Audit Selection and Data Warehousing – WSATA Oct. 2019

Oregon Department of Revenue

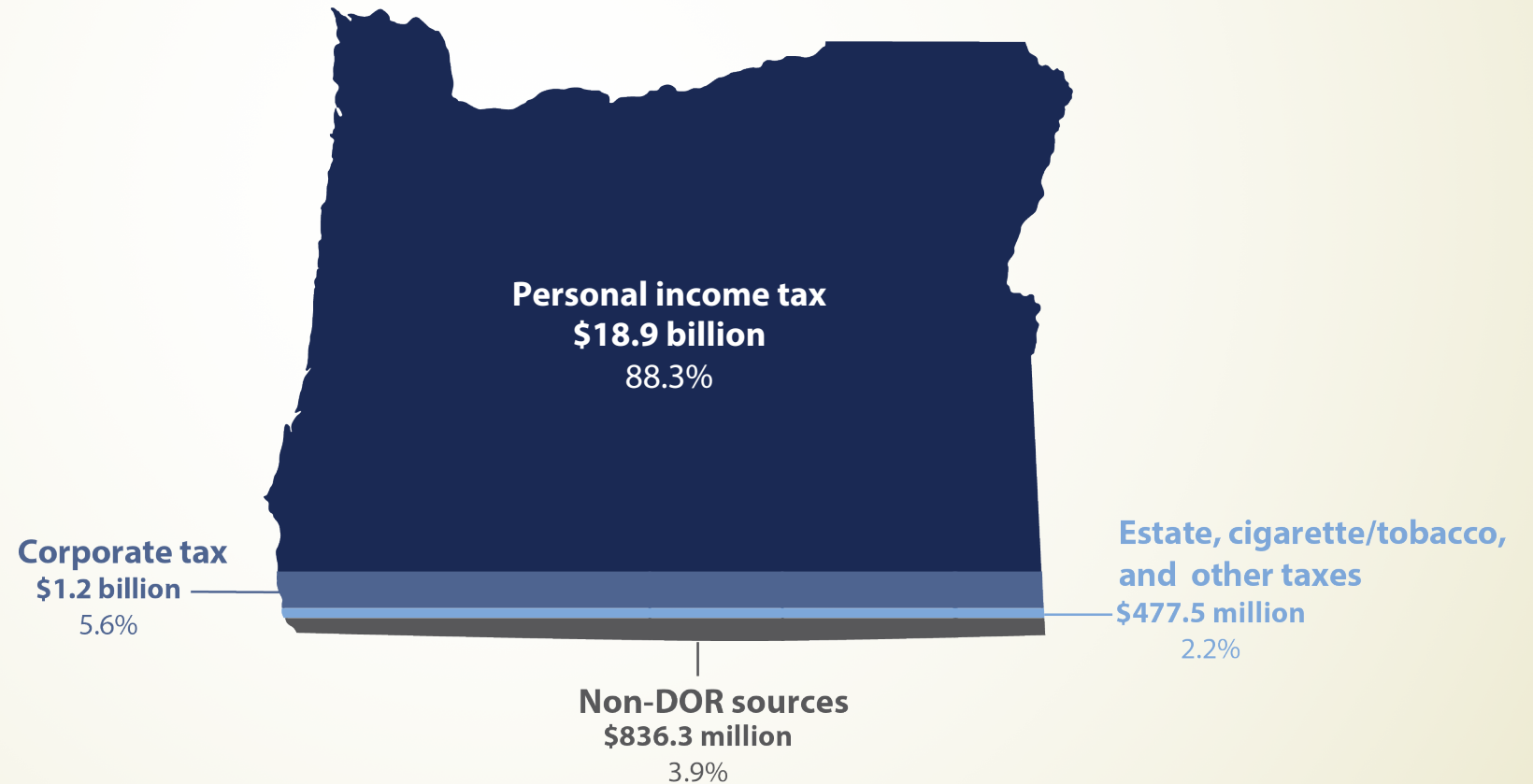Matt Claflin

