

Tax Penalties Under Current Law and Proposed under CSHB2001(RES) and CSSB 2001(JUD)

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I. CURENT LAW

1. Penalties applicable to all state tax types.

Under AS 43.05.220, the state may levy three types of civil penalties for failure to file a return or report or pay the full amount of tax:

- basic penalty for underpayment or failure to file
- penalty for negligence
- penalty for fraud

All three are general provisions applying to all state taxes, including the oil and gas production tax. Penalties are calculated as a percentage of the tax deficiency and are cumulative, so that a fraudulent taxpayer, for example, could be assessed the fraud penalty, in addition to the negligence penalty and the basic failure to file or pay penalty.

2. Federal IRS Penalties Incorporated into State Law

Additional penalties are levied under the Internal Revenue Service code, for which the state has no equivalent. The state has incorporated these penalties in its corporate income tax structure by reference in AS 43.20.021. These include penalties for deficient estimated taxes, substantial understatement, Gross Value Misstatement, and others that are less significant for state purposes.

3. Penalties unique to oil and gas production taxes (AS 43.55).

HB 2001 did not propose any change to the applicability of the general penalties and their application to the oil and gas production tax. Currently, there are no penalties specific to the failure to file or the underpayment of taxes due under AS 43.55.

II. PROPOSED CHANGES TO LAW

1. Penalties Associated with Reporting Requirements.

SB/HB 2001, CSHB2001(RES) and CSHB2001(JUD) propose to add penalties for failure to comply with the proposed information reporting

requirements. (See Sec. 43 and Sec. 45 of CS House Bill 2001(Res)). The penalty provisions allow the department to assess not more than \$1000 per day for each day a taxpayer fails to make the required report. These additional penalty provisions are necessary because the existing penalties are structured as a percentage of a tax deficiency and the reporting requirements do not have associated tax deficiencies. These penalties will ensure that the Department receives timely and complete reporting of costs, potential tax credits, etc., from explorers and producers to enable it to fulfill its revenue forecasting duties for the Governor and the Legislature.

2. House Penalty for Improper Monthly Installment Payments.

Section 25 of CSHB2001 (RES) also proposes a 5% civil penalty for failure to file timely the monthly installment payments due under AS43.55.020(a)(1)-(4). This provision is necessary because under the House bill, production tax is owed annually, and the monthly estimated payments would not give rise to tax deficiencies. Therefore current penalties structures would not function with this monthly reporting structure.

3. Senate Penalty for substantial and gross understatement of tax.

Section 49 of CSSB 2001 (JUD) provides for a 20% and 40% penalty for substantial and gross understatement of tax, in a manner similar to the federal IRS rules. A substantial understatement is greater than 10% of the tax requirement or at least \$10 million. A gross understatement is greater than 20% of the tax requirement or at least \$20 million.

The following is more detailed information about the penalties identified above:

Failure to File (Basic) Penalty

State of Alaska / Federal, IRS

The basic failure to file penalty arises when the taxpayer fails to file a return or report when required or pay the full amount due. The penalty levied by the state in this case, is generally the same as would be issued by the Internal Revenue Service (IRS). Five percent of the unpaid balance of the tax liability is added to a tax for each 30 day period, or fraction of the period of noncompliance. This penalty may not exceed a total of 25% of the unpaid

balance. The penalty may be forgiven if the taxpayer shows that the failure to file or pay is due to reasonable cause and not willful neglect.¹

Reasonable cause is not easy to show and the burden of proof lies with the taxpayer. The taxpayer must demonstrate in writing, and under penalty of perjury, that they acted in good faith to take all reasonable steps to ensure timeliness of the filing or payment. In determining whether the taxpayer has shown that the failure was due to reasonable cause and not willful neglect, the department considers the standards imposed by the Internal Revenue Code. Circumstances that may constitute reasonable cause include acts of God, war, other disaster that made filing or delay unavoidable, or acts by another person beyond the control of the person required to file.²

Fraudulent Failure to File

Federal, IRS

Fifteen percent of the unpaid balance of the tax liability is added to a tax for each 30 day period, or fraction of the period of noncompliance. This penalty may not exceed a total of 75% of the unpaid balance.

Negligence Penalty

State of Alaska

In addition to the basic penalty, if a deficiency is due to negligence or intentional disregard of a law or regulation, the department will, in its discretion, assess a penalty of 5% of the total amount of the deficiency. The penalty is calculated based on the total deficiency, even if only a part of the deficiency is due to negligence or intentional disregard. Negligence or intentional disregard may be shown by any relevant evidence including that the taxpayer has substantially deviated from the statutes or regulations, failed to keep adequate records, exaggerated deductions, or understated income without justification.³

Federal, IRS

Federal accuracy-related penalties are generally set at 20% of the portion of the underpayment. This applies to:

¹ AS 43.05.220(a). For more detail on failure to file and failure to pay penalties, see 15 AAC 05.210.

² 15 AAC 05.200.

