

DEPARTMENT OF TAXATION

2001 Fiscal Impact Statement

1. **Patron** Woodrum

3. **Committee** House Finance

4. **Title** Individual Income Tax: Interest and Penalty
on Tax Refunds

2. **Bill Number** HB 2832

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would change the manner in which the department pays interest on individual income tax overpayments ("refunds"). For individual income tax returns filed before May 1, interest would accrue on refunds beginning on June 1 or 60 days from the date such return was filed, whichever is earlier. For returns filed on or after May 1, interest would accrue on refunds beginning 30 days from the date a return was filed. The period at which the department can cut off the payment of interest on individual income tax refunds would be reduced from 30 to 7 days prior to the date of the refund check. In addition, this bill would require the department to pay a penalty at a rate of 6% each month that interest accrues. Also, interest would be accrued on the penalty.

The effective date of this bill is not specified.

6. **Fiscal Impact Estimates are:** Tentative (See Line 8.)

7. **Budget amendment necessary:** No.

8. **Fiscal implications:**

Processing individual income tax refunds within the time frame that this bill specifies would be difficult due to the volume of returns the department receives annually. The department would need to expedite all aspects of its current individual income tax processing, including the opening of mail, processing of returns and the resolution of returns with errors which require manual review. During 2000, the department received in excess of 3.2 million individual income tax returns. Of these returns, nearly 2.8 million were paper returns. Refunds were requested on approximately 70% of the paper returns. Virginia is a national leader in refund processing, issuing an average of 85% of refunds within twelve days.

The department currently processes returns in a manner which balances the need to timely deposit checks remitted with tax due returns with the need to issue refunds as

expeditiously as possible. Generally, business and individual tax checks must be deposited within 24 hours. Processing all refunds for returns filed before May 1st by June 1st would make it difficult to achieve both of these objectives.

This bill would have little or no General Fund revenue impact if the department is able to accelerate the processing of income tax returns. However, if the department is unable to speed up the process of issuing refund checks, General Fund revenues would be reduced by an estimated \$15.5 million in Fiscal Year 2002 and \$16.8 million in Fiscal Year 2003.

The cost for implementing a **single** piece of legislation cannot be calculated precisely due to economies of scale. The actual cost to implement **all** legislation enacted during a given session will more than likely be less than the sum of the costs attributed to individual bills. Further, the ability to accurately predict costs is complicated because the department is replacing its current database system. As a result, legislative changes may need to be made to both the current and the future system, depending on the effective date. Therefore, the department is not providing specific systems costs for this bill, but will calculate the total for all tax bills once they have been acted upon favorably in both houses and prior to the conference committee report.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: None.

11. Other comments:

Current Law

Virginia currently starts accruing and paying interest on all refunds of taxes beginning from 60 days from the date the return is filed or the due date of the return, whichever is later. Refund interest is stopped at a date proceeding the date of the refund check by not more than 30 days. The department's current policy is to compute refund interest up until the date that the refund is posted to a taxpayer's account. The refund check is issued no more than two business days later.

Proposed Legislation

This bill would reduce the period of time before the Commonwealth would begin accruing interest on individual income tax refunds. On returns filed before the May 1st due date, interest would begin accruing 60 days after the filing of a return or June 1st, whichever is earlier. For returns filed on or after May 1st, interest would begin accruing 30 days after the return is filed. In addition, the period at which the department can cut off the payment of interest on individual income tax overpayments would be reduced from 30 to 7 days prior to the date of the refund check.

In addition, the Commonwealth would pay a penalty of 6% per month, or any portion thereof, up to 30%, for the period in which the interest accrues. Interest would accrue on amount of penalty in addition to the tax.

Comparison to Other Tax Authorities

A survey of other states that impose an individual income tax, the District of Columbia ("D.C."), and the Internal Revenue Service ("IRS") reveals a variety of rules for accruing and paying refund interest. For example, 20 states' period for beginning to accrue refund interest is longer than 60 days (75 days to six months); four states are the same as Virginia; and 11 states, D.C., and the IRS have a period less than 60 days (30 to 45 days). The IRS uses a 45-day period. Seven states do not have any delay period for the accrual of refund interest except for those taxpayers who file before the due date of a return.

Period of Days for Beginning to Accrue Refund Interest

	> 60 Days	60 Days	< 60Days	None
Taxing Authorities	20 states	4 states & Virginia	11 states, D.C. & the IRS	7 states

In addition, 37 states, D.C., and the IRS are similar to Virginia in that the beginning of their period for accruing refund interest is from the later of the due date of the return or the date the return is filed. Two states start their period from the date a return is due, and the three states have periods that begin when the return is filed.

Start Date for Period of Days for Beginning to Accrue Refund Interest

	Due Date	Filing Date	Later of Filing or Due Date
Taxing Authorities	2 states	3 states	37 states, D.C., the IRS & Virginia

Further, ten states and the IRS are allowed the same refund interest cut off period as Virginia. Twelve states and D.C. have a cut off period shorter than 30 days while 20 states do not have a specified time in which to cut off the accrual of refund interest. The following tables illustrate how these taxing authorities accrue and pay interest on individual income tax refunds.

Refund Interest Accrual Cut Off Period

	30 Days	< 30 Days	None Specified
Taxing Authorities	10 states, the IRS &	12 states & D.C.	20 states

Virginia		
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The department's research revealed no other state that pays a penalty on refunds that are not issued within the prescribed time period.

cc: Secretary of Finance

Date: 1/26/01/DTM

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