

MR 04-09

Title

Income Information Reporting

Introduction

This proposal would expand income information-reporting requirements for certain taxpayers.

Background

The Franchise Tax Board's (FTB) filing enforcement process for individual and corporate taxpayers utilizes the Integrated Nonfiler Compliance (INC) system, which uses various income information sources to identify and secure compliance from otherwise noncompliant taxpayers. Under the INC system, more than 220 million records received from employers, banks, the Internal Revenue Service (IRS), and other sources, are sorted and matched against tax returns filed. Taxpayers with California income for whom FTB has no record of an income tax return being filed are sent a letter requesting that the past due tax return be filed. If a return is not filed as required, the taxpayer's net income is estimated from the available information, and a proposed deficiency assessment is issued. For the 2001 taxable year, more than 369,000 proposed assessments were issued.

In addition to this automated filing program, FTB has a large audit staff designed to encourage compliance with the income tax laws. For this purpose, typically, computer programs search state and federal income records to detect leads as to discrepancies between income items that were reported and should have been reported on income tax returns. Based on the computerized search of these records, one of many audit-type activities may be initiated, ranging from clerical inquiries, computer-generated inquiries, manual desk audits or field audits to a combination of computer and manual audits.

However, despite these FTB programs, failure to report income still exists. One fact that contributes to failure to report income is the ability of the taxpayer to escape detection. For example, a payor may fail to report a disbursement and the payee may fail to report the income. In the event that the payer and payee have a personal relationship, the likelihood of accurate information return reporting is decreased. Likewise, accurate information return reporting is decreased if an individual is aware of the absence of an income/expense paper trail.

Current Federal/State Law

The Federal Bank Secrecy Act (BSA) requires currency transaction reporting from financial institutions, including money services businesses (MSB), which are businesses that cash checks, issue money orders, and do money transfers. The Currency Transaction Report (CTR) is one report that is required to be filed by financial institutions. The report contains information to be reported to the United States Treasury Financial Crimes Network (FinCEN) and supplied only to law enforcement officials to be used for fighting money laundering and other financial crimes. The definition of "currency" does not include bank checks or other negotiable instruments not customarily accepted as money.

Under the Internal Revenue Code, any person who is engaged in a trade or business and in the course of that business receives more than \$10,000 in cash in one transaction or two or more related transactions must report the cash payments to the Internal Revenue Service (IRS) and FinCEN on IRS Form 8300, Report of Cash Payments Over \$10,000 Received in a Trade or Business.

This reporting requirement does not apply to cash received in a transaction that is reported under the BSA if it is determined that the reporting would duplicate the reporting under the BSA. In addition, the reporting requirement does not apply to cash received by a financial institution as described under the BSA. However, the definition of “designated reporting transaction” as used in Regulation Section 1.6050I-1(c)(1)(iii) would eliminate application of this reporting requirement for MSBs. This definition limits the reporting requirement to the sale of a consumer durable, a collectible, or a travel or entertainment activity.

Generally, state law regarding information returns follows federal law. All persons engaged in a trade or business and making payment in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of \$600 or more in any taxable year must file a federal information return and provide a copy to the payee. An information return can include, but is not limited to, federal Forms 1098, 4789, 5471, and various Form 1099’s, including those for interest (1099 INT), dividends (1099 DIV), and miscellaneous income (1099-MISC). Under current law, certain payments are not required to be reported regardless of the amount paid. These payments include, but are not limited to, payments of any type to a corporation, payments made by a broker to a customer, and payments of income not subject to tax. Current law provides that a person filing more than 250 information returns must submit the returns via magnetic media or electronic filing. Generally, a person that fails to file an information return is subject to a \$50 penalty for each return not filed with the IRS, up to a maximum of \$250,000 for a taxable year. An additional penalty of \$50 can be imposed for each return not furnished to a payee, up to a maximum of \$100,000. There are more severe penalties for intentional disregard of the filing requirements.

