

PERFORMANCE AUDIT REPORT

Improving Collections On Closed Sales Tax Accounts

**A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
January 1986**

Legislative Post Audit Committee

Legislative Division of Post Audit

THE LEGISLATIVE POST Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$5 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U.S. General Accounting Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. The standards also have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

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OBTAINING AUDIT INFORMATION

This audit was conducted by Mary Beth Green, Senior Auditor, and Jim Davis and Cindy Lash, Auditors, of the Division's staff. If you need any additional information about the audit's findings, please contact Ms. Green at the Division's offices.

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IMPROVING COLLECTIONS ON CLOSED SALES TAX ACCOUNTS

Summary of Legislative Post Audit's Findings

Sales taxes are paid by consumers but collected by retailers and remitted periodically to the Department of Revenue. In some cases, retailers go out of business before remitting all the taxes they have collected. This audit was conducted to address legislative concerns about the Department of Revenue's procedures for collecting delinquent sales taxes from such retailers.

What is the sales tax liability of retailers who have gone out of business before remitting the sales tax receipts they owe? As of September 30, 1985, the Department of Revenue's accounts receivable records indicated that retailers who have gone out of business before remitting all sales tax receipts may owe the State as much as \$11.5 million. Also, these retailers owe up to \$1.1 million to the counties and another \$1.1 million to the cities. Automobile- and food-related businesses account for more than half of the outstanding liability.

What efforts are made to recover or minimize these outstanding sales tax liabilities, and how successful have those efforts been? The Kansas Retailers' Sales Tax Act provides several remedies for collecting delinquent sales taxes, but none apply specifically to retailers who have gone out of business. These remedies include penalty and interest charges, bonding, tax warrants, revocations of registration certificates, and injunctions. State law also provides for the imposition of liability on purchasers of businesses with delinquent sales taxes, and for fines and jail terms for delinquent retailers.

Once retailers have gone out of business, the State's collection procedures are generally ineffective. In a sample of 50 delinquent, closed businesses, the auditors found that the Department of Revenue collected only about \$49,000 of the \$545,000 owed to the State, or about nine percent. Most of the amount collected--\$43,450--was recovered from bonds. However, few retailers had bonds when they closed, and the available bonds were not even sufficient to cover the outstanding taxes. In addition, 38 of the closed businesses sampled had some history of payment problems while they were operating. In those cases, the Department was often lenient with the retailers while they were still in business.

Can the State improve its ability to collect outstanding sales tax receipts from retailers who are going or have gone out of business? The Department of Revenue should attempt to maximize collections before businesses close. If collections cannot be made on delinquent accounts, the Department should attempt to have businesses closed before further obligations are incurred. The audit recommends that the Department of Revenue develop and follow standard procedures for more aggressive and uniform enforcement of the Retailers' Sales Tax Act. Changes in State law and administrative procedures could also improve collections.



IMPROVING COLLECTIONS ON CLOSED SALES TAX ACCOUNTS

The Kansas Retailers' Sales Tax Act requires all businesses selling tangible personal property for final use or consumption to register with the Department of Revenue and collect sales tax. Sales tax is imposed on and paid by consumers, but retailers are responsible for collecting the tax and remitting it to the Department. Legislative concerns have been raised about the Department's procedures for collecting outstanding sales tax receipts from retailers who have gone out of business before remitting the taxes they collected to the Department of Revenue. To address these concerns, the Legislative Post Audit Committee directed the Legislative Division of Post Audit to conduct a performance audit in this area. The audit addresses three questions:

- 1. What is the sales tax liability of retailers who have gone out of business before remitting the sales tax receipts they owe?**
- 2. What efforts are made to recover or minimize these outstanding sales tax liabilities, and how successful have those efforts been?**
- 3. Can the State improve its ability to collect outstanding sales tax receipts from retailers who are going or have gone out of business?**

To answer these questions, the auditors reviewed State laws and regulations and interviewed Department of Revenue officials. They also reviewed information provided by the Department concerning the number and type of retailers that discontinued operations without remitting all sales tax collected. They examined a sample of case files for closed sales tax accounts. They also contacted other states to identify ways to improve the State's sales tax collection procedures.

In general, the auditors found that retailers who have gone out of business without remitting all sales tax receipts may owe the State up to \$11.5 million. Once these retailers have discontinued operations, the Department of Revenue generally does not collect the outstanding amounts. In some cases these liabilities cannot be avoided. But in many instances, the Department could enhance the collections made before these retailers go out of business through more stringent enforcement of current laws and regulations. Changes in administrative practices and State law could also help maximize the collections made on delinquent sales tax accounts. These findings are discussed following a brief overview of the sales tax program.

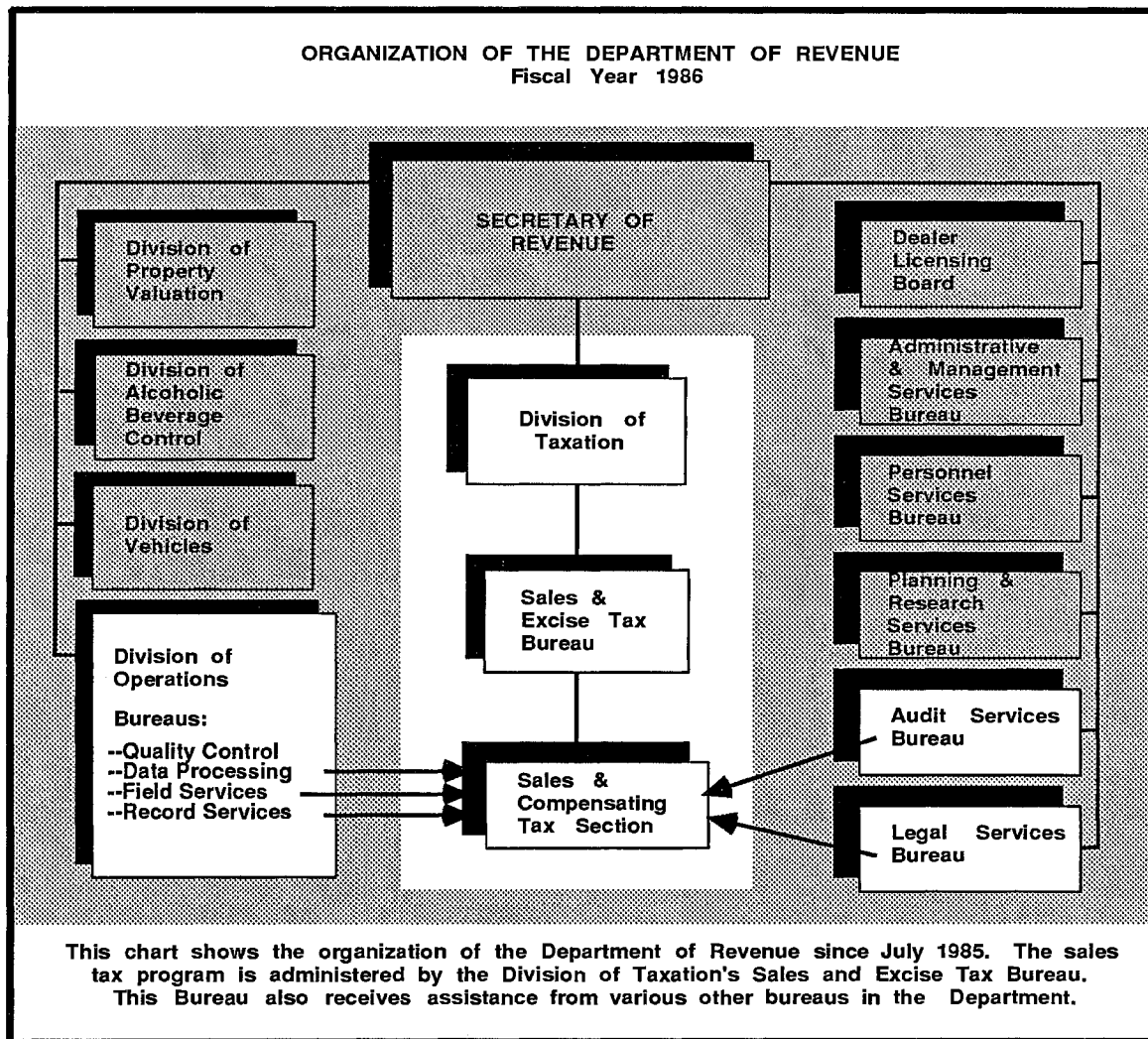
An Overview of the Sales Tax Collection Program in Kansas

Sales taxes were originally enacted in 1937 by the Kansas Retailers' Sales Tax Act, K.S.A. 79-3601 *et seq.* Current State law levies a sales tax of three percent on retail sales. Counties and cities are allowed to impose additional sales taxes of up to one percent on retail sales. Effective January 1, 1986, 58 counties and 106 cities in Kansas had local sales taxes.

