

# Taxpayers' Bill of Rights **Annual Report to the Legislature**



STATE OF CALIFORNIA  
**Franchise Tax Board**

# 2018

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## Executive Summary

We are grateful to our partners, stakeholders, and, above all, state taxpayers whom we constantly strive to provide the best service and support.

In the past year, the Franchise Tax Board (FTB) made great progress in our efforts to improve customer service, modernize our information technology systems, and protect taxpayer information.

Our call centers continued to improve their year-over-year performance through the careful management of staff resources and self-service options. Together, our Filing Services Bureau and Accounts Receivable Management Division answered upwards of 2.6 million calls, and also supported 250,000 Live Chat engagements through our website. Customer feedback surveys from the Live Chat sessions show taxpayers continue to appreciate the service.

FTB also processed more than 250,000 pieces of general correspondence and maintained the 90-day or better response time goal. Meanwhile, **ftb.ca.gov** logged more than 18 million hits throughout the year.

FTB continues to work towards the second phase of its 30-year tax system modernization plan, Enterprise Data to Revenue (EDR). The second phase, named EDR<sup>2</sup>, will incorporate FTB's studies on Customer Experience (CX) that analyze a taxpayer's entire journey through FTB's systems and services.

EDR<sup>2</sup> will increase self-service options, expand our case management tools and data warehouse, improve our audit modeling and fraud detection, streamline business processes, and replace outdated technology.

FTB also remains focused on protecting taxpayers by fighting identity theft and tax refund fraud. We are an active member of the Internal Revenue Service (IRS) Security Summit which is an alliance of state and federal officials, tax preparation firms, software developers, and financial institutions. This group works together to share information and collaboratively develop tools to keep fraudulent returns out of the tax system and protect taxpayers' refunds.

As always, we recognize this work would not be possible without the strong relationship we enjoy with our stakeholders, especially tax professionals, whose input and feedback help us to shape our path towards providing even better customer service to taxpayers.

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**  
Executive Officer

## Advocate's Address

Every year in the Advocate's Address, I highlight areas in the department that have made significant improvements in reducing taxpayer burden, those places where we need to do more, and of course the issues and cases that require Advocate assistance or came up at the annual Taxpayers' Bill of Rights Hearing. This year is no exception.

The Office of Tax Appeals (OTA) was established in 2017, taking over the appeal, which is a significant piece of the taxpayer's right to due process. The change from the Board of Equalization (BOE) to OTA for franchise and income tax appeals has introduced more formality to the process, which has raised concerns that taxpayers who represent themselves may be at a disadvantage. Having access to representation during an appeal helps ensure the taxpayer's right to be heard and to pay no more than the correct amount of tax owed.

Prior to the separation of BOE from the California Department of Tax and Fee Administration (CDTFA), the BOE/CDTFA Taxpayers' Rights Advocate administered a program providing free legal assistance to taxpayers who couldn't afford to hire a professional to help them with their appeal. After their separation from BOE, CDTFA determined it was no longer appropriate to represent taxpayers with franchise and income tax appeals and they asked FTB to take over this part of the free legal assistance program.

For the past year, my office has worked closely with CDTFA to bring this part of the Taxpayer Appeals Assistance Program (TAAP) to FTB to ensure that taxpayers with a franchise or income tax appeal will continue to have access to free legal assistance. I appreciate the support from our sister agencies and FTB's Executive Team during the transition process.

### Bill of Rights Issues

The Advocate holds an annual Taxpayers' Bill of Rights Hearing to give the public an opportunity to express their comments, concerns, and suggestions regarding California's tax laws and the programs that FTB administers to the three-member Franchise Tax Board (Board). In this section, I'd like to follow up on some previous issues as well as address some new ones from the 2017 hearing.

### The Right to Representation and Improving FTB's Power of Attorney Process and Forms

An important right for taxpayers, especially when they have a disputed liability with the department, is the right to representation. This right includes having FTB work directly with their chosen representative and having no unnecessary barriers or impediments for authorized representatives. Due to tax professionals' concerns about existing FTB practices, my office worked with FTB to formalize a new policy to address and affirm the right to representation.

When a taxpayer appoints a representative, FTB must work directly with the representative on all matters within the scope of the representative's authorization.<sup>1</sup> The taxpayer's right to representation must be respected by our employees at all times. FTB will continue to respond to any direct communication from a taxpayer, and will include the taxpayer in correspondence sent to the representative, when appropriate. If a representative fails to respond to inquiries or requests, especially in matters requiring immediate action and where a failure to respond could result in significant burden to the taxpayer, FTB staff may contact the taxpayer, after consulting with a supervisor.

<sup>1</sup>This policy does not apply to investigations conducted by the Criminal Investigation Bureau.

Every taxpayer also has the right and expectation that FTB will keep the taxpayer's confidential information in FTB's possession secure from access or use by unauthorized individuals. FTB faces continuous challenges in finding an acceptable balance between maintaining data security and ease of representation.

In January 2018, FTB introduced the Taxpayer Information Authorization (TIA) relationship, patterned after IRS' similar TIA and limited the acceptable Powers of Attorney (POA) to FTB's own forms in order to simplify processing taxpayer/representative relationships. FTB verifies all new POA and TIA relationship requests and now requires that taxpayers affirmatively consent to their representative having online access to their confidential information. When FTB is unable to verify the relationship between the taxpayer and representative during initial processing of a POA or TIA, FTB may contact the taxpayer to authorize the relationship.

Many external stakeholders are concerned that the increased security protocols are extending the time for some POA approvals beyond the normal collection cycle creating a significant burden to the taxpayer. While maintaining the level of security required to protect taxpayers' confidential information is of paramount importance, FTB must find a way to approve requests for representation within a reasonable time and definitely within the time allowed for the normal collection cycle. This concern becomes even more critical now as the department processes returns more efficiently and identifies errors which result in notices that do not have "protest" rights, meaning these accounts move directly into collections if not paid. As tax laws continue to increase in complexity and more taxpayers self-prepare using software or free services like the Voluntary Income Tax Assistance (VITA) Program, the taxpayer's right to representation and to be heard is critical so that taxpayers have the opportunity to properly dispute a bill.

### **Filing Enforcement**

Our Filing Enforcement (FE) Program locates taxpayers who have an obligation to file a California income tax return, but fail to do so. FTB's FE Program uses two methods primarily 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. Nonfilers who receive a *Request for Tax Return* letter are asked to either file a tax return or demonstrate that they don't have a filing requirement. For both nonresponsive nonfilers and individuals who do not satisfactorily demonstrate to FTB that they have no filing requirement, an assessment (notice) is issued. Last year, FTB issued approximately 860,000 personal income tax (PIT) notices to individuals and 80,000 Business Entity (BE) notices to taxpayers who may have had a filing requirement. This represents an overall 1.4 percent increase in FE notices mailed from the prior year.

At last year's Taxpayers' Bill of Rights Hearing, taxpayers raised two concerns regarding the FE Program. The first concern was regarding the department's policy in accounting for payments held in suspense and the application of those credits/ payments to FE notices. When FTB's Integrated Nonfiler Compliance (INC) System builds a nonfiler case, it calculates tax due based on the income amounts reported to each nonfiler. INC also applies any identifiable withholding credits and estimated tax payments associated with that specific taxpayer. However, when INC encounters a joint estimated tax payment, it can only apply that joint estimated tax payment to a joint nonfiler case. Because FE assessments are specific to individual taxpayers, when a taxpayer fails to file a return for a tax year, but has joint estimates or credits, FTB cannot apply the joint estimated tax payments to the individual's final liabilities absent the taxpayer filing a return(s) and instructing FTB how to apply the joint estimated tax payments. This treatment is consistent with federal law.

FTB respects the taxpayer's right to pay no more than the correct amount of tax. However, the taxpayer is required to file a tax return to inform us of the correct amount they believe they owe. As a result of the issues raised at the annual Taxpayers' Bill of Rights Hearing, my staff continues to work with the department to improve communication to taxpayers on filing requirements and potential unclaimed credits, including a pilot program to notify taxpayers who haven't filed a return that they may have unclaimed withholding or estimated payments.

The second concern raised at the Taxpayers' Bill of Rights Hearing was in regard to using active licensing information from California's occupational and professional licensing boards as an indicator that a taxpayer may have a filing requirement. Licensees who are no longer residents of California and do not have a filing requirement, experience an additional burden because they often don't become aware of a liability created by the department or FTB's subsequent attempts to collect on that liability until their bank accounts are frozen as part of the collection process. For filing enforcements based on economic indicators, the request was for FTB to support these types of assessments with actual evidence of income.

