REVISED INITIAL STATEMENT OF REASONS FOR
PROPOSED REGULATION SECTION 19266,
RELATING TO THE FINANCIAL INSTITUTION RECORD MATCH

PUBLIC PROBLEM, ADMINISTRATIVE REQUIREMENTS, OR OTHER CONDITION OR CIRCUMSTANCE THAT THE REGULATION IS INTENDED TO ADDRESS

The proposed regulation is designed to implement the requirements of the Financial Institution Record Match (FIRM) program, as established by Revenue and Taxation Code (RTC) section 19266 (the "FIRM statute"). Under subdivision (a)(2) of RTC section 19266, regulations are specifically required to implement the FIRM program.

The FIRM statute authorizes the Franchise Tax Board to match income and franchise tax and non-tax debtor files referred to the Franchise Tax Board for collection (collectively, the "Debtor File") against accounts held at financial institutions (banks, credit unions, insurance and brokerage companies) doing business in California.

An amendment to the FIRM statute was enacted June 27, 2012 (Stats. 2012, ch. 37, § 2) (the "first FIRM amendment"). The first FIRM amendment provides for the following: (a) expands the FIRM program to the Employment Development Department ("EDD") and Board of Equalization ("BOE"); (b) provides for the submission of information by EDD and BOE to the Franchise Tax Board relating to delinquent debtors (as defined in the FIRM statute) to be used for data matching purposes under the FIRM program; and (c) requires reimbursement by EDD and BOE to the Franchise Tax Board for its costs in the implementation and administration of data collection under this portion of the FIRM program.

Another amendment to the FIRM statute was enacted on August 28, 2013 (Stats. 2013, ch. 200) (the "second FIRM amendment") to permit the Franchise Tax Board, BOE, and EDD to use FIRM address information received from financial institutions for purposes other than collection.

The enactments of the first FIRM amendment and the second FIRM amendment have no impact on the text or scope of the proposed regulation. The proposed regulation is designed to implement this section, thereby aiding in the tax and non-tax collection function as anticipated by RTC section 19266.

SPECIFIC PURPOSE OF THE REGULATION

As required by subdivision (a)(2) of RTC section 19266, the proposed regulation addresses the following:

- A structure by which financial institutions shall receive from the Franchise Tax Board the delinquent debtor files to match against its own list of account holders.

- An optional structure by which financial institutions without the technical ability to match the data may forward a list of their account holders to the Franchise Tax Board, and then Franchise Tax Board will match that list against the delinquent debtor files.
- Authority for the Franchise Tax Board to temporarily exempt a financial institution from FIRM participation if the Franchise Tax Board determines that the financial institution's participation would not generate sufficient revenue to be cost effective.
- A process by which financial institutions may be temporarily suspended from FIRM participation if the financial institution is undercapitalized, significantly undercapitalized, or critically undercapitalized as defined by Federal Deposit Insurance Corporation regulations or National Credit Union Association regulations.

NECESSITY/PROBLEM THE REGULATION INTENDS TO ADDRESS

RTC section 19266, subdivision (a)(2), provides, in part, that "[t]he Franchise Tax Board shall prescribe any rules and regulations that may be necessary or appropriate to implement this section." In addition, subdivision (a)(2) states that the rules and regulations are to include the items described above under the heading, "Specific Purpose of the Regulation." The Franchise Tax Board has not adopted regulations under this section.

The FIRM statute and program were patterned after the Financial Institution Data Match (FIDM) program adopted under Family Code section 17453 (the FIDM statute) and in accordance with the federal Personal Responsibility and Work Opportunity Reconciliation Act of 1996. Historically, financial institutions doing business in California have performed data matches with the Department of Child Support Services pursuant to Family Code section 17453 and the federal guidelines. The FIDM statute aids in the enforcement of child support collections.

