Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Sen. Budget Committee	Analyst:	LuAnna Hass	Bill Number:	SB 1100
Related Bills:	See Legislative History	Telephone:	845-7478	Amended Date:	July 28, 2004
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Extension Of Natural Heritage Preservation Tax Credit/Suspension Of Teacher Retention Credit//Franchise Tax Board Administer Tax Amnesty/Proposed Fees For Services

SUMMARY

For purposes of laws administered by the Franchise Tax Board (FTB), this budget trailer bill would do the following:

1. Extend the years during which the Natural Heritage Preservation Tax Credit may be awarded and claimed (Page 3).
2. Suspend the Teacher Retention Tax Credit for the 2004 and 2005 taxable years (Page 5).
3. Create a tax amnesty program for certain taxpayers that 1) failed to file income tax[1] returns, 2) underreported income on a previously filed income tax return, or 3) failed to pay any taxes previously assessed (Page 7).
4. Allow FTB to charge fees for specific services requested by an individual or entity (Page 13).

This analysis addresses only those provisions of the bill affecting FTB.

EFFECTIVE/OPERATIVE DATE

As an urgency statute, this bill would be effective immediately upon enactment.

1. For purposes of the Natural Heritage Preservation Tax Credit, the operative date would be extended to include contributions made no later than June 30, 2008.
2. For purposes of the Teacher Retention Credit, the suspension would be operative for the 2004 and 2005 taxable years.
3. For purposes of the amnesty program, the operative date would apply to taxable years beginning before January 1, 2003, only, and the amnesty program period would commence February 1, 2005.
4. For purposes of the fees for FTB services, the operative date would be the same as the effective date and apply to services provided on or after that date.

[1] In this analysis, "income tax" is intended to include generally the income tax for individuals, fiduciaries, estate, trusts, partnerships, and corporations, as well as the franchise tax, which is the corporate tax measured by income for corporations doing business in this state.

Board Position:			Department Director	Date
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______ N	______ OUA	______ PENDING	Lynette Iwafuchi for Gerald H. Goldberg	8/4/04

SUMMARY OF FISCAL IMPACT

Department costs to implement this bill are estimated to be approximately $10.3 million for fiscal year 2004-05. See the discussions of provisions Nos. 3 and 4 for additional information.

Department Costs To Implement SB 1100 ($ Millions)	
Tax Amnesty	10.2
Fees For Services	.1
Total	10.3

SUMMARY OF ECONOMIC IMPACT

The following table reflects the estimated impacts of the above provisions of this bill:

Estimated Revenue Impact of SB 1100 Fiscal Year Impact (In Millions)				
	2004-05	2005-06	2006-07	2007-08
Natural Heritage Preservation Credit	$13	$8	$4	Minor Loss
Teacher Retention Credit	$210	$180	No Impact	No Impact
Tax Amnesty	$200	-$10	$10	$15
Proposed Fees	**	**	**	**
Total	$423	$178	$14	Approx. $15

**Reimbursement of FTB costs as discussed below.
Minor = less than $500,000

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

The revenue discussion is included with each provision.

POSITION

No position on this bill; however, on June 10, 2004, the Franchise Tax Board voted 2-0 to support AB 2203 (Chu), which is substantially the same as the Amnesty provision of this bill.

1. Extend The Natural Heritage Preservation Tax Credit

ANALYSIS

FEDERAL/STATE LAW

Under the California Public Resources Code (PRC), the Natural Heritage Preservation Tax Credit Act of 2000 was established to encourage donations of land to the state, to local governments, or to designated nonprofit organizations. The donated property must be approved for acceptance by the Wildlife Conservation Board (WCB), which notifies FTB of the amount of tax credit awarded for each donation.

Under the PRC, the WCB has the authority to award no more than a total of $100 million in preservation tax credits beginning with fiscal year 2000/2001. The WCB may not award preservation tax credits after fiscal year 2004/2005 without further statutory authorization.

Under the Revenue and Taxation Code (R&TC), a taxpayer is allowed an income tax credit of up to 55% of the fair market value of the donated property. Any unused credit may be carried over for up to seven years.

Due to budget constraints, the credit was suspended for fiscal year 2002/2003. The suspension of the credit ended July 1, 2003; however, the WCB has not accepted any new applications or awarded any new credits since the suspension ended.

THIS BILL

This provision would extend the period in which the preservation credits may be awarded and claimed from ending fiscal year 2004/2005 to ending 2007/2008.

This provision specifies that tax credits may be awarded between July 1, 2002, and June 30, 2005, only if the amount of all lost revenue resulting from the credit is reimbursed to the General Fund (GF). Without reimbursement to the GF, the WCB may not resume awarding credits until July 1, 2005.

LEGISLATIVE HISTORY

AB 2722 (Laird, 2003/04) would allow the WCB to award Natural Heritage Preservation Tax Credits and use bond funds to reimburse the GF for all lost revenue resulting from the award of the credits. AB 2722 is currently in the Senate Appropriations Committee.

SB 1052 (Budget & Fiscal Review Committee, 2003/04) would limit award of the Natural Heritage Preservation Tax Credits to fiscal years 2000/2001 and 2001/2002. SB 1052 failed to pass out of the house of origin by the constitutional deadline.

