

Taxpayers' Bill of Rights
ANNUAL REPORT TO THE LEGISLATURE

Franchise Tax Board

October 1, 2004

We prepared this report 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 divided the report into five parts.

Executive Summary

- I. Sample Data from the Audit Process
- II. Taxpayer Filing Errors
- III. Taxpayers' Bill of Rights Hearing
- IV. Compliance
 - Statutes or Board Regulations
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 - Taxpayer Communication/Education
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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 the 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.

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

We found that:

1. For corporation taxes, during 2003 the largest cumulative dollar amount in proposed assessments resulted from allocation and apportionment audits.
2. For personal income taxes, during 2003 the largest cumulative dollar amount in assessments resulted from filing enforcement assessments.
3. Tax practitioners prepared nearly 68 percent of personal income tax returns. The percentage of taxpayers preparing their own returns was slightly more than 32 percent.
4. Taxpayer errors detected during return processing amounted to a taxpayer error rate of approximately four percent. This is the same error rate as last year for this time period.

We continue improving our communications and services to taxpayers and tax practitioners. Our 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 that provides automated telephone service for general state tax information.
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 including CalFile, formerly NetFile.
10. Providing practitioners with information and assistance to meet their mandatory e-file requirements.
11. Continuing to gather input from our stakeholders.
12. Providing outreach through our Collections Program to help taxpayers and tax professionals understand and comply with tax laws.
13. Implementing our Secured Electronic Communications network allowing taxpayers expanded options in communicating with our audit staff.

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 assessments that became final in 2003. 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
NPAs Finalized in 2003 Categorized by Primary Statute (Issue)

Issue	Number of NPAs		Tax Assessed (Millions)		Average Assessment Per NPA
		%		%	
Assess Minimum Tax	717	21	\$ 0.6	0.1	\$ 793
State Adjustments	362	11	10.1	2.3	27,874
Allocation/Appportionment	897	26	236.1	54.7	263,215
Revenue Agent Reports	1,311	38	36.9	8.5	28,205
Other	123	4	147.9	34.2	1,202,211
Totals/Average	3,410	100	\$ 431.6	100	\$ 126,572

NOTE: All tables in PART I of this report reflect tax increase assessments only. The assessments became final in 2003. We may have issued the assessments in prior years, however, due to cases in protest status, we did not resolve them until 2003. 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
NPAs Finalized in 2003 Categorized by Primary Statute (Issue)

Issue	Number of NPAs		Tax Assessed (Thousands)		Average Assessment Per NPA
		%		%	
CP2000	42,747	11	\$ 18,946	2	\$ 443
Filing Enforcement	306,952	77	930,346	86	3,031
Filing Status	3,590	1	3,570	0	995
Revenue Agent Reports	7,753	2	21,854	2	2,819
Other	37,401	9	107,190	10	2,866
Totals/Average	398,443	100	\$ 1,081,906	100	\$ 2,715

- 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 NPAs Finalized in 2003

Industry	All Corporations 2002 Tax Year		Corporations with NPAs		Tax Assessed (Millions)	
		%		%		%
Manufacturing	45,108	8	263	12	\$ 60.2	13.9
Trade	99,105	18	171	8	34.5	7.9
F.I.R.E.*	93,897	17	146	7	158.7	36.7
Services	219,600	40	232	11	22.0	5.0
Other **	93,143	17	1,323	62	156.2	36.1
Totals	550,853	100	2,135	100	\$ 431.6	100

* 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 finance, insurance, real estate, and holding companies.

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 issued a separate NPA to the taxpayer for each year included in an audit adjustment.

For corporations, we show the notices issued by taxable year in Table 3A. We show the frequency of multiple NPAs issued at the same time to a single corporation in Table 3B. In Table 4, we show this data with respect to individual taxpayers.

**TABLE 3A
CORPORATION TAX LAW
NPAs Finalized in 2003 Issued by Taxable Year**

Average Taxable Year	Number of NPAs	%	Tax Assessed (Millions)	%	Average Assessment per NPA
1996 and prior	1,261	36.9	\$ 221.9	51.4	\$ 175,981
1997	248	7.2	27.3	6.3	110,051
1998	361	10.5	23.0	5.3	63,698
1999	484	14.1	152.2	35.2	314,505
2000	327	9.5	4.8	1.1	14,614
2001	485	14.2	1.9	0.4	3,966
2002	244	7.1	0.5	0.1	1,998
Totals/Average	3,410	100	\$ 431.6	100	\$ 126,572

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, the Employment Development Department, and the State 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 Finalized in 2003 for the Same Taxpayer