Within the Department of Revenue, the Division of Taxation's Sales and Excise Tax Bureau Administers the Sales Tax Program

By law, counties and cities are prohibited from administering their portions of sales taxes. As a result, the Department of Revenue's Sales and Excise Tax Bureau administers all State, county, and city sales taxes. Sales tax receipts remitted to the State are deposited in the State treasury. Periodically, the State Treasurer's Office transfers money to the localities. In fiscal year 1985, retailers remitted approximately \$480 million in State sales tax, and an additional \$133 million in local sales taxes.

The Sales and Excise Tax Bureau has the primary responsibility for administering the sales tax program, but several other bureaus within the Department provide assistance. The Records Services Bureau handles return processing and money. The Audit Services Bureau reviews taxpayer records to ensure that the proper amounts of tax have been paid. The Field Services Bureau acts as the agency's collection arm. The Legal Services Bureau handles litigation and court actions. Finally, the Data Processing Services Bureau maintains computerized records of taxpayer account information. The organization chart below shows the bureaus involved in administering the sales tax program.



In fiscal year 1985, the Sales and Excise Tax Bureau spent about \$1.7 million on operations. Of that amount, \$1.2 million, or 70.6 percent, was spent on salaries and wages. Budgeted expenditures for fiscal year 1986 are more than \$1.9 million. The Bureau has 66 authorized positions, 23 of which are assigned to the sales and compensating tax section. The Bureau's sales tax activities include registering retailers, processing returns, maintaining payment records, and closing out accounts of taxpayers no longer in operation. In addition to sales tax, the Bureau is responsible for compensating, excise, motor fuel, and bingo taxes.

What Is the Sales Tax Liability of Retailers Who Have Gone Out of Business Before Remitting the Sales Tax Receipts They Owe?

To answer this question, the auditors reviewed sales tax information provided by the Department of Revenue. Because retailers who have gone out of business often fail to file the required returns, the Department's figures include many estimated account balances. When a business does not file a sales tax return, the Department estimates the amount of tax owed, together with penalties and interest, and bills the taxpayer for that amount. This process is called a jeopardy assessment. Thus, the information presented here includes figures provided by jeopardy assessments. The information does not include all penalty and interest charges for businesses that filed returns without remitting taxes. In those cases, the Department knows the exact amount of tax owed by the retailer.

Retailers Who Have Gone Out of Business Without Remitting Sales Tax Receipts May Owe the State Up to \$11.5 Million

As of September 30, 1985, the Department's accounts receivable records indicated retailers who have gone out of business without remitting all sales tax receipts may owe the State up to \$11.5 million. In addition, these retailers owe up to \$1.1 million to the counties and another \$1.1 million to the cities. Although \$11.5 million is a significant amount, this figure represents less than three percent of the State's annual sales tax receipts.

Retailers Classified as Automobile- and Food-Related Businesses Account for More Than Half of the Outstanding Liability

The Department of Revenue classifies retailers into 11 major groups for registration purposes. As shown in the table at the top of the next page, two of these major groups--the automotive group and the food group--account for 52.5 percent of the \$11.5 million outstanding. However, these business classifications are not entirely accurate because they are not updated. Retailers who obtain a sales tax registration may change their line of business without contacting the Department. As a result, when a retailer goes out of business, the classification may not always reflect its final line of operations.

Each major classification contains numerous subgroups. For example, the automotive group includes auto, aircraft, and bicycle dealers, service stations, and garage/repair shops. The food group includes grocery stores, restaurants, bakeries, and vegetable markets. A detailed listing of the subgroups for all classifications, along with the number of accounts and amounts outstanding in each subgroup, can be found in Appendix A.

OUTSTANDING STATE SALES TAX FOR CLOSED ACCOUNTS
By Business Classification
As of September 30, 1985

<u>Business Classification</u>	<u>Number of Accounts</u>	<u>Average Account Balance</u>	<u>Balance Due</u>	<u>Percent of Total</u>
Apparel	293	\$ 651	\$ 190,864	1.7%
Automotive	1,682	1,317	2,214,510	19.3
Food	3,288	1,161	3,816,847	33.2
Furniture	863	1,660	1,432,467	12.5
General Merchandise	858	512	439,359	3.8
Lumber & Building	650	1,694	1,101,087	9.6
Professional & Personal Services	1,064	776	826,192	7.2
Public Utilities	8	1,512	12,099	.1
Farm & Garden Produce	84	389	32,669	.3
Manufacturing & Trading	476	1,559	741,890	6.4
Unclassified	<u>783</u>	<u>874</u>	<u>684,242</u>	<u>5.9</u>
Totals	<u>10,049</u>	<u>\$1,144</u>	<u>\$11,492,226</u>	<u>100.0%</u>

Many Closed Sales Tax Accounts Have Insignificant Balances

The Department of Revenue currently maintains computerized records for more than 10,000 closed sales tax accounts. Many of these accounts have small balances such as \$1.02, \$7.16, and \$20.06. According to Department officials, many of these small balances are the residual amounts due after the retailers make final payments. The auditors did not count the total number of accounts with insignificant balances, but of a total of about 300 closed grocery store accounts, 63 accounts had balances of \$50 or less. The Department's current policy for writing off accounts receivable, including closed sales tax accounts, is to write off any account after seven years have passed without any transactions.

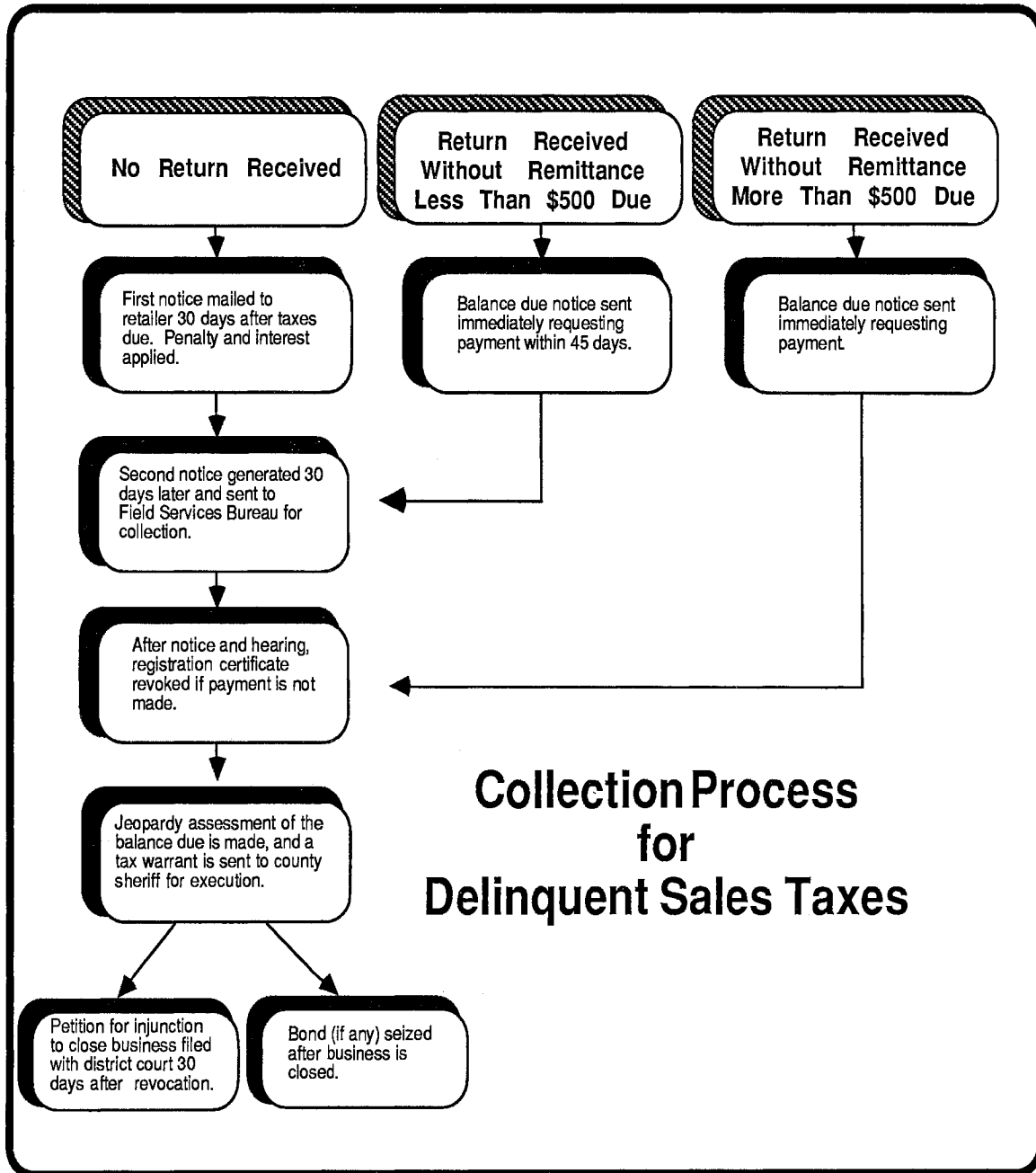
**What Efforts Are Made to Recover or
Minimize These Outstanding Sales Tax Liabilities,
and How Successful Have Those Efforts Been?**

To answer this question, the auditors reviewed State laws and regulations, as well as the Department of Revenue's procedures for collecting sales taxes. A sample of closed sales tax accounts was examined to determine what efforts the Department made to recover the outstanding amounts. The auditors evaluated the effectiveness of those collection procedures after firms had gone out of business.

