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# Progress Report

June 1999

Report No. 98-85

## Interest and Penalty Provisions for Taxes Administered by the Department of Revenue

### *at a glance*

Since our report, the Legislature has modified penalties for late payment of tax on intangible property to bring it in line with other state tax penalties. In addition, some penalty rates were reduced from 10% per month to 5%.

The Legislature has not amended the process for handling penalty waivers.

The Legislature has adopted a single, variable interest rate for taxes owed the state. The rate is generally equal to the prime lending rate adjusted each six months. However, the new rate does not include the 3% to 4% margin as recommended by OPPAGA.

The department developed and installed an electronic system to minimize the subjective nature of the penalty waiver process. To further improve its processing of penalty waiver requests, OPPAGA recommends that the department consider installation of an "expert" type system.

### Purpose

In accordance with state law, this progress report informs the Legislature of actions taken by the Department of Revenue in response to our 1996 report.<sup>1,2</sup> This report presents our assessment of the extent to which the department has addressed the findings and recommendations included in our report.

### Background

The state levies and collects taxes to fund state and local government operations. The state benefits when taxpayers voluntarily comply with state tax laws because pursuing owed taxes is costly. For example, although about 98% of state tax collections are paid voluntarily, approximately 70% of the Department of Revenue's General Tax Administration staff are employed to collect the remaining 2% of total tax collections. Therefore, the state achieves greater efficiency when taxpayers pay owed taxes timely and correctly.

<sup>1</sup> Section 11.45(7)(f), F.S.

<sup>2</sup> *Review of Interest and Penalty Provisions for Taxes Administered by the Department of Revenue*, [OPPAGA Report No. 96-13](#), November 4, 1996.

## Prior Findings

### Interest Provisions

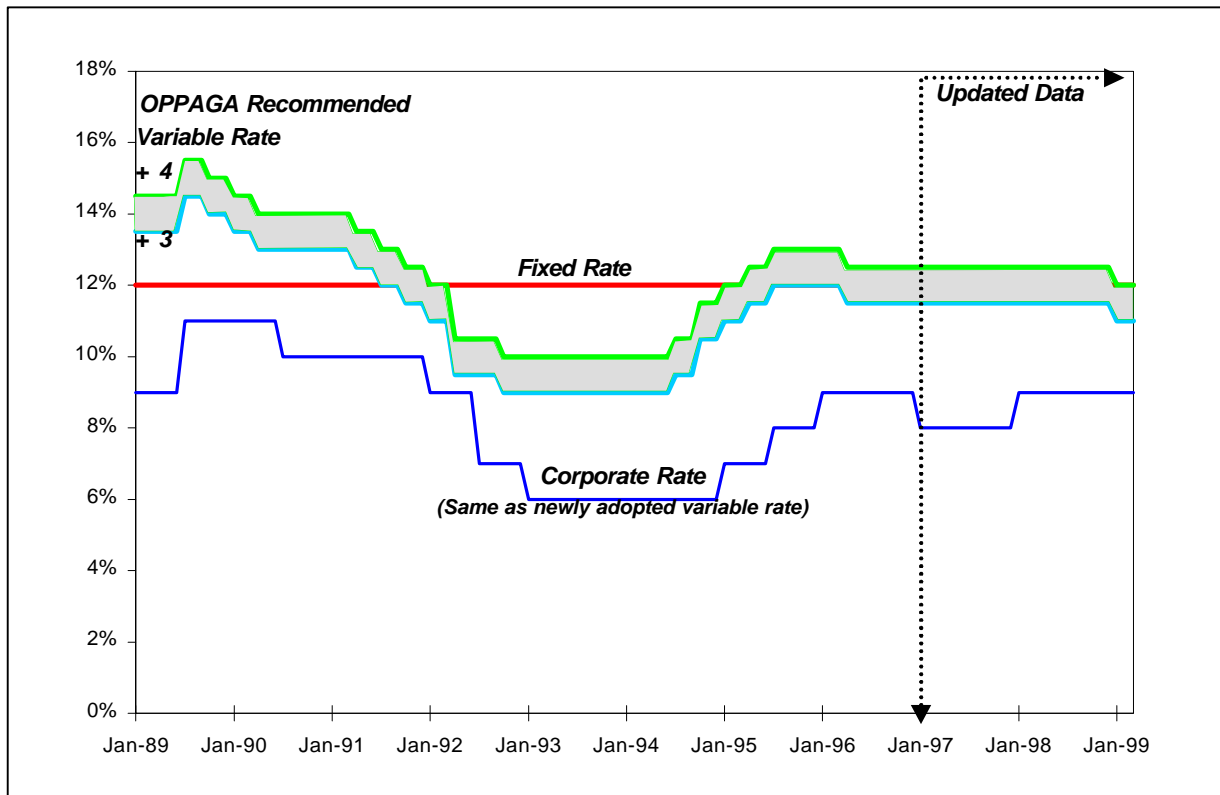
The department assesses an interest charge on the amount of owed tax to taxpayers who do not pay taxes in a timely manner. Prior to our report, Florida tax laws established two interest rates: a variable rate for corporate tax, which equals the "Adjusted Prime Rate" rounded to the nearest full percent, and a fixed interest rate for all other taxes, which is set by law at 12%.

