Taxpayers' Bill of Rights
Annual Report to the Legislature

STATE OF CALIFORNIA
Franchise Tax Board

2017

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Executive Summary

We are grateful to the vast majority of Californians who comply with their income tax obligations. Their willingness to support our great state in this way is the foundation of our state tax system.

To further lessen the burden of compliance, Franchise Tax Board (FTB) continues to focus on customer experience (CX) disciplines. CX is a modern and holistic way of approaching the customer service dynamic. The changes we are planning for next year will help us better tailor our interactions to meet the ease and efficiency needs of taxpayers in a manner that helps them feel confident and comfortable when interacting with FTB.

While exciting improvements lay ahead of us, there were also initiatives this past year that achieved wins for our customers:

- Customer Service Dashboard

  I'm pleased to announce that FTB implemented an award winning online Customer Service Dashboard this past year that provides taxpayers with information about processing and contact center wait times. This information helps our customers choose the communication channel that best meets their needs.

- Increased Levels of Access

  As you will read in this report, FTB achieved a significant increase in access levels to our contact centers during this past filing season. The improvements were primarily an outcome of managing tax notice distributions throughout the year in order to provide appropriate levels of phone support to those who receive the notices.

A challenge that requires our continued focus is in the arena of cyber security. This past year brought alarming reports of very significant data breaches across the globe. I want to assure our stakeholders that this topic will remain an area of significant attention at FTB. Security of taxpayer data is foundational to tax compliance.

As we continue to seek feedback from taxpayers through our CX efforts, we also look to the tax practitioner community and our advisory board to help FTB strengthen our communication channels and our self-service processes in order to ease the filing burden. The unspoken partnership between tax professionals and tax administrators flourishes when we engage in open and constructive dialogue.

With the above in mind, I humbly submit this year's Taxpayers' Bill of Rights Annual Report to the Legislature for your review. Thank you for your support as we work together to serve the great state of California.

Selvi Stanislaus

Selvi Stanislaus
Executive Officer

Advocate's Address

Members of the California Legislature:

I submit for your review the 2017 Taxpayers' Bill of Rights Annual Report to the Legislature.

The Taxpayers' Rights Advocate's Office (TRAO) strives to be a trusted voice for taxpayers and tax professionals as experts in the needs of the tax community. In keeping with this, TRAO works closely with both taxpayers and the tax professional community – Franchise Tax Board's (FTB) valued partners–in ensuring compliance with California's tax laws. Understanding the needs of our partners, we have undertaken many initiatives to improve taxpayers' and tax professionals' interactions with FTB and reduce taxpayer burden. In this address, I would like to share some of these accomplishments with you.

In addition, at the December 2016 Taxpayers' Bill of Rights Hearing, many suggestions for improvement were made to FTB's Board. As your Taxpayers' Rights Advocate, it is my responsibility to follow up on these suggestions and ensure that FTB gives each one its full consideration. This year we had many good suggestions to improve services, reduce taxpayer burden, and provide clarification about laws and FTB policies. In this year's Advocate's Address, I will update you on the progress we made on some of these outstanding issues.

Finally, a significant part of what we do is providing assistance to taxpayers and tax professionals when normal channels fail. In this address, I'd like to highlight a few of the more significant instances where we were able to resolve issues on behalf of those who contacted our office for assistance.

Education and Outreach

The vitality of the Advocate's role is closely linked to our relationships with taxpayers and the tax professional community, so I take education and outreach very seriously by working closely with FTB's business areas in order to keep taxpayers and tax professionals abreast of new law, programs, and procedures. I also want to link FTB's services with taxpayers that need the support, bringing the two together in a way that's beneficial to both parties.

After our initial rollout of MyFTB last year, FTB tasked itself with enhancing the online service application and I am pleased with the enthusiasm FTB has shown. One key initiative is to improve the Power of Attorney (POA) portion of the application, as well as to give tax professionals a more secure and useful platform to manage their clients' information. My office facilitated focus groups with tax professionals to better understand their concerns and day-to-day work needs. We started a monthly column in September 2016, "MyFTB Corner," within our online publication, *Tax News,* to provide articles outlining the new features and pointing to resources. We also worked closely with MyFTB business areas to present the most up-to-date information for our live presentations and training.

During FY 2016/2017, my office participated in over 130 live presentations covering:

- California tax updates
- MyFTB
- Cal EITC
- FTB 989, *Understanding California Taxes*
- FTB 1123, *Forms of Ownership*
- Small business tax materials

These presentations included bilingual education and outreach to taxpayers and tax professionals throughout California. This past year, my staff responded to over 1,100 requests from taxpayers and tax professionals for assistance and calls about general tax and business-related requirements. *Tax News*, our award-winning technical publication with nearly 28,000 subscribers, also continues to be a valuable resource for the tax professional community. With the support of FTB's business areas' proactive approach to writing articles, our content continues to be relevant, timely, and informative. In addition, we partnered with other tax agencies and external stakeholders to share information about educational opportunities like IRS' webinars and resources such as California Business Incentives Gateway's new web portal.

Taxpayer Information and Privacy

As we move into the next phase of our tax modernization efforts, FTB wants to ensure we only collect and use the data we need to administer California's tax and nontax programs entrusted to us. With the completion of our Enterprise Data to Revenue tax modernization project, there has been a substantial increase in FTB's ability to collect, sort, use, and store specific information about taxpayers. Although taxpayers have the right to know what types of information we gather and how we use it, very few taxpayers are aware of our new abilities to use and store information about them. Ensuring there is an appropriate balance between taxpayer privacy and FTB's ability to administer its programs is, and should be, of the utmost importance to FTB.

While the tax return is the primary source of data for taxpayers, FTB has numerous data exchange agreements based on statutory authority to share and use information with other state agencies and private industry entities including the IRS and Lexis Nexis. In the future, FTB will use a taxpayer's information and filing history to create a profile to tailor messages and contacts specifically for them. However, it is important that we give taxpayers the opportunity to choose the extent to which we use this information for these purposes.

To notify taxpayers about their right to privacy we provide information on our public website and include FTB 1131, *Franchise Tax Board Privacy Notice*, with our letters and notices when FTB asks taxpayers for information. If a taxpayer feels that their information was collected without the proper authority to do so, they may seek administrative relief under the Information Practices Act and/or a legal remedy in the civil court system.

Filing Enforcement

Our Filing Enforcement (FE) program works to locate taxpayers who have an obligation to file a California income tax return, but fail to do so. Last year, FTB issued approximately 830,000 personal income tax (PIT) notices to individuals and 95,000 notices to business entity (BE) taxpayers who may have had a filing requirement. FTB's FE program primarily uses two methods to establish a tax liability. The first method is through confirmed income sources, such as a W-2 or 1099. The second method is based on income indicators such as an occupational license or a mortgage. When planning its enforcement efforts, FTB must consider the burden placed on those who receive tax assessments which are unwarranted or incorrect.

For several years, I have been concerned with FTB sending FE letters and assessments to incorrect or noncurrent addresses. During FY 2016/2017, two percent of the PIT and three percent of the BE request and demand letters were returned as undeliverable due to noncurrent addresses. With this issue in mind, it's likely that other notices may not reach the taxpayer despite multiple efforts to obtain the most current address. This situation can lead to a potential tax liability that a taxpayer is unaware of, creating a burden for the taxpayer and additional work for FTB. This year, FTB placed additional focus on improving returned mail processes so that FTB can reach taxpayers at the earliest possible opportunity before a potential liability is created. In addition, this year our Management Development Program (MDP) launched the Return Mail Project. This project will present FTB with a documented process and recommendations to improve current processes that may allow for better information service to the taxpayer. Due to the complexity of this important issue and the time frame of the program, we expect the recommendations by July 2018. In the meantime, as the team and program areas identify immediate opportunities to improve processes, I hope FTB will make these changes a priority.

Many taxpayers who hold California occupational or professional licenses move and establish themselves in a neighboring state, yet retain their California license because they may wish to return to work in California. FTB annually contacts many of these taxpayers to determine whether they have a California filing requirement. This creates an undue burden for taxpayers and additional work for FTB. This year my office worked with FE program managers to modify procedures for taxpayers who move out of California and retain a California business or occupational license. FTB will contact the taxpayer less frequently because they have established why they do not file with California.

