TO: **The Joint Fiscal Committee**

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

DATE: **November 13, 2015**

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

The Tax Computer System Modernization Fund (the "Modernization 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. Currently, the Modernization 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 first section in this report provides an update on our integrated tax system, VTax, from our last report in November 2014. Last year we successfully completed Phase 1 in December, and just this week we are going live with the second of the four phases. The second section provides an update from last year's November report on the sources of revenue and uses of the Modernization Fund.

As an additional note, the Department successfully launched a new website in October. Based on the new state template, the site offers much improved navigation and plain language information. It can be updated easily to meet any current demands. The website will be a powerful tool as we continue to roll out our new IT system.

Update on VTax Project
Last year's reports described the Department's contract with FAST Enterprises, LLC for an integrated tax system. VTax will provide a modern electronic platform to handle all aspects of taxpayer interaction for all tax types. Among other things, VTax will enable the Department: to provide modern customer service, including e-services; to produce enhanced accounting and reports; and to ensure the best practices in essential security. With a single view of the taxpayer, VTax will improve our ability to analyze data and maximize audit initiatives. When fully installed, VTax will allow the Department to retire three legacy systems. The FAST solution is in full production in over sixteen states. FAST moved over 20 employees to Vermont for VTax implementation upon contract signing in January of last year, and every milestone to date has been met.

Phase 1, Corporate and Business Income Tax, Completed December 2014
Less than one year after the contract signing, we went live with the first phase of VTax, migrating our corporate and business income taxes from the Oracle ETM system. This allowed us to offer online filing of corporate and business income tax for the first time, piggybacking on the IRS Modernized E-File system. We also launched myVTax, an online web portal which can be used by tax preparers and taxpayers to register, file and pay, as well as to communicate securely and keep a record of accounts. Unfortunately, with respect to online filing, most of the tax preparation software vendors either did not code their product to include Vermont returns, or did so late in the filing season. In discussions with practitioners, we agreed that online filing mandates would spur software development and that most of the taxpayers for the Phase 1 and 2 taxes actually welcome the opportunity to eliminate paper returns. For the 2015 tax year we are mandating the online filing of Corporate Income, Business Income, and Fiduciary Income taxes when prepared by a tax preparer (we will of course, entertain requests for an exception based on unusual circumstances).

When we went live, we still had tens of thousands of corporate and business income returns which ETM could not process and thus we could not convert. We developed a protocol for closing out of statute and low dollar cases, and

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then staff had to manually review the remainder. Our taxpayer services division met the very difficult goal of clearing this entire backlog, built up over the four years of ETM, before go live of the second phase (which was key, since this phase involves new billing business processes described below).

Phase 2, Meals & Rooms, Sales & Use, Withholding and 6 Other Tax Types, Go Live November 12, 2015
Phase 2 is a considerably larger launch, involving conversion of a total of nine taxes from our Advantage Revenue and manual processing systems into VTax. These include Meals & Rooms, Sales & Use, Payroll Withholding, Fuel Gross Receipts, Premium Insurance, Captive Insurance, Fiduciary, Bank Franchise and Health Care Claims Taxes. The schedule for Phase 2 followed that of Phase 1 – design, development, systems testing, end to end testing, training, conversion and go live. As in Phase 1, all milestones were met on time.

As of Friday, November 6, the Department has temporarily shut down all of its processing systems and we appear to be on course for "go live" on Thursday, November 12. This launch is more daunting than Phase 1 not only in size, but also because many of these taxes are already paid online through our legacy VTBizFile portal that was built and maintained by VIC. We have been warning users that VTBizFile will no longer be available, and advising them to copy their old returns. As of Thursday, VTBizFile will have limited read-only function, and users will get a prompt with a secure code that will take them to register in myVTax. Non VTBizFile users will receive the registration instructions in the mail. We have been focusing our outreach particularly on monthly filers for these tax types, who will need to file and pay for October by November 25. We have done extensive testing with our staff, as well as usability testing with some taxpayers and tax professionals, so we are optimistic that the myVTax transition will be as smooth as possible. We have set up a separate phone line for questions that center around myVTax and are prepared to answer many telephone inquiries in the first couple weeks.

VTax has also allowed us to revamp our business processes with respect to assessment and appeal, which has also been a major undertaking. Prior to any assessment of past tax due, we will issue a "Notice of Intent to Assess" (NOIA) and give the taxpayer the opportunity to exchange information with us informally. We believe that this informal period will be less intimidating for the taxpayer, and should lead to early resolutions which will eliminate many appeals. If the case does go on to assessment and appeal, we have outlined firm timelines to move a case along from the line staff to the supervisor, director and ultimately to our hearings docket. The procedures include defined opportunities for informal resolution, but if all fail, the timeline results in the case being heard in eighteen months. Speedy resolutions address one of the most frequent complaints about our current processes.

Chainbridge Microsimulation Model
FAST also has completed installation and training of a microsimulation model developed by Chainbridge for sales and use and income tax. The Chainbridge model provides a robust analytical tool allowing JFO to query proposed tax changes and quickly receive reports aggregating data. The income tax model, originally based on 2011 tax year data, has been updated to 2013 tax year data.

