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April 27, 2007

Mr. Michael Cohen
Legislative Analyst's Office
925 L Street, Suite 1000
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Re: LAO Report on Tax Agency Information and Data Exchange

Dear Mr. Cohen,

The Budget Subcommittees for the Board of Equalization (BOE) and the Franchise Tax Board (FTB) have requested responses to recommendations made in the Report on Tax Agency Information and Data Exchange published in January 2007. While these two agencies have formally responded in writing to LAO, we have not yet articulated – along with the Employment Development Department (EDD) – the specific initiatives that will be undertaken by BOE, FTB, and EDD to support data sharing and use. This memorandum transmits our near-term and mid-term data sharing initiatives, recommendation for governance structure, and proposal to identify technology solutions to improve data sharing and use.

Future Data Sharing Efforts

Attachment #1 is a list of specific data sharing initiatives the three tax agencies will pursue in the next 2 – 3 years. We have noted which initiatives require funding or legislation.

You will note that the initiatives shown in Attachment #1 differ somewhat in content from those in Figures 2 and 3 of the report ("Additional Data Sharing and Collection", pages 13-15). The initiatives reflected in Figures 2 and 3 were developed based on earlier discussions with the LAO which have since been further developed. We believe that the initiatives in Attachment #1 have greater potential return on investment in our current environment and, therefore, would be a higher priority.

Please note that these initiatives would build upon data sharing agreements already in place. Between the three tax agencies there are over 400 data sharing efforts with other State departments, the IRS, local and state agencies, and the private sector.

Governance Structure

The three tax agencies agree that the success of these future initiatives is dependent upon a strong governance structure to provide support and oversight. It is fortunate that this structure already exists in the form of the FedState Partnership. This partnership has proven its value as a forum for collaboration and the sharing of information and

“best practices” in tax administration. This partnership was originally established in 1993 and continues to serve as a virtual “agency consolidation” of purpose and taxpayer service that:

- Shares data for compliance purposes;
- Focuses on the taxpayer;
- Achieves leverage through combined resources; and
- Embodies a solid, collaborative partnership

The effectiveness of the FedState Partnership is demonstrated by the following successfully implemented efforts:

- The California Tax Information Center provides one-stop Internet access for general tax program information from the three tax agencies and the IRS.
- Automated Call Distributor (ACD) and Interactive Voice Response (IVR) Interconnectivity allows the seamless transfer of phone calls between agencies. FTB’s IVR includes the most commonly asked questions from EDD and BOE. Additionally, public service staff is trained to answer general questions about the agencies’ programs and services.
- Taxpayer Service Centers were created, allowing the tax agencies to co-locate field offices to enhance taxpayer services through a functioning integrated field office environment.
- A Federal Information Rediscovery Agreement was executed with the IRS to allow direct exchange between the tax agencies of confidential federal tax information. The approved agreement from the IRS effectively treats the Partnership as a single tax agency for purposes of receiving and sharing federal tax information through FTB.

In addition to the above, the FedState Partnership is currently engaged in the following three data sharing initiatives:

- Business Licensing Inspection Program – BOE is identifying taxpayers who are required to collect sales and use tax in San Francisco and Los Angeles and is sharing that information with EDD and FTB. FTB and EDD will use this information to identify additional non-filers and to create audit and collection leads.
- Sharing Customs and CA Department of Agriculture (CFDA) Information – BOE will share this information with FTB. FTB will use this information to identify additional non-filers and to create audit and collection leads.
- Multi Agency Contract for Lexis / Nexis – A single contract is being explored for Lexis / Nexis services that will meet each agency’s data needs and reduce State costs.

The FedState Partnership will work closely in tandem with Tax Gap efforts of the three tax agencies to identify future data sharing initiatives. Recent tax gap efforts resulted in information being added to FTB’s Integrated Non-filer Compliance (INC) system, which is accessible to all three tax agencies:

- Motor fuel data from BOE;
- Business license data from several California cities;
- Liquor license data from the Alcohol Beverage Control (ABC); and
- Licensed childcare provider data from the Department of Social Services.

The three tax agencies are confident that this partnership can continue to effectively facilitate future data sharing and use by evaluating and determining appropriate implementation plans for those efforts. However, specific expertise is needed to identify technology solutions and develop implementation strategies that will support expanded information sharing and use.

Technology Solutions

In addition to the data sharing initiatives identified above, the three tax agencies agree that an important step to take in achieving the goals of the Legislature is to define, with appropriate stakeholder input, the next steps to further improve information sharing and use.

