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BILL ANALYSIS

Senate Fiscal Agency

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Senate Bill 931 (Substitute S-4 as passed by the Senate)
Sponsor: Senator Doug Carl
Committee: Finance

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RATIONALE

Numerous complaints from citizens in recent years have alleged improper treatment of taxpayers by the Department of Treasury in its capacity as the administrator of State tax laws and the collector of taxes. Citizens have complained that the Department is too quick to assume that taxpayers are tax cheaters when an error or omission is revealed on a tax return; that the Department is far too slow in responding to taxpayer inquiries or concerns during a dispute, even though interest and penalties are being added each month of the dispute; that it is prohibitively expensive to enter into litigation with the Department, considering that even if the taxpayer proves to be correct in the dispute, he or she cannot recover costs from the Department; and that the Department routinely assesses heavy penalties even though a taxpayer may be guilty of nothing more than an inadvertent error in calculation. Such concerns may have arisen in conjunction with, or because of, a growing belief nationwide by taxpayers that they should be treated fairly, equitably, and respectfully by the tax laws and the people who administer the laws. Concerns for taxpayer rights resulted in the enactment in 1988 of the Federal Taxpayer Bill of Rights, similar state legislation in California, Indiana, Kansas, South Carolina, and Texas, and several proposals for taxpayer protections in other states. The Federal Taxpayer Bill of Rights created new protections for taxpayers regarding audits and interviews, Internal Revenue Service (IRS) notices and regulations, collection practices, and taxpayer litigation.

In Michigan, the House Republican Task Force on Taxpayer Rights took testimony on and studied the issue of taxpayer rights during 1989,

and published a report of its findings in January 1990. While the task force report acknowledged that the Department deserved credit for developing new taxpayer assistance programs, such as the Problems Resolution Office, a computerized refund information system, an electronic tax filing system, and publication of the "Michigan Tax Guide", the report also claimed that no formal legislative review of tax collection practices had been conducted since 1963, and that steps could be taken to ensure that taxpayers were not subjected to unreasonable actions by the Department. The report makes 20 recommendations to address taxpayer protections, among them that taxpayers should be given fair and courteous treatment, that the Department should adopt formal guidelines for the conduct of its employees, that penalty and interest levies should apply not only to taxpayers' errors but also to errors made by the State, and that taxpayers should be allowed to recover litigation costs in defending themselves against unjustified actions by the State. It has been suggested that several of the recommendations be placed in statute.

CONTENT

The bill would establish the "State Revenue Administration Act" within the revenue Act. The bill would require the Department of Treasury to establish rules to provide for standards for the fair and courteous treatment of the public by employees; to develop a handbook with guidelines for employees involved in the collection or auditing of taxes; and to develop a brochure that listed taxpayers'

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protections and recourses. The bill also would provide for changes in current procedures regarding the payment, administration, and levy of interest and penalties on unpaid taxes and taxes in dispute, and would allow a taxpayer who incurred expenses as a result of an unjustified tax collection action to recover costs for the expenses plus attorney fees. Following is a detailed description of the bill.

Department Rules

Within one year after the effective date of the bill, the Department would have to submit rules to provide for: a) standards to be followed by Revenue Division officers and employees for the fair and courteous treatment of the public, and a system for monitoring compliance with those standards; b) definitions of what constitutes negligence by the Department; and c) procedures governing an informal conference. (Under the revenue Act, under certain circumstances, taxpayers have a right to an informal conference with the Department to discuss tax disputes.) The rules for procedures governing an informal conference would have to include the following:

- A method by which the Department would attempt to schedule the conference "at a mutually convenient time and place".
- A requirement that the Department include in the notice for the conference the scope and nature of the conference's subject.
- Authorization for the taxpayer to make a sound recording of the conference with prior notice to the Department, and for the Department to do the same with prior notice to the taxpayer.

Assessment and Levy

Currently, under the revenue Act, if a taxpayer fails or refuses to file a return, or if the Department has reason to believe that a return has insufficient information to determine accurately the tax due, the Department can obtain information by examining the books and records of the taxpayer. The Act provides that, as soon as possible after procuring the information, the Department must assess the tax determined to be due and notify the taxpayer of the amount and reasons for the

assessment. The bill would eliminate this provision requiring the Department to assess the tax and notify the taxpayer, and instead would require the Department to send the taxpayer a letter of inquiry stating, "in a courteous and unthreatening manner", the Department's opinion that the taxpayer needs to furnish further information or owes taxes, and the reason for that opinion. Not less than 14 days after sending a taxpayer a letter of inquiry, the Department would have to give notice to the taxpayer of its intent to levy the tax. Currently, if the taxpayer gives the Department written notice within 20 days after receiving the Department's notice to levy, and remits the uncontested portion of the liability, the taxpayer can request an informal conference on the levy. The bill provides that if the taxpayer served written notice upon the Department within 45 days after receiving the Department's notice, the taxpayer would be entitled to an informal conference. If the Department served a notice of intent to levy upon a taxpayer, and the taxpayer did not protest the notice within the 45-day time limit, the Department could levy the tax and the interest and penalty due on the tax.