Generally, taxpayers that are required to file an information return with the IRS may be required to file an information return or a copy of the federal information return with the FTB. However, FTB currently participates in the IRS combined reporting program, which generally allows taxpayers to submit an information return to the IRS and, once the IRS captures the information, it is then forwarded to FTB.

Problem

There are at least two specific types of payments made or received by a taxpayer where the lack of information reporting contributes to the State’s ongoing tax gap:

1. Real estate commission reporting. When a real estate broker receives his or her commission out of escrow, current law lacks a requirement for the escrow company or the seller to issue a Form 1099 for the commission.
2. Reporting by third-party check cashing businesses. By utilizing a third party check cashing business a person paid by check for which no reporting requirement exists is able avoid creating a paper trail that may be discovered by FTB.

Proposed Solution

This proposal would resolve the problems above by adding provisions to California law.

1. Require real estate escrow companies to issue a Form 1099 MISC for all real estate brokers to report real estate commissions paid through escrow.
2. Require licensees in the business of conducting transactions that involve cashing checks to report information to FTB regarding people who frequently cash business receipts or checks. A licensee as defined under the California Financial Code does not include a state or federally chartered bank, thrift, savings association, industrial loan company, or credit union. Licensee also excludes retail sellers that cash checks as a service to its customers. FTB could use the information to identify possible sources of income that should have been reported by the taxpayer

Effective/Operative Date of Solution

If enacted during the 2004 legislative session, these proposals would be effective and operative January 1, 2005.

Justification

Allowing FTB to receive additional information on current and potential taxpayers would directly target the tax gap in California. The information that the department would receive under these proposals would identify taxpayers earning income and corporations doing business in California but failing to file tax returns or underreporting income. FTB would request that the taxpayer file a return or explain why the taxpayer failed to file a return or report income. Non-compliance with this initial request may result in FTB issuing a proposed assessment based on the available information.

Implementation

The proposal could be implemented in the department's annual program updates.

Fiscal Impact

FTB staff anticipates the total cost to implement the three provisions of this proposal would be approximately \$421,000 as follows:

The department anticipates \$121,000 in costs for every 100,000 contacts made in a targeted notification and education process. For purposes of this estimate, department staff estimated a combined 100,000 contacts for the two proposals, for a total of \$121,000.

Minor programming and testing of the INC system would be needed to accommodate the additional information that would be received. It is estimated these costs would be \$150,000 for each of the proposals, for a total of \$300,000.

Economic Impact

The proposals would result in the following revenue gains:

1. Real estate commission reporting.

Require Title/Escrow Companies To Issue Form 1099s On Real Estate Brokers			
Fiscal Years	2005-06	2006-07	2007-08
	\$1 million	\$2 million	\$2 million

This proposal would result in a potential revenue increase of approximately \$2 million annually, one to three years after the first tax year. While this would require escrow companies to issue additional Form 1099s, the information that is required by this proposal is information that the escrow companies currently possess. However, the estimates assume there would be significant penalties to insure compliance by the title companies.

2. Reporting by third-party check cashing businesses.

Reporting by Third Party Check-Cashing Businesses (In Millions)			
Fiscal Years	2005-06	2006-07	2007-08
	\$0.5	\$1.5	\$2.2

Policy Considerations

These proposals would create differences between federal and California tax law, thereby increasing the complexity of California information reporting. In addition, since these reporting requirements would not be required at the federal level, it is unclear at this time what impact these proposals would have on the IRS, but the impact could be significant.

Requiring third-party check cashing establishments to collect the information in this proposal could be burdensome to those establishments. Depending on the type of information that an establishment currently requires from the customer, this proposal could require the establishment to begin collecting names, addresses, and other customer identification information, including a social security number. Such a new requirement could raise privacy issues and could result in customers cashing checks with financial institutions instead of check cashing establishments.

Other States

A review of the general information reporting requirements for *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York* finds that such reporting is not required in *Illinois* and *New York*. In addition, *Michigan* and *Minnesota* information returns are not generally required unless the Department of Revenue requests them. However, recently enacted Michigan legislation provides that as of November 2003 a person required to file a Form 1099 MISC with the IRS must also provide a copy of that form to the Department of Revenue. The general requirements for *Massachusetts* information reporting are similar to current California requirements.

