Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author: Correa | Analyst: LuAnna Hass | Bill Number: AB 1845

Related Bills: See Legislative History | Telephone: 845-7478 | Amended Date: April 22, 2002

Attorney: Patrick Kusiak | Sponsor: _____

SUBJECT: Lien Priority/Liens To Enforce A Victim Restitution Order Take Priority Over Liens Filed By The State

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO _____.

____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED _____ STILL APPLIES.

X OTHER - See comments below.

SUMMARY

This bill would allow the interest of a crime victim with a restitution order to take priority over any state tax lien.

SUMMARY OF AMENDMENTS

The April 22, 2002, amendments removed the bill's provision that related to priority for liens filed to enforce court-ordered restitution fines or victim's restitutions and replaced it with the provisions discussed in this analysis.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to allow the victim of a crime to collect on their restitution order prior to the state collecting on a state tax lien.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative January 1, 2003.

POSITION

Pending.

Board Position:			Department Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Alan Hunter for GHG	5/17/02
____ N	____ OUA	X PENDING		

ANALYSIS

FEDERAL/STATE LAW

Criminal restitution is a process by which offenders are held accountable for the financial losses they have caused to the victims of their crimes. The restitution payment is the sum of money paid by the offender to the victim to balance this monetary loss.

Under federal law, it is mandatory for a defendant to pay restitution for many types of federal crimes. The Mandatory Victim Restitution Act of 1996 (MVRA) established procedures for determining the amount of restitution to which a victim may be entitled. In most fraud cases, restitution may be ordered in an amount equal to each victim's actual losses, usually the value of the principal or property fraudulently obtained. The MVRA provides that an order of restitution may be enforced by the United States (U.S.) according to the practices and procedures for the enforcement of a civil judgment under federal or state law. An order of restitution is a lien in favor of the U.S. on all property and rights to property of the defendant as if it were a liability for unpaid taxes.

In addition, a victim may choose to request the U.S. Clerk of Court to issue an Abstract of Judgment certifying that a judgment has been entered in a victim's favor in the amount specified in the Judgment. A victim may then file this with the Recorder's Office in any county within the state in which a defendant was convicted and where the victim believes the defendant has assets.

Under state law, any person convicted of a crime must pay a court-ordered restitution fine and restitution to any victim of that crime that suffered an economic loss as a result of the crime. The order to make restitution to the victim is enforced as if the order were a civil judgment. A victim may also request a lien as a judgment creditor to be filed in any county where it is believed the defendant has assets.

Existing state law imposes tax on the income earned by individuals, estates, trusts, and certain business entities. An individual that fails to report any portion of income may be assessed taxes on the unreported income. If the taxpayer fails to pay their taxes in full, the Franchise Tax Board (FTB) notifies the taxpayer that collection action may commence, which may include wage garnishments, liens, or other forms of levies.

An unrecorded, enforceable tax lien is automatically created when a taxpayer fails to pay an amount that becomes due and payable (statutory lien date). To be generally recognized and to compete with non-tax liens, a notice of state tax lien must be recorded in the county where real property is located and attaches to a taxpayer's interest in all real property owned by the taxpayer in that county. Once recorded, real property will be subject to that state tax lien for 10 years, unless released earlier by FTB or extended. State tax law allows FTB to release all or any portion of the property subject to a lien if the department determines that the taxes are sufficiently secured by a lien on other property, or that the release will not endanger or jeopardize the collection of taxes.

Although it is not required under state law, FTB may file a notice of tax lien with the Secretary of State (SOS) that is enforceable against all personal property of the taxpayer. State income tax law gives FTB the authority to collect against personal property using other collection remedies, without regard to the statutory lien and without the need for a separate court-issued abstract of judgment or a notice of lien filed with the a county recorder or the SOS.

Under current law, a state tax lien attaches to all real and personal property, tangible and intangible, including all rights to property and any property acquired after the lien is recorded. A state tax lien is not valid against real property where other lien holders, such as a judgment lien creditor or mechanic's lienor, have perfected (recorded) their interest prior to the state perfecting their lien. Multiple lien holders against a taxpayer's real property are satisfied depending on which lien holder perfected their lien first, or "first in time, first in right."

