

Approved: 3/8/94
Date

MINUTES OF THE HOUSE COMMITTEE ON TAXATION.

The meeting was called to order by Chairperson Keith Roe at 9:00 a.m. on February 24, 1994 in Room 519-S of the Capitol.

All members were present except: Representative Empson, excused
Representative Lahti, excused

Committee staff present: Chris Courtwright, Legislative Research Department
Tom Severn, Legislative Research Department
Don Hayward, Revisor of Statutes Office
Bill Edds, Revisor of Statutes Office
Lenore Olson, Committee Secretary

Conferees appearing before the committee:
Secretary Nancy Parrish, Kansas Department of Revenue
T. C. Anderson, Kansas Society of Certified Public Accountants
Alan Alderson, Kansas Bar Association
Bob Corkins, Kansas Chamber of Commerce and Industry

Others attending: See attached list

Chairperson Roe opened the hearings on SB 480 and SB 503.

SB 480 - taxation; interest on delinquent payment and refunds.

SB 503 - taxation; penalties for delinquent returns and unpaid taxes.

T. C. Anderson, Kansas Society of Certified Public Accountants, testified in support of SB 480 and SB 503. Mr. Anderson said these bills would bring fairness back to the Kansas tax system where 18 percent interest rates no longer reflect the true time value of money and where the current 10 and 25 percent penalty base applied across the board seems harsh for taxpayers trying to comply with the law. Mr. Anderson offered technical amendments to both bills as shown on (Attachment 1).

Representative Wilk requested staff to provide information on the total number of dollars of interest and penalties the state generated in the last fiscal year.

Alan Alderson, Kansas Bar Association, testified that they support both SB 480 and SB 503, as amended in the Senate. Mr. Alderson requested SB 503 be amended regarding the 10 percent penalty added by the Department of Revenue to amounts unpaid pursuant to an assessment as shown on pages 2 and 3 of his written remarks. Mr. Alderson also proposed language to cover both income and sales tax statutes as shown on page 4 of (Attachment 2).

Bob Corkins, Kansas Chamber of Commerce and Industry, testified in support of SB 480 and SB 503. He said KCCI believes these bills propose reasonable reforms to the state's policies for imposing penalties and interest on the late payment of taxes (Attachment 3).

Secretary Nancy Parrish, Department of Revenue, testified on SB 480. The Secretary reviewed considerations suggested by the Department and amendments proposed by the Senate subcommittee. She said the amendments proposed by the Senate Committee and adopted by the full Senate represent a compromise among interested parties and are supported by the Department (Attachment 4).

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON TAXATION, Room 519-S Statehouse, at 9:00 a.m. on February 24, 1994.

Secretary Nancy Parrish, Department of Revenue, reviewed the provisions of SB 503. Also reviewed by the Secretary were amendments proposed by the Senate subcommittee. Secretary Parrish said the Committee may wish to examine the effective date of the amendment relating to requests for extensions (Attachment 5).

A fiscal note on SB 503 was distributed by the Division of Budget (Attachment 6).

Representative Rock reviewed a letter showing various interest rates and penalty rates for late payment (Attachment 7).

Chairperson Roe concluded the hearings on SB 480 and SB 503.

The Chair directed the Committee to turn to HB 2933.

HB 2933 - individual medical accounts.

Representative Wagle reviewed a balloon showing proposed amendments to HB 2933 (Attachment 8).

A motion was made by Representative Wagle, seconded by Representative Glasscock, to amend HB 2933 with the changes shown on the balloon from Representative Wagle. HB 2933 is to be further amended to strike the words "and long term care" on page 2 line 17.

The Committee discussed the proposed amendments to HB 2933. The Department of Revenue was requested to provide a worksheet addressing the rate of return scenario as described by Representative Krehbiel.

Terry Leatherman, Kansas Chamber of Commerce and Industry was requested to provide an example of how this legislation could be of use to a citizen of Kansas.

The meeting adjourned at 10:40 a.m. with no vote taken on the motion to amend HB 2933. The next meeting is scheduled for February 25, 1994.

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Kansas Society of
Certified Public Accountants

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FOUNDED OCTOBER 17, 1932

TESTIMONY ON SB 480 & SB 503

TO THE HOUSE
COMMITTEE ON TAXATION

by

T.C. Anderson, Executive Director
Kansas Society of Certified Public Accountants

February 24, 1994

2/24/94
House Taxation Cmte
Attachment 1

Chairman Roe,
Members of the House Taxation Committee

I am T.C. Anderson, Executive Director of the Kansas Society of Certified Public Accountants. I appear before you today to urge your favorable consideration of SB 480 & SB 503, both as amended by the Senate Committee. I would also ask your favorable consideration to technical amendments I will be offering on both bills.

These bills were introduced as the end product of a joint Kansas Society and Kansas Bar Task Force that addressed the current 18 percent Kansas interest rate on unpaid taxes and the 10 and 25 percent penalties imposed upon taxpayers who do not pay their tax in full by the due date.

With me today is John Luttjohann, a Topeka certified public accountant and a member of the Task Force, who will be happy to address any technical questions you might have.

I might also note from the outset that the Task Force has worked closely with the Kansas Department of Revenue and the amendments contained in the two bills before you today were the result of a cooperative effort on the part of both organizations.

With regard to SB 480, Kansas currently charges the second highest interest rate in the nation on unpaid taxes. Only Connecticut with a 20 percent rate is higher.

SB 480 would set the Kansas interest rate on unpaid taxes at 12 percent beginning January 1, 1995. After December 31, 1997, the rate would switch to the underpayment rate in effect on the previous July 1, as prescribed by Section 6621 of the federal Internal Revenue Code, plus one percent. Today the IRS rate is 7 percent.

Interest the State pays on refunds of overpayment of certain taxes would be reduced from 12 percent to 6 percent beginning January 1, 1995. After December 31, 1997, the rate would be the overpayment rate paid by the Internal Revenue Service. Today the IRS rate is 6 percent.

