

Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: De La Torre Analyst: Angela Raygoza Bill Number: AB 2605
Related Bills: None Telephone: 845-7814 Introduced Date: February 19, 2010
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Franchise Tax Board (FTB) Fraud Reporting Reward Program

SUMMARY

This bill would provide a funding mechanism for the FTB Informant Reward program, as specified.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill would be to offer a monetary reward to motivate citizens to bring alleged violations of tax laws to the attention of the FTB.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2011, and would apply to rewards authorized in accordance with this bill after that date.

POSITION

Pending.

ANALYSIS

FEDERAL LAW

The Internal Revenue Service (IRS) will, at its discretion, pay rewards to informers for information about tax law violations. Any informant is eligible for a reward, except for Treasury employees and certain other federal employees. The amount of the reward generally will not exceed 15 percent of the additional taxes, penalties, and fines collected as a result of the informant's information.

The IRS may pay sums it deems necessary for detecting underpayments, bringing to trial, and punishing persons guilty of violating, or conspiring to violate the tax laws. In determining whether a reward will be paid under IRS's discretionary authority, all relevant factors, including the value of the information furnished in relation to the facts developed by an investigation of the violation, are taken into account. Rewards are paid out of the proceeds (other than interest) of either:

- Additional amounts collected, or
- False or erroneous claims for refund denied.

Information on violations of tax laws may be submitted in person at an IRS office or by mail.

Board Position:	Legislative Director	Date
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STATE LAW

Since 1984, state tax law has authorized the FTB to conduct an informant reward program; however, there has been no funding appropriated to pay informants.

PROGRAM BACKGROUND

The IRS has agreements with state tax agencies under which information about federal tax, including increases or decreases, is exchanged with the states. Currently, the IRS furnishes the FTB copies of the federal audit reports issued to corporate and individual taxpayers with California addresses. This information is used by FTB to make adjustments to state income tax returns. It is under the FTB's agreement with the IRS that the FTB receives whistleblower adjustment information from the IRS.

For audit cases with less than a 5:1 cost benefit ratio, the case is considered a low priority and becomes part of a discretionary workload. The Budget Committee funds workloads for the FTB when the cost benefit ratio is 5:1 or greater.

THIS BILL

This bill would require the FTB to establish a reward program for information resulting in the identification of underreported or unreported income subject to taxes under the Personal Income Tax Law (PITL) and Corporate Tax Law (CTL).

Under this bill, a person could receive a reward as a result of an administrative or judicial action based on information about state income tax underpayments or underreporting the person provides to the FTB. A person could receive a reward of at least 15 percent but no more than 30 percent of the collected proceeds resulting from an administrative or judicial action, or related action, or from any settlement related to that action.

This bill would allow a reward of no less than 10 percent of the collected proceeds if the administrative or judicial action would be one the FTB determines to be based principally on disclosures of specified allegations arising from the following:

- Administrative hearing,
- Audit,
- Investigation, and
- News media.

To determine the reward amount, the FTB would be required to take into account the importance of the person's information and the role of the person and any legal representative of the person in contributing to the administrative hearing, judicial hearing, or settlement.

Under this bill, the rewards program would apply to administrative or judicial action against any person who has a tax liability under the PITL or CTL. For a person whose income is subject to tax under the PITL, this bill would apply if the person's gross income exceeds \$200,000 for any taxable year subject to the administrative or judicial action and the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed \$2 million.

This bill would define “collected proceeds” to include, but would not be limited to, penalties, interest, additions to tax, and any additional amounts.

This bill would permit, within 30 days of the FTB's determination of a reward amount, appeal of the amount or denial of a reward to the State Board of Equalization.

Under this bill, a contract with the FTB would not be required for any person to receive a reward.

This bill would allow a person receiving a reward to be represented by counsel.

Under this bill, any person employed by or under contract with any state or federal tax collection agency shall not be eligible for a reward.

This bill would deny a reward based on information submitted to the FTB unless the information is submitted under penalty of perjury.

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.

