STATE OF CALIFORNIA
FRANCHISE TAX BOARD
PO Box 115
Rancho Cordova, CA 95741-0115
Telephone (916) 845-4543
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M E M O R A N D U M

To: Gerald H. Goldberg May 26, 2004

From: Titus S. Toyama

Subject: May Revision Proposals for FY 2004-05

The Governor's May Revision includes the following proposals that will impact the department's FY 2004-05 Budget. The proposals and related funding needs were heard and approved by the Senate and Assembly Budget Subcommittees.

Litigation Costs for Hyatt Case

The Administration requested additional funding of $1.3 million and two limited term positions on behalf of the FTB in order to provide the initial resources needed to defend a lawsuit filed by a taxpayer in the State of Nevada. The funds will pay for Nevada counsel and related support. The potential liability to the State of California could reach $200 million. The case is scheduled for trial in August of 2006. Please see Attached May Revise document for further detail.

Taskforce on Abusive Tax Shelters

The Administration requested additional funding of $4.3 million and 42 positions (23.2 PYs) to provide the FTB with resources to fund additional consulting service contracts with tax shelter experts and to fund the staffing costs for additional audit staff. These resources will enable the FTB to increase the number and scope of audits of abusive tax shelter transactions, investors and promoters, and to hire outside consultants with expertise in economics and financial products that will support the identification and processing of abusive tax shelter audits. It is anticipated that the additional tax shelter audits and the value added of the consultants will produce cash revenue benefits of $56 million in the first year, increasing over time to $176 million in FY 2006-07. Please see Attached May Revise document for further detail.

Tax Amnesty

The Administration requested additional funding of $10.2 million and 71.8 PYs (limited term positions) on behalf of the FTB in order to provide the resources needed for the department to administer a personal income and corporate tax amnesty program. It is anticipated the program will generate $185 million in new revenue and $410 million in accelerated revenues. The amnesty period is from February 1, 2005 through March 31, 2005 and would effect tax years before January 1, 2003. Please see Attached May Revise document for further detail.

If you have any questions please contact me at 845-4106.

Chief Financial Officer

STATE OF CALIFORNIA
MAY REVISE - COVER SHEET
FOR FISCAL YEAR 2004/05
DF-46 (REV 03/03)

Department of Finance
915 L Street
Sacramento, CA 95814
IMS Mail Code: A-15

May Revise #	PRIORITY NO	ORG CODE	DEPARTMENT
2		**1730**	**Franchise Tax Board**

PROGRAM	ELEMENT	COMPONENT
10 Tax Programs	10 Personal Income Tax	

TITLE OF PROPOSED CHANGE:

Hyatt v. Franchise Tax Board

SUMMARY OF PROPOSED CHANGE:

Provide funding of $1,334,000 for the department to defend against a lawsuit filed by a taxpayer in the court in the state of Nevada. This lawsuit could cost the state General Fund over $200 million and set precedence for other taxpayers to challenge California's authority and method for determining and collecting taxes.

REQUIRES LEGISLATION	CODE SECTION(S) TO BE AMENDED/ADDED	BUDGET IMPACT-PROVIDE LIST AND MARK IF APPLICABLE
☐ YES ☒ NO		☒ ONE-TIME COST ☐ FULL-YEAR COSTS ☐ FACILITIES/CAPITAL COSTS ☐ FUTURE SAVINGS ☐ REVENUE

PREPARED BY:	DATE	REVIEWED BY:	DATE
PROGRAM APPROVAL:			
DEPARTMENT DIRECTOR	DATE	AGENCY SECRETARY	DATE

Pending Board Approval

IF PROPOSAL AFFECTS ANOTHER DEPARTMENT, DOES OTHER DEPARTMENT CONCUR WITH PROPOSAL? Yes

☒ YES ☐ NO

ATTACH COMMENTS OF AFFECTED DEPARTMENT SIGNED AND DATED BY THE DEPARTMENT DIRECTOR OR DESIGNEE.

FOR INFORMATION TECHNOLOGY REQUESTS, SPECIFY THE DATE SPECIAL PROJECT REPORT (SPR) OR FEASIBILITY STUDY REPORT (FSR) WAS APPROVED BY THE DEPARTMENT OF FINANCE.

DATE PROJECT # FSR ☐ OR SPR ☐

DOF ANALYST USE
(ADDITIONAL REVIEW)

CAPITAL OUTLAY ☐ TIRU ☐ FSCU ☐ OSAE ☐ CALSTARS ☐

Department of Finance
915 L Street
Sacramento, CA 95814
IMS Mail Code: A-15

May Revise # 2 | **DATE** April 16, 2004 | **Title of Proposed Change:** Hyatt v. Franchise Tax Board

PROGRAM Tax Programs | **ELEMENT** Personal Income Tax | **COMPONENT**

	Personnel Years CY	Personnel Years BY	Current Year	Budget Year
Total Salaries & Wages a/	.0	2.0	$ 0	$ 146,000
Salary Savings	.0	-.1	$ 0	-$ 6,000
Net Total Salaries and Wages	.0	1.9	$ 0	$ 140,000
Staff Benefits b/			$ 0	$ 40,000
Total Personal Services			$ 0	$ 180,000

Operating Expenses and Equipment	Current Year	Budget Year
General Expenses /1	$ 0	$ 4,000
Printing /2	0	0
Communications /3	0	2,000
Postage	0	0
Travel-In-State /4	0	8,000
Travel Out-of-State /5	0	37,000
Training	0	0
Facilities Operations /6	0	1,000
Utilities	0	0
Cons & Prof Svs - Interdept'l	0	0
Cons & Prof Svs - External /7	0	1,008,000
Consolidated Data Center	0	0
California Health and Human Services Agency Data Center	( )	( )
Stephen P. Teale Data Center	( )	( )
Data Processing /8	0	94,000
Equipment	0	0
Other Items of Exp (Specify Below)	0	0
Total Operating Expense & Equipment	$ 0	$ 1,154,000

a/ Itemized detail on Page II-3 by classification as in Salaries and Wages Supplement.
b/ Detail provided on following pages.
/1 General Expense for Branch @ $437, and for Depart'l $442 per position. Plus minor equipment. Modular furniture, chairs, etc. @ $1510 per position.
/2 Departmental $102 per position.
/3 Departmental $954 per position.
/4 Includes costs for trips to Los Angeles, San Francisco and Sacramento for depostions and meetings .
/5 Includes costs for trips to Las Vegas, Reno and Dallas/Washington for depositions and meetings .
/6 Departmental $332 per position.
/7 Includes costs for outside counsel of $952,000, legal/accounting consulting services of $50,000 and $6,000 for photocopying.
/8 Includes costs for licensing fee for Litigtor's Notebook and case management services.

Current Year Budget Year

TOTAL OPERATING EXPENSES AND EQUIPMENT		$ 0	$ 1,154,000
SPECIAL ITEMS OF EXPENSE d/			
		$ 0	$ 0
PROGRAM ADMINISTRATION		$ 0	$ 0
Distributed Admin		$ 0	$ 0
TOTAL STATE OPERATIONS EXPENDITURES		$ 0	$ 1,334,000

Source of Funds	**Appropriation No.** Org - Ref - Fund		
General Fund	1730 001 0001	$ 0	$ 1,334,000
		0	0
		0	0
		0	0
		0	0
		0	0
		0	0
Reimbursements	1730 501 0995	0	0
Totals		$ 0	$ 1,334,000

LOCAL ASSISTANCE		$(0)	$(0)
Source of Funds	**Appropriation No.** Org - Ref - Fund		
General Fund	1730 001 0001	$ 0	$ 0
		0	0
		0	0
		0	0
		0	0
Reimbursements		0	0
Totals		$ 0	$ 0

d/ Special Items of expense must be titled. Please refer to the Uniform Codes Manual for a list of the standardized Special Items of expense objects which may be used.