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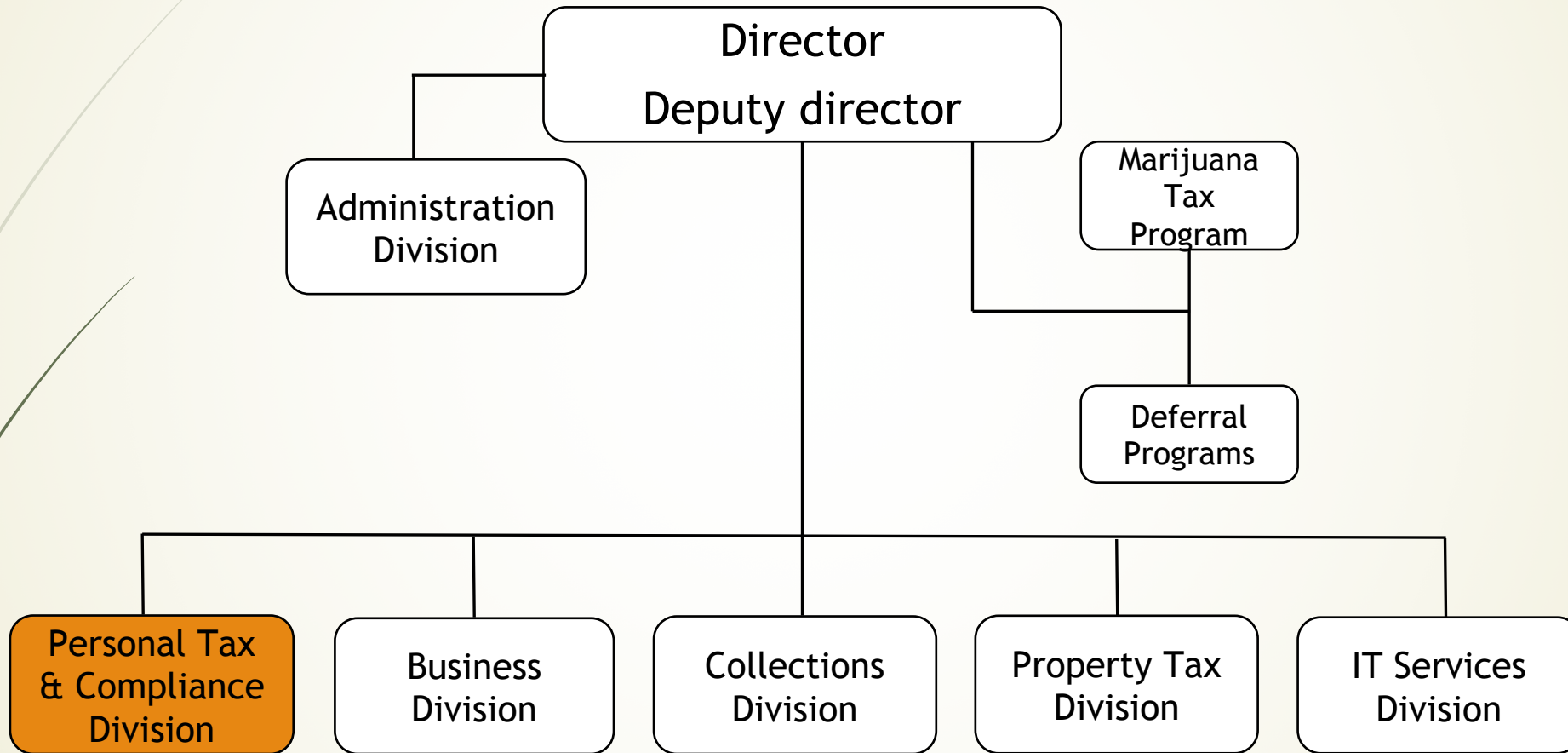- Personal income tax filing enforcement

