STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date Amended:	**04/09/08**	Bill No:	**AB 2047**
Tax:	**Sales and Use** **Special Taxes and Fees**	Author:	**Horton**
Related Bills:		Position:	**Support as Sponsor**

BILL SUMMARY

This Board-sponsored bill would allow the Board to compromise certain final tax, fee or surcharge (tax) liabilities of (1) businesses that are not discontinued or transferred if the final tax liability arises from transactions in which the taxpayer did not receive sales tax reimbursement or use tax, (2) persons liable as successors, and (3) consumers who incurred a use tax liability.

Summary of Amendments

The amendments to this bill since the previous analysis make clarifying, technical changes specifying that *if the Board finds* no evidence that the tax or fee was collected by the taxpayer, and the other conditions for a compromise exist, then the provisions would apply.

CURRENT LAW

Under the existing Sales and Use Tax Law, Use Fuel Tax Law, Cigarette and Tobacco Products Tax Law, Alcoholic Beverage Tax Law, Emergency Telephone Users Surcharge Act, Oil Spill Response, Prevention, and Administration Fees Law, Underground Storage Tank Maintenance Fee Law, Fee Collection Procedures Law, and Diesel Fuel Tax Law, the Board is allowed to compromise a final tax liability if certain requirements are met.

Under these laws, one of the requirements to compromise a final tax liability is that an offer can only be considered with respect to liabilities that were generated from a business that has been discontinued or transferred, where the taxpayer making the offer no longer has a controlling interest in or association with the transferred business or a controlling interest in or association with a similar type of business as the transferred or discontinued business. Therefore, under existing law, unless the business is discontinued or transferred, the Board may not accept an offer to compromise a tax debt from taxpayers.

Under existing law, when a final tax liability is not paid when due, the Board bills the taxpayer or feepayer (taxpayer), negotiates for payments, searches for the taxpayer's assets, and takes collection actions to gain access to assets to satisfy the debt. Collection actions may include manually searching records for assets, making telephone calls, or seizing and selling such assets as vehicles, vessels, or stocks. In the event of a hardship, existing law allows installment payment arrangements or deferred collection until the financial situation of the tax debtor improves. However, if taxpayers can obtain loans or can use credit lines to pay their tax debts, they are expected to do so.

If a debt remains unpaid for a number of years and a lien has been filed but assets cannot be located, the Board may write off the debt. When a debt is written off, it is

still due and owing and any liens recorded are still valid, but routine billing and collection actions are discontinued unless assets are subsequently located. The debt also remains on the taxpayer's credit record, impeding his or her ability to obtain credit.

PROPOSED LAW

This bill would amend Sections 7093.6 (Sales and Use Tax Law), 9278 (Use Fuel Tax Law), 30459.15 (Cigarette and Tobacco Products Tax Law), 32471.5 (Alcoholic Beverage Tax Law), 41171.5 (Emergency Telephone Users Surcharge), 46628 (Oil Spill Response, Prevention, and Administration Fees Law), 50156.18 (Underground Storage Tank Maintenance Fee Law), 55332.5 (Fee Collection Procedures Law), and 60637 (Diesel Fuel Tax Law) of the Revenue and Taxation Code to do the following:

1) Allow a qualified final tax liability to be compromised regardless of whether the business has been discontinued or transferred or whether the taxpayer has a controlling interest or association with a similar type of business.
2) Define "qualified final tax liability" to mean that part of the final tax liability, including interest, additions to tax, penalties, or other amounts assessed, arising from a transaction or transactions in which the Board finds no evidence that the taxpayer collected the tax from the purchaser or other person and which was determined against the person, or a final tax liability against a successor, or that part of a final use tax liability, as specified.
3) Specify that a qualified final tax liability may not be compromised with a taxpayer who previously received a compromise, as specified.
4) Allow the Board to enter into a written installment payment agreement that permits a taxpayer to pay the compromise installments for a period not exceeding one year.
5) Allow the Board to enter into any collateral agreement deemed necessary for the protection of the interests of the state, as specified.
6) Require a taxpayer that has received a compromise to file and pay by the due date all subsequently required returns and/or reports for a five-year period, as specified.

The bill would become operative on January 1, 2009.

IN GENERAL

In general, an offer in compromise is a process whereby the taxpayer offers to pay an amount that he or she believes to be the maximum amount that he or she can pay within a reasonable time. If the parties agree to the amount offered, the debt is compromised (reduced) to that amount.

In the offer in compromise process, the Board administers the program consistent with procedures followed by the Franchise Tax Board (FTB) and the Employment Development Department (EDD) with respect to:

- The terms of the offer
- The process leading up to the acceptance of the offer, including high levels of review; and

- The refunding of rejected offers without interest, at the taxpayer's discretion.

The Board has created an Offers in Compromise Section which is solely responsible for making compromises under the current provisions of law. Compromises are accepted when a tax liability is final and the Offers in Compromise Section finds that the amount the taxpayer proposes to pay represents the maximum amount the Board can expect to collect from that taxpayer in a reasonable period of time – typically five to seven years.

