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STATE COMPTROLLER



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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

September 22, 1997

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

Re: Corporation Tax Refunds
Report 97-D-13

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, 1997.

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 handled by the Department's Processing and Revenue Management Division. Refunds 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 pre-audit and payment.

During the fiscal year ended March 31, 1997, we processed 37,820 corporation tax refunds totaling about \$516 million. Utilizing a statistical sampling approach, we audited 11,703 refunds totaling about \$505 million.

B. Results of Audit

We found that 483 of the 11,703 refunds we audited (4.13%) contained material errors that would cause us to reject or adjust the refund. This error rate is slightly less than the error rate from the prior fiscal year.

As of March 31, 1997, the Department had reevaluated 423 of the 483 refunds that we rejected or adjusted. The Department confirmed that nearly \$2.4 million would have been overpaid had we not

identified the errors. In addition, as a result of our audit, the Department issued assessments totaling \$54,942 for additional tax due for four of the 423 refunds. The Department also identified \$21,461 in additional amounts due for five of the 423 refunds. We also identified that for 19 of the 423 refunds, the Department reallocated \$151,837 among taxpayers' accounts to cover the tax liability and refund request. Our audit activity assured that taxpayers' accounts were in balance and prevented the \$151,837 from being inappropriately used in future periods to cover liabilities or refunds. As of March 31, 1997, the Department had not completed its review of the remaining 60 rejected refunds.

Our audit also identified errors that did not preclude payment of the refund. When this happens, we pay these refunds 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 396 such refunds. After further review, the Department authorized additional payments totaling \$654,303 for 120 of the refunds. The Department also determined that 127 of the 396 refunds contained \$1,657,703 in excess payments. The Department allocated the \$1,657,703 to the next open period within the taxpayers' accounts. For six of the 396 refunds, the Department reallocated \$214,472 among tax years within the taxpayers' accounts to cover the tax liability and refund request. As of March 31, 1997, 103 of the paid as submitted refunds were unresolved.

During the current audit period, 186 refunds which had been rejected or paid as submitted during prior fiscal years were reevaluated by the Department. The Department determined that for 69 of these refunds our audit averted overpayments of \$84,182. In addition, after recalculating these refunds, the Department issued one assessment in the amount of \$4,844 for additional tax liability and issued 48 additional refunds totaling \$442,687. Also, as a result of reevaluating 40 prior period rejected or paid as submitted refunds, the Department allocated \$505,806 in excess payments to the next open period within the taxpayer's account. In reevaluating five prior period rejected or paid as submitted refunds, the Department reallocated \$10,031 within the taxpayers' account to cover the tax liability and refund request. Twenty-nine refunds which were rejected or paid as submitted in prior fiscal years remained unresolved as of March 31, 1997.

The 879 refunds that were rejected, adjusted or paid as submitted during this fiscal year contained a total of 1,043 errors. The following paragraphs provide highlights concerning these errors. The overall results of our audit are summarized in Exhibit A, which is 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 390 of the 1,043 errors (37.4%) were attributable to tax and payment accounting problems: 285 (27.3%) had occurred because the Department did not correctly reconcile computerized taxpayer payment records with tax liability; and 105 (10.1%) 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 \$40,766 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 were due the taxpayer. The Department subsequently authorized an additional refund to the taxpayer totaling \$54,753.

- When reviewing the documentation for a \$12,711 refund, we determined that not only did the taxpayer's account have insufficient money to cover the refund, but the tax liability for the period was underpaid by \$13,634. We returned the refund to the Department for further review. Subsequently, the Department canceled the refund and reallocated \$13,634 within the taxpayer's account to cover the tax liability.
- Our review of the corporation's transcript pertaining to a \$209,712 refund found an amended return was not posted to the taxpayer's account. The amended return increased the tax liability by \$20,864 and requested that the remaining overpayment of \$188,848 be credited to the next open tax period. We returned the refund to the Department which subsequently canceled the refund.

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 332 errors of the 1,043 errors (31.8%) resulted from the Department's incorrect application of these complex rules: 183 (17.5%) occurred because the Department incorrectly calculated the corporation's tax liability; 93 (8.9%) related to the Department's incorrect calculation of the interest accruing on refunds; and 56 (5.4%) resulted from other calculation errors. The following are examples of the errors we identified:

- In reviewing the documentation for a \$647,351 refund, we found the Department had excluded the tax surcharge when calculating the combined corporation's tax liability. We adjusted the refund and prevented an overpayment of \$174,784.
- Our review of a \$712,185 refund found the Department had not used the correct dates when calculating interest. We adjusted the refund and prevented an overpayment of \$52,149.
- In reviewing the documentation for a \$980,817 refund, we found that when the Department calculated the tax liability, it had used an incorrect alternative net operating loss deduction. We adjusted the refund and prevented the overpayment of \$190,813.

