

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Wolk Analyst: Deborah Barrett Bill Number: SB 402
Related Bills: None Telephone: 845-4301 Introduced Date: February 26, 2009
Attorney: Patrick Kusiak Sponsor: Franchise Tax Board

SUBJECT: Financial Institution Record Match (FIRM) System for Collection of Delinquent Debts

SUMMARY

This Franchise Tax Board (FTB) sponsored bill would 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.

PURPOSE OF THE BILL

The purpose of this bill is to permit FTB, in a timely and efficient manner, to identify and levy on previously unknown deposit accounts held by debtors to collect outstanding income tax debts and non-tax debts.

EFFECTIVE/OPERATIVE DATE

If enacted in the first year of the two-year session, this bill would be effective on January 1, 2010, and would be operative for delinquent tax debtors on and after that date.

POSITION

In its meeting of March 6, 2008, the three-member Franchise Tax Board voted 2-0, with the Member from the Department of Finance abstaining, to support the provisions of this bill.

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.

Board Position:

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Department Director

Date

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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 BILL

This bill 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 bill would authorize FTB to promulgate rules or regulations necessary to implement the provisions of the bill that include both of 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.

This bill would provide that any use of the information obtained under this bill's provisions 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 bill provides 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 bill 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-acountholder, or co-depositor that their identifying information has been received for furnished to the FTB.

This bill would provide that a financial institution will not incur liability or obligation for any of the following:

- Furnishing information to FTB as required by this bill,
- 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 bill.

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

The bill would provide 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 bill would provide 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 Franchise Tax Board 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 bill would require FTB to consult with financial institutions to develop a reasonable methodology to reimburse actual costs incurred by financial institutions to conduct tax data matches. The provisions of this bill apply specifically to tax debtors that are delinquent on or after the effective date of the act adding the provisions.

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 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.

FISCAL IMPACT

To ensure that existing collection processes can handle the increased volume of data expected under this bill, modifications to core processes would be required. This bill 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 will implement a semi-automated effort in phase I of the project, whereby collection staff will 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 proposal. The table below reflects the summary of costs for the phased project.

FIRM Summary of Costs

(Dollars in thousands)

	FY 2009/10	FY 2010/11	FY 2011/12	FY 2012/13	Total
Total Project Costs	\$2,923	\$4,297	\$2,178	\$1,216	\$10,614
Total Program Costs	\$1,005	\$2,944	\$3,136	\$3,536	\$10,621
Total Project + Program Costs	\$3,928	\$7,241	\$5,314	\$4,752	\$21,235

ECONOMIC IMPACT

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

Estimated Revenue Impact of FIRM Proposal Effective For Accounts Past Due After 1/1/2010 Assumes Funding After 7/1/2010 Collections Begin After 7/1/2011 (\$ in Millions)			
	2010/2011	2011/2012	2012/2013
Vehicle Registration Collections		\$1	\$2
Court Ordered Debt		\$2	\$4
General Fund	\$35	\$63	\$99

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.

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).

Growing this estimate using the Consumer Price Index and since the new collection process would begin twelve months after enactment, the revenue impact for the first fiscal year (2011-12) would total \$38 million. General fund revenue in the table has been accrued back one year and attributed to fiscal year 2010-11.

Based on these implementation dates, the 50,000 OTW limit would be applicable to the first twelve months of collection, which runs July, 2011, to July, 2012. Subsequent to fiscal year 2011-12, 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 2017-18. 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 2017-18, additional collections are projected at \$150 million per year for both tax and non-tax programs.

ARGUMENTS/POLICY CONCERNS

This proposal would impact financial institutions; however, because current federal law requires these entities to participate in the Financial Institution Data Match (FIDM) process for child support obligors, the extent of the impact would be minimized by use of a file format similar to the existing FIDM program.

Financial institutions charge fees to their customers for processing of levies that range up to \$125 per levy. Although the financial institutions are not reimbursed for the costs of levies that do not find open accounts, the levies issued under this proposal would utilize more current financial information and would be more likely to attach to active accounts, which would result in reimbursement for the financial institutions on a higher percentage of levies processed.

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