

ANALYSIS OF ORIGINAL BILL

Author:	<u>Brough</u>	Analyst:	<u>Janet Jennings</u>	Bill Number:	<u>AB 2692</u>
Related Bills:	<u>See Legislative History</u>	Telephone:	<u>845-3495</u>	Introduced Date:	<u>February 19, 2016</u>
		Attorney:	<u>Bruce Langston</u>	Sponsor	

SUBJECT: FTB & BOE Tax Penalty & Fee Waiver Amnesty Program

SUMMARY

This bill would require the Franchise Tax Board (FTB) and the Board of Equalization (BOE) to conduct a tax penalty and fee waiver program (Amnesty Program).

This analysis only addresses the provisions of the bill that would affect the FTB's programs and operations.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for the bill is to encourage taxpayers to come forward and begin to comply with the state's tax laws.

EFFECTIVE/OPERATIVE DATE

The bill would be effective on January 1, 2017, and would specifically apply to tax liabilities for taxable years beginning before January 1, 2015. The Amnesty Program would be conducted during a three-month period beginning February 1, 2017, to April 30, 2017, inclusive, or during a timeframe ending no later than June 30, 2017.

FEDERAL/STATE LAW***Federal Law***

Federal law has never allowed a general income tax amnesty.

The Internal Revenue Service provides an Offshore Voluntary Disclosure Program (2009 OVDP), an Offshore Voluntary Disclosure initiative (2011 OVDI), and an Offshore Voluntary Disclosure Program (2012 OVDP and 2014 OVDP). These programs allow for taxpayers who wish to voluntarily disclose their offshore accounts and assets to avoid prosecution and limit their exposure to civil penalties.

State Law

Under State law the department has conducted two general tax amnesty programs and three targeted tax amnesty programs called the Revenue Acceleration Project, Voluntary Compliance Initiative 1, and Voluntary Compliance Initiative 2.

PROGRAM BACKGROUND

Amnesty is literally the abolishment of an obligation to the government. An income tax amnesty generally is understood to be an offer of forgiveness of any combination of tax, interest, penalties, and forgoing criminal prosecution for persons who fail to file a tax return, in exchange for filing the return and paying the associated tax liability. Amnesty legislation generally includes increased penalties or enhanced filing enforcement or collection authority as inducements to participate.

1984 Amnesty

The first California income tax amnesty was conducted in 1984.¹ It was a traditional amnesty focused on non-filers. The 1984 Amnesty provided enhanced filing enforcement and collection authority for the FTB. Taxpayers that participated were allowed waivers of penalties and forgoing of criminal prosecution in exchange for filing and paying the associated tax liability.

2002 Revenue Acceleration Project (RAP)

In 2002, legislation was enacted² that allowed the FTB to identify eligible taxpayers with high-risk collection accounts and offer those taxpayers the opportunity to satisfy an unpaid tax liability by paying the tax in full and receiving a waiver of interest, penalties, and fees. This interest and penalty waiver program, also known as RAP, was in effect from October 1, 2002, through June 30, 2003. The RAP generated approximately \$32 million in revenue.

2003 California Voluntary Compliance Initiative 1 (VCI 1)

In 2003, California enacted a first-in-the-nation comprehensive anti-abusive tax avoidance transaction (ATAT) statute to curtail the use of ATATs and restore fairness to the tax system.³ Part of that legislation authorized a narrow amnesty called a VCI 1 to induce taxpayers who had used an ATAT on their previously-filed tax returns to file an amended return and pay the correct amount of tax. In exchange, taxpayers were able to avoid all current penalties and the new anti-ATAT penalties. Approximately 1,000 taxpayers participated, and the state collected an additional \$1.4 billion of revenue.

2005 Amnesty

The second general income tax amnesty was conducted in 2005.⁴ The 2005 Amnesty was broader than the traditional non-filer amnesty in that it focused on all three major components of the tax gap:

- taxpayers that failed to file a return,
- taxpayers that understated their taxes on a previously filed return, and
- taxpayers that failed to pay their tax obligation timely and were in the department's collection system.

