Calculate Penalty and Interest on Individual Income Tax Returns

PROCESS: CALCULATE PENALTY AND INTEREST

SPECIAL AUDIENCE: Localities

EFFECTIVE DATE: 11/7/08

PURPOSE

The Calculate Penalty and Interest on Individual Income Tax Returns task provides instructions to local offices for computing penalty and interest charges on delinquent and deficient income tax liabilities. These liabilities include returns filed without payment or with insufficient payment, returns filed late, and returns filed on extension without sufficient prepayment of tax. The Authorized Locality Representative should use this task for an original assessment only if the IRMS Calculator functionality is not available or not accurate. The Authorized Locality Representative should always use this task for updating penalty and interest charges on an existing assessment that has remained unpaid for more than 30 days.

DEFINITIONS

Authorized Locality Representative: The Authorized Locality Representative is the local revenue official or designated staff member in a local office who is authorized to perform portions of this task. Local Commissioners of the Revenue and their designated staff members may perform Steps 1 through 4 of this task, while Steps 5 through 7 are reserved for local Treasurers and their designated staff members.

Local Assessment: Also referred to as a local bill, a local assessment is an assessment issued by a local Treasurer, rather than by the Department of Taxation. This term may refer to an original or updated assessment.

Original Assessment: The initial (or first notice) bill sent to a taxpayer is the original assessment. For locality purposes, the original assessment is usually issued from the information entered on Form 759 by the Commissioner of the Revenue. In some cases, as discussed under late payment penalties, the Treasurer may need to assess a late payment penalty in addition to the amount computed by the Commissioner of the Revenue prior to issuing the original assessment.

Updated Assessment: Once an original assessment has been issued and remains unpaid for longer than 30 days, the penalty and/or interest will need to be updated. The assessment showing the updated balances is called an updated assessment, and is sometimes referred to as a second notice assessment.

SPECIAL NOTES

- For an original assessment, this task should be used only if the IRMS Calculator functionality is not available or is not accurate.
- This task, Steps 6 and 7, should always be used for purposes of updating penalty and interest charges on an existing assessment that has remained unpaid for more than 30 days.
- Prior to using this task, the Authorized Locality Representative must have completed the following online courses in the Learning Management System (LMS) to gain an understanding of the most current provisions of the law, as well as the correct application of penalty and interest charges: RS.06.02 Determine Whether Penalty and Interest Charges Apply to an Individual Income Tax Return; RS.06.03 Calculate Extension Penalty and Late Payment Penalty; RS.06.04 Calculate Late Filing Penalty; and RS.06.05 Calculate Interest and Update Assessments.
- For individual income tax, penalties apply only to returns that show a balance of tax due. Individual income tax returns that reflect an overpayment, as well as “zero” returns, are not subject to penalty.
- For purposes of determining timely filing, the filing date is the postmark date on the envelope, or the date the return is hand delivered to the local office.
- An individual income tax return filed within six months from the original due date may be subject to an extension penalty and/or a late payment penalty. A return filed within six months from the due date is never subject to a late filing penalty.
- An individual income tax return that is filed more than six months after the due date is subject to the maximum late filing penalty. A return filed more than six months after the due date is never subject to an extension penalty or to a late payment penalty.
- For an original assessment, interest is accrued only on the unpaid tax (See Step 5.C). If the assessment remains unpaid for more than 30 days, interest then accrues on the entire unpaid balance of the original assessment.

PROCEDURE

RESPONSIBILITY	STEPS
Authorized Locality Representative in the Office of the Commissioner of the Revenue	**Note:** Steps 1 - 5 apply to the calculation of liabilities for an original assessment. Steps 6 and 7 apply to the calculation of penalty and interest updates on existing assessments. Before beginning Step 1, verify the balance of tax due with the return. 1. Review the return to determine whether the return was filed by the due date. Note the submitted date (postmark or date stamped in, if hand delivered to local office). • For a calendar year return, the due date is May 1. For a fiscal year return, the due date is the 15th day of the fourth month following the close of the taxable year. If the due date falls on a Saturday,

Sunday, or legal holiday, the due date is automatically changed to the next business day.

- Note whether the return falls under a special category that would change the normal due date. For a calendar year filer who is out of the country on May 1, the due date is July 1. The appropriate oval should be filled in on the return.
- Other special categories may be created in the case of situations such as special military filing extensions, or extensions granted for filers affected by natural disasters. Details would be found on the agency's website at www.tax.virginia.gov, and would have been emailed to local offices. Special notations are generally required on such returns to ensure proper treatment.
- If the return was filed by the proper due date, as explained above, with full payment for any tax due, no penalty or interest charges should be computed. If the return was not filed by the due date, or if the tax due was not paid in full, proceed to Step 2.

