DRAFT

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**02/19/10**	Bill No:	**SB 1306**
Tax:	**Sales and Use Special Taxes**	Author:	**Runner**
Related Bills:			

BILL SUMMARY

This bill would authorize the Board to enter into contracts with private collection entities for the purpose of collecting in-state delinquent accounts. Funds received by the Board would be deposited into the Delinquent Sales and Use Tax Collection Fund, which this act creates, and, among other things, would be used to reimburse the Board's contracting costs.

ANALYSIS

CURRENT LAW

Under Revenue and Taxation Code Section 6830, the Board may enter into an agreement with one or more private persons, companies, associations, or corporations providing debt collection services outside this state. The contract may be for locating persons or businesses that owe taxes, or for the collection of taxes, interest, additions to tax, and penalties. The contract may also provide that the compensation amount be added to the amount required to be collected from the tax debtor.

Existing Chapter 4.3 (commencing with Section 16580) of Part 2 of Division 4 of Title 2 of the Government Code (GC), known as the Accounts Receivable Management (ARM) Act, provides that a participant, including the Board, may enter into a contract with a private debt collector for the assignment or sale of all or part of its accounts receivable (AR) under specified conditions. The ARM Act also provides the following:

- Section 16583 requires state agencies to allocate collection resources based on giving highest priority to those AR's with the highest expected return. Each state agency is also required to consult with the Franchise Tax Board (FTB) or other state agencies which have established an effective AR collection system.
- Section 16583.1 allows a state agency to impose a reasonable fee, not to exceed the actual costs, for the costs of collection on a past due amount. (effective July 28, 2009, SBx4 16, Ch. 23 of the 4th Ex. Session)
- Section 16583.2 requires state agencies to submit an annual report to the State Controller's Office (SCO) of the AR and discharged accounts. The SCO would inform that state agency of the format and due date of the annual report. (effective July 28, 2009, SBx4 16, Ch. 23 of the 4th Ex. Session)

GC Section 13292.5 requires seven specified state agencies, including the Board, to submit an annual report to the Department of Finance (DOF) on the status of that agency's liquidated and delinquent accounts, and its efforts to collect these accounts during the previous fiscal year. The DOF must submit an annual report to the Legislature on the status of delinquent AR's of state agencies. "Liquidated and delinquent accounts" were defined as any AR's or other monetary obligation owed to a state agency that is unpaid for 180 or more days after the obligation was first due. (inoperative July 1, 2010 and repealed January 1, 2011)

Existing law authorizes the Board to use various collection actions to collect delinquent AR's, including but not limited to: bank levies, liens, wage garnishments, till-taps or keeper warrants, permit revocations, alcoholic beverage license suspensions, seizures of assets, offsets, and court actions. The Board's use of these tools is consistent with its established collection policies and procedures as provided in the Compliance Policy and Procedures Manual, Chapter 7, Collections.

The State's collection procedures to collect delinquent accounts are detailed in the State Administrative Manual (SAM) Section 8776 (et seq).

In the case where the Board is unable to collect the liability, or collection of the liability is not cost effective, the Board may discharge or "write-off" the AR under the following provisions:

- Chapter 3 (commencing with 13940) of Part 4 of Division 3 of Title 2 of the GC allows the Board to make an application to the State Victim's Compensation and Government Claims Board (SVCGC) for discharge from accountability to relieve the agency of the responsibility for collection, thereby removing the item from the AR.
- GC Section 13943.2 provides the SVCGC with authority to approve state agency requests to discharge AR up to $500, if the state agency's efforts have not resulted in payment and it would not be cost beneficial to pursue additional collection efforts.
- Under GC Section 13943.2, the Board has established a "small balance" write-off process in which the Board writes off balances of $500 or less, as specified, after a period of 180 days upon the liability becoming due and payable, with specified exceptions (e.g., security is available).

PROPOSED LAW

This bill would add Sections 6830.5 and 6830.6 to the Revenue and Taxation Code to authorize the Board to enter into contracts with private collection entities for the purpose of collecting in-state delinquent accounts. The contract may also provide for the rate and manner that the private collection agency may be paid, but that compensation amount may not be added to, or collected from, the tax debtor.

Funds received by the Board would be deposited into the Delinquent Sales and Use Tax Collection Fund (Fund), which this act creates in the Treasury, and would be used to reimburse the Board's contracting costs. Any funds remaining in the Fund would be transferred to the Retail Sales Tax Fund by the SCO upon notification by the Board.

