



Business and Income Taxes Division – Compliance and Collections Fiscal Year End 2012 Report

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Table of Contents

Introduction

Overview of Business and Income Taxes Division	3
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Compliance

Compliance Results	4
Audit Collection Comparison by Fiscal Year	5
Office and Field Audit Collections Breakout	6

Income and Withholding

Individual Income Tax	7
Pass-Through Entities.....	8

Business Tax and Valuation

Corporation License Tax	9
Miscellaneous Tax.....	10
Natural Resources Tax.....	11
Industrial and Centrally Assessed Property	12-13
Work Items Completed.....	14
GenTax Discovery.....	15
Statement of Account/Tax Appeals.....	16

Administrative Research Team

Summary of Responsibilities.....	17
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Introduction

The Business and Income Taxes Division (BITD) oversees audits and verifies compliance with Montana tax law for all state taxes administered by the Department of Revenue, and completes appraisals and assessments of industrial and centrally assessed property. The division also seeks to return unclaimed property (lost money and other properties) to its rightful owners.

The purpose of this report is to provide summary information on the main performance measures currently tracked by the BITD. The performance measures give a glimpse of the amount of work and accomplishments achieved by the division. To be successful in meeting our mission, all of the division resources must be focused on the common goals of ensuring compliance and administering tax laws fairly. The outstanding effort demonstrated by the division employees has allowed our division to produce impressive results and meet our fiscal goals.

BITD consists of two bureaus: Business Tax and Valuation (BTV) and Income and Withholding Taxes (IWT) with the support of one administrative unit.

Throughout the report several common performance measures are used. These common measures are defined as follows:

Audits: Audit activities determine the correct tax liability for individuals and business entities in accordance with the Montana Code Annotated, Title 15 (Taxation). These activities include both the detailed examination of tax returns and supporting documents, and the automated verification of return edits identified during return (batch) processing.

Work Items: A work item is a task that is tracked by Gentax and must be completed. Work items can be assigned to specific users, or put in a work item queue by the system. Users may search and work them accordingly. Work items can be manually created or automatically generated through Gentax for the majority of all tax types in the system.

Leads (Discovery): A lead is identified through scoring models and filter criteria in the Discovery manager. Leads can be created and assigned to certain auditors to review and make adjustments as necessary to Montana tax filings. From a lead, an auditor may send letters, make notes, adjust returns, or perform desk or field audits.

Appraisals: Appraisals are conducted periodically to ensure that market value is achieved in accordance with Montana Statute.

Compliance Results

**Summary of Compliance Activities
Fiscal Year End 2012
July 1, 2011 – June 30, 2012**

Compliance Activities	First Half	Second Half	Total
Individual Income Tax	\$ 15,960,810	\$ 14,579,150	\$30,539,960
Corporation License Tax	\$ 18,650,200	\$ 9,235,240	\$27,885,440
Natural Resource Tax	\$ 742,900	\$ 1,450,730	\$ 2,193,630
Miscellaneous Taxes	\$ 635,510	\$ 754,460	\$ 1,389,970
Pass-Through Business Taxes ²	\$ 301,730	\$ 180,140	\$ 481,870
Centrally Assessed/Industrial Property	\$ 0	\$ 552,130	\$ 552,130
Total Audit Collections	\$36,291,150¹	\$26,751,850¹	\$63,043,000¹

**Summary of Compliance Activities
Fiscal Year End 2011
July 1, 2010 – June 30, 2011**

Compliance Activities	First Half	Second Half	Total
Individual Income Tax	\$ 16,892,300	\$ 17,019,400	\$ 33,911,700
Corporation License Tax	\$ 7,269,200	\$ 20,165,820	\$ 27,435,020
Natural Resource Tax	\$ 793,800	\$ 2,492,750	\$ 3,286,550
Miscellaneous Taxes	\$ 1,056,040	\$ 793,630	\$ 1,849,670
Pass-Through Business Taxes ²	\$ 69,400	\$ 353,800	\$ 422,600
Centrally Assessed/Industrial Property	\$ 3,660	\$ 0	\$ 3,660
Total Audit Collections	\$26,084,400¹	\$40,824,800¹	\$66,909,200¹

¹ GenTax Discovery collections are included in the Audit Collection total.

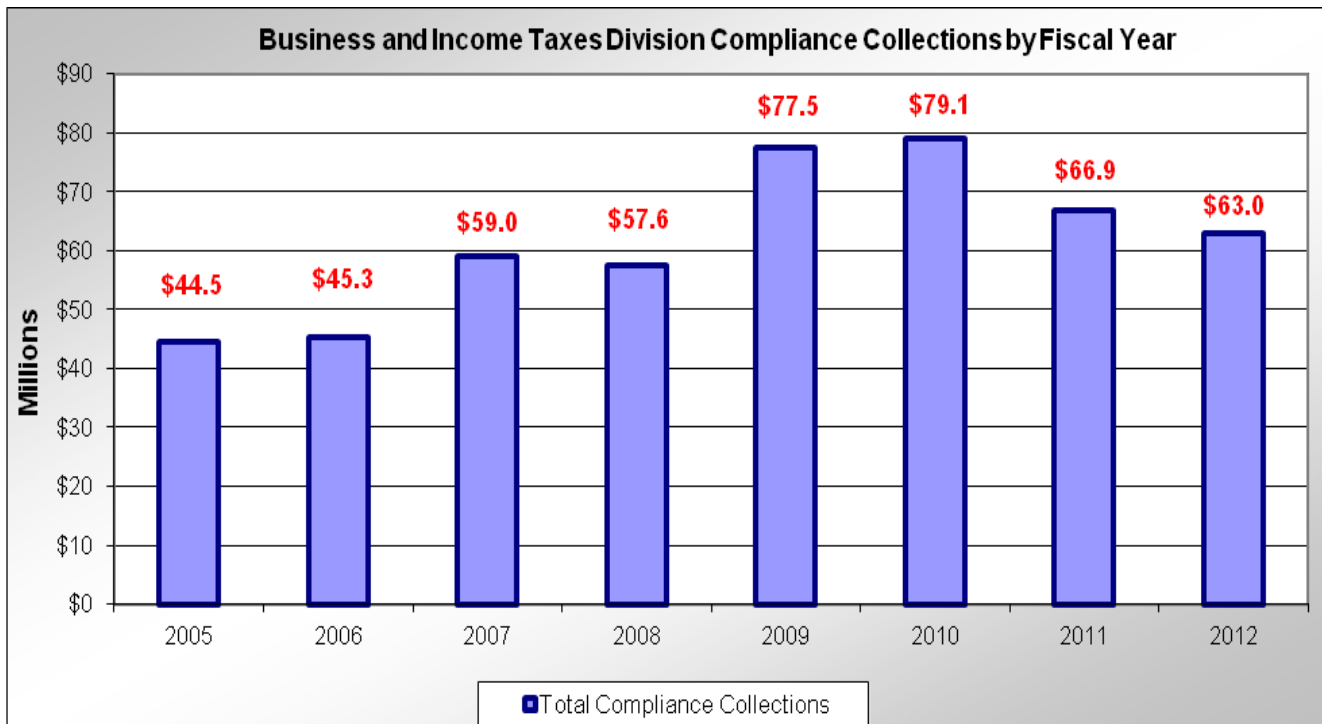
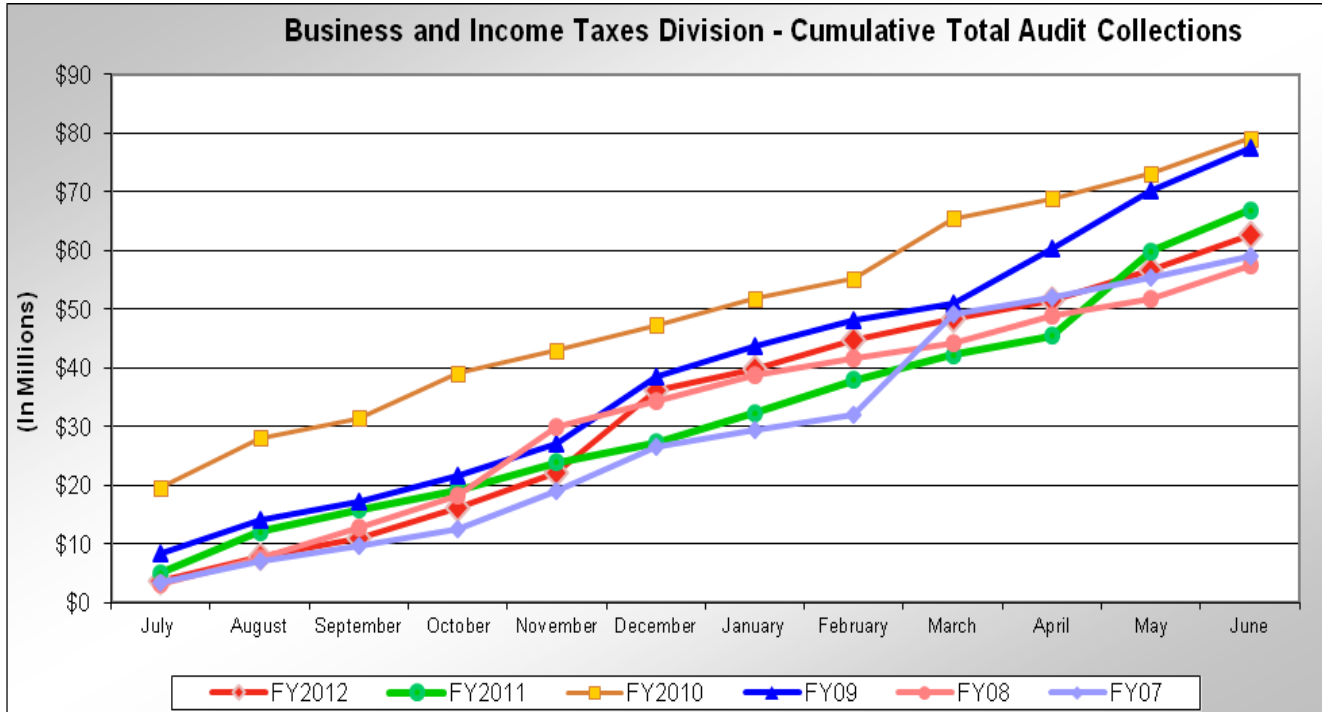
² All individual collections attributed to pass-through compliance activities are included in the Individual Income Tax total.

