



INTRODUCTION

Chairman Jordan, Ranking Member O'Brien, and members of the Senate Finance Subcommittee on General Government and Agency Review, my name is Joe Testa, Tax Commissioner for Ohio. Thank you for the opportunity to testify today on the budget recommendations for the Ohio Department of Taxation (ODT) for the Fiscal Year (FY) 2018-19 biennium.

DEPARTMENT OVERVIEW

ODT's purpose is embodied in its mission statement: to provide quality service to Ohio taxpayers by helping them comply with their tax responsibilities and by fairly applying the tax law. ODT strives to administer Ohio's tax system in the most customer-focused, impartial, efficient and professional manner possible.

ODT administers and enforces 27 different state and local taxes and fees including state and school district individual income taxes, state and local sales taxes, and various business and excise taxes. ODT also oversees the ad valorem appraisals in Ohio's 88 counties. Collections of taxes and fees administered by ODT generate approximately \$30 billion each year to support many functions of state and local government including education, health care, transportation, and law enforcement. ODT also provides support services for taxpayers who need assistance preparing Ohio returns or have tax-related issues. In FY2016, ODT processed 9.6 million electronic filings and payments, 1.5 million paper returns and 1.9 million checks. Over four million individual income tax refunds were issued and 221,000 suspected fraudulent refund requests were blocked, protecting \$175.8 million in taxpayer refunds. In total, 1.2 million taxpayers were assisted with their tax-related inquiries.

FY2018-19 BUDGET RECOMMENDATION

Budget Fund Groups

ODT's budget is composed of four fund groups: Fiduciary Funds, the Holding Account, the Dedicated Purpose Funds (DPF) and the General Revenue Fund (GRF).

Together, the Fiduciary Fund and the Holding Account groups are known as the Revenue Distribution funds. These are cash funds from which ODT makes distributions and payments as necessary. These funds are not budgeted for ODT's operations. The *Fiduciary Funds* group is the largest at over \$1.5 billion and is used to (1) issue refunds to taxpayers who have either overpaid or have a credit due; (2) provide reimbursements to counties and municipalities, and (3) distribute vendor's license payments to counties. The *Holding Account* group is the smallest and is a place to 'park' misdirected tax payments until missing information is available and monies can be forwarded. Appropriation requested for this group is \$25,500 per fiscal year.

Together, the DPF and GRF are known as the Tax Administration funds. Spending from these funds is monitored daily. These appropriations fund the divisions that administer taxes, process and distribute revenues, provide taxpayer assistance and conduct compliance activities, and the support divisions such as information technology, facilities management and human resources. The *DPF* appropriations are used to perform a specific function or to pay for the administration activities related to specific taxes. The *GRF* is used to pay for the administration activities related to taxes that are deposited in the GRF and to pay for taxpayer services and the tax policy and analysis functions. GRF is also used to pay for personal service contracts, equipment and maintenance, and other expenses that are not covered by DPF.

Budget Request

ODT's as-introduced all funds budget request for FY2018 is \$141.4 million, or \$67.9 million for GRF and \$73.5 million for DPF. The total request for FY2019 is \$145 million, or \$70.6 million for GRF and \$74.4 million for DPF. The difference in size of appropriations between FY2018 and FY 2019 assumed the passage of the municipal net profit tax proposal included in the introduced version of H.B. 49. ODT's budget request included \$3.0 million in FY2018 and \$6.6 million in FY2019 to expend the revenue collected from administrative fees to administer this new tax.

Following House passage, H.B. 49 reduces ODT’s all funds budget appropriation for FY2018 to \$133.8 million. The total budget appropriation for FY2019 is \$133.4 million. A portion of the reduction between the introduced and House-passed versions of H.B. 49 is attributable to the removal of the municipal net profits administration proposal, which reduced DPF funds by \$3.0 million and \$6.6 million in FY2018 and FY2019, respectively. The House also decreased DPF of \$1.7 million each year for Commercial Activity Tax (CAT) Administration and more than \$2.8 million each year for Local Tax Administration operating expenses line items. The GRF was cut \$500,000 in FY 2019.

