

VERMONT DEPARTMENT OF TAXES

2017 TAXPAYER ADVOCATE REPORT

2017 TAXPAYER ADVOCATE ANNUAL REPORT

SUBMITTED TO

House Committee on Ways and Means
Senate Committee on Finance

SUBMITTED BY

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January 13, 2017

To The Honorable Members of:
House Committee on Ways and Means
Senate Committee on Finance

In accordance with Title 32 V.S.A. §3205(c), I submit the Vermont Taxpayer Advocate's Annual Report for activity in calendar year 2015. The Vermont Taxpayer Advocate Annual Report is required to identify problems encountered by taxpayers interacting with the Vermont Department of Taxes as well recommend administrative and legislative actions to resolve those problems. The report shall also identify problems that affect an entire class of taxpayer or specific industry and present solutions.

The reporting period of this year's report contains activity from December 1, 2016 to December 1, 2017. Gloria Hobson was Taxpayer Advocate until September 30, 2016. I took over the duties of Taxpayer Advocate on October 1, 2016. The observations and recommendations contained in this report will be based on the period from October 1, 2016 and December 1, 2016.

In prior years, the Taxpayer Advocate has reported statistics such as the number of calls, e-mails, etc. for each tax type and issue. These numbers have been affected by the Department's call center being closed on Wednesdays causing many more routine calls to go to individual numbers, such as the Taxpayer Advocate line, on Wednesdays. Additionally, various personnel and transition issues make reporting annual statistics for 2016 in a meaningful way impossible. For these reasons, this report will have few numbers or charts than previous years. Going forward, I will be keeping track of the Taxpayer Advocate work in two categories. The first category will be complaints about the Department by issue. The second category will be issues where intervention by the Taxpayer Advocate was necessary to solve the taxpayer's problem (extraordinary relief, offer in compromise, hardship, etc.) by tax type and issue.

Even in my short time as Taxpayer Advocate, I have identified some areas where the Department can improve its interaction with taxpayers. Some of these can be addressed by administrative changes that are currently being undertaken by the Department. Others issues require statutory changes. In this report, I submit my recommended actions and identify the taxpayer issues that they hope to address.

Respectfully submitted,

Jeffrey M. Dooley



Description of Taxpayer Advocate

The Vermont Commissioner of Taxes created the Taxpayer Advocate in 2001. Title 32 V.S.A § 3205 requires the Vermont Department of Taxes to maintain a Taxpayer Advocate. The Duties of that position include:

1. Identifying subject areas where taxpayers have difficulties interacting with the Department of Taxes;
2. Identifying classes of taxpayers or specific business sectors who have common problems related to the Department of Taxes;
3. Proposing solutions, including administrative changes to practices and procedures of the Department of Taxes;
4. Recommending legislative action as may be appropriate to resolve problems encountered by taxpayers;
5. Educating taxpayers concerning their rights and responsibilities under Vermont's tax laws;
6. Educating tax professionals concerning the Department of Taxes' regulations and interpretations by issuing bulletins and other written materials; and
7. Assisting individual taxpayers in resolving disputes with the Department of Taxes.

The legislation serves to codify the longstanding role and functions performed by the Taxpayer Advocate and highlights the Taxpayer Advocate's position to improve taxpayer services.

The legislation also requires the Taxpayer Advocate to report annually to the House Committee on Ways and Means and the Senate Committee on Finance. 32 V.S.A. § 3205(c). The Legislature prescribed the following information for the report:

- Actions taken by the Taxpayer Advocate to improve taxpayer services and responsiveness of the Department of Taxes
- Identification of problems encountered by taxpayers in interacting with the Department of Taxes, including specific recommendations for administrative and legislative actions to resolve the identified problems
- Identification of any problems that span an entire class of taxpayer or specific industry, proposing class or industry-wide solutions.

New Administrative Initiatives

Offer in Compromise Program

Issue: There are taxpayers that have unpaid tax liabilities that they do not dispute or no longer have the legal right to dispute, that are financially incapable of paying their liabilities and likely will never be able to fully pay off their tax liabilities. In the past, upon realizing that they are unlikely to ever pay off their outstanding liability to the Department, many of these taxpayers would simply cease trying to pay off their liability. This would result in the taxpayer having the debt hanging over their head and affecting their credit score and the Department receiving none of the tax that it was owed.

