'12

Taxpayers' Bill of Rights

Annual Report to the Legislature

State of California
Franchise Tax Board

December 1, 2012

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Executive Summary

It never ceases to amaze me how smoothly and efficiently we process the millions of electronic transactions and pieces of paper that flood this department every year. The fact that we perform these tasks year after year does not diminish my appreciation for the hard work and level of service Franchise Tax Board (FTB) employees achieve.

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

The Advocate's Address briefly discusses significant issues, concerns, and challenges to both taxpayers and the department, such as auditor retention, collections, and conformity. 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 addresses the Taxpayers' Rights Advocate's responsibilities and contacts. For Fiscal Year (FY) 2011/2012 (July 1, 2011, through June 30, 2012), the Taxpayers' Rights Advocate's Office responded to over 21,200 contacts from taxpayers. The Taxpayers' Rights Advocate:

- 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's Office conducted a study using samples of both corporation and personal income tax (PIT) Notices of Proposed Assessments. These proposed assessments result from FTB audits. The primary findings include the largest cumulative dollar amounts in proposed assessments:

- Corporation taxes—allocation and apportionment audits.
- Personal income taxes—filing enforcement (FE) assessments.
- Manufacturing industry—based on California's primary business activity.

The Taxpayers' Rights Advocate's Office compiled information on taxpayers' filing errors detected during tax return processing. We issued Return Information Notices (RINs) to taxpayers who filed tax returns with errors that resulted in a change in tax liability. Advocate staff detected a taxpayer error rate of approximately 2.7 percent during tax 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 make it easier for taxpayers to meet their obligations. We continue 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 2012 Taxpayers' Bill of Rights Annual Report to the Legislature.

I would like to give FTB special acknowledgement for their efforts and quality service to California taxpayers during this difficult economic time. In spite of various challenges, FTB continues to generate opportunities for growth and improvement. For instance, they are making significant progress with the Enterprise Data to Revenue (EDR) Project.

The EDR Project aims to modernize FTB's tax systems and business processes. Modernization brings new technologies that FTB will use to leverage the tremendous amount of data they collect to more effectively administer California's income tax system and generate revenue for the state. In FY 2011/2012, FTB expected to generate $65 million associated with the project but actually generated $116 million. The EDR Project brings more efficient operations throughout FTB and more revenue for the state allowing FTB to make significant progress toward reducing the tax gap. Additionally, the EDR Project promises a higher level of transparency, better customer service, and reduced taxpayer burden.

The EDR Project enables FTB to provide taxpayers and tax professionals online access to the information they want and need regarding their California income taxes. In the future, The EDR Project's Taxpayer Folder component will significantly expand the online information that FTB currently provides. By June 2014, taxpayers and tax professionals will securely access important tax information online, including net tax liability, balance due, payments made, images of tax returns, notices received, and much more. Providing this information online allows taxpayers and authorized tax professionals the convenience of 24 hours a day, 7 days a week access to their critical tax information, eliminating the need to make phone calls or write letters.

Additionally, in June 2014, FTB will roll out a new secure Live Chat service. Currently, FTB handles only general information issues with their Live Chat program due to the lack of confidential security features in the program. The new secure program will allow FTB staff to work with the taxpayer or tax professionals in a secure, confidential chat session to resolve specific tax issues. I assigned staff to various EDR Project teams to look for opportunities for additional improvements to customer service and increased transparency.

I continue to maintain constant interaction with the tax professional community and with taxpayers. I personally participated in presentations to a variety of tax professionals, community organizations, business groups, and government groups throughout California. My involvement in these events allows me to stay apprised of how law changes, FTB's policies, processes, and procedures effect taxpayers. Meeting with these groups allows me to gain firsthand knowledge on issues, concerns, and challenges taxpayers face and the impact legislation has on businesses in California and taxpayer compliance. One issue business owners expressed to me is they feel California burdens them with filing requirements from multiple state agencies as well as local governments. The overall complexity of California tax laws: changing legislation, regulations, increased enforcement, and lack of conformity, all add to the burden business owners must overcome to be self-compliant taxpayers in California.

California continues to look for ways to reduce the current deficit and lessen the tax gap. As I mentioned earlier, the EDR Project is one of FTB's current strategies to address the tax gap. With the EDR Project, FTB increases its use of data and, in some cases, makes modifications to how it interprets and filters data—all with the goal to encourage filing compliance and collect delinquent taxes.

FTB should be mindful to protect compliant taxpayers as they use new data to identify and collect delinquent taxes. Recently, FTB made a technical change in its FE program which identifies potential nonfilers. That change inadvertently resulted in erroneous contacts to a small number of taxpayers who receive social security income which is not taxable by California. Although FTB immediately took action to address this issue, it is indicative of the types of unintended consequences that can occur absent a thorough analysis of how data should be interpreted.

Included in this report, I identify areas where FTB can improve its operations and services to taxpayers, including systemic issues that impact the department. The following highlights the type of issues submitted through our Systemic Issue Management System (SIMS):

> *A self-employed taxpayer with a Federal Employer Identification Number and no employees files a California tax return using his social security number. Subsequently, FTB demanded an income return from the entity for income already reported by the taxpayer on his CA income tax return.*

My goal is to ensure that taxpayers' rights are protected. To meet that goal, my staff strive to improve the communication and services that FTB provides and identify systemic issues. In FY 2011/2012, taxpayers and professionals submitted 241 issues into SIMS compared to 284 issues submitted in FY 2010/2011, a 15 percent decrease. We believe this decrease is due to the department as a whole to become more responsive to taxpayer concerns by increasing transparency and our education and outreach efforts. Of the issues submitted, we identified 8 as possible systemic issues and forwarded them to program areas for research and resolution. The program areas resolved 7 of the 8. The remaining issue is in research status.

In the following section, I discuss issues, areas of concern, and challenges that both taxpayers and FTB face.

1. Auditor Retention

Last year, I reported the Audit Division lost a significant number of newly hired auditors and the trend continues. I also recommended the Audit Division conduct a training needs assessment to determine Audit Division staff's training needs. I am happy to report they completed the training needs assessment. Retaining and training qualified staff to perform at the highest levels ensures the department's ability to meet the standards as set forth in the Taxpayers' Bill of Rights.

In FY 2011/2012, the Audit Division hired 60 new auditors. During the same period, 19 new auditors with an average of two years experience or less left FTB. Once again, a common reason given by staff who resigned was they could not adjust to the reduced compensation package provided in budget negotiations. As private sector jobs begin to recover, the Audit Division anticipates it will see more staff leave for better paying jobs. Recent pension reform changes may also play a role to retain and recruit staff throughout the department as well as our Audit Division.

On average, the state spends an estimated $40,000 for each new auditor's training. FTB spends even more resources in on-the-job training as leads and supervisors mentor new auditors. The department is hopeful resource expenditures yield a return on the investment through producing quality auditors who will one day perform at the most senior levels. When auditors accept positions outside of the department, not only do they take their knowledge, they reduce resources as well. The reduction of a resource that can only be replaced through training and experience makes this loss even greater. Therefore, it is not only imperative that FTB retains audit staff, but we must also provide the training necessary to develop them into more experienced auditors.

Currently, 31 percent of audit staff have less than five years experience, while another 24 percent have five to ten years experience. Investing in training less experienced auditors will likely impact taxpayers positively by shortening the time it takes to complete the audit while improving the accuracy of the outcome. The training assessment done by the Audit Division indicated that 53 percent of those surveyed rated themselves as intermediate in overall auditing skills while an additional 40 percent rated themselves as expert. Despite their ratings, the majority of staff said they would like to enhance their skills through more training. As a result, the Audit Division recommends a structured training development plan that would focus on common areas for all staff, such as research skills, while including an individual plan that would match staff's personal skill level.

The training needs assessment completed by the Audit Division was a valuable step in the right direction and I am pleased with the recommendations. I look forward to the follow-up survey planned for 2014 when the implemented changes can be evaluated for their effectiveness. As the Audit Division defines training and measures performance consistently, auditors will be more prepared to face the challenges ahead of them.

When considering options to retain staff in the auditor classifications, consideration should be given to higher staffing classifications as result of the complexity of work, length, and amount of training required to perform the work.

2. Collections

FTB accounts receivable decreased to $8 billion, a reduction of 6 percent from $8.5 billion last year. I want to thank Collections staff for their efforts in reducing accounts receivable.

Our Collections and FE areas continue to send large volumes of notices. The information reflected in the chart below depicts the actual number of personal income tax FE collection cases created and the dollar amounts associated during each of the fiscal years listed.

Personal Income Tax Filing Enforcement Notices

Fiscal Year	Volume	Dollars
2008/2009	359,195	$1.5 billion
2009/2010	364,396	$1.3 billion
2010/2011	352,747	$1.2 billion
2011/2012	234,301	$850 million

*The data provided in the chart for FY 2008/2009, 2009/2010, and 2010/2011 has been adjusted from last year's annual report to provide consistent reporting (captured at the same time each year) for the information. This is a one-time adjustment.

Over the years, there has been a number of FE notices that are sent that do not reach the taxpayer. Currently, FTB does not specifically track the number of FE notices that are returned due to an undeliverable address. Last year, Collections sent out 234,301 billing notices based on FE assessments. FTB issued approximately 25,000 FE assessments that went final on accounts with undeliverable addresses. The dollar value of these FE assessments sent to an undeliverable address is estimated to be approximately $125 million. Currently, nearly half (47 percent) of the $8 billion total accounts receivable balance consists of FE assessments. If this information were taken as an average of how many FE assessments with undeliverable addresses go final per year and given the 20-year collection statute, the impact of these accounts on FTB's total accounts receivable could be substantial. It should be noted that the FE and Collection areas are working together to proactively use resources to secure better addresses before attempts are made to contact these taxpayers prior to issuing an FE assessment and before taking involuntary collection actions.

FTB has a general 20-year statute of limitations to collect on accounts receivable, and due to new EDR Project data and enforcement tools, FTB will be able to collect more effectively to generate much needed revenue for the state. However, aged account receivable (discharged from accountability) have significant interest accrued on the balances and in many cases, no recent contact from FTB since the Taxpayers' Bill of Rights does not require FTB to send annual collection notices to accounts discharged from accountability. The extended time between contacts from the department seems problematic and burdensome for many taxpayers. My staff is currently working with the ARM Division to assess this issue and the impact to taxpayers.

Taxpayers continue to find it difficult to pay their accounts in full. In FY 2011/2012, the number of taxpayers entering into installment agreements increased by 26 percent. At the end of FY 2011/2012, there were over 250,000 taxpayers in an installment payment arrangement. I believe making taxpayers aware of our online installment agreement option as well as marketing the option contributed towards the increase.

In March 2011, FTB was granted legal authority to conduct a record match between financial institution customer records and FTB delinquent debtors' records. The program is known as Financial Institution Records Match (FIRM). The information obtained through FIRM will enable FTB to obtain timely asset information for use in collecting delinquent debt. FIRM implemented, as scheduled, on April 16, 2012. FTB identified and enrolled 180 financial institutions in the first quarter of the FIRM program. Financial institutions submitted over 780,000 matched records as of May 25, 2012. In preparation for FIRM, FTB took proactive steps to meet increased contacts from the financial institutions and taxpayers as a result of the FIRM generated levies. For levy related calls, nearly 85 percent of personal income tax and 82 percent of business entity calls were answered for FY 2011/2012.

In last year's report, I mentioned that we received systemic issues in our SIMS database about collection actions being suspended while amended tax returns processed and the extremely long processing times. I want to recognize the Collections programs efforts to ensure all collectors are trained on the proper procedures for collection relief pending processing of amended tax returns as a result of the systemic issues my staff received.

