Taxpayers' Bill of Rights
Annual Report to the Legislature

STATE OF CALIFORNIA
Franchise Tax Board

2016

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Executive Summary

Times have certainly changed since I began my service as Franchise Tax Board’s (FTB) executive officer over a decade ago.

As technology improves and instant access to information increases, citizens across the state expect and demand more from their government. Any good executive officer knows you have to change with the times. We at FTB use technology to deliver more products and services to our customers.

Although California’s Revenue and Taxation Code (R&TC) guides FTB legally, we make it a priority to interact with and learn from our customers. Improving the customer experience for government enables us to succeed in three ways:

- Compliance
  Customers will file and pay their taxes on time.
- Expansion
  Customers will adopt the new technology we introduce.
- Advocacy
  Customers will speak positively about their FTB experience.

This report and the input I receive from my Advisory Board help us improve the customer experience. The unspoken partnership between the tax professional community and tax administrators flourishes when we engage in open and constructive dialogue. While our relationship with the Advisory Board is sometimes adversarial in its nature, we share a common goal: ensuring that each taxpayer files an accurate tax return and is treated with respect.

The Taxpayers’ Bill of Rights Annual Report to the Legislature is a valuable resource. Not only does this report present an opportunity for us to communicate our plans to improve our level of service, but more importantly it serves as an indicator of the level of collaboration and trust between FTB and our stakeholders.

With this as background, I humbly submit our Taxpayers’ Bill of Rights Annual Report to the Legislature for your review. We take all of the issues raised in this report very seriously and always look for ways to improve our practices. The bottom line is, we are committed to developing new solutions for California’s taxpayers.

Thank you for the service you provide to our mutual customers.

Selvi Stanislaus

Selvi Stanislaus
Executive Officer

Advocate’s Address

Members of the California Legislature:

I submit for your review the 2016 Taxpayers’ Bill of Rights Annual Report to the Legislature. This year has been one of many changes at FTB and I would like to give special acknowledgement to FTB staff for their efforts to continue to assist and provide quality service to California taxpayers during this difficult time of change.

The most notable changes this year were implementation of the internal Taxpayer Folder, Case Management, and the external MyFTB. The internal Taxpayer Folder and Case Management system took the place of aging legacy systems and paper processes to handle taxpayer accounts. The external MyFTB is a web-based portal for taxpayers, businesses, and tax professionals, allowing them to access their account information 24 hours a day, 7 days a week and to complete many transactions online. These were the much anticipated final steps of our five-year information technology (IT) modernization project known as Enterprise Data to Revenue (EDR). Since FTB implemented the Taxpayer Folder and MyFTB, we discovered many benefits and challenges with this new online way of doing business. As Taxpayers’ Rights Advocate, I have watched the progress closely and helped the department by providing feedback from taxpayers and tax professionals about their customer experiences with the new systems.

While taxpayers and practitioners have reported many things that they like about the new MyFTB, there have also been significant challenges; some of these challenges were anticipated, while others were not. One of the most difficult challenges with the new system has been finding an acceptable balance between quick and easy access for MyFTB users and providing security for taxpayer data. MyFTB users who experienced difficulties and those who couldn’t resolve their tax issues by using MyFTB needed to call us. Additionally, less than five percent of all taxpayers signed up for a MyFTB account in the first year. These issues combined with withholding errors and an increase in notices sent out, led FTB to see an increase in call volumes during this past filing season. As the Advocate, I understand tax issues can be complicated and the need to speak to a live person can be essential in getting an issue resolved. This is especially true for unrepresented taxpayers who may not understand why they received a notice from us and how best to resolve it. Additionally many taxpayers are unable to resolve their issues in an online environment.

As was the case last year, customer service is once again one of my focus areas. I am pleased to report the department is also focused on improving the customer’s experience when interacting with FTB. This will help us better understand how customers perceive their communications with FTB so areas of improvement can be identified.

Another area of concern for me over the past year has been the need to properly balance our revenue goals with the Taxpayers’ Bill of Rights so that we are careful not to increase taxpayer burden. It is equally important as we focus on revenue that we take steps to move taxpayers into voluntary compliance which is not only less expensive, but also more efficient and less intrusive. As director of the department’s Education and Outreach program, each year my staff and I participate in the following events which promote voluntary compliance by providing education on existing tax laws:

- Tax professional seminars
- Industry conferences
- Small business events

Our publication, *Tax News*, reaches over 26,000 tax professionals and business owners informing them about state income tax laws, regulations, policies, procedures, and events that affect taxpayers and the tax practitioner community. Our Education and Outreach program is instrumental in helping us to identify the needs of the taxpayer and tax professional so that together we can minimize taxpayer burden and the hurdles that taxpayers face in complying with our complex tax system.

MyFTB/POA

One of the new features changing the way taxpayers and representatives conduct business with FTB is the ability to submit and approve a Power of Attorney Declaration (POA) online using the new MyFTB. During the fiscal year (FY) 2015/2016 FTB processed just over 160,000 POAs, with nearly 20,000 of these submitted through MyFTB.

When a tax professional submits a POA online through MyFTB, the client will either log into their own MyFTB account and approve the POA or sign a paper copy. The POA can then be uploaded for FTB to verify and process. FTB provided information to taxpayers and tax professionals about the benefits of approving an uploaded POA online through the taxpayer's MyFTB account. Unfortunately, less than one percent of POAs submitted by representatives have been approved by clients online using their own MyFTB account. Nearly all POAs submitted by tax professionals using the online system included an uploaded, signed POA (i.e., a scanned image of the POA).

When first implementing this tool there was a high rejection rate for POAs submitted through MyFTB. Reasons for the rejections included:

- The information provided through MyFTB did not match the attached POA Declaration.
- The POA Declaration was not signed.

The online process has since improved due to a combination of education and outreach to the tax professional community and systems enhancements. These enhancements allow for additional editing/verification steps to be taken before a POA is rejected.

Representatives voiced concerns about the length of time it takes for us to process POAs. Our current expected processing time frames for POAs submitted through MyFTB take up to 30 business days. Paper (faxed/mailed) POAs take 90 business days or more, unless an appropriate exception is noted on the form. In June 2016, FTB mailed letters to taxpayers and representatives filing paper declarations (those expecting to wait 90 days or more for processing) informing them about our alternate methods for faster processing.

In addition, in an effort to combat identity theft, FTB incorporated a 10 business day hold advising the taxpayer a POA has been filed for them by the primary representative listed on the POA. This hold is in addition to the processing time frames. While this is an added layer of protection for taxpayers, tax professionals do not have access to their client's account during this time frame.

The majority of contacts between FTB and tax representatives can be quickly resolved if the representative has a copy of the notice or letter we sent and sufficient client information to allow us to establish the tax professional/client relationship. However, many tax professionals reported to the Advocate's office that they were being told they would need to wait 30 days for the POA to be processed before customer service staff would help them.

FTB has taken a number of steps to improve the POA process, including increasing staffing levels for POA processing, beginning with FY 2016/2017. In addition, a formal team has been organized to review the current POA system and identify improvements to facilitate easier and increased use by representatives. FTB, along with the Advocate's office, is also working with practitioner groups to educate them on how to use the online technology; however, a "one size fits all" approach to training doesn't always work due to varying comfort levels in adopting new technology. Perhaps more importantly, we continue to educate internal FTB staff that establishing a tax professional/client relationship allows for continuous communication between FTB and representatives on represented matters (regardless of whether a POA declaration has been submitted or where it is in processing).

One final area I would like to discuss regarding MyFTB, which makes substantially more taxpayer information available online, is making sure unauthorized tax professionals do not gain access to confidential information and taxpayer data. One of FTB's most difficult challenges with the new system has been finding an acceptable balance between quick and easy access for MyFTB users and providing security for taxpayer data. As a result, we have had to make modifications such as incorporating delays in both the registration process for all users and in allowing representatives to view clients' information. The registration delay is necessary to verify the user's identity by sending a PIN number to the address of record, which must be used to complete the registration process. Similar to the processing steps for a POA, we have added a 10 business day hold before allowing tax professionals access to client information. This hold allows the taxpayer time to acknowledge the client/representative relationship. The hold has resulted in tax professionals commenting that it makes MyFTB less useable in their business if they need information in real-time or they have a short deadline to respond to a notice, especially during filing season.

Finally, I applaud FTB for taking the steps necessary to engage the tax professional community for ideas about how we can work together to make MyFTB more user friendly and secure for taxpayers.

Customer Service

Customer service continues to remain one of my top concerns as Advocate and also one of the top concerns of the department. Again this year, our customer service levels of access (LOA) and response times in FTB's largest contact centers were simply unacceptable. This year in particular, FTB had a much higher volume of customer contacts due to an increase in letters and notices being sent. I am concerned that FTB has not fully managed the impact outgoing mail has on customer service channels. However, I am optimistic that the Enterprise Notice Council formed to manage the impact will now oversee and manage mail volume sent department-wide and the LOA needed to support the contacts they generate. FTB has also taken steps to improve customer service by requesting additional resources, starting with FY 2016/2017.