DETAIL OF STAFF BENEFITS
AND PERSONAL SERVICES

Positions		**Positions** CY	BY	**Salary Range**		**Amount** CY	BY
Compliance - Audit							
Tax Auditor - Rg B	OT					$ 0	$ 31,000
Total Compliance - Audit		.0	.0			$ 0	$ 31,000
Adjust for Part Year Positions		.0	.0				
Net Positions/ PYs before salary savings		.0	.0				
Legal Branch							
Sr Legal Analyst	LT	0.0	2.0	$ 4,316	$ 5,247	$ 0	$ 115,000
Total Legal Branch		.0	2.0			$ 0	$ 115,000
Adjust for Part Year Positions		.0	.0				
Net Positions/ PYs before salary savings		.0	2.0				

Total Salaries and Wages					
	Positions	.0	2.0	$ 0	$ 146,000
	Part Yr Adj	.0	.0		
	P.Y.s	.0	2.0		

Schedule of Staff Benefits Costs
FOR FISCAL YEAR 2004/05

Staff Benefits	2003/04	2004/05
OASDI /1	$ 0	$ 8,000
Dental /2	0	1,000
Health /3	0	12,000
Retirement /4	0	16,000
Vision /5	0	0
Medicare /6	0	2,000
Worker's Comp /7	0	1,000
Industrial Disability /8	0	0
Non Industrial Disability /9	0	0
Unemployment Insurance /10	0	0
Total Staff Benefits	$ 0	$ 40,000

1/ For permanent and overtime, 6.2% of net salary.
2/ For permanent, $500 per net personnel year.
3/ For permanent, $6,100 per net personnel year.
4/ For permanent, 14.843% of net salary.
5/ For permanent, $100 per net personnel year.
6/ 1.45% of net salary for permanent.
7/ 1.12% of net salary for permanent.
8/ 0.1% of net salary for permanent.
9/ 0.11% of net salary for permanent.
10/ 12.89% of net salary for temporary help.

FRANCHISE TAX BOARD
Fiscal Year 2004/05

May Revise	**No. 2**
Hyatt v. Franchise Tax Board	**Date: April 16, 2004**

A. Nature of Request

The Franchise Tax Board (FTB) requests $1,334,000 for FY 2004/05 to defend the department against a lawsuit filed by a taxpayer in the court in the state of Nevada. This proposal also includes a request for two limited-term positions to provide analytical support towards this effort.

The FTB is being sued in a Nevada court by a taxpayer who is pursuing an award, potentially in excess of $200 million, for alleged damages incurred as a result of FTB's methods in conducting an audit and assessment. At issue before the Nevada court is the entire audit process that was directed at the taxpayer, whether in Nevada, California, or elsewhere. Any degree of success by the taxpayer may provide precedence for other wealthy taxpayers to challenge California's authority and methods for determining and collecting taxes.

FTB lacks the necessary resources to provide the rigorous defense necessary in this case. Outside Counsel has provided an estimate of nearly $3.8 million to represent the State of California in this litigation through trial. Due to the potential for future costs to change based on the claimant's actions and the Nevada Court's response to those actions, this proposal requests $952,000 for outside counsel funding that is associated only with the FY 2004/05 case activity. As the case progresses, future outside counsel action and those associated costs will be presented in a request/proposal for FYs 2005/06 and 2006/07, pursuant to the Budget Cycle processes. Attachment "A" represents the anticipated case activity and associated costs for outside counsel. Regardless of how this case is decided on its merits, it is most likely that either party would appeal and the need for funding outside counsel in such litigation will be extended beyond 2006/2007.

Following statewide polices and practices, FTB has been represented by the state Attorney General on all tax litigation matters, including the Hyatt case. However, the Department of Finance recently decided against augmenting the Department of Justice's (DOJ) budget for additional Hyatt expenditures after July 1, 2004. Based on that decision, DOJ advised this department on March 24, 2004 (refer to Attachment "C") that they will no longer represent FTB in the Hyatt litigation after July 1, 2004. At the same time, DOF granted FTB permission to retain private counsel pursuant to Government Code section 11040. As a result of this direction, the Department of Finance requested the Franchise Tax Board to submit a May Revise proposal for the costs of defending Hyatt vs. Franchise Tax Board.

B. Background/History

Contrary to FTB's findings, the taxpayer claims he was a resident of Nevada, not California, when he received income resulting in a California tax assessment in excess of $7 million (with penalty and interest, the assessment liability is now in excess of $40 million). In early 1998, the taxpayer filed suit against the FTB in the State of Nevada, District Court, Las Vegas, seeking declaratory relief and damages based on numerous alleged tortious acts and invasion of privacy. The taxpayer claims that FTB permanently destroyed his licensing business from which he realized over $80 million in the first few months of operation. Discovery papers assert that the claimant's suit will be pursuing damages in the "hundreds of millions of dollars" range.

Unsuccessful attempts were made to resolve the case via motions for summary judgment. Several writs have been taken to the Nevada Supreme Court, which initially ruled in California's favor in 2001 but then reversed itself in April 2002. The United States Supreme Court agreed to review the decision, but ultimately ruled against California and FTB.

Subsequent to the United States Supreme Court's April 2003 ruling against California, the Nevada District Court entered adverse discovery orders, which greatly expanded the claimant's latitude to scrutinize the California tax process. This discovery order allows the claimant to re-open and expand Nevada's examination of the California tax process, including the ongoing administrative tax process. The case is continuing to trial in Nevada—presently scheduled for August in FY 2006/07.

The taxpayer has not demonstrated financial restraint in pursuing this action. The taxpayer has engaged six law firms including a high profile firm in Los Angeles; a prominent bad faith insurance lawyer who has won large plaintiff awards from insurance companies; patent attorneys, and, a prominent Nevada attorney who is a former Nevada Supreme Court Justice. The claimant's assembled legal team has been extremely aggressive and has continually driven up the costs of defending this case.

In 1998, the Attorney General retained the Nevada law firm of McDonald, Carano, Wilson, et al. to assist the Attorney General in representing FTB in this case. The following above-baseline expenditures were approved for the Attorney General's Office: FY 1999/00, $1.8 million; Fiscal Year 2000/01, $1.6 million; FY 2002/03, $703,000; and, FY 2003/04, $265,000.

The continued direct involvement of the Attorney General's Office is hampered by the local Rules of Court (Nevada Supreme Court Rule 42.14), requiring local Nevada counsel to be fully responsible for all litigation before Nevada state courts. This rule requires Nevada attorneys to appear at all proceedings and sign all documents presented to the court. This rule was fortified by a September 23, 2003 court order commanding strict adherence to the rule by the attorneys in this specific case. At a minimum this will require appearance by local counsel at all hearings and conferences, and their review of and signature on all pleadings and court documents filed in the court. The Rules of the Court also requires active participation of local counsel in major depositions, including the deposition of the plaintiff in Nevada. Consequently, the Attorney General's Office has granted to FTB, pursuant to Government Code Section 11040, the authority to contract for services directly with the outside counsel.

Besides funding for outside counsel, this case will require the participation of two experienced Senior Legal Analysts beginning July 1, 2004 and extending through the trial proceedings in order to provide document control and management at FTB. These activities will include working at the direction of the two existing Tax Counsel III staff assigned to the litigation team, reviewing, indexing, and systematically cataloguing all documents, and all electronic or video discovery data for quick and efficient retrieval and/or reference. The Senior Legal Analysts will also assist FTB with the collection of materials to prepare for witness depositions and discovery efforts. It is anticipated that 75 percent of analyst time will be spent with document management and control, and 25 percent with discovery and witness preparation efforts.

