Taxpayers' Bill of Rights
Annual Report to the Legislature

State of California
Franchise Tax Board

2015

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Executive Summary

The Taxpayers' Rights Advocate's Office prepares this report each year as required by the Taxpayers' Bill of Rights (Revenue and Taxation Code (R&TC) Sections 21006 and 21009). The report supports open government and transparency as it addresses taxpayers' concerns and Franchise Tax Board (FTB) systemic issues. We take this report very seriously and continuously strive to further protect taxpayers' rights and ease their filing burden.

This is our new Taxpayers' Rights Advocate Susan Maples' first report. Susan has fearlessly accepted her new role and brought a new vigor and enthusiasm to the position. I am excited to have her as the Taxpayers' Rights Advocate and know the tax professional community will treat her with the same consideration as our former Advocate.

The year brought more opportunities to expand our service to California taxpayers as well as the tax professional community.

Our Enterprise Data to Revenue (EDR) project is on schedule. On January 4, 2016, we will release the improved MyFTB. We upgraded the registration process to enhance security and add features such as viewing returns, account information, balance due, account alerts, and more. In addition, we added online services such as submitting a Power of Attorney declaration, submitting a protest, sending correspondence, and initiating real-time chat.

Our six field offices implemented a cash-free process at their public counters. Taxpayers and business entities have the option to make payments using the following methods:

- Debit card with a credit card logo.
- VISA, MasterCard, American Express, or Discover credit cards.
- Cashier's, personal, or business checks.
- Money order.

We continue to provide taxpayers with information on the financial institutions closest to the field office where they may convert their cash to a cashier's check or money order.

We also launched our open data portal. The portal figuratively opens the door to a world of state income tax data. Users are now able to download, export, and use this data for many purposes. We anticipate our main customers will be reporters, academics, and local governments.

Lastly, our campus is abuzz with activity as we work to ensure we:

- Remain on track with all Earned Income Tax Credit (EITC) implementation tasks.
- Make changes to existing tax forms.
- Develop a new EITC form.

Our marketing team is feverishly collaborating with California's extensive network of social assistance nonprofits, sister state agencies, local governments, and the private sector. In addition, we know we can count on the support of the tax professional community to help spread the word about this vital new tax credit.

Thank you for the continued privilege to serve,

Selvi Stanislaus
Executive Officer

Selvi Stanislaus

Advocate's Address

Members of the California Legislature:

I submit for your review the 2015 Taxpayers' Bill of Rights Annual Report to the Legislature.

As FTB's new Taxpayers' Rights Advocate, I understand the role of the Advocate is crucial in maintaining a balance between the Taxpayers' Bill of Rights and FTB's obligation to collect the proper amount of tax due. It is with enthusiasm that I hope to reduce the burden on taxpayers and increase the satisfaction taxpayers and tax practitioners have when they interact with FTB. Many foreseeable challenges are on the horizon, some of which are the same challenges businesses themselves face such as resources and legislation issues. I am confident; however, FTB can make improvements to ease the burden on taxpayers while increasing the department's ability to be more efficient and customer centric.

As Advocate, my main areas of focus are to ensure taxpayers' issues are handled promptly and fairly, to provide an independent review of taxpayer complaints, to improve the communication and services that FTB provides, and to identify errors of significant noncompliance while working to find solutions to these problems. The Advocate's role challenges the department internally on issues that affect taxpayers and practitioners. While I maintain independence, I can provide review of cases, identify inequities, propose changes, and ensure courteous treatment of the public. Since I work closely with taxpayers and the tax practitioner community, I gain firsthand knowledge on issues, concerns, challenges taxpayers face, and the impact legislation has on businesses in California and taxpayer compliance.

As director of the department's Education and Outreach program, each year, my staff and I participate in tax professional seminars, industry group workshops, and small business events. Our publication, Tax News, reaches over 20,000 tax professionals and business owners informing them about state income tax laws, regulations, policies, procedures, and events that affect the tax practitioner community. These programs are vital in helping me to accomplish my goal to build and strengthen relationships with taxpayers and the tax practitioner community. In the future, I hope to expand this outreach to include more taxpayers, practitioners, and businesses outside of California as changing laws necessitate our ability to communicate better beyond our borders.

Audit Training and Retention

FTB's Audit Division administers and enforces California's income tax laws. The Audit Division's goal is to develop knowledgeable and engaged employees and to timely conduct business with fairness and integrity. The training, development, and retention of Audit staff are crucial when it comes to meeting this goal. The Audit Division offers training through a variety of methods including formal classroom training, working group discussions, case consultation, and on-the-job mentoring. Providing initial and ongoing training to Audit staff helps them to effectively identify and examine areas of potential noncompliance with tax laws. In last year's annual report, the Advocate recommended mandatory use of individual development plans (IDP) for all Audit staff responsible for performing or reviewing audits.

An IDP is an agreement between an auditor and their supervisor listing the projects, experience, and training the auditor would like to obtain during the current calendar year. This past year, approximately 71 percent of Audit staff had an IDP in place, up from 68 percent the previous year. However, the percentage of staff with an IDP that were able to complete their plans declined from 84 percent last year to 69 percent this year. As a result, less than 50 percent of Audit staff overall were able to fully complete an IDP. Reasons for staff not completing training plans included workload constraints, changes in workloads and assignments, and not being able to find classes or training that met their specific needs. Additionally, all Audit staff were required to attend multiple training classes, apart from their individual IDPs, for our new EDR System.

In the fields of accounting and taxation, ongoing continuing professional education requirements are commonplace. While I am concerned at the decline in the percent of Audit staff that were able to fully complete an IDP, I am encouraged by the progress the Audit Division has made including using FTB's new talent management system. I recognize that Audit staff has opportunities for informal training outside of their IDP, including panel discussions with external CPAs, consultation days with senior program specialists, and quarterly program-wide forums discussing technical issues. However, it is difficult to determine the level of participation by Audit staff if not tracked.

I recommend that Audit Division management consider implementing a more formal approach to required annual training for Audit staff, including:

- The development of structured IDPs for newer staff (based on program needs).
- Increased emphasis on participation and completion of annual or biennial IDPs by all Audit Division staff.

Audit Division management may also want to consider tracking some of the more structured non-classroom training provided to staff and include these in the IDPs. This will enable management to better monitor the training their staff receives throughout the year.

In addition to developing a well-trained Audit staff, it is important that FTB retains its Audit staff so that FTB receives the benefit of their training and experience. Based on available data for the fiscal year (FY) 2014/2015, FTB retained our more experienced staff in terms of length of service. FTB's Audit Division experienced a turnover rate of between four to five percent over the past several fiscal years; this year's rate was slightly higher than last year's, but well within an acceptable range. The percentage of auditors with five or more years of experience increased during this fiscal year from 73 percent to 79 percent, while the percentage of auditors with more than ten years of experience also increased from 43 percent to 46 percent. Additionally, the percentage of Audit staff working in the more advanced classifications, i.e., the Program Specialist series, remained relatively constant during the FY 2014/2015. However, FTB saw an increase of nearly nine percent in Audit staff working at the higher levels (II and III) of the Program Specialist series. With respect to Audit managers, nearly all come from our existing Audit staff. Their experience rates, in terms of years of service, remained nearly constant during the fiscal year.

While the Audit Division's workforce is currently stable and staff turnover remains within acceptable ranges, certain areas of specialized knowledge and expertise within the Division are currently held by only a few individuals. The loss of this knowledge and expertise through separation or transfer within FTB could significantly impact the Division's ability to complete assigned workloads. Therefore, my recommendation is that Audit implements a training process to transfer this critical knowledge and expertise to others within the Division.

Docketed/Undocketed Protests

Docketed Protests: In September 2013, the Legal Division embarked on a program to reduce docketed protest cases[1] over 36 months of age. I am pleased to report that they continue to make progress in decreasing the inventory of these oldest cases. As of June 30, 2015, the Legal Division closed 45 percent of over 36-month cases, meeting their goal for the year.

1 Docketed protests are those handled by FTB's Legal Division and generally involve disputes with larger dollar amounts, more complex issues, issues of first impression, and abusive tax avoidance transactions.

In FY 2014/2015, 31 percent of the tax assessments (in dollars) associated with docketed protests were sustained. Of the cases closed, 62 percent were sustained in their entirety or modified and 38 percent were reversed. As with prior years, because the number of docketed cases closed is statistically small, the overall results are significantly impacted by a few high-dollar cases. As we have also seen in previous years, the vast majority of cases reversed or modified were due to factors other than the conduct of the audit. In cases where taxpayers chose to provide information to Legal that had not been provided to Audit, Audit generally agreed with modifications to proposed assessments based on the new information.

Undocketed Protests: For undocketed protest cases,[2] the Protest section closed 394 of these cases during FY 2014/2015. Approximately two-thirds were personal income taxpayers with the remaining one-third business entities. In FY 2014/2015, 59 percent of the tax assessments (in dollars) associated with these cases were sustained. Of the total number of cases closed, 77 percent were sustained in their entirety or modified and 23 percent were withdrawn. Additionally, 134 cases were transferred to the Settlement Bureau and subsequently closed there.

Protest modifications and withdrawals for both docketed and undocketed protest cases were due to a variety of reasons including:

- New information presented by the taxpayer that was not supplied at audit.
- Differences in interpretation of the tax law.
- New case law.

Both the Legal and Audit Divisions continue to work closely on the protest backlog issue and to consider public suggestions and prioritize them so that Audit can start to implement high priority suggestions that are the most feasible. The Audit Division enhanced these efforts by conducting two round table discussions with the public. Discussions included an audit accuracy discussion, and the public suggested ways to:

- Improve communication between the auditor, audit supervisor, and the taxpayer.
- Incorporate subject matter experts with more transparency.
- Narrow the issues of the audit.
- Resolve issues at the lowest level.
- Provide industry training for auditors.
- Spend more than two years if needed to ensure an accurate audit.

Also, the Audit Division is in the process of creating a standardized process for taxpayers and representatives to request a consultation with Audit and Legal subject matter experts during the audit process. Audit hopes to implement a standardized process this year.

