

A Review of

# Tax Settlements at the Office of the Comptroller of Public Accounts

September 2005

Report No. 06-002



## *A Review of Tax Settlements at the Office of the Comptroller of Public Accounts*

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As required by Texas Government Code, Section 321.0138, the State Auditor's Office and the Legislative Audit Committee reviewed the Office of the Comptroller of Public Accounts' (Comptroller's Office) records related to tax settlements and other information maintained by the Texas Ethics Commission.

This report is the result of our efforts to review tax settlement and related information to meet the requirements of the Texas Government Code. We make no conclusions regarding the information in this report. We are not implying any wrongdoing on the part of any individual or group associated with the information in this report. The information included in this document provides a summary of the contribution and tax settlement analysis, presents recommendations and proposed statutory language, describes our methodology, and provides a copy of Texas Government Code, Section 321.0138.

The nature, circumstances, and facts of each settlement are different.

### Key Points

- We identified 3,656 tax settlements (for 755 distinct taxpayers) that occurred within one year of a related contribution (see page 4). The related contributions totaled approximately \$2 million. These tax settlements, which totaled approximately \$461 million, took place from January 1999 through August 2004. These 3,656 tax settlements included 448 management halts and 428 administrative hearings.
- Of the 3,656 settlements identified above, we identified 146 amended audit assessments (associated with 90 distinct taxpayers) for which the amended assessment was at least \$10,000 less than the original audit assessment. These 90 taxpayers received a total of approximately \$227 million in decreased audit assessments.
- During calendar years 1998 through 2004, 19 selected taxpayer representatives made 261 campaign contributions totaling \$1.7 million. These entities represent and assist taxpayers in recovering overpayments, planning tax strategies, and resolving tax disputes.
- The Comptroller's Office does not always sufficiently document why a management halt was placed on a tax account. Management halts are cases in which the Comptroller's Office temporarily stops (1) tax collection actions, (2) issuance of tax overpayment notices, and (3) automatic transfers of tax credits. As of January 14, 2005, **11,699 management halts** that the Comptroller's Office put into effect between fiscal years

1998 and 2004 **had not been concluded**. We did not review outstanding management halts put into effect prior to fiscal year 1998.

- For administrative hearings, we were unable to determine disputed tax liability amounts and could not readily determine final tax settlement amounts because of the manner in which the Comptroller's Office maintains this information.

#### Selected Recommendations

The Legislature should consider:

- Enacting legislation to prohibit campaign contributions to the Comptroller of Public Accounts or a person seeking election to the Office of the Comptroller of Public Accounts from any individual or entity representing taxpayers before the Office of the Comptroller of Public Accounts.
- Requiring the Texas Ethics Commission to create a new class of registrant for taxpayer representatives. All taxpayer representatives should register with and provide the appropriate information to the Texas Ethics Commission and be subject to the same provisions as other registrants with the Texas Ethics Commission.
- Requiring the Comptroller's Office to create a taxpayer representative registry and maintain power of attorney documentation for all taxpayer representatives. The registry should identify all taxpayer representatives **associated** with **each tax settlement** and taxpayer. If multiple taxpayer representatives are associated with a tax settlement, the registry should identify the relevant dates each taxpayer representative was associated with the settlement.
- Enacting legislation to transfer the authority to conduct tax dispute hearings from the Comptroller's Office to the State Office of Administrative Hearings or another independent entity. Currently, disputed tax cases are assigned to an administrative law judge appointed by the Comptroller of Public Accounts. While we found no evidence of preferential treatment, this arrangement could present the **appearance** that hearings are not processed in an objective and impartial manner and that **independence could be impaired**. To maintain the technical knowledge and efficiency of current operations, the administrative law judges, their support staff, and their equipment should be transferred to the State Office of Administrative Hearings to continue their duties. The Comptroller's Office should provide technical tax expertise as appropriate.

Detailed results are included in the following sections of this document:

- Part 1: Analysis of Campaign Contributions and Tax Settlements (page 4)
- Part 1-A: Summary of Taxpayer Representative Campaign Contribution Analysis (page 5)
- Part 2: Summary of Analysis of Tax Settlements (page 8)
- Part 3: Detailed Analysis of Tax Settlements (page 10)
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- Methodology for Compiling, Analyzing, and Reviewing Tax Settlements and Contributions (page 25)
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- Management's Responses (page 32)

## Part 1: Analysis of Campaign Contributions and Tax Settlements

We identified 3,656 tax settlements (for 755 distinct taxpayers) that occurred **within one year** of a “related campaign contribution.” These tax settlements took place from January 1999 through August 2004. We considered a related campaign contribution to be:

### Tax Settlement Analysis

- 3,656 tax settlements occurred within one year of a related campaign contribution. These 3,656 tax settlements were made between January 1999 and August 2004 and totaled approximately \$461 million. The 3,656 includes 448 management halts and 428 administrative hearings, which do not have an associated dollar amount.
  - 23,514 tax settlements had a related campaign contribution during the seven-year period we reviewed.
  - 182,287 tax items for the seven-year period we reviewed were identified. These items included
    - ♦ 82,641 management halts, which do not have an associated dollar amount
    - ♦ 6,968 administrative hearings, which do not have an associated dollar amount
    - ♦ 92,678 tax items that were either (1) tax settlements that were at least \$10,000 or (2) tax settlements for taxpayers that cumulatively received tax waivers or tax refunds of at least \$10,000.
- Instances in which the taxpayer made the contribution.
  - Instances in which the taxpayer’s registered agent(s) or officer(s) made the contribution.
  - Instances in which the taxpayer’s registered lobbyist(s) made the contribution.
  - Instances in which the taxpayer’s representative(s) made the contribution.
  - Instances in which a political action committee with the taxpayer’s address made the contribution.

## *Part 1-A: Summary of Taxpayer Representative Campaign Contribution Analysis*

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During calendar years 1998 through 2004, 19 selected taxpayer representatives made 261 campaign contributions totaling approximately \$1.7 million to the Comptroller in office from 1999 through 2004. A summary of these contributions is presented in Table 1.

Initially, we identified 73 taxpayer representatives that appeared on both lists maintained by two different Comptroller's Office's divisions. We compared information regarding these taxpayer representatives with campaign contributors' names. In addition, we identified agents and officers registered with the Secretary of State for these taxpayer representatives and compared them with campaign contributors' names. We also performed this analysis for five additional taxpayer representatives that we selected from the list the Comptroller's Office provided from its Hearings Tracking System. This analysis resulted in the identification of 19 selected taxpayer representatives.

We performed an additional analysis on taxpayer representatives that contributed at least \$10,000. Specifically, we identified and compared key employee names with campaign contribution data from the Texas Ethics Commission. We defined a key employee as any employee who focuses on state and local taxation or state tax issues. We identified key employees by researching taxpayer representatives' Web sites. The additional contributions we identified through this analysis are included in Table 1.

Table 1

Summary of Taxpayer Representative Campaign Contributions to the Comptroller in office from 1999 through 2004 1998-2004 <sup>a</sup>		
Contribution Amount Range	Number of Taxpayer Representatives Who Made Contributions in Range	Total Amount of Contributions in Range
\$0 - \$999	2	\$ 900
\$1,000 - \$4,999	3	7,600
\$5,000 - \$9,999	1	5,000
\$10,000 - \$49,999	4	159,167
\$50,000 - \$99,999	7	540,725
\$100,000 - \$499,999	1	223,400
\$500,000 or more	1	812,928
Totals	19	\$1,749,720

<sup>a</sup> The Texas Ethics Commission maintains contribution information on a calendar year basis. Therefore, the information included in Table 1 is also presented on a calendar year basis.

As Table 1 shows, one taxpayer representative made almost one-half of all contributions from the 19 selected taxpayer representatives. Total contributions from these 19 selected taxpayer representatives increased from \$137,650 in 1998 to \$542,737 in 2004 (a 294 percent increase).

Table 2 lists all 19 selected taxpayer representatives and their respective contributions for calendar years 1998 through 2004. For confidentiality purposes, the names of individuals have been removed.

