

2012 Legislative Proposals

LP #	TITLE
A	Assess Penalties & Reimbursement Fees to Suspended, Forfeited, or Non-qualified Limited Liability Companies (LLCs) That Similarly-Situated Corporations are Subject to/Codify LLC Discretionary Revivor
B	Conformity to Federal Holiday Due Date Extensions
C	Re-enact Taxpayer Advocate Equity Relief
D	Relief from Imposition of the Minimum Franchise Tax on Charitable Corporations

LEGISLATIVE PROPOSAL A EXECUTIVE SUMMARY

- **Title:** Assess Penalties & Reimbursement Fees to Suspended, Forfeited, or Non-qualified Limited Liability Companies (LLCs) That Similarly-Situated Corporations are Subject to/Codify LLC Discretionary Revivor
- **Problem:** The Franchise Tax Board (FTB) lacks the express authority to treat LLCs as it treats corporations in regards to suspension-related services, fees, and penalties, resulting in unreimbursed administrative costs and inequitable treatment between LLCs and corporations.
- **Proposed Solution/Justification:** Authorize the FTB to assess the \$2,000 failure to file a return penalty (\$2,000 Penalty) to LLCs, impose an Entity Status Letter Fee to LLCs, impose a walk-thru revivor fee to LLCs, and expressly provide for LLC discretionary revivor. This will result in the equitable treatment between LLCs and corporations in regards to suspension-related services, fees, and penalties, and, in the process, will properly reimburse FTB for its costs.
- **Major Concerns/Issues:** None.
- **Revenue:** This proposal would result in the following revenue gains beginning in 2011/12.

Estimated Revenue Impact of LP A Effective for Penalties Imposed On or After January 1, 2013 Enactment assumed after June 30, 2012 (\$ in Millions)					
	2011/12	2012/13	2013/14	2014/15	2015/16
Total Revenue Impact	+\$0.50	+\$0.65	+\$0.75	+\$0.95	+\$1.10

Title

Assess Penalties & Reimbursement Fees to Suspended, Forfeited, or Non-qualified Limited Liability Companies (LLCs) That Similarly-Situated Corporations are Subject to/Codify LLC Discretionary Revivor

Introduction

This proposal would grant the Franchise Tax Board (FTB) authority to treat LLCs in the same manner as corporations with regard to suspension-related services, fees, and penalties.

Program History/Background

In 1994, the Legislature authorized the formation of LLCs in California by enacting the Beverly-Killea Limited Liability Company Act (Act).¹ Under the Act, LLCs were specifically included in the definition of “taxpayer” and authorization was granted to the FTB to submit LLCs for suspension to the Secretary of State (SOS) for non-payment of taxes or for failure to file required tax returns. Other code sections outside of the Act relating to suspension, forfeiture, and revivor-related services and penalties were inadvertently not amended to include LLCs.

Because current law governing suspension and revivor-related services fails to address in every instance LLCs, the FTB lacks the ability to charge an LLC for an expedited, walk-thru revivor or an Entity Status Letter that similarly situated corporations are currently charged a fee to receive, resulting in inequitable treatment between LLCs and corporations.

The FTB provided expedited revivor services to 41 LLCs during the fiscal year 2010/2011,² where similarly-situated corporations were required to pay a walk-thru revivor fee to reimburse the FTB for the additional cost to provide expedited services. The fee is currently \$56.

The FTB manually provided Entity Status Letters to 5,073 LLCs during the 2010 calendar year at no cost to the LLCs, where similarly-situated corporations were required to pay a \$20 Entity Status Letter fee to the FTB for these services.

In addition, the FTB lacks authority to assess a penalty on an LLC that is suspended, forfeited, or not qualified to do business within the state and that has failed to file a tax return, whereas a similarly-situated corporation would be assessed a \$2,000 Penalty. During the 2010 calendar year, it is estimated that a total of 1,011 LLCs would have been assessed a \$2,000 Penalty, if the FTB had the authority.

The FTB has also offered discretionary revivor services for LLCs, although not expressly authorized under statute, in order to provide equitable treatment between LLCs and corporations.

¹ Revenue and Taxation Code sections 17000 et seq. added by Stats. 1994, Ch. 1200 (SB 469).

² The fiscal year 2010/2011 period was used as it was the only available period of data on expedited revivor services from the department’s district offices. All other data is from the first full calendar year after the implementation of LLC suspension—the 2010 calendar year.

Current Federal Law

Under existing federal law, the Internal Revenue Service (IRS) does not suspend corporations. The IRS is authorized to charge user fees for ruling letters, opinion letters, determination letters, and other similar requests. The amounts of these fees vary and are based on the average time and difficulty to complete the request.