OPPAGA found that the interest rate charged for corporate income taxpayers may not be high enough to encourage timely payment of taxes because it is lower than the commercial loan borrowing rate available to most businesses. Further, the fixed interest rate for other taxes does not

adjust to changing market conditions. At times in recent years the interest rate has been too low to encourage voluntary compliance, while at other times it has been so high that it may have served as an additional penalty.

To serve as an incentive for businesses to make timely tax payments and to treat all taxpayers consistently, OPPAGA recommended that the Legislature adopt one common variable interest rate that applies to all taxpayers and is 3% to 4% higher than the prime commercial loan borrowing rate. This could be accomplished by deleting references to interest rates currently contained in subsections of statutes dealing with various taxes and amending Ch. 213, F.S., general tax provisions, to establish a single interest rate for all taxes. As indicated in Exhibit 1, conditions are still favorable for such a change.

**Exhibit 1: Favorable Conditions Still Exist for Florida to Adjust Its Interest Rate for Owed Taxes**



Source: Department of Revenue and U.S. Federal Reserve Board data.

## Penalty Provisions

In addition to charging interest, the law also authorizes the department to assess penalties to taxpayers that violate tax laws. The law authorizes the department to assess penalties based on the type of tax (e.g., sales, corporate, and intangible) and the type of violation (e.g., late or nonpayment of owed taxes, filing an incomplete return, and tax evasion).

Although there is no consensus about what level of penalties are optimal for encouraging voluntary compliance, OPPAGA found that the penalty levels for the intangible tax were high compared to other state taxes and should be reduced to be more comparable to penalties for other taxes.

In order to make the penalties for intangible tax violations more comparable to other taxes, OPPAGA recommended that the Legislature amend s. 199.282, F.S., to reduce the penalty for late payment and filing of intangible taxes to be comparable to the 10% penalty for the corporate tax, which is also collected annually.

### **Penalty Waivers**

The Legislature's intent is that the revenue laws of the state be administered in an efficient, fair, and impartial manner. However, OPPAGA found that the department's administration of penalty waivers was inefficient and did not treat taxpayers fairly and consistently.

The department may consider taxpayer compliance history when waiving penalties, but not when assessing penalties. This practice is inefficient because it is time-consuming for department staff to prepare and send penalty assessment notices, then review and ultimately waive these penalties. Authorizing the department to consider compliance history when assessing penalties would be more efficient.

Additionally, the department's policies and procedures did not assure that taxpayers under similar circumstances were treated consistently. Three factors were identified that may result in taxpayers being treated inconsistently under similar circumstances: the department had not established clear policies and procedures for how taxpayer history is to be considered in approving penalty waivers; department staff interpreted the penalty waiver provisions differently; and department management did not review the consistency of penalty waiver decisions made within each office.

