

## **TITLE 18. FRANCHISE TAX BOARD**

As required by Government Code section 11346.4, this is notice that a public hearing has been scheduled at 1:00 p.m., on Wednesday, March 27, 2013, at the Franchise Tax Board, 9646 Butterfield Way, Town Center, Valley Quail Room, Sacramento, California, to consider the adoption of California Code of Regulations, title 18, section 19266, pertaining to the framework for the Franchise Tax Board and financial institutions doing business in California to implement and administer the Financial Institutions Record Match (FIRM) system established under Revenue and Taxation Code section 19266 (the FIRM statute).

An employee of the Franchise Tax Board will conduct the hearing. Government Code section 15702, subdivision (b), provides for consideration by the three-member Franchise Tax Board of any proposed regulatory action, if any person makes such a request in writing. If a written request is received, the three-member Franchise Tax Board will consider the proposed regulatory action prior to adoption.

Interested persons are invited to present comments, written or oral, concerning the proposed regulatory action. It is requested, but not required, that persons who make oral comments at the hearing also submit a written copy of their comments at the hearing.

### **WRITTEN COMMENT PERIOD**

Written comments will be accepted until 5:00 p.m., March 27, 2013. All relevant matters presented will be considered before the proposed regulatory action is taken. Comments should be submitted to the agency officer named below.

### **AUTHORITY & REFERENCE**

Revenue and Taxation Code section 19503 authorizes the Franchise Tax Board to prescribe regulations necessary for the enforcement of Part 10 (commencing with section 17001), Part 10.2 (commencing with section 18401), Part 10.7 (commencing with section 21001) and Part 11 (commencing with section 23001). Revenue and Taxation Code section 19266, subdivision (a)(2), specifically requires that the Franchise Tax Board adopt this regulation to implement the FIRM system.

### **INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW**

The FIRM statute was enacted March 24, 2011 (Stats. 2011, ch. 14, § 4). Pursuant to Revenue and Taxation Code sections 19266 and 19560.5, the Franchise Tax Board is authorized to match Franchise Tax Board tax and non-tax debtor files referred to the Franchise Tax Board for collection (collectively, "delinquent debtor files") against accounts held at financial institutions (banks, credit unions, insurance and brokerage companies) doing business in California.

Revenue and Taxation Code section 19266 was amended June 27, 2012 (Stats. 2012, ch. 37, § 2) (the "FIRM amendment"). The FIRM amendment is effective and operative January 1, 2013, and 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 tax 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.

Revenue & Taxation Code section 19266 specifically requires the Franchise Tax Board to promulgate rules or regulations necessary to implement the provisions of this new law, including 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 process the data exchange may forward a list of their account holders to the Franchise Tax Board, and then the 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 Administration regulations.

The Franchise Tax Board has not adopted regulations under this section. The proposed regulation is designed to implement this section, thereby aiding in the tax and non-tax collection function as anticipated by Revenue and Taxation Code section 19266. The enactment of the FIRM amendment has no impact on the text or scope of the proposed regulation that was approved by the three-member Franchise Tax Board at its December 1, 2011 meeting.

#### **IS THERE AN EXISTING, COMPARABLE FEDERAL STATUTE OR REGULATION**

There is no existing, comparable federal statute or regulation.

#### **ANTICIPATED BENEFITS FROM THE PROPOSED REGULATION**

Nonmonetary and monetary benefits of the FIRM statute and the proposed regulation are as follows:

- *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.

- *Provides Up-To-Date, Additional Sources of Assets for Tax Collection.* Prior to the passage of the FIRM statute in March, 2011 (SB 86, 2010 stats. Ch. 14), 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 lacked access to bank account information. The FIRM statute and the proposed regulation assist in identifying up-to-date bank or other financial accounts (as defined in the statute) of taxpayers as additional sources of assets for tax and non-tax collection and enforcement.
- *Creates a More Efficient Process to Identify Debtor Assets.* Implementing the FIRM statute and 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 to identify previously unknown deposit accounts held by delinquent debtors to collect outstanding debts and help close the tax gap.
- *Leads to a Significantly Higher Success Rate in Tax and Non-Tax Collection.* By using more accurate bank data the Franchise Tax Board will have a significantly higher success rate in its involuntary tax and non-tax collection measures for delinquent taxes and non-tax debts of individuals and business entities.
- *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 of or non-compliance with their tax or non-tax liabilities. It indirectly aids in self-compliance measures for tax and non-tax debtors.
- *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 increase in revenue, 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 process and technology improvements currently underway by the Franchise Tax Board. Also, as the program matures, additional financial institutions may be added, changing the revenue of the program.