Many BE taxpayers are reluctant to file past-due tax returns because they fear penalties, especially those not based on tax due. These penalties include the Per Partner Penalty and Per Shareholder Penalty that partnerships, S-Corporations, and LLCs may incur. We worked with our Filing Division and Legislative Bureau to present legislative proposals that address the burden from these penalties, particularly in those cases where the BEs are unaware of their filing requirement.

Two bills were drafted this year which should encourage BE taxpayers who are doing business in California and want to comply with their filing requirements, but the cost of penalties makes it difficult for them to do so. Assembly Bill 1719 (Stats. 2017, Ch. 176) expands the Voluntary Disclosure Program (VDP) to allow S corporations and LLCs classified as partnerships relief from the failure to file penalty. TRAO was instrumental in the legislative proposal that spurred Senate Bill 813 (Stats. 2017, Ch. 288). Senate Bill 813 expands VDP to most out-of-state partnerships with nonresident partners of general partnerships, limited partnerships, limited liability partnerships, and out-of-state trusts with California resident beneficiaries to participate in the VDP.

I am pleased with our efforts this past year and expect to see additional improvements in the coming year which will increase taxpayer compliance and reduce taxpayer burden. Improved addressing of letters and assessments, less frequent contacts, and VDP enhancements will help ensure that everyone pays the correct amount to fund services important to Californians.

Collections

This fiscal year our accounts receivables (AR) balance totaled $8.4 billion, a three percent decrease from last year. In addition, FTB saw a two percent reduction in the number of collection notices sent out to taxpayers. While collections are always a sensitive area for taxpayers, this year taxpayers brought the following issues to my attention:

- Installment agreement (IA) policies
- Hardship policies
- Offer in Compromise (OIC) program

When a taxpayer has a financial hardship, FTB can place the taxpayer in a six-, nine-, or twelve-month hardship status, which will prevent collection action during that time frame. While the Accounts Receivable Management (ARM) Division generally works with taxpayers to determine the appropriate length of time for the hardship, at the end of the hardship period the taxpayer may request another extension of hardship status if their situation has not improved. This cycle is time consuming and burdensome to both the taxpayer and FTB if it continues. When a taxpayer's situation is not expected to improve within the foreseeable future, FTB can place the taxpayer in a permanent hardship status which can reduce taxpayer burden. The number of taxpayers in permanent hardships increased this year by 180 percent to 743, while the number of taxpayers in temporary hardships decreased by 16 percent to 10,816. There were also 227,846 new IAs approved which represented a 64 percent increase.

Similar to hardships, FTB also periodically reviews IAs. The standard IRS review period for IAs is once a year. However, it was common for FTB to require the taxpayer to provide complete financial statements every six months to maintain acceptance in an IA plan. I worked with the ARM Division to reevaluate their process and agree to a yearly review. This revised process will significantly reduce the burden on the taxpayer and resources FTB expends to review financial information when likely not much has changed in six months. Though I realize there are a variety of circumstances to consider when deciding whether a taxpayer should be considered for a hardship or an IA, I am working with the ARM Division to minimize the burden on taxpayers while keeping in mind their responsibility to pay the correct amount of tax owed.

Last year, I also discussed the need to provide more information to taxpayers about the OIC program. I am happy to report that we have made great strides this year in getting information out to taxpayers about the OIC program. This can be seen in the 19 percent increase in the number of OIC applications for FY 2016/2017. Of the total applications, 65 percent were for PIT taxpayers and 35 percent for BEs. Of those applications submitted, 18 percent of PIT applications were approved and 54 percent of BE applications were approved.

TRAO has continued to work with the OIC program to provide information to taxpayers, tax professionals, and small business owners. We are updating the OIC webpage, developing an OIC information brochure, and developing a *Tax News Live* video to let taxpayers know more about the program. It is our hope that the OIC *Tax News Live* video will mirror our *How to Close a Business Entity* video that has over 10,000 views.

Bill of Rights Issues

Improving FTB's Power of Attorney Process and Forms

One of FTB's goals is to timely assist taxpayer representatives with resolving their clients' tax matters. Historically, representatives provided power of attorney (POA) declarations by fax or mail as part of this process. Beginning in January 2016, FTB's preferred method for POA submission was the new MyFTB online POA wizard. Due to many factors, processing mail and electronically submitted POAs using the new system led to longer processing times, which left tax professionals concerned that they would be unable to resolve their clients' issues in a timely manner. In response, the California Society of Enrolled Agents brought this issue to the December 2016 Taxpayers' Bill of Rights Hearing.

FTB took several steps this past year to enhance its online services with the goal to expedite processing, reduce POA rejection rates, and strengthen MyFTB security. As an integral part of this process, we facilitated several focus groups with tax professionals to explain the proposed POA enhancements. These focus groups provided us with valuable insights and suggestions, many of which FTB incorporated into new form designs and POA processes.

Of equal importance, FTB also improved internal procedures to enable staff to assist representatives in most cases without a POA declaration through the process of implied consent. Implied consent is established when a representative provides enough information from an FTB notice or a taxpayer's account to indicate that the representative has authorization to discuss specific account information.

While implied consent is not new at FTB, given the changes in our POA process and increase in identity theft, we saw a need to reemphasize this process to FTB staff and tax professionals. FTB assembled a department-wide team to review implied consent procedures and provided training to all contact center staff, supervisors, and managers to ensure tax professionals receive a consistent experience when contacting FTB on behalf of their clients. We also prominently featured implied consent in our education and outreach to tax professionals through articles in *Tax News*, partnering with trade media, and presenting information during our California Tax Updates. My staff and I have received many positive comments from practitioners that implied consent is working for them and that they are able to quickly resolve many of their clients' issues.

Right to Representation

During the process of discussing pain points with tax professionals surrounding the POA process, my office received several complaints that even when an active POA was on file FTB would disregard the taxpayer's right to representation and contact the taxpayer directly without contacting the POA first.

Taxpayers have the right to know what they must do to comply with California's tax laws and FTB must take care to honor the taxpayer's rights when collecting a tax or auditing a filed tax return. Over time, the increasing complexity of our tax laws has caused many taxpayers to seek out a tax professional to help them understand their filing obligations and liabilities. Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with FTB. A tax professional with a POA has the expectation that FTB will notify and communicate with them instead of, or in addition to, the taxpayer.

TRAO recognizes the importance of this process and strives to ensure that all taxpayers receive their right to representation when dealing with FTB. During this past year, a team comprised of TRAO and key FTB business area staff researched and drafted language for FTB policy and general procedures. FTB should formalize a new policy later this year, which we will share with taxpayers and tax professionals.

I am proud of the work we have done this year to improve taxpayers' and tax professionals' interactions with FTB. We listened to the tax professional community and carefully considered their insights and concerns. We have had a very productive partnership this past year and accomplished many things that would not have otherwise been possible.

Refund Fraud and Identity Theft Letters

Another issue brought forward at the December 2016 Taxpayers' Bill of Rights Hearing was in regard to letters FTB sends when it suspects refund fraud or identity (ID) theft. The two letters of concern are FTB 3904 ENS, *Confirm Tax Return Filing*, and FTB 4734 D ENS, *Request for Tax Information and Documents*. These letters asked taxpayers to send sensitive identifying information, including copies of social security cards and driver's licenses, to FTB by mail or fax. Taxpayers and many tax professionals received these letters and wondered whether the letter was a phishing scam because of the volume and type of information requested. In addition, taxpayers had concerns about the increased risk of ID theft if they sent copies of their most personal information in the mail.

I am happy to report that FTB is redesigning the letters for the upcoming filing season. In the case of FTB 3904 ENS, instead of requesting this information by mail, we will ask the taxpayer to call us when they receive this letter. We may reduce the number of documents requested with FTB 4734 D ENS, specifically social security and individual tax identification number documents, depending on the situation. This change could happen as early as March 2018.

FTB is committed to providing a high level of access and service in the contact center, with an average wait time of less than 10 minutes. FTB's goal is to ensure that taxpayers feel more secure by not having to send their personal information through the mail. FTB also provides information about our common letters and notices on our website. Taxpayers can check the website for assurance that FTB sent the letter or notice.

Business Entity Dissolution/Cancellation

Last year in the Annual Notice section of my address, I discussed how OIC could be an option for corporations or LLCs that were dissolving or canceling. The issue of dissolution was also raised at the December 2016 Taxpayers' Bill of Rights Hearing. An administrative dissolution is needed for those entities that were created but never did business or those BEs that partially completed the dissolution process but are now currently suspended. Taxpayers and business owners continue to be assessed the $800 minimum tax and applicable penalties and interest year after year and it is unlikely we will ever collect on that liability. The process to end a business in California is complicated and requires the taxpayer to complete steps with both FTB and the Secretary of State (SOS). FTB's research indicates that only 50 percent of taxpayers that seek to end their business in California complete the process successfully while the other 50 percent ultimately become suspended.