The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

LEGISLATIVE STAFF CONTACT

LuAnna Hass
Franchise Tax Board
845-7478
LuAnna.Hass@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
Brian.Putler@ftb.ca.gov

Analyst LuAnna Hass
Telephone # 845-7478
Attorney Patrick Kusiak

AMENDMENT 1

SEC. 1. Section 18631.5 is added to the Revenue and Taxation Code as follows:

18631.5. (a) Every person doing business as a "real estate escrow person" shall make a return showing the name and address of each person that is paid a commission with respect to a disposition of a "California real property interest," with details regarding the amount of that commission and any other information that the Franchise Tax Board may by forms or instructions require (including electronic filing) regarding a commission paid with respect to that disposition of a "California real property interest."

(b) (1) Every person required to make a return under subdivision (a) shall furnish to each person that is paid a commission with respect to a disposition of a "California real property interest" whose name is required to be set forth in that return a written statement showing all of the following:

(A) The name and address of the person required to make that return.

(B) The information required to be shown on that return with respect to that person.

(2) The written statement required under paragraph (1) shall be furnished to the person that is paid a commission with respect to a disposition of a "California real property interest" on or before January 31 of the year following the calendar year for which the return under subdivision (a) was required to be made.

(c) For purposes of this section, "real estate escrow person" means any of the following persons involved in the real estate transaction:

(1) The person (including any attorney, escrow company, or title company) responsible for closing the transaction.

(2) If no person is responsible for closing the transaction, then any other person who receives and disburses the consideration or value for the interest or property conveyed.

(d) For purposes of this section, "California real property interest" means an interest in real property located in California and defined in Section 897(c)(1)(A)(i) of the Internal Revenue Code.

(e) This section shall not apply to the portion of any payment which is required to be reported under subdivision (b) of Section 18631 (or would be so required but for a dollar limitation contained in the Internal Revenue Code Section made applicable by subdivision (c) of Section 18631) if the "real estate escrow person" specifies in a written certificate executed by the "real estate escrow person," certifying under penalty of perjury, that the "real estate escrow person" is (or would be) required to file a return under subdivision (b) of Section 18631 and Section 6045(e) of the Internal Revenue Code with respect to any commission that is paid to a person in connection with a disposition of a "California real property interest."

SEC. 2. Section 18631.7 is added to the Revenue and Taxation Code to read:

18631.7. (a) Any licensee who is engaged in the trade or business of deferred deposit transactions, and who, in the course of such trade or business, defers the deposit of a customer's personal check of more than ten thousand dollars (\$10,000) in one transaction or two or more related transactions shall file a report with respect to such transaction or related transactions with the Franchise Tax Board.

(b) The report required in subdivision (a) shall be in the form and manner prescribed by the Franchise Tax Board and shall contain:

(1) The name, address, and any other identification information of the customer as the Franchise Tax Board deems necessary.

(2) The amount and date of the deferred deposit transaction or related transactions.

(3) Other information, including the identification of the licensee filing the report, as the Franchise Tax Board may prescribe.

(c) For purposes of this section:

(1) "Customer" as used in this section means customer as applicable for purposes of the California Deferred Deposit Transaction Law (commencing with Section 23000 of the Financial Code).

(2) "Deferred deposit transaction" means a transaction as defined under Section 23001 of the Financial Code.

(3) "Licensee" means any person as defined under Section 23001 of the Financial Code.

(d) A person that fails to file a report required by this section shall be subject to the same civil and criminal sanctions applicable to a person that fails to file a return under Section 6050I of the Internal Revenue Code.

SEC. 3. Section 19183 of the Revenue and Taxation Code is amended to read:

19183. (a) (1) A penalty shall be imposed for failure to file correct information returns, as required by this part, and that penalty shall be determined in accordance with Section 6721 of the Internal Revenue Code.

(2) Section 6721(e) of the Internal Revenue Code is modified to the extent that the reference to Section 6041A(b) of the Internal Revenue Code shall not apply.