Corporations with...	Number of Taxpayers	Tax Assessed (Millions)	Average Assessment per Taxpayer
One NPA	1,335	\$ 187.8	\$ 140,671
Two NPAs	519	73.7	142,036
Three NPAs	179	57.3	320,056
Four or more NPAs	102	112.8	1,105,963
Totals/Average	2,135	\$ 431.6	\$ 202,160

TABLE 4
PERSONAL INCOME TAX LAW
NPAs Finalized in 2003 Issued by Taxable Year

Taxable Year	Number of NPAs		Assessment Amount (Thousands)		Average Assessment Amount
		%		%	
1997 & prior	1,557	0.4	\$ 12,725	1.2	\$ 8,173
1998	535	0.1	8,835	0.8	16,514
1999	12,946	3.2	46,892	4.3	3,622
2000	41,849	10.5	165,451	15.3	3,954
2001	64,025	16.1	45,763	4.2	715
2002 & later	277,531	69.7	802,240	74.2	2,891
Totals/Avg.	398,443	100	\$ 1,081,906	100	\$ 2,715

Individuals typically have audit changes for just one year. More than 98 percent of the individuals who received NPAs during 2003 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, 2002 & 2003 Process Years**

Preparer	2002 Returns Processed		2003 Returns Processed		% Change
	(Thousands)	%	(Thousands)	%	
Taxpayer	4,462	32.8	4,360	32.1	-0.7
Professional	9,134	67.2	9,198	67.8	0.6
VITA*	7	0.0	17	0.1	0.1
Totals	13,603	100	13,575	100	

* Volunteer Income Tax Assistance 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, 2003	July 31, 2004	% Change
e-file	3,740,000	6,930,000	85
TeleFile	122,000	74,000	-39
* Online Filing (a subset of e-file)	856,000	1,019,000	19
Direct Deposit of Refund	2,360,000	3,013,000	28
Direct Debit of Balance Due (EFW)	97,000	173,000	78
Credit Card Payments (Average payment is \$908)	85,000	65,000	-24

* 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.

NOTE: Due to implementation delays, we did not send any notices out for tax years 2000 and 2001. We are sending notices out for tax year 2002. We will update this table for the next report.

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
2003/2004	499,602	265,534	\$ 2,986

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 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 2003 original tax returns processed between January 1, 2004, and August 24, 2004. We issued *Return Information Notices* to taxpayers who filed returns with errors that resulted in a change of tax liability. We explained the errors in adjustment paragraphs within the notices. The total number of adjustment paragraphs we issued does not equal the total number of *Return Information Notices* we sent, because many returns contain multiple errors, each error requiring an explanation.

**TABLE 8A
INDIVIDUAL RETURN VALIDATION ADJUSTMENTS: 2004 PROCESS YEAR SUMMARY
Number of Adjustment Paragraphs Issued by Return Type**

Adjustment Type	540	540 2EZ	540A	540NR	*N/A	Grand Total	% of Total
Filing Status Adjustment	38	39	60	56	138	331	0.06
Exemptions Adjustment	13,161	234	15,433	6,859	15,822	51,509	9.77
AGI Adjustment	229	236	219	2,136	290	3,110	0.59
Deductions Adjustment	4,132	35	6,398	1,131	10,779	22,475	4.26
Tax Computation Adjustment	11,677	240	11,197	3,666	10,190	36,970	7.01
Special Credits Adjustment	247	0	1	65	292	605	0.11
Renter's Credit Adjustment	3,100	5,151	7,268	850	4,696	21,065	4.00
Total Tax Adjustment	8,256	61,318	12,994	1,202	7,570	91,340	17.33
Withholding Adjustment	11,948	2,814	2,546	4,318	16,669	38,295	7.26
Estimate Payment Adjustment	72,126	1,391	9,405	7,085	62,426	152,433	28.91
SDI Adjustment	12,840	1	4,289	1,107	10,664	28,901	5.48
CDC Adjustment	4,929	0	3,358	499	7,459	16,245	3.08
Use Tax Adjustment	0	1	1	0	37	39	0.01
Nonresident Adjustment	7	3	2	20,449	308	20,769	3.94
Miscellaneous Adjustment	13,204	6,621	6,816	2,024	14,448	43,113	8.18
TOTAL	155,894	78,084	79,987	51,447	161,788	527,200	100

* Return type is undetermined.

