

Taxpayers' Bill of Rights
ANNUAL REPORT TO THE LEGISLATURE

Franchise Tax Board

October 1, 2003

This report is in response to the Taxpayers' Bill of Rights (Stats. 1988, Ch. 1573), Sections 21006 and 21009(a) of the California Revenue and Taxation Code. We have divided the report into five parts.

Executive Summary

- I. Sample Data From the Audit Process
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You can direct any questions regarding this report to Debbie Newcomb, Taxpayer Advocate, at (916) 845-4300. If you would like a transcript of the Taxpayers' Bill of Rights hearing, please call (916) 845-5249.

Gerald H. Goldberg
Executive Officer

EXECUTIVE SUMMARY

Revenue and Taxation Code Section 21006(a) requires Franchise Tax Board to report to the Legislature on October 1 of each year its findings with respect to recurrent taxpayer noncompliance. To satisfy the provision's requirements, we conducted a study using a sample of both corporation and personal income tax notices of proposed assessment. These proposed assessments are the result of Franchise Tax Board audits. Our staff also compiled information on taxpayers' filing errors detected during return processing.

The audit results show where we direct our audit resources. Our audit programs focus primarily on those areas that are most cost efficient.

We found that:

1. For corporation taxes, during 2002 the largest cumulative dollar amount in proposed assessments resulted from allocation and apportionment audits.
2. For personal income taxes, during 2002 the largest cumulative dollar amount in assessments resulted from filing enforcement assessments.
3. Tax practitioners prepared approximately 72 percent of personal income tax returns. The percentage of taxpayers preparing their own returns was nearly 28 percent.
4. Taxpayer errors detected during return processing amounted to a taxpayer error rate of approximately 4 percent. Overall, the number of Return Information Notices issued to taxpayers decreased 5.4 percent compared to last year.

We continue our efforts to improve communications and services to taxpayers and tax practitioners. These efforts include:

1. Providing well-written materials for accurate filing.
2. Distributing tax products using methods that are convenient for taxpayers and tax practitioners.
3. Participating with other tax agencies and state departments to develop cooperative communication efforts.
4. Providing information on our department's Website.
5. Issuing statewide press releases to inform taxpayers of tax law changes and using *Tax News* to inform tax practitioners of the same.
6. Maintaining and enhancing an Interactive Voice Response system.
7. Improving products and services to persons with disabilities.
8. Providing information and assistance to taxpayers and tax practitioners in languages other than English.
9. Marketing e-programs.
10. Continuing to gather input from our stakeholders.
11. Providing outreach through our Collections Program to help taxpayers and tax professionals understand and comply with tax laws.

PART I
SAMPLE DATA FROM THE AUDIT PROCESS

We used a statistically valid sample of corporation *Notices of Proposed Assessment* for this study. For individuals, we collected assessment information from the personal income tax NPA display file for 2002 final assessments. The volumes and dollar amounts shown represent the sample study numbers projected to the total universe of assessments. The results of the study are as follows.

Revenue and Taxation Code Section 21006(b)(1)(A) – “The statute or regulation violated by the taxpayer” and **Section 21006(b)(1)(B)** – “The amount of tax involved.”

The following table shows the distribution of NPAs by issue and tax assessed. In those cases where multiple issues are included in a single notice, we have categorized the notice under the issue that provides the majority of the tax change. Where there is no distinct primary issue, we have categorized the NPA as *Other*.

TABLE 1A
CORPORATION TAX LAW
Finalized 2002 NPAs Categorized by Primary Statute (Issue)

| Issue | Number of NPAs | | Tax Assessed (Millions) | | Average Assessment Per NPA |
|---------------------------|----------------|-----|-------------------------|-------|----------------------------|
| | | % | | % | |
| Assess Minimum Tax | 105 | 3 | \$ 0.8 | 0.0 | \$ 759 |
| State Adjustments | 602 | 14 | 19.6 | 1.9 | 32,512 |
| Allocation/Appportionment | 2,220 | 53 | 912.3 | 90.2 | 410,965 |
| Revenue Agent Reports | 1,155 | 28 | 67.1 | 6.6 | 58,133 |
| Other | 82 | 2 | 12.3 | 1.2 | 150,255 |
| Totals/Average | 4,164 | 100 | \$ 1,011.5 | 100.0 | \$ 242,905 |

NOTE: All tables in PART I of this report reflect tax increase assessments only. The assessments became final in 2002. We may have issued the assessments in prior years, due to being in protest status, we did not resolve them until 2002. The totals in PART I reflect rounded figures and may not compute exactly.

- *State Adjustments* reflect the differences between the Internal Revenue Code and the California Revenue and Taxation Code.
- *Allocation/Appportionment* involves corporations doing business within and outside of California.
- *Revenue Agent Reports* are copies of Internal Revenue Service tax change notices. These typically result when California conforms to federal law, and a change to a taxpayer's federal tax return also applies to the taxpayer's California tax return.

TABLE 1B
PERSONAL INCOME TAX LAW
Finalized 2002 NPAs Categorized by Primary Statute (Issue)

| Issue | Number of NPAs | | Tax Assessed (Thousands) | | Average Assessment Per NPA |
|-----------------------|----------------|-----|--------------------------|-----|----------------------------|
| | | % | | % | |
| CP2000 | 34,147 | 8 | \$ 18,151 | 1 | \$ 532 |
| Filing Enforcement | 350,827 | 79 | 1,777,714 | 93 | 5,067 |
| Filing Status | 19,469 | 4 | 16,871 | 1 | 867 |
| Revenue Agent Reports | 9,138 | 2 | 40,519 | 2 | 4,434 |
| Other | 29,716 | 7 | 62,285 | 3 | 2,096 |
| Totals/Average | 443,297 | 100 | \$ 1,915,540 | 100 | \$ 4,321 |

- The *CP2000* category results from the IRS comparing information documents that report income paid to individuals by third parties against income reported on their tax returns.
- *Filing Enforcement* refers to assessments issued to individuals who have not filed a state income tax return after we notified them of their filing requirement.
- *Filing Status* primarily reflects notices issued due to head of household adjustments.

RTC Section 21006(b)(1)(C) – "The industry or business engaged in by the taxpayer."

The following table categorizes the distribution and amount of NPAs according to the industry in which the taxpayer is engaged.

TABLE 2
CORPORATION TAX LAW
Corporations by Industry With Finalized 2002 NPAs

| Industry | All Corporations 2001 Tax Year | | Corporations With NPAs | | Tax Assessed (Millions) | |
|---------------|--------------------------------|-----|------------------------|-----|-------------------------|-------|
| | | % | | % | | % |
| Manufacturing | 42,986 | 8 | 269 | 19 | \$ 167.7 | 16.5 |
| Trade | 95,054 | 18 | 221 | 15 | 116.5 | 11.5 |
| F.I.R.E.* | 89,076 | 17 | 142 | 10 | 77.8 | 7.6 |
| Services | 205,640 | 40 | 172 | 12 | 22.7 | 2.2 |
| Other ** | 87,300 | 17 | 632 | 44 | 626.8 | 61.9 |
| Totals | 520,056 | 100 | 1,436 | 100 | \$ 1,011.5 | 100.0 |

* Finance, insurance, real estate, and holding companies

** Includes agriculture, construction, utilities, and other industries not classified in the sample

For corporations that are not filing via a combined report, we base the industry designation on the corporation's primary business activity in California. In the case of combined reports, we base the industry designation on the primary occupation of the group, not necessarily on the industry of the parent. However, if the parent is a holding company of a diverse group of subsidiary corporations, then we group it with *F.I.R.E.*

RTC Section 21006(b)(1)(D) – "The number of years covered by the audit period."