Currently, the FE Program has an open study to evaluate the overall performance of occupational licenses in an effort to improve the quality of contacts to potential nonfilers. The estimated completion date for the study is spring 2019. Additionally, as I mentioned in my report last year, my office worked with the FE Program to modify procedures for taxpayers who move out of California and retain a California business or occupational license. FTB will not contact the taxpayer for up to two years once they have established why they do not file with California.

In last year's report, I also mentioned my concern about returned mail and its effect on due process for the taxpayer. The volume of filing enforcement returned mail last year was approximately the same as this year, about 12 percent. Overall our department has a returned mail percentage of about 10 percent for all notices. Often when a notice comes back as returned mail, we are able to find a better address and send it again. However, some notices will still be returned at which point they are held awaiting a better address. After we processed the returned mail for Fiscal Year (FY) 2017/2018, 1.4 percent of the PIT and 3.6 percent of the BE request and demand letters were still awaiting a better address, roughly the same as last year.

Last year, I also reported that FTB launched a Returned Mail Project as part of the 2017 Management Development Program (MDP). Included in the project report was the acknowledgement that due process may be affected if we send mail to the wrong address. The team immediately identified two changes to improve returned mail processing. The first change eliminated a duplicative process and allowed us to correct an address or associate return mail with the originator more quickly. The second change began a process to look for a better address if mail had been returned prior to collection activity occurring. FTB staff revised this process to ensure an additional address search in collections was done for all accounts with a return mail indicator before sending a final notice.

The team also made final recommendations for the department as a whole ranging from assigning a single owner to this process, performing a cost analysis to determine which business area is most impacted by returned mail, and reviewing our address tools utilizing technology in our solution. In line with the recommendations, FTB staff identified a process owner, prioritized recommendations, and began analysis and development of the improvement opportunities. Furthermore, enhancements scheduled for March 2019 will help the FE program improve the overall quality of addresses and reduce the number of INC notices that cannot be mailed or are returned.

Over the past year, I see progress in the returned mail effort, and I expect to see further improvements in the coming year. The goal is to prevent premature collection action, decrease returned mail (in all programs), and increase taxpayer compliance.

## Collections

This fiscal year our accounts receivable balance totaled \$8.3 billion, a 1 percent decrease from last year. PIT and BE taxpayers unable to pay the full amount owed within 90 days of the first notice or who have a financial hardship may be eligible to pay by installment agreement (IA) or submit an Offer in Compromise (OIC). In last year's report, I noted that IAs, hardship policies, and the OIC Program were areas of concern for taxpayers. This year, I followed up on these and other issues.

Last year, my office worked with the OIC Program to provide information about OICs to taxpayers, tax professionals, and small business owners. The OIC Program updated their website to provide more detailed information about the program, created an information brochure to be distributed at outreach events, and created an OIC video that is available on the OIC webpage. Of the total OIC applications received for FY 2017/2018, 62 percent were for PIT and 38 percent for BEs. Of the OIC applications submitted, 20 percent of PIT OIC applications were approved and 55 percent of BE OIC applications were approved. Overall, while there was a 19 percent decrease in the total number of OIC applications received, the percentage of OIC applications approved remained steady at approximately 34 percent.

The total number of people in hardships decreased this year with temporary hardships decreasing by 18 percent to 8,855. There was also a six percent decrease in new IAs approved. To help taxpayers better navigate the hardship process, the Accounts Receivable Management (ARM) Division revised the financial statement used to evaluate the taxpayer's financial status and the ability to pay. The form, when coupled with our evaluation procedures, will provide a consistent process and reduce the taxpayer burden for documenting income and expenses used to determine an individual's ability to pay personal income tax liabilities.

Customer service continues to be an area of interest, especially in the ARM Division where failure to address taxpayer contacts can lead to involuntary collection action and increased taxpayer burden. In the Collection Contact Center, BE Level of Access (LOA) increased by 4.2 percent to 64.7 percent for FY 2017/2018. The LOA for PIT saw a 2.6 percent improvement for FY 2017/2018 to 51.9 percent LOA. This is an improvement from the last three years and reflects the ARM Division's efforts to improve the LOA in both the PIT and BE Collection Contact Centers. The ARM Division adjusted the timing and volume of outgoing notices to better balance these with the resources available to respond to the calls. They also were able to redirect resources from other critical workloads to answer calls during peak times. Finally, the ARM Division is working on rolling out their call center dashboard in early 2019 to show taxpayers the call, correspondence, Live Chat, and Secure Chat wait times to help them decide the appropriate method to contact us.

## Protest Update

FTB's Audit Protest Section and Legal Division both resolve protests for assessments that taxpayers believe are incorrect. Our Protest Section is responsible for undocketed protest cases while the Legal Division resolves docketed protest cases. Docketed protest cases generally involve highly complex issues, issues of first impression, and/or large dollar amounts.

FTB issued Notice 2018-01, Process of Docketing Protest, in March 2018, providing information about our internal procedures for docketed protests, including a goal of making a final determination within 36 months or less of the filing date of the protest. FTB has historically used 36 months as a benchmark for determining when cases have become "aged," and have discussed in prior years the inventory of older protests, docketed and undocketed, and efforts taken to become current.

As in prior years, our Legal Division has continued to reduce the inventory of the oldest cases that are workable. Over the past five fiscal years, workable docketed protests

have declined from 248 at the beginning of FY 2013/2014 to 61 at the end of FY 2017/2018. This year, we also looked at the number of aged cases over five years. The number of workable docketed cases over 5 years old was 22 at the beginning of the year and was reduced by half to 11 at the end of this fiscal year.

Our Protest Section's overall volume of older (over 36 months) cases remained constant for the FY 2017/2018 at 49. We are evaluating our internal processes in an attempt to more timely assign protest cases because it is important to us and the taxpayer to have a consistent and timely resolution of our cases. I am happy to report that our Protest Section has no workable cases over five years old.

When the resolution of a protest case is delayed for an extended period of time, it is important that FTB periodically informs the taxpayer and their representative about the status of their case. For this reason, I recommend that both our Legal Division and Protest Section make contact with the taxpayer and/or representative at least once every six months for all protest cases, unless both FTB and the taxpayer establish a longer response time frame.

### **Business Dissolution/Cancellation**

As noted in last year's report, the issue of business entities forming, but not dissolving/canceling in the proper way continues to be very important. The Business Dissolution/Cancellation Process Analysis Team was created to study the entity dissolution/cancellation process and provide recommendations to improve it. Along with increasing our education and outreach efforts, one of the areas we concentrated on was to pursue analysis and development of legislative proposal recommendations that included administrative dissolution possibilities. These recommendations resulted in Assembly Bill (AB) 2503.

We are very pleased that AB 2503 was passed by the California State Legislature and signed into law by the Governor. Sponsored by FTB, this bill makes a domestic corporation and a limited liability company subject to administrative dissolution or administrative cancellation if FTB suspended the corporation or limited liability company for a specified period of time. It also allows for the abatement of annual taxes and related interest and penalties that continue to accrue to businesses that no longer exist, simply because they failed to complete the paperwork necessary for dissolution.

### **Case Resolution**

Taxpayers may contact the Taxpayers' Rights Advocate's Office (TRAO) if they have an ongoing state income tax problem that they have been unable to resolve through normal channels. The following cases illustrate how the TRAO coordinates resolution of taxpayers' complaints or problems with the cooperation of FTB staff. The following three cases in particular demonstrate how the TRAO is able to take a fresh and independent look at a case and recommend procedural or other changes to the department to ensure taxpayers' positions are given due consideration.

**Case #1 Background.** The law authorizes the department to collect "any amount of tax in excess of that disclosed by the return, due to a mathematical error" or erroneously omitted tax by sending a notice to the taxpayer. A *Notice of Tax Return Change* (NTRC) is issued when errors are discovered during return processing. These notices are not deficiency assessments and the taxpayer has no right of protest or appeal based on the NTRC. As a result, any additional tax, penalty, and interest is due and payable. Taxpayers may request "due and payable" amounts be canceled or waived without first making payment, and the department may act on these unpaid requests, but the taxpayer has no appeal rights if denied.

**Issue.** The TRAO is frequently contacted by taxpayers and tax representatives who received an erroneous NTRC notice and have attempted numerous times to get it corrected. Often the taxpayer is being asked to pay substantial amounts. In one such

case, the department processed a BE taxpayer return which claimed an estimated tax payment. Instead of receiving credit for that payment an NTRC was issued. The taxpayer made numerous attempts to get the payment applied. Despite the taxpayer's efforts, staff assigned to the case did not sufficiently review the taxpayer's arguments to determine the validity of their position.

