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# Digest of a Performance Audit of the Utah State Tax Commission

We believe that in most instances the Tax Commission provides adequate due process to protect taxpayer rights by providing adequate notice and an opportunity to be heard. However, improvements are possible in the timeliness and consistency with which disputed tax assessments are resolved. Better defined organizational roles and procedures can help produce improvements, but management must comply with existing controls.

By its nature, the Tax Commission is one of the most controversial state agencies. Its mission is to collect revenue for state and local governments and to equitably administer tax laws. In requiring the public to pay taxes, the commission has a public trust to ensure that taxpayers are treated fairly. Individual taxpayers in tax disputes with the Tax Commission rely on due process to prevent the government from illegally taking their property. At the same time, Tax Commission processes need to protect the interests of other taxpayers by ensuring that everybody pays their fair share of taxes. The interests of governments that depend on tax revenue also must be protected.

The Tax Commission is an administrative agency whose decisions are appealable to the judicial system. The **Utah Constitution** establishes a four-member Tax Commission to “administer and supervise” the tax laws of the state. Most of the 850-person organization which supports the four commissioners report to an executive director. The staff may determine how much taxpayers owe and take actions to compel payments. Staff actions are appealable to commissioners for an administrative ruling. The final decision of the Tax Commission is appealable to the state’s judicial system.

The Constitutional Revision Commission (CRC) is studying whether the constitutional status of the Tax Commission should be changed to better separate tax administration from tax adjudication. The proposed change would allow a Revenue Department to collect taxes independent of the Tax Commission which would adjudicate tax disputes. We believe the changes recommended in this report are needed whether or not the Legislature and the electorate decide to change the commission’s structure.

The specific findings of this report include:

**Administration Plan Should Clearly Define Roles.** Legislation passed in 1983 requires that the Tax Commission implement an administration plan which establishes the duties and responsibilities delegated to the executive director. However, the commissioners and the executive director did not agree to a plan until October 1994. This essential document

should have been prepared much earlier to better distinguish the adjudicative role of the commission from the administrative role of the executive director. As the plan is updated and clarified, we feel the following items should be considered. Tax commissioners need to make adjudication a higher priority and take control of the appeals process by:

(1) devoting more time to appeals, (2) clearly defining participant roles, and (3) allocating additional resources to adjudication. On the administrative side, the following issues are important: (1) authority to forgive taxes needs continuing attention, (2) administration's involvement in appeals process needs clarification, and (3) relationship between auditing effort and mission needs clarification.

**Tax Commission Needs to Better Define Administrative Appeals Process.**

Currently, administrative appeals take too long to complete. As a result, the Tax Commission has a backlog of appeals that adversely affects county governments, taxpayers, and the state. The statutory requirement that centrally assessed appeals be decided within four months should be reconsidered since many appeals now take years to be resolved. The Tax Commission recognizes that a problem exists, and has proposed a plan to reduce the backlog and improve appeals processing time. While we support the commission's plan, further action is needed to prevent the problem from occurring again. Screening criteria are needed to identify all appeals which can be handled informally. In addition, better case-management procedures are needed, including: (1) a tracking system, (2) a scheduling system, and (2) case documentation standards. Finally, additional hearing procedures are needed to clarify the purpose of settlement conferences, to assist the commission in preparing for hearings, and to establish guidelines for when decisions will be issued after hearings.

**Administrative Actions Should Follow Well-defined Internal Control Processes.** To guard against some taxpayers receiving special treatment, the processes for assessing and collecting taxes must be well-defined and obeyed. In the past, important control processes have sometimes been bypassed at management discretion. However, an equally important factor in many questionable management actions has been the lack of clearly defined policy from the commission. We feel that the Administration Division should not adjust taxpayer accounts outside of normal processes, and that the Problem Resolution Group should be moved out of the Administration Division. In addition, the commission needs to clarify the appropriate method to change an audit assessment after it has been finalized. All taxpayer payments must be deposited and accounted for in the appropriate accounts and any promissory notes received should be promptly entered onto the accounts receivable system. Finally, procedures for making account adjustments should be revised to better control changes to taxpayer accounts.

# Chapter I

## Introduction

This report addresses due process at the Tax Commission. We believe that in most instances the Tax Commission provides adequate due process to protect taxpayer rights by providing adequate notice and an opportunity to be heard. However, improvements are possible in the timeliness and consistency with which disputed tax assessments are resolved. Better defined organizational roles and procedures can help produce improvements, but management must comply with existing controls.

The Tax Commission is an administrative agency whose decisions are appealable to the judicial system. The **Utah Constitution** establishes a four-member Tax Commission to “administer and supervise” the tax laws of the state. The commissioners are appointed by the governor and confirmed by the Senate. An 850-person organization, also called the Tax Commission, supports the four commissioners. Most of the commission staff report to an executive director who is appointed by the commissioners in consultation with the governor and confirmed by the Senate. The executive director supervises staff who may determine how much taxpayers owe and take actions to compel payments. Staff actions are appealable to the commissioners for an administrative ruling. The final decision of the Tax Commission is appealable to the state’s judicial system.

By its nature, the Tax Commission is one of the most controversial state agencies. Its mission is to collect revenue for state and local governments and to equitably administer tax laws. In requiring the public to pay taxes, the commission has a public trust to ensure that taxpayers are treated fairly. Concerns about how the Tax Commission administers the tax laws led to the request for this audit.

### **Due Process Helps Provide Fairness**

Due process requires following an established course of proceedings that protects the rights of all parties. Individual taxpayers in tax disputes with the Tax Commission rely on due process to prevent the government from illegally taking their property. At the same time, Tax Commission processes need to protect the interests of other taxpayers by ensuring that everybody pays their fair share of taxes. The interests of governments that depend on tax revenue also must be protected.

Due process requirements are subject to ongoing legal debates. In general, adequate due process should provide as fair, timely and inexpensive a resolution as possible depending on the risk of loss to the parties involved in each specific case. Our audit work focused on the procedural aspects of due process, which require that specific minimum procedures be established and that those rules be obeyed. Another aspect of due process concerns the ability of the Tax Commission to make an independent ruling about the appropriateness of their staff's actions. The state's Constitutional Revision Commission (CRC) has studied whether the commission's adjudicative and administrative responsibilities should be separated.

Adequate due process procedures do not necessarily require a separation of the commission's adjudicative and administrative responsibilities. However, those responsibilities should be functionally segregated within the agency. For example, an individual who argues the commission's position on a tax dispute cannot be involved in making a ruling on the issue. Due process in an administrative agency like the Tax Commission requires the following basic elements:

1. adequate notice,
2. an opportunity to hear evidence or facts supporting the agency decision,
3. an opportunity to present facts or evidence to the deciding authority, and
4. a fair hearing.

While we believe the basic safeguards needed for due process are included within the Tax Commission, there are at least two aspects of the process that can be improved. First, it takes too long to resolve some appeals. Second, there has been inconsistency in the decision-making process.

### **CRC Has Studied Commission's Role**

The Constitutional Revision Commission (CRC) is studying whether the constitutional status of the Tax Commission should be changed. A 1930 constitutional amendment established a bipartisan Tax Commission to administer and supervise the state's tax laws. Utah is one of the few states whose constitution establishes a Tax Commission; most states have statutorily created tax-collecting agencies. Two resolutions to change the constitutional responsibilities of the Tax Commission were introduced but not passed during the 1994 legislative session. The proposed change would have allowed a Revenue Department to collect taxes independent of the Tax Commission which would adjudicate tax disputes. Even if approved by the Legislature a constitutional change is subject to voter approval. The CRC continues to study potential changes for possible consideration in the 1996 election.

Proponents of the constitutional change argue that the “administer and supervise” language in the constitution is too broad, resulting in an inadequate separation of powers. Proponents argue philosophically that a separation of adjudication and administration is needed. That position was advocated at least as early as 1966 when the Little Hoover Commission report stated: *“He who judges ought not to formulate the rule and administer the program. Functions should be separated in the interests of impartiality and fairness.”*

Opponents of amending the constitution argue that it is not needed and could politicize the administration of the state’s tax laws. For example, the Utah Taxpayer’s Association editorialized against the bills being considered by the 1994 Legislature because it would lessen the political insulation of the commission’s staff. It was suggested that a politicized department of revenue could use tax audits in a political vendetta or provide generous tax settlements as political payoffs. Another major concern was that not enough was known about the organization that would administer the tax laws instead of the Tax Commission. Finally, it is argued that the constitution should not be amended until the impact of changes made during the 1993 legislative session but not effective until July 1994 could be evaluated. Those changes expanded the role of the judicial review of Tax Commission decisions to include rehearing evidence and testimony rather than solely reviewing the written record.

The CRC study provides the Legislature with information about whether the constitutional status of the commission should be changed. We did not specifically evaluate whether adjudication and administration should be separated. We believe the changes recommended in this report are needed whether or not the Legislature and the electorate decide to change the commission’s structure.

## **Audit Scope and Objectives**

We focused our examination on the procedural due process provided by the Tax Commission. We examined both whether established processes were adequate and whether such processes were followed. In particular, we evaluated:

1. the process of handling formal appeals,
2. the appropriateness of special handling of selected cases,
3. the adequacy of organizational plans, and
4. the effectiveness of selected internal controls.

Just before and during our audit a number of significant changes occurred at the Tax Commission. Two new commissioners including a new chairman were confirmed and a new executive director was appointed. The commission has issued a strategic plan and agreed with the executive director on a management plan describing the roles of the commission and its staff.

The Auditing, Collections, Operations, and Property Tax Divisions have new directors. A new code of conduct and a new undue influence policy have been implemented and a committee is drafting fraud policy. In addition, legislation affecting the appeal procedures by requiring a settlement conference before formal hearings and changing what may be considered in judicial appeals has taken effect.

## **Chapter II Administration Plan Should Clearly Define Roles**

As mentioned earlier, the Constitutional Revision Commission (CRC) has been reviewing the need to separate the Tax Commission's adjudicative and administrative functions. One reason for the continued ambiguity over commission and operating division roles has been the delay in implementing the statutorily required administration plan. In 1983, the Legislature extensively revised the Tax Commission (**Laws of Utah 1983**, Ch. 315). Four new commissioners were appointed and the position of executive director was created. Recognizing the need to clearly define roles, the 1983 legislation required an administration plan to define the executive director's function. According to **Utah Code 59-1-207**:

*The commission shall prepare and implement a plan for the administration of the divisions and other offices of the commission which do not report directly to the commission. The plan shall, by rule, establish the duties and responsibilities to be delegated to the executive director.*

While drafts of an administration plan were discussed over the years, the commissioners and executive director were unable to arrive at an agreement. Finally, in October 1994, the commissioners and executive director signed an administration plan. The plan is currently in the rule-making process.

