CHANGE REQUEST for FY 2009-10 BUDGET REQUEST CYCLE

Department:	Revenue
Priority Number:	DI-1
Change Request Title:	Out-of-State Tax Law Compliance and Enforcement

SELECT ONE (click on box):

☒ Decision Item FY 2009-10
☐ Base Reduction Item FY 2009-10
☐ Supplemental Request FY 2008-09
☐ Budget Request Amendment FY 2009-10

SELECT ONE (click on box):

Supplemental or Budget Request Amendment Criterion:

☒ Not a Supplemental or Budget Request Amendment
☐ An emergency
☐ A technical error which has a substantial effect on the operation of the program
☐ New data resulting in substantial changes in funding needs
☐ Unforeseen contingency such as a significant workload change

Short Summary of Request: The Department requests $957,418 General Fund to add 10.1 FTE in FY 2009-10 for an enhanced out-of-state audit presence that will expand current out-of-state offices and establish new ones. This request annualizes to $1,765,637 General Fund and 20.0 FTE in FY 2010-11.

Background and Appropriation History: The Taxation Business Group is charged with the collection, administration, auditing and enforcement responsibilities for all taxes, fees, bonds and licenses covered under Colorado tax laws. This group includes the Taxation and Compliance Division (TAC), which is responsible for auditing both in- and out-of-state businesses. District offices are maintained throughout Colorado, the New York metropolitan area, Dallas, and San Francisco. Audits are conducted at taxpayer places of business for the purpose of ascertaining the correct tax liability and primarily focus on retail sales, consumer's use, and corporate income taxes.

The expansion of the Colorado economy in recent years has created areas where the Department of Revenue's tax enforcement presence is not as thorough as it should be,

specifically as it relates to companies headquartered out-of-state. With an appropriation of additional resources, particularly for out-of-state audit activities, the Department is in a position where it can generate substantial revenue. The following table provides an overview of the total appropriations and fund splits for this Division since FY 2006-07.

TAXATION AND COMPLIANCE			
Line Item	**FY 2006-07 Actual**	**FY 2007-08 Actual**	**FY 2008-09 Appropriation**
Personal Services	$14,284,595	$14,723,683	$13,724,406
FTE	207.0	198.5	215.4
Operating Expenses	$616,470	$604,392	$821,028
Total Operating Budget	**$14,901,065**	**$15,328,075**	**$15,468,506**
Fund Splits			
General Fund	$14,767,702	$15,201,822	$14,539,581
Cash Funds	$1,269	$1,269	$1,269
CFE/Reappropriated Funds	$132,094	$124,984	$201,828

FTE levels have not changed in the last three fiscal years. The 3.2 percent increase in the overall operating budget for TAC in FY 2008-09 includes the usual personal services continuation common policy appropriations (salary survey, performance-based pay, etc.) increase, and an $180,234 operating expenses increase to support the field audit program costs for its implemented out-of-state audit travel requirement for senior auditors. This additional funding was submitted as a decision item for FY 2008-09 and is intended to allow the Department's tax auditors the ability to increase the out-of-state audit presence through a travel program (see change request from FY 2008-09, page 462 for more information). This request will be complementary to the one submitted last year.

General Description of Request: This request will provide the Department with the ability to conduct more out-of-state audits. Due to the size and scope of the request, the Department proposes implementing

this request over two fiscal years: 10.1 FTE in FY 2009-10, which will annualize to 20.0 FTE in FY 2010-11. All calculations in the following narrative are reflective of needs at the proposal's maturity in FY 2010-11.

Companies doing business in Colorado, but headquartered in other states are often large corporations and thus have the potential to owe more in taxes to the state than audits of smaller entities headquartered in the state. In addition, recent changes to the corporate income tax system have magnified the dollars at risk from out-of-state corporations compared to prior years. Currently, the Department's out-of-state revenue agents are at a minimal level relative to total tax revenue. This is shown on the following table that reflects a sample of other states.[1]

Out-of-State Auditors and Dollars at Risk

State	Auditors	2006 Gross Tax Revenue (in thousands)	Auditors/Revenue (in thousands)
California	170	$62,335,848	$366,681
Colorado	3	$6,673,902	$2,224,634
Florida	221	$34,749,986	$157,240
Indiana	51	$8,704,232	$170,671
Iowa	14	$3,627,019	$259,073
Louisiana	45	$9,272,352	$206,052
Massachusetts	75	$7,951,359	$106,018
Missouri	19	$7,438,336	$391,491
New York	40	$40,647,366	$1,016,184
Washington	45	$15,413,138	$342,514
Wisconsin	15	$7,090,858	$472,724

[1] The Department of Revenue contacted other state tax agencies to survey their resources devoted to out-of-state auditing.

