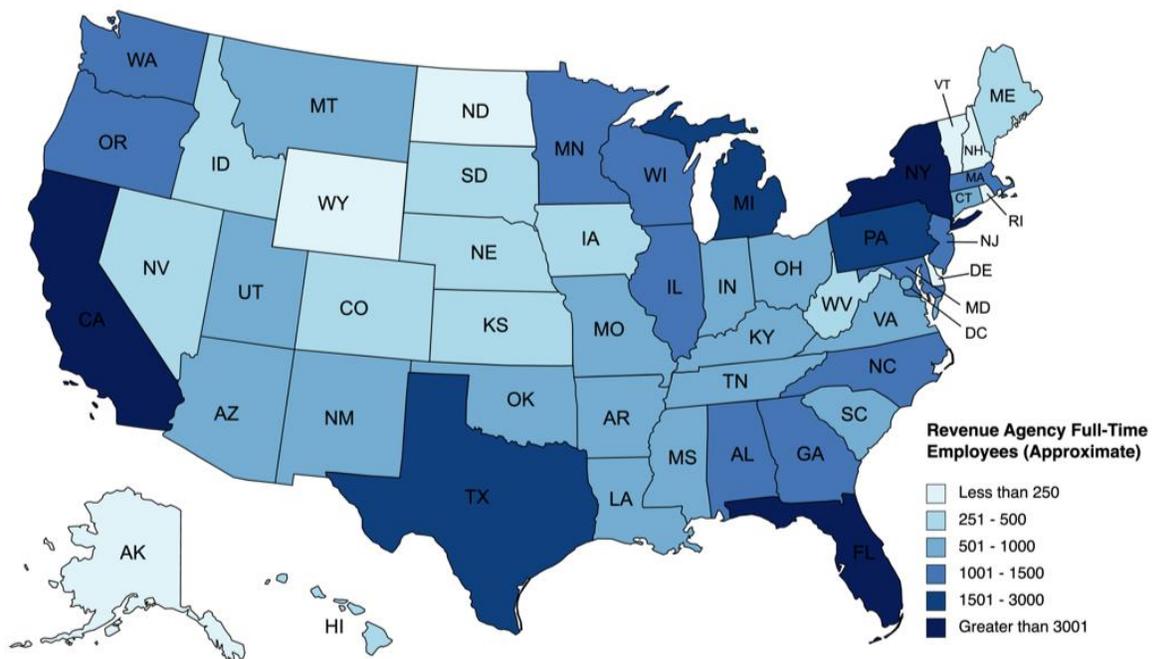


Statement for the Record of
The Federation of Tax Administrators
On
“Spotlighting IRS Customer Service Challenges”
United States Senate
Committee on Finance
Thursday, February 17

Introduction

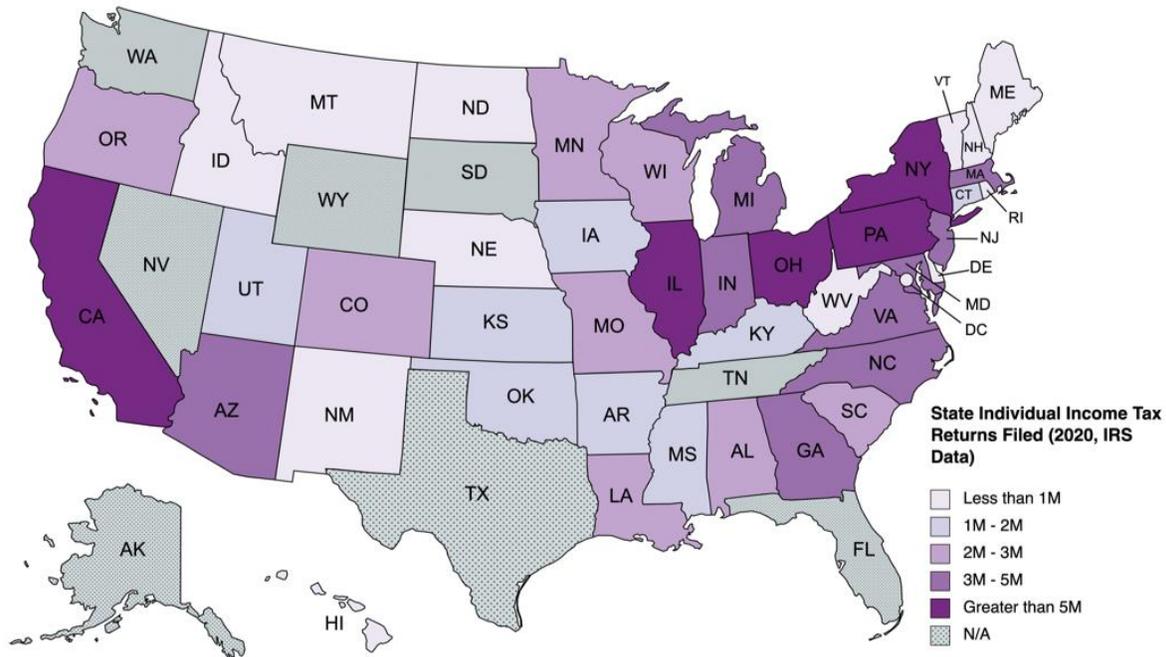
The Federation of Tax Administrators (FTA) appreciates the opportunity to submit a statement on the current state of this year's filing season. We also want to thank the U.S. Senate Committee on Finance for examining these key issues facing tax administration both at the federal and state levels. FTA is eager to work with the Committee during the 117th Congress and beyond to identify ways to improve taxpayer experience, strengthen revenue collection, and increase voluntary tax compliance within our nation's departments of tax and revenue.