(b) (1) A penalty shall be imposed for failure to furnish correct payee statements as required by this part, and that penalty shall be determined in accordance with Section 6722 of the Internal Revenue Code.

(2) Section 6722(c) of the Internal Revenue Code is modified to the extent that the references to Sections 6041A(b) and 6041A(e) of the Internal Revenue Code shall not apply.

(c) A penalty shall be imposed for failure to comply with other information reporting requirements under this part, and that penalty shall be determined in accordance with Section 6723 of the Internal Revenue Code.

(d) (1) The provisions of Section 6724 of the Internal Revenue Code relating to waiver, definitions, and special rules, shall apply, except as otherwise provided.

(2) Section 6724(d)(1) is modified as follows:

(A) The following references are substituted:

(i) Subdivision (a) of Section 18640, in lieu of Section 6044(a)(1) of the Internal Revenue Code.

(ii) Subdivision (a) of Section 18644, in lieu of Section 6050A(a) of the Internal Revenue Code.

(B) References to Sections 4093(c)(4), 4093(e), 4101(d), 6041(b), 6041A(b), 6045(d), 6051(d), and 6053(c)(1) of the Internal Revenue Code shall not apply.

(C) The term "information return" shall also include each of the following:

(i) ~~the~~The return required by paragraph (1) of subdivision (i) of Section 18662.

(ii) The return required by subdivision (a) of Section 18631.5.

(3) Section 6724(d)(2) is modified as follows:

(A) The following references are substituted:

(i) Subdivision (b) of Section 18640, in lieu of Section 6044(e) of the Internal Revenue Code.

(ii) Subdivision (b) of Section 18644, in lieu of Section 6050A(b) of the Internal Revenue Code.

(B) References to Sections 4093(c)(4)(B), 6031(b), 6037(b), 6041A(e), 6045(d), 6051(d), 6053(b), and 6053(c) of the Internal Revenue Code shall not apply.

(C) The term "payee statement" shall also include each of the following.

(i) ~~the~~The statement required by paragraph (2) of subdivision (i) of Section 18662.

(ii) The statement required by subdivision (b) of Section 18631.5.

(e) In the case of each failure to provide a written explanation as required by Section 402(f) of the Internal Revenue Code, at the time prescribed therefor, unless it is shown that the failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and demand of the Franchise Tax Board and in the same manner as tax, by the person failing to provide that written explanation, an amount equal to ten dollars (\$10) for each failure, but the total amount imposed on that person for all those failures during any calendar year shall not exceed five thousand dollars (\$5,000).

(f) Any penalty imposed by this part shall be paid on notice and demand by the Franchise Tax Board and in the same manner as tax.

MR 04-11

Title

Informant Reward program

Introduction

This proposal would allow the Franchise Tax Board (FTB) to pay informants a reward for information about tax law violations.

Current Federal Law

The Internal Revenue Service (IRS) will, in its discretion, pay rewards to informers for information about tax law violations. Any informant is eligible for a reward except for Treasury and certain other federal employees. The amount of the reward normally will not exceed 15% of the additional taxes, penalties, and fines collected as a result of the informant's information.

The IRS may pay sums it deems necessary for detecting underpayments and detecting and bringing to trial and punishment persons guilty of violating, or conniving to violate, the tax laws. Thus, the IRS may pay rewards in suitable amounts for information that leads to detection or bringing to trial and punishment tax law violators, whether the information relates to civil or criminal violations.

In determining whether a reward will be paid under IRS's discretionary authority, all relevant factors, including the value of the information furnished in relation to the facts developed by an investigation of the violation, are taken into account. Rewards are paid out of the proceeds (other than interest) of either:

- Additional amounts collected, or
- False or erroneous claims for refund denied.

Information on violations of tax laws may be submitted in person at an IRS office or by mail.

Note: On May 11, the Senate by a 92-5 vote passed S. 1637, formally entitled the *Jumpstart Our Business Strength (JOBS) Act*. The bill contains a provision that would make extensive changes to the federal informant reward program. If the federal bill is enacted, this proposal may be reevaluated for modifications.