Claims for Refund

In recent years, this report addressed concerns with claims for refund processing time frames and the lack of interest paid on business entity (BE) claims. As the new Taxpayers' Rights Advocate, I also share these same concerns. I would like to give special acknowledgement to FTB for implementing the Taxpayers' Rights Advocate's recommendations made in previous Annual Reports to the Legislature. Also, I am happy to report this past year FTB analyzed the claims process and took steps to improve the process. While improvements were made, FTB should continue to work to ensure that claims for refund are processed as quickly as possible.

2 Undocketed protest cases are those cases worked by non-attorneys in the Protest section of our Audit Divison.

In an effort to review and improve best practices associated with claims for refund, the Audit Division assembled a team to explore the possibility of refunding more claims sooner. In addition, the Audit Division conducted two roundtable discussions with taxpayers, representatives, and other interested parties. The roundtable sessions covered the Form 100X, *Amended Corporation Franchise or Income Tax Return*, claims for refund process, and other items. These meetings allowed FTB to:

- Share general information regarding the steps in the claims process and typical time frames with the public.
- Provide attendees with the opportunity to share their experiences, offer solutions, and provide insight to help us prioritize the issues most important to them.

FTB evaluated these suggestions and is developing short- and long-term initiatives. These initiatives are specific to improved communication and include an acknowledgement letter to taxpayers on their claim, the addition of the supervisor and manager in communications, and the availability of information on MyFTB.

This past year, FTB analyzed the steps associated in referring a BE claim for audit consideration. As a result, the Audit and Filing Divisions made improvements to the process by changing from paper to electronic modes, so fewer BE claims are reviewed manually for audit issues. This reduced the audit referral time from months to several weeks. In addition, Audit and Filing refined the audit referral criteria to move toward refunding additional claims prior to audit review. The Filing Division was also able to streamline certain processes and procedures to enable staff to work cases more quickly, thereby reducing the turn-around time for issuing refunds. Filing increased the number of people who perform claims processing activities and dedicated additional hours to this workload. All of these improvements resulted in the Filing Division eliminating their claims inventory backlog. As a result, FTB works all claims filed within their six-month time frame processing goal.

Similarly, Audit implemented changes that are starting to have a positive impact; fewer returns are being held for audit and Audit's open BE claim inventory declined from last year in both volume and dollars. Last year, 62 percent of the apportioning claims were allowed before audit consideration, which is a 3 percent increase from the year before. Audit kept the remaining 38 percent for review. In the past year, Audit closed several very large apportioning corporation claims, thus the dollar value of the BE claim inventory declined by 40 percent and the volume decreased 20 percent. However, the denial rate for apportioning corporation claims that are kept by audit for review continued to climb. Last year, Audit denied 69 percent of the amounts claimed compared to 50 percent the year before. Since many of these changes to the claims review and referral process were just recently fully implemented, FTB expects to see this trend continue in the coming years.

This past year, FTB also analyzed the steps associated in referring a personal income tax (PIT) claim for audit consideration. Based on this analysis, the Audit and Filing Divisions modified the referral criteria. These modifications are now in place for FY 2015/2016. In addition to this modification, beginning in September 2015, FTB refers PIT claims to Audit through Return Analysis (RA). The RA system will provide better tracking of FTB claims inventory and faster processing of claims in general.

While FTB made improvements, I feel FTB needs to continue to work to ensure that claims for refund are processed as quickly as possible.

Penalties

Penalties are an important and necessary part of voluntary tax compliance. They can encourage taxpayers to timely file their tax returns, provide information, and make estimated payments to avoid penalties. However, I am also aware penalties can discourage taxpayers who have missed a deadline from filing a tax return or making estimated payments, and can create personal liability for the tax professional or withholding agent. Therefore, it is imperative that penalties are reasonable and their amounts reflective of the seriousness and intent of the error or omission, as provided under the law.

As previously reported, 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 filed tax returns late or provided incomplete information.

FTB increased its efforts to bring taxpayers into compliance and to include more out-of-state taxpayers. As a result of these efforts, I discovered Limited Liability Companies (LLC) classified as partnerships that received penalties in excess of $100,000, when the tax is the $800 minimum tax. These companies are either:

- Registered with the California Secretary of State, but were not doing business in California.
- Members of an LLC that is considered doing business in California.

In both instances, the companies were simply not aware of their California filing requirement. Failure to timely file their California tax return not only resulted in the imposition of the Late-filing penalty, but the Failure of Partnership to Comply with Filing Requirements penalty as well. This penalty is the product of $18 multiplied by the number of persons who were in the partnership during any part of the year. For LLCs with many owners, this has resulted in a large penalty despite the fact that neither the partnership nor any of the partners had any California source income.

There is a reasonable cause exception to the Failure of Partnership to Comply with Filing Requirements penalty, and 43 other penalties FTB may impose. Reasonable cause may be established if a taxpayer can show that failure to comply with the law occurred despite the exercise of ordinary business care and prudence. The burden of proof is on the taxpayer to show reasonable cause exists by providing credible and competent evidence to support the abatement of the penalty. This hurdle has proven difficult for some because they simply didn't know they had a filing requirement and ignorance of the law generally does not constitute reasonable cause. Determining the existence of reasonable cause also requires an in-depth analysis of each case by FTB by taking into consideration all facts and circumstances.

We have identified some education and outreach opportunities that may increase our taxpayer compliance goals:

- Better communication of California filing requirements with our out-of-state taxpayers.
- Promotion of the Voluntary Disclosure Program, particularly for taxpayers unaware of California tax rules that want to come into compliance and avoid harsh penalties.

We are presently proposing legislative changes to reduce the severity of the Failure of Partnership to Comply with Filing Requirements penalty for partnerships where neither the partnership nor any of the partners had any California source income. Furthermore, legislative changes to provide first-time penalty abatement similar to the Internal Revenue Service (IRS) practice of granting administrative relief to compliant taxpayers could reduce taxpayer dissatisfaction and result in increased filing compliance.

As FTB undergoes further enhancements to our automated billing system, I recommend increased efforts to monitor the impact of those enhancements on the 36 penalties that FTB may automatically assess when a specific action is not properly taken by the taxpayer or tax professional.

Filing Enforcement

The department's Filing Enforcement (FE) program identifies and contacts individuals and business entities that appear to have a California filing requirement but have not yet filed a California tax return. This year, more than 20 percent of our FE notices are issued to business entities with an out-of-state address. It has become very difficult for taxpayers to know when they must file a California tax return due to:

- Changes in the definition of "Doing Business."
- The impact of Proposition 39.
- The use of numerous pass-through entity forms of ownerships.
- Increasing complexities surrounding how to determine California source income.

Taxpayers are often not aware that they have a requirement to file until FTB contacts them. Once contacted, they file returns only to later receive large penalties.

In addition to the increasing number of out-of-state filing enforcements, my concern as Advocate is that taxpayers may receive demands to file California tax returns but may not have a filing requirement in California. These notices not only increase the burden to taxpayers but they increase the number of calls to our call centers when taxpayers try resolve their accounts. In FY 2014/2015, nearly 70 percent of PIT and 37 percent of BE demand letters resulted in *Notices of Proposed Assessment*. Of those notices, 27 percent of PIT and 66 percent of BE amounts were based on FTB estimates of income rather than hard income sources such as 1099's, K-1s, and W2 information.

As FTB improves the data sources it has available to identify taxpayers who may have a filing requirement, I urge the department to consider customer service impacts especially because a filing enforcement notice could result in an erroneous balance due.

Collections

Our accounts receivable (AR) inventory for 2015 totaled $7.9 billion, a 10 percent reduction from 2014. FTB is resolving its AR inventory by pursuing better data and enforcement tools, such as using EDR sources, the Federal Treasury Offset Program (FTOP), Financial Institutions Records Match (FIRM), and the Top 500 program. We also continue to focus on improving our operations to make it easier for taxpayers to resolve their delinquent accounts. For example, we successfully implemented the credit card payment option for business taxpayers on May 1, 2014.

In previous years, my predecessor voiced concerns about our increasing AR balance due to taxpayer's having more difficulty paying their accounts in full, and as a result opting to enter into installment agreements or the collection system. While I am also concerned about the ability of taxpayer's to pay their debts in full, I am optimistic that the economy is improving because AR inventory is down significantly this year and our installment agreement inventories increased less than one percent from last year.

ARM Customer Service

One of the main issues I continue to hear from taxpayers is in regards to customer service. When taxpayers are unable to reach us, account balances often go unpaid. Many of these taxpayers want to avoid further collection action and enter into an installment agreement, or pay the account in full. Many taxpayers call Advocate Services because they simply can't get through to our phone lines to talk to a live person and a collection action creating financial hardship for the taxpayer is looming. For FY 2014/2015, FTB Collections received approximately 1.2 million PIT calls. With an average level of access (LOA) of 64.5 percent for PIT collections, 421,000 taxpayers did not receive assistance. For BE calls, the LOA was 63 percent. There were just over 107,000 BE taxpayers that did not get through to a live person.

FTB's inability to provide customer service to all callers leaves taxpayers struggling to deal with notices and involuntary collection actions that can lead to financial hardship. Additionally, the revenue from these noncompliant taxpayers is significantly delayed in flowing to the general fund. Providing customer service assistance to these taxpayers is more than just "nice to have," it is critical to resolving our accounts receivable with them. When taxpayers cannot reach a call agent for assistance regarding their collection matters, accounts are more likely to move to the more costly involuntary collection cycle.

Annual Notice

Many of the calls to our call centers are a result of notices from FTB. For example, law requires FTB to provide written notification once a year to all taxpayers with a tax delinquency detailing their delinquent balance due as of the date of the notice. When taxpayers receive these and other notices, they frequently call us. However, if taxpayers cannot get through, it leaves them struggling to find answers to questions about the notice and other information needed to comply with filing requirements as well as pay outstanding tax liabilities. This is especially true for out-of-state taxpayers who were subject to a filing enforcement action when they have never filed with us before.

The annual notice that goes out to individuals and business entity taxpayers lets them know our records indicate they have a balance due, how they can make a payment, and to call if they are unable to pay in full. However, the annual notice does not inform them of the options to enter into an installment agreement, a provisional payment plan, or an offer in compromise.

Additionally, some of these notices are sent to suspended corporations or LLCs that are no longer active and did not formally surrender or dissolve. In most cases, FTB is not likely to collect from these business entity taxpayers as there are no assets. By informing the corporation or LLC that they may be able to enter into an offer in compromise, we may be able to collect a balance that FTB would not otherwise collect and allow these entities to revive so they can dissolve. Currently, many taxpayers and owners just "walk away" from the entity while each year FTB assesses another $800 minimum tax that FTB will never collect.