In general, they found that State law provides several remedies for collecting outstanding sales taxes, but that it has no special provisions for collecting delinquent sales taxes from closed businesses. Once retailers go out of business, it appears that the State's collection procedures are generally ineffective. However, the auditors determined that many businesses that close before remitting all taxes have historically been problem accounts. In such cases, the Department is often lenient with the businesses before they discontinue operations.

The Retailers' Sales Tax Act Provides a Number of Remedies For Collecting Outstanding Sales Taxes

Retailers are required to remit sales tax receipts to the Department semi-monthly, monthly, quarterly, or annually. Individual remittance cycles depend on the retailer's annual tax collections. When a retailer does not file a sales tax return by the due date, the Department uses its standard procedures to collect the outstanding amount. These procedures include mail notices, personal contacts, penalties and interest charges, hearings, revocations of sales tax registrations, tax warrants, bond seizures, and court proceedings. The main procedures used by the Department to collect delinquent amounts are shown in the figure below.



As the figure shows, the Department uses numerous administrative procedures when attempting to collect from delinquent retailers. After this process is exhausted, it must rely on the district courts for additional actions. The State's major remedies for collecting outstanding amounts include:

Penalties and interest charges. Retailers who fail to remit taxes on time may be charged interest on the balance due, at the rate of 18 percent annually. Penalties can range from 10 percent to 50 percent of the amount due.

Bonding. All corporations applying for a sales tax certificate of registration must file a cash, escrow, or surety bond. The bond amount is equal to three months' average tax liability. Under certain circumstances, the bond requirement for corporations may be waived. The Department may also require bonds from any type of business--sole proprietorship, partnership, or corporation--with a poor payment record.

Revocation of registration certificates. After reasonable notice and a hearing, the Director of Taxation may revoke an entity's registration certificate. It is unlawful for any person to engage in the business of selling tangible personal property at retail without a valid registration certificate.

Tax warrants. After determining the amount due from a retailer, the Department can issue a tax warrant. Tax warrants are legal notices authorizing officials to seize and sell real and personal property of retailers to satisfy delinquencies. Warrants are generally sent to county sheriffs for execution. Warrants are filed with the clerk of the district court and become judgments against retailers and liens upon real property.

Injunction proceedings. For any retailer making sales without a valid registration certificate, the Department may file a petition for an injunction prohibiting the business from making retail sales. Injunction petitions are filed with the district courts.

Imposing successor liability. According to K.S.A. 79-3612, the purchaser of a business shall be personally liable for the payment of any unpaid sales taxes of the seller, up to the value of the property received.

Jail terms and fines: Upon conviction, retailers may be fined \$100 to \$1,000 or may be imprisoned in the county jail for one month to six months for violating the Retailers' Sales Tax Act.

Some of the actions the Department may take when collecting delinquent sales taxes are punitive, but they will not directly produce monetary results. For example, assessing penalties and interest will not necessarily result in the retailer remitting the taxes due, particularly if the retailer has used those sales tax receipts for other purposes. After retailers have gone out of business, many of these remedies for collecting delinquent sales taxes are inherently ineffective. For example, revocation of a sales tax registration certificate is meaningless once the retailer has gone out of business. Likewise, there is no point in seeking an injunction to have a business closed if operations have already ceased.

Theoretically, the methods that should be most effective when collecting from closed businesses include seizing bonds, issuing tax warrants, holding purchasers responsible for liabilities, and imposing jail sentences or fines. After businesses close, the Department generally seizes available bonds, issues tax warrants for the amount due, and files claims in bankruptcy courts.

The auditors found that the procedures involving bonds and tax warrants generally are ineffective, as discussed in the section below. Department officials also indicated that they have not historically held purchasers of businesses responsible for the sales tax liabilities of the sellers, and recent attempts to do so have not been successful. Further, the Department does not generally initiate the legal actions that could result in jail terms or fines.

The Department's Collection Procedures Are Generally Ineffective After Retailers Have Gone Out of Business

To determine what actions the Department actually takes to recover outstanding amounts from closed businesses, the auditors examined 50 accounts of retailers who went out of business before remitting all sales taxes. The 50 accounts reviewed included 25 automobile dealers and 25 grocery stores that owed the State at least \$1,000 at the time they closed. Automobile dealers and grocery stores were selected for review because those subgroups belong to the two business classifications responsible for more than half the outstanding liability for closed sales tax accounts. In total, the 50 accounts owed the State more than \$545,000 and owed cities and counties approximately \$103,000.

The auditors found that the Department has collected delinquent sales taxes from only 12 of the 50 closed businesses sampled. It has collected approximately \$49,000 of the \$545,000 owed to the State by the 50 accounts, or about nine percent. The Department generally collected from businesses with bonds, but few businesses had them. For those that did, the bond amount covered only about one-fifth of the tax liability. The Department generally does not collect on tax warrants it files against closed businesses. These areas are discussed in more detail below.

The Department usually collected from businesses with bonds, but few businesses had them. According to the Department's administrative regulations, bonding requirements are only mandatory for corporations. Any bond requirement can be waived, at the retailer's request, after the firm establishes a satisfactory payment record for 12 consecutive months. The Department's bonding policies are discussed in more detail in the box on page eight.

Only 11 of the 50 cases reviewed had bonds posted at the time the business closed, and the Department collected the bonded amount in all 11 cases. The bonded businesses included five corporations, five proprietorships, and one partnership.

Bond amounts were not sufficient to cover the taxes owed. For the 11 cases with bonds, the accounts had total outstanding balances of \$204,159, and the total amount recovered from bonds was only \$43,450. Thus, the bonds represented only 21.3 percent of the total amount due, ranging from 1.2 percent to 44.6 percent. Individually, the amounts due ranged from \$2,900 to more than \$133,000. Bond amounts ranged from \$50 to \$35,000.

The Department waited an average of seven months after businesses closed to seize available bonds. For the 11 bonds in the auditors' sample, an average of more than seven months elapsed between the time the business closed and the actual date of the bond seizure. Department officials explained that such time lapses occur because of the time required to perform the internal, final audit of the account and arrive at the final balance due. For surety bonds, the Department does not request payment from the surety company until six weeks after the final audit is performed. Although this time lapse does not affect the amount collected on the bonds, it delays the State's ability to use these funds.

SALES TAX BONDING REQUIREMENTS

The Director of Taxation has statutory authority to require a bond from any retail seller. Such bonds help protect the State against the loss of tax revenues when businesses fail to remit sales tax receipts. According to the Department of Revenue's administrative regulations, this requirement is mandatory only for corporations, because corporate officials are not personally liable for unremitted sales tax.

To qualify for a sales tax registration certificate, a corporation must post bond in an amount equal to three months' average tax liability. Any bond requirement may be waived if a corporation provides a certified financial statement showing net worth in excess of one year's liability, or establishes a satisfactory payment record for 12 consecutive months. (The Department has proposed some changes to these regulations. The new rules would require all corporations to post bond in an amount equal to six months' average tax liability, or \$1,000, whichever is greater. The proposed changes would not allow for any exemptions to bonding requirements. If adopted, these changes would become effective May 1, 1986.)

Businesses can obtain three types of bonds to satisfy Department regulations. A **surety bond** works much like an insurance policy, with the surety company paying the taxpayer's delinquent tax up to the face amount of the bond. An **escrow bond** is a deposit of cash held by a third party, usually a bank or an escrow company. A **cash bond** is a deposit of cash held by the Department of Revenue.

The Surety Association of America's suggested rate schedule sets the annual cost of a sales tax surety bond at \$20 per \$1,000 of coverage, with a \$30 minimum annual premium. The following are examples of the annual cost to retailers of a surety bond using these rates.

