'09

Taxpayers' Bill of Rights
Annual Report to the Legislature

State of California
Franchise Tax Board

December 1, 2009

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Executive Summary

This has been a difficult year. Nationally, the United States struggles with a recession and hopes for an economic recovery that experts predict will happen by the end of this year. In California, we face record deficits, revenue losses, and cash flow problems. Unfortunately, this crisis has led our department to furlough employees, eliminate positions, and impose other severe budget cuts. The Franchise Tax Board (FTB) has been charged with doing the same quality work with fewer resources. In spite of all the challenges, FTB remains rock solid and continues to process returns, issue refunds, conduct audits, collect delinquent accounts, and support our operations.

The Taxpayers' Rights Advocate's Office prepared this report in response to the Taxpayers' Bill of Rights (Stats. 1988, Ch. 1573), Sections 21006 and 21009 of the California Revenue and Taxation Code.

In the Advocate's Address, you will find a brief discussion of significant issues, concerns, and challenges to both taxpayers and the department. Some of the topics discussed are furloughs, auditor retention, and conformity to name a few. In another section of the report, the Taxpayers' Rights Advocate identifies areas where FTB can make improvements to ease the burden on taxpayers and increase self-compliance.

The report also includes the Taxpayers' Rights Advocate's responsibilities and contacts. From July 1, 2008, through June 30, 2009, the Taxpayers' Rights Advocate's Office responded to over 26,700 contacts from taxpayers. In addition to assisting taxpayers, the Taxpayers' Rights Advocate also:

- Explains taxpayers' rights.
- Provides education services to taxpayers and tax professionals.
- Conducts the Annual Taxpayers' Bill of Rights hearing.
- Communicates with tax professional groups and industry representatives.

To satisfy the Taxpayers' Bill of Rights requirements, the Taxpayers' Rights Advocate Office conducted a study using a sample of both corporation and personal income tax (PIT) *Notices of Proposed Assessments*. These proposed assessments are a result of FTB audits. The primary findings include:

- For corporation taxes, the largest cumulative dollar amount in proposed assessments from one primary issue resulted from allocation and apportionment audits.
- For personal income taxes, the largest cumulative dollar amount in proposed assessments resulted from filing enforcement assessments.
- Based on the primary business activity in California, the largest dollar amount comes from one activity under the industry designated as Manufacturing.

The Taxpayers' Rights Advocate's Office compiled information on taxpayers' filing errors detected during return processing. *Return Information Notices (RINs)* were issued to taxpayers who filed returns with errors that resulted in a change in tax liability. Advocate staff detected a taxpayer error rate of approximately 4.4 percent during return processing. They examined this data to identify and address some of the most common taxpayer errors.

Along with the Taxpayers' Rights Advocate, the department continues its efforts to reduce the number of notices issued and make it easier for taxpayers to meet their obligations. The department also continues to provide information and assistance to taxpayers and tax professionals as issues arise.

Selvi Stanislaus

Selvi Stanislaus
Executive Officer

Advocate's Address

Members of the California Legislature:

I submit for your review the 2009 Taxpayers' Bill of Rights Annual Report to the Legislature.

I continue to be proactive, visible, and accessible to taxpayers. I maintain constant interaction with the tax professional community and with taxpayers using many different venues. I personally participated in nearly half of our presentations to a variety of tax professional, community, and government groups throughout California. My involvement in over 50 events this year allowed me to hear about the effects FTB's policies, processes, and procedures have on taxpayers. Meeting with these groups allows me to hear firsthand what issues, concerns, and challenges taxpayers face and the impact that tax legislation has had on them.

Included in this report, I have identified areas where FTB can improve its operations and its services to taxpayers, including systemic issues that impact the department.

My goal is to ensure that taxpayers' rights are protected. One of my responsibilities is to improve the communication and services that FTB provides. As reported last year, my staff worked on the development of a web-based application where taxpayers and tax professionals can provide comments on our processes, procedures, laws, and legislation that create a burden for taxpayers. This system, which was modeled after the IRS' Systemic Advocacy Management System (SAMS), allows my staff to track and identify systemic problems and recommend solutions. The Systemic Issue Management System (SIMS) was released to the public on March 4, 2009.

In fiscal year 2008/2009, 71 issues were submitted through SIMS. Of the issues reported, eight were identified as possible systemic issues and forwarded to program areas for research and resolution. All of the systemic issues have been resolved.

The following highlights the types of issues we have received through SIMS:

- Mid-year conversion of legal entities, such as limited partnerships (LPs) and limited liability companies (LLCs), requires two separate tax returns to be filed. After researching this issue, our Legal Division is drafting a notice to allow mid-year conversion without filing of multiple returns.
- FTB was issuing RINs when a taxpayer claimed excess State Disability Insurance (SDI) or Voluntary Plan Disability Insurance (VPDI) on an electronically filed return. This issue was researched and steps were taken to train employees to verify the amount entered before a notice is sent.

Auditor Retention

Over the past year, a troubling trend has emerged in FTB's Audit Division. An alarming number of senior audit staff retired or left state service to accept positions with the Internal Revenue Service (IRS) and the private sector. Historically, auditor attrition occurs primarily at entry level audit classifications. The loss of these seasoned auditors, particularly to other government agencies, is new and is making it very difficult to keep pace with the increasingly complex and evolving tax environment such as unraveling complex tax shelters and addressing the tax gap. This increased level of attrition also requires the department to expend more time and resources training new auditors. As the Taxpayers' Rights Advocate, my concern is the department's ability to meet the standards as set forth in the Taxpayers' Bill of Rights.

Between July 2008 and August 2009, 65 auditors left the department. Of those that left the department, 40 percent were at senior auditor classifications. Without these auditors, FTB is opening fewer audits, taking longer to complete open audits, and is less efficient on the more complex audits. There may also be lost opportunity costs where audit issues potentially are missed by less experienced auditors. Less experienced auditors also impact taxpayers' costs with longer audit times and the potential for more mistakes. Key factors that appear to be at the root of this trend include the following:

Salary disparity – The IRS is aggressively recruiting and hiring at senior levels. Their pay scale can be up to 25 percent higher than state salary scales (in light of salary reductions due to furloughs) for similar work. Moreover, they sometimes offer signing bonuses. Private sector companies also offer lucrative signing bonuses and sometimes offer salaries that are up to 100 percent higher than state salaries.

Furlough days – Furlough salary reductions are causing staff near retirement to evaluate their options. As salaries decrease, retirement appears to be a more viable option for senior staff. Also, retiring staff often leave with minimal notice, which impacts workforce planning and strategies, especially on more complex workloads.

Loss of benefits – The Rural Health Care Equity Program was eliminated by the Legislature affecting a significant number of employees that live in areas where an HMO was not offered. In addition, the IRS offers a $230 per month transit subsidy while the state offers $65 per month.

The IRS acknowledged the importance of greater enforcement as a method of closing the tax gap and plans on hiring hundreds of new revenue agents through 2010. To date, they already hired several FTB senior level auditors. Unfortunately, it is very difficult for FTB to bring in experienced senior level staff because of the learning curve, desire of existing employees to be promoted into the few opportunities available, and requirements of the state hiring system. Instead, FTB hires new auditors at entry level positions. This past fiscal year FTB hired approximately 80 new auditors at an approximate cost of $40,000 per auditor. FTB estimates it will take more than four years for a new auditor to be promoted to the Program Specialist I level and, currently, 66 percent of the audit staff has not yet reached this level. Only 18 percent of the audit staff is at FTB's highest senior levels, the Program Specialist II and III classifications. California needs to maximize its revenue sources. The audit program struggles to train less experienced staff to fill senior positions as more departures occur, and to retain staff as this trend continues. Without the staff FTB needs to make the audit program successful, California's tax gap increases, taxpayers are frustrated, and revenue is lost.

Accounts Receivable

Due to the current economic climate, the accounts receivable increased approximately $1.6 billion dollars. One reason for this growth is a 50 percent increase in the amount owed on self-assessed tax. As the Taxpayers' Rights Advocate, I am concerned that available staff time for normal workloads has already been reduced by furloughs. This increase in accounts receivable means more taxpayer contacts to the department to resolve their balance due accounts. As a result, more taxpayers could potentially fall into involuntary collection action as their ability to resolve their account issues is hindered by FTB's inability to provide adequate customer service.

Conformity

Last year FTB raised the awareness that the lack of conformity to federal laws had a direct correlation to taxpayer self-compliance, the costs of administration and enforcement of the income tax laws, and the state's conformity to the federal Internal Revenue Code (IRC). I applaud your efforts to get California's tax laws in-line with the federal rules. During this 2008/2009 legislative session, there were a few bills submitted on the topic of conformity. The primary bill that emerged was AB 1580, which was passed but then vetoed by the Governor. I continue to believe that the lack of conformity has effects beyond revenue increases or decreases.

The lack of conformity has:

- Affected taxpayer's ability to self-assess.
- Increased the unintentional taxpayer error.
- Increased the burden of preparing tax returns for most taxpayers.
- Increased the cost for taxpayers to prepare their returns.
- Increased administrative costs to the state.[1]

So I reprise my call for simplification through conformity and I encourage you to continue your efforts to pass a conformity bill. As you are aware, getting a conformity bill passed is time intensive. The growing disparity between the federal and California tax laws makes the lack of conformity one of the biggest areas of concern for California taxpayers. Without conformity, complex tax law continues to place burdens on taxpayers, and these burdens lead to increased errors, penalties, and return preparation costs.

[1] Last year, I proposed a conformity study be conducted to help us make these connections. However, due to budget constraints and limited resources, we were unable to pursue this study.

Late State/Federal Legislation

Over the past few years, another troubling trend has emerged, which I believe is adding to the burden on both taxpayers and FTB--the passage of late legislation. In many instances, the implementation of this late legislation is retroactive to the beginning of the year. I believe the burdens I have listed above are not limited to the conformity issue. I believe late legislation, whether at the state or federal level, also adds to the burden on taxpayers and their ability to be self-compliant. The constant change in tax laws and lack of conformity confuses taxpayers and leads to unintentional taxpayer errors and assessed penalties. Taxpayers may not have the information they need to understand the changes; they may not have the most current forms; and, industry groups may not have time to update their tax preparation products with any changes resulting from late legislation. For FTB, changes in tax law require programming and process changes, revising tax forms, instructions, and publications. When legislation is enacted late in the year or when laws are changed during the taxable year, as was done with the increase in the tax rate and the reduction to the dependent credit, there is insufficient time to conduct the necessary taxpayer education. More importantly, taxpayers and businesses are unable to make the necessary budgetary plans needed to ensure that when it comes time to file and pay their tax liabilities they have the necessary funds.

Last year I proposed FTB have dedicated staff and resources available to follow and provide analysis on both state and federal legislation. I encourage you to reconsider the impact late legislation has, not only on FTB but on the taxpayers of this state. And I say again, FTB must dedicate staff and resources required to address this issue.

Cancellation of Debt - Foreclosure

FTB continues to experience a very challenging time with California's economy. Many taxpayers are struggling with financial crisis; a great many of them are faced with the reality of not only losing their jobs and their homes, but also face the overwhelming reality of owing taxes as a result of their loss.

Most financially distressed individuals do not even realize that the loss of their home may increase their tax liabilities. What makes this even harder for them to understand is how the loss of their home could result in reportable income. In contrast, if they had been able to sell the home for the amount of their loan or even for a profit of as much as $500,000[2], in most cases, they would not have income to report[3].

In 2007[4], Congress addressed this inequity by carving out a federal exclusion to help homeowners whose mortgage debts were canceled through foreclosure in 2007 through 2012[5]. California adopted a modified version of this legislation, but only for a discharge of debt occurring in either 2007 or 2008. Taxpayers continue to lose homes as a result of foreclosure in 2009, with signs that it will continue into later years. California does not have an exclusion to help homeowners who have a cancellation of debt due to a foreclosure in 2009 or later. I encourage the Legislature to pass legislation that grants relief for California taxpayers losing their homes as a result of foreclosure.

[2] The limit is $250,000 for a single taxpayer or a married/RDP person filing a separate return.

[3] As long as the home qualifies as the taxpayer's principal residence and the sale meets the requirements of Section 121 of the Internal Revenue Code.

[4] The Mortgage Forgiveness Debt Relief Act was introduced in Congress on September 25, 2007, and became law on December 20, 2007.

[5] The Mortgage Forgiveness Debt Relief Act of 2007 originally added Internal Revenue Code Section 108 (h), applicable to taxable years 2007 through 2009, to allow taxpayers to exclude up to $2 million of forgiven debt income on their principal residence. The limit is $1 million for a married/RDP person filing a separate return. Legislation enacted in October 2008 extended this relief through 2012.