AB 238 (Oropeza, 2003/04) and AB 2097 (Oropeza, 2003/04) would have extended the years during which the Natural Heritage Preservation Tax Credit may be awarded and claimed. Both AB 238 and AB 2097 failed to pass out of the house of origin by the constitutional deadline.

AB 3009 (Budget Committee, Stats. 2002, Ch. 1033) suspended the Natural Heritage Preservation Tax Credit between July 1, 2002, and June 30, 2003, inclusive.

SB 1647 (O'Connell, Stats. 2000, Ch. 113) established the Natural Heritage Preservation Tax Credit Act of 2000 in the PRC and established the tax credits within the R&TC.

FISCAL IMPACT

This bill would not impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on the discussion below, the revenue impact from this provision would be as follows:

Estimated Revenue Impact Natural Heritage Preservation Tax Credit Fiscal Year Impact (In Millions)				
Fiscal Year	2004-05	2005-06	2006-07	2007-08
Revenue Impact	+$13	+$8	+$4	*Minor Loss

*Minor = less than $500,000

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this provision.

Revenue Discussion

The Natural Heritage Preservation Tax Credit Act of 2000 set aside $100 million for the preservation of qualified property. Actual allocations of tax credits totaled $37 million for 2001 and 2002. The remaining $63 million has yet to be allocated ($100 million minus $37 million).

The above estimate is based on the following assumptions:

1. There will be no funding available to reimburse the GF in 2004-05.
2. The remaining $63 million is allocated over three fiscal years–2005-06, 2006-07 and 2007-08, or $21 million each fiscal year.
3. Each fiscal year allocation of $21 million will take five years to be used, that is, claimed on tax returns by the taxpayers that made the corresponding contributions, or $4 million each fiscal year.

In the 2004-05 fiscal year, there is no allocation made under this provision because it was assumed that no funding would be available to reimburse the GF. Therefore, this provision would result in a revenue savings of $13 million for the 2004-05 fiscal year. Beginning with the 2005-06 fiscal year, the first $4 million would be used. Under current law, the revenue loss would have been $13 million, resulting in a revenue savings of $8 million (rounded to the nearest million). In 2006-07, there remains a carryover of $4 million from the 2005-06 allocation, plus $4 million from the 2006-07 allocation for a total of $8 million. The $13 million that would have been used under current law, minus $8 million as provided by this provision would result in a revenue savings of $4 million (rounded to the nearest million).

In 2007-08 and in 2008-09, the amounts allocated under current law equals the amounts as proposed by this provision, resulting in a minor revenue loss. Beginning in 2009-10, revenue losses increase because this provision would extend the credit allocations three years beyond current law.

2. Suspension Of The Teacher Retention Credit

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state laws provide various tax credits designed to provide tax relief for taxpayers that incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they might not otherwise undertake.

Current state law allows a tax credit for credentialed teachers based upon the taxpayer's years of service as a credentialed teacher. The credit amount varies as follows:

Years of Service	Credit
At least 4 but less than 6 years	$250
At least 6 but less than 11 years	$500
At least 11 but less than 20 years	$1,000
20 or more years	$1,500

The credit cannot exceed 50% of the amount of tax that would be imposed on a teacher’s salary, excluding pensions or other deferred compensation, after application of the standard deduction or itemized deductions.

The Teacher Retention Credit was enacted in 2000 and first operative for the 2000 taxable year. It was subsequently suspended for the 2002 taxable year, but available again for the 2003 taxable year.

THIS BILL

This provision would suspend the Teacher Retention Credit for taxable years 2004 and 2005. Since there are no carryover provisions for this credit, including the period that the credit was previously suspended, the suspended credit amounts as proposed by this provision would not be available to reduce tax for any other taxable year.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

LEGISLATIVE HISTORY

AB 2065 (Oropeza, Stats. 2002, Ch. 488) suspended the Teacher Retention Credit for the 2002 taxable year.

AB 428 (Budget Committee, 2001-2002) contained similar provisions as this bill. This bill failed passage on the Senate floor.

AB 433 (Budget Committee, 2001-2002) contained a similar provision as this bill, with the suspension of the credit being for taxable year 2002. This bill was subsequently amended to remove reference to the credit.

AB 2879 (Jackson, Stats. 2000, Ch. 75) enacted the Teacher Retention Credit.

FISCAL IMPACT

This provision would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact Teacher Retention Credit Suspension Fiscal Year Impact (In Millions)			
2004-05	2005-06	2006-07	2007-08
$210	$180	No Impact	No Impact

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this provision.

Revenue Discussion

The revenue estimate is based on actual credits claimed in 2000 and 2001, using a 5% growth rate for future years. The Teacher Retention Credit cannot be carried forward; therefore, the total impact of the two-year suspension is reflected in the 2004-05 and 2005-06 fiscal years.

3. FTB Administer Tax Amnesty Program

ANALYSIS

FEDERAL LAW AND PRACTICE

Federal law does not provide for a comparable amnesty program.

Existing federal law prohibits the disclosure of any taxpayer information, except as specifically authorized by statute.

