Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Committee on Budget & Fiscal Review	Analyst:	William Koch	Bill Number:	SBX8 8
Related Bills:	See Legislative History	Telephone:	845-4372	Amended Date:	February 22, 2010
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Occupational And Professional License Suspension For Unpaid Tax/Abusive Tax Shelters/Financial Institution Record Match

SUMMARY

This bill would do the following:

Provision No. 1: Suspend a delinquent taxpayer's occupational or professional license once an income tax delinquency is at least five months old and four notices have been issued by Franchise Tax Board (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: 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.

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

SUMMARY OF AMENDMENTS

This bill as introduced January 20, 2010, expressed the intent of the Legislature to enact changes to the Budget Act of 2009.

The February 22, 2010, 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 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 January 8, 2010.

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

Board Position:			Department Director	Date
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__X__ SA	_____ O	_____ NAR	Selvi Stanislaus	03/09/10
_____ N	_____ OUA	_____ PENDING		

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.

RECOMMENDATION

FTB supports provisions 1 and 3 listed in the "SUMMARY" section.

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 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 3 listed in the "SUMMARY" section.

The three-member FTB has not considered provision 2 in the "SUMMARY" section.

ECONOMIC IMPACT – SUMMARY REVENUE TABLE ($ in Millions)

Fiscal Year		**09/10**	**10/11**	**11/12**	**12/13**
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	+$19	+$19
Provision No. 2:	Provide a single, consistent definition for ATSs, modify the ATS-use penalty and create a new California reportable-transaction category for transactions of interest.	+$.9	-$5.7	+$2.8	+$5.6
Provision No. 3:	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.	n/a	+$32	+$32	+$41
	***TOTAL**	**+$14.9**	**+$45.3**	**+$53.8**	**+$65.6**

*** 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 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 Contractors 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 if convicted of serious crimes.

THIS PROVISION

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 who 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. 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 that is no longer operative. The license would be suspended 30 days after the date the deferral ceases to be 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 R&TC section 19008.
- "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.

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

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[2] Administrative Procedures Act Government Code section 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.

LEGISLATIVE HISTORY

ABX3 19 (Evans, 2009/2010) and SBX 3 17 (Ducheny, 2009/2010) both contained provisions similar to this provision. ABX3 19 was sent to enrollment but was withdrawn from enrollment without action by the Governor. SBX3 17 was vetoed by Governor Schwarzenegger on June 30, 2009.

ABX8 8 (Committee on Budget, 2009/2010) contains provisions identical to the provisions in this bill. ABX8 8 is currently referred to the Assembly Committee on Rules.

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 licenses 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, Iowa, Massachusetts, Minnesota, Oregon, Vermont, 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, *New Jersey*, and *Oklahoma* 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.

Indiana, *Maine, and Maryland* state tax laws provide that the licensing boards are required to not issue or renew the license or certificate of an applicant or licensee if the licensee or applicant has a state tax delinquency. *Indiana* and *Maine* licensing boards are notified by the revenue department of the applicant or licensees state tax delinquencies. *Maryland* licensing boards verify with the revenue department whether a licensee or applicant has a state tax delinquency.

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.

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. The department estimates that revenue attributable to Occupational/Professional License Suspension would start within six months of receiving funding. Accordingly, assuming funding July 1, 2010, revenues due to the proposal would start accruing January 1, 2011.

ECONOMIC IMPACT

Revenue Estimate:

The revenue gain from this provision would be as follows:

Estimated Revenue Impact of Profession and Occupational License Suspension Assumed Effective June 1, 2010, and Funding Received by July 1, 2010 ($ in Millions)				
Occupational	2009-10	2010-11	2011-12	2012-13
License	+$14	+$19	+$19	+$19

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

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, 2010.
- 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]

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

- Listed transactions;[6]
- Confidential transactions; [7]
- Transactions with contractual protection;[8]
- Loss transactions;[9] and
- 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).

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

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.
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 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 the FTB issuing a deficiency notice.

[11] IRC section 6601.
[12] IRC section 6404(g).
[13] IRC section 6404(g)(1).
[14] IRC section 6404(g)(2).
[15] R&TC sections 19753, 19755, 19777, and 19116.

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."

