

2013 Legislative Proposals

LP #	TITLE
A	Equal Tax Treatment of Nonqualified Foreign Limited Liability Companies (LLCs) for Contract Voidability
B	Repeal Tax Clearance Requirement for Specified Estates with Nonresident Beneficiaries
C	Allow Use of Financial Institution Record Match (FIRM) Address Information for Tax Administration Purposes
D	Tax-Data Sharing Between the Franchise Tax Board (FTB) and Cities--Repeal Sunset
E	Electronic Communications

LEGISLATIVE PROPOSAL A EXECUTIVE SUMMARY

- **Title:** Equal Tax Treatment of Nonqualified Foreign Limited Liability Companies (LLCs) for Contract Voidability
- **Problem:** The law does not treat foreign nonqualified LLCs in the same manner as it treats foreign nonqualified corporations in regards to contract voidability, resulting in inequitable treatment between similarly situated business entities.
- **Proposed Solution/Justification:** This proposal would include foreign nonqualified LLCs within the definition of taxpayer as it relates to contract voidability, in order to provide an additional incentive to foreign nonqualified LLCs to register with the Secretary of State and to stay current with their state tax obligations, as well as provide greater protections to California consumers.
- **Major Concerns/Issues:** None
- **Fiscal Impact:** This proposal would not significantly impact the department's costs.
- **Revenue:**

Estimated Revenue Impact of LP A For Taxable Years Beginning On or After January 1, 2014 Assumed Enactment After June 30, 2013		
2013-14	2014-15	2015-16
+\$30,000	+\$80,000	+\$20,000

This estimate does not account for changes in employment, personal income, or gross state product that could result from this proposal.

Title

Equal Tax Treatment of Nonqualified Foreign Limited Liability Companies (LLCs) for Contract Voidability

Introduction

This proposal would allow contracts of foreign nonqualified LLCs that fail to file a tax return or pay the amount of tax due, to be voidable.

Program History/Background

In 1994, the Legislature authorized the formation of LLCs in California by enacting the Beverly-Killea Limited Liability Company Act (Act).¹ Under the Act, domestic and foreign² qualified³ LLCs were specifically included within the definition of “taxpayer.”⁴ These business entities along with corporations were specifically subject to contract voidability⁵ for failure to pay taxes, penalties, fees, or interest, or for failure to file required tax returns. When an entity is subject to contract voidability, any contract entered into may be voided by another party to the contract. Foreign nonqualified LLCs were inadvertently not included with the entities that may be subject to contract voidability.

The following business entities may be subject to contract voidability, and are able to avail themselves of relief from contract voidability as follows:

Entity Type	Contract Voidability	Relief From Contract Voidability
Domestic Corporation	X	X
Foreign Qualified Corporation	X	X
Foreign Nonqualified Corporation	X	X
Domestic LLC	X	X
Foreign Qualified LLC	X	X
Foreign Nonqualified LLC		

¹ Stats. 1994, Ch. 1200 (SB 469).

² Foreign refers to any entity not organized within California.

³ Qualified refers to an entity that is registered with the California Secretary of State.

⁴ The definition of taxpayer for purposes of Article 7 of Chapter 2 of Part 11 of the Revenue and Taxation Code (commencing with section 23301).

⁵ Domestic and foreign registered corporations and LLCs are subject to contract voidability as part of suspension or forfeiture. Foreign non-qualified corporations are also subject to contract voidability, but are not subject to suspension or forfeiture.

All entities that are subject to contract voidability are able to overcome contract voidability by filing and paying all delinquent tax returns, taxes, penalties, fees, and interest, and then may file an application for revivor if the entity is also suspended or forfeited.

Current Federal Law

Under existing federal law, business entities are not subject to contract voidability for failure to pay taxes, penalties, fees, or interest, or for failure to file required tax returns with the Internal Revenue Service (IRS). Nor does the IRS offer relief from contract voidability for any business entities.

Current State Law

Domestic or foreign registered (qualified) LLCs or domestic or foreign qualified corporations may be subject to suspension or forfeiture for failure to file a tax return or for failure to pay delinquent taxes, penalties, fees, or interest within 60 days of the FTB mailing a final notice. One consequence of suspension or forfeiture is being subject to contract voidability for the period in which the entity is suspended or forfeited.

Foreign nonqualified corporations that do not have an FTB-assigned account number, because the FTB is unaware of the entities' business activities within the state, that fail to file a return are immediately subject to contract voidability. Foreign nonqualified corporations that have an FTB-assigned account number may be subject to contract voidability for failure to file a tax return or for failure to pay delinquent taxes, penalties, fees, or interest within 60 days of the FTB mailing a final notice before contract voidability.

All corporations and domestic or foreign qualified LLCs that enter into a contract while subject to contract voidability may have the contract voided by another party to the contract. The third party may exercise the right to declare a contract void only in a lawsuit brought by either party with respect to the contract. A court shall not issue a final judgment rescinding the contract unless the taxpayer subject to contract voidability is provided a reasonable opportunity to cure the voidability. In no event shall a court order a contract rescinded without providing the taxpayer full restitution of the benefits provided by the taxpayer under the contract.

Foreign nonregistered (nonqualified) LLCs are not subject to contract voidability for failure to file tax returns or for failure to pay taxes, penalties, fees, or interest. Consequently, foreign nonqualified LLCs do not need to obtain relief from contract voidability.

Entities that are subject to contract voidability may elect to obtain relief from contract voidability. If obtained during the revivor process, the entity may choose relief for a portion of the time in which the entity was subject to contract voidability by choosing the starting tax year for which the relief period will begin. If an entity elects to obtain relief from contract voidability outside of the revivor process, the entity must choose relief for the entire period for which the entity was subject to contract voidability. Relief from contract voidability is granted at a cost of \$100 a day for the period of relief granted. The amount cannot exceed the amount of tax due for the relief period. When a return is not due, the minimum franchise tax is considered the tax due for that period.

Problem

The law does not treat foreign nonqualified LLCs in the same manner as it treats foreign nonqualified corporations in regards to contract voidability, resulting in inequitable treatment between similarly situated business entities.

Proposed Solution

Amend the definition of taxpayer as it relates to suspension, forfeiture, revivor, and contract voidability, to specifically include all LLCs.

Effective/Operative Date of Solution

If enacted in the 2013 legislative session as an administrative measure, this proposal would be effective on January 1, 2014, and operative as of that date. Contract voidability for foreign nonqualified LLCs without an FTB-assigned account number would be specifically operative for contracts entered into during the period beginning on the later of January 1, 2014, or the first day of the taxable year for which the taxpayer has failed to file a return.

Justification

This proposal would provide greater protection to California consumers by allowing consumers who enter into contracts with foreign nonqualified LLCs to void those contracts in specified situations⁶ and would provide an additional incentive for foreign nonqualified LLCs to register with the Secretary of State and to stay current with their state tax obligations.

Implementation

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

⁶ These situations include when a foreign nonqualified LLC does not have an FTB-assigned account number and fails to file a required tax return or when the foreign nonqualified LLC fails to file a tax return or pay delinquent taxes, penalties, fees, or interest within 60 days of the FTB mailing a final notice before contract voidability.

Fiscal Impact

This proposal would not significantly impact the department's costs.

Economic Impact

Revenue Estimate

Estimated Revenue Impact of LP A For Taxable Years Beginning On or After January 1, 2014 Assumed Enactment After June 30, 2013		
2013-14	2014-15	2015-16
+\$30,000	+\$80,000	+\$20,000

This estimate does not account for changes in employment, personal income, or gross state product that could result from this proposal.

Revenue Discussion

The revenue estimate is determined by applying the compliance rate for similarly situated foreign nonqualified corporations to foreign non-qualified LLCs that would be subject to contract voidability under this proposal.

The revenue estimate includes collections from both "new" contract-voidable LLCs that arise each year, as well as collections from the existing inventory of nonqualified LLCs that would be subject to contract voidability under this proposal.

Pro & Con Arguments

Pro: Proponents could argue that this proposal would provide greater protection to California consumers when contracting with foreign nonqualified LLCs.

Con: Opponents could argue that this proposal would place an additional burden on specified LLCs, thus discouraging economic activity within the state.