Currently, if a taxpayer is aggrieved by an assessment, decision, or order of the Department, he or she can appeal to the Tax Tribunal within 30 days after the assessment, decision, or order. The bill would allow a taxpayer 45 days to appeal. Currently, a taxpayer can appeal an assessment, decision, or order to the Court of Claims, but he or she must first pay the tax, including any applicable penalties and interest, under protest and claim a refund as part of an appeal. The bill would eliminate this provision. The bill provides that within 90 days after an assessment, decision, or order of the Department was final, or if the Department did not issue an assessment, decision, or order, a taxpayer who incurred expenses as a result of a tax collection action by the Department, "that is without substantial justification in law or fact", could commence an action in the Court of Claims to recover the actual costs relative to expenses he or she incurred, plus reasonable attorney fees incurred as a result of the action.

If a taxpayer filed with the Department a written request to send to an attorney copies of letters and notices regarding a dispute, the Department would have to send to the attorney

a copy of each letter or notice that had been sent to the taxpayer. A taxpayer could not designate more than one attorney.

Interest and Penalty

Under the Act, if the Department believes that a taxpayer has not satisfied a tax liability or that a claim is excessive, the Department must determine the liability and notify the taxpayer. If the tax paid is less than should have been paid or an excessive claim is made, the deficiency, and interest on the deficiency at a monthly rate of 1 percentage point above the adjusted prime rate from the time the tax was due until paid, are due and payable. If a taxpayer's deficiency or excessive claim currently is due to negligence but not with intent to defraud, a penalty of \$10 or 10% of the total deficiency, whichever is greater, is added. The bill provides that if the Department received payment of the tax before it sent a letter or notice to the taxpayer regarding that tax, the penalty would be \$10 or 5% of the deficiency, whichever was greater. Further, if a taxpayer subject to penalty demonstrated to the satisfaction of the Department that adding the penalty was "substantially unjust", the penalty could not be added.

Currently, if a taxpayer fails or refuses to file a return or pay a tax within the specified time, the Department must assess the tax as soon as possible and notify the taxpayer. Penalties and interest are added to the tax from the time the tax was due until paid. A person who fails or refuses to file a return or pay a tax within a time specified is subject to a penalty of \$10 or 5% of the tax, whichever is greater, with an additional 5% penalty for each month the return is not filed or the tax is not paid. If a return is filed or the tax is paid after the specified time, and it is shown to the satisfaction of the Department that the failure was due to "reasonable cause" and not willful neglect, the penalty can be waived at the discretion of the Revenue Commissioner. The bill would require that the penalty be waived, and provides that the penalty could not be imposed if the Department did not submit for a public hearing, by August 16, 1990, a rule defining what constituted "reasonable cause" for waiver of the penalty. The definition would have to include illustrative examples.

Refunds

Currently, the Department is required to refund or credit an overpayment of taxes; taxes, penalties, and interest erroneously assessed and collected; and all taxes, penalties, and interest found to be unjustly assessed, excessive, or wrongfully collected. A credit or refund must include interest at the rate of $\frac{3}{4}$ of 1% per month, and must be added to the refund commencing 45 days after a claim is filed or 45 days after the date established by law for filing a return, whichever is later. The bill would require the Department to pay interest on a refund or credit in the amount of the current monthly rate of 1 percentage point above the adjusted prime rate.

The bill also would require the Department to add to a refund a penalty of \$25 or 25% of the total amount, whichever was greater, if an overpayment, tax, penalty, or interest were unjustly assessed, excessive, or wrongfully collected due to the Department's negligence. Further, the Department would have to add to the refund interest in the amount of the current monthly rate of 1 percentage point above the adjusted prime rate.

Handbook and Brochure

The bill would require the Department to develop guidelines to govern employee responses to inquiries from the public and standards for tax audit activities. The guidelines would have to "explicitly exclude the use of a collection goal or quota for evaluating an employee". The Department would have to assemble the guidelines into an employee handbook, distribute the handbook to all employees involved in the collection and auditing of taxes, and make the handbook available to the public.

The Department would have to prepare a brochure that listed and explained, "in simple and nontechnical terms", a taxpayer's protections and recourses in regard to a departmental action administering or enforcing a tax statute, including at least the following:

- A taxpayer's protections and the Department's obligations during an audit.

- Both the administrative and judicial procedures for appealing a departmental decision.
- The procedures for claiming refunds and filing complaints.
- The means by which the Department can enforce a tax statute, including assessment, jeopardy assessment, and enforcement of a lien.

The Department would have to include the brochure with a communication to a taxpayer concerning the determination or collection of a tax.

Award Expenses

The bill provides that in an administrative or judicial proceeding that was brought by or against the State in connection with the determination, collection, or refund of a tax, interest, or penalty, a taxpayer could be awarded the reasonable and necessary expenses and attorney's fees of the proceeding. An award could be made only if the Department's position in the proceeding were taken without substantial justification in law or in fact.

MCL 205.21 et al.

