

Tax Code Development and Administration
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Introduction

The focus of this brief paper is to explain the parts and pieces of tax and tax administration, including basic considerations in drafting a tax, important milestones for implementation, bare bones administration processes, and some of the bells and whistles.

A large taxing organization will have a much different tax administration outlook than a smaller taxing organization, but the two have commonalities. This paper will explain and identify elements important for both types of organizations.

Jurisdictional aspects of tribal taxation, and any applicable state law issues, are not the subject of this paper.

Terminology

Administration: The day to day processes for registering, reporting, paying, educating, compliance, enforcement, and appeals.

Amnesty: A program to allow tax evaders and unregistered taxpayers to come forward, with no or reduced penalties for past behavior.

Appeal: Processes to contest taxability issues.

Audit: The examination of a taxpayer's books and records, and a review of its business processes, to determine whether the taxpayer is reporting tax correctly. There are correspondence audits (also known as desk audits) and full books and records audits (known as field audits.)

Base: This is also called the measure of the tax and is the value to which the tax rate is applied.

Claim period: A period set in statute that establishes a timeframe after which claims are not allowed in regard to tax issues. The time during which a claim can be made or during which the tax administrator can assess is referred to as "open years." For particularly egregious behavior the open years may be longer. These types of statutes are called "nonclaim statutes."

Compliance: Tax administration efforts to influence taxpayer behavior are often referred to as "compliance" programs. Compliance programs range from education to seizure of assets. The tax administration goal is for high voluntary compliance, with targeted enforcement.

Confidentiality: Information that has been identified in the tax code as nondisclosable under public records laws in order to protect privacy, proprietary information, or promote specific taxpayer behavior.

Credits: Amounts subtracted from tax (offset against taxes owed)

Deductions: Amounts subtracted from taxable amounts, to reduce the amount of income, value, property, etc, subject to tax.

Education: Specific efforts to inform and communicate with the taxpayer community or taxpayer to increase awareness of obligations and improve compliance.

Enforcement: Targeted efforts to address tax avoidance (noncompliance). Enforcement includes fines, penalties, and prison. It can involve subpoenas, discovery, surveillance, and other investigative methods.

Exempt: The status of not being subject to tax, whether it is a person, place, category of property, etc.

Implementation: The execution and roll out of the tax.

Incidence: Who bears the tax. Sometimes this is discussed in terms of legal incidence (who is legally required to pay the tax) and economic incidence (who bears or really pays the tax.)

Letter Rulings: Application of law to facts, documented in writing, in order to provide specific guidance to taxpayers.

Measure: The amount or value subject to tax.

Productivity: To what extent a tax produces revenue. Some taxes are very productive and very stable (not volatile).

Rate: The amount applied to the measure. $\text{Rate} \times \text{measure} = \text{tax}$. Sometimes this is called the statutory tax rate.

Refund: Amount of tax that has been overpaid.

TABOR: Taxpayer Bill of Rights. For an example see chapter 82.32A RCW, which lays out taxpayer rights and responsibilities in Washington state.

Tax: A mandatory charge imposed by a government to raise revenue for a public purpose. Under state and federal law fees are different from taxes, but often the terms are used interchangeably and loosely. Generally taxes may be used for any purpose and fees must have some relationship to the fee payer in terms of services and benefit.

Tax gap: The difference between what taxpayers pay, versus the total amount due from taxpayers. The gap is noncompliance basically, and includes underreporting, underpayment, and nonpayment.

Trigger: The event that causes the tax to be imposed, such as a sale, a use, possession, death, cutting timber, floor space over 2,000 square feet, bottling, and so forth.

Volatility: A tax is volatile if its productivity swings up and down. Volatility basically measures change. Global and national economic conditions, business cycles, and consumer behavior contribute to volatility. Given a choice a stable tax is preferred over a volatile tax.

Decision Points

There are a multitude of decisions to make before you prepare the tax code draft. Some of these may be more or less decided for you due to facts and circumstances.

