**Franchise Tax Board**

# ANALYSIS OF AMENDED BILL

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|---|---|---|---|---|---|
| Author: | Evans | Analyst: | William Koch | Bill Number: | ABX3 19 |
| Related Bills: | See Legislative History | Telephone: | 845-4372 | Amended Date: | June 30, 2009 |
| | | Attorney: | Patrick Kusiak | Sponsor: | |

**SUBJECT**: Backup Withholding/Estimated Tax Payments/Wage Withholding/Financial Institution Record Match/ Withholding On Certain Amounts Reported On IRS Form 1099 MISC (aka Independent Contractor Withholding)/Occupational And Professional License Suspension For Unpaid Tax/Abusive Tax Shelters


**SUMMARY**

This analysis does not address provisions of the bill that are related to the sales and use tax laws.

This bill would do the following:

Provision No. 1: Suspend a delinquent taxpayer's occupational or professional license once a delinquency is at least five months old and four notices have been issued by FTB.

Provision No. 2: Provide a single, consistent definition for abusive tax shelters (ATSs), modify the ATS-use penalty,[1] and create a new California reportable-transaction category for transactions of interest.

Provision No. 3: Conform, with modifications, to the federal backup withholding regime.

Provision No. 4: Require withholding on amounts reported on IRS Form 1099 MISC (aka Independent Contractor Withholding).

Provision No. 5: Increase the withholding rate on wages, supplemental wages, stock options and bonus payments.

Provision No. 6: Modify estimated tax payment percentages.

Provision No. 7: Establish a record match process between financial institution customer records and FTB debtor records. FTB would use the match information, which would be more current than information now available to FTB, to collect delinquent state income tax debts and non tax debts using existing laws and computer systems.


[1] The ATS-use penalty under R&TC section 19777 is often referred to as the interest-based penalty.

| Board Position: | | | Department Director | Date |
|---|---|---|---|---|
| _______ S | _______ NA | _______ NP | | |
| X SA | _______ O | _______ NAR | Selvi Stanislaus | 07/17/09 |
| _______ N | _______ OUA | _______ PENDING | | |

**SUMMARY OF AMENDMENTS**

This bill as introduced January 5, 2009, expressed the intent of the Legislature to enact changes to the Budget Act of 2008.

The June 30, 2009, amendments removed the intent language and added the provisions discussed in this analysis.

This is the department's first analysis of this bill.

**PURPOSE OF THE BILL**

It appears the purpose of this bill is to accelerate revenue and increase tax compliance to address the fiscal emergency declared by the Governor by proclamation on December 19, 2008.

**EFFECTIVE/OPERATIVE DATE**

As a special session bill, this bill would become effective 91 days after adjournment of the special session. The operative dates of these provisions vary and are addressed separately for each provision.

**POSITION**

Support.

On November 28, 2007, the three-member FTB voted 2-0, with the representative from Department of Finance abstaining, to sponsor the language added by provision 1 listed in "SUMMARY" section.

On November 28, 2007, the three-member FTB voted 2-0, with the Department of Finance abstaining, to sponsor the language added by provision 3 listed in the "SUMMARY" section.

On March 6, 2008, the three-member FTB voted 2-0, with the Member from the Department of Finance abstaining, to support the language added by provision 7 listed in the "SUMMARY" section.

The three-member FTB has not considered provisions 2, 4, 5, and 6 listed in the "SUMMARY" section.

## ECONOMIC IMPACT – SUMMARY REVENUE TABLE (in Millions)

| **Fiscal Year<br>$ in Millions** | | **08/09** | **09/10** | **10/11** | **11/12** |
|---|---|---|---|---|---|
| Provision No. 1: | Suspend occupational and professional licenses as a matter of law because of an unpaid income tax liability and require FTB to notify the applicable licensing agency of the suspension. | $14 | $19 | $26 | $13 |
| Provision No. 2: | Provide a single, consistent definition for ATSs, Modify the ATS-use penalty and create a new California reportable-transaction category for transactions of interest. | $.7 | -$1.4 | $10.0 | $8.7 |
| Provision No. 3: | Conform, with modifications, to the federal backup withholding regime. | | $26 | $25 | $26 |
| Provision No. 4: | Require withholding on certain amounts reported on IRS Form 1099-MISC (aka Independent Contractor Withholding) | | | | |
| | Compliance | | $65 | $230 | $300 |
| | Acceleration | | $1,900 | -$100 | -$730 |
| | Sub Total | | $1,965 | $130 | -$430 |
| Provision No. 5: | Increase the withholding rate on wages, supplemental wages, and stock options and bonus payments. | | $1,600 | $1 | $58 |
| Provision No. 6: | Modify estimated tax payment percentages and annualized method | | $600 | $19 | $37 |
| Provision No. 7: | Establish a record match process between financial institution customer records and FTB debtor records. FTB would use match information to collect delinquent state income tax debts and non tax debts using existing laws and computer systems. | | | | |
| | General fund Revenue | | $22 | $60 | $96 |
| | Non-Tax Debt | | | $2 | $6 |
| | *TOTAL | **$14.7** | **$4,230.6** | **$273** | **-$185.3** |

*** The revenue estimates in this analysis do not reflect uncertainties involving state employee furloughs and layoffs or the impact of prioritizing and implementing multiple projects simultaneously. The revenue estimates are also contingent upon legislative approval and receipt of the funding required to implement and administer the above provisions.**

**PROVISION NO. 1: SUSPENSION OF OCCUPATIONAL AND PROFESSIONAL LICENSES**

**EFFECTIVE/OPERATIVE DATE**

As a special session bill, this provision would become effective and operative 91 days after the close of the special session.

**ANALYSIS**

FEDERAL/STATE LAW

Under both federal and state income tax laws, in general, if taxpayers have delinquent tax amounts, a tax lien automatically arises by operation of law for that amount, known as a statutory tax lien. A statutory tax lien is a claim upon real and personal property for the satisfaction of a tax debt. For federal purposes, the statutory tax lien exists as long as the delinquency exists or until automatically released ten years after a tax is assessed.

For state purposes, a statutory tax lien arises automatically when the debt becomes final and exists for ten years, unless the liability becomes satisfied or, if the debt remains unpaid, a Notice of State Tax lien is recorded. The recording of the notice provides notice to the world of the debt against all real and personal property belonging to the taxpayer and located in the California county where recorded.

Current state law authorizes FTB to use several collection tools to collect delinquent tax liabilities:

- An Order to Withhold (OTW) can be issued to any third-person in possession of funds or properties belonging to the debtor, for example vacation trust funds, interest, financial assets, and 1099 miscellaneous payors. Upon receipt of an OTW, the entity notified is required to submit to the department all cash or cash equivalents due the debtor that will satisfy the amount of the OTW.
- A warrant can be issued to seize property and convert it to cash to satisfy a debt. Warrants are enforced by county sheriffs or the California Highway Patrol. The most common use of the warrant is to seize and sell vehicles.
- An Earnings Withholding Order for Taxes (EWOT) is used to collect delinquent tax liabilities for which a tax lien is in effect. An EWOT is a continuing wage garnishment based on a percentage of a debtor's earnings, not to exceed 25 percent of disposable income.

Current state law specifies that the Contractor’s State License Board (CSLB) may refuse to issue, reinstate, reactivate, suspend, or renew a contractor’s license for the failure of a licensee to pay state taxes and any fees that may be assessed by the CSLB, the Department of Industrial Relations, the Employment Development Department, or the FTB.

Current state law also authorizes professional license denial and suspension for failure to pay court-ordered child support debt. The local child support agencies compile a list for the Department of Child Support Services (DCSS) of obligors who are more than 30 calendar days in arrears in making their child support payments. DCSS reviews the list to verify the information is accurate and then sends the list of obligors to the various licensing boards. Once the list is received, those boards immediately send a 150-day compliance letter to the obligor. If the obligor fails to comply within the 150-day timeframe and the licensing board fails to receive a release letter from the local child support agency, the occupational, professional, or driver's license is suspended by the licensing board.

Under current state tax law, FTB is prohibited from disclosing any confidential taxpayer information unless an exception to the general disclosure law specifically authorizes the disclosure.

Current state law provides that the California Supreme Court may suspend or disbar an attorney from practice for an act of professional misconduct or convicted of serious crimes.

<u>THIS PROVISION</u>

This provision would suspend an occupational or professional license by operation of law because of an unpaid income tax liability. The suspension would occur only after the following have been provided by FTB to the debtor:

- Notice of State Income Tax Due,
- Final Notice Before Levy,
- Order To Withhold is issued (if debtor's bank information is available to FTB),
- Notice of State Tax Lien (issued when a state tax lien is recorded),
- Sixty day preliminary suspension notice.

This provision would allow FTB to disclose to the licensing boards the fact of the suspension--unpaid taxes.

This provision would require that the licensee pay the total unpaid tax liability or enter into an installment arrangement to cancel a suspension. This bill would specify that a licensee that enters into an installment payment agreement would have their license suspended if he or she fails to comply with the terms of the agreement. The license would be suspended 30 days after the date the agreement has been terminated and a notice of suspension would be provided to the licensing entity and mailed to the licensee.

