

**TO: The Joint Fiscal Committee**

**FROM: Mary Peterson, Commissioner, Department of Taxes**

**DATE: November 20, 2013**

**SUBJECT: Annual Report on the Tax Computer System Modernization Fund**

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The Tax Computer System Modernization Fund (the “Fund”) was created in 2007 to use part of the enhanced revenue gained through modernization of processes at the Department of Taxes (the “Department”) to re-invest in further modernization, including an integrated tax system (“ITS”). In essence, the Fund is the vehicle by which tax modernization projects pay for themselves – vendors are paid only after the department uses the new tools to collect from taxpayers who otherwise would escape their tax liabilities.

The tax commissioner is directed to report on the Fund annually at the November joint fiscal committee meeting. The sources of funds and use of funds have been amended twice, as outlined below. Thus far, two modernization projects have contributed to the Fund, a small data warehouse designed by the Department, and then a comprehensive data warehouse designed and installed by an experienced tax vendor. The main investment objective for the Fund is the ITS, which itself will generate additional revenue.

At this time, the Department is close to finalizing a contract with FAST Enterprises for an ITS. The Department selected FAST after the evaluation of three bids. The FAST ITS platform has been in production since 1999, and is used in 17 states and several provinces. Eventually, the administration will request a final amendment to the Fund to accommodate this anticipated ITS contract through FY2021.

As planned, the Fund will underwrite a decade of modernization at the Department. The ITS will provide a modern, standard platform for all administrative functions for all tax types – including efilng options, tax practitioner portals, security protocols, accounting, and revenue reports. Additionally, FAST has offered an option for a microsimulation model, which will allow more robust analysis of our tax data by both the Department and the Joint Fiscal Office. At the same time these investments are made possible through self-funding, 20% of the additional revenue will be transferred to the General Fund. After 2021, the General Fund will reap the entire benefit of the Department’s vastly improved capabilities to collect tax that is owed.

This report outlines the history of the Fund. Attached is a table summarizing the revenue sources, appropriations, and expenditures to date.

## **History of the Fund**

### Creation in 2007

#### *Source of Funds*

The Fund was initially set up in 2007. The source of funds was primarily an in house project by the Department to generate non-filer leads from Department of Labor Data (the “DOL Project”).

#### *Use of Funds and Appropriation*

A basic 80/20 split of revenue between the Fund and the General Fund was established. An appropriation of \$7.8M was made from the Fund in order to facilitate the Department’s purchase of Oracle’s Enterprise Tax Management (“ETM”) product from CGI for use in administration of the corporate income and several other small taxes. The ETM

project went live in 2010, and the Department continues to use this software. However, after extensive discussions with Oracle, and an RFI to survey the ITS market, the Department decided in 2012 to seek other bids on an ITS.

The General Fund received \$2.74M as a result of the DOL Project. After payments to CGI/Oracle, the Fund has brought forward \$2.76M for the Department to put toward an ITS.

### Amendment in 2011

#### *Source of Funds*

A new source of funds was added: tax receipts received from a data warehouse to be built by Revenue Solutions Inc. (RSI). RSI is under a five year contract running from 2011 to 2016. The data warehouse project (which includes nonfiler detection, discrepancy analysis, refund fraud review, audit selection and collection scoring) currently is estimated to yield a total of \$16.1M in enhanced revenue. This represents tax amounts that are owed, but would not have been paid without modernizing the Department's collection tools.

#### *Use of Funds and Appropriation*

Under the self funding principle, RSI agreed to be paid out of a sliding percentage of enhanced revenue generated from its warehouse. The Commissioner of the Department of Finance and Management approves the baselines from which the RSI enhanced revenue is measured. The 80/20 split between the Fund and the General Fund continues net of the RSI payments. An appropriation of \$7.5M was made from the Fund, primarily in order to facilitate the payments to RSI. RSI is forecasted to receive total payment of \$4.9M through 2016.

The General Fund is forecast to receive a total of \$2.2M as a result of the RSI project, and \$8.9M from the RSI project will be retained in the Fund to put toward an ITS. It must be noted that the RSI project currently is on time, and on track to meet the five year forecast. So far this project has generated over \$5.4M in tax receipts that the State would not otherwise have collected.

### Amendment in 2013

#### *Sources of Funds*

The source of funds remained the DOL and RSI projects.

#### *Use of Funds and Appropriation*

As noted above, the Department decided in 2012 to go back out to bid for an ITS. Therefore, the uses of the funds were amended to replace references to ETM with the generic "ITS", and language was added to allow for planning and implementation. An additional \$9.02M was appropriated; together with the \$7.5M from 2011, the Department has a \$16.52M appropriation currently from the Fund. After the anticipated \$4.9M payment to RSI and other expenses, there eventually will be approximately \$10M available appropriation to put toward an ITS.