**Resolution.** The TRAO worked with the Legal Division to affirm the taxpayer's position. A department review of the case was requested by the TRAO to determine where procedural changes could be made to ensure taxpayers receive the help they need on the first contact, including procedures to ensure taxpayers' positions reported on a tax return are given due consideration before the department takes additional collection action.

**Case #2 Background.** The 14th Amendment of the United States Constitution guarantees in part that no state shall deprive any person of their property without due process of law. Assurance that all taxpayers are afforded due process is perhaps the most important aspect of any legally significant enforcement and/or collection action taken against taxpayers. The essential elements of due process are reasonable notice of an action taken that affects an individual and an opportunity to be heard to present any claims or defenses.

**Issue.** A taxpayer whose funds were withdrawn from her bank account by the department contacted the TRAO because she had not received prior notice. An NTRC advising the taxpayer that the department corrected a math error was sent to an incomplete address previously provided by the taxpayer. Because the taxpayer's account had a returned mail indicator, subsequent notification, including the *Notice of State Income Tax Due* was not mailed to the taxpayer prior to the bank levy.

**Resolution.** About the same time the TRAO brought this issue to Collections, the Returned Mail Project Team also identified the underlying problem. In response, a system change was submitted to ensure the *Notice of State Income Tax Due* is sent when there is a returned mail indicator. Accordingly, the department will send a sequence of three collection letters at a minimum of 30-day intervals on delinquent accounts as outlined in the State Administrative Manual. While mailing the notice to the last known address meets due process, FTB uses the industry best practice of looking for a better address prior to issuing an involuntary action. Also, the department provides additional staff training on updating addresses. In this case, staff did not update the address accurately once a better address was received, which impeded proper notification.

**Case #3 Background.** In an effort to increase compliance with California Revenue and Taxation Code (R&TC), if specific California statutory requirements are satisfied, California law provides FTB the authority to collect withholding when California real estate is sold. The law also provides FTB the authority to assess a penalty on the withholding agent for failure to withhold based on the amount required to be withheld. However, the penalty is limited to the amount of tax due by the seller of the property. This penalty is due upon our notice and demand.

**Issue.** The TRAO was contacted by a tax professional who explained his clients were Internal Revenue Code (IRC) 1031 (tax-deferred exchange) intermediaries and accommodators involved in numerous deferred exchanges and had received erroneous notices assessing substantial penalties due to their failure to obtain properly completed form FTB 593-Cs, *Real Estate Withholding Certificate*, (which demonstrate an exception to the withholding requirements) related to several 1031 exchanges. In each case, a form FTB 593-C was obtained but was incomplete because of lack of a date, title, or taxpayer identification number.

**Resolution.** The TRAO worked with department staff and the Legal Division to determine that the penalties should be withdrawn based on the position that withholding was not required. It was also agreed to train staff to ensure that the department does not assess penalties where no withholding is due, regardless of whether the withholding agent completed the forms as required.

## Taxpayers' Rights Advocate Contact Information

TAXPAYERS' RIGHTS ADVOCATE'S OFFICE MS A381  
**FRANCHISE TAX BOARD**  
PO BOX 157  
RANCHO CORDOVA CA 95741-0157

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### Taxpayers' Rights Advocate

Susan Maples, CPA  
**Phone:** 916.845.6724

To get this publication, go to [ftb.ca.gov](http://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 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 Taxpayers' 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 California 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 Filing Division forms and notices, POA 2.0, Enterprise Data to Revenue<sup>2</sup> (EDR<sup>2</sup>), legal and litigation updates, and Audit and Customer Experience break-out sessions.

## 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 present and discuss FTB's upcoming projects and issues, and we respond to questions from tax professionals. At last year's meetings we gave presentations on cannabis, tax forms, and POA 2.0.

## Legislative Information Letter

In addition to assisting legislative staff with their constituents' tax issues, TRA0 provides legislative staff with annual filing season updates and information on services available to taxpayers. This year we provided information about available online services and taxpayer assistance information.

## Interest Abatement

We may cancel interest if a taxpayer can show the interest accrued because we made an unreasonable error or delay in performing certain kinds of acts. We may also cancel interest, under certain circumstances, if the IRS 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 (Board), employees, legislators, state and federal agencies, and taxpayers or their representatives contact us by mail, fax, telephone, and email. We received over 29,000 contacts in FY 2017/2018. Over 63 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 11,000 pieces of correspondence (letters, faxes, and emails) during this reporting period. Having multiple methods of communication available allows us to respond more efficiently and serve more taxpayers.

The top five PIT reasons taxpayers contacted TRAO in FY 2017/2018 include:

- FEs
- Wage garnishments
- Bank levies
- Liens
- Disagree with prior FTB answer

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

#### FEs

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 BE contacted TRAO in FY 2017/2018 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 California R&TC. If the balance is valid, we work with the taxpayer to set a due date for payment, or we will set an IA.

### **Never Conducted Business, but Received a Bill**

If a business registered in the state but never conducted business, we explain that the entity is 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 taxpayer to set a due date for payment, or we will set an IA.

### **Revivor Request**

When contacted for a Revivor request, we provide direction to the BE on the need to file delinquent tax returns, pay any balance due, and submit any other documentation so that we can coordinate the Revivor process.

### **Missing/Misapplied Payments**

When contacted on missing payments, we will request that the taxpayer provide a copy of the canceled check and we will search our records. Once the payment is located, we analyze the account and if appropriate, move 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 \$10,500 for 2018.
- 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 2017/2018, we received 369 issues through SIMS. Of the issues submitted, we identified five 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 *Notice of Proposed Assessment* (NPA) display file for assessments that became final in FY 2017/2018. 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.

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 trade industry.

For PIT, 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 PIT taxpayers for failure to file a state income tax return.

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-four percent of the individuals who received NPAs during FY 2017/2018 had audit changes for a single tax year.

An in-house accounting department or an accounting or legal firm prepares virtually all corporation tax returns. The data indicates that tax professionals file over 65 percent of all PIT returns. We consider corporation tax returns as professionally prepared. In the absence of a paid tax professional's signature, we consider that taxpayers self-prepared their PIT returns.

We also compiled statistics for e-filing and payments. For these figures, see Appendix 1, Table 6. e-filing continues to increase, with a four percent increase from July 1, 2012, to June 30, 2013. As of June 30, 2013, we received 784,000 e-filed BE tax returns, a 21 percent increase.

## Taxpayer Filing Errors

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

We compiled taxpayer error information on approximately 18.1 million current year tax returns processed between July 1, 2017, and June 30, 2018. During this time, FTB sent approximately 615,000 NTRCs to taxpayers who filed tax returns with errors that resulted in a change. This figure equates to approximately 3 percent of tax returns. We explain the errors in the notices and inform customers how they can resolve any discrepancies.

Just under half (47 percent) of the adjustments we made were on paper-filed tax returns, even though only 12 percent of total current year tax returns were paper-filed. Adjustments on electronically filed tax returns (88 percent of total current year tax returns) accounted for the remaining 53 percent.

The top two most common taxpayer errors, for all filing methods, are wage withholding and estimate payment discrepancies. Together, these two errors account for almost 40 percent of all taxpayer errors during processing of tax returns.

Twenty percent of all the NTRCs sent contained 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 (EDD) by the taxpayer's employer.

The other most common taxpayer error identified during processing is claiming the incorrect estimate payment amount. This error accounted for another 19 percent of NTRCs sent to taxpayers and resulted in an adjustment and notice from FTB. This error is also one of the most common reasons PIT and BE taxpayers and their representatives call during our peak pre-Filing Season.

In an effort to help taxpayers claim the right amount of estimate payments, FTB is piloting a project aimed at the BE community. We will provide BE taxpayers with a notice detailing their 2018 annual estimate payments and credit information. Findings from this pilot will help determine feasibility of future efforts for additional taxpayers.

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 2017/2018, the Taxpayer Services Center (Taxpayer Services Unit (TSU) number 800.852.5711 and Practitioner Hotline number 916.845.7057) answered almost 1.3 million incoming calls. TSU redirected correspondence staff to the phone on Mondays in an effort to reduce repeat calls during the week and 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. TSU answered 71 percent of the calls in FY 2017/2018 which was an improvement from the previous year of 58 percent. The Practitioner Hotline answered 77 percent of the incoming calls.