THIS BILL

This bill would allow a crime victim's restitution order to supersede the state's interest in the "criminal's" real or personal property when the following conditions are met.

- The tax liability that is the basis of the state tax lien arose from a taxpayer's activities that resulted in a criminal restitution order under state law, federal law, or law of another state, which gives the crime victim the status of judgment creditor.
- The crime victim is owed an unsatisfied portion of the restitution order, described above.
- The restitution order was made to provide restitution to the crime victim for an economic loss arising from the same activity that gave rise to the tax liability.

This bill would define "crime victim" by reference to the term "victim" in the California Penal Code, which would include:

1. The immediate surviving family of the actual victim.
2. Any corporation, business trust, estate, trust, partnership, association, joint venture, government, governmental subdivision, agency, or instrumentality, or any other legal or commercial entity when that entity is a direct victim of a crime.
3. "Derivative victims," which is defined as a resident of California or another state that is one of the following:
    - parent, grandparent, sibling, spouse, child, or grandchild of the victim at the time of the crime,
    - living in the household of the victim at the time of the crime,
    - a person with a relationship similar to 1 above, who had previously lived in the household of the victim for a period of at least two years,
    - another family member of the victim, including fiancé or fiancée, who witnessed the crime, or
    - primary caretaker of a minor victim, but was not the primary caretaker at the time of the crime.

The provisions of this bill could result in a circularity of lien priority. This happens when the victim's lien is made senior to a perfected state tax lien, and the state tax lien is senior to at least one other creditor's lien, which in turn is senior to the victim's lien. In this instance, payment would be made as follows (example below):

A. The victim's lien would be satisfied (paid) first, up to the amount of the state tax lien.
B. If the victim's lien is less than the state tax lien and fully paid under A, and additional funds are available, then partial payment would be made under the state tax lien.

C. If the victim's lien exceeds the state tax lien and not fully paid under A, payment is made to any other lien creditors that have an established priority between the state tax lien and the victim's lien. Any excess funds would then be paid under the victim's lien, until it is fully satisfied.
D. If the victim's lien is fully paid under A, and after any payment in B, payment would be made to any other lien creditors that have an established priority between the state tax lien and the victim's lien.
E. If the state tax lien has not been fully satisfied (paid) after A, B, C, and D, then the state would be paid to the extent that the state tax lien was not satisfied by partial payment under B. (The state would take the original position of the victim in the recordation priority in order to receive full satisfaction.)

Example: Assume $100,000 in recorded liens and $90,000 is available for distribution from the sale of the "criminal's" real property.

Lien Recordation Priority (Current Law Payment)	Circularity Priority (This Bill Payment)	A-E (Above)
FTB $30,000	Victim $20,000	A
IRS $35,000	**FTB $10,000**	B
Other Creditor A $10,000	IRS * $35,000	D
Other Creditor B $ 5,000	Other Creditor A $10,000	D
Victim $20,000	Other Creditor B $ 5,000	D
	FTB $10,000	E

* This bill would have no effect on federal tax liens.

IMPLEMENTATION CONSIDERATIONS

The department anticipates implementing this bill on a case-by-case basis. The department has identified the following implementation concerns and if these concerns were resolved, this bill would not significantly impact the department's programs and operations.

- This bill allows the interest of a crime victim to take priority over a state tax lien, but does not require the crime victim to record their interest as a judgment creditor, which is contrary to state lien law that requires the recordation of liens. Without recordation, a title company and FTB may be unaware of a victim's priority and FTB may receive proceeds from the sale of the "criminal" taxpayer's real property. Under current practice, if the proceeds received from the sale completely satisfy the FTB tax liability, FTB would release the state tax lien. Since a state tax lien would be invalid against the interest of a crime victim, FTB could be required to pay over to the victim any proceeds collected from the "criminal" taxpayer. The payment would, in principle, reinstate the unpaid tax liability of the "criminal" taxpayer. Since FTB would have already released the tax lien upon receiving the proceeds from the sale, nothing in current law allows the department to reinstate that tax lien to reflect the original recordation date. Therefore, FTB would be relegated to a position where it would have no secured interest in the "criminal's" real property. If the crime victim had voluntarily recorded his lien, this scenario would still cause FTB to lose priority to any other existing lien holding creditors. However, amounts would not have been received before a victim's restitution order was satisfied.

