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STATE COMPTROLLER



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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

February 20, 1997

Mr. Michael H. Urbach
Commissioner
Department of Taxation and Finance
Building 9, State Campus
Albany, NY 12227

Re: Corporation Tax Refunds
Report No. 96-D-25

Dear Mr. Urbach:

Pursuant to the State Comptroller's authority as set forth in Section 1, Article V of the State Constitution, Section 111 of the State Finance Law and Section 1086 of the State Tax Law, the following summarizes our review of the records and procedures applicable to the payment of corporation tax refunds for the State fiscal year ended March 31, 1996.

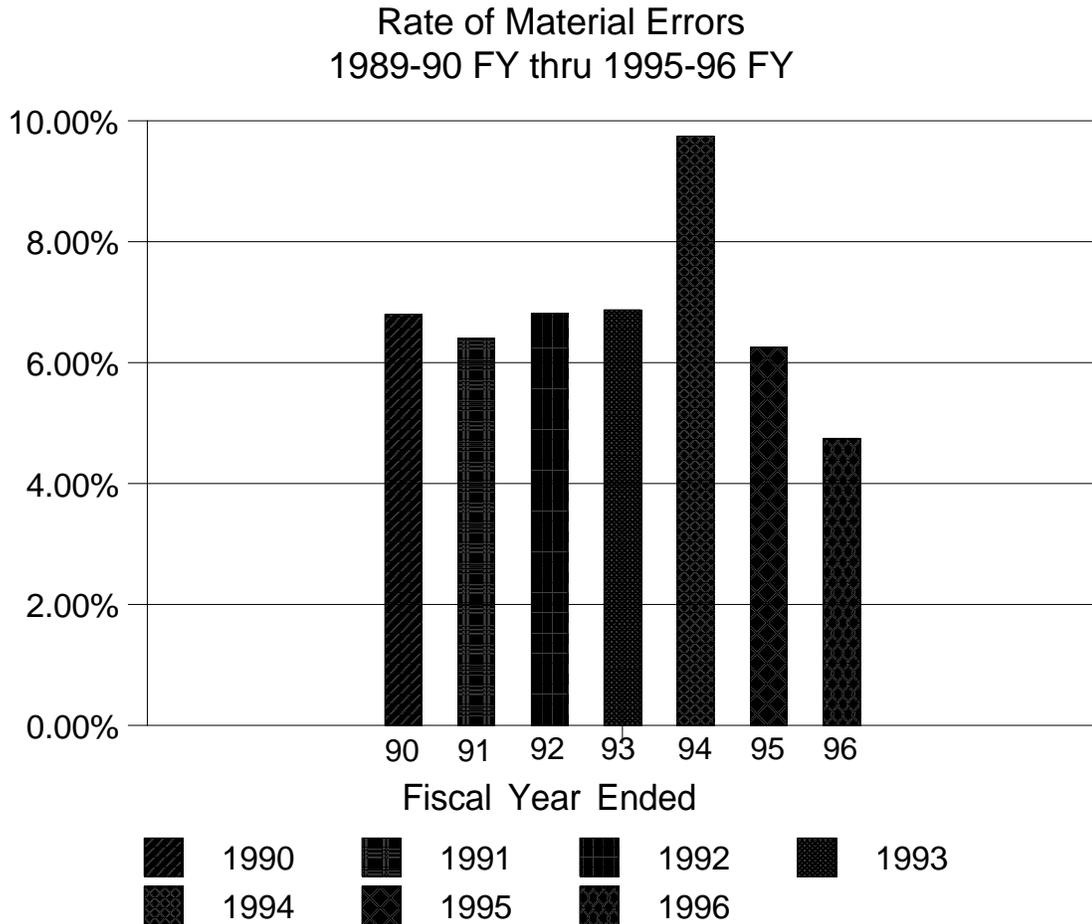
A. Background

The Department of Taxation and Finance (Department) is responsible for administering the corporation franchise tax imposed by Articles 9, 9A, 13, 27, 32 and 33 of the State Tax Law. Refunds of corporation taxes result primarily from overpayments of current tax year liabilities, field audits, and net operating loss claims. Refunds resulting from overpayments are generally computer-processed and are handled by the Department's Processing and Revenue Management Division. Refunds resulting from field audits and net operating loss claims are usually more complex. These refunds are reviewed and processed by the Department's Audit Division. After the Department processes and certifies the refunds, they are sent to Office of the State Comptroller (OSC) for audit and payment.

During the fiscal year ended March 31, 1996, we processed 37,363 corporation tax refunds totaling about \$547 million. Utilizing a statistical sampling approach, we audited 12,030 refunds totaling about \$536.5 million.