3. Conformity

This is the fifth year I address the need for ongoing conformity between federal and California tax laws in my report. Each year, I raise concerns about how the lack of conformity to the Internal Revenue Code (IRC) increases the complexity for the taxpayer, and how disparity leads to lower taxpayer self-compliance and greater costs to administer and enforce income tax laws.

As I expressed in my 2008 report, the R&TC is a system based on conformity, that is, FTB adopted a system where the California personal income tax (PIT) codes generally begin with the federal IRC through adoption of various sections or chapters as of a specific date and then, if necessary, make specified modifications. Senate Bill (SB) 401 (Ch. 14 of the Statutes of 2010), The Conformity Act of 2010, was the last major piece of conformity legislation enacted that has brought California's PIT law into general conformity with most of the provisions of the federal law but only those changes that were enacted as of January 1, 2009. While I applaud efforts with the enactment of subsequent conformity legislation, that includes Assembly Bill (AB) 36 (Ch. 17 of the Statutes of 2011), Medical Care Expense Exclusion/Deduction for Children Under 27; AB 242 (Ch. 727 of the Statutes of 2011), Conformity to Federal Health Care Reform; AB 1423 (Ch. 490 of the Statutes of 2011), Regulated Investment Company (RIC) Conformity; and AB 318 (Ch. 313 of the Statutes of 2012), Conformity to Federal Holiday Due Date Extension, these additional bills only provide for conformity to certain IRC sections. In the two years since the enactment of SB 401, Congress enacted over 30 public laws that amended the IRC.

Conformity through the adoption of the most recent IRC reduces the administrative burden for both taxpayers and the state. The California tax system is based largely on self-assessment. We need to realize the majority of taxes are collected through voluntary compliance with the vast number of taxpayers who file and pay voluntarily according to the law. Without major ongoing conformity, complex tax law continues to burden taxpayers and leads to increased errors, penalties, and tax return preparation costs. To promote continual improvement in our voluntary compliance system, FTB needs to ensure tax laws are understandable through tax simplification. Tax simplification also helps to reduce the administrative costs by enabling California to rely on the information exchanges with the Internal Revenue Service (IRS). Without ongoing conformity, expensive compliance efforts are needed to ensure taxpayers are in compliance with California law.

While FTB highly commends your efforts to bring us into alignment with federal law, I reprise my call for simplification through conformity, and I encourage you to continue your efforts to pass a timely full conformity bill.

The lack of conformity affects the ability to self-assess and increases:

- Complexity.
- Taxpayer errors.
- Taxpayer penalties.
- Return preparation burden.
- Taxpayers' costs.
- State's administrative costs.

4. Late State/Federal Legislation

The passage of late legislation creates a burden on taxpayers and their ability to be self-compliant. Whether at the state or federal level, late legislation creates a burden on taxpayers, tax professionals, tax filing industry, FTB staff, and businesses in California.

I believe the recent increased trend of passing late legislation that impacts a taxpayers' income tax filing and planning has had a negative effect on doing business in California. Business owners need to plan for the future. Late legislation has both current and future implications on business plans, their capital available to fund expansion, and hire more employees. Business owners monitor tax laws and act accordingly to improve their bottom lines. Knowledge of tax laws also helps to minimize the risks of the business undergoing time-consuming and costly audits, requiring businesses to spend more time on survival than on success. More concerning is how often legislation is enacted late when the effects of the legislation is intended to assist struggling taxpayers with financial relief. Oftentimes the relief comes with little or no time for FTB to develop and implement taxpayer education and information programs directed at the very taxpayers impacted. On point are two recently enacted bills, AB 2332, (Monning, Ch. 203, Stats. 2012), Income taxes: deductions: disaster losses: County of Santa Cruz, and SB 1544, (Hernandez, Ch. 284, Stats. 2012), Income taxes: deductions: disaster losses: Counties of Los Angeles and San Bernardino. These two examples of late legislation created a burden on taxpayers, tax professionals, FTB staff, and businesses. Both of these bills were intended to provide taxpayers impacted by severe storms that occurred in 2011 with financial relief. Both require the affected taxpayers to proactively take steps to secure the benefits offered within a very short period of time (in one case within 30 days) or lose out on the financial relief offered. There is also a significant impact on FTB to conduct last-minute education and outreach to inform affected taxpayers and tax professionals of the changes.

Late legislation, whether at the state or federal level, leads to confusion and taxpayer errors, creates significant compliance costs, frustration, and anxiety for taxpayers, decreased voluntary compliance and increased difficulties for FTB to administer tax laws.

5. Tax Liens

In the 2010 Taxpayers' Bill of Rights Annual Report, I recommended the lien threshold be increased to $2,500 due to the current economic climate and the negative impact a lien has on a taxpayer's credit report. I also discussed how increasing the lien threshold would result in a decrease in liens filed in error. As a result of my recommendation, in January 2011, FTB created a Lien Program Improvement Team. The team recommended implementing two initiatives. The first initiative was the lien educational language on the Compliance and Resolution Services Interactive Voice Response system and the second initiative was to revise our Frequently Asked Questions into statements on the public website. Additional initiatives include: a quarter-page insert to provide further taxpayer education, lien language on our final notice, and an effort to change the envelope color from white to mint on final notices.

Also, in the 2010 report, I noted the National Taxpayer Advocate in her report to Congress dated December 2009, recommended that prior to filing a lien, the IRS determines if the benefits of filing a lien outweigh the harm to the taxpayer, and I believe that FTB should follow the same reasoning with regard to filing a lien. In last year's report, I noted that in February 2011, the IRS significantly increased their minimum threshold for issuing a lien. In addition, they instituted a policy of withdrawing liens when taxpayers fully pay their tax debt or enter into a direct debit installment agreement through their "fresh start" program.

Over the last fiscal year, we received several entries into our systemic issue database regarding liens being filed on out-of-state taxpayers resulting from a filing enforcement. Two systemic issues identified:

1. For some FE cases our Integrated Nonfiler Compliance System may overlay a more current address on our Taxpayer Information System. Therefore, the notice may not reach the taxpayer.

2. FE assessments based solely on the occupational license model with an out-of-state address appears to be problematic because the taxpayer may not have a filing requirement or moved out of state, yet their occupational license remains active.

As a result of these identified systemic issues, FTB created an enterprise team to attend to out-of-state filing enforcements with undeliverable addresses.

As the chart below reflects, FTB has seen a downward trend in the number of liens filed over the last three fiscal years. In my analysis of prior years, I found that as FTB files more liens, we have a disproportionate increase in liens that we are required to release as filed in error. The most common reasons for liens to be released are FE assessments being fully abated when a taxpayer proves they did not have a filing requirement or the resolution of tax assessments result in no tax liability. In addition, as mentioned earlier in my address, I believe it would be beneficial for taxpayers if California considers legislation for withdrawing liens when taxpayers fully pay their tax debt.

Analysis of Liens Filed in Error

Fiscal Year	Liens Filed	% of Liens Filed Increase/ Decrease	Liens Released	% of Liens Released	Liens Released as Filed in Error	% of Liens Released Filed in Error
2007/2008	201,785	28%	78,832	39%	11,253	5.6%
2008/2009	267,745	33%	90,380	33%	17,036	6.4%
2009/2010	295,027	10%	103,959	35%	19,406	6.6%
2010/2011	264,138	-10%	112,280	42%	17,913	6.8%
2011/2012	240,550	-9%	143,645	59%	17,871	7.4%

6. Criminal Investigation Program Transparency

In my 2010 and 2011 reports, I recommended that FTB's Criminal Investigation Bureau (CIB) improve program transparency by increasing their presence on FTB's public website. In reviewing the information on the IRS website regarding their Criminal Investigation (CI) program, they maintain an extensive procedure manual, with a detailed table of contents. In addition, they offer information about their enforcement strategy, statistics, the CI annual business plan, compliance strategies, and fact sheets showing CI's involvement in investigating tax fraud and financial crimes in different professions. In this year's annual report, I must state that there has been no significant improvement to increase transparency since this issue was identified in my 2010 report. Although CIB made no changes to the public website, I would like to note CIB recently added enhancements to an online case management system which will give them the ability to better track program performance and report appropriate investigation results. They made considerable improvements to update their manuals maintained on our internal website–a necessary precursor to publishing on our public website. The program anticipates deploying its own webpage on **ftb.ca.gov** in early 2013.

7. Penalties

This year, I dedicated resources to take a statistical look at how often FTB issued penalties during FY 2008/2009 through FY 2011/2012.

The most frequently imposed penalty during this period was the mandatory assessment of the delinquent filing penalty. We impose it when a tax return is filed after the original or extended due date, as applicable, with an unpaid tax due. This penalty is intended to deter taxpayers from filing their tax returns late. However, it can be waived upon a showing of reasonable cause and lack of willful neglect.

In addition to the delinquent filing penalty, if a partnership, limited liability partnership, or limited liability company fails to file a tax return by the original or extended due date, a separate late filing penalty is imposed. This mandatory penalty is also imposed for tax returns which fail to provide the required complete information. This late filing penalty is also known as the per-partner or per-member penalty.

The accuracy-related penalty is assessed most commonly for substantial understatement of income tax and negligence or disregard of rules or regulations. It was assessed 3,057 times during the last four fiscal years. Before assessing this penalty, the auditor must analyze facts and circumstances of each proposed tax change. This penalty can be waived if reasonable cause exists, among other exceptions. During this same time period, FTB waived previously assessed accuracy-related penalties, including assessments made prior to the four-year period indicated above.

FTB assessed 821 failure-to-furnish information penalties. With respect to audits, this penalty is used to discourage taxpayers from disregarding formal legal demands to furnish information. Once a failure-to-furnish information penalty is properly assessed, it can only be waived by a demonstration of reasonable cause and no willful neglect for the failure. However, if FTB reduces the tax assessment, it will also reduce the failure-to-furnish information penalty to coincide with the reduced tax liability.

Mandatory amnesty-related penalties were the next most frequently imposed. The amnesty program conducted in 2005 provided an opportunity for taxpayers to file original or amended tax returns and pay taxes and interest owed without the threat of most penalties. Taxpayers who did not choose to participate in this program were subject to an interest-based amnesty penalty equal to 50 percent of the interest that accrued on the balance due from the original due date to the end of amnesty on March 31, 2005. The 50 percent interest-based amnesty penalty applied to any past-due liabilities as of the end of amnesty and the post-amnesty penalty applied to additional tax assessments after March 31, 2005. There is no reasonable cause relief available for these interest-based amnesty penalties, but a taxpayer may contest the penalty by arguing that FTB computed the penalty incorrectly. In addition, if the tax amount is reduced, the interest and the penalty would be reduced accordingly.

Also, FTB assessed tax shelter penalties during this same time period. The most common of those penalties were the interest-based penalty and the noneconomic substance transaction understatement (NEST) penalty. The interest-based penalty is assessed against taxpayers who have deficiencies attributable to abusive tax avoidance transactions and have been contacted by FTB regarding the deficiencies. The penalty is equal to 100 percent of the interest due through the date of the proposed assessment relating to the tax shelter. However, the penalty is decreased to 50 percent of the interest if taxpayers file amended tax returns reporting the tax shelter after being contacted by FTB, but before the notice of proposed assessment is issued. The NEST penalty equals 40 percent of the understated and undisclosed tax attributable to any transaction that lacks economic substance. The NEST penalty rate is 20 percent if the transaction was adequately disclosed. Combined, FTB assessed these two tax shelter penalties 383 times. While there is no relief for the interest-based penalty, taxpayers may request NEST penalty relief from FTB's Chief Counsel. During this same time period, FTB waived this penalty 122 times, many resulting from the Voluntary Compliance Initiative 2 (VCI 2).

The remaining assessments were for various other penalties referenced in FTB 1024, *Penalty Reference Chart*, and many contain the ability to be waived when reasonable cause exists. However, during the period at issue, the majority of these remaining penalties were sustained.

