

SUMMARY ANALYSIS OF AMENDED BILL

Author: Ting Analyst: Scott McFarlane Bill Number: AB 154
 Related Bills: See Prior Analysis Telephone: 845-6075 Amended Date: June 30, 2015
 Attorney: Bruce Langston Sponsor _____

SUBJECT:	Conformity Act of 2015 & Corporation Penalty Relief
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SUMMARY

This bill would enact two conformity provisions and a provision to provide corporation penalty relief. The conformity provisions would:

1. Change California's general "specified date" of conformity to federal income tax laws from January 1, 2009, to January 1, 2015, for taxable years beginning on or after January 1, 2015, and thereby generally conform to the numerous changes that were made to federal income tax laws during that six-year period, except as otherwise provided; and
2. Generally conform to the federal net operating loss (NOL) rules that allow corporations expecting an NOL carryback to extend the time for payment of taxes for the preceding taxable year.

The third provision relating to corporation penalty relief would modify the large corporate understatement penalty (LCUP) to provide certain exceptions to the penalty.

Summary Revenue Estimate	2015-16	2016-17	2017-18
Provision 1 – General Conformity	\$15,170,000	\$16,020,000	\$17,220,000
Provision 2 – Corporation Payment Extension	-\$12,000,000	-\$8,000,000	-\$3,000,000
Provision 3 – Corporation Penalty Relief	-\$200,000	-\$200,000	-\$200,000
Total Revenue Estimate	\$2,970,000	\$7,820,000	\$14,020,000

RECOMMENDATION

No position.

Summary of Amendments

The June 30, 2015, amendments added the third provision that would modify the LCUP, and made minor technical changes. As a result of the amendments, new "Provision 3" sections are added, and the "Effective/Operative Date" section of the department's analysis of this bill as amended May 28, 2015, is revised, as provided below. The remainder of the department's analysis of this bill as amended May 28, 2015, still applies.

Summary of Suggested Amendments

Amendments are suggested to make non-substantive technical modifications.

Board Position:	Legislative Director	Date
_____ S _____ NA _____ X _____ NP	Gail Hall	7/6/15
_____ SA _____ O _____ NAR		
_____ N _____ OUA _____		

EFFECTIVE/OPERATIVE DATE

As an urgency statute, this bill would be effective immediately upon enactment.

Provisions 1 and 2 would generally be operative for taxable years beginning on or after January 1, 2015, except as otherwise provided.

Provision 3 would generally be operative for taxable years beginning on or after January 1, 2015, except the LCUP modifications relating to the Franchise Tax Board's (FTB's) imposition of an alternative apportionment or allocation method would be operative for any taxable year for which the statute of limitations on assessments has not expired as of the effective date of this bill.

Provision 3 – Corporation Penalty Relief

FEDERAL/STATE LAW

Federal Law

There is no comparable penalty under federal law.

State Law

The LCUP is assessed against any corporation that has an understatement of tax if such understatement exceeds the greater of:

- \$1 million; or
- 20 percent of the tax shown on an original return (or amended return filed on or before the original or extended due date of the original return).

The penalty is 20 percent of the understatement of tax. For purposes of this penalty, an understatement of tax means the difference between the amount of tax shown on an original return (or amended return, if filed on or before the extended due date of the original return) and the correct amount of tax.

In the case of taxpayers that are required or authorized to be included in a combined report, the \$1 million/20 percent threshold applies to the aggregate amount of tax liability for all taxpayers that are required or authorized to be included in the combined report.

A corporation may not protest or appeal the imposition of the LCUP, and the LCUP is imposed in addition to any other applicable penalty.

Exceptions to the LCUP provide that it does not apply to any understatement of tax that is attributable to:

- A change in law, a regulation, a legal ruling of counsel, or a published federal or California court decision that occurs after the earlier of either the date the taxpayer files the return for the taxable year for which the change is operative or the extended due date for the return of the taxpayer for the taxable year for which the change is operative; or

- A taxpayer's reasonable reliance on written advice of the FTB, but only if such advice was a legal ruling by the Chief Counsel (within the meaning of the Taxpayers' Bill of Rights).

A credit or refund for any amounts paid to satisfy the penalty may be allowed only on the grounds that the amount of the penalty was not properly computed by the FTB.

THIS PROVISION

This provision would provide additional exceptions to the LCUP for the following:

1. An increase to tax from a proper Internal Revenue Code section 338 election as reported on the first amended return; and
2. An understatement attributable to either of the following:
 - a. The FTB's imposition of an alternative apportionment or allocation method under the authority of Revenue and Taxation Code section 25137 to prevent distortion in the allocation and apportionment of income to California; or
 - b. A change to the taxpayer's federal method of accounting, but only to the extent of understatements for taxable years where the due date of the return, without regard to any extension of time for filing the return, is before the date the Secretary of the Treasury consents to that change.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would require changes to the department's operations, tax forms and instructions, which could be accomplished during the normal annual update.