- 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 the FTB regarding a "potentially ATS." This provision refers to ATS-use penalty rules for the definition of a "potentially ATS."

- Noneconomic 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.

  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.

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.

[16] R&TC section 19774(c)(1).

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 the 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

The department has identified the following technical considerations:

Page 22, line 1, delete "the act" and insert "that act."

Page 22, line 2, delete "the effective" and insert "that effective."

LEGISLATIVE HISTORY

ABX3 19 (Evans, 2009/2010) and SBX 3 17 (Ducheny, 2009/2010) both contained provisions similar to this provision. ABX3 19 was sent to enrollment but was withdrawn from enrollment without action by the Governor. SBX3 17 was vetoed by Governor Schwarzenegger on June 30, 2009.

ABX8 8 (Committee on Budget, 2009/2010) contains provisions identical to the provisions in this bill. ABX8 8 is currently referred to the Assembly Committee on Rules.

SB 401 (Wolk, 2009/2010) contains provisions similar to this provision. SB 401 was placed in the Assembly inactive file on September 9, 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

Revenue Estimate:

The revenue from this provision would be as follows:

Estimated Revenue Impact of Abusive Tax Shelter Provision Assumed Effective June 1, 2010 ($ in Millions)				
Abusive Tax	2009/10	2010/11	2011/12	2012/13
Shelter Provision	+$.9	-$5.7	+$2.8	+$5.6

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

PROVISION NO. 3: FINANCIAL INSTITUTION RECORD MATCH SYSTEM

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

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.

THIS PROVISION

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.

IMPLEMENTATION CONSIDERATIONS

FTB would utilize existing systems and functionality to implement this new process. Implementing this bill 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.

PROGRAM BACKGROUND

FTB uses information return data primarily to identify non-filers 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 the 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 the 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

ABX3 19 (Evans, 2009/2010) and SBX 3 17 (Ducheny, 2009/2010) both contained provisions similar to this provision. ABX3 19 was sent to enrollment but was withdrawn from enrollment without action by the Governor. SBX3 17 was vetoed by Governor Schwarzenegger on June 30, 2009.

ABX8 8 (Committee on Budget, 2009/2010) contains provisions identical to the provisions in this bill. ABX8 8 is currently referred to the Assembly Committee on Rules.

SB 402 (Wolk, 2009/2010) contained provisions to implement FIRM that were similar to the provisions in this bill. The provisions to implement FIRM were amended out of SB 402.

FISCAL IMPACT

Because FIRM was not adopted in the 2008/2009 fiscal year, the department directed information technology resources towards other priority projects. Those resources would have been used to modify the department's computer systems to automate the use of the data matches obtained by FIRM. Because those resources are no longer available, the department would implement FIRM by utilizing a third party vendor to assist in the data matching with the financial institutions. Once the matched data is received, FTB will use additional collection staff to add the new financial data obtained manually into the collection system and to issue orders to withhold to financial institutions subsequently. This change results in lower project costs, but also limits the ongoing revenue previously anticipated from FIRM. The department estimates that revenue attributable to the FIRM data would start within 12 months of receiving funding to secure procurement of a third party vendor and develop secure transmission protocols with the financial institutions. The department would automate the use of the data matches obtained by FIRM eventually and would utilize the normal budget change proposal process to obtain funding.

The fiscal costs are estimated to be as follows:

	FY 2010/11	FY 2011/12	FY 2012/13	Total
Total Project Costs	**$869,843**	**$335,129**	**$335,129**	**$1,540,101**
Total Financial Institution Reimbursement Costs	$495,000	$2,155,000	$800,000	$3,450,000
Other Program Costs	$45,750	$2,617,082	$2,476,178	$5,139,010
Total Program Costs	**$540,750**	**$4,772,082**	**$3,276,178**	**$8,589,010**
Total Project + Program Cost	**$1,410,593**	**$5,107,211**	**$3,611,307**	**$10,129,111**

ECONOMIC IMPACT

Revenue Estimate:

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

Estimated Revenue Impact of FIRM Provision Assumed Effective June 1, 2010, and Funding Received by July 1, 2010 ($ in Millions)			
	2010-11	2011-12	2012-13
FIRM	+$32	+$32	+$41

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

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