While the FIRM statute and program are substantially similar to the FIDM statute and program, it is necessary to provide financial institutions with clarity as to how the FIRM program is to be operated and administered by the Franchise Tax Board to aid in the enforcement and collection of tax and non-tax debts. As such, the Franchise Tax Board has determined that a stand-alone state regulation is necessary. The regulation addresses the required provisions of RTC section 19266 as well as other necessary provisions prepared in collaboration with financial institutions, for financial institutions to conduct the quarterly data match as required under the FIRM statute.

Without adopting this regulation, the Franchise Tax Board cannot otherwise require or compel financial institutions to participate in the FIRM program under RTC section 19266, as the statute is not self-executing and requires a regulation to be adopted by the Franchise Tax Board.

The purpose of each subsection in the proposed regulation is described below.

(a) Overview. Subsection (a) provides a general overview of the regulation, explaining that pursuant to the FIRM statute and the regulation, the Franchise Tax Board shall operate and administer the FIRM program, which utilizes automated data exchanges to the maximum extent feasible to identify accounts of delinquent tax and non-tax debtors held at financial institutions doing business in California. The subsection is necessary to explain the overall authority of the Franchise Tax Board in administering the FIRM program and establishing a structure by which financial institutions shall receive from the Franchise Tax Board the delinquent debtor files to match against its own list of account holders, pursuant to subdivision (a)(2) of RTC section 19266.

(b) FIRM Program Administrator. Subsection (b) explains that the Franchise Tax Board and its designated third party administrator (collectively, FIRM Program Administrator) shall operate and administer the quarterly data exchange under the FIRM Participation Schedule set forth in subsection ((h), pursuant to the FTB Publication 2057 (rev. 08-2013), FIRM General Information Booklet. The subsection is necessary to explain that the FIRM Program Administer administers the quarterly data exchange under the FIRM Participation Schedule, thereby establishing the FIRM program structure pursuant to subdivision (a)(2) of RTC section 19266.

(c) Employment of a Third Party Vendor (Transmitter) by a Financial Institution. Subsection (c) explains the requirements for a financial institution to use Transmitter for the automated data exchanges. The subsection also explains that the financial institution must provide the name and contact information of the Transmitter to the FIRM Program Administrator on FTB Form 2060 PC (rev, 08-2013), Election. The subsection is necessary to provide additional guidance on the employment of Transmitters in conjunction with subdivision (a)(2)(A) of RTC section 19266.

(d) Match Methodology. Subsection (d) explains the requirements for participating financial institutions to complete and submit FTB Form 2060 PC, Election, whereby a financial institution chooses one of two methods of data matching with the Franchise Tax Board. The subsection also explains the two methods, which includes an optional structure (Method 1) by which a financial institution without the technical ability to match the data may forward its list of account holders to the Franchise Tax Board. The Franchise Tax Board will then match that list against the Debtor File. The subsection also addresses the ability of financial institutions to use a Transmitter to assist in the data transmission process and the quarterly submission requirements of the data file via the secured internet transfer protocol set forth in FTB Publication 2057 PC, FIRM General Information Booklet. The subsection also explains the Method 2 process whereby a financial institution matches all open accounts maintained by the financial institution against the Debtor File. The subsection is necessary to provide additional guidance on the process by which financial institutions match their data under the two methods, thereby establishing the FIRM program structure pursuant to subdivisions (a)(2)(A) and (a)(2)(B) of RTC section 19266.

(e) Filing FTB Form 2060 PC, Election. Subsection (e) explains the use of FTB Form 2060 PC, Election, including the form submission requirements, name changes, Transmitter changes, contact information changes, and filing requirements. . The subsection is necessary to provide additional guidance on submission requirements of FTB Form 2060, Election, thereby establishing the FIRM program structure pursuant to subdivisions (a)(2)(A) and (a)(2)(B) of RTC section 19266.

(f) Acknowledgement of Receipt of FTB Form 2060 PC, Election. Subsection (f) explains the review and written notification process used by the FIRM Program Administrator to notify the financial institution if it has received a completed FTB Form 2060 PC, Election, what happens if an incomplete form is received, and when to begin the FIRM data match participation process under the FIRM Participation Schedule set forth in subdivision (h) pursuant to FTB Publication 2057, FIRM General Information Booklet. The subsection is necessary to provide additional guidance on the receipt, review, and re-submission of FTB Form 2060, Election, thereby establishing the FIRM Program structure pursuant to subdivisions (a)(2)(A) and (a)(2)(B) of RTC section 19266.