Administrative Resolution: The Department is in the process of instituting an Offer in Compromise program. This program would allow taxpayers with liabilities that they are unlikely to be able to ever pay off their tax liability in full to submit proof of their inability to pay to the Department. Upon submission of such proof, the Department may agree to a settlement payment that is less than the entire amount owed. This would allow the state to recoup more of the money owed to it than if the taxpayer gave up on paying the debt and will allow the taxpayer to move forward without a large tax debt on their shoulders.

Mediation

Issue: Many taxpayers are frustrated at the length of time that the appeals process takes within the Department.

Administrative Resolution: The Department is launching a pilot program to include mediation as part of its process for resolving disputes and appeals in more efficient manner. There will be two types of mediation processes available to taxpayers that have a dispute with Department.

All taxpayers will have the option to request mediation from a list of pre-approved mediators at the taxpayer's expense. Because of the cost associated with paying for a mediator's services, this option is likely to only be used by taxpayers with a large potential liability to the state. The taxpayer or the Department may choose to accept or reject the findings of the mediator. If, however, the Department chooses to reject the findings of the mediator on an issue where the mediator finds in favor of the taxpayer, the Department will waive penalties and interest with respect to that issue.

The Department will also offer mediation for lower liability but fact specific disputes, such as domicile issues, that will be paid for by the Department. The Department will make a mediator available for these cases for a day or two (depending on volume) and the mediator will hear several cases and make findings of fact in each case. Like the mediation paid for by the taxpayer above, the Department or the taxpayer may accept or reject the findings. If the Department chooses to reject the findings of the mediator on an issue where the mediator finds in favor of the taxpayer, the Department will waive penalties and interest with respect to that issue.

If successful, these programs will become a permanent part of the Department process of settling disputes and will increase the efficiency and transparency of the dispute resolution process.



Statutory Proposals

Homestead Declaration/Property Tax Adjustment

1. **Issue:** In circumstances where a married couple lives on a piece of property that is only in the name of one spouse and that spouse passes away, the surviving spouse is not eligible to file a homestead declaration or claim a property tax adjustment under the letter of the law while the property is legally owned by the deceased spouse's estate. This is true even if the surviving spouse continues to reside on the property year-round, continues to make all the property tax payments on the property, and will inherit the property once the deceased spouses will go through probate.

Proposed Resolution: 32 V.S.A. § 5401(7) is amended to read:

(7) "Homestead":

(A) "Homestead" means the principal dwelling and parcel of land surrounding the dwelling, owned and occupied by a resident individual as the individual's domicile or owned and fully leased on April 1, provided the property is not leased for more than 182 days out of the calendar year, or for purposes of the renter property tax adjustment under subsection 6066(b) of this title, rented and occupied by a resident individual as the individual's domicile.

* * *

(E)(i) A homestead also includes a dwelling on the homestead parcel owned by a farmer as defined under section 3752 of this title, and occupied as the permanent residence by a parent, sibling, child, grandchild of the farmer, or shareholder, partner, or member of the farmer-owner, provided that the shareholder, partner, or member owns more than 50 percent of the farmer-owner, including attribution of stock ownership of a parent, sibling, child, or grandchild.

(ii) A homestead further includes the principal dwelling of a widower or widow when the dwelling is owned by the estate of the person's deceased spouse and it appears reasonably likely that the dwelling will pass to the widower or widow by law or valid will when the estate is settled.

2. **Issue:** Currently, an individual claiming a property tax adjustment must include the income of their spouse in their household income unless they have obtained a legal separation. This is true even if the claimant is the victim of domestic abuse and has a relief from abuse or restraining order against their spouse. The results in a scenario where a victim of domestic abuse could be denied a property tax adjustment claim unless they contact their spouse, against whom they have a relief from abuse or restraining order, to obtain information about the spouse's income. This obviously places the claimant spouse in a potentially dangerous position.

Proposed Resolution: 32 V.S.A. § 6061(4) is amended to read:

(4) "Household income" means modified adjusted gross income, but not less than zero, received in a calendar year by:

(A) all persons of a household while members of that household; and

(B) the spouse of the claimant who is not a member of that household and who is not legally separated from the claimant, unless the spouse is at least 62 years of age and has moved to a nursing home or other care facility with no reasonable prospect of returning to the homestead; but shall not include



(C) the spouse of a claimant when the spouse is subject to a protection order, as defined in 15 V.S.A. § 1101(5), as long as the order is in effect at the time household income is reported to the Department of Taxes.