<u>Monthly Retail Sales</u>	<u>Monthly Sales Tax Collections</u>	<u>Bond Currently Required</u>	<u>Annual Bond Premium</u>	<u>Monthly Bond Premium</u>
\$ 10,000	\$ 300	\$ 900	\$ 30	\$ 2.50
50,000	1,500	4,500	90	7.50
100,000	3,000	9,000	180	15.00
250,000	7,500	22,500	450	37.50

The Department generally does not collect on tax warrants once they are filed. Tax warrants are legal notices authorizing officials to seize and sell a retailer's property to satisfy delinquencies. Sales tax warrants are sent to county sheriffs for execution and are filed with the clerk of the district court, where they become liens against real property. In the 33 cases where warrants were filed after the business closed, the Department collected on the warrant in only two cases. A total of \$5,815 was recovered, out of warrants filed for approximately \$464,000. In the 17 cases where no warrants were filed after the business closed, 13 cases involved bankruptcy proceedings. In 10 of those 13 cases, the Department filed claims with the bankruptcy court. It has not received payment on any of those claims.

According to Department officials, one factor that contributes to the Department's inability to collect on warrants is its reliance on county sheriffs to identify and sell the retailer's available property. Under the current system, there is little incentive for sheriffs to make a serious effort to identify and sell property. Finally, warrants may not be satisfied in cases when the retailer leases property, or liens of higher priority are already attached to the property.

The Department often does not file warrants until months after businesses close. For the 33 cases where warrants were filed after the retailer went out of business, the Department filed the warrants an average of four and one-half months after the business closed. Although tax warrants become liens on property, the more time that elapses between the business closing and the warrant filing date, the less likely it is that assets will be available to satisfy the delinquency.

For Many Closed Accounts, the Department Was Lenient With the Retailers While They Were Still In Business

Because the Department is so unsuccessful at collecting outstanding amounts once retailers have gone out of business, the auditors examined the history of the 50 sampled accounts prior to the business closings. They found that 12 of the 50 retailers had no history of delinquencies or other remittance problems prior to the date the business closed. In those cases, the Department could not be expected to foresee collection problems. However, each of the remaining 38 cases, or 76 percent of the sample, had some history of payment problems. Because most of these businesses were problem accounts, the circumstances encountered and the Department's actions often varied from account to account. However, typical problems included chronic instances of one or more of the following:

- failure to file timely returns
- failure to remit taxes collected
- failure to promptly obtain bonding
- paying with insufficient funds checks

While a delinquent retailer is still operating, the Department can effectively charge penalties and interest, require bonds, revoke registration certificates, issue tax warrants, and initiate injunction proceedings. For the 38 accounts with histories of payment problems, the auditors examined the actions taken by the Department on the accounts prior to the closings. They found that the Department generally did assess penalties and interest on the accounts, and in many cases did revoke registration certificates. However, the Department did not always take disciplinary actions promptly and did not act aggressively to collect the sales tax owed. Further, many of the problem accounts were not required to post bonds. For the businesses with bonds, the Department has adopted a policy not to seize the bonds to satisfy delinquencies while retailers are still operating. These areas are described in the following sections.

A Business Was Allowed to Operate Without a Sales Tax Certificate For More Than Three Years

A grocery store opened in May 1975 and closed when the owner died in November 1982. Between March 1976 and October 1978, the retailer wrote 13 insufficient funds checks to the Department of Revenue totaling more than \$3,400. In October 1978, the Department filed its first complaint against the retailer. At that time, the Department requested and received an additional \$200 cash bond. The next month the retailer paid the balance due and the complaint was dismissed.

In February 1979, the Department filed a second complaint against the business. This second complaint cited six months of delinquency--three of these months had been cited in the prior complaint and were noted in November as having been paid. The next month, March 1979, the Department revoked the business' tax registration and stated that the retailer must pay the balance due and post an \$800 bond to be reinstated.

Despite the revocation, the business continued to make retail sales--in violation of State law--until the owner died in November 1982. The Department apparently did not file a petition for an injunction to prohibit the retailer from operating at any time between March 1979 and November 1982. In April 1983, the Department sent the deceased retailer notice of an estimated balance due of over \$17,000. A tax warrant for \$16,600 was also filed in April. In May 1983, four bonds totaling just \$800 were seized. No further action has been taken. Department officials stated there was no apparent reason why the business was allowed to continue operating for more than three years without a valid registration certificate.

A Retailer's Failure to Remit Sales Taxes Over a 31-Month Period

A grocery store that opened in June 1970 went out of business in August 1974. At that time, the Department of Revenue noticed that the business had not remitted any sales tax since January 1972. In December 1974, the Department made a \$15,000 assessment for the 31-month period and issued a tax warrant. The Department abated \$5,700 of the assessment in January 1975 because returns were filed for February through December 1972. However, no actual payments were made for that period. Because this delinquency occurred more than 10 years ago, Department of Revenue officials could not explain why the account was allowed to operate for 31 months without remitting any sales tax receipts.

The retailer made nominal payments on the account in June and August 1975. In April 1976, the Department sent a letter to the retailer's attorney regarding a garnishment the Department had filed. This letter stated that several garnishments had been filed and that more would be filed until the balance due was remitted. From January 1976 to May 1979 the retailer paid approximately \$2,975 of the outstanding balance. The Department has not received any payments on this account since May 1979, and the State balance due on September 30, 1985 was about \$10,000.

In many cases, the Department did not take prompt action against retailers who were delinquent in remitting sales taxes. For example, the Department filed a complaint and scheduled a revocation hearing for a grocery store in February 1983. The complaint indicated the business had been delinquent for 10 of the 14 months it had been operating. When the retailer's registration certificate was revoked in March 1983, the retailer was delinquent for December 1981, March through December 1982, and January 1983.

The auditors found that 15 of the 38 problem accounts did not have valid registration certificates when the retailer went out of business. Seven of these retailers went out of business within about three months of the Department's revocation order. The remaining eight retailers operated an average of more than 18 months after revocation. The Department filed petitions for injunctions against five of these retailers, but an average of eight months elapsed between the revocation orders and the filings. The Department issued four additional revocations after the associated retailers had already gone out of business.

When the Department did take remedial actions, those actions were

often not aggressive. For example, the Department revoked a grocery store's registration certificate in September 1983, following chronic tax delinquencies. At the time, the Department indicated the retailer would have to remit past taxes due and submit a \$1,500 bond before being reinstated. The business continued operating after the revocation, in violation of State law. In October 1983, an employee of the Field Services Bureau requested that injunction proceedings be initiated. The Department did not file an injunction petition until almost one year later, in September 1984. The retailer then posted a \$750 bond. The Department had the injunction action dismissed in November, because the field representative had provided the Legal Services Bureau with an incorrect name under which to file the action. A second injunction petition was filed in December under the correct name. The Department never received the remaining \$750 bond. By April 1985, the business was closed and the retailer had declared bankruptcy. The final amount due on this account was \$19,600.

The Department did not require many problem accounts to post bonds. According to the Department's administrative regulations, bonding requirements are only mandatory for corporations. Unlike owners of proprietorships and partnerships, corporate officials are not currently liable for unremitted sales tax. In some cases, the Department also requires firms with poor payment records to post bonds. Of the 38 problem accounts reviewed by the auditors, only 10 accounts had bonds at the time the business closed. If more of the remaining 28 accounts had been bonded, the Department could have collected on more closed accounts.

A Retailer Was Allowed to Operate Despite A Poor Payment Record

A grocery store opened in November 1981 and closed in January 1985. The owner apparently had problems remitting sales tax from the outset. In November 1982, the Department filed a complaint against the business and requested a \$750 bond. The next month, the Department revoked the retailer's sales tax registration certificate and issued a tax warrant for the balance due of \$3,300. For reinstatement, the retailer was required to pay the balance due and post a \$750 bond.

In February 1983, the retailer sent a check (that later proved to be insufficient) for part of the delinquency. That same month, a representative of the Field Services Bureau recommended that the business be shut down. In March 1983, the Department sent the retailer a letter advising him that if he did not pay off the balance and post the \$750 bond, it would seek an injunction to close the business. In April 1983, the field representative sent a memo to the Topeka office stating that the taxpayer had made a payment of more than \$800 with an insufficient funds check, had not filed returns for several months, had not applied for a payment plan, and had not posted the \$750 bond. The field representative again requested an injunction to close the business. He requested one again in July 1983.

In September 1983 the pattern changed. The retailer appeared and filed all delinquent returns. The retailer explained that he was currently involved in litigation that was about to net him enough money to pay off his balance due, and he would be back the next

month to do just that. In the meantime, he paid \$500 on his account. A November memo from the field representative stated that the retailer came back in October, but only paid \$200 because the lawsuit was not yet settled. The field representative went on to say that the retailer was supposed to make a "substantial" payment in November. In December 1983, the Department dismissed its complaint against the business. A memo from the field representative in March 1984 said that the retailer had remitted the tax for January, but nothing on the balance. Lawsuit proceeds were expected in 30 to 60 days.