Further note: Activities associated with delinquent account receivables of taxes owed are also included in the Audit Collection total.

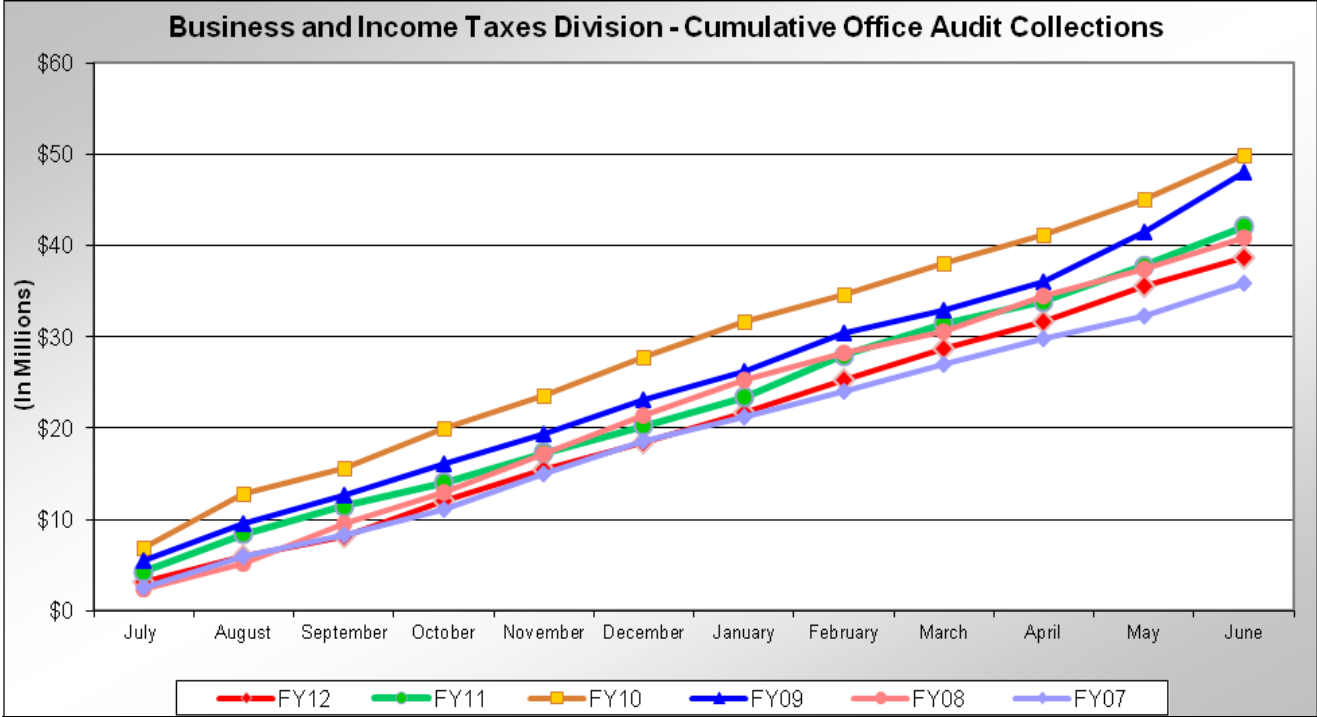
Audit Collection Comparison by Fiscal Year

The following line chart compares FY12 audit activities with those of the five prior fiscal years. Detailed information of audit collections by tax type for FY12 is shown in the following pages.

