COMMONWEALTH of VIRGINIA
Department of Taxation
Richmond, Virginia 23282

MEMORANDUM

TO: Ronald L. Holt, Supervisor
Technical Services Section

FROM: Janie E. Bowen, Director JEB
Tax Policy Division

DATE: November 29, 1990

SUBJECT: Computation of Income Tax Penalty and Interest

This will reply to your memorandum of October 29, 1990, in which you request guidance regarding the proper computation of income tax penalty and interest, effective for taxable year 1990.

As you know, the statutory penalty changes were enacted as part of the 1989 Virginia Tax Amnesty legislation (SB 732 and HB 1596). As an incentive to encourage delinquent taxpayers to come forward under the amnesty program, the late filing and late payment penalties for individual and corporate income tax filers were increased. Also, in changing the penalties, the intent was to equate the income tax penalties with the existing penalties for business taxes and to create a uniform penalty structure for all major taxes.

Below are your inquiries and responses to each:

1. Under § 58.1-450, a minimum $100 late filing penalty is imposed on corporations even if no tax is due. Does this mean that the minimum penalty should be imposed against corporations which file after the due date and are due a refund or have a loss for the year?

Va. Code § 58.1-450, effective for taxable years beginning on and after January 1, 1990, provides for a late filing penalty equal to five percent of the amount of taxes assessable per month. The maximum penalty is limited to twenty-five percent of the taxes assessable, with a minimum penalty of $100. The statute further provides that the minimum penalty of $100 shall apply "whether or not any tax is due for the period for which the filing of a report or return is required."

Since corporations may be required to file a return, even when they have no tax liability, any corporation that is required to file a return and fails to do so within the time required, may be liable for the minimum penalty of $100. Like the penalty under the previous law, the decision to assess the penalty is an operational one. It is recommended that before the decision is made to begin assessing this penalty routinely, consideration be given to the impact on STARS, Taxpayer Assistance and Debt Set-off.

2. How will the penalty apply in situations involving extensions? For example:

   a. The return with the tax payment is filed after the extension expires. Does the penalty accrue from the original due date or the date the extension expired?

In order for an extension to be valid, the taxpayer must take all of the following actions:

- Complete the extension request.
- Complete the tentative tax return.
- Remit the extension request, tentative tax return and the amount of tax shown to be due on the tentative tax return on or before the original due date of the return.
- File the tax return prior to the expiration of the extension period.

If the taxpayer fails to take any of the above actions, the taxpayer is subject to the late filing and late payment penalties, as if the extension had never been filed. Based upon the scenario you present, the extension would be voided and the late penalties would accrue from the original due date of the return.

   b. The return is filed within the extended period, but the tax is paid after the expiration of the extension. On what date does penalty begin to accrue?

Both individual and corporate income taxes have separate and distinct penalties for late filing a return or paying the amount of tax due late. In the above scenario, the taxpayer met all the requirements necessary to have a valid extension; therefore, the late filing penalty is not applicable. Since the due date of the return was extended by means of a valid extension, the late payment penalty would begin to accrue on the balance of tax due as of the extended due date. As long as the actual tax due shown on the return does not exceed the tentative tax computed on the tentative tax return by more than 10%, no extension penalty would be applicable.

c. Currently, we do not assess the extension penalty and the late filing/payment penalty. Is this correct or can both penalties be assessed if the taxpayer pays less than 90% of his liability by the original due date and pays the balance due after the extension expires?

A taxpayer may never be liable for both the extension penalty and the late filing penalty. As long as the taxpayer has a valid extension [see 2(a) above], he is liable for the extension penalty, rather than the late filing penalty. The extension penalty is computed on the amount by which the actual tax due shown on the return exceeds the tentative tax computed on the tentative tax return, if such amount is more than 10% of the actual tax due shown on the return. For example:

$700	Actual Tax Due on Return
$500	Tentative Tax Remitted
$200	Excess of Actual Tax Over Tentative Tax
	200/700 = 29%

Since the difference is greater than 10%, the extension penalty is applicable. The extension penalty (1/2% per month) would be assessed on $200 from the original due date to the extended due date or the date that the return is filed, whichever is earlier.

If the taxpayer has a valid extension and full payment of the balance due is not received with the return and the balance due exceeds 10% of the actual tax due, the late payment penalty may be assessed on the balance of tax due, in addition to the extension penalty. Since the due date of the return was extended by means of a valid extension, the late payment penalty would begin to accrue on the balance of tax due as of the extended due date or the date that the return was filed, whichever is earlier.

3. Interest - It would be helpful to have an example which shows the computation of interest on a tax due return beginning with the initial assessment and continuing monthly until the full 25% penalty has been assessed.

The intent of the legislation making the income tax penalties equal to the existing penalties for business taxes was to make the administration of the income taxes easier for both the department and tax practitioners. However, the legislature did not amend the language that specified how interest would accrue on the tax and penalties.

To continue to apply interest to accrued income tax penalties, not yet assessed, would put these taxpayers in a disadvantaged position relative to other business taxpayers. In addition, not to conform the penalty and interest structure for income taxes fully to the penalty and interest structure of other business taxpayers, would be inconsistent with the intent of the legislation. Accordingly, the method of assessing penalty and interest for sales and withholding taxes should be applied to individual and corporate income taxes.

The following example demonstrates how to compute penalty and interest for income taxes (assuming the interest rate is 11%).

Assume that the taxpayer is a calendar year individual who files his return on July 1, 1991, showing a tax due of $100.

$100.00	Tax Due as of May 1, 1991
10.00	Late Filing Penalty (2 months X 5% per month = 10% X $100)
1.84	Interest Due - .01838 (61 Days) X $100.00 (Tax Only)
$111.84	Total Assessed - 7/1/91
$ 1.05	8/1/91 - Accrued Interest .00934 (31 Days) X $111.84
5.00	Late Payment Penalty (1 month X 5% per month = 5% X $100)
$117.89	Total Due - 8/1/91
$ 50.00	Payment 8/25/91
$ 67.89	Balance Due After Payment
$ .58	9/1/91 - Accrued Interest .00934 (31 Days) X $61.84 ($111.84 - 50.00)
2.50	Late Payment Penalty (1 month X 5% per month = 5% X $50)
$ 70.97	Total Due - 9/1/91
$ .56	10/1/91 - Accrued Interest .00904 (30 Days) X $61.84
2.50	Late Payment Penalty (1 month X 5% per month = 5% X $50)
$ 74.03	Total Due - 10/1/91

Interest will continue to accrue on $61.84 until paid.

I hope that this has answered your questions. Please let me know if you have additional questions.

APPROVED: ____________________
W. H. Forst
Tax Commissioner

TPD/4704