While I am hopeful that legislation allowing administrative dissolution of these entities will pass into law, I believe that increasing the information we provide in the annual notice will not only help taxpayers comply, but also help FTB collect what would otherwise be uncollectable. Therefore, my recommendation to add additional information to the annual notices aligns with my goal of increasing our education and outreach to improve self-compliance.

Tax Liens

In January 2015, Collections ended the pilot for the *Intent to Lien* notice and implemented the notice as part of the automated collection cycle. This is a perfect example of how education and outreach can increase taxpayer awareness, increase taxpayer compliance, and reduce the number of collection actions taken on an account. As a result of this educational effort, FTB continues to see a downward trend in the number of liens filed. In FY 2014/2015, the number of liens filed was 113,401, a decrease of two percent (this is a 40 percent decrease in the last two years). Approximately 97 percent of those liens were released, but only 12 percent released were because of liens filed in error, down from 17.5 percent the year before.

In general, FTB does not file or extend liens for balances below $2,000. Where an exception exists to file or extend a lien for a balance below $2,000, FTB reinforced the lien guidelines to ensure that there is a valid justification. In FY 2014/2015, the number of liens filed below $2,000 was 508, approximately a 66 percent decrease from FY 2013/2014.

Lien Statistics						
Fiscal Year	Liens Filed	% of Liens Filed Increase/ Decrease	Liens Released	% of Liens Released	Liens Released Filed in Error	% of Liens Released 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%
2013/2014	116,034	-38%	127,089	109%	20,306	17.5%
2014/2015	113,401	-2%	110,613	97%	13,376	12.0%

Customer Service

FTB considers customer service a high priority and our mission statement identifies customer service as one of our core values. However, the customer service access levels and response times in FTB's largest contact centers are simply unacceptable with roughly 900,000 unanswered calls this past year and an average of 40,000 to 70,000 pieces of correspondence backlogged taking us on average six to eight months to respond.

In FY 2014/2015, the Filing Services Bureau (FSB) received over 2 million telephone calls of which only 1.1 million were answered. The average wait time was 12 minutes and the LOA was 52 percent for taxpayers. Tax professionals had a longer average wait time of 19 minutes but had a higher LOA at 74 percent. This is a decrease compared to FY 2013/2014 where LOA for taxpayers was at 62 percent and tax professionals had an 82 percent level of access. My concern is that FTB does not have the staff and resources to respond to the volume of phone calls and correspondence received. The majority of taxpayers who call us are trying to file a return or pay their balance. As a result, taxpayers are unable to resolve their tax liabilities in a timely manner and revenue collection is impacted.

FTB does have other options for taxpayers, including Live Chat and Virtual Hold. Virtual Hold allows taxpayers who call the 800 number and experience long wait times to request a call back within the same time frame as their current hold wait time. In FY 2014/2015, Live Chat FSB had a LOA of 97.8 percent for PIT and 98.2 percent for BE. In FY 2014/2015, Virtual Hold on an enterprise wide level had 73.6 percent for accepted return calls. Unfortunately these features are not available to practitioners as FTB cannot use Live Chat to discuss specific account information and the practitioner hotline does not have Virtual Hold. Without other options available, practitioners are left charging clients for the time spent waiting on hold to get their clients' problems resolved. With the roll out of the new MyFTB in January 2016, practitioners will have the option to use Secure Chat to speak with FTB customer service agents about their clients' accounts. I recommend that the department keep a close eye on the LOA for Secure Chat.

In FY 2014/2015, two efforts were conducted with regard to FTB's notices as they impact customer service. The first effort was carried out by the Enterprise Notice Planning Team who developed the Notice Response Forecasting Tool (NRFT). This tool was used to plan notice volumes, mailing schedules, and staffing levels to calculate the expected call center LOA and correspondence received from taxpayers. The team monitored the actual results over FY 2014/2015 and compared it to the forecasting tool's expectation and verified that the tool's forecast was within an acceptable range of reliability. The second effort was performed by the Notice Response Forecasting Strategy team as part of FTB's Management Development Program. This team evaluated options for how to govern and use the NRFT in FTB's operations. The team recommended and received approval to develop an Enterprise Notice Council, whose role is to fully implement and continue to use the NRFT. The council's use of the tool will optimize the department's customer service LOA in the various call centers and assist in allocating resources to respond to taxpayer correspondence.

I am pleased to see that FTB is fully supporting the Enterprise Notice Council to manage the number of notices sent department-wide and the LOA needed to support the contacts they generate. However, without significant resources, my fear is that the LOA will continue to deteriorate this coming filing season with the roll out of the new MyFTB folder and security requirements, leaving many taxpayers including those hoping to take advantage of the new EITC program with nowhere to turn to get their questions answered and returns filed.

Education and Outreach

Education and outreach is an important part of the Advocate's role for FTB and I continue to encourage FTB to take a proactive approach of education before compliance. Talking to taxpayers and tax professionals regularly, I see a strong need to continue to educate, provide outreach to, and inform taxpayers and tax professionals about FTB services and the changes that are coming.

This last year my staff and I worked closely with the Governor's Office of Business and Economic Development (GO-Biz) in the development of the California Business Portal (CBP). The CBP provides information from all of California's regulatory and taxing agencies in one location. My office worked closely with GO-Biz to provide information for the different business entity types and their filing requirements. In addition, our education and outreach staff responded to over 1,200 inquiries from taxpayers and tax professionals. We also participated in approximately 150 presentations throughout California for FY 2014/2015, an increase of nearly 23 percent from last year. For FY 2015/2016, we expect this upward trend to continue. I attend quite a few of these events and find that our participation is invaluable to the business community and reinforces the need for us to continue to participate in these presentations and other similar events.

Tax News and *Tax News Flashes* are another way FTB communicates with tax professionals about important information, changes in department policy or administration, and time-sensitive information. We continue to expand *Tax News'* readership and recently reached a milestone of 20,000 subscribers. In the final phase of FTB's EDR project, many changes are coming that will impact tax professionals and taxpayers using online services. *Tax News* is essential to communicating information about the enhancements and changes to the tax professional community. In addition to *Tax News*, FTB also uses YouTube to market programs like CalFile, provide tax tips, and news releases on issues related to critical filing errors and available tax credits. FTB participated in webinars in the past, and I hope that we participate in more education webinars on a variety of topics in the upcoming year. FTB also continues to use social media, maintaining a presence on Facebook and Twitter. I commend FTB as it continues to look for new ways to connect with taxpayers and tax professionals to provide important information necessary to increase compliance and decrease taxpayer burden.

Late Legislation and Conformity

For the last eight years, my predecessor raised concerns about how the lack of conformity to the Internal Revenue Code (IRC) increases complexity for the taxpayer. State conformity to federal tax law advances simplicity in that a taxpayer only needs to understand one set of tax rules. While FTB has a general policy in favor of conformity and supporting legislation, the process of developing legislation properly lies with state legislators. This year I am pleased Assembly Bill 154 (Ting) was chaptered, bringing California closer into alignment with federal laws.

California's tax system should promote economic growth, reduce taxpayer frustration, and be more efficient, understandable, transparent, and timely. California's tax system has evolved into a complex method of conformity and late legislation. The tax system should not impede or reduce the productive capacity of businesses in California. Taxpayers should know that a tax exists and how and when it is imposed. The tax law should be simple so that taxpayers can understand the rules and comply with them correctly and in a cost-efficient manner. Businesses need to know the tax rules, when to pay, how to pay, and how to determine the amount to pay. Overly complicated taxes discourage compliance and are costly to enforce.

The passage of late legislation also creates a burden on taxpayers, tax professionals, the tax filing industry, FTB staff, and businesses in California. Business owners monitor tax law and act accordingly to improve their bottom lines. While I am pleased that California has modified conformity, late legislation continues to lead to confusion, frustration, more taxpayer errors, decreased voluntary compliance, and significant compliance costs. When legislation that impacts taxpayers' income tax filing and planning is passed late in the year, I believe there is a negative effect on individuals and businesses in California. Taxpayers need to plan for the future. I encourage you to consider the impacts when legislation is passed.

Withholding Services

In last year's annual report, concern about the lack of transparency of our Withholding Services and Compliance Section (WSCS) was expressed. Specifically, to appear more transparent about the activities of our WSCS programs, it was recommended that WSCS develop a comprehensive manual and publish the procedures that staff should follow. I am pleased that work on this procedure manual nears completion. WSCS will make the manual available on our external website beginning in 2016. In addition, WSCS significantly expanded their education and outreach efforts to California real estate professionals to include more presentations, an informative brochure, a guideline booklet, and a helpful quick reference sheet that summarizes how the agent should perform their withholding responsibilities.

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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 reviews 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 quantity 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 4058B, *California Taxpayers' Bill of Rights – Your Rights as a Taxpayer.* A one-page overview of California Taxpayers' Bill of Rights. This publication highlights some of taxpayers' basic rights.
- FTB 4058C, *California Taxpayers' Bill of Rights – An Overview*. This publication describes the R&TC provisions and how we implement them.

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 legislative, audit, and collections updates as well as discussion about emerging 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 about 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 IRS cancelled interest on a federal assessment that formed the 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 34,000 contacts in FY 2014/2015. The majority of taxpayers (over 25,000 contacts) contacted us by telephone. We provide taxpayers a public number (800.883.5910) to contact our Advocate Hotline.

We also received 8,954 pieces of correspondence (letters, faxes, and emails) 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 2014/2015 include:

- Filing enforcement
- Refund
- Balance due
- Order to withhold
- 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 cancelled assessments or addressed hardship issues.

Refund

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

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.

Installment Agreement

We reviewed requests for Independent Administrative Review and other contacts regarding installment agreements. We allowed, modified, reset, or denied installment agreements as appropriate.

Equity Relief

Senate Bill 540 (Stats. 2015, Ch. 541, Sec. 1), effective January 1, 2016:

- Extended and made permanent the Taxpayers' Rights Advocate penalty, interest, and fee relief provisions.
- Increased the relief limitation to $10,000, indexed annually for inflation.
- Maintained the requirement for the concurrence by the executive officer of the board with any relief granted in which the total reduction exceeds $500, also indexed annually for inflation.

