

SUMMARY ANALYSIS OF AMENDED BILL

Author: Wolk Analyst: Scott McFarlane Bill Number: SB 401
 Related Bills: See Prior Analysis Telephone: 845-6075 Amended Date: July 1, 2009
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Abusive Tax Shelters & 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 _____.
- REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED
- MAY 28, 2009, STILL APPLIES.
- 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 (ATS), which would be referred to as “abusive tax avoidance transactions.”

In addition, this bill would:

- Modify the ATS-use penalty¹ to no longer allow taxpayers to avoid the penalty by filing an amended return prior to FTB issuing a notice of proposed deficiency; 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
<input type="checkbox"/> S	Brian Putler	07/03/09
<input type="checkbox"/> NA		
<input type="checkbox"/> SA		
<input type="checkbox"/> N		
<input type="checkbox"/> NP		
<input type="checkbox"/> O		
<input type="checkbox"/> NAR		
<input checked="" type="checkbox"/> PENDING		

SUMMARY OF AMENDMENTS

The July 1, 2009, amendments would:

- Provide that the new reportable-transaction category of transactions of interest apply only to taxable years beginning on or after January 1, 2010;
- Eliminate the ability to identify transactions of interest in forms of published guidance other than a regulation or notice;
- Allow the Chief Counsel of the Franchise Tax Board (FTB) to compromise all or any portion of the ATS-use penalty;
- Make the amended-return provision of the ATS-use penalty apply to amended returns filed more than 180 days after the January 1, 2010; and
- Make other technical amendments.

PURPOSE OF THE BILL

The purpose of the bill is to clarify state tax laws that apply to ATSS, 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 180 days after January 1, 2010, with respect to the taxable years beginning on or after January 1, 2010.

POSITION

Pending.

Summary of Suggested Amendments

Amendments 1, 3, 4, 5, 6, and 7 are provided to make technical changes. Amendment 2 is provided to eliminate reference to a previously-deleted paragraph.

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. A reportable transaction that is not adequately disclosed;
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 transaction” 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 FTB issuing a notice of proposed deficiency; instead, this bill would impose 50 percent of the penalty in such situations; and
- Allow the Chief Counsel of the FTB to compromise all or any portion of the penalty.

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 or regulation as a transaction of interest.

California transactions of interest would:

- Be identified by FTB by notice or regulation;
- Apply to taxable years beginning on or after January 1, 2010; and
- Be published on FTB’s website.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of SB 401 as Amended July 1, 2009 Assumed Operative for Notices Issued On or After January 1, 2010 and Amended Returns filed 180 Days After January 1, 2010 \$ in Millions			
	2008/09	2009/10	2010/11
Stream 1	\$2.5	\$6.3	\$8.8
Streams 2 & 3	\$5.6	-\$8.0	-\$8.7
Total *	\$8.1	-\$1.7	\$0.1

*Additionally, 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.

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 180-day period to avoid the ATS-use penalty.
3. The revenue decrease due to allowing a 50-percent reduction in the ATS-use penalty.
4. The revenue increase from transactions of interest.

Stream 1:

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

Modifying the definition of “abusive tax avoidance transactions” 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 shelters would create departmental efficiencies, potentially reducing the time needed to develop cases at 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 & 180-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 a reportable transaction that is not adequately disclosed, 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 in 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 2010/11. This delayed revenue will be realized in future years when the audits are complete.

Additionally, because the change in law would be operative 180 days after the effective date of the legislation, some taxpayers currently under audit are anticipated to file amended returns during this 180-day period to avoid the ATS-use penalty. In the first year, this portion of the proposal is estimated to accelerate approximately \$5.6 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 has been 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 \$5.6 million during the first year and this revenue is accrued back to fiscal year 2008/09. In total, \$8.1 million would be accrued to 2008/09.

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.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 401
As Amended July 1, 2009

AMENDMENT 1

On page 2, lines 18-19, ~~strikeout "the effective date of this section."~~,
and insert:

that effective date.

AMENDMENT 2

On page 8, ~~strikeout lines 2 through 8, inclusive.~~

AMENDMENT 3

On page 8, line 10, ~~strikeout "(g)"~~ and insert:

(f)

AMENDMENT 4

On page 8, line 11, ~~strikeout "the"~~ and insert:

that

AMENDMENT 5

On page 8, line 12, ~~strikeout "of the act".~~

AMENDMENT 6

On page 8, line 13, after "after", ~~strikeout "the"~~ and insert:

that

AMENDMENT 7

On page 8, lines 15-16, after "after", ~~strikeout "the effective date of
this section."~~, and insert:

that effective date.