GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Fiscal Note 2015 Biennium

To open, right click on "Select a bill", select Worksheet Object/Edit. To exit, click outside the spreadsheet.

Bill #	**Revenue and Transportation Interim Committee:** Penalty and Interest Bill Draft February 2012	**Title:**	#N/A
Primary Sponsor:	#N/A	**Status:**	As Introduced

This fiscal note reflects estimates of revenue and cost impacts using HJ2 from the 2011 legislative session and other assumptions as of February 1, 2012. The fiscal note for any bill introduced in the 2013 session will be based on HJ2 adopted by the Revenue and Transportation Interim Committee in November 2012. Thus, the official fiscal note during the 2013 session will be different.

FISCAL SUMMARY

To open the fiscal Summary spreadsheet, right click on the spreadsheet, select Worksheet Object/Edit. To exit the spreadsheet, click outside of the spreadsheet.

	FY 2014 Difference	FY 2015 Difference	FY 2016 Difference	FY 2017 Difference
Expenditures:				
General Fund	$67,500	$0	$0	$0
State Special Revenue	$0	$0	$0	$0
Federal Special Revenue	$0	$0	$0	$0
Other	$0	$0	$0	$0
Revenue:				
General Fund	$0	$142,000	$218,000	$135,000
State Special Revenue	$0	($62,000)	($250,000)	($381,000)
Federal Special Revenue	$0	$0	$0	$0
Other	$0	$0	$0	$0
Net Impact-General Fund Balance:	($67,500)	$142,000	$218,000	$135,000

Description of fiscal impact: (In a few short sentences, describe.)

This bill revises several provisions relating to interest and penalties for late tax payments, late filing, not filing a return, and filing a false return. It would first apply to returns and late payments for tax year 2014.

FISCAL ANALYSIS

Assumptions:

Interest Waiver

1. This bill would increase the interest the department may waive from $100 to $500 and allow an additional waiver of $100 per tax period for taxpayers who meet all terms of a payment plan.
2. The department enters into about 3,600 payment plans with taxpayers each year. On average, taxpayers entering into a payment plan have debt from 2.5 tax periods. If all taxpayers met all the terms of their payment plans and the department forgave $100 of interest per period to each, the total would be $900,000 per year. Not all taxpayers who enter into a payment plan meet all its conditions. About 4% default, and an unknown percent fall behind or otherwise fail to meet all conditions. Also, not all taxpayers with payment plans will have $100 of accumulated interest per period. Therefore, this fiscal note assumes that the department would forgive an additional $450,000 in interest each year.
3. This provision would first apply for payment plans associated with back taxes from 2014. These plans would not be set up before FY 2016, and few if any would be paid off before the end of FY 2017. Thus, reduced revenue from increased interest waivers will occur after FY 2017.

Late Filing Penalty

4. Under current law, the penalty for failing to file a return and pay tax owed by the due date is the lower of $50 or the tax due. This bill would change the penalty to 5% of the tax due per month up to 25%.
5. Penalties were calculated for late 2008 income tax returns under current law and under this bill. Penalties under this bill were $470,000 higher. This fiscal note assumes that this bill would increase late filing penalties by this amount each year. Since the increased penalties will first apply to tax year 2014, increased penalties will not be assessed until after 2014 extension returns are due in October 2015. Thus, the increase in revenue will first occur in FY 2016.

Late Payment Penalties

6. Section 15-1-216, MCA sets penalties for taxpayers who pay taxes late. Penalties for all taxes other than the individual income tax, telecommunications tax, accommodations tax, and rental car tax are 1.2% of the late amount multiplied by the number of full or partial months that the payment is late, with a maximum of 12% of the late amount. This bill would change this penalty rate from 1.2% to 0.5% per month.
7. This bill also would change the penalty calculation for all taxes. Under current law, the penalty is based on the number of full or partial months that payment is late. This bill would make penalties accrue daily.
8. Penalty and interest payments are recorded separately from other collections in the state accounting system only for the income tax, corporate tax, oil and gas tax, and telecommunications tax. For FY 2009 through FY 2011, penalty and interest for these taxes were 1.46% of total collections. This fiscal note assumes that the percentage is the same for the taxes affected by this bill.
9. Penalty and interest are recorded together in the same accounts, so that the split between penalty and interest is unknown. The sums of penalty and interest calculated at the time of filing for 2008 income tax and corporate tax returns were calculated. It was found that penalties were 66% of the total for income tax and 43% of the total for corporate tax. This fiscal note assumes that over all affected taxes, penalty and interest each are half of the total.
10. For payments between 1 and 10 months late, late payments under this bill would be 58% lower than under current law. For payments between 11 and 23 months late, late payments under this bill range from 54% to 4% lower than payments under current law. For payments 24 or more months late, late payments under this bill would be the same as under current law. The range of timing for late payments is unknown. This

fiscal note assumes that, on average, late payments under this bill would be 25% lower than under current law. This is equivalent to payments averaging 18 months late.