¹ AB 3230 (Hannigan et al., Stats 1984, Ch.1490).

² AB 2065 (Oropeza, Stats. 2002, Ch. 499).

³ SB 614 (Cedillo, Stats. 2003, Ch. 656) and AB 1601 (Frommer, Stats. 2003, Ch. 654).

⁴ SB 1100 (Committee on Budget and Fiscal Review, Stats 2004, Ch. 226).

The 2005 amnesty, with the exception of taxpayers that had engaged in abusive tax shelters or were already under criminal investigation, allowed taxpayers an opportunity to pay any unpaid balances from tax years prior to 2002 in exchange for forgiveness of penalties, fees, and criminal prosecution. Eligible taxpayers that chose not to participate in the amnesty were subject to a penalty of 50 percent of the interest accrued as of March 31, 2005, on any amnesty eligible year.

The 2005 amnesty produced total gross revenues of \$765 million in income tax and interest. Of that amount, the FTB estimated \$727 million was accelerated revenue that would have come in over the next three fiscal years, rather than new revenue.

Additionally, the FTB received approximately 2,100 protective tax deposits totaling more than \$3.7 billion. The Legislative Analyst's Office estimated that of the \$3.7 billion in protective tax deposits, \$2.9 billion was a combination of accelerated revenue collection and deposits that would be refunded.

2010 California Voluntary Compliance Initiative 2 (VCI 2)

In 2011, California enacted VCI 2⁵ that provided an opportunity for taxpayers, who underreported their California income tax liabilities by utilizing ATATs or offshore financial arrangements, to amend their returns for 2010 and prior tax years and obtain a waiver of most penalties. VCI 2 raised \$350 million with \$293 million received in cash and later an additional \$57 million was raised from installment payments.

THIS BILL

This bill would require FTB to conduct an Amnesty Program for taxpayers subject to the Personal Income Tax Law and Corporation Tax Law. The program would provide an opportunity for eligible taxpayers to receive a waiver for unpaid penalty and fee amounts assessed on all taxable years beginning before January 1, 2015. The FTB would accept applications for the program starting February 1, 2017, and ending April 30, 2017, inclusive, or a period ending no later than June 30, 2017.

The following taxpayers would be ineligible to participate in the Amnesty Program, if as of February 1, 2017, any of the following applies:

- The taxpayer is on notice of a criminal investigation by a complaint having been filed against the taxpayer.
- The taxpayer is under criminal investigation.
- A court proceeding has already been initiated.

⁵ SB 86 (Committee on Budget and Fiscal Review, Stats. 2011, Ch. 14).

The Amnesty Program would not apply to any nonreported or underreported tax liability amount attributable to tax shelter items that could have been reported under either the state VCI 1, or the Internal Revenue Service's (IRS) Offshore Voluntary Compliance Initiative, or the IRS's Voluntary Disclosure Program as discussed above under Federal Law and Program Background .

No refund or credit would be granted with respect to any penalty or fee paid with respect to a taxable year prior to the time the taxpayer makes a request for a waiver under the Amnesty Program for that taxable year. A taxpayer may not file a claim for refund or credit for any amounts paid in connection with this bill's Amnesty Program.

A taxpayer could participate in the Amnesty Program if the following requirements were met:

- The taxpayer is eligible to participate in the Amnesty Program.
- The taxpayer files a completed waiver application with the FTB, signed under penalty of perjury, electing to participate during the Amnesty Program.
- The taxpayer, within 60 days after the conclusion of the waiver period, does the following:
 - Files a completed original tax return for any taxable year eligible for the Amnesty Program for which the taxpayer has not filed a return.
 - Files an amended return for any taxable year eligible for the Amnesty Program where the taxpayer underreported income on the (original) tax return.
 - Pays in full any taxes and interest due for each taxable year for which the Amnesty Program is requested or applies for an installment payment agreement. For taxpayers who have not paid in full any taxes previously proposed to be assessed, and pays in full the taxes and interest due for that portion of the proposed assessment for each taxable year for which a waiver is requested or applies for an installment payment agreement.
 - The FTB could enter into an installment payment agreement, but only if final payment under the terms of that agreement is due and is paid no later than June 30, 2018. This installment payment agreement would include interest on the outstanding amount due. Failure by the taxpayer to fully comply with the terms of this installment payment agreement would render the waiver of penalties and fees under the Amnesty Program null and void, unless the FTB determines that the failure was due to reasonable cause and not due to willful neglect. In the case of any failure, the total tax, interest, fees, and all penalties would become immediately due and payable.

For purposes of the full payment provisions discussed above, if the full amount due is paid within 15 calendar days, set forth in Section 19101, after the date the FTB mails a notice resulting from the filing of a waiver application or the full amount is paid within 60 days after the conclusion of the Amnesty Program, the full amount due would be treated as paid during the waiver period.

Taxpayers that are under the jurisdiction of a federal bankruptcy court would be authorized to participate in the tax penalty and fee waiver program upon submission of an order from a federal bankruptcy court that allows them to participate.

The Amnesty Program application would be in a form and manner specified by the FTB, but in no case could a mere payment of any taxes and interest due, in whole or in part, for any taxable year otherwise eligible for a waiver be deemed to constitute an acceptable waiver application. The application of a refund from one taxable year to offset a tax liability from another taxable year could not, without the filing of a waiver application, be deemed to constitute an acceptable waiver application. The revenues derived from the Amnesty Program application would be subject to Sections 19602 (Personal Income Tax Fund) and 19604 (Corporation Tax Fund).

Upon conclusion of the Amnesty Program, the FTB could do the following with respect to the difference between the amount shown on an original income tax return and the correct amount of tax:

- Assess additional tax,
- Impose penalties and fees, or
- Initiate criminal action.

In addition, this bill would provide the following:

- If any overpayment of tax shown on an original or amended return filed under the Amnesty Program is refunded or credited within 180 days after the return is filed, no interest would be allowed on that overpayment.
- The FTB may issue forms, instructions, notices, rules, or guidelines, and take any other necessary actions needed to implement the Amnesty Program, specifically including any forms, instructions, notices, rules, or guidelines that specify the form and manner of any acceptable form of waiver application.
- Exempt the FTB's standards, criteria, procedures, determination, rules, notices, or guidelines from the requirements of the Administrative Procedure Act.
- Require the FTB to conduct a public outreach program and adequately publicize the Amnesty Program to maximize public awareness and to make taxpayers aware of the program. In addition, the FTB would be required to make taxpayers aware of the new and increased penalties associated with taxpayer failure to participate in the Amnesty Program.
- Require the FTB to make reasonable efforts to identify taxpayer liabilities and, to the extent practicable, send written notice to taxpayers of their eligibility for the Amnesty Program. Failure of the FTB to notify a taxpayer of the existence or correct amount of a tax liability eligible for the Amnesty Program would not preclude the taxpayer from participating in the program.

Section 19777.5⁶ would not apply to the waiver period of the Amnesty Program.

IMPLEMENTATION CONSIDERATIONS

Department staff has identified the following implementation consideration. Department staff is available to work with the author's office to resolve this and other concerns that may be identified.

The waiver program would occur during the department's heaviest tax processing workload period of February 1, 2017, through April 30, 2017, and could impact the department's ability to process these two time sensitive workloads. The author may wish to move the Amnesty Program's application period after the peak filing season.

TECHNICAL CONSIDERATIONS

Not all bankruptcy cases require a court order to allow a taxpayer to participate in the Amnesty Program. The author may wish to change the language to address debtors in cases under Title 11 of the United States Bankruptcy Code only.

The bill provides that the FTB would be required to make taxpayers aware of the new and increased penalties associated with taxpayer failure to participate in the Amnesty Program. Because the bill lacks new or increased penalties, the author may want to delete this reference.

