

Approved: Jan 18, 1994
Date

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION.

The meeting was called to order by Chairperson Audrey Langworthy at 11:05 a.m. on January 18, 1994 in Room 519-S of the Capitol.

Members present: Senator Langworthy, Senator Tiahrt, Senator Martin, Senator Bond, Senator Corbin, Senator Feleciano Jr., Senator Hardenburger, Senator Lee, Senator Reynolds, Senator Sallee, Senator Wisdom

Committee staff present: Tom Severn, Legislative Research Department
Chris Courtwright, Legislative Research Department
Don Hayward, Revisor of Statutes
Elizabeth Carlson, Committee Secretary

Conferees appearing before the committee: T.C. Anderson, Kansas Society of Certified Public Accountants
Stan Andeel, Kansas Bar Association
Nancy Parrish, Secretary, Department of Revenue

Others attending: See attached list

APPROVAL OF MINUTES

Senator Bond moved to approve the minutes of January 12 and 13, 1994. The motion was seconded by Senator Corbin. The motion carried.

SB 480--Taxation; interest on delinquent payment and refunds and
SB 503--Taxation; penalties for delinquent returns and unpaid taxes

T. C. Anderson, Executive Director, Kansas Society of Certified Public Accountants, appeared in support of these two bills. He spoke from a prepared statement. (Attachment 1) He said Kansas currently charges the second highest interest rate in the nation on unpaid taxes. SB 480 would lower the current interest rate on unpaid taxes to the rate charged by the Internal Revenue Service on July 1st of the year immediately preceding the calendar year for which the rate is being set. Today that rate would be 7 per cent. This bill would also set the rate of interest paid by the state on overpayment of taxes at 1 per cent less than that charged for underpayment. Currently, the state pays 12 per cent on refunds. In SB 503, the interest rates proposed would be at the federal rate of 1/2 per cent a month up to a maximum of 25 per cent. He gave some examples of how these rates would affect the taxes. He included a chart of tax rates charged by the surrounding states.

Ron Smith, Kansas Bar Association, introduced Stan Andeel, Kansas Bar Association, Wichita, who spoke from a prepared statement by Alan Alderson, on behalf of the Kansas Bar Association. (Attachment 2) Mr. Andeel stated the members of the KBA Tax Committee and the Kansas Society of CPA's worked together on the presentation of these two bills. He said the 18 per cent interest rate currently required by law is exorbitant and out of line with appropriate charges for the use of a taxpayer's funds today. He also stated the Department of Revenue has changed its interpretations of the various penalty statutes to require the imposition of a 25 per cent penalty on amounts shown on all returns not filed more than sixty days after the due date or all taxes not paid more than 60 days after the due date. Under SB 480, interest payable on refunds would be consistent with the federal rate. SB 503 revises Kansas penalty provisions applicable to delinquent returns and unpaid taxes. It also would bring some uniformity to the various statutes which permit the Director of Taxation or Secretary of Revenue to waive the penalty. He urged the committee to consider these bills favorably.

Nancy Parrish, Secretary, Department of Revenue, appeared with some suggestions, questions and proposed changes in SB 480 and SB 503. (Attachment 3) She said the Department has worked with the Kansas Bar Association and the Kansas Society of Certified Public Accountants on these two bills. Instead of amendments proposed in SB 480, the Department of Revenue proposed to change the existing rate structure by lowering the assessment rate to 12 per cent and the refund rate to 6 per cent. In SB 503, the

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION, Room 519-S
Statehouse, at 11:05 a.m. on January 18, 1994.

recommendations from the Department were a 10 per cent penalty if a taxpayer fails to file or pay the tax with 180 days of the due date; a 25 per cent penalty would be imposed after 180 days; and no penalties would be applied in the circumstances where an extension to file has been requested by the taxpayer.

A question was asked if taxpayers with very large fluctuating income would have to pay on last years amount of income even if this year was a bad year? Does this address that problem? Secretary Parrish said this does not address that problem, however, she did not think this problem would be as bad as last year because people are more aware that the Department is enforcing the law.

Secretary Parrish stated the Department does pay 12 per cent on refunds to taxpayers if the mistake was made in the Department.

The meeting adjourned at 12:05 p.m.

The next meeting is scheduled for January 19, 1994.

DATE: Jan 18, 1994

[illegible]



Kansas Society of Certified Public Accountants

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Testimony on SB 480 & SB 503
by

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

Senate Assessment and Taxation Committee

January 18, 1994

*Senate Assess + Tax
Jan. 18, 1994
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Chair Langworthy
Members of the Senate Assessment Taxation Committee

I'm T. C. Anderson, Executive Director of the Kansas Society of Certified Public Accountants and I appreciate the opportunity to appear before you today to discuss SB 480 and 503.

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

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

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 lower the current interest rate on unpaid taxes to the rate charged by the Internal Revenue Service on July 1 of the year immediately preceding the calendar year for which the rate is being set. Today that would be 7 percent.

SB 480 also would set the rate of interest paid by the state on overpayment of taxes at one percent less than that charged for underpayments. Currently Kansas pays 12 percent on refunds.

