

## BILL ANALYSIS

Department, Board, Or Commission <b>Franchise Tax Board</b>	Author <b>Fuller &amp; Runner</b>	Bill Number/Version Date <b>SB 526 (E-08/18/16)</b>
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### SUBJECT

Joint Returns / Dissolution of Marriage Court Orders

### SUMMARY

Under the Administration of Franchise and Income Tax Laws (AFITL), this bill would modify provisions related to relief of joint liability by court order.

### REASON FOR THE BILL

The reason for this bill is to ease the financial burden of a spouse obtaining relief by divorce court order and improve government efficiency by allowing the Franchise Tax Board (FTB) to honor a divorce order.

### EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2017, and specifically operative for court orders served or acknowledged on or after that date.

### FEDERAL/STATE LAW

Existing federal and state laws provide that taxpayers who file a joint return are each responsible for the accuracy of the tax return and are jointly and severally liable for the full tax liability due for that tax year.<sup>1</sup> These obligations apply regardless of which spouse earns the income, or whether the correct amount of the tax is reported on the original return or whether the taxing authority subsequently assesses additional tax for the tax year in question. The concept of obligating each spouse individually for all of the tax liability is called joint and several liability. However, joint and several liability can result in inequitable consequences to one spouse in certain circumstances.

Consequently, both the federal government and California enacted “innocent spouse” legislation that may allow a spouse to be relieved of some or all of the responsibility for a joint tax debt.<sup>2</sup> Generally, the requesting spouse may not be relieved of tax liability on income that the requesting spouse earned or controlled.

However, the Internal Revenue Service (IRS) may provide an exception to this general rule in situations where the nonrequesting spouse abused or exercised financial control over the requesting spouse.

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<sup>1</sup> Per Treasury Regulation section 1.6013-4(b), this means that each spouse is liable for the entire joint tax liability; and Revenue and Taxation Code (R&TC) section 19006(b). Under state law, this provision also applies to registered domestic partners who file a joint tax return.

<sup>2</sup> Internal Revenue Code (IRC) section 6015 and R&TC section 18533. State law, under R&TC section 18533(i), also provides for relief based on IRS determinations if applicable facts and circumstances are the same for federal and state income tax liabilities.

State law, in addition to the “innocent spouse” provisions discussed above, also provides for relief when the liability has been revised by court order in a proceeding for dissolution of marriage.<sup>3</sup> The FTB will grant relief to the requesting spouse provided the order does not relieve the requesting spouse of tax liability on income earned by or subject to the exclusive management and control of that spouse.<sup>4</sup> The order is effective when the FTB is served with or acknowledges receipt of the order, and if the order:<sup>5</sup>

- Separately states the income tax liabilities for the taxable years for which revision of tax liability is granted.
- Does not revise a tax liability that has been fully paid prior to the effective date of the order.

Additionally, the requesting spouse must obtain from the FTB and file with the divorce court a tax revision clearance certificate if:

- Gross income reportable on the return exceeds \$150,000, or
- The amount of tax liability the spouse is relieved of exceeds \$7,500.

## **THIS BILL**

This bill, under the AFITL, would provide that a court, in a proceeding for dissolution of marriage, may not reduce the amount of liability on a joint return, but that court may determine the individual responsible for all or part of that liability.

This bill also would allow a court order issued in a proceeding for dissolution of marriage to relieve a spouse of liability on income earned by or subject to the exclusive management and control of that spouse, unless either:

- Assets or liabilities are transferred between the individuals filing a joint return for the principal purpose of avoidance of the payment of tax or as part of a fraudulent scheme by those individuals, or
- The liability is uncollectable, and within three years of the date the FTB is served with or acknowledges receipt of the order, the spouse obligated by the court order does either of the following:
  - Files for bankruptcy and that liability is discharged in bankruptcy, or
  - Becomes a nonresident.

This bill also would increase the threshold amounts for a tax revision clearance certificate from gross income of \$150,000 to gross income of \$200,000 and for the amount of tax liability relieved from \$7,500 to \$10,000.

Beginning in January 2018, the increased threshold amounts would be adjusted for inflation.

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<sup>3</sup> R&TC section 19006(b).

<sup>4</sup> R&TC section 19006(b) (1).

<sup>5</sup> R&TC section 19006(b) (2).

## LEGISLATIVE HISTORY

SB 1065 (Walters, Chapter 318, Statutes of 2010) required the FTB to grant innocent spouse relief when the IRS has granted relief under the same facts and circumstances.

AB 1748 (Assembly Revenue and Taxation Committee, Chapter 342, Statutes of 2007) made changes to more closely conform California law to federal "innocent spouse" provisions and to provide the FTB the authority to issue guidelines and rules.

SB 285 (Speier, Chapter 370, Statutes of 2003) required the FTB to grant innocent spouse relief to an individual who had received an IRS grant of innocent spouse relief when the underlying facts and circumstances were the same. SB 285 was repealed by its own provisions effective January 1, 2009.

AB 2979 (Assembly Revenue and Taxation Committee, Chapter 374, Statutes of 2002) increased the gross income and tax liability thresholds for a tax revision clearance certificate to reflect inflation from 1977 to 2001, so that the amounts became \$150,000 for the gross income threshold and \$7,500 for the state income tax liability threshold.

## 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, Minnesota, and New York* all provide innocent spouse relief; however, it is unclear whether the states provide relief comparable to the relief this bill would provide.

*Florida* does not have a personal income tax.

## FISCAL IMPACT

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

## ECONOMIC IMPACT

### Revenue Estimate

This bill would result in a revenue impact to the general fund in an unknown amount.

### Revenue Discussion

According to calculations, for every \$1 million in tax liability relief granted, the revenue loss would be \$60,000. This bill would not reduce the amount of liability on a joint return, but instead would allow a divorce court order to modify the amount of joint liability each spouse is responsible to pay.

Estimating cases of relief per divorce court order as part of the judgment for dissolution of marriage cannot be predicted. To determine the magnitude of relief, both the frequency and the dollar amount of these judgments must be known. Because it is difficult to predict the frequency and the value of future actions, the revenue impact is unknown.

**APPOINTMENTS**

None.

**SUPPORT/OPPOSITION<sup>6</sup>**

Support: Fiona Ma, Member, State Board of Equalization

Sen. George Runner (Retired), Member, State Board of Equalization

Opposition: None provided.

**VOTES**

	<b>Date</b>	<b>Yes</b>	<b>No</b>
Concurrence	08/18/16	36	0
Assembly Floor	08/11/16	78	0
Senate Floor	06/02/15	39	0

**LEGISLATIVE STAFF CONTACT**

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<sup>6</sup> As noted in the Assembly Revenue and Taxation Committee analysis dated January 8, 2016.