ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Campbell	Analyst:	LuAnna Hass	Bill Number:	AB 2480
Related Bills:	See Legislative History	Telephone:	845-7478	Introduced Date:	February 19, 2004
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Repeal Mandatory Electronic Filing (e-file) For Tax Practitioners

SUMMARY

This bill would repeal recently enacted provisions that require tax practitioners that meet specific requirements to electronically file (e-file) individual income tax returns.

PURPOSE OF THE BILL

According to the author's staff, this bill is a spot bill and the purpose of this bill will be to amend the current tax practitioner mandatory e-file requirement and penalty.

EFFECTIVE/OPERATIVE DATE

As an urgency measure this bill would be effective and operative upon enactment.

POSITION

Pending.

ANALYSIS

STATE LAW

Recently enacted legislation, AB 1756 (Assembly Budget Committee, Stats. 2003, Ch. 228) and AB 1742 (Assembly Revenue and Taxation Committee, Stats. 2003, Ch. 455), generally requires all returns prepared by an income tax preparer that prepared more than 100 timely original individual income tax returns during any calendar year, beginning with the 2003 calendar year, to be e-filed in subsequent years if one or more of those tax returns was prepared using tax preparation software. This law applies to individual income tax returns required to be filed for taxable years beginning on or after January 1, 2003.

In addition, the law provides that an income tax preparer that is subject to the requirements is subject to a $50 penalty for each acceptable individual income tax return that is prepared and then not e-filed, unless the failure to e-file is due to reasonable cause and not due to willful neglect. Reasonable cause would include, but not be limited to, a taxpayer's election not to e-file the return.

As discussed below under Fiscal Impact, the intended purpose of the mandate was to reduce the Franchise Tax Board (FTB) costs of processing personal income tax returns.

Board Position:			Department Director	Date
_______ S	_______ NA	_______ NP		
_______ SA	_______ O	_______ NAR	Gerald H. Goldberg	4/19/04
_______ N	_______ OUA	___X___ PENDING		

<u>THIS BILL</u>

This bill would repeal the provisions of recently enacted legislation, as discussed above, that requires tax practitioners, that prepare more than 100 individual income tax returns in a calendar year, to e-file all individual returns beginning with the following calendar year.

<u>IMPLEMENTATION CONSIDERATIONS</u>

While it is anticipated that this bill would not significantly impact the department's programs and operations, the department may not realize the intended budget savings, as discussed below under Fiscal Impact.

LEGISLATIVE HISTORY

AB 1756 (Assembly Budget Committee, Stats. 2003, Ch. 228) generally requires returns prepared by tax practitioners that prepare more than 100 individual income tax returns in a calendar year to be e-filed with FTB beginning with the following calendar year. In addition, the law provides that an income tax preparer that is subject to the requirements is subject to a $50 penalty for each acceptable individual income tax return that is prepared and then not e-filed, unless the failure to e-file is due to reasonable cause and not due to willful neglect.

AB 1748 (Assembly Budget Committee, 2003/2004) and SBX 7 (Senate Committee on Budget and Fiscal Review, 2003/2004) contained a provision similar to the provision enacted in AB 1756 (Assembly Budget Committee, Stats. 2003, Ch. 228). However, those bills would have required tax practitioners to file all individual returns with FTB in subsequent years using magnetic media or other machine-readable form. AB 1748 was amended to remove the provision and SBX 7 is with the Assembly Budget Committee.

PROGRAM BACKGROUND

FTB received over six million tax returns for the 2002 taxable year that were 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.

FTB received approximately three million e-filed tax returns for the 2002 taxable year that were prepared by tax professionals. 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 before a return is accepted as filed, the return is less likely to contain errors that result in notices to taxpayers, which further reduces department costs.

OTHER STATES' INFORMATION

The following states have a requirement that would require tax practitioners to e-file tax returns once a specific threshold is attained.

- *Michigan* requires tax preparers that prepared more than 200 returns in 2003 to e-file all subsequent returns.

- *Minnesota* requires tax preparers that prepare more than 100 tax returns in 2003 to e-file all subsequent returns. A $5 paper filing fee is applied for every eligible return not e-filed by preparers. The taxpayer may elect not to e-file, but the $5 fee is still applied.
- *Wisconsin* requires tax preparers that prepared more than 100 returns in 2002 to e-file all subsequent returns. Waivers are available for those in hardship and taxpayers may opt out of e-filing.
- *Ohio* does not have a mandate for income tax returns. However there is a pilot program in place for mandatory e-filing of sales tax returns.
- *Oklahoma* requires tax preparers that prepared more than 50 returns to e-file all subsequent returns. The taxpayer may elect to file a paper return.
- *Pennsylvania* is planning an e-file mandate for the filing of business and personal income tax returns and payments for 2005.

FISCAL IMPACT

The 2003/2004 Budget Act included a net permanent reduction in FTB's baseline budget of $1.23 million and 45.5 PYs beginning with the 2003/2004 fiscal year for the legislation to mandate e-file for tax practitioners that prepare more than 100 individual income tax returns. The savings was based on a volume of 2,925,000 returns converting from paper to electronic filing.

Since this bill would repeal the provision mandating e-file for practitioners, it is possible the conversion of the full volume of returns would not occur without the mandate and the department would not realize the full budget savings. As a result, the 45.5 PY reduction would need to be restored for the 2004/2005 fiscal year. This would allow the department to maintain the prior level of return processing and avoid possible delays in issuing taxpayer refunds in the event a significant volume of the 2,925,000 returns are received via paper instead of electronically.

ECONOMIC IMPACT

This bill would not impact state income tax revenue.

ARGUMENTS/POLICY CONCERNS

Since the enactment of AB 1756 (Assembly Budget Committee, Stats. 2003, Ch. 228) in August 2003, approximately 11,400 tax professionals have enrolled in FTB's e-file program. However, the department is unable to distinguish those tax professionals that enrolled due to the mandatory e-file requirement. It is anticipated that some of the 11,400 tax professionals are not mandated to e-file and joined the program voluntarily. In addition, some of the tax professionals that are required to e-file under the new law may have already been e-filing some tax returns prior to the mandate.

Current law gives FTB authority to assess a $50 penalty for each tax return a tax preparer is required to e-file but fails to do so. However, the law excepts a tax preparer from the penalty if the taxpayer elects not to have their tax return e-filed. Consequently, receipt of a paper tax return arguably indicates the election of the taxpayer not to e-file, thus rendering the penalty ineffective.

LEGISLATIVE STAFF CONTACT

LuAnna Hass	Brian Putler
Franchise Tax Board	Franchise Tax Board
845-7478	845-6333
luanna.hass@ftb.ca.gov	brian.putler@ftb.ca.gov