EXECUTIVE SUMMARY

In response to a request by Assemblyman Bill Leonard and as a follow-up on a recent study regarding the underground economy, the Commission on California State Government Organization and Economy, also known as the Little Hoover Commission, initiated a study of the organization and operation of the State's major revenue and tax collection functions and selected cash management activities. While there have been numerous prior studies regarding the organization of California's taxing agencies, the Commission's study focused on identifying practical and useful recommendations for improving the revenue and tax collection operations, generating additional revenue for the State, and reducing costs.

The State of California collected approximately $38.3 billion in fiscal year 1984-85 in revenue and tax collection payments from businesses and individuals. There are several major departments in the State which are responsible for revenue and tax collection payments. These include the Board of Equalization, the Franchise Tax Board, the Employment Development Department, the Department of Motor Vehicles, and several other departments. The study reviewed the cashiering, auditing, appeals, collections, data processing and revenue forecasting functions performed by these departments.

While California is a leader in certain aspects of its revenue and tax collection activities, the study identified certain problems and opportunities that exist in how the State conducts these activities. Based upon conservative estimates, the State could generate additional revenue and cost savings ranging from $35 million to $52 million annually by taking action to address the problem areas and opportunities identified in this study. The study identified 37 individual recommendations that affect one or more of the departments reviewed. These findings also may pertain to some extent to other departments in the State involved in revenue and tax collection activities. The following sections provide a summary of the findings identified in each of the areas reviewed in the study.

GENERAL FINDINGS

Although there are historical reasons for the present assignment of tax collection responsibilities among state agencies, there is considerable duplication in the functions and activities performed by the State's major revenue and tax collection departments. This duplication occurs in the areas of cashiering, auditing, appeals, collection, and data processing. As a result, the potential exists to reduce the costs of operation, administration, and overhead through the consolidation or integration of organizations and functions.

A survey of other states and the Internal Revenue Service showed that California, unlike the federal government and all other states in the country, does not have a consolidated department of revenue. While California is well-respected for some of its revenue and tax collection operations, including the joint collection of personal income tax withholding and employer payroll-based taxes, there are significant differences between how other states and the federal government collect revenue and taxes and how California conducts these activities.

CASHIERING

The State of California is experiencing delays in the mailing, processing, and depositing of payments received by its revenue and tax collection departments. As a result of these delays, funds are not being deposited in the bank as soon as possible and the State is losing interest earnings. In the area of mail handling, the State is not taking full advantage of opportunities available to it to expedite the receipt of mail, such as intercepting mail at its point of origin and taking special measures to speed its delivery to the department's cashiering operations.

Among the remittance processing problems that the State is experiencing are the failure of some departments to pick up mail when it is first available at the post office and the lack of matching mail processing shifts with mail availability at the post office. Moreover, some departments are not operating work shifts on week-ends or using the necessary remittance processing equipment to ensure the timely processing of payments.

Certain departments are not conducting their remittance processing activities in a manner that ensures the timely deposit of funds in the bank. This occurs for a variety of reasons, including the failure to perform remittance processing until the latest possible cut-off time, the lack of use of appropriate payment processing priorities, and due to insufficient sorting and encoding of checks for deposit to banks.

AUDITING

Each of the State's major revenue and tax collection departments, including the Franchise Tax Board, Board of Equalization, and the Employment Development Department, conduct separate audits of taxpayers. As a result, individual departments are not necessarily aware of what audit activities are being performed by other departments and the State is not maximizing audit coverage and penetration. The study showed that the audit programs used by individual departments do not include testing for other departments or the detection of the underground economy. Moreover, the current number of revenue and tax collection auditors in the State do not allow the State to perform the level of auditing necessary to deter tax avoidance and ensure the full integrity of California's self-assessment taxation system.

APPEALS

The study revealed that there is a concern by taxpayers regarding the lack of independence of the current appeals process within the Franchise Tax Board and the Board of Equalization. This occurs because two persons who are members of the Franchise Tax Board, the State Controller and the Chairman of the Board of Equalization, sit on both the Franchise Tax Board and the Board of Equalization. Taxpayers do not believe they receive an impartial hearing from the leaders of the same organization that is imposing the questioned taxes.