STATE LAW AND PRACTICE

Under current state income tax laws, numerous penalties may be imposed against individuals and corporate taxpayers that fail to report or underreport income. Additionally, certain penalties are imposed against third parties that assist taxpayers in the nonreporting or underreporting of income. Further, certain fees are imposed against taxpayers that fail to file returns or pay their tax liabilities. Appendix A provides details regarding these fees and penalties.

Taxpayers that fail to report or underreport their income also may be subject to criminal prosecution and sanctions. Depending upon the gravity of the offense, such taxpayers may be guilty of either a misdemeanor or felony. Upon conviction, such taxpayers are subject to fines or imprisonment or both, together with costs of investigation and prosecution. Typically, the district attorney acts as the prosecuting attorney.

When a taxpayer fails to file an income tax return, there is no statute of limitations for enforcing the filing requirement.

If a taxpayer fails to report or underreport income, FTB has the authority to estimate the net income of that taxpayer from any available information. Once the tax liability is determined based upon the estimate of net income, FTB may issue a notice of proposed deficiency assessment (NPA) for the additional tax, penalties, and interest.

As a result of the 1984-85 tax amnesty program, the Legislature increased the ability of FTB to target nonreporting and underreporting of tax liabilities. Appendix B provides details relating to these activities: enforcement, collection, and criminal investigation.

Existing state law prohibits the disclosure of any taxpayer information, except as specifically authorized by statute. Taxpayer information includes the amount of income earned, or any particulars on the return, including the business affairs of a corporation. Under the CTL, a taxpayer is defined as any association, corporation, business, trust, or organization of any kind subject to the corporate franchise tax.

<u>THIS BILL</u>

This provision would create a tax amnesty program, which would include, but is not limited to, the following provisions:

- FTB would have the authority to administer an amnesty program for taxpayers subject to PITL and CTL.
- Taxpayers under criminal investigation or criminal prosecution would be excluded from participating in amnesty.
- Those taxpayers eligible for either the state or federal abusive tax shelter voluntary compliance initiatives would be excluded from participating in amnesty for items and amounts that would have been eligible under the initiatives. However, those same taxpayers would be eligible for amnesty for items and amounts that are not related to abusive tax shelters.
- The amnesty filing timeframe would be February 1, 2005 - March 31, 2005, or during a timeframe ending no later than June 30, 2005.
- Amnesty would provide a penalty and fee waiver for taxable years 2002 and older.
- Taxpayers participating in amnesty that are underreporters would be required to file an amended return and nonfilers would be required to file a tax return. In addition, both would be required to pay tax and interest under the amnesty program.
- A taxpayer under federal bankruptcy court protection could participate in amnesty if a court order is obtained from the federal bankruptcy court with jurisdiction over the taxpayer's case approving the taxpayer's participation, and the approved plan is submitted to FTB with the application to participate in the amnesty program.
- No refunds would be allowed on balances paid prior to amnesty.
- Payment in full would be required within 60 days of the conclusion of the amnesty period or an installment agreement would need to be initiated with final payment due by June 30, 2006. A taxpayer that defaults on an installment agreement entered under amnesty would have the amnesty revoked.
- In the event FTB issues a correction notice to the taxpayer as a result of an amnesty application, this provision would allow the taxpayer 15 days from the date of the notice to pay the amount reflected on the correction notice and the payment would still be considered a payment made within the amnesty period.
- FTB would be allowed to issue deficiency assessments post-amnesty for taxable years eligible for amnesty. Penalties would only be assessed on the additional assessment amount and not any amount self-assessed and paid during amnesty.
- A taxpayer that takes advantage of amnesty would waive all rights to file a claim for refund for amounts paid in connection with amnesty.

In addition, this provision would provide:

- An increase in the current accuracy-related penalty for a taxable year that would be eligible for amnesty from 20% to 40% of the understatement for any assessment issued after the close of amnesty. However, the increased penalty would not apply to any taxpayer in audit, protest, appeal, settlement, or litigation as of the start of the amnesty period. In addition, the increased accuracy-related penalty would not apply to understatements relating to tax shelter items.
- Two new amnesty "penalties" equal to 1) 50% of the existing unpaid interest amount on any tax year for a taxpayer that failed to take advantage of amnesty, and 2) 50% of the unpaid interest subsequently assessed on deficiency amounts where the taxpayer could have but failed to take part in amnesty. A taxpayer with a current installment agreement with FTB that fails to take advantage of amnesty would avoid this penalty.
    - Amnesty participants could file returns and submit payment(s) within the 60-day extension period, while still avoiding the new 50% end of amnesty penalty that applies to amounts not actually paid during the tax amnesty period.
    - In addition, the new 50% amnesty penalty would not apply to a taxpayer that 1) initiates and is compliant with an installment agreement to pay amounts due under the amnesty program, or 2) pays in full the taxes and interest due within 15 days of receiving notification from FTB of a math error or interest computation correction.

<u>IMPLEMENTATION CONSIDERATIONS</u>

Implementing this provision would have a significant impact on the department, as discussed below under Fiscal Impact. However, with the appropriate funding in the 2004/2005 Budget Act, the department anticipates administering the tax amnesty program from February 1, 2005, through March 31, 2005, which would require taxpayers to submit an amnesty application during this two-month period and make payment and file returns within 60 days of the conclusion of the amnesty program (March 31, 2005).

