State of California
Franchise Tax Board

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TECHNICAL ADVICE MEMORANDUM 2008-1

Requested by: Peggy Willis, Filing Methods Section
Requested Date: 09/16/2008
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Subject: Return Filing Thresholds and Computed Tax

QUESTION PRESENTED

Must a taxpayer file a tax return and pay tax if the taxpayer's gross income and adjusted gross income are both below the filing threshold amounts provided in Revenue and Taxation Code (RTC) section 18501, but a computed tax is due under the tax rate tables or other code section?

CONCLUSIONS

Yes. RTC section 18501 establishes thresholds which require an individual taxpayer to file a return. It does not state that an individual taxpayer does not have to file a return if the taxpayer's gross income or adjusted gross income is below those thresholds. If a tax would be due under the tax rates or brackets set forth in RTC section 17041 based on the filing status used by the taxpayer, or under other code sections, a tax is due under the law and must be shown on a tax return under RTC section 18407.

ANALYSIS AND DISCUSSION

RTC section 18501 requires every individual to "make a return to the Franchise Tax Board, stating specifically the items of the individual's income from all sources and the deductions and credits allowable" if the individual has gross income or adjusted gross income in excess of specified amounts. These amounts are indexed annually for inflation. Different amounts are specified for the taxpayer "if single" and "if married." These filing thresholds are set at levels where tax at the computed tax rate less exemption credits would usually result in no tax liability. (See AB 1140, Stats. 1999, Ch. 196, and FTB Legislative Proposal 99-30, for an analysis of the effect of exemption credits on filing requirements.) The threshold amounts for married taxpayers correctly compute the threshold for married filing joint taxpayers and for married filing separate taxpayers in the usual situation where all of the income of a married filing separate taxpayer is community property income, taxable one-half to each

spouse. This assumption is not always correct. However, the statute only specifies the circumstance when a return *must* be filed, and does *not* state that a return *need not* be filed if income is below the threshold amounts.

RTC section 18521 requires a taxpayer to use the same filing status that he or she used on his or her federal tax return for the taxable year, with certain limited exceptions, including where FTB determines that the federal filing status was "incorrect."

RTC section 17041 imposes a tax on the entire taxable income of every resident and nonresident individual at specified rates, indexed annually for inflation.

RTC section 18407 incorporates Internal Revenue Code (IRC) section 6011, except as otherwise provided. IRC section 6011(a) requires a return to be filed when required by federal regulations. Federal Regulations require returns generally where any federal tax is due. Subdivision (a) of section 18407 modifies the language of IRC sec. 6011(a) to read: "every person liable for a tax imposed by [the California RTC] shall make a return or statement according to forms and regulations by the Franchise Tax Board."

RTC section 19307 provides that no refund of withholding or estimated tax shall be allowed to a taxpayer who fails to file a return for the taxable year of the withholding or estimated tax payment.   Even if a taxpayer is not otherwise required to file a return and has no tax liability, a return must be filed to claim a refund of withholding or estimated tax paid or credited to the year.

In *Ordlock v. Franchise Tax Board* (2006) 38 Cal. 4th 897, 906-909, the California Supreme Court held that principles of statutory construction require conflicting statutes to be harmonized by considering a particular clause or section in "the context of the … statutory scheme of which it is a part." (*Ordlock* at 909).

ANALYSIS AND DISCUSSION

The problem presented is that, in some situations, for married and Registered Domestic Partner (RDP) taxpayers using the married filing separately filing status, the taxpayer will have gross income and AGI below the RTC section 18501 thresholds that require a return to be filed, but will still owe a significant tax on California taxable income under RTC section 17041. This will happen when one spouse/RDP has primarily non-community property separate income and the other spouse/RDP has little or no taxable income.

Additionally, there are other situations, such the 2.5% tax on early distributions from a retirement plan, where FTB forms and instructions currently require that a return be filed, even though the filing thresholds are not met.

Taxpayers argue that because they are not required to file a return under the provisions of RTC section 18501, they owe no California tax for the year.

This is incorrect. RTC section 18501 is but one of several provisions that set forth criteria that give rise to a filing requirement. That section sets forth minimum thresholds above which a return must be filed. It does not establish standards for when a return does not

need to be filed. Other sections use different criteria to establish the presence of a filing requirement. These various sections operate independently of one another and the fact that the criteria of any one section has not been satisfied does not mean that the separately stated criteria in other provisions do not apply. Any other reading of the statute would render RTC section 18407 meaningless, violating a basic rule of statutory construction.

In *Ordlock v. Franchise Tax Board*, the California Supreme Court considered an alleged statutory conflict between various statute of limitation provisions. The Court held that under a strict reading of the statutes involved, the specific provisions extending the statute of limitations following federal determinations prevailed over the general statute of limitations statute. The same rule applies here. Although the general rule set forth in RTC section 18501, the filing requirement statute, is that taxpayers must file a return when gross or adjusted gross income is above certain levels, and arguably therefore are not required to file a return by RTC section 18501, specific exceptions to this rule apply when taxpayers have additional tax due from various other provisions of the code, notably additional tax from certain distributions from retirement accounts.

This same consideration applies to married/RDP taxpayers who do not elect the married filing joint filing status but instead file separately. If they file separate federal returns, they are normally required to file separate state returns as well (with exceptions for same-sex married/RDP couples that are not allowed to file joint federal tax returns). This being the case, some married taxpayers filing separately for federal purposes will fall under the "married" filing threshold amounts of RTC section 18501 for California purposes, but still owe a computed tax under the tax rates and tables under RTC section 17041.

These statutes can be reconciled, to the extent necessary, under the principles set forth in *Ordlock*. RTC section 18501 establishes when a return is always required – when income is above the thresholds. RTC sections 17041 and 18407 both list situations where a return is also required because a computed tax exists, even though the general requirements of RTC section 18501 are not met.

Therefore, every individual taxpayer who has gross income or adjusted gross income in excess of the amounts set forth in RTC section 18501 must file a California return. In addition, individual taxpayers who have gross income or adjusted gross income below those amounts, but nevertheless have a tax liability, either due to filing separately with separate income or from one of the other provisions of the code that impose a tax liability, must also file a return and pay California tax.

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