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 the states reviewed impose contract voidability, nor do they offer relief from contract voidability.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS FOR LP A

AMENDMENT 1

SECTION. 1. Section 23304.1 of the Revenue and Taxation Code is amended to read:

23304.1. (a) Every contract made in this state by a taxpayer during the time that the taxpayer's ~~corporate~~ powers, rights, and privileges are suspended or forfeited pursuant to Section 23301, 23301.5, or 23775 shall, subject to Section 23304.5, be voidable at the instance of any party to the contract other than the taxpayer.

(b) If a foreign taxpayer that neither is qualified to do business nor has an ~~corporate~~ account number from the Franchise Tax Board, fails to file a tax return required under this part, any contract made in this state by that taxpayer during the applicable period specified in subdivision (c) shall, subject to Section 23304.5, be voidable at the instance of any party to the contract other than the taxpayer.

(c) For purposes of subdivision (b), the applicable period shall be the period beginning on January 1, 1991, or the first day of the taxable year for which the taxpayer has failed to file a return, whichever is later, and ending on the earlier of the date the taxpayer qualified to do business in this state or the date the taxpayer obtained an ~~corporate~~ account number from the Franchise Tax Board. In the case of a limited liability company, the applicable period shall begin on January 1, 2014, or the first day of the taxable year for which the taxpayer has failed to file a return, whichever is later.

(d) If a taxpayer fails to file a tax return required under this part, to pay any tax or other amount owing to the Franchise Tax Board under this part or to file any statement or return required under Section 23772 or 23774, within 60 days after the Franchise Tax Board mails a written demand therefor, any contract made in this state by the taxpayer during the period beginning at the end of the 60-day demand period and ending on the date relief is granted under Section 23305.1, or the date the taxpayer qualifies to do business in this state, whichever is earlier, shall be voidable at the instance of any party to the contract other than the taxpayer. This subdivision shall apply only to a taxpayer if the taxpayer has an ~~corporate~~ account number from the Franchise Tax Board, but has not qualified to do business under ~~Section 2105 of the Corporations Code~~. In the case of a taxpayer that has not complied with the 60-day demand, the taxpayer's name, Franchise Tax Board ~~corporate~~ account number, date of the demand, date of the first day after the end of the 60-day demand period, and the fact that the taxpayer did not within that period pay the tax or other amount or file the statement or return, as the case may be, shall be a matter of public record.

SEC. 2. Section 23305.5 of the Revenue and Taxation Code is amended to read:

23305.5. (a) For the purposes of this article;

(a) The term "taxpayer" shall mean either of the following:

~~include any limited liability company, foreign or domestic, that is~~

organized in this state or registered with the Secretary of State. (1) A corporation subject to tax under this chapter. (2) A business entity organized under a state statute, or under a statute of a federally recognized Indian Tribe, if the statute describes or refers to the entity as a limited liability company.

~~(b) For purposes of this article, in~~ the case of a limited liability company:

(1) "Articles of incorporation" shall include a limited liability company's articles of organization.

(2) "Tax" shall include the tax and fee imposed by Sections 17941 and 17942, or former Sections 23091 and 23092, respectively.

LEGISLATIVE PROPOSAL B EXECUTIVE SUMMARY

- **Title:** Repeal Tax Clearance Requirement for Specified Estates with Nonresident Beneficiaries
- **Problem:** The tax clearance requirement is a burdensome process that is not necessary to prevent assets under probate control from being distributed to nonresident beneficiaries before state income tax liabilities are paid.
- **Proposed Solution/Justification:** This proposal would repeal the tax clearance requirement for specified estates, which would eliminate the burden that the tax clearance requirement places on the state probate court system and specified estates. It would allow the Franchise Tax Board (FTB) to redirect resources to other revenue generating activities, without compromising the FTB's ability to collect delinquent taxes from specified estates, because existing notice requirements outside of the tax clearance requirement provide the FTB the opportunity to file a timely claim in probate court to protect the state's interest in tax liabilities.
- **Major Concerns/Issues:** None
- **Revenue:**

Estimated Revenue Impact of LP B Repeal of Tax Clearance Certificates Effective January 1, 2014 Enactment Assumed After June 30, 2013			
2012-13	2013-14	2014-15	2015-16
0	-\$3,000	-\$6,000	-\$7,000

This estimate does not account for changes in employment, personal income, or gross state product that could result from this proposal.

Title

Repeal Tax Clearance Requirement for Specified Estates with Nonresident Beneficiaries

Introduction

This proposal would eliminate the tax clearance requirement for estates that have an appraised value in excess of \$1,000,000 with aggregate distributions to nonresident beneficiaries in excess of \$250,000.

Program History/Background

California repealed its state inheritance tax by ballot measure in 1982. However, a final decedent income tax return is required to be filed to account for the decedent's final tax year. If any income is generated by the estate prior to distribution to its beneficiaries, a fiduciary income tax return is required to be filed for the estate.

The Probate Court may oversee the payment of the probate estate debts and the distribution of the estate assets. Not all estates are subject to probate administration. Decedent property that is contained within a trust is generally exempt from probate proceedings. Decedent property that passes to beneficiaries by a will, or passes by intestacy because no will has been executed, is generally subject to probate. In addition, some estates elect to participate in probate proceedings where there are disputes among beneficiaries or where creditors' claims need to be addressed or extinguished.

The tax clearance requirement was enacted in 1935¹ to prevent assets under the control of the Probate Court of California from being distributed out of state before all state income taxes have been paid or secured. Over the last four years, tax clearance certificates have been requested by an average of 500 estates each year. From these requests, an average of 440 estates required a tax clearance certificate, resulting in an average collection amount of \$10,000² per year.

The tax clearance certificate requirement places a burden on the estate and the probate court system. In ordinary situations and especially in situations where estates are not aware of the tax clearance requirement, or where estates only become aware later in the process that the estate meets the threshold requirements for tax clearance, the requirement can create a significant delay often requiring the postponement of judicial proceedings. This increases the administrative costs of probate for both the court and the estate.

¹ Stats. 1935, Ch. 329, Section 26.

² The taxes collected include estimate payments and payments for future liabilities that are not past due, but that would be due during the period in which the tax clearance certificate is valid.

In 2008, legislation was enacted to require an estate representative to provide notice to the FTB that the administration of a decedent’s estate has been opened in Probate Court. This requirement gives the FTB the opportunity to file a Creditor’s Claim in the probate proceedings to protect the state’s tax liability interest in the estate’s distributable assets. Since the notice requirement became operative, the compliance rate for all estates has reached 99 percent within 12 months of the close of the taxable year. The following table depicts the 99 percent compliance rate for estates for taxable years 2008, 2009, and 2010.

	TY 2008	TY 2009	TY 2010
	as of 12/31/2009	as of 12/31/2010	as of 12/31/2011
Total Tax Due	\$446,691,584	\$300,579,825	\$424,594,502
Unpaid Total	\$4,593,194	\$3,957,980	\$3,811,974
Percent Unpaid	1.03%	1.32%	0.90%
	as of 12/31/2010	as of 12/31/2011	as of 08/30/2012
Total Tax Due	\$447,781,381	\$341,327,038	\$472,773,922
Unpaid Total	\$2,176,107	\$2,821,820	\$4,146,284
Percent Unpaid	0.49%	0.83%	0.88%

Because all claims filed against an estate in probate must be resolved prior to closing the administration of the estate, this notice requirement allows the FTB to prevent assets under the control of the Probate Court of California from being distributed before tax liabilities are paid.

Current Federal Law

The administration of a decedent's estate is exclusively a matter of state law. The IRS is treated as a creditor of an estate when an estate has a federal tax debt. There is no federal tax clearance certificate required for an estate to close probate.

Current State Law

A personal representative or estate attorney is required to provide the FTB notice of a decedent’s death no later than 90 days after the date letters of administration are first issued to a personal representative. The FTB may file a claim for outstanding tax liabilities against an estate in probate court within 18 months of receiving written notice of the administration of the estate, or if no notice is provided, within 18 months of receiving a request for a prompt audit of the decedent’s or estate’s tax return by the estate’s personal representative. If no notice or written request is given to the FTB and the estate has been distributed, the FTB may file a claim against any beneficiary of the estate that received the property.

