



Peter Franchot
Comptroller

TESTIMONY OF COMPTROLLER PETER FRANCHOT *Fiscal Year 2016 Budget Presentation*

*For Presentation to the House Appropriations Subcommittee on Public Safety & Administration
and the Senate Budget & Taxation Subcommittee on Education, Business & Administration*

It is my privilege to present to you the Fiscal Year 2016 budget request for the Office of the Comptroller of Maryland and to address the issues raised by Mr. Rosado in his analysis.

I take pride in the strong working relationship my agency and I share with this subcommittee. With your support, advice and feedback, as well as the efforts of my outstanding staff, we continue to be regarded as the most efficient and effective Comptroller's Office in the nation. This budget reflects our shared desire to find ways to deliver exceptional taxpayer services as affordably as possible.

My senior staff and I work extremely hard to find efficiencies and continually strive to deliver the highest standard of customer service at the lowest conceivable cost to the taxpayers. As we continue to adapt to changing times and fiscal realities, I would like to briefly review some of our signature accomplishments in the core areas of taxpayer service, tax fairness, and fiscal responsibility.

As you know, the top priority of the Comptroller's Office is to respect the vast majority of Marylanders who pay their fair share of taxes on time, by making the filing process as easy and convenient as possible. With the help of our marketing and outreach efforts, more than 2.4 million Marylanders filed their returns electronically in Tax Year 2013, representing over 80% of all income tax returns and setting yet another all-time high. For each electronic return filed, the State saves over two dollars in administrative costs, and those taxpayers using direct deposit can generally expect their refund deposited into their bank account within three business days. This sustained improvement would not have been possible without your continued support of our technological advancement and departmental legislation that requires paid preparers to file their clients' returns electronically.

Your support has also assisted the Comptroller's Office in implementing the most sophisticated techniques to detect and prevent tax fraud. Our agency has successfully stopped nearly \$130 million in undeserved refunds over the past eight years and we employ a highly-skilled team of tax professionals dedicated solely on fraud detection. We also continue to modernize our network of firewalls, network security appliances, intrusion detection and prevention programs and Internet access control procedures. We have installed a modernized data loss prevention system, established a highly-restrictive Internet and network activity monitoring system and invested in "up-to-the-minute" virus prevention software and spyware, e-mail and spam filtering, laptop encryption and security patches.

During Fiscal Year 2014, more Marylanders than ever chose to take advantage of our free online taxpayer services, with more than 233,000 taxpayers utilizing our free online service for individuals; as of last week, more than 152,000 have already done so for this current tax year. In addition, over 224,000 returns were filed using the companion service for businesses, and almost 125,000 taxpayers used our online BillPay system to settle over \$57 million in outstanding tax obligations.

In the interest of saving taxpayers' time along with precious state resources, we encourage Marylanders to utilize our online taxpayer services. However, we still help those taxpayers who need old-fashioned assistance through both our twelve branch offices and our call center, where employees answered almost 500,000 calls in calendar year 2014 alone.

Our ongoing efforts to reunite Maryland families with their hard-earned money remain highly successful. Our Unclaimed Property Division, for example, settled over 51,000 claims last fiscal year, returning more than \$62 million to taxpayers. Also, we captured more than \$7.5 million in delinquent child support payments from parents failing to fulfill their obligations and returned it to their spouses and children in need. On behalf of those families and my agency, I am deeply grateful to this committee for your leadership on this issue.

Our agency continues to reward those taxpayers who follow the law by aggressively pursuing those who do not. In the Comptroller's Office, tax fairness is not an abstract concept – it's a driving principle. By consistently implementing new, innovative and aggressive strategies, our Office has collected approximately \$4 billion in delinquent taxes over the last eight years. I must stress that these are not new taxes; rather, these are taxes lawfully owed to the State, but were until recently, virtually uncollectible.

Jumpstarted by the General Assembly's \$1 million investment, our first-in-the-nation vendor offset program continues to pay large dividends, allowing us to recover more than \$82 million from federal contractors with unsatisfied state liabilities. Our Data Warehouse has already enabled us to collect more than \$300 million in delinquent tax payments in just a few years. We also continue to ensure that large corporations are paying their fair share, recovering nearly \$900 million over the past several years by cracking down on Delaware Holding Companies and disallowing the so-called "Captive REIT" deduction.

In addition to our successful tax compliance efforts, our nationally-recognized Field Enforcement Division continues to diligently and proactively work across Maryland to battle illegal tobacco and alcohol sales, and ensure taxes are properly paid. Since I took office, our agents have made nearly 900 arrests for tobacco violations, confiscating more than 1.1 million packs of untaxed cigarettes with a market value of approximately \$5.7 million. The continued disparity between our cigarette prices and those in some of our neighboring states, as well as our proximity to multiple interstate corridors, make Maryland a prime target for smuggling activity. Mindful of the lost revenue to the State and the public health and safety implications illegal tobacco sales pose to our children in particular, I appreciate the continued support from the General Assembly regarding increased penalties for cigarette smuggling.