I recommend the department perform a more comprehensive review of the various penalties that FTB assesses and the basis for waivers.

8. Education and Outreach

The need to educate, provide outreach to, and inform taxpayers and tax professionals continues to grow due to California and federal income tax laws continuously changing, the passage of late legislation, the lack of federal and state conformity, and reductions in taxpayer services. Without education and outreach efforts, taxpayers may not be properly informed of new law changes or the services available to them.

FTB continues to participate in tax education seminars, including business seminars sponsored by Board of Equalization (BOE) members and the State Controller's Office. In addition to seminar presentations, my staff extends education and outreach efforts by continuous improvement to FTB's website and the use of other media methods to get our information to taxpayers. We now offer a virtual seminar on State Income Tax and Small Business on our webpage. FTB utilizes YouTube to market programs like ReadyReturn, CalFile, and VCI 2 and to provide tips and news releases on critical filing errors and credits not being taken advantage of. FTB participates and conducts webinars on a variety of topics, and has a presence on Facebook and Twitter. I commend FTB's continued diligence to provide cost effective information and customer service to taxpayers in these very lean budget times.

In February 2011, my staff conducted a *Tax News* survey to explore ways to better serve our subscribers. One point of interest subscribers expressed is the need for more transparency. Within *Tax News*, we provide a calendar of events that identify what my staff and I participate in.

Currently, my staff provides materials, publications, and information on FTB's public website, including our monthly publication *Tax News*, about a variety of topics. Last year, our education and outreach efforts focused on topics such as California's VCI 2, streamlining the Power of Attorney (POA) processing, real estate tax deduction, and the new Top 500 Delinquent Taxpayers law. I continue to use social media, Twitter, and *Tax News* flashes to link my followers to late-breaking information. *Tax News* not only expanded its products to include video articles, but partnered with the California Society of Enrolled Agents (CSEA) Educational Foundation.

I recommend my office continue to engage in creative ways to provide education and outreach through the use of social media and collaboration with our stakeholders to produce videos and webinars. In addition, I suggest we conduct surveys at our outreach events to assess and evaluate the effectiveness of the information we provide and identify the needs of our audiences.

9. Protests

A review of all the protests resolved during FY 2006/2007 through FY 2011/2012 reveals the most significant reversals of proposed tax assessments occurred in docketed protests involving large business entities. These cases are assigned to our Legal Division and typically involved complex areas of the tax law.

I am concerned about the number of revisions to assessments that occur once a business entity taxpayer elects to file a protest which is the first level of appeal after the examination is completed. The additional time and resources required for a taxpayer to appeal an assessment can be considerable.

The reasons for a determination at protest that revises or withdraws an assessment could be numerous: an administrative or court decision addressing the issue raised in the protest that is issued subsequent to the assessment, additional information provided by the taxpayer during the protest process, newly asserted claims for refund, initiatives, effects from federal audits, or an incorrect auditor determination due to lack of detailed knowledge of the law, are all possible reasons for a revision at the protest level.

In 2009, a study team comprised of our Audit and Legal Divisions identified probable causes and underlying theories for revisions that occur at the docketed protest level, and offered these recommendations:

- Use subpoenas when necessary to facilitate case development.
- Continue to provide ongoing training to audit staff to enhance case-development skills.
- Use more technical-advice memorandums.
- Consult with attorneys during the audit.

These recommendations have been put into place. The impact of many of these recommendations may not be seen or measured for a few years. We plan to follow this issue.

10. Customer Service

Customer service is a high priority. FTB's service commitment is to treat taxpayers professionally, be accessible, provide accurate and clear information, and respond promptly. In fact, FTB's Mission Statement identified customer service as one of FTB's core values. FTB's Mission Statement is to provide the services and information to help taxpayers file accurate and timely tax returns and pay the proper amount owed. FTB constantly strives to find innovative technology solutions to provide cutting-edge ways to improve customer service; for example, Live Chat, Virtual Hold, as well as information through an automated phone system and the public website.

However, one ongoing concern brought to my attention in conversations with tax professionals and taxpayers and entered into our systemic issue database, is they cannot always get through to talk to a live person to discuss a notice. When Virtual Hold is not available due to heavy call volumes, they often resort to searching our website to find another number to try to get through to a live person.

I asked my staff to analyze the volume of notices sent out and the level of access at our call centers, from an enterprise-wide perspective, to determine if there was any correlation between them. They reviewed the access levels at our call centers and did a side-by-side comparison with the notices sent out each month for the entire fiscal year. The analysis revealed that our call center access rate decreased in months when higher volumes of notices were sent. In last year's annual report, I raised the concerns about our inability to keep up with the customer service demands with the number of FE and collection notices being sent out. In addition, I discussed that at times those areas are understaffed, call center hold times are too long, and there are backlogs in answering correspondence. I have the same concerns this year, and again I recommend additional staffing and that those business areas consider correspondence processing backlogs when issuing additional notices.

After completing this analysis, my staff identified there was no complete tracking of total notices sent out by the department as a whole. I recommend that FTB begin to track and use this information from an enterprise perspective to better manage our call centers' resources to handle the increased call volumes. This information will allow FTB to provide better customer service and to meet our service commitment stated above.

I thank you for this opportunity to report some of the main issues FTB and our taxpayers faced throughout FY 2011/2012. I discussed the above issues and concerns with the department's responsible areas, and, in all cases, the respective business areas are taking additional action to address these concerns.

Taxpayers' Rights Advocate Contact Information

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Taxpayers' Rights Advocate

Taxpayers' Rights Advocate's Office Mission

Our office works with program areas to protect taxpayers' rights. 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 FTB 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.

Taxpayers' Rights Advocate's Responsibilities

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 FTB employee performance based on taxpayer contact and not on the revenue produced.

The Taxpayers' Rights Advocate's Office coordinates education and outreach efforts throughout California, such as tax professional and Advisory Board meetings. In addition, our staff participates 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 content is clear, accurate, and current. We train staff to apply department writing standards and follow guidelines to meet readability requirements as well as technical accuracy. We include revision dates on all of our publications. We offer quality translated 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 about procedures, remedies, and rights during audit, appeal, and collection proceedings.

We provide detailed information about Taxpayers' Bill of Rights legislation in our publications:

- FTB 4058, *California Taxpayers' Bill of Rights – Information for Taxpayers*. This publication provides a basic overview of taxpayers' rights and includes the major provisions of the 1988, 1997, and 1999 California legislation.
- FTB 4058C, *California Taxpayers' Bill of Rights – A Comprehensive Guide*. This publication describes provisions of the California Taxpayers' Bill of Rights and 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 updates from the Audit Division, Litigation Update, Collections Update, EDR Project, and an overview of our Strategic Plan.

Annual Meetings With Tax Professionals

We coordinate liaison meetings with the California Society of Enrolled Agents and the California Society of Certified Public Accountants. We provide legislative, filing, and audit updates. We present and discuss FTB's upcoming projects and issues, and we 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 available online services 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, or if a 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 FTB's erroneous processing or collection actions. 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, ensuring that their issues are handled promptly and fairly. We also interact with other state and federal agencies and assist in identifying and resolving department problems.

The Governor's Office, three-member Franchise Tax Board, employees, legislators, state and federal agencies, and taxpayers or their representatives contact us by mail, fax, telephone, and email. We received over 21,200 contacts in FY 2011/2012. The majority of taxpayers (over 14,200 contacts) contacted us by telephone. We provide taxpayers a public number (800.883.5910) to contact our Advocate Hotline.

We also received over 2,400 email contacts during this reporting period. Taxpayers often chose to email the Taxpayers' Rights Advocate when they could not contact the department by telephone or when there was extensive telephone wait time.

The top five reasons taxpayers contacted the Taxpayers' Rights Advocate's in FY 2011/2012 include:

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

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

Filing Enforcement

We explained assessments and provided information to assist taxpayers to complete their tax returns. In some cases, we canceled assessments or addressed hardship issues.

Balance Due

We updated taxpayers on their balance due or delayed collection action to allow tax returns or payments to post. We mailed tax computations, sent Offer in Compromise packages, reevaluated assessments, and encouraged taxpayers to send payments.

Earnings Withholding Order for Taxes

We modified or released these orders based on additional information provided.

Installment Agreement

We updated taxpayers on their balance due and set up payment plans. When needed, we delayed collection action to allow tax returns or payments to post.

Refund

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

Systemic Issue Management System (SIMS)

The Taxpayers' Rights Advocate identifies systemic issues and finds solutions in a cooperative effort with FTB's audit, collections, and filing programs. In FY 2011/2012, we received 241 issues through SIMS. Of the issues submitted, we identified eight as possible systemic issues and forwarded to program areas for research and resolution. The program areas resolved seven of the eight. The remaining issue is in research status.

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 tax returns.

We collected assessment information from the personal income tax Notice of Proposed Assessment display file for assessments that became final in FY 2011/2012. When we used sample data, 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" when there was no distinct primary issue.

For corporation taxes, the largest dollar amount in proposed assessments resulted from one primary issue–allocation and apportionment audits, which involves 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 an 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.

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

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

We issue 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 90 percent of the individuals who received Notices of Proposed Assessment during FY 2011/2012 had audit changes for a single tax year.

An in-house accounting department or an accounting or legal firm prepares virtually all corporation tax returns. The data indicates that tax professionals file over 70 percent of all personal income tax 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.

We also compiled statistics for e-filing and payments. For these figures, see Appendix 1, Table 6. e-filing continues to increase, with a seven percent increase from July 1, 2011, to June 30, 2012. As of June 30, 2012, we received 648,000 e-filed Business Entity (BE) tax returns, a 30 percent increase.

FTB informs taxpayers about their California filing requirements through its website, letters, and contacts with nonfilers. FTB sends first-time nonfilers who met their filing requirements in the previous four years a Request for Tax Return notice. We send repeat nonfilers a *Demand for Tax Return* notice. We send a Notice of Proposed Assessment to nonfilers, who do not file the necessary tax returns after receiving a request or demand notice. 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 43 percent of the taxpayers contacted for failure to file a tax return subsequently file their tax returns.

Taxpayer Filing Errors

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

We compiled taxpayer error information on approximately 15.9 million current year tax returns processed between July 1, 2011, and June 30, 2012. During this time, FTB made approximately 350,000 adjustments and issued just over 310,000 Return Information Notices (RINs) to taxpayers who filed tax returns with errors that resulted in a change of tax liability. This equates to 1.95 percent of tax returns. The errors are explained in the notices. The number of adjustments is greater than the number of notices because many tax returns contained multiple errors. These numbers do not include counts for adjustments which did not affect the tax liability, such as adjustments to estimate transfers, voluntary contributions, or refund offsets to other tax years or other debts.

Close to 53 percent of all adjustments are made on paper-filed tax returns (20 percent of total current year tax returns filed), while only 47 percent of all adjustments are made on electronically filed tax returns (80 percent of total current year tax returns filed).

The most common taxpayer error, for all filing methods, was to claim the wrong amount of estimated tax credits. Of all current year RINS, 42.3 percent contain 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, forgot 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 tax return type and filing method, and include a definition of what typically caused each adjustment.

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. This fiscal year, we identified areas of the law during the review process for which we proposed legislation that was signed by the Governor.

Chaptered Legislation–
AB 1369 (Gatto, Stats. 2011, Ch. 454)
This act amends current law to deny a deduction for expenses and costs of goods sold attributable to the following:

- Any person that commits insurance fraud by referring or procuring clients, cases, patients, or customers to a third party for compensation or inducement.
- Crimes listed under the "California Control of Profits of Organized Crime Act" found in California Penal Code sections 186, et seq.

Regulations

The laws administered by FTB broadly authorize the adoption of rules and regulations necessary for their enforcement. Occasionally, specific statutory provisions require us to adopt 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; although we have not addressed whether FTB has existing resources needed to make these improvements.

