F I S C A L   I M P A C T   R E P O R T

		ORIGINAL DATE	3/01/07		
SPONSOR	Gonzales	**LAST UPDATED**	3/21/07	**HB**	1251/aHBIC/aHFL
SHORT TITLE	Modifying Tax Penalties & Interest			**SB**	
				ANALYST	Schardin

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	**FY08**	**FY09**		
		$3,347.0	Recurring	General Fund
	($1,260.0)		Nonrecurring	General Fund
		$1,225.0	Recurring	Local Governments

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of HFl Amendment

The House Floor amendment to House Bill 1251 further amends the penalty for misreporting food and medical services gross receipts tax deductions so the penalty will apply only to the extent that incorrect reporting resulted in incorrect local government distributions that would have been received if the deductions were correctly reported.

The amendment also creates a tax credit for taxpayers who paid the penalty for misreporting the food and medical services deductions before July 1, 2007. The amount of the credit will be the difference between amount of the penalty paid in the past and the penalty that would have been paid given the amendments proposed in this bill. The credit must be claimed by July 1, 2010 and may be claimed against gross receipts tax, compensating tax, or withholding tax.

The House Floor amendment changes the effective date of the provisions of Sections 1 through 5, which contain all provisions of the bill except the penalty for misreporting the food and medical services deductions, to July 1, 2008 The provisions of Sections 6 and 7, which pertain to the food and medical services deductions, will become effective on July 1, 2007.

Synopsis of HBIC Amendment

The House Business and Industry Committee amendment to House Bill 1251 change the effective date of the bill from July 1, 2007 to January 1, 2008. This change eliminates TRD's concern that filing instructions for several taxes would be incorrect.

Synopsis of Original Bill

House Bill 1251 amends provisions relating to penalties and interest for incorrect and late tax payments.

Section 1 increases from $10 to $25 the minimum amount that a taxpayer must owe for TRD to assess.

Sections 2 and 3 amend language to replace the current 15 percent interest charged when a taxpayer underpays or overpays taxes with a rate established for individuals pursuant to Section 6621 of the Internal Revenue Code. That section of federal code sets the rate of interest on underpaid taxes at the federal funds rate plus 3 percent, and sets the rate on interest on overpaid taxes as the federal funds rate plus 3 percent or 2 percent if the taxpayer is a corporation.

Section 3 also amends statute so that TRD would be allowed up to 125 days to process a claim for refund on severance taxes before interest would be earned by a taxpayer. Currently, TRD is allowed up to 60 days to process a refund claim before interest is earned by the taxpayer.

Section 4 increases the maximum penalty that may be assessed when a taxpayer fails to pay a tax due to negligence or disregard for TRD rules from 10 to 20 percent of the amount of tax due. The penalty will still be imposed at a rate of 2 percent per month up to the maximum.

Section 5 expands the $50 penalty for failing to file an information return on time pursuant to the gasoline tax act to include wholesalers, retailers and rack operators. Currently, that penalty applies only to "taxpayers."

Section 6 amends the penalty for incorrect reporting of the food and medical services gross receipts tax deductions enacted in 2004. Under current law, health care practitioners and food retailers pay a penalty in the amount of the difference between the incorrect deduction and the correct deduction amount, multiplied by twice the total local option tax rate in effect in the reporting period. The bill would allow medical service providers and food retailers to pay a penalty of 2 percent per month, up to 20 percent of the incorrect payment amount multiplied by the total local option tax rate in effect in the reporting period.

The effective date of these provisions will be July 1, 2007.

FISCAL IMPLICATIONS

TRD reports that in FY05, interest collections from taxpayers who underpaid were about $20 million, while interest payments to taxpayers who overpaid were about $3 million. Thus, lowering interest rates on under and overpayments will result in a general fund revenue reduction. TRD expects general fund interest payments to fall by $2,108 thousand in FY09 and by about $8,292 thousand in FY12, when the impact of lower interest rates is expected to level off. Local governments will also lose revenue due to the lower interest rates.

TRD reports that in FY05, penalty collections were about $8 million, 95 percent of which was due to payments at the maximum rate of 10 percent. Increasing the maximum rate to 20 percent is expected to increase penalty revenue in about 75 percent of taxpayer cases because taxpayers will have more incentive to pay on time. Additional general fund revenue due to higher penalties is expected to be about $5,454 thousand in FY09. Local governments will also gain revenue due to higher penalties.

TRD reports that total penalties for the food and medical services deductions are about $1.4 million since the penalties were first imposed in January 2005. The credit would give back about 90 percent of those penalties, or $1,260. This revenue reduction to the general fund will be nonrecurring.

The table on page one of this analysis reflects the net revenue impacts both lower interest rates, higher penalties, and the food and medical services penalty credit created in the House Floor amendment.

SIGNIFICANT ISSUES

Taxpayers have protested to TRD that the 15 percent interest imposed on underpayments is too high compared with current market rates. Currently, the federal funds rate is about 5 percent. The federal government responded to this problem by enacting Section 6621 of the Internal Revenue Code. That section allows interest on tax underpayments to fluctuate as market interest rates fluctuate.

The food and medical services gross receipts tax deductions enacted in 2004 contained the penalty provision that is amended in Section 6 of this bill. Under current law, health care practitioners and food retailers pay a penalty in the amount of the difference between the incorrect deduction and the correct deduction amount, multiplied by twice the total local option tax rates in effect in the reporting period. TRD is uncertain whether the “double local option” penalty is currently contributing to more or less accurate reporting of the medical services deduction. TRD reports that the penalty was enacted to ensure correct reporting because the provision holding local governments harmless from the deduction depends on it. However, many taxpayers view the penalty as unfair. As a consequence, it appears they have not voluntarily disclosed misreporting that would be subject to the penalty. Many assessed penalties have been protested, which are costly for TRD to resolve.

ADMINISTRATIVE IMPLICATIONS

TRD reports that changing the interest rate on underpayments and overpayments of tax from a fixed 15 percent to a rate that moves with the federal funds rate will require systems changes. TRD will change instructions and forms. If the interest and penalty are changed effective July 1, 2008, then instructions for filing personal income tax, corporate income tax, fiduciary tax and property tax returns will be incorrect for the last half of 2008. Incorrect instructions will affect late filers and extension filers.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House Bill 1251 conflicts with Senate Bill 356 and Senate Bill 258. These bills make different amendments to Section 7-1-71.2, which imposes penalties for incorrect claims of the food and medical service gross receipts tax deductions enacted in 2004.

SS/mt:csd