This provision would allow a financial hardship hearing. The FTB staff would provide a hearing, upon request of a debtor, for a license holder who believes he or she would experience a financial hardship as a result of the suspension. "Financial hardship" would be defined by reference to Revenue and Taxation Code (R&TC) section 19008, as determined by FTB, where suspension of a license would result in the licensee being financially unable to pay his or her taxes including penalties, interest, and applicable fees and is unable to qualify for an installment payment arrangement pursuant to R&TC section 19008. In order to establish that a financial hardship exists, the licensee shall submit any information, including information related to reasonable business and personal expenses, requested by FTB for making the determination. FTB would conduct the hearing within 30 days of receipt of the request, unless FTB postpones the hearing upon a showing of good cause. Suspension would be deferred until the hardship hearing was completed. If a debtor substantiates financial hardship, FTB would defer or cancel the suspension.

The provision specifies that the administrative adjudication provisions of the Administrative Procedures Act[2] would not apply to the suspension of a license as result of delinquent tax liabilities.

In addition, this provision would require a license to be suspended if the deferral of a license suspension is a result of a financial hardship is no longer operative. The license would be required to be suspended 30 days after the date the deferral is no longer operative. This provision would require FTB to provide a notice of suspension to the licensing entity and mail a notice of suspension to the licensee.

This provision would allow a licensing entity to impose a fee on licensees who have had their license suspended as a result of a delinquent tax liability. The fee would be limited to the actual costs of suspension.

This provision would define the following:

- “Financial hardship” means financial hardship, as determined by FTB, where the taxpayer is financially unable to pay any part of their taxes including penalties, interest, and applicable fees and is unable to qualify for an installment payment arrangement pursuant to Section 19008 of the Revenue and Taxation Code.
- “License” includes certificate, registration, or any other authorization to engage in a business or profession issued by a state governmental licensing entity.
- “Licensee” means any entity authorized by a license, certificate, registration, or other authorization to engage in a business or profession issued by a state governmental licensing entity.
- “State governmental licensing entity” means any entity included in Sections 101, 1000, or 19420 of the Business and Professions Code (approximately 41 licensing entities), the Office of Attorney General, the Department of Insurance, the State Bar of California, the Department of Real Estate, and any other state agency, board, or commission that issues a license, certificate, or registration authorizing a person to engage in a business or profession. “State governmental licensing entity” excludes the Department of Motor Vehicles.

This provision would allow the Contractors State License Board to continue to have authority to suspend a contractor’s license for unpaid tax liabilities.

[2] Administrative Procedures Act Government Code 11500 provides procedures for administrative hearings to be conducted by the licensing boards to determine whether a right, authority, license or privilege should be revoked or suspended.

This provision would require licensing boards to provide FTB with information at a time requested by FTB.

The provision specifies that implementation of these provisions would be contingent upon funding approval.

**LEGISLATIVE HISTORY**

AB 484 (Eng, 2009/2010) and AB 1925 (Eng, 2007/2008) are similar to this provision. AB 484 would have required a 150-day preliminary suspension notice. AB 484 failed passage out of the Senate Revenue and Taxation Committee. AB 1925 would have allowed a 60-day preliminary suspension but would not have allowed the licensing entities to impose a fee for suspended licensees or exclude administrative adjudication provisions of the Administrative Procedures Act. AB 1925 failed passage out of the Senate Revenue and Taxation Committee.

**PROGRAM BACKGROUND**

Current data indicates that there are over 25,000 delinquent taxpayers who possess an occupational or professional license. The department is unable to use its most effective collection tools, namely EWOTs, OTWS, and warrants, to collect delinquent liabilities from individuals who operate on a cash basis because of the lack of third-party reporting on transactions such as commissions, rents, and payment for services provided.

**OTHER STATES' INFORMATION**

*Illinois, Massachusetts, Minnesota, Oregon,* and *Wisconsin* tax laws provide for suspension of licensees for unpaid personal income tax liabilities. The revenue department for each of those states directs the licensing authority to suspend the licenses.

*Missouri* income tax laws provide that the revenue department can suspend a professional or occupational license for delinquent income tax liability. The revenue department suspends the license and then notifies the licensing board of the suspension of the license holder.

Recently, *Pennsylvania* enacted an information exchange program to ensure that individuals and businesses licensed by the state pay their state income, sales and use, cigarette, liquor, and property taxes. The revenue department will notify a licensing board when it determines that an applicant or licensee has a state tax delinquency. The licensing board will deny or suspend a license for failure to comply with state tax laws.

*Florida, Michigan, and New York* do not have statutory authority to suspend occupational and professional licenses for delinquent tax liabilities.

**FISCAL IMPACT**

Staff estimates a one-time cost of approximately $2.5 million to program, develop, and test a new process within existing systems and add collection staff to review, process, and suspend accounts that have been matched to licensees. Staff estimates on-going annual costs of approximately $1.4 million for mailing notices and responding to taxpayer inquiries resulting from those notices. This new function would be operative in the 2009-10 fiscal year.

**ECONOMIC IMPACT**

**Revenue Estimate:**

The revenue gain from this provision would be as follows:

| Estimated Revenue Impact of Occupational License Suspension<br>Operative On Or After November 1, 2009<br>Enactment Assumed After June 30, 2009<br>($ in Millions) | | | |
|---|---|---|---|
| Occupational | 2008-09 | 2009-10 | 2010-11 |
| License | $14 | $19 | $26 |

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

**Revenue Discussion:**

The revenue impact for this provision would be determined by the number of delinquent taxpayers who are required to possess an occupational or professional license and who pay their tax liabilities under either pending notice of or an actual suspension of their occupational license.

This estimate was calculated using the account balances of the department's accounts receivables for the affected taxpayers, excluding accounts in bankruptcy and installment agreements. Taxpayers subject to the bill are those with an outstanding liability of $1,000 or more and who have owed a tax debt for a minimum of one year.

There is currently an inventory of approximately 25,000 delinquent taxpayers with occupational and professional licenses that are in the collection process. It is estimated that approximately 9,500 taxpayers would comply with this bill in 2010. The average payment amount for these cases would be $2,000 resulting in additional collections of approximately $19 million (9,500 taxpayers x $2,000 average payment). Using a manual system until an automated system can be operational, it is assumed that $8.2 million ($19 million additional collections x 40%) would be would be collected in 2009-10, approximately 40 percent of the $19 million.

In addition, it is estimated that each year 17,200 taxpayers with occupational and professional licenses will enter the collection process. Of the 17,200 taxpayers, approximately 6,600 are expected to comply resulting in additional annual collections of $13.3 million (6,600 taxpayers x $2,000 average payment). In 2009-10, approximately $5.6 million, or 40 percent of the $13.3 million, would be collected. It is estimated that the total 2009-10 revenue would be approximately $14 million ($8.2 million + $5.6 million).

In 2010-11, the remainder of the one-time inventory from 2009-10 would be approximately $10.7 million ($19 million - $8.2 million), as well as the remainder of the 2009-10 annual inventory, approximately $7.6 million ($13.3 million - $5.6 million), and a $0.2 million of the 2010-11 annual inventory for total collections of approximately $18.5 million ($10.7 million + $7.6 million + $0.2 million).

In 2011-12, the remaining inventory from 2010-11 ($13.3 million - $0.2 million = $13.1 million) as well as all of the 2011-12 annual inventory ($13.3 million) would be received, for total collections of $26.4 million ($13.1 million + $13.3 million).

Thereafter, this bill would result in annual collections of $13 million. Because these cash flows all relate to tax liabilities from prior years, they are accrued back one year. Therefore, the $14 million estimated fiscal year cash flow increase for 2009-10 would actually be a $14 million revenue increase for fiscal year 2008-09.

**PROVISION NO. 2: CONSISTENT DEFINITION FOR ATSs, MODIFICATION OF ATS-USE PENALTY, AND CREATION OF A NEW CALIFORNIA REPORTABLE-TRANSACTION CATEGORY FOR TRANSACTIONS OF INTEREST**

**EFFECTIVE/OPERATIVE DATE**

As a special session bill, this provision would become effective 91 days after the close of the special session. The operative dates would be as follows:

- The provision relating to transactions of interest would be operative for transactions of interest published on or after the effective date.
- The provision relating to interest suspension would be operative for notices mailed or amended returns filed on or after the effective date.
- The provision relating to subpoenas would be operative for subpoenas issued on or after the effective date.
- The provision relating to the eight-year statute of limitations would be operative for taxable years beginning on or after January 1, 2009.
- The provision relating to the ATS-use penalty would be operative for notices mailed on or after the effective date, and for amended returns filed more than 90 days after the effective date, with respect to the taxable years for which the statute of limitations for mailing a notice of proposed assessment has not expired as of the effective date.

FEDERAL LAW

Tax Shelters in General

A “tax shelter” is generally a partnership or other entity (such as a corporation or trust), an investment plan or arrangement, or any other plan or arrangement used for the principal purpose of avoiding or evading tax. These transactions generally have no business purpose other than reducing tax; however, a tax shelter is often cloaked in a series of transactions to make it appear to have a business purpose or structured to create an incidental business purpose. Federal Treasury Regulations provide that the principal purpose of an entity, plan or arrangement is to avoid or evade federal income tax if that purpose exceeds any other purpose. Tax-shelter transactions are generally structured with one or more of the following characteristics:[3]

[3] IRC section 6662(d)(2)(C) and Treas. Reg. section 1.6662-4(g)(2).