Excluding Colorado, on average there is one out-of-state auditor for approximately $348.9 million in gross tax revenues. However, in Colorado there is one out-of-state auditor for $2.2 billion in gross tax revenue. As a result of this disparity and the significant risk to the fairness of Colorado's tax laws, the Department requests 10.1 FTE (annualizing to 20.0 FTE in FY 2010-11) to enhance its out-of-state audit presence. Once the request matures in FY 2010-11, resources will be sufficient to expand the three current offices and open three new offices. The additional 14.0 FTE identified in the table below are requested at the Revenue Agent III classification.

Location of Out-of-State Offices and Staff at Maturity			
Location	**Current FTE**	**Requested FTE**	**Total FTE**
New York Metro	1.0	5.0	6.0
Dallas	1.0	1.0	2.0
San Francisco	1.0	1.0	2.0
Houston	0.0	2.0	2.0
Chicago	0.0	3.0	3.0
Los Angeles	0.0	2.0	2.0
TOTAL	**3.0**	**14.0**	**17.0**

This request would lower the ratio of gross revenue to each auditor from $2.2 billion to approximately $392.6 million. This is in line with the average of the nine other states included in the comparison above.

The Department will also require 4.0 FTE (Revenue Agent IV) to act as supervisors, 1.0 FTE (General Professional VII) as a national out-of-state audit manager, and 1.0 FTE (Administrative Assistant II) located in Denver for administrative support.

Increasing both the number of out-of-state office locations and the FTE levels at all office locations (from the current three, 1.0 FTE staffed, out-of-state locations) requires regional managers (Revenue Agent IV) to supervise the FTE and manage the program in those locations.

The national manager (General Professional VII) position is required to direct and coordinate the duties of the out-of-state offices to ensure uniformity in audit selection and procedures and direct the offices toward Department goals. These audits represent the most complex and difficult of audits, and consistent and centralized leadership is necessary to make certain the efforts of the auditors are as efficient and accurate as possible.

With no administrative support staff at these out-of-state audit office locations, the program will require centralized administrative support FTE (Administrative Assistant II) to coordinate all travel for these office locations. The new auditors will not have administrative support on site, so this FTE will also be responsible for providing such support. This will include soliciting and compiling requests for office supplies and various other needs of the offices, subsequently communicating them to procurement staff. The Administrative Assistant will handle issues related to basic on-site infrastructure needs, such as ensuring vendors are contacted regarding issues with copiers and telephones, for example. Additionally, this position will ensure correspondence is managed correctly and manage all other records related to the new offices. Correspondence will include written documents as well as ensuring telephone and electronic communications are related to the proper office manager or other authority.

The Department evaluates its auditors through audit production. Production measures the total adjustments to a tax liability calculated through an audit. The great majority of audit production represents assessments to taxpayers that owe the state, but a small component of the production number represents audit adjustments that result in refunds to taxpayers. The program's goal is to accurately determine tax liability, and this measure allows it to illustrate work that it completes. The Department does not evaluate its auditors based on the total revenue they generate; the production measure more accurately and fairly represents the output of the program.

Historical data indicates the Department realizes approximately 40.0 percent of production as actual revenue. Enhancing the out-of-state audit presence with the approval of this request, will result in approximately $46.8 million generated audit

production annually once the program matures in FY 2011-12. This in turn will generate approximately $18.7 million in additional General Fund revenue realized by the state beginning in that year. Due to the implementation time frame of selecting, hiring, training, and assigning these new FTE to the out-of-state offices, it is anticipated that the Department's FY 2009-10 production related to the request will be about 37.0 percent of what production will be when out-of-state audit performance generated pursuant to this request matures. For the second year, this is expected to increase to 90.0 percent, with the full audit production occurring in FY 2011-12.