For example, you may only have one business to tax, for example a resort. It makes sense you would impose a tax on lodging, but you have to decide the tax rate, and how to collect it, and how the money will be used. There are other activities at the resort as well, and you might decide to tax the various activities, such as restaurant meals, entertainment, golfing, and so forth. You have vendors coming and going at the resort, and you need to decide how to tax those. (A related part of this decision point exercise is whether the state is taxing these same transactions and if the concurrent jurisdiction issue still needs to be resolved.) Lodging needs to be defined because you do not want to sweep in other rentals and uses of property inadvertently.

The following is a list of information you need before you start drafting:

- To understand who and what you can tax;
- To know what you want to tax;
- To have an awareness of the operations of the person or business on whom the tax will be imposed;
- What processes will be used to educate, collect, enforce, refund, and appeal;
- Whether an administrative body, such as a tax commission or tax department, will manage the tax, or will some other method of assigning the workload be used.
- An idea of what you will generate in revenue and how the money will be used;
- What is reviewable in tribal court.

A tax law should specify how much each taxpayer is liable to pay and what the taxpayer's rights and obligations are and should provide a legal basis for all of the administrative processes. In the most general terms, a tax law should be drafted with the overall goal to get taxpayers to report and pay taxes on time and correctly. And everything should be done with the goal of making it easy for a taxpayer to comply with the tax obligations. Simplicity improves compliance and high compliance reduces the cost of administration.

Parts of the tax draft

Definitions

All key terms should be defined. This includes who is the taxpayer and what is being taxed. If lodging is being taxed, then what is and what isn't lodging needs to be set forth clearly. Using utility tax as an example, you may have definitions for: Utility, property, owner, railroad, pipeline, transmission, broadcasting, electricity, gas, person, tax, reservation, and tribe.

Imposition, rate, measure, and trigger

The tax rate should be clearly set forth and the measure of the tax must be clear. The imposition itself needs to be set forth, meaning who is the taxpayer, and the trigger should be described, meaning what causes the tax to be imposed. Imposition, rate, measure, and trigger can be written like this "There is imposed on each person using the solid waste services of a solid waste collection business a solid waste collection tax equal to three and six-tenths percent of the consideration charged for the services."

Processes

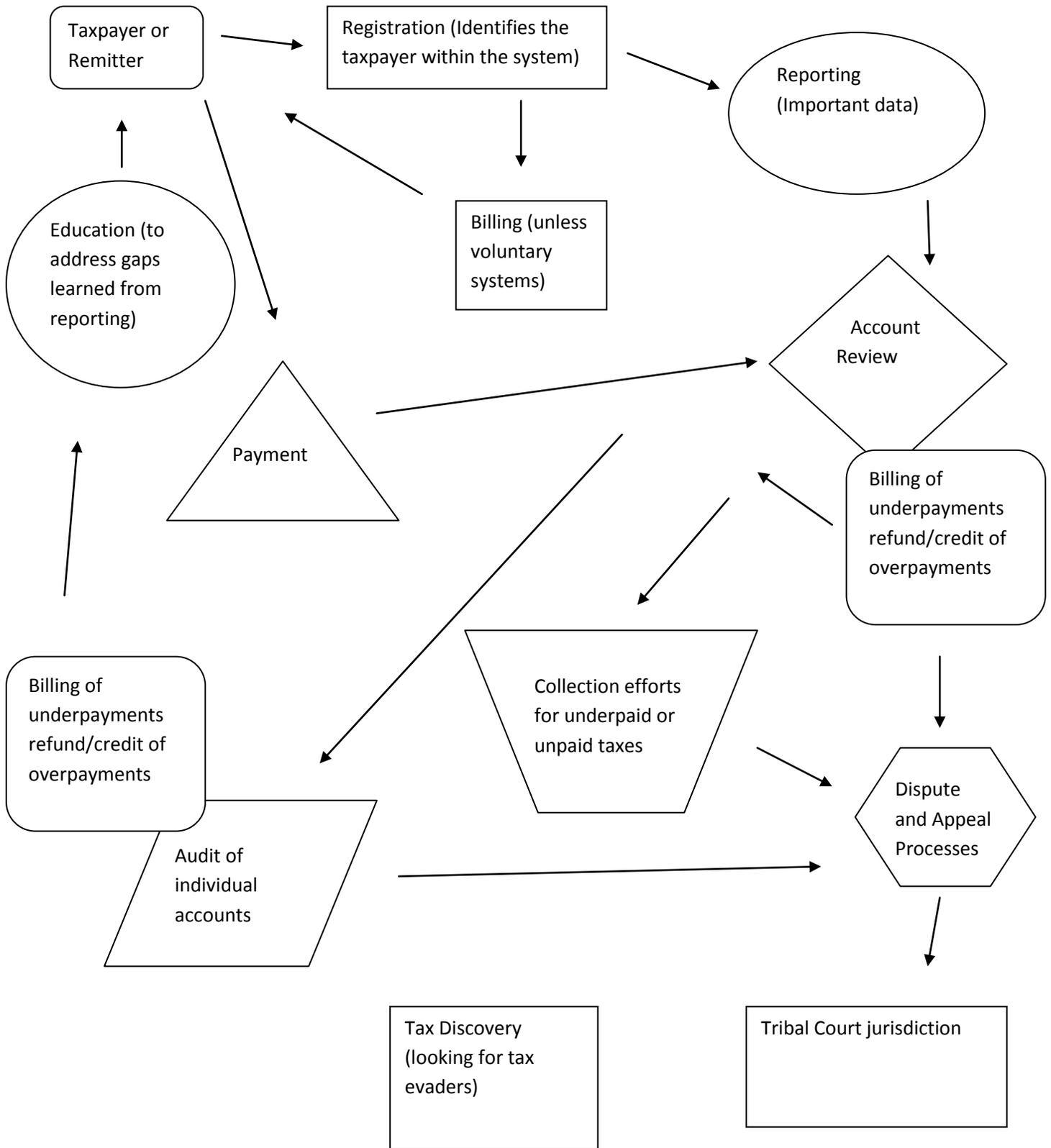
The tax code should include all of the provisions necessary to administer the code such as:

