

STATE OF WEST VIRGINIA

**FULL PERFORMANCE EVALUATION OF THE
DEPARTMENT OF TAX AND REVENUE**

**In a Relatively Small Number of Cases,
The Department Applies Its Criteria for
Waiving Additions to Taxes Inconsistently
and Leniently**

**OFFICE OF LEGISLATIVE AUDITOR
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June 2000

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June 2000

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Antonio E. Jones, Ph.D.
Director

June 11, 2000

The Honorable Edwin J. Bowman
State Senate
129 West Circle Drive
Weirton, West Virginia 26062

The Honorable Vicki V. Douglas
House of Delegates
Building 1, Room E-213
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0470

Dear Chairs:

Pursuant to the West Virginia Sunset Law, we are transmitting a Full Performance Evaluation of the *Department of Tax and Revenue*, which will be presented to the Joint Committee on Government Operations on Sunday, June 11, 2000. The issue covered herein is "*In a Relatively Small Number of Case, The Department Applies Its Criteria for Waiving Additions to Taxes Inconsistently and Leniently.*"

We conducted an exit conference with the *Department of Tax and Revenue* on June 1, 2000.

Let me know if you have any questions.

Sincerely,

A handwritten signature in cursive script that reads "John Sylvia".

John Sylvia
Acting Director

JS/wsc

Joint Committee on Government and Finance

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EXECUTIVE SUMMARY

Issue Area 1: In a Relatively Small Number of Cases, The Department Applies Its Criteria for Waiving Additions to Taxes Inconsistently and Leniently.

The Legislative Auditor's Office tested the Tax Department's procedure of waiving additions to tax to determine if it is consistent with State law and Tax Department policy. **Overall, this report is favorable with a few exceptions.** The Legislative Auditor found that the Department grants waivers in a relatively small number of cases (less than 1%) and it also waives a relatively small amount (less than 1%) compared to the total amount the Compliance Division collects in delinquent taxes each year (\$80 million). There are on average about 100 accounts each year in which the Compliance Division does not apply its waiver policy consistently. However, these cases account for only four-tenths of one percent.

Additions to tax are imposed by West Virginia Code §11-10-18 for the following:

- Failure to file a tax return.
- Failure to pay the amount of tax shown due on a tax return.
- Failure to pay an amount of tax not shown on a tax return.

Statute imposes additions to tax on the above violations unless it is demonstrated that the failure to perform these acts is due to "*reasonable cause*" and not due to willful neglect. While the statute does not define reasonable cause, the Compliance Division defines it as:

...acts or circumstances over which a person has no control and that a reasonable and prudent person could not foresee.

The main concerns that the Legislative Auditor has is as follows:

- The Tax Department waives additions to tax on *trust fund taxes* for reasons of financial difficulties. However, by Department policy, financial difficulty is not a viable reason for not timely paying trust fund taxes to the State. This is a good policy since trust fund taxes, such as the consumer sales tax and income tax withholding, are collected and are available to be paid to the State, however, the taxpayer chose to use the funds for personal use instead of paying the State.
- The second concern is that waivers are being granted with no indication of reasonable cause listed. After reviewing descriptions on reasonable cause it was clear that there are cases in which reasonable cause does not exist or at least is not mentioned in the description.

- Another concern is that waivers are being granted for circumstances controllable by the taxpayer. The general rule of the waiver policy is that the taxpayer had no control over the delinquent payment of the tax. Many waivers are granted to businesses for citing problems with their own employees. These reasons do not constitute reasonable because employees are under the control of the taxpayer and therefore, should not be granted a waiver.
- Another concern is the issuance of multiple waivers by the Compliance Division. Although the number of multiple waiver cases was only 30, the Compliance Division should monitor the issuance of waivers to avoid granting multiple waivers for similar reasons or for reasons that do not constitute reasonable cause.
- The final concern is that Offers in Compromise (OIC) should be used more often in some of these cases. The OIC process is used when the issue is not reasonable cause but is doubt as to the tax liability being collected. The test for doubt of collectibility is more stringent than determining reasonable cause. The cases that concern the Legislative Auditor do not fit the definition of reasonable cause and therefore are viable candidates to undergo the higher standard of an Offer in Compromise.

These concerns result in a smaller amount of tax revenue being collected of between \$100,000 to \$300,000. Also, some taxpayers receive differential treatment.

Review, Scope, and Methodology

The Department of Tax and Revenue oversees the Tax Division which is responsible for the administration and enforcement of the State's tax laws. Within the Tax Division are several subdivisions. One of these subdivisions is the Compliance Division. This division collects delinquent taxes from taxpayers, imposes additions to tax for late filings and payments and grants waivers for additions to taxes.

Objective

The objective of this review is to examine the Compliance Division's application of its policy to waive additions to taxes.

Scope

The Scope focuses on a review of a Log of Waiver of Additions for the past five years, calendar year 1995 through 1999. The focus is on all taxes for which additions to tax can be imposed, with particular concern on *Trust Fund Taxes*.