For FY 2015/2016, there were over 2.2 million more mailings, which include notices, sent out than in FY 2014/2015. Of this increase, 2.1 million mailings were sent during the months January through May, our peak call season. This increased calls to our various call centers during our busiest times when taxpayers are trying to get information to file current year tax returns. As a result, the increase in calls significantly affected the LOA. The increase in mail was in part due to our new MyFTB system automating many of our processes.

During FY 2015/2016, the Filing Division received over 2.2 million personal income tax (PIT) telephone calls (an increase of 200,000 calls from last year). Approximately half the calls, 1.1 million, were not answered. The average wait time was almost 16 minutes and the LOA was only 47 percent for taxpayers. Tax professionals had a longer average wait time of 18 minutes, but had a much higher LOA at 73 percent. The wait times increased from last year and the LOA was slightly lower as well. My concern continues to be that FTB does not have the staff and resources to respond to the volume of phone calls and correspondence received, especially during filing season. The majority of taxpayers who call us or send in correspondence are trying to resolve their account issues, file a tax return, or locate their refund. As a result, taxpayers are unable to resolve their tax liabilities in a timely manner, taxpayer burden is increased, and revenue collected is impacted.

Public Service Contact Centers						
Division	**Call Type**	**Calls Offered**	**Calls Answered**	**% Answered (LOA)**	**Calls Not Answered**	**% Not Answered**
Filing	PIT	2,081,732	958,344	46.0	1,123.388	54.0
Practitioner Hotline	PIT	139,255	101,699	73.0	37,556	27.0
TOTAL PIT		**2,220,987**	**1,060,043**	**47.7**	**1,160,944**	**52.3**
Filing	BE*	482,729	219,682	45.5	263,047	54.5
Practitioner Hotline	BE	106,353	78,603	73.9	27,750	26.1
TOTAL BE		**589,082**	**298,285**	**50.6**	**290,797**	**49.4**

*Business entity

FTB does have other customer service options for taxpayers, including Live Chat. In January of 2016, with the roll out of the new MyFTB, FTB expanded this service to include Secure Chat. Secure Chat allows tax professionals and taxpayers to speak with FTB customer service agents about confidential taxpayer account information. In FY 2014/2015, the Filing Division had a better than 95 percent LOA for PIT and BE. However, in FY 2015/2016, the Live Chat LOA percentages decreased by more than 20 percent as more taxpayers used this option to communicate with us.

FTB has taken steps to improve customer services, including adding additional resources starting in FY 2016/2017 to handle the growing demand for live customer service options. Care needs to be taken to continue to monitor the burden placed upon FTB staff to continue to handle a greater number of phone calls and keep up with the number of customer contacts as new service options are developed.

Collections

Our accounts receivable (AR) inventory for 2016 totaled $8.7 billion, a 10 percent increase from 2015. The reasons for the increase in the AR balance vary. Part of the increase is due to revenue acceleration activity in December 2015, when over 100,000 filing enforcement (FE) demand notices previously set not to go out until June 2016 were sent to taxpayers. Another acceleration happened towards the end of this FY due to the early release of billing notices for self-assessed tax returns, causing these accounts to enter into the collection cycle sooner than in previous FYs. In addition, as I mentioned in the customer service section, FTB sent 2.2 million more mailings this FY than last. Not only did the number of notices increase, but the dollar value did as well. For example, the value of Statement of Tax Due notices generated from audit, filing, and self-assessed tax returns increased by $981 million (25 percent) from FY 2014/2015.

As expected, with an increase in the AR inventory, we saw the number of taxpayers entering into installment agreements (IAs) increase by 10 percent from July 2015 to July 2016. The AR balance associated with the IAs increased by 12 percent during the same period. At the end of FY 2015/2016, there were 187,235 taxpayers in IAs. This year, I am very concerned about taxpayers' ability to pay their debts in full and whether FTB is able to handle the call volumes that a 10 percent increase in AR inventory will produce.

Accounts Receivable Management Division – Call Center Customer Service

The Collection call centers were affected this FY as well. For FY 2015/2016, FTB Collections received approximately 1.6 million PIT calls (an increase of 400,000 calls from last year). The average LOA was 61 percent for PIT collections, resulting in 39 percent of the calls (nearly 618,000) not answered. For business entity (BE) calls the

LOA was 59 percent, leaving 41 percent of calls (just over 107,000) not answered. Many taxpayers simply hung up while others called other numbers, including Executive and Advocate Services (EAS) hoping to talk to a live person. As Advocate, I am concerned that taxpayers who are struggling with notices and involuntary collection actions are not able to get through to the department. It is critical to provide the appropriate level of customer service assistance to taxpayers to ensure they get answers and be compliant. Our critical customer service efforts help resolve accounts before they reach the more costly involuntary collection cycle.

Some taxpayers chose to use FTB's Live Chat options. PIT Live Chat had over 18,000 chats with an LOA of 97 percent. For BE Live Chat there were more than 8,000 chats with an LOA of nearly 100 percent. As more taxpayers choose to use the Live Chat option to communicate, FTB will need to keep pace to ensure the LOA remains high.

Collections offers taxpayers the option to take a customer satisfaction survey at the end of their call. On average, the Accounts Receivable Management (ARM) PIT call center received more than 63,000 calls and approximately 1.5 percent of the callers opted to take the customer satisfaction surveys. Of those that completed the entire survey, 81 percent indicated they were very satisfied with the quality of service. This is a good indicator that when the taxpayers get through to a live representative they are satisfied with the quality of service that they receive. The key moving forward for FTB Collections is to find ways to improve call center access to taxpayers, especially during filing season.

Tax Liens

The downward trend of reduced lien filings ended with 120,071 liens filed last fiscal year. This number represents an increase of six percent over the prior FY. The increase in the number of liens filed is most likely attributed to the accounts moved to discharge and the increase/acceleration in billing notices. In addition to an increase in the number of liens filed, we also identified that fewer liens were released, and fewer liens were released as filed in error. The number of liens filed below the $2,000 threshold also decreased 62 percent over last fiscal year.

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
2015/2016	120,071	6	89,967	75	10,946	9.1

Annual Notice

As I discussed last year, FTB has an important statutory duty to provide individual and business entity taxpayers with an annual notice letting them know:

- Our records indicate they have a balance due.
- How they can make a payment.
- To call if they are unable to pay in full.

However, the current version of the annual notice does not inform taxpayers of their options to enter into an installment agreement, a provisional payment plan, or an offer in compromise (OIC). Annual notices are also 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 OIC, we may be able to collect a partial balance that FTB would not otherwise collect and allow these entities to revive so they can dissolve. Currently, many taxpayers and owners simply "walk away" from the entity while year after year FTB assesses another $800 minimum tax that FTB will likely never collect.

For FY 2015/2016, out of 717 total applications for business entities to enter into an OIC, only 495 OIC applications were accepted. We estimated that 30 percent of these applications were for business entities that never actually conducted any business. This is a 19 percent decrease from the number of applications accepted in FY 2014/2015. Adding OIC information to the annual notice may increase the number of business entities choosing this option instead of just "walking away."

While I am still hopeful that legislation will allow for administrative dissolution of these business entities in certain cases, I believe that increasing the information FTB provides in the annual notice will help taxpayers comply. Providing more information will also help FTB collect what would otherwise be uncollectable. I continue to recommend that FTB add additional information to the annual notices, while my staff continues our efforts to increase education and outreach to improve self-compliance.

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 the proactive approach of education before compliance. However, education and outreach isn't limited to just improving compliance. It is also vital in getting information to taxpayers and tax professionals about new laws and programs administered by FTB. FTB's approach on providing educational information and materials in the rollout of MyFTB was key to the transition for both taxpayers and tax professionals. Additionally, FTB's comprehensive efforts to inform taxpayers and tax professionals about the first-ever California Earned Income Tax Credit (Cal EITC) were crucial to its success.

As part of our rollout of MyFTB, we had a major marketing campaign across many channels to reach end users. Our outreach efforts included:

- Webinars with tax professional groups.
- YouTube videos.
- Articles in *Tax News* and other news publications.
- Live presentations and training.
- Information on our website.

We developed logos, printed informational handouts and brochures, and partnered closely with trade media. For the new Cal EITC, our efforts informing taxpayers and tax professionals were similar but also included:

- Partnering with the State's Interagency Workgroup for Reducing Poverty.
- Producing multilingual presentations, posters, flyers, and public service announcements.

By all accounts FTB's efforts were exceptional. During the first year of Cal EITC, 377,000 claims were allowed and nearly $200 million dollars were refunded to California's working families and individuals.

