimate the income tax gap while limiting the "sales tax" estimate to GRT revenues. Compensating and worker's compensation taxes associated with the combined reporting system were excluded. However, the GRT tax gap estimate did cover both the general fund and local government shares.

The TRD analysis overstated the 2013 collectability rate. Diverting from the federal methodology, TRD used the actual collections made during the fiscal year 2013 (FY13) to estimate the collectability of the gross gap dollars. Reporting $174 million collected for the tax categories included in the study, the analysis indicated a 30 percent collectability rate. This rate assumed 100 percent of the tax gap value would be immediately ready for collection, an unrealistic assumption.

According to New Mexico economist and tax expert, Laird Graeser, tax enforcement efforts follow along a well-worn path of "identify, register, enforce filing, and audit for under-reporting and non-filing." Collections only occur at the tail-end of this process, on a significantly lower value of established liabilities. How much lower would depend on the breadth and effectiveness of processes in place to find taxpayer scofflaws and book their obligations. Thus, the full tax gap value is a long way from being an established liability upon which collections can be made. Projecting the amount that could reasonably end up a true liability subject to collection would be part of a state-based analysis.

Absent a New Mexico-based study, using the IRS collection rate of 11 percent would have been more realistic, yielding $63 million.

"We suspect the destructive nature of the last downturn and the prolonged weak recovery pushed a record number of people into that murky world of cash transactions."

-Bernard Baumohl, Economic Outlook Group

Underground or cash economy siphons off tax revenue

Tax revenue is lost due to unreported cash transactions. Economists calculate the total underground economy somewhere between 8 percent and 14 percent of gross national product, equating to as much as $2 trillion in 2012. And it is growing. According to the IRS, the federal government is losing about $195 billion a year due to unreported income, about double the estimate reported in 1992. About $500 billion was reported lost due to unreported wages in 2012 versus $384 billion in 2001 as more people were paid under the table. Shadow economies are no longer isolated to drug deals or organized crime and appear a resilient legacy of the last recession.

New Mexico might be losing over $600 million in taxes due to the cash economy.

Using 8 percent, New Mexico's underground economy can be estimated around $7 billion. Taxes lost to unreported cash transactions could run as high as $630 million, although the amount that could be reasonably collected through compliance efforts would likely be much less.

University of Boston professor and tax zapper expert, Richard Ainsworth, estimates a 50 percent to 80 percent "infection rate" of tax zapping technology use in some industries and areas of the country.

Skimming gone high tech

"Tax zapping," or installing software on point-of-sale systems to falsify electronic records, is another way businesses are cheating state and local tax departments by reducing the amount of reported sales. For example, a $5 transaction might become a $3 purchase. The buyer pays the full $5 plus the associated tax. The zapper subsequently changes the electronic record to reflect the lower price and tax, and the owner keeps the extra sales or gross receipts tax collected, which adds up over time. Businesses with a high percentage of cash transactions, such as convenience stores and restaurants, lend themselves to this type of tax fraud because debit and credit cards leave audit trails. However, credit card transactions can be switched from the business to the individual bank account and the sale wiped out.

Tax zapping also lowers income tax collections, which deflates personal or corporate income taxes depending on the legal structure of the business.

Posing another avenue for lost revenues, corporate tax havens cost states $20.7 billion in 2011.

New Mexico's portion: an estimated $72 million (under prior corporate income tax rates).

Source: Governing

Online and catalog sales going unreported and taxes uncollected

The National Conference of State Legislators (NCSL) pegs the estimated uncollected remote taxes from vendors without a state physical presence (known as nexus) at $24 billion nationally, estimating New Mexico's portion at $246 million. Technically, these taxes are not owed because of legal constraints and would normally fall outside the tax gap discussion. Yet NCSL proposes it plays a large role in state's lost revenues and should be paid. Thus, it enters as a policy issue to consider.

Table 6. New Mexico Estimated Uncollected Tax from all Remote Sales in 2012
(in millions)

Non-electronic Business to Customer (B2C)	$72
Non-electronic Business to Business (B2B)	$54
Electronic Business to Business and Business to Customer	$120
Total	$246

Source: National Conference of State Legislators (NCSL)

Besides the loss of revenue, proponents of remote sales tax legislation assert the advent and growth of the internet has created an unlevel playing field for in-state vendors who would be subject to sales or gross receipts tax on the same tangible goods.

Progress on addressing the issue of remote sales has been stymied by a 24-year old U.S. Supreme Court ruling, Quill Corp v. North Dakota, 504 U.S. 298 (1992) that found mail-order retailers were not compelled to collect and remit use taxes to the states due, in part, to the complexities of doing so at the time. Under Quill, a seller must have a physical presence in a state before the state can collect taxes.

Congressional inaction is forcing states' hands, creating a patchwork solution that will complicate future compliance. Congress has been debating a national law governing nexus for almost 15 years. Current legislation under consideration includes:

- Marketplace Fairness Act
- Online Sales Simplification Act
- Remote Transactions Parity Act

The federal Permanent Internet Freedom Act (2016) retains the federal inoculation against direct taxation on the internet but does not apply to online purchases.

Congressional inaction to establish one nexus standard applicable to all states has prompted states to advance varied solutions to what the NCSL dubs "the remote sales tax loophole" that has grown alongside the internet. While some nudge up against Quill's edges, other administrative or legislative actions take direct aim at Quill, looking to the courts to eventually overturn the precedent.

Table 7 summarizes these efforts under the four primary nexus models that have emerged over the years in the attempt to outflank Quill and retrieve needed revenues.

Table 7. States Taking Action on Taxing Online Sales to Recover Lost Revenue

Model	Timetable	Coverage	Highlights
Streamlined Sales Tax (SST) : aimed at ironing out the differences among state taxation levels to ease reporting and paying tax across states	1999	24 member states	Notable exceptions include the largest states: California, New York, and Texas are not members.
Click-through or Affiliate Nexus: imposes nexus on remote retailers based on in-state presence of affiliate individuals or entities. Skirts Quill.	2008	20 states First state: New York	New York's high court upheld the law, prompting 20 states to follow suit and adopt similar legislation.
Economic Nexus Model: bases presence on unique sales thresholds that disregards the physical presence paradigm, basing a taxation system entirely on sales.	2015	8 states First state: Alabama	Alabama Department of Revenue put an administrative rule in place taxing remote vendors with more than $250 thousand in-state sales. This directly challenges the idea "presence" is defined by brick and mortar. States hope court cases will eventually undo Quill.
Reporting Model: requires seller report sales. Ranges from notifying taxpayers of their purchases made during the year to some required reporting to the state's taxing authority	2010	9 states First states: Colorado and Oklahoma	Colorado law being contested. Oklahoma offers option of voluntary tax collection or customer notification.

Sources: National Conference of State Legislators (NCSL); *Daily Tax Report*

New Mexico's relatively unique tax structure of gross receipts tax trims options of transferring other state schemes based on a sales tax structure. For example, New Mexico could not participate in the Streamlined Sales Tax Initiative.

Unique New Mexico Tax Laws. In direct contrast to GRT, New Mexico places the burden of compliance with the compensating tax code governing remote sales on the buyer, imposing a 5.125 percent tax on "the privilege ***of using*** tangible property in New Mexico" (emphasis added). Some services are also subject to a 5 percent tax. This requirement is discharged if the seller, who must be a registered agent for the department, charges the compensating tax and remits the amount to TRD.

The emphasis on self-reporting was codified into law in Section 7-9-7.1 NMSA 1978, which prohibits TRD from going after individuals for compensating tax on purchased items for their personal use. Thus, administrative regulations focus on business activity, and compensating tax is reported as part of the combined reporting system (CRS). Compensating tax for FY16 was reported near $62 million, or $46.3 million general fund.

Prior to enacting its reporting law, Oklahoma's use tax compliance rate was 4 percent. This peek at another state's baseline rate is not transferable to New Mexico but does indicate the uphill battle states face in collecting remote sales taxes under Quill-type constraints. Self-reporting absent third party reporting requirements consistently exhibits low compliance. A House amendment removed a provision to expand nexus as part of Senate Bill 6 passed during the Second Special Session of the Fifty-Second Legislature (special session).

Rising identify-theft and tax refund fraud

In addition to the myriad of methods used for tax evasion, states are losing money to criminals snatching income tax refunds before the legitimate taxpayer has a chance to file his or her return. The state faces paying the same refund twice if the first, illegal refund was not stopped and the real taxpayer is authenticated.

Table 8. IRS Fraudulent Refunds Stopped in Processing
(in millions)

Year	#	$
2013	2.4	$15,690.4
2014	2.1	$15,209.8
2015	1.7	$11,439.8

Source: Treasury Inspector General

Identity-based income tax refund fraud occurring at the state level is up 3,700 percent, prompted by increased data breaches; a shift from small-time fraudsters to large, sophisticated criminal groups; an increase in tax credits that generate refunds; and an increase in e-filing over the years. Intuit, a major third-party tax preparation software provider, also points to a tougher IRS filtering system for sending fraudsters to softer targets – states.

States are fighting back, participating in the Suspicious Filer Exchange Program sponsored by the Federal Tax Administration, building data warehouses that use filters and data metrics to stop questionable refunds before they go out, and coordinating with state, federal, and third-party organizations through a federally-sponsored Security Summit to implement anti-fraud strategies.

The Treasury Inspector General attributes the decrease in the number of fraudulent tax refunds detected and stopped to expanded IRS processes that reject fraudulent returns <u>before</u> they get posted to the system.

IRS has expanded its identity-theft filters from 11 in 2012 to 183 by 2016.

Revenue is also lost to tax expenditures, posing a significant tax policy issue

Tax expenditures take the form of rate differentials, credits, exemptions, or deductions that provide tax relief intended to promote citizen welfare or incentivize particular economic activities or behavior. Essentially, a tax expenditure is a form of government spending through the tax code as it removes revenues that otherwise would have been received. TRD catalogues 130 New Mexico tax expenditures projected to reduce state general fund and local government revenues by an estimated $1.3 billion.

Table 9. Estimated New Mexico Tax Expenditures FY16
(in millions)

Categories	General Fund	Local Gov's	Total
Economic Development	$135	$21.1	$156
Relieve Poverty, Improve Health and Education	$504.2	$36.9	$541
Renewable Energy and Energy Conservation	$89.9	$1.6	$92
Other	$479.4	25.5	$505
Total	$1,208.5	$85.1	$1,294

Source: LFC Files

Of these, the film production tax credit and the high-wage jobs tax credit were selected for compliance review based on their top-10 rankings, potential application risks, and legislative interest. However, other tax expenditures are discussed in the context of revealing potential weaknesses in how the state manages these tax reduction programs.

Tax expenditures impact local revenues in addition to the general fund. In some cases, such as the health care practitioner deduction, statute triggers a "hold harmless" provision requiring the state make up the lost monies to local entities. Thus, the state gives up revenue in two ways. The state amended the provision in 2013 to phase out the distribution for larger municipalities and counties over 15 years.

Table 10. Top 10 FY15 New Mexico Tax Expenditures General Fund Impacts
(in millions)

Ranking	Tax Expenditure	General Fund	Percent of Total
1	sale of food and hold harmless	$238.9	19.6%
2	medical insurance pool credit against premium tax assessments	$93.5	7.7%
3	nonprofit organizations exemption	$80.0	6.6%
4	sales to nonprofits	$76.0	6.2%
5	health care practitioner deduction and hold harmless	$70.1	5.7%
6	high wage jobs credit	$69.9	5.7%
7	prescription drugs & oxygen deduction	$67.3	5.5%
8	medical and health care services deduction	$55.0	4.5%
9	working families tax credit	$51.5	4.2%
10	film credit	$50.0	4.1%

Sources: Taxation and Revenue Department - 2015 Tax Expenditure Report, Office of Superintendent of Insurance, LFC Files

Taxation & Revenue Department

- ***Program Support***
  - ***Office of the Secretary***
  - ***Administrative Services Division***
  - ***Office of Internal Oversight***
  - ***Information Technology***
- ***Tax Administration Act Program***
  - ***Audit and Compliance Division***
  - ***Revenue Processing Division***
- ***Motor Vehicle Program***
- ***Property Tax Program***
- ***Compliance Enforcement Program***
  - ***Tax Fraud Investigations Division***

The Taxation and Revenue Department administers most, but not all, of the state's tax programs

Sections 9-11 through 9-11-13 NMSA 1978 created the Taxation and Revenue Department (TRD) to provide a single, unified department for the administration of laws and functions relating to taxation, revenue, and motor vehicles. The department is a cabinet-level agency consisting of five programs, as depicted in the agency organizational chart provided as Appendix B and noted in the sidebar. Divisions specific to this evaluation include the Audit and Compliance Division and the Tax Fraud Investigations Division.

Audit and Compliance Division (ACD). This division continues to reorganize resources aimed at priority tax compliance areas. Most recently, TRD renamed the Compliance Bureau the Questionable Refund Unit (QRU), representing a greater focus of the group on possible fraudulent activities such as refund fraud.

ACD hosts two primary sections aimed at ensuring compliance with the tax Administration Act (TAA), as shown in Figure 2.

Figure 2. Audit and Compliance Division Sections

Audit

Conducts audits, reviews business tax credits, and reviews refund applications greater than $20,000.

Collections and Taxpayer Assistance

Resolves tax issues, performs collection and compliance activities, and provides customer service through the division's district offices.

Source: TRD

The Audit section is further divided into seven bureaus performing an array of audit activities ranging in complexity and tax program.

Figure 3. Audit Section Bureaus

Field Audit Bureau A and Bureau B

- Audit large tax programs: gross receipts, compensating, withholding, and worker's compensation.

Field Audit Bureau C

- Audit small tax programs: gasoline, special fuels, petroleum products loading fee, cigarette and other tobacco products, International Fuels Tax Agreement (IFTA), International Registration Plan (IRP), and weight distance.

Desk Audit Bureau D

- Conduct gross receipts limited scope audits (Schedule C and under-reporters)
- Process Schedule C high-volume audits
- Conduct tape match audits
- Administer managed audit program
- Perform above-the line and limited scope PIT audits.

Types of Audits

Field audits: TRD auditor goes to taxpayer's place of business and examines the taxpayer's records.

Desk audits: Audit is performed in TRD offices where a taxpayer's return is checked for supporting documentation.

Limited scope audits: Audit is limited to a specific area or time period and is performed as a desk audit.

Managed audits: Managed audit allows taxpayers to conduct a self-audit after entering into a signed agreement between TRD and the taxpayer or the taxpayer's representative.

Option A: Taxpayer prepares the audit work papers and self-assesses; taxpayer remains subject to audit by the agency for that particular tax period.

Option B: Taxpayer works with a TRD auditor and the work papers are reviewed by the auditor; if auditor accepts the results, the taxpayer is assessed and those issues are closed to further audit by TRD.

Above-the-line audits: reviews derivation of federal adjusted gross income, such as applying deductions.

Oil and Gas Bureau

- Ensure compliance with Severance Tax programs through education, audit, collection and compliance activities.

Federal Royalty Audit Bureau

- Conduct audits under the Federal Royalty Program via a contract with the Office of Natural Resource Revenue of the Department of the Interior to ensure the correct amount of federal royalties are paid.

Technical Support Services Bureau

- Reviews audits to ensure compliance with tax laws
- Works with taxpayer to offer opportunity to provide pertinent information prior to assessment
- Generate all assessments except for Oil & Gas
- Review tax credits.

Source: TRD

The Technical Support Services Bureau (TSSB) reviews audits to ensure compliance with tax laws and consistency across audit programs. TSSB personnel also conduct final conferences with taxpayers as a last opportunity to submit pertinent information prior to an assessment. Assessments originate in TSSB.

ACD recently reorganized personnel performing credit reviews into one unit (6 FTE) within TSSB. A stand-alone team audits film credits while the business credit review team (7 FTE) covers the remainder.

Additonally, TSSB reviews applications for seven tax credits for accuracy, completeness, and adherence to statute: film, high-wage, investment, technology job, advanced energy, alternative energy production, and rural job. As categorized in Appendix C, Revenue Processing Division reviews submitted forms prior to approval for 16 credits and six other state agencies have sole approval authority for 10 additional credits: Economic Development Department; Department of Health; Energy, Minerals and Natural Resources Department; Department of Cultural Affairs; Soil & Water Conservation District; and Mortgage Finance Authority.

The Collections and Taxpayer Assistance section goes by various names:

- ***Compliance***
- ***Collections***

The Collections and Taxpayer Assistance section is home to two bureaus and four district offices. This section ensures compliance for tax programs under the Tax Administration Act by resolving tax issues, performing collection and compliance activities, and providing customer service through its district offices.

Figure 4. Collections and Taxpayer Assistance

Questionable Refund Unit (QRU)

- Hosts a small 4-FTE team that conducts limited PIT projects
- 3 FTE handle bankruptcies
- 25 FTE monitor fraudulent activity and process questionable refunds

Call Center Bureau

- Contacts delinquent taxpayers and non-filed returns
- Takes incoming calls from taxpayers
- File lien, wage, or bank levies

District A
Santa Fe Field Office

District B
Albuquerque Office

District C
Las Cruces Field Office

District D
Roswell Field Office

Source: TRD

ACD FY17 Budget and Vacancy Rates. General fund transfers reflect a 4 percent reduction from FY16 of $650 thousand before an anticipated 5.5 percent decrease of $764 thousand imposed by Senate Bill 9 passed during the recent special session as a solvency action. About $1.5 million in federal money helps support audits of the federal oil and gas royalties. Starting in FY12, other revenue appropriations replaced the general fund appropriation by $5.5 million, enabled by language allowing TRD retain a small percent of distributions to municipalities and counties for offsetting food deductions and health care practitioner services deductions. For FY17 this administrative fee totals $6.3 million. However, the "hold harmless" provision sunsets over time and this funding source will not be available.

Table 11. ACD FY17 Operating Budget*
(in thousands)

Sources	Amount	% of Total
General Fund Transfers	$13,882	64%
Federal Revenues	$1,507	7%
Other Revenues	$6,305	29%
Total	$21,694	100%
Uses	**Amount**	**% of Total**
Personal Services & Employee Benefits	$18,628.8	86%
Contractual Services	$36.3	-
Other	$3,028.9	14%
Total	$21,694.0	100%

*Before special session Senate Bill 9 reductions estimated at 5.5 percent.
Source: LFC Files

Table 12. ACD Operating Budget over Time
(in thousands)

Fiscal Year	ACD Total All Revenues-(Actuals)	General Fund (GF) (Actuals)	% GF to Total
2009	$21,161	$19,209	91%
2010	$24,718	$21,386	87%
2011	$22,864	$18,934	83%
2012	$21,609	$13,468	62%
2013	$21,661	$13,514	62%
2014	$21,963	$13,835	63%
2015	$22,185	$14,069	63%
2016	$22,344	$14,532	65%
2017*	$21,694	$13,882	64%

* Before special session Senate Bill 9 reductions estimated at 5.5 percent.
Source: TRD Administrative Services Division

Table 13. ACD FTE and Vacancy Rates over Time

Fiscal Year	FTE	GF FTE	FTE Vacancy Rate	GF FTE Vacancy Rate
2009	364	331	15%	13%
2010	420	385	12%	9%
2011	376	343	18%	15%
2012	364	329	22%	14%
2013	362	322	22%	18%
2014	348	324	15%	15%
2015	348	316	19%	20%
2016	349	318	19%	19%
2017*	349	318	22%	23%

*Before special session Senate Bill 9 reductions estimated at 5.5 percent.
Source: TRD Administrative Services Division

Tax Fraud Investigations Division (TFID). This program is charged with enforcing criminal statutes relative to New Mexico's Tax Administration Act and other financial crimes, listed in Appendix D. The Forensic Tax Audit Bureau personnel evaluate incoming information for valid leads, work with the investigator on cases, and provide expert testimony on cases. The special agent positions within the Tax Fraud Investigations Bureau conduct the actual investigations of individuals and businesses. If warranted, the agent will recommend a case for trial. The final unit, Internal Investigations Bureau, conducts internal audits and reports independently to the Office of the Secretary.

Figure 5. Tax Fraud Investigations Division

Tax Fraud Investigations Bureau	Forensic Tax Audit Bureau	Internal Investigations Bureau
• Conducts investigations • Obtains evidence • Obtains testimony • Prepare investigative report and recommend prosecution	• Reviews and analyzes leads • Works with investigator • Acts as technical tax advisor • Attends court proceedings and provide expert testimony	• Investigates allegations of non-tax related activities and employee misconduct • Performs other internal audits

Source: TRD

Table 14. FY17 TFID Operating Budget*
(in thousands)

Sources	Amount	% of Total
General Fund Transfers	$1,695.6	100%
Federal Revenues	-	
Other Revenues	-	
Total	$1,695.6	
Uses	**Amount**	**% of Total**
Personal Services & Employee Benefits	$1,413.3	83%
Contractual Services	$23.7	2%
Other	$258.6	15%
Total	$1,695.6	100%

*Before special session Senate Bill 9 reductions estimated at 5.5 percent.
Source: FY18 TRD Budget Request

Table 15. TFID Vacancy Rates

Fiscal Year	Operating Budget	Vacant*	Rate
2009	38	12	32%
2010	36	11	31%
2011	31	8	26%
2012	28	7	25%
2013	28	7	25%
2014	28	6	21%
2015**	22	7	25%
2016	22	6	27%
Current**	21	6	27%

*As of June 30 each fiscal year except FY12 (December 1, 2011) and Current (10/13/2016)
**FY15: Authorized FTE of 28 less 6 FTE (Internal Audit section) transferred to Office of the Secretary; FY17: Authorized 22 FTE less 1 FTE transferred.
Sources: TFID Operating Budgets and PeopleSoft Organizational Listing Report

Information Technology

GenTax is TRD's book of record for receiving tax revenues and collections. Laws 2012, Chapter 19, appropriated $6.2 million to TRD to upgrade the tax administration software used to support the New Mexico tax administration program. Funding added to the operating budget enables TRD to adequately maintain the system.