Customer Service Call Center Access Rates

In FY 2011/2012, the Taxpayer Services Center (public number 800.852.5711 and hotline number 916.845.7057) answered approximately 71 percent of incoming calls. This increase is an improvement from the previous year of 67 percent calls answered. A large part of the success continues due to the Queue Management Project that was implemented in May 2010. Since implementation, the abandoned call rate has also improved. Additionally, the improved acces rate is due to the successful redirection of taxpayers to applications on the Web.

During FY 2011/2012, the Accounts Receivable Management Division implemented new technologies, such as Virtual Hold, which improved our overall level of access. For levy-related calls, nearly 85 percent of Personal Income Tax and 82 percent of Business Entity calls were answered compared to 70 percent and 89 percent respectively for FY 2010/2011. For other general collection related calls, 45 percent of Personal Income Tax and 72 percent of Business Entity calls were answered. This increase is an improvement from FY 2010/2011 when 27 percent of Personal Income Tax and 41 percent of Business Entity calls were answered. Levies may impact a taxpayer's financial (employer or bank actions) circumstances; therefore, the levy response rate is higher than the general response rate.

Response to Correspondence Time Frames

Taxpayers writing to the department continue to experience delays in processing and responding to their correspondence. The average response time to correspondence still varies greatly throughout the department. Our general response time is 25 to 30 days, but in other areas, the response time was as high as 90 days at various times during the year. Backlog reduction efforts have been successful and the current average response time is closer to 60 days.

Pending and Enacted Federal Legislation

The lack of conformity and the passage of late legislation, whether at the state or federal level, directly affects taxpayers' ability to be self-compliant. In FY 2011/2012, there were three disaster loss bills, two of which were enacted late and created burdens for taxpayers, businesses, tax professionals, and FTB. The bills were intended to provide affected taxpayers with financial relief from severe storms that occurred in 2011. The bills required taxpayers to take proactive steps to secure the benefits offered within a very short period of time (in one case within 30 days) or forego the financial relief. There is also a significant impact to FTB to conduct last-minute education and outreach efforts to avoid confusion.

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.

When there is pending or final 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 state conformity legislation.

FTB needs dedicated staff and resources to follow and provide analysis on pending, late, and final state and federal legislation on an ongoing basis. The lack of conformity to federal legislation burdens taxpayers and the department. FTB must allocate resources to reflect the federal tax law changes in our processing, programming, and revising tax forms, instructions, and publications.

In an effort to inform our tax professionals on late-breaking legislation or to clarify the impact of laws, we write articles for *Tax News* monthly, periodically release *Tax News* flashes to our subscribers, and post information on the Advocate's Twitter account.

Education and Outreach

We continue to increase our education and outreach efforts and utilize the social media tools available. We used media tools, such as Twitter and Facebook, to provide taxpayers with information on California and federal tax law and FTB service changes. We also participated in webinars on a variety of topics and created short video presentations available on our website. We continue to participate in BOE and State Controller's Office sponsored events to provide small business education and outreach throughout California. Our efforts 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. We will continue to increase our online efforts, including the number of short video presentations, as they are practical from both a cost and access point of view.

e-Services

In an effort to reduce taxpayer 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 is a voluntary tax-filing method where FTB uses wage and withholding information to complete "simple tax returns" for taxpayers. FTB pre-selects taxpayers who filed as single or head of household, have income only from wages, and claim the standard deduction. Taxpayers may choose to view, update, and e-file their ReadyReturn online. Usage has climbed from approximately 11,000 tax returns in 2008 to almost 90,000 tax returns in 2012.

The ReadyReturn program continues to receive positive feedback from taxpayers. Over 98 percent of users report they were "satisfied" or "very satisfied" with the program and that it is the type of service government should provide. Several taxpayers left comments, including: "I highly recommend this service. It's great for people like me whose returns are simple. I feel more confident the figures will be calculated more accurately and it reduces chances of errors on my part. Thank you. This is terrific." and "I love this service! I did it for the first time in 2011, the experience that time was great...just as great this year! Thanks!"

CalFile

CalFile is a free, secure, online application that allows taxpayers to e-file their state income tax return directly with FTB. CalFile eases the filing burden for taxpayers by guiding them through an easy question-and-answer process in order to complete their tax return. In 2012, approximately half a million taxpayers filed using CalFile.

MyFTB Account

MyFTB Account is the secure web program that serves as the central location for taxpayers and tax professionals to interact with FTB online. Users complete a one-time registration and select a user name and password that they manage. Taxpayers must provide key pieces of information from their tax returns to register, while tax professionals must provide their industry credentials. To view a client's account, tax professionals should have their client's written permission and will need to provide information from the client's tax return.

MyFTB Account for Individuals gives users access to estimated tax payment information, recent payments made, the total balance due on their account, their California wage and withholding information, and FTB-issued 1099-G and 1099-INT information. Individual taxpayers can update their address and telephone number, sign up for estimated tax payment email reminders, and access additional services such as CalFile, ReadyReturn, and Web Pay.

MyFTB Account for Businesses lets users view their entity's estimated tax payments and make payments using Web Pay. In 2012, the Center for Digital Government awarded MyFTB Account for Businesses the *2012 Best of California* award for Best Application Serving the Public.

Web Pay

Web Pay is a free, secure, online service that allows individual and business taxpayers to make their tax payments online. Taxpayers can schedule payments to come out of a checking or savings account up to one year in advance. In January 2012, taxpayers were given the ability to view scheduled payments and cancel those that have not been processed.

Training

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

FTB provides technical employee training, 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 regarding:

- 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 provides core compliance training courses including:

- Penalties and interest.
- Filing requirements.
- Installment agreements (collection program).
- Tax assessments.
- Power of Attorney (POA).

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 auditors baseline expertise in the following areas:

- Organizational mission and values and customer service.
- Taxpayers' Bill of Rights and the principles of tax administration.
- Audit process, case management, policies and procedures.
- Tax law and research methodologies.
- Disclosure and information security.
- Technologies and systems.

FTB offers ongoing support for 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 auditors. FTB also provides broad-based development to optimize knowledge of the latest electronic technologies, specialized transactions, and improved auditing techniques.

FTB supports its auditors who seek Certified Public Accountant status. Under the Board of Accountancy guidelines, FTB provides Certified Public Accountants 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 (FE) Program

FE program identifies and contacts individuals and business entities that appear to 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 with partnership income, and any other individuals with unreported income. More than 500 million income records were provided to FTB by the IRS, BOE, Employment Development Department (EDD), financial institutions, and other sources.

The business entity nonfiler program also uses various income sources, including information from the IRS, BOE, EDD, and financial institutions, to identify potential nonfiling corporations, limited liability companies, limited liability partnerships, and limited partnerships that appear to have a filing requirement.

Additionally, with the introduction of the EDR Project, FE has upgraded its efficiency in choosing the best cases for individual and business entity nonfiler contacts to further advance the goal of taxpayer compliance. Within the EDR Project, FE has created an analyst team to review new business rules and practices implemented by the EDR Project to protect taxpayers from erroneous contacts and involuntary collections that could result from these changes.

FTB continuously strives to improve the FE programs and services 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 our website:

- Request additional time to file a tax return. This service may assist those who are experiencing a personal or financial crisis, or who need more time to obtain records to file a tax return.
- Provide updated address information.
- 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 administer and enforce the law with fairness and integrity to pay the proper amount owed. The program utilizes innovative methods to promote these objectives through customer service, education, self-compliance letters, initiatives, and partnerships with other federal and state agencies. In performing these activities, the program considers the effects on taxpayers and focuses on adherence to FTB Regulation Section 19032, Audit Procedures.

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 Result in 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. 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.

Recent Legislation to Encourage Self-Compliance

The legislature enacted a second Voluntary Compliance Initiative (VCI 2), which allowed taxpayers who engaged in abusive tax avoidance transactions or who failed to report income from the use of offshore financial arrangements to correct their state income tax returns for tax years 2010 and prior. Taxpayers electing to participate in the initiative would avoid most penalties and any future criminal action. The initiative's filing period ran from August 1 and extended to October 31, 2011. FTB promoted public awareness and participation in the initiative by informing taxpayers of the benefits of participating and also the consequences of not participating in the initiative. In addition, FTB published articles and gave presentations to tax professionals and used other media to encourage taxpayer participation.

More than 1,800 taxpayers participated and more than 10,000 returns were processed as part of this program. VCI 2 raised $350 million in additional revenue. This amount exceeded the planned revenue of $270 million. June 15, 2012, also marked the deadline for payments on installment. Qualifying taxpayers who were unable to pay their VCI 2 tax liability by October 31, 2011, were allowed to enter into installment agreements and pay their additional tax due monthly as long as the final payment was made on or before June 15, 2012. Although the filing period has ended for this program, FTB staff continue to resolve unique account issues, respond to late filers, and close related audits.

Collections Program

The Collections program collects tax and nontax debts on behalf of the State of California. Tax debts are primarily filing enforcements, unpaid audits, and tax return assessments for individuals and business entitites. Nontax debts include vehicle registration fees and various court-ordered debts. This program uses a variety of methods and tools to enforce the laws covering tax and nontax debt.

FTB maintains a call center staffed by collection experts, including several Spanish/English speaking employees. FTB also maintains an Advocate Hotline to assist taxpayers, tax representatives, and tax professionals 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 lien notices and to levy wages and bank accounts. Individual collectors or an automated system can issue these notices and levies.

Accounts Receivable Collection System

FTB uses this automated system to process and maintain approximately 2.0 million 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, so collectors can 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. Actions include gathering case information, securing asset information, obtaining commitment, taking collection actions when voluntary compliance cannot be obtained, and properly documenting the case.

Contract Collection

Outsourcing collection accounts provides FTB with an alternative collection strategy for accounts that are not economically feasible to assign to an FTB collector. We view outsourcing as a way to broaden our ability to collect debts owed to the state. FTB uses Private Collection Agencies (PCAs) to collect debts in certain tax workloads. 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. FTB takes great care to safeguard taxpayers' data and protect their rights when outsourcing accounts to PCAs. FTB requires all PCAs to adhere to the Fair Debt Collection Practices Act, FTB's Taxpayers' Bill of Rights, California R&TC, and all other FTB applicable policies.

Payment Methods

Installment Agreements–FTB provides both individual and business taxpayers who are experiencing a financial hardship and are unable to pay the full amount they owe in one payment the option of installments. Individual taxpayers can now apply and check the status of their installment agreement requests online.

Provisional Payment Plans–FTB allows taxpayers to make payments while they are preparing their valid personal income tax returns. After all required and valid tax returns are filed, taxpayers may be converted into a formal installment agreement if they meet the requirements. Since the program's inception in December 2009, 32,000 tax returns have been filed and $27 million collected. Provisional payment plans increase compliance with tax laws, accelerate collection revenue, provide greater efficiencies, and improves customer service.

Offer in Compromise–FTB's Offer in Compromise Program is for taxpayers who do not have, and will not have in the foreseeable future, the income, assets, or means to pay their tax liability. It allows a taxpayer to offer a lesser amount for payment of an undisputed final tax liability.

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.

Criminal Investigations

Special agents focus on the underground economy and bring felony criminal R&TC charges against the most egregious cases of state income tax fraud and evasion. Special 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 tax returns, failing to pay taxes due, and making illegal cash payments to employees. Special agents present their investigative reports to prosecutors, assist in the prosecution, and seek publicity through FTB's Public Affairs program. Prosecuting individuals for these criminal activities and publicizing the cases result in tax revenue for the State of California collected from the convicted individuals and others who, due to knowledge of the consequences, are deterred from violating the income tax laws.

Special agents also work with federal agencies and prosecutors assisting in the investigation and prosecutions of federal charges such as mail fraud and money laundering. They increased their participation in ID theft and refund fraud investigations by working closely with federal agencies.

