

# **California Tax Gap Strategies**

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# Size of the Tax Gap

- **Federal Tax Gap**

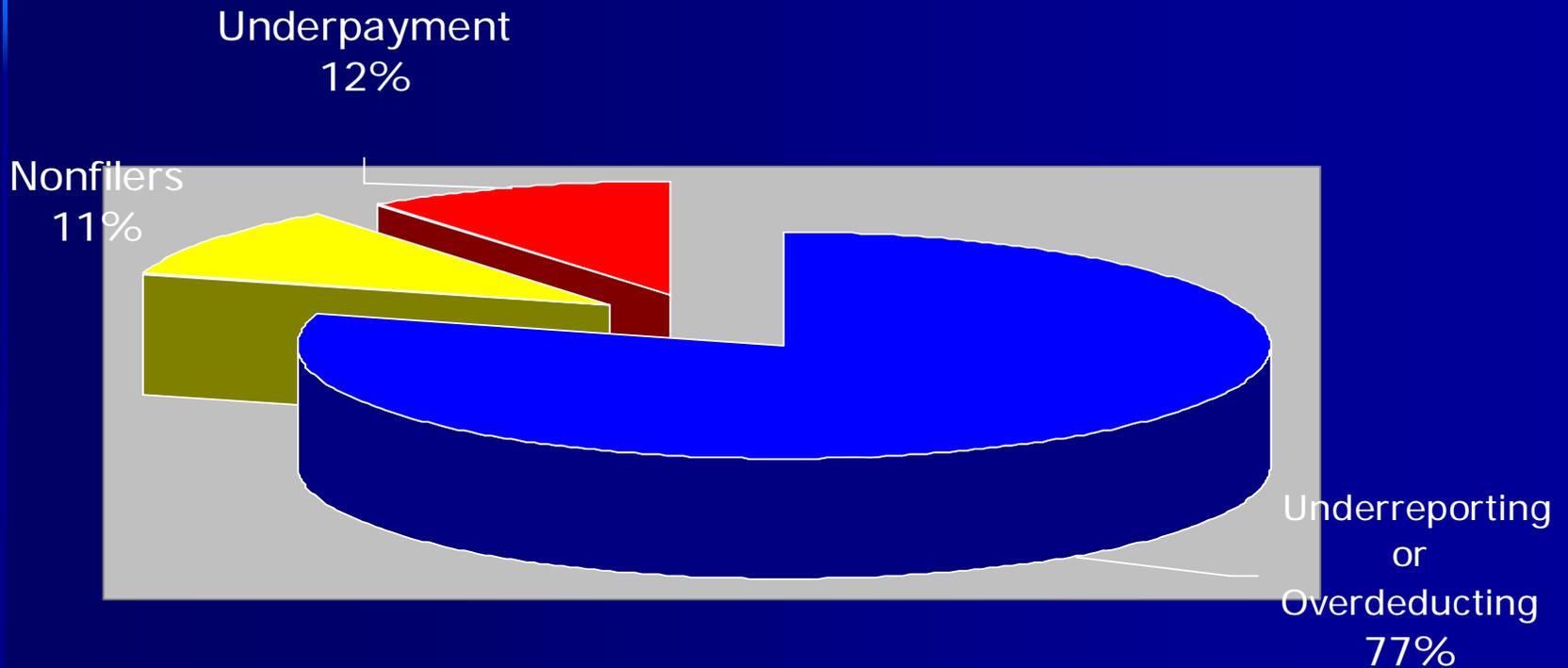
- **Estimate for 2001 tax year      \$290.0 B\***

**\*Estimate for all types of tax**

- **California Income Tax Gap**

- **1985 estimate                      \$2.0 B**
- **2004 estimate                      \$6.5 B**

# Tax Gap Components



# Tax Gap: An Intractable Issue

- **The tax gap across history.**
- **Tax gap data is incomplete, making it hard to take effective action.**
- **Enforcement brings in additional revenue but has not significantly reduced the tax gap.**