**TABLE 8B
INDIVIDUAL RETURN VALIDATION ADJUSTMENTS: 2004 PROCESS YEAR SUMMARY
Number of Adjustment Paragraphs Issued by Filing Method**

Adjustment Type	e-file	Internet	Paper	Telefile	Grand Total	% of Total
Filing Status Adjustment	2	0	329	0	331	0.06
Exemptions Adjustment	392	12	51,100	5	51,509	9.77
AGI Adjustment	54	0	3,056	0	3,110	0.59
Deductions Adjustment	2,332	28	20,115	0	22,475	4.26
Tax Computation Adjustment	252	2	36,715	1	36,970	7.01
Special Credits Adjustment	122	0	483	0	605	0.11
Renter's Credit Adjustment	408	0	20,655	2	21,065	4.00
Total Tax Adjustment	745	4	90,576	15	91,340	17.33
Withholding Adjustment	9,666	99	28,506	24	38,295	7.26
Estimate Payment Adjustment	71,853	549	80,018	13	152,433	28.91
SDI Adjustment	13,241	33	15,627	0	28,901	5.48
CDC Adjustment	2,760	36	13,449	0	16,245	3.08
Use Tax Adjustment	0	0	39	0	39	0.01
Nonresident Adjustment	686	0	20,083	0	20,769	3.94
Miscellaneous Adjustment	8,511	28	34,574	0	43,113	8.18

TOTAL	111,024	791	415,325	60	527,200	100
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We issued 553,292 *Return Information Notices* out of 13,567,876 current year original tax returns processed from January 1, 2004, through August 24, 2004. This is an adjustment rate of four percent. The adjustment rate was the same as last year for this time period (528,050 *Return Information Notices* issued for 13,316,061 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.

Filing Status (0.06 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 (9.77 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 (0.59 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 (4.26 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 (7.01 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 (0.11 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 (4.0 percent of all adjustments) – This adjustment occurs when taxpayers do not qualify for this credit due to filing status or income limitations.

Total Tax Liability (17.33 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 (7.26 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 (28.91 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 (5.48 percent of all adjustments) – This adjustment occurs when taxpayers claim more excess State Disability Insurance than allowable.

Child and Dependent Care Expenses Credit (3.08 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.

Use Tax (0.01 percent of all adjustments) – This adjustment occurs when taxpayers incorrectly report their use tax. For taxable years beginning on or after January 1, 2003, taxpayers can report their California use tax on their personal income tax return.

Nonresident Only (3.94 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 we computed the tax on the Form 540NR contributing to the increase in adjustments from 2.2 percent in 2002 to 5.7 percent last year. Increased taxpayer and practitioner knowledge about AB 1115 has decreased the number of adjustments for the current processing year.

Miscellaneous Computation (8.18 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, December 2, 2003, at the State Board of Equalization, Sacramento, California. Two individuals presented proposals to the three-member Board. We also received two comments through email.

Gina Rodriquez, representing Spidell Publishing

Ms. Rodriquez submitted two new recommendations and three previously addressed proposals to the Board.

Double Withholding (New recommendation)

A limited liability company whose nonresident members do not sign Form FTB 3832, *Limited Liability Company Nonresident Members' Consent*, must double withhold on distributions at 7 percent and again on the members' total share of the income, whether or not distributed, at 9.3 percent.

Ms. Rodriquez said there appears to be a conflict in the law, which causes the double withholding. She suggests a legislative fix for this problem and, until then, she advises taxpayers who find themselves in this situation to contact the Taxpayers' Rights Advocate.

We formed a departmental team to look at this issue. A recommendation from the team is still pending. We have advised Ms. Rodriquez of our progress.

Annual Tax for Limited Partnerships (New recommendation)

When a limited partnership ceases business, it must file Form LP-3, *Certificate of Dissolution*, and Form LP-4/7, *Certificate of Cancellation*, with the Office of the California Secretary of State by the end of the partnership's taxable year, and file a final return with the Franchise Tax Board. Form LP-4/7 stops the clock on taxes, penalties, and interest and cancels the partnership registration after its affairs are concluded. If the partnership does not file Form LP-4/7 before the end of its taxable year, the partnership is still considered active and will be assessed the \$800 annual tax for each year that the limited partnership is not formally cancelled. Filing a final return and checking the box that says "final" does not stop the clock on annual taxes.

Under partnership law, a general partner is personally liable for the debts of the partnership. If a partnership does not formally dissolve, the liability continues to increase by \$800 every year, plus penalties and interest, until the proper forms are filed with the Secretary of State.

Ms. Rodriquez recommends sponsoring legislation that not only offers amnesty for these partnerships but also allows the state to recognize the formal dissolution of a limited partnership if it files a final return with the Franchise Tax Board.

We are developing a Taxpayer Bill of Rights proposal that we are presenting to our Board at an upcoming meeting. We have advised Ms. Rodriquez of our progress.

