

# Memorandum

To: Honorable Jerome Horton, Chairman  
Honorable Michelle Steel, Vice Chair  
Honorable Betty T. Yee, First District  
Senator George Runner (Ret.), Second District  
Honorable John Chiang, State Controller

Date: May 10, 2012

From: Jeffrey L. McGuire, Deputy Director  
Sales and Use Tax Department



Subject: **Board Meeting – May 30-31, 2012**  
**Item P3 – Sales and Use Tax Deputy Director’s Report**  
**Update on the Proposal to Establish an Informant Reward**  
**Program**

Staff’s preliminary evaluation indicates that there is substantial uncertainty that the revenue received from an informant reward program would outweigh the costs to administer the program. In addition, there does not appear to be any outside interest in the issue. For these reasons, staff recommends that the Board discontinue the interested parties process for the proposed program.

### **Background**

At the August 23, 2011, Board Meeting, staff presented a concept Tax Gap 2 plan that included a suggestion to establish and seek funding for an informant reward program. After a brief discussion at the August meeting, the Board Members referred the issue to the Business Taxes Committee for further analysis and consideration.

The Board of Equalization (BOE) was granted authority to establish a reward program for information leading to the collection of underreported or unreported sales and use taxes in 1984 ([RTC section 7060](#)). However, the Legislature has never appropriated funds for the purpose of an informant reward program.<sup>1</sup> In 1984 and 1987, the Board considered establishing a reward program, but deferred action. The Board supported legislative bills that included provisions to fund a reward program in 1988 and 1992, however, those bills met opposition in the legislature and the informant reward provisions in the bills were deleted.

Like BOE, the Franchise Tax Board (FTB) has had the authority to establish an informant reward program since 1984, but has not done so. In 2005, FTB proposed a legislative change that would have established a reward program similar to the Internal Revenue Service’s program and provided funding for the program. The proposal was not supported

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<sup>1</sup> Rewards cannot be paid from the Retail Sales Tax Fund. Revenue and Taxation Code section 7102, which controls the disposition of those funds, does not authorize the Controller to draw money from the fund for the purpose of a reward program.

by business advocacy groups such as the California Taxpayers Association (CalTax) who were concerned about taxpayer privacy and unsubstantiated, erroneous claims against businesses. The proposal did not move forward.

Most recently, AB 2605 was introduced in the 2009-2010 legislative session that would have required the FTB to establish a reward program for information resulting in the identification of underreported or unreported income subject to taxes under the Personal Income Tax Law or Corporation Tax Law. As with prior bills, AB 2605 met opposition and in June 2010 the bill was amended with the reward program provisions removed.

Response to Staff's Discussion Paper. On January 20, 2012, staff distributed a discussion paper which included a list of questions intended to promote discussion about a possible BOE reward program. At the February 7, 2012, interested parties meeting, only one person from industry attended and was there primarily to listen. Although no submissions from interested parties were received in response to staff's paper, staff did contact Ms. Gina Rodriguez from CalTax to see if her association had an opinion on the proposal. Ms. Rodriguez explained that CalTax opposes funding informant programs because they provide tremendous incentive for people to betray one another using dishonest tactics in the interest of financial gain. She further explained that the Taxpayers' Bill of Rights includes provisions to prevent taxpayer harassment by prohibiting Board employees from receiving remuneration or advancement based on revenue collected. She believes that informant programs run contrary to the spirit of this provision, because they provide citizens with an incentive to harass others.

#### **Discussion**

In addition to the lack of interest from outside parties, staff is also concerned that it cannot clearly show that increased tax recovery from the program would exceed administrative costs. As a new effort, it would be difficult to estimate the additional revenue BOE could expect from the program and when that revenue would be received. Results could not be definitively determined until the program was established, leads were received and investigated, determinations issued, any appeals resolved, and funds collected.

With regard to costs, there would be initial costs to develop program procedures and regulations. In addition, there would be ongoing costs to administer the program, specifically staff resources to administer and monitor the program, investigate leads, handle appeals, and collect accounts. BOE would either need additional resources to handle this new workload or redirect resources to work on the project. Staff is also concerned that offering monetary rewards may result in an increased number of erroneous or unsubstantiated leads that do not result in tax recovery, but would still require investigation.

There are few sources to examine for guidance in estimating results. Although other states encourage the reporting of tax fraud, most do not provide compensation to informants. Staff was able, however, to obtain revenue information from Florida regarding their informant reward program.

Florida Department of Revenue. Florida's current informant reward program has been in effect since 1993 and includes several tax programs in addition to sales and use taxes. Total tax collections attributed to the program are approximately \$58.4M with sales and use tax making up \$41.2M of that total (about 70%). Using that 70% estimate, sales and use taxes collected under the program in the last few years were: 2007-08 - \$1.4M; 2008-09 - \$6.8M; and 2009-10 - \$4.5M. Sales and use tax collections in the first years of the program (using the 70% estimate) were: 1993-94 - \$1M; 1994-95 - \$0.9M; 1995-96 - \$2.4M.

Using data from the last three years, Florida estimates that about 18% of submitted claims result in a reward being paid. They further estimate that it takes approximately 500 days before a claim is paid. Specific costing information to operate Florida's program was not available, but they note that the program affects employees in several areas such as Audits, Investigations, Collections, Protests, General Counsel, Operational Accounting, and Taxpayer Rights.

### **Recommendation**

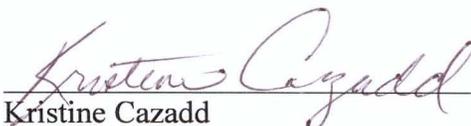
Although staff could use the information from Florida's program to estimate expected revenue, it may be several years before any revenue is received. Staff recommends that BOE discontinue the interested parties process because staff does not believe it can clearly show that increased tax recovery from the program will exceed administrative costs. We believe staff resources would be better spent on other collection efforts.

Please let us know if you have any questions or concerns. Unless directed otherwise, staff will remove this issue from the Business Taxes Committee calendar.

JLM:lw

cc: Ms. Regina Evans  
Mr. Joel Angeles  
Mr. Alan LoFaso  
Mr. Sean Wallentine  
Ms. Marcy Jo Mandel  
Ms. Kristine Cazadd

Approved: \_\_\_\_\_

  
Kristine Cazadd  
Executive Director