3. Return Processing

The administration of corporation taxes begins with the filing of a complete and accurate return in compliance with 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 321 of the 1,043 errors (30.8%) occurred in return and refund processing: 88 errors (8.5%) resulted from the Department's incorrect entry of taxpayer name, refund amount and other required information on the refund voucher; 57 errors (5.5%) 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; 39 (3.7%) resulted from the taxpayer's return not containing a valid original signature; and 137 (13.1%) resulted from noncompliance with various other sections of the Tax Law and Departmental procedures. The following are examples of errors we noted:

- In reviewing the documentation for eight refunds for the same taxpayer totaling \$2,649,153, we found the Department had entered an incorrect taxpayer's name on the voucher. We returned the refunds to the Department without approval. The

Department subsequently resubmitted the refunds with the correct name. This error resulted in a 14 day delay in processing the corporation's refund and also resulted in the State incurring \$13,970 in additional interest costs.

- Our review of four refunds for the same taxpayer totaling \$15,613 found that the taxpayer had not filed a report for a prior period. We returned the refunds to the Department without approval. The Department subsequently canceled the refunds.
- In reviewing the documentation for a \$42,372 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 applied \$19,347 to the tax liability and resubmitted the remaining overpayment.

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, Jill Conway, Susan Dutcher, Carol Weizenhofer, Nancy Wittemer, Michelle Jackson and Brian Neddo.

We would appreciate receiving your response to the recommendation made in this report within 30 days indicating any action planned or taken to implement the recommendation. 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 A. Woodward

DEPARTMENT OF TAXATION AND FINANCE
 AUDIT OF CORPORATION TAX REFUNDS
 SUMMARY OF AUDIT RESULTS
 FOR THE YEAR ENDED MARCH 31, 1997

Exhibit A

Refunds with Errors			Audit Results (3)										
Status	Original Refund Number	Amount	Overpayments Prevented		Additional Assessments		Additional Refunds To Taxpayers		Excess Taxpayer Payments Moved To Future Tax Periods		Adjustments Within Taxpayer Accounts To Cover Refunds And Tax Liability (4)		Pending
			Number	Amount (1)	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number
Rejected / Adjusted	483	\$37,884,943	423	\$2,367,508	4	\$54,942	5	\$21,461	N/A	N/A	19	\$151,837	60
Paid As Submitted	396	\$46,787,543	N/A	N/A	0	\$0	120	\$654,303	127	\$1,657,703	6	\$214,472	103
Total Current Period Errors	<u>879</u>	<u>\$84,672,486</u>	<u>423</u>	<u>\$2,367,508</u>	<u>4</u>	<u>\$54,942</u>	<u>125</u>	<u>\$675,764</u>	<u>127</u>	<u>\$1,657,703</u>	<u>25</u>	<u>\$366,309</u>	<u>163</u>
Total Prior Period Errors (2)	<u>215</u>	<u>\$91,580,488</u>	<u>69</u>	<u>\$84,182</u>	<u>1</u>	<u>\$4,844</u>	<u>48</u>	<u>\$442,687</u>	<u>40</u>	<u>\$505,806</u>	<u>5</u>	<u>\$10,031</u>	<u>29</u>
Total All Period Errors	<u>1,094</u>	<u>\$176,252,974</u>	<u>492</u>	<u>\$2,451,690</u>	<u>5</u>	<u>\$59,786</u>	<u>173</u>	<u>\$1,118,451</u>	<u>167</u>	<u>\$2,163,509</u>	<u>30</u>	<u>\$376,340</u>	<u>192</u>

Notes To Exhibit:

- 1) This amount does not reflect processing costs, which the Department may have incurred in correcting these errors.
- 2) This is the status as of March 31, 1997 of refunds with errors which we had identified in prior periods.
- 3) The aggregate of the audit results numbers may not equal the total number of refunds with errors since individual refunds could have multiple errors.
- 4) These amounts represent monies moved from another tax year to fund a refund in the current audit year. They represent overpayments prevented not for the current audit period but for a future audit period.