

ANALYSIS OF AMENDED BILL

Author: Chu Analyst: Anne Mazur Bill Number: AB 911
 Related Bills: See Legislative History Telephone: 845-5404 Amended Date: June 20, 2005
 Attorney: Patrick Kusiak Sponsor: Franchise Tax Board

SUBJECT: Amnesty Clean-Up

SUMMARY

This bill would address unintended consequences of the income tax amnesty administered by the department as follows:

1. Allow underpayments for amnesty-eligible years to be offset by overpayments from other years for purposes of computing the amnesty penalty.
2. Establish a 20-year statute of limitations to collect income or franchise tax balances due from taxpayers, and thereafter extinguish the liability to pay such balances by abating the tax.
3. Allow the Franchise Tax Board (FTB) to extinguish certain inactive taxpayer debts.
4. Repeal the provision of law that requires taxpayers that participate in amnesty to pay any tax due for the 2005 and 2006 taxable years to avoid having the benefits of amnesty revoked and the amnesty penalty imposed.
5. Make technical clarifications of certain amnesty provisions.

Each provision of this bill is discussed separately in this analysis.

SUMMARY OF AMENDMENTS

The June 20, 2005, amendment deleted provisions that would have changed the Revenue and Taxation Code relating to Sales and Use Tax Law and inserted clean-up provisions related to the recently concluded income and franchise tax amnesty program.

PURPOSE OF THE BILL

According to the author's staff, the purpose of this FTB sponsored bill is to provide equity and clarity in the application of amnesty-related provisions.

EFFECTIVE/OPERATIVE DATE

As an urgency statute, this provision would be effective upon enactment. Operative dates are described for each provision in the analyses below.

Board Position:

<input checked="" type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input type="checkbox"/> PENDING

Department Director

Will Bush

Date

7/6/2005

POSITION

Support.

On March 29, 2005, the FTB voted 3-0 to sponsor the provisions of this bill.

SUMMARY OF ECONOMIC IMPACT

Estimated Revenue Impact of AB 911 Assumed Enactment After June 30, 2005 (in millions)			
	2005/2006	2006/2007	2007/2008
Netting Overpayments Against Underpayments For Amnesty Years	- \$5.0	- \$5.0	- \$5.0
20-Year Statute Of Limitations For Collections To Extinguish Uncollectible Debts	- 2.0	- 2.0	- 2.0
Discretion To Extinguish Inactive Taxpayer Debts Based On Specified Criteria	Minor Loss*	Minor Loss*	Minor Loss*
Elimination Of The Amnesty Continuing Compliance Requirement	- 5.0	- 5.0	- 5.0
Technical Clarification Of Certain Amnesty Provisions	None	None	None
Total	- \$12.0	- \$12.0	- \$12.0

*A minor loss is less than \$500,000.

This estimate does not consider the possible changes in employment, personal income, or gross state product that would result from this bill.

The revenue discussions are included, below, with each provision.

1. NETTING OVERPAYMENTS AGAINST UNDERPAYMENTS FOR AMNESTY YEARS

EFFECTIVE/OPERATIVE DATE

As an urgency statute, this provision would be effective upon enactment and apply to post-amnesty penalties imposed under Revenue and Taxation Code section 19777.5(a)(2).

ANALYSIS

STATE LAW

SB 1100 (Stats. 2004, Ch. 226) authorized FTB to administer a tax amnesty program for individual and business entity taxpayers with respect to tax liabilities for taxable years beginning before January 1, 2003. The amnesty program was conducted during the period beginning February 1, 2005, and ending March 31, 2005. Taxpayers participating in amnesty received a waiver of unpaid penalties and fees. Taxpayers that chose not to participate in the program will be subject to new and enhanced penalties with respect to any liabilities for amnesty-eligible years.

The amnesty penalty imposed under Revenue and Taxation Code section 19777.5(a)(1) is an amount equal to 50% of the accrued underpayment interest payable under section 19101 for the period beginning generally on the original due date of the return for the taxable year to the last date of the amnesty period of March 31, 2005. This penalty applies to balances outstanding on March 31, 2005.

The amnesty penalty imposed under section 19777.5(a)(2) is an amount equal to 50% of the underpayment interest computed at the rate referenced in section 19101 for the period from the original due date of the return for the taxable year to the last date of the amnesty period. This penalty is applied for amounts that become due, including final deficiencies and amounts that are self-assessed, after March 31, 2005.