Current State Law

Revenue and Taxation Code Section 19525 has authorized FTB to conduct an informant reward program since 1984. That statute was not used because the growing complexity and sophistication of abusive tax shelters and other abusive schemes requires a greater degree of FTB discretion and clarity of the amount to pay informants and the funding mechanism used to pay informants.

Problem

FTB lacks the flexibility to encourage and reward informants who provide insightful information to identify and curtail abusive tax shelters and other abuses of the tax code.

Proposed Solution

Expand and clarify the statutory authority allowing FTB to pay rewards to informants who provide valuable information, thereby conforming to existing federal provisions. This proposal would:

- Identify persons eligible for the reward,
- Establish rules for the amount and payment of the award, and
- Establish a mechanism for:
 - Submission of information,
 - Filing a claim for reward, and
 - Paying approved claims.

Effective/Operative Date of Solution

This bill would be effective January 1, 2005, and apply to rewards authorized after that date.

Justification

This proposed program would offer a monetary reward to motivate citizens to bring alleged violations of tax laws to the attention of FTB. This proposal would also increase the fairness of California's tax system by leading to the detection of tax evasion and ultimately should encourage increased compliance.

Implementation

Implementing this bill would not significantly impact the department's programs and operations.

Fiscal Impact

This bill would result in departmental costs of approximately \$600,000 annually. Of this total, approximately \$500,000 would be attributable to personnel and administrative costs, and \$100,000 to rewards paid. The rewards are expected to be approximately 3% of the collections.

Economic Impact

This program is expected to generate approximately \$2.8 million in revenue. This estimate is based on federal experience with a similar program, modified for FTB experience with California-only issues.

Other States

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. None of these states have an informant reward program similar to this proposal.

LEGISLATIVE STAFF CONTACT

Norman Catelli
Franchise Tax Board
845-5117
Norm.Catelli@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
Brian.Putler@ftb.ca.gov

Analyst Norman Catelli
Telephone # 845-5117
Attorney Patrick Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS

AMENDMENT 1

SEC. 1. Section 19525 of the Revenue and Taxation Code is amended to read:

19525. (a) The Franchise Tax Board, under regulations prescribed by the Franchise Tax Board may establish a reward program for information resulting in the identification of the following:

(1) Underreported or unreported income subject to taxes imposed by Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).

(2) Violations (including conspiracies to violate) described in Chapter 9 (commencing with section 19701) of this part. Any reward may not exceed 10 percent of the taxes collected as a result of the information provided. Any person employed by or under contract with any state or federal tax collection agency shall not be eligible for a reward provided for pursuant to this section.

(b) The rewards provided under this section will be paid from the proceeds of amounts, other than interest, collected as a direct result of the information provided.

(c) Proceeds of amounts, other than interest, collected as a direct result of the information provided includes both:

(1) Additional amounts collected as a direct result of the information provided, and

(2) Amounts collected prior to receipt of the information if the information leads to the denial of a claim for refund that otherwise may have been paid.

(d) (1) Any person, other than certain present or former employees described in paragraph (2), that submits, in the manner described in subdivision (f), information relating to a violation pursuant to subdivision (a), is eligible to file a claim for reward under this section.

(2) No person who was a member, officer or employee of the Franchise Tax Board, the State Board of Equalization, the Employment Development Department, or the United States Department of the Treasury at the time the individual came into possession of information relating to the violations, or at the time the individual divulged such information, is eligible for a reward under this section.

(3) A claim for reward may be filed by an executor, administrator, or other legal representative on behalf of a deceased informant if, prior to the informant's death, the informant was eligible to file a claim for reward under this section.

(e)(1) All relevant factors, including the value of the information furnished in relation to the facts developed by the investigation of the

violation, will be taken into account in determining whether a reward will be paid, and if so, the amount of the reward.

(2) The amount of the reward will represent what the Franchise Tax Board deems to be adequate compensation in the particular case, not to exceed 15 percent of the amounts, other than interest, collected (or in the case of a refund claim, retained) by reason of the information.