The three tax agencies agree that the idea of an alternative technology approach such as a “software overlay” or other technology enhancements characterized in the LAO report has merit. While the FedState partnership has had prior discussions in this area, a comprehensive technology solution has not yet been explored by the three sister agencies corporately.

The three tax agencies recommend engaging the services of a consultant to explore existing technology solutions to increase data sharing efforts and promote compliance. This would provide for the impartial expertise desirable to ensure an unbiased analysis is completed timely. While the specifics and deliverables of the consultant services would be determined under the leadership of the FedState Partnership, the following three general areas would be addressed by the consultant:

- Work with the three tax agencies to identify common business objectives and information sharing opportunities, including:
 - An assessment of the business processes, missions, objectives, governance, technologies, and readiness of the three tax agencies to support additional information sharing and use through technology.
 - Development of an inventory of available information and how it may be used to achieve our individual and collective missions and objectives.
- Identify current and emerging technologies that will enable information sharing and use to achieve the programmatic missions and objectives of the agencies.
- Work with the three tax agencies to develop a collaborative information technology strategy that leverages individual initiatives and technologies, to maximize results for the short term, near term, and long term. Where possible, the consultant would also develop estimates of the costs and benefits associated with any recommendations made.

The deliverable of the consultant services would be recommended strategies and steps to further data sharing and use by the three tax agencies.

We appreciate LAO's support in this effort, which could be accomplished via Budget Control Language in the coming year. The departments will be working with you to discuss whether the language should also address additional funding or other options

for each agencies' consultant costs. The next step would be for the three tax agencies to collaborate in conducting the procurement, and selecting a consultant. The contract would be awarded and the work would begin in FY2007/08.

We look forward to working with the various Legislative committees, the Department of Finance, and the Legislative Analyst's Office as we identify and implement data sharing and use initiatives that will contribute to closing the tax gap for California taxpayers and businesses.

Sincerely,

/SIGNED /
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Executive Director
Board of Equalization

/SIGNED/
Selvi Stanislaus
Executive Officer
Franchise Tax Board

/SIGNED/
Patrick W. Henning
Director
Employment Development
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cc: Honorable Juan Arambula, Chair, Assembly Budget Subcommittee #4
Honorable Michael Machado, Chair, Senate Budget and Fiscal Review
Subcommittee #4
Honorable John Chiang, State Controller
Honorable Michael C. Genest, Finance Director
Honorable Betty T. Yee, Chairwoman, State Board of Equalization
Honorable Judy Chu, Ph.D., Vice-Chair, State Board of Equalization
Honorable Bill Leonard, Member, State Board of Equalization
Honorable Michelle Steel, Member, State Board of Equalization
Elizabeth Hill, Legislative Analyst
Rosario Marin, Secretary, State and Consumer Services Agency
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Dan Rabovsky, Consultant, Assembly Budget Subcommittee #4
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Bryan Ehlers, Consultant, Senate Budget Subcommittee #4
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Brian Annis, Consultant, Senate Budget Subcommittee #3
Celia Mata, Consultant, Assembly Budget Subcommittee #4
Todd Jerue, Department of Finance

**FUTURE DATA SHARING EFFORTS
BOE/FTB/EDD**

Requesting Agency: Franchise Tax Board (FTB)

Information and Data Involved	Use of Data	Source of Data	Barriers Limiting Data Sharing	Cost	Revenue	Operational Date <i>1/</i>
Wage and Withholding Data for Federal Employees.	To identify nonfilers, under reporters and provide asset information.	Federal government, EDD, SSA	TBD	Low	Low	Dec. 2008
K-1 Data for Limited Liability Corporations (LLCs).	To identify nonfilers and under reporters. We have LLC Returns but we don't currently use the K-1 data. FTB proposes to load the K-1 information into INC and the INC data warehouse. It would then be available to BOE and EDD.	LLCs, FTB	None	Low	High	Dec. 2008
EDD Unemployment Insurance (UI) and Disability Insurance (DI) Claimant Address Data.	To provide better addresses for nonfiler cases.	EDD	TBD	Low	None <i>2/</i>	Dec. 2008
Data matching our common debtors (those with A/R balances and delinquencies). <i>4/</i>	To develop a work plan for response. Are these taxpayers having financial difficulties and simply cannot pay or are they taxpayers that make a conscious decision not to pay taxes?	Internal	TBD	TBD	TBD	TBD
Imaged bank information collected from tax deposits and payments. <i>3/ & 4/</i>	Upload imaged bank information collected from tax deposits and payments into a data pool that could be shared by BOE, EDD, and FTB for collection of delinquent taxes.	BOE, EDD, and FTB	MOU required, costs.	TBD	TBD	TBD

