

BILL ANALYSIS

Department, Board, Or Commission	Author	Bill Number/Version Date
Franchise Tax Board	Senate Comm. On Budget & Fiscal Review	SB 1015/E-06/27/12

SUBJECT

Board of Equalization (BOE) & Employment Development Department (EDD) Participate In Franchise Tax Board's (FTB) Financial Institution Record Match System (FIRM) For Collections--Earnings Withholding Orders (EWOT) For Taxes For Liability Without Recording Lien--Repeal Multistate Tax Compact

REASON FOR BILL

The reason for this bill is to make various changes to state laws regarding tax administration and compliance necessary for the implementation of the Budget Act of 2012.

EFFECTIVE/OPERATIVE DATE

As an act that provides for an appropriation and that has been identified as related to the budget in the Budget Bill, this bill would become effective immediately upon enactment. The operative dates of these provisions vary and are addressed separately for each provision.

ECONOMIC IMPACT – SUMMARY REVENUE TABLE (\$ in Millions)

Fiscal Year	11/12	12/13	13/14	14/15
Provision No. 1: Revise Definition Of "State Tax Liability" For Purposes Of EWOTS Issued By The FTB	11	27	32	34
Provision No. 2: Require the BOE and the EDD to participate in the FTB'S FIRM	*	*	*	*
Provision No. 3: Repeal of Multistate Compact and Application of the Doctrine of Election	**	**	**	**
TOTAL	11	27	32	34

* Provision No. 2 would not impact state income tax revenue. No estimate is provided by FTB of the impact to state use tax or payroll tax revenue as a result of this provision.

** Provision No. 3 does not make any changes to the calculation or the collection of tax. There is no revenue impact associated with this provision.

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PROVISION NO. 1: Revise Definition of “State Tax Liability” for Purposes of Earnings Withholding Orders for Taxes (EWOTS) Issued by the FTB**OPERATIVE DATE**

This provision would be operative upon enactment and specifically apply to any amount that is unpaid on or after the effective date of this bill, or any amount that first becomes due and payable, and unpaid, after the effective date of this bill.

ANALYSIS**FEDERAL/STATE LAW****Creation of a Tax Lien**

Under both federal and state income tax laws, in general, if a taxpayer owes delinquent tax amounts, a tax lien automatically arises by operation of law for that amount, and is known as a statutory tax lien. A statutory tax lien is an unrecorded claim upon real and personal property for the satisfaction of a debt.

Recording of a Tax Lien

The recording of a tax lien is a public record and is against all real and personal property belonging to the taxpayer. With respect to real property, a Notice of State Tax Lien may be filed with the County Recorder’s Office of the county in which the real property is located. For personal property, a Notice of State Tax Lien may be filed with the California Secretary of State. In general, credit bureaus monitor public records for recorded liens and notate such liens on credit reports. This may prevent or delay a taxpayer’s ability to conduct various financial transactions such as buying, selling or transferring real property, and obtaining additional credit.

Duration of a Tax Lien

For federal purposes, a statutory tax lien exists as long as the delinquency exists or until it is unenforceable due to the expiration of the general 10-year collection statute of limitations, without regard to whether the lien is recorded.

For state purposes, a statutory tax lien arises on the date of an assessment and exists for 10 years, unless the liability is satisfied or a Notice of State Tax Lien is recorded. A recorded Notice of State Tax Lien continues in effect for 10 years from the date of recording unless it is released or extended.

Extension of the Duration of a Tax Lien

A recorded federal tax lien can be refiled and therefore continue in effect, but only in the limited situations in which the general federal 10-year collection statute of limitations is extended. When a Notice of State Tax Lien has been recorded, it can be extended for an additional 10 years and is released when the liability is satisfied or the state collection statute of limitations has expired.

Collection Statute of Limitations

Federal law provides a general 10-year statute of limitations on the collection of tax debts. After 10 years, the Internal Revenue Service (IRS) is statutorily prohibited from taking any actions to collect the debt.

Current state law, enacted by AB 911 (Stats. 2005, Ch. 398), provides a 20-year collection statute of limitations for state income tax debts. Prior to AB 911, there was no statute of limitations for the collection of state income tax debts.