In response to this issue, a Business Dissolution/Cancellation Process Analysis Team was created. This is a multi-state agency team, which includes representatives from FTB, SOS, and the Governor's Office of Business and Economic Development (GO-Biz). The team studied the entity dissolution/cancellation process and provided recommendations to improve it by using a two-pronged approach:

1. To pursue areas to increase/improve our education and outreach concerning the dissolution/cancellation process.
2. To pursue analysis and development of legislative proposal recommendations such as a single point of filing for dissolution/cancellation documents and administrative dissolution possibilities.

In the area of education and outreach, FTB made a great deal of progress by adding dissolution/cancellation language to various forms and publications referencing the corresponding agency for the appropriate steps in the dissolution or cancellation of a BE. FTB also provided information about the dissolution/cancellation process at our various education and outreach seminars and presentations. In addition, we created a *Tax News Live* video, Closing your Business Entity, which continues to be viewed by thousands. We also worked with GO-Biz on their California Business Portal "Closing a Business" webpage, so that it now includes an embedded drop-down link to dissolution/cancellation information from FTB and SOS.

The analysis of recommended legislative proposals is ongoing and has been very productive. Meetings between SOS and FTB have regularly taken place with more scheduled. Two items of focus have been opportunities to simplify how a business entity dissolves and expanding administrative dissolution to for profit businesses. We expect to hear results from these meetings in the coming months.

Protest Activity and Aged Inventory

FTB's Protest section and Legal Division both resolve protests of assessments that taxpayers believe are incorrect. Our Protest section resolves undocketed protest cases, while our Legal Division resolves docketed protest cases, which are generally those involving highly complex issues, issues of first impression, and/or large dollar amounts.

At the completion of the protest process, an assessment may be affirmed, modified, or withdrawn. Protest modifications and withdrawals are due to a variety of reasons. Some of the most common reasons are if the taxpayer provides new information during the protest process or if there are differences in interpretation of the tax law. During

FY 2016/2017, 160 docketed protest cases were closed along with 294 undocketed protest cases.

At the December 2013 Taxpayers' Bill of Rights Hearing, it was pointed out that FTB was taking an average of 44 months to close a docketed protest, which is longer than the 24-month goal provided for in FTB Notice 2006-6. In previous reports, TRAO discussed FTB's inventory of aged (over 36 months) protest cases and the efforts taken to become current. This year, I also worked with representatives who had concerns about the length of time it takes to resolve a protest. Therefore, I would like to follow up on FTB's efforts to reduce its combined aged protest inventory.

I am pleased to report the number of workable aged docketed and undocketed protest cases has decreased from FY 2013/2014 through FY 2016/2017. Docketed aged protest cases decreased from 222 in FY 2013/2014 to 107 at the end of FY 2016/2017 while undocketed aged protest cases decreased from 63 to 49 during the same time. While there has been on overall decrease in the number of aged cases (and total inventory), we noted an increase in undocketed aged cases from 30 at the beginning of FY 2016/2017 to 49 at the end of FY 2016/2017. FTB plans to reallocate resources to focus on reducing the undocketed protest aged inventory.

Not all older or aged cases are workable. Some cases are deferred due to litigation, federal action, bankruptcy, or other matters outside our control. Approximately 15 percent of the aged protest cases, both docketed and undocketed, are currently unworkable for these reasons.

Our Legal and Audit Divisions continue to work closely, leading to better case development. Both divisions added new technical experts and policy advisors this past year to assist staff with questions and consultation needs aimed at increasing knowledge, improving the quality of audits, and resolving cases at the lowest levels. My hope is that this effort will help reduce the number of protest cases and the time necessary to resolve them.

Correspondence Time Frames

During the December 2016 Taxpayers' Bill of Rights Hearing, the issue of correspondence time frames was discussed. At the hearing, a request was made to FTB to delay collection activity when timely correspondence is received but not worked quickly enough to prevent a subsequent notice from being generated. It is not uncommon for FTB to transfer correspondence to multiple areas of FTB, making it difficult to handle issues timely. Taxpayers who respond timely to notices often receive follow up notices and can be subjected to involuntary collection activity when FTB does not process their correspondence timely. As a result, the taxpayer must call or chat online with us to resolve their issue.

Last year I shared my concern about FTB's ability to handle call volumes and help taxpayers. Customer service continues to be an area of concern for all of us. Often, taxpayers cannot resolve amounts in dispute with self-serve options. In the Collection contact center, BE level of access (LOA) increased by two percent to 61 percent for FY 2016/2017. However, over 91,000 BE taxpayer calls were not answered. PIT calls remained at 1.6 million. However, the LOA dropped by seven percent to 54 percent for FY 2016/2017. This resulted in nearly 750,000 PIT taxpayer calls not answered. Although this is the third year that the PIT LOA has dropped, the ARM Division is determined to improve the LOA in its PIT Contact Center. The ARM Division understands this challenge and plans to adjust the timing and volume of outgoing notices to better balance with the resources available to respond to the calls. ARM also plan to adjust their hiring strategy to ensure positions are filled timely and redirect resources from other critical workloads to answer calls during peak times. In addition, ARM plans to continue to collaborate with other business areas at FTB to help overall efforts to answer calls.

While I understand the challenges of implementing a hold on collection activity when FTB receives timely correspondence, FTB must ensure the taxpayer is heard. As a result, FTB is exploring delaying a subsequent action when correspondence has been received but not yet worked. I also look forward to seeing ARM's progress over the coming year with their LOA and hope to see ARM Division join our "Know Your Wait Times" website dashboard. Knowing ARM Division call, correspondence, and live chat wait times will help taxpayers decide the appropriate method to contact us.

Examples of Taxpayers' Rights Advocate's Office Cases

Taxpayers may contact TRAO if they have an ongoing state income tax problem that they have been unable to resolve through normal channels. The following four cases illustrate how the TRAO coordinated resolution of a taxpayer's complaint or problem by taking a fresh look at the case and reviewing its merits, the law, and FTB's position. With the cooperation of FTB staff, these cases resulted in procedural changes to ensure all taxpayers in similar circumstances are given due consideration.

TRAO Identified Systemic Errors

A systemic issue:

- Affects multiple taxpayers.
- Impacts segments of the population locally, regionally, or nationally.
- Relates to FTB systems, policies, or procedures.
- Involves protecting taxpayer rights, or reducing or preventing taxpayer burden.

One of the ways my office reduces the burden on all taxpayers is through identifying and coordinating a resolution of systemic issues.

FTB Form 3800

Background

California law follows federal law in prescribing when a child's unearned income must be taxed at the parent's tax rate. Taxpayers may choose one of two ways to report this tax. One way to report is to include the child's investment income on the parent's tax return and attach Form 3803, *Parent's Election to Report Child's Interest and Dividends*. The other way is for the child to file a tax return and attach Form 3800, *Tax Computation for Certain Children with Unearned Income*. California law provides for the allowance of personal exemption credits. However a taxpayer is not allowed a personal exemption credit if they could be claimed as a dependent by another taxpayer, regardless of whether the other taxpayer actually claims the credit or if the credit is reduced or eliminated by phase-out rules.

Issue

Several tax representatives contacted TRAO to complain that FTB improperly denied their client's personal exemption credit. In each case, the tax return at issue was filed for a minor taxpayer that had elected to file their own tax return and report their unearned income using Form 3800.

Resolution

TRAO worked with Filing Division staff and discovered a processing rule relating to Form 3800 was causing FTB to issue the erroneous notices. Once the rule error was identified, Filing Division staff deactivated the rule and distributed procedures to all areas within FTB advising staff on how to handle taxpayer contacts related to this issue.

Other State Tax Credit

Background

California law allows an Other State Tax Credit (OSTC) to alleviate double taxation, assuming specific California statutory requirements are satisfied. The statutory requirements for the credit vary, depending on the residency and status of the taxpayer. Generally the law provides that FTB will not allow the credit if the other state "allows residents of [California] a credit against the taxes imposed by that [other] state" for taxes paid or payable in California. Such states that provide a credit to California residents are referred to as "reverse credit states." An exception to this rule is when the taxpayer paid taxes to a reverse credit state through the use of a composite (group) tax return as the reverse credit state does not allow a credit for taxes paid to California on the group tax return.

