TO:	**The Joint Fiscal Committee**
FROM:	**Craig Bolio, Deputy Commissioner, Department of Taxes**
DATE:	**November 8, 2018**
SUBJECT:	**Annual Report on the Tax Computer System Modernization Fund (CMF)**
CC:	**Kaj Samsom, Adam Greshin**

The Tax Computer Modernization Fund (CMF) was created in 2007 to establish a funding mechanism to modernize the old IT systems (legacy systems) used by the Department of Taxes (Tax). The fund is replenished by "benefits" of the VTax system – enhanced collection and compliance activity above what the legacy systems produced. Vermont law dictates that 80% of the benefits remain in the CMF for use by Tax to fund modernization projects, and 20% are sent to the fund the revenue was originally intended for in a lump sum transfer in June.

The VTax project had its fourth and final conversion on November 3, 2017. Tax is now administering all its tax types through one system. We have established a VTax support team that includes tax subject matter experts, state developers, and vendor (FAST Enterprises) developers. The support team continues to improve the system and update it, installing two main software patches per year, and making dozens of smaller ad-hoc improvements each quarter.

The VTax system has created $23.9 million in measurable benefits, and over $4 million of those benefits have been reallocated back to the General, Education, and various special funds. In October, Tax made a final payment to FAST of $5.09 million to pay the remaining implementation portion of the FAST contract. Tax will continue to make maintenance payments that give the Department access to patches and software upgrades from the vendor. In addition to the VTax project, the CMF is currently paying for the scanning system upgrade project awarded to Fairfax Imaging. Tax has accumulated enough money in the CMF to pay for the remaining Fairfax invoices to be received over the next year.

The CMF will continue to accumulate enhanced collection and compliance funds at the 80% retention rate until 2024. Outside of Tax's current spending authority that covers these projects, Tax will be required to seek additional spending authority from the Legislature to draw from this fund. Given the current landscape, Tax intends to ask the Legislature to scale back the CMF and consider three ideas in the upcoming 2019 session that would take effect on July 1, 2020.

1) Tax proposes to reduce the percentage of enhanced collections that the CMF receives from its current 80% rate to 40%.
2) Tax proposes to eliminate the practice of shifting all benefits to the CMF and returning a portion to other funds at FY end. Only the percentage that the CMF is owed would be transferred in. This is administratively more efficient, and it will ensure that the other funds have more revenue sooner.
3) Tax will request spending authority to pay for continued modernization expenses as outlined below.

Tax has identified several costs that would be appropriate to fund with the CMF.

1) **IT-Related implementation costs.** Act 208 of the 2018 legislative session tasked the Department with collection of unredeemed bottle deposits from deposit initiators for the clean water fund. That tax is set to take effect on January 1, 2020, and the Department has not received an appropriation to pay for the implementation. The CMF could be used for similar costs in the future as well.
2) **Economic microsimulation software.** The Tax Department and Joint Fiscal Office incur numerous expenses related to the use of Chainbridge economic simulation/modeling software. There is an additional software module the State could purchase to enhance the State's policy modeling and revenue forecasting efforts, and the data maintenance for this model requires semi-annual expenditures.
3) **Grand list management software.** This FY, the Department intends to issue an RFP for grand list management software. This project would modernize the computer systems that oversee much of the state's collection of more than $1 billion in education taxes. This project has been reviewed by the Agency of Digital Services and they are working with Tax to draft the RFP.

These proposals would ensure that Tax continues to have a reliable and efficient revenue collection infrastructure. Tax is hopeful that the Legislature will work with the Department to enact these proposals into law during the upcoming 2019 session.

CMF Balances

Enhanced revenue (via VTax through 09/30/2018):	$23.9m
Distribution:	
FAST Benefit Payments	$15.9m
Transfers to Originating Funds	$4.1m
Fairfax Imaging Payments	$0.3m
Current CMF Balance:[1]	$5.2m
Earmarked for FYE 2019 transfer	$0.65m
Future Fairfax Imaging Invoices	$0.65m
Remaining balance	$3.9m

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[1] Current CMF fund balance reflects accrued interest and potential residual funds from prior projects.