2. Determine whether the return was filed by the extended due date.
    - Effective for taxable years beginning on or after January 1, 2005, the law allows an automatic six-month filing extension. **No application for extension is required.** For example, a calendar year return not subject to special circumstances that is filed after May 1, but not later than November 1, is always considered to be filed on extension and will not be subject to a late filing penalty. If the return was filed within the automatic extension period, proceed to Step 3. If the return was filed more than six months after the due date, go to Step 4. If the return was filed on or before May 1, but the tax has not been paid as of May 1, the local Treasurer will need to compute a late payment penalty under Step 5.
3. Compute the extension penalty and/or interest charges.
    A. Under the extension provisions, an individual is required to pay at least 90% of the tax due by the original due date. To determine whether the requirement was met, compare the tax due with the return (e.g., line 25 of Form 760) with the total tax liability (e.g., line 17 of Form 760). If the tax

due is more than 10% of the tax liability, an extension penalty must be assessed.

1. Determine the number of months in which to apply the penalty. The penalty will apply to each month or part of a month from the due date through the date the return is filed. For a calendar year return, count as follows: May 2-June1= 1 month; June 2-July 1= 2 months; July 2-August 1= 3 months; August 2-September 1= 4 months; September 2-October 1= 5 months; October 2-November 1= 6 months. For example, if the return is filed on September 17, the penalty will apply for five months. Five months x 2% = 10% penalty.
2. Multiply the tax due amount (not the tax liability) by the percentage computed in Step 3.A.1. The amount obtained from this calculation is the extension penalty. If the tax due with the return has been paid, proceed to Step 3.B. If the tax has not been paid, the local Treasurer will need to compute a late payment penalty under Step 5.

B. Even if the amount of tax due with the return is 10% or less of the total tax liability, interest must be accrued on any balance of tax that is not paid by the due date. If the IRMS Calculator is not available or is not accurate, use the following procedure to calculate interest.

1. First, determine the interest factor to use in the calculation. The Department of Taxation publishes interest rates and charts each quarter in the form of Tax Bulletins. These documents are available online in the Tax Policy Library, and the interest tables are available in the TARP Job Aids repository. To use the charts, select the date that the interest accrual should end. For an original assessment, the accrual will end on the date of payment or on the date the local assessment is prepared, whichever is earlier. Then select the due date. Subtract the factor for the due date from the factor for the ending date of accrual. The factor obtained from

this calculation is the interest factor for the original assessment.

2. Multiply the tax due with the return by the factor computed in Step 3.B.1 to calculate the interest due. Do not apply the factor to the extension penalty.

4. Compute the late filing penalty and interest charges

- The late filing penalty applies only in cases where the return is filed more than six months after the due date. The late filing penalty cannot be applied to a return that is subject to the extension penalty or the late payment penalty. Effective for taxable years beginning on or after January 1, 2005, the late filing penalty is always imposed at the maximum rate of 30%.

A. Verify that the return was filed more than six months after the due date (generally after November 1 for calendar year filers). Multiply the tax due (not the tax liability) by 30%. The resulting amount is the late filing penalty.

B. Interest must be accrued on any balance of tax that is not paid by the due date. If the IRMS Calculator is not available or is not accurate, use the following procedure to calculate interest.

1. First, determine the interest factor to use in the calculation. The Department of Taxation publishes interest rates and charts each quarter in the form of Tax Bulletins. These documents are available online in the Tax Policy Library, and the interest tables are available in the TARP Job Aids repository. To use the charts, select the date that the interest accrual should end. For an original assessment, the accrual will end on the date of payment or on the date the assessment is prepared, whichever is earlier. Then, select the due date. Subtract the factor for the due date from the factor for the ending date of accrual. The factor obtained from this calculation is the interest factor for the original assessment.

RESPONSIBILITY
Authorized Locality Representative in the Office of the Treasurer

5. Compute the late payment penalty and interest charges.

   A. This step applies when the full balance of tax due has not been paid with a return that was **filed on or before the due date.**

      1. If the return is filed on or before the due date, but the full balance of tax due is not paid by the due date, the late payment penalty is assessed at the rate of 6% per month or part of a month from the due date through the date the local assessment is issued. The maximum penalty is 30% of the tax due. **NOTE:** To ensure accurate penalty calculations, do not issue assessments for unpaid tax on or before the due date of the return.

      2. Determine the number of months in which to apply the penalty. The penalty will apply to each month or part of a month from the due date through the date the original assessment is issued. For a calendar year return, count as follows: May 2-June1= 1 month; June 2-July 1= 2 months; July 2-August 1= 3 months; August 2-September 1= 4 months; September 2-October 1= 5 months; October 2-November 1= 6 months. For example, if the payment has not been made as of May 4, and the original assessment is being made on that date, a penalty of 6% will apply for one month.

      3. Multiply the tax due amount (not the tax liability) by the percentage computed in Step 5.A.2. The amount obtained from this calculation is the late payment penalty. Proceed to Step 5.C.1 for calculation of interest.

