

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: SB 415 Analyst: Gloria McConnell Bill Number: SB 415

Related Bills: See Legislative History Telephone: 845-4336 Amended Date 03/27/01

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: FTB Provide Free Electronic Filing & Interactive Forms/Tax Information Disclosure for Business Transactions

SUMMARY

This bill would require Franchise Tax Board (FTB) to provide individuals, free of charge, interactive forms or software needed to file any tax return electronically.

This bill also would make amendments to existing laws relating to the disclosure of a consumer's income tax return information by third parties. This provision does not directly affect the FTB, and therefore, is not addressed in this analysis.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to allow individuals to use FTB's Internet website to fill out their income tax returns and to electronically file their returns directly with FTB without having to use a commercial third-party intermediary.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative on January 1, 2002.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current state income tax law requires the department to make tax forms as simple as possible for taxpayers to use to report their income and compute their tax liability. The department is required to design the forms so taxpayers can copy figures from their federal returns or attach a copy of their federal returns.

The state income tax law for all individuals is largely patterned upon the federal income tax law; however, since there are differences between federal and state laws, federal adjusted gross income (AGI) must be modified to arrive at California AGI. In addition, itemized deductions also may need to be modified to calculate California taxable income.

Board Position:

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Department Director

Date

Gerald H. Goldberg

04/05/01

THIS BILL

This bill would require FTB to provide to any individual, free of charge, interactive forms or software needed to file any required tax return electronically.

IMPLEMENTATION CONSIDERATION

Staff anticipates this bill would be implemented over several years, beginning January 1, 2002, with the e-filing of the taxable year 2001 Form 540 2EZ.¹

PROGRAM BACKGROUND

When preparing a California paper income tax return form, the individual may be directed to transfer amounts from their federal tax return. The California instructions may use a paper schedule or worksheet provided by FTB to make certain calculations or modifications to amounts on the federal return to reflect differences between federal and state laws. Depending upon the income item, a schedule reflecting the modification or a copy of the federal income tax return may need to be attached to the California income tax return. After the return is prepared, the individual mails the paper income tax return form to FTB.

The department also provides a variety of tax forms (including instructions and schedules) for PIT taxpayers at FTB's website. All of the forms and many of the simpler schedules are fillable. Even though the personal income tax return forms are fillable at FTB's website, the forms cannot be sent electronically from FTB's website directly to FTB. Individuals must print and mail them to FTB.

FTB members have publicly considered various technology options that the department might undertake so taxpayers can file directly with FTB. In 1999, at least one FTB member expressed concern about FTB being in the "tax software business." At its February 8, 2000, meeting, a majority of FTB members instructed staff to develop a direct portal e-file system for taxpayers. The direct portal e-file system was designed to allow the taxpayer to file any tax return prepared using commercially available software directly to FTB.

The portal was put into service for the current tax filing season. Success of the portal this filing season has been limited because only one commercial tax preparation company offers direct portal e-filing to the public as discussed below.

Tax Preparation -- With the growth of technology, there are various electronic ways to prepare an income tax return:

1. *Practitioner tax preparation* -- Individuals use the services of a tax professional that utilizes tax preparation software to complete the income tax return. The professional offers tax advice through a combination of personal interviews and personal or software generated questions/answers (queries). The software used by the professional makes various calculations and computes the income tax.

¹ This goal assumes the Form 540 2EZ design for tax year 2001 would generally be the same as tax year 2000.

2. *Purchased software* -- Individuals may purchase tax preparation software. The software is installed on a personal computer and used to complete the income tax return. The software makes various calculations and computes the income tax. The software may offer tax advice by generating queries.
3. *On-line preparation* -- Several companies offer tax preparation programs that can be accessed with a personal computer via the Internet. These on-line programs are generally the same as the software services described in # 2 above.
4. *Fillable forms* -- Individuals may use "fillable" forms available on FTB's website. To use these forms, individuals make the calculations and compute the tax as though they were preparing paper income tax return forms, but enter the information onto the form using their personal computer.

A significant advantage of using purchased software or on-line programs is that generally the software/programs prepares both state and federal income tax returns.

Tax return filing -- Paper and fillable forms must be mailed to FTB. Technology allows certain California taxpayers three ways to file electronically (e-file).

- *Practitioner e-filing* -- Tax professionals who are approved by FTB as electronic return originators (EROs) may transmit the taxpayer's tax return electronically. The transmission is generally from the ERO's computer system to a third party transmitter and then to FTB's computer system. However, the taxpayer's tax return resides on the ERO's computer system, as it does with any computer prepared return from a tax professional.
- *On-line e-filing* -- Individuals using purchased tax preparation software or on-line tax preparation programs may transmit certain tax returns electronically. The transmission uses FTB-approved on-line filing service providers (OLSPs). The OLSP transmits the taxpayer's tax return electronically to FTB's computer system using the OLSP's computer system. Typically, e-filing programs for both federal and state income tax returns are contained in the same software. The taxpayer's tax return always resides on the OLSP's computer system and may also reside on the taxpayer's computer.
- *Direct portal e-filing* -- The FTB portal was developed to allow taxpayers to file their tax returns via their Internet service provider (ISP) directly to FTB. However, the commercial third-party company that currently offers direct portal e-filing, an on-line tax preparation company, requires that the individual's software-prepared tax return be transmitted to FTB via the company's ISP.

Costs -- The cost for tax preparation through tax professionals, purchased software and on-line services varies. The cost for using tax preparation software/programs may include the e-filing services. E-filing services are generally provided for a fee. However, some companies offer certain e-file services gratis. Such free services are subject to change by the provider and could be withdrawn at will at any time.

Several companies offer free electronic tax preparation and filing services if the individual's AGI is below a specified amount or if the individual is filing a Form 540 2EZ. FTB does not charge for using fillable forms, but they cannot be e-filed. FTB does not charge for the use of its direct filing portal, but the one company enabling use of the portal charges its customers, except for Form 540 2EZ.

The IRS electronic process is generally the same as FTB's.

OTHER STATES' INFORMATION

Based on a recent newspaper article in USA Today, staff could verify that at least 11 states² offer direct on-line filing. To a varied extent all of these income tax return forms and schedules are fillable. Of the 11 states, the majority perform calculations to some unknown extent and a few generate queries.

FISCAL IMPACT

Departmental Costs

Staff anticipates this bill could be implemented through offsetting savings from the reduced processing of paper income tax returns.

ECONOMIC IMPACT

Tax Revenue Estimate

Both refunds and tax payments would be accelerated due to facilitating e-filing; however, the extent is unknown.

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² Arkansas, Colorado, Delaware, Iowa, Illinois, Indiana, Maryland, Massachusetts, Missouri, New Mexico, and South Carolina.