The call center currently uses two IT systems. The interactive voice response (IVR) system handles calls. Taxpayers calling in can choose to wait in a queue after being informed of the anticipated wait time. Revenue agents make outbound calls to customers. Calls are recorded and can be reviewed as warranted, such as in response to a customer complaint. IntelliCenter is the reporting tool, recording call statistics to aid in center management.

A third system, a predictive dialer, is not operational. Predictive dialers make outbound calls until a person is reached and then transfers the call to an agent, saving unproductive agent time reaching a live call.

The Data Warehouse is a repository of at least 20 sources of data. Known sources include the Internal Revenue Service (IRS), Department of Workforce Solutions, GenTax, and Motor Vehicle Division. The warehouse allows data matching to locate discrepancies that might indicate disparities in taxes owed. The data warehouse also propels the questionable tax refund process. ACD analysts use data analytics to develop models to score output from the warehouse to provide auditors and revenue agents leads for review. ACD is continuously adding its sources across federal, state, and private entities but keeps the list confidential pursuant to Section 7-1-11(E) NMSA 1978 and to maintain integrity of the process.

Historical Efforts to Address the Tax Gap

The state has executed various strategies to improve the tax gap. Most have focused on increasing collections through compliance and enforcement actions.

Funding for the Enhanced Delinquent Tax Collection Initiative. The most recent large-scale effort to reduce the tax gap by expanding ACD and creating TFID started in 2003. Expansion of the program ran through 2009 and then solvency measures taken in 2010 through 2014 to address continued recession revenue declines reversed course. In 2015 funding was partially restored as the economy began to recover, only to be further eroded in 2016 as the oil & gas downturn slashed state revenues.

Table 16. Timeline for Enhanced Tax Collection Initiative

Session Year	Actions
2003	A $5 million special appropriation created the Tax Fraud Bureau (16 FTE) within the Office of the Secretary and expanded the Audit and Compliance Division (42 FTE). Estimates at the time indicated $68 million in outstanding taxes from various taxpayers.
2004	Appropriated $2.3 million to ACD. LFC Post-Session Review reported an additional $25 million in “new” money resulting from the expanded audit program.
2005	Legislature authorized a new Tax Fraud Investigation Division within the Tax Fraud Bureau to investigate criminal violations relative to the state’s tax laws. Chapter 108 (House Bill 411) also created new criminal penalties for willful failure to collect or pay overdue taxes, modified existing penalties for tax fraud, extended time limits for prosecution of related criminal violations, and authorized TRD to employ law enforcement officers. Appropriated $2.7 million to TRD to expand Initiative efforts: $1,968.8 to ACD; $450 thousand to Revenue Processing Division (RPD); and $300 thousand to Program Support
2006	Created Compliance Enforcement program by moving 33 FTE from other bureaus: TFID (13 FTE); ACD (2 FTE); RPD (1 FTE); Program Support (8 FTE); and MVD (FTE). No added money.
2007	Appropriated $1,567.6 thousand and added 28 FTE for revenue enhancement activities in the Tax Administration Program. Appropriated $38.4 thousand for 1 TFID FTE for revenue enhancement activities.
2008	Legislature appropriated $419.6 thousand and 8 new FTE for tax credit application reviews and audits. Total personal salary and employee benefits increased by $802 thousand.
2009	Increased Tax Administration Act (TAA) FTE from 501 to 560 and increased personal salary and employee benefits by $2.4 million, including general fund appropriation increase of $2 million to implement phase two of the “fair share” initiative to collect $29.2 million delinquent taxes in FY10, and $45 million thereafter, and increase compliance in the Weight-Distance Tax Act. TAA includes both the Audit and Compliance Division and the Revenue Possessing Division (RPD).
2010	Reduced TAA Program by 70.5 FTE, $2.3 million general fund appropriation, and $827 thousand personal and employee benefits.
2011	Reduced TAA Program by 17 FTE, $6.1 million general fund appropriation (partially offset by an increase of $4.9 million in other state funds) to produce an overall $1.2 million reduction in personal services and employee benefits, and $827 thousand personal salary and employee benefits
2012	Reduced TAA Program by 2 FTE; personal salary employee benefits (PS&EB) general fund appropriation reduced by $664 thousand plus $37.6 reduction in other state funds yielded a PS&B reduction of $700 thousand.
2013	Reduced TAA FTE by 7.5 but personal salary and employee benefits saw an increase of $466 thousand funded by increased general fund appropriation.
2014	FTE no longer noted in HB 2: Slight reduction in personal salary & employee benefits of $125 thousand; overall general fund appropriation across all categories is up slightly at $75 thousand due to $192.7 increase in the other category.
2015	As economy recovered, TAA saw an increased general fund appropriation of $567 thousand, primary funding an increase of $518 thousand in the personal services and employee benefits category.
2016	As the oil & gas revenues declined, solvency actions reduced the TAA general fund appropriation by almost $1 million, with the impact of reducing personal services and employee benefits by $708 thousand.

Source: LFC Files, HB2

Legislative Finance Committee Tax Policy Principles

1. Adequacy: Revenue should be adequate to fund needed government services.
2. Efficiency: Tax base should be broad as possible and avoid excess reliance on one tax.
3. Equity: Different taxpayers should be treated fairly.
4. Simplicity: Collection should be simple and easily understood.
5. Accountability: Preferences should be easy to monitor and evaluate.

New Mexico Is Not Deploying All Tools to Address the Tax Gap and Collect Additional Revenues

The Minnesota Department of Revenue plans to conduct periodic tax gap studies that will allow it to track changes in the size and nature of the income tax gap.

Washington State's Department of Revenue publishes a bi-annual study documenting the estimated revenue losses derived from tax non-compliance.

The Taxation and Revenue Department has not performed a New Mexico tax gap analysis based on state-specific data and modeling

The Taxation and Revenue Department (TRD) prepared a 2013 tax gap presentation adopting noncompliance rates of 14 percent for income taxes from the Internal Revenue Service (IRS) and 9.9 percent rate for gross receipts tax from a Minnesota sales tax gap study, producing a gross tax gap of $572 million. The department acknowledges the limitations inherent to this methodology.

Without a state-specific baseline study, size and changes in the nature of the tax gap cannot be accurately determined. While challenges and complexity still characterize tax gap studies, developing a New Mexico baseline and applying consistent modeling would enable TRD derive a reasonable baseline estimate, monitor compliance rates over time, help evaluate effectiveness of tax gap initiatives, and reassign resources to track effectively with shifting tax evasion strategies.

TRD maintains the cost to produce a state-based estimate outweigh the benefits given the uncertainties inherent in such studies, and the agency measures effectiveness of its tax gap initiatives through goal setting, review of project outcomes, and an iterative approach to developing its data warehouse and scoring mechanisms that includes a feedback loop of "lessons learned" to improve models.

Legislative Finance Committee (LFC) staff update. Updating the 2013 analysis with fiscal year 2016 (FY16) revenues shows a slightly higher gross tax gap but the result merely reflects higher revenues, particularly for gross receipts tax (GRT).

Before collection and enforcement actions, the TRD model indicates tax underpayments potentially cost the general fund almost $500 million while local governments lost about $150 million.

Table 17. Estimated Gross New Mexico Tax Gap Analyses
(in millions)

Tax Gap	LFC FY16	TRD FY13*
Gross income tax gap	$239	$236
Gross receipts tax (GRT) gap	$396	$374*
Total Gross Tax Gap	$635	$609*

*Revaluated based on stated methodology to correct apparent computational errors.
Source: LFC Analysis based on 2013 TRD Tax Gap Methodology

Table 18. General Fund Portion of the Estimated Gross Tax Gap
(in millions)

Tax Program	State GF	Local Gov
Income tax	$239	-
GRT	$238	$158
Total	$476	$158

Source: LFC Analysis

Because the model retains the assumptive noncompliance rates, any real changes in those rates over time are left undetected. Thus, how much programs are improving taxpayer compliance remains unknown and any real tax gap reduction is left unmeasured. Furthermore, the model excludes important marketplace dynamics contributing to the tax gap.

This methodology likely understates the size of the state's gross tax gap and loss of potential revenues. By limiting the analysis to personal, corporate, GRT, and withholding taxes, some taxation arenas fall outside the grasp of this analysis. Most notable is the state's compensating tax on remote sales such as internet or catalog purchases. Voluntary compliance under current law must be higher than Oklahoma's 4 percent, as FY16 compensating tax revenue of $62 million would generate $1.5 billion in lost tax dollars under that metric. But it is just as unlikely to reach 100 percent. Some portion must leak into the tax gap.

California investigators have found employers who commit worker's compensation fraud also often underpay employment taxes, licensing fees, corporate and personal income taxes, sales taxes, and other employment contributions required by law.

The National Conference of State Legislators pegs New Mexico's lost revenue to remote sales due to legal constraints on collections near $240 million and is later discussed as a policy issue.

Payroll taxes are also excluded from the tax gap analysis, although current enforcement efforts directed at CIT and GRT generally capture other business taxes owed. Similarly, current TRD programs tap into the cash economy, but at least some of this underground activity remains completely hidden and would not be reflected in assumed tax compliance rates based on tax dollars found. How much of the roughly $630 million cash economy tax dollars fall outside the analysis and should be added is questionable. As with the tax gap itself, TRD has not measured its magnitude or makeup to answer this question.

Finally, a few taxes are administered by agencies outside TRD and not covered by the tax gap analysis. For example, the Office of the Superintendent of Insurance collects a tax from health insurance companies. A recent State Auditor's report claimed the five largest companies were in arrears by $193 million, although the Superintendent placed the deficit closer to $100 million.

Tugging in the opposite direction, New Mexico's plethora of tax expenditures would throw some of the missing tax dollars derived from the IRS or Minnesota schemes out of play. The associated tax dollars are not owed according to statute, thereby lowering the tax gap.

The best estimate of retrievable tax dollars given current information and modeling is $70 million. The general fund would receive about $52 million of this amount.

Table 19 illustrates this calculation. Excluding all potential tax gap contributors but GRT, corporate income tax (CIT), and personal income tax (PIT), the 2013 TRD model produces an estimated tax gap of $635 million based on 2016 revenues. Applying the IRS rate of 11 percent yields $70 million as an estimated collected amount. About 60 percent of the GRT amount and 100 percent of the income tax dollars collected would flow to the general fund, or $52 million.

Table 19. Estimated 2016 Tax Gap and Collections
(in millions)

Income Tax Gross Gap	$239
GRT Tax Gross Gap	$396
Total Gross Tax Gap	$635
IRS 11% Rate of Collectable Amount	$70
GRT Portion of the 11%	$44
Income Tax Portion of the 11%	$26
60% GRT to General Fund	$26
100% Income Tax to General Fund	$26
Total Collectable Estimate	$52

Source: LFC Analysis based on TRD 2013 Model

Although the tax gap appears to have grown slightly larger from 2013, the impact stems from increased GRT. The model assumes a constant compliance rate.

California started directly combating the underground economy as early as 1995, creating a coalition of agencies called the Joint Enforcement Strike Force (JESF), with the stated goals:

- ***Eliminate unfair business competition***
- ***Protect workers***
- ***Protect consumers***
- ***Reduce the tax burden on law-abiding citizens***
- ***Reduce the tax gap.***

Addressing intentional and unintentional taxpayer noncompliance requires different strategies; a tax gap analysis would help effectively deploy resources. Some taxpayers unintentionally file erroneous returns due to variety of reasons. Providing an easy-to-use online tax filing system and simplified forms helps improve compliance for honest taxpayers. Education is also important, whether through online resources, access to tax staff to answer questions, public outreach, or training seminars. However, strategies dealing with intentional tax fraud are more complex and costly. A state-centered study would quantify these two taxpayer segments, allowing policy makers weigh costs and benefits of pursuing various contributors to the tax gap. The following discussion provides options adopted by other states to address tax fraud; legislation would likely be required for New Mexico to follow suit.

Unlike some states, New Mexico has not taken a direct, coordinated approach to addressing the cash economy

At least three other states have established specific units, strike teams, or multi-agency investigative programs to deter cash economy violations and recapture lost revenues. These units target specific industries for education programs, sting and sweep operations, prosecution, and tax collection.

In California, the Underground Economy Operations fosters coordination through its Joint Enforcement Strike Force (JESF). JESF partners performed 926 onsite inspections, 91 sting operations and 148 sweeps, 664 audits, and prosecuted 187 cases. These actions represented over $130 million in payroll tax liabilities, payroll assessments, back-wages, and penalties associated with the cash economy for 2015.

The Underground Economy Unit of the California Attorney General's Office has brought also civil and criminal actions under the state's Unfair Competition law involving wage, tax, and insurance issues.

Six key elements to successful cooperative cash economy initiatives:

- ***Codifying the structure in statute for continuity and funding***
- ***Identifying noncompliant industries***
- ***Tailoring education and enforcement actions to those areas***
- ***Coordinating initiatives across appropriate agencies***
- ***Enacting legislation to allow sharing of information, if needed***
- ***Prioritizing resources to address those with the highest risk and return on investment.***

Source: LFC Analysis

By allowing agencies to share data and resources, California's Assembly Bill 576, (effective January 2014) enabled seven agencies to form a coalition known as TRaCE to combat the underground economy. Extending beyond labor-related concerns, this multi-agency task force houses investigators and special agents from multiple agencies working to investigate, prosecute, and recover revenue lost to the underground economy. It includes the Board of Equalization, Department of Alcoholic Beverages Control, Department of Justice, Employment Development Department, Federal Bureau of Investigation, Franchise Tax Board, and Homeland Security Investigations.

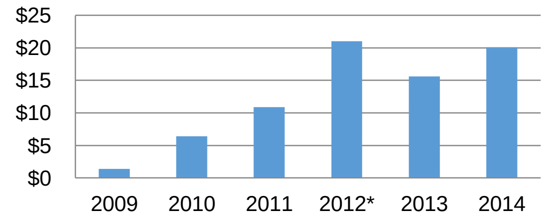
Washington State focused its efforts on reducing the underground economy associated with the construction industry, estimating it impacted 20 percent to 50 percent of this commerce. A Joint Legislative Task Force on the Underground Economy – finding roughly $109 million lost to sales, business, and occupation taxes – made extensive recommendations in its initial 2007 report regarding five areas:

- New registration requirements and stiffer penalties;
- Increased enforcement activities;
- Increased education and outreach;
- Continuation of data sharing and detection capabilities; and
- Clarifying tests for determination of independent contractor status.

Enacted legislation subsequently embodied these recommendations and staffing was increased by 8 FTE at several agencies to carry out enforcement at a cost of $1 million.

Created in 2008 by executive order, the Massachusetts Joint Task Force on the Underground Economy (JTF) was codified into law in 2014. Rebranded the Council on the Underground Economy (CUE) in 2015, CUE is charged with coordinating multiple state agencies "to stamp out fraudulent employment activities and increase fair business competition." The state's Executive Office of Labor and Workforce Development reports CUE has recovered over $76 million over a six-year period starting in 2008. Chart 5 shows how this type of program can mature over time to increase productivity.

Chart 5. Progression of CUE Recoveries
(in millions)



*Reported results spanned 18 months
Source: Massachusetts Council on Underground Economy

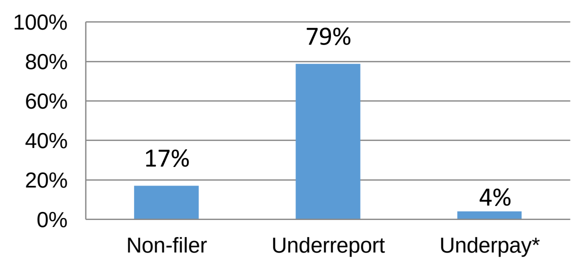
Education and public relations campaigns extend reach of state initiatives to engage the public and improve compliance. States prioritizing the combat against the underground economy also highlight public relations campaigns to educate the public on the costs associated with the cash economy. For example, multiple agency websites in California contain public information spots warning the public on its negative impacts.

Figure 3. California Anti-Underground Slogan

TRD uses indirect methods to tackle the cash economy. In addition to data warehouse processes already in place, the agency is looking at capturing errant cash income based on the IRS 1099-K (K-9) program that requires merchants reconcile reportable income to a third-party statement for debit, credit, or store-value card payments above minimum reporting thresholds. In most cases, business income also flows in the form of cash or checks. The K-9 provides one clear data point to help spotlight potential suspicious returns that display an unrealistically high percentage of reported income associated with the K-9, or non-cash transactions. Cash is likely lurking in the till that remains unreported in that case and ensuing audits would initially perform an income probe to tie down revenue sources.

Such forensic audits are complex and require extensive training to conduct. Furthermore, this technique will likely miss non-filers, or 100 percent cash merchants that defy the federal tax system (and state). It will also not capture service providers in New Mexico who operate on a cash basis to escape GRT. As a consequence, these dynamics playing outside the TRD tax gap methodology most likely understate the size and proportion of the segment attributed to non-filers who operate underground.

Chart 6. Estimated New Mexico Gross Tax Gap Breakdown



*Individual taxes only; Non-filer and Underreporting percentages combine income tax and GRT rates.
Source: LFC Analysis based on 2013 TRD Methodology

"Click-through" laws that use a remote vendor's in-state affiliates to establish presence, have been adopted in 20 states. In 2009, Amazon cut ties with affiliates in North Carolina and Rhode Island in response to affiliate-type legislation in those states. More recently, however, Amazon supported Oklahoma's reporting bill.

New Mexico has not joined states' effort to recover remote sale taxes, leaving up to an estimated $246 million uncollected

Reportedly in the billions of dollars, taxes lost to remote vendors such as those operating from the internet are prompting cash-strapped states to pursue statutory solutions in the absence of Congressional action to address e-commerce nationally. At least 16 states have introduced 42 sales tax nexus bills in 2016, leading to enacted legislation in Louisiana, Oklahoma, South Dakota, and Vermont.

The expressed intent is to foster a court case for Supreme Court review that would do away with Quill's taxing restraints. In particular, South Dakota is challenging the original 1992 Supreme Court ruling by enacting legislation that would allow the state to collect more sales taxes based on the economic nexus model, particularly on internet purchases, in direct defiance to the old nexus concept. So far 89 sales tax licenses have been issued under the South Dakota law, and tax experts see the trend toward embracing economic nexus through legislation or regulation will continue into 2017.

The National Conference of State Legislators (NCSL) is supporting this state effort and has made closing the online sales tax loophole a top priority. Advocating for e-fairness legislation to level the playing field for local businesses, NCSL also notes the debilitating effect of the recession on state budgets and sees online sales taxes as an option to cutting services or raising other taxes to meet budget needs. NCSL intends to double its efforts encouraging more state legislatures to bring challenges.

Some taxpayer advocates see this push toward taxing online sales as a tax increase or representing state over-reach of the Commerce Clause of the U.S Constitution.

Those on the other end of the debate focus on the draconian impact the internet has had on state tax bases and see it as merely collecting what is already due while addressing e-fairness issues.

New Mexico has yet to enter this legal fray. Bills introduced in 2011 adopted an affiliate or "click through" regime but died, presumably over fears large internet vendors would pull out of the state. One attempt was made in 2012 to repeal Section 7-9-7.1 NMSA 1978, and would have required people report all purchases made online or through catalogs and pay the compensating tax. TRD would have been able to collect the tax through collection efforts, although the agency noted the difficulties of doing so without a reporting or registration mechanisms for vendors. More recently, Senate Bill 6 – submitted during the Second Special Session of the Fifty-Second Legislature (special session) – proposed taxing large out-of-state vendors but a House amendment struck the provision.

With an estimated $23 billion at stake, it is likely states will continue to pursue options to reset the taxation milieu to align with the game-changing digital marketplace.

Installing or selling a tax zapping device or software is not illegal in New Mexico, limiting enforcement

About 30 of the 46 states with some sort of sales tax have raised tax zapping into their legislative crosshairs, with 24 enacting tax zapping legislation. Georgia was the first state to take action, enacting House Bill 415 that made it illegal to willfully and knowingly sell, purchase, install, transfer, or possess any automated sales device, zapper, or phantom-ware in the state. Prior to the legislation, only the actual fraud was penalized, as it currently stands in New Mexico. Georgia now outlaws the technology that facilitates the fraud, which opens a new avenue for enforcement.

New York and Maine offer amnesty programs to merchants that voluntarily disclose a zapper. Other states have taken a zero tolerance approach. Oklahoma not only imposes a penalty of up to $100 thousand and one to five years in jail, the offender is subject to a $10,000 administrative penalty and may lose his or her business license for up to 10 years. Furthermore, Oklahoma is one of at least eight states that simply penalize, immediately, if a zapper is found.

Estimated loss of revenues to states: $21 billion, according to tax zapper expert, Boston University Professor Richard Ainsworth.

New York found sting operations effective, discovering most of the 24 sales representatives responding to solicitations for electronic registers for dummy restaurants actively tried to sell suppression software as part of their machines. However, reports from Europe indicate zappers are making it to the cloud, hiding the salesman who used to walk in the door behind a screen of anonymity. As a consequence, New York-style operations to catch zapper peddlers will need updating or become obsolete.

