AN EVALUATION

Administration of the County Sales and Use Tax

Department of Revenue

01-10

May 2001

LEGISLATIVE AUDIT BUREAU

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May 29, 2001

Senator Gary R. George and
Representative Joseph K. Leibham, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator George and Representative Leibham:

We have completed an evaluation of the administration of the 0.5 percent county sales and use tax, as requested by the Joint Legislative Audit Committee. This tax is levied on the same goods and services affected by the State's 5.0 percent sales and use tax. The Department of Revenue administers the tax on behalf of the counties and retains 1.75 percent of the collections, as prescribed by s. 77.76(4) Wis. Stats. During calendar year 2000, the Department distributed $215.2 million to 53 counties that imposed the tax.

The $215.2 million that was distributed to counties in 2000 included a delayed distribution of $13.0 million, which the counties should have received in January and February 2000 but which they did not receive until June 2000. The delay occurred because the Department did not have adequate procedures in place to ensure that all tax returns were fully processed and included in distributions to counties. We also found that the 90- to 180-day time limit for distributing county sales and use tax revenues prescribed by Wisconsin Statutes is longer than limits established by other states, and improvements in business practices and technological advances enable the Department to process returns and distribute funds to the counties in significantly less time than statutory time limits allow. Therefore, we have included a recommendation that the Legislature reduce the time period for distributing county sales and use taxes to county governments.

In fiscal year (FY) 1999-2000, the Department retained $3.9 million in administrative fees from county sales and use taxes. In reviewing the Department's time reporting system, we found that administrative fees supported 10.38 more full-time equivalent positions than were reportedly used to administer the county sales and use tax. Wisconsin's administrative fee is the second-highest among surrounding midwestern states and generates more revenue than the Department expends to administer the tax. In FY 1999-2000, $931,600 in county sales and use tax administrative fees lapsed to the General Fund.

Funding from the administrative fee is used to support the Department's new Integrated Tax System (ITS). The administrative fee is expected to support $8.8 million of the system's total costs, which are projected to be $78.0 million. The amount of ITS costs to be funded by the county sales and use tax administrative fee appears to have been based on the unencumbered funds available in the appropriation for administration of the tax, rather than on an analysis of system costs and benefits.

We appreciate the courtesy and cooperation extended to us by the Department of Revenue. The Department's response is Appendix 2.

Respectfully submitted,

Janice Mueller
State Auditor

JM/DB/cm

Summary

County governments in Wisconsin are authorized by statute to impose a sales and use tax of 0.5 percent on the same goods and services that are taxable under the State's general sales tax. In calendar year 2000, 53 county governments imposed the tax, from which they received $215.2 million in revenues. The Department of Revenue has responsibility for processing tax returns, enforcing the tax, and administering monthly payments to counties. In exchange for these services, statutes currently require the Department to retain 1.75 percent of the taxes collected as an administrative fee. In fiscal year (FY) 1999-2000, the Department retained $3.9 million in administrative fees from county sales and use taxes. The Department expended $3.0 million and lapsed $931,600 to the General Fund.

Typically, county sales and use tax revenues are distributed to county governments within 45 days of the retailer filing deadline. However, in June 2000, the Department made a delayed distribution of $13.0 million that had been overlooked in January 2000. This delayed distribution raised concerns among county officials about both the accuracy and the timeliness of the Department's distribution process. In response to these concerns, and at the direction of the Joint Legislative Audit Committee, we reviewed the Department's procedures for processing the county sales and use tax, including the circumstances surrounding the June 2000 delayed distribution.

Retailers report county sales and use taxes to the Department on paper returns and via the Sales Internet Process, which currently allows 700 retailers to file returns electronically. The Department of Natural Resources and the Department of Transportation also collect county use taxes from individuals involved in private sales of boats, snowmobiles, recreational vehicles, automobiles, and other assets these departments license. Tax information from retailers, the Department of Natural Resources, and the Department of Transportation is collected in data files that are subsequently used by the Department of Revenue to make monthly distributions of county sales and use taxes to county governments. The June 2000 delayed distribution occurred because the Department had overlooked two data files containing a total of $13.0 million in county sales and use tax revenues. The Department has since developed measures to reduce the likelihood of data being overlooked in the future. These include verifying the number of returns entered into the sales tax system and the number of returns reflected in the distribution.

County officials have also raised concerns about the timeliness of distributions. Currently, statutes allow the Department to distribute county sales and use tax revenues to the counties as late as 180 days after retailer reporting. Surrounding midwestern states allow significantly less time. Delayed distribution reduces county governments' potential interest earning from sales and use tax revenues. For example, if the $13.0 million delayed distribution had been made within the Department's customary time period and these funds had been invested by counties in the Local Government Investment Pool of the State Investment Fund, we estimate that the counties could have earned $240,000 in interest.

Improvements in business practices and technological advances have permitted the Department to process and distribute county sales and use taxes within 45 days. However, s. 77.76(3), Wis. Stats., allows up to 180 days for distribution. We include a recommendation that the Legislature reduce the time period specified in statues for distribution of county sales and use taxes to county governments. For example, requiring the Department to distribute the tax to county governments within 75 days of the retailer reporting deadline would still allow an additional 30 days beyond current practice for circumstances that are beyond the control of the Department. As the sales and use tax component of the Department's new Integrated Tax System (ITS) becomes fully operational in FY 2002-03, the Legislature may wish to consider further reductions in the distribution time limit to reflect additional anticipated processing efficiencies.

In addition to concerns about the accuracy and timeliness of the distributions, county officials have also questioned the reasonableness of the Department's administrative fee. As noted, in FY 1999-2000, the statutorily established fee of 1.75 percent of the county sales and use taxes collected generated $3.9 million to fund the Department's administration of the tax. Of this amount, the Department expended $3.0 million and lapsed $931,600 to the State's General Fund.

In FY 1999-2000, more than half of the Department's administrative expenditures charged to the county sales and use tax were related to salary and fringe benefit costs for 33.25 full-time equivalent (FTE) positions the Department estimates are required to administer the tax. We compared the estimates with data from the Department's time reporting system and found that in FY 1999-2000, the county sales and use tax administrative fee funded 10.38 FTE positions more than were reportedly used to administer the tax.