(3) Payment of a reward will be made as promptly as the circumstances of the case permit, but not until the taxes, penalties, or fines involved have been collected in full (or in the case of a refund claim, its final resolution). However, if the informant waives any claim for reward with respect to an uncollected portion of the taxes, penalties, or fines involved, the claim for reward may be immediately processed.

(4) Partial reward payments, without waiver of the uncollected portion of the taxes, penalties, or fines involved, may be made when a criminal fine has been collected prior to completion of the civil aspects of a case, and also when there are multiple tax years involved and the deficiency for one or more of the years has been paid in full.

(5) No person is authorized under this section to make any offer or promise, or to otherwise bind the Franchise Tax Board, with respect to the payment of any reward or the amount of the reward.

(f) A person desiring to claim a reward under this section must submit information relating to underpayment or underreporting (or improper refund claim) in a form and manner to be determined by the Franchise Tax Board.

(g) A person desiring to claim a reward under this section must file a formal claim in a form and manner to be determined by the Franchise Tax Board.

(h) No unauthorized person will be advised of the identity of an informant.

(i) The Franchise Tax Board may prescribe any regulations necessary to carry out the purposes of this section.

(j) The Franchise Tax Board shall determine the amount of rewards incurred pursuant to this section and notify the Controller of that amount which shall be transferred from the Personal Income Tax Fund or the Corporation Tax Fund to the Franchise Tax Board for reimbursement of rewards paid pursuant to this section.

MR 04-12

Title

Tax Representative Suspension/Disbarment

Introduction

This proposal would conform California law to federal law so that tax representatives who are suspended or disbarred by the Internal Revenue Service (IRS) would be likewise prevented from representing taxpayers in matters before the Franchise Tax Board (FTB).

Current Federal Law

Rules governing the regulation of attorneys, certified public accountants (CPAs), enrolled agents (EAs), enrolled actuaries, and other persons representing clients before the IRS are spelled out in Treasury Department regulations popularly known as Circular No. 230 (Circular 230). Circular 230 specifies the requirements practitioners must meet, their duties, and provides sanctions for practitioners who do not comply.

Circular 230 sets forth rules governing the regulation of attorneys, CPAs, EAs, enrolled actuaries, tax return preparers, and other persons representing clients before the IRS. Thus, a taxpayer may be represented by anyone authorized to do so under Circular 230 (and that also meets power of attorney requirements) before the IRS.

Practice before the IRS contemplates all matters connected with a presentation to the IRS relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the IRS. These presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the IRS, and representing a client at conferences, hearings, and meetings.

Simply preparing a tax return, furnishing information at the request of the IRS, or appearing as a witness for the taxpayer is not considered practicing before the IRS under Circular 230. However, only a properly authorized and qualified individual will be allowed to advocate for a taxpayer, as a representative, on any issues raised.

After due notice to the practitioner and an opportunity for a proceeding before an Administrative Law Judge, the IRS may censure (publicly reprimand), suspend, or disbar any practitioner from practice before the IRS if the practitioner:

- Is shown to be incompetent or disreputable,
- Refuses to comply with any of the Circular 230 requirements, or
- With intent to defraud, willfully and knowingly misleads or threatens a client or prospective client.

Circular 230 contains detailed procedural rules governing disciplinary proceedings for suspension or disbarment, including expedited procedures to suspend practitioners who have had their state license to practice law or accounting or to practice as an actuary suspended or revoked for cause or have been convicted of specified crimes, or have violated conditions imposed by the Director of the Office of Professional Responsibility.

Circular 230 prohibits tax practitioners from accepting assistance from, or assisting, any person who is disbarred or suspended. To enable attorneys, CPAs, EAs, and enrolled actuaries to identify restricted persons, the IRS announces the name, city and state, professional designation, effective date of disciplinary action, and period of suspension of each restricted person.

Current State Law

The California Tax Preparers Act (Business and Professions Code, Chapter 14, Sections 22250-22259) provides for the registration and regulation of tax preparers in California. The Legislature established the California Tax Education Council to administer the Act and promote competent tax preparation within California. The Act is applicable to “any person who for a fee, assists with or prepares a State or Federal tax return, or assumes responsibility for such a return, or who offers these services.” Generally, attorneys, CPAs, and EAs, and anyone employed by these individuals, are exempt from the Act.