When relief is granted, the three-member board shall be notified and a public record placed on file for at least one year.

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 2014/2015, we received 441 issues through SIMS. Of the issues submitted, we identified 12 as possible systemic issues and forwarded to program areas for research and resolution.

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 PIT Notice of Proposed Assessment display file for assessments that became final in FY 2014/2015. 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 FE 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 2014/2015 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 88 percent of all PIT 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 PIT 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 BE tax returns, a 21 percent increase.

Taxpayer Filing Errors

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

We compiled taxpayer error information on approximately 15.5 million current year tax returns processed between July 1, 2014, and June 30, 2015. During this time, FTB made approximately 300,000 adjustments and issued just over 310,000 *Return Information Notices* (RINs) to taxpayers who filed tax returns with errors that resulted in a change of tax liability. This equates to just under 2 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 (56 percent) of the adjustments we made were on paper-filed tax returns, even though only 16 percent of total current year tax returns were paper-filed. Adjustments on electronically filed tax returns (92 percent of total current year returns) accounted for the remaining 44 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, 34 percent contain an Estimate Payment Credit adjustment, up from 31 percent in FY 2012/2013. Taxpayers 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. We identified several areas of the law during the review process for which we proposed legislation to facilitate administration of our duties.

Chaptered Legislation

AB 1143 (Skinner, Stats. 2014, Ch. 325), This act amended the definition of taxpayer as it relates to suspension, forfeiture, revivor, and contract voidability, to specifically include foreign nonqualified LLCs and updated, to May 1, 2014, the date the state's check-the-box regulations are required to be consistent with federal check-the-box regulations.

AB 2754 (Committee on Revenue and Taxation, Stats. 2014, Ch. 478), This act, among other things, included FTB-sponsored provisions that requires (1) dependent social security numbers on returns for purposes of the dependent exclusion and (2) certain business entities to e-file their tax return unless a waiver is granted.

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 2014/2015, the Taxpayer Services Center (public number 800.852.5711 and hotline number 916.845.7057) answered approximately 54 percent or 1.1 million of the incoming calls. Due to the learning curve of adapting to new systems this is a decrease from the previous year; however, staff are quickly learning and increased production rates are already noticeable. 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 2014/2015, the Accounts Receivable Management (ARM) Division maintained their service to customers at 68 percent for both 2013/2014 and 2014/2015. During FY 2014/2015, ARM used technologies, such as Virtual Hold and modified additional queue configuration, to maintain our level of access service to our customers. Overall, ARM answered 1.2 million, or 68 percent, of PIT and BE tax collection customer contact calls.

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 90 days at various times during the year. The EDR Project involves an effort to improve correspondence services. Beginning in June 2013, we began scanning paper correspondence relating to three FTB notices and in January 2014, we began scanning all PIT and

BE taxpayer correspondence. By scanning correspondence into the system, we are able to provide improved service with the ability to view and eliminate multiple contacts from the same taxpayer with only one response.

Education and Outreach

We continue to increase our education and outreach efforts. We use social media tools, such as Twitter and Facebook to publicize information on California and federal tax law and FTB service changes to help taxpayers comply. We continue to participate in Board of Equalization (BOE) sponsored events to provide small business education and outreach throughout California. Also, our staff collaborated with California GO-Biz in the development of the California Business Portal (businessportal.ca.gov). The Portal provides information from all of California's regulatory and taxing agencies in one location. It includes information for the different business entity types, including hyperlinks to information on their filing requirements from our website. We added educational information to our presentations and ran several *Tax News* articles pointing to new tools and resources available to taxpayers and tax professionals to help increase taxpayer compliance. One of the areas we need to improve is our efforts to provide information to taxpayers and tax professionals outside of California so they can comply. The key point is that we are 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.

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 January 2014, we enhanced CalFile to allow the filing of not only the current tax year, but also the previous tax year return. In January of 2015, we enhanced CalFile to allow filing of a current tax year as well as the previous two tax year returns.

In 2015, approximately 240,000 taxpayers filed their current tax year (2014) return, approximately 8,000 filed a (2013) return, and approximately 2,500 more filed their 2012 return.

MyFTB

MyFTB 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 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 and Web Pay.

MyFTB 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 MyFTB).

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 Folder (TPF).
- Case Management (CM).
- 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 rigorous nine- to ten-week training session to newly hired collection staff. The objective is to provide a concrete foundation of general system and collection knowledge for three business areas; PIT, BE, and Non-Tax Debt. Within each session, we provide system instruction for collection and accounting systems. We also provide soft skill courses which aid in day-to-day tasks; negotiations, conflict management, inventory management, telephone management, and telephone techniques. An integral part of the training session is on-the-job training.

In addition to the new hire training classes, we provide Advanced Collector Training classes for veteran staff. The ARM Career Center developed a new advanced training class: Heavy Workloads versus Time Management. This class focuses on providing staff time management tools to manage complex workloads with shifting daily priorities. The Collection Advisory Team also provided 78 additional training classes to collection staff on advanced collection techniques, including Liens on Cause of Action, Nominee Actions, Subpoenas, and Warrants.

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

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

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

FTB offers ongoing support for auditors to develop their skills throughout their careers with an emphasis on just-in-time technical law training. Mentors or leads provide continued guidance, direction, and on-the-job training and support for auditors. FTB also provides broad-based development to optimize knowledge of the latest 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 prefiling assistance and information, FTB continues to identify ways to improve its enforcement capabilities.

Filing Enforcement 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 PIT 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 IRS, BOE, Employment Development Department (EDD), financial institutions, and other sources.

The business entity nonfiler program also uses various income sources, including information from 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 continues to make better use of data that we already have to perfect cases and reduce erroneous contacts. In addition, an income tax and business entity quality assurance program was developed to review new business rules and practices implemented by the EDR Project to protect taxpayers from erroneous contacts and involuntary collection actions 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 uses innovative methods to promote these objectives through customer service, education, self-compliance letters, initiatives, and partnerships with 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, their representatives, and other agencies to continue to promote best audit practices.

Addressing California's Tax Gap

The tax gap is the difference between the amount of taxes legally owed and voluntarily paid.

Addressing issues that cause taxpayers to underreport, under pay, or to not file their returns remains a top priority for FTB. We compliment these priorities with efforts to educate the citizens of California regarding prevalent areas of noncompliance. FTB continues to apply new tools and data sources that aid in the detection of taxpayers who contribute to the tax gap by using or promoting schemes to evade taxes.

FTB continues to pursue abusive tax shelter transactions. FTB's ongoing partnership with other states, IRS, and other agencies enhances the sharing and exchanging of abusive tax shelter information, training, and informant leads. FTB focuses audit resources to identify, evaluate, and examine these transactions and the related tax shelter penalties.

Collections Program

The Collections program collects tax and nontax debts on behalf of the State of California. Tax debts are primarily FEs, 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 contact 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 over 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 taxpayers. Collectors take appropriate actions to fully resolve cases. Actions include:

- Gather case information.
- Secure asset information.
- Obtain commitments to file, pay, and furnish required information.
- Take collection actions when voluntary compliance cannot be obtained.
- Properly document 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. We routinely evaluate the effectiveness of outsourcing accounts receivables. For example, FTB made the decision to temporarily suspend the procurement process for a new PCA pending the full implementation of the EDR Project.

Payment Methods

Installment Agreements

FTB provides the option of an installment agreement to both individual and business taxpayers who are financially unable to pay the balance in full. Individual taxpayers can now apply and check the status of their installment agreement requests online. Since March 2012, individual taxpayers have the option to set up Installment Agreements through the Interactive Voice Response (IVR). In FY 2014/2015, 223,000 total installment agreements were set up, and nearly 10,000 of those were set by taxpayers selecting the IVR option.

Provisional Payment Plans

FTB allows individual taxpayers to make payments while valid PIT returns are being prepared. Once valid tax returns are filed and the criteria for an installment agreement are met, we convert the provisional plan to a formal installment agreement. From December 2009 through June 30, 2015, 92,637 tax returns have been filed and over $96 million collected. Provisional payment plans increase compliance with tax laws, accelerate 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

FTB special agents are sworn peace officers charged with the investigation of individuals and business entities suspected of committing income tax crimes. In the course of investigating suspected violations, special agents gather evidence, analyze assets and liabilities, interview witnesses, interrogate suspects, and plan and effect search and arrest warrants. Special agents work in conjunction with the Audit and Collections programs, and other local, state, and federal organizations and law enforcement agencies. When a case moves into the prosecution phase, special agents serve as expert witnesses and assist prosecuting attorneys in preparation and prosecution of departmentally approved cases, ensure appropriate media coverage is obtained in accordance with the department's Public Affairs Media Program, and ensure terms of probation directly affecting the department are fulfilled.

For FY 2014/2015, criminal investigations activities resulted in:

- 34 new cases.
- 21 individuals arrested.
- 21 search warrants executed at 88 locations.
- 14 new cases approved for prosecution.
- 25 guilty pleas entered.
- 3 guilty verdicts from trials.
- 1,481 months incarceration and 576 probation months sentenced.
- 56 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 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

As mentioned in the Advocate's Address and portions of this report, the Advocate staff strives to provide taxpayers and tax professionals with the information they need to file their state tax returns completely, accurately, and timely. The department continues to focus on education and outreach efforts, to build strong tools and resources, and to improve services.

In spite of the ongoing economic challenges and resource limitations faced by the Multilingual Communications Program, the program continues to increase and enhance the amount of non-English products, services, and communications.

We added a complaint form to our public website so customers have a way of communicating interpreter and translation concerns. Our goal is to continue to ensure limited English proficient customers have equal access to be compliant and do not experience delays due to their limited English proficiency.

We continue to partner with other California state agencies and programs to educate taxpayers, in person, on the requirements to file and pay state income taxes as well as resources for filing services. We continue to increase our distribution of non-English materials to our field offices and public distribution sites, by request, throughout the state. These communication channels have enabled us to increase taxpayer education and outreach at a minimal cost to the department.

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 but not limited to income tax booklets in large print and on audiocassette.