Table 2

**Contributions by Taxpayer Representative by Calendar Year  
To the Comptroller in Office from 1999 through 2004  
(1998 through 2004)**

Taxpayer Representative Firm	Contributor Total	Total Contributions Made During Calendar Year						
		2004	2003	2002	2001	2000	1999	1998
Ryan & Company	\$ 812,928	\$398,928	\$196,000	\$95,000	\$25,000	\$25,000	\$25,000	\$48,000
Vinson & Elkins LLP	\$223,400	\$30,000	\$28,000	\$46,000	\$40,000	\$30,000	\$20,000	\$29,400
Scott, Douglass & McConnico LLP	\$96,450	\$17,750	\$19,000	\$5,500	\$15,000	\$16,000	\$11,000	\$12,200
Fulbright & Jaworski LLP	\$98,500	\$10,500	\$10,000	\$20,000	\$10,000	\$20,000	\$10,000	\$18,000
Clark, Thomas & Winters	\$67,250	\$10,500	\$10,000	\$10,250	\$10,000	\$10,000	\$6,500	\$10,000
McGinnis Lochridge & Kilgore LLP	\$60,050	\$10,000	\$10,000	\$15,050	\$10,000	\$5,000	\$5,000	\$5,000
Akin Gump Strauss Hauer & Feld LLP	\$70,750	\$10,000	\$10,250	\$10,500	\$10,000	\$10,000	\$10,000	\$10,000
Individual	\$85,000	\$10,000	\$15,000	\$10,000	\$30,000	\$20,000	\$0	\$0
Locke Liddell & Sapp LLP	\$41,000	\$5,000	\$10,000	\$10,000	\$5,000	\$11,000	\$0	\$0
The SALT Group	\$62,725	\$10,000	\$12,500	\$20,000	\$0	\$10,225	\$10,000	\$0
Hance, Scarborough, Wright, Ginsberg & Brusilow LLP	\$49,882	\$10,534	\$10,000	\$5,298	\$15,000	\$3,000	\$5,000	\$1,050
Individual	\$48,285	\$19,525	\$7,500	\$7,760	\$5,000	\$3,500	\$5,000	\$0
Bickerstaff Heath Smiley Pollan Kever & McDaniel LLP	\$20,000	\$0	\$2,000	\$5,000	\$5,000	\$5,000	\$2,000	\$1,000
Pricewaterhouse-Coopers, LLP	\$4,100	\$0	\$1,000	\$100	\$0	\$0	\$0	\$3,000
STS Consultants	\$5,000	\$0	\$0	\$5,000	\$0	\$0	\$0	\$0
Gamble Simmons and Company	\$2,000	\$0	\$1,000	\$1,000	\$0	\$0	\$0	\$0
Burr Wolff	\$1,500	\$0	\$0	\$1,500	\$0	\$0	\$0	\$0
Stahl, Martens & Bernal LLP	\$500	\$0	\$0	\$0	\$0	\$500	\$0	\$0
KPMG LLP	\$400	\$0	\$0	\$0	\$0	\$400	\$0	\$0
<b>Annual Totals</b>	<b>\$1,749,720</b>	<b>\$542,737</b>	<b>\$342,250</b>	<b>\$267,958</b>	<b>\$180,000</b>	<b>\$169,625</b>	<b>\$109,500</b>	<b>\$137,650</b>

## Part 2: Summary of Analysis of Tax Settlements

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### Management Halts

#### Management Halts

Management halts are cases in which the Comptroller's Office temporarily stops tax collection actions, issuance of tax overpayment notices, or automatic transfers of tax credits. The stop action can be at a taxpayer, tax, or period obligation level.

As of January 14, 2005, 11,699 management halts that the Comptroller's Office put into effect between fiscal years 1998 and 2004 **had not been concluded**. We did not review outstanding management halts put into effect prior to fiscal year 1998.

In 2000, the Comptroller's Office began using the reason "**Administrative Request**" more frequently to place taxpayer accounts on management halt. Between fiscal years 2000 and 2004, the Comptroller's Office used the reason "Administrative Request" to place 13,686 taxpayer accounts on management halt. In addition:

- In fiscal year 1999, the Comptroller's Office used "Administrative Request" as the reason for **less than 5 percent** of all management halts concluded in that year.
- In fiscal years 2000 through 2004, the annual percentage of management halts with the reason code "Administrative Request" ranged from **24 percent to 38 percent**.

The Comptroller's Office does not always sufficiently document the explanation for why a management halt was put into effect. In our review of 68 randomly selected management halts concluded between January 1999 and August 2004, we could determine the reasons for 43 management halts based on interviews with the Comptroller's Office or through comments placed in the Integrated Tax System (ITS). We were **unable to locate additional, corroborating information**.

### Administrative Hearings

We randomly selected and reviewed 33 disputed tax cases that were finalized through administrative hearings between January 1999 and August 2004. For these 33 cases, we were **unable to determine the disputed tax liability amounts** and could not readily determine the final settlement amounts because of the manner in which the Comptroller's Office maintains this information.

### Tax, Penalty, and Interest Waivers

We randomly selected and reviewed 28 tax, penalty, and/or interest waivers that were approved between January 1999 and August 2004 and identified one instance in which the Comptroller's Office did not follow its policies and procedures. Specifically, the Enforcement Division waived a tax penalty it was not authorized to waive. The tax penalty was less than \$5,000.

### **Tax Refunds**

We randomly selected and reviewed 68 refunds approved between January 1999 and August 2004 and identified one instance in which the Comptroller's Office did not have sufficient documentation to support the approval of an individual refund.

### **Amended Audit Assessments**

We randomly selected and reviewed four amended audit assessments (for three distinct taxpayers) done between January 1999 and August 2004, and we did not identify any cases in which the Comptroller's Office did not follow its processes.

### **Credit Audits**

We randomly selected and reviewed two credit audits (for two distinct taxpayers) that resulted in a credit between January 1999 and August 2004, and we did not identify any cases in which the Comptroller's Office did not follow its processes.

### *Part 3: Detailed Analysis of Tax Settlements*

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We identified 3,656 tax settlements (for 755 distinct taxpayers) that occurred within one year of a related campaign contribution. These settlements took place from January 1999 through August 2004. The information below provides the results of our analysis by settlement type.

#### **Management Halts**

Management halts are cases in which the Comptroller's Office temporarily stops tax collection actions, issuance of tax overpayment notices, or automatic transfers of tax credits. The stop action can be at a taxpayer, tax, or period obligation level. We were unable to identify the tax settlement amounts resulting from management halts based upon the data elements maintained in the Comptroller's Office's files.

Between fiscal years 1999 and 2004, the Comptroller's Office concluded 65,130 management halts. We identified some cases that were halted for more than 10 years. Figure 1 shows the trend in selected categories of management halts. Table 3 presents all management halts that were concluded during that time period.