For estates that have an appraised value in excess of \$1,000,000 with aggregate distributions to nonresident beneficiaries in excess of \$250,000, the California Superior Court, Probate Division, is prohibited from allowing the estate to close probate unless the FTB certifies to the court that all income taxes due have been paid and all taxes that may become due are secured by a security deposit or otherwise. Within 30 days after receiving a request for a certificate, the FTB is required to either issue the certificate or notify the person requesting the certificate of the amount that is required to be paid or the amount of bond, deposit, or other security that is required to be furnished as a condition of issuance of the certificate. To facilitate the probate administration of an estate, the FTB does provide expedited tax clearance letters to estates for a \$100 fee, which is used to reimburse the FTB for the cost of administering the expedited service.

Problem

The tax clearance requirement is a burdensome process that is not necessary to prevent assets under probate control from being distributed to nonresident beneficiaries before state income tax liabilities are paid.

Proposed Solution

Repeal the tax clearance requirement and eliminate the associated authority to provide expedited tax clearance certificates.

Effective/Operative Date of Solution

If enacted in the 2013 legislative session, this proposal would be effective January 1, 2014, and would be operative for estates closing probate on or after January 1, 2014.

Justification

This proposal would eliminate the burden that the tax clearance requirement places on the state probate court system and specified estates.³ It would allow the FTB to redirect resources to other revenue generating activities, without compromising the FTB's ability to collect delinquent taxes from specified estates,⁴ because existing notice requirements outside of the tax clearance requirement provide the FTB the opportunity to file a timely claim in probate court to protect the state's interest in tax liabilities.

Implementation

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

³ Estates that have an appraised value in excess of \$1,000,000 with aggregate distributions to nonresident beneficiaries in excess of \$250,000.

⁴ *Ibid.*

Fiscal Impact

This proposal would result in a savings of .5 PYs or \$22,500. This savings would be absorbed by other revenue generating workloads.

Economic Impact

Revenue Estimate

Estimated Revenue Impact of LP B Repeal of Tax Clearance Certificates Effective January 1, 2014 Enactment Assumed After June 30, 2013			
2012-13	2013-14	2014-15	2015-16
0	-\$3,000	-\$6,000	-\$7,000

This estimate does not account for changes in employment, personal income, or gross state product that could result from this proposal.

Revenue Discussion

The FTB issues approximately 440 tax clearance certificates a year. The four-year average collected through the tax clearance requirement has been \$10,000, and not all of the money collected is made up of unpaid taxes, but includes estimate payments that will come due. Therefore, the four-year average collected was reduced by 50 percent to approximate the amount of taxes that would be at risk of ending up in collections. That amount was grown using the Department of Finance total Personal Income growth rate. It is assumed that without the tax clearance requirement there would be a 10-percent increase in non-compliance. That value is fiscalized and is reflected in the table above.

Other Agency/Industry Impacted

The California Superior Court, Probate Division, would no longer require a tax clearance certificate from specified estates, thus eliminating any delays attributable to the tax clearance requirement.

Pro & Con Arguments

Pro: Proponents could argue that the probate process is already a challenging and lengthy ordeal, and the elimination of the tax clearance requirement would make the probate process faster and easier.

Con: Opponents could argue that the elimination of the tax clearance requirement would make it easier for specified estates to avoid paying the state income taxes that are owed by the estate.

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.

Under *Michigan* law, a probate estate may be closed only after a clearance has been obtained from the Michigan Department of Treasury stating that all *Michigan* taxes which may be due have been paid.

Florida, Illinois, Massachusetts, Minnesota, and New York do not require a tax clearance letter before closing probate.

Potential Compromises

By regulation, the FTB could narrow the tax clearance requirement to affect a smaller number of estates by increasing the required value of the estate and the required value of the assets distributed to nonresident beneficiaries before the tax clearance requirement would be imposed. This would reduce the burden on the probate court system, estates, and the FTB.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS FOR LP B

AMENDMENT 1

SECTION 1. Section 17735 of the Revenue and Taxation Code is repealed.

~~17735. In the case of an estate, no deductions shall be allowed under Section 661(a) of the Internal Revenue Code with respect to amounts attributable and taxable to nonresident beneficiaries if the fiduciary fails to obtain a certificate as provided by Section 19513.~~

SEC. 2. Section 19513 of the Revenue and Taxation Code is repealed.

~~19513. (a) If assets of an estate are distributable to one or more nonresident beneficiaries, the final account of the fiduciary shall not be allowed by the probate court unless the fiduciary obtains from the Franchise Tax Board and files with the court a certificate to the effect that all taxes, additions to tax, penalties, and interest imposed by Part 10 (commencing with Section 17001) or this part upon the estate or decedent which have become payable have been paid, and that all taxes, additions to tax, penalties, and interest which may become due are secured by bond, deposit or otherwise.~~

~~—(b) This section only applies if the value of the assets of the estate at the death of the decedent and the value of the assets distributable to one or more nonresidents exceed amounts prescribed by regulations promulgated by the Franchise Tax Board.~~

SEC. 3. Section 19514 of the Revenue and Taxation Code is repealed.

~~19514. Within 30 days after receiving a request for a certificate, the Franchise Tax Board shall either issue the certificate or notify the person requesting the certificate of the amount that shall be paid or the amount of bond, deposit, or other security that shall be furnished as a condition of issuance of the certificate.~~

SEC. 4. Section 19515 of the Revenue and Taxation Code is repealed.

~~19515. The certificate of the Franchise Tax Board does not relieve the estate for which the fiduciary acts of liability for any amounts which are due and unpaid at the time the certificate is issued or which may become due from the decedent or estate after the issuance of the certificate. It also does not relieve the fiduciary of the liability imposed by Section 19516.~~

SEC. 5. Section 19591 of the Revenue and Taxation Code is amended to read:

19591. (a) Specialized tax services fees shall be imposed upon the following services provided by the board:

- (1) Installment payment programs.
- (2) Expedited services for:
 - (A) Corporation revivor requests.
 - ~~(B) Tax clearance certificate requests.~~
 - ~~(B)~~ Tax-exempt status requests.
 - ~~(D)~~ Limited partnership revival confirmation letter requests.

(b) (1) For periods on or after the effective date of this section and prior to January 1, 2006, the Franchise Tax Board shall publish by notice a schedule of specialized tax services fees to be imposed, which notice shall be exempt from the requirements of Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code. The amounts of these fees under this paragraph shall be calculated in the same general manner as required under paragraph (2).

(2) Commencing on January 1, 2006, the amount of the specialized tax services fees shall be established by the board through regulations adopted pursuant to Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code, and shall be established in the manner and in the amounts necessary to reimburse the board for the costs of administering the specialized services, including the board's direct and indirect costs for providing specialized tax services.

(3) For periods on or after the effective date of this section, and prior to January 1, 2011, the amount of the specialized tax service fee for limited partnership revival confirmation letter requests shall be one hundred dollars (\$100). Commencing on January 1, 2011, the specialized tax service fee for limited partnership revival confirmation letter requests shall be calculated in the same general manner as required under paragraph (2).

LEGISLATIVE PROPOSAL C EXECUTIVE SUMMARY

- **Title:** Allow Use of Financial Institution Record Match (FIRM) Address Information for Tax Administration Purposes
- **Problem:** In some situations, the Franchise Tax Board (FTB) is unable to utilize a taxpayer's updated, correct address information, which hinders those taxpayers from receiving notices, refunds or important correspondence from the department.
- **Proposed Solution/Justification:** Amend current law to remove the prohibition on using FIRM address information as a taxpayer's current address for purposes other than tax collection. Allowing the use of address information obtained from FIRM would improve fair and efficient tax administration by allowing the use of the most current address available to contact taxpayers for reasons other than collection purposes and prevent inconsistent address information in the FTB's systems by updating all of the department's systems to reflect the same address regardless of source.
- **Major Concerns/Issues:** None
- **Fiscal Impact:** This proposal would not significantly impact the department's costs.
- **Revenue:**

Estimated Revenue Impact of LP C			
For Cases Worked With New Addresses On or After January 1, 2014			
Assumed Enactment After June 30, 2013			
2012-13	2013-14	2014-15	2015-16
+\$150,000	+\$200,000	+\$150,000	+\$150,000

This estimate does not account for changes in employment, personal income, or gross state product that could result from this proposal.