Our ongoing media efforts, including the use of social media, play a major role in communicating information to taxpayers and tax professionals. We post information on social media outlets, create video clips, and provide public service announcements to educate taxpayers. We continuously look for ways to improve our website and provide more self-service options for taxpayers. *Tax News* continues to expand and has recently reached a milestone of 20,000 subscribers. We send out *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 following issues:

Mortgage Debt Forgiveness

California partially conforms to the American Taxpayer Relief Act of 2012, which applies to discharges occurring on or after January 1, 2013, and before January 1, 2014, with modifications, for mortgage debt secured by the taxpayer's principal residence.

Student Loan Debt

Taxpayers can exclude from California taxable income debt forgiven or repaid under income-based repayment programs administered by the U.S. Department of Education.

Turf Removal Water Conservation Programs

Taxpayers can exclude from California taxable income a financial incentive issued by a local water agency or supplier.

Professional License

Taxpayers can use an individual taxpayer identification number to secure a professional license. The licensing board must provide specific information to FTB upon request or be subject to a $100 penalty. The information is not a public record and is not open to the public for inspections.

Professional Sports Fines or Penalties

Professional sports franchise owners are not allowed a deduction for a fine or penalty imposed by the professional sports league.

FTB Collect Restitution Orders Referred by Counties

FTB is allowed to collect on behalf of counties for the restitution debts resulting from prison realignment.

Limited Liability Company Contract Voidability

As with all corporation and other LLC classifications, foreign nonregistered (nonqualified) LLCs may now be subject to suspension or forfeiture for failure to file a tax return or for failure to pay delinquent taxes, penalties, fees, or interest within 60 days of FTB mailing a final notice.

Check-the-box Entity Classifications

State regulations conform to the May 1, 2014, federal regulations. This allows the entity to check-the-box to elect classification as a corporation, partnership, or disregarded entity.

Must e-file if Business Entity Return is Prepared With Software

A business entity using tax preparation software to prepare its original or amended return must electronically file that return to FTB. The initial penalty of $100 is increasing to $500.

Taxpayer Identification Number required for each Dependent Exemption Credit

Taxpayer must include dependent's taxpayer identification number to receive the Dependent Exemption Credit.

California Competes Credit

GO-Biz's California Competes Credit may now reduce the tentative minimum tax.

Charitable Remainder Trust

Charitable remainder trusts that have unrelated business taxable income may retain their tax-exempt status on other trust income.

College Access Tax Credit

This credit is available to individuals and businesses that make cash contributions to the College Access Tax Credit Fund administered by California Educational Facilities Authority. The contribution goes to fund the Cal Grant B program, which provides money for books and living expenses to low-income college students. The amount of the credit for each tax year is calculated as:

- 60 percent of the amount contributed for the 2014 tax year.
- 55 percent of the amount contributed for the 2015 tax year.
- 50 percent of the amount contributed for the 2016 tax year.

Use Tax Offset

Taxpayers may elect to report and pay state use tax directly to BOE or report and pay use tax on their state tax return. When reported on the state tax return the payment is first applied to BOE liability, and any excess may then be applied to any FTB liability.

Disaster Loss for 2014 San Diego Wildfires

Eligible taxpayers may claim a disaster loss on the tax return filed for the year of the loss, or for preceding year on an amended return. Net operating loss carryback/forward rules apply.

Public Health Department Information Exchange

FTB may provide taxpayer information to the State Public Health Department to verify a taxpayer's adjusted gross income to establish eligibility for state and federal HIV treatment programs.

Political Reform Audit

California law modified the Political Reform Act of 1974 to allow commencement of an audit or investigation prior to the filing of any reports or statements for general, runoff, or special elections; and allow the audit or investigation of all campaign statements and reports.

FTB's and the Fair Political Practices Commission's (Commission) ability to audit or investigate any report or statement required under the Act broadened.

California extended the time period that FTB requires to complete a random basis audit from within one year to within two years after the person or entity is selected for audit by the Commission.

Natural Heritage Preservation Tax Credit

California extended the credit for five years until June 30, 2020. A 15-year carryover is available.

Golden State ScholarShare Savings Trust

Taxpayers may directly deposit a state tax refund to ScholarShare 529 College Savings Plans.

Voluntary Contributions

Voluntary Contribution Funds include California Firefighters' Memorial, California Peace Officer Memorial Foundation, California Senior Legislature, Habitat for Humanity, California Sexual Violence Victim Services, and School Supplies for Homeless Children.

New Regulations

- Withholding at Source regulations updated to conform to current withholding laws, provide transparency, and present a more useful framework.
- Limited Liability Company Fee regulations provide guidance on how to determine "total income from all sources derived or attributable to this state" for purposes of calculating LLC fee.
- Intercompany Transactions regulations provide rules for taking into account items of income, gain, deduction, and loss of members of a combined reporting group from intercompany transactions.
- FIRM regulations provide financial institutions with clarity as to how the FIRM program is to be operated and administered by FTB to aid in the enforcement and collection of tax and nontax debts.

Tax Incentives

Incentives include Motion Picture and Television Production Credit, Fresh Fruit and Vegetable Credit, Research and Development Credit, and New Employment Credit.

The Top Debtors List

The list must be updated at least twice a year and requires 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.

Taxpayer Advocate Relief

Taxpayers can get relief from tax, penalty, and interest caused by erroneous actions or inactions by FTB, when no other relief is available (limited to $7,500). The taxpayer must not have significantly caused the error or delay.

Online Services

Services include Where's my refund?, Live Chat, Ask a Legal Expert, Tax News, MyFTB, Power of Attorney, Web Pay, Installment Agreements, Offer in Compromise, SIMS, Return and Payment Processing, Outbound Calling, and Secure Email.

Interactive Voice Response

FTB provides over 40 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. PIT 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 saved over 3.2 million hours of hold time since implementation and over 860,000 hours during FY 2014/2015. When offered the option, 74 percent of the callers chose to have a call back. We successfully connected with 88 percent of the callers.

California Tax Information

In an effort to provide one-stop service for California taxpayers, FTB participates with other state tax agencies to maintain the California Tax Service Center website managed 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.

Last year, FTB worked closely with GO-Biz in the development of the California Business Portal **(businessportal.ca.gov)**. The portal provides information from all of California's regulatory and taxing agencies in one location. It includes information for the different business entity types, including hyperlinks to FTB filing requirements.

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 now use our *Tax News Flashes* for only the most time-sensitive, vital information in order to not desensitize our readers. This year we reduced the number of flashes to nine. We continue to increase the use of electronic notification because it provides a fast and cost-efficient mode of communication, as well as sharing information and links through social media like Twitter and Facebook.

In our effort to increase subscribership, we marketed *Tax News* through other state agencies and trade association's newsletters and websites. We produced a short video article in our *Tax News* Live series continuing our partnership with California Society of Enrolled Agents. *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 conduct seminars and develop programs to help small businesses meet their state income tax filing requirements. In conjunction with BOE, EDD, and IRS, we develop products that simplify the process to obtain information on most business filing requirements.

We participate in small business seminars sponsored by BOE members throughout California.

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

- FTB 984 - *Common Business Expenses for the Business Owner and Highlights of Federal/State Differences*
- FTB 985 - *Audit/Protest/Appeals (The process)*
- FTB 4058B - *Your Rights as a Taxpayer*
- FTB 4058C - *California Taxpayers' Bill of Rights - An Overview*
- BOE Pub. 170 - *Striking Gold in California - What You Need to Know About Taxes and Your Small Business*

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 1,200 calls this year, most of which came through our Small Business Liaison phone line. We continue to receive many calls from out-of-state taxpayers inquiring about doing business in California and filing requirements. Also, we worked with our *Tax News* editor to publish a series of articles about business entities and changes in the law.

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 staff holds meetings with the affected public 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 and IRS recruit VITA and TCE volunteers statewide. Both agencies provide training on their respective area of personal income taxes and provide 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.

Department Initiatives and Projects

Key Initiatives for 2015

Strategic Plan

The Midterm Progress Report for the 2012-2016 Strategic Plan is available on FTB's website. Go to **ftb.ca.gov** and search for **midterm report.**

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. New applications and processes for handling tax returns, payments, and correspondence. The new applications (Taxpayer Folder, Case Management, and Return Analysis) automate manual processes, enhance our capacity to capture and validate data, standardize our processes, and leverage the same applications to process both PIT and BE tax data.
2. Enterprise data warehouse. The data warehouse makes all appropriate data accessible to our legacy systems and authorized FTB users.
3. Enhanced MyFTB. MyFTB provides authorized users (such as taxpayers and taxpayer representatives) secure online access to images of tax returns, payments, notices, correspondence, and more. In addition, it allows users to perform new self-service options such as sending correspondence, submitting an online protest, calculating a future balance due, filing a Nonresident Withhold Waiver and filing a Power of Attorney Declaration. MyFTB is located at **ftb.ca.gov**.
4. Updated legacy systems. We update legacy systems so they work with the new processing applications, the data warehouse, and the enhanced MyFTB.

The EDR Project Schedule

The EDR Project is a 66-month project divided into three major design stages, each of which includes various major and minor releases.

We separate each design stage and release to allow us to slowly implement the project in well-defined increments, 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 we implement the next release.

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 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 successfully implemented numerous early initiatives to increase our efficiency and effectiveness resulting in about $76 million in revenue. We fully implemented two of the three project design stages. The final release of the project will be implemented by December 31, 2015.

New Applications and Processes for Handling Tax Returns, Payments, and Correspondence

Within the first four years of the project, we:

- Reengineered the return and payment processing pipeline.
- Deployed a new data entry and capture system.
- Added five new scanners.
- Introduced 2-D barcodes for PIT returns.
- Automated our payment deposit process.
- Implemented the Internal Taxpayer Folder to provide more efficient processing and customer service.
- Implemented the Case Management application to manage and process correspondence online.

These efforts significantly reduced our manual processes for tax returns and payments.

In January 2015, we introduced a pilot version of our new Return Analysis System for PIT returns. This system provides full automation of our tax return and payment posting, correction, and notice processes. We plan full implementation for PIT return processing in October 2015. In January 2016, we will start the pilot of the new Return Analysis for BE returns which will automate real-time processing and validation of returns and payments.

Enterprise Data Warehouse

Over the past few years, we loaded and converted hundreds of files and millions of records to our data warehouse. Our new data management processes allow us to leverage this important data to more effectively develop our collections and audit models, which results in additional revenue for the state. Our data conversion processes will continue through 2015.