This year, the program began case modeling efforts combining data from various federal and state sources to identify additional cases of nonreported income. For FY 2011/2012, criminal investigations activities resulted in:

- 84 new cases.
- 71 individuals arrested.
- 32 search warrants executed at 114 locations.
- 48 cases approved for prosecution.
- 55 individuals prosecuted.
- 46 cases closed.

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, small business, foreign scholars, withholding, audit, forms of ownership, enterprise zone credits, and other topics as requested. We participated in over 120 presentations throughout California. Our education and outreach staff responded to over 1,250 inquiries from taxpayers and tax professionals. We continue to use social media, such as Facebook and Twitter, to provide information to taxpayers and tax professionals. In addition, we send important information through news flashes and post them on our website. We expanded our online educational products to include short video presentations on the New Jobs Credit, Systemic Issue Management System, estimated penalty, and record keeping. We will focus our future efforts to increase the number of short presentations available on our website.

The Multilingual Services program mission is to provide the fundamental tools and resources necessary for our limited English-proficient (LEP) customers to capitalize on the same resources available to our English-proficient customers. In the collaborative effort to address these language barriers, we provide numerous resources such as quality translated materials, centralized translation coordination, and the necessary tools for our employees to provide multilingual services accurately, efficiently, and cost effectively to the state. Our goal is to provide more resources in Spanish on the web and make it easier for the public to access information.

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.

Our ongoing media efforts, including Spanish media, play a major role in reducing taxpayer errors. We give news interviews, prepare news releases, post information on social media outlets, create video clips, public service announcements, and *Tax News* flashes to inform taxpayers of changes to tax law, new programs, and current issues of interest.

California Tax Law and FTB Services Updates

In our commitment to provide timely information to promote complete, accurate, and timely filed returns, we developed a California tax and FTB services update presentation and presented it throughout the year statewide to tax professionals.

This year's presentations provided information, explanations, and promoted discussions about:

- Use Tax Tables included on individual income tax returns and instructions to facilitate the estimating and reporting of the use taxes owed.
- Dependent and Child Care Credits no longer refundable.
- VCI 2 program that allowed participants who were associated with abusive tax avoidance transactions or have unreported offshore account income to avoid penalty and criminal prosecution.
- Development of a new Financial Institutions Records Match (FIRM) system that will allow us to exchange information with California financial institutions and collect delinquent debts.
- Conformity to federal law allowing exclusions or deductions for certain health care coverage for a child under 27 years of age.
- Community property tax guidance for Registered Domestic Partners (RDPs) and Same-Sex Married Couples (SSMCs).

- New Jobs Credit available to small business for hiring new employees.
- Online services, such as *Tax News*, MyFTB Account, Web Pay, Installment Agreements, SIMS, and Secure E-mail.

Interactive Voice Response

FTB maintains and regularly enhances approximately 36 Interactive Voice Response (IVR) applications. These applications provide recorded responses to the most frequently asked questions regarding general state tax information. In addition, the IVR provides account information, such as current balance due, payments and refund status. Callers can also order common personal income tax and business entity forms through the IVR. They can also apply for an installment agreement. Most of the applications are available in both English and Spanish. In many cases, callers may choose to speak to a representative after navigating through the IVR applications. If they are transferred to one of the larger call centers, they may be given the option to wait on hold, or request a call back without losing their place in queue. They would receive a call back utilizing Queue Management technology (also known as Virtual Hold).

Queue Management

In May 2010, we implemented Queue Management technology for external customers who call our 800 numbers. Rather than wait on hold, customers can choose to terminate the call, maintain their place in the calling queue, and receive a call back just as promptly as if they had remained on the line. The customer is given a call back time based on the Estimated Wait Time at the time of their call. Customers welcome this new feature. This service has decreased the average overall wait time by 15.6 percent.

Since implementation the number of abandoned calls has been reduced by approximately 65 percent. Abandoned calls are callers who hang up because they are not able to continue waiting on the line. FTB has currently saved over 62 million minutes of hold time since implementation and almost 33 million minutes in FY 2011/2012. When offered the option, 68 percent of the callers chose to have a call back. We successfully connected with 89 percent of the callers.

California Tax Information

In an effort to provide one-stop service for California taxpayers, FTB participated with other state tax agencies to establish the California Tax Service Center website that is maintained by BOE.

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

Our monthly online publication, *Tax News*, informs tax professionals about state income tax laws, regulations, policies, procedures, and events that affect the tax professional community. This past year, we expanded our calendar of events to include not only our Taxpayers' Rights Advocate and staff event participation, but events within FTB, such as FTB Board meetings and interested party meetings. We also utilized our *Tax News Flashes* to push time-sensitive information quickly to our subscribers on subjects such as disaster relief, VCI 2, several webinars, forums, and other educational opportunities. We continue to increase our flashes mainly because it provides a fast and cost-efficient mode of communication, as well as sharing like information and links through social media like Twitter and Facebook. Our short video articles, *Tax News* Live, focus on services and information that is not being utilized, such as Reporting Systemic Issues. Also, this past year, we partnered with the California Society of Enrolled Agents Education Foundation to produce *Tax News*

Live video, *Recordkeeping*. *Tax News* continues to experience positive feedback; our subscription base continues to increase; and trade media publications repost and quote our 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 to obtain information on most business filing requirements.

We participate in small business fairs sponsored by BOE members and the State Controller's Office throughout California.

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

- FTB 1123 - *Franchise Tax Board's Guide to: Forms of Ownership*.
- FTB 984 - *Franchise Tax Board: Common Business Expenses for the Business Owner and Highlights of the Federal/State Differences*.
- FTB 987 - *Top Twelve Tax Scams*.
- FTB 689 - *Read the Fine Print About Forming a Business Entity Outside of California*.
- FTB 982 - *How to Select an Income Tax Return Preparer*.
- FTB 985 - *Audit/Protest/Appeals: The Process.*
- FTB 1024 - *Penalty Reference Chart* (**ftb.ca.gov** only).
- FTB 989 - *Understanding Your California Taxes* (**ftb.ca.gov** only).
- FTB 3730 - *Online Buying or Selling: Know Your Tax Obligation* (**ftb.ca.gov** only).

Our Small Business Liaison provides education and outreach to small businesses and receives calls from taxpayers. The liaison offers small business owners and taxpayers interested in starting a business tax information and information about specific filing requirements, based on their business ownership or proposed business ownership type. The liaison refers business owners and taxpayers to the appropriate program areas within our department and to the other state or federal agencies to answer their questions.

The education and outreach staff received over 1,250 calls this year, and 1,050 of those calls were to the Small Business Liaison. We received many calls from out-of-state taxpayers inquiring about doing business in California and the tax requirements.

Speakers' Bureau

Speakers' Bureau helps 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 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 laws or proposed initiatives, regulations, projects, and other topics of interest.

Free Filing Assistance

FTB and IRS jointly administer the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) volunteer programs to provide free tax help to limited or fixed 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 collaborated with the IRS to administer the Schools' VITA program at two area high schools. This program provided students with opportunities to develop job skills, earn school credit, and learn about the value of volunteerism as they help non-English speaking, disabled, senior, and limited or fixed income members of the community prepare basic state and federal tax returns. Unfortunately, the current economic climate made it necessary for us to suspend our administration of the Schools' VITA program. However, one high school continues to work with the IRS to offer free tax return preparation services to the local community. FTB employees also volunteer on their own time to assist the school and student preparers with tax return preparation.

Department Initiatives and Projects

Key Initiatives for 2012

Promote and Encourage Self-Compliance

FTB's Performance Management program is represented in the 2012 Strategic Plan as Outcome Measures. This Strategic Plan is the first to contain the Tax Business model, which focuses on helping taxpayers file their tax returns, file accurately and pay the proper amount owed. Through a comprehensive performance management program, FTB will achieve its vision to achieve the highest level of excellence in tax administration.

Modernize Our Tax Systems

The EDR Project is the first of several planned FTB modernization projects described in our Strategic Plan.

The EDR Project brings us new technologies that we will use to leverage the data we collect to more effectively administer our tax systems. This means more efficient operations throughout FTB, better customer service, a higher level of transparency, and more revenue. In short, the EDR Project gives us the opportunity to provide better customer service, reduce taxpayer burden, and make significant progress toward reducing the tax gap.

The EDR Project includes four major components:

1. A new return processing system.
   The new system automates manual processes, enhances our capacity to capture and validate data, standardizes our processes, and combines personal income tax and business entity tax processing into one system.
2. An enterprise data warehouse.
   The data warehouse makes all data accessible to our legacy systems and FTB users.
3. A secure online taxpayer folder.
   The folder provides FTB staff and our stakeholders secure access to information such as tax returns, payments, notices, etc.
4. Updated systems.
   Legacy systems are updated so they will work with the new processing system, the data warehouse, and the taxpayer folder.

The EDR Project kick-off was July 1, 2011. Since then, we have implemented numerous revenue producing early initiatives to help fund the project. At the same time, we started development work on Design Stage 1 of the project. Design Stage 1 includes reengineering processing of our tax returns and payments.

The EDR Project is a 66-month project divided into three major design stages with nine primary releases. Each design stage includes three releases.

Manageable components allow us to slowly implement the project in well-defined releases, in which each release builds upon the previous release. Additionally, the project has a six-month stabilization period after each major release to ensure the solution is functioning correctly and stabilized over a period of time before the next release is implemented. The first major release is scheduled for September 30, 2012.

The project schedule is designed to have all project deliverables in place prior to the final year of the project. This schedule allows us to specifically focus on our workforce transition during the last 12 months of the project to ensure our ability to maintain and use the solution.

In FY 2011/2012, the EDR Project early initiatives resulted in $76 million in new revenue for the state. The EDR Project revenue will continue to increase during the project. Revenue benefits will level out at $1 billion annually starting in 2016, and continue each year thereafter. The new revenue over the project reporting period is $4.7 billion.

The EDR Project revenue estimates are based on current tax law and do not factor in any new taxes or penalties. The primary source of funding for the EDR Project is drawn from more efficient collections and increased tax compliance.

The EDR Project contract was awarded to CGI Technology Solutions, Inc. in June 2011. CGI has extensive experience on large, complex information technology projects. We have worked with CGI on several large tax projects in the past.

Tax Gap Action Committee Initiatives

- Provide background information on the underground and illegal economies. The Committee will explore the possibility that enhanced partnering among California agencies could improve compliance with tax and other laws.
- Increase FTB's ability to identify fraudulent refund claims and prevent the issuance of the erroneous refunds when a false claim is the result of identity theft. The Committee will support research to identify new identity theft fraud models and work to identify the most cost effective methods to accomplish this initiative.

Projects

Live Chat

Live Chat was launched on March 11, 2011, so the public could ask FTB representatives nonconfidential questions regarding personal income tax, finding a form or publication, and to get help with our website. In August 2011, the Live Chat pilot became a permanent service.

In FY 2011/2012, we responded to 87,000 taxpayers and tax professionals on personal income tax questions. In October of 2011, based on feedback from our customers, we expanded our services and began offering Live Chat for business entities. Through June 2012, 30,000 business entities have used our Live Chat service. Overall, we continue to receive positive response to this new communication channel with an approval rating of four out of five stars.

On April 23, 2012, FTB expanded its Live Chat communication to include collection program activities. The Collection Live Chat pilot provides general installment agreement and PIT collection information regarding nonconfidential inquiries. At the point when we require confidential account information, the Live Chat session is converted to secure email. These additional services allow customers to have immediate access to collection staff, increase the use of self-service options and provide a better customer experience with FTB. From April through June 2012, the Collections Live Chat pilot received and completed 2,234 chats. Customer satisfaction survey results have provided positive feedback from taxpayers regarding the service. Taxpayers have expressed they are happy to get quick answers to general PIT collection questions without having to spend considerable time on the phone.