11. All but two of the affected taxes have revenue estimates in HJ2. The rates for the consumer counsel tax and public service commission tax are set by rule to cover the budgets for these agencies, so their FY 2013 budgets were used as revenue estimates. The forecasts were extended through FY 2017 by assuming that the growth rate for FY 2013 would hold for the next four years.
12. This provision would apply to late payments for tax reporting periods beginning after December 31, 2013. In the first years, a portion of late payments would be for tax periods before December 31, 2013, with penalties assessed at the old rate. This fiscal note assumes that the fraction of late payments from before December 31, 2013 is seven-eighths in FY 2014, one-half in FY 2015, and one-fourth in FY 2016. All penalties are assumed to be at the new rate beginning in FY 2017.
13. The following table shows projected revenue, estimated penalty payments under current law and under this bill, and the difference, in millions of dollars.

	FY 2014	FY 2015	FY 2016	FY 2017
Forecast Revenue from Affected Taxes	$586.281	$593.603	$603.543	$616.279
Estimated Late Payment Penalties				
Current Law	$4.287	$4.340	$4.413	$4.506
Proposed Law	$4.153	$3.798	$3.585	$3.379
Difference (Proposed - Current)	-$0.134	-$0.543	-$0.827	-$1.126

14. Revenue from taxes affected by this bill is split between the general fund and state special revenue funds, with an average of 54% going to the general fund in FY 2009 through FY 2011. Assuming that the same split applies in future years, the following table shows how the revenue impacts are split.

	FY 2014	FY 2015	FY 2016	FY 2017
Reduced Late Payment Penalties				
General Fund	-$0.072	-$0.293	-$0.447	-$0.608
State Special Revenue Funds	-$0.062	-$0.250	-$0.381	-$0.518

Penalties for Substantial Understatement of Tax

15. For the last three years, the IRS imposed accuracy-related penalties, including penalties for substantial understatement of income, on 0.257% of returns.
16. The IRS count of accuracy related penalties includes penalties imposed for reasons other than gross understatement of tax, and some understatements of taxable income that would meet the federal threshold for gross understatement of tax would not meet the threshold in this bill. This fiscal note therefore assumes that the state would impose penalties for substantial understatement at one-third the rate of IRS accuracy-related penalties or 0.086% of returns.
17. About 500,000 Montana income tax returns and about 16,000 Montana corporate tax returns will be filed each year. The department will impose about 430 (0.086% x 500,000) penalties on individuals for substantial understatement each year and about 14 (0.08% x 16,000) on corporations.
18. This bill defines substantial understatement for individual income tax as the greater of $3,000 or 10% of the correct amount of tax. For all other taxes, it defines substantial understatement as the greater of $10,000 or 10% of the correct amount of tax or any understatement of at least $0.5 million.
19. The minimum penalty for an individual would be $600 (20% x $3,000). The minimum penalty for all other taxes would be $2,000 (20% x $10,000).
20. This fiscal note assumes that the average penalty would be 150% of the minimum, or $900 for individual income tax and $3,000 for other taxes.

21. Annual penalties for substantial understatement of tax would be $429,000 (430 * $900 + 14 * $3,000). Penalties would begin to be assessed in FY 2015, and additional revenue would begin to be collected in the second half of FY 2015. Therefore, additional collections would be $214,500 in FY 2015 and $429,000 in later years.

Penalty for Purposely and Knowingly Failing to File

22. Current law sets the penalty for purposely or knowingly failing to file a return at $1,000 to $10,000. This bill would change that to 15% of the tax due per month with a maximum of 75%. This provision is intended to serve as a deterrent, and is seldom used. In a typical year, this change would not affect penalties assessed.

Fraud Penalties

23. For the last three years, the IRS reports that the number of tax fraud penalties imposed were 0.0015% of the number of tax returns for individual income tax and 0.0026% of the number of tax returns for corporate tax. Average federal fraud penalties were about $60,000 for individuals and $91,000 for corporations. Since Montana tax rates are about one fifth the corresponding federal rates and apply only to Montana income, state fraud penalties would be lower. This fiscal note assumes that the average fraud penalty would be one-fifth of the average federal penalty for individuals or $12,000
24. The department would file criminal fraud charges and obtain convictions at about the same rate as the IRS. This would result in eight (0.0015% x 500,000 + 0.0026% x 16,000) convictions per year. Annual penalties would be $96,000 (8 x $12,000). The first convictions would be in FY 2016 with the first penalties collected in FY 2017.
25. Section 4 makes filing a false or fraudulent claim for the elderly home-owner renter credit subject to the same penalty and interest provisions as other taxes. This change is included in the estimate of fraud penalties.

Penalty for Frivolous Returns

26. This bill creates a penalty of $2,500 for filing a frivolous return. The department would occasionally impose this penalty, but not every year. Therefore, no revenue is estimated from this provision.

