

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Ma Analyst: Deborah Barrett Bill Number: AB 361
Related Bills: See Legislative History Telephone: 845-4301 Introduced Date: February 14, 2007
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Notice To FTB Of The Administration Of A Decedent's Estate Required By Estate Representative

SUMMARY

This FTB sponsored bill would require an estate representative to provide notice to the Franchise Tax Board (FTB) that the administration of a decedent's estate has been opened.

PURPOSE OF THE BILL

The purpose of this bill is to codify a process that would assure that an estate representative discovers and resolves a decedent's income tax obligation, thus helping to close the tax gap.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2008, and would be operative for all estates open or opened on or after that date. For estates that are opened before January 1, 2008, and have not received an order for final distribution by that date, the provisions of this bill would be operative within 90 days of January 1, 2008.

POSITION

Support

On December 4, 2006, the Franchise Tax Board voted 2-0, with the member from the Department of Finance abstaining, to sponsor the language included in this bill.

ANALYSIS

Current Federal Law

The administration of a decedent's estate is exclusively a matter of state law. The IRS is treated as a creditor of an estate when an estate has a federal tax debt.

Current State Law

Probate proceedings are administered in the county where the decedent resided or owned real property. The personal representative of a decedent's estate is required to make a reasonably diligent effort to identify creditors of the decedent and is required to provide any reasonably

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ascertainable creditor with a Notice of Administration of a Decedent's Estate (notice). The notice is to be provided within four months after the date the representative receives letters of administration or within 30 days from when the representative first has knowledge of the creditor. Additionally, under certain circumstances, the representative is required to provide specific notice to the Director of Health Services and the Director of the California Victims Compensation and Government Claims Board.

Creditors of a decedent, including a state agency, are required to file a claim in the estate proceedings within specific timeframes to obtain payment of a debt. All claims filed in an estate must be resolved prior to closing the administration of the estate.

After a return is filed reporting both income earned by the decedent and income earned by the estate, a representative may request a prompt audit of that return by FTB. If FTB proposes to adjust the amount of tax reported, FTB must issue a notice proposing to assess the additional tax or commence a proceeding in court without assessment for the collection of tax within 18 months from the date the representative requested the audit. FTB is barred from making a claim in a probate proceeding after the 18-month period expires.

A claim by a public entity is not barred unless notice has been provided to that entity. Where written notice is not provided, the claim is enforceable by an action against the beneficiaries of the estate for the unpaid claim. If property is distributed before expiration of the time allowed a public entity to file a claim, the public entity has a claim against the beneficiaries of the estate that received the property. The state's recourse when estate assets have been distributed before a claim is filed is to pursue a transferee assessment against the beneficiaries that received the estate assets.

THIS BILL

This bill would require an administrator or executor of a decedent's estate or the estate attorney to provide notice of the administration of the estate to FTB no later than 90 days after the date letters are first issued to a general personal representative. This bill would require estates that are opened before January 1, 2008, and have not received an order for final distribution by that date, to provide notice within 90 days of the bill's effective date.

IMPLEMENTATION CONSIDERATIONS

This proposal could be implemented in the department's annual program updates.

PROGRAM BACKGROUND

FTB's method of collecting a decedent's unpaid tax liability depends on how assets of the decedent are disbursed. Generally, there are three methods available to conclude a decedent's affairs. Depending on the size of the estate and actions taken prior to the taxpayer's death, assets are transferred through a court probate estate proceeding, through a trust established prior to the taxpayer's death, or informally by family members.

FTB's Decedent Unit receives a Notice of Administration of a Decedent's Estate (notice) in two ways:

1. The representative provides actual notice to FTB as required for reasonably ascertainable creditors of an estate, or
2. FTB's Decedent Unit independently identifies an open probate by searching probate case files in the superior courts of all 58 California counties.

FTB initiates a search for a probate estate when the FTB Decedent Unit determines that a taxpayer with an income tax liability is deceased. FTB sends a Request for Probate Information (FTB Form 4777) to the superior court to locate probate information. The superior court probate clerk in any of the 58 counties that a FTB Form 4777 is sent must search their records for probate information and return the form indicating whether a probate estate was established in that county. If probate information is located, FTB files a Creditor's Claim in the proceeding.

The Decedent Unit estimates that of the 50,000 estates probated each year, approximately 65% are fully compliant with their tax obligations or have no obligations to resolve. The Decedent Unit estimates that of the remaining 35% of cases probated annually, 25% of those estates, or 4,375 cases, provide notice to FTB or are independently located by FTB staff. Finally, of the approximately 13,125 cases, or 75% of the remaining probate case universe, FTB staff never locates.

During the last five years FTB has pursued approximately 94 transferee assessment cases where the estate failed to satisfy the decedent's unpaid tax liability. These cases had an estimated value of \$1.8 million. The transferee assessment process is a manual collection procedure that is costly, time consuming, and often not pursued for cost benefit reasons. In addition, these cases surprise beneficiaries and require the beneficiaries to pay amounts to the state that they believed were their unencumbered inheritance. In many cases, the beneficiaries have already committed the assets. FTB discharges approximately 165 transferee assessment cases each year with an estimated value of \$2.0 million for cost benefit reasons that could be resolved through FTB's receipt of timely notice and the opportunity to file timely probate claims.

FISCAL IMPACT

This proposal would reduce the effort by FTB and superior court clerks searching for open probate cases and would be expected to reduce the quantity and cost of resources spent pursuing after-the-fact remedies such as transferee assessments. Because FTB currently has processes in place to issue probate claims in response to notices, no additional information technology resources would be needed. Staff augmentation of 2 PYs would allow the Decedent Unit to absorb the increase in the volume of notices. This bill would reduce the effort spent searching for open probate cases.

ECONOMIC IMPACT

Based on data and assumptions discussed below, the PIT Tax revenue impact from this bill would be as follows:

Estimated Revenue Impact Effective On Or After January 1, 2008 Enactment Assumed After June 30, 2007 (\$ in Millions)		
2006-07	2007-08	2008-09
+\$1	+\$5	+\$5

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

Revenue Discussion:

In FY 2005-06, FTB’s Decedent Unit collected \$4.5 million from claims filed with Probate Courts. The Decedent Unit estimates that it is properly notified, and in a timely manner, in only about 25% of the probate cases. The cases on which the FTB is not properly notified will tend to have smaller debts than the group for which the FTB is properly notified. The Decedent Unit estimates that, on average, the value of the debts of these other cases is about 40% of the value of the debts for which the FTB is properly notified. In effect, the tax per case that would be collected from the new cases would only be 40% of current collections.

Additional revenue collections from probate claims would be \$5.4 million (\$4.5 million currently collected x 3 x 0.4). The new revenue from this proposal of \$5.4 million is reduced by approximately \$0.3 million for the amount that would have been collected from decedent’s heirs after disbursements from probate. Under current law, this leaves a net new revenue gain of \$5.1 million in FY 07-08.

This proposal would apply to disbursements made from probate after January 1, 2008. Estimates are rounded and accrued back one year since they relate to tax liabilities from prior years. It is assumed that it would take a year until the probate community was fully aware of this law.

POLICY CONSIDERATIONS

Probate seeks to bring finality to the affairs of the decedent by providing a process for resolution of all claims against the estate and the distribution of the remaining assets to the beneficiaries. Failure of the estate representative to notify a state tax department of the administration of the estate makes finality of the affairs of the decedent illusory.

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