This section applies to either the taxable years for which we issued NPAs or the number of years for which a taxpayer receives notices of proposed assessment because of multiple taxable year audits during the same audit cycle. We issue a separate NPA to the taxpayer for each year included in an audit adjustment. For corporations, Table 3A shows the notices issued by taxable year and Table 3B shows the frequency of multiple NPAs issued at the same time to a single corporation. Table 4 shows this data with respect to individual taxpayers.

**TABLE 3A
CORPORATION TAX LAW
Finalized 2002 NPAs Issued by Taxable Year**

| Average Taxable Year | Number of NPAs | | Tax Assessed (Millions) | | Average Assessment per NPA |
|----------------------|----------------|-------|-------------------------|-------|----------------------------|
| | | % | | % | |
| 1995 and prior | 2,134 | 51.2 | \$ 877.2 | 86.7 | \$ 411,066 |
| 1996 | 353 | 8.4 | 52.2 | 5.1 | 147,942 |
| 1997 | 495 | 11.8 | 40.7 | 4.0 | 82,124 |
| 1998 | 559 | 13.4 | 13.4 | 1.3 | 23,978 |
| 1999 | 405 | 9.7 | 25.1 | 2.4 | 61,950 |
| 2000 | 189 | 4.5 | 2.5 | 0.2 | 13,473 |
| 2001 | 29 | 0.6 | 0.3 | 0.0 | 11,319 |
| Totals/Average | 4,164 | 100.0 | \$ 1,011.5 | 100.0 | \$ 242,905 |

The earlier years, in which the statute of limitations for assessing additional tax has passed, reflect final figures for those years.

Beginning with the 1993 taxable year, we sent notices to additional nonfilers who we identified through information provided by the Internal Revenue Service, Employment Development Department, and the Board of Equalization. Prior to the 1993 taxable year, we only sent filing enforcement notices to those corporations that had previously filed California tax returns, but had not done so for the year in question.

**TABLE 3B
CORPORATION TAX LAW
Multiple NPAs for the Same Taxpayer – 2002**

| Corporations With... | Number of Taxpayers | Tax Assessed (Millions) | Average Assessment per Taxpayer |
|----------------------|---------------------|-------------------------|---------------------------------|
| One NPA | 530 | \$ 15.9 | \$ 30,073 |
| Two NPAs | 425 | 57.9 | 136,220 |
| Three NPAs | 176 | 44.3 | 251,898 |
| Four or more NPAs | 305 | 893.3 | 2,928,825 |
| Totals/Average | 1,436 | \$ 1,011.5 | \$ 704,358 |

**TABLE 4
PERSONAL INCOME TAX LAW
Finalized 2002 NPAs Issued by Taxable Year**

| Taxable Year | Number of NPAs | | Assessment Amount (Thousands) | | Average Assessment Amount |
|--------------|----------------|------|-------------------------------|-------|---------------------------|
| | | % | | % | |
| 1996 & prior | 3,636 | 0.8 | \$ 27,177 | 1.4 | \$ 7,474 |
| 1997 | 993 | 0.2 | 6,558 | 0.3 | 6,604 |
| 1998 | 2,356 | 0.5 | 14,478 | 0.8 | 6,145 |
| 1999 | 43,787 | 9.9 | 108,271 | 5.7 | 2,473 |
| 2000 | 160,968 | 36.3 | 752,430 | 39.3 | 4,674 |
| 2001 & later | 231,557 | 52.2 | 1,006,626 | 52.6 | 4,347 |
| Totals/Avg. | 443,297 | 100 | \$ 1,915,540 | 100.0 | \$ 4,321 |

Individuals typically have audit changes for just one year. More than 90 percent of the individuals who received NPAs during 2002 had audit changes for a single year.

RTC Section 21006(b)(1)(E) – "Whether professional tax preparation assistance was utilized by the taxpayer."

An in-house accounting department or an accounting or legal firm prepares virtually all corporate returns. Therefore, we consider corporate tax returns as prepared by professionals.

We consider that taxpayers prepared their individual tax returns in the absence of a paid preparer's signature.

**TABLE 5A
PERSONAL INCOME TAX LAW
Resident Tax Return Preparation, 2001 & 2002 Process Years**

| Preparer | 2001 Returns Processed | | 2002 Returns Processed | | % Change |
|---------------|------------------------|--------------|------------------------|--------------|----------|
| | (Thousands) | % | (Thousands) | % | |
| Taxpayer | 4,511 | 33.6 | 3,762 | 27.7 | -5.9 |
| Professional | 8,913 | 66.3 | 9,834 | 72.3 | 6.0 |
| VITA* | 17 | 0.1 | 7 | 0.0 | -0.1 |
| Totals | 13,441 | 100.0 | 13,603 | 100.0 | |

* Volunteer Income Tax Assistance. This is a program that provides tax return preparation assistance for the elderly, disabled, non-English speaking, and those with low incomes.

**TABLE 5B
ELECTRONIC FILING AND PAYMENT STATISTICS**

| Activities | July 31, 2002 | July 31, 2003 | % Change |
|--|---------------|---------------|----------|
| e-File | 3,094,000 | 3,740,000 | 21.0 |
| TeleFile | 234,000 | 122,000 | -48.0 |
| * Online Filing (a subset of e-file) | 713,000 | 856,000 | 20.0 |
| Direct Deposit of Refund | 1,901,000 | 2,360,000 | 24.0 |
| Direct Debit of Balance Due (EFW) | 88,000 | 97,000 | 10.0 |
| Credit Card Payments (Average payment is \$814) | 36,000 | 85,000 | 136.0 |

* We include this volume in the e-file volume.

RTC Section 21006(b)(1)(F) – "Whether income tax or bank and corporation tax returns were filed by the taxpayer."

**TABLE 6
CORPORATION TAX LAW
Nonfilers Detected Through the Automated Nonfiler System**

| Tax Year | NPAs | Returns Filed | Total Assessments (Millions) ¹ |
|----------|--------|--------------------|---|
| 1994 | 12,671 | 7,708 ² | 273.5 |
| 1995 | 15,601 | 3,772 ² | 379.5 |
| 1996 | 16,790 | 5,014 ² | 592.0 |
| 1997 | 16,019 | 8,170 ³ | 432.4 |
| 1998 | 12,473 | 8,516 ⁴ | 387.2 |
| 1999 | 11,847 | N/A | 383.9 |

1. These amounts represent tax, penalties, and interest.
2. We extrapolate these results from a sample test performed in August of 1999.
3. This result is a cumulative total as of July 1, 2000.
4. This result is a cumulative total as of August 1, 2001.

**TABLE 7
PERSONAL INCOME TAX LAW
Nonfilers Detected Through the Automated Nonfiler System**

| Fiscal Year | NPAs Issued ¹ | Returns Filed ² | Total Assessments (Millions) ³ |
|------------------------|--------------------------|----------------------------|---|
| 1994/1995 | 369,307 | 266,687 | \$ 634 |
| 1995/1996 | 348,288 | 232,845 | \$ 857 |
| 1996/1997 | 404,509 | 241,649 | \$ 926 |
| 1997/1998 | 398,729 | 245,453 | \$ 953 |
| 1998/1999 | 420,679 | 241,294 | \$ 1,061 |
| 1999/2000 | 459,777 | 220,496 | \$ 1,188 |
| 2000/2001 | 87,647 ⁴ | 99,376 ⁴ | \$ 261 ⁴ |
| 2001/2002 | 294,216 ⁴ | 151,102 ⁴ | \$ 1,669 |
| 2002/2003 ⁵ | 594,212 | 258,629 | \$ 4,122 |

1. The total number of Notices of Proposed Assessment mailed by the Personal Income Tax Nonfiler Program during the fiscal year.
2. The Compliance Automated Tracking System determines the "returns filed" volumes. The system tracks nonfiler accounts from the issuance of the demand for a return until the account resolution.
3. The total includes tax, penalties, and interest assessed.
4. The totals are lower than normal due to the delay in implementation of the new automated nonfiler system and a subsequent delay in mailing nonfiler notices.
5. Fiscal year 2002/2003 numbers are higher than normal primarily because we worked multiple years at the same time.