³ AS 43.05.220(b); 15 AAC 05.210(g). For more detail on the additional penalty for negligence or intentional disregard, see 15 AAC 05.220.

- Negligence
- Substantial Understatements: An understatement of the greater of \$5000 or 10% of the due tax
- Substantial Valuation Misstatements: Valuation is off by 200% or more

Gross Valuation Misstatement

This penalty is similar to other negligence penalties under the IRS code, for Substantial Valuation Misstatement, but applies when valuation is off by more than 400%. Under this circumstance, the penalty is increased from 20% to 40% of the portion of the underpayment.

Fraud Penalty

State of Alaska

If a deficiency is due to fraud, the department shall add a penalty equal to 50% of the tax due or \$500, whichever is greater. The penalty is calculated based on the total deficiency, even if only a part of the deficiency is due to fraud. To establish fraud, the department must show by clear and convincing evidence that the taxpayer understated a tax liability with the intent to evade tax. The intent to evade the tax may be shown by any relevant evidence including evidence of false explanations regarding income, false source documents, unjustified omissions or significant understatements of income, or substantial overstatement of a deduction.⁴

In addition to the three civil penalties discussed above, AS 43.05.290 provides for a number of criminal penalties for tax evasion and willful failure to comply with payment, filing, truthful accounting and information requirements, and for perjury. Along with several misdemeanors, penalties include felonies for willfully attempting to evade a tax, willfully failing to truthfully account for and pay a tax, and willfully and knowingly assisting in preparing or presenting a false return.

Federal, IRS

The IRS generally levies a penalty of 75% of the underpayment amount attributable to fraud.

⁴ AS 43.05.220(c); 15 AAC 05.230.

Proposed Changes to Current Law

1. Penalties Associated with Reporting Requirements.

SB/HB 2001, CSHB2001(RES) and CSHB2001(JUD)

AS.43.55.030(d)—Failure to file annual and monthly reports

(d) Reports **required under this section** [BY OR ON BEHALF OF THE PRODUCER] are delinquent the first day following the day the report is due. **The person required to file the report is liable for a penalty, as determined by the department under standards adopted in regulation by the department, of not more than \$1,000 for each day the person fails to file the report at the time required. The penalty is in addition to the penalties in AS 43.05.220 and 43.05.290 and is assessed, collected, and paid in the same manner as a tax deficiency under this title. In this subsection, "report" includes a statement.**

AS.43.55.040(6)—Failure to provide reports needed for state revenue forecasts

(6) assess against a person required under this section to file a report, statement, or other document a penalty, as determined by the department under standards adopted in regulation by the department, of not more than \$1,000 for each day the person fails to file the report, statement, or other document at the time required; the penalty is in addition to the penalties in AS 43.05.220 and 43.05.290 and is assessed, collected, and paid in the same manner as a tax deficiency under this title.

2. House Penalty for Improper Monthly Installment Payments.

Section 25 of CSHB2001 (RES)

Sec. 25. AS 43.55.020 is amended by adding a new subsection to read:

(i) A civil penalty shall be added to the amount of an installment payment required under (a)(1) - (4) of this section if the full amount of the payment is not paid by the date the payment is due. The penalty is equal to five percent of the difference between the amount of the installment payment that was made timely and the amount of the installment payment required under (a)(1) - (4) of this section. If no part of the required installment payment was made timely, the penalty is equal to five percent of the installment payment

required under (a)(1) - (4) of this section. The penalty is in addition to the interest imposed under (g) of this section and a penalty added under AS 43.05.220, if any.

3. Senate Penalty for substantial and gross understatement of tax.
Section 49 of CSSB 2001 (JUD)

Sec. 49. AS 43.55. is amended by adding a new section to read:

Sec. 43.55.055. Penalty for understatement of tax. (a) In addition to other penalties prescribed by law, if there is a substantial understatement of tax required to be shown on a return under this chapter, there shall be added to the tax an amount equal to 20 percent of the substantial understatement of tax.

(b) In addition to other penalties prescribed by law, if there is a gross understatement of tax required to be shown on a return under this chapter, there shall be added to the tax an amount equal to 40 percent of the gross understatement of tax.

(c) In addition to the penalties imposed under (a) or (b) of this section, a person who has made a substantial or gross underpayment of tax is liable to the state for the reasonable costs of the state's enforcement action, including auditing costs.

(d) For purposes of this section,

(1) a substantial understatement of tax for any taxable year exists if the amount of the understatement for the taxable year exceeds the lesser of 10 percent of the tax required to be shown on the return for the taxable year or \$10,000,000;

(2) a gross understatement of tax for any taxable year exists if the amount of the understatement for the taxable year exceeds the lesser of 20 percent of the tax required to be shown on the return for the taxable year or \$20,000,000;

(3) "understatement" means the amount by which the tax required to be shown on the return for the taxable year exceeds the amount of the tax reported as due by the taxpayer as shown on the return.