In our opinion, the administration plan is an essential document that should have been prepared much earlier. We believe that its preparation and implementation are key in distinguishing between the roles of the commission and executive director. We also believe that the administration plan should be reviewed periodically to update it because of changing relationships. In conducting these periodic reviews, we suggest that the Tax Commission consider the issues we discuss below to assess whether additional clarifications may be needed.

### **Tax Commission Should Spend More Time on its Adjudication Role**

When examining its roles, we believe the commission needs to make adjudication a higher priority. At the time of our review, confusion existed about who controlled the appeals process.

The confusion has resulted in a backlog of appeals and lengthy delays in completing hearings. (See Chapter III for a discussion of the backlog and its effects.) In our opinion, the Tax Commission must take control of the appeals process. In fact, they have agreed that they can do more to make the appeals process more efficient and effective. At our suggestion, they have prepared an appeals plan that states the commission will assume active management of the appeals process. In taking control of the appeals process, we believe the commission must devote more time to appeals, clearly define participant roles, and allocate additional resources to adjudications.

**Devote More Time to Adjudication.** To gain control of the appeals process, the Tax Commission will need to devote more time to reorganizing the process and reducing the current backlog. Commissioner time will be required to design an improved appeals processing system by defining participant roles and approving appeals processing procedures. In addition, the commission will have to devote more time to hearings to reduce the backlog. In our discussions with taxpayer attorneys and division staff, they told us that it is extremely difficult to schedule hearings with the commission. This issue was also raised by experts testifying before the Constitutional Revision Commission. Concerns were raised about the amount of time the commission as a whole and individual commissioners spend adjudicating appeals. In our opinion, the commission should evaluate its current time commitments and increase the importance of its adjudicatory role until the backlog of cases is eliminated and the timeliness of appeals processing is improved.

**Define Participant Roles.** At this time, it is unclear who is responsible for moving appeals through the established process. The Appeals Section reports directly to the commission and receives appeals from the administrative divisions. However, the Appeals Section does not have clear authority to schedule hearings, establish time deadlines, or require action.

We attempted to identify the current status of all open appeals filed before 1991, and some filed more recently. To identify the status of outstanding appeals, we had to discuss each one with the administrative division involved. Frequently, they could not advise us about the current status or reasons for delays. They referred us to the Attorney General's Office and to taxpayers or their attorneys.

In our opinion, the Tax Commission should give the Appeals Section the authority to monitor all appeals and to require administrative division and taxpayer action. This change will require changing the current working relationship with the administrative divisions. At the time of our review, the Appeals Section waited for the administrative divisions to advise them when they were ready to proceed. For example, the Auditing Division completed a sales and use tax audit and sent the taxpayer a statutory notice that additional taxes were due. Division practice was to continue to negotiate with the taxpayer after an appeal was filed. The Appeals Section staff waited for the Auditing Division to advise them when they wanted to start the next step in the appeals process -- the pre-hearing conference. While we encourage the divisions to continue negotiations with taxpayers, we believe that to avoid delays and backlogs, the Appeals Section

should take control of the appeals process once the appeal is filed. The Appeals Section should be responsible for scheduling hearings according to commission guidelines and monitoring compliance with the hearing schedule.

In clarifying the Appeals Section role, the Tax Commission also needs to review the authority and responsibilities of the Administrative Law Judges (ALJs) who work in the section. At this time, participants in the process, especially taxpayer attorneys, do not understand the role of ALJs and believe it should be expanded. In their opinion, the commission should allow the ALJs to have greater decision-making authority. At the time of our review, it was not clear why ALJs can preside over hearings but cannot issue decisions. The state's Administrative Procedures Act (**Utah Code** 63-46b) indicates that the presiding officer should issue decisions. Experts advise that ALJs should regulate the course of administrative appeals through scheduling, resolving procedural and evidentiary disputes, and issuing initial decisions.

In defining the role of ALJs, we also believe the Tax Commission needs to review its use of informal hearings. According to Tax Commission rules, there are two types of adjudicative proceedings--formal and informal. As we understand current practice, informal hearings are primarily used to decide appeals of penalty and interest involving \$250 or less. They also are used in all proceedings to revoke, suspend, or refuse renewal of any license or permit related to motor vehicles. By expanding the use of informal hearings, the Tax Commission may be able to improve the efficiency and effectiveness of the adjudication process. They might consider giving ALJs and individual commissioners the responsibility to conduct informal hearings and prepare written decisions appealable to the full commission for review. As we mention later, appeals should be screened with the most important going to the full commission for a formal hearing. However, many of the appeals filed involve residential property with small dollar amounts in dispute. These and others that the commission may identify might be more efficiently heard and decided by an ALJ or a single commissioner in an informal hearing.

**Additional Resources Needed to Adjudicate Appeals.** In our opinion, the Tax Commission needs some additional staff resources to efficiently and effectively adjudicate appeals. Specifically, we believe the commission needs its own legal counsel and tax policy specialists.

All of the taxpayer attorneys and county attorneys who we talked with told us that the commission needs its own independent legal counsel. Currently, the Attorney General's Office provides legal representation to the administrative divisions and the Tax Commission. During a hearing, an assistant attorney general advocates the position of a division against the taxpayer. Since the assistant attorney general advocates for one of the parties, he or she cannot provide independent legal advice to the commissioners. In addition, many of the hearings conducted by the commission involve very difficult and technical legal issues. The commission would benefit from its own counsel in preparing for these hearings, reviewing the legal issues presented at hearings, and preparing their written opinions. At the present time, only one commissioner has any legal training.

Another concern may arise if a Tax Commission ruling in favor of the taxpayer is appealed to the judiciary. When a centrally assessed hearing is held, the attorney general advocates the position of the Property Tax Division against the taxpayer. If the commission decides for the taxpayer and against the Property Tax Division and the affected counties appeal, the attorney general must change roles and defend the Tax Commission on appeal. In defending the commission's ruling, the attorney general must argue against the Property Tax Division's position which it previously advocated. Taxpayer attorneys and county attorneys believe this creates a serious independence problem.

To provide independent legal counsel, the Legislature will need to reassign existing staff or appropriate additional funds to either the commission or the attorney general. If the Legislature accepts this recommendation, the Tax Commission's legal counsel should be someone with a strong administrative law background.

In addition to independent legal counsel, we believe that the Tax Commission needs experienced tax policy specialists to assist it with its adjudicative role. Currently, the commissioners do not have any tax experts reporting directly to them. The role of a tax policy specialist could include screening appeals, advising the commission on technical issues, and preparing tax advisory opinions. These specialists should be experienced in all the major tax types such as centrally assessed property, corporate franchise, sales and use, and income.

Before seeking to hire additional staff as tax policy specialists, the Tax Commission should look within the administrative divisions for possible staff transfers. Although the commissioners' staff lack tax expertise, the commission sometimes calls on operating divisions to provide expertise. For example, the Auditing Division currently prepares tax advisory opinions. According to the Auditing Division, taxpayers frequently write requesting advice. If the information is routine, anyone asked usually answers the question. However, when more complex and technical questions are raised, these are given to a senior auditor who prepares a written advisory opinion. These are reviewed by auditing management, the executive director, and given to the commission for approval. In our opinion, preparing and issuing advisory opinions may be more appropriately handled at the commission level. Consolidating the preparation and issuance of advisory opinion within the commission may give greater consistency to tax policy. If the responsibility for preparing advisory opinions was transferred from the Auditing Division to the commission, then staff resources could be transferred as well.

### **Executive Director's Principal Role Should Be Administration**

The administration plan should outline the executive director's administrative role and provide the guidelines for clarifying the role as conditions change. In our opinion, the current plan is a good start that needs to be further developed over time. The plan outlines the executive

director's role and requires that *"The Executive Director shall meet with the commission periodically to report on the status and progress of this agreement, update the commission on the affairs of the agency and seek policy guidance."* In an organization as large and complex as the Tax Commission, problems will come up that must be discussed and resolved. A written administration plan cannot anticipate every issue but should provide the policy direction needed to resolve potential conflicts over roles, responsibilities, and procedures. Keeping the plan updated and keeping each other informed as the plan requires are key to resolving the types of issues we discuss below.

## **Authority to Forgive Taxes Needs Continuing Attention**

An important issue within the Tax Commission is who has the authority to forgive taxes. In our opinion, this authority rests directly with the commission, and the administration should only forgive tax liability within the guidelines established by the commission. In our review, we identified a number of instances where Tax Commission administrators may have stepped outside the role of their delegated authority.

The authority to forgive taxes can be delegated to Tax Commission administration, but should be exercised within the guidelines established by the commission. In fact, the newly established management plan reserves the commission's authority to *"...approve all waivers of penalty and interest over \$10,000..."* and to *"approve all offers in compromise which abate tax, penalty and interest over \$10,000..."* These provisions appear to give the administrative divisions limited authority to forgive taxes. Any administrative division's authority to forgive taxes should be carefully defined because tax forgiveness is fundamentally a commission role and can have serious consequences if not carefully exercised. In our opinion, this delegated administrative responsibility requires regular monitoring and discussion between the commission and executive director.

In our review, we identified a number of instances where division administrators may have forgiven taxes beyond the scope of their delegated authority. For example, one large tax amount was forgiven under the signature of the former Collections Division director. In our opinion, he did not have the authority to forgive the taxes involved. A document was prepared by the attorney of a businessman who wanted to purchase a business that was going into bankruptcy. The document provided that the Tax Commission would forgive \$100,000 in taxes owed and \$53,000 in penalties and interest. In addition, personal assessments of about \$250,000 against the prior business owner were to be forgiven. In return, the new business owner would pay the remaining \$186,000 in taxes due. The document prepared by the businessman's attorney provided that approval of the agreement would be indicated by having "an appropriate person" sign the document. The collector responsible for the case told us he used the Collections

Division Director's signature stamp to indicate Tax Commission approval because the former executive director told him to do so. However, the former executive director told us he disapproves of the use of signature stamps and would never have directed that one be used.

In another instance, the director of the Collections Division provided a document to a taxpayer titled "Release of Interest." The taxpayer owed a substantial amount of back taxes that were secured by liens. There was no apparent reason for releasing the taxpayer from his obligations. However, the document stated that:

*The Utah State Tax Commission by and through its Collection Division Director, does hereby release any and all claims, rights, title and interest it previously had against all assets both real and personal property of [the taxpayer].*

Collections Division employees stated that they had never seen a similar document used before in the division.

At the time these incidents occurred, the Tax Commission had not developed an administrative plan defining the executive director's role and authority. In our opinion, Tax Commission administrators must have clear delegated authority or obtain Tax Commission approval before forgiving tax liability. We could find no record that the transactions described above were approved by the commission. We believe that transactions like these must either be supported by delegated authority in the administrative plan or submitted to the Tax Commission for approval before taxes are forgiven. In addition to reserving all waiver and offer-in-compromise decisions exceeding \$10,000 to the commission, the plan requires that requests for individual exceptions and circumstances not covered by policy be referred to the commission.