**PART II
TAXPAYER FILING ERRORS**

The tables below reflect errors taxpayers made on 2002 original tax returns processed between January 1, 2003, and August 8, 2003. We issue *Return Information Notices* to taxpayers who file returns with errors that result in a change of tax liability. We explain the errors in adjustment paragraphs within the notices. The total number of adjustment paragraphs we issue does not equal the total number of *Return Information Notices* we send, because many returns contain multiple errors, each error requiring an explanation.

**TABLE 8A
INDIVIDUAL RETURN VALIDATION ADJUSTMENTS: 2003 PROCESS YEAR SUMMARY
Number of Adjustment Paragraphs Issued by Return Type**

| Adjustment Type | 540A | 540 2EZ | 540 | 540NR | Grand Total | % of Total |
|-----------------------------|----------------|----------------|----------------|---------------|----------------|----------------|
| Filing Status Adjustment | 141 | 70 | 200 | 63 | 474 | .1% |
| Exemptions Adjustment | 58,343 | 479 | 35,795 | 6,302 | 100,919 | 12.9% |
| AGI Adjustment | 398 | 327 | 567 | 3,955 | 5,247 | .7% |
| Deductions Adjustment | 36,745 | 241 | 32,065 | 5,615 | 74,666 | 9.5% |
| Tax Computation Adjustment | 18,445 | 571 | 39,899 | 9,911 | 68,826 | 8.8% |
| Special Credits Adjustment | 1 | 0 | 450 | 92 | 543 | .1% |
| Renter's Credit Adjustment | 13,438 | 6,599 | 7,574 | 1,105 | 28,716 | 3.7% |
| Total Tax Adjustment | 24,645 | 83,202 | 25,092 | 4,340 | 137,279 | 17.5% |
| Withholding Adjustment | 4,273 | 3,085 | 11,393 | 5,831 | 24,582 | 3.1% |
| Estimate Payment Adjustment | 19,802 | 1,925 | 144,412 | 7,889 | 174,028 | 22.2% |
| SDI Adjustment | 11,086 | 0 | 33,946 | 1,204 | 46,236 | 5.9% |
| CDC Adjustment | 8,064 | 0 | 15,101 | 1,285 | 24,450 | 3.1% |
| Nonresident Adjustment | 3 | 1 | 155 | 44,222 | 44,381 | 5.7% |
| Miscellaneous Adjustment | 12,444 | 7,479 | 29,495 | 2,876 | 52,294 | 6.7% |
| TOTAL | 207,828 | 103,979 | 376,144 | 94,690 | 782,641 | 100.00% |

**TABLE 8B
INDIVIDUAL RETURN VALIDATION ADJUSTMENTS: 2003 PROCESS YEAR SUMMARY
Number of Adjustment Paragraphs Issued by Filing Method**

| Adjustment Type | e-File | Paper | TeleFile | Internet | Grand Total | % of Total |
|-----------------------------|---------------|----------------|------------|------------|----------------|----------------|
| Filing Status Adjustment | 2 | 472 | 0 | 0 | 474 | .1% |
| Exemptions Adjustment | 366 | 100,544 | 5 | 4 | 100,919 | 12.9% |
| AGI Adjustment | 271 | 4,975 | 1 | 0 | 5,247 | .7% |
| Deductions Adjustment | 2,824 | 71,837 | 1 | 4 | 74,666 | 9.5% |
| Tax Computation Adjustment | 373 | 68,451 | 1 | 1 | 68,826 | 8.8% |
| Special Credits Adjustment | 69 | 474 | 0 | 0 | 543 | .1% |
| Renter's Credit Adjustment | 228 | 28,487 | 1 | 0 | 28,716 | 3.7% |
| Total Tax Adjustment | 991 | 136,253 | 33 | 2 | 137,279 | 17.5% |
| Withholding Adjustment | 955 | 23,595 | 14 | 18 | 24,582 | 3.1% |
| Estimate Payment Adjustment | 30,371 | 143,563 | 25 | 69 | 174,028 | 22.2% |
| SDI Adjustment | 8,312 | 37,918 | 0 | 6 | 46,236 | 5.9% |
| CDC Adjustment | 2,295 | 22,155 | 0 | 0 | 24,450 | 3.1% |
| Nonresident Adjustment | 1,758 | 42,623 | 0 | 0 | 44,381 | 5.7% |
| Miscellaneous Adjustment | 2,521 | 49,703 | 69 | 1 | 52,294 | 6.7% |
| TOTAL | 51,336 | 731,050 | 150 | 105 | 782,641 | 100.00% |

We issued 528,050 *Return Information Notices* out of 13,316,061 current year original tax returns processed from January 1, 2003, through August 8, 2003. This is an adjustment rate of 4 percent. The adjustment rate for the same time period last year was 4.2 percent (558,076 *Return Information Notices* issued for 13,445,650 returns). In the preceding tables, we displayed the adjustments by return type and filing method.

The following analysis provides information regarding each adjustment type and a description of what typically causes each type of adjustment. Assembly Bill 1115 (Stats. 2001, Ch. 920) changed the way we compute tax on the form 540NR. There were no other significant form or legislative changes that would affect the adjustments. Overall, the number of *Return Information Notices* we issued to taxpayers decreased by 5.4 percent compared to last year. The decrease in adjustments was spread evenly over all error types, with some exceptions that we discuss below.

Filing Status (0.1 percent of all adjustments) – This adjustment occurs for two primary reasons: either a taxpayer files a tax return jointly, yet the return contains only one name, social security number, and signature; or a taxpayer claims the head of household filing status, but does not include the name of the qualifying person. We adjust the return to reflect the single filing status, and recalculate the corresponding exemption, standard deduction, and tax amounts. We issue a *Return Information Notice* advising the taxpayer that we need additional information to allow the filing status the taxpayer claimed.

Exemptions (12.9 percent of all adjustments) – This adjustment occurs when taxpayers do not claim an exemption amount, claim the incorrect personal, blind, or senior exemption amount, claim a number of dependents that does not match the number of dependent names, or calculate exemptions incorrectly.

Adjusted Gross Income and California Adjustments (0.7 percent of all adjustments) – This adjustment occurs when taxpayers erroneously calculate California adjusted gross income, usually by improperly applying the California additions and subtractions (Schedule CA) from the federal adjusted gross income amount.

Deductions (9.5 percent of all adjustments) – This adjustment occurs when taxpayers claim the incorrect standard deduction amount for their filing status, claim the incorrect filing status when another person can claim them as a dependent on their return, claim an itemized deduction amount lower than the standard deduction amount, or leave the deduction line blank.

Tax Computation (8.8 percent of all adjustments) – This adjustment occurs when taxpayers select a tax amount from the incorrect row or column of the tax table, or calculate taxable income incorrectly.