B. Results of Audit

We found that 571 of the 12,030 refunds we audited (4.75 %) contained material errors that caused us to reject or adjust the refund. This represented a 1.5 % decrease in the material error rate from the prior fiscal year and the lowest error rate in the last seven years as shown in the following chart.



As of March 31, 1996, the Department had reevaluated 509 of the 571 refunds that we rejected or adjusted. The Department confirmed that nearly \$2.8 million would have been overpaid had we not identified the errors. In addition, as a result of our audit the Department issued assessments totaling \$356,000 for additional tax due for 3 of the 509 refunds. The remaining 62 rejected refunds had not been reviewed by the Department as of March 31, 1996.

We also identified that for 27 of the 509 refunds, the Department reallocated \$606,000 among tax years within the taxpayers' accounts to cover the tax liability and refund request. Our audit activity assured that the taxpayers' accounts were in balance and prevented the \$606,000 from being inappropriately used in future periods to cover tax liabilities or refunds.

Our audit also identified errors that did not preclude payment of the refund. When this happens, we pay the refund as submitted and notify the Department of the law or fact in question that needs to be investigated. These are primarily situations where accounting adjustments need to be made or the taxpayer is due an additional refund amount. During our audit period, we identified and questioned 544 such refunds. After further review, the Department authorized additional payments totaling \$2.3 million for 187 of the 544 refunds. The Department also determined that 116 of the 544 refunds contained \$2.5 million in excess payments. The Department adjusted these refunds and allocated the \$2.5 million to the next open period within the taxpayers' accounts.

In total we found that the 1,115 refunds contained 1,294 errors. The following paragraphs present highlights concerning these errors. We also determined that 106 refunds, which had been rejected by us during prior fiscal years, were reevaluated by the Department during the current audit period, averting overpayments totaling \$274,143. An additional 12 refunds, which we rejected in prior fiscal years, remain unresolved by the Department as of March 31, 1996. The overall results of our audit are summarized in Exhibits A and B, attached to this report.

1. Tax and Payment Accounting

Many of the errors we identified occurred because the complex and continually changing tax laws made it difficult for the Department to maintain its accounting systems properly. We found that 541 of the 1,294 errors (41.8%) were attributable to tax and payment accounting problems: 374 (28.9%) had occurred because the Department did not correctly reconcile computerized taxpayer payment records with tax liability; and 167 (12.9%) resulted from an inaccurate presentation of the status of a taxpayer's account. The following are examples of the errors we identified:

- Our review of a \$129,984 refund found that additional overpayments remained in the taxpayer's account. We paid the refund as submitted and requested the Department review the corporation's account to determine whether additional amounts were due to the taxpayer. The Department subsequently authorized two additional refunds to the taxpayer totaling \$610,263.
- Our review of a \$340,155 refund found additional overpayments remained in the taxpayer's account. We paid the refund as submitted and requested the Department review the corporation's account to determine whether additional amounts should be requested. The Department subsequently determined that payments of \$223,750 needed to be reallocated to a future tax period in the taxpayer's account.
- When reviewing the documentation for a \$75,000 refund, we found there was insufficient money in the taxpayer's account to cover the tax liability and refund. We returned the refund to the Department for further review. Subsequently, the Department canceled the refund.
- In reviewing a corporation's account pertaining to a \$37,926 refund, we found the Department had reallocated money from one tax period to another after the account was in balance. We paid the refund as submitted and questioned how there could be money reallocated after the account was in balance. The Department subsequently reallocated \$2,500 into the original tax period to bring the account back in balance.

2. Calculations and Computations

The Tax Law and Departmental procedures contain complex rules for computing a corporation's tax and resulting refund. We found that 463 of the 1,294 errors (35.8%) resulted from the Department's incorrect application of these complex rules: 177 (13.7%) occurred because the Department incorrectly calculated the corporation's tax liability; 147 (11.4%) related to the Department's incorrect calculation of interest accruing on refunds; 63 (4.9%) occurred because the Department incorrectly computed the taxpayer's first installment payment and 76 (5.8%) resulted from other calculation errors. The following are examples of the errors we identified:

- In reviewing the documentation for a \$476,639 refund, we found the Department had incorrectly excluded the tax surcharge when calculating the combined corporation's tax liability. We returned the refund to the Department without approval. The Department canceled the refund.
- In reviewing the documentation for a \$17,985 refund, we found that when the Department calculated the tax liability, it had used an incorrect combined alternative business allocation percentage. We returned the refund to the Department without approval. Subsequently, the Department canceled the refund.
- Our review of a \$26,442 refund found the Department had not used the correct dates when calculating the interest. We adjusted the refund and prevented an overpayment of \$6,950.
- Our review of two related refunds totaling \$123,846 found the taxpayer's first installment was computed incorrectly. We adjusted the refunds and prevented an overpayment of \$5,447.

