**Franchise Tax Board**

# SUMMARY ANALYSIS OF AMENDED BILL

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|---|---|---|---|---|---|
| Author: | AR&T Committee | Analyst: | John Pavalasky | Bill Number: | AB 1115 |
| Related Bills: | See Prior Analysis | Telephone: | 845-4335 | Amended Date: | April 23, 2001 |
| | | Attorney: | Patrick Kusiak | Sponsor: | Franchise Tax Board |

**SUBJECT**: Nonresident Taxation/Coordination of Minimum Tax Credit with Credits that Reduce Tax Below Tentative Minimum Tax/Full Payment Rule/ Usage of Tax Credit by Holders of Interests in Pass-Through Entities/ Disclosure of Return and Return Information for Personnel Matters/ Limited Partnership Tax Technical Change

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

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

_X_ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended March 28, 2001.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ________________________.

_X_ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 23, 2001,. STILL APPLIES.

_X_ OTHER - See comments below.

## SUMMARY

This Franchise Tax Board (FTB) sponsored bill would:

- **Make a comprehensive change in the manner that nonresidents and part-year residents are taxed** - Specify, for the first time, clear, definitive rules that would be applied consistently to all taxpayers for calculating loss carryovers, deferred deductions, and deferred income.

- **Resolve a potential federal constitutional issue** - Allow the alimony deduction and itemized deductions to nonresidents, thus making California law consistent with case law from the U.S. Supreme Court.

- **Coordinate the Alternative Minimum Tax Credit (AMTC) with credits that reduce tax below Tentative Minimum Tax (TMT)** - Eliminate conflicting statutory language and to provide clear and definitive rules for the ordering of credits that are applied against tax.

| Board Position: | | | Legislative Director | Date |
|---|---|---|---|---|
| _X_ S | ____ NA | ____ NP | | |
| ____ SA | ____ O | ____ NAR | Alan Hunter for GHG | 06/19/01 |
| ____ N | ____ OUA | ____ PENDING | | |

- **Full payment rule** - Ensure that taxpayers can file refund claims for overpaid income taxes even though the tax was paid through installment payments.

- **Usage of tax credits by holders of interests in pass-through entities** - Remove an inequity in the law by allowing a holder of an interest in a pass-through entity to realize the same tax benefits whether the pass-through entity files on a fiscal year or calendar year basis.

- **Disclosure of return and return information for personnel matters** - Authorize disclosure of confidential taxpayer information to an FTB employee or former FTB employee, a legal representative of such employee, an Administrative Law Judge (ALJ), or a Superior Court Judge for use in disciplinary actions. The authorization provided by this provision would follow the same methodology used by the Internal Revenue Service (IRS) in handling personnel actions.

- **Limited partnership tax technical change** - Make references to the limited partnership annual tax in the Revenue and Taxation Code (R&TC) correct and consistent.

**SUMMARY OF AMENDMENTS**

The April 23, 2001, amendments added the following five FTB sponsored proposals:

- **Coordination of the AMTC with credits that reduce tax below TMT**

- **Full payment rule**

- **Usage of tax credits by holders of interests in pass-through entities**

- **Disclosure of return and return information for personnel matters**

- **Limited partnership tax technical change**

A new revenue estimate table is provided. The remainder of the previous analysis dated March 26, 2001, still applies. In addition, an analysis of each of the provisions is separately discussed below.

**EFFECTIVE/OPERATIVE DATE**

This bill would become effective January 1, 2002, and would apply to taxable years beginning on or after that date. The provision allowing the alimony deduction to nonresidents would apply to all open years.

**POSITION**

Support.

At its December 18, 2000, meeting, the Franchise Tax Board voted 2-0 to sponsor the language introduced in this legislation.

**ECONOMIC IMPACT**

Revenue Estimate

This bill would result in the following revenue effects. The bill is effective with taxable years beginning on and after January 1, 2002. Revenue impacts, if any, in 2001-02, would be negligible.

