

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Skinner Analyst: David Scott Bill Number: AB 318

Related Bills: None Telephone: 845-5806 Amended Date: August 14, 2012

Attorney: Patrick Kusiak Sponsor: Franchise Tax Board

SUBJECT: Conformity To Federal Holiday Due Date Extension/ Expand Imposition Of The Non-Qualified/Suspended/Forfeited Failure To File Penalty To LLCs

SUMMARY

This bill would do the following for taxable years beginning on or after January 1, 2013:

- Provision No. 1: Expand the definition of a legal holiday for California income and franchise tax purposes to include those legal holidays recognized by the Internal Revenue Service (IRS) that extend the due date for federal returns, payments, and other tax related documents (e.g., Emancipation Day).
- Provision No. 2: Expand the imposition of the non-qualified, suspended, or forfeited failure to file penalty (\$2,000 Penalty) to include limited liability companies (LLCs).

RECOMMENDATION

Support.

On December 1, 2011, the three-member Franchise Tax Board (Board) voted 2-0 to sponsor the language included in this bill, with the representative from the Department of Finance abstaining.

Summary of Amendments

The August 14, 2012, amendments added Provision 2, which would expand the imposition of the failure to file penalty to LLCs.

REASON FOR THE BILL

The reason for this Board-sponsored bill is as follows:

1. To help eliminate taxpayer confusion when the Franchise Tax Board's forms and instructions require taxpayers to use federal tax return information, but the due date for federal returns is later than the due date for California returns, and
2. To provide equitable treatment between LLCs and corporations by requiring the Franchise Tax Board (FTB) to impose a \$2,000 Penalty on LLCs where similarly situated corporations are already subject to the penalty.

Board Position:

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Executive Officer

Date

Selvi Stanislaus

8/24/12

PROVISION NO. 1: Conformity To Federal Holiday Due Date Extension

EFFECTIVE/OPERATIVE DATE

This provision would become effective and operative on January 1, 2013.

ANALYSIS

FEDERAL/STATE LAW

Current Federal Law

The Internal Revenue Code (IRC) generally imposes upon taxpayers that file on a calendar year basis a deadline of April 15 for filing income tax returns. When April 15 falls on a Saturday, Sunday, or legal holiday, a return is considered timely filed and payments are considered timely made if filed or mailed on the next succeeding day that is not a Saturday, Sunday, or legal holiday. For federal income tax purposes, a "legal holiday" means a legal holiday in the District of Columbia. Under District of Columbia law, Emancipation Day, April 16, is a legal holiday.¹

Effect of Emancipation Day on Federal Filing Deadlines²

For taxpayers nationwide, when Emancipation Day, April 16, falls on a:

- Saturday: Friday, April 15 is the observed date and the filing deadline for all tax forms and payments required to be filed or completed on or before April 15, is Monday, April 18.
- Sunday: Monday, April 17 is the observed date and the filing deadline for all tax forms and payments required to be filed or completed on or before April 15, is Tuesday, April 18.
- Monday: Monday, April 16 is the holiday and the filing deadline for all forms and payments required to be filed or completed on or before April 15, is Tuesday, April 17.

Example 1: In 2011, Emancipation Day fell on a Saturday, meaning that it was observed on Friday, April 15, 2011. The filing deadline for all tax forms and payments required to be filed or completed was on or before Monday, April 18, 2011.

Example 2: In 2012, Emancipation Day will fall on a Monday, meaning that it will be observed on Monday, April 16, 2012. The filing deadline for all tax forms and payments required to be filed or completed will be on or before Tuesday, April 17, 2012.

¹ IRC sections 6072 and 7503.

² Internal Revenue Bulletin 2011-10.

Current State Law

The actual due dates of income tax returns and payments are set by statute.³

- Calendar-year individual, fiduciary, partnership, and limited liability company income tax returns and payments are due on or before April 15 following the close of the calendar year. The due dates for fiscal-year filers are on or before the 15th day of the 4th month following the close of the fiscal year.
- Calendar-year corporation returns and payments are due on or before March 15 following the close of the calendar year. Due dates for corporation fiscal-year filers are on or before the 15th day of the 3rd month following the close of the fiscal year.
- Exempt returns are due the 15th day of the 5th full calendar month following the close of the taxable year.
- Estimated tax installments are due quarterly on the 15th day of the month.

By statute, when the last day for filing returns falls on a Saturday, Sunday, or other legal holiday, returns may be filed and payments may be made on the following day without penalty.⁴ Similarly, when the FTB is required to mail a notice on or before a certain date, if the notice is mailed on the next business day, it will have the “same effect as if it had been performed on the day appointed.”⁵ However, interest computations, statutes of limitation, and extension periods all begin on the actual due date even if it falls on a weekend or holiday.

The FTB is required to design tax forms so that taxpayers can copy figures from, or attach copies of, federal income tax returns to California income tax returns.⁶

Currently, California does not recognize Emancipation Day as a holiday.

THIS PROVISION

This provision adds language to expand the definition of a legal holiday for California income and franchise tax purposes (due dates for income tax return, payments, and other related documents) to include legal holidays that are recognized by the IRS. This change gives the FTB statutory authority to change the due dates on forms and instructions where previously those changes were made administratively.

³ California Revenue and Taxation Code (R&TC) sections 18566, 18601, 18633, 18633.5, 19026, 19136.1, 23771, 23772, and 23774.

⁴ California Code Regs., tit. 18, section 18566, California Government Code sections 11002, 11003.

⁵ California Government Code sections 6706-7 cf. IRC section 7503.