Methodology

The Compliance Division provided the Legislative Auditor's Office with a Log of Waivers of Additions to tax for calendar years 1995 through 1999. The log included a total of 1,400 approved waivers. For each account that was granted a waiver of additions to tax, the log included the name of the taxpayer, the taxpayer's identification number, the amount waived by the Compliance Division, the date the waiver was requested, and a brief description of why the taxpayer requested a waiver and/or why the Compliance Division granted the waiver. Every description was reviewed by the Legislative Auditor's Office to determine if approved waivers met the departmental policy for approval. The evaluation was based entirely on the description in the Log of Waiver of Additions. A sample of 73 accounts was drawn from 474 waivers that were deemed questionable to determine the type of tax involved and additional information in cases where a limited description on why the waiver was requested was provided. Each of the 474 waivers that were determined questionable were provided to the Compliance Division for its response to Legislative Auditor's objections. Every aspect of this review complied with **Generally Accepted Government Auditing Standards**.

Issue Area 1: In a Relatively Small Number of Cases, The Department Applies Its Criteria for Waiving Additions to Taxes Inconsistently and Leniently.

The Legislative Auditor's Office tested the Tax Department's procedure of waiving additions to tax to determine if it is consistent with State law and Department policy. **Overall, this report is favorable with a few exceptions.** The Legislative Auditor found that the Department grants waivers in a relatively small number of cases (less than 1%) and it also waives a relatively small amount (less than 1%) compared to the total amount the Compliance Division collects in delinquent taxes. There are on average about 100 accounts each year in which the Compliance Division does not apply its waiver policy consistently. However, these cases only account for about four-tenths of one percent.

Additions to tax are imposed by West Virginia Code §11-10-18 for the following:

- Failure to file a tax return.
- Failure to pay the amount of tax shown due on a tax return.
- Failure to pay an amount of tax not shown on a tax return.

An amount of one-half percent of the net tax due is added for failure to pay the amount of tax due, and for each month that the failure continues. Statute imposes additions to tax on the above violations unless it is demonstrated that the failure to perform these acts is due to "*reasonable cause*" and not due to willful neglect. While the statute does not define reasonable cause, the Compliance Division defines it as:

...acts or circumstances over which a person has no control and that a reasonable and prudent person could not foresee.

Additions to tax can also be waived if there is substantial doubt that the tax or additions to tax can be collected.

The general rule is that reasonable cause only exists in circumstances that are beyond the control of the taxpayer, and the taxpayer's actions did not contribute to the cause. Some examples of circumstances that constitute reasonable cause according to policy include:

- Natural Disasters or Other Catastrophes
- Serious Illness or Death
- Theft or Embezzlement
- Reliance on An Outside Professional
- Reliance on Tax Department Personnel
- Financial and Economic Difficulties

If it can be demonstrated that any of these circumstances are the cause for an untimely filing of a return or payment of tax, the amount of the additions to tax can be waived. Although the focus

of this report is on waivers of additions to tax for all taxes for which additions can be imposed, of particular interest is the application of the waiver policy with respect to *trust fund taxes*. Trust fund taxes include the sales and use tax, and personal income withholding taxes which are collected or withheld from liable taxpayers by retailers or employers.

Concerns of the Legislative Auditor

The Legislative Auditor's Office received a log of waivers of additions to tax for the past five years. For each account that was granted a waiver of additions to tax, the log included the name of the taxpayer, the taxpayer identification number, the amount waived by the Compliance Division, the date the waiver was requested, and a brief description of why the taxpayer requested a waiver and/or why the Compliance Division granted the waiver. Table 1 is a summary of the log showing the total number of accounts that received waivers, and the total amount waived by year.

Table 1
Number Of Waivers Granted and Amounts Waived by Year

Calendar Year	Waivers Granted	Amount Waived	Average Amount
1995	163	\$412,616	\$2,531
1996	226	\$548,010	\$2,424
1997	245	\$534,861	\$2,183
1998	338	\$917,680	\$2,715
1999	428	\$1,394,349	\$3,257
Totals	1,400	\$3,807,516	\$2,719

The Legislative Auditor's Office reviewed each description on the log describing why the Compliance Division justified its approval of a waiver request. Based on the descriptions in the log, the Legislative Auditor concludes that of the 1,400 waivers granted, 474 descriptions do not constitute reasonable cause by definition. These waivers represent **33.8%** of all cases granted a waiver, and the amount of these waivers represents **\$1,740,559** dollars which is **45.7%** of the total amount waived. **However, this amount is approximately 0.4% of the total amount of delinquent taxes collected by the Division over the same time period.**

Although the amount of revenue involved is relatively small compared to the total amount of revenue collected by the Tax Department, in absolute terms the amount of revenue waived inconsistently is significant. Furthermore, the amount is growing each year, with the amount waived increasing by 52% in 1999. Also, the inconsistent application of policy creates differential treatment for hundreds of taxpayers, and it defeats the purpose of imposing additions to tax which is to

discourage late payment of taxes. Discouraging late payment of trust fund taxes is especially important because generally the tax has been collected and is available for payment, but in many cases the taxpayer uses the State's money for personal use.

