

Is An Upward Adjustment to the IIT Debt Setoff
Collection Fee Justified Based Upon The Current
Costs Incurred By DOR?

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CPM Class of 2010 Project

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STATE DOCUMENTS

The mission of the South Carolina Department of Revenue is to administer the revenue and regulatory laws of this state in a manner deserving the highest degree of public confidence in our integrity, effectiveness, and fairness. To accomplish this mission, the South Carolina Department of Revenue will administer revenue and regulatory laws in a fair and impartial manner, collect the revenue due the state, recommend improvements to the laws administered, ensure a professionally trained staff of employees, continually improve the quality of services and products, and provide guidance to foster compliance with revenue and regulatory laws. I have chosen to research the Individual Income Tax Debt Setoff Collection fee that is currently retained by the South Carolina Department of Revenue in administering the Individual Income Tax Debt Setoff program and determine if an upward adjustment to this fee is justified based upon the current costs incurred by DOR. I believe that this type of research should be done periodically on the services that DOR provides to ensure that this agency is successfully fulfilling our mission.

The Individual Income Tax Debt Setoff Program administered by the South Carolina Department of Revenue was enacted with the passage of the 'Setoff Debt Collection Act' (Code Section 12-54-410; recodified as 12-56-10 in 1995) in 1988. Under this program, any state agency, board, committee, commission, public institution of higher learning, political subdivision, housing authorities and even the IRS (i.e. claimant agencies) can choose to submit a list of taxpayers (i.e. debtors) that have delinquent debts to the claimant agencies to the South Carolina Department of Revenue for collection. The program takes effect when debtors file their individual income tax returns and are due refunds. The debtor's refund is then submitted to the claimant agency

with whom the taxpayer owes the debt. Code Section 12-54-460(B) specifically states that the South Carolina Department of Revenue shall retain \$25.00 of each of these refund setoffs to defray its administrative expenses.

This \$25.00 refund setoff fee retained by the South Carolina Department of Revenue was the amount originally established in the 1988 Setoff Debt Collection Act. This continues to be the fee currently used today, some 21 years later. To my knowledge, no analysis has been done to determine if this \$25.00 administrative fee is still a sufficient amount of money for the Department of Revenue to retain for each refund setoff. Much has changed in state government over this period of time. This particular fee, along with fees for other services that the South Carolina Department of Revenue provides, is being counted on much more heavily today to cover operating expenses due to shortfalls in General Fund budget appropriations.

Data Collection

The age of the Individual Income Tax Debt Setoff program does make it somewhat difficult in gathering historical data. Some information, such as claimant agency participation and relevant collections, is included in the Department of Revenue's annual report and is readily available back to the program's inception. DOR's fee collection totals by tax year are not as easily accessible. Data purges from DOR's mainframe accounting system as well as changes in DOR accounting methods make getting 100% accurate information back to the program's inception virtually impossible. I was able to determine accurate DOR collection setoff fees back to the 1993 Tax Year which should be sufficient for the scope of this project. Outside collection agency (private enterprises) fees were found through internet research and were readily available

on the collection agencies' websites. An analysis of the Department of Revenue's yearly budget appropriation amounts was also done to recognize the agency's increasing reliance on "fees" to cover overall operating expenses. These totals were looked at for the past 14 years.

There has been a dramatic increase in participation in the Individual Income Tax Debt Setoff program in the last 21 years. During the program's first year only 13 other agencies participated compared to 104 participating agencies during the 2008 tax year. Total collections for all claimant agencies through the Individual Income Tax Debt Setoff program increased from \$8,466,657.36 to \$110,341,336.30 during the same time period. The table below illustrates this rapid incline from the 1989 tax year to the most recently completed tax year of 2008.