LEGISLATIVE HISTORY

AB 3230 (Hannigan, Stats. 1984, Ch. 1490) provided for an amnesty program for individual taxpayers relating to the nonpayment and underreporting of tax or the nonpayment of any previously assessed tax. Attachment C provides additional details about that program.

SB 1439 (Oller, 2001/2002) would have created a tax penalty amnesty program for certain taxpayers that had not reported or had underreported their income taxes. This bill was held in the Assembly Appropriations Committee.

AB 2203 (Chu, 2003/2003) would provide for a tax amnesty program similar to the program required by this bill. This bill is with the Senate Revenue and Taxation Committee.

PROGRAM BACKGROUND

1. 1984-1985 State Income Tax Amnesty Program

According to a 1986 report completed by FTB, California's 1984-85 amnesty program emerged from a growing perception among tax administrators and others that the state's "tax gap" was unacceptably large and growing larger. The general intent of the 1984 legislation, as outlined in the legislative intent language of AB 3230 (Hannigan, Stats. 1984, Ch. 1490), was to improve compliance with the income tax laws and accelerate and increase collections. In addition to the acceleration of collections, it was anticipated there would be a future benefit in that taxpayers would permanently be brought into the tax system. The Legislature expressly indicated that the amnesty program would be a one-time occurrence, not to be repeated in the future, as that would be counterproductive. The amnesty provisions were enacted along with post-amnesty enforcement tools and penalty provisions.

The 1984-85 amnesty program administered by FTB applied to the nonreporting or underreporting of an individual's income and nonpayment of individual income tax liabilities. It did not apply to corporate taxpayers. This legislation also included amnesty for sales and use tax that was administered by the Board of Equalization. The legislation provided for an amnesty window of 94 days (December 10, 1984, through March 15, 1985). The amnesty program produced total gross revenues of $154 million in income taxes and interest. The department estimated it would have collected $119.5 million from those individuals through its ongoing enforcement programs even if amnesty had not been adopted. Departmental costs were $6.5 million ($5.2 million for personnel and $1.3 million for operating costs), which resulted in a cost-to-benefit ratio (CBR) of 1:24. Though the amnesty program ended in March 1985, the processing of amnesty applications and returns continued through June 1986 because the returns and payments could be filed or paid after making an application.

As part of marketing the amnesty program, FTB significantly increased the visibility of its enforcement program. FTB publicized the amnesty program to taxpayers by publicizing property seizures and criminal prosecutions. The legislation also gave FTB new enforcement tools, such as enhanced penalties and misdemeanor sanctions, and the authority to use private collection agencies to resolve out-of-state collection accounts. These new tools were also publicized. The message that was presented on billboards throughout the state was that detection methods, penalties, and collection tools would be improved and enhanced, so "get to us before we get to you."

2. 2002 Revenue Acceleration Project

In 2002 legislation was enacted[1] that allowed FTB to identify eligible taxpayers with high-risk collection accounts and offer those taxpayers the opportunity to satisfy an unpaid tax liability by paying the tax in full and receiving a waiver of interest, penalties, and fees. This interest and penalty waiver program, also known as the Revenue Acceleration Project (RAP), was in effect from October 1, 2002, through June 30, 2003. RAP generated approximately $32 million in revenue and had a CBR of 1:8.

[1] AB 2065 (Oropeza, Stats. 2002, Ch. 499)

3. 2003 California Abusive Tax Shelter Legislation

Recently enacted California legislation[2] to combat abusive tax shelters included a state voluntary compliance initiative (VCI) from January 1, 2004, through April 15, 2004. This initiative permitted a taxpayer that participated in an abusive tax shelter transaction to file an amended return to pay the tax and interest associated with an abusive tax shelter and not be assessed any penalties. In addition, the bills provide several new and expanded enforcement tools, including an expanded regime of penalties and reporting requirements applicable to investors, promoters, tax advisors, and tax preparers involved in abusive tax shelters. VCI was projected to bring in approximately $90 million in revenue for each fiscal year 2003-04 and 2004-05. VCI brought in over $1 billion.

OTHER STATES' INFORMATION

According to information furnished by the Federation of Tax Administrators, as of March 2004, 11 states[3] and New York City had enacted legislation providing for a tax amnesty during 2003. Each state's amnesty program varies. The number of months in the amnesty window varies, as does the taxes that amnesty covers. For additional information, Appendix C provides a chart of the past and current amnesties administered by other states. The chart is from the website of the Federation of Tax Administrators at www.taxadmin.org/fta/rate/surveys.html.

FISCAL IMPACT

FTB has formulated an implementation plan for conducting an amnesty program as required by this provision. The department costs are estimated to be approximately $10.2 million. This amount includes costs resulting from increased customer service contact and notices, publicity costs necessary to the success of amnesty, and modifications to the basic processing functions and department systems.

According to the Department of Finance, the proposed Budget Act includes an increase in FTB's budget of approximately $10.2 million for fiscal year 2004/05 for the proposal to require FTB to administer a tax amnesty program. Upon approval of the Budget Act, the department's budget will be increased to reflect the $10.2 million increase.