Based on the Compliance Division's descriptions for granting waivers, the Division's written waiver policy, and most waivers are granted for trust fund taxes, the Legislative Auditor has the following concerns:

Concern #1: Most Waivers are Granted on Trust Fund Taxes

Since most of the amount of delinquent taxes collected by the Compliance Division are from trust fund taxes, most waivers of additions to tax are granted on *trust fund taxes*. According to West Virginia Code §11-10-5j:

*Whenever any person is required by this article to collect or withhold any tax from any person, and pay it over to the tax commissioner, the amount of tax so collected or withheld will be deemed to be moneys held **in trust** for the state of West Virginia.*
(Emphasis added)

A trust is developed in a sense that the vendor is held responsible for collecting and paying to the State someone else's tax liability. In addition, West Virginia Code §11-15-4 requires that vendors who collect the sales tax are to keep the amount of the tax collected separate from the proceeds of the sale, unless the Tax Commissioner authorizes the tax to be held in an alternative manner. In other words, **vendors are prohibited from commingling the proceeds of sales and the sales tax**. This is intended to prevent the vendor from using the tax collected for the vendor's purposes, and it facilitates having the tax collected available for timely payment to the State. Failure to pay trust fund taxes in a timely manner is similar to these businesses granting themselves a loan from the State.

In a sample of 73 accounts of the 474 accounts that do not constitute reasonable cause, **95%** of the waivers were for trust fund taxes. This is expected since most of the delinquent taxes collected by the Compliance Division are trust fund taxes. Many of these accounts received waivers for citing financial difficulty as the reason for untimely payment. This is a violation of the *Compliance Division Penalty Policy Procedures and Criteria*. The policy states:

... We do not normally recognize financial difficulties as reasonable cause for failure to pay over trust fund taxes such as, sales and use taxes or personal income withholding taxes that were collected or withheld from the taxpayers, customers, or employees. There may be circumstances involving other liabilities that extreme financial difficulties would be recognized as reasonable cause for failure to pay.

Tax liabilities other than trust fund taxes can receive a waiver of additions to tax if extreme financial difficulty is the stated reason. However, **financial difficulty is not a viable excuse for granting a waiver when it involves a trust fund tax.** This is an understandable policy, because with trust fund taxes, vendors have the tax collected in their possession but they make a conscious decision to use the tax money for a purpose other than paying the State. The policy and the law are intended to prevent someone who is entrusted to collect and pay someone else's taxes from using those monies to pay their own bills.

There are 130 accounts totaling nearly \$480,000 that received waivers for reasons identified as financial or economic difficulties. Appendix A provides the complete description for a sample of these accounts. The following list provides a brief description of some typical reasons waivers were granted for trust fund accounts:

- *a bad economy;*
- *financial difficulties;*
- *cash flow problems;*
- *struggling business;*
- *drastic decrease in sales;*
- *poor location;*
- *business operates at a loss most of the year;*
- *consistent and unpredictably slow business.*

With respect to other tax liabilities, vendors may not have funds available to pay **their own** taxes. Therefore, the Compliance Division may grant a waiver of additions to tax in these extreme cases. However, with respect to trust fund taxes, the vendor invariably collected the tax and had it available for payment to the State, but because of financial difficulties, the tax was used for other purposes. To receive a waiver of additions to tax in these cases is **unfair** to taxpayers who pay trust fund taxes timely, and it is **inconsistent** with the law and Tax Department policy. Furthermore, inconsistent application of the waiver policy does not **discourage** untimely payment of these taxes.

Concern #2: Waivers Granted With No Indication of Reasonable Cause

In reviewing descriptions on reasonable cause, it is clear that there are cases in which reasonable cause does not exist or at least is not documented. In some cases the description field was blank. The Legislative Auditor sampled some of the cases with no descriptions to review additional documentation in the case file. Upon receiving additional documentation it could be concluded that reasonable cause still did not exist in these cases. Appendix B provides a sample of approved waivers where reasonable cause does not exist. However, the list below provides the general wording within the descriptions of why these accounts received waivers.

- *The taxpayer promises to stay current;*
- *Waiver Granted as an Enticement to Taxpayer to clear up the account;*
- *The taxpayer requested the waiver;*

- *The taxpayer has been current since being on a payment plan;*
- *Taxpayer will be put on a payment plan;*
- *The taxpayer wants to clear up the account;*
- *The taxpayer has paid the interest and tax and is now current;*

As can be seen, these types of explanations for granting a waiver do not indicate why the taxpayer did not pay timely. Instead, the Compliance Division simply states that the additions to tax will be waived. In some cases, the Division justifies its decision simply by stating that the taxpayer is current or granting the waiver will clear up the account. This obviously *creates an inequity* between taxpayers who pay timely and those who pay the additions to tax when they pay late.

