Tax Gap Plan: A STRATEGIC APPROACH TO REDUCING CALIFORNIA'S TAX GAP

Franchise Tax Board

Letter From Steve Westly, State Controller

I'm pleased to introduce the Franchise Tax Board's plan to address California's tax gap. Creating a tax system where every taxpayer pays the correct amount of tax—no more and no less—goes to the heart of our mission to fairly and effectively administer the State's income taxes. Each year, however, California taxpayers pay $6.5 billion less in income taxes than they legally owe. Shrinking this "tax gap" is the goal of this plan.

This new plan builds on a foundation of current, successful enforcement and customer service programs. Since 2004, the Voluntary Compliance Initiative (VCI) for abusive tax shelter participants and Tax Amnesty have brought in over $6 billion to California. These two programs demonstrate the impact that effective tools can have in addressing the tax gap. But current enforcement programs and initiatives haven't done enough to narrow the tax gap. We must embark on a multi-year plan that addresses all of the root causes of the tax gap. Steps to increase overall confidence in the tax system and reduce the burden and complexity of complying with the tax laws are included in this approach.

In developing this plan, FTB collaborated with academics, taxpayer groups, tax professionals, business representatives, legislative staff, and other stakeholders. These stakeholders deserve appreciation for contributing their time and expertise to improving California's tax system. We now look forward to working with our stakeholders to take action and reduce California's tax gap.

Sincerely,

STEVE WESTLY
California State Controller
Chair, Franchise Tax Board

Tax Gap Plan:
Franchise Tax Board

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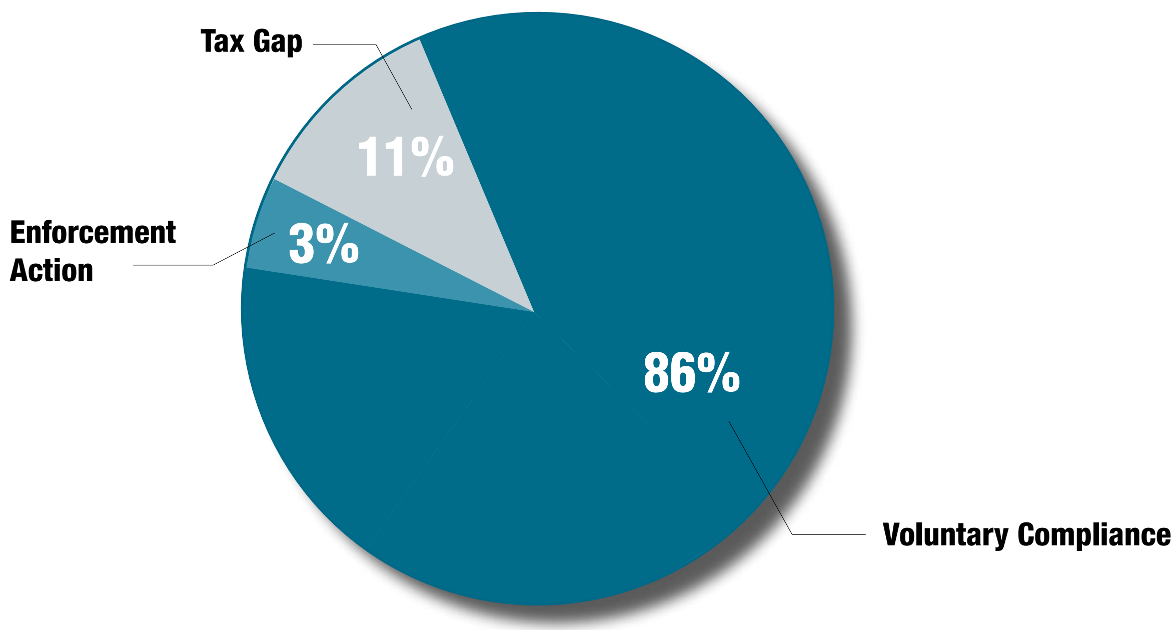
INTRODUCTION:
Most of us do the right thing—we pay our taxes

Each year, about 14 million individuals and nearly one million businesses voluntarily file their tax returns and pay their California income taxes. This is 86 percent of all the income taxes owed. This is also the revenue that provides much of the funding for California's public services. An additional three percent of income taxes owed is collected through FTB enforcement actions that compel payment of taxes not voluntarily paid.

This still leaves a "tax gap"—the total amount of taxes owed but not paid—of about 11 percent in a typical year. This equals approximately $6.5 billion a year in unpaid taxes.

PERCENTAGES OF TOTAL TAX OWED

THE TAX GAP AND PAYMENTS FROM VOLUNTARY COMPLIANCE AND ENFORCEMENT ACTION



The failure by some to pay what they owe means that the rest of us bear an additional burden. This can come in the form of higher fees and taxes, fewer government services, or budget deficits—or all three.