During FY 2017/2018, ARM Division improved their service to customers by 8.2 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 69.2 percent, of calls.

#### Response to Correspondence Time Frames

In FY 2017/2018, we processed over 250,000 pieces of general correspondence and maintained the 90-day or better time frame goal for the year. We accomplished this by the following measures:

- Internal redirection of section staff when possible and use of six spring finance letter positions received in FY 2016/2017.
- 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 continue to look for ways to improve and increase our education and outreach efforts. Our use of Twitter, Facebook, YouTube, and other social media platforms allowed us to maximize our potential to reach taxpayers, operate more efficiently, and publicize California and federal tax law information. Participating in various webinars was an important tool in providing important information to help taxpayers stay compliant. We also participated in local and statewide events targeted towards the tax professional community. We continue to participate in CDTFA sponsored events to provide small business education and outreach throughout the state of California. Also, our staff collaborated with California Governor's Office of Business and Economic Development (GO-Biz) and the California Secretary of State on the Business Dissolution/Cancellation Process Analysis Team. This team was initiated to study the entity dissolution/cancellation process and provide recommendations to improve it. The recommendations provided were made with the goal of making the process easier for BEs to understand and accomplish better compliance, and expanding the effort

of joint education and outreach between state agencies. From the recommendations of this team, FTB sponsored AB 2503. This bill would make a domestic corporation and a limited liability company subject to administrative dissolution or administrative cancellation if the corporation or limited liability company was suspended by FTB for a specified period of time. We continue to add educational information to our presentations and have several Tax News articles pointing to new tools and resources available to taxpayers and tax professionals to help increase taxpayer compliance. The main idea we want to get across 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 2018, approximately 130,000 taxpayers filed their current tax year (2017) tax return, approximately 9,500 filed a 2016 tax return, and approximately 4,500 more filed their 2015 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 or have a POA on file.

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 1.7 million payments, totaling over \$33.6 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, public service counter, and collections staff. Training topics include customer service sensitivity, telephone techniques, negotiation skills, and new training on POA, implied consent, and financial hardship evaluation. Contact center staff provide taxpayer assistance by phone, correspondence, and Live and Secure 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
- INC System
- Taxpayer Folder
- Taxpayer Information System
- Delinquent Vehicle Registration System
- Court Ordered Debt (COD) 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 develop and 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 in addition to collection policies and procedures and California R&TC Sections that govern them. 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 Skillssoft online learning and college courses to refresh their skills and/or continue their education.

FTB is responsible for providing new audit staff with the knowledge needed to analyze tax returns, research issues, and communicate findings in a clear and efficient manner. New auditors receive six weeks of formal classroom training and subsequent on-the-job training. New auditors are familiarized with tax forms, tax law and research, audit process and procedures, and systems training. PIT and BE issues are taught separately with specific curriculum developed for each. Issue-specific training is provided for commonly audited issues and kept up to date with current law changes. Staff are provided continuous opportunities for additional audit-related training throughout their careers at FTB. Audit training emphasizes the overall need for clear communication with taxpayers and their representatives.

## **Enforcement**

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

### **FE Program**

The FE Program identifies, contacts, and requests tax returns from individuals and BEs 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, CDTFA, 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 EDR Project, FE upgraded its efficiency in choosing the best cases for individual and BE 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.

FE continues to evaluate business rules and practices in order to identify the best cases for individual and BE nonfiler contacts while incorporating new data. In addition, we implemented enhanced procedures to ensure we are informing nonfilers of their filing requirement in a timely manner and protecting taxpayers from erroneous contacts and collection actions.

This year, the FE Program sent over 940 million contacts to PIT and BE nonfilers and issued over 794 million notices of proposed assessment resulting in 376 million tax returns filed and \$929 million in revenue collected.

FTB continuously strives to improve the FE Program and services available to both the taxpayer and the tax professional communities. For example, the PIT Request and Demand Notices have undergone extensive review for department writing and accessibility standards, and to direct taxpayers to self-help tools. The new notices aim to clarify why a taxpayer received the notice and how they can seek resolution.

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 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 BEs. 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, which include 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**

#### **IAs**

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 2017/2018, 226,576 total IAs were set up, and 22,257 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, 2018, 159,052 tax returns have been filed and over \$195 million collected. Provisional payment plans increase compliance with tax laws, accelerate revenue, provide greater efficiencies, and improve customer service.

### Self-service Options

FTB provides self-service options for PIT taxpayers and COD debtors with a short term inability to pay. Web and IVR self-service options are available for PIT taxpayers to allow them 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 into their MyFTB account to use the web self-service options or call 1.800.689.4776 to use the IVR self-service options. Web skip payment and bill delay self-service options are also available for COD debtors and can be accessed by logging in to their MyCOD account. A COD IVR IA self-service option was implemented in June 2018.

### 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 related 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 local, state, and federal law enforcement agencies. Once criminal charges are filed, special agents serve as expert witnesses and assist prosecuting attorneys in the preparation and prosecution of their cases. Special agents ensure appropriate media coverage is sought in accordance with the department's Public Affairs Office and Criminal Investigations Bureau (CIB)'s mission.

For FY 2017/2018, criminal investigations activities resulted in:

- 11 individuals arrested.
- Search warrants executed at 77 locations.
- 10 new cases approved for prosecution.
- 21 guilty pleas entered.
- 2 guilty verdicts from trials.
- 1,305 months incarceration and 700 probation months sentenced.
- 30 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 OTA, 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, create useful tools and resources, and improve services.

Our Multilingual Communications program continues to provide vital services to our Limited English Proficient (LEP) taxpayers, as well as, our bilingual representatives and the tax preparers who serve these taxpayers.

Our goal is to ensure LEP taxpayers have equal access to the tools and resources available in order to file tax returns timely, accurately, and pay the correct amount without experiencing delays due to a language barrier.

New translations implemented this year include:

- California Earned Income Tax Credit (CalEITC) brochure in Vietnamese, Chinese, Korean, and Spanish.
- CalEITC Postcard in Spanish.
- CalEITC Spanish advertisements in local news outlets.
- FTB 5616, *Security Tips for Tax Professionals*, in Spanish.
- Facebook Video scripts on *How to select a Tax Preparer*, in Chinese and Spanish.

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 an important role in communicating information to taxpayers and tax professionals. We post information on social media platforms, create video clips and webinars, and provide public service announcements to educate taxpayers. We always look for ways to improve our website and provide more self-service options for taxpayers. *Tax News* continues to expand and has recently reached a milestone of 30,000 subscribers. We send *Tax News Flashes* to inform taxpayers of changes to tax law, new programs, and current issues of interest.

The Processing Services Bureau's Exempt Organization Unit participated in education and outreach events sponsored by 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.

### 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 and 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 \$10,500). The taxpayer must not have significantly caused the error or delay.

## California Earned Income Tax Credit

In 2017, California allowed a refundable credit to working families, similar to the federal EITC. The credit ranges from \$223 to \$2,775 for incomes from \$15,008 to \$22,302. 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 \$3,562 in investment income.

## Office of Tax Appeals

With the passage of the Taxpayer Transparency and Fairness Act of 2017, the OTA was created as an independent and impartial appeals body. The office was established to hear appeals from California taxpayers regarding various taxes and fees administered by CDTFA and FTB. We continue our efforts to assure due process and we informed tax professionals about the new organization including how and where to file an income tax appeal.

## Partnership Due Dates

The extended due date for a partnership return was extended from six months to seven months which is the maximum number of months that FTB may grant as an automatic extension of time for filing partnership returns required to be filed under California R&TC Sections 18633 or 18633.5 for tax years beginning on or after January 1, 2017.

The provision allowed FTB to presume reasonable cause and not willful neglect in the case of any partnership that filed a 2016 return by the extended due date under former law; and the partnership requested relief from either or both the delinquent filing penalty under California R&TC Section 19131, and failure of a partnership to comply with filing requirements penalty under California R&TC Section 19172.

## Sales and Use Tax Reported on Tax Returns

Individual income tax returns and instructions require taxpayers to enter a number on the use tax line of personal income tax returns. If a taxpayer enters zero on the use tax line, they are required to check one of two boxes to validate that they have either paid the use tax due for the tax year to CDTFA or that they owe no use tax.

Additionally, taxpayers can report use tax on an original return regardless of the date the original return is filed.