In June 1984, the field representative sent another memo stating that the owner had paid his taxes for February through April (with a check that was later returned for insufficient funds), but still had not received the proceeds from the lawsuit. The field representative told the retailer that he should provide some proof of the forthcoming proceeds from the lawsuit, such as a copy of the most recent journal entry in the case, or the Department would close him down. In August 1984, the retailer remitted his May tax in cash. In January 1985, a memo from the field representative stated that the retailer still had not brought in the journal entry and he had canceled several appointments.

The retailer closed the business in January 1985. In March 1985 he filed all the delinquent returns (without remittance) and stated that he was going to file bankruptcy. The final balance due on the account was about \$5400. The Department did not file a bankruptcy claim against the retailer because he had no assets subject to the bankruptcy proceeding.

The Department will not seize a bond from a delinquent retailer as long as the firm is making retail sales. According to Department officials, this policy was adopted because if a bond was seized before the business closed, the retailer would have to obtain another bond. If the retailer failed to do so, the Department would be forced to initiate revocation proceedings. Because the Department will not seize a bond from a retailer until the business is closed, retailers can incur liabilities and even violate State law without having their performance bonds seized. For example, the Department revoked an auto dealer's registration certificate in July 1983, but the retailer continued to operate until February 1984. By that time, the retailer owed the State approximately \$5,000 in delinquent sales taxes. Yet, the Department did not seize the retailer's \$300 bond until September 1984.

Businesses That Incurred Large Liabilities In a Short Time

An automobile dealership made its first sales in January 1983 and closed in December 1983. The dealer never filed a sales tax return and never remitted any sales tax. The Department made a jeopardy assessment against the dealer in early October 1983 covering the entire period the business had been open. The amount of sales tax due was in excess of \$1,100. Later that month, the Department filed a complaint against the dealer. The complaint identified the period of delinquency and stated that, to avoid revocation, the dealer must post a bond of \$150. The complaint was sent by certified mail, but the dealer never claimed it. In November 1983, the Department revoked the dealer's sales tax registration. In December, the field representative reported that the business was closed and the owner's whereabouts were unknown. The final balance due from this dealer was approximately \$1,400. The Department has never been able to locate the owner.

Another automobile dealership operated only nine months--March to November 1979--before it closed. The Department sent notices asking for payment in August, October, and November, the month the business closed. The Department filed a complaint in January 1980 and, that same month, learned that a local auction company had held a liquidation sale for the business in November. The State received none of the proceeds from that sale. When the final jeopardy assessments were made, the balance due to the State was nearly \$22,000. In September 1980, a notation was made in the file that the business had filed bankruptcy, and the Department filed a claim with the bankruptcy court later that month. The State has received nothing more on the account from the bankruptcy action or otherwise.

A Retailer With Chronic Delinquencies

An automobile dealership began operating in February 1972 with a \$500 surety bond. This level of bond coverage was continued until November 1975, when the requirement was increased to \$1,500. The Department's field representative cited the retailer's "chronic delinquency" as justification for the increase. During the next year, the retailer was assessed penalty and interest on five delinquent returns, and in November 1976 its bond requirement was raised to \$2,500. In July 1977, the Department filed a complaint asserting that the retailer had been delinquent for 15 of the past 18 months. The sales tax registration was revoked in early August, but by mid-month the retailer brought the account up to date, and at the end of August the registration was reinstated.

This scenario was repeated several times before the business closed on September 30, 1980. In the three-year period from July 1977 to September 1980, the Department filed five complaints against the retailer for continuous delinquency. Two of the complaints resulted in revocation, followed by payment from the retailer and reinstatement. The final revocation occurred in August 1980 after the \$3,500 surety bond was canceled, and the retailer was unable to secure another. On September 25, an employee of the Department's Field Services Bureau recommended that the Department begin injunction proceedings to have the business closed. Five days later the retailer went out of business.

The Department made a jeopardy assessment of taxes due and filed a tax warrant in January 1981. In March, the jeopardy assessment was abated in lieu of returns filed for May and July-September 1980. The final audit of the account, completed in April 1981, showed a balance due of \$9,400.

Can the State Improve Its Ability to Collect Outstanding Sales Tax Receipts from Retailers Who Are Going or Have Gone Out of Business?

Collecting outstanding sales tax from retailers who are going or have gone out of business is complex and time-consuming. The Department has numerous administrative remedies available for collecting from delinquent retailers, but some of these remedies are

not effective for closed businesses. Further, once the administrative remedies are exhausted, the Department of Revenue must rely on the district court system for additional remedies.

The auditors reviewed State law, regulations, and procedures for collecting outstanding sales tax receipts. They also contacted nine other states regarding their collection procedures. Other states' procedures are similar to the ones used in Kansas. There are, however, some provisions and policies that Kansas does not have or does not use. These include holding corporate officials personally liable for delinquencies, having State enforcement officials, and imposing criminal sanctions against offenders. The other states' procedures are summarized in the box on page 14.

In general, the State's procedures for collecting outstanding sales taxes are ineffective once retailers go out of business. The auditors concluded that for businesses with no history of payment problems, the Department of Revenue cannot be expected to foresee collection problems. However, with many other retailers, the Department should be aware that problems exist. In those cases, the Department should attempt to maximize the collections made before the firms go out of business. Such actions would include imposing penalties, filing tax warrants, and seizing bonds.

If collections cannot be made on delinquent accounts, the Department should attempt to have those businesses closed before further obligations are incurred. This would require the Department to promptly revoke registration certificates and seek injunctions prohibiting retailers from operating. Finally, after delinquent retailers go out of business, the Department could enhance collections by strengthening its bonding policies and tax warrant procedures. Some collections are currently made on bonded accounts, but the bond amounts are not sufficient to cover outstanding liabilities and many firms do not even have bonds. Once businesses are closed, the Department generally does not collect at all on tax warrants.

A Retailer That Closed With No History of Payment Problems

A grocery store made its first sales in June 1976 and closed six years later in August 1982. The Department of Revenue's files show no sign of the business having any history of payment problems. In September 1982, the Department sent the retailer notice that no sales tax return had been filed for July 1982. In November, the Department contacted the retailer by telephone asking about returns for July and August. The retailer said that those returns had been mailed the previous week without the tax remittance. In December, the returns still had not been received, and a field representative requested a jeopardy assessment. In January 1983, the Department closed the account with a balance due of more than \$6,000 in tax, penalty, and interest for July and August 1982. A tax warrant for \$6,100 was filed on this account in May 1983. The files show no payments having been received and no further contact with the retailer.

COLLECTING DELINQUENT SALES TAXES IN OTHER STATES

The auditors contacted nine other states, including the four surrounding states, to determine how those states collected delinquent sales tax receipts. Most have procedures similar to Kansas', with Iowa's and Oklahoma's being virtually identical. The following is a summary of the responses that were different.

Colorado--Colorado has an automated collection system that identifies sales tax delinquencies immediately. If the retailer does not pay the delinquent tax after proper notification, Colorado issues a distraint warrant authorizing tax compliance agents to seize and sell the retailer's property. The retailer's sales tax permit may be revoked, but the state usually does not do so. Colorado does not require retailers to be bonded.

Indiana--If a retailer in Indiana does not remit the tax owed, the state sends a warrant to the local sheriff. The sheriff can then file a lien against the retailer's property. If the sheriff cannot or does not collect, state collection attorneys file suit against the business. Private collection agencies are often used for firms headquartered outside Indiana. The state can revoke sales tax permits and can collect from corporation officials.

Massachusetts--Revenue officials in Massachusetts say the state has taken an aggressive, high-profile collection stance in recent years. Massachusetts turns delinquent accounts over to a state collection agent. The agent records a tax lien and looks for specific property to levy against. Massachusetts has an active seizure program, giving agents the power to seize property after 10 days' notice. Failure to file returns and remit sales tax is a felony, and the state is now sending violators to prison. Revenue officials believe this has increased voluntary compliance by several million dollars. Massachusetts has no bonding requirement.

Minnesota--If a retailer does not pay delinquent taxes after three months, the state tax commissioner may levy against any of that retailer's assets by issuing a distraint warrant. If no assets are discovered, Minnesota has other means to collect. It can hold corporation officials personally liable, seize income tax refunds, offset payments to retailers that sell to the state, and hire private collection agencies for retailers that have left the state. Minnesota also can require a bond and can revoke sales tax permits. It refuses to grant a permit to anyone who already owes \$1,000 or more in delinquent sales taxes.

