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## MEMORANDUM

To: Jon David Vaschè  
Director, Economics, Taxation, and Fiscal Forecasting  
Legislative Analyst's Office  
March 25, 2003

From: Gerald H. Goldberg

Subject: Response to Recommendations in Analysis of the 2003-04 Budget Bill

My staff and I have reviewed your recommendations regarding the Franchise Tax Board (FTB) budget as presented in the Legislative Analyst's Office (LAO) Analysis of the 2003-04 Budget Bill. We are providing the following comments and information in response to the LAO analysis and recommendations.

### 1. Increase Tax Practitioner E-Filing

*"We recommend that the budget proposal requiring E-filing for all tax practitioners filing 100 or more returns be expanded to require E-filing for all those filing 50 or more returns. (Reduce Item 1730-001-0001 by \$140,000.) We also recommend that the Franchise Tax Board (FTB) charge tax practitioners for the use of the hotline maintained and staffed by FTB at the expense of taxpayers in general. (Reduce Item 1730-001-0001 by \$1 million.)"*

#### Expanding E-File Proposal.

As stated in the LAO's analysis, if the Administration's mandatory e-file proposal were expanded to include all tax practitioners who file 50 or more returns, the potential additional savings would be \$140,000 and 5.5 PYs. This estimate of savings is based on the assumption that the mandatory e-file requirement would apply to **all** such practitioners.

Under the Administration's proposed legislation, tax preparers who are currently using tax preparation software would be required to E-file, but preparers who currently prepare the returns by hand would be exempted. This approach follows the intent of the proposal, which is to move preparers who were already using software but not e-filing, to follow through by submitting the returns electronically rather than printing and filing paper returns. However, an exemption is included to avoid imposing a burden on practitioners who currently do not use software. This typically includes smaller scale proprietorships, many of whom fall below the 100 tax return threshold.

If the mandatory e-file proposal were adopted with the exemption for manually prepared returns, the savings in processing costs would be less than the estimated

\$140,000 indicated above. This estimate was based on a volume of 431,000 returns and includes all practitioners who file 50 to 100 returns. If the estimate had been based on those practitioners who currently use the software, it would have been 289,000 instead of the 431,000, which reduces the estimated savings to \$94,000. In addition to the lower savings, FTB would incur more costs to communicate with practitioners who “opt out” of the mandate by showing or proving they are not using software or are subject to the non-compliance penalty. The costs to administer this process of verifying their non-use of software and exempting from the mandate is difficult to quantify and was not included as in the previous estimate of \$140,000 in savings. Therefore, the savings cannot be fully achieved and could be offset completely.

*LAO Recommendation to Charge Tax Practitioners for Special Services.*

The Analysis recommends that the department charge a fee for special services provided to tax practitioners. Among these services, one of the most important is the Tax Practitioner Hotline. This service, which FTB has provided since the late 1980s, provides assistance to practitioners on complex tax law questions, procedural matters, and resolution of taxpayer account problems. This program was established in response to concerns raised by practitioners that it was too hard to get their questions answered timely, due to inadequate staffing levels in the call center, and often the answers were inaccurate or incomplete.

Currently, the practitioner contacting the Hotline is paying for the call since it is not a toll-free number. The cost to the department for staff and operating expenses (approximately \$1 million and 12 PY's) has been covered within our baseline budget. We believe that there is a strong business case for the program, given that professional tax preparers represent over 60% of California taxpayers. FTB has continued to provide the service to tax professionals as a way to encourage them to contact us as early as possible to resolve problems with their clients' accounts. This helps ensure that returns are filed timely and accurately, and reduces our costs for correcting returns as well as collecting unpaid taxes. The program itself has consistently been rated as “excellent” in customer surveys that we have conducted in the practitioner community.