Concern #3: Waivers are Granted for Controllable Circumstances

From the descriptions provided, the Compliance Division waives additions for circumstances that are under the **control** of the taxpayer. For example, the Division's policy recognizes reasonable cause in cases when a taxpayer relies in good faith on *outside professionals* for advice on tax matters, filing of returns, or payment of taxes. The policy recognizes that the work of a contracted company is outside of the control of the taxpayer, and therefore would justify waiving additions to tax. The general rule of the waiver policy is that the taxpayer had no control over the delinquent payment of the tax. However, many waivers are granted when the taxpayer cites problems with its **own** employees. This does not constitute reasonable cause for a waiver because the taxpayer's employees are under the control of the taxpayer. Appendix C provides a sample of the complete description of approved waivers where the taxpayer's staff caused the late payment of tax. However, the general statements of these approved waivers are listed below:

- *Incompetent staff;*
- *Personnel problems;*
- *Mismanagement;*
- *Employee mishandled funds causing hardship.*

Concern #4: Issuance of Multiple Waivers to the Same Taxpayer

From calendar year 1995 to calendar year 1999, 30 taxpayers were approved for more than one waiver, totaling over \$433,000. The Compliance Division does not adequately monitor approvals of waivers for repeat offenders for similar if not the same reason, or for reasons that do not constitute reasonable cause. The Tax Department indicated that multiple waivers may not necessarily mean they were granted as separate or independent occurrences. The Department explained that:

Over a period of time as the taxpayers delinquencies became established or discovered (due to delays in our automated billing systems that we have previously discussed), separate entries were made in the log to clear the account.

This explanation suggests that because of delays in receiving information on a taxpayer's delinquency, some multiple waivers are actually for the same occurrence but they were entered separately. This may be true in most cases (63.9% of the amount of multiple waivers) since the difference in time between the first and second waiver is relatively short, 2 to 12 months (See Table 2). However, nearly 22% of the amount of multiple waivers has a difference in time of over 18 months. Furthermore, in these cases taxpayers are granted additional waivers for similar reasons, such as personnel problems, financial difficulty, etc. Although the total number of these types of cases is small, there is some indication that the Compliance Division does not adequately monitor multiple waivers. The Division may also want to consider a limit on how many waivers can be granted to the same taxpayer over a certain time period when the reasons are similar.

Table 2
Time Difference Between First and Second Waiver

Time Period	Number of Accounts	Total Amount Waived From Both Waivers	Percent of Total Amount Waived
Less than 12 months	11	\$277,028	63.9%
13 to 18 months	5	\$62,282	14.3%
19 to 24 months	4	\$52,089	12.0%
Over 24 months	10	\$42,423	9.8%
Totals	30	\$433,822	100.0%

Causes for the Lenient and Inconsistent Application of the Waiver Policy

Cause #1: The Compliance Division Does Not Take a Strong Stand Against Collection of Additions to Taxes of Delinquent Trust Fund Taxes

The Compliance Division's policy of not waiving additions on trust fund taxes when the reason is financial difficulty is appropriate because not paying to the State **someone else's taxes** is a violation of the trust established. The Division should hold this trust in the highest regard. However, the Division does not enforce this policy or apply it consistently. There are companies collecting consumer sales tax or withholding personal income taxes and then using these tax monies for purposes other than timely paying the State. As an example, Ohio's Tax Department will waive additions to taxes on trust fund taxes only by approval of the Tax Commissioner.

If the Compliance Division does not take a strong stand against delinquent payments of trust fund taxes, it is defeating the purpose of additions to tax. Additions to tax are to discourage delinquent payments. In these instances the Compliance Division gives many taxpayer breaks or

rewards the taxpayer for not paying trust fund taxes by waiving additions to tax. There is a significant difference when taxpayers cannot pay their **own** taxes, but when they do not timely pay someone else's tax that they have in their possession, the policy should be strictly followed.

The Tax Department indicated that its policy is that "normally" it does not grant waivers of additions to tax for trust fund taxes if the excuse is financial difficulty. However, the Department indicated that these taxpayers are not its "normal" accounts. The following is the Department's approach to these types of accounts:

The cases involving trust fund taxes in which additions to tax have been waived are not our normal accounts but are exceptions that require different treatment to ensure that the interest of the State is protected and that we collect this maximum amount of the delinquent tax, interest and additions to tax due the State. These taxpayer's are generally experiencing severe financial difficulties. They normally are indebted to the IRS, the Bureau of Employment Programs, financial institutions and other trade creditors. We are in competition with all of these creditors for a share of whatever money may be available, and we make every effort to work with the taxpayer and other creditors to reach a mutually acceptable resolution to the problem. In these cases, we do consider the taxpayer's financial condition to be reasonable cause for waiver, and we use waiver as a negotiating tool and incentive to the taxpayer to meet their State tax obligation.

For these taxpayers, instead of providing them differential treatment, the Department should consider having them go through the more stringent test of determining the taxpayer's ability to pay. This is a procedure that the Department is authorized to use but does not often exercise it, which is discussed in Cause #2. Instead, the Department leniently waives these additions to tax in these cases. This defeats the purpose of additions to tax which is to discourage delinquent payment, and it also **creates an inequity** among taxpayers who pay additions to tax and those who pay timely returns.