Personal Income Tax in Oregon
Oregon General Fund Revenue Sources

$21.4 billion, Oregon Office of Economic Analysis, 2019 – 2021 Biennium Forecast

Personal income tax
$18.9 billion
88.3%

Corporate tax
$1.2 billion
5.6%

Estate, cigarette/tobacco, and other taxes
$477.5 million
2.2%

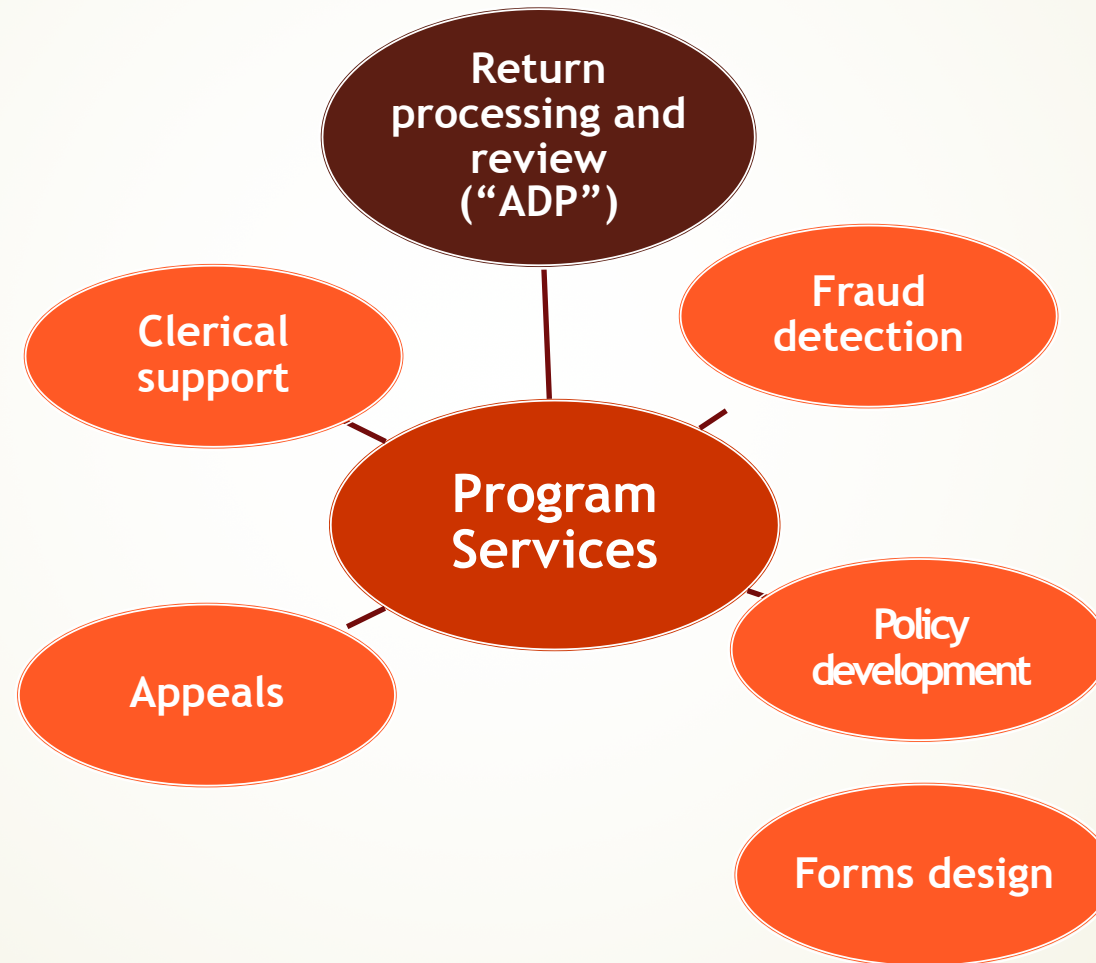**Non-DOR sources**
$836.3 million
3.9%

Organizational Structure – Oregon DOR:

Personal Tax and Compliance Division (PTAC)

Program Services Section

Appeals, Discovery, Processing (ADP):

Tax programs – Personal income tax, partnerships

Work Performed:

Return Suspense -
Correct errors
Work processing edits

Federal audit adjustments – EOAD (RAR's) and CP2000's

Audit after processing -Work discovery leads based on current filing season.

Filing enforcement – cases that need research before automated processes.

Appeals – written objections and conferences.