**Estimated Revenue Impact of AB 1115**
**As Amended 4/23/01**
[$ In Millions]

| | Provision | 2002-03 | 2003-04 | 2004-05 |
|---|---|---|---|---|
| 1 | Change in taxing nonresidents and part-year residents * | unknown | unknown | unknown |
| 2 | Allow alimony deduction | -$5 | -$2 | -$2 |
| 3 | Definitive rules for ordering of applied credits | minor gain | minor gain | minor gain |
| 4 | Full payment rule | minor loss | minor loss | minor loss |
| 5 | Usage of tax credit by holders of interests in pass-through entities | -- | -- | negligible loss |
| 6 | Disclosure of confidential tax return information for disciplinary actions | no impact | no impact | no impact |
| 7 | Limited partnership tax technical change | no impact | no impact | no impact |

Negligible loss is less than $250,000.
Minor gain or loss is less than $500,000.
* Both revenue gains and losses would result depending on tax characteristics of nonresident filers.

**1. <u>COMPREHENSIVE CHANGE IN TAXATION OF NONRESIDENTS AND PART-YEAR RESIDENTS</u>** - Specify, for the first time, clear, definitive rules that would be applied consistently to all taxpayers for calculating loss carryovers, deferred deductions, and deferred income.

Analysis dated March 26, 2001, still applies.

**2. <u>RESOLVE A POTENTIAL FEDERAL CONSTITUTIONAL ISSUE</u>** - Allow the alimony deduction and itemized deductions to nonresidents, thus making California law consistent with case law from the U.S. Supreme Court.

Analysis dated March 26, 2001, still applies.

**3. <u>COORDINATION OF THE AMTC WITH CREDITS THAT REDUCE TAX BELOW THE TMT</u>**

**SUMMARY**

This provision would eliminate conflicting statutory provisions that specify the order that credits are applied against tax.

**PURPOSE OF THE PROVISION**

The purpose of this provision is to eliminate conflicting statutory language and to provide clear and definitive rules for the ordering of credits that are applied against tax.

**EFFECTIVE/OPERATIVE DATE**

The effective and operative date of this bill would be for taxable years beginning on or after January 1, 2002.

**ANALYSIS**

<u>FEDERAL/STATE LAW</u>

Federal Law

Existing federal law provides for an alternative minimum tax liability, which ensures that taxpayers with credits, deductions, and other tax preference items do not completely escape taxation.

In the computation of the alternative minimum tax (AMT), various adjustments are made to regular taxable income to arrive at alternative minimum taxable income (AMTI). The minimum tax rate, which can be lower than the regular tax rate, is applied to AMTI to derive the TMT. If the TMT exceeds the regular income tax for that year, the excess is the taxpayer's AMT for that year. On the other hand, if regular tax exceeds TMT, there is no AMT for that year.

Many of the adjustments required to derive AMTI are timing adjustments that may reverse themselves in subsequent years[1]. To reverse these timing adjustments, Internal Revenue Code (IRC) §53 provides an AMTC. In general, the AMTC available in any year is the excess of the taxpayer's cumulative AMT from prior years less any AMTC allowed in prior years. AMTC may be used to reduce the taxpayer's regular income tax liability in years when the regular tax liability exceeds TMT; however, AMTC cannot reduce regular tax below TMT. (With few exceptions, other federal credits are not permitted to reduce regular tax below TMT.)

IRC §53(c) clarifies that for purposes of determining the amount by which the regular tax exceeds the TMT (the amount available for offset by available AMTC), the regular tax is first reduced by other non-refundable tax credits. A few of these credits may be carried back or forward to other taxable years.

California Law

California generally conforms to the federal AMT provisions, including the AMTC, but with some modifications. California modifies the federal ordering rules applicable to AMTC and the other non-refundable tax credits.

R&TC § 23036(c) specifies the order in which credits must be used to reduce regular tax for California purposes. This subdivision overrides any other provision to the contrary. Credits are allowed against tax in the following order:

(1) Credits that do not contain carryover provisions. (Credits that expire if they are not used in the year acquired.)
(2) Credits that contain carryover provisions. (When the credit exceeds the "tax," the excess is allowed to be carried over to offset the "tax" in succeeding taxable years.)
(3) The minimum tax credit allowed by Section 23453. (The AMTC discussed above and the topic of this proposal.)
(4) Credits for taxes withheld. (Withholding credits are refundable.)

Prior California Law

California law, R&TC § 23036(d), provides that 17 credits (all with carryover provisions) are allowed to reduce regular tax below TMT. Prior to 1989 the law was clear regarding the order in which these credits could be applied in the computation of regular tax. Each of these 17 carryover credits was applied **before** AMTC.

