

# ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Burton Analyst: Gloria McConnell Bill Number: SB 445

Related Bills: See Legislative History Telephone: 845-4336 Amended Date: 03/26/01

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Taxpayers' Bill of Rights/Intent of Legislature Regarding Disputed Tax Liability

## SUMMARY

This bill would add the following to the Taxpayers' Bill of Rights (TBR):

- state that the purpose of any tax proceeding between the Franchise Tax Board (FTB) and the taxpayer is the correct determination of the taxpayer's liability; and
- state that both the FTB and the taxpayer have the opportunity to present and consider all relevant information pertaining to the disputed liability.

Additionally, this bill would require that certain written public records distributed prior to or during an FTB meeting be disseminated as specified before the matter is scheduled to be heard by the FTB.

The provisions relating to the TBR and dissemination of writings are separately analyzed.

## PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to:

- overturn the department's proposed protest regulations; and
- ensure that the persons who request notice of an FTB meeting receive copies of pertinent information relating to decisions made at that meeting

## EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative on January 1, 2002.

## ECONOMIC IMPACT

### Tax Revenue Estimate

This bill would not affect Personal Income Tax or Bank and Corporation Tax liabilities.

Board Position:

\_\_\_\_ S      \_\_\_\_ NA      \_\_\_\_ NP  
\_\_\_\_ SA      \_\_\_\_ O      \_\_\_\_ NAR  
\_\_\_\_ N      \_\_\_\_ OUA      X PENDING

Department Director

Date

**Gerald Goldberg**

**04/17/01**

## **POSITION**

Pending.

### **Summary of Suggested Amendments**

For the TBR provision, the potential for amendments is discussed under "Implementation Considerations." For the provision relating to the dissemination of writings, staff's suggested amendments, as discussed under "Implementation Considerations," are attached.

## **ANALYSIS OF TBR PROVISION**

### STATE TAX LAW

California's Administration of Franchise and Income Tax Laws (AFITL) requires FTB to examine returns and determine the correct amount of tax as soon as practicable. Taxpayers who dispute the FTB's determination may appeal to the State Board of Equalization (BOE) and ultimately to the courts as provided by law.

The department determines the correct tax administratively through audits of returns and claims for refund, protests of proposed assessments of additional tax, appeals from the denial of protests or claims for refund. An audit may include a range of activities, from an automated process based on comparisons to electronic information (e.g., federal audits) to a field audit where a direct examination of a taxpayer's books and records are made. During audit, the amount of communication between the department and the taxpayer and the volume of supporting documentation requested by the department will vary depending upon the type of audit and the case complexity. At the conclusion of the audit, if the amount of tax reported on the taxpayer's tax return is less than the tax determined by FTB, the department mails the taxpayer a notice of proposed assessment (NPA). Since the NPA is merely a proposed assessment, the NPA starts the time to run on a process for the taxpayer to dispute the proposed changes to the taxpayer's return.

If the taxpayer disagrees with the NPA, the taxpayer may file a written protest with the department within 60 days from the mailing of the NPA. The written protest must state the specific grounds for the disagreement. The taxpayer is entitled to a hearing on the protest. Under current protest procedures, taxpayers are allowed to raise any new issues that were not raised during the audit.<sup>1</sup> The department is generally limited to raising new issues that are related to the proposed assessment reflected in the NPA. Once a tax year is audited, that year will generally not be reopened for a subsequent audit. An exception is for adjustments to the amount of tax based on federal audits. After reviewing the protest and supporting documentation, and holding any requested hearings, the department must affirm, revise, or withdraw the NPA. In accordance with the AFITL, the department must notify the taxpayer of the action taken on the protest, which is done by mailing a Notice of Final Action (NOA).

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<sup>1</sup> Taxpayers can raise any issues in the claim for refund. It would serve no useful purpose to require a taxpayer to pay any additional assessment and then file a claim for refund on the basis of the other issue the taxpayer wishes to raise.

The AFITL allows the taxpayer to appeal the department's final action to the BOE within 30 days of mailing the NOA. The appeal is considered by the BOE after the taxpayer and department have an opportunity to file briefs explaining their respective positions. In some cases, additional communication or exchanges of information and supporting documentation may occur between the department and the taxpayer.

If the taxpayer disagrees with the decision of the BOE, the taxpayer may pay the tax amount and file a claim for refund with the FTB. If a claim for refund is administratively denied, the taxpayer may bring a claim for refund action in Superior Court. In a claim for refund action, the ultimate issue before the court is to determine whether the taxpayer has overpaid their tax. To make this determination the court must determine the taxpayer's correct amount of tax liability for the year at issue.

### *TAXPAYERS' BILL OF RIGHTS (TBR)*

The federal TBR makes no express reference to determining the "correct" amount of tax or time frames for resolving tax disputes.

