

LAW SUMMARY - INTEREST ABATEMENT MINISTERIAL OR MANAGERIAL ACT

Taxes are due and payable as of the original due date of the taxpayer's return (without regard to extension). If the tax is not paid by the original due date, or if the Franchise Tax Board (FTB) assesses additional tax and that assessment becomes due and payable, the law provides for the charging of interest on the resulting balance due, compounded daily. (Revenue and Taxation Code section 19101.)

The State Board of Equalization (SBE) has determined that FTB's imposition of interest is mandatory, and FTB is not allowed to abate interest except where authorized by law. (*Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977.) Interest is not a penalty imposed on the taxpayer, and there is no reasonable cause exception to the imposition of interest. It is simply compensation for the use of money. (*Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.)

The Revenue and Taxation Code provides for certain situations where the FTB may exercise its discretion to abate interest for errors or delays in the performance of ministerial or managerial acts by an FTB or IRS employee or officer. (Revenue and Taxation Code section 19104(a).)

1. Ministerial Act

Revenue and Taxation Code section 19104(a)(1) and (2) state that the FTB may waive all or part of interest charged to the extent that any deficiency or any delay in payment is attributable to an unreasonable delay or error on the part of an FTB officer or employee in performing a ministerial act.

There are three requirements that a taxpayer must meet in order for the FTB to be able to abate interest under this provision.

First, the taxpayer must show that there was an error or delay in the performance of a ministerial act by the FTB. (Revenue and Taxation Code section 19104(a)(1) and (2).)

A "ministerial act" is a procedural or mechanical act that does not involve the exercise of judgment or discretion, and that occurs during the processing of a taxpayer's case after all prerequisites to the act, such as conferences and review by supervisors, have taken place. A decision concerning the proper application of federal tax law (or other federal or state law) is not a ministerial act. (Treas. Reg. section 301.6404-2(b)(2).)

The examination or auditing of a return and the determination of a deficiency are not ministerial acts. Determining facts and applying the law in the course of the examination of a return is a discretionary act and not a ministerial act. (*Appeal of Michael and Sonia Kishner*, 99-SBE-007, September 29, 1999.) The decision on how to prioritize the processing of returns based on the expiration of the statute of limitations is a general administrative decision. Interest attributable to such decisions cannot be abated under the ministerial act interest abatement provision. (Treas. Reg. section 301.6404-2(c), example 8.)

The second requirement is that the error or delay must have occurred after the FTB has contacted the taxpayer in writing about the deficiency or payment. (Revenue and Taxation Code section 19104(b)(1).)

The third requirement is that an error or delay shall be taken into account only if no significant aspect of that error or delay can be attributed to the taxpayer involved. (Revenue and Taxation Code section 19104(b)(1).)

Waiver of interest pursuant to this statute is subject to FTB's discretion. If FTB determines that interest should be waived, FTB may not waive any of the interest which may have accrued before September 25, 1987.

2. Managerial Act

Under Revenue and Taxation Code section 19104(a)(1) and (2), the FTB may waive all or part of interest charged to the extent that any deficiency or any delay in payment is attributable to an unreasonable delay or error on the part of an FTB officer or employee in performing a managerial act.

There are three requirements which a taxpayer must meet in order for the FTB to be able to abate interest under this provision.

First, the taxpayer must show that there was an error or delay in the performance of a managerial act by the FTB. (Revenue and Taxation Code section 19104(a)(1) and (2).)

A "managerial act" is an administrative act that occurs during the processing of a taxpayer's case which involves the temporary or permanent loss of records. A managerial act is also the exercise of judgment or discretion relating to management of personnel. A decision concerning the proper application of state (or federal) law is not a managerial act. Also, a general administrative decision such as the decision on how to organize the processing of tax returns or a delay in

implementing a new computer system is not a managerial act. (Treas. Reg. section 301.6404-2(b)(1).)

The second requirement is that the error or delay must have occurred after the FTB has contacted the taxpayer in writing about the deficiency or payment. (Revenue and Taxation Code section 19104(b)(1).)

The third requirement is that an error or delay shall be taken into account only if no significant aspect of that error or delay can be attributed to the taxpayer involved. (Revenue and Taxation Code section 19104(b)(1).)

Waiver of interest pursuant to this statute is subject to FTB's discretion. The provisions regarding waiver of interest based on a managerial act are operative for taxable or income years beginning on or after January 1, 1998.

3. Delays due to workload constraints are not a basis for abating interest.

According to the examples in the relevant federal Treasury Regulations, delays due to prioritizing and organizing workloads are not acts for which interest may be abated under Internal Revenue Code section 6404. (See Treas. Reg. section 301.6404-2(c), Example 8.) California's interest abatement statute (section 19104) is substantially similar to the federal interest abatement statute (Internal Revenue Code section 6404). Thus, the interpretation and effect given to federal interest abatement law applies to California's interest abatement provisions.

Also, Federal case law holds that workload constraints are not a basis for an abatement of interest. In *Leffert v. Commissioner* (2001) T.C. Memo 2001-23 and *Strang v. Commissioner* (2001) T.C. Memo 2001-104, the Tax Court determined that delays by the IRS's revenue agents due to an evaluation of "caseload" and workload priorities do not constitute a delay for purposes of abating interest under Internal Revenue Code section 6404. In addition, the Court held that the decision to order work based on caseload priorities was not a ministerial act as that term is defined in section 6404.