Penalties

Taxpayers and the tax professional community address me with growing concerns about the increased number of penalties that can be assessed. In addition to the increased number of penalties, they are concerned about the fairness, clarity, how and when, and the motives as to why they are being assessed. The number of penalties has grown. Since 2004, there have been 19 penalties either added to our statutes or changed. There is a definite need to have penalties that can be assessed in order to encourage voluntary income tax compliance. However, there are increasing concerns that penalties are created and assessed to act as revenue raisers for the state that has been going through a financial fiscal crisis over the last few years. Penalties should be reasonable and their amounts reflective of the seriousness and intent of the error or omission. The taxpayer should be afforded due process at a reasonable cost in challenging the penalty once assessed. I also believe that these penalties should have reasonable cause provisions that allow a waiver of the penalty under special circumstances. I have concerns with the increased number of penalties being enacted that do not allow a taxpayer to challenge the penalty beyond FTB. Five penalties specifically prohibit review by any administrative or judicial proceeding, and two only allow the taxpayer to challenge the penalty computation. Some of these penalties have been described as obscure or unduly harsh.

I propose that my staff conduct a penalty study and FTB direct dedicated resources to take a statistical look at how often penalties were assessed and withdrawn in the past three fiscal years. I believe a proactive approach to studying this issue would put FTB in a better position to respond to taxpayer concerns and allow me to adequately address issues raised at the Taxpayers' Bill of Rights Hearing held in 2008.

Education and Outreach

Due to California and federal income tax laws continuously changing, passage of late legislation, lack of federal and state conformity, and reductions in taxpayer services, FTB needs to improve and increase our education and outreach efforts. The need to keep taxpayers and tax professionals informed is greater than ever. Good examples are the impact the income tax withholding rates mid-year change and the exemption credit reduction may have on taxpayers when they file their 2009 income tax returns. Without proper planning, taxpayers may find that they unexpectedly owe state income taxes when they complete their California income tax returns.

In the past year, FTB reduced the number of seminars on e-file, income tax withholding, nonprofit, and small business information due to limited resources. In addition to presentations, my staff's education and outreach efforts extend to improving FTB's website and using other media methods to get our information to taxpayers. It is important that despite the resource challenges, FTB continues to provide and make information available to taxpayers.

My staff currently provides materials, including Tax News, publications, and information on the website, on a variety of topics. This last year, we focused a large part of our education and outreach effort on informing taxpayers and tax professionals of the issues related to foreclosures, same sex married couples (SSMCs), new home credit, and enterprise zone credits. I now have a presence on Twitter, linking my followers to late breaking information. I believe FTB needs to expand its services on the website to include virtual presentations on subjects important to taxpayers.

Taxpayers' Rights Advocate Contact Information

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To get this publication, go to **ftb.ca.gov** or write to the address above.

Taxpayers' Rights Advocate

Mission of the Taxpayers' Rights Advocate Office

The Taxpayers' Rights Advocate's Office works with program areas to ensure taxpayers' rights are protected. We identify systemic problems and find solutions in a cooperative effort while protecting taxpayers' rights and recognizing the goals of our audit, collection, and filing programs. We also coordinate the resolution of taxpayer complaints and problems, including complaints regarding unsatisfactory treatment of taxpayers by employees. We promote integrity and responsibility so our customers can rely on quality information and efficient service.

Taxpayers' Bill of Rights Legislation

In 1988, the California Legislature enacted the Taxpayers' Bill of Rights. For the first time legislation spelled out California taxpayers' rights and FTB's obligations. This law codified many existing department procedures and established a Taxpayers' Rights Advocate.

On July 30, 1996, the federal Taxpayers' Bill of Rights 2 passed, followed a few months later by California Taxpayers' Rights Conformity Legislation.

California lawmakers enacted the Taxpayers' Bill of Rights Act of 1999 to further guarantee taxpayers' rights.

An amendment to California Revenue and Taxation Code (R&TC) 21004 in 2008 now provides the Taxpayers' Rights Advocate the discretionary authority to grant relief from penalties, fees, or interest imposed on a taxpayer because of erroneous actions or inactions of the department.

Responsibilities of the Taxpayers' Rights Advocate

The Taxpayers' Rights Advocate has a direct reporting relationship to the Executive Officer. As enacted by the Legislature in the California R&TC, the Taxpayers' Rights Advocate:

- Coordinates the resolution of taxpayer complaints and problems including complaints regarding unsatisfactory treatment by FTB employees.
- Develops and implements a taxpayer education and information program.
- Identifies areas of recurrent taxpayer noncompliance.
- Conducts an annual hearing where individual taxpayers and industry representatives may present proposals to clarify the California R&TC.
- Makes recommendations to improve taxpayer compliance and uniform tax administration.
- Informs taxpayers in simple, nontechnical language of procedures, remedies, and rights during audit, appeal, and collection proceedings.
- Evaluates employees' performance based on taxpayer contact and not on the revenue produced.
- Possesses the discretionary authority to grant relief from penalties, fees, or interest imposed on a taxpayer because of erroneous actions or inactions of the department.

The Taxpayers' Rights Advocate's Office coordinates education and outreach efforts throughout California, such as tax professional and Advisory Board meetings. In addition, the Taxpayers' Rights Advocate and staff participate in tax professional seminars, industry group workshops, and small business events. We provide filing season updates and information to legislative offices. The Taxpayers' Rights Advocate also conducts independent administrative review and administers the Interest Abatement and Third-Party Fee Programs.

Explanation of Taxpayer Rights in Publications

We develop, review, and revise our notices, forms, and publications to ensure our written materials are clear, accurate, and timely. Staff is trained to follow department standards and writing guidelines to meet readability requirements as well as technical accuracy. We also include revision dates on all of our publications and offer some publications in Spanish, Chinese, Korean, Russian, and Vietnamese.

Our tax booklets and notices include information about taxpayers' rights. Our goal is to inform taxpayers in simple, nontechnical language of procedures, remedies, and rights during audit, appeal, and collection proceedings.

We provide detailed information on Taxpayers' Bill of Rights legislation in our Taxpayers' Rights Advocate's Office publications:

- *California Taxpayers' Bill of Rights* (FTB 4058) – This brochure gives a basic description of taxpayers' rights during the audit process. It also instructs taxpayers how to protest and appeal.
- *California Taxpayers' Bill of Rights 2* (FTB 4063) – In response to further federal legislation, the California Legislature enacted the Taxpayers' Bill of Rights 2. This brochure provides information about additional protection of taxpayers' rights under this California legislation.
- *California Taxpayers' Bill of Rights Act of 1999* (FTB 4064) – To further guarantee taxpayers' rights as California taxpayers, California's lawmakers enacted the Taxpayers' Bill of Rights Act of 1999. This brochure provides the major highlights of this legislation.
- *California Taxpayers' Bill of Rights – A Comprehensive Guide* (FTB 4058C) – This publication describes provisions of the California Taxpayers' Bill of Rights and informs how we implement these provisions.

We also review external publications and communications for compliance with the Taxpayers' Bill of Rights legislation.

Advisory Board

We coordinate annual Advisory Board meetings with representatives from industry, state and federal government, and our department to discuss issues related to California income tax. This Board provides our Executive Officer with insight and contributions on the various projects and programs FTB administers.

The topics from our latest meeting included a Taxpayers' Rights Advocate update, filing season update, including information on ReadyReturn and CalFile, discussions about tax gap activities, abusive tax shelters, and conformity legislation.

Annual Meetings With Tax Practitioners

We coordinate liaison meetings with the California Society of Enrolled Agents and the California Society of Certified Public Accountants. At the meetings, we provide legislative, filing, and audit updates. We present and discuss FTB's upcoming projects and issues. We also respond to questions from tax professionals.

Legislative Information Letter

In addition to assisting legislative staff with their constituents' tax issues, the Taxpayers' Rights Advocate's Office provides legislative staff with annual filing season updates and information on services available to taxpayers. This year we provided information on tax law changes, online services available on the website, and taxpayer assistance information.

Interest Abatement

We may cancel interest a taxpayer owes if the taxpayer can show that an unnecessary delay in our processing caused the interest to accrue or delay their payment. We may also cancel interest if the taxpayer can show the interest accrued because we made an unreasonable error in performing certain kinds of acts. If we deny a taxpayer's request, they have the right to appeal our action.

Third-Party Fees

Taxpayers may file a claim for refund for reimbursement of charges imposed by an unrelated third party as the direct result of an erroneous processing or collection action by FTB. Charges that may be reimbursed include, but are not limited to, usual and customary charges for complying with levy instructions and reasonable charges for overdrafts that are a direct result of FTB's erroneous action.

Taxpayers' Rights Advocate Contacts

Taxpayers or their representatives contact the Taxpayers' Rights Advocate's Office when they are unable to resolve their issues through regular channels. We assist taxpayers by reviewing their unresolved tax problems, and ensure that their issues are handled promptly and fairly. We also interact with other state and federal agencies, and assist in identifying and resolving departmental problems.

The Governor's Office, Franchise Tax Board members, employees, legislators, state and federal agencies, and taxpayers or their representatives contact us. We are contacted by mail, fax, telephone, and email. We received over 26,700 contacts from July 1, 2008, through June 30, 2009. The majority of taxpayers (over 20,000 contacts) contacted us by telephone. We provide a public number for taxpayers to contact our Advocate Hotline at 800.883.5910.

We received over 2,900 contacts by email during this reporting period. Taxpayers also chose to email the Taxpayers' Rights Advocate's Office when they could not contact the department by telephone or when the telephone wait time was too lengthy.

The top five reasons taxpayers contacted the Taxpayers' Rights Advocate's Office from July 1, 2008, through June 30, 2009, include:

- Balance Due
- Filing Enforcement
- Earnings Withholding Order for Taxes
- Refund
- Installment Agreement

Some examples of how we assisted taxpayers with these issues include:

Balance Due
We mailed tax computations, sent Offer in Compromise packages, reevaluated assessments, and encouraged taxpayers to send payments.

Filing Enforcement
We explained assessments and provided information to assist taxpayers in completing their returns. In some cases, we canceled assessments or addressed hardship issues.

Earnings Withholding Order for Taxes
We modified or released these orders based on additional information.

Refund
We assisted taxpayers by checking the status of their refunds or reissuing refunds.

Installment Agreement
We updated taxpayers on their balance due, set up payment plans, or delayed collection action to allow returns or payments to post.

Equity Relief

Assembly Bill 3078 (Stats. 2008, Ch. 305), effective January 1, 2009, authorizes the Taxpayers' Rights Advocate to abate penalties, fees, additions to tax, or interest, if it is determined that the penalties, fees, additions to tax, or interest are caused by an error attributable to FTB. For the period of January 1, 2009, to June 30, 2009, we did not receive any requests for relief.

Systemic Issue Management System (SIMS)

One of the roles of the Taxpayers' Rights Advocate is to identify systemic issues and find solutions in a cooperative effort with FTB's audit, collections, and filing programs. SIMS is a web application that was released to the public on March 4, 2009. Taxpayers and practitioners can submit systemic issues to us for research and resolution. In fiscal year 2008/2009 we received 71 issues through SIMS. Eight of those issues were identified as possible systemic issues and forwarded to program areas for research and resolution. All of the issues received in fiscal year 2008/2009 have been resolved.

Identify Areas of Noncompliance

Sample Data From the Audit Process

We compiled and analyzed data from the audit process to identify areas of recurrent taxpayer noncompliance. The data, some of which is derived from statistical samples, includes:

- The statute or regulation violated by the taxpayer.
- The amount of tax involved.
- The industry or business engaged in by the taxpayer. (Sample data)
- The number of years covered in the audit period.
- Whether the taxpayer used professional tax preparation assistance. (Sample data)
- Whether the taxpayer filed individual or corporate returns.

We collected assessment information from the personal income tax *Notice of Proposed Assessment* display file for assessments that became final in fiscal year 2008/2009. When sample data was used, the volumes and dollar amounts represent the sample study numbers projected to the total universe of assessments. See tables in Appendix 1 for details.

We collected data for the distribution of *Notices of Proposed Assessment* by issue and tax assessed. If a single notice included multiple issues, we categorized the notice under the issue that provided the majority of the tax change. We categorized the assessment as "Other" where there is no distinct primary issue.

For corporation taxes, the largest dollar amount in proposed assessments from one primary issue resulted from allocation and apportionment audits. Allocation and apportionment audits involve corporations doing business within and outside California.

Allocation is the assignment of nonbusiness income to a particular state. Apportionment is the division of business income among states by the use of a three-factor apportionment formula. Within the apportionment formula, the sales factor is the most frequent audit issue for corporations. The higher rate of noncompliance associated with allocation and apportionment may be attributed to the complexity of the issues involved. In addition, noncompliance may occur due to diverse interpretations of the tax laws.