Although we agree that answering phone calls to the hotline could be considered the “cost of doing business,” the potential impacts of charging tax practitioners for the calls would result in increased contacts to other areas in the department. If practitioners call the toll-free 800 number, the additional demand will lower our level of service and many more regular taxpayers will not be serviced through our call center. The inability to contact our Customer Service Specialists in the Call Center may result in additional fallout and errors on returns that are filed. Similarly, if the Hotline program is reduced, the practitioner may not have access to the higher level of staff and expertise to respond to the more complex questions.

Despite our desire to continue the present program, we understand the state's current fiscal crisis may compel the department to begin charging for the Tax Practitioner Hotline service. As stated in your analysis, certain options such as a charge per call would require the department to establish a new telephone

infrastructure. Nonetheless, we will continue to gather the information regarding other options, such as an annual fee for tax practitioners, and report our findings at the budget hearings.

## **2. Nonfiler Program Threshold Should Be Lowered –**

*“We recommend that the Legislature augment the budget in order to expand the integrated nonfiler compliance (INC) program, which would lead to increased revenues of \$4.4 million. (Augment Item 1730-001-0001 by \$800,000 for 14 positions and recognize an additional \$4.4 million in revenues.)”*

The Personal Income Tax Integrated Nonfiler Compliance (INC) Program identifies and gains compliance from individuals that are not filing returns by using a variety of automated and manual processes. The INC Program contacts 650,000 potential nonfilers a year and generates approximately \$300 million in cash revenue per year. These figures represent the total filing enforcement program contacts and revenue, which includes additional revenue collected as a result of the INC project. The current minimum threshold for contacting a potential Nonfiler is \$200 in tax.

As stated in the recommendation, lowering this threshold to \$100 would result in an additional \$4.4 million in revenues. This change would result in a potential 120,000 new nonfiler cases which would be identified through the non-filer program. The additional funding and PY's are necessary to process the additional case workload created by the lower threshold.

## **3. FTB Should Revisit the Treasury Offset Program (TOP)**

*“We recommend that the Franchise Tax Board report at budget hearings regarding the feasibility and cost-effectiveness of participating in the existing Treasury Offset Program in order to reduce tax collection costs and increase revenues to the General Fund.”*

While the FTB understands the potential benefits of using the Treasury Offset Program (TOP) as an alternate means of collection, we believe that current circumstances do not warrant participation in the program at this time.

The LAO report makes reference to a 1998 FTB study that considered California's participation in the TOP program. The study determined that TOP would not be a more effective method of collection, based on the program's costs and limitations. Recently, we contacted every state participating in TOP to interview them about their experience with the program and gain insight that might lead us to consider the program at FTB. These contacts, however, indicated that the TOP still may not be viable for California. Moreover, since 1998, when the TOP was studied, the department has continued to improve its existing collection systems and processes. Currently, our collections program handles over 1.2 million accounts

and generates \$1.6 billion in revenue, with an overall cost-benefit ratio of approximately 20:1.

While other states may have reduced costs or increased collections by participating in TOP, the same would not be true for California. The department's collection processes are highly automated and more administrative authority is granted to FTB to conduct collections compared to other states. As a result, California has the ability to collect tax debts much more efficiently using our current systems. The major advantages of the current process follows:

- The department's Accounts Receivable Collection System (ARCS), implemented in FY 2000/01 provides FTB with collection processes that are less intrusive and less expensive than what would be available under the Treasury Offset Program. The other states participating in TOP do not have a collection system that compares to the sophistication and automation of ARCS.
- Other states lack the administrative authority to collect on tax debts and must obtain judgments through their court systems. California has a broad administrative authority that allows FTB to issue levies and liens in a very effective and efficient manner.

In response to the LAO recommendation, as part of our ongoing review and continuous improvement of the Collections program, we continue to evaluate TOP and its possible benefits for FTB. We also monitor changes to the requirements of TOP that might make that program more cost effective than our current collection processes in certain circumstances. Some of the program's requirements that make California's participation difficult include the offset fee that would be absorbed by California and/or its taxpayers, the required use of certified letters of intent, and the restriction against submitting accounts with out of state addresses. If the more restrictive and cost prohibitive requirements of TOP were alleviated, this program could provide value as a collection tool for FTB.

