Franchise Tax Board

REVISED ANALYSIS

Author:	Calderon	Analyst:	Gail Hall	Bill Number:	AB 697
Related Bills:	See Legislative History	Telephone:	845-6111	Revised Amended Analysis Date:	June 1, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Repeal 20 Percent Corporation Understatement Penalty

X REVENUE ESTIMATE CHANGED.

____ FURTHER CONCERNS IDENTIFIED.

____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED _____ STILL APPLIES.

____ OTHER – See comments below.

SUMMARY OF BILL

This bill revises the operative date for the Corporation Understatement Penalty (CUP) and adds a repeal date.

REASON FOR REVISION

The revenue figures in the chart included in the "Economic Impact" section of the department's analysis of the bill as amended June 1, 2009, are being revised after further review of the analytical model determined that the figures included in the department's prior analysis did not fully include all the factors that would impact revenue. In addition, the estimated amount that taxpayers would accelerate and report on original tax returns for taxable years 2008 through 2016 in order to avoid the CUP was revised from $5.4 billion to $5.0 billion. The corrections are shown below by strike out for deletions and underline for additions.

POSITION

Pending.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	7/7/09
____ N	____ OUA	X PENDING		

ECONOMIC IMPACT (Revised)

Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses beginning in 2008-09.

Estimated Revenue Impact of AB 697 as amended June 1, 2009 Effective for tax years BOB January 1, 2008 Enactment Assumed After 6/30/09 ($ In Millions)		
2008-09	2009-10	2010-11
~~-$105~~ -$580	~~-$310~~ -$690	~~-$265~~ -$500
Losses in subsequent years would decrease from approximately $400 million in 2011-12 to $175 million in 2015-16 and ultimately to $100 million per year. ~~In subsequent fiscal years, revenue losses will be approximately $80 million annually through 2013-14 decreasing to around $50 million in 1214-15 and subsequent years.~~		

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue loss from repealing the CUP prospectively would depend upon the amount of accelerated revenue that would have been paid on original returns if the CUP had been operational, the amount of CUP that would have been imposed, and the amount of revenue from audit issues that would have been identified by taxpayers on their original returns.

Franchise Tax Board (FTB) estimated that taxpayers would accelerate and report an additional ~~$5.4~~ $5.0 billion in tax on original tax returns for taxable years ~~2009~~ 2008 through 2016 in order to avoid the CUP. These payments would be made on the original returns with the penalty in place. Absent the penalty, it is unlikely that taxpayers will pay this money until a final audit assessment is made. The timing of that assessment could range from two to seven years, or even longer, therefore the ~~$5.4~~ $5.0 billion would be accelerated from two to seven years. For example, it is estimated that for 2009 returns, over $500 million in tax revenue would be paid on original returns in the 2009-10 fiscal year, over what would be paid in the absence of the penalty. This loss of accelerated revenue is the primary cause of the significant revenue loss associated with repeal of the CUP.

In addition, the revenue loss includes lost penalties, which are estimated to range from approximately ~~$40 to $50~~ $10 to $25 million starting in the 2010-11 fiscal year. Finally, the revenue loss arises from a permanent loss of revenue in the audit of corporate tax returns. It is expected that FTB will be better able to identify audit issues on corporate returns, under the CUP, in which taxpayers filed conservatively and then subsequently filed a claim for refund, versus if the CUP is repealed and taxpayers file their original returns that include potentially controversial positions. It is estimated that the additional revenue associated with this improvement in information would be in the range of approximately $30 to $40 million per tax year.

This revenue estimate considers additional amounts paid on original returns, penalties, and offsets that would occur when refunds are paid. Revenue received on original returns (under current law) is counted, in the table above, in the year in which the return is received. Penalty revenue (under current law), refund offsets (under current law), and audit assessments (under proposed law) are all accrued back one year prior to the year the revenue is received (paid out).

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