Conformity or Return to Stand-alone Personal Income Tax Returns

At the hearing, Ms. Rodriquez proposed that if nonconformity continues to be the default rule in California, Franchise Tax Board should look at developing a “stand-alone” tax form.

She wrote in her proposal, “A stand-alone tax form would help protect unwary taxpayers against audits for failing to make state adjustments to the federal numbers.”

We researched this issue and determined that we do not have the resources available to undertake this proposal in current economic times. We have advised Ms. Rodriquez of our progress.

Nanny/Elder Care Tax Simplification

Ms. Rodriquez stated that she had brought this proposal to the Board many times:

California has an extremely complicated reporting and payment system for household employers, which results in widespread noncompliance. Taxpayers face compliance issues with the “nanny tax,” as it is widely known, but more and more practitioners are seeing clients with elder care issues as our population ages.

Since 1995, the IRS has allowed household employers to report and pay household employment taxes on their personal income tax returns. California household employers must report wages and pay taxes quarterly, although there are certain situations whereby annual payment of taxes is allowed.

Ms. Rodriquez requests that the Board sponsor legislation or find some other means to simplify this system.

We are developing a Taxpayer Bill of Rights proposal that we are presenting to our Board at an upcoming meeting. We have advised Ms. Rodriquez of our progress.

Restructure Homeowner and Renter Assistance Program

Ms. Rodriquez said she addressed the Board at a previous hearing to discuss a restructuring of the Homeowner and Renter Assistance Program. She submitted a proposal to change the Homeowner and Renter Assistance filing date to coincide with the tax return filing due date. She wrote in part in her proposal:

A consistent filing date would not only serve the approximately 150,000 people who file both a tax return and an HRA claim and allow these people to efile their claim forms, which is currently not allowed, but it would also allow all claimants to use the FTB's existing infrastructure to check the status of their assistance checks by using the FTB's Website instead of calling the FTB's toll-free number. We also suggested many other alternatives for cutting administrative costs with respect to the HRA programs.

We formed a departmental team to look at restructuring this program, but our focus was diverted to the recommendation contained in the California Performance Review. We have advised Ms. Rodriguez of our progress.

Richard E.V. Harris

"Deemed Denial" Provision

Mr. Harris addressed a proposal that came up during the protest regulation proceedings.

He said that taxpayers have options with respect to refund claims, to deem a refund claim denied, and to move on to the State Board of Equalization or to the courts. He proposed a "deemed denial" provision that will address protests.

Mr. Harris proposed that if the Franchise Tax Board fails to mail a notice of action on any protest within two years, after the protest was filed, the taxpayer could consider the protest to be deemed denied by the Franchise Tax Board and file an appeal to the State Board of Equalization.

It would be limited to administrative appeals to the SBE. It would not deal with the court.

Mr. Harris suggested creating a statutory provision that would parallel or roughly parallel California Revenue and Taxation Code Section 19331, which is what now provides for allowing for refund claims. And it would be parallel in policy to California Revenue and Taxation Code Section 19348 and 19385.

Our Legal staff is still reviewing this issue. A recommendation is pending.

EMAIL REMARKS

Brent P. Patteson

Online Filing

Mr. Patteson wrote the following in an email to us:

In recent weeks, many tax filing corporations have expressed concern that by continuing to expand the ability to file taxes online, through your Website, this may threaten some of their business. I strongly disagree with this position, and write to you today, to urge you to continue to authorize funds to expand the online tax preparation and filing features of the Franchise Tax Board Website. While up until this point the many companies who have online and offline software to help prepare tax returns, I feel, have been very successful in providing reasonably priced and efficient applications for filing tax information, this should not stop the process towards e-government and making it easier for citizens to file their tax returns.

We shared Mr. Patteson's opinion with our Board members. His views are in-line with the decision made by the Board to offer CalFile, formerly NetFile, in the 2004 year.

D.J. Dobson

Flat Tax

D.J. Dobson proposed a flat tax for equity.

We shared Mr. Dobson's opinion with our Board members at the 2003 Taxpayer's Bill of Rights Hearing.

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 we review areas of the law and propose legislation in order to carry out our responsibility of improving taxpayer compliance and enhancing administration. We identified several areas of the law during the review process for which we proposed legislation to facilitate administration of our duties.

Chapered Legislation

AB 1260 (Matthews) (Stats. 2004, Ch. 163) – This act specifies under the Revenue and Taxation Code that it is a crime to fraudulently aid, abet, or obtain a state-issued income tax refund, in any form, including direct deposit refunds.

