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Taxpayers' Bill of Rights Annual Report to the Legislature

State of California
Franchise Tax Board

December 1, 2013

Table of Contents

Executive Summary

Looking over my Executive Summaries to the last few years' reports, I used the phrase "difficult times" or "recession" several times. This year, California's tax collections are robust, the budget was signed timely in June, and, "California's finances are in very solid shape for the first time in a decade," Governor Brown said.

Regardless of whether the financial climate is positive or negative, Franchise Tax Board (FTB) must be vigilant in its commitment to administer the Revenue and Taxation Code (R&TC) fairly and continually strive to provide excellent customer service.

This report prepared by the Taxpayers' Rights Advocate's Office in response to the Taxpayers' Bill of Rights, R&TC Sections 21006 and 21009, is an excellent tool to measure our success in achieving both commitments.

The Advocate's Address briefly discusses significant issues, concerns, and challenges to both taxpayers and the department, such as increasing the lien threshold, increasing transparency in our Criminal Investigation Bureau, and the successful rollout of our 2012 – 2016 Strategic Plan.

The report also addresses the Taxpayers' Rights Advocate's responsibilities and contacts. For Fiscal Year (FY) 2012/2013 (July 1, 2012, through June 30, 2013), the Taxpayers' Rights Advocate's Office responded to over 21,400 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 Notices of Proposed Assessment. 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 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 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 3.2 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 2013 Taxpayers' Bill of Rights Annual Report to the Legislature.

This year, I give special acknowledgement to the Franchise Tax Board (FTB) for implementing the recommendations in my previous Annual Reports to the Legislature. The Accounts Receivable Management Division (ARM) evaluated and reviewed the effectiveness of the lien program, including the impact of dollar amount guidelines to file liens. As a result of this review, FTB increased the general guideline amount for lien filing from $1,000 to $2,000 beginning July 2013. Also, the Criminal Investigation Bureau made considerable improvements to achieve transparency by creating an external webpage on FTB's public website. This webpage contains information about their program as well as its policy and procedure manuals.

In addition to implementing some of my recommendations, the department completed its rollout of the 2012-2016 Strategic Plan, with Taxpayer Centric Service as one of its primary goals. This goal commits FTB to understand the needs of taxpayers and their representatives, and provide high-quality services and information to help taxpayers fulfill their tax obligations. As Taxpayers' Rights Advocate, I continue to maintain constant interaction with the tax professional community and taxpayers. Meeting with the tax professional community grants me firsthand knowledge on issues, concerns, and challenges taxpayers face and the impact legislation has on businesses in California and taxpayer compliance.

One way FTB improves taxpayer services and makes it easier to comply with the tax laws is by offering more online options. The department's Enterprise Data to Revenue (EDR) Project is in its second year of modernizing FTB's tax systems and business processes. FTB currently images approximately 300,000 pieces of correspondence, 4 million personal income tax returns, nearly 1 million business entity returns, and over 7 million checks annually. In the future, taxpayers and their representatives will be able to securely access this correspondence and other important tax information online using the enhanced MyFTB Account. We anticipate the enhanced MyFTB Account will reduce taxpayer burden by providing greater convenience, more self-service options, and also minimize phone calls or letters to the department.

My goal is to ensure taxpayers' rights are protected. To meet that goal, FTB strives to improve the communication and services it provides and identify areas where they can improve operations and taxpayer services, which include systemic issues that impact the department. Some emerging issues I am currently watching closely are:

- Filing Enforcement (FE) and final notices before involuntary collection action. The department's FE program identifies and contacts individuals and business entities that appear to have a California filing requirement and have not filed. In my 2012 report, I reported approximately $125 million in FE assessments were associated to accounts with undeliverable addresses in accounts receivable. As a result of my concerns, FTB determined as of June 2013, an estimated $2.5 billion of the total open and discharged accounts receivable balance consisted of accounts with an undeliverable address, $1.5 billion of this balance is the result of FE assessments. Approximately $166 million of the $2.5 billion are cases that are available for levy. These cases include $135 million in FE assessments. FTB sends notices to the taxpayer's last known address as an integral part of providing due process. The responsibility is therefore placed on the taxpayer to notify FTB of any change of address. However, FTB may not have had contact with the taxpayer in several years or the taxpayer may never have filed a tax return. FTB's current processes are dependent upon the receipt and timely processing of returned mail. This process is worrisome given my expressed customer service concerns. The Internal Revenue Service (IRS) is required by law to send taxpayers correspondence by certified mail to fulfill "Due Process of Collection." There is a delicate balance between revenue collection and due process. FTB must be able to assist these taxpayers in a timelier manner, and consider all efforts to reduce the possibility of unnecessary or erroneous involuntary collection actions. This is especially true in situations where FTB uses the last known address for collection of an FE assessment with an undeliverable address.

I ask FTB to consider sending FE assessments by certified mail when there is no response from our notices prior to initiating involuntary collection action.

- Protest and appeal rights for withholding assessments. The obligation to act as a withholding agent has become very difficult due to the increasing complexities surrounding how to determine California source income. Yet, when an assessment is made using California source income determined by an examination performed by our Withholding Service and Compliance Section (WSCS), there are no protest and appeal rights available without first paying the liability. To clearly explain that the statute does not provide protest and appeal rights for these assessments, we should add language to the information WSCS presently provides on FTB's website, in publications, and on the correspondence they use during their examinations. WSCS should further improve transparency by developing and publishing their procedures manual on FTB's website. I also recommend the department pursue a legislative remedy to this issue.

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

1. Auditor Retention

In recent years, I reported the Audit Division lost a significant number of auditors due to reduced compensation and benefits packages provided in budget negotiations. I am happy to report the number of auditors who left in Fiscal Year (FY) 2012/2013 dropped 40 percent from when I first reported this issue in FY 2008/2009. While fewer auditors leave the department, the Audit Division needs to continue its training assessment of current auditors to ensure they receive the training necessary to develop into more experienced auditors. It is essential to retain and train qualified staff to perform at the highest levels to ensure the department's ability to meet the standards as set forth in the Taxpayers' Bill of Rights.

For the first time since FY 2008/2009, the percentage of audit staff with less than five years experience dropped below 30 percent. In fact, this year, nearly 75 percent of audit staff have been with the department for more than five years. By FTB's investment in training, these auditors will likely impact taxpayers more positively and shorten the time it takes to complete an audit while improving the accuracy of the outcome. The training needs assessment completed by the Audit Division recommended a structured training development plan that focuses on common areas for all staff, such as, research skills and include an individual training plan to match each staff's personal skill level. While the Audit Division offered training to staff in a variety of technical as well as soft skill topics, I am still concerned there is not adequate tracking by the Audit Division on how many auditors attend these classes.

In addition, on-the-job training still continues to be a difficult area to measure and formally track. As Taxpayers' Rights Advocate, my concern is the Audit Division appears to offer more training as part of the structured training development plan, but it does not ensure all staff members receive additional technical training as part of an individual plan. Training these auditors to perform at the highest level should continue to be a priority and the department should consider requiring a minimum number of individual training hours, similar to the continuing education requirements tax practitioners must complete for many professional licenses. As the Audit Division defines training and measures performance consistently, auditors will be more prepared to face the challenges ahead of them.

2. Collections

The overall accounts receivable inventory increased from $8 billion to $8.5 billion (6 percent) over the previous fiscal year. While FTB strives to reduce its accounts receivable inventory, many taxpayers find it more difficult to pay their accounts in full and timely due to various economic factors. Taxpayers who previously paid their taxes as they became due now opt for installment agreements (FTB currently has over 195,000 taxpayers in an installment agreement), or they enter into the collection cycle. As a result, FTB continues to see high installment agreement receivables and an increase in the length of the collection process.

Financial Institution Records Match (FIRM)

In March 2011, FTB was granted legal authority to conduct a record match between financial institution customer records and FTB delinquent debtor records. We use FIRM as an enforcement tool to collect delinquent taxes and nontax debts of individuals and business entities. FIRM directly addresses the FTB data availability business problem by making additional assets available for the FTB Collections program (addresses the tax gap and FTB's Strategic Plan Effective Enforcement goal).

