



chair **John Chiang**
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State of California
Franchise Tax Board

02.03.11

Lynn Freer
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Dear Ms. Freer,

Thank you for your submission for the Taxpayers' Bill of Rights Hearing held on December 2, 2010. I am responding to the proposal you submitted to request that we review the idea of going back to a standalone return similar to the federal return.

This proposal discusses the history of California adoption of a tax return that currently uses federal AGI as a starting point to complete the California tax return. Our 2009 Bill of Rights Hearing response to a similar proposal includes additional discussion on the history and benefits of the current format of the California tax return.

To revisit the benefit of the current tax return format, we have looked to the types of state adjustments that are commonly reported by taxpayers who filed a 540/540A/540NR tax return. Our research finds that about half of these taxpayers do not show a California adjustment to federal AGI. Looking closer at those returns with a California adjustment to federal AGI, we found three common adjustments to federal AGI make up 58 percent of all adjustments to federal AGI.

California adjustments to federal AGI	Percentage of all adjustments to federal AGI
• State tax refunds	➤ 33%
• Social security benefits	➤ 15%
• Unemployment compensation	➤ 10%
• All other adjustments	➤ 5% or less, for each adjustment

(Based on 2008 data)

We also find that 50 percent of taxpayers report a state adjustment for the deduction of state taxes as the only adjustment to federal itemized deductions. In addition, 38 percent of taxpayers report no state adjustment to federal AGI or itemized deductions.

We believe the taxpayer's burden to file is simplified by using the current format to allow the taxpayer to begin with a completed federal return, and then only report adjustments for differences in federal and California law on the Schedule CA of the California return. This is supported by our research findings that the majority of taxpayers have either no adjustment or one of the three most common adjustments. Using a standalone return format would require taxpayers to report every line of income and expense on both their federal and state

return, including the majority of tax return lines where the reported amounts are identical. Under both the current return and the standalone return, the taxpayer must account for difference between federal and California tax law.

The majority of taxpayers use software which computes state and federal income and deductions. A side by side comparison is currently available to all taxpayers by reviewing the Schedule CA, which replicates the current Federal 1040, with corresponding state adjustment columns for each federal line number. Tax professionals may suggest to software companies their desire for an additional software product that includes an analysis of state and federal differences.

The proposal also points out that much effort would be required to revert to a standalone return. We agree significant resources and costs would be necessary to redesign the tax return, return processing, and system programming to revert to a standalone tax return. Devoting resources to such an effort at this time would impact FTB's ability to implement the current Enterprise Data to Revenue (EDR) project. EDR deliverables include reduction to the \$6.5B tax gap, improved processes, and providing more taxpayer data to our customers.

Finally, this proposal highlights the potential impact of Proposition 26 in relation to federal conformity. We agree that a lack of updated federal conformity impacts taxpayer's burden to file, and we continue to support and encourage federal conformity in order to simplify taxpayer's burden to file. While the number of state and federal differences will continue to increase without updated federal conformity, our findings show that the majority of taxpayers are able to complete their California tax return with few, if any, state adjustments.

For the reasons stated above, we do not believe reverting to a standalone return will result in an overall reduction in taxpayer's burden to file. We also continue to earnestly support updated federal conformity. We will continue to monitor the reporting of state adjustments, federal non-conformity, and the related impact on the taxpayer's burden to file.

Sincerely,

Steve Sims, EA
Taxpayers' Rights Advocate

cc: Hon. John Chiang, Chair
Hon. Jerome E. Horton, Member
Hon. Ana J. Matosantos, Member