AB 1740 (Assembly Revenue & Taxation Committee) (Stats. 2004, Ch. 13) – This act:

- Provides clean-up legislation for AB 1115 (Stats. 2001, Ch. 920). It clarifies the method of calculating the taxable income of nonresidents and part-year residents to eliminate concerns that were identified during the implementation of AB 1115.
- Corrects a drafting error made when the California child and dependent care credit was enacted in 2000 as well as a cross-reference error created from a law change made in 2002.
- Resolves a potential federal constitutional issue by allowing a nonresident taxpayer a prorated alimony deduction.
- Presumes that the late filing penalty does not apply when, under certain circumstances, the corresponding federal late filing penalty is determined not to apply.

AB 3071 (Assembly Revenue & Taxation Committee) (Stats. 2004, Ch. 353) – This act:

- Removes an erroneous statutory reference to the statute of limitations for relief from joint and several liability.
- Makes payment due dates between two sections of California tax law consistent by excluding the LIFO (last in first out) recapture tax from estimated tax underpayment for a C corporation electing S corporation treatment.

AB 3073 (Assembly Revenue & Taxation Committee) (Stats. 2004, Ch. 354) – This act:

- Conforms California law to the federal claim of right provisions.
- Extends the voluntary disclosure program to limited liability companies and their owners.

SB 1172 (Ackerman) (Stats. 2004, Ch. 62) – This act provides expressly that California is conformed to federal statutes that limit or preempt California's ability to tax the California source income of specified nonresidents.

REGULATIONS

Regulation Section 17952 – Income From Intangible Property

On April 29, 2003, we received approval from the Board to proceed with the draft of proposed changes to Regulation 17952. These proposed changes address the timing of the sourcing of gains from sales of intangible personal property. We 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 *mobilis* 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 *mobilis* 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, we believe that a clarification would be prudent.

We scheduled a symposium on August 13, 2003, in the event we received public interest or written comments on this issue by July 8, 2003. Receiving neither, we published a notice of cancellation on our Website on July 30, 2003. We will submit the proposed amendments to State and Consumer Services Agency for approval sometime in October 2004.

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

On April 29, 2003, we received approval to commence a formal regulatory 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, 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. Our 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.

We submitted the proposed amendment to State and Consumer Services Agency for approval on June 30, 2004. We scheduled a formal regulatory hearing, as required under the Administrative Procedure Act, for October 4, 2004, in the event we received public interest or written comments on this issue by September 17, 2004. Receiving neither, we cancelled the hearing. We are finalizing the regulation.

Regulation Section 19133 – Penalty for Failure to File After Notification

On October 1, 2002, we received authorization from the Board to proceed with the formal rulemaking process for the above proposed regulation. Our 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 us. Revenue and Taxation Code Section 19133 provides us with the authority to assess a notice and demand penalty upon those taxpayers who do not file a tax return upon our notice and demand.

The proposed regulation is to clarify under what circumstances we will impose a notice and demand penalty upon individual taxpayers. Under the proposed regulation, we 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 not responding to either a request for tax return or a demand for tax return within the previous four years. A repeat nonfiler who does not 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.

We submitted the proposed regulation to State and Consumer Services Agency for approval on March 23, 2004. We scheduled a formal regulatory hearing, as required under the Administrative Procedure Act, for June 7, 2004, in the event we received public interest or written comments on this issue by May 21, 2004. We received no public interest, but we received two comments. We are in the process of finalizing the regulation for submission to the Office of Administrative Law sometime in the fall of 2004.

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

On April 29, 2003, we received authorization from the Board to proceed with the formal rulemaking process for the above proposed regulations. The proposed regulations address certain definitions and criteria applicable to the Senior Citizen Homeowners and Renters Property Tax Assistance (HRA) law. This law generally establishes a program that provides assistance for the elderly and disabled individuals with the payment of property tax assessments on their places of residence.

We submitted the proposed regulations to the State and Consumer Services Agency for review and approval on March 22, 2004. Agency has approved the regulations and they are ready for submission to the Office of Administrative Law to publish the Notice and proceed with the formal rulemaking process.

Since we proposed the regulations to the Board for approval to proceed, there has been mounting evidence that one provision of the proposed regulations, proposed regulation section 20504, subdivision (a)(4), is the primary source of fraud within the HRA program. Under this section of the regulations applicants can establish that they are disabled, thereby making them eligible for assistance, by submitting a statement from a doctor. However, the method provided for in the proposed regulation is susceptible to abuse, as evidenced by the fact that claimants have misappropriated physicians' medical license numbers, falsified letters, and filed multiple claims by using self-created letters. Moreover, we have learned that claimants' requests for signed affidavits have placed physicians in the position of being forced to sign the affidavit for individuals who although impaired do not technically meet the definition of disabled as found in the Revenue and Taxation Code and the Social Security Act.