TRD has taken an active role in the IRS Security Summit.

The IRS reported it prevented $15 billion in fraud in 2015 but lost an estimated $5 billion to fraudsters filing false returns. The magnitude of identity theft has prompted an unusual collaboration among states, the IRS, and industry partners to establish robust and consistent approach to detect and prevent fraudulent income tax filing. TRD's secretary and chief security officer both actively participate in this initiative.

TRD also participates in the Suspicious Filer Exchange sponsored by the Federation of Tax Administrators and is a member of the Multi-State Commission.

Recommendations

The Legislature should consider:

Creating a non-partisan task force led by the Revenue Stabilization & Tax Policy interim committee to review the complex tax gap issues and make recommendations to the full Legislature for action;

Providing funding for a tax gap and cash economy study;

Monitoring other state and NCSL efforts to solve the nexus issue to tax online sales and consider legislation appropriate to New Mexico, including whether to repeal Section 7-8-7.1 NMSA 1978, which bans TRD from collecting compensating tax from individuals for online and catalog sales; and

Enacting legislation outlawing use of tax zapping mechanisms.

The Taxation and Revenue Department should:

Enlist University of New Mexico's Bureau of Business and Economic Research and New Mexico State University's Arrowhead Center in developing a broad-ranged, state-based tax gap analysis and characterizes the state's cash economy;

Identify areas to expand and broaden tax gap initiatives, including multi-agency efforts, and detail any expansion requests with clear return on investment quantifiers;

In particular, identify areas for underground economy compliance; and

Adopt a bi-annual review process to monitor progress in narrowing the tax gap and identifying emerging areas of concern.

Tax Expenditure Design Weaknesses Impact State Revenues Much More Than Expected

The Pew Center on the States identified ways states could have greater predictability in assessing and budgeting for the impact of tax incentives by:

- ***Creating reliable cost estimates by projecting the economic impact, warning about uncertainties, linking cost estimates to policy making, and making the process transparent***
- ***Establishing annual cost controls by regularly budgeting for tax incentives, setting annual caps, and ensuring incentives are reconsidered in future years***

Pew also emphasized the importance of evaluating tax incentives to improve economic development policy, identifying key evaluation components including:

- ***Establishing who will evaluate a certain tax incentive, when, and how***
- ***Assessing the results for the state's economy and budget***
- ***Building evaluation into policy and budget deliberations***

Tax policies can have positive results, but also readily impact a state's finances, making assessment and evaluation vital tools in policy making

Many states, including New Mexico, have encountered much larger price tags for tax incentive programs than anticipated. In a December 2012 report titled *Avoiding Blank Checks: Creating Fiscally Sound State Tax Incentives*, The Pew Center on the States identified various cases where states were left with significant financial liabilities from certain tax policies. For example, a Hawaii tax credit for renewable energy cost the state $34 million in FY10, but was expected to jump to an estimated $260 million in FY13, leading revenue forecasters to reduce revenue projections. New Mexico faced a similar situation in 2012 when both the high-wage jobs and the film production tax credits experienced significant increases in applications and fiscal impact. These examples speak to the importance of evaluating the impact of tax policies.

States have taken action to achieve greater accountability around their tax code. Washington State is a pioneer in evaluating tax expenditures, where the Legislature passed a law requiring performance audits in 2007. Staff of the Joint Legislative Audit and Review Committee (JLARC) review a selection of tax expenditures set by a citizen commission with the goal of reviewing most tax expenditures over a ten-year period. Staff recommends continuing, making modifications to, or terminating tax expenditures.

More states have formalized review processes for tax expenditures, including eleven states ranging from Hawaii to Texas to Maine in 2015 and 2016 alone. Statutes requiring tax expenditure evaluation vary by state, with some stipulating an executive agency conduct the review, while others designate a legislative entity or an independent board as the evaluator. Review cycles range from five to ten years. Most of these statutes require the evaluating entity to make recommendations on whether to keep, change, or terminate reviewed tax expenditures, similar to Washington State.

TRD publishes a tax expenditure report annually, detailing the intended purpose, requirements, and forgone revenue estimates for tax expenditures currently in law. Data from this report is published in LFC's Volume III. While the tax expenditure report is an important step forward in identifying and monitoring tax policy in New Mexico, it is vital to go further by evaluating and fine-tuning tax policy to make it most effective.

New Mexico's approach to tax expenditure review is primarily reactionary. Twenty-four bills were presented to the Legislature between 2014 and 2016 to strengthen, clarify, or make adjustments to the tax code. Thirteen of these bills were signed into law. While it is valuable to address loopholes and other issues in tax statute, other states have moved towards evaluation-driven decision making processes. New Mexico has not followed suit.

Various tax expenditures lack a well-defined purpose and eligibility criteria, clear outcome measurements, or timelines for review

For this evaluation, LFC staff identified four tax policies currently in effect to show where potential policy weaknesses exist. These include the high-wage jobs tax credit, the healthcare practitioner deduction from gross receipts tax, the film production tax credit, and the corporate income tax rate reduction along with the single sales factor apportionment. Issues with these policies have had a significant financial impact on the state's general fund via forgone revenue, and in some cases, as revenue paid for credits refunded to taxpayers. Based on various tax incentive review criteria, the four selected tax policies are scored in Table 20.

Table 20. Select Tax Policy Scorecard

Tax Policy	FY15 Forgone Revenue (in millions)	Clearly Stated Purpose or Goal	Clear Eligibility Criteria	Quantifiable Outcome Measurement	Cap	Sunset Provision	Evaluation Requirement
Corporate Income Tax Rate Reduction	$40.2	N/A	Yes	No	No	No	No
Single Sales Factor Apportionment		N/A	Yes	No	No	No	No
Film Production Tax Credit	$50.0	Yes	Yes	Yes	Yes	Yes	No
High-Wage Jobs Tax Credit	$69.9	Yes	Yes	Yes	No	Yes	No
Health Care Practitioner Deduction	$70.1	No	No	No	No	No	No

Note: Corporate income tax reduction and single sales apportionment forgone revenue figure based on FY16 estimate.

Source: 2015 NM Tax Expenditure Report and LFC Files

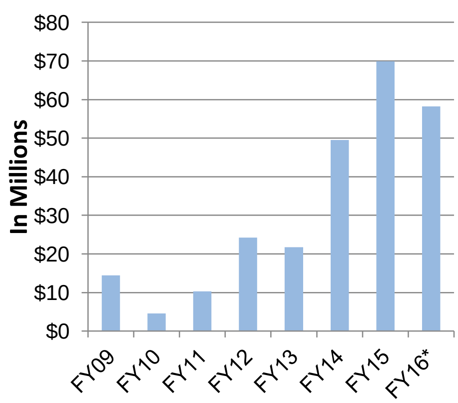
The selected tax expenditures are reviewed in more detail below, looking at structure of enabling statute, potential weaknesses, fiscal impact, and emerging issues.

High-Wage Jobs Tax Credit

The high-wage jobs tax credit was enacted in 2004 with the purpose of incentivizing the creation and filling of higher wage jobs in New Mexico. Businesses can apply for the credit for a new high-wage job for a total of four years, salary criteria is specified for urban versus rural jobs, and the applying company must have 50 percent of sales going out of state to qualify for the credit.

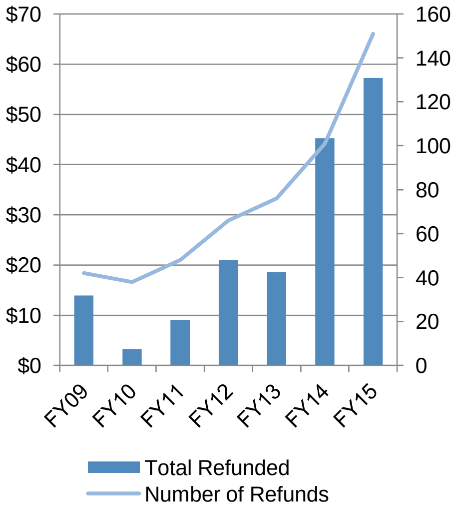
Between FY09 and FY15, total high-wage jobs tax credits grew 384 percent, with the greatest increases occurring after statutory changes were made in 2013. In testimony before the Revenue Stabilization and Tax Policy Committee in 2012, TRD expressed concern at the volume of claims the department was receiving for the high-wage jobs tax credit, anticipating $50 million in total claims for FY12. While total credits for FY12 did not reach this level, subsequent years saw sharp increases in credits claimed as shown in Chart 7.

Chart 7. High-Wage Jobs Tax Credit FY09-FY16



Note: FY16 figure estimated.
Source: 2014 and 2015 NM Tax Expenditure Reports

Chart 8. High-Wage Jobs Tax Credit Refunds
(dollars in millions)



Source: 2014 and 2015 NM Tax Expenditure Reports

Moreover, as one of few refundable credits in the state's tax code, companies applying for the high-wage jobs tax credit are entitled to a refund of the credit if it exceeds the modified combined tax liability. The number of credits resulting in a refund grew 260 percent between FY09 and FY15, and the total revenue paid to companies eligible for a credit refund grew 310 percent over the same time period as shown in Chart 8.

From July 2008 to July 2016, the state paid over $215 million in refunds and lost another $20 million in forgone revenue from companies claiming the high-wage jobs tax credit. The top 20 companies leveraging the high-wage jobs tax credit accounted for $114 million of total credits taken. Of this $114 million, 56 percent went to companies in natural resource extraction, 19 percent to firms performing research and development or serving the computer industry, and 12 percent to other miscellaneous manufacturing or service companies as shown in Table 21.

Table 21. Top 20 High Wage Job Tax Credit Aggregate Amounts by Industry July 2008-July 2016
(in millions)

Industry	Refund	Credit	Total	Percent of Total
Extraction	$58.2	$5.0	$63.3	56%
Technology/R&D	$20.3	$1.6	$21.9	19%
Other	$12.8	$0.7	$13.5	12%
Aviation	$10.1	$0.1	$10.2	9%
Health Care	$4.0	$1.1	$5.1	4%
Total	$105.4	$8.5	$113.9	100%

Source: TRD

While the purpose of the high-wage jobs tax credit is clearly defined in statute, jobs in highly cyclical industries such as natural resource extraction greatly impact the state's revenues while evidence to the level of new jobs created is not clear.

The Legislature addressed various concerns in the statute governing the high-wage jobs tax credit in 2013. A 2012 LFC evaluation noted industry concerns over the high-wage job tax credit's structure, some of which were addressed through Laws 2013, Chapter 160 (HB 641), such as employee benefits being clearly defined and the sunset provision being extended to the beginning of FY20. Wage rates also were increased from $40 thousand to $60 thousand for urban jobs and from $28 thousand to $40 thousand for rural jobs effective July 1, 2015.

Additionally, a deadline to apply for the credit was established to be within twelve months of the final (fourth) qualifying period; however, this would allow the taxpayer to apply for up to four years of the credit by this same closing date, which could create some volatility in both forgone revenue and credits resulting in refunds. To correct this issue, statute should be amended to require credit applications be submitted in a more timely fashion to allow appropriate forecasting of both expected credit refunds and forgone revenue.

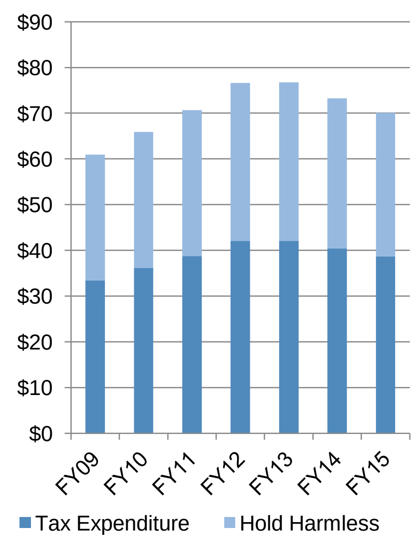
Even after strengthening the governing statute around the high-wage jobs tax credit, weaknesses persisted requiring legislative action. For example, to qualify for the high-wage jobs tax credit, a company must either make 50 percent of its sales outside New Mexico or be eligible for the Job Training Incentive Program (JTIP) through the Economic Development Department (EDD). In the case of extraction companies, they would not be eligible for the high-wage jobs tax credit by way of JTIP, as companies eligible for JTIP have to be manufacturers or provide a non-retail service with 50 percent of revenue coming from a customer base outside New Mexico. However, extraction and other non-manufacturing businesses are eligible for the high-wage jobs tax credit through the less stringent 50 percent outside sales clause in Section 7-9G-1 NMSA 1978. Amending statute to peg eligibility for the high-wage jobs tax credit to eligibility for JTIP would exclude the extraction industry, with its high employee turnover rate, from being eligible for the credit. During the Second Special Session of the Fifty-Second Legislature, a bill passed and was signed into law requiring both 50 percent of sales or services out of state *and* eligibility or participation in JTIP to claim the high-wage jobs tax credit.

Also, as the high-wage jobs tax credit is refundable and directly impacts the general fund, the credit is a strong contender for a cap. Enacting a cap would provide increased predictability to both the state for budget purposes as well as to industry. Capping this tax credit could ensure revenue predictability for the state similar to how the Legislature appropriates a fixed amount annually to the Local Economic Development Act (LEDA) fund and JTIP.

Healthcare Practitioner Deduction

The Healthcare Practitioner Deduction was enacted in 2004 virtually eliminating gross receipts tax liability for medical services. Health care providers such as physicians, dentists, and nurses can deduct payments from organized health plans for services to patients from gross receipts. The purpose of this deduction is not clearly defined in statute.

Chart 9. Healthcare Practitioner GRT Deduction and Hold Harmless FY09-FY15
(in millions)

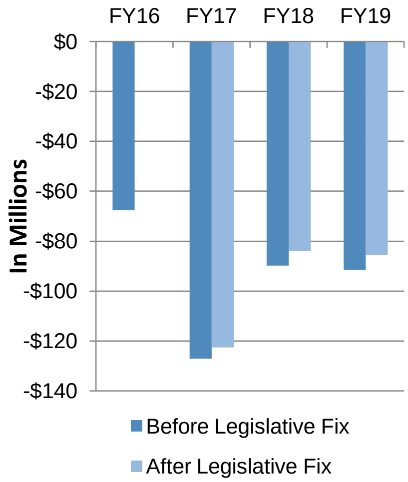


Source: 2014 and 2015 NM Tax Expenditure Reports

The Healthcare Practitioner Gross Receipts Tax Deduction, along with associated hold harmless payments to local governments, cost the state $494 million between FY09 and FY15. When the Legislature repealed gross receipts tax for food and medical services in 2004, it also created a hold harmless payment to local governments. These payments were intended to offset lost revenue from local gross receipt taxes. The impact of the tax deduction and the associated hold harmless payments is shown in Chart 9.

The intent of this tax expenditure is not clearly defined in statute, but legislative analysis of the bill speculated eliminating the tax would increase provider take home pay, which could enhance recruitment and retention. Moreover, providers would not be able to pass the tax burden on to patients, increasing citizen disposable income. A 2011 LFC evaluation found the health care practitioner GRT tax deduction and the associated hold harmless payments to local governments resulted in a double impact to the general fund through both forgone revenue and direct expenditures. In 2013, the Legislature repealed the hold harmless payments for local governments, phasing the payments out completely by 2029.

Chart 10. Healthcare Practitioner GRT Deduction and Hold Harmless Estimated General Fund Impact



Source: August 2016 Consensus Revenue Estimate and LFC Files

A May 2016 Administrative Hearings Office (AHO) ruling greatly impacts the health care practitioner tax deduction due to unclear statute. A rehabilitation hospital operating in the state attempted to claim the health care practitioner deduction, and was denied by TRD based on the hospital not meeting the definition of a health care practitioner. However, AHO ruled in favor of the rehabilitation hospital stating the deduction is clearly for services provided by a healthcare practitioner, but there is no statutory restriction as to which taxpayer may use the deduction in Section 7-9-93 NMSA 1978. This ruling sets a precedent allowing other types of hospitals and medical facilities that employ or contract with providers who meet the statutory definition of health care practitioner to take this deduction against gross receipts taxes.

Without clarifying in statute who may take this deduction, the state stands to lose millions in additional forgone revenue. As this tax deduction triggers a hold harmless payment for local governments, the AHO decision will also impact the general fund directly. The August 2016 Consensus Revenue Estimate forecast the combined impact of the health care practitioner tax deduction and hold harmless payments to local governments through FY19 as noted in Chart 10. The Legislature took action to clearly define who is eligible to claim the health care practitioner tax deduction during the Second Special Session of the Fifty-Second Legislature. The impact of this legislative change is also noted in Chart 10.

Film Production Tax Credit

The Legislature passed the Film Production Tax Credit in 2002 with the goal of increasing employment by establishing the film industry as a permanent component of New Mexico's economic base. Production companies can take a 25 percent credit (30 percent in the case of television productions) for expenditures made in New Mexico.

Table 22. Film Production Tax Credit Timing

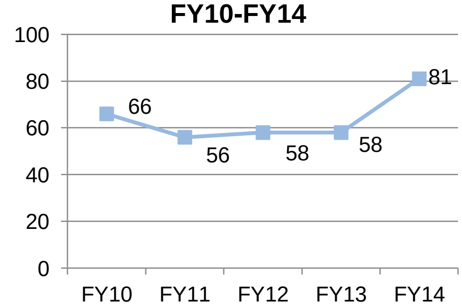
Credit Amount	Timing of Payment
Less than $2 million	Upon authorization for payment
$2 million to $5 million	Divided into two payments twelve months apart
$5 million and greater	Divided into three payments twelve months apart

Source: LFC Analysis of Section 7-2F-1 NMSA 1978

The film production tax credit is an example of how a cap can be used successfully to ensure more predictability for both the state and the taxpayer. Between FY03 and FY12, the film production tax credit was a volatile tax expenditure, ranging from as low as $1 million to as high as $82 million in credits annually. With enactment of HB 641 in 2013, the Legislature put a $50 million cap on the credit, allowing for disbursement of credits to be spaced out based on amount claimed across as many as three years and allowing dollars still available under the cap to be used towards future payments as defined in Table 22.

These actions provided some flexibility to TRD to manage the dollars assigned to the film credit. Pew found, in their 2012 report, caps similar to the one placed on the film production tax credit are the strongest type of cap because it controls a state's costs annually on a particular tax incentive. Furthermore, evidence shows use of the credit grew since enactment of the $50 million cap, with a 40 percent increase from FY13 to FY14 alone, as shown in Chart 11.

Chart 11. Film Production Credit Claims FY10-FY14



Source: 2015 NM Tax Expenditure Report

The cap on the film production tax credit also provides evidence showing demand for the credit. While the fiscal impact report for HB 641 does not go into detail about why a cap of $50 million was proposed, taxpayer behavior since the cap was enacted shows the $50 million dollar ceiling is appropriate. In fact, for FY13-FY15, initial credits came in below the $50 million cap, allowing TRD to accelerate payments slated for the second or third year for larger credits.

Corporate Income Tax

The corporate income tax rate reduction, while intended to increase economic activity, is further contributing to declining general fund revenues. A 2011 Ernst & Young report expressed concerns over the state's tax structure and its potential negative impact on attracting businesses to the state. The New Mexico Tax Research Institute noted reducing the top corporate income tax rate would make the state more appealing to business investment. As part of a larger tax package passed in 2013, the Legislature passed a corporate income tax (CIT) rate reduction for the top two rate tiers to be fully phased in by 2018, as shown in Table 23.

Table 23. Corporate Income Tax Rates 1987-2018

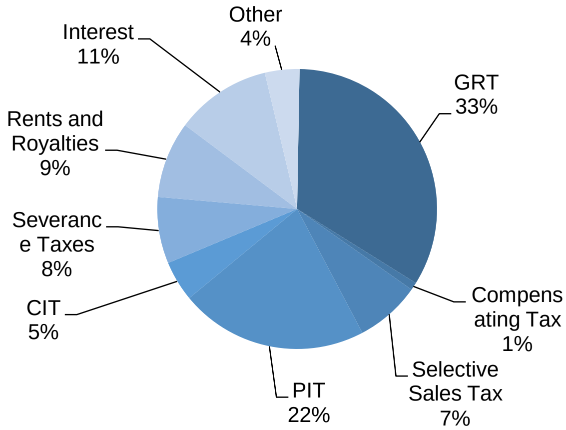
Thresholds	1987-2013	2014	2015	2015	2017	2018
Up to $500,000	4.8%	4.8%	4.8%	4.8%	4.8%	4.8%
$500,000.01 to $1,000,000	6.4%	6.4%	6.4%	6.4%	6.2%	6.2%
Over $1,000,000	7.6%	7.3%	6.9%	6.6%	6.2%	5.9%

Source: 2015 NM Tax Expenditure Report

However, declining CIT collections have further exacerbated general fund impact of declining royalties and severance tax revenues from the oil and gas industry. The fiscal impact report for this bill spoke to potential lost revenue estimated at $157 million through FY17, but it failed to look at what this lost revenue would signify in the greater context of how different state revenue sources interact with each other. For example, the Consensus Revenue Estimating Group noted in its August 2016 brief that corporate income tax revenues appear to depend on the oil and gas industry as CIT decreases coincided with the drop in both oil prices and drilling activity. If this interdependence between CIT and oil and gas prices holds true, the impact of this rate reduction is far greater than just reducing revenues for a tax that accounts for less than 5 percent of general fund revenues as shown in Charts 12 and 13.