Figure 1

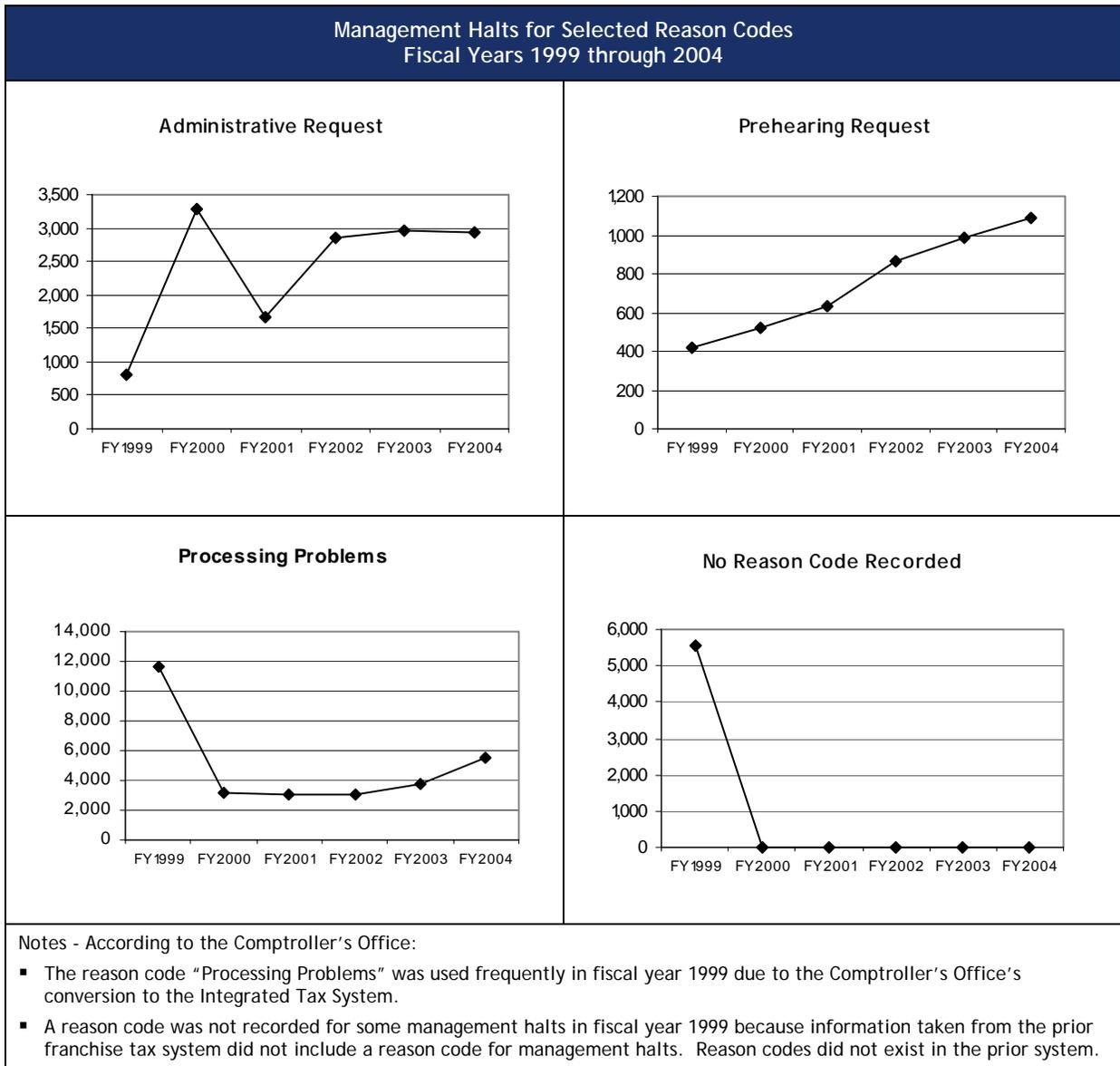


Table 3

Number of Management Halts by Reason Category for Management Halts That Were Concluded in Fiscal Years 1999-2004						
Reason for Management Halt	Fiscal Years					
	1999	2000	2001	2002	2003	2004
Protest Payment Made	84 (.43%)	101 (1.18%)	58 (.83%)	33 (.40%)	78 (.80%)	23 (.19%)
Audit in Progress	258 (1.33%)	515 (6.02%)	304 (4.33%)	569 (6.81%)	638 (6.58%)	631 (5.19%)
Motion for Rehearing	<=5 (<=.03%)	7 (.08%)	25 (.36%)	11 (.13%)	17 (.18%)	8 (.07%)
Penalty Waiver Request	161 (.83%)	448 (5.24%)	495 (7.05%)	394 (4.72%)	761 (7.85%)	1,597 (13.13%)
Amended Audit	363 (1.88%)	464 (5.42%)	494 (7.03%)	369 (4.42%)	202 (2.08%)	161 (1.32%)
Split Audit	<=5 (<=.03%)	<=5 (<=.06%)	0 (0%)	<=5 (<=.06%)	<=5 (<=.05%)	10 (.08%)
<sup>a</sup> Processing Problems	11,647 (60.22%)	3,137 (36.66%)	3,087 (43.96%)	3,004 (35.96%)	3,822 (39.43%)	5,530 (45.46%)
Administrative Request	817 (4.22%)	3,285 (38.39%)	1,659 (23.62%)	2,852 (34.14%)	2,954 (30.48%)	2,936 (24.13%)
Prehearing Request	415 (2.15%)	518 (6.05%)	628 (8.94%)	868 (10.39%)	984 (10.15%)	1,086 (8.93%)
Prehearing Amend Audit	0 (0%)	<=5 (<=.06%)	<=5 (<=.07%)	6 (.07%)	18 (.19%)	40 (.33%)
Attorney Account	<=5 (<=.03%)	18 (.21%)	<=5 (<=.07%)	7 (.08%)	<=5 (<=.05%)	<=5 (<=.04%)
Chapter 7 - Chapter 7 N/A Corp	20 (.10%)	46 (.54%)	230 (3.27%)	100 (1.20%)	57 (.59%)	80 (.66%)
Chapter 11 Liquidation	<=5 (<=.03%)	<=5 (<=.06%)	0 (0%)	14 (.17%)	22 (.23%)	<=5 (<=.04%)
Other - Bankruptcy	6 (.03%)	14 (.16%)	36 (.51%)	124 (1.48%)	134 (1.38%)	61 (.50%)
<sup>b</sup> No Reason Code Recorded	5,556 (28.73%)	0 (0%)	0 (0%)	0 (0%)	0 (0%)	0 (0%)
Totals	19,340	8,556	7,023	8,353	9,693	12,165

<sup>a</sup> According to the Comptroller's Office, the reason code "Processing Problems" was used frequently in fiscal year 1999 due to the Comptroller's Office's conversion to the Integrated Tax System.

<sup>b</sup> According to the Comptroller's Office, a reason code was not recorded for some management halts in fiscal year 1999 because information taken from the prior franchise tax system did not include a reason code for management halts. Reason codes did not exist in the prior system.

Source: Reason codes were obtained from the Comptroller's Office's Tax Data Dictionary.

Between fiscal years 2000 and 2004, the Comptroller’s Office used the reason “Administrative Request” to place 13,686 cases on management halt. The annual percentage of management halts with the reason code “Administrative Request” ranged from **24 percent to 38 percent** during these years.

In addition to analyzing management halts that were concluded, we identified management halts that were not concluded. As of January 14, 2005, 11,699 (16.4 percent) of 71,357 management halts put into effect between fiscal years 1998 and 2004 had not been concluded. We did not review outstanding management halts put into effect prior to fiscal year 1998.

#### Management Halt Analysis

- 82,641 concluded management halts were identified.
- Of those 82,641 concluded management halts, 3,794 had a related campaign contribution.
- Of those 3,794 concluded management halts, 635 occurred within one year of a related campaign contribution.
- Of those 635 concluded management halts, 448 were concluded between January 1999 and August 2004.

We identified 448 management halts that had a related contribution **within one year**. These 448 management halts were associated with 273 distinct taxpayers and were concluded between January 1999 and August 2004. We randomly selected and reviewed 68 of these management halts, which were associated with 48 distinct taxpayers:

- For 43 of the 68 (63 percent) management halts we reviewed, we determined the reasons for the management halts based on assertions made by the Comptroller’s Office (either through interviews or through comments placed in ITS) because additional documentation or information regarding the reasons for the management halts was not available.
- For 25 of the 68 (37 percent) management halts we reviewed, we determined that the management halts appeared to be appropriate based on other corroborating documentation or information available in ITS and other databases.
- Although the concluded management halts we reviewed were not selected from the population of all concluded management halts, inconsistent and insufficient documentation for reasons explaining why management halts are put into effect appears to be a systematic issue.

#### Administrative Hearing Analysis

- 6,968 administrative hearings were identified.
- Of those 6,968 administrative hearings, 2,262 had a related campaign contribution.
- Of those 2,262 administrative hearings, 436 occurred within one year of a related campaign contribution.
- Of those 436 administrative hearings, 428 were finalized between January 1999 and August 2004.

#### Administrative Hearings

The Comptroller’s Office handles disputed tax cases through its administrative hearings process. We identified 428 administrative hearings that had a related contribution **within one year**. These 428 administrative hearings were associated with 301 distinct taxpayers and were finalized between January 1999 and August 2004. The Comptroller’s Office asserts that it does not track either (1) original disputed tax liability amounts or (2) final settlement amounts that are determined through the administrative hearings process.