Missouri--Missouri files a lien against the assets of a retailer who has a delinquent sales tax account. It seizes the retailer's bond (all are required to have a bond) and revokes the retailer's sales tax permit. The account is then given to the county prosecutor who retains locally 20 percent of whatever can be collected. Missouri imposes successor liability on purchasers of businesses having outstanding sales tax receipts. Also, sales taxes for motor vehicles are paid directly to the state rather than to dealers.

Nebraska--If a retailer fails to remit sales taxes owed, Nebraska seizes any bond. However, retailers headquartered out-of-state are generally the only ones required to obtain a bond. Nebraska imposes personal liability on corporate officials. If a delinquent retailer continues to operate, the state may obtain a court order to take delinquent taxes from its profits.

Wisconsin--Wisconsin issues a delinquent warrant for outstanding sales tax accounts. The warrant is both a personal judgment against the retailer and a lien against the retailer's property. If retailers refuse to remit the taxes owed, they may be taken to court on the basis of the warrants. Personal judgments follow individuals and can lead to later garnishments of wages. Wisconsin may revoke sales tax permits. Bonds may also be required, but for a maximum of \$15,000. The state can pursue corporation officials, but must initiate a separate assessment process.

Recommendations

1. To maximize the collections made on both delinquent and closed sales tax accounts, the Department of Revenue should:
 - a. Establish and follow standard procedures for more aggressive, consistent enforcement of the Retailers' Sales Tax Act against delinquent retailers. Such procedures could include:
 - seizing bonds before retailers go out of business
 - revoking registration certificates promptly
 - seeking injunctions promptly
 - b. Strengthen its bonding policies. All retailers should be required to secure and maintain bonds, bond amounts should be increased, and bonds should be seized to satisfy delinquencies before businesses close. Legislative Post Audit made similar recommendations in its 1982 performance audit of the Division of Taxation.
 - c. Systematically pursue enforcement of successor liability. State law currently requires the Department to hold purchasers of businesses liable for outstanding sales tax of sellers, up to the value of the property received.
 - d. Seek legislation authorizing the imposition of personal liability for delinquent sales tax on corporate officials.
 - e. Develop procedures for writing off closed sales tax accounts with insignificant balances. In many cases, it is not feasible or cost effective to collect these accounts, and writing them off would reduce the number of closed sales tax accounts managed by the Department.
2. To minimize delinquencies and enhance the sales tax collections made after delinquent retailers go out of business, the Department should explore these options:
 - a. Developing procedures at the State level for identifying assets owned by delinquent retailers and providing county sheriffs with lists of those assets when warrants are filed.
 - b. Providing financial incentives to county officials for collecting on tax warrants. A penalty could be added to the warrant amount and earmarked for the locality.
 - c. Requiring purchasers to pay sales tax on large purchases directly to county treasurers or the Department of Revenue. State law currently requires sales tax on isolated purchases of motor vehicles to be paid in this manner.



APPENDIX A

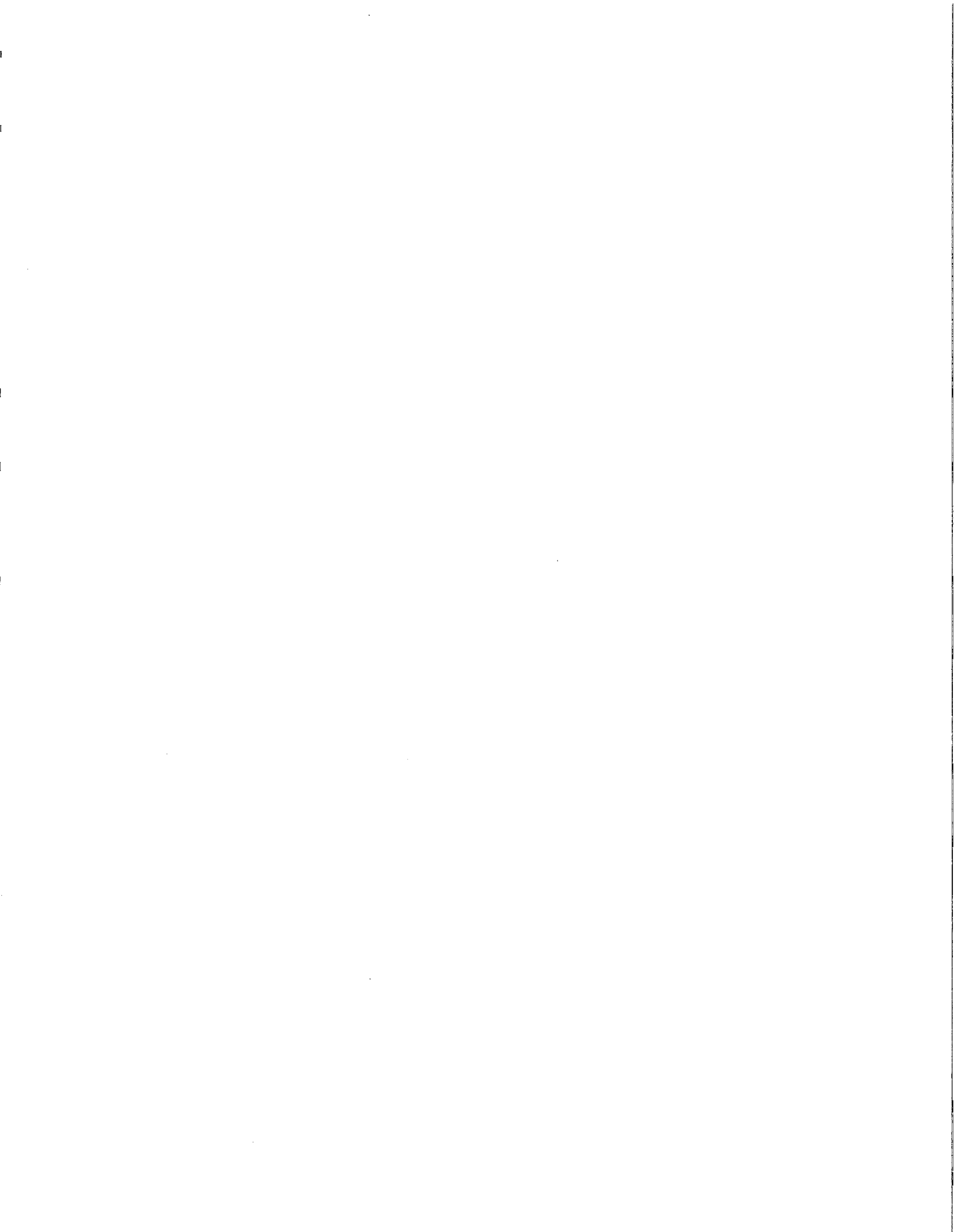
**Outstanding State Sales Tax for Closed Accounts
By Business Classification
As of September 30, 1985**

<u>Business Classification</u>	<u>Number of Accounts</u>	<u>Balance Due</u>	<u>Average Balance</u>
Apparel			
Boot and Shoe Stores	31	\$ 22,142	\$ 714
Clothing Stores - Men	26	25,310	973
Clothing Stores - Women	70	56,533	808
Shoe Repair Shops	19	2,793	147
Other Apparel Stores	147	84,086	572
Subtotal - Apparel	293	190,864	651
Automotive			
Accessories, Tires, Batteries	182	256,270	1,408
Auto, Aircraft, Bicycle Dealers	324	1,108,124	3,420
Filling and Service Stations	399	210,698	528
Garages & Repair Shops	720	509,402	708
Other Automotive Stores	25	8,207	328
Aircraft and Allied	26	40,369	1,553
Occasional Auto Sales	6	81,440	13,573
Subtotal - Automotive	1,682	2,214,510	1,317
Food			
Bakeries	162	150,810	931
Candy & Confectionery	102	35,842	351
Fruit & Vegetable Markets	9	3,173	353
Grocery Stores & Meat Markets	292	662,400	2,268
Lunch Rooms & Roadside Sales	1,129	840,864	745
Restaurants & Cafeterias	1,466	2,068,445	1,411
Other Food Stores	128	55,313	432
Subtotal - Food	3,288	3,816,847	1,161
Furniture			
Furniture Stores	473	937,107	1,981
Household Appliances	106	92,294	871
Radios & Musical Instruments	271	394,289	1,455
Other Furniture & Appliances	13	8,777	675
Subtotal - Furniture	863	1,432,467	1,660