Founded in 1937, FTA is an association of principal tax administration agencies in all fifty states, the District of Columbia, Philadelphia, and New York City. Collectively, FTA members include more than 57,000 employees across our state and city departments of revenue. Our purpose is to improve the techniques and standards of tax administration through a program of research, information exchange, training, intergovernmental and interstate coordination, and representing the interests of state tax administration before Congress and the Administration. Through these efforts, FTA works as a bipartisan organization to ensure that states' interests are effectively represented, and that consideration is given to the impact federal tax law changes have on state tax administration.



State tax agencies play a vital role in each filing season with taxpayers across the country filing annually an estimated 120 million state individual income tax returns. These taxpayers rely on the state tax agencies to administer the tax system effectively and efficiently, and we take that responsibility seriously. The tax system is based on the premise of voluntary compliance, and with each filing season, we must work to ensure taxpayers have the information and tools they need to

meet their tax filing obligations while balancing the preservation and integrity of the revenue system.



Although state tax agencies meet the challenges facing them each new filing season, external factors frequently impact the efficiency in which we do our work. This statement documents some of the challenges the departments face, like our sister agency, the Internal Revenue Service (IRS) and outlines opportunities for addressing these issues. We also respectfully request the Committee to carefully consider the impact potential federal tax measures may have on state and local income tax systems.

Revenue Collection Across the States

In total, forty-one states and the District of Columbia have broad-based individual income taxes similar to the federal income tax. Overall, state individual income taxes were the largest revenue source accounting for thirty-six percent of total state tax revenue collected in 2020, and it was the largest source of tax collection in thirty states. States collected \$388 billion from individual income taxes in fiscal year (FY) 2020¹.