(in millions)

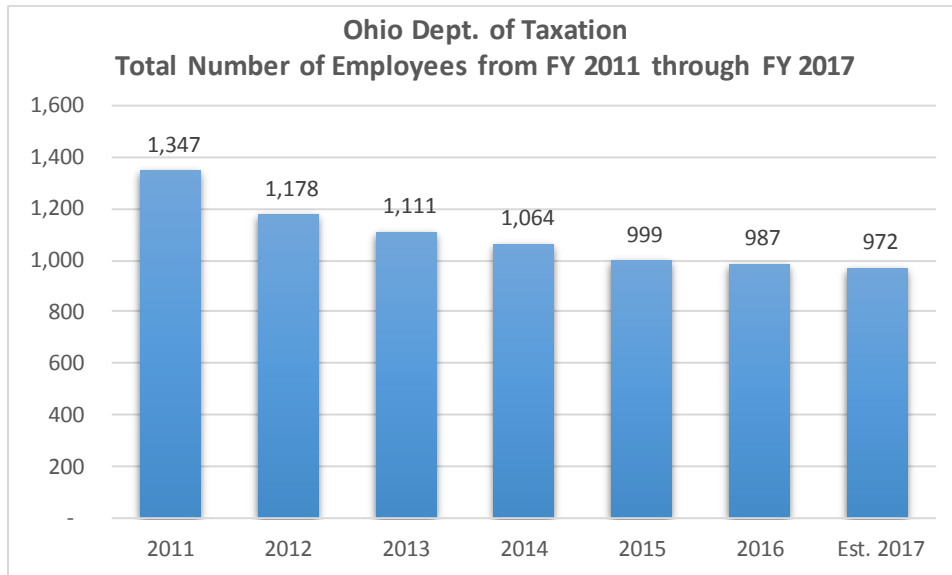
	FY 2016 Actual	FY 2017 Est. Appropriation	FY 2018 Request	FY 2019 Request	FY 2018 House	FY 2019 House
GRF	\$ 69.5	\$ 70.6	\$ 67.9	\$ 70.6	\$ 67.9	\$ 70.1
DPF	\$ 62.3	\$ 66.1	\$ 73.5	\$ 74.4	\$ 65.9	\$ 63.3
Total	\$ 131.8	\$ 136.7	\$ 141.4	\$ 145.0	\$ 133.8	\$ 133.4

Looking ahead, ODT plans to submit for Senate consideration a revised municipal net profit tax proposal which allows businesses to opt-in to centralized municipal net profit tax administration with ODT instead of mandating centralized administration. Included in this proposal will be an appropriation request of \$2.25 million and \$5.0 million for FY2018 and FY2019, respectively, to authorize spending the administrative fees collected for the tax. This is a reduced appropriation amount from the introduced version to account for potentially fewer businesses utilizing the ODT administration opt-in. Should the revised municipal net profits proposal not be adopted by the Senate, these appropriations would be removed as well.

Combining the revised municipal net profit appropriations request and the House-passed reductions, ODT’s appropriation request would be \$136.1 million for FY2018 and \$138.3 million in FY2019. This represents a 3.8 percent decrease in FY2018 and 4.5 percent decrease in FY2019 in all funds, as compared to the as-introduced request. Later in this testimony, I will expand upon the discussion of the municipal net profit tax amendment.

During this administration, ODT has focused on making better use of DPF, and thereby reducing reliance on GRF. ODT has recently contracted with an accounting firm to review budgeting practices, including allocation of expenses to more accurately attribute to the DPF both the direct and indirect costs related to the tax collection activities for the various non-GRF taxes.

ODT's GRF request for FY2018-19 is consistent with the actual expenditures forecast for FY2017. The attached graph in Appendix A shows actual Tax Administration expenditures since FY2011, FY2017 forecasted expenditures, and the FY2018-19 request which includes House-passed reductions and the revised municipal net profits proposal. A chart displaying the number of ODT employees between FY 2011 and FY 2017 can be found below.



Since FY2011, ODT's internal restructuring and productivity and efficiency increases have allowed for flat funding of the agency. These efficiency gains have allowed ODT to absorb contractual pay increases, increased employer-paid health care costs, increased costs for software upgrades and IT storage, and other internal expenses.

Operational Highlights

ODT anticipates continuing its investment in technology, creating additional efficiencies, reducing security risks, and improving service to taxpayers in FY 2018-2019. Current and future major projects are described below.

STARS Completion – ODT's STARS project is approaching a successful completion. After significant issues at the start of this project, Hewlett Packard Enterprises and ODT agreed to a project reset in July of 2012, including the adoption of the Agile development methodology that facilitated an accelerated

implementation schedule. ODT is now administering 22 taxes on the STARS platform with the 23rd and final tax to be added in June 2017.