<u>Tax Year</u>	<u>Debt Setoff Fees Retained by DOR</u>	<u>Amounts Collected on behalf of all other Agencies (includes DOR collections)</u>	<u>% of Total Debt Setoff Collections Retained by DOR</u>
1993	\$2,326,500	\$23,012,251.13	9.18%
1994	\$2,843,250	\$29,849,108.57	8.70%
1995	\$3,734,325	\$42,159,322.94	8.14%
1996	\$3,912,950	\$43,909,261.14	8.18%
1997	\$4,415,550	\$47,404,279.00	8.52%
1998	\$4,156,575	\$42,942,983.00	8.83%
1999	\$4,339,300	\$46,306,793.94	8.57%
2000	\$4,601,325	\$49,553,522.63	8.50%
2001	\$5,019,475	\$58,660,015.33	7.88%
2002	\$4,900,775	\$59,303,494.43	7.63%
2003	\$5,018,975	\$63,444,526.87	7.33%
2004	\$5,237,325	\$69,569,228.00	7.00%
2005	\$5,215,425	\$72,452,467.00	6.72%
2006	\$5,701,400	\$83,016,743.00	6.43%
2007	\$6,561,275	\$102,856,899.85	6.00%
2008	\$6,687,150	\$110,341,336.30	5.71%

By comparison, the Debt Setoff Fees that were retained by DOR for this program only increased from \$2,326,500 in Tax Year 1993 to \$6,687,150. The far right column of the table gives the percentage of the total Debt Setoff Collections that are retained by DOR, a “collection cost” if you will. Notice that in the 2008 tax year the percentage of collections retained by DOR versus the total amount collected was a mere 5.71%. We will look more at this figure a little later and compare it with current collection rates that are charged by non-governmental collection agencies.

History

As mentioned earlier, the total number of agencies participating in the Debt Setoff Program has increased dramatically over the past 21 years, from 13 to 104 to be exact. The addition of new claimant agencies that participate in the program has resulted in a considerable increase in workload for DOR staff. Data is not available to measure the exact cost implication on the Department of Revenue due to the increased workload. However, there are some obvious increased work processes that are easy to notate. Prior to each tax year, claimant agencies submit data lists of the debtors’ social security numbers and debt amounts to the Department of Revenue. DOR’s Information Resource Management division is then responsible for loading all of the debtor information into the internal Individual Income Tax system. The claimant agencies also submit their contact information along with their information for receiving payments from the program. State Agencies that participate in the program receive their payment through Appropriation Transfer vouchers submitted through the Statewide Accounting system. All other non-state agencies that participate in the program receive their payments by check. Either way, all of the claimant agency information for receipt of payments must be loaded into

DOR's taxpayer accounting system and has to be maintained by DOR's Information Resource Management division. There are approximately 100 Individual Income Tax Refund processing runs during any calendar year. There is one disbursement voucher type for each participating claimant agency. So, if there are collections for each of the 104 claimant agencies during one of the Individual Income Tax Refund processing runs, then there will be 104 additional vouchers for the Accounting department to process. This also means that the accounting department would be responsible for distributing the information to the 104 claimant agencies that would receive collection amounts from that particular IIT refund run. This would be a copy of the appropriation transfer voucher/taxpayer listings to the state agencies and the refund check/taxpayer listings to the non-state agencies. These tasks represent a great amount of time spent in the Accounting department related to IIT Debt Setoff program even if technological advances over the past 21 years has negated some of the increase in workload. The Department's Debt Setoff Coordinator in the collections department also spends much more time dealing with any type of miscellaneous problems that are reported by the claimant agencies. As you can imagine, the more claimant agencies involved in the program increases the amount of issues that arise concerning the coordination of information sharing.

The table on page 3 illustrated the total "collection cost" of the entire Individual Income Tax Debt Setoff program that the Department of Revenue retains. That figure has dropped from 9.18% for the 1993 tax year to 5.71% for the 2008 tax year. For comparison's sake, I did some online research to see how much private collection agencies charge for debt collection services. The table below illustrates the rates that

four different private debt collection agencies charge. Each of the agencies that I looked at charge a percentage of the debt that is collected, rather than the flat amount (\$25.00) that the Department of Revenue charges as its Debt Setoff Collection Fee.

