BILL ANALYSIS

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Department, Board, Or Commission	Author	Bill Number
Franchise Tax Board	**Niello**	**AB 2249**

SUBJECT

Direct Deposit Refund (DDR) Errors

SUMMARY

This Franchise Tax Board (FTB) sponsored bill would do the following:

- Allow a taxpayer to quickly recover an income tax refund that they misdirected to the wrong bank account,
- Allow FTB, where necessary, to use its assessment and collection powers to get a misdirected refund back from a third-party who is the unintended recipient of a misdirected refund, and
- Allow financial institutions to disclose financial information to certain persons for cases of elder abuse.

The provision pertaining to elder abuse would not impact FTB and is not discussed in this analysis.

PURPOSE OF BILL

The purpose of this bill is to assure that taxpayers receive their refunds and to maintain taxpayer confidence in electronic direct deposit, which is the fastest and most economical method for the state to issue tax refund

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2009, and would be specifically operative for misdirected refunds deposited on or after that date.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

Under federal law, taxpayers may select one or more accounts for purposes of directly depositing their federal tax refunds; however, the IRS assumes no responsibility in the event the taxpayer or their preparer puts an incorrect account or routing number on a return.

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Under the federal Electronic Funds Transfer Act, financial institutions are not required to match taxpayer names with the names on an account designated for direct deposit. Financial institutions are required to resolve problems related to electronic funds transfer (EFT) errors in instances where the error is attributable to the financial institution or a failure within the Fedwire system. Federal law specifies what constitutes an error; a misdirected DDR does not qualify as an EFT error. With limited exceptions, federal financial privacy laws prohibit a financial institution from divulging the personal information of account holders without a civil or criminal subpoena or court order.

Current state law allows taxpayers to designate one or more accounts at a financial institution for direct deposit of their state tax refund. FTB can recover an erroneous refund if FTB issues a notice and demand for repayment of the erroneous refund within two years from when the refund is made or during the period within which FTB may mail a notice of proposed deficiency assessment, whichever period expires later. FTB may recover any erroneous refund, including accrued interest, in an action brought in a court of competent jurisdiction in the County of Sacramento.

Except under specified conditions, the California Right to Financial Privacy Act (CRPA) prohibits an officer, employee, or agent of a state agency or department from requesting or receiving from a financial institution the financial information of a customer. The CRPA generally requires that a consumer notice be sent to the account holder prior to the delivery of an administrative subpoena before the financial institution can release account information, including the name of the account holder.

One express exception to the CRPA requires a financial institution to provide specified public retirement systems with the names and addresses of accounts of a customer who received direct deposit transfers from the retirement system after the date of his or her death.

Taxpayers can exercise a civil remedy on their own to recover their misdirected deposits through civil litigation in small claims or superior courts. Once the taxpayer receives a judgment, the taxpayer can execute the judgment through warrants, as provided in the California Code of Civil Procedure.

THIS BILL

This bill would define a misdirected refund to mean a direct deposit refund that was deposited in the account of a person other than the taxpayer entitled to the refund. A misdirected refund is not any refund caused by FTB error.

This bill would authorize FTB to mail a notice and demand for repayment to the recipient of a misdirected refund. Effective on the date the notice and demand for repayment is mailed to the recipient; the taxpayer would be reimbursed for the amount of the misdirected refund.

This bill would authorize a reimbursement to the taxpayer for the amount of the misdirected refund when an affidavit is executed by the taxpayer stating the following:

- The taxpayer notified the financial institution that the taxpayer, tax preparer, or electronic return originator entered an incorrect financial institution account or routing number.
- The state issued refund was directly deposited into an account not owned, directly or indirectly, by the taxpayer entitled to the refund.
- Neither the taxpayer nor the taxpayer's representative has custody or control over the account at the financial institution that received the direct deposit refund.
- Neither the taxpayer nor the taxpayer's representative has received reimbursement of the refund money from any source.