Taxpayers’ Bill of Rights Hearing

Taxpayers presented proposals to the three-member Franchise Tax Board (Board) at the annual Taxpayers’ Bill of Rights hearing on December 1, 2011. The meeting took place at FTB in Sacramento, California. For copies of the complete responses, go to **ftb.ca.gov** and search for **hearing responses**. Each response below is documented in order of appearance at the hearing.

David Feldman, ZF Micro Solutions

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

- FTB considers legislation that would require all taxpayers to submit proof of payment of taxes and proof of good standing with the Secretary of State prior to any city, county, or state agency providing any service, including services such as building permits or fire department inspections.

In his letter dated February 16, 2012, Taxpayers’ Rights Advocate Steve Sims responded that while the department appreciates your desire to ensure full compliance with the tax laws, this proposal goes far beyond the scope of FTB with the limits it would place on the ability of local governments to provide services. For this reason, we are unable to recommend that the Board sponsor such a legislative proposal.

Vicki Mulak, California Society of Enrolled Agents (CSEA)

Ms. Mulak provided oral comments to the Board on the following issues:

- Power of Attorney Notification on all FTB Taxpayer Correspondence.
- Implementation of Virtual Hold Technology on Practitioner Hotline.
- Update Requested on Increase to Lien Filing Threshold.
- Collection Process Inconsistencies Remedied.
- Cessation of Use Tax Collection on Income and Franchise Tax Returns.
- Remedy Needed for Disaster Treatment Confusion.
- Improved Outreach Needed on Withhold-at-Source Requirements.
- Assistance Needed with IRS-Approved Continuing Education Regulations.

In his letter dated February 16, 2012, Taxpayers’ Rights Advocate Steve Sims responded regarding power of attorney notification as we mentioned in last year’s response, our present POA system does not allow us to automate the noticing process and it would be cost prohibitive in most cases to provide duplicate notices to the taxpayer and their representative. We understand your concerns and to that extent, we are sending your comments to the EDR Project, so that these concerns can be considered during the requirement development process.

Regarding implementation of virtual hold technology on the practitioner hotline, Mr. Sims responded that Virtual Hold (VH) systems are designed for call centers with high call volumes and large staffing levels. Risks are involved when implementing VH into a small call center; therefore, the vendor recommended that the Practitioner Hotline not offer this tool. FTB tried Virtual Hold on a small toll-free call center and has found it extremely difficult, if not impossible, to manage effectively. We value our relationship with the practitioner community. Although Virtual Hold is not feasible for the Hotline, FTB is committed to providing excellent service to tax practitioners.

Regarding an update to increasing the lien threshold, Mr. Sims responded that FTB continues to evaluate and review the effectiveness of the lien program including the impact of our current dollar threshold for filing liens. During our ongoing review, we identified improvements to current lien practices and procedures and the need for taxpayer focused education. We expect to enhance lien information available on our public website in March 2012, and also plan for future enhancements to our Interactive Voice Response (IVR) and collection notices to better educate taxpayers on the impacts of a lien.

Regarding collection process inconsistencies, Mr. Sims advised that FTB strives to provide consistent and equitable treatment to all of our customers. We are committed to following our mission to administer and enforce California's tax laws effectively with fairness and integrity.

Regarding cessation of use tax collection on income and franchise tax returns, Mr. Sims responded that while FTB would be happy to provide technical assistance to the BOE or to any legislator in drafting this proposal, staff is unable to recommend that the FTB sponsor this legislative idea. The BOE has responsibility for administration of the sales and use tax, and we feel that any proposed changes in collection practices should originate with the BOE.

Regarding a remedy needed for disaster treatment confusion, Mr. Sims responded by referring you to specific state disaster rules, and FTB Publication 1034, Disaster Loss How to Claim a State Tax Deduction, available on the FTB website. It provides a chart detailing both state and federal disaster loss provisions for California disasters.

Regarding improved outreach needed on withhold-at-source requirements, Mr. Sims responded that FTB is continually looking to improve our education and outreach efforts related to withholding. Based on feedback we have received this year related to the lack of awareness of withholding requirements, particularly among small businesses, the Withholding Services and Compliance Section is exploring additional outreach efforts. As we explore the outreach efforts, actual implementation will depend on the availability of departmental resources.

Regarding assistance needed with IRS-approved continuing education regulations, Mr. Sims responded that while we recognized that there may be some Enrolled Agents and Preparer Tax Identification Number (PTIN) holders that are not in need of continuing education regarding California tax matters for IRS purposes, the majority of California tax practitioners do need this type of education to meet requirements for their professional classification or membership in professional organizations. Although receiving Return Preparer Office (RPO) approval for California only tax issues such as residency and enterprise zone credits does not seem likely, it appears RPO approval could be received under the new "80 percent rule" by using a comparison approach format. According to the IRS, an education program that covers state tax law issues will not qualify for IRS continuing education credit unless at least 80 percent of the program material consists of a comparison between federal and state tax laws. Accordingly, we will request clarification and examples from the IRS of how to meet the new "80 percent rule."

Just a reminder, these IRS changes do not affect the present California continuing education process.

Lynn Freer, Spidell Publishing, Inc.

Ms. Freer provided oral comments to the Board on the following issues:

- Disability Waiver of Mandatory e-Payment Requirement.
- Property Tax Deduction on Schedule CA.

In his letter dated February 16, 2012, Taxpayers' Rights Advocate, Steve Sims responded that FTB looked at the legislative process to create a permanent disability mandatory e-pay waiver. We determined that we could handle the waiver requests administratively.

Regarding the Property Tax Deduction on the Schedule CA, Mr. Sims responded that we understand the importance of educating taxpayers and tax practitioners to improve self-reporting of property taxes as itemized deduction. After exhaustive research, we believe and have announced that federal law is clear in that an itemized deduction for real property tax is not allowed for a Mello-Roos assessment, to the extent it is not based by the value of the property assessed. However, the Chief Counsel of the Franchise Tax Board formally requested clarification from Chief Counsel of the Internal Revenue Service (IRS) in Washington DC regarding the validity of a memorandum authored in 2003 by a local IRS attorney indicating that a Mello-Roos assessment may be deductible even though it is not assessed on an ad valorem basis. We also contacted each county with information about our Real Estate Tax Deduction Education Campaign. This includes our education efforts for the current filing season, as well as additional reporting requirements beginning with the 2012 tax return.

Gina Rodriquez, Cal-Tax

Ms. Rodriquez provided oral comments to the Board on the following issues:

- Charitable Remainder Trust Conformity.

In his letter dated February 16, 2012, Taxpayers' Rights Advocate Steve Sims responded that FTB staff understands that CalTax is seeking an author to carry legislation to conform to the 2006 federal law change with charitable remainder trusts. We briefly discussed the issue of expanding areas of automatic conformity in December. One barrier to automatic conformity has been the prohibition in the California Constitution on delegating legislative authority. Thus, it may be that addressing the issue of automatic conformity is more a legislative function than FTB's. Staff did contact policy committee staff to see if there would be interest in discussing this issue after the January bill deadlines have been met.

Evaluating Franchise Tax Board Employees

In previous years, we reported changes to employee performance evaluations and probationary reports as well as changes in the evaluation process itself. We explained that "customer service" was included as a performance dimension for supervisors and employees. We evaluate employees on how well they provide "quality customer service, while striving to exceed customers' expectations," their treatment of taxpayers, and providing "accurate, timely, and complete assistance." We continue to reaffirm that employees are not to be evaluated based on the revenue they produce through additional tax assessments or collections.

In 2008, we focused on developing a plan to ensure all eligible employees received an annual performance appraisal by August 31 of each year. Since that time, the percentage of employees and supervisors who receive a required performance appraisal has risen to nearly 95 percent.

In 2010, we concentrated our efforts on improving the communication process between supervisors and those employees evaluated and holding staff accountable for expected results/behaviors. These efforts included a presentation of training to all supervisors that focused on honest and respectful communication with staff which included conversations related to expectations and performance evaluations.

For FY 2011/2012, we focused on two areas:

FTB's New Strategic Plan (2012-2016)—Two primary goals detailed in our new Strategic Plan specifically address our desire to improve customer service and invest in our employees to build a stronger organization. Employee and supervisor performance in these areas will be considered in future evaluations.

I**mproving the "Content" of Performance Evaluations**—We developed and offered Performance Evaluation Refresher Training to all supervisors. Also, throughout the year, we released a series of "human resource tips" to assist supervisors in the evaluation of their employees. These tips included topics such as making sure there were no surprises in the performance evaluation, discussing what to include and/or exclude, how to focus on employee strengths in order to build on them in the future, and how to build relationships with our employees.

Appendices

Appendix 1

All tables in Appendix 1 reflect tax increase assessments only. The assessments became final in FY 2011/2012. We may have issued the assessments in prior years; however, due to cases in protest status, we did not resolve them until FY 2011/2012. Appendix 1 totals reflect rounded figures and may not compute exactly.

Table 1A **Corporation Tax Law**
NPAs Finalized in Fiscal Year 2011/2012 Categorized by Primary Statute (Issue)

Issue	Number of NPAs	%	Tax Assessed (Millions)	%	Average Assessment Per NPA
Allocation/Apportionment	516	22.7	$ 351.4	78.6	$ 681,074
Assess Minimum Tax	35	1.5	0.0	0.0	786
Revenue Agent Reports	1,369	60.2	43.0	9.6	31,415
State Adjustments	160	7.0	34.3	7.6	214,110
Other	192	8.5	18.0	4.0	93,762
Totals/Average	2,272	100	$ 446.7	100	$ 196,616

- *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 2011/2012 Categorized by Primary Statute (Issue)

Issue	Number of NPAs	%	Tax Assessed (Thousands)	%	Average Assessment Per NPA
CP2000	174,820	20.8	$ 134,038	6.1	$ 767
Filing Enforcement	567,452	67.7	1,725,573	78.2	3,041
Filing Status	33,473	4.0	31,469	1.4	940
Revenue Agent Reports	33,101	3.9	132,610	6.0	4,006
Other	29,923	3.6	183,319	8.3	6,126
Totals/Average	838,769	100	$2,207,009	100	$ 2,631

- 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 2011/2012						
Industry	**All Corporations 2010 Tax Year**	**%**	**Corporations with NPAs**	**%**	**Tax Assessed (Millions)**	**%**
F.I.R.E.*	130,623	17.7	139	9.8	$ 36.4	8.1
Manufacturing	45,481	6.2	140	9.9	159.3	35.6
Services	313,829	42.5	297	21.0	18.2	4.0
Trade	125,359	17.0	202	14.3	31.4	7.0
Other **	122,932	16.7	632	44.8	201.4	45.0
Totals	738,224	100	1,410	100	$ 446.7	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 through a combined report, we base the industry designation on the corporation's primary business activity in California. In the case of corporations filing through 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 2011/2012 Issued by Taxable Year					
Average Taxable Year	**Number of NPAs**	**%**	**Tax Assessed (Millions)**	**%**	**Average Assessment Per NPA**
2004 and prior	395	17.4	$ 304.6	68.2	$ 771,113
2005	192	8.4	25.2	5.6	131,486
2006	347	15.2	51.4	11.5	148,049
2007	526	23.1	48.9	10.9	93,049
2008	590	25.9	14.1	3.1	23,962
2009	202	8.8	2.1	.4	10,591
2010 and later	20	0.9	0.3	0.1	14,109
Totals/Average	2,272	100	$ 446.7	100	$ 196,616

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 2011/2012 for the Same Taxpayer

Corporations With...	Number of Taxpayers	Tax Assessed (Millions)	Average Assessment Per Taxpayer
One NPA	822	$ 46.3	$ 56,301
Two NPAs	406	113.8	280,192
Three NPAs	129	75.3	583,928
Four or more NPAs	53	211.3	3,987,676
Totals/Average	1,410	$ 446.7	$ 316,816

Table 4 **Personal Income Tax Law**
NPAs Finalized in Fiscal Year 2011/2012 Issued by Taxable Year

Taxable Year	Number of NPAs	%	Assessment Amount (Thousands)	%	Average Assessment Amount
2005 and prior	4,412	0.5	$ 109,108	4.9	$ 26,342
2006	5,258	0.6	50,799	2.3	9,661
2007	66,053	7.9	210,342	9.5	3,184
2008	264,457	31.5	511,755	23.2	1,935
2009	173,174	20.6	370,710	16.8	2,141
2010 and later	325,685	38.8	954,295	43.2	2,930
Totals/Average	838,769	100	$2,207,009	100	$ 2,631

Table 5 **Personal Income Tax Law**
Resident Tax Return Preparation, Process Years 2010 and 2011

Preparer	2010 Tax Returns Processed (Thousands)	%	2011 Tax Returns Processed (Thousands)	%	% Change
Professional	9,901	67.6	10,483	70.8	3.2
Taxpayer	4,513	30.8	4,069	27.5	-3.3
VITA*	225	1.5	262	1.8	0.3
Totals	14,638	100	14,814	100	

* Volunteer Income Tax Assistance is a program that provides tax return preparation assistance for seniors, disabled, non-English speaking, and those with limited or fixed incomes.

