State of California
Franchise Tax Board

02.04.2015

Gina Rodriquez
CA Taxpayers Association
1215 K Street, Ste 1250
Sacramento, CA 95814

Dear Ms. Rodriquez:

Thank you for your letter submitted for the Taxpayers' Bill of Rights Hearing held on December 4, 2014. Below is my response to the proposals you submitted.

The Franchise Tax Board (FTB) continues to actively take steps to address CalTax concerns and continue to make good progress on reducing aged inventories. The timely resolution of aging cases continues to be our number one priority.

In both the Audit and Legal Divisions, our short-term solution is to focus on cases over 36 months old. We have prioritized our workloads and focused staffs' efforts on closing the oldest cases. Our long-term solutions include involving attorneys earlier in the audit process, increased training for auditors, updating procedures, streamlining processes, and establishing individual case plans to ensure staff are focused on resolving the oldest cases for the correct amount of tax. We are also working with taxpayers and their representatives to develop plans that keep cases moving in a timely manner.

<u>Protests</u>
We reviewed specific protest cases in order to identify emerging trends, educational items, and other items that may affect sustainability. We found a variety of reasons why assessments are not fully affirmed. These include subsequent closing agreements, new information provided during protest, and new issues identified at protest or modifications due to federal adjustments. In cases where taxpayers chose to provide information during the protest, the Audit staff often agreed with modifications to proposed assessments based on the new information, emphasizing the need to obtain information as early in the audit process as possible.

To improve the accuracy of proposed assessments and minimize intrusiveness to taxpayers, we focus on the following:

- Be proactive in our review and processing of notices. Most large audits are assigned a technical reviewer during the audit, prior to closing.

- Audit and Legal staff collaborate closely to evaluate proposed positions; Legal provides feedback to Audit when significant modifications are made on a case.

Taxpayers' Rights Advocate MS A381
PO Box 1468
Sacramento CA 95812-1468
tel 916.845.6724
fax 916.845.3800
ftb.ca.gov

- Provide training classes to Audit staff in various venues.

Processing Refund Claims

We typically process about 75 percent of corporation claims within 5-6 months when no audit is underway. Refund claims filed by amended returns are tracked and processed by our systems and are the most precise method to claim a refund. New technology will enable us to track letter claims when items of correspondence are identified as claims.

- **Claims Inventory:** The volume of corporate claims received fluctuates from one year to the next. As you noted, we received more claims in FY 12/13 than we did in FY 11/12. However, last year the volume of large corporate claims received decreased slightly. Over the past 4 years, claims filed by large corporations have decreased by about 48 percent. In FY 2009/10, about 1,500 claims were filed by large corporations as compared to about 760 in FY 2013/14.

  We do not have a dedicated claims audit unit, since many of the claims are associated with an ongoing audit. In any event, the claims workload is a priority when considering assignments. The average time required to audit a large corporation is about 20 months. Most of the 500 claims that are over 3 years old were filed by large corporations. Typically, these claims include complex issues that require a lengthy process to fully develop. However, these claims remain our top priority and we expect to close approximately 85 percent of our inventory of "over 3 year-old" audit claims by June 30, 2015.

  Some claims may remain open for extended timeframes until litigation or other proceedings are final and claim amounts are identified by taxpayers.

- **SBX1 28**: introduced by the Senate Committee on Budget on September 19, 2008, and signed into law October 1, 2008, enacted a new penalty of 20 percent of the understatement of tax for large corporate taxpayers. This penalty is referred to as the LCUP. SBX1 28 provided no legislative findings or declarations as to the purpose of the legislation and did not require any reports by the department to the Legislature. We indicated in our analysis of SBX1 28 that the penalty was estimated to improve taxpayer compliance and accelerate revenues. As provided for in the statute, a number of taxpayers filed amended returns by May 31, 2009, to increase their reported tax and avoid the LCUP. However, original and amended returns filed subsequent to the enactment of the law are not designated by the taxpayer as being filed to avoid the LCUP penalty.

- **Request to Allow Taxpayers to Apply Overpayments to Estimated Taxes or Other Liability:** Revenue and Taxation Code Section 19383 provides that payments that are transferred from one tax year to another are effective as of the date the payments are transferred. (United States v. Swift & Co. (1931) 282 U.S. 468, 476.)

The estimated tax payment does not become effective until and unless the claim is allowed. This can often be some time after the amended return is filed, especially for complex corporate cases. This means that even though a taxpayer might ask that the claimed overpayment be applied to a specific estimate, if we do not take action on the claim by the due date of the estimated tax payment, the credit will not be timely applied and the taxpayer will incur an estimated tax penalty if they were relying on the amended return amount to satisfy the estimated tax requirement. In addition, the denial rate for large corporation claims has increased in recent years; less than half of these claims are allowed at audit.

However, we currently are looking into alternatives to reduce the timeframes to refund claims.

- **Regarding AB 1984:** (Harkey), Unless a bill is a department legislative proposal approved by the three-member Franchise Tax Board, the department does not take "support" positions on bills or provisions of bills.

- **No Interest on Corporate Overpayments**: At present, the State does not pay interest on corporate overpayments because the rate of interest is prescribed by a statutory formula (lesser of 5 percent or the bond equivalent rate of 13-week US Treasury Bills rounded to the nearest full percent). From 7/1/2009 to the present, this formula has yielded a result of zero percent. However, from July 1, 2002 through June 30, 2009, the interest rate ranged from 1-5 percent for corporate overpayments.

