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#### Tax on Insurers - Excess Prepayment of Tax

Under Revenue and Taxation Code section 12257, if an insurer's prepayments for a calendar year exceed the amount of tax due for that year, the insurer may elect to credit its overpayment against the amounts due and payable as the prepayment for the first quarter of the following year. This provision does not grant an insurer who makes an overpayment of prepayments an election to apply any remainder in excess of the first quarter prepayment to the insurer's second quarter prepayment. Under Revenue and Taxation Code section 12977, the Controller is required to credit any excess to any amounts then due and payable from the insurer and refund the balance. As such, the remaining net credit in excess of the first quarter prepayment due will be refunded. Any inappropriate application by the insurer of a prepayment excess to its second quarter prepayment will subject the insurer to a penalty with respect to a resulting late second quarter prepayment. 12/9/92. (Am. 2003-3, Am. 2005-1).

## Memorandum

To: Mr. Monte Williams  
Excise Taxes

Date: December 9, 1992

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Subject: Request for Relief from Penalty

This is in response to your memorandum dated September 21, 1992 regarding a request for relief from penalty imposed with respect to an insurer's 1992 second quarter prepayment (actually, there are apparently two insurers with the same circumstances, but my discussion will remain in the singular so that, hopefully, I can avoid problems with my tenses). Also, although your questions were apparently triggered by the insurer's request for relief of penalty, my understanding is that you are not asking whether the insurer is entitled to relief under section 12636. Rather, my understanding is that your question relates to whether a penalty should have been imposed in the first place, and I therefore do not address any questions with respect to section 12636.

The insurer's prepayments during 1991 exceeded the amounts that the insurer owed for its 1991 annual tax plus its 1992 first quarter prepayment. It took a credit in the amount of the remaining prepayment overpayment against its second quarter prepayment, submitting a check for the difference. The insurer then received a refund check for its overpayment from the Controller. That is, the refund issued by the Controller was in the same amount as the credit the insurer had taken against its second quarter prepayment. Since that prepayment was underpaid in the amount of the credit taken by the insurer, the Controller's office notified the insurer of the applicable interest and penalty, and the insurer now requests relief.

As you note, section 12257 states that if the total of prepayments for a year exceed the amount of tax due for that year, the excess is treated as any other overpayment of tax except that, at the election of the insurer, the overpayment may be credited against the amounts due as the prepayment for the first quarter of the following year. The refund or credit of any amount not so credited is governed by section 12977, et seq.

You also note that subdivision (c) of section 12977 provides that, upon the Controller's receipt of the Board's certification of a refund, the Controller shall credit that amount against any amounts *then* due and payable and refund the remainder. The only difference between a refund of overpaid prepayments

and a refund of an overpayment of the annual tax is that the certification need not be approved by the Board of Control, without regard to the amount of the refund. (Rev. & Tax. Code § 12977 (b).)

You state that the Board and the Controller attempt to make the actual refunds of excess prepayments prior to June 30<sup>th</sup> of each year to avoid additional interest due from the state. You state further:

“With the second quarter prepayment due June 15<sup>th</sup>, and delivered to the office of the commissioner, it would be next to impossible for the Controller’s office to verify the amount of each prepayment and still meet the June 30<sup>th</sup> deadline. However, since the insurer made the second quarter prepayment prior to June 15<sup>th</sup>, minus the excess amount, and before the previous year’s excess prepayment refund check was mailed from the State Controller’s office, could this be construed as a timely second quarter prepayment made in full? Would this situation, pursuant to Section 12977, require that the excess amount be credited against the second quarter prepayment, even though it was unknown to be due and payable at that time, and be considered timely?”

We must start with the specific provisions of 12257, which grants an insurer who pays more in prepayments than due from that insurer in annual tax an election to apply the amount of that overpayment to the insurer’s first prepayment. This provision does not grant an insurer making an overpayment of prepayments an election to apply any remainder of that overpayment to the insurer’s second quarter prepayment.

