Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Wolk Analyst: Scott McFarlane Bill Number: SB 401

Related Bills: See Prior Analysis Telephone: 845-6075 Amended Date: May 28, 2009

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Tax Shelters And Tax-Shelter Penalties

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ____________.

____ 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 ____________.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED APRIL 28, 2009, STILL APPLIES.

X OTHER – See comments below.

SUMMARY

This bill would eliminate inconsistencies in various abusive tax-shelter laws by providing a single, consistent definition for abusive tax shelters (ATSs), which would be referred to as "abusive tax avoidance transactions."

In addition, this bill would:

- Modify the ATS-use penalty[1] to no longer allow taxpayers to avoid the penalty by filing an amended return prior to the Franchise Tax Board (FTB) issuing a deficiency notice; instead, this bill would impose 50 percent of the penalty in such situations; and
- Create a new California reportable-transaction category for transactions of interest.

[1] The ATS-use penalty under R&TC section 19777 is often referred to as the interest-based penalty.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	06/25/09
____ N	____ OUA	X PENDING		

SUMMARY OF AMENDMENTS

The May 28, 2009, amendments would:

- Revise the definition of the newly-created California reportable-transaction category of transactions of interest to be similar to the federal definition of transactions of interest;[2]
- Modify the general definition of abusive tax shelters, which would be referred to as "abusive tax avoidance transactions;" and
- Make technical and cross-referencing changes.

PURPOSE OF THE BILL

The purpose of the bill is to clarify state tax laws that apply to potentially abusive tax avoidance transactions, and to improve the effectiveness of the ATS-use penalty.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2010. The operative dates would be as follows:

- The provision relating to transactions of interest would be operative for transactions of interest published on or after January 1, 2010.
- The provision relating to interest suspension would be operative for notices mailed or amended returns filed on or after January 1, 2010.
- The provision relating to subpoenas would be operative for subpoenas issued on or after January 1, 2010.
- The provision relating to the eight-year statute of limitations would be operative for taxable years beginning on or after January 1, 2009.
- The provision relating to the ATS-use penalty would be operative for notices mailed on or after January 1, 2010, and for amended returns filed more than 90 days after January 1, 2010, with respect to the taxable years for which the statute of limitations for mailing a notice of proposed assessment has not expired as of January 1, 2010.

POSITION

Pending.

Summary of Suggested Amendments

Technical amendments are suggested and have been provided.

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[2] Treas. Reg. section 1.6011-4(b)(6).

ANALYSIS

THIS BILL

This bill would provide a single, consistent definition for “abusive tax avoidance transactions,” which would mean any of the following:

1. A federal tax shelter;
2. An undisclosed reportable transaction;
3. A listed transaction;
4. A gross misstatement; or
5. A transaction subject to the noneconomic substance transaction understatement penalty.

This bill would coordinate this definition of “abusive tax avoidance transactions” in the application of:

- The eight-year statute of limitations;
- The ATS-use penalty;
- The interest-suspension rule; and
- The authority to issue subpoenas.

This bill would modify the ATS-use penalty to no longer allow taxpayers to avoid the penalty by filing an amended return prior to the FTB issuing a deficiency notice; instead, this bill would impose 50 percent of the penalty in such situations.

This bill would enact a new California reportable-transaction category of transactions of interest, similar to the federal reportable-transaction category of transactions of interest. A California transaction of interest would be a transaction that is the same as, or is substantially similar to, a transaction specifically identified by FTB by notice, regulation or other form of published guidance as a transaction of interest. All transactions of interest would be published on the FTB’s website.

ECONOMIC IMPACT

Revenue Estimate

The May 28, 2009, amendments do not change the revenue estimate; however, the revenue estimate provided in the Summary Analysis of SB 401, as amended April 28, 2009, was inadvertently understated. Based on new information, the revenue estimate is revised to reflect an increase to the revenue estimated to be generated through audit assessments (See page 6, under the heading "*Revenue Impact Due to Revenue Streams 1, 2 and 3*").

Original Revenue

Estimated Revenue Impact of SB 401 As Amended April 28, 2009 Assumed Operative on January 1, 2010 Assumed Enacted After June 30, 2009 ($ in Millions)		
2008/09	2009/10	2010/11
$3.5	-$3.6	-$1.7

Revised Revenue

Estimated Revenue Impact of SB 401 As Amended April 28, 2009 and As Amended May 28, 2009 Assumed Operative on January 1, 2010 Assumed Enacted After June 30, 2009 ($ in Millions)		
2008/09	2009/10	2010/11
$5.9	-$1.8	$1.5

Additionally, transactions of interest are anticipated to increase awareness and could increase taxpayer compliance. Although the impact to revenue in future years is unknown, approximately $600 million in tax revenue would be gained for every one percent increase in self compliance.