FIRM was implemented in April 2012, with the first FIRM levies sent in late June 2012. As expected, we had an increase in collection contacts from the FIRM levies.

FIRM statistics as of June 2013:

- FIRM revenue FY 2012/2013: $111 million
- FIRM Order To Withhold (OTW) notices issued: Approximately 299,337
- Financial institutions enrolled in FIRM: 658

Filing Enforcements and Collection Cases

In last year's report, I mentioned that a number of our FE notices do not reach the taxpayer and FTB did not specifically track the number of FE notices returned due to an undeliverable address. I also mentioned FTB issued approximately 25,000 FE assessments with an estimated value of approximately $125 million that went final on accounts with undeliverable addresses. I recommend FTB begin tracking the notice volume sent to undeliverable addresses along with the associated dollar value that resides in accounts receivable.

I am pleased to report the FE and Collections areas took some steps to correct the issue of undeliverable addresses. FE placed a hold on issuing assessments without a mailable address to allow time to search for a better address. FE sent bad address cases to Lexis Nexis to obtain a better address. FTB also sent records with a bad address to the Department of Motor Vehicles (DMV). DMV sent FTB a DMV record with an address 47 percent of the time. FTB could then compare this address to our files and update and use the address if appropriate.

Personal Income Tax FE Collection Cases

In last year's report, I mentioned that our Collections and FE areas continue to send large volumes of notices. The information in the chart below depicts the number of new personal income tax FE collection cases, and the dollar amounts associated during each fiscal year listed. The chart shows a 78 percent increase over last fiscal year, resulting from a fluctuation in the timing of the notices.

Personal Income Tax Filing Enforcement Data

Fiscal Year (FY)	Volume	Dollars
2009/2010	364,396	$1.3 billion
2010/2011	352,747	$1.2 billion
2011/2012	234,301	$850 million
2012/2013	418,346	$1.4 million

I also mentioned in last year's report that 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. I indicated my staff was working with Collections to assess the issue and the impact to taxpayers. As a result, in FY 2012/2013, Collections extended the annual notice process to taxpayers with debts currently discharged from accountability. The annual notice provided a breakdown of the balance due with penalties and interest. In addition to the annual notice, 30 days before any involuntary action occurs, FTB sends the taxpayer an additional balance due notice requesting payment.

As I mentioned earlier, our accounts receivable increased 6 percent (8 billion to 8.5 billion), and FTB currently has over 195,000 taxpayers in an installment agreement, which represents a 2 percent decrease from last fiscal year. In spite of the decrease of installment agreements, taxpayers still find it difficult to pay their accounts in full.

3. Conformity

I once again raise concerns about the growing disparity 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 low taxpayer self-compliance and greater costs to administer and enforce income tax laws. Our stakeholders often raise this matter asking us to seek out support for conformity legislation, and this matter has been a reoccurring issue at our Taxpayers' Bill of Rights Hearing, where industry representatives and individual taxpayers are afforded the opportunity to voice their concerns. As I explained in my 2008 and 2012 reports, the Revenue and Taxation Code (R&TC) is a system based on conformity. That is, we adopted a system where the California personal income tax 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 brought California's personal income tax law into conformity with most of the provisions of federal law, but only those changes that were enacted as of January 1, 2009. Since the enactment of SB 401, there have been nine bills enacted that conform California to federal law. While I applaud your efforts with the enactment of subsequent conformity legislation, these nine additional bills only provide for conformity to certain IRC sections. In the years since the enactment of SB 401, Congress enacted numerous public laws that amended provisions of the IRC that apply to California tax laws, resulting in California law being out of conformity with more than 20 of the IRC sections modified since the enactment of SB 401.

The California tax system is based largely on self-assessment. FTB collects the vast majority of taxes through voluntary compliance from taxpayers who file and pay according to the law. Conformity, through the adoption of the most recent IRC, reduces the administrative burden for both taxpayers and the state. Without major ongoing conformity, complex tax laws continue 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 administrative costs by enabling California to rely on information exchanges with the IRS. Without ongoing conformity, expensive compliance efforts are needed to ensure taxpayers are in compliance with California law.

While FTB recognizes the efforts to bring the state into alignment with federal law, and I commend your efforts, I reprise my call for tax simplification through conformity, and I encourage you to continue efforts to pass a timely, full conformity bill.

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

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

4. Late State/Federal Legislation

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

When legislation impacts taxpayers' income tax filing and planning is passed late, there is a negative effect on businesses in California. Business owners need to plan for the future. Late legislation has both current and future implications on business plans, the capital available to fund expansion, and the hiring of employees. Business owners monitor tax law and act accordingly to improve their bottom lines.

For example, this year many homeowners who completed a short sale or contemplated a short sale were unaware what the full financial consequences of their decision would be, such as, whether or not they needed to pay state tax on their debt cancellation. Taxpayers were left to decide whether to make tax payments or to risk additional penalties if relief was not given because the fate of the legislation to extend mortgage forgiveness debt relief through 2013 was not known until mid-September.

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

5. Tax Liens

As a result of my concerns related to the number of tax liens filed and the negative impact on taxpayers, the Collections program embarked on a number of initiatives to educate taxpayers on how to prevent and resolve a tax lien and the impacts a lien can have on their credit report, ability to purchase a home, and ability to retain or gain employment.

In January 2011, a team of technical collection experts identified options and alternatives related to the lien threshold and formed the Lien Program Improvement Team. This team's purpose was to develop initiatives to mitigate the volume of liens filed and address the concerns identified in my 2010 report and subsequent reports. The initiatives undertaken by the team:

- Revised the Collections program's Contact Center Interactive Voice Response system to include educational information on liens.
- Revised the lien educational language on the FTB public website.
- Reviewed procedures to gain consistency across the department in how to utilize the Filed in Error Release (FIE).
- Revised the Final Notice to include the impacts of a lien.
- Began to develop a pilot to issue a Notice of Intent to Record State Tax Lien. FTB will mail this notice after the Final Notice and prior to the issuance of a Notice of State Tax Lien. The language on the notice is very direct and informs the taxpayer that FTB will file a tax lien if payment is not received within 30 days of the notice date. The goal is to reduce the volume of liens filed by educating taxpayers on the impacts of liens and provide information on how to resolve their tax liability.

I want to take this opportunity to thank the Collections program for their efforts to address my concerns regarding tax liens.

In addition, as I reported in last year's lien article, FTB has seen a downward trend in the number of liens filed over the last three fiscal years. I am pleased to report that 22 percent fewer liens were filed during FY 2012/2013. However, I am still concerned because as the chart below reflects, although FTB filed fewer liens, more liens were released as FIE.

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 as Filed in Error
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%
2012/2013	187,945	-22%	125,131	66%	22,401	12.0%

6. Penalties

Penalties are an important and necessary part of voluntary tax compliance. However, penalties can significantly increase the amount the taxpayer owes as well as create personal liability for the tax professional or withholding agent. The public expressed concerns that FTB creates and assesses penalties to act as revenue raisers for the state. We have taken the following steps to address these issues:

- My staff created and maintains FTB 1024, *Penalty Reference Chart*, which outlines all 69 penalties, the applicable R&TC sections, corresponding IRC sections, reason, computation, and exemptions.
- Previously, I dedicated resources to take a statistical look at how often FTB issued penalties during FY 2008/2009 through FY 2011/2012. We found the most frequently assessed penalties were the mandatory delinquent filing penalty for individuals, and the similar late-filing penalty for different types of business entities that file tax returns late or provide incomplete information. Also, of significance during this period, there were the two mandatory tax-shelter and amnesty-related penalties.