It is a principle of income tax law that each tax year "stands on its own" and must be considered separately. (*Pope Estate Co. v. Johnson* (1941) 43 Cal.App.2d 170, 173.) Only when an overpayment is determined and *finally approved* may FTB credit the amount from the overpayment year to any other amount then due from the taxpayer and refund the balance. (Rev. & Tax. Code §§19301 and 19302; *Appeal of John and Mary French*, 58-SBE-058; *Appeal of General Telephone Company of California*, 78-SBE-076.) Taxpayers may not on their own initiative offset a claimed overpayment from one year against a liability from a different year. (Cal. Code Regs., tit. 18, §19322, sub. (b).)

Current state law provides that, as a general rule, an overpayment made by a taxpayer for any year may be credited against the taxpayer's deficiency for any other year assuming the period for allowing a credit for the overpayment has not expired. The balance, if any, may be refunded to the taxpayer. No interest is assessed on the portion of the deficiency offset by the credit for the period of time after the date overpayment was made. California also allows interest netting in limited situations involving spouses, trusts, and related parties. California does not conform to federal law that provides broad interest netting, in some cases, that allows taxpayers to retroactively recompute previously paid interest.

THIS PROVISION

For purposes of computing the amnesty penalty, this provision would permit interest netting of amounts among different years in situations where interest netting is currently permitted, such as in a multi-year audit resulting in both an overpayment for one or more years and an underpayment for amnesty-eligible years.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would not significantly impact the department's programs or operations.

LEGISLATIVE HISTORY

SB 1100 (Senate Budget Committee, Stats. 2004, Ch. 226), among other things, established a tax amnesty program.

OTHER STATES' INFORMATION

A comparison of this provision to the tax laws of other states would not be meaningful.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

Based on the assumptions and data discussed below, the revenue loss from this provision is as follows:

Estimated Revenue Impact For Netting Interest To Compute Post-Amnesty Penalty Assumed Enactment After June 30, 2005 (in millions)		
2005-06	2006-07	2007-08
-\$5	-\$5	-\$5

Revenue Discussion

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

Estimates are based on actual departmental data and discussions with the department's Legal and Audit Divisions. According to these sources it is estimated that approximately \$10 million in interest would be offset annually due to netting for taxable years 2002 and prior. Assuming this trend would continue for the next several years it is estimated that \$5 million (50% x \$10 million) in amnesty penalties would not be imposed due to this provision.

2. ESTABLISH A STATUTE OF LIMITATIONS ON COLLECTIONS TO EXTINGUISH UNCOLLECTIBLE DEBTS

EFFECTIVE/OPERATIVE DATE

As an urgency statute, this provision would be effective upon enactment and would be applied on and after July 1, 2006, to tax liabilities that are due and payable, as defined, before, on, and after that date.

ANALYSIS

FEDERAL/STATE LAW

Under both federal and state income tax laws, in general, once a tax liability becomes due and payable, a statutory lien arises for that amount upon all real and personal property belonging to that taxpayer. For federal purposes, this statutory tax lien exists as long as the delinquency exists or until it is unenforceable by reason of lapse of time. For state purposes, the statutory lien exists for 10 years, but does not become unenforceable by lapse of time. The expiration of the statutory lien does not extinguish or abate the underlying tax liability. The statutory lien may be extended by filing a Notice of State Tax Lien with the county recorder within 10 years from the date the statutory lien is created. A notice of federal or state tax lien may be recorded or filed as provided by law.

Under federal law, the IRS is precluded from taking any collection action 10 years after the assessment of tax, unless the taxpayer agrees to waive this period of limitation. The 10-year limitation on collection is extended or suspended under a number of circumstances, such as bankruptcy actions, installment agreements, offers in compromise, wrongful levies, or pending court actions. The federal 10-year limitation applies to all taxpayers.

Under current state law, there is no statute of limitations on the collection of an income or franchise tax delinquency.

THIS PROVISION

This provision would establish a statute of limitations on collections that sets the period during which tax may be collected to the period that expires 20 years from the last statutory lien date for each tax year. After that date, the liability for the tax year would be extinguished by abating the underlying tax.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would not significantly impact the department's programs or operations.

LEGISLATIVE HISTORY

AB 2414 (Bill Campbell, 2001/2002) generally would have precluded FTB from collecting personal income tax liabilities that are more than 10 years old. The bill failed to move out of the Senate Revenue and Taxation Committee.

SB 2171 (Senate Revenue and Taxation Committee, 1999/2000) had the same 10-year SOL provisions as AB 2414 (Bill Campbell, 2001/2002), but the provisions were amended out of the bill prior to it being heard in its first policy committee.