Collection Tools

Current federal law authorizes the IRS to use many collection tools, including wage garnishments. The IRS may use wage garnishments to collect tax debts during the entire federal collection statute of limitations.

Current state law authorizes FTB to use a variety of collection tools to collect delinquent tax debts, one of which is the Earnings Withholding Order for Taxes (EWOT). An EWOT is a continuing wage garnishment based on a percentage of a debtor's earnings, not to exceed 25 percent of a taxpayer's disposable income. Current state law authorizes the FTB to issue an EWOT to collect only outstanding tax debts for which a tax lien, whether recorded or unrecorded, is in effect.

BACKGROUND

Of the approximately 220,000 tax liens recorded per year by the department, collection staff estimates nearly 80,000 are attributable to preserving the ability to issue an EWOT. Without recording a Notice of State Tax Lien, an EWOT issued by the FTB cannot be in effect past the statutory lien period. In some instances, for a variety of reasons, the department does not record a Notice of State Tax Lien. As a result, the FTB expends resources to identify accounts that no longer have a tax lien, release EWOTs against such accounts, monitor payments for proper tax year application, and review accounts prior to issuing additional EWOTs.

THIS PROVISION

This provision would revise the definition of “state tax liability” relating to wage garnishment law within the Code of Civil Procedure to include any liability due the FTB under the Personal Income Tax Laws (commencing with R&TC Section 17001), the Administration of Franchise and Income Tax Laws (commencing with R&TC Section 18401), and the Corporation Tax Laws (commencing with R&TC Section 23001).

As a result, this provision would eliminate the need for the FTB to record a lien to preserve the ability to issue an EWOT for the entire 20-year collection statute of limitations.

LEGISLATIVE HISTORY

AB 853 (Jones, 2005/2006) contained language that would have had a similar result as this provision. AB 853 was vetoed by Governor Schwarzenegger. In his veto message, the Governor stated that while he was supportive of the author’s intent to increase tax collections, he would not do so at the expense of employers by lengthening the time indefinitely that they would be required to withhold for past due tax bills on behalf of the state.

AB 911 (Stats. 2005, Ch. 398), among other things, established a 20-year statute of limitations to collect income or franchise tax debts, and thereafter extinguished the liability to pay such balances.

OTHER STATES’ INFORMATION

The states surveyed include *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.

Illinois state law provides a 20-year statute of limitation on collections and provides that when a lien arises, the lien may continue for the entire 20 years. Levies can be placed upon the wages of a taxpayer and continue until the amount of the liability is paid, unless the employment is terminated or the notice of levy is rescinded or modified.

Massachusetts state law provides a six-year statute of limitations and provides that when a lien arises, a levy may be placed on the salary or wages of a taxpayer and shall continue from the date the levy is first made until the liability is satisfied or becomes unenforceable by reason of lapse of time.

Michigan state law allows an unlimited amount of time to collect a tax debt and provides that the effect of a levy on salary or wages is continuous from the date the levy is first made until the liability is satisfied. Research indicates that a lien does not need to be in place in order to levy wages.

Minnesota state law provides a five-year statute of limitations on collections. *Minnesota* state law allows a levy to be filed upon a taxpayer’s wages for which a lien is in effect and specifies that the levy shall continue until the liability is satisfied or unenforceable by law.

New York has a six-year statute of limitations. *New York* state law provides that when a tax warrant (similar to a California state tax lien) has been filed to publicly record the debt, an Income Execution may be issued and continues until the liability has been satisfied or is unenforceable due to the statute of limitations. An Income Execution allows for wage deductions not to exceed 10 percent of gross income.

FISCAL IMPACT

Implementing this provision would result in one-time costs of approximately \$40,000 for information technology system programming changes. This provision would also result in a reduction of a manual workload which would allow approximately 3 Personnel Years (PYs) to be redirected to other collection workloads.

ECONOMIC IMPACT

Estimated Revenue Impact Of Provision No. 1 - Revise Definition of “State Tax Liability” For Purposes Of EWOTS Issued By The FTB Enactment Assumed After June 30, 2012 (\$ in Millions)			
2011-12	2012-13	2013-14	2014-15
\$11	\$27	\$32	\$34

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

PROVISION NO. 2: Require the BOE and the EDD to participate in the FTB’S FIRM

OPERATIVE DATE

This provision would be operative upon enactment and specifically require the EDD and BOE to participate in FTB’s FIRM on or after January 1, 2013.