On an ongoing basis, my education and outreach staff responded to over 1,600 inquiries this year from taxpayers and tax professionals for general tax and business-related filing requirements. FTB also participated in approximately 150 live presentations for FY 2015/2016, the majority of which included information about the new MyFTB and Cal EITC. We were also invited to speak about the Cal EITC at several Legislative members' events. In addition, we are expanding our partnerships with tax professional groups to provide content for webinars and other online education. For FY 2016/2017, FTB expects to have at least the same amount of events and will continue to include Cal EITC events. The positive response FTB receives at the various events we attend is valuable and reinforces the need for us to continue to participate in these presentations and other similar events.

Our monthly online publication, *Tax News*, informs tax professionals about important changes in state income tax laws, regulations, policies, and procedures. We know that *Tax News* is important and valued by its readers, having doubled our subscribership this year to just over 26,000 tax professionals. This increase in subscribership wouldn't have been possible if we didn't have relevant, timely, and informative content. Our *Tax News* content is often reposted by other trade media publications. Notably, FTB received an Award of Excellence from APEX, Communication Concepts Award Publication for Excellence recognizing *Tax News*. In the coming year, we plan to increase our outreach by including content relevant to tax professionals in other states with clients that have California tax obligations. We will also continue to use social media like Twitter and Facebook and produce short videos in our *Tax News* Live series. Early in the year, FTB produced the Taxpayers' Rights Advocate video that summarized how the Advocate can help taxpayers. Most recently we released our latest video, *How to Close a Business Entity*, outlining the crucial steps to close an entity.

Filing Enforcement

Our FE program works to locate taxpayers who have an obligation to file a tax return, but fail to do so. This effort needs to be accomplished in a way that is not intrusive. Consequently, FTB must strike a balance between our enforcement efforts and the burden placed upon taxpayers who receive an FE letter or an assessment for a tax amount that ends up being incorrect. To the extent we can refine our processes to limit unnecessary contacts, FTB will reduce taxpayer burden.

Last year, I mentioned that I was concerned about the increasing number of FE notices going out-of-state and the difficulties those individuals and business entities can have with understanding California's tax laws. I am pleased to report that this year the Advocate's office has noticed a decrease in the number of out-of-state contacts from previous years. Also, I collaborated with the Filing Enforcement program to identify additional education options and strategies for use in the Voluntary Disclosure Program (VDP) to educate before compliance. This program has the potential to help out-of-state business entities become compliant if they are required to file with California.

I am also encouraged to know that we are making efforts with refinements to our FE models and we are able to reduce the number of unnecessary contacts. In the past, the Advocate's office has been concerned with the number of FEs going to bad addresses. While steps were taken in previous years to reduce the number of filing enforcements going to a bad address, the Advocate's office continues to hear concerns from taxpayers who have moved from California and receive FE notices sent to their last known California address from occupational licenses. In February 2016, FTB employed a new tool called "Best Address." As the title implies, it searches for the best address for the taxpayer; this can be a mutual benefit to both taxpayer and FTB. 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 FE notice could result in an erroneous balance due.

Penalties

As I reported last year, penalties are an important and necessary part of voluntary tax compliance. Penalties can encourage taxpayers to timely file their tax returns, provide information, and make estimated payments as required under the R&TC. However, I want to address that penalties can also discourage taxpayers who have missed a deadline from filing a tax return or making estimated payments. Penalties can also create personal liability for the tax professional or withholding agent. Therefore, penalties must be reasonable and their amounts reflective of the seriousness and intent of the error or omission, as provided under the law.

FTB administers California's R&TC. Although, it cannot be selective upon which laws it administers; where there is an appearance of unfairness, FTB must suggest and take actions to improve consistency and decrease taxpayer burden. I support the efforts already made and the continued efforts to train our staff and educate taxpayers about:

- California's sophisticated rules on filing requirements.
- Expanded interpretation of the reasonable cause exception as it applies to taxpayers who may not know they have a filing requirement.
- Legislation such as expansion of the VDP.

I also strongly encourage the Legislature to consider first-time penalty abatement, in conformity with the IRS, to ease the burden for those who are struggling to understand our complex tax system or who simply made an honest mistake. I am also pleased to report that our Legislative Services Bureau plans to work with the Advocate's office to prepare a comprehensive penalty and interest study review to determine potential recommendations for legislative changes.

Taxpayers’ Rights Advocate Contact Information

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To get this publication, go to **ftb.ca.gov** and select the **Taxpayer Advocate** link at the bottom of the page 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 $10,000.

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 department procedure updates as well as discussion about strategic plan and security, fraud, and identity theft.

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, taxpayer assistance information, and two new programs-MyFTB Online Service and Cal EITC. Cal EITC is a new refundable tax credit that puts money back in the pockets of eligible working families and individuals.

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 and 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 50,000 contacts in FY 2015/2016. Over 80 percent of taxpayers contacted us by telephone. We provide taxpayers a public number (800.883.5910) to contact us through our Advocate Hotline.

We received approximately 9,000 pieces of correspondence (letters, faxes, and emails) during this reporting period. Taxpayers often chose to email the Taxpayers' Rights Advocate when they were unable to successfully 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 2015/2016 include:

- Filing enforcements (FE)
- Wage garnishments
- Bank levies
- Liens
- Installment agreements

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

Filing Enforcements

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

Wage Garnishments and Bank Levies

We determined why garnishments or bank levies were issued and provided explanations to taxpayers. We determined if there were hardships, and we modified or released orders as appropriate.

Liens

We reviewed accounts to determine the validity of liens and responded appropriately, which may have included confirming or releasing liens.

Installment Agreements

We allowed, modified, reset, or denied installment agreements as appropriate.

With the exception of FE contacts, we may conduct independent administrative reviews when requested and appropriate.

Equity Relief

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

- Extended and made permanent the Taxpayers' Rights Advocate (in coordination with Chief Counsel of the Board) 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.

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 2015/2016, we received 449 issues through SIMS. Of the issues submitted, we identified 6 as possible systemic issues and forwarded to program areas for research and resolution.

Identify Areas of Noncompliance

Audit Process Sample Data

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

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

We collected assessment information from the Personal Income Tax (PIT) Notice of Proposed Assessment (NPA) display file for assessments that became final in FY 2015/2016. 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 NPAs 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 (Table 1A).

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 finance, insurance, real estate, and holding companies (FIRE) industry (Table 2).

For personal income taxes, the largest dollar amount in proposed assessments resulted from filing enforcement (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 (Table 1B).

We issue a separate NPA to the taxpayer for each tax year included in an audit adjustment. Individuals typically have audit changes for just one tax year. Eighty-eight percent of the individuals who received NPAs during FY 2015/2016 had audit changes for a single tax year (Table 4).

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.

Taxpayer Filing Errors

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

We compiled taxpayer error information on approximately 16.6 million current year tax returns processed between July 1, 2015, and June 30, 2016. During this time, FTB made approximately 330,000 adjustments and issued just over 340,000 *Notices of Tax Return Change (NTRC)* to taxpayers who filed tax returns with errors that resulted in a change of tax liability. This figure equates to approximately 2 percent of tax returns. We explain the errors in the notices. 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 (54 percent) of the adjustments we made were on paper-filed tax returns, even though only 14 percent of total current year tax returns were paper-filed. Adjustments on electronically filed tax returns (94 percent of total current year tax returns) accounted for the remaining 46 percent.

The most common taxpayer error, for all filing methods, was to claim the wrong amount of estimated tax credits. Of all current year NTRCs, 34 percent contain an Estimate Payment Credit adjustment, up from 31 percent in FY 2013/2014. 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

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 2015/2016, the Taxpayer Services Center (public number 800.852.5711 and hotline number 916.845.7057) answered over 1.1 million incoming calls. We continue to use technology to maximize and increase the options for taxpayers to self-serve. The new MyFTB and authenticated live chat services should enable more taxpayers to get the information they need without having to call us. These new services should allow for more staff availability to address important questions and concerns. In addition, in FY2016/2017 new staff positions were allocated to the department through the spring finance letter. These positions will allow call center staff to achieve customer service performance targets.

During FY 2015/2016, the Accounts Receivable Management (ARM) Division held their service to customers at 66 percent. ARM used technologies, such as Virtual Hold and modified additional queue configuration, to maintain our level of access service to our customers. Overall, ARM staff answered 1.5 million, or 66 percent, of calls.

Response to Correspondence Time Frames

In FY 2015/2016, we processed over 160,000 pieces of general correspondence. We expanded enterprise partnerships and increased efficiencies and effectiveness to maximize production. These efforts helped us improve our customer response times by several months. In addition, we increased staffing positions for FY 2016/2017, which will help eliminate backlogs and maintain reasonable inventory volumes within the new 90-day time frame for general correspondence.

