



STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0092
(916) 324-1825 • FAX (916) 322-4530
www.boe.ca.gov

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Third District, Rolling Hills Estates

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Fourth District, Los Angeles

JOHN CHIANG
State Controller

KRISTINE CAZADD
Executive Director

January 20, 2012

Dear Interested Party:

Enclosed is the Initial Discussion Paper on the proposal to establish and seek funding for an informant reward program for sales and use tax. Discussion regarding this issue is scheduled for the Board's **May 30, 2012 Business Taxes Committee** meeting.

However, before the issue is presented at the Business Taxes Committee meeting, staff would like to provide interested parties an opportunity to discuss the issue and present any suggested changes or comments. Accordingly, a meeting is scheduled in **Room 122 at 10:00 a.m. on February 7, 2012**, at the Board of Equalization; 450 N Street; Sacramento, California.

If you are unable to attend the meeting but would like to provide input for discussion at the meeting, please send your submission to the above address or fax to (916) 322-4530 before the February 7, 2012 meeting. If you are aware of other persons that may be interested in attending the meeting or presenting their comments, you are welcome to provide them with a copy of the enclosed material and extend an invitation to the meeting. In addition, please feel free to publish this information on your website or otherwise distribute it to your association or members.

If you plan to attend the meeting or would like to participate via teleconference, please let staff know by contacting Ms. Lynn Whitaker at (916) 324-8483 or Lynn.Whitaker@boe.ca.gov prior to February 3, 2012. This will allow staff to make alternative arrangements should the expected attendance exceed the maximum capacity of Room 122 and to arrange for teleconferencing.

Whether or not you are able to attend the above interested parties meeting, please keep in mind that the due date for interested parties to provide written responses to staff's analysis is **February 24, 2012**. Please be aware that a copy of the material you submit may be provided to other interested parties. Therefore, please ensure your comments do not contain confidential information.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Business Taxes Committee" page on the Board's Internet website (<http://www.boe.ca.gov/meetings/btcommittee.htm>) for copies of Committee discussion or issue papers, minutes, a procedures manual and calendars arranged according to subject matter and by month.

Thank you for your consideration. I look forward to your comments and suggestions. Should you have any questions, please feel free to contact Ms. Kirsten Stark, Supervisor, Business Taxes Committee and Training Section, at (916) 322-0849.

Sincerely,



Susanne Buehler, Chief
Tax Policy Division
Sales and Use Tax Department

SB:llw

Enclosures

cc: (all with enclosures)

Honorable Jerome E. Horton, Chairman, Fourth District
Honorable Michelle Steel, Vice Chair, Third District
Honorable Betty T. Yee, Member, First District (MIC 71)
Senator George Runner (Ret.), Member, Second District (MIC 78)
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel

(Via E-mail)

Mr. Robert Thomas, Board Member's Office, Fourth District
Mr. Neil Shah, Board Member's Office, Third District
Mr. Tim Treichelt, Board Member's Office, Third District
Mr. Alan LoFaso, Board Member's Office, First District
Ms. Mengjun He, Board Member's Office, First District
Mr. Lee Williams, Board Member's Office, Second District
Mr. James Kuhl, Board Member's Office, Second District
Ms. Natasha Ralston Ratcliff, State Controller's Office
Ms. Kristine Cazadd
Mr. Randy Ferris
Mr. Jeffrey L. McGuire
Mr. Jeff Vest
Mr. David Levine
Mr. Bradley Heller
Mr. Robert Tucker
Mr. Scott Claremon
Mr. Todd Gilman
Ms. Laureen Simpson

Mr. Robert Ingenito Jr.
Mr. Bill Benson
Mr. Stephen Rudd
Mr. Kevin Hanks
Ms. Lynn Whitaker
Mr. Robert Wilke

INITIAL DISCUSSION PAPER

Informant Reward Program - Section 7060

Issue

Should the Board of Equalization (BOE) establish and seek funding for an informant reward program for sales and use taxes?