  Of the remaining penalties issued during this FY 2008/2009 through FY 2011/2012 time period, the accuracy-related penalty and failure-to-furnish penalties were the most frequently issued nonmandatory penalties. FTB assessed the accuracy-related penalty for substantial understatement of income tax and negligence or disregard of rules or regulations. Before FTB assesses 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. The failure-to-furnish information penalty is used to discourage taxpayers from disregarding formal legal demands to furnish information during audits. Once FTB asseses a failure-to-furnish information penalty, 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.
- This year, we dedicated resources to perform a more comprehensive study of the various nonmandatory penalties that FTB assesses with respect to audits, and the basis for waivers. This study found that 23 percent of these penalties were adjusted when additional information regarding the tax or penalty was provided to the Hearing Officer. Twenty-five percent were waived for participation in tax shelter initiatives. The most frequent reason for reductions in tax or penalty occurred 28 percent of the time when the Hearing Officer reached a different conclusion than the auditor on the penalty or underlying tax. Many of the cases where the underlying tax was revised or withdrawn involved highly complex issues, such as, tax shelters, characterization of income as business/nonbusiness, or nexus.

  This study also found that the accuracy of penalties being assessed has improved since providing taxpayers information about potential penalties earlier in the examination process, penalty training to auditors, collaborating opportunities with subject matter experts and legal staff, and when taxpayers provide requested information during the audit.

  We established that the majority of penalty assessments are correct with respect to FTB audits. These findings support that penalty assessment can be a useful tool in educating taxpayers for future voluntary compliance. However, the fact that the most frequent reason for reducing or waiving nonmandatory penalties assessed during audits is due to the reduction of the underlying tax again supports my concern about the high rate of revisions to the tax that occur after our audit assessments are issued.

7. Education & Outreach

I continue to see the need to educate, provide outreach to, and inform taxpayers and tax professionals. This need is due to California and federal income tax laws continuously changing, the passage of late legislation, the lack of federal and state conformity, and the 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 the Board of Equalization members and the State Controller's Office. My staff participated in over 103 presentations throughout California. In addition to seminar presentations, my staff extends education and outreach efforts to get our information to taxpayers by making continuous improvement to FTB's website and the use of other media methods including *Tax News* where we continue to add new subscribers. FTB also utilizes YouTube to market programs like ReadyReturn and CalFile and provides tax tips and news releases on issues related to critical filing errors and available tax credits. 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 addition, FTB continues to use social media, Twitter, Facebook, and *Tax News Flashes* to communicate late-breaking information. *Tax News* not only expanded its products to include video articles, but it has done so in partnership with the California Society of Enrolled Agents Educational Foundation.

I continue to encourage FTB 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. Last year, I suggested 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. Due to resource constraints, we did not implement the surveys, but we will consider it again this year.

8. Protests

Last year, I raised concern 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 the taxpayer to appeal an assessment can be considerable.

For FY 2012/2013, the amount of tax sustained for docketed business-entity protests rose to 75 percent from the average sustained tax rate of 47 percent for the prior six fiscal years, a 28 percentage points increase. The successful use of collaboration between our Audit and Legal departments, including increased frequency of legal staff consulting on audits, may have contributed to this increase. In addition, as previously recommended, our Legal department has taken an active role in providing training to our auditors.

Yet, I am still concerned about the additional time and resources required for the taxpayer to appeal an assessment. In the last fiscal year, over 70 percent of business entity docketed protests were revised. Thus, the need remains for us to continue to follow this issue.

9. Customer Service

In my 2012 report, I recommended that FTB begin to track the notice volume mailed and our call centers' level of access from an enterprise-wide perspective to better manage our call centers' resources with increased call volumes. My staff's analysis indicated a correlation between the notice volume and the level of access.

The department formed an Enterprise Notice Team tasked with reviewing noticing from an enterprise-wide perspective with membership throughout the department. Extensive data has been gathered, and it is in the process of being analyzed. However, I must state in this year's annual report the department has not made sufficient progress. Considering the increased mailing of notices and decrease in customer service, I believe the level of priority assigned to review this issue during the last FY is problematic. While each business area analyzes their mailings, an enterprise-wide perspective could benefit the department as a whole.

FTB continues to increase the volume of notices mailed without analyzing from an enterprise-wide perspective the impact these mailings have on customer service. My staff's analysis shows a direct impact on customer service. For example, the volume of new personal income tax (PIT) FE collection cases increased 78 percent over last fiscal year, which directly results in an increased number of notices being sent. Our records show the PIT collection notices sent increased 15 percent. Overall, the total volume of PIT and BE collection notices (including levies and other legal actions) increased 6 percent this last year. During this same period in the Filing Division, the level of access on the customer service phone lines decreased 15.4 percent over last fiscal year. However, this significant decrease is not reflective of all areas.

In addition, the department typically has a backlog of correspondence. The department's collection cycle generally results in involuntary collection actions initiated 135 days after mailing the Statement of Tax Due Notice. My concern is when there are delays in processing correspondence a taxpayer can respond to a notice the day after receiving it, provide the information to cancel the notice, and they are still subject to an erroneous involuntary collection action before the correspondence unit processes and reviews the information.

The department considers customer service to be a high priority and FTB's mission statement identifies customer service as one of FTB's core values. Unfortunately, FTB has limited resources to respond to taxpayers' customer service needs, and I would like to recognize FTB's efforts to provide the most efficient service possible given these circumstances. To fulfill our mission statement, we must do all that we can to assess the impact of increased mailings on our call centers, correspondence processing, and self-service options. Technology gives us the ability to locate and identify more potential taxpayers out of compliance. We need to assist these taxpayers trying to come into compliance in a timelier manner to reduce the possibility of unnecessary and often erroneous involuntary collection actions, such as, bank levies, wage garnishment, and the filing of liens.

Once again, I recommend the department look for ways to improve customer service from an enterprise-wide perspective. It is important that we commit sufficient resources towards the tracking of notice volumes, the impacts to our call centers and correspondence, and use this information to effectively manage the timing, quantity, and type of notices we send. I also recommend the department request resources to add more staff and seek other ways to improve efficiencies.

10. Claim For Refund

I am concerned with amended tax return processing time frames and the lack of interest paid for the State of California's use of taxpayer money. Specifically, I have concerns with the processing of corporate refund claims. Since 2009, corporations have not received interest on untimely paid overpayments. The increasing volume of corporate refund claims filed has highlighted this issue. Business owners and tax professionals have brought concerns to the Taxpayers' Rights Advocate's Office regarding the time frame for receiving a refund on a corporate claim for refund and lack of compensation, even when the refund requested is the result of a minor reporting error in their self-assessed tax. Particularly troublesome is when a corporation has a tax liability due, currently assigned to collection, and the corporation filed an amended tax return that would reduce or eliminate the tax liability. Businesses often pay the tax liability or enter into an installment agreement just to stay off involuntary collection actions. The taxpayer then waits for the amended tax return to be processed to receive a refund. In the past, collection staff instructed taxpayers take this approach. Currently, the department instructs collectors to hold or delay collection actions pending the processing of the tax return if they can determine the tax liability will be satisfied in full or result in a refund when the tax return is processed. Interest does continue to accrue for any unpaid tax liabilities that the amended tax return may not eliminate, charged at a current (as of July 1, 2012) interest rate of 3 percent. However, if we select the amended tax return for examination, the processing of the amended tax return could take between 24 to 30 months. For refunds, the rate of interest paid on the corporate overpayments has been calculated at zero since July 1, 2009.

As a result of these concerns, I requested a review of the department's processing of corporate claims over a two year period of time. This year, the department saw a 33 percent increase in the volume of corporate claim for refund returns (100X) filed, with a 19 percent increase in dollar amount.

Amended tax returns fall into three basic categories: 1) informational (no tax change), 2) amended to report additional tax, and 3) claim for refund (100X) returns. Amended informational and additional tax returns, on average, take 10 months to be processed (worked from the date FTB received the tax return to the date a bill or notices [when required], is issued). The taxpayer continues to accrue interest during this processing time.

When an amended tax return is a corporate claim for refund (100X), on average, 70 percent are processed within 8 to 12 weeks. The remaining claims, mostly multistate corporations, are subject to audit examination. The magnitude of the business entity, sophistication of the corporate structure, and complexity of the business transactions reported in the claim for refund are contributing factors to the length of time needed to audit these claim for refund tax returns.