   B This step applies if the return was filed within six months from the due date, and the full balance of tax due with the return has not been paid. If the return is subject to the extension penalty, confirm that the appropriate calculation of extension penalty has been made under Step 3. The extension, as well as associated extension penalty liability, ends on the date the return is filed. If the balance of tax due is not paid with the return when filed, the late payment penalty applies on the next day, even if that day falls within the same calendar month in which an extension penalty has been applied. For example, a return is filed on September 15 showing 100% of the tax due. No payment is made with the return. The extension penalty will apply from May 2 through September 15, and application of the late payment penalty will begin on September 16.

1. For a return filed within the extended period that reflects a balance of unpaid tax, the late payment penalty is assessed at the rate of 6% per month or part of a month from the date the return is filed through the date the original assessment is issued. The maximum penalty is 30% of the tax due. The combined maximum extension penalty and late payment penalty that can be assessed on a return is 42% of the tax due (12% extension penalty and 30% late payment penalty).
2. Determine the number of months in which to apply the penalty. The penalty will apply to each month or part of a month from the date the return is filed through the date the original assessment is issued. For example, if the return is filed on September 15, and the assessment is being prepared on September 18, the penalty will apply for one month at 6%.
3. Multiply the tax due amount (not the tax liability) by the percentage computed in Step 5.B.2. The amount obtained from this calculation is the late payment penalty. Proceed to Step 5.C.1 for calculation of interest.

C. Virginia law requires the accrual of interest on any balance of tax that is not paid by the due date. If the IRMS Calculator is not available or is not accurate, use the following procedure to calculate interest.

1. First, determine the interest factor to use in the calculation. The Department of

Taxation publishes interest rates and charts each quarter in the form of Tax Bulletins. These documents are available online in the Tax Policy Library, and the interest tables are available in the TARP Job Aids repository. To use the charts, select the date that the interest accrual should end. For an original assessment, the accrual will end on the date of payment or on the date the local assessment is prepared, whichever is earlier. Then, select the due date, or the date the interest computation made by the Office of the Commissioner of the Revenue ended, whichever is later. Subtract this factor from the factor for the ending date of accrual. The factor obtained from this calculation is the interest factor for any interest that needs to be added to the Commissioner's computation for the original assessment.

2. Multiply the tax due amount by the factor computed in Step 5.C.1 to calculate the interest due.

6. Compute additional penalty and interest on unpaid assessments. Perform this step for unpaid assessments that are over 30 days old.

   A. Compute interest on any unpaid balance from the original assessment, including penalty, using the methods described in Steps 4 and 5. **Do not** update penalties or include previous penalty and interest updates when performing this step. Interest should be applied from the date of the assessment through the date the updated assessment is prepared.

   B. If the assessment includes unpaid tax, determine whether the appropriate maximum late payment penalty has been applied, and compute any additional penalty due as described in Steps 1-5. Because the extension penalty applies only through the date of filing, this penalty is never updated after the initial assessment is issued.

   - Example 1: Return was filed on May 15, showing 100% of the tax due. No payment was made with the return. The original assessment was issued on May 18, showing a 2% extension penalty and a 6% late payment penalty. An updated bill is being prepared on July 1. The extension penalty applies only through the date of filing, so no further extension penalty is due. The late payment penalty continues to accrue to a maximum of 30% of the unpaid tax. The late payment penalty on the initial bill covered the period of May 16 through June 15. As of July 1, and additional 6% penalty should be assessed for the period of June 16 through July 15.

- Example 2: Return was filed on November 10, showing a balance of tax due. No payment was made with the return. The original assessment was issued on November 12, showing a 30% late filing penalty. Because the maximum late filing penalty has been applied and the combined late payment and late filing penalties cannot exceed 30% of the tax due, no further penalty updates will be needed.

7. Compute penalty and interest on unpaid balances when partial payments have been made on the assessment. Use this step when a portion of an assessment is unpaid for longer than 30 days, but one or more payments have been made on the balance due. The bill should be updated in the locality's records each time a payment is received, even if an updated assessment will not actually be mailed.

   A. Perform this step before applying the current payment. Deduct any previous payments from the balance of the original assessment and compute interest on the unpaid balance of the original assessment, excluding any previous penalty and interest updates. Interest should be applied to this balance from the date of assessment through the date the bill is being updated, using the method described in Steps 4 and 5. If the bill has previously been updated, apply interest to the unpaid balance from the date of the last update through the date of the current update.

   B. If the bill includes unpaid tax, determine whether additional penalty should be applied before or after the date the payment was made.
   Example: Return was filed without payment on May 15, showing the entire tax of $1,000 due. The original assessment was issued on May 18,

showing a 2% extension penalty and a 6% late payment penalty, plus interest on the tax from May 1 through May 18. The taxpayer made a payment of $100 on June 14. The account is being updated on June 17. The maximum allowable extension penalty has already been assessed, but the late payment penalty could accrue to a maximum of 30%. The original assessment included late payment penalty for the period of May 16 through June 15. Since the payment of $100 was made before June 15, the payment should be deducted before any penalty updates are made. Therefore, when the account is updated on June 17, an additional 6% penalty will be applied to the tax balance of $900 (after application of payment).