[2] SB 614 (Cedillo, Stats. 2003, Ch. 656) and AB 1601 (Frommer, Stats. 2003, Ch. 654)
[3] Arizona, Colorado, Florida, Illinois, Kansas, Maine, Massachusetts, Missouri, New York, North Dakota, and Virginia.

ECONOMIC IMPACT

Revenue Estimate

Based on the discussion below, the revenue impact of this provision is as follows:

Estimated Revenue Impact Tax Amnesty For Tax Reporting Periods Ending On or Before January 1, 2003 Fiscal Year Impact (In Millions)				
	2004-05	**2005-06**	**2006-07**	**2007-08**
Total Gross Revenue	$555	$60	$45	$30
Collections Absent Amnesty Attributable To Amnesty Participants	-$355	-$70	-$35	-$15
Total Net Revenue	$200	-$10	$10	$15

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this provision.

Revenue Discussion:

The number of taxpayers that file amnesty applications, file the appropriate returns, and pay the required tax under the amnesty program (less what would have been collected under current law) will determine the net revenue impact for this provision.

These estimates are based on New York's experiences in administering a tax amnesty program during 2002/2003. Using New York's experience, adjusted to better fit California's filing and non-filing profile, this analysis attempts to measure the extent to which people would respond to tax amnesty based on relative economic elasticities experienced by New York. The essence of the calculation is to apply New York's elasticity factor response to their amnesty program (compared to the cost implications of not participating in amnesty) to California's relative advantage of participating in amnesty versus the cost implication of non-participation.

4. FTB To Charge Fees For Specific Services

ANALYSIS

FEDERAL/STATE LAW

Under existing federal law, the IRS is authorized to charge user fees for requests for ruling letters, opinion letters, determination letters, and other similar requests. The amounts of the fees vary and are based on the average time and difficulty of completing the request.
The IRS may also charge a fee for setting up, reinstating, or restructuring an installment agreement. The current fee, as prescribed by regulation, to establish an installment agreement is $43. The fee for reinstating or restructuring an installment agreement is $24.

Federal law requires that all fees be paid in advance.

Under current state law, FTB is authorized to charge for copies of income tax returns, collection cost recovery fees, and *Tax News* and *Package X* publications.

THIS BILL

This provision would authorize FTB to charge fees for providing the following specialized tax services:

- installment payment programs,
- expedited corporation revivor requests,
- expedited tax clearance certificate requests, and
- expedited tax-exempt status requests.

This provision specifies that prior to January 1, 2006, FTB shall publish by notice a schedule of specialized tax service fees to be imposed. After January 1, 2006, the amount of the fees shall be established through regulations. This provision states that the amount of the fees shall be established in the manner and in the amounts necessary to reimburse FTB for the costs of administering the specialized services.

IMPLEMENTATION CONSIDERATIONS

This provision would have a minor impact on the department, and it is anticipated that the department would implement the fees once the appropriate notice is published or regulations are adopted.

TECHNICAL CONSIDERATION

This provision erroneously refers to FTB using the term “board,” which is defined in the R&TC as the State Board of Equalization. Department staff suggests amending the bill to replace the references to “board” with the correct reference to FTB.

FISCAL/ECONOMIC IMPACT

This provision would require FTB to charge fees for specific services, which would require changes to department systems. The costs to implement this provision are approximately $100,000. These costs include system updates and manual processing.

The proposed Budget Act reduces FTB's budget by $900,000 for the last half of fiscal year 2004/2005 and provides a $1 million reimbursement authority, which would assume that FTB would collect $1 million in fees to offset the amount of the budget reduction and the department's costs as described above. Therefore, by reducing the department's budget in anticipation of reimbursement through collection of the fees, this provision would result in a savings to the GF.

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APPENDIX A (TAX AMNESTY PROVISION)
PENALTY AND FEE INFORMATION

Commonly Imposed Penalties

The following are the more commonly imposed penalties under current income tax laws against taxpayers that do not report or underreport their income, or do not pay deficiency assessments:

- Late filing – income tax returns that are filed late are subject to a late filing penalty that is: (1) a basic penalty of 5% of the unpaid tax per month that the return is late, up to a maximum of 25% of the tax, or (2) a minimum penalty of the lesser of $100 or 100% of the tax liability, if the return is filed 60 days or more late and the basic penalty is less than $100. If the failure to file is due to fraud, the basic penalty is 1% per month, up to a maximum of 75%.
- Underpayment –- income taxes that are not paid by the original due date of the income tax return are subject to a penalty of 5% of the unpaid tax PLUS 1/2 of 1% per month, up to a maximum of 40 months (20%).
- Demand –- income tax returns that are not filed upon notice and demand from the FTB are subject to a penalty of 25% of the amount of the tax required to be shown on the return.
- Frivolous return -– income tax returns that are not sufficiently completed to substantially determine the correct self-assessed tax are subject to a penalty of $500.
- Accuracy-related –- negligence or disregard of rules or regulations, substantially understating income tax, overstating values of items, or overstating pension liabilities are subject to a penalty of 20% of the underpayment amount. If the misstatements are due to fraud, the penalty is 75% of that resulting tax.