PROGRAM BACKGROUND

As a result of FTB's current practices, including its automated collection system, virtually all tax delinquencies remain subject to collection until full payment is made.

FTB currently uses an automated billing/collection system to collect the majority of its delinquent accounts. Taxpayers with tax delinquencies receive one or more notices informing them of the balance due and that collection actions may occur if the balance is not resolved. Collection actions include, but are not limited to, attaching bank accounts, garnishing wages, or filing a Notice of State Tax Lien with the county recorder. Liens are effective for 10 years from the date recorded and, if the liability meets the criteria established by the department, may be extended for an additional 10 years. FTB routinely issues Notices of State Tax Liens on both individual and business entity accounts.

Once FTB determines that an account is currently or permanently uncollectible, the department may be discharged from collection accountability with respect to that account pursuant to the Government Code. When a liability is placed in discharge status, the debt still exists; however, generally no additional notices are sent to the taxpayer regarding that liability unless new address or asset information is obtained. In addition, if there is an overpayment of tax from another tax year, the overpayment is applied against the discharged delinquency before any remaining overpayment is refunded.

In conjunction with the recent amnesty program, 1.7 million letters were mailed to taxpayers urging their participation in the program. Many of these letters related to very old balances due for which the department had been absolved from collecting, although the debts continued to exist.

OTHER STATES' INFORMATION

Six of the larger states with tax laws similar to California's were reviewed. The period for collection for each of these states is noted in the table below. It does not appear that any of these states have a provision to expressly extinguish or abate a balance that has become uncollectible by reason of lapse of time.

State	<i>Florida</i>	<i>Illinois</i>	<i>Massachusetts</i>	<i>Michigan</i>	<i>Minnesota</i>	<i>New York</i>
Period	20 years	20 years	6 years	No SOL	5 years	6 years

FISCAL IMPACT

The cost to implement this provision is approximately \$1.7 million for systems design, programming, testing, and related system startup costs.

ECONOMIC IMPACT

Revenue Estimate

Based on the assumptions and data discussed below, the revenue loss from this provision is as follows:

Estimated Revenue Impact For a 20-Year SOL on Collections Assumed Enactment After June 30, 2005 (in millions)		
2005-06	2006-07	2007-08
-\$2	-\$2	-\$2

Revenue Discussion

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

The amount of taxes, additions to tax, penalties, fees, and interest determined to be beyond the proposed 20-year SOL that would have been otherwise collected would determine the revenue impact of this bill. Based on collection data, it is estimated that this provision would result in revenue losses of roughly \$2 million annually.

ARGUMENTS/POLICY CONCERNS

- California currently does not conform to the federal 10-year statute of limitations on collections. This provision would move California in the direction of conformity. However, this provision is significantly different from the federal law. Most notably, this provision would establish a 20-year limitations period for collections, in comparison to the federal 10-year period. This provision would also extinguish the actual taxpayer debt by abating the tax. Federal law is a bar to further collection activity by IRS after 10 years.
- It is not unusual for final federal determinations to take many years to resolve and become final, particularly for tax shelter or other complex issues involving partnerships. FTB may not become aware of such determinations until after the expiration of the collections limitations period under this provision. As such, any liabilities previously extinguished by reason of lapse of time would not be “revived” when FTB proposes a deficiency assessment based on a final federal determination. However, any new California final liability resulting from the federal determination occurring before the expiration of the 20-year period would restart the period of collection for the total liability for the tax year.
- For taxpayers that fail to file a return, FTB has an unlimited amount of time to mail notices of proposed deficiency assessment. Under this provision, liabilities attributable to assessments issued to nonfilers under FTB’s filing enforcement program would be extinguished by reason of lapse of time. This provision would effectively create a limitations period when deficiency assessments are issued to nonfilers. For example, FTB issued a notice of proposed assessment to a nonfiler based on third party information. After 20 years, the resulting liability becomes uncollectable and is extinguished by lapse of time. After that lapse of time the taxpayer files a return including the income upon which the notice was based and pays the tax. Under this provision, FTB may be required to refund the payment as uncollectible. The collections limitation period would not apply in the case of nonfilers that have not been mailed notices of proposed assessment.

3. DISCRETION TO EXTINGUISH CERTAIN TAXPAYER DEBTS

EFFECTIVE/OPERATIVE DATE

As an urgency statute, this provision would be effective and operative upon enactment.