Current 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 business 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.

For an LLC or corporation to be revived and brought back into good standing, the entity must file all delinquent tax returns and pay all delinquent taxes, penalties, and interest. In addition, the entity must file an application for certificate of revivor.

The FTB has express discretionary authority to revive a corporation without full payment if the FTB determines that reviving the corporation will improve the prospects for collection of the full amount due. Under existing law, this ability is not expressly granted to the FTB for LLCs.

Under existing law, if an LLC or corporation requires immediate revival because of escrow closing, litigation, or a loan or federal grant pending, the entity may request a walk-thru revivor. A walk-thru revivor is a one-day process that is carried out in the FTB field offices. Under existing law, corporations are charged a \$56 fee to reimburse the FTB for the expedited revivor services; LLCs are not required to reimburse the FTB for these same expedited services.

A business entity or individual may request an Entity Status letter to obtain certification of a given entity's standing for the following:

- Legal status in court proceedings.
- An outstanding liability that could have an effect on an entity's credit rating (e.g., the closing of escrow).
- Verification of an exempt status.
- A corporation or LLC registering to transact business in another state.

Under current law, the FTB is authorized to charge the corporation a \$20 fee to reimburse the FTB for providing an entity status letter, but lacks the authority to charge LLCs for the same service. The FTB is currently working to put in place an automated web-based application that would allow the public to have access and self-print Entity Status Letters for any taxable entity. When this application is implemented, the Entity Status Letter fee will no longer be imposed, as the FTB will no longer manually provide Entity Status Letters.

Problem

The FTB lacks the express authority to treat LLCs as it treats corporations in regards to suspension-related services, fees, and penalties, resulting in unreimbursed administrative costs and inequitable tax treatment between LLCs and corporations.

Proposed Solution

Amend Revenue and Taxation Code sections 19135, 19591, and 23305.5 to accomplish the following:

- Authorize the assessment of a \$2,000 Penalty when an LLC continues to operate after suspension.
- Authorize the FTB to charge fees to reimburse the department for specialized services provided to LLCs for entity status letters and rush revivor requests.
- Authorize the FTB to grant discretionary revivors to LLCs.

Effective/Operative Date of Solution

If enacted in the 2012 legislative session as an administrative measure, this proposal would be effective on January 1, 2013, and apply to all LLCs as of that date.

Justification

This proposal would provide consistent treatment for both LLCs and corporations when providing specialized services and provide consistent treatment for failure to file a return while operating while suspended, forfeited, or not qualified to do business in the state of California.

This proposal would also provide reimbursement to the FTB for elective services that are requested by LLCs.

Implementation

Implementing this proposal would not significantly impact the department's programs and operations.

Fiscal Impact

This proposal would not significantly impact the department's costs. Any savings that would result from this proposal will be re-directed towards other revenue producing programs.

Economic Impact

This proposal would result in the following revenue gains beginning in fiscal year 2011/12.

Estimated Revenue Impact of LP A Effective for Penalties Imposed On or After January 1, 2013 Enactment assumed after June 30, 2012 (\$ in Millions)					
	2011/12	2012/13	2013/14	2014/15	2015/16
Total Revenue Impact	+\$0.50	+\$0.65	+\$0.75	+\$0.95	+\$1.10

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

Revenue Discussion

This proposal would generate revenue by imposing a \$2,000 Penalty on affected LLCs. Suspended, forfeited, or non-qualified corporations that still do business in California and fail to file required tax returns are charged a \$2,000 Penalty. Over a period of 10 years starting in 1999, data indicates that approximately 5 percent of suspended corporations have been assessed the \$2,000 Penalty, of which 14 percent have paid. During the 2010 calendar year, 20,229 LLCs were suspended. Assuming that suspended LLCs behave similarly to corporations, approximately 1,011 (5% x 20,229) of them would be assessed the \$2,000 Penalty and 142 (14% x 1,011) of them would pay the penalty. The revenue gain would be approximately \$284,000 (142 x \$2,000).

This estimate assumes a 10 percent annual growth in the number of LLCs affected by this proposal. It also assumes that over the next several years the FTB expects to increase its assessment rate due to the implementation of the Enterprise Data to Revenue project and the Financial Institutions Record Match program. For the 2013 calendar year, the revenue gain is estimated to be \$520,000. This estimate assumes that the Entity Status Letter Fee will not be imposed during the projected fiscal years.

The revenue in the chart reflects fiscal year cash flows accrued back one year.

Other States

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.

