

Author: Calderon Analyst: Jessica Deitchman Bill Number: AB 449  
Related Bills: See Prior Telephone: 845-6310 Amended Date May 1, 2017  
Analysis Attorney: Bruce Langston Sponsor: \_\_\_\_\_

**SUBJECT:** Modify Notice and Demand Penalty/Abatement of Notice and Demand Penalty

## **SUMMARY**

This bill would modify the penalty for failure or refusal to file a return or furnish information requested in writing after notice and demand and create a new abatement program for this penalty.

## **RECOMMENDATION – NO POSITION**

## **SUMMARY OF AMENDMENTS**

The May 1, 2017, amendments added language that would create a new abatement program for the notice and demand penalty. As a result of these amendments, an additional implementation consideration has been identified. Except for the “This Bill,” “Effective/Operative Date,” “Implementation Considerations,” and “Economic Impact” sections, the remainder of the department's analysis of the bill as introduced February 13, 2017, still applies. The “Fiscal Impact” section has been restated below for convenience.

## **EFFECTIVE/OPERATIVE DATE**

This bill would be effective and operative for taxable years beginning on or after January 1, 2018.

## **THIS BILL**

This bill would, for taxable years beginning on or after January 1, 2018, reduce the notice and demand penalty from 25 to 15 percent and modify the penalty calculation by replacing “tax determined pursuant to Section 19087” (meaning, the estimated tax due as based upon available information) with “the amount of the total unpaid tax” as a basis for the calculation.

Additionally, this bill would require the Franchise Tax Board (FTB), upon taxpayer request, to abate the notice and demand penalty when all of the following apply:

- A penalty under this section has not been imposed on the taxpayer by the FTB in the calendar year of the request for abatement or in the immediately preceding four taxable years.
- The taxpayer has filed the information or return as of the date of the taxpayer's request for abatement under this paragraph.
- The taxpayer has paid in full the tax that is due as of the date of the taxpayer's request for abatement.

## **IMPLEMENTATION CONSIDERATIONS**

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

The bill states that the penalty would be based on the amount of "unpaid tax" or the deficiency amount. However, the bill fails to define what "unpaid tax" means. The absence of definitions to clarify this phrase could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, the bill should be amended.

This bill uses phrases that are undefined, i.e., "date and time the notice and demand is issued" "paid in full the tax that is due." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this bill. The author may wish to amend the bill to clearly define the terms.

The bill would require a taxpayer to have paid in full the "tax that is due." Because the bill fails to specify otherwise, all tax due from any taxable year would be required to be paid for an abatement to be considered, and those taxpayers that have entered into payment agreements would be ineligible for abatement consideration. If this is contrary to the author's intent, the bill should be amended.

Implementing this bill would require changes to the department's accounting system, and the development of procedures, training materials, and other internal and external documents for noticing and tracking of requested relief and the outcome of each request.

## **TECHNICAL CONSIDERATIONS**

Penalties are issued when taxpayers fail to respond to the FTB. For clarity, it is recommended that bill be amended to specify that the change to the notice and demand penalty would be for penalties issued by the FTB on or after January 1, 2018, without regard to the taxable year.

## **FISCAL IMPACT**

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

## ECONOMIC IMPACT

### Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 449 As Amended May 1, 2017 Assumed Enactment After June 30, 2017 (\$ in Millions)		
2017-18	2018-19	2019-20
- \$0	- \$0	- \$8.3
*It is estimated that the revenue loss would reach \$23 million in 2020-21, \$36 million in 2021-22, and would continue to grow reaching approximately \$80 million in 2035-36.		

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

### Revenue Discussion

For taxable years beginning on or after January 1, 2018, penalties issued were estimated and recalculated at the proposed 15 percent rate on an estimated revised tax basis of \$600 million, resulting in an estimated revenue loss of \$75 million from the decrease in the penalty percentage and the change in the penalty basis. It is assumed the “total unpaid tax” as specified in the bill language, used as the basis to calculate the failure to file a return upon notice and demand penalty would be reduced by timely payments. It is also assumed this would reduce the tax basis used to calculate the penalty by 20 percent. The estimate assumes the first time the modified penalty would be issued for taxable year 2018 would be in 2020. It is further estimated that 60 percent, or \$45 million in penalties would be issued in 2020, 20 percent, or \$15 million would be issued in 2021, and the remaining 20 percent would be issued over the next several years. That same distribution is assumed for each taxable year thereafter resulting in a loss of \$63 million in penalties issued in 2021, and \$67 million in penalties issued in 2022. It is estimated that \$8 million of the total penalty assessments in 2020 would be paid upon notification and \$38 million would be referred to FTB collections. It is assumed that 50 percent of penalties would be collected within the first 3 years of assessment. This results in a revenue loss of \$14 million in 2020, \$9 million from the reduction in penalty rates and change in penalty basis and approximately \$5 million from taxpayer compliance.

Using FTB data for taxable year 2014 for taxpayers who have not had the failure to file a return upon notice and demand penalties issued in the preceding four taxable years, penalties were recalculated using the 15 percent rate on the modified basis resulting in an estimated \$4 million in penalties issued. These amounts were adjusted for changes in the economy over time, resulting in an estimated \$4.3 million in penalties issued for taxable year 2018. Of these amounts, it is estimated that approximately 25 percent, or \$1 million, would qualify for penalty relief, as proposed in this bill, and would request abatement in tax year 2020. With each year the program is in place, the amount of qualifying penalties would decrease. Of these amounts, it is estimated that 30 percent would have been collected in the year assessed, 15 percent one

year after assessed, and would continue to decline each year thereafter. This results in an estimated revenue loss of \$300,000 in 2020, and \$460,000 in 2021.

The tax year estimates are converted to fiscal year estimates, and then rounded to arrive at the estimates shown in the above table.

### **SUPPORT/OPPOSITION<sup>1</sup>**

Support: California Chamber of Commerce, California Society of Enrolled Agents, California Taxpayers Association.

Opposition: None provided.

### **LEGISLATIVE STAFF CONTACT**

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<sup>1</sup> As provided in the Assembly Revenue and Taxation Committee analysis dated April 24, 2017.