Staffing:

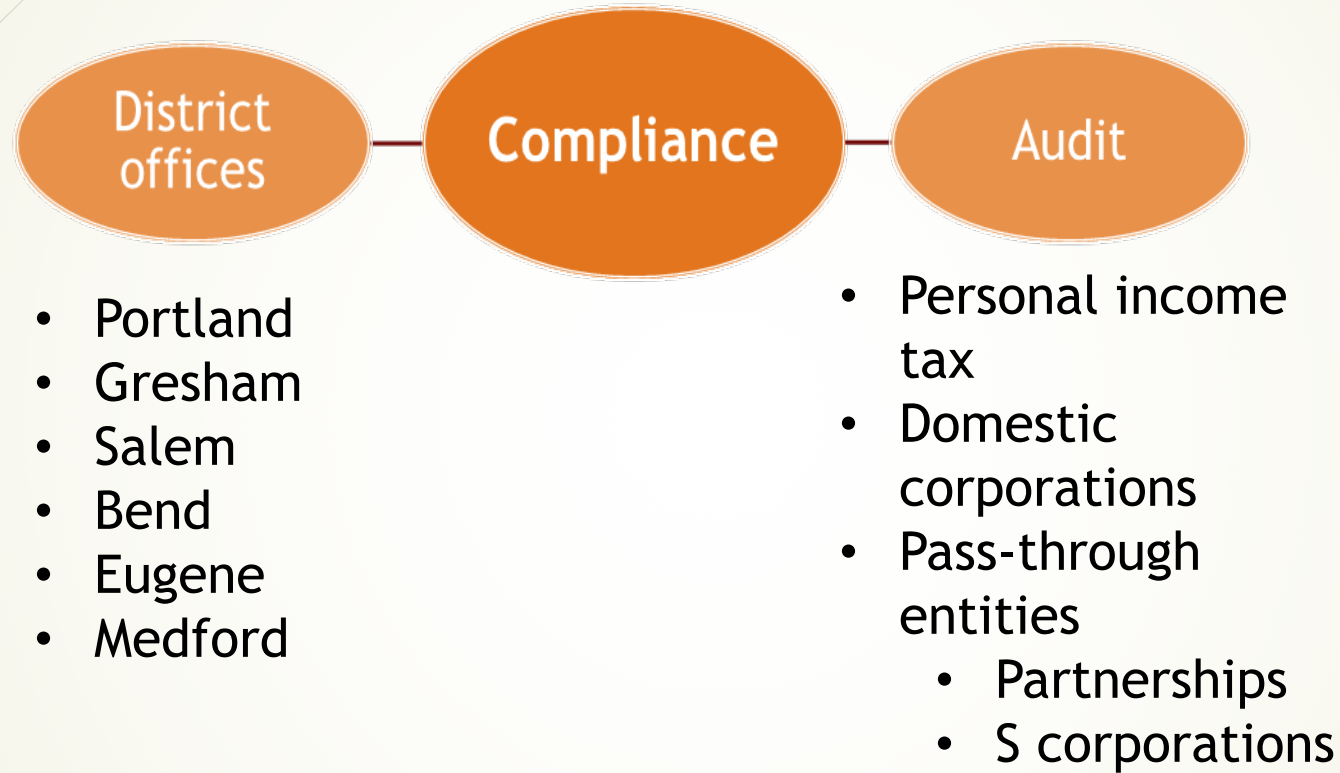**Administrative Specialist 1** – 14 positions

Administrative Specialist 2 – 20 positions

All staff located in Salem.

Conference:

Tax Auditor 2 (senior tax auditor) – 6 positions

Personal Tax and Compliance Section

District offices — Compliance — Audit

District offices
- Portland
- Gresham
- Salem
- Bend
- Eugene
- Medford

Audit
- Personal income tax
- Domestic corporations
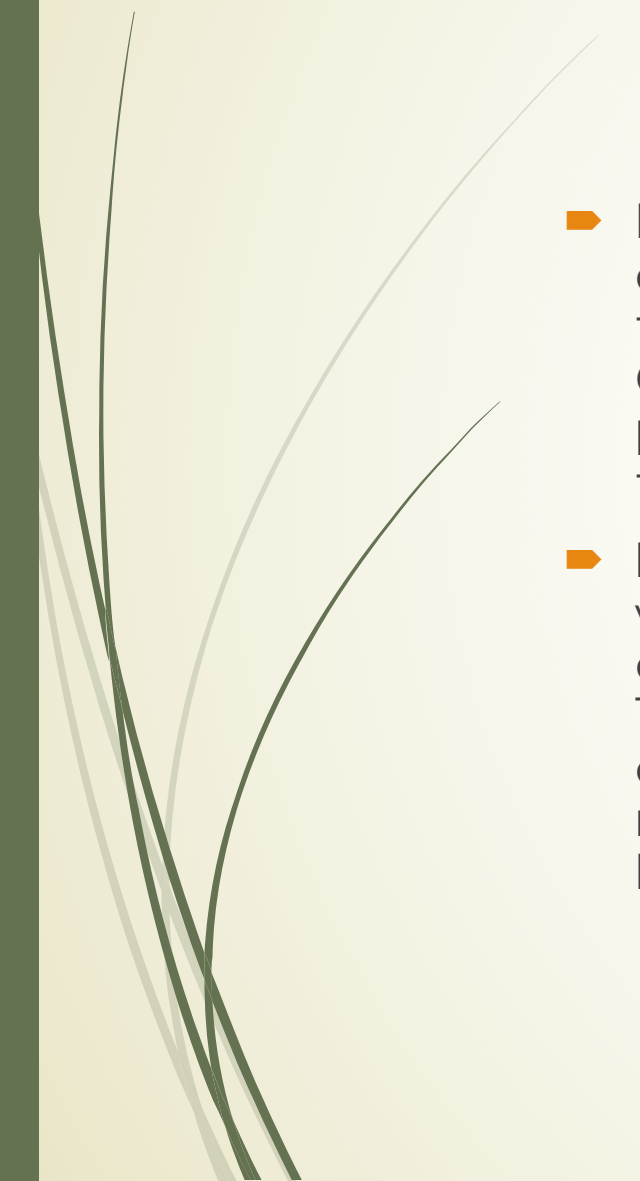- Pass-through entities
  - Partnerships
  - S corporations

Tax Auditor Entry/Tax Auditor 1 – 71 positions

Tax Auditor 2 ("Senior Tax Auditor") – 25 positions

Audit Case Selection - History

- Prior to the late 1990's, audit cases were generally selected by senior auditors in each office and used as a pool of cases for the district. At the time, Oregon required all federal returns and schedules be attached to the Oregon return when filed. The case selection process was manual review of paper returns and based on "auditor judgement". There was little to no tracking of results other than cases closed; tax, penalty and interest billed.

- In 1998 we were running out of space to hold tax returns, so the decision was made to only require the federal 1040. A computer program was developed to allow auditors to query federal data (IRTF) for case selection. The case selection process was then a mix of manual review and data queries – both were still based on "auditor judgement". There was little to no tracking of results other than cases closed, tax, penalty and interest billed.

Audit Case Selection, cont.

In anticipation of moving from our legacy computer systems to an off-the-shelf replacement, a case selection process was implemented in 2010 to gather significant data:

- Document auditor ideas of case selection queries (e.g. "good audit cases")

- Prioritization of cases in a pool of leads (generally based on revenue generated)

- Return line items adjusted (federal and state) along with tax, penalty and interest billed

- Comparison of whether the closed cases met expectations or discarded as poor leads

- Information on taxpayer behavior that may have led to the non-compliance

- Appeal rates as well as adjustments based on appeals

All leads were pulled by specific persons and issued to auditors upon request. Monthly reports were run on several measures and discovery queries were corrected or improved as necessary.

Data used for case selection was federal data (IRTF, IRMF) and Oregon return data gathered during return processing.

Cases were assigned by manager or lead worker.

Auditors no longer had direct access to pull cases for audit. They did provide feedback on case results.

Case Selection - Today

In 2015, the Oregon personal income tax program was implemented in GenTax and the decision was made to use the GenTax Discovery process.

There are 2 specific positions with computer, GenTax, and tax backgrounds charged with developing and maintaining 3 areas of discovery:

- Business audit case selection
- Issue audit case selection (Oregon issues), and
- Filing enforcement

These persons work with developers in IT to create the queries in GenTax that populate the audit lead pools.

In general, the queries and data used in the case selection system prior to GenTax were used after system implementation.