⁶ R&TC section 19582.

PROGRAM BACKGROUND

The District of Columbia's Emancipation Day, April 16, which falls close to the April 15 statutory due date for filing most personal income tax returns, as well as for making certain tax-related payments and elections, is not a holiday recognized in California. When Emancipation Day or another holiday that is recognized for federal, but not state, purposes falls on the due date of a tax return, related payment, or other document, a Saturday, Sunday, or Monday, California and Federal income tax returns, related payments, and other documents may have different due dates. For the April 16 Emancipation Day holiday, this will happen in 8 out of the next 19 years. This is 42 percent of the next 19 years, which makes it more than an occasional problem. Because a completed federal income tax return and other federal-related information is necessary to prepare a California income tax return and/or other documents, the FTB has announced, without direct statutory authority, that filing tax returns and related payments can be made, in the affected years, on the same date that corresponding federal tax returns and payments are required by the IRS. This may cause taxpayer confusion because state law does not provide for Emancipation Day, yet the FTB takes it into consideration in the income tax forms and instructions.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. *Illinois, Massachusetts, Michigan, and New York* have a statutory due date of the 15th day of the 4th month following the close of the year. These states administratively change the due date for filing to match the due date for federal purposes. *Texas* franchise tax returns are due on May 15 and are not affected by Emancipation Day. *Florida* corporate returns are due on the 15th day following the due date of the related federal return. Therefore, *Florida* is unaffected by Emancipation Day.

ECONOMIC IMPACT

Provision No. 1 would not impact the state's income tax revenue.

ARGUMENTS

Pro: A new statute to recognize holidays recognized by the IRS would eliminate the need for the FTB to administratively change the due date in each affected year.

Con: The statutory due date for filing a return or making a payment does not change. California is allowing taxpayers to file and pay later because of a federal holiday that is not recognized in California. Taxpayers should plan accordingly and file and pay by the statutory due date.

PROVISION NO. 2: Expand Imposition Of The Non-Qualified/Suspended/Forfeited Failure To File Penalty To LLCs

EFFECTIVE/OPERATIVE DATE

This provision would be effective January 1, 2013, and operative for non-qualified, suspended, or forfeited LLCs that fail to file a return on or after January 1, 2013.

ANALYSIS

STATE LAW

Current state law authorizes the creation of many different types of business entities, including corporations and LLCs. An LLC is a hybrid, unincorporated business entity having one or more members. All corporations and LLCs that are either doing business in California, or incorporated or registered and qualified by the Secretary of State (SOS) to do business in California, are required to file the appropriate income tax returns or information returns and pay the appropriate tax, penalties, and interest. A corporation or LLC that fails to pay its taxes, penalties, and interest, or fails to file the appropriate tax return or information return, may have its powers, rights, and privileges suspended or forfeited (in the case of a foreign corporation) by a submission from the FTB or by the SOS.

A suspended or forfeited corporation or LLC:

- May not legally transact business.
- May not bring an action or defend itself in court.
- Cannot be granted an automatic extension of time to file.
- Cannot file a claim for refund.
- May not file or maintain an appeal before the Board of Equalization.
- May not continue a protest.
- May have any contract declared void by the other party if entered into during the period of time in which the LLC or corporation was suspended or forfeited.

Under existing law, any corporation or LLC that fails to file a tax return after receiving a notice of demand to file may be subject to a demand penalty. A foreign corporation that fails to qualify to do business in this state, or any corporation whose powers, rights, and privileges have been forfeited or suspended, and is doing business⁷ in this state and fails to file a tax return within 60 days of receiving a demand to file, may also be subject to a \$2,000 Penalty. Under existing law, any foreign LLC that fails to qualify to do business in this state, or any LLC whose powers, rights, and privileges have been forfeited or suspended, and is doing business in this state and fails to file a tax return within 60 days of received a demand to file, may be subject only to a demand penalty, and not a \$2,000 Penalty.

⁷ As defined under Revenue and Taxation Code section 23101.

THIS PROVISION

This provision would require the FTB to assess a \$2,000 Penalty against an LLC that is doing business⁸ within the state while not registered to do business within the state, or while suspended or forfeited, if the LLC has failed to file a requested tax return for that period within 60 days after the FTB has sent a formal demand for the past due return.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

None of the states surveyed assess a penalty similar to the \$2,000 Penalty.

ECONOMIC IMPACT

Revenue Estimate

This provision would result in the following revenue gains:

Estimated Revenue Impact of Provision 2 of AB 318 For the Collection of Penalties Assessed On Non-qualified, Suspended, or Forfeited LLCs That Fail to File a Return On or After January 1, 2013 Enactment Assumed After June 30, 2012				
2011-12	2012-13	2013-14	2014-15	2015-16
+\$330,000	+\$400,000	+\$490,000	+\$600,000	+\$700,000

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

ARGUMENTS

Pro: Some taxpayers may advocate that this provision would provide equitable treatment between LLC and corporate business structures.

Con: Some taxpayers may argue that imposing an additional penalty on non registered, suspended, or forfeited LLCs may discourage LLCs from transacting business within the state.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

⁸ *Ibid.*

SUPPORT/OPPOSITION

Support: On December 1, 2011, the FTB voted 2-0 to sponsor the language included in this bill.

Opposition: None provided.

LEGISLATIVE STAFF CONTACT

David Scott
Legislative Analyst, FTB
(916) 845-5806
David.Scott@ftb.ca.gov

Gail Hall
Legislative Director, FTB
(916) 845-6333
gail.hall@ftb.ca.gov