Corporate Penalties Relating To Doing Business

Corporations that are doing business in California while out of compliance with the tax laws are subject to the following penalties that may be significant:

- If a corporation’s rights, powers, and privileges are suspended or forfeited for failure to file an income or franchise tax return or pay the tax, the corporation’s contracts are voidable. To be relieved of voidability, the corporation must be brought to full compliance with the tax laws by filing all past due returns and payment of all past due tax amounts and pay an additional penalty of $100 for each day that voidability relief is being sought (not to exceed the tax amount).
- Certain corporations that are doing business in California while their privileges are suspended or forfeited for nonpayment of tax or nonfiling of returns are subject to a $2,000 penalty per tax year.

Enforcement Fees

Taxpayers that fail to file returns or pay their income or franchise tax liabilities during fiscal year 2003-04 may be liable for the following fees relating to the enforcement of the income or franchise tax return or liability:

- $108 for individuals and $175 for corporations that fail to file income or franchise tax returns within 25 days after FTB mails its formal legal demand for the returns.

- $101 for individuals and $150 for corporations that fail to pay their income or franchise taxes after FTB mails its notice for payment that advises that continued nonpayment may result in collection action.

Third-Party Penalties

Third parties that assist taxpayers in their failure to comply with the income tax laws may be subject to the following penalties:

- tax preparers who understate a taxpayer's tax liability on any return are subject to a $250 penalty, which increases to $1,000 if the understatement is a result of willful or reckless conduct.
- persons who aid and abet a taxpayer in understating the taxpayer's tax liability are generally subject to a penalty of $1,000 per taxpayer for each year.

APPENDIX B (TAX AMNESTY PROVISION)
ENFORCEMENT AND COLLECTION ACTIVITIES

Enforcement Activities

In 2001, FTB began its filing enforcement process for individual taxpayers under its newly developed Intergrated Nonfiler Compliance (INC) system. In 2002, INC expanded to include corporate taxpayers. Under INC, the computer sorts through more than 220 million records received from employers, banks, the IRS, and other sources, and matches them against tax returns filed. Individual taxpayers with California income for whom FTB has no record of an income tax return being filed, and are repeat nonfilers, are sent a demand letter (Demand For Tax Return) requesting that the past due return be filed. Repeat nonfilers that do not file as requested are subject to the demand penalty and the filing enforcement fee. A first-time nonfiler receives a Request For Tax Return notice instead of a demand letter and, hence, is not subject to the demand penalty or fee. All corporate nonfilers are sent demand letters and are subject to the demand penalty and filing enforcement fee if a return is not filed after demand.

If a return is not filed as required, the taxpayer's net income is estimated from the available information, and a deficiency assessment is proposed. For taxpayer assistance, a special Internet website has been created. Under this website, taxpayers identified through INC can request more time to file their income tax returns, retrieve information that can assist them in the filing of the income tax return, learn about payment options, and correct misreported information. The filing enforcement process generally begins after the extended due date of the tax return and with issuance of the demand or reminder letter. During 2001, more than 200,000 NPAs were issued for income tax returns that were not filed for tax year 1999. It is anticipated that when INC for individual taxpayers is fully operational, the proposed assessments will be issued within 12 months from the beginning of the process. Once fully operational, within the next few years, staff anticipates INC NPAs will total 400,000 per year.

In addition to this automated filing program, FTB has a large audit staff designed to encourage compliance with the income tax laws. For this purpose, typically, computer programs search state and federal income records to detect leads as to discrepancies between income items that were reported and should have been reported on income tax returns. Based on the computerized search of these records, 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 audit-type activities for all cases with a CBR of 1:5 or greater, based on the net proposed tax assessments. Audits with a lesser CBR may be conducted on a case-by-case basis.

Collection Activities

Once assessments are final, taxpayers are notified and payment is requested. Taxpayers having a financial hardship and unable to pay their taxes in full may be eligible to enter into installment payment agreements. For taxpayers who do not have, and will not have in the foreseeable future, the income, assets, or means to pay their tax liability, the taxpayer may consider offering a lesser amount for payment of the tax liability. If taxpayers disregard FTB's notice for payment, FTB will send taxpayers notice prior to the taking of collection action. There is no statute of limitation on collections. If an account is unpaid after sending the collection notice, FTB uses an automated computer system to continually search asset records. Typically, a notice of state tax lien is recorded as the first action taken. Then, depending upon the type of asset identified, the appropriate collection remedy is initiated, which may include garnishing wages, attaching bank accounts, or taking other collection actions.

Criminal Investigation Activities

FTB investigators work leads from various information sources to identify the amount of tax that should have been reported. FTB investigators are peace officers, enabling them to issue search warrants and recover the cost of FTB's criminal investigation from the taxpayer. Currently investigators are working approximately 500 cases. In addition to the direct benefit to the state from the compliance achieved from the taxpayers that are prosecuted, the primary objective is to create a deterrent effect by discouraging others from committing similar frauds.