Cause #2: Compliance Division Does Not Sufficiently Put Taxpayers through the Higher Standard of Proof of the Taxpayer's Ability to Pay

Distinct from the process of waiving additions to taxes is the process of approving *Offers in Compromise (OIC)*. West Virginia Code §11-10-5q authorizes the State Tax Commissioner to accept offers in compromises from taxpayers on their tax liabilities. The Tax Department is allowed to compromise a tax liability for one or both reasons: 1) doubt as to whether the taxpayer actually owes the liability; or, 2) doubt that the liability can be collected in full. If there is doubt in collecting the entire tax liability, which includes the tax, interest, additions to tax, and penalties, it may be in the State's best interest to accept a lower amount. The basic difference between the OIC process and the process of waiving additions is that additions to tax are waived based on the standard of

reasonable cause, which is a lower standard than doubt of collectibility or liability. Also, the OIC process can be used not only for additions but for any part of the tax liability if there is doubt of collectibility.

The Department's Offer in Compromise process is a stringent test of the taxpayer's ability to pay. The taxpayer must make an offer that is a reasonable reflection of what can be collected. Documentation must be provided by the taxpayer indicating assets, debts, tax returns, etc. Consideration is given to whether more can be collected from the liquidation of assets or from present or future income than the amount that is offered. The goal is to collect what can actually be collected at the earliest possible time and at the least cost to the State.

The standard of establishing ability to pay under the OIC process is higher than the standard of establishing reasonable cause under the process of waiving additions to tax. However, **the Compliance Division often waives additions to tax under the lower reasonable cause standard when in fact reasonable cause is not the issue, ability to pay is the issue.** As indicated previously, there are 130 accounts that list financial difficulties as reasonable cause. In these cases, the Compliance Division does not indicate any reason why the taxpayer paid late except that the taxpayer is experiencing financial difficulty. Since these waivers are most likely for trust fund taxes, the excuse of financial difficulty is not reasonable cause. A sample of some of the types of reasons are briefly described below:

- *Financial hardship;*
- *Net loss on financial statement;*
- *Out of Business;*
- *This is all that could be borrowed;*
- *Hardship;*
- *Company may go out of business;*

It is clear that in these types of cases, the issue is not reasonable cause, but whether the liability can be collected. Therefore, these types of cases are viable candidates for an Offer in Compromise. Yet, the Compliance Division does not refer these accounts for an offer in compromise. Instead, it routinely waives the additions to tax under the lower standard of reasonable cause if the taxpayer agrees to pay the tax and interest. In fact, the Department's OIC process is used only when the amount the taxpayer can pay is something less than the tax and interest.¹ This is contrary to law which allows the OIC to be used when the amount offered is less than any part of the tax liability. In other words, if a taxpayer can pay the tax and interest but not the additions to tax, the taxpayer will avoid the stringent test of the OIC under the Department's use of the OIC. Had an OIC been pursued in these cases, it is possible that the Compliance Division would have also collected all or some portion of the additions to tax.

¹In each of the 38 OIC's for the past two years, the amount offered by the taxpayer is less than the amount of tax and interest.

The Legislative Auditor is not suggesting that everyone of these cases should have gone through an OIC. There are several accounts that had relatively small additions waived, (amounts less than \$100, etc.). However, many cases had relatively large amounts of additions waived, with the largest one-time waiver exceeding \$108,000. These types of cases should be considered for an OIC instead of inappropriately using the lower standard of reasonable cause. Table 3 illustrates the infrequent use of OIC's.

Table 3
Offers In Compromises
Total Number & Total Amount Reduced in Taxpayer's Liability

Year	Number of OIC's	Total Amount Reduced From Compromise	Median Reduction in Liability
1998	22	\$653,793	\$19,355
1999	16	\$3,486,609	\$6,979
<i>The median was used because in 1999 one account received a reduction in tax liability of over \$3.3 million.</i>			

There are two problems with this restrictive use of the OIC. One problem is that by law the OIC is to be considered when **any** part of the tax liability cannot be paid, not simply the tax and interest. Also, the Compliance Division's policy indicates that when reasonable cause does not exist but doubt of collectibility is the issue, then an offer in compromise is a viable option. The Compliance Division does not adhere to this policy. This creates differential treatment of taxpayers because a taxpayer whose liability does not include additions to tax will go through the more stringent OIC process. However, if you cannot pay your tax liability and it includes additions to tax, then your tax liability can be reduced by the amount of the additions to tax without going through the OIC process. The inequity can be seen in that 12 of the 38 OIC's over the last two years did not have additions to tax as part of the tax liability. Therefore, they went through the OIC process. Conversely, many taxpayers had additions to tax waived using the lower standard simply because they had additions to tax, even though reasonable cause did not exist. On an individual basis, the reduction in tax liability is far greater for taxpayers whose additions to tax were waived than those whose tax liability was reduced through the OIC process.

Another problem with the restrictive use of the OIC is that it treats additions to tax with a lower priority in these cases. By statute (West Virginia Code §11-10-4(d)), a tax is defined as including the tax due, the interest, additions to tax, and penalties. The legislative intent is for the Tax Department to have no less emphasis on collecting any part of the total tax liability. Also, West Virginia Code §11-10-18 states that:

*Additions to tax prescribed under this section of any tax shall be assessed, **collected**, and paid in the **same manner** as taxes. [emphasis added]*

Again, this indicates that there should be no more emphasis on collecting the tax and interest than on collecting additions to tax and penalties. However, it is clear through the restrictive use of the OIC that **the Compliance Division in many cases places more emphasis on collecting the tax and interest than it does on collecting additions to tax.** The Legislative Auditor understands that the Tax Department must consider the risk of not collecting anything and therefore, must consider sacrificing additions in order to collect some portion of the liability. However, when additions to taxes are waived inconsistent with policy and the OIC process is avoided, *the result is that differential treatment occurs*, the purpose for imposing additions is defeated, which is to discourage delinquent payments, and the State collects *less* tax revenue.