- o Little or no motive of realization of economic gain;
- o Intentional mismatching of income and deductions;
- o Overvalued assets or assets with values subject to substantial uncertainty;
- o Non-recourse financing and financing techniques that do not conform to standard commercial business practices; and
- o Mischaracterization of the substance of the transaction.

Reportable Transactions

A reportable transaction is generally any transaction that has a potential for avoiding or evading tax and the transaction is required to be included a return or statement.[4] Federal law requires a taxpayer who participated in a reportable transaction to disclose the transaction on an original or amended return for any taxable year the taxpayer participates in the transaction.[5] The current categories of reportable transactions include:

- o Listed transactions;[6]
- o Confidential transactions; [7]
- o Transactions with contractual protection;[8]
- o Loss transactions;[9] and
- o Transactions of interest.[10]

Listed Transactions

A listed transaction is a transaction that has been identified by the IRS or the FTB to be a tax-avoidance transaction (i.e. an abusive tax shelter).

Transactions of Interest

A transaction of interest is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest.

Interest Suspension

In general, the IRC requires the payment of interest on any amount of tax imposed that is not paid on or before the last date prescribed for payment of tax.[11] The IRC precludes taxpayers from filing administrative claims for abatement with respect to income, estate or gift taxes.[12] However, the IRC provides an exception to the general rule under the interest-suspension rule.

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[4] IRC section 6707A(c)(1).
[5] Treas. Reg. section 1.6011-4(a).
[6] Treas. Reg. section 1.6011-4(b)(2).
[7] Treas. Reg. section 1.6011-4(b)(3).
[8] Treas. Reg. section 1.6011-4(b)(4).
[9] Treas. Reg. section 1.6011-4(b)(5).
[10] Treas. Reg. section 1.6011-4(b)(6).
[11] IRC section 6601.
[12] IRC section 6404(g).

The interest-suspension rule suspends the accrual of interest and time-sensitive penalties if the Secretary of the Treasury does not provide notice to the taxpayer specifically stating the amount due and the basis for the liability within 36 months of the later of the due date of the return (without regard to extensions) or the date the return is filed.[13] The interest-suspension rule does not apply to any interest, penalty, and addition to tax, or additional amount with respect to any undisclosed reportable transaction, listed transaction, or gross misstatement.[14]

CALIFORNIA LAW

SB 614 (Stats. 2003, Ch. 656)[15] created the following definitions and provisions to curtail the use of abusive tax shelters:

- Potentially Abusive Tax Avoidance Transaction – is defined as any tax shelter or a plan or arrangement which is of a type that the Secretary of the Treasury or the FTB determines by regulation as having a potential for tax avoidance or evasion.

- Eight-Year Statute – if the Franchise Tax Board (FTB) identifies an adjustment relating to an "abusive tax avoidance transaction," the FTB may notify the taxpayer of a proposed deficiency assessment up to eight years after the taxpayer has filed the return, rather than the normal four-year statute of limitations.

- ATS-Use Penalty – applies if the FTB contacts a taxpayer regarding a deficiency that results from the use of an undisclosed reportable transaction, a listed transaction, or a gross misstatement. The penalty is 100 percent of the interest payable up to the date that a notice of proposed deficiency is mailed.

  Because the ATS-use penalty is based on the amount of interest on a deficiency, a taxpayer may avoid the penalty by filing an amended return prior to FTB issuing a deficiency notice.

- Interest Suspension – is a temporary suspension of the imposition of interest and certain penalties if the FTB does not issue a notice within 18 months from the date of a timely-filed return. Interest may not be computed on the additional proposed tax from the day after that 18-month period until 15 days after the notice is issued. This rule does not apply to taxpayers with income greater than $200,000 and that have been contacted by FTB regarding a "potentially ATS." This provision refers to ATS-use penalty rules for the definition of a "potentially ATS."

- Non-economic Substance Transaction Understatement (NEST) Penalty – is imposed on any understatement attributable to any transaction that lacks economic substance. A "noneconomic substance transaction understatement" is a reportable transaction understatement,[16] or an understatement resulting from the disallowance of any loss, deduction or credit or addition to income that is attributable to a determination that the arrangement lacks economic substance. A transaction is treated as lacking economic substance if the taxpayer does not have a valid nontax business purpose for entering into the transaction.

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[13] IRC section 6404(g)(1).
[14] IRC section 6404(g)(2).
[15] R&TC sections 19753, 19755, 19777, and 19116.
[16] R&TC section 19774(c)(1).

The penalty is 40 percent of the understatement if the transaction is not disclosed, and is 20 percent if the transaction is adequately disclosed. The penalty applies to the entire amount of the understatement, even if the benefit of the understatement is not recognized on a current-year return. For example, if a taxpayer reports a $100 million capitol loss resulting from a transaction that lacks economic substance, but only utilizes $10 million of the loss in the current year due to the capitol loss limitations, the penalty is based on $100 million, the total *understated* amount.

AB 115 (Stats. 2005, Ch. 691) modified the tax shelter provisions, and one of the modifications was to the ATS-use penalty. The penalty was changed *from* applying to a deficiency resulting from “any tax shelter or a plan or arrangement which is of a type that the Secretary of the Treasury or the FTB determines by regulation as having a potential for tax avoidance or evasion” *to* instead apply to a deficiency resulting from “an undisclosed reportable transaction, a listed transaction or a gross misstatement.”

THIS PROVISION

This provision would provide a single, consistent definition for “abusive tax avoidance transactions,” which would mean any of the following:

1. A federal tax shelter;
2. An undisclosed reportable transaction;
3. A listed transaction;
4. A gross misstatement; or
5. A transaction subject to the noneconomic substance transaction understatement penalty.

This provision would coordinate this definition of “abusive tax avoidance transactions” in the application of:

- The eight-year statute of limitations;
- The ATS-use penalty;
- The interest-suspension rule; and
- The authority to issue subpoenas.

This provision would modify the ATS-use penalty to no longer allow taxpayers to avoid the penalty by filing an amended return prior to FTB issuing a deficiency notice; instead, this provision would impose 50 percent of the penalty in such situations

This provision would enact a new California reportable-transaction category of transactions of interest, similar to the federal reportable-transaction category of transactions of interest. A California transaction of interest would be a transaction that is the same as, or is substantially similar to, a transaction specifically identified by FTB by notice, regulation or other form of published guidance as a transaction of interest. All transactions of interest would be published on the FTB’s website.

TECHNICAL CONSIDERATIONS

On page 11, line 18, “any to” should read “to any.”

**LEGISLATIVE HISTORY**

SB 401 (Wolk, 2009/2010) contains provisions similar to this provision. This bill is currently scheduled to be heard in the Assembly Revenue and Taxation Committee on July 6, 2009.

SB 614 (Stats. 2003, Ch. 656) added and modified ATS definitions and penalties, as explained in the California Law section above.

AB 115 (Stats. 2005, Ch. 691) modified the ATS and penalty statutes.

**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. (*Florida* imposes corporate income tax, but does not impose personal income tax.)

These states generally follow federal definitions of tax shelters, but the standard for imposing tax-shelter penalties and reporting requirements vary by state. For example, similar to California, *Illinois*, *Minnesota* and *New York* impose penalties on undisclosed reportable transactions; however, the penalty amounts vary by state. No states were found to have an ATS-use penalty similar to California’s.

**FISCAL IMPACT**

This provision would not significantly impact the department’s costs.

**ECONOMIC IMPACT**

Based on data and assumptions discussed, this provision would result in the following revenue gains beginning in fiscal year 2008/09.

| Estimated Revenue Impact of Abusive Tax Shelter Provisions<br>Assumed Operative for Proposed Assessments Issued after November 1, 2009<br>Assumed Enacted After August 1, 2009<br>($ in Millions) | | |
|---|---|---|
| 2008/09 | 2009/10 | 2010/11 |
| $.7 | -$1.4 | $10 |

Additionally, transactions of interest are anticipated to increase awareness and could increase taxpayer compliance. Although the impact to revenue in future years is unknown, approximately $600 million in tax revenue would be gained for every one percent increase in self-compliance.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue is estimated using the following revenue streams:

1. The penalty revenue from expanding the definition of "abusive tax avoidance transactions."
2. The accelerated revenue from taxpayers that take advantage of the 90-day period to avoid the ATS-use penalty.
3. The revenue decrease due to allowing a 50-percent reduction in the ATS-use penalty.
4. The revenue increase from transactions of interest.

| Estimated Revenue Impact of Abusive Tax Shelter Provisions<br>Assumed Operative for Notices Issued On or November 1, 2009<br>Assumed Enacted After August 1, 2009<br>$ in Millions | | | |
|---|---|---|---|
| | 2008/09 | 2009/10 | 2010/11 |
| Stream 1 | $2.75 | $6.6 | $9.0 |
| Streams 2 & 3 | -$2.0 | -$8.0 | $1.0 |
| Total * | $.7 | -$1.4 | $10.0 |

* For Stream 4, see explanation below

*Stream 1:*

*Revenue from Modifying the Definition of "Abusive Tax Avoidance Transactions"*
Modifying the definition of "abusive tax avoidance transaction" is estimated to increase penalty assessments by $10 million annually (250 cases X $40,000).