## Voluntary Disclosure Program

The Voluntary Disclosure Program (VDP) allows certain taxpayers who may have incurred an unpaid California tax liability and an unfulfilled filing requirement to disclose their liability voluntarily. If the taxpayer qualifies, FTB will waive certain

penalties in accordance with a Voluntary Disclosure Agreement (VDA). For VDAs entered into on or after January 1, 2018, the statute was modified to allow eligibility for out-of-state partnerships with nonresident partners of general partnerships, limited partnerships, and limited liability partnerships; and, eligibility for out-of-state trusts with California resident beneficiaries to participate in the program.

Additionally, the VDP expanded S-corporations and limited liability companies (LLCs) classified as partnerships relief from failure to file and late filing penalties.

### **IVR, Live Chat, and Secure Chat**

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 30 days. FTB also supports nontax IVR applications that provide general information for COD and Vehicle Registration Collections. Eligible COD callers can now apply for IAs. 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 contact centers, they may be given the option to wait on hold or request a call back without losing their place in queue.

FTB also provides Live Chat for three of our larger contact centers, which allows taxpayers the option to chat online with an agent to ask general questions regarding personal and business income tax, or get help with our website. Taxpayers can also ask specific questions about their account by accessing Secure Chat through their MyFTB account.

### **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 1.1 million hours of hold time hours during FY 2017/2018. When offered the option, 76 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.

The California homepage ([ca.gov](http://ca.gov)) and California Tax Service Center ([taxes.ca.gov](http://taxes.ca.gov)) provide taxpayers with easy access to a variety of state and federal tax information through links from one website to another.

FTB continues to work closely with GO-Biz by providing them tax information for the California Business Portal ([businessportal.ca.gov](http://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 BE types, including links to FTB filing requirements.

## **Tax News**

*Tax News* products include our monthly online publication, email, videos, and social media. Our online publication, *Tax News*, remains 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. 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 use our email delivery service for *Tax News Flashes* sending only the most time-sensitive, vital information, for example sending critical information, updates, and resources for California's fire victims.

*Tax News Live* released three new short videos – *Market Based Source*, *California State Income Tax (Gig Economy)*, and *Offer in Compromise*. We provide links from *Tax News* articles and the *Tax News* webpage, but these videos are on YouTube as a resource for tax practitioners and taxpayers.

We continue to increase our use of electronic notification through social media like Twitter and Facebook. This year we focused our attention on producing quick conversational video shorts on Facebook. The topics included Record Keeping for Cash-Based Businesses, Cyber Criminal Alert for Tax Professionals, and How to Choose a Tax Preparer, which we provided in three languages (English, Spanish, and Chinese).

*Tax News* products allow us to deliver fast and cost-efficient communications, providing an effective way to share information and link directly to FTB and external online resources.

## **Small Business Outreach**

We conduct seminars and develop programs to help small businesses meet their state income tax filing requirements. Together with CDTFA, 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 CDTFA throughout California.

We are in the process of updating BOE Pub. 170, *Striking Gold in California - What You Need to Know About Taxes and Your Small Business*, to address common questions related to small business taxpayers.

Our Small Business Liaison provides education and outreach to small businesses and receives calls from taxpayers. The liaison provides current and future small business owners and taxpayers with tax 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 2,200 calls this year, most of which came through our Small Business Liaison phone line. We receive many calls and questions about the different filing requirements for the different forms of ownership. We also continue to receive many calls from out-of-state taxpayers inquiring about doing business in California. We continuously work with our *Tax News* editor to publish a series of articles that address the requirements of the different BEs and changes in the law.

### **Speakers' Bureau**

Speakers' Bureau helps nonprofit organizations, community groups, and government-funded educational institutions learn more about tax-related issues. Speakers typically make presentations to groups of 25 or more that can include tax professionals, small business owners, and taxpayers. We provide speakers in other languages upon request and availability. The Speakers' Bureau is one of our ongoing efforts 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 PIT 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 2018

#### ID Theft and Refund Fraud Program

We participate in the IRS Security Summit. The IRS convened this public-private partnership to respond to the growing threat of tax identity theft and stolen identity refund fraud. This group is made up of IRS officials, CEOs of leading tax preparation firms, software developers, payroll and tax financial product processors, financial institutions, tax professionals, and state tax administrators. The summit has improved safeguards in the tax return submission pipeline, keeping false returns out of the system, improving internal fraud filters, and preventing fraudulent refunds from being paid. This partnership was formalized with the piloting of Identity Theft Refund Fraud Information Sharing Analysis Center (IDTTRF ISAC) in 2017 and the full implementation in 2018. We are an active participant and contributor to the nationwide IDTTRF ISAC, including holding a seat on the Senior Executive Board and many of the sub-teams.

#### 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](http://ftb.ca.gov) with information about medical marijuana provisions to help taxpayers comply with income tax filings and payments.

#### 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 VDP 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.

#### 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.

## Projects

### EDR

In 2007, FTB created a three-phase, 30-year plan to modernize its tax systems commencing with the EDR project. This first phase laid the foundation for the plan's infrastructure and architecture. The four major components delivered with EDR were:

1. New applications and processes for handling tax returns, payments, and correspondence. The new applications (Taxpayer Folder, Case Management, and Return Analysis) automated manual processes, enhanced our capacity to capture and validate data, standardized our processes, and leveraged the same applications to process both PIT and BE tax data.
2. Enterprise Data Warehouse. The data warehouse made all appropriate data available to existing legacy systems and authorized FTB users.
3. Enhanced MyFTB. MyFTB provides authorized users (such as taxpayers and taxpayer representatives) secure online access to images of tax returns, withholding, payments, notices, correspondence, and more. In addition, MyFTB allows users to perform new self-service options such as secure chat, sending correspondence, submitting an online protest, calculating a future balance due, and filing a POA Declaration and *Tax Information Authorization* request or a *Nonresident Withhold Waiver* request online. MyFTB is located at [ftb.ca.gov](http://ftb.ca.gov).
4. Updated legacy systems. FTB updated its legacy systems so they will operate with the new processing applications, data warehouse, and enhanced MyFTB.

### Revenue

The EDR project successfully concluded in 2016. It was completed on time, within budget and continues to significantly increase revenue for the state of California. For example, the project generated \$121 million during June 2018 and \$1.28 billion for FY 2017/2018. Since the project began in 2011, it has generated a total of \$5.14 billion which is 109 percent or \$400 million over the revenue estimated for this time period.

### EDR<sup>2</sup>

EDR<sup>2</sup> is the second phase of FTB's 30-year tax system modernization plan which will build upon EDR's foundation. The second phase will primarily focus on building upon enterprise process improvements, serving more taxpayers, and continuing to address the tax gap which generates revenue for the state. The six major components for EDR<sup>2</sup> are:

1. Increased Customer Service (Self Services)
2. Expanded Case Management (Legacy Systems)
3. Expanded Data Warehouse (Data Availability)
4. Increased Audit Modeling and Fraud Detection (Analytics)
5. Business Process Improvements (Redundancy and Reuse)
6. Replace Aging and Obsolete Technology

FTB has engaged the CA Department of Technology's Project Approval Lifecycle (PAL) process. The EDR2 project is scheduled to start in 2021.

## Live and Secure Chat

### Filing Division

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 Secure Chat as a companion to our general Live Chat service. By establishing their identity through creation of a MyFTB account on FTB's website, customers have access to the Secure 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 2017/2018, Filing Services Bureau experienced an 84 percent access rate overall for both Live and Secure Chat, responding to over 117,000 contacts. Live Chat answered over 84,000 contacts and Secure Chat answered over 33,000 contacts.

### Accounts Receivable Management Division

In FY 2017/2018, we experienced an 85.9 percent access rate overall for both Live and Secure Chat, responding to over 140,000 contacts. Live Chat answered over 98,000 contacts and Secure Chat answered over 42,000 contacts.

Since Live Chat's launch in 2011, PIT and BE Live Chat agents have responded to 325,590 chats regarding general collection and tax questions from individuals and tax professionals. Of this amount, 222,866 chats were regarding PIT and 102,724 chats were regarding BE. During FY 2017/2018, ARM's BE and PIT Live Chat agents completed 23,259 chats with a 95.5 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 2 minutes or a BE Live Chat agent in 38 seconds. During FY 2016/2017, PIT and BE Collections' Live Chat completed 23,259 chats.

## Taxpayers' Bill of Rights Hearing

Taxpayers presented proposals to the three-member Board at the annual Taxpayers' Bill of Rights hearing on December 7, 2017. The meeting took place at FTB in Sacramento, California. For copies of the complete responses, go to [ftb.ca.gov](http://ftb.ca.gov) and search for **hearing responses**. The responses are in order of the presentations at the meeting.