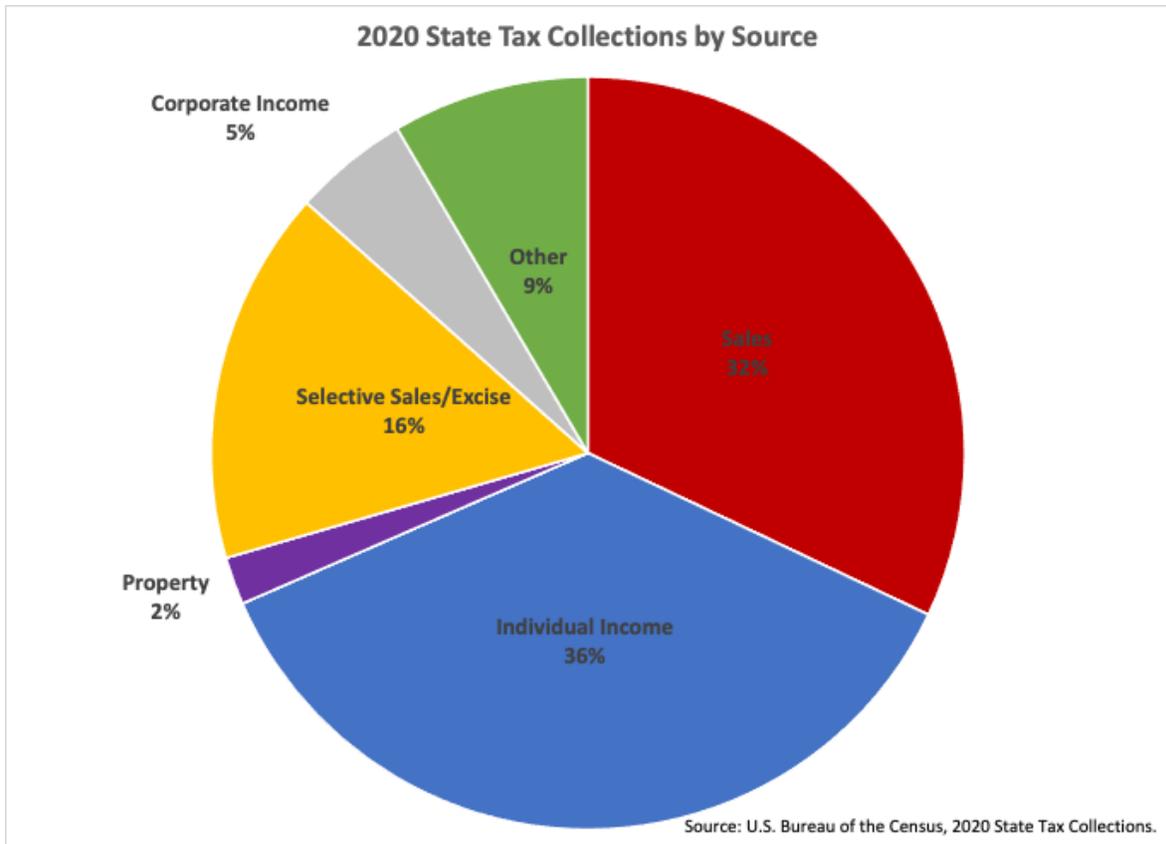
Of the forty-one state income taxes, all but five conform to the federal Internal Revenue Code (IRC) by starting their state income calculations with the federal definition of income². In addition,

¹ Source for 2020 data was the Census Bureau. The National Association of State Budget Officers' (NASBO) Fiscal Survey of the States-Fall 2021 reports preliminary revenue of \$463 billion. Note, some states reported above normal payments due to a shift in final payments from the previous fiscal year.

² State Individual Tax Conformity to Federal IRC Graph.