A new provision has been added to the Kansas tax code in SB 480. New Section 3 of the bill that can be found on page 4, line 19 would permit taxpayers to make a deposit with

the Director of Taxation of all or any part of additional income taxes assessed and the amount deposited would not be subject to any interest from the time of the deposit until the liability is finally determined. One of the amendments I mentioned earlier in my testimony deals with this new section.

I would propose, per the attached balloon, to make the deposit available for all types of taxes administered by the Department of Revenue. In addition, our amendment would make it clear that the deposit is to include interest and penalty related to that portion of tax placed on deposit. Finally, the amendment would provide for interest to be paid the taxpayer on the amount of the deposit, if the taxpayer is successful in his or her challenge of the tax in question, but only if the Department pays interest on refunds of the type of tax involved.

With regard to SB 503, let me address two areas of concern to taxpayers and tax professionals and how this bill would affect them.

The first is extended returns. Until the fall of 1992 the Kansas Department of Revenue had not imposed a penalty on underpayment of tax for validly extended returns. Thus, if during the six month extension period permitted by the IRS, a Kansas taxpayer determined he or she owed the state \$100, that taxpayer would pay that amount plus interest calculated at 1 1/2 percent per month or \$9.00 for a total of \$109.00.

When the Department also began to assess a 25 percent penalty on this situation, the tax bill increased to \$134.00. Let me be quick to point out, the Department has been waiving this penalty on extended returns, under most circumstances, if the taxpayer requests.

SB 503 would exempt extended returns from the penalty provisions provided 90 percent of the income tax due was paid by the due date. This parallels federal law. In addition the bill will extend the period of time for a 10 percent penalty on underpaid or unpaid taxes from 60 days to 6 months. When coupled with SB 480, the taxpayer who owed the \$100 in tax on a valid extension would pay a total of \$106.00 if 90 percent of the total tax obligation had been paid by April 15 or \$116.00 if 90 percent of the tax had not been paid by April 15, thus kicking in the 10 percent penalty provision.

Likewise, Kansas taxpayers who voluntarily file amended returns are currently being clipped with the annual 18 percent interest plus 25 percent penalty if the additional tax payment is made 60 days after the original due date.

Page 3
SB 480 and SB 503

As an example a taxpayer receives an amended K1 on a limited partnership that results in an additional \$100 tax. If the amended return is submitted April 15 of the following year, the taxpayer would owe \$18.00 interest plus the \$25.00 penalty or \$143.00 for voluntarily submitting the amended return.

Under SB 480 and SB 503 the taxpayer in this example would own \$106.00 provided the amended return was not filed as a result of the taxpayer being advised that a prior year's return was going to be audited. SB 503 would waive the penalty imposed on amended returns except or the reason noted. It is our understanding the IRS waives the penalty on voluntarily amended returns where there clearly was no intent to evade taxes.

To help expedite this change in Kansas law we would ask the Committee to further amend SB 503 to as to make it effective upon publication in the Kansas Register and apply to tax returns filed after January 1, 1994.

SB 480 and SB 503 have no sympathy for taxpayers who fail to file or for taxpayers who grossly underestimate their tax obligation to the state.

SB 480 and SB 503 would bring fairness back to the Kansas tax system where 18 percent interest rates no longer reflect the true time value of money and where the current 10 and 25 percent penalty base applied across the board seems harsh for taxpayers trying to comply with the law.

Thank you, and I'll be happy to stand for questions.

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1-5

1 prescribed for filing such return, determined with regard to exten-
 2 sions, no interest shall be allowed or paid for any period before the
 3 date on which the return is filed;

4 (6) in the case of a refund, interest shall be allowed and paid
 5 from the date of the overpayment to a date preceding the date of
 6 the refund check by not more than 30 days, as determined by the
 7 director, whether or not such refund check is accepted by the tax-
 8 payer after tender of such check to the taxpayer, but acceptance of
 9 such check shall be without prejudice to any right of the taxpayer
 10 to claim any additional overpayment and interest thereon; and

11 (7) if any overpayment is refunded within two months after the
 12 last date prescribed, or permitted by extension of time, for filing
 13 the return of such tax, or within two months after the return was
 14 filed, whichever is later, no interest shall be allowed or paid. For
 15 the purposes of this section, an overpayment shall be deemed to
 16 have been refunded at the time the refund check in the amount of
 17 the overpayment, plus any interest due thereon, is deposited in the
 18 United States mail.

19 *New Sec. 3. Whenever an assessment is issued pursuant to*
 20 *~~K.S.A. 79-2926, and amendments thereto, for additional income~~*
 21 *taxes, the taxpayer may deposit with the director of taxation all or*
 22 *any portion of the amount of additional taxes so assessed and the*
 23 *amount so deposited shall not be subject to any interest for the*
 24 *period from the time such deposit is made until the time the liability*
 25 *is finally determined. If the amount of liability finally determined*
 26 *is less than the amount deposited, interest shall be paid on the*
 27 *overpayment at the rate prescribed by K.S.A. 79-32,105, and amend-*
 28 *ments thereto.*

29 Sec. 3 4. K.S.A. 79-2968 and K.S.A. 1993 Supp. 79-32,105 are
 30 hereby repealed.

31 Sec. 4 5. This act shall take effect and be in force from and after
 32 its publication in the statute book.

relating to any tax administered by the Department of Revenue,

together with interest and penalty related to that portion
 of the tax,

or penalty

,if interest is otherwise paid on refunds of the type of
 tax involved,

same

and in the same manner as allowed with regard to other
 overpayments of the type of tax involved.