This Tax Gap Plan addresses the problem of unpaid taxes. The plan includes near-term and longer range actions. These actions, along with some already underway, will have immediate revenue effects. Over the next three years, the actions will bring in as much as $1.5 billion in taxes that today remain uncollected.

Although we will probably never completely close the tax gap, we believe that the proposed approach will significantly reduce it.

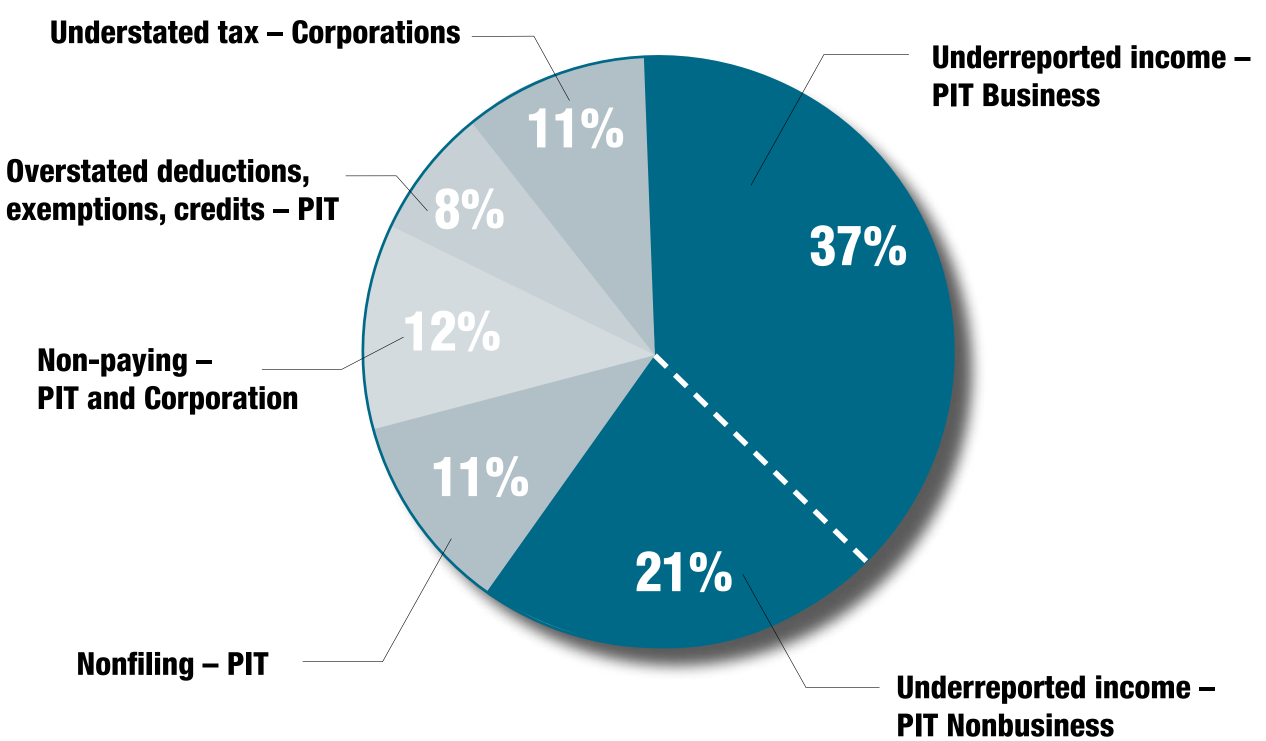
ASSESSING THE TAX GAP: Who Is Not Paying Taxes?

Our estimate of the State tax gap is based on the IRS estimate of the federal tax gap, adjusted for California. However, it is likely that the estimates are low. They are based on incomplete data and do not fully account for all taxes lost to the underground economy and abusive tax shelters, such as hiding income offshore. For example, fiscal years 2003-04 and 2004-05 saw revenues higher than typical years due to two special FTB programs. The Voluntary Compliance Initiative (VCI) brought in $1.4 billion from taxpayers seeking to avoid penalties by voluntarily paying taxes they had previously avoided through the use of abusive tax shelters. The Tax Amnesty Program brought in $4.8 billion from other taxpayers who used the opportunity to come into compliance with the provisions of tax law and thereby avoid penalties.

According to the federal estimate, different segments of the population account for differing percentages of the tax gap. The chart below shows the estimated shares of the tax gap by filing segment and type of misreporting. Note that "PIT" stands for Personal Income Tax.