Education and Outreach

We continuously look for ways to improve and increase our education and outreach efforts. Our use of social media tools, such as Twitter, Facebook, and YouTube, allow us to maximize our ability to reach taxpayers, operate more efficiently, and publicize information about California and federal tax law. We also participated in various webinars that provided important information to help taxpayers comply with California tax laws. 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 Governor's Office of Business and Economic Development (GO-Biz) and the California Secretary of State on the Business Dissolution/Cancellation Process Analysis Team. This team was initiated to study the entity dissolution/cancellation process and provide recommendations to improve it. The recommendations provided in this analysis were made with the goal of making the process easier for business entities to understand and achieve better compliance and expand the joint education and outreach effort between state agencies. 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. The main idea we want to convey is that we are here to help.

e-Services

We continue to enhance and develop our online services to:

- Reduce taxpayer burden.
- Increase access to information.
- Make filing and paying taxes easier.
- Improve the timeliness and accuracy of tax returns.

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.

CalFile is easy to use and has many convenient features such as the ability to save a partially completed tax return and come back later to finish. Another feature is the ability to import information from FTB's accounting system into the tax return (e.g., address, wages, estimated tax payments made, etc.). Taxpayers can also request an email confirming their tax return was filed.

CalFile allows the filing of not only the current tax year, but also the previous two tax year tax returns.

In 2016, approximately 153,000 taxpayers filed their current tax year (2015) tax return, approximately 8,000 filed a (2014) tax return, and approximately 3,000 more filed their 2013 tax 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 gives individual taxpayers and authorized tax professionals access to the taxpayer's:

- Estimated tax payment information.
- Recent payments made.
- Total balance due on the account.
- California wage and withholding information.
- FTB-issued 1099-G and 1099-INT information.

Taxpayers can use MyFTB to update their address and telephone number as well as access additional services such as CalFile and Web Pay.

We significantly enhanced MyFTB in January 2016 to provide additional information to taxpayers and tax professionals, as well as provide additional online features. New features include allowing taxpayers to:

- View notices online.
- Opt to receive electronic notification of notices instead of receiving a paper notice.
- Chat securely with an agent about their account.
- Upload correspondence.

We made these features available to individual taxpayers, business taxpayers, and authorized tax professionals.

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 essential training regarding:

- Tax law.
- Taxpayers' Bill of Rights.
- Account analysis and resolution.
- Security and disclosure.
- Negotiations.
- Customer service.
- Filing requirements.
- Legal actions.
- Financial statements.

To ensure all collection staff have the required skills and abilities to administer tax laws, FTB provides a rigorous eight- 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 Accounts Receivable Management Division (ARMD) developed a new advanced training class: *Heavy Workloads versus Time Management*. ARMD is currently developing another course, *Making the Proper Decisions and*

Conclusions. In addition, we are revising existing classes to accommodate new business methods. ARMD also provided 15 additional training classes to collection staff on advanced collection techniques, Earnings Withholding Order for Taxes (EWOT), and Continuous Order to Withhold (COTW) Noncompliance.

FTB invites subject matter experts to serve as mentors and coaches, training consultants, and/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 six-week basic professional auditor training series was established to give auditors baseline expertise in the following areas:

- Organizational mission and values.
- 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 certified licensing and 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

Filing Enforcement (FE) program educates, contacts, and requests tax returns from 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.

As a result of the EDR Project, FE upgraded its efficiency in choosing the best cases for individual and business entity nonfiler contacts to further advance the goal of taxpayer compliance. FE continues to make better use of data that we already have to perfect cases and reduce unnecessary contacts. In addition, a PIT and BE 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 program 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.
- Retrieve information that can assist in filing a tax return.
- Learn about payment options.
- Access their MyFTB account.
- 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, underpay, or to not file their tax 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 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 Collections

Outsourcing collection accounts provides us 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. We routinely evaluate the effectiveness of outsourcing accounts receivables. In 2016, FTB temporarily suspended the procurement process for a new private collection agency 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 2015/2016, 253,000 total installment agreements were set up, and nearly 22,000 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. Since implementation in December 2009 through June 30, 2016, 114,097 tax returns have been filed and over $126 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 suspected of committing income tax crimes or crimes against FTB. In the course of investigating suspected violations, special agents gather evidence, interview witnesses, interrogate suspects, and plan and effect search and arrest warrants. Special agents work cooperatively with FTB's Audit, Collections, and Fraud programs, as well as other local, state, and federal law enforcement agencies. Once criminal charges are filed, special agents:

- Serve as expert witnesses.
- Assist prosecuting attorneys in the preparation and prosecution of their cases.
- Ensure appropriate media coverage is obtained in accordance with the department's Public Affairs Office.

For FY 2015/2016, criminal investigations activities resulted in:

- 44 new cases.
- 19 individuals arrested.
- 13 search warrants executed at 39 locations.
- 13 new cases approved for prosecution.
- 20 guilty pleas entered.
- 1 guilty verdict from trials.
- 707 months incarceration and 528 probation months sentenced.
- 54 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.

The Multilingual Communications program achieved several milestones this year, increasing the number of non-English products and services, conducting outreach to the non-English speaking community, and updating our Spanish web pages.

We provided vital services as part of implementing the new Cal EITC. We translated the new Cal EITC form into Spanish as well as marketing materials, social media messages, telephone assistance scripts, and direct mailers. We created and maintained the public Spanish webpage with important information about the program. Cal EITC brochures in Spanish were sent with tax booklets to over 700 public distribution sites.

We continue to partner with other California state agencies and programs to educate taxpayers on the requirements to file and pay state income taxes as well as resources for filing services. We attended the 37th Annual Migrant Parent Conference with nearly 900 participants. We provided educational materials in Spanish including Cal EITC and Volunteer Income Tax Assistance (VITA) brochures. We demonstrated how to access Spanish information and materials on our public website by the use of laptops and mobile devices and answered general tax questions.

We increased the number of Spanish language products and services this year. We translated the new Head of Household Schedule and Identity Theft Affidavit. We created new Spanish language web content including:

- A page to request to skip an installment agreement payment.
- A survey to provide feedback about webpages.

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

For persons with disabilities, we provide access to our programs, services, and facilities in accordance with Title II of the Americans with Disabilities Act of 1990. At the taxpayer's request, we provide reasonable accommodations in alternative format, including 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 webinars, and provide public service announcements to educate taxpayers. We regularly 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 26,000 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 tax 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:

Conformity Act of 2015

California Revenue and Tax Code adopted conformity to the Internal Revenue Code as of January 1, 2015.

Net Operating Loss

California generally conforms to the federal net operating loss (NOL) rules that allow corporations expecting an NOL carryback to extend the time for payment of taxes for the preceding taxable year.

Taxpayer Advocate Relief

The Taxpayers' Rights Advocate, in coordination with the Chief Counsel and with concurrence of the Board's executive officer, may grant relief from tax, penalty, and interest caused by erroneous actions or inactions by FTB, when no other relief is available (limited to $10,000). The taxpayer must not have significantly caused the error or delay.

Nonprofit Corporation Administrative Dissolution/Surrender

Allows FTB to administratively dissolve or surrender a nonprofit corporation, if the nonprofit corporation's corporate powers are suspended or forfeited by FTB and have been suspended or forfeited for a specified period of time. The nonprofit corporation may file a written objection to the administrative dissolution or administrative surrender and is allowed an additional 90 days to revive. An additional feature allows for a short-form dissolution if the nonprofit was less than two years old. The nonprofit corporation may qualify for abatement of minimum tax, penalty, and interest.

California Earned Income Tax Credit

In 2015 California allowed a refundable credit to working families, similar to the federal EITC. The credit ranges from $214 to $2,653 for incomes from $6,580 to $13,870. Taxpayers must meet the following requirements to qualify for the credit:

- Lived in California for more than half the year.
- Earned income subject to wage withholding.
- Received less than $3,400 in investment 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 helps 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 and 2017 tax years.

Donors must request an allocation of the credit from the California Educational Facilities Authority before they make the donation.

Losses – Declaration of Disaster by Governor

Beginning on or after January 1, 2014, and before January 1, 2024, the Governor of California may declare areas of disaster in a state of emergency. Taxpayers may elect to claim losses under the provisions relating to disaster losses under IRC 165 (i). Net operating loss carryback/forward rules apply.

Voluntary Contributions

Voluntary Contribution Funds include State Children's Trust Fund for the Prevention of Child Abuse, California Sea Otter Fund, and Prevention of Animal Homelessness & Cruelty Fund.

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 almost 4.5 million hours of hold time since implementation and over 1.2 million hours during FY 2015/2016. When offered the option, 76 percent of the callers chose to have a call back. We successfully connected with 86 percent of the callers.

California Tax Information

In an effort to provide one-stop service for California taxpayers, FTB 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.

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 use our *Tax News Flashes* for only the most time-sensitive, vital information. 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.

Through a marketing effort, we doubled subscribership to 26,000 tax professionals. We plan to increase our subscribership by reaching out to tax professionals in other states with clients that have California tax obligations. We continue to produce short videos in our *Tax News Live* series. Early in the year, we produced the Taxpayers' Rights Advocate video that summarized how the Advocate can help taxpayers. The latest video, *How to Close a Business Entity*, outlines the crucial steps to close an entity. *Tax News* continues to experience positive feedback, our subscription base continues to increase, and trade media publications repost and quote our articles. Also, we received an Award of Excellence from APEX, Communication Concepts

Awards for Publication Excellence.