Finally, the increase in out-of-state audits will likely result in an increase of tax assessment disputes which will be directed to the Tax Conferee in future years. The Department will monitor the workload of the Tax Conferee and request additional resources if necessary in future fiscal years.

Consequences if Not Funded:

If this request is not approved, the Department will lose an opportunity to enhance General Fund revenue by $18.7 million from annual production levels generated by this request. The State of Colorado will remain far behind other states' efforts to fairly audit businesses headquartered out-of-state. The Department tries to maintain a balance between audits headquartered in the state and out of the state. The Department feels strongly that each type of business should bear a fair share, and thus feels it's desirable to maintain a balance of audit activity if possible.

Calculations for Request:

Summary of Request FY 2009-10	Total Funds	General Fund	Cash Funds	Reappropriated Funds	Federal Funds	FTE
Total Request	$957,418	$957,418	$0	$0	$0	10.1
Leased Space	$80,000	$80,000	$0	$0	$0	0.0
Base Salary	$654,159	$654,159	$0	$0	$0	10.1
PERA	$66,397	$66,397	$0	$0	$0	0.0
Medicare	$9,484	$9,484	$0	$0	$0	0.0
General Operating	$67,958	$67,958	$0	$0	$0	0.0
Travel Needs	$53,511	$53,511	$0	$0	$0	0.0
Training	$19,754	$19,754	$0	$0	$0	0.0
Shipping Costs	$6,155	$6,155	$0	$0	$0	0.0

Summary of Request FY 2010-11	Total Funds	General Fund	Cash Funds	Reappropriated Funds	Federal Funds	FTE
Total Request	$1,765,637	$1,765,637	$0	$0	$0	20.0
Leased Space	$80,000	$80,000	$0	$0	$0	0.0
Base Salary	$1,320,240	$1,320,240	$0	$0	$0	20.0
PERA	$134,004	$134,004	$0	$0	$0	0.0
Medicare	$19,144	$19,144	$0	$0	$0	0.0
General Operating	$66,052	$66,052	$0	$0	$0	0.0
Travel Needs	$100,534	$100,534	$0	$0	$0	0.0

Summary of Request FY 2010-11	Total Funds	General Fund	Cash Funds	Reappropriated Funds	Federal Funds	FTE
Training	$39,508	$39,508	$0	$0	$0	0.0
Shipping Costs	$6,155	$6,155	$0	$0	$0	0.0

Cash Funds Projections: Not applicable.

Assumptions for Calculations: The Personal Services cost detail is based on the FY 2008-09 Department of Personnel and Administration compensation schedule for range minimum salaries for all positions. Operating expenses are based on Office of State Planning and Budgeting approved amounts for capital outlay and on-going operating expenses per FTE. The additional operating expenses are summarized below.

FTE and Operating Costs

Fiscal Year(s) of Request		**FY2009-10**	**FY 2010-11**	**FY 2009-10**	**FY 2010-11**	**FY 2009-10**	**FY 2010-11**	**FY 2009-10**	**FY 2010-11**	**FY 2009-10**	**FY 2010-11**
APERSONAL SERVICES	**Title:**	**Revenue Agent III**		**Revenue Agent IV**		**General Professional VII**		**Administrative Assistant II**		**TOTAL**	
Number of PERSONS / class title		7	14	2	4	1	1	1	1		
Number of months working in FY 2009-10 and FY 2010-11		12	12	12	12	12	12	12	12		
Number months paid in FY 2009-10 and FY 2010-11		11	12	11	12	11	12	11	12		
Calculated FTE per classification		**6.4**	**14.0**	**1.8**	**4.0**	**0.9**	**1.0**	**0.9**	**1.0**	**10.1**	**20.0**
Annual base salary		$65,556	$65,556	$73,860	$73,860	$76,140	$76,140	$30,876	$30,876		
Salary		$420,651	$917,784	$135,410	$295,440	$69,795	$76,140	$28,303	$30,876	$654,159	$1,320,240
PERA	**10.15%**	$42,696	$93,155	$13,744	$29,987	$7,084	$7,728	$2,873	$3,134	$66,397	$134,004
Medicare	**1.45%**	$6,099	$13,308	$1,963	$4,284	$1,012	$1,104	$410	$448	$9,484	$19,144
Subtotal Personal Services at Division Level		**$469,446**	**$1,024,247**	**$151,117**	**$329,711**	**$77,891**	**$84,972**	**$31,586**	**$34,458**	**$730,040**	**$1,473,388**
OPERATING EXPENSES											
Supplies @ $500	**$500**	$3,500	$7,000	$1,000	$2,000	$500	$500	$500	$500	$5,500	$10,000