Special Credits (0.1 percent of all adjustments) – This adjustment occurs when taxpayers claim a credit for which they were not eligible, commonly due to income limitations, maximum credit amounts, or carryover limitations.

Renter's Credit (3.7 percent of all adjustments) – This adjustment occurs when taxpayers do not qualify for this credit due to filing status or income limitations. The number of adjustments issued this year decreased again.

Total Tax Liability (17.5 percent of all adjustments) – This adjustment occurs when taxpayers make calculation errors after they compute tax, and before they apply prepaid credits (withheld tax, estimate payments, State Disability Insurance). The difference between this category and tax computation errors is the tax return line location where the error occurs.

Withheld Tax (3.1 percent of all adjustments) – This adjustment occurs when taxpayers claim withholding amounts different from the allowable amount, which we determine from a variety of sources, including a database of Employment Development Department information.

Estimate Payment Credit (22.2 percent of all adjustments) – This adjustment occurs when taxpayers claim estimate and extension payment amounts that do not match payment amounts contained on our accounting system. This category does not include erroneous calculations of estimate penalties.

State Disability Insurance (5.9 percent of all adjustments) – This adjustment occurs when taxpayers claim more excess state disability insurance than allowable.

Child and Dependent Care Expenses Credit (3.1 percent of all adjustments) – This adjustment occurs when taxpayers incorrectly claim the Child and Dependent Care Expenses Credit. These errors include simple math errors, nonresident filers who did not maintain a California home for a qualified individual, and taxpayers filing as married filing a separate return. Increased taxpayer and practitioner knowledge about the credit and modifications to the form clarifying eligibility rules continue to decrease adjustments.

Nonresident Only (5.7 percent of all adjustments) – This adjustment occurs when taxpayers make errors involving proration calculations and Schedule CA transfers. In addition to Nonresident Only errors, each of the other error types can occur on a nonresident return. Assembly Bill 1115 (Stats. 2001, Ch. 920) changed the way Franchise Tax Board computes the tax on the form 540NR contributing to the increase in adjustments from 2.2 percent in 2002 to 5.7 percent this year.

Miscellaneous Computation (6.7 percent of all adjustments) – This adjustment occurs when taxpayers make miscellaneous addition or subtraction errors. An example is when taxpayers make an error in subtracting an estimate credit transfer amount from their overpaid tax amount.

PART III

TAXPAYERS' BILL OF RIGHTS HEARING

Revenue and Taxation Code Section 21006(b)(2) – “Conduct an annual hearing before the Board itself where industry representatives and individual taxpayers are allowed to present their proposals for changes to the Personal Income Tax Law or the Corporation Tax Law which may further facilitate achievement of the legislative findings.”

We held the annual Taxpayers' Bill of Rights hearing on Tuesday, November 26, 2002, at the State Board of Equalization, Sacramento, California. Three individuals presented proposals to the three-member Board.

Roland A. Boucher Form 540 2EZ for Seniors

Mr. Boucher discussed his continuing efforts to remove income limitations so more seniors could file using the Form 540 2EZ.

Several changes have been made to the Form 540 2EZ for tax year 2003 that will make it a viable alternative for many senior taxpayers. The most significant changes are the inclusion of the senior exemption credit and social security income.

In a letter to Mr. Boucher dated January 27, 2003, Taxpayer Advocate Debbie Newcomb thanked him for his efforts to make it easier for seniors to file. She indicated that Franchise Tax Board staff would continue to look at changes allowing more California taxpayers to use the Form 540 2EZ.

Gina Rodriquez, representing Spidell Publishing Assembly Bill 1115 Clean-Up

Ms. Rodriquez requested statutory language to substantiate Franchise Tax Board's formulas for prorating losses and carryovers in light of Assembly Bill 1115 (Stats. 2001, Ch. 920).

Functional Consolidation of Tax Agencies

Ms. Rodriquez requested that the Franchise Tax Board, the Employment Development Department, and the Board of Equalization move toward a functional consolidation of certain functions of these agencies such as:

- Offer in Compromise
- Nanny Tax/Elder Care Tax
- Use Tax

FTB Forms and the Web

Ms. Rodriquez requested that Franchise Tax Board provide a directive to staff to update tax forms on their Website when there is a legislative change that affects the forms.

Subsequent to the hearing, Franchise Tax Board staff developed a policy and procedures to ensure that appropriate changes are made to forms on the Website, as soon as possible after statutory, regulatory or judicial actions are taken that impact the content of the forms.

Tax Code and Regulation Simplification

Ms. Rodriguez said that at a previous Bill of Rights hearing, she requested the Board devote some resources to find a way to simplify the tax code. She felt it was imperative that Franchise Tax Board staff strive for simplicity by incorporating federal Internal Revenue Code sections, not act sections, whenever possible.

Ms. Rodriguez said she is seeing a growing trend of regulations drafted without an operative date.

California Ridesharing Benefits

Ms. Rodriguez stated that at a previous Board meeting, she had presented the problems with California's ridesharing benefits. If the Board won't support statutory simplification through conformity, she requested that they provide guidelines for the existing rules.

Real Estate Withholding for Individuals

With the new legislative mandate requiring California residents to withhold 3 1/3 percent of the sales price on California real estate, Ms. Rodriguez requested the Board sponsor legislation to reinstate the waiver process for individuals.

In a letter dated January 27, 2003, addressed to Ms. Rodriguez, Taxpayer Advocate Debbie Newcomb responded to her recommendations.

Richard E.V. Harris, representing the Coalition for Complete Audit File Access Complete Audit File Access

Mr. Harris addressed an issue he brought up at the previous Bill of Rights' hearing. He requested a directive requiring Franchise Tax Board to provide a complete copy of the taxpayer audit file, including review notes and reports.

Field Audit Requests for Legal Advice

Mr. Harris suggested that Franchise Tax Board should advise taxpayers when field auditors ask for advice from Franchise Tax Board's Legal Department so taxpayers know who is participating in the audit.

Audit Regulation Process

Mr. Harris complimented staff on the town meetings and suggested similar meetings to get realistic input from taxpayers.

Franchise Tax Board's Legal Department is working with Mr. Harris on his proposals.

PART IV COMPLIANCE

Revenue and Taxation Code Section 21006(c) - "The Board shall include in its report recommendations for improving taxpayer compliance and uniform administration, including, but not limited to, all of the following:

- (1) Changes in statute or board regulations.
- (2) Improvement of training of board personnel.
- (3) Improvement of taxpayer communication and education.
- (4) Increased enforcement capabilities."

STATUTES OR BOARD REGULATIONS

STATUTES

Each year Franchise Tax Board reviews areas of the law and proposes legislation in order to carry out its responsibility of improving taxpayer compliance and enhancing administration. Several areas of the law were identified during the review process for which legislation was proposed to facilitate the department's administration of its duties.

Chaptered Legislation

AB 1742 (Assembly Revenue & Taxation Committee) (Stats. 2003, Ch. 455) – This act:

- Renumbers the tax law code section for the Golden State Scholarshare Trust.
- Simplifies the computation of interest on erroneous refunds.
- Clarifies Franchise Tax Board's authority to use the information contained in the new-hire and contractor registries maintained by the Employment Development Department.

AB 1743 (Assembly Revenue & Taxation Committee) (Stats. 2003, Ch. 185) – This act culminates a code maintenance project to correct cross-references, repeal obsolete provisions, and amend provisions to reflect the current style for drafting legislation.