#### **4. Consolidation of District Office Activities for Board of Equalization and FTB and Increase Agencies' Reliance on Call Centers to Provide Public Services.**

The LAO Report, 2003-04 Budget: Perspective and Issues, includes an option to reduce state spending by consolidating BOE and FTB district office activities and relying more on call centers to provide public services. We understand that the proposal would close eleven FTB public counters throughout California, generating savings of \$425,000 and 9 PY's, which represents approximately 25 percent of the total cost associated with the counter service at the 16 district offices (\$1.7 million). If implemented, it will significantly change the way FTB interacts with the public. And, as such, we believe this is a policy matter for the Legislature and Administration involving the appropriate level and type of customer service for taxpayers.

Given the proposed funding reduction, we estimate that approximately 150,000 contacts would not be serviced through our district offices. Generally, these would be contacts where the taxpayer is requesting general assistance and other services related to collection activities. Certain steps could be taken by the department to minimize the impact on taxpayers currently utilizing field office services. We would attempt to provide taxpayers with an alternative to personal contact at each location where a counter is closed. This may include direct-dial telephones to call centers, racks for commonly used forms and receptacles for tax returns or payments. Furthermore, it may become necessary to redirect the remaining resources among the five remaining public counters based on demand, or possibly shift some resources to the statewide call center which would allow us to answer additional calls.

I am hopeful that this information addresses your issues and provides you with additional justification for FTB's budget requests. If you have any questions, please feel free to contact Titus S. Toyama, FTB Chief Financial Officer, at 845-4106.

Executive Officer

cc: Hon. Rudy Bermudez, Chair, Assembly Budget Subcommittee #4  
Hon. Joseph Dunn, Chair, Senate Budget Subcommittee #4  
Ms. Elizabeth Hill, Legislative Analyst  
Aileen Adams, Secretary, State and Consumer Services Agency  
Connie Squires, Program Budget Manager, Department of Finance  
Dan Rabovsky, Consultant, Assembly Budget Subcommittee #4  
Paul Deiro, Consultant, Assembly Budget Subcommittee #4  
Judi Smith, Consultant, Senate Budget and Fiscal Review Subcommittee #4  
Tom Sheehy, Consultant, Senate Budget Subcommittee #4  
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STEVE WESTLY  
Chair  
CAROLE MIGDEN  
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STEVE PEACE  
Member

## MEMORANDUM

To: Hon. Steve Westly, Chair  
Hon. Carole Migden, Member  
Hon. Steve Peace, Member

April 4, 2003

From: Titus S. Toyama

Subject: Response to Legislative Analyst's Budget Recommendations for Franchise Tax Board

We are providing you with a copy of the staff's written response to the Legislative Analyst's (LAO) Recommendations for the Franchise Tax Board, which appeared in the LAO's Analysis of the 2003-04 Budget Bill. The LAO's specific issues and recommendations include:

**Mandatory E-Filing:** LAO recommends expanding the Administration's proposed mandatory e-file proposal to require practitioners filing 50 or more returns (rather than 100) to submit returns electronically, resulting in savings of \$140,000.

**Non-File Program:** LAO recommends reducing minimum dollar amount for tax non-filer cases from \$200 to \$100, resulting in additional revenue of \$4 million.

**Federal Treasury Offset Program:** The LAO recommends that we report on the feasibility and cost-effectiveness of participating in the federal Treasury Offset Program (TOP) to reduce tax collection costs and increase revenue.

**Tax Practitioners Hotline Service:** LAO recommends that the FTB charge fees for special services provided to tax practitioners, including the existing telephone "hotline".

**District Offices Counter Assistance:** LAO recommends that consolidate FTB district office activities, and rely more on call centers to provide public services, for a savings of 425,000 and 9 PYs.

The attached memorandum provides the LAO with information and comments in response to each of their recommendations. If you have any questions, please feel free to give me a call.

Chief Financial Officer

cc: Gerald Goldberg