Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Hayashi	Analyst:	Deborah Barrett	Bill Number:	AB 2755
Related Bills:	See Legislative History	Telephone:	845-4301	Introduced Date:	February 22, 2008
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Mandatory Personal Income Tax Electronic Payments

SUMMARY

This three-member Franchise Tax Board sponsored bill would require personal income taxpayers with estimated tax or extension payments that exceed $20,000 or with tax liabilities of more than $80,000 to remit their payments electronically.

PURPOSE OF THE BILL

As a three-member Franchise Tax Board sponsored bill, the purpose of this bill is to take advantage of commonly used technology to increase efficiencies in state government and reduce delays in deposits of payments.

EFFECTIVE/OPERATIVE DATE

As an administrative measure, this bill would be effective on January 1, 2009, and would specifically apply to tax payments made on or after that date.

POSITION

Support.

On November 28, 2007, the three-member Franchise Tax Board voted 2-0, with the member from the Department of Finance abstaining, to sponsor the language included in this bill.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

Federal Reserve Banks and certain financial institutions that are depositories or financial agents of the United States have authority to accept tax payments for tax imposed under the federal tax laws. Because federal tax payments can be made at most local banks, the need for electronic payment processing is reduced significantly at the federal level.

Taxpayers with aggregate tax payments over $200,000 in a calendar year are required to make those tax payments by Electronic Funds Transfer (EFT) methods.

Board Position:			Department Director	Date
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N	OUA	PENDING		

Under current state law, for tax years beginning on or after January 1, 1995, a corporate taxpayer with a tax liability exceeding $80,000 in a taxable year or with an estimated tax payment in excess of $20,000 is required to remit its tax payment electronically. If a taxpayer is required to remit payment electronically and remits payment using another method, it is subject to a penalty calculated at 10% of the amount paid, unless the failure was due to reasonable cause. Taxpayers subject to these requirements may request a waiver from Franchise Tax Board (the Department) under certain circumstances. PIT taxpayers can voluntarily choose to remit funds by EFT.

<u>THIS BILL</u>

This bill would require for all payments made by an individual on or after January 1, 2009, regardless of the taxable year to which the payments apply, to be electronically remitted to the Department in a form and manner prescribed by the Department once either of the following conditions are met for taxable years beginning on or after January 1, 2009:

- Any installment payment of estimate tax or extension payment exceeds $20,000.
- The total tax liability, as defined, exceeds $80,000.

For purposes of this section, the following definitions apply:

- "Total tax liability" is the total tax liability as shown on the original return after any adjustments are made for mathematical errors or erroneously omitted tax.
- "Electronically remit" means to send payment through use of any of the electronic payment applications provided by the Department.

This bill would permit a taxpayer that is required to remit electronic payments to elect to discontinue making electronic payments in instances where the threshold requirements are not met in the preceding taxable year. A taxpayer required to remit electronic payments may obtain a waiver of those requirements if the Department determines that the amounts paid in excess of the threshold amounts were not representative of the taxpayer's tax liability. Once the waiver is received, the requirement to make, or not make, future electronic payments are subject to the terms of the waiver.

A taxpayer that is required to remit electronic payments, but remits payment by other means, can be subject to a penalty of 10% of the amount paid, unless the failure to remit electronically was for reasonable cause and not willful neglect.

This bill would specify that requirements of the Administrative Procedures Act are not applicable to the provisions of this bill.

<u>IMPLEMENTATION CONSIDERATIONS</u>

The Department would implement the provisions of this bill using existing processes.

TECHNICAL CONSIDERATION

The following technical change is needed to clarify the application of the election to discontinue electronic payments.

On page 2, line 17, after “(1)”, “and” should be struck out and “or” inserted.

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 filed electronically with the Department beginning with the following calendar year.

AB 2480 (Campbell, Stats 2004, Ch. 267) authorizes for tax returns required to be filed on or after January 1, 2005, a penalty for tax preparers that are required to file returns electronically but fail to do so, unless that failure is attributable to reasonable cause and not willful neglect.

PROGRAM BACKGROUND

The Department processed 8.1 million PIT paper payments in fiscal year (FY) 2006-07. These large volumes of paper payments require extensive manual processing. In addition, delays in depositing these payments of several days after receipt occur during tax return filing season, which results in significant loss of interest income to the State.

During FY 2006-07, the Department processed approximately 141,000 paper payments over $20,000 totaling $14.2 billion. The Department received approximately 59,000 payments over $20,000 between April 16 and April 27. It took an average of seven days to deposit these payments. The remaining paper payments received in FY 2006-07 took an average of three days for deposit. The following table highlights this scenario:

Criteria	Number of Days To Make Deposits	Annual Daily Interest Rate[1]	Annual Deposit	Increase in Interest Earned
Estimated Paper Deposits: payments greater than $20,000 received 4/16/07-4/27/07	7	0.0142465753%	$6,770,392,318	$6,751,843
Estimated Paper Deposits: payments greater than $20,000 (remainder of year)	3	0.0142465753%	$7,400,288,004	$3,162,862
TOTAL			$14,170,680,322	$9,914,705

[1] Per State Treasurer’s Office, Annual Interest rate – 5.2%, daily Interest Rate Annualized - 0.0142465753%

Paper payment processing results in a minimum two-day delay in depositing the paper payment (one day for the post office and one day to deposit) and can take up to 16 days. Currently, 13.6% of PIT payments are remitted electronically, which represents 2.4% of all PIT payment dollars. For corporations, the volume of electronic payments is 3.2% of the total payments made, representing approximately 80% of the total payment dollars remitted.