OPPAGA identified two options for the Legislature to consider for improving the efficiency of the penalty waiver process.

- If the Legislature wanted the assessment of penalties to be uniform regardless of taxpayer history, then the Legislature should amend the law to prohibit the consideration of taxpayer history for granting waivers.
- Alternatively, if the Legislature concurred with the department's practice of granting penalty waivers for first-time offenders, then the Legislature should amend the various tax laws to authorize the department to assess penalties based on the number of the taxpayer's prior offenses.

If the Legislature wanted the department to continue to consider taxpayer history during the penalty waiver process, OPPAGA recommended the department minimize the subjective nature of the penalty waiver process. The department should clarify its guidelines to more clearly address how staff are to review and approve penalty waivers and require periodic management reviews of samples of penalty waiver decisions to assure greater consistency. The department could also implement an "expert" or knowledge-based system, which could eliminate or substantially reduce

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individual biases and provide a more consistent decision making process.

## Current Status

The Legislature and department have taken steps to address some of the concerns identified by OPPAGA.

## Actions Taken

### *Penalty Provisions*

The Legislature reduced the severity of intangible tax penalties with the passage of Chapter 98-132, Laws of Florida. The penalties for intangible tax are now similar to those of other taxes.

The Legislature also reduced the penalties for several other taxes. For example, the penalty for late payment of sales tax was reduced from 10% per month, with a maximum of 50%, to 5% per month, with a maximum of 25% per month, the pre-1992 penalty rate. Notably, documentary stamp and intangible tax penalties were similarly changed. Penalties for late or non-payment for other taxes, such as motor fuel, mineral severance, utility, and estate taxes, were not changed.

## Actions Not Taken

### *Penalty Waivers*

As of April 1999, the Legislature has not acted to amend the process for handling of penalty waivers.

## Actions Partially Taken

### *Interest Provisions*

The 1999 Legislature adopted a single conditional, variable interest rate for all taxes owed to the state and collected by the Department of Revenue.<sup>3</sup> The new

rate is based on the prime lending rate in a similar manner as previously used exclusively for corporate tax. Generally, beginning January 1, 2000, the department is to charge an interest rate on owed taxes equal to the prime rate as of March 31 and September 30 of each year effective July 1 and January 1, respectively. The conditional provision is that the new variable rate or the flat 12% rate still specified in most individual tax laws will apply, whichever rate is less.

However, the new rate does not include the 3% to 4% margin as recommended by OPPAGA. Based on the prime interest rate from September 1998 through May 1999, the resultant statutory interest rate would be 8%, or a reduction of 4% from the prior rate. This could create a disincentive for prompt payment for some taxpayers.

### *Penalty Waivers*

The department adopted new procedures and developed an electronic waiver decision assistance system to minimize the subjective nature of the penalty waiver process. Upon receipt of a penalty waiver request, staff can now query the system, input basic information from the request, and obtain feedback to make more consistent waiver decisions. Although an improvement over the prior processing procedures, the system still falls short of benefits of an "expert" type system, as OPPAGA recommended. OPPAGA encourages the department to further investigate the benefits of improving the system. An expert type system should be able to further remove bias from the system, be self-learning from decision records, and it may even reduce the need for management oversight.

<sup>3</sup> Senate bill 172 amended Chapter 213, *State Revenue Laws: General Provisions*, Florida Statutes.

OPPAGA provides objective, independent, professional analyses of state policies and services to assist the Florida Legislature in decision-making, to ensure government accountability, and to recommend the best use of public resources. This project was conducted in accordance with applicable evaluation standards. Copies of this report in print or alternate accessible format may be obtained by telephone (850/488-0021 or 800/531-2477), by FAX (850/487-3804), in person (Claude Pepper Building, Room 312, 111 W. Madison St.), or by mail (OPPAGA Report Production, P.O. Box 1735, Tallahassee, FL 32302).

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