

Memorandum

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Mr. Clarence E. Ward
Excise Taxes Section

Date : November 14, 1991

From : David H. Levine
Senior Tax Counsel

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Subject :

This is in response to your memorandum dated September 23, 1991 regarding the interpretation of the new section 12636. That provision provides that every payment on a delinquent insurance tax shall be applied first to the interest due on the tax and second to any penalty imposed. Only then would remaining amounts of the payment be applied to the balance of the tax itself. This is opposite from the manner in which we had previously applied payments. Mr. Donald Hennessy wrote a memorandum dated April 24, 1991 to Mr. Edward King on this issue in which he explained the background and proper interpretation of this provision. You wrote a letter dated _____ to _____ in which you noted that the manner in which we apply payments of delinquent tax liabilities was changed by the new section 12636. On behalf of _____ wrote you a letter dated _____ stating his opinion that certain payments should be applied in the manner we previously applied them because they are not payments of delinquent taxes. You ask my opinion.

The Board issued an assessment against _____ for taxes due on its split funded group insurance policies. _____ timely petitioned for redetermination of these assessments, thereby halting efforts to collect the assessed tax. Nevertheless, _____ made payment towards the tax assessments which _____ characterizes as "prepayments." _____ believes that these tax payments are not payments of "delinquent" taxes within the meaning of section 12636. He therefore believes that _____ should be able to direct application of the payment towards the tax before application to the interest. Although I admire _____ ingenuity in his argument, he has misused the term "prepayment" in order to reach his incorrect conclusion.

notes that delinquent is used in sections 12676 and 12801 as well as in the section at issue. He believes these provisions equate "delinquent" with "due and payable." Section 12676 provides that the Controller may file suit for collection of taxes that are due and payable. The section refers to these taxes as "delinquent taxes." The amounts for which the Controller may file suit are clearly delinquent taxes, and that is all the reference means (to refer back to the taxes in question). The use of the term "delinquent taxes" is not used in order to define delinquent taxes as only those taxes for which the Controller may file suit for collection. Section 12801 refers to taxes which are "delinquent" or taxes which became "due and payable." That provision does not define delinquent as due and payable. Thus, we disagree with the assertion that it can be fairly concluded that delinquent means due and payable.

Although noting that "due and payable" is not defined in part 7 of the code, the Controller contends that it is clearly defined in effect by sections 12431, 12428, and 12301. These provisions are not relevant since we are not attempting to define due and payable. Nevertheless, this argument shows the error of the Controller's analysis. He contends that section 12301 actually is not directly relevant because it refers to taxes which are due and payable by April 15. His contention is that it is not relevant because the taxes at issue were not due and payable on April 15 and that the "prepayments" in question relate to additional taxes which may or may not become due depending upon the result of the pending litigation. We all know, as the Controller surely does, that the issue in the litigation and in the pending petitions for redetermination is not whether additional taxes will become due at the end of those proceedings. Rather, the issue in those proceedings is simply whether the tax is due at all. If so, it was due on April 1 of the year following the year in which the gross premiums were received.

The amounts that the Controller characterizes as "prepayments" are not. Prepayments within the meaning of California's insurance tax is covered in sections 12251 through 12260. The payments by the Controller in question are not prepayments within the meaning of those provisions but rather are simply payments of taxes that the Commissioner concluded were due with the annual return. Under the Controller's own argument, the amounts at issue were due and payable on April 1 of the year following the year in which the gross premiums were received, as provided in section 12301.

The Controller concludes by stating that it appears sound policy for the Board to encourage such "prepayments." Perhaps this is true. Nevertheless, this is not an issue we may consider since the primary policy arm of state government, the Legislature, has considered the issue and nevertheless adopted section 12636.

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As noted in Mr. Hennessey's memorandum to you, the legislative bill analysis specifically considered that the method prescribed by section 12636 may also discourage persons from making partial payments. Nevertheless, the Legislature made the policy decision that payments of delinquent tax must be applied first to the interest.

If we were to adopt the analysis, what we would be concluding would be, in effect, payments are applied to interest first only when the payment is of a tax which was late enough to warrant a penalty. For example, a deficiency assessment is issued against an insurer who thereafter files a petition for redetermination. The matter is redetermined without adjustment and 30 days later the tax becomes due and payable under section 12431. If the insurer pays on the 30th day, one day before imposition of penalty under section 12632, the insurer may direct that payment be applied first to the taxes due. If the insurer waits one more day, that same payment will be applied first to the interest. When looking at the statute as a whole, this makes no sense and clearly is not what the Legislature intended. Rather, I believe that the intention of the Legislature, and the simple rule, is that whenever tax liability is not paid by the date upon which interest begins to accrue, that tax is delinquent. This means that whenever interest is due because of such late payment, payments must first be applied to interest. This analysis is confirmed by section 12636 itself. Subdivision (b) requires application of any payments to "any" penalty imposed by this part. The clear implication of this provision is that the provision applies even if the late payment did not require imposition of penalty. Otherwise, "the" would have replaced "any." That is, the Legislature instructed us that to apply payments to interest first even if there was not penalty imposed by virtue of the delinquency of the tax.

If you have further questions, feel free to write again.

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