

## WINNING THE BUSINESS TAX WAR: ARMING THE DEPARTMENT OF REVENUE TO COLLECT WHAT'S OWED

During the past year, while helping coordinate the Alabama Superauditor program, I was able to observe the operations of our Department of Revenue as a tax collections agency. The Department is staffed with intelligent, hard working and dedicated professionals, many with over twenty years of service. Its career professionals include the Secretary, Director of Tax Policy, Assistant Commissioner and the Division heads. Many have worked long hours to revise our antiquated tax structure, collect the taxes owed and keep our schoolhouses open.

However, due to a lack of resources and structural inefficiencies, the Department has fallen short in fulfilling its Mission Statement:

The Alabama Department of Revenue will efficiently  
and effectively administer the revenue  
laws in an equitable, courteous and  
professional manner to fund  
governmental services for the citizens  
of Alabama.

This article suggests staffing and collections procedure reforms which, in my opinion, would boost fair business tax collections by \$100 to \$150 million per year. It would be tragic if the following simple and inexpensive business tax collection suggestions are not followed, with individual and poor taxpayers having to shoulder an increasing share of the income tax burden while multistate businesses gaming the system go scot free.

State Government is owned by the taxpayers of Alabama. We are shareholders in a big company, with the most important department being the Billing and Collections Department, our

Department of Revenue. For our State government to succeed it needs to have an effective billing and collections department. Just as we become upset when our investments sour, we should demand performance from the State government in which we invest every April 15. We have to make this company perform more efficiently, and there are many ways to support our Billing and Collections Department.

Over the years, the Department has done a very good job in collecting taxes. However, due to the explosion of abusive accounting tax avoidance schemes since the late 1990's, when Alabama business tax revenues fell by about \$150 million per year, the Department, like those of many states, has lost ground in the collection of business income tax revenue. If properly funded and staffed, the Department would have the tools needed to remedy this shortfall, but the tax keeps eluding us. It's like watching a tractor rust while it sits in the middle of a hundred acres of good bottom land. We need to start plowing the field.

The key to bridging the business tax deficit is tax auditing expertise. The Department of Revenue should focus on hiring well trained tax auditing specialists at competitive salaries to audit our biggest tax evaders. They should be CPA's or lawyers with a Masters Degree in Taxation. These persons will be on the front lines against the finest accounting firms in the country, and they must have the skill set and unfettered support of the entire Department to win the tax audit battle. It's not too different from the frustrating weapons inspection going on in Iraq today. High powered specialists are paid by the taxpayer to rearrange the company's operations to make them look like something other than a profitable enterprise. Those reviewing the resulting handiwork need to have a detailed knowledge of these tax avoidance techniques or they'll never find the smoking gun.

Right now, the Department employs approximately 1300 persons. Of this number, approximately 15 auditors and a small number of in state examiners, or less than 5% of the work force, are responsible for ensuring that the largest companies in the world doing business in Alabama are obeying Alabama's tax laws. If the Department of Revenue had the resources to hire 30 auditors trained in sophisticated tax avoidance techniques and auditing the Fortune 1000, we would see a dramatic difference.

The Department should have on staff 30 such Superauditors earning salaries comparable to their counterparts in the large accounting firms, \$40,000 to \$60,000 per year. That's a \$1.5 million annual investment.

These 30 auditors could each conduct 10 audits per year of the Fortune 1000, covering a third of the companies annually. A squad of 30 suprauditors can therefore audit the Fortune 1000 over a three year cycle. The three years bears significance because of the three year statute of limitations during which time the Department must assess unpaid business income taxes. Based on our experience with the Superauditor program, we can safely assume that each audit of a Fortune 1000 company will yield approximately \$150,000 in additional income tax revenues for the State per year audited using the sophisticated forensic auditing techniques available. This slight increase in Department funding and change in procedure, using the tools currently at the Department's disposal, could therefore yield \$150 million per annum in new tax revenues, constituting a 10,000% return on Alabama's \$1.5 million investment in sophisticated auditors.

By contrast, 40% of the Internal Revenue Service's resources are already devoted to tax

enforcement.<sup>1</sup> The new Federal Budget proposed by President Bush ( not a man known to be unfair to business), "would increase by a third or more the number of audits of taxpayers suspected of hiding income received from their businesses, partnerships, investments, and offshore accounts".<sup>2</sup> Do any of these Federal problems sound familiar to Alabama? Even with beefing up enforcement, "the vast majority of tax cheats the I.R.S. identifies will get away without paying."<sup>3</sup> Bear in mind that this restructuring and focus on enforcement comes at a time when the I.R.S. is busy implementing and complying with the *IRS Restructuring and Reform Act of 1998*, an Act passed to make the I.R.S. fairer and more understanding of the taxpayer. If the I.R.S. is getting nicer to the taxpayer, Alabama must be the Mahatma Ghandi of Revenue Departments. This time, though, the schoolchildren are fasting in the Mahatma's stead.

Please encourage Governor Riley and Finance Director Drayton Nabors to give the Department of Revenue adequate resources to hire these 30 sorely needed Superauditors. The collections arm of our Department has had to "do more with less" for too long.

Other collection reforms would require simple procedural changes in the Department. The bulk of the business income tax collection problems with the Alabama Department of Revenue occur in the audit and assessment process. From the Department's website, we find a chart outlining how the audit and assessment process should work. In reality, the collection of the tax owed the State

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<sup>1</sup>Johnston, "Budget Gives I.R.S. More Money to Investigate Tax Cheats", New York Times, (Wednesday, February 5, 2003).

<sup>2</sup>Ibid

<sup>3</sup>Ibid

slows down in a couple of areas. Here is how the process should work according to [www.ador.state.al.us](http://www.ador.state.al.us):