SB 1061 (Senate Revenue & Taxation Committee) (Stats. 2003, Ch. 633) – This act:

- Adds a definition of the term "taxable year" for California franchise tax purposes that was inadvertently repealed for taxable years beginning on or after January 1, 2000.
- Fundamentally reforms the water's-edge election procedures to resolve problems that arise with elections made under the current contract rules. Under this bill, water's-edge elections will be made by statutory election rather than by contract.

SB 1065 (Senate Revenue & Taxation Committee) (Stats. 2003, Ch. 486) – This act mandates that federal tax elections made by a person prior to becoming a California taxpayer apply for California purposes.

REGULATIONS

Regulation Section 17000.3 – Meetings of the FTB (Bagley-Keene Open Meeting Act)

Effective January 1, 2002, the Bagley-Keene Open Meeting Act was amended to require public dissemination of certain writings distributed to the Board members, when those writings relate to an open session agenda item on which the Board may take action at a noticed Board meeting. This new provision is Government Code section 11125.1, subdivision (c). On December 16, 2002, staff held a formal regulatory hearing in Sacramento on the proposed regulation regarding meetings of the Franchise Tax Board. Two members from the public attended the hearing. Extensive comments were offered at the regulation hearing regarding both the purpose of the original legislation (SB 445, Burton, Stats. 2001, Ch. 670) and whether the language of the proposed regulation furthered that purpose.

Staff has done a preliminary analysis of those comments and notes that additional legislative action may be required in order to fully reflect the suggested changes.

Regulations Sections 17053.36 and 23636 – Joint Strike Fighter Wage Credit and 17053.37 and 23637 – Joint Strike Fighter Property Credit

On March 6, 2002, staff received authorization from the Board to proceed with the formal rulemaking process for each of the four proposed regulations above dealing with the Joint Strike Fighter Property and Wage Credits. On September 13, 2002, a notice was published in the Office of Administrative Law's weekly Notice Register of Franchise Tax Board's intent to adopt these regulations. On October 29, 2002, staff held a formal regulatory hearing in Culver City. Two members from the public attended the hearing. Although several questions were asked at the hearing concerning the application of the credit to unique situations of specific taxpayers, no comments were received concerning the proposed draft regulations. Accordingly, staff did not make any changes to the draft regulations previously approved by the Board. The rulemaking file was submitted to the Office of Administrative Law for approval on December 11, 2002, and filed with the Secretary of State on January 23, 2003. The regulations were adopted on February 24, 2003.

Regulation Section 17952 – Income From Intangible Property

On April 29, 2003, staff received approval from the Board to proceed with draft proposed changes to Regulation 17952. These proposed changes address the timing of the sourcing of gains from sales of intangible personal property. Staff identified a need to clarify when the sourcing of the sale of intangible property should be fixed for purposes of sourcing installment sales proceeds. Under the *mobilia* doctrine, absent a business situs, intangible property is sourced to the state of residence of the owner. If a California resident sells intangible property, the gain is taxable under a residency theory. If a California nonresident sells intangible property, the gain would be sourced to the nonresident's state of residence and California would not tax the gain, unless the intangible property had acquired a California business situs.

However, if a resident sells intangible property under the installment method and subsequently moves away, there may be some ambiguity as to the source of the gain. Arguably, the *mobilia* doctrine already provides that the source of the gain is in California

because that is where the taxpayer was when the property was sold. The source could not have moved with the taxpayer because he or she no longer owned the property.

This has not been an issue in the past because California would have applied Revenue and Taxation Code section 17554 to assert that the gain had already accrued prior to the move. Revenue and Taxation Code section 17554 was repealed in 2002, operative for taxable years beginning on or after January 1, 2002. That section provided for the accrual of income under certain circumstances upon a change of residency. Without Revenue and Taxation Code section 17554, staff believes that a clarification would be prudent.

A symposium was scheduled on August 13, 2003, if public interest was expressed and/or written comments were received by July 8, 2003. No public interest was expressed and no written comments were received so a notice of cancellation was published on Franchise Tax Board's Website on July 30, 2003. Staff anticipates holding the formal public regulatory hearing required under the Administrative Procedure Act sometime in the fall of 2003.

Regulation Section 18001-1 – Credit For Taxes Paid to Another State

On April 29, 2003, staff received approval to commence with a formal regulation project to amend Regulation 18001-1. Currently, the regulation text provides that the credit for income taxes paid to another state will only be applied against "net tax" imposed on the income in the same year. However, the governing statute (Revenue and Taxation Code section 18001, subdivision (a)) does not require that the credit be applied only against the "net tax" on the income in the "same year." Instead, the credit for taxes paid to another state may be properly claimed when the same income that was taxed by the other state is also taxed by California. The proposed change to the regulation eliminates the requirement that the income for which the credit is claimed be recognized in the same year for both states. It is anticipated that a formal public regulatory hearing, required under the Administrative Procedure Act, will be held in November or December of 2003.

Regulation Section 19032 – Audit Practices

Staff held symposiums on December 1, 2000, and April 23, 2001, to solicit public comments concerning the draft regulation addressing the department's auditing practices and procedures. Public comments were taken into account in revising the draft regulation. On March 6, 2002, staff received permission from the three-member Board to proceed with the formal regulation process concerning the remaining unresolved comments. On June 7, 2002, a notice of Franchise Tax Board's intent to adopt this regulation was published in the Office of Administrative Law's weekly Notice Register. A hearing was held on August 19, 2002. Three comments were received. Staff considered these comments and issued a 15-day notice containing minor revisions to the regulation on December 30, 2002. The rulemaking file was submitted to the Office of Administrative Law on February 10, 2003, and was filed with the Secretary of State on March 25, 2003. The regulation was adopted on April 24, 2003.

Regulation Section 19133 – Penalty for Failure to File After Notification

On October 1, 2002, staff received authorization from the Board to proceed with the formal rulemaking process for the above proposed regulation. The Franchise Tax Board's Filing Enforcement system identifies individual taxpayers who have not filed a personal income tax return when a return appears to be required based upon information available to the department. Revenue and Taxation Code section 19133 provides the Franchise Tax Board with the discretionary authority to assess a notice and demand penalty upon those taxpayers who fail to file a tax return upon notice and demand by the Franchise Tax Board.

The proposed regulation is to clarify under what circumstances the Franchise Tax Board will impose a notice and demand penalty upon individual taxpayers. Under the proposed regulation, the Franchise Tax Board will impose the notice and demand penalty only upon those individual taxpayers who are determined to be "repeat nonfilers." A repeat nonfiler is an individual who has received a proposed assessment of tax after receiving and failing to respond to either a request for tax return or a demand for tax return within the previous four years. A repeat nonfiler who fails to respond to a current demand for tax return in the manner and within the time period specified on the demand for tax return will be subject to the imposition of the notice and demand penalty, which is equal to 25 percent of the total tax liability without regard to any payments or credits.

The proposed regulation has been submitted to the State and Consumer Services Agency for approval.

Regulations Sections 20501 – “Medically Incapacitated” Defined, 20502 – “Substantially Equivalent to Property Taxes” Defined, 20503 – Submission of Property Tax Bill, 20504 – Proof of Disability, and 20505 – Opportunity to Cure Deficiency

Staff received permission from the Board on April 29, 2003, to proceed with a formal regulation process for each of the five proposed regulations above dealing with Senior Citizens Homeowners and Renters Property Tax Assistance laws. These proposed regulations are designed to define certain unclear terms and specifically identify the types of evidence needed to establish a claimant's eligibility under the criteria set forth in the relevant statutes. The definitions in these proposed regulations are based upon similar and/or referenced statutory or decisional definitions, as well as a decision by the State Board of Equalization, *Appeals of Helen Cantor, et al.*, 2002-SBE-008, Nov. 13, 2002.