Over the course of the next year, FTB anticipates that the claimant's representatives will depose 15 employees. Approximately one-third of these depositions will include the subpoena of records, which will need to be redacted in accordance with the Information Privacy Act to protect confidential taxpayer information. FTB's Disclosure Unit is funded in part to ensure that staff adheres to the requirements of the Information Practices Act. However, the most recent deposition and records subpoena incident in this case required 200 hours of staff time at an average rate of $33 per hour. FTB is requesting $33,000 in overtime funds for the estimated 5 of 15 depositions that will be subject to records subpoenas and redacting.

Due to the significance of this legal action and the associated expenditures and risks, FTB proposes that an additional $50,000 per year is authorized for the hire of a legal/accounting external consultant to monitor and audit the outside counsel's legal and billing activity. FTB also requests an Operating Expense and Equipment augmentation of $143,700 that will be applied towards the continued use of an electronic case management data mart, in-state and out-of-state-travel, and photocopying expenses. Attachment "B" provides a breakdown and discussion of these costs.

C. <u>State Level Consideration</u>:

The Attorney General is responsible for this litigation under Article V, Section 13 of the California Constitution. The Attorney General's Office has provided written authorization for FTB to contract directly with outside counsel, pursuant to Government Code Section 11040.

The State is currently in a significant fiscal crisis, and a solution does not appear to be imminent. To make matters worse, this case could exacerbate the budget crisis if the court awards damages to the claimant or modifies in any way FTB's ability to collect taxes. Failure by the State to vigorously defend this case will expose the General Fund to a potential liability exceeding $200 million, and would likely invite other wealthy taxpayers to attempt to avoid proper collection of California taxes by dragging the State into other extremely costly out-of-state litigation. Successful litigation of this case would protect the State from a huge potential judgment, deter other taxpayers from pursuing such costly litigation, and allow the Franchise Tax Board to freely pursue its large tax assessment against the claimant.

D. Justification:

This case, brought by a person claiming to be a Nevada resident against a California taxing agency, will be tried before a Nevada jury in a state that does not impose a personal income tax. The plaintiff will be claiming damages of $200 million or more for the destruction of his licensing business that, the plaintiff alleges was caused by improper actions of the FTB. The taxpayer clearly has the resources to advance his claim, including virtually unlimited legal representation and expert witnesses. A conservative estimate of plaintiff expenditures to date may be in excess of $10 million. Considering the potential risk of exposing a significant source of the General Fund's revenue and the fiscal commitment demonstrated by the plaintiff, the State of California needs to assemble an equitable defense to this suit. It is essential that FTB be granted authority to hire well-established Nevada counsel to act as lead defense counsel as well as the authority to assemble the remaining compliment of staff and services requested in this proposal.

F. Analysis of All Feasible Alternatives:

Alternative #1 - Provide $1,334,000 funding to support FTB's efforts to defend the State's interest in the Hyatt case.

Funding will be used in accordance with the detail provided in Attachments A and B. This alternative provides the best probability of success in this case thus potentially saving the General Fund over $200 million in damages that could be awarded to the claimant.

Alternative #2 – Provide $1,356,000 funding to support FTB's effort to defend the State's interest in the Hyatt case.

This alternative allows FTB to assume a larger role in the direction of this litigation. A cost savings would not result due to the greater involvement of FTB staff and a lesser role of the outside counsel. In addition, the efficacy of the defense team would likely be diminished due to the inexperience of FTB staff in tort issues. Hiring staff that is experienced in tort issues as well as the Rules of the Nevada Court and Motion practice would also be problematic. Furthermore, the amount of direct involvement FTB/California Counsel may have in Nevada Court activities is limited to the conditions of the recent amendment to the Rules of the Nevada Court that require the lead of Nevada counsel.

Alternative #3 – Do not provide additional resources.

The FTB does not possess the subject matter expertise required to present a successful defense and does not have discretionary resources to fund this issue. The negative impact on General Fund revenue would be very significant.

F. Time Table:

Implement request on July 1, 2004.

G. Recommendation:

Alternative #1 is recommended. This will allow FTB to assemble an equitable defense to this lawsuit. If FTB is unsuccessful, this lawsuit could cost California General Fund over $200 million and may provide precedence for other taxpayers to challenge California's authority and methods for determining and collecting taxes.

FRANCHISE TAX BOARD
Fiscal Year 2004/05 Finance Letter/May Revise
Hyatt v. Franchise Tax Board
Attachment "A"

Outside Counsel
Estimated Work and Fees

ACTIVITY	2004/2005	2005/2006	2006/2007	TOTALS
DEPOSITION DISCOVERY includes attorney fees, travel, transcript/video costs	$ 350,000	$ 150,000		**$ 500,000**
WITNESS PREPARATION prep materials, subpoena prep	$ 100,000	$ 200,000	$ 200,000	**$ 500,000**
EXPERT WITNESS AND CONSULTANTS for rebuttal of Hyatt experts	$ 25,000	$ 100,000	$ 125,000	**$ 250,000**
DEFENSE OF HYATT'S MOTION PRACTICE AND DISCOVERY REQUESTS	$ 200,000	$ 100,000	$ 50,000	**$ 350,000**
FTB DISCOVERY MOTIONS	$ 50,000	$ 50,000		**$ 100,000**
MOTIONS IN LIMINE			$ 50,000	**$ 50,000**
COURT REPORTER for final percipient witness depos			$ 100,000	**$ 100,000**
PRIVATE INVESTIGATORS	$ 20,000	$ 20,000	$ 10,000	**$ 50,000**
TRAVEL client and litigation team meetings	$ 20,000	$ 20,000	$ 10,000	**$ 50,000**
FILING MRCP 41 (b) MOTION			$ 150,000	**$ 150,000**
TRIAL CONSULTANT	$ 5,000	$ 5,000	$ 40,000	**$ 50,000**
MOCK TRIAL			$ 50,000	**$ 50,000**
TRIAL TEAM			$ 350,000	**$ 350,000**
TRAVEL for trial defense participants			$ 175,000	**$ 175,000**
SUMMARY JUDGEMENT RENEWAL	$-	$ 200,000	$-	**$ 200,000**
POST TRIAL MOTIONS			$ 100,000	**$ 100,000**
WRIT PRACTICE	$ 100,000	$ 100,000	$ 200,000	**$ 400,000**
SUBTOTALS	$ 870,000	$ 945,000	$ 1,610,000	**$ 3,425,000**
CONTINGENCY 10%	$ 82,000	$ 89,500	$ 161,000	**$ 332,500**
TOTALS	**$ 952,000**	**$ 1,034,500**	**$ 1,771,000**	**$ 3,757,500**

FRANCHISE TAX BOARD
Fiscal Year 2004/05 Finance Letter/May Revise
Hyatt v. Franchise Tax Board
Attachment "B"

Extraordinary Funding Needs

Legal/Accounting Consultant — $200 hourly rate — 250 annual hours — **$50,000**

scope: confer with Franchise Tax Board regarding legal strategy and direction given to Outside Counsel. Reconcile monthly billing statements and validate Outside Counsel's billing of stated rates and hours worked with the Legal team's authorized work plan. Estimated consultant work at 21 average hours per month times 12 months.

Case Management Data Mart — **$93,700**

scope: Litigator's Notebook
presently used in all Hyatt proceedings by Attorney General and Outside Counsel and currently contains approximately 40,000 pages of documents relating to this case. Cost previously incurred by Attorney General.
Monthly usage fee is $550 x 12 months = $6,600.

