COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF REVENUE
HARRISBURG, PENNSYLVANIA
17128-1100

THE SECRETARY

June 1, 2012

The Honorable Tom Corbett
Governor of Pennsylvania
225 Main Capitol Building
Harrisburg, PA 17120

Dear Governor Corbett:

As required by section 1730-L (3) of Act 46-2010, an act amending the act of April 9, 1929 (P.L.343, No.176), known as The Fiscal Code, the Department of Revenue hereby submits to the Pennsylvania General Assembly the annual report concerning the Enhanced Revenue Collection Account (ERCA).

According to Act 46, the Department of Revenue shall furnish an annual report to the Governor, the Majority and Minority Chairs of the Appropriations Committee of the Senate and Majority and Minority Chairs of the Appropriations Committee of the House of Representatives by June 1 annually. The report provides a detailed breakdown of the Department's administrative costs in implementing the program. The report also provides the total amount of revenue collected and refunds avoided by the program. These revenues are also broken down by tax type.

Sincerely,

C Daniel Hassell for DM

Daniel Meuser
Secretary of Revenue

Report to the General Assembly on the Enhanced Revenue Collection Account

June 1, 2012

Pennsylvania Department of Revenue
Bureau of Research

Introduction

Act 46 of 2010 created the Enhanced Revenue Collection Account (ERCA). Revenues collected and refunds avoided as a result of expanded tax return review and tax collection activities are earmarked for deposit to the account. For fiscal years 2010-11 and 2011-12, as much as $4.3 million is to be appropriated annually to the Department of Revenue to cover the administrative costs in increasing tax collection enforcement and reducing tax refund errors. Per Act 46, the balance of the account on June 15, 2011 and each year thereafter must be transferred to the General Fund.

ERCA funding has enabled the Department of Revenue to increase its scrutiny of returns requesting refunds as well as initiate additional audits. The Bureau of Corporation Taxes, Bureau of Individual Taxes, and the Deputate of Compliance and Collections were provided with extra staff and resources, translating into more audits, more collections activity, and more aggressive enforcement initiatives.

Implementation of the Program

The Department formed a project team to plan and manage the implementation of Act 46. The project team established a goal that any revenue or refund reduction amounts reported under the project must be accurate and fully verifiable. Where necessary, new system reports were developed in order to track the activities of positions funded by ERCA. The following sections provide detail on project implementation in each of the major tax areas.

Bureau of Corporation Taxes

The Bureau of Corporation Taxes began filling 17 positions in September 2010 to implement its ERCA initiatives. These specific positions included Corporation Tax Officers, Corporation Tax Account Technicians, Accounting Assistants, and Revenue Research Analysts. These positions were filled by transferring existing personnel with the requisite expertise, as well as hiring additional staff.

The Bureau of Corporation Taxes continues to focus on four primary initiatives:

- Enhanced efforts in cursory review of tax returns
- Increased desk audits of returns
- Increased amended return review
- Refund policy changes

Corporation Tax Account Technicians allowed for the dedication of resources to a more thorough review of refunding and potential offsets, while maintaining needed resources in all account maintenance and customer service areas. Corporation Tax Officers provided for the dedication of resources to earlier desk audits of returns and suspensions of refunds to determine under-reporters. Revenue Research Analysts' scoring and manual review of cases selected for potential determination resulted in a more directed utilization of the additional resources, while smaller liability returns were reviewed by the Accounting Assistants for differences in reported tax and calculated tax.

The Department of Revenue's Corporate Tax Refund Policy was also altered to enhance revenue and minimize future collection costs. Specifically, requested corporate tax refunds were no longer immediately refunded, but rather, held pending the resolution of disputed tax liabilities.

These initiatives were implemented with limited programming due to resource constraints and an archaic legacy computer system. Accordingly, most of the Bureau of Corporation Tax costs associated with ERCA implementation are attributable to employee salary and benefits. Minor revisions to the Bureau of Corporation Taxes' existing computer programs were necessary for report querying and tracking purposes. In particular, a greater number of corporate tax reports at various tax liability levels were reviewed or examined for accuracy.

