



**New Jersey State Legislature
Office of Legislative Services
Office of the State Auditor**

**Department of the Treasury
Division of Taxation
Interest on Late Tax Refund Payments**

July 1, 2000 to July 31, 2002

**Richard L. Fair
State Auditor**

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President of the Senate

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Speaker of the General Assembly

Mr. Albert Porroni
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Enclosed is our report on the audit of the Department of the Treasury, Division of Taxation for the period July 1, 2000 to July 31, 2002. The scope of this audit was limited to interest paid by the division on late tax refunds. If you would like a personal briefing, please call me at (609) 292-3700.

A handwritten signature in black ink, appearing to read "Richard L. Fair".

Richard L. Fair
State Auditor

January 23, 2003

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Department of the Treasury
Division of Taxation
Interest on Late Tax Refund Payments

Scope

We have completed an audit of the Department of the Treasury, Division of Taxation for the period July 1, 2000 through July 31, 2002. The scope of this audit was limited to interest paid on late tax refunds.

The state is required by law to pay interest at the prime rate on requested refunds not paid within six months. Interest is computed back to the beginning of the six-month period. During our audit period, the state paid interest totaling \$14.5 million on Corporation Business Tax (CBT) and Gross Income Tax (GIT) refunds of \$2.4 billion.

Objectives

The objective of our audit was to determine the reason refunds were not processed within six months and incurred interest expense.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the State Comptroller, and policies of the division. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of financial transactions. We also read the budget message, reviewed financial trends, and interviewed division personnel to obtain an understanding of the programs and the internal controls.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Sample populations were sorted and transactions were judgmentally selected for testing.

Conclusions

We found multiple causes for refunds not being paid within six months: 1) the need for closer monitoring over refund processing; 2) the failure to process refunds in a timely manner; 3) and a weakness in the Generic Tax System (GENTS) regarding the generation of a specific report. As a result, interest on CBT and GIT refunds during our audit period total \$14.5 million.

Findings and Recommendations

Refunds should be processed in a more timely manner to reduce interest expense.

Tax returns are received by the Division of Revenue (DOR) and posted to the taxpayer's account on GENTS. The Division of Taxation then applies various criteria to determine which refunds, are held for manual review by its CBT and GIT Refund Units. Upon completion of this review a refund is issued. The state is required by law to pay interest at the prime rate on requested refunds not paid within six months. Interest is computed back to the beginning of the six-month period.

There are various causes for refunds not being paid within six months. In some cases returns were not posted to GENTS in a timely manner, while in other instances returns were posted timely but were not processed by the division quickly enough to avoid paying interest.

In addition, representatives of the CBT and GIT Refund Units informed us that the "Refunds/Credits to be Reviewed List" was not providing the units with all newly posted refunds pending review. To address this problem, ad-hoc reports were periodically produced to obtain all refunds to be reviewed. These ad-hoc reports disclosed some of

the refunds that did not appear on the GENTS report. The refunds discovered were sometimes close to or past the six-month threshold.

Furthermore, the division has not requested the comprehensive aged file which separates all refunds pending review into six age categories. This file would be useful in identifying refunds approaching the six-month limit. We requested the file and found that as of July 2002, there were 27,846 CBT refund requests pending review totaling \$116.2 million for return years 1990 through 2001. Analysis of the report revealed that 26,892 of the refund requests pending review totaling \$90 million were more than 120 days old. We extracted all 28 CBT refunds pending review that were more than \$20,000 and greater than 120 days old. The 28 refunds totaled \$2 million. We requested the CBT Refund Unit review the refunds and they came to the following conclusion:

Seventeen of the 28 refund requests totaling \$1.6 million were for return years 1990 through 1992 and were an average of over 9 years old. They had not been reviewed because only refunds for the tax year 1993 and forward are entitled to receive interest. All 17 appear to be valid; however, locating the taxpayers may prove difficult due to the significant amount of time that has passed without working on the refund requests. One of the valid returns was for \$322,728 from return year 1992. However, since the company is no longer in business and has not filed a return since 1994, the overpayment will remain in the company's account and eventually revert to the state.

