

Memorandum

To : Honorable Judy Chu, Ph.D., Chair
Honorable, Betty T. Yee, Vice Chairwoman
Honorable Bill Leonard
Honorable Michelle Steel
Honorable John Chiang

Date: February 29, 2008

From : Randie L. Henry, Deputy Director
Sales and Use Tax Department

Subject : **Electronic Transition Plan**

This is to provide you with the details and next steps regarding the staff's proposed plan to transition sales and use taxpayers from paper to electronic filing (e-filing). While our prior outreach efforts that mainly focused on raising the awareness of e-filing have produced a steady incremental increase in participation, it is time now to shift our activities to a more assertive participation approach that will help create the efficiencies and cost savings inherent in doing business electronically. The Electronic Transition Plan encompasses activities that will be undertaken over the next two fiscal years in an effort to transition the majority of sales and use taxpayers from paper to e-filing.

Background

The Board of Equalization (BOE) is committed to providing an accessible, adaptable and customer focused environment to tax and fee payers through electronic services. Since the initial implementation of the BOE's free e-file system, BOE-file, in September 2005, many enhancements have been made to make the system more streamlined and easier for taxpayers to use. Additionally, more payment options have been added including the ability to e-file and pay amounts due by paper check. Overall taxpayer comments¹ about BOE-file have been positive (e.g., it is convenient, easy, and government is doing things right). As BOE-file continues to mature and expand, we are in a much better position to encourage e-filing participation which ultimately will reduce costs associated with paper processing.

The Legislature appropriated funds for the current e-services project, the E-Filing Infrastructure Project, with the intent that the funds are to be used to improve the state's efficiencies in tax administration. However, the current e-filing participation rate of 2.5% does not allow for the realization of sufficient cost savings expected by the Legislature, the BOE and the state as a whole. The full potential of cost savings can only be realized as the participation levels increase.

The current voluntary approach to e-filing is not yielding the expected results. It is clear that the BOE must take a more assertive approach to transitioning taxpayers to e-filing. Even though participation levels have risen incrementally over the past several fiscal years, the

¹ Comments received from the BOE-file survey that is offered at the end of the e-filing.

BOE will likely not achieve the estimated 20% participation rate (as reported to the Senate Subcommittee last year) by the 2009-10 fiscal year without a more assertive transition plan.

We, as an organization, face several challenges with encouraging taxpayers to voluntarily e-file including: 1) no incentive, such as refunds, 2) change is slow especially when there is a comfort level as there is with paper filing, and 3) taxpayers find paper forms easy to complete and do not readily see the benefits associated with e-filing. However, we are making some progress overcoming some of these challenges as experienced recently in some of our district offices. Taxpayer Assistance Clinics (with personal computers and printers) were set up in four district offices for the January 31, 2008 filing due date. Given the choice, most taxpayers that came into the offices preferred to continue to paper file initially; however, those that were persuaded to complete their returns electronically were amazed by how simple and fast the process was and saw the benefits. Many of these taxpayers indicated that they would continue to e-file on their own.

The Legislative Analyst's Office (LAO) recently recommended that the BOE implement mandatory e-filing for sales and use taxpayers whose average monthly tax liability is \$10,000 or more per month and are required to pay by electronic funds transfer (EFT). The LAO is estimating that mandatory EFT accounts will generate \$500,000 in cost savings from e-filing.

Prior Electronic Transition Efforts

Beginning in May 2007, the BOE implemented a "Toss the Paper" pilot in order to determine the readiness and willingness of sales and use taxpayers to e-file and discontinue receipt of a paper return. Three groups (monthly, fiscal yearly and quarterly accounts) of 1,000 taxpayers each eligible to e-file were randomly selected to participate in the pilot. Each taxpayer in the pilot received an invitation to e-file in lieu of their paper return. Overall, 21% of the pilot group of taxpayers e-filed. This 21% participation rate demonstrates that there is a willingness and capability by sales and use taxpayers to transition to e-filing.