ANALYSIS

FEDERAL/STATE LAW

Current federal law allows the Secretary of the Treasury to abate any unpaid portion of an assessment or any liability if the Secretary determines that the administration and collection costs would not warrant collection of the amount due.

Current state law does not allow the department to extinguish any outstanding debts from its financial records.

Under current state law, the department has the authority to place taxpayer debts that meet certain criteria into inactive status. An inactive debt remains on the collection system as due and payable, but no further collection action is taken unless the department receives new asset information. An inactive debt is a debt deemed uncollectible or the amount of which is uneconomical to pursue.

Recently enacted legislation (SB 1100, Stats. 2004, Ch. 226), among other things, established a tax amnesty program. Taxpayers identified by the collection system as having a potentially delinquent tax liability, including inactive accounts, were notified and invited to participate in the program. Under amnesty, taxpayers could have all penalties and fees on their accounts waived if they filed all past returns and paid all tax and interest due. Taxpayers that did not participate, but had an outstanding debt, would be subject to an amnesty penalty in an amount equal to 50% of the current interest owing on their account.

THIS PROVISION

This provision would amend existing law to extinguish liability for inactive taxpayer accounts with a debt of less than \$250 or regardless of amount if deemed by FTB to be uncollectible and any of the following criteria are met:

- Decedent cases where the liable person has been deceased for four years or more and there is no active probate, that is there are no assets being administered in a trust or estate
- Accounts with permanent financial hardship, as determined by the department.
- Accounts older than 30 years.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would not significantly impact the department's programs or operations.

PROGRAM BACKGROUND

Typically, the department deems accounts inactive if (1) the amount of the liability is less than \$250, (2) the taxpayer has been deceased over four years, (3) the taxpayer has a permanent financial hardship, or (4) the debt is over 30 years old.

The department has identified 208,579 tax liabilities where the total amount due is less than \$250. These liabilities total approximately \$33 million.

The department has identified nearly 64,000 decedent accounts with a balance due of \$743.6 million. The number of decedent accounts increases every year and adds approximately \$3.5 to \$4 million per year to the department's reported accounts receivable.

The department has also identified 12,000 accounts where taxpayers have been determined to have a permanent financial hardship and no future collection potential. These accounts total approximately \$450.7 million. The department generally assigns permanent financial hardship status to accounts where the taxpayer has no assets, little to no income, and no future earning potential.

Finally, the department's records indicate there are 3,108 accounts with a balance due older than 30 years. These accounts total approximately \$216.1 million.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Illinois state law allows tax liabilities of less than \$1,000 to be extinguished from the Department of Revenue's records when the department determines that the cost of collection would exceed the amount to be collected.

Massachusetts state law allows the appellate tax board to abate taxes and interest deemed uncollectible by the commissioner of the Department of Revenue after two years from the date of the assessment.

Minnesota state law provides that when a debt is determined to be uncollectible, the debt may be extinguished from the financial accounting records. *Minnesota* deems a debt to be uncollectible when (1) all collection efforts have been exhausted, (2) the cost of collection is more than the debt, (3) the debtor cannot be located, or (4) the debt has been discharged in bankruptcy.

New York state law allows the tax commission to abate any unpaid balance of tax if the tax commission determines that the collection costs would outweigh collection of the amount due.

It does not appear the *Florida* or *Michigan* allow for the extinguishing of taxpayer debts.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

Based on the assumptions and data discussed below, the revenue loss from this provision is as follows:

Estimated Revenue Impact For Extinguishing Inactive Taxpayer Debts Assumed Enactment After June 30, 2005			
Fiscal Year	2005-06	2006-07	2007-08
	a/	a/	a/

a/ Minor losses of less than \$500,000

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

Revenue Discussion

The amount of taxes, penalties, fees, and interest determined to meet the criteria to be extinguished under this provision that would have been otherwise collected would determine the revenue impact of this bill. Based on collection data and discussions with the department's collection staff, it is estimated that this provision would result in losses of less than \$500,000 annually.

4. ELIMINATION OF THE AMNESTY CONTINUING COMPLIANCE REQUIREMENT

EFFECTIVE/OPERATIVE DATE

As an urgency statute, this provision would be effective and operative upon enactment.

ANALYSIS

STATE LAW

Recently enacted legislation, (SB 1100, Stats. 2004, Ch. 226), among other things, established a tax amnesty program. Under amnesty, taxpayers that meet specific criteria may have all penalties and fees currently on their account waived in exchange for paying all taxes due within a specific period. In addition, the taxpayer must agree to pay any tax due for the 2005 and 2006 taxable years. If a taxpayer fails to pay taxes due for those years and that failure results in the imposition of a collection cost recovery fee, then all penalties, fees, and associated interest previously waived under amnesty immediately become due and payable.