Through our efforts to combat the illegal sale and consumption of alcohol, we have confiscated nearly 2,700 gallons of distilled spirits, 75,000 containers of beer, and 1,600 gallons of wine in the past eight years, with a combined retail value of over \$387,000. We have also worked in collaboration with the General Assembly to modernize our alcoholic beverages laws and trade practice regulations in order to foster the growth and success of Maryland's burgeoning wine, distilling and brewing industries.

I am particularly proud of our successful efforts to expand consumer choice and implement commonsense advancements, which have resulted in Maryland's wine industry growing from 25 wineries when we began to 77 open for business today, including 12 opening in the last year alone.

My field enforcement officers have also conducted over 28,000 motor fuel inspections to ensure Maryland consumers are getting what they pay for at the pump, and that motor fuel taxes are being paid properly. Based upon the results of these inspections, I'm proud to say that the overwhelming majority of our service stations deal with their customers fairly and operate in accordance with the law.

Additionally, our partnership to clear outstanding warrants with the Anne Arundel County Sheriff's Office has produced remarkable results. Since beginning this collaborative venture, we have held over a thousand tax returns due to outstanding warrants, valued at almost \$760,000. This success led to the passage of legislation last year to establish similar programs in Washington County and Baltimore City, both of which have recently begun. We look forward to passage of legislation this session to expand the program to jurisdictions across the State, including Montgomery, Harford, Charles, and Carroll Counties, as well as the Eastern Shore. This relationship between my agency and county law enforcement is a shining example of how state and local governments can work together to improve public safety and the lives of our citizens.

Finally, none of these successes would be realized without the professionalism and dedication of our team in the Comptroller's Office, as well as our agency's longstanding partnership with this subcommittee. I am deeply appreciative for your support of our efforts to implement efficient and innovative programs, and I look forward to our continued cooperation in the years to come. With gratitude, I respectfully ask for your support of the Comptroller of Maryland's Fiscal Year 2016 budget request in order to continue the successful work we have undertaken together on behalf of Maryland's taxpayers.

**Fiscal Year 2016 !
Response to Issues and Recommended Actions !
of the Department of Legislative Services !**

Issues

The Comptroller's Office should comment on why it expects to find more individual and business tax delinquents in future years and the current measures it is taking to decrease the amount of delinquents.

The increase in delinquent individual and business tax accounts is attributed partly to the downturn in the economy, but mostly due to the development and implementation of our data warehouse and related discovery programs. The Comptroller's Office continues to develop discovery programs to identify non-filers and under-reporters. The use of our data warehouse technology, coupled with our continued participation in various federal matching programs and other efforts, will ensure that the agency continues to increase its base of delinquent accounts.

Despite the increased volume of delinquencies, the division has utilized its current allotment of resources to collect from an increasing number of these delinquent accounts, but due to cost containment issues, we are not reaching the full potential that we would if given additional resources. For the first time in many years, additional positions and funding has been provided in our FY 2016 budget to hire additional auditors, collectors and programmers to support our collection and enforcement efforts. By adding positions and new data warehouse programs, we do not have to rely as heavily on manually intensive collections tools such as wage garnishments and bank attachments, and can instead focus on the more cost-effective, automated collection tools such as federal and state offsets, professional and MVA license holds, and external collection agencies. These enforcement tools have assisted the office with our collections initiatives; however, without additional resources it is less likely to collect from taxpayers who are: self-employed, unemployed, no longer Maryland residents, or do not have the financial means to repay their debts. With a new tax collection system and additional funding to expand our contracts with third-party collections agencies, the Comptroller's Office would reduce its delinquencies and increase its collections at a much higher rate than projected.

The Comptroller's Office should comment on the expected number of new programs the Comptroller's Office will be able to identify over the lifetime of the data warehouse, how the data warehouse will be integrated into the ITS, corresponding estimated revenues and the expected long-term cost of developing these new programs.

The number of new programs that we can identify over the lifetime of the project is effectively unlimited. We have an existing list of programs that are of interest, and that list is ever-growing. As we become more knowledgeable about our data and our tools' capabilities, and as we involve more units in the data warehouse, we will continue to discover new opportunities for compliance programs and realize greater operational efficiencies.

With existing resources, we can implement two to three substantial projects annually, partially through the termination of less efficient, existing programs. Associated revenues will vary, but individual compliance programs will result in several million dollars to perhaps \$10 million or more annually. Programs targeted at finding operational efficiencies will result in staff time that can be redirected to revenue-generating activities. Some may be one-time programs, though most would be continuous.