Electronic Transition Plan

Section 6452 of the Sales and Use Tax Law states, ...a return shall be filed with the board in the form prescribed by the board, which may include, but not be limited to, electronic media. This section provides the basis for the Electronic Transition Plan and by using a phased approach, the BOE seeks to increase the number of sales and use taxpayers that e-file and thereby maximize efficiencies by reducing the cost of processing and storing paper returns.

As Internet access and usage continues to rise, current statistics demonstrate that most California taxpayers have Internet access and have the ability to e-file. Today 73% of Californians use the Internet according to a September 2007 report from the Public Policy Institute of California. Broken down demographically, the number of Internet users ranged from 41% to 95%. The lowest demographic group of users was non-citizens at 41%. An income level of \$80,000 or more was the highest demographic group of Internet users at 95%. When broken down demographically by race/ethnicity, the percentage of Internet users varied from 51% for Latinos to 89% for Asians. The range of Internet users by region varied from 67% in the Los Angeles area to 80% for Orange/San Diego. The current number of Californian's using the Internet, further supports the timing for the implementation of the Electronic Transition Plan and the expected 25 % to 50% participation rate.

Attached is a summary of the BOE's Electronic Transition Plan proposal that will begin the process of increasing e-filing participation rates and creating cost savings without the mandate recommended by the LAO.

Under the Electronic Transition Plan, the BOE proposes to "prescribe" e-filing (as authorized under section 6452) and discontinue sending paper returns/forms for various groups of sales and use taxpayers beginning with new seller's permit holders and those that are required to file prepayment forms. The plan also provides for advance notifications prior to transitioning each group to e-filing as well as systematic reminders (initially via paper and e-mail). The following is an example of the transition process:

Taxpayer Base: Quarterly prepayment accounts (group 2 on plan summary)

Prescribed E-Filing Effective Date: 3rd quarter 2008 return due October 31, 2008

First Notification: Inserted in 2nd quarter 2008 return mailed between June 10th and 20th

- Provide instructions on how to register as an e-client
- Promote benefits of e-filing and address potential concerns
- Provide exemption information and due date to request a one year exemption²
- Advise that paper returns will no longer be provided
- Envelope overprint advising last paper return provided

Second Notification: Inserted in July 2008 prepayment mailed between July 14th and 31st

- Provide instructions on how to register as an e-client and use Express Login
- Include BOE-file Users Guide
- Advise that paper returns will no longer be provided
- Envelope overprint advising paper is going away

Third Notification: Inserted in August 2008 prepayment mailed between August 4th and 29th

- Provide instructions on how to register as an e-client and use Express Login
- Advise that paper returns will no longer be provided
- Envelope overprint advising last paper form

Fourth Notification: E-mail and postcard in lieu of 3rd quarter paper return

- Reminder of approaching tax return due date

Estimated Potential Cost Savings

Estimated potential cost savings over the next two fiscal years are shown on the attached Electronic Transition Plan Summary. The cost savings shown range from a 25% to a 50% participation level for each transition group. The 25% participation rate is a very conservative figure based upon the results of the "Toss the Paper" campaign while the 50% is our targeted goal. The estimated potential cost savings shown on the attached summary for the Electronic Transition Plan exceed the estimated cost savings associated with the LAO recommended mandate of e-filing for EFT accounts

Next Steps

- Develop formal implementation plan with activities and associated due dates.
- Provide plan details and estimated potential cost savings in the Supplemental Report due to the Legislature and Department of Finance on March 31, 2008.
- Create notification letters, mailers, postcards and other outreach materials that will take the BOE from an awareness to a participation e-filing campaign.

² Taxpayers will have the ability to request a one year exemption from transitioning to e-filing. If an exemption is granted, taxpayers will continue to receive paper returns for the one year period.

- Develop an exemption form and process.
- Roll-out plan Boardwide to ensure that all BOE staff promote e-filing and assist taxpayers with the transition process.
- Track the progress of each group (e.g., e-client registrations, number of exemption requests, number of e-filed transactions).
- Perform lessons learned sessions after the rollout of each group and modify plan, if necessary.