For personal income taxes, the largest dollar amount in proposed assessments resulted from filing enforcement assessments. Filing enforcement assessments refers to individuals who have not filed their state income tax return after we notified them of their filing requirement. Most of the proposed assessments were issued to personal income taxpayers for failure to file a state income tax return.

Based on the primary business activity in California, the industry group that was assessed the largest dollar amount was the Manufacturing industry.

We issued a separate *Notice of Proposed Assessment* to the taxpayer for each tax year included in an audit adjustment. Individuals typically have audit changes for just one tax year. More than 89 percent of the individuals who received *Notices of Proposed Assessment* during fiscal year 2008/2009 had audit changes for a single tax year.

An in-house accounting department or an accounting or legal firm prepares virtually all corporation returns. We consider corporation tax returns as professionally prepared. In the absence of a paid tax professional's signature, we consider that taxpayers self-prepared their personal income tax returns. The data indicates that tax professionals file over 68 percent of all personal income tax returns.

We also compiled statistics for e-filing and payments. For these figures, see Appendix 1, Table 6. e-filing continues to increase, with a 4 percent increase from July 1, 2008, to June 30, 2009. As of June 30, 2009, we received 293,000 e-filed Business Entity (BE) returns, a 66 percent increase.

FTB informs taxpayers about their California filing requirements through its website, letters, and contacts with nonfilers. FTB sends first time nonfilers who have met their filing requirements in the previous four years a *Request for Tax Return* notice. Repeat nonfilers are sent a *Demand for Tax Return* notice. Nonfilers, who do not file the necessary tax returns after receiving a request or demand notice, are sent a *Notice of Proposed Assessment*. See Appendix 1, Tables 7A and 7B, for volumes of notices issued. Our goal is to obtain tax returns from those who have a filing requirement without having to issue a *Notice of Proposed Assessment*.

Approximately 40 percent of the taxpayers contacted for failing to file a tax return subsequently file their returns.

Taxpayer Filing Errors

The R&TC requires the Taxpayers' Rights Advocate to identify the most common errors made by taxpayers when they file their returns and evaluate how those errors may be avoided or corrected.

We compiled taxpayer error information on approximately 15.7 million current year tax returns processed between July 1, 2008, and June 30, 2009. During this time frame, FTB made approximately 700,000 adjustments and issued close to 386,000 RINs to taxpayers who filed returns with errors that resulted in a change of tax liability. This equates to roughly 2.5 percent of returns. The errors are explained with adjustment paragraphs in the notices. The number of adjustments is greater than the number of notices because many returns contained multiple errors.

Close to 71 percent of all adjustments are made on paper filed returns (35 percent of total returns filed), while only 29 percent of all adjustments are made on electronically filed returns (65 percent of total returns filed).

The most common taxpayer error, for all filing methods, was claiming the wrong amount of estimated tax credits. Just over half (53 percent) of all RINs contained an Estimate Payment Credit adjustment. Taxpayers either neglected to claim estimate payments they submitted, claimed a credit for a payment that differs from what they submitted, forgot estimate transfers or adjustments to estimate transfers from the previous year, or claimed credits for payments that FTB had no record of receiving.

Tables in Appendix 2 display the number of adjustments by return type and filing method, and include a definition of what typically caused each adjustment.

Return Information Notices (RINs) Mailing

Taxpayers who submitted payments with their tax returns on or around April 15 received RINs. The notices acknowledge that FTB received their return, but do not show FTB received a payment. Since this has a potential taxpayer impact and has been a recurring issue from prior years, we established a pilot process for the 2008 tax year. We further delayed the issuance of the RINs until after FTB recorded the payments. Currently, we are analyzing the pilot to determine if the delay was effective.

Improve Compliance

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.

Chaptered Legislation –
AB 1546 (Assembly Revenue & Taxation Committee, Stats. 2009, Ch. 544)
This act impacts FTB as follows:

- Requires a cancelled domestic limited partnership to pay outstanding fees, file missing tax returns, and pay a service fee for expedited revival requests, in addition to the current requirements to revive.
- Clean-up provisions from the recently enacted budget provisions in ABX3 3 (Evans, Stats. 2009, Third Extraordinary Session, Ch. 18) and SBX3 15 (Calderon, Stats. 2009, Third Extraordinary Session, Ch. 17).

Regulations

The laws administered by FTB broadly authorize the promulgation of rules and regulations necessary for their enforcement. Occasionally, specific statutory provisions require us to promulgate regulations. See Appendix 3 for a list of regulations.

Areas for FTB to Improve

We are identifying areas to improve that could result in increased taxpayer compliance. In identifying these areas, we have not addressed whether FTB has existing resources needed to make these improvements.

Customer Service Call Center Access Rates
Taxpayers continue to experience problems in contact with FTB call centers. In fiscal year 2007/2008, the Taxpayer Services Center answered approximately 45 percent of the incoming calls. The contact center increased the number of calls answered by approximately 5 percent in fiscal year 2008/2009. The Collections Service Center answered an average of 37.6 percent of incoming calls, a 22 percent decrease from last year. Most of the calls were not answered within our performance goal of 80 percent within two minutes. It was common for staff to answer only 25 percent of all incoming calls and respond to as few as 2 percent of the calls within two minutes. Taxpayers continue to experience long wait times to speak with a customer service representative.

Response to Correspondence Time Frames
Taxpayers writing to the department to either ask for or provide information continue to experience delays in our processing and responding to their correspondence. The average response time to correspondence still varies greatly throughout the department. In some areas the response time is 25-30 days, and in other areas the response time is over 60 days.

Check Processing and Depositing
Last year we received an increasing number of contacts from taxpayers inquiring about the status of their submitted payments. Taxpayers complained that their checks took three weeks or longer to clear their bank accounts. At the time of the report, we were nearing the end of an Internal Audit review of FTB's cashiering function. Internal Audit completed the review in February 2009 and identified some areas for improvement with regard to processing

payments timely and accurately and utilizing resources effectively and efficiently. As a result, we streamlined the issue identification and resolution process; reallocated resources and workloads; provided staff additional research tools and training; updated procedures; revised forms and instruction; and initiated a pilot to delay notices on e-filed returns to allow additional processing time.

Return Information Notices (RINs) Mailing

As mentioned in the Taxpayer Filing Error Section of this report, we have further delayed the issuance of RINs until the payments were recorded for the 2008 tax year. Analysis of the pilot is currently in process to determine if the delay was effective.

FTB Tax Forms

FTB 2008 tax forms were more accurate than prior years. We attribute this improvement to a process which includes earlier drafts and review, as well as earlier public release of draft forms. Late law changes at both the state and federal level continue to elicit last minute forms revisions and delay official release.

Pending and Enacted Federal Legislation

The lack of conformity to federal legislation has a direct effect on taxpayer compliance and increases the burden on the taxpayer. California has not conformed to many of the federal law changes enacted after January 1, 2005, and in other areas in which California has automatic conformity. There have been over 17 federal tax acts enacted since the last California conformity date of January 1, 2005.

California's complex method of conformity results in a significant need for FTB to identify and analyze pending and passed federal legislation. When changes are made to the federal income tax law, California does not automatically adopt such provisions. Instead, state legislation is needed to conform to most of those changes. We need to be able to prepare timely, accurate, objective, and in-depth analysis of pending and passed federal legislation.

Currently, when there is pending or passed federal legislation, FTB has to reallocate resources to analyze and understand the federal legislative changes and the impact to California taxpayers. FTB then has to train staff and respond to taxpayer and tax professional inquiries within short time frames and, in some cases, prior to the passing of legislation.

As a result, FTB needs to have dedicated staff and resources available to follow and provide analysis on pending and passed federal legislation on an ongoing basis.

The lack of conformity to federal legislation adds a burden to the department. FTB's current systems start with federal numbers. FTB must allocate resources to reflect the federal tax law changes. This requires programming, process changes, and revisions to tax forms, instructions, and publications.

In an effort to inform our tax professionals on late breaking legislation or clarifying impact of laws, we periodically release *Tax Newsflashes* to our subscribers.

Education and Outreach

We need to improve and increase our education and outreach efforts. In the last year, we had more constraints on our ability to provide taxpayers with information on California and federal tax law and FTB service changes. FTB should reconsider education and outreach efforts cancelled because of limited resources. This could significantly reduce the number of taxpayer and tax professional errors. In addition to increasing our presence at seminars, we need to continue to expand our online taxpayer educational products. Increasing our online efforts is practical from both a cost and access point of view.

e-Services

In an effort to reduce the taxpayer's burden, increase access to information, make filing and paying taxes easier, and improve the timeliness and accuracy of tax returns, we continue to enhance and develop our online services. Below are a few of the e-services available and some highlights of the year's activities.

ReadyReturn

ReadyReturn was approved by the three-member Franchise Tax Board in December 2006, and was implemented in January 2008. *ReadyReturn* is a tax-filing method where FTB uses wage and withholding information to complete tax returns for taxpayers with "simple returns." *ReadyReturn* is a voluntary program and taxpayers have the option to view, make changes, and e-file their *ReadyReturn* online.

In 2008 (taxable year 2007), over 11,000 taxpayers used this filing method. Of those users, 99 percent were satisfied or very satisfied with the program and 98 percent indicated that it is the type of service government should provide.

For 2009 (for tax year 2008 returns), the eligible population was expanded to include taxpayers who filed as head of household, had dependents (up to 5) or could be claimed as a dependent, or who were renters. By including these taxpayers, *ReadyReturn* doubled its eligible population. In 2009, over 61,000 taxpayers used *ReadyReturn*, an increase of over 450 percent from the previous year.

CalFile

CalFile is FTB's free, secure, online application allowing taxpayers to build their state income tax return and e-file it directly to FTB. *CalFile* eases the filing burden for taxpayers by guiding them through an easy question and answer process in order to complete their return. In 2009, FTB enhanced *CalFile* to automatically check and notify users if they were eligible for *ReadyReturn*. Taxpayers had the option to use *ReadyReturn* or continue on with *CalFile*. Over 227,000 taxpayers used *CalFile* in 2009, an increase of 18 percent over the previous year.

MyFTB Account

MyFTB Account is a secure online service allowing users to view estimated tax payments, recent payments made, and the total balance due on their account. Taxpayers can access their California wage and withholding information, FTB-issued 1099-G and 1099-INT information, and sign up for estimated tax payment email reminders.

Due to budgetary constraints and the delay of implementing a new authentication solution, the following enhancements originally planned for implementation in 2009 are now scheduled for implementation in mid to late 2010. These enhancements include providing the ability to:

- View and/or change address information.
- Access BE information.
- Opt out of receiving paper 1099s.

Web Pay

Web Pay is a free, secure, online service that allows personal income taxpayers to make their tax payments online. In 2009, FTB planned to provide BE taxpayers with the ability to make tax payments online; however, due to the delay in implementing an authentication solution for business taxpayers, that option will be made available in mid 2010.

Training

To improve services to the public and encourage voluntary compliance, FTB develops employees' skills and abilities. FTB provides extensive training to our public service staff on how to deliver quality service and telephone techniques. The call center represents the front line process. Properly staffed employees trained to provide critical pre-filing assistance, tax law explanations, and forms can have a positive effect on compliance. This service also minimizes the cost associated with collection and audit functions that result when returns are not filed timely, properly, or with the appropriate amount of payment.

FTB provides technical training to its employees, including public service staff, tax technicians, compliance representatives, and auditors, on the following systems:

- Taxpayer Information System (TI).
- Business Entity Tax System (BETS).
- Accounts Receivable Collection System (ARCS).
- Integrated Nonfiler Compliance System (INC).
- Other systems as necessary.

In addition to technical training, FTB trains employees on workplace diversity, sexual harassment awareness, disability awareness, career development and upward mobility, and other administrative courses.

FTB also provides the following essential training:

- Tax law.
- Taxpayers' Bill of Rights.
- Account analysis and resolution.
- Security and disclosure.

To ensure all compliance representatives and tax technicians in the collection program and public service areas have the required skills and abilities to administer tax laws, FTB trains them on core compliance courses which include:

- Penalties and interest.
- Filing requirements.
- Installment agreements (Collection Program).
- Tax assessments.
- Power of Attorney.

FTB invites subject matter experts to serve as mentors and coaches, training consultants, or guest instructors to provide new or updated training. FTB encourages employees to further their education by enrolling in classes, including computer-based courses and college courses, to refresh or further their existing skills or knowledge.

FTB provides professional training to its auditors from the moment they begin their work with FTB. A four-week basic professional auditor training series was established to give auditor's baseline expertise in the following areas:

- Organizational mission and values and customer service.
- The Taxpayers' Bill of Rights and the principles of tax administration.
- Audit process, case management protocols, and policies and procedures.
- Disclosure and information security.
- Technologies and work systems (PASS, BETS, TI, INC, etc.).
- Tax law and research methodologies.

