

## Efforts to Address California's Tax Gap

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The cornerstone of our tax system is voluntary compliance. The vast majority of taxpayers voluntarily file and pay taxes they owe but a significant number do not. The difference between what taxpayers owe under the law and what they voluntarily pay is the tax gap.

- Addressing the tax gap is important because it causes other Californians to bear the additional load of higher taxes, less services, and bigger deficits. The Tax Gap also undermines honest taxpayers' sense of equity in our tax system and places honest businesses at a competitive disadvantage.
- The Tax Gap is significant and complex. A federal study done about 10 years ago estimated the size of the national tax gap to be over \$29 billion annually, and economists have estimated that California's tax gap to be \$6.5 billion annually.
- The FTB focuses on the impact our efforts have on narrowing the tax gap and influencing taxpayer behavior. Since the 05/06 fiscal year, we have received budget augmentations to fund many of our efforts to narrow the tax gap and have assessed or collected more than \$450 million of additional revenue.

The Tax Gap is generally attributable to four categories of taxpayers:

- Non-Filers: those who owe taxes but don't file returns.
- Under-reporters (or over-deducters): taxpayers who file but under-report income or take deductions to which they are not entitled. This category is the largest component of the tax gap and includes everything from inadvertent errors to abusive tax shelters.
- Under-payers: taxpayers who file returns but fail to pay balances due by not paying, under withholding, or failing to make estimated payments.
- Fraud: taxpayers who intentionally misrepresent information in order avoid taxes or obtain refunds of refundable credits.

It is important to note that accounts receivable is the tangible culmination of the portion of the tax gap that the department has validated as currently due and payable. However, it does not represent the entire tax gap. The rest of the tax gap can only be estimated because it consists of taxes that are due under the law but have not been validated because income, transactions, or other activities have either not been reported or have been hidden from the state.

### **Department Activities Under 2010/2011 Budget Change Proposals**

The first budget change proposal was approved to continue our existing tax gap enforcement activities. So far, we are on track to meet our revenue estimates of an additional \$114 million this fiscal year. Our efforts under this BCP include:

- Expanding the Individual Non-filer Program by adding Information Returns Master File (IRMF) information from IRS. We contact an additional 60,000 non-filers annually using this data and have collected more than \$50 million in revenue since July 2008.
- Targeting specific industries to increase compliance with nonresident withholding where we determined non-resident taxpayers or withholding agents were not complying with their tax obligations.
- Expanding our efforts to contact non-filers by obtaining more data sources in order to find non-filers with bad addresses.
- Leveraging DMV Luxury Auto Registration Information through a pilot project to evaluate the use of luxury vehicle registration information from the DMV as a data source.

The second budget augmentation relates to the Federal Treasury Offset Program (FTOP), which added a new collection tool to accelerate revenue for the general fund. This budget proposal projected \$6 million in revenue in fiscal year 2010/2011 increasing to \$93 million by 2013/2014. As of December 1, actual receipts are \$3.4 million, or 60 percent of the annual projection.

The Third BCP addressed accounts receivable growth. We increased enforcement measures and enhanced our ability to collect outstanding debts and reduce accounts receivable. We are currently ahead of projected revenue for this fiscal year.

### **Other Department Initiatives**

Department wide, our primary initiative is increasing taxpayer compliance efforts through better use of existing data. We continually reevaluate our inventory and use of data to determine what data can be better utilized to enhance compliance efforts. We look for ways to recover unused data and use existing data to identify additional noncompliant taxpayers. Our primary focus under this initiative is the Enterprise Data to Revenue (EDR) Project, which will help narrow the tax gap by allowing us to better adapt to our customers' needs and increase transparency. In doing so, we will encourage more voluntary compliance while generating more revenue for the state.

Our other activities to better use existing data include:

- Publishing the List of the Top 250 Delinquent Taxpayers, a list that identifies the top 250 individuals and businesses with recorded state income tax liens over \$100,000. This initiative has raised \$62 million since inception.
- Our Fraud and Discovery Section uses sophisticated and innovative methods to detect fraud and underreporting by conducting studies to detect and discover taxpayers who do not file tax returns, underreport income, or file false claims for refund. A good example of our efforts in this area is our effort related to the Child and Dependent Care and Withholding Credits.