FEDERAL TAX GAP PERCENTAGES

ACCOUNTED FOR BY THE TYPE OF FILER AND NONCOMPLIANCE



As the chart shows, the underreporting of income on Personal Income Tax returns contributes the largest portion of the tax gap. In fact, the underreporting of business income by personal income taxpayers makes up nearly 40 percent of the total tax gap. The IRS estimates that the majority of this underreported income is from business sectors that do business largely in cash.

Because so much of the tax gap is still unknown, it is a difficult issue to resolve. Over the years, FTB has continuously increased the total amount of taxes collected voluntarily and through enforcement. However, the percentage of taxes owed but not paid has remained constant because the amount of tax owed has also increased. This plan puts in place a framework for actions that can finally begin to decrease this persistent tax gap.

A STRATEGIC APPROACH TO DECREASING THE TAX GAP

Our approach to reduce California's tax gap is to address the primary causes—not just the symptoms—of the tax gap. We developed goals to address those primary causes and appropriate initiatives to achieve those goals. This approach balances "soft" approaches and enforcement-oriented approaches. Soft approaches, such as increasing taxpayer confidence and reducing burden and complexity, narrow the tax gap by increasing taxpayer willingness to voluntarily comply. Voluntary compliance is a key for making major inroads into the tax gap. As previously stated, typically, about 86 percent of California's income tax revenue comes from taxpayers that voluntarily report and pay their taxes. Increasing that rate by just one percentage point from 86 to 87 percent would narrow the tax gap by about $500 million.

> **"Increasing the rate of voluntary compliance by just one percentage point from 86 to 87 percent would narrow the tax gap by about $500 million."**

Enforcement—taking action to compel payment and enforce penalties—also has an important role in reducing the tax gap. Enforcement increases the rate of voluntary compliance because it gives honest taxpayers confidence that cheaters get caught. It also deters those who would otherwise find cheating too tempting.

In addition to balancing soft and enforcement actions, the plan also balances tactical, short-term actions with more foundational, long-term actions. Here is the difference between the two approaches: Tactical actions address immediate tax gap issues and generate short-term revenue, primarily through enforcement. In contrast, foundational activities seek to make lasting changes in taxpayer behavior to increase voluntary compliance. They also improve FTB's capacity to respond to future tax gap challenges.

By moving forward to implement new initiatives described in this plan and continuing existing efforts already underway, FTB expects to collect as much as $1.5 billion in tax revenue over the next 3-5 years from:

- Nearly $1 billion from targeting abusive tax shelters.
- About $200 million from increased audit activity, including speeding up certain amnesty-related audits.
- About $300 million from new tax gap initiatives that fall into the tactical and foundational categories listed below.

Tactical:

1. Conduct more audits.
2. Focus on preparers that prepare problem returns and that promote sham, out-of-state incorporations.
3. Audit issues related to independent contractors.
4. Use more data sources to detect nonfilers.
5. Expand the program to find certain business nonfilers.

Foundational:

1. Target independent contractors with education and outreach to increase voluntary compliance.
2. Promote tax compliance through a statewide education campaign based on the successful Amnesty campaign.
3. Make changes to FTB programs based on direct input from taxpayers and other stakeholders on actions that will increase willingness to correctly report and pay taxes.
4. Make FTB's information return (1099) program—where those making payments to others report that information to FTB—easier so we receive more returns.
5. Revise tax returns to include a line that shows total income covered by information returns.
6. Devise better audit modeling for catching underreporting of income and enhance FTB's ability to track evolving tax cheating approaches.
7. Integrate FTB's data systems to improve usefulness for enforcement and voluntary compliance initiatives.
8. Increase criminal prosecution for significant abuses of the tax laws.
9. Use taxpayer tips as leads to find significant noncompliance.

The above actions are a balance of soft and enforcement approaches. When given the choice, FTB would always prefer to bring in taxes owed to the State through voluntary means rather than resorting to enforcement. Our recent experience with the tax amnesty and VCI programs indicates that encouraging voluntary compliance is not only less intrusive on taxpayers, but is also very cost effective. For example, for an investment of under $13 million, the VCI and the Tax Amnesty Programs brought nearly 175,000 people into voluntary compliance and garnered $4.8 billion from tax amnesty and an additional $1.4 billion from VCI in taxes that otherwise would not have been paid.

However, FTB still needs enforcement methods when voluntary methods fail. We are seeing increasingly sophisticated techniques for hiding income, and cash businesses are moving further underground. For example, as of the end of March 2006, FTB's abusive tax shelter efforts are currently addressing audit cases with estimated revenue of nearly $1 billion. These efforts required that we develop new audit methods to find transactions that did not exist 15 years ago.

Regardless of the approach used, we need to be able to measure the success of our methods in decreasing the tax gap. We also need the resources and funding to pursue the tax gap plan initiatives. A more detailed explanation of these metrics as well as FTB's funding request, is included in a separate Budget Change Proposal that has been submitted to the Department of Finance.

