

Final Report

EVALUATION OF
CORPORATE INCOME
TAX PROCESSING

PROGRAM EVALUATION DIVISION
Office of the Legislative Auditor
State of Minnesota

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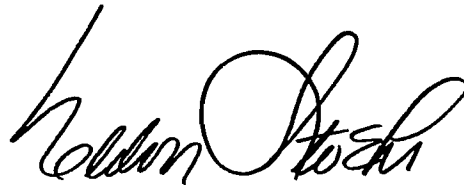
March 17, 1981

PREFACE

This report examines the Department of Revenue's performance in administering the state's corporate income tax laws. It is part of a broader Program Evaluation Division study of income tax processing and auditing. A second report will assess the department's performance in using and developing computerized tax processing systems and a third report will examine individual income tax processing and auditing. The study was authorized by the Legislative Audit Commission.

In this report we indicate several specific inadequacies in the department's corporate income tax processing system, particularly the department's inability to detect timely and adequate payment of tax liabilities. But even more alarming, the department has failed to establish clear, consistent, and coordinated policies and procedures for the administration of the state's corporate income tax laws. As a result, the department's work is fragmented, often duplicative, and can result in inconsistent taxpayer treatment. We believe that the department's performance should be and can be significantly improved. To that end we make numerous recommendations throughout this report.

We thank the department for cooperating with our study and hope that our report will be viewed as constructive and useful. SherryENZler is the author of this report. She received assistance from Allan Baumgarten and Ed Burek, who was project manager for the study.



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March 17, 1981

PROGRAM EVALUATION DIVISION

The Program Evaluation Division was established in 1975 to conduct studies at the direction of the Legislative Audit Commission (LAC). The division's general responsibility, as set forth in statute, is to determine the degree to which activities and programs entered into or funded by the state are accomplishing their goals and objectives and utilizing resources efficiently. A list of the division's studies appears at the end of this report.

Since 1979, the findings, conclusions, and recommendations in Program Evaluation Division reports are solely the product of the division's staff and not necessarily the position of the LAC. Upon completion, reports are sent to the LAC for review and are distributed to other interested legislators and legislative staff.

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EXECUTIVE SUMMARY

Our study of the Department of Revenue's corporate income tax processing system addressed three major issues:

- Adequate Payment of Corporate Liabilities: Are present programs sufficient for detecting adequate and timely payment of corporate tax liabilities? Are such programs equitable and consistent with statutory requirements?
- Development and Coordination of Policies and Procedures: Does the Department of Revenue effectively control and coordinate the corporate tax processing system to ensure the efficient and timely processing of corporate tax payments and forms?
- Communication: Is communication between the various organizational units involved in corporate tax processing sufficient to ensure an orderly processing system?

A. ADEQUATE PAYMENT OF CORPORATE LIABILITIES

We found that present procedures for detecting adequate and timely payment of corporate tax liabilities and for making adjustments were not always effective, equitable, or consistent with statutory requirements.

The Department of Revenue does not maintain an ongoing program to verify the appropriate and timely payment of quarterly declaration payments despite the requirements of Minnesota Statutes §290.934 (1978). Approximately 12,000 of the 39,000 corporations filing Minnesota corporate income tax returns file declarations of estimated tax. In addition, 81 percent of all revenue collected through Minnesota corporate income tax is collected by the declaration system. The need to verify the timeliness of declaration payments is illustrated by the following findings:

- Despite statutory requirements to file appropriate and timely declaration payments, approximately 18 percent of the corporations with a Minnesota taxable income over \$100,000 had delinquent or inappropriate declaration payments in 1978 which were undetected.
- The Department of Revenue does not regularly impose interest on delinquent quarterly declaration payments despite statutory requirements to do so. Additional monies assessed could equal as much as \$400,000 per year.

While our evaluation of the corporate income tax auditing system was cursory, we did find inadequacies in the present corporate tax auditing system which allow for inequitable treatment of taxpayers:

- The Department of Revenue does not review corporate returns to ensure that all corporations requesting extensions file a year-end return. Present policies allow small corporations which fail to file a year-end return to go undetected.
- The audit program for corporate estimated declaration payments is designed to catch only a limited number of offenders. The detection system applies more stringent criteria to small corporations than to large corporations.

The assessment of interest and penalty on both delinquent tax liabilities and additional tax liabilities is conducted by various organizational units throughout the Department of Revenue. Our evaluation demonstrated that in many cases present policies allow for inconsistent treatment of taxpayers and in one case violated statutory requirements.

- The Department of Revenue has not always assessed interest and penalties on underpayments of corporate tax.
- Inconsistencies in statutory provisions and lack of policy guidance for calculating interest and penalty have resulted in inconsistent treatment of similar taxpayers.

B. DEVELOPMENT AND COORDINATION OF POLICIES AND PROCEDURES

We found that the Department of Revenue has failed to establish consistent processing procedures to coordinate the corporate income tax processing system.

The processing of corporate income tax returns is a recurring function of the Department of Revenue and requires a processing system which is well-defined, cohesive, and can be easily identified by all organizational units involved in the processing of corporate returns. The lack of such a cohesive system has resulted in the following:

- The Department of Revenue does not maintain updated procedural manuals for processing corporate tax returns, and, as a result, individual organizational units must create their own manuals or adopt guidelines from other units.
- The development of processing procedures by the organizational units involved in corporate tax processing has resulted in the use of several contradictory sets of criteria

for processing like cases, therefore resulting in inconsistent treatment of taxpayers.

- The lack of policy guidance has caused gaps in the present processing system. Refund warrants are not verified against outstanding liabilities, the department has no program for detecting extension nonfilers, and the timeliness of quarterly declaration payments is not verified.
- There is a needless duplication of certain processing functions, including collection of delinquent tax liabilities.

Procedures which do exist for assessing and collecting verified underpayments are not cost effective or effectively executed. For example:

- Present manual billing costs exceed \$9.00 per bill. Billing costs could be reduced to \$.05 per bill if billings were conducted by the computerized Accounts Receivable system.
- 33 percent of the underpayment discrepancies we reviewed were not in fact underpayments, but were errors attributable to the absence of guidelines for processing unidentifiable tax payments. Many incorrect billings could have been avoided with department-wide guidelines and better planning of computer systems prior to development.

The development of a cohesive corporate tax processing system requires information concerning the number and types of corporate returns to be processed. Such data would include the number of corporations filing installment returns, declarations, and extensions, as well as the number of returns subject to each phase of processing. In addition to maintaining this data, it is imperative that the organizational units involved in corporate processing have access to it. At present, the Department of Revenue does not maintain the data needed to define the corporate tax processing system. For example:

- Data pertaining to the number of corporate returns verified, the number of underpayments detected, and the number of corporations filing declarations are not maintained by the department. Such data is essential for long-range planning.
- Data maintained on the various computerized systems are not always the data which would be of most use to units involved in corporate tax processing.

The bulk of corporate tax processing is done manually, leading one to expect a certain number of time lags. Nonetheless, we believe that by any reasonable standard the Department of Revenue takes too long to perform this important, ongoing function:

- An average of eight months elapses between filing of a corporate return and completed verification.
- Corporations with verified underpayments were issued three billings over more than six months before their accounts were entered into the Accounts Receivable system.
- Extension verification takes close to two months because of the lack of updated Extension Master Lists.

SUMMARY OF RECOMMENDATIONS

The following pages list the recommendations made throughout this report. While we feel it is useful to draw these together in a single list, a thorough understanding of these points requires reference to the text of the report.

DETECTING ADEQUATE PAYMENT OF CORPORATE LIABILITIES

- The Department of Revenue should regularly verify the timeliness and appropriateness of quarterly payments as required by the provisions of Minnesota Statutes §290.934 (1978).
- Corporations with delinquent quarterly payments should regularly be assessed an underpayment charge at the rate of 8 percent for the duration of the delinquency.
- The Department of Revenue should consider proposing legislation to increase the 8 percent interest rate required by statute to a level which reflects interest rates in the present economy.
- The Department of Revenue should routinely examine extension applications and cross-check them with year-end returns to ensure that corporations which have been granted an extension file a year-end return.
- The department's auditing program for corporate declaration payments should be re-evaluated and re-designed to provide for a more equitable system of audit selection. The department could consider, at some future date, the development of a computerized corporate declaration match program to perform this function.
- The Department of Revenue should coordinate and review its procedures to ensure that both interest and penalty are imposed on delinquent tax liabilities in a uniform and equitable fashion.

DEVELOPMENT AND COORDINATION OF POLICIES AND PROCEDURES

- The Department of Revenue should document the present corporate tax processing system and the documentation should be compiled in a procedural manual to be distributed to all units.

- Once the system is documented, the Department of Revenue should undertake a review of the corporate tax processing system with the intent of streamlining and coordinating the present manual system.
- The Department of Revenue should consider developing standard, department-wide policies for assessing interest and penalty as well as setting standardized audit cut-offs. Such policies are necessary to ensure the consistent treatment of taxpayers.
- The Department of Revenue should enter all underpayment billings on the Accounts Receivable system upon identification. Neither the Accounting Unit nor the Corporate Audit Unit should be involved in the notification of corporations and collection of corporate tax liabilities once an underpayment has been identified.
- The Department of Revenue should issue department-wide policies and guidelines for the processing of unidentifiable tax payments. These policies should be transmitted to all units involved in corporate tax processing.
- The Department of Revenue should not allow corporations with delinquent tax obligations to transfer payments made on the present tax year to a previous year's liability.
- The Department of Revenue should identify the number and types of documents processed at each step of the corporate tax processing system. Data pertaining to the department's workflow should be maintained at a central point in the department.
- The Department of Revenue should re-evaluate the usefulness of information stored on the various computer systems.
- After documenting the corporate tax processing system, the Department of Revenue should streamline the system and identify bottlenecks which delay processing.

