

**Written Testimony of  
Georgia Commissioner of Revenue  
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Before  
Subcommittee on Federal Financial Management, Government  
Information, and International Security  
Committee on Homeland Security and Governmental Affairs  
United States Senate  
On the Tax Gap and Tax Compliance  
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**Introduction**

Mr. Chairman and members of the subcommittee, thank you very much for allowing me the opportunity to discuss with you the initiatives we have begun in Georgia to collect in excess of \$1.6 billion in past due taxes and to insure that there is greater compliance with our laws annually. Even at the state level, tax evasion, fraud and aggressive practices have a substantial impact on state services and operations each year not to mention the perception and reality of an inequitable tax system on various taxpayers.

In order to best understand how Georgia resolved to address this issue it is important to have some background information. Governor Sonny Perdue's election in 2002 represented the first change in political party in 130 years. His commitment was, and continues to be, to bring professionalism and fairness to state government. One factor contributing to this was to appoint professionals with private sector experience who could share new practices and insight to the multitudes of intelligent, hard working legacy staff throughout state government. I was and continue to be one of the fortunate enough to be asked to serve. I truly believe that another very important aspect of our success to date is driven by my not having worked on the Governor's campaign.

My background prior to appointment includes twelve years of corporate banking and capital market services and seven years as a chief financial officer of a middle market business which included a small defense contractor, commercial bank and information technology firm. Each of the latter was being prepared for sell-off or raising private equity. After I joined the Governor's transition team, I served as Deputy Chief Financial Officer for the State of Georgia which gave me an initial six month opportunity to meet the legislative leadership. This too served me well when I was appointed Revenue Commissioner because we had established relationships such that I was believed to be a fair, reasonably intelligent and disciplined person.

**Identifying the Problem**

Upon my appointment in June of 2003 I began a review of the department much like I would have done with any business I financed or helped operate earlier in my career. This, I felt, was necessary for me to understand the operations of the department and the

culture. I also needed to better understand the culture and people many of whom have more than 20 years experience in public service. I found a wealth of very knowledgeable people working in a very decentralized platform of multiple divisions. Many had their own audit functions whose auditors had been working with the same taxpayers for years. This snapshot highlighted the applicability of applying some aspects of the Sarbanes-Oxley Act to a more robust system of dual accountability all the way to the commissioner's office and rotation of auditors. I also found the need to restructure the department to a functional-based platform from a tax-type platform to gain efficiencies. This allows for more cross training, retention of institutional knowledge and reduces the ability of taxpayers to "window shop" or keep asking the same question until they get the result they expect. Another way we attacked the ability of taxpayers to obtain overly aggressive tax planning was the formation of the Tax Law and Policy Division that reports to the Commissioner's Office.

Another task undertaken was to determine the quality of our assets – the known liabilities owed the State of Georgia. Upon inquiry no one could readily tell me what the known delinquencies were. After two weeks without an answer it was obvious there was a problem. After three weeks I was given a delinquency answer of \$1.6 billion and greater than one million accounts. This so impressed the executive branch that many believed I was merely talking about \$1.0 million or that the liabilities were not "real." Shortly after we began our initiative people became convinced.

I want to reiterate that even though Governor Perdue was managing through a significant deficit that he inherited from the prior administration there was never and continues to not be a goal to see how much money we can collect. The goal is to collect the correct amount of money from the correct obligated taxpayers. To treat everyone fairly and equitably while simultaneously insuring everyday that we do not get overzealous in our enforcement or even a perception of overzealousness is also critical. However, in order to succeed in this one must often be fairly aggressive.

## **A Cultural Shift**

In June of 2003 many people, including career revenue employees, were pushing to rebuild the department's technology platform which goes on today. However, their approach was to seek up to \$200 million and engage in a 3-4 year implementation exercise. This, to me, seemed rather illogical given the state budget deficit and priority needs. People tend to want results and relief as timely as possible. There is always time to continue to improve the new developments as long as you build with flexibility and with market based products and services rather than using legacy development.

There was also a previously unsuccessful strategy of "Help us get \$5.0 million in increased appropriations and we'll collect \$50.0 million in delinquencies". My perception has always been to show results with what you have and then ask for support. In this example my plan was to conservatively respond with "We're going to collect over \$100 million with what we have and then ask for more assistance." I saw the significant past dues as an opportunity such that legislators facing a large deficit could not fail to

respond with support for our efforts with delinquencies exceeding \$1.6 billion when they were also faced with cuts in healthcare and education.

Critical to our success in compliance is that no individual or organization would get preferential treatment over another one. Everyone is expected to get one opportunity to do the right thing after which our efforts escalate quickly. The equitable treatment applies to revenue employees who have tax checks done annually. Non-compliance regularly leads to terminations. We have also begun cross referencing W-2's for other state employees and found the need to apply fairness to non-compliant judges and legislators, as well as, other state administrators. This sends a strong message to the public which is in great support of our efforts. It is not us versus them. It is equivalent to getting dressed down by a college coach. It generally is quite humorous until the agenda turns to you.