### **Administration's Involvement in Appeals Process Needs Clarification**

Another function specifically reserved to the commission is adjudicating appeals. The administrative plan specifically reserves adjudicative authority and appeals processing to the commission. However, the Auditing Division's practice of amending appealed audits may preempt the commission's control of the appeals process. Such amendments also can allow administrative intervention outside their delegated authority.

In our opinion, the commission needs to clarify who has the authority to end the appeal. Many appeals are initiated after the Auditing Division completes an audit and sends the taxpayer a statutory notice informing them of any additional audit assessments. At that time, the taxpayer may choose to file an appeal with the commission. The Auditing Division continues negotiations with the taxpayer in an attempt to resolve the appeal. There are three ways that the negotiations can lead to the appeal being ended without a hearing. First, the taxpayer may decide to withdraw the appeal and pay the assessment as determined by the audit. We do not question this outcome,

because the audit assessment remains unchanged. Second, as a result of negotiations, the Auditing Division and taxpayer may reach a written agreement to settle the appeal. We do not question this outcome because settlement agreements must be reviewed and approved by the commission. Third, the Auditing Division may amend the original audit because of new information received. The amendment may cause the taxpayer to withdraw his or her appeal. We believe this outcome is questionable because a contested audit is settled without commission oversight.

In our opinion, the commission should clarify whether amending an audit is an appropriate way to end an appeal. They might consider a number of options in addressing this issue. They could require a settlement agreement rather than an amended audit that they could review. Another possibility would be to have a tax policy specialist at the commission level review the amended audit to assess whether the appeal should be ended. The commission cannot control the adjudicative process unless it prohibits amendments to appealed audits or at least reviews the changes made.

An example helps illustrate the problems caused by amending appealed audits. In one case, an appealed audit assessment was reduced by \$95,630. According to the memorandum signed by the auditor, the amendment was made “per instructions received.” Auditing Division staff report that the instructions came from a commissioner, and that they complied with the instructions because a commissioner is their boss. However, the auditors did not agree with the decision that was made. The commissioner involved told us that he never instructed the Auditing Division to amend an audit because it was not his role to do so. He said if the Auditing Division feels strongly about an issue, it should be brought to the commission through the appeals process. The audit staff involved said that to avoid disagreements such as occurred on this audit amendment, changes should only be made through stipulations that are reviewed and approved by the commission. Requiring written stipulations would provide a clear written record of decisions made and provide better guidance to the Auditing Division.

The failure to resolve the audit discussed above through a written stipulation resulted in the inconsistent application of tax laws and unequal treatment of taxpayers. Another company that produced the same type of product as the first was later selected for an audit. Without having any commission ruling to rely on, and feeling the now former commissioner’s instructions on the prior case were wrong, auditors made a \$29,000 assessment on the second taxpayer. Knowing that its competitor was not paying taxes on the same transaction, the second taxpayer has appealed the assessment. We think the commission should review how appeals may now be ended to ensure that appropriate rationale guides future administrative decisions and ensures the consistent treatment of taxpayers.

## **Relationship Between Auditing Effort and Mission Needs Clarification**

As the Tax Commission and executive director discuss and update the administrative plan, we suggest they review the role of the Auditing Division. In our opinion, the Auditing Division should develop and implement a strategic plan to direct audit efforts and to define the priorities of the division. Our 1986 report, **A Performance Audit of the Tax Commission's Auditing Division** recommended that the Auditing Division develop a staffing plan, yet division management have not implemented this recommendation. However, many other recommendations of our prior report have been implemented, and division operations are much improved. A strategic plan would help to focus auditing efforts so that fair and equal treatment of taxpayers is maximized. In the absence of such a document, there is no clear rationale for where the Auditing Division is concentrating their efforts.

A strategic plan would help define the importance of generating revenue from audits compared to ensuring compliance with tax laws. Historically, the commission has emphasized the ability of auditors to return their cost many times over by finding additional audit assessments. In fact, some legislators have expressed concern that commission auditors are so intent on generating revenue that audit methods may be too aggressive. We did not find evidence that audit methods are too aggressive. However in some instances, we question why taxpayer compliance is not pursued. The Tax Commission Mission Statement reads: *"The mission of the State Tax Commission is to provide fair, efficient and cost-effective administration of the tax laws of the State of Utah, giving due regard for the rights of each taxpayer and to the end that each taxpayer bear their equitable and legal share of the costs of government."* A strategic plan would help the Auditing Division decide how much emphasis to put into compliance audits of government entities, higher education institutions, and income tax non-filers.

**Audits of Local Governments.** Recently a decision by Auditing Division management eliminated local government accounts from the sales and use audit selection process. Local governments are legally required to collect taxes on certain transactions, just like any other taxpayer. However, government accounts were eliminated from the audit selection process because such audits were not considered productive. From a political perspective, there is also a question about whether it makes sense to ever audit a government entity, since to pay an assessment the government would have to tax its citizens. However, from a compliance perspective, anyone required to pay tax should be subject to audit.

Although the productivity of local government audits has been questioned, evidence suggests such audits can result in sizable assessments. Recently, a city was audited because a significant non-compliance issue was discovered while auditing a private business. The city that was supplying the electricity to the company was not collecting the required sales tax. The audit revealed that the city was not in compliance with sales tax laws and an assessment for \$46,000

was issued. Because the audit has been appealed, its final resolution is pending. However, if the city's apparent non-compliance with tax laws had not been inadvertently discovered, it would have continued indefinitely. In addition, before the decision was made to eliminate local governments from the audit selection process, two other audits produced sizable assessments. One audit assessment totaled \$139,000 and the other totaled \$81,000.

The examples cited above indicate that local governments' compliance with tax laws should be monitored, and can result in sizable assessments. One concern of the Auditing Division may be that such audits have historically been abated. Possibly because of political considerations both the \$139,000 and \$81,000 assessment against cities were abated in return for prospective compliance. However, from a compliance or future revenue perspective the audits were very important.

An Auditing Division strategic plan should clarify the division's treatment of local government accounts. Recent changes in tax laws have increased the areas where government must collect sales tax. When non-government taxpayers are affected by tax law changes the likelihood of an audit to determine compliance is increased. However, if the commission determines that local government should not be subject to audit, that should be included in the strategic plan.

**Audits of Higher Education Institutions.** In most respects, the question of whether to audit higher education institutions is similar to the question of whether to audit local governments. The same political, productivity and compliance issues arise. However, the reason that such audits are not conducted is different.

According to division management and the former executive director, commissioners instructed that higher education institution audits be discontinued. Some years ago the commission discovered that the institutions were inconsistently applying tax laws. An audit of one institution resulted in an assessment of over \$700,000 and of another institution less than \$3,000. Audits of other institutions were planned, and an audit at one institution was begun. However, the audit-in-process was canceled; reportedly auditors were instructed to leave during the entrance conference with school officials. The former executive director told us that commissioners instructed that higher education audits be eliminated so they could develop a policy with the Board of Regents on compliance with tax laws. Auditing Division management report that institutions continue to be excluded from the audit selection process pending development of the policy.

A commissioner told us he does not understand why colleges and universities have been dropped from the audit process. In his opinion, the commission has never told them not to audit in this area. He said that following meetings with the Board of Regents about five years ago, the institutions agreed to collect sales tax on all retail sales. The commissioner feels the policy issue

was decided some time ago and the colleges and universities should be part of the audit selection process.

An Auditing Division strategic plan would prevent a misunderstanding between commission and staff about audit policy. Auditing Division staff told us they were not sure current practice was good tax policy. A written plan can help translate intended policy into auditing practice. Without periodic audits there is no mechanism in place that enforces compliance in the colleges and universities.

**Individual Income Tax Non-filer Audits.** A strategic plan also would help the Auditing Division decide whether to place additional emphasis on audits of income tax non-filers. A few years ago Auditing Division management and the Legislature considered individual income tax non-compliance a serious enough issue that they allocated funds to design a targeted non-filer project. Unfortunately, the project was administered in an overly aggressive manner resulting in its cancellation. Ten staff were transferred from income tax auditing to the Collections Division. A limited number of non-filing audits are still done in the Auditing Division but only when they are identified through other audit processes; the division does not seek or target income tax non-filers.

The Auditing Division's previous non-filer program was not administered properly. As a result some invalid audits were assessed and some liens placed on taxpayers' property without notification. Division staff acknowledge that mistakes were made because audit work was not backed up with sufficient information. For example, some assessments were sent to incorrect addresses and were returned as undeliverable. This resulted in liens being placed on taxpayer property because the audits and correspondence from the Tax Commission went unanswered. In addition, the audits assessed taxes on 120 percent of Adjusted Gross Income, overstating the assessments. One positive result of the non-filer project was that around 40 percent of taxpayers who received a request-to-file letter voluntarily filed a return as a result of the inquiry. Division staff report that they have corrected past mistakes and now assess taxes on known income after careful screening. Nevertheless, the program basically was discontinued.

An Auditing Division strategic plan could help the Tax Commission coordinate agency-wide efforts to ensure taxpayer compliance. Although the Auditing Division has greatly scaled back its non-filer program, the compliance section of Collections Division targets chronic non-filers, and tax protesters who refuse to file. According to compliance auditing staff, they mainly pursue individuals who have not filed a return for more than four years. In addition, the commission encourages compliance by educating taxpayers about their legal obligations to file a return. The auditing and education efforts of other divisions can be considered in the Auditing Division strategic plan in deciding the level of resources to devote to non-filer audits.

## **Recommendations:**

1. We recommend that the Tax Commissioners devote more of their time to adjudication in order to conduct hearings and improve the efficiency of the appeals process.
2. We recommend that the Tax Commission revise the role of the Appeals Section staff by:
  - a. making staff responsible for monitoring appeals and scheduling hearings, and
  - b. authorizing administrative law judges to issue written decisions.
3. We recommend that the Tax Commission consider reallocating existing resources or requesting an additional appropriation in order to provide additional staff as:
  - a. tax policy specialist, and
  - b. legal counsel to the commission.
4. We recommend that the Tax Commission clarify who has authority to forgive taxes.
5. We recommend that the Tax Commission eliminate the practice of amending appealed audits and require stipulated agreements whenever audit amounts are reduced following the receipt of an audit appeal.
6. We recommend that the Tax Commission implement an Auditing Division strategic plan relating the agency's mission to division objectives of generating revenue and monitoring compliance with tax laws and rules. The strategic plan should help the division determine whether audit resources should be devoted to:
  - a. audits of local governments,
  - b. audits of higher education institutions, and
  - c. audits of possible income tax non-filers.

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## **Chapter III**

# **Tax Commission Needs to Better Define Administrative Appeals Process**

Currently, administrative appeals take too long to complete. As a result, the Tax Commission has a backlog of appeals that adversely affects county governments, taxpayers, and the state. The Tax Commission recognizes that a problem exists, and has proposed a plan to reduce the backlog and improve appeals processing time. While we support the commission's plan, we believe further action is needed to prevent the problem from occurring again. We also believe that a better defined and more efficient appeals process will eliminate much of the conflict between the Tax Commission and the counties over centrally assessed property and improve Tax Commission relations with taxpayers.