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 is estimated using the following revenue streams:

1. The penalty revenue from expanding the definition of “abusive tax avoidance transactions;”
2. The accelerated revenue from taxpayers that take advantage of the 90-day period to avoid the ATS-use penalty;
3. The revenue decrease due to allowing a 50-percent reduction in the ATS-use penalty; and
4. The revenue increase from transactions of interest.

Original Revenue

Estimated Revenue Impact of SB 401 As Amended April 28, 2009 Assumed Operative for Notices Issued On or After January 1, 2010 Assumed Enacted After June 30, 2009 $ in Millions			
	2008/09	2009/10	2010/11
Stream 1	$2.5	$6.3	$8.8
Streams 2 & 3	$1.0	-$9.9	-$10.5
Total	$3.5	-$3.6	-$1.7

Revised Revenue

Estimated Revenue Impact of SB 401 As Amended April 28, 2009 and as Amended May 28, 2009 Assumed Operative for Notices Issued On or After January 1, 2010 Assumed Enacted After June 30, 2009 $ in Millions			
	2008/09	2009/10	2010/11
Stream 1	$2.5	$6.3	$8.8
Streams 2 & 3	$3.4	-$8.0	-$7.3
Total	$5.9	-$1.8	$1.5

* For Stream 4, see explanation below.

Stream 1:

Revenue from Modifying the Definition of “Abusive Tax Avoidance Transactions”

Modifying the definition of “abusive tax avoidance transaction” is estimated to increase penalty assessments by $10 million annually (250 cases X $40,000). Because this penalty may be protested, the revenue is anticipated to be collected over three years. Assuming that 50 percent of taxpayers protest their penalty assessments, $5 million ($10 million X 50%) would be collected during the first year. For fiscal year 09/10, this figure is reduced to $2.5 million to reflect only assessments issued after January 1, 2010.

Additionally, providing a consistent definition for abusive tax avoidance transactions would create departmental efficiencies, potentially reducing the time needed to develop cases at the audit and protest levels. These efficiencies would enable staff to pursue additional tax shelter cases. This estimate does not consider revenue gains that may result from these efficiencies.

Streams 2 and 3:

Reducing the ATS-Use Penalty by 50 Percent for Amended Returns & 90-Day Period

Under current law, taxpayers can avoid the ATS-use penalty by filing an amended return after the department has contacted the taxpayer regarding an undisclosed reportable transaction, a listed transaction, or gross misstatement, but before FTB issues a deficiency notice. The department currently receives approximately $17 million annually in revenue from taxpayers that file amended returns to specifically avoid the ATS-use penalty.

It is estimated that because this bill would allow a 50-percent reduction to the penalty in this situation, some taxpayers would continue to file amended returns voluntarily, but not at the volume the department currently receives. This portion of the proposal is estimated to result in delayed revenue collections of $8.5 million ($17 million X 50%) beginning in fiscal year 10/11. This delayed revenue would be realized in future years when the audits are complete.

Additionally, because the change in law would be operative 90 days after the effective date of the legislation, some taxpayers currently under audit are anticipated to file amended returns during this 90-day period to avoid the ATS-use penalty. In the first year, this portion of the proposal is estimated to accelerate approximately $5 million from audits that would be in progress, which would have been completed over the next few years.

Revenue Impact Due to Revenue Streams 1, 2 and 3

Because this bill would affect prior tax years, the revenue estimate for each revenue stream is accrued back one fiscal year. The revenue estimate for fiscal year 2009/10 consists of penalty revenue collection of $2.5 million (reflected in fiscal year 2008/09). Netting revenue streams two and three results in accelerated payments of $3.4 million[3] during the first year and this revenue is accrued back to fiscal year 2008/09.

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3 The revenue estimate provided in the Summary Analysis of SB 401 as amended April 28, 2009 understated the revenue gains generated through audit assessments. In that Summary Analysis, netting revenue streams two and three was estimated to result in accelerated payments of $1 million. Due to new information received, accelerated payments are increased to $3.4 million. This change impacts the first year (taxpayers that continue to file amended returns voluntarily), as well as the portion of taxpayers that are later found during the normal audit process.

Stream 4

Creating a California reportable-transaction category for transactions of interest is anticipated to increase awareness and could increase taxpayer compliance. Although the impact to revenue in future years is unknown, approximately $600 million in tax revenue would be gained for every one percent increase in self-compliance.

LEGISLATIVE STAFF CONTACT

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