We randomly selected and reviewed 33 disputed tax cases that were finalized through these administrative hearings. For these 33 cases, we were unable to determine the disputed tax liability amounts and could not readily determine the final settlement amounts because of the manner in which the Comptroller's Office maintains this information. We did not identify any cases in which the Comptroller's Office did not follow its processes.

#### Tax, Penalty, and Interest Waiver Analysis

- 31,130 tax, penalty, and interest waivers were identified for taxpayers that received waivers that cumulatively totaled at least \$10,000.
- Of those 31,130 tax, penalty, and interest waivers or groups of waivers, 4,152 had a related campaign contribution.
- Of those 4,152 tax, penalty, and interest waivers, 864 occurred within one year of a related campaign contribution.
- Of those 864 tax, penalty, and interest waivers, 714 totaling approximately \$29 million were approved between January 1999 and August 2004.

#### Tax, Penalty, and Interest Waivers

Several divisions at the Comptroller's Office process tax waivers through which the amount of taxes, penalties, and/or interest a taxpayer must pay is reduced or eliminated. We identified 714 approved tax, penalty, and/or interest waivers that had a related campaign contribution **within one year**. These 714 waivers cumulatively totaled at least \$10,000 for each of the 285 distinct taxpayers and were approved between January 1999 and August 2004. These 285 taxpayers received a total of approximately \$29 million in waivers.

We randomly selected and reviewed 28 tax, penalty, and/or interest waivers that had a related campaign contribution **within one year**. These waivers were approved between January 1999 and August 2004 and totaled approximately \$2.3 million. We noted one exception. As a collection tool, the Enforcement Division is authorized to waive only late filer penalties; this division is not authorized to waive taxes, penalties other than late filer penalties, or interest. However, we noted one instance in which the Enforcement Division waived a penalty, that was less than \$5,000, in Winter 2002. The Enforcement Division has clarified its policies and procedures, and the Comptroller's Office asserts that it has restricted system access to correct this issue.

#### Tax Refund Analysis

- 53,876 approved tax refunds were identified for taxpayers that received tax refunds that cumulatively totaled at least \$10,000.
- Of those 53,876 refunds, 11,965 tax refunds had a related campaign contribution.
- Of those 11,965 approved tax refunds, 2,334 occurred within one year of a related campaign contribution.
- Of those 2,334 approved tax refunds, 1,865 totaling \$148 million were approved between January 1999 and August 2004.

#### Tax Refunds

Several divisions at the Comptroller's Office process tax refunds. Tax refunds can be made when taxpayers or their representatives request them. We identified 1,865 tax refunds that occurred **within one year** of a related contribution. These 1,865 tax refunds were associated with 258 distinct taxpayers and totaled approximately \$148 million. These 1,865 tax refunds were approved between January 1999 and August 2004.

We randomly selected and reviewed 68 approved refunds processed by several divisions within the Comptroller's Office and identified one exception, which occurred in the Audit Division. Specifically, the Audit Division did not have sufficient documentation to

support the approval of a refund. The Comptroller's Office processed this refund in Spring 1999.

#### Amended Audit Analysis

- 5,412 amended audits were identified.
- Of those 5,412 amended audits, 1,002 had a related campaign contribution.
- Of those 1,002 amended audits, 189 occurred within one year of a related campaign contribution.
- Of those 189 amended audits, 146 were amended between January 1999 and August 2004. These decreased audit assessments totaled approximately \$227 million.

#### Amended Audit Assessments

The Comptroller's Office can amend original audit assessments to change the tax liability. For example, if a taxpayer disputes an audit assessment and the case goes through an administrative hearing, the original audit assessment could need to be amended. We identified 146 amended audit assessments that had a related campaign contribution **within one year**. These 146 amended audit assessments: (1) were associated with 90 distinct taxpayers, (2) occurred between January 1999 and August 2004, and (3) had assessment amounts that were at least \$10,000 less than the original audit assessment. These 90 taxpayers received a total of approximately \$227 million in decreased audit assessments.

We randomly selected and reviewed four amended audit assessments for three distinct taxpayers and did not identify any cases in which the Comptroller's Office did not follow its processes. These three distinct taxpayers received decreased audit assessments totaling \$460,616.

#### Credit Audit Analysis

- 2,260 credit audits were identified.
- Of those 2,260 credit audits, 339 had a related campaign contribution.
- Of those 339 credit audits, 67 occurred within one year of a related campaign contribution.
- Of those 67 credit audits, 55 resulted in tax credits between January 1999 and August 2004. These 55 credits totaled approximately \$58 million.

#### Credit Audits

When the Comptroller's Office's Audit Division conducts an audit that results in a tax credit to the taxpayer, this is considered a credit audit. We identified 55 credit audits that had a related campaign contribution **within one year**. These 55 credit audits for 49 distinct taxpayers resulted in a credit of at least \$10,000 between January 1999 and August 2004. These 49 taxpayers received a total of approximately \$58 million in credits resulting from audits.

We randomly selected and reviewed two credit audits (for two distinct taxpayers) that resulted in credits between January 1999 and August 2004. The tax credits from these audits totaled approximately \$56,000. We did not identify any cases in which the Comptroller's Office did not follow its processes.

## Recommendations

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The Legislature should consider:

- Enacting legislation to prohibit campaign contributions to the Comptroller of Public Accounts or a person seeking election to the Office of the Comptroller of Public Accounts from any individual or entity representing taxpayers before the Office of the Comptroller of Public Accounts.
- Requiring the Texas Ethics Commission to create a new class of registrant for taxpayer representatives. All taxpayer representatives should register with and provide the appropriate information to the Texas Ethics Commission and be subject to the same provisions as other registrants with the Texas Ethics Commission
- Requiring the Comptroller's Office to create a taxpayer representative registry and maintain power of attorney documentation for all taxpayer representatives. The registry should identify all taxpayer representatives **associated** with **each tax settlement** and taxpayer. If multiple taxpayer representatives are associated with a tax settlement, the registry should identify the relevant dates each taxpayer representative was associated with the settlement.
- Enacting legislation to transfer the authority to conduct tax dispute hearings from the Comptroller's Office to the State Office of Administrative Hearings or another independent entity. Currently, disputed tax cases are assigned to an administrative law judge appointed by the Comptroller of Public Accounts. We found no evidence of preferential treatment. This arrangement could present the **appearance** that hearings are not processed in an objective and impartial manner and that **independence could be impaired**. To maintain the technical knowledge and efficiency of current operations, the administrative law judges, their support staff, and their equipment should be transferred to the State Office of Administrative Hearings to continue their duties. The Comptroller's Office should provide technical tax expertise as appropriate.
- Requiring the Comptroller's Office to establish and publish in the Texas Register and on its Web site its policies and procedures related to management halts, including defining when it is appropriate to use management halt reason codes "Administrative Request" and "Processing Problems." The Comptroller's Office also should be required to establish more specific reason codes.
- Requiring the Comptroller's Office to limit the timeframe of management halts.
- Requiring the Comptroller's Office to consistently enter specific comments into its Integrated Tax System when management halts are

placed on tax cases. These comments should be sufficient to clearly identify the circumstances supporting the management halt and should refer to any other relevant supporting information.

- Requiring Comptroller's Office to specify (1) the tax liability amounts associated with tax cases put on management halt and (2) the original, disputed, and final tax assessment amounts associated with administrative hearings.
- Requiring the Office of the Secretary of State to require that each business entity that register with it to provide the business entity's Federal Employee Identification Number or its Social Security Number. The Office of the Secretary of State also should record this information in its automated systems. Currently, some business entities registered with the Office of the Secretary of State provide Federal Employee Identification Numbers or Social Security Numbers, but others do not.

## *Draft Statutory Language*

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Recommendation: The Legislature should consider enacting legislation to prohibit campaign contributions from taxpayer representatives to the Comptroller of Public Accounts or any individual seeking election to the Comptroller of Public Accounts

Elections Code, Section 253.0342. RESTRICTIONS ON CONTRIBUTIONS BY A TAXPAYER REPRESENTATIVE.

(a) For the purposes of this section, 'officeholder' means a state officer-elect for the office of comptroller of public accounts beginning on the day after the date of the general or special election at which the individual was elected.

