

# ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Figueroa Analyst: Roger Lackey Bill Number: SB 1955

Related Bills: See Legislative History Telephone: 845-3627 Amended Date: 07-03-02

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** FTB Enforce Provisions Regulating Tax Preparers

## SUMMARY

This bill would require the Franchise Tax Board (FTB) to enforce the laws regulating Tax Preparers.

This bill would make numerous other changes to the Business and Professions Code. This analysis will only discuss those provisions impacting FTB.

## SUMMARY OF AMENDMENTS

The July 3, 2002, amendments deleted provisions not impacting the department.

The June 20, 2002, amendments added language requiring FTB to enforce the laws regulating Tax Preparers. The amendments also added several other provisions that would not impact FTB.

This is the department's first analysis of the bill.

## PURPOSE OF THE BILL

It appears the purpose of the bill is to increase compliance with the laws regulating Tax Preparers.

## EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative January 1, 2003.

## POSITION

Pending.

## ANALYSIS

### FEDERAL/STATE LAW

Federal law allows the federal government to initiate administrative proceedings against an individual who practices before the Internal Revenue Service or who is violating the requirements of practice as required under federal law. In general, the office of the Director of Practice in the office of the Secretary of the Treasury approves applications for enrollment and oversees the practice of representatives before the Internal Revenue Service (IRS).

Board Position:

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Department Director

Date

Gerald H. Goldberg

7/24/02

Certified Public Accountants (CPA) and attorneys are authorized to represent persons before the IRS. Others, such as enrolled agents and enrolled actuaries must apply for permission to practice before the IRS. The Director of Practice is responsible for enforcing the laws that regulate these individuals and has the authority to begin administrative proceedings to disbar or suspend an individual in violation of those laws. A CPA, tax attorney, enrolled agent, or other professional who is suspended or disbarred is no longer allowed to practice in front of the IRS unless authorized by the Director of Practice.

Like the IRS, the primary purpose of the Franchise Tax Board is to administer the tax laws. The FTB administers the California franchise and income tax laws.

Under state law, the Department of Consumer Affairs is the established entity that regulates the practices of the various professionals. Prior to the elimination of the Tax Preparer program [SB 1077 (Greene, Stats. 1996 Ch. 1137)] and the creation of the California Tax Education Council (CTEC), the Department of Consumer Affairs regulated Tax Preparers. CTEC is comprised of a representative from each professional society, association, or other entity operating as a California nonprofit corporation that chooses to participate in the council and that represents Tax Preparers, enrolled agents, attorneys, or CPAs with a membership of at least 200 for the last three years. The CTEC also may include not more than one representative from each for-profit tax preparation corporation that chooses to participate in the council and that has at least 200 employees and has been operating in California for the last three years.

State law defines a "Tax Preparer" as a person who, for a fee or for other consideration, assists with or prepares state or federal tax returns for another person or who assumes responsibility for final completed work on a tax return, or solicits business offering such services. Certified public accountants, members of the state bar, an employee of a trust, a financial institution regulated by the state and federal government, or enrolled agents practicing before the IRS are exempt from the requirements applicable to tax preparers.

Existing state law has been interpreted to require Tax Preparers to register with the CTEC. CTEC is responsible for approving the curriculum of tax schools and certifying the education of Tax Preparers. CTEC has the authority to establish guidelines for Tax Preparers, including specific initial and continuing education requirements, as well as a \$5,000 bond requirement.

Existing state law also allows a person to petition the superior court to prevent a Tax Preparer from continuing to violate the rules governing Tax Preparers. Further, existing law provides that a violation of the rules governing Tax Preparers is a misdemeanor, punishable by a fine not exceeding \$1,000 or county jail for not more than one year, or both. Under current law, violations consist of certain specified behavior. However, preparation of a return by a Tax Preparer who has not registered with CTEC or who has not completed CTEC-approved initial or annual education and training is not specifically identified as a violation. The laws regulating the professional performance of Tax Preparers will cease to be operative July 1, 2008, and are repealed January 1, 2009.

Currently, FTB reports questionable Tax Preparers to CTEC in cases where fraud is involved.

### THIS BILL

This bill would require FTB to enforce the rules governing Tax Preparers, as described above in "FEDERAL/STATE LAW." This bill would authorize FTB to:

- cite individuals preparing tax returns in violation of the rules governing tax preparers,
- levy a fine on these individuals not to exceed \$1,000, and
- issue a cease and desist order, effective until the Tax Preparer is in compliance.

This bill would allow FTB to accept funds from CTEC for purposes of enforcing this bill.

### IMPLEMENTATION CONSIDERATIONS

FTB administers the income tax laws; its expertise is not in the enforcement of the business and professions requirements of Tax Preparers. If FTB were authorized to enforce these requirements, development of a new program, including possible additional equipment, education, staff, and other resources would be necessary to properly implement the provisions of this bill.

Since the bill would provide that FTB enforce the entire chapter related to Tax Preparers, FTB would also be responsible for the education and continuing education standards of the Tax Preparers including the issuance of licenses.