TECHNICAL CONSIDERATIONS

Minor technical amendments are suggested.

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. A review of these states' laws found that none have a penalty similar to the LCUP.

FISCAL IMPACT

Implementing this provision would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of Provision 3 of AB 154 As Amended June 30, 2015 Assumed Enactment After September 30, 2015		
2015-16	2016-17	2017-18
- \$200,000	- \$200,000	- \$200,000

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

Revenue Discussion

This estimate represents the minimum penalty loss per occurrence. It is anticipated that the occurrence of this provision's exceptions to the LCUP would be rare, but when they do occur the estimated revenue impact would range from losses of \$200,000 to \$1 million per occurrence.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Those in support of this provision may argue that it would provide penalty relief for understatements that are generally unforeseeable and unexpected.

Opponents: Those in opposition to this provision may argue that corporations with large understatements should be penalized unless one of the current-law exceptions apply.

LEGISLATIVE STAFF CONTACT

Scott McFarlane
Legislative Analyst, FTB
(916) 845-6075
scott.mcfarlane@ftb.ca.gov

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484
jame.eiserman@ftb.ca.gov

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

Analyst	Scott McFarlane
Telephone #	845-6075
Attorney	Bruce Langston

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO
AB 154 AS AMENDED JUNE 30, 2015

AMENDMENT 1

On page 39, line 35, after "is before the date", strikeout "on" and insert:

of

AMENDMENT 2

On page 46, strikeout lines 1 through 40, inclusive, and on page 47, strikeout lines 1 through 18, inclusive, and insert:

SEC. 23. Section 19167 of the Revenue and Taxation Code, as amended by Chapter 21 of the Statutes of 2015, is amended to read:

19167. (a) A penalty shall be imposed under this section for any of the following:

~~(a)~~(1) In accordance with Section 6695(a) of the Internal Revenue Code, for failure to furnish a copy of the return to the taxpayer, as required by Section 18625.

~~(b)~~(2) In accordance with Section 6695(c) of the Internal Revenue Code, for failure to furnish an identifying number, as required by Section 18624.

~~(c)~~(3) In accordance with Section 6695(d) of the Internal Revenue Code, for failure to retain a copy or list, as required by Section 18625 or for failure to retain an electronic filing declaration, as required by Section 18621.5.

~~(d)~~(4) Failure to register as a tax preparer with the California Tax Education Council, as required by Section 22253 of the Business and Professions Code, unless it is shown that the failure was due to reasonable cause and not due to willful neglect.

~~(1)~~(A) The amount of the penalty under this ~~subdivision~~ paragraph for the first failure to register is two thousand five hundred dollars (\$2,500). This penalty shall be waived if proof of registration is provided to the Franchise Tax Board within 90 days from the date notice of the penalty is mailed to the tax preparer.

~~(2)~~(B) The amount of the penalty under this ~~subdivision~~ paragraph for a failure to register, other than the first failure to register, is five thousand dollars (\$5,000).

~~(e)~~(C) The Franchise Tax Board shall not impose the penalties authorized by ~~subdivision (d)~~ this paragraph until either one of the following has occurred:

~~(1)~~(i) Commencing January 1, 2006, and continuing each year thereafter, there is an appropriation in the Franchise Tax Board's annual budget to fund the costs associated with the penalty authorized by ~~subdivision (d)~~ this paragraph.

~~(2)(A)(ii)(I)~~ An agreement has been executed between the California Tax Education Council and the Franchise Tax Board that provides that an amount equal to all first year costs associated with the penalty authorized by ~~subdivision (d) this paragraph~~ shall be received by the Franchise Tax Board. For purposes of this ~~subparagraph~~, subclause, first year costs include, but are not limited to, costs associated with the development of processes or systems changes, if necessary, and labor.

~~(B)(II)~~ An agreement has been executed between the California Tax Education Council and the Franchise Tax Board that provides that the annual costs incurred by the Franchise Tax Board associated with the penalty authorized by ~~subdivision (d) this paragraph~~ shall be reimbursed by the California Tax Education Council to the Franchise Tax Board.

~~(C)(III)~~ Pursuant to the agreement described in ~~subparagraph (A), subclause (I)~~, the Franchise Tax Board has received an amount equal to the first year costs described in that ~~subparagraph subclause~~.

~~(f)(5)~~ In accordance with Section 6695(g) of the Internal Revenue Code, for failure to be diligent in determining eligibility for earned income credit for returns required to be filed on or after the effective date of the act adding this subdivision June 24, 2015.

(b) Section 6695(h) of the Internal Revenue Code, relating to adjustment for inflation, shall not apply.