

Date of Hearing: July 7, 2025

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION

Mike Gipson, Chair

SB 591 (Valladares) – As Amended March 26, 2025

Majority vote. Fiscal committee.

SENATE VOTE: 38-0

SUBJECT: Taxation: electronic funds transfer: penalties

SUMMARY: Reduces the penalties applicable to taxpayers required to remit payment to the Franchise Tax Board (FTB) electronically but that fail to do so. Specifically, **this bill:**

- 1) Contains the following legislative findings and declarations:
 - a) It is important to promote and protect the integrity of the California tax system;
 - b) It is important that California's tax system is perceived as, and is in fact, fair to all taxpayers;
 - c) It is important that violations of the Revenue and Taxation Code (R&TC) are subject to appropriate penalties; and,
 - d) It is important that these penalties are commensurate with the violation or violations.
- 2) Reduces the penalty applicable to a corporate taxpayer required to remit payment by electronic funds transfer (EFT) that makes payment by other means. Specifically, replaces the current penalty equaling 10% of the amount paid with a penalty of \$100 for the initial noncompliance and \$500 for each subsequent violation.
- 3) Reduces the penalty applicable to an individual required to remit payment electronically who makes payment by other means. Specifically, replaces the current penalty equaling 1% of the amount paid with a penalty of \$100 for the initial noncompliance and \$500 for each subsequent violation.

EXISTING LAW:

- 1) Provides that, with respect to any corporation, specified payments must be remitted to the FTB by EFT if any of the following conditions are met:
 - a) Any installment payment of estimated tax made under R&TC Section 19025 or the payment made pursuant to R&TC Section 18604 with regard to an extension of time to file exceeds \$20,000; or,
 - b) The total tax liability exceeds \$80,000. (R&TC Section 19011(a).)

- 2) Provides that any corporate taxpayer required to remit payment by EFT that makes payment by other means shall pay a penalty of 10% of the amount paid, unless it is shown that the failure to make payment as required was for reasonable cause and was not the result of willful neglect. (R&TC Section 19011(c).)
- 3) Provides that any corporate taxpayer required to remit payments by EFT may request a waiver of those requirements from the FTB, as specified. (R&TC Section 19011(d).)
- 4) Provides that payment is considered complete on the date the EFT is initiated, if settlement to the state's demand account occurs on or before the banking day following the date the transfer is initiated. (R&TC Section 19011(e).)
- 5) Provides that, in the case of an individual, specified payments must be electronically remitted to the FTB, once either of the following conditions are met by an individual:
 - a) Any installment payment of estimated tax in excess of \$20,000, or any payment made pursuant to R&TC Section 18567 with regard to an extension of time to file that exceeds \$20,000; or,
 - b) The total tax liability exceeds \$80,000. (R&TC Section 19011.5(a).)
- 6) Provides that any individual taxpayer required to remit payment electronically who makes payment by other means shall pay a penalty of 1% of the amount paid, unless it is shown that the failure to make payment as required was for reasonable cause and was not the result of willful neglect. (R&TC Section 19011.5(c).)
- 7) Provides that any individual taxpayer required to remit payments electronically may request a waiver of those requirements from the FTB, as specified. (R&TC Section 19011.5(d).)

FISCAL EFFECT: The FTB notes that this bill would not impact the computation of state income or franchise tax. At the same time, the FTB has noted that, by reducing future penalty amounts, this bill would likely result in lost General Fund (GF) revenues exceeding this Committee's suspense threshold of \$150,000.

COMMENTS:

- 1) The author has provided the following statement in support of this bill:

California's tax system should encourage compliance, not punish honest mistakes with eye-watering penalties. Under current law, a business that pays its entire tax bill on time – but mails a check instead of sending an electronic transfer – can face a 10-percent surcharge that quickly climbs into six figures. Individuals face a 1-percent hit for the same clerical slip. These penalties dwarf the offense, create distrust, and make California an outlier among states.

SB 591 replaces those uncapped percentage penalties with a sensible, two-tier flat fee: \$100 for a first misstep and \$500 for any subsequent ones, unless the taxpayer shows reasonable cause. The new structure still discourages paying by check and directs taxpayers toward the lower-cost Electronic Funds Transfer system, but it eliminates disproportionate, windfall fines that bear no relationship to intent or harm.

This bill aligns enforcement with fundamental principles of fairness, brings California's practice closer to other jurisdictions, and strengthens public confidence in the integrity of our tax administration. Penalties should promote compliance – never overburden taxpayers for a paperwork error.

2) This bill is supported by PwC, which notes the following:

Currently, taxpayers in California who are required to remit payments via the Electronic Funds Transfer (EFT) system risk disproportionately high penalties when they inadvertently remit payments by another method – even if the payment otherwise arrives in full and on time. Specifically, under CRTC Sections 19011 and 19011.5, corporations can face a penalty of 10% on the amount paid, while individuals face a penalty of 1%, without regard to the actual harm or intent.