INTRODUCTION

We have evaluated the Minnesota Department of Revenue's procedures for processing Minnesota corporate income tax. This evaluation, conducted as part of an evaluation of state income tax processing and auditing, addresses these issues:

- Adequate Payment of Corporate Liabilities: Are present programs sufficient for detecting adequate and timely payment of corporate tax liabilities? Are such programs equitable and consistent with statutory requirements?
- Development and Coordination of Policies and Procedures: Does the Department of Revenue effectively control and coordinate the corporate tax processing system to ensure the efficient and timely processing of corporate tax payments and forms?
- Communication: Is communication between the organizational units involved in corporate tax processing sufficient to ensure an orderly processing system?

For the purposes of this report, the term "corporate tax processing system"¹ is defined as the methods used by the Department of Revenue to manage the collection, deposit, and audit of the Minnesota corporate income tax and accompanying forms as required by Minnesota state law. This processing function can be divided into three phases: collection of estimated corporate income tax; collection of year-end tax liabilities and accompanying forms; and procedures for auditing corporate tax returns and processing audit adjustments as appropriate.

At present, the Department of Revenue does not maintain updated processing manuals for the corporate income tax processing system. Consequently, it was necessary to interview Department of Revenue personnel involved in all phases of the processing system. Each person interviewed was asked to describe the phase of processing in which he was involved, identify problem areas, and describe the remaining portions of the processing system as he understood them to be implemented.

From the initial interviews a description of the processing system was derived and problem areas were identified. (Organizational units involved in corporate tax processing are identified in Appendix A.) In addition, information provided was used to identify factors to be examined in the following data searches, which we conducted:

¹Unless specifically stated, the term "system" does not refer to computerized processing systems operated by the Department of Revenue.

Declaration Accounts: 284 corporate accounts from 1978 were examined. (A further breakdown of these accounts by Minnesota taxable income is found in Appendix B.) Accounts were examined to assess the timeliness of quarterly payments and to verify the amount of quarterly payments. Accounts indicating discrepancies were noted and their tax history files were pulled so that the year-end tax returns for years ending in both 1977 and 1978 could be examined.

Extensions: 113 accounts from the Declaration Master File were identified as having made extension payments. Tax history files were pulled for the 113 accounts in order to examine the timeliness and the amount of extension payments.

Verification of Year-End Returns: Corporate verification procedures in the Accounting Section were monitored for a two-month period between April 15 and June 15, 1980, in order to estimate the number of returns verified against the Declaration Master File and the number of discrepancies detected within a given time frame.

Verified Overpayments: Records maintained in the Corporate Audit Section of the Income Tax Division were examined to review the processing of corporate overpayments between January 1 and June 30, 1980. A total of 124 accounts were examined to determine the method of adjustment, the length of time after the filing date needed to make adjustments, and the method used to calculate interest on refunds.

Verified Underpayments: 170 first corporate billings and any subsequent billings issued over a six-month period by the Accounting Section were examined to review the processing of verified underpayments. In addition, 60 underpayment accounts processed by the Corporate Audit Section were examined.

Installment Payments: 10 percent (143 out of 1,435) of all installment accounts due June 15, 1980 were examined to verify the timeliness and the amount of second-installment payments.

Audited Returns: 75 audit reports were reviewed to identify the methods used by the Department of Revenue to assess interest and/or penalty on refund and additional liability adjustments.

I. DETECTING ADEQUATE PAYMENT OF CORPORATE TAX LIABILITIES

This chapter presents our evaluation of the Department of Revenue's procedures for detecting adequate and timely payment of corporate income tax liabilities and the processing of audit adjustments. In general we found that procedures for detecting adequate and timely payment of corporate tax liabilities and making adjustments therein are not always equitable, effective, or consistent with statute:

- The Department of Revenue does not maintain an ongoing program to verify the appropriate and timely payment of quarterly declaration payments of estimated tax despite the requirements of Minnesota Statutes §290.934 (1978).
- There are inadequacies in the present corporate tax auditing system which allow inequitable treatment of taxpayers.
- The Department of Revenue has not always imposed interest on underpayments of corporate tax.

These findings are discussed in three major sections focusing on delinquent declaration payments, gaps in the present auditing system, and the assessment of interest on verified underpayments.

A. VERIFICATION OF DECLARATION PAYMENTS

THE DEPARTMENT OF REVENUE DOES NOT MAINTAIN AN ONGOING PROGRAM TO VERIFY THE APPROPRIATE AND TIMELY PAYMENT OF QUARTERLY DECLARATION PAYMENTS OF ESTIMATED TAX DESPITE STATUTORY REQUIREMENTS TO DO SO.

Minnesota Statutes §290.931, subd. 1 (1978) requires all corporations whose Minnesota income tax liability is estimated to be \$1,000 or more to file a declaration of estimated tax by the 15th day of the third month of the corporate fiscal year. Payment of the declaration is to be made in four quarterly installments due in the third, sixth, ninth, and twelfth month of the corporate fiscal year. Statutory requirements [Minn. Stat. §290.934 (1978)] also provide that late quarterly payments be regarded as delinquent tax. Interest is to be assessed from the date the payment was due to the date on which payment was remitted or the due date of the year-end return, whichever occurs first.

Under present department processing procedures, quarterly declaration payments are not reviewed at the close of the tax year to verify timeliness and accuracy; thus corporations are not routinely

assessed interest for delinquent quarterly installments. The timeliness of quarterly declaration payments is only verified when a corporate return is selected for audit by the Department of Revenue's audit program for corporate estimated declaration payments. To be selected for audit, a corporation must have underpaid its total declaration. The timeliness of declaration payments is not a selecting factor.

- Despite statutory requirements to file appropriate and timely declaration payments, approximately 18 percent of the corporations with a Minnesota taxable income over \$100,000 had delinquent or inappropriate declaration payments in 1978 which were undetected.

According to Department of Revenue data, approximately 12,000 of the 39,000 corporations filing Minnesota corporate income tax returns file declarations. In addition, 81 percent of all revenue collected through the Minnesota corporate income tax (\$329,136,000 in declaration payments for 1980) is collected via the declaration system. Despite this, the Department of Revenue does not detect delinquent or inappropriate quarterly payments on a regular basis.

In order to estimate the number of corporations which make delinquent declaration payments but are not detected by the Department of Revenue, we examined a sample of 284 corporate accounts. The sample was stratified by Minnesota taxable income, the majority of which had a Minnesota taxable income exceeding \$100,000. While these large corporations account for less than 10 percent of all corporate returns filed in Minnesota, they account for 80 percent of the Minnesota corporate income tax collected in 1978.

We estimate that during 1978 roughly 18 percent of these large corporations had delinquent or inappropriate payments which were not detected by the department's audit program. This estimate excludes corporations which assessed themselves by filing the required Form M-429C, "Statement Relating to Underpayment of Estimated Income Tax by Corporations" (see Appendix C) with the year-end return.

- The Department of Revenue does not regularly impose penalty on delinquent or inappropriate quarterly declaration payments despite requirements of Minnesota Statutes §290.934 (1978). Additional monies assessed could equal as much as \$400,000 per year.

We found that because the Department of Revenue fails to detect delinquent quarterly payments on a regular basis, it also does not impose interest on delinquent quarterly accounts. In order to estimate the amount of additional interest charges which could be assessed, we examined a sample of 284 corporate accounts stratified by Minnesota taxable income. Using the procedures defined by the Corporate Audit Section, we estimate that approximately \$400,000 in additional interest could have been charged on delinquent declaration payments in 1978. In short, by failing to verify the timeliness and

appropriateness of quarterly payments and assessing interest, the Department of Revenue is providing interest-free loans to corporations which fail to remit their declaration payments in a timely fashion. Furthermore, given the fact that borrowing rates in the economy exceed the 8 percent statutory interest rate on delinquent liabilities, there may be a greater incentive to file delinquent payments even if statutory provisions pertaining to delinquent quarterly payments were enforced. Present federal policies provide for an adjustment of the federal interest rate as the prime rate changes. The Internal Revenue Service is currently using an interest rate of 12 percent.

Based on our analysis of the Department of Revenue's procedures for verification of quarterly declaration payments, we recommend that:

- The Department of Revenue should regularly verify the timeliness and appropriateness of quarterly declaration payments as required by the provisions of Minnesota Statutes §290.934 (1978).
- Corporations with delinquent quarterly payments should regularly be assessed an underpayment charge at the rate of 8 percent for the duration of the delinquency.
- The Department of Revenue should consider proposing legislation to increase the 8 percent interest rate required by statute to a level which reflects interest rates in the present economy.

B. AUDITING PROCEDURES

THERE ARE INADEQUACIES IN THE PRESENT CORPORATE INCOME TAX AUDITING SYSTEM WHICH ALLOW INEQUITABLE TAXPAYER TREATMENT.

Corporate income tax audit selection is conducted by the Field Operations Division and by the Corporate Audit Section of the Income Tax Division.¹ These units maintain separate audit selection programs. The Field Operations Division bases its selections on a review of tax history files, while the Corporate Audit Section makes its selection based on a review of corporate returns during year-end processing. According to both organizational units, there is insufficient interaction between the two. While our evaluation was cursory, two findings were obvious: the Department of Revenue does not have an extension nonfiler program nor is Revenue's present audit program for detecting appropriate payment of estimated tax equitable.

¹The Department of Revenue has recently changed this practice. A central Audit Selection Unit now exists.

- The Department of Revenue does not review corporate returns to verify that all corporations requesting extensions file a year-end return. Present policies would allow small corporations which fail to file a year-end return to go undetected.

The Corporate Audit Section of the Income Tax Division does maintain a nonfiler program. The program entails an examination of sales and withholding tax information and a review of Internal Revenue Service audits. Corporations that file sales, withholding, or federal information, but fail to file a Minnesota corporate income tax return are noted for future audit. In addition, the Field Operations Division regularly reviews tax history files of all corporations with large net incomes. Neither program ensures that corporations requesting extensions have filed their year-end return.