Disability claims make up the bulk of the fraud that we have investigated in connection with the HRA program. This fraud has grown to a level that an HRA fraud case pursued by the Los Angeles District Attorney's office this year, was adjudicated and closed in March of 2004. The claimant/defendant in that case had filed multiple claims using multiple copies of a physician's signature and license number, as well as various social security numbers. The court sentenced the claimant/defendant, pursuant to the penal code violations involved, to 180 days in the county jail and placed him on three years formal probation. Further, he was ordered to make restitution in the amount of \$17,973.55 to Franchise Tax Board.

In addition, the State Board of Equalization recently imposed a \$500 frivolous appeal penalty against a claimant for submitting fraudulent documents containing a doctor's forged signature. The SBE concluded that the appellant had submitted a fraudulent document and, moreover, committed perjury when preparing his HRA claim form.

Given the documented increase in fraudulent activity associated with the use of affidavits, we recommend that the proposed regulation be amended to identify reliance on a local, state, or federal agency's determination to verify that a claimant is disabled. Reliance on a finding of disability by a governmental agency is consistent with the HRA statutory scheme because, as indicated above, the Legislature has adopted the federal definition of disability as the standard for the HRA program. Further, we have the ability to verify a claimant's Social Security eligibility through an interagency agreement with the Department of Health Services with regard to the current year.

Using such documentation, as set forth in proposed regulation section 20504, subdivisions (a)(1-4), we can verify that the claimant is eligible under the specified definition as well as verify the social security number of the individual for identification purposes.

At the August 25, 2004 Board meeting, we recommended and received approval for the revision of the proposed regulation section 20504, subdivision (a)(4), to reduce and potentially eliminate the bulk of the fraudulent claims received by the HRA program. We also received authorization to proceed with the formal regulatory process and anticipate holding a public hearing sometime in the fall of 2004.

Regulation Section 25106.5-11 – Election to File a Group Return

On June 10, 2004, we received approval to follow the partial symposium process described in the Chief Counsel's January 15, 1999, memorandum to the Board regarding processing regulations and to announce a tentative symposium.

As discussed in the proposed regulation, each taxpayer that is subject to the California Corporation Tax Law has an obligation to file a return. If taxpayers conduct business within and without California, they must attach a copy of a combined report to their return, which shows how their business income is apportioned amongst the various states. In many instances, many California corporate taxpayers are members of the same combined reporting group. This means that the same combined report relates to each of them. Therefore, each must file its own return, attaching a copy of the same combined report to each return. This creates administrative difficulties and burdens, both for taxpayers and Franchise Tax Board.

As a matter of administrative convenience, it has been our practice that taxpayers who are members of the same combined reporting group can file a single "group return," thereby satisfying each taxpayer's return-filing obligation. Taxpayers attached a copy of the combined report to this return, showing how the business income of the group is apportioned amongst the various states. To qualify for this treatment, one of the affiliated taxpayers had to agree to be designated as the "key corporation" for the combined reporting group. The key corporation agreed to act as agent and surety for the remaining taxpayers included in the combined report. Affiliated taxpayers could avoid the burden of filing duplicative combined reports, while allowing us to coordinate with only one taxpayer as opposed to many. When one of the taxpayer members files Form 100, attaching a completed Schedule R, Schedule R-7, it effectuates the designation of the key corporation and identifies the remaining taxpayer members included in the single group return.

The taxpayer community has followed this existing practice, so we do not anticipate that this discussion draft of the proposed regulation will be controversial. This new proposed regulation will simply formally codify the department's long-standing administrative practice described above.

We held a symposium on August 30, 2004. We plan to schedule a hearing for January 2005.

Regulation Section 25110 – Water's-Edge Election Group

On June 10, 2004, we received approval to follow the partial symposium process described in the Chief Counsel's January 15, 1999, memorandum to the Board regarding processing regulations and to announce a tentative symposium.

Under Revenue and Taxation Code Section 25110, subdivision (a)(4), a foreign corporation with less than 20 percent average U.S. factors, or a foreign bank, are included in a water's-

edge combined report to the extent of their U.S. source income and factors. When regulations were first promulgated under this section, we defined U.S. source income by reference to existing federal foreign taxation rules to mean the income that is “effectively connected” with the conduct of a U.S. trade or business (so-called effectively-connected income, or “ECI”). California Code of Regulations, title 18, section 25110, subsection (d)(2)(F)3., also provides that deductions attributable to U.S. source income shall be determined using the allocation and apportionment rules set forth in Treasury Regulation sections 1.861-8 (other than interest expense) and 1.882-5 (interest expense).