Collection Agency	Fees Charged For Collecting
Bullseye Collection Agency, Inc. www.bullseyecollectionagency.com	30% for new placements; 40% if the file had been previously placed with another agency; 50% if legal action against the debtor is initiated by Bullseye.
RPS Worldwide www.rpsworldwide.net	30% of the amount collected on accounts that are < 1 year old. 40% of the amount collected on accounts that are > 1 year old. 50% of the amount collected on accounts that require litigation.
National Debt Services, Inc www.ndscollections.com	\$100 fee on accounts from \$250 - \$500. 30% on accounts from \$500 - \$4999.99 25% on accounts from \$5000 to \$24999.99 20% on accounts from \$25k to \$49999.99 18% on accounts from \$50k to \$99999.99 15% on accounts greater than \$100,000.00
Roberto & Associates www.nationalcollectionnetwork.com	30% of the amount collected on accounts < 1 year old. 40% of the amount collected on accounts > 1 year old.

As the rates in the table illustrate, the flat \$25.00 fee that the Department of Revenue retains, regardless of the debt amount, is an absolute better deal than any of the private collection agencies' rates. For example, if the Department of Revenue, charged 30% of the amount collected, as 3 of the 4 agencies surveyed charge on accounts under 1 year of

age, its Debt Setoff Collection Fees for the 2008 tax year would have been \$33,102,400.89 rather than the actual amount of \$6,687,150.00!

Over the past 14 fiscal years the Department of Revenue's General Fund budget appropriation has essentially remained the same despite a continuous increase in workload and job functions. What this means is that the Department has become increasingly reliable on fees that the agency charges for services such as the IIT Debt Setoff Fee to cover normal operating expenses. The figures below illustrate the percentage of the Department of Revenue's total budget that is comprised of non-general fund dollars.

Fiscal Year	General Fund Appropriation (Budgeted)	Other Funding (Budgeted)	% of Total Budget comprised of Other Funding
FY97	\$36,144,873.00	\$3,686,492.00	9.26%
FY98	\$37,035,492.00	\$5,360,566.00	12.64%
FY99	\$37,125,488.00	\$5,360,566.00	12.62%
FY00	\$38,207,208.00	\$6,200,463.00	13.96%
FY01	\$38,828,959.00	\$6,490,910.00	14.20%
FY02	\$30,534,833.00	\$6,487,820.00	16.52%
FY03	\$32,114,598.00	\$8,538,165.00	19.56%
FY04	\$29,558,044.00	\$8,411,273.00	21.98%
FY05	\$38,558,044.00	\$8,636,000.00	18.30%
FY06	\$39,339,399.00	\$11,397,000.00	22.46%
FY07	\$40,708,682.00	\$11,897,000.00	22.62%
FY08	\$41,890,318.00	\$15,804,093.00	27.39%
FY09	\$33,387,648.00	\$16,279,093.00	28.47%
FY10	\$35,933,851.00	\$16,279,093.00	31.18%

Notice that the General Fund Appropriations for the Department of Revenue is actually lower for the current Fiscal Year 2010 than it was in Fiscal Year 1997. Other Funding Sources that DOR relies on increased by more than 5 times during that same time span. Over the last 14 years, total net tax revenue collections have increased from \$5.2 billion

in FY97 to \$7.6 billion in FY09. DOR is responsible for the collection and administering of many new tax types over this time period while the cost to do this has steadily increased. Tax laws have become increasingly complex to administer resulting in system changes and additions to employee workloads.

Fee Increase Figures

Now that we have taken a brief look at some of the historical figures and information regarding the Individual Income Tax Debt Setoff fee, I think that it is important to take a hypothetical look at increasing the fee. I decided to calculate the additional amount of money that DOR would have received had the Individual Income Tax Debt Setoff Fee been \$30.00 and if it would have been \$35.00. The last 10 years figures for this exercise are listed in the table below.