Issue

Tax representatives contacted TRAO because FTB adjusted a client's OSTC and advised the taxpayers that they should pay the tax due and file a claim for refund. In each case, the taxpayer had claimed the OSTC for taxes paid in "reverse credit states" and met the exception as the taxes being claimed had been the distributive share of a composite (group) tax return where the other state did not allow a credit on a group tax return. In addition, an issue with claims related to city tax came to light.

Resolution

TRAO worked with Filing and Legal Division staff to determine that FTB would make changes to allow the OSTC related to the composite tax returns. FTB's Legal Division also opined that FTB should not disallow the city tax as a math error on a *Notice of Tax Return Change* (NTRC), but rather disallow the city tax on a *Notice of Proposed Assessment* (NPA) to allow the taxpayer an opportunity to exercise their due process rights pre-payment. Once these matters were identified, procedures were updated from a systemic perspective moving forward.

TRAO Collaboration on Pilot Program – Conditional Revivor

Background

Under California law a legal BE that has had its powers, rights, and privileges either suspended or forfeited may not legally conduct business until FTB has revived the entity back to good standing.

Issue

TRAO received multiple requests for assistance by BEs because they had either been suspended or forfeited and due to the recent economic downturn did not have the resources to make full payment of their balance including taxes, penalties, and interest due. A BE wishing to revive, but without the immediate ability to pay in full, was denied a revivor. Many of these businesses wanted to pay over time (installment agreements); however, they were forced to continue to operate in a suspended status to keep the doors open or simply close leaving FTB little ability to collect revenue.

Resolution

TRAO worked with ARM Division staff on a Conditional Revivor pilot with a goal of expanding FTB's interpretation and application of a law that authorizes FTB to revive BEs prior to full payments. ARM Division staff will study the success of the pilot program to determine if the program kept businesses open and improved the prospects for collection. ARM will also look at the effectiveness of allowing BEs to negotiate terms of payment, offering various payment options including initial and balloon payments, monthly payments, and delayed promise to pay in full.

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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 mission is to provide quality service to taxpayers through:

- Education and Outreach – We educate and engage taxpayers and tax professionals by addressing changes in law, the most common errors, and information about FTB. We solicit feedback from external stakeholders about FTB services, policies, and procedures to improve transparency.
- Case Advocacy – We provide services to individuals and businesses with problems ranging from customer service to complex audits and filing issues not resolved through normal channels.
- Systemic Advocacy – We identify legislative issues. We analyze and find resolution for broad-based taxpayer problems. We work with external stakeholders to identify problems. We provide input to FTB on behalf of taxpayers and tax professionals.

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 Revenue and Taxation Code (R&TC), the Taxpayers' Rights Advocate:

- Coordinates the resolution of taxpayer complaints and problems, including complaints about 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.

TRAO 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 $10,200.

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, legal, and department procedure updates as well as discussion about market-based sourcing, nexus standards, and single sales factor apportionment.

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, TRAO provides legislative staff with annual filing season updates and information on services available to taxpayers. This year we provided information about available online services and taxpayer assistance information.

Interest Abatement

We may cancel interest if a taxpayer can show the interest accrued because we made an unreasonable error or delay in performing certain kinds of acts. We may also cancel interest, under certain circumstances, if IRS canceled 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 TRAO 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 45,000 contacts in FY 2016/2017. Over 60 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 18,000 pieces of correspondence (letters, faxes, and emails) during this reporting period. More than in prior years, taxpayers chose to email or write 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 four personal income tax reasons taxpayers contacted TRAO in FY 2016/2017 include:

- FEs
- Wage garnishments
- Bank levies
- Liens

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 canceled 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.

The top five reasons a business entity contacted TRAO in FY 2016/2017 include:

- Penalty abatement
- Never conducted business in California, but received a bill
- Disagree with prior FTB answer
- Revivor requests
- Missing/misapplied payments

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

Penalty Abatement

We review accounts for reasonable cause and proceed accordingly within the confines of the R&TC. If the balance is valid, we work with the business entity to set a payment due date or an IA.

Never Conducted Business in California, but Received a Bill

We receive contacts from businesses registered in the state that have never conducted business. We explain that they are still responsible for filing returns and paying any balance due, whether or not they actively did business or made a profit. If the balance is valid, we work with the business entity to set a payment due date or an IA.

Revivor Request

When contacted for a revivor request, we direct the business entity to file missing tax returns, pay any balance due, and submit any other documentation so we can coordinate the revivor process.

Missing/Misapplied Payments

When contacted about missing payments, we ask the business entity for a copy of the canceled check. We search our records to locate the payment. When we locate the payment, we analyze the account and, if appropriate, apply the payment to the correct account or tax year.

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; the limit was indexed to $10,200 for 2017.
- 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 2016/2017, we received 341 issues through SIMS. Of the issues submitted, we identified 5 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 PIT NPA display file for assessments that became final in FY 2016/2017. 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 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. Ninety-five percent of the individuals who received NPAs during FY 2016/2017 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 89 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 17.7 million current year tax returns processed between July 1, 2016, and June 30, 2017. During this time, FTB made approximately 540,000 adjustments and issued just over 586,000 NTRCs to taxpayers who filed tax returns with errors that resulted in a change of tax liability. This figure equates to approximately 3 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 (52 percent) of the adjustments we made were on paper-filed tax returns, even though only 13 percent of total current year tax returns were paper-filed. Adjustments on electronically filed tax returns (87 percent of total current year tax returns) accounted for the remaining 48 percent.

The most common taxpayer error, for all filing methods, was to claim the wrong amount of estimated tax payments. Of all current year NTRCs, 27 percent contain a wage withholding adjustment. Taxpayers claimed a wage withholding amount that could not be verified based on the withholding information provided by the taxpayer and/or based on amounts reported to the Employment Development Department by the taxpayer's employer.

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 in progress.

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 2016/2017, the Taxpayer Services Center (public number 800.852.5711 and hotline number 916.845.7057) answered over 1.1 million incoming calls. TSCS targeted 15 specific busy days throughout the year and added additional staff in an effort to improve customer service. Throttling notices to distribute notices more evenly throughout the year helped to manage call center volumes. We also continue to use technology to maximize and increase the options for taxpayers to self-serve. TSCS answered 58 percent of the calls in FY 2016/2017 which was an improvement from the previous year of 42 percent.

During FY 2016/2017, ARM Division held their service to customers at 61 percent. ARM used technologies, such as Virtual Hold and modified additional queue configuration, to maintain our LOA service to our customers. Overall, ARM staff answered 1.3 million, or 61 percent, of calls.

Response to Correspondence Time Frames

In FY 2016/2017, we processed over 270,000 pieces of general correspondence, eliminated backlogs, and maintained the 90-day time frame goal from February through June. We accomplished this by the following measures:

- Using enterprise partnerships and spring finance letter positions.
- Throttling notices to level the number of notices sent throughout the year.
- Increasing system efficiencies and effectiveness to maximize production.

Plans are in place to continue to minimize backlogs.

Education and Outreach

We continuously look for ways to expand 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 events to provide small business education and outreach throughout California. Also, our staff collaborated with GO-Biz and SOS on the Business Dissolution/Cancellation Process Analysis Team. This team studied the entity dissolution/cancellation process and provided recommendations to improve it. The team's recommendations provided business entities with an easier process to understand and achieve better compliance through an expanded joint education and outreach effort between SOS and FTB. We included the new process and resources in our presentations as well as through articles in our monthly publication, *Tax News*.

We believe that pointing taxpayers and tax professionals to new tools and resources will increase 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 2017, approximately 150,000 taxpayers filed their current tax year (2016) tax return, approximately 8,500 filed a 2015 tax return, and approximately 3,000 more filed their 2014 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.

Other MyFTB features for individual taxpayers, business taxpayers, and authorized tax professionals include:

- 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.

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). Last year, more than 1.3 million payments, totaling over $29 billion, were made by individuals and businesses using Web Pay.

Training

FTB develops knowledgeable and engaged employees to:

- Improve the customer experience and accomplish FTB's mission.
- Provide the services and information to help taxpayers file accurate and timely tax returns and pay the proper amount owed.

FTB provides extensive classroom and on-the-job training to contact center and public service counter staff. Training topics include customer service sensitivity and telephone techniques. Contact center staff provide taxpayer assistance by phone, correspondence, and Live Chat. Staff explain income tax laws, assist with general tax questions, and provide forms and publications. Collections staff provide taxpayers with information and offer solutions to help taxpayers resolve delinquent debts.

