Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Koretz	Analyst:	Gloria McConnell	Bill Number:	AB 2942
Related Bills:	See Legislative History	Telephone:	845-4336	Amended Date:	08-05-2002
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Labor Commissioner Consult With FTB & Joint Enforcement Strike Force On Underground Economy To Set Up Standards To Trigger Audit

SUMMARY

This bill would require the Labor Commissioner, in consultation with the Franchise Tax Board (FTB) and the Joint Enforcement Strike Force On Underground Economy (JESF), to develop standards for recommending an audit by appropriate state taxing authorities of employers that violate the minimum wage and overtime labor laws.

SUMMARY OF AMENDMENTS

The August 5th amendments added the above-described provisions to the bill and deleted the previous provisions that would have required the Labor Commissioner to notify the appropriate taxing authorities when an employer violates working hours and wage laws.

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

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to have the Labor Commissioner, FTB, and JESF establish a process and working relationship for the sharing of information to enforce compliance with the labor and tax laws.

EFFECTIVE/OPERATIVE DATE

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

POSITION

Pending.

ANALYSIS

BACKGROUND

In 1993, the Governor signed Executive Order W-66-93 that created the JESF. This Order was subsequently codified under Section 329 of the Unemployment Insurance Code and is further explained below under FEDERAL/STATE LAW.

Board Position:			Department Director	Date
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FTB has computer programs that sort through employer information received through the Employment Development Department (EDD) and matches this information against an individual's income tax returns. Individuals with wages reported to EDD for whom FTB has no record of an income tax return being filed are asked to file a return. If tax returns are filed, but individuals have not reported all their wages as income on their tax returns, FTB may issue notices of proposed deficiency assessments for the additional tax. If an employer does not properly report to EDD the wages it is paying, this also may be an issue for FTB if those wages are improperly reported as a deduction on the tax returns required to be filed with FTB. For example, the employer may not be reporting the correct amount of wages as a deduction on its tax return.

FTB has a large audit staff designed to encourage compliance with the income tax laws. For audit purposes, computer programs search state and federal income tax records, including EDD records, to detect leads as to discrepancies between income that was reported and that which should have been reported on tax returns. In addition, the department may receive audit leads from informal associations with other governmental agencies or other sources. From these computerized searches and other leads, one of many audit-type activities may be initiated, ranging from clerical inquiries, computer-generated inquiries, manual desk audits, or field audits to a combination of computer and manual audits. FTB typically seeks funding for these audit-type activities for all cases with a cost-to-benefit ratio (CBR) of 1:5 or greater, based on the cost to determine the amount of the proposed deficiency assessments. Audits with a lesser CBR may be conducted on a case-by-case basis.

In cases where there are indications of criminal violations of the tax law, FTB has investigators who are peace officers. As peace officers, they obtain leads through their association with members of appropriate task forces and through information from other governmental agencies that may focus on criminal activity. To work their criminal cases, these officers may conduct necessary audits, obtain search warrants, work with the district attorney, and perform other activities necessary to complete that criminal case. By law, certain information received by FTB's investigative staff cannot be shared with non-peace officers, which include FTB's audit staff and members of the JESF.

FTB and the other taxing authorities historically have explored whether trends or patterns of noncompliance in one area of law automatically would reflect a trend or pattern of noncompliance in another area of law and the benefit, if any, of joint audits. However, past studies have not supported that such trends or patterns exist or that joint audits by taxing authorities are routinely productive.

FEDERAL/STATE LAW

Under federal law, the Department of Labor administers the Fair Labor Standards Act (FLSA) that regulates the basic minimum wage, overtime pay standards, work hours, and various other labor related issues.

Under state law:

- Department of Industrial Relations (DIR) administers the Labor Code relating to employees' working hours, wages, and working conditions. Within DIR is the Division of Labor Standards Enforcement headed by the Labor Commissioner. The DIR reports to the newly created California Labor and Workforce Development Agency.

- EDD administers the Unemployment Insurance Code (UIC) relating to employer/employee employment taxes based on wages. EDD also reports to the newly created California Labor and Workforce Development Agency.

- FTB administers the Personal Income Tax Law and Corporation Tax Law, which impose taxes based on or measured by individuals' or corporations' income.

- JESF is generally responsible for developing enforcement resources to deter tax evasion and maximize recoveries from tax evaders and employers that are violating the law relative to cash payments. EDD is lead agency for the JESF. Required participants are EDD, Department of Consumer Affairs, DIR, Department of Insurance, and the Office on Criminal Justice Planning. FTB, BOE, and Department of Justice, are encouraged to participate.

Information disclosed on returns, reports, or documents required to be filed with FTB, including the business affairs of a corporation, cannot be disclosed to other parties, unless the disclosure is expressly authorized by law. Under current law, FTB is expressly authorized to share this information with the following taxing authorities: IRS, EDD, and BOE.

THIS BILL

This bill would require the Labor Commissioner, in consultation with FTB and JESF, to develop and implement an appropriate set of standards that establish guidelines and standards that would trigger a potential audit by the appropriate taxing authority.

This bill would require the Labor Commissioner after July 1, 2003, to take the following actions with respect to an employer who has met the standards for triggering an audit recommendation:

- Notify the appropriate state tax authorities each time the set of standards is met by the employer.
- Provide the state tax authorities with the name of the employer and all relevant and necessary information about the violations.
- Make a recommendation to the appropriate state tax authorities that the employer be audited.

This bill would require the Labor Commissioner to compile a list of referrals made to the state tax authorities annually. The list would have the employer's name and tax identification number as well as the nature of the violations.

IMPLEMENTATION CONSIDERATIONS

According to the author's staff, this bill will not pass the Legislature this year, but staff anticipates that the Assembly Labor Committee will continue to work with the FTB and JESF to resolve any problems with this bill to facilitate enactment in the future. For this purpose, the following considerations should be noted:

- FTB audit and investigation staff currently look for any enforcement projects, leads, and information sources that would result in compliance with the tax law and for which FTB is budgeted.

- It is uncertain the length of time it would take for FTB to undertake the project required by this bill. Given the overall reduction in staff required by all state agencies, it is unclear whether time could be allotted to this JESF project without redirecting staff from revenue producing projects.

- One of the standards for triggering a recommendation for an FTB audit could be a CBR consistent with FTB's guidelines for seeking funding for audits. However, such a standard may significantly limit the number of recommendations that would be generated for an FTB audit.

- The limitation on FTB to disclose tax return information to all JESF members may be an obstacle in achieving the desired results of this bill and resulting JESF project.

OTHER STATES' INFORMATION

Illinois, Michigan, Minnesota, Massachusetts, and *New York* each have a Department of Labor that protects the rights, wages, working conditions, and working hours of employees. Research did not provide information about whether any of these states set standards resulting in audit recommendations to taxing authorities in conjunction with violations of labor laws.

The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

FISCAL IMPACT

Departmental Costs

The departmental costs that may be associated with this bill are unknown.

ECONOMIC IMPACT

Revenue Estimate

To the extent potentially identified taxpayers would not otherwise be discovered through existing programs and additional assessments of tax result which the department is able to collect, this bill would produce additional revenue of an unknown amount annually.

LEGISLATIVE STAFF CONTACT

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