**2009 Assessments**

For the first year, tax year 2009, assessments are reduced by 90 percent to $1 million ($10 million x 10%) to account for late year operative date of November 1st 2009. Because this penalty may be protested, assessments are anticipated to be collected over three years. It is assumed that 50 percent of taxpayers would protest their penalty assessments during 2010. Of the revenue that remains, $0.25 million is anticipated to be collected during fiscal year 2009/10.

**2010 Assessments**

Based on the same assumptions above, penalty revenue is estimated to total $5 million for tax year 2010 ($10 million x 50% collections). Half of this revenue, or $2.5 million would also be attributed to fiscal year 2009/10.

In total, 2009 & 2010 penalty collections would total $2.75 million ($0.25 million + $2.5 million).

Additionally, providing a consistent definition for abusive tax avoidance transactions would create departmental efficiencies, potentially reducing the time needed to develop cases at audit and protest levels. These efficiencies would enable staff to pursue additional tax shelter cases. This estimate does not consider revenue gains that may result from these efficiencies.

*Streams 2 and 3:*

*Reducing the ATS-Use Penalty by 50 Percent for Amended Returns & 90-Day Period*

Under current law, taxpayers can avoid the ATS-use penalty by filing an amended return after the department has contacted the taxpayer regarding an undisclosed reportable transaction, a listed transaction, or gross misstatement, but before FTB issues a deficiency notice. The department currently receives approximately $17 million annually in revenue from taxpayers that file amended returns to specifically avoid the ATS-use penalty.

It is estimated that because this bill would allow a 50-percent reduction in the penalty in this situation, some taxpayers would continue to file amended returns voluntarily but not at the volume the department currently receives. This portion of the proposal is estimated to result in delayed revenue collections of $8.5 million ($17 million X 50%) beginning in fiscal year 2009/10. This delayed revenue will be realized in future years when the audits are complete.

Additionally, because the change in law would be operative 90 days after the effective date of the legislation, some taxpayers currently under audit are anticipated to file amended returns during this 90-day period to avoid the ATS-use penalty. In the first year, this portion of the proposal is estimated to accelerate approximately $5 million from audits that would be in progress, which would have been completed over the next few years.

*Revenue Impact Due to Revenue Streams 1, 2 and 3*

Because this bill would affect prior tax years, the revenue estimate for each revenue stream has been accrued back one fiscal year. The revenue estimate for fiscal year 2009/10 consists of penalty revenue collection of $2.75 million (reflected in fiscal year 2008/09). Netting revenue streams two and three results in a revenue loss of $2 million during the first year and this revenue is accrued back to fiscal year 2008/09.

*Stream 4*

Creating a California reportable-transaction category for transactions of interest is anticipated to increase awareness and could increase taxpayer compliance. Although the impact to revenue in future years is unknown, approximately $600 million in tax revenue would be gained for every one percent increase in self-compliance.

## PROVISION NO. 3: MODIFIED CONFORMITY TO FEDERAL BACKUP WITHHOLDING

**EFFECTIVE/OPERATIVE DATE**

As a special session bill, this provision would become effective and operative 91 days after the close of the special session and would be specifically operative for payments issued on or after January 1, 2010.

FEDERAL LAW

Banks and other businesses that make payments of the type that are required to be reported on an information return— i.e., Form 1099 series—may be required to backup withhold on those payments. A payee is required to provide a correct taxpayer identification number (TIN) to the payer who must report that information on the applicable Form 1099.

Payments subject to backup withholding include interest (Form 1099-INT); dividends (1099-DIV); certain patronage dividends (1099-PATR); rents, profits, or other gains (Form 1099-MISC); commissions, fees, or other payments to independent contractors (1099-MISC); payments by brokers (1099-B); certain payments by fishing boat operators (1099-MISC); royalty payments (1099-MISC); and certain gambling winnings (W-2G). Payments that are excluded from federal backup withholding include, among other things, real estate transactions, unemployment compensation, and state or local income tax refunds.

Payments to the payee will be subject to backup withholding at a rate of 28 percent in the following situations:

- Payee does not give the payer his or her TIN in the required manner.
- The IRS notifies the payer that the TIN payee gave was incorrect.
- Payee is required, but fails, to certify that he or she is not subject to withholding.
- The IRS notifies the payer to start withholding on interest or dividends because the payee has underreported interest or dividends on his or her federal income tax return. The IRS will do this only after it has mailed the payee four notices over at least a 210-day period.

Federal law provides civil and criminal penalties for giving false information to avoid backup withholding. This civil penalty is $500. The criminal penalty, upon conviction, is a fine of up to $1,000 or imprisonment of up to one year, or both.

CURRENT STATE LAW

California does not conform to federal backup withholding provisions.

THIS PROVISION

This provision would require the social security number or other taxpayer identification number of the recipient of income to be furnished upon demand by the person paying the income.

For “reportable payments” made on or after January 1, 2010, this provision would conform, with modifications, California tax law to the federal backup withholding regime to require such withholding at a rate of 7 percent for California purposes.

The bill defines “reportable payment” by reference to Section 3406(b) of the Internal Revenue Code and only includes payments of income as defined in Section 18662 of the Revenue and Taxation Code and applicable regulations, with respect to rents, prizes and winnings, compensation for services, including bonuses, and other fixed or determinable annual or periodic gains, profits, and income.

The following payments of income would be specifically excluded from California backup withholding:

- Interest and dividends
- Any release of loan funds made by a financial institution in the normal course of business

This bill defines the term financial institution as:

- A depository institution, as defined in Section 1813(c) of Title 12 of the United States Code;
- An institution-affiliated party, as defined in Section 1813(u) of Title 12 of the United States Code;
- Any Federal credit union or State credit union, as defined in Section 1752 of Title 12 of the United States Code, including an institution-affiliated party of such a credit union, as defined in Section 1786(r) of Title 12 of the United States Code.

California backup withholding would supersede any other withholding provision of Article 5 of Chapter 2 of Part 10.2 of the Revenue and Taxation Code that would otherwise require withholding.

This provision would require that any payer required to withhold tax pursuant to this provision should notify the payee of such withholding at a time and manner as prescribed in forms and instructions issued by the FTB.

**LEGISLATIVE HISTORY**

AB 1848 (Ma, 2007/2008) contained identical provisions to this provision. AB 1848 failed to pass out of the Senate.

**PROGRAM BACKGROUND**

The California tax gap is estimated to be approximately $6.5 billion per year. Almost 80 percent of the tax gap is attributable to underreporting of income or overreporting of deductions, primarily by individuals. Studies conducted by the IRS indicate that taxpayers voluntarily report 96 percent of income that is subject to information reporting. That rate increases to 99 percent when the income is subject to withholding.

Current federal and California law requires business payers to file with the government and payees information returns on many types of payments that generally produce taxable income. The federal Form 1099 series is used to report various types of income such as nonemployee compensation, interest and dividends, or brokerage proceeds. Information reporting is effective at improving compliance because the information is shared with the government and this reporting encourages taxpayers to include this reported income on their voluntarily filed returns. The effectiveness of information returns as a compliance tool is compromised if the information cannot be successfully linked to the correct taxpayer because of bad or missing taxpayer identification numbers (TINs).

To address the problem of bad or missing TINs, federal law requires backup withholding—that is, withholding at the time and source of payment—at a rate of 28 percent on certain payments if the payee fails to furnish a TIN to the payer or the payer is notified by the IRS that the provided TIN is incorrect. Backup withholding also applies to interest and dividend payments if the taxpayer has previously underreported such payments.

Payers are instructed to use federal Form W-9, Request for Taxpayer Identification Number and Certification, to request a payee's TIN. A TIN is usually a federal employer identification number (FEIN) or social security number (SSN). In general, the TIN used for information reporting for IRS purposes is accepted by the FTB. However, California state agencies are required to use Standard Form 204, Payee Data Record, to request a service-provider's (i.e., payee's) TIN and the service-provider must provide a correct TIN in order to do business with the State of California. For this purpose, the appropriate TIN for an individual or sole proprietor is their SSN.

The FTB currently administers a withhold-at-source program on payments to nonresidents for services performed by independent contractors, rents, royalties, estate distributions, trust distributions, and partnership distributions and allocations of income. Withholding, generally at a rate of 7 percent, is required when payments to a nonresident exceed a threshold amount. The FTB also administers withholding on sales of California real estate by residents and nonresidents. California does not have a backup withholding program.

**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.

*Minnesota* law follows the federal provisions for backup withholding on payments for personal services only. The amount withheld is determined by applying the highest individual income tax rate, currently 7.85 percent. In addition, if an entertainment entity fails to provide the payer with a TIN, the payer must withhold at the backup rate of 8.5 percent. Corporations are exempt from backup withholding.

*Illinois* law expressly states that no withholding is required on payments subject to federal backup withholding.

Review of the laws of *Florida*, *Massachusetts*, *Michigan*, and *New York* did not reveal any backup withholding requirements.

**FISCAL IMPACT**

First year implementation costs are estimated to be $300,000. Annual costs to administer and process backup withholding remitted to the department, to process tax returns claiming backup withholding credits, and to respond to taxpayer contacts would be approximately $500,000.