THIS PROVISION

This provision would repeal the provision of law that requires taxpayers that participate in amnesty to pay any tax due for the 2005 and 2006 taxable years to avoid having the benefits of amnesty revoked and the amnesty penalty imposed.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would not significantly impact the department's programs or operations.

LEGISLATIVE HISTORY

SB 1100 (Senate Budget Committee, Stats. 2004, Ch. 226), among other things, established a tax amnesty program.

OTHER STATES' INFORMATION

Eleven states¹ and New York City had an amnesty program during 2003. Of these states, only Missouri required taxpayers to remain in tax compliance for three years from the end of the amnesty program or have the waiver of penalties and interest revoked and those penalties and interest retroactively added back to their accounts.

FISCAL IMPACT

The provision would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on the assumptions and data discussed below, the revenue loss from this provision is as follows:

Estimated Revenue Impact Of Repealing The Amnesty Continuing Compliance Requirement Assumed Enactment After June 30, 2005 (in millions)			
Fiscal Year	2005-06	2006-07	2007-08
	a/	-\$5	-\$5

a/ Minor losses less than \$500,000

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

¹ Arizona, Colorado, Florida, Illinois, Kansas, Maine, Massachusetts, Missouri, New York, North Dakota, and Virginia.

Revenue Discussion

Estimates are based on a projected \$70 million in potential waived penalties, fees, and associated interest as a result of amnesty participants. Assuming the default rate for amnesty participants is comparable to the default rate experienced for tax collections (17%), then approximately \$12 million of total potential waived penalties, fees, and associated interest that would have otherwise been collected would be lost as a result of this provision ($\$70 \text{ million} \times 17\% = \12 million). The fiscal year cash flow patterns are based on an estimate of when the penalties, fees, and interest that comprise the \$12 million would have been collected absent this provision.

5. TECHNICAL CLARIFICATION OF AMNESTY PROVISIONS

EFFECTIVE/OPERATIVE DATE

If enacted as an urgency statute, this provision would be effective beginning on and after the date of enactment and operative as if included in the original amnesty legislation.

ANALYSIS

STATE LAW

Recently enacted legislation (SB 1100, Stats. 2004, Ch. 226), among other things, established a tax amnesty program. Under amnesty, taxpayers could have all penalties and fees on their accounts waived if they applied for amnesty between February 1, 2005, and March 31, 2005, and filed all necessary past due or amended returns and paid all tax and interest due by May 31, 2005. In addition, taxpayers must agree to pay all taxes due for the 2005 and 2006 taxable years. Taxpayers that did not participate, but had an outstanding debt, would be subject to an amnesty penalty in an amount equal to 50% of the current interest on their account. However, the penalty would not be imposed on liabilities for which an individual taxpayer had an installment agreement with the FTB prior to the start of amnesty.

THIS PROVISION

This provision would:

- Clarify which required actions for amnesty participation must occur no later than March 31, 2005, and which actions must occur no later than May 31, 2005.
- Clarify that only those amounts covered by a current installment agreement will be exempt from the amnesty penalty, and that any other amounts not covered by the installment agreement would be subject to the amnesty penalty.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would not significantly impact the department's programs or operations.

TECHNICAL CONSIDERATIONS

This provision provides that a taxpayer that “satisfies both of the following requirements” may successfully participate in the amnesty program; however, there are five conditions that the taxpayer must meet. Amendment 1 is included to correct the language.

LEGISLATIVE HISTORY

SB 1100 (Senate Budget Committee, Stats. 2004, Ch. 226), among other things, established a tax amnesty program.

OTHER STATES’ INFORMATION

Since this provision would clarify existing California law, a comparison of other states is unnecessary.

FISCAL IMPACT

This provision would not significantly impact the department’s costs.

ECONOMIC IMPACT

This provision would not impact the state’s income tax revenues.

LEGISLATIVE STAFF CONTACT

Anne Mazur
Franchise Tax Board
(916) 845-5404
anne.mazur@ftb.ca.gov

Brian Putler
Franchise Tax Board
(916) 845-6333
brian.putler@ftb.ca.gov

Analyst	Anne Mazur
Telephone #	916-845-5404
Attorney	Pat Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 911
As Amended June 20, 2005

AMENDMENT 1

On page 8, line 5, strikeout "both of" and insert:

all of