Title

Allow Use of Financial Institution Record Match (FIRM) Address Information for Tax Administration Purposes

Introduction

This proposal would remove the prohibition on using FIRM address information as a taxpayer's current address for purposes other than tax collection.

Current Federal Law

The fourteenth amendment of the United States Constitution guarantees individuals specific rights, including the right to due process of law before property can be taken by the government. The essential elements of due process include reasonable notice.

Under current federal law, the due process element of reasonable notice is met when the Internal Revenue Service (IRS) mails a required notice to the taxpayer at the taxpayer's last known address. Federal regulations require that unless the IRS has been given clear and concise notice of a different address, the address that appears on the taxpayer's most recently filed federal tax return is the taxpayer's last known address. The regulation also provides that under certain conditions, updated address information received from the United States Postal Service National Change of Address database will be considered the taxpayer's last known address unless the IRS is given clear and concise notification of a different address. When the tax agency has reason to believe that the address previously provided by the taxpayer is no longer correct, the agency has a duty to exercise reasonable diligence to ascertain the correct address.

Current State Law

Current state law provides that use of the taxpayer's last known address is sufficient to satisfy the reasonable notice element of due process. Last known address is defined as the address that appears on the last return filed with the FTB unless the taxpayer has provided the FTB clear and concise written or electronic notification of a different address or the FTB has an address it has reason to believe is the most current address for the taxpayer.

Under current state law, FIRM requires financial institutions doing business in this state to participate in a quarterly data exchange process with the FTB to match the FTB's list of delinquent debtors with the financial institution's account holder records.¹ Through FIRM, the FTB receives information regarding those accounts, including current address information on the financial institution's records. Current state law specifies that any use of the information received from FIRM for purposes other than tax collection is prohibited and is a misdemeanor.

SB 1015 (Stats. 2012, Ch.37) expanded FIRM to include specified debts owed to the Employment Development Department (EDD) and the Board of Equalization (BOE).

¹ Under Revenue and Taxation Code section 19266(a)(2), a financial institution may provide a list limited to accountholders that are a match to the FTB's list of delinquent debtors or, for institutions that lack the resources to provide matched accountholders only, the institution may provide a list of all accountholders to the FTB with the FTB performing the data match to limit the data utilized to that of delinquent debtors. Additionally, the FTB is authorized to grant exemptions from or temporarily suspend the FIRM reporting requirements as specified.

SB 1015 requires the FTB to administer the quarterly FIRM data match program on behalf of the EDD and the BOE. The EDD and the BOE are required to submit their respective delinquent tax debtor files to the FTB in the format and manner specified by the FTB for inclusion in the FIRM process. SB 1015 imposes the same statutory provisions and restrictions on the EDD and the BOE relating to the use of financial institution data received under the FIRM data match program.

Background

When an FTB notice is returned by the post office as undeliverable, the FTB will place a "bad address" indicator on the account. To ensure that notices related to valid assessments reach the taxpayer prior to initiating involuntary collection action, the FTB attempts to locate a better address using various skip tracing² techniques and address verification resources.

When the FTB receives a new address for a taxpayer, the FTB's current business method is to update the new address into the department's accounting and collection systems. Because the literal language of the statute as enacted states that information from FIRM can only be used for "collection purposes," it could be argued that the department is unable to use address information received from FIRM for any purpose not directly related to collections. As a result, the department is arguably prohibited from adding the FIRM address information to a usable database as the best possible address for the taxpayer for other tax administration purposes.

Problem

In some situations, the FTB is unable to utilize a taxpayer's updated, correct address information, which hinders those taxpayers from receiving notices, refunds or important correspondence from the department.

Proposed Solution

Amend current law to allow taxpayer addresses to be updated based on information obtained from FIRM.

Effective/Operative Date of Solution

This proposal would be effective January 1, 2014, and would be specifically operative with respect to information obtained through FIRM before, on, or after that date.

² According to the Government Revenue Collection Association, "Skiptracing" (also skip tracing) is a colloquial term used to describe the process of locating a person's whereabouts for any number of purposes. A skip tracer is someone who performs this task, which may be the person's primary occupation. The term comes from the word "skip" being used to describe the person being searched for, and comes from the idiomatic expression "to skip town," meaning to depart, perhaps in a rush, and leaving minimal clues behind for someone to "trace" the "skip" to a new location. <http://www.govcollect.org/improving-collections/collection-technology/skip-tracing>

Justification

Expanding the use of the information obtained from FIRM would do the following:

- Improve fair and efficient tax administration by allowing the use of the most current address available to contact taxpayers.
- Prevent inconsistent address information in the FTB's systems by updating all systems with the same address regardless of source.
- Allow the FTB's database to maintain the most current taxpayer address information.

Implementation

Implementing this proposal would not significantly impact the department's programs or operations.

Fiscal Impact

This proposal would not significantly impact the department's costs.

Economic Impact

Revenue Estimate

Estimated Revenue Impact of LP C For Cases Worked With New Addresses On or After January 1, 2014 Assumed Enactment After June 30, 2013			
2012-13	2013-14	2014-15	2015-16
+\$150,000	+\$200,000	+\$150,000	+\$150,000

This estimate does not account for changes in employment, personal income, or gross state product that could result from this proposal.

Revenue Discussion

The estimated revenue impact of this proposal would be dependent on the quality of the address matches received from FIRM and the volume of filing enforcement cases awaiting good addresses.

For purposes of this estimate, personal income tax filing enforcement cases awaiting good addresses (cases) for tax years 2008 through 2010 were matched against the department's accounting system to determine the number of these cases that have an existing collection account (2010 – 6,177 matches; 2009 – 5,340 matches; 2008 – 4,286 matches). Of this total population of matched accounts, it was assumed that the FIRM address matching process would provide current addresses for 25 percent of these matched cases. The result was then multiplied by the average assessment amount for cases awaiting good addresses, \$667.

Finally, the historical rates for collection account abatements and filing enforcement collections were applied to arrive at the estimated additional revenue amounts of \$169,952, \$146,923, and \$117,927 for tax years 2010, 2009, and 2008, respectively.

An estimated growth factor of 8 percent was applied to the 2010 estimated revenue to grow the revenue through fiscal year 2015-2016. Based on historic collection data, approximately 75 percent of the cases from tax years 2010 and 2011 would also be worked using an address identified as a result of the FIRM data match process. Using the results of the foregoing revenue estimates, we fiscalized, accrued back one year, and rounded the final estimate.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS FOR LP C

Amendment 1

Section 19266 of the Revenue and Taxation Code is amended to read:

19266. (a) (1) The Franchise Tax Board, in coordination with financial institutions doing business in this state, shall operate a Financial Institution Record Match System utilizing automated data exchanges to the maximum extent feasible.

(2) The Franchise Tax Board shall prescribe any rules and regulations that may be necessary or appropriate to implement this section. These rules and regulations shall include all of the following:

(A) A structure by which financial institutions, or their designated data-processing agents, shall receive from the Franchise Tax Board the file or files of delinquent debtors that the institution shall match with its own list of accountholders to identify delinquent tax debtor accountholders at the institution.

(B) An option by which financial institutions without the technical ability to process the data exchange, or without the ability to employ a third-party data processor to process the data exchange, may forward to the Franchise Tax Board a list of all accountholders and their social security numbers or other taxpayer identification numbers, so that the Franchise Tax Board shall match that list with the file or files of delinquent tax debtors.

(C) Authority for the Franchise Tax Board to exempt a financial institution from the requirements of this section if the Franchise Tax Board determines that the financial institution participation would not generate sufficient revenue to be cost effective for the Franchise Tax Board.