3. **Issue:** Cancellation of debt is currently treated as income included in Federal Taxable Income. It is therefore also treated as income for the purposes of Vermont Personal Income Tax and household income for the purposes of property tax adjustment claims. This means that for the purposes of a property tax adjustment claim, a low-income individual that has a long-term debt forgiven, such as credit card debt, student loan debt, or mortgage debt, will have their household income drastically artificially inflated for a year even though, unlike with other forms of income, the taxpayer has not gained any additional resources to pay their property tax liability.

Proposed Resolution: 32 V.S.A. § 6061(5) is amended to read:

(5) “Modified adjusted gross income” means “federal adjusted gross income”:

* * *

(C) Without the inclusion of: any gifts from nongovernmental sources other than those described in subdivision (B) of this subdivision (5); surplus food or other relief in kind supplied by a governmental agency; or the first \$6,500.00 of income earned by a full-time student who qualifies as a dependent of the claimant under the federal Internal Revenue Code; the first \$6,500.00 of income received by a person who qualifies as a dependent of the claimant under the Internal Revenue Code and who is the claimant’s parent or adult child with a disability; any income attributable to cancellation of debt; or payments made by the State pursuant to 33 V.S.A. chapters 49 and 55 for foster care, or payments made by the State or an agency designated in 18 V.S.A. § 8907 for adult foster care or to a family for the support of a person who is eligible and who has a developmental disability. If the Commissioner determines, upon application by the claimant, that a person resides with a claimant who has a disability or was at least 62 years of age as of the end of the year preceding the claim, for the primary purpose of providing attendant care services (as defined in 33 V.S.A. § 6321) or homemaker or companionship services, with or without compensation, which allow the claimant to remain in his or her home or avoid institutionalization, the Commissioner shall exclude that person’s modified adjusted gross income from the claimant’s household income. The Commissioner may require that a certificate in a form satisfactory to him or her be submitted which supports the claim.

Land Use Change Tax

4. **Issue:** A lien is placed on land when it is enrolled in current use, in case the taxpayer changes the use of the land and eventually owes land use change tax on the land. So, the lien protects the Department’s interest in a debt that is hypothetical at the lien is recorded. This is different than any other tax type where a lien is only recorded after the taxpayer has incurred a liability to the state. The result is that when taxpayers attempt to refinance their property, they often will be required to request that the Department subordinate its lien of a hypothetical debt to the lien that the financial institution will be placing on the property for the actual amount of money owed to the financial institution. This results in delays and can cost the taxpayers financially if the interest rate is not locked at the time the request is made. This is especially frustrating for taxpayers whose equity in the property, even after the refinancing, far exceeds the amount of any potential land use change tax liability.

Proposed Resolution: 32 V.S.A. § 3757 (f) is amended to read:

(f)(1) ~~When the application for use value appraisal of agricultural and forestland has been approved by the State, the State shall record a lien against the enrolled land in the land records of the municipality that shall constitute a lien to secure payment of the land use change tax to the State upon development. The landowner shall bear the recording cost. The land use change tax and any obligation to repay benefits paid in error shall not constitute a personal debt of the person liable to pay the same, but shall constitute a lien which shall run with the land~~ land use change tax is not remitted timely pursuant to subsection (c), the amount, together with all penalties and interest and any costs that may accrue in addition thereto, shall be a lien in favor of the State of Vermont the property. All of the administrative provisions of chapter 151 of this title, including those relating to collection and enforcement, shall apply to the land use change tax. The Director shall release the lien when notified that:

- (A) the land use change tax is paid;
- (B) the land use change tax is abated pursuant to this section;
- (C) the land use change tax is abated pursuant to subdivision 3201(5) of this title;
- (D) the land is exempt from the levy of the land use change tax pursuant to this section and the owner requests release of the lien; or
- (E) the land is exempt from the levy of the land use change tax pursuant to this section and the land is developed.

(2) Nothing in this subsection shall be construed to allow the enrollment of agricultural land or managed forestland without a lien to secure payment of the land use change tax. Any fees related to the release of a lien under this subsection shall be the responsibility of the owner of the land subject to the lien.