The administrative fee is also used to fund the Department's new computerized tax processing system, ITS, which will combine 30 separate state and local tax systems. ITS is expected to be fully operational in FY 2006-07 and to have a total cost of $78.0 million. The implementation phase that includes the sales and use tax, as well as accounting, registration, and data warehousing functions, is scheduled for FY 2002-03. Its estimated cost is $27.2 million, including finance charges. Approximately 32.4 percent of this amount, or $8.8 million, will be funded by the county sales and use tax administrative fee. The amount of ITS costs to be borne by the county sales and use tax administrative fee does not appear to be based on an analysis of the benefits or costs of the system to the county sales and use tax. Rather, it appears that the county sales and use tax was assessed the amount the Department determined was available from funds generated by the administrative fee. However, the Department anticipates that when ITS is operational, it will allow for faster processing of county sales and use taxes, greater capacity for Internet tax filing, faster distribution of county sales and use tax revenues, and better reporting of information to the counties of the amounts of taxes collected.

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Introduction

In calendar year 2000, sales and use tax revenues totaling $215.2 million were distributed to counties.

Wisconsin statutes permit county governments to levy a 0.5 percent sales and use tax on the same goods and services subject to the 5.0 percent state sales and use tax. The county taxes are collected primarily by the Department of Revenue from retailers; however, the departments of Revenue, Natural Resources, and Transportation also make some collections from individuals. In counties that levy the taxes, retailers submit their state and county sales and use tax returns and collections to the Department of Revenue, which processes the returns, retains a statutorily prescribed percentage of collections as an administrative fee, and distributes the reported tax revenues to county governments. In calendar year 2000, the Department distributed $215.2 million in county sales and use tax revenues to 53 counties that imposed the tax.

A $13.0 million delayed distribution raised concerns about accuracy and timeliness.

In June 2000, a delayed distribution of $13.0 million in county sales and use taxes from returns that had been overlooked in processing raised concerns among county officials and the Wisconsin Counties Association about the accuracy and timeliness of the Department's distribution process. Furthermore, because some of the funds retained by the Department for administrative purposes have lapsed to the General Fund, counties have questioned whether the administrative fee is too high.

In response to these concerns, and at the request of the Joint Legislative Audit Committee, we reviewed:

- the steps the Department has taken to ensure the accuracy of payments;
- how promptly payments are made to counties; and
- the amount and types of administrative costs the Department charges to the program, including the costs for a portion of the Integrated Tax System (ITS).

In conducting this evaluation, we interviewed Department of Revenue staff, officials in four counties, revenue personnel in four midwestern states, and UW-Extension staff who annually project county sales and use tax revenues. We also analyzed the Department's sales tax reporting and distribution data, as well as data from its time reporting system.

The state sales and use tax, which took effect in 1962, is assessed on retailers' gross receipts, as well as on individuals who do not pay tax on out-of-state purchases that would be taxable if purchased in

Wisconsin. As shown in Table 1, the amount of state sales and use tax collected increased from $2.9 billion in FY 1996-97 to $3.5 billion in FY 1999-2000. Most of these funds were received from retailers, who collected them from individuals at the time purchases were made.

Table 1

State Sales and Use Tax Collections
(in millions)

Fiscal Year	Tax Collected
1996-97	$2,864.4
1997-98	3,047.4
1998-99	3,284.7
1999-2000	3,501.7

Like the state sales and use tax, the county tax applies to retailers and individuals. Retailers making sales subject to the 0.5 percent county tax must collect 5.5 percent on purchases at the time of each sale—the sum of the state and county sales tax rates—and file an annual, quarterly, or monthly return with the Department of Revenue. The county use tax is due from individuals who reside in counties that levy the tax and make purchases on which the tax is not collected. These include, for example, catalog and on-line purchases from vendors without a physical presence in the state, and private purchases of motor vehicles, boats, all-terrain vehicles, and snow mobiles. County use taxes may be paid by individuals on their individual income tax forms or collected by the Department of Natural Resources or the Department of Transportation in conjunction with their licensing activities.

Currently, 54 counties impose the 0.5 percent sales and use tax.

Although ch.154, Laws of 1969, permitted any county to impose a local sales and use tax, this legislation directed that all county tax revenues be distributed to cities, villages, and towns and not retained by the county governments. Therefore, no counties imposed the tax until after the enactment of 1985 Wisconsin Act 29, which allowed county governments to retain all or a portion of the revenues generated by the 0.5 percent county sales and use tax. As of April 1, 2001, 54 counties have enacted county sales and use taxes. These counties are shown in Figure 1. The date the tax took effect in each county is shown in Appendix 1.

Figure 1

Counties that Impose Sales and Use Taxes

Enforcing compliance with both county and state sales and use taxes is difficult, especially on Internet sales made by retailers in other states. Since March 2000, several states have joined the Streamlined Sales Tax Project (SSTP), which has as its goal designing and implementing a simplified sales tax collection system that will enable remote retailers to voluntarily collect the tax. Department representatives have been extensively involved in SSTP, and Wisconsin is one of four states participating in a pilot project to test the necessary technology. In addition, model legislation to simplify state sales tax systems is under consideration by many state legislatures. In April 2001, the Joint Legislative Committee on Information Policy and Technology introduced legislation in both houses of the Legislature that would create the Uniform Sales and Use Tax Administration Act and permit the Department to enter into the SSTP agreement with other states.

Retailers are required to file sales and use tax returns monthly, quarterly, or annually based on the amount of tax due.

As compensation for collecting applicable taxes, Wisconsin retailers retain what is referred to as the retailer's "discount," which is 0.5 percent of the tax collected. As shown in Table 2, up to 157,000 retailers submit returns and payments to the Department, either monthly, quarterly, or annually. As specified in s. 77.58, Wis. Stats., and s. Tax 11.93, Wis. Adm. Code, the frequency of sales tax reporting is determined by the amount of state sales and use tax liability incurred during the quarter.

Table 2

Retailer Reporting Requirements for Sales and Use Taxes

State Tax Liability	Filing Frequency	Filing Requirement	Number of Retailers
Less than $300 in the Last Calendar or Fiscal Year	Annually	Last day of the month following close of calendar or fiscal year	59,000
$0 to $600 Quarterly	Quarterly	Last day of the month following quarter in which taxes were collected	44,000
$601 to $3,600 Quarterly	Monthly	Last day of the month following month in which taxes were collected	37,000
Over $3,600 Quarterly	Monthly	20th of the month following month in which taxes were collected	17,000
Total Retailers Reporting			157,000

In FY 1999-2000, the Department retained $3.9 million in county sales and use taxes as an administrative fee.