In 1989, the law was amended by AB 802 (Stats. 1989, Ch. 1352). Franchise Tax Board's (the department) legislative analysis of AB 802 indicated the department understood that these amendments were intended to provide that AMTC would be applied **before** tax credits that could

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[1] Taxpayers using an accelerated depreciation method (such as double declining balance (DDB)) would have an AMT adjustment in the early part of the asset's depreciable useful life. The AMT adjustment would be the excess of the depreciation amount computed under the DDB method over the depreciation that would have been allowed using the straight-line method. In later years, the depreciation amount computed under the DDB method would be less than the amount computed under the straight-line method. In this situation, the taxpayer deducted less depreciation for regular tax purposes than what was allowed for AMT purposes.

reduce regular tax below TMT. Most noteworthy, the credit ordering intended by that legislation did not conform to federal rules. However, the non-conformity was considered justified because many California tax credits may reduce regular tax below TMT, but very few federal credits may reduce regular tax below TMT. R&TC § 23036(d) is a “notwithstanding” subdivision, meaning that this subdivision should override R&TC § 23036(c) (which is also a “notwithstanding” subdivision).

R&TC § 23453 provides the rules for how AMTC is computed and what is allowable in any one year. Prior to 1989, R&TC § 23453(c) clearly stated that the allowable AMTC for the year was to be reduced by credits allowed under R&TC §23036(d) (the credits that may reduce regular tax below TMT). Prior to 1989, R&TC § 23453 and R&TC § 23036 did not conflict. AB 802 also amended R&TC § 23453(c). The amendment does not appear to change the ordering of the credits. Instead, the amendment arguably required AMTC to be zero before another credit could be used to reduce regular tax below TMT. The legislative intent of this amendment, as suggested by the department’s analysis of AB 802, was to clarify the change in the ordering of the credits to allow AMTC to be applied **before** other credits that can reduce regular tax below TMT[2].

Present Inconsistencies in the Law

There is conflicting language in the PITL Sections 17039(a), 17039(c)(1), and 17063(c) and in B&CTL Sections 23036(c), 23036(d), and 23453 regarding the ordering of tax credits. Specifically, these provisions conflict over whether AMTC is applied **before** or **after** tax credits that reduce tax below TMT.

R&TC § 23036(c) (the credit ordering section) provides that credits with carryover provisions are applied **before** AMTC. R&TC § 23036(d) provides that the listed credits (all with carryover provisions) may be applied to reduce TMT, but only **after** application of AMTC.
These two subdivisions contradict each other, and both subdivisions contain “notwithstanding any other provision” language that seeks to make both sections the superseding rule.

Further, R&TC § 23453(c) conflicts with both § 23036(c) and (d). Rather than providing that regular tax is reduced by credits other than credits that can go below TMT before the application of AMTC, it provides that the regular tax is reduced by credits other than **that portion** of any credit that reduces tax below the TMT. This provision can be interpreted to mean that credits that reduce regular tax below TMT are bifurcated and that the portion that does not go below TMT is applied against the regular tax before the AMTC. However, if a taxpayer has a credit that will reduce tax below the TMT, the portion of that credit that does not go below TMT will reduce the regular tax to equal the TMT. After reducing regular tax by that portion of the credit, there will no longer be any excess of regular tax over TMT, so no AMTC could be allowed. Under that interpretation, the requirement in § 23036(d) that credits may reduce tax below TMT “only after allowance of the [AMTC]” would be meaningless because there could be no circumstances in which an AMTC could be used before a credit that goes below the TMT.

Current Problem

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[2] The above sections are from the California Bank and Corporation Tax Law (B&CTL). Similar provisions are found in the corresponding sections of the California Personal Income Tax Law (PITL): § 17039(a), § 17039(c)(1), and 17063(c). PITL § 17063(c)(1) provides that 21 different PITL credits may reduce regular tax below TMT.

A taxpayer's net liability could change depending on how the conflicting language is administered. Because of the conflicting language, however the credit is administered, it will not be in compliance with all sections and/or subdivisions of the R&TC. The department has administered AMTC by permitting credits that may reduce regular tax below TMT to be bifurcated. Although the department does not believe that this reflects the intent of the 1989 legislation (as stated in the department's analysis of AB 802 in 1989), it is the most beneficial to the taxpayer. The department allows credits that can reduce regular tax below TMT to be applied **before** and **after** the application of AMTC. The provisions of this bill would be different from the present method used by the department.