IN GENERAL

Due to its effective tax administration, the Legislature and other state agencies who have contracted with the Board have given the Board the responsibility for administering various taxes and fees. Currently, the Board administers over 20 different tax and fee (tax) programs. As indicated in the Board's 2007-08 Annual Report, those programs generated $53.1 billion in revenue at a cost of $239 million – only 75 cents for every $100 of revenue collected.

Despite the best of efforts, certain tax debts are not readily collectable. After a liability has become due and payable, a taxpayer may avail themselves of several alternatives that could result in the aging of the receivable. For example, taxpayers may enter into installment payment agreements with the Board. Some of these payment plans are short-term (under twelve months), others are long-term, and the result is a cooperative resolution of the receivable. Other taxpayers may file a bankruptcy petition which imposes an automatic stay of collection actions. Still others file a "late protest," which is an administrative process that allows a taxpayer to file a late appeal which may result in the deferral of collection actions.

In general, collection of an AR progresses through various automated and manual collection processes. After collection efforts have been exhausted and it is determined that it is no longer cost effective to pursue collection of an outstanding liability, a discharge recommendation is initiated as provided in the GC and further specified in the SAM section 8776.6.

BACKGROUND

Assembly Bill 2591 (Chapter 506, Stats. 2006) required seven specified state agencies, including the Board, to submit an annual report to the DOF on the status of that agency's liquidated and delinquent accounts, and its efforts to collect these accounts during the previous fiscal year.

Since the enactment of AB 2591, there have been three reports submitted to the Legislature. As a result of the findings from the first report, 2006-07 Delinquent Accounts Report, the DOF established an Accounts Receivable Workgroup for purposes of improving administrative procedures and collections on delinquent accounts. The AR Workgroup, over the past year, evaluated existing AR processes and procedures, implemented new administrative procedures for locating debtors and for performing reviews of ARs, evaluated and submitted initial recommendations on the feasibility of selling the state's discharged debts or ARs, identified that statewide AR amounts may be misleading, and made updates to the SAM.

On April 3, 2009, the DOF submitted the second report, 2007-08 Delinquent Accounts Report, to the Assembly Budget Committee, Senate Budget and Fiscal Review Committee, and Assembly and Senate Appropriations Committees. The report discusses actions taken, and recommendations made by the AR Workgroup. Two of these recommendations proposed to increase the threshold to discharge delinquent accounts and allow state agencies to charge a fee for their costs of collecting delinquent AR's. As a result of the second report the Legislature included these two recommendations in a bill passed last year (SBx4 16, Ch. 23, Stats. 2009). Additionally, the DOF obtained Legislative approval for other recommendations from the AR Workgroup, including limited funding to pay for the contingency fees of private collection agencies, and funding for SCO's collection and analysis of AR data from state agencies.

On February 26, 2010, the DOF submitted the third report, 2008-09 Delinquent Accounts Report, which highlighted the measures that were implemented as a result of the AR Workgroup's efforts. According to DOF the data provided to SCO will be more extensive and require agencies to provide details on their AR characteristics and the extent of their collection efforts. The SCO will report to DOF their findings and recommendations, with the AR Workgroup and DOF evaluating potential ways to improve the state's collection efforts.

COMMENTS

1. **Sponsor and purpose.** The bill is sponsored by the author and is intended to provide statutory authority to utilize the services of private debt collection vendors to collect in-state past due accounts receivables that cannot be collected internally.

2. **Delinquent accounts should be defined.** As defined in GC Section 13292.5, for the purposes of the DOF AR Report, "liquidated and delinquent account" means any AR or other monetary obligation owed to a state agency that is unpaid for 180 or more days after the obligation was first due. The report would identify receivables that were valid and collectible. "Valid" is defined as an amount that is due and payable with no known disagreement about the liability, and "collectible" is defined as due and payable without collections being deferred by any provision of law.

   A definition of "tax delinquency" is provided in Revenue and Taxation Code Section 7063 which relates to the list of the 250 largest sales and use tax delinquencies over $100,000. With regards to the list, a delinquency is described as an amount of tax that has been either determined by the Board or self assessed by the taxpayer and that is delinquent for more than 90 days for which a state tax lien has been filed, but would not include:

   - Any delinquency that is under litigation in a court of law;
   - Any delinquency for which suitable payment arrangements have been made with the Board; or
   - Any delinquency for which the taxpayer has filed bankruptcy.

   As there are now various administrative and statutory definitions that may apply to "delinquent accounts," it is suggested that the author provide a definition of this term as it relates to private in-state collection agreements.