Our second major initiative is to continue to expand partnerships with sister tax agencies and other government agencies.

- We participate in a Federal/State Steering Committee to share best practices in tax administration with the IRS and other California state agencies.
- We formed a Joint Agency Data Sharing Team, which includes staff from the FTB, The State Board of Equalization, and the Employment Development Department. This team meets regularly to identify new opportunities or obstacles for data sharing.

Finally, we are seeking ways to encourage taxpayer compliance. We develop self-compliance efforts that encourage taxpayers to self comply without necessarily being subjected to audit, and encourage tax return preparers to meet the California Tax Education Counsel (CTEC) registration and continuing education requirements.



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Enterprise Data to Revenue

**EDR**

# Addressing California's Tax Gap

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## What is the Tax Gap?

- The difference between what taxpayers owe under the law and what they voluntarily pay.



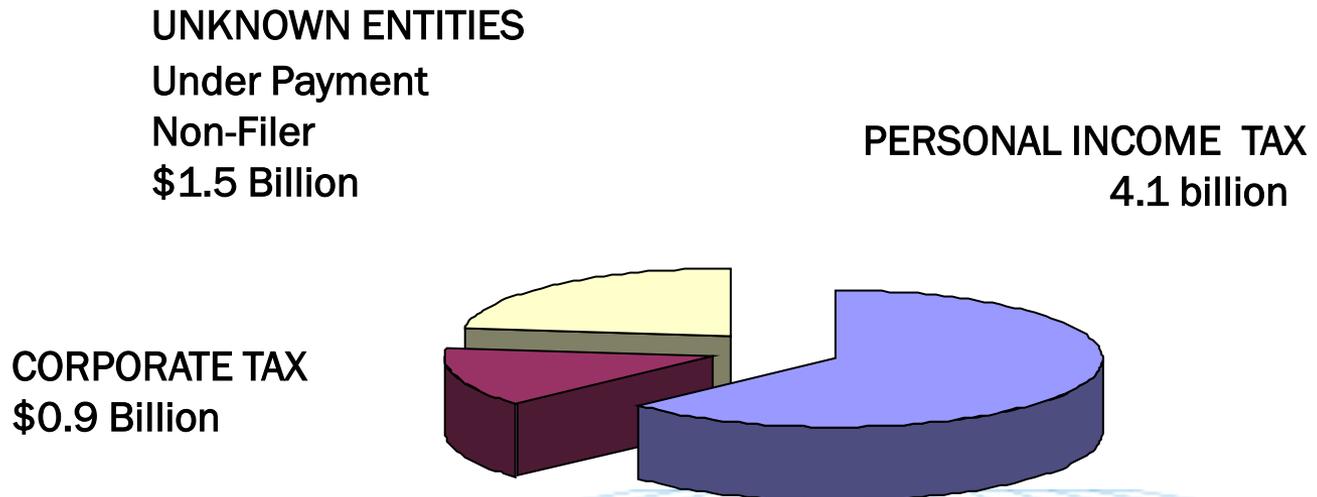
## Addressing the Tax Gap

- Causes honest taxpayers to bear the burden of less services, higher taxes, and bigger deficits.
- Places honest business taxpayers at a competitive disadvantage.



## California's Tax Gap

- Federal Tax Gap in 2001: \$290 billion.
- California's share in 2005: **\$6.5 billion annually.**



## Addressing California's Tax Gap

- FTB focuses on the impact our efforts have on narrowing the tax gap and influencing taxpayer behavior.
- Since fiscal year 05/06, these efforts have resulted in more than **\$450 million** in assessments or collections.