FTE and Operating Costs											
Fiscal Year(s) of Request		**FY2009-10**	**FY 2010-11**	**FY 2009-10**	**FY 2010-11**	**FY 2009-10**	**FY 2010-11**	**FY 2009-10**	**FY 2010-11**	**FY 2009-10**	**FY 2010-11**
Computer @ $900/$0	**$900**	$6,300	$6,300	$1,800	$1,800	$900	$0	$900	$0	$9,900	$8,100
Office Suite Software @ $330/$0	**$330**	$2,310	$2,310	$660	$660	$330	$0	$330	$0	$3,630	$2,970
Office Equipment @ $3,998/$0 (includes cubicle and chair)	**$3,998**	$27,986	$27,986	$7,996	$7,996	$3,998	$0	$3,998	$0	$43,978	$35,982
Telephone Base @ $450	**$450**	$3,150	$6,300	$900	$1,800	$450	$450	$450	$450	$4,950	$9,000
Auditor Travel	**$5,631**	$39,417	$78,834	$0	$0	$0	$0	$0	$0	$39,417	$78,834
Manager Travel @ 4 trips per year	**$2,644**	$0	$0	$5,288	$10,576	$0	$0	$0	$0	$5,288	$10,576
Manager Travel in CA and TX	**$2,318**	$0	$0	$2,318	$4,636	$0	$0	$0	$0	$2,318	$4,636
National Manager Travel @ 4 trips per year	**$1,622**	$0	$0	$0	$0	$6,488	$6,488	$0	$0	$6,488	$6,488
MTC Training for Out of State Agents	**$2,822**	$19,754	$39,508	$0	$0	$0	$0	$0	$0	$19,754	$39,508
Shipping costs for case files		$6,155	$6,155	$0	$0	$0	$0	$0	$0	$6,155	$6,155
Subtotal Operating Expenses		**$108,572**	**$174,393**	**$39,924**	**$19,012**	**$12,666**	**$7,438**	**$6,178**	**$950**	**$147,378**	**$212,249**
Leased Space										**$80,000**	**$80,000**
GRAND TOTAL ALL COSTS		**$578,018**	**$1,198,640**	**$171,079**	**$359,179**	**$90,557**	**$92,410**	**$37,764**	**$35,408**	**$957,418**	**$1,765,637**

Travel – For the Out-of-State Revenue Agents it is expected that each will require $5,631 annually, which will include mileage reimbursements and all other related travel costs. This is based on an expected two regional (2-week) trips per year, and up to 15 weeks per year of local city travel (100 miles per week) per FTE.

Out-of-State Revenue Agent Travel at Maturity			
Regional Trip (Two-weeks per trip)			
Item	**Average Rate**	**Cost**	**Total Cost**
Lodging (13 nights)	$100.00	$1,300.00	
Per diem (12.5 days)	$64.00	$800.00	
Mileage (600 miles per trip total)	$0.53	$318.00	
Per Trip Total		$2,418.00	
TWO Annual Regional Trips Total per FTE			**$4,836**

Out-of-State Revenue Agent Travel at Maturity			
Metro Travel (One week per trip)			
Item	**Average Rate**	**Cost**	**Total Cost**
Mileage (100 miles per trip total)	$0.53	$53.00	
FIFTEEN Metro Trips Total per FTE			**$795**
Total Travel Cost per FTE			**$5,631**
TOTAL Costs for 14.0 FTE			**$78,834**

For the Revenue Agent IVs ("regional" managers), it is anticipated that each will make one trip annually to Denver from their out-of-state based office at an estimated cost of $1,622. Also, these managers will have limited travel to perform or assist with audits requiring an additional $1,022 in travel.