THIS BILL

This bill would amend the R&TC to require that AMTC be applied **before** any credit that can reduce regular tax below the TMT. This provision also clearly codifies and correctly reflects the legislative intent of AB 802.

OTHER STATES' INFORMATION

Five of the larger states with tax laws similar to California were reviewed: *Illinois, Massachusetts*, *Michigan, Minnesota,* and *New York*. The tax laws in these states are not germane to this provision.

## FISCAL IMPACT

This bill would not significantly impact the department's costs.

## ECONOMIC IMPACT

The potential revenue impact for this provision is unknown, but is believed to be minor. There could be a minor revenue gain in future years associated with taxpayers generating AMTC and the MIC and/or other credits with carryover provisions that are limited in the number of years (e.g., enterprise zone credits, MIC) available. Under the proposal, these taxpayers would be required to use any AMTC first, before using any credits that can reduce TMT.

The AMTC statute provides that the credit can be carried forward until exhausted, while other credit statutes have specified expiration dates. This scenario could result in taxpayers claiming the AMTC in lieu of other credits up to the point that the other credits expire.

## ARGUMENTS/POLICY CONCERNS

This provision is necessary to eliminate conflicting statutory provisions that set forth the order in which credits are applied. Statues that are in conflict lead to confusion for taxpayers and the department. Moreover, conflicts within the code often lead to litigation between taxpayers and the department.

## 4. FULL PAYMENT RULE

**SUMMARY**

This provision would allow a taxpayer that is making installment payments on their taxes to file a claim for refund before the taxes are fully paid (a protective refund claim).

**PURPOSE OF THE PROVISION**

The purpose of this provision is to ensure that taxpayers can file refund claims for overpaid income taxes even though the tax was paid through installment payments.

**EFFECTIVE/OPERATIVE DATE**

This provision would apply to claims for refund filed on or after January 1, 2002, without regard to taxable year. However, installment payments would only be refunded to the taxpayer if the protective refund claim is filed within the usual statute of limitations (SOL) for claiming a refund. Thus, installment payments made before January 1, 2001, would not be subject to a refund under this provision.

**ANALYSIS**

FEDERAL/STATE LAW

Under current State tax law and the California Constitution, taxes must be fully paid before the taxpayer can file a refund claim and before that claim must be acted on administratively (granted or denied, subject to protest and appeal) or judicially (court). This is commonly called the “full payment rule.” In addition, State law limits the amount that can be refunded to amounts that are paid and for which a claim for refund is filed within the statute of limitations (SOL). The SOL is the later of:

- four years from the original due date of the return,
- four years from the date the return was timely filed, or
- one year from the date of payment.

Once the SOL has expired, the taxpayer’s right to a refund of the overpayment is lost.

For taxpayers paying their taxes in installments, payment in full is typically made within three years, and no longer than seven years.

Federal case law allows for an informal claim process that holds open the SOL until the tax is fully paid. (The usual federal SOL for claiming overpayments is the later of three years from the date the return is due or two years from the time the tax is paid.)

THIS BILL

This provision would allow taxpayers that are making installment payments to satisfy a tax liability to file a refund claim before their taxes are fully paid.

## OTHER STATES' INFORMATION

The claims for tax refund provisions of five of the larger states with tax laws similar to California were reviewed: *Illinois, Massachusetts, Michigan, Minnesota,* and *New York*. These states, which have both personal income and corporate tax laws, like California, allow taxpayers to file refund claims and have SOLs for making refunds. However, no laws in these states appear to allow the filing of protective refund claims.

## FISCAL IMPACT

This bill's impact on FTB's departmental costs is unknown, but is believed to be minor, if any.

## ECONOMIC IMPACT

A minor decrease in tax revenue would result from this bill because taxpayers would be able to have amounts refunded that otherwise would be barred under current law.

## SUPPORT/OPPOSITION

Support: FTB. The full payment rule was discussed over the past three years by members of the California State Bar, Taxation Section, State and Local Committee (State Bar Committee) and FTB as well as other governmental staff at the invitation of the State Bar Committee. The members of the State Bar Committee indicated support of the solution provided by this provision.

## ARGUMENTS/POLICY CONCERNS

- For taxpayers that are experiencing financial hardship and cannot pay their taxes without making installment payments, California's full payment rule may be unduly harsh. Due to the SOL, these taxpayers may lose the right to obtain a refund of tax amounts they paid and that are later found by the Board of Equalization or a court not to be owed to the state.