(g) Data Format and Media Methodology. Subsection (g) provides financial institutions with the necessary information as to how data is to be exchanged and submitted to the FIRM Program Administrator, in accordance with the specifications for data formatting, record layout, naming conventions, and secure internet transfer protocol set forth in FTB Publication 2057, FIRM General Information Booklet. The subsection is necessary to provide additional guidance on the exchange of data, thereby establishing the FIRM Program structure pursuant to subdivisions (a)(2)(A), (a)(2)(B), (c)(1), and (h) of RTC section 19266.

(h) Participation Schedule. Subsection (h) sets out the FIRM Participation Schedule. It also explains that if the due date falls on a weekend or holiday, the due date shall be the next business weekday. The subsection is necessary to provide additional guidance regarding the quarterly data exchange and the FIRM Participation Schedule, thereby establishing the FIRM program structure pursuant to subdivision (a)(2) of RTC section 19266.

(i) Replacement Files. Subsection (i) provides that the FIRM Program Administrator may request the financial institution to submit a data match replacement file if there were errors encountered while processing the original file, and includes the timing requirements for financial institutions to submit a replacement file. The subsection is necessary to provide additional guidance on the resubmission of data, thereby establishing the FIRM Program structure pursuant to subdivisions (a)(2)(A), (a)(2)(B), (c)(1), and (h) of RTC section 19266.

(j) Temporary Exemptions. Subsection (j) sets forth the process for the Franchise Tax Board to temporarily exempt a financial institution from FIRM participation if the Franchise Tax Board determines that the financial institution's participation would not generate sufficient revenue to be cost effective. The subsection is necessary to provide additional guidance for temporary exemptions, pursuant to subdivision (a)(2)(C) of RTC section 19266.

(k) Temporary Suspension. Subsection (j) sets forth the process by which financial institutions may be temporarily exempted from FIRM participation if the financial institution is undercapitalized, significantly undercapitalized, or critically undercapitalized as defined by Federal Deposit Insurance Corporation regulations or National Credit Union Association regulations. It also sets for the reinstatement process for FIRM participation. The subsection is necessary to provide additional guidance for temporary suspensions, pursuant to subdivision (a)(2)(C) of RTC section 19266.

(l) Reimbursement to Financial Institutions. Subsection (l) explains the two types of reimbursements that participating financial institutions may be entitled to under the FIRM statute: (a) actual costs for FIRM one-time start-up operations of no more than $2,500; and (b) actual costs for FIRM data matching (other than one-time start up operations) of no more than $250 per calendar quarter. The subdivision also outlines the process and timing for participating financial institutions to submit a completed FTB Form 2059 PC (rev. 08-2013), Reimbursement Invoice. The subsection is necessary to provide additional guidance on the process for reimbursement for financial institutions, pursuant to subdivision (i) of RTC section 19266

(m) Enforcement and Penalties. Subsection (m) explains that the Franchise Tax Board may institute civil proceedings to enforce the provisions of RTC section 19266 and this regulation. The subsection also explains that the Franchise Tax Board shall assess a penalty for willful failure to comply with rules and regulations relating to RTC section 19266 and these regulations, unless it is shown that the failure is due to reasonable cause. The subsection also states the penalty amount for willful failure to comply. The subsection is necessary to provide additional guidance relating to enforcement and penalties for non-compliance by financial institutions, pursuant to subdivision (e) of RTC section 19266

NONMONETARY AND MONETARY BENEFITS ANTICIPATED FROM THE REGULATORY ACTION, INCLUDING THE BENEFITS OR GOALS PROVIDED IN THE AUTHORIZING STATUTE

1. *Establishes a Coordinated FIRM Program With Financial Institutions, Resulting in a Uniform Treatment of the Financial Industry over the FIRM Process.* The FIRM statute mandates that the Franchise Tax Board shall operate and administer, in coordination with financial institutions doing business in California, a Financial Institution Record Match system. The coordinated effort with financial institutions, established through an industry workshop and interested parties meetings, assists in uniform treatment of the financial industry. It also provides a vehicle to address mutual issues, such as privacy protections.

