

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Horton Analyst: LuAnna Hass Bill Number: AB 1433

Related Bills: See Legislative History Telephone: 845-7478 Amended Date: May 20, 2002

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Military Service Members /Deferment of Collection of Tax/Interest

SUMMARY

This bill would provide various civil protections and relief to military service members who are ordered to active federal or state military duty.

In addition, this bill would clarify that, with the exception of the provisions added by this bill to the Military and Veterans Code, the provisions of the Government Code govern various rights and benefits of state employees who are ordered into active military duty. This change would not be administered by the department and is not discussed in this analysis.

SUMMARY OF AMENDMENTS

The May 20, 2002, amendments state that the intent of the Legislature is to allow the qualification for the benefits and protections under this bill to apply retroactively to September 11, 2001. However, it is also the intent of the Legislature that the actual benefits and protections under this bill would only apply on a prospective basis.

The May 6, 2002, amendments would clarify that, with the exception of the provisions added by this bill to the Military and Veterans Code, the provisions of the Government Code govern various rights and benefits of state employees that are ordered into active military duty.

The April 29, 2002, amendments would make various technical changes to the bill.

The April 3, 2002, amendments would impact the department by providing various civil protections and relief to military service members who are ordered to active federal or state military duty.

The previous versions of this bill did not impact the department and are not discussed in this analysis.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

It appears the purpose of this bill is to provide active military personnel protections under state law similar to those provided under the federal Soldiers' and Sailors' Civil Relief Act (SSCRA), and to expand those protections to members of the National Guard while they are on active state duty.

Board Position:

_____ S	_____ NA	_____ NP
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_____ N	_____ OUA	_____ X PENDING

Department Director

Date

Gerald H. Goldberg

5/31/02

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective upon enactment and operative January 1, 2003, and specifies that qualification for the benefits and protections under this bill would be retroactive to September 11, 2001. However, the benefits and protections under this bill would only apply on a prospective basis.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Under federal law, the SSCRA provides a comprehensive set of civil protections for members of the federal armed services, including protections with respect to litigation, loans, eviction, taxes, and professional liability insurance. In addition, the SSCRA contains a general relief provision that authorizes a military member, at any time during military service or within six months after, to apply to a court for relief of 1) any obligation or liability incurred by the member before active duty, or 2) any tax assessment that falls due before or during active military service. The SSCRA applies to any person in military service, on active federal duty with a branch of service, or in a reserve component that is ordered to report for military service. The SSCRA places limits on state taxation of members of the armed forces with respect to their personal property and their compensation for military service. Currently, the SSCRA covers members of the National Guard only while they are on federal active duty; state duty does not qualify.

Existing state law imposes tax on the income earned by individuals, estates, trusts, and certain business entities. Tax is imposed on the entire taxable income of residents of California and upon the taxable income of nonresidents derived from sources within California. The tax for individuals is computed on a graduated scale at rates ranging from 1% to 9.3%. Existing state law imposes interest on any payment of tax that is not paid on or before the last date prescribed for payment. Existing law establishes the applicable rate of interest.

Federal and state law provides that the time served in a designated combat zone by a member of the Armed Forces, the hospitalization time of a member of the Armed Forces, and the next 180 days are disregarded in determining whether specific acts were performed within the time prescribed. The acts include but are not limited to the filing and payment of any return of income, estate, or gift tax; or filing a claim for credit or refund of any tax, assessment of any tax, or the collection (by levy or otherwise) of the amount of any liability in respect of any tax.

In addition, under state income tax law, the Franchise Tax Board automatically grants to individuals that are members of the Armed Forces serving outside the United States an extension of time for various measures, including the filing of their tax return and paying the tax. The extension is granted until 180 days after their return to the United States and the extension is free of interest and penalties.

The California Constitution states that no legal or equitable process can issue in any proceeding in any court against the State to prevent or suspend the collection of tax. After the taxpayer pays the tax, an action may be taken to recover the tax paid. The California Constitution also states that an administrative agency does not have the power to declare a state statute unenforceable on the basis that federal law prohibits its enforcement, unless an appellate court has made a determination that federal law prohibits the enforcement of the statute.

THIS BILL

This bill would codify for state purposes provisions that are generally similar to many, but not all, of the provisions of the federal SSCRA. In addition, this bill would extend those provisions to members of the National Guard who are ordered into active state service by the Governor. With respect to income taxes and administration, this bill would require:

- The period of military service to be excluded when computing any period limited by law for bringing any action or proceeding in any court, board, bureau, commission, department, or other agency of the government.
- Any liability incurred by the service member prior to their entry into active service to bear an interest rate of no more than 6% per year, unless a court has concluded that the ability of the service member to pay an interest rate in excess of 6% is not materially affected by their service.
- The collection of any income tax that is due prior to or during the period of military service to be deferred for a period of up to six months after the termination of active military service. Interest and penalties for nonpayment of the tax would not accrue during the time the liability is deferred. Further, the running of the statute of limitations against the collection of any tax would be suspended for the period of military service and for an additional nine months after termination of active service.

Further, this bill would allow a court to grant the following relief (after notice and hearing) if a service member applies for the relief of any tax or assessment that is due prior to or during the period of military service:

- A stay of the enforcement of the tax during the period of military service.
- The service member may pay the balance of an unpaid liability and interest in equal periodic installments for a period beginning on either the date of the termination of service or the date of application for relief and equal to the period the member spent in military service.

When a court has granted the stay, no fines or penalties can accrue during the period of the relief outlined above.