### Christine Grab

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

- Funds applied/carried over to a subsequent tax year
- Inform taxpayers about the Taxpayers' Bill of Rights Hearing
- Make filing policies more closely aligned with IRS
- FTB notices must be sent out with correct department phone number
- Penalty relief for caregivers

In her letter dated January 1, 2018, Taxpayers' Rights Advocate, Susan Maples responded regarding funds being applied/carried over to a subsequent tax year. FTB receives more than 60 different types of income and income indicator information. Typically, these income records are for the individual taxpayer. For this reason, the vast majority of nonfiler cases are for individual taxpayers. When INC builds a nonfiler case, it calculates tax due based on the amounts of income reported to each nonfiler and applies withholding credits and/or any estimate payments to that specific taxpayer.

INC can only apply joint estimate payments to a joint nonfiler case. Meaning, when a taxpayer fails to file a return for a tax year and we have federal tax return information showing a joint return for that year, FTB cannot apply joint estimated tax payments to individual final liabilities absent the taxpayers filing a return(s) and instructing FTB how to apply the joint estimated tax payments. Credits due on a joint return only become available when the return has finished processing and can only be applied towards another joint tax liability.

Under federal law, when taxpayers make joint estimated tax payments but they subsequently file separate returns, the taxpayers can apportion the joint estimated tax payments between them in any manner they agree on (Treasury Regulation Sections 1.6654-2(e)(5)(ii)(A)). However, the IRS cannot make this allocation without the taxpayers filing returns. (See Chief Counsel Advice 201727007 (July 7, 2017)). Similarly, when FTB issues assessments to married taxpayers that go final and are due and payable, FTB cannot allocate the joint estimated tax payments to the taxpayers' separate liabilities absent a return(s).

Regarding informing taxpayers about the Taxpayers' Bill of Rights, Mrs. Maples responded that keeping taxpayers informed about their rights is of high importance. Pursuant to California R&TC Section 21006(b)(2), an annual Taxpayers' Bill of Rights hearing is held before the three-member Board. Following Government Code Sections 11120-11132, known as the Bagley-Keene Open Meeting Act, FTB provides a ten-day public notice of the meeting and the agenda on its website. Typically held in December, the meeting gives industry representatives and individual taxpayers opportunities to present their proposals on changes to the PIT or Corporation tax law. FTB encourages and welcomes comments and suggestions in person, at the meeting, or by correspondence through mail or email prior to the meeting. We will then provide responses to taxpayers' comments and suggestions. To better inform the public at large about the annual Taxpayers' Bill of Rights hearing, a notice link to the meeting was included on our home page during the ten-day period leading up to the meeting.

Moreover, throughout the year, the Advocate's education and outreach staff meet with disparate tax professional groups, including the California Societies of Enrolled Agents, Certified Public Accountants, and State Bar attorneys to provide more information

on various topics, including details about the Bill of Rights hearing. In meeting with tax professionals, we are able to hear the concerns of the taxpayers they represent. Additionally, we contact our trade media partners and others prior to the annual meeting to gauge their concerns and those of the individuals and businesses they represent.

Regarding making filing policies more closely aligned with IRS, Mrs. Maples responded that FTB cannot determine if a refund is due on a particular tax year in the absence of a filed tax return for that year. FTB does apply payments and credits on a tax year to the tax, penalties, and interest on that year once a tax return is filed. If a credit balance remains on the tax year after the return is filed, and there are no other outstanding liabilities for other tax years or with other external agencies, FTB can then determine if a refund is due and refund that amount. In addition, FTB notifies taxpayers on a yearly basis when an estimated tax payment is received and a tax return for the corresponding tax year is not located on file. Examples of these notice letters, Form FTB 4410 MEO, *Payment Received – No Return on File* (prior to the 2015 tax year) and Form FTB 4410 ENS, *Payment Received – No Return on File* (after 2015) were provided.

Regarding sending notices with the correct department phone number, Mrs. Maples responded that in striving to provide the appropriate service at your first point of contact, ensuring swift and efficient service, FTB provides a phone number on all FTB notices which corresponds to the call center that can best provide assistance to resolve the issue. A customer may be transferred to another unit when specialized account review is needed. FTB recognizes that there are times that call demands are greater than our service capacity. We continually strive to improve customer experience by updating business processes and implementing information technology solutions, such as, voice and data technology. We also offer real-time customer support through Live Chat and Virtual Hold service.

Regarding penalty relief for caregivers, Mrs. Maples responded that, unfortunately, there is no provision in federal or state law to allow extensions or forgive penalties for caregivers who care for an ill spouse, child, or parent, other than establishing reasonable cause. When a taxpayer fails to respond to a formal legal demand to file a return, FTB imposes demand penalties under California R&TC Section 19133. Unless the failure is due to reasonable cause and not willful neglect, FTB may impose a penalty of 25 percent of the amount of tax. The burden of proof is on the taxpayer to show reasonable cause to support an abatement of the penalty. The courts routinely reject claims of reasonable cause when a taxpayer has selective inability to file tax returns while attending to other responsibilities, as in when one spouse has a qualifying illness but the other is able to handle his or her affairs.

### **Torie Charvez, EA – California Society of Enrolled Agents**

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

- FTB FE INC System
- FTB VDP
- Unclaimed Real Estate Withholding Credits and Amended Returns
- California Stand-Alone AGI calculation

In her letter dated January 30, 2018, Taxpayers' Rights Advocate, Susan Maples responded regarding FTB FE INC System. The FE Program has been using active licensing information from California occupational and professional licensing boards since its inception (Tax Year 1999). In doing so, those nonfiler cases have generated nearly 350,000 tax returns and more than \$400 million dollars in new revenue for the state of California. Understanding that not every individual who voluntarily applies for and pays to keep their occupational license active is deriving income from that license, FTB sends a Return Request Letter. The license holder can reply to the questionnaire

which allows them to quickly and simply indicate that they are not using the license. They can also call or go to FTB's website and provide that same information. FTB staff will verify the information provided and close the nonfiler case, if appropriate. Additionally, when FTB staff identify nonfiler cases that were created for taxpayers who are not deriving income from their licenses, procedures are in place to contact the taxpayers less frequently because they have established why they do not file with California for the tax year in question. FTB's FE Program continually strives to improve their practices and is in the process of evaluating the use of the occupational licensing information.

Regarding FTB VDP, Mrs. Maples responded that under California R&TC Section 19192(a)(2)(A), an entity is not qualified to participate in VDP if it is organized and existing under the laws of California, qualified to do business in California by registration with the Office of the Secretary of State, or maintained or staffed in a permanent facility (does not include storing goods in a public warehouse). Once a qualified entity has submitted a VDP application, the taxpayer is free to file California entity formation documents or qualification to do business with the Office of the Secretary of State. It is the prompt submission of a complete VDP application, including supporting facts, returns, and payment as provided under the VDP provisions, which will stop FTB from taking further measures to determine that entity's tax and return obligations in California.

Regarding unclaimed real estate withholding credits and amended returns, Mrs. Maples responded that it is FTB's goal is to ensure that withholding credits are available and reflected on the taxpayer's account prior to the taxpayer filing their tax return. In an effort to mitigate the challenges involving Non-Wage Withholding credits, FTB has implemented several processes, including our *Pre-Verification Process*, where we resolve discrepancies involving withholding credits before contacting the customer. We have also ensured that Non-Wage Withholding is reflected on the taxpayer's MyFTB account so taxpayers and their preparers can verify the amount of withholding available prior to filing their tax return. In addition, FTB sends notifications, under two categories, filed and not filed, to taxpayers notifying them of unclaimed credits and instruction on what they need to do to resolve the matter. Unfortunately, due to the number of variables associated with reporting real estate income, we cannot allow the unclaimed credit for income not reported unless we receive an amended return. Both letters remind taxpayers that the return must be filed prior to the expiration of the statute of limitations.

Regarding California Stand-Alone AGI Calculation, Mrs. Maples responded that The Tax Cuts and Jobs Act (H.R. 1) that was signed in late December 2017 contains the most significant changes to the IRC in over 30 years. Because the California R&TC specified date of January 1, 2015, California tax law will not conform to most provisions in H.R. 1. FTB continues to have a departmental team analyzing the federal tax reform and its impact to California. The departmental team will determine what changes will be necessary to forms, instructions, and FTB's website based on our analysis of the new federal tax law. The team will consider all solutions keeping taxpayers, tax preparers, and the department in mind, as well as taking into consideration any changes made to conformity by the Legislature.