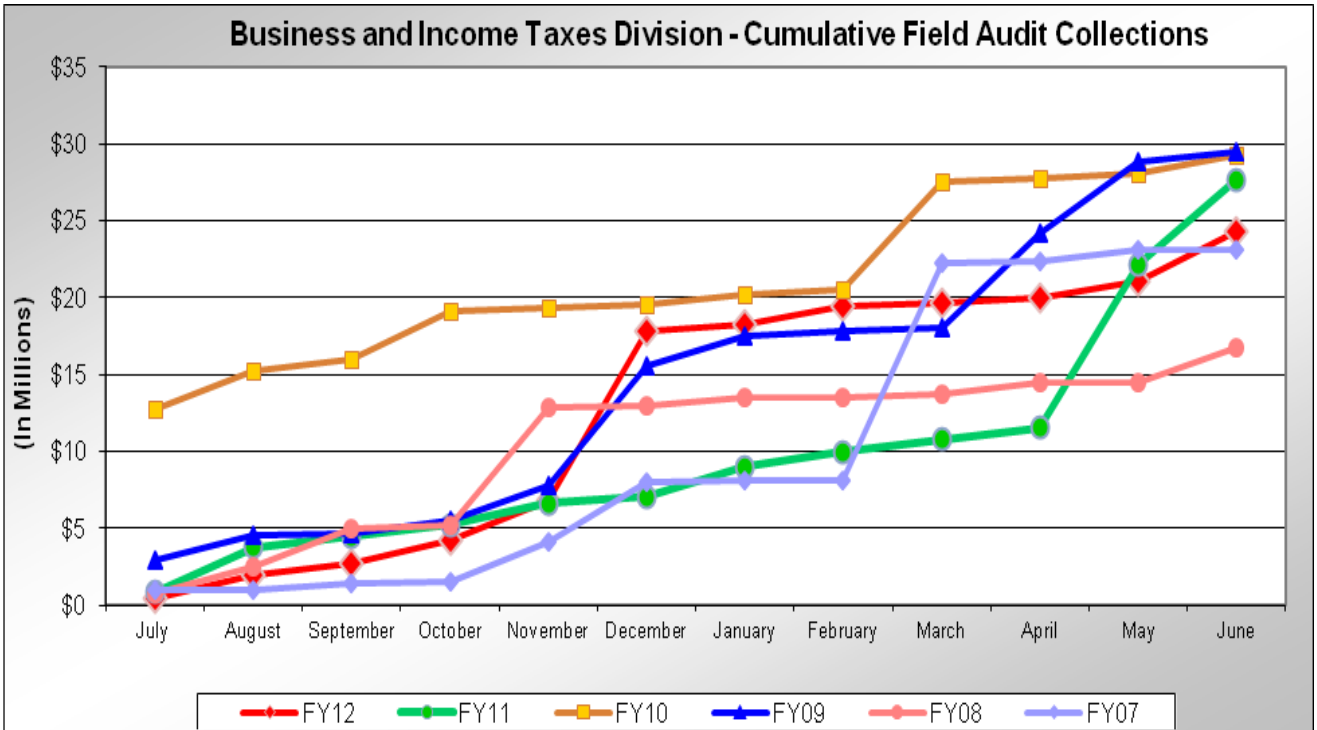
Total Audit Collections: \$63.0 million



Office Audit Collections: \$38.7 million



Field Audit Collections: \$24.3 million

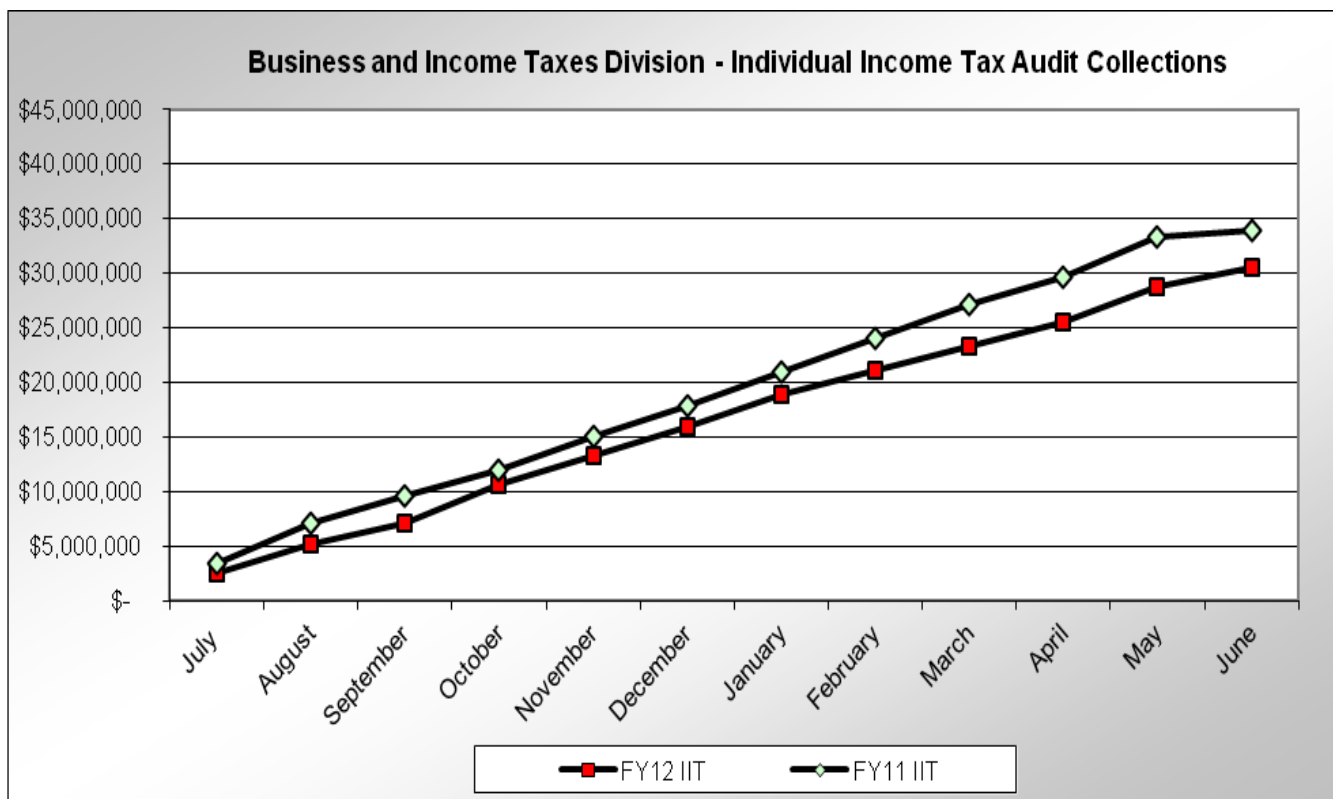


Individual Income and Withholding Taxes

In Montana, the individual income tax has a graduated rate structure with rates ranging from 1% to 6.9% of taxable income. This is a “progressive” tax because taxpayers with higher incomes pay a higher percentage of their income. Not only are residents of Montana required to file, but part-year residents and non-residents with income from Montana sources are required to file an individual income tax return.

Income tax revenues are collected primarily through employer withholding, periodic estimated tax payments, and payments made when the return is filed. In addition, audit collections are included in the overall income tax revenue and are collected through audit and bill payments.

Individual income tax audit collections for fiscal year 2012 totaled \$30.5 million.