FTB offers ongoing support for new auditors to develop their skills throughout their careers with an emphasis on just-in-time technical law training. Mentors or leads provide continued guidance, direction, and on-the-job training and support for new auditors. FTB also provides broad-based development to optimize knowledge of the latest electronic technologies, evolve business practices, specialize financial transaction tracing, and improve auditing techniques.

FTB supports its auditors who seek Certified Public Accountant status. Under the Board of Accountancy guidelines, FTB provides Certified Public Accountants with the opportunity to receive continuing education credits for courses FTB develops and administers.

Enforcement

Although FTB encourages voluntary compliance through taxpayer education by providing pre-filing assistance and information, FTB continues to identify ways to improve its enforcement capabilities.

Filing Enforcement Program

The Filing Enforcement (FE) Program identifies and contacts individuals and business entities that have a requirement to file a California tax return and have not filed.

The Personal Income Tax FE Program uses various income sources to contact wage earners, self-employed individuals, individuals with unreported capital gains, nonresidents with California source income, individuals who have partnership income, and any other individuals with unreported income. Recently, the FE Program began contacting additional nonfilers as a result of increased contract services to purchase address information. The FE Program also improved manual efforts to perform quality assurance on nonfiler cases. Both of these efforts are the result of an approved Tax Gap Budget Change Proposal.

The Corporation Nonfiler Program uses various income sources, including information from the IRS, the State Board of Equalization (BOE), the Employment Development Department (EDD), and financial institutions, to identify potential nonfiling corporations. Recently, the program began using Schedule K-1 distribution information to identify nonfiling corporations.

FTB continuously strives to improve the filing enforcement programs and the services that are available to both the taxpayer and the tax professional communities. FTB's website provides around-the-clock access and was implemented based on feedback that tax professionals and taxpayers provided. The following features are available to taxpayers from the website:

- Taxpayers can request additional time to file a tax return. This service may assist those who are experiencing a life crisis, or who need more time to obtain records to file a return.
- Taxpayers can provide updated address information.
- Taxpayers can request an email reminder to file for future tax years.

Audit Program

The Audit Program incorporates FTB's strategic goals. The program works with taxpayers and their representatives to promote fairness and compliance with the tax law and improve customer service. The program utilizes innovative methods to promote these objectives, such as self-compliance letters, tax shelter initiatives, and partnerships with other federal and state agencies. In performing these activities, the program considers the effects of its actions on taxpayers and focuses on adherence to Audit Regulation 19032.

Over the past year, the program's efforts have materialized into results:

- Self-compliance letters – Self-compliance letters are sent when FTB has information indicating potential noncompliance. Self-compliance letters allow a taxpayer to voluntarily comply before an audit is conducted.
- Shelter Initiatives – Shelter Initiatives are limited-time opportunities for taxpayers to voluntarily disclose participation in a tax shelter transaction, with the possibility of reduced penalties or other incentives.
- Partnerships – FTB partners with other federal and state agencies to share knowledge and information. For example, FTB partnered with other state revenue agencies and the IRS in exchanging information to address potentially abusive tax shelters. These collaboration efforts allow FTB to leverage resources for both itself and other agencies by consulting on the same taxpayer or similar issues.

FTB continues to seek new opportunities to form partnerships with taxpayers and other agencies and promote the best audit practices.

Address Tax Gap Initiatives That Promulgate Underreporting of Tax
The tax gap is the difference between the amount of taxes legally owed and voluntarily paid. FTB continues to identify those who intentionally and continually underreport taxes and contribute to the tax gap. FTB focuses its efforts to identify schemes used to evade reporting the correct tax amount. FTB dedicates specialized auditors to evaluate nontraditional sources to identify taxpayers who may not have fully self-assessed and paid the correct tax amount. Additionally, the tax professional audit program penalizes tax professionals who claimed deductions or credits erroneously. To complement these efforts, FTB takes strides in educating the citizens of California in common areas where noncompliance is prevalent.

Pursue Abusive Tax Shelter Investors and Promoters
FTB continues to diligently pursue the examination of abusive tax shelter participants and promoters. FTB's partnership with other states, the IRS, and other federal agencies enhanced the sharing and exchanging of abusive tax shelter information, training, and information leads. FTB focuses and dedicates audit resources to identify and evaluate investor leads, promoters, and to assess disclosure and information return penalties.

- Investor Leads – In addition to conducting audits, auditors contact taxpayers suspected of participating in tax shelters and offer them an opportunity to self-correct their tax return.
- Promoters – Audit created a database of potential promoters and began assessing abusive tax avoidance transaction promoter penalties.
- Disclosure and Information Return Penalties – In 2007, FTB issued FTB Notice 2007-3 and FTB Notice 2007-4, where investors had a 60-day grace period to file complete disclosure statements if they had failed to do so before issuance of this notice. Currently, FTB identifies and assesses penalties for investors and promoters who were required but have failed to file disclosure statements or information returns.

Resolve Protective Claims Filed During Tax Amnesty 2005
Taxpayers paid $3.6 billion in protective claims in 2005 because of tax amnesty. As of June 30, 2009, FTB finalized $1.967 billion in protective claims. Of that figure, $1.350 billion was retained and the taxpayers overpaid $618 million. For the overpaid amount, FTB refunded $411 million and taxpayers requested $207 million be kept on account as a cash deposit for future use.

For the amounts listed above, during the past year, FTB completed audits on over $133 million in protective claims. FTB resolved $205 million in protective claims with no further protest or appeal rights. Protective claims cases that remain outstanding as of June 30, 2009, include cases in the following categories:

Open audits	$ 188 million
Pending federal	$ 152 million
Protest	$ 911 million
Appeal	$ 48 million
Settlement	$ 269 million
Closed – Nonfinal	$ 64 million

Collections Program

The Collections Program collects tax and nontax debts on behalf of the State of California. Tax debts are primarily unpaid audit and return assessments for individuals and corporations. Nontax debts include vehicle registration fees and various court-ordered and industrial health and safety debts. Collections uses a variety of methods and tools to enforce the laws covering tax and nontax debt.

FTB maintains a collections call center staffed by collection experts, including several who are bilingual. FTB also maintains an Advocate Hotline to assist taxpayers, tax representatives, and practitioners with fast and direct access to collection experts. FTB provides online access to collection information, procedures, and electronic forms.

Liens and Levies

FTB has authority to issue notices of liens and to levy wages and bank accounts. Individual collectors or an automated system can issue notices of liens and levies.

Accounts Receivable Collection System

FTB uses this automated system to process and maintain approximately 1.8 million individual and 450,000 business accounts annually. FTB applies a customized approach to accounts, which greatly reduces the intrusion into taxpayers' lives. By automating many key collection functions, the staff uses the system to maximize efficiency and free collectors to answer questions, resolve problems, and help taxpayers find ways to pay their tax debts.

Field Collections

Based in field offices in various California locations, the field collectors make in-person contact with persistently noncompliant tax debtors. Collectors take appropriate actions to fully resolve cases. This includes gathering case information, securing asset information, obtaining commitment, and properly documenting the case.

Contract Collection

FTB uses private collection agencies to collect debts in certain unfunded workloads. Both the taxpayer and the state benefit by resolving tax debts. FTB seeks 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, FTB provides a variety of options to help taxpayers resolve their tax debts.

Payment Methods

Installment Agreements – FTB provides taxpayers who are unable to pay the full amount they owe in one payment the option of making their payments in installments. Taxpayers can now apply and check the status of their requests online.

Offer in Compromise – FTB provides taxpayers who currently do not have (nor will have in the future) the necessary means to pay their tax liability with an option to offer a lesser amount for payment of an undisputed final tax liability.

Expanded Access to Innocent Spouse Status

By conforming to the innocent spouse portion of the Taxpayers' Bill of Rights III in the IRS Restructuring and Reform Act of 1998, we further expanded relief for innocent spouses. In addition, outreach events in 2000 and legislation in 2003 and 2004 increased opportunities for relief.

Quality Assurance Practices

FTB follows quality assurance practices to validate that it meets targets and deadlines, complies with legal due process requirements, and takes corrective actions.

Investigations

Investigative specialists focus on the underground economy and bringing felony criminal charges against the most egregious cases of tax evasion. Agents work cooperatively with federal, state, and local law enforcement agencies throughout California to uncover illegal behaviors that contribute to the tax gap. These behaviors include underreporting income, overstating deductions, failing to file returns, failing to pay taxes due, and making illegal cash payments to employees. Prosecuting these criminal activities result in many millions of dollars of tax revenue for the State of California.

Legal

The Legal Division 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, representation in appeal proceedings before the BOE, attorney general staff support in tax litigation proceedings in California and federal judicial proceedings, and representation in out-of-state bankruptcy proceedings.

Taxpayer Education and Outreach

We strive to provide taxpayers and tax professionals with the information they need to file their state tax returns completely, accurately, and timely. We provide presentations to taxpayers and tax professionals on a variety of different topics including tax updates, e-file services, withholding, audit, offer-in-compromise, same sex married couples, forms of ownership, enterprise zone credits, and other topics as requested. We participated in over 180 presentations throughout California. We are developing two new publications in partnership with other state tax agencies and the IRS. The publication, *Understanding Your State Taxes*, provides general information about state taxes and filing requirements. We plan to distribute this publication to a variety of audiences, including college students and newly naturalized citizens. This publication also will be available in other languages. The second publication, *Buying or Selling Online: Know Your Tax Obligations* (actual title not finalized), provides clarification about laws such as prohibiting the taxation of Internet access (Internet Tax Freedom Act) and limiting sales tax on interstate sales. These laws have led some to incorrectly believe that Internet sales income including online auctions is not subject to income tax. We will distribute this information at small business fairs and through online auction businesses, such as eBay.

One of our service goals is to improve our communications to better serve the growing communities of non-English speaking taxpayers. We strive to make our publications, notices, and other documents available in other languages for the non-English speaking taxpayers of California. We implemented a Multilingual Services Program that coordinates and provides consistency in the translation of forms, publications, web information, news releases, and other documents as needed. We have publications available on our website in Spanish, Chinese, Korean, Russian, and Vietnamese.

Our Spanish web portal continues to expand. We provide Spanish-speaking taxpayers and tax professionals with tax information, how to contact us, and e-services. Starting in February of 2009, we provided our Spanish speaking taxpayers with the 2008 540 2EZ instructional booklet in Spanish.

For persons with disabilities, we provide access to our programs, services, and facilities in accordance with Title II of the Americans with Disabilities Act of 1990. At the taxpayer's request, we provide reasonable accommodations in alternative format, including income tax booklets in large print and on audiocassette.

An ongoing media effort, including Spanish media, is a major component in our goal to reduce taxpayer errors. We give news interviews, prepare news releases, and make public service announcements to inform taxpayers of changes to the tax law, new programs, and current issues of interest.

Same-Sex Married Couples (SSMCs)/ Registered Domestic Partners (RDPs)
Proposition 8 approved by voters on November 4, 2008, amended the California Constitution to provide that "only marriage between a man and a woman is valid or recognized in California." On May 26, 2009, the California Supreme Court ruled that the Proposition 8 constitutional amendment is valid. The court also held that same-sex couples' marriages performed in California after 5p.m. on June 16, 2008, and before November 5, 2008, are valid marriages for California purposes. In addition, California law allows for the formation of Registered Domestic Partners (RDPs). Senate Bill 1827 (Stats. 2006, Ch. 802), effective January 1, 2007, requires RDPs to file their personal income tax returns as either married filing jointly or married filing separate.

Since the passage of this legislation, we continue to inform the public of the state tax ramifications and get requests for presentations on this issue. RDP education and outreach efforts that began in 2006 were expanded to include SSMC and have continued into 2009.

FTB Notice 2008-5 addressed this issue and three publications are readily available online or in print for RDPs and SSMCs regarding their California income tax treatment and their filing obligations:

- FTB 737 – *2007 Tax Information for Registered Domestic Partners*
- FTB 776 – *2008 Tax Information for Same-Sex Married Couples*
- FTB 1051A – *Guidelines for Married/RDP Filing Separate Returns*

In addition, our dedicated webpages provide information on both RDPs and SSMCs. This gives taxpayers and professional tax preparation groups the opportunity to check for updated information, including frequently asked questions, important news, and other information on each tax topic. FTB continues to provide subscription services to allow individuals and tax professionals to sign up and receive updates on RDPs and SSMCs, along with a variety of other topics.

Cancellation of Debt - Foreclosures

As a result of public demand, last year we informed the public of the state tax ramifications of foreclosures, short sales, and other activities resulting in debt forgiveness. We added a discussion topic on foreclosures to our public presentations when appropriate. We partnered with the IRS and the State Controller's Office to provide information of foreclosure prevention and the latest information on the tax aspects of foreclosures – personal and business -throughout California.