- **New Claim Issue Raised at Audit:** Generally, our practice is to incorporate claims for refund into the ongoing audit. Frequently, the taxpayer files one or more claims during the last stages of, or upon completion of, the audit. These claims remain open while all audit issues (including the filed claims) are resolved. This expands the audit scope and lengthens the time required to complete the audit. We make every effort to resolve the audit and the claim together.

  On occasions when the audit is near completion or has been completed, taxpayers raised new issues that may result in an overpayment which has not been fully determined by the taxpayer. In these instances, we may ask taxpayers to file a claim for refund to be resolved separately.

Currently, we continue to evaluate how we process claims, and review alternative solutions that may mitigate delays in refunding claims. We streamlined inventory management and audit processes, identified cases for closing agreements, continue auditor training, and work closely with Legal staff.

<u>Audit Timeframes</u>
Our goal is to complete cases within the 24 month guideline under Audit Regulation 19032 while maintaining accuracy of the assessments.

We continue to leverage the expertise of our subject matter experts and the Legal Division, and work in teams for more complex audits. We identify ways to further streamline our cases and practices. For example, where appropriate, we encourage the use of closing agreements to bring certainty and closure to an issue. While most cases are closed within the 24 month timeframe, we recognize some audits may take longer or require a waiver to complete due to a variety of factors. These include:

- **Federal Audits:** Federal audit changes may impact the California return. When a federal audit is near completion, it is typically more efficient to wait for the federal changes and include them in the California examination as opposed to opening a second examination for the federal changes only.

- **Pending Other Years/Matters:** There are often situations where taxpayers or FTB request an examination be placed on hold or delayed pending a determination from a prior year, usually when similar positions are reported on the later year return.

- **Issues Identified After Audit Plan is Established**: Filing a refund claim during an audit sometimes expands the audit scope and lengthens the audit timeline. Claims filed by large corporations typically often involve complex issues that may require intensive factual analysis, detailed documentation, and complex legal analysis to substantiate the claimed position. The later in the process a claim or claims are filed, the more likely it is to delay the resolution of the audit.

  The length of time needed to examine an issue is reduced if the taxpayer has the proper support and source documentation available when the claim is filed. If a claim is filed before or at the beginning of the audit process, we can more efficiently incorporate it into the audit plan.

- **Requests for Extension of Time to Respond**: There are times where the audit staff or the taxpayer will ask for an extension of time to review or gather information. These extensions of time to respond are typically agreed to between the auditor and the taxpayer/representative and may extend the time to resolve the case.

- **Staffing Changes:** When an auditor, representative, or taxpayer staff member changes, it can impact the audit timeline while the new contact becomes familiar with the case. To mitigate the potential impact of our staff changes, many of our complex audits are worked in teams. The remaining team members can often quickly assume the role of the team member on leave. In other cases that are not part of a team, auditors often work with leads who can assume the tasks, or supervisors reassign the case to another qualified auditor. In certain cases, it may be beneficial to wait for the auditor to return from leave (e.g., the case is close to completion and the leave duration is short), or a representative may request the case remain with the auditor. These situations can extend the audit timeline.

To help facilitate the audit process, we encourage good record-keeping practices, open communication, and complete and timely responses to information requests during the audit. If a taxpayer or representative has concerns regarding the audit process or timeline, we encourage them to reach out to the Audit supervisor or manager so that we can expeditiously address any concern. A successful audit requires cooperation and a time commitment from both the auditor and taxpayer.

As an upcoming effort, we are planning roundtable focus group discussions so we can gather more information from taxpayers, representatives and others to understand their concerns and gather ideas to improve our processes.

<u>Appeals</u>
Concerns were raised with perceived delays in the appeal process. As you appropriately recognize, appeals from an action by us are administered by the State Board of Equalization (SBE). The rules for tax appeals involving the briefing process, conducting oral hearings and preparing decisions were promulgated by the SBE and we are bound by those rules to the same extent as any taxpayer. You indicate that FTB can assist in the process by using discretion when deciding whether to move forward with an appeal. Franchise Tax Board must follow the law in determining whether to move forward on a case. In doing so, if Legal staff determines that the FT B's position is not sustainable under the law, FTB readily concedes on the issue before the SBE. In addition, FTB works regularly with Board Proceedings staff at the SBE to ensure that the processes outlined in the Rules for Tax Appeals are followed.

<u>Publishing Legal Ruling When Pending Court Litigation</u>
Legal Rulings are issued to apply legal analysis to a specific set of hypothetical facts when an issue is of a recurring nature and/or of wide interest. Such rulings are issued to provide a formal statement of the analysis of the FTB staff. Legal Rulings are the counterpart to Internal Revenue Service Revenue Rulings.

The driving force behind a decision to issue a Legal Ruling is guided by the principles above. Thus, in situations where staff has received numerous requests for guidance over an extended period of time, Legal Rulings are appropriate to provide the taxpayer community a formal statement of the analysis of staff on a particular issue.

A recent Legal Ruling was issued after numerous requests for guidance from taxpayers and practitioners over an extended period of time. In that case, staff was required to balance the public's expressed need for guidance on the subject matter of the ruling with the possibility that a refund suit might, but would not necessarily, address some related principles. On balance, staff determined that the requested guidance was needed in the taxpayer community and therefore, it should be issued.

Sincerely,

Susan Maples, CPA
Taxpayers' Rights Advocate

cc: Hon. Betty T. Yee, Chair
Hon. Jerome E. Horton, Member
Hon. Michael Cohen, Member