

**Pro Forma Return Pilot
Board Action Item**

I. Request for Action

Controller Westly requested that Franchise Tax Board staff prepare preliminary information for the three-member Board regarding *pro forma return filing*. Returns filed using the pro forma approach are initially completed by the tax agency without direct taxpayer input. After generating the completed return, the tax agency provides it to the taxpayer for review, modification (as needed), and validation. Then the taxpayer submits the completed return to the tax agency where it is routinely processed. Controller Westly is interested in testing the feasibility of this filing concept for California taxpayers.

This is a request for approval to deploy a pro forma return filing pilot program by February 2005.

II. Background

The primary focus of the Pro Forma Return Pilot is to reduce taxpayer burden. The Pilot would benefit those taxpayers who struggle with tax forms due to a language barrier or who are intimidated by the filing process.

The Pilot provides for the evaluation of various components of the concept that are essential to its success, such as data accuracy and taxpayer acceptance. Additionally, the Pilot is the first step toward providing taxpayers secure and private online access to their tax data. If the Pilot is successful, taxpayers could choose to directly access their data, provide access to tax practitioners, or download their data to commercial tax software products.¹

III. Pro Forma Return Activity

At the national level and in several foreign countries, including the United Kingdom, Germany and Japan², the pro forma return concept has surfaced as a means of easing the filing burden on taxpayers.

Over the last 20 years, the IRS, Congress, and national taxpayer advocate groups have actively discussed, studied, and proposed various solutions and recommendations to simplify tax return filing through the use of a pro forma return filing system. The Internal Revenue Service Restructuring and Reform Act of 1998 requires the Secretary of Treasury to develop procedures for implementing a system using the pro forma return concept for appropriate individuals by 2007. The Act also requires the Secretary to periodically report on resources, procedures, legislation, and target audience needed to successfully implement a pro forma return system.

The IRS conducted a survey to measure taxpayer interest in pro forma return filing options.³ Overall, nearly 40% of respondents would consider participating in a pro forma

¹ Access to taxpayer data would be only with the consent of the taxpayer.

² The United Kingdom, Germany, and Japan use various forms of the Exact Withholding System. Denmark and Sweden operate Agency Reconciliation Systems. Finland and Norway are testing the Agency Reconciliation approach.

³ Department of the Treasury, *Report to The Congress on Return-Free Tax Systems: Tax Simplification Is a Prerequisite*. December 2003, pp. 24-31.

**Pro Forma Return Pilot
Board Action Item**

return filing program. The IRS does not plan to implement a pro forma return filing system in the immediate future.

Similar to the IRS, the FTB has also attached strategic importance to a pro forma return filing system. In its 2000 report, *Filing 2010 – The Future of State Income Tax Filing*, the FTB lays out a vision for a system similar to the pro forma return filing concept that would use as a foundation, applications and programs that the FTB already has in place. Among other systems and applications, these include the Integrated Nonfiler Compliance (INC) system and the e-file system.

Currently, FTB's INC program uses an Agency Reconciliation method to provide pro forma⁴ returns for previous-year nonfilers. However, FTB has not taken steps to measure taxpayer interest in this type of program for current-year filers.

As FTB already processes wage and withholding information early enough in the filing season to make an Agency Reconciliation option available for California taxpayers, we would not have to institute the type of changes the IRS report identifies as critical to the success of a pro forma filing program. FTB's proven ability to leverage existing applications and use various sources of information to assemble pro forma returns puts FTB in a situation to relatively easily develop a pilot that could be used to gauge taxpayer interest and benefit.

IV. Pro Forma Return Pilot Overview

A. Taxpayer Experience

The Pilot scope includes providing selected taxpayers the opportunity to partially bypass the traditional tax filing process, thus significantly reducing their filing burden. The selected taxpayers would be contacted by mail regarding their eligibility to participate in the Pilot. They would be presented with their tax filing data (online and, in some cases, on paper also). They would then have the option to approve the information provided and forward it, with their signature, to FTB, or they could opt to not use the provided information.

B. Selection of Participating Taxpayers

The Pilot targets those taxpayers who file the simplest returns. The Pilot will select taxpayers representing all filing methods and profiles, including former TeleFilers, e-filers, paper filers, consistently compliant filers and nonfilers.⁵ Using Employment Development Department wage information and proprietary FTB data (i.e., the taxpayer's previous year, 2003, return), the Pilot will select taxpayers who meet the following criteria:⁶

⁴"Pro Forma" defined as: Provided in advance so as to prescribe form or describe items.