When Senate Bill 1055 (Stats. 2008, Ch. 282), effective September 25, 2008, conformed California law to the federal Mortgage Forgiveness Debt Relief Act of 2007, applicable to discharges of indebtedness on or after January 1, 2007, we worked diligently to inform the public of the state tax ramifications, including the need to amend 2007 tax returns filed prior to the enactment of this legislation.

Enterprise Zone (EZ) Credits and Benefits

The Enterprise Zone Program targets economically distressed areas throughout California. The program combines special state and local incentives intended to encourage business investment and promote the creation of new jobs. The Enterprise Zone Tax Incentive Program was created in 1986. Between October 2006 and March 2009, 34 original California enterprise zones expired. Assembly Bill AB 1550 (Stats. 2006, Ch. 718), effective September 29, 2006, reformed the Enterprise Zone Program. This bill provided for the administration and oversight of geographically targeted economic development areas, known as G-TEDAs, which include enterprise zones. This bill also increased the number of enterprise zones which allowed a total of 42 enterprise zones statewide. Since its passage, FTB, is participating in events sponsored by the State Controller's Office and local zone managers to provide local business owners and tax professionals an opportunity to receive information relative to Enterprise Zone Tax Credits and benefits. In 2009, FTB has continued and expanded efforts that began in 2006.

Interactive Voice Response

FTB maintains and regularly enhances an Interactive Voice Response System that provides recorded responses to the most frequently asked questions regarding general state tax information. FTB also maintains and enhances an Interactive Voice Response System for Spanish-speaking taxpayers.

California Tax Information

In an effort to provide one-stop service for California taxpayers, FTB participated with other state tax agencies to establish State Taxpayer Service Centers.

On the Internet, the California Homepage (**ca.gov**) and California Tax Service Center (taxes.ca.gov) provide taxpayers with easy access to a variety of state and federal tax information through hypertext links from one website to another.

Tax News

Tax News, our monthly online publication, informs tax professionals about state income tax laws, regulations, policies, procedures, and events that affect the tax professional community. Tax professionals can subscribe to Tax News by email or go to **ftb.ca.gov**. We also periodically release *Tax Newsflashes* to quickly notify subscribers of urgent, time-sensitive information. Consecutively, for the last two fiscal years, subscriptions increased by a steady 14 percent. We also experienced a positive trend that other trade media publications such as Klienrock, Tax Express, and Spidell linked to and used several of our *Tax News* articles.

Small Business Outreach

We provide training at seminars and develop programs to help small businesses meet their state income tax filing requirements. In conjunction with the BOE, EDD, and IRS, we develop products that simplify the process of obtaining information on most business filing requirements. This year, through our partnership with the three state tax agencies and the IRS, we completed the revision to the *Striking Gold in California: What You Need to Know About Taxes and Your Small Business* brochure. It includes basic tax information for new business owners and soon-to-be business owners. We participate in small business fairs sponsored by BOE members throughout California.

We created and updated publications to address common questions related to small business taxpayers:

- *Franchise Tax Board's Guide to: Forms of Ownership (FTB 1123).*
- *Franchise Tax Board: Common Business Expenses for the Business Owner and Highlights of the Federal/State Differences (FTB 984).*
- *Top Twelve Tax Scams (FTB 987).*
- *Don't Gamble With Your Taxes: Read the Fine Print About Incorporating in Nevada (FTB 689).*
- *How to Select an Income Tax Return Preparer (FTB 982).*
- *Audit/Protest/Appeals: The Process (FTB 985).*
- *Striking Gold in California: What You Need to Know About Taxes and Your Small Business (FTB 170).*

We also have a Small Business Liaison that provides education and outreach to small businesses and receives calls from taxpayers. The liaison provides small business owners and taxpayers interested in starting a business with tax information about specific filing requirements, based on their business ownership or proposed business ownership type. The liaison provides referrals to the appropriate program areas within our department and to the other state or federal agencies to answer taxpayers' questions. We received approximately 950 calls this year, an increase of approximately 24 percent, including many calls from out-of-state taxpayers.

Speakers' Bureau
Speakers' Bureau is available to help nonprofit organizations, community groups, and government-funded educational institutions learn more about tax-related issues. Speakers typically make brief presentations to groups of 25 or more. We also provide speakers in other languages upon request and availability. The Speakers' Bureau is one of our ongoing ventures that acknowledge the continuing educational needs of tax professionals and nonprofit tax-related organizations.

Interested Parties Meetings
FTB holds meetings to discuss or generate feedback from interested parties about specific topics such as implementation of new law or proposed initiatives and other topics of interest.

Free Filing Assistance
The FTB and IRS jointly administer the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) volunteer programs to provide free help to low-income, senior, disabled, and non-English speaking persons who need to file simple federal and state tax returns.

FTB recruits VITA and TCE volunteers statewide, provides training to the volunteers, and provides outreach to let the public know about the programs. FTB also provides VITA services for the U.S. Armed Forces with training and support for tax law questions and to military VITA sites throughout California.

Schools' Partnership Program Volunteer Income Tax Assistance
FTB collaborates with the IRS to administer the Schools' VITA Program at two area high schools. This program provides students with opportunities to develop job skills, earn school credit, and learn about the value of volunteerism as they help non-English speaking, disabled, elderly, and low-income members of the community prepare basic state and federal tax returns.

Department Initiatives and Projects

Key Initiatives for 2009

Promote and Encourage Self-Compliance

An ongoing Performance Management Program provides a framework for relevant performance measures, productive performance discussions, and effective improvement actions.

FTB's performance is directly related to the taxpayer's ability to participate in the tax system. In order to continually improve performance, FTB must maintain a focus on taxpayers and what they need to meet their tax obligations. Through a comprehensive Performance Management Program, FTB can manage, monitor, and improve the products and services it delivers in order to promote and encourage self-compliance.

Modernize Our Tax Systems

The Enterprise Data to Revenue (EDR) Project plans to implement many of the opportunities identified in the FTB Information Technology (IT) Strategic Plan. The EDR Project will reengineer and replace FTB's return processing systems with new technologies, implement an enterprise data warehouse, and make changes to several current systems to access and use the data. The EDR Project is expected to achieve significant tax revenue benefits. FTB completed a feasibility study report and the Department of General Services is working to procure the required contractor services to begin July 1, 2011.

Projects

External Authentication for Secure E-services (EASE)

FTB has begun work on implementation of a robust authentication solution for use by external PIT and BE customers, which will replace the stovepipe methods currently used for FTBNet e-services. In order to provide all customers access to e-services, which will help reduce taxpayer burden and also reduce FTB's operational costs, the department will implement a self-managed authentication solution that meets industry standards for security and usability. The original implementation date was late summer of 2009, but due to procurement delays resulting from the Governor's Executive Order S-09-09 issued on June 8, 2009, FTB will not implement EASE until after the 2010 filing season.

Web Pay for Businesses

FTB currently offers Web Pay for individual taxpayers. FTB works to expand an online payment system to let all BE customers make electronic payments. Planned implementation is summer 2010.

MyFTB Account Enhancements

FTB is enhancing the MyFTB Account to provide individual taxpayers the address it has on record, as well as the means to update it online. This enhancement furthers a commitment to increased transparency and customer service. Planned implementation is summer 2010.

Taxpayer Compliance Assistance Plan (TCAP)

FTB developed a Taxpayer Compliance Assistance Plan (TCAP) that provides an enterprise plan for delivering customer service to taxpayers. The stated strategic goals are:

1› Focus customer service activities on maintaining and improving self-compliance.

2› Identify customer groups and their specific service needs.

3› Maximize customer satisfaction.

4› Deliver FTB services effectively.

5› Be innovative and respond to changing needs.

Tactical initiatives are developed in a two-year plan to address the strategic goals.

Systemic Issues Management System

The Systemic Issue Management System was released to the public on March 4, 2009, through our website. This web-based application was modeled after the IRS' Systemic Advocacy Management System (SAMS). It allows taxpayers and tax professionals to report systemic issues to us through our website. It also allows us to keep track of the issues until they are resolved.

Taxpayers’ Bill of Rights Hearing

Taxpayers presented proposals to the three-member Franchise Tax Board at the annual Taxpayers’ Bill of Rights hearing on December 4, 2008. The meeting took place at FTB in Sacramento, California. For copies of the responses, go to **ftb.ca.gov** and search for **hearing responses**. The responses are in order of the presentations at the meeting.

David Shaw, California Society of Enrolled Agents (CSEA)

Mr. Shaw provided oral comments to the Board on the following issues:

- Conformity
- Substantial Authority Penalty Standard

In his letter dated March 4, 2009, Taxpayers’ Rights Advocate Steve Sims responded by stating conformity between federal and California tax law is an important goal in tax administration. He also indicated that FTB plans to sponsor legislation to address the federal changes enacted since January 1, 2005.

Mr. Sims indicated FTB will draft a legislative proposal to conform to the recent federal change with respect to the standards for the preparer penalty.

Gina Rodriquez, Spidell Publishing, Inc.

Ms. Rodriquez presented written materials and provided oral comment to the Board on the following issues:

- Accelerated Estimated Tax Payments
- Claiming Refunds of Estimated Tax Payments
- Texas Franchise Tax
- Double Withholding
- Suspend Collection Action When Claim Pending
- Estimated Tax Payments Held in Suspense
- Small Refund Checks

In his letter dated June 2, 2009, Taxpayers’ Rights Advocate Steve Sims responded that as the result of legislation enacted last year, new California estimate payment requirements began January 1, 2009. This new law changed the percentage amount for estimated tax installment payments from four equal installments of 25 percent of the required annual amount to installments of 30 percent of the required annual amount for each of the first two installments and 20 percent of the required annual amount for the last two installments. The new law did not change withholding requirements; therefore, wage earners do not need to change their withholding to address the change to the percentage amount for estimated tax installment payments, so long as the total amount of tax owed with the return for 2009 or 2008, after being reduced by credits and taxes withheld for the applicable year, is less than $500 ($250 in the case of a married individual filing separately). This $500 threshold was increased this year. In previous years, the threshold was $200.

Regarding claiming refunds of estimated tax payments, Mr. Sims advised we will explore the feasibility of enhancing the amended return processing and tax accounting systems to allow overpayments to be applied as an estimated tax payment to a future year.

Regarding suspending collection action while a claim is pending, Mr. Sims responded that FTB can continue to collect the balance due until and unless the refund claim is allowed. FTB agents are instructed not to place a tax year hold until the refund claim has been allowed. However, if supporting documentation *can be provided showing the claim for refund will likely be allowed, the agent may place a tax year hold for a reasonable time allowing the claim to be evaluated.*

In his follow-up letter dated, June 23, 2009, regarding double withholding, Mr. Sims indicates the issue that Spidell is asking FTB to address is double withholding on non-California partnerships. FTB does not see this issue as double withholding. FTB recognizes this issue as a tax gap. California residents and nonresidents are subject to real estate withholding tax when California real property is sold. Before January 1, 2009, all partnerships were exempt from real estate withholding. When California real property was sold belonging to a partnership, there was no withholding. FTB recognized the exemption as a tax gap for non-California partnerships. FTB continuously works on California partnerships and partnerships qualified to do business in California to withhold on distributions. The only means of assuring the property sale is reported on a California tax return is to withhold at the source.

Regarding estimated tax payments held in suspense, Mr. Sims responded that last August, FTB sent the new "two-year" notification to taxpayers who had made estimate payments, but had not filed a tax return. FTB mailed 24,000 notices to taxpayers who had made a total of $117 million estimate payments. These notices were for tax year 2005. If returns are not filed, the statute of limitations will expire in April 2010. We do not yet know how many of these 24,000 taxpayers have since filed a return. We plan to begin gathering that information soon, but we are intentionally waiting until most of the returns from this filing season have been processed. However, we will not be able to measure the full impact of this additional notification until the end of the statute of limitations.

Regarding small refund checks, Mr. Sims responded that Revenue and Taxation Code Section 19301 requires FTB to refund any overpayment to the taxpayer. Exceptions exist to offset tax liabilities on other years and other specified liabilities. Taxpayers may also request overpayments of estimated taxes be transferred to the next year. However, it was determined that it would be cost prohibitive to encourage taxpayers to roll over low dollar overpayments to the next year.

Regarding Accelerated Estimated Tax Payment, Mr. Sims provided an update to advise that on March 26, 2009, AB 1580 was introduced to clean up the Accelerated Estimated Tax Payment issue by correcting the wage-withholding problem.

Regarding Claiming Refunds of Estimated Tax payments, Mr. Sims provided an update to advise that FTB's Tax Forms and Notices Action Team (TFNAT) formed a sub-team to study this suggestion. We feel this is feasible, and could be treated as an informal process not requiring legislation.