- This bill addresses a fundamental issue of fairness for taxpayers and may be viewed as good tax policy.

- This bill would allow California taxpayers making installment payments to follow the same refund claim process allowed for federal purposes.

- California law allows taxpayers experiencing financial hardships to pay their tax through installment payments and avoid involuntary collection of tax. Therefore, for the law to allow installment payments but then deny a refund of some of the payments because they are beyond the SOL may be viewed as a trap for the taxpayer. This bill would eliminate this problem.

## 5. USAGE OF TAX CREDITS BY HOLDERS OF INTERESTS IN PASS-THROUGH ENTITIES.

### SUMMARY

This provision would provide a general default rule for consistent treatment of pass-through credits.

### PURPOSE OF THE PROVISION

The purpose of this provision is to remove an inequity in the law by allowing a holder of an interest in a pass-through entity to realize the same tax benefits whether the pass-through entity files on a fiscal year or calendar year basis.

### EFFECTIVE/OPERATIVE DATE

The effective and operative date of this provision would be for taxable years beginning on or after January 1, 2002.

### ANALYSIS

FEDERAL/STATE LAW

Existing federal and state laws provide various tax credits that are designed to provide tax relief for taxpayers that must incur certain expenses (e.g., renter's credit) or to influence behavior, including business practices and decisions (e.g., research credits).

Under federal law, tax credit statutes are generally enacted with transactional dates that allow credits for specified costs paid or incurred beginning and ending on specified dates.

Under state law, tax credit statutes are generally enacted with operative dates beginning and ending by reference to specified taxable years. The purpose of the taxable year operative date language is to provide consistent treatment for calendar year and fiscal year taxpayers by allowing them to claim the credit for the same period of time (e.g., for the five years the credit is available).

However, the taxable year operative date language in credit statutes does not provide consistent treatment for holders of interests in pass-through entities (e.g., partnerships or S corporations). A holder of an interest in a fiscal year pass-through entity is generally precluded from utilizing tax incentives earned by that entity and passed-through to the holder of the interest in the last year a credit is available if the holder's tax year begins after the credit's operative period ends.

**Example**

ABC Partnership has a 2002 fiscal year ending June 30, but the partners of ABC Partnership report on the calendar year. The partnership made expenditures that qualify for the Child Care Facility Credit for ABC Partnership's fiscal year ending June 30, 2003.

The Child Care Facility Credit is applicable for taxable years beginning on or after January 1, 1998, and before January 1, 2003. The partnership's taxable year begins July 1, 2002; thus, the partnership qualifies to take the credit. The credit is passed through under normal partnership rules to the partners effective June 30, 2003. The credit is reportable on the partner's tax return for 2003 (the period beginning January 1, 2003, and ending December 31, 2003). However, the credit is not allowed for taxable years beginning on or after January 1, 2003. Consequently, the partners are precluded from claiming the credit passed-through to them from ABC Partnership on June 30, 2003.

The taxable year operative date language produces an inequitable result for some investors in a fiscal year pass-through entity.

<u>THIS BILL</u>

This provision would provide a general default rule to allow holders of interests in pass-through entities, irrespective of the taxable year of the holder, to claim the pass-through credit. The general default rule would apply even if the pass-through entity files its returns on a fiscal year different than that of the holder of the interest and even if the operative date of the credit has expired.

<u>IMPLEMENTATION CONSIDERATIONS</u>

Implementing this bill would require some changes to existing tax forms and instructions that could be accomplished during the normal annual update.

**OTHER STATES' INFORMATION**

Review of *Illinois, Massachusetts, Michigan, Minnesota,* and *New York* tax credits provided no information regarding how credits flow through when a credit expires. It could not be determined if the flow through issue occurs for these states.

These states were chosen because of their similarity to California's size, economy and tax system.

**FISCAL IMPACT**

This bill would not significantly impact the department's costs.

**ECONOMIC IMPACT**

The revenue impact of this bill would depend on the number of credits containing the taxable year operative date issue that cease to be operative after December 31, 2001, and the number of fiscal year pass-through entities that generate these credits in the year the credit expires. The revenue loss associated with this bill is projected to be negligible, less than $250,000 per year starting in 2004/05. This projection is based on the expiration of the credit for Qualified Deposits in Community Development Financial Institutions that ceases to apply for taxable years beginning on or after January 1, 2002, and the Employer Child Care and Qualified Care Plan credits, both of which cease to apply for taxable years beginning on or after January 1, 2003. These are the first credits to expire after the enactment date of this bill.

