

FINDING OF EMERGENCY

Subject: Procedures and Standards on Requests for Release

The Franchise Tax Board (FTB) finds a statutory deemed emergency exists and that the proposed emergency regulations are necessary for the immediate preservation of the public peace, health, and safety, or general welfare of the citizens of California.

Statement of Emergency

The proposed regulations are a deemed emergency pursuant to California Business and Professions Code (BPC) Section 494.5(o). Specifically, BPC Section 494.5(o) provides:

Any rules and regulations issued pursuant to this section by any state agency, board, or department may be adopted as emergency regulations in accordance with the rulemaking provisions of the Administrative Procedure Act (Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code). The adoption of these regulations shall be deemed an emergency and necessary for the immediate preservation of the public peace, health, and safety, or general welfare. The regulations shall become effective immediately upon filing with the Secretary of State.

Under BPC Section 494.5(p), FTB shall adopt regulations as necessary to implement BPC 494.5.

Technical, Theoretical, and Empirical Study, Report, or Similar Document, if any, Upon Which the Franchise Tax Board Relied

None.

Authority and Reference

Authority: Business and Professions Code Section 494.5(p) and (o) and Revenue and Taxation Code Section 19503.

Reference: Business and Professions Code Section 494.5, Revenue and Taxation Code Section 19195, and Government Code Sections 11435.20 and 11435.25.

Informative Digest / Policy Statement Overview

FTB is responsible for administering two of California's major tax programs: Personal Income Tax and Corporation Tax. Although the vast majority of taxpayers voluntarily comply with their tax obligation, some do not file, file incorrectly, or fail to pay their taxes as the law requires. For taxpayers in any of these groups, FTB has the responsibility to enforce the law through a variety of measures with fairness and flexibility to help these taxpayers return to compliance as soon as possible. Two enforcement mechanisms authorized by the

Legislature are provided by California Revenue and Taxation Code (RTC) Section 19195 and BPC Section 494.5.

Under RTC Section 19195(a), FTB is required to publish a list of its top 500 tax delinquencies in excess of \$100,000 (Top 500 List) at least twice each year. Before including a taxpayer's name on the Top 500 List, FTB must inform the taxpayer that the taxpayer's name will be included on the list unless the taxpayer pays the amount due or makes arrangements with FTB for payment of the amount due. (RTC Section 19195(d).)

Under BPC Section 494.5(c), FTB forwards a list of the taxpayers on the Top 500 List to the following California state governmental licensing entities (Licensing Entities):

- Department of Alcoholic Beverage Control
- State Bar of California
- California Highway Patrol
- Department of Business Oversight
- Commission on Teacher Credentialing
- Department of Consumer Affairs
- Department of General Services - Office of the State Architect
- Department of Motor Vehicles
- Department of Real Estate
- Department of Insurance
- Office of Real Estate Appraisers
- Horse Racing Board
- Housing and Community Development
- Toxic Substances Control

The Licensing Entities must (or may in the case of the Department of Alcoholic Beverage Control and the State Bar of California) send a preliminary notice (Preliminary Notice) to an applicant for a license or a licensee (hereinafter, Taxpayer) appearing on the list received from FTB, of the Licensing Entities' intent to suspend or withhold issuance or renewal of the Taxpayer's license unless the Licensing Entity receives a release from FTB. (BPC Section 494.5(e)(2) and (f)(1).) If FTB provides a release, the Taxpayer's license will not be suspended or a license will be issued or renewed upon payment of any required fees.

The Taxpayer has the right to request a release from FTB, and FTB is required to immediately send a release to the appropriate Licensing Entity and the Taxpayer, if the Taxpayer (1) pays the unpaid taxes, (2) enters into an installment payment arrangement with FTB under RTC Section 19008 to satisfy the unpaid taxes, (3) submits a request for release within 45 days after receipt of the Preliminary Notice, but FTB is unable to make a determination related to whether to issue a release within 45 days of its receipt of the request for release through no fault of the Taxpayer, or (4) has a current financial hardship. (BPC Section 494.5(h).) Under the statute, "financial hardship" means financial hardship as determined by FTB, where the Taxpayer is unable to pay any part of the outstanding tax liability and the Taxpayer is unable to qualify for an installment payment arrangement as provided by RTC Section 19008. (BPC Section 494.5(h)(3).)

Several taxpayers have recently challenged FTB's procedures for determining whether a release must be provided. (See *Franceschi v. Chiang*, Case No. 14-01960 (C.D. Cal.); *Berjikian v. Franchise Tax Board*, B252427 (Cal. Ct. App.); and *Berjikian v. Franchise Tax Board*, Case No. 13-06301 (C.D. Cal.)) Although the decisions in these cases are not controlling, staff has reexamined its procedures and has determined that FTB should: (1) publish procedures under which taxpayers would be allowed a hearing on the issue of whether FTB must provide a release; and (2) publish standards to be used in connection with such a hearing. FTB believes that it is essential that these regulations be in place promptly in order to protect the Top 500 program from adverse litigation and to make these taxpayer protections available to taxpayers on the Top 500 List that was published in October of 2016.

Regulation Section 19195-1 will provide the procedures under which the Taxpayer will be provided a hearing on the issue of whether FTB should provide a release. The hearing will take place before a hearing officer who has had no prior involvement with the Taxpayer. At the hearing, the Taxpayer will be able to present witnesses, offer documentary evidence, and make arguments in support of the Taxpayer's request for a release. After the hearing, the hearing officer will decide whether the Taxpayer is entitled to a release. If a release is not provided, the hearing officer will provide the Taxpayer with a written decision explaining why a release will not be provided.