**ECONOMIC IMPACT**

Revenue Estimate

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

| Estimated Revenue Impact of Backup Withholding<br>Effective for tax years Beginning On or After 1/1/2010<br>Enactment assumed after 6/30/2009<br>$ Millions | | | |
|---|---|---|---|
| 2009-10 | 2010-11 | 2011-12 | 2012-13 |
| $26 | $25 | $26 | $28 |

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

Revenue Discussion

The revenue impact was estimated as follows. First, federal backup withholding amounts were estimated from the federal data. The IRS provided data on total tax withheld from forms 1099-B, 1099-MISC, 1099-DIV, 1099-INT, 1099-OID, 1099-PATR, and W2-G from taxpayers with California addresses. Not all of the taxes withheld are backup withholding. It is assumed that 50 percent of the tax withheld on form 1099-MISC, 75 percent of the tax withheld on form W2-G, and 100 percent of the tax withheld on all remaining forms are for federal backup withholding purpose. It is estimated that about $543 million of federal backup withholding were withheld on 376,000 taxpayers with California addresses in 2005.

Next, the California backup withholding amounts were estimated because California does not have jurisdiction over out-of-state banks, brokers, and firms that do not have nexus in the state. Not all-federal backup withholding can be subject to California backup withholding. The assumed percentages of federal backup withholding that are subject to California backup withholding vary by tax forms, ranging from 20 percent for form 1099-B to 75 percent for form 1099-MISC. In addition, the estimates were adjusted to reflect the fact that the proposed California backup withholding rate of 7 percent is much lower than the federal rate of 28 percent. It is estimated that about $74 million of backup withholding would have been withheld on 143,000 California taxpayers in 2005.

The estimated California backup withholding amount was adjusted downward to reflect (1) taxes that taxpayers would have paid anyway under current law (assumed to be 50 percent), (2) refunds due to over-withholding under this proposal (assumed to be 12 percent), and exclusion of interest and dividend income from backup withholding (assumed to be 6.6 percent). The net impact of the proposed California backup withholding program was then extrapolated to later years. The extrapolation was based upon the latest DOF forecast for personal income. For the 2010 tax year, the California backup withholding was estimated at $81 million. The amount of tax that taxpayers would have paid anyway under current law was estimated at $40 million. The refunds due to over-withholding was estimated at $10 million. These amounts were reduced by 20 percent to reflect amounts that would be collected under the new independent contractor withholding program proposed to be implemented concurrently with this proposal. Finally, the amounts were converted to a fiscal year basis.

## PROVISION NO. 4: WITHHOLDING ON CERTAIN AMOUNTS REPORTED ON IRS FORM 1099-MISC (AKA INDEPENDENT CONTRACTOR WITHHOLDING)

### EFFECTIVE/OPERATIVE DATE

As a special session bill, this provision would become effective and operative 91 days after the close of the special session and would be specifically operative for payments issued on or after January 1, 2010.

### ANALYSIS

FEDERAL/STATE LAW

Current federal law requires that any payments in the aggregate of $600 or more for services performed for a trade or business by a person not treated as its employee, i.e., independent contractor, are required to be reported to the IRS on Form 1099-MISC. Medical and health care payments to a physician, or other supplier or provider of medical or health care services are also reported on Form 1099-MISC. A copy of the form is required to be provided to the recipient of the payment and the FTB.

Current federal law does not require withholding of tax for payments made to independent contractors, except in two instances. One instance is if the independent contractor is a foreign person performing personal services in the U.S. The second instance is when the independent contractor is subject to back-up withholding. Back-up withholding is required if the payee fails to furnish a taxpayer identification number or the payer is notified by the IRS that the identification number provided is incorrect. Federal law requires independent contractors to make estimated tax payments in lieu of withholding requirements on income.

Current federal law requires wage information to be reported on the federal Wage and Tax Statement, Form W-2, for employees that receive compensation from an employer. In addition to wage information, employers are required to withhold, report, and remit to the IRS, federal income tax and employee's social security tax and Medicare. Federal law requires employers to regularly deposit funds withheld with an authorized federal depository, generally a bank.

Current state law parallels the information return requirements and wage withholding and reporting requirements of the federal government. The 1099-MISC forms are filed with the FTB to report payments for services performed for a trade or business by an independent contractor. Payments to corporations are generally exempt from this requirement. The W-2 forms are filed directly with EDD to report wages paid to employees. EDD also processes the payments for tax as well as any other withholding employers are required to withhold from employees. An employer who fails to file W-2 forms with EDD is subject to a penalty in the amount of $50.

Current state law requires payors of income to withhold 7percent on payments to nonresidents for services provided in California. This withholding program is administered by FTB. Since a contract may include goods as well as services to be provided to the California service recipient, the nonresident independent contractor can certify an allocation between goods and services. Therefore, certification of the allocation will only result in withholding on the services portion of payment, not the goods. In addition, a waiver process exists for nonresident contractors meeting certain conditions. FTB also administers withholding on sales of California real estate by residents and nonresidents.

Under current state law, all contracts entered into by any state agency for (1) the acquisition of goods or elementary school textbooks, (2) services, whether or not the services involve the furnishing or use of goods or are performed by an independent contractor, (3) the construction, alteration, improvement, repair, or maintenance of property, real or personal, or (4) the performance of work or services by the state agency for or in cooperation with any person, or public body, are void unless and until approved by the Department of General Services.

Work on all projects is done under contract awarded to the lowest responsible bidder. An agency is required to recruit potential bidders for a contract by identifying the requirements of the project, and posting an advertisement for bid by publication once a week for at least two consecutive weeks. The notice is required to state the time and place for the receiving and opening of sealed bids and describe in general terms the work to be done.

All bids are presented under seal. A uniform system of rating bidders that is based on standard questionnaires and financial statements is used to evaluate the bids. On the day cited in the public notice, the agency publicly opens the sealed bids and awards the contract to the lowest responsible bidder.

In general, to the extent a project involves information technology resources, and depending on the cost of the project, additional approval is required from the Office of the State Chief Information Officer and the Department of Finance.

THIS PROVISION

This provision would require any person engaged in a trade or business to withhold state tax on payments that are required to be reported on federal Form 1099-MISC as medical and health care payments and nonemployee compensation.

In addition, this provision would:

- Require the withholding rate to be 3 percent of payments to residents and 7 percent of payments to nonresidents (other than payments on which amounts have been withheld pursuant to current law).
- Exempt payments to tax-exempt entities, governments, and intergovernmental payments.
- Exempt payments of wages or other payments on which amounts have been deducted and withheld pursuant nonresident withholding provisions in Revenue & Taxation Code section 18662.
- Require a person remitting amounts withheld under this provision for 250 or more persons to submit payments and data to FTB electronically, in a form and manner prescribed by FTB.
- Require withholding payments to be remitted each April 15, June 15, September 15, and January 15, or on any alternate dates prescribed by FTB.
- Consider amounts withheld and remitted to FTB as a payment of estimated tax.
- Exempt from the Administrative Procedures Act any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by FTB to implement this provision.
- Provide FTB authority to expedite the procurement, development, and implementation of this provision, as specified.
- Require the State Auditor to monitor and evaluate the procurements made to implement this provision.

**LEGISLATIVE HISTORY**

ABX1 12 (Evans, 2009/2010) would have required withholding by a service recipient on payments to a contracting party for goods or services to be administered by the Employment Development Department. This bill was vetoed by Governor Schwarzenegger. In the veto message the Governor stated, “I am returning Assembly Bill X1 12 without my signature because it is part of a package of bills that does not deal with California's current budget and economic crisis. This package of bills punishes Californians by raising revenue without providing permanent and ongoing cuts, does not create jobs or stimulate our economy, does not allow government to run more efficiently in California, and makes no attempt to keep people in their homes.”

SB 267 (Deddeh and Maddy, 1991/1992) carried provisions to implement independent contractor withholding that excluded certain brokers (e.g., real estate or cemetery) and direct salespersons from the 1099-MISC reporting requirements. These provisions were amended out of the bill.

## OTHER STATES' INFORMATION

The state of *Minnesota* has a modified version of Independent Contractor Withholding. Beginning on January 1, 2009, *Minnesota* requires a construction contractor who makes payments to an individual construction contractor carrying on a trade or business as a sole proprietorship to withhold 2 percent of the payments made. Payments are subject to the 2 percent withholding only if the work is performed in *Minnesota* and the total payments made during the year exceed $600.

The states of *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York* were surveyed due to their similarities to California's economy, business entity types, and tax laws.

## FISCAL IMPACT

Implementing this provision would require the department to make changes and enhancements to existing computer systems and to make changes to the department's withholding system currently being developed. Implementing this provision would increase costs to the department to administer and process withholding remitted to the department and to process returns where the taxpayer claims independent contractor withholding. This provision would require the department to create tax forms and instructions for payors to remit amounts withheld. The department would incur one-time costs of approximately $25,000,000 and annual ongoing costs of approximately $20,000,000.

## ECONOMIC IMPACT

### Revenue Estimate

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

| The Revenue Estimate for ICW<br>Effective for Payments Beginning On Or After 1/1/2010<br>Assumed Enactment Date After June 30th, 2009<br>[$ In Millions ] | | | |
|---|---|---|---|
| | 2009/10 | 2010/11 | 2011/12 |
| Compliance | +$65 | +$230 | +$300 |
| Acceleration | +$1,900 | -$100 | -$730 |
| **Total** | **+$1,965** | **+$130** | **-$430** |

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision.

**Revenue Discussion:**

The revenue impact of this bill would depend on gross receipts and profits of independent contractors and on the following:

- The extent self-compliance increases among independent contractors when there is withholding.
- The extent and the speed that independent contractors adjust other pre-payments (wage withholding or estimated payments) in response to the proposed 3% withholding regime.