SB 591 addresses this issue by replacing these percentage-based penalties with a fixed penalty amount set at:

- One hundred dollars (\$100) for an initial failure to use EFT, and
- Five hundred dollars (\$500) for each subsequent failure, unless it is shown that the failure was for reasonable cause and not due to willful neglect.

By instituting a modest tiered penalty system, the bill preserves the integrity of the EFT requirement while preventing taxpayers from incurring penalties that are excessively punitive. Importantly, the measure provides a safeguard for circumstances in which the failure to pay via EFT was not the result of willful neglect – aligning the state's penalty framework more closely with principles of equity and fairness.

3) The FTB notes the following implementation consideration in its staff analysis of this bill:

This bill does not provide a specific operative date. For clarity, the author may wish to amend the bill to include an operative date to specify application to payments made on or after a certain date.

4) Committee Staff Comments:

- a) *General background:* A taxpayer whose total tax liability exceeds \$80,000, or that makes an estimated tax or extension payment exceeding \$20,000, is required to remit electronically all future payments, regardless of the payment type, amount, or the taxable year. Corporate taxpayers that are required to pay electronically but that remit payment by other means are assessed a penalty of 10% of the payment. Individual taxpayers, in turn, who are required to pay electronically but pay by other means are assessed a mandatory e-pay penalty of 1% of the payment. The penalty is assessed unless the taxpayer can show that the failure to make the electronic payment was for reasonable cause and not the result of willful neglect.

The FTB notes that taxpayers can request a waiver from the mandatory electronic payment requirement if:

- i) The taxpayer did not make an estimated tax or extension payment in excess of \$20,000 for the previous taxable year;
- ii) The tax liability for the previous year did not exceed \$80,000; or,
- iii) The amount paid was not representative of future payments or tax liability.

If the FTB grants a waiver and the taxpayer subsequently meets the mandatory electronic payment requirements, the taxpayer must resume making payments electronically. Certain taxpayers with permanent physical or mental impairment may request a permanent waiver of the mandatory electronic payment requirement.

- b) *When were the mandatory electronic payment requirements enacted?* It appears that the mandatory electronic payment requirements for corporations, along with the associated penalty for noncompliance, were originally enacted in 1994, with the passage of AB 3389 (Friedman), Chapter 271, Statutes of 1994. The Legislature enacted the mandatory electronic payment requirements for individual taxpayers with the passage of AB 1389 (Committee on Budget), Chapter 751, Statutes of 2008. According to the Senate Floor Analysis of this budget trailer bill, the FTB estimated that this provision would increase GF interest earnings by \$2 million in fiscal year 2008-09 and by \$4 million annually thereafter "due to quicker receipt of these funds."
- c) *Why is electronic payment beneficial?* Electronic payment provides a host of benefits for both taxpayers and tax agencies. Not only are EFT payments considered very safe, but when a taxpayer initiates payment via EFT, there is a clear record of the payment having been made. By comparison, when a taxpayer sends a check by mail, the envelope may be lost or even stolen by bad actors seeking access to information useful in identity theft. Alternatively, envelopes can and often do arrive without a postmark, leading to disputes about the timeliness of payment. EFT payments take less time to post to the state's accounts, which accelerates cash receipts and increases the amount of interest earned. EFT payments also require less handling and processing, thereby increasing tax agency efficiency. As such, for the last 31 years, the state has required corporations with sizable tax payments to avail themselves of EFT. Individual taxpayers with significant liabilities have been required to do so for 17 years.
- d) *The Federal Government moves in the same direction:* California is by no means alone in moving towards EFT wherever possible. On March 25, 2025, the Federal Government issued Executive Order 14247 to promote operational efficiency by mandating the transition to electronic payments for all Federal disbursements and receipts. In setting forth the purpose of this action, the Executive Order noted the following:

The continued use of paper-based payments by the Federal Government, including checks and money orders, flowing into and out of the United States General Fund [. . .] imposes unnecessary costs; delays; and risks of fraud, lost payments, theft, and inefficiencies. Mail theft complaints have increased substantially since the COVID-19 pandemic. Historically, Department of the Treasury checks are 16 times more likely to be reported lost or stolen, returned undeliverable, or altered than an electronic funds transfer (EFT). Maintaining the physical infrastructure and specialized technology for digitizing paper records cost the American taxpayer over \$657 million in Fiscal Year 2024 alone.