The Revenue and Taxation Code provides for numerous civil penalties applicable to tax return preparers, among them:

- Understatement of liability by tax return preparer,
- Failure to furnish a copy of a tax return to the taxpayer,
- Failure to furnish an identifying number,
- Failure to retain a copy of a return or a list as required, and
- Aiding and abetting understatement of tax liability.

California law does not contain any practitioner regulatory provisions similar to Circular 230.

Problem

Current California law lacks ability to protect California taxpayers against known federally suspended or disbarred tax practitioners.

Proposed Solution

This proposal would add provisions to California law to prohibit federally suspended or disbarred tax practitioners from representing taxpayers before FTB.

Effective/Operative Date of Solution

This proposal would be effective and operative for final federal orders of suspension or disbarment issued on or after the enactment date of this proposal.

Justification

A California taxpayer should receive the same protection for state income tax purposes as provided for federal income tax purposes. Protecting taxpayers against unscrupulous practitioners would also protect state income tax revenues and reduce tax administration expenses.

Implementation

Implementing this bill requires the creation of a hearing process to assure the disbarred/suspended practitioner’s constitutional “due process” rights are satisfied, which would be accomplished during the normal annual update.

Fiscal Impact

The department's costs to administer this bill are anticipated to be \$106,000 annually, representing one personnel year. This amount includes personnel costs, employee benefits, and administrative overhead necessary to conduct the due process hearings this proposal would require.

Economic Impact

This measure will not directly impact state income tax revenues, but is expected to have a deterrent effect on fraudulent tax reporting.

Other States

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, New York, and South Carolina*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. *South Carolina* was the only state to have statutory controls on the representation of taxpayers during the administrative tax process. The *South Carolina* statute relies heavily on Circular 230 in determining who may practice.

LEGISLATIVE STAFF CONTACT

Norman Catelli
Franchise Tax Board
845-5117
Norm.Catelli@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
Brian.Putler@ftb.ca.gov

Analyst Norman Catelli
Telephone # 845-5117
Attorney Patrick Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS

AMENDMENT 1

SEC. 1. Section 19523.5 is added to the Revenue and Taxation Code to read:

19523.5. (a) If the Secretary of the Treasury has, under the authority of Section 330(b) of Title 31 of the United States Code, suspended or disbarred a person from practice before the Department of the Treasury, the Franchise Tax Board shall, after notice and opportunity for a proceeding, suspend or disbar that person from practice before the Franchise Tax Board during the period of federal suspension or disbarment, unless the action of the Secretary of the Treasury was clearly erroneous.

(b) For purposes of this section:

(1) "Practice" or "practices" means all matters connected with a presentation to the Franchise Tax Board or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Franchise Tax Board.

(2) "Presentations" means, but is not limited to, preparing and filing documents, corresponding and communicating with the Franchise Tax Board, and representing a client at conferences, hearings, and meetings.

(c)(1) Every person who practices before the Franchise Tax Board and is suspended or disbarred from practice before the Department of the Treasury shall notify the Franchise Tax Board in writing within forty-five days of the issuance of a final order disbaring or suspending the person pursuant to Section 10.80 of Title 31, Code of Federal Regulations, Subtitle A, Part 10, revised as of July 26, 2002.

(2) Any person that fails to notify the Franchise Tax Board pursuant to paragraph (1) shall be subject to a penalty of \$5,000.

(d) The written notice required by subdivision (c) shall concede the accuracy of the federal action or state why it is clearly erroneous.

(e) Any person that has been suspended or disbarred from practice before the Franchise Tax Board may seek review of that determination by bringing an action pursuant to Section 1085 of the Code of Civil Procedure.

(f) The Franchise Tax Board may prescribe any regulations necessary to carry out the purposes of this section.

(g) This section shall be effective for final federal orders of disbarment or suspension issued on or after the enactment date of this act.