

SUMMARY ANALYSIS OF AMENDED BILL

Author: Cook Analyst: Will Koch Bill Number: AB 1006
 Related Bills: See Prior Analysis Telephone: 845-4372 Amended Date: April 25, 2011
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: FTB Burden Of Proof In Any Court Or Administrative Tax Proceeding/ FTB Must Have Just Cause Before Commencing Audit

SUMMARY

This bill would do the following:

- Provision No. 1: For taxpayers who are individuals, add a new provision to the Government Code for certain tax controversy cases that would transfer the burden of proof for factual determinations from the taxpayer to the Franchise Tax Board (FTB).
- Provision No. 2: Require the FTB to have “just cause” to begin any audit.

RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

SUMMARY OF AMENDMENTS

The April 25, 2011, amendments eliminated provisions that would have reduced the Statute of Limitations (SOL) for the FTB to issue a proposed deficiency assessment from four years (six in certain instances) to three years and reduced the SOL for a taxpayer to amend his or her separate return to a joint return from four years to three years from the original due date of the return. Additionally, the April 25, 2011, amendments would limit the application of the change of the burden of proof to individual taxpayers subject to an adjusted gross income (AGI) limitation.

As a result of the April 25, 2011, amendments, the “Legal Concern” and “Policy Concern” with regard to modifying the SOL are no longer applicable. The “This Bill,” “Implementation Considerations,” “Economic Impact,” and “Policy Concerns” sections have been revised. The “Effective/Operative Date” and “Fiscal Impact” sections are presented for convenience.

EFFECTIVE/OPERATIVE DATE

This bill would be effective on January 1, 2012, and operative as of that date. Provision No. 1 specifically would only apply to court and administrative proceedings involving assessments and notices of determination issued on or after the operative date of this bill. Provision No. 2 would apply to audits commenced on or after January 1, 2012.

Board Position:	Legislative Director	Date
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ANALYSIS

THIS BILL

Provision No. 1: Place Burden of Proof to the FTB

This provision would, for individual taxpayers other than those filing joint returns with AGI less than \$100,000 and for taxpayers filing joint returns with AGI less than \$250,000, transfer the burden of proof from the taxpayer to the FTB with respect to a factual issue related to ascertaining the tax liability of a taxpayer in the following situations:

- Administrative tax proceedings, or
- Court proceedings

This provision would also do the following:

- Define “tax liability” as any tax or fee assessed or determined by the FTB, including any interest accrued or penalties levied in association with the tax or fee.
- Define “administrative tax proceeding” as the oral hearing before members of the BOE for disputes concerning taxes collected by the FTB.
- Require that the FTB meet the “preponderance of evidence” standard of burden of proof for oral hearings before the BOE.
- Not subject a taxpayer to unreasonable search or access to records in violation of the U.S. Constitution, the California Constitution, or any other law.
- Apply to court and administrative tax proceedings involving assessments or notices of determination issued on or after the operative date of this bill.

Provision No. 2: Require the FTB to Have “Just Cause” to Begin any Audit

This provision would require the FTB to have “just cause” to begin any audit.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

- Historically the burden of proof has been on the taxpayer in tax controversy cases because the taxpayer has possession and control of the records pertaining to his or her own tax return. Under the bill, a taxpayer could refuse to provide the FTB information requested during an audit in an attempt to prevail on appeal by depriving the FTB the evidence necessary to meet the burden of proof.
- This bill would place the burden of proof on the FTB for a deficiency assessment issued by the FTB based on changes to a taxpayer’s federal income tax return by the IRS. Changing the burden of proof for cases based on federal audits could require the FTB to reexamine issues already determined by the IRS.

- For franchise and income tax appeals made to the BOE, this bill would be limited to oral hearings. Thus, appeals where the taxpayer waives the right to an oral hearing would not be subject to the change in the burden of proof. Currently most taxpayers waive the right to an oral hearing. If it is the author's intent that this bill apply to all appeals before the BOE, the author may wish to clarify the language to state that the burden of proof would apply to any taxpayer that waives the right to an oral hearing before the BOE.
- The bill states that it would only apply to court or administrative tax proceedings involving assessments or notices of determination issued on or after the operative date of the bill. Consequently, it would not extend to claims for refund. It is recommended that the bill be amended to clarify the provisions of the bill in this regard.
- This bill would require the FTB to have "just cause" to begin any audit, but fails to define just cause. Undefined terms or phrases could lead to disputes with taxpayers and complicate the administration of this bill. For example, a taxpayer whose tax was increased as a result of an audit adjustment could argue that the FTB did not have "just cause" to begin the audit regardless of the tax law supporting the validity of the audit adjustment. Because responding to "just cause" arguments could be costly for both the taxpayer and the department, it is recommended that this bill be amended to define "just cause."

FISCAL IMPACT

The FTB assumes no additional resources would be approved by the Legislature to compensate for the effects of this bill. This bill would not significantly impact the department's costs; rather, this bill would result in Audit and Legal staff spending more time developing cases. Spending more time developing cases for the FTB to issue a deficiency assessment would result in fewer audits conducted and resolved each year.

ECONOMIC IMPACT

Estimated Revenue Impact of AB 1006 Operative for Assessments and Notices of Determination Issued On or After January 1, 2012 Enactment Assumed After June 30, 2011 (\$ in Millions)		
2011-12	2012-13	2013-14
-\$3.6	-\$34	-\$55

This estimate does not include any revenue loss from a decrease in self compliance that may occur due to the provisions relating to the standard for burden of proof and just cause. A rule of thumb estimate is that for every 1 percent decrease in compliance due to these provisions, the estimated revenue loss would be in the \$400 million range.

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

POLICY CONCERNS

This bill might be characterized as conforming California law to federal law; however, it would not limit application of the change in the burden of proof to court proceedings or an individual and small business taxpayer as required under the federal law. This bill would not require the taxpayer to meet the minimum threshold of providing evidence with respect to a factual issue in dispute. Under long standing case law, deductions and credits are characterized as a matter of legislative grace, and the burden is on the taxpayer to establish entitlement to the claimed deduction or credit.

Without conforming to the federal requirement that the taxpayer meet a minimum threshold of credible evidence, it would be difficult in many cases for the taxing agency to meet its burden of proof because the taxpayer has control of the records necessary to prove the taxpayer's tax liability. Because the records of wage earners and retired individuals are supplied to the IRS and FTB by employers and others, placing the burden of proof on the taxing agency for this type of taxpayer would be somewhat insignificant. However, businesses dealing primarily with cash transactions, those in the "underground economy," could benefit from a change in the burden of proof due to the voluntary compliance nature of providing such information to taxing agencies because this type of taxpayer has sole control of corroborating records.

The current burden of proof requirements reflect the fact that the taxpayer is in control of the records and documents related to their tax return. If the burden of proof is placed on the FTB, the taxpayer may have little or no incentive to maintain accurate documentation. This would make the deficiency determination process extremely difficult and could result in more time-consuming and intrusive audits involving third-party interviews, credit report requests, review of other agencies' returns, and/or searches for any available relevant documents maintained by the taxpayer and/or others.

SUPPORT/OPPOSITION

Support: None Provided.

Opposition: None Provided.

LEGISLATIVE STAFF CONTACT

Will Koch
Legislative Analyst, FTB
(916) 845-4372
will.koch@ftb.ca.gov

Brian Putler
Legislative Director, FTB
(916) 845-6333
brian.putler@ftb.ca.gov