Regarding Suspend Collection Action When Claim Pending, Mr. Sims provided an update indicating that FTB's existing procedures appear to coincide with the methods used by the IRS to manage cases with these issues. Current policy follows the IRS' policy to give reasonable consideration to suspend collection activities on a tax year until a taxpayer's claim for refund can be processed.

Regarding the request for guidance on the Texas franchise tax issue, in his letter dated August 4, 2009, Mr. Sims enclosed a copy of FTB Notice 2009-06 issued by the department on July 20, 2009. The notice describes California treatment of the Revised Texas franchise tax for purposes of determining eligibility for an Other State Tax Credit or a deduction for California income and franchise tax purposes.

Lenny Goldberg, CA Tax Reform Association

Mr. Goldberg provided oral comments to the Board on the following issue:

- e-filing and IRS

In his letter dated March 4, 2009, Taxpayers' Rights Advocate Steve Sims responded by agreeing that it is a good idea for IRS and FTB to work together to support and improve e-file programs. FTB works with IRS, other states, and the software industry on the development and implementation of the IRS' modernized e-file. California is also actively involved with the Electronic Tax Administration Advisory Committee (ETAAC), and will continue this partnership in an effort to assist IRS with direct e-file program development.

Roland Boucher, United Californians for Tax Reform

Mr. Boucher presented oral comments to the Board on the following issue:

- Increase standard deduction to same value offered to federal taxpayers

In his letter dated March 4, 2009, Taxpayers' Rights Advocate Steve Sims responded by advising departmental support is not recommended for the suggestion to increase the standard deduction to an amount equal to the senior federal standard deduction and eliminate the 1 percent tax rate. The suggestion includes elimination of the 1 percent tax rate in order to make this change revenue neutral. However, this assumption would only be true for those taxpayers whose itemized deductions are currently between the state and federal standard deduction amounts. For all other taxpayers with itemized deductions greater than the federal standard deduction, this would result in a tax increase since the tax rate would start at 2 percent instead of 1 percent with no corresponding increase in deduction.

G. Michelle Ferreira, Holme, Roberts, & Owen, LLP

Ms. Ferreira presented oral comments to the Board on the following issues:

- Noneconomic Substance Transaction (NEST) Penalty
- Post-amnesty Penalty
- Interest-based-only Penalty

In his letter dated March 4, 2009, Taxpayers' Rights Advocate Steve Sims responded by advising that FTB's Legal and Audit Divisions are continuing to work together to ensure consistent and appropriate application of the NEST penalty, as intended by the California Legislature.

Mr. Sims also indicated that FTB is administering the post-amnesty penalty as provided by the State Legislature. Because the penalty applies only to tax years prior to January 1, 2003, FTB should see fewer instances of this penalty for most taxpayers.

Additionally, Mr. Sims' letter indicated that the interest-based penalty is another one where the Audit and Legal Divisions work together to ensure the penalty is imposed correctly in the appropriate cases, after fully developing the facts to support imposition of the penalty.

John Woodford, California Society of Certified Public Accountants

Mr. Woodford presented oral comments to the Board on the following issue:

- SB 28 and changes to Revenue and Taxation Code Section 19136-3 regarding the elimination of the prior year's exception

In his letter dated March 4, 2009, Taxpayers' Rights Advocate Steve Sims responded that the elimination of the prior year's exception does not apply to a taxpayer with an adjusted gross income (AGI) of less than $1 million. Thus, an AGI test is already used to determine whether the prior year exception applies or not, even though it is the AGI of the current year and not the prior year.

Evaluating Franchise Tax Board Employees

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. 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."

As part of our initiative to increase employee engagement, we implemented a plan to ensure all eligible employees receive an annual performance appraisal by August 31 of each year. This provides employees continuous feedback and allows us to track and report on the completion of performance appraisals. We initiated a talent development program that enables employees to take control of their own development in a way that is beneficial to themselves and the organization.

We also developed mission and value statements that emphasize the commitment of management and employees to do a job well, continuously improve service to customers, and provide courteous, fair treatment to 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 managers, supervisors, and staff at all levels throughout the department. We continue to revisit our values to ensure they meet the needs of our organization and customers.

Appendices

Appendix 1

All tables in Appendix 1 reflect tax increase assessments only. The assessments became final in fiscal year 2008/2009. We may have issued the assessments in prior years; however, due to cases in protest status, we did not resolve them until 2008/2009. Appendix 1 totals reflect rounded figures and may not compute exactly.

Table 1A **Corporation Tax Law**
NPAs Finalized in Fiscal Year 2008/2009 Categorized by Primary Statute (Issue)

Issue	Number of NPAs	%	Tax Assessed (Millions)	%	Average Assessment Per NPA
Allocation/Apportionment	690	28.3	$ 437.0	78.9	$ 633,368
Assess Minimum Tax	267	10.9	0.2	0.0	799
Revenue Agent Reports	966	39.7	93.8	16.9	97,064
State Adjustments	201	8.2	11.0	2.0	54,795
Other	309	12.9	11.5	2.1	37,234
Totals/Average	2,433	100	$ 553.5	100	$ 227,505

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

Table 1B **Personal Income Tax Law**
NPAs Finalized in Fiscal Year 2008/2009 Categorized by Primary Statute (Issue)

Issue	Number of NPAs	%	Tax Assessed (Thousands)	%	Average Assessment Per NPA
CP2000	190,933	21.8	$ 137,423	5.9	$ 720
Filing Enforcement	580,193	66.4	1,894,892	81.7	3,266
Filing Status	33,072	3.8	30,946	1.3	936
Revenue Agent Reports	35,847	4.1	92,361	4.0	2,577
Other	34,363	3.9	164,145	7.1	4,777
Totals/Average	874,408	100	$2,319,767	100	$ 2,653

- 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.

Table 2 **Corporation Tax Law**
Corporations by Industry with NPAs Finalized in Fiscal Year 2008/2009

Industry	All Corporations 2007 Tax Year	%	Corporations with NPAs	%	Tax Assessed (Millions)	%
F.I.R.E.*	131,906	18.6	169	12.8	$ 109.4	19.8
Manufacturing	50,181	7.1	148	11.2	181.3	32.8
Services	281,222	39.6	197	15.0	63.8	11.5
Trade	122,611	17.3	197	15.0	46.4	8.4
Other **	124,021	17.5	606	46.0	152.6	27.5
Totals	709,941	100	1,317	100	$ 553.5	100

*Finance, insurance, real estate, and holding companies.
** Includes agriculture, construction, utilities, transportation, communication information, and other industries not classified in the sample.

For corporations not filing via a combined report, we base the industry designation on the corporation's primary business activity in California. In the case of corporations filing via combined reports, we base the industry designation on the primary occupation of the group, not necessarily on the industry of the parent. 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.

Tables 3A, 3B, and 4, apply 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.

Table 3A **Corporation Tax Law**
NPAs Finalized in Fiscal Year 2008/2009 Issued by Taxable Year

Average Taxable Year	Number of NPAs	%	Tax Assessed (Millions)	%	Average Assessment Per NPA
2001 and prior	589	24.2	$ 320.9	58.0	$ 544,822
2002	138	5.6	52.0	9.4	376,450
2003	302	12.4	79.5	14.4	263,192
2004	445	18.2	65.9	11.9	147,986
2005	531	21.8	26.9	4.9	50,638
2006	312	12.8	7.8	1.4	25,007
2007 and later	116	4.7	0.5	0.0	4,702
Totals/Average	2,433	100	$ 553.5	100	$ 227,505

Because the statute of limitations for assessing additional tax has passed, the earlier years reflect final figures.

Table 3B **Corporation Tax Law**
Multiple NPAs Finalized in Fiscal Year 2008/2009 for the Same Taxpayer

Corporations With...	Number of NPAs	Tax Assessed (Millions)	Average Assessment Per Taxpayer
One NPA	663	$ 55.9	$ 84,353
Two NPAs	413	114.2	276,607
Three NPAs	138	58.6	424,465
Four or more NPAs	103	324.8	3,153,199
Totals/Average	1,317	$ 553.5	$ 420,289

Table 4 **Personal Income Tax Law**
NPAs Finalized in Fiscal Year 2008/2009 Issued by Taxable Year

Taxable Year	Number of NPAs	%	Assessment Amount (Thousands)	%	Average Assessment Amount
2002 and prior	2,966	0.3	$ 75,385	3.3	$ 25,416
2003	5,389	0.6	27,046	1.2	5,019
2004	28,523	3.3	107,246	4.6	3,760
2005	254,934	29.2	504,337	21.7	1,978
2006	466,011	53.3	1,287,320	55.5	2,762
2007 and later	116,585	13.3	318,432	13.7	2,731
Totals/Average	874,408	100	$2,319,767	100	$ 2,653

Table 5 **Personal Income Tax Law**
Resident Tax Return Preparation, Process Years 2008 and 2009

Preparer	2007 Returns Processed (Thousands)	%	2008 Returns Processed (Thousands)	%	% Change
Professional	10,076	70.1	10,339	68.9	-1.2
Taxpayer	4,137	28.8	4,485	29.9	1.1
VITA*	169	1.2	192	1.3	0.1
Totals	14,383	100	15,016	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 6 **E-filing and Payment Statistics**

Activities	July 1, 2008	June 30, 2009	% Change
Credit Card Payments (Average payment is $978)	121,000	108,000	-11
Direct Debit of Balance Due (Electronic Funds Withdrawal)	383,000	369,000	-4
Direct Deposit Refund	5,077,000	5,299,000	4
e-file	10,650,000	11,083,000	4
* *CalFile*	193,000	228,000	18
* Online Filing	2,083,000	2,362,000	13
* Business Entity	177,000	293,000	66

* We include these volumes in the e-file volume.
Note: e-file volume includes Business Entity returns.

Table 7A **Corporation Tax Law**
Nonfilers Detected Through the Automated Nonfiler System

Fiscal Year	Demands	NPAs Issues
2004-05	10,744	15,064
2005-06	19,047	0
2006-07	8,927	13,271
2007-08	31,819	18,855
2008-09	65,954	23,807

Table 7B **Corporation Tax Law**
Nonfilers Detected Through the Automated Nonfiler System

Fiscal Year	Demands/Requests	NPAs Issues
2004-05	756,183	528,856
2005-06	754,613	509,066
2006-07	826,612	546,614
2007-08	839,818	463,315
2008-09	1,222,050	849,650

Table 8A **Top Errors by Return Type**
July 1, 2008 through June 30, 2009

	Code	Total	540 2EZ	540 A	540	540 NR	540 X
EP	Estimate Payment	**204,300**	**1,900**	**3,900**	**183,400**	**15,000**	100
DS	Deductions	**48,100**	100	**12,200**	**31,300**	**4,300**	200
TC	Tax Amount	**45,500**	400	**5,500**	**29,800**	**8,300**	**1,500**
TT	Total Credits/Liability	**41,500**	**11,500**	**10,100**	**17,000**	**2,600**	**300**
AA	Adjusted Gross Income	**40,200**	**39,900**		100	200	
EX	Exemptions	**30,700**	300	**9,200**	**18,000**	**3,100**	100
TY	Total Tax Revised - AGI, Filing Status, or Dependents	**28,000**	**28,000**				
OC	Estimate Transfer Revised	**25,200**		600	**21,000**	**3,600**	
SS	State Disability Insurance Revised	**22,300**		1,000	**20,700**	500	100
ND	California Taxable Income Revised	**19,100**			100	**18,900**	100
OA	Refund Revised - Incorrect Payments or Credits	18,100	**3,600**	**3,400**	**9,300**	600	**1,200**
OF	Amended Refund Did Not Equal Original Refund	17,200	**800**	200	4,500	500	**11,200**
DI	Standard Deduction Greater Than Itemized Amount	16,500		**3,800**	**11,400**	1,100	**200**
CT	Amended Credits Revised to Match Original Credits	12,930	280	100	900	50	**11,600**
RN	Renters Credit Revised	12,600	**3,100**	**4,000**	5,100	400	
NP	Nonresident Ratio Revised	12,500			100	**12,400**	
NN	Total Tax Revised - Nonresident Errors	11,500			100	**11,400**	
OM	Amended Payments Did Not Match Original	10,700	300	100	2,900	300	**7,100**
AW	Withholding Did Not Match Attachments	10,700	**1,400**	700	**7,900**	500	200
WS	Withhold at Source Revised	9,100			3,500	**5,500**	100
OW	Amended Withholding Did Not Match Original	8,700					**8,700**
AM	Withholding Not Verified by Employer	7,800	**900**		6,200	700	
OB	Balance Revised - Incorrect Payments or Credits	6,100	**1,500**	**1,200**	3,100	100	200
TI	Taxable Income Revised	5,400		**1,900**	3,200	200	100
OP	Amended Estimate Payments Did Not Match Original	1,300			300		**1,000**
AR	Amended Return Received - No Record of Original Return	900					**900**
CI	CDC Disallowed - No Form FTB 3506	900		100	400		**400**
AD	Incorrect Year Tax Form	100		100			
	All Others	21,600	800	3,200	13,800	2,600	1,200
	Top Ten	**504,900**	**92,600**	**55,200**	**349,800**	**85,100**	**43,900**
	Total	689,530	94,780	61,300	394,100	92,850	46,500

Table Legend:

Bold › Top ten codes issued by Return Type. Light › Not top ten.