- registration of the taxpayer (if that is a process for the particular tax),
- how values are established,
- due dates, what are the consequences of late filing and late payment,
- what are the requirements to seek a refund,
- what interest rates will be used,
- what authority does the tax organization have to examine books and records,
- is there an appeal process and what are its steps and requirements,
- what type of matters can be appealed to the tribal court,
- enforcement and collection processes should be set forth , for example, if the tax will be enforced through a lien this should be described,
- if there a process to settle tax disputes or entering into closing agreements this should be set out, with identification of who has the authority to enter into settlements and under what circumstances, and
- any parameters around sharing of information outside of the taxing organization.

Authority

Because taxation is so serious (the government is taking peoples' money and using it for redistributive purposes and government expenses) the tax code needs to be precise regarding authority. The entity with authority to administer the tax needs to be identified. Where applicable the tax code should give general authority to develop forms, hire staff, hear disputes, and provide guidance, among other activities.

The following is a generic flowchart for a tax administration system.



Tax Administration Processes

Tax administration capacity is a real issue for implementation of a tax code. A tax code can be administered by one person. Two sounds much more fun, and is sounder because it allows segregation of duties. Typically, a tax code that is complex and has multiple taxes, due dates, and processes will have an organization with a variety of staff that work cooperatively but are divided functionally. Tax administration processing involves handling of money, sometimes vast amounts of money. Accounting principles, segregation of duties, and internal controls should be considered at each step. Tax administration functions should dovetail with budgeting, with the tribal CFO, and with the legal department.

The system should be set up with the overall goal in mind, which is one hundred percent accurate and on time payment in full by all taxpayers. One hundred percent is not the true performance goal of course, but it is every tax administrator’s dream. Test each system part against the following principles:

1. **Filing is easy**
2. **Paying is convenient**
3. **Tax obligations are understandable**
4. **Systems are in place to detect and respond to noncompliance**
5. **Assistance is available**

The following is a description of each box in the tax administration system flow chart above.

