EHTC BUSINESS STRATEGISTS
CERTIFIED PUBLIC ACCOUNTANTS
ECHELBARGER, HIMEBAUGH, TAMM & CO., P.C.

Penalty and Interest

The authority for the imposition of penalty and interest is found in the Revenue Act, specifically sections 23 (MCL 205.23) and 24 (MCL 205.24). Revenue Administrative Bulletin 2005-3 more fully explain the imposition of penalties and interest and the process and procedure for waiver of penalty.

If a return is not filed, submitted late or without remittance, a penalty of 5 percent per month (maximum 50 percent) (MCL 205.24(2)) plus interest of 1% over prime (MCL 205.23(2)) will be imposed from the due date to the date payment is received.

To avoid penalty for late filing of an annual return, the taxpayer may file for an extension. (MCL 208.73(3)) A copy of the federal extension with remittance of estimated tax and form C-4267 APPLICATION FOR EXTENSION OF TIME TO FILE ANNUAL MICHIGAN TAX RETURN should be sent to the Department prior to the due date. (MCL 208.73(3))

The filing of an extension and payment of an estimated tax will automatically extend the SINGLE BUSINESS TAX return for the same period of the federal extension, plus 60 days. If a federal extension has not been applied for, use Department form C-4267. (MCL 208.73(4))

Quarterly Return Filing Requirement

Any taxpayer whose annual SINGLE BUSINESS TAX liability exceeds $600 (MCL 208.71(1)) must file four quarterly estimated returns (Form C-8002 QUARTERLY RETURN), to avoid penalties for failure to file. The estimates are due one month after the end of each business quarter. (MCL 208.71 (3))

Safe Harbor Rule

Because it is difficult to estimate the annual liability at the due dates of the quarterly returns, Section 71(4) (MCL 208.71(4)) provides a "safe harbor" rule. This rule when followed will avoid all interest and penalty charges. The rule simply is to pay in four equal installments the previous year's liability. However, the “safe harbor” rule applies only if the prior year tax was $20,000 or less. (MCL 208.71(4))

If the previous year's liability is zero, no estimated returns are required.

If the previous year's liability was over $20,000 the safe haven rule may not be used. If the previous year was a short period, the liability should be annualized. For instance, if the preceding year was only six months long and the liability was $400, the safe haven estimated payments should total $800.

If the taxpayer does not or cannot use the safe haven rule, he/she must remit 85 percent of the annual liability on a quarterly basis. (MCL 208.71(4)(a)) As an alternative, the estimates may be paid in the quarter in which the liability is incurred. This procedure may be helpful for taxpayers with seasonal or highly erratic business activity. (MCL 208.71(10))

Instead of filing form C-8002 QUARTERLY RETURN the practitioner may elect to have the taxpayer pay the estimates on the monthly/quarterly Sales, Tax, Withholding forms. This form calls for a payment of one percent of gross receipts. However, the amount determined to be proper under the above-mentioned guidelines can be remitted on the form. (MCL 208.71(10))

Interest and Penalty on Underpaid Quarterly Returns

The penalty for failure to file a quarterly return form is 5 percent per month of the amount due with a 50 percent maximum.

The interest charge for failure to file an estimated return or underpaying an estimate is 1% over prime from the due date of the quarterly estimated return to the due date of the annual return.

Interest and penalty computations are done on form C-8020 Penalty And Interest, Non-filing Of Estimated Payments Or Underestimating. The Department of Treasury will bill the taxpayer for interest and penalties if the practitioner does not compute them.

Administrative Guidance on Penalty Provisions

The Department of Treasury has issued Revenue Administrative Bulletin 2005-3 on July 19, 2005. The title of the bulletin is "Penalty Provisions" which is to advise and illustrate the discretionary and non-discretionary penalty provisions of the Revenue Act. The bulletin also provides guidance on when penalties can be abated and how to seek a waiver of penalty.

DEFINITIONS

Negligence: Lack of due care in failing to do what a reasonable and ordinarily prudent person would have done under the particular circumstances.

Intentional Disregard: Knowingly and willfully disregarding the laws, rules and instructions published and/or administered by the Department of Treasury without the intent to commit fraud or evade payment of tax.