<u>Business Classification</u>	<u>Number of Accounts</u>	<u>Balance Due</u>	<u>Average Balance</u>
General Merchandise			
Department Stores	31	\$ 31,633	\$ 1,020
Drug Stores	39	22,033	565
Dry Goods Stores	36	15,895	442
General Stores	13	6,134	472
Hardware Stores	51	35,312	692
Jewelry Stores	51	26,727	524
Luggage & Leather Goods	7	14,996	2,142
Secondhand Stores	86	24,928	290
Sporting Goods	156	114,567	734
Variety & Specialty Stores	371	125,829	339
Other General Merchandise Stores	16	21,169	1,323
Plastics - Retail	1	136	136
Subtotal - General Merchandise	858	439,359	512
Lumber & Building			
Building & Construction Contractor	270	415,261	1,538
Building, Hardware, & Machinery	3	1,591	530
Building Material Dealers	33	132,593	4,018
Electrical Equipment Supplies	61	46,027	755
Paint, Glass, & Wallpaper	39	27,157	696
Plumbing, Heating, & Air Cond	237	407,157	1,718
Other Lumber & Building Supplies	7	71,301	10,186
Subtotal - Lumber & Building	650	1,101,087	1,694
Professional & Personal Services			
Auctioneers	32	17,767	555
Barber & Beauty Shops	113	14,766	131
Optician Sales	14	3,774	270
Photographers	78	48,319	619
Other Professional Sales	27	11,436	424
Hotels & Motels	90	133,777	1,486
Laundry	79	71,063	900
Carwash	19	4,386	231
Cable Television & Radio Services	9	2,393	266
Carpenter & Janitorial Services	603	518,511	860
Subtotal - Prof & Pers Services	1,064	826,192	776
Public Utilities			
Telephone Companies	6	12,052	2,009
Water Companies	1	4	4
Electricity & Water Companies	1	43	43
Subtotal - Public Utilities	8	12,099	1,512

<u>Business Classification</u>	<u>Number of Accounts</u>	<u>Balance Due</u>	<u>Average Balance</u>
Farm & Garden Produce			
Hatcheries & Supplies	5	\$ 1,583	\$ 317
Livestock	69	26,693	387
Other Farm & Garden Produce	10	4,393	439
Subtotal - Farm & Garden	84	32,669	389
Manufacturing & Trading			
Beverages	5	5,246	1,049
Chemicals & Products	75	18,143	242
Food & Food Preparations	7	5,310	759
Leather & Leather Products	11	3,311	301
Lumber & Wood Products	14	10,031	717
Metal & Metal Products	26	71,916	2,766
Paper & Pulp Products	3	1,211	404
Machinery & Equipment	172	393,329	2,287
Printing & Publishing	81	118,119	1,458
Stone, Sand, & Gravel Products	46	104,032	2,262
Textiles	1	521	521
Other Manufacturing & Trading	31	9,251	298
Plastics - Wholesale	4	1,470	368
Subtotal - Mfr & Trading	476	741,890	1,559
Unclassified Retail			
Amusement Parks & Theatres	40	58,256	1,456
Athletic Games & Tournaments	149	78,014	524
Blacksmiths & Machine Shops	42	9,121	217
Cigar Stores & Smoking Supplies	6	835	139
Coal, Wood, Fuel, & Ice Dealers	11	10,215	929
Farm Implements & Machinery	25	78,492	3,140
Seed, Feed, Grain, & Fertilizer	33	33,043	1,001
Plants & Nursery Stock	125	48,441	388
Magazines & Newspapers	74	18,114	245
Monuments & Tombstones	4	1,354	339
Office Equipment & Supplies	98	175,659	1,792
Undertakers & Funeral Parlors	2	2,943	1,472
Other Unclassified	88	58,564	666
Rentals & Leasing	86	111,191	1,293
Subtotal - Unclassified Retail	783	684,242	874
TOTALS	10,049	\$11,492,226	\$ 1,144

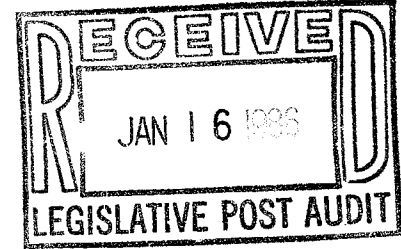
APPENDIX B
Agency Response





KANSAS DEPARTMENT OF REVENUE
Office of the Secretary
State Office Building · Topeka, Kansas 66612-1588

January 17, 1986



Mr. Meredith Williams
Legislative Post Audit
301 Mills Building
109 SW Ninth Street
Topeka, Kansas 66612

Re: Audit of Department of Revenue's
Collection of Outstanding
Liabilities on Closed Sales Tax
Accounts

Dear Meredith:

As requested by Legislative Division of Post Audit, the Department of Revenue hereby submits its response to the above-referenced Post Audit draft report. The Department expresses its appreciation for the courteous manner in which the audit was conducted and compliments the staff members of the Post Audit Division for their efforts in compiling the recommendations designed to improve the collection of outstanding sales tax liabilities for closed accounts.

Prior to specifically addressing the Department's response to each Post Audit recommendation, however, the Department wishes to clear upon a couple of factual misstatements contained in the audit report itself.

The chart on page 5 is somewhat misleading as to the actions the Department takes with respect to returns received without remittance and which have a liability of more than \$500. The chart suggests that the Department proceeds immediately with revocation hearings on such accounts. Such is not the case, as the taxpayer is first mailed a balance due notice and if payment is not received, the revocation hearing is then scheduled.

On page 10, approximately in the middle of the page, Post Audit describes a grocery store account and would have the Legislature believe that the Department dismissed the injunction action since the account posted a \$750 bond. In reality, the injunction action was dismissed due to the fact the Department's Field Representative had provided Legal Services Bureau with the wrong name under which to file the action. Therefore, the first injunction action had to be dismissed and a second one filed under the correct name.

As for the Department accepting the \$750 bond, this bond was accepted in lieu of returning it and not receiving another bond back for the full \$1,500. The bond requirement was never reduced to \$750; the Department was still seeking the remaining \$750 when the business closed.

Post Audit Recommendation

Page 15 -- 1. To maximize the collections made on both delinquent and closed sales tax accounts, the Department of Revenue should:

a. Establish and follow standard procedures for more aggressive, consistent enforcement of the Retailers' Sales Tax Act against delinquent retailers. Such procedures should include:

- seizing bonds before retailers go out of business.
- revoking registration certificates promptly.
- seeking injunctions promptly.

Agency Response

The Department of Revenue makes every effort to streamline the collection and enforcement of the Kansas Retailers' Sales Tax Act (hereinafter referred to as "Act"). In our endeavor to streamline these collection efforts, the Department has considered the procedures suggested by Legislative Post Audit as being helpful but believe each would be ineffective due to the following reasons.

Seizing bonds before retailers go out of business would result in the State being able to use these funds sooner than under the current procedure; however, the benefit derived from making earlier demand is outweighed by the consequences which would occur. Specifically, the Department foresees the following consequences:

1. The Department would require the retailer to post another bond. This sounds easy, but since the retailer is already delinquent, there is a problem of where the money for a bond would come from. Cash flow is already a problem with the retailer, therefore, a cash bond or escrow bond would probably be impossible for the retailer to post. In addition, there are fewer and fewer insurance companies willing to write surety bonds for retailers with a good history of reporting sales tax, let alone for delinquent retailers.

2. Assuming the retailer is unable to post the bond, the sales tax registration certificate would be revoked and the account referred to the

Department's Legal Services Bureau for injunctive action. Courts have been historically reluctant to issue injunctions prohibiting retailers to operate their businesses where the only impediment to the retailer lawfully operating under the Act is the posting of a bond. What has been gained by seizing the bond?

Revoking registration certificates more promptly and seeking injunctions more promptly would require additional staff for not only the Sales and Excise Tax Bureau but also for Legal Services Bureau. In addition, the fact that an injunctive action is filed does not guarantee the business will actually close. The Court must first issue a permanent injunction order and if the retailer continues to operate, the Department must then obtain a contempt of court citation.

The Sales and Excise Tax Bureau has recently started reviewing sales tax accounts in the larger counties throughout the state to determine those accounts which remit \$500 or more per month and which are delinquent five or more months. These accounts are then being set up for revocation hearings immediately. In addition, the Director of Taxation is contemplating eliminating the thirty (30) day referral to Field Services after a sales tax account has been revoked. The Director is considering referring the account to Legal Services Bureau immediately after the revocation letter is mailed. The main obstacle to such a procedure, however, is the increased number of accounts which Legal Services would have to handle with the present level of personnel.

Further, the Department is working on implementing a procedure for car dealerships whereby the sales tax certificate of registration and the dealer's license can be revoked at the same hearing. Of course, the Department would have to file a court action to enforce either revocation.

One further procedure in the endeavor to collect delinquent sales taxes which has recently been implemented by the Department is the simultaneous notification to the taxpayer (retailer) and the Department's Field Services Bureau on those accounts which have outstanding liabilities of \$1,000 or more. It is anticipated that this procedure will accelerate the collection of delinquent sales tax liabilities with this earlier involvement of Field Services Bureau.