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, or are in the process of updating, 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 1123 - *Forms of Ownership*
- 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 1,600 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

The 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 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 to the U.S. Armed Forces personnel in the manner of training, support for California tax law questions, and military VITA sites throughout California.

Department Initiatives and Projects

Key Initiatives for 2016

Compliance Action Committee (CAC) Initiatives

The CAC explored opportunities to improve data, information, and knowledge sharing with the tax community and government partners. The CAC helps identify noncompliant taxpayer segments and customize our actions to improve compliance.

Medical Marijuana Project Planning

FTB now has a landing page at **ftb.ca.gov** with information about medical marijuana provisions to help taxpayers comply with income tax filings and payments. A departmental team will discuss proactive measures to prepare for the potential legalization of marijuana and what that means for income tax filings, payments, and enforcement.

Joint Enforcement Strike Force Collaboration

In partnership with FTB compliance and investigations programs, the CAC collaborated with EDD to learn more about their role with the Joint Enforcement Strike Force (JESF). The collaboration effort will also explore how our tax gap/compliance efforts could benefit from their enforcement related information.

Market-Based Rule Project

In collaboration with the Audit program, the committee is examining market-based sourcing. This project seeks to identify multistate businesses that may now have a filing requirement, or may have increased source income based on the changes made by Proposition 39 and the single-sales factor.

Federal Employer Wage Reporting

To help improve filing compliance, the CAC is partnering with the Federation of Tax Administrators (FTA). This initiative aims to provide California, and other states, with detailed wage and withholding information for individual employees from all federal employers.

ID Theft and Refund Fraud Program

We established an Enterprise ID Theft (IDT) committee to address enterprise-wide policies and practices that relate to FTB's IDT program. In collaboration with FTB compliance programs, the committee provided support that increased FTB's ability to identify fraudulent refund claims and prevent the issuance of erroneous refunds when a false claim is the result of identity theft.

Modernize Our Tax Systems

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

The EDR Project brought us new technology that we 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 gave 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 included 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) automated manual processes, enhanced 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, and filing a Power of Attorney Declaration or a Nonresident Withhold Waiver online. MyFTB is located at **ftb.ca.gov**.
4. Updated legacy systems. We updated our legacy systems so they will operate with the new processing applications, the data warehouse, and the enhanced MyFTB.

The EDR Project Schedule

The EDR Project was a four and a half year project, completed on time! The project was divided into three major design stages, each of which included various major and minor releases.

We separated each design stage and release to allow us to slowly implement the project in well-defined increments, in which each release built upon the previous release. Additionally, the project had a six-month stabilization period after each major release to ensure the solution was functioning correctly and stabilized over a period of time before we implemented the next release.

The project schedule was designed to have all project deliverables in place prior to the final year of the project. This schedule allowed 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

The EDR Project was on schedule, within budget, and exceeded revenue targets.

The EDR Project kicked-off in July 2011 and had three implementation phases. We fully implemented all three phases as of December 31, 2015.

EDR Project Revenue

Fiscal Year	Target Amount: Millions	Actual Amount: Millions	% of Target
2011/12	$ 35.0	$ 75.8	216
2012/13	$ 148.4	$ 304.5	205
2013/14	$ 260.3	$ 560.3	215
2014/15	$ 684.6	$ 744.0	109
2015/16	$ 1,146.0	$ 952.3	83

EDR has achieved $2.8 billion in total revenue and revenue will continue to increase during the project's lifespan. Starting in 2016, we foresee revenue benefits leveling out to approximately $1 billion annually. 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.

What Did the Project Deliver?

1. Improved Data Availability
   - 5000 additional data elements captured on tax returns using imaging technology.
   - Images of all PIT and BE tax returns available for FTB staff.
   - Enterprise data warehouse and data marts.
   - Improved data matching so tax returns, tax payments and third party data (W-2s, 1099s, etc.) get associated to the correct taxpayer.
2. Improved Data Analytics
   - Enterprise modeling data mart.
   - Improved modeling tools and expertise.
   - Predictive models for collections, audit, refund, fraud, and filing enforcement.
3. Improved Business Processes
   - 100 percent digital office.
   - Correspondence imaged and worked in digital cases.
   - Implementation of the Taxpayer Folder which provides an enterprise view of the taxpayer for 4000 FTB employees in 13 locations.
   - PIT return analysis with 350 new rules for processing tax returns.
   - Improved processes for obtaining new addresses for taxpayers.
   - Extended use of case management technology to streamline business processes.
4. Improved Self-Service for Taxpayers and Tax Professionals
   - Enhanced our previous application to add new services, information, and ways to communicate with FTB for:
     - Individuals
     - Businesses
     - Tax Representatives
   - Includes viewing tax returns, power of attorney functionality, protest online, Live Chat for confidential information, etc.
   - IVR functionality for setting up installment agreement.
5. Improved Legacy Systems
   - Real time validation of business tax returns.
   - Improved accounting and audit notices for taxpayers.
   - Improved enforcement tools for collection staff.

Projects

Live Chat

In 2011, FTB launched Live Chat as a fast and efficient way for the public to ask FTB representatives nonconfidential PIT and BE tax questions, find a form or publication, and to get help with our website. In January 2016, FTB introduced Authenticated Live Chat as a companion to our general Live Chat service. By establishing their identity through creation of a MyFTB account on the FTB website, customers have access to the Authenticated Live Chat service option. These customers, both taxpayers and tax representatives, are now able to securely chat with FTB regarding account-specific matters, offering a modern alternative to resolving account matters by phone or correspondence.

In FY 2015/2016, FTB experienced an 80 percent access rate overall for both authenticated and nonauthenticated chat, responding to over 145,000 contacts. Nonauthenticated chat answered over 120,000 contacts and authenticated chat answered over 25,000 contacts since the January 2016 implementation date.

Since Live Chat's launch in 2011, PIT and BE Live Chat agents have responded to 107,991 chats regarding general collection and tax questions from individuals and tax professionals. Of this amount, 77,007 chats were regarding PIT and 30,984 chats were regarding BE. During FY 2015/2016, ARM's BE and PIT Live Chat agents completed 25,934 chats with a 97.5 percent level of access. Customer satisfaction survey results provided positive feedback from taxpayers regarding the Live Chat service. Taxpayers have expressed that they are happy to get quick answers to their general collection questions without having to spend considerable time on the phone. On average, individuals can connect with a PIT Live Chat agent in 4 minutes or a BE Live Chat agent in 30 seconds. During FY 2014/2015, PIT and BE Collections' Live Chat completed 32,024 chats.

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 8, 2015. 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.

Teresa Casazza, Cal-Tax

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

- Slow resolution of compliance inventory.
- FTB interest miscalculation.
- Pre-partner/pre-shareholder penalty.
- R&TC Section 23036(i) Credit Limitation.
- Written advice.

In her letter dated January 29, 2016, Taxpayers' Rights Advocate, Susan Maples responded regarding slow resolution of compliance inventory that as of December 31, 2015, 89 percent of our audit cases, including claims, are less than two years old. We are regularly reinforcing our best practices and audit techniques that ensure an audit is completed in the time frame planned. Additionally, we are working closely with staff to troubleshoot and streamline the closing of aging cases. In an effort to ensure that audit accuracy is not impacted, we are balancing the speed of closing audit cases with necessary diligence on a case by case basis. FTB welcomes CalTax's, and other interested parties', participation in helping us complete our compliance workload within the prescribed time frames by encouraging that:

1. Claims for refund are filed before or at the beginning of the audit process, so the claim can be reviewed within the originally established audit plan.
2. Source documentation is readily available and accessible when the claim is filed.

Regarding FTB interest miscalculation, Mrs. Maples responded that California law follows federal law in this area. Federal cases hold that after interest on an underpayment has been calculated and paid pursuant to a validly issued notice or bill, recalculation of interest due to interest netting and the May Department Stores adjustments is an overpayment that must be claimed or discovered within the statute of limitations. (Exxon Mobil Corp. & Affiliated Cos. (2d Cir. 2012) 689 F.3d 191; Computervision Corporation v. U.S. (Fed. Cir. 2006) 467 F.3d 1322; Federal National Mortgage Association v. U.S. (Fed. Cir. 2006) 469 F.3d 968.)

Regarding per-partner/per-shareholder penalty, Mrs. Maples responded that FTB has formed a team to study these issues and plans on submitting recommendations to Executive Management by June 30, 2016. The recommendations may include administrative, regulatory, and/or legislative proposed changes. The department will reach out to stakeholders with the department's findings and recommendations.