LEGISLATIVE HISTORY

AB 567 (Gibson, 2015/2016) would provide a targeted amnesty program for the medical cannabis related businesses. SB 567 is currently referred to the Senate Committee's on Health, and Governance and Finance.

OTHER STATES' INFORMATION

According to the Federation of Tax Administrators, since 1982, 46 states and the District of Columbia have offered at least one tax amnesty. The number of months in the amnesty window varies, as do the taxes that the amnesty covers.

FISCAL IMPACT

The department's costs to implement this bill have yet to be determined, but are expected to be significant. The bill would impact all areas of the department including, but not limited to, education and outreach, programming, printing, postage, call centers and processing costs.

⁶ This section imposes an amnesty penalty where the FTB mails a notice of proposed assessment or a notice of tax due or where a taxpayer self assesses additional tax for an amnesty eligible year after the end of an amnesty period.

As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested.

ECONOMIC IMPACT

This bill would result in the following revenue impact:

Estimated Revenue Impact of AB 2692 As Introduced February 19, 2016 Assumed Enactment After June 30, 2016 (In \$ Millions)		
2015-16	2016-17	2017-18
+ \$100.0	+ \$6.9	- \$65.0

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill. In addition, this estimate only reflects the revenue impact to income and franchise taxes.

Revenue Discussion:

Historically, Amnesty Programs produce a short term gain followed by a net loss over several years due to the forgiveness of penalties and acceleration of tax that would have been collected in the subsequent years. This bill is expected to have a similar impact, revenue acceleration followed by several years of reduced income tax collection.

The revenue impact for this bill would be determined by the number of taxpayers that would file approved amnesty applications, file the appropriate returns, and pay the required tax under the Amnesty Program less the fees and penalties that would have been collected under current law. The revenue impact of this bill is highly sensitive to the value of the tax liabilities for the participants. Any one high value account could significantly impact the revenue.

Based on data from the 2005 amnesty program including the observed participation rates, it is estimated that approximately 360,000 taxpayers would participate in the Amnesty Program. Based upon an analysis of eligible accounts and historical collection rates, it is estimated that this bill would bring in \$270 million from program participants with existing account balances for taxable years beginning before January 1, 2015, and additional revenue of \$70 million attributable to tax and interest due to the state by non-filers yet to be identified by the department; resulting in a total gross revenue gain of \$340 million in fiscal year 2016/17.

It is assumed 70 percent, or approximately \$240 million, would be received by June 30, 2017, from taxpayers paying within 60 days of the conclusion of the waiver period. The remaining 30 percent or \$100 million would be received from taxpayers entering into installment agreements and paid by June 30, 2018. The gross revenue is offset by what would have been collected absent the Amnesty Program resulting in a net revenue acceleration of \$100 million in fiscal year 2016/17, \$6.9 in fiscal year 2017/18 and a \$65 million net revenue loss in the fiscal year 2018/19. Because this bill would affect taxpayers with prior year tax liabilities, these amounts are accrued back one year.

SUPPORT/OPPOSITION

Support: None on file.

Opposition: None on file.

ARGUMENTS

Proponents: Some could argue that this bill would accelerate revenue needed to fund state programs.

Opponents: Some could argue that this bill may create cynicism among law-abiding taxpayers who will see tax debtors benefiting from recurring noncompliance and encourage noncompliance as taxpayers wait for the next amnesty

POLICY CONCERNS

The bill precludes participation by taxpayer's eligible for, but not participating in the department's VCI 1 program and allows taxpayers that were eligible for, but did not participate in the department's VCI 2 or 2005 Amnesty programs. Thus this bill would treat similarly situated taxpayers differently in addition to allowing some taxpayers a second chance at relief of penalties imposed for failing to participate in the VCI 2 or 2005 Amnesty program.

Historically, relief programs have included penalties that place taxpayers that are eligible to participate, but choose not to, in a less favorable economic position than if they had participated. This bill lacks such penalties.

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