### **James Garrison – Pacific Federal Insurance Corporation**

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

- Correct notices to accurately reflect the required payment method
- Review Electronic Funds Transfer (EFT) 10 Percent Penalty

In her letter dated January 30, 2018, Taxpayers' Rights Advocate, Susan Maples responded regarding sending out correct notices to accurately reflect the required payment method. FTB recognizes that further clarification of the payment instructions

would be helpful to taxpayers who are subject to the EFT requirements and will implement changes as soon as possible.

Regarding EFT 10 Percent Penalty, Mrs. Maples responded that the EFT penalty was enacted in the statute in 1994 by the Legislature. The EFT penalty statute has been amended four times since the enactment date to lower the dollar threshold that determines when a taxpayer is subject to mandatory EFT payments. Any further modification made to the amount of the penalty would have to be made through the Legislature in a change to the statute.

### **Lynn Freer, EA – Spidell Publishing, Inc.**

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

- POA: copies of certain notices
- Form 1099-G
- EITC Refunds
- Audits
- OTA
- Partnership audit changes
- Swart Enterprises

In her letter dated January 30, 2018, Taxpayers' Rights Advocate, Susan Maples responded that the POA representative not receiving copies of certain notices is due to system limitations. FTB is aware of the issue that when a notice is sent out of our collection system such as the *Intent to Levy or a Final Notice Before Levy*, the POA representative is not getting a copy of the notice in their MyFTB folder and therefore not getting an email that correspondence has been added to their clients' account. FTB is conducting the necessary system analysis to identify viable solutions.

Regarding Form 1099-G, Mrs. Maples responded that FTB's volume of refunds filed in one year, but issued in the next is usually very small in comparison to the volume of refunds issued, normally less than .05 percent. The percentage rose to .3 percent in 2015 and to .2 percent in 2016, which were attributable to the normal training and adoption of the new EDR system. By continually improving our processes, the percentage of refunds for the 2017 process year that will be potentially issued the following year is less than .05 percent. FTB has published a *Tax News* article to educate tax professionals about the situation and is evaluating the possibility to proactively notify the taxpayer of the potential tax implications if the refund they requested is issued in the following year.

Regarding EITC Refunds, Mrs. Maples responded that FTB uses all available and permitted data and resources to validate refund claims. Many of our tools are specialized using advanced automated technology resulting from the EDR project. If we cannot validate a claim and determine we need further documentation, we will send a letter to the taxpayer with the request. Proactively reviewing claims and new information may remove the need for verification, the system will automatically issue the refund, allowing the taxpayer to get their refunds as soon as possible.

Regarding audits, Mrs. Maples responded that it is important to FTB to consistently and efficiently process and complete our audits. In working to do so, we have continued dialogues with the tax community to identify which areas we could improve. Responding to this feedback, FTB has provided better access to supervisors and managers. FTB has added contact information to key correspondence. This past year, FTB has added three senior technical experts to our Legal Division and two technical policy advisors to our Audit Division. We have also made improvements in the audit process by encouraging staff to communicate with the taxpayer or representative throughout the audit process, especially when requesting documentation. Another

area of improvement has been when cases are reassigned, i.e. when an auditor has changed position or is no longer employed by the department. When this occurs, every effort is made to handle the reassignment as quickly as possible.

Regarding the OTA, Mrs. Maples responded that the OTA Emergency Regulations filed with the Secretary of State on January 5, 2018, are similar to the previous BOE rules for appeals. However, there are some differences that have required FTB to make changes to its procedures. One of those changes is a reduced period for FTB to file its opening brief from 90 to 60 days. In addition to the change resulting from the creation of the OTA and CDTFA, FTB has had to update our forms and publications to address the changes. We revised FTB 985, *Audit/Protest/Appeals (The Process)*, by January 1, 2018.

Regarding partnership audit changes, Mrs. Maples responded that like many in the practitioner community and tax departments across the country, FTB has been evaluating the new federal partnership audit regime established by the Bipartisan Budget Act (BBA) of 2015 and what it may mean for our own compliance programs. One of the first impacts we recognized is to our federal adjustment program and ensuring we have statutory authority to piggyback any final federal audit adjustments made as a result of this new regime. To address this item, we drafted a legislative proposal that our Board approved at their December 2017 meeting. We will continue to monitor how the new regime is implemented at the federal level and analyze whether a similar regime is feasible at the state level. In the meantime, our current partnership audit process will continue since any changes at this time could be premature. We open our audits at the entity level, but assess any adjustments at the partner level.

Regarding Swart Enterprises, Inc., Mrs. Maples responded that *Swart Enterprises, Inc. v. Franchise Tax Board* (Cal. App. 5th Dist. 2017) 7 Cal. App. 5th 497 (“*Swart*”) is a Court of Appeal decision interpreting the doing business provision contained within subdivision (a) of California R&TC Section 23101. In Notice 2017-01, FTB published guidance as to what the Court of Appeal held in *Swart* and how FTB will apply that decision to taxpayers who believe their tax situations are similar to that of Swart Enterprises, Inc. Absent further guidance from the courts or California Legislature, Notice 2017-01 will not be amended. However, FTB is planning on publishing a *Tax News* article discussing the forms of substantiation taxpayers can provide to establish they have the same fact pattern as Swart Enterprises, Inc.

## Evaluating FTB 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.

Our goal is that all eligible employees not only receive a written performance evaluation annually, but that the evaluation and feedback they receive is valuable. Beginning with 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 2017/2018. We may have issued the assessments in prior years; however, due to cases in protest status, we did not resolve them until FY 2017/2018. Appendix 1 totals reflect rounded figures and may not compute exactly.

Table 1A **Corporation Tax Law**

NPAs Finalized in FY 2017/2018 Categorized by Primary Statute (issue)

Issue	Number of NPAs	%	Tax Assessed (Millions)	%	Average Assessment Per NPA
Allocation/Apportionment	656	22.6	\$ 230.3	67.0	\$ 351,017
Assess Minimum Tax	24	0.8	0.0	0.0	758
Revenue Agent Reports	2,042	70.4	62.5	18.2	30,606
State Adjustments	74	2.6	4.6	1.4	62,664
Other	104	3.6	46.2	13.4	443,902
Totals/Average	2,900	100	\$ 343.6	100	\$ 118,478

- *Allocation/Apportionment* involves corporations doing business within and outside 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 2017/2018 Categorized by Primary Statute (issue)

Issue	Number of NPAs	%	Tax Assessed (Thousands)	%	Average Assessment Per NPA
CP2000	169,263	22.1	\$ 153,417	6.5	\$ 906
FE	526,980	68.7	1,817,966	76.7	3,450
Filing Status	12,437	1.6	15,346	0.6	1,234
Revenue Agent Reports	15,083	2.0	77,890	3.3	5,164
Other	43,218	5.6	305,188	12.9	7,062
Totals/Average	766,981	100	\$ 2,369,807	100	\$ 3,090

- 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.
- *FE* 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 2017/2018

Industry	All Corporations 2015 Tax Year		Corporations with NPAs		Tax Assessed (millions)	
		%		%		%
FIRE*	148,902	16.5	107	6.4	\$ 16.4	4.8
Manufacturing	48,297	5.4	136	8.1	49.6	14.4
Services	393,942	43.8	413	24.6	38.4	11.2
Trade	149,236	16.6	265	15.8	52.0	15.1
Other **	159,981	17.8	757	45.1	187.2	54.5
Totals	900,358	100	1,678	100	\$ 343.6	100

\* Finance, insurance, real estate, and holding companies.

\*\* Includes agriculture, construction, utilities, transportation, communication, information, and other industries not classified in the sample.

For corporations not filing through a combined report, we base the industry designation on the corporation's primary business activity in California. In the case of corporations filing through combined reports, we base the industry designation on the primary occupation of the group, not necessarily on the industry of the parent. If the parent is a holding company of a diverse group of subsidiary corporations, then we group it with finance, insurance, real estate, and holding companies.

Tables 3A, 3B, and 4, apply to either the taxable years for which we issued NPAs or the number of years for which a taxpayer receives Notices of Proposed Assessment because of multiple taxable year audits during the same audit cycle.