Attached to my testimony is a chart showing the state interest rates from across the country as of June 1, 1993.

To help offset the cost to the state of lost revenue by lowering the interest rates SB 503 would impose penalties, however, at a rate less than the current 10 and 25 percent rates.

The interest rates proposed in SB 503 would be at the federal rate of 1/2 percent a month up to a maximum of 25 percent.

With this background let me address two areas of concern to taxpayers and tax professionals and how SB 408 and SB 503 would affect them.

The first is extended returns. Up until the fall of 1992 the Kansas Department of Revenue had not imposed a penalty on underpayment of tax for validly extended returns.

If after the six month extension period I owed the state \$100, I would pay that amount plus interest calculated at 1 1/2 percent per month or \$9.00 or \$109.00.

When the Department began also to assess a 25 percent penalty on this situation the tax bill increased to \$134.00.

Under SB 480 and SB 503 the tax bill would be \$106.50. That includes 1/2 percent penalty per month and 3 1/2 percent interest.

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

As an example a taxpayer receives an amended K1 on a limited partnership which results in an additional \$100 owed the state. 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 we would anticipate the tax in this situation to be \$107.00. The Internal Revenue Service waives any penalty on voluntarily amended returns where there clearly is no intent to evade taxes.

SB 480 and SB 503 have no sympathy for taxpayers who fail to file or for taxpayers who fail to amend their Kansas return as a result of an Internal Revenue audit of their federal return.

SB 480 and SB 503 would bring fairness back to the Kansas tax system where 18 percent interest rates are no longer true of the times and a 10/25 percent penalty base seems harsh for taxpayers trying to comply with the law.

Where does Kansas stand today in regard to interest and penalty with its neighboring states.

Interest

Kansas	18 percent on underpay	12 percent on refunds
Missouri	12 percent on underpay	6 percent on refunds
Oklahoma	15 percent on underpay	15 percent on refunds
Colorado	Prime + 5 percent on underpay	Prime + 5 percent on refunds
Nebraska	7 percent on underpay	7 percent on refund
Iowa	9 percent on underpay	9 percent on refunds

Penalty on Extensions

Kansas	10 percent 60 days/25 percent after 60 days
Missouri	5 percent of balance due
Oklahoma	If less than 90 percent of tax due is paid by April 15 then the penalty becomes 5 percent of the unpaid balance.
Colorado	If less than 90 percent of tax due is paid by April 15 then the penalty becomes 5 percent first month/ 1/2 percent each month thereafter to 12 % on unpaid balance.
Nebraska	No penalty; only interest through the extension due date.
Iowa	Same as Oklahoma.

June 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 7%	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.

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* Changed July 1, 1993

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DANIEL B. BAILEY

MEMORANDUM

TO: Members of Senate Assessment and Taxation Committee

FROM: Alan F. Alderson

RE: Senate Bill Nos. 480 and 503

DATE: January 18, 1994

I am unable to appear before you today due to a conflict in my schedule, but I am preparing this testimony on behalf of the Kansas Bar Association in support of Senate Bill No. 480 and its companion measure which was also introduced by this Committee and was distributed to you on January 11, 1994. My involvement in the preparation of these bills has been in my capacity as Legislative Liaison on the Kansas Bar Association's Tax Committee. Stan Andeel, a tax attorney from Wichita who has also been involved in the formulation of these proposals will be presenting the Bar Association's testimony for me.

Members of the KBA Tax Committee have collaborated with the Kansas Society of CPAs in this project. T.C. Anderson will be presenting testimony this morning to explain the impact of these bills on amended and extended returns. This testimony will address the other aspects of this legislation. We have been meeting with the Director of Taxation and the Secretary of Revenue and their staff people since approximately June of last year trying to come up with a resolution to the problems faced by businesses and individuals in this state, but have been unable to resolve our differences by compromise at this point.

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; and (2) for approximately the last year, the Department has changed its interpretations of the various penalty statutes to require the imposition of a 25 percent penalty on amounts shown on all returns not filed more than sixty days

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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 propose to remedy the first problem by tying interest to the federal rate set pursuant to Section 6621 of the Internal Revenue Code of 1986. In order to give the Department of Revenue adequate lead time, it is proposed that the federal rate on July 1 of 1994 would be the rate payable on delinquent taxes for all of calendar year 1995. The July 1 rate would continue to apply in each succeeding calendar year. We believe that the Department of Revenue would have more than adequate time to publish and adjust its computers to establish these new rates each year. The Department of Revenue tells us that this cannot be done.

Under Senate Bill No. 480, interest payable on refunds would be one percent less than the amount charged to taxpayers on delinquent taxes. This is also consistent with the federal rate.

In the event the Congress eliminates its present system, Senate Bill No. 480 provides its own backup system which would establish rates at the judgment rate that in K.S.A. 16-204 until this Legislature would have an opportunity to revisit the problem.