Florida allows corporations and LLCs to revive after being administratively suspended; however, *Florida* does not provide any expedited revivor services for corporations or LLCs. *Florida* provides entity status letters to corporations for an \$8.25 fee and LLCs for a \$5.00 fee.

Illinois allows corporations and LLCs to revive after being administratively suspended and provides expedited revivor services for corporations and LLCs for an additional fee of \$100.

Michigan allows corporations and LLCs to revive after being administratively suspended and provides expedited revivor services for corporations and LLCs for a \$100 fee for 24-hour turnaround service, \$200 fee for same-day service, \$500 fee for two-hour service, and \$1,000 fee for one-hour service. *Michigan* provides entity status letters for a \$10 fee.

Massachusetts allows corporations and LLCs to revive after being administratively suspended and provides expedited electronic revivor services for a \$9 fee. *Massachusetts* provides entity status letters for a \$12 fee.

Minnesota allows corporations and LLCs to revive after being administratively suspended and provides expedited electronic revivor services for corporations and LLCs for a \$10 fee. *Minnesota* provides entity status letters for a \$5 fee.

New York allows corporations and LLCs to revive after being administratively suspended and provides expedited revivor services for corporations and LLCs—\$25 fee for 24-hour turnaround service, \$75 fee for same-day service, \$150 fee for two-hour service. *New York* provides entity status letters for a \$25 fee.

None of the states reviewed provide for discretionary revivors, nor do they assess a penalty similar to the \$2,000 Penalty imposed for doing business while suspended.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS FOR LP A

AMENDMENT 1

19135. Whenever any foreign corporation or any foreign limited liability company which fails to qualify to do business in this state or whose powers, rights, and privileges have been forfeited, or any domestic corporation or any domestic limited liability company which has been suspended, and which is doing business in this state, within the meaning of Section 23101, fails to make and file a return as required by this part, the Franchise Tax Board shall impose a penalty of two thousand dollars (\$2,000) per taxable year, unless the failure to file is due to reasonable cause and not willful neglect. The penalty shall be in addition to any other penalty which may be due under this part. The penalty shall be imposed if the return is not filed within 60 days after the Franchise Tax Board sends the taxpayer a notice and demand to file the required tax return.

AMENDMENT 2

19591. (a) Specialized tax services fees shall be imposed upon the following services provided by the board:

- (1) Installment payment programs.
- (2) Expedited services for:
 - (A) Corporation or limited liability company revivor requests.
 - (B) Tax clearance certificate requests.
 - (C) Tax-exempt status requests.
 - (D) Limited partnership revival confirmation letter requests.

(b) (1) For periods on or after the effective date of this section and prior to January 1, 2006, the Franchise Tax Board shall publish by notice a schedule of specialized tax services fees to be imposed, which notice shall be exempt from the requirements of Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code. The amounts of these fees under this paragraph shall be calculated in the same general manner as required under paragraph (2).

(2) Commencing on January 1, 2006, the amount of the specialized tax services fees shall be established by the board through regulations adopted pursuant to Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code, and shall be established in the manner and in the amounts necessary to reimburse the board for the costs of administering the specialized services, including the board's direct and indirect costs for providing specialized tax services.

(3) For periods on or after the effective date of this section, and prior to January 1, 2011, the amount of the specialized tax service fee for limited partnership revival confirmation letter requests shall be one hundred dollars (\$100). Commencing on January 1, 2011, the specialized tax service fee for limited partnership revival confirmation letter requests shall be calculated in the same general manner as required under paragraph (2).

AMENDMENT 3

23305.5. (a) For the purposes of this article, "taxpayer" or "corporation" shall include any limited liability company, foreign or domestic, that is organized in this state or registered with the Secretary of State.

(b) For purposes of this article, in the case of a limited liability company:

(1) "Articles of incorporation" shall include a limited liability company's articles of organization.

(2) "Tax" shall include the tax and fee imposed by Sections 17941 and 17942, or former Sections 23091 and 23092, respectively.

LEGISLATIVE PROPOSAL B

EXECUTIVE SUMMARY

- **Title:** Conformity to Federal Holiday Due Date Extensions
- **Problem:** When the federal Emancipation Day holiday falls on the same date that income tax returns and payments are due, the Internal Revenue Code provides for extending the filing deadline; however, the Franchise Tax Board (FTB) must administratively change the due date for California income tax documents and payments to ensure that penalties are not assessed for taxpayers who file on the IRS extended deadline.
- **Proposed Solution/Justification:** Add language to the Revenue and Taxation Code to define a legal holiday for California income tax purposes to include those legal holidays recognized by the Internal Revenue Service for federal returns, other documents, and payments (e.g., Emancipation Day).
- **Major Concerns/Issues:** None.
- **Revenue:** This proposal would not impact the state's income tax revenue.