Apportioning corporations currently make up 82 percent of Audit Division's inventory of open claims. Historically, 44 percent of these corporation claims will be refunded. My concern is these taxpayers will receive no interest on the amounts refunded. On the other hand, corporations that have underpaid their tax are charged interest.

The Large Corporation Understatement Penalty (LCUP) was enacted in 2008 to encourage large corporate taxpayers to properly report income on original tax returns. Reports reflect that there has been an increase in the amount of tax being reported on original corporate tax returns. This statement has been made to me on numerous occasions by tax practitioners and large corporate taxpayers. Because this 20 percent penalty is only assessed on original tax returns, taxpayers appear to be taking a conservative approach on the original tax returns, then filing a claim for refund to reverse or alter positions taken on the original tax return. The complexity of tax returns of this nature appears to be a contributing factor why audited claims require longer processing time frames. With an increasing number of corporate claims being submitted that will require an audit examination of these more complex taxpayers, it is hard to say if it is possible or even probable to shorten the time for processing these claims.

Regardless of the size of the corporate taxpayer, the inability to collect interest on money that is owed but not paid over a reasonable amount of time is a burden to the taxpayer. Increases in claims by corporate taxpayers will more than likely increase the processing time for all corporate taxpayers that are subject to examination. A legislative change would be required to alter the way interest is calculated on corporate underpayments to allow for interest to be paid to taxpayers in those situations where the claim was not processed timely. Individuals are paid interest on overpayments if the refund is not made timely. Legislation should be considered to allow for the payment of interest on corporate overpayments that are not processed in a reasonable amount of time.

Additionally, FTB needs to continue to evaluate and improve the process of examining corporate claims to reduce the length of time for processing them. Although, as I acknowledged above, it does not appear that improved operational efficiencies will shorten the processing time frames if the number of claims filed continues to increase.

I thank you for this opportunity to report some of the main issues FTB and our taxpayers faced throughout FY 2012/2013. 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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To get this publication, go to **ftb.ca.gov** and search for **taxpayers annual report** or write to the address above.

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.

In addition, the Taxpayers' Rights Advocate has been given authority to abate penalties, fees, additions to tax, or interest under certain circumstances which are attributable to an FTB error or delay. The relief is limited to $7,500.

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 limited quality translated publications in Spanish, Chinese, Korean, 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 FTB Website Changes, EDR Taxpayer Folder, Filing Season Update, and Audit Update and Issues.

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 if a taxpayer can show the interest accrued because we made an unreasonable error or delay in performing certain kinds of acts. We may also cancel interest, under certain circumstances, if the Internal Revenue Service cancelled interest on an federal assessment that formed a basis for our assessment. 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 21,400 contacts in fiscal year (FY) 2012/2013. The majority of taxpayers (over 16,900 contacts) contacted us by telephone. We provide taxpayers a public number (800.883.5910) to contact our Advocate Hotline.

We also received over 1,500 email contacts and 3,000 pieces of correspondence 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 Office in FY 2012/2013 include:

- Filing Enforcement
- Balance Due
- Order to Withhold (bank levy)
- Refund
- Installment Agreement

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.

Order to Withhold

We upheld, modified, or released these orders, as appropriate, based on review of the accounts and any additional information provided.

Refund

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

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.

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 2012/2013, we received 257 issues through SIMS. Of the issues submitted, we identified six as possible systemic issues and forwarded to program areas for research and resolution. The program areas resolved the issues.

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 2012/2013. 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. Ninety-one percent of the individuals who received Notices of Proposed Assessment during FY 2012/2013 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 four percent increase from

July 1, 2012, to June 30, 2013. As of June 30, 2013, we received 784,000 e-filed Business Entity (BE) tax returns, a 21 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 47 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 16 million current year tax returns processed between July 1, 2012, and June 30, 2013. During this time, FTB made approximately 500,000 adjustments and issued just under 320,000 Return Information Notices (RINs) to taxpayers who filed tax returns with errors that resulted in a change of tax liability. This equates to two 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.

Just over half (51.4 percent) of the adjustments we made were on paper-filed tax returns, even though only 20 percent of total current year tax returns were paper-filed. Adjustments on electronically filed tax returns (80 percent of total current year returns) accounted for the remaining 48.6 percent.

The most common taxpayer error, for all filing methods, was to claim the wrong amount of estimated tax credits. Of all current year RINS, 31.1 percent contain an Estimate Payment Credit adjustment, down from 42.3 percent in FY 2011/2012. 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 318 (Skinner, Stats. 2012, Ch. 313)

For taxable years beginning on or after January 1, 2013, this act does the following:

- Expands the definition of a legal holiday for California income and franchise tax purposes to include those legal holidays recognized by the Internal Revenue Service that extend the due date for federal returns, payments, and other tax related documents (e.g., Emancipation Day).
- Expands the imposition of the nonqualified, suspended, or forfeited failure to file penalty to limited liability companies

AB 2271 (Perea, Stats. 2012, Ch. 482)

This act allows Franchise Tax Board Seasonal Clerks to maintain leave balances while on unpaid leave due to a lack of work.

AB 2686 (Committee on Revenue and Taxation, Stats. 2012, Ch. 349)

This act authorizes the Franchise Tax Board's Taxpayers' Rights Advocate to waive penalties or additions to tax, fees, and interest that are a result of an FTB error or delay. Relief under this statute is limited and may only be granted if relief is not available under any other provision.

SB 1341 (Wolk and Cedillo, Stats. 2012, Ch. 710)

This act requires the Franchise Tax Board to notify charitable corporations that they are out of compliance with the registration and reporting requirements of the California Attorney General and allows the FTB to abate the minimum franchise tax on these charitable corporations.

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 2012/2013, the Taxpayer Services Center (public number 800.852.5711 and hotline number 916.845.7057) answered approximately 59 percent or 1.3 million of the incoming calls. We continue to use technology to maximize the methods and ease by which the taxpayer can contact FTB. Queue management, the successful redirection of taxpayers to applications on the web and live chat help maintain open communication channels.

During FY 2012/2013, the Accounts Receivable Management (ARM) Division utilized technologies, such as Virtual Hold and modified additional queue configuration, to maintain and improve our overall level of access. Overall 900,000, or 62 percent, of personal income tax and business entity collection calls were answered. This is a marked improvement over the 53 percent access rate for FY 2011/2012.

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 some areas, the response time was as high as 60 days at various times during the year. The EDR (Enterprise Data to Revenue) project involves an effort to improve correspondence services. Beginning in June 2013, we began scanning paper correspondence relating to 3 FTB notices. Eventually all correspondence will be scanned, resulting in faster, more efficient processing thereby reducing the response time frame.

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. There is also a significant impact to FTB when there is a need to conduct last-minute education and outreach efforts.

California's complex method of conformity results in a significant need for FTB to identify and analyze pending and final federal legislation once it is passed into law. When changes are made to the federal income tax law, California generally does not automatically adopt such provisions. Instead, state legislation is needed to conform. However, some federal law changes may result in automatic California conformity for example California law provides for the same treatment as applicable for federal income tax purposes (without regard to date enacted or taxable year) when there is a federal law change that relates to deferred compensation (pension, profit-sharing, stock bonus plans, etc., and rules relating to minimum funding standards and benefit limitations).

As a result, 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. Franchise Tax Board 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 of 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. In addition, we participated in webinars with the SCO on Sole Proprietor versus Limited Liability Companies, and How to Request Waivers for the Underpayment of Estimated Tax Penalty due to Proposition 30.

We also collaborated with the California Society of Enrolled Agents (CSEA) and participated in a webinar on liens. The webinar provided information on how to prevent state tax liens, the impacts of a lien and how to get a lien released and collection accounts resolved. The key point is that FTB is here to help.

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 80,000 tax returns in 2013.

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. ReadyReturn comments received from taxpayers include, "I was able to do my taxes in less than 5 minutes. Thank you," and "Going online and finding my prefilled return, all I could say was WOW!"