FTB provides technical employee training to compliance representatives, customer service specialists, and tax technicians, on the following systems:

- Accounts Receivable Collection System
- BE Tax System
- Case Management
- Integrated Nonfiler Compliance System
- Taxpayer Folder
- Taxpayer Information System
- Delinquent Vehicle Registration System
- Court Ordered Debt System

FTB provides employee training in workplace diversity, sexual harassment awareness, disability awareness, employee assistance program, career development and upward mobility, and other administrative courses.

FTB also provides essential training for:

- Account analysis and resolution
- Billing cycle
- Filing requirements
- Financial hardship evaluation
- Legal actions
- Penalties and interest
- Privacy, security, and disclosure
- Tax assessments
- Taxpayers' Bill of Rights

New collectors receive eight to ten weeks of formal classroom training and up to one year of on-the-job training for basic collection techniques. As new technologies become available or new laws impact FTB's processes, we provide additional training to ensure staff is current with issues that affect business practices. 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 training session, staff receive system instruction for collections and accounting systems. Soft skill courses aid in day-to-day tasks. Classes include: negotiations, conflict management, inventory management, customer service and sensitivity, and telephone techniques. An integral part of the training session is on-the-job training.

In addition to new hire training classes, we offer refresher and advanced collector training classes. The newest advanced training classes offered include: Time Management vs. Heavy Workload, Dealing with Difficult Situations and Taxpayers, and Making Proper Decisions and Conclusions.

FTB invites subject matter experts to serve as mentors, training consultants, and/or guest instructors to provide new or updated training as it relates to the business area. FTB encourages employees to further their education by enrolling in Skillsoft online learning and college courses to refresh their skills and/or continue their education.

Enforcement

Although FTB encourages voluntary compliance by providing taxpayer education as well as prefiling assistance and information, FTB continues to identify ways to improve its enforcement capabilities.

Filing Enforcement Program

The FE program identifies, 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 a variety of income sources to contact wage earners, self- employed individuals, individuals with unreported capital gains, nonresidents with California source income and individuals with partnership income. The PIT FE program receives more than 500 million income records provided by IRS, California Department of Tax and Fee Administration (CDTFA), Employment Development Department (EDD), financial institutions, and other sources.

The BE nonfiler program also uses various income sources, including information from IRS, CDTFA, 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 Enterprise to Data Revenue (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 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.
- Provide information that will help resolve their nonfiler case.
- Learn about payment options.
- Access their MyFTB account.

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 transactions. We focus our audit resources on the most egregious tax filing strategies, share information across programs, train staff, and follow up on leads.

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.

Payment Methods

Installment Agreements

FTB provides the option of an IA 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 IA requests online. Since March 2012, individual taxpayers have the option to set up IAs through the Interactive Voice Response (IVR). In FY 2016/2017, 220,000 total IAs 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 IA are met, we convert the provisional plan to a formal IA. Since implementation in December 2009 through June 30, 2017, 135,483 tax returns have been filed and over $164 million collected. Provisional payment plans increase compliance with tax laws, accelerate revenue, provide greater efficiencies, and improve customer service.

Offer in Compromise

FTB's OIC 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 2016/2017, criminal investigations activities resulted in:

- 18 individuals arrested.
- 104 locations searched while executing a warrant.
- 25 new cases approved for prosecution.
- 29 guilty pleas entered.
- 2 guilty verdicts from trials.
- 873 months incarceration and 840 probation months sentenced.
- 21 cases closed.

Legal

The Legal Division supports the enforcement effort by providing consultation and litigation support for positions developed in cooperation with the other enforcement programs. Support activities include representation in protests, representation in appeal proceedings before the Office of Tax Appeals, 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.

Our Multilingual Communications program continues to provide vital services to our non-English speaking community. The program works closely with our agency's business areas to better understand the needs of our non-English speaking customers as well as the bilingual representatives who serve these customers.

Representatives attended the 38th Annual California Department of Education Migrant Parent Conference, providing educational Spanish materials to nearly 800 participants. Materials included Cal EITC and free Volunteer Income Tax Assistance (VITA) brochures.

Participants showed a continued interest in Spanish self-service options and online information, available by mobile device. In turn, representatives had the opportunity to demonstrate how to access Spanish information and materials on our public website by the use of laptops and mobile devices. 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 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 audio CD.

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*, our award winning technical publication, also continues to be a valuable resource for the tax professional community. With our business areas' proactive approach to writing articles, our content continues to be relevant, timely, and informative.

The Processing Services Bureau's Exempt Organization Unit participated in education and outreach events sponsored by California State Board of Equalization (BOE) members, the State Controller's Office, and various nonprofit groups. Presenters engaged with the public to discuss various aspects of exempt organizations including:

- How to become an exempt organization.
- Filing requirements.
- How to keep exempt status.
- Various issues, such as unrelated business income and suspensions.
- Other items by audience request.

In 2016, the Exempt Organization Unit conducted 11 presentations in locations across California.

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:

Advocate Services

We inform tax professionals when to contact the Taxpayers' Rights Advocate for assistance. When normal channels fail, tax professionals should contact us for assistance with a tax problem.

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 $10,200). The taxpayer must not have significantly caused the error or delay.

California Earned Income Tax Credit

In 2016 California allowed a refundable credit to working families, similar to the federal EITC. The credit ranges from $217 to $2,706 for incomes from $6,717 to $14,161. New for this year, employers are required to inform employees of the credit (regardless of eligibility). A qualifying tier exists for families with three or more children who may be eligible for the maximum credit. 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.

Right to Representation

We acknowledged the delay in processing POA declarations. We explained how FTB continued to allow the right to representation through various authentication methods during the POA processing period. We also shared changes to the POA process in the coming year.

Know Your Wait Times

We released the new customer service dashboard for our wait times. The dashboard displays the estimated time for the following information:

Contact Wait Times

- Customer service general lines
- Tax Practitioner Hotline
- Secure Live Chat
- General Live Chat

Processing Time Frames

- Payments
- Refunds
- Returns
- Correspondence

Business Entity Due Dates

AB1775 changed due dates for corporate and partnership tax returns filed on or after January 1, 2016. Additionally, AB 119 changed extended due dates for partnerships and limited liability companies filing as partnerships for tax returns filed on or after January 1, 2018. The extended due date changed from September 15 to October 15 for calendar year filers. There is a reasonable cause provision for penalty abatement for the described entities if they do not file by September 15, 2017.

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. Eligible PIT callers can apply for IAs, skip up to two IA monthly payments, or delay their tax bill one time for thirty days. 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 5.9 million hours of hold time since implementation and over 1.4 million hours during FY 2016/2017. When offered the option, 77 percent of the callers chose to have a call back. We successfully connected with 85 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 EDD.

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 also continues to work closely with GO-Biz to provide information for 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

Tax News, our award-winning monthly online publication, is the department's primary external communication source to inform 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. *Tax News* allows us to deliver fast and cost-efficient communications, providing an effective way to share information and link directly to FTB and external online resources. We continue to increase our use of electronic notification through social media like Twitter and Facebook.

Our subscribership continues to grow at a steady pace. We partner with IRS and other state and county agencies to share pertinent information with their customers and our subscribers. *Tax News* continues to experience positive feedback, and trade media publications repost and quote our articles.

We updated our look in our *Tax News Live* series and hope to release several new videos in the coming months.

Small Business Outreach

We conduct seminars and develop programs to help small businesses meet their state income tax filing requirements. In conjunction with BOE, EDD, and IRS, we develop products that simplify the process to obtain information on most business filing requirements.

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

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

- FTB 984 *Expenses for the Business Owner and Highlights of Federal/State Differences*
- FTB 1123, *Forms of Ownership*

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

The education and outreach staff received over 1,100 calls this year, 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 2017

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.

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. We drafted an education letter to inform businesses about the law changes. The letter encourages voluntary filing compliance by providing information about the benefits of the Voluntary Disclosure Program and Filing Compliance Agreement.

Exploring Nudging Techniques

The "Nudge Theory" is a concept of examining nonforced compliance gained by positive reinforcement and indirect suggestions. The "Nudge Theory" of nonforced compliance may have the potential to influence the motives, incentives, and decision making of groups and individuals more effectively than direct instruction, legislation, or enforcement. As a new initiative, the FTB Nudge Team will explore the potential benefits of applying these techniques within the world of state income taxes. We will use Nudge within FTB programs to support our goals.

