

# Memorandum

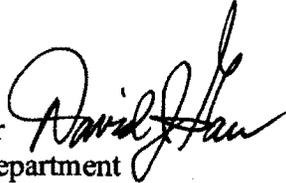
To : Ms. Kristine Cazadd  
Interim Executive Director

Date: November 30, 2010

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



David J. Gau, Deputy Director  
Property and Special Taxes Department



**Subject : Board Meeting, December 14-15, 2010  
Item P3- Sales and Use Tax Department's Deputy Director Report  
Collections Cost Reimbursement Program Implementation Plan**

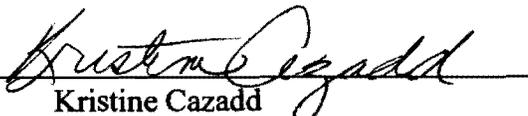
At the December 14-15, 2010 Board Meeting, we will be sharing our implementation plan for the Collection Cost Reimbursement Program the BOE will be required to impose on past due liabilities beginning January 1, 2011 and Board member approval.

Please place this item on the December 15, 2010 Board Meeting agenda under P3.1.

JLM:ma

Attachment

cc: Ms. Diane Olsen (MIC 80)

Approved:   
Kristine Cazadd  
Interim Executive Director

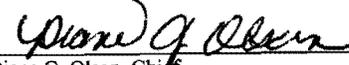
*12/15/10  
Board adopted  
Alternative 1  
D.C.*

## STATE BOARD OF EQUALIZATION



BOARD APPROVED 15 2

At the 12-14-10 Board Meeting

  
Diane G. Olson, Chief  
Board Proceedings Division

Item P3.1  
12/15/10

- For Information  
 For Discussion  
 For Decision Making

BOARD OF EQUALIZATION  
**INFORMAL ISSUE PAPER**

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## Collection Cost Reimbursement Program

### I. Issue

Senate Bill (SB) 858 (Chapter 721, Statutes 2010) requires the Board of Equalization (BOE) to assess a fee on past due liabilities. This issue paper provides alternatives and a recommendation for implementing this fee.

### II. Background

#### a. SBx4-16

As part of SBx4-16, Government Code (GC) section 16583.1 was enacted in 2009 authorizing state agencies to impose a fee on past due liabilities. Although this section does not specify how the fee amount should be calculated or determined, it does require the fee to be reasonable and not exceed actual collection costs incurred. GC section 16583.1 does not provide BOE with the authority to obtain payment of the fee through involuntary collection action (e.g., liens, levies, wage garnishments).

#### b. SB 858

As part of a budget trailer bill SB 858, laws were enacted which require the BOE to impose a fee on past due liabilities effective January 1, 2011. The sections enacted under SB 858 are identified in Table 1. "Past due" is not defined in the statutes nor is the manner in which the fee is to be calculated. These laws do, however, require that the fees assessed equal the collection costs incurred by BOE. Demand notices mailed by BOE on or after January 1, 2011, must inform taxpayers that continued failure to pay a past due liability may result in collection action being taken, including the assessment of a collection fee.

Other important provisions of the enacted laws include the ability for BOE to collect the fee in the same manner as a tax liability and the ability to waive the fee upon written, taxpayer request. Waiver of the fee is limited to instances where a taxpayer fails to pay a liability due to reasonable cause and circumstances beyond their control.

**Table 1 - Collection Fee Statutes Resulting from SB 858**

Sales and Use Tax Law (6833)	Hazardous Substances Tax Law (43449)
Use Fuel Tax Law (9035)	Integrated Waste Management Fee Law (45610)
Private Railroad Car Tax Law (11534)	Oil Spill Response (46466)
Cigarette & Tobacco Products Tax Law (30354.7)	Underground Storage Tank Maintenance Fee Law (50138.8)
Alcohol Beverage Tax Law (32390)	Fee Collections Procedures Law (55211)
Timber Yield Tax Law (38577)	Diesel Fuel Tax Law (60495)
Energy Resources Surcharge Law (41127.8)	

**c. Revenue**

Revenue is estimated to increase by approximately \$5.2 million in FY 2010-11, assuming BOE begins assessing a fee in April 2011. Beginning in FY 2011-12, revenue is anticipated to increase by \$19.4 - \$22.6 million each year.

