

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Honda Analyst: Marion Mann DeJong Bill Number: AB 2360

Related Bills: See Legislative History Telephone: 845-6979 Introduced Date: 02/24/2000

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Interest on Overpayments and Underpayments/Elimination of Interest on Overlapping Periods of Overpayments and Underpayments/Conformity

SUMMARY

This bill would conform to federal law by eliminating the interest differential on overlapping periods of interest on tax overpayments and underpayments.

EFFECTIVE DATE

Assuming enactment in 2000, this bill would be effective January 1, 2001, and would apply to interest for periods beginning after January 1, 2001. If the applicable SOL has not expired, this bill would also apply to interest for periods beginning before the effective date of the bill if the taxpayer (1) reasonably identifies and establishes the periods of underpayment and overpayment for which a zero net interest rate applies and (2) on or before December 31, 2001, requests in writing that the FTB apply the zero net interest rate to those periods.

LEGISLATIVE HISTORY

In 1998, the President signed the Internal Revenue Service Restructuring and Reform Act of 1998 (IRS Reform Act). The IRS Reform Act established a net interest rate of zero on equivalent amounts of overpayment and underpayment that exist for any period.

SB 94 (Stats. 1999, Ch. 931) conformed, with some modifications, to selected provisions of the IRS Reform Act. The net interest rate provision was in SB 94 as amended on May 12, 1999, but was later removed from the bill because of its revenue impact.

SPECIFIC FINDINGS

Prior to the IRS Reform Act, taxpayers paid higher interest rates on tax underpayments than the IRS paid on tax overpayments. The specific rates were issued quarterly by the IRS and were calculated as a set number of percentage points above the federal short-term rate:

	Points over Short-Term Rate
Underpayments	3
Overpayments	2
Large corporate underpayments (hot interest)	5
Corporate overpayments > \$100,000	0.5

Board Position:

____ S ____ NA ____ NP
____ SA ____ O ____ NAR
____ N ____ OUA ____ X PENDING

Department Director

Date

Alan Hunter for GHG

3/17/00

If a taxpayer had an underpayment of tax from one year and an overpayment of tax from a different year that were outstanding at the same time, the IRS typically offset the overpayment against the underpayment and applied the appropriate interest rate to the resulting net underpayment or overpayment. However, if either the underpayment or overpayment had been satisfied, the IRS would not typically offset the two amounts, but rather would assess or credit interest at the underpayment or overpayment rate. This had the effect of assessing the underpayment at the higher underpayment rate and crediting the overpayment at the lower overpayment rate, resulting in the taxpayer being assessed a net interest charge even when the amounts of overpayment and underpayment were the same.

The IRS had the authority to credit the amount of any overpayment against any liability under the IRC. Under the federal Taxpayers' Bill of Rights II (TBR 2), Congress directed the IRS to implement procedures for "netting" overpayments and underpayments to the extent a portion of tax due was satisfied by a credit of an overpayment.

The IRS Reform Act established a net interest rate of zero on equivalent amounts of overpayment and underpayment that exist for any period. Each overpayment and underpayment is considered only once in determining whether equivalent amounts of overpayment and underpayment exist. The special rules that increase the interest rate paid on large corporate underpayments and decrease the interest rate received on corporate underpayments in excess of \$100,000 do not prevent the application of the net zero rate. This global netting is available for any type of tax imposed by the IRC.

Current state law is generally conformed to federal law for the imposition of interest, except that the overpayment rate is the same as the underpayment rate. State law also is conformed to the federal "hot interest" provisions for underpayments in excess of \$100,000 (additional 2% charged to corporations). If a taxpayer has an underpayment of tax from one year and an overpayment of tax from a different year that are outstanding at the same time, the FTB offsets the overpayment against the underpayment and applies the appropriate interest rate to the resulting net underpayment or overpayment.

This bill would conform to federal law eliminating the interest differential on overlapping periods of interest on tax overpayments and underpayments. Since the state overpayment and underpayment rates are generally the same, this bill would only impact corporate taxpayers with "hot interest."

Implementation Considerations

This bill would require systems changes to the Business Entity Tax System (BETS) because of the interest differential currently imposed on corporate taxpayers. It is anticipated that these changes could be made during the department's normal annual system update.

FISCAL IMPACT

Departmental Costs

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

Tax Revenue Estimate

Based on limited data and assumptions discussed below, any forgone interest as a result of the proposal is estimated to be on the order of \$1 million annually beginning in fiscal year 2000/01.

This estimate decreased the revenue loss estimate contained in SB 94 from \$1.5 million annually to \$1 million annually because the prior estimate incorrectly included a PIT impact.

Tax Revenue Discussion

This estimate is based on the results of FTB's current audit programs, current audit practices and available information on returns filed. The following assumptions were applied:

- The average period of time for overlapping overpayment and underpayment regarding "hot interest" is estimated to be approximately one year.
- On average, overpayments represent approximately 50% of underpayments.
- Adjustments were made to allow for the differential in interest for overpayments and underpayment interest.

BOARD POSITION

Pending.