TAX GAP PLAN GOALS

FTB's plan contains six key goals, with each goal targeting a primary cause of the tax gap. The goals are shown on the following pages. For the specific initiatives, objectives, and timeframes for each goal, please refer to appendix 1.

Goal 1
Improve Taxpayer Confidence in the Tax System

Over the last 20 years, a growing number of studies have concluded that taxpayers' willingness to voluntarily report and pay their full, legally-owed tax liabilities increases when they:

- Have confidence that the tax agency uses fair procedures.
- Perceive that the agency treats them with respect.
- Believe that most taxpayers pay what they owe.

It is also important that businesses, including large corporations, have confidence in the tax system. Willingness to honestly report and pay declines when this confidence is undermined. These conclusions are consistent with FTB's experience with taxpayers, tax professionals, and taxpayer groups. In addition to the perceived fairness of tax agency procedures, it is also important that individuals and businesses regard paying taxes as part of being good citizens and understand the important role they play by paying the taxes needed to support essential services.

"Last year, 87 percent [of taxpayers surveyed] said it was not acceptable at all to cheat, compared to 91 percent in 1999. We must stem this tide; not to do so would place the entire tax administration system in peril."

Mark Everson, IRS Commissioner, IRS Oversight Board Annual Report 2004

Goal 2
Make Taxes Less Taxing

Estimates of taxpayers' annual costs to comply with federal tax laws range from $75 to $265 billion. We know less about the burden of complying with state tax laws. But we do know that the burden of complying with California tax laws increases when State requirements differ from federal requirements. That is, when they do not "conform" to federal requirements.

This burden is not equal for all taxpayers. Estimates suggest that small businesses' costs to comply with tax laws is a larger share of their total costs than it is for large businesses. In California, many businesses must deal with more than one State agency to meet all of their tax requirements. In addition, California's diverse population suggests that a one-size-fits-all tax system will be easier for some taxpayers to navigate than others. Immigrants, seniors, college students, independent contractors, out-of-state taxpayers, and others have their own sets of unique circumstances. FTB needs to collect more information about different taxpayers' needs to make it as easy as possible for all California taxpayers to meet their tax obligations.

Burden and complexity may increase the tax gap in several ways:

- Complex tax laws can cause well-intentioned, honest taxpayers to make inadvertent errors.
- Complex requirements may cause some taxpayers to simply choose not to take all the steps necessary to determine their true tax liability. This approach can lead taxpayers to underpay, but can also cause overpayment. Some taxpayers may even drop out of the tax system to avoid the cost of compliance.
- Complexity can lead to differing interpretations by taxpayers and tax administrators, which may undermine taxpayers' perception of procedural fairness.
- More complex tax laws give dishonest taxpayers more opportunities to conceal tax evasion through complex schemes.

The goal of reducing burden and complexity is also relevant to the prior goal of increasing taxpayer confidence in the tax system. Burden and complexity can erode taxpayer confidence, because taxpayers can view a complex system as less fair and lacking respect for them and their time.

"...simpler taxes would generate more public support and thus should be an essential part of any effort to improve delivery of government services. The biggest complaint about the tax system for many people is not the amount of taxes they pay but rather the sheer, and seemingly needless, complexity of what appear to be everyday tax situations."

William H. Gale, Brookings Institute in testimony to Congress 2001

Goal 3

Make It Harder to Cheat

Studies show that people who think about cheating on their taxes mainly consider two things: the likelihood of getting caught and how much they'll have to pay if they do get caught. Unfortunately, several economic trends are making it harder for FTB to track income and other tax information needed to detect cheating. These trends include globalization, electronic commerce, offshore banking, and an increase in the number of independent contractors. We also see evidence that business is increasingly conducted in cash to hide income.

Information is key to detecting tax cheating. Compliance rates are highest where the IRS and FTB get data from employers and other third parties about income and other tax information. While FTB's traditional enforcement approach has been to crosscheck this data with the information supplied on tax returns, newer tax cheating methods require that FTB uncover information that is left completely off the return. Sharing information across agencies and jurisdictions, as well as finding new sources of data, are increasingly important. Automated tools and systems provide the ability to examine and compare large quantities of data to detect noncompliance. In seeking information, FTB must guarantee taxpayers that we will continue to maintain all privacy principles and safeguards.