New Enhanced MyFTB

Our work to provide external stakeholders easy, secure online access to confidential tax data continues. In summer 2014, we initiated a year-long test plan for our new MyFTB program. The test plan included comprehensive security and usability testing by external consultants, in addition to FTB's experts. MyFTB provides taxpayers and their authorized representatives access to important tax information such as tax returns, payments, correspondence, and account information. In addition, MyFTB will provide more self-service options through our website, **ftb.ca.gov.** MyFTB rolls out to the public in January 2016.

Updated Legacy Systems

As we deploy new applications, we continue to update our legacy systems to ensure they support the applications. Also, we continue work to modernize our technical architecture, doubling our computing power, ensuring that we're prepared to support our modernization efforts for decades to come.

All of our EDR Project work enables us to work more efficiently, plan effectively, provide even better customer service, and collect more revenue for the state. In fact, in June 2014, we reached our first $1 billion in new revenue due to the project, 10 months ahead of projections.

EDR Project Revenue

Fiscal Year	Target Amount: Millions	Actual Amount: Millions	% of Target
2011/12	$63.0	$115.7	184%
2012/13	$174.7	$338.5	194%
2013/14	$260.3	$560.3	215%
2014/15	$744.0	$684.6	109%

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 more than $4 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 FE questions.

In FY 2014/2015, continuing forward with the positive momentum we gained since our 2011 launch, our general Live Chat service agents responded to 141,938 chats from individuals and tax professionals. Of this amount, 91,879 chats were regarding PIT questions and 50,059 chats regarding BE tax questions.

During FY 2014/2015, the PIT and BE Collections Live Chat completed 30,024 chats with a 99.6 percent level of access. During FY 2013/2014, PIT and BE Collections Live Chat completed 30,262 chats. Customer satisfaction survey results provided positive feedback from taxpayers regarding the Live Chat service. Taxpayers expressed they are happy to get quick answers (average wait time of 23 seconds) 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 4, 2014. 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.

Lynn Freer, Spidell Publishing, Inc.

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

- Conformity to federal self-employment health insurance deduction
- Real estate withholding
- Clean the books of dead corporations and LLCs
- Ralite-type entities
- Shorten the 540

In her letter dated February 04, 2015, Taxpayers' Rights Advocate, Susan Maples responded regarding conformity to federal self-employment health insurance deduction that California currently conforms to the federal deduction for self-employed health insurance premiums. This includes the amount deductible for self-employed taxpayers who are allowed the IRC Section 36B refundable credit for coverage under a qualified health plan.

Regarding real estate withholding, Mrs. Maples responded that FTB has increased its education and outreach efforts to help escrow companies understand the importance of accurately reporting real estate withholding. FTB is planning to have individual nonwage withholding information, which includes real estate withholding, viewable on MyFTB with the summer of 2015 Enterprise Data to Revenue release. We plan to work with Legal to add clarifying language to the Form 593, Real Estate Withholding Tax Statement, and expect to complete this process in mid-2016, with the anticipated changes made to the forms for the 2017 tax year. In the meantime, FTB is implementing a manual process to identify these inaccurate or incomplete forms.

Regarding cleaning the books of dead corporations and LLCs, Mrs. Maples responded that our staff will expand the scope of the departmental team that was formed as a result of AB 1529. The team will review the dissolution, surrender, and termination processes for all business entities, and continue to look at ways to streamline these processes. In the interim, FTB continues to educate taxpayers about their annual or minimum tax requirements, including information on FTB forms and website.

Regarding the ralite-type entities, Mrs. Maples responded that FTB attempts all reasonable means to acquire any delinquent entity returns and/or any balances due from the entity itself. For transfer of liability at equity, the Ralite decision and California law requires FTB to have "exhausted all reasonable remedies against the taxpayer-transferor" prior to pursuing a transferee assessment. Exhausting such reasonable collection remedies against the entity as required by law admittedly delays assessment against any transferee/shareholder(s), but is necessary to protect the taxpayer's rights to due process.

Regarding shortening the 540, Mrs. Maples responded that FTB currently uses the minimum type size and format that meet specifications which allow enhanced data capture capability through both 2D barcode and optical character recognition (OCR) technologies. FTB continues to explore other alternatives for reporting voluntary contributions on the tax return as part of FTB's annual changes for next year.

Gina Rodriquez, Cal-Tax

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

- Protests
- Processing refund claims
- Audit timeframes
- Appeals
- Publishing legal ruling when pending court litigation

In her letter dated February 4, 2015, Taxpayers' Rights Advocate, Susan Maples responded regarding protests that to improve the accuracy of proposed assessments and minimize intrusiveness to taxpayers, we will focus on being proactive in our review and processing of notices. Audit and Legal staff will collaborate closely to evaluate proposed positions, and training classes will be provided to Audit staff in various venues.

Regarding processing refund claims, Mrs. Maples responded that we expect to close approximately 85 percent of our inventory of 'over 3 year-old' audit claims by June 30, 2015. Currently, we continue to evaluate how we process claims, and review alternative solutions that may mitigate delays in refunding claims. We streamlined inventory management and audit processes, identified cases for closing agreements, continue auditor training, and work closely with Legal staff.

Regarding audit timeframes, Mrs. Maples responded that we continue to leverage the expertise of our subject matter experts and the Legal Division, and work in teams for more complex audits. We identify ways to further streamline our cases and practices. As an upcoming effort, we are planning roundtable focus group discussions so we can gather more information from taxpayers, representatives, and others to understand their concerns and gather ideas to improve our processes.

Regarding appeals, Mrs. Maples responded that FTB must follow the law in determining whether to move forward on a case. In addition, FTB works regularly with Board Proceedings staff at the State Board of Equalization to ensure that the processes outlined in the Rules for Tax Appeals are followed.

Regarding publishing legal ruling when pending court litigation, Mrs. Maples responded that legal rulings are issued to apply legal analysis to a specific set of hypothetical facts when an issue is of a recurring nature and/or of wide interest. Such rulings are issued to provide a formal statement of FTB staff analysis. Legal rulings are the counterpart to Internal Revenue Service revenue rulings.

Patricia Kappen, CSEA

Vicki Mulak provided oral comments to FTB on the following issues:

- Inability to dissolve/cancel business entities formed but not launched
- Real estate withholding
- Withholding on pass-through entities
- Disaster declaration vs. legislation

In her letter dated February 4, 2015, Taxpayers' Rights Advocate, Susan Maples responded regarding the inability to dissolve/cancel business entities formed but not launched. Our staff will be expanding the scope of the departmental team that was formed as a result of AB 1529. The team will review the dissolution, surrender, and termination processes for all business entities, and continue to look at ways to streamline these processes. In the interim, FTB continues to educate taxpayers about their annual or minimum tax requirements, including information on FTB forms and website.

Regarding real estate withholding, Mrs. Maples responded that FTB is planning to have individual nonwage withholding information, which includes real estate withholding, viewable on MyFTB with the summer 2015 Enterprise Data to Revenue release. During the past year, FTB formed a team to review taxpayer accounts and resolve unclaimed withholding credits. In October 2014, FTB began notifying taxpayers of their unclaimed credits and their options to claim their credits.

Regarding withholding on pass-through entities, Mrs. Maples responded that FTB is in the process of working towards new pass-through entity withholding regulations. We shared your comments with Legal to be included in the feedback received at the recent Interested Parties Meeting.

Regarding disaster declaration vs. legislation, Mrs. Maples responded that the department believes the decision to adopt automatic disaster loss treatment is a policy decision that should be made by the Legislature.

Evaluating Franchise Tax Board Employees

In evaluating FTB employees, we continue to stress the importance of customer service. We evaluate employees on: 1) how well they provide quality customer service, while striving to exceed customers' expectations, 2) their treatment of taxpayers, and 3) 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.

Over the last few years, we focused on several efforts to improve our evaluation process, including the following.

- 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 through the FY 2014/2015, we are focusing on two areas:

1. **FTB's Strategic Plan (2012-2016)**
   Two primary goals detailed in our 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 addressed in annual performance evaluations.

2. **Improving the "Content" of Performance Evaluations**
   In 2013, we offered Performance Evaluation Refresher Training for supervisors and offered one-on-one sessions with those who wanted assistance. We offered the training again in 2014, and 2015, and included training in another related area, Duty Statements. This training gave supervisors the tools necessary for communicating expectations to their employees and then increasing empowerment and accountability at all levels.

Appendices

Appendix 1

All tables in Appendix 1 reflect tax increase assessments only. The assessments became final in FY 2014/2015. We may have issued the assessments in prior years; however, due to cases in protest status, we did not resolve them until FY 2014/2015. Appendix 1 totals reflect rounded figures and may not compute exactly.

Table 1A **Corporation Tax Law**
NPAs Finalized in FY 2014/2015 Categorized by Primary Statute (issue)

Issue	Number of NPAs	%	Tax Assessed (millions)	%	Average Assessment Per NPA
Allocation/Apportionment	549	29.2	$ 298.4	78.6	$ 543,551
Assess Minimum Tax	38	2.0	0.0	0.0	771
Revenue Agent Reports	1,078	57.3	41.2	10.8	38,217
State Adjustments	166	8.8	35.0	9.2	210,644
Other	51	2.7	5.3	1.4	132,398
Totals/Average	3,618	100	$ 379.9	100	$ 201,846

- *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 2014/2015 Categorized by Primary Statute (issue)

Issue	Number of NPAs	%	Tax Assessed (thousands)	%	Average Assessment Per NPA
CP2000	188,850	25.1	$ 151,783	7.3	$ 804
Filing Enforcement	465,673	61.8	1,613,777	77.5	3,465
Filing Status	13,965	1.9	16,802	0.8	1,203
Revenue Agent Reports	37,226	4.9	117,940	5.7	3,168
Other	47,311	6.3	180,746	8.7	3,820
Totals/Average	753,025	100	$2,081,049	100	$ 2,764

- 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 2014/2015

Industry	All Corporations 2013 Tax Year	%	Corporations with NPAs	%	Tax Assessed (millions)	%
F.I.R.E.*	242,349	30.3	105	9.8	$ 27.2	7.2
Manufacturing	42,426	5.3	128	12.0	70.5	18.5
Services	299,337	37.4	248	23.2	101.0	26.5
Trade	122,572	15.3	147	13.8	13.0	3.4
Other **	94,361	11.8	441	43.3	168.2	44.3
Totals	801,045	100	1,069	100	$ 379.9	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 tax years for which we issued NPAs or the number of years for which a taxpayer receives NPAs because of multiple tax year audits during the same audit cycle.