Statewide Identity Theft Collaboration

Compliance team members will research and identify the state programs and departments that could be a focus for identity thieves. Team members will document the need and benefits of a statewide team focused on detecting and preventing government benefit, tax, and health related identity theft.

Data Analytics

We document our current processes, tools, and data to establish a baseline and assess the multitude of tools available to perform modeling and data analytics. We use this information to develop and publish a process for future offers, inquiries, and requests from data analytics software vendors.

Taxpayer Segmentation

Compliance team members will study various segments of the taxpayer population to determine where additional education is needed to encourage compliance.

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.

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 2016/2017, FTB experienced an 85 percent access rate overall for both authenticated and nonauthenticated chat, responding to over 159,000 contacts. Nonauthenticated chat answered over 117,000 contacts and authenticated chat answered over 42,000 contacts.

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 LOA. 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.

Installment Agreement Skip Payment and Notice Bill Delay Project

FTB now provides self-service options for PIT taxpayers and court ordered debt (COD) debtors with a short-term inability to pay. Web and Interactive Voice Response (IVR) self-service options are available for PIT taxpayers to request a skip payment for their current IA and request a one-time 30 day bill delay to pay their balance in full. Taxpayers can log in to their MyFTB account to use the web self-service options or call 800.689.4776 to use the IVR self-service options. COD debtors can log in to their MyCOD account for self-service options to request a skip payment and bill delay.

The PIT Web IA Skip Payment self-service option was implemented in January 2016. The PIT Web Bill Delay self-service option was implemented in September 2016. Through July 26, 2017, there have been 11,663 skip payment eligibility checks and 1,408 successful skip payments. There have been 9,624 bill delay eligibility checks and 103 successful bill delays for the same period.

The PIT IVR IA Skip Payment self-service option was implemented in September 2016. The PIT IVR Bill Delay self-service option was implemented in June 2017.

Through July 26, 2017, there have been 8,438 skip payment eligibility checks and 1,654 successful skip payments. There have been 1,746 bill delay eligibility checks and 220 successful bill delays for the same period.

The COD Web Skip Payment and Bill Delay self-service options were implemented in August 2016. Through July 26, 2017, there have been 1,638 skip payment page views with 205 successful skip payments. There have been 2,521 bill delay page views and 325 successful bill delays for the same period.

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, 2016. 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.

Rex Halverson, Rex Halverson & Associates

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

- Encrypted email
- POA registration
- MyFTB
- POA processing time frames
- Form 592, *Resident and Nonresident Withholding Statement*
- Failure to respond to penalty

In her letter dated February 16, 2017, Taxpayer's Rights Advocate, Susan Maples responded regarding encrypted emails that FTB prioritizes taxpayer information and privacy. A secure email system is available for staff to communicate with external customers when the external customer has an established relationship with FTB staff, agrees to communicate by secure email, and validates their current email address. FTB offers a help link on the recipients secure email and technical support to assist customers about issues related to secure emails. If a customers' system or security controls do not correspond with our secure email service, the customer will need to establish another communication method with their FTB contact.

Regarding POA registration, Mrs. Maples responded that FTB has been working to refine the online process of POA declarations through the following measures:

- Education and outreach
- Increased staffing
- System enhancements including a "known tax professional" method and an improved "implied consent" procedure

Through efforts to decrease processing time frames and identify solutions that will increase operational excellence and customer service, the number of POA rejections submitted online through MyFTB has dropped.

Regarding MyFTB term confusion, Mrs. Maples responded that FTB has received comments about confusion surrounding the term "tax preparer" and we are looking into adding clarifying language to the website. A "tax preparer" refers to someone representing taxpayers on tax related matters with one of more of the following IDs: a California certified public accountant number, a California state bar number, a preparer tax identification number, or an electronic filing identification number. An "individual" refers to a personal income tax filer, and a "business representative" refers to someone authorized by the business to access the MyFTB account.

Regarding POA processing time frames, Mrs. Maples responded that the FTB's goal is to provide representatives with timely assistance to help their client resolve tax matters and improving the POA process is a top priority. FTB is making necessary changes, both short- and long-term, so that representatives are able to conduct business efficiently and effectively. Short-term changes include increased staffing to decrease processing time frames and improved procedures such as “implied consent” through clarification and simplification to enable staff to work with representatives quickly and easily. Implied consent may not always be the solution for every practitioner, for this reason long-term efforts are underway to improve other areas of concern and make changes where possible.

Regarding Form 592, Mrs. Maples responded that Form 592 is necessary to perform a complete and accurate accounting of the remittance sent to us and to ensure the timely application of the withholding. We strive to publish clear and concise instructions and welcome any input and suggestions.

Regarding failure to respond to penalties, Mrs. Maples responded that FTB assesses a “failure to provide information requested/failure to file a return upon demand” penalty equal to 25 percent of the total tax liability assessed without regard to any payments or credits. The penalty is only applied if the taxpayer has tax due and a filing requirement, if the taxpayer can prove that the failure to file was due to reasonable cause and not willful neglect, the statute allows the penalty to be abated.

Douglas Pickford, EA – California Society of Enrolled Agents

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

- BE dissolution/cancellation failures (follow-up)
- POA submissions
- Web Pay anomalies and payment credits
- Form 4734D taxpayer verification requests
- Coordination of correspondence cycles and billing cycles
- Level of service

In her letter dated February 16, 2017, Taxpayer’s Rights Advocate, Susan Maples responded regarding BE dissolutions and cancellation failures that reducing the number of entities closing but failing to properly dissolve is vital to FTB. FTB actively collaborates with SOS and GO-Biz to revise and coordinate messaging on all platforms, to expand joint education and outreach efforts, and to educate businesses on how to properly dissolve. For the longer term, FTB will determine the feasibility of submitting required dissolution/cancellation paperwork electronically.

Regarding POA submissions, Mrs. Maples responded that FTB’s goal is to provide representatives with timely assistance to help their clients resolve tax matters. Short- and long-term steps to improve the POA process including increased staffing to decrease processing time frames and improved procedures such as “implied consent” to enable staff to work with representatives quickly and easily. Long-term efforts are underway as well to improve and address other areas of concern. If you have submitted a POA for processing and it has not been worked within our processing time frames, you may request expedited processing.

Regarding web pay anomalies and payment credits, Mrs. Maples responded that FTB’s accounting system is usually able to recognize payments in suspense and properly apply payments prior to issuing a notice. FTB has put procedures in place so that we can identify and correct scenarios where the system does not automatically apply “misclassified” payments.

Regarding FTB 4734D, R*equest for Tax Information and Documents*, Mrs. Maples responded that FTB has made several changes to the opening and closing of the taxpayer verification requests. To improve taxpayer confidence in the request, individuals can now use FTB’s public website to verify the legitimacy of the request. Internal procedures for the 2017 filing season have been changed in the event that the social security card is unavailable or the taxpayer is uncomfortable due to phishing or identity theft schemes. Refunds will still be issued to taxpayers that were unable to or chose not to provide a copy of the card when staff can verify the taxpayer's identity over the phone to ensure the return was filed by the taxpayer.

Regarding coordination of correspondence cycles and billing cycles, Mrs. Maples responded that FTB understands frustration arises from receiving additional correspondence or a billing notice that doesn't acknowledge an earlier response. To help reduce these occurrences of overlap, new mail strategies and steps to increase responsiveness are being implemented. These steps include increased staffing, expedited cross-training, improved internal procedures, and an increased number of self-service tools and automated tools. We are confident these steps will lead to a meaningful reduction in instances of overlap.

Regarding the level of service, Mrs. Maples responded that FTB is committed to providing an acceptable level of service and continuously seeking out opportunities to improve our LOA and service provided to customers. FTB is adding processes to help smooth out the volume of calls we receive to reduce overall wait times. FTB has added technology solutions which provide options for practitioners to self-serve and more quickly resolve their issues, these include Live Chat and Secure Chat.

Lynn Freer, EA – Spidell Publishing, Inc.