Tax Process	Discussion
Taxpayer/Remitter	The issue here is identifying the taxpayer and how the tax will be collected. How will taxpayers know they are the taxpayer and their obligations to report and pay? Sometimes the taxpayer does not report the tax or even register, such as with the retail sales tax. Sales tax is collected typically at the point of sale and the retailer will be acting as an agent for the tribe, and will collect, hold, and transmit the tax. If you are taxing extracting (mining, timber harvesting, etc) the taxpayer is the extractor typically and will be the person/entity registering and reporting. For some taxes you will have nearly complete knowledge of who is in the taxpayer pool, such as persons harvesting under a tribal permit. In other circumstances you will need additional information to identify the taxpayers, for example if you are taxing permanent improvements on trust land persons leasing from tribal allottees might not be in tribal records.
Registration	Registration gets the taxpayer in your system so that you are able to track their behavior, send them notices, update them on tax changes, and bill them. Some systems use voluntary registration and then tax discovery and enforcement as the motivator for self-registration. Tax administrators can pre-register taxpayers and send them periodic forms. The choice of method depends on what information you have available, the number of taxpayers, and the system you have developed. Modern tax administration systems use web-based applications and on-line processes.
Reporting	This process step is how information is provided to the tax administrator. What information is reported and in what format is an important decision. The development of the form is an important step so that it captures the taxpayer identity and any information necessary for the tax administrator to analyze trends and calculate tax due. This data is important for reconciliation of amounts owed,

	<p>billings, and payments. It is used for desk reviews and selection of field audits and for collection. Having good data is a huge part of risk management and is how work gets prioritized. But taxpayers are the source of much of the data and a tax administrator has to balance a perfect world of maximum data with the burden on taxpayers of reporting. A lot of thought needs to go into what a taxpayer needs to report on a regular basis. If the tax becomes a regular source of reliable income for the Tribal budget it will be important to do revenue estimating. This raw data and any trends can be integrated into that system.</p>
Payment	<p>This step is separate from reporting (although it can be simultaneous) because the actual financial information and money is handled separately from the data and information. Large organizations use electronic payments, automatic payments, pay pal, credit cards, etc. Most organizations continue to accept checks but some organizations no longer accept cash due to the risk associated with cash handling. You can impact your budget year by the way your schedule tax due dates. Tax administrators need to work with their CFOS and Treasurers (who knows, they may be the same person wearing different hats, depending on your organization.)</p>
Account Review	<p>This step is dependent on the size of your organization, the sophistication of your processes, and the number of taxpayers. If you have a taxpayer base of 300 tenants, you can develop a simple desk method to review all filings and payments. If you have thousand of taxpayers you likely will have a computerized method where errors and glaring holes are flagged and reports are automatically generated. The point is to have a method to ascertain whether taxpayers are reporting correctly and a plan on what to do with the information.</p>
Audit	<p>There are basically two types of audit, the desk audit and the field audit. Desk audits take place at the tax organization and use the data that has been reported as well as any additional information the tax administrator may request of the taxpayer. Field audits are more involved and are at the taxpayer's location(s). Field audits look at books and records and analyze business processes. Field audits are very time consuming and expensive. Generally most taxpayers are not subjected to field audits. An audit is both an enforcement tool (deterrence and detection) and an education tool. At the conclusion of an audit (either desk or field) the taxpayer will be billed for underpaid tax, will receive a credit or refund, or will be at status quo. Reporting instructions might be provided that highlight areas of concern. In a way, a field audit tests your entire system and is a way to evaluate whether your outreach and education has had its intended effect. Since audits are expensive in terms of staff and time, a tax administrator will want to develop audit selection criteria. Some random audits are usually done and then data is used to select specific taxpayers or industries.</p>
Billing	<p>Depending on your system, a taxpayer is either billed for each payment or billed for underpayments or not paying. Late payment fees can be assessed if that is part of the compliance program (this should be included in your tax code authority) as well as fines and penalties for noncompliance.</p>
Refunds/Credits	<p>A process should be in place to allow taxpayers to apply for refunds. Refunds are due when a taxpayer makes a mistake in filing, when the tax administrator changes an interpretation and it is retroactive, when the tax administrator has made a</p>