"Consider what happened one spring evening at midnight in 1987: 7 million American children suddenly disappeared… It was the night of April 15, and the Internal Revenue Service had just changed a rule. Instead of merely listing each dependent child, tax filers were now required to provide a Social Security Number for each child. Suddenly, 7 million children—children who had existed only as phantom exemptions on previous year's 1040 forms—vanished…"

Malcolm Gladwell in Freakonomics

Goal 4

Level the Playing Field for Businesses

IRS tax gap studies show that tax cheating is much more common in some sectors of the economy than in others, and is generally the worst where taxpayers have the opportunity to conduct business in cash. When cheating becomes widespread, a snowball effect can occur. Margins in business are often small and difficult to maintain, so businesses have a temptation to duck tax obligations to help their bottom line. If most businesses underreport, then competitive markets squeeze prices downward to reflect lower costs from the tax cheating. Ultimately, the lower prices leave margins that cannot cover taxes and expenses, so businesses that pay taxes can no longer compete. They must join in underreporting or go out of business. Even where such market pressure has not developed, lack of confidence in the tax system may lead to lower levels of correct self-reporting in sectors where cheating occurs.

Future State efforts must respond to this problem to help level the playing field for all businesses. This includes developing programs that will focus on business sectors where tax cheating has been identified and is putting honest businesses at a competitive disadvantage. Also, those specific businesses that are noncompliant with tax law should not be permitted to contract with the State.

"… Additionally they don't pay any payroll taxes on these people, don't have to provide any benefits, and can use these savings to reduce the price of their products. We are beginning to be unable to compete…"

Business owner in a letter to the State Controller

Goal 5

Support High Standards in the Tax Professions

Tax professionals play an important part in California's tax system, preparing nearly 70 percent of California's Personal Income Tax returns. Tax professionals understand tax laws and make fewer mistakes than non-professionals, which helps both taxpayers and FTB. However, honest tax professionals face increasing competition from unethical providers of tax services.

Tax professionals have always felt pressure from clients who want to prepare returns that do not reflect the full amount of tax owed. Ethical tax professionals can sometimes lose business to unscrupulous preparers who are willing to help taxpayers cheat. For example, in 2005, some California tax professionals expressed frustration that FTB was not doing more to dispute the claims of out-of-state tax advisors offering to reduce taxes through sham corporations set up in other states. Narrowing the tax gap requires that FTB work closely with the tax professional community to understand the most effective ways to support ethical preparers.

"Compliance with California's complex tax laws requires representation of California taxpayers by ethical and responsible tax service professionals at all levels."

California Society of CPAs

Goal 6

Become More Innovative in Attacking the Tax Gap

When FTB and the IRS have effectively focused on specific categories of tax cheating, they have pushed evaders to use strategies that tax agencies have not yet learned to detect. The rise of abusive tax shelters in the past decade demonstrated this phenomenon. As tax agencies learned about abusive tax shelters, aggressive promoters continued to evolve complex financial transactions that are more difficult to detect. The indicators previously used to select tax returns for audit no longer work on these evolved transactions. Given the rapidly evolving nature of the tax gap, FTB must develop the ability to innovate and detect new modes of cheating. FTB's ability to innovate will be crucial to reducing the tax gap over the long-term.

"A balanced approach does not ignore areas of noncompliance simply because they are difficult to deal with. It includes creative approaches to intractable problems. And it does it on a solid foundation of research, so that valuable and limited resources are used wisely and effectively."

Nina Olson, The National Taxpayer Advocate, in testimony to the Senate, July 2004.

CRITICAL SUCCESS FACTORS

Making significant progress in closing California's tax gap is a huge undertaking, and FTB recognizes that our commitment alone won't make it happen. There are several factors we will need to address to be successful.

We must partner with others. FTB cannot solve the tax gap problem alone. Others have a role and an interest in reducing the tax gap as well, and wise use of public dollars means building and leveraging partnerships with those who have relevant skills or insight into helping us reduce the tax gap. This includes elected officials, other government agencies, taxpayer groups, academic and other empirical researchers, tax professionals and their associations, software companies, and the business community.

We must leverage federal efforts. A taxpayer's decision to underreport income or overstate deductions is often made primarily to avoid federal income tax, because federal tax rates are generally three times as high as California tax rates. The IRS has recently announced that it believes as much as one-third of the tax gap may be recovered as a result of activities currently proposed at the federal level. Because federal income tax law generally serves as the basis for California tax law, California stands to benefit significantly from these federal tax gap activities.

We must ask taxpayers and tax professionals what they think. As tax administrators, we see the tax system from the inside out—a critical perspective in figuring out how to close the tax gap, but not the only one. Taxpayers, tax professionals, and other stakeholders bring a different perspective, which is also critical for understanding how we can take effective action. To understand the view of the tax system from the outside in, we must ask taxpayers and others their views about why there is a tax gap and how we can ensure every taxpayer pays the correct amount of tax.