Requesting Agency: Board of Equalization (BOE)

Information and Data Involved	Use of Data	Source of Data	Barriers Limiting Data Sharing	Cost	Revenue	Operational Date <i>1/</i>
Listing of warehouses tied to out-of-state persons. <i>3/</i>	Identify businesses that have nexus and require a permit.	EDD	None	Low	Low	Jan. 2008
Listing of large businesses including number of employees. <i>3/</i>	Use for audit selection.	EDD	None	Low	Low	Oct. 2007
Obtain individual drivers license information in real time and in mass. <i>3/</i>	Verify identity against DMV's records at time of permit registration.	DMV	Legislation required.	Low	Low	TBD
Mandate reporting of wholesale sales for specific industries based on dollar thresholds. <i>3/</i>	Reporting verification and audit selection.	Third-party	Legislation required.	Medium	Medium	TBD
Data matching our common debtors (those with A/R balances and delinquencies). <i>4/</i>	To develop a work plan for response. Are these taxpayers having financial difficulties and simply cannot pay or are they taxpayers that make a conscious decision not to pay taxes?	Internal	TBD	TBD	TBD	TBD
Imaged bank information collected from tax deposits and payments. <i>3/ & 4/</i>	Upload imaged bank information collected from tax deposits and payments into a data pool that could be shared by BOE, EDD, and FTB for collection of delinquent taxes.	BOE, EDD, and FTB	MOU required, costs.	TBD	TBD	TBD

Key: Revenue and Cost ranges are defined as follows:
 Low = Under \$1 million
 Medium = \$1 to \$5 million
 High = Over \$5 million

**FUTURE DATA SHARING EFFORTS
BOE/FTB/EDD**

Requesting Agency: Employment Development Department (EDD)

Information and Data Involved	Use of Data	Source of Data	Barriers Limiting Data Sharing	Cost	Revenue	Operational Date <i>1/</i>
1099 INT/DIV (interest and dividend) information: manual use. <i>3/</i>	Payroll tax collections. EDD is working with FTB to obtain more timely 1099 INT/DIV data for use in manual collections.	FTB	None	Minimal	Low	Oct. 2007
FTB INC system - incorporation of selected INC data into EDD's ACES system. <i>3/</i>	Payroll tax collection and audit.	FTB	Funding required. Security and technology costs, time to implement.	TBD <i>5/</i>	<i>5/</i>	FY 2009/10
FTB INC System data - on-line access. <i>3/</i>	Payroll tax collection and audit.	FTB	Funding required. Security and technology costs, time to implement.	TBD <i>5/</i>	<i>5/</i>	FY 2009/10
Large cash withdrawal data from financial institutions.	Payroll tax audit.	IRS	None	Low	Low	May 2007
Audit case information exchange. Audit leads and audit results information that meets specified thresholds will be exchanged between EDD and IRS to use as audit leads.	Payroll tax audit.	IRS	None	Low	Low	May 2007
Data matching our common debtors (those with A/R balances and delinquencies). <i>4/</i>	To develop a work plan for response. Are these taxpayers having financial difficulties and simply cannot pay or are they taxpayers that make a conscious decision not to pay taxes?	Internal	TBD	TBD	TBD	TBD
Imaged bank information collected from tax deposits and payments. <i>3/ & 4/</i>	Upload imaged bank information collected from tax deposits and payments into a data pool that could be shared by BOE, EDD, and FTB for collection of delinquent taxes.	BOE, EDD, and FTB	MOU required, costs.	TBD	TBD	TBD

Key: Revenue and Cost ranges are defined as follows:

- Low = Under \$1 million
- Medium = \$1 to \$5 million
- High = Over \$5 million

Footnotes:

1/ This is the anticipated date in which the data will be available to the requesting department. Once the data is available, the usability and revenue impacts of that data can be better assessed.

2/ This process is to obtain better information for INC cases with bad addresses. As such it does not create additional revenue so much as it accelerates existing revenue.

3/ This data sharing effort is included in Figure 2 or 3 of the LAO Report.

4/ All three tax agencies are requesting this data share item.

5/ EDD's ACES project will result in an integrated and automated payroll tax collection system. The use of 1099 INT/DIV, INC system, and other data is integral to the success of the ACES project. ACES will increase annual payroll tax collections by approximately \$70 million by the end of SFY 2013/2014 and each year thereafter. Initial revenues, estimated at \$20 million, will begin to be realized in SFY 2009-2010. Assignment of revenues attributable to specific data elements within the ACES system may not be feasible.