An examination of extension records indicates that corporations could easily file an extension request and fail to remit a year-end return. We found that at least 4 out of 113 corporations with extensions failed to file year-end returns for the year in which they requested an extension. Furthermore, Central Files was unable to locate records of tax history files for 11 additional corporations. This occurred even though information on the Declaration Master File indicated that these 11 corporations had requested extensions in several previous tax years and therefore should have had active tax history files. While it could be argued that the nonfiler rate is low in this instance and the nonfilers noted are relatively small corporations, the fact remains that there is little to prevent a small corporation from repeatedly failing to file a year-end return.

- The audit program for corporate estimated declaration payments is designed to catch only a limited number of offenders. The detection system applies more stringent criteria to small corporations than to large corporations.

A second weakness in audit selection procedures used by the Department of Revenue is the criteria used in the audit program for corporate estimated declaration payments. Although the program provides a means to detect corporations which are not in compliance with declaration requirements, it detects only a limited number of gross offenders. The program is designed to flag only those corporations which have a tax liability above a certain level and which have paid less than 50 percent of that liability through the declaration system. A printout of all corporations identified by this routine is forwarded to the Corporate Audit Section for auditing purposes. Technically, a corporation is normally required to pay its previous tax-year's liability minus \$1,000. Thus, a small corporation may be flagged for a small monetary violation while a larger corporation must grossly underfile before it will be flagged by the system.

¹We are unable to publish additional details on the audit selection criteria because the Department of Revenue considers this information to be classified.

Furthermore, the audit program fails to detect late quarterly payments. It is the Department of Revenue's policy that the detection of untimely quarterly payments is an auditing function, yet the timeliness of quarterly payments is verified only if it is determined that the corporation did not remit the appropriate payment. Consequently, corporations which remit the appropriate payment but fail to do so until the third or fourth quarter are never detected.

As a result of our evaluation of present corporate income tax auditing systems, we recommend the following:

- The Department of Revenue should routinely examine extension applications and cross-check them with year-end returns as they are filed to ensure that corporations which have been granted an extension file a year-end return.
- The department's auditing program for corporate declaration payments should be re-evaluated and re-designed to provide for a more equitable system of audit selection. The department could consider, at some future date, the development of a computerized corporate declaration match program to fulfill this function.

C. IMPOSITION OF INTEREST AND PENALTIES

PROVISIONS FOR ASSESSING INTEREST AND PENALTY ON DELINQUENT TAX AND ADDITIONAL TAX LIABILITIES HAVE NOT ALWAYS BEEN EQUITABLE OR CONSISTENT WITH STATUTE.

The assessment of interest and penalty on both delinquent tax liabilities and additional tax liabilities is conducted by various organizational units throughout the department. Our evaluation demonstrated that in many cases present policies allow for inconsistent taxpayer treatment and in one case violated statutory requirements.

- The Department has not always assessed interest and penalties on underpayments of corporate tax.

At the time our study was begun the Department of Revenue did not assess interest on corporate underpayments identified by verification. This occurred despite the fact that Minnesota Statutes §290.53 (1978) specifically requires that a 10 percent penalty be levied on the underpayment and that interest be assessed on the amount of the underpayment plus penalty at the rate of 8 percent for the duration of the underpayment.

Over the six-month¹ period for which we examined underpayment discrepancy billings, the Accounting Section issued notifications of underpayments totaling \$300,083. However, prior to examination of the Department of Revenue's files by the Office of the Legislative Auditor, not a single corporation had been billed interest or penalty on identified underpayments. A review of potential interest receipts based on billings issued between January and June 1980 demonstrated that had interest been assessed and collected on underpayment billings which had not been cancelled, the Department of Revenue could have collected an additional \$10,000. This sum would have covered over one-half of the cost of running the verification program. As a result of our evaluation, the Department of Revenue is now assessing interest and penalty on verified underpayments.

- Inconsistencies in statutory provisions and lack of policy guidance for calculating interest and penalty result in inconsistent treatment of taxpayers.

Because of ambiguities in the statutes and varying interpretations by the Department of Revenue, delinquent tax obligations resulting from taxpayer error may be treated differently.

For example, if a taxpayer makes an error on line 33 of the year-end return by overstating the amount of money the corporation has paid in quarterly estimated tax, the error would be detected in the verification of tax payments. At the time of our evaluation, the department was simply billing the corporation for additional tax without imposing interest or penalty on the obligation. However, since this fact was brought to the attention of the department, the department began to impose interest and penalty under provisions specified in Minnesota Statutes §290.53, subd. 1 (1978). This statute specifies that a taxpayer should be billed for the additional tax plus a 10 percent interest penalty, plus interest on both the additional tax and the penalty.

If a second corporation understated its taxes for an identical amount on any line other than line 33, it would be detected by the corporate audit staff and the corporation would be billed for the additional tax plus interest. Only if the taxpayer failed to respond promptly to the billing would a penalty be imposed. This treatment is justified under the provisions of Minnesota Statutes §290.46. This statute requires that the department audit corporate returns to determine the accuracy of the tax obligation as identified by the corporation. If an additional liability is owed the state, the department is to

¹The Department of Revenue makes a distinction between notifications of underpayments issued by the Accounting and Corporate Audit Sections and billings. However, we feel that because such notifications require payment of the underpayment plus interest and penalty or verification of previous payment, a notification may be considered a billing. A copy of a notification of underpayment is found in Appendix D.

demand payment along with interest. [Minn. Stat. §270.72, subd. 1 (1978).] This statute requires that only interest be imposed; penalty is not imposed unless the corporation fails to respond to the notification informing it that an additional tax liability is owed.

In a third case, a corporation could owe an "underpayment" tax charge stemming from its failure to remit quarterly declaration payments. Technically, corporations are to self-assess interest and penalty for any underpayment of quarterly declaration payments on Form M-429C and are required to state the total additional tax charge on the year-end return. Interest is imposed for the duration of the underpayment as specified in Minnesota Statutes §290.934, subd. 3 (1978), which defines the duration of the delinquency as a period to extend from the date the quarterly payment should have been paid to the date payment was made or the due date of the year-end return. It could be argued that under the provisions of Minnesota Statutes §290.53 the underpayment charge is, in fact, an additional tax charge to be added to the tax due and subject to assesment of interest and penalty. Underpayment charges are not subject to such interpretation, however. Rather, based on the provisions of Minnesota Statutes §270.75, the department has argued that underpayment charges should not accrue interest and penalty.

In summary, our study demonstrated that in cases where a corporation has been subject to an audit, if payment is prompt, the corporation will only be billed for the additional tax obligation plus interest. In cases which are thought to be processing in nature, normally enforced by processing units, a corporation will be billed for additional tax plus a 10 percent penalty on the delinquent obligation plus interest. Generally, issues relating to the timeliness of corporate tax payments are handled in processing units. This implies that how a taxpayer will be treated depends on whether the department considers a particular type of error to be audit-related or processing-related. In fact, there is not a clear distinction between these functions, and assignment of a particular case into one category or the other is, to some extent, arbitrary.

We recommend:

- The Department of Revenue should coordinate and review procedures to ensure that both interest and penalty are imposed on delinquent tax liabilities in a uniform and equitable fashion. The development of a uniform assessment policy may require some statutory changes.

II. DEVELOPMENT AND COORDINATION OF POLICIES AND PROCEDURES

This chapter examines the Department of Revenue's ability to manage and oversee the corporate income tax processing systems. In general we found that the Department of Revenue has failed to establish consistent processing procedures and coordinate the corporate income tax processing system:

- The Department of Revenue has failed to develop a coherent and documented corporate tax processing system.
- Procedures which do exist for assessing and collecting verified underpayments are not cost effective.
- The Department of Revenue does not maintain information which could be used to measure the flow of returns through the corporate income tax processing system.
- Ineffective coordination of the corporate tax processing system has caused excessive delays in processing returns.

These findings are discussed in four major sections focusing on identification of the present processing system, verified underpayment processing, identification of workflow, and delays in processing.

A. DEVELOPMENT AND DOCUMENTATION OF PROCESSING PROCEDURES

THE DEPARTMENT OF REVENUE HAS FAILED TO DEVELOP A COHERENT AND DOCUMENTED CORPORATE INCOME TAX PROCESSING SYSTEM.

The processing of corporate income tax returns is an on-going function of the Department of Revenue which requires a processing system which is well-defined, cohesive, and which can be easily identified by all organizational units involved in the processing of corporate returns. Our evaluation has demonstrated that such a system does not exist. The failure of the department to provide such a system has resulted in a piecemeal processing system characterized by duplication of effort and processing gaps.

- The Department of Revenue does not maintain an updated procedural manual for processing corporate tax returns. Consequently, individual organizational units must create their own guidelines or adopt them from other units.

The department has not maintained an updated procedural manual delineating the steps in the processing system, the flow of

returns through the processing system, and the responsibilities of the various organizational units involved in corporate tax processing. The absence of a departmental manual for corporate tax processing has resulted in a poorly defined system which hampers the effective processing of corporate tax returns.

In an attempt to define some aspects of tax processing, a few sections have developed their own procedural and policy guidelines. Such guidelines are developed independent of policies developed by other units involved in the corporate tax processing system. As a result, the written procedures that do exist are piecemeal. For example, three sets of guidelines now exist which identify how interest and penalty are to be assessed on untimely returns or audit adjustments.

Some sections have attempted to fill the policy void by requesting policy guidance from other units. In the past the Cashier Section, for example, sought guidance from the Corporate Audit Section of the Income Tax Division, a unit with an auditing function and therefore a greater familiarity with statutory requirements. Yet the Corporate Audit Section has been generally reluctant to provide the needed guidance, and when guidance is provided, according to Cashier personnel, the Cashier Section is often instructed to perform traditional audit functions.