The Tax Commission receives appeals of its own staff's actions and of counties' actions. Staff actions that generate appeals include audits, penalty and interest waiver denials, and centrally-assessed property appraisals. County appraisals of locally-assessed property values lead to the greatest number of appeals to the commission. In 1994, the commission received 2,260 appeals, including about 1,600 of local property appraisals, 280 of waiver denials, 145 of audits, 120 of centrally-assessed property appraisals and 115 of other types.

During our audit, we discussed with the commission our concerns about the appeals process. They pointed out that some of the appeals backlog was due to a few major issues that were pending court decisions. Nonetheless, commissioners agreed with many of our concerns and prepared for us an outline of their plan to correct the problems that exist. The commission plans to:

1. more aggressively manage high-volume, low-dollar appeals, including local property tax and penalty and interest waivers;
2. assign a case manager to complicated centrally assessed appraisal, corporate franchise tax, and sales and use tax appeals;
3. implement a case-tracking system;
4. review staff needs; and
5. revise its procedural rules.

We support the commission's planned administrative actions to improve the appeals process. In addition to describing why changes are needed, the remainder of this chapter discusses changes we think the commission should consider as it continues to evaluate the existing process and begins revising its appeals procedures and rules.

## **Some Appeals Take Years to Resolve**

Many appeals to the Tax Commission remain open for years. Even after the Tax Commission makes a decision, it is appealable to the judicial system. This chapter focuses only on appeals open before the commission. An appeal is considered closed when it is withdrawn, defaulted, settled by an approved stipulation, or decided by a Tax Commission order. Our review focused on appeals of sales tax audits, corporate franchise tax audits and centrally assessed property tax appraisals. These types of appeals tend to be for larger dollar amounts than other appeals. Of course, all types of appeals may raise important policy issues and should be resolved as quickly and inexpensively as possible by the commission.

### **Centrally Assessed Appeals**

We reviewed all centrally assessed appeals filed between 1991 and 1993 to determine the number filed, the time required to complete them, and the dollar value in dispute. The Tax Commission's Property Tax Division assesses mines, utilities, and properties that cross county boundaries. Figures I and II summarize the results of our analysis.

<b>Figure I</b>			
<b>Centrally Assessed Property Appeals</b>			
<b>Percent Cases Remaining Open*</b>			
<b>Years Since Appeal Filed</b>	<b><u>1991 Appeals</u> (114 cases*)</b>	<b><u>1992 Appeals</u> (125 cases*)</b>	<b><u>1993 Appeals</u> (159 cases*)</b>
0.33	89%	88%	97%
0.67	71%	60%	82%
1.00	57%	46%	64%
1.33	47%	36%	43%
1.67	37%	31%	-
2.00	30%	29%	-
2.33	26%	18%	-
2.67	25%	-	-
3.00	24%	-	-
3.33	18%	-	-

*\*Includes only timely filed taxpayer appeals*

Figure I shows the number of centrally assessed valuation appeals filed each year and the percentage that remain open at various lengths of time after they are filed. The Property Tax Division notifies property owners and counties of its appraised values on May 1 of each year; valuation appeals must be filed by June 1. According to **Utah Code 59-2-1007(3)**, the Tax Commission should decide all centrally-assessed property appeals by October 1. Most appeals take longer than the four months prescribed in the code; some take years longer. For example, at the time of our review, October 1, 1994, 18 percent of the 1991 appeals were still unresolved.

**Figure II**  
**Centrally Assessed Property Appeals**  
**Percent of Disputed Value Remaining Open\***

Years Since Appeal Filed	<u>1991 Appeals</u> \$2,693,000,000 In Dispute*	<u>1992 Appeals</u> \$2,279,000,000 In Dispute*	<u>1993 Appeals</u> \$2,410,000,000 In Dispute*
0.33	80%	98%	94%
0.67	77%	95%	91%
1.00	67%	87%	87%
1.33	54%	83%	84%
1.67	50%	79%	-
2.00	49%	77%	-
2.33	43%	75%	-
2.67	43%	-	-
3.00	43%	-	-
3.33	41%	-	-

*\*Includes only timely filed taxpayer appeals*

The financial impact of these appeals is reflected in Figure II. In 1991, the 114 appeals filed involved disputed values amounting to approximately \$2,693,000,000. This amount is the difference between the Property Tax Division's appraised value and the taxpayer's appraisal of value. Comparing Figures I and II shows that disputes involving large dollar amounts tend to take longer to resolve than lesser dollar amounts. Figure II shows, at the end of three and one-third years, approximately \$1,100,000,000 was still in dispute. Assuming a tax rate of 1.5 percent, about \$16,500,000 of local governments' 1991 tax collections are still in dispute.

## Audit Appeals

The financial significance of corporate franchise and sales and use tax appeals is not as great, but is still important. We reviewed calendar year 1992 and found that 37 corporate franchise tax audits identified \$7.7 million in additional audit assessments that were appealed. During the same period, there were 71 sales and use tax audits amounting to \$10.7 million that were also appealed. Figure III shows the number and dollar value of unresolved audits at different periods after the taxpayer filed the appeal.

<b>Figure III</b>				
<b>1992 Audit Appeals</b>				
<b>Percent Remaining Open</b>				
<b>Years Since Appeal Filed</b>	<b><u>Sales and Use Audits</u></b>		<b><u>Corporate Franchise Audits</u></b>	
	<b>Appeals Open (71 cases)</b>	<b>Assessments Open* (\$10,747,909)</b>	<b>Appeals Open (37 cases)</b>	<b>Assessments Open* (\$7,705,380)</b>
0.33	89%	98%	92%	99%
0.67	73%	92%	76%	98%
1.00	49%	83%	51%	96%
1.33	34%	79%	38%	90%
1.67	23%	70%	32%	89%
2.00	17%	50%	30%	85%
<b><i>*Total assessment amount may not be in dispute.</i></b>				

As Figure III shows, two years after their appeals were filed, 11 (30 percent) of the corporate franchise audits and 12 (17 percent) sales and use tax audits had not been resolved.

## **Timely Resolution of Appeals is Important**

Unresolved appeals negatively affect governments, taxpayers, and Tax Commission staff. Amounts in dispute makes local government budgeting difficult because revenue may later have to be refunded. Because centrally assessed property taxpayers must pay taxes on protested appraisals, they may have substantial sums of money tied up for long periods. Delays in completing corporate franchise tax audit and sales and use tax audit appeals have less significant impacts on government funds and taxpayers. However, timely resolution of all types of appeals is critical to effective tax administration.

Timely resolution of appeals is important to guide Tax Commission staff on how to administer tax laws and to guard against political or economic pressures influencing the process. Many appeals arise because taxpayers disagree with methods used by commission staff. Speedy appeal resolution is important to either confirm the appropriateness of the methods or to change them. In either case, future appeals also may be avoided. For example, many large centrally assessed properties have appeals pending for multiple years. If the first year's appeal was settled for either party, the disputed appraisal methodology might have been either accepted or changed in subsequent years. Speedy resolution also guards against political or economic pressure affecting the result. For example, large audits of prominent businesses sometimes are under appeal for years. During that time, pressure may build on the commission staff to settle for reasons outside of normal processes.

### **Centrally Assessed Appeals**

Delays in resolving centrally assessed appeals have a significant financial impact on local governments. For example, a major source of revenue for counties, school districts, special service districts, and other local governments comes from taxes on centrally assessed properties. Constitutionally, the Tax Commission is responsible for assessing these properties and hearing all administrative appeals. Because it is critical to setting budgets, statutes set a "property tax calendar" that specifies when critical events should occur. As indicated in Figures I and II above, the commission is far from being able to meet the calendar requirement of resolving all appeals within four months.

The impact of unresolved appeals on local governments depends on the amount remaining in dispute. Figure IV shows the total amount of centrally-assessed value in dispute before the Tax Commission as of October 1, 1994. Additional disputed amounts that the commission has ruled on but have been appealed to the judiciary are not included in Figure IV. According to statute, the commission should have settled valuation appeals by October 1 each year. The reason for requiring quick resolution is that counties need to know property values to set tax rates.

**Figure IV**  
**Centrally Assessed Property Appeals**  
**Open as of October 2, 1994**

Appeal Year	Appeals Open	Appraised Value Remaining in Dispute
1988	4	\$ 320,000,000
1989	7	1,018,000,000
1990	14	1,057,000,000
1991	20	1,118,000,000
1992	23	1,695,000,000
1993	62	1,992,000,000
<u>1994</u>	<u>112</u>	<u>2,136,000,000</u>
<b>Total:</b>	242	\$9,336,000,000
<i>*Includes only timely filed taxpayer appeals</i>		

The amounts shown in Figure IV represent appraised value remaining in dispute, not taxes in dispute. Tax rates vary both by location of the property and by time of assessment. However, assuming an average 1.5 percent tax rate, the \$9.3 billion appraised value in dispute shown in Figure IV corresponds to about \$140 million of taxes in dispute.

Local governments must balance expenditure needs with revenue sources to establish a budget. Because some property values remain in dispute when the budget is finalized, county officials must decide whether or not to spend the disputed amounts. If disputed revenue is spent, there is a risk that future refunds will require special tax assessments. If disputed revenue is set aside in a special account rather than being spent, then current tax rates must be increased or budgets must be cut. Counties now have the options of using a “judgement levy” to finance refunds of revenue already spent or to “escrow” amounts in dispute.

Besides the options mentioned above, two other proposals exist to ease the financial impact of unresolved appeals on local governments. One proposal is to increase current tax rates by a “factor” based on historical average changes in disputed appraisals. The factoring approach was attempted the past year by 27 counties, but was disallowed by the Tax Commission. However, the factoring approach remains a possibility. Another proposal is to change the “lien date” so that local governments base their current year’s budget on the prior year’s value. Changing the lien date would give the commission an extra year to resolve appeals before local governments

used the values in their budget process. However, changing the lien date would have little effect unless the commission also resolved appeals more quickly. In our opinion, the Legislature may want to consider these proposals, but we believe that the Tax Commission can take administrative action to speed up the appeals process and lessen the financial impact on local government entities.

## **Audit Appeals**

Delays in resolving audit appeals also can have a significant financial impact on the parties involved. For example, one 1990 corporate franchise tax audit amounting to an additional audit assessment of \$16,819,622 is still under appeal. While the company is not required to pay the assessment until the commission issues their decision, four years later the commission still has not held a formal hearing. The taxpayer wrote the Appeals Section a letter saying that since the case was four years old, the taxpayer was anxious to set a formal hearing date and expressed concern about time extensions granted the Auditing Division.

On another audit appeal a taxpayer filed a motion asking for payment of the taxpayer's attorneys' fees if any additional delay was granted the Auditing Division. The motion stated that, although the discovery period had closed and a hearing date set, the Auditing Division had been granted, over the taxpayer's objection, the right to undertake additional discovery and postpone the hearing.