Litigator's Notebook licensing fees: 4 @ FTB and 3 @ Outside Counsel,
7 x $200 per month x 12 months = $16,800

DM Information Systems and Fast Track Litigation Support, parallel services to code and create reference numbers for documents/materials stored in the data mart.
Previous annual costs were $19,800 and $50,500, respectively = $70,300

Photocopying — **$5,600**

scope: based on the highest year of photocopying expenses incurred by FTB since the inception of the Hyatt litigation.

In-State Travel — **$7,700**

scope: Depositions

Los Angeles; 6 trips 30 days	$5,600

Meetings

Los Angeles, 3 trips, 2 nights, 2 people	$1,020
San Francisco, 3 trips, 2 nights, 2 people	$967
Sacramento Trips, 200 miles x .31 per mi	$124

Out of State Travel — **$36,700**

scope: Depositions

Las Vegas, 6 trips, 30 nights, two people	$14,744
Reno, 32 nights, 2 people	$10,100
Dallas/Washington, 3 trips, 24 days 1 person	$7,500

Meetings

Reno, 5 nights, 3 people	$4,312

Total — **$193,700**

BILL LOCKYER
Attorney General

State of California
DEPARTMENT OF JUSTICE

1300 I STREET, SUITE 125
P.O. BOX 944255
SACRAMENTO, CA 94244-2550

Public: (916) 445-9555
Telephone: (916) 324-5431
Facsimile: (916) 323-5317
E-Mail: andrea.hoch@doj.ca.gov

March 24, 2004
REVISED LETTER

RECEIVED
APR 12 2004

John W. Davies, Chief Counsel
Franchise Tax Board
P. O. Box 2229
Sacramento, California 95812-2229

RE: OC-22: Withdrawal From Representation
Consent to Employ Counsel Other Than The Attorney General
Hyatt v. Franchise Tax Board

Dear Mr. Davies:

As you are aware, the Attorney General's Office's (AGO) costs incurred in defending the Franchise Tax Board (FTB) in the *Hyatt* case far exceed the General Fund allocation for handling FTB matters. The AGO is currently providing legal services for approximately 500 active FTB cases at an average cost of approximately $12,000 per case per year. In the past, we have been able to obtain funding augmentation to defend the FTB in the *Hyatt* case and simultaneously to continue representation of the FTB in other matters.

This year, the AGO sought an additional augmentation from the Department of Finance to help fund some of the estimated $4.8 million additional litigation costs needed to retain outside (Nevada-based) counsel and in-house resources to continue the defense of the FTB in the *Hyatt* litigation. The Department of Finance is recommending that the request be denied. This means that our funding for *Hyatt* will end on June 30, 2004. Without the proposed augmentation, the AGO cannot both fund the *Hyatt* litigation and meet its obligation to represent the FTB in other litigation matters referred to this office. Our options are limited. We can reject new cases referred to the AGO by the FTB and/or return a significant number of existing cases. Alternatively, we can give the FTB written permission to directly hire outside counsel to defend the *Hyatt* case.

Nevada local court rule 42.14 and the Nevada court's interpretation of that rule in this case prohibit our office from representing the FTB without substantial input and involvement from local Nevada counsel. This greatly limits the AGO's role as legal counsel. Given our limited resources and our limited role as legal counsel in the *Hyatt* case, we believe it makes more sense to provide FTB with consent to directly retain outside counsel. This will allow our attorneys to use their expertise to handle FTB referrals of cases in California.

Based on the foregoing, as of July 1, 2004, our office will no longer represent FTB in the *Hyatt* litigation and consent to retain private counsel in the *Hyatt* case is therefore granted to the FTB pursuant to Government Code section 11040. Your agency may have to obtain other State approvals or clearances, so we urge you to make the necessary arrangements to secure any such approvals or clearances as soon as possible. In the meantime, we will do all we can to ensure an orderly transfer of the case.

Please provide Diane Calkins of the Civil Law Division with a copy of the fully-executed legal services contract affixed to a copy of this consent letter following contract approval.

Thank you for your cooperation in this matter. Please do not hesitate to contact me if I can be of further assistance to you.

Sincerely,

Andrea Lynn Hoch

ANDREA LYNN HOCH
Chief Assistant Attorney General

For BILL LOCKYER
Attorney General

cc: David S. Chaney, SAAG, DOJ, Business & Tax, Los Angeles

bcc: Don Buxton
Ben Miller

STATE OF CALIFORNIA
MAY REVISE - COVER SHEET
FOR FISCAL YEAR 2004/05
DF-46 (REV 03/03)

Department of Finance
915 L Street
Sacramento, CA 95814
IMS Mail Code: A-15

May Revise #	PRIORITY NO	ORG CODE	DEPARTMENT
3		1730	**Franchise Tax Board**
PROGRAM	ELEMENT	COMPONENT	
10 Tax Programs	00 All Tax Programs		

TITLE OF PROPOSED CHANGE:

Abusive Tax Shelter Task Force

SUMMARY OF PROPOSED CHANGE:

Provide funding of $4.31 million and 23.2 PYs to create a special task force to combat abusive tax shelters. This task force will increase General Fund revenues estimated to be $56 million in FY 2004/05 for a total of $680 million through FY 2008/09.

REQUIRES LEGISLATION	CODE SECTION(S) TO BE AMENDED/ADDED	BUDGET IMPACT-PROVIDE LIST AND MARK IF APPLICABLE
☐ YES ☐ NO		X ONE-TIME COST X FULL-YEAR COSTS ☐ FACILITIES/CAPITAL COSTS ☐ FUTURE SAVINGS X REVENUE

PREPARED BY:	DATE	REVIEWED BY:	DATE
PROGRAM APPROVAL:			
DEPARTMENT DIRECTOR:	DATE	AGENCY SECRETARY:	DATE

Pending Board Approval

IF PROPOSAL AFFECTS ANOTHER DEPARTMENT, DOES OTHER DEPARTMENT CONCUR WITH PROPOSAL? N/A

☐ YES ☐ NO

ATTACH COMMENTS OF AFFECTED DEPARTMENT SIGNED AND DATED BY THE DEPARTMENT DIRECTOR OR DESIGNEE.

FOR INFORMATION TECHNOLOGY REQUESTS, SPECIFY THE DATE SPECIAL PROJECT REPORT (SPR) OR FEASIBILITY STUDY REPORT (FSR) WAS APPROVED BY THE DEPARTMENT OF FINANCE.

DATE PROJECT # FSR ☐ OR SPR ☐

DOF ANALYST USE
(ADDITIONAL REVIEW)

CAPITAL OUTLAY ☐ TIRU ☐ FSCU ☐ OSAE ☐ CALSTARS ☐

Department of Finance
915 L Street
Sacramento, CA 95814
IMS Mail Code: A-15

May Revise # 3	**DATE 5/11/2004**	**Title of Proposed Change:** **Abusive Tax Shelter Task Force**
PROGRAM	**ELEMENT**	**COMPONENT**
Tax Programs	**All Tax Programs**	

	Personnel Years CY	Personnel Years BY	Current Year	Budget Year
Total Positions / Salaries & Wages	.0	42.0	$ 0	$ 2,773,000
Part-year adjustment	0.0	-17.5	$ 0	-$ 1,114,000
Total Salaries & Wages a/	.0	24.5		1,659,000
Salary Savings	0.0	-1.3	$ 0	-$ 83,000
Net Total Salaries and Wages	.0	23.2	$ 0	$ 1,576,000
Staff Benefits b/			$ 0	$ 530,000
Total Personal Services			$ 0	$ 2,106,000

Operating Expenses and Equipment	Current Year	Budget Year
General Expenses /1	$ 0	$ 189,000
Printing /2	0	2,000
Communications /3	0	23,000
Postage /4	0	4,000
Travel-In-State /5	0	46,000
Travel Out-of-State /6	0	102,000
Training	0	0
Facilities Operations /7	0	8,000
Utilities	0	0
Cons & Prof Svs - Interdept'l	0	0
Cons & Prof Svs - External /8	0	1,800,000
Consolidated Data Center	0	0
California Health and Human Services Agency Data Center	( )	( )
Stephen P. Teale Data Center	( )	( )
Data Processing /9	0	30,000
Equipment	0	0
Other Items of Exp (Specify Below)	0	0
Total Operating Expense & Equipment	$ 0	$ 2,204,000

a/ Itemized detail on Page II-3 by classification as in Salaries and Wages Supplement.
b/ Detail provided on following pages.
/1 General Expense for Branch @ $437, and for Depart'l $442 per position. Plus minor equipment @ $1510 per position. PCs @$2600 per position.
/2 Departmental $102 per position.
/3 Departmental $954 per position.
/4 Postage costs to mail 10,000 notices.
/5 Travel costs for auditors.
/6 Travel costs for auditors and attorneys.
/7 Departmental $332 per position.
/8 Estimated amount required to hire economists and financial products experts for one-half year.
/9 Software for PCs@$700 per PC.