We must be mindful of unintended consequences. Closing the tax gap is important for California, but it's not the only important public policy goal in the State. For example, as we collect and use more data to detect tax noncompliance, we must maintain rigorous privacy standards. As we look for more sources of income information, we must take into account that mandated data reporting puts a burden on the third parties who supply the data—often businesses, including small businesses that can least afford the burden. As we work to catch tax cheats, we must also be mindful of evidence suggesting that overly aggressive enforcement causes people to negatively view paying taxes, in general.

We must have sufficient resources and allocate them wisely. FTB will seek to redirect staff to actions laid out in this plan from current actions with less potential for reducing the tax gap. However, additional resources may be needed. To obtain the additional resources, we need the support of the Governor and the Legislature. Also, we must be able to measure the success of our actions in order to justify the long-term fiscal merit of our efforts.

CONCLUSION

This plan has grown out of the recognition that narrowing the tax gap will require balanced, long-term action and investment. Current research and experience indicate that the actions proposed in this plan have promise to reduce the tax gap. As we move forward, we expect discussions about what's working, what isn't, and what new ideas need to be added. These discussions will occur at FTB and with others that will be part of resolving California's tax gap—elected officials, administration representatives, large and small businesses, taxpayer groups, tax professionals, community organizations, and many others.

We look forward to continue our dialogue with our stakeholders, as we work together to put in place a system in which every California taxpayer pays the correct amount of tax—no more, no less.

APPENDIX 1
Plan Detail and Implementation Schedule

This appendix provides specific initiatives, objectives, tasks and their timeframes for each of the six tax gap goals.

Goal 1
Improve taxpayer confidence in the tax system

Goal 1: Improve taxpayer confidence in the tax system	Timeframe for Implementation		
	short-term 0-3 years	mid-term 4-5 years	long-term 5+ years
Ensure that administration of the tax laws is fair, open, and respectful of taxpayers.			
Establish and implement performance measures of fairness, openness, and respectful treatment of taxpayers in key areas throughout FTB.	X		
Seek stakeholder feedback regarding FTB's fairness, openness, and respect shown to taxpayers.		X	
Communicate more about FTB to make FTB information, processes, and decisions more transparent to stakeholders.	X		
Use modern communication methods to increase dialogue between stakeholders and FTB.	X		
Determine the most effective ways to increase Californians' confidence in tax administration so that honest tax reporting and paying increases.			
Ask taxpayers, tax professionals, and non-filers what FTB can do to improve their confidence in the tax system so that they are most willing to honestly pay taxes.	X		
Investigate and implement a public relations campaign to change attitudes about social norms regarding taxes, using campaigns by nonprofit organizations such as MADD, businesses, and other states and countries as examples.	X	X	
Conduct research on the potential for appropriately designed taxpayer appreciation or incentive programs to increase willingness to honestly report and pay taxes.		X	
Investigate how both non-enforcement and enforcement programs impact voluntary compliance.		X	
Increase publicity of FTB's audit and criminal enforcement activities.	X		
Conduct outreach to California's diverse communities.			
Use diverse staff to work in communities.		X	
Seek out community partners such as AARP and cultural chambers of commerce to better understand the needs of our diverse taxpayer population.		X	

Give recognition to the majority of taxpayers as honest and good citizens, who provide the resources needed to make California a great state.	short-term 0-3 years	mid-term 4-5 years	long-term 5+ years
Test the most promising methods for increasing taxpayer understanding about the high percentage of Californians who honestly pay their taxes and about the services these taxpayers fund.			
Conduct an ongoing education program focused on helping potential new income-earners understand the importance to California of fulfilling their tax responsibilities.			

Goal 2
Make taxes less taxing

Timeframe for Implementation

Make it easier for taxpayers to correctly file and pay their taxes.	short-term 0-3 years	mid-term 4-5 years	long-term 5+ years
Provide taxpayers with timely, easy access to their Personal Income Tax account information.			
Provide taxpayers with online, interactive tools to help them file and pay correctly.			
Make California withholding tables more consistent with federal tables.			
Explore methods to help taxpayers track when to pay estimated taxes and how much they've paid.			
Continue to work with sister tax agencies to make meeting all California tax requirements more seamless.			

Reduce the burden on taxpayers from FTB's administrative systems.	short-term 0-3 years	mid-term 4-5 years	long-term 5+ years
Shorten resolution times for compliance issues.			
Distinguish between intentional and unintentional non-compliance and use appropriate approaches to address each.			
Reduce the time between the filing of a return and the beginning of enforcement activity.			
Continue to improve staff's knowledge and consistent application of federal/state law differences.			
Educate taxpayers about audit issues so they can correctly file future returns.			
Implement business process re-engineering to streamline all processes so that voluntary compliance is less burdensome to taxpayers and uses fewer tax dollars to accomplish.			