Retailers submit state and county sales and use tax returns and payments to the Department through the State's depository bank in Milwaukee. Bank employees deposit the payments to state accounts and forward the returns to the Department for further processing. Statutes specify that 98.25 percent of the county sales and use tax reported to the State is to be distributed to counties that have enacted the tax, while 1.75 percent of the amount collected is to be retained by the Department as an administrative fee to fund administrative costs such as staff positions for processing and auditing the county sales and use tax, postage, printing fees, and computer charges. In FY 1999-2000, the State retained $3.9 million in county sales and use tax administrative fees to fund these administrative costs. 1999 Wisconsin Act 9 increased the Department's administrative fee from 1.5 percent to 1.75 percent of county sales and use tax collections. Other administrative fees specified in statutes include 1.5 percent of the taxes collected for administration of the Green Bay-Brown County Professional Football Stadium District Tax, 1.5 percent of the taxes collected for administration of the Local Professional Baseball Park District Tax, 2.55 percent of the taxes collected for the administration of the Local Exposition District Tax, and 3.0 percent of the taxes collected for the administration of the Premier Resort Area Tax in the Village of Lake Delton and the City of Wisconsin Dells.

As shown in Table 3, county sales and use tax distributions have increased significantly as additional counties have levied the tax. However, some county officials have acknowledge difficulties in accurately forecasting revenues. For example, Eau Claire County imposed the county sales and use tax beginning January 1, 1999. Later that year, and based on less than a full year's experience in 1999, UW-Extension projected that Eau Claire County would receive $8.0 million from the tax in 2000. County officials budgeted for $7.0 million, or 12.5 percent less than the amount projected by UW-Extension, based on their own projections and the amount of revenue received for part of calendar year 1999. Actual revenue in 2000 was $6.9 million, or 13.8 percent less than the UW-Extension projection. Although UW-Extension publishes annual projections for all Wisconsin counties, including those that do not impose the county sales and use tax, UW-Extension staff caution county officials about their use of these projections, especially when the tax is new.

Table 3

County Sales and Use Tax Distributions

Calendar Year	Counties Imposing Tax*	Tax Distributed (in millions)
1986	2	$ 0.9
1987	12	7.7
1988	18	16.2
1989	24	22.5
1990	28	30.3
1991	40	70.8
1992	42	111.5
1993	43	124.5
1994	46	136.0
1995	48	144.6
1996	48	151.0
1997	49	160.7
1998	49	186.0
1999	53	191.5
2000	53	215.2

* On April 1, 2001, Lafayette County became the 54th county to impose the tax.

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The Department typically distributes county taxes within 45 days of the retailer filing deadline.

The Department typically distributes tax revenues to counties within 45 days of the retailer filing deadline. In June 2000, however, the Department made a delayed distribution of $13.0 million in county sales and use tax revenues that had been overlooked during processing in January 2000. This delayed distribution raised concerns among county officials about the accuracy of the distributions made by the Department. To address these concerns, we examined how the Department processes returns and evaluated its controls over the distribution process. We also compared the time period Wisconsin Statutes specify for making distributions to the distribution time lines of other midwestern states.

Processing Tax Returns

The Department receives sales and use tax returns from the State's depository bank in Milwaukee, which deposits retailer tax payments into state accounts and records payment information on the returns. The returns document the amounts of applicable sales and use tax for the State; for counties; and for special districts, such as the local professional baseball park and football stadium districts. After they have been received from the bank, returns are scanned into the Department's computerized sales tax system, which calculates the amount of county sales and use tax liability and verifies it against the amounts reported by retailers. Incorrect returns are manually adjusted by staff in the Department on a case-by-case basis. After the returns are verified, the electronically scanned information is compiled into a larger data file for further processing.

Instead of filing paper returns, approximately 700 retailers currently use the Department's Sales Internet Process. The Sales Internet Process allows retailers to file electronically and make payment via an electronic funds transfer. It significantly improves the speed and accuracy with which retailer returns are processed because the filing software incorporates automated verification, and the paperless process requires less staff time than paper returns. By July 31, 2001, the Department intends to expand the Sales Internet Process by inviting 20,000 retailers to participate. As retailer participation in the Sales Internet Process increases and results in a reduction of the number of paper returns submitted, the Department anticipates improvements in overall processing efficiency.

Over a two-week period, large data files accumulate information from returns filed via the Sales Internet Process and electronically scanned information from paper returns. These files may also contain county sales and use tax information the Department of Natural Resources and the Department of Transportation collect on the private sale of boats, snowmobiles, all-terrain vehicles, automobiles, trucks, and other assets these departments license. The amount of county sales and use tax distributed to county governments is based on the merger of two large data files, which together represent four weeks—or a processing month—of county sales and use taxes. As shown in Table 4, the processing month ends approximately on the 15th of each calendar month. Distributions are made to each county that imposes the county sales and use tax on the last business day of the month, via paper check or electronic funds transfer.

Table 4

Processing Time Lines for Monthly Filers of County Sales and Use Tax Returns
First Quarter CY 2000

Sales Month	Retailer Filing Deadline*	End of Processing Month	Distribution Date
November 1999	December 20, 1999 December 31, 1999	January 12, 2000	January 31, 2000
December 1999	January 20, 2000 January 31, 2000	February 14, 2000	February 29, 2000
January 2000	February 20, 2000 February 29, 2000	March 13, 2000	March 31, 2000

* Deadline based on filing requirements shown in Table 2.

Since 1999, processing backlogs twice led the Department to estimate and subsequently adjust the amounts distributed.

In both 1999 and 2000, unusual circumstances significantly affected the monthly distribution. In both instances, staff in the Department estimated the amount to be distributed by calculating a weighted average based on past distributions for each county. When the dollar amount of processed returns was significantly below the estimated level, the Department established the monthly distribution based on the higher estimate and recouped the funds in ensuing months.

Delayed Distribution of Overlooked Taxes

A $13.0 million delayed distribution resulted from inadequate procedures to ensure all returns had been fully processed.