Table 8B **Top Errors by Filing Method**
July 1, 2008 through June 30, 2009

	Code	Grand Total	Elec-tronic	Paper
EP	Estimate Payment	**204,200**	**113,200**	**91,000**
DS	Deductions	**48,100**	**12,700**	**35,400**
TC	Tax Amount	**45,400**	**2,500**	**42,900**
TT	Total Credits/Liability	**41,500**	1,300	**40,200**
AA	Adjusted Gross Income	**40,300**	**20,200**	**20,100**
EX	Exemptions	**30,700**	300	**30,300**
TY	Total Tax Revised - AGI, Filing Status, or Dependents	**28,000**	500	**57,500**
OC	Estimate Transfer Revised	**25,200**	**11,800**	13,400
SS	State Disability Insurance Revised	**22,300**	**12,000**	10,300
ND	California Taxable Income Revised	**19,100**	1,700	**17,400**
OA	Refund Revised - Incorrect Payments or Credits	18,100	900	**17,200**
OF	Amended Refund Did Not Equal Original Refund	17,200	600	**16,700**
DI	Standard Deduction Greater Than Itemized Amount	16,400	**4,100**	12,400
NP	Nonresident Ratio Revised	12,500	**2,200**	10,300
WS	Withhold at Source Revised	9,100	**2,600**	6,500
AM	Withholding Not Verified by Employer	7,900	**7,500**	400
	All Others	103,200	8,100	95,100
	Top Ten	**504,800**	**188,800**	**368,700**
	Grand Total	689,200	202,200	517,100

Table Legend:

Bold › Top ten codes issued by Return Type. Light › Not top ten.

Table 8 **Definitions**

AA	Amount of CA AGI adjusted.
AD	Incorrect year form was used.
AM	Withheld tax credit revised; could not be verified through employer.
AR	Amended return filed with no record of original return.
AW	Withheld tax credit revised to match total shown on attached withholding documents.
CH	Child and Dependent Care Expenses Credit revised; Another taxpayer claimed at least one of the qualifying person's SSN claimed on return.
CI	Child and Dependent Care Expenses Credit disallowed; Form FTB 3506 not attached to return.
CT	Child and Dependent Care Expenses Credit revised to match the amount claimed on original return.
DI	Standard Deduction allowed because it was greater than the Itemized Deduction amount claimed.
DS	Deduction amount revised to correct amount for allowed Filing Status.
EP	Estimated Tax Payment credit revised based on accounting system record of received payments.
EX	Total Exemptions not computed or transferred correctly, or revised due to AGI limitation.
ND	CA taxable income revised; computed or transferred incorrectly, deduction percentage computed incorrectly, or percentage incorrectly applied to deduction.
NN	Total Tax revised; CA Tax Rate, CA Credit Percentage, or CA Exemption Credit Percentage incorrectly computed; or error computing/transferring tax on Sched. G-1 or Form FTB 5870A.
NP	Total Tax revised; ratio computed incorrectly or ratio incorrectly applied to tax amount and credits.
OA	Refund revised; total payments and credits added incorrectly or subtracted incorrectly from total tax.
OB	Balance revised; total payments and credits added incorrectly or subtracted incorrectly from total tax.
OC	Estimated Tax Transfer revised due to an error on the return that affected the available transfer amount.
OF	Amount of refund received reported on Amended return Did Not match amount on original return.
OM	Amount paid with original return plus payments made after return filed Did Not match amount claimed on Amended return.
OP	Amount of estimated tax payments reported on Amended return Did Not match amount on original return.
OW	Amount of CA Withholding reported on Amended return Did Not match amount on original return.
RN	Nonrefundable Renter's Credit revised; wrong amount claimed for filing status, CA AGI over maximum amount, part-year resident or nonresident.
SS	Excess State Disability Insurance revised/disallowed to maximum amount substantiated by W-2s attached.
TC	Tax amount incorrectly computed.
TI	Taxable income adjusted - deductions incorrectly subtracted from AGI.
TT	Total Tax revised; error computing total credits or tax liability.
TY	Total Tax revised based on AGI, filing status and dependents claimed.
WS	Real estate of nonresident withholding revised to the amount substantiated by attached forms or the amount of available credit identified in the accounting system.

Regulation Section 17942 – LLC Fees

For years beginning January 1, 2007, the Legislature amended R&TC Section 17942 to modify the language of the statute and add a new provision. Section 17942 now provides that the LLC fee is based on total income from all sources attributable to or derrived from California. In addition, the amended LLC fee statute provides, "'total income from all sources derived from or attributable to this state' shall be determined using the rules for assigning sales under Sections 25135 and 25136 and the regulations thereunder, as modified by regulations under Section 25137, other than those provisions that exclude receipts from the sales factor."

R&TC Sections 25135 and 25136 are the sections that assign sales to the California numerator of the sales factor. Section 25135 assigns sales of tangible personal property and contains as its primary rule the assignment of the sale to California if the property is delivered to a purchaser in this state. Section 25136 assigns all other sales, and its primary rule assigns sales on the basis of where the income-producing activity associated with that sale occurred. The regulations under Section 25136 also provide special rules for assigning specific items such as income from real property, which is assigned to the state where the real property is located.

The regulations adopted pursuant to R&TC Section 25137 provide specific apportionment rules for special industries, such as banks and financials, truckers, and franchisors. These regulations also provide specific sales factor rules for various types of income that are especially problematic.

While the new LLC fee methodology utilizes the sales factor numerator rules to determine the total income assignable to California for purposes of the LLC fee calculation, the method is not the Uniform Division of Income Tax Purposes Act (UDITPA) apportionment method. There is no calculation of a factor, only the determination of whether a given item of income is assignable to California using the sales factor numerator assignment mechanism. Both business and nonbusiness income from items are assigned using the sales factor rules. Once the total income of the LLC is assigned to the various states using this methodology, the fee is calculated based on the total income assignable to California.

On November 28, 2007, staff received authorization from the three-member Franchise Tax Board to proceed with an interested parties meeting to discuss what regulatory guidance (if any) should be provided regarding the use of this new assignment mechanism. An interested parties meeting was held on June 17, 2008. No further action has been taken.

Regulations Sections 18662-0 Through 18662-8 and 19002 – Withholding at Source

Withholding at source is an essential part of the department's tax gap compliance initiative. Withholding's "pay as you go" process helps taxpayers by ensuring that tax is collected as income is received. It helps the state to ensure that tax is paid as it is incurred on specific transactions, encouraging taxpayers to file returns at the end of the year.

California law requires FTB to issue regulations to implement the withholding at source statutory requirements (R&TC Section 18662, subdivision (a)). These regulations have not been updated in many years, and do not currently reflect statutory and other changes affecting the withholding statutes themselves. They were written at a time when electronic filing and payment were not available, and also need to be updated to align these filing and payment procedures with modern practices.

The text of the existing regulations has been rewritten and reorganized into a simpler, more descriptive order. The revised text contains a Table of Contents, and the draft regulations begin with the definitions and general rules applicable to all withholding at source, then provide specific guidance for the two major withholding areas that FTB administers: Real Estate Withholding and Withholding on Payments (Nonresident Withholding).

On June 27, 2007, staff received authorization from the three-member Franchise Tax Board to proceed with an interested parties meeting to discuss the draft proposed regulations and instructions to reflect current statutory requirements under R&TC Section 18662, subdivision (a). An interested parties meeting was held August 13, 2007. Three comments were received. On November 28, 2007, staff received approval to commence a formal regulatory project, as required under the Administrative Procedure Act, from the three-member Franchise Tax Board. No further action has been taken.

Regulations Sections 23701(i) and 23772(d) – Exemption From Taxation and Information Returns and Statements of Exempt Organizations

AB 897, Stats. 2007, Ch. 238, changed the rules for California income and franchise tax purposes for organizations that are exempt under IRC Section 501(c)(3). Specifically, AB 897 added a new subdivision to R&TC Section 23701d that provides generally that IRC Section 501(c)(3) exempt organizations will be exempt for California purposes upon submission of a copy of the organization's IRC Section 501(c)(3) federal determination letter to the FTB. This change specifically applies to requests for tax-exempt status in California filed by organizations with the FTB on or after January 1, 2008.

As the legislative purpose of AB 897 is to allow federal law under IRC Section 501(c)(3) to control, to the extent that existing California regulations conflict with federal law under IRC Section 501(c)(3), consideration of any conflict in existing regulations is required to effectuate the Legislature's intent in AB 897.

Currently, both California and federal law recognize a group of organizations as tax-exempt if they are affiliated with a central organization (one which has one or more subordinates under its general supervision or control). The concept of a central organization applying for tax exemption for itself and its subordinates (i.e., chapter, local, post, or unit) is known as a "group exemption."

Staff received approval from the three-member Franchise Tax Board on June 5, 2008, to proceed with an interested parties meeting to address whether existing Regulation Sections 23701(i) and 23772(d) should be amended to allow incorporated subordinates to be able to obtain tax exemption by virtue of being part of a group. An interested parties meeting was held July 22, 2008. There were no attendees or comments submitted. Staff held a formal regulatory hearing, as required under the Administrative Procedure Act, on January 12, 2009. There were no comments made. The final approved regulations were filed by the Office of Administrative Law with the Secretary of State on March 19, 2009.

Regulations Sections 25101.3 and 25137-7 – Air Transportation Companies – Allocation and Apportionment of Income

FTB has identified the current statute and regulation used to apportion air transportation company income to this state as potentially needing both a new regulation and amendments to an existing regulation. (R&TC §§25137 and 25101.3; Cal. Code Regs., Tit. 18, § 25137-7.) The property factor for apportioning income of an air transportation company is calculated according to California R&TC Section 25101.3. There currently is no regulation interpreting that statute. The discussion draft of Regulation 25137-7 includes several major amendments.

Staff received approval to proceed with an interested parties meeting at the April 4, 2007, three-member Franchise Tax Board meeting. An interested parties meeting was held September 6, 2007, to discuss updating the existing airline transportation regulations to provide a uniform apportionment formula that can be applied industry-wide, and to clarify factor representation for airfreight activities. Staff received comments and as a result drafted proposed language for Regulation Section 25101.3 and amendments to existing Regulation Section 25137-7. A second interested parties meeting was held March 27, 2008, to discuss updated model/type groupings. Staff anticipates holding a formal regulatory hearing, on January 13, 2010.

Regulations Sections 25111 and 25113 – Water's-Edge Election

In 1988, the California Legislature adopted Section 25110, et seq., which allowed California taxpayers that were members of a unitary group to "elect to account for and determine their income derived from California sources by considering only the income and apportionment factors" of certain affiliated corporations, which are generally only the domestic members of the Unitary group, which is called the "water's-edge" method.

Originally, taxpayers that wanted to utilize the water's-edge method of combined reporting were required to enter into a contract with FTB for an 84-month period. The requirements for satisfying the terms of the contract were contained in Section 25111 and the regulations promulgated thereunder. For taxable years beginning on or after January 1, 2003, the provisions for making a water's-edge election were substantially changed when Section 25113 was enacted and Section 25111 was amended. Section 25113 replaced the contract provided for Section 25111 with a statutory election, which is also to be made for an 84-month period.

Regulation Section 25111 previously provided definitions or explanations of several key concepts and Section 25113 provided new rules for taxpayers to use in terminating their water's-edge election. Both sections indicate that taxpayers that have valid elections for taxable years beginning before January 1, 2003, will continue to file on a water's-edge basis and will be deemed to have elected under the new rules for taxable years beginning on or after January 1, 2003. However, the election commencement date under the new rules will continue to be the commencement date as originally elected under the old rules.

On November 28, 2007, staff received permission from the three-member Franchise Tax Board to hold an interested parties meeting to address changes to the existing regulation providing for the contract method of making a water's-edge election and to discuss the content of a new regulation incorporating rules on making a statutory water's-edge election. An interested parties meeting was held on March 25, 2008. Staff held a formal regulatory hearing, as required under the Administrative Procedure Act, on April 22, 2009.