Background

At the August 23, 2011 Board Meeting, staff presented a concept Tax Gap 2 plan that included a suggestion to fund an informant reward program. “Tax gap” refers to the difference between taxes owed and taxes paid. For sales and use taxes, BOE breaks the gap into three major components: use tax liabilities (consumers and businesses that are not required to register with BOE), registered taxpayers (underreporting and non-payment), and non-filers/tax evasion. The idea of an informant reward program was suggested to address the non-filers/tax evasion component of the gap. After brief discussion at the August meeting, the Board Members referred the issue to the Business Taxes Committee for further analysis and consideration. This issue is scheduled to be presented at the May 30, 2012 Business Taxes Committee meeting.

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. However, the Legislature has never appropriated funds for the purpose of an informant reward program.¹ 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. The issue appears to have last been brought up in 1995 when the Sales and Use Tax Department sent an informational issue paper to the Board Members with the recommendation that BOE not seek funding to implement a reward program. The Board did not take any action to establish a program at that time.

Like BOE, the Franchise Tax Board (FTB) has had the authority to establish an informant reward program since 1984, but has not done so. 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 regarding funding for BOE, AB 2605 met opposition and in June 2010, the bill was amended with reward program provisions removed.

¹ 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.

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BOE's current statutory provisions. Revenue and Taxation Code (RTC) section 7060 provides:

Reward program for unreported tax information. (a) The board, under regulations prescribed by the board, may establish a reward program for information resulting in the identification of underreported or unreported taxes due under this part. Any reward may not exceed 10 percent of the taxes collected as a result of the information provided. Any person employed by or under contract with any state or federal tax collection agency shall not be eligible for a reward provided pursuant to this section.

(b) Within 2½ years of the effective date of the act adding this subdivision or with 2½ years of the commencement of a program pursuant to subdivision (a), whichever is later, the board shall report to the Legislature on all of the following:

(1) The number of informant letters and telephone calls received during the 2-year period following the effective date of the act adding this subdivision or following the commencement of a program pursuant to subdivision (a), whichever is later.

(2) The amount of additional taxes and penalties assessed and collected as a result of this program and the amount of rewards distributed.

(3) The administrative costs incurred in implementing and operating this program.

(c) Rewards paid pursuant to this section shall be paid from amounts appropriated by the Legislature for that purpose.

BOE current procedures for reporting tax fraud information. Although BOE does not pay informants rewards, BOE does encourage taxpayers to report suspected tax fraud. On the BOE website homepage under the Quick Links “How do I...” is a link titled, “[Report Suspected Tax Fraud.](#)” From there, the user chooses the applicable BOE tax or fee program for further instructions. The page also provides a link to an FAQ page which answers common questions about filing complaints including: why it is important to report suspected fraud; what information the BOE needs to investigate suspected fraud; and some signs that might indicate sales, fuel, cigarette, or tobacco tax evasion. The page also explains that BOE does not pay rewards for reporting tax crime; that informants can remain anonymous if they wish; and that because of confidentiality laws, informants will not be updated on the status of BOE investigations.

BOE's “Sales Tax Evasion” page explains what evasion is, why tax evasion is harmful, and how to contact BOE's Investigation Division or toll free Tax Evasion Hotline. The webpage also allows users to email their complaint to the Investigations Division with the option of remaining anonymous (completing the field for the user's name and email address is optional).

In addition to the procedures posted on BOE website, BOE's Audit Manual section 0124.00, *Informant Contact Procedures*, and Compliance Policy and Procedures Manual section 135.076, *Guidelines for Release of an Informant's Name*, provide information about the confidentiality of an informant's identity under the Information Practices Act.

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Discussion of other state government reward programs

As a general rule, state tax agencies encourage the reporting of tax fraud and provide the means for informants to report suspected activities. However, most states do not provide compensation to informants for information resulting in the additional collection of taxes. With regard to the collection of sales and use taxes, only Florida provides an informant reward program. Florida statutes authorize the Executive Director of the Department of Revenue to compensate persons who provide information leading to the registration of a noncompliant taxpayer and/or collection of taxes, penalties, and interest with respect to specified taxes, including the corporate income tax, fuel taxes, insurance premium taxes, and sales and use taxes.

When information is received, the Department determines whether an investigation or audit is a wise use of the public funds under the particular circumstances. The Executive Director makes the final determination whether compensation should be paid. The rate of compensation, not to exceed ten percent, depends on the information provided. A \$100 flat fee is also available when information leads to the registration of a noncompliant taxpayer. Rewards are paid when all amounts (tax, interest, penalties) are collected. However, the informant may elect to be paid early if they waive their right to any uncollected amounts. Information must be submitted in writing and a claim for compensation form must be filed soon thereafter.