BACKGROUND

The authorization for the Board to accept offers in compromise was added into law by AB 1458 (Stats. 2002, Ch. 152) and applied to final tax liabilities under the Sales and Use Tax Law, the Use Fuel Tax Law, and the Underground Storage Tank Maintenance Fee Law. In 2006, AB 3076 (Stats. 2006, Ch. 364) added similar provisions under the Cigarette and Tobacco Products Tax Law, Alcoholic Beverage Tax Law, Timber Yield Tax Law, Energy Resources Surcharge Law, Emergency Telephone Users Surcharge Law, Hazardous Substances Tax Law, Integrated Waste Management Fee Law, Oil Spill Response, Prevention, and Administration Fees Law, Fee Collection Procedures Law, and Diesel Fuel Tax Law.

Before these authorizations were added into law, in order to compromise a taxpayer's liability, the Board was required to obtain a stipulated judgment from the court.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the Board of Equalization in order to extend the Board's current offers in compromise program to those open and active businesses that have not received reimbursement from the taxes, fees or surcharges owed and to successors of businesses that may have inherited tax liabilities of their predecessors. In addition, this bill would also apply to consumers that have incurred a use tax liability.

   The current offers in compromise program only applies to businesses that have discontinued or transferred their operations. The Board is seeking to allow compromises with those taxpayers who may otherwise have to sell or discontinue their businesses because of their inability to pay in full a final tax liability that arose from transactions in which the taxpayers did not collect tax from the purchasers or other persons. These situations arise because taxpayers mistakenly believe that their transactions are not subject to the tax. Upon audit, the taxpayer first learns that the transactions are subject to tax, but the taxpayer cannot legally or realistically collect the tax from his or her customers. In addition, this bill would allow compromises with respect to successor liabilities where the successor is still in business,[1] and from use tax assessed by the Board against a consumer who is not required to hold a seller's permit. The Board has found that these liabilities often come as a surprise to the taxpayer and can financially cripple otherwise law-abiding taxpayers.

[1] Current law holds a purchaser of a business personally liable for the unpaid sales and use tax liability of the seller up to the purchase price of the business, if the purchaser fails to withhold sufficient funds to cover the liability when purchasing the business.

The bill has been introduced in order to address those unique situations where the Board believes that it would be in the best interest of the state to compromise a tax debt, when the taxpayer does not have the means to pay more than the amount offered now or in the near future. It would provide for a voluntary resolution that is agreeable to both taxpayers as well as the Board.

2. **The April 9, 2008 amendments** make clarifying, technical changes specifying that *if the Board finds* no evidence that the tax or fee was collected by the taxpayer, and the other conditions for a compromise exist, then the provisions would apply. Also, the amendments clarify that the Board is authorized to enter into a *written* installment payment agreement that permits a taxpayer to pay the compromise in installments.

3. **What if the Board compromises a tax debt and the business becomes profitable?** The bill contains a provision that specifies that taxpayers may be required to enter into any collateral agreement that is deemed necessary for the protection of the interests of the state. The bill provides that the collateral agreement may include a provision that allows the Board to reestablish the liability or any portion thereof, if the taxpayer has sufficient annual income during the succeeding five-year period.

4. **What do the other tax agencies do?** Offers in Compromise programs are also available for income tax liabilities due the Internal Revenue Service (IRS) and the FTB, as well as employment tax liabilities due the EDD. Both the IRS and FTB's programs have the ability to compromise liabilities of ongoing businesses, and according to FTB, compromises are frequently made with collateral agreements. Thus, this measure would be consistent with those tax agencies' programs. Also, the IRS and EDD allow installment payment option terms for offered amounts where the offered funds cannot be paid in a lump sum. This measure would also allow installment payment terms, as long as payment of the offered funds is made within a year.

COST ESTIMATE

The Board would incur some administrative costs related to reviewing and resolving an estimated 945 additional offers in compromise expected to be generated from this measure. In anticipation of these additional offers, staff estimates that two full-time staff positions at the level of Business Taxes Specialist I positions would be necessary. The personnel costs associated with these positions are estimate to be $180,000 annually.

REVENUE ESTIMATE

Currently, the Board's Offers in Compromise program approves 21.4 percent of the applications submitted by taxpayers and collects about 41% of the liability on these cases. Based on an analysis of audits completed during the last three years, the number of accounts that would be eligible for compromise under the provisions of this bill would amount to approximately 945. The amount of "qualified tax liability" as defined in this bill attributable to these audits is an estimated $20.1 million, or an average $22,200 liability per account.

Assuming the same percentage of approved applications under current law would apply to applications submitted under this bill, we would expect to grant about 202 applications (945 x 21.4 percent). Applying these 202 applications to the average liability per account would result in an estimated total liability (tax, interest and penalty that the Board would likely never collect) for granted applications of $4.5 million ($22,200 x 202).

We estimate that, by allowing the Board to compromise these tax debts, about half of the $4.5 million would be collected through the offers in compromise program proposed in this bill (since the taxpayers would still be in business, we assume a higher percentage of liability would be collected). Therefore, the total annual revenue that the Board would collect under this bill is estimated to be $2.25 million, calculated as follows:

State General Fund (5%)	$1,416,877
State Fiscal Recovery Fund (1/4%)	70,844
Local Revenue Fund (1/2%)	141.687
Local Public Safety Fund (1/2%)	141,687
Local and County (1%)	283,376
Special districts (.69%)	195,529
Total	$2,250,000

Analysis prepared by:	Sheila T. Waters	(916) 445-6579	04/14/08
Revenue estimate by:	David E. Hayes	(916)445-0840	
Contact:	Margaret S. Shedd	(916) 322-2376	

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.