In addition, the study found that if the State rescinds the unitary tax method, the State's current appeals process would probably have to be modified to handle the increased complexity of cases and the more time it takes to hear tax cases under "waters-edge accounting" methods.

COLLECTIONS

The State's major revenue and tax collection departments are not taking full advantage of automated collection systems to increase the productivity of staff involved in collections activities. While the Franchise Tax Board uses an automated collection system, the Employment Development Department and the Board of Equalization are in the process of developing automated collection systems. The State also is only making limited use of private collection agencies to collect delinquent accounts receivable that are not profitable for the State to pursue.

The State could make greater use of its inter-departmental offset program to ensure that funds owed by a taxpayer for any of the taxes collected by the State are paid prior to a taxpayer receiving any tax refunds. In addition, the study indicated that the State could increase its collections of delinquent accounts, reduce collection costs and help avoid the large write-off of uncollectible accounts that it experiences each year by establishing a central state collection agency.

DATA PROCESSING

The major revenue and tax collection departments in the State, including the Franchise Tax Board, the Board of Equalization, and the Employment Development Department, operate separate automated data processing systems to maintain their taxpayer information. Although these departments have been making improvements in their systems, the study indicated that these departments need to continue to improve them by working toward the development of more compatible automated data processing systems and applications. This will allow these departments to share information more readily and minimize the amount of redundant information maintained regarding taxpayers.

FORECASTING

There are two state departments with responsibility for revenue forecasting, the Department of Finance and the Commission on State Finance. While having two departments producing forecasts is a duplication of effort, the study indicated that since these departments' revenue estimates are based on different assumptions, there is value in having this duplication. However, the study showed that if the departments issued revenue forecasts on consistent time periods the revenue forecasts would be more useful to the Governor, the Legislature and the general public.

OTHER ISSUES

The State's revenue and tax collection departments operate in a dynamic environment. Virtually all of the factors which impact the efficiency of revenue and tax collection are subject to rapid change. Therefore, no matter how effectively a system is established initially, it could soon be out-dated if management is not vigilant and aggressive in anticipating or reacting to changes in the environment. The State of California has not established one department with the ongoing responsibility for managing the cash collection and deposit activities performed by all departments conducting revenue and tax collection activities. As a result, the State is unable to achieve and maintain a high-level of performance in these activities.

The opportunity cost of activities plays a prominent role in management decision-making in remittance processing operations. The study showed that the State has not paid sufficient attention to the cost-benefit considerations related to remittance processing in terms of interest earnings, equipment costs, salaries, and facilities to ensure that the State is maximizing the benefits of its remittance processing activities. As a result, the State is unnecessarily losing interest earnings and/or incurring unnecessarily high processing costs that could be avoided.

RECOMMENDATIONS

The unnecessary duplication of functions and the fragmentation of responsibility within the State of California's major revenue and tax collection departments result in operational inefficiencies and lost interest earnings for the State. While the Commission on California State Government Organization and Economy supports the general concept of creating a single revenue and tax collection department, it recognizes the significant political and institutional barriers to full consolidation of the State's revenue and tax collection departments. In addition, it is concerned about the potential disruption of services that might occur in a large-scale consolidation.

To realize the potential cost savings and additional revenue identified in this study, and to provide an opportunity to accommodate future growth and promote further efficiency, the Commission has made 35 separate recommendations in this report. These recommendations are presented in Chapter V. Among the Commission's major recommendations are:

- Create a state-run lock-box facility that functionally consolidates the remittance processing and cashiering operations performed by the State's major revenue and tax collection departments in one location;

- Enhance the equipment, facilities and operations used in the State's remittance processing activities;
- Expand the scope of field audits to include testing for other departments and the detection of the underground economy;
- Increase the number of revenue and tax collection auditors;
- Establish an independent tax appeals board;
- Expand the use of automated collection systems, private collection agencies, and inter-departmental offset programs;
- Establish a central state collection agency for collecting delinquent accounts receivable that are not collectible through routine collection means;
- Establish centralized management responsibility for the State's remittance processing activities; and
- Make operating improvements in individual state departments involved in revenue and tax collection activities.

By implementing these recommendations, the State will be able to improve the overall efficiency of its revenue and tax collection functions and cash management activities and generate additional revenue for the State.