2. *Provides Up-To-Date, Additional Sources of Assets for Tax Collection*. Prior to the enactment of the FIRM statute in March, 2011, and with the enactment of the first FIRM amendment in June, 2012, of the three largest sources of asset data that can be used for collection of unpaid tax debts — real property records, wage and payment reporting, and bank accounts — the Franchise Tax Board, BOE, and EDD lacked access to bank account information. The FIRM statue, the first FIRM amendment, and the proposed regulation assist in identifying up-to-date bank or other financial accounts (as defined in the FIRM statute) of taxpayers as additional sources of assets for tax and non–tax collection and enforcement.

3. *Creates a More Efficient Process to Identify Debtor Assets.* Adopting the regulation will improve the processes necessary to identify debtor assets, reduce staff time, and gain compliance by delinquent debtors. The record match will permit the Franchise Tax Board, BOE, and EDD to identify previously unknown deposit accounts held by delinquent debtors to collect outstanding tax and non-tax debts and help close the tax gap.

4. *Leads to a Significantly Higher Success Rate in Tax and Non-Tax Collection.* By using more accurate bank data the Franchise Tax Board, BOE, and EDD will have a significantly higher success rate in involuntary collection measures for delinquent tax and non-tax debts of individuals and business entities.

5. *Indirectly Aids In Self-Compliance.* The FIRM data match system — along with the tax collection process – may act to deter tax and non-tax debtors from future avoidance or non-compliance of their tax or non-tax liabilities. It indirectly aids in self-compliance measures for tax and non-tax debtors.

6. *Monetary Benefits--Increases Tax and Non-Tax Collections and Helps Reduce the Tax Gap.* Statewide monetary benefits will be derived from the Franchise Tax Board's tax and non-tax collection efforts following FIRM's quarterly data match program. As a result of the FIRM system, the Franchise Tax Board's projected revenue from implementation of the FIRM statute, after being accrued back a year, is as follows:

   2011/2012 - $37 million
   2012/2013 - $30 million
   2013/2014 - $32 million
   2014/2015 - $33 million

The above projections do not include revenue collected from non-tax debt, which is also part of the FIRM data match project (scheduled to be implemented October, 2012). Non-tax collections may also increase revenue. The actual tax revenue may vary from the above projections due to other process and technology improvements currently underway by the Franchise Tax Board. The above projections also do not include revenue to be collected from non-tax debt of BOE or EDD under the first FIRM amendment. Also, as the program matures, additional financial institutions may be added, changing the revenue of the program.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDIES, REPORTS, OR DOCUMENTS

In drafting the proposed regulation, Franchise Tax Board staff primarily relied upon RTC section 19266, including the items specified in subdivision (a)(2) of the FIRM statute. Staff also reviewed the following:

- Legislative history and analyses of Senate Bill 402 (2009/2010 Legislative Session) and Senate Bill 86 (2011/2012 Legislative Session), available at www.leginfo.ca.gov. Information is also available at www.ftb.ca.gov and search **firm sb 402** or **firm sb 86.**
- Franchise Tax Board's Legislative Proposal 08-02, available at www.ftb.ca.gov and search **firm legislative proposal 08-02.**
- Notices, agendas, reference materials, and summaries of industry workshops and interested parties meetings held on August 16, 2011 and September 27, 2011. This is available at www.ftb.ca.gov and search **firm interested parties.**
- Franchise Tax Board's proposed FIRM procedures, developed in conjunction with the financial institutions industry, available at www.ftb.ca.gov and search **firm.**
- Procedures for the FIDM program, established under Family Code section 17453, available at www.ftb.ca.gov and search **fidm.**

- Similar FIRM statutes adopted in Kentucky, Maryland, Massachusetts, New Jersey, and New York, which are available via the Internet.