Table 3A **Corporation Tax Law**  
NPAs Finalized in FY 2017/2018 Issued by Taxable Year

Average Taxable Year	Number of NPAs	%	Tax Assessed (Millions)	%	Average Assessment Per NPA
2010 and prior	496	17.1	\$ 201.9	58.8	\$ 26,911
2011	397	13.7	41.2	12.0	103,867
2012	792	27.3	38.9	11.3	49,122
2013	783	27.0	39.7	11.6	50,688
2014	311	10.7	18.6	5.4	59,917
2015	99	3.4	2.7	0.8	26,997
2016 and later	22	0.8	0.5	0.1	1,119
Totals/Average	2,900	100	\$ 389.2	100	\$ 118,478

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 2017/2018 for the Same Taxpayer

Corporations With...	Number of Taxpayers	Tax Assessed (Millions)	Average Assessment Per Taxpayer
One NPA	827	\$ 50.8	\$ 61,413
Two NPAs	581	92.3	158,923
Three NPAs	203	108.9	536,621
Four or more NPAs	67	91.5	1,366,091
Totals/Average	1,678	\$ 343.6	\$ 204,759

Table 4 **Personal Income Tax Law**  
NPAs Finalized in FY 2017/2018 Issued by Taxable Year

Taxable Year	Number of NPAs		Assessment Amount (Thousands)		Average Assessment Amount
		%		%	
2011 and prior	10,918	1.4	\$ 184,981	7.8	\$ 16,943
2012	4,958	0.6	64,664	2.7	13,042
2013	90,364	11.8	186,756	7.9	2,067
2014	213,266	27.8	382,759	16.2	1,795
2015	447,475	58.3	1,550,647	65.4	3,465
2016 and later	0	0.0	0	0.0	0
Totals/Average	766,981	100	\$2,369,807	100	\$ 3,090

Table 5 **Personal Income Tax Law**  
Resident Tax Return Preparation, Process Years 2016 and 2017

Preparer	2016 Tax Returns Processed (Thousands)		2017 Tax Returns Processed (Thousands)		% Change
		%		%	
Professional	10,732	65.5	10,778	64.9	-0.6
Taxpayer	5,350	32.7	5,495	33.1	0.4
VITA*	298	1.8	328	2.0	0.2
Totals	16,380	100	16,601	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, 2017	June 30, 2018	% Change
Individual Payments	5,143,000	5,453,000	6
Business Payments	592,000	833,000	41
Direct Deposit Refund	7,972,000	8,603,000	8
Individual e-file	15,900,000	16,482,000	4
** CalFile	150,000	143,000	-5
Business e-file	1,437,000	1,561,000	9

\*\* 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
2017/2018	78,793	44,166

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
2017/2018	861,376	750,007

## Appendix 2

Table 8A **Top Errors by Tax Return Type**

July 1, 2017, through June 30, 2018

Code		Grand Total	540 2EZ	540	540 NR	540 X
GC	Withholding Adjusted	216,693	7,665	166,014	38,835	4,179
EP	Estimate Payment Revised	209,066	19	176,500	24,023	8,524
WS	Withhold at Source Revised	55,439	*	15,613	38,591	1,234
OF	Refund Reported on Amended Tax Return Does Not Match Original Tax Return	54,072	83	5,048	249	48,692
OC	Estimated Tax Transfer Revised: Error Affected the Available Transfer Amount	45,913	*	36,510	9,402	*
FM	Dependent Exemption Disallowed Because Dependent's ID Number Used On Another Tax Return	44,683	469	43,627	587	*
OM	Amount Paid With Original Tax Return Plus Payments Made After Tax Return Filed Does Not Match Amount Claimed on Amended Tax Return	34,609	21	2,327	133	32,128
SS	State Disability Insurance Revised	26,247	*	24,758	506	983
BK	Error Transferring Deductions To Tax Return	19,821	*	17,418	1,315	1,088
FK	Dependent Exemption Disallowed Because Provided Dependent ID Was Invalid	17,748	412	15,333	2,003	*
BJ	Math Error Made When Calculating CA Adjusted Gross Income	16,820	*	16,820	*	*
TC	Tax Amount Revised	13,540	*	10,247	582	2,711
VL	Unable to Verify Withholding	12,650	625	10,280	1,664	81
EM	Earned Income Tax Credit: Form Issue	12,448	2,354	8,822	170	1,102
GF	CA Tax Rate Incorrectly Calculated	11,323	*	*	11,322	*
KI	Error Using 2EZ Table When Calculating Tax	10,752	10,752	*	*	*
AC	Incomplete Tax Return	10,398	650	9,086	597	65
EK	Earned Income Tax Credit Calculation Error	10,168	371	9,123	586	88
KC	Error Subtracting Total Special Credits From Net Tax	9,896	*	9,441	455	*
BM	Error Transferring Exemption Credits To Tax Return	9,821	*	9,821	*	*
Top Twenty		842,107	23,422	586,788	131,020	100,877
All Others		250,867	18,900	177,068	39,687	15,212
Grand Total		1,092,974	42,322	763,856	170,707	116,089

\*Reflects fewer than three tax returns.

Table 8B **Top Errors by Filing Method**

July 1, 2017, through June 30, 2018

Code		Grand Total	Electronic	Paper
GC	Withholding Adjusted	216,693	164,257	52,436
EP	Estimate Payment Revised	209,066	154,737	54,329
WS	Withhold at Source Revised	55,439	40,053	15,386
OF	Refund Reported on Amended Tax Return Does Not Match Original Tax Return	54,072	1,912	52,160
OC	Estimated Tax Transfer Revised: Error Affected the Available Transfer Amount	45,913	34,705	11,208
FM	Dependent Exemption Disallowed Because Dependent's ID Number Used on Another Tax Return	44,683	21,866	22,817
OM	Amount Paid With Original Tax Return Plus Payments Made After Tax Return Filed Does Not Match Amount Claimed on Amended Tax Return	34,609	573	34,036
SS	State Disability Insurance Revised	26,247	20,427	5,820
BK	Error Transferring Deductions To Tax Return	19,821	11,349	8,472
FK	Dependent Exemption Disallowed Because Provided Dependent ID Was Invalid	17,748	2,347	15,401
Top Ten		724,291	452,226	272,065
All Others		368,683	130,044	238,639
Grand Total		1,092,974	582,270	510,704

\*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 AB 92. (Stats. 2013, Ch. 26.) Under AB 92, for tax years beginning on or after January 1, 2014, taxpayers who perform IRC Section 1031 exchanges of property located in California for property located outside of California are required to file an annual information return with FTB for each year in which the gain or loss from that exchange has not been recognized. (See 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 taxpayers 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 2019.

### **Regulation Section 18567 - Automatic Extension of Time for Filing Tax Returns by Partnerships**

California Code of Regulations, Title 18, Section 18567 (Automatic Extension Regulation) was adopted on October 12, 2001, to provide an automatic paperless extension for a tax return required to be filed by an individual, fiduciary, or partnership, if the tax return is filed within the extension period. Subsequent to its adoption, FTB staff determined that the Automatic Extension Regulation required updating, to provide consistency with the authority granted by the California Legislature in 2017, to extend the automatic extension period to seven months for a tax return filed by a partnership, or by a limited liability company (LLC) that is classified as a partnership for California tax purposes. Accordingly, the purpose of this regulation project is to provide consistency with the statutory authority granted by the Legislature and provide clarity to taxpayers and tax preparers that the automatic extension period is seven months for a tax return filed by a partnership or an LLC that is classified as a partnership for California tax purposes, for taxable years beginning on or after January 1, 2017, while the extension period for an individual or fiduciary tax return remains six months.

Staff received permission to proceed to the formal regulatory process at the Franchise Tax Board meeting on December 7, 2017.

### 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 interested parties meetings on December 12, 2014, and September 8, 2017. Staff anticipates revising the draft language and either holding a third interested parties meeting or requesting permission from the three-member Board to proceed to the formal regulatory process in 2019.

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

On January 1, 1997, the IRS 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 BE shall be determined under regulations of 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. The *Notice of Proposed Rulemaking* was published on May 11, 2018.

### **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 three-member Board granted permission for the proposed regulations to proceed with the formal regulatory process. The *Notice of Proposed Rulemaking* was published on November 24, 2017.

#### 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. Staff held a second interested parties meeting on June 12, 2018, to present draft regulatory language for public comment. Staff anticipates requesting permission from the three-member Board to proceed to the formal regulatory process in late 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 additional interested parties meetings on June 16, 2017, and May 18, 2018, to present draft amendments. A fourth interested parties meeting is expected to be held in 2019.

#### **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 three-member 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 with an expected second interested parties meeting to be held in late 2018.

## **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 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 Board to proceed with the formal regulation process. The *Notice of Proposed Rulemaking* was published on November 3, 2017, and a Public Regulation Meeting was held December 18, 2017. A 15-day notice of amendments to the text of the proposed regulations was published on February 15, 2018.

**The Taxpayers' Rights Advocate's Office**

works with FTB'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.

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