	Current Year	Budget Year
TOTAL OPERATING EXPENSES AND EQUIPMENT	$ 0	$ 2,204,000

SPECIAL ITEMS OF EXPENSE d/

	Current Year	Budget Year
	$ 0	$ 0
PROGRAM ADMINISTRATION	$ 0	$ 0
Distributed Admin	$ 0	$ 0
TOTAL STATE OPERATIONS EXPENDITURES	$ 0	$ 4,310,000

Source of Funds

	Appropriation No. Org	Ref	Fund	Current Year	Budget Year
General Fund	1730	001	0001	$ 0	$ 4,310,000
				0	0
				0	0
				0	0
				0	0
				0	0
				0	0
Reimbursements	1730	501	0995	0	0
Totals				$ 0	$ 4,310,000

	Current Year	Budget Year
LOCAL ASSISTANCE	$(0)	$(0)

Source of Funds

	Appropriation No. Org	Ref	Fund	Current Year	Budget Year
General Fund	1730	001	0001	$ 0	$ 0
				0	0
				0	0
				0	0
				0	0
Reimbursements				0	0
Totals				$ 0	$ 0

d/ Special Items of expense must be titled. Please refer to the Uniform Codes Manual for a list of the standardized Special Items of expense objects which may be used.

DETAIL OF STAFF BENEFITS
AND PERSONAL SERVICES

Positions		Positions CY	Positions BY	Salary Range		Amount CY	Amount BY
Compliance - Audit							
* Program Spec III	PERM	0.0	4.0	$ 6,029	$ 6,647	$ 0	$ 152,000
* Program Spec II	PERM	0.0	13.0	$ 5,208	$ 6,329	$ 0	$ 450,000
* Administrator II	PERM	0.0	2.0	$ 4,960	$ 6,028	$ 0	$ 66,000
* Program Spec I	PERM	0.0	11.0	$ 4,743	$ 5,763	$ 0	$ 347,000
* Assoc Tax Auditor	PERM	0.0	2.0	$ 4,110	$ 4,997	$ 0	$ 55,000
* Office Tech Gen	PERM	0.0	1.0	$ 2,348	$ 2,855	$ 0	$ 16,000
* Tax Program Tech I, Ftb	PERM	0.0	1.0	$ 2,348	$ 2,855	$ 0	$ 16,000
* Tax Technician, Ftb	PERM	0.0	1.0	$ 2,220	$ 2,700	$ 0	$ 15,000
Total Compliance - Audit		.0	35.0			$ 0	$ 1,117,000
Adjust for Part Year Positions		.0	-17.5				

Net Positions/ PYs before salary savings		.0	17.5				

Part Year Positions

* Program Spec III	Current yr start date for 0 P.Y.s.	1/1/2005 Budget yr start date for 2 P.Y.s.
* Program Spec II	Current yr start date for 0 P.Y.s.	1/1/2005 Budget yr start date for 6.5 P.Y.s.
* Administrator II	Current yr start date for 0 P.Y.s.	1/1/2005 Budget yr start date for 1 P.Y.s.
* Program Spec I	Current yr start date for 0 P.Y.s.	1/1/2005 Budget yr start date for 5.5 P.Y.s.
* Assoc Tax Auditor	Current yr start date for 0 P.Y.s.	1/1/2005 Budget yr start date for 1 P.Y.s.
* Office Tech Gen	Current yr start date for 0 P.Y.s.	1/1/2005 Budget yr start date for 0.5 P.Y.s.
* Tax Program Tech I, Ftb	Current yr start date for 0 P.Y.s.	1/1/2005 Budget yr start date for 0.5 P.Y.s.
* Tax Technician, Ftb	Current yr start date for 0 P.Y.s.	1/1/2005 Budget yr start date for 0.5 P.Y.s.

Legal Branch

Tax Counsel - Rg D	PERM	0.0	7.0	$ 5,703	$ 7,034	$ 0	$ 535,000
Total Legal Branch		.0	7.0			$ 0	$ 535,000
Adjust for Part Year Positions		.0	.0				
Net Positions/ PYs before salary savings		.0	7.0				

Operations Branch & Enterprise Technology

Tax Program Assistant	OT			$ 0	$ 5,000
Tax Program Tech I, Ftb	OT			$ 0	$ 2,000
Total Operations Branch & Enterprise Technology		.0	.0	$ 0	$ 7,000
Adjust for Part Year Positions		.0	.0		
Net Positions/ PYs before salary savings		.0	.0		

Total Salaries and Wages	Positions	.0	42.0	$ 0	$ 1,659,000
	Part Yr Adj	.0	17.5		
	P.Y.s	.0	24.5		

Schedule of Staff Benefits Costs
FOR FISCAL YEAR 2004/05

Staff Benefits	2003/04	2004/05
OASDI /1	$ 0	$ 99,000
Dental /2	0	11,000
Health /3	0	141,000
Retirement /4	0	232,000
Vision /5	0	3,000
Medicare /6	0	22,000
Worker's Comp /7	0	18,000
Industrial Disability /8	0	2,000
Non Industrial Disability /9	0	2,000
Unemployment Insurance /10	0	0
Total Staff Benefits	$ 0	$ 530,000

1/ For permanent and overtime, 6.2% of net salary.
2/ For permanent, $500 per net personnel year.
3/ For permanent, $6,100 per net personnel year.
4/ For permanent, 14.843% of net salary.
5/ For permanent, $100 per net personnel year.
6/ 1.45% of net salary for permanent.
7/ 1.12% of net salary for permanent.
8/ 0.1% of net salary for permanent.
9/ 0.11% of net salary for permanent.
10/ 12.89% of net salary for temporary help.

FRANCHISE TAX BOARD
Fiscal Year 2004/05

May Revise **No. 3**

Abusive Tax Shelter Task Force **Date: May 11, 2004**

A. Nature of Request

This proposal requests funding of $4.31 million and 23.2 PYs to address serious non-compliance by creating a special task force to coordinate all matters related to combating abusive tax shelters. The proposal will increase the number and scope of audits of abusive tax shelter transactions, investors and promoters, and hire outside consultants with expertise in economics and financial products. The Abusive Tax Shelter Task Force will also increase the state's General Fund revenues, estimated to be $850 million ($680 million discounted for cash revenue) for FY 2004/05 through FY 2008/09. It is anticipated that the additional tax shelter audits and the value added of the consultants will produce cash revenue benefits of $56 million in the first year, increasing over time to $176 million in FY 2006/07. Costs will increase to $9.2 million and 58 PYs in FY 2005/06 and subsequent years.