**EVALUATION OF WHETHER THE PROPOSED REGULATION IS INCONSISTENT OR INCOMPATIBLE WITH EXISTING STATE REGULATIONS**

The Franchise Tax Board has made an initial evaluation of the proposed regulation and determined that the adoption of the proposed regulation is not inconsistent or incompatible with existing state regulations. There are no comparable existing state regulations.

**IS THE PROPOSED REGULATION MANDATED BY FEDERAL STATUTE OR REGULATION?**

The proposed regulation is not mandated by federal statute or regulation.

**ARE THERE OTHER STATUTORY REQUIREMENTS IDENTIFIED IN THE NOTICE THAT ARE SPECIFIC TO THE AGENCY OR TYPE OF REGULATION?**

There are no other statutory requirements identified in the notice.

**MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS**

None.

**COST TO ANY LOCAL AGENCY OR SCHOOL DISTRICT WHICH MUST BE REIMBURSED UNDER PART 7, COMMENCING WITH GOVERNMENT CODE SECTION 17500, OF DIVISION 4**

None.

**COST OR SAVINGS TO ANY STATE AGENCY**

Franchise Tax Board's projected costs for FIRM are:

	FY 2011/12	FY 2012/13	FY 2013/14	FY 2014/15	Total
<b>Total Project Costs</b>	<b>\$632,917</b>	<b>\$622,980</b>	<b>\$595,714</b>	<b>\$595,714</b>	<b>\$2,447,325</b>
Total Financial Institution Reimbursement Costs	\$495,000	\$2,155,000	\$800,000	\$800,000	\$4,250,000
Other Program Costs	\$0	\$2,505,794	\$2,344,746	\$2,344,746	\$7,195,286
<b>Total Program Costs</b>	<b>\$495,000</b>	<b>\$4,660,794</b>	<b>\$3,144,746</b>	<b>\$3,144,746</b>	<b>\$11,445,286</b>
<b>Total Project + Program Cost</b>	<b>\$1,127,917</b>	<b>\$5,283,773</b>	<b>\$3,740,460</b>	<b>\$3,740,460</b>	<b>\$13,892,610</b>

The above projections do not include costs related to 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 costs. The actual costs may vary from the above projections due to process and technology improvements currently underway by the Franchise Tax Board. Also,

as the program matures, additional financial institutions may be added, changing the costs of the program. If additional financial institutions are added, the costs for the one-time and on-going reimbursement to the financial institutions and the cost of contractual services for data matching will increase proportionally. Also, the cost of contractual services for the out years may vary with economic conditions.

In addition, any estimated revenue from the FIRM amendment from inclusion of EDD and BOE under FIRM, as described under the Informative Digest/Policy Statement Overview above, is identified in the Governor's 2012-2013 [California State Budget Summary](#) and in the legislative history to Senate Bill 1015 (2011/2012 Legislative Session). It is further anticipated that the enactment of the FIRM amendment will not create any additional costs to businesses, including financial institutions, under this regulation because all data requested from the financial institutions under FIRM, whether for EDD, BOE, or the Franchise Tax Board, will be solely transmitted by the Franchise Tax Board under the provisions of the FIRM statutes and this regulation to those financial institutions,

**OTHER NON-DISCRETIONARY COST OR SAVINGS IMPOSED UPON LOCAL AGENCIES**

None.

**COST OR SAVINGS IN FEDERAL FUNDING TO THE STATE**

None.

**SIGNIFICANT EFFECT ON HOUSING COSTS**

None.

**WHETHER THERE IS A SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS INCLUDING THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE WITH BUSINESSES IN OTHER STATES**

The Franchise Tax Board has made an initial determination that the FIRM statute and the proposed regulation do not create a significant statewide adverse impact on financial institutions doing business in California. The Franchise Tax Board has also made an initial determination that the FIRM statute and the proposed regulation do not create a significant statewide adverse impact on the ability of California financial institutions to compete with financial institutions in other states.