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 January 2013, CalFile was implemented with new features and an improved "look and feel." One of the new features is the ability to save a partially completed return and come back later to finish. Another enhancement is the ability to import information from FTB's accounting system into the return (e.g., address, wages, estimated tax payments made, etc.). Taxpayers can also request an email confirming their tax return was filed.

In 2013, over a quarter of 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.

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. Taxpayers have the ability to view scheduled payments and cancel those that have not been processed (when accessing Web Pay through their MyFTBAccount).

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 collection staff have the required skills and abilities to administer tax laws, FTB provides a comprehensive eight-week training series for new collectors. In addition to customer service and other essential training mentioned above, we provide core compliance training courses including Legal Actions, Negotiation Skills, and complex account analysis:

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. Several collection staff also attended IRS Collection training this year.

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 effectively to ensure that all taxpayers meet their obligations to file and 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, increases the timeliness and effectiveness of enforcement actions, and focuses on adherence to FTB Regulation Section 19032, Audit Procedures, to complete audits in a timely manner. When new issues arise, FTB collaborates with subject matter experts to operate its programs in an efficient manner and seeks better use of technology and data.

FTB continues to seek new opportunities to form partnerships with taxpayers and other agencies and promote 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 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 audit resources to identify and evaluate investor leads, promoters, and to assess disclosure and information return penalties.

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 entities. 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 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. In addition, as of March 12, 2012, taxpayers have the option to set up Installment Agreements through the Interactive Voice Response (IVR). In FY 2012/2013, over 224,000 installment agreements were set up, with just over 5,000 of those being set through the IVR option.

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, 50,440 tax returns have been filed and $45 million collected. Provisional payment plans increase compliance with tax laws, accelerate collection revenue, provide greater efficiencies, and improve 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 2012/2013, criminal investigations activities resulted in:

- 79 new cases.
- 37 individuals arrested.
- 45 search warrants executed at 170 locations.
- 41 cases approved for prosecution.
- 42 individuals prosecuted.
- 66 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 and collection 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, limited liability companies, foreign scholars, withholding, audit, forms of ownership, enterprise zone credits, and other topics as requested. We participated in over 103 presentations throughout California. Our education and outreach staff responded to over 1,100 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 *Record Keeping* and *Avoid an Estimate Penalty*. We will focus our future efforts to increase the number of short presentations available on our website.

The Multilingual Services Program (MSP) achieved several milestones this year, increasing the amount of non-English products and services, conducting outreach to the non-English speaking community, updating our Spanish web pages, and providing training to our internal staff.

MSP revised non-English products and services on the web, adding new information, new products, and organizing them in a way that is clear and easy for users. We created a Spanish left navigation so that our Spanish speaking taxpayers can easily navigate through the Spanish information.

We partnered with other California state agencies and programs to increase our attendance in community events reaching out to educate taxpayers on free filing services and providing general answers to their tax questions and concerns, in order to gain compliance. We also increased our social media visibility, connecting with taxpayers by using social media tools such as Facebook, Twitter, and Youtube to update non-English speaking taxpayers on important information, such as filing and payment dates, new products, community events, and self-service options. These communications channels enabled us to increase taxpayer education and outreach at a minimal cost to the department.

MSP was invited to present at the 2012 Annual Midwestern States Association of Tax Administrators Conference in Missouri. We provided the Tax Administrators insight on our process, lessons learned, successes, and future goals of our program.

This year we also increased internal training, translation tools and resources, and communications to bilingual staff. Keeping bilingual staff well-informed of FTB's non-English products and services, outreach events, glossaries, and translation tools allow our staff to provide efficient and quality service to our non-English speaking taxpayers.

Our goal is to continue to provide non-English products, services, and education in an effort to gain tax compliance and ensure that our products and services are readily available and accessible to the public.

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:

- The restoration of Taxpayer Advocate's authority to provide relief from penalties, fees, additions to tax, and interest up to $7,500 for erroneous actions or inaction by FTB when no other relief is available, and the taxpayer did not significantly cause the error or delay.
- FTB's extended authority to postpone certain tax-related deadlines to Governor declared disasters, authority to waive interest for delays in sending certain correspondence into a disaster area, and give these taxpayers appeal rights.
- The increase in general filing requirement threshold for California exempt organizations to $50,000 of average annual gross receipts.
- The new 120-day grace period to comply with Attorney General registration and reporting requirements before revocation of tax-exempt status.
- The top debtors list increased from 250 to 500, list must be updated at least twice a year, and required suspension of debtor's occupational, professional, and driver licenses. State agencies are also being prohibited from entering into a contract for goods and services with the debtor.
- California withholding agent and federal back-up withholding requirements.
- Mortgage debt relief on personal residents.
- Online services, such as Live Chat, *Tax News*, MyFTB Account, Web Pay, Installment Agreements, SIMS, and Secure E-mail.

Interactive Voice Response

Franchise Tax Board has 37 IVR applications. The majority of the applications, available in both English and Spanish, provide general tax information for individuals and business entities. In addition, current balance due, applied payments, and refund information can be accessed, and many of the most common forms can be ordered. Personal income tax callers can even apply for installment agreements. FTB also supports nontax IVR applications that provide general information for Court Ordered Debt and Vehicle Registration Collections. Callers may have the option to speak to a representative after navigating through the application. If they are transferred to one of FTB's larger call centers, they may be given the option to wait on hold or request a call back without losing their place in queue.

Queue Management

We continue to use Queue Management technology, which was implemented in May 2010, 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 welcomed this feature and continue to take advantage of the option. The queue management technology reduced the number of abandoned calls 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 2 million hours of hold time since implementation and over 900,000 hours during FY 2012/2013. When offered the option, 72 percent of the callers chose to have a call back. We successfully connected with 86 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. We expanded our articles by adding a quarterly column from our Chief Counsel and a monthly column from our multilingual department. We continue to utilize our *Tax News Flashes* to push time-sensitive information quickly to our subscribers on subjects such as 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. We continue our partnership with the California Society of Enrolled Agents Education Foundation. We produced several short video articles, *Tax News Live*. *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 worked on updating the following publications to address common questions related to small business taxpayers:

- FTB 987 - *Top Twelve Tax Scams*.
- FTB 982 - *How to Select an Income Tax Return Preparer*.
- FTB 1024 - *Penalty Reference Chart* (**ftb.ca.gov** only).
- FTB 4060 - *California's Other WIthholding*.
- FTB 4058C - *California Taxpayers' Bill of Rights*.

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 1,100 calls this year, and 808 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 filing 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

Due to the current economic climate and budgetary constraints, the administration of the Schools’ VITA Program is currently suspended. Historically, FTB collaborated with the IRS to administer the program at two area high schools, providing students with opportunities to develop job skills, earn school credit, and learn about the value of volunteerism as they helped non-English speaking, disabled, senior, and limited or fixed income members of the community prepare basic state and federal tax returns. Even though the program itself has been suspended, 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 2013

Risk Management Program

FTB will establish an Enterprise Risk Management Program to provide a common framework to capture, report, and address issues and risks. This comprehensive Risk Management Program will support FTB's vision to achieve the highest level of excellence in tax administration.

Modernize Our Tax Systems

Introduction

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.

EDR Project Components

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 Schedule

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 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.

EDR Project Implementation Status

The EDR Project is on schedule, within budget, and exceeding revenue targets.

Since the EDR Project kick-off in July 2011, we have successfully implemented numerous early initiatives to increase our efficiency and effectiveness resulting in about $76 million in revenue. Additionally, by December 2013 we will have implemented five of the nine primary project releases, as described below.

Release 1.0 and Release 1.0.1: Personal Income Tax Return and Payment Processing

For the 2013 Filing Season, we increased our personal income tax (PIT) processing speed and efficiency. We implemented a new data processing system that enabled us to capture more data from returns and payments. With the implementation of 2D Barcodes on PIT tax returns, we were able to significantly reduce our key data entry workload. The addition of four new scanners allowed us to scan and image more than 24 million PIT pages, resulting in a significant increase to our processing production rate.

Release 2: Correspondence Processing and Case Management Pilot

In July 2013, we deployed a small pilot to test the technical architecture of our Internal Taxpayer Folder. The pilot allows us to electronically route and view images of a small subset of PIT correspondence.