The proposed regulations were submitted to State and Consumer Services Agency on July 30, 2003, for approval.

Regulation Section 23334 – Tax Clearance Certificate

During 2000, staff received Board permission to proceed with a rulemaking project to amend Regulation 23334. This regulation explains generally that in order to complete the dissolution, withdrawal, or merger process with the California Secretary of State, a corporation must obtain a tax clearance certificate from the Franchise Tax Board and file it with the Secretary of State. Staff determined that many corporations are unaware that they continue to remain subject to the minimum franchise tax until the actual completion of the dissolution,

withdrawal, or merger process. As a result, staff felt that the existing regulation needed greater clarity.

The proposed amendments were noticed and public comments were received, but due to additional changes staff believed were necessary at that time, they were unable to complete the project within the time period mandated under the Administrative Procedure Act.

Staff prepared the additional amendments and received approval from the Franchise Tax Board to proceed with the revised language on March 25, 2002. The Office of Administrative Law published a notice of hearing on June 21, 2002. The comment period ended on August 5, 2002. Staff indicated in the notice that a public hearing would not be held unless requested at least 15 days before the close of the written comment period. No one requested a hearing, but one comment was received that required minor modifications of the proposed text. Staff incorporated the comment into the regulatory text and a 15-day notice was published. The rulemaking file was submitted to the Office of Administrative Law for approval on November 22, 2002, and, after approval, was filed with the Secretary of State on January 9, 2003, effective February 8, 2003.

Regulation Section 24344(c) – Offset of Interest Expense Incurred for Foreign Investment

Staff received permission to proceed with the proposed amendments to this regulation on March 6, 2002. The amendments to this regulation would incorporate the definition of “commonly controlled group” as found in Revenue and Taxation Code Section 25105 into California Code of Regulations, Title 18, Section 24344, Subsection (c), and would correct the word “and” to “or” and make the requirements of California Code of Regulations, Title 18, Section 24344, Subsections (c)(2)(A)1.a. and b., disjunctive rather than conjunctive.

On May 24, 2002, a notice of Franchise Tax Board’s intent to amend this regulation was published in the Office of Administrative Law’s weekly Notice Register. A hearing was set for July 22, 2002. Staff indicated in the notice that a public hearing would not be held unless requested by an interested person at least 15 days before the close of the written comments period. No one requested a hearing and no comments were received. The rulemaking file was submitted to the Office of Administrative Law on August 28, 2002, and, after approval, was filed with the Secretary of State on October 8, 2002, effective November 7, 2002.

Regulations Sections 25130 – Property Valuation and 25137(b) – Other Apportionment Methods

On October 18, 2002, the Franchise Tax Board issued FTB Notice 2002-4 announcing a symposium to solicit public comments on proposed amendments to California Code of Regulations, Title 18, Section 25137, Subsection (b) and conforming amendments to California Code of Regulations, Title 18, Section 25130. The proposed amendments would add language to the two regulations designed to address how to calculate the net annual rental rate of a taxpayer for property factor purposes for the use of the property of someone other than the taxpayer from which natural resources such as timber, oil, gas, or hard minerals are extracted.

Staff received written comments by the December 31, 2002, deadline stated in FTB Notice 2002-4. On January 29, 2003, a symposium was held, during which additional public comments were orally presented to staff.

Currently, staff is working with interested members of the public to make certain technical changes to the proposed regulatory amendments. Staff does not believe that a second symposium will be necessary due to both the technical nature of the public comments and the amicable working relationship between staff and interested members of the public with respect to resolving the relatively minor technical differences in the current language of the proposed regulatory amendments.

Regulation Section 25137-2 – Long-Term Contracts for the Manufacture of Tangible Personal Property

On March 6, 2002, staff received permission from the Franchise Tax Board to release draft proposed changes to the existing regulation. The proposed changes addressed the apportionment rules to be used when a taxpayer has elected to account for the sales of tangible personal property under the rules governing the long-term contract method of accounting. On March 14, 2002, a notice was published to inform the public of the proposed changes and to announce a symposium scheduled for April 29, 2002. The notice stated that if no public interest was voiced and no written comments were received by April 12, 2002, the symposium would be cancelled. No comments were received and no public interest was voiced. Subsequently a formal public regulatory hearing notice under the Administrative Procedure Act was mailed and published on September 20, 2002. The original notice specified that no oral hearing would be held unless a request was made at least 15 days before the close of the written comment period on November 8, 2002. Since no request for an oral hearing was received prior to that date, no oral hearing was held. No written comments were received during the public comment period. The rulemaking file was submitted to the Office of Administrative Law on December 5, 2002, and, after approval, was filed with the Secretary of State on January 21, 2003, effective February 20, 2003.

TRAINING

We strive to assure quality service to the public by developing the skills and abilities of our employees through ongoing training programs.

Filing Services

We provide basic training on our Taxpayer Information computer system to new employees in the Filing Services Bureau. We use these training classes to introduce our Filing Services Bureau employees to Taxpayer Information account processing, to model effective use of the Taxpayer Information computer system manual, and to practice basic account transactions. In addition, we offer advanced Taxpayer Information computer system training to employees responsible for more complex and specialized account analysis and resolution.

We provide basic training on our Business Entity Tax System to employees assigned to work with business entity accounts. We use these training classes to introduce Filing Service Bureau employees to Business Entity Tax System account processing, to model effective use of the system manual, and to practice basic account transactions. We offer advanced Business Entity Tax System training to employees responsible for more complex and specialized account analysis and resolution.

We provide basic training on the Accounts Receivable Collection System and the Integrated Nonfiler Compliance system to all Filing Services Bureau employees assigned to handle collection accounts. These training classes introduce employees to billing cycles and account analysis. We offer advanced Accounts Receivable Collection system training to employees responsible for more complex and specialized account analysis, resolution, and quality review.

We provide extensive training on tax laws, provisions of the Taxpayers' Bill of Rights, account analysis and resolution, security and disclosure, and telephone techniques to new public service staff in the Filing Services Bureau. Because our public service staff are often the public's only contact with government, we include a discussion of our goals, such as providing excellent service and resolution of each caller's issue with only one contact whenever possible.

All public service staff in the Filing Services Bureau receive ongoing training on changes to tax laws, information systems, and procedures.

Collections

The Accounts Receivable Management Division provides training for Compliance Representatives and Tax Technicians to ensure they have the required skills and abilities to administer the tax laws mandated by the legislature. All new hires into the Accounts Receivable Management Division collection program go through a rigorous initial six-week

training program consisting of core compliance classes. Some examples of the core classes are:

- Security and Disclosure
- System Training
- Account Resolution
- Customer Service
- Penalties and Interest
- Filing Requirements
- Installment Agreements
- Tax Assessments
- Taxpayer Bill of Rights

In addition to compliance-related training, we provide mandatory training on taxpayers' rights and information security. We coordinate Collections training primarily through the Accounts Receivable Management Division Career Center, whose staff and management work as a team to provide classroom instruction to new collectors, and skills enhancement for seasoned employees. To keep the cost of training at a minimum, the Career Center partners with journey-level staff directly involved in the collection process to assist in training workshops. We use computer-based training in the Collections Division to provide low-cost individual instruction to employees. Division employees are strongly encouraged to continue the learning process throughout their careers by enrolling in classes to refresh their existing skills or knowledge.

