Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

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Late Filing Fees/Providing Schedules to Beneficiaries, Partners, or Shareholders (DOR -- Tax Administration)

[LFB 2009-11 Budget Summary: Page 561, #11]

CURRENT LAW

Under current law, late filing fees for tax returns are as follows: (a) $30 for corporate income and franchise tax; (b) $2, $3, $5, or $30 (depending on net tax liability and actual date filed) for individual income tax; and (c) $30 for partnerships.

GOVERNOR

Establish a standard late filing fee for individual income and corporate income and franchise tax returns of $50 for each violation. Fiduciaries, partnerships, or tax-option corporations that were required to file a tax return would also be required to provide a schedule to each beneficiary, partner, or shareholder, respectively, of their share of income, deductions, credits, or other items of the entity that would affect the beneficiary’s, partner's, or shareholder's tax liability. A person who was required to provide a schedule and failed to do so by the due date, including any extension, or that provided an incorrect or incomplete schedule, would be subject to a $50 penalty for each violation. The federal extension period allowed for filing a partnership return (which varies from two to six months) would be adopted for state income tax purposes. These provisions would first apply to tax year 2010.

DISCUSSION POINTS

1. Wisconsin individual income tax returns are due on the April 15 following the year for which the return is filed, unless an extension is granted. The 2008 individual income tax return is due April 15, 2009. Any extension of time granted by federal law for filing a federal individual

income tax return automatically extends the time for filing the corresponding Wisconsin return. A federal extension extends the due date of the Wisconsin return to the extended due date of the federal return. Extensions of time to file federal individual income tax returns with the Internal Revenue Service (IRS) include: (a) an automatic six-month extension from the original due date of the return; (b) an extension of 30 days after the date on which a taxpayer expects to meet the residence or physical presence test to qualify for the foreign earned income exclusion and/or the foreign housing exclusion or deduction; (c) an automatic two-month extension from the original due date of the return, for certain persons living or on active duty in military or naval service outside the U.S.; (d) an additional four-month extension for certain persons living or on duty in military or naval service outside the U.S.; and (e) extensions related to serving in a combat zone. Extensions available under federal law may be used for Wisconsin purposes, even if the corresponding federal return is filed without an extension.

2. Generally, a corporation must file its Wisconsin franchise or income tax return by the 15th day of the third month following the close of its tax year. A corporation with calendar year 2008 as its tax year must file its state franchise/income tax return by March 15, 2009. Any extension of time granted by federal law or the IRS for filing a federal corporate income tax return automatically extends the due date for the Wisconsin return to 30 days after the extended due date of the federal return. Extensions of time to file federal corporation income tax returns include: (a) an automatic six-month extension from the original due date of the return; (b) an automatic three-month extension for certain foreign corporations, and domestic corporations with income from sources within U.S. possessions, or with books, records, and business outside the U.S.; and (c) an additional three-month extension for corporations eligible for the extension under (b). The Wisconsin extended due date is 30 days after the federal extended due date. If a corporation does not request a federal extension, Wisconsin law provides an automatic extension of the later of, seven months after the original Wisconsin due date, or until the original due date of the corporation's federal return.

3. A partnership must file its Wisconsin partnership return by the 15th day of the fourth month following the close of its tax year. A partnership with calendar year 2008 as its tax year would have to file its Wisconsin income tax return by April 15, 2009. Any extension of time granted under federal law for filing a federal partnership return automatically extends the time for filing the corresponding Wisconsin return to the extended due date of the federal return. Extensions of time to file federal partnership returns with the IRS include: (a) an automatic five-month extension from the original due date of the return; (b) an automatic six-month extension from the original due date of the return, for certain electing large partnerships; (c) an automatic two-month extension from the original due date of the return for certain partnerships with books and records outside the U.S.; and (d) an additional four-month extension for partnerships eligible for the extension under (c). Filing extensions provided for partnership returns under federal law may be used for Wisconsin purposes, even if the corresponding federal partnership return is filed without an extension.

4. As noted, current late filing fees for individual income tax returns range from $2 to $30. Specifically, the late filing fee is: (a) $2 if the taxpayer's income tax is less than $10; (b) $3 if

the taxpayer's income tax is between $10 and $20; and (c) $5 if the taxpayer's income tax is $20 or more. In addition, non-corporate taxpayers are subject to a $30 penalty for filing a return 60 or more days after the due date. Corporate franchise and income tax returns are subject to a $30 late filing fee.

5. The number of individual income taxpayers that were assessed a late filing fee was 39,953 in calendar year 2007, and 44,647 in calendar year 2008. The number of corporate taxpayers that were assessed a late filing fee was 10,217 in calendar year 2007, and 6,220 in calendar year 2008.

6. The IRS penalty for late filed federal income tax returns is 5% of the unpaid tax for each month, or part of a month, the return is late, but not more that 25% of the unpaid tax on the due date (without regard to extensions). If a return is over 60 days late, the minimum late filing penalty is the lesser of $135, or 100% of the unpaid tax.