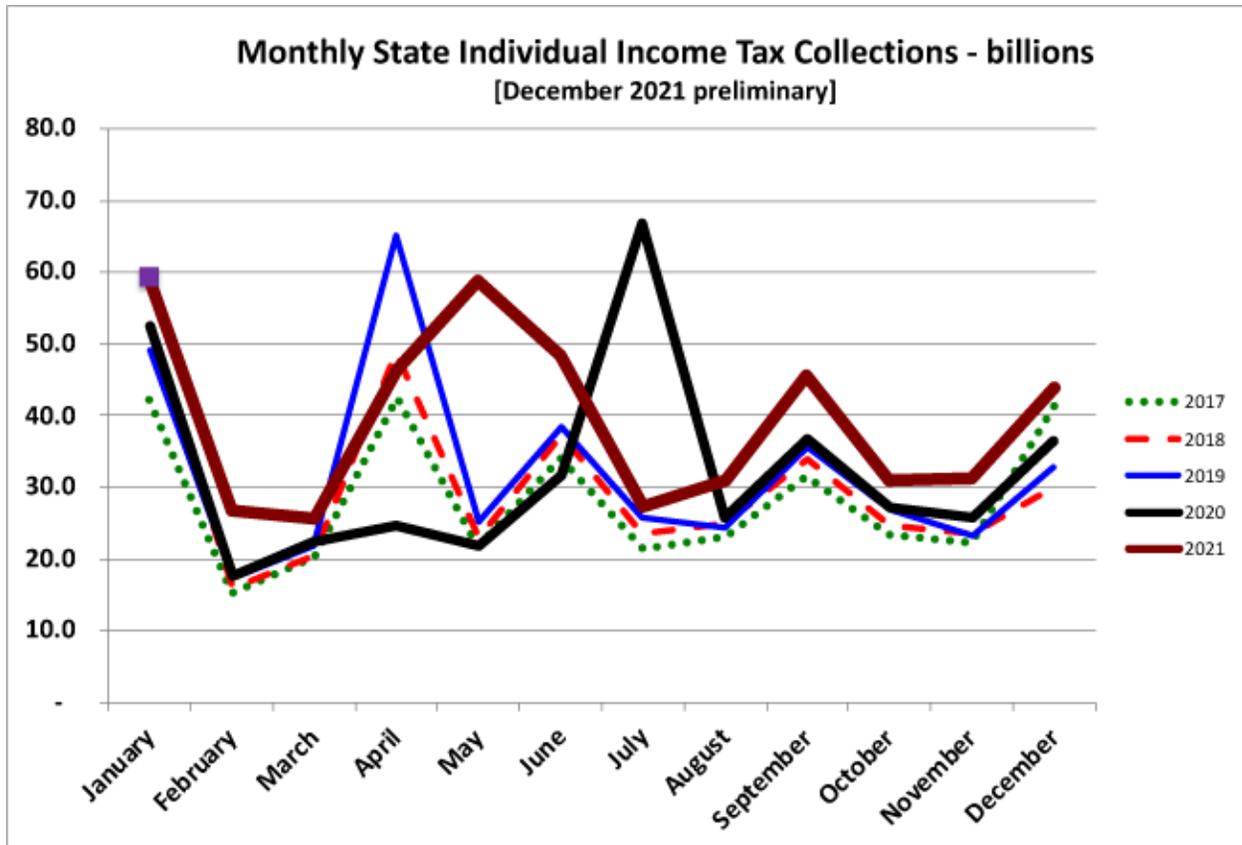
which in turn required many states to shift income from FY20 to FY21. While most states had sufficient reserves to handle the cash flow and managed this budget situation, the revenue shift provides an example of federal changes impacting state revenues and their long-term fiscal planning.

As depicted in “2020 State Tax Collections by Source ⁴,” income tax receipts are a major source of state tax revenue. Accounting for more than a third of states’ tax collection, it is important for state budgets that income taxes remain a stable revenue source.



The chart titled “*Monthly State Individual Income Tax Collections,*” plots monthly state income tax receipts for calendar year (CY) 2017 through 2021. Beginning in March 2020, there was a sharp decline on state individual income tax collections due to the COVID-19 pandemic [black line]. After March, collected revenue remained below CY19 collections until July, when income tax estimated and final payments were received. The July 2020 revenue peak did not recover the losses from the four previous months. For the remainder of CY20, income tax revenue was flat and at the same level as CY19.

⁴ U.S. Bureau of the Census, State Tax Collections 2020.



Thanks to the unprecedented fiscal stimulus, CY21 revenues quickly rebounded as the economy recovered and inflationary effects began to take effect.

FY22 revenue estimates are currently expected to decline by nearly three percent from the previous year. It is largely due to an inflated FY21 revenue base as the tax filing deadlines changes, and federal stimulus payments boosted revenues last year⁵.

Priorities for State Tax Administration

Each filing season presents new challenges and opportunities. FTA continues to work with our federal and corporate partners to advance tax administration. Some of these priorities include:

Combating Fraud

In 2020, the Federal Bureau of Investigation's (FBI) Internet Crime Report reflected a sixty-nine-percent increase in internet enabled fraud with a reported loss of \$4.1 billion dollars and numbers increasing exponentially as criminals use automated methods in attempts to steal and use more data. States play a key role in fraud detection and prevention, and while they do not publicly disclose fraud detection and prevention strategies, states deploy diverse fraud strategies that utilize intelligence, technology, and people to detect and prevent fraud. States are also a member of the Identity Theft Tax Refund Fraud Information and Analysis Center (ISAC), and states are proud to

⁵ NASBO, Fiscal Survey of the States-Fall 2021.

share that they are major contributors of fraud alerts and data used by the IRS and other tax partners to identify and prevent identity theft tax refund fraud. The ISAC plays a significant role in the global tax fraud detection and prevention efforts, and the states want to thank you for your continued support of the ISAC as it is making a difference in this important fight.