Title

Conformity to Federal Holiday Due Date Extensions

Introduction

This proposal would provide statutory authority for the Franchise Tax Board (FTB) to extend the date that filings or payments would be accepted when the last day to file or make a payment falls on a Saturday, Sunday, or legal holiday that is recognized by the IRS as a holiday.

Program History/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 occur 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 Internal Revenue Service (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.

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" includes a legal holiday in the District of Columbia. Under District of Columbia law, Emancipation Day, April 16, is a legal holiday.¹

¹ IRC section 7503.

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.

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

² Internal Revenue Bulletin 2011-10.

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.

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.⁶ 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.⁷

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

Problem

When the federal Emancipation Day holiday falls on the same date that income tax returns and payments are due, the IRC provides for extending the filing deadline; however, the FTB must administratively change the due date for California income tax documents and payments to ensure that penalties are not assessed for taxpayers who file on the IRS extended deadline.

Proposed Solution

The solution is to add language to the Revenue and Taxation Code to define a legal holiday for California income tax purposes to include those legal holidays (e.g., Emancipation Day) recognized by the IRS for federal returns, other documents, and payments. The proposed language includes references to Part 10, Personal Income Tax Law, and Part 11, Corporation Tax Law, to include not only the returns and payments due, but also elections under those parts that are required on a timely-filed original return due on April 15.

Effective/Operative Date of Solution

Assumed enactment during the 2012 legislative session as an administrative measure, this proposal would be effective on January 1, 2013, and apply to calendar years beginning on or after January 1, 2013.

Justification

This proposal would modify the filing and payment due dates in some years to mirror federal holiday due date extensions. The proposal would accomplish the following:

- Minimize the burden of tax-return preparation because a completed federal income tax return is necessary to prepare a California income tax return.
- Allow California to apply statutorily the dates on forms and in instructions for affected years rather than administratively. Codified due dates will lead to less confusion and erroneous interpretations.

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

⁶ Franchise Tax Board Technical Advice Memorandum 97-0027.

⁷ R&TC section 19582.

Implementation

Implementing this proposal would not significantly impact the department's programs and operations.

Fiscal Impact

This proposal would not impact the department's costs.

Economic Impact

This proposal would not impact the state's income tax revenue.

Other States

The states surveyed include *Illinois, Massachusetts, Michigan, New York, and Florida*. 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. *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.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENT TO LP B

AMENDMENT 1

Section 18410 of the Revenue and Taxation Code is added to read:

18410. For purposes of Part 10 (commencing with section 17001), Part 11 (commencing with section 23001) and this part, a legal holiday includes a federal legal holiday recognized by the Internal Revenue Service under Internal Revenue Code section 7503.

LEGISLATIVE PROPOSAL C

EXECUTIVE SUMMARY

- **Title:** Re-enact Taxpayer Advocate Equity Relief
- **Problem:** The expiring statutory authority to administratively remedy an error made by Franchise Tax Board (FTB) staff will require taxpayers to seek a remedy outside of the department.
- **Proposed Solution/Justification:** Re-enact Section 21004, Part 10.7, Division 2 of the Revenue and Taxation Code to permanently authorize the Advocate to waive penalties or additions to tax, fees, and interest that are a result of an FTB error.
- **Major Concerns/Issues:** None.
- **Revenue:** Cases of erroneous departmental action/guidance are relatively infrequent. To determine the magnitude of the potential impact to the General Fund, both the frequency of erroneous actions and the dollar amount of those errors must be known. Because it is difficult to predict the frequency and the value of future errors on the part of the FTB, the revenue impact to the General Fund is unknown; however, it is expected to be minor.

Title

Re-enact Taxpayer Advocate Equity Relief

Introduction

This proposal would re-enact the discretionary authority of the Taxpayers' Rights Advocate to grant relief to taxpayers from penalties, fees, additions to tax, or interest imposed on a tax liability because of erroneous actions of the department.

Program History/Background

Assembly Bill 3078 (Assembly Committee on Revenue and Taxation) Chapter 305, Statutes of 2008, granted the Franchise Tax Board's (FTB's) Taxpayers' Rights Advocate the discretionary authority to grant relief to taxpayers from penalties, fees, additions to tax, or interest imposed on a liability because of erroneous actions of the department. This authority will expire on January 1, 2012.

Since January 1, 2009, there have been two occurrences in which the FTB has used the discretionary authority to abate interest.