ERCA implementation by the Bureau of Corporation Taxes was accomplished with minimal or no impact upon taxpayers and other external constituents. No tax forms or website changes were necessary to effect the implementation or maintenance of any of the four primary corporate tax initiatives: enhanced cursory review; increased desk audits; increased amended return review; and refund policy changes.

Bureau of Individual Taxes

The Bureau of Individual Taxes began filling 16 positions in August 2010 to implement the ERCA initiatives for the Personal Income Tax (PIT) program. These specific positions included 13 Tax Examiners, 2 Tax Account Collections Technicians, and a PIT Specialist.

Eight of those positions were filled by experienced Tax Examiners from existing personnel, while the remaining eight were filled by newly-hired employees and the assignment of other existing personnel in the PIT operations impacted by the Act 46 initiative. Four of the new positions were filled by internal candidates based on their knowledge and work experience with the PIT computer system. The position backfills stemming from the assignment of existing staff and the remainder of the new positions were filled by six internal candidates and ten candidate referrals from the Bureau of State Employment. ERCA funding has enabled the restoration of PIT positions lost through attrition in recent years, reducing the need to make hard choices between customer service and dedicated enforcement.

The Bureau of Individual Taxes has continued to focus on three primary initiatives:

- Enhanced effectiveness of front-end examinations and increased billing and assessment, payment application, and post-assessment enforcement.
- Increased desk examination of specially selected current year returns and the examination of the taxpayers' prior years' returns still open for review by statute.
- Introduction of expanded criteria and parameters when selecting returns for suspension review.

These three initiatives have allowed the Bureau of Individual Taxes to increase the number of adjustments to taxable income and credits reported by taxpayers, allowing for more equitable enforcement of Pennsylvania's tax laws.

Compliance and Collections

ERCA funds continue to cover the expense for 40 employees originally hired and deployed between September and November 2010. Included bureaus are CATS, Compliance, EPAD, and PTBO positions in the Deputate of Compliance and Collections and the Bureau of Audits. They have been utilized for the following enforcement business units and/or enhanced revenue initiatives:

- Pass Through Business Review
- Delinquent Collections Call Center Program
- Field Tax Enforcement and Collections
- Sales and Use Tax Field Audits
- Collection Agency Program Administration and Support
- Business Use Tax Voluntary Compliance Initiative
- Skip Tracing

Revenue Fiscal Analysts performed review and assessment of complex pass through business entities' operations and tax returns, as well as the shareholders and partners. As the number and total net income of partnerships and S Corporations grow, increased scrutiny of pass through entities becomes more imperative in tax collection efforts.

Additional Call Center Agents assigned to the Delinquent Call Center Program conducted telephone collection activities of business and individual taxpayers. The step-up in early enforcement contacts enabled the Department of Revenue to resolve delinquent accounts sooner and at less cost. Contact Center Agents also joined the Business Use Tax Voluntary Compliance Initiative increasing the resources available for bringing businesses into compliance with their use tax obligations.

Additional Revenue Collection Agents were assigned to Field Tax Enforcement and Collections allowing the Department to increase its direct field audit activities. Two collection agents and a supervisor also provided administrative support to the Collection Agency Program which utilizes private collection agencies through the Office of Attorney General. Furthermore, Field Auditors were added to the Sales and Use Tax Field Audit staff, increasing their ability to conduct on-site audits.

The Department obtains "skip tracing" services to identify current and accurate contact information for delinquent accounts with no valid phone number and/or an inaccurate mailing address. Use of the skip tracing services to produce better contact data, especially accurate phone numbers, resulted in earlier resolution and increased collections from delinquent accounts. Results through March 31, 2012 include over 320,000 delinquent account records updated and ERCA revenue generated from this collections tool in excess of $1.5 million.

Personnel investments previously described occurred primarily within existing Compliance and Collections programs and leveraged existing technology and tools. ERCA-funded resources, especially personnel, have permitted a number of enforcement programs and collections systems to be ramped up. These programs included:

- Enhanced tax clearance programs are being implemented. The Licensee Tax Responsibility Program (LTRP) was established by Executive Order 2011-06 and expanded the clearance activities for business and professional licensees. The Employee Tax Clearance Program annually reviews the tax obligations of commonwealth employees.
- Internet publication of tax liens that were not paid in full and satisfied beginning in FY 2010-11 and continuing.
- Continued expanded use of Act 46 citations for tax delinquent businesses continuing operation without a valid sales tax license. These citations are issued by the Department of Revenue's Field Enforcement Agents against operating businesses who have significant state tax debt and have not taken appropriate steps to resolve their obligations. In most instances, such tax delinquents are collecting and not remitting sales taxes and personal income tax withholding to the Department of Revenue.
- A sustained high volume corporate officer/responsible party assessments for corporate owners, officers, or other officials responsible for collection of Pennsylvania employer withholding and/or sales taxes. These taxes are considered "trust funds" held on behalf of the Commonwealth and the responsible official(s) can be held personally liable if they are not remitted. A new processing module was implemented in June 2010 resulting in more efficient administration and expanded issuance of corporate officer/responsible party assessments.
- Expanded use of wage garnishment for individual tax delinquents.

To be clear, these tools were not implemented through the ERCA initiative. However, ERCA funded personnel were responsible for greater and more efficient use, all the while assisting the Department in sustaining delinquent collections levels.

Summary

The ERCA investment in Pennsylvania tax compliance was timely. The 2010 Tax Amnesty Program concluded on June 18, 2010. The resolution of many accounts receivable cases was accelerated by the Amnesty offering with taxpayers filing and participating in the program to receive the abatement of all penalties and 50 percent of interest. The accounts of tax delinquents who declined Amnesty participation were returned to routine workflows. ERCA funded, newly-hired collectors permitted the Department of Revenue to return to and sustain pre-Amnesty compliance and collections levels.

ERCA provided an opportunity for the Department to remain productive in tax enforcement programs in the face of attrition in certain key revenue producer positions. For fiscal year 2011-12, the program generated $74.3 million in recovered tax revenue and $35.0 in refunds avoided, surpassing by $19.5 million the $89.8 million estimate set for the program. For fiscal year 2010-11, the program generated $47.9 million in recovered tax revenue and $22.3 in refunds avoided.

Statistical tables detailing ERCA implementation are provided below[1]:

Costs of Program Implementation[2]

Salaries and Benefits	$ 4,550,000
Travel Expenses	$ 45,000
Legal Services/Fees	$ 250,000
Total Operating Costs[3]	***$ 4,845,000***

ERCA Revenue

Total Additional Revenue Collected	$ 74,316,067
Total Refunds Avoided	$ 34,993,546
Total ERCA Revenue	***$ 109,309,613***

Collections by Tax Type

Corporate Net Income	$ 13,707,581
Capital Stock	$ 9,832,078
Foreign Franchise	$ 6,062,738
Loans Tax	$ 190
Sales and Use	$ 19,605,074
Personal Income - Withholding	$ 1,830,791
Personal Income - Annual	$ 18,671,033
Inheritance	$ 4,606,582
Total Additional Revenue Collected	***$ 74,316,067***

Avoided Refunds by Bureau

Corporation Taxes	$ 428,257
Personal Income Tax	$ 34,565,289
Total Refunds Avoided	***$ 34,993,546***

[1] Figures in statistical tables only represent revenue collected and moved to ERCA through May, 2012.
[2] Costs of Program Implementation projected through June 30, 2012.
[3] Due to the limitation of the Act, only $4.3 was recouped.

In addition to revenue collected, significant gains were made in the area of tax assessments. Through May 2012, the Bureau of Individual Taxes issued 21,039 PIT assessments for $14,209,427 for fiscal year 2011-12; payments totaling $4,815,213 were received, representing a collection success rate of 33.9%. During the same time period, the Bureau of Corporation Taxes issued $92,645,535 while collecting $11,755,568. Due to a lengthy appeals process, but high rate of collection, those figures can be considered anticipated revenues for the next fiscal year.

There are two operations from the enforcement side of the Department performing liability creation: the Bureau of Audits and the Pass Through Business Office. The assessment totals for Bureau of Audits and the Pass Through Business Offices were $10,966,209 and $34,580,898 respectively for fiscal year 2011-12. Delays in collection are generally attributable to due process and tax appeals.

The ERCA program is funded through fiscal year 2011-12. In the Governor's 2012-13 budget proposal a new funding level of $10 million is proposed, with a continuation of the program through fiscal year 2016-17. That funding is estimated to bring in $100 million of additional revenue each fiscal year.