**WHAT ARE THE FACTS, EVIDENCE, AND DOCUMENTS ON WHICH THE AGENCY RELIES TO SUPPORT AN INITIAL DETERMINATION THAT THE ACTION WILL NOT HAVE A SIGNIFICANT ADVERSE ECONOMIC IMPACT ON BUSINESS?**

The FIRM statute and the proposed regulation only impact financial institutions doing business in California. Impact on these financial institutions will be minimal or substantially reduced due to the alternatives and mitigation measures adopted. Facts in support of this initial determination are as follows:

- A. FIRM Record Match Requirements are Similar to Existing Record Match Requirements Currently Used and Required by Financial Institutions in Another Program.

The FIRM data match record format required to be used by financial institutions is similar to the Financial Institution Data Match (FIDM) record format that is already used and required by financial institutions to support the collection of child support debt, pursuant to Family Code section 17453.

B. 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 Legislature concluded that these amounts were an accurate representation of costs incurred by financial institutions during the legislative process, and the Franchise Tax Board believes this to still be the case. 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.

C. 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 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:

- 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.

- 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.
- 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.
- 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.

Following the above changes, in accordance with Government Code section 11346.5, subdivision (a)(13), the Franchise Tax Board has determined that no alternative considered by it would be more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons and businesses than the proposed regulatory action.

**WHAT ARE THE FACTS, EVIDENCE, AND DOCUMENTS ON WHICH THE AGENCY RELIES TO SUPPORT AN INITIAL DETERMINATION THAT THE ACTION DOES NOT CREATE A SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT ON THE ABILITY OF CALIFORNIA FINANCIAL INSTITUTIONS TO COMPETE WITH FINANCIAL INSTITUTIONS IN OTHER STATES?**

In pre-legislative meetings between Franchise Tax Board staff and the financial industry (see history immediately above this topic heading), a financial industry advisory workshop meeting held March 25, 2011, and an interested parties meeting held August 16, 2011, Franchise Tax Board staff provided data and information demonstrating that at least five states (Indiana, Kentucky, Maryland, Massachusetts, New Jersey, and New York) had adopted FIRM-type legislation to aid in their tax collection efforts. This information is available on the website of the respective state taxing agencies. Given the implementation of a FIRM-type program by these states, there is a significant likelihood that other states throughout the country will follow this trend.

Franchise Tax Board staff has found no facts or evidence that California financial institutions are being placed at a competitive disadvantage, particularly when other states have adopted similar legislation and California financial institutions are reimbursed by the state for start-up costs and annual costs relating to the quarterly FIRM data match process.

**RESULTS OF THE ECONOMIC IMPACT ANALYSIS**

Pursuant to Government Code Section 11346.3, subdivision (b), the results of the Economic Impact Analysis are shown below.

1. Impact on business and individuals: See Item 2 below.
2. Total number of businesses impacted:

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. The Franchise Tax Board has determined that the FIRM statute and the proposed regulation will not affect small business. Under Government Code section 11342.610, the definition of “small business” does not include financial institutions.

3. Number of businesses created or eliminated:

None. It is anticipated that data-matching will be conducted by either in-house personnel or the information technology service provider for the financial Institutions.

4. Geographic extent of impacts:

Statewide. See Item 2 above.

5. Number of jobs created or eliminated:

No jobs will be eliminated. It is anticipated that less than one-quarter ( $\frac{1}{4}$ ) 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 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.

Types of jobs or occupations impacted:

As discussed in 5 above, 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.

Will the regulation affect the ability of California business to compete with other states by making it more costly to produce goods or services here?

No. See the above topic heading, “What Are The Facts, Evidence, And Documents On Which The Agency Relies To Support An Initial Determination That The Action Does Not Create A Significant Statewide Adverse Economic Impact On The Ability Of California Financial Institutions To Compete With Financial Institutions In Other States?”

## SECTION B. ESTIMATED COSTS TO BUSINESSES AND INDIVIDUALS

1. What are the total statewide dollar costs that businesses and individuals may incur to comply with this regulation over its lifetime?

None. Costs are incurred by financial institutions (not individuals) in order to comply with the statutory requirements of Revenue and Taxation Code section 19266. Costs are not the result of the proposed regulation. However, Franchise Tax Board has set out the statutory reimbursement cost for financial institutions under the FIRM statute for initial start-up costs (up to \$2,500) and annual costs for data matching (up to \$1,000 annually--\$250 per quarter).

The reimbursement amounts for initial start-up costs and annual costs for data match processing were discussed during the 2011/2012 legislative session in meetings with the financial industry on Senate Bill 86. 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.

The Franchise Tax Board is not aware of any cost impacts that a representative private person would necessarily incur in reasonable compliance with the proposed regulation.