- Assuming this bill is effective and operative January 1, 2003, the language is silent on whether this bill applies to restitution orders issued before or after that date.
- It is unclear whether this bill would have any direct impact on the department's other means of collecting taxes by levy on personal property. This bill could be construed to allow a victim with a restitution order to supersede any collection actions taken by FTB. However, this bill does not provide for a retroactive effect, which would prohibit a payment to the victim of funds collected from the "criminal" taxpayer prior to the effective date of this bill.
- If a victim were to assert their interest as priority over FTB, it is unclear if FTB would be required to substantiate the amount of unpaid restitution to be collected by the victim, and how the department would substantiate those amounts.

OTHER STATES' INFORMATION

After a review of *Florida, Illinois, Massachusetts, Michigan, Minnesota*, and *New York* laws, it appears that none of these states allow a lien for a restitution fine or victim restitution order to take priority over a state tax lien. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until the implementation concerns have been resolved.

ECONOMIC IMPACT

Collection Estimate:

Based on limited information and the discussion below, it is estimated that the potential reduction in Personal Income Tax (PIT) collections due to the change in collection priorities would be as follows:

Estimated Revenue Impact of AB 1845 Effective After Enactment Assumed Enactment After 6/30/2002		
2002-03	2003-04	2004-05
-$2.5	-$2.5	-$3.0

This proposal does not take into consideration any collection revenue attributable to wage levies or other collection actions nor does it consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

Collection Discussion:

Revised collection losses above reflect an increase of approximately $500,000 annually for 2002-03 and 2003-04 and $1 million for 2004-05 from the previous version of this bill as introduced January 28, 2002. These changes in losses are primarily attributable to instances where the provisions of this bill would result in a circularity of lien priority, where the victim's lien is made senior to a state tax lien, but the state tax lien is senior to one or more lien creditors that are senior to the victim's restitution lien.

In addition this estimate does not include additional losses resulting from unrecorded victim liens taking priority over state tax liens. Such losses cannot be quantified since the data and information needed are not available.

ARGUMENTS/POLICY CONCERNS

Criminal restitution orders are assessed against a defendant for any crime committed in California. Many taxpayers that have delinquent state taxes (income, sales, or employment) also may owe restitution. Under this bill, a victim's restitution order would take priority if the tax liability that is the basis of the state tax lien arose from a taxpayer's activities that resulted in a criminal restitution. It is unclear why tax collection efforts, which benefit the state as a whole, should be given a lower priority.

Victims of "white-collar" crimes (embezzlement, fraud) often are individuals that are business owners that have insurance to cover financial losses due to these types of crimes. Depending on the insurance policy, the insurance company may reimburse the victim to cover the loss and then collect on the restitution order to reimburse their funds. Other policies may reimburse the victim to cover the loss (up to a maximum amount stated in the policy) and require the victim to collect on the restitution order. The victim would be allowed to keep any additional funds recovered after reimbursing their insurance company for the amount of the loss coverage. Therefore, this bill could be construed to give collection of restitution by insurance companies a higher priority than the collection of taxes.

Although this bill would allow liens filed to enforce a victim's restitution order to take priority over state tax liens, it would not affect federal tax liens that come into existence before the lien for restitution. Therefore, if a federal lien has first priority followed by the department's state income tax lien, a lien for restitution would take priority over the department's lien. The department would lose priority to the restitution lien, but the lien for restitution would still only be satisfied to the extent of amounts in excess of the federal lien.

Similarly, if the department's lien has first priority and a federal lien has second priority, and no other third party creditor liens exist, the liens for restitution would take precedence over the department's lien. If the victim receives payment that is equivalent to the full amount of the state tax lien (as described above under This Bill) and since this bill has no effect on the federal lien, the department's lien would move from first priority to third priority as a result of this bill.

LEGISLATIVE STAFF CONTACT

LuAnna Hass
Franchise Tax Board
845-7478

Brian Putler
Franchise Tax Board
845-6333