Regarding R&TC Section 23036(i) Credit Limitation, Mrs. Maples responded that FTB's position is that 23036(i) has not been revised and the credit limitations under this section also apply to any potential assignee. Any change can only be made by the legislature. In the case of motion picture credits, the legislature specifically provided that the 23036(i) limitation does not apply to assignees of the credit.

Regarding written advice, Mrs. Maples responded that FTB will review the recommendation to consider responses provided by the Ask the Legal Expert program as “written advice” pursuant to California R&TC Section 21012. In addition, where taxpayers relied on erroneous written advice by staff, R&TC Section 21004, as recently reenacted by SB 540, provides that the Taxpayer Advocate may relieve penalties, fees, and interest in appropriate circumstances where taxpayers relied on erroneous written advice.

Douglas Pickford, CSEA

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

- Inability to dissolve/cancel business entities formed but not launched.
- Inadvertent failure to file Form 568 by single member LLCs (SMLLC).
- 2015 California disasters.

In her letter dated January 29, 2016, Taxpayers’ Rights Advocate, Susan Maples responded regarding the inability to dissolve/cancel business entities formed but not launched that FTB has set up a team to study why entities continue to have challenges with dissolving and cancelling. The team will formalize a planned approach including anticipated deliverables no later than July 2016. We anticipate the deliverables to include a complete analysis of the dissolution and cancellation process, identification of opportunities for improved education and outreach, and a review of administrative, regulatory, and/or legislative changes that might present opportunities to address this continuing issue. This effort would include seeking input and feedback from our partner state agencies and our stakeholders.

Regarding inadvertent failure to file Form 568 by single member LLCs (SMLLC), Mrs. Maples responded that FTB is currently working on a feasibility study in regards to the SMLLC filing requirements for PIT filers. We will also include in this study the filing requirements for corporations that have SMLLCs. Our feasibility study will address potential form changes suggested by the California Society of Enrolled Agents (CSEA) and Spidell as well as impacts to department business areas such as processing, systems, Legal, and Audit. We expect to complete the study and recommend a resolution by spring 2016.

Regarding 2015 California disasters, Mrs. Maples responded that FTB has updated FTB 1034 and the links to the publication on FTB’s external disaster webpage. Additionally, we are updating our procedures so that we are aware of federal amendments to presidentially-declared disasters.

Lynn Freer, Spidell Publishing, Inc.

Ms. Freer provided oral comments to the Board about expedited processing.

In her letter dated January 29, 2016, Taxpayers’ Rights Advocate, Susan Maples responded regarding expedited processing that the time frames under which FTB must issue a transferee *Notice of Proposed Assessment* (NPA) is generally the normal period for assessment of additional tax, plus one year. Taxpayers are afforded protest rights to an NPA issued due to a transferee basis. These time frames are statutorily set and we must adhere to the limitations. We are required to exhaust available collection remedies against the business entity before we can pursue a transferee for the unpaid liability.

FTB is reviewing the administrative dissolution process to find a way to provide some level of relief. We continue to analyze the impact of inactive business entities and are hopeful the end result will ease the burden for taxpayers in dissolving their business entity correctly. We would like to take Ms. Freer up on her offer to meet to discuss her ideas on how we might improve efficiencies related to how we apply transferee liability to business entities.

Evaluating Franchise Tax Board Employees

FTB continues its commitment to evaluating and providing feedback to our employees. Customer service is one of our highest priorities. As part of the evaluation process, we assess 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. Employees are not evaluated based on revenue that is produced through additional tax assessments or collections.

In recent years we have focused on making sure that all eligible employees receive a written performance evaluation annually, and that the evaluation and feedback they receive is valuable. We've provided automated tools for ease of preparing performance evaluations and continue to give training to supervisors on how to have the conversations that communicate expectations to their employees, and that increase 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 2015/2016. We may have issued the assessments in prior years; however, due to cases in protest status, we did not resolve them until FY 2015/2016. Appendix 1 totals reflect rounded figures and may not compute exactly.

Table 1A **Corporation Tax Law**
NPAs Finalized in FY 2015/2016 Categorized by Primary Statute (issue)

Issue	Number of NPAs	%	Tax Assessed (millions)	%	Average Assessment Per NPA
Allocation/Apportionment	613	26.6	$ 379.9	78.9	$ 619,745
Assess Minimum Tax	33	1.4	0.0 [1]	0.0	800
Revenue Agent Reports	1,382	59.9	67.5	14.0	48,872
State Adjustments	197	8.6	13.4	2.8	68,235
Other	80	3.5	20.7	4.3	258,574
Totals/Average	2,305	100	$ 481.6	100	$ 208,937

- *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 2015/2016 Categorized by Primary Statute (issue)

Issue	Number of NPAs	%	Tax Assessed (thousands)	%	Average Assessment Per NPA
CP2000	196,997	21.7	$ 137,493	5.3	$ 698
Filing Enforcement	599,191	65.9	2,011,702	77.7	3,357
Filing Status	33,301	3.7	37,930	1.5	1,139
Revenue Agent Reports	27,195	3.0	105,046	4.1	3,863
Other	52,363	5.7	296,984	11.5	5,672
Totals/Average	909,047	100	$ 2,589,135	100	$ 2,848

- 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.

[1]$26,400 for tax assessed for 33 NPAs (average of $800), converted to million is $0.0264.

Table 2 **Corporation Tax Law**
Corporations by Industry with NPAs Finalized in FY 2015/2016

Industry	All Corporations 2014 Tax Year	%	Corporations with NPAs	%	Tax Assessed (millions)	%
FIRE*	137,798	16.6	120	9.2	$ 147.5	30.6
Manufacturing	49,465	6.0	150	11.6	86.4	17.9
Services	356,706	43.1	294	22.6	77.0	16.0
Trade	137,954	16.7	231	17.8	32.9	6.8
Other **	146,157	17.7	504	38.8	137.8	28.6
Totals	828,080	100	1,299	100	$ 481.6	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 2015/2016 Issued by Tax Year

Average Tax Year	Number of NPAs	%	Tax Assessed (millions)	%	Average Assessment Per NPA
2008 and prior	547	23.7	$ 277.9	57.7	$ 507,976
2009	288	12.5	88.2	18.3	306,227
2010	516	22.4	76.2	15.8	147,695
2011	613	26.6	25.7	5.3	41,867
2012	273	11.8	8.0	1.7	29,371
2013	61	2.6	4.8	1.0	78,702
2014 and later	7	0.3	0.8	0.2	121,564
Totals/Average	2,305	100	$ 481.6	100	$ 208,937

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 2015/2016 for the Same Taxpayer			
Corporations With...	**Number of Taxpayers**	**Tax Assessed (millions)**	**Average Assessment Per Taxpayer**
One NPA	618	$ 88.6	$ 143,294
Two NPAs	467	112.0	239,881
Three NPAs	153	102.3	668,738
Four or more NPAs	61	178.7	2,929,552
Totals/Average	1,299	$ 481.6	$ 370,746

Table 4 **Personal Income Tax Law** NPAs Finalized in FY 2015/2016 Issued by Tax Year					
Tax Year	**Number of NPAs**	**%**	**Assessment Amount (thousands)**	**%**	**Average Assessment Amount**
2009 and prior	3,407	0.4	$ 206,409	8.0	$ 60,584
2010	6,162	0.7	39,898	1.5	6,475
2011	129,453	14.2	193,761	7.5	1,497
2012	236,837	26.1	395,840	15.3	1,671
2013	315,544	34.7	1,036,938	40.0	3,286
2014 and later	217,644	23.9	716,288	27.7	3,291
Totals/Average	909,047	100	$2,589,135	100	$ 2,848

Table 5 **Personal Income Tax Law** Resident Tax Return Preparation, Process Years 2014 and 2015					
Preparer	**2014 Tax Returns Processed (thousands)**	**%**	**2015 Tax Returns Processed (thousands)**	**%**	**% Change**
Professional	13,729	88.6	14,079	88.8	0.2
Taxpayer	1,481	9.6	1,480	9.3	-0.3
VITA*	282	1.8	297	1.9	0.1
Totals	15,491	100	15,856	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-file Tax Return and Electronic Payment Statistics**			
Activities	**June 30, 2015**	**June 30, 2016**	**% Change**
Individual Payments	4,269,000	4,716,000	10
Business Payments	329,000	409,000	24
Direct Deposit Refund	6,991,000	7,447,000	7
Individual e-file	14,854,000	15,632,000	5
** *CalFile*	257,000	165,000	-36
Business e-file	1,114,000	1,329,000	19