(D) Authority for the Franchise Tax Board to temporarily suspend the requirements of this section for a financial institution if the financial institution provides the Franchise Tax Board with a written notice from its supervisory banking authority that it is determined to be undercapitalized, significantly undercapitalized, or critically undercapitalized as defined by FDIC Regulation 325.103(b)(3), (4), and (5) or NCUA Regulation 702.102. The notice provided pursuant to this subparagraph shall be subject to the protections of Section 19542.

(b) The Financial Institution Record Match System shall not be subject to any limitation set forth in Chapter 20 (commencing with Section 7460) of Division 7 of Title 1 of the Government Code. However, any use of the information (other than information relating to address) provided pursuant to this section for any purpose other than the collection of amounts identified in paragraphs (1), (2), and (3) shall be a violation of Section 19542.

(1) Delinquent amounts due the board, as imposed under Part 1 (commencing with Section 6001), Part 1.5 (commencing with Section 7200), Part 1.6 (commencing with Section 7251), Part 1.7 (commencing with Section 7280), Part 3 (commencing with Section 8601), Part 3.5 commencing with Section 9401), Part 6 (commencing with Section 11201), Part 13 (commencing with Section 30001), Part 14 (commencing with Section 32001), Part 18.5 (commencing with Section 38101), Part 19 (commencing with Section 40001), Part 20 (commencing with Section 41001), Part 22 (commencing with Section 43001), Part 22.5(commencing with Section 44000), Part 23 (commencing with Section 45001), Part 24 commencing with Section 46001), Part 26

(commencing with Section 50101), Part 30 (commencing with Section 55001), or Part 31 (commencing with Section 60001).

(2) Delinquent amounts due the Employment Development Department, as imposed under the Unemployment Insurance Code, or other debts or penalty assessments referred to the Employment Development Department for collection.

(3) Delinquent franchise or income tax or other debts referred to the Franchise Tax Board for collection, as imposed under Part 5 (commencing with Section 10701), Part 10 (commencing with Section 17001), ~~Part 10.2 (commencing with Section 18401)~~ this part, or Part 11 (commencing with Section 23001).

(c) (1) To effectuate the Financial Institution Record Match System, financial institutions subject to this section shall provide to the Franchise Tax Board on a quarterly basis the name, record address, and other addresses, social security number or other taxpayer identification number, and other identifying information for each delinquent tax debtor, as identified by the Franchise Tax Board by name and social security number or other taxpayer identification number, who maintains an account at the institution.

(2) The first data file created by the Franchise Tax Board for purposes of matching tax debtor records to financial institution accountholder records shall be limited to 600,000 tax debtor records. The number of tax debtor records included in a subsequent data file created by the Franchise Tax Board may be increased by no more than 600,000 tax debtor records greater than the number of tax debtor records included in the immediately preceding data file until all eligible tax debtor records are included in the data match file.

(d) Unless otherwise required by law, a financial institution furnishing a report or providing information to the Franchise Tax Board pursuant to this section shall not disclose to a depositor or an accountholder, or a codepositor or coaccountholder, that the name, address, social security number or other taxpayer identification number, or other identifying information of that delinquent tax debtor has been received from or furnished to the Franchise Tax Board.

(e) A financial institution shall incur no obligation or liability to any person arising from any of the following:

(1) Furnishing information to the Franchise Tax Board as required by this section.

(2) Failing to disclose to a depositor or accountholder that the name, address, social security number or other taxpayer identification number, or other identifying information of that delinquent tax debtor was included in the data exchange with the Franchise Tax Board required by this section.

(3) Any other action taken in good faith to comply with the requirements of this section.

(f) The Franchise Tax Board may institute civil proceedings to enforce this section.

(g) Any financial institution that willfully fails to comply with the rules and regulations promulgated by the Franchise Tax Board for the administration of delinquent tax collections, unless it is shown to the satisfaction of the Franchise Tax Board that the failure is due to reasonable cause, shall be assessed a penalty upon notice and demand of the Franchise Tax Board and collected in the same manner as tax. The penalty imposed under this section shall be in an amount equal to fifty dollars (\$50) for each record not provided, but the total imposed on that financial institution for all such failures during any calendar year shall not exceed one hundred thousand dollars (\$100,000).

(h) For purposes of this section:

(1) "Account" means a demand deposit account, share or share draft account, checking or negotiable withdrawal order account, savings account, time deposit account, or money market mutual fund account, regardless of whether the account bears interest.

(2) "Financial institution" means:

(A) A depository institution, as defined in Section 1813(c) of Title 12 of the United States Code.
(B) An institution-affiliated party, as defined in Section 1813(u) of Title 12 of the United States Code.

(C) A federal credit union or state credit union, as defined in Section 1752 of Title 12 of the United States Code, including an institution-affiliated party of a credit union, as defined in Section 1786(r) of Title 12 of the United States Code.

(D) A benefit association, insurance company, safe deposit company, money-market fund, or similar entity authorized to do business in this state.

(3) "Delinquent tax debtor" means any of the following:

(A) Any person liable for any tax, fee, or surcharge amounts, and any penalty, interest, or other amounts required to be paid to the board, where the liability remains unpaid after 30 days from demand for payment by the board, and the person is not making current timely installment payments on the liability under an installment payment agreement as provided by law.

(B) Any person liable for any amounts required to be paid to the Employment Development Department or for any debts or penalty assessments referred to the Employment Development Department for collection and the person is not making current timely installment payments on the liability under an approved installment payment agreement as provided by law.

(C) Any person liable for any income or franchise tax or other debt referred to the Franchise Tax Board for collection as imposed under Part 5 (commencing with Section 10701), Part 10 (commencing with Section 17001), ~~Part 10.2 (commencing with Section 18401)~~ this part, or Part 11 (commencing with Section 23001), including tax, penalties, interest, and fees, where the tax or debt, including the amount, if any, referred to the Franchise Tax Board for collection remains unpaid after 30 days from demand for payment by the Franchise Tax Board, and the person is not making current timely installment payments on the liability under an agreement pursuant to Section 19008.

(i) A financial institution shall be reimbursed by the Franchise Tax Board for actual costs incurred to implement the provisions of this section. Upon receipt of an invoice from the financial institution, cost reimbursement by the Franchise Tax Board shall be limited to the following:

(1) For one-time startup costs of a financial institution, no more than two thousand five hundred dollars (\$2,500).

(2) For data matching costs of a financial institution, other than one-time startup costs, no more than two hundred fifty dollars (\$250) per calendar quarter.

(j) The first data exchange for purposes of matching tax debtor records to financial institution accountholder records shall occur no earlier than April 1, 2012.

(k) This section shall be operative 120 days after the effective date of ~~the act adding this section~~ Chapter 14 of the Statutes of 2011 and shall apply with respect to persons that are delinquent tax debtors on and after that date.

(1) Notwithstanding any other provision of law, on or after January 1, 2013, and on a quarterly basis thereafter, the board and the Employment Development Department shall, in the format and manner specified by the Franchise Tax Board, provide their respective delinquent tax debtor information to the Franchise Tax Board for inclusion in the Financial Institutions Records Match System.

(2) The Franchise Tax Board shall include the delinquent tax debtor information provided by the board and the Employment Development Department in its data file used to match delinquent tax debtor records to financial institution accountholder records.

(3) The Franchise Tax Board shall provide the board or the Employment Development Department, as applicable, with any matched financial institution accountholder record information resulting from the delinquent tax debtor information provided by the board or the Employment Development Department.

(4) The board and the Employment Development Department shall reimburse the Franchise Tax Board for any costs incurred by the Franchise Tax Board related to the implementation and administration of this section with respect to delinquent tax debtors described in subparagraph (A) or (B), respectively, of paragraph (3) of subdivision (h).

(m) The amendments to this section by the act adding this subdivision shall apply to information provided pursuant to this section before, on, or after the effective date of that act.