While taxpayers expressed frustration with the delays in resolving the two audit appeals described above, we do not know if there was any merit in the specific cases. Auditing Division management report they seek to resolve all appeals as quickly as possible but often are thwarted by motions filed by opposing counsel. We feel the problem of delay is best addressed by the commission taking responsibility for ensuring that appeals are settled more quickly.

## **Organizational and Control Changes Can Address Problems**

Better defined responsibilities and procedural changes can lead to faster appeal resolutions and elimination of the existing backlog. Chapter II discussed roles and responsibilities of participants in the appeals process, as well as some staffing issues. This section focuses on procedural changes.

As noted earlier, the Tax Commission recognizes improvements are needed in their appeals process and has prepared a plan to make changes. While we feel the commission's plan is good, additional changes may be necessary. To assist the commission in improving their appeals process, we have proposed one approach the commission might consider in implementing their

plans and addressing our concerns. In addition to our suggested organizational changes, we have outlined the procedural controls that we believe are needed in whatever system they choose to adopt. Some of our suggestions are already incorporated in the commission's plan.

The basic elements of the current appeal process are as follows. An appeal is initiated by a taxpayer filing a petition for redetermination. The Appeals Section creates a file, but takes no other action so that the parties may hold division conferences to try to resolve the issue. When division conferences have run their course without resolving the issue, the division notifies the Appeals Section to schedule a pre-hearing conference (PHC). The PHC should result in a scheduling order that sets hearing dates. Appeals of waiver denials of less than \$250 are scheduled for an informal hearing. Other appeals are scheduled for a settlement conference to be followed at least 30 days later by a formal hearing. The process can be stopped at any time by agreement of the parties in a written stipulation that is submitted to the commission for approval, or through withdrawal of the appeal by the taxpayer. This simplified discussion describes the basic elements of the process, but it is not intended to be comprehensive.

### **Several Appeal Issues Need Attention**

While many aspects of the current process are good, changes are needed for more timely appeals resolution. Our concerns with the current process are described below.

**Indefinite Delay Before the Initial PHC.** After a petition for redetermination is filed, years may pass without the Appeals Section scheduling a hearing. Some centrally-assessed appeals go two or three years without a PHC. The intent of the indefinite delay is to allow for possible resolution of the dispute by the parties through division conferences. Division conferences are not part of the formal appeals process controlled by the Appeals Section, but are an efficient and effective way to settle many appeals through agreement of the parties.

**Control of the Appeals Process is Ambiguous.** At this time, several divisions and other participants have unclear responsibilities for various parts of the appeals process. Generally, the PHC awaits a request from a division to schedule it. However, some division staff told us they were ready to proceed, but the assistant attorney general assigned was not. We feel the Appeals Section should control the process rather than the Tax Commission division, whose actions are being protested.

**Too Few Appeals are Considered Informal.** Currently only appeals of denials of taxpayer requests for a waiver of penalty and interest involving less than \$250 are classified as informal. Classifying appeals as formal usually results in the involvement of attorneys, thus slowing the process. The Tax Commission uses a \$10,000 limit in its waiver delegation policy; the commission could use a similar dollar limit in classifying waiver denial appeals as informal. Audit and property tax appeals also could be classified as informal based on a dollar limit or an assessment of potential policy implications.

**Purpose of the Settlement Conference is Unclear.** The Legislature added the settlement conference requirement in 1993 to encourage resolution in a less formal setting. However, commission staff and attorneys told us that as used, the settlement conference is similar to a PHC. Rather than settle appeals in a less formal setting, the settlement conference has complicated the process by adding another layer to bog down the process.

**Commissioners Take too Long to Issue Decisions.** Commission staff and taxpayer attorneys feel the Tax Commission should issue decisions more quickly following a formal hearing. One recent centrally assessed appeal decision was not issued for more than 10 months following the hearing. Many audit appeal decisions from formal hearings were not issued for more than six months following the hearing, and some took over a year. However, a commissioner reports most decisions are issued within 90 days.

**File Documentation is not Adequate.** File documentation is sometimes missing or incomplete. We frequently could not determine whether scheduled hearings were held. Often we could not find a pre-hearing order, following a PHC. One attorney reports that when submitting documents to the commission, he has a second copy date stamped for his own records because the commission sometimes loses documents.

**Appeal Tracking System is not Adequate.** The commission plans to remedy this problem with a new computerized tracking system. To trace cases through the system, we had to discuss each case with the Auditing Division, the Property Tax Division, the Appeals Section, the Tax Commission, the Attorney General's Office, and the taxpayer or his attorney. Even after these discussions, we were unsure of the status of some appeals.

In summary, the Tax Commission appeals process is too ambiguous and confusing. In contrast, the hearing procedures of the Public Service Commission are much more detailed and complete. One taxpayer attorney told us that the Tax Commission should adopt procedures like the Public Service Commission to move appeals along. Another taxpayer attorney told us he could explain to us the hearing procedures used by the Public Service Commission or the Federal Energy Regulatory Commission, but he could not explain the Tax Commission's appeal process.

## **Proposal Would Streamline Appeals Process**

This section discusses our proposal for organizing the appeals process. We believe this is one of many approaches the commission might consider that ensures due process while bringing better order and efficiency to the process. Our suggestions attempt to incorporate the commission's appeals plan and problems we identified in earlier sections. While division conferences are not included in our description, they are important to resolving appeals. Division conferences may continue throughout the appeals process for possible agreement among the parties to the dispute. Any stipulation of an agreement should go to the commission or its designee for approval.

An appeal is initiated when a taxpayer files a petition for redetermination. Essential to moving the process forward at this stage is the Appeals Section taking control. The Appeals Section becomes responsible for monitoring and tracking the appeal once it is filed. Division conferences between the taxpayer and initiating division should continue in an attempt to reach a settlement. However, the appeals process should move forward while these negotiations continue.

**Appeal Screening.** Appeals Section staff should screen appeals as they are received. Using screening criteria prepared by the Tax Commission, staff should decide whether the appeal needs a formal hearing before the full commission or an informal hearing before a single commissioner or ALJ. The tax policy specialists we recommended in Chapter II may be able to fulfill the appeal screening function. Screening criteria might include such things as dollar amounts, case complexity, and policy implications.

Depending on the screening outcome, a scheduling order may be prepared immediately, or a pre-hearing conference (PHC) scheduled to prepare a scheduling order. If a PHC is needed, it should be held within a reasonable period of time after screening. The Appeals Section has already started issuing scheduling orders on locally assessed properties without holding a PHC. It was found that holding a PHC on such cases accomplished little other than delaying resolution of the appeal. Again, the Appeals Section should be responsible for monitoring and tracking the appeal to make sure it moves to the next step in the process within the time set by the commission.

**Informal Hearing.** In our opinion, most appeals should be handled informally. These informal hearings should be conducted before a single commissioner or administrative law judge. These informal hearings do not require representation by counsel and do not result in a written record. Hearings are conducted informally so the taxpayer can directly present the facts of his or her case and hear the opposing arguments. The presiding officer would prepare a written decision following the hearing. If either side felt the ruling was incorrect, they could request that the full commission review the decision, and possibly order another hearing. The objective of the informal hearing is that most appeals be settled at this stage as quickly and inexpensively as possible.

**Formal Hearing.** Formal hearings would be scheduled only for appeals that meet certain screening criteria, such as large dollar amounts, and important policy implications. Thus, the formal hearing process would be reserved for those few cases whose importance justifies the greater cost of formal proceedings. To further help in completing formal hearings in a timely manner, the commission should take some action to ensure that they are prepared to hear the case and that the parties are ready to proceed. They can accomplish this by requiring the parties to submit in writing all essential information in advance of the hearing. This requirement will allow the commission to prepare for the hearing by consulting the tax policy specialists and their legal counsel to help them prepare. After the hearing, the commission should issue a written order within a reasonable period of time.

## **Management Controls are Needed to Make the Process Work**

Whatever organizational structure is implemented, the Tax Commission will have to develop needed management controls and procedures. Based on our proposed appeal process, we have outlined those controls that we think are essential. These controls include three categories: (1) case-management procedures, (2) screening criteria, and (3) hearing procedures.

**Case-management Procedures are Needed.** At this time, the Tax Commission does not have adequate case-management procedures. Specifically, the commission needs to implement a tracking system, a scheduling system, and case documentation standards.

As part of our review, we attempted to identify the current status of unresolved appeals filed before 1991 as well as some filed more recently. The Appeals Section could not identify where these appeals were in the process. To obtain this information, we had to review files in the Appeals Section, Auditing Division, and Property Tax Division. In addition, we interviewed each participant in the process including administrative law judges, tax auditors, property tax appraisers, assistant attorney general, and taxpayer attorneys. In our opinion, the Appeals Section should be responsible for developing a tracking system. In fact, the Tax Commission's appeals plan includes steps to develop a new automated system.

In developing this system, we suggest the Tax Commission ensure that the system include several elements. The system should not only identify who has a case and the next step in the process but should be used to track the appeals inventory and generate reports. In our opinion, the system should separate appeals by tax type and generate regular reports that should be given to the Tax Commission, administrative law judges, the Attorney General's Office, counties, the Legislature and taxpayers. These reports can be used to monitor not only the status of individual appeals but the appeals inventory.

A case-management system should also include specific scheduling procedures. To establish these procedures, the Tax Commission will need to identify expected completion dates for important steps in the appeals process. They will also have to assign responsibility to the Appeals Section to monitor these dates and give the section authority to require compliance. In addition, the Tax Commission will have to commit significant time to conducting formal and informal hearings to ensure that appeals are completed in a timely manner.

To complete a case-management system, the Tax Commission should significantly improve appeals file documentation. Currently, the Appeals Section files are incomplete. There is not a complete file for each appeal, but each participant keeps their own individual records about what has happened with an appeal. In our opinion, a central file is needed for all appeals that includes all pertinent information related to the appeal.

**Screening Criteria are Needed.** If the Tax Commission chooses to implement our appeals screening recommendation, they will need to develop screening criteria for the tax policy specialists. As we suggested earlier in this report, we believe the commission should employ tax policy specialists to determine which appeals should go directly to the commission for formal hearings. We believe these criteria should be based on the significance of the appeal determined by dollar size, policy importance, and political significance. For example, the criteria might send all locally assessed residential property appeals to informal hearing while the large centrally assessed property tax appeals would go directly to the commission for formal hearing.

**Hearing Procedures are Needed.** Because the commission has limited time, we believe that more could be done to prepare them for formal hearings. We have already suggested that they need additional staff support through their own legal counsel and tax policy specialists. In our opinion, the commission could better prepare for hearings by using this staff and by requiring that participants in formal hearings submit all information and legal filings in writing to the commission and its staff in advance of the hearing. For example, the commission might require the exchange of appraisals before the hearing. They should also consider requiring pre-filing of all direct testimony, briefs, and proposed findings of facts and conclusions of law from both sides. At the end of the hearing, any modifications or amendments to the proceedings and written closing arguments could be required. The commission could use this information to more effectively prepare for hearings and would be better prepared to issue a written decision within a reasonable period of time at the close of the hearing.