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

- Clarify policy regarding Other State Tax Credit and the Texas Franchise Tax
- Clarify relationship of sourcing rules for personal services, nonresident withholding, and Other State Tax Credit
- Availability of interest waivers on "stale" penalties
- Clean the books of dead corporations and limited liability corporations (LLC)

In her letter dated February 16, 2017, Taxpayer's Rights Advocate, Susan Maples responded regarding clarifying policy about the Other State Tax Credit and the Texas Franchise Tax. FTB issued Technical Advice Memorandum 2016-01 on January 12, 2016, indicating that payment of the Revised Texas Franchise Tax (RTFT) is not eligible for the Other State Tax Credit (OSTC) for any tax year. FTB is currently drafting a legal ruling to affirm the position taken in Technical Advice Memorandum 2016-01. Prior guidance by the FTB indicating the RTFT may be eligible for the OSTC in some cases was withdrawn on January 17, 2014, by FTB Notice 2014-01. In the event a taxpayer relied on FTB's prior guidance in deciding to file a return claiming the OSTC for payment of the RTFT for tax years prior to 2015, such reliance will be taken into consideration when determining whether cause has been shown to abate penalties imposed by the disallowance of the OSTC.

Regarding clarifying relationships of sourcing rules for personal services, nonresident withholding, and OSTC, Mrs. Maples responded that market-based sourcing rules come into play for individuals taxed on income earned both within and without California. The sourcing rule requires individuals to source their income based on where the customer of their services benefitted from such services. FTB will issue a legal ruling shortly explaining this rule to taxpayers, however this will not address withholding. Regulatory changes will be required to implement withholding requirements based on market-based sourcing. Until a regulation project can be completed, language in Regulations 18662-4 and 18662-5 state that withholding will not be required on income which may otherwise be sourced in California unless such income is also from services performed in California.

Regarding availability of interest waivers on "stale" penalties, Mrs. Maples responded that where FTB delayed in sending a billing or assessment notice, R&TC Section 19104 provides FTB with the discretionary authority to abate interest. However R&TC

Section 19104(b)(1) states FTB cannot exercise its discretion to abate interest when alleged delay occurred prior to first written contact. R&TC Section 21004(c)(1)(A) and (B) allows FTB to abate interest if the interest charges are attributable to an erroneous action or inaction by FTB in processing documents filed by the taxpayer or for unreasonable delays caused by FTB and only if the relief is not available under any other code section. FTB is evaluating why its computer systems are imposing penalties on notices that are delayed and will consider whether interest may be abated on a case-by-case basis.

Regarding cleaning the books of dead corporations and LLCs, Mrs. Maples responded that reducing the number of business entities failing to properly dissolve is vital to FTB. FTB's OIC process has already provided resolution to a significant number of business owners who failed to dissolve or cancel their entity. FTB actively collaborates with SOS and GO-Biz to revise and coordinate messaging on all platforms, to expand joint education and outreach efforts, and to educate businesses on how to properly dissolve.

Therese Twomey – California Taxpayers Association

Ms. Twomey provided oral comments to the Board about partnership return extended filing dates.

In her letter dated February 16, 2017, Taxpayer's Rights Advocate, Susan Maples responded regarding partnership return extended filing dates that under existing law, taxpayers subject to Personal Income Tax Law are allowed an automatic extension of up to six months from the original due date to file their return. For taxpayers subject to the Corporation Tax Law, FTB may grant a reasonable extension of time to file a return of no more than seven months from the original due date. AB 1775 (Stats. 2016, Ch. 348) mirrored federal changes that modified the original due date for partnership returns and C Corporations returns. AB 1775 did not modify the law regarding extended due dates but as a result, the filing deadline for partnerships precedes the return due dates for their individual and corporate investors. FTB Notice 2016-04 modified the automatic extension for filing corporation returns for tax years beginning on or after January 2, 2016, from seven months to six months from the due date established by AB 1775 in order to retain the current extended due date of the 15th day of the 10th month after the close of the tax year for returns filed under the Corporation Tax Law. FTB Board members are urged by CalTax's proposal to sponsor legislation that would modify R&TC Section 18567 to allow an automatic paperless extension for up to seven months rather than six months for pass-through entities subject to the Personal Income Tax Law. Consistent with existing processes, the department will review the proposal expecting to be finished by fall of 2017.

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 focused on making sure that all eligible employees received a written performance evaluation annually and that the evaluation and feedback they received were valuable. For the 2016 performance appraisal cycle, we successfully implemented automated tools that assisted supervisors in writing, routing, and storing employee performance evaluations. These tools helped us better reach our goal of every eligible employee receiving an evaluation. It also helped ensure that the evaluations were completed and provided to the employees more timely. Even though the evaluations are produced and stored electronically, the most important part of the process is the sincere, respectful, and open conversations with employees regarding expectations and performance.

Appendices

Appendix 1

All tables in Appendix 1 reflect tax increase assessments only. The assessments became final in FY 2016/2017. We may have issued the assessments in prior years; however, due to cases in protest status, we did not resolve them until FY 2016/2017. Appendix 1 totals reflect rounded figures and may not compute exactly.

Table 1A **Corporation Tax Law**
NPAs Finalized in FY 2016/2017 Categorized by Primary Statute (issue)

Issue	Number of NPAs	%	Tax Assessed (millions)	%	Average Assessment Per NPA
Allocation/Apportionment	698	32.3	$ 260.0	66.8	$ 372,492
Assess Minimum Tax	19	0.8	0.0	0.0	742
Revenue Agent Reports	1,263	58.4	55.9	14.3	44,231
State Adjustments	105	4.8	9.3	2.3	88,262
Other	74	3.3	64.0	16.5	865,349
Totals/Average	2,159	100	$ 389.2	100	$ 180,260

- 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 2016/2017 Categorized by Primary Statute (issue)

Issue	Number of NPAs	%	Tax Assessed (thousands)	%	Average Assessment Per NPA
CP2000	120,081	22.9	$ 135,548	8.1	$ 1,129
Filing Enforcement	328,409	62.6	1,124,032	67.2	3,423
Filing Status	10,623	2.0	13,592	0.8	1,279
Revenue Agent Reports	32,757	6.2	123,348	7.4	3,766
Other	33,148	6.3	275,999	16.5	8,326
Totals/Average	525,018	100	$1,672,519	100	$ 3,186

- The CP2000 category results from the IRS comparing information documents that report income paid to individuals by third parties against income reported on their tax returns.
- Filing Enforcement refers to assessments issued to individuals who have not filed a state income tax return after we notified them of their filing requirement.
- Filing Status primarily reflects notices issued due to head of household adjustments.

Table 2 **Corporation Tax Law**
Corporations by Industry with NPAs Finalized in FY 2016/2017

Industry	All Corporations 2015 Tax Year	%	Corporations with NPAs	%	Tax Assessed (millions)	%
FIRE*	142,955	16.5	135	11.1	$ 71.8	18.4
Manufacturing	48,899	5.7	150	12.3	59.9	15.4
Services	374,802	43.3	248	20.3	30.2	7.8
Trade	141,254	16.3	230	18.9	30.9	7.9
Other **	157,683	18.2	456	37.4	196.4	50.5
Totals	865,593	100	1,219	100	$ 389.2	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 2016/2017 Issued by Tax Year

Average Tax Year	Number of NPAs	%	Tax Assessed (millions)	%	Average Assessment Per NPA
2009 and prior	484	22.4	$ 194.9	49.3	$ 402,581
2010	264	12.2	63.6	16.3	240,746
2011	617	28.6	79.4	20.4	128,739
2012	543	25.2	30.9	7.9	56,950
2013	189	8.8	15.9	4.1	84,468
2014	53	2.4	2.2	0.5	40,721
2015 and later	9	0.4	2.3	0.5	255,055
Totals/Average	2,159	100	$ 389.2	100	$ 180,260

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 2016/2017 for the Same Taxpayer

Corporations With…	Number of Taxpayers	Tax Assessed (millions)	Average Assessment Per Taxpayer
One NPA	597	$ 64.5	$ 108,034
Two NPAs	442	147.1	332,680
Three NPAs	113	49.2	435,385
Four or more NPAs	67	128.4	1,917,032
Totals/Average	1,219	$ 389.2	$ 319,262

Table 4 **Personal Income Tax Law**
NPAs Finalized in FY 2016/2017 Issued by Tax Year

Tax Year	Number of NPAs	%	Assessment Amount (thousands)	%	Average Assessment Amount
2010 and prior	3,386	0.6	$ 122,056	7.3	$ 36,047
2011	5,651	1.1	41,426	2.5	7,331
2012	66,687	12.7	245,683	14.7	3,684
2013	206,271	39.3	366,009	21.9	1,774
2014	233,467	44.5	871,950	52.1	3,735
2015 and later	9,556	1.8	25,395	1.5	2,658
Totals/Average	525,018	100	$1,672,519	100	$ 3,186