(b) A candidate for the office of comptroller of public accounts, officeholder for the office of comptroller of public accounts or a specific-purpose committee for supporting, opposing, or assisting a candidate or an officeholder of the office of comptroller of public accounts may not knowingly accept a political contribution from a person if:

(1) the person has or will represent a taxpayer in the taxpayer's claim or suit described in subsection (d) of this section.

(c) A person may not knowingly make a political contribution, as defined by Section 251.001, Elections Code to candidate for the office of comptroller of public accounts, officeholder for the office of comptroller of public accounts or a specific-purpose committee for supporting, opposing, or assisting a candidate or an officeholder of the office of comptroller of public accounts if the person has or will:

(1) represent a taxpayer in the taxpayer's claim or suit described in subsection (d) of this section.

(d) This section applies to a taxpayer representative in the following claims or suits:

- (1) a settlement of a claim for tax, penalty, or interest imposed by Title 2, Tax Code;
- (2) a claim for a refund or credit of a tax, penalty, or interest imposed by Title 2, Tax Code; or
- (3) a taxpayer suit under Chapter 112, Tax Code.

**Recommendation:** The Legislature should consider requiring the Texas Ethics Commission to create a new class of registrant for taxpayer representatives.

Government Code, Section 305.012. TAXPAYER REPRESENTATIVES  
REQUIRED TO REGISTER.

(a) A person must register as a taxpayer representative with the commission under this chapter if the person:

(1) represents a taxpayer in a taxpayer's claim or suit of:

(a) a settlement of a claim for tax, penalty, or interest imposed by Title 2, Tax Code;

(b) a claim for a refund or credit of a tax, penalty, or interest imposed by Title 2, Tax Code; or

(c) a taxpayer suit under Chapter 112, Tax Code.

(b) Subsection (a)(1) requires a person to register if the person, as part of his regular employment, has or will directly represent a taxpayer in a taxpayer's claim or suit of:

(a) a settlement of a claim for tax, penalty, or interest imposed by Title 2, Tax Code;

(b) a claim for a refund or credit of a tax, penalty, or interest imposed by Title 2, Tax Code; or

(c) a taxpayer suit under Chapter 112, Tax Code.

Recommendation: The Legislature should consider enacting legislation to transfer the authority to conduct tax dispute hearings from the Comptroller's Office to the State Office of Administrative Hearings or another independent entity.

Amend the Tax Code by adding Section 111.00455 to read to as follows:

Sec. 111.00455. CONTESTED CASES PERFORMED BY TAX DIVISION OF STATE OFFICE OF ADMINISTRATIVE HEARINGS; FEES.

(a) The tax division of the State Office of Administrative Hearings shall perform any contested case hearing as provided by Section 2003.0491, Government Code, in relation to the collection, administration, and enforcement of:

- (1) a tax imposed under this title; and
- (2) any other tax or fee that the comptroller is required to collect under a law not included in this title.

(b) A reference in law to the comptroller that relates to the performance of a contested case hearing described by Subsection (a) means the tax division of the State Office of Administrative Hearings.

(c) The tax division of the State Office of Administrative Hearings shall charge a fee of \$25 from the person bringing the contested case. The State Office of Administrative Hearings shall deposit the revenue generated by this fee into the general revenue fund.

(d) The State Office of Administrative Hearings may not charge a fee to a government body or to a government official appearing in a representative capacity.

(e) The State Office of Administrative Hearings may not charge a fee to an individual if the individual files a sufficient affidavit attesting to the fact that the individual is unable to pay the fee. The affidavit must contain sufficiently complete factual information regarding the individual's income, assets, and debts to demonstrate to the satisfaction of the State Office of Administrative Hearings that the individual is unable to pay the fee established under Subsection (c).

Amend the Government Code, 1 by adding Section 2003.0491

Sec. 2003.0491. TAX DIVISION.

(a) The office shall establish a tax division to conduct hearings relating to contested cases involving the collection, administration, and enforcement of taxes and fees as prescribed by Section 111.00455, Tax Code.

(b) Only an administrative law judge in the tax division may conduct a hearing on behalf of the comptroller.

(c) To be eligible to preside at a hearing, an administrative law judge must:

- (1) have been licensed to practice law in this state for at least 10 years;
- (2) have at least five years of experience in state tax laws; and
- (3) have substantial knowledge of tax law and substantial experience in tax cases in making the record suitable for judicial review.

(d) The office and the comptroller shall jointly adopt rules providing for certification to the comptroller of an issue that involves an ultimate finding of compliance

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Note: This statutory language is in draft form and is subject to review and redraft by the Texas Legislative Council.

with or satisfaction of a statutory standard the determination of which is committed to the discretion or judgment of the comptroller by law. The rules must address, at a minimum, the issues that are appropriate for certification and the procedure to be used in certifying the issue. Each agency shall publish the jointly adopted rules.

(e) Notwithstanding Section 2001.058, the comptroller may change a finding of fact or conclusion of law made by the administrative law judge or vacate or modify an order issued by the administrative law judge only if the comptroller:

- (1) determines that the administrative law judge:
  - (A) did not properly apply or interpret applicable law; or
  - (B) issued a finding of fact that is not supported by a preponderance of the evidence;or

- (2) determines that a comptroller policy or a prior administrative decision on which the administrative law judge relied is incorrect or should be changed.

(f) The comptroller shall state in writing the specific reason and legal basis for its determination under Subsection (e).

(g) An administrative law judge, on the judge's own motion or on motion of a party and after notice and an opportunity for a hearing, may impose appropriate sanctions as provided by Subsection

(h) against a party or its representative for:

- (1) filing a motion or pleading that is groundless and brought:

- (A) in bad faith;
- (B) for the purpose of harassment; or
- (C) for any other improper purpose, such as to cause unnecessary delay or needless increase in the cost of the proceeding;

- (2) abuse of the discovery process in seeking, making, or resisting discovery; or

- (3) failure to obey an order of the administrative law judge or the comptroller.

(i) A sanction imposed under Subsection (g) may include, as appropriate and justified, issuance of an order:

- (1) disallowing further discovery of any kind or of a particular kind by the offending party;

- (2) holding that designated facts be deemed admitted for purposes of the proceeding;

- (3) refusing to allow the offending party to support or oppose a designated claim or defense or prohibiting the party from introducing designated matters in evidence;

- (4) disallowing in whole or in part requests for relief by the offending party and excluding evidence in support of such requests; and

- (5) striking pleadings or testimony, or both, in whole or in part, or staying further proceedings until the order is obeyed.

(i) Hearings conducted for the comptroller by the office shall be held in hearing rooms provided by the comptroller. The comptroller shall also provide the tax division access to its computer systems, databases, library resources, and all records.

(j) The office shall charge the comptroller a fixed annual fee rather than an hourly rate for services rendered by the tax division to the comptroller. The

amount of the fee may not be less than the amount appropriated to the comptroller in the General Appropriations Act for payment to the tax division to conduct comptroller hearings. The amount of the fee shall be based on the costs of conducting the hearings, the costs of travel expenses and telephone charges directly related to the hearings, docketing costs, and other applicable administrative costs of the office, including the administrative costs of the tax division. The office and the comptroller shall negotiate the amount of the fixed fee

biennially, subject to the approval of the governor, to coincide with the comptroller's legislative appropriations request.

(k) Judicial review of a final decision of the tax division is by trial de novo in district court.

(l) A finding of fact or conclusion of law made by an administrative law judge conducting a hearing under this section must be:

- (1) independent and impartial; and
- (2) based on state law and the evidence presented at the hearing.

(m) An administrative law judge conducting a hearing under this section may not directly or indirectly communicate in connection with an issue of fact or law with a party or its representative, except on notice and opportunity for each party to participate. The comptroller may not attempt to influence the findings of fact or the administrative law judge's application of the law except by proper evidence and legal argument.

(n) Appearances in hearings conducted for the comptroller by the office may be by:

- (1) the taxpayer;
- (2) an attorney licensed to practice law in this state;
- (3) a certified public accountant; or
- (4) an enrolled agent authorized to practice before the Internal Revenue Service.