Fraud: Knowingly and willfully acting in a manner to commit fraud, such as: failing or refusing to file a return, or filing a false return with the intent to evade payment of tax or part of a tax; claiming a false refund or a false credit; or aiding, abetting or assisting another in an attempt to evade payment of a tax or part of a tax, claim a false refund or claim a false credit.

Information Return: Any tax return required by the Department that does not, by law, require the payment of a tax liability. However, this definition specifically excludes an informational return wherein, as a result of reconciliation, a tax is determined due. In such cases, the tax return is treated like a non-informational return.

Non-Negotiable Remittance: A remittance by a taxpayer on an instrument that is not legally capable of being transferred by endorsement or delivery.

Discovery: Any deficiency or delinquency identified solely as a result of efforts by the Department, based on information already in the Department's possession or supplied by third parties. Discovery does not include a deficiency or delinquency brought to the Department's attention by the taxpayer, when the Department made no overt effort, directed either at the specific disclosure or in general at the taxpayer involved, that may have persuaded the taxpayer to disclose.

Discretionary: A collective term that addresses the negligence, intentional disregard and fraud penalties as judgmental in application and distinctly separate from the obvious errors of failure to file and failure to pay. The application of these penalties requires the reviewer to evaluate facts, circumstances, degrees of action or omission and apply penalty accordingly.

Frivolous: A term that describes a taxpayer's attempts to avoid or delay the payment of tax by raising arguments that are clearly insufficient or have been repeatedly found to have no merit in prior litigation.

Discretionary Penalties

The Revenue Act contains the penalty provisions applicable to the taxes administered by the Act. The discretionary penalties of negligence, intentional disregard, and fraud are found in Section 23 of the Revenue Act. (MCL 205.23(3), (4), and (5))

How Discretionary Penalties Are Applied

Every case involving a tax deficiency must be reviewed as to whether discretionary penalties apply. Facts, circumstances and taxpayer intent must be examined using the best information available. If the examination reveals that a discretionary penalty applies, then a determination is made as to which penalty applies. This determination is made in descending order of the severity of the penalty.

First	-	Fraud	100%
Second	-	Intentional Disregard	25%
Third	-	Negligence	10%
Fourth	-	No Penalty	-0-

Once it is determine that discretionary penalty applies and which penalty will be applied, it must be determined on what amount the penalty will apply. "Deficiency" as used in Section 23 of the Revenue Act, (MCL 205.23), is the amount to which the discretionary penalties are applied. Deficiency is a tax liability determined by the

Department. A deficiency may result from an underpayment of tax or an excessive claim for refund. Generally, adjustments reducing the amount of a refund are not subject to these penalties because there is no deficiency.

If any part of the deficiency for a taxable year is subject to one of the discretionary penalty provisions, then generally the penalties applied to the entire deficiency for that taxable year. If more than one of these penalties is applicable to a deficiency, then the higher percentage penalty applies.

Types of Discretionary Penalties

Civil Tax Fraud

Recommendation of the tax fraud penalty shall be made when it is supported by facts leading to the conclusion that the taxpayer's intent was to evade payment of tax. Fraud involves deception: a purposeful act of a taxpayer to disguise, present and/or omit facts in such a way as to put forward a false situation. The fraud penalty may be applied when it is evident that the taxpayer knowingly and willfully acted in a manner to evade payment of all or a portion of a tax.

As a general rule, all factors taken together will set forth a course of conduct revealing an intent to defraud. However, the mere failure to file a tax return is insufficient to sustain a charge of fraud without the presence of some overt act showing intention to defraud. The Department must prove that a tax is due and that the taxpayer filed a false return or failed to file a return, and that the taxpayer intended to evade payment of a tax.

Some indicators of intent to defraud are:

1. Understated, omitted, undisclosed, hidden, or disguised sales, purchases or income resulting in a substantial tax liability.
2. A substantial tax liability
3. Having a double set of books and records.
4. False, altered, distorted or missing records.
5. Unlicensed or unregistered business operations both legitimate and illegal.
6. Unexplained differences between related items from different tax returns (e.g., gross receipts for single business tax vs. income tax vs. annual sales tax returns.
7. Concealing assets in secret accounts or registering assets or accounts in false names or the names of others.
8. Consistent pattern of failure to file or pay.
9. False, inflated or disguised deductions or expenses resulting in a substantial tax liability.
10. Any action or conduct by the taxpayer having the effect of concealing or misleading.