## **Recommendations:**

1. We recommend that the Tax Commission propose to the Legislature a centrally assessed appeals resolution date that it can meet for possible amendment of **Utah Code 59-2-1007(3)**. If that date is changed, then other dates including the lien date and corporate filing date need to be reviewed.
2. We recommend that the Tax Commission establish screening criteria including such factors as dollar amounts involved, case complexity and importance of policy issues raised to guide staff in screening appeals.
3. We recommend that the Tax Commission establish an appeals screening process to determine which appeals should be classified as informal or formal.
4. We recommend that the Tax Commission establish an appeals tracking system that provides current information on the status of all appeals and enables commission staff to monitor appeal progress.
5. We recommend that the Tax Commission establish appeals scheduling guidelines including expected completion dates for important steps in the process and provide

guidelines for Appeals Section staff to schedule hearings and other actions.

6. We recommend that the Tax Commission establish appeals case documentation standards to ensure that appeals files contain all necessary information.
7. We recommend that the Tax Commission establish additional procedures for the conduct of formal hearings. Items to consider include:
  - a. clarifying the purpose and intended outcomes of settlement conferences;
  - b. requiring the pre-filing of testimony and exhibits; and
  - c. establishing guidelines for when written decisions will be issued following hearings.

## **Chapter IV**

# **Administrative Actions Should Follow Well-defined Internal Control Processes**

Chapter II discussed how the new administration plan should help differentiate the adjudicative role of the commission from the administrative role of staff. Chapter III discussed changes that can help the commission more effectively complete its adjudicative responsibilities. This chapter discusses management controls that can help staff more effectively complete their administrative responsibilities. In the past, important control processes have sometimes been bypassed at management discretion. However, an equally important factor in many questionable management actions has been the lack of clearly defined policy from the commission. In addition to the importance of following established internal control processes, this chapter discusses some areas where a clearer policy or improved procedures are needed.

Tax liabilities should be determined by established processes based on laws, rules, policies, and procedures. However, as discussed in this chapter, tax liabilities have sometimes been forgiven or audit amounts not assessed on the basis that a superior ordered it. In some instances staff knowingly took inappropriate actions because they felt their job was at stake if they did not do so. The undue influence policy was adopted to address situations where managers may use their positions to change the outcome of an established Tax Commission process. The new policy makes it clear that “per the director” is not adequate justification for violating statute, rule, policy or procedure. Of course, the ability of a policy to prevent management circumvention is limited if management chooses to do so.

This chapter includes many case examples that illustrate concerns with existing control processes. Most of the cases discussed were raised by commission staff as problematic. We identified the cases by reviewing the internal auditor’s reports, talking with commission staff, and using anonymous sources. The special handling received by some taxpayers raises questions about the process used to decide audit assessments and collection actions. In a few instances, actions taken have been inappropriate. However, for the most part policy clarification and improved procedures along with improved enforcement of existing control processes can address the problems discussed in this chapter.

## **Administration Division Authority to Determine Taxpayers' Liabilities Should be Limited**

The activities of the Administration Division have extended beyond the expected support and control functions to include making decisions about individual taxpayer liabilities. A decision about a specific taxpayer's account is fundamentally an operating rather than an administrative function that is ordinarily performed in the Auditing, Collections, or Operations Divisions. The Administration Division has expanded its role by directly instructing other divisions how to handle certain accounts and by including a special Problem Resolution Group that handles sensitive accounts.

### **Involvement in Specific Accounts is Questionable**

The authority of the Administration Division to make decisions about individual taxpayers' accounts should be limited. While such decisions are normally made by the operating divisions, this chapter discusses a number of instances where the Executive Director's Office became involved in deciding assessment amounts.

The Executive Director's Office needs broad authority to manage the operating divisions. At times, the Executive Director's Office may need to investigate methods used to make assessment and collection decisions about a specific taxpayer's account in order to verify the appropriateness of actions taken. However, it is not the role of the executive director to set specific assessment amounts or make specific collection decisions outside of normal processes.

The administration plan and undue influence policy have helped clarify the role of management. The prior lack of policy regarding the role of management appears to be a significant factor that allowed management's involvement in tax cases outside of normal procedures. Because no policy specifically prohibited management from intervening in the audit or collection processes, management occasionally took cases outside normal channels and decided how to handle them. Special handling of selected cases outside normal processes may cause unequal treatment of taxpayers because tax laws are inconsistently applied.

For example, in one instance the Administration Division made an audit decision about whether taxes should be assessed on specific sales. By Tax Commission rule, a business must have an exemption certificate for any sale on which it does not collect sales tax. When auditors

applied the rule on one audit, the taxpayer complained to the deputy executive director. The audit file included the explanation that:

*sales were deleted per [the deputy executive director] of the Administration Division. Their division determined . . . that the sales appeared to be for resale.*

The Administration Division's involvement in this particular audit resulted in unequal treatment of taxpayers. Auditors report that following this case they did not change their application of the rule to other taxpayers. If there is a problem with the way the Auditing Division applies a rule, then audit procedures need to be changed for all taxpayers, not just selected taxpayers. Later in this chapter, we discuss other examples of executive management involvement in audits outside of the normal process. Regardless of the decisions made in individual cases, the special handling outside of normal processes can be unfair to other taxpayers.

### **Placement of Problem Resolution Group is Questionable**

We question whether the Problem Resolution Group (PRG) is appropriately located reporting to the Executive Director's Office, rather than being in the Operations Division. The role of the PRG in the Administration Division is to resolve taxpayer problems when "normal Tax Commission procedures" do not work. Additionally, the PRG is assigned any account about which a legislator or the governor's office has inquired. The PRG staff do not merely investigate account status; they have authority to make adjustments to accounts. The PRG enables the Executive Director's Office to closely monitor high profile accounts, but may encourage or give the appearance of preferential treatment to select taxpayers.

One important change would be to require other divisions to approve changes recommended by PRG. Such a change would prevent, for example, PRG from abating audit assessments without the knowledge of the Auditing Division. Although some auditors told us such abatements had occurred, they could not identify any specific accounts for us to investigate. However, we did identify a waiver granted by PRG without the involvement of the Waivers Unit. PRG approved the waiver because the Waivers Unit had taken no action although five months had passed since the waiver was requested. Including the Waiver Unit in the final decision would have allowed an investigation of why the original waiver request had been lost. In our opinion, the Tax Commission should evaluate the necessity of PRG staff, or anyone in the Administration Division, adjusting individual taxpayer accounts.

We think the Operations Division, which already has other problem resolution specialists, is a more appropriate location for the PRG. It is important to have specialists who can respond to taxpayer inquiries, but questions are raised by having the PRG report to the Executive Director's Office. Because it provides special handling to high profile accounts, the PRG could lead to preferential treatment of certain taxpayers. Taxpayers with political connections should not receive special handling outside the normal process. If PRG is not relocated, the Tax

Commission may want to clearly specify criteria for PRG accounts so that there is no question about which accounts are assigned to it. In addition, the duties and responsibilities of this group should be defined. The possibility of accounts receiving preferential treatment could be lessened by taking these steps because accounts would be better screened and the boundaries of PRG actions would be better understood. At stake is the fundamental issue of equal treatment among taxpayers.

## **Authority to Change Audit Amounts Should be Clarified**

Fair treatment of taxpayers and consistent application of tax laws is enhanced through compliance with well-established audit procedures. In most audits we reviewed, a standardized process was followed. However, in a few instances brought to our attention by commission staff, audits were taken outside of the normal audit process and received special handling.

In some cases, management may have directed audit changes outside the normal auditing process. Since changes may have been made to audits either before or after they were issued, two issues are raised. First, what authority should management have to decide audits outside of normal processes? The Tax Commission has already addressed this issue through a new undue influence policy. Second, should the Auditing Division amend audits under appeal or whose appeal rights have lapsed? We think the Tax Commission should address this issue because such amendments effectively prevent control of the accounts from being transferred to the Appeals Section or Collections Division.

The Tax Commission's undue influence policy resulted from concerns of Auditing Division staff that some audits were not decided by proper means. An internal audit was initiated by the Tax Commission chairman after he received a letter from an Auditing Division employee alleging that:

*In the past, the Tax Commission has yielded, or succumbed to the pressures of prominent [individuals]. Large audit assessments . . . have been abated or shelved without benefit of hearings. Merely a call from [prominent individuals] have pressured the Commission to totally abate or shelve an audit.*

After reviewing specific allegations, the internal auditor concluded that state tax laws were violated; Tax Commission policies and procedures were not followed; audits were not assessed; and audits were not put through the appeals process.

## Management Direction of Audit Outcomes is Questionable

Special handling of any audit leads to the potential for unfair treatment either in favor or against the taxpayer being audited. Therefore, management direction of audit outcomes must be avoided. Compliance with standard audit procedures is essential to provide consistent application of tax laws. If management identifies a problem with audit procedures, it must ensure that procedures are changed for all taxpayers. This section discusses instances where management directed changes outside of normal audit processes.

The normal audit process is detailed in the Auditing Division procedure manuals. An initial contact is made followed by an entrance conference. After the audit is conducted, an exit conference is held where the preliminary findings are discussed. After incorporating any additional information provided, a preliminary notice is sent to the taxpayer showing any additional assessment based on the audit. If the taxpayer provides no additional information, a statutory notice finalizing the assessment follows in 30 days. All audits are reviewed by an audit supervisor and division director before issuance. The Executive Director's Office is not included in the normal audit review process, but Auditing Division management may inform the executive director of potentially sensitive audits before they are released.

In a few cases the audit files state that executive management directed changes in audit results. Auditors told us that when they presented the preliminary audit results at one exit conference, the taxpayer, who was a former legislator, said he was going to meet with the former executive director about the audit. The taxpayer disagreed with the auditors because tax had been paid to other states even though it should have been paid to Utah. The auditors' position was that Utah law required the taxpayer to pay Utah and that refunds could be obtained from the other states. The auditors determined that the same problem had been found on a prior audit of the taxpayer, so he was well informed about the law. However, the assessment was changed and the audit file states that "*[the former executive director] forgave them of their proper tax liability of \$21,031 based on [the former legislator's] assertion that there was some kind of misunderstanding.*" The former executive director told us he remembers meeting with the taxpayer about the audit but does not remember directing that the audit be changed.

In a second instance, the taxpayer felt the assessment shown on a preliminary notice was unfair and wrote the former Tax Commission chairman, who referred the matter to the Auditing Division for consideration. The audit file indicates that the Auditing Division decided the assessment should not be changed because it was correct under state law. However, the audit report states that a decision was made to "*waive the statute per instructions from the [former executive director].*" A refund of \$794 was issued to the taxpayer. The former executive director told us he does not remember this audit.