A distribution of $13.0 million that should have been sent to the counties in January and February 2000 was instead delayed until June 9, 2000. This delayed distribution represented 6.0 percent of the $215.2 million in sales and use tax distributed to the 53 counties that imposed the tax during calendar year 2000. It appears that the delay occurred because the Department did not have adequate procedures in place to ensure that it fully processed all returns that had been filed by retailers. The coincidental presence of a backlog of returns waiting to be scanned into the Department's computer system in January and February 2000 led the Department to inaccurately attribute the smaller amounts of reported returns in January and February exclusively to the backlog.

The overlooked $13.0 million could have earned counties an estimated $240,000 in interest.

When distribution of tax revenues is delayed, county governments can lose other potential revenue from interest earnings. For example, had the $13.0 million that was delayed until June 2000 been distributed normally and invested in the Local Government Investment Pool within the State Investment Fund, we estimate that the counties would have earned approximately $240,000 in interest from the scheduled distribution dates of January and February 2000 until actual distribution occurred in June 2000.

One reason the unprocessed returns were not detected earlier is that staff in the Department attributed a lower-than-expected volume of returns in January and February 2000 entirely to the presence of a backlog of unprocessed returns. The processing backlog, independent of the overlooked returns, developed in January 2000 because of December 1999 difficulties with the installation of new computer equipment.

As the Department prepared the January 2000 distribution, only $9.7 million in returns had been processed. The Department estimated the January distribution should have been $15.0 million and, to maintain consistent monthly distributions, raised the distribution to that amount, or by $5.3 million. Following past practice, the Department intended to deduct the $5.3 million from the February 2000 distribution, based on the assumption that the backlog would be eliminated by February, and the unprocessed returns from January would be reflected in February's distribution. However, the amount processed in February did not increase above usual levels, as would have occurred if the backlog had been reduced. That the February distribution did not increase to reflect a reduction in the volume of backlogged returns should have prompted staff to look for explanations other than the backlog. However, since a portion of the backlog still remained at the end of February, efforts to find explanations other than a backlog for the less-than-anticipated distributions were not launched until later, and two unprocessed data files containing $13.0 million in tax return information scanned from

December 30, 1999 through January 28, 2000 were not discovered until May 2000.

In March 2000, processed returns totaled $16.4 million, as shown in Table 5. From this amount, the Department deducted $4.0 million, or 75 percent of the $5.3 million it had added to the January 2000 distribution. Because of the $4.0 million deduction, the actual distribution in March 2000 was $12.4 million. In April 2000, the Department deducted the remainder of the $5.3 million it had added in January. By the end of April 2000, $52.4 million had been distributed to counties. However, had the two overlooked data files been fully processed, $65.4 million, or $13.0 million more, would have been distributed.

Table 5

County Sales and Use Tax Distributions in Calendar Year 2000
(in millions)

	January	February	March	April	Total
Processed Returns	$ 9.7	$14.0	$16.4	$12.3	$52.4
Actual Distribution	15.0	14.0	12.4	11.0	52.4
Processed Amount and Overlooked Returns	16.2	20.5	16.4	12.3	65.4

Department Corrective Measures

Procedural changes should reduce the likelihood of inaccurate distributions in the future.

The Department has initiated procedures to improve the accuracy of its monthly distributions to the counties. First, several components of the file retrieval process have been automated to reduce the possibility of overlooking data. Second, every two weeks the number of returns processed is matched against the number of returns noted in the monthly distribution, to ensure that all of the files have been retrieved. Third, staff in the Department review the monthly distribution amounts on a county-by-county basis to identify trends and fluctuations in the distributed amounts. Fourth, the Department has begun monitoring the volume of returns processed by the depository bank to estimate the size of any backlog accumulated there. This action will provide the Department with an estimate of the number of returns in backlog but will not determine the dollar value of county sales and use taxes they contain. Finally, the Department intends to implement a trend analysis that will compare the amounts of county sales and use tax collected to the amounts of state sales tax collected, with the expectation that some relative proportional trend should be identified. The procedural changes implemented and planned by the Department should reduce the likelihood of inaccurate distributions in the future.

Some county officials have been concerned about potential variances between the amounts distributed to the counties and the amounts collected by the Department. Since county sales and use tax distributions are based on the amount of tax reported, some counties have questioned whether the amounts of county sales and use tax actually collected might exceed the reported amounts. While counties receive information about the calculation of their monthly distributions, they report difficulty determining whether the distribution amount is less than, equal to, or greater than the amount actually collected by the Department.

County governments currently receive monthly summary information from the Department about their distributions, including:

- the amount of county sales and use tax reported by retailers;
- the deduction for the retailer's discount;
- the deduction for the 1.75 percent administrative fee;
- other adjustments in the distribution made by the Department; and
- their total county sales and use tax distribution.

Upon request, the Department provides additional information to counties, such as a microfiche that contains information from retailer returns, and worksheets the Department uses to determine the distribution amount. The additional information does not clearly present data on tax collections, and county officials report that it has not been possible for them to reconcile county sales and use tax collections with distributions based on this information.

Because tax collection is an ongoing activity, determining variances between reported and collected amounts is difficult. For example, March 2000 collections may include taxes paid by retailers in March, delinquent tax payments from January and February 2000, and amounts collected as a result of audits of retailer filings from previous years. Therefore, the Department's March 2000 collection information would not reconcile to amounts reported by retailers in March 2000.

The Department anticipates ITS will enable better tracing of taxes collected and reported.

The Department anticipates that its computerized tax processing system, ITS, will allow it to better inform counties about the amount of county sales and use tax collected and, eventually, enable county governments to obtain data from which they can verify the Department's distribution calculations. Allowing county governments to verify distribution calculations and better understand the magnitude of any difference between reported and collected amounts will increase confidence in the accuracy of county sales and use tax distributions.

Timeliness of County Sales and Use Tax Distributions

Since 1969, Wisconsin statutes have allowed the Department up to 180 days to distribute tax revenues after collection by the State, which is longer than the time allowed by other midwestern states. Given the Department's technological advances and the anticipated implementation of ITS, the current time period specified in statutes for distribution no longer reflects practical expectations.

Original legislation allowed the State up to 180 days after collection to distribute the tax.