June 1, 1

4/State Income Tax Alert

State Interest Rates and Related Dates						
State	Statute of Limitations (1)		Interest Rates (2)	Automatic Penalties (3)	Protest Period (Days) (4)	Extended Due Dates (5)
	Assessments	Refunds				
Ala.	3 yrs.	3 yrs.	Same as federal	Yes	30	9/15
Alaska	3 yrs.	3 yrs.	Varies by formula equally applied	No	60	9/15
Ariz.	4 yrs.	4 yrs.	Same as federal	Yes	90	10/15
Ark.	3 yrs.	3 yrs.	10% equally applied	No	30	9/15
Calif.	4 yrs.	4 yrs.	Varies by formula differential same as fed.	No	60	10/15
Colo.	4 yrs.	4 yrs.	Prime + 5% equally applied	No	30	10/15
Conn.	3 yrs.	3 yrs.	1.666%/mo. assessments; 5%/mo. refunds	Yes	30	9/30
Del.	3 yrs.	3 yrs.	12%/yr. equally applied	No	90	10/1
D.C.	3 yrs.	3 yrs.	18%/yr. assessments; 6% yr. refunds	Yes	30	9/15
Fla.	5 yrs.	3 yrs.	Varies by formula equally applied	Yes	60	10/1
Ga.	3 yrs.	3 yrs.	12% assessments; 9%/yr. refunds	No	30	9/15
Hawaii	3 yrs.	3 yrs.	8% equally applied	No	30	10/20
Idaho	3 yrs.	3 yrs.	12% equally applied	Yes	30	10/15
Ill.	3 yrs.	3 yrs.	9% equally applied	Yes	60	10/15
Ind.	3 yrs.	3 yrs.	8% equally applied	No	60	10/15
Iowa	3 yrs.	3 yrs.	9% equally applied	Yes	60	10/15
Kan.	4 yrs.	4 yrs.	18% assessments; 12% refunds	No	30	10/15
Ky.	4 yrs.	4 yrs.	8% equally applied	Yes	45	10/15
La.	3 yrs.	3 yrs.	Varies by formula equally applied	No	15	11/15
Maine	3 yrs.	3 yrs.	12% equally applied	Yes	30	10/15
Md.	3 yrs.	3 yrs.	12% assessments; 9% refunds	No	30	9/15
Mass.	3 yrs.	3 yrs.	18% equally applied	Yes	30	9/15
Mich.	4 yrs.	4 yrs.	1% over prime assessments; 9% refunds	Yes	20	12/30
Minn.	3.5 yrs.	3.5 yrs.	Varies by formula equally applied	No	60	10/15
Miss.	3 yrs.	3 yrs.	12% equally applied	Yes	30	9/15
Mo.	3 yrs.	3 yrs.	12% assessments; 6% refunds	Yes	30	10/15
Mont.	5 yrs.	5 yrs.	12% equally applied	No	30	11/15
* Neb.	3 yrs.	3 yrs.	14% equally applied 72	Yes	90	10/15
Nev.	N/A	N/A	N/A	N/A	N/A	N/A
N.H.	3 yrs.	3 yrs.	15% assessments; 10% refunds	No	20	10/15
N.J.	5 yrs.	2 yrs.	Prime + 5% assessments; 0% refunds	Yes	30	10/15
N.M.	3 yrs.	3 yrs.	15% equally applied	Yes	30	10/15
N.Y.	3 yrs.	3 yrs.	Varies by formula equally applied	No	90	9/15
N.C.	3 yrs.	3 yrs.	8% equally applied	Yes	30	10/15
N.D.	6 yrs.	3 yrs.	12% assessments; 10% refunds	Yes	30	9/15
Ohio	3 yrs.	3 yrs.	10% equally applied	Yes	30	10/15
Okla.	3 yrs.	3 yrs.	15% equally applied	No	30	10/15
Ore.	3 yrs.	3 yrs.	11% equally applied	No	30	10/15
Pa.	(6)	2 yrs.	9% equally applied	Yes	90	10/15
R.I.	3 yrs.	2 yrs.	10% equally applied	No	10	9/15
S.C.	3 yrs.	3 yrs.	Same as federal	No	30	9/15
S.D.	N/A	N/A	N/A	N/A	N/A	N/A
Tenn.	3 yrs.	3 yrs.	12.5% equally applied	No	30	1/1
Texas	4 yrs.	4 yrs.	12% assessments; 0% refunds	Yes	30	N/A
Utah	3 yrs.	3 yrs.	12% equally applied	No	30	10/15
Vt.	3 yrs.	3 yrs.	9.6% equally applied	Yes	30	10/15
Va.	3 yrs.	3 yrs.	Same as federal	No	90	10/15
Wash.	4 yrs.	4 yrs.	2% over prime assessments; 1% over prime refunds	No	30	N/A
W.Va.	3 yrs.	3 yrs.	9% equally applied	No	60	9/15
Wis.	4 yrs.	4 yrs.	12% assessments; 9% refunds	Yes	60	9/15
Wyo.	N/A	N/A	N/A	N/A	N/A	N/A

(1) Statute of Limitations: Defines the rights of parties. As such, they should apply even-handedly to assessments and refund claims.

(2) Interest Rates: Failure to equalize interest rates diminishes the value of the taxpayer's remedy of recovering tax monies to which it is legally entitled.

(3) Automatic Penalties: Their sole purpose is to raise additional revenues and, as such ignore the conceptual basis for penalty provisions.

(4) Protest Period: The protest period should be at least 60 days. Shorter periods are unreasonable and jeopardize a taxpayer's ability to fully respond to a proposed assessment.

(5) Extended Due Date: The extended due date for state income or franchise tax returns should be set at some point beyond the federal extended due date. By setting extended due dates, state administrators can assist taxpayers in efficiently filing state returns.

(6) End of year succeeding year of return.

Source: COST Procedural Bill of Rights. Reprinted with permission, Committee on State Taxation, Washington, D.C.

* Changed July 1, 1993

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DANIEL B. BAILEY

MEMORANDUM

TO: Members of House Committee

FROM: Alan F. Alderson, Kansas Bar Association

DATE: February 24, 1994

RE: Senate Bill Nos. 480 & 503

I am appearing before you today on behalf of the Kansas Bar Association in support of Senate Bill Nos. 480 & 503, each of which has been amended in the Senate. The Kansas Bar Association supports these bills, as amended.