There could be more significant revenue losses associated with credits that will expire in later years, including any credits the Legislature may subsequently eliminate that are not currently scheduled to expire.

## 6. <u>DISCLOSURE OF RETURN AND RETURN INFORMATION FOR PERSONNEL MATTERS.</u>

### SUMMARY

This provision would allow limited disclosure of confidential taxpayer information in FTB employee disciplinary actions.

### PURPOSE OF THE PROVISION

The purpose of this provision is to authorize disclosure of confidential taxpayer information to an FTB employee or former FTB employee, a legal representative of such employee, an Administrative Law Judge (ALJ), or a Superior Court Judge for use in disciplinary actions. The authorization provided by this provision would follow the same methodology used by the Internal Revenue Service (IRS) in handling personnel actions.

### EFFECTIVE/OPERATIVE DATE

This provision would be effective January 1, 2002, and operative for all disclosures made on or after that date in personnel matters.

### ANALYSIS

<u>FEDERAL/STATE LAW</u>

Current federal law allows disclosure of tax return and return information for use in personnel matters. Upon written request, the Secretary of the Treasury (Secretary) is authorized to disclose confidential taxpayer information to an employee or former employee of the Department of the Treasury or his or her authorized legal representative solely for use in the preparation of or as evidence in a disciplinary action. The Secretary is authorized to disclose the confidential taxpayer information to the extent the Secretary determines that such confidential taxpayer information is or may be relevant to the action. The Secretary also is authorized to disclose the confidential taxpayer information to officers and employees of the Department of the Treasury for use in those administrative actions. Federal law also authorizes the Department of Treasury to disclose the relevant confidential taxpayer information to other specified recipients, including the Department of Justice, for prosecution and other purposes.

Under current state tax law, it is a misdemeanor for any current or former FTB employee to disclose confidential taxpayer information, except as specified. Disclosure in connection with personnel matters is not expressly identified as an authorized disclosure.

<u>THIS BILL</u>

This provision would clearly authorize disclosure of confidential taxpayer information to an FTB employee or former FTB employee, a legal representative of such employee, an Administrative Law Judge (ALJ), or a Superior Court Judge for use in disciplinary actions. The disclosures authorized by this bill would only be for personnel matters brought under the Civil Service Act or the Ralph C. Dills Act.

<u>IMPLEMENTATION CONSIDERATIONS</u>

The department would redact any particulars identifying the taxpayer, the nature or source of the taxpayer's income, or any other identifying information from the documents provided to support the disciplinary action. Where identifying information is redacted, the department would place an identification reference in the document. For example, "Taxpayer A" would pertain to an unidentified, but specific taxpayer. The redacted document would be offered in evidence. The department would create a key identifying the references provided in the redacted document. For example, "Taxpayer A means Taxpayer John Q. Public." The department would provide the key to participants, including the legal representative, the ALJ or administrative board members in an adjudicative hearing, and the judge in a judicial proceeding. The key would not be entered into evidence and would not become a part of the public record. The participants would be admonished that the disclosure of confidential taxpayer information is unlawful. The IRS follows similar procedures.

**FISCAL IMPACT**

This provision should not significantly impact department costs.

**ECONOMIC IMPACT**

This provision would not impact state income revenue.

**Program Background**

The department faces a number of instances regarding personnel matters where the interests of taxpayer privacy may result in depriving a present or former department employee of due process rights or in limiting the ability of the department to prosecute personnel disciplinary matters successfully.

State Personnel Board (SPB) case law requires that a Notice of Adverse Action served on an employee against whom a disciplinary action is taken under the Civil Service Act include copies of all documents relied upon by the department in taking the action. This step is required to satisfy the employee’s due process rights. After the disciplinary action is served, the employee is given the opportunity to discuss the action with the appointing authority (the department) in what is called a Skelly Hearing. Once the employee has either had the opportunity for or has participated in a Skelly Hearing, the employee may file an administrative appeal with the SPB. An SPB Administrative Law Judge (ALJ) appointed by the SPB or the actual SPB are authorized to decide the appeal.

Decisions of the SPB may be appealed to the Superior Court either by the employee or by the state agency. The parties can settle the disputed disciplinary action at any time.