Release 2.1: Expand Correspondence Processing and Case Management Pilot

In December 2013, we plan to expand the pilot to include more types of correspondence, both PIT and Business Entity (BE) related.

Release 1.1: BE Return and Payment Processing

Also in December 2013, we will initiate processing of BE returns and payments using the systems that we deployed for PIT processing in December 2012.

EDR Project Revenue

For FY 2011/2012, the EDR Project revenue target was $35 million. Actual revenue was $76 million, 214 percent of our target.

For FY 2012/2013, our revenue target was $148 million. Actual revenue was $306 million, 207 percent of our target.

Our revenue target for FY 2013/2014 is $260 million. As of August 2013, we have generated about $68 million. If this trend continues, we estimate FY 2013/2014 revenue at $544 million. This is 209 percent of our target.

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 estimated to be $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.

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

In 2011, FTB launched Live Chat as a fast and efficient way for the public to ask FTB representatives nonconfidential questions regarding PIT and BE tax questions, find a form or publication, and to get help with our website. Also in 2011, as a companion to our general Live Chat service, we began to offer PIT Chat customers the opportunity to move from the Live Chat channel to secure email in order to resolve their account-specific Return Information Notices, Statement of Tax Due, and Filing Enforcement questions.

In FY 2012/2013, our general Live Chat service agents responded to 129,000 chats from individuals and tax professionals. Of this amount, 93,000 chats were regarding PIT questions and 36,000 chats regarding BE questions. We are seeing a significant increase in the total number of chats we receive annually, another sign that our customers like interacting with our agents through this new service channel. Overall, we continue to receive positive responses to this new communication channel with an approval rating of four out of five stars.

The extremely positive response to our general Live Chat program motivated us to launch the PIT Collections Live Chat in April 2012. The BE Collections Live Chat followed with a February 2013 launch. Both Collections Live Chat lines provide general installment agreement and PIT or BE Collection information depending on which online chat line the taxpayer uses. With either chat line, at the point when we require confidential account information, the Live Chat session is converted to secure email or telephone callback. In addition, staff uses the Live Chat platform to educate taxpayers and walk them through the many self-service options available on our public website.

During FY 2012/2013 the PIT Collections Live Chat completed 16,130 chats. BE Collections Live Chat was implemented on February 28, 2013. During FY 2012/2013, BE Collections Live Chat completed 1,472 chats. Customer satisfaction survey results provided positive feedback from taxpayers regarding the service. Taxpayers expressed they are happy to get quick answers to general 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 5, 2012. 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**. The responses are in order of the presentations at the meeting.

Vicki Mulak, California Society of Enrolled Agents (CSEA)

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

- Combining Secretary of State Statement of Information Filings.
- Update on Increase to Lien Filing Threshold to $5,000.
- IRS Data Sharing With FTB on CP 2000 Reversals.
- Disaster Treatment Simplification and Improved Training.
- Withhold-at-Source Education and Outreach.
- Financial Institution Record Match Collection Identification Errors.

In his letter dated February 11, 2013, Taxpayers’ Rights Advocate, Steve Sims, responded regarding combining Secretary of State (SOS) Statement of Information filings. While staff is available to provide technical assistance to the SOS, or to any legislator in drafting this proposal, the department is unable to recommend that the FTB sponsor the legislative idea.

Because the processing and maintenance of business filings is the responsibility of the SOS, proposed changes in the processing and maintenance of the Statement of Information should originate with the SOS.

Regarding increasing the lien filing threshold to $5,000, Mr. Sims responded that FTB continues to balance the effectiveness of liens including the threshold for filing liens with sensitivity to the impact liens have on taxpayers. FTB monitors the number of liens filed annually and continues to pursue efforts to contact taxpayers early in the collection process to educate and encourage them to respond to FTB notices and calls prior to FTB filing a lien.

Regarding IRS data sharing with FTB on CP 2000 reversals, Mr. Sims responded that the IRS does not notify FTB of any changes that have been made to a CP 2000 adjustment after it closed. The IRS position is that the notice the taxpayer receives clearly states the taxpayer is to notify the applicable state tax entity of the federal change. We are working with the IRS to get information of the adjustments to a CP 2000 adjustment after information is provided to FTB. That information exchange request is pending.

Regarding disaster treatment, Mr. Sims advised FTB that the issue of automatic disaster loss treatment has been raised before. AB 1782, introduced in 2010 by Assembly Member Harkey, would have added a general provision to the current list of specified disasters to provide automatic disaster loss treatment for all gubernatorially-declared disasters. The bill failed to pass out of the Assembly Revenue and Taxation Committee. The committee analysis stated that although the bill would streamline the process for providing tax relief to disaster-stricken areas, it would eliminate Legislative discretion concerning the scope of California relief provided in California-declared disasters. Because the proposal for automatic disaster loss treatment has recently been rejected by an Assembly Policy Committee, the department is unable to sponsor this proposal.

Regarding withhold-at-source education and outreach, Mr. Sims responded that we will continue to improve our education and outreach of the withholding requirements for the small business and sole proprietors. In the coming year, we will focus on *the following; nonresident withholding brochure, withholding YouTube videos, new webinars, news articles, and speaking engagements.*

Regarding financial institution record match, Mr. Sims responded that FTB is sensitive to this issue and has existing procedures in place to proactively resolve any instances of taxpayer misidentification resulting in erroneous bank levies for our tax and nontax programs. If a taxpayer believes we issued a bank garnishment in error, we encourage them to contact us as soon as possible so we can assist them and resolve the error. FTB has dedicated priority phone lines to discuss bank levies with taxpayers in the event a financial hardship exists or for any other reason. If we issued a bank garnishment in error, we will delay the bank garnishment, confirm the error, and immediately mail and fax a garnishment release notice to the bank. For instances where the bank garnishment was issued in error and the payment was already sent to us, we refund the payment and reimburse bank charges or fees.

Lynn Freer, Spidell Publishing, Inc.

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

- Reasonable Cause Regulation.
- Cutler Decision.
- Amended Returns and Mandatory e-Payment.
- Identity Theft.

In his letter dated February 11, 2013, Taxpayers' Rights Advocate, Steve Sims, responded regarding reasonable cause legislation that following the release of a report by the U.S. Treasury Inspector General for Tax Administration critical of the Internal Revenue Service (IRS) penalty abatement procedures (http://www.treasury.gov/tigta/auditreports/2012reports/201240113fr.pdf), the IRS indicated it is reviewing its procedures for its first-time abate policy. Therefore, we decided to defer any further action for proposing a California equivalent until the IRS completes its review.

Regarding the Cutler decision, Mr. Sims responded that we drafted the quoted instructions to circulate to software developers after the release of FTB Notice 2012-03 – Implementation of Court of Appeal's Decision in Cutler v. Franchise Tax Board (2012) 208 Cal. App. 4th 1247. FTB issued the Notice after the Court of Appeal's decision became final.

Regarding amended returns and mandatory e-Payment, Mr. Sims responded we are evaluating how best to modify our accounting system to include special processing rules for payments associated with an amended return, which would have characteristics similar to an NPA payment type. The amended return payment type would "sit in suspense" until we process an amended return and post to the accounting system. Thereby, reducing the number of payments erroneously refunded (we may not be able to resolve the issue entirely due to taxpayers still selecting the wrong payment type). In the interim, we will update our website instructions to include a workaround to avoid the refunding of amended return payments received prior to receipt of the amended return.

Regarding identity theft, Mr. Sims responded FTB takes every opportunity to leverage relationships with other agencies in order to enhance our ability to service taxpayers. Specific to identity theft, this year the Internal Revenue Service (IRS) and FTB started to pilot a new sharing agreement related to identity theft and refund fraud. IRS invited FTB to participate in this pilot due to our robust refund fraud and identity theft program. IRS and FTB will evaluate the pilot and leverage this opportunity to share information, including data and best practices. Additionally, this year FTB opened up discussions regarding identity theft issues at the quarterly federal/state meeting that includes, FTB, BOE, EDD, and IRS representatives. Both, IRS and FTB, shared information concerning our refund fraud and identity theft programs. FTB is very concerned with identity theft and takes precautions to prevent hackers from *accessing data.*

Gina Rodriquez, Cal-Tax

Dave Doerr and Therese Twomey provided oral comments to the Board on the following issues:

- Conformity.
- Revenue Estimates.
- 23036(i) Credit Limitation.
- Erroneous Refund Penalty.