(o) The office may allow an attorney or accountant authorized to practice or licensed in any other jurisdiction of the United States to appear and represent a taxpayer in hearings before the office for a particular matter. In addition, the office may adopt rules allowing a taxpayer to be represented by an officer, employee, or member of the taxpaying entity. The comptroller is represented by an authorized representative in all hearings conducted for the comptroller by the office.

SECTION \_\_\_\_ .03.

(a) A task force is established to administer the transfer of contested case hearings from the comptroller to the State Office of Administrative Hearings. The task force is composed of:

- (1) the governor or the governor's designee;
- (2) the lieutenant governor or the lieutenant governor's designee;
- (3) the speaker of the house of representatives or the speaker's designee;
- (4) the comptroller or the comptroller's designee;
- (5) a designee of the Legislative Budget Board; and
- (6) the chief administrative law judge of the State Office of Administrative Hearings or the judge's designee.

- (b) The governor or the governor's designee is the presiding officer of the task force.
- (c) The task force shall:
  - (1) determine the equipment, electronic information and databases, electronic files, records, appropriations, contracts, rights, money, leases, facilities, full-time equivalent positions, employees and other items that will be transferred under this article and the schedule for the transfers; and
  - (2) mediate and resolve disputes between the respective agencies relating to a transfer.
- (d) After the transfers have been completed, the task force shall prepare a written report detailing the specifics of the transfers and shall submit the report to the governor and the legislature.
- (e) In determining a transfer under this article, the task force shall ensure that the transfer does not adversely affect a proceeding before the comptroller or the rights of the parties to the proceeding.

SECTION \_\_\_\_ .04.

- (a) No later than six months following the effective date of this Act, the following are transferred to the tax division of the State Office of Administrative Hearings:
  - (1) all hearings described by Section 2003.0491(a), Government Code, as added by this article;
  - (2) subject to the proceeding section of this article, all equipment, data, facilities, appropriations, contracts, and other items of the comptroller's administrative hearings division; and
  - (3) subject to the proceeding section of this article, all full-time equivalent positions, employees of the comptroller of public accounts whose primary functions, on the date of passage of this Act, relate to conducting hearings
- (b) Before the transfers in subsection (a) of this section are made, the hearings shall continue to be held by the comptroller under the law related to the conduct of those hearings by the comptroller that existed on the date of passage of this Act, and that law is continued in effect only for this purpose.

SECTION \_\_\_\_ .05. The changes in law made by this article that relate to the procedures governing a hearing before the tax division of the State Office of Administrative Hearings apply only to a case that is filed on or after the effective date of this Act. Procedures relating to a case filed before the effective date of this Act, shall continue to be used in a hearing as those provisions existed on the date of passage of this Act, and are continued in effect only for this purpose.

## ***Methodology for Compiling, Analyzing, and Reviewing Tax Settlements and Contributions***

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Our methodology for compiling, analyzing, and reviewing tax settlements and contributions included four steps:

- **Step 1:** Identification of taxpayers who received tax settlements. This step also included identifying (1) these taxpayers' agents and officers registered with the Office of the Secretary of State, (2) individuals registered with the Texas Ethics Commission to represent these taxpayers as lobbyists, and (3) these taxpayers' representatives as recorded by the Comptroller's Office.
- **Step 2:** Identification of campaign contributions related to taxpayers who received tax settlements and identification of campaign contributions related to these taxpayers' (1) registered agents and officers, (2) individuals registered with the Texas Ethics Commission as lobbyists, and (3) taxpayer representatives.
- **Step 3:** Identification of selected taxpayer representatives' contributions.
- **Step 4:** Review of tax settlement files for compliance with state laws, regulations, and Comptroller's Office policies and procedures.

### **Description of This Project**

This project was performed as a nonaudit service as described in the Government Accountability Office's *Government Auditing Standards*, Section 2.14.

Although we reviewed samples of tax settlements for compliance with state laws, regulations, and Comptroller's Office policies and procedures, the majority of the information provided through this project was not subjected to all of the tests and confirmations that would be performed in an audit.

Each of these steps is described in more detail below.

### **Step 1: Identification of Taxpayers Who Received Tax Settlements**

We focused our analysis on taxpayers who received tax settlements during fiscal years 1998 through 2004. A taxpayer can be an individual or a business that is required to pay taxes. Specifically, we focused on:

- Taxpayers who received tax settlements of at least \$10,000 through amended audits and credit audits.
- Taxpayers who received tax refunds and waivers that cumulatively totaled at least \$10,000 during fiscal years 1998 through 2004.
- Taxpayers associated with disputed tax cases that were processed through administrative hearings and management halts.

Because we were unable to identify the tax settlement amounts resulting from administrative hearings and management halts, we included all of these taxpayers in the population of taxpayers.<sup>1</sup>

We obtained tax settlement information from the Comptroller's Office's Integrated Tax System, Agency Work Manager Tracking System, Universal Refund System, and Hearings Tracking System.

Registered Agents and Officers, Individuals Registered with the Texas Ethics Commission, and Taxpayer Representatives

For each of the taxpayers identified, we determined the taxpayer's agents and officers registered with the Office of the Secretary of State. The completeness of this analysis was limited because the Office of the Secretary of State does not require a taxpayer identification number for registered entities. As a result, in some cases we relied on entity names as they were recorded in the systems or databases of the Comptroller's Office and the Office of the Secretary of State. Variations in entities' names prevented us from identifying registered agents and officers for all the taxpayers.

We also obtained registered lobbyist information from the Texas Ethics Commission. We compared the names of lobbyists' clients to the names of the taxpayers. The completeness of this analysis also was limited because of name variations in each data source.

Using information in the Comptroller's Office's Hearings Tracking System, we also identified which of the taxpayers used external representatives for administrative hearings in fiscal years 1998 through 2004. Using taxpayer identification numbers, we later determined whether those taxpayers received other settlement types during this period. We are not asserting that these representatives represented these taxpayers for every settlement we identified.

In addition, we identified taxpayer representatives' agents and officers registered with the Office of the Secretary of State. The completeness of this analysis also was limited because of name variations in each data source.

The analysis completed in Step 1 identified 182,287 tax settlements.

**Step 2: Identification of Campaign Contributions Related to Taxpayers Who Received Tax Settlements**

Within the population of taxpayers identified in Step 1, we identified 23,514 tax items with a related contribution. Within those tax items, we identified

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<sup>1</sup> Settlement amounts associated with administrative hearings and management halts are not stored electronically. Determining those amounts would have required a labor-intensive manual review of a significant number of files and numerous interviews with staff who worked on those cases.

4,525 tax settlements (for 1,000 distinct taxpayers) that took place in fiscal years 1998 through 2004 and that occurred within one year of a related campaign contribution.

To identify campaign contributions associated with the 1,000 taxpayers for those 4,525 cases, we compared the information regarding the taxpayers identified in Step 1 with campaign contribution data maintained by the Texas Ethics Commission.

For individuals serving as State Comptroller between September 1997 and December 2004, we obtained information regarding 33,099 contributions from the Texas Ethics Commission. State Auditor's Office staff manually entered information regarding approximately 18,000 contributions that were made from January 1997 through December 1999 (manual data entry was necessary because the Texas Ethics Commission did not maintain this data electronically during that time period). We obtained electronic information regarding the remaining contributions that were made from January 2000 through December 2004.

The Texas Ethics Commission does not have a unique identifier (such as a taxpayer identification number) for each contributor. Therefore, to match taxpayer data with contribution data, we compared the following information:

- Individual taxpayer name (first and last name)
- Business taxpayer name
- Taxpayer address and city
- Registered agent name
- Registered officer name
- Registered lobbyist name
- Registered lobbyist address
- Registered lobbyist firm name
- Taxpayer representative name
- Taxpayer representative registered agent name
- Taxpayer representative registered officer name

We then refined the results of this process by matching the cities of taxpayers, registered agents, and registered officers with the cities of contributors.

For each individual who served as State Comptroller between September 1997 and December 2004, we excluded tax settlements and related contributions

that occurred when the individual was not in office. Additionally, we excluded any tax settlements that did not occur within one year of a related contribution. This resulted in our final tax settlement population of 4,525. Of those 4,525 tax settlements, 869 occurred between September 1997 and December 1998 and 3,656 occurred between January 1999 and August 2004.