** 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
2015/2016	120,703	77,310

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
2015/2016	886,328	644,479

Table 8A **Top Errors by Tax Return Type**
July 1, 2015 through June 30, 2016

	Code	Grand Total	540 2EZ	540	540 NR	540 X
EP	**Estimate Payment Revised**	**196,099**	**2,298**	**174,213**	**19,273**	**183**
DS	**Deductions Revised**	**65,213**	**119**	**57,884**	**6,607**	**395**
WS	**Withhold at Source Revised**	**52,751**	**121**	**24,286**	**27,490**	**854**
TC	**Tax Amount Revised**	**43,958**	**228**	**34,398**	**6,898**	**2,262**
AA	**Adjusted Gross Income Revised**	**31,963**	**31,778**	**168**	**12**	**3**
AW	**Withholding Did Not Match Attachments**	**30,662**	**2,869**	**26,087**	**1,110**	**534**
DI	**Standard Deduction Allowed Because Greater Than Itemized Deduction Claimed**	**29,781**	*	**27,501**	**1,804**	**399**
CT	**Child and Dependent Care (CDC) Credit Revised to Match Original Return**	**29,696**	**149**	**640**	**35**	**28,866**
OC	**Estimated Tax Transfer Revised: Error Affected the Available Transfer Amount**	**29,052**	**-**	**21,886**	**7,112**	**14**
OF	**Refund Reported on Amended Return Does Not Match Original Return**	**22,785**	**650**	**5,490**	**481**	**16,113**
OM	Amount Paid With Original Return Plus Payments Made After Return Filed Does Not Match Amount Claimed on Amended Return	19,684	266	2,984	318	16,088
TT	Total Credits/Liability Revised	18,589	5,930	11,236	651	510
EX	Exemptions Revised	17,925	115	15,815	1,643	103
SS	State Disability Insurance Revised	17,704	-	17,043	358	256
ND	California Taxable Income Revised	16,989	-	*	16,828	160
TY	Total Tax Revised - Adjusted Gross Income (AGI), Filing Status, or Dependents	12,994	12,994	-	-	-
OW	Withholding Reported on Amended Return Does Not Match Original Return	10,826	-	-	-	10,826
RN	Nonrefundable Renter's Credit Revised; Wrong Amount Claimed for Filing Status, California AGI Over Maximum Amount, Part-Year Resident, or Nonresident	7,818	1,725	5,816	152	10
OA	Refund Revised, Total Payments and Credits Added or Subtracted Incorrectly From Total Tax	7,270	964	4,225	186	1,851
AT	Withheld Tax Credit Disallowed; Withholding Documents Not Attached	6,381	535	3,995	1,487	329
NP	Total Tax Ratio Calculated Incorrectly or Ratio Incorrectly Applied	6,112	-	*	6,087	26
AR	Amended Return Filed With No Record of Original Return	6,323	5	35	10	5,135

TI	Taxable Income Revised	4,117	13	2,129	125	76
OP	Estimated Tax Payments Reported on Amended Return Do Not Match Original Return	3,474	8	409	46	1,858
OB	Balance Revised - Incorrect Payments or Credits	2,970	309	1,576	44	344
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*	2,006	-	*	1,790	*
EE	Senior Exemption Credit Revised to Correct Amount	1,910	315	1,226	132	*
	Other Paragraph Codes Not Listed	7,794	376	3,638	605	1,309
	Top Ten	**531,960**	**38,214**	**372,552**	**70,822**	**49,622**
	All Others	170,886	23,555	70,127	30,462	38,881
	Grand Total	**702,846**	**61,768**	**442,697**	**101,284**	**88,503**

*Reflects fewer than three tax returns.

Bold Text › Top ten codes issued by Tax Return Type.

Table 8B **Top Errors by Filing Method**
July 1, 2015 through June 30, 2016

	Code	Grand Total	Electronic	Paper
EP	**Estimate Payment Revised**	**196,099**	**149,996**	**46,104**
DS	**Deductions Revised**	**65,213**	**37,017**	**28,196**
WS	**Withhold at Source Revised**	**52,751**	**39,253**	**13,499**
TC	**Tax Amount Revised**	**43,958**	**3,981**	**39,977**
AA	**Adjusted Gross Income Revised**	**31,963**	**6,568**	**25,395**
AW	**Withholding Did Not Match Attachments**	**30,662**	**17,738**	**12,925**
DI	**Standard Deduction Allowed Because Greater Than Itemized Deduction Claimed**	**29,781**	**16,594**	**13,187**
CT	**CDC Credit Revised to Match Original Return**	**29,696**	**46**	**29,650**
OC	**Estimated Tax Transfer Revised: Error Affected the Available Transfer Amount**	**29,052**	**20,558**	**8,494**
OF	**Refund Reported on Amended Return Does Not Match Original Return**	**22,785**	**358**	**22,427**
OM	Amount Paid With Original Return Plus Payments Made After Return Filed Does Not Match Amount Claimed on Amended Return	19,684	131	19,553
TT	Total Credits/Liability Revised	18,589	1,118	17,471
EX	Exemptions Revised	17,925	1,359	16,566
SS	State Disability Insurance Revised	17,704	12,120	5,585
ND	California Taxable Income Revised	16,989	5,563	11,426
TY	Total Tax Revised - AGI, Filing Status, or Dependents	12,994	549	12,444
OW	Withholding Reported on Amended Return Does Not Match Original Return	10,826	-	10,826
RN	Nonrefundable Renter's Credit Revised; Wrong Amount Claimed for Filing Status, California AGI Over Maximum Amount, Part-Year Resident, or Nonresident	7,818	2,732	5,087
OA	Refund Revised, Total Payments and Credits Added or Subtracted Incorrectly From Total Tax	7,270	680	6,590
AT	Withheld Tax Credit Disallowed; Withholding Documents Not Attached	6,381	919	5,462
NP	Total Tax Ratio Calculated Incorrectly or Ratio Incorrectly Applied	6,112	557	5,556
AR	Amended Return Filed With No Record of Original Return	5,186	-	5,186
TI	Taxable Income Revised	2,397	3	2,394
OP	Estimated Tax Payments Reported on Amended Return Do Not Match Original Return	2,327	33	2,294

OB	Balance Revised - Incorrect Payments or Credits	2,304	459	1,845
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*	1,791	153	1,638
EE	Senior Exemption Credit Revised to Correct Amount	1,688	182	1,506
	Other Paragraph Codes Not Listed	6,078	734	5,344
	Top Ten	**531,960**	**292,109**	**239,854**
	All Others	164,064	27,293	136,773
	Grand Total	**696,024**	**319,402**	**376,627**

Table Legend:

Bold › Top ten codes issued by Tax Return Type.

Appendix 3

Regulation Section 17951-7 and 25137(e) – 1031 Exchanges

On June 27, 2013, the California Legislature enacted Assembly Bill (AB) 92. (Stats. 2013, Ch. 26.) Under AB 92, for tax years beginning on or after January 1, 2014, taxpayers who perform Internal Revenue Code (IRC) Section 1031 exchanges of property located in California for property located outside of California are required to file an annual information return with the Franchise Tax Board (FTB) for each year in which the gain or loss from that exchange has not been recognized. (See Revenue and Taxation Code (R&TC) Sections 18032 and 24953.) AB 92 reflects existing California law requiring taxpayers to recognize deferred gains/losses associated with IRC Section 1031 exchanges of property located in California as California source income; however, as a result of the new reporting requirement, FTB has received numerous requests for clarification of the determination of California source income in such exchanges.

For personal income tax, R&TC Section 17954 specifically authorizes FTB to issue regulations for allocating and apportioning gross income from sources within and without California for the purposes of computing taxable income of nonresidents and part-year residents under paragraph (1) of subdivision (i) of R&TC Section 17041. FTB also has authority for corporate franchise and income tax to require alternative apportionment formulas where the standard allocation and apportionment provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA) do not fairly represent the extent of the taxpayer's business activity in this state. (R&TC Section 25137).

The purpose of this regulation project is to: (1) clarify the sourcing of deferred gains/losses from IRC Section 1031 exchanges of property located in California; and (2) determine which year's apportionment factor(s) should be applied to deferred gains/losses from IRC Section 1031 exchanges for apportioning taxpayers.

Staff held an interested parties meeting on February 3, 2016, to discuss multiple scenarios regarding the sourcing and factors for 1031 exchanges. Staff anticipates drafting language and holding another interested parties meeting in 2017.