Reduce legal complexity in the tax system.	short-term 0-3 years	mid-term 4-5 years	long-term 5+ years
Assess complexity and compliance burden in the bill analyses FTB provides to the Legislature.			
Be more proactive in providing tax law simplification ideas to the Legislature for both proposed legislation and current law.			
Identify areas of federal law that are too complex and work with Congress to reduce the complexity.			
Educate external policy-makers regarding the additional complexity faced by taxpayers whenever California tax law does not conform to federal law.			
Explore tools to make it easier for taxpayers and tax professionals to identify differences between federal and California law.			
Address the unique needs of different taxpayers.			
Learn from multicultural taxpayers about any special needs they may have in navigating tax requirements so FTB can design and deliver services to meet those needs.			
Customize the filing experience to fit taxpayers' circumstances.			
Add more languages to FTB's Internet site, forms, and instructions as needed for non-English speakers to understand and comply with tax laws and ensure FTB's call-centers have necessary staff to respond effectively to calls from non-English speakers.			

Goal 3
Make it harder to cheat

Find and stop more instances of noncompliance by using more data and improving automated systems to use it more effectively while strictly adhering to FTB's privacy policy and principles.	Timeframe for Implementation		
	short-term 0-3 years	mid-term 4-5 years	long-term 5+ years
Obtain an independent evaluation of how FTB collects and uses data, including ways to effectively use more data.			
Develop and implement a tax systems strategy to improve our ability to use information within FTB.			
Build the organizational capacity to mine data to identify noncompliance.			
Test the most promising sources of additional information to determine their usefulness in detecting noncompliance.			
Change policy, acquisition procedures, and statutes to facilitate the use of additional data.			
Continue working with other government agencies to better use data to detect potential noncompliance.			
Develop and publicize a process to be more responsive to informants and their information.			

	short-term 0-3 years	mid-term 4-5 years	long-term 5+ years
Improve our information return (1099) reporting program.			
Assess FTB's information reporting program to ensure that all mandated reports are used, and make requirements clearer and reporting easier for our third-party information providers.			
Review the potential for acquiring more information returns through an information return reporting amnesty.			
Ensure that all legally mandated information returns are received and make penalties for failure to report more practical to administer.			
Revise tax forms to include a separate line reporting income covered by information returns.			
Explore the potential to disallow deductions by businesses for payments to independent contractors when the business has not given a corresponding information return (1099) to FTB and seek technical clarifying legislation.			
Look for ways to address the specific issues associated with independent contractors.			
Provide education about independent contractor issues to businesses that hire large numbers of independent contractors and to the contractors themselves.			
Further evaluate the costs, benefits, and equity concerns of withholding on independent contractors.			
Increase speed and coverage of enforcement activities.			
Refer more accounts to private collection agencies when it makes sense to do so.			
Further improve FTB's strategic audit approach for increasing the number of noncompliant taxpayers audited without intruding on taxpayers who have correctly reported.			
Increase criminal enforcement for significant abuses of tax laws.			
Maximize the effectiveness of penalties.			
Review penalty provisions to ensure that they are effective and applied consistently.			
Work with the Legislature to revise penalties that are ineffective			

Goal 4
Level the playing field for businesses

Develop a program that focuses on sectors where tax evasion is putting honest businesses at a competitive disadvantage.

Identify sectors with widespread noncompliance and devise sector-specific techniques for enforcement.

Gain the confidence of sector businesses that want to comply through education and effective action against noncompliant businesses.

Enlist compliant businesses in an education campaign to promote the understanding that noncompliant businesses hurt the business climate.

Coordinate actions across all of State government against businesses that cheat.

Ensure that noncompliant businesses do not contract with the State.

Partner with other government agencies to reduce opportunities for noncompliance.

Timeframe for Implementation

short-term 0-3 years	mid-term 4-5 years	long-term 5+ years

Goal 5
Support high standards in the tax professions

Partner with tax professionals in creating conditions for maintaining high standards.

Get input from professionals to determine the best ways for FTB to support ethical behavior in the tax professions.

Improve transparency and communications with tax professionals so that they have all the information they need to perform ethically and can promote awareness of compliance issues.

Partner with organizations and agencies related to tax professionals to address areas of concern.

Work more closely with the Board of Accountancy, other regulatory bodies, and professional organizations to address issues.

Make professional practitioner misconduct unprofitable.

Identify problem practitioners and audit the returns they prepare.

Bring more enforcement actions against preparers promoting sham, out-of-state incorporations.

