



Iowa Department of Revenue

Director: Courtney M. Kay-Decker
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October 3, 2016

Mr. Glen Dickinson
Director
Iowa Legislative Services Agency
State Capitol
L O C A L

Office of the Secretary of Senate
Iowa Senate
For Senate Ways & Means Chairpersons and Ranking Members
State Capitol
L O C A L

Office of the Chief Clerk
Iowa House of Representatives
For House Ways & Means Chairpersons and Ranking Members
State Capitol
L O C A L

Dear Mr. Dickinson, Senate and House Chairpersons and Ranking Members:

Pursuant to Code of Iowa, Section 421.17(23) and 2015 Iowa Acts, 86th G.A. ch. 138, § 106, please find attached an annual report of costs incurred and paid for services to support the department's Tax Gap Compliance Program for Fiscal Year 2016.

The Code of Iowa, Section 421.17(23) states:

"The Director shall report annually to the Legislative Services Agency and the chairpersons and ranking members of the Ways and Means Committees on the amount of cost incurred and paid during the previous fiscal year pursuant to this subsection."

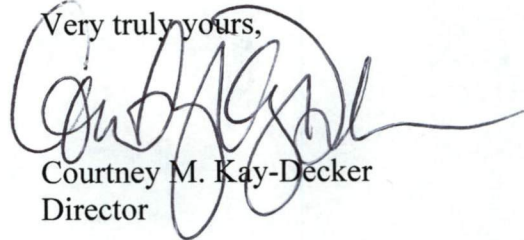
2015 Iowa Acts, 86th G.A. ch. 138, § 106 states:

"Implementation—report. The director of revenue shall implement the procedures required by this division of this Act no later than January 1, 2016. The director shall submit a report on the director's progress in implementing the procedures required by this division of this Act to the general assembly by October 3, 2016. The report shall include

any statutory changes necessary to facilitate the implementation of this division of this Act.

If you have any questions or further information is needed, please let me know.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Courtney M. Kay-Decker', with a long horizontal flourish extending to the right.

Courtney M. Kay-Decker
Director

Enclosure



Iowa Department of **REVENUE**

Tax Gap Compliance Project Revenue and Expenditure Report for Fiscal Year 2016 October 2016

Overview

The Iowa Department of Revenue Tax Gap Program (“**Program**”) was established pursuant to Iowa Code § 421.17(23). The Program allows the Department to pay for the costs of closing the “tax gap” from revenues collected through Program activities. The “tax gap” consists of non-filers of tax returns and non-payers of taxes. During the 2015 legislative session, the General Assembly broadened the Program to include identification and prevention of fraudulent and erroneous refunds. *See* 2015 Iowa Acts, 86th G.A. ch. 138, § 105.

This report is required by Iowa Code section 421.17(23) and 2015 Iowa Acts, 86th G.A. ch. 138, § 106. The report contains the costs of the Program, amounts billed and collected under the Program, refund claims reduced or denied under the Program, and general recommendations to facilitate and improve the Program.

Tax Gap Program Results

In fiscal year 2016, the Program produced over **\$41.4 million** in gross revenue, broken down as follows:

FY 2016 Program Revenues:

| | |
|--------------------|--------------------|
| Corporation Income | \$3,474,416 |
| Individual Income | \$34,977,786 |
| Sales/Use | <u>\$2,968,310</u> |

TOTAL Program Revenues \$41,420,512

The revenues set forth above are reported on a cash basis, meaning that only amounts that have been both billed and paid under the Program are included. From these revenues, the Department paid the following expenses to administer the Program:

FY 2016 Program Expenditures:

| | |
|--------------------------|------------------|
| Professional Service | \$668,550 |
| Outside Service & Repair | \$3,105 |
| OCIO Reimbursement | \$7,438,842 |
| Data Processing | \$270,624 |
| Salaries | \$6,864,972 |
| Support | <u>\$314,318</u> |

TOTAL Program Expenditures \$15,560,411

The expenditures are also on a cash basis. Net revenues transferred to the general fund as a result of the Program totaled over **\$25.8 million** for fiscal year 2016.

In addition to revenue collected from non-filers and non-payers, the Department also works to prevent issuing fraudulent or erroneous refunds. Refund reductions occur when the Department determines the amount of a taxpayer's refund request is incorrect and reduces the refund amount accordingly. As part of the Program, the Department has a team dedicated to identifying and preventing refund fraud. The work of the Department's fraud prevention and detection team generally results in refund reductions.

FY 2016 Program Refund

Reductions:

| | |
|---------------|---------------------|
| Fraud Team | \$8,160,209 |
| Other Tax Gap | <u>\$24,364,069</u> |

***TOTAL Program Refund
Reductions***

\$32,524,278

When the amounts collected under the Program are added to the refunds reduced, the Program produced a total value to the State of nearly **\$58.4 million** after expenses during FY 2016.

We note that the Department recently amended its administrative rules in furtherance of the Program's compliance and fraud prevention efforts. The Department's amended rule requires large employers to submit electronically W-2 and 1099 data to the Department by January 30, 2017. The rules require all employers to submit such information electronically to the Department starting January 30, 2018. The Department promulgated these rules pursuant to existing statutory authority. See Iowa Code § 422.16 (2015) & ARC 2739C (adopted and filed at Iowa Admin. Code r. 701-46.3 "f" & "g"). Based on comparative research and discussions with some of the numerous states that have such electronic filing requirements, the Department believes this rule will be a valuable compliance tool under the Program, especially with respect to preventing fraudulent or erroneous refunds.

Recommendations

The legislation that expanded the scope of the Program states that this report "shall include any statutory changes necessary to facilitate the implementation of this division of the Act." 2015 Iowa Acts, 86th G.A. ch. 138, § 106. In general, the Department endeavors to identify fraud and non-compliance in a manner that is as non-intrusive as possible. To that end, the Department uses available data and analytics to continually refine our methodologies to minimize false positives. We recommend that the legislature be mindful of these efforts when enacting tax legislation.