Table 3A **Corporation Tax Law**
NPAs Finalized in FY 2014/2015 Issued by Tax Year

Average Tax Year	Number of NPAs	%	Tax Assessed (millions)	%	Average Assessment Per NPA
2007 and prior	429	22.8	$ 204.3	53.8	$ 476,311
2008	248	13.2	75.1	19.8	302,793
2009	427	22.7	65.6	17.3	153,643
2010	465	24.7	26.3	6.9	56,532
2011	246	13.1	6.9	1.8	27,906
2012	55	2.9	1.6	0.4	28,807
2013 and later	12	0.6	0.1	0.0	8,481
Totals/Average	1,882	100	$ 379.9	100	$ 201,846

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 2014/2015 for the Same Taxpayer

Corporations With...	Number of Taxpayers	Tax Assessed (millions)	Average Assessment Per Taxpayer
One NPA	526	$ 47.2	$ 89,777
Two NPAs	377	109.5	290,417
Three NPAs	109	55.7	510,591
Four or more NPAs	57	167.5	2,938,761
Totals/Average	1,069	$ 379.9	$ 355,354

Table 4 **Personal Income Tax Law**
NPAs Finalized in FY 2014/2015 Issued by Tax Year

Tax Year	Number of NPAs	%	Assessment Amount (thousands)	%	Average Assessment Amount
2008 and prior	3,830	0.5	$ 122,791	5.9	$ 32,060
2009	4,595	0.6	32,201	1.5	7,008
2010	138,187	18.4	214,694	10.3	1,554
2011	198,907	26.4	317,913	15.3	1,598
2012	293,615	39.0	1,000,963	48.1	3,409
2013 and later	113,891	15.1	392,487	18.9	3,446
Totals/Average	753,025	100	$2,081,049	100	$ 2,764

Table 5 **Personal Income Tax Law**
Resident Tax Return Preparation, Process Years 2013 and 2014

Preparer	2012 Tax Returns Processed (thousands)	%	2013 Tax Returns Processed (thousands)	%	% Change
Professional	13,340	87.8	13,729	88.6	0.8
Taxpayer	1,592	10.5	1,481	9.6	-0.8
VITA*	268	1.8	282	1.8	0.0
Totals	15,120	100	15,491	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, 2014	June 30, 2015	% Change
Credit Card Payments (average payment is $1,192)	181,000	204,000	13
Direct Debit of Balance Due (electronic funds withdrawal)	609,000	718,000	18
Direct Deposit Refund	6,610,000	6,991,000	6
e-file	15,018,000	15,968,000	6
** *CalFile*	286,000	257,000	-10
** Online Filing	3,692,000	4,017,000	9
** Business Entity	916,000	1,114,000	22

** 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
2013/2014	109,146	70,766
2014/2015	100,463	35,424

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
2013/2014	900,194	579,296
2014/2015	910,828	592,071

Table 8A **Top Errors by Tax Return Type**
July 1, 2014 through June 30, 2015

	Code	Grand Total	540 2EZ	540	540 A	540 NR	540 X
EP	**Estimate Payment Revised**	**182,418**	**2,138**	**162,059**	**123**	**17,928**	**170**
DS	**Deductions Revised**	**60,663**	**111**	**53,846**	**193**	**6,146**	**367**
WS	**Withhold at Source Revised**	**49,071**	**113**	**22,592**	**-**	**25,572**	**794**
TC	**Tax Amount Revised**	**40,891**	**212**	**31,998**	**160**	**6,417**	**2,104**
AA	**Adjusted Gross Income Revised**	**29,733**	**29,561**	**156**	*****	**11**	**3**
AW	**Withholding Did Not Match Attachments**	**28,523**	**2,669**	**24,267**	**57**	**1,033**	**497**
DI	**Standard Deduction Allowed Because Greater Than Itemized Deduction Claimed**	**27,703**	*	**25,582**	**71**	**1,678**	**371**
CT	**Child and Dependent Care (CDC) Credit Revised to Match Original Return**	**27,624**	**139**	**595**	**5**	**33**	**26,852**
OC	**Estimated Tax Transfer Revised: Error Affected the Available Transfer Amount**	**27,025**	**-**	**20,359**	**37**	**6,616**	**13**
OF	**Refund Reported on Amended Return Does Not Match Original Return**	**21,195**	**605**	**5,107**	**47**	**447**	**14,989**
OM	Amount Paid With Original Return Plus Payments Made After Return Filed Does Not Match Amount Claimed on Amended Return	18,311	247	2,776	26	296	14,966
TT	Total Credits/Liability Revised	17,292	5,516	10,452	244	606	474
EX	Exemptions Revised	16,674	107	14,712	231	1,528	96
SS	State Disability Insurance Revised	16,469	-	15,854	44	333	238
ND	California Taxable Income Revised	15,804	-	*	-	15,654	149
TY	Total Tax Revised - Adjusted Gross Income (AGI), Filing Status, or Dependents	12,087	12,087	-	-	-	-
OW	Withholding Reported on Amended Return Does Not Match Original Return	10,071	-	-	-	-	10,071
RN	Nonrefundable Renter's Credit Revised; Wrong Amount Claimed for Filing Status, California AGI Over Maximum Amount, Part-Year Resident, or Nonresident	7,273	1,605	5,410	108	141	9
OA	Refund Revised, Total Payments and Credits Added or Subtracted Incorrectly From Total Tax	6,763	897	3,930	41	173	1,722
AT	Withheld Tax Credit Disallowed; Withholding Documents Not Attached	5,936	498	3,716	33	1,383	306
NP	Total Tax Ratio Calculated Incorrectly or Ratio Incorrectly Applied	5,686	-	*	-	5,662	24

AR	Amended Return Filed With No Record of Original Return	4,824	5	33	-	9	4,777
TI	Taxable Income Revised	2,230	12	1,980	51	116	71
OP	Estimated Tax Payments Reported on Amended Return Do Not Match Original Return	2,165	7	380	7	43	1,728
OB	Balance Revised - Incorrect Payments or Credits	2,143	287	1,466	29	41	320
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*	1,666	-	*	-	1,665	*
EE	Senior Exemption Credit Revised to Correct Amount	1,570	293	1,140	13	123	*
	Other Paragraph Codes Not Listed	5,654	350	3,384	139	563	1,218
	Top Ten	**494,846**	**35,549**	**346,561**	**695**	**65,881**	**46,160**
	All Others	152,618	21,911	65,235	966	28,336	36,170
	Grand Total	**647,464**	**57,460**	**411,796**	**1,661**	**94,217**	**82,330**

*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, 2014 through June 30, 2015

	Code	Grand Total	Electronic	Paper
EP	**Estimate Payment Revised**	**182,418**	**139,531**	**42,887**
DS	**Deductions Revised**	**60,663**	**34,434**	**26,229**
WS	**Withhold at Source Revised**	**49,071**	**36,514**	**12,557**
TC	**Tax Amount Revised**	**40,891**	**3,703**	**37,188**
AA	**Adjusted Gross Income Revised**	**29,733**	**6,110**	**23,623**
AW	**Withholding Did Not Match Attachments**	**28,523**	**16,500**	**12,023**
DI	**Standard Deduction Allowed Because Greater Than Itemized Deduction Claimed**	**27,703**	**15,436**	**12,267**
CT	**CDC Credit Revised to Match Original Return**	**27,624**	**43**	**27,581**
OC	**Estimated Tax Transfer Revised: Error Affected the Available Transfer Amount**	**27,025**	**19,124**	**7,901**
OF	**Refund Reported on Amended Return Does Not Match Original Return**	**21,195**	**333**	**20,862**
OM	Amount Paid With Original Return Plus Payments Made After Return Filed Does Not Match Amount Claimed on Amended Return	18,311	122	18,189
TT	Total Credits/Liability Revised	17,292	1,040	16,252
EX	Exemptions Revised	16,674	1,264	15,410
SS	State Disability Insurance Revised	16,469	11,274	5,195
ND	California Taxable Income Revised	15,804	5,175	10,629
TY	Total Tax Revised - AGI, Filing Status, or Dependents	12,087	511	11,576
OW	Withholding Reported on Amended Return Does Not Match Original Return	10,071	-	10,071
RN	Nonrefundable Renter's Credit Revised; Wrong Amount Claimed for Filing Status, California AGI Over Maximum Amount, Part-Year Resident, or Nonresident	7,273	2,541	4,732
OA	Refund Revised, Total Payments and Credits Added or Subtracted Incorrectly From Total Tax	6,763	633	6,130
AT	Withheld Tax Credit Disallowed; Withholding Documents Not Attached	5,936	855	5,081
NP	Total Tax Ratio Calculated Incorrectly or Ratio Incorrectly Applied	5,686	518	5,168
AR	Amended Return Filed With No Record of Original Return	4,824	-	4,824
TI	Taxable Income Revised	2,230	3	2,227
OP	Estimated Tax Payments Reported on Amended Return Do Not Match Original Return	2,165	31	2,134

OB	Balance Revised - Incorrect Payments or Credits	2,143	427	1,716
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*	1,666	142	1,524
EE	Senior Exemption Credit Revised to Correct Amount	1,570	169	1,401
	Other Paragraph Codes Not Listed	5,654	683	4,971
	Top Ten	**494,846**	**271,728**	**223,118**
	All Others	152,618	58,253	71,853
	Grand Total	647,464	329,981	294,971

Table Legend:

Bold › Top ten codes issued by Tax Return Type.

Appendix 3

Regulation Section 18416.5 – Alternative Communication Method

FTB is considering an alternative communication method authorized under California R&TC Section 18416.5. At the request of the taxpayer or the taxpayer's authorized representative, Section 18416.5 allows FTB to provide notification to the taxpayer in a preferred electronic method. The taxpayer designates their preference so their notice, statement, bill, or other communication is available for viewing in the taxpayer's limited-access secure folder on the FTB Internet website. This alternative communication method also allows the taxpayer or the taxpayer's authorized representative to electronically file a protest, notification, and/or other communication to FTB in a secure manner.[1]

FTB's electronic notifications under the alternative communication method shall be treated as if it were mailed by United States mail, postage prepaid, notwithstanding any other law regarding the use of United States mail (pursuant to R&TC Section 18416.5, subdivision (d)). This treatment applies to any notice, statement, bill, protest, and/or other communication from FTB to a taxpayer or the taxpayer's authorized representative and from a taxpayer or the taxpayer's authorized representative to FTB pursuant to the alternative communication method authorized by this proposed regulation.