Regulation Section 19195-1 will also provide the Taxpayer with an opportunity to request that the hearing officer reconsider the decision denying a request for release and an opportunity for the Taxpayer to request that the Taxpayers' Rights Advocate or her designee review, and overrule, the hearing officer's decision.

Regulation Section 19195-2 will provide the standards that the hearing officer will use in determining whether the Taxpayer has a current financial hardship that will enable the taxpayer to obtain a release. If the hearing officer determines that the Taxpayer does not have a current financial hardship, the hearing officer will use the standards contained in the regulation and as incorporated by reference, where applicable, to determine how much the Taxpayer must pay and the terms of an installment payment agreement the Taxpayer must sign in order to obtain a release.

These regulations will assist FTB in its efforts to publically ensure taxpayers are treated fairly and in accordance with law.

FTB has conducted an evaluation, and has determined that these regulations would be the only regulations concerning BPC Section 494.5, and RTC section 19195 that would establish procedures under which taxpayers would be allowed a hearing on the issue of whether FTB must provide a release, and standards to be used in connection with such a hearing. FTB therefore has determined that there is nothing in these regulations that is inconsistent or incompatible with any other existing state regulations.

Standards Incorporated by Reference

The following standards are hereby incorporated by reference:

- The Internal Revenue Service Allowable Living Expenses Standards, Rev 10/16.

These standards are the guidelines used by the Internal Revenue Service, and the FTB intends for the hearing officer to use those same standards for purposes of making a hardship determination as indicated in the regulation.

Other Matters Prescribed by Statute Applicable to the Agency or to Any Specific Regulation or Class of Regulations

None.

Mandate on Local Agencies or School Districts

FTB has determined the proposed emergency regulations do not impose a mandate or a mandate requiring reimbursement by the State pursuant to Part 7 (commencing with Section 17500) of Division 4 of the Government Code. Local agencies or school districts will not be required to incur additional costs in order to comply with the proposed emergency regulations.

Fiscal Impact (Attached Form 399)

FTB has assessed the potential for significant statewide adverse impact that might result from the proposed emergency regulations as follows:

- A. Costs or Savings to State Agencies: These proposed emergency regulations will assist in preserving the integrity of the denial and suspension license collection tool contained in BPC section 494.5. In 2015, taxpayers with licenses subject to denial or suspension who requested that FTB provide a release had combined outstanding liabilities of about \$10 million. Overall, the revenue gain from the Top 500 program is estimated to be about \$20 million per year. FTB does not know with certainty how different taxpayers' payments will be if the proposed regulations are or are not adopted; but FTB anticipates that adoption of the proposed emergency regulations will likely increase the state's revenue by several million dollars per year.

If the proposed regulations are not adopted and a formal hearing process is not implemented, it is possible that courts will determine that license suspensions or denials under the Top 500 program violate the rights of these taxpayers. Accordingly, failure to adopt these regulations is likely to result in legal action and could compromise this revenue source.

FTB estimates that it will incur about \$100,000 per year in additional administrative expenses to conduct formal hearings which will be absorbed within existing budgets and resources.

- B. Costs to any Local Agency or School District that is required to be reimbursed under Part 7 (commencing with Section 17500), Division 4 of the Government Code: None
- C. Other Nondiscretionary Costs or Savings Imposed on Local Agencies: None
- D. Costs or Savings in Federal Funding to the State: None.

Cost Impacts on Private Sector Including Impact on Individuals, Businesses, and Jobs (Attached Form 399)

FTB estimates that up to 55 businesses that require professional, occupational, and driver licenses may be affected by the proposed regulations per year.

If the proposed regulations are not adopted and a formal hearing process is not implemented, it is possible that courts will determine that license suspensions or denials under the Top 500 Program violate the rights of these taxpayers. If so, the number of license suspensions and denials will likely be larger if the proposed regulations are adopted than if they are not. The greater number of suspensions and denials may lead to the elimination of some businesses. It is not known how many of the taxpayers with professional, occupational, or driver licenses affected by the Top 500 Program would choose to file suit to retain their licenses in the absence of the proposed regulations or how many of those taxpayers own businesses that would fail if they lost their license but would remain viable if they did not. However, FTB has determined that the majority of licensees are held by employees rather than employers so the number of businesses eliminated would be small. Overall, FTB estimates that the economic impact on the private sector of the Top 500 Program, including these proposed regulations, is between \$10 and \$25 million per year.

Other Statutory Requirements

None.

Approval by Board

On September 8, 2016, FTB met in an open session at 1:30 p.m. at 9646 Butterfield Way, Gerald Goldberg Auditorium, Sacramento, California. Present were Deputy Controller Yvette Stowers, Member Fiona Ma, CPA, and Chief Deputy Eraina Ortega, Department of Finance, for Member Michael Cohen (collectively referred to as the Board). The Board approved staff's Request for Permission to Proceed with the proposed emergency regulation. This approval included a grant of authority to staff to make changes to approved proposed regulatory text as may be required by the Office of Administrative Law during the emergency regulatory process. The Board also approved staff's request to proceed into the formal regulatory process to ultimately adopt the proposed emergency regulations as final regulations.