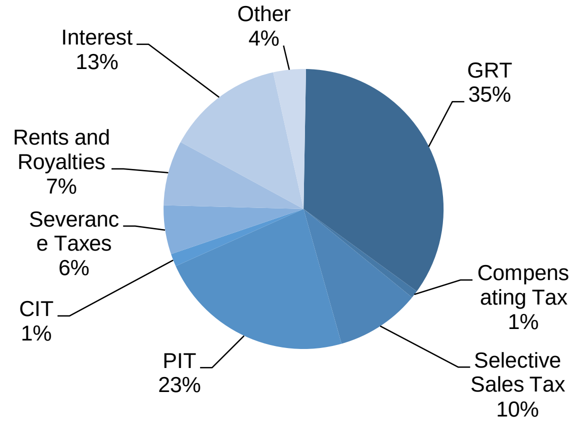
When combined, the three tax revenues most impacted by the oil and gas industry (severance taxes, rents and royalties, and CIT) make up close to 15 percent of the general fund, making it the third largest revenue source after GRT and personal income taxes. This would make for a far different discussion on the impact of corporate income tax policy changes in the current economic environment. Moreover, the legislation did not provide for an evaluation of the CIT rate reduction which, in light of the current situation, would be a valuable tool in assessing the true impact of this tax policy.

Chart 12. FY13 Revenue Mix



Source: December 2013 Consensus Revenue Estimate

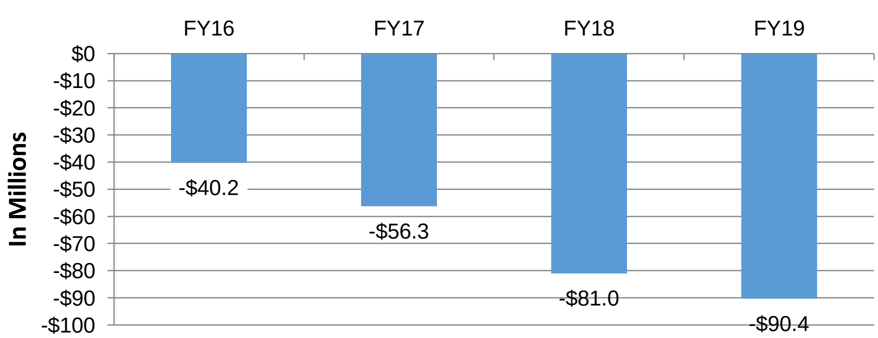
Chart 13. Estimated FY18 Revenue Mix



Source: August 2016 Consensus Revenue Estimate

Corporate income tax revenues are further impacted by the single sales factor apportionment for manufacturing. HB641 also included a provision for manufacturers to apportion business income based on a formula placing greater emphasis on sales versus property or payroll. Full implementation of this formula will occur in tax year 2018. The fiscal impact report for HB641 identified potential forgone revenue of $85 million through FY17, however analysts noted the definition of manufacturer in the bill was broader than what analysts could identify for their fiscal impact analysis. This could lead to greater forgone revenue. In their August 2016 report, the Consensus Revenue Estimating Group forecast the general fund impact of the CIT rate reduction and single sales factor through FY19 as noted in Chart 14.

Chart 14. CIT Rate Reduction and Single Sales Apportionment Estimated General Fund Impact



Source: August 2016 Consensus Revenue Estimate

Recommendations

The Legislature should consider amending statute to:

Create a broad sunset review process for tax expenditures, where tax policies are reviewed every five years, and where alternating groups of tax expenditures are reviewed every year to meet this five-year requirement with the Legislature voting to extend, terminate, or amend the tax expenditure. The review should include the completion of an evaluation assessing overall impact and make recommendations to the sunset committee on how to strengthen or whether to eliminate the tax expenditure. This review timeline should not preclude agencies overseeing tax expenditure data from publicly reporting data more frequently as statute or practices dictate, nor prevent agencies overseeing tax expenditures, such as TRD, from bringing forth proposed changes to address loopholes as needed. The sunset review will require data sharing where taxpayers may have to waive confidentiality to an extent to perform the evaluation. Statute should also address what entity will manage the sunset review process;

Require newly proposed tax expenditures be vetted through interim committees including the Revenue Stabilization and Tax Policy Committee and the Legislative Finance Committee where fiscal, legal, and general policy parameters can be reviewed. A report either endorsing or expressing concerns over the legislation should be generated from this process;

Require all newly proposed tax expenditures include a cap in order to better predict fiscal impact with the ability to amend a cap upward or downward during sunset reviews; and

Place an annual cap on the high-wage jobs tax credit with the ability to adjust the cap as needed.

The Legislative Finance Committee should consider adopting:

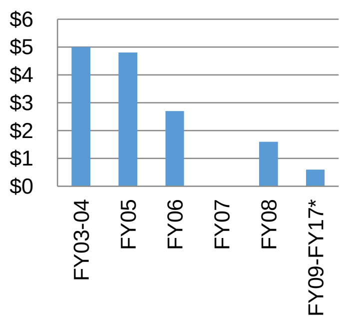
A fiscal impact report form and process for staff specific to tax expenditure bills identifying if proposed legislation meets the following criteria:

Vetting: Was the bill vetted through LFC or RSTP reviewing fiscal, legal, and general policy issues?
Targeting: Does the bill include a clear purpose, long-term goals, and measureable annual targets to identify progress?
Transparency: Does the bill require annual reporting to TRD and other relevant agencies?
Accountability: Does required reporting allow the public to determine progress towards goals, as well as efficiency and efficacy? Does the bill include a sunset clause?
Effectiveness: Does the tax expenditure fulfill the stated purpose, such as altering taxpayer behavior? Would the intended recipient of the tax expenditure behave the same if the tax expenditure did not exist?
Efficiency: Is the proposed bill the most cost-effective way to achieve the desired outcome?

The Audit and Compliance Division Collected $1 Billion over the Last Five Years but Growing Challenges Threaten Revenues

The Legislature appropriated $15 million from 2003 through 2009 to support various aspects of the Enhanced Delinquent Tax Collection Initiative (Initiative).

Chart 15. Appropriations for Initiative
(in millions)



*Increases in FTE and Personal Salary & Employee Benefits appropriations were offset by reductions during solvency years.
Sources: LFC Files; General Appropriation Act FY09-FY17

The Audit and Compliance Division (ACD) projects ACD assessments will decline by $70 million in FY17 from $196 million for FY16, impacting future revenues collected

The Legislature launched the latest large-scale effort to collect more delinquent taxes in 2003, expanding programs within TRD through 2009. Momentum for the Enhanced Delinquent Tax Collection Initiative (Initiative) has slowed the last few years, almost to the point of reversing course. Budget constraints imposed by solvency measures taken during economic downturns continue to impact staffing, impeding the division's function as a revenue generator. Internal inefficiencies compound this issue.

The ability to support the Initiative, originally robust, has bumped along with state revenues since the Great Recession. Legislative support enabled TRD to execute several key actions central to the Initiative's performance:

- Increased staff by 62 FTE in the Audit and Compliance Division;
- Reorganized the Tele-collection Bureau as an official Call Center Bureau, assigning additional resources;
- Upgraded GenTax to track collection metrics, automate some functions, provide a seamless process for account management, and help assess viability of delinquent accounts;
- Instituted the online taxpayer access point (TAP) that allowed tax payers easier access to accounts and make payments; and
- Expanded audit and compliance programs that offered additional avenues to both assess and collect delinquent taxes.

Since the Great Recession, however, ACD has seen an ebb and flow in its operating budget and filled full-time-equivalent (FTE) count supported by general fund (GF) appropriations.

Total Reductions over Period:

General fund: ($8.2 million)

Total FTE: (71.5)

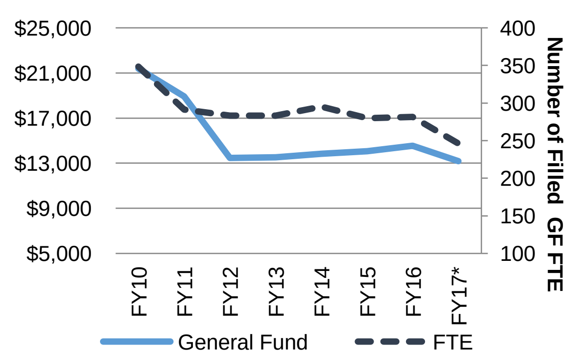
GF FTE: (67)

Filled GF FTE: (102.5)

Other state funds increased from under $500 thousand to $6 million over this period.

Sources: TRD Administrative Services Division, TRD Operating Budgets

Chart 16. Decline in GF Budget and Filled GF FTE
(dollars in thousands)



*FY17 budget still requires the Special Session reduction of 5.5 percent.
Source: TRD

ACD is one of two divisions in the Tax Administration Act (TAA) program. The other is the Revenue Processing Division (RPD). TAA saw its largest general fund reduction of $6.1 million for FY12, which was partially offset by a $5 million increase in other state funds. Policymakers anticipated savings accruing from efficiencies gained in RPD – such as the increased electronic filing, the modernization of the building housing RPD, and GenTax enhancements – would help make up the difference. TRD has not quantified savings from these improvements.

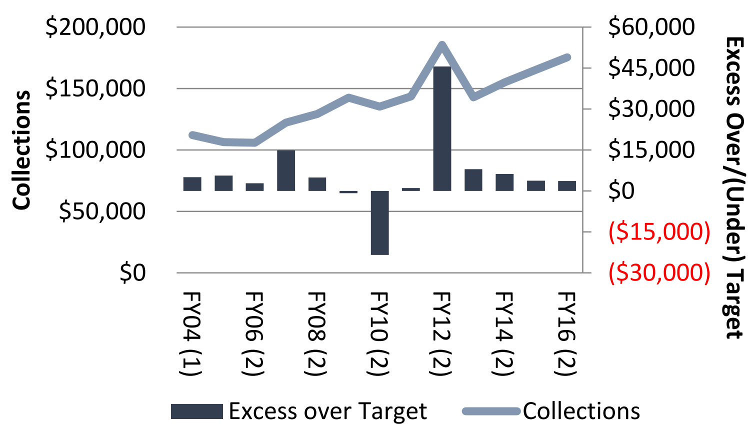
ACD reported a record assessments value of $196 million for FY16 despite budget constraints but now indicates more budget cuts mean reducing expectations for FY17. Beginning FY17 down over $3 million in its operating budget and minus 72 FTE since the program's peak in FY10, ACD is expecting another 5.5 percent general fund reduction per Senate Bill 9 passed during the special session to balance the state's budget. This will trim another $763 thousand. Consequently, ACD's initial July projection for assessments of $138.9 million (down $57.1 million from FY16), is dialed even further down to $126 million.

From inception of the Initiative, ACD increased collections going to the general fund by 200 percent

The agency met or exceeded most targets associated with the Initiative. Targets are set for total collections as well as for the general fund. General fund targets include a computed baseline plus any goal amount added for the year. Since the inception of the Initiative, TRD has exceeded its general fund targets in all but two years. From $112.5 million reported for FY04, general fund collections grew to $175 million in FY16. The original 2003 baseline was $57 million.

The most recent five-year collection activity covered 25 taxes, ranging from $700 million for gross receipts tax to $541for the conservation tax. Table 24 highlights the top tax programs while Appendix F details the "other" category, spanning 18 special taxes that combine for 2 percent of total amount collected.

Chart 17. Enhanced Delinquent Tax Collection Initiative Since Inception



Source: TRD

Table 24. Total ACD Collections FY12 – FY16
(in thousands)

Tax Program	Amount	Percent of Total
CRS - Gross Receipts	$694,869.7	61%
Personal Income Tax	$191,060.5	17%
Corporate Income Tax	$89,962.8	8%
CRS - Withholding	$77,110.2	7%
Oil & Gas	$44,516.6	4%
OGP Withholding Tax	$10,629.0	1%
CRS - Compensating	$7,939.7	1%
Other*	$21,907.8	2%
Total	$1,137,996.4	100%

*See Appendix F for detail.
Source: TRD

Table 25. Primary Taxes – Percent Contributed to the General Fund*

Gross receipts	61%
Compensating	100%
Withholding	100%
Corporate	100%
Personal	100%
Oil & Gas	44%

*As of FY16
Source: TRD

Despite progress, a 36 percent increase in delinquent accounts since FY12 indicates a slowdown in collection effectiveness

Taxes owed but not paid have drifted up from $539 million in FY12 to over $730 million by the end of FY16.

Table 26. Delinquent Debt – FY16*
(in thousands)

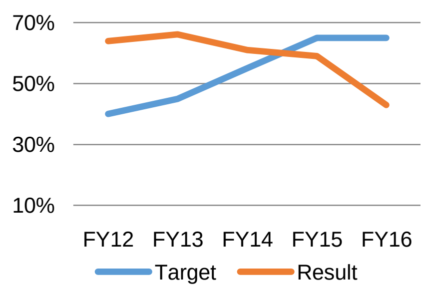
Tax Program	Yearend Receivables*	% of Total
Corporate income tax	$109,656.5	15%
Combined Report System	$354,143.5	48%
Personal income tax	$243,750.7	33%
Other	$25,750.5	4%
Total	$733,301.2	100%

*Unaudited
Source: TRD

TRD staff points to New Mexico's sluggish economy as a consideration. Assessments run two years behind the fiscal year due to the federal reporting timelines, meaning taxpayers were being assessed in FY16 for tax year 2012 or earlier. It is possible taxpayers had healthy incomes during that period to generate tax obligations they can't pay now because they have subsequently retired, remained out of work, worked for less money, or closed businesses due to the recession and subsequent oil and gas slowdown.

Collections have not kept pace with assessments. Collections are made on aged delinquent accounts arising in prior fiscal years as well as new assessments entering into the system in the current fiscal year. ACD tracks collections as a percent of each category separately to measure progress made on both fronts. While the percent of aged accounts being collected has remained fairly stable at 18 percent over the last five years, the percent of new assessments being collected has plunged from a high of 66 percent to 43 percent reported for FY16.

Chart 18. Collections on Current Year Field Audit Assessments



Source: TRD

Performance Measure:

Collections as a percent of collectable (field) audit assessments generated in the current fiscal year.

The Council on State Taxation (COST) attributed New Mexico's improvement from a D to a B score primarily to the 30-to-90 day protest extension.

In FY14, the agency attributed the decline to the state enacting Laws 2013, Chapter 27, an agency-sponsored bill meant to make the Tax Administration Program more taxpayer friendly by extending timelines for taxpayer action, such as moving the amount of time to protest an assessment from 30 days to 90 days. From the Compliance Bureau's staff point of view, "*The new legislation of 90 days for the department to act has severely hampered our ability to collect on these assessments*."

Best practices approach to debt management supports this view: as the debt ages, the likelihood of it being collected declines. A model testing whether 90-day dollars were more difficult to collect than 30-day dollars was inconclusive. However, waiting the extra 60 days has impacted collection efforts on new assessments, contributing to the accounts receivable rise from FY13 as an indirect effect. Yet other factors weigh in, as discussed below.

Delinquent collections primarily occur in the call center. Call center staffing became an issue in FY16, particularly the last half of the year, when vacancies jumped from five to eight in January and the vacancy rate peaked at 21 percent. Seven positions remained unfilled for the rest of FY16.

Forced vacancies during a year of record assessments further dampened FY16 results.

As reported by division management, paperwork to fill six vacant collector positions was submitted in January as part of the division package for filling vacancies but got held up in the unofficial hiring freeze. When approval finally came through to hire, it restricted the authorization only to classifications with "Auditor" in the title.

Collectors are "Tax Examiner/Collection/Revenue Agents" and so did not qualify. In essence, the dictate compounded the problem by potentially increasing audit assessments with a limited number of collection staff to follow-up on them once delinquent. As of October, the six revenue agent positions remain vacant.

Based on a TRD 2008 analysis, replacing three revenue agents would have generated $1.9 million net of expenses, or $1.3 million general fund, within 12 months and half that for January-June. The numbers and methodology for their development appear reasonable. However, ACD is currently updating its ROI analysis for revenue agents to justify filling positions.

The call center's collection efforts have been hampered by both internal and imposed inefficiencies. While collections occur across the Audit and Compliance Division (ACD), primary responsibility for delinquent accounts rests with the Compliance Bureau. Accounts over $50 thousand are assigned to the appropriate field office to handle, and the rest are routed to the Call Center Bureau located in Albuquerque. Call center activity accounted for over 50 percent of FY16 collections as shown in Table 27.

Table 27. FY16 Collections by Compliance Bureau
(in thousands)

Location	Collected	Percent of Total
District A - Albuquerque	$28,065.7	14%
District B - Santa Fe	$37,942.4	19%
District C - Las Cruces	$11,003.3	6%
District D - Roswell	$12,349.1	6%
Call Center Bureau	$105,775.3	54%
Total	$195,135.8	100%

Source: TRD

The collections call center is handicapped by staffing issues, lack of expert management, ineffective business practices, and antiquated technology. The agency is beginning to consider a proposed overhaul similar to the one executed for Motor Vehicle Department offices in 2012 as discussed below.

The call center IT systems are woefully inadequate, all the way from providing industry-standard customer service to obtaining basic call reports normally used to manage operations. The interactive voice response (IVR) system does not meet security standards, does not offer flexibility such as customers being able to select an option for Spanish, and is generally outdated.

An $800 thousand predictive dialer upgrade installed in 2013 to gain efficiency through automated outbound calls remains inoperable. A predictive dialer calls numbers until a person is reached and then transfers the call to an agent, eliminating unproductive agent time.

ACD commissioned Heights Consulting to analyze its call center but has not implemented any recommendations contained in the 2014 report: "Roadmap for New Mexico Taxation and Revenue Customer Contact Center."

In contrast, MVD uses a cloud-based system, providing several advantages such as remote diagnostics and fixes, a set cost versus per call and per service charges, and a flexible system that keeps pace with technology.

Call metrics are vital to optimize staffing and staff accountability.

During an LFC onsite visit to the call center, only five revenue agents were taking calls and the wait time was 40 minutes. Other staff were taking breaks or working on lien or levy projects.

Productivity cannot be monitored because the reporting system (IntelliCenter) generates inaccurate data on call metrics. For instance, for the period of the LFC site visit, IntelliCenter reported 252 calls were received and only 9 answered, with 10 calls abandoned. Staff was able to locate information elsewhere confirming 118 calls answered and recorded. TRD has been requesting converting from IntelliCenter to another DoIT product, Call Management System (CMS), since June. While DoIT confirmed TRD was a priority customer for this migration, as of October 4, TRD has not received an update since July on the implementation timetable.

Personnel issues range from a lack of a career ladder to create professional advancement within the center to inefficient business practices. Almost a third of the staff work part-time, including many students looking for flexible schedules. Performance metrics are not set for employees, leading to uncertain productivity. For example, call center employees averaged 51 seconds between calls while MVD sets its wait time between calls at 30 seconds and is considering lowering it since staff average 15 seconds. Minimal training in customer service is provided, with new staff paired with a senior person for two to three weeks before taking calls independently. In contrast, MVD offers scripts for consistent messaging, holds regular customer service training, and provides additional opportunities for staff to upgrade skills.

Call center collection activity has been diluted with the shift of incoming calls from other divisions, such as taking 75 percent of Revenue Processing Division customer calls since FY14. Non-collection calls reportedly spiked during the 2016 tax season as people wanted to know where their refunds were. However, TRD cannot break down call volumes by type to quantify the impact. The agency is looking to reduce the incidence of division call transfers so the call center can focus on collections.

According to IntelliCenter reports, the call center has seen some efficiency gains with the arrival of an interim director who replaced the long-time director who retired in January. The dropped call rate of 23 percent reported for April 2016 fell to 7 percent by September. The voicemail option was also removed due to the ineffective back and forth messaging that took place.

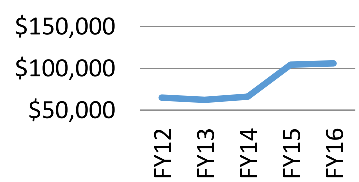
Changing taxpayer behavior also contributed somewhat to the rise in accounts receivable. Accounts receivable can be permanently reduced or temporarily frozen through seven types of actions regarding delinquent accounts noted in Table 28. Defined in Appendix G, they reduce the number of accounts that revenue agents can pursue.

Table 28. Change in Reductions FY12-FY16

Reduction Types	FY12	FY16	$ Change FY12-FY16	% Change FY12-FY16
Audit	$902	$2,356	$1,454	161%
Adjusted Down	$11,691,474	$36,350,320	$24,658,846	211%
Abated	$10,301,506	$23,678,551	$13,377,045	130%
Deactivated	$20,325,604	$10,871,521	($9,454,083)	(47%)
Protested	$121,181	$5,192,000	$5,070,819	4185%
Reversed	$19,125,020	$24,240,090	$5,115,070	27%
Bankruptcy	$3,654,127	$5,631,429	$1,977,303	54%
Other	$410	$4,956	$4,546	1109%
Total Reductions	$65,220,223	$105,971,223	$40,751,000	62%

Source: LFC Analysis based on TRD data

Chart 19. Total Reductions (in thousands)



Source: TRD

Spiking 62 percent from FY12 to FY16, or $41 million, most were permanent reductions due to taxpayers filing amended returns (adjusted down), submitting documentation justifying the reduction, or receiving a favorable protest outcome (abated). Deactivated accounts bucked the trend, peaking in FY12.

Analyzing protest trends would provide valuable insight into tax code vagaries open to interpretation and loopholes requiring fixes.