**d. Impact of Accounts Receivable Balances**

While a fee will result in increased revenue, it will also result in increasing the BOE's accounts receivables since payment for only a portion of the fees imposed will be received. Imposing a fee is anticipated to increase accounts receivables by \$53.3 million in FY 2010-11, with a cumulative increase of \$79.6 million through FY 2013-14. Accounts receivable balances increase substantially in FY 2010-11 since the fee will be assessed to liabilities previously billed but which remain unpaid.

**III. Fee Imposition – Common Attributes of Alternatives**

Three alternatives for assessing a fee have been identified and are discussed in section IV. However, all of the alternatives have many attributes in common, which are discussed in this section. Table 2 summarizes the common attributes identified in this section.

**a. Fee Assessment**

BOE's existing operations generally provide taxpayers with several opportunities to pay a liability prior to it being assigned to collection staff. Liabilities that remain unpaid are assigned to staff for resolution via BOE's Automated Compliance Management System (ACMS). While the case assignment rules utilized by ACMS vary based on several factors (e.g., liability amount, tax/fee program), a liability is generally referred to staff after it remains unpaid for approximately 90 days. Since costs incurred by BOE in obtaining payment of a liability increase when staff intervention is required, it is proposed a fee only be assessed when a liability remains unpaid for more than 90 days. Further, this approach should provide taxpayers with sufficient opportunity to avoid the fee before it is assessed.

Instead of imposing the fee on all past due liabilities regardless of dollar amount, the fee would only be applied to liabilities for which significant costs are incurred. BOE's existing collector staffing level and collection workload require that significantly fewer staff resources be expended on small dollar liabilities. As a result, it is recommended that a fee only be imposed on liabilities greater than \$250. It is further recommended that a separate fee be assessed on *each* past due liability of greater than \$250 remaining unpaid after 90 days. This approach will result in taxpayers with several past due liabilities being assessed a separate fee on each liability. Beyond acting as a deterrent for continued non-compliance, this approach is equitable since BOE must continue to allocate resources on taxpayers that continue to incur additional liabilities. With respect to payment application rules, a payment not specifically designated by a taxpayer at the time of payment would be applied to unpaid fees prior to other liabilities (e.g., tax, interest, penalties).

b. Fee Amount

By statute the amount of the fees imposed must be the same as the collection costs incurred by BOE. In 2009-10, BOE's direct personnel costs identified to collection activities was nearly \$29.7 million.<sup>1</sup> This amount is comprised of collection costs incurred by both the Sales and Use Tax Department (SUTD) and the Property and Special Taxes Department (PSTD). Although the alternatives identified in section IV provide different approaches for assessing the fee, in each alternative the total fees assessed are the same as the collection costs incurred by BOE.

To ensure the fees assessed by BOE continue to equal the costs incurred, the fee amount will need to be periodically recalculated. We recommend staff recalculate the fee each fall using data from the prior fiscal year. The revised fee amount will be presented to the Board for approval on the consent calendar. Upon approval, the revised fee amount would go into effect on January 1<sup>st</sup> of the following year. This schedule will allow sufficient time to obtain the necessary data, perform the required calculations, obtain Board approval, and update BOE's Integrated Revenue Information System (IRIS) with the new fee amount.

c. Fee Assessed- Existing Liabilities

In addition to assessing the fee prospectively on liabilities newly billed after January 1, 2011, BOE would assess the fee on liabilities previously billed that meet the criteria. This approach is fair since BOE is expending resources, and must continue to do so, to obtain payment of these liabilities. To properly assess the fee on outstanding final liabilities, BOE would mail new Demand Notices to the impacted taxpayers and provide them with an opportunity to avoid the fee by either paying their liability in full or entering into an installment payment agreement.

d. Installment Payment Agreement Exclusion

Some taxpayers are unable to pay their liability in full within 90 days but are willing to enter into an installment payment agreement (IPA) to pay their liability over time. To avoid such taxpayers from being unfairly penalized, it is recommended the fee not be assessed when a taxpayer has entered into an IPA prior to the fee being assessed. All existing IPA policies and procedures would continue to be followed as provided for in the Compliance Policies and Procedures Manual (CPPM) section 770.000.

