Thoughts on Interest Rate Disparities on Taxes

Interest Rate Disparity: Evaluate the rate of interest charged on delinquent property taxes and delinquent state taxes, compared to the rate of interest paid on property tax refunds and state tax refunds.

- Evaluate the effect of interest rate disparity on the assessment decisions of governments and the payment decisions of taxpayers.
- Quantify the amount by which state and local governments profit from interest rate disparity.
- Identify best practices among other states regarding interest rates charged and paid.
- Recommend a plan and timeline to reduce interest rate disparity.

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General Principles

1. Penalties should be used to as a punishment or deterrent for bad behavior.
2. Interest, at a market rate, should compensate for the time value of money and should be equal for both government and for taxpayers.

Summary

<u>The playing field is not level</u>

State Tax

Taxpayer must pay up—right or wrong (the taxpayer is presumed to be in the wrong). In a dispute over state taxes, the taxpayer must pay the amount at issue before going to court—diminishing their business of working capital and reducing income. This is NOT a matter of choice—it is a requirement of law.

The state then gets to freely use the taxpayer's money. Rather than hold this money in suspense, the disputed amounts are included within the Comptroller's revenue estimate and available for general state spending.

If the taxpayer wins, they are penalized by being undercompensated for the money they had to put up. If the taxpayer wins, they do get their money back, but with minimal interest that does not compensate them for the loss of the use of those funds. In effect, even if the court finds that no tax was ever due, the taxpayer is penalized by losing the use of the money with scant compensation.

If the state assesses the taxpayer for back taxes, the taxpayer must pay more in interest than the state would pay them on a refund. If the state assesses a taxpayer for unpaid tax, in addition to penalties, the state charges the taxpayer interest at the prime rate plus one percent, even though the state earns a far lower rate of interest on the money it holds in the Treasury.

Property Tax.

In a dispute over property tax, the taxpayer does <u>NOT</u> have to pay tax on amounts at issue; however, should they be found to owe tax, it is assessed back to the original due date as if the taxpayer failed to remit it.

A taxing jurisdiction is generally <u>not</u> required to pay interest on routine refunds; however, a taxpayer must pay an interest rate increasing by one percent for each month the tax is considered delinquent, plus penalties, plus applicable collection fees.

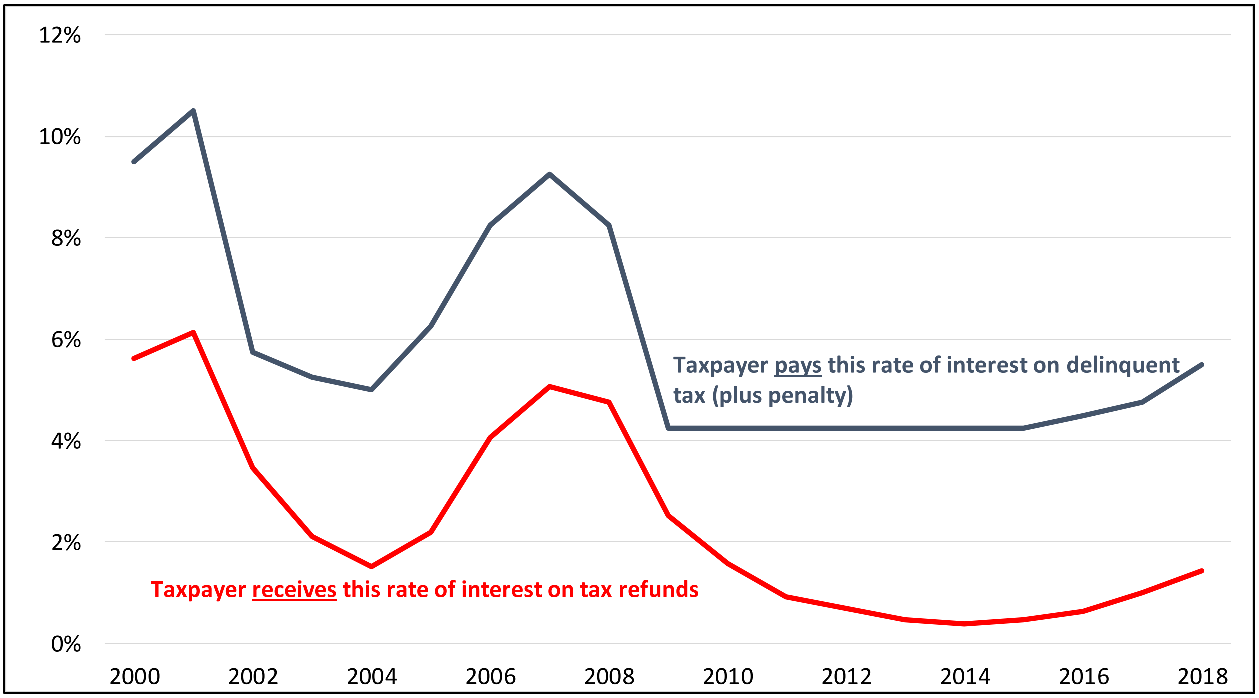
Local jurisdictions are not required to hold property taxes paid in protest in suspense, and, like the state, may spend protested amounts without restriction.