Current State Law

Current law allows FTB staff to abate penalties, fees, additions to tax, or interest in the following narrow circumstances:

- Interest may be abated in situations where the interest is attributable to an unreasonable delay by the FTB in performing a ministerial or managerial act. Interest abatement is limited to interest that accrues after the FTB's first contact with the taxpayer regarding the tax year.
- Interest may be abated in situations where the FTB issues an assessment based on an Internal Revenue Service (IRS) assessment and the IRS abates interest due to an IRS delay.
- Interest may be abated in situations where a taxpayer is experiencing an extreme financial hardship caused by a significant disability or catastrophic circumstance.
- Interest, penalties, fees and/or tax may be abated in situations where a taxpayer reasonably relied on the written advice of a legal ruling by the Chief Counsel.
- Penalties may be abated in situations where the penalties carry reasonable-cause exceptions. Reasonable cause generally means that despite ordinary business care and prudence, the action that caused the penalty or addition to tax occurred. Not all penalties carry a reasonable-cause exception.
- Interest is suspended in situations where the FTB fails to provide a notice to the taxpayer stating the amount owed and the basis of the amount owed within 36 months from when the return was filed, or if later, the date it is due without regard to extension.

- Penalties or fees may be abated in situations where the Chief Counsel rescinds the application of tax shelter penalties or fees as authorized.
- Interest, penalties, tax, or fees may be abated in situations where the Taxpayers' Rights Advocate grants relief to a taxpayer because of erroneous actions or inactions of the FTB. This remedy went into effect January 1, 2009, and will sunset on January 1, 2012.

Taxpayers can appeal an action of the FTB to the State Board of Equalization (BOE). If a taxpayer loses the appeal at the BOE, the taxpayer can either file a lawsuit for refund of taxes or file a claim with the Victim Compensation and Government Claims Board (VCGCB). Taxpayers can file claims with the VCGCB for refund of tax or losses caused by the action or inaction of a state agency.

Problem

The expiring statutory authority to administratively remedy an error made by FTB staff will require taxpayers to seek a remedy outside of the department.

Proposed Solution

Re-enact Section 21004, Part 10.7, Division 2 of the Revenue and Taxation Code to permanently authorize the Advocate to waive penalties or additions to tax, fees, and interest that are a result of an FTB error.

Effective/Operative Date of Solution

If enacted in the 2012 legislative session, this proposal would be effective January 1, 2013, and would be operative on and after that date.

Justification

As stated under Current Law, this is the only remedy for the abatement of penalties, fees, additions to tax, or interest that has a sunset provision. The Legislature generally requires sunset provisions in order to allow the Legislature to review whether a law is meeting its objective. The FTB Taxpayers' Rights Advocate has prudently applied the granting of relief to taxpayers since 2009. By re-enacting the law without a sunset provision, this proposal would place this remedy on the same permanent basis as other remedies. In addition, this proposal would reduce the burden for taxpayers seeking relief from FTB errors by eliminating the need for the taxpayer to appeal to the BOE or the VCGCB as the only remaining methods to obtain relief.

Implementation

Implementing this proposal would not impact the department's programs and operations.

Fiscal Impact

Although the FTB is unable to quantify future case volumes, it is expected that this proposal would ultimately save minor litigation and appeal costs incurred for the issues that the FTB is unable to resolve should the current statutory authority not be reinstated. It is estimated that any workload increases to the Advocate staff created by this proposal would be absorbable.

Economic Impact

Cases of erroneous departmental action/guidance have been infrequent. To determine the magnitude of the potential impact to the General Fund, both the frequency of erroneous actions and the dollar amount of those errors must be known. Because it is difficult to predict the frequency and the value of future errors on the part of the FTB, the revenue impact to the General Fund is unknown; however, it is expected to be minor.

Other States

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. These states have interest waiver and reasonable-cause exceptions to certain penalty provisions that are similar to the existing federal and California provisions. Statutes granting administrative relief at the tax-agency level were not found in the laws of the compared states.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS FOR LP C

AMENDMENT 1

SEC. 1. Revenue and Taxation Code Section 21004, as added by Section 8 of Chapter 305 of the Statutes of 2008, is amended to read:

21004. (a) The board shall establish the position of the Taxpayers' Rights Advocate. The advocate or his or her designee shall be responsible for coordinating resolution of taxpayer complaints and problems, including any taxpayer complaints regarding unsatisfactory treatment of taxpayers by board employees. The advocate shall report directly to the executive officer of the board.