There is one other very important aspect of S.B. No. 480: It corrects a problem which has inadvertently existed in Kansas law since the enactment of K.S.A. 79-2968 (Section 1 of this bill). When this section was originally enacted in 1980, it failed to provide for the payment of interest on excise tax refunds. Therefore, taxpayers who determined that they may be entitled to a refund of sales taxes or other excise taxes previously paid are forced to litigate those issues without the ability to receive interest on any amounts to which they are ultimately entitled to be paid. This is contrary to federal law and to Kansas law as it applies to income tax. It is also grossly inequitable and should be corrected by this Legislature.

Senate Bill No. 503 revises Kansas penalty provisions applicable to delinquent returns and unpaid taxes. Current law prescribes a 10 percent penalty for taxes not paid or amounts shown to be due on returns not filed within 60 days of the due date of the return or the payment of the tax. The penalty for taxes not paid or returns not filed for more than 60 days past the due date is 25 percent of the amount ultimately determined to be due.

For many years -- perhaps since this scheme of imposing penalties was enacted in 1933 -- the Department of Revenue has routinely added a 10 percent penalty to amounts unpaid pursuant to an assessment. During the last year, the Department has 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 before the issuance of the assessments, a 25 percent penalty must be added because the tax was due more than 60 days previous to the date of the 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 typical case in which a field audit is performed and an assessment of income tax or sales tax is issued, additional sums at 18 percent interest and 25 percent penalty are tacked on. A 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 March 1, 1989 through February 28 of 1992 in the amount of \$163,769. This assessment predated the Department of Revenue's change in policy, so \$16,383 penalty (10 percent) was issued and interest had already accrued during the assessment period of \$49,545. Had the Department of Revenue's current policy been in effect, there would have been an additional \$24,565 in penalty at the time of the assessment. The total assessment would have been \$254,256 and, even at the time of the assessment, the penalty and interest portion would have been \$90,487, 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 for 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. Just to get to the point where we are still waiting on a decision from the Director of Taxation, I estimate that

additional interest has accrued of approximately \$50,000. This is unconscionable in light of the \$90,000 in penalty and interest which would have been initially assessed under the Secretary of Revenue's current policy.

The proposed legislation before you would conform to federal Internal Revenue Code standards. It should be disturbing to you that the Department of Revenue's current policy makes the Internal Revenue Service look like a philanthropist. The Bar Association and the Society of CPAs recommend that you adopt a proposal under which the Department of Revenue can assess a penalty of five percent per month on amounts determined to be due on unfiled returns, not to exceed 25 percent; or one-half percent per month on unpaid taxes, not to exceed 25 percent. As does the Internal Revenue Code, the Department of Revenue would be precluded from imposing both the nonpayment penalty and the nonfiling penalty on the same amounts.

The other aspect of the penalty bill is to bring some uniformity to the various statutes which permit the Director of Taxation or Secretary of Revenue to waive the penalty. There are a number of different standards expressed in Kansas law and we propose that the general standard would allow waiver of penalty whenever the Secretary of Revenue or the Secretary's designee determines that the failure to file or pay was due to reasonable causes, and that the taxpayer acted in good faith. This, again, conforms to federal language and would provide the taxpayer with some benchmark standard.

Again, the Department of Revenue has advised us that their computers are not capable of implementing the proposal you have before you. Whatever this Committee determines to be possible, however, we urge you to adopt and to bring Kansas law as much in conformity with this proposal as possible.

STATE OF KANSAS

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Department of Revenue
Office of the Secretary

MEMORANDUM

To: The Honorable Senator Audrey Langworthy, Chairperson
Senate Committee on Assessment and Taxation

From: Nancy Parrish, Secretary
Kansas Department of Revenue

Date: January 18, 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. Under the bill 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 allow interest to be paid on all excise tax refunds. These provisions would be effective January 1, 1995.

As the Senate Committee considers the merits of S.B. 480, it should consider the following:

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 as proposed in this bill although the actual decrease in revenue is difficult to quantify. The effect of statutory

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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. It is estimated that a fluctuating interest rate would lower receipts by \$7-8 million although it would take several years to realize the revenue loss. The payment of refund interest on excise tax also would reduce general fund balances although the precise amount of the reduction is unknown at this time.

In lieu of amendments proposed in S.B. 480, the Department would propose to change the existing rate structure by lowering the assessment rate to 12% (same as property tax) and the refund rate to 6%. The current policy of not paying interest on excise tax refunds would be continued. These proposed adjustments 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	14%	14%
Oklahoma	15%	15%

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

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

STATE OF KANSAS

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Department of Revenue
Office of the Secretary

MEMORANDUM

To: The Honorable Audrey Langworthy, Chairperson
Senate Committee on Assessment and Taxation

From: Nancy Parrish, Secretary
Kansas Department of Revenue

Date: January 18, 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. It does the following:

1. imposes a failure to file penalty of 5% per month not to exceed 25%;
2. imposes a failure to pay penalty of .5% per month not to exceed 25%;
3. provides 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 considers the merits of the bill, it should consider the following:

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 Department would propose the following amendments in lieu of S.B. 503:

1. a 10% penalty if a taxpayer fails to file or pay the tax within 180 days of the due date; a 25% penalty would be imposed after 180 days;
2. no penalties would be applied in the circumstances where an extension to file has been requested by the taxpayer.

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.