State Taxpayer Penalty and Interest

Provision	Taxpayer Owes Money	State Owes Taxpayer Money
State Taxes (Sales, Franchise, Fuels, etc.		
Penalty	**5 percent** if tax is 1 to 30 days past due, (111.061) **Additional 5 percent if** tax is more than 30 days past due (111.061) **Additional 10 percent** if more than 20 days after Comptroller issues a determination of tax due (111.0081 or 111.022) **Additional penalty of 50 percent** is assessed if the tax delinquency is the result of fraud or intent to evade tax (111.061) **Additional 5 percent** if taxpayer does not remit funds electronically as required (111.063)	Not Applicable
Interest Rates[1]	Prime rate plus one percent, assessed from the date the tax was due (111.060); **in 2018 (fiscal year) this would be 5.5 %.**	The lesser of 1) prime rate as of January 1 of the year, plus one percent or 2) the rate of interest earned by the state Treasury during December of the previous year (111.064);assessed from 60 days after the tax was paid; **in 2018 (fiscal year) this would be 1.429 %.** *Note: If the taxpayer chooses to use the refund amount as a credit on a subsequent tax return, they are not entitled to <u>any</u> interest (111.064(b)).*
Property Tax		
Penalty	**6 percent** for the first calendar month the tax is delinquent, plus an additional 1 percent each month the tax remains delinquent, up to a maximum of 12 percent (33.01). **Up to an additional 20 percent** of principal, penalties and interest if the taxing unit contracts with an attorney to enforce the collection of the delinquency and tax is delinquent as of July 1 (6.30 and 33.07) or, in the case of taxes on tangible personal property, 60 days after the date taxes become delinquent (33.11)	Not Applicable
Interest Rates	**1 percent for each month** the tax is delinquent (statute says to "*compensate the taxing unit for the revenue lost because of the delinquency*") (33.01) **5 percent per year** if taxpayer is elderly or disabled and has filed for a deferral with the Chief Appraiser (33.06)	A taxpayer is **not** entitled to refund interest; however, an unpaid refund will accrue **1 percent for each month** after 60 days a liability is determined to be due (31.12) **9.5 percent per year** on refunds granted in a judicial order (42.43).

[1] http://www.window.state.tx.us/taxinfo/int_rate.html

State Taxpayer Interest Provisions



On an amount the state determines was underpaid, in addition to penalties, the state assesses a rate of interest on the taxpayer equal to the prime rate plus one percent, back to 60 days after the date on which the original tax payment was due.

On an amount determined to have been overpaid, the state pays an interest rate equal to the *lesser* of:

1. the rate of interest earned on deposits in the state treasury, or
2. the prime rate plus one percent.

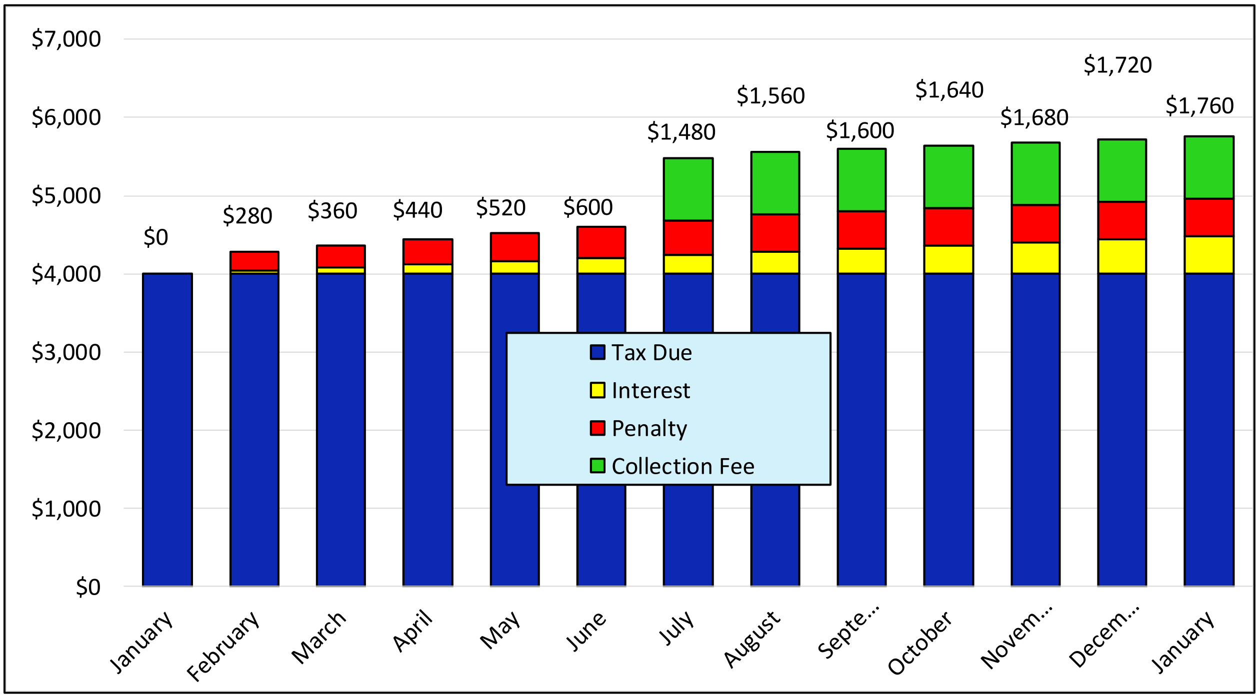
Interest begins to accrue on the later of 60 days after : the date the payment was made or the date tax was due for that particular reporting period.