Finally, this bill would state that the intent of the Legislature is to allow service members to qualify for the benefits and protections under this bill retroactive to September 11, 2001. However, it is also the intent of the Legislature that the actual benefits and protections to service members would only apply on a prospective basis after January 1, 2003, which is the operative date of this bill. Therefore, with respect to the provision of this bill that would defer the collection of any income tax, service members that are in active service as of September 11, 2001, would qualify for the deferral, but the deferral would be effective only on or after January 1, 2003.

IMPLEMENTATION CONSIDERATIONS

This bill would require the period of military service to be excluded when computing any period limited by law for bringing of any action or proceeding in any court, board, department, or other agency of the government. State income tax laws outline specific time frames regarding the administration of Notice of Proposed Assessments (NPA), protests, and appeals. Unless amended, this bill would require these time frames to be extended for the period of active military service, which could have the result of preventing NPAs from becoming final assessments so long as the service member is on active duty.

In addition, this bill states this exclusion of the military service would not apply with respect to any period of limitation under the Internal Revenue Code (IRC). Since this bill is creating a state law, this provision relating to the IRC would have no legal effect. The author may wish to replace the reference to the IRC with a reference to the California Revenue and Taxation Code, which would eliminate the concern outlined above.

TECHNICAL CONSIDERATIONS

This bill contains two provisions that are labeled as Section 411 of the Military and Veterans Code. The author may wish to renumber one provision as 410 since the bill does not contain a Section 410.

LEGISLATIVE HISTORY

SB 2096 (Stats. 1986, Ch. 614) provided an exclusion from gross income for compensation for military or naval service performed by a nonresident member of the armed forces not domiciled in the state and attributable to a resident spouse solely because of the application of any community property law or rule. The Legislature indicated this provision was consistent with the department's interpretation of state law and the SSCRA.

AB 1365 (Oller, 1999/2000) would have excluded from gross income any military retirement pay, military disability pay, or any other benefits received by a person retired from the armed forces. This bill failed passage in the Assembly Revenue and Taxation Committee. AB 2561 (Zettel, 1999/2000), and AB 1222 (Rod Pacheco 2001/2002) would have allowed a credit for taxpayers who received retirement pay as a result of active duty in the armed forces. AB 2561 died in Assembly Revenue and Taxation Committee while AB 1222 was amended to increase the dependent credit. SB 1725 (Haynes, 1999/2000) and AB 294 (Zettel and Kehoe, 2001/2002) would have both provided that gross income would not include benefits and payments received under the federal Retired Serviceman's Family Protection Plan, the Survivor Benefit Plan, and the Supplemental Survivor Benefit Plan. SB 1725 died in the Senate Revenue and Taxation Committee, while AB 294 died in the Assembly Revenue and Taxation Committee.

AB 1862 (Wyman 2001/2002) and SB 1776 (Poochigian 2001/2002) would allow a 100% credit for wages paid to a qualified employee who is on active duty as a result of Operation Enduring Freedom or any successor military action. However, under AB 1862 benefits paid in taxable years beginning on or after January 1, 2002 qualify, while under SB 1776 any benefits paid on or after September 11, 2001, and before January 1, 2002, are to be treated as if paid during the 2002 calendar year. AB 1862 is currently referred to both the Assembly Revenue and Taxation Committee and the Veterans Affairs Committee. SB 1776 is currently referred to both the Senate Revenue and Taxation Committee and the Veterans Affairs Committee.

OTHER STATES' INFORMATION

The U.S. Supreme Court has declared that the federal SSCRA must be read with "an eye friendly to those who dropped their affairs to answer their country's call." A majority of federal and state courts have construed the present SSCRA in this spirit.

FISCAL IMPACT

This bill provides for a reduced interest rate of 6% that would apply to any liability incurred by the service member prior to their entry into active service, unless a court has concluded that the ability of the service member to pay an interest rate in excess of 6% is not materially affected by their service. The department's systems are not designed for recalculation of interest as specified in this bill; therefore some systems changes would be required to identify and isolate all returns recognized as activated military. Since the actual volume of service members is unknown, the department's costs are based on an estimated volume of 6,000 to 12,000 returns. Preliminary costs to administer this bill are anticipated to be in the range of \$200,000 to \$240,000, including one-time implementation costs of \$126,000, for changes to the department's systems in order to isolate the returns for manual resolution. It is estimated that this bill would require the department to incur an additional 3-5 positions based on the volume of returns the department receives.

In addition to the systems costs, these accounts would require manual resolution. Since the actual volume of returns is unknown; costs for the manual resolution of these accounts have not been determined.

ECONOMIC IMPACT

This bill is not anticipated to have a significant impact in Personal Income Tax (PIT) collections. Any reduction in collections would depend upon the extent to which interest owed would have otherwise been collected and are anticipated to be less than \$250,000.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

LEGAL CONCERN

The California Constitution states that no legal or equitable process can issue in any proceeding in any court against the State to prevent or suspend the collection of tax. This bill would allow a court to grant a stay of the enforcement of the tax during the period of military service and provide the service member the ability to pay the balance of the unpaid liability in equal periodic installments for an extended period. This provision of the bill could be construed to be in conflict with the California Constitution so that the courts may not be able to grant a stay of enforcement.

ARGUMENTS/POLICY CONSIDERATIONS

As stated above under "Federal/State Law," the California Constitution states that a state agency cannot fail to enforce a state statute on the basis that federal law prohibits its enforcement, unless an appellate court has made a determination that federal law prohibits the enforcement of the state statute. The provisions of this bill would allow state agencies generally to provide the same protections as provided by those aspects of the federal SSCRA without having to litigate the issue of whether the federal statute supersedes state law.

LEGISLATIVE STAFF CONTACT

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