For California purposes, historically legislators, taxpayers, tax practitioners, tax attorneys, and FTB members have expressed concern with the length of time that it takes the department to resolve protests. The initial TBR required the department to develop, a plan by July 1, 1989 to reduce the time to resolve protests and appeals. The TBR required that the plan be developed in cooperation with the BOE, state bar association, certified public accountants, and other interested parties. The TBR required that the plan include "determination of standard time frames and special review of cases that take more than the standard time frame." A plan was implemented by the department through conforming forms and instructions. (See Program Background, below.)

### *REGULATION AUTHORITY AND REQUIREMENTS*

The AFITL requires FTB to prescribe regulations necessary for the enforcement of the laws that it is responsible for administering. Under current law, the Office of Administrative Law (OAL) reviews all proposed regulations and approves a regulation only when the department has adequately considered public comments. Also, OAL requires that the regulation be easily understood, necessary, authorized, and consistent with the law under which it is promulgated. A regulation, which is approved by the OAL and filed with the Secretary of State (SOS), has the force and effect of law. If a proposed regulation were inconsistent with the law, it could be rejected by OAL.

### THIS BILL

This bill would find and declare in the TBR that the purpose of any tax proceeding between FTB and a taxpayer is the correct determination of the taxpayer's liability. It would further provide that both parties to a dispute over the amount of a tax liability be granted every opportunity to present and consider all relevant information.

This bill would emphasize that the department's responsibility in tax matter disputes is to correctly determine the taxpayer's tax, which is the ultimate purpose of a protest, appeal, and claim for refund action.

## IMPLEMENTATION CONSIDERATIONS

Current law requires FTB to examine returns and determine the correct tax as soon as practicable. This bill provides that the purpose of FTB tax dispute proceedings is to make a correct determination of the tax liability. The placement of the word “correct” could be interpreted to relate to the procedural validity of the determination process rather than the substantive amount of the tax liability. Consequently, it is unclear whether the provision is intended to change or supplement current law. To supplement current law, the author may want to consider adding “correct” before the word “tax.”

The first provision of this bill focuses on the “correct determination of the taxpayer’s liability.” The second provision focuses on the “information pertaining to the disputed liability.” By limiting the focus of the second provision to the disputed liability, the department may not be able to make a “correct determination of the taxpayer’s liability.” To make a correct determination of the taxpayer’s liability, the relevant information would be pertaining to the taxpayer’s liability, not just limited to the disputed liability. Also, by limiting the information to only that information pertaining to the disputed liability, taxpayers would be restricted from raising new issues, which is not in accordance with FTB’s current procedures.

By merely stating that the purpose of the tax proceeding is the “correct determination of the taxpayer’s liability,” the bill is subject to interpretation and would cause confusion for staff and the taxpayers. It is not clear whether this statement is sufficient to accomplish the purpose stated by the author’s staff. FTB’s Initial Statement of Reasons for the Adoption of the Protest Regulations provides in part that the purpose of those regulations is to refine the law relating to protests. Therefore, FTB’s proposed regulations can be viewed as merely expediting the administrative process so FTB can make a “correct determination of the taxpayer’s liability.” Under this view, the proposed regulations would be in compliance with this bill.

## **LEGISLATIVE HISTORY**

AB 2788 (Harris; Statutes 1988, Ch. 1573) enacted the original TBR that applies to FTB. Subsequent additions have been added legislatively.

## **PROGRAM BACKGROUND**

The TBR plan for reducing resolutions of protests and appeals was implemented by the department in 1989. The time frames developed pursuant to this plan varied depending on the complexity of each case, ranging from two months for certain automated audits to 38 months for cases involving multijurisdictional taxpayers.

In accordance with the TBR, the department, among other things, is required to prepare and publish statements that explain procedures. The department issued a Protest Hearing Information Sheet that provided the taxpayer a description of the protest hearing process. In August of 1998, the OAL determined that the information sheet was an invalid regulation, therefore, the limitations reflected in the information sheet were not valid.

In March of 1999, the department issued Notice 99-1 stating that the department’s goal for resolving protests is generally 33 months or less. Shortly thereafter, the department began the proposed protest regulation process. The proposed protest regulations were drafted over a two-year period.

The process included public input, a public hearing, symposia, and various FTB meetings. The stated purpose of the regulations was to:

- refine the law relating to protests,
- establish with certainty the rights of taxpayers, and
- provide taxpayers with information about how the department will handle protests and conduct oral protest hearings.