LEGISLATIVE PROPOSAL D EXECUTIVE SUMMARY

- **Title:** Tax-Data Sharing Between the Franchise Tax Board (FTB) and Cities--Repeal Sunset
- **Problem:** Current law that allows tax-data sharing between the FTB and cities is scheduled to sunset on December 31, 2013, which jeopardizes an important compliance tool that generates revenue for both the State of California and cities by identifying individuals that fail to report business income or obtain required city business licenses.
- **Proposed Solution/Justification:** Repeal the sunset provision of current law and continue the tax-data-sharing program between the FTB and cities. Repealing the sunset provision would provide stability and reliability to the program, which could encourage additional cities to participate in the program and result in increased revenue for the State of California and cities.
- **Major Concerns/Issues:** None
- **Fiscal Impact:** Implementing this proposal would require the department to continue directing 8.8 personnel years (PYs) to the tax-data-sharing program, for a total of approximately \$718,000 per year.
- **Revenue:**

Estimated Revenue Impact of LP D City Business Tax Information Exchange For Data Exchanges On or After January 1, 2014 Enactment Assumed After June 30, 2013 (\$ in Millions)				
2012-13	2013-14	2014-15	2015-16	2016-17
N/A	N/A	+\$1.2	+\$3.8	+\$5.5

This estimate does not account for changes in employment, personal income, or gross state product that could result from this proposal.

Title

Tax-Data Sharing Between the Franchise Tax Board (FTB) and Cities-Repeal Sunset

Introduction

This proposal would repeal the sunset provision of current law that allows tax-data sharing between the FTB and cities.

Background

The FTB compiles information from many sources including employers, financial institutions, and federal and state entities for purposes of ensuring compliance with the state's income tax laws. When the FTB receives information indicating that a tax return should be filed for a taxable year, but has no record of a return, the FTB may contact the taxpayer to request that the taxpayer file a return or explain why no return is required. When a taxpayer is required to file a return, but fails to do so, the FTB is authorized to assess tax based on reported and estimated income from all available sources.

Currently, the department has entered into reciprocal tax-data-sharing agreements with over 100 California cities. The FTB uses data obtained from cities to ensure compliance with state income tax requirements; cities use data obtained from the FTB to ensure compliance with city business tax requirements. In fiscal year 2011-2012, the tax data received from cities resulted in approximately \$3 million in revenue for the State of California.

Current State Law

Existing state law prohibits the disclosure of taxpayer and return information, except as specifically authorized by statute. Generally, disclosure is authorized to other state tax agencies and federal tax agencies for tax administration purposes only.

Current state law authorizes the FTB to enter into agreements with cities to exchange tax data. The agreements can either require the cities to reimburse the FTB's costs for providing the data, or allow for waiver of the FTB's costs if the cities agree to provide the FTB their tax data without costs to the FTB. If the cities provide tax data to the FTB without agreeing to receive tax data from the FTB free of charge, the FTB is required to reimburse the cities' costs associated with providing the tax data to the FTB at a maximum rate of \$1 per usable record. Employees of the cities may only use the tax data received from the FTB for city business tax administration purposes—any other use or disclosure of the information is a misdemeanor.¹ The FTB may only provide a city with tax data for taxpayers with an address within that city's jurisdiction and is limited to the following data:

- Taxpayer name,
- Taxpayer address,
- Taxpayer social security number or taxpayer identification number, and
- Principal business activity code.

¹ Revenue and Taxation Code sections 19542 and 19552.

In addition, tax officials of a city may request from the FTB any other taxpayer information but must do so by affidavit. At the time the tax official requests the tax information, he or she must provide a copy of the affidavit to the taxpayer whose information is sought, and upon request, make the obtained information available to that person.

The information the FTB can request from cities is limited to the following:

- The name of the business if it is a corporation, partnership, or limited liability company, or the owner's name if it is a sole proprietorship,
- Business mailing address,
- Federal employer identification number, if applicable, or the business owner's social security number,
- Standard Industry Classification (commonly referred to as "SIC") Code or North American Industry Classification System (commonly referred to as "NAICS") Code,
- Business start date,
- Business cease date,
- City number, and
- Ownership type.

Current state law provides a sunset date of December 31, 2013, for the above-described tax-data sharing between the FTB and cities.

Problem

Current law that allows tax-data sharing between the FTB and cities is scheduled to sunset on December 31, 2013, which jeopardizes an important compliance tool that generates revenue for both the State of California and cities by identifying individuals that fail to report business income or obtain required city business licenses.

Proposed Solution

Repeal the sunset provision of current law and continue the tax-data-sharing program between the FTB and cities.

Effective/Operative Date of Solution

This proposal would be effective on January 1, 2014 and operative as of that date.

Justification

Repealing the sunset provision of current law that allows tax-data sharing between the FTB and cities would allow the tax-data-sharing program to continue and provide stability and reliability to the program, which could encourage additional cities to participate in the program and result in increased revenue for the State of California.

Out of the 478 incorporated cities in California, the FTB has a reciprocal agreement with 102 cities. The program continues to provide revenue for participating cities during a time of financial crisis for most local governments.

Respondents to a survey of participating cities reported significant revenue in 2011-12 fiscal year:

Reporting City	Revenue Generated FY 2011-12
Los Angeles	\$13.9 million
San Diego	\$1.1 million
Newport Beach	\$360,500
Oakland	\$260,000
Menlo Park	\$172,000
Concord	\$154,000
Sunnyvale	\$131,000

Implementation

Implementing this proposal would require the department to continue administering the tax-data-sharing program.

Fiscal Impact

Implementing this proposal would require the department to continue directing 8.8 PYs to the tax-data-sharing program, for a total cost of approximately \$718,000 per year.

Economic Impact

Revenue Estimate

Estimated Revenue Impact of LP D City Business Tax Information Exchange For Data Exchanges On or After January 1, 2014 Enactment Assumed After June 30, 2013 (\$ in Millions)				
2012-13	2013-14	2014-15	2015-16	2016-17
N/A	N/A	+\$1.2	+\$3.8	+\$5.5

This estimate does not account for changes in employment, personal income, or gross state product that could result from this proposal.

Revenue Discussion

The estimated revenue impact of this proposal assumes that the FTB will continue this program only if the sunset on reciprocal agreements is extended. The estimate represents total future collections from the city business tax (CBT) program as it currently operates.

The table above projects the fiscal-year cash flow of the collections revenue resulting from non-filer contacts associated with tax years 2013 through 2015. Revenues from the CBT program are estimated to be approximately \$6 million, \$6.5 million and \$6.6 million for the three years, respectively.

The estimate has two main elements: revenues from cities that participated in tax year 2010 and revenues from cities that join the program after 2010. For 2010, the program expects to collect a total of \$3.5 million from the information provided by the 102 cities that participated in the program. The estimate grows this amount by anticipated increases in personal income and the number of filers through 2016.

The estimate also reflects expected revenues as new cities join and leave the program. In 2011 and 2012, a net total of 5 cities left the program. The program expects to add 30 cities in 2013 and 15 cities each year thereafter through 2016. Although it is expected some cities will drop out due to lack of resources, the program plans to maintain current workload volumes.

The timing of the cash flow from these revenues is determined using the pattern of the FTB's non-filer collections. Historically, a city's submission for one tax year will result in non-filer collections that will be received over a 10-year cycle. Collections are small in Year 1, and almost 85 percent are collected by the end of Year 4. The tax year 2013 data would be submitted by the cities to the FTB in calendar year 2014, and the FTB would receive the resulting collections revenue in the second half of calendar year 2015, or fiscal year 2015-16. Since the revenue relates to a prior tax year, it is accrued back one year. The table above shows the first revenue in fiscal year 2014-15.

The FTB receives business entity (BE) information from the cities; the CBT program currently works only personal income tax cases. The FTB recently began studying the feasibility of expanding the CBT program to include BEs. BE revenues are not included in the table above as it is unknown if the FTB will pursue adding BEs to the CBT workload.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS FOR LP D

AMENDMENT 1

Section 19551 of the Revenue and Tax Code, as amended by section 1 of Chapter 345 of the Statutes of 2008, is amended to read:

19551. (a) The Franchise Tax Board may permit the Commissioner of Internal Revenue of the United States, other tax officials of this state, the Multistate Tax Commission, the proper officer of any state imposing an income tax or a tax measured by income or the authorized representative of that officer, or the tax officials of Mexico, if a reciprocal agreement exists, to inspect the income tax returns of any taxpayer, or may furnish to the commission, or the officer or the authorized representative thereof an abstract of the return or supply thereto information concerning any item of income contained in any return or disclosed by the report of any investigation of the income or return. The information shall be furnished to the Multistate Tax Commission, the federal or state officer or his or her representative, or the officials of Mexico for tax purposes only. Except when furnished pursuant to a written agreement, information furnished pursuant to this section shall be furnished only if the request is in the form of an affidavit under penalty of perjury stating that the purpose for the request relates to an investigation of the tax specified in the request and that the information will be used in the ordinary performance of the applicant's official duties.

