

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Alarcon Analyst: Gloria McConnell Bill Number: SB 573

Related Bills: See Legislative History Telephone: 845-4336 Introduced Date: 02/20/03

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Labor Commissioner in Consultation With FTB & Joint Enforcement Strike Force On Underground Economy Develop Standards For Tax Audit Trigger

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 that appropriate state taxing authorities audit employers that violate the minimum wage and overtime labor laws.

PURPOSE OF THE BILL

According to Senate Labor and Industrial Relations Committee staff, this bill is not intended to pass the Legislature as introduced. This bill will be amended to address other issues that have yet to be identified, and the current provisions in the bill will be deleted.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative beginning on January 1, 2004.

POSITION

Pending.

ANALYSIS

BACKGROUND

In 1993, the JESF was created by the Governor upon signing Executive Order W-66-93. This Order was subsequently codified under Section 329 of the Unemployment Insurance Code and is further explained below under state law.

FTB's audit and filing enforcement processes are designed to encourage compliance with the income tax laws. Computer programs search state and federal income tax records, including the Employment Development Department (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 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.

Board Position:

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Department Director
Gerald H. Goldberg

Date
04/10/03

In cases where there are indications of criminal violations of the tax law, FTB peace officers may 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 these criminal cases, the peace 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 peace officers cannot be shared with non-peace officers, which include FTB's audit staff and members of the JESF.

FEDERAL/STATE LAW

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

Under state law:

- 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 JESF. Required participants are EDD, Department of Consumer Affairs, Department of Industrial Relations (DIR), Department of Insurance, and the Office on Criminal Justice Planning. FTB, Board of Equalization (BOE), and Department of Justice, are encouraged to participate.
- 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. DIR reports to the California Labor and Workforce Development Agency.
- EDD administers the Unemployment Insurance Code relating to employer/employee employment taxes based on wages. EDD along with DIR reports to the 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.

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 taxing authorities.

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, 2004, 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

The following considerations should be noted:

- The number of hours that would be needed for FTB to undertake the project required by this bill is uncertain. It is unclear whether time could be allotted to this JESF project without redirecting staff from revenue producing projects.
- The limitations on FTB to disclose tax return information to all JESF members may be an obstacle in effectively implementing and administering this bill.

LEGISLATIVE HISTORY

AB 2942 (Koretz; 2001/02) as amended in the second house was the same as this bill. AB 2942 was held in the Senate Labor and Industrial Relations Committee.

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 disclose information about whether any of these states set standards resulting in audit recommendations to taxing authorities in conjunction with violations of labor laws. These states were selected due to their similarities to California's economy, business entity types, and tax laws to California's income tax laws.

FISCAL IMPACT

Departmental Costs

The number of hours that would be needed for FTB to undertake the project required by this bill is uncertain. Consequently, 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 that the department is able to collect, this bill would produce additional revenue of an unknown amount annually.

ARGUMENTS/POLICY CONCERNS

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

LEGISLATIVE STAFF CONTACT

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