Examples of Fraud

Department establishes from facts that:

1. Taxpayer buys a car (boat, airplane) from another individual and substantially understates the purchase price on the use tax return.
2. Taxpayer buys a car (boat, airplane) from another individual who is not a relative but claims the purchase is exempt from use tax because it was purchased from a relative (father, mother, brother, sister, etc.).
3. Taxpayer has knowledge of a tax obligation and willfully decides not to comply with obligation.
4. Taxpayer makes taxable purchases that substantially exceed reported taxable sales.
5. Personal representative of an estate substantially under reports taxable asset distributions on an inheritance tax return.
6. Taxpayer apportions the tax base by falsely claiming apportionment to another state(s), when the taxpayer knows the income is not taxable in the other state(s).
7. Taxpayer claims a capital acquisition deduction for non-existing assets.
8. Taxpayer claims false exemption deductions.
9. Taxpayer supplies a false W-2 form showing withholding tax in excess of what was actually withheld by the employer.
10. Taxpayer supplies a false or altered property tax bill or false rent receipts to support a false claim for tax credit.
11. Taxpayer claims false Schedule C business losses on a non-existent business.
12. Taxpayer, as part of a scheme, files an excessive number of false credit claims.

Intentional Disregard

The determining factor for intentional disregard is the taxpayer's intent. When applying this penalty, the issue is whether the taxpayer has intentionally disregarded the tax laws, rules or instructions. While the intent of a taxpayer is difficult to discern, such intent will be presumed when a taxpayer has received specific instructions from the Department as to the proper reporting of an item of income or deduction, but fails to do so.

Examples of Intentional Disregard

1. Taxpayer has been advised of correct reporting by either an office review or audit, but fails to report correctly in a subsequent filing.
2. Taxpayer failed to file an amended return within 120 days after a final determination by the Internal Revenue Service which affected the taxpayer's single business tax liability.

Negligence

A reasonable, prudent person will read the instructions for filing tax returns before making a determination of tax liability. If a taxpayer fails to file a tax return in accordance with instructions, negligence is presumed. Except for the no penalty situation discussed below, or where intentional disregard of fraud exists on a portion of the liability, a negligence penalty may be added to the remaining tax deficiency.

Examples of Negligence:

1. The single business tax forms and instructions clearly require the add back of depreciation to the tax base, but the taxpayer fails to report or understates the amount of depreciation.
2. The income tax forms and instructions clearly require the add back of the married couple deduction to the tax base, but the taxpayer either fails to report or understates the amount of the deduction.
3. The sales tax rules, forms and instructions clearly define exempt sales to educational institutions, but the taxpayer overstates this deduction on the annual sales tax return.
4. The single business tax instructions clearly require the prepayment of at least 85% of the annual tax, but the taxpayer (without intentional disregard) remits established payments of less than 50% of the annual tax.
5. A taxpayer fails to file an income tax amended return within 120 days, as required by law, after a final alteration, modification, recombination or determination of a deficiency under the provisions of the Internal Revenue Code.

No Penalty Situations

Certain deficiency situations occur in spite of the taxpayer's good faith effort to comply with the tax laws.

Examples of No Penalty Situations:

1. Taxpayer in good faith accepts a claim for sales tax exemption from an unrelated third party that proves to be wrong.
2. A business taxpayer establishes and maintains an accounting system which minimizes the likelihood of mathematical errors or mispostings.
3. An individual taxpayer makes simple transpositions or mathematical errors.
4. A taxpayer (generally within 30 days of the due date of the return) takes action to hire a different tax preparer or bookkeeper or otherwise remedy the problem when the preparer or bookkeeper:
5. Does not submit returns to the taxpayer to be filed on time, or
6. Does not suitably prepare returns for the taxpayer to be filed.