We did not identify all contributions for the taxpayers identified in Step 1. This limitation is the result of how the Comptroller's Office and the Texas Ethics Commission define and format data. For example, taxpayer names are not always recorded in the same manner as contributor names. In addition, contributor names may not be reported consistently each time a contribution is made or each time a filer reports contributions.

We categorized contributions by type, such as taxpayer, agent, officer/director, registered lobbyist, political action committee (PAC), or taxpayer representative. For some contributions, we could not easily identify a particular contributor type, and we categorized these contributions as taxpayer.

Officers/directors, registered lobbyists, PACs, and taxpayer representatives may be associated with more than one taxpayer. In addition, taxpayers may have used more than one taxpayer representative during fiscal years 1998 through 2004.

### Step 3: Identification of Selected Taxpayer Representatives' Contributions

The Comptroller's Office provided two lists of taxpayer representatives as recorded in its Hearings Tracking System and Agency Work Manager Tracking System. According to the Comptroller's Office, the creation of these lists is not a part of its regular procedures. We did not attempt to validate the completeness or accuracy of these lists.

Seventy-three taxpayer representatives appeared in both of these lists. We compared information regarding these taxpayer representatives with campaign contributors' names. In addition, we identified registered agents and officers for these taxpayer representatives and compared them with campaign contributors' names. We also performed this analysis for five additional taxpayer representatives that we selected from the Hearings Tracking System list.

We performed an additional analysis on taxpayer representatives that contributed at least \$10,000. Specifically, we identified and compared key employee names with campaign contribution data from the Texas Ethics Commission. We defined a key employee as any employee who focuses on state and local taxation or state tax issues. We identified key employees by researching taxpayer representatives' Web sites.

Step 4: Review of tax settlement files for compliance with state laws, regulations, and Comptroller's Office policies and procedures.

We reviewed the tax settlement files that we sampled for compliance with state laws, regulations, and Comptroller's Office policies and procedures.

## *Texas Government Code, Section 321.0138*

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### 321.0138. REVIEW OF STATE TAX SETTLEMENTS AND OTHER DECISIONS.

(a) This section applies to:

(1) a settlement of a claim for a tax, refund, or credit of a tax, penalty, or interest imposed by Title 2, Tax Code;

(2) a settlement of a taxpayer suit under Chapter 112, Tax Code; or

(3) any circumstance in which a taxpayer received a warrant, offset, check, payment, or credit from the comptroller or comptroller's office arising from the filing of a tax return with the state.

(b) The state auditor and the committee shall review the comptroller's records of all tax refunds, credits, payments, warrants, offsets, checks, and settlements for the preceding six years from the effective date of this section. The state auditor and the committee may review the comptroller's records of all tax refunds, credits, payments, warrants, offsets, checks, and settlements that occur following the effective date of this section. Notwithstanding any other law, in reviewing these tax refunds, credits, payments, warrants, offsets, checks, and settlements, the state auditor and the committee are entitled to access to related information to the same extent they would be entitled under Section 321.013 if the information were in a department or entity that is subject to audit. In accordance with Section 321.013(h), neither the state auditor nor the committee may conduct audits of private entities concerning the collection or remittance of taxes or fees to this state.

(c) Within six months following the effective date of this section, the comptroller shall provide to the state auditor information designated by the state auditor, after consultation with the comptroller, relating to tax refunds, credits, payments, warrants, offsets, checks, and settlements made in the past six years as requested by the state auditor. Commencing February 1, 2004, on a monthly basis, the comptroller shall provide to the state auditor information designated by the state auditor relating to tax refunds, credits, payments, warrants, offsets, checks, and settlements to which this section applies.

(d) A review by the state auditor under this section is considered an audit for purposes of the application of Section 552.116, relating to confidentiality of audit working papers. Information obtained or possessed by the state auditor or the committee that is confidential under law when in the possession of the comptroller remains confidential while in the possession of the state auditor or committee, except as provided by Subsection (e).

(e) The committee shall determine the manner in which the state auditor shall report information obtained pursuant to Subsection (b). The report may include any information obtained during the review, except that the report may not be formatted in a manner or include any information that discloses or effectively discloses the specific identity of an individual or taxpayer. The report must state the information by category or by numeric pseudonym and may include other information maintained by the Texas Ethics Commission.

(f) Except as provided by Subsection (e), this section does not affect any other law relating to confidentiality of information relating to tax information, including Sections 111.006, 151.027, and 171.206, Tax Code.

(g) This section does not affect any other law relating to release of information for legislative purposes, including Section 552.008, Government Code.



CAROLE KEETON STRAYHORN  
Texas Comptroller

### TEXAS COMPTROLLER OF PUBLIC ACCOUNTS

P.O. BOX 13528  
AUSTIN, TX 78711-3528

September 7, 2005

John M. Keel, CPA  
State Auditor  
State of Texas  
1501 North Congress Avenue, Room 4.224  
Austin, Texas 78701-1429

Dear Mr. Keel:

I am sending you our responses to your audit report entitled "A Review of Tax Settlements at the Office of the Comptroller of Public Accounts." We appreciate the opportunity to provide our responses.

#### **The Audit Raises No Significant Issues with State Tax Administration**

The Comptroller is gratified that after an unprecedented three-year effort to review the Comptroller's tax administration process the State Auditor has provided a clean bill of health to the agency.

The Comptroller of Public Accounts is committed to the fair and efficient administration of the Texas state tax system. This process involves 2,000 public servants in the Comptroller's Office and approximately 1.7 million active taxpayers. Texas taxpayers are, in the vast majority of cases, honest and committed to paying their fair share of taxes. They want to comply with the state's tax laws. There should be no implication from this report that taxpayers' rights should not be respected. The tax system should be fair to all involved, and the Comptroller works diligently to ensure that that is the case.

While the Auditor presents a range of statistics and recommendations, the ultimate conclusion of the report is:

*We are not implying any wrongdoing on the part of any individual or group associated with the information in this report. (p. 1)*

After a detailed and extensive review and analysis covering six years of transactions, the Auditor noted only one tax refund that was not sufficiently documented but recognized it to be an anomaly. The Auditor concluded that they "did not identify any cases in which the Comptroller's Office did not follow its processes."

The presentation of information in the Auditor's report attempts to draw a parallel between statistics on political contributions and "tax settlements." In this case, "tax settlements" were broadly defined to include:

- (1) a settlement of a claim for a tax, refund, or credit of a tax, penalty, or interest imposed by Title 2, Tax Code;
- (2) a settlement of a taxpayer suit under Chapter 112, Tax Code; or
- (3) any circumstance in which a taxpayer received a warrant, offset, check, payment, or credit from the Comptroller or the Comptroller's Office arising from the filing of a tax return with the state.

This definition therefore covers virtually every transaction conducted by the Comptroller on a daily basis other than processing original tax returns. Nonetheless, the Auditor ultimately found no evidence of any actual causal relationship or failure by the agency to follow its own processes in making legitimate refunds.

The Auditor vindicates the Comptroller's Office in that its conclusions are consistent with the Auditor's findings in another detailed audit of tax revenue administration conducted in 2003.

The Comptroller administers the taxes for the State of Texas. Inevitably this work involves literally millions of taxpayers and tens of millions of transactions. It is important to underscore again that the report as presented summarizes a bare fraction of those transactions, and as such, it could lead to misinterpretation that the Auditor doubtlessly does not intend given the overall conclusion of the report. The Comptroller, therefore, wishes to provide information relevant to understanding the information selectively presented by the Auditor's Office in fulfilling its legislative directive.

#### **An Extensive Audit in 2003 Raised No Issues with State Tax Administration**

In January 2003, the State Auditor notified the Comptroller that it would be undertaking a study of the state revenue administration system, a routine audit required to be conducted every two years under state law. Similar reviews had been conducted biennially throughout the history of the Comptroller's administration of state taxes. The Auditor has often made positive suggestions for the improvement of tax administration, and these have been implemented. The Auditor has never raised—nor found—any significant weaknesses with state tax administration.

