

- SUBJECT:** New procedures for tax auditing, collection, and refunds
- COMMITTEE:** Ways and Means — favorable, without amendment
- VOTE:** 9 ayes — Oliveira, McCall, Bonnen, Craddick, Y. Davis, Hilbert, Keffer, T. King, Ramsay
- 0 nays
- 2 absent — Heflin, Sadler
- SENATE VOTE:** On final passage, April 7 — voice vote
- WITNESSES:** No public hearing
- BACKGROUND:** Current law requires Texas businesses to keep records of their purchases and sales transactions and to keep those records open to inspection by auditors of the Comptroller’s Office. While businesses must review each transaction to determine tax liabilities, auditors may review a sample of transactions. Sampling is used when an audit of all records is impractical, impossible, or unreasonably costly compared to potential benefits.
- Businesses that overpaid taxes to the state must request a refund in writing stating the specific grounds upon which the claim is founded. Under current law, the comptroller may refund the tax only to the person who remitted it. If the business purchased an item from a supplier and erroneously overpaid sales tax to the supplier, then the business must seek a refund from the supplier, which must in turn seek one from the state.
- DIGEST:** SB 1319 would authorize the comptroller to initiate managed audit, percentage-based reporting, and refund sampling programs.
- The comptroller could authorize a taxpayer to conduct a managed audit, which would be a review and analysis of invoices, checks, accounting records, or other documents to determine that taxpayer’s sales tax liability. A managed audit could be limited to certain categories of tax liability and would be limited

to specific periods of time. The decision to authorize or not authorize a managed audit would belong solely to the comptroller.

The comptroller would be allowed to examine records and perform necessary reviews before the audit was finalized. Unless this review uncovered fraud or willful tax evasion, the comptroller would not be able to assess a penalty and would be able to waive any interest on amounts identified by the managed audit as due to the state. The bill would entitle taxpayers to refunds of any overpayments disclosed by the managed audit.

SB 1319 would enable the comptroller to authorize the holder of a direct payment sales tax permit to use a percentage-based reporting method. Percentage-based reporting would be a method of computing tax liability based on samples of invoices for categorized transactions. Based on this sample, a percentage of the total purchases would be determined to be taxable, and this percentage would be applied to the entire amount of all invoices within the specific category.

The authorized percentage would have to be used for three years unless the authorization was revoked by the comptroller. The bill would make the comptroller's revocation of an authorization final. The comptroller could specify procedures by rule to implement percentage-based reporting.

The bill would allow a person holding a sales tax permit to compute an amount of overpayment using a sample of transactions. The sampling method would have to comply with generally accepted methods approved by the comptroller. The person would be able to obtain a credit on one or more sales tax returns or file for a refund for the amount of the overpayment calculated through sampling. This procedure would apply whether the tax was remitted directly to the state or to a supplier. The comptroller could inspect the records and the method by which a projection of the overpayment based on a sample was made. The comptroller would be able to issue rules to implement this method of calculating overpayment of sales taxes.

SB 1319 would take effect on October 1, 1999.

SUPPORTERS
SAY:

SB 1319 would implement several recommendations made by the comptroller in the latest Texas Performance Review, *Challenging the Status Quo*, to make tax reporting, auditing, and refunding processes easier and less costly. The programs created by SB 1319 would reduce processing time, enable businesses and the state to devote their personnel to better uses, and save the state money.

Managed audits would benefit both businesses and the state. Businesses would benefit from the elimination of penalties and interest. In turn, the state would benefit because the businesses would be performing the comptroller's audit work themselves. State auditors could verify results relatively quickly by going through a smaller sample and thus be able to conduct more audits in a given period of time. Managed audits also would free auditors to pursue more complicated audits.

Ohio initiated a managed audit program in 1994. Today, four out of every 10 audits conducted by the state are managed audits performed by the business. Virginia also has had considerable success with managed audits and has actually collected more than \$1.5 million in additional taxes that were remitted after the voluntary self-audits were completed. These taxes probably would not have been collected through normal auditing procedures.

Percentage-based reporting could greatly reduce the reporting burden on large companies holding direct payment permits. In Texas, businesses that purchase at least \$800,000 of taxable items annually may apply for a direct payment permit from the comptroller. This permit allows responsible businesses to issue a special exemption certificate to their vendors and instead remit to the state all taxes that would have been due at the time of purchase. Under current law, permitted businesses must review each individual invoice for taxable and exempt items to calculate their tax bill.

SB 1319 would authorize a percentage-based reporting method that would save a substantial share of the staff hours needed by businesses and the state to use direct payment permits. Virginia's Department of Taxation estimates that its percentage-based reporting program has reduced its time involved in auditing by half.

SB 1319 would make requesting a refund of overpayment in sales taxes easier and less time-consuming. Businesses should be able to take advantage of the

same method used by the audit division to calculate refunds of overpaid taxes. The refund could be verified using the comptroller's audit process, resulting in a substantial time savings for the business and the state.

Overall, these three innovative programs could save the state an estimated \$27 million for the biennium, according to the fiscal note, and could allow the comptroller to redirect up to 10 percent of staff hours spent on audits to more productive purposes.

Participation in these programs would be completely up to the comptroller, and only responsible, law-abiding businesses would be allowed to participate.

**OPPONENTS
SAY:**

These new procedures for auditing and refunding sales taxes owed the state should be limited to a small trial program for the next three years. The comptroller should be required to issue a report to the Legislature at the conclusion of the trial program, reviewing the effectiveness of these programs, their benefits to the state and business, and their cost savings. Such a report would provide the Legislature with sufficient quantitative evidence to determine whether these programs should be extended, modified, or eliminated.