Regulation Section 18662-0 through 18662-6 and 18662-8 – Withholding

The purpose of the proposed regulatory item is twofold:

(1) To discuss possible amendments to California Code of Regulations (CCR), Title 18, Sections 18662-0 through 18662-6, and Section 18662-8 (withholding regulations), to make various technical changes to the withholding regulations, including changes to terminology in the current regulatory language and line items on the withholding forms. Specifically, possible amendments include, but are not limited to:

- Clarifying the process by which a waiver is requested using California Form 588, *Nonresident Withholding Waiver Request*;
- Clarifying the threshold requirements (Part IV, Withholding Computation) for California Form 589, *Nonresident Reduced Withholding Request*;
- Within the withholding regulations, adding a new term, "remitter," to the definition section (Regulation Section 18662-2), and revising the definition of "withholding agent" and other terms as necessary in the definition section;
- Clarifying the process by which a promoter may qualify for an exemption if certain requirements are met;
- Within the withholding regulation, adding total sales price and ownership percentage fields to California Form 593, *Real Estate Withholding Statement*, which is proposed because these additions will make the audit process more accurate;

- Within the withholding regulations, clarifying the modified information return penalty amounts in R&TC Section 19183 as per AB 154 (Stats. 2015, Ch. 359);
- Within the withholding regulations, detailing that Form 593 will now include elements of the following forms which will no longer exist: California Form 593-I, *Real Estate Withholding Installment Sale Acknowledgement*, California Form 593-C, *Real Estate Withholding Certificate,* and California Form 593-E, *Real Estate Withholding Computation of Estimated Gain or Loss*;
- Within the withholding regulations, changing the terms “alternate withholding calculation” and “optional gain on sale” to the term “alternative withholding calculation”;
- Clarifying and correcting the person responsible for withholding during an installment sale (buyer is responsible for withholding, not the real estate escrow person);
- Within the withholding regulations, changing the term “California tax” to “resident and/or nonresident tax” in Regulation Section 18662-8;
- Clarifying what can or cannot be filed electronically;
- Within the withholding regulations, making other grammatical and technical changes as necessary.

(2) Discuss possible amendments to the withholding regulations related to domestic pass-through entity (PTE) withholding filing requirements. Possible amendments may include:

- For PTEs only, possible change to the current quarterly California Form 592, *Resident and Nonresident Withholding Statement*, allocation of withholding scheme to an annual filing and allocation of withholding scheme.
- Inclusion of a mandatory notification provision by the PTE to payees within 10 days of each quarterly withholding payment remitted by the PTE, similar to what is required under current Treasury Regulation Section 1.1446-3(d)(1)(ii).
- Whether the current requirement to attach a copy of the California Form 592-B, *Resident and Nonresident Withholding Tax Statement*, to the partner’s income tax return to claim withholding credit should be retained.
- Impact of de *minimis* withholding threshold amount on the PTE withholding scheme.

Staff held an interested parties meeting on October 12, 2015, and July 11, 2016. Staff anticipates requesting permission to proceed to the formal regulatory process at the Franchise Tax Board meeting on December 8, 2016.

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.

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 2017.

Regulation Sections 19195-1 and 19195-2 – Procedures and Standards for License Suspension Hearings

Under R&TC section 19195, FTB is required to publish, at least twice a year, a list of its top 500 tax delinquencies in excess of $100,000 (Top 500 List). Under Business and Professions Code (BPC) Section 494.5(c), FTB submits a list of the taxpayers on the Top 500 List to certain California state governmental licensing entities. Taxpayers who are on that list will generally have an application for issuance of certain licenses denied and will generally have certain licenses suspended unless FTB provides the relevant governmental licensing entity with a release. BPC Section 494.5 permits a taxpayer to request a release from FTB.

Proposed new regulation Section 19195-1 will provide the procedures under which the taxpayer will be provided a hearing on the issue of whether FTB should provide a release. The hearing will take place before a hearing officer who has had no prior involvement with the taxpayer. At the hearing, the taxpayer will be able to present witnesses, offer documentary evidence, and make arguments in support of the taxpayer's request for a release. After the hearing, the hearing officer will decide whether the taxpayer is entitled to a release. If a release is not provided, the hearing officer will provide the taxpayer with a written decision explaining why a release will not be provided.

Regulation Section 19195-1 will also provide the taxpayer with an opportunity to request that the hearing officer reconsider the decision denying a request for release and an opportunity for the taxpayer to request that the Taxpayers' Rights Advocate or her designee review, and overrule, the hearing officer's decision.

Proposed new regulation Section 19195-2 will provide the standards that the hearing officer uses to determine whether the taxpayer has a current financial hardship that will enable the taxpayer to obtain a release. If the hearing officer determines that the taxpayer does not have a current financial hardship, the hearing officer will use the standards contained in the regulation to determine how much the taxpayer must pay and the terms of an installment payment agreement the taxpayer must sign in order to obtain a release.

On September 8, 2016, FTB authorized staff to proceed with emergency regulations and then to convert the emergency regulations to standard regulations through the formal rulemaking process. Staff anticipates that the emergency regulations will be effective by the second week of October.

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 interested parties meetings on December 3, 2010, and April 21, 2016. A third interested parties meeting has been scheduled for November 3, 2016.

Regulation Sections 23038-1 through 23038-5 – Check the Box

On January 1, 1997, the Internal Revenue Service issued regulations designated 26 Code of Federal Regulations Sections 301.7701-1 through 301.7701-3, commonly called the "check-the-box" regulations. These regulations provided rules for the classification of business entities for federal tax purposes.

In 1997, the California R&TC was amended to state in part that the classification of a business entity shall be determined under regulations of the FTB, which shall be consistent with the new federal regulations. FTB adopted regulations implementing this legislation which were designated CCR, Title 18, Sections 23038(b)-1 through 23038(b)-3.

This proposed rulemaking action would conform California's regulations with changes to the federal regulations.

Staff held an interested parties meetings on January 11, 2016, and August 3, 2016. Staff anticipates requesting permission to proceed to the formal regulatory process at the Franchise Tax Board meeting on December 8, 2016.

Regulation Section 23663 – Assignment of Credits to Combined Group Members

a. Regulation Section 23663-1 through 5

R&TC Section 23663 permits the assignment of credits among affiliated members of the same combined reporting group. In some situations taxpayers have made defective elections to assign credits under this section. Because the assignment election is irrevocable, taxpayers are left with uncertainty regarding the allocation of credits which are the subject of a defective election, as well as having no clear recourse to correct a defective election. Therefore, the purpose of the proposed regulations is to give taxpayers certainty as to how credits are allocated when a defective election occurs. The proposed regulations also give taxpayers flexibility in determining how credits are allocated when there is agreement between the parties involved in the defective election. Finally, the proposed regulations give taxpayers one year to correct certain errors in defective elections.

Staff held three interested parties meetings for the defective election regulation project and received positive feedback from attendees and other interested parties. On December 4, 2014, the Franchise Tax Board granted permission for the proposed regulations to proceed with the formal regulatory process. Presently, staff is awaiting outside approval of economic information necessary to begin the final steps of the formal regulatory process.

b. Regulation Section 23663-6

We began a separate regulation project for Section 23663 to clarify when an eligible assignee is properly treated as being in the same combined reporting group as an assignor. This clarification is important since a requirement to assign credits under Section 23663 is that the assignee be in the same combined reporting group as the assignor. The regulation project includes providing related guidance on reorganizations and other corporate restructuring, such as transactions in which tax attributes, including credits, would survive.

On June 12, 2014, the same date that staff held the third interested parties meeting for the defective election regulation project, staff also held the first interested parties meeting for the same combined reporting group regulation project during which general structural issues for the regulation were discussed. Based on this discussion, staff plans to schedule a second interested parties meeting for winter 2016 or spring 2017 during which the Franchise Tax Board will present draft regulatory language for public comment.

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.

Staff is now drafting proposed regulatory language for another proposed rulemaking action on this section. This new project would focus on the annual reporting requirement for those corporations that transfer appreciated property to an insurer and claim the gain deferral provided under subdivision (b) of that section (transferred property used in the active conduct of a trade or business of the insurer).

Regulation Section 25122

This rulemaking project would discuss possible amendments to the regulations at CCR, Title 18, Section 25122, regarding taxpayers who are taxable in another state.

Staff anticipates holding a first interested parties meeting in February or March of 2017.

Regulation Section 25134

This rulemaking project would discuss possible amendments to the regulations at CCR, Title 18, Section 25134, regarding the apportionment sales factor.
Staff anticipates holding a first interested parties meeting in 2017.

Regulation Section 25137- Procedures for Section 25137 Hearing

R&TC Section 25137 states that when the standard allocation and apportionment provisions of the UDITPA (R&TC Sections 25120-25139) do not fairly represent the extent of a taxpayer's business activity in this state, the taxpayer may petition for the use of an alternative method to accomplish an equitable allocation or apportionment of income to this state. In recent years, the number of taxpayers seeking to utilize alternative apportionment methodologies under the authority of R&TC Section 25137 has increased. This proposed rulemaking project would provide guidance to assist taxpayers with submitting petitions for relief under R&TC Section 25137.

On July 12, 2016, the Franchise Tax Board gave permission for staff to move forward with the informal regulatory process.

Regulation Sections 25137-1 and 17951-4 – 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.

On September 30, 2014, staff was granted Board approval to proceed with the formal regulation process. Staff anticipates holding a formal regulatory hearing sometime in 2017.

Regulation Sections 25137-4.2 and 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 interested parties meetings on December 4, 2014, and April 20, 2016. Staff is evaluating whether to hold a third interested parties meeting or proceed to the formal regulation process.

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 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 interested parties meetings on July 9, 2015, and April 13, 2016. On July 12, 2016, staff was granted Board approval to proceed with the formal regulation process. A formal regulatory hearing remains to be scheduled.

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.