In his letter dated February 11, 2013, Taxpayers' Rights Advocate, Steve Sims, responded that the FTB has a general policy in favor of conformity, and FTB staff regularly work with the Legislature to provide a thorough analysis of annual federal law changes. The department does not believe that the process for developing recommended conformity legislation properly lies with FTB staff because conformity is a legislative function rather than an administrative function of the FTB. FTB staff will continue to provide the Legislature all necessary research and analysis relating to conformity legislation.

Regarding revenue estimates, Mr. Sims indicated in his letter that prior to 2010, in addition to providing the estimated revenue impact, FTB's legislative bill analyses also included a narrative discussion of the revenue estimate and described in some detail the methodology and assumptions used in developing the estimate. The development and publication of the narrative discussion required a great deal of staff time as it required the translation of complex assumptions, methodologies and calculations into easily understood prose for its target audiences. By 2010, employee furloughs, position reductions, and increased workload demands required FTB to prioritize and limit its workload to only its core functions. It was determined that the resources available were not sufficient to continue the practice and the decision was made to devote FTB's limited resources to maintaining the integrity of the revenue estimates rather than to continue the development and publication of the more detailed narrative descriptions. FTB intends to continue its practice of providing detailed descriptions of its assumptions and methodology upon request and will continue to publish contact information on all its legislative bill analyses. In addition, the Economic and Statistical Research Bureau will develop and publish on FTB's website by April 30, 2013, a narrative description, with examples, of how it generally develops revenue estimates in an effort to promote enhanced transparency about the tools and methodologies used in its work.

Regarding 23036(i) credit limitation, Mr. Sims responded that the Legislature has modified Revenue and Taxation Code Section 23036 five times since the enactment of AB 1234 in 1997 and has not made a change to the credit limitation rules included under the section. Additionally, the Legislature specifically did not amend Section 23036 to modify or remove the credit limitation for disregarded entities when it enacted legislation to allow members of a combined report to share credits in 2009. It appears that the Legislature does not believe there is a general policy argument for deviating from the statutory treatment of the credit limitation rules in Section 23036. This is a substantive tax policy issue rather than a tax administration issue. The FTB has traditionally deferred to the Legislature and other tax officials for substantive tax policy matters. For these reasons, the department is unable to sponsor this proposal and would suggest instead that this proposal be provided to a legislative representative for consideration.

Regarding the erroneous refund penalty, Mr. Sims responded that the department is always looking to improve compliance, including efforts to reduce erroneous claims for refund, and we welcome your suggestions. FTB staff will also continue to provide all necessary research and analysis to assist the Legislature if it chooses to further consider conforming to the penalty on erroneous refund claims or enact alternative remedies.

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.

Beginning in FY 2011/2012 and continuing in FY 2012/2013, we are focusing on two areas:

FTB’s 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 are being considered in current evaluations.

Improving the “Content” of Performance Evaluations—We expanded our Performance Evaluation Refresher Training for supervisors and offered one-on-one sessions with those who wanted assistance. Also, we continued to stress the concepts rolled out through HR Tips during the previous year that related to employee evaluation. 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 2012/2013. We may have issued the assessments in prior years; however, due to cases in protest status, we did not resolve them until FY 2012/2013. Appendix 1 totals reflect rounded figures and may not compute exactly.

Table 1A **Corporation Tax Law**
NPAs Finalized in FY 2012/2013 Categorized by Primary Statute (Issue)

Issue	Number of NPAs	%	Tax Assessed (Millions)	%	Average Assessment Per NPA
Allocation/Apportionment	440	29.4	$ 174.8	63.2	$ 397,189
Assess Minimum Tax	23	1.5	0.0	0.0	783
Revenue Agent Reports	777	51.9	47.6	17.2	61,291
State Adjustments	127	8.4	46.5	16.8	366,415
Other	128	8.8	7.4	2.8	58,048
Totals/Average	1,495	100	$ 276.4	100	$ 184,862

- *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 FY 2012/2013 Categorized by Primary Statute (Issue)

Issue	Number of NPAs	%	Tax Assessed (Thousands)	%	Average Assessment Per NPA
CP2000	118,454	16.3	$ 73,738	3.9	$ 623
Filing Enforcement	499,156	68.8	1,433,132	76.4	2,871
Filing Status	27,225	3.8	27,996	1.5	1,028
Revenue Agent Reports	47,025	6.5	164,203	8.8	3,492
Other	33,181	4.6	176,300	9.4	5,313
Totals/Average	725,041	100	$1,875,368	100	$ 2,587

- 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 FY 2012/2013						
Industry	**All Corporations 2011 Tax Year**	**%**	**Corporations with NPAs**	**%**	**Tax Assessed (Millions)**	**%**
F.I.R.E.*	132,599	17.6	108	12.2	$ 70.2	25.3
Manufacturing	46,165	6.1	114	12.9	110.7	40.0
Services	326,717	43.3	172	19.5	10.0	3.6
Trade	123,417	16.4	108	12.2	14.6	5.2
Other **	125,417	16.6	378	42.9	70.8	25.6
Totals	754,315	100	880	100	$ 276.4	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 FY 2012/2013 Issued by Taxable Year					
Average Taxable Year	**Number of NPAs**	**%**	**Tax Assessed (Millions)**	**%**	**Average Assessment Per NPA**
2005 and prior	396	25.6	$ 210.4	75.2	$ 531,395
2006	164	10.9	21.5	7.7	131,107
2007	244	16.3	24.8	8.9	101,681
2008	400	26.7	12.8	4.6	31,949
2009	244	16.3	4.9	1.7	20,195
2010	44	2.9	1.9	0.6	43,525
2011 and later	3	0.2	0.0	0.0	865
Totals/Average	1,495	100	$ 276.4	100	$ 184,862

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 FY 2012/2013 for the Same Taxpayer

Corporations With...	Number of Taxpayers	Tax Assessed (Millions)	Average Assessment Per Taxpayer
One NPA	505	$ 38.4	$ 76,052
Two NPAs	249	118.5	476,104
Three NPAs	73	33.3	456,613
Four or more NPAs	53	86.1	1,624,157
Totals/Average	880	$ 276.4	$ 314,056

Table 4 **Personal Income Tax Law**
NPAs Finalized in FY 2012/2013 Issued by Taxable Year

Taxable Year	Number of NPAs	%	Assessment Amount (Thousands)	%	Average Assessment Amount
2006 and prior	3,599	0.5	$ 106,863	5.7	$ 29,693
2007	5,137	0.7	71,139	3.8	13,848
2008	62,620	8.6	170,641	9.1	2,725
2009	238,870	32.9	446,886	23.8	1,871
2010	140,132	19.3	401,289	21.4	2,864
2011 and later	274,683	37.9	678,548	36.2	2,470
Totals/Average	725,041	100	$1,875,369	100	$ 2,587

Table 5 **Personal Income Tax Law**
Resident Tax Return Preparation, Process Years 2011 and 2012

Preparer	2011 Tax Returns Processed (Thousands)	%	2012 Tax Returns Processed (Thousands)	%	% Change
Professional	10,483	70.8	10,510	70.0	-0.8
Taxpayer	4,069	27.5	4,248	28.2	0.7
VITA*	262	1.8	284	1.9	0.1
Totals	14,814	100	15,042	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, 2012	June 30, 2013	% Change
Credit Card Payments (Average payment is $1,207)	154,000	154,000	0
Direct Debit of Balance Due (Electronic Funds Withdrawal)	381,000	505,000	33
Direct Deposit Refund	6,046,000	6,200,000	3
e-file	13,429,000	13,953,000	4
** *CalFile*	244,000	257,000	5
** Online Filing	3,130,000	3,351,000	7
** Business Entity	648,000	784,000	21