Members of the KBA Tax Committee have collaborated with the Kansas Society of CPAs in the project which led to the drafting of these bills. T.C. Anderson will be presenting testimony this morning to explain the impact of these bills on tax return preparers and CPAs. I will address the issues that are more important to the attorneys who represent the businesses who appeal from assessments issued by the Kansas Department of Revenue.

The society of CPAs and the Bar Association have been meeting with the Director of Taxation and the Secretary of Revenue and their staff since approximately June of last year trying to resolve problems faced by businesses and individuals in this state caused by excessive interest rates and penalties. The problem is twofold: (1) The 18 percent interest rate currently required by law is exorbitant and out of line with any appropriate charge for the use of a taxpayer's funds today; (2) for approximately the last year, the Department of Revenue has changed its interpretation of the various penalty statutes to require the imposition of a 25 percent penalty on amounts shown on all returns not filed more than 60 days after the due date or all taxes not paid more than 60 days after the due date. The first problem is clearly a legislative policy matter, but the second problem has been created by the Department of Revenue's new interpretation of an old statute.

The Kansas Bar Association and the Society of CPAs originally proposed to remedy the first problem by tying the interest

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rate to the federal rates set pursuant to Section 6621 of the Internal Revenue code of 1986. The Department of Revenue believes it is not possible under its current computer configuration to administer a law which would require calculating variable rates. The Senate Assessment and Taxation Committee has adopted the recommendation of its Subcommittee and has prescribed a 12 percent rate for periods commencing after January 1, 1995, and would require the implementation of the variable rate calculated with the reference to the federal rate, for taxable years ending after December 31, 1997. The rate for refunds paid by the Department of Revenue would continue to have a six percent differential until that time, at which time the rate for payment on refunds would be one percent less than the amount collected on underpayments. The KBA can support these amendments.

The penalty provisions of Senate Bill No. 503 have been revised substantially by the Senate Assessment and Taxation Committee, again in response to the Department of Revenue's indication that the one-half percent per month and five percent penalties proposed by the Society of CPAs and the KBA could not be administered under the current computer configuration. The Department of Revenue has agreed to extend the period under which only a ten percent penalty is to be assessed from the current 60 days to six months. The KBA has removed its requests to have interest payable on excise tax refunds, because the Department of Revenue has again posed numerous problems that it cannot handle in trying to determine the dates for which interest on these types of refunds would apply. The Senate Committee removed those provisions from the bill. Again, the KBA could support these recommendations.

However, there is one flaw in Senate Bill No. 503 that must be remedied by this Committee in order for the Kansas Bar Association to support Senate Bill No. 503, in total. We believe the bill was not properly drafted to accomplish one of the recommendations of the Senate Assessment and Taxation Committee, which recommendation emanated from the report of its Subcommittee, consisting of Senator Tiahrt, Senator Reynolds and Senator Feleciano. This recommendation represented the most important facet of this bill, as far as the Bar Association was concerned.

The problem it addressed has been caused by recent change in interpretation of the law by the Department of Revenue. For many years, the Department of Revenue has routinely added a ten percent penalty to amounts unpaid pursuant to an assessment. During the last year, the Department changed its policy radically and now contends that, in any situation where an assessment of tax is issued for periods of three or four

years prior to the issuance of the assessment, a 25 percent penalty must be added because, under a strict interpretation of the statute, these periods occurred more than 60 days previous to the date of issuance of the assessment. While there is some logic to this interpretation of the statute, the business community has been outraged by this sudden change in interpretation to their extreme detriment.

It is now routine that, in a case in which a field audit is performed and an assessment of income tax or sales tax is issued, additional sums of interest at 18 percent and penalty in the amount of 25 percent are tacked on. The taxpayer is fearful of litigating legitimate tax issues because the interest continues to run throughout the extended appeal period and the possibility of not getting the 25 percent penalty waived, if the tax portion of the assessment is contested.

For example, I currently represent a taxpayer who was assessed Kansas Retailers Sales Tax for the period of March 1, 1989, through February 28, 1992, in the amount of \$163,769.00. This assessment predated the Department of Revenue's change in policy, so \$16,383.00 of penalty (10%) was issued, and interest had already accrued during the assessment period of \$49,545.00. Had the Department of Revenue's current policy been in effect, there would have been an additional \$24,565.00 in penalty at the time of the assessment. The total assessment would have been \$254,256.00 and, even if the time of the assessment, the penalty and interest portion would have been \$90,487.00, or 36 percent of the total.

This litigation has proceeded at normal speed and has been heard by the Director of Taxation. Briefs were filed many months ago and the taxpayer is still awaiting a decision from the Director of Taxation. Prior to submitting the case to hearing, the taxpayer had to make some decisions about the viability of some of the issues identified in its petition, and has paid a portion of the taxes out of fear of accruing additional interest on marginal issues. On the remaining issues still subject to the appeal, the taxpayer will probably have to continue its appeal through the Board of Tax Appeals and then to the Kansas Court of Appeals. Several more years will have passed before the taxpayer is likely to get a final ruling.

This assessment was issued May 26, 1992, in the amount of \$229,697.00 just to get to the point where we are still awaiting on as decision from the Director of Taxation, I estimate that additional interest has accrued of approximately \$50,000.00. This is unconscionable in light of the \$90,000.00

in penalty and interest which would have been initially assessed under the Secretary of Revenue's current policy.

The Secretary of Revenue's agreement to extend the 60 day period to six months does not begin to take care of this problem. The Senate Assessment and Taxation Committee's Subcommittee had recommended that "... the penalty on assessments by the State of Kansas be ten percent if the tax shown due on the original return was paid with that return, unless, after review of the return the Secretary or the Secretary's designee determines that a 25 percent penalty is appropriate." This recommendation of the Subcommittee was adopted by the full Senate Assessment and Taxation Committee, but was never implemented in the amended draft.

