

**SUMMARY ANALYSIS OF AMENDED BILL**

Author:     Klehs     Analyst:     Gail Hall     Bill Number:     AB 675      
 Related Bills:     See Prior Analysis     Telephone:     845-6111     Amended Date:     August 7, 2006      
 Attorney:     Patrick Kusiak     Sponsor: \_\_\_\_\_

**SUBJECT:** Require Certain Corporations To Report Tax and Book Differences/Penalty For Failure/FTB Report To Legislature Regarding Book Income and Tax Shelter Activities

- DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended June 20, 2006.
- 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 \_\_\_\_\_.
- REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED MAY 1, 2006, STILL APPLIES.
- OTHER – See comments below.

**SUMMARY**

This bill would require certain corporations to provide detailed information on the differences between book income and taxable income.

**SUMMARY OF AMENDMENTS**

The August 7, 2006, amendments made the following changes to the bill:

1. Added intent language that Franchise Tax Board may require an information return (CA Schedule M-3) from other business entity types (i.e., partnerships). This resolved argument/policy concern number one in the analysis of the bill as amended June 20, 2006.
2. Clarified the filing requirement for the CA Schedule M-3 when a publicly traded corporation is included in a California tax return with other corporations (combined report). This resolved implementation consideration number two discussed in the analysis of the bill as amended June 20, 2006.

Board Position:	Legislative Director	Date
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<input type="checkbox"/> NA		
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3. Provided a definition for "corporation whose stock is traded on a public stock exchange." This resolved implementation consideration number one discussed in the analysis of the bill as amended June 20, 2006.
4. Revised the failure to furnish penalty to a failure to file penalty. This resolved the technical consideration discussed in the analysis of the bill as amended June 20, 2006.

Except for the discussion in this analysis, the remainder of the department's analysis of the bill as amended May 1, 2006, still applies.

## **POSITION**

Pending.

## **ANALYSIS**

### THIS BILL

This bill would require a corporation whose stock is traded on a public stock exchange to file with its tax return a CA Schedule M-3. "Corporation whose stock is traded on a public stock exchange" is defined as a corporation that is subject to the filing requirements of the United States Securities and Exchange Commission. If a publicly traded corporation is included in a combined report with other corporations, every member of the combined report subject to California franchise (or income) tax would be required to file the CA Schedule M-3. The CA Schedule M-3 would consist of a reconciliation of financial statement net income or loss to the net income or loss reported on the tax return. The reconciliation would include the distributive share of items from a unitary partnership.

In addition, this bill would impose two penalties relating to the CA Schedule M-3, one relating to failing to file the CA Schedule M-3 and one for filing a false or incomplete CA Schedule M-3. The failure to file penalty would equal \$15,000 if the corporation fails to make and file the information return on or before the due date of the return, unless the failure was due to reasonable cause and not willful neglect. The false or incomplete CA Schedule M-3 penalty would equal \$50,000. There would be two exceptions to imposing the false or incomplete penalty:

1. If FTB notifies the corporation that the CA Schedule M-3 is false or incomplete, and the corporation corrects the schedule within 60 days from the date of the notice.
2. The Chief Counsel of FTB rescinds all or any portion of the false or incomplete penalty if both of the following apply:
  - a. Imposing the penalty would be against equity and good conscience, and
  - b. Rescinding the penalty would promote tax compliance and effective tax administration.

The failure to file and false or incomplete return penalties added by this bill shall be in addition to any other penalty provided by law.

This bill would require FTB to report to the Legislature, on or before December 1, 2011, the level of compliance. The report would include a discussion of the relative value of the information with respect to increasing accuracy in book income reported and identifying participation in tax shelter activities. In addition, the report shall include significant differences between book income and taxable income.

The bill includes intent language that the Franchise Tax Board may require a CA Schedule M-3 from other business entity types (i.e., partnerships).

## **ECONOMIC IMPACT**

The book-to-tax-income reconciliation would be a significant audit tool. This tool could assist auditors in identifying tax shelter activity and could dissuade some taxpayers from entering into tax avoidance schemes. The revenue gain is dependent on the number and size of tax shelters identified, the amount of additional income self-reported by taxpayers, and the number of taxpayers that fail to provide the reconciliation or file a false or incomplete reconciliation. Because future corporate tax shelter activities are unknown, it is impracticable to calculate the revenue gain from future audit assessments and penalties.

## **ARGUMENTS/POLICY CONCERNS**

The following concerns were discussed in the analysis of the bill as amended June 20, 2006, and are provided below for convenience purposes.

1. Requiring publicly traded corporations to provide detailed information relating to differences between book and taxable income would provide investors protection against corporations manipulating accounting transactions to overstate book income.
2. This bill would create differences between federal and California tax reporting, thereby increasing the complexity of California tax return preparation.

## **LEGISLATIVE STAFF CONTACT**

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