ANALYSIS

STATE LAW

Current state law, enacted by SB 86 (Stats. 2011, Ch. 14) requires the FTB to coordinate with financial institutions doing business in this state to establish FIRM using automated data exchanges to the maximum extent feasible. The FTB was required to promulgate any rules or regulations necessary to implement FIRM. These rules and regulations were required to include the following:

- A structure by which financial institutions or their designated data processing agent receive from the FTB the file or files of delinquent debtors that the institution will match with its own list of accountholders 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 the FTB a list of all accountholders and their Social Security numbers, or other taxpayer identification numbers so the FTB can match that list with the file or files of delinquent tax debtors.
- Authority for the FTB to exempt a financial institution from the requirements of FIRM 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 FIRM temporarily for a financial institution if a financial institution provides the FTB with a written notice from its supervisory banking authority that it is determined to be undercapitalized, significantly undercapitalized, or critically undercapitalized. Any notice provided to the FTB for this purpose is subject to the same confidential restrictions that exist for a taxpayer or tax return information obtained by the FTB.

Any use of the information obtained under FIRM for any purpose other than the collection of delinquent franchise or income tax or other debts referred to the FTB for collection is a violation of existing disclosure restrictions. FIRM contains express authority for the FTB to provide confidential taxpayer data to the financial institutions for purposes of data matching.

On a quarterly basis, FIRM requires financial institutions to provide the 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 the FTB who maintains an account at the financial institution. Financial institutions may not disclose to the accountholder, depositor, co-acountholder, or co-depositor that their identifying information has been received or furnished to the FTB, unless required to do so by law.

Under FIRM, a financial institution does not incur liability or obligation for any of the following:

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

If a financial institution willfully fails to comply with the requirements of the rules promulgated by the FTB, unless that failure is due to reasonable cause satisfactory to the FTB, the financial institution is 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.

Under FIRM, the following definitions apply:

(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.

FIRM includes reimbursement by the FTB of one-time start up costs in an amount up to \$2,500 for each financial institution, and provides for reimbursement by FTB for the quarterly data matches conducted in an amount up to \$250 per quarter per financial institution.

The initial size of the FTB first data match file sent to financial institutions was limited to no more than 600,000 records and subsequent data match files can increase each quarter by no more than an additional 600,000 records until the full universe of tax debtors is included in the data match file.

THIS PROVISION

This provision would, on or after January 1, 2013, and on a quarterly basis thereafter, require the BOE and EDD to participate in the FTB's FIRM.

This provision would require the BOE and EDD to submit their respective delinquent tax debtor information to the FTB in the format and manner as specified by the FTB. The FTB would be required to include the BOE's and the EDD's delinquent tax debtor information in its data file used to match delinquent tax debtor records to financial institution accountholder records. The FTB would provide the BOE and EDD any matched financial institution accountholder record information as a result of the data provided by the BOE or EDD respectively.

The BOE and EDD would be required to reimburse the FTB for any costs incurred by the FTB related to those departments participating in FIRM.

LEGISLATIVE HISTORY

AB 1307 (Skinner, 2011/2012) would have, among other things, required the BOE to operate and implement a FIRM in cooperation with the FTB. This provision was amended out of AB 1307.

SB 86 (Stats. 2011, Ch. 14) requires the FTB to coordinate with financial institutions doing business in this state to establish FIRM using automated data exchanges to the maximum extent feasible.

FISCAL IMPACT

As indicated above in the "This Provision" section, the BOE and EDD would be required to reimburse FTB's costs for those agencies participating in FIRM. The department estimates first-year costs to implement this provision to be \$592,000 and annual ongoing costs to be \$471,000.

ECONOMIC IMPACT

This provision would not impact state income tax revenue. No estimate is provided by FTB of the impact to state use tax or payroll tax revenue as a result of this provision.

PROVISION NO. 3: Repeal of Multistate Tax Compact and Application of the Doctrine of Election**OPERATIVE DATE**

The provision repealing the Multistate Tax Compact would be operative immediately upon enactment. The provision regarding the Doctrine of Election, is declaratory of existing law, and applies before, on, and after the effective date.