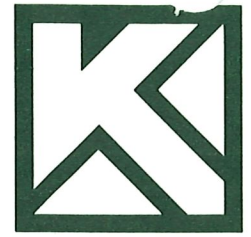
In order to accomplish the recommendation of the Senate Assessment and Taxation Committee that we believe has already been adopted and should have been in the amended version of the bill, I would recommend the following language be inserted at the end of Subsection (b) of Section 1 and again at the end of Subsection (b) of Section 6. This would cover both income and sales tax statutes. The proposed language is as follows:

"In no event, however, shall the penalty provided for in this subsection be imposed *included in* for any month in ~~which an~~ assessment is issued following an audit if, for that period, a return was filed by the taxpayer and all of the tax was paid pursuant to that return unless, after review of the return, the Secretary or the Secretary's designee determines that the underpayment of taxes as shown on the assessment was due to a failure to make a reasonable attempt to comply with the provision of this act."

The phrase I have used in this language for what triggers the 25 percent penalty is the federal definition of negligence under I.R.C. §6662 which pertains to the imposition of accuracy-related penalties. I think this language is very closely related to what we are trying to accomplish and is much easier for the Department of Revenue to prove than the "intent to evade" standard to which the Secretary originally objected.

We strongly urge this Committee to adopt this recommendation and to recommend the passage of this bill, as further amended. I would be glad to answer any questions regarding these proposals.

LEGISLATIVE TESTIMONY



Kansas Chamber of Commerce and Industry

835 SW Topeka Blvd. Topeka, Kansas 66612-1671 (913) 357-6321 FAX (913) 357-4732

SB 480 & 503

February 24, 1994

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the
House Taxation Committee

by
Bob Corkins
Director of Taxation

Mr. Chairman and members of the Committee:

My name is Bob Corkins, director of taxation for the Kansas Chamber of Commerce and Industry and I appreciate the chance to express our support for SB 480 and SB 503. We believe they propose reasonable reforms to the state's policies for imposing penalties and interest on the late payment of taxes.

The Kansas Chamber of Commerce and Industry (KCCI) is a statewide organization dedicated to the promotion of economic growth and job creation within Kansas, and to the protection and support of the private competitive enterprise system.

KCCI is comprised of more than 3,000 businesses which includes 200 local and regional chambers of commerce and trade organizations which represent over 161,000 business men and women. The organization represents both large and small employers in Kansas, with 55% of KCCI's members having less than 25 employees, and 86% having less than 100 employees. KCCI receives no government funding.

The KCCI Board of Directors establishes policies through the work of hundreds of the organization's members who make up its various committees. These policies are the guiding principles of the organization and translate into views such as those expressed here.

This subject has become increasingly important to our members over the last several months. KCCI's own internal tax committee recently took a look at the problem in response to a significant

*2/24/94
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Attachment 3*

number of unsolicited calls we received from our membership. Our conclusion was that the interests of the state could be better balanced with the interests of taxpayers if Kansas' tax penalties and interest more closely conformed to those imposed by the federal government.

The state has valid concerns for encouraging prompt tax payment, penalizing tax evasion, and protecting the time-value of its rightful revenues. However, taxpayers should not be saddled with financial consequences that exceed their degree of culpability, that provide an inequitable windfall to the state, and that discourage the prompt settlement of good faith disputes. We believe that SB 480 and SB 503 would strike a much better balance between the competing interests. The impressive cooperation exhibited by the Kansas Department of Revenue in arriving at the proposals before you today is evidence of that fact.

KCCI therefore respectfully asks that you recommend both of these proposals favorably for passage. We thank you for your time and attention.

STATE OF KANSAS

Nancy Parrish, Secretary of Revenue
Robert B. Docking State Office Building
915 S.W. Harrison St.
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Department of Revenue
Office of the Secretary

MEMORANDUM

To: The Honorable Keith Roe, Chairperson
House Committee on Taxation

From: Nancy Parrish, Secretary
Kansas Department of Revenue

Date: February 24, 1994

RE: S.B. 480 - Interest Rates on Delinquent Taxes

Thank you for the opportunity to appear on S.B. 480. The bill represents the coordinated efforts of the Kansas Society of Certified Public Accountants and the Kansas Bar Association to lower the interest rate on delinquent taxes owed to the state of Kansas. As originally introduced, the bill would have provided that the interest rate on delinquent accounts would be the rate prescribed by the Internal Revenue Code which is in effect on July 1 of the preceding year in which the state rate is determined. The bill also would have allowed interest to be paid on all excise tax refunds.

A number of issues were considered by the Senate Committee as it debated the merits of the bill. Some of those considerations suggested by the Department included:

1. S.B. 480 only affects the small percentage of taxpayers (5-10%) who do not pay on time. The remaining 90-95% of the timely filers are not affected by the bill.
2. The interest rate in effect should reflect the time value of money. The State should not get into the business of providing low interest loans which is the practical effect if the state's interest rate is too low.
3. There is a direct relationship between the rate of interest on delinquent taxes and a taxpayer's desire to pay. If the rate of interest is lower than that charged by other creditors such as on unsecured loans, then the taxpayer's state tax liability will be the last debt to be satisfied. A decline in the rate of collections can be expected if the rate is lowered drastically although the actual decrease in revenue is

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House Taxation Note
Attachment 4

difficult to quantify. The effect of statutory changes on taxpayer behavior should always be a primary consideration in legislation such as this.

4. The possibility of paying interest on excise tax refunds (sales/use) is problematic because the taxes are generally held in trust for the state by retailers. Refunds are paid to retailers only after they can document that taxes have previously been remitted to their customers. Are retailers also going to compute refund interest to their customers? How is that interest computed - when does it begin to run and when does it stop? These are questions which must be resolved or the state would be paying interest to parties who are not entitled to it.

