

**NORTH CAROLINA GENERAL ASSEMBLY**

**LEGISLATIVE FISCAL NOTE**

**BILL NUMBER:** House Bill 1551 (House Finance Committee Substitute)

**SHORT TITLE:** Tax Enforcement

**SPONSOR(S):**

<b>FISCAL IMPACT</b>					
	<b>Yes (X)</b>	<b>No ( )</b>	<b>No Estimate Available ( )</b>		
	<b><u>FY 2000-01</u></b>	<b><u>FY 2001-02</u></b>	<b><u>FY 2002-03</u></b>	<b><u>FY 2003-04</u></b>	<b><u>FY 2004-05</u></b>
<b>REVENUES</b>					
General Fund					See Assumptions and Methodology
<b>EXPENDITURES</b>					
<b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTED:</b>					Department of Revenue, State Bureau of Investigations
<b>EFFECTIVE DATE:</b>	Section 2 (frivolous returns) is effective October 1, 2000, and applies to returns filed on or after that date. Sections 3 through 7 (locals report to Revenue) become effective December 1, 2000, and apply to arrests or seizures occurring on or after that date. The remainder of the act is effective when it becomes law.				

**BILL SUMMARY:**

This bill (1) allows the Secretary of Revenue to administer the oath of office to Department of Revenue Law Enforcement Agents, (2) allows Revenue Law Enforcement Agents to enforce misdemeanor tax laws, (3) creates a \$500 civil penalty for filing frivolous income tax returns, and (4) permits local law enforcement agencies to report non tax paid unauthorized substance cases directly to the Department of Revenue.

**ASSUMPTIONS AND METHODOLOGY:**

Section one of the bill, granting Revenue Law Enforcement Agents arrest powers in selected misdemeanors, has no fiscal impact. These agents currently investigate all misdemeanor tax cases but depend on local law enforcement officials to make the arrests. There is no additional revenue from penalties.

Section two of the bill creates a \$500 civil penalty for filing a frivolous tax return, thus adding North Carolina to a list of 18 states and the Internal Revenue Service that charge a fee for

fraudulent taxpayer actions. This penalty applies to persons who knowingly use a tax preparer that guarantees lucrative state and federal income tax refunds by using such schemes as exaggerating the number of dependents or inflating deductions such as medical or charitable contributions.

The Department of Revenue's Criminal Investigations nine person unit currently has six tax preparers under indictment and four tax preparers under investigations. The Director of the unit expects to investigate 6 to 10 cases a year over the next five years. In these cases, it is estimated that each tax preparer fraudulently prepares 100 to 200 income tax returns per year. In 951 civil audits conducted on fraudulent returns filed from 1996 to 1998, the average overpayment of refund was \$1,463. While prosecution of these fraudulent returns recovered the overpayments, few penalties were assessed on the taxpayers. As few as 5% of the cases were charged with fraud because of the tremendous staff time needed to provide the evidence necessary for a conviction.

Based on the projected caseload of fraudulent tax preparers (6 to 10 per year) and the number of returns filed illegally by each preparer (100 to 200), the revenue from this \$500 civil penalty could range between \$300,000 to \$1 million a year. (This revenue will be deposited into the General Fund.) This is a rough estimate because of the following factors. First, the revenue the Department now receives from fraud penalties should be netted against this new revenue. Unfortunately, the Department cannot provide the amount of penalty revenue currently received. Second, given the severity of the case, the Department of Revenue might not apply the penalty in every case, thus diminishing the revenue gain. Finally, the frequent application of this penalty to fraudulent taxpayers in the next few years and the publication of this new penalty and taxpayer prosecutions will serve as a deterrent for future tax fraud. Such deterrence of criminal action will reduce the amount of penalty revenue.

Sections 3 through 7 remove the State Bureau of Investigations (SBI) from the reporting of non tax paid unauthorized substances. This change will allow local law enforcement agencies to send reports directly to the Department of Revenue. SBI staff indicates that the agency does not review or use any of the information that is contained in the 4,000 to 6,000 cases that are forwarded each year to the Department of Revenue. The SBI estimates no fiscal impact from these sections.

**FISCAL RESEARCH DIVISION 733-4910**

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**DATE:** May 30, 2000



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