Taxpayers must remain in compliance with the terms of their IPA and pay their liability in full to avoid the IPA from being terminated and the fee assessed. In instances where BOE terminates an IPA, the fee would be assessed immediately upon termination of the IPA.<sup>2</sup> This provision would be disclosed to taxpayers prior to terminating an IPA.

e. Relief from Fee

The statute which requires imposition of the fee also allows BOE to grant taxpayers relief from the fee under certain circumstances. Similar to statutes that allow relief of penalties, BOE can grant relief of the fee in instances where a taxpayer failed to pay a liability due to reasonable cause and circumstances beyond their control. Taxpayers seeking relief must submit their request under penalty of perjury and describe the reason(s) they failed to remit payment.

To implement this provision, BOE will rely upon existing processes utilized for relief from penalty requests. BOE would make available to taxpayers a form for use in submitting such requests. As with requests for relief from penalty, several factors will be taken into consideration in determining whether or not a taxpayer's request should be granted.

f. Taxpayer Notification and Outreach

Prior to BOE imposing a fee, an outreach effort would be developed and implemented to notify taxpayers of the fee. Outreach activities would include:

- Printing and mailing a special notice to taxpayers with unpaid liabilities. The notice would provide taxpayers with general information regarding the fee.
- Modifying the BOE's notices to inform taxpayers that a fee will be assessed if their liability is not paid or if they fail to enter into an IPA.

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Amount is comprised of \$43.7 million in costs incurred by both SUTD and PSTD for FY 2009-10. Of this amount, 68%, or \$29.7 million, was identified as being spent on collecting billed accounts receivables. (Approximately 32% of staff's time is spent on other compliance activities, specifically, obtaining delinquent tax returns.)

<sup>2</sup> Assuming the liability is more than 90 days past due and more than \$250 in unpaid liability remains due on the date the IPA is terminated.

- Including information regarding the fee in the BOE's Tax Information Bulletins.
- Posting information regarding the fee on BOE's website.
- Developing and distributing news releases prior to BOE assessing the fee.
- Special mailing to tax practitioners and industry groups.

**Table 2 – Summary of Attributes Common to All Alternatives**

<b>Attribute</b>	<b>Summary</b>
Assessment Time	Assess fee when liability is 91 days past due.
Liability Dollar Threshold	Assess fee on liabilities greater than \$250.00 (flat-fee and stratified flat-fee alternatives only). For the percentage-based alternative, no dollar threshold would be used.
Recalculation of Fee Amount	The fee amount will be recalculated annually and presented to the Board for approval on the consent calendar. The new fee amount would become effective on January 1 <sup>st</sup> of each year.
Avoidance of Fee	Taxpayers can avoid the fee by paying the liability in full or enter into Installment Payment Agreement (IPA) prior to the fee being assessed.
Notification	Demand Notices issued on or after January 1, 2011 will include the required notification about the fee.
Earliest Fees will be Assessed	April 1, 2011
Assess Fee on Existing Liabilities	In early 2011, mail new Demand Notices to taxpayers with liabilities originally billed prior to January 1, 2011. Such taxpayers will be provided with a 90-day opportunity to avoid the fee by remitting payment or entering into an IPA.
Relief from Fee	BOE can grant relief of the fee in instances where a taxpayer failed to pay a liability due to reasonable cause and circumstances beyond their control. A form will be available for use by taxpayers in requesting relief.
Notification and Outreach	Mail special notice to taxpayers with existing liabilities eligible for the fee, modify other BOE notices, post information on BOE's website, include fee information in the Tax Information Bulletins, special mailing to tax practitioners and industry groups, issue a news release, and revise selected BOE publications.

**IV. Alternatives**

This section identifies three alternatives for assessing a fee on past due liabilities: flat-fee, stratified flat-fee, and percentage based. As discussed in section III, all of the alternatives have many attributes in common. For ease of discussion, the common attributes are not described for each alternative.

**1. Alternative 1 - Stratified Flat-fee**

Under this alternative, a flat-rate fee would be applied to each liability greater than \$250, however, the fee amount would vary based on the dollar amount of the past due liability. Large dollar liabilities would be assessed a higher fee than medium and small liabilities. Stratification of the fee amount based on the amount of the liability is intended to reflect the fact that, overall, greater resources are expended by BOE to collect large dollar liabilities.