Effective for taxable years beginning on or after January 1, 1992, the California regulations expanded the scope of U.S. source income to include not only ECI, but also U.S. source business income that is not effectively connected with the conduct of a U.S. trade or business (“NECI”). However, the portion of our regulations relating to the determination of deductions attributable to U.S. source income remained unchanged.

Under Internal Revenue Code section 882(a), except to the extent provided by treaty, foreign corporations are subject to U.S. *net basis* taxation on ECI. Foreign corporations with ECI may also be subject to a branch profits tax. Under Internal Revenue Code section 881(a), foreign corporations' U.S. source NECI is subject to a *gross basis* tax at a flat tax rate of 30 percent, unless reduced or eliminated by treaty. Therefore, there are no federal rules to determine deductions for NECI. Consequently, for federal purposes Treasury Regulation sections 1.861-8 and 1.882-5 specifically do not apply in the determination of deductions for U.S. source NECI, which is taxed at gross.

An amendment to California Code of Regulations, title 18, section 25110, subsection (d)(2)(F)3., is necessary to provide guidance in determining deductions attributable to non-effectively connected income of a foreign corporation that is included in a water's-edge combined report. The discussion draft of the proposed amendment to the existing regulation would set forth the rule that the allowable deductions against the non-effectively connected income shall be determined in accord with California Code of Regulations, title 18, section 25120, subsection (d).

We anticipate holding a symposium sometime in October 2004.

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

On October 18, 2002, we 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.

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

We worked with interested members of the public to make certain technical changes to the proposed regulatory amendments. We submitted the proposed amendments to the State and Consumer Services Agency for review and approval on June 8, 2004. We anticipate holding a public hearing sometime in the fall of 2004.

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. We provide on-going training on changes to tax laws, information systems, and procedures to all public service staff.

Collections

We provide training for all compliance representatives and tax technicians in the Collections Program through our Accounts Receivable Management Division Career Center. Employees in the Collections Program must complete a comprehensive six-week training program to ensure they have the required skills and abilities to administer the tax laws.

The training program consists of core compliance courses, including:

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

In addition to specific compliance-related training, employees in the Collections Program receive mandatory training on information security.

Career Center staff and management work as a team to provide classroom instruction to new collectors, and skills enhancement for experienced employees. To minimize the cost of training, the Career Center partners with journey-level staff directly involved in the collection process to assist in training workshops. Computer-based training also provides low-cost, individual instruction to employees. Accounts Receivable Management Division employees are strongly encouraged to continue the learning process throughout their careers by enrolling in classes to refresh their existing skills or knowledge.

In response to the budget crisis in the State of California this past year, we redeployed many employees into revenue-producing positions. From January through August 2004, the Career Center conducted training for employees redeployed to the Collections Program, to ensure that they received a strong foundation in procedures and tax law.

Audit

The Audit Division continues to operate training and recruiting under one umbrella. This has allowed consistency of the messages given through the recruiting, hiring, and training process.

We provide professional training to our auditors from the moment they begin their work as a new tax auditor. 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:

- Organizational mission and values
- Principles of tax administration
- Audit process
- Technologies and work systems
- Research methodologies
- Tax law
- Taxpayer rights

- Security and disclosure
- Information security
- Policies and procedures
- Case management protocols
- Customer service

Our new auditor training was recently revamped in response to management comments and participant evaluations. To allow for greater effectiveness and application of skills, the auditors applied three different audit scenarios throughout their training courses. We found this helped solidify their newly acquired knowledge as well as provide an indication of their grasp of the subjects taught. In addition, we added on-line training courses to our curriculum during our latest training to a group of new auditors. These courses consisted of a variety of accounting related classes.

New auditors continue learning on the job throughout their probationary period and beyond. Each audit program provides on-going technical tax law training.

We support our auditors who seek certified public accountant status. Under the Board of Accountancy guidelines, we provide certified public accountants the opportunity to receive continued education credit for courses we develop and administer.

In cooperation with other Department Recruiters, the Audit Division is working on revising our "Career in Taxation and Audit" brochure. Our brochure will now be printed in-house for a fraction of the previous printing cost.

In an attempt to attract experienced accountants to our department, we continue to attend public career fairs in addition to our regular schedule of campus events. We attend meetings with student organizations and campus career centers at no cost to the department while providing name recognition and free advertising for our organization.

TAXPAYER COMMUNICATION/EDUCATION

Our goal is to provide taxpayers and tax practitioners with the information they need to file their state tax returns completely, accurately, and timely. This year our communication efforts included promoting CalFile, formerly NetFile, and educating tax practitioners about mandatory e-file.