Based on departmental data of gross receipts reported on Forms 1099-MISC, it is estimated that there would be $207 billion of independent contractor gross receipts subject to withholding in 2010. The model employed to calculate the impact of withholding on independent contractors involves several levels of assumptions regarding how taxpayers would respond to the withholding requirement. Ultimately, self-compliance--the percentage of income that is reported on Forms 1099-MISC that is also reported on California income tax returns--is expected to increase from 90 percent to 96 percent when withholding is implemented. In 2010, the first year of withholding, it is expected that compliance would increase from 90 percent to 94 percent and then to 96 percent for 2011 and subsequent years. This would translate into an estimated revenue impact from compliance of $192 million in 2010 ($207 billion in gross receipts X 4% increase in compliance X 2.32% average tax rate on gross receipts = approximately $192 million). By 2013, the compliance impact is estimated to be $345 million ($227 billion in gross receipts X 6% increase in compliance X 2.32% average tax rate on gross receipts = approximately $316 million)

This provision would also result in a significant acceleration of revenue. The acceleration of revenue would be particularly significant in fiscal year 2009/10: $1.9 billion. The acceleration of revenue in 2009/10 would turn negative in the next fiscal year as taxpayers adjust their wage withholding or their estimated payments to account for the independent contractor withholding. It is assumed that taxpayers would fully adjust to the additional withholding by 2013.

The revenue estimate in the chart above includes adjustments for projected growth in taxable income and reflects a fiscal year cash flow basis.

**PROVISION NO. 5: INCREASE WITHHOLD RATE ON WAGES, SUPPLEMENTAL WAGES, STOCK OPTIONS AND BONUS PAYMENTS**

**EFFECTIVE/OPERATIVE DATE**

As a special session bill, this provision would become effective and operative 91 days after the close of the special session and would be specifically operative for wages, supplemental wages, stock options and bonus payments paid on or after October 1, 2009, or the effective date, whichever is later.

## ANALYSIS

STATE LAW

On an annual basis, FTB is required to provide the Employment Development Department (EDD) with wage withholding tables to be used by employers to withhold taxes on wages paid to their employees. The tables are based on the estimated amount of tax due on the wages paid by the employer. In addition, employers required to withhold tax on supplemental wages can use a method that applies a fixed rate to the supplemental wage amount. This rate is 6 percent for supplemental wages other than stock options and bonus payments. The rate of withholding for stock options and bonus payments is 9.3 percent. Taxpayers are required to make estimated tax payments if the amount of taxes withheld or otherwise available for a taxable year is less than the amount due.

<u>THIS PROVISION</u>

This provision would require FTB to prepare wage withholding tables that would equate to an amount that is 10 percent higher than the amounts estimated to be due on wages earned under current law for wages paid on or after October 1, 2009.

This provision would also increase the fixed rate of tax withheld from supplemental wages from 6 percent to 6.6 percent, and would increase the fixed rate withheld from stock options and bonus payments from 9.3 percent to 10.23 percent for amounts paid on or after October 1, 2009.

## LEGISLATIVE HISTORY

ABX3 36 (Laird, 2007/2008) contained provisions similar to this provision. Governor Schwarzenegger vetoed this bill. In the veto message the Governor stated, “I am returning Assembly Bill X3 36 without my signature, as I can not support taking more money away from the paychecks of hard working Californians to balance the state budget. While this year's budget does not permanently solve California's structural deficit, it solves this year's $15.2 billion dollar budget gap, does not take money out of people’s paychecks or borrow from voter-approved local government or transportation funds.”

AB 2065 ( Oropeza, Stats. 2002, Ch. 488) authorized 9.3 percent withholding on stock options and bonus payments in lieu of the withholding tables or supplemental income withholding rates

## OTHER STATES’ INFORMATION

The states of *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York* were surveyed due to their similarities to California's economy, business entity types, and tax laws. With the exception of *Florida*, which does not have a personal income tax, all of these states require withholding of tax on wages paid by employers to their employees. However, these states do not require withholding greater than the estimated amount of tax due.

## FISCAL IMPACT

The department estimates implementing this provision would increase first-year tax return processing costs by approximately $110,000 and $70,000 annually thereafter.

## ECONOMIC IMPACT

### Revenue Estimates:

Based on data and assumptions discussed below, this bill would result in the following annual revenue gains beginning in 2009/10.

| Estimated Revenue Impact of Withholding Provision<br>Effective for PIT withholding Beginning On or After October 1, 2009<br>Enactment Assumed After 6/30/09<br>($ In millions) | | |
|---|---|---|
| 2009-10 | 2010-11 | 2011-12 |
| $1,600 | $1 | $58 |

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

**Revenue Discussion:**
The revenue impact of this bill is dependent on the amount of additional withholding under the bill than otherwise under current law.

Based on projections of personal income tax withholding by the Department of Finance, an additional 10% withholding beginning on October 1, 2009, is estimated to generate $576 million for tax year 2009, $3.2 billion, for tax year 2010, $3.1 billion each for tax years 2011 and 2012. Based on departmental data the additional withholding would reduce final tax payments, normally received with the return when filed, by 25 percent for 2009 and 15 percent for 2010 and subsequent tax years. It is anticipated that 73 percent of 2009 and 83 percent of 2010 and subsequent years additional withholding would be refunded. The first fiscal year 2009/10 would have a revenue gain of $1.6 billion ($2,200 million - $565 million).

| | |
|---|---|
| Additional withholding for 2009 | $ 576 million |
| 50% of additional withholding for 2010 | $1,600 million |
| | $2,200 million |
| Reduced final payments in 2009 | -$144 million |
| 73% of additional withholding refunded in 2009/10 | -$421 million |
| | -$565 million |

In subsequent fiscal years, refunds of additional withholding and reduced final payments offset much of the additional withholding.

## PROVISION NO. 6: MODIFY ESTIMATED TAX PAYMENT PERCENTAGES

## EFFECTIVE/OPERATIVE DATE

As a special session bill, this provision would become effective and operative 91 days after the close of the special session. The operative dates vary for certain aspects of this provision. The various operative dates are identified in the “THIS PROVISION” section.

## ANALYSIS

STATE LAW

In general, prior California law required individual and corporate taxpayers to remit four estimated tax payments each equal to 25 percent of their required annual payment. Recently enacted state law, SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1), changed the required applicable percentages so that the estimated tax payments for taxable years beginning on or after January 1, 2009, is now 30 percent, 30 percent, 20 percent, and 20 percent for the 1st, 2nd, 3rd, and 4th quarter installments, respectively.

Current state law requires the "annual payment" for an individual to be the lesser of the following:

- Option 1: 90 percent of the tax shown on the return for the taxable year, or
- Option 2: 100 percent of the tax shown on the return for the preceding taxable year.

In addition, current state law requires the annual payment under option 2 to be increased from 100 percent to 110 percent of the tax shown on the return if the adjusted gross income (AGI) of the taxpayer for the preceding taxable year exceeds $150,000 ($75,000 in the case of a married individual filing a separate return). SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1) modified the options above to provide additionally that a taxpayer with AGI equal to or greater than $1 million ($500,000 in the case of a married individual filing a separate return) may not use option 2 for taxable years beginning on or after January 1, 2009.

Under existing state law and unchanged by SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1), the "annualized income installment method" allows a taxpayer to calculate the required estimated tax payment based on an estimate of income, deductions and credits attributable to each installment period[17]. The computation of estimated tax payments under the "annualized income installment method" requires the annualized tax due for each installment period to be multiplied by an increasing percentage of 22.5 percent, 45 percent, 67.5 percent, and 90 percent. The percentages used in the calculation equate to 25 percent, 50 percent, 75 percent, and 100 percent of the required annual payment under Option 1.

Under previously existing state law and not explicitly changed by recently enacted state law, wage withholding is equally applied 25 percent, 25 percent, 25 percent, and 25 percent as quarterly installments toward a taxpayer's required annual payment.

Generally, a taxpayer is subject to a penalty for any underpayment of estimated tax. The penalty is an amount equal to the underpayment rate multiplied by the amount of the underpayment. The underpayment rate is the same as the interest rate charged for tax delinquencies, currently 5 percent. The penalty is calculated by comparing the required amount for each estimated tax payment, determined under either the regular method (formerly 25 percent, 25 percent, 25 percent, 25 percent, now 30 percent, 30 percent, 20 percent, 20 percent) or the "annualized income installment method", with the amount paid by the due date of that installment.

[17] A taxpayer whose income fluctuates throughout the year may have a lower required installment using the "annualized income installment method".

THIS PROVISION

This provision would:

1. Provide explicit authority for FTB to apply wage withholding in percentages consistent with the percentages required for estimated tax payments for taxable years beginning on or after January 1, 2009.

2. Revise the percentages used to determine estimated tax payment requirements under the annualized income installment method to percentages consistent with SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1) for taxable years beginning on after January 1, 2009, and before January 1, 2010.

3. Eliminate the 3rd quarter estimated tax payment by revising the estimated tax payment percentages. The percentages would be 30 percent, 40 percent, 0, and 30 percent for the 1st, 2nd ,3rd, and 4th quarter installments for taxable years beginning on or after January 1, 2010. Corporations not required to make an estimated tax payment for the first quarter would be required to make estimated tax payments of 60 percent, 0, and 40 percent for the 2nd, 3rd, and 4th quarter installments, respectively. Corporations not required to make an estimated tax payment for the first and second quarter would be required to make estimated tax payments of 100 percent, and 0, for 3rd, and 4th quarter installments, respectively.