Protests increased significantly, as shown in Table 28, from $122 thousand in FY12 to over $5 million by FY16. Whether due to the expanded time taxpayers have to file a protest, the surge in high-wage credit applications that were denied, or a decline in audit quality is indeterminate. TRD does not monitor protests as a quality control measure to provide feedback to the Audit Division and has limited data due to an inadequate tracking system for protests. For example, protest amounts for credit and refund denials were not captured.

TRD is likely understating collections. TRD does not internally audit collections, a best practice. If the agency had, it likely would have caught an anomaly that crept into GenTax reporting in 2012 that causes any adjustments in prior year collections to show up as a negative. Known as "reversals," these entries generally entail moving the amount from one tax program to another but should not impact the current year.

One report adds the total reversal amount as an adjustment to generate total collections to calculate collection goals, but TRD has been using the unadjusted amount to report collections. The reversal amount has grown from $1.3 million in FY12 to over $10 million in FY16. A more thorough investigation is warranted to determine how the reversals should be handled, whether this GenTax glitch can be fixed, and the cause of the rise: whether staff is improperly coding collections or receiving additional information to correct the original entry.

Rather than collecting money, two Initiative programs focus on preserving state dollars by preventing state money from improper distribution, but effectiveness cannot be measured

The Enhanced Delinquent Tax Collection Initiative followed three tracks to advance general fund revenues.

Figure 6. Enhanced Delinquent Tax Initiative

Collections + **Credit Denials** + **Refunds Stopped**

Goals are established annually for each segment and performance is reported against those goals. However, credit denials and refunds stopped are combined in the final reporting format. Separate goals are set for the general fund impact because not all dollars flow back to the general fund. As summarized in Table 29 and detailed in Appendix H, the agency reported achieving 105 percent of its general fund goal of $183 million, or $192 million, in FY16.

Table 29. Summary of FY 16 Initiative Report
(in millions)

Total Collections/Credits/Refunds	
Collections	$239
Credit Denials and Refunds Stopped	$18
Total	$257
Amounts to the General Fund	
Collections	$186
Credit Denials and Refunds Stopped	$16
Total	$192

Source: TRD

Reporting general fund savings of $16 million from refund-credit denials, or 152% of the goal, misrepresents program effectiveness. The results reflect only initial denials. Subsequent actions on pending items are not reflected. For example, successful protest actions that would reduce that amount are not included. Furthermore, this information is not available. Not only are the credit amounts approved though the protest process missing, amounts abated for personal income tax refund denial protests are similarly unknown. Thus, the amount shown for refund-credit denials to represent general fund savings is likely overstated and true ending general fund savings associated with these programs remain unknown.

The Audit & Compliance Division (ACD) does appear to thoroughly vet each application to minimize unwarranted approvals. ACD disallowed almost half of the $436 million in requested credits over the last three fiscal years for the seven programs it monitors. Staff auditors follow a standardized process and, per statute, have 180 days to complete the review or the credit is considered approved. Reasons for disallowing all or part of a credit range from incomplete submissions, which can apply to any credit, to issues related to statutory requirements specific to each credit, called an "element."

When elements, or statute, are clear-cut, the review is relatively straight-forward. ACD staff notes the film program falls into this category. Compliance is also enhanced by the close partnership TRD has developed with the Economic Development Department to work closely with production companies. The low, three-year average of 3 percent for disallowing film credits shown in Table 30 is fairly stable as a consequence.

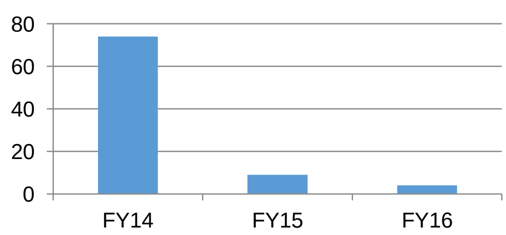
Table 30. Credit Applications Completed FY14 –FY16
(in thousands)

Credit Type	# Applications	Requested	Allowed	Disallowed	% Disallowed
Film Production	206	$147,597.6	$142,620.8	$4,976.8	3%
High-wage Jobs	551	$247,075.0	$45,907.3	$175,956.8	71%
Advanced Energy	5	$4,324.0	$880.4	$3,443.6	80%
Alternative Energy	3	$190.7	-	$190.6	100%
Investment	53	$10,799.7	$3,640.1	$7,159.7	66%
Rural jobs	17	$4,543.0	$4,383.2	$159.8	4%
Technology	110	$21,470.5	$14,647.6	$6,822.9	32%
Total	945	$436,000.5	$237,290.3	$198,710.2	46%

Source: TRD/ACD

Other credits have been more problematic, such as the high-wage credit. A protest indicates there is an underlying issue, whether it is a misapplication of law, differing interpretations of law, missing documentation, or outright data mining to test boundaries to exploit. Lawyers and accountants can be aggressive in serving their clients and pushed hard on the high-wage credit prior to statutory changes. Over this three-year period the protest office logged 89 protests; all but two related to this credit as businesses scrambled to take advantage of the loopholes before some were closed. In this case, protests reflected taxpayer behavior. TRD did not provide the final dollar amount of protested credits that were subsequently approved.

Chart 20. Number of High-Wage Credit Protests



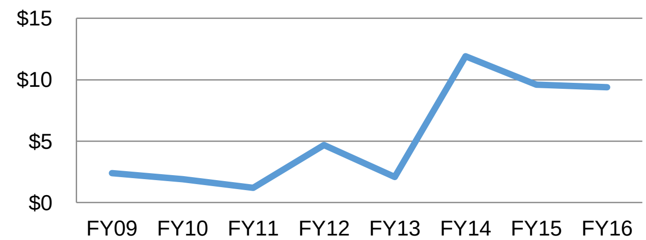
Source: TRD

The evaluation reviewed templates, procedures, and process flow charts for the film and high-wage credits, and conducted extensive interviews with staff, but did not review individual applications to verify accuracy and proper application of law due to confidentiality restrictions TRD imposed at the time.

Tax refund denials have almost tripled since FY09 as part of the effort to combat refund fraud but TRD cannot say how much is actually fraudulent. Denied refunds for personal income taxes (PIT) topped in FY14 at $12 million, settling just under $10 million for the last two years. TRD distinguishes between questionable returns – those being flagged by the data warehouse to set them aside – and those actually determined to be fraudulent. For FY16, 14 percent fell into the fraud category, or $1.3 million out of the $9.4 million questioned. The remaining refunds totaling $8 million will remain in the questionable category unless legitimate taxpayers step forward to claim refunds or a subsequent investigation determines returns originated from illegal activity. Additionally, ACD cannot provide how much was actually refunded as an illegal payout. Thus, the effectiveness of the program cannot be measured by the total amount stopped. For FY16, 420 refund denials were protested at an undetermined success rate.

TRD did not provide the final dollar amount of protested credits or refunds that were subsequently approved.

Chart 21. Value of PIT Refunds Stopped
(in millions)



Recommendations

The Legislature should consider:

Restoring funding in areas of ACD that demonstrate a high return-on-investment for enhanced revenue collections, such as funding auditors and revenue agents, through shifts from other TRD operations plus new money;

Also consider funding half (3 FTE) of the six vacant revenue agent positions, looking for efficiency gains in call center operations as an alternative to increased staffing until revenues recover; and

Adding budget adjustment request (BAR) authority to provide flexibility to TRD for moving a limited amount of general fund dollars from other programs to collections as need arises.

The Taxation and Revenue Department should:

Modernize the call center to current best practices by taking the following actions:

- Hire a call center expert as the director and revamp the call center business processes, reporting, personnel management, and culture, including incorporating appropriate best practices identified in the Heights Consulting, "*Roadmap for New Mexico Taxation and Revenue Customer Contact Center;*
- Consider transferring the call center from DoIT information technology products to the more advanced cloud-based platform used by the Motor Vehicle Division call center; and
- Consider long-range plans to consolidate all TRD call centers under single management;

Upgrade the Protest Office IT tracking capability to so the bureau can report key metrics back to ACD for gaining insight on protest outcomes to enable quality control measures on audits, tax law, and individual auditors;

Investigate the GenTax glitch producing reversed accounts, determine the cause behind their increase, fix the glitch if cost-effective, and revise reports to accurately reflect collections if needed; and

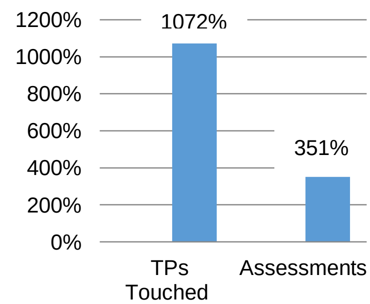
Implement processes to better define and measure the questionable refund initiative's effectiveness in preventing fraudulent refunds by tracking actual fraudulent refunds stopped, refunds eventually paid to legitimate taxpayers, and fraudulent returns filed that were not stopped and paid twice.

Data Warehouse Technology Has Driven Huge Efficiency Gains but Some Weaknesses Weigh Against Attaining Full Benefit

Data warehouse technology increased assessments by 351 percent that has not been matched by an equal advancement in collections

The advancement of data warehousing and analytics has revolutionized states' ability to track down missing tax dollars. The power lies in the information technology advancements that now allow TRD to collect a large amount of data, gathered from a wide range of sources, into a single repository. Within the repository, data elements can then be compared to discover discrepencies, such as comparing an IRS tax return to the one submitted to the state to check reported income. Information is then processed through scoring models (data analytics) to generate leads with the highest risk. TRD began developing its data warehouse in 2005, adding new sources of information and leveraging its functionality since then.

Chart 22. Increase in Tax Compliance Outcomes due to Implementing Data Warehouse



Source: TRD

Before and after comparisons highlight the effectiveness of adopting the data warehouse platform as a primary tool in targeting taxpayer (TP) noncompliance, whether unintentional or intentional. Comparing outcomes for two tax programs occurring prior to its implementation and eight years after reveals assessments more than tripled under the data warehouse regime.

Table 31. Comparing Outcomes Before and After Data Warehouse Implementation for Two Programs
(dollars in millions)

Period	Warehouse?	Tax Program	# Taxpayers	$ Assessments
1991-2004	No	PIT	12,000	$33
1991-2004	No	Schedule C		$40
Total Assessments				$73
2005-2013	Yes	PIT	140,653	$227
2005-2013	Yes	Schedule C		$102
Total Assessments				$329

Source: Taxation and Revenue Department (TRD)

However, collection efforts failed to keep up with the new pace. The percent of assessments actually collected declined between the two periods from 67 percent to 40 percent for the personal income tax (PIT) program and from 40 percent to 29 percent for the Schedule C project. This project compares the federal Schedule C form that sole proprietors submit to the IRS to New Mexico's gross receipts taxes reported to the state. The data warehouse will pick up any discrepancies, allowing TRD to follow up with those taxpayers. However, the process will not work if the taxpayer underreports to both entities by the same amount.

Collections did increase $82 million from the pre-data warehouse period.

Essentially, the data warehouse modernized the audit side of the Audit and Compliance Division (ACD) while leveraging data warehouse information to aid collections to a much lesser degree. Without increased automation for collections afforded by GenTax upgrades, the discrepancy in outcomes for the two sections would have been much greater. Nevertheless, total collections increased $82 million from the pre-data-warehouse period.

Example GenTax Automations:
-Case management tracking
-Staging for valid phone number
-Automated notices
-Automated monthly account statements

Only two of the 40 warehouse projects support collections. The Collection project was abandoned in favor of the levy and lien projects, which populate GenTax with potential assets for revenue agents to pursue for tax debt obligations.

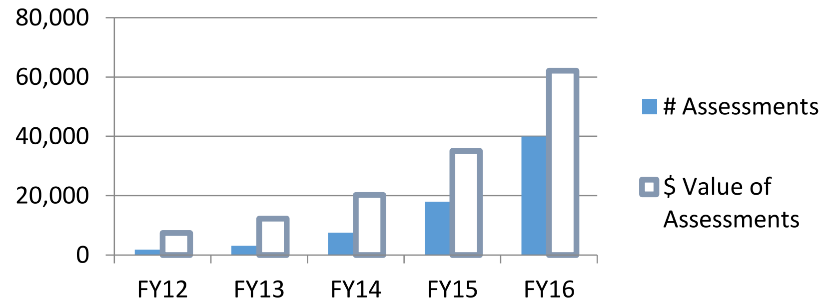
Data warehouse projects seem to follow a typical bell-curve lifecycle, ramping up effectiveness once deployed until facing a point of diminishing returns

To expand functionality of the data warehouse, the division transitioned from the stand-alone Discover Tax platform to the combined GenTax Data Warehouse, beginning in 2012. The transition occurred in four phases covering 40 projects or phases of projects, as shown in Appendix I. The effort yielded 16 separate tax gap initiatives but only two actively support collections.

The Schedule C project, targeting sole proprietors, has been one of the most successful programs but appears to be reaching a point of diminishing returns. Growing from 1,805 assessments made in FY12, ACD executed almost 40,000 in FY16. Total assessment value shot up 700 percent.

ACD increased the efficiency of the sole proprietor initiative by introducing a multi-year approach in FY15 rather than focusing on a single year.

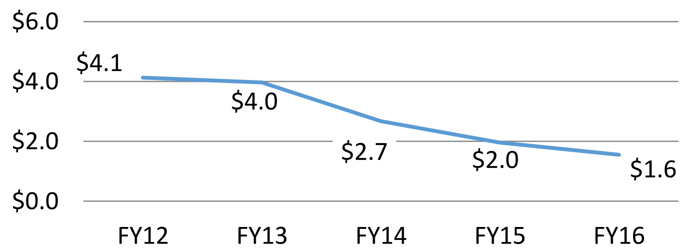
Chart 23. Maturity of Sole Proprietor Initiative (Schedule C) over Five Years
(dollars in thousands)



Source: TRD

However, the average value of each assessment declined over the period.

Chart 24. Five-YearSchedule C Average Assessment
(in thousands)



Source: TRD

ACD employs business processes to guide data warehouse resources, such as rotating through various projects and starting new ones. New projects follow a robust project development process that begins with an idea and follows a well-laid track to final deployment. Post-phase results are analyzed for both effectiveness and "lessons learned" that can be incorporated into the next version of the project's model. Ineffective projects are dropped. ACD plans to broaden its data warehouse programs to produce leads for cigarette field audits, above-the-line personal income tax limited scope audits, and special fuels field audits. Another project to augment collection activity is also on the planning board. Adding projects refreshes the inventory for lead generation.

Effectiveness of the data warehouse to produce quality leads cannot be determined with limited data. ACD supervisors request a batch of leads called a "discovery" from the data warehouse administrators. Leads are then assigned and reviewed for viability, and invalid leads are removed by closing the case. Table 32 might indicate the standard 80-20 rule applies, with 20 percent of leads being discarded, but the inconsistency across projects and lack of a complete data set prevents making any firm conclusion.

Table 32. Percent of Leads Discarded

Data Warehouse Project	FY13	FY14	FY15	FY16
PIT Income Source	N/D	20%	I/D	20%
PIT Tape match	N/D	5%	21%	2%
PIT Revenue Agent Report	16%	N/D	2%	21%

N/D No Data
I/D Insufficient data-only 4 cases reported, 100% discarded.
Source: TRD

According to ACD, generating this limited data set on one tax program was very labor intensive. However, staff indicates this type of performance tracking can be built into the reporting process. ACD does not currently use benchmarking to test data warehouse productivity.

Management decisions can impact data warehouse program effectiveness

The data warehouse process essentially replaces traditional audit planning and review practices, which generally followed an audit plan laid out by management, sometimes powered by a tax gap or risk analysis, and conducted primarily through field and desk audits.

The emergence of the data warehouse process prompted new methods for audit selection, the most visible being the high volume audit. In this case, the data warehouse produces a mass listing of potential leads that are then worked as desk audits. Desk audits are those performed in-house without venturing to the taxpayer's place of business to review records and are quite expedient.

Overlaying managed audits on Schedule C audits produced another efficiency gain by bringing taxpayers current.

The sole proprietor (Schedule C) project is an example of a high volume project, producing the highest assessment total out of the audit type categories reported for FY16.

Table 33. FY16 Assessments by Audit Type
(in thousands)

Audit Type	# of Assessments	Assessment Total	Average Value/Assessment
Field-Combined Reporting (CRS)	245	$54,964	$224
Field-Corporate Income	47	$9,586	$204
Field-Weight Distance	43	$1,315	$31
Field-IFTA/IRP	200	-	-
Field-Other	111	$1	-
Subtotal Field		$65,865	$102
Desk-Managed Audits	996	$18,709	$19
Limited Scope-PIT Above the line	577	$1,315	$2
Limited Scope-High volume-Schedule C (Sole Proprietor)	39,932	$62,129	$2
Limited Scope-Weight Distance Projects	6,375	$14,257	$2
Limited Scope-Compliance (PIT Projects)	7,415	$28,050	$4

Source: LFC

TRD management presumes the data warehouse process adequately replaces all the traditional tools by its ability to point to areas of greatest potential noncompliance and provide large data sets. TRD does not perform traditional tax gap, compliance rates, and audit coverage analyses. Audit coverage measures the effectiveness of an audit program to provide an "audit presence" to

ACD could not provide data to compute coverage rates for its top tax programs.

According to a multi-national study of tax collection performance, a 2009 report concluded, "Top performers conduct extensive research on the nature and prevalence of noncompliance, and regularly define their segmentation based on these insights."

Source: The Road to Improved Compliance, McKinsey & Company, 2009

encourage compliance. Establishing an audit presence means conducting a sufficient number of audits among the various segments of the taxpaying population to make people aware they have a reasonable chance of being audited. As one would expect, adequate coverage improves compliance. Measuring this metric over time can point to potential areas for auditing to bolster public awareness. When coupled with a tax gap analysis that also measures compliance rates, the agency would detect how the data warehouse effectively directs resources to improve taxpayer compliance.

High volume audits might yield significant coverage for sole proprietors but the data warehouse reports the number of assessments, which generally covers multiple periods for one taxpayer. The number of taxpayers is consequently obscured, rendering this metric unsuitable for calculating coverage for this taxpayer segment.

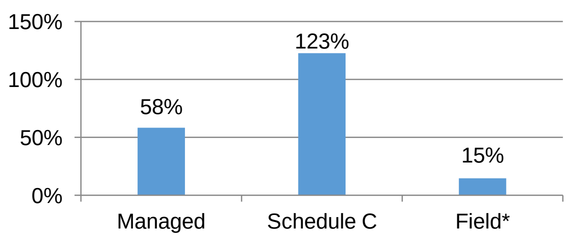
Management focuses on return-on-investment metrics to measure program success; this metric reveals staffing issues can swamp data warehouse efficiency gains. While the data warehouse points to areas of noncompliance, particularly with the maturing of scoring models, ACD management still reviews project performance outcomes and allocates resources accordingly. Return-on-investment (ROI) results are viewed weekly for almost all audit bureaus, combined for monthly reports, and accumulated for end-of-year reviews. The ROI is computed by taking total assessments compared to personnel costs.

Table 34. FY15 & FY16 Return on Investment (ROI) Comparison

Bureau	Audit Types	FY15 ROI	FY16 ROI	Change
Audit Bureau A	Field Audit: GRT, Compensating, Withholding, Workman's Comp, PIT	$29.28	$14.66	($14.62)
Audit Bureau B	Field Audit: GRT, Compensating, Withholding, Workman's Comp, PIT	$21.87	$27.65	$5.78
Audit Bureau C	Field Audit: IFTA/IRP, Fuel Tax, Cigarette & Tobacco Products, Road Use Tax	Not provided as part of the performance tracking.		
Audit Bureau C	Personal Income Tax- Above the line	$4.62	$4.96	$0.30
Audit Bureau D	Desk Audit: Managed Audit	$25.25	$38.39	$13.14
Audit Bureau D	Desk Audit: Schedule C- High Volume/Tape Match	$28.76	$51.94	$23.18

Source: TRD

Chart 25. Percent Change in Number of Assessments FY15-FY16



*CRS & CIT
Source: TRD

As indicated in Table 34, ROIs improved from FY15 for three of the bureaus. In particular, the ROI for managed audits and Schedule C outcomes soared under higher volumes, as shown in Chart 25. Being more labor intensive, field audit volumes ended closer to the FY15 count.

Bucking bureau improvement from one year to the next, Audit Bureau A's performance plummeted by 50 percent. ACD attributes the drop to a series of staffing issues, primarily occurring at the Las Cruces office, and vacancies elsewhere. The Las Cruces tax auditor supervisor was promoted to ACD Director given his extensive experience in private tax practice and 10 years with the IRS.

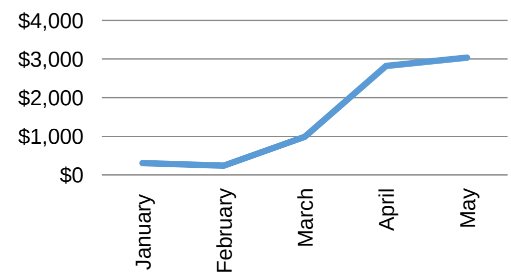
According to TRD, this position has yet to be back-filled due to lack of qualified candidates. Two auditors retired last March, leaving a 50 percent vacancy rate in that office for almost half a year. Despite "auditor" positions being approved in FY16, all three positions remain vacant as of the state's September 1, 2016, organizational listing. Hiring temporary help would assist the office to function more effectively until proper staffing can be attained.

TRD is prioritizing staffing resources to further develop the data warehouse and the questionable refund unit, perhaps at the cost of filling audit and other revenue agent positions. Despite recent budget challenges, ACD filled two positions in the Data Analytics and Analysis Bureau to better meet the demands imposed by the data warehouse's complex testing, modeling, and implementation of the program's Statistical Analysis Software (SaS). The analytic team now consists of two economists, one borrowed from the Tax Research Bureau, and two auditors.