Table 5 **Personal Income Tax Law**
Resident Tax Return Preparation, Process Years 2015 and 2016

Preparer	2015 Tax Returns Processed (thousands)	%	2016 Tax Returns Processed (thousands)	%	% Change
Professional	14,079	88.8	14,560	89.4	0.6
Taxpayer	1,480	9.3	1,436	8.8	-0.5
VITA*	297	1.9	298	1.8	-0.1
Totals	15,856	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, 2016	June 30, 2017	% Change
Individual Payments	4,716,000	5,143,000	9
Business Payments	409,000	592,000	45
Direct Deposit Refund	7,447,000	7,972,000	7
Individual e-file	15,632,000	15,900,000	2
** *CalFile*	165,000	150,000	-9
Business e-file	1,329,000	1,437,000	8

** 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
2016/2017	95,454	58,166

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
2016/2017	831,646	400,028

Table 8A **Top Errors by Tax Return Type**
July 1, 2016, through June 30, 2017

	Code	Grand Total	540 2EZ	540	540 NR	540 X
EP	Estimate Payment Revised	238,569	83	207,240	26,709	4,537
GC	Withholding Adjusted	209,406	11,143	170,904	25,495	1,864
OC	Estimated Tax Transfer Revised: Error Affected the Available Transfer Amount	45,377	18	37,891	7,467	*
WS	Withhold at Source Revised	33,098	3	11,516	21,056	523
OF	Refund Reported on Amended Tax Return Does Not Match Original Tax Return	32,681	1,183	13,174	1,269	17,055
FM	Dependent Exemption Disallowed Because Dependent's ID Number Used On Another Tax Return	31,314	369	30,528	412	5
SS	State Disability Insurance Revised	25,824	*	24,994	453	377
FK	Dependent Exemption Disallowed Because Provided Dependent ID Was Invalid	20,523	930	17,143	2,445	5
BJ	Math Error Made When Calculating CA Adjusted Gross Income	20,067	*	20,021	*	44
OM	Amount Paid With Original Tax Return Plus Payments Made After Tax Return Filed Does Not Match Amount Claimed on Amended Tax Return	18,831	248	3,814	458	14,311
TC	Tax Amount Revised	15,855	34	14,009	633	1,179
GF	CA Tax Rate Incorrectly Calculated	13,730	*	*	13,721	6
BK	Error Transferring Deductions To Tax Return	12,689	43	10,834	1,282	530
BB	Personal Exemptions Revised Based On Filing Status	12,454	33	10,239	2,155	27
KC	Error Subtracting Total Special Credits From Net Tax	11,982	*	11,422	538	22
BM	Error Transferring Exemption Credits To Tax Return	11,771	*	11,703	*	67
KI	Error Using 2EZ Table When Calculating Tax	11,511	11,504	5	*	*
EA	Personal Exemption Credit Revised	10,484	6	9,182	1,290	6
VL	Unable to Verify Withholding	9,872	1,468	7,224	1,163	17
EB	Dependent Exemption Credit Disallowed Because No Dependent Names Listed On Tax Return	9,599	1,121	7,886	556	36
	Top Twenty	795,637	28,190	619,731	107,102	40,614
	All Others	191,472	22,610	130,277	31,159	7,426
	Grand Total	987,109	50,800	750,008	138,261	48,040

*Reflects fewer than three tax returns.

Table 8B **Top Errors by Filing Method**
July 1, 2016, through June 30, 2017

	Code	Grand Total	Electronic	Paper
EP	Estimate Payment Revised	238,569	176,564	62,005
GC	Withholding Adjusted	209,406	159,585	49,821
OC	Estimated Tax Transfer Revised: Error Affected the Available Transfer Amount	45,377	31,040	14,337
WS	Withhold at Source Revised	33,098	23,307	9,791
OF	Refund Reported on Amended Tax Return Does Not Match Original Tax Return	32,681	1,986	30,695
FM	Dependent Exemption Disallowed Because Dependent's ID Number Used on Another Tax Return	31,314	17,235	14,079
SS	State Disability Insurance Revised	25,824	18,879	6,945
FK	Dependent Exemption Disallowed Because Provided Dependent ID Was Invalid	20,523	266	20,257
BJ	Math Error Made When Calculating CA Adjusted Gross Income	20,067	*	20,067
OM	Amount Paid With Original Tax Return Plus Payments Made After Tax Return Filed Does Not Match Amount Claimed on Amended Tax Return	18,831	568	18,263
	Top Ten	675,690	429,430	246,260
	All Others	311,419	41,147	270,272
	Grand Total	987,109	470,577	516,532

*Reflects fewer than three tax returns.

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 late 2017 or early 2018.

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

The purpose of this proposed regulatory item is to amend 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, planned 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 regulations, 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.

Staff held interested parties meetings on October 12, 2015, and July 11, 2016. Staff received permission to proceed to the formal regulatory process at the Franchise Tax Board meeting on April 13, 2017.

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 held a second interested parties meeting on September 8, 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.

Regulation Section 19195-1 provides 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 by telephone or in person 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. The written decision also will include information about how the taxpayer may request reconsideration of the hearing officer's decision under this regulation and how and when a taxpayer may request reconsideration of the hearing officer's decision by the Taxpayers' Rights Advocate or her designee as provided for by this regulation.

Regulation Section 19195-2 provides 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.

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, April 21, 2016, and November 3, 2016. Staff anticipates requesting permission to proceed to the formal regulatory process at the Franchise Tax Board meeting on December 7, 2017.

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 make California's regulations consistent with the applicable federal regulations.

Staff held interested parties meetings on January 11, 2016, and August 3, 2016. Staff received permission to proceed to the formal regulatory process at the Franchise Tax Board meeting on December 8, 2016. Staff will begin the formal regulatory process upon outside approval of the economic impact analysis.

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. Staff will begin the formal regulatory process upon outside approval of the economic impact analysis.

b. Regulation Section 23663-6

Staff 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 2017 during which the Franchise Tax Board will present draft regulatory language for public comment.

Regulation Sections 23701, 23731, 23772, 23775, 23776, 23777, 23778 – Exempt Organization Clean-Up

Various sections of the R&TC establish the legal requirements for organizations to obtain exemption from taxation. The corresponding regulations have not been updated since 1982, though the related R&TC sections have been amended several times. The lack of updates has led to outdated cross-references, incorrect dollar amounts, references to obsolete forms, and nonoperational procedures. This regulation project would seek public input on issues relating to these technical problems and would potentially lead to proposed amendments which would address these issues. Staff anticipates including these regulation sections in the annual rulemaking calendar which will come before the three-member Franchise Tax Board for approval at the Franchise Tax Board meeting on December 7, 2017.

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 – When Taxable in Another State

This rulemaking project would discuss possible amendments to the regulations at CCR, Title 18, Section 25122, regarding taxpayers who are taxable in another state for purposes of allocation and apportionment of income.

Staff anticipates holding a first interested parties meeting in late 2017 or early 2018.

Regulation Section 25134 – Sales Factor

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 2018.

Regulation Section 25136-2 – Market Based Rules for Sales Other Than Sales of Tangible Personal Property

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

CCR, Title 18, Section 25136-2 (which became effective on March 27, 2012, and operative for tax years beginning on or after January 1, 2011) provides cascading rules for sales of services and sales of intangible property. In those rules, there are specific provisions for assignment of sales of stock or interests in a pass-through entity and for the incorporation of the special industry rules under CCR Section 25137, including those for mutual fund providers under CCR Section 25137-14.

Staff held an interested parties meeting on January 20, 2017, to elicit public input on further amendments to Section 25136-2, regarding benefit of the service received, asset management fees, government contracts, reasonable approximation, dividends, freight forwarding, and other issues. Staff held a second interested parties meeting on June 16, 2017, to present draft amendments. Another interested parties meeting is expected to be held in late 2017 or early 2018.

Regulation Section 25137 – Alternative Apportionment Method Petition Procedures

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. Staff held an interested parties meeting on June 30, 2017, and is currently drafting proposed regulatory amendments.

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 CCR, 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 revision of the proposed amendments and solicit input on any other issues that might need to be addressed.

On September 30, 2014, staff received approval from the three-member Franchise Tax Board to proceed with the formal regulation process. Staff will begin the formal regulatory process upon outside approval of the economic impact analysis.

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 was held on June 16, 2017. Staff has submitted the regulation to the Office of Administrative Law for approval.

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.