4. Revise the percentages used to determine estimated tax payment requirements under the annualized income installment method to percentages consistent with percentages in item 3 above for taxable years beginning on or after January 1, 2010.

**LEGISLATIVE HISTORY**

AB 1546 (AR&T, 2009/2010) contains provisions that would revise the revise the percentages used to determine estimated tax payment requirements under the annualized income installment method to percentages consistent with SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1). This bill is currently waiting to be heard in the Senate Committee on Revenue and Taxation.

SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1) changed the required estimated tax payment percentages to 30 percent, 30 percent, 20 percent, and 20 percent for the 1st, 2nd, 3rd, and 4th quarter installments, respectively.

**OTHER STATES' INFORMATION**

Because this provision would modify estimated tax payment percentages unique to California, a comparison of other states is unnecessary.

**FISCAL IMPACT**

Implementing this provision would require the department to make changes to existing computer systems and tax forms and instructions. The department estimates one-time cost would be approximately $100,000.

**ECONOMIC IMPACT**

**Revenue Estimate:**

Based on data and assumptions discussed below, this proposal would result in the following annual revenue gains beginning in 2009/10.

| Estimated Revenue Impact of Estimated Tax Provision<br>Effective for taxable years Beginning On or After January 1, 2010<br>Enactment Assumed After 6/30/09<br>($ In millions) | | |
|---|---|---|
| 2009-10 | 2010-11 | 2011-12 |
| $600 | $19 | $37 |

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

**Revenue Discussion:**
The revenue impact of the bill is dependent on the amount of additional estimated tax payments under this bill than otherwise under current law.

This proposal would shift to the prior fiscal year half of the tax payments normally made in the September installment. The 2010 September estimated tax installment is projected to be $3.7 billion by the Department of Finance. Under this proposal half of the $3.7 billion, or $1.8 billion, would be remitted in June 2010. Current law requires one - third of September's estimated payments, or $1.2 billion ($3.7 billion / 3), to be accrued to the prior fiscal year. Therefore, $1.2 billion is subtracted from the accelerated $1.8 billion resulting in a revenue gain in fiscal year 2009/10 of $600 million. For fiscal year 2010/11 the prior year acceleration of $600 million offsets the subsequent year's acceleration of estimated tax payments resulting in a revenue gain estimated at $19 million. The revenue from accelerating estimated tax payments assumes the acceleration applies to both quarterly and annualized installment payments.

**<u>PROVISION NO. 7: FINANCIAL INSTITUTION RECORD MATCH SYSTEM</u>**

**EFFECTIVE/OPERATIVE DATE**

As a special session bill, this provision would become effective 91 days after the close of the special session and would by its terms become operative 120 days from the date that funding is received.

## ANALYSIS

FEDERAL/STATE LAW

Current federal law mandates the Financial Institution Data Match (FIDM) for the collection of delinquent child support debts. This process involves the matching of child support obligors with financial institution customer records in order to identify and levy the funds belonging to the obligors. Federal law prohibits the information received through FIDM to be used for any purpose other than child support collection. Current state law prohibits FTB from collecting against taxpayers with income tax debts that also have child support debts.

Under federal and state law, every individual, partnership, limited liability company, bank, corporation, estate, trust, or other organization engaged in a trade or business is required to file information returns to report various types of non-payroll compensation and other miscellaneous income. The types of transactions reported on the information return include, among other things, payments of interest, dividends, and certain gambling winnings. The filing requirements and dollar reporting thresholds vary and are generally contingent on the reporting requirements for the state in which the form 1099 recipient resides.

The California Right to Financial Privacy Act (the Act) prohibits financial institutions from disclosing confidential account records, unless certain exceptions are met. Criminal search warrants and subpoenas are two examples of exceptions. Current law provides that the Act supersedes any law that appears to violate the provisions of the act, unless that other law specifically provides that the Act does not apply to that particular law.

Current state law authorizes FTB to use several collection tools in order to collect delinquent tax liabilities, one of which is an Order to Withhold (OTW). An OTW can be issued to any third person in possession of funds or properties belonging to the debtor. Upon receipt of an OTW, the recipient notified is required to freeze the taxpayer’s assets in their possession and hold those assets for ten days, and then remit to the department all cash or cash equivalents held that will satisfy the amount of the OTW. If the recipient of the OTW is in possession of any assets other than cash or cash equivalents, they must hold that item, notify FTB, and await further instructions.

Current law prohibits FTB from disclosing any confidential taxpayer information unless specifically authorized by law.

<u>THIS PROVISION</u>

This provision would require FTB to coordinate with financial institutions doing business in this state to establish a Financial Institution Record Match system (FIRM) using automated data exchanges to the maximum extent feasible. The provision would require FTB to promulgate rules or regulations necessary to implement the provisions of the provision that include the following.

- A structure by which financial institutions or their designated data processing agent shall receive from FTB the file or files of delinquent debtors that the institution will match with its own list of accountholder to identify delinquent tax debtor accountholders at that institution.
- An option by which financial institutions without the technical ability to process the data exchange, or without the ability to employ a third party data processor to process the data exchange to forward to FTB a list of all account holders and their Social Security Numbers, or other taxpayer identification numbers so the FTB can match that list with file or files of delinquent tax debtors.
- Authority for the FTB to exempt a financial institution from the requirements of this provision if the FTB determines that the financial institution's participation would not generate sufficient revenue to be cost effective for the department.
- Authority for the FTB to suspend the requirements of this section temporarily for a financial institution if a financial institution provides FTB with a written notice from its supervisory banking authority that it is determined to be undercapitalized, significantly undercapitalized, or critically undercapitalized, as defined. Any notice provided to FTB for this purpose is subject to the same confidentially restrictions that exist for taxpayer or tax return information obtained by FTB.

This provision would provide that any use of the information obtained under this provision for any purpose other than the collection of delinquent franchise or income tax or other debts referred to FTB for collection would be a violation of existing disclosure restrictions. The provision contains express authority for FTB to provide confidential taxpayer data to the financial institutions for purposes of the tax data match.

On a quarterly basis, this provision would require financial institutions to provide FTB the name, record address and other addresses, social security number or other taxpayer identification number, and identifying information for each delinquent tax debtor as identified by FTB who maintains an account at the financial institution as defined. Financial institutions may not disclose to the accountholder, depositor, co-accountholder, or co-depositor that their identifying information has been received for furnished to the FTB, unless required to do so by law.

This provision would state that a financial institution would not incur liability or obligation for any of the following:

- Furnishing information to FTB as required by this provision,
- Failing to disclose to a depositor or accountholder that their personal identifying information was included in the data exchange with FTB, or
- Any other action taken in good faith to comply with the requirements of this provision.

The provision authorizes FTB to institute civil proceedings to enforce the provisions of this provision.

The provision would include that if a financial institution willfully fails to comply with the requirements of the rules promulgated by FTB, unless that failure is due to reasonable cause satisfactory to FTB, the financial institution shall be subject to a penalty upon notice and demand in the amount of $50 for each debtor's record not provided up to a maximum of $100,000 in any calendar year.

The provision would include the following definitions for the terms used:

(1) "Account" means any demand deposit account, share or share draft account, checking or negotiable withdrawal order account, savings account, time deposit account, or money market mutual fund account, regardless of whether the account bears interest.

(2) "Financial institution" means:

- A depository institution, as defined in Section 1813(c) of Title 12 of the United States Code.
- An institution-affiliated party, as defined in Section 1813(u) of Title 12 of the United States Code.
- Any federal credit union or state credit union, as defined in Section 1752 of Title 12 of the United States Code, including an institution-affiliated party of a credit union, as defined in Section 1786(r) of Title 12 of the United States Code.
- Any benefit association, insurance company, safe deposit company, money-market fund, or similar entity authorized to do business in this state.

(3) "Delinquent tax debtor" means any person liable for any income or franchise tax or other debt referred to the FTB for collection as imposed under Part 5 (commencing with Section 10878), Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 19280), or Part 11 (commencing with Section 23001), including tax, penalties, interest, and fees, where the tax or debt, including the amount, if any, referred to the FTB for collection remains unpaid after 30 days from demand for payment by the FTB, and the person is not making current timely installment payments on the liability under an agreement.

The provision would include reimbursement of one time start up costs in an amount up to $2,500 for each financial institution, and would provide for reimbursement for the quarterly data matches conducted in an amount up to $250 per quarter per financial institution.

The provision would limit the initial size of the FTB data match file sent to financial institutions to no more than 600,000 records and would allow for an incremental increase each quarter of no more than an additional 600,000 records until the full universe of tax debtors is included in the data file.

The provision would be specifically operative 120 days after the date funding is received.

IMPLEMENTATION CONSIDERATIONS

FTB would utilize existing systems and functionality to implement this new process. Implementing this provision would have a significant impact on the department, as described below under Fiscal Impact. Due to the changes required, the department anticipates it would be able to initiate levies within 12 months of receiving funding through manual efforts and would be fully automated within 18 months from the date funding is received.