Increasing Voluntary Tax Compliance

One of the best ways to increase voluntary tax compliance is through customer service. Ensuring taxpayers have the information and tools they need to comply with their tax responsibilities is a priority for states. States continue to innovate as they find new and creative ways to engage taxpayers, deliver information and resources, and provide customer service. Their engagement and service strategies facilitate the filing of timely and accurate tax returns. Their innovation covers a broad spectrum ranging from plain language initiatives designed to make it easier for taxpayers to understand how to comply to increasing access to tax credits through robust communication initiatives. State tax agencies work to increase current and future voluntary tax compliance by providing staff professional development and training, participating in tax practitioner educational programs, implementing self-service options and customer relationship management solutions on agency websites, with the use of chatbots, data analytics and other technology solutions. These strategies also allow the states to better understand the communities they serve by engaging in diversity and inclusion efforts within the agency and the community and increase voluntary compliance while improving constituent relations.

Addressing Staffing Challenges

State tax agencies are not immune to the significant staffing challenges facing the private and public sectors. Like the IRS, many states have experienced high attrition during the pandemic and continue to identify innovative ways to recruit and retain talented tax administrators. Staffing challenges create knowledge gaps and can disrupt the tax administration cycle. Impacts may include, but are not limited to processing delays, customer service issues, and challenges achieving voluntary compliance. States are optimistic that the human capital, continuous improvement, and technology investments made over the past several years will temper some of the negative consequences of staffing shortages during the filing season.

Modernizing Technology

The states are a lead investor in technology that facilitate tax administration. They recognize the critical importance of investing in technology that supports the filing season and beyond. Many states have implemented Commercial Off the Shelf Technology (COTS) which makes it easier to maintain, modernize, and advance tax administration. They continue to invest in cyber and data security strategies designed to protect the integrity of their systems and the taxpayers they serve. Lastly, they have implemented Voice Over Internet Protocol (VOIP) technology to support remote work and deployed self-service technology allowing taxpayers to meet their filing requirements in a timely manner, increasing efficiency and improving the taxpayer experience.

Administering Retroactive and Late Tax Law Changes

FTA would be remiss in neglecting to share the challenges state agencies face as it relates to retroactive tax laws and tax law changes that occur late in the tax filing season. As mentioned previously, most states conform with federal tax laws and their state tax return begins with information from the federal tax return. Federal tax law changes can result in issues that require

most states to seek state tax laws changes to conform to federal law. In addition, there are typically system changes, current year return processing, payment processing, amended return and other account adjustments, while trying to manage an active filing season. Late tax law changes especially create a significant risk of error and vulnerability because technology changes cannot be fully tested due to time constraints and system limitations. Retroactive and late law changes impacting state tax administration, such as the Unemployment Income exclusion and Payroll Protection Program loan forgiveness exclusion create taxpayer and tax practitioner confusion, contribute to processing backlogs, and can promote fraud—all causing potential delays in processing returns and issuing refunds. By understanding organizational effectiveness and managing human and technological resources, states have led through the pandemic and met the challenges presented by the retroactive and late tax law changes.

Conclusion

State tax agencies are very empathetic to the challenges facing the IRS, and these challenges have a direct impact on state tax administration. As laboratories for innovation, many state tax agencies have successfully modernized their tax processing systems and have implemented other emerging technology to enhance the taxpayer experience. As a result, state tax agencies have well-established best practices the IRS can leverage, and FTA stands ready to liaise with the IRS and state tax authorities for the purpose of identifying proven solutions to address the challenges raised.

FTA thanks the Committee for holding this important hearing on this year's filing season. We appreciate you giving state tax administrators the opportunity to express our contribution to the filing season experience. As the Committee continues its work in a bi-partisan manner on this important issue, FTA and our membership look forward to being a resource for you and your staff. Through FTA's continued work to improve the techniques and standards of tax administration through research, information exchange, intergovernmental and interstate coordination, and communicating interests, we look forward to ensuring that the federal and state governments work closely together to provide a superior taxpayer experience for the advancement of tax administration and in support of the communities we serve.