The data warehouse process cannot operate effectively without people to follow up on leads and provide audit coverage.

Furthermore, in its drive to preempt fraudulent refunds, in February 2014 TRD reorganized its Compliance Division to create a stand-alone Questionable Refund Unit (QRU) staffed by 25 auditors. Reviewing personal income tax (PIT) returns for possible fraudulent refund activity was originally dispersed across three divisions: Compliance, Tax Fraud Investigation, and Revenue Processing. Furthermore, TRD expanded the program from a seasonal effort to year-round vigilance on combating tax fraud resulting from identify theft, removing all other tasks but bankruptcy reviews performed by three staff.

Chart 26. 2015 Tax Year - Increasing Value of Stopped Refunds Processed



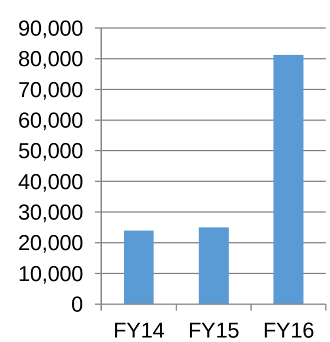
Source: TRD

During the 2016 tax season, management overreacted to data breaches, causing a three-fold increase in the number of returns flagged by the data warehouse as questionable. Driven by IRS and private sector computer breaches accessing W-2 wage and personal information, TRD's security concerns escalated. Each data breach prompted TRD to download data files from the offended organization as a precaution, causing the data warehouse to churn out more questionable returns as depicted by the climbing value of stopped refunds shown in Chart 26.

As the number of questionable returns being generated by the warehouse system spiked in early 2016, six audit FTE were loaned to QRU to aid in their processing. By mid-March the backlog had climbed to the point management abandoned the normal process of reviewing warehouse leads to determine their validity in favor of allowing the system to automatically generate letters to flagged taxpayers requesting additional information. Otherwise, projections showed the refund backlog would persist into July.

Choosing to upload multiple data breaches into the data warehouse, compounded by the decision to forgo the control point where staff reviewed the resulting warehouse leads, sent the number of notices mailed to taxpayers soaring from around 25,000 in 2015 to over 80,000 in 2016, as depicted in Chart 27. The department now acknowledges data breaches today are not likely to produce tax fraud the next day and is revamping the 2017 tax year process to minimize impacts on honest taxpayers. Yet the agency cautions, refund payment delays are here to stay as a part of doing business in this era of burgeoning identity theft.

Chart 27. Number of Refund Denied Notices Mailed



Source: TRD

This tremendous dedication of resources in 2016 did not deliver additional questionable refund dollars but almost doubled the number of refunds denied from 8,753 in FY15 to just over 16,000 in FY16. By the end, the value of refunds stopped fell just below FY15 results, as shown in Table 35. It could be a high number of stopped refunds were eventually authenticated or a higher percentage involved small dollar amounts. TRD staff explained the agency did not set up screening factors, such as a threshhold dollar amount, because fraudsters can use low refund values to establish legitimacy as a New Mexcio taxpayer as a strategy to gain access to higher refund amounts later.

Table 35. Refunds Stopped FY14 – F16
(in thousands)

Fiscal Year	TFID & RPD	QRU	Total
FY14	$6,025	$5,834	$11,859
FY15	-	$9,492	$9,492
FY16	-	$9,399	$9,399

Source: TRD

Refund Mills Dollars Stopped
2012: $3.82 million
2013: $1.45 million
Source: TRD

While TRD cannot report the actual amount of fraudulent refunds stopped or paid, the $1.3 million ACD registered as fraudulent might indicate advanced screeding techniques are working to reduce fraud. As with the IRS, reported amounts have declined from prior years. However, without the actual amount of "false positives" and actual fradulent refunds paid, the progam's effectiveness cannot be determined.

Recommendations

The Taxation and Revenue Department should:

Continue to develop data warehouse projects to aid collections and add performance metrics;

Determine the optimum number of collection staff required to cash in on each data warehouse project that increases assessments above a pre-determined amount;

Assign collectors to work with auditors on priority projects;

Reassess staffing for the Questionable Refund Unit, reassigning resources to higher return-on-investment positions until operating budgets in those areas can be restored;

Incorporate "lessons learned" into the tax refund process; and

Augment the data warehouse with additional reporting tools to evaluate effectiveness, including tax gap and compliance rate analyses.

The Department Deploys Most of the Effective Strategies for Collecting Delinquent Debt but Not All

The Taxation and Revenue Department could do more to bring in revenues but some options require legislation

The agency could provide survey opportunities at any point in the process a taxpayer comes in contact with TRD staff.

Effective tax collection requires a broad array of strategies and tools to assess and recover monies due to the state. Additionally, enforcement actions targeting tax fraud with criminal intent can act as an effective deterrent to illegal activity.

The primary strategy is to treat taxpayers fairly, providing due process that includes proper notices and dispute opportunities, which the agency does through its various statutory and procedural mandates. A taxpayer survey would shed light on the perceived effectiveness of these activities in meeting customer needs and resolving issues. The department does not currently survey clients for service delivery improvement.

Table 35 highlights collection tools states use most often and are noted as best practices. TRD employs seven of the 10 listed.

Table 35. New Mexico's Use of the Most Effective Collection Strategies

Strategy	Yes/No	Description
1. Offsetting state and federal tax refunds	Yes	Participates in the Treasury Offset Program (TOP).
2. Liens, levies, and license holds (if available)	Yes	
a. Liens	Yes	Uses data warehouse to provide leads by batch.
b. Levies	Yes	Uses data warehouse to provide leads by batch.
c. License holds	Limited	Only on alcohol licenses per statute. Driver licenses are not revoked.
3. Automated notices and correspondence	Yes	GenTax generates most letters mailed.
4. Centralized collections	Delinquent taxes mainly at TRD	Agencies that have own delinquent account processes: Office of the Superintendent of Insurance; State Land Office; and Regulation and Licensing Department.
5. Better use of private collection agencies	No	Fired one company due to under-performance. Allowed contracts to lapse due to federal concerns over confidentiality. Under management review to reinitiate.
6. Automated collection software	No	Data warehouse provides leads but TRD does not have auto-collect capability.
7. Electronic payments	Yes	Taxpayers can pay online through TAP or CRS system.
8. Imposition of penalties and interest	Yes	Applied per statute.
9. Increased staffing	No	Budget constraints have limited expansions despite ROI analyses that suggest additional revenues would more than pay for staffing.
10. State vendor offset	Yes	Intercepts payments to state vendors to offset debt obligations.

Sources: National Association of State Auditors, Comptrollers and Treasurers; TRD

As an example of the effectiveness of these tools, in FY15 New Mexico recovered $20 million through three state programs in the Treasury Offset Program (TOP):

- $3.6 million Income Tax,
- $3.5 million Unemployment Insurance, and
- $13 million Child Support.

The online Combined Reporting System (CRS-1) for businesses and Taxpayer Access Point (TAP) for individuals are also notable successes, allowing taxpayers online access to their accounts and to make payments. However, TRD recognizes TAP might be too sophisticated for some taxpayers as it was crafted from the accountant's point of view. The agency has engaged a firm to conduct focus groups and develop recommendations for making it more user-friendly.

Twenty-three states maintain public online lists of debtors in an effort to increase collections, according to an independent research tally as of December 31, 2014.
Source: Oregon Report 2015-25

Yet there are other proven tools TRD does not employ, such as internet posting of debtors. Delaware and Wisconsin are among 23 states turning to cyber-shaming as an alternative to the more controversial option of raising taxes to make up revenue shortfalls. Delaware reportedly collected over $9 million in the first five years of its program while Wisconsin reported bringing in $164 million in collections from 2006 to June 2014 using this method. Timely warning letters provide the taxpayer ample opportunity to protest the assessment or pay the debt and avoid public embarrassment. Due process and confidentiality issues must be resolved and amounts posted accurate.

Table 36. Other Effective Tools

Strategy	Yes/No	Description
1. State lien registry	No	The state does not have a consolidated online registry, although some discussion has centered on consolidating all counties to the Secretary of State. Currently, TRD has to contact each county separately and not all are online.
2. Lottery winnings offset	No	Taxes owed are paid before winnings delivered.
3. Unclaimed property offset	No	The unclaimed property program resides at TRD.
4. Internet posting of debtors	No	Delaware reports it had collected more than $9 million in the first five years of its practice of posting 100 individual and businesses with the largest outstanding debts. Taxpayers receive notice and can avoid tax delinquency shame by paying in full or making payment arrangements.

Sources: Oregon Secretary of State; Governmental Technology

A University of Michigan and Microsoft Research joint study found posting tax debt reduces tax delinquencies; many taxpayers pay before posting to avoid embarrassment.

Offsets, which reduce a payment made to a taxpayer by the amount of tax due to the state, are proven strategies to reduce tax liabilities. The most familiar offset is the Treasury Offset Program (TOP). According to TRD, ACD does offset payments made to state vendors. Lottery winnings and unclaimed property provide added assets that would not require taxpayers generate cash to pay their tax obligations.

A state lien registry would offer a one-stop shop to register liens against debtors rather than filing liens in each of the 33 counties where TRD believes the debtor resides. Considered an efficiency measure, freed-up time contacting individual county offices could be spent on other collection activities.

Additional efficiency gains would evolve from using data warehouse decision analytics to optimize collections and resource allocation. Systematically applying the "5 Rs" – right account with the right resources at the right time using the right tools to achieve right results – would help direct the most effective and efficient workflows. For example, predicting the expected yield would indicate how much time to spend on account collection, allowing scarce staff resources to focus on highest priority accounts with the most appropriate action-optimal work efforts.

With the development of its data warehouse, TRD engages two of the most important best practices for debt management: data gathering and decision analytics.

Emerging best practices in debt management would require investing in up-to-date call systems to enable automation. According to a white paper published by CGI, Inc., manual processing of levies and garnishments is old fashioned and can be replaced by automating involuntary enforcement on clearly defined business rules and data sharing. While TRD provides online payments, extending this self-service capability to touch-tone phone (IVR) would free up staff time while increasing collections.

TRD is promoting managed audits as an alternative to tax amnesty programs, but ACD estimates lost penalties and interest can be substantial. TRD sponsored a tax amnesty program in 2010, processing 6,300 cases within a short timeframe. Almost 85 percent of the $52 million assessed was collected in the first two years following the amnesty window; as of June 2016, only $4 million remains on balance.

Table 37. Cost of 2010 Tax Amnesty Program
(in millions)

Special GF Appropriation	FY10	$0.5
Special GF Appropriation	FY11	$0.5
Special GF Appropriation	FY12	$0.5
Total		$1.5
Amnesty FTE Added		12.5

Source: TRD

While such programs offer the opportunity to bring in quick cash to plug budget holes, experts caution negative long-term consequences accrue if done too often. Most notably, multiple amnesty offers discourage timely compliance and can actually worsen revenue collection over time.

Moreover, such programs strike paying taxpayers as unfair, giving a special deal to tax evaders. Finally, evidence shows the more amnesties a state holds, the less money it takes in. Nearly all states used to wait at least 10 years between amnesties but in the last decade barely a quarter have waited that long.

TRD prefers the Managed Audit route, offering essentially the same package in a more controllable format that doesn't bring other collection activities to a standstill. Open to gross receipts, compensating, corporate income, withholding, and personal income taxes, qualifying taxpayers can chose between conducting self-audits or working with a field auditor. Penalties and interest can be avoided if the full payment is made within 180 days. Interest accrues otherwise.

ACD staff notes another advantage of using managed audits is it allows the taxpayer the option of bringing all tax years into compliance. Typically ACD runs two years behind based on federal timelines.

A seven-member team (when all positions are filled) administers managed audits, which have climbed 138 percent and yielded $75 million in assessments over the last five years. TRD projects between 85 percent to 90 percent is collected within six months.

In forgoing penalty and interest (P&I), both programs favor the benefit of receiving cash quickly over receiving more cash gradually. ACD estimates managed audits reduce P&I by 75 percent based on the percent of taxpayers that pay timely but did not provide an estimated dollar amount.

The Tax Fraud Investigations Division (TFID) performance has been impacted by a focus on nontax issues and vacancies

The Tax Fraud Investigation Division conducts investigations of individuals and businesses suspected of committing criminal violations of the Tax Administration Act, referring viable cases to prosecutors for processing through the court system. Investigations leading to successful prosecutions are intended to increase revenue through enhancing voluntary compliance as a result of publicizing the state's prosecuting results.

New Mexico's fraud unit receives tips from a variety of sources, ranging from its tip hotline to internal referrals from auditors and collectors. Various governmental agencies also provide information leading to investigations, as shown in Table 38.

Table 38. External Sources of Tips*

Judicial Districts
Attorney General
Police Departments
Federal Drug Enforcement Agency
Regulation and licensing Department
Human Services Department

* Reported for FY16
Source: TRD

The Forensic Tax Audit Bureau forensic auditors evaluate information received from the various sources for criminal investigation potential. Viable cases are given case numbers and assigned to an investigator.

Table 39. Types of Fraud Cases*

CRS Underreporting
Medicaid Fraud
Non-filer
Omitted income
Refund mill

*Reported for FY16
Source: TRD

Table 40. Adjudicated Cases - FY16

Tax Fraud	Cost to State
Sylvia Franco – Roswell tax preparer overstating deductions	$120,493
Tanya Skoropad, stealing tax refunds	Between $24,000 and $122,500
Deborah Quintana – Espanola tax preparer filing false returns	Between $14,000 and $70,000 $21,000 GRT
Juan Chavez, tax evasion	$109,000 GRT
Mercy Martinez, embezzlement	Not reported
Flora Mascarenas, Albuquerque tax preparer filing fraudulent returns with stolen identities	Not reported.
Ricardo Franco, embezzlement; failure to pay PIT	$4,300
Charles Fleming, embezzlement	Not reported.

*Reported for FY16
Source: TRD Press Releases

Table 41. TFID Vacancy Rates as of 10.13.16

Fiscal Year	Vacancy Rate
2009	32%
2010	31%
2011	26%
2012	25%
2013	25%
2014	21%
2015	25%
2016	27%
Current*	27%

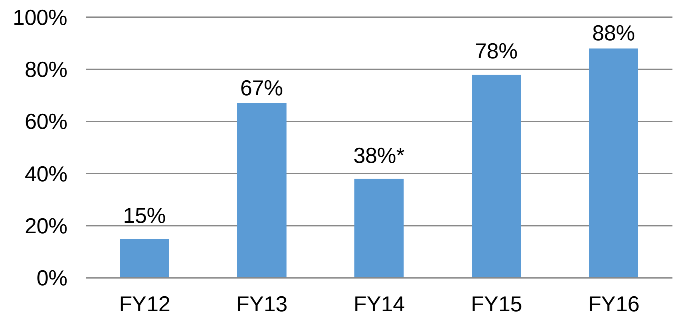
*As of 10.13.16
Sources: TRD Operating Budgets and PeopleSoft Organizational Listing Report

However, even after assignment, cases can be discontinued. Reasons listed for nine discontinued cases during FY15 andFY16 included:

- Lack of resources (Refund mill)
- Insufficient documentation (Medicaid fraud, Omitted income)
- Referred for civil consideration – Audit Bureau (Non-filer)
- Diminimis – Referred for civil consideration – Audit Bureau (Omitted income)
- Nontaxable income (Indian and out-of-state)

The division does not track recovered dollars but emphasizes its value as a deterrent. To measure program effectiveness, TFID reports the percent of assigned tax fraud investigations that are subsequently referred to prosecutors. Over the last five years, the division has seen varied success according to this measure.

Chart 28. Percent Assigned Cases Referred for Prosecution



*Recalculated from the reported percentage of 33 percent.
Source: TRD

Yet this measure can reflect other factors unrelated to investigative quality residing outside the division's control. For example, according to TFID, the dips in FY12 and FY14 can be traced to three influences: a management directive to focus investigative resources on the Foreign National Licenses Program, which was a non-tax initiative; high vacancy rates; and a series of complicated cases in FY14 that reduced caseload efficiency. Without these intervening factors impacting results, the division has exceeded the target of 50 percent the last two years.

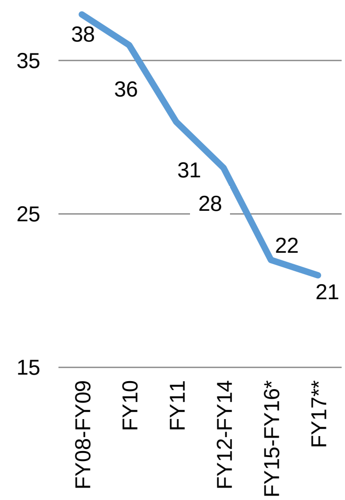
Almost 65 percent of pending cases logged for FY16 have not been assigned due to lack of resources. Twenty viable cases have not been assigned out of the 32 listed for FY16 because the bureau has been operating with only one of the five authorized investigator positions filled.

Four investigator positions were filled at the beginning of FY16 but three out of four investigators resigned, starting in October. Subject to the unofficial hiring freeze, recruitment efforts were further delayed by a more recent state personnel reclassification of the investigator range. Management reports one investigator has been hired with an October start date while a second is planned for November. The fourth investigator position that had been filled will be left vacant. Limited staffing will undoubtedly reduce the cases assigned and referred for FY17.

Unless TFID fills positions as planned, referred cases will likely decline for the current fiscal year.

When other states have been ramping up tax fraud units to recover dollars lost to the underground economy, New Mexico's has been shrinking. Established in 2003, the division has seen its peak 2008 staffing count of 38 dwindle to 21 for the current fiscal year. Seven of the 17 FTE reductions are due to TRD reorganizing its MVD internal investigations unit under the Office of the Secretary. The vacancy rate has averaged 27 percent.

Chart 29. Decline in TFID FTE Count



*The General Appropriation Act (GAA) authorized 28 FTE for FY15 but a TRD reorganization moved 6 FTE.
**The GAA authorized 22 FTE for FY17 but TRD transferred 1 position.

Sources: GAA, TRD Operating Budgets; TRD

Recommendations

The Legislature should consider:

Enacting legislation to permit internet posting of tax defrauders;

Expanding authorized license holds and adding offsets for gambling, lottery winnings, and reclaimed property; and

Prioritize resources in the Tax Fraud Investigation Division to address the underground economy based upon any interim committee recommendations having nonpartisan and business community support.

The Taxation and Revenue Department should:

Consider deploying additional tools used by other states to encourage taxpayer compliance, such as employing collection agencies to work difficult accounts; supporting the effort to develop a state lien registry; and proposing legislation to permit internet posting of delinquent taxpayers and expanded offsets;

Upgrade the phone system to leverage data warehouse capabilities to implement "new generation" collection tools, such as implementing a risk analysis of accounts, automating some labor intense activities, automating collections, and improving customer service through a phone payment option;

Model the managed audit progam to quantify costs and benefits;

Develop a Tax Fraud Investigative Division (TFID) measure that would track revenue regained from criminal tax fraud activity, similar to how Massachusetts's Council on Underground Economy (CUE) reports its activities; and

Fill Tax Fraud Investigation Division vacancies and pursue backlog of potential fraud cases.

TAXATION & REVENUE
NEW MEXICO

October 24, 2016

David Abbey
Director
Legislative Finance Committee
325 Don Gaspar, Suite 101
Santa Fe, NM 87501

Dear Director Abbey:

This letter sets forth New Mexico Taxation and Revenue Department's (TRD) response to LFC Report # 16-07, entitled "Tax Gap, Audit and Compliance, and Fraud" (Report). The Report is intended to present findings from an LFC program evaluation of TRD. The stated purpose of the program evaluation was to examine the "status of New Mexico's tax gap and the TRD's efforts to enhance revenue collections." A copy of the entrance letter is attached as Appendix B. The anticipated closing date of the evaluation was August 2016, but the actual evaluation took four and a half months, culminating in the Report. TRD provided full cooperation to LFC evaluators during the evaluation period.

In terms of structure, TRD's response is two-fold. First, in the body of this letter TRD will present a brief discussion of four areas of commentary on the Report itself. These four discussion areas will cover: TRD's accomplishments in context of the budget; best practices for program evaluations; the tax gap and tax gap studies; and agency evaluation versus larger issues of policy. Each of these subject areas is discussed, in turn, below.

Second, in the attached Appendix A, TRD responds to each recommendation to TRD contained in the Report. While the discussion in the body of this letter levels some criticisms, TRD agrees with many of the LFC evaluation recommendations and believes that the implementation of the recommendations will improve Department performance.

I. While not apparent on the face of the Report, TRD set a record for assessments in FY 2016 and had its second highest collections year in agency history in FY 2016, despite a $3 million dollar budget reduction and a 72 FTE staff reduction since FY 2010.

Results matter. What may be lost in a reading of the report is that despite the budget cuts, the lack of a state specific tax gap analysis, or the obvious needed improvement in the call center, ACD assessed $67.5 million and collected $38.3 million more in FY2016 than it did in FY2011, with 72 fewer positions and $3 million less in appropriations.

Similarly, the return-on-investment metric for assessments utilized by ACD improved 19.6% from FY2015 to FY2016. This fact may be lost in the Report on page 47 under the title "Management focuses on return-on-investment metrics to measure program success; this metric reveals staffing issues

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can swamp data warehouse efficiency gains." The Report segregates ROI by audit division but fails to summarize the overall ROI.