Table 6 **E-filing and Payment Statistics**

Activities	**July 1, 2011**	**June 30, 2012**	**% Change**
Credit Card Payments (Average payment is $1,009)	137,000	154,000	12 .0
Direct Debit of Balance Due (Electronic Funds Withdrawal)	414,000	381,000	-8 .0
Direct Deposit Refund	5,624,000	6,046,000	8 .0
* e-file	12,553,000	13,429,000	7 .0
** *CalFile*	258,000	244,000	-5 .0
** Online Filing	2,848,000	3,130,000	10 .0
** Business Entity	497,000	648,000	30 .0

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

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

Fiscal Year	**Demands**	**NPAs Issued**
2007/2008	31,819	18,855
2008/2009	65,954	23,807
2009/2010	26,367	27,286
2010/2011	43,924	23,629
2011/2012	54,595	30,492

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

Fiscal Year	**Demands/Requests**	**NPAs Issued**
2007/2008	839,818	463,315
2008/2009	1,222,050	849,650
2009/2010	1,243,842	706,104
2010/2011	1,067,776	774,627
2011/2012	1,043,258	689,165

Table 8A **Top Errors by Tax Return Type**
July 1, 2011 through June 30, 2012

	Code	Grand Total	540 2EZ	540	540 A	540 NR	540 X
EP	Estimate Payment	**163,362**	**1,701**	**143,474**	**2,342**	**13,450**	172
AW	Withholding Did Not Match Attachments	**26,948**	**4,835**	**18,793**	**939**	**929**	**548**
OC	Estimate Transfer Revised	**25,667**		**20,348**	363	**4,334**	25
OF	Amended Refund Did Not Equal Original Refund	**24,564**	**1,018**	**6,841**	270	521	**15,912**
EX	Exemptions	**20,685**	108	**10,570**	**8,538**	**947**	111
TC	Tax Amount	**20,028**	149	**10,581**	**5,650**	**2,086**	**1,561**
WS	Withhold at Source Revised	**19,755**	4	**5,684**	4	**13,603**	**319**
OM	Amended Payments Did Not Match Original	**19,516**	358	3,458	117	302	**15,279**
TY	Total Tax Revised - AGI, Filing Status, or Dependents	**16,130**	**16,127**				
SS	State Disability Insurance Revised	**13,647**		**12,103**	**982**	378	183
TT	Total Credits/Liability	10,375	**1,384**	3,772	**4,092**	177	**435**
RN	Renters Credit Revised	8,275	**1,750**	**3,873**	**2,371**	262	19
OA	Refund Revised - Incorrect Payments or Credits	8,213	**1,213**	3,493	**1,506**	275	**1,511**
AT	Withholding Documents Not Attached	7,912	**840**	3,784	402	**1,567**	245
DS	Deductions	6,308	20	**3,944**	**1,665**	**543**	133
AR	Amended Tax Return Received - No Record of Original Tax Return	3,990	*				**3,820**
ND	California Taxable Income Revised	3,944		*		**3,913**	29
TI	Taxable Income Revised	3,878	21	1,925	**1,614**	194	118
OB	Balance Revised - Incorrect Payments or Credits	2,575	**436**	1,227	441	63	**295**
NN	Total Tax Revised - Nonresident Errors	2,296		*		**2,293**	*
OP	Amended Estimate Payments Did Not Match Original	2,247	7	450	25	52	**1,712**
AA	Adjusted Gross Income	1,478	**1,373**	52	40	*	9
	All Others	12,248	646	6,505	1,703	1,163	1,525
	Top Ten	**350,302**	**30,677**	**236,211**	**29,699**	**43,665**	**41,392**
	All Others	73,739	1,315	24,668	3,365	3,389	2,571
	Grand Total	424,041	31,992	260,879	33,064	47,054	43,963

*Reflects fewer than three tax returns.

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

Table 8B **Top Errors by Filing Method**
July 1, 2011 through June 30, 2012

	Code	Grand Total	Electronic	Paper
EP	Estimate Payment	**163,362**	**106,616**	**56,746**
AW	Withholding Did Not Match Attachments	**26,948**	**13,154**	**13,794**
OC	Estimate Transfer Revised	**25,667**	**14,664**	**11,003**
OF	Amended Refund Did Not Equal Original Refund	**24,564**	417	**24,147**
EX	Exemptions	**20,685**	766	**19,919**
TC	Tax Amount	**20,028**	195	**19,833**
WS	Withhold at Source Revised	**19,755**	**10,444**	**9,311**
OM	Amended Payments Did Not Match Original	**19,516**	116	**19,400**
TY	Total Tax Revised - AGI, Filing Status, or Dependents	**16,130**	171	**15,959**
SS	State Disability Insurance Revised	**13,647**	**8,841**	4,806
TT	Total Credits/Liability	10,375	**945**	**9,430**
RN	Renter's Credit Revised	8,275	**1,320**	6,955
AT	Withholding Documents Not Attached	7,912	**870**	7,042
DS	Deductions	6,308	**1,589**	4,719
NH	New Home Credit	1,563	**1,066**	497
	All Others	39,306	2,562	36,744
	Top Ten	**350,302**	**159,509**	**199,542**
	All Others	73,739	4,227	60,763
	Grand Total	424,041	163,736	260,305

Table Legend:

Bold › Top ten codes issued by Tax Return Type.

Table 8 **Definitions**

AA	Amount of California adjusted gross income (AGI) adjusted.
AR	Amended tax return filed with no record of original tax return.
AT	Withheld tax credit disallowed; withholding documents not attached to tax return.
AW	Withheld tax credit revised to match total shown on attached withholding documents.
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	California taxable income revised; computed or transferred incorrectly, deduction percentage computed incorrectly, or percentage incorrectly applied to deduction.
NH	New Home or First-Time Buyer Credit revised or denied.
NN	Total Tax revised; California tax rate, California Credit Percentage, or California Exemption credit percentage incorrectly computed; or error computing/transferring tax on Schedule G-1, *Tax on Lump-Sum Distributions* or Form 5870A, *Tax on Accumulation Distribution of Trusts*.
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 tax return that affected the available transfer amount.
OF	Amount of refund received reported on Amended tax return does not match amount on original tax return.
OM	Amount paid with original tax return plus payments made after tax return filed does not match amount claimed on Amended tax return.
OP	Amount of estimated tax payments reported on Amended tax return does not match amount on original tax return.
RN	Nonrefundable Renter's Credit revised; wrong amount claimed for Filing Status, California 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 amount was revised.
TT	Total Tax revised; error computing total credits or tax liability.
TY	Total Tax revised based on AGI, Filing Status and dependents claimed.

Appendix 3

Regulation Section 17052.6 – California Child and Dependent Care Expenses (CDC) Credit

In 2000, the legislature passed and the Governor signed Assembly Bill (AB) 480, which added Section 17052.6 to the Revenue and Taxation Code. This section provided for a credit against net California tax of a percentage (determined by adjusted gross income) of the federal credit allowed under Internal Revenue Code Section 21 for tax years beginning on or after January 1, 2000. This section provided for a refundable credit as originally enacted. However, in 2011 Senate Bill (SB) 86 amended this section to make the credit nonrefundable for tax years beginning on or after January 1, 2011.

Section 17052.6 incorporates by reference the provisions of Internal Revenue Code Section 21, which requires taxpayers to identify their qualifying individual and care provider, and the amount paid for qualifying expenses. This proposed regulation seeks to provide clarification for the taxpayer as to the documents that can be used to establish the identity of the qualifying individual, the care provider, and the amount paid for qualifying expenses.

On December 2, 2010, staff received authorization from the three-member Franchise Tax Board to proceed with an interested parties meeting to discuss possible adoption of new regulations for Revenue and Taxation Code Section 17052.6. An interested parties meeting was held on May 31, 2011. A second interested parties meeting was held on February 15, 2012, to elicit comments from the public on the draft language of the proposed regulations. On June 7, 2012, the three-member Franchise Tax Board approved staff's recommendation to proceed with the formal regulatory process, as required under the Administrative Procedure Act. Staff anticipates holding a formal regulatory hearing in the fall of 2012 or spring of 2013.

Regulation Section 17942 – Limited Liability Company (LLC) Fees

For taxable years beginning on or after January 1, 2007, the legislature amended Revenue and Taxation Code 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 derived from California. In addition, the amended LLC fee statute provides that, "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."

Revenue and Taxation Code Sections 25135 and 25136 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 Revenue and Taxation Code 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. Interested parties meetings were held on June 17, 2008, and November 19, 2010. Staff held a third interested parties meeting on October 4, 2011, to provide proposed language for public input. On March 8, 2012, the three-member Franchise Tax Board approved staff's recommendation to proceed with the formal regulatory process, as required under the Administrative Procedure Act. Staff anticipates holding a formal regulatory hearing in the fall of 2012 or spring of 2013.

Regulation 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 tax returns at the end of the year.

California law requires FTB to issue regulations to implement the withholding at source statutory requirements (Revenue and Taxation Code 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 Revenue and Taxation Code Section 18662. 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; however, staff felt it would be necessary to hold a second interested parties meeting which was held on July 14, 2011. On December 1, 2011, the three-member Franchise Tax Board approved staff's recommendation to proceed with the formal regulatory process, as required under the Administrative Procedure Act. Staff anticipates holding a formal regulatory hearing in the fall of 2012 or spring of 2013.

Regulation 19089 – Notice of Bankruptcy or Receivership

Revenue and Taxation Code Section 19089 provides, in part, that "[e]very trustee in a case under Title 11 of the United States Code, receiver, assignee for the benefit of creditors or like fiduciary shall give notice of qualification as such to the Franchise Tax Board in the manner and at the time that may be required by regulations of the Franchise Tax Board" and that "[t]he Franchise Tax Board may by regulation provide any exemptions from the requirements of this section that the Franchise Tax Board deems proper." The Franchise Tax Board has not yet adopted regulations under this section.

The potential new regulation would be designed to implement the section. The regulation would address such issues as who is required to give notice of qualification, the manner in which notice must be provided, the time requirement for providing the notice, and whether any exemptions to the notice requirement are appropriate.

An interested parties meeting was held on December 3, 2010, with the purpose of eliciting public input into the potential new regulation and discussing issues to be considered in drafting the language of the new regulation. At the conclusion of the meeting, staff reiterated its interest in hearing and receiving additional comments. Staff held a second interested parties meeting on November 1, 2011, to elicit comments on the draft language. On December 1, 2011, the three-member Franchise Tax Board approved staff's recommendation to proceed with the formal regulatory process, as required under the Administrative Procedure Act. Staff is currently awaiting receipt of an approved Form 399 from the Department of Finance and will then submit the rulemaking file to the Office of Administrative Law for final approval in the fall of 2012.