Other states may offer reward programs for income tax law violations. For example, in Oregon, the Department of Revenue may pay rewards to persons, other than officers or employees of the department, furnishing information that leads to the recovery of tax from other persons guilty of violating the provisions of income tax laws. Such rewards are not to exceed ten percent of the net amount of tax, penalty, and interest and are paid only in cases where such evasions of tax would not be disclosed by the audit of returns or from other information available to the Department. Informants are advised in advance that they must rely on the Department for fair treatment and have no recourse, and that payments of rewards may be long delayed while issues involved in determination of tax liability are finally resolved.

In New York, the state's False Claims Act², which was most often used for healthcare and government contract fraud, was recently expanded to include tax fraud. Under the new provisions, a citizen can bring a lawsuit against a person or business that makes more than \$1 million in annual net income and defrauds the state of more than \$350,000 by knowingly making a false claim. The court determines the percentage of proceeds, up to 30% in some cases, by considering the extent to which the plaintiff contributed to the prosecution of the case.

² California's False Claims Act (commencing with Government Code Section 12650) does not apply to claims, records, or statements made under the Revenue and Taxation Code.

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Issues to consider

The information and questions in following sections are intended to promote discussion among staff and interested parties.

Before recommending a program, staff must define the limits of the program. For example:

1. Staff would likely want to limit the program to cases where tax was intentionally underreported or unreported. Would the program limit a reward to cases where staff imposed a fraud or intent to evade penalty? What if that penalty was later relieved in the appeals process?
2. Should the program include cases where the information led to a denial of an erroneous claim for refund? (This would require revision to section 7060.)
3. Should the program require that a minimum dollar amount be discovered in order to qualify for a reward? This provision would allow BOE to exclude small claims from investigation.
4. Should the program include a maximum dollar amount that would be paid?
5. Would BOE use a flat percentage to determine the reward amount, or would BOE use different percentages based on the significance of information given in relation to the amount discovered by the investigation? For example, one IRS whistleblower program offers a tiered reward system (15-30% of the amount collected) based on the value of the information received. If BOE elected to use different percentages at its discretion, how would BOE determine which percentage would apply? Would the informant be able to appeal the decision to apply a particular percentage?

With regard to the actual payment of rewards, BOE would likely not want to be required to pay a reward until after the last of the following has occurred: The collected proceeds are deposited into the appropriate state fund and the taxpayer has exhausted all legal remedies, or the statute of limitations for filing a claim for refund for or otherwise for contesting, any amount subject to the reward has expired. Accordingly, it may be several years before a reward is paid to an informant. In addition, the calculation of a reward may reveal confidential information about the account that was investigated. BOE will need to review its confidentiality statutes and policies for possible conflict.

Staff and interested parties should also consider:

6. What if the taxpayer pays the liability and files a claim for refund? Or files a lawsuit? The program should specify that BOE would postpone the payment of a reward until the due dates for these possibilities have passed. And, if either is filed, that BOE will wait until their outcome before paying a reward.
7. How would the reward payment be affected if the taxpayer pays under an installment agreement?

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8. How would the reward payment be affected if the Board approved a settlement agreement or offer in compromise?

Other considerations:

9. Should a reward program apply to other taxes and fees administered by BOE? (This would require legislative action.)
10. BOE would want to exclude informants from a reward program if the informant was responsible or contributed to the underreported or unreported tax.
11. Should the reward program impose time limits to provide information to encourage reporting information related to current liabilities? For example, staff might not want to investigate claims of unpaid use tax from 8 years ago.
12. The offer of a monetary reward may result in an increased number of erroneous or unsubstantiated informant tips. What protections would BOE offer businesses against disgruntled former employees or spouses?
13. How would BOE handle multiple claims from different people with similar information?
14. What if BOE received information on an account that has already been selected for audit?
15. Would informants have any ability to appeal the amount of the reward?

Summary

Interested parties are welcome to submit comments or suggestions on the issues discussed in this paper, and are invited to participate in the interested parties meeting scheduled for February 7, 2012.

Prepared by the Tax Policy Division, Sales and Use Tax Department

Current as of 01/20/2012