Moreover, ACD was able to accomplish these results while simultaneously tackling one of the most pervasive fraud movements hitting tax agencies nationwide. Through internal alignment of personnel, the agency also stopped $ 9.39 million in questionable PIT refunds. These efforts prevent these funds from leaving New Mexico and circulating in the underground economy located in some other part of the world.

What is also lost in the report is that the Department recognized the need for additional staff in the call center and in collections. TRD made repeated requests in FY 2016 and FY 2017 budgets for additional personnel in the call center and in collections. TRD recognized the increase in the total collections and outstanding balance and presented a request for additional funds to reduce the forced vacancy rate. These requests were made to the LFC on December 8, 2014 and December 7, 2015 respectively.

II. In many significant respects, LFC should consider revamping the evaluation process to ensure a more robust assessment and policy-maker review.

TRD would like to raise several procedural issues regarding the evaluation process and the Report. TRD appreciates the LFC staff's hard work on this evaluation and report and enjoyed a good working relationship throughout the process. However, aspects of this process and the Report could be improved to stimulate a more robust, more utilitarian discussion on performance and policy, resulting in better government.

First, the duration and process time frames should be evaluated. As an agency that is intimately familiar with the auditing process, TRD knows how intrusive, disruptive, and resource-intensive the process can be. TRD recommends that evaluation scopes be more specifically defined. Indeed, unlike all recent agency evaluations, this Report's Appendix A did not contain either information on LFC authorization nor on the scope of the evaluation. Additionally, time-frames and timetables should be agreed upon in advance and adhered to. No agency would argue with a short extension, but evaluations that take two months longer than anticipated cause severe disruption. Similarly, the time frames from draft report to exit interview to management response to hearing should be reconsidered. A scant few days to prepare a management response is preclusive of full dialogue on the subject matters covered in the evaluation.

Second, there are issues with the Report itself that raise problems of fairness and confusion, and, as such, do not contribute to a fulsome evaluation. First, as noted in Section I, above, true successes should be highlighted. Readers have no indication from the face of the Report that TRD neared or exceeded all previous historical high water marks with respect to assessments, collections, and audit ROIs during FY 2016.

Third, the Report should be more transparent regarding source documentation. The Report itself contains very little documentation to support many of the recommendations or analyses contained therein. No source documentation was provided in a manner timely enough to be evaluated by the agency in preparing its management response. In fact, the Report did not even contain a bibliography at the time it was presented to TRD.

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Fourth, to avoid practical problems, evaluations should avoid "apples" to "oranges" comparisons. One example in this Report involves recommendations that TFID develop a multi-agency strategy to address the underground economy. The Report cites California, Washington, and Massachusetts as states conducting best practices. However, these states, through legislative or executive authority and funding, operate multi-agency, joint, coordinated tasks forces. Setting an expectation that TFID can achieve similar results or operate in a similarly effective manner, given current staffing and resource constraints, is a comparison that sets both policy-makers and the agency up for failure.

Finally, David M. Walker, former Controller General of the United States, described GAO processes that are akin to these types evaluations. He commented that these types of evaluations should provide "government decision-makers, and the public as well, the professional, objective, fact-based, nonpartisan, non-ideological, fair, balanced, and reliable information they need to make timely and informed decisions."

III. The notion that state-specific tax gap studies constitute "basic requirements" or "best practices," as well as the notion that they serve as useful tools in developing strategies for compliance initiatives or resource allocation is not supported by any empirical evidence in the Report.

All would agree that, at this juncture, agency resources should be devoted to their highest and best use. The Report suggests that state-specific, multiple program, tax gap studies constitute a best practice among the states. Indeed, the Report calls these studies a "basic requirement," indicates these studies can assist policy makers, and heralds these studies as means to develop compliance tools and allocate resources. Report, 1, 9, 19. None of these statements are supported by any empirical evidence.

As an initial matter, the value of tax gap studies remains controversial. Indeed, the drafters of Georgia's 2011 state-specific tax gap study on personal income tax note, "there is substantial debate on the reliability and value of tax gap estimates" and studies. J. Alm & K. Borders, How Large is the "Tax Gap" for the Georgia Personal Income Tax?, FRC Report No. 232 (April 2011) [hereinafter, "Georgia Report"]. The reasons should be obvious. No tax gap study can accurately quantify an unknown. There is no reliable information on which to measure tax that is not being paid and any approach necessarily results in a vast amount of imprecision. *Id.* at 1. In short, regardless of the quality of methodology and execution, a tax gap study is a "best guess," leading some researchers to sarcastically call the number of tax gap studies produced by the IRS to be, at best, a "dubious achievement." *Id.* at 5.

Moreover, the limited number of states that have conducted state-specific baseline analyses directly contradicts the Report's assertion that these studies are essential tools or best practices. The Report cites only four states that have conducted baseline studies in the last 22 years. Report, Table 5, p. 9. Each of those studies involved only income tax(es) or sales tax, as opposed to the multiple-program, comprehensive study advocated by the LFC in the Report. The Oxford Handbook of State and Local Government Finance adds four additional states that have completed studies in the last fifteen years – Georgia, Montana, Oregon, and Wisconsin. Oxford Handbook of State & Local Gov't Fin. 475 (Robert D. Ebel & J.E. Perterson, eds., Oxford Univ. Press) (2012) [hereinafter, "Oxford Handbook"]. All but one of these additional state studies covered only one tax program. *Id*. Thus, over a 22-year period, only eight states have conducted tax gap analyses. None have conducted the type of comprehensive, multi-program analysis contemplated in the LFC report. As the Oxford Handbook notes, "only a handful of states have prepared these studies, *and because of the enormous amount of analysis associated with them*, they appear only at irregular intervals." *Id.* at 475 (emphasis added).

Finally, the Report is bereft of any empirical evidence that a state-specific tax gap study, followed by periodic updates, serves as a useful tool in developing strategies and allocating resources to address non-compliance. It lacks any discussion of the costs of these studies or the benefit derived from them. The Report touts Minnesota and Washington as exemplary state-specific tax gap study states. There are several problems with this. First, neither state has produced the comprehensive, multi-program analysis suggested by the Report. In fact, Washington's report is a non-compliance report that makes no effort to calculate the cash economy. Second, under these state analyses, the gaps are not shrinking. The Minnesota Department of Revenue's own website indicates that the state's sales tax gap has increased from $451 million in 2000 to a projected $700 million in 2007, despite its periodic studies. Available at: http://www.revenue.state.mn.us/research_stats/Pages/ Sales -Tax-Gap-Study.aspx (last visited Oct. 22, 2016). Similarly, Washington, whose "biennial" compliance study was produced in 2016 (for the first time since 2010), does not demonstrate any measurable increase in tax compliance. Wash. Dep't of Revenue, 2016 Compliance Study, 3 (June 1, 2016). The IRS has been periodically producing tax gap studies for more than 30 years, yet the non-compliance rate yielded by these studies has remained a relatively constant at 16% - 20%. These results do more than challenge the value of these studies as compliance tools; they outright refute it.

State specific tax gap studies may comprise worthy endeavors in Minnesota and Washington, whose revenue agencies are funded at over $250 million biennially[1]. But TRD tends to agree with the Idaho Tax Commissioner, who declared in that state's income tax gap study, the best return on investment a state can achieve with respect to tax compliance is an investment in auditors and collection agents. *See,* Idaho Tax Commission, Idaho's Tax Gap, 2009: Estimating Idaho's Tax Gap and Developing Strategies to Reduce It 11 (Nov. 2009). Indeed, when asked about the utility of its 2009 income tax study in developing compliance initiatives, an Oregon representative responded "it might be useful, but the sources of the tax gap are pretty clear without a study."

IV. TRD cautions Legislators to be mindful of the difference between the evaluation and policy components of the Report.

TRD cautions the committee to carefully distinguish tax compliance issues TRD's Audit and Compliance Division can address from larger issues of policy. The LFC Report uses the standard definition of "tax gap" – the difference between the amount of tax *owed under existing law* and the amount of tax paid. Report, p. 5; Georgia Report, at 5. However, the format and presentation of the report intersperses larger policy issues with the TRD evaluation, tending to blur the line between subject areas within TRD's control and those that are not. Consequently, the committee needs to be mindful of when sections of the report evaluate TRD specifically or New Mexico policy generally. The substantial discussion of the taxation of online sales and tax expenditures constitute specific examples of areas where the report notes revenue loss, but that do not fall within the "tax gap" and do not, in significant degree, represent compliance issues within TRD's control.

Moreover, as a policy document, the Report has only marginal value, as it addresses only a few policy issues. Online sales are already on policy-maker's radar. With respect to online sales, TRD has already exhausted judicial challenges. TRD litigated on the tip of the spear during this administration, challenging *Quill's* physical presence requirement. *See, N.M. Taxation & Revenue Dep't v.*

[1] Budgets for Minnesota and Washington can be found at https://mn.gov/mmb/budget/currentbud/gov16-17-budget/16-17-background.jsp and http://www.ofm.wa.gov/budget/legbudgets/1517biennial.asp respectively.

BarnesandNoble.com, LLC, 2013-NMSC-023, ¶ 5. One of TRD's primary arguments, which was successful before the New Mexico Court of Appeals, was that the online vendor established constitutional nexus through the use of its intangible property and goodwill within the state. *Id.* ¶ 2. Intangibles and goodwill are not "physical." Thus, TRD was pushing the limits of *Quill*. While the New Mexico Supreme Court upheld the decision, it did so on traditional notions of physical presence, not on TRD's "intangible" nexus arguments. *Id.* ¶ 2. In short, with this decision, TRD views itself as bound by *Quill* and cannot, as an agency, set New Mexico policy judicially.

With respect to tax expenditures, two of the four items discussed in the report – the high wage jobs tax credit and the medical practitioner deductions – were already addressed in the 2016 Special Session, with significant input from TRD. And, most of the state's costliest tax expenditures by dollar amount were not discussed.

The tax fraud recommendations, in and of themselves, have limited value. The Report advocates for "anti-zapper" legislation and authorization to publicly shame non-compliant taxpayers through internet postings. But the former is very resource intensive to administer as a compliance tool. The latter has already been tried by TRD and abandoned because of the resources necessary to maintain an accurate list in order to avoid defamation suits and other potential liabilities. However, in a four and a half month evaluation, LFC evaluators did not request input from the Tax Fraud Investigations Division (TFID) on policy improvements.

There are several perhaps more effective and more timely policy issues surrounding tax fraud. For example, New Mexico is one of the only states that has a statute of limitations on fraudulent returns or non-filers.[2] Providing an unlimited statute of limitations in cases of fraud or non-filers can act as a significant deterrent to non-compliance. Additionally, changes could be made to sentencing under Section 7-1-73 NSMA 1978 to allow aggregation of counts. With this change district attorneys would be more willing to prosecute low-level, but systemic, refund claim fraud. Finally, as a non-compliance tool amendment to New Mexico's Procurement Code to require vendor proof of tax registration and tax compliance before being awarded a contract or contract renewal with the state or its political subdivisions could be made.

[2] Unlike New Mexico, most states do not set limitations periods in the case of false or fraudulent returns or non-filers for all or most of their tax programs. See, e.g., Ala. Code § 40-2A-7(b)(2)(a); Alaska Stat. § 43.05-260; Ariz. Rev. Stat. § 42-1104(B)(1); Ark. Code Ann. § 26-18-306(f); Colo. Rev. Stat. § 39-21-107(4); Del. Code Ann. tit. 30, § 531(C); D.C. Code Ann. § 47-4301(d)(1); Fla. Stat. § 95.091(3)(a); Ga. Code Ann. § 48-2-49 (sales and use taxes); Haw. Rev. Stat. § 235-111(c); Idaho Code §§ 63-3068(c), 63-3633(b); Ind. Code § 6-8.1-5-2(g); Iowa Code § 422.25(1)(b) (income taxes); La. Rev. Stat. Ann. § 47:1580(A) & (B); Me. Rev. Stat. Ann. tit. 36, § 141(2)(B); Md. Code Ann. Tax-Gen. § 13-1102 (numerous, but not all taxes); Mass. Gen. L. tit. 62C, § 26(d); Minn. Stat. § 289A.38, Subd. 5; Mont. Code Ann. § 15-30-2605(4); Ne. Rev. Stat. § 77-2786(3) (for income taxes); N.H. Rev. Stat. Ann. § 21-J:29, II(a); N.J. Rev. Stat. § 54:49-6(b); N.C. Gen. Stat. § 105-241.1(e); N.D. Cent. Code §§ 57-38-38(5), 57-39.2-15; Okla. Stat. tit. 68, § 223(C); Or. Rev. Stat. § 314.410(4)(a); Pa. Stat. Ann. tit. 72, § 7348; R.I. Gen. L. § 44-30-83(b); S.C. Code Ann. § 12-54-85(C)(1); Tenn. Code Ann. § 67-1-1501(b); Utah Code Ann. § 59-1-1410(3)(a); Vt. Stat. Ann. tit. 32, §§ 5882(b), 9815(b), 9273(b), 8919(b); Wash. Rev. Code §§ 82.32.100(3); W. Va. Code § 11-10-15(a); Wis. Stat. §§ 71.77, 77.59(8).

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If you have further questions on TRD's response to LFCs report, please let us know.

Sincerely,

Demesia Padilla, CPA
Cabinet Secretary
New Mexico Taxation and Revenue Department

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Recommendations & Taxation and Revenue Department Responses

1) **Enlist University of New Mexico's Bureau of Business and Economic Research or New Mexico State University's Arrowhead Center in developing a broad-ranged, state-based tax gap analysis that also characterizes the state's cash economy. Use the analyses to inform the Legislature on the most promising avenues to reclaim lost revenues by quantifying the costs and benefits.**

   Disagree. As stated in TRD's accompanying management response letter, the evidence does not support the assertion that a tax gap analysis is a "basic requirement" or a "best practice. As an alternative, the Taxation and Revenue Department (TRD) agrees that the following could be prepared by March 1, 2018 to help better characterize areas of non-compliance:

   - A field audit under-compliance rate could be developed for gross receipts tax and corporate income tax based on the results of field audits within the Audit and Compliance Division (ACD); the report could likely identify the primary sources of under reporting within those tax programs;
   - An under-compliance rate could be developed for personal income tax, based on above-the-line audits within ACD; this report could identify the primary sources of under reporting.
   - Development of a non-filer rate based on limited scope and other data matching programs.

2) **Reassess resource allocation and redirect staffing to the audit and collection efforts with proven high rates of return.**

   Agree. It should be noted that TRD requested an additional $600,000 for FY15 for ACD personnel including call center employees on August 29, 2014, and $1,000,000 on September 1, 2015, in order to reduce the forced vacancy rate for collectors and call center employees. TRD is load balancing the budget in order to protect the ACD budget. In FY17, ACD is taking a 2.7% cut, and a 1.7% cut in FY18 as opposed to 5% and 5.5%. Moreover, TRD will be transferring at least six positions to ACD from other divisions in FY18 after the completion of a joint desk audit effort between TRD's Human Resources Bureau and Internal Audit Unit that will analyze position production and efficiency.

3) **Improve collections by filling vacancies, modernizing the call center, leveraging data warehouse capacity to aid collections, and requesting authorization to adopt additional collection tools.**

   Agree. On October 8, 2016, ACD hired a highly experienced call center manager from whom we have requested an in-depth analysis of the call center's needs, staffing, and technology modernization. Recommended solutions will depend on ACD's ongoing budget resources. There are two substantial data warehouse collection projects recently developed and in process of implementation by ACD in order to more efficiently and effectively collect the State's tax money. This initiative should begin producing measurable results beginning on or around April 1, 2017. Additional statutory changes may be required to aid in TRD's collection efforts. These proposed changes will be drafted, for internal review and in conjunction with other TAA clarification measures, prior to the beginning of the upcoming Legislative Session in January 2017.

4) **Fill Tax Fraud Investigation Division (TFID) vacancies and pursue backlog of potential fraud cases.**

   Agree. TRD will fill three vacant TFID positions by March 1, 2017. One of these three positions began employment on October 24, 2016.

5) **Identify areas to expand and broaden tax gap initiatives, including multi-agency efforts, and detail any expansion requests with clear return on investment quantifiers**

   Agree. ACD is currently using SAS Visual Analytics statistical software to analyze populations and to make recommendations for new initiatives where there is a high occurrence of non-compliant taxpayers. This analysis is ongoing. Depending on their scope, multi-agency efforts may require additional resources.

6) **In particular, identify areas for underground economy compliance.**

   Agree. This work has been ongoing through TFID. TFID participates in task forces designed to address some of the underground economy. One in particular, the Suspicious Activity Review Team (SAR-RT), is a collaborative effort between federal and state law enforcement agencies to discuss the reports filed by financial institutions on individuals who are engaging in large cash transactions of a suspicious nature. TFID's participation on this and other task forces is an ongoing effort to make it known to other law enforcement agencies that TRD seriously pursues the investigation of anyone who is not reporting their cash income derived from illegal or legal sources. TFID's success in this area over the period FY2013 – FY2016 is demonstrated by the fact that 85% of those who were prosecuted were evading tax obligations based on some type of cash based income.

7) **Adopt a bi-annual review process to monitor progress in narrowing the tax gap and identifying emerging areas of concern.**

   Agree in part. See response to recommendation No. 1. Additionally, TRD's Internal Audit Unit will add the evaluation of the progress of compliance with the agreed upon TRD responses to the evaluation findings beginning in the 2017 cycle. ACD will continue to issue monthly assessment and collection reports to monitor audit and compliance activity pertaining to existing initiatives. ACD will report in writing to the TRD's Cabinet Secretary in March and September of each year on the progress of the annual assessments and collections plan and identify any areas of concern or changes to the business plan.

8) **A fiscal impact report form and process for staff specific to tax expenditure bills identifying if proposed legislation meets criteria.**

   Agree. Though the recommendation was listed as the responsibility of the legislature, TRD has already incorporated most of the concepts detailed in the recommendation into its bill analysis.

9) **Modernize the call center to current best practices by taking the following actions: 1) Hire a call center expert as the director and revamp the call center business processes, reporting,**

personnel management, and culture, including incorporating appropriate best practices identified in the Heights Consulting, "Roadmap for New Mexico Taxation and Revenue Customer Care Center; 2) Consider transferring the call center from DOIT information technology products to the more advanced cloud-based platform used by the Motor Vehicle Division call-center; and 3) Consider long-range plans to consolidate all TRD call centers under single management.

Agree. Recommendation 9.1 has already been partially completed. In September 2016, ACD hired a call center expert to manage the center and evaluate the call center processes, efficiencies, technology, consolidation, and expansion opportunities. By March 1, 2017, the evaluation should be complete and the remaining recommendations under 9.1, 9.2, and 9.3 will be analyzed and implemented, in whole or in part, depending on available resources.

10) Upgrade the Protest Office IT tracking capability so the bureau can report key metrics back to ACD for gaining insight on protest outcomes to enable quality control measures on audits, tax law, and individual auditors.

Agree. The Protest Office meets with Audit & Compliance at regular intervals to discuss feedback on protest decisions. The agenda at the next meeting will include key metrics and other data that Audit & Compliance would like feedback on to improve the process. At that point, management will evaluate whether an IT or manual process would be most efficient for exchanging this type of information.

11) Investigate the GenTax glitch producing reversed accounts, determine the cause behind their increase, fix the glitch if cost-effective, and revise reports to accurately reflect collections if needed.

Agree. The Department shall submit the request to correct the GenTax report by October 31, 2016.

12) Implement processes to better define and measure the questionable refund initiative's effectiveness in preventing fraudulent refunds by tracking actual fraudulent refunds stopped, refunds eventually paid to legitimate taxpayers, and fraudulent returns filed that were not stopped and paid twice.

Agree. ACD has been working with our information technology partners to develop better data tracking and reporting of fraudulent refunds stopped, refunds eventually paid to legitimate taxpayers, and other statistical data to measure fraudulent refund processes. TRD anticipates this enhanced reporting to be implemented for the 2017 refund season on or about March 1, 2017.

13) Continue to develop data warehouse projects to aid collections and add performance metrics.

Agree. ACD will continually enhance its performance metrics of data warehouse projects to aid in the improvement of collection efforts.

14) Determine the optimum number of collection staff required to cash in on each data warehouse project that increases assessments above a pre-determined amount.

Agree. ACD continually monitors the allocation of resources in order to leverage our successes from already completed data warehouse projects.

15) Assign collectors to work with auditors on priority projects.

Agree. For approximately four years, ACD has assigned collectors to work with auditors on priority projects in some District Offices, but not others. This initiative will be implemented division-wide beginning January 1, 2017.

16) Reassess staffing for the Questionable Refund Unit (QRU), reassigning resources to higher return-on-investment positions until operating budgets in those areas can be restored.

Disagree. ACD has made a decision that the QRU initiative is so vital that reassigning resources to higher-return-on-investment positions until operating budgets are restored is not an option. In addition, QRU activities are not measured by traditional return on investment (ROI) analysis. New Mexico is following the same procedures as the IRS and other states involved in the Security Summit.

17) Incorporate "lessons learned" into the tax refund process.

Agree. ACD already developed "lessons learned" analysis this past August 2016. The improvements in processes from those lessons will be implemented in the 2017 refund season on or about March 1, 2017.

18) Augment the data warehouse with additional reporting tools to evaluate effectiveness, including tax gap and compliance rate analyses.

Agree in part. ACD is continually evaluating data warehouse matrix tools to evaluate the effectiveness of new and ongoing initiatives impacting the tax gap. ACD does plan to implement additional tools to measure compliance rates in a variety of tax programs beginning on or about January 31, 2017.