REASONABLE ALTERNATIVES TO THE PROPOSED REGULATORY ACTION PROPOSED BY THE PUBLIC THAT WOULD LESSEN ANY ADVERSE IMPACT ON SMALL BUSINESS. IF REASONABLE ALTERNATIVES WERE PROPOSED AND REJECTED, EXPLAIN THE REASONS.

In accordance with the requirement of Government Code section 11346.2, subdivision (b)(5), that the Franchise Tax Board consider alternatives to the proposed regulatory action, staff of the Franchise Tax Board conducted three interested parties meetings.

Under Government Code section 11342.610, the definition of "small business" does not include financial institutions. As a result, the Franchise Tax Board has determined that the proposed regulation will not affect small business.

ALTERNATIVES TO THE PROPOSED REGULATORY ACTION PROPOSED BY THE PUBLIC AS LESS BURDENSOME AND EQUALLY EFFECTIVE. IF ALTERNATIVES WERE PROPOSED AND REJECTED, EXPLAIN THE REASONS.

A. Alternatives and Mitigation Measures Considered and Implemented in Meetings with Industry and Interested Parties during Franchise Tax Board's Legislative Proposal Process.

Pre-legislative meetings between Franchise Tax Board staff and the financial industry were held to discuss the proposed FIRM legislation, its impact on financial institutions, and mitigation measures. Meetings with the financial industry were held on December 15, 2006 and August 8, 2007.

As a result of these meetings, mitigation measures were added to Senate Bill 402 (2009/2010 Legislative Session), which included the following: 1) a temporary exemption for financial institutions in regulatory distress; and 2) a stated maximum number of taxpayer debtor files to be received by financial institutions as part of the initial phase of the FIRM program. Mitigation measures were also added in a subsequent legislative session via Senate Bill 86 (2011/2012 Legislative Session), which required the state to reimburse financial institutions for their start-up costs associated with FIRM (up to $2,500) and quarterly costs (up to $250 per quarter). The Franchise Tax Board considers this an accurate representation of costs incurred by financial institutions. In addition, due to greater accuracy and an expanded levy process, financial institutions would likely receive additional revenue from bank fees or charges to accountholders to process the levies, which can range up to $125 per levy.

B. Additional Alternatives and Mitigation Measures Considered and Implemented in Meetings with Industry and Interested Parties Prior to the Formal Regulatory Process.

Following the enactment of Senate Bill 86 (Stats 2011, ch. 14) on March 23, 2011, Franchise Tax Board staff held an advisory workshop on July 25, 2011, with financial institution trade associations to discuss the implementation of the FIRM statutory provisions and to seek ways to mitigate impact on the financial institutions, or make the process less burdensome. Interested parties' meetings were also held with the public and members of the financial institution industry on August 16 and September 27, 2011. In these meetings, Franchise Tax Board staff explained that the record format to be used in the FIRM data match program would be the same record format that is already used by financial institutions in their required participation under the FIDM data match program to support the collection of child support debt. Franchise Tax Board staff requested input and sought alternative procedures which would lessen the impact on financial institutions in implementing the FIRM program. The following suggestions and alternatives were implemented:

1. The first form was changed from an agreement to a participation/election form. This would greatly reduce the number of forms sent to in-house counsel for review.

2. Staff eliminated the "under penalty of perjury" language from the participation forms used in the FIRM booklet. Instead, the forms would be signed by officers of the financial institution. This greatly lessened the review by in-house counsel.

3. Franchise Tax Board staff confirmed that the department required that transmission of FIRM personal data be encrypted. Both the Franchise Tax Board and financial institutions wanted to ensure proper safeguards and privacy protections.

4. Franchise Tax Board staff requested--and the Department of Finance accepted--the procedure of having financial institutions submit their reimbursement bill on a yearly basis rather than a quarterly basis, thereby reducing the number of bills prepared by each financial institution.

