

Memorandum

To : Mr. Ramon J. Hirsig
Executive Director

Date: May 6, 2010

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



Subject : **Board Meeting - May 25-26, 2010**
Item P3- Sales and Use Tax Department's Deputy Director Report
Informal Discussion Paper on a Collections Cost Recovery Fee

At the May 25-27, 2010 Board Meeting, I will be sharing information on options for assessing a fee on past due liabilities.

Please place this item on the May 26, 2010 Board Meeting agenda under P3.1.

RLH:ma

Attachment: Informal Discussion Paper

cc: Ms. Diane Olsen (MIC 80)

Approved: _____



Ramon J. Hirsig
Executive Director

- For Information
- For Discussion
- For Decision Making

BOARD OF EQUALIZATION
INFORMAL ISSUE PAPER

Collections Cost Recovery Fee

I. Issue

Discussion of a Collections Cost Recovery Fee ("fee") and its potential impact.

II. Background

a. SBx4-16

As part of Senate Bill SBx4-16, Government Code (GC) section 16583.1 was enacted in 2009 authorizing state agencies to impose a fee on past due liabilities. GC section 16583.1 does not specify how the amount of the fee should be calculated or determined. The only requirements are that the fee is reasonable and does not exceed actual collection costs incurred. Specifically, the section states:

"A participant may impose a reasonable fee, not to exceed the actual costs, to recover the participants collection costs on a past due account."

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). However, all information provided in this document assumes BOE is provided with such authority via new legislation.

b. Budget Letter 09-37

The following information was contained in Budget Letter 09-37 issued by the Department of Finance on September 29, 2009.

"Departments are encouraged to adopt practices, when feasible, that will help prevent ARs from occurring and encourage prompt collections to prevent delinquent ARs. As such, Government Code (GC) Section 16583.1 was added [Chapter 23, Statutes of 2009, Fourth Extraordinary Session (SB 16)]. GC Section 16583.1 allows departments to charge a reasonable fee, not to exceed the actual costs incurred by the department, to recover the department's collection costs on past due ARs.

When preparing billing notices/invoices, departments should indicate on the billing notice/invoice possible consequences of not paying timely, such as additional fees that may be incurred pursuant to GC Section 16583.1. If your department plans to recover costs pursuant to this Section, departments should consider actual costs incurred, including, but not limited to, staff time to send out collection letters, postage, equipment costs, and contingency fees for private collectors.

Departments will record this fee as revenue, source code: 161200 - Delinquent Receivables – Cost Recoveries. Departments are requested to maintain a count of the number of accounts collected with this fee added. Finance may later request this information to determine the effectiveness of adding this fee to delinquent accounts."

c. 2010-11 Budget Possibilities

The Legislature and the Department of Finance reviewed the collection fee concept paper that was originally included on the April 13, 2010 Board Meeting agenda, but later pulled. The concept paper has prompted inquiries to staff regarding the implementation of a collection fee in the budget year. The possibility exists that the May budget revision or trailer bill language may mandate the imposition of a collection fee.

III. Research - Other States/ Agencies

Fees on past due liabilities are imposed by the Franchise Tax Board (FTB