This bill would require a financial institution to provide contact information of any co-owner, cosigner, or any other person who had access to funds in an account when FTB certifies in writing that the following has occurred:

- A taxpayer filed a tax return that authorized a direct deposit refund with an incorrect financial institution account or routing number that resulted in all or a portion of the refund not being received, directly or indirectly, by the taxpayer;
- The direct deposit refund was not returned to FTB, and
- The refund was deposited directly on a specified date into the account of an accountholder of the financial institution.

This bill would provide that if the account is closed, the financial institution is to provide the name and address of the person who closed the account.

Once identifying information is obtained from the financial institution, this bill would apply existing erroneous refund remedies to a misdirected refund. In order for the erroneous refund remedies to apply, the following must occur:

- A taxpayer filed a tax return that designated one or more direct deposit refunds.
- The taxpayer, tax preparer, or electronic return originator entered an incorrect financial institution account or routing number that resulted in all or a portion of the refund not being received, directly or indirectly, by the taxpayer due the refund.
- The taxpayer did not receive the refund.
- The recipient of the misdirected refund was not entitled to the refund.

The bill contains intent language that the remedies provided in the bill to recover a misdirected refund is to occur only after all other avenues to recover the misdirected refund have been exhausted. The provisions of this bill apply to misdirected refunds deposited on or after January 1, 2009.

PROGRAM BACKGROUND

FTB processes approximately 4 million DDR requests each year and receives rejections on approximately 60,000 DDRs due to incorrect routing or account numbers. FTB reissues a rejected DDR to the taxpayer in the form of a paper refund warrant by US Mail. Annually, FTB receives approximately 450 requests to research missing DDRs. These missing deposits generally are found in the taxpayer's bank account; however, some are discovered deposited in a third-party's account because the taxpayer provided an incorrect routing or account number. This type of errant deposit is called a misdirected DDR.

In some cases, FTB can request a financial institution either to return the DDR to FTB or to move it to the correct taxpayer's account, which resolves the issue. FTB is unable to resolve approximately 20 cases of misdirected DDRs each year. Less than $50,000 is involved on a yearly basis. The dollar amount will grow each year with greater public use of DDRs.

Federal and state laws allow the government to recover an erroneous refund—a refund where due to an error made by the government a refund is made in the wrong amount or to the wrong person; however, a misdirected DDR is not an erroneous refund because the taxing agency has followed the taxpayer's instructions.

The department only has account and routing information and has no statutory authority to obtain the identity of the third-party account holder from a financial institution. Current subpoena powers are ineffective to learn the identity of the third-party because the account holder is required to be served with the subpoena before the financial institution can honor the subpoena; however, FTB lacks the identity of the account holder and thus, cannot issue an effective subpoena.

OTHER STATES' INFORMATION

The IRS assumes no responsibility in the event the taxpayer or their preparer puts an incorrect account or routing number on a return.

A review of *Illinois, Massachusetts, Michigan*, *Minnesota*, and *New York* laws found no comparable provisions that would assist a taxpayer in recovering the funds from a misdirected direct deposit. These states were reviewed because of the similarities between California income tax laws and their tax law.

FISCAL IMPACT

This bill would take advantage of current assessment and collection processes, resulting in absorbable costs to FTB to implement.

ECONOMIC IMPACT

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of AB 2249 Enactment Assumed for Misdirected DDRs Issued On or After 01/01/2009			
Fiscal Impact	2008-09	2009-10	2010-11
Revenue Loss	< $150,000	< $150,000	< $150,000

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

The revenue impact would depend on the number of misdirected DDRs where the third-party fails to return the funds that are reimbursed to the taxpayer. With an annual universe of misdirected DDRs of approximately $50,000, FTB anticipates the volume of remaining DDRs after collection efforts to be less than that amount. The $50,000 estimate would grow over time with the increase in the use of DDRs. Estimating annual growth rate of 10% in DDRs, this option would have an inconsequential effect on state revenue.

APPOINTMENTS

None.

Support/Opposition

Support: Franchise Tax Board

Opposition: None on File

VOTES

Assembly Floor – Ayes: 75, Noes: 0
Senate Floor – Ayes: 38, Noes: 0
Concurrence – Ayes: 76, Noes:0

LEGISLATIVE STAFF CONTACT

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