



## Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #684

### **Electronic Filing Incentives (DOR -- Tax Administration)**

[LFB 2009-11 Budget Summary: Page 560, #10]

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#### **CURRENT LAW**

Under current law, if the Internal Revenue Service (IRS) requires a person to file information returns or wage statements electronically for federal income tax purposes, the person is required to also file comparable state information returns or wage statements electronically with the Department of Revenue (DOR). Under administrative rules, tax preparers or tax preparation entities are required to file individual income tax returns electronically, if the preparer or entity prepared 100 or more individual income tax returns in the prior year.

#### **GOVERNOR**

Modify statutory provisions related to electronic filing of tax returns as follows:

a. Provide that, if a person is required to file 50 or more wage statements or 50 or more of any one type of information return with DOR, the person would be required to file the statements or the returns electronically. If a person failed to file a statement or return electronically, as required by DOR, a penalty of \$10 for each case of noncompliance could be imposed.

b. Create a penalty for failure to electronically file an individual income tax return. If any tax return preparer or tax preparation entity that the Department required, by rule, to electronically file individual income tax returns prepared by the preparer or entity, failed to electronically file one or more returns, the tax return preparer or tax preparation entity would be subject to a \$50 penalty for each return that was not electronically filed. The Department would be required to waive a penalty if the tax return preparer or tax preparation entity showed that the violation resulted from a reasonable cause and not willful neglect.

c. For the purposes of filing the rental vehicle or dry cleaning fee, define "file" to mean mail or deliver a document that DOR prescribes to the Department, or to use another method of submitting or submit to another destination, if prescribed by the Department. This would allow DOR to require electronic filing of those fee returns.

These provisions would take effect on January 1, 2010, and result in a minimal increase in revenues from the penalties.

## **DISCUSSION POINTS**

1. Current law includes the following mandates for electronic filing of state tax returns and related information:

a. DOR is authorized to require a person that is registered (or required to be registered) for Wisconsin sales and use tax purposes to file its sales and use tax returns by an electronic means.

b. A tax preparer or tax preparation firm that prepared 100 or more Wisconsin individual income tax returns for the prior tax year is required to file the current year individual income tax returns by electronic means

c. DOR may require an employer that is registered (or required to be registered) to withhold Wisconsin income taxes from employees' wages to file its WT-7 form by electronic means. The WT-7 form is the employer's annual reconciliation of Wisconsin income tax withheld from employee wages.

2. The Secretary of Revenue may waive each of these electronic filing requirements, if the Secretary determines that the requirement causes an undue hardship. In determining whether the electronic filing requirement causes undue hardship, the Secretary can consider the following factors: (a) unusual circumstances that could prevent filing by an electronic means; or (b) any other factor the Secretary determines is pertinent. In order to receive a waiver, a person must request the waiver in writing, and clearly indicate why the electronic filing requirement causes undue hardship.

3. There are no penalties imposed for failure to file in an electronic means, sales and use tax returns, tax preparer/tax preparation firm income tax returns, and WT-7 forms.

4. Current law also requires wage statements and information returns to be filed electronically with DOR if: (a) the IRS requires comparable documents to be filed on magnetic media or in machine-readable form; and (b) the person filing the documents files more than 250 wage statements or information returns with the state.

5. The bill would make three changes to current law electronic-filing mandate provisions:

a. The threshold number of wage statements and information returns required to be filed

with DOR that would trigger the electronic filing requirement for such forms would be lowered from 250 to 50, and a \$10 penalty would be established for each case of failure to file electronically. According to DOR a total of 2,800 employers are currently subject to electronic filing requirements for wage statements and information returns. An additional 10,000 employers would be subject to the filing requirements due to the lower amount of statements and returns that establish the electronic filing requirement.

b. A \$50 penalty would be established for each individual income tax return that was not filed electronically by a tax preparer or tax preparation entity that was subject to electronic filing requirements. DOR indicates that 1,550 tax preparers/ tax preparation firms are subject to the current electronic filing requirement.

c. DOR would be authorized to require that rental vehicle fee and dry cleaning facility fee returns be filed electronically. There are approximately 200 taxpayers subject to the rental vehicle fee, and 225 taxpayers subject to the dry cleaning facility fee.

6. DOR indicates that the electronic filing provisions and related penalties would increase the use of electronic filing, and compliance with electronic filing requirements. Studies have found that increases in the fine rate on tax returns slightly increase compliance. The income fine rate elasticity is less than 0.1, meaning an overall 10% increase in all penalties would result in a less than 1% increase in collections (Alm, 2008). Electronic filing improves tax processing administration and reduces taxpayer errors. For example, paper income tax returns cost about \$3.85 to process compared with 0.82 cents for electronically filed returns. The error rate on paper sales tax returns is about 14.4% compared with 2.2% for electronically filed sales tax returns.

7. By reducing the threshold amount of wage statements and information returns, a number of smaller businesses could be subject to the electronic filing requirements. In addition, individually owned dry cleaners and rent-a-car businesses could be required to file rental vehicle and dry cleaning facility fees electronically. Businesses filing paper returns might be forced to purchase software or other filing services from private vendors. A 2005 study of small businesses conducted by the National Federation of Independent Business ("NFIB National Small Business Poll, The State of Technology") indicated that 32% of respondents did not employ high-speed Internet in their business. The study notes that "the data suggest that most small businesses have relatively limited technological capabilities." However, it is likely that this percentage is smaller in 2009.

8. There are no penalties for failure to file sales tax returns and WT-7 forms electronically, under current law, and no penalty provisions are included in the bill. To provide consistent treatment for e-filers, an alternative would be to also establish a \$50 penalty for not filing sales tax returns electronically, and a penalty of \$10 for not filing WT-7 forms electronically. For tax year 2008, approximately 488,600 sales tax returns were filed electronically. About 42,600 WT-7 forms were filed electronically. There would be a minimal increase in revenues due to the penalties.

## **ALTERNATIVES**

1. Adopt the Governor's recommendation to: (a) require a person that is required to file 50 or more wage statements or 50 or more of any one type of information return with DOR, to file the statements or the returns electronically subject to a penalty of \$10 for each case of noncompliance; (b) create a penalty of \$50 for each return for failure to electronically file an individual income tax return; (c) and authorize DOR to require electronic filing for the rental vehicle and dry cleaning fees.

2. In addition to the Governor's recommendation: (a) create a penalty of \$10 for each case of noncompliance for failure to file a WT-7 form electronically; and (b) create a penalty of \$50 for each return for failure to file a sales tax return electronically.

3. Delete the Governor's recommendation.

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