1 (b). Years (future years for annual costs and reimbursements):

On-going.

Items 2- 5 are responded to in other portions of this Notice.

#### SECTION C. ESTIMATED BENEFITS

I -3. What are the total statewide benefits from this regulation over its lifetime?

None. Statewide benefits are derived from the FIRM statute, not from the regulation. See the nonmonetary and monetary benefits under the above topic heading, "Anticipated Benefits From The Proposed Regulation." Also, the other items referred to in Items 1-5 are set forth in this Notice.

#### SECTION D. ALTERNATIVES TO THE REGULATION

1. List Alternatives. See the above topic heading, "What Are The Facts, Evidence, And Documents On Which The Agency Relies To Support An Initial Determination That The Action Will Not Have A Significant Adverse Economic Impact On Business."

2. List total statewide costs and benefits.

For statewide costs, see Item 1 in Section B. For statewide benefits, see Item 1 above in Section C.

3. Quantification of costs and benefits for the regulation or alternatives. See Item 1 in Section D above.

4. Mandated Technologies.

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.

#### SECTION E. MAJOR REGULATIONS

1-3. Will the estimated costs to California business exceed \$10 million?

No.

## **COST IMPACTS ON REPRESENTATIVE PRIVATE PERSONS OR BUSINESSES**

The Franchise Tax Board has made an initial determination that the FIRM statute and the proposed regulation will impact financial institutions doing business in California. For cost impacts on financial institutions, see the above topic heading, Section B, “Estimated Costs to Businesses and Individuals.”

The Franchise Tax Board is not aware of any cost impacts that a representative private person would necessarily incur in reasonable compliance with the proposed regulation.

## **REPORTING REQUIREMENTS IMPOSED BY THE REGULATION**

None. Reporting requirements are imposed pursuant to the statutory requirements of Revenue and Taxation Code section 19266, not the regulation.

## **EFFECT ON SMALL BUSINESS**

None. The Franchise Tax Board has determined that the proposed regulation will not affect small business. Under Government Code section 11342.610, the definition of “small business” does not include financial institutions.

## **CONSIDERATION OF ALTERNATIVES**

In accordance with Government Code section 11346.5, subdivision (a)(13), the Franchise Tax Board must determine that no reasonable alternative considered or that has otherwise been identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed regulatory action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

## **AVAILABILITY OF STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION**

The Franchise Tax Board has prepared an initial statement of the reasons for the proposed regulatory action. The express terms of the proposed regulatory action, the initial statement of the reasons for the regulatory action, and all the information upon which the proposed regulatory action is based, are available upon request from the agency officer named below. When the final statement of reasons is available, it can be obtained by contacting the agency officer named below, or by accessing the Franchise Tax Board’s website at [www.ftb.ca.gov](http://www.ftb.ca.gov).

## **CHANGE OR MODIFICATION OF ACTIONS**

The proposed regulation may also be adopted with modifications if the changes are nonsubstantive or the resulting regulations are sufficiently related to the text made available to the public so that the public was adequately placed on notice that the regulations as modified could result from that originally proposed. The text of the regulation as modified will be made available to the public at least 15 days prior to the date on which the regulations is adopted. Requests for copies of any modified regulation should be sent to the attention of the agency officer named below.

## **ADDITIONAL COMMENTS**

If you plan on attending or making an oral presentation at the regulation hearing, please contact the agency officer named below.

The hearing room is accessible to persons with physical disabilities. Any person planning to attend the hearing, who is in need of a language interpreter, including sign language should contact the officer named below at least two weeks prior to the hearing so that the services of an interpreter may be arranged.

## **CONTACT**

All inquiries concerning this notice or the hearing should be directed to Colleen Berwick at Franchise Tax Board, Legal Division, P.O. Box 1720, Rancho Cordova, CA 95741-1720; Telephone (916) 845-3306; Fax (916) 845-3648; E-Mail: [Colleen.Berwick@ftb.ca.gov](mailto:Colleen.Berwick@ftb.ca.gov). In addition, all questions on the substance of the proposed regulation can be directed to Kenneth A. Davis: Telephone (916) 845-3839; Fax (916) 843-6146; E-Mail: [Kenneth.Davis@ftb.ca.gov](mailto:Kenneth.Davis@ftb.ca.gov). The notice, the initial statement of reasons and express terms of the regulation are also available at the Franchise Tax Board's website at [www.ftb.ca.gov](http://www.ftb.ca.gov).