For example, there is an error in a tax return on a tax due April 20, 2014 of $1,000, identified in January 2018:

- If it was an underpayment, in addition to penalties, the taxpayer owes the state $162 in interest with their tax payment;
- If it was an overpayment, the state will reimburse the taxpayer and add $24 in interest.

The Internal Revenue Service generally uses the same rate of interest for refunds and delinquencies: the "federal short-term rate" plus 3 percentage points, rounded up to the nearest half-point. Interest paid to corporate taxpayers is discounted by one percentage point.

Property Taxpayer Interest Provisions



Taxing jurisdictions charge <u>delinquent</u> taxpayers a rate of interest equal to one percent for each month the tax is delinquent, in addition to any penalty due.

Taxpayers owed a property tax refund are generally not entitled to interest unless:

- They do not receive their refund within 60 days, after which they are entitled to an interest rate of one percent per month, but dating only to the date it was determined that a refund was due, **<u>not</u>** the date the tax was overpaid, or
- In the event a court decision results in a refund of taxes overpaid, in which case they are entitled to an annual interest rate of 9.5 percent. In 2016, appraisal districts valued 19.2 million parcels. Roughly 2 million protests were filed, but only 18 cases were resolved by a court decision to which the 9.5 percent would apply (roughly one thousandth of a percent).

A property owner does not have to pay the amount in dispute in order to pursue judicial review; however, if the court determines that some amount is owed, they are assessed penalty and interest back to the original due date of the tax.

Special Provisions Relating to Property Taxpayer Interest and the Rates Stated

1. Sale of a residence homestead replacement structure (after a casualty): difference in taxes, plus 7% annual interest.
2. Sale of property qualifying for an exemption for certain low-income housing to an ineligible person: difference in taxes, plus 12% annual interest.
3. Sale of property qualifying for an exemption as a Colonia model subdivision: difference in taxes, plus 12% annual interest.
4. Transfer of property owned by a religious organization: difference in taxes, plus 7% annual interest.
5. Change of use of agricultural land: difference in taxes, plus "interest at the rate for delinquent taxes" (i.e. 1% per month) until paid.
6. Change of use of open-space land: difference in taxes, plus 7% annual interest.
7. Change of use of timber land: difference in taxes, plus 7% annual interest.
8. Change of use of recreational and scenic land: difference in taxes, plus 7% annual interest.
9. Change of use of public access airports: difference in taxes plus 7% annual interest.
10. Change of use of restricted-use timber land: difference in taxes plus 7% annual interest.
11. Back assessment for omitted property: tax due, plus interest at 1% per month from the date the tax would have become delinquent had the tax been imposed correctly.
12. If a refund is not paid to a taxpayer within 60 days, interest is added at 1% per month.
13. Tax deferral or abatement: 8% annually.
14. Tax deferral of taxes on appreciating residence homesteads: 8% annually.
15. Post-appraisal litigation requiring a supplemental tax payment accrues 6% penalty plus 1% per month interest from the date the tax would have been delinquent.

Recommendations

1. Interest should be the time value of money determined by market conditions. State and local governments should use the same rate of interest on delinquencies and refunds. Interest should not be used to penalize the taxpayer. A separate penalty may be assessed for reasons of compliance and enforcement.

2. If taxpayers are not to be entitled to equal interest on refund claims, they should be allowed access to the courts without having to pay amounts in dispute.

3. If amounts in dispute are required to be paid prior to a final determination of liability, those amounts paid under protest should be held in trust, unavailable for governments to spend until the dispute is finally resolved.