Timeframe for Implementation

short-term 0-3 years	mid-term 4-5 years	long-term 5+ years

Goal 6
Become more innovative in attacking the tax gap

	Timeframe for Implementation		
	short-term 0-3 years	mid-term 4-5 years	long-term 5+ years
Further develop in-house expertise to combat tax cheating schemes.			
Acquire and share expertise across programs.			
Get information on the latest schemes used to avoid paying taxes by: 1) Making it easier for knowledgeable outsiders to contact FTB on tax avoidance schemes. 2) Providing amnesty to tax offenders in exchange for information.			
Continually develop new ideas to reduce the tax gap.			
Create a roundtable of representatives of corporations to get ideas to facilitate compliance.			
Use contracts with outside experts that pay only for successful performance in making inroads into the tax gap.			
Leverage partnerships with outside research and tax experts to build cost effective research capabilities.			
Establish a roundtable of academic researchers to advise FTB on research methods and ideas.			
Collaborate with external researchers to design and conduct studies to quantify the effect of specific actions on the tax gap.			
Urge the Federation of Tax Administrators and the Multistate Tax Commission to create a national institute to address tax gap topics.			
Study what other state jurisdictions are doing to address their tax gaps.			

APPENDIX 2

Planning Process and Members of the Executive Officer Advisory Board

The Planning Process

To develop this plan, FTB staff reviewed research and conferred with academic, non-profit, government, and industry experts on the causes, challenges, and solutions to the tax gap. Using this information and their own knowledge and expertise, FTB's planning participants developed a draft plan that was shared with the Executive Officer Advisory Board for review and comment. The Advisory Board consists of representatives from 16 different organizations, including tax professional groups, taxpayer associations, legislative committees, and business groups.

Advisory Board members were generally supportive of the ideas and initiatives in this plan and expressed particular support for actions to increase enforcement, address the complexity caused by differences in state and federal tax laws, improve communication and public relations, and increase cultural awareness. Members' key concerns included the need to leverage our efforts across government agencies, the challenges associated with implementing the plan, the interplay between FTB's efforts to address the tax gap and our overall mission, and the potential burden on taxpayers and third parties if new legal and reporting requirements were proposed. FTB made several changes to the plan to incorporate Advisory Board input and provided it to the three-member Franchise Tax Board for review. A full description of the input received from the Advisory Board and a list of Advisory Board members follows.

A list of the experts consulted during the initial phase of the planning process is attached as Appendix 3.

On March 1, 2006, the Executive Officer Advisory Board assembled to provide input on a draft of the Tax Gap Plan created by FTB staff. The Advisory Board represents a cross-section of FTB stakeholders. The following Advisory Board members attended the meeting:

Kimberly Bott, *Assembly Revenue and Taxation Committee*

Jim Brandes, *California Manufacturers and Technology Association*

Dan Crosbie, *California Society of Certified Public Accountants*

David R. Doerr, *California Taxpayers' Association*

Lenny Goldberg, *California Tax Reform Association*

Martin Helmke, *Senate Revenue and Taxation Committee*

Don Hug, *American Association of Retired Persons*

Bronwyn Hughes, *California Society of Enrolled Agents*

Catherine Apker, *California Society of Enrolled Agents (special guest)*

Gayle Miller, *Senate Revenue and Taxation Committee*

Gary Renville, *Internal Revenue Service*

Bernice Fischer, *Internal Revenue Service (special guest)*

Charles P. Rettig, *State Bar of California, Taxation Section*

Gina Rodriquez, *Spidell Publishing*

Jean Ross, *California Budget Project*

Kathleen Wright, *California State University, Hayward*

For a more detailed list of the Advisory Board's input, please visit ***www.ftb.ca.gov.***

APPENDIX 3
External Sources of Information

Tax Gap Presentations to FTB Staff

Jeff Arkin, U.S. Government Accountability Office (GAO), "Tax Gap Report Summary and Measures to Address the Tax Gap."

Joseph Bankman, Ralph M. Parsons Professor of Law and Business, Stanford Law School, "Ideas for Narrowing the Tax Gap."

Steven Bonovich, Tax Attorney, Intel Corporation, "Abusive and Potentially Abusive Transactions: How to Detect, Analyze and Report Them."

Steven Kolodney, Vice President, State and Local Solutions for CGI-AMS and former State CIO for California and for Washington, "Strategy in an Era of Strained Resources: A Technology Story."

Alan Plumley, Technical Advisor, National Headquarters for Research, Internal Revenue Service, "Overview of the Federal Tax Gap" (teleconference).

Joshua Rosenberg, Professor of Law, University of San Francisco, "A Cognitive Psychology View of Tax Compliance."

Jean Ross, Director, California Budget Project, "What Can Wage and Income Data Tell Us About the Tax Gap?"

Joel Slemrod, Professor of Business Economics and Public Policy and Economics, University of Michigan, "Questions and Answers on Why People Don't (and Do) Pay Taxes" (teleconference).

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