

Client Alert

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FTB Releases Plans for *May Department Stores* Interest Computation Adjustments

By Eric J. Coffill

The California Franchise Tax Board (FTB) has announced plans to make adjustments to interest rate calculations in certain circumstances involving *May Department Stores v. United States* to approximately 27,000 taxpayer accounts, primarily where overpayments were transferred or refunded from a particular tax year, followed by an additional tax assessment on that same year.

In its August 2015 edition of *Tax News*, California Franchise Tax Board (FTB) has announced plans to make adjustments to interest rate calculations in certain circumstances involving *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996), *acq.* AOD CC-1997-008 (Aug. 4, 1997), to approximately 27,000 taxpayer accounts, primarily where overpayments were transferred or refunded from a particular tax year, followed by an additional tax assessment on that same year.

At the prompting of the California Taxpayers Association and practitioners earlier this year, FTB has been examining its longstanding and widespread misapplication of interest calculations relating to *May Department Stores* and two IRS pronouncements. In Rev. Rul. 99-40, 1999-2 C.B. 441, which cited to *May Department Stores*, the IRS addressed the issue of the date from which interest will be assessed on a subsequently determined deficiency for the overpayment return year where an overpayment claimed on a return is credited to the succeeding year's estimated tax or refunded without interest. In Rev. Proc. 94-60, 1994-2 C.B. 774, the IRS described how interest on an underpayment will be calculated when a taxpayer has previously received a tax refund with interest for the same tax year. FTB refers to those authorities presenting two issues: (1) the *May Department Stores* issue under that decision and Rev. Rul. 99-40; and (2) the Corporate Interest Netting issue under Rev. Proc. 94-60. On April 8, 2015, FTB issued a *Tax News Flash* on the subject. Also on April 8, 2015, the California Controller issued a Press Release stating FTB had been directed to review and adjust interest calculations based upon those legal authorities.

FTB's August 2015 issue of *Tax News* now states that upon direction from the Controller, FTB has determined that interest rate calculations based on *May Department Stores*, Rev. Rul. 99-40, and Rev. Proc. 94-60 may affect an estimated in-statute account universe of 27,000 taxpayers. More specifically, FTB believes 24,000 personal income tax accounts and 2,000 business entity accounts are affected by the *May Department Stores* issue, and 1,000 business entity accounts are affected by the Corporate Interest Netting issue. FTB's criteria for creating this universe were centered primarily around overpayments transferred or refunded from a particular tax year, followed by an additional tax assessment on that same year. Note these figures are for "accounts" and a single account may affect multiple tax years of a taxpayer. FTB stated that it has yet to identify the fiscal impact of these interest computation adjustments, but intends to provide an update in September 2015.

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FTB has stated that it has previously made these adjustments when requested to do so (a policy which the author can confirm). However, FTB is only now working on a semi-automated method to proactively make these adjustments, which are complex and currently must be manually performed.

In an April 9, 2015 *Public Service Bulletin*, FTB earlier explained it believes the *May Department Stores* interest issue may impact individuals and business entities that satisfy *all* of the following conditions:

1. Taxpayer filed an amended return for additional tax OR received a deficiency assessment after the original return was filed for the same tax year; AND
2. On the original return, taxpayer elected an overpayment transfer to the subsequent year's estimate tax; AND
3. On the subsequent year, the required first quarter estimate payment was less than the required overpayment transfer amount. FTB states that, in this scenario, the maximum amount of the *May Department Stores* adjustment is one year of interest on the additional tax or deficiency amount.

The Public Service Bulletin goes on to explain FTB believes the Corporate Interest Netting issue may impact corporations that satisfy *both* of the following conditions:

1. Previous refund or payment transfer, AND
2. Subsequent deficiency or amended return for additional tax with interest for the same tax year.

Because of potential statutes of limitation soon expiring for tax year 2010, taxpayers who believe they have been impacted by either the *May Department Stores* issue or the Corporate Interest Netting issue should contact FTB as provided in the Public Service Bulletin. Note also that FTB's current outreach program is limited to what FTB determined are "in-statute accounts" under the general rules of four years after the return was required to be filed or one year from the date of overpayment. (See Cal. Rev. & Tax. Code §§ 19057, 19066, 19306.) Accordingly, taxpayers should actively look for this issue in earlier years, for example, when the FTB statute of limitations is automatically extended when a taxpayer files a federal waiver to six months after the expiration date of the federal waiver. (See Cal. Rev. & Tax. Code § 19065.)

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