Taxpayers that are under criminal investigation are not immediately or readily notified of the on-going criminal investigation. The element of surprise is necessary in obtaining the needed records or information through a search warrant, subpoena, interviews, or other actions. It is only when these actions are taken that the taxpayer may be aware of pending criminal investigations.

FTB's criminal investigation cases are turned over to the appropriate district attorney, who in turn files a complaint against the taxpayer. A criminal investigation case may take several years to complete from the time the lead is obtained until the time the complaint is filed.

APPENDIX C

State Tax Amnesty Programs

November 22, 1982 -- Present

STATE	AMNESTY PERIOD			LEGISLATIVE AUTHORIZATION		MAJOR TAXES COVERED	ACCOUNTS RECEIVABLE INCLUDED	Collections ($ Millions) (a)		INSTALLMENT ARRANGEMENTS PERMITTED (b)
ALABAMA	1/20/84	-	4/1/84	No	(c)	All	No	3.2		No
ARIZONA	11/22/82	-	1/20/83	No	(c)	All	No	6.0		Yes
	1/1/02	-	2/28/02	Yes		Ind. Income	No			No
	9/1/03	-	10/31/03	Yes		All (t)		73.0		Yes
ARKANSAS	9/1/87	-	11/30/87	Yes		All	No	1.7		Yes
	7/1/04	-	12/31/04	Yes		All				
CALIFORNIA	12/10/84	-	3/15/85	Yes		Ind. Income	Yes	154.0		Yes
				Yes		Sales	No	43.0		Yes
COLORADO	9/16/85	-	11/15/85	Yes		All	No	6.4		Yes
	6/1/03		6/30/03			All		18.4		Yes
CONNECTICUT	9/1/90	-	11/30/90	Yes		All	Yes	54.0		Yes
	9/1/95	-	11/30/95	Yes		All	Yes	46.2		Yes
	9/1/02	-	12/2/02			All		109.0		
FLORIDA	1/1/87	-	6/30/87	Yes		Intangibles	No	13.0		No
	1/1/88	-	6/30/88	Yes	(d)	All	No	8.4	(d)	No
	7/1/03	-	10/31/03	Yes		All		80.0		
GEORGIA	10/1/92	-	12/5/92	Yes		All	Yes	51.3		No
IDAHO	5/20/83	-	8/30/83	No	(c)	Ind. Income	No	0.3		No
ILLINOIS	10/1/84	-	11/30/84	Yes		All(u)	Yes	160.5		No
	10/1/03	-	11/17/03	Yes		All		532.0		
IOWA	9/2/86	-	10/31/86	Yes		All	Yes	35.1		
KANSAS	7/1/84	-	9/30/84	Yes		All	No	0.6		No
	10/1/03	-	11/30/03	Yes		All	Yes	53.7		
KENTUCKY	9/15/88	-	9/30/88	Yes	(c)	All	No	100.0		No
	8/1/02	-	9/30/02	Yes	(c)	All	No	100.0		No
LOUISIANA	10/1/85	-	12/31/85	Yes		All	No	1.2		Yes (f)
	10/1/87	-	12/15/87	Yes		All	No	0.3		Yes (f)
	10/1/98	-	12-31-98	Yes		All	No (q)	1.3		No
	9/1/01	-	10/30/01	Yes		All	Yes	173.1		No
MAINE	11/1/90	-	12/31/90	Yes		All	Yes	29.0		Yes
	9/1/03		11/30/03	Yes		All		34.7		
MARYLAND	9/1/87	-	11/2/87	Yes		All	Yes	34.6	(g)	No
	9/1/01	-	10/31/01	Yes		All	Yes	39.2		No
MASSACHUSETTS	10/17/83	-	1/17/84	Yes		All	Yes	86.5		Yes (h)
	10/1/02	-	11/30/02	Yes		All	Yes	96.1		Yes
	1/1/03		2/28/03	Yes		All	Yes			
MICHIGAN	5/12/86	-	6/30/86	Yes		All	Yes	109.8		No