- e) *What would this bill do?* As noted above, this bill would significantly reduce the penalties applicable to both individual and corporate taxpayers that are required to remit payment by electronic means but that fail to do so for whatever reason. Specifically, this bill would eliminate the percentage-based penalties for both individual and corporate taxpayers and replace them with flat penalties of \$100 for the first noncomplying payment and \$500 for each subsequent failure to remit payment electronically.
- f) *What do California's other tax agencies do?* As we move well into the 21st Century, the FTB is by no means alone in requiring taxpayers with sizable liabilities to make their payments electronically. For example, the California Department of Tax and Fee Administration, which administers the Sales and Use Tax (SUT) Law along with a host of other tax and fee programs, requires electronic payment in multiple situations. Specifically, one must make payment by EFT if:
 - i) Your average monthly SUT liability equals or exceeds \$10,000 over a 12-month period;
 - ii) Your average monthly Prepaid Mobile Telephony Services Surcharge liability equals or exceeds \$10,000; or,
 - iii) Your average monthly special tax and fee liability equals or exceeds \$20,000 over a 12-month period.

Moreover, the CDTFA notes that if you are required to make payments via EFT and use another means (e.g., check, cash, money order, etc.), you will be subject to the following penalties:

- i) Monthly and quarterly tax or fee returns will be assessed a 10% penalty on the taxes or fees due; and,
- ii) SUT prepayments will be subject to a 6% penalty.

Thus, if California were to enact this bill and eliminate percentage-based penalties for taxpayers remitting payment to the FTB, it may serve as a precedent for legislation targeting California's other tax agencies and programs.

- g) *Balancing the equities involved:* Percentage-based penalties currently apply only to taxpayers with significant income and attendant tax liabilities. In the case of individuals, the 1% penalty applies only to taxpayers with a state tax liability of more than \$80,000. Ostensibly, these are the very taxpayers best positioned to hire knowledgeable and competent tax professionals to inform them of an EFT requirement that has been on the books for 17 years. That said, it is not impossible to envision a scenario where a taxpayer is given erroneous advice and submits a check as payment in good faith, only to realize later that this triggered a penalty. In the case of some very high income taxpayers, this penalty may be sizable. For example, an individual making an estimated payment of \$20 million by check would incur a penalty of \$200,000.

Under this bill, such a taxpayer would only pay a penalty of \$100 for making this first-time mistake. One would hope that, after paying this nominal penalty representing a

minuscule fraction of their annual tax liability, they would realize that all future payments must be remitted by EFT and comply with the law moving forward.

The problem, however, is that under this bill, the same taxpayer, with full knowledge of their EFT obligation, could make the exact same "mistake" the next year, and the year after that, and only incur a penalty of \$500 for each violation. Supporters might contend that no rational taxpayer would intentionally invite additional FTB scrutiny by making a check payment after the first offense. But this only raises the question of why this bill authorizes a de minimis \$500 penalty for such repeated errors.

In addition, the Committee may wish to consider whether this penalty structure introduces a perverse incentive for very wealthy taxpayers to pay repeatedly by check because the nominal cost of the \$500 penalty is outweighed by the interest earned while funds wait to be credited to the state's accounts. The FTB notes that, in most cases, checks are extracted, deposited, and applied to the state's accounts within two to five days. However, by mid-April, during the FTB's peak workload, this process can take up to two weeks depending on whether a payment must be manually matched to a taxpayer's accounts.

- h) *An alternate approach?* The state has actually already grappled with the inherent tension of seeking to provide good-faith actors relief from a penalty for their first mistake while not creating a structure that incentivizes repeated bad acts. It did so by enacting AB 194 (Committee on Budget), Chapter 55, Statutes of 2022. AB 194 enacted a One-Time Penalty Abatement program that authorizes the FTB to provide individual taxpayers a one-time abatement of timeliness penalties. This includes the failure to file penalty (R&TC Section 19131) and the failure to pay penalty (R&TC Section 19132). The one-time penalty abatement is a once-in-a-lifetime abatement and is available only to individuals subject to the Personal Income Tax Law. To that end, the author and Committee may wish to consider whether it would be preferable to do something similar for the EFT penalty, by providing a nominal penalty of \$100 for a first time error, and reverting to the normal percentage-based penalties for subsequent failures.
- i) *Prior legislation:*
 - i) AB 1397 (Low), of the 2023-24 Legislative Session, would have modified the electronic payment penalty applicable to individuals by capping the 1% penalty at \$25,000 per payment. AB 1397 would have applied to payments made on or after January 1, 2024, and retroactively to any payment made before January 1, 2024 that was, or may become, the subject of a timely filed protest or claim for refund. AB 1397 was not heard by this Committee.
 - ii) AB 1389 (Committee on Budget), Chapter 751, Statutes of 2008, among other things, required personal income taxpayers with estimated tax or extension payments in excess of \$20,000, or total tax liability in excess of \$80,000, to remit payment to the FTB by EFT, subject to specified requirements.

REGISTERED SUPPORT / OPPOSITION:

Support

California Society of Enrolled Agents
California Taxpayers Association
PwC

Opposition

None on file

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