	<p>mistake requiring payment, and other similar situations. Refunds often include payment of interest (the time value of money.) If a taxpayer has an ongoing payment stream then a tax credit to offset other tax obligations is an option. Tax credits in the place of refunds should be included in the tax code, if this is a desired feature of your tax code. The tax administrator will also initiate refunds when it discovers overpayments during account review or audit or when mistakes or errors are made at its end. For example, sometimes forms or instructions will be written incorrectly, and the consequences of this needs to be unwound.</p>
Collection	<p>Collecting unpaid taxes can be done in-house or through the use of a collection agency. This is a business decision and depends on the size of outstanding liabilities, the cost of collection, and the likelihood of collecting the unpaid tax. Other methods of recovering taxes include seizing property and garnishing wages. The tax code needs to include these processes.</p>
Tax Discovery	<p>Tax discovery is the sleuthing out of unregistered businesses, under the counter transactions, and working to get the underground economy to register and pay taxes. Some tax discovery involves sharing information with the federal government and state government. Large tax organizations spend time crunching and cross matching IRS 1099 data to find businesses that are not registered. All of this requires at least general statutory authority.</p>
Dispute and Appeal	<p>Taxpayers need a fair opportunity to challenge the accuracy and legal validity of an assessment for taxes and penalties. This can include appeals to managers and supervisors, appeals to the head of the department, appeals to a separate hearing officer, and appeals to the tribal court. In developing the appeals process it is important to include time lines, expectations of taxpayer documentation, whether a tax needs to be paid in order for a taxpayer to challenge the assessment, and finality of decisions.</p>
Education	<p>Education will help taxpayers and their advisors understand their obligations and rights (taxpayers cannot comply if they do not understand the tax laws and procedures). Modern taxpayer education happens across a broad spectrum, including on-line chat, video conferencing, in person training, advisories, bulletins, facebook, and twitter. The point is to be smart, targeted, and clear. Large organizations operate call centers. These call centers often are used for targeted work throughout the year, and sometimes for collection efforts. User-centered design can help the tax administrator create the right forms and instructions. Considering working with your stakeholders to understand their point of view and needs.</p>

Ethics and Public Employment

Depending on the size of your tax base and the amount of revenue collected, you might be dealing with financial transactions equivalent to what a bank handles. Tribal tax departments are not banks, but they do need policies and procedures in place to keep them a trusted and integrity driven organization. Here are some things to think about for public employees administering taxes.

- Access to data
- Secrecy
- Fairness/uneven application of the law
- Looking the other way
- Favoritism
- Fraud/Corruption
- Conflict of interest
- Misuse of authority
- Perception
- Gifts

Enacting a code of ethics specifically for the tax department is a good policy.

Finally

Almost anything can be taxed. Taxation is just a method of getting money for your government by identifying opportunities that lend themselves to taxing. If you notice it, or can get information about it, you can tax it. Examples of taxes:

Business activity taxes

Sales and use tax

Income tax

Property tax

Leasehold/Possessory interest tax

Utility tax

Estate tax

Cigarette/tobacco tax

Lodging tax

Floor tax

Head tax

Tire tax

Fuel tax

Pollution tax

Oil Spill tax

Litter tax

Luxury cars

Conclusion

If you have endless resources your tax department might look like this:

Taxpayer account division identifies taxpayers

Taxpayer education division develops a welcome letter and education information targeted to the industry and taxpayer, after consulting with the ***policy division***

Taxpayer account division sends the taxpayer this new business orientation kit in advance of the due dates

Taxpayer account division sends filing and reporting information to each taxpayer electronically on a monthly basis

Taxpayers report electronically and pay using convenient methods

Audit division reviews all account information using its super computer and data warehouse

Revenue officers from the **compliance division** collect delinquent taxes

The **call center** answers phone calls

The **automated telephone system** takes calls and emails tailored forms and taxpayer guides

Data entry processes the paper filings using optical character reading technology and bar codes

The Tribal treasurer distributes funds to tribal subdivisions

IT division fixes glitches and develops leading edge applications.

Reality

Most tribes do not have the staff or need to create a tax collecting empire. But that is not the end of the story. Using the information you have roles that are essential can be identified. Using a white board you can sketch out the tax month and the tax year. You can establish the framework for taxpayer outreach, taxpayer filing, taxpayer due dates, audit and compliance, and taxpayer. The taxes you impose can be well managed and productive.