FISCAL IMPACT

The bill would have an indeterminate fiscal impact on State and local government.

ARGUMENTS

Supporting Argument

As has developed on the Federal level and in several states, Michigan taxpayers should be assured of certain rights and protections in regard to tax laws and the administration of those laws. While it is clear that the Department has taken steps in recent years to improve communication between taxpayers and the Department, and increase access to Department forms and information, from the individual taxpayers' perspective his or her options in dealing with the Department over a tax dispute are severely limited. In short, currently the Department holds all the trump cards.

While the laws need to be strong in order for the State to deal sternly with tax cheats, the laws

must also be fair so that persons who make unintentional errors or minor mistakes are not treated in the same fashion as persons who knowingly attempt to avoid paying what they rightfully owe. The bill would ensure that taxpayers were treated fairly, equitably, and courteously, and had the tools to protect themselves when they were unjustly pulled into a tax dispute with the Department.

Supporting Argument

The tax laws are complicated, and the Department needs to be more flexible in dealing with the average taxpayer so that minor errors or disagreements don't result in major financial burden for a taxpayer. The bill would address several areas that have been identified as needing reform in order to protect taxpayers.

- Currently, Department employees can examine the books and records of any taxpayer subject to any tax and, if they have reason to believe that a tax is due, assess the amount and send the taxpayer a notice of intent to assess. It has been argued that this procedure is unfair because it presumes that the taxpayer is guilty, and requires the taxpayer to show why he or she is innocent. The bill would correct this problem by requiring the Department to send a "courteous and unintimidating" letter of inquiry to the taxpayer requesting information or informing the taxpayer of its intent to levy the tax, and would require the Department to wait at least 14 days after sending the letter of inquiry before sending the notice of intent to assess.
- Although the Department says that standards of conduct for its employees are already contained in an employee handbook and enforced on an informal basis, taxpayers continue to complain about rude or intimidating treatment in dealing with the Department. It has been suggested that the best way to ensure proper treatment from employees would be to require the Department to develop and publish guidelines to govern employee contacts with the public, and in particular, to prohibit the Department from evaluating employees based on collection goals or quotes. The bill would accomplish both of these

suggestions. Further, the bill would require the Department to prepare a brochure explaining taxpayer protections and recourses in regard to the Department's administration or enforcement of the tax laws.

-- Currently, the revenue Act requires a taxpayer who appeals a tax dispute to the Court of Claims to pay the tax and applicable penalties and interest, and then claim a refund if he or she prevails. Further, while the Act does not allow a taxpayer any method of recovering court costs and attorney fees if the Department has taken an unjustified action or made an unsubstantiated claim in a tax dispute, it does allow the Department to penalize a taxpayer for a frivolous protest by assessing a penalty. These provisions are completely unfair to taxpayers and give the State license to bully: requiring payment of taxes and penalties before a case is decided is another instance in which the State assumes the guilt of taxpayers until they are proven innocent; and leaving a taxpayer with no method to recover costs in a dispute, even though the State may be dead wrong, undermines taxpayer confidence in the fairness of the tax system and leads to great frustration. The bill would delete the provision that requires payment of taxes before a suit can be brought to the Court of Claims, and would allow taxpayers under certain conditions to recover the costs of litigation.

-- Currently, although delinquent taxes are assessed interest at a rate of 1% above the prime interest rate per month, interest applied to unpaid refunds to taxpayers is only 3/4 of 1% per month, which is a much lower amount. Why should the delinquent individual suffer a substantial interest charge while the delinquent State suffers hardly at all? The bill would correct this inequity by requiring the State to pay interest of 1% above the prime interest rate per month on delinquent refunds.

unpopular responsibility to collect the taxes and administer the tax laws of the State, will satisfy every customer. It has been stated that the Department's goal is to achieve as high a percentage of voluntary compliance with the tax code as is possible, and that mission cannot be accomplished by angering large segments of the tax paying population. In recent years the Department has made several efforts to simplify and streamline the process whereby taxpayers fulfill their tax paying responsibilities, and has responded to taxpayer concerns. The Department has simplified tax forms, offered citizens an opportunity to make suggestions in its tax booklet, offered a toll-free number to answer taxpayer questions, established a computerized refund information system open 24 hours a day for refund questions, opened telephone lines with prerecorded income tax information, provided a way for taxpayers to order tax forms over the phone, introduced the Problem Resolution Office as a taxpayer "resource of last resort", and established a hotline for professional tax preparers to use. Obviously, not all taxpayer complaints or concerns have fallen on deaf ears or been met with resistance.

When considering taxpayer complaints it must be remembered that there is no way the Department can be error-free when dealing with so many taxpayers, nor can it possibly please everybody while taking their money. While there may be areas in which the administration of the tax laws could be improved, or the tax laws themselves changed to enhance taxpayer protections, any implication that there is a widespread pattern of taxpayer abuse by the Department is simply unfounded.

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Opposing Argument

The Department of Treasury deals with nearly 5 million taxpayers per year. It is impossible to expect that the Department, which has the

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.