The original time period for distribution of county sales and use tax to municipalities through county governments was established by Chapter 154, Laws of 1969. This legislation required the Department to apportion sales tax revenue based on property value and population and required the Department to distribute the tax collected to county governments by the end of the third month following the end of the calendar quarter the tax was collected by the State. Depending on the collection date of the tax by the State, the Department was allowed between 90 and 180 days after collection to distribute tax revenues to county governments. For example, county sales and use tax collected by the State on the first day of the quarter could be distributed up to 180 days after collection, while tax collected on the last day of the quarter would be distributed within 90 days of collection.

In 1985, two separate pieces of legislation made changes to the county sales and use tax. As noted, 1985 Wisconsin Act 29 repealed the apportionment requirement and allowed county governments to retain all or a portion of the tax revenue. 1985 Wisconsin Act 41 changed the basis of the distribution from the amount of tax collected by the Department to the amount of tax reported by the retailer. In addition, the timeliness requirement was changed from the month county sales and use tax was collected by the State to the month when amounts of tax were reported by retailers. Although the county sales and use tax generally is reported and collected simultaneously, the Department does distribute amounts of tax that have yet to be collected.

The Department's current practice typically distributes taxes within 45 days of the retailer filing deadline.

In practice, the Department typically distributes county sales and use taxes on a monthly basis within 45 days of the retailer filing deadline. Despite the reductions in requirements and the Department's actual practices, current law, as stated in s. 77.76(3), Wis. Stats., reflects the same time period as the original enabling legislation. Although the distribution of $13.0 million in overlooked county sales and use taxes was delayed five months, distribution was made within the time period specified by statute.

Other midwestern states have shorter distribution time lines than Wisconsin's.

To compare Wisconsin's timeliness requirements with those of other states, we contacted staff in Illinois, Iowa, Minnesota, and Ohio, which allow local governments to impose a local sales tax and distribute those revenues monthly. Indiana and Michigan do not allow local governments to impose a local option tax. As shown in Table 6, three of the four other midwestern states that allow the tax have shorter timeliness requirements than Wisconsin's.

Table 6

Processing Period Requirements
End of Sales Period to Distribution

State	Time Period
Minnesota	40 days
Ohio	75 days
Illinois	85 days
Wisconsin	**90 to 180 days**
Iowa	N/A*
Indiana	**
Michigan	**

* Revenue is distributed for the first nine months based on estimated amounts. The final three months of distribution and the year-end reconciliation are based on processed amounts for the fiscal year.

** The state does not allow local governments to impose a local option tax.

Improvements in business practices and technological advances have permitted the Department to process and distribute county sales and use taxes well within the time period specified by the original enabling legislation enacted in 1969. The use of scanning equipment and the ability of retailers to file their sales and use tax returns over the Internet have led to significant improvements in the efficiency and timeliness of processing returns. Therefore, *we recommend the Legislature revise s. 77.76(3), Wis. Stats., to reduce the time period for distributing county sales and use taxes to county governments*. For example, the Legislature could require that the Department distribute the tax to county governments within 75 days of the retailer reporting deadline. Such a requirement would reflect the Department's current practice of distributing the tax within 45 days of the retailer reporting deadline, while allowing an additional 30 days for unforeseen circumstances beyond the control of the Department. As the sales and use tax component of ITS becomes fully operational in FY 2002-03, the Legislature may wish to consider requiring further reductions in the distribution time period. For example, anticipated processing efficiencies resulting from the implementation of ITS and increased use of Internet filing may make it possible to distribute tax revenues to counties more promptly than the 45 days it currently takes from the retailer reporting deadline.

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Administrative Fee and Expenditures

The Department retains 1.75 percent of collections as an administrative fee.

As required by statutes, the Department currently retains 1.75 percent of county sales and use tax collections as an administrative fee, which is intended to fund the supplies, services, and staff salary and fringe benefit costs associated with administering the tax. Wisconsin's administrative fee is higher than those charged by three of four other midwestern states; only Minnesota's is higher. To address questions about the Department's methodology for determining administrative charges, we compared the Department's estimates of the number of staff positions required to administer the tax with data from its time reporting system. We also reviewed how costs for the Department's computerized tax collection system are funded by the county sales and use tax administrative fee.

Administrative Fee

Reductions in the administrative fee were vetoed in past biennial budgets.

Since the first county government began to levy a county sales and use tax, statutes have allowed the Department to retain a set percentage of tax revenues to fund its administrative expenses. The percentage of tax retained has changed twice since 1969. Chapter 154, Laws of 1969, allowed the Department to retain 3 percent of the taxes, interest, and penalties collected as an administrative fee. 1985 Wisconsin Act 41 required that all interest and penalties be retained by the State in the General Fund. The administrative fee remained at 3 percent until 1991 Wisconsin Act 37 reduced it to 1.5 percent of the amount of county sales and use tax collected. Despite efforts by the Department and the Legislature to further reduce the administrative fee to 1.3 percent in both the 1995-97 and the 1997-99 biennial budgets, the proposed reductions were vetoed by the Governor.

The administrative fee increased to 1.75 percent of county sales and use taxes collected in 1999 Wisconsin Act 9, the 1999-2001 Biennial Budget Act, and as shown in Table 7, the Department retained $3.9 million in county sales and use tax administrative fees in FY 1999-2000.

Table 7

Administrative Fee Retained

Fiscal Year	Administrative Fee	Amount Retained by Department (in millions)
1996-97	1.50%	$2.4
1997-98	1.50	2.8
1998-99	1.50	2.8
1999-2000	1.75*	3.9

* The Department began collecting this fee in November 1999.

Wisconsin's administrative fee is second-highest among midwestern states.

As shown in Table 8, among the four other midwestern states that administer local option taxes, only Minnesota charges local units of government a larger administrative fee. Minnesota's 1.8 percent administrative fee is determined based on a biennial review of actual expenditures for administration of local option taxes. Therefore, the fee assessment is closely tied to the costs associated with administering the tax. By comparison, Wisconsin's administrative fee is prescribed in statute and remains in effect until changed by subsequent legislative action.