The Compliance Division Needs to Clarify Its Penalty Waiver Policy

After obtaining penalty waiving policies from our surrounding states, the Legislative Auditor concludes that the West Virginia Tax Department needs to update their penalty waiver policy. A higher standard needs to be placed on waivers concerning financial difficulty, especially ones involving a trust fund tax. States that recognize financial difficulty as reasonable cause use a higher evaluation before granting the waiver. The Compliance Division should also clarify their definition on uncontrollable circumstances and what reasons should be listed as uncontrollable (i.e., mismanagement, bookkeeper and personnel problems).

The current penalty waiver policy allows for uncertainty when approving waivers for taxpayers. When an agent denies a taxpayer a waiver for the same reason another agent approves a waiver for another taxpayer, the result is an inequity among taxpayers.

Recommendation 1:

The Compliance Division should adhere more consistently to its criteria for waiving additions to taxes. The Department should also consider establishing policy that provides limitations on multiple waivers.

Recommendation 2:

The Compliance Division should consider a more frequent use of the Offer In Compromise process in cases where trust fund taxes were not timely paid due to financial difficulty.

Recommendation 3:

The Compliance Division should improve its documentation of why taxpayers received a waiver of additions to tax, and improve its monitoring of multiple waivers.

APPENDIX A
Financial Difficulty

Financial Difficulty

Amount Waived	Reason for Waiver
\$3,867	Tp has been in financial problems and built new facility putting Tp in problems in taxes.
\$1,376	Hardship
\$8,908	Owner has expanded and hired more employees a cash flow problem resulted
\$53,038	Offer in compromise was denied. Will start Tp back upon TT. 1st payment reflected is above balance. Hardship corp officers have been assessed. Tp will pay 750 a month on trust fund taxes. Above items are Trust Fund only. Abatement only if Tp completes repayment agreement.
\$12,910	The business was financial trouble and The tax monies were used for other purposes. As of this date, all tax has been paid on the above REC billings. Tp is requesting int and additions be waived. I request/recommend that additions only be waived.
\$11,717	Due to poor cash flow, officers are paying debt of corp. and are not taking a salary. \$75,000 paid previously
\$6,678	Mismanagement, economic conditions, hardship
\$18,865	Hardship- negative net income for 97, Tp already on TT
\$5,194	Hardship will be on TT at 500 a month. 500 applied to delinquent billings. Prior payment of 3,708 paid
\$8,928	Loss of rental income resulted in cash flow problem. Owners applying for refinancing of the mortgage of the business
\$2,838	Drastic decrease in sales-Tp will be on TT. Tp lost two major contracts. Hardship
\$2,333	Tp has had decline in business finances. Hardship
\$3,588	Business lack of experience by two young boys parents now advising & supporting financial hardship see Tp letter
<i>Tp-Taxpayer</i>	<i>TT-Thumbtax(Payment Plan)</i>

APPENDIX B

No Indication of Reasonable Cause

No Indication of Reasonable Cause

Amount Waived	Reason For Waiver
\$3,472.68	Enticement to Tp to clear up account
\$1,318.80	Enticement to Tp to clear up account. Settlement
\$3,847.22	Tp requested waiver-waiting to pay account. Will pay \$2000 down and then approximately \$700 a month until paid in full.
\$10,269.02	Requesting waiver with each payment
\$8,745.89	Waiving per document as paid
\$5,721.31	First late filing in years has paid interest and tax
\$14,049.60	Paid tax in full. Payment plan for interest 400 a month. Waive additions
\$9,371.52	Tp was assessed, on a payment plan, wanted additions waived, paying in full with cashiers check
\$19,379.93	Taxpayer has previously paid tax interest and additions of \$64,633.84
\$1,110.61	Tp requested waiver so he could pay all in full and clear record
\$16,074.82	Payment Plan
\$10,646.97	Tp requests waiver of additions. Tp has sold business, tp paid tax and interest in full
\$1,592.00	Wants payment plan of 500 per month
\$2,939.12	Tp borrowed money from family members to pay off in 3 monthly payments
\$9,672.05	Oob. Payment plan, officer are paying back debt
\$12,508.40	Payment Plan, Tp requested waiver- has already paid approx 80,000 in tax due
\$785.50	Taxpayer requests waiver of additions. Tp paid tax and int in full
\$3,313.06	<i>No Definition Listed</i>
<i>Tp-Taxpayer</i>	<i>TT-Thumbtax(Payment Plan)</i>