# Abusive Tax Shelters and VCI

- **FTB sought ideas to close the tax gap and collect additional revenue.**
- **Most ideas had little overall impact.**
- **The Voluntary Compliance Initiative**
  - **Increased SOL and penalties.**
  - **Provided amnesty for participants.**
  - **\$1.4 billion in revenue, 1,200 participants**
  - **Showed that new ideas can make a big impact.**

# Other Recent Tax Gap Actions

- **Amnesty**
- **Out-of-state sham incorporations**
- **California Tax Shelter Resolution Initiative**

# Tax Gap Symposia

- Held to identify ways to cut the tax gap.
- Included IRS, tax professionals, FTB.
- Strategies:
  - Use more data and data matching.
  - Make complying easier, noncompliance more difficult.
  - Pursue abusive preparers, promoters, and transactions that conceal tax liabilities.
  - Convey positive messages about societal benefits of tax compliance.

# After the symposia - the need for a plan

- Ideas were still largely tactical.
- 2005/06 Tax Gap BCP 0.5% of California's annual tax gap.
- We needed a clear articulation of the tax gap issues, root causes, and what can be done to address them.
- Strategic plans have driven FTB action on key issues.

# Tax Gap Planning Objectives

- **A more holistic, strategic approach to addressing the tax gap.**
- **Clarify direction and get internal consensus on our approach to the tax gap.**
- **Articulate to stakeholders the need to reduce the tax gap.**
- **Build support for resources and policies needed to reduce the tax gap.**

# Planning Process

- Brought in outside experts, reviewed literature.
- Large planning group included staff and managers involved in tax gap efforts.
- Identified tax gap segments and root causes.
- Identified goals, initiatives and actions to address root causes.
- Sought and incorporated input from Board and stakeholders.

# Plan Overview

- **Balanced between "soft" and enforcement oriented approaches.**
- **Improve Confidence in the Tax System.**
  - **Determine ways to increase Californians' confidence in tax administration.**
  - **Recognize honest taxpayers' contribution.**
- **Reduce Burden and Complexity.**
  - **Make it easier for taxpayers to file and pay.**
  - **Reduce burden and legal complexity.**

# Plan Overview, continued

- **Make It Harder to Cheat.**
  - Use more data and better data mining.
  - Improve information return reporting.
  - Increase enforcement speed and coverage.
- **Level the Playing Field for Businesses.**
  - Focus on sectors where tax cheating hurts honest businesses.
  - Coordinate actions against businesses that cheat.

# Plan Overview, continued

- **Support High Standards in the Tax Professions.**
  - **Make practitioner misconduct unprofitable.**
- **Become More Innovative in Attacking the Tax Gap.**
  - **Develop expertise to fight tax cheating.**
  - **Continually develop new ideas to reduce the tax gap.**
  - **Work with outside experts to build research capabilities.**

# Why “Soft” Approaches Matter

- **Taxpayer confidence in the tax system increases compliance, e.g., transparency and perceived fairness.**
- **Burden and complexity contribute to the tax gap.**
- **Innovation is key to reducing the tax gap.**

# Enforcement is Still Needed

- **Enforcement helps ensure everyone pays, shows that cheating doesn't pay.**
- **Deterrence is important.**
- **Helps reduce cynicism.**
- **It brings in revenue we otherwise wouldn't collect.**

# Critical Success Factors

- **Partnerships are key to the plan's success.**
- **Leverage efforts by IRS and other states.**
- **Seek input from taxpayers and tax professionals.**
- **Obtain sufficient resources use them wisely.**
- **Obtain better metrics to determine success.**

# Next Steps

- **Get Board approval of the plan.**
- **Increase transparency, outreach, and build partnerships with stakeholders to increase confidence.**
- **Seek funding and begin implementing initiatives.**
- **Identify changes as needed.**

**Thank you!**

**Questions?**

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