



March 28, 2017

Senator Julie Rosen
Chair
3235 Minnesota Senate Building
95 University Avenue West
Saint Paul, Minnesota 55155-1206

Senator Richard Cohen
2301 Minnesota Senate Building
95 University Avenue West
Saint Paul, Minnesota 55155-1206

Representative Mary Kiffmeyer
Chair
3103 Minnesota Senate Building
95 University Avenue West
Saint Paul, Minnesota 55155-1206

Senator Jim Carlson
2207 Minnesota Senate Building
95 University Avenue West
Saint Paul, Minnesota 55155-1206

Dear Chairs and Senators:

As SF 605 moves from the Finance Committee to the floor, I write to express deep concerns about the funding in the bill, and its impact on taxpayers and Minnesota's overall fiscal health. This bill will provide the Department of Revenue with \$32 million *less* in funding than is needed to maintain our current level of services – an effective cut to current service funding of over 13 percent. This could mean a reduction of approximately 200 additional employees who deliver services to Minnesotans each day and a reduction of revenue of at least \$38 million over the biennium.

Funding Levels

Failing to fund the Governor's request for the department's operating adjustment alone would mean a loss of 121 employees who work each day to serve Minnesotans. The bill further reduces base funding by over \$11M for FY 2018-19, which will result in an estimated reduction of an additional 77 FTE per year.

The bill also ignores the Governor's proposed investment needed to address new demands, such as emerging patterns in fraud and the growing number of customer requests for guidance on complex tax questions.

As we described in the State Government Finance Committee, the department has already made significant reductions in our operational costs. Specific examples included a \$2.5 million per year reduction in the appropriation for FY14-15 biennium; and, we closed three offices and made other changes to realize cost reductions of \$2.5 million during FY16-17. These reductions

have allowed us to maintain critical staffing levels. Even so, our agency is down by 200 employees from just a few years ago.

Impact on Taxpayers

The practical impact of these combined reductions on Minnesota taxpayers includes:

- Significant delays in processing tax returns and refunds
- Difficulty for customers trying to reach someone by phone or email and longer wait times on the phone and in our lobby
- Greater risk of criminals using taxpayer identity information to steal their refunds
- Reduced security of taxpayer information and the consequent risk of a breach and other disruptions for taxpayers
- Reductions in timely guidance for taxpayers through fact sheets, industry guides, revenue notices, and other outreach and education
- Diminished capacity to provide the Legislature with revenue analysis and other information about their proposals
- Fewer skilled staff to find those furthest from compliance and bring them back into compliance – meaning the loss of a level playing field for all taxpayers
- Audits taking longer to complete
- Delays in taxpayer appeals and the resolution of disputes
- Reductions in service to local property tax assessors and oversight, which will increase inequities in local valuation assessments

We anticipate that these impacts would frustrate your constituents and our customers.

These reduced services will also mean that taxpayers across the state will not have a level playing field. If we lack capacity to educate taxpayers or use our enforcement tools with those furthest from compliance, other taxpayers who are following the law will face a disadvantage. A small retailer who collects and remits the right amount of sales tax should not have to compete with a business who collects tax but, instead of remitting to the state, keeps it to fund their operations.

Appropriation Structure Constrains Services and Responsiveness

We have significant concerns with the structure of the appropriations in the bill. For over 20 years, the department has received appropriations for each of its two programs— tax system management and debt collection. This structure has worked well for two decades and there is no reason to make this change now. The more-detailed appropriations structure in the bill will actually reduce our ability to respond in real time to quickly changing needs.

For example, when the fraud problem hit in 2015, we moved some of our most seasoned tax specialists from one activity to another to help mitigate the impact on taxpayers waiting for refunds – and it worked. And, as cybersecurity threats continue to grow, the department will lose the flexibility it needs to quickly refocus resources.

During Finance Committee consideration, a provision was added to require the department to prioritize the processing of individual income tax returns, taxpayer fraud, and ensuring refunds are not delayed. Because the department already puts significant focus on processing income tax refunds and fraud, this provision does nothing to advance that work. Instead, by prioritizing specific department activities in the appropriations bill – along with enacting significant base reductions – the bill only limits the department's ability to focus resources for the benefit to our customers.

Taxpayers will feel a deeper cut in phone and other services that help them voluntarily file and pay. Service levels in the areas of appeal processing, providing analyses for legislative proposals on tax law changes, and other core functions will take longer and inconvenience customers. Counties, cities, and townships will not receive needed guidance, education, or regulation on complicated property tax laws that fund their services to their residents.

Finally, it's important to note that appropriating at the budget activity level does nothing to improve transparency. Significant detail is available to the Legislature in the BPAS system and an even larger amount of information and detail is available at [TransparencyMN](https://www.transparencymn.gov/) website. Instead, this change to our appropriation structure is an unnecessary burden on how the agency serves customers, and it interferes with the operational efficiency of the agency.

Impact on Revenue

Additionally, as we shared with you in Committee, failure to fund our technology systems, outreach and education services, and audit and collection work, will have a negative impact on the state's revenue stream. The bill's base reductions, along with the requirement to prioritize certain activities, could result in an estimated reduction of revenue of at least \$38 million in general fund revenue.

This estimate assumes an approximate 3:1 ratio – three dollars of revenue loss for every one dollar reduction to our tax system management program. This is a conservative estimate, especially in light of our already reduced staff and the well-publicized reduction in federal audit capacity – on which we depend for a significant portion of our state adjustments. It is also conservative when compared to historical compliance initiative ratios, which were often higher than the ratio used in this estimate.

Cybersecurity

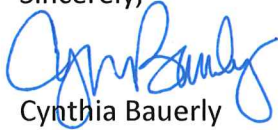
I also need to highlight the bill's failure to fund the Governor's request for MNIT services – particularly the request for cybersecurity. Approximately 120 MNIT employees work alongside department staff each day. Personnel cuts to MNIT will translate to reduced use of technology by agencies or additional costs to agencies through higher rates.

We cannot overstate the importance of securing the data across state government. For the Department of Revenue, that means securing the tax data of millions of Minnesotans, and financial information for over 400,000 businesses. This bill puts that security at risk.

Moving Forward

The department is eager to serve Minnesota taxpayers in the most efficient and effective way possible. To do that, we need your help in securing the appropriate level of financial resources. We welcome any opportunity to discuss how we can best do that on behalf of Minnesota.

Sincerely,

A handwritten signature in blue ink, appearing to read "Cynthia Bauerly", is written over the printed name.

Cynthia Bauerly
Commissioner