(b) The advocate or his or her designee shall give highest priority to reviewing and taking prompt and appropriate action, including staying actions where taxpayers have suffered or will suffer irreparable loss as the result of board action. Applicable statutes of limitation shall be tolled during the pendency of a stay. Any penalties and interest which would otherwise accrue shall not be affected by the granting of a stay.

(c) This section shall become operative on January 1, 2012.

(d) (1) Beginning on and after January 1, 2013, the advocate may review any application for relief pursuant to this subdivision and abate any penalties, fees, additions to tax, or interest assessed on a taxpayer, if it is determined by the advocate that the penalties, fees, additions to tax, or interest that have been assessed, or any part thereof, is attributable to any of the following:

(A) Erroneous action or erroneous inaction by the board in processing documents filed or payments made by taxpayers.

(B) Unreasonable delay caused by the board.

(C) Erroneous written advice that does not qualify for relief under Section 21012.

(2) Relief may be granted pursuant to this subdivision only if no significant aspect of that error or delay can be attributed to the taxpayer involved and relief is not available under any other provision of this part, Part 10 (commencing with Section 17001), or Part 11 (commencing with Section 23001), including any relief granted under any regulation or other administrative pronouncement of the board.

(3) (A) (i) Any relief granted pursuant to this subdivision in which the total reduction in penalties, fees, additions to tax, or interest exceeds five hundred dollars (\$500) shall be submitted to the chief counsel, for concurrence.

(ii) If the total relief granted pursuant to this subdivision, including penalties, fees, additions to tax, and interest, exceeds seven thousand five hundred dollars (\$7,500), the chief counsel shall notify the board.

(B) Whenever relief is granted under this subdivision, there shall be placed on file in the office of the executive officer of the board a public record with respect to that relief. The public record shall include the following:

(i) The taxpayer's name.

(ii) The total amount involved.

(iii) The amount payable or refundable due to the error or delay.

(iv) A summary of why the relief is warranted.

(4) A refund may be paid as a result of relief granted under this subdivision only if the applicable statute of limitations, with respect to filing a claim for refund, remains open as of the date that the basis for providing relief, as authorized in subparagraphs (A) to (C), inclusive, of paragraph (1), as reflected in a written communication received by the advocate.

(d) No other entity may participate in the grant or denial of relief pursuant to this section.

(e) On January 1 of each calendar year beginning on or after January 1, 2009, the board shall increase the amount specified in subparagraph (A) of paragraph (3) of subdivision (c) to the amount computed under this subdivision. That adjustment shall be made as follows:

(1) The Department of Industrial Relations shall transmit annually to the board the percentage change in the California Consumer Price Index, as modified for rental equivalent home ownership for all items, from June of the prior calendar year to June of the current calendar year, no later than August 1 of the current calendar year.

(2) The board shall then:

(A) Compute the percentage change in the California Consumer Price Index from the later of June 2008 or June of the calendar year prior to the last increase in the amount specified in paragraph (1).

(B) Compute the inflation adjustment factor by adding 100 percent to the percentage change so computed, and converting the resulting percentage to the decimal equivalent.

(C) Multiply the amount specified in paragraph (1) for the immediately preceding calendar year, as adjusted under this subparagraph, by the inflation adjustment factor determined in subparagraph (B), and round off the resulting product to the nearest one hundred dollars (\$100).

(f) Notwithstanding any other law or rule of law, all determinations made under subdivision (d) (1) shall not be subject to review in any administrative or judicial proceeding.

LEGISLATIVE PROPOSAL D

EXECUTIVE SUMMARY

- **Title:** Relief from the Imposition of the Minimum Franchise Tax on Charitable Corporations
- **Problem:** When charitable corporations fail to comply with the Attorney General (AG) annual filing requirements, the Franchise Tax Board (FTB) is required to assess the minimum franchise tax for all years the corporation failed to file with the AG, which often leads to large tax bills that a charitable corporation is unable to address.
- **Proposed Solution/Justification:** Amend current law to no longer require the FTB to assess a minimum franchise tax on all charitable corporations that fail to meet their filing requirements with the AG. Instead, this proposal would allow the FTB to provide notice to the charitable corporation that it has fallen out of compliance with the AG. The notification would specify that if the AG filing requirements are not met within a 120-day deadline, the charitable corporation would have its charitable status revoked and the minimum franchise tax would be assessed for each year after the exempt status was revoked. This proposal would also allow the minimum franchise tax to be abated if the charitable corporation came back into compliance after the 120-day deadline under current revocation laws.
- **Major Concerns/Issues:** None.
- **Revenue:** There would be no revenue impact as a result of this proposal.