Historical and Projected Costs for Travel (Out-of-State)	
	Average Cost for 1 Week of Travel
FY 2004-05	$1,066.54
FY 2005-06	$1,187.86
FY 2006-07	$1,251.24
Total Increase in Costs	17.32%
Annualized Increase	5.77%
FY 2007-08 Estimate (Based on actual costs and per diem policy change)	$1,449.53
FY 2008-09 Estimate	$1,533.17
FY 2009-10 Estimate	$1,621.63

Manager (Revenue Agent IV) Regional/Metro Travel Estimates at Maturity

Item	Average Rate	Cost	Total Cost
Lodging (3 nights)	$100.00	$300.00	
Per diem (3 days)	$64.00	$192.00	
Mileage (1,000 miles total)	$0.53	$530.00	
Metro Travel Total Cost per FTE			**$1,022**
Denver Trip Cost per FTE			**$1,622**
Total Costs for 4.0 FTE			**$10,576**

Additionally, the regional managers located in California and Texas will require two trips per year to the second office located in that state, as well as potential travel to perform or assist with audits.

California/Texas Manager Regional Office Per Trip Cost			
Item	**Average Rate**	**Cost**	**Total Cost**
Lodging (5 nights)	$100.00	$500.00	
Per diem (4.5 days)	$64.00	$288.00	
Mileage (700 miles total)	$0.53	$371.00	
Travel Total Cost			**$1,159**
TWO Annual Regional Trips Total per FTE			**$2,318**
TOTAL Costs for 2.0 FTE			**$4,636**

For the GP VII ("national" manager), it is anticipated that this position will require 4 separate trips to out-of-state offices each year, at an estimated cost of $1,622 per trip for a total of $6,488.

Multistate Tax Commission (MTC) Training – This request includes operating funds for MTC field auditor training of the 14.0 FTE Out-of-State Revenue Agents. The MTC is an organization established cooperatively by a number of states to assist the states in protecting their tax sovereignty, promoting tax uniformity, and assisting in the audit of

and litigation against multistate taxpayers. The MTC has designed various training programs to assist state tax agencies in training their employees. The cost of the class itself is $1,200, and the estimated cost of one week out-of-state travel, as indicated above, is $1,622. The total training cost is $39,508.

Shipping – Field Audit is required to ship audit files to and from the national offices. At the current staffing level of 3.0 FTE and three national offices, Field Audit spends approximately $1,318 annually on shipping. With the 467.0 percent increase in FTE (from 3.0 to 17.0) and doubling the number of national offices, the expected increase in shipping cost is $6,155. The table below supplies the detail.

Postage and Freight Costs - Transfers of Files			
	FY 2006-07 Actual	**FY 2007-08 Actual**	**Two-Year Average**
TAC Division	$5,151	$4,586	$4,869
Field Audit (Out-of-State Offices)	$1,503	$1,132	**$1,318**
Projected Increase for Request (467% increase in auditor FTE - 3 to 17)		(4.67 x $1,318)	**$6,155**

Leased Space – EDO – The estimated annual cost of additional leased space for the new office locations and additional 20.0 FTE included in the request, is $20 per square foot. At 200 square feet per FTE for office space the total leased space cost is $80,000.

Audit Production – Audit production has been examined over the last five years to determine the value of each audit type. Due to the implementation time frame of selecting, hiring, training, and assigning these new FTE to the out-of-state offices, it is anticipated that the Department's production related to the request will be about 37.0 percent of what production will be when out-of-state audit performance matures. For the second year, this is expected to increase to 90.0 percent, with the full audit production occurring in FY 2011-12. For purposes of this request, the Department has identified the out-of-state audits by type and made adjustments to more accurately reflect the

production level expected for the FTE in this request. Out-of-state audits include those audits conducted by employees residing in other states, through adjustments by supervisors once an agent returns from trips, and Multistate Tax Commission audits. These activities have been discounted in the analysis. Finally, the Department accounts for atypical audits – single audits that may return up to $10,000,000 – that the Department does not include in its projections for production.

The following table shows the adjustments and calculation for estimating the average production value per audit hour. After accounting for these adjustments, the average return for one hour of out-of-state auditing is $2,227.