Table 8

Administrative Fee Charged by Midwestern States

State	Administrative Fee as Percent of Collections	Determination of Fee Amount
Minnesota	1.80%	Biennial review of actual expenditures
Wisconsin	**1.75**	**Established in statute**
Ohio	1.00	Consistency with other fee levels
Illinois	0.00	No administrative fee charged
Iowa	0.00	No administrative fee charged
Indiana	No local option tax	-
Michigan	No local option tax	-

Administrative Expenditures

The funds generated by the administrative fee are used to support expenditures related to the administration of the county sales and use tax. The county sales and use tax is processed at the same time and by the same staff in the Department who administer the state sales tax. Similarly, staff performing audit functions are working on all types of tax administered by the State, including the county sales and use tax.

In FY 1999-2000, personnel costs represented over 50 percent of the expenditures charged to the administrative fee.

The expenditures charged to the county sales and use tax administrative fee have increased from approximately $2.0 million in FY 1996-97 to approximately $3.0 million in FY 1999-2000, or by approximately 50 percent. The increase is explained, in part, by $646,000 in permanent property costs incurred by the Department in FY 1999-2000 for equipment and leases associated with ITS, its computerized tax collection system. As shown in Table 9, personnel costs for salaries and fringe benefits make up the majority of the costs charged to the administration of the county sales and use tax each year. In FY 1999-2000, the Department spent $1.6 million, or more than 50 percent of all costs charged to the administrative fee, for permanent salaries, limited-term employee (LTE) salaries, and fringe benefits.

Table 9

Expenditures Charged to the County Sales and Use Tax Administrative Fee

	FY 1996-97	FY 1997-98	FY 1998-99	FY 1999-2000
Permanent Salaries	$1,006,400	$1,025,700	$1,093,600	$1,092,700
LTE Salaries	32,600	49,900	56,400	89,100
Fringe Benefits	382,100	392,300	420,900	426,000
Subtotal, Personnel	1,421,100	1,467,900	1,570,900	1,607,800
Supplies and Services	380,600	570,100	571,300	510,100
Permanent Property	123,100	149,400	171,200	762,300
Payment to Department of Natural Resources	71,600	71,600	71,600	71,600
Total Expenditures	$1,996,400	$2,259,000	$2,385,000	$2,951,800

The Department of Natural Resources has not provided annual analysis of its processing costs for county sales and use taxes.

In addition to expenditures for staff, there are other costs associated with the Department's administration of the county sales and use tax. For example, the Department has paid $71,600 annually to the Department of Natural Resources as reimbursement for costs associated with the collection of county use taxes from private sales of items such as boats, all-terrain vehicles, and snowmobiles. In FY 1999-2000, the Department of Natural Resources collected approximately $336,000 in county use taxes and was reimbursed $71,600, or 21.3 percent of the amount collected. According to the terms of a 1995 memorandum of agreement signed by both departments, the Department of Natural Resources is required to submit annual statements detailing all costs incurred to collect county use tax revenues, from which appropriate reimbursements are to be made. In November 1991, the Department of Natural Resources prepared an analysis that determined its administrative costs related to county use tax collections were $71,600. Although the Department of Natural Resources has submitted regular billing requests for this amount that document the total volume of sales tax work, the requests have not justified the county use tax portion of those costs as required by the memorandum of agreement. Therefore, the amount paid to the Department of Natural Resources has remained constant since FY 1996-97, as was shown in Table 9. Staff in the Department of Natural Resources indicate they plan to review the 1991 analysis when preparing a billing request for FY 2000-01. The Department of Transportation, which collects county use taxes from private sales of motor vehicles, does not receive any reimbursement from the Department of Revenue and includes its costs in its own administrative expenses.

If the Legislature wishes to address the apparent inequity in administrative payments to agencies that collect the county sales and use tax on behalf of the Department of Revenue, it may wish to consider requiring the Department of Revenue to sign a memorandum of agreement that would establish a process for funding the Department of Transportation's administrative costs relating to the county sales and use tax. Furthermore, the Legislature may wish to consider requiring the Department of Revenue to periodically review the administrative costs of county sales and use tax collections incurred by the Department of Natural Resources and the Department of Transportation, to ensure administrative payments are more closely associated with costs of collection.

Lapses of Administrative Fees to the General Fund

In recent years, revenue generated by the county sales and use tax administrative fee has exceeded the Department of Revenue's costs to administer the tax. As shown in Table 10, in FY 1998-99, expenditures charged to the administrative fee represented 1.28 percent of total collections, while in FY 1999-2000 expenditures represented 1.38 percent of total collections.

Table 10

Administrative Charges as a Percentage of County Sales and Use Taxes Collected

	FY 1998-99	FY 1999-2000
County Sales and Use Taxes Collected	$186,740,200	$214,057,600
Administrative Charges	2,385,000	2,951,800
Expenditures as a Percentage of Collections	1.28%	1.38%

In FY 1999-2000, $931,600 in unencumbered administrative fees lapsed to the State's General Fund.

The administrative fee is deposited into appropriation 20.566(1)(g), and expenditures to administer the county sales and use tax are charged to this appropriation. Since enactment of 1997 Wisconsin Act 27, the unencumbered balance in this appropriation has lapsed to the General Fund at the end of each fiscal year. Amounts lapsed in each of the last four years are shown in Table 11. A one-time adjustment to the Department's schedule for claiming administrative fees in FY 1999-2000 increased the amount lapsed to $931,600.

Table 11

Amounts Expended and Lapsed
County Sales and Use Tax Administration Appropriation

	FY 1996-97	FY 1997-98	FY 1998-99	FY 1999-2000
Beginning Balance*	$ 1,000,200	$ 196,600	$ 132,400	$ 17,300
Fee Retained	2,414,400	2,756,600	2,801,100	3,871,800
Less: Expenditures	(1,996,400)	(2,259,000)	(2,385,000)	(2,951,800)
Ending Balance	1,418,200	694,200	548,500	937,300
Less: Encumbrances	(196,600)	(132,400)	(17,300)	(5,700)
Lapsed to General Fund	$ 1,221,600	$ 561,800	$ 531,200	$ 931,600

* Represents encumbrances from the prior-year appropriation.

As shown in Table 12, 19.0 percent of the retained administrative fee lapsed to the General Fund in FY 1998-99. In FY 1999-2000, the percentage lapsed increased to 24.1 percent of the amount retained.

