

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Runner Analyst: Deborah Barrett Bill Number: SB 234

Related Bills: See Legislative History Telephone: 845-4301 Introduced Date: 02-15-2005

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Disclosure of Tax Return Information Only For Resolution of Issues In Administrative Proceeding Of BOE

SUMMARY

This bill would prohibit the use of income tax returns or return information in judicial proceedings and limit the administrative proceedings in which tax returns can be disclosed to only those pending before the Board of Equalization (BOE).

PURPOSE OF THE BILL

According to the author's staff, the purpose of the bill is to protect taxpayer information from public disclosure.

EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2006, and become operative in proceedings on or after that date.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing state law prohibits the disclosure of any taxpayer information, except as specifically authorized by statute. Tax return information may be disclosed in a judicial or administrative proceeding pertaining to tax administration if any of the following are present:

- 1) The taxpayer is a party to the proceedings,
- 2) The purpose of the proceeding is to determine the taxpayer's criminal liability or civil obligations or involve the collection of the taxpayer's tax liability.
- 3) The treatment of an item reflected on the return is directly related to the resolution of an issue in the proceeding, or
- 4) The return directly relates to transactional relationships between a person, who is a party in the proceeding, and the taxpayer, and the information directly affects the resolution of the issues in the proceeding.

Board Position:

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Department Director

Date

Gerald H. Goldberg

4/7/05

Current law permits a taxpayer to appeal disputes between a taxpayer and the department to the BOE. BOE conducts appeals from taxpayers on issues that include deficiency assessments, jeopardy assessments, interest abatements, claims for refund, and innocent spouse determinations. The BOE normally issues a published decision or unpublished decision that is also a public record. Following exhaustion of administrative remedies, the taxpayer may bring a suit for refund in the superior court.

Current law requires the department to utilize judicial proceedings to pursue bankruptcy and probate claims. If the department fails to file timely claims in bankruptcy or probate proceedings, the department is precluded from collecting the unpaid tax, penalty, and interest owed by the debtor in bankruptcy or the estate in probate.

Current law authorizes the department to hold, upon a taxpayer's request, a hearing on a taxpayer's protest of a proposed deficiency assessment, jeopardy assessments, and denials of interest abatements or refunds. The department also holds hearings on claims for exemption and third party claims when property is seized.

The department can initiate but most often defends in judicial proceedings concerning jeopardy assessments, erroneous refunds, recovery of interest, or unpaid tax, controversies concerning the priority of a tax lien, and other civil actions in the administration and collection of tax. Judicial proceedings are also used to obtain search warrants and prosecute tax fraud and criminal tax evasion.

The California Public Records Act requires state agencies to, when requested by a member of the public, disclose information retained within the agency records that pertain to the agency's activities. Documents submitted as part of an appeal are public records, and, under open meeting rules, hearings on taxpayer appeals must be open to the public. In the case of BOE, documents provided for appeals pending before the BOE may be subject to disclosure in response to a Public Records Act request. BOE proceeding regulations permit the exclusion of confidential tax information from Public Records Act requests, and BOE practice is to redact personal information, specifically taxpayer address, phone number, and social security number prior to releasing documents under the Public Records Act request.

THIS BILL

This bill would eliminate the authority for the department to disclose returns or return information in a judicial proceeding. In addition, this bill would limit the administrative proceedings in which return information can be disclosed to only proceedings before the BOE. Return information that can be disclosed in BOE proceedings would also be limited to the return or return information that is necessary for the resolution of the issues in dispute.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The author's staff indicated that the intent for this bill is to limit the amount of information that would be made available in a BOE hearing. As written, this bill would restrict the department's use of tax returns or return information in the collection of tax. Removing the reference to judicial proceedings may create a more restrictive limitation than intended by the author.

As written, this bill could prevent the department from providing relevant evidence in the following administrative or judicial proceedings:

- When defending a lawsuit for refund of tax brought by a taxpayer,
- Audit assessments appealed by taxpayers to BOE,
- Collection actions, such as enforcing a state tax lien or any other collection action that could result in an administrative or judicial proceeding, and
- Claims in bankruptcy or probate proceedings.