Calculation of Average Hourly Production for Out-of-State Audits				
	Total Out-of-State Audit Production	Total Hours	Average Hourly Production	Average Yearly Production
5 Year Total	$320,885,759	94,416.1	$3,399	$64,177,152
Multistate Tax Commission Audits	($67,031,421)	(3,013.0)	$22,247	($13,406,284)
Revenue Agent Report Audits	($9,264,369)	(4,024.0)	$2,302	($1,852,874)
Adjusted Audit Production	$244,589,969	87,379.1	$2,799	$48,917,994
Less Atypical Audits	($50,000,000)	0.0	n/a	($10,000,000)
Net Audit Production	$194,589,969	87,379.1	$2,227	$38,917,994

Audit Production and Revenue Projections – One full-time equivalent out-of-state based auditor in the Department averages 1,500 audit production hours per fiscal year.

Projected Audit Production and Revenues						
Fiscal Year	**Total FTE**	**Annual Production Hours (per FTE)**	**Audit Assessment Production Rate (per hour)**	**Estimated Production Level**	**Estimated Audit Production Value**	**Estimated Revenue Generated (40% of Production)**
2009-10	**7.0**	1,500	$2,227	37%	$8,651,895	$3,460,758

Projected Audit Production and Revenues						
Fiscal Year	**Total FTE**	**Annual Production Hours (per FTE)**	**Audit Assessment Production Rate (per hour)**	**Estimated Production Level**	**Estimated Audit Production Value**	**Estimated Revenue Generated (40% of Production)**
2010-11	**14.0**	1,500	$2,227	64%	$29,930,880	$11,972,352
2011-12	**14.0**	1,500	$2,227	95%	$44,428,650	$17,771,460

Impact on Other Government Agencies: None.

Cost Benefit Analysis: An increase in Out-of-State Revenue Agents will expand the presence of the Colorado Department of Revenue outside the state boundaries and allow the Department to more effectively enforce and administer the tax laws of Colorado with increased audits of national and multinational corporations headquartered outside of Colorado. This will result in an increase of General Fund revenues for Colorado at a level much greater than the cost of the investment in this request.

Benefits	Cost	Ratio
With the additional 20.0 FTE, audit production would increase by $46.8 million, and General Fund revenues will be enhanced by approximately $18.7 million dollars when the initiative matures in FY 2012-13.	$1,765,637	Benefit/Cost ratio is: $18,706,800 / $1,765,637 = 10.6 to 1.

Implementation Schedule:

Task	Month/Year
Start of Leases at New Office Locations Selected	July 2009
FTE Hired	July2009 through June 2011

Statutory and Federal Authority:

24-35-108 C.R.S. (2008). Functions of department of revenue - collection of state taxes.

(1) In addition to any function specified in this article, the functions of the department of revenue and the duties of the executive director of the department of revenue as the head of said department or of the head of a group, division, or subordinate department appointed by the executive director in accordance with this article are:

(a) To collect delinquent taxes, assessments, and licenses under the jurisdiction of the department of revenue;

(b) To assist the attorney general in the prosecution of any legal actions commenced for the collection of any delinquent tax, assessment, or license within the jurisdiction of the department of revenue;

(c) To audit reports and returns of taxpayers in connection with all taxes, assessments, and licenses within the jurisdiction of the department of revenue, and, in the performance of this function and duty, the work of the department of revenue shall be so planned and organized that when a field auditor of the department of revenue investigates the tax liability of a taxpayer, to the extent practical, he or she shall examine the tax liability of such taxpayer with respect to all state taxes as to which the return or report of the taxpayer is in question to the end that separate audits by different auditors shall be reduced to a minimum;.

Performance Measures:

The Department of Revenue seeks to enhance its revenue collections through the fair administration of Colorado's tax laws. Productivity gains and seeking initiatives with ideal returns on investment are priorities. To this end, the Department looks for ways to increase audit revenues and the number of delinquent collections.

Performance Measure	Outcome	FY 2006-07 Actual	FY 2007-08 Actual	FY 2008-09 Appropriation	FY 2009-10 Request
Total dollars assessed by income and business tax audits.	Benchmark	$258,687,545	$258,687,545	$258,687,545	$281,769,447
	Actual	$258,687,545	$283,490,653	TBD	TBD