Interest on Late Income Tax Payments

27. Under current law, interest on late income tax payments is charged at the greater of the rate established by the IRS or 8%. This bill would remove the 8% floor for payments beginning with payments for tax year 2014.
28. The IRS rate is calculated by adding 3% to the average of rates for federal notes and bonds maturing within three years and rounding to the nearest full percentage point. Based on Global Insight's forecast of interest rates on federal notes and bonds, the IRS rate is projected to be 7% for the period from FY 2014 through FY 2017. Under current law, the interest rate on late income tax payments would be 8% for each of these years.
29. For FY 2009 through FY 2011, penalty and interest were 0.094% of income tax revenue. Assuming that 34% of recorded penalty and interest is interest (see assumption 9), current law late payment interest is assumed to be 0.32% of forecast income tax revenue. The following table shows the HJ2 forecast of income tax revenue, late payment interest under current law and under this bill, and the difference, in millions of dollars. Since this bill would first apply to late payments for tax year 2014, the first impact is in FY 2015.

	FY 2014	FY 2015	FY 2016	FY 2017
Forecast Income Tax Revenue	$912.829	$970.795	$1,032.441	$1,098.002
Estimated Late Payment Interest				

Current Law	$2.921	$3.107	$3.304	$3.514
Proposed Law	$2.921	$2.718	$2.891	$3.074
Difference (Proposed - Current)	$0.000	-$0.388	-$0.413	-$0.439

Provisions with Minimal Impact

30. Section 2(2) specifies that there is to be no late payment penalty if the taxpayer has met requirements for income tax withholding or estimated payments during a tax year or if the taxpayer pays within 30 days of receiving an assessment notice. The Department of Revenue generally waives penalties in these cases, so there would be minimal revenue impact.
31. Section 5(5)(f) specifies that there is to be no underpayment interest if a taxpayer has met requirements for income tax withholding or estimated payments during a tax year by making four approximately equal estimated payments. Since four equal payments is the default requirement for estimated payments, few taxpayers would be affected by this provision.
32. Section 3(15) gives a procedure for determining the portion, if any, of a taxpayer's federal income tax refund that must be included in adjusted gross income. This is the same as the procedure in administrative rules, and there would be no effect on revenue.

Total Revenue Impact

33. The following table shows all of the revenue impacts of this bill. There are no impacts in FY 2014 because the bill first applies to tax year 2014, with the first affected payments being after tax year 2014 ends in FY 2015. FY 2018 is shown because some provisions will not affect revenue until after FY 2017.

General Fund

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Interest Waiver	-	-	-	-	-$0.450
Late Filing Penalty	-	-	$0.470	$0.470	$0.470
Late Payment Penalties	-	-$0.072	-$0.293	-$0.447	-$0.608
Substantial Understatement Penalties	-	$0.215	$0.429	$0.429	$0.429
Fraud Penalties	-	-	-	$0.096	$0.096
Interest on Late Income Tax Payments	-	-	-$0.388	-$0.413	-$0.439
Total	-	$0.142	$0.218	$0.135	-$0.503

State Special Revenue

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Late Payment Penalties	-	-$0.062	-$0.250	-$0.381	-$0.518

34. Changes to the penalty and interest calculations in the department's data processing system would be done by the vendor at a cost of $67,500 in FY 2014.

To open the spreadsheet below, right click on the spreadsheet, select Worksheet Object/Edit. To exit the spreadsheet, click outside of the spreadsheet.

	FY 2014 Difference	FY 2015 Difference	FY 2016 Difference	FY 2017 Difference
Fiscal Impact:				
FTE	0.00	0.00	0.00	0.00
Expenditures:				
Personal Services	$0	$0	$0	$0
Operating Expenses	$67,500	$0	$0	$0
Equipment	$0	$0	$0	$0
Benefits	$0	$0	$0	$0
Transfers	$0	$0	$0	$0
TOTAL Expenditures	$67,500	$0	$0	$0
Funding of Expenditures:				
General Fund (01)	$67,500	$0	$0	$0
State Special Revenue (02)	$0	$0	$0	$0
Federal Special Revenue (03)	$0	$0	$0	$0
Other	$0	$0	$0	$0
TOTAL Funding of Exp.	$67,500	$0	$0	$0
Revenues:				
General Fund (01)	$0	$142,000	$218,000	$135,000
State Special Revenue (02)	$0	($62,000)	($250,000)	($381,000)
Federal Special Revenue (03)	$0	$0	$0	$0
Other	$0	$0	$0	$0
TOTAL Revenues	$0	$80,000	($32,000)	($246,000)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	($67,500)	$142,000	$218,000	$135,000
State Special Revenue (02)	$0	($62,000)	($250,000)	($381,000)
Federal Special Revenue (03)	$0	$0	$0	$0
Other	$0	$0	$0	$0

Effect on County or Other Local Revenues or Expenditures:

1.
2.
3.

Long-Term Impacts:

1. The increased interest waivers beginning in FY 2018 would reduce the additional revenue from this bill to $450,000 per year.
2. The revenue impact of the change to late payment interest will vary from year to year. In years when the IRS rate is 8% or higher, there will be no revenue impact. In years when the IRS rate is lower than 8%, there will be a revenue reduction, with lower IRS rates leading to larger revenue reductions.
3.

4.

Technical Notes:

1.
2.
3.

______________	______________	______________	______________
Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*

Fiscal note prepared by:	Dan Dodds
Agency:	Revenue (58010)
Phone number:	444-2668