Title

Relief from the Imposition of the Minimum Franchise Tax on Charitable Corporations

Introduction

This proposal would eliminate the requirement that the Franchise Tax Board (FTB) assess the minimum or measured franchise tax on charitable corporations that fall out of compliance with the California Attorney General's (AG's) registry of charitable trusts filing requirements.

Current State Law

Under existing state law, unless specifically exempted by statute, every corporation organized, qualified to do business, or doing business in this state, whether organized in-state or out-of-state, is subject to a minimum franchise tax of \$800. Corporate taxpayers must pay the minimum franchise tax only if it is more than their measured franchise tax. In general, only taxpayers subject to Corporation Tax Law with net income less than approximately \$9,040 pay the minimum franchise tax because the amount of "measured" tax owed would be less than \$800 ($\$9,039 \times 8.84\% = \799).

Current law allows charitable organizations that have had their exempt status revoked to be reinstated after the filing requirements have been fulfilled. The tax that was assessed due to the revocation may be abated. This abatement is generally allowed when the revocation was due to one of the following:

- Failure to file a return,
- Failure to comply with the FTB's rights to examine records and subpoena witnesses, or
- Failure to confine its activities to those permitted by its exempt status.

Under current law, the FTB lacks the authority to abate the minimum or measured franchise tax for any year or years that the exemption was disallowed for the charitable corporation due to failing to comply with the AG's filing requirements.

Current state law relating to charitable corporations requires¹ that upon written notification from the AG when a charitable organization has not complied with the AG's Registry of Charitable Trusts filing requirements, the FTB shall disallow the organization's tax exemption for the years covered in the letter from the AG. After the disallowance of the tax exempt status occurs, the minimum franchise tax must be assessed on the entity as if it were a nonexempt corporation. In order for the tax exemption to be reinstated, the organization must comply with its filing requirement with the AG and pay all the minimum tax that resulted from this disallowance.

¹ California Revenue and Taxation Code (R&TC) section 23703.

Program History/Background

When certain charitable corporations are deemed to be out of compliance with the AG in any of its filing requirements, the AG notifies the FTB of the noncompliance, and current state law requires the FTB to assess the \$800 minimum franchise tax on the charitable corporation for each year the entity is out of compliance. Frequently, the letter the FTB receives from the AG's office covers multiple tax years, resulting in the charitable corporation incurring several thousand dollars in minimum franchise tax.

Problem

When charitable corporations fail to comply with the AG annual filing requirements, the FTB is required to assess the minimum franchise tax for all years the corporation failed to file with the AG, which often leads to large tax bills that a charitable corporation is unable to address.

Proposed Solution

Amend current law to no longer require the FTB to assess a minimum franchise tax on all charitable corporations that fail to meet their filing requirements with the AG. Instead, this proposal would allow the FTB to provide notice to the charitable corporation that it has fallen out of compliance with the AG. The notification would specify that if the AG filing requirements are not met within a 120-day deadline, the charitable corporation would have its charitable status revoked and the minimum franchise tax would be assessed for each year after the exempt status was revoked.

This proposal would also allow the minimum franchise tax to be abated if the charitable corporation came back into compliance after they had been revoked under current revocation laws.

Effective/Operative Date of Solution

If enacted in the 2012 legislative session, this proposal would apply to notices of noncompliance received from the AG before, on, or after January 1, 2013.

Justification

This proposal would provide an administrative remedy for charitable corporations that come into compliance with the AG filing requirements, sparing them from receiving large tax bills that they are typically unable to pay. Under current law, the entities cannot be in compliance until they have paid all tax assessed.

Implementation

This proposal could be implemented with minimal impact to the department's operations.

Fiscal Impact

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

Economic Impact

Many of the charitable corporations that fall out of compliance with the AG are small charities that are unaware of the filing requirements. These small charitable corporations lack the resources to pay large assessments and in the past, the FTB has abated the assessed minimum tax once these corporations come into compliance. Because the assessments are uncollected, there would be no revenue impact as a result of this proposal.

Other States

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.

Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York rely on the federal exempt status for purposes of determining whether or not a charitable corporation is required to file a return, including an initial information return. No provisions comparable to California's provision providing for revocation of a charitable corporation's state-level exempt status were identified.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS FOR LP D

AMENDMENT 1

SECTION 1. Section 23703 of the Revenue and Taxation Code is repealed.