B. Background

In recent years individuals and business entities have increasingly taken advantage of abusive tax shelters. Abusive tax shelters are transactions marketed with the promise of excessive tax benefits. These transactions lack economic purpose other than reducing taxes and typically involve the use of multiple layers of domestic and foreign corporations and pass-through entities including partnerships, S corporations, and trusts to hide the abusive shelter from review by government revenue agencies.

The IRS is vigorously pursuing taxpayers participating in apparent abusive tax shelters. They are focusing on tax return preparers and the promoters of these investment schemes, and are pursuing penalties and criminal prosecution for these cases. They have established the Office of Tax Shelter Analysis (OTSA) as a service-wide focal point for shelter compliance initiatives. OTSA is responsible for planning, coordinating, and providing assistance to examiners working abusive tax shelter issues.

The complex nature of abusive tax shelters and the extensive staff time required to pursue such cases place new and increased demands on FTB's existing enforcement efforts. FTB is requesting resources to create a specialized abusive tax shelter task force within FTB similar to OTSA, and increase the number of auditors devoted to the abusive tax shelter workloads. In addition we are requesting funding to hire outside consultants to provide overall expertise in creation of the task force and to provide economic and financial products expertise to auditors involved in direct tax audit workloads. The task force will work to:

- Coordinate FTB's response to abusive tax shelters.
- Collect and analyze information about abusive tax shelters.
- Develop strategies to identify organizers, promoters, and participants in abusive tax shelters.
- Ensure compliance with tax shelter registration requirements.
- Provide litigation support on abusive tax shelter cases.
- Utilize economists and financial experts to assist with identification of tax shelters.
- Coordinate efforts and share information with federal and state tax authorities, as well as foreign tax authorities where appropriate.

C. <u>State Level Considerations</u>

The additional resources provided by this proposal will produce revenue benefits of $56 million in the first year increasing to $176 million in subsequent years. In addition, the emphasis placed upon this high profile non-compliance issue will encourage future self-compliance by taxpayers who might otherwise continue to utilize abusive tax shelters as a way to circumvent their tax obligation.

D. <u>Facility/Capital Outlay Considerations</u>

Existing space in central offices and the field offices will be used to accommodate the additional staff in FY 2004/05. However, costs relating to modular furniture and move costs required to relocate the new auditors to the State Office Building are not included in this request but will be included as part of the request for Phase III occupancy costs for FY 2005/06.

E. <u>Justification</u>

The Abusive Tax Shelter Task Force will generate $56 million (discounted for cash) for the General Fund. The cost for the generation of revenue will be $4.3 million and 23.2 PYs in FY 2004/05.

The expanded audit efforts will encourage self-compliance in the long-term (which is not a quantifiable revenue increase). Taxpayers will have a better tax administration that will be able to assure more taxpayers are paying their fair share.

F. <u>Analysis of all feasible alternatives</u>

<u>Alternative #1:</u> Provide funding of $4.3 million and 23.2 PYs to fund an Abusive Tax Shelter Tax Force, increase the number of audit resources for the abusive tax shelter workloads, and hire outside consultants with abusive tax shelter expertise. Increase funding to $9.2 million and 58 PYs in FY 2005/06.

The Abusive Tax Shelter Task Force, audit resources, and the consultant services will increase revenue by $70 million, or $56 million discounted for cash. The total projected revenue for the Audit Program will be increased by $850 million, $680 million discounted for cash, by FY 2008/09.

Alternative #2: Provide no additional funding to form an Abusive Tax Shelter Task Force and provide expert consultants.

Do not provide additional resources. The Audit Program will continue to work as many of these audits as possible with current staffing resources. Without the additional resources provided, the revenue from the audit of abusive tax shelters will decrease overall by $391 million ($28 million in FY 2004/05).

G. Timetable

Upon approval of the Abusive Tax Shelter Task Force, the Audit Program will begin to redirect existing auditors to abusive tax shelter workloads. New auditors will be hired in January 2005 to replace the experienced auditors who have been redirected to the Task Force.

H. Recommendations

The department recommends Alternative #1. This alternative would achieve the desired objective of increasing revenue for the General Funds, and encouraging self-compliance. This proposal would 1) generate additional tax revenues needed to fund state operations; 2) provide an increased audit presence which discourages non-compliance; 3) help to provide assurance to self-compliant taxpayers that everyone with a valid tax liability pays their fair share for government services; and 4) carry out the administration of tax laws.

STATE OF CALIFORNIA
MAY REVISE - COVER SHEET
FOR FISCAL YEAR 2004/05
DF-46 (REV 03/03)

Department of Finance
915 L Street
Sacramento, CA 95814
IMS Mail Code: A-15

May Revise #	PRIORITY NO	ORG CODE	DEPARTMENT
4		1730	**Franchise Tax Board**
PROGRAM	ELEMENT	COMPONENT	
10 Tax Programs	10 Personal Income Tax		

TITLE OF PROPOSED CHANGE:

Tax Amnesty

SUMMARY OF PROPOSED CHANGE:

This is a request by the administration to accelerate and/or increase revenue and create an amnesty program for those taxpayers that fail to file income tax returns, underreport income on previously filed income tax returns, or fail to pay any taxes previously assessed. The 60 day amnesty program would run from February 1, 2005 through March 31, 2005.

REQUIRES LEGISLATION	CODE SECTION(S) TO BE AMENDED/ADDED	BUDGET IMPACT-PROVIDE LIST AND MARK IF APPLICABLE
[X] YES [ ] NO		[X] ONE-TIME COST [ ] FULL-YEAR COSTS [X] FACILITIES/CAPITAL COSTS [ ] FUTURE SAVINGS [X] REVENUE

PREPARED BY:	DATE	REVIEWED BY:	DATE
PROGRAM APPROVAL			
DEPARTMENT DIRECTOR	DATE	AGENCY SECRETARY	DATE

Pending Board Approval

IF PROPOSAL AFFECTS ANOTHER DEPARTMENT, DOES OTHER DEPARTMENT CONCUR WITH PROPOSAL? N/A

[ ] YES [ ] NO

ATTACH COMMENTS OF AFFECTED DEPARTMENT SIGNED AND DATED BY THE DEPARTMENT DIRECTOR OR DESIGNEE.

FOR INFORMATION TECHNOLOGY REQUESTS, SPECIFY THE DATE SPECIAL PROJECT REPORT (SPR) OR FEASIBILITY STUDY REPORT (FSR) WAS APPROVED BY THE DEPARTMENT OF FINANCE.

DATE PROJECT # FSR [X] OR SPR [ ]

DOF ANALYST USE
(ADDITIONAL REVIEW)

CAPITAL OUTLAY [ ] TIRU [ ] FSCU [ ] OSAE [ ] CALSTARS [ ]

STATE OF CALIFORNIA
MAY REVISE - FISCAL DETAIL
FOR FISCAL YEAR 2004/05
DF-46 (REV 03/03)

Department of Finance
915 L Street
Sacramento, CA 95814
IMS Mail Code: A-15

May Revise # 4	**DATE**	**May 7, 2004**	**Title of Proposed Change:** **Amnesty**
PROGRAM	**ELEMENT**		**COMPONENT**
Tax Programs	**Personal Income Tax**		

	Personnel Years CY	Personnel Years BY	Current Year	Budget Year
Total Salaries & Wages a/	.0	71.9	$ 0	$ 4,948,000
Salary Savings	.0	-.1	$ 0	-$ 5,000
Net Total Salaries and Wages	.0	71.8	$ 0	$ 4,943,000
Staff Benefits b/			$ 0	$ 1,181,000
Total Personal Services			$ 0	$ 6,124,000