5. There is a fiscal note associated with the passage of S.B. 480 as introduced. It is estimated that a variable interest rate would lower receipts by \$7-8 million although it would take several years to realize the revenue loss. The payment of interest on excise tax refunds also would reduce general fund balances although the precise amount of the reduction is unknown at this time.

A subcommittee chaired by Senator Todd Tiahrt proposed several amendments to the bill (all of which were adopted) after conferring with representatives of the Kansas Society of Certified Public Accountants, Kansas Bar Association and Department of Revenue. It was proposed that the assessment rate be reduced to 12% (same as property tax) and the refund rate to 6%, effective January 1, 1995. Beginning January 1, 1998, the interest rate would be a variable rate which changes annually. The rate would equal the federal rate plus 1%. The introduction of a variable rate at that time would coincide with the installation of a new computer system within the Department of Revenue.

It also was suggested that the current policy of not paying interest on excise tax refunds be continued. The proposed rates would be consistent with the rates imposed by surrounding states:

	Assessment <u>Rate</u>	Refund <u>Rate</u>
Colorado	Prime + 5%	Prime + 5%
Iowa	9%	9%
Missouri	12%	6%
Nebraska	7%	7%
Oklahoma	15%	15%

The Subcommittee's recommendations would reduce state general fund receipts by approximately \$4 million annually. Again the loss of revenue would occur over a period of years.

Finally, the Subcommittee created a mechanism for making deposits, in whole or in part, of an outstanding liability in order to allow taxpayers to stop the accrual of additional interest . A balloon suggesting a change in the

The Honorable Kei. Roe
February 24, 1994
Page 3

deposit language is attached. It is believed that the proposed amendment would conform the treatment of deposits to that provided by the Internal Revenue Service.

The amendments proposed by the Senate Committee and adopted by the full Senate represent a compromise among interested parties and are supported by the Department. I would be happy to respond to any questions you might have.

prescribed for filing such return, determined with regard to extensions, no interest shall be allowed or paid for any period before the date on which the return is filed;

(6) in the case of a refund, interest shall be allowed and paid from the date of the overpayment to a date preceding the date of the refund check by not more than 30 days, as determined by the director, whether or not such refund check is accepted by the taxpayer after tender of such check to the taxpayer, but acceptance of such check shall be without prejudice to any right of the taxpayer to claim any additional overpayment and interest thereon; and

(7) if any overpayment is refunded within two months after the last date prescribed, or permitted by extension of time, for filing the return of such tax, or within two months after the return was filed, whichever is later, no interest shall be allowed or paid. For the purposes of this section, an overpayment shall be deemed to have been refunded at the time the refund check in the amount of the overpayment, plus any interest due thereon, is deposited in the United States mail.

New Sec. 3. Whenever an assessment is issued pursuant to K.S.A. 79-2268, and amendments thereto, for additional income taxes, the taxpayer may deposit with the director of taxation all or any portion of the amount of additional taxes so assessed and the amount so deposited shall not be subject to any interest for the period from the time such deposit is made until the time the liability is finally determined. If the amount of liability finally determined is less than the amount deposited, interest shall be paid on the overpayment at the rate prescribed by K.S.A. 79-22,105, and amendments thereto.

Sec. 3 1. K.S.A. 79-2268 and K.S.A. 1993 Supp. 79-32,105 are hereby repealed.

Sec. 4 5. This act shall take effect and be in force from and after its publication in the statute book.

relating to any tax administered by the Department of Revenue,

together with interest and penalty related to that portion of the tax,

or penalty

if interest is otherwise paid on refunds of the type of tax involved,

same

and in the same manner as allowed with regard to other overpayments of the type of tax involved.

4-4

STATE OF KANSAS

Nancy Parrish, Secretary of Revenue
Robert B. Docking State Office Building
915 S.W. Harrison St.
Topeka, Kansas 66612-1588



(913) 296-3041
FAX (913) 296-7928
Information (913) 296-3909

Department of Revenue
Office of the Secretary

MEMORANDUM

To: The Honorable Keith Roe, Chairperson
House Committee on Taxation

From: Nancy Parrish, Secretary
Kansas Department of Revenue

Date: February 24, 1994

RE: S.B. 503 - Penalties on Delinquent Taxes

Thank you for the opportunity to appear on S.B. 503. The bill is the work product of the Kansas Society of Certified Public Accountants and the Kansas Bar Association. It is designed to adjust the manner in which penalties are assessed for delinquent taxes. As originally introduced, the bill would have done the following:

1. imposed a failure to file penalty of 5% per month not to exceed 25%;
2. imposed a failure to pay penalty of .5% per month not to exceed 25%;
3. provided a new "good faith" requirement which is in addition to the "reasonable cause" defense which may be raised by a taxpayer as a basis for requesting a waiver of a penalty.

As the Senate Committee debated the merits of the bill, the following matters were considered:

1. Penalties are designed to provide an incentive for taxpayers to file and pay on time.
2. S.B. 503 only affects the small percentage of taxpayers (5-10%) who do not pay on time. The remaining 90-95% of the timely filers are not affected by the bill.
3. Before major adjustments are made to the penalty provisions, a thorough understanding of the effect of those changes on voluntary compliance should be obtained. The assessment of interest on delinquent taxes alone is insufficient to provide taxpayers the motivation to file and pay on time.

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4. The variable penalty system proposed in the bill cannot be accommodated by the Department's current computer system. Until enhancements are brought on line over the next 4-5 years, the current system will not accept the new changes.
5. The current grounds for waiving penalties are based upon "reasonable causes." A reasonable cause is such a cause as would prompt an intelligent man to act under similar circumstances as did the taxpayer in failing to file a return or pay a tax on time. This is the federal standard which is supported by numerous judicial determinations. The additional "good faith" requirement is not defined.
6. The entire system of penalties should not be altered because of a few problem areas. Those areas which are problematic may be addressed by a bill without adversely affecting voluntary compliance.