~~**23703.** (a) No exemption shall be allowed under this article to any charitable corporation as defined in Sections 12582.1 and 12583 of the Government Code for any year or years for which it fails to file with the Attorney General, on or before the due date, any registration or periodic report required by Article 7 (commencing with Section 12580) of Chapter 6, Part 2, Division 3, Title 2, of the Government Code.~~

~~— (b) The exemption shall be disallowed under this section only after the Attorney General has notified the Franchise Tax Board in writing that a charitable corporation subject to the provisions of subdivision (a) has failed to file any such registration or periodic report on or before the due date thereof.~~

~~— (c) If an exemption is disallowed under this section, such exemption may be reinstated when the registration or periodic reports are filed; however, any such charitable corporation shall pay the minimum tax provided for by Section 23153 for any year or years for which its exemption was disallowed under this section.~~

~~— (d) No exemption shall be disallowed under this section for taxable years commencing before January 1, 1962.~~

~~— (e) The Franchise Tax Board may make any regulations which it deems necessary to effectuate the purposes of this section.~~

SEC. 2. Section 23703 is added to the Revenue and Taxation, to read:

23703. (a)(1) The exemption granted to a charitable corporation under the provisions of Article 1 (commencing with Section 23701) of this chapter shall be revoked by the Franchise Tax Board in accordance with this section if the charitable corporation fails to file with the Attorney General any registration or periodic report required by Article 7 (commencing with Section 12580) of Chapter 6, Part 2, Division 3, Title 2, of the Government Code.

(2) A revocation shall occur under this section only after the Attorney General has first notified the Franchise Tax Board in writing that a charitable corporation has failed to file any registration or periodic report on or before the due date thereof and the Franchise Tax Board has mailed a notice to the charitable corporation stating that the Franchise Tax Board intends to revoke the exemption if the charitable corporation does not file with the Attorney General all past due and currently due documents required by Article 7 (commencing with Section 12580) of Chapter 6, Part 2, Division 3, Title 2, of the Government Code.

(3) The Attorney General shall provide prompt notification to the Franchise Tax Board and the charitable corporation that the charitable corporation has filed all past due and currently due documents required by Article 7 (commencing with Section 12580) of Chapter 6, Part 2, Division 3, Title 2, of the Government Code.

(b) For purposes of this section, "charitable corporation" means a corporation defined in Section 12582.1 of the Government Code that is required to comply with the filing requirements set forth in Article 7 (commencing with Section 12580) of Chapter 6, Part 2, Division 3, Title 2, of the Government Code.

(c)(1) Failure to obtain notification from the Attorney General that the charitable corporation has complied with the filing requirement described in subdivision (a) by the last day of the applicable period shall result in the revocation of the charitable corporation's exempt status pursuant to Section 23777 as of the first day after the applicable period.

(2) For purposes of this subdivision, the applicable period means:

(A) For notifications of noncompliance from the Attorney General that are received by the Franchise Tax Board before the effective date of the act adding this section, the applicable period shall be 120 days after the effective date of the act adding this section.

(B) For notifications of noncompliance from the Attorney General that are received by the Franchise Tax Board on or after the effective date of the act adding this section, the applicable period shall be 120 days after the Franchise Tax Board mails notification of the intent to revoke.

(d) For taxpayers whose exempt status had been revoked prior to the effective date of the act adding this section pursuant to former Section 23703, the Franchise Tax Board may reestablish a charitable corporation's exempt status under Section 23778, after receipt of notification of noncompliance from the Attorney General that the filing requirements set forth in Article 7 (commencing with Section 12580) of Chapter 6, Part 2, Division 3, Title 2, of the Government Code, have been fulfilled.

(e) This section shall apply with respect to notifications of noncompliance received from the Attorney General, on or after the effective date of the act adding this section.

AMENDMENT 2

SEC. 3. Section 23778 of the Revenue and Taxation Code is amended to read:

23778. An organization whose exemption was revoked under Sections 23703 or 23777 may be reestablished as an exempt organization upon:

(a) The filing or payment of:

(1) A new application for exemption and payment of the filing fee required under Section 23701; and

(2) Any returns, statements, or payment of any amounts due under this part or Part 10.2 (commencing with Section 18401) which were not previously submitted or paid and which resulted in the revocation.

(b) When revocation occurred under subdivision (c) of Section 23777, satisfactory proof that--

(1) The organization has corrected its nonexempt activities; and

(2) That it will operate in an exempt manner in the future; and

(3) The payment of any tax for periods the organization was not qualified for exemption.

SEC. 4. The Legislature finds and declares that the abatement of the minimum franchise tax and related penalties, and interest for charitable corporations by this act with respect to previous taxable years serves a public purpose of encouraging charitable corporations to come into compliance with exempt filing requirements so that all Californians can continue to support and donate to much needed nonprofits.