**PROGRAM BACKGROUND**

FTB uses information return data primarily to identify nonfilers and collect delinquent income taxes. In the non-filer program, information returns are used in FTB's Integrated Non-filer Compliance (INC) system to identify taxpayers that have sufficient income to require them to file a return but have failed to do so. Under the INC system, more than 220 million records received from employers, financial institutions, the Internal Revenue Service (IRS), and other sources are sorted and matched against tax returns filed. Taxpayers with California income for whom FTB has no record of an income tax return being filed are sent a letter requesting the past due tax return be filed. If a return is not filed as required, the taxpayer's net income is estimated from the available information, and a proposed deficiency assessment is issued.

FTB uses information returns to collect delinquent income taxes by associating the reported interest, dividend, or miscellaneous payments to the taxpayer with outstanding tax liabilities and issuing a levy to seize the assets of the taxpayer in the hands of a third party. In 2005, FTB issued approximately 100,000 financial institution levies and collected approximately $70 million using this process. Information returns do not identify the non-interest bearing assets that may be held at a financial institution and due to the reporting cycle, those returns do not generally provide current information.

In addition to the non-filer and collection programs, FTB has an audit staff designed to encourage compliance with the income tax laws. For this purpose, computer programs search state and federal income records to detect leads as to discrepancies between income items that were reported and should have been reported on income tax returns. Based on the computerized searches of these records, one of many audit-type 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.

Despite these FTB programs, failure to report income still exists. One reality that contributes to failure to report income is the ability of the taxpayer to escape detection. For example, a payer may fail to report a disbursement and the payee may fail to report the income. In the event that the payer and payee have a personal relationship, the likelihood of accurate information return reporting is decreased. Likewise, accurate information return reporting is decreased if an individual is aware of the absence of an income and/or expense paper trail.

Under the FIDM program, financial institutions have two methods of transmitting data to comply with the requirements of the program. Method 1 allows financial institutions to send their complete file of financial institution accounts on a quarterly basis to be matched by FTB against child support debtor records. Method 2 requires FTB to send a file of child support debtors to the financial institution or their third party data processor to match with account holders. A file of matched records is returned to FTB. Generally, the method chosen by each financial institution depends on the financial institution's data processing capabilities.

## OTHER STATES' INFORMATION

Laws in *Kentucky, Maryland*, *Massachusetts, Minnesota, Indiana, New York,* and *New Jersey* provide the revenue departments of those states authority to use a financial institution record match process for the collection of delinquent income taxes.

In *Kentucky*, the financial institutions that provide debtor records may charge a fee against an account levied by the Department of Revenue under the match process. The fee may not exceed $20.

*Maryland* financial institutions are reimbursed the actual costs incurred.

It does not appear that the laws in *Massachusetts* or *New Jersey* permit reimbursement to financial institutions that provide customer records.

*Minnesota* enacted legislation to conduct a tax debtor bank match effective January 1, 2009. *Minnesota* statutes provide for reimbursement for costs incurred in the data match to financial institutions up to $150 per quarter.

*New York's* financial Institution record match program does not provide for any reimbursement to the financial institutions to conduct a data match.

In February 2008, Indiana enacted legislation permitting a financial institution data match for employer debts owed to the state. Under the Indiana law, financial institutions are reimbursed at least $5 for every warrant issued from the data obtained through the match process.
The state of Minnesota published a survey of tax agency collection techniques in December 2007, which indicated that the *District of Columbia, Florida, Georgia, Iowa, and New Mexico* were considering legislation in the upcoming sessions that would implement some level of financial institution data matching for tax debts. The Federation of Tax Administrators Tax Express report in October 2008 reported that as a tax-gap effort, the Treasury and the IRS are discussing a requirement for financial institutions to report bank account information.

## LEGISLATIVE HISTORY

SB 402 (Wolk, 2009/2010) contains provisions to implement FIRM that are identical to the provisions in this bill. SB 402 is scheduled to be heard in the Assembly Revenue and Taxation Committee hearing on July 6, 2009.

## FISCAL IMPACT

To ensure that existing collection processes can handle the increased volume of data expected under this provision, modifications to core processes would be required. This provision would impact core functions in the collection system and would require system programming, development, and testing to ensure successful integration. In an effort to bring in revenue as soon as possible, FTB would implement a semi-automated effort in phase I of the project, whereby collection staff would manually generate the OTWs. Upon full project implementation, which is estimated to take 18 months, an automated process would be available to issue the OTWs generated from the new data obtained under this provision. The table below reflects the summary of costs for the phased project, including reimbursement to the financial institutions for start up costs and quarterly match costs.

The fiscal estimate assumes that the start up costs incurred by financial institutions would be incurred over two fiscal years. Additionally, it is assumed that the coordination of data file exchanges with 800 financial institutions would take approximately 10 to 12 months to complete, which would result in a delay of cost reimbursement to all financial institutions.

Financial Institutions Record Match
Summary of Costs, and Estimated Budget Change Proposal Requests (dollars in thousands)

| | FY 2009/10 | FY 2010/11 | FY 2011/12 | FY 2012/13 | Total |
|---|---|---|---|---|---|
| Total Project Costs | \$3,155 | \$4,484 | \$2,216 | \$1,251 | \$11,106 |
| Total Program Costs | \$1,500 | \$5,332 | \$4,160 | \$4,640 | \$15,632 |
| Total Project + Program Costs | \$4,655 | \$9,816 | \$6,375 | \$5,891 | \$26,738 |
| Estimated BCP Request[18] | \$3,180 | \$7,921 | \$4,718 | \$4,923 | \$20,742 |

**ECONOMIC IMPACT**

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

Estimated Revenue Impact of FIRM Proposal
Assumes Enacted by June 30, 2009
(Under Special Session Rules)
Assumes Collections Begin After 11/1/10
($ in Millions)

| | 2009/10 | 2010/11 | 2011/12 |
|---|---|---|---|
| General Fund | \$22 | \$60 | \$96 |
| Vehicle Registration Collections | | \$1 | \$2 |
| Court Ordered Debt | | \$1 | \$4 |
| **Grand Total** | **\$22** | **\$62** | **\$102** |

**Tax Revenue Discussion:**

The revenue impact of this bill would be determined by the number of successful matches identified by financial institutions and the collection rate on those accounts. Because, on average, tax accounts have larger delinquent balances than non-tax accounts, the revenue estimate is determined by the volume and balance of delinquent tax accounts. Due to the difference in average balances, the estimate of accelerated and additional collections starts by analyzing tax accounts and then adjusted to include non-tax accounts.

[18] Total costs less redirected resources.

Under this bill, the department would obtain current financial account information on tax debtors from financial institutions. The department sends approximately 125,000 OTWs annually to financial institutions based on information obtained from Form 1099 interest information returns. These OTWs result in $75 million in collections ($70 million tax + $5 million non-tax accounts). Assuming that the ability of financial institutions to process additional OTWs would be limited, FTB would limit the increase in volume of OTWs to an increase of 50,000 accounts for the first full year and increase by 50,000 accounts each year thereafter. This bill would result in both accelerated revenue and new money.

Acceleration

Based on delinquent tax account data, of the $70 million currently collected using OTWs, the department estimates that the issuance of additional OTWs could accelerate 50 percent of collections by one year, or approximately $35 million during the first year of implementation. However, because of the assumed processing limitations of the financial institutions, this potential acceleration is reduced 80 percent to approximately $7 million ($35 million x 20%).

New Money

FTB estimates the matches would identify approximately $2.5 billion in assets maintained at financial institutions from 1.5 million debtors. Assuming that financial institutions could process 15 percent of these levies with 8 percent of the balance collected based on historical Accounts Receivable Management collection rates. Thus, during the first-year, new money would equal approximately $30 million ($2.5 billion x 15% x 8%). The combined impact of accelerated collections and additional collections would total $37 million ($7 million + $30 million).

To include non-tax accounts, the additional 50,000 OTWs that financial institutions would be able to process during the first year are allocated between tax and non-tax accounts, 80 percent and 20 percent respectively. The average balance for tax accounts pursued through the new match process is $740 ($37 million ÷ 50,000 additional OTWs). Allocating 40,000 OTWs to tax account collections reduces the revenue impact for the first year from $37 million to $30 million ($740 x 40,000). The average collection for non-tax accounts that would be pursued through the new match process is estimated to total $280. Allocating 10,000 OTWs to the non-tax program would accelerate collections by approximately $3 million ($280 x 10,000).

This estimate is grown by using the Consumer Price Index and reduced because the new collection process would begin at the earliest, after November 2010. The revenue impact for the first fiscal year (2010-11) would total $22 million. General fund revenue in the table has been accrued back one year and attributed to fiscal year 2009-10.

Based on these implementation dates, the 50,000 OTW limit would be applicable to the first twelve months of collection, which runs July 2010, to July 2011. Subsequent to fiscal year 2010-11, as financial institutions are able to process additional OTWs, accelerated and additional collections would increase. However, it is assumed that financial institutions would not be able to process OTWs for the entire population of matches until 2016-17. Additionally, it is assumed that 30 percent of new OTWs would lead to installment agreements and would generate revenue for the following two years. Finally, over the first few years, as FIRM is implemented and enhanced, increased functionality will allow collection staff to refine the selection process for issuing OTWs by prioritizing accounts with the highest yield. When the proposal is fully phased-in by 2016-17, additional collections are projected at $150 million per year for both tax and non-tax programs.

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