PROGRAM BACKGROUND

The California Legislature enacted the Uniform Division of Income for Tax Purposes (UDITPA) in 1966 and the Multistate Tax Compact in 1974. The concept of the Compact originated with the predecessor to the current Federation of Tax Administrators, the National Association of Attorneys General, and the National Conference of State Legislators. The Compact and its administrative body, the MTC, originally were formed to provide an organization for collective action on tax matters by the states.

The MTC promotes uniformity and compatibility in state tax systems through such efforts as model regulations, statutes, and guidelines, and works toward avoidance of duplicative taxation. In addition, the MTC provides special programs on a contracted basis, such as the nexus and audit programs in which California does not participate. In the income tax area, the UDITPA was adopted as part of the Compact.

The FTB has taken various steps to reduce the department's participation in the MTC programs:

- In 1989, the FTB significantly reduced participation in MTC audit services.
- In September 1996, the FTB was no longer included in the MTC's Nexus Program Bulletin.
- In October 1996, the FTB prompted the MTC to amend its public participation policy to basically incorporate a portion of the Bagley-Keene Open Meeting Act.
- Finally, on February 4, 1998, the FTB directed department staff to send a letter to the MTC to 1) terminate the department's contract for the remaining audit and nexus program services, 2) notify the MTC of the FTB's belief that all MTC services should be provided to member states in return for the membership fee, and 3) that all non-member states bear the full cost of services provided to them by the MTC.

The Members of the BOE, in 1997, voted to continue to pay MTC membership dues but to withdraw from participation in the MTC nexus program. However, because the MTC decided to waive for two years California's fees for the nexus program, both the BOE and FTB resumed some participation in that program.

ANALYSIS

FEDERAL/STATE LAW

Doctrine of Election

“The doctrine of election, as it applies to Federal tax law, consists of the following two elements: (1) there must be a free choice between two or more alternatives; and (2) there must be an overt act by the taxpayer communicating the choice to the Commissioner; i.e., a manifestation of choice.¹ Under the doctrine of election, a taxpayer who makes a conscious election may not, without the consent of the Internal Revenue Service Commissioner, revoke or amend it merely because events do not unfold as planned.² Subject to a few narrow exceptions, "once the taxpayer makes an elective choice, he is stuck with it."³

THIS PROVISION

This provision would do the following:

- Repeal Part 18 of the R&TC, the Multistate Tax Compact, thereby ending California's membership in the MTC.
- Make legislative findings that the Doctrine of Election is applicable for any election that affects the computation of income or franchise tax under the R&TC, unless otherwise provided, as declaratory of existing law.

The provision includes language indicating that repeal of the Multistate Tax Compact by the bill shall not be construed to create any inference that a change in interpretation with respect to that part, or any reference to that part, prior to its repeal is implied by the repeal.

LEGISLATIVE HISTORY

AB 753 (Kaloogian, 1999/2000) would have repealed the Multistate Tax Compact and ended California's membership in the MTC. The bill failed to pass from the house of origin by the constitutional deadline.

SB 1517 (Johnson, 1995/1996) would have repealed the Multistate Tax Compact and ended California's membership in the MTC. The bill failed to pass from the house of origin by the constitutional deadline.

¹ *Grynberg v. Commissioner*, 83 T.C. 255, 261 (1984); *Bayley v. Commissioner*, 35 T.C. 288, 298 (1960).

² See, e.g., *J.E. Riley Inv. Co. v. Commissioner*, 311 U.S. 55 (1940); *Pacific Natl. Co. v. Welch*, 304 U.S. 191 (1938).

³ *Roy H. Park Broadcasting, Inc. v. Commissioner*, 78 T.C. 1093, 1134 (1982).

FISCAL IMPACT

Repeal of the Multistate Tax Compact and corresponding withdrawal as a general member of the MTC may result in savings to FTB, from cessation of member dues, in the approximate amount of \$270,000 (FTB's half of the annual California membership dues).

ECONOMIC IMPACT

This provision does not make any changes to the calculation or the collection of tax. There is no revenue impact associated with this provision.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

Appointments

None.

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