(b) Notwithstanding subdivision (a) and except as otherwise provided in Section 19551.1, tax officials of political subdivisions of this state shall request information from the Franchise Tax Board by affidavit only. At the time a tax official makes the request, he or she shall provide the affected person with a copy of the affidavit and, upon request, make the information obtained available to that person.

(c) For purposes of this section, "reciprocal agreement" means a formal agreement to exchange information between national taxing officials of Mexico and taxing authorities of the State Board of Equalization, the Franchise Tax Board, and the Employment Development Department. Furthermore, the reciprocal agreement shall be limited to the exchange of information that is essential for tax administration purposes only. Taxing authorities of the State of California shall be granted tax information only on California residents. Taxing authorities of Mexico shall be granted tax information only on Mexican nationals.

~~(d) This section shall remain in effect through and including December 31, 2013, and shall be repealed on January 1, 2014.~~

AMENDMENT 2

Section 19551 of the Revenue and Taxation Code, as added by section 2 of Chapter 345 of the Statutes of 2008, is repealed.

~~19551. (a) The Franchise Tax Board may permit the Commissioner of Internal Revenue of the United States, other tax officials of this state, the Multistate Tax Commission, the proper officer of any state imposing an income tax or a tax measured by income or the authorized representative of that officer, or the tax officials of Mexico, if a reciprocal agreement exists, to inspect the income tax returns of any taxpayer, or may furnish to the commission, or the officer or the authorized representative thereof an abstract of the return or supply thereto information concerning any item of income contained in any return or disclosed by the report of any investigation of the income or return. The information shall be furnished to the Multistate Tax Commission, the federal or state officer or his or her representative, or the officials of Mexico for tax purposes only. Except when furnished pursuant to a written agreement, information furnished pursuant to this section shall be furnished only if the request is in the form of an affidavit under penalty of perjury stating that the purpose for the request relates to an investigation of the tax specified in the request and that the information will be used in the ordinary performance of the applicant's official duties.~~

~~(b) Notwithstanding subdivision (a), tax officials of political subdivisions of this state shall request information from the Franchise Tax Board by affidavit only. At the time a tax official makes the request, he or she shall provide the affected person with a copy of the affidavit and, upon request, make the information obtained available to that person.~~

~~(c) For purposes of this section, "reciprocal agreement" means a formal agreement to exchange information between national taxing officials of Mexico and taxing authorities of the State Board of Equalization, the Franchise Tax Board, and the Employment Development Department. Furthermore, the reciprocal agreement shall be limited to the exchange of information that is essential for tax administration purposes only. Taxing authorities of the State of California shall be granted tax information only on California residents. Taxing authorities of Mexico shall be granted tax information only on Mexican nationals.~~

~~(d) This section shall become operative on January 1, 2014.~~

AMENDMENT 3

Section 19551.1 of the Revenue and Taxation Code is amended to read:

19551.1. (a) (1) The Franchise Tax Board may permit the tax officials of any city to enter into a reciprocal agreement with the Franchise Tax Board to obtain tax information from the Franchise Tax Board, as specified in subdivision (b).

(2) For purposes of this section, "reciprocal agreement" means a formal agreement to exchange information for tax administration purposes between tax officials of a city and the Franchise Tax Board.

(b) The information furnished to tax officials of a city under this section shall be limited as follows:

(1) The tax officials of a city are authorized to receive information only with respect to taxpayers with an address as reflected on the Franchise Tax Board's records within the jurisdictional boundaries of the city who report income from a trade or business to the Franchise Tax Board.

(2) The tax information that may be provided by the Franchise Tax Board to the tax officials of a city is limited to a taxpayer's name, address, social security or taxpayer identification number, and business activity code.

(3) Tax information provided to the tax officials of a city may not be furnished to, or used by, any person other than those tax officials or an employee or agent of those tax officials.

(4) The information provided to the tax officials of the city or the employees or agents of those tax officials by the Franchise Tax Board under this section is subject to Section 19542, and may not be used for any purpose other than the city's tax enforcement, or as otherwise authorized by state or federal law.

(5) Section 19542.1 applies to this section.

(c) The Franchise Tax Board may not provide any information pursuant to this section until all of the following have occurred:

(1) An agreement has been executed between a city and the Franchise Tax Board, that provides that an amount equal to all first year costs necessary to furnish the tax officials of the city information pursuant to this section shall be received by the Franchise Tax Board before the Franchise Tax Board incurs any costs associated with the activity permitted by this section. For purposes of this section, first year costs include costs associated with, but not limited to, the purchasing of equipment, the development of processes, and labor.

(2) An agreement has been executed between a city and the Franchise Tax Board, that provides that the annual costs incurred by the Franchise Tax Board, as a result of the activity permitted by this section, shall be reimbursed by the city to the Franchise Tax Board.

(3) Pursuant to the agreement described in paragraph (1), the Franchise Tax Board has received an amount equal to the first year costs.

(d) Any information, other than the type of tax information specified in subdivision (b), may be requested by the tax officials of a city from the Franchise Tax Board by affidavit. At the time a tax official makes the request, he or she shall provide the person whose information is the subject of the request, with a copy of the affidavit and, upon request, make the information obtained available to that person.

(e) This section does not invalidate any other law. This section does not preclude any city or county from obtaining information about individual taxpayers, including those taxpayers not subject to this section, by any other means permitted by state or federal law.

(f) Nothing in this section shall be construed to affect any obligations, rights, or remedies regarding personal information provided under state or federal law.

(g) Notwithstanding subdivision (c), the Franchise Tax Board shall waive a city's reimbursement of the Franchise Tax Board's cost if a city enters into a reciprocal agreement as defined in paragraph (2) of subdivision (a). The reciprocal agreement shall specify that each party shall bear its own costs to furnish the data involved in the exchange authorized by this section and Section 19551.5, and a city shall be precluded from obtaining reimbursement as specified under Section 5 of the act adding this subdivision.

~~(h) This section shall remain in effect through and including December 31, 2013, and shall be repealed on January 1, 2014.~~

AMENDMENT 4

Section 19551.5 of the Revenue and Taxation Code is amended to read:

19551.5. (a) Notwithstanding any other law, each city that assesses a city business tax or requires a city business license shall, upon the request of the Franchise Tax Board, annually submit to the Franchise Tax Board the information that is collected in the course of administration of the city's business tax program, as described in subdivision (b).

(b) Information, collected in the course of administration of the city's business tax program, shall be limited to the following:

- (1) Name of the business, if the business is a corporation, partnership, or limited liability company, or the owner's name if the business is a sole proprietorship.
- (2) Business mailing address.
- (3) Federal employer identification number, if applicable, or the business owner's social security number.
- (4) Standard Industrial Classification (SIC) Code or North American Industry Classification System (NAICS) Code.
- (5) Business start date.
- (6) Business cease date.
- (7) City number.
- (8) Ownership type.

(c) The reports required under this section shall be filed on magnetic media such as tapes or compact discs, through a secure electronic process, or in other machine-readable form, according to standards prescribed by regulations promulgated by the Franchise Tax Board.

(d) Cities that receive a request from the Franchise Tax Board shall begin providing to the Franchise Tax Board the information required by this section as soon as economically feasible, but no later than December 31, 2009. The information shall be furnished annually at a time and in the form that the Franchise Tax Board may prescribe by regulation.

(e) The city data provided to the Franchise Tax Board under this section is subject to Section 19542, and may not be used for any purpose other than state tax enforcement or as otherwise authorized by law.