Comments were received involving changes to Section 25113. There were no additional changes to Section 25111. Staff then published a fifteen-day notice incorporating the proposed revisions on February 17, 2009, and the final approved regulations were filed by the Office of Administrative Law with the Secretary of State on April 6, 2009, and became effective May 6, 2009.

Regulation Section 25114 – Presumptions Arising From Federal Audits

In 1988, the California Legislature adopted R&TC Section 25110, et seq., which allowed California taxpayers that were members of a unitary group to "elect to account for and determine their income derived from California sources by considering only the income and apportionment factors" of certain affiliated corporations, which are generally only the domestic members of the unitary group, which is called the "water's-edge" method.

Previously, R&TC Section 25114, subdivision (a), required FTB to examine all returns filed by taxpayers pursuant to the water's-edge rules. If FTB then determined that there was potential noncompliance, it was required to conduct a detailed examination under the federal transfer pricing rules of IRC Section 482 unless the IRS was examining the taxpayer for the same years and issues. This detailed examination was required to be conducted notwithstanding the "potential net revenue benefit to the state."

On October 5, 2007, the Governor signed SB 788 (Stats. 2007, Ch. 306), which amended R&TC Section 25114. Under amended R&TC Section 25114, FTB is still required to examine all returns filed by taxpayers pursuant to the water's-edge rules. The amendments to R&TC Section 25114 have deleted the requirement for FTB to conduct a detailed examination in cases of potential noncompliance. The decision to conduct a detailed audit, including a transfer pricing audit, has been left to the discretion of the FTB audit staff. If a decision to conduct a transfer pricing audit is made, FTB must still conduct the audit under the federal transfer pricing rules of IRC Section 482, unless the IRS is examining the taxpayer for the same years and issues.

On November 28, 2007, staff received permission from the three-member Franchise Tax Board to hold an interested parties meeting to address statutory changes to the existing regulation requiring FTB to examine the returns filed by taxpayers pursuant to the water's-edge rules. An interested parties meeting was held on March 25, 2008. A public notice, as required under the Administrative Procedure Act, was mailed and published on February 13, 2009. The notice required that any interested persons request a public hearing at least 15 days before the close of the written comment period. The department did not receive a request for a hearing by April 7, 2009, or any written comments during the comment period, which ended on April 22, 2009. The final approved regulations were filed by the Office of Administrative Law with the Secretary of State on May 21, 2009, and became effective on June 20, 2009.

Regulation Section 25128 – Apportionment of Business Income

In 1993, R&TC Section 25128 was amended to require that the sales factor be double-weighted for most taxpayers. Exceptions to double-weighting are provided for in subdivision (b) of R&TC Section 25128 when an apportioning trade or business derives more than a threshold percent of its gross business receipts from one or more of the four activities that are enumerated in subdivision (c).

One enumerated exception is "banking or financial business activity" (subdivision (c)(4) of R&TC Section 25128). Banking or financial activity is defined generally in subdivision (d)(5) as "activities attributable to dealings in money or moneyed capital in substantial competition with national banks." The remaining three activities are defined comprehensively, either in separate regulations (extractive business activity in Regulation Section 25128-1 and agricultural business activity in Regulation Section 25128-2), or in subsection (c) (savings and loan activity). Only "banking or financial business activity" lacks a comprehensive definition, either in the statute itself or in Regulation Section 25128.

On September 5, 2007, staff received permission from the three-member Franchise Tax Board to hold an interested parties meeting to address identified concerns and include a comprehensive definition of "banking or financial business activity." Staff held an Interested Parties Meeting on January 9, 2008. Attendees expressed concerns and after the meeting staff agreed to hold a working group meeting to further discuss the issues and whether changes should be made to the regulation. A working group meeting was held on September 30, 2008, and after considerable discussion, in 2009 it was determined no changes were needed at this time.

Regulation Section 25136 – Sales Factor. Sales Other Than Sales of Tangible Personal Property in This State

California Code of Regulations, title 18, Section 25136 (Regulation Section 25136), is based upon, and is virtually identical to, Multistate Tax Commission (MTC) Regulation IV.17 prior to the most recent amendments. Regulation Section 25136 generally provides that sales of other than tangible property are assigned to the numerator of the sales factor based upon where the income-producing activity is performed. Under subsection (b) of the current regulation, income-producing activity only includes "activity directly engaged in by the taxpayer in the regular course of its trade or business" and "does not include transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor."

FTB issued Legal Ruling 2006-2 on May 3, 2006. This Legal Ruling held that: Due to the effects of combined reporting when the contractor and the subcontractor are in a unitary relationship and are members of the same combined reporting group, the activities of the subcontractor in performance of the contract will be considered income-producing activities *directly* engaged in by the contractor for purposes of the sales factor in order to more accurately assign the receipt to the place where the services were performed.

At the Annual Meeting of the MTC held on August 2, 2007, the MTC approved amendments to the Commission's Regulation IV.17. The amendments adopted by the MTC reverse the general rule found in Regulation Section 25136, subsection (b), and make assignments based upon activities of both the taxpayer and those performed on behalf of the taxpayer.

On September 5, 2007, staff received permission from the three-member Franchise Tax Board to hold an interested parties meeting to discuss the possibility of adopting and, to what extent, the amended MTC model regulation for Regulation Section 25136. On January 9, 2008, an interested parties meeting was held. Public comments were received and were considered by staff. On June 5, 2008, FTB approved staff's recommendation to proceed with the formal regulatory process, as required under the Administrative Procedure Act, providing staff solicit public comment on examples that were being developed prior to initiating the formal regulatory process. The formal regulatory hearing is scheduled for January 13, 2010.

Regulation Section 25137-1 – Apportionment and Allocation of Partnership Income

When a taxpayer subject to the Corporation Tax Law is a partner in a partnership as defined in R&TC Section 17008, the computation of its distributive share of partnership items is determined in accordance with Chapter 10 of Part 10 of Division 2 of the R&TC. The portion of such distributive share (constituting business and nonbusiness income) that has its source in this state, or that is included in the taxpayer's business income, is determined in accordance with California Code of Regulations, Title 18, Section 25137-1 (the "partnership regulation"), which was first promulgated in 1972 and last amended in 1985.

The partnership regulation has generally functioned well over the years, but the passage of time has rendered some of its provisions out of date and new business models have arisen that the regulation does not address. For these reasons, FTB staff has studied the regulation and identified several issues that it believes should give rise to consideration of amending the regulation.

On November 28, 2007, staff received permission from the three-member Franchise Tax Board to hold an interested parties meeting to address numerous issues identified by staff. An interested parties meeting was held on September 19, 2008. No further action has been taken.

Regulation Section 25137-8 – Apportionment of Income for Motion Picture and Television Film Producers and Television Networks

Several years before the UDITPA was adopted by California, FTB and the motion picture industry recognized that special rules were needed for the allocation and apportionment of income from the industry's activities. Working together, the department and industry developed special rules which were adopted in 1982 as Regulation Section 25137-8. Since the regulation in its current form was adopted over 25 years ago, it may be time to revisit the regulation to determine what, if any, changes might be appropriate.

Subsequent to the adoption of the existing regulation in 1982, the television network broadcasting industry has undergone significant changes, and is continuing to do so. Today, television networks operate almost exclusively on a multistate basis. Technology has changed as well and network programs and advertising are transmitted as a digital signal to satellites, accessed by affiliates and released to subscribers across the country and, in some cases, around the world.

At the time the regulation was drafted, the focus was on major studios, and independent distributors do not appear to have been represented at the hearings. While the regulation was subsequently enlarged to include independent television broadcasters, there was no discussion or inclusion of independent film distributors and they are not covered by the existing regulation.

The changes in advertising-driven media continue to cross industry lines. Today, television, print and film industries regularly utilize online advertising formats and web companies are brokering advertisements in the television, radio, print, and gaming industries, as well as the internet. These multiple formats mean that what is defined as an advertisement is rapidly changing.

On September 5, 2007, staff received permission from the three-member Franchise Tax Board to hold an interested parties meeting to discuss updating the existing regulation to address the need for definitions of "gross receipts," "advertisement," "independent film distributor," and "tangible/intangible" with regard to distribution rights. In addition, the issue of advertising revenues from online advertising in the Motion Picture and Television Industries, as well as whether other online advertising-driven media industries should be included in Regulation Section 25137-8, were discussed with interested parties. On January 8, 2008, an interested parties meeting was held. Public comments were received and were considered by staff. A working group meeting was held as a result of the January 8, 2008, interested parties meeting. Staff anticipates holding a formal regulatory hearing sometime in the spring of 2010.

Regulation Section 25137-11 – Allocation and Apportionment of Income of Trucking Companies

Due to the mobile nature of the trucking industry, it is often difficult to isolate and measure the level of California activity in comparison to the level of activity everywhere in order to assign property, payroll, and sales to this state. For this reason, FTB promulgated California Code of Regulations, Title 18, Section 25137-11, to calculate the property, payroll, and sales factors of trucking companies. This regulation provides an efficient way for trucking companies to calculate their apportionment factors, as mileage is routinely recorded, and hence, it provides a readily available measure of business activity both within and without California. The rules for determining the apportionment factors for the trucking industry, pursuant to Regulation Section 25137-11, have generally been derived from, and are parallel to, the trucking regulation promulgated by the MTC.

The apportionment formula found in Regulation Section 25137-11 uses an interstate ratio to apportion property, payroll, and sales related to the transport of goods between states. Shipments that are driven only inside of California are assigned to the California numerator of the property, payroll, and sales factors. The interstate ratio for hauls crossing state lines is miles driven inside of California divided by total miles. In this way, property, payroll, and sales are assigned in proportion to the miles driven within California.

On November 28, 2007, staff received permission from the three-member Franchise Tax Board to hold an interested parties meeting to discuss whether to update or add definitions to the existing regulation. An interested parties meeting was held July 17, 2008. Discussions included whether the "trucking company" definition should be amended and whether a "trucking activity" definition should be added. A second iterested parties meeting was held on May 26, 2009. Discussions included the proposal to use only one category called 'trucking activity' and deleting the use of the term 'trucking company' from the regulation. Also discussed was whether 'back haul' mileage should be included in the interstate ratio, treatment of 'owner operators', and how to define 'owner operators.' Also discussed were freight forwarding and third-party independent contractor fact situations. Public comments were received and were considered by staff. Project is currently on hold.

Regulation Section 25137-12 – Print Media

Regulation Section 25137-12, adopted in 1995, addresses both the nature and sourcing of advertising in magazines and periodicals ("print media"). The precursor to this regulation was Legal Ruling 367, issued in 1973, in which the department ruled (1) that sales of advertising in print media generated business income under R&TC Section 25120, (2) that the advertising was so intrinsically a part of the printed media itself, and (3) that the sale of advertising was to be treated as a sale of tangible personal property under R&TC Section 25134 (the ruling noted that the advertiser's primary purpose was to reach the market established by the print media publisher). Further, sales of advertising were to be sourced on a geographical basis according to circulation statistics: they were sourced to California in the ratio that sales of the printed media bore to the total sales of printed media everywhere.

The regulation also addresses the issue of "nowhere income" by including a throw-back rule that requires advertising receipts to be thrown back to the state from which the printed media containing the advertising was shipped, stored, etc. To the extent that a publisher is not taxable in the state of the purchaser/subscriber of its printed media, the gross receipts from the sales and subscriptions of the printed material are thrown back to the state from which the printed media was shipped.

Traditional "print media" activities now include online advertising services that are not covered under any of the R&TC Section 25137 special industry regulations. Some corporations provide online advertising services that are geographically targeted. FTB has identified the following scenarios that are not currently covered by Regulation Section 25137-12: (1) sales of online advertising, (2) sales of "embedded advertising," and (3) sales of advertising distributed via cable or satellite transmission.

On September 5, 2007, staff received approval from the three-member Franchise Tax Board to proceed with an interested parties meeting to discuss updating the existing regulation to encompass advertising revenue from all technology used by print media to distribute advertising, to determine the characteristics of advertising revenue (i.e., as tangible or intangible property), and to update the regulation in response to other changes occurring in the print media industry. An interested parties meeting was held January 8, 2008. After considerable discussion, the consensus in 2009 was that no regulatory change to California Code of Regulations, title 18, section 25137-12 appears justified, the department will not pursue a regulatory project at this time.

The Taxpayers' Rights Advocate's Office works with Franchise Tax Board's program areas to ensure taxpayers' rights are protected. We identify systemic problems and find solutions in a cooperative effort while protecting taxpayers' rights and recognizing the goals of our audit, collection, and filing programs. We also coordinate the resolution of taxpayer complaints and problems, including complaints regarding unsatisfactory treatment of taxpayers by employees. We promote integrity and responsibility so that our customers can rely on quality information and efficient service.