In light of the above considerations, the subcommittee chaired by Senator Todd Tiahrt proposed the following amendments to S.B. 503:

1. a 10% penalty if a taxpayer fails to file or pay the tax within 6 months of the due date; a 25% penalty would be imposed after 6 months;
2. no penalties would be assessed in the circumstances where an extension to file has been requested by the taxpayer, and 90% of the tax has been paid by the due date; and
3. no penalties would be assessed where an amended return is filed, the taxpayer pays the amount of the underpayment at the time the return is filed and the return in question is not under audit at the time of filing.

In addition to these changes the Department has agreed to a proposed amendment that provides that a 10% penalty would be imposed on assessments following an audit unless it is determined that the taxpayer failed to make a reasonable attempt to comply with the controlling tax provisions. In that event, a 25% penalty could be assessed.

As a final note, the Committee may wish to examine the effective date of the amendment relating to requests for extensions. The Committee may wish to make that provision applicable to the current income tax filing cycle.

These adjustments along with a reduction in the interest rate for delinquent taxes would address many of the concerns raised by taxpayers over the past several months.

I would be happy to respond to any questions you might have.

MEMORANDUM

TO: Ms. Gloria M. Timmer, Director
Division of Budget

DATE: February 23, 1994

FROM: Kansas Department of Revenue

RE: Senate Bill 503
As Amended By
Senate Committee

BRIEF OF BILL:

Senate Bill 503, as amended by Senate Committee, amends K.S.A. 79-3228, 79-3495, 79-34,111, 79-3615, 79-3706, 79-41a03a and K.S.A. 1993 Supp. 79-3221, 79-32,107 and 79-3410 relating to taxation, the penalties of certain delinquent returns and unpaid taxes. The Senate Committee amendments delete the variable penalty rates and the term "good faith" from the bill.

In general, the bill as Amended by Senate Committee brings into conformity the penalty language of individual income, motor-vehicle and special fuels, LP-Gas fuel, interstate fuel, retail sales, use and liquor statutes. It changes the time of penalty imposition from 60 days to within six months after the time required, for income, sales, use and liquor statutes. For use and liquor law, the time-extension determination is made by the Secretary (from Director). The bill adds to withholding, motor-vehicle and special fuels, and LP-Gas fuel statutes a clause of "reasonable causes," for failure to comply, conforming them to other statutes; and adds that the Secretary (from Director) may reduce (as well as waive) the penalty amount for these taxes as well as interstate fuel. It removes the term "willful neglect" from reasonable-cause statutes of sales, use and liquor taxes, conforming them to income, withholding and motor fuels. Under current individual income tax law, penalty is a percent of the "unpaid balance." That language is added to sales, use and liquor statutes, replacing "the amount of such tax due."

The bill amends individual income tax law to provide that no penalty is assessed for underpayment reported on an amended return when "at the time of filing" the underpayment is paid and the return is not being examined; and for filing an extension, waives the penalty when 90% of the liability is paid at the original due date.

The effective date of this bill would be January 1, 1995, and after its publication in the statute book.

FISCAL IMPACT:

The fiscal impact on the State General Fund, State Highway Fund and Special City/County Highway Fund is indeterminable for Fiscal Year 1995.

The effect of changing the penalty imposition date from 60 days to six months is not known. Currently, in most cases of corporate income tax, the penalty is minimal or waived. Also, an Audit Bureau sample of sales and excise cash collections found the current penalty amount to be a small part (2%) of the total. It is thought that the penalty on individual income and liquor would also be minimal or waived.

The penalty imposition date and rates are not changed for the motor fuel taxes.

ADMINISTRATIVE IMPACT:

The administrative impact of passage of Senate Bill 503, as amended by Senate Committee, would be:

In the Taxpayer Assistance Bureau of the Department: Approximately \$2,000 in printing costs and \$10,000 in additional postage is anticipated as a result of passage of this bill.

In the Collections Processing Bureau of the Department: Approximately 252 hrs of user testing related costs at and average salary of \$11.22 per hour (\$2,827); approximately \$1,262 to modify calculation programs on 80 MacIntosh and portable computers; approximately \$4,614 in education and training expense for a total of \$8,703 in one-time expenses in the Collections Processing Bureau.

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APPROVED BY:

A handwritten signature in dark ink, appearing to read "Nancy Parrish", written over a horizontal line.

Nancy Parrish
Secretary of Revenue

LEE A. GREGG, JR.
CERTIFIED PUBLIC ACCOUNTANT

110 EAST CENTRAL AVE.
TELEPHONE 316 / 442-8450

POST OFFICE BOX 252
ARKANSAS CITY, KANSAS 67005

February 3, 1994

Representative Rand Rock
State Capitol Building - 273W
Topeka, KS 66612-1504

RE: Kansas Dept. of Revenue Penalty and Interest Imposed

Dear Representative Rock:

I have two clients who have been severely penalized for obtaining valid extensions of time to file their individual income tax returns for 1992.

Both clients had valid reasons for obtaining an extension and neither client knew their Kansas liability at April 15, 1993 due to unknown tax information. Both clients knew if they were underpaid they would be charged interest and some penalty. Their main problem is the amount of penalty and interest.

INTEREST

1. The prime interest rate is 6%.
2. The IRS interest rate is 9%.
3. The Kansas interest rate is 18%.

PENALTY - LATE PAYMENT

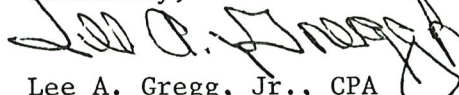
1. The IRS rate is $\frac{1}{2}\%$ per month or 6% per annum.
2. The KS rate is 10% flat for the first 60 days or 25% flat for over 60 days. For a 4-month extension this is an annual rate of 75%.