Any proposed regulation package must include an Economic and Fiscal Impact Statement (Form 399 for approval by the Secretary of State and Consumer Services Agency (Agency)). The Form 399 identifies the department's anticipated costs and estimated revenue effect that would result from the proposed regulation. FTB's proposed protest regulation package was submitted to Agency for approval in August and resubmitted in October of 2000. Each of the packages were withdrawn by the department because of issues raised by FTB members or the Department of Finance (DOF), respectively, relating to the departmental costs identified in the Form 399s. In December of 2000, the department resubmitted the proposed protest regulation package for Agency approval. The Form 399 identified no departmental costs or revenue effect in FTB's response to issues raised by DOF. In February of 2001, Agency returned FTB's proposed regulation package, including Form 399, without approval.

Under current work plans for protest cases, the department is, or anticipates, meeting the 33-month time frame on average. The department is completing its most complex cases in 48 months; however, the goal remains to complete all case within 33 months. The department was granted a budget augmentation for the current fiscal year to provide sufficient staff to accomplish the 33-month goal.

## **OTHER STATES' INFORMATION**

The majority of states have a TBR. A search of the TBR publications for Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York was made because these are six of the larger states. The TBRs for each of these states make no mention of the determination of the correct tax. Since this is a common standard for income tax agencies, it is believed that the standard is stated elsewhere in the relevant codes or regulations of these states.

## **FISCAL IMPACT**

### Departmental Costs

The department's costs to administer this bill cannot be determined until the "Implementation Considerations" are resolved.

## **ANALYSIS OF FTB DISSEMINATION OF WRITINGS PROVISION**

### STATE LAW

California law requires the meetings of FTB and other governmental boards to be open to the public. The notice of an FTB meeting must include the name of a person who can be contacted for information prior to the meeting and a specific agenda. In addition, public records distributed to FTB members prior to or during an FTB meeting must be made available for public inspection at the meeting. If the writing is prepared by other than the government, it must be made available for public inspection after the meeting.

### THIS BILL

This bill would require that certain written public records distributed prior to or during an FTB meeting be disseminated as specified before the matter is scheduled to be heard by the FTB.

### IMPLEMENTATION CONSIDERATIONS

Staff has identified the following considerations, which have been discussed with the author's staff. At the direction of the author's staff, these considerations were also discussed with the sponsor of the bill.

1. The bill requires that the writings be distributed to all persons that "request notice." According to the author's office, this provision would apply to persons requesting notice of an FTB meeting. The attached Amendment 1 would make the requested notice be specific to the meeting.
2. The bill does not indicate who would be responsible for disseminating the writings. According to the sponsor, the state body should be responsible for disseminating the writings required under this bill. The attached Amendment 2 would make the state body responsible for disseminating the writings.
3. The material that must be disseminated before the item is scheduled to be heard includes writings distributed to FTB members during the meeting. According to the sponsor, the intended focus of this provision is the final actions taken by the FTB, not the scheduling of the item. The attached Amendment 2 would substitute "a final action is taken on the item" for "the time the item is scheduled to be heard."

As further discussed with the sponsor, in the absence of defining what constitutes a final action, virtually every action taken by the FTB could be subject to postponement to permit dissemination of writings related to that item. This would occur, even if the action taken by the FTB is administrative in nature and does not have any legal or substantive effect. This could disrupt the day-to-day administration of the department.

### **PROGRAM BACKGROUND**

FTB meetings are open to the public and the FTB invites interested parties to speak on agenda items. During the meeting, FTB staff or other parties may prepare and distribute written information or provide information orally that the FTB may consider in taking final action on an item.

## **OTHER STATES' INFORMATION**

A search for similar laws in Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York was made because these are six of the larger states. For these states, the taxing authorities are not governmental boards to which an open meeting act applies; therefore, a meaningful comparison cannot be made.

## **FISCAL IMPACT**

### Departmental Costs

The department may experience additional costs to disseminate the writings as required under this bill, but the costs are not anticipated to be significant.

## **ARGUMENTS/POLICY CONCERNS**

- Requiring the dissemination of all writings pertaining to an FTB agenda item before an item can be scheduled (or the FTB can take final action on that item) could either unreasonably delay or effectively prevent final FTB actions. A person may disagree with board policies or positions and imminent final FTB actions. As a means to postpone or prevent that imminent final FTB action, a person could distribute a writing during or immediately prior to the meeting, and each subsequent meeting during which the item is scheduled.
- This bill addresses only writings distributed to a state body. However, the FTB may take final actions based solely on oral testimony, which would not be covered by this bill.

## **LEGISLATIVE STAFF CONTACT**

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO SB 445  
As Amended 03/27/01

AMENDMENT 1

On page 3, line 25, strike out "in writing" insert:

of meetings in writing pursuant to subdivision (a) of Section 11125 of the  
Government Code

AMENDMENT 2

On page 4, strike out lines 1 and 2, and insert:

inspection at the meeting, by the state body prior to that state body taking any  
final action on that item.