(f) If a city enters into a reciprocal agreement with the Franchise Tax Board pursuant to subdivision (a) of Section 19551.1, the city shall also waive reimbursement for costs incurred to provide information required under this section and shall be precluded from obtaining reimbursement as specified under Section 5 of Chapter 345 of the Statutes of 2008. The reciprocal agreement shall specify that each party shall bear its own costs to furnish the data involved in the exchange authorized by Section 19551.1 and this section, and the Franchise Tax Board shall be precluded from obtaining reimbursement as specified under subdivision (c) of Section 19551.1.

(g) A city shall not be required to provide information to the Franchise Tax Board pursuant to this section if the Franchise Tax Board fails to provide tax information to the city pursuant to a reciprocal agreement entered into pursuant to subdivision (a) of Section 19551.1 for reasons other than concerns related to confidentiality of tax information provided to the city.

~~(h) This section shall remain in effect through and including December 31, 2013, and shall be repealed on January 1, 2014.~~

LEGISLATIVE PROPOSAL E

EXECUTIVE SUMMARY

- **Title:** Electronic Communications
- **Problem:** Current law is silent on whether communications and correspondence, with no signature requirement, that are received by the Franchise Tax Board (FTB) either on paper or electronically from taxpayers and stored electronically, are deemed as valid original documents. The lack of specificity may lead to possible confusion for the department and taxpayers that could lead to legal disputes.
- **Proposed Solution/Justification:** Specify in state law that any communication or correspondence received by the FTB in any format from a taxpayer or on behalf of a taxpayer, whether signed or not, would be deemed a valid original document. In addition, expand definitions in existing law to encompass current and future technologies. With the continued evolution of the FTB from paper to electronic technologies, this proposal would bring certainty that electronic communications and correspondence would be deemed as valid original documents. Clarifying the statute to deem all captured communications in any format whether signed or not as valid original documents upon reproduction would mirror the federal statute. As a result, the department would prevent evidentiary confusion and possible litigation. In addition, this proposal would broaden the definition of electronic technology to encompass current and future technologies, which would remove the need for future legislation as technologies advance.
- **Major Concerns/Issues:** None
- **Fiscal Impact:** Clarifying the statute to deem all communications between the department and the taxpayer as valid in a court of law when captured electronically and reproduced would not impact the department's costs.
- **Revenue:** This proposal would not impact the state's income tax revenue.

Title

Electronic Communications

Introduction

This proposal would provide certainty that electronically captured communications between the department and taxpayers would be deemed valid original documents.

Program History/Background

In 1950, the Legislature put in place the current FTB, and from the time of the FTB's establishment to present day, taxpayers are sent paper notices and bills through the U.S. mail and are able to respond in the same manner.

Legislation enacted in 1992 allows the FTB to deem electronically-filed returns, captured returns (returns filed by paper then "captured" using electronic imaging technology), and signed declarations, statements or other documents that are paper filed and then electronically captured, as valid original documents upon reproduction to paper. The first electronically-filed returns were tax-year 1993 returns that were processed in 1994. Shortly thereafter in 1994, due to further technological innovations, legislation was enacted to broaden the definition of "Electronic Technology."

Current technology has evolved significantly since 1994, which was the last time the electronic filing statute was updated. The current statute lacks clarity regarding unsigned correspondence and correspondence that is captured using anything other than electronic imaging technology.

Current Federal Law

Under existing federal law, the Internal Revenue Service allows taxpayers to submit returns electronically. Additionally, federal law further permits any business, institution, member of a profession or calling, or any department or agency of government to record and reproduce original documents in the regular course of business. These reproductions are admissible as evidence in any judicial or administrative proceeding whether the original documents are in existence or not.

Current State Law

Current state law authorizes electronic receipt and storage of any income tax return, declaration, statement, or other document required to be signed by a taxpayer. The law provides that if such documents are filed by the taxpayer using electronic imaging technology, or filed in a traditional medium and captured using electronic imaging technology, they are deemed to be signed valid original documents.

Problem

Current law is silent on whether communications and correspondence, with no signature requirement, that are received by the FTB either on paper or electronically from taxpayers and stored electronically, are deemed as valid original documents. The lack of specificity may lead to possible confusion for the department and taxpayers that could lead to legal disputes.

Proposed Solution

Specify in state law that any communication or correspondence received by the FTB in any format from a taxpayer or on behalf of a taxpayer, whether signed or not, would be deemed a valid original document. In addition, expand definitions in existing law to encompass current and future technologies.

Effective/Operative Date of Solution

If enacted in the 2013 legislative session, the provisions of this proposal would be effective and operative beginning January 1, 2014.

Justification

With the continued evolution of the FTB from paper to electronic technologies, this proposal would bring certainty that electronic communications and correspondence would be deemed as valid original documents. Clarifying the statute to deem all captured communications in any format whether signed or not as valid original documents upon reproduction would mirror the federal statute. As a result, the department would prevent evidentiary confusion and possible litigation. In addition, this proposal would broaden the definition of electronic technology to encompass current and future technologies, which would remove the need for future legislation as technologies advance.

Implementation

Implementing this proposal would not impact the department's programs and operations as the proposal would only expand the current statute to deem all captured communications in any format whether signed or not between taxpayers and the department as valid original documents.

Fiscal Impact

Clarifying the statute to deem all communications between the department and the taxpayer as valid in a court of law when captured electronically and reproduced would not impact the department's costs.

Economic Impact

This proposal would not impact the state's income tax revenue.

Pro & Con Arguments

Pro: Allowing all communications to be deemed valid original documents when captured electronically would prevent confusion and possible legal disputes.

Con: This proposal is unnecessary because the FTB has other means such as the California Evidence Code and federal law that could be used to prove validity of a document if a legal dispute were to occur.

Other States

A review of laws from *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* revealed that while each of these states have electronic filing available for taxpayers, only the state of *Massachusetts* also permits the filing of any document by electronic data submission and *New York* stipulates specific criteria on how to reproduce tax forms to the taxpayer. Furthermore, these states are silent on whether captured or reproduced documents between taxpayers and agency are considered valid original documents. These states were chosen due to the similarity to California's tax laws and economy.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS FOR LP E

AMENDMENT 1

Section 18621.5 of the Revenue and Taxation Code is amended to read:

18621.5. (a) Any return, declaration, statement, or other document required to be made under this part and any communication or correspondence received from a taxpayer or on behalf of a taxpayer that is filed by or received using electronic technology shall be in a form as the Franchise Tax Board may prescribe and is not complete, and therefore not filed, unless an electronic filing declaration is signed by the taxpayer, in accordance with Section 18621 in the case of individuals, subdivision (a) of Section 18505 in the case of estates or trusts, corporations, or limited liability companies classified as corporations for California income tax purposes, subdivision (a) of Section 18633 in the case of a partnership, or Section 18633.5 in the case of limited liability companies classified as partnerships for California income tax purposes. The Franchise Tax Board may prescribe forms and instructions for requiring the electronic filing declaration to be retained by the preparer or taxpayer and may require the declaration to be furnished to the Franchise Tax Board upon request.

(b) Notwithstanding any other provision of law, any return, declaration, statement, or other document and any communication or correspondence received from or on behalf of a taxpayer whether otherwise—required to be signed or not, that is filed or received in a traditional medium and captured using electronic ~~imaging~~ technology, shall be deemed to be a valid original document including upon reproduction to paper form by the Franchise Tax Board.

(c) Notwithstanding any other law, any return, declaration, statement, or other document and any communication or correspondence received from a taxpayer or on behalf of a taxpayer whether otherwise—required to be signed or not, that is filed or received by ~~the taxpayer~~ using electronic technology in a form as required by the Franchise Tax Board shall be deemed to be a signed, valid original document, including upon reproduction to paper form by the Franchise Tax Board.

~~(d) "Electronic imaging technology" means a system of microphotography, optical disk, or reproduction by other technique that does not permit additions, deletions, or changes to the original document. The system may include, but is not limited to, any magnetic media or other machine readable form.~~

~~(e)~~(d) "Traditional medium" means any return, declaration, statement, or other document ~~required to be made pursuant to this article~~ other than those made using electronic ~~imaging~~ technology.

~~(f)~~(e) "Electronic technology" includes, but is not limited to, computer modem, magnetic media, optical disk, facsimile machine, ~~or telephone,~~ portable document format, internet, cloud computing, or an electronic information delivery system.