This bill would allow a reward of 15 percent but no more than 30 percent of the collected proceeds of the administrative or judicial action. This bill fails to provide criteria for the significance of information that would give an informant the minimum or maximum percentage. Unless FTB gave an informant the maximum amount allowable in the bill, it is likely the FTB will have disputes. If this is not the author's intent, it is recommended the bill be amended to allow for a set amount of either 15 percent or 30 percent.

The term “collected proceeds” includes, but is not limited to, penalties, interests, additions to tax, and any additional amounts. The term “collected proceeds” raises a timing issue about when the FTB would pay a reward. For example: if a taxpayer, after losing at the State Board of Equalization, pays the tax, penalties, and interest, the FTB would have “collected proceeds” and can issue a reward, but if the taxpayer files a suit for refund with the Superior Court, the amount of the reward paid out by the FTB would be lost. In addition, the bill is silent about how FTB would retrieve rewards paid out in instances where the taxpayer subsequently files a successful claim for refund. (The statute of limitations for filing such a claim can be one year from payment of the tax). Accordingly, it is recommended that the bill be amended to require that all legal remedies be exhausted and that the statute of limitation for contesting any tax and penalties has expired before the FTB is required to pay a reward.

It is unclear if the term “gross income” is determined based on an originally filed tax return or on the “as adjusted” amount following a federal or state audit. The absence of clarity could lead to disputes with taxpayers and would complicate the administration of this reward program.

The phrase “in dispute” could cause conflict for purposes of calculating whether a reward should be paid. For example, if FTB proposes a \$3 million adjustment and the PIT taxpayer agrees to \$2 million of the adjustment, would the informant receive a reward because the original adjustment was \$3 million or no reward because the “disputed” amount is \$2 million. Additionally, it is unclear if the \$200,000 gross income threshold would be applied before or after any adjustment that FTB would make. If this is not the author’s intent, further clarification would be needed.

This bill fails to specify whether a former employee of a state tax collection agency would be eligible for a reward. Former state employees may have obtained taxpayer information during their employment and could use that information to obtain a reward. The author may wish to amend the bill to exclude former employees from being eligible for a reward to eliminate any dishonest behavior.

The bill would be effective January 1, 2011, and operative as of that date; however, it is unclear whether information received by FTB before that date could provide the basis for a reward. For example, if FTB received informant information on January 1, 2011, this bill would apply depending on the specified operative date. If this is not the author’s intent, it is recommended the bill be amended to add a specific operative date for first contact.

TECHNICAL CONSIDERATIONS

There is a spelling error with regards to the term “interest.” On page 3, line 17, ~~strikeout~~ “interests” and insert “interest.”

The term “persons” is broadly defined by statute and includes individuals, trusts, and pass-thru entities subject to tax under the PITL. To narrow the definition it is recommended replacing the term “person” with “individual.”

OTHER STATES’ INFORMATION

The states surveyed include *Florida, 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. None of these states have an informant reward program.

FISCAL IMPACT

The exact costs could not be determined at this time due to the Implementation Considerations discussed above. However, staff preliminarily estimates on-going costs of approximately \$420,000 (5 PYs) to track informant tips, audit new cases, manually track collection cases, and monitor disbursements from collected proceeds. Once the Implementation Considerations have been addressed a more accurate costing will be provided.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue gains:

Estimated Revenue Impact of AB 2605 For Taxable Years Beginning On or After January 1, 2011 Enactment Assumed After June 30, 2010		
2010-11	2011-12	2012-13
\$200,000	\$350,000	\$400,000

POLICY CONCERNS

This bill would allow an informant to appeal the FTB's decision of the amount or denial of the reward to the BOE. In defending the FTB's position before the BOE, disclosure of confidential taxpayer information may be necessary. Because general disclosure laws prohibit the disclosure of confidential taxpayer information, the FTB staff may be unable to defend the department's position.

This bill would require a taxpayer to have an adjusted gross income of over \$200,000 and a state tax adjustment of \$2 million before an informant can claim a reward. These threshold amounts are high and could result in few rewards being paid out.

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