APPENDIX C
Controllable Circumstances

Controllable Circumstances

Amount Waived	Reason for Waiver
\$6,232.26	Incompetent bookkeeper. Already in TT.
\$3,094.01	Bookkeeper problems.
\$15,620.30	Mismanagement and economy created his tax debts. Business is still operating, but at a much lower inventory level. Tp is filing/paying current taxes, but has unable to remit payments. I respectfully request we accept his request with the stipulation that his loan is approved and all tax/interest paid.
\$2,709.45	Inadequate handling by various personnel created delinquency and debt. Those areas have been corrected and taxpayer is filing/paying current. Tax/int was previously paid on statement #340929 for periods 7,8 9/96. Taxpayer has filed actual returns and paid int/taxes. Due to circumstances recommend and request waiver be approved.
\$650.00	Tp requested waiver due to poor accounting habits. Tp has acquired help to file taxes when required
\$6,787.29	Hardship-incompetent bookkeeper. Balance of Liability is for #906497 and will be set up on TT at 700 a month
\$742.94	Manager for business failed to perform tax filing duties. Once officers were made aware of delinquencies, tax info was complied and tax/int paid
\$2,780.51	As Tp states, mismanagement of tax money created delinquency. Delinquencies occurred during first year of operation. Tp is current and has acquired funds to pay tax/int through a bank loan
\$2,699.37	Problems with bookkeeper whom has been discharged. No other billings
\$2,384.06	Incompetent bookkeeper- Tp had a prior waiver. Tp is keeping current with me after my contact with him
\$3,320.20	Owner unaware that bookkeeper wasn't filing returns timely. bookkeeper signs the checks. Incompetent bookkeeper
\$627.00	Incompetence by employee responsible for completing taxes
\$3,649.29	Tp requests to clear records. Payoff all taxes - Bookkeeper failed to do job
\$5,641.11	Mis-management by partner of business monies. 3 brothers were not aware of problem lat Dec 1995. Business inactive 2/95 brothers borrowing money to pay tax and int. Hardship
<i>Tp-Taxpayer</i>	<i>TT-Thumbtax (Payment Plan)</i>

APPENDIX D
Multiple Waivers

Multiple Waivers

Business	Comments	Amount Waived	Date	Approx. Time Difference
1	History good. Request due to oversight.	\$84	11/18/99	30 months
	Bookkeeper problems	\$3,094	04/23/97	
2	Enticement to TP to clear up account	\$2,215	09/30/96	6 months
	Net loss on financial statement- received total of 96,473 to cover liability.	\$12,938	02/18/96	
3	Enticement to TP to clear up account. Settlement	\$1,319	09/30/96	17 months
	Net loss on financial statement.	\$2,215	03/12/98	
4	TP requesting. Trying to payoff as many doc as possible and put the rest on a payment plan. (This tp has trouble with HA) at 500 a month	\$5,983	07/21/97	16 months
	Same as (Taxpayer Name)- he is owner of both businesses per lexie	\$4,704	12/21/98	
5	Requesting waiver with each payment	\$10,269	11/18/99	2 months
	Waiving per document as paid	\$8,746	01/20/00	
6	TP was aware of tax liabilities but didn't have the money to pay. They had a lack of cash and experience significant problems with consistent cash flow. They are a critical access hospital and feel that due to changes in federal regulations their cash flow should improve significantly. They will make payments on balance due and should be able to pay in full by June, 1999.	\$104,935	03/10/99	10 months
	Taxpayer is paying the tax and interest and requested a waiver due to lack of cash. They are a critical access hospital and have experienced significant problems with consistent cash flow.	\$43,349	01/20/00	
7	TP will pay me 500 and will be on TT at 260 per month. Waiver to be accepted upon successful completion of payment plan. TP is on road driving truck so wife didn't pay bills. TP net diff is 6.47 month	\$803	11/20/96	13 months
	TP job, all returns filed hardship already on TT on prior billing	\$1,224	01/13/98	
8	TP has been struggling to keep his current taxes paid and make payment on back taxes. He was able to obtain money to pay this amount which will bring him current at this time	\$687	09/20/96	28 months

	Tp having difficult time keeping business open	\$1,049	02/23/99	
9	Poor location, tp selling business	\$3,001	04/26/99	2 months
	Business operates at loss most of the year. Acct on payment plan for 23,000	\$1,321	02/05/99	
10	Poor economic conditions - borrowed money from son to pay \$6854.06 - she is current in 96	\$1,982	06/10/96	41 months
	Wants to restructure business and can't get financing until this lien is paid	\$2,918	11/18/99	
11	Payment plan	\$16,075	09/26/95	13 months
	Payment plan	\$12,738	09/26/95	
	Tp has made previous payments of \$34,591 of which approx 6,000 applied to penalty. Tp asking for waiver of remaining penalty. Bal of tax and int paid with check	\$5,567	11/22/96	
12	Hardship will be on TT at 500 per month. 500 applied t delinquent billings. Prior payment of 3,708 paid	\$5,194	07/11/95	21 months
	Hardship- has incurred loss past five years. Waiver accepted only after successful completion of payment plan	\$6,220	04/03/97	
13	Old DW. Not pursued due to confusion between Auditing and Compliance. Tp thought it was paid in full 2 years ago. I wasn't sure until Agent reviewed audit file and found tax still due	\$1,407	10/27/95	3 months
	In lieu of payment plan Tp borrowed money to bring him up to date. Tp daughter now helping him with taxes. He promises to stay current in future	\$1,803	02/23/96	
14	Owner has expanded and hired more employees a cash flow problem resulted	\$8,908	05/28/97	20 months
	Tp able to obtain SBA loan for 65,000	\$17,777	02/17/99	
15	Incompetent bookkeeper- TP had a prior waiver. TP is keeping current with me after my contact with me	\$2,384	07/28/95	2 months
	Owner unaware that bookkeeper was not filing returns timely. Bookkeeper signs the checks. Incomplete bookkeeper	\$3,320	05/23/95	
16	Incompetence by employee responsible for completing taxes.	\$627	04/19/95	33 months
	Numerous administrative personnel changes over	\$109	02/11/98	

