

BILL ANALYSIS

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Department, Board, Or Commission	Author	Bill Number
Franchise Tax Board	Ma	AB 361

SUBJECT

Notice To FTB Of The Administration Of A Decedent's Estate Required By Estate Representative

SUMMARY

This FTB sponsored bill would require an estate representative to provide notice to the Franchise Tax Board (FTB) that the administration of a decedent's estate has been opened.

PURPOSE OF BILL

The purpose of this bill is to codify a process that would assure that an estate representative discovers and resolves a decedent's income tax obligation, thus helping to close the tax gap.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2008, and operative for estates opened on or after July 1, 2008.

ANALYSIS

FEDERAL/STATE LAW

The administration of a decedent's estate is exclusively a matter of state law. The IRS is treated as a creditor of an estate when an estate has a federal tax debt.

Probate proceedings are administered in the county where the decedent resided or owned real property. The personal representative of a decedent's estate is required to make a reasonably diligent effort to identify creditors of the decedent and is required to provide any reasonably ascertainable creditor with a Notice of Administration of a Decedent's Estate (notice). The notice is to be provided within four months after the date the representative receives letters of administration or within 30 days from when the representative first has knowledge of the creditor. Additionally, under certain circumstances, the representative is required to provide specific notice to the Director of Health Services and the Director of the California Victims Compensation and Government Claims Board.

Creditors of a decedent, including a state agency, are required to file a claim in the estate proceedings within specific timeframes to obtain payment of a debt. All claims filed in an estate must be resolved prior to closing the administration of the estate.

After a return is filed reporting both income earned by the decedent and income earned by the estate, a representative may request a prompt audit of that return by FTB. If FTB proposes to adjust the amount of tax reported, FTB must issue a notice proposing to assess the additional tax or commence a proceeding in court without assessment for the collection of tax within 18 months from the date the representative requested the audit. FTB is barred from making a claim in a probate proceeding after the 18-month period expires.

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A claim by a public entity is not barred unless notice has been provided to that entity. Where written notice is not provided, the claim is enforceable by an action against the beneficiaries of the estate for the unpaid claim. If property is distributed before expiration of the time allowed a public entity to file a claim, the public entity has a claim against the beneficiaries of the estate that received the property. The state's recourse when estate assets have been distributed before a claim is filed is to pursue a transferee assessment against the beneficiaries that received the estate assets.

THIS BILL

This bill would require an administrator or executor of a deceased's estate to provide notice of the administration of the estate to FTB no later than 90 days after the date letters are first issued to a general personal representative. This bill would require notice to be provided by any estate opened on or after July 1, 2008.

IMPLEMENTATION CONSIDERATIONS

This proposal could be implemented in the department's annual program updates.

PROGRAM BACKGROUND

FTB's method of collecting a decedent's unpaid tax liability depends on how assets of the decedent are disbursed. Generally, there are three methods available to conclude a decedent's affairs. Depending on the size of the estate and actions taken prior to the taxpayer's death, assets are transferred through a court probate estate proceeding, through a trust established prior to the taxpayer's death, or informally by family members.

FTB's Decedent Unit receives a Notice of Administration of a Decedent's Estate (notice) in two ways:

1. The representative provides actual notice to FTB as required for reasonably ascertainable creditors of an estate, or
2. FTB's Decedent Unit independently identifies an open probate by searching probate case files in the superior courts of all 58 California counties.

FTB initiates a search for a probate estate when the FTB Decedent Unit determines that a taxpayer with an income tax liability is deceased. FTB sends a Request for Probate Information (FTB Form 4777) to the superior court to locate probate information. The superior court probate clerk in any of the 58 counties that a FTB Form 4777 is sent must search their records for probate information and return the form indicating whether a probate estate was established in that county. If probate information is located, FTB files a Creditor's Claim in the proceeding.

The Decedent Unit estimates that of the 50,000 estates probated each year, approximately 65% are fully compliant with their tax obligations or have no obligations to resolve. The Decedent Unit estimates that of the remaining 35% of cases probated annually, 25% of those estates, or 4,375 cases, provide notice to FTB or are independently located by FTB staff. Finally, the approximately 13,125 cases, or 75% of the remaining probate case universe remain unidentified by FTB staff.

During the last five years, FTB has pursued approximately 94 transferee assessment cases where the estate failed to satisfy the decedent’s unpaid tax liability. These cases had an estimated value of \$1.8 million. The transferee assessment process is a manual collection procedure that is costly, time consuming, and often not pursued for cost benefit reasons. In addition, these cases surprise beneficiaries and require the beneficiaries to pay amounts to the state that they believed were their unencumbered inheritance. In many cases, the beneficiaries have already committed the assets. FTB discharges approximately 165 transferee assessment cases each year with an estimated value of \$2.0 million for cost benefit reasons that could be resolved through FTB’s receipt of timely notice and the opportunity to file timely probate claims.

FISCAL IMPACT

The department will absorb any costs associated with the implementation of this bill.

ECONOMIC IMPACT

Based on data and assumptions discussed below, the Personal Income Tax revenue gain from this bill would be as follows:

Estimated Revenue Impact of AB 361 Effective On Or After July 1, 2008 Enactment Assumed After June 30, 2007 (\$ in Millions)				
Probate	2007-08	2008-09	2009-10	2010-11
Claims	No impact	+\$5	+\$5	+\$5

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of this bill is determined by the number of additional tax debts that FTB will be able to collect due to receiving timely notice. Notice would be sent to personal representatives of decedents’ estates beginning July 1, 2008. It is anticipated that collections from these estates will generally take 12 – 18 months. Therefore, the first collections will not occur until July 1, 2009. Estimates are rounded and accrued back one year as they relate to tax liabilities from prior years

In fiscal year 2005-06, FTB’s Decedent Unit collected \$4.5 million from claims filed with Probate Courts. The Decedent Unit estimates that it is properly notified, and in a timely manner, in only about 25% of probate cases that have unresolved tax issues.

If FTB were properly notified in all probate cases, additional collections would potentially be \$13.5 million. ($\$4.5 \text{ million} \div 25\% = \18 million ; $\$18 \text{ million} - \$4.5 \text{ million currently collected} = \13.5 million .) The cases on which FTB is not properly notified will tend to have smaller debts than the group for which FTB is properly notified.

The Decedent Unit estimates that, on average, the value of income tax debts of the cases that would be impacted by this bill would be about 40% of the value of the debts for which FTB is properly notified. Additional collections from probate claims would be \$5.4 million (\$13.5 million potential revenue x 40% of the value of the debts). The additional collection from this bill of \$5.4 million is reduced by approximately \$0.3 million for the amount that would have been collected from decedent's heirs after disbursements from probate. Under this bill, net new collections of \$5.1 million would result in the first full taxable year in 2009.

VOTES

Assembly Floor – Ayes: 74, Noes: 0

Senate Floor – Ayes: 37, Noes: 0

Concurrence – Ayes: 77, Noes: 0

LEGISLATIVE STAFF CONTACT

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