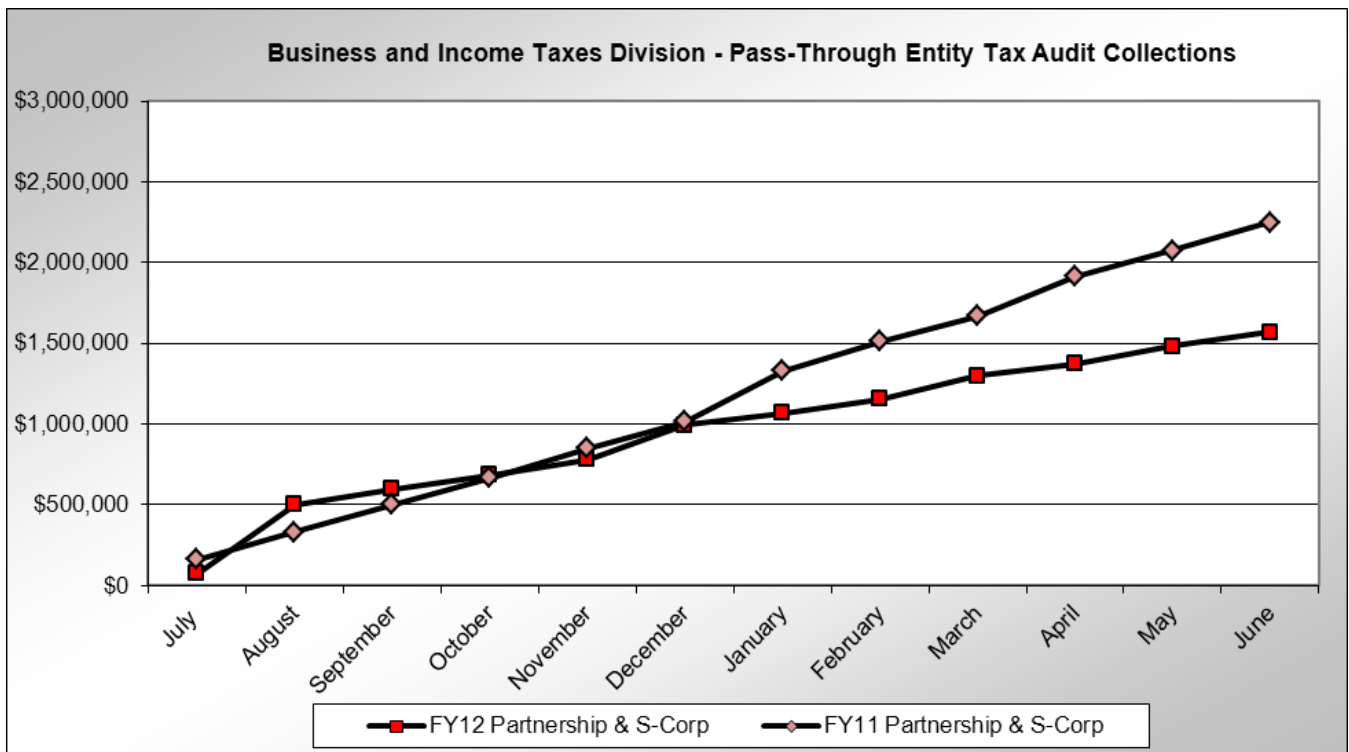


Pass-Through Entities

Increasingly, in Montana and nationwide, business and investment activities are being conducted by pass-through entities. The most common type of pass-through entity today is the limited liability company or LLC. Other types of pass-through entities are partnerships, S corporations, fiduciaries, and disregarded entities. Income and expenses are reported in the tax returns of the owners. These owners can be corporations, individuals, other pass-through entities, or a mix of all of them. Due to the complex nature of pass-through entities, they often represent a challenge for tax administration.

The pass-through audit program is a combination of office and field audits at both the business and individual level. In the chart below, individual and business tax collections are represented.

Pass-through entity tax audit collections for fiscal year 2012 totaled \$1.6 million.

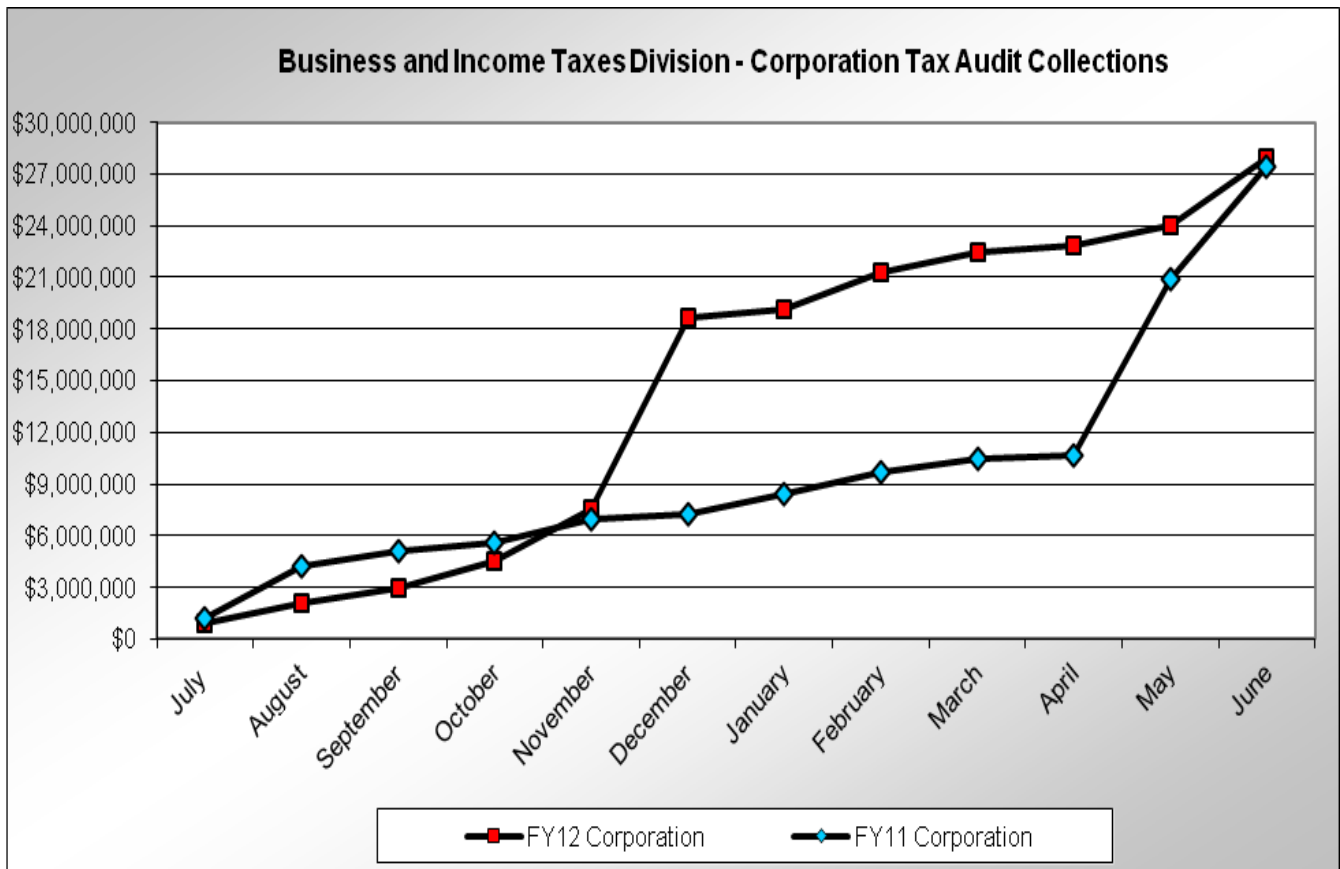


Note: Individual audit collections are counted in both the individual income tax audit collection chart and the pass-through entity tax audit collection chart.

Corporation License Taxes

Montana's corporation license tax is a franchise tax levied on corporations for "the privilege of carrying on business in this state." The tax is levied at the rate of 6.75% on net income earned in Montana. Corporations conducting business that is taxable both within and outside the state (multi-state corporations) are required to allocate income to Montana based on an equally-weighted, three-factor apportionment formula, where sales, property, and payroll are the three factors.

Corporation tax audit collections for fiscal year 2012 totaled \$27.9 million.