Next Two Phases
Phase 3 will commence in January, and involve the conversion of individual income tax. Go live again will be in November, and by January 2017 the bulk of our processing will be in VTax and most taxpayers will have access to myVTax. At that point, the Department will be able to turn off its Advantage Revenue legacy system. Various miscellaneous taxes and the remaining billing and collection functions will be converted in Phase 4, to be completed in November 2017. At that point, we will realize the goal of a truly integrated tax system, and no longer use ETM or the Mainframe. We will then enter a seven year maintenance phase, with fixed costs based on the level of service we choose from FAST.

Note on Staffing
The Department has devoted one business user, Craig Bolio, and one IT developer, Kelly Reagan, to serve as full time Project Leads. The Department has also dedicated at least one, and in some cases two, "implementation coordinators" from each of our business divisions to serve as subject matter experts full time on the project. After the

design and development stage, the code is put through rigorous system testing, with comprehensive sets of scenarios each tested by two to three business users. During the system testing, mostly in the summer months, we had up to one third of our staff devoted to the project. A number of business users were still involved in the fall during three rounds of end to end testing. As noted above, staff this year has also been involved in cleaning up old corporate and business income files, as well as in revamping our procedures around assessment and appeal. All of this while the Department lost several positions in the RIF and retirement incentive. We have had to tamp down service expectations, for example, by closing our general telephone call center one day a week. But the fact that the Department was able to bring this second phase in on time is a testament to the tireless dedication of our team.

Update on the Modernization Fund

The Modernization Fund was first established in 2007, and the sources of funds and use of funds were amended three times throughout 2014, as outlined in our previous reports. In Act 58 of 2015 there was an additional appropriation of $15.5M to carry through FY 2024. The basic structure has remained where enhanced revenue from projects have been split 80/20 between the Modernization Fund and the General Fund. Prior to the VTax project, two modernization projects contributed to the Fund, a small data warehouse designed by the Department and a comprehensive data warehouse designed and installed by an experienced tax vendor, Revenue Solutions Inc. ("RSI"). RSI is paid from the Modernization Fund pursuant to its contract that runs through 2016. The main investment objective for the Modernization Fund is VTax, which itself will generate additional revenue necessary to pay FAST under its contract that runs through 2024.

An independent review of the FAST bid, utilizing a cost-benefit analysis with very conservative assumptions, concluded that over the 10 year life of the VTax project, Vermont will realize $36M in increased revenue over and above vendor payment. After FY 2024, the General Fund will reap the entire benefit of the Department's vastly improved capabilities to collect tax that is owed.

Attached is a table summarizing the revenue sources and expenditures to date. The Department has made payments to RSI, FAST and Chainbridge pursuant to the respective contracts. The Department has paid consultants who have worked on the procurement and evaluation of the project. The Department has paid DII expenses related to the Project out of the Modernization Fund. The Department has also paid one IT employee out of the Fund, though this position will be transitioned to our operating budget.

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 taxes actually paid).

This initiative will be completed with the installation of VTax, a modern integrated tax system. From 2011 to2024, the Department will have thoroughly 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, ensure 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 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 includes amounts that would have escaped collection but for the Department's improved ability to ensure that what is owed is actually paid. After 2024, the Department will fully operationalize its costs with respect to VTax, and at that point, all of the additional revenue from the modernization will accrue directly to the General Fund.

TAX COMPUTER SYSTEM MODERNIZATION FUND (MF)[1]

Statutory References: Act 65 of 2007 Section 282, Act 63 of 2011 Section C.103, Act 1 of 2013 Section 65 and 66, Act 95 of 2014 Section 62

Sources of Funds: Enhanced revenue from DOL project (2007-2012), RSI data warehouse (2011-2016), FAST integrated tax system (2014-2024)

Use of Funds: Technology investments to allow for modernized compliance and an Integrated Tax System

I. DOL Project: 2007-January 29, 2012

	Total
Enhanced Revenue	$13,308,724
Distribution:	
CGI/Oracle[2]	$7,800,000
GF	$2,746,552
MF	$2,762,172

II. RSI Project: 2011-2016 (Live: February 2012)

	Estimate (Cumulative through 2016)	To Date
Enhanced revenue	$16,100,000	$20,236,455
Distribution:		
RSI contract payments	$4,900,000	$5,046,865
GF	$2,200,000	$2,435,404
MF	$8,900,000	$12,754,186

III. FAST Project: 2015-2016 (phases I & II)

	Estimate (Cumulative through 2016)	To Date
Enhanced revenue	$750,000	$1,554,066
Distribution:		
FAST benefit payments	$600,000	$1,243,252
GF	$150,000	$310,813
FAST non-benefit payments (MF)	$ 0	$11,290,0000
Discount Achieved	$ 0	$1,320,000

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[1] To date is as of FY16 Q1.
[2] $7,8000,000 appropriation in 2007, payments 2008-2011.

IV. MF Misc Expenditures: FY2012-To Date

Expenditure	To Date
FAST Chainbridge (net)	$198,264
DII Hardware, maintenance, and support	$927,871
VTax procurement services	$117,525
Other VTax project expenses[3]	$161,987
Oracle services[4]	$32,030
CHAMP	$277,045
Additional IT FTE[5]	$386,890
Total	$2,101,612

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[3] Additional services paid through the Department's budget.

[4] Additional services paid through the Department's budget.

[5] IT FTE will eventually be rolled into the Department's budget.