The requested file for GIT identified 320,912 refund requests pending review totaling \$74.4 million for return years 1999 through 2001. Analysis of the report revealed that 200,479 refund requests totaling \$22.4 million were more than 120 days old. We

extracted the 35 GIT refunds pending review with potential refunds of more than \$10,000 and greater than 120 days old from the file. The 35 refund requests totaled \$1.4 million. We requested that the GIT Refund Unit review the refunds and as a result:

1. eleven refunds totaling \$1.26 million were paid plus an additional \$38,915 in interest,
2. fifteen refunds requesting \$173,713.85 were held pending further review,
3. eight refunds requesting \$23,947 were denied, and
4. one refund was approved for \$35,335.53 but was not paid due to a SOIL claim.

It should be noted that the above refund requests were processed relatively quickly once they were brought to the division's attention. While all these refund requests may not be approved, the review of selected refund requests did reveal that the report did identify valid refunds.

Recommendations

We recommend:

- (1) The Division of Taxation work with the Division of Revenue to ensure that all returns are posted to GENTS in a timely manner.
- (2) The Division of Taxation's CBT and GIT Refund Units work with the Technical Support branch to ensure that all overpayments to be reviewed are captured in a timely manner.
- (3) The Division of Taxation start utilizing the comprehensive aged file of refunds pending review to ensure that all refunds pending review are reviewed in a timely manner, particularly those approaching the six-month time limit.

Auditee's Response

(1) The Division of Taxation and Revenue will work together to improve the timeliness of the posting of Corporation Business Tax Returns. Issues of staffing, training and priorities will be examined as well as the issues of edit corrections with the goal of processing all CBT returns in a more timely manner.

(2) The Division of Taxation will re-examine the various programs that generate lists of overpayments for review. It appears that most of the items that were not listed for active review were due to either the failure of the taxpayer to indicate that a refund was being requested or the failure to capture this request during processing. The Division has made changes to the refund selection program that indicate overpayments that have been calculated but no refund has been requested.

As indicated in your report, the Division of Taxation has been utilizing ad-hoc reports to help identify apparent overpayments, especially large ones that were not listed for review by the standard selection criteria. Taxation will also review this selection source for potential improvement.

(3) The Division of Taxation will examine the processes used to identify refunds requiring review before payment and determine the best methods for ensuring valid refunds are available for review in a timely manner.

In addition to the above, there are several comments regarding the findings from Taxation that I am including in my response.

Allocation of resources will always be an issue. The decision to pull an auditor off an assignment that is generating a million dollars in revenue to examine review categories of potential refunds where a refund may or may not be due is problematical. This is especially true in categories where it appears there is an overpayment, but the taxpayer has not requested a refund.

In 2002, the Division, in a cost saving effort, relocated the Corporate Tax Refund Group from the Document Control Center to the Taxation Building. The delay in reviewing some corporate tax refunds was exacerbated by this move and going forward, the unit should be able to operate more efficiently.

The audit findings include a discussion about 320,912 “requested refunds” awaiting review. A more accurate description would be apparent overpayments. There is a significant difference between a requested refund and an account currently indicating an overpayment.

Based on the set criteria, certain accounts indicating an overpaid situation are placed in one of 23 active review categories or 10 inactive categories. Within these categories are requested refunds, unrequested overpayments, refund/credit forward requests and credit forward requests. (Interest is only paid on accounts involving a requested refund). The majority of items are in categories that do not have review priority. They include accounts indicating an overpayment but no refund request. These are often caused by incorrect posting of payments. There are 146,600 in this category. Another is overpayments caused by redeposit of checks returned by the post office. There are 51,600 in this category. A third is refunds of less than \$1.00. There are 18,000 in this category. When all the categories are broken down, the result is there are 15,868 active items for tax years 1999, 2000 and 2001 and only those items that requested a refund and are paid more than six months after the later of the due date or filing date, will be entitled to interest. While we can all agree it would be best to have no unresolved, out of balance accounts, resource allocation is again an important consideration.