The only means available for the department to collect an unpaid tax debt from a debtor in bankruptcy or probate is through the filing of a claim in the bankruptcy or probate proceeding. Such a claim must necessarily contain tax return information that, under this bill, could no longer be provided. There are no alternate sources of information for the department to use to prove such claims. If the department fails to file a claim in such a proceeding, the debt would be precluded from being collected.

A critical component in pursuing cases of criminal tax fraud or tax evasion is that the information reported on the return was false, inaccurate, or inconsistent. It would be impossible to pursue these crimes without the necessary, relevant evidence-the tax return.

This bill could be construed to conflict with Revenue and Taxation Code Section 19556 that permits the department to use tax return information in administrative appeals of personnel actions taken against a department employee. These hearings typically involve the unlawful disclosure or unwarranted inspection of tax return information and the disciplinary consequences of this prohibited behavior. This bill may also prevent the applicability of sanctions if the information unlawfully disclosed cannot be presented as evidence in an administrative or judicial proceeding.

This bill limits the applicable administrative proceedings under which tax return information can be disclosed in BOE proceedings. Disclosures authorized under existing laws would become illegal. The bill does not provide for alternatives for resolving issues currently available under other administrative proceedings, such as FTB meetings where hearings are held for allocation and apportionment of income petitions.

It is unclear how cases currently pending in judicial or administrative proceedings would be completed if this bill were enacted. Any disclosure made before this bill was enacted could be a retroactive violation.

TECHNICAL CONSIDERATIONS

The change this bill would make to the statute creates a conflict within the statute. The change would allow tax return information to be presented only at BOE hearings where a taxpayer is a party to the proceeding in connection with determining civil or criminal liabilities. The BOE cannot determine criminal liability. Criminal liability is determined in a judicial proceeding. The author would need to remove the references to criminal liability to remain consistent within the statute.

LEGISLATIVE HISTORY

AB 735 (Campbell, 2003) sought to implement a Taxpayer Privacy Bill of Rights that would require tax information to be submitted under court seal. The bill was held in the Assembly Revenue and Taxation Committee.

AB 2421 (Campbell, 2004) also sought to implement a Taxpayer Privacy Bill of Rights with similar restrictions on the use of return information in court proceedings. This bill was referred to the Revenue and Taxation Committee's suspense file, with no further action taken.

OTHER STATES' INFORMATION

The states surveyed include *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. *Minnesota* statutes parallel California's current statute related to return information in judicial and administrative proceedings. *Illinois*, *New York*, and *Massachusetts* authorize the use of return information in proceedings related to tax administration. *Michigan* authorizes the use of return information in proceedings related to tax or pursuant to a judicial order.

FISCAL IMPACT

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

ECONOMIC IMPACT

Tax Revenue Estimate

This bill would have a significant, negative impact on state income and franchise tax revenues exceeding \$500 million annually beginning January 1, 2006.

Tax Revenue Discussion

The department would be severely limited by the bill in asserting its responsibility to administer and collect the state's tax revenue. Preventing the department from disclosing tax return information in judicial proceedings and limiting the disclosure in administrative proceedings to those issues before the BOE disables many forums the department currently must use to resolve tax disputes. It is the disabling of these forums for resolving tax disputes that would determine the revenue impact of the bill.

During the 2003-04 fiscal year, the department collected the following tax revenues through judicial proceedings: nearly \$50 million from filing bankruptcy and decedent claims and approximately \$100 million from filing tax liens. Additionally, the department issued net assessments in excess of \$1 billion based on audit programs affecting both individuals and business entities. Based on the dollar amount of these assessments, it is projected that this bill could impact assessments in the range of \$500 million or more annually, if the department could not pursue the assessments based on the restrictions of this bill. If the bill impacted only the specific programs indicated here, the revenue loss would exceed \$500 million [\$50 million + \$100 million + \$500 million = \$650 million].

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