	5/15/02	-	6/30/02	Yes		All	Yes			
MINNESOTA	8/1/84	-	10/31/84	Yes		All	Yes	12.1		No
MISSISSIPPI	9/1/86	-	11/30/86	Yes		All	No	1.0		No
MISSOURI	9/1/83	-	10/31/83	No	(c)	All	No	0.9		No
	8/1/02	-	10/31/02	Yes		All	Yes	76.4		
	8/1/03	-	10/31/03	Yes		All	Yes	20		
NEVADA	2/1/02	-	6/30/02			All		7.3		
NEW HAMPSHIRE	12/1/97	-	2/17/98	Yes		All	Yes	13.5		No
	12/1/01		2/15/02	Yes		All	Yes	13.5		
NEW MEXICO	8/16/99	-	11/12/99	Yes		All	Yes	45		Yes
NEW JERSEY	9/10/87	-	12/8/87	Yes		All	Yes	186.5		Yes
	3/15/96	-	6/1/96	Yes		All	Yes	359.0		No
	4/15/02	-	6/10/02	Yes		All	Yes	276.9		
NEW MEXICO	8/15/85	-	11/13/85	Yes		All (i)	No	13.6		Yes
NEW YORK	11/1/85	-	1/31/86	Yes		All (j)	Yes	401.3		Yes
	11/1/96	-	1/31/97	Yes		All	Yes	253.4		Yes (o)
	11/18/02		1/31/03	Yes		All	Yes	520.0		Yes (s)
NEW YORK CITY	10/20/03	-	1/23/04	Yes		All (v)	Yes (w)			No
NORTH CAROLINA	9/1/89	-	12/1/89	Yes		All (k)	Yes	37.6		No
NORTH DAKOTA	9/1/83	-	11/30/83	No	(c)	All	No	0.2		Yes
	10/1/03	-	1/31/04	Yes				6.9		
OHIO	10/15/01	-	1/15/02	Yes		All	No	48.5		No
OKLAHOMA	7/1/84	-	12/31/84	Yes		Income, Sales	Yes	13.9		No (l)
	8/15/02	-	11/15/02			All (r)	Yes			
PENNSYLVANIA	10/13/95	-	1/10/96	Yes		All	Yes	n.a.		No
RHODE ISLAND	10/15/86	-	1/12/87	Yes		All	No	0.7		Yes
	4/15/96	-	6/28/96	Yes		All	Yes	7.9		Yes
SOUTH CAROLINA	9/1/85	-	11/30/85	Yes		All	Yes	7.1		Yes
	10/15/02	-	12/2/02	Yes		All	Yes	66.2		
SOUTH DAKOTA	4/1/99	-	5/15/99	Yes		All	Yes	0.5		
TEXAS	2/1/84	-	2/29/84	No	(c)	All (m)	No	0.5		No
	3/11/04	-	3/31/04	No	(c)	All (m)	No			No
VERMONT	5/15/90	-	6/25/90	Yes		All	Yes	1.0	(e)	No
VIRGINIA	2/1/90	-	3/31/90	Yes		All	Yes	32.2		No
	9/2/03	-	11/3/03	Yes		All	Yes	98.3		
WEST VIRGINIA	10/1/86	-	12/31/86	Yes		All	Yes	15.9		Yes
	?/?/04	-	?/?/04	Yes						
WISCONSIN	9/15/85	-	11/22/85	Yes		All	Yes (n)	27.3		Yes
	6/15/98	-	8/14/98	Yes		All	Yes	30.9		
DIST. OF COLUMBIA	7/1/87	-	9/30/87	Yes		All	Yes	24.3		Yes
	7/10/95	-	8/31/95	Yes		All (p)	Yes	19.5		Yes (p)

Source: ***The Federation of Tax Administrators.***

(a) Where applicable, figure includes local portions of certain taxes collected under the state tax amnesty program.
(b) "No" indicates requirement of full payment by the expiration of the amnesty period. "Yes" indicates allowance of full payment after the expiration of the amnesty period.
(c) Authority for amnesty derived from pre-existing statutory powers permitting the waiver of tax penalties.
(d) Does not include intangibles tax and drug taxes. Gross collections totaled $22.1 million, with $13.7 million in penalties withdrawn.
(e) Preliminary figure.
(f) Amnesty taxpayers were billed for the interest owed, with payment due within 30 days of notification.
(g) Figure includes $1.1 million for the separate program conducted by the Department of Natural Resources for the boat excise tax.
(h) The amnesty statute was construed to extend the amnesty to those who applied to the department before the end of the amnesty period, and permitted them to file overdue returns and pay back taxes and interest at a later date.
(i) The severance taxes, including the six oil and gas severance taxes, the resources excise tax, the corporate franchise tax, and the special fuels tax were not subject to amnesty.
(j) Availability of amnesty for the corporation tax, the oil company taxes, the transportation and transmissions companies tax, the gross receipts oil tax and the unincorporated business tax restricted to entities with 500 or fewer employees in the United States on the date of application. In addition, a taxpayer principally engaged in aviation, or a utility subject to the supervision of the State Department of Public Service was also ineligible.
(k) Local taxes and real property taxes were not included.
(l) Full payment of tax liability required before the end of the amnesty period to avoid civil penalties.
(m) Texas does not impose a corporate or individual income tax. In practical effect, the amnesty was limited to the sales tax and other excises.
(n) Waiver terms varied depending upon the date of tax liability was accessed.
(o) Installment arrangements were permitted if applicant demonstrated that payment would present a server financial hardship.
(p) Does not include real property taxes. All interest was waived on tax payments made before July 31, 1995. After this date, only 50% of the interest was waived.
(q) Exception for individuals who owed $500 or less.
(r) Except for property and motor fuel taxes.
(s) Multiple payments can be made so long as the required balance is paid in full no later than March 15, 2003.
(t) All taxes except property, estate and unclaimed property.
(u) Does not include the motor fuel use tax.
(v) All NYC taxes administered by the NYC Dept. of Finance are covered except for Real Estate Tax. NYC Sales & Use Tax & NYC Resident Personal Income Tax also are not covered because they are administered by the NYS Dept. of Taxation & Finance.
(w) Taxpayers under audit as of 3/10/03 are ineligible; Taxpayers with an existing installment agreement are ineligible; Taxpayers under criminal investigation are ineligible; Taxpayers party to an administrative or court proceding must withdraw as a condition of amnesty.
Last Updated: March 2004