In other words, a 4-month extension with a balance due of \$1,000 yields IRS penalty and interest of \$50.00, with Kansas the same 4-month extension and balance due yields KS penalty and interest of \$310.00. KS charges 620% of the Federal rate.

Rand, I think this is absolutely ridiculous and I believe you will hear from other people who will agree with me.

I would appreciate you showing a copy of this letter to Senator Rock and looking into this issue.

Sincerely,


Lee A. Gregg, Jr., CPA

LAG/mls

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HOUSE BILL No. 2933

By Representatives Wagle, Boston, Bradley, Bryant, Chronister, Cornfield, Cox, Crowell, Donovan, Empson, Farmer, Flower, Freeborn, Gatlin, Haulmark, Hayzlett, Jennison, Kejr, King, Phill Kline, Lawrence, Lowther, Mason, Mayans, Mead, Mollenkamp, Morrison, Myers, Neufeld, O'Neal Packer, Pottorff, Samuelson, Scott, Shallenburger, M. Smith, Snowbarger, Toplikar, Vickrey, E. Wells and Wilk

2-4

14 AN ACT relating to individual medical accounts; amending K.S.A.
15 1993 Supp. 79-32,117 and repealing the existing section.

16
17 *Be it enacted by the Legislature of the State of Kansas:*

18 New Section 1. This act may be cited as the individual medical
19 account act.

20 New Sec. 2. For the purposes of this act:

21 (a) "Account holder" means the individual on whose behalf the
22 individual medical account is established.

23 (b) "Dependent [child]" means [any person] under the age of 21
24 years [or any person who is] legally entitled or subject to a court
25 order for the provision of proper and necessary subsistence, edu-
26 cation, medical care or any other care necessary for their health,
27 guidance or well-being, and who is not otherwise emancipated, mar-
28 ried or a member of the armed forces of the United States, [or who]
29 [is] mentally or physically incapacitated.

30 (c) "Individual medical account" means a trust created or organ-
31 ized to pay the eligible medical, dental and long-term care expenses
32 of the account holder.

33 (d) "Trustee" means [a chartered state bank or trust company
34 authorized to act as a fiduciary, a national banking association or
35 savings and loan association authorized to act as a fiduciary, or an
36 insurance company.]

37 New Sec. 3. (a) [For taxable years beginning on or after the
38 effective date of this act, a resident] shall be allowed to deposit
39 contributions to an individual medical account. The amount of deposit
40 for the first taxable year subsequent to the effective date of this act
41 shall not exceed:

- 42 (1) \$2,000 [for the] account holder; or
43 (2) \$2,000 for the account holder and \$1,000 for each dependent

the spouse of the account holder and any child
of the account holder who is: (1)

; (2)

; (3)

or the account holder and the account holder's
dependents

: (1) A national or state chartered bank, a
federal or state chartered savings and loan
association, or a federal or state chartered
credit union;

(2) A trust company authorized to act as a
fiduciary;

(3) An insurance company authorized to do
business in this state;

(4) A broker-dealer, commodity issuer,
investment advisor, or agent registered
pursuant to article 12 of chapter 17 of the
Kansas Statutes Annotated, and amendments
thereto;

(5) A third party administrator registered
pursuant to article 38 of chapter 40 of the
Kansas Statutes Annotated, and amendments
thereto;

(6) A certified public accountant licensed
to practice in this state;

(7) An attorney licensed to practice in
this state; or

(8) An employer that contributes to an
employee's individual medical account.

An individual

if the individual medical account is for th-
sole benefit of the

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1 child of the account holder

2 (b) The maximum allowable amount of deposit for subsequent
3 years shall be increased annually by a percentage equal to the pre-
4 vious year's increase in the national consumer price index.

5 (c) Interest earned on an individual medical account shall be
6 exempt from state income taxation as adjusted gross income in this
7 state

8 (d) Upon agreement between an employer and employee, an
9 employer may contribute to the employee's individual medical ac-
10 count or continue to make contributions under the employee's ex-
11 isting health insurance policy or program, subject to the restrictions
12 in subsection (f)(1).

13 (e) The individual medical account shall be established as a trust
14 under the laws of this state and placed with a trustee. The trustee
15 shall.

16 (1) Purchase major medical coverage for each account holder to
17 cover all medical, dental and long-term care expenses in excess of
18 \$10,000 and

19 (2) utilize the trust assets solely for the purpose of paying the
20 medical, dental and long term care expenses of the account holder.

21 (f) Individual medical account funds may be withdrawn by the
22 account holder at any time for any purpose, subject to the following
23 restrictions and penalties

24 (1) There shall be a distribution penalty for withdrawal of indi-
25 vidual medical account funds by the account holder. Such penalty
26 shall be 10 percent of the amount of interest earned as of the date
27 of withdrawal on the account and, upon such withdrawal, the in-
28 terest earned during the tax year in which withdrawal occurs shall
29 be subject to state income taxation;

30 (2) after an account holder reaches 60 years of age, withdrawals
31 shall be permitted for medical, dental or long-term care expenses
32 only, and may be withdrawn without penalty.

33 (g) Upon the death of the account holder, the account principal,
34 as well as any interest accumulated thereon, shall be distributed to
35 the decedent's estate and taxes as part of the estate.

36 Sec. 4. K.S.A. 1993 Supp. 79-32,117 is hereby amended to read
37 as follows: 79-32,117. (a) The Kansas adjusted gross income of an
38 individual means such individual's federal adjusted gross income for
39 the taxable year, with the modifications specified in this section.

40 (b) There shall be added to federal adjusted gross income:

41 (i) Interest income less any related expenses directly incurred in
42 the purchase of state or political subdivision obligations, to the extent
43 that the same is not included in federal adjusted gross income, on

\$5,000 if the individual medical account is for
the benefit of the account holder and the
account holder's dependents

\$6,000

provisions

for use for other than medical, dental and long
term care expenses

equal to 10% of the amount withdrawn

the amount withdrawn and

8-2