On December 1, 2011, staff received authorization from the three-member Franchise Tax Board to proceed with an interested parties meeting to discuss alternative communication methods under R&TC Section 18416.5. Staff held an interested parties meeting on March 14, 2014. Staff received comments, published draft language, and requested public input on the draft language. Staff held a second interested parties meeting on August 27, 2014, to elicit input and discussion of the draft language. As required by Government Code Section 11346.4, staff mailed and published a public notice on February 27, 2015, 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 July 3, 2015. Staff received no requests for a hearing. Staff anticipates that the final regulations will be sent to the Office of Administrative Law in the fall of 2015.

Regulation Section 18662-7 – Withholding on Domestic Pass-through Entities

The purpose of this proposed regulation is to revise existing withholding on pass-through entities to reflect current statutory requirements under R&TC Section 18662. In particular, the purpose of this regulation is to modify the withholding on pass-through entities to consider withholding on the "distributive share" of income. There are two reasons supporting this modification. First, R&TC Section 18662, subdivision (a) and (b), authorizes FTB to require a pass-through entity to withhold on "items of income," including "partnership income or gains." Requiring a pass-through entity to withhold on a nonresident partner or member's "distributive share" of the pass-through entity's income is consistent with Section 18662, subdivision (a) and (b), because the withholding amount is determined by the pass-through entity's income rather than distributions made. Second, FTB staff has found that a vast majority of the states have switched to requiring pass-through entities to withhold on "distributive share" of income. Modifying California's pass-through entity withholding to be consistent with the rest of the states will lessen the burden on out-of-state pass-through entities that are required to comply with multiple state withholding schemes.

A secondary purpose behind this proposed regulation is to adopt a withholding scheme that best resolves the issues arising from the allocation of withholding.

1 Notices, statements, bills, and other communications required or authorized under Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), or Part 11 (commencing with Section 23001)

Specifically, pass-through entities have difficulty in filing timely forms to allocate withholding through multiple tiers. This results in the ultimate individual partners or members being denied a claimed withholding credit because the withholding has not been properly allocated.

Staff held an interested parties meeting on December 12, 2014. Staff anticipates holding a second interested parties meeting during late 2016.

Regulation Section 19322 – Refund Claim

In 1993, SB 3 added Section 19322 to the R&TC 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 before FTB acts on 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 R&TC Section 19322. Staff held an interested parties meeting on December 3, 2010. Staff anticipates holding a second interested parties meeting in 2016.

Regulation Section 21019 – Liens Filed in Error

FTB is considering the adoption of a new regulation that would authorize and establish specific procedures under which FTB staff could release a lien under the discretionary language in R&TC Section 21019, subdivision (f). That subdivision provides, in pertinent part, that FTB "may release a lien under any circumstances to facilitate the collection of the tax liability or, if that release is in the best interest of the taxpayer and the state, take any action associated with the release of that lien it deems appropriate." Staff anticipates that any such proposed regulation would include provisions under which staff would release such liens with a statement that the released lien should be treated as though it was filed or recorded in error.

This proposed rulemaking action is not intended to address the mandatory release situations described in R&TC Section 21019, subdivisions (c) and (d), relating to liens filed either not in accordance with administrative provisions, or after the taxpayer has entered into an installment payment agreement under R&TC Section 19008.

On December 4, 2013, staff received authorization from the three-member Franchise Tax Board to proceed with an interested parties meeting. Staff held an interested parties meeting on February 14, 2014. Staff received comments. Staff anticipates holding a second interested parties meeting in 2016.

Regulation Section 23663 – Assignment of Credits to Combined Group Members

R&TC Section 23663 permits the assignment of credits among affiliated members of the same combined reporting group. R&TC 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 R&TC 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 R&TC 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. Staff held an interested parties meeting 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. The interested parties meeting also helped 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. Staff held a second interested parties meeting on December 5, 2013, for discussion that would establish default rules regarding the allocation of credits in the case of defective elections under this section. The regulation would also authorize and establish procedures for alternative allocations and corrections for certain defective elections. Staff held a third interested parties meeting on June 12, 2014, to discuss proposed regulations which would define a defective assignment and provide rules for the treatment of defective assignments. Specifically, the draft language would provide default rules for the allocation of credits that are the subject of defective assignments, alternative allocations that are available before first contact, and corrections of errors that are available before the filing of the subsequent year's tax return. These rules provide certainty for taxpayers as to the availability of credits that were the subject of a defective assignment. On December 4, 2014, staff received approval from the three-member Franchise Tax Board to begin the formal regulatory process, as required under the Administrative Procedure Act. Staff anticipates holding a formal regulatory hearing under the Administrative Procedure Act sometime in late 2015.

Regulation Section 24465-3 – 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 R&TC. 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 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 R&TC Section 24465. Staff held a second interested parties meeting on March 29, 2012, to discuss proposed language under subdivision (c) of R&TC 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. As required by Government Code Section 11346.4, staff mailed and published a public notice on June 27, 2014, 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 September 11, 2014. There were no requests made. The final approved regulations were filed by the Office of Administrative Law with the Secretary of State on February 26, 2015, and became operative on April 1, 2015.

Regulation Section 25106.5-6 – Treatment of Net Operating Losses by Single Sales Factor Taxpayers

R&TC Section 25106.5 allows FTB to adopt regulations pertaining to taxpayers whose California-source income is determined by the use of allocation and apportionment. Such taxpayers often generate net operating losses that can be applied in subsequent taxable years, or carried back into previous taxable years, for purposes of determining their California taxable income. The determination of net operating losses in California is currently governed by R&TC Sections 17276.20 and 24416.20. This regulation would provide guidance on how to determine the proper application of net operating loss carryforwards and carrybacks when net operating losses are carried forward and applied in years when the apportionment rules differ from those in effect when the net operating losses were generated, or when losses may be carried back into earlier years with a different apportionment method than the one applicable when a loss was generated.

On July 21, 2015, staff received permission from the three-member Franchise Tax Board to hold an interested parties meeting to address numerous issues identified by staff. Staff anticipates holding an interested parties meeting in late 2015.

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

For taxable years beginning on or after January 1, 2011, R&TC Section 25136 provides the sales factor numerator assignment rules for all sales other than sales of tangible personal property. R&TC 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. Comments were received. Staff held a second interested parties meeting on October 18, 2013, to discuss proposed amendments to the regulation. On July 8, 2014, staff held a third interested parties meeting to discuss issues that were not discussed at the first or second interested parties meetings; primarily a market-based approach for assignment of sales other than sales of tangible personal property to the sales factor. On December 4, 2014, staff received approval from the three-member Franchise Tax Board to begin 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 August 7, 2015, to announce that a public hearing would be held on September 22, 2015.

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

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

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

On November 28, 2007, staff received permission from the three-member Franchise Tax Board to hold an interested parties meeting to address numerous issues identified by staff. Staff held an interested parties meeting on September 19, 2008. On October 18, 2013, staff held a second interested parties meeting to discuss proposed amendments to the regulation. On July 8, 2014, staff held a third interested parties meeting to discuss a discussion draft and get input on any other issues that might need to be addressed. Staff anticipates holding a formal regulatory hearing sometime in 2016.

Regulation Section 25137-10 – Combination of General (Nonfinancial) and Financial Corporations

When unitary combination requires financial entities to be included in a combined reporting group with general corporations, issues arise as to the proper apportionment rules to be applied in order to properly apportion the business income of the group. In 1974 the FTB issued Legal Ruling 370, which addressed the combination of general and financial corporations. The Ruling sets forth a set of rules for combination, and at the end provided:

> It is recognized that the combination of general and financial corporations represents a change in the administrative practice of the department. It is further recognized that the activities of the business community are dynamic and that new forms of organization and new transactional practices and techniques are emerging frequently. The rules set forth above may not in all cases result in a fair representation of the extent of a taxpayer's business activity in this state. Problems of this type are expected to arise particularly in cases where the financial corporation is the dominant factor in the combination. Where such is

> the case, a reasonable treatment shall be devised under Section 25137 of the R&TC. Section 25137, however, will only be invoked in specific cases where unusual fact situations produce incongruous results.

Many years later, FTB issued Regulation Section 25137-10, which now provides a blended apportionment formula when financial and nonfinancial entities are included in a combined report. Unfortunately, the regulation is only applicable in situations where the general corporation is the dominant provider of the income subject to apportionment. This regulation therefore only addresses part of the problem, usually in combined reporting groups where a retailer of tangible goods also has a financing arm, perhaps a credit card company, through which it offers financing to facilitate sales of its products. What remains unclear is what the appropriate apportionment rules should be when the financial entities are the predominant earners of income, but the group also contains general corporations, such as registered broker/dealers.

Staff held an interested parties meeting on December 4, 2014. Staff anticipates holding a second interested parties meeting in early 2016.

Regulation Section 25137-15 – Space Transportation Activities

In the case of certain industries such as air, rail, trucking, and ship transportation, the standard apportionment provisions found in R&TC Sections 25120-25138 of the Uniform Division of Income for Tax Purposes Act (UDITPA) do not set forth appropriate procedures for determining the apportionment factors arising from such activities. In such cases, FTB has promulgated special industry regulations under R&TC Section 25137. Private companies now launch satellites into orbit above the earth and transport supplies to and from the International Space Station. In the near future, these companies anticipate transporting people to and from space as well. Like the other transportation activities mentioned above, the standard apportionment provisions of UDITPA do not set forth appropriate procedures for determining the apportionment factors arising from space transportation activities. Industry has requested that FTB develop a special industry regulation to determine the apportionment factors applicable to income arising from transportation of property and people to and from space.

On March 24, 2015, staff received permission from the three-member Franchise Tax Board to hold an interested parties meeting to address numerous issues identified by staff. Staff held an interested parties meeting on July 9, 2015. Staff anticipates holding a second interested parties meeting in 2016.

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.