Our current expectation is that the existing data warehouse will be fully integrated with the ITS. Many of the ITS providers also offer data warehousing solutions, however preliminary analysis indicates that the opportunity costs – financial and experiential – may lead us to prefer the current data warehouse solution. Full integration will provide new opportunities, particularly in fraud detection, as the operational system will have real time access to our data and analytics. Currently, most data from our current transactional system is delayed up to one week before it is in the data warehouse due to limitations of the existing ITS.

Ongoing maintenance of the data warehouse will cost about \$2.5 million annually. While we intend to continue to build some analytics programs in-house, we will require contractual assistance for complex analytics – with the promise of higher revenue generation – for the foreseeable future. Every program is different, but the direct costs for recent programs have ranged from \$250,000 to \$350,000. And costs associated with these programs are not limited to the data warehouse itself. We will require additional resources for all aspects of tax administration – responding to correspondence, collection activity, call center staff, hearing officers and more. The data warehouse provides substantial opportunities, but to realize its full value, additional resources are required.

Recommended Actions

1. *\$Reduce funding for 0.4 contractual positions* \$26,157

We concur with this recommendation.

2. *\$Reduce funding for 1 contractual position* \$22,937

We concur with this recommendation.

3. *\$Delete funding for the Integrated Tax System* \$1,090,308

We respectfully urge the rejection of this recommendation.

Saving \$2.5 million for this project in the fiscal year 2016 budget could lead to severe consequences and prohibitive long-term costs for the State of Maryland and its taxpayers. The current SMART tax processing system was installed in 1993; the associated CACS collections system is approaching three decades old. These COBOL mainframe-based systems, which processed and accounted for \$22.3 billion in fiscal year 2014, have grown and adapted over the years through substantial *ad hoc* development. The result is a tax processing system which is both extraordinarily complex and functionally archaic. In the coming years, it will cost more to maintain, scale, and add capacity to SMART than it would to implement a new system, largely because of the difficulty in hiring and retaining qualified professionals.

While our staff goes above and beyond to ensure SMART operates smoothly, every day that passes brings increasing risks of substantial system failures due to the antiquated technology and ever-diminishing pool of qualified professionals.

Unfortunately, should SMART become inoperable for an extended period, it is primarily our constituents who will feel the effects in three key respects:

- Refunds could not be issued;
- Accounts could not be adjusted to reflect recent activity, resulting in substantial complications when the system is brought up again;
- Bills could not be issued, which could cause taxpayers to fall further behind on their obligations.

Other ramifications of a substantial outage include a loss of revenue for the State. The Compliance Division collects about \$600 million of delinquent taxes annually – each business day of downtime would cost about \$2.5 million of revenue.

Accounting for revenues would not be possible during an extended outage, with the result that distributions of revenue to special funds and local governments could be affected. And while we would generally continue to receive and be credited for electronic payments, we would have no ability to reconcile payments to bank records. We do believe that these issues could be addressed after the fact, but only at increased cost and further complications for taxpayers and this office.

It generally takes 4 to 5 years to implement a state-of-the-art tax system. Even under the most optimistic scenario, SMART has to function at least five more years, and possibly seven. In addition, the State's investment in our data warehouse cannot be fully realized until we have upgraded SMART to today's technology. Therefore, we cannot implement the most effective, real-time fraud detection and other analytics programs in SMART and we also cannot provide taxpayers with the interactive tools they expect in this day and age without new technology.

Finally, we cannot take advantage of the most up-to-date security measures inherent in modern technology, putting at unnecessary risk the confidential information of Maryland taxpayers, including social security numbers and bank account information. Every year, this necessary project is delayed another year before these issues can be addressed. Given the advancing age and diminishing capabilities of our current system, as well as the lost opportunities associated with inaction and the extraordinary consequences of system failure, we would respectfully contend that time is truly of the essence.

In our Information Technology Project Request (ITPR), we identified the likely cost of a new system at \$110 million both as a conservative budgeting figure and based on prior generations of technology. Subsequent research since that time indicates that the cost of a fully modernized integrated tax system is likely to be in the \$50 million to \$70 million range, a substantial reduction. Although the ITPR identified several areas as high risk, we strongly disagree that the overall project rating is High Risk as characterized by DLS. All currently identified risks are deemed to be within the acceptable range given recognized mitigation strategies. In fact, delaying this critical project for any period of time is the greatest risk to the secure, efficient and effective functioning of Maryland's tax system. Successful implementations of commercial off-the-shelf solutions in many other states provide irrefutable evidence that the current generation of integrated tax systems can be implemented successfully.

4. *Contingent reduction that reduces funds for abandoned property notifications*

We concur with this recommendation.