Non-discretionary Penalties

The failure to file/pay penalties are found in the Revenue Act. (MCL 205.24)

How Failure to File/Pay Penalties are Applied

Every case involving a return and/or payment filed after the due date must be reviewed as to whether late penalties apply.

Failure to file tax return	- 5% per month	(max. 50%)
Failure to pay a tax	- 5% per month	(max. 50%)

Failure to file an informational return - $10 per day (max. $400)

Failure to file an amnesty return - 50%

Except for the informational returns, these penalties are a percentage of tax due after subtracting credits and prepayments.

The maximum penalty of 50% is a combined maximum for failure to file and/or pay.

Types of Non-Discretionary Penalties

Failure to File

This penalty of 5% of the tax due per month (maximum) 50%) is applied to any monthly, quarterly or annual return, or any other tax return required by law that is filed after the prescribed due date for the return or an authorized extended due date. If adjustments are made that increase the tax due, then the total tax due is subject to this penalty. The additional tax due may be subject to the discretionary penalties.

Failure to Pay

When a taxpayer has filed a return but fails to pay the tax due, the penalty of 5% of the tax due per month (maximum 50%) is added. If adjustments are made that increase the tax due, then the total tax is subject to this penalty. The additional tax due may be subjected to the discretionary penalties.

Failure to File Informational Returns

Since there is no tax due on these returns, this penalty is the only penalty applied in this situation.

Examples of information returns:

1. Annual sales tax reconciliation showing no tax due.
2. Fiduciary income tax return reporting beneficiary information showing no tax due.

Non-Negotiable Remittance

Any taxpayer who remits a non-negotiable payment (i.e., insufficient funds check) to satisfy a tax liability, including amount due on estimated tax returns, is subject to a penalty of 25% of the amount of such payment. This penalty will be imposed in addition to any other applicable penalties.

Examples of non-negotiable remittance.

1. An individual files and remits payment by check of the tax due on the annual MI-1040 on April 10, 1986. The bank did not honor the check. Therefore, an assessment is issued for the amount of tax due, penalty of 25% of the payment, and failure to pay penalty 5% (50% maximum) from April 15, 1986, plus interest.

2. A corporation remits a payment by check of its third quarterly estimate on October 31, 1986. The bank did not honor the remittance. Therefore, an assessment is issued for the amount of payment, penalty 25% of the payment, failure to pay penalty from October 31, 1986 until paid, plus interest. Credit will be given on the annual return for the tax amount assessed.

3. A gasoline wholesaler-distributor files its July 1986 report late on August 25, 1986 and remits the tax amount, 5% penalty, plus interest. The bank did not honor the check. Therefore, an assessment is issued for the amount of payment plus a penalty of 25% of the payment (tax, penalty and interest). The failure to pay penalty will accrue at 5% (maximum 50%).

Simultaneous Penalties

The non-discretionary penalties for failure to file/pay and non-negotiable remittance may be simultaneously applied. In addition to these non-discretionary penalties, a discretionary penalty may be charged for a given return period.

Objections or Defenses to Penalties

If the Department assesses a discretionary penalties against a taxpayer and the taxpayer objects to the penalties, the taxpayer bears the burden of establishing facts which will negate a finding of intent (in the case of a civil fraud or intentional disregard penalties) or a finding of negligence (in the case of a negligence penalties). The taxpayer must file a written petition with the Department, stating in detail the facts relied on to defeat the penalties assessment.

Taxpayer-Initiated Disclosure

Except as applied to estimated tax returns, taxpayer-initiated disclosure means any voluntary disclosure of a tax deficiency when there has been no prior contact by the Department.

No penalties will be applied to tax deficiencies on amended returns if:
- there has been no contact by the Department;
- the taxpayer is not under investigation by the Department for the tax period involved; and
- the taxpayer or agent pays the tax deficiency and interest without further action by the Department.

No penalties will be applied to tax deficiencies paid with the filing of a delinquent return if:

- there has been no contact with the Department;
- the taxpayer is not under investigation by the Department;
- the tax period of the return(s) includes the taxpayer's first filing period for that tax; and
- the taxpayer or agent pays the tax deficiency and interest without further action by the Department.

The taxpayer must file a written request or statement to be considered for the taxpayer-initiated disclosure exception from penalties.

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