Audit

Recently, the Audit Division aligned its recruiting and training functions under a single leader. One of the reasons for this change is to ensure their new employees are familiar, from initial contact, with the department's values and approach to protecting taxpayers' rights while pursuing our mission. We provide professional training to our auditors. They receive initial and ongoing support for their skills development throughout their careers in the Audit Division. Most new auditors complete a six-week basic professional auditor series in an academy format to establish a baseline expertise. The series develops skills in the following areas:

- Orientation to California state service
- Organizational mission and values
- Principles of tax administration
- Audit process
- Technologies and work systems
- Research methodologies
- Tax law
- Taxpayer rights
- Information security
- Policies and procedures
- Case management protocols
- Quality review

- Customer service
- Plain language guide

New auditors continue learning on the job throughout their probationary period and beyond. We provide ongoing technical training through Academy-developed programs and onsite college programs that address:

- Principles of accounting
- Tax law changes
- Scope of business practices
- Legislative initiatives
- Taxpayer education
- Promotion of tax law compliance

We also support our auditors who seek certified public accountant status. Under new guidelines, we provide certified public accountants with continuing education credit for courses we develop and administer.

Throughout new auditor training, we emphasize the importance of building relationships with taxpayers and their representatives. With the reorganization of recruiting and training under one umbrella, we help supervisors with staff development throughout the hiring and probationary periods and beyond.

As part of our ongoing commitment to "protect taxpayer privacy and ensure security of taxpayer information" we have taken major strides in presenting organization-wide training to ensure our auditors understand and comply with our goals. The Audit Division is taking steps to incorporate this information into subsequent training sessions to guarantee consistency in application throughout the division.

Development of an auditor's expertise through these various means supports our mission, and the "Statement of Principles of Tax Administration." These principles direct us to carry out tax policy by correctly applying the laws enacted by the Legislature; to determine the reasonable meaning of various code provisions following legislative intent; and to perform this work in a fair and impartial manner. To assure continuity, the audit training staff evaluates auditor-training courses and conducts ongoing learning needs assessments to determine how we can improve audit or training and what new topics we need to address.

TAXPAYER COMMUNICATION/EDUCATION

It is our goal to provide taxpayers and tax practitioners with the information they need to file their state tax returns completely, accurately, and timely. Some of the strategies we use to continually improve our communication with the public include:

1. Providing well-written materials for accurate filing by:
 - Ensuring that tax booklets contain forms and instructions that are clear and easy to understand.
 - Reviewing and revising our notices, forms, and publications to provide accurate information.
 - Developing new forms and filing methods designed to simplify the filing process.
2. Distributing tax products using methods that are convenient for taxpayers and tax practitioners. Our distribution efforts include:
 - Mailing tax booklets to taxpayers who used paper forms in the previous year.
 - Providing commonly used forms in banks, post offices, libraries, Franchise Tax Board field offices, and other government agencies throughout the state.
 - Providing tax forms and publications on the Internet through the California Home Page at www.ca.gov or directly through the department's Website at www.ftb.ca.gov.
 - Providing advance drafts of tax forms to software developers, and maintaining standards and an approval process for development of substitute forms and scannable forms generated by commercial software products.
3. Participating with other tax agencies and state departments to develop cooperative communication efforts by:
 - Providing easy access to a variety of tax information through hypertext links from one site to another on the California Home Page and individual agency Websites and through the California Tax Information Center Website at www.taxes.ca.gov.
 - Establishing joint field offices and providing service to taxpayers and tax practitioners through a single call, regardless of the tax agency called.
 - Participating in small business conferences with other state departments and agencies.
 - Developing and maintaining a joint e-file marketing program with the Internal Revenue Service to disseminate e-file-related information, participation requirements, and training to tax practitioners.
 - Educating specific groups in partnership with the Internal Revenue Service through the Volunteer Income Tax Assistance/Tax Counseling for the Elderly, VITA Military, and Homeowner and Renter Assistance volunteer programs.
4. Providing information on our Website such as regulations, press releases, frequently asked questions, and program-specific information, including personal income tax refund status, account balance, and payment information. Taxpayers and tax practitioners also can find information on the various e-programs.
5. Issuing statewide press releases to inform taxpayers of changes to the tax law and using *Tax News* to inform tax practitioners of legislative changes, e-file updates, new

programs, etc. An ongoing media effort is a major component in our goal to reduce errors.

6. Maintaining and enhancing an Interactive Voice Response system that provides automated telephone service to a large number of callers at a low cost. The Interactive Voice Response system provides recorded responses to the most frequently asked questions regarding general state tax information. The system also allows callers to:
 - Check the status of their current year personal income tax and homeowner and renter assistance refunds.
 - Order state tax forms for the current year and prior two years.
 - Order homeowner and renter assistance claim forms for the current year.
 - Order current year federal tax booklets and resolve some filing enforcement issues.
 - Check personal income tax account balance information and verify various payments.
 - File personal income tax returns through the TeleFile program.
 - Transfer to a Franchise Tax Board representative when necessary.
7. Improving products and services to persons with disabilities by:
 - Providing the personal income tax booklet in a large-print version and on audiocassette.
 - Improving the overall readability of the Homeowner and Renter Assistance Booklet and providing it on audiocassette.
 - Using a diagnostic software tool that analyzes Web pages, helping to increase Internet accessibility.
8. Providing information and assistance to taxpayers and tax practitioners in Spanish and other languages by:
 - Partnering with agencies, organizations, and individuals to provide tax information and assistance in various languages to non-English speaking communities through Volunteer Income Tax Assistance and Homeowner and Renter Assistance volunteer sites.
 - Developing informational materials such as press releases, informational flyers, brochures, etc., in various languages.
 - Maintaining and enhancing an IVR system that provides automated telephone service to a large number of Spanish-speaking persons.
 - Providing information in Spanish on the Internet.
9. Marketing of e-programs by:
 - Conducting direct mail efforts to inform tax professionals and taxpayers about e-programs.
 - Requesting hyperlinks to our Website from other strategic Websites.
 - Participating in various statewide tax professional organization events.
 - Developing and co-sponsoring with the Internal Revenue Service e-file-focused seminars for tax professionals.
 - Partnering with the State Controller's office to promote e-file to state employees through payroll inserts, posters, a global message printed on employees' paychecks and an article in employee newsletters.

10. Continuing to gather input from stakeholders. This helps us modify and enhance our programs based on what our stakeholders truly want and need.
11. Providing outreach through our Collections Program to help taxpayers and tax professionals understand and comply with tax laws by:
 - Providing information online including the Collections Procedure Manual, answers to questions about bills and notices, what taxpayers can do if they are unable to pay (offer in compromise, installment agreement, and credit card payment), as well as phone numbers and addresses.
 - Maintaining a Collections Call Center staffed with collection experts to answer questions and assist taxpayers with collection problems.
 - Providing assistance directly to the tax professional community through the Tax Practitioner Liaison Unit. Collection experts are available to answer questions via telephone, a FAX help line, or our “911 – Request for Relief From Hardship” form.
 - Providing presentations on the offer in compromise, installment agreement, and collection programs.
 - Forming an Innocent Spouse Unit to develop and conduct outreach workshops in response to Taxpayers’ Bill of Rights legislation changing Innocent Spouse Relief provisions. The unit also developed and will launch an interactive Web page dedicated to Innocent Spouse Relief on our Website.

ENFORCEMENT

Integrated Nonfiler Compliance Program

Our Integrated Nonfiler Compliance Program identifies and contacts individuals and business entities that have a requirement to file a California tax return yet have not done so.

Some of the taxpayers we contact are wage earners, self-employed individuals, individuals with unreported capital gains, nonresidents with California source income, and individuals who have partnership income. Beginning with tax year 1997, our program began contacting individuals who paid large amounts of mortgage interest with no reported income source and no California tax return filed.