7. Examples of penalties imposed for late filing of income tax returns in other states include the following: Michigan -- 5% of unpaid tax up to a maximum of 25%, for individuals and corporations; Minnesota -- 5% of unpaid taxes for individuals and corporations; Illinois -- the lesser of $250 or 2% of tax, for individuals and corporations; Iowa -- 10% of tax due, for individuals and corporations; Indiana -- the greater of 10% of the tax due or $5, for individuals and corporations; Nebraska -- 5% of the unpaid tax due up to a maximum of 25% of tax due, for individuals and corporations; and California a maximum of 25% of the unpaid tax, and the lesser $100 or 10% of the unpaid tax after 60 days, for individuals, and 5% of the tax due per month, up to a maximum 25%, for corporations.

8. The Department of Revenue (DOR) indicates that the varying amounts of the late filing fees for individual income tax returns makes the fee difficult to administer. Under current provisions, a partnership is not subject to a late filing fee until the return is more than 60 days late. The statutes are not clear on whether a partnership return is subject to individual and fiduciary income tax extension provisions or corporate income and franchise tax extension provisions. The bill would clarify the extension period for partnership returns by specifying that it would be the same as the federal extension period. A uniform late filing fee of $50 would be established for all state income and franchise tax returns. The standard late filing fee would improve the efficiency of administering the late filing fees, and the higher penalty amount could improve compliance.

9. Studies have found that an increase in the fine rate on tax returns slightly increases compliance. The income fine rate elasticity is less than 0.1, meaning an overall increase of 10% in all penalties would result in a less than 1% increase in collections. (Alm, 2008)

10. The standard $50 late filing fee would be greater than the taxpayer's income tax liability in some cases. The $20 increase, from $30 to $50, in the standard late filing fee represents a 67% increase in the penalty amount.

11. Fiduciaries, partnerships, and tax-option corporations are required to include, with

income tax returns, schedules of each beneficiary's, partner's, or shareholder's share of income (or loss), deductions, credits, and other similar items. Schedule 2K-1 lists a beneficiary's share of income (or loss), deductions, credits, and other related items. Schedule 3K-1 lists a partner's share of such items, and Schedule 5K-1 lists a tax-option company shareholder's share. Instructions for each of these schedules direct the fiduciary, partnership, or tax-option corporation to include a schedule with the entity's income tax return, keep a copy as part of the entity's records, and to give a copy to each beneficiary, partner, or shareholder, respectively. However, current statutory provisions do not require a fiduciary, partnership, or tax-option corporation to provide this information to beneficiaries, partners, or shareholders.

12. Under the bill, every fiduciary, partnership, or tax-option corporation required to file an income tax return would also be required, on or before the due date of the return, including extensions, to provide a schedule to each beneficiary, partner, or shareholder, respectively, if their share of income, deductions, credits, or other items of the entity could affect the beneficiary's, partner's, or shareholder's tax liability. The schedule would have to separately indicate the beneficiary's, partner's, or shareholder's share of each item. A person who was required to provide a schedule and failed to do so by the due date, including any extension, or that provided an incorrect or incomplete schedule, would be subject to a $50 penalty for each violation. DOR would be required to waive the penalty, if the person showed that a violation resulted from a reasonable cause and not from willful neglect.

13. In tax year 2008, there were approximately 71,000 S corporation, 87,500 fiduciary, and 60,800 partnership returns filed with DOR.

14. DOR indicates that, because there is not a requirement and related penalty for a failure to provide a schedule of a beneficiary's, partner's, or shareholder's shares of income, deductions, credits, and other related items, there are cases where that information is not provided to individual taxpayers. Without, that information, a beneficiary, partner, or shareholder may not properly report their proportionate share of income, loss, or expenses for Wisconsin income tax purposes. As a result, this could reduce income tax revenues. However, because information about the number of cases where such information is not provided is not available, the estimated fiscal effect is unknown.

15. As noted, tax return instructions direct the partnership, fiduciary, or tax-option corporation to provide copies of the schedules to partners, beneficiaries, or shareholders. The number of cases where the information is not shared is unknown.

16. The bill estimates that the additional revenue from the late filing fees would be a minimal amount. However, for the last two tax years, an average of 8,200 corporation and 42,300 individual income tax returns were assessed late filing fees. Based on these numbers, and the 2010 effective date, the increase in late filing fees would result in an additional $500,000 in revenue in 2010-11 and $1 million annually thereafter.

ALTERNATIVES

A. Late Filing Fees

1. Adopt the Governor's recommendation to: (a) establish a standard late filing fee for individual income, partnership, and corporate income and franchise tax returns of $50 for each violation; and (b) adopt the federal extension period allowed for filing a partnership return for state income tax purposes. Reestimate the additional revenue from late filing fees to be $500,000 in 2010-11 and $1 million annually thereafter.

ALT 1	**Change to Bill** Revenue
GPR	$500,000

2. Delete the Governor's recommendation.

B. Penalties for Failure to Provide Records

1. Adopt the Governor's recommendation to require every fiduciary, partnership, or tax-option corporation required to file an income tax return, on or before the due date of the return, including extensions, to provide a schedule to each beneficiary, partner, or shareholder, respectively, if their share of income, deductions, credits, or other items of the entity could affect the beneficiary's, partner's, or shareholder's tax liability. Require the schedule to separately indicate the beneficiary's, partner's, or shareholder's share of each item. Provide that a person who was required to provide a schedule and failed to do so by the due date, including any extension, or that provided an incorrect or incomplete schedule, would be subject to a $50 penalty for each violation.

2. Delete the Governor's recommendation

Prepared by: Ron Shanovich