Department of Finance and Administration

Legislative Impact Statement

Bill: HB1796
Bill Subtitle: TO AMEND THE TIME LIMITATIONS FOR TAX ASSESSMENTS, COLLECTIONS, REFUNDS, AND PROSECUTION; AND TO LIMIT THE TIME AVAILABLE FOR A TAX AUDIT.

Basic Change :

Sponsor: Representative Gates

HB1796 amends the Arkansas Tax Procedure Act, § 26-18-101 et seq. to change from ten (10) years to seven (7) years the time period for which a levy or a court proceeding can begin for the collection of a tax imposed by state law. The bill also adds a new subsection to § 26-18-306 that appears to prevent an audit of a tax if an assessment, payment, return, or refund occurred more than seven (7) years before the earlier of the date the relevant return was required to be filed or the date the relevant return was filed. The act is effective for tax years beginning on or after January 1, 2017.

Revenue Impact :

$15.1 Million in Annual Reduced State Tax Revenue Collections
[Impact based on FY2016 tax collections. $15,097,197 in state revenue was collected in FY2016 on past due debt aged from seven to ten years. Debts collected in FY2016 included: Corporation Income Tax - $3,831,092; Fiduciary Income Tax - $1,638; Income Composite Tax - $236; Individual Income Tax - $4,586,128; Sales and Use Tax - $5,628,621; and Withholding Wage - $1,049,482.]

It is unclear whether assessments and refunds due to IRS audits of periods more than seven years old will be affected in the future.

Taxpayer Impact :

Any outstanding tax debt on a taxpayer's account after a period of seven (7) years would no longer be collectable via levy or proceeding in court if the levy or proceeding had not begun within seven (7) years after the date of the assessment of the tax.

Resources Required :

Training, procedures manuals, and computer programs will need to be updated.

Time Required :

It would be difficult to implement these changes for tax years beginning on or after January 1, 2017. Since this would be a major change, it would be beneficial if the bill is passed to implement these changes for tax years beginning on or after January 1, 2018.

Procedural Changes :

Educate staff of the law change and modification of computer systems to delete tax debts after the passage of seven years from tax lien filing. Collections processes will need to be revised.

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Other Comments :

The bill is effective for tax years beginning on or after January 1, 2017. Therefore, existing assessments and audits will not be affected by the bill. Only debts arising from assessment of tax years beginning in 2017 and after will be subject to the change in policy. It is unclear whether assessments and refunds due to IRS audits of periods more than seven years old will be affected in the future.

Legal Analysis :

Section 1 of HB1796 reduces the time during which a levy or proceeding in court may be pursued to collect delinquent taxes. Currently, delinquent taxes may be collected by levy or proceeding in court within ten years following issuance of the tax assessment. HB1796 requires the levy or proceeding in court to occur within seven years of the date of the assessment. Under current law, the 10-year period for levy or action in court coincides with the 10-year period for which state tax liens are valid. If HB1796 is enacted, state tax liens will still be effective for ten years but no legal actions can be taken to collect on those tax liens by levy or proceeding in court during the last three years a lien is effective.

DFA currently collects money on tax liens through foreclosures filed by lenders during the last three years a lien is effective. Section 1 of HB1796 may prevent collection of those sale proceeds to pay toward the delinquent tax debt since the foreclosure is a proceeding in court. Similarly, delinquent taxes are also collected pursuant to a tax lien through a wage garnishment issued by a court. Those wage garnishments continue until paid and may cover wages received by the debtor for several years into the future. HB 1796 may limit the ability to collect delinquent taxes beyond seven years pursuant to periodic payments made in accordance with a wage garnishment. Also, federal bankruptcy law often prevents DFA from pursuing any collection activity against a delinquent taxpayer for up to five years. In this situation, DFA may have a dramatically reduced window during which tax collections can be pursued against a taxpayer who filed for bankruptcy protection if HB1796 is enacted.

Section 2 of HB1796 is unclear. Specifically, the meaning of the following language is uncertain: *"Tax assessments … are not subject to an audit … if the assessment … occurred more than seven (7) years before the earlier of the date the relevant return was required to be filed or the date the relevant return was filed."* DFA does not audit tax assessments. DFA issues tax assessments in accordance with state law following an audit. Current law does not contain a specific limit on when an audit may be conducted. Instead, current law provides limits on when an assessment of tax may be issued. Those limits provide that an assessment of tax may not be made after the expiration of three years from the date the return was required to be filed or the date the return was filed, whichever expires later. However, if the taxpayer understates the amount of tax due by more than 25%, the tax may be assessed prior to the expiration of six years from the date the return was required to be filed or the date the return was filed, whichever expires later. In the case of a fraudulent return or a taxpayer's failure to file a return, current law allows an assessment at any time.

If the goal of Section 2 of HB1796 is to limit the amount of time for DFA to conduct audits, then Section 2 will have no impact except to limit audits resulting from fraud or failure to file a tax return. Current law provides that all other tax assessments must currently be made in less than seven years so a 7-year limitation on conducting audits, other than those audits resulting from fraud or failure to file, will have

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no practical effect. If the purpose of HB1796 is to extend the time period for DFA to conduct an audit to seven years, the language limiting DFA's ability to make a tax assessment should also be extended. Otherwise, there would be no reason to conduct an audit beyond the current 3-year or 6-year limitation period for making an assessment.