CalFile is an interview-based, direct online e-file application. We promoted CalFile through media contacts and press releases. Designed to allow millions of Californians to e-file their returns for free, CalFile is fast, direct, and easy to use. When taxpayers file their returns using CalFile, they get a fast refund or a choice to pay the amount they owe electronically. They also receive confirmation that they filed their return.

With the passage of Assembly Bill 1756 (Stats. 2003, Ch.228), California law now requires certain income tax preparers to e-file individual income tax returns unless they cannot e-file the returns due to reasonable cause. Some of the outreach efforts we undertook to inform practitioners of the new law include:

- Sending mandatory e-file letters to practitioners
- Adding a frequently asked questions about mandatory e-file page on our Website
- Creating a Web page dedicated to mandatory e-file
- Preparing a Tax News article
- Holding seminars
- Partnering with professional organizations and the Internal Revenue Service

We strive to continually improve our communications and services to the public:

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 our 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.
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, we began contacting individuals who paid large amounts of mortgage interest with no reported income source and who did not file a California tax return.

Our Corporation Nonfiler Program uses information from other taxing agencies (the Internal Revenue Service, the State Board of Equalization, and the 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.

Through implementation of the audit regulations we have expanded the use of best audit practices throughout our program. The audit regulations stipulate responsibilities, expectations, and timeframes taxpayers can experience during an audit. Taxpayers can expect their audits completed within two years. We encourage our audit staff to continually work with taxpayers and practitioners to identify additional best audit practices.

We have increased our examinations of abusive tax avoidance transactions and wherever possible, are offering taxpayers the opportunity to voluntarily comply. Twelve hundred taxpayers took advantage of our recent Voluntary Compliance Initiative, generating \$1.4 billion in additional revenue. By working cooperatively with the Internal Revenue Service and revenue agencies in other states, we are analyzing extensive, non-traditional sources of information and focusing our efforts on the most abusive transactions and encouraging voluntary compliance.

We continue to use technology to improve communications with taxpayers and to ensure taxpayer privacy. We have implemented our Secured Electronic Communications network which allows 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.

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.

We use a variety of methods and tools to enforce the laws covering tax and non-tax debt.

- Liens and Levies: We have administrative authority to issue liens and levy wages and bank accounts. Individual collectors or our automated system can issue liens and levies.
- Accounts Receivable Collection System (ARCS): We use this automated system to process over one million individual and business accounts annually. We apply a customized approach to accounts, which greatly reduces the intrusion into taxpayer lives. By automating many key collection functions, we use ARCS to maximize efficiency and free collectors to answer questions, resolve problems, and help taxpayers find ways to pay their tax debts.
- Field Collections and Investigations: Based out of field offices in various California locations, our field collectors make in-person contact with tax debtors who are persistently noncompliant. Our special investigators focus on the underground economy and bring felony criminal charges against the most egregious cases of tax evasion. Prosecuting these criminal activities results in many millions of dollars of tax revenue for the State of California.
- Contract Collections: We have contracts with several private collection agencies to pursue collections on unfunded workloads: out-of-state cases, for example, where our levy authority does not apply.
- Collection Approach: Both the taxpayer and the state of California benefit by resolving tax debts. We seek the best way to resolve each individual account through a combination of automated actions, attention from experienced, highly trained professional staff, and a customer-centered collections approach. In keeping with this approach, we provide a variety of options to help taxpayers resolve their tax debts.
 1. Assistance and communications methods:
 - a) We maintain a Collections call center staffed by collections experts, including several who are bilingual.
 - b) We also maintain a tax practitioner FAX hotline providing tax representatives and practitioners with fast, and direct access to collections experts.
 - c) We provide online access to collections information, procedures, and electronic forms on our Internet Website.
 2. Payment Methods:
 - a) Installment Agreements – We provide taxpayers who are unable to pay the full amount they owe in one payment the option of making their payments in installments.

b) Offer in Compromise – We provide taxpayers who do not have, and will not have in the foreseeable future, the money, assets, or means to pay their tax liability the option to offer a lesser amount for payment of a non-disputed final tax liability.

3. Innocent Spouse:

By conforming to the Innocent Spouse portion of “Taxpayer Bill of Rights III” in the Internal Revenue Service Restructuring and Reform Act of 1998, we further expanded access to the innocent spouse status for taxpayers.

4. Quality Assurance:

We follow quality assurance practices to validate that we meet targets and deadlines, follow due process, and do what we say we are going to do.

Legal

Legal Department 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” is a performance dimension in the evaluations for supervisors and employees. We evaluate employees 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.”

We 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.