4. FTB is only permitted to abate interest after first written contact regarding the notice of the deficiency or payment.

The court in *Hugh D. and Nancy L. Sims v. Commissioner*, T.C. Memo. 1999-414, held that the IRS' decision to audit and the timing thereof cannot be attacked using the interest abatement statute because it applies only after the IRS has contacted the taxpayer in writing about the deficiency or payment of tax. (See also *Krugman v. Commissioner*, 112 T.C. 230, 239 (1999).) The court concluded that the interest abatement statute does not permit the abatement of

interest for the period of time between the date the taxpayer files a return and the date the IRS commences an audit, regardless of the length of that time period. (Citing to H. Rept. 99-426, at 844 (1985), 1986-3 C.B. (Vol. 2) 1, 844; S. Rept. 99-313, at 208 (1986), 1986-3 C.B. (Vol. 3) 1, 208.)

Similarly, the interest abatement statute, Revenue and Taxation Code section 19104(b)(1), does not permit the abatement of interest for the period of time between the date the taxpayer files a return and the date FTB commences an audit.

5. Generally, the timeliness of a Notice of Proposed Assessment which is issued within the statute of limitations, does not give rise to interest abatement.

In *Charles A. Nerad v. Commissioner*, T.C. Memo. 1999-376, the taxpayer argued that the IRS failed to promptly examine his return and notify him accordingly. The court held that it is not at liberty to modify a period of time prescribed by a statute of limitations in which the Commissioner is authorized to act. (See *Foster v. Commissioner* [Dec. 39,817], 80 T.C. 34, 229 (1983), *affd.* in part and vacated in part on another issue [85-1 USTC ¶9300] 756 F.2d 1430 (9th Cir. 1985); *Saigh v. Commissioner* [Dec. 24,857], 36 T.C. 395, 424-425 (1961).) Further, the court held that the statute of limitations expressly defines the period that the IRS was authorized to assess deficiencies against taxpayers. As such, the timeliness of the IRS's examination and subsequent notice of the deficiency within the time period provided for in the statute of limitations was held not be an error or delay for purposes of the interest abatement statute.

Similarly, the timeliness of FTB's examination and issuance of the Notice of Proposed Assessment (NPA) prior to the expiration of the statute of limitations does not constitute an error or delay for purposes of the interest abatement statute. The general statute of limitations (Revenue and Taxation Code section 19057), allows FTB four years from the date the tax return was filed to issue the NPA.

6. Federal Abatement of Interest

Revenue and Taxation Code section 19104(a)(3) provides that where the Internal Revenue Service has abated interest under Internal Revenue Code section 6404(e) based on an error or delay which occurred on or before the issuance of a final federal determination, the FTB may also abate interest accruing on a related deficiency based on a final federal determination of tax, for the same period of time that the Internal Revenue Service abated interest. This provision applies to only interest accrued after September 25, 1987. The managerial act provision is applicable to a taxable or income year beginning on or after January 1, 1998, for which the FTB may propose an assessment or allow a claim for refund.

7. State Board of Equalization Jurisdiction of Interest Abatement Requests: Unpaid Interest

In the case of unpaid interest, where the taxpayer has received a Notice of Proposed Assessment (NPA), if the taxpayer protests the NPA, and the taxpayer intends to request an abatement of interest, the request to abate interest must accompany the protest or a subsequent appeal from the FTB's Notice of Action on the protest. If the request for abatement of interest is not made at the time of protest or appeal, the FTB may not then consider the request, and the State Board of Equalization would not have jurisdiction to consider a later appeal of interest which accrued prior to the time the deficiency is final. However, the taxpayer may thereafter request an abatement of interest which accrued after the deficiency is final. (Revenue and Taxation Code section 19104(b)(4).)

If the taxpayer wishes to request an abatement of unpaid interest unrelated to an NPA, the taxpayer should file a request for abatement of interest on a FTB Form 3701.

If the FTB denies the taxpayer's request for an abatement of interest, the taxpayer will receive a Notice of Determination Not to Abate Interest explaining rights of appeal to the State Board of Equalization.

If the taxpayer intends to file an appeal from the FTB's Notice of Determination Not to Abate Interest, the appeal must be filed within thirty (30) days of the date of mailing of the Notice of Determination. (Revenue and Taxation Code section 19104(b)(2)(A)(i).)

8. State Board of Equalization Jurisdiction of Interest Abatement Requests: Paid Interest

If the taxpayer wishes to request an abatement of paid interest, the taxpayer should file a request for abatement of interest on a FTB Form 3701.

If the FTB denies the taxpayer's request for an abatement of interest, the taxpayer will receive notice of our action/determination explaining rights of appeal to the State Board of Equalization.

If the taxpayer intends to file an appeal from the FTB's notice of action denying interest abatement, the appeal must be filed within ninety (90) days of the date of mailing of the notice of action/determination. (Revenue and Taxation Code section 19104(b)(2)(A)(ii).)

9. Where the FTB Fails to Mail a Notice of Determination on a Request for Abatement of Interest

If the FTB fails to mail a Notice of Determination to the taxpayer within six months of the filing of the taxpayer's request for abatement of interest, the taxpayer may consider the request to be denied and file an appeal with the State Board of Equalization. This provision does not apply to interest abatement requests which are made with protests of NPAs. (Revenue and Taxation Code section 19104(b)(3).)