- The development of processing procedures by the several organizational units involved in corporate tax processing has resulted in the use of several sets of contradictory criteria for processing like cases. The use of several uncoordinated processing procedures promotes inconsistent taxpayer treatment.

First, base discrepancy figures used by the department in like cases vary. Sections within the Administrative Services Division use one base discrepancy figure (tax adjustments below this amount are not made), while the Corporate Audit Section of the Income Tax Division uses a smaller base discrepancy figure. Consequently, whether action is taken on a discrepancy which demonstrates an overpayment or an underpayment of corporate tax liabilities can depend on which organizational unit identifies the discrepancy. While Minnesota Statutes §270.07, subd. 3 (1978) does provide that a cost effective base discrepancy figure may be established by the Department of Revenue, it is reasonable to assume that the same base figure should be used by all organizational units involved in processing corporate tax returns.

Second, three contradictory policies for the assessment of interest and penalty are maintained within the department. Three independent policies have been issued by three organizational units within the Department of Revenue (the Field Operations Division; the Steno Section, Income Tax Auditing Division; and the Corporate Audit Section of the Income Tax Auditing Division) defining procedures for assessing interest and penalty on untimely returns and corporate tax adjustments. Procedures defined by the organizational units for assessing interest and penalty vary.

The Field Operations Division has issued directives to its staff to be used in instances where corporations wish to remit immediate payment. According to the Field Operations Division manual, interest is to be assessed from the original due date of the return to the date the corporation is notified of a delinquency. However, documentation provided by the Steno Section of the Income Tax Auditing Division states that if the original year-end return was timely, interest is to be assessed on the delinquency using a split factor. In applying the split factor, the amount of the delinquency is divided in half and interest is assessed on the first half from the original due date of the return. Interest on the second half, however, is assessed from a date established three months after the original due date. Consequently, the amount of interest imposed on an account depends, in part, on where it is assessed.

Until recently, the Corporate Audit Section of the Income Tax Division used a third policy: that of not assessing interest on delinquent corporate accounts. This policy was cited by the Accounting Section as the reason it failed to assess interest on corporate underpayments prior to May 1980. This no-interest policy was clearly contrary to the requirements of Minnesota Statutes §290.53, subd. 1 (1978).

These three contradictory interest policies have a serious negative impact on the corporate tax processing system. First, they allow for inequitable taxpayer treatment as the amount of interest assessed on a liability is, in part, dependent upon which organizational unit assesses the interest. A second equally important ramification is noted in the Cashier Section. This section has repeatedly requested policy guidance pertaining to the assessment of interest and penalty. It has been provided with three contradictory policies and is unable to determine which policy should be followed.

- The lack of policy guidance has resulted in gaps in the present tax processing system.

First, refund warrants are not always verified against outstanding liabilities. It is a policy of the Department of Revenue that prior to issuing corporate refund warrants an attempt will be made to verify that the corporations receiving the refunds have no outstanding tax liabilities. In fact, such a review of unpaid tax liabilities takes place only in the case of large refunds. Thus, despite departmental policies to the contrary, corporations with outstanding liabilities may be issued refund warrants.

Second, no attempt is made on a regular basis to determine if all corporations requesting extensions actually file their year-end return. The Cashier Section of the Administrative Services Division, the Corporate Audit Section and the Extension Section of the Income Tax Division, and the Field Operations Division all claim that such a verification is not their responsibility. In fact, there are no provisions for detecting extension recipients which could be nonfilers.

We analyzed 113 corporate tax history files with extension payments for 1978 indicated on the Declaration Master File and found that 4 of the corporations had failed to file year-end returns despite the fact that they had applied for and been granted extensions for the years in question.

TABLE 1
1978 EXTENSION NONFILERS

Corporation	Year of Extension Request	Last Return On File
Corporation A	1976	1974
Corporation B	1976-1979	1962
Corporation C	1976	1974
Corporation D	1979	1975

In addition, Central Files was unable to locate nor did it have records of tax history files for 11 additional corporations which had applied for extensions between 1974 and 1978. While the nonfiler rate is relatively low in the case of extensions, the data gathered illustrate that small corporations requesting extensions could fail to file a year-end return without being detected.

Finally, the department does not verify the timeliness of quarterly declaration payments. The timeliness and amount of quarterly declaration payments are never verified unless a corporation is determined to have underpaid its estimated tax at the end of the tax year. Corporations which fail to file timely payments for the appropriate amount during the tax year are to file Form M-429C, "Statement Relating to Underpayment of Estimated Income Tax by Corporations" (see Appendix C), with their year-end return. The form requires corporations to calculate the unpaid declaration liability and interest which are to be remitted with the year-end return.

The Corporate Audit Section told us that the majority of corporations file their estimated quarterly payments in a timely fashion with the appropriate payment. While this may be true, our survey of 284 corporate accounts and related tax history files revealed that 18 percent of the corporations with a Minnesota taxable income exceeding \$100,000 demonstrated one or more delinquent or inappropriate quarterly payments.

- There is needless duplication of certain processing functions.

Collection of delinquent tax liabilities is conducted by four organizational units. At present, two organizational units outside of the Compliance and Field Operations Divisions are attempting to collect additional corporate tax liabilities. Both the Accounting Section of the Administrative Services Division and the Corporate Audit Section of the Income Tax Division attempt to collect corporate tax liabilities when verification indicates that a corporation has underpaid its tax liability. Billing in this instance is done manually, and the response rate is well below that of bills issued through the computerized Accounts Receivable system. The Accounts Receivable system has an 80 percent response rate for the one-month period allotted for response; the Accounting Section, on the other hand, is only able to achieve a 64 percent response rate with a three-month response deadline.

Based on our analysis of the Department of Revenue's procedures for processing corporate income tax returns, we recommend that:

- The Department of Revenue should document the present corporate tax processing system and the documentation should be compiled in a procedural manual to be distributed to all corporate tax processing units.
- Once the system is documented the Department of Revenue should undertake a review of the corporate tax processing system with the intent of streamlining and coordinating the present manual system.
- The Department of Revenue should consider developing standard, department-wide policies for assessing interest and penalty as well as setting standardized audit cut-offs. Such policies are necessary to ensure the consistent treatment of taxpayers.

B. COLLECTION OF UNDERPAYMENTS

PROCEDURES WHICH DO EXIST FOR ASSESSING AND COLLECTING VERIFIED UNDERPAYMENTS ARE NOT COST EFFICIENT OR EFFECTIVELY EXECUTED.

Verified underpayments occur when it is determined, as a result of an examination of the corporate year-end return and the Declaration Master File, that the amount the corporation claims to have previously paid on its tax liability is greater than the amount indicated on the corporation's account on the Declaration Master File. Problems experienced by the Department of Revenue in this area include costly underpayment billings and a lack of department-wide guidelines.

- Present costs for manual billing of verified underpayments are unnecessarily high. Billing costs could be substantially reduced if bills were issued through the computerized Accounts Receivable System.

Corporate returns which have been detected as underpayments are manually processed by the Accounting Section and the Corporate Audit Section. Close to 50 percent of the programmatic expenditures for the entire verification program in each unit are used to process underpayments. Personnel costs for both sections are cited in Table 2.

TABLE 2
PERSONNEL COSTS
ATTRIBUTED TO VERIFICATION
(FY 1979)

	Personnel Costs
Accounting Section (1.5 positions)	\$ 9,000 ^a
Corporate Audit (portion of 1 position)	4,895
TOTAL	\$13,895

Source: Interviews with Department of Revenue personnel.

^aPersonnel costs cited above do not include the cost of verifying the corporate year-end return against the Declaration Master File.

At the time our study was begun, the Accounting Unit did not monitor the number of underpayment billings which it issues in a given year. Our review of billings issued between January 1 and June 30, 1980 revealed that the Accounting Section had issued 170 first billings; as a result of the initial billings 60 second billings were issued, and 14 accounts were forwarded to the Corporate Audit Section for collection. Assuming the Accounting Section spends 50 percent of its allocated resources on underpayment billings and processing, the Accounting Section has personnel costs of \$9.22 per account.

However, costs for billing through the Accounts Receivable system are substantially less. According to the Department of Revenue Systems Office, the personnel cost of entering an account into the Accounts Receivable system and billing through the system is

\$.05--\$.03 to enter the account and \$.01--\$.02 to issue the billing. If underpayment billings were entered directly into the Accounts Receivable system, the Department of Revenue could save approximately \$9.00 per billing.

- A significant number of underpayment billings issued between January 1 and June 30, 1980 were cancelled after it was determined that additional liabilities did not actually exist. Many incorrect billings could have been avoided with department-wide guidelines and better planning of computer systems prior to development.

Our analysis of 170 underpayment accounts revealed that 33 percent of the underpayment discrepancies verified were not, in fact, underpayments. In each case, the apparent underpayment could be attributed to bookkeeping errors by the Department of Revenue. Table 3 indicates the most common reasons for cancellation of verified underpayment discrepancies. In many cases an incorrect billing could have been avoided, saving the state the cost of manual billings, had department-wide policies been provided for entering data into the various computerized data systems.

We have found that the department has not established policy guidelines for the identification and transfer of overpayments on the Declaration Master File. Prior to February 1979, verified overpayments were not noted by the Department of Revenue on the Declaration Master File; consequently, it often appeared as though corporations were claiming overpayments which did not exist, when in fact information pertaining to actual overpayments had simply not been entered into the Declaration Master File. Overpayments from previous tax years which were not entered into the Declaration Master File are still surfacing and affecting the verification of corporate tax payments.

Although department policies since February 1979 provide that corporate tax overpayments are to be entered into the Declaration Master File, overpayments are not automatically transferred from one tax year to the next. Consequently, overpayments are often not identified as credits on corporate accounts for the current tax year. Should a corporation attribute an overpayment, which had not been transferred to its current tax liability, the account would indicate an underpayment when, in fact, an underpayment did not exist. If individual corporate accounts on the Declaration Master File were balanced annually this problem would not exist.

The absence of department-wide policies for transferring payments from one tax year to the next has occasionally resulted in the transfer of tax payments for present tax years to previous tax years. In one instance a corporation, in response to a billing issued in March 1980, requested that the Department transfer declaration payments made for the tax year in process to a previous tax year to cover an underpayment of the previous year's tax liability. In granting this request the Accounting Section merely transferred the corporation's delinquent liability to the following tax year, allowing the corporation an interest-free one-year extension.

TABLE 3

REASONS FOR CANCELLING UNDERPAYMENT BILLINGS

(January - June 1980)

	Total Number Cancellations	Wrong/ Duplicate Business Number	Previous Overpayments	Unidentifiable Receipt System	Accounts Receivable System	Attributed To Wrong Tax Type	Other
January	15	4	6	2	2	1	-
February	1	-	1	-	-	-	-
March	16	9	1	1	3	1	1
April	12	6	4	2	-	-	-
May	12	6	1	3	-	1	1
June	0	-	-	-	-	-	-
TOTAL	56	25	13	8	5	3	2

Furthermore, official policies have not been established for handling unidentifiable receipts. Three types of errors were attributable to corporations making tax payments without designating where the payment was to be attributed: unidentifiable receipts, Accounts Receivable system account payments, and liabilities attributed to the incorrect tax type (see Table 3). Department of Revenue procedures for identifying and processing such payments have been developed by the Cashier Section. However, according to both Compliance and Accounting personnel not all Revenue employees involved in locating tax payments are aware of these procedures. This lack of knowledge hinders the process of locating tax payments.

We recommend that:

- The Department of Revenue should enter all underpayment billings on the Accounts Receivable system upon identification. Neither the Accounting Unit nor the Corporate Audit Unit should be involved in the notification of corporations and collection of corporate tax liabilities once an underpayment has been identified.
- The Department of Revenue should issue department-wide policies and guidelines for the processing of all tax payments and corporate tax documents. These policies should be transmitted to all units involved in corporate tax processing.
- The Department of Revenue should not allow corporations with delinquent tax obligations to transfer payments made on the present tax year to a previous year's liability.

C. IDENTIFICATION OF WORKFLOW

AN IDENTIFICATION OF THE FLOW OF RETURNS THROUGH THE CORPORATE INCOME TAX PROCESSING SYSTEM IS HAMPERED BY THE DEPARTMENT OF REVENUE'S FAILURE TO MAINTAIN NECESSARY INFORMATION.

The development of a cohesive corporate tax processing system requires information concerning the number and types of corporate returns to be processed. Such data would include the number of corporations filing installment returns, declarations, and extensions, as well as the number of returns subject to each phase of processing. In addition to maintaining this data it is imperative that organizational units involved in corporate processing have access to it. This would require the compilation of data at a central locale.

- Data needed to define the processing workload are not maintained by the Department of Revenue. Such data is essential for long-range planning.

First, data pertaining to verification are not maintained. All corporate year-end returns indicating a declaration payment, extension payment, or a previous overpayment are subject to verification against the Declaration Master File. This verification is normally conducted manually by the Accounting Section of the Administrative Services Division. When asked how many corporate returns were verified per year, neither the Accounting Section supervisor nor personnel doing the verification could provide a figure. Furthermore, information concerning the number of discrepancies discovered as a result of verification was also unavailable. Such data are essential for defining the verification workload and for the assignment of departmental resources to the verification function.

Until recently, neither the Accounting Section nor the Corporate Audit Section of the Income Tax Division recorded the number of corporate underpayments which they processed. Both sections have recently begun to maintain records identifying the amount of additional tax collected as a result of underpayment billings. However, records pertaining to the number of underpayment billings and the rate of response to those billings are not maintained by either section. Our review of underpayment billings issued by the Accounting Section between January 1 and June 30, 1980 indicated a 64 percent response rate to the initial billing. Even more interesting, however, was the fact that 56 of the 117 corporations which responded to the first billing notice were able to demonstrate that the liability had been previously remitted, but was not attributed to the appropriate account by the Department of Revenue. (A breakdown of corporate responses to underpayment billings is found in Appendix E.) Identification of the nature and numbers of cancellations could help reduce the number of erroneous billings.

Second, the department does not maintain records of the number of corporations filing extensions and declarations. The figures which are maintained specify the total number of transactions in a given year. These figures are not suitable for determining such information as the number of extensions filed by corporations, or the number of corporations filing extensions or declarations without remitting payment, or other data essential for the detection of delinquent taxpayers.

- Data maintained on the various computerized systems are not always the data which would be of most use to units involved in corporate tax processing.

The department's failure to collect and post information pertaining to no-remit declaration statements (Form M-18) has resulted in information gaps on the Declaration Master File and has made the file useless for certain auditing functions. No-remit declaration statements normally pertain to one of two situations: a corporation which has transferred an overpayment from a previous tax year to cover an estimated tax liability in the present tax year, or a corporation which has filed an amended declaration statement reducing the amount of estimated tax liability due and whose previous declaration payments cover the amended declaration payment for the quarter in which the amendment was filed.

In both instances, the result is an apparent discrepancy between the amount of the total declaration liability and total quarterly payments as recorded on the Declaration Master File. In the case of an overpayment, the amount of the total declaration will not be recorded on the Declaration Master File. Consequently, there is no way to determine if the amount of the previous overpayment covers the corporation's estimated liability for one or more quarters.

Amended declarations are normally used by corporations to adjust the total amount of the estimated tax liability. If an adjustment represents a decrease in the total liability and past quarterly payments cover the amount that would be due, the amount of the decreased liability would not be entered into the Declaration Master File. Old data retained on the file would, however, indicate an underpayment when in fact an underpayment did not exist.

We also found that Extension Master File lists, used by the Cashier Section to verify the timeliness of year-end returns with extensions, do not provide the Cashier Section with the information it needs to make an adequate determination of timeliness. The format of the list was designed by the Extension Section of the Income Tax Auditing Division and the list is compiled on a monthly basis by the Accounting Section of the Administrative Services Division. Each list includes the names of corporations that have requested extensions and the date on which extensions were requested. However, this information is not sufficient to allow the Cashier Section to make an accurate determination of timeliness. Data on the lists do not indicate whether the extension referred to is a first or a second extension, nor is the amount of any previous extension payment indicated. Another complicating factor is that once the list has been issued, the extension file is cleared and a new list compiled. The new list does not include corporations from previous lists that had failed to file a return.

Extension Master File lists are issued once a month by the Accounting Section; however, the Cashier Section receives them two months late. The lists are forwarded by the Accounting Section to the Extension Section of the Income Tax Division where they are reviewed prior to being forwarded to the Cashier Section. Cashier Section personnel have found that they must regularly request copies of updated lists from the Extension Section. Lists are often delayed at least a month in the Extension Section. Consequently, the Cashier Section must either process extension returns without updated information or hold them for one to two months.

As a result of our examination of data needed to define the department's workflow, we recommend that:

- The Department of Revenue should identify the number and types of documents processed at each step of the corporate tax processing system. Data pertaining to the department's workflow should be maintained at a central point in the department.

- The Department of Revenue should re-evaluate the usefulness of information stored on the various computer systems.
- The Department of Revenue should consider re-designing the Declaration Master File so that accounts may be balanced at the tax year-end.

D. PROCESSING DELAYS

INEFFECTIVE COORDINATION OF THE CORPORATE INCOME TAX PROCESSING SYSTEM HAS CAUSED EXCESSIVE DELAYS IN PROCESSING RETURNS.

The bulk of corporate tax processing is done manually, leading one to expect a certain number of time lags. Nonetheless, we believe that by any reasonable standard, the Department of Revenue takes too long to perform this important ongoing function.

- An average of eight months elapses between the filing of a corporate return and completed verification.

Our review of 124 verified overpayment returns processed between January 1 and June 30, 1980 indicated that of the 26 corporations requesting refunds, only 9 were contacted concerning their overpayment within six months of their filing date. Furthermore, records indicated only 40 corporations whose accounts indicated credited overpayments were contacted within the same six-month period. The average time lag between the date returns were filed and the date corporations were notified was 259 days or 8.6 months.

While the corporate processing system is a manual one, a review of that system indicates that the majority of corporate returns are subject to only two processing steps prior to verification. These steps are deposit of any cash payments accompanying the return by the Cashier Section and preparation of a computerized listing of corporate returns in a given batch. Corporations are notified of any overpayment or underpayment of tax liabilities within one month of verification.

- Corporations with verified underpayments were issued three billings over more than six months before their accounts were entered onto the Accounts Receivable system.

The first notification of underpayment issued by the Accounting Section states that a corporation will be granted 10 days to remit the balance of its tax liability or verify previous payment. In practice, a corporation has a much longer period of time to respond to the first billing. Our survey of initial bills issued by the Accounting Section between January 1 and March 30, 1980, indicated that corporations were allowed an average of 117.6 days in which to respond to the initial billing.

Second billings are issued to corporations that have failed to respond to the initial billing. Again, the notification grants each corporation a 10-day response period. In practice, they have 30 days; thus delinquent accounts are not forwarded to the Corporate Audit Section until five months after the initial billing date. Once the Corporate Audit Section has issued its billing, the corporation is granted an additional 30 days to respond. In short, prior to May 1980 a corporation with a verified underpayment was allowed six months to remit payment before the account was assessed additional interest and penalty and entered into the Accounts Receivable system. Corporations with other types of liabilities were given only 60 days to respond to billings prior to the assessment of additional interest and penalty.

- Extension verification is often irregular and may take up to two months, delaying further processing.

Verification of corporate year-end returns claiming extensions against the list of corporations which have filed extension applications is a function of the Cashier Section. Technically, such verification should be conducted immediately upon receipt of the year-end return; until recently the Cashier Section did not receive an updated Extension Master List on a regular (monthly) basis and as a result returns were often held for up to two months before they were verified and forwarded for further processing.

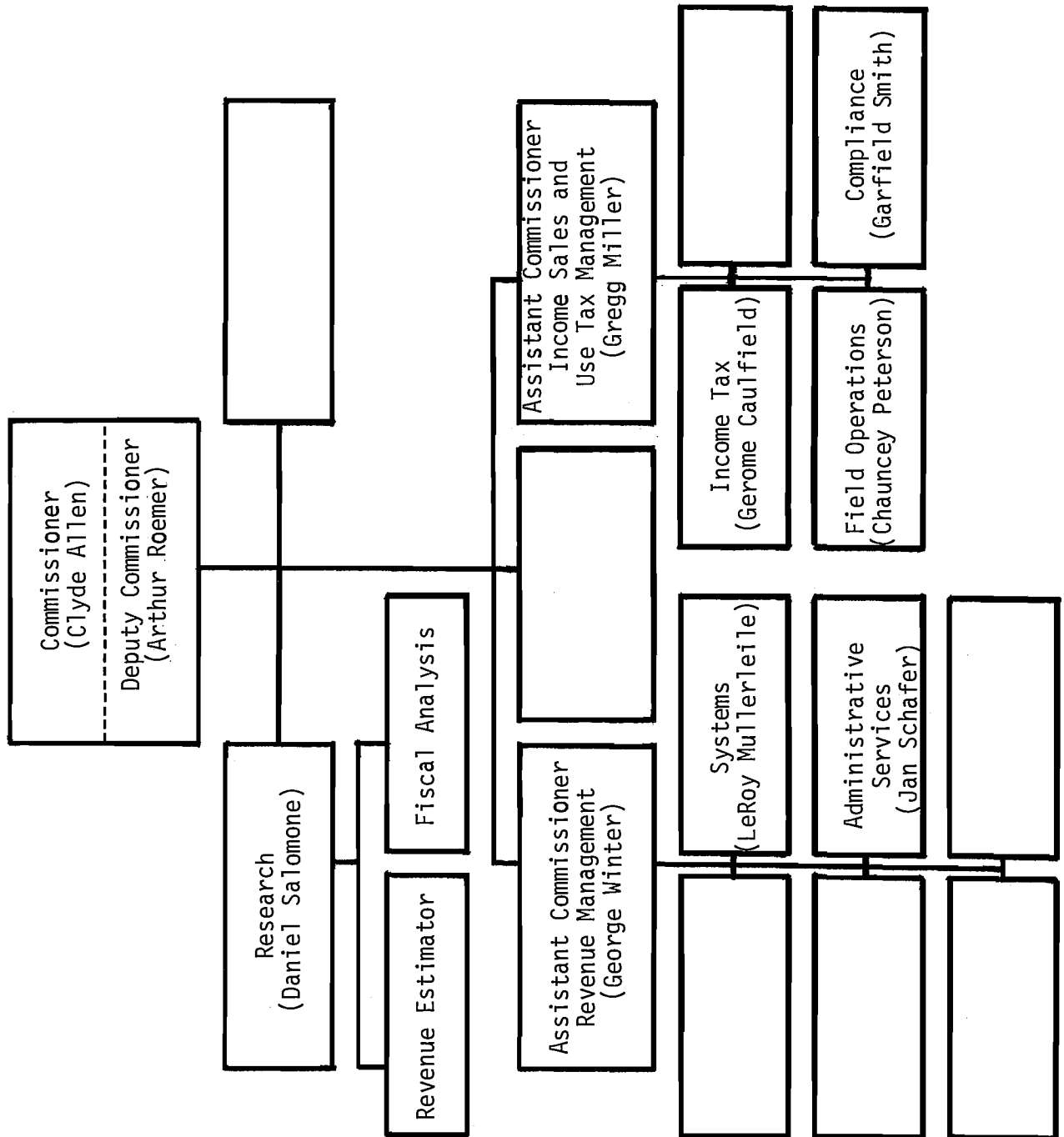
We recommend that:

- After documenting the corporate tax processing system, the Department of Revenue should streamline the system and identify bottlenecks which delay processing.

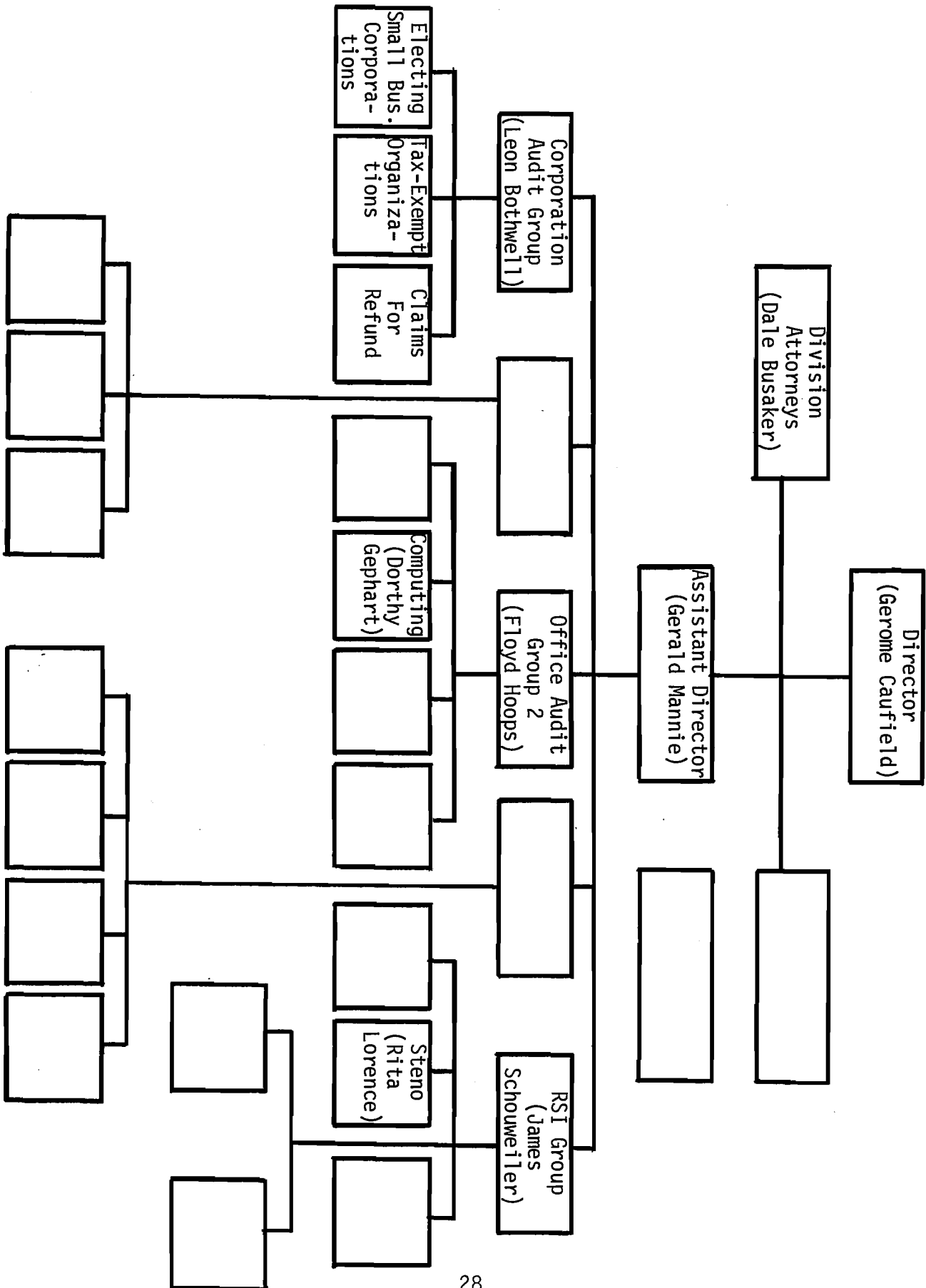
APPENDICES

APPENDIX A

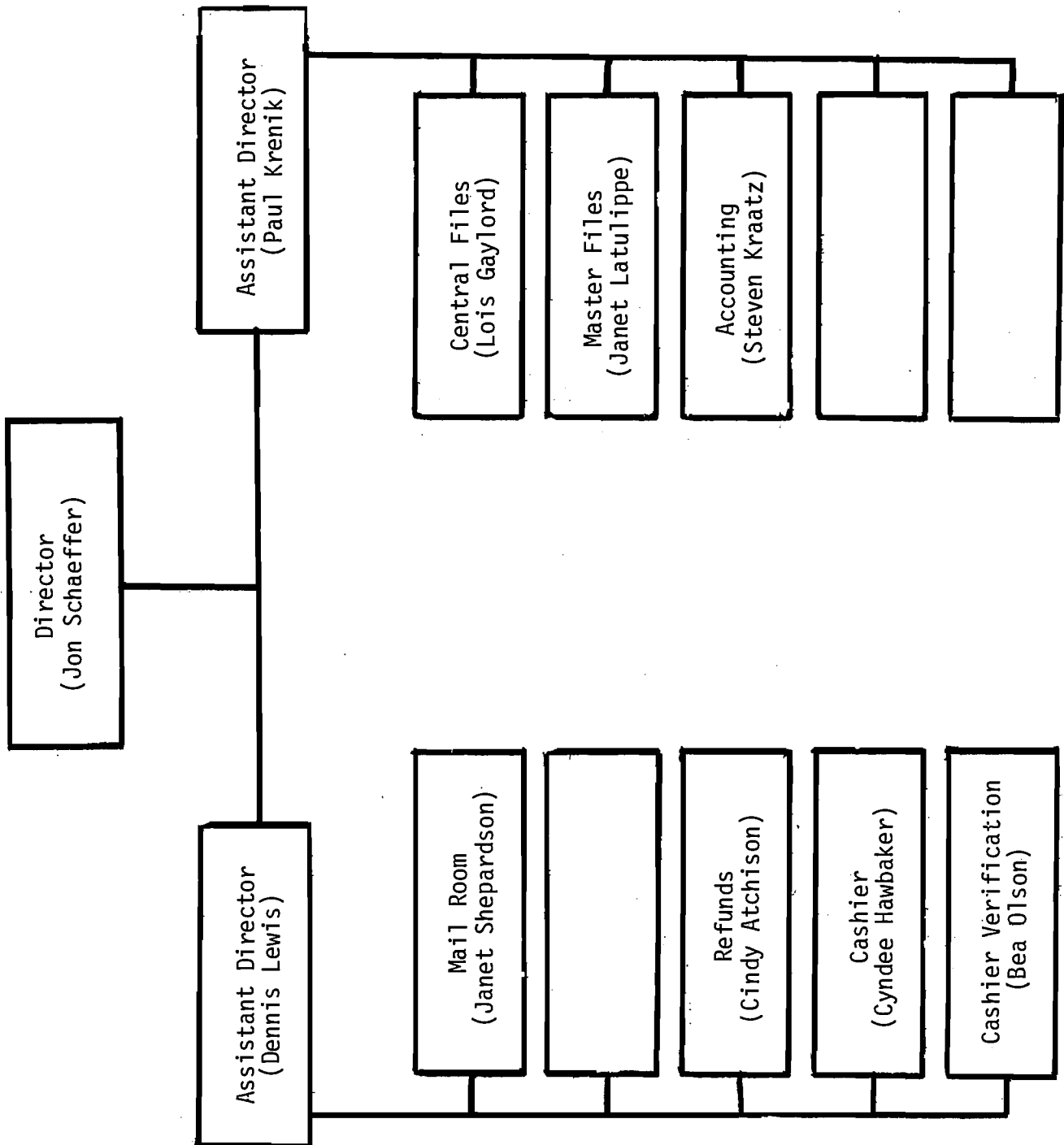
MINNESOTA DEPARTMENT OF REVENUE ORGANIZATIONAL CHARTS: CORPORATE INCOME TAX PROCESSING



CORPORATE INCOME TAX PROCESSING: INCOME TAX DIVISION
(Prior to January 6, 1981)



CORPORATE INCOME TAX PROCESSING:
ADMINISTRATIVE SERVICES



APPENDIX B

1978 CORPORATE DECLARATION ACCOUNTS REVIEWED

Minnesota Taxable Income	Total Number Returns Filed, 1978	Number of Returns Reviewed
\$ 5,000,000 and over	48	29
\$ 1,000,000 - \$ 5,000,000	259	34
\$ 500,000 - \$ 1,000,000	388	38
\$ 200,000 - \$ 500,000	1,000	50
\$ 100,000 - \$ 200,000	1,250	50
\$ 60,000 - \$ 100,000	1,200	30
\$ 40,000 - \$ 60,000	2,000	25
\$ 10,000 - \$ 40,000	6,900	35

Statement Relating To Underpayment Of Estimated Income Tax By Corporations

(Must be filed with your income tax return)

Name of Corporation		Minnesota Identification Number	
Address (number and street or rural route)	City, Town or Post Office	State	Zip Code

Computation Of Underpayments

1. Calendar year	1						
2. Fiscal year ending	2						
3. Tax (from Form M-____, page 1, line____) . . .	3	\$					
4. Statutory exemption	4		1,000.00				
5. Estimated tax balance (subtract line 4 from line 3).	5	\$					
			1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	
6. Fill in the due dates	6						
7. Fill in 25% of line 5 in each column	7	\$		\$		\$	
8. Amount paid each period	8						
9. Overpayment of previous installment*. . .	9		XXXXXXX				
10. Total of lines 8 and 9	10						
11. Underpayment (or overpayment) (subtract line 10 from line 7)	11	\$		\$		\$	

*An overpayment of an installment on line 11 which is greater than all of the prior underpayments should be applied as a credit against the next installment.

There is no additional charge imposed on an underpayment on line 11 for any installment date if by that date the corporation made the minimum payment determined under the following exception:

Exception — An amount equal to the tax on the return filed for the previous tax year. The previous year's return must cover a period of 12 months and show a tax liability.

Check each underpaid installment where this exception applies. 1st Qtr. ☐ 2nd Qtr. ☐ 3rd Qtr. ☐ 4th Qtr. ☐

Computation Of Additional Charge

If there is an underpayment of estimated tax on line 11 above for an installment and the exception is not applicable, compute the additional charge by completing the portion(s) of this schedule applicable to the installment(s).

			1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	
12. Fill in the due dates	12						
13. Amount of underpayment (line 11 above) . .	13	\$		\$		\$	
14. Date of payment**	14						
15. Time elapsed from the due date of installment to the date on line 14 above . . .	15						
16. Additional charge (8% per year on the amount on line 13 for the time on line 15). .	16	\$		\$		\$	
17. Underpayment Charge — Total of amounts on line 16 (fill in on page 1, Form M-4, on the applicable line. Pay this amount in full at the time of filing the return.)	17	\$					

**A payment of estimated tax on any installment date will be considered a payment of any previous underpayment only to the extent that the payment is more than the amount of the installment on line 7. If the corporation made more than one payment for a given installment, attach a schedule showing a separate computation for each payment.

Instructions

Declaration of Estimated Tax Payment Vouchers (Form M-18 or Form M-20) and payments of estimated tax are required to be made by every corporation which is subject to Minnesota income tax if its income tax for the year can reasonably be expected to be more than \$1,000. Corporations with an estimated tax of \$1,000 or more must file declarations and make quarterly payments based on their entire estimated tax. The law imposes an additional charge for failure to pay estimated tax in the amounts and by the installment dates specified by law. In the case of a corporation which fails to file an estimated tax for a tax year when one is required, the period of the underpayment will run from the four installment dates as set forth in Minnesota Statute 290.933, subd. 1, (1), to whichever of the periods set forth in Minnesota Statute 290.934, subd. 3, (1) and (2) is the earlier.

This form is designed for corporations which are required to pay their estimated tax in four installments. Fill in the due dates of each install-

ment on the blank lines under each quarter.

For a calendar year corporation, the estimated tax installment must be paid on or before the 15th day of March, 15th day of June, 15th day of September and the 15th day of December. If the corporation's return is not on a calendar year basis, the installment dates should be changed to correspond with its fiscal year and be filed on or before the 15th day of the third month, sixth month, ninth month or twelfth month. The computation will be different if the corporation was not required to file a declaration until a later date or if it amended its declaration. In this case, you may obtain advice from the Corporation Section of the Minnesota Income Tax Division.

The total **Underpayment Charge** on line 17 of Form M-429C is to be shown on page 1, Form M-4 on the applicable line, and must be paid in full at the time of filing the return. If you file your income tax return on a form other than Form M-4, disregard references to Form M-4.

RV-00062-06

APPENDIX D

NOTIFICATION OF UNDERPAYMENT

In Re: Minnesota Corporation Income Tax Return

Gentlemen:

We are eager to reconcile the credit you claimed on Line 31 of your October 31, 1978 return with ours.

TOTAL CREDITS PER OUR RECORDS - IDENTIFICATION NUMBER XXXXXXXXXX

<u>DATE PAID</u>	<u>VALIDATION NUMBER</u>	<u>AMOUNT</u>
1/18/78	4601038	\$ 9,000.00
4/26/78	4609465	\$ 9,000.00
10/16/78	4627893	\$ 9,000.00
1/17/79	4675180	\$16,000.00
Total credits verified		\$43,000.00
Total credits claimed per the return		\$52,000.00
<u>D I F F E R E N C E</u> -----		\$ 9,000.00

To verify your payment of the difference, please send a copy of the front and back of your cancelled check. If this isn't possible, send the 7 digit identification number stamped in the upper right hand corner on the face of the check.

Without this verification the amount due is subject to penalty and interest.

Please direct your reply to the attention of the undersigned within the next ten (10) days. A self-addressed envelope is enclosed for your convenience.

Sincerely,

Jean M Jochim

Jean M. Jochim, Accounting Section
Administrative Services Division

JMJ:Pas
Enclosure (1)

ch # 19994
7/10/78

APPENDIX E

VERIFICATION OF CORPORATE RETURNS: RESPONSE TO UNDERPAYMENT NOTIFICATIONS

(January - June 1980)

	Total Number Underpayments	Number Payments	Number Clarified	No. of Returns Forwarded Corp. Audit	Total Number Returns No Action
January	41 (100%)	15 (36%)	15 (36%)	11 (28%)	0
February	3 (100%)	1 (33%)	1 (33%)	1 (33%)	0
March	31 (100%)	10 (32%)	16 (52%)	1 (33%)	4 (13%)
April	43 (100%)	22 (51%)	12 (28%)	0	9 (21%)
May	52 (100%)	13 (25%)	12 (33%)	0	25 (48%)
June	0	0	0	0	0
TOTAL	170 (100%)	61 (37%)	56 (33%)	13 (08%)	38 (22%)

APPENDIX F

MINNESOTA STATUTORY REQUIREMENTS

Corporate Income Tax

1. General Corporate Requirements

- a. An annual income tax is to be assessed to all corporations conducting business within the State of Minnesota or whose business within the state consists exclusively of foreign and/or interstate commerce. [Minn. Stat. §290.03 (1978)]
- b. Corporate income tax is to be assessed at the rate of 12 percent and all corporations are required to remit a tax of no less than \$100. [Minn. Stat. §290.06, subd. 1 (1978) and Reg. 2006 (1)]

2. Declaration Requirements

- a. All corporations whose estimated income tax can reasonably be expected to exceed \$1,000 are required to file a declaration of estimated tax with the Minnesota Department of Revenue. [Minn. Stat. §290.931, subd. 1 (1978) and Reg. 2093.1-1]
- b. Estimated tax is defined as the amount of income tax liability over \$1,000 that the corporation anticipates to acquire in the taxable year after allowable credits have been deducted. [Reg. 2093.1-2]
- c. Corporate declarations are to be made on Form M-18 and are to be based on the corporation's estimated gross income. Determination of the gross income is to be based upon information available to the corporation at the time the declaration is filed. [Minn. Stat. §290.931, subd. 3 (1978) and Reg. 2093.1-3]
- d. A corporation is permitted to amend its declaration no more than once per quarter. [Minn. Stat. §290.932, subd. 2 (1978), Reg. 2093.1-4, and Reg. 2093.2-2]
- e. Declarations of estimated tax are to be filed by the fifteenth day of the third month of the corporate tax year. [Minn. Stat. §290.932, subd. 1 (1978)]
- f. The Commissioner of the Department of Revenue may grant an extension of time for filing the declaration for not more than six months. [Minn. Stat. §290.932, subd. 4 (1978)]

- g. Declaration payments are to be made in four equal installments due on the fifteenth day of the third, sixth, ninth, and twelfth months of the corporate tax year. [Minn. Stat. §290.933, subd. 1(1) (1978) and Reg. 2093.3-1(a)]
- h. Corporations which determine that their estimated income tax liability will exceed \$1,000 after the first quarter of their corporate year are required to file a declaration on the fifteenth day of the sixth, ninth, or twelfth month of their tax year depending upon which quarter the determination is made. In this instance the amount due is to be paid in equal installments, in which the number of payments equals the number of remaining quarters in the tax year. For example, corporations filing an initial declaration on the fifteenth day of the sixth month would be required to pay their estimated tax in three equal installments on the fifteenth day of the sixth, ninth, and twelfth months. [Minn. Stat. §290.932 (1978), Minn. Stat. §290.933, subd. 1 (1978), and Reg. 2093.3-1(b)]
- i. Corporations which are delinquent in filing their quarterly installment or which underfile their quarterly installment are to be assessed interest on the delinquent amount for the duration of the delinquency. The duration of the delinquency is to be measured from the date the installment was due to the fifteenth day of the third month following the end of the corporation's tax year or the date on which payment is made, whichever is first. [Minn. Stat. §290.934, subd. 1-3 (1978), Minn. Stat. §270.75 (1978), Reg. 2093.4-1, and Reg. 2093.4-3]
- j. Interest will not be imposed on declaration underpayments when the declaration is based on an estimated tax which is calculated as \$1,000 less than the tax shown on the corporation's return for the preceding tax year. [Minn. Stat. §290.934, subd. 4 (1978) and Reg. 2093.4-4]
- k. Overpayments on individual quarterly payments are to be credited against the amount owed in the following quarter. If the total amount of all four quarterly payments exceeds by \$1,00 or more the tax as reported on the year-end return the overpayment is to be refunded to the corporation. [Minn. Stat. §290.936 (1978) and Reg. 2093.5]

3. Year-End Returns

- a. Corporations are required to file an annual income tax return no later than the fifteenth day of the third month following the close of the corporate tax year. [Minn. Stat. §290.42 (1978) and Reg. 2042 (1)(a)(2)]

- b. A corporation may elect to pay the balance of its year-end tax liability in two equal installment payments. The first payment is to be remitted along with the year-end return on or before the due date. The second installment payment is due on or before a date set three months after the due date. [Minn. Stat. §290.45, subd. 1(a) (1978)]
- c. The Commissioner of Revenue may grant an extension of time to file to corporations for a period not more than six months. Corporations wishing to receive such an extension must file Form M-522C on or before their due date. The Commissioner of Revenue may also require each corporation to pay a tax on the basis of information contained on the M-522C at the time it is filed. [Minn. Stat. §290.42(6) (1978) and Reg. 2042(6)]

4. Auditing Provisions

- a. The Commissioner of Revenue may examine returns, records, and accounts of corporations in order to verify the accuracy of the year-end return. [Minn. Stat. §290.46 (1978)]
- b. If, as the result of an audit, the corporation is found to owe an additional tax liability a tax is to be assessed for the amount of the liability. In such cases the corporation is given 60 days after notification to remit payment [Minn. Stat. §290.46 (1978)]
- c. If, as the result of an audit, the corporation is discovered to have overpaid its tax liability, the corporation is due a refund for the amount of the overpayment plus interest. [Minn. Stat. §290.50 (e) (1978)]
- d. Corporations that fail to file a year-end return or file a fraudulent return are to be given 30 days after written notification from the Commissioner of Revenue to file an appropriate year-end return. [Minn. Stat. §290.47 (1978)]
- e. The Commissioner of Revenue may require a copy of the corporation's federal return for auditing purposes. In addition, corporations are required to notify the Department of Revenue of any changes in their federal return. [Minn. Stat. §290.56 (1978) and Reg. 2056]
- f. The Commissioner of Revenue may appoint tax examiners to examine corporate tax returns. [Minn. Stat. §290.57 (1978) and Reg. 2057]

5. Assessment of Interest and Penalty

- a. Delinquent taxes are to be assessed interest at the rate of 8 percent per year. The length of the delinquency is to be measured from the date the tax was due until the date the "tax is paid" (for practical purposes the Department of Revenue assesses interest through the billing date). [Minn. Stat. §270.75 (1978)]
- b. In cases where an "extension of time" has been granted to the corporation, interest on any delinquent portion of the tax shall be at 8 percent measured from the date payment would have been due if an extension had not been granted, or until the date the tax is paid. [Minn Stat. §270.75 (1978)]
- c. Interest on penalties is to be assessed at the rate of 8 percent per year or from the date the penalty was assessable until the date the penalty was paid. [Minn. Stat. §270.75, subd. 3 (1978)]
- d. Interest on underpayments of declaration payments is to bear interest at the rate of 8 percent for the duration of the delinquency. [Minn. Stat. §270.75, subd. 4 (1978), Minn. Stat. §290.934, subd. 1.3 (1978), and Reg. 2093.4-3)]
- e. A 10 percent penalty is to be assessed on any tax which is not remitted on or before the due date. The penalty is to be collected as a part of the tax and is to bear interest for the duration of the delinquency. [Minn. Stat. §290.53, subd. 1 (1978) and Reg. 2053 (1)(b)]
- f. In cases where a delinquent tax liability was to have been paid in installments the entire delinquency shall be due and interest assessed. [Reg. 2053 (1)(c)]
- g. Corporations which receive an extension of time to file and fail to remit their liability in a timely fashion are to be assessed interest and penalty dating back to the original due date of the year-end return. [Reg. 2053 (1)(c)]
- h. The Commissioner of Revenue is granted the authority to abate any interest and penalties assessed. [Minn. Stat. §290.53, subd. 6 (1978) and Reg. 2053 (b)]
- i. Delinquent year-end returns are to be assessed a 10 percent penalty for the first 30 days of delinquency and an additional 5 percent for each additional 30 days, not to exceed 25 percent. In addition the delinquent return is to

bear interest on the tax liability and the interest at the rate of 8 percent per year for the duration of the delinquency. [Minn. Stat. §290.53, subd. 2 (1978) and Reg. 2053 (2)]

- j. If the amount of a corporate overpayment of estimated tax exceeds \$10.00 the Department of Revenue is required to pay the corporation interest on the overpayment at the rate of 6 percent to be computed at a date 90 days after the due date of the return or the date the return was filed if the return was delinquent. [Minn. Stat. §290.936 (1978), Minn. Stat. §290.50 (1978), Reg. 2093.5, and Reg. 2050] (Note: Reg. 2093.5 states that an overpayment may be either refunded or credited as provided by Department of Revenue Regulations.)
- k. The Commissioner of Revenue may credit any overpayment of tax including interest against any outstanding liability of any tax or assessed penalty owed by the corporation. [Reg. 2050 (5)]
- l. In cases where a corporation requests to credit an overpayment to its account, the overpayment shall be considered to be credited on the date the year-end return was filed and no interest shall be attributed to the overpayment. [Reg. 2050 (5)]

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STUDIES OF THE PROGRAM EVALUATION DIVISION

Final reports and staff papers from the following studies can be obtained from the Program Evaluation Division, 122 Veterans Service Building, Saint Paul, Minnesota 55155, 612/296-8315.

1977

1. Regulation and Control of Human Service Facilities
2. Minnesota Housing Finance Agency
3. Federal Aids Coordination

1978

4. Unemployment Compensation
5. State Board of Investment: Investment Performance
6. Department of Revenue: Assessment/Sales Ratio Studies
7. Department of Personnel

1979

8. State Sponsored Chemical Dependency Programs
9. Minnesota's Agricultural Commodities Promotion Councils
10. Liquor Control
11. Department of Public Service
12. Department of Economic Security, Preliminary Report
13. Nursing Home Rates
14. Department of Personnel, Follow-up Study

1980

15. Board of Electricity
16. Twin Cities Metropolitan Transit Commission
17. Information Services Bureau
18. Department of Economic Security
19. Statewide Bicycle Registration Program
20. State Arts Board: Individual Artists Grants Program

1981

21. Department of Human Rights
22. Hospital Regulation
23. Department of Public Welfare's Regulation of Residential Facilities for the Mentally Ill
24. State Designer Selection Board
25. Corporate Income Tax Processing

In Progress

- 26. Computer Support for Tax Processing
- 27. Cost Overruns at Minnesota Correctional Facility --
Oak Park Heights
- 28. State Sponsored Chemical Dependency Programs,
Follow-up Study
- 29. Individual Income Tax Processing
- 30. Division of State Building Construction
- 31. Real Estate Management Division