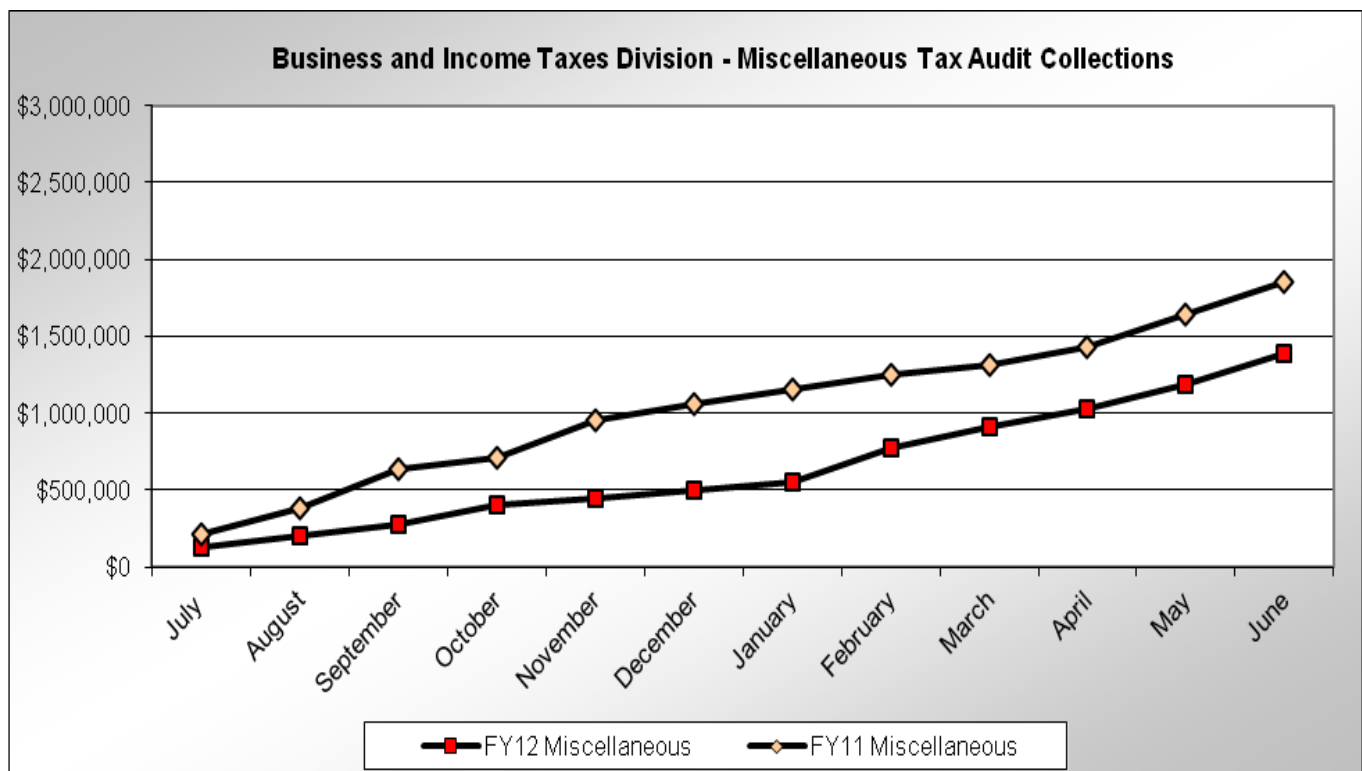
Miscellaneous Taxes

Various miscellaneous taxes are imposed in Montana including excise taxes, wholesale taxes on distributors, cigarette taxes from internet sales, and special assessments. The BITD tracks collections on over 15 different miscellaneous taxes.

Several miscellaneous taxes that make up a significant part of the division's audit collections are:

- Retail Telecommunications Excise Tax
- Electrical Energy Tax
- Wholesale Energy Transaction Tax
- Public Service Commission Tax
- Consumer Counsel Tax
- TDD Telecommunications Service Fee
- Statewide 911 Emergency Telephone System Fee
- Lodging Facilities Use Tax
- Rental Vehicle Tax
- Cigarette/Tobacco Products Tax
- Nursing Facilities Bed Tax
- Abandoned Property
- Contractor's Gross Receipts

Miscellaneous tax audit collections for fiscal year 2012 totaled \$1.4 million.



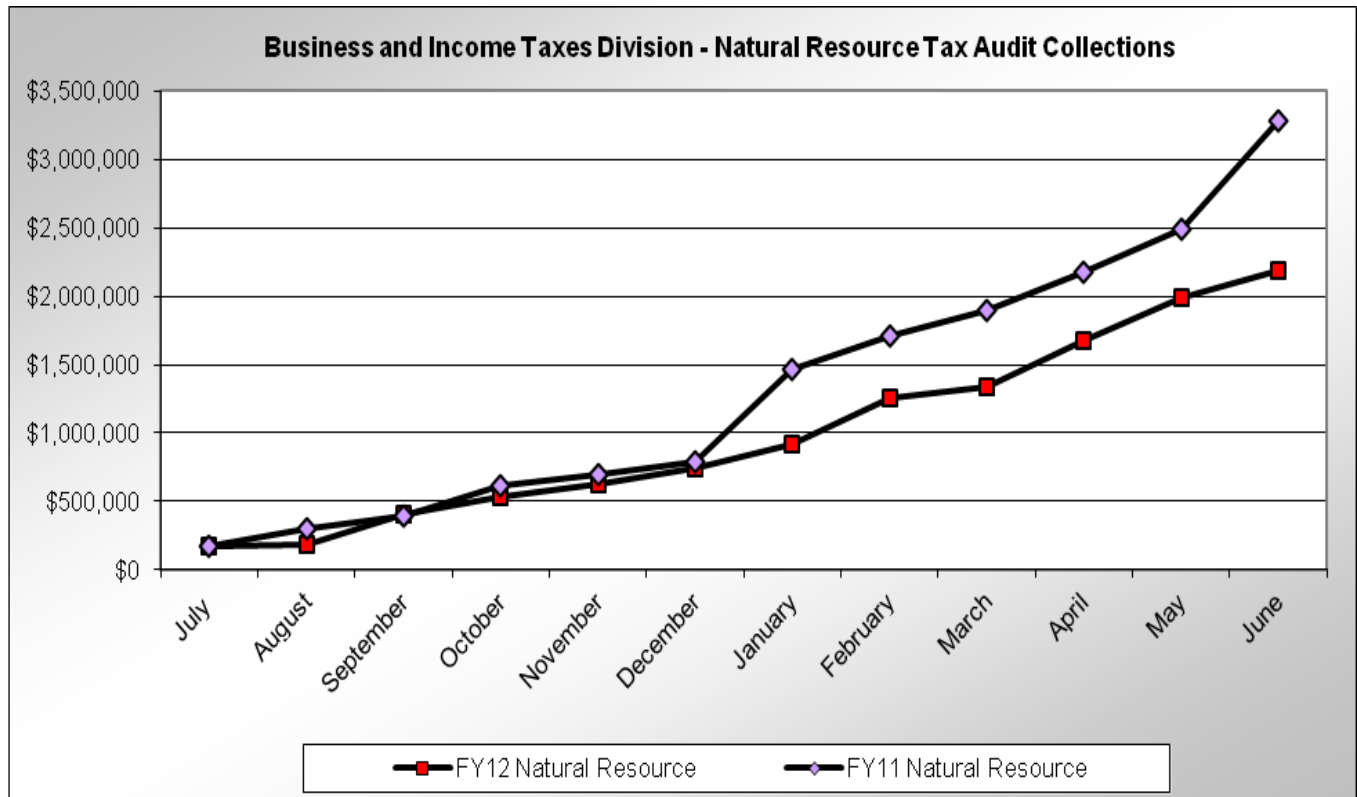
Natural Resource Taxes

Generally, natural resource taxes may be categorized as either severance/license taxes, or some form of ad valorem taxes. Each of the different natural resource taxes in Montana vary by certain characteristics including tax rates, filing requirements, disposition of the tax, and production tax incentives.

Natural resource tax collection is largely made up of the oil and natural gas production tax, however other sources of significant revenue are:

- Coal severance tax
- Coal gross proceeds tax
- Metalliferous mines license tax
- Metal mines gross proceeds tax
- Bentonite production tax
- Miscellaneous mines net proceeds tax
- Resource indemnity and groundwater assessment tax
- Cement and gypsum tax

Natural resource tax audit collections for fiscal year 2012 totaled \$2.2 million.

