Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Assembly Revenue & Taxation Committee Analyst: Rachel Coco Bill Number: AB 1767

Related Bills: See Prior Analysis Telephone: 845-4328 Amended Date: April 20, 2005

Attorney: Patrick Kusiak Sponsor: ______

SUBJECT: Claim of Right Deduction/Liquidation Of Securities/Reimbursement Due To Erroneous Actions/FTB Provide Taxpayer Address Information To DOJ For Locating Unregistered Sex Offenders

_____ 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 DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended ______________.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO ______________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED March 17, 2005, STILL APPLIES.

OTHER – See comments below.

SUMMARY

This bill would:

1. clarify current state law by conforming more closely to federal law with regard to the claim of right deduction,
2. require financial institutions, upon request, to liquidate a taxpayer's securities to satisfy the taxpayer's tax liability,
3. provide an exception to the underpayment of estimated tax penalty due to an erroneous action by the Franchise Tax Board (FTB),
4. incorporate into the Revenue and Taxation Code (R&TC) a provision of the Penal Code that provides an exception to FTB's general disclosure law, and
5. allow reimbursement to persons for third-party charges and fees caused by an erroneous action by FTB.

SUMMARY OF AMENDMENTS

The April 20, 2005, amendments added language to clarify the conformity of California law to federal law regarding the claim of right deduction. As a result of the amendments, an **ANALYSIS** for the claim of right deduction is included below. The analysis of items 2-5 above, as discussed in the department's analysis of the bill as introduced March 17, 2005, still applies.

Board Position:			Department Director	Date
__X__ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	4/25/05
____ N	____ OUA	____ PENDING		

EFFECTIVE/OPERATIVE DATE

This provision would be effective and operative beginning January 1, 2006.

POSITION

Support.

On December 1, 2004, the Franchise Tax Board voted 2-0, with the representative from the Department of Finance abstaining, to sponsor items 2-5 of this bill.

ANALYSIS

BACKGROUND

The United States Supreme Court first enunciated the claim of right doctrine in North American Oil v. Burnet (1932) 286 U.S. 417. Generally, under the claim of right doctrine a taxpayer must include in gross income any income to which the taxpayer has an apparent unrestricted right at the time of receipt or accrual. Examples of an individual's income that may be subject to the claim of right doctrine are: incorrectly computed wages or commissions, excess social security payments, and excess unemployment compensation payments. Under federal law, a taxpayer who repays that amount in a subsequent year may claim either a deduction or a refundable credit for the amount of tax paid on the repaid income in the previous year, as explained below.

FEDERAL/STATE LAW

Internal Revenue Code (IRC) Section 1341 provides a special relief provision intended to compensate the taxpayer in the year of repayment for taxes paid on amounts included in income under the claim of right doctrine. Taxpayers are allowed to deduct the amount of claim of right income repaid in the year of repayment or claim a credit equal to the decrease in tax for the year of the receipt if the repaid item is excluded from gross income in that year, whichever results in the least tax.

IRC Section 1341 may be applied if all three of the following requirements are met:

- An item of income was properly included in income for a prior year because it appeared that the taxpayer had an unrestricted right to the income,
- It is established that the taxpayer did not have an unrestricted right to all or a portion of the item of income, and
- The amount of the repayment exceeds $3,000.

California law generally conforms to federal claim of right provisions for taxpayers subject to the Personal Income Tax Law for taxable years beginning on or after January 1, 2004.

THIS BILL

This bill would make conforming changes to the current claim of right deduction provision in order to more closely resemble IRC Section 1341.

LEGISLATIVE HISTORY

SB 217 (Dutton, 2004/2005) would retroactively conform the state claim of right relief provisions to federal law. SB 217 is scheduled to be heard in the Senate Revenue & Taxation Committee on April 27, 2005.

AB 3073 (Assembly Revenue and Taxation Committee, Stats. 2004, Ch. 354) generally conforms California law to the federal claim of right provisions, and is operative beginning January 1, 2004.

OTHER STATES' INFORMATION

The federal government provided permanent statutory relief in claim of right situations to taxpayers in 1954, and many other states have followed that example and provided relief to their taxpayers.

Arizona, Connecticut, Michigan, Minnesota, New York, Oregon, and *Wisconsin* have statutes that generally conform to federal law. *Illinois* does not allow itemized deductions, but allows a subtraction from AGI if the taxpayer uses the federal credit method. *Pennsylvania* does not recognize the claim of right doctrine, allowing an amended return to be filed to adjust the overpayment year.

FISCAL IMPACT

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

ECONOMIC IMPACT

This provision would not impact state income tax revenue.

LEGISLATIVE STAFF CONTACT

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