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Department, Board, Or Commission	Author	Bill Number
Franchise Tax Board	**Senate Revenue and Taxation Committee**	**SB 1492**

SUBJECT

Voluntary Disclosure Agreements

SUMMARY

This bill would make changes to the California Revenue and Taxation Code (R&TC) sections related to participation in what is commonly called a Voluntary Disclosure Agreement (VDA).

PURPOSE OF BILL

The purpose of this Franchise Tax Board (FTB) sponsored bill is to revise the VDA statutes to eliminate impediments to satisfying the VDA, thus reducing the risk of taxpayers failing to comply with the VDA and incurring penalties and collective actions.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2011, and specifically operative for VDAs entered into on or after January 1, 2011.

PROGRAM BACKGROUND

Some out-of-state taxpayers that conduct business in California as defined by the R&TC may not be aware of their California franchise or income tax liability or filing requirements. The FTB also may not readily identify such taxpayers through its filing enforcement or other compliance programs. Given the substantial penalties for delinquent filing of returns and late payment of taxes, and the open statute to audit all taxable years preceding identification, these taxpayers may be reluctant to disclose their California presence and report any tax liability voluntarily.

Current VDA statutes allow qualified entities, qualified shareholders, or qualified beneficiaries to disclose their liability voluntarily through a VDA. The qualified entities, qualified shareholders, or beneficiaries that choose to participate in a VDA may anonymously apply to the FTB and in exchange, if accepted, must disclose their California tax liability for the immediately preceding six taxable years. Under the VDA statute, the FTB in turn waives its authority to assess taxes, additions to tax, fees, or certain penalties for the taxable years ending before the six taxable years covered by the VDA.

The Multistate Tax Commission (MTC) has an agreement with 30 states, including California, which provides incentives for taxpayers to request a VDA. The states that participate in MTC's voluntary disclosure program follow guidelines and processes provided by the MTC, thereby allowing applicants to request VDAs for multiple states through the MTC. The voluntary disclosure period in these states is the four taxable years ending before the signing date of the VDA.

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Each of these states allows the taxpayer to remain anonymous during the application period. As a result, the estimated tax payments due in the year immediately after the voluntary disclosure period may be late, and the taxpayer is penalized for the late payments. The other states in the MTC Compact address penalties on a case-by-case basis.

With the exception of California's six-year VDA period, current state law generally conforms to the MTC's VDA application procedures and guidelines.

ANALYSIS

FEDERAL/STATE LAW

Current federal law has no comparable voluntary disclosure statutes.

Current state law allows the FTB to enter into a VDA with qualified taxpayers and waive the following penalties that would normally apply for the period covered by the VDA:

1. Failure to make and file a return under R&TC section 19131,
2. Failure to pay tax by the due date under R&TC section 19132,
3. Underpayment of estimated tax under R&TC sections 19136 and 19142,
4. Failure to file Corporate Organization Statement under R&TC section 19141,
5. Failure to furnish information or maintain records under R&TC section 19141.5,
6. Failure to file a partnership return under R&TC section 19172,
7. Failure to file information returns under R&TC section 19183, and
8. Any penalty related to relief from contract voidability under R&TC section 23305.1.

Current state law allows a taxpayer requesting a VDA to remain anonymous until the signed agreement is returned to the FTB. Current state law also defines qualified taxpayers for the purposes of a VDA as qualifying business entities, including corporations, certain limited liability companies (LLCs), qualified trusts, qualified shareholders, qualified members of LLCs, and qualified beneficiaries of qualified trusts. These entities are defined as follows:

- A "qualifying business entity" includes any out-of-state corporation or LLC not classified as a corporation that has never filed a California income or franchise tax or LLC return and that voluntarily applies for a VDA prior to any contact from the FTB regarding income, franchise, or LLC tax liability.
- A "qualified shareholder" is a nonresident shareholder of an S corporation that has applied for a VDA and disclosed all material facts pertaining to the shareholder's liability.
- A "qualified member" is an individual who is a nonresident on the signing date or a corporation or LLC that is not organized in California nor qualified or registered with the office of the Secretary of State. A qualified member in all cases is a member of an LLC that has applied for a VDA and disclosed all material facts pertaining to the member's liability.

- A “qualified trust” is a trust that has never been administered in California and that has had no resident beneficiaries in California for six taxable years ending immediately preceding the signing date of the VDA. However, “qualified trust” includes a trust with a resident beneficiary whose interest in the trust is contingent and who has not received a distribution from the trust during the preceding six taxable years.
- A “qualified beneficiary” is an individual who is a beneficiary of a qualified trust and is a nonresident on the signing date of the VDA and for each of the preceding six taxable years.

Under the terms of the VDA, the FTB waives certain penalties for noncompliance, including the underpayment-of-estimated-tax penalty, but requires specified reporting and payment requirements for the six taxable years immediately preceding the agreement. For the taxable years ending more than six years prior to the agreement, the applicant's income or franchise tax, additions to tax, fees, or penalties are waived.

To satisfy the terms of the VDA, approved taxpayers must return a signed agreement to the FTB, make all payments, and submit all returns to the FTB within a 120-day statutory deadline that begins upon the signing date of the VDA. Failure to perform timely renders the VDA null and void. An exception to the requirement that complete payment be made within 120 days allows the applicant to enter into an installment payment arrangement (IPA). A taxpayer with a VDA also approved for an IPA would be allowed to make monthly installment payments on the outstanding tax liability for up to 36 months and would still be in compliance with VDA.

The three-member Franchise Tax Board must approve all VDAs.

THIS BILL

This bill would amend current law to do the following:

- Allow taxpayers to file the current year tax return as late as the extended due date,
- Eliminate the underpayment of estimated tax penalty when imposed because the VDA is signed after the quarterly tax payment due date, and
- Allow VDA applicants requesting an Installment Payment Arrangement (IPA) additional time to satisfy the VDA if the IPA request is denied after the VDA period ends.

LEGISLATIVE HISTORY

AB 3073 (Assembly Revenue and Taxation Committee, Stats. 2004, Ch. 354) allowed Limited Liability Companies to qualify for VDAs.

SB 1185 (Senate Revenue and Taxation Committee, Stats. 2001, Ch. 543) allowed multi-jurisdictional trusts to qualify for VDAs.

AB 2280 (Caldera, Stats. 1994, Ch. 367) allowed the FTB to enter into VDAs with out-of-state business taxpayers that unknowingly have a tax liability in the state of California.

FISCAL IMPACT

This bill would not impact the department's costs.

ECONOMIC IMPACT

This bill would not impact state income tax revenue.

Support/Opposition

Support:

Franchise Tax Board

Opposition:

None on file.

VOTES

Assembly Floor – Ayes: 78, Noes: 0
Senate Floor – Ayes: 30, Noes: 0

LEGISLATIVE STAFF CONTACT

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