** 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
2008/2009	65,954	23,807
2009/2010	26,367	27,286
2010/2011	43,924	23,629
2011/2012	54,595	30,492
2012/2013	92,683	53,470

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

Fiscal Year	Demands/Requests	NPAs Issued
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
2012/2013	1,003,994	625,018

Appendix 2

Table 8A **Top Errors by Tax Return Type**
July 1, 2012 through June 30, 2013

	Code	Grand Total	540 2EZ	540	540 A	540 NR	540 X
EP	Estimate Payment Revised	**158,790**	**1,458**	**140,616**	**1,393**	**15,246**	77
DS	Deductions Revised	**43,348**	105	**33,812**	**4,695**	**4,569**	167
WS	Withhold at Source Revised	**35,027**	175	**15,699**	26	**18,868**	259
AA	Adjusted Gross Income Revised	**33,414**	**33,256**	29	19	100	10
TC	Tax Amount Revised	**30,198**	187	**19,789**	**2,844**	**6,354**	**1,024**
OC	Estimated Tax Transfer Revised: Error Affected the Available Transfer Amount	**23,149**	*	**17,872**	251	**5,011**	14
AW	Withholding Did Not Match Attachments	**21,301**	**1,932**	**17,561**	609	1,014	185
TT	Total Credits/Liability Revised	**17,214**	**6,018**	**5,265**	**4,631**	1,031	**269**
ND	California Taxable Income Revised	**15,782**				**15,699**	83
EX	Exemptions Revised	**13,631**	131	**7,618**	**4,987**	840	55
SS	State Disability Insurance Revised	13,315		**11,983**	**875**	340	117
CT	CDC Credit Revised to Match Original Return	13,278	84	325	12	29	**12,828**
TY	Total Tax Revised - AGI, Filing Status, or Dependents	12,335	**12,335**				
OF	Amended Refund Did Not Equal Original Refund	12,320	**453**	2,884	95	279	**8,609**
DI	Standard Deduction Greater Than the Itemized Deduction Amount Claimed	11,628	*	**7,968**	**2,230**	**1,195**	234
NP	Total Tax Ratio Calculated Incorrectly or Ratio Incorrectly Applied	8,399				**8,389**	10
OM	Amount Paid With Original Return Plus Payments Made After Tax Return Filed Does Not Match Amount Claimed on Amended Tax Return	7,802	129	738	20	133	**6,782**
AT	Withheld Tax Credit Disallowed; Withholding Documents Not Attached	5,720	**404**	2,851	212	**2,121**	**132**
RN	Nonrefundable Renter's Credit Revised; Wrong Amount Claimed for Filing Status, California AGI Over Maximum Amount, Part-Year Resident, or Nonresident	5,162	**1,270**	2,358	**1,305**	224	5
OA	Refund Revised, Total Payments and Credits Added or Subtracted Incorrectly From Total Tax	4,370	**1,022**	1,438	**834**	259	**817**
OW	Amount of Withholding Reported on Amended Tax Return Does Not Match Amount on Original Tax Return	3,075					**3,075**
AR	Amended Tax Return Filed With No Record of Original Return	2,415	6	6	*		**2,402**
TI	Taxable Income Revised	1,880	42	884	**764**	120	70

NN	Total Tax Revised; California Tax Rate, California Credit Percentage, or California Exemption Credit Percentage Incorrectly Calculated; or Error Calculating/Transferring Tax on Schedule G-1, Tax on Lump-Sum Distributions or Form 5870A, Tax on Accumulation Distribution of Trusts.	1,772		*	*	**1,770**	
EE	Senior Exemption Credit Revised	1,210	**271**	483	242	214	
OP	Amount of Estimated Tax Payments Reported on Amended Tax Return Does Not Match Amount on Original Tax Return	1,075	5	163	7	24	**876**
OT	Amount of Taxable Income Reported on Amended Tax Return Does Not Match Amount on Original Tax Return	318	6	12	*	*	**297**
	Top Ten	**391,854**	**58,419**	**278,183**	**24,558**	**79,222**	**36,979**
	All Others	118,336	1,516	20,786	2,870	5,544	2,113
	Grand Total	510,190	59,935	298,969	27,428	84,766	39,092

*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, 2012 through June 30, 2013

	Code	Grand Total	Electronic	Paper
EP	Estimate Payment Revised	**158,790**	**127,521**	**31,269**
DS	Deductions Revised	**43,348**	**25,711**	**17,637**
WS	Withhold at Source Revised	**35,027**	**23,520**	11,507
AA	Adjusted Gross Income Revised	**33,414**	**11,623**	**21,791**
TC	Tax Amount Revised	**30,198**	2,863	**27,335**
OC	Estimated Tax Transfer Revised: Error Affected the Available Transfer Amount	**23,149**	**16,278**	6,871
AW	Withholding Did Not Match Attachments	**21,301**	**12,524**	8,777
TT	Total Credits/Liability Revised	**17,214**	784	**16,430**
ND	California Taxable Income Revised	**15,782**	**3,882**	**11,900**
EX	Exemptions Revised	**13,631**	993	**12,638**
SS	State Disability Insurance Revised	13,315	**9,352**	3,963
CT	CDC Credit Revised to Match Original Return	13,278	50	**13,228**
TY	Total Tax Revised - AGI, Filing Status, or Dependents	12,335	176	**12,159**
OF	Amended Refund Did Not Equal Original Refund	12,320	389	**11,931**
DI	Standard Deduction Greater Than the Itemized Deduction Amount Claimed	11,628	**4,055**	7,573
EC	Blind Exemption Credit Revised	4,811	**4,768**	43
	Top Ten	**391,854**	**239,234**	**176,318**
	All Others	118,336	12,985	81,653
	Grand Total	510,190	252,219	257,971

Table Legend:

Bold › Top ten codes issued by Tax Return Type.

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. As required by Government Code Section 11346.4, staff mailed and published a public notice on February 15, 2013, to announce that a public hearing would be held on April 18, 2013. There were no comments made at the public hearing and no written comments were received. The final approved regulations were filed by the Office of Administrative Law with the Secretary of State on May 31, 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 sometime in the fall of 2013 or spring of 2014.

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 2013 or spring of 2014.

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. As required by Government Code Section 11346.4, staff mailed and published a public notice on April 6, 2012, to announce that a public hearing would be held if requested by an interested person at least 15 days prior to the close of the comment period of May 24, 2012. There were no requests made. The final approved regulations were filed by the Office of Administrative Law with the Secretary of State on December 12, 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. As required by Government Code Section 11346.4, staff mailed and published a public notice on January 18, 2013, to announce that a public hearing would be held on

March 27, 2013. As a result of the hearing, a 15-day notice will be mailed and posted to identify further changes to the proposed regulation sometime in October 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. Staff anticipates holding a second interested parties meeting sometime in the spring or summer of 2014.

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. A second interested parties meeting will be held sometime in the fall of 2013 or the spring of 2014.

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 2013 or spring of 2014.

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. As required by Government Code Section 11346.4, staff mailed and published a public notice on December 7, 2012, to announce that a public hearing would be held on February 6, 2013. There were three comments received at the hearing. As a result of the hearing, a 15-day notice was issued. There were no comments or requests made during the 15-day comment period. Staff is finalizing the regulation and plans to submit the proposed regulation to the Office of Administrative Law for approval and filing with the Secretary of State sometime in September or October 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. As required by Government Code Section 11346.4, staff mailed and published a public notice on April 26, 2013, to announce that a public hearing would be held on July 25, 2013. There were three comments received at the hearing. As a result of the hearing, a 15-day notice was issued. There were no comments or requests made during the 15-day comment period. Staff is finalizing the regulation and plans to submit the rulemaking file to the Office of Administrative Law for approval and filing with the Secretary of State sometime in September or October 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, and anticipates holding a second interested parties meeting sometime in the fall of 2013.

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. Staff anticipates holding a second interested parties meeting sometime in the spring of 2014.

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.