A process of auditor feedback and matric comparison to expected results is still used to improve and update queries.

Business Audit Case Selection – Personal Income Tax

Predominately, federal IRTF and IMF data in the data warehouse is used for case selection. Some Oregon return data is used to help prioritize leads to those that would have the greatest revenue generation.

Leads are generated and placed in a queue for assignment by managers. The GenTax "Get Next Task" process is not used to assign leads as it is too cumbersome to create and maintain separate work groups for assignment of cases (necessary for "get next task" in GenTax"):

- There are over 15 areas of audits generated by the discovery queries
- Leads are assigned based on skill level and the development of the auditor
- Focus on specific locations is sometimes necessary due to travel

Audit leads are assigned by managers or lead workers and may be discarded upon lead worker or manager approval. Auditors don't select their own leads.

Several measures are monitored monthly including cases closed, discarded cases, revenue generated per case, time spent, appeals, plus others.

Discovery queries are updated based on auditor feedback, changes in tax law, and results of cases as compared to expectations.

Business Audit Case Selection

- Based on research done by the IRS, and our own Research section on compliance and the tax gap, tax auditor resources were shifted to focus in the following areas to have the greatest impact on long-term tax compliance:

  - Schedule C's

  - Rentals

  - Farms

  - Pass through entities (partnerships and S corporations)

  - Domestic (Oregon) C corporations

  - Employee business expenses (based on our own experience with compliance)

  The research shows that these areas account for the greatest percentage of under reported tax. This is largely due to little or no 3rd party reporting as well as increased opportunities for evasion through manipulation of income and expenses.

  Employee Business Expenses (EBE) deductions has historically been a problem area for tax compliance in Oregon.

Business Audit Case Selection, TCJA

During the 2013-2015 biennium, business cases were 13% of audit cases closed, in 2019-2021 the projection is 85% business cases.
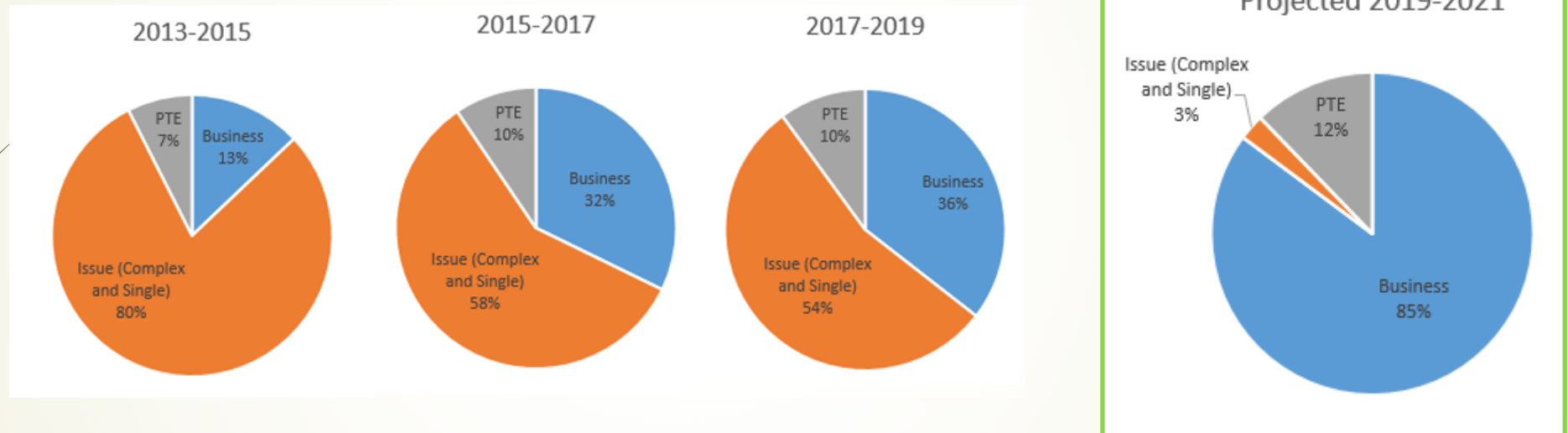
Although the plan was for a gradual shift to focus on business audits, the federal Tax Cuts and Jobs Act (TCJA) accelerated Oregon's plan by eliminating employee business expenses from itemized deductions.