<u>Tax Year</u>	<u>Debt Setoff Fee Collections @ \$30.00</u>	<u>Total Possible Increase in Collections (\$30 vs. \$25)</u>	<u>Debt Setoff Fee Collections @ \$35.00</u>	<u>Total Possible Increase in Collections (\$35 vs. \$25)</u>
2008	\$8,024,580	\$1,337,430	\$9,362,010	\$2,674,860
2007	\$7,873,530	\$1,312,255	\$9,185,785	\$2,624,510
2006	\$6,841,680	\$1,140,280	\$7,981,960	\$2,280,560
2005	\$6,258,510	\$1,043,085	\$7,301,595	\$2,086,170
2004	\$6,284,790	\$1,047,465	\$7,332,255	\$2,094,930
2003	\$6,022,770	\$1,003,795	\$7,026,565	\$2,007,590
2002	\$5,880,930	\$980,155	\$6,861,085	\$1,960,310
2001	\$6,023,370	\$1,003,895	\$7,027,265	\$2,007,790
2000	\$5,521,590	\$920,265	\$6,441,855	\$1,840,530
1999	\$5,207,160	\$867,860	\$6,075,020	\$1,735,720
Totals	\$63,938,910	\$10,656,485	\$74,595,395	\$21,312,970

Suffice to say, an increased fee over the past 10 years would have had a tremendous fiscal impact on DOR's operating budget.

Final Analysis

There is no arguing that the Individual Income Tax Debt Setoff Program has been a great success over the past 21 years both for the South Carolina Department of Revenue and for the claimant agencies that participate. If the trends continue as expected, the number of participating claimant agencies will continue to increase as well as the amount of money collected through the program will continue to increase. The question now becomes, is an upward adjustment to the IIT Debt Setoff Collection Fee justified based upon the current costs incurred by DOR? While this seems like a simple question, a simple answer cannot be provided. I do believe that a minimal fee increase would give the Department of Revenue some much needed funds to use on vital areas such as process enhancements and developments. The Department of Revenue has been at the forefront in utilizing technology to improve its processes to better serve the taxpayers of South Carolina. Since such items as product enhancements are not inexpensive, an increase in the fee could be wisely used to maintain our Agency's existing innovative mindset. However, the Department of Revenue has to be cognizant of the impact that a fee increase would have on its two main stakeholders related to the program: claimant agencies and taxpayers. It is important to remember that a fee increase in the program would reduce the amount of money sent out to the claimant agencies. As the table on page 9 indicates, a fee increase to \$30 last year would have increased DOR's collection portion by over 1.3 Million Dollars. That means that over 1.3 Million Dollars less would have been distributed to the 104 participating claimant agencies. All of the claimant agencies are experiencing the same type of budget shortfalls that the Department of Revenue is experiencing and are relying on every dollar they receive to meet their own

needs. It also means that 1.3 Million Dollars more would have come from taxpayers to the Department of Revenue rather than the agencies to which they owed debts. While it is sometimes hard to empathize with taxpayers that have delinquent debts, we must recognize the fact that unemployment is at an all time high during this current economic recession.

Recommendation

A quick visit to the website www.usinflationcalculator.com tells us that \$25.00 in 1988 (the year that the IIT Debt Setoff Fee was established) would be the equivalent of \$45.00 in 2010. I suggest that the fee be increased to \$30.00 with a few stipulations. I believe that this minimal increase should not be proposed until the current economic climate drastically improves. On Jan. 21, 2010, a portion of a headline on www.wistv.com read, "Nix on fee hikes on SC Dems' agenda". It is popular for many politicians to simply take stands against these fee hikes by referring to them as "hidden taxes" without viewing the agencies' justification for doing so. The following is somewhat of an "implementation plan" to be utilized when the economy rebounds to get the IIT Debt Setoff Fee increased to \$30. I believe that more specific cost data on the IIT Debt Setoff Program will need to be obtained to justify this increase. Once this data is obtained, it will need to be presented to the Department of Revenue's Chief Financial Officer along with all other pertinent information contained in this paper. The Chief Financial Officer will then need to submit this proposal to our agency's Legislative Services section. It is our Legislative Services section's responsibility to utilize all of this information to gather support from state lawmakers to recommend a change in the current law increasing the IIT Debt Setoff Fee. Such a task will not be simple or easy. The

legislature should be reminded that the Department of Revenue currently collects over 90% of the General Fund monies for this state and history has indicated that this agency has the capability to increase collections when given budgetary, or in this case, fee increases. If the legislature agrees to put this proposal into effect, claimant agencies will be notified of the fee increase in their annual information packets that they receive each July.