Regulations Sections 19266 – Financial Institutions Record Match (FIRM)

The Financial Institution Record Match (FIRM) program was enacted March 24, 2011 (SB 86, Stats. 2011, ch. 14). Sections 19266 and 19560.5 were added to the Revenue and Taxation Code, which authorizes FTB to match FTB tax and nontax debtor files referred to FTB for collection (collectively, "delinquent debtor files") against accounts held at financial institutions (banks, credit unions, insurance and brokerage companies) doing business in California.

On July 25, 2011, FTB hosted a FIRM Advisory Workshop. The invitees included the financial institution trade associations. The purpose of this workshop was to obtain input from the financial institutions as to the steps FTB is taking to implement the FIRM statutory provisions and to mitigate potential impacts to the financial institutions. FTB provided the Advisory Workshop participants with the draft FIRM documents to review and provide feedback.

On August 16, 2011, FTB held the first interested parties meeting to discuss FIRM processes, procedures, and the necessary components of the FIRM regulations. A second interested parties meeting was held on September 27, 2011, to solicit public input on the draft regulations. On December 1, 2011, the three-member Franchise Tax Board approved staff's recommendation to proceed with the formal regulatory process, as required under the Administrative Procedure Act. Staff anticipates holding a formal regulatory hearing in the fall of 2012 or spring of 2013.

Regulation Section 19322 – Refund Claim

In 1993, SB 3 added Section 19322 to the Revenue and Taxation Code by consolidating separate sections that previously were in the Personal Income Tax Law and the Corporation Tax Law into this new section. This section provides that all claims for refund must be made in writing and be signed by the taxpayer or the taxpayer's representative. Section 19322 further mandates that all claims for refund state the specific grounds upon which the claim is based.

The current claim for refund Regulation Section 19322 provides requirements for the manner of filing refund claims, grounds that must be set forth in refund claims, and information regarding the oral hearing process. The current rulemaking project proposes regulatory amendments to update current Regulation Section 19322. The potential amendments to the existing regulation aim to clarify the manner of filing refund claims both to make clear the preference for claims to be reported on the prescribed amended tax return form and also to encompass electronic means of filing claims which may become available in the future. Additionally, the potential amendments seek to clarify the grounds that must be set forth in a valid refund claim both through additional specific language in the regulation and through the use of examples of valid and invalid claims. Finally, the regulation seeks to clarify the oral hearing process available to taxpayers for their claims for refund.

On December 4, 2008, staff received authorization from the three-member Franchise Tax Board to proceed with an interested parties meeting to discuss proposed amendments to the existing regulations for Revenue and Taxation Code Section 19322. An interested parties meeting was held on December 3, 2010, and staff is currently preparing draft language for the regulation amendments based on the comments received at the interested parties meeting. A second interested parties meeting will be scheduled to elicit comments from the public on the draft language of the regulation amendments.

Regulation Section 23663 – Assignment of Credits to Combined Group Members

Revenue and Taxation Code Section 23663 permits the assignment of credits among affiliated members of the same combined reporting group. Revenue and Taxation Code Section 23663 was added by Section 10 of AB 1452 (Stats. 2008, ch. 763) and is specifically operative for assignments made in taxable years beginning on or after July 1, 2008, and first permits assigned credits to be claimed against the "tax" of the assignee in taxable years beginning on or after January 1, 2010.

An assignment is made as an election on a taxpayer's original tax return on the Form FTB 3544 and is irrevocable under Revenue and Taxation Code Section 23663, subdivision (c). In some situations taxpayers have made defective elections, such as when the total credits available to be assigned are less than the assignor contemplated when the original tax return was filed, or an assignee was not a member of the same combined reporting group on the required dates. Because the assignment election is irrevocable, taxpayers are left with no clear recourse to fix such defective elections, and the department has not yet established any standards to apply in adjusting such defective elections.

Under Revenue and Taxation Code Section 23663, subdivision (e), paragraph (4), the Franchise Tax Board is specifically authorized to issue necessary regulations to specify the treatment of any assignment that does not comply with the requirements of Section 23663, including where the taxpayer and assignee are not members of the same combined reporting group on the dates required.

On June 7, 2012, staff received authorization from the three-member Franchise Tax Board to proceed with an interested parties meeting. An interested parties meeting was held on October 1, 2012, to elicit public input on a proposed regulation which would authorize and establish specific procedures under which taxpayers may request that Franchise Tax Board staff permit the correction of defective elections, and identify general standards under which staff would review requests for the correction of a defective election, including examples of situations where such requests may or may not likely be granted following staff review.

Regulations Sections 24465 – Transfer of Appreciated Property to an Insurer

In 2004, the legislature passed and the Governor signed AB 263, which added Section 24465 (and other provisions) to the Revenue and Taxation Code. This section would, in connection with specified exchanges, provide that if a taxpayer transfers property to an insurer, the insurer shall not, for purposes of gain recognition, be considered to be a corporation for purposes of the Corporation Tax Law.

On March 8, 2011, staff held an interested parties meeting to discuss proposed regulations to implement specific subdivisions of Revenue and Taxation Code Section 24465. A second interested parties meeting was held on March 29, 2012, to discuss proposed language under subdivision (c) of Revenue and Taxation Code Section 24465 (Annual Statement) and the economic impact, if any, of the proposed language. On September 5, 2012, the three-member Franchise Tax Board approved staff's recommendation to proceed with the formal regulatory process, as required under the Administrative Procedure Act. Staff anticipates holding a formal regulatory hearing in the fall of 2012 or spring of 2013.

Regulations Sections 25106.5 – Finnigan/Joyce Sales Factor

Revenue & Taxation Code Section 25135 provides the sales factor numerator assignment rules for sales of tangible personal property. During 2009, the legislature amended Revenue and Taxation Code Section 25135, operative for taxable years beginning on or after January 1, 2011. As amended, Revenue and Taxation Code Section 25135 requires that sales of tangible personal property delivered or shipped to a purchaser in California be assigned to California if the seller or any member of the seller's combined reporting group is taxable in California. In addition, all sales of tangible personal property delivered to a state other than California are not assigned (thrown back) to California if any member of the seller's combined reporting group is taxable in that state.

The first interested parties meeting was held on May 26, 2011, and a summary of that meeting was posted on the Franchise Tax Board website. Public input regarding possible regulatory language was elicited at the first interested parties meeting. During the first interested parties meeting, an attendee suggested that the Hearing Officer draft proposed language to amend the existing California Code of Regulations, title 18 (Regulation), Section 25106.5 based on a prior discussion draft the FTB prepared but did not adopt during the 2000 regulation amendment. A second interested parties meeting was held on October 4, 2011, to discuss the proposed language. On December 1, 2011, the three-member Franchise Tax Board approved staff's recommendation to proceed with the formal regulatory process, as required under the Administrative Procedure Act. Staff anticipates holding a formal regulatory hearing in the fall of 2012 or spring of 2013.

Regulations Sections 25106.5-1 – Intercompany Transactions

During 1999, the Franchise Tax Board promulgated California Code of Regulations, Title 18, Section 25106.5-1, which addresses the treatment of intercompany transaction in a combined report context occurring on or after January 1, 2001. Regulation Section 25106.5-1 generally follows the federal consolidated intercompany regulations (Treasury Regulation Section 1.150-2-13 et seq.) with respect to many of the issues in those regulations, but because income is not apportioned for federal purposes, Regulation Section 25106.5-1 also provides applicable apportionment rules.

For income tax purposes, gain or loss from intercompany transactions is ordinarily deferred until there is a triggering event, such as the sale of the deferred item outside the group to a third party. Notwithstanding this general principle, both the California and federal intercompany regulations allow taxpayers in specified circumstances to elect to account for their income or loss from intercompany transactions on a "separate entity" basis. This election allows current recognition of income or loss from intercompany transactions. The election is governed by Regulation Section 25106.5-1, subsection (e), for California tax purposes and Treasury Regulation Section 1.1501-13, subsection (e)(3), for federal tax purposes.

Both the California and federal regulations include "simplifying rules" provisions. This election is included within those "simplifying rules." Regulation Section 25106.5-1, subsection (e), authorizes federal "separate entity" elections to be effective for California tax purposes. Even in situations in which the taxpayer has not made a federal "separate entity" election, taxpayers can elect to recognize intercompany income or loss on a separate entity basis as long as they have "properly reported" the intercompany income or loss on a separate entity basis for federal or foreign national tax purposes.

Questions have arisen regarding the proper sales factor treatment of intercompany transactions that are recognized on a separate entity basis due to the above described election. Some taxpayers have suggested that because the election results in current income recognition from intercompany transactions, as opposed to the normal scheme of deferral, that the sales factor for the year of election should contain the gross receipts related to the income recognized currently due to the election, which results in a higher sales factor denominator and reduced California apportioned income. Staff believes that it is prudent to clarify that a Regulation Section 25106.5-1, subsection (e), election does not allow taxpayers to include intercompany transaction receipts in their sales factor denominator in the year of election. Instead, receipts are only included in the sales factor when the intercompany items are sold to third parties, giving rise to economic gain or loss to group as a whole. If intercompany receipts were to be recognized currently due to the election, the receipts that arise when the items are eventually sold outside the group would result in a double count of the actual economic activity in the sales factor. Furthermore, inclusion in the sales factor in the current year due to a subsection (e) election is inconsistent with Regulation Section 25106.5(a)(5)(A) and (a)(5)(B).

On December 3, 2009, staff received permission from the three-member Franchise Tax Board to hold an interested parties meeting to discuss possible amendments to Regulation Section 25106.5-1 to provide further guidance in two areas and to address conformity with federal laws. Staff held an interested parties meeting on April 21, 2010. Comments were received. A second interested parties meeting was held on September 22, 2010, to discuss proposed amendments to the regulation.

On August 16, 2011, staff held a third interested parties meeting to discuss proposed amendments to the Deferred Intercompany Stock Account (DISA) provisions to provide additional guidance to the taxpayers. On December 1, 2011, the three-member Franchise Tax Board approved staff's recommendation to proceed with the formal regulatory process, as required under the Administrative Procedure Act. Staff anticipates holding a formal regulatory hearing in the fall of 2012 or spring of 2013.

Regulation Section 25136-2 – Market-Based Rules for Sales Factor

For taxable years beginning on or after January 1, 2011, Revenue and Taxation Code Section 25136 provides the sales factor numerator assignment rules for all sales other than sales of tangible personal property. Revenue and Taxation Code Section 25136, subdivision (b), provides the market-based rules for assignment of sales of other than sales of tangible personal property where taxpayers have made a single-sales factor election.

California Code of Regulations, Title 18, Section 25136-2, which became effective on March 27, 2012, and operative for taxable years beginning on or after January 1, 2011, provides cascading rules for sales of services and sales of intangible property. In those rules, there are specific provisions for assignment of sales of stock or interests in a pass-through entity and for the incorporation of the special industry rules under California Code of Regulations Section 25137, including those for mutual fund providers under California Code of Regulations Section 25137-14. Currently, there are no provisions for assignment of dividends under California Code of Regulations Section 25136-2.

On December 1, 2011, staff received permission from the three-member Franchise Tax Board to hold an interested parties meeting to address certain sales of services and intangible property which were not addressed in the proposed language of California Code of Regulations Section 25136-2. Specifically, possible amendments include situations involving sales in connection with asset management services, dividends, and reasonable approximation of the factor information of the underlying corporation where the taxpayer does not have the factor information. Staff held an interested parties meeting on March 29, 2012. No further action has been taken.

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 Revenue and Taxation Code 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 Revenue and Taxation Code. 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.

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, Collections, 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.