Franchise Tax Board

ANALYSIS OF AMENDED BILL

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Related Bills:	See Legislative History	Telephone:	845-7478	Amended Date:	April 28, 2003
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Mandatory Filing for Tax Practitioners

SUMMARY

This bill would require tax practitioners that prepare more than 100 individual income tax returns in a calendar year to file all individual returns with the Franchise Tax Board (FTB) in subsequent years using magnetic media or other machine-readable form.

Since the department currently accepts and processes returns filed using machine-readable forms, this bill as written would not impact the department. Therefore, this bill would not result in the desired cost savings that was intended by the Governor's budget, as discussed below under Fiscal Impact.

SUMMARY OF AMENDMENTS

The April 28, 2003, amendments removed the bill's general provision relating to the 2003/2004 budget and replaced it with various specific budget provisions, including the provision discussed in this analysis.

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

PURPOSE OF THE BILL

It appears the purpose of this bill is to reduce FTB's cost of processing personal income tax returns.

EFFECTIVE/OPERATIVE DATE

As a budget trailer provision, this requirement would be effective immediately upon enactment and be operative for individual income tax returns filed on or after that date.

POSITION

Pending.

Summary of Suggested Amendments

The original intent of this provision, as outlined in the Governor's January budget, was to require tax practitioners that prepare more than 100 individual income tax returns in a calendar year to *electronically file (e-file)* all subsequent individual income tax returns. This bill would instead require practitioners to file all subsequent individual income tax returns using *magnetic media or other machine-readable form*. Department staff has been in contact with the Department of Finance and the Assembly Budget Committee regarding possible amendments to reflect the original intent.

Board Position:			Department Director	Date
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ANALYSIS

FEDERAL/STATE LAW

Under federal law, income tax returns are in a form prescribed by the Secretary of the Treasury. In addition, federal income tax law has several provisions relating to e-filing returns with the Internal Revenue Service (IRS).

Current state income tax law provides that returns shall be in any form that FTB may prescribe, including, but not limited to, paper, magnetic media, or electronic imaging technology. In addition FTB may prescribe regulations providing standards for determining which tax returns shall be filed on magnetic media or in other machine-readable form.

THIS BILL

This bill would:

- require an income tax preparer that prepares more than 100 timely original individual income tax returns during a calendar year to file all tax returns in subsequent years using magnetic media or other machine-readable form;
- define “income tax return preparer” as:
  - any person that prepares for compensation or employs one or more persons to prepare for compensation any tax return under the Personal Income Tax Laws; or
  - any person that is required to include a tax preparer identification number on a tax return;
- define “original individual tax return” as a tax return filed by an individual;
- provide that “timely” original individual tax returns are those returns that are required to be filed during a calendar year, regardless of extensions, which would generally exclude amended returns and prior year returns;
- define "acceptable individual income tax return” as a tax return filed by an individual that FTB determines may be filed on magnetic media or in other machine-readable form;
- provide that the Administrative Procedure Act provisions in the Government Code regarding administrative regulations and rulemaking are not applicable for purposes of rules, notices, or guidelines that identify those returns that shall be treated as acceptable individual income tax returns for purposes of this bill; and
- provide that the requirement to file returns using magnetic media or other machine-readable form as outlined under this bill would not apply during a calendar year if the income tax preparer filed 25 or fewer returns during the previous calendar year.

In addition, this bill would provide for a $50 penalty for each acceptable individual income tax return that is prepared by a tax return preparer using software and then not filed by the preparer using magnetic media or other machine-readable form, unless the failure is due to reasonable cause and not due to willful neglect. For purposes of this bill, reasonable cause would include a paper return prepared by a tax preparer required to file returns using magnetic media or other machine-readable form, where the failure to file the tax return using that technology was due to a taxpayer’s refusal to file the return on magnetic media or in other machine-readable form. Essentially, this would create an opt-out provision.

IMPLEMENTATION CONSIDERATIONS

Since the department currently accepts and processes returns filed using machine-readable forms, this bill as written would not impact the department. Therefore, this bill would not result in the desired cost savings that was intended by the Governor's budget, as discussed below under Fiscal Impact.

TECHNICAL CONSIDERATIONS

This bill uses the term "original individual tax return." Department staff suggests clarifying the term to state "original individual income tax return."

This bill contains references to a tax preparer that "prepares and files" income tax returns. Under current law, tax preparers are those persons that *prepare* tax returns. The law does not specify that the tax preparer *file* tax returns. Technically, the taxpayer is responsible for filing the tax return. Department staff suggests clarifying the references to remove the reference that tax preparers *file* tax returns.

The language of the provision states that a tax preparer that prepared more than 100 tax returns during the "previous calendar year" would be subject to the requirement under this bill. Due to the urgency clause contained in the bill, the requirement in this provision would be effective and operative upon enactment. As a result, the reference to the "previous calendar year" would take into account 2001 taxable year returns filed during the 2002 calendar year, which would subject the preparers to the requirement of this provision for the preparation of the 2002 taxable year returns filed during 2003, for which the return filing season began January 1, 2003. Since the original intent of the provision was to require preparers that prepared more than 100 tax returns *beginning with calendar year 2003* to be subject to the requirement in this provision, department staff suggests clarifying the language to reflect the original intent.

LEGISLATIVE HISTORY

A proposal similar to this bill was included in the Governor's Budget Proposal for the 2002/2003 fiscal year that was submitted to the Legislature in January 2002. That proposal would have required tax practitioners that prepare more than 100 individual income tax returns in a calendar year to *electronically file (e-file)* all individual returns with the Franchise Tax Board (FTB) in subsequent years. The proposal failed during department budget negotiations with the Senate Budget Committee prior to the proposal being introduced in a bill.

SBX 7 (Senate Committee on Budget and Fiscal Review, 2003/2004) contains a provision identical to the provision discussed in this analysis. This bill is currently with the Assembly Budget Committee.

PROGRAM BACKGROUND

FTB receives approximately five to seven million tax returns annually that are prepared by tax professionals using a computer and tax preparation software. Although these tax returns are prepared electronically, they are submitted to FTB on paper through the mail. Typically, department operational costs to process paper returns are higher than those costs to process returns received electronically. Once the return is received via mail, the information on the return must be either scanned or manually keyed to transfer the data on the return to department systems. However, a return that is received *electronically* is less expensive to process because the information is already in electronic format. In addition, because much of the electronic information can be validated up front, the return is less likely to contain errors that result in notices to taxpayers, which further reduces department costs.

OTHER STATES' INFORMATION

Since this bill would require practitioners to prepare individual income tax returns using magnetic media or other machine-readable form, which is a process that the department currently uses for processing returns, a review of other states information would not be relevant at this time.

FISCAL IMPACT

This bill would require income tax return preparers that prepared more than 100 individual tax returns during the previous calendar year to file all acceptable returns prepared using tax preparation software in the subsequent year in a *machine-readable format*. This is the existing processing method for income tax returns that are prepared using tax preparation software and filed on paper, therefore, the bill as drafted will not impact the department. As a result, this bill would not realize the savings as intended by the Governor's budget proposal. The Governor's budget proposal requires income tax return preparers that file more than 100 timely original individual income tax returns to file those returns *electronically (e-file)* for a savings of $1.4 million and 50.5 PYs.

ECONOMIC IMPACT

This bill would not impact state income tax revenue.

LEGISLATIVE STAFF CONTACT

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