Operating Expenses and Equipment

	Current Year	Budget Year
General Expenses /1	$ 0	$ 71,000
Printing /2	0	390,000
Communications /3	0	2,445,000
Postage /4	0	919,000
Travel-In-State	0	0
Travel Out-of-State	0	0
Training	0	0
Facilities Operations /5	0	23,000
Cons & Prof Svs - Interdept'l	0	0
Cons & Prof Svs - External /6	0	210,000
Consolidated Data Center	0	0
California Health and Human Services Agency Data Center	( )	( )
Stephen P. Teale Data Center	( )	( )
Data Processing /7	0	1,000
Equipment	0	0
Other Items of Exp (Specify Below)	0	0
Total Operating Expense & Equipment	$ 0	$ 4,059,000

a/ Itemized detail on Page II-3 by classification as in Salaries and Wages Supplement.
b/ Detail provided on following pages.
/1 General Expense for Branch @ $367, and for Depart'l $433 per position for 71.9 positions. Includes $10,000 for boxes, pallets and crates. PCs @ $1300 for one position. Plus minor equipment @ $1722 for one position.
/2 Departmental $107 per position for 71.9 positions. Includes $383,000 for printing invitations and envelopes.
/3 Departmental $793 per position for 71.9 positions. Also includes $2.3 million for advertisement, etc. and Megacom cost of $89,000.
/4 Postage costs to mail approximately 2.5 million invitations.
/5 Departmental $315 per position for 71.9 positions.
/6 Consultant services for system changes to accommodate the amnesty program.
/7 PC Software @$700 for one position

				Current Year	Budget Year
TOTAL OPERATING EXPENSES AND EQUIPMENT				$ 0	$ 4,059,000
SPECIAL ITEMS OF EXPENSE d/					
				$ 0	$ 0
PROGRAM ADMINISTRATION				$ 0	$ 0
Distributed Admin				$ 0	$ 0
TOTAL STATE OPERATIONS EXPENDITURES				$ 0	$ 10,183,000
Source of Funds	**Appropriation No.**				
	Org	Ref	Fund		
General Fund	1730	001	0001	$ 0	$ 10,183,000
				0	0
				0	0
				0	0
				0	0
				0	0
				0	0
Reimbursements	1730	501	0995	0	0
Totals				$ 0	$ 10,183,000
LOCAL ASSISTANCE				$(0)	$(0)
Source of Funds	**Appropriation No.**				
	Org	Ref	Fund		
General Fund	1730	001	0001	$ 0	$ 0
				0	0
				0	0
				0	0
				0	0
Reimbursements				0	0
Totals				$ 0	$ 0

d/ Special Items of expense must be titled. Please refer to the Uniform Codes Manual for a list of the standardized Special Items of expense objects which may be used.

DETAIL OF STAFF BENEFITS
AND PERSONAL SERVICES

Positions		Positions CY	Positions BY	Salary Range		Amount CY	Amount BY
Legal Division							
Tax Counsel III Spec	LT	0.0	1.0	$ 6,902	$ 8,517	$ 0	$ 93,000
Total Legal Division		.0	1.0			$ 0	$ 93,000
Adjust for Part Year Positions		.0	.0				
Net Positions/ PYs before salary savings		.0	1.0				
Financial Management Division							
Staff Operations Specialist/Ftb	OT					$ 0	$ 90,000
Acctg Tech	OT					$ 0	$ 49,000
Total Financial Management Division		.0	.0			$ 0	$ 139,000
Adjust for Part Year Positions		.0	.0				
Net Positions/ PYs before salary savings		.0	.0				
Accounts Receivable Management Division							
Staff Info Sys Analyst Spec	OT					$ 0	$ 83,000
Total Accounts Receivable Management Division		.0	.0			$ 0	$ 83,000
Adjust for Part Year Positions		.0	.0				
Net Positions/ PYs before salary savings		.0	.0				
Administrative Services Division							
Mailing Machines Operator II	OT					$ 0	$ 16,000
Seasonal Clerk	OT					$ 0	$ 5,000
Staff Space Planner	OT					$ 0	$ 45,000
Personnel Specialist - Rg B	OT					$ 0	$ 28,000
Seasonal Clerk	TEMP	0.0	0.9	$ 1,325	$ 1,514	$ 0	$ 15,000
Total Administrative Services Division		.0	.9			$ 0	$ 109,000
Adjust for Part Year Positions		.0	.0				
Net Positions/ PYs before salary savings		.0	.9				
Filing Division							
Customer Service Specialist - Rg B	OT					$ 0	$ 455,000
Assoc Info Systems Analyst	OT					$ 0	$ 172,000
Assoc Info Systems Analyst	OT					$ 0	$ 602,000
Staff Prog Analyst Spec	OT					$ 0	$ 377,000
Assoc Prog Analyst Spec	OT					$ 0	$ 344,000
Assoc Info Systems Analyst	OT					$ 0	$ 43,000
Sr Programmer Analyst Spec	OT					$ 0	$ 52,000
Assoc Operations Spec/Ftb	TEMP	0.0	1.0	$ 4,111	$ 4,997	$ 0	$ 55,000
Tax Program Supervisor	TEMP	0.0	3.0	$ 2,898	$ 3,524	$ 0	$ 116,000
Tax Program Tech II,Ftb	TEMP	0.0	6.0	$ 2,757	$ 3,353	$ 0	$ 220,000
Tax Program Tech II,Ftb	TEMP	0.0	9.0	$ 2,757	$ 3,353	$ 0	$ 330,000
Tax Technician, Ftb - Rg B	TEMP	0.0	22.0	$ 2,632	$ 3,201	$ 0	$ 770,000
Office Tech Typ	TEMP	0.0	2.0	$ 2,510	$ 3,050	$ 0	$ 67,000
Key Data Operator - Rg B	TEMP	0.0	8.0	$ 2,289	$ 2,780	$ 0	$ 243,000
Tax Program Assistant - Rg B	TEMP	0.0	16.0	$ 1,938	$ 2,354	$ 0	$ 412,000
Total Filing Division		.0	67.0			$ 0	$ 4,258,000
Adjust for Part Year Positions		.0	.0				
Net Positions/ PYs before salary savings		.0	67.0				

Technology Services Division							
Staff Prog Analyst Spec	OT					$ 0	$ 189,000
Tax Program Assistant - Rg B	TEMP	0.0	3.0	$ 1,938	$ 2,354	$ 0	$ 77,000
Total Technology Services Division		.0	3.0			$ 0	$ 266,000
Adjust for Part Year Positions		.0	.0				
Net Positions/ PYs before salary savings		.0	3.0				
Total Salaries and Wages	Positions	.0	71.9			$ 0	$ 4,948,000
	Part Yr Adj	.0	.0				
	P.Y.s	.0	71.9				

Schedule of Staff Benefits Costs
FOR FISCAL YEAR 2004/05

Staff Benefits	2003/04	2004/05
OASDI /1	$ 0	$ 300,000
Dental /2	0	33,000
Health /3	0	404,000
Retirement /4	0	336,000
Vision /5	0	6,000
Medicare /6	0	70,000
Worker's Comp /7	0	26,000
Industrial Disability /8	0	2,000
Non Industrial Disability /9	0	2,000
Unemployment Insurance /10	0	2,000
Total Staff Benefits	$ 0	$ 1,181,000

1/ For permanent and overtime, 6.2% of net salary.
2/ For permanent, $500 per net personnel year.
3/ For permanent, $6,000 per net personnel year.
4/ For permanent, 14.843% of net salary.
5/ For permanent, $100 per net personnel year.
6/ 1.45% of net salary for permanent.
7/ 1.12% of net salary for permanent.
8/ 0.1% of net salary for permanent.
9/ 0.11% of net salary for permanent.
10/ 12.89% of net salary for temporary help.