In a third instance, Auditing Division staff report that despite their objections, the former executive director ordered the cancellation of a \$116,000 audit assessment. Apparently, the taxpayer was entering bankruptcy and the former executive director was negotiating with the person who purchased the business out of bankruptcy to pay some of the existing tax liability. Reportedly, the Auditing Division was told to cancel the \$116,000 audit assessment because the amount could not be collected anyway. There was some question among the collection agents assigned to the case about whether there were sufficient assets available to collect most or all of the delinquent taxes owed--including the additional \$116,000 assessment. Regardless of whether it appears to be collectible, there is no provision in the normal audit process to cancel a completed audit. The commission's internal auditor identified this case as having undue influence. The former executive director told us it would not have done any good to issue the audit because of the settlement negotiations; however, he does not remember telling the auditors not to issue the audit report.

In conclusion, management should not provide special treatment to selected taxpayers. While management should not act outside established audit procedures, it may legitimately identify concerns with existing processes. Depending on the nature of the concern, it could be addressed in a variety of ways. In some instances, simply changing the audit procedures manual may solve the problem. However, if the concern stems from a rule or prior Tax Commission decision, then the commission should be involved in any change to the process.

### **Amendments of Completed Audits are Questionable**

The Tax Commission should address the appropriateness of the Auditing Division amending finalized audits. As we described in the prior section, an audit culminates with the issuance of a statutory notice that assesses any additional amounts due. The statutory notice informs the taxpayer of his or her right to appeal any assessment by filing a petition for redetermination within 30 days. If the audit is appealed, no collection action will be taken until the appeal is resolved. If the audit is neither paid nor appealed within 30 days, the Collections Division may initiate actions to compel payment. According to the statutory notice, unless it is appealed within 30 days, the notice constitutes a "final assessment." However, in practice the assessment may be amended at the discretion of the Auditing Division long after it is supposedly final.

Because audits may be amended long after the statutory notice is filed, control of the process is ambiguous. Chapter II described how audits under appeal may be resolved by amending the audit and the taxpayer withdrawing the appeal. That practice basically accomplishes the same thing as a stipulation between the parties. The key difference between an appeal withdrawal and a stipulation is that the commission does not control the resolution by reviewing the agreement. Eliminating amendments of appealed audits would ensure that the commission controls the appeals process. A similar control issue arises when audits that have been assigned to the Collections Division for action are subsequently amended by the Auditing Division.

Auditing Division amendments of finalized assessments brings additional ambiguity to the process. The division has felt that if additional information becomes available at any time showing that an audit assessment is too high, it should be reduced. However, rather than the Auditing Division amending a finalized audit, the Collections Division has a process that may accomplish the same end in a more appropriate manner. The Offer-in-Compromise (OIC) program is set up to abate amounts where there is a question about either the taxpayer's liability or ability to pay. The OIC program enables a taxpayer to offer to pay only a portion of the assessment if documentation is provided proving the taxpayer should not owe the full amount or is unable to pay the full amount. Certainly, if the taxpayer claimed he or she was not liable for an audit assessment, we would expect the OIC program to consult with the Auditing Division before abating an audit. However, commission staff report that the OIC program is not intended to address situations where the taxpayer provides new information after an audit assessment is finalized. If the OIC program cannot be used to replace the practice of the Auditing Division amending finalized audits, then a new process should be developed. Either developing a new process or using the OIC process rather than allowing the Auditing Division to amend finalized audits would enable the commission to better control tax forgiveness since any abatement of more than \$10,000 is reserved to the commission. We reviewed cases where abatements were made by auditors, collectors, or both without commission involvement. The ambiguity in how amendments and abatements occur now increases the likelihood of administration acting outside its delegated authority.

In one case, we found the deputy executive director had an audit amended after the taxpayer's appeal rights had expired. The deputy executive director told us he became involved in the case because the taxpayer approached him and was concerned that the audit assessment would put him out of business. In this case, a sales and use tax audit completed by the Auditing Division identified an additional \$30,000 owed in taxes. The Auditing Division filed a statutory notice with the taxpayer advising him of the amount owed and outlining his appeal rights. Approximately one year after the taxpayer's appeal rights lapsed, the business owner contacted the deputy executive director for assistance. His account had been turned over to the Collections Division which had contacted the taxpayer about paying the \$30,000 assessment. The deputy executive director worked with the taxpayer, Auditing Division, and Collections Division and determined that the original assessment should be reduced by \$12,000. The Auditing Division amended the audit and the reduction was made. The normal audit process is designed to determine the amount owed, not the taxpayer's ability to pay. However, the OIC program in the Collections Division does have an established process to consider the taxpayer's financial condition. In our opinion, rather than amending an audit after the taxpayer's appeal rights have expired, the established OIC process should be followed. Using this program, the taxpayer can have their financial situation reviewed and an agreement worked out to pay a reasonable portion of taxes due.

In a second case, the Auditing Division abated approximately \$18,000 in taxes and interest a year after the assessment. The audit had not been appealed by the taxpayer, but the deputy executive director was contacted. The deputy executive director felt the audit result was unfair to

the company and instructed the Auditing Division to abate the assessment. Auditors told us they advised the deputy executive director his instructions were contrary to Tax Commission rulings in two similar cases. The deputy executive director told our office that he was aware of one of the rulings by the commission at the time he made his decision, but still felt he had done the “fair” thing. In our opinion, the appropriate way to handle this case would have been to appeal the audit initially to the commission or once that right lapsed to apply for an abatement through the OIC program.

In a third case, the Auditing Division first amended a finalized audit and later worked with a collector who abated a large assessment. Because an out-of-state taxpayer would not provide requested information, the Auditing Division had to establish the tax liability without important information. The statutory notice was sent but was not appealed, supposedly finalizing the assessment. In fact, the account was assigned to the Collections Division for action. Nonetheless, when the taxpayer provided some information six months later, the auditors amended their initial audit. Again a statutory notice was sent, but not appealed. Nearly a year later, the taxpayer finally supplied the requested information showing that tax was not owed. The collector assigned provided the information to the Auditing Division who determined that little of the tax assessed was actually owed. The collector then abated \$380,000 and the taxpayer paid the remaining \$220. Rather than the collector abating the assessment in cooperation with the auditor, we think the commission should have been involved. Any abatement more than \$10,000 goes before the commission for approval. Had the commission reviewed this case, they may have chosen to require the taxpayer to pay more than \$220 since the assessment had been legally finalized. As it turned out, the Tax Commission expended significant resources because of the taxpayer’s failure to cooperate, as legally required.

We believe that changing taxpayer liabilities by amending finalized audit assessments should not be within the scope of administrative authority. The existing OIC program may be used whether the issue involves a claim that the taxpayer is not liable or is unable to pay. If the OIC program is not used when finalized audits are contested, then a new process under the commission’s delegated authority may be needed. Using established processes allows the commission greater control of tax forgiveness decisions. The administration plan recently adopted by the commission specifically mentions the OIC program and delegates to administration the authority to abate tax, penalty, and interest under \$10,000. At the time these incidents occurred, the administration plan had not been approved, but the OIC policy was in place. We believe that Tax Commission administrators should exercise care to follow existing procedures and bring to the attention of the Tax Commission changes that need to be made.

## **Collections Division Controls Need Improvement**

The need to follow well-established procedures is even more important with collections issues than it is with auditing issues. It makes little difference what amounts are due if the

Collections Division decides not to collect them. Although we completed only limited work in the Collections Division, this section addresses a number of concerns. First, in two instances the commission's budget was supplemented by mishandling taxpayer payments. Second, management has sometimes intervened in the normal process to make collection decisions without proper documentation. Third, procedures for posting notes receivable to the system are inadequate.

Some of the incidents discussed in this section involve the former Collections Division director. The commission's internal auditor reported some of the incidents described here, as well as others, to the commissioners. The individual left the commission and was prosecuted.

### **Tax Commission Budget Was Supplemented by Inappropriately Handled Payments**

In at least two instances Tax Commission staff inappropriately handled tax payments, apparently to supplement the budget. In the first case, a series of inappropriate transactions ended with \$9,100 in sales tax revenue in the commission's spending account. In the second case, \$10,000 of credit for services at a resort, which had been transferred to the commission to settle a sales tax liability, was used by the commission. In doing so, tax records were falsified and sales tax revenues due local governments and the state general fund were withheld.

Payments received on a large sales tax account were kept in inappropriate Tax Commission accounts for more than two years. The Tax Commission approved a settlement whereby an \$800,000 note receivable would be paid in installments as settlement of a larger tax obligation. As shown in Figure V, beginning in December 1990, payments that should have been deposited in a sales tax account were deposited in a drug stamp account or a dedicated credit account.

**Figure V**  
**Time Line of Inappropriately Deposited  
and Transferred Payments**

Date	Deposits and Transfers
Dec 1990	\$72,500 deposited in Drug Stamp Account
Jan 1991	\$5,700 deposited in Drug Stamp Account
Jan 1991	\$3,400 deposited in Drug Stamp Account
Jan 1991	\$39,700 deposited in Drug Stamp Account
Feb 1992	\$40,000 deposited in Dedicated Credit Account
Mar 1992	\$121,300 transferred from Drug Stamp Account to Dedicated Credit Account
May 1992	\$152,200 transferred from Dedicated Credit Account to Sales Tax Clearing Account
* <b><i>\$9,100 Remains in a Dedicated Credit Account</i></b>	

Funds initially deposited in a drug stamp account were later transferred to the dedicated credit account. State agencies may spend funds out of dedicated credit accounts to meet their own needs. Most of the funds inappropriately deposited into the dedicated credit account were eventually transferred to the sales tax account where the funds belonged. However, \$9,100 inappropriately remained in the Tax Commission’s dedicated credit account.

The Tax Commission also inappropriately handled a payment on another sales tax account. In this case the commission accepted a business’ offer-in-compromise (OIC). Under the OIC agreement, the business was to pay \$1,700 cash and transfer \$14,400 in credit for services at a resort to the commission. In return for the cash and credit, the commission agreed to abate the remaining tax liability of \$4,700. Tax Commission staff kept the resort credit for its own use by also abating its value from the taxpayer’s account. Almost \$10,000 of the resort credit was used for Tax Commission seminars, workshops, and employee appreciation parties (\$4,400 of the credit remained unused). The Tax Commission employee who approved the abatement told us he knew it was wrong to do so but feared for his job if he did not follow instructions. The Tax Commission’s internal auditor reported that *“in our opinion, the former Executive Director and the former Collection Division Director intentionally misapplied \$9,961 of the credit for the benefit of the Tax Commission.”* The former executive director told us he discussed use of the credit with the state finance director before its use. However, the state finance director told us he was not consulted, and that use of the credit may have violated the Budgetary Procedures Act and

circumvented the appropriations process. The deputy executive director told us that the commission intends to remedy the situation by transferring funds from the administration budget to the sales tax account.