Table 12

Percentage of Administrative Fee Lapsed to General Fund

	FY 1997-98	FY 1998-99	FY 1999-2000
Administrative Fee Retained	$2,756,600	$2,801,100	$3,871,800
Lapse to General Fund	561,800	531,200	931,600
Percentage Lapsed	20.4%	19.0%	24.1%

Department Personnel Funded by Administrative Fee

The number of positions funded by the fee is not adjusted annually to reflect reported hours worked.

Some have questioned the Department's methodology for determining the expenditures charged to the administrative fee. For example, the Department determines the number of staff the administrative fee will fund by estimating the staff time needed to complete individual tasks. As shown in Table 13, for several fiscal years the number positions funded by the administrative fee has remained constant. However, both the number of counties imposing a sales and use tax and the amounts collected in taxes have increased, suggesting that the Department does not review and revise its estimates annually. For example, although eight additional counties imposed the tax and the amount distributed increased from $111.5 million in calendar year 1992 to $144.6 million in calendar year 1995, the administrative fee funded a constant 39.80 full-time equivalent (FTE) positions from FY 1991-92 through FY 1995-96. Currently, 33.25 FTE positions are funded by the administrative fee: 29.75 are within the Division of Income, Sales and Excise Tax and 3.5 are within the Office of Information Services. Budgeted staffing levels were reduced beginning in FY 1996-97 as a result of efficiencies gained by the introduction of electronic scanning devices.

Table 13

Personnel Funded by County Sales and Use Tax Administrative Fee

Fiscal Year	FTE Permanent Positions
1985-86	6.75
1986-87	11.80
1987-88	12.80
1988-89	15.30
1989-90	19.50
1990-91	19.50
1991-92	39.80
1992-93	39.80
1993-94	39.80
1994-95	39.80
1995-96	39.80
1996-97	33.25
1997-98	33.25
1998-99	33.25
1999-2000	33.25

As shown in Table 14, the county sales and use tax administrative fee funded 29.75 of the 803.25 FTE positions budgeted for the Department's Division of Income, Sales and Excise Tax during the 1999-01 biennium. Of the 29.75 positions funded by the fee, 17.5, or 58.8 percent, were performing tax compliance functions such as making adjustments to returns and assisting taxpayers by responding to questions.

Table 14

Budgeted FTE Positions in the Division of Income, Sales and Excise Tax, by Function and Funding Source
(1999-01 Biennium)

Funding Source	Audit	Tax Compliance	Tax Processing	Administration	Total
State (GPR)	324.80	223.70	131.05	42.80	722.35
Other Tax Program	18.75	31.90	0.50	0.00	51.15
County Sales Tax Administrative Fee	6.00	17.50	6.25	0.00	29.75*
Total	349.55	273.10	137.80	42.80	803.25

* Does not reflect 3.5 FTE positions assigned to the Office of Information Services.

In FY 1999-2000, the administrative fee funded more positions than were used to administer the tax.

Staff in the Department use an internal time reporting system to record the amount of time they spend on each different type of tax. We compared the Department's staffing estimates with data from its time reporting system for staff in the Division of Income, Sales and Excise Tax. As shown in Table 15, we found differences between the number of positions funded by the county sales and use tax administrative fee and the number of positions reported to be performing county sales and use tax activities. For example, in FY 1999-2000 the county sales and use tax administrative fee funded 10.38 FTE positions more than time reporting records indicated had worked on administration of the tax. Although these data are self-reported on a monthly basis and may contain discrepancies between hours reported and actual hours of work performed, the size of the discrepancy in recent years suggests that either considerably less staff time is spent processing the county tax than estimated or there are errors in the administration of the time reporting system.

Table 15

FTE Positions Reported Administering County Sales and Use Tax*

Fiscal Year	FTE Positions Funded by Fee	FTE Positions Reported Administering Tax	Difference
1996-97	29.75	29.65	0.10
1997-98	29.75	26.34	3.41
1998-99	29.75	20.88	8.87
1999-2000	29.75	19.37	10.38

* Does not reflect 3.5 FTE positions assigned to the Office of Information Services

In FY 2000-01, the Department instructed its staff to more fully recognize county sales and use tax processing on their time reports. Preliminary data for FY 2000-01 suggests that staff are reporting more time administering county sales and use taxes than was reported during the previous fiscal year.

County Sales and Use Tax and the Integrated Tax System

In addition to supporting costs for personnel, supplies, and services, the county sales and use tax administrative fee has recently been used to support costs for the development of the Department's computerized tax processing system, ITS. One explanation for the administrative fee's increase from 1.5 percent to 1.75 percent of collections was that the increase would fund the county sales and use tax program's share of development and implementation costs for ITS. An increase in the fee at the same time unencumbered fees were lapsing to the General Fund led some county officials to question how the Department determined the county sales and use tax program's share of ITS costs.

The Department currently maintains separate computer systems for each of 30 state and local taxes, which will be combined under ITS. The Department asserts that benefits from ITS will include increased revenue collection, Internet tax filing, and faster refunds. Eventually, the Department believes ITS may lead to increased processing speed and faster distribution of county sales and use tax revenues to counties. The budget for ITS, including the estimated costs of financing the project through master leases, was approved during the 1997-99 biennium and totaled $78.0 million.

Estimated costs of the ITS phase containing the sales and use tax are $27.2 million.

As noted in our review of the State's use of computer consultants (report 01-06), ITS development is currently two years behind the original time line, and completion of the entire system is now anticipated in FY 2006-07. Implementation of ITS is scheduled in several phases, and the phase that includes the sales and use tax is to be the first implemented, in FY 2002-03. This phase includes elements specific to the sales and use tax, as well as system-wide elements such as the design and development of accounting, registration, and data warehousing functions. Because all of the elements are interrelated, isolating costs for only the sales and use tax is difficult. Costs for the entire phase, including a proportional share of financing charges, are estimated at $27.2 million.

The administrative fee will fund $8.8 million, or 32.4 percent, of the ITS project phase involving the sales and use tax.