EBE audits were characterized as a "complex issue" and were a large part of our audit pool.

Business Audit Case Selection – Pass Through Entities and C Corporations

- Discovery leads are generated using Oregon return data as well as federal BRTF and BMF data.

- Due to minimal useful data available in the warehouse, the leads are then reviewed by senior tax auditors for audit potential with poor leads being discarded from the pool.

- Audit leads are then assigned by managers or lead workers based on demonstrated skill level of the auditor. Some auditors can self-select leads directly from the discovery pool.

There are few criteria available in the discovery queries for partnerships, S corporations and C corporations because there is little information captured by the IRS or by our own return processing system.

Discovery queries are updated based on auditor feedback and changes in tax law.

Audit after Processing Season, Case Selection – Personal Income Tax

- The abilities in GenTax for return processing edits and fraud detection are extensive, however they take a toll in increased resource needed to review suspended returns as well as the time it takes all returns to work through the processing pipeline.

- This increase in time to process returns conflicts with the increasing expectation by taxpayers for quick refunds. This meant that a change needed to be made to speed the processing of returns that didn't compromise the accuracy of returns filed.

- A decision was made to reduce the number of edits during return processing and to create audit discovery leads to work <u>after</u> the return processing season is completed.

  - **Advantages** – faster return processing, fewer resources needed to review suspended returns. More flexibility in choosing audit leads over return processing edits. Audits can be worked by AS2's - freeing tax auditors to work more complex business cases.

  - **Disadvantages** – people getting bills for tax that generally would have been corrected during processing. Billing back for refunds already spent by taxpayers. May not have time to audit leads before the next season.

Audit after Processing Season – Case Selection

- Data for these "Audits After Processing" are based only on Oregon data and only for the current processing season.

- Case selection queries are based on previous return processing edit or identified issues that grew apparent during the processing season (routine errors on returns that are new for the current tax year.)

- These leads are for "desk audits" that require don't require documentation or information to request from taxpayers prior to adjusting returns.

- Each query is a single line item issue from the return that is then assigned to a specific work group to be worked in GenTax. However, one return may show in more than one group due to multiple errors on the return.

- Administrative Specialist 2's are assigned to these work groups and use "Get Next Task" to receive work and complete the audit.

- Staff is trained on a "Just in Time" basis as one group of leads are exhausted and a new group is made available.

- Adjustments have pre-written explanations that are selected by staff and sent to taxpayers. This helps speed the audit process, creates consistency, and allows staff with limited tax knowledge to work these cases.

PIT Filing Enforcement – Past

- Prior to GenTax, filing enforcement was mostly a manual process that required a significant use of staff resources.

  - A legacy application used by a program lead worker provided access to federal data (IRTF, IRMF, IMF) as well as wage data from the Oregon Employment Division to generate leads. Leads were then assigned to AS1's by a lead worker or manager.

  - An in-house built application was used by staff to create and print letters, identify taxable income sources, set the filing status, and calculate tax and applicable penalty for each case. These calculations were then reviewed by lead workers for accuracy.

  - Approved cases were closed and then uploaded to another application that issued the billing.

  - There was no lead prioritization or scoring. Leads were identified and entered into the system by other DOR staff – generally collectors or auditors.

  - There was little evaluation of the success of enforcement efforts of nonfilers. Since many leads came from collectors, we assessed nonfilers year after year, even when collection actions were active on prior assessments. There was Little to no evaluation of collectability.

PIT Filing Enforcement – Present

- With GenTax, most leads are identified, compiled, and automatically billed by the system.

- DOR staff are no longer used to identify leads. Any individual with income in the warehouse is part of the discovery if they haven't filed for a tax year.

- Discovery is used to find taxable income from the data warehouse (Oregon W2's and 1099's, IRMF, IMF, IRTF) and determine the filing status, net tax and penalty for each nonfiler lead.

- Discovery also allows us to score leads and prioritize work.

- Even with automation, there are still leads that require manual intervention prior to billings by GenTax. Generally, this would be in cases where Oregon residency is in question and income sources and an Oregon filing requirement couldn't be determined.

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