### **Management Handling of Some Collection Cases was Questionable**

The Collections Division has collection agents who are assigned taxpayer accounts on which payment is past due. The agents contact the taxpayer to arrange for payment. If the taxpayer cannot pay the full amount immediately, the agent may arrange a payment agreement whereby the taxpayer makes regular payments toward the debt. If the taxpayer claims he or she is unable to pay his or her debt, the agent may classify the account as uncollectible and cease efforts to collect. In order to justify an uncollectible classification, an agent must conduct a financial analysis to verify that the taxpayer does not have a reasonable prospect of paying. The financial analysis is critical to ensure that all taxpayers pay the amounts they owe unless they are truly unable to do so.

In some instances, it appears that management instructed agents to write-off accounts despite a financial analysis indicating the prospect for payment. Because unsupported write-offs are outside the normal process, the prospect of special treatment of certain taxpayers is increased.

In one case the former director of the Collections Division instructed that \$1 million in sales and withholding taxes owed by one taxpayer be written off as uncollectible. The collector assigned to the account had conducted a financial analysis and felt that sufficient assets existed to pay at least some of the taxes owed. However, the collector complied with the instructions of his division director. Contrary to normal procedure, a personal assessment was not issued against the taxpayer prior to writing off the account as uncollectible. Collection agents assigned to the case reported that the taxpayer had garnishable assets and income of about \$8,000 per month, but the former director of collections would not consent to garnishing the taxpayer's assets or wages. Collection agents assigned to the case indicated that the files contained evidence that additional assets were available. Unfortunately, files pertaining to this case are missing.

In another instance, the former Collections Division director instructed collection agents to cease collection activity on a taxpayer owing more than \$400,000. The former executive director told us that the commission was involved in this case. A commissioner told us the taxpayer came to his office and was directed to the former Collections Division Director. The two collection agents assigned to the case told us that their financial analysis showed that sufficient assets were available to pursue collection. The collection agents assigned to the case

reported that despite their financial analysis, the former director of Collections Division instructed them to stop collection activity on the account. We could not locate case files that may have contained documentation to support the write-offs.

In another case, \$7,700 in interest was abated without using the waiver process or OIC process. Two separate adjustment forms were completed to abate audit interest a year after it was assessed. One form prepared by Auditing Division staff that abated \$1,400 included the explanation that “[the former executive director] said to abate interest.” The other form prepared by Collections Division staff that abated \$6,400 included the explanation “*abate interest per [the former executive director] and [the former Collections Division director].*” According to **Utah Code 59-1-401(8)**, “*Upon making a record of its actions, and upon reasonable cause shown, the commission may waive, reduce or compromise any of the penalties or interest imposed under this part.*” Neither the waiver program nor OIC processes were used to change the account. There is no documentation that program criteria were met or that any evaluation was completed. In addition, since these abatements occurred before the policy delegating waiver and OIC decisions of less than \$10,000 to commission staff, it appears the abatement should have been considered by the commission. The former executive director told us he did not remember the specific interest abatement on this case, but if he had ordered it he would have involved the commission and there would be written documentation.

## **Procedures for Controlling Notes Receivable Need Strengthening**

The commission does not have a clear procedure for monitoring the payment of promissory notes. Earlier in this chapter, we described how payments on a \$800,000 note receivable were inappropriately deposited in the drug stamp and dedicated credit accounts. After becoming aware of the mishandling of some payments on the note, we sought to verify how later payments were deposited. However, division staff were not even aware of the note receivable, because it was never entered onto the accounts receivable system. Division staff report that they only rarely receive promissory notes. However, concerns raised by the three instances we became aware of show that better controls are needed.

The commission should establish better procedures for monitoring the collection of promissory notes. As mentioned earlier, the Tax Commission approved acceptance of the \$800,000 note from the purchaser of a business in satisfaction of a larger tax debt. Apparently, the account was monitored personally by the former director of the Collections Division. After his departure, current management was unaware of the account’s status or even the existence of the note. If the note had been entered onto the system and the account monitored according to normal practice, it is unlikely that many of the problems surrounding this account would have occurred.

It is difficult to understand how such a large note receivable could fail to be entered onto the system and the account not monitored. However, even after we discussed the case with division

staff, there was uncertainty about how the note should have been recorded. One view was that it should have been recorded as owing from the defunct business since it was in satisfaction of its debt. In fact the amount transferred from the dedicated credit account was credited to the defunct business' sales tax account. Another view was that it should be shown on the account of the successor business. A third view was that a special sales tax account for the individual note maker should have been established.

This case also demonstrates the need to secure a note with property whenever possible. Although \$160,000 (less attorney fees) were paid on the note, because the note was unsecured, it appears that the remaining \$640,000 will go uncollected. The promissory note was structured as a personal obligation of the purchaser, and was not collateralized by the assets of the business. Before the promissory note was signed, the commission had a claim on the business' assets through its tax liens. Those business assets must have been worth at least \$800,000 since the purchaser agreed to pay that amount to obtain them. Therefore, the note should have been collateralized against those assets. Unfortunately for the commission, the business subsequently changed hands and the maker of the note will apparently not be able to fulfill his obligation. The current business owner apparently has no obligation to pay on the note.

In a second case, a promissory note was not fully paid even though it was secured. A promissory note for \$160,000 was secured by a trust deed on property belonging to the taxpayer. Although only \$90,000 had been paid on the obligation, the deed was returned to the taxpayer. The taxpayer did not pay the remaining \$70,000 obligation. Apparently, the deed securing the note was released at the instruction of the former director of the Collections Division. As the failure to collect the final \$70,000 owed proves, the property securing a promissory note should not be released until the terms of the note are fulfilled.

In a third instance, the Tax Commission accepted a taxpayer's offer-in-compromise (OIC). The OIC agreement provided for payment of \$59,000 in cash plus a promissory note to pay \$20,000 within ten years. The commission had previously rejected the taxpayer's offer to settle the account by paying only the cash amount without the promissory note. After meeting with the taxpayer, the former executive director had the OIC resubmitted with the promissory note which was accepted by the commission. According to file notes and the employee involved, after the commission approved the OIC, the former executive director and the taxpayer both told the employee that the note was to be discarded and not collected. The former executive director told us he did not remember this specific case, but that he absolutely did not do what has been reported.

## **Adjustment Forms Policy is not Consistently Followed**

The adjustment forms policy, which was established by the Administration Division's Control Group, is not enforced. An adjustment form is the document used to change taxpayer

liabilities, including assessing taxes, posting payments, and abating assessments. Because it is used to change taxpayer liabilities, it is vital that adjustment forms be controlled by a clear policy so inappropriate adjustments are not made. The existing policy requires that each division that generates adjustment forms provides a list of individuals who may approve adjustments. Policy also requires that Operations Division staff verify that a form has been properly approved before it is entered onto the system. Because the policy is not enforced, divisions have developed a range of procedures to approve them. In some instances, unauthorized adjustments have resulted.

### **Control Policy is not Consistently Applied or Enforced**

The adjustment form control policy is inconsistently applied by the divisions that generate the forms. The policy was developed in 1991 to govern the adjustment forms process for the Tax Commission. The Auditing, Collections, Operations and Administration Divisions all prepare and approve adjustments to accounts, including payments. However, some divisions are not complying with the policy's guidelines. For example, each division should establish a signature list of all persons authorized to approve for that division, and provide the list to the Operations Division. The list contains the names, signatures and initials of all authorized approvers and is an internal control used to validate adjustment forms before data on the tax system are changed. Only one of the four divisions actually keeps a list and checks the adjustment form signatures against the signatures on the list. Since signature lists do not exist, the Operations Division cannot check forms for authorized signatures. Data entry staff report that any signature is accepted.

Because the policy is not enforced, divisions have developed a variety of practices. Only the Auditing Division has a signature list, while other divisions have developed different practices. The Collections Division reports it has recently established a process where all adjustments have to be approved by one of three authorized approvers. The Operations Division reports that the supervisor in each of eight units may authorize an adjustment. Only in the Administration Division did we discover the same individual both preparing and approving an adjustment form. Although the adjustment form policy does not state that the same person should not prepare and authorize their own work, the Control Group staff assumed that to be understood. Since the signature review process is not followed there is no mechanism to detect deviations from the policy.

The purpose of the Control Group's policy is to avoid the type of inconsistency described above. It makes little sense to tightly control a process in one division if it is only loosely controlled in another. For example, according to Operations Division staff, payment adjustment forms require one signature, and other adjustment forms require two signatures. A special exception is made for refunds over \$15,000 that require three signatures to ensure its validity. In contrast, we found one adjustment form for a \$48,000 refund was prepared, checked and approved by the same person in the Administration Division.

## **Lack of Policy Enforcement Allows Inappropriate Use of Adjustment Forms**

Besides bringing greater consistency to commission practices, following a clearly-defined policy will help to prevent inappropriate use of adjustment forms. As described above, although the divisions have each developed their own procedures for reviewing the forms, the important control function that the signature list performs is missing. In some instances the lack of control has led to improper adjustment being made.

As discussed previously, and shown in Figure V, some sales tax payments were inappropriately credited to drug stamp accounts. Although the adjustment forms for these payments did not have any signatures, they were routinely processed. In general, divisions do not control payment adjustment forms as tightly as other adjustment forms. In most instances, if a payment is not credited to the correct account, the taxpayer will identify the problem. However, some payments, such as those associated with uncollectible, drug stamp or bankrupt accounts are more subject to abuse than others. Current policy does not provide for different treatment of payments from other adjustments.

In another instance, a number of valid audits were inappropriately abated. Apparently, two commission employees prepared and approved the improper adjustment forms. At the time, neither of the employees was authorized to approve adjustment forms. However, since the Operations Division does not verify the appropriateness of the signatures on forms, there is no method to routinely detect improper approvals. According to Auditing and Operations Division management, the adjustments that went through were inappropriate and the employees involved are no longer with the commission.

### **Recommendations:**

1. We recommend that the Tax Commission treat all taxpayers equally. Normal processes should be followed in resolving all assessment and collection matters and no taxpayer should receive special treatment.
2. We recommend that the Tax Commission move the Problem Resolution Group out of the Administration Division.
3. We recommend that the Tax Commission eliminate the practice of amending finalized audits and require the use of existing Collections Division processes whenever finalized audit amounts are reduced.

4. We recommend that the Tax Commission deposit and account for all taxpayer payments in the appropriate accounts. In addition, the commission should transfer \$9,100 from its dedicated credit account to the appropriate sales tax account and transfer approximately \$10,000 from its budget to the appropriate sales tax account.
5. We recommend that the Tax Commission establish procedures to ensure that all promissory notes received are promptly entered onto the accounts receivable system.
6. We recommend that the Tax Commission revise its adjustment form policy and procedures to better control changes to taxpayer accounts.

## **Agency Response**