1999 Wis. Act 9 authorized the Department to expend $750,000 in county sales and use tax administrative fees in FY 1999-2000 for ITS-related costs. As noted, by the close of FY 1999-2000, the Department had reported expending $646,000 for ITS-related leases and equipment. In June 2000, it made a formal request to the Joint Committee on Finance under s. 13.10, Wis. Stats., for the release of ITS funds for FY 2000-01. The Department's request assessed the county sales and use tax administrative fee $800,000 in ITS costs in that fiscal year. Because this assessment is included in the base funding for ITS, $800,000 will be funded by the county sales and use tax administration appropriation in each fiscal year through FY 2009-10, when all financing costs for the ITS project have been paid. As shown in Table 16, it is anticipated that from FY 1999-2000 through FY 2009-10, $8.8 million in ITS costs, or 32.4 percent of the estimated $27.2 million cost of the sales and use tax phase, will be funded by the county sales and use tax administrative fee.

Table 16

Percentage of ITS Costs Funded by the County Sales and Use Tax Administrative Fee
(in millions)

ITS Component	Estimated ITS Costs with Financing	Total County Sales and Use Tax Funding	Percentage Funded by Administrative Fee
Sales and Use Tax Component	$27.2	$8.8	32.4%
All ITS Components and Finance Costs	78.0	8.8	11.3

ITS charged were based on unencumbered funds available in the appropriation.

Department staff indicate that the $800,000 annualized cost assessment was not determined by any analysis of the costs or benefits of ITS associated with the county sales and use tax. Instead, they indicate that each tax program's share of system costs was based on the funds available in that program's appropriation without an increase in any administrative fee. Therefore, it appears the county sales and use tax was assessed $800,000 in ITS costs because this was the amount the Department determined was available from the funds generated by the administrative fee.

****

Appendix 1

Effective Dates of County Sales and Use Taxes

County	Effective Date	County	Effective Date
Adams	Jan. 1994	Marathon	Apr. 1987
Ashland	Apr. 1988	Marquette	Apr. 1989
Barron	Apr. 1986	Milwaukee	Apr. 1991
Bayfield	Apr. 1991	Monroe	Apr. 1990
Buffalo	Apr. 1987	Oconto	Jul. 1994
Burnett	Apr. 1989	Oneida	Apr. 1987
Chippewa	Apr. 1991	Ozaukee	Apr. 1991
Columbia	Apr. 1989	Pepin	Apr. 1991
Crawford	Apr. 1991	Pierce	Apr. 1988
Dane	Apr. 1991	Polk	Apr. 1988
Dodge	Apr. 1994	Portage	Apr. 1989
Door	Apr. 1988	Price	Jan. 1993
Douglas	Apr. 1991	Richland	Apr. 1989
Dunn	Apr. 1986	Rusk	Apr. 1987
Eau Claire	Jan. 1999	St. Croix	Apr. 1987
Forest	Apr. 1995	Sauk	Apr. 1992
Green Lake	Jul. 1999	Sawyer	Apr. 1987
Iowa	Apr. 1987	Shawano	Apr. 1990
Iron	Apr. 1991	Taylor	Jul. 1999
Jackson	Apr. 1987	Trempealeau	Oct. 1995
Jefferson	Apr. 1991	Vernon	Jan. 1997
Juneau	Apr. 1992	Vilas	Apr. 1988
Kenosha	Apr. 1991	Walworth	Apr. 1987
La Crosse	Apr. 1990	Washburn	Apr. 1991
Lafayette	Apr. 2001	Washington	Jan. 1999
Langlade	Apr. 1988	Waupaca	Apr. 1989
Lincoln	Apr. 1987	Waushara	Apr. 1990

State of Wisconsin • **DEPARTMENT OF REVENUE**

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Scott McCallum
Governor

Richard G. Chandler
Secretary of Revenue

May 21, 2001

Ms. Janice Mueller, State Auditor
Legislative Audit Bureau
22 East Mifflin Street, Suite 500
Madison, WI 53703

Dear Ms. Mueller:

We appreciate the opportunity to comment on the Legislative Audit Bureau's (LAB) report regarding the Department of Revenue's administration of the county sales and use tax. The Department extends its appreciation to you and your staff for your thorough review and evaluation.

Specifically, the Department would like to comment on the following areas in the report:

1) The Department supports the recommendation to reduce the statutory time period for distributing sales and use taxes to county governments. The Department believes it would be able to meet a 75 day deadline. In the future, as the sales and use tax component of the Integrated Tax System (ITS) is implemented and the use of Internet filing increases, the Department would be in a position to ensure timely distribution.

2) The department has implemented a number of processing control measures which we believe will improve our ability to identify potential problems early on in the process, thereby significantly reducing the likelihood of inaccurate distributions. As identified in the report, a number of procedural changes were implemented in March 2000 to relieve the backlog effect on county distributions. The Department will continue to closely monitor and evaluate the processing of returns to ensure accurate distributions.

3) The Department believes that errors in the administration of the time reporting system accounted for the discrepancy between the number of full-time equivalent (FTE) positions funded by county sales and use tax administrative fees and the reported number of equivalent positions performing county sales and use tax activities. Since the LAB identified the differences, department staff have been directed to be more diligent in their reporting of actual time spent on the administration of county sales and use tax. A Department review of the first six months of time reporting data in FY 2000-01 indicated that 26.18 FTE positions were used to administer the tax, a difference of only 3.57 FTE from the 29.75 funded FTE positions. The Department will continue to closely monitor and analyze the time reporting data and make changes to the time reporting system, as necessary, to ensure the validity of the time reporting system.

4) As the report notes, the Department believes that implementation of ITS will provide several benefits to the counties such as increased revenue collection. ITS is being developed and implemented in phases with the help of outside vendors. The final phase is to be completed in FY 2005-06. Although the implementation schedule has been delayed by one year than originally planned in 1999, we continue to be within scope and budget. ITS scope includes developing the necessary knowledge and skills of our employees to cost-effectively maintain the system after full implementation.

The sales and use tax component will be the first tax type scheduled to be implemented in FY 2002-03. This phase provides a core foundation for all future tax types by incorporating data capture, registration, accounting and processing functionality. During this phase, we also plan to expand three pilot projects that were implemented in FY 1999-00: increase in the use of scanning and imaging; expansion of sales internet filing (SIP); and expansion of the data warehouse to enable direct access to sales data for use in audit selections.

We value the Audit Bureau's feedback regarding the Department's administration of the county sales and use tax, and remain committed to continuing to improve the administration of the tax.

Sincerely,

Richard G. Chandler
Secretary of Revenue

RGC:rfr