In some cases, the facts underlying the disciplinary action necessitate the disclosure of confidential taxpayer information. For example, when a disciplinary action is based on unauthorized browsing of a taxpayer's account, the department currently does not have clear authority to disclose confidential taxpayer information to an employee's representative, an ALJ or SPB members in an SPB hearing, or a Superior Court judge at an appeal of the SPB decision.

When offering documentary evidence in disciplinary actions before the SPB, the department currently redacts the taxpayer’s identity or identifying information. A corresponding letter is substituted for the identity of each taxpayer. A key to the corresponding letters, which contains both the taxpayer names and the corresponding letters, is created and maintained. The department does not have clear statutory authority to provide the key to the employee or former employee, to the employee’s legal representative, to the ALJ presiding over the SPB administrative hearing, or to any subsequent appellate court.

For federal purposes, the Treasury Department in IRS personnel matters is not required to provide an employee with copies of all documents relied upon when the employee is first notified of an impending disciplinary action. The Internal Revenue Code (IRC) authorizes the release of confidential taxpayer information upon written request to employees or former employees or to their representatives if the information is relevant to the disciplinary action. If the employee requests the information, but does not indicate that the information is for their legal representative, the Treasury Department requires the employee to submit a second written request to share the relevant confidential taxpayer information with their legal representative.

The IRC establishes standards under which Treasury Department employees may utilize confidential taxpayer information to represent the agency in personnel related matters. The Treasury Department redacts the confidential taxpayer information and provides a key to the parties involved in the disciplinary action with the admonition that it is unlawful to release the confidential taxpayer information, such as contained in the key, for any purpose other than the instant proceeding.

**ARGUMENTS/POLICY CONCERNS**

This provision would allow the prudent disclosure of confidential taxpayer information to satisfy an employee's due process rights in disciplinary actions brought against department employees for their conduct, including inappropriate disclosure of confidential taxpayer information. Without authorization to disclose relevant confidential taxpayer information, the department might be found to have deprived the employee of his or her due process rights, thus voiding the disciplinary action. If confidential taxpayer information is not used to prosecute the disciplinary action, the department may be unable to meet its burden of proof in SPB hearings or in Superior Court. If unable to successfully discipline employees for inappropriate disclosure of confidential taxpayer information, continued or increased inappropriate disclosure could occur.

**7. LIMITED PARTNERSHIP TAX TECHNICAL CHANGE.**

**SUMMARY**

This provision would make technical changes to the description of the tax due annually on limited partnerships.

**PURPOSE OF THE PROVISION**

The purpose of this provision is to make references to the limited partnership annual tax in the Revenue and Taxation Code correct and consistent.

**EFFECTIVE/OPERATIVE DATE**

This provision would be effective and operative January 1, 2002.

**ANALYSIS**

FEDERAL/STATE LAW

Existing state law requires every limited partnership organized in this State, registered with the Secretary of State (SOS), and doing business in California to file a tax return and pay an annual tax of $800 for the privilege of doing business in the state.

A limited partnership that ceases to be a limited partnership or that wishes to cancel its registration with the SOS must file a certificate of cancellation with the SOS. Upon receipt of a tax return from a limited partnership that is designated the final return, the FTB notifies the taxpayer that the annual tax of $800 will continue to be assessed annually until the certificate of cancellation is filed with the SOS.

THIS BILL

This bill would make a technical change to remove the term “minimum tax” in reference to the annual tax on limited partnerships in California. Reference to “minimum tax” would be replaced with the “tax imposed by this chapter.”

**OTHER STATES’ INFORMATION**

A review of other state tax laws is not relevant to the provision of this bill relating to the technical changes of the R&TC.

**FISCAL IMPACT**

This provision would not impact the department’s costs.

**ECONOMIC IMPACT**

This provision would not impact revenues.

**Program Background**

The provision referring to the annual tax on limited partnerships erroneously uses the term “minimum tax” in reference to the $800 annual tax due each year for doing business in California. While this annual tax is the same amount as the minimum franchise tax imposed on most corporations, it is neither the minimum franchise tax nor a minimum tax.

**ARGUMENT/POLICY CONCERN**

References to misleading terminology within the R&TC can cause confusion for taxpayers and the department. Correcting the terms will ensure that the law is consistent throughout the R&TC.

**LEGISLATIVE STAFF CONTACT**

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