3. **DOF comments and conclusions regarding delinquent accounts.** The DOF 2008-09 Delinquent Account Report notes that "although the receivable amounts are large, the entire amount cannot be viewed as collectible. These amounts include estimated receivables, uncollectible accounts, and receivables which will be collected in the normal course of business." The report indicates that the growth in receivables can be partially attributed to the overall economic downturn. In addition to the economic impact of the recession, the Board has been dealing with hiring freezes and a $40 million reduction of the Board's budget for the 2009-10 fiscal year. Despite these challenges, the Board has "made strides to improve revenue collections." The report summarizes that the Board "continues to be proactive in improving taxpayer compliance such as enhancing their identification and collections of sales and use tax through the Tax Gap Program implemented in 2008-09, and improving enforcement efforts on compliance on all taxes and fees."

4. **The Legislative Analyst's Office (LAO) has suggestions to increase state revenues.** In it's report of the 2009-10 Budget, the LAO provided several proposals to Increase State Revenues by Making Changes to Tax Programs. Among these proposals was changing the criteria for when the Board issues a lien – do it earlier in the collection process and do it on lower balances. LAO also notes that the Board does not charge a penalty for bad checks or money orders – in contrast, both the FTB and the federal government assess penalties. The report also describes a service fee for both an installment agreement and an offer in compromise.

5. **The Board's 3-year Business Plan for FY 2008-2011** discusses how to implement the plan and measure the objectives related to meeting the Board's strategic goals. Bearing in mind that the Board is a tax administration agency, the objectives include the following measures: reduce the tax gap; increase collections of AR's; improve interagency partnerships; expand electronic services; expand communication through web services; and improve taxpayer education and outreach. Board staff is available to discuss any of the suggestions to improve collections, including previous private collection agreements involving out-of-state delinquent accounts.

6. **There are various reasons for delinquent receivables.** As mentioned previously, taxpayers have several alternatives to address an AR that may result in the aging of the AR, some of which include, but are not limited to, the following: petition for redetermination (appeal/protest); installment payment arrangements; bankruptcies; settlements; offer in compromise; and "late protests." Additionally, the Board may pursue collection actions that are more advanced and require additional time and resources to develop. These include, but are not limited to, the following: bankruptcy claims, including in-state or out-of-state representation; probate cases; successor liability accounts (collecting from the seller/buyer of a business under specified conditions); corporate officer liability accounts (assessing personal liability to a corporate officer); collection from sureties or guarantors; collection of multiple account balances for a single business (the Board administers over 20 different tax and fee programs); and collecting from closed or open businesses (generally, collections are more difficult from a business that is no longer operating). Board staff is available to explain in more detail the tax programs involved, the nature of the receivables, the administrative procedures, and the collection processes and actions that may explain why an account is delinquent.

7. **The DOF's 2008-09 Delinquent Accounts Report indicates that the Board collected approximately 44% of the AR's established during that fiscal year.** The supplemental data reported by DOF indicated that the AR's established during the 2008-09 fiscal year was approximately $958.8 million, with Board collections received on those AR's during the same fiscal year was approximately $421.5 million. The report also indicated that the delinquent AR's (those over 180 days) as of July 1, 2008 was $875.8 million, with the Board collection recovery rate of approximately 5%, which resulted in collections received on delinquent AR's during the 200-09 fiscal year of $44.3 million. In contrast, the collection recovery rate for amounts referred to collection agencies for FTB AR's was less than 1% (.47%).

COST ESTIMATE

This bill would not directly impact the Board's administrative costs. To the extent the Board would enter into any contract with a private collection agency, then there would be costs involved to administer and service the contract. Costs would primarily be related to providing the background and updated information to the collection agencies. Based on previous experience, staff time involved is labor intensive in validating the amount owed by the taxpayer to the state. A detailed cost estimate is pending.

REVENUE ESTIMATE

As reported in the DOF 2008-09 Delinquent Account Report, the Board had an AR balance of $1.092 billion as of July 1, 2008, with a delinquent account AR balance as of July 1, 2008 of $875.8 million.

As also reported in the DOF 2008-09 report, the AR balance as of July 1, 2009 was 1.406 billion. The delinquent account AR balance as of July 1, 2009 was not available.

In May 2007 the Board conducted an analysis of the potential revenues that may be derived from contracting with a private collection agency. The Board made certain assumptions, but determined that of the delinquent accounts approximately $183 million would be considered for referral. At that time, the Board assumed a 1% rate of return on accounts referred to a private collection agency.

Assuming a delinquent account is consistent with the definition provided in GC Section 13292.5, all accounts are valid and collectible, and that of the delinquent accounts approximately $183 million would be available for "in-state" referral, then the Board would estimate revenues in the following range, based on a 0.47% and 1% rate of return:

Rate of return	Delinquent AR	Revenue
0.47%	$183,000,000	$860,100
1%	$183,000,000	$1,830,000

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This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.