The 2003 review was concluded in October 2003, and the Comptroller was provided with a copy of the findings. In that draft report, the Auditor stated no significant findings concerning state tax administration were found. In fact, the Auditor concluded:

*The Office of the Comptroller of Public Accounts (Comptroller's Office) generally ensures that its process for tax assessment and collection (including taxpayer audits and third-party refund requests) and taxpayer identification are conducted in accordance with state laws, regulations, and agency policies and procedures. We also audited the tax disputes function and found that the Comptroller's Office processes these disputes in accordance with state laws and regulations.*

This report was never issued. Toward the end of the audit period, the Legislature passed and the Governor signed House Bill 7 during the Third Called Session of the 78<sup>th</sup> Legislature. Under this legislation, the Auditor launched what would become an extended review of "tax settlements," which were broadly defined to include virtually any transaction involving the state's taxpayers.

Included in the audit's scope were taxpayer audits, hearings, applications for refunds and other transactions administered by the Comptroller on behalf of the state as a matter of law. These transactions were to be analyzed in relation to political contributions to the Comptroller of Public Accounts. The review culminated two years later in this report, Report 06-002.

**The Tax Settlement Audit Yielded No Significant Conclusions or Additions to the Original 2003 Report**

In the latest report, the Auditor establishes no statistical relationship or other evidence of any other relationship between political contributions and the broadly defined "tax settlements." The simple reason for this is that no such relationship exists. Most "tax settlement" actions are carried out on a daily basis by the men and women of the Comptroller's Office who are state employees and are attempting to fairly administer the state tax system in accordance with legislative directive and judicial rulings.

The transactions for taxpayers noted in the report were no different than many other transactions carried out for all other taxpayers, both large and small, in the regular course of the state's business. The report makes no charges of impropriety against any person identified in the report, but singles them out merely for exercising their constitutional right to support candidates for political office.

Further, the Auditor's report is structured to present a selected group of statistics without adequate context thereby leading to potential misinterpretation. Owing to its specific and highly technical nature, the report does not provide a clear and complete overview of the sheer volume of tax collections by the State of Texas. For example, the Auditor focuses on 3,656 "tax settlements" over a six year period involving \$461 million. Although this amount stated in isolation is a significant amount of money, it pales in comparison to the number and size of transactions processed by the agency in that period.

The Comptroller administers and collects more than 50 taxes for the State of Texas with collections totaling more than \$30 billion annually. This work involves literally millions of taxpayers located in Texas and across the United States and tens of millions of transactions. The Auditor's report summarizes a bare fraction of those transactions, and presents the data in a way that implies that a relationship between the political contributions and various "tax settlements" might exist. But in fact, no such relationship was found by the Auditor. Statistical examination and extensive interviews with the staff of the Comptroller's Office found no such information or relationship. Nonetheless, the data are presented in such a way that they could be misinterpreted, a conclusion doubtlessly unintended by the Auditor given the overall conclusion of the report. The Comptroller, therefore, wishes to provide information relevant to understanding the selective data presented by the Auditor's Office in fulfilling its legislative directive.

State law requires the Comptroller to refund erroneously paid tax. Certainly, there should be no question that taxpayers who inadvertently overpay taxes or dispute audits by the Comptroller are entitled to refunds if they are found not to owe taxes. The Comptroller's goal is now, and always has been, to collect only the dollars owed to the state and not a penny more. There should be no implication, however unintended by the Auditor, that the State should simply keep money paid in error by honest taxpayers who make honest errors in their tax payments or who have honest disputes with the State over the application and interpretation of state tax law.

Here are the actual facts that show the size and volume of state tax administration:

- Over the period covered by the Auditor's review, the Comptroller collected \$188.9 billion in state taxes and fees.
- The agency processed more than 21.6 million tax returns involving 1.7 million active taxpayers annually.
- There were 653,500 refund requests in this period, involving more than \$5.9 billion.

John Keel, CPA  
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September 7, 2005

- The Auditor does not acknowledge the fact that during the six year period in question, the Comptroller's Audit staff conducted 84,927 audit examinations and assessed better than \$3.5 billion.
- The Audit Division also is involved when taxpayers make requests for refunds for overpayments of tax owed to the state. The purpose of this review is to make sure that taxpayers receive all money that is owed to them but not one penny more. In this period, Audit staff reviewed more than 9,402 refund requests totaling \$3.4 billion. Less than 40 percent of these refunds were actually approved by Audit staff.
- In the same six year time period, the Enforcement Division collected \$4.1 billion in delinquent taxes owed to the state.
- In combination, Audit and Enforcement activities over the period produced \$7.5 billion in taxes and assessments that were fairly owed to the state.
- The Auditor's report fails to indicate that management halt under "administrative request" includes automatic halts in the collections processed triggered by requests for administrative hearings. These halts are vital to the fair treatment of taxpayers.

#### **State Laws Affecting State Officials Should Be Uniformly Applied**

With respect to political contributions and the Auditor's recommendations in this area, the Comptroller will abide by any rules the Legislature chooses to impose. Such rules do not exist at this time and would require action by the Texas Legislature. The Legislature considered legislation of this type in 2003 and rejected the idea. In any case, any such changes, if enacted, should apply to all state elected officials.

The Comptroller does not agree with the recommendation to move the hearings process to the State Office of Administrative Hearings. This recommendation has been considered by the Legislature several times in the past. It has been rejected in each case because it is costly to the taxpayers and does not improve the overall effectiveness of state tax administration.

The Comptroller's Office has worked extensively with the Auditor's staff over the three years involved in this review. We appreciate the professionalism of the Auditor's Office staff. The Comptroller does not generally agree with the Auditor's recommendations, but again, the Comptroller is gratified that the audit showed that the Comptroller's Office managed state tax administration in a way that raises no substantive issues after years of careful scrutiny.

Sincerely,



Billy Hamilton  
Deputy Comptroller



CAROLE KEETON STRAYHORN  
Texas Comptroller

## TEXAS COMPTROLLER OF PUBLIC ACCOUNTS

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### Addendum to Comptroller's Response Relating To Management Halt Records

In addition to the foregoing responses, consider the following related to the portions of Report 06-002 that concern management halts.

As of September 08, 2005, the Comptroller has identified 11,693 management halt records established during the period covered by Report 06-002, the status of which are as follows:

- 2,486 management halt records are now closed in accordance with the routine review and closure procedures.
- 9,207 management halt records remain active for the following reasons:

• Protest Payment	50	.54%
• Audit in progress	29	.31%
• Motion for Rehearing	3	.03%
• Amended Audit	7	.08 %
• Processing Problems	56	.61%
• Administrative Request	276	3.0%
• Prehearing Request	68	.74%
• Prehearing Amended Audit	1	.01 %
• Attorney Account	2	.02%
• Bankruptcy*	8715	94.66%
<b>TOTAL</b>	<b>9207</b>	<b>100.0%</b>

\* Federal bankruptcy law imposes an automatic stay on all proceedings against the bankrupt party pending finalization of the bankruptcy. Thus, a principal reason for management halts is to comply with Federal bankruptcy law. The 8,715 uncompleted bankruptcy management halts reflected above relate to Federal bankruptcy cases that have been in the database for years. The vast majority involve "no asset" bankruptcies without any collection possibility. Article III, Section 55 of the Texas Constitution prohibits the release of any debt or obligation owed the State, which includes the tax liabilities of these bankrupt taxpayers. Since they are uncollectible due to the no asset status of the taxpayer, but the liability cannot be extinguished, these remain on the system. Without management halt status for these cases, the system would generate notice and collection assignments that would violate Federal law.

Attached hereto is the Memorandum dated March 28, 1996, outlining the long-standing agency procedures relating to bankruptcies.

Copies of this report have been distributed to the following:

### **Legislative Audit Committee**

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair  
The Honorable Tom Craddick, Speaker of the House, Joint Chair  
The Honorable Steve Ogden, Senate Finance Committee  
The Honorable Thomas “Tommy” Williams, Member, Texas Senate  
The Honorable Jim Pitts, House Appropriations Committee  
The Honorable Jim Keffer, House Ways and Means Committee

### **Office of the Governor**

The Honorable Rick Perry, Governor

### **Office of the Comptroller of Public Accounts**

The Honorable Carole Keeton Strayhorn, Comptroller of Public Accounts  
Mr. Billy Hamilton, Deputy Comptroller



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