The reorganization of the department also demonstrated that we were willing to squeeze out all non-essential functions which were differentiated by those things that were nice to have from things we had to have. This entire process was accomplished by using our own experience which not only saved the state consulting fees but also insured institutional buy-in from those who remain with the department today.

Repeatedly, I heard from managers and direct reports that "we don't have enough time, money or people to do our job". In some instances I began to understand why. We would discuss case resolution or habitual violators four to six times in the same tax year with no change in behavior because the financial gain to the taxpayer or tax professional was worth more than the repercussions. It was obvious that people couldn't get their work done because we gave our best customer service to our worst delinquents. That is, we spent the most time with our worst delinquents forcing resolution of their matters instead of focusing our attention on those taxpayers who are trying their best to fairly comply with their obligations.

My desire was to "execute ways to make taxpayers be accountable for themselves" or if not identify strategies that would engage one taxpayer against another or one industry level against the other to generate compliance. This was not intended to spur conflict but to, as I learned in capital markets, have everyone put skin in the game. For instance, if a liquor distributor knows he might have a business interruption for delivering to an unlicensed customer he will not likely engage in the activity. My desire was not to discourage consumption but to drive it across the street if need be to get compliance.

Further contributing to the delinquency was that without the previously mentioned system of dual accountability any tax examiner could place an account on hold without manager approval and without an adequate process in existence to resolve the cases in a timely manner. This too is a practice that is now managed.

It was, as I believe you have heard from Commissioner Everson, that the penalties, fines, and prosecutions simply were not strong enough to deter non-compliance. Also, relevant to Georgia's ability to get the job done is the economic and population growth that has continued to accelerate throughout my twenty year career. While Georgia's population

and registered business have at least doubled, in the last five years state funding and employees have declined well into the double digits. Further exacerbating the problem in Georgia is that no one could tell me when in the last 15 years anyone had been criminally prosecuted for tax evasion. I resolved with the attorney general that we would begin making our own cases with evidence and presenting the worst of the worst to the office of the attorney general for prosecution. This co-chairing would create the dual accountability for follow-up that is critical in all goals.

The culminating strategy had to be for the department to efficiently and timely execute a better way to go to market or, said in different way, find another way to do business. In any business, in any culture or any political ideology, if you put pressure on someone's money source, there is virtually nothing they will not do to cooperate. Our challenge has been to reduce the practice of chasing one taxpayer at a time consecutively but to motivate taxpayers to operate compliantly not only on their own tax returns and payments but at all levels of their business activity. As for the aggressiveness of tax professionals, we always make it a practice to learn who is representing who in which cases because in very short order we will see the same professionals seeking assistance for other clients. Our cooperation in each case is often influenced by the straightforwardness we obtain from taxpayers and their tax professionals.

I mentioned earlier the priority of not getting overzealous. This is particularly applicable to me as commissioner. Georgia is a very pro-business state proven recently by our corporate income tax reform of the 2005 legislative session. It is imperative that the department foster this climate. Additionally, I previously spent my entire career raising capital for companies. I have a one time opportunity for public service that I have resolved to do professionally and equitably. Anything less would earn a partisan reputation which would prohibit me from being able to associate with the kind of people I want to associate with the rest of my career, not to mention that I have a wife and young daughter and son which will require me working for many years to come.

### **Implementation of the Plan**

Once we established the verifiable magnitude of the non-compliance problem two senior managers – Ed Many, Deputy Commissioner for Tax Administration and Bobby Lenihan, Deputy Commissioner – joined me in identifying what became a four phased collection initiative. The driving forces were to obtain results as timely as possible by transitioning the way we went about our business while enhancing customer service without infringing on anyone's due process.

Phase I centered on individual taxpayers whereby we reduced the length of time we would work with someone from 480 days to 165 days before we turned their tax lien case over to a private collection agency. This was accomplished with existing staff and existing funding. Also contributing greatly to this success was our extended participation in the Treasury Offset Program (TOPS) with the IRS.

Phase II focuses on trust taxes such as withholding and sales & use taxes. Common practices of account aging, likelihood of payment and large dollar obligations were prioritized. Again, we have shifted the collection cycle from 480 days to 245 days. Sales & Use tax in Georgia along with withholding tax abuse is significant to the point that I believe that as much as 10-12% is illegally used or uncollected annually. This extends from the level of small entrepreneurs to Fortune 1000 companies. My own father, Stewart M. Graham, who is not a tax professional, identified to me two Fortune 1000 companies with nexus in Georgia that were illegally avoiding the collection of sales tax while using mail order marketing. Upon investigation, both settlements resulted in the taxpayer remitting to the state in excess of \$600,000 with agreements to comply without exception in the future.

