

Cash-Strapped States Delay Paying Income-Tax Refunds

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This year, more Americans and businesses may be asking: Where's my tax refund?

That's because cash-strapped states such as North Carolina, Alabama and Hawaii have been forced to slow down issuing income tax refunds to individuals and businesses because of a lack of funds in their budget.

Kansas has hinted that a delay might be possible, and processing paper refunds in Iowa has slowed because the state doesn't have enough employees to get them processed faster.

Another state, New York, is still considering whether they'll follow the likes of Hawaii and delay refund payments.

"States typically do this when they are tight and they don't have a budget in place," said Karla Dennis, CEO of Cohesive, a nationwide tax preparation firm. Things are dire at many states: forty-one states are expected to have mid-year budget gaps totaling \$37.7 billion, according to the Center on Budget and Policy Priorities.

Delaying the refund, Dennis says, "gives the state funds to work with in the interim to fill a gap in their revenues."

Hawaii's Department of Taxation announced last month that it will delay income tax refunds until July 1, when processing and payments will resume on a "first-in-first-out basis," according to a news release. The state is delaying the funds to alleviate a \$721 million revenue shortfall for the fiscal year ending June 30, 2010.

Under Hawaiian law, processing refunds must be done 90 days after the April 20 due day (or later if a return is filed after the due date).

After that, the actual payment must be made within 45 days or interest has to be paid on the refund. Most states have similar laws about when interest kicks in, but they differ from state to state, said Scott Clark a tax attorney and partner at Sonnenschein Nath & Rosenthal.

Something similar is happening in North Carolina. The state's Department of Revenue posted a note on its website stating that the "state continues to feel the effects of the slow economy, and the department is managing the distribution of refunds as a result."

Refund payments were slow to be processed in North Carolina last year too, the only different now is that the department is keeping mum on when taxpayers might expect to receive their refunds. Last year, deadlines weren't met.

"We ended up not being right and people got even more upset," said Thomas Beam, a spokesperson at the North Carolina's Department of Revenue. He says besides managing funds, other factors-such as wrong addresses, social security numbers or not attaching the right forms-can further slow down payments.

The state continues to release refunds at a slower pace, and updates how much they've processed on the site regularly. As of late February, 727,282 refunds were processed in North Carolina totaling over \$500 million.

Ivan Kenneally, an assistant professor of political science at the Rochester Institute of Technology, says that more states could join in delaying state income tax refunds as states realize they have little option.

"It's essentially an involuntary no interest loan from the taxpayer," Kenneally said. "Other states have done it in a noncommittal way. But in the meantime they've slowed down the process."

Last year California and Alabama delayed processing refunds. This year, a spokesperson at California's Franchise Tax Board says that refunds are being sent out in a timely fashion. In Alabama, however, refunds are being processed slower, according to Carla Snellgrove, a spokesperson at the state's Department of Revenue.

"Refunds are being approved but are going out slowly this year," said Snellgrove. "We haven't stopped issuing refunds." She said under normal conditions an electronic refund would take about five to six days to get to taxpayers. This year, it's slower, but there's no timetable on when taxpayers can expect refunds.

"It varies," Snellgrove said. "Refunds are issued as the fund balance allows them to be issued."

Kansas Secretary of Revenue Joan Wagnon has been quoted in news reports that a shortfall could delay income tax refunds, but a spokesperson at the office said that refunds weren't delayed yet and Wagnon was just saying that it could be a possibility at some point.

These are examples of states that have been more candid about delays, said Kim Rueben it might be some are slowing down the process but are being quieter.

New York is currently considering delaying some \$500 million in refunds to alleviate a \$1.4 billion deficit, said Matt Anderson, a spokesperson for the New York State Division of the Budget.

"Clearly, the fact that we have to delay payments speaks to how dire the state's budget is," he said. In December 2009, New York's Governor David Patterson (D) did something similar when the state held back \$750 million in payments for schools. The funds were finally released in January 2010.

Iowa has a different problem: while the state has the funds for income tax refunds, it can't afford to pay a staff to process the paper filings. Fifty employees worked on processing paper refunds last year. This year there are none.

Instead, Renee Mulvey, a spokesperson at the Iowa Department of Revenue says that people who work at the department doing other stuff-such as auditing and IT-are also doing rotations to get paper statements out as fast as they can. It can take as much as 16 weeks to get a paper return. Electronic returns are being processed normally.

"These are states that are explicit that there might be some delay," said Kim Rueben, a senior fellow and public finance economist at the Tax Policy Center. "Others are slowing down the process but are being more quiet."

Outside of the states mention in this article, spokespeople from each individual state said that refunds were being sent out on time.

But all the delays could affect how taxpayers file in the future.

"If there's all this anxiety about whether taxpayers will get their refunds, you might see them changing how they approach their tax burden," Kenneally said.

After seeing a major delay in their refunds, Dennis said that she has seen clients and other taxpayers go to their employers and lower their state withholdings so that they pay less state taxes throughout the year in hopes of avoiding getting a refund all together.

"Taxpayers are really resentful that states are holding their money, especially since they feel like they paid their taxes all year long," she said.

The problem is that some taxpayers get too aggressive and find they unexpectedly owe their state money for a sum they didn't save up for which can be an issue for many Americans who are trying to scrape by in a recession.

"People are in desperate situations," said Clark. "It's their money. The state really owes it to the people."

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