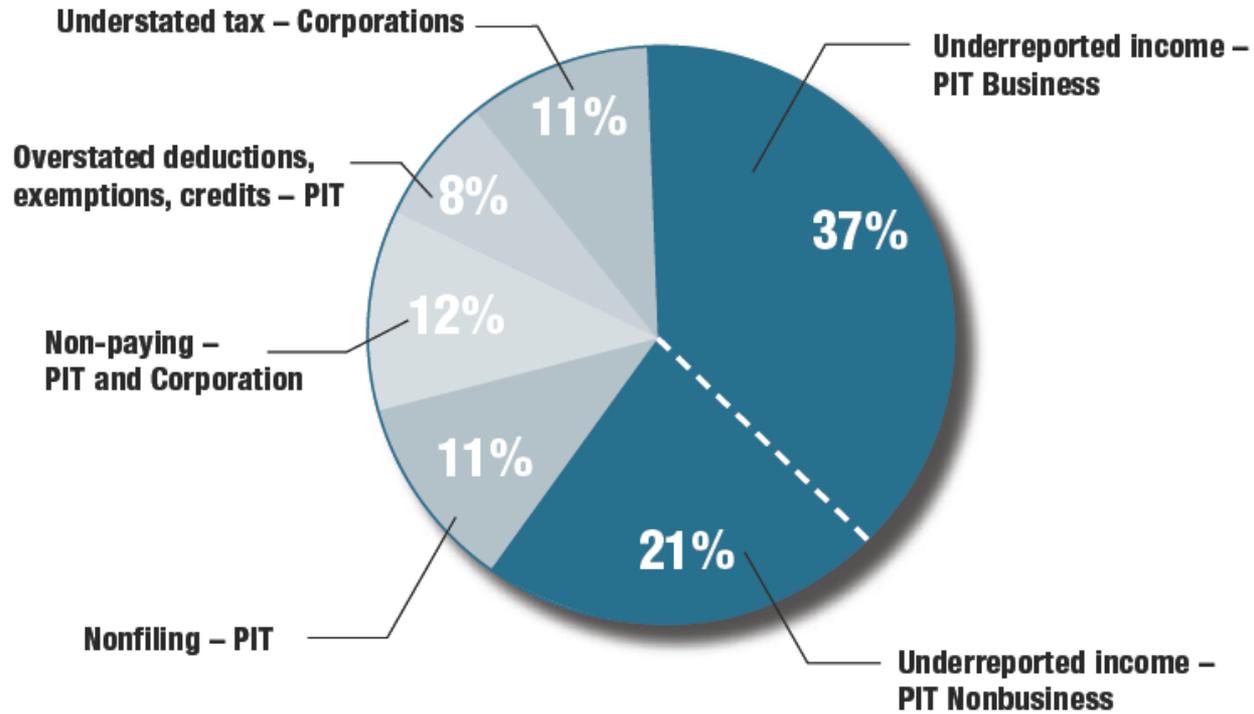
## California's Tax Gap

- Generally attributable to four categories of taxpayers:
  1. Non-filers,
  2. Under reporters,
  3. Under payers,
  4. Fraud.



### FEDERAL TAX GAP PERCENTAGES

ACCOUNTED FOR BY THE TYPE OF FILER AND NONCOMPLIANCE



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# California's Tax Gap

- Note:

Accounts Receivable is not the same as the tax gap.



## 2010/2011 Budget Augmentations

- Continue existing enforcement activities to generate \$114 million in additional revenue:
  - Added the Information Returns Master File (IRMF) Program from the IRS.
  - Targeted specific industries.
  - More non-filer contacts.
  - DMV Luxury Auto Registration Pilot.



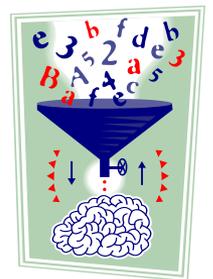
## 2010/2011 Budget Augmentations

- Federal Treasury Offset Program (FTOP).
- Accounts Receivable growth.



## Primary Initiative: Better Use of Existing Data

- Data is the key to addressing the tax gap.
- Primary focus:  
Enterprise Data to Revenue Project (EDR).



## Better Use of Existing Data

- Publishing the list of the Top 250 Delinquent Taxpayers with liens over \$100,000.
- Conducting studies to detect fraud and under reporting
  - Dependent and Child Care Credit .



## **Initiative: Expand Partnerships with Government Agencies**

- **Federal/State Steering Committee**
- **Joint Agency Data Sharing Team**





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