	the past years have caused confusion and mismanagement of taxes. Due to circumstances			
17	Tp job. House was refinanced and all liens did not get picked up due to indexing of lien book sat court house. Refinancing again. Hardship	\$2,851	08/17/99	46 months
	Tax and int.= \$8,457.67. Tp says finance company will loan him 8,000. Tp paid he could probably get balance from his mother. Hardship	\$1,083	09/25/95	
18	Tp had adds for 91 & 92 CST waived on 11/94 in the amount of 4,829. Tp feels these adds for 93 & 94 should be waived also. He has a letter of explanation attached	\$6,628	06/15/95	40 months
	Paid CST to Ky when office was located, by mistake. Later paid CST to WV after our contact. See letter from CPA attached	\$4,830	11/14/98	
19	Incompetent bookkeeper	\$133	03/22/99	2 months
	Incompetent bookkeeper	\$490	05/28/99	
20	Tp got loan hardship	\$918	03/30/96	46 months
	Financial hardship	\$636	02/03/00	
21	Has filed and paid outstanding returns in excess of 10,000 Int & Adds. No other liabilities	\$13,898	06/10/98	9 months
	Due to oil & gas prices at 5 year low, tp is unable pay at this time added to current TT payments	\$558	03/31/99	
22	Has a lot of sales tax due, but purchaser takes time in picking electronic items up, his wife didn't know she could file with no pay, no prior waivers done. Tp borrowed money	\$619	04/27/99	46 months
	Allows tp to start a new- business economics caused delinquent. Tp filed and paid current	\$927	07/14/95	
23	Due to computer error, tp found on their own, usually a timely filer, mistake within family due to illness	\$219	07/08/99	19 months
	See attached- microfilm	\$550	12/02/97	
24	Tp is current on pay plan could not pay 1998 annual. If these adds are not waived business may close	\$34,009	03/10/99	4 months
	Hardship due to loss from patients ability to pay	\$2,094	11/05/98	
25	Tp on payment plan- paying on time	\$278	12/02/96	5 months
	Tp secured a bank loan to pay off tax and int. He	\$6,061	05/01/97	

	has been a good tp since being on payment plan. He is current and I will monitor him			
26	Mismanagement, economic conditions, hardship	\$6,678	03/28/97	23 months
	Tp suffering from depression and anxiety under doctors care. Unable to operate bus correctly during this time period. He has improved greatly and is showing substantial improvement	\$6,548	03/03/99	
27	Problems with former bookkeeper cash flow problems due to slow insurance payments.	\$18,893	01/06/99	9 months
	Problems with former bookkeeper cash flow problems due to slow insurance reimbursement	\$4,936	04/07/98	
28	Tp had poor accountant who has not even given him back his records.	\$2,232	11/10/98	47 months
	Tp cant get former accountant to do anything on this estimated billing. Accountant has his records. This was a good estimated figure. There is no reconciliation	\$645	11/22/94	
29	John you wanted to follow up on this. Tp agreed with your request of 5,000 per month. U stated you would waiver her late charges. Tp is presently on TT. Upon receipt of approved waiver, I will have adds deleted & will up the payment amount to 5,000 from 3,000 per month	\$8,583	05/07/96	18 months
	Job-hardship	\$3,076	11/25/97	
30	Non profit agency had problems getting forms	\$493	04/23/97	30 months
	Cash flow problems, non profit organization	\$6,903	11/18/99	
	Cash flow problems. A non profit corporation tp has non filed and paid withholding due thru 11/99	\$3,118	01/20/00	

APPENDIX E

Transmittal Letter to Agency

WEST VIRGINIA LEGISLATURE
Performance Evaluation and Research Division

Building 1, Room W-314
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0610
(304) 347-4890
(304) 347-4939 FAX



Antonio E. Jones, Ph.D.
Director

May 26, 2000

Ron Stone, Deputy Tax Commissioner
State Capitol Complex
Building 1, Room W-300
1900 Kanawha Blvd., East
Charleston, WV 25305-0842

Dear Mr. Stone:

This is to transmit a copy of the preliminary performance review on the Tax Department. We would appreciate your response by Monday, June 5, 2000. We would like to meet with you Tuesday, May 30, 2000, or Wednesday, May 31, 2000, to discuss any questions related to factual errors, or if you need clarification on any part of the report.

Thank you for your cooperation.

Sincerely,

A handwritten signature in cursive script that reads "John Sylvia".

John Sylvia
Research Manager

JS/mdp

Enclosure

c: Jim Dixon

Joint Committee on Government and Finance