⁵ Selecting nonfilers for the Pilot could result in the acceleration of revenue, dependent upon the number of nonfilers who opt to participate in the Pilot.

⁶ This list represents the primary selection criteria. Other more detailed criteria will also apply.

**Pro Forma Return Pilot
Board Action Item**

- Single
- Wage earners with only one employer
- Standard deduction
- No dependents
- No special credits

C. Taxpayer Groups within the Pilot

The Pilot will select taxpayers who meet the criteria shown above. We anticipate dividing this population into two primary groups:⁷

- One group will receive a letter and completed paper return.
- The second group will receive only a letter directing them to view and electronically file⁸ their return via our *Pro Forma Return Website*.⁹

Taxpayers in both groups will have the option to accept, modify, or ignore the return information provided. Both groups of taxpayers can accept or modify their returns electronically by going to the *Pro Forma Return Website*. The group of taxpayers that receives the completed paper return may send it to the FTB with no changes, or with modifications. We anticipate typical modifications to be changing filing status, changing an address, including additional income information, claiming tax credits, making voluntary contributions, and electing for a direct deposit of their refund.

D. Leveraging Current FTB Systems

The Pilot will leverage FTB's current systems to generate taxpayer data. Additionally, the Pilot will leverage current system functionalities to provide a secure online application capable of integrating changes taxpayers may need to make to their tax data.

V. Pro Forma Return Pilot Costs and Benefits

A. Costs

The estimated one-time cost for the Pilot is \$200,000.¹⁰ No new funding is needed for this pilot. The Pilot will be funded through the redirection of previously budgeted resources within the Filing and Technology Services Divisions. This redirection will cause the delayed completion of certain workloads, but these delays will not impact FTB's external stakeholders.

⁷ The Pilot will include about 50,000 taxpayers. This volume will assure that enough responses are received to result in a valid sample.

⁸ The letter will include vital information on security, privacy, and other issues. Additionally, it will include information on FTB's e-file programs: traditional practitioner e-file, commercial software e-file, and IRS Free File.

⁹ The public name has yet to be determined.

¹⁰ Detailed costing will be completed as a component of the feasibility study process.

**Pro Forma Return Pilot
Board Action Item**

B. Benefits

The Pilot yields both tangible and intangible benefits for:

Taxpayers by:

- Relieving some of their filing burden because FTB handles collecting their tax data.
- Reaching many of those who qualify for a refund but do not file a tax return due to the perceived burden.
- Reducing the possibility of participants receiving notices for wage and withholding discrepancies.
- Providing former TeleFilers with a convenient filing alternative.¹¹ (Preliminary estimates indicate that over 40% of TeleFilers would meet the Pilot criteria.)
- Providing participants with the benefits of e-file.

Government by:

- Helping to close the Tax Gap by reaching certain nonfilers.
- Transitioning traditional paper filers to e-file and thus reducing processing costs.
- Providing FTB the opportunity to promote various e-services to taxpayers via the Pro Forma Return letter.
- Testing the concept of providing taxpayers' data directly to them.

Industry by:

- If the Pilot is successful, providing taxpayers online, secure, and private access to their data. Taxpayers (and their authorized representatives (e.g. tax practitioners)) could then access their FTB data via commercial software. (This service would be made available in 2006, or later.)¹²
- Adding value and convenience to software products.

VI. Pro Forma Return Pilot Evaluation

By August 2005, a detailed evaluation of the Pilot will be completed. The evaluation will focus on the following issues:

1. How effective is pro forma return filing in terms of reducing the filing burden for taxpayers?
2. What is the taxpayer acceptance rate of pro forma return filing?
3. Will taxpayers who traditionally file on paper be motivated to try electronic options?
4. What effect will pro forma return filing have on FTB's compliance costs?
5. What effect will pro forma return filing have on external stakeholders, including the tax preparation and tax software industries?

¹¹ FTB is discontinuing the TeleFile Program in October 2004.

¹² This program enhancement is dependent upon the success of the Pilot and acquiring the appropriate approvals.