

Department of Finance and Administration

Legislative Impact Statement

Bill: HB1681

Bill Subtitle: TO AMEND THE DEFINITIONS UNDER THE ARKANSAS TAX PROCEDURE ACT; AND TO PROVIDE THAT ERRONEOUSLY PAID REFUNDS ARE CONSIDERED UNDERPAYMENTS OF TAX AND ARE SUBJECT TO ASSESSMENT.

Basic Change :

Sponsor: Rep Jett

HB1681 clarifies the definitions of “tax deficiency” under the Arkansas Tax Procedure Act (TPA), § 26-18-101, et seq. In addition, the bill adds a new definition to the TPA for “erroneously paid refund” that will mean “a refund of tax received by a taxpayer that was not entitled to receive the refund.”

In addition, Arkansas law does not currently provide a clear mechanism to issue an assessment to recover a tax refund erroneously paid to a taxpayer. HB1681 is designed to permit the Department of Finance and Administration (DFA) to make an assessment to recover an erroneously paid refund.

Revenue Impact :

It is undetermined the amount of erroneously paid refunds that may be recovered through allowing DFA to issue an assessment that was erroneously paid to a taxpayer.

Taxpayer Impact :

A taxpayer that received an erroneously issued tax refund may be issued an assessment.

Resources Required :

None.

Time Required :

None.

Procedural Changes :

None.

Other Comments :

None.

Legal Analysis :

Under current law, interest can be assessed by the Department of Finance and Administration (DFA) on tax deficiencies. Tax deficiencies are currently defined in a complicated manner as the amount shown as the tax by the taxpayer on his or her return, if a return was made by the taxpayer, plus amounts previously collected without assessment as a deficiency. The definition of “tax deficiency” does not specifically include underpayments of tax, which are defined as the difference between the state tax paid and the amount required to be paid under the state tax law in question. These definitions

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have resulted in legal challenges to assessments of interest in instances where a taxpayer underpays the amount of tax due. HB1681 was requested by DFA in part to avoid future challenges to interest assessments by clarifying that the definition of tax deficiency to mean "the amount of tax due from a taxpayer that is not paid when due."

Under current law, DFA's authority to issue an assessment to recover erroneously paid tax refunds is not clear in the statutory language. An erroneously paid tax refund means a refund of tax received by a taxpayer that was not entitled to receive the refund. Successful challenges have been made in instances in which the Internal Revenue Service (IRS) has attempted to issue an assessment to recover erroneously paid refunds. For instance, in the case of *deRochemont v. U.S.*, 23 Cl.Ct. 80 (1991), the IRS issued a tax assessment against a taxpayer to recover a fraudulently induced refund; however, the Claims Court determined that, while the fraudulently induced refund gave rise to a debt, it did not amount to an assessment of tax for purposes of assessment statutes. To avoid challenges to assessments to recover tax refunds, other states, such as Minnesota, have specifically defined an "erroneous refund" to be an underpayment of tax subject to assessment. HB1681 was requested by DFA in part to specifically clarify that an erroneous refund is a tax deficiency subject to assessment for purposes of recovering the refund. The bill amends the definition of tax deficiency to include erroneously paid refunds and provides a mechanism under state law to issue an assessment to recover the refund, provide taxpayers with an opportunity to challenge the assessment, and provide DFA with post-assessment collection remedies (such as tax liens and writs of execution) to recover erroneously paid refunds.