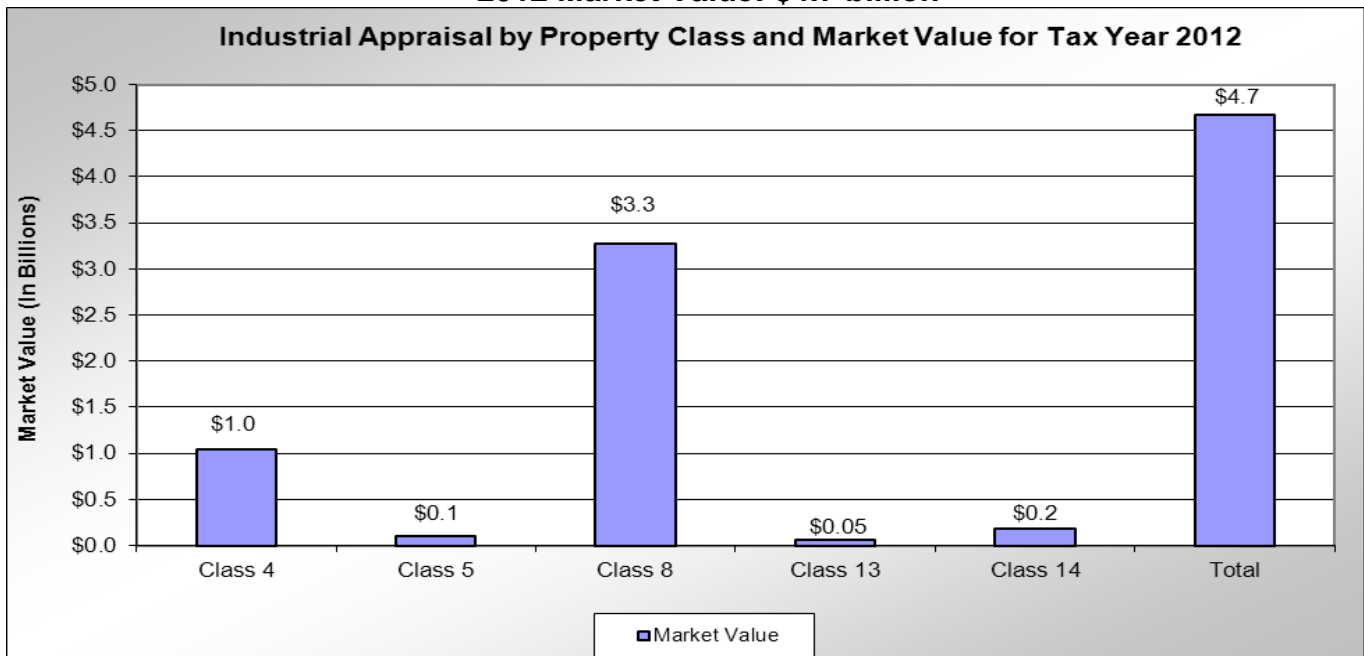


Industrial and Centrally Assessed Property

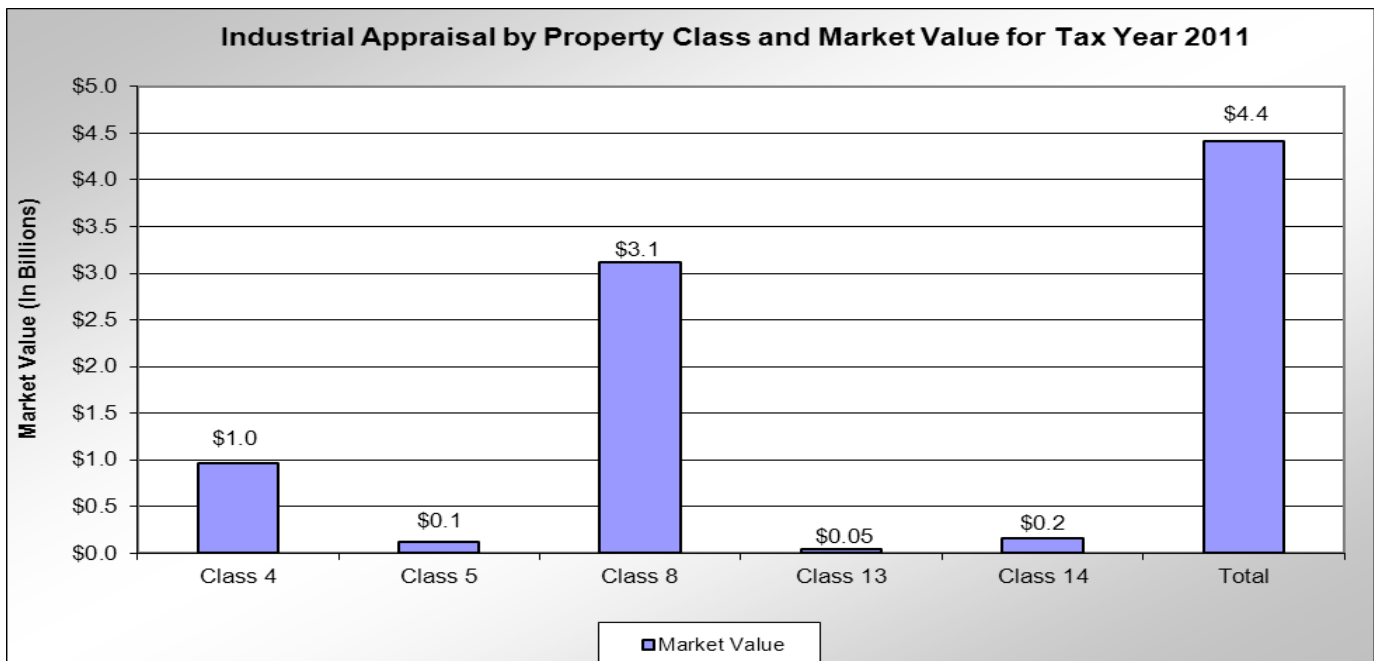
Industrial Property Appraisals:

- Responsible for the appraisal and assessment of approximately 1,900 parcels of taxable property located across the State of Montana;
- Includes large companies within the grain industry, mining, wood products, and oil refining, plus many smaller commercial manufacturing companies and companies that have established locations in more than one county in the state.