Phase III focuses on accelerating delinquent income tax investigations, creation of an internal call center to work delinquencies, hiring of 15, first time ever, out of state auditors focused on corporate income taxes and trust taxes, and the formation of a special investigation and litigation group which focuses solely on fraudulent refund schemes of multiple returns and ineligible dependents. Other fraudulent practices are also the focus of this group. It is led by a former assistant district attorney. In the first tax season of their existence in 2005, fraudulent refunds in excess of \$1.2 million were stopped. We also established a fraud hot line for people to report abuses that might warrant further inquiry. All contacts are recorded and follow-on updates are shared between divisions to build teamwork and a sense of accomplishment within the department.

Phase IV which is only in its infancy focuses on aggressive treatment of incentives and deductions. This is somewhat outside the scope of my understanding of what the federal tax gap is defined to be.

### **Results to Date**

Total collections under these initiatives which are verifiable and outside the scope of business practices used previously total \$172.5 million from November 2003 through September 2005.

The components of these efforts include but are not limited to:

Private Collection Agencies	- \$40.1 million
Compliance Call Center	- \$17.5 million
Alcohol License Hold	- \$23.2 million
Internet Listing of Delinquents	- \$18.6 million
Individual Income Tax	- \$ 5.2 million
Tax Incentive Examination	- \$ 3.2 million
Treasury (IRS) Offset Program	- \$64.7 million

A number of the strategies employed during this initiative have included:

1. The cessation of renewing alcohol licenses to those with outstanding tax obligations. Out of 20,000 license holders in 2003, over 2,100 had outstanding obligations at the renewal date. Rather than taking 10 months to track each down and possibly get partial payment we withheld the alcohol license resulting in over 1,900 of them bringing over \$11.5 million to the department within a twelve week window of renewal. The incentive is that, without licensing, the alcohol distributors in Georgia's three tier system stood to face substantial fines or suspensions if they delivered without a license being present.
2. Enhanced participation in the Treasury Offset Program (TOPS) has yielded substantial results. We are currently working on adding withholding tax compliance to this initiative.
3. Accelerated use of private collection agencies has been a significant success. While they were being used previously, the paper they received had generally been worked two or three times within the department prior to turning it over. To shift our approach to market we eliminated two non-required notice periods so that the agencies received the paper within 190 days with the paper only having been worked once, possibly twice, by the department. This increased the likelihood of greater collections by the agencies. To protect the state's interest, an additional collection fee of 20 percent is added onto the bill which is the funding source for the agencies. To protect taxpayers, all complaints of abuse are investigated and resolved. Any habitual problems with an agency will result in their removal from the program. To date, none have been removed for taxpayer treatment issues. The agencies are much happier, as well, given the growth in their collection potential.
4. Establishment of an internal call center in order to try to resolve tax obligations one final time prior to filing tax liens and referring to private collection agencies. To support 20 employees in the call center only required a \$40,000 commitment.
5. In February 2004, we began posting the names of individual taxpayers with liens on the internet. No exceptions were made to protect people's identity. In May 2004, the list was expanded to include corporate officers. The list now includes 15,000 businesses and over 14,000 individuals. These are the largest of the large. The full list would be many hundreds of thousands.
6. Establishment of a special levying team to efficiently execute liquidations while minimally disrupting the operation of field offices throughout the state. This also allows for standardized treatment of taxpayers and better cross training. The focus of this activity is exclusively commercial.

## **Essentials for Success**

Our continued expansion of these initiatives and their success necessitates the department being available to the media to explain the program's purpose and goals without compromising confidential taxpayer information. We continually have received positive feedback from the media and the public as we have been impartial and avoided any perception of being overzealous. Further success and support also requires our continual communication of our goals, practices and results to the executive branch, the legislative branch and the public.

Our long term success will continue to be driven by our resolve to initiate change. We must always treat everyone fairly, equitably and consistently with no exceptions. It is essential to continually demonstrate the magnitude of the problem and disclose certain outrageous practices that we encounter. An example of this is the recent \$315 million settlement of tax claims by Georgia and 14 other states (Georgia received \$39.7 million) in the MCI/WorldCom bankruptcy case in which MCI/WorldCom created huge royalty fees to an untaxed entity in exchange for “management foresight.” This was a highly successful result from our perspective and the result of many hours of hard negotiations.

We also are quick to release to the public any internal abuses of non-compliance by departmental employees so that the public can see that we hold ourselves to a higher and consistent standard. Lastly, we continue to seek legislation and rewrite rules and regulations with progressive penalties so that we can deal with taxpayers “fewer numbers of times for less amount of time” and have them go away with a basic belief that they received a fair opportunity or received what they wanted.

### **Thank you**

Thank you again for allowing me to appear before you today. We are pleased with our progress in Georgia and look forward to expanding our relationship with the IRS and other states. For me personally, this is special. Having grown up comfortably middle class with two parents of the depression era who gave me opportunities along the way, as well as numerous others who have given me opportunities such as Governor Perdue, it is especially rewarding to share some of our accomplishments – none of which would be present without the opportunities and the support and diligent work of the Georgia Department of Revenue employees who execute our mission everyday. Nothing happens without their commitment.

I will be pleased to take your questions and to appear again if I can be of further assistance.