Our Corporation Nonfiler Program uses information from other taxing agencies (Internal Revenue Service, State Board of Equalization, and Employment Development Department) to identify potential nonfilers.

Audit

We work with the federal government and other state agencies to identify new areas of noncompliance and to optimize the effectiveness of our audit resources. Our Audit Division is currently focused on:

- Curtailing the use of abusive tax schemes by individuals and business entities.
- Auditing business entity taxpayers, specifically large multinational corporations, pass through entities, and limited liability companies.
- Examining compliance issues unique to California law.

Regulations guiding our audit practices were finalized in 2003. The audit regulations stipulate responsibilities, expectations, and timeframes taxpayers can experience during an audit. Taxpayers can expect their audits completed within two years. We incorporated many of our best audit practices identified in meetings with practitioners throughout the country into these audit regulations.

We have increased our examinations of abusive tax avoidance transactions and wherever possible, are offering taxpayers the opportunity to voluntarily comply. California's adoption of the federal Offshore Voluntary Compliance Initiative led the way for other states, and serves as a model of cooperation and communication with the Internal Revenue Service.

We continue to use technology to improve communications with taxpayers, to minimize audit intrusiveness, and to ensure taxpayer privacy. We are in the pilot phase of our Secured Electronic Communications project which will allow taxpayers expanded options in communicating with our audit staff. We are continuing to integrate and streamline our audit systems to better utilize existing data and minimize unnecessary contact with taxpayers.

In an ongoing effort to monitor and improve customer service, our Audit Division continues to conduct taxpayer opinion surveys addressing field examinations, and correspondence

opinion surveys addressing desk examinations. The latest surveys demonstrate that 88 percent of those who responded were satisfied with how we conduct our audits.

Collections

Our Collections Program collects tax and non-tax debts on behalf of the state of California. Tax debts are primarily unpaid audit and return assessments for individuals and corporations. Non-tax debts include delinquent child support, vehicle registration fees, and various court-ordered and industrial health and safety debts. Our Collections Program fills a vital function within state government, as Franchise Tax Board provides more than half of the revenue for the state's general fund.

Our Collections Program uses a variety of methods and tools to enforce the laws covering tax and non-tax debt.

- **Liens and Levies:** Franchise Tax Board has administrative authority to issue liens and to levy wages and bank accounts. We can establish liens and levies through individual collectors or through our Accounts Receivable Collection System.
- **Accounts Receivable Collection System:** Our Collection Program's automated system is a powerful tool, processing over one million individual and business accounts annually. Using over 10,000 business rules, it evaluates the unique characteristics of each account, applying a set of actions and collection notices over time that will best meet the needs of each account. This tailored approach to each account greatly reduces the intrusion into taxpayers' lives and gives them choices for how to best resolve their accounts. Our Accounts Receivable Collection System leverages multiple information sources and automates many key collection functions: fee assessment, skip tracing, discharge, and levies against wages and financial institutions. Reliance on the automated system to perform these collection tasks maximizes efficiency and frees collectors to answer questions, solve problems, and help taxpayers find ways to pay their debts.
- **Field Collections and Investigations:** In addition to automated collections and office collections, Franchise Tax Board's field collectors make in-person contact with tax debtors who are persistently noncompliant. Field offices are located throughout California and in several major cities in other states. Our special investigations function focuses on the underground economy. Special Investigators bring criminal charges against the most egregious cases of tax avoidance and evasion, resulting in many millions of dollars of tax revenue and prosecution of criminal activities.
- **Contract Collections:** Franchise Tax Board has contracts with several private collection agencies to pursue collections on workloads that Franchise Tax Board is not otherwise funded for: out-of-state cases, for example, where our levy authority does not apply.
- **Collection Approach:** Although the primary mission of the Franchise Tax Board Collections Program is to enforce the tax laws by collecting delinquent taxes, this mission is accomplished within a customer-centered approach emphasizing respect and sensitivity toward the plight of individual taxpayers. Adopting this approach makes good business sense. Resolving tax debts benefits the tax debtor and the state. Our Collections Program

seeks the best way to resolve each individual account, and to provide resolution options to taxpayers by:

1. Offering many forms of assistance and communications methods. We maintain our own collections:
 - a) Call center providing a staff of collections experts, including several who are bilingual to answer taxpayer's questions.
 - b) Tax practitioner fax hotline to provide direct access for tax representatives and practitioners.
 - c) Internet Website to provide detailed information and many online forms.
2. Expanding and simplifying our Installment Agreement and Offer In Compromise options over the past five years. If taxpayers are unable to pay the full amount they owe in one payment, they may choose to make installment payments, based on their monthly ability to pay, until their tax debt is paid in full. If they have experienced a catastrophic event that permanently affects their ability to fully pay their tax debt, they may apply for an Offer In Compromise to resolve their tax debt by paying what they can afford.
3. Allowing taxpayers to claim "innocent spouse" status when their spouses or former spouses have failed to pay the taxes they owe, without the knowledge or consent of the applicant for innocent spouse status. We conformed to the Innocent Spouse portion of "Taxpayer Bill of Rights III" in the Internal Revenue Service Restructuring and Reform Act of 1998, which further expanded access to Innocent Spouse status for deserving taxpayers.
4. Waiving penalties, interest, and fees on certain high-risk collection accounts authorized for a limited term by Assembly Bill 2065 (Stats. 2002, Chap. 488). Taxpayers who meet the criteria are invited to participate, and must agree to pay the full amount of tax due, less existing penalties, interest, and fees, by June 30, 2004. Through this program, we bring in tax revenue that we might not otherwise collect and bring taxpayers into compliance.
5. Following quality assurance practices to validate that we meet targets and deadlines, follow due process, and do what we say we are going to do.

A state-of-the-art collection system, highly trained, professional staff, and a customer-centered collections philosophy help the Collections Program accomplish dual purposes – bring in the maximum amount of tax revenue owed to the state of California and preserve a fair and respectful relationship with California's taxpayers.

Legal

Legal Branch staff supports the enforcement effort by providing consultation and litigation support for positions developed in cooperation with the other enforcement programs. Support activities include representation in protests, appeal proceedings before the Board of Equalization, attorney general staff support in tax litigation proceedings in California and federal judicial proceedings, and representation in out-of-state bankruptcy proceedings.

PART V
EVALUATING FRANCHISE TAX BOARD EMPLOYEES

Revenue and Taxation Code Section 21009 – “(a) The board shall develop and implement a program which will evaluate an individual employee’s or officer’s performance with respect to his or her contact with taxpayers. The development and implementation of the program shall be coordinated with the Taxpayers’ Rights Advocate. (b) The board shall report to the Legislature on the implementation of this program in its annual report.”

We completely revised the employee performance evaluation and probationary reports after the adoption of the Taxpayers’ Bill of Rights in 1989. Since that time, these forms continue to evolve. In the most recent revision, the term “Customer Service” occurs as a performance dimension in the evaluations for supervisors and employees. Employees are evaluated on how well they provide “quality customer service, while striving to exceed customers’ expectations,” their treatment of taxpayers, and providing “accurate, timely, and complete assistance.”

Our staff also developed mission and value statements that emphasize the commitment of management and employees to a job well done, continuously improving service to customers, and courteous, fair treatment of everyone. We created the Mission and Values Team to promote an awareness of these concepts and to foster and encourage the achievement of a work environment reflecting them. The team consists of employees of all designations – managers, supervisors, and rank and file from all areas of the department.