### Expenditures FY12 and FY13 to Date

The Department has spent \$952,285 from the Fund since completion of the ETM project, as listed on the attachment. Over half of that amount was spent on hardware and upgrade purchases from DII, for both the data warehouse and ongoing operations. The next largest expenditure was to meet the need for additional IT services to support the continuing operation of ETM. Finally, we engaged a consultant to develop a current business case for the ITS, write updated functional requirements for the ITS, and draft the RFP. Assuming that we come to terms with FAST, we anticipate that during the remainder of this fiscal year we will make expenditures for additional preparation work, as well as the microsimulation model (payment terms still under negotiation with the JFO).

## **Future of the Fund**

### Structure of ITS Payments

#### *Sources of Funds*

When the Department put out its request for proposals for an ITS earlier this year, it specified that the vendor must structure its bid such that it would be paid out of enhanced revenue from the Department's modernization efforts, including the ITS itself. Therefore, FAST has proposed that although it will invoice the Department pursuant to completed milestones, the invoices will only be paid as the Department has available monies from enhanced revenue. The Department is negotiating the details of these payments with FAST presently. The Department anticipates that it will seek amendment of the sources of funds language such that 80% of the enhanced revenue from the ITS project, again as measured against baselines approved by the Commissioner of Finance and Management, is deposited in the Fund to repay the vendor.

#### *Use of Funds and Appropriation*

Although we are still in negotiations with FAST, we are anticipating a six year contract (through late 2020), with implementation to be completed in four years (2018). The total price tag will include the options for the microsimulation model. Throughout the ITS project, the General Fund will be accruing 20% of the enhanced revenue from the Department's improvements.

## **Conclusion**

The Department has successfully developed a model whereby modernization of its processes has brought in additional revenues for the state without raising taxes. 80% of those revenues are leveraged further on modernization efforts that continue to close the Tax Gap, the difference between the taxes owed and actually paid.

This initiative will be completed with the installation of a modern ITS system. In the decade from 2011-2021, the Department will have completely modernized its compliance processes and tax administration. The Department will have efficient, integrated operations that, among other things, will maximize employee productivity, provide data security, insure accurate accounting, and furnish robust reports of revenue. Both the administration and the legislature will have better tools to analyze the impacts and results of future revenue proposals. Vermonters will be able to more easily pay the taxes they owe, for example, with standardized 24 hour online access to their accounts.

In the meantime, over the entire course of the Department's modernization, the General Fund will be receiving "found money". This money comes without any tax increase – it is amounts that would have escaped collection but for the Department's improved ability to insure that what is owed is actually paid. After 2021, the Department will operationalize its costs with respect to the ITS, and at that point, all of the additional revenue from the modernization will accrue directly to the General Fund.

**TAX COMPUTER SYSTEM MODERNIZATION FUND as of 11/15/13**

Act 65 of 2007 Section 282, Act 63 of 2011 Section C103, Act 1 of 2013, Section 65 and 66

Sources of Funds: Enhanced revenue from DOL project (2007-2012), Data Warehouse (2011-2016)

Use of Funds: Investments in modernized compliance and an Integrated Tax System (ITS)

**DOL Project: 2007-January 29, 2012. Over \$13M in enhanced revenue.**

GF (20%) 2,746,552

CSMF (80%)10,562,172

To CGI/Oracle: 7,800,000 (Appropriation 2007, payments 2008-2011)

Balance forward: 2,762,172

**RSI Project: 2011-2016 (Live in February, 2012).**

Expected estimated enhanced revenue \$16M

RSI 4.9M

Subtotal 11.1M

GF (20%) 2.2M

CSMF (80%) 8.9M

**Total Enhanced Revenue through November 15, 2013:**

Enhanced revenue received \$5,419,243

RSI 2,904,809

Subtotal \$2,514,434

GF (20%) 502,887

CSMF (80%) 2,011,547

**Spending by Department From CSMF FY12 through to date (other than RSI/GF payments)**

DII Hardware 394,534

Registry Software 4,799

ITS Procurement Services 6,125

Oracle Services\* 32,030

CHAMP 118,364

Business Case, Functional Requirements, and RFP 99,880

Additional IT FTE\*\* 296,553

**Total \$952,285**

\*additional services paid through Department Budget

\*\*IT FTE eventually rolled to Department Budget

**CURRENT APPROPRIATIONS:**

Act 1 of 2013, Section 65 \$7,500,000

Act 1 of 2013, Section 66 \$9,022,173