There are approximately 25 schools that have their curriculum evaluated and approved by CTEC. Under this bill, it could be interpreted to require FTB to evaluate and approve the actions of CTEC in approving the curriculum of those schools and any other prospective schools, since it would be FTB's responsibility to enforce the chapter.

Under this bill, FTB would be able to levy a fine of up to \$1,000 for any violation. It is unclear if this fine is in addition to the \$1,000 criminal fine that currently exists in the Business and Professions Code or is the same fine. If it is the same fine, the bill should be amended to reference the appropriate section of the Business and Professions Code. If this bill would create a new fine, it is unclear where the money received from imposition of the fine would be allocated.

In addition, this bill would provide no compliance period for the Tax Preparer to comply with any remedial measures. As a result, the Tax Preparer could be immediately fined upon discovery of a violation. It's unclear what impact this may have on the department's relationship with Tax Preparers and taxpayers.

It does not appear that a Tax Preparer would have any right to protest or appeal a fine issued by FTB. Consequently, a Tax Preparer would not receive due process and would be unable to dispute an erroneous fine.

It is unclear if FTB would have the authority to take collection action against the Tax Preparer if the Tax Preparer failed to pay the fine.

Since the Tax Preparer chapter of the Business and Professions Code would become inoperative July 1, 2008, it is unclear if the outstanding citation and fine balances would remain collectible or be waived or dismissed.

The department currently captures information from tax returns regarding persons who prepared state tax returns. However, that information is not maintained on a database with the ability to track specific Tax Preparers. A new system would need to be developed to capture information from several different sources, data match that information, and track specific Tax Preparers.

The requirements of existing law for tax preparers apply to those persons who prepare only federal income tax returns. Enforcement of the requirements of state law with respect to the preparation of federal returns may conflict with the federal requirements for practice before the IRS. These conflicts may complicate enforcement of the provisions of state law.

This bill would allow FTB to accept funds from CTEC. However, it does not require CTEC to give funds to FTB to administer the program. This provision is unclear because it cannot be determined if funds would be reimbursement to the department for expenses related to the enforcement of the provisions of the bill.

Due to limited budget and resources, an additional appropriation would be necessary to implement this bill.

### LEGISLATIVE HISTORY

SB 1077 (Greene, Stats. 1996 Ch. 1137) eliminated the Tax Preparer program and instead entrusted a similar program to CTEC.

### OTHER STATES' INFORMATION

The laws of *Florida, Illinois, Michigan, Minnesota, Massachusetts, and New York* were reviewed due to their similarities with California income tax law. However, no information was found relating to the enforcement of the rules Tax Preparers are required to follow in these other states.

### FISCAL IMPACT

First year implementation costs are estimated to be \$1.2 million, which includes six new positions to visit approximately 3,000 sites. The department would have to begin working on an education strategy immediately to publicize FTB's new enforcement responsibilities.

SECTION	COST '02	PY '02
<b>COLLECTIONS</b>	\$ 92,654	1.0
<b>Phone Calls</b>	\$ 1,959	0.1
<b>ITSMB – OT</b>	\$ 24,812	0.3
<b>Cite &amp; Fine Staff</b>	\$ 538,671	6.0
<b>Cite &amp; Fine Mgr.</b>	\$ 91,640	1.0
<b>Travel &amp; Education</b>	\$ 325,000	0.0
<b>BRANCH OH 8.0%</b>	\$ 45,731	*
<b>DEPT OH 7.8%</b>	\$ 48,154	*
<b>TOTAL</b>	<b>\$1,168,620</b>	<b>8.4</b>

#### Assumptions:

3,000 site visits (10% increase to the existing 30,000 registered with CTEC).

One personnel year and \$25,000 travel funds for every 250 site visits = \$300,000.

To visit 3,000 sites would require six Associate Tax Auditors and an Administrator 1 to manage.

To educate tax preparer community, \$25,000.

Collections program costs are for a database that will track and issue notices for citations only.

Phone calls-If 50% of the 3,000 fined Tax Preparers call at 12 calls per hour it would require 125 hours.

The above estimate does not include any legal costs that could result from legal actions brought against FTB by Tax Prepares arguing the citation and fines.

## **ECONOMIC IMPACT**

### Revenue Estimate

Although there is a potential for significant fines to be assessed, an estimate for the amount of fines collected annually cannot be quantified until the implementation considerations are resolved.

## **ARGUMENTS/POLICY CONCERNS**

By requiring FTB to enforce the rules governing Tax Preparers, it is unclear what impact this bill would have on the positive relationship that currently exists between Tax Preparers and the department.

Since CTEC is responsible for enforcing the rules governing Tax Preparer, it may be more appropriate to allow CTEC the authority to issue the citations, fines, and orders provided for by this bill.

### Additional Comments

The department's fraud staff has an existing memorandum of understanding (MOU) with CTEC. Among other things the MOU provides that fraud staff when visiting Tax Preparers would provide CTEC information to Tax Preparers. However, due to recent budget and resource constraints, visits to Tax Preparers by the department's fraud staff has been significantly reduced.

## **LEGISLATIVE STAFF CONTACT**

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