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Tax Amnesty Implementation Falters – FTB Declines to Adopt a Definition of “Due and Payable”

SACRAMENTO -- After a lengthy discussion about tax amnesty, the three-member Franchise Tax Board on September 7 declined to adopt an existing statutory definition of “due and payable” for determining when the amnesty program’s 50 percent interest penalty applies.

“The Tax Amnesty Business Coalition is very disappointed with the lack of action by the Franchise Tax Board. It is the board’s responsibility to provide clarification for implementing existing law. Unfortunately, the ambiguity of the appropriate definition of ‘due and payable’ will now need to be resolved through litigation,” said Larry McCarthy, president of the California Taxpayers’ Association (Cal-Tax).

Attorney Jeff Vesley, with Pillsbury Winthrop, told the board that the amnesty statute uses the term “due and payable” to establish when the 50 percent amnesty interest applies, but does not define the term. He said the tax agency has the authority by regulation to define the term and the definition in the Revenue and Taxation Code (Section 19049) is the most common usage of the term. He pointed out FTB staff uses the definition in a handbook to explain the due process rights of taxpayers.

FTB staff opposed the proposal, saying it didn’t comport with what they believed to be legislative intent of last year’s bill that authorized the program allowing taxpayers to submit applications last February and March. Steven Yin, director of domestic income tax for Hewlett-Packard, refuted this interpretation of legislative intent, noting that the bill analysis said nothing about the \$3.5 billion in protective claims that were filed. If the Legislature had intended the staff interpretation, the additional revenue generated would have been expected, he said.

Cal-Tax’s McCarthy, testifying before the board, said the deeply flawed and badly drafted program is now hurting the state’s economy. Legitimate taxpayers are caught in a trap, he said, and this reinforces the perception that California is a risky state in which to do business.

Intel Tax Affairs Director Ray Rossi said corporations were required to predict the unknowable in complying with amnesty and the FTB should do as much as administratively possible to fix the problem. Others supporting board action to define “due and payable” were Gina Rodriguez of Spidell Publishing; Matt Sutton, representing

the California Manufacturers and Technology Association, and Katherine Hatch, representing the American Electronics Association.

FTB Member Tom Campbell, the state's finance director, said adopting the due and payable definition in Section 19049 would be a "good start" and urged the board to do so. He said that if the FTB adopts the definition, the Legislature can change it if they don't like it. On the other side of the issue, Controller Steve Westly, the FTB chair, said the board should not adopt the due and payable definition. He said FTB staff's view appears to be the intent of legislative leadership. Initially, Controller Westly moved to deny the request and it appeared his motion was going to pass, with the third member, State Board of Equalization Chair John Chiang, indicating he was in agreement. However, the FTB staff said no vote was required as inaction would be deemed the same as a negative vote.

At one point, Mr. Chiang asked FTB staff to state legislative authority for how they were interpreting the law. When a direct answer was not forthcoming, he said he was not satisfied with the response.

The impact of using the statutory definition of due and payable: Due and payable is not defined in the tax amnesty provisions; however, it is defined statutorily in three different sections. The definition most widely used states that a tax becomes due and payable 15 days after the taxpayer is given notice of the final assessment.

Several administrative actions were taken to address some of the unintended consequences of amnesty. FTB staffer Debbie Lansea told the board that the protest process for protective claims appeals will be shortened from 33 months to 24 months. Mr. Westly said he wanted the time cut even further to 18 to 20 months if possible. The audit period will also be shortened from two years to one year.

The board voted unanimously to recommend several additional legislative proposals to change the amnesty program to address the unintended consequences problems. The proposed legislation will equalize interest paid on both over- and under-assessments for taxpayers with protective claims. Mr. Westly said this was only fair.

Proposed legislation will also authorize the FTB chief counsel to provide amnesty interest penalty relief, under very limited circumstances. Another proposal will exempt from the amnesty interest penalty any deficiencies created by post-amnesty court decisions or regulatory changes. Also, the board will ask the Legislature to change the amnesty interest penalty, to just interest, to allow taxpayers to deduct the amount from federal income taxes. Staff said the IRS might not allow the deduction even if it is renamed interest.

FTB staff was also asked by the board to draft two proposals for further discussion, with no commitment to sponsor the bills in the next legislative session.

One would eliminate the 50 percent amnesty penalty for taxpayers under audit, protest, appeal, settlement negotiation or litigation at the start of amnesty. The other would eliminate the 50 percent amnesty penalty for taxpayers with less than \$100,000 of adjusted gross income. Mr. Campbell said he could see no rationale for the second proposal.