FRANCHISE TAX BOARD
Fiscal Year 2004/2005
May Revise Issue

Amnesty **Date: May 7, 2004**

A. Nature of Request

This proposal by the Administration will accelerate and/or increase revenue and create an amnesty program for those taxpayers that fail to file income tax returns, underreport income on previously filed income tax returns, or fail to pay any taxes previously assessed. The 60 day amnesty program would run from February 1, 2005 through March 31, 2005 and would apply for taxpayers subject to the personal income tax (PIT) and corporation (CT) laws. The cost to implement this program in FY 2004/05 is $10.2 million and will generate $595 million ($185 in new revenue and $410 million in accelerated revenues) in the same year.

B. Background/History

Tax Amnesty is a program designed to increase revenue and address those taxpayers that contribute to the overall tax gap. It is an opportunity for individuals and businesses to pay back taxes without penalties, fees, or fear of criminal prosecution. The amnesty program would apply to taxable years beginning before January 1, 2003.

Tax Amnesty will begin on February 1, 2005 and will end March 31, 2005.

If approved, the Tax Amnesty bill AB2203 will create an amnesty program for certain taxpayers that:

- Failed to file income tax[1] returns
- Underreported tax liability on a previously filed income tax return, or
- Failed to pay any taxes previously assessed.

Requirements

- Payment in full by March 31, 2005 or
- Taxpayer initiates/requests an installment arrangement by March 31, 2005 with final payment due by June 30, 2006 (default will revoke amnesty)
- Must waive claim for refund rights for amounts paid through amnesty

Eligible for amnesty

- ✓ Individuals
- ✓ Fiduciaries
- ✓ Estates & Trusts
- ✓ Partnerships
- ✓ Corporations

[1] generally includes the income tax for individuals, fiduciaries, estates, trusts, partnerships, and corporations, as well as the franchise tax which is the corporate tax measured by income.

Excluded from amnesty

- Under criminal investigation as of January 1, 2005
- Taxpayers eligible for state or federal abusive tax shelter voluntary compliance initiatives (VCI) for items and amounts that would have been eligible under VCI or federal OVCI

Program Background of past Amnesty type efforts:

1. 1984-1985 State Income Tax Amnesty Program

According to a 1986 report completed by FTB, California's 1984-85 amnesty program emerged from a growing perception among tax administrators and others that the state's "tax gap" was unacceptably large and growing larger. The general intent of the 1984 legislation, as outlined in the legislative intent language of AB 3230 (Hannigan, Ch. 1490, Stats. 1984), was to improve compliance with the income tax laws and accelerate and increase collections. In addition to the acceleration of collections, it was anticipated there would be a future benefit in that taxpayers would permanently be brought into the tax system. The Legislature expressly indicated that the amnesty program would be a one-time occurrence, not to be repeated in the future, as that would be counterproductive. The amnesty provisions were enacted along with post-amnesty enforcement tools and penalty provisions.

The 1984-85 amnesty program administered by FTB applied to the nonreporting or underreporting of an individual's income and nonpayment of individual income tax liabilities. It did not apply to corporate taxpayers. This legislation also included amnesty for sales and use tax that was administered by the Board of Equalization. The legislation provided for an amnesty window of 94 days (December 10, 1984, through March 15, 1985). The amnesty program produced total gross revenues of $154 million in income taxes and interest. The department estimated it would have collected $119.5 million from those individuals through its ongoing enforcement programs even if amnesty had not been adopted. Departmental costs were $6.5 million ($5.2 million for personnel and $1.3 million for operating costs). Though the amnesty program ended in March 1985, the processing of amnesty applications and returns continued through June 1986 because the returns and payments could be filed or paid after making an application.

As part of marketing the amnesty program, FTB significantly increased the visibility of its enforcement program. FTB publicized the amnesty program to taxpayers by publicizing property seizures and criminal prosecutions. The legislation also gave FTB new enforcement tools, such as enhanced penalties and misdemeanor sanctions, and the authority to use private collection agencies to resolve out-of-state collection accounts. These new tools were also publicized. The message that was presented on billboards throughout the state was that detection methods, penalties, and collection tools would be improved and enhanced, so "get to us before we get to you."

2. 2002 Revenue Acceleration Project (RAP)

In 2002 legislation was enacted[2] that allowed FTB to identify eligible taxpayers with high-risk collection accounts and offer those taxpayers the opportunity to satisfy an unpaid tax liability by paying the tax in full and receiving a waiver of interest, penalties, and fees. This Interest and Penalty Waiver Program, also known as the Revenue Acceleration Project (RAP), was in effect from October 2002, through October 2003. RAP generated approximately $36.8 million in revenue.

3. 2003 California Abusive Tax Shelter Legislation- (VCI)

Recently enacted California legislation[3] to combat abusive tax shelters included a state VCI from January 1, 2004, through April 15, 2004. This initiative permits a taxpayer that participated in an abusive tax shelter transaction to file an amended return to pay the tax and interest associated with an abusive tax shelter and not be assessed any penalties. In addition, the bills provide several enforcement tools, including an expanded regime of penalties and reporting requirements applicable to investors, promoters, tax advisors, and tax preparers involved in abusive tax shelters. VCI was projected to bring in approximately $90 million in revenue for each fiscal year 2003-04 and 2004-05. To date, VCI has brought in over $1.3 billion.

C. Level Considerations

The FTB will comply with the AB 2203 Legislation and implement an amnesty program with the additional resources requested.

D. Facilities

The facilities funding requested equates to $315 per position for utilities. This amount was derived from using the actual average cost per position.

E. Justification

It is the intent of the Legislation to increase revenue and address those taxpayers that are nonfilers who contribute to the overall tax gap. This proposal will generate revenue as displayed on the following page.

[2] AB 2065 (Oropeza, Ch 499,Stats. 2002)
[3] SB 614 (Cedillo, Ch. 656, Stats. 2003) and AB 1601 (Frommer, Ch 654, Stat. 2003)

Revenue Estimate:

Estimated Revenue Impact of AB 2203 For Tax Reporting Periods Ending On of Before January 1, 2003 Fiscal Year (In Millions)				
	2004-05	**2005-06**	**2006-07**	**2007-08**
Total Gross Revenue	$595	$70	$55	$40
Collections Absent Amnesty Attributable To Amnesty Participants	-$410	-$85	-$45	-$20
Total Net Revenue	$185	-$15	$10	$20

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

F. Analysis of All Feasible Alternatives

Alternative #1 – Provide Funding for the Amnesty Program

Augment the department's budget by $10,183,000 and 71.9 PY's in FY 2004/05. The positions requested will be established for one year with the exception of the Tax Council III position, which is three year limited term. This will create an amnesty program for certain taxpayers that have failed to file income tax returns, underreported income on a previously filed income tax return, or failed to pay any taxes previously assessed and will help close the State of California's tax gap. This program is expected to generate $595 million.

Alternative #2 – Provide Funding for the RAP Program only

Augment the Departments budget by $1,980,000 and 27.7 PY's in FY 2004/05. It is estimated that extending the program another year will result in additional revenue of approximately $23 million.

The original Penalty and Interest Waiver Program (commonly referred to as the Revenue Acceleration Program, or RAP) generated $36.8 million in revenue at a cost of $4 million.

Alternative #3 – Provide no additional funding.

If funding is not authorized, the department will be unable to establish the amnesty program and the $185 million in revenue will not be realized and the Department would not be able to accelerate revenues of $410 million.

G. Timetable

Funding to be provided on July 1, 2004 and the 60-day amnesty program will run from February 1, 2005 through March 31, 2005.

H. Recommendation

Alternative 1 is recommended. This alternative provides the FTB the necessary funding to comply with the new legislation, creating an amnesty program that will collect $595 million in revenue.