Post Audit Recommendation

Page 15 -- 1.b. Strengthen its bonding policies. All retailers should be required to secure and maintain bonds, bond amounts should be increased, and bonds should be seized to satisfy delinquencies before businesses close. Legislative Post Audit made similar recommendations in its 1982 performance

audit of the Division of Taxation.

Agency Response

The Department has proposed an amendment to K.A.R. 92-19-35 (see copy attached). Under the proposed K.A.R. 92-19-35, each corporation applying for a certificate of registration would have to post a bond in an amount equal to its six months' average tax liability or \$1,000, whichever is greater. There would be no provisions for waiver of this bond requirement and the bond would have to remain posted to the account until the business closed.

As for requiring sole proprietorships and partnerships to secure and maintain bonds, the Department believes its present policy of requiring bonds only after such businesses have become delinquent is a much better procedure to follow. Assets owned by each individual owner may be made available to satisfy sales tax liabilities of the business whereas corporate officers at the present time cannot be held personally liable for sales tax liabilities incurred by the corporate business.

Further, strengthening the bonding policies would only make it harder for businesses to begin operations which sheds a poor light on any attempt at advancing the economic development within the state of Kansas. And finally, businesses would open up anyway without posting the required bond.

Post Audit Recommendation

Page 15 -- 1.c. Systematically pursue enforcement of successor liability. State law currently requires the Department to hold purchasers of businesses liable for outstanding sales tax of sellers, up to the value of the property received.

Agency Response

K.S.A. 79-3612 provides that:

"The tax imposed by this act shall be a lien upon the property of any person who shall sell his or her business consisting of tangible personal property....The purchaser shall be personally liable for the payment of any unpaid taxes of the seller, to the extent of the value of the property received by the purchaser."

In order for liability for unpaid sales taxes to become the obligation of a subsequent purchaser, the two requirements under K.S.A. 79-3612 must be met: 1) there must be a sale of the business, and 2) personal property must be conveyed with the purchase. In many instances, these two conditions can not

be met. Many delinquent taxpayers, when they are about to close their doors, are unable to "sell their business" because there is no goodwill which is salable. Moreover, even if the business concept is one which could be sold, the second requirement of "sale of tangible personal property" is often impossible to meet since these same taxpayers often lease their property or buy it on credit. The seller often has no interest in the tangible personal property transferred since it is financed and subject to prior security interests. Often the financial institutions are the real owners in interest, their transfer of property would not give rise to a duty on behalf of the purchaser to remit the tax.

It is difficult for the Department of Revenue to determine when there is, in fact, a successor that has purchased tangible personal property since these individuals may not locate at the same business location or use the same business name as the seller used in conducting his/her business.

It is the recommendation of the Department of Revenue that the sellers be made personally liable for unpaid sales taxes. Such a recommendation would make the persons who failed to remit the tax responsible and would not involve satisfying the requirements of K.S.A. 79-3612.

Post Audit Recommendation

Page 15 -- 1.d. Seek legislation authorizing the imposition of personal liability for delinquent sales tax on corporate officials.

Agency Response

The Department has and will seek legislation during this Legislative Session authorizing the imposition of personal liability for delinquent sales tax on corporate officials. (See recommendation #1 on page 2 of the Department's proposed legislation).

Post Audit Recommendation

Page 15 -- 1.e. Develop procedures for writing off closed sales tax accounts with insignificant balances. In many cases, it is not feasible or cost effective to collect these accounts, and writing them off would reduce the number of closed sales tax accounts managed by the Department.

Agency Response

The Department does have a written procedure for writing off sales tax accounts and the cost of "managing" these accounts is negligible. Incurring any significant costs, either personnel or computer-related, to write-off the account any sooner than the present seven years would not be cost-effective.

The Department would agree that a tolerance level should be established for sales tax liabilities. When a business closes and the liability is below the tolerance level, the tax examiner working the close-out of the account can simply abate the liability and not have to spend time auditing the account to determine if the liability is accurate. Any type of such tolerance level would appear to need legislative approval, however. The Department would recommend that the tolerance level be the same amount which is presently used as a minimum balance due before a tax warrant will be filed.

Post Audit Recommendation

Page 15 -- 2. To minimize delinquencies and enhance the sales tax collections made after delinquent retailers go out of business, the Department should explore these options:

- a. Developing procedures at the State level for identifying assets owned by delinquent retailers and providing county sheriffs with lists of those assets when warrants are filed.
- b. Providing financial incentives to county officials for collection on tax warrants. A penalty could be added to the warrant amount and earmarked for the locality.

Agency Response

The Department has and will continue to attempt to identify vehicles owned by delinquent taxpayers which are free and clear of all liens and issue a special execution to the Sheriff for such vehicles. In addition, the Department has been successful at times at requesting a special execution for the Sheriff to seize a delinquent taxpayer's cash register. Both of these procedures, however, can only be successful if the Sheriff is willing and able to act upon the special executions.

The Department believes that a better avenue to pursue, and one which would produce better results, would be to establish an internal unit within the Department of Revenue for criminal investigation purposes. Such a unit would be responsible for gathering and obtaining evidence which would enable the state to institute criminal actions against delinquent taxpayers. For example, file embezzlement charges against taxpayers who have "converted" sales tax monies to their own personal use.

Post Audit Recommendation

Page 15 -- 2.c. Requiring purchaser to pay sales tax on large purchases directly to county treasurers or the Department of Revenue. State law currently requires sales tax on isolated purchases of motor vehicles to be

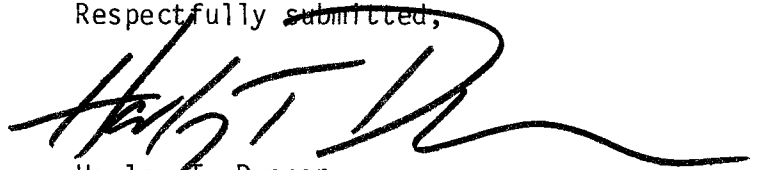
paid in this manner.

Agency Response

This recommendation can only be applied to automobiles or other vehicle purchases. To apply it to other types of purchases would seem to place a significant amount of sales tax in jeopardy.

The Department, however, has opposed this approach for motor vehicle sales. The Department believes this approach may lead to sales tax evasion through failure to register and increase delinquencies because of insufficient fund checks. Moreover, these delinquencies will be relatively small and expensive to collect. The Department sees no need to treat vehicle purchases differently than other transactions.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Harley T. Duncan", with a long, sweeping horizontal line extending to the right.

Harley T. Duncan
Secretary of Revenue

HTD:do

ATTORNEY GENERAL

DEPT. OF ADMINISTRATION

DEC 13 1985

DEC 13 1985

APPROVED BY *[Signature]*

92-19-35. Application for ~~APPROVED BY J.S.S.~~ of registration; bond requirements. (a) ~~Every~~ Each corporation applying for a certificate of registration shall be required to post a bond with the department in an amount equal to their ~~three (3)~~ six months' average tax liability, or \$1,000, whichever is greater. New businesses applying for sales tax certificates of registration, who have no previous tax experience, may estimate their expected sales tax liability projected over a ~~twelve (12)~~ 12 month period and submit a bond in an amount equal to ~~twenty-five~~ 50 percent (25%) of the projected tax liability or \$1,000, whichever is greater.

(b) Certificates of registration ~~will~~ shall not be issued until the bond requirements are met. Bond requirements may be satisfied through surety bonds purchased from a corporate surety, escrow bond agreement or through the posting of a cash bond with the department.

Bond requirements may be waived by the director of taxation under the following conditions only: (a) the corporation may submit a certified financial statement showing net worth in excess of its ~~one (1)~~ year's average sales tax liability; or (b) the bond requirement may be waived in consideration of a satisfactory prior continuous compliance record. A satisfactory prior continuance compliance record is defined as a ~~twelve (12)~~ month period in which sales tax returns were filed and in which there were no delinquencies in payment of sales tax liabilities or returned checks.

(c) Sales tax bonds, and certified financial statements accepted in lieu of bonds ~~will~~ may be reviewed on a periodic basis by the department, and the director may at any time require an additional bond or a current certified financial statement if the existing bond or financial statement is not sufficient to meet the current average ~~three (3)~~ six months' sales tax liability. The director may reduce the required bond to an amount equal to three months' average tax liability, but not less than \$1,000, in

consideration of a satisfactory reporting history consisting of the prior 12 months in which there were no delinquencies or returned checks. (Authorized by K.S.A. 79-3616; 79-3707 79-3618; implementing K.S.A. 79-3616; effective May 1, 1979; amended May 1, 1986.)

ATTORNEY GENERAL

DEC 13 1985

APPROVED BY J.S.S.

DEPT. OF ADMINISTRATION

DEC 13 1985

APPROVED BY J.S.S.