Personal income taxpayers can currently use the following options to pay their taxes:

- Payment by paper check, money order, or cashier's check,
- Payment by credit card, subject to payment of a "convenience fee,"
- Payment through an electronic filing application that debits the taxpayer's bank account for a designated amount at a time determined by the taxpayer, or
- Payment through the Department's Web-pay service that debits a bank account for a designated amount at a time determined by the taxpayer.

Businesses and individuals can pay all their federal taxes using the Electronic Federal Tax Payment System (EFTPS). Individuals can pay their quarterly estimated taxes electronically using EFTPS, and they can make payments weekly, monthly, or quarterly, as well as schedule payments for the entire year in advance. EFTPS is accessible via the Internet or telephone. Businesses can initiate a transaction from their financial institutions that will credit their FTB account through Electronic Funds Transfers (EFT), or can instruct the Department to initiate the transaction to debit their financial institution account for their tax liabilities or estimated payments.

OTHER STATES' INFORMATION

Laws from the states of *New Jersey, Illinois, Massachusetts, Michigan, Minnesota, and New York* were reviewed due to their similarities to California's economy, business entity types, and tax laws. While all of the states provide electronic payment options, only *New Jersey*, *Massachusetts,* and *Illinois* have mandatory EFT requirements*.*

- *New Jersey* requires any taxpayer with a prior year liability of $10,000 or more in any single tax year to remit payments for all taxes by using EFT methods.
- *Massachusetts* limits mandatory EFT requirements to business taxes and withholding payments, but does not have mandatory EFT requirements for PIT payments.
- *Illinois* requires EFT for any PIT tax payments that exceed $200,000. *Illinois* also participates in an IRS pilot program that allows taxpayers to remit both federal and state tax payments through EFTPS.

FISCAL IMPACT

From an operational cost reduction perspective, the Department estimates that this bill would save approximately 72 cents in processing costs for each paper payment converted into an electronic payment. Assuming this bill would convert approximately 141,000 paper payments into electronic payments, Department staff anticipates it will save over $100,000 in processing costs annually.

The bill would require system reprogramming and processing changes. The Department estimates that one-time costs of $260,000 would offset the anticipated processing savings of $100,000 in the first year. The Department would incur ongoing costs of approximately $161,000 annually to provide customer service for electronic payment specific issues, which would also be offset by $100,000 in processing savings annually.

ECONOMIC IMPACT

Based on data and assumptions discussed below, the bill would result in the following revenue impact:

Estimated Revenue Impact of AB 2755 Enactment Assumed after 6/30/2008 Effective for Tax Payments Made for Tax Years BOA 1/1/2009			
Fiscal Impact	2008-09	2009-10	2010-11
Penalty Revenues	Gain < $150,000	Gain < $150,000	Gain < $150,000
Reduced Taxes	N/A	Loss < $500,000	Loss < $500,000
*Interest Income due to Reduced Float Time	+$4 million	+$ 9 million	+$9 million

*Because this indirect revenue effect does not involve the collection of income tax revenues, they are outside the scope of this tax revenue estimate.

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

Revenue Discussion

The revenue impact of this bill would depend on the amount of penalty for failure to remit electronically that is collected and the extent the taxpayer's interest income is reduced by reduced deposit delays.

The Department estimates approximately 28,000 taxpayers would be impacted by this bill (140,000 total PIT payments greater than $20,000 ÷ 5 payments[2] per taxable year = 28,000 individual taxpayers). Based on the high compliance rate under mandatory EFT for corporations, the Department expects potential revenue attributable to penalty assessment to be less than $150,000 annually.

The Department expects this bill to reduce the interest income of affected taxpayers by approximately $6 million annually. ($14 billion targeted EFT payments x money market daily rate of 0.0082% x 5 fewer float days ≈ $6 million reduced taxable interest income). Assuming a marginal tax rate of 8%, the revenue loss from the reduced taxable incomes of affected taxpayers would be approximately $500,000 ($6 million interest income x 8%).

[2] Four quarterly estimated payments + one return payment.

It is estimated that mandatory EFT for individuals will indirectly result in an increase of approximately $9 million of interest revenues to the General Fund based on the Department of Finance's estimate of the interest rate yields for the Pooled Money Investment Account ($14 billion targeted EFT payments x average PMIA daily rate[3] x 5 fewer float days ≈ $9 million). The first fiscal impact year, 2008-09, reflects 6/10 of a full year because approximately 60% of net PIT collections occur in the first half of the calendar year.

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[3] Average PMIA daily rate: 2009: 0.01279%, 2010 and 2011: 0.01313%.