ECONOMIC IMPACT ANALYSIS

The proposed regulation is designed to implement the requirements of the FIRM system, as established by RTC section 19266. The FIRM statute authorizes the Franchise Tax Board to match income and franchise tax and non-tax debtor files against delinquent debtor files held at financial institutions doing business in California. The proposed regulation ultimately aids in the Franchise Tax Board's tax and non-tax collection/enforcement functions as anticipated by RTC section 19266.

The nonmonetary and monetary benefits anticipated from the regulatory action are set forth under the topic heading, "Nonmonetary And Monetary Benefits Anticipated From The Regulatory Action, Including The Benefits Or Goals Provided In The Authorizing Statute." In summary, the benefits are as follows:

- *Establishes a Coordinated FIRM Program With Financial Institutions, Resulting in a Uniform Treatment of the Financial Industry over the FIRM Process.*
- *Provides Up-To-Date, Additional Sources of Assets for Tax and Non-Tax Collection*.
- *Creates a More Efficient Process to Identify Debtor Assets.*
- *Leads to a Significantly Higher Success Rate in Tax and Non-Tax Collection.*
- *Indirectly Aids In Self-Compliance.*
- *Monetary Benefits--Increases Tax and Non-Tax Collections and Helps Reduce the Tax Gap.*

Pursuant to Government Code section 11346.3, subdivision (b), the Franchise Tax Board has made the following assessments regarding the proposed regulation:

Creation or Elimination of Jobs Within the State

No jobs will be eliminated. It is anticipated that less than one-quarter (¼) of one full-time equivalent staff person would be needed per financial institution to assist in complying with the requirements of FIRM.   The same staff person who conducts the required FIDM program for the financial institution would likely handle the required record match under the FIRM program. The FIDM and FIRM programs utilize similar record formats for the data match processes.

Creation of New or Elimination of Existing Businesses Within the State

Since it is anticipated that data-matching will be conducted by either in-house personnel or the information technology service provider for the financial Institutions, there will be no effect on the creation of new or elimination of existing businesses within the state.

Expansion of Businesses or Elimination of Existing Businesses Within the State

Since it is anticipated that data-matching will be conducted by either in-house personnel or the information technology service provider for the financial Institutions, there will be no effect on the expansion of businesses or the elimination of existing businesses within the state.

The Franchise Tax Board is not aware of any impacts to private persons (individuals) relating to the proposed regulation.

DOES THE REGULATORY ACTION MANDATE THE USE OF SPECIFIC TECHNOLOGIES OR EQUIPMENT?

The FIRM statute mandates data matching as a methodology using "automated data exchanges to the maximum extent possible."   The proposed regulation does not mandate any specific technologies or equipment.

DOES THE REGULATORY ACTION CONTAIN ONE OR MORE REGULATIONS THAT ARE IDENTICAL TO ONE OR MORE CORRESPONDING FEDERAL REGULATIONS?

The proposed regulation is not a federally mandated regulation. The proposed regulation does not contain one or more regulations that are identical to one or more corresponding federal regulations.

ADVERSE ECONOMIC IMPACT ON BUSINESS

The Franchise Tax Board has made an initial determination that the FIRM statute and proposed regulation will impact approximately 800 financial institutions doing business in California. As the program matures, additional financial institutions may be added if required.

Impacts on financial institutions doing business in California will be minimal or substantially reduced due to the alternatives and mitigation measures adopted. Moreover, the record format used in the FIRM data match program is similar to the FIDM data match record format, which is currently required by financial institutions for compliance with the FIDM program to support the collection of child support debt. Additionally, the financial institutions receive an initial reimbursement for start-up costs and thereafter, reimbursements for quarterly data matching costs, as set forth in RTC 19266. Based on the above, the Franchise Tax Board has made an initial determination that the regulatory action will not have an adverse economic impact on financial institutions doing business in California.

Facts in support of this initial determination are found under the topic heading, “Alternatives to the Proposed Regulatory Action Proposed by the Public as Less Burdensome and Equally Effective.”