Electronic Filing – Motor fuel taxpayers are no longer limited to paper returns, making it more convenient and easier to file and make payments. Detailed monthly schedules, sometimes containing 100 or more pages, were previously keyed into the motor fuel tax administration system. Now that motor fuel is in STARS, taxpayers can upload this same information via an electronic file. Pass-through entity tax is the final tax type being developed in STARS. Once it is implemented in June, those taxpayers also will be able to file and pay electronically instead of mailing in their returns and payments.

Fighting Tax Fraud – Since 2014, ODT has blocked the attempted theft of nearly \$565 million by cyber-criminals filing phony tax returns. Data analytics are now being used to identify suspected fraud perpetrated by an individual or a tax preparer. This new approach is expected to continue to reduce the number of legitimate taxpayers who need to verify their identity either through taking the quiz or mailing in supplemental information.

Identity Validation – ODT has participated in the Enterprise Identity Management program. This program is being offered by the Ohio Department of Administrative Services Office of Information Technology. The service requires the implementation of access and authorization protocols designed to assure that an authorized identified user (e.g., a taxpayer requesting a personal income tax refund) is in fact who they proclaim themselves to be. This program is under development and will be implemented in June 2017.

Audit Selection – Data analytics are also being used to objectively identify taxpayers who may not be compliant with their tax obligations. Examiners are now able to effectuate a more efficient use of their time.

OFAST Replacement – OFAST is a standalone program custom-written for the Audit Division in 2001. OFAST does not accommodate the newer taxes, such as the commercial activity tax. The replacement software package will handle additional taxes, interface with STARS, and be accessible by ODT's Tax Appeals Division. This project kicked off in January 2017 and will conclude in June 2018.

Travel Expense – ODT has cut travel expenses in half compared to just a few years ago by performing more audits remotely and finding other ways to save on travel.

OBG 3.0 – ODT partners with the Ohio Business Gateway (OBG) to provide businesses a portal to file and pay their business taxes electronically. OBG is currently modernizing to be more user-friendly and to simplify navigation, while routing the business information to the appropriate state agency. ODT will

play an important part in this modernization by providing technical and business expertise as needed during the design and testing phases of the project.

Security Enhancements – At ODT's request, Ohio Homeland Security (a division of the Ohio Department of Public Safety) performed a Threat and Vulnerability Risk Assessment of the Northland facility which is the hub of ODT's operations. Utilizing recommendations made in the report, ODT is enhancing the building's security by installing a new camera system, creating safe rooms, implementing a mass notification system, and making landscape/hardscape improvements. Additional measures are being considered, dependent on available funding.

Municipal Net Profit Tax Administration – In the Executive version of the budget bill, the concept of mandating that administration of the municipal net profit tax move from the municipalities to ODT was introduced. The House-passed version changed the focus from administration of the tax to instead focusing solely on providing the business with an option for centralized filing and payment. This does not solve the problem expressed to us by the business community, which is the time and cost of dealing with the individual municipalities on their billing notices, audits, appeals and other administrative functions. ODT listened to the concerns expressed by the municipalities during House testimony and is submitting its own amendment to improve upon our introduced version.

We heard a number of municipalities testify in House that some business prefer to continue to have their local municipality administer their net profits tax. We listened to these and other comments and are addressing these requested changes:

- Ohio businesses would be able to “**opt-in**” for tax administration to be performed by ODT. If a business wants to continue to deal directly with the municipalities, the business is free to do so.
- Businesses “**opting-in**” will file **one** return through the Ohio Business Gateway (OBG), rather than with **each** municipality in which the taxpayer does business.
- OBG will accept electronic upload of tax returns from commercial software.
- The Ohio Tax Commissioner will be the administrator of this tax for the municipalities in which the business files.
- Businesses choosing to opt-in commit for five years with an automatic renewal unless cancelled by the taxpayer.
- Tax collections will be distributed monthly to the appropriate municipality by ODT, with interest, minus a 1% administrative fee.

- Municipalities will have access to the same information from ODT as they would have received on a filing made with the municipality.
- Municipalities can request that ODT review a business filing.

The revised proposal significantly reduces compliance costs for businesses that opt-in, takes advantage of economies of scale leading to a more efficient and streamlined tax system, is less costly than third-party administrators and improves compliance by cross-checking with other data that can be accessed by ODT, thereby increasing revenue for the municipalities. Everyone wins with this proposal.

CONCLUSION

With that, Mr. Chairman, I conclude my remarks and I thank you for the opportunity to testify on ODT's budget recommendations for the upcoming biennium. ODT remains committed to achieving its mission of administering Ohio's tax laws while providing quality customer service to Ohio taxpayers. I would be glad to entertain any questions that you or members of the committee may have for me.

Appendix A: Tax Administration Expenditures