For calendar year 2011, the fee amounts would be \$185, \$550, or \$925 and assessed on small, medium, and large liabilities, respectively. The three fee amounts and associated liability ranges are summarized in Table 3.

**Table 3 – Stratified Flat-Fee (Year 2011)**

<b>Liability Size</b>	<b>Liability Dollar Range</b>	<b>Fee Amount</b>
Small	\$250.01 - \$2,000.00	\$185
Medium	\$2,000.01 - \$50,000.00	\$550
Large	\$50,000.01 +	\$925

*a. Pros*

- Allows the fee amount to more closely represent costs incurred by BOE since, generally, greater resources are expended to obtain payment of larger dollar liabilities.
- For small dollar liabilities, the fee amount would not exceed the amount of the liability.
- In comparison to alternative 2, may be more likely to prompt taxpayers to remit payment of the past due liability since the fee amount assessed on medium and large dollar liabilities would be greater.

*b. Cons*

- Could increase taxpayer confusion with respect to understanding why different fee amounts are assessed on different liabilities.

**2. Alternative 2 - Flat-fee**

Under this alternative, the same fee would be applied to each liability exceeding \$250. For calendar year 2011, the fee amount would be \$319.

*a. Pros*

- Provides parity between BOE and FTB since FTB assesses a flat rate fee on taxpayers with past due liabilities. FTB's fee does not vary based on the dollar amount of the past due liability.
- Simplifies fee assessment since the same fee would be applied to all past due liabilities eligible for the fee.

*b. Cons*

- In instances where the past due liability is less than \$319, the fee would exceed the amount of the liability.
- With respect to taxpayers with high-dollar liabilities, the fee may not prompt payment of the past due liability since the fee amount would be minor in relation to the amount of the past due liability.
- May not be equitable for small or large dollar liabilities since resources expended by BOE to obtain payment of a past due liability may be significantly less than or greater than the fee amount assessed.

**3. Alternative 3 - Percentage Based Fee – With \$50,000 Cap**

Under this alternative, the fee amount would be determined based on a percentage of a taxpayer's liability that remained due after 90 days. Unlike alternatives 1 and 2, a percentage based fee would be imposed on all liabilities, including those less than \$250. To prevent the fee amount from being unreasonable, the fee would be limited, or "capped," at \$50,000 since costs incurred by BOE in working a past due liability would rarely exceed this amount.

For calendar year 2011, the fee would be set at 6.8%. The average unpaid liability is \$3,428 and would, therefore, result in an average fee of \$233 being assessed under this alternative. Imposing a cap or limit would result in a fee of \$50,000 being assessed on unpaid balances of greater than \$735,294.<sup>3</sup> Based on data from FY 2009-10, a capped fee of \$50,000 would be assessed on approximately 40 liabilities each year.

<sup>3</sup> \$50,000 / 6.8% = \$735,294

*a. Pros*

- Increases the likelihood that the fee amount assessed on a liability will cover the collection costs incurred by BOE since greater resources are generally required to resolve large dollar liabilities.
- Prevents the fee assessed on a liability from being excessive since the fee amount is capped.
- Increases the likelihood of prompting voluntary compliance on larger liabilities since the fee amount imposed would be greater in comparison to alternatives 1 and 2.

*b. Cons*

- The fee amount assessed on large dollar liabilities would be significantly greater in comparison to alternatives 1 and 2.

**VIII. Recommendation**

Staff recommends alternative 1. Under this alternative, a stratified flat-fee will be assessed on past due liabilities. This alternative allows the fee amount to more closely represent costs incurred by BOE while preventing the fee amount from being excessive.

As discussed in section III, the fee would be assessed on each liability greater than \$250 that remained unpaid for more than 90 days. Demand notices issued by the BOE on or after January 1, 2011 will warn taxpayers of the fee prior to it being assessed. Taxpayers will be able to avoid the fee by either paying their liability in full or entering into an installment payment agreement prior to the fee being assessed. Each year the fee amount will be recalculated and presented to the Board for approval on the consent calendar. The revised fee amount would become effective beginning January 1<sup>st</sup> of each year.