19) Consider deploying additional tools used by other states to encourage taxpayer compliance, such as employing collection agencies to work difficult accounts; supporting the effort to develop a state lien registry; and proposing legislation to permit internet posting of delinquent taxpayers and expanded offsets.

Agree in part. This change would be highly effective in helping TRD to meet the goal of reducing the tax gap through collections. The current lien process requires that each lien be recorded manually in each county clerk's office based on the address of the taxpayer. This is very time consuming and is dependent on the cooperation of the clerks. By consolidating the lien recordings in one centralized location (e.g., the Secretary of State), it can be developed into a more efficient electronic system. TRD will take the recommendation regarding internet posting of delinquent taxpayers into consideration, pending LFC's provision of the University of Michigan Study to TRD. For a more fulsome discussion of other policy options for reducing non-compliance and addressing fraud, see the management response letter.

20) Upgrade the phone system to leverage data warehouse capabilities to implement "new generation" collection tools, such as implementing a risk analysis of accounts, automating some labor-intense activities, automating collections, and improving customer service through a phone payment option.

Agree in part. This is an evaluative process that ACD has implemented by hiring a call center expert to manage the call center and to evaluate call center processes, efficiencies, technology, consolidation and expansion opportunities. By March 1, 2017, TRD anticipates the evaluation to be complete and recommendations will be analyzed and implemented, in whole or in part, depending on available resources.

21) Model the managed audit program to quantify costs and benefits.

Agree. ACD already performs ROI analysis on managed audits and ACD is in the process of developing more performance oriented matrix tools to better allocate resources in this area, which TRD anticipates to be complete on or around March 31, 2017.

22) Develop a Tax Fraud Investigation measure that would track revenue regained from criminal tax fraud activity, similar to how Massachusetts's Council on Underground Economy (CUE) reports its activities.

Disagree. The methodology used by the Massachusetts's Council on Underground Economy (CUE) was not shared with TFID during this review. A cursory review of their website reveals that the CUE is a funded multi-agency effort that reports its results captured from labor-related issues, such as unpaid wages and the related tax. The CUE and TFID do not perform similar activities, thus use of their measurement methodology would not provide useful information for New Mexico. Capturing the revenue regained from criminal tax fraud activity is an intangible amount that cannot be adequately quantified.

23) Fill Tax Fraud Investigation Division vacancies and pursue backlog of potential fraud cases.

Agree. TRD will fill three vacant TFID positions by March 1, 2017. One of these positions began employment on October 24, 2016. This recommendation is duplicative of Recommendation No. 4.

State of New Mexico
LEGISLATIVE FINANCE COMMITTEE

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David Abbey
Director

May 18, 2016

Demesia Padilla, Secretary
Taxation and Revenue Department (TRD)
Joseph Montoya Building
1100 South St. Francis Drive
Santa Fe, New Mexico 87502

Dear Secretary Padilla,

The Legislative Finance Committee's 2016 work plan includes an evaluation on the status of New Mexico's tax gap and the Taxation and Revenue Department's efforts to enhance revenue collections. The evaluation includes the following objectives:

- Assess the effectiveness of TRD's strategies toward evaluating and addressing New Mexico's tax gap; and
- Assess efficiency and effectiveness of TRD audit and compliance programs, including its fraud investigations function.

Michelle Aubel, Program Evaluator, will lead the team, coordinating day-to-day activities. Ms. Aubel will arrange an entrance conference with you and your staff and might request information prior to the entrance conference to assist with background research for the project. Please designate a contact person to coordinate the evaluation on behalf of your respective agencies.

The evaluation is anticipated to be completed by August 2016 and is tentatively scheduled for a hearing September 2016. Should you have questions or comments regarding this engagement, please contact Michelle Aubel at 986-4517, or Mr. Charles Sallee, Deputy Director for Program Evaluation, at 986-4528.

Thank you for your cooperation.

Sincerely,

David Abbey

David Abbey, Director

Cc: Senator John Arthur Smith, Chairman, Legislative Finance Committee
Representative Jimmie C. Hall, Vice-Chairman, Legislative Finance Committee
Timothy Keller, State Auditor
Dr. Tom Clifford, Secretary, Department of Finance and Administration
Keith Gardner, Chief of Staff, Office of the Governor

Appendix A: Evaluation Scope and Methodology

Evaluation Objectives.

- Assess the effectiveness of TRD's strategies toward evaluating and addressing New Mexico's tax gap;
- Assess efficiency and effectiveness of TRD audit and compliance programs, including its fraud investigations function; and
- Provide a broader context for discussing tax policy by reviewing ways the state could be losing revenues and what actions other states are taking to retrieve those lost dollars.

Scope and Methodology.

- Interview agency staff in the Audit and Compliance Division (ACD) and Tax Fraud Investigation Division (TFID), including visiting the call center;
- Interview additional staff in the Revenue Processing Division for credits processing and the Motor Vehicle Division to review its call center operations;
- Review state and federal laws, regulations, and policies;
- Review previous LFC evaluations of Taxation and Revenue Department;
- Review other states' evaluations regarding tax gap analyses or delinquent account collections;
- Review IRS and other publications related to best practices for debt management and closing the tax gap;
- Research what other states are doing for addressing tax policy areas impacting revenues;
- Review relevant ACD and TFID reports, annual performance reports, strategic plans, detail listings for the film and high-wage credits, and other related documents; and
- Analyze reported data to determine trends, effectiveness, and efficiencies.

Evaluation Team.
Michelle Aubel, Lead Program Evaluator
Maria D. Griego, Program Evaluator

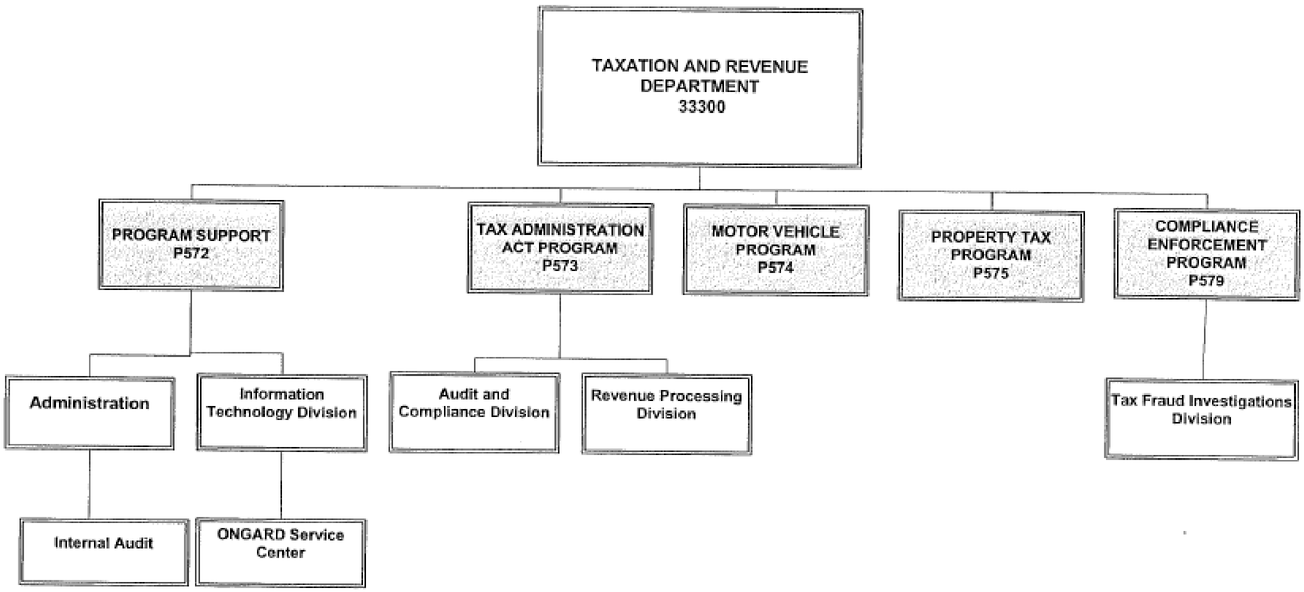
Authority for Evaluation. LFC is authorized under the provisions of Section 2-5-3 NMSA 1978 to examine laws governing the finances and operations of departments, agencies, and institutions of New Mexico and all of its political subdivisions; the effects of laws on the proper functioning of these governmental units; and the policies and costs. LFC is also authorized to make recommendations for change to the Legislature. In furtherance of its statutory responsibility, LFC may conduct inquiries into specific transactions affecting the operating policies and cost of governmental units and their compliance with state laws.

Exit Conferences. The contents of this report were discussed with the Secretary of the Taxation and Revenue Department and her staff on October 19, 2016.

Report Distribution. This report is intended for the information of the Office of the Governor, the Taxation and Revenue Department, the Office of the State Auditor, and the Legislative Finance Committee. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Charles Sallee
Deputy Director for Program Evaluation

Appendix B: Tax and Revenue Organizational Chart



Appendix C: Tax Credits Processed by RPD and other Agencies

#	Credit Type	Issuing Agency	Verifying Document
1	Affordable Housing	NMMFA	Certificate from Issuing Agency
2	Ag Water Conservation	SWCD	Credit active 2007-2012
3	Agricultural Biomass	EMNRD	No claims to date
4	Angel Investment Tax Credit	EDD	Certificate from Issuing Agency
5	Biodiesel Blending Facility	EMNRD and TRD	Certificate from Issuing Agency, TRD final approval (No claims to date)
6	Blended Biodiesel Fuel	TRD	RPD-41340 Claim form is reviewed by WDT supervisor before approval
7	Business Facility Rehabilitation	EDD	2015 PIT-5 would be reviewed along with statute requirements before approval
8	Cancer Clinical Trial	TRD	RPD-41358 would be reviewed along with statute requirements before approval (BCM Position)
9	Corporate-Supported Child Care	TRD	CIT-3 is reviewed along with statute requirements before approval (CIT unit)
10	Cultural Properties Preservation Tax Credit	NMDCA	Approval Letter from Issuing Agency
11	Electric Card Reading Equipment	TRD	RPD-41246 purchase and use statement is reviewed along with statute requirements before approval (BCM position)
12	Geothermal Ground Heat Pump	EMNRD	Certificate from Issuing Agency
13	Hospital Gross Receipts	TRD	RPD-41324 is reviewed along with statutory requirements before approval in (CRS Unit)
14	Intergovernmental Tax Credit	TRD	RPD-41160 reviewed along with statute requirements before approval
15	Job Mentorship Tax Credit	TRD	RPD-41279 sent to TRD by school requesting credit. Certificate issued to school. School issues out Certificate
16	Lab Partnership with Small Business Tax Credit	TRD	RPD-41325 is reviewed along with documents provided by entity before approval
17	Land Conservation Tax Credit	EMNRD and TRD	Approval Letter from Issuing Agency, Final approval in ARSB by BCM, (Transferable)
18	Renewable Energy Tax Credit	EMNRD	Approval letter from Issuing Agency, A yearly Notice of Allocation from the Issuing Agency
19	Res & Dev Small Business	TRD	RPD-41298 reviewed along with submitted docs from the taxpayer before approval
20	Rural Health Practitioner	NMDOH	Certificate from Issuing Agency
21	Service for Resale against Gov	TRD	RPD-41300 and RPD-41305 are reviewed along with submitted docs before approval
22	Solar Market	EMNRD	Certificate from Issuing Agency
23	Sustainable Building	EMNRD and TRD	Certificate from Issuing Agency, Final approval at ARSB, Transfers researched at ARSB
24	New Sustainable Building Credit	EMNRD and TRD	Certificate from Issuing Agency, Final approval at ARSB, Transfers researched at ARSB
25	Unpaid Doctors Services	TRD	RPD-41323 is reviewed along with statute requirements before approval
26	Veterans Employment	TRD	RPD-41371 and RPD-41370 is reviewed, DD form 214, submitted docs and statute requirements before approval
27	Welfare-to-work	TRD	No current claims. Federal Repeal
LEGEND	RPD Reviewed Credits		
DCA	Department of Cultural Affairs	EMNRD	Energy Minerals and Natural Resources Dept.
DOH	Department of Health	SWCD	Soil and Water Conservation District
EDD	Economic Development Dept.	TRD	Taxation and Revenue Department
MFA	Mortgage Finance Authority	BCM	Business Credit Manager

Source: TRD

Appendix D: Criminal Statutes

According to the TRD webpage, the Tax Fraud Investigations Division primarily investigates possible violations of the following criminal statutes. A summary of applicable NMAC rules is not provided here.

7-1-72 Attempts to Evade or Defeat Tax:
Any person who willfully attempts to evade or defeat any tax or the payment of tax.

7-1-73 Tax Fraud:
(1) Any person who willfully makes and subscribes any return, statement or other document that contains or is verified by a written declaration that it is true and correct as to every material matter and that the person does not believe it to be true and correct as to every material matter.
(2) willfully assists in, willfully procures, willfully advises or willfully provides counsel regarding the preparation or presentation of a return, affidavit, claim or other document pursuant to or in connection with any matter arising under the Tax Administration Act or a tax administered by the department, knowing that it is fraudulent or knowing that it is false as to a material matter.
(3) files any return electronically, knowing the information in the return is not true and correct as to every material matter; or
(4) with intent to evade or defeat the payment or collection of any tax, or, knowing that the probable consequences of the person's act will be to evade or defeat the payment or collection of any tax, removes, conceals or releases any property on which levy is authorized or that is liable for payment of tax under the provisions of Section 7-1-61 NMSA 1978, or aids in accomplishing or causes the accomplishment of any of the foregoing.

30-16-8 Embezzlement: A person embezzling or converting to the person's own use anything of value, with which the person has been entrusted, with fraudulent intent to deprive the owner thereof.

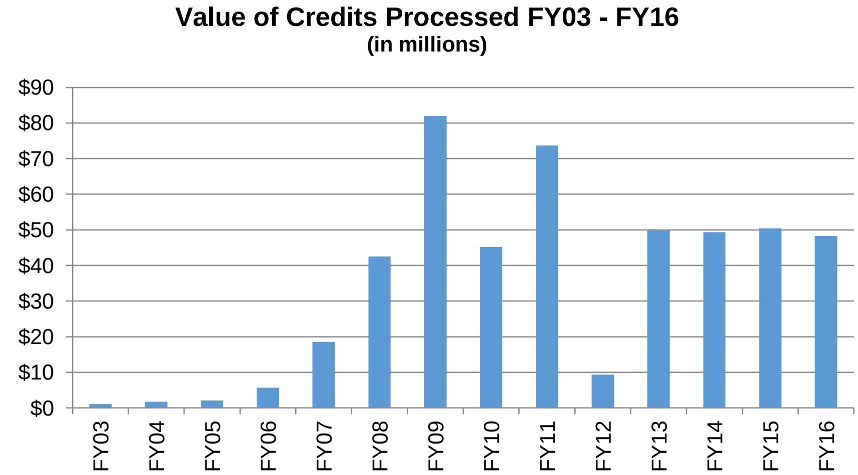
30-45-3 Computer Access with Intent to Defraud or Embezzle: A person who knowingly and willfully accesses or causes to be accessed a computer, computer system, computer network or any part thereof with the intent to obtain, by means of embezzlement or false or fraudulent pretenses, representations or promises, money, property or anything of value.

30-28-2 Conspiracy: Conspiracy consists of knowingly combining with another for the purpose of committing a felony within or without this state.

30-51-4 Money Laundering: It is unlawful for a person who knows that the property involved in a financial transaction is, or was represented to be, the proceeds of a specified unlawful activity to:
i. conduct, structure, engage in or participate in a financial transaction that involves the property, knowing that the financial transaction is designed in whole or in part to conceal or disguise the nature, location, source, ownership or control of the property or to avoid a transaction reporting requirement under state or federal law;
ii conduct, structure, engage in or participate in a financial transaction that involves the property for the purpose of committing or furthering the commission of any other specified unlawful activity;
iii transport the property with the intent to further a specified unlawful activity, knowing that the transport is designed, in whole or in part, to conceal or disguise the nature, location, source, ownership or control of the monetary instrument or to avoid a transaction reporting requirement under state or federal law; or
iv make the property available to another person by means of a financial transaction or by transporting the property, when he knows that the property is intended for use by the other person to commit or further the commission of a specified unlawful activity.

Source: TRD

Appendix E: Film Production Tax Credit



Source: TRD

Appendix F: Five-Year Collections – Other Category Detail

Revenue Source	Amount	Percent of Total Collections
Combined Fuel Tax	$7,581,869	0.7%
Weight Distance Tax	$7,921,968	0.7%
Workers Compensation Fee	$3,098,271	0.3%
Tobacco Products Tax	$153,357	0.0%
Fiduciary Tax	$283,828	0.0%
Cigarette Tax	$3,270	0.0%
Severance Tax	$1,897,350	0.2%
E911 Service Surcharge	$38,240	0.0%
Gaming Operator Tax	$247,952	0.0%
Water Conservation Fee	$10,284	0.0%
Resource Excise Tax	$582,152	0.1%
TRS Surcharge	$703	0.0%
Liquor Excise Tax	$13,871	0.0%
Local Liquor Excise Tax	$63,707	0.0%
Private Railroad Cars	$8,333	0.0%
Conservation Tax	$541	0.0%
Alternative Fuels Excise Tax	$211	0.0%
Bingo & Raffle Tax	$1,867	0.0%
Total Other Category	$21,907,772	
Total Five-Year Collections	$1,137,996,360	2%

Appendix G: Definition of Terms for Account Reductions

Term	Definition
Audit	A credit given in the course of an audit
Abated	The balance has been removed and is no longer due. Taxpayer may have provided documentation to substantiate less tax due or a protest decision was made in the taxpayer's favor
Adjusted Down	The balance due at the beginning of the fiscal year was reduced by the filing of an amended return
Deactivated	The debt is no longer being collected on. Most commonly due to the age of the debt (7-9-19) but can also be applied to defunct corporations or deceased taxpayers
Protested	The balance due at the beginning of the fiscal year is currently in protest and collection actions are on hold until there is a decision
Reversed	The balance due at the beginning of the fiscal year was reversed, often accrued penalty and interest is reversed back to the effective date of the payment once posted.
Bankruptcy	The balance due at the beginning of the fiscal year is covered by an active bankruptcy stay

Source: TRD

Appendix H: Enhanced Delinquent Tax Collection Initiative

FY16 ACD Collections Initiative Report
(in millions)

Collections Summary	
Year-to-Date (YTD) Collections	$238.5
Percent of YTD Goal	99.58%
Over/(Under) YTD Total	($1.0)
General Fund (GF) YTD Collections	$175.5
Percent of GF YTD Goal	102.14%
Over/(Under) YTD GF Goal	$3.7
YTD GF Goal	$171.9
Credit – Refund Summary	
YTD Denials	$18.1
Percent of YTD Goal	80.29%
Over/(Under) Denial Total	($4.4)
GF Denials for Year	$16.2
Percent of YTD Goal	152.46%
Over/(Under) YTD GF Denials Goal	$5.6
YTD GF Denials Goal	$10.6
Net Compliance Summary	
YTD Net	$256.6
Percent of YTD Goal	97.92%
Over/(Under) YTD Goal	($5.5)
YTD Net Goal	$262.1
GF Net for year	$191.7
Percent of YTD Goal	105.06%
Over/(Under) YTD GF Net Goal	$9.2
YTD GF Net Goal	$182.5

Source: TRD

Appendix I: Data Warehouse Projects

Phase 1 (6/2012 – 10/2012)

Fraud Discovery	
Collections Discovery	Collections (Defunct)
RAR** PIT project	Tax Gap Initiative
RAR** CIT project	Tax Gap Initiative

**Revenue Agent Report shows IRS adjustments.

Phase 3 (11/2012 – 12/2015)

QRU Discovery **	Tax Gap Initiative
PIT Tape match 2010	Tax Gap Initiative
SRFMI PIT 2013	
SRFMI CRS 2013	
LEVY Discovery	Collections
SRFMI PIT 2014	
SRFMI CRS 2014	
PIT RAR V2	Tax Gap Initiative
QRU Discovery V2	Tax Gap Initiative
CIT Nexus Audit Selection	Tax Gap Initiative
PIT-IS 2011	Tax Gap Initiative
Schedule C/1099-Misc V2	Tax Gap Initiative
Mail upgrade for Case/Lead	
Weight-Distance V3	Tax Gap Initiative
LIEN Discovery	Collections

**Questionable Refund Unit

Final Phase (1/2017 – 12/2017)

Transfer all historical case data and financial data from Discover tax from 2001 for the 40 projects worked.

Source: TRD

Phase 2 (11/2012 – 12/2013)

Business Credits	
Managed Audit	Tax Gap Initiative
Audit Selection V4	Tax Gap Initiative
Schedule C/1099 Misc	Tax Gap Initiative
SRFMI PIT 2012**	
SRFMI CRS 2012 **	
PIT Prior Period Review	
CRS Prior Period Review	
Zero filers for the Commercial Vehicle Bureau in MVD	
PIT Income Source 2010	Tax Gap Initiative
TFID First time filers	

**State Reverse File Match Initiative

Phase 2 (11/2012 – 12/2013)

SaS Visual Analytics Server**	
QRU Discovery V3	Tax Gap Initiative
Auto File Transfer	
Refund Case Project	
Fraud Manager	
Combined Fuel Tax V1	Tax Gap Initiative
Managed Audit Offer	Tax Gap Initiative
SRFMI PIT 2015	
SRFMI CRS 2015	
SRFMI CIT 2015	

**Statistical Analysis Software