32 V.S.A. § 3757 is amended to read:

~~The Commissioner in his or her discretion may subordinate the lien provided for in subsection 3757(f) of this title to a lender's mortgage interest in enrolled land to the extent that the Commissioner is satisfied that the landowner will maintain sufficient equity in the enrolled land to satisfy both the lender and any potential land use change tax that would arise upon development of the enrolled land. In order for subordination to be considered, the lender must complete an application form as prescribed by the Commissioner and pay a fee of \$179.00. The application shall provide all information deemed necessary by the Commissioner to determine the extent to which the State's lien can be subordinated to the lender's interest without adversely affecting the interest of the State.~~

Long Term Considerations

Simplify and Remove Tight Time Restrictions from Property Tax Adjustment Program

By far, the amount of time and resources spent on assisting taxpayers with property tax adjustment issues outweighs time and resources spent on any other tax type. There are several reasons. Those receiving property tax adjustments tend to be lower income taxpayers that are less sophisticated in dealing with paperwork and do not have the resources to hire a preparer or accountant. The forms and the overall process are some of the most complicated forms and processes that the Department administers. The deadlines are the strictest and have the harshest penalties for missing them of any tax type. The amount of a property tax adjustment tends to be significant relative to taxpayers' income so the consequences of not receiving it are often significant.

Some of the factors listed above cannot be helped given the nature of the program. Some of the factors should be looked at and consideration should be given to whether there is a better way to administer this program. The two factors that should be looked at are the complexity of the program and the strict nature of the deadlines.

As mentioned above, the property tax adjustment forms are one of the most complicated forms that the Department of Taxes administers. It requires the filing of two forms that are two pages each with a total over 100 fields to potentially be filled in by the taxpayer. The forms have several fields that if not filled in or if accidentally filled in incorrectly will result in the taxpayer be denied a property tax adjustment entirely. This leads to many taxpayers making mistakes or omissions on their forms that result in a reduced or denied property tax adjustment. The Department sends letters to the majority of taxpayers that made a mistake or missed a required field but, even then, most taxpayers do not understand what went wrong or how to correct it.

A possible solution to this issue is to simplify the program. This can be done by moving away from the concept of household income that is used for the program and towards a concept similar to MAGI that is used at the federal level for health care purposes.

The strict nature of the deadlines is also a major problem for many taxpayers. For most tax types, taxpayers have three years to amend their returns. A three-year period for property tax adjustment claims is unworkable for several reasons but the current October 15th deadline is also problematic. It gives taxpayers that filed on extension very little time to work with the Department to correct a problem with a property tax adjustment claim. In addition, a taxpayer that is notified of a problem well before October 15 may not understand the letter they receive or the consequences of the issue because of the complexity discussed above. These taxpayers may not realize what has happened until they receive their property tax bills in late September or early October and then will only have a week or two to correct the issue. Further, some towns first property tax payment is not due until November 15th, this means that some taxpayers do not realize that something went wrong until they go to make their first payment, which is a month after they no longer have any remedy. Another problem is taxpayers whose mortgage company makes the property tax payments on the taxpayers' behalf. These taxpayers often do not find out what happened until they are contacted by their bank because their mortgage payment has gone up because they do not have enough in escrow.

It is unclear what deadline would work best to balance the needs of the towns, the state, and the taxpayers but the current deadline appears to be having a disproportionately negative effect on taxpayers.



Taxpayer Class or Industry Tax Issues

Class or Industry	Issue	Recommendation
Manufacturing	Misinterpretation of exempt purchases for manufacturing such as taxable fuels, fixed assets, office supplies, materials, tools and when direct sales are taxable.	Issue comprehensive written guidelines; taxpayer education
Retailers	Purchasing items tax free for business use that are taxable such as software, fixed assets, office supplies, materials & supplies. Collecting local option tax continues to be overlooked. Problems occur when untaxed sales are erroneously purchased with exemption certificates. These issues are commonly detected during audits.	Issue comprehensive written guidelines; taxpayer education
Food & Lodging	Purchasing items sales tax free for business use that are taxable such as fixed assets, office supplies, materials & supplies. Tax free sales of meals and under reporting of alcohol sales occur. Local option tax compliance issue with both sales & meals/rooms taxes.	Issue comprehensive written guidelines; taxpayer education
Vendors of Online Products	The taxability of specified digital products and prewritten computer software but non-taxability of cloud computing products has created some confusion about what is subject to sales tax and what is not.	Issue comprehensive written guidelines; taxpayer education