With your support, staff proposes to implement the Electronic Transition Plan (which includes EFT accounts) as an alternative to the LAO recommended mandate specifically for EFT accounts. While EFT accounts are likely to be the most technologically capable to e-file, this is a much smaller group of taxpayers that file the most complex, multiple location returns. The largest of these taxpayers will want to send us data files directly in lieu of using our web-based BOE-file system. Our ultimate plan is to prescribe e-filing for these accounts; however, we believe that the staff proposal is a more effective approach and better suits the needs of our taxpayers while providing the state with sufficient cost savings.

If you have any questions regarding the information provided, please feel free to contact me at (916) 445-1441 or Mr. Jeffrey McGuire at (916) 324-1825.

RLH:mlm

Attachment

cc: Mr. Steve Shea
Mr. Alan LoFaso
Ms. Barbara Alby
Mr. Erik Caldwell
Ms. Marcy Jo Mandel
Mr. Ramon J. Hirsig, MIC 73
Mr. David Gau, MIC 63
Ms. Liz Houser, MIC 69
Ms. Anna Brannen, MIC 26
Ms. Anita Gore, MIC 86
Mr. Jeffrey McGuire, MIC 92
Ms. Michelle Maciel, MIC 92
Ms. Kari Hammond, MIC 19

Honorable Board Members

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February 29, 2008

bcc: Ms. Freda Orendt, MIC 47
Mr. Steve Rudd, MIC 46
Mr. Joseph Young, MIC 49



Board of Equalization
Electronic Transition Plan Summary
Sales and Use Tax Accounts
March 2008

Group	Taxpayer Base	# of Accounts	# of Annual Filings	Notification	Prescribed E-filing Effective Date	Range of Potential Cost Savings for Fiscal Year 2008-09 ¹	Range of Potential Cost Savings for Fiscal Year 2009-10 ¹
1	New Seller's Permit Holders	Approximately 165,000 annually	442,092	At time of Registration	First Return Due after July 1, 2008	\$290,213 - \$580,426	\$323,186 - \$646,372
2	Quarterly Prepayment Accounts (Returns)	81,966	327,864	June through September 2008	3 rd Quarter 2008 Return	\$203,087 - \$406,174	\$270,782 - \$541,564
3	Quarterly Prepayment Accounts (Prepayments)	81,966	655,728	June through September 2008	October 2008 Prepayment	\$203,029 - \$406,058	\$270,705 - \$541,410
4	Monthly Accounts	29,343	352,116	July through November 2008	December 2008	\$131,269 - \$262,537	\$262,537 - \$525,074
5	Calendar Yearly Accounts	256,470	256,470	Calendar Year 2008 Return	Calendar Year 2009 Return	\$0	\$186,648 - \$373,296
6	Quarterly Accounts Filing 401-EZ Returns	110,949	443,796	December 2008 through March 2009	1 st Quarter 2009 Return	\$71,834 - \$143,669	\$287,338 - \$574,676
7	Quarterly Accounts Filing 401-A Returns	135,603	542,212	March through June 2009	2 nd Quarter 2009 Return	\$0	\$446,193 - \$892,386
8	Fiscal Yearly Accounts	143,823	143,823	Fiscal Year 2007-08 Return	Fiscal Year 2008-09 Return	\$0	\$104,074 - \$208,148
9	Multiple Location Accounts	59,368	166,826	June through September 2009	3 rd Quarter 2009 Return	\$0	\$441,790 - \$883,580
10	Electronic Funds Transfer Accounts (Returns)	42,636	175,084	September through December 2009	4 th Quarter 2009 Return	\$0	\$150,476 - \$300,952
Totals		859,788 ²	3,506,281			\$899,432 - \$1,798,864	\$2,743,729 - \$5,487,458

¹ Potential cost savings range from a 25% to 50% participation level.

² Total does not include New Seller's Permit holders.