2012 Market Value: \$4.7 billion



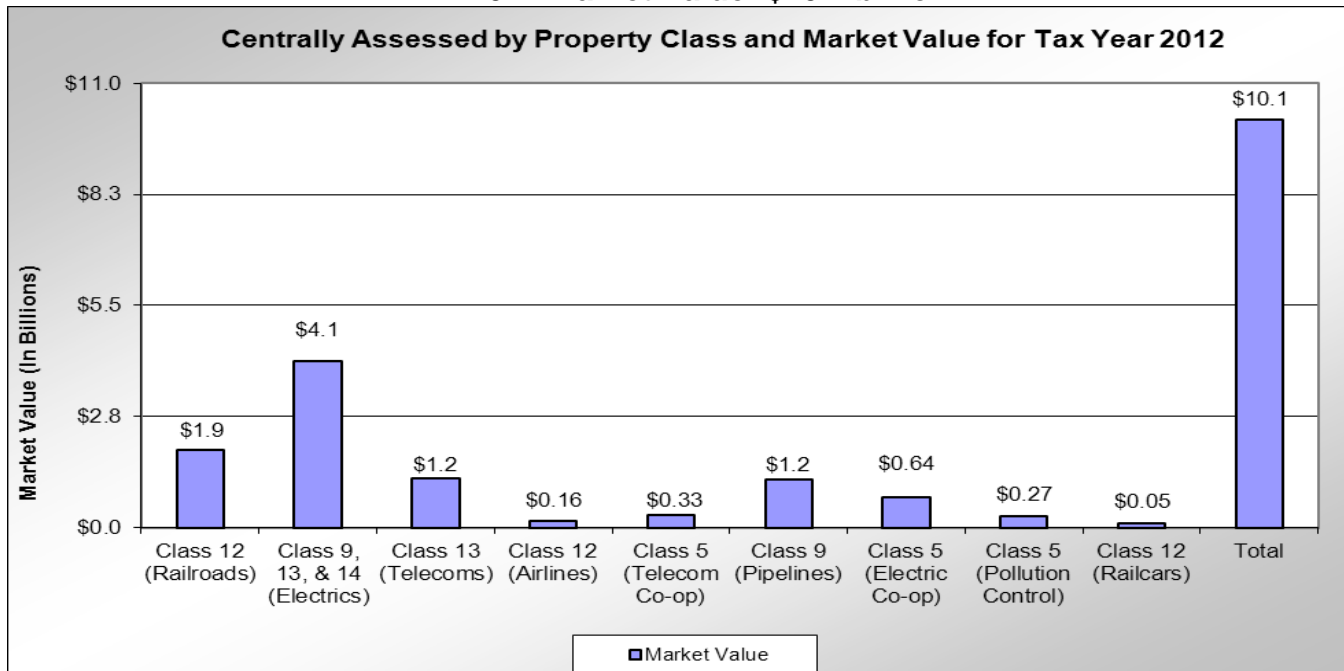
2011 Market Value: \$4.4 billion



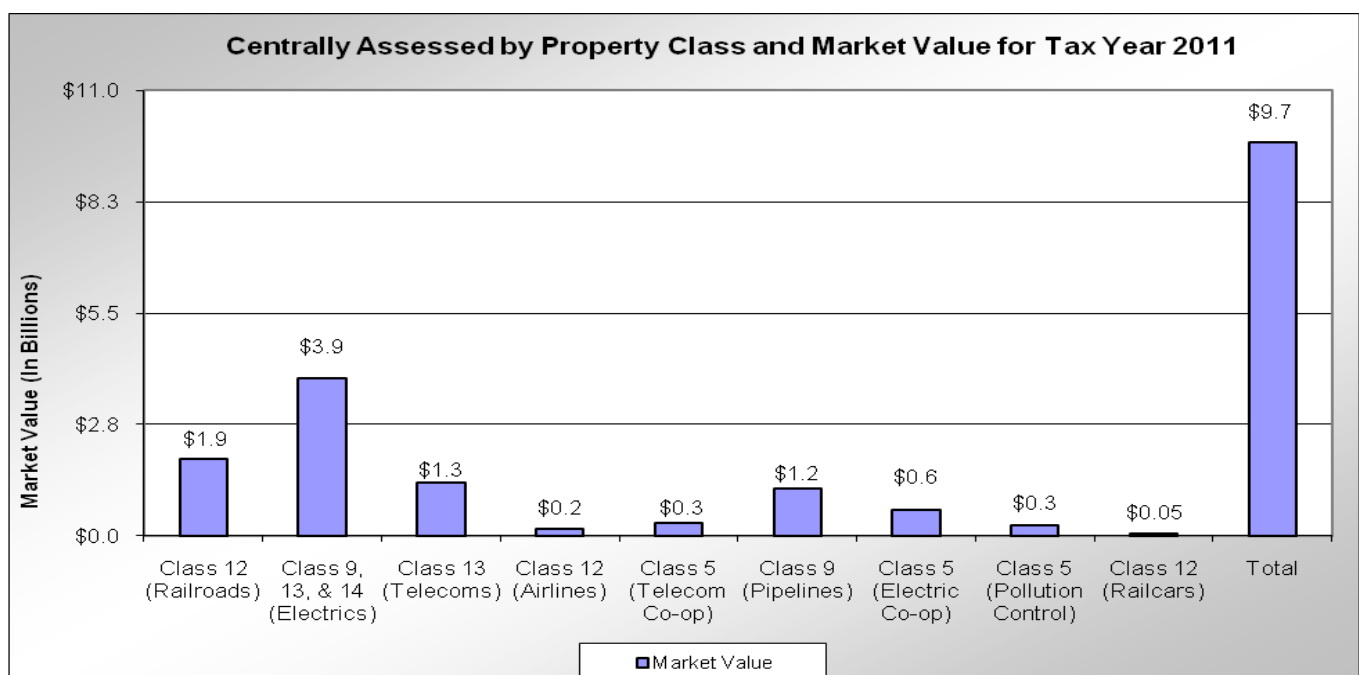
Utility Property Appraisals:

- Responsible for the appraisal and assessment of approximately 330 public utility type properties located across the state or the country.
- State of Montana has the responsibility to assess for ad valorem tax purposes certain properties or portions of properties of large corporations that operate across county and state lines.
- Includes properties of railroads, utilities, pipelines, airlines, water transportation companies, railroad car companies, electric cooperatives, communications companies, and other public service companies.

2012 Market Value: \$10.1 billion

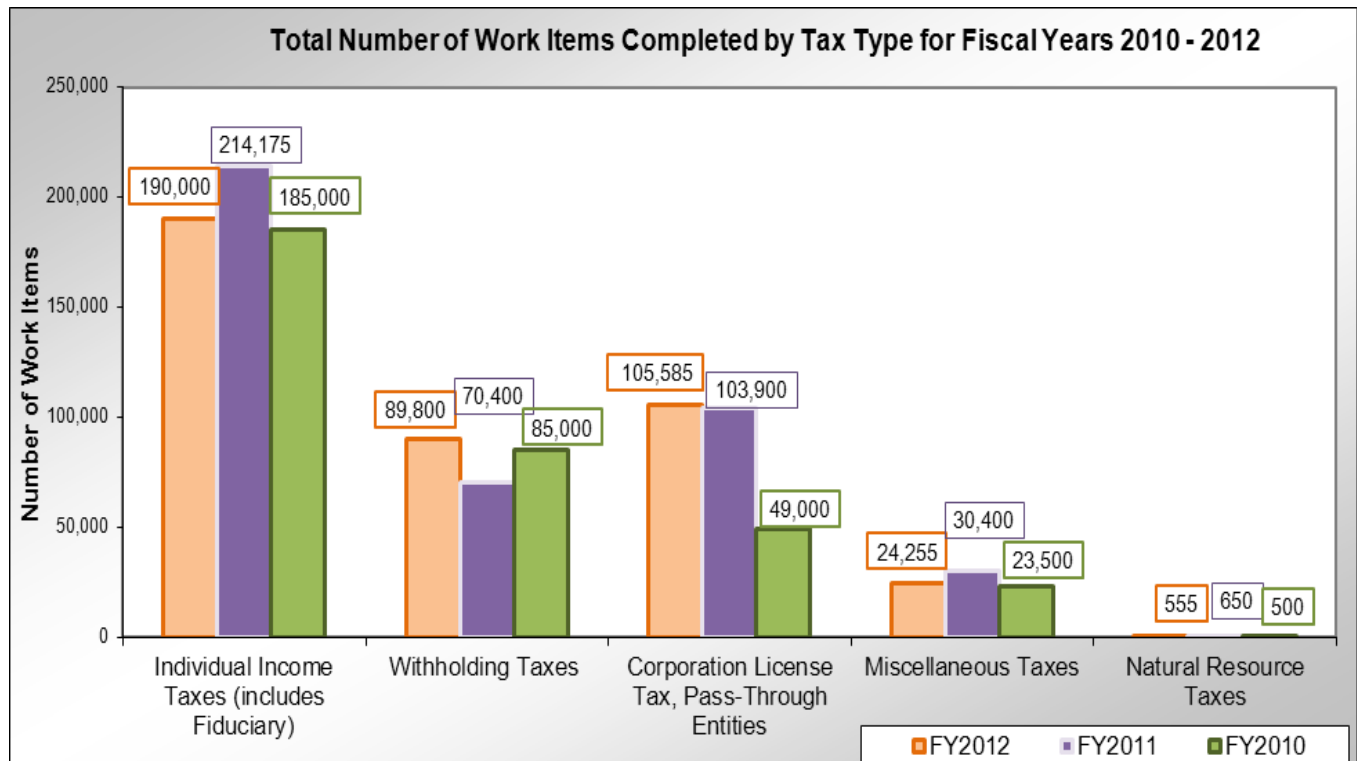


2011 Market Value: \$9.7 billion



Work Items-Tax Errors or Omissions Completed in FY12 Compared to FY10 and FY11

A work item is a task that is tracked by Gentax and must be completed. Work items can be assigned to specific users, or put in a work item queue by the system. Users may search and work them accordingly. Work items can be manually created or automatically generated through Gentax for the majority of all tax types in the system.

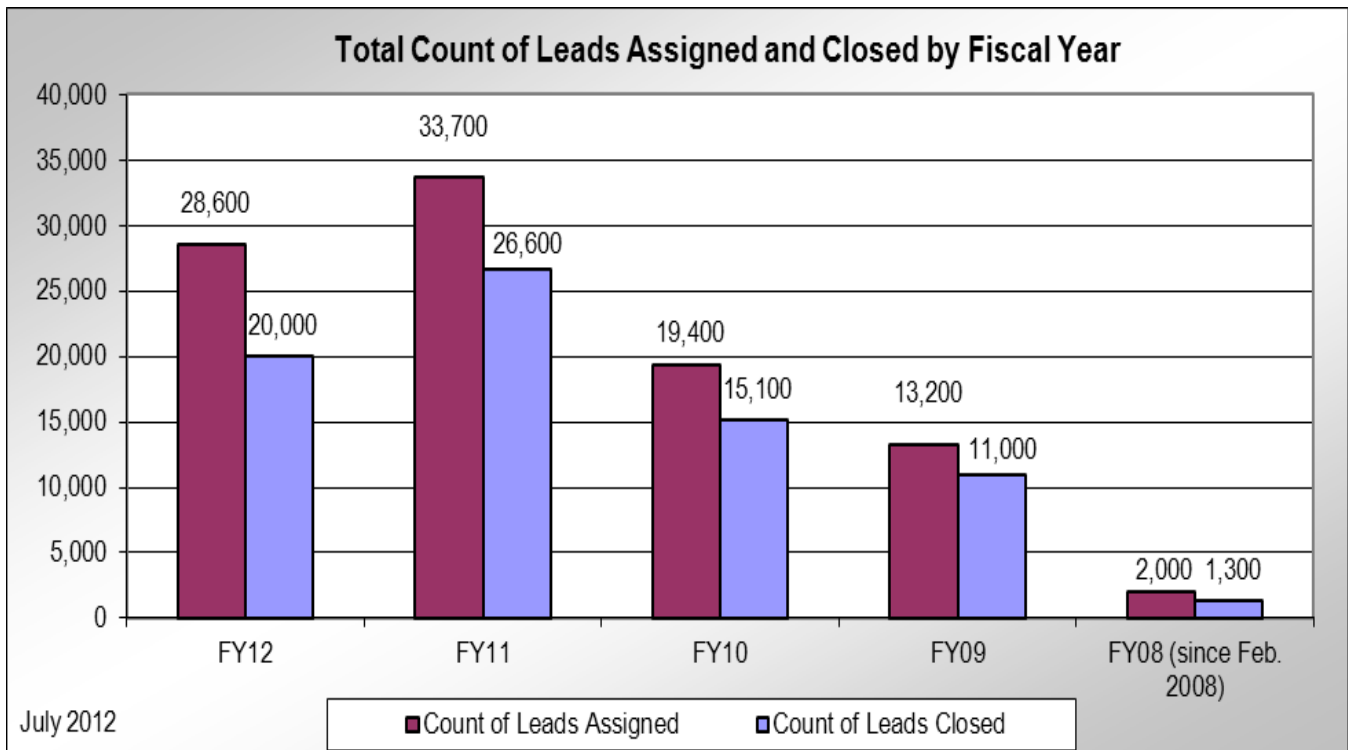


GenTax Discovery

Discovery is a Gentax product that is able to retrieve and cross match pertinent data for the purpose of “discovering” opportunities to improve tax compliance from non-registrants, non-filers, and under-reporters. Discovery uses data imported from external sources such as data files received from the Internal Revenue Service, other state agencies, and internal Gentax data that is all stored in a data warehouse in Gentax.

Since the development and implementation of Gentax Discovery, managing and working potential audit leads has become an integral part of the Business and Income Taxes Division’s daily operations. Through the use of Discovery, the division can better identify, analyze, and investigate multiple data files to effectively pursue more accurate assessments of tax liabilities. In conjunction with Discovery, the data warehouse has also proven to be a fundamental tool in effectively leveraging large volumes of data in one single location.

To date, over 150 discoveries have been completed or are in progress and several new discoveries are prepared and ready to begin. Since implementing Discovery in February 2008, approximately 96,900 leads have been assigned and 74,000 leads have been closed.



Statement of Account (SOA) and Tax Appeals

A Statement of Account (SOA) is a written explanation of the adjustments made by the department that results in an amount due. The SOA is sent to a taxpayer detailing the net liability, interest, penalties, and any payments that have been made.

An SOA is generated monthly and sent to taxpayers who have a debt on account types administered by the department or by another government agency contract. If the taxpayer disagrees with the SOA balance, they may submit an objection within 30 days of when the SOA was sent. An SOA objection indicator is created on the account and removed when the balance is resolved, a payment plan is created, or the account moves to the next level in the appeal process.

FY 2012 – Individual Income Tax

Out of the total SOA's mailed, only 1% have an SOA objection indicator created.

Within the fiscal year, 97% of all SOA objection indicators created are ceased.

FY 2012 – Corporation License Tax

Out of the total SOA's mailed, only 4% have an SOA objection indicator created.

Within the fiscal year, 94% of all SOA objection indicators created are ceased.

FY 2012 - Pass Through Entity

Out of the total SOA's mailed, only 4% have an SOA objection indicator created.

Within the fiscal year, 93% of all SOA objection indicators created are ceased.

FY 2012 - Lodging Facility Sales and Use Tax

Out of the total SOA's mailed, only 1% have an SOA objection indicator created.

Within the fiscal year, 91% of all SOA objection indicators created are ceased.

Administrative Research Team

The administrative team consists of 5 research technicians, 1 support lead, and 1 management officer.

The administrative team is responsible for a wide variety of duties that span across all three divisions. Several of these duties include:

- Tracking/documentation of the Statement of Accounts (SOA), suggested replies, correspondence and legal referrals
- Front desk responsibilities – greeting/assisting taxpayers
- Management of state vehicles – tracking mileage, assign/manage the appointments to reserve the vehicles
- Data entry/writs of execution
- Transcript Delivery System (TDS) Requests – pulling data from Federal data base, logging and providing info. to auditors
- Track/update potential fraud case spreadsheet
- Complete requested tax certificates for all business types
- Assist taxpayers with requests for W-2s from previous years
- Assist the processing division during income tax season researching refunds that were returned due to bad addresses
- General administrative activities.