The only reasonable interpretation of due and payable in section 12977 is that we are not entitled to apply an amount otherwise refundable against a tax owed by the taxpayer unless its due date has passed. Thus, if you wanted to apply a refund due an insurer against its second quarter prepayment on the 15<sup>th</sup> and you asked my opinion, my answer would be no since that prepayment is not due and payable under section 12977 on the 15<sup>th</sup>. Furthermore, my understanding is that we would treat such a payment as timely as long as it was mailed by the 15<sup>th</sup>.<sup>1/</sup> Thus, in answer to that question I would advise you wait a sufficient period to receive any payments that might have been mailed timely. (Of course, under such circumstances I assume the refund check would be held up, if it were deemed necessary, but this does not affect the analysis.)

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<sup>1/</sup> The following example shows why we cannot apply a refund as a credit on the 15<sup>th</sup>. Insurer A is entitled to a refund which all relevant agencies finalize on the fourteenth. On the morning of the 15<sup>th</sup>, since the prepayment has not yet been received, the overpayment is credited against the prepayment due on the 15<sup>th</sup> instead of refunding that amount to A. The Postal Service, who is running late on the 15<sup>th</sup>, delivers A’s prepayment check at 4 pm. Although the check would have been the correct amount had we received it before the time we credited the overpayment, that deed is already done. Thus, if we had the right to apply a credit to the amount owed by a taxpayer prior to the time that payment is late, A in this example would have overpaid its second quarter prepayment in the amount of the credit and would not get a refund this year. Clearly, we cannot do this, and therefore the insurer cannot require us to do so.

Based on the analysis above, my conclusion is that we do not have the right to credit a refund against a tax payable by the insurer until that insurer has already incurred a penalty for having failed to make a timely payment. Section 6901 is the parallel provision to section 12977 in the context of refunds of sales taxes, and as relevant here includes the same provisions. When the Refunds Unit receives a claim for refund under section 6901, it sends the claimant a letter acknowledging the claim and telling the claimant not to deduct the amount claimed overpaid from the taxes the claimant owes. (You may send the same type of acknowledgment, but since I am not sure I mention the one I do know about.) I believe this accurately states the applicable rules.

If a person is entitled to a refund, it is this agency, and not that person, who ascertains whether a tax is due and payable and whether the amount of the refund should, instead of being refunded, be credited against the amount due. I believe the method you have used is the correct one. If we do not know that the prepayment is late, we should not be required to absolutely ascertain whether or not it is late prior to refunding the overpayment. If we deem it appropriate to do so (e.g., with a potentially insolvent taxpayer) then of course we should, but I do not believe that we are required to slow down our administration of the tax in order to do so.

More importantly, in the context of your question, it does not matter. As mentioned above, for us to have the right to credit the overpayment against the insurer's second quarter prepayment, that prepayment must already be late at the time we apply the credit against it, and the insurer would already have incurred the penalty. Under the specific facts here, the insurer paid some of the second quarter prepayment on time. The amount that the insurer did not pay became late on the 16<sup>th</sup>. If, at that time, a refund was ready for issuing to that insurer and all relevant state agencies were aware of the underpayment, then it would have been entirely appropriate to credit the amount of the overpayment against the underpayment instead of refunding it. The insurer would still have incurred the penalty, but would have avoided additional interest having accrued beyond the 16<sup>th</sup>. Nevertheless, if at the time the refund check is issued all relevant agencies do not have a "meeting of the minds" with respect to there also being an underpayment for past due taxes, then it is entirely appropriate to issue the refund.

In summary, it is my opinion that allowing an insurer to claim a credit for overpayment of its previous year's prepayments against its second quarter prepayment would be contrary to the provisions of section 12257. Rather, I conclude that the only way an insurer can avoid the imposition of a penalty for the late payment of some or all of its second quarter prepayment is to actually pay that prepayment, in full, by the 15<sup>th</sup>.

David H. Levine