3. Return Processing

The administration of corporation taxes begins with the filing of a complete and accurate return in compliance with the Tax Law. Departmental procedures are designed to facilitate efficient processing of the return and to ensure that tax compliance efforts are maximized. We found that 290 of the 1,294 errors (22.4%) occurred in return and refund processing: 81 (6.3 percent) occurred because the Department did not provide sufficient information as required by the Tax Law and Departmental procedures for documenting the refund and permitting the verification of tax; 50 (3.9%) resulted from the taxpayer's return not containing a valid original signature; and 159 (12.2%) resulted from noncompliance with various other sections of the Tax Law and Departmental procedures. The following are examples of the errors we noted:

- We reviewed the documentation for a \$9,999,999 refund, during the refund's interest free period. We determined the Department had not scheduled an additional \$973,275 refund for the same tax period. We alerted the Department to this condition, and the Department immediately authorized the additional refund. The quick response time by both agencies to identify and correct this error resulted in nearly \$84,000 in interest being avoided.

- In reviewing the documentation for a \$155,865 refund we found the Department had not applied the refund to an open tax liability. We returned the refund to the Department without approval. The Department subsequently canceled the refund and applied the amount to the tax liability.
- Our review of a \$33,711 refund found the taxpayer had not filed returns for two prior periods. We returned the refund to the Department without approval. The Department subsequently canceled the refund.
- Our review of a \$17,115 refund found that the Department had not submitted any documentation to support the refund. We returned the refund to the Department for further review. The Department canceled the refund when it was determined that this refund had been scheduled twice for payment.

Recommendation

Establish and monitor procedures and internal controls to ensure corporation tax refunds are processed in compliance with the Tax Law and Department procedures.

Major contributors to this report were Marvin Loewy, John Corbett, Theresa Waitt, Jennifer Carrara, Kathleen Green, Irene Huston, Kathleen Gavigan, Susan Dutcher, Carol Weizenhofer, Nancy Wittemer, Michelle Jackson and Brian Neddo.

We would appreciate receiving your response to the recommendations made in this report within 30 days indicating any action planned or taken to implement the recommendations. We also wish to express our appreciation for the courtesies and cooperation extended to our auditors during their review.

Very truly yours,

Jerry Barber
Audit Director

cc: Patricia Woodward

**DEPARTMENT OF TAXATION AND FINANCE
AUDIT OF CORPORATION TAX REFUNDS
SUMMARY OF ERRORS IDENTIFIED
FOR THE YEAR ENDED MARCH 31, 1996**

Refunds with Errors			Overpayments Prevented		
			Confirmed		Pending
Status	Number	Original Refund Amount	Number	Amount ^[1]	Number
Rejected	288	\$ 16,117,237	226	\$ 1,406,622	62
Adjusted	283	19,014,963	283	1,382,022	
Paid as Submitted	<u>544</u>	<u>132,933,396</u>	<u> </u>	<u> </u>	<u> </u>
Total	1,115	\$168,065,596	509	\$ 2,788,644	62
Prior Period Errors ^[2]	118	\$ 2,180,540	106	\$ 274,143	12

Notes to Exhibit:

^[1] This amount does not reflect processing costs, which the Department may have incurred correcting these errors.

^[2] This is the status as of March 31, 1996 of refunds with errors which we had identified in prior periods.

EXHIBIT B**DEPARTMENT OF TAXATION AND FINANCE
AUDIT OF CORPORATION TAX REFUNDS
SUMMARY OF MONETARY IMPACT
FOR THE YEAR ENDED MARCH 31, 1996**

	Total Overpayments Prevented	Total Underpayments Prevented
Fiscal Year 1995/96 Audits:		
Total Refunds Prevented	\$2,788,643	
Total Money Movements To Cover Refund	606,374	
Total Assessments Issued	356,292	
Total Additional Refunds To Taxpayer		\$2,317,933
Total Additional Money Carried Forward		2,475,714
Total Fiscal Year 1995/96 Audits	\$3,751,309	\$4,793,647
Prior Fiscal Year Audits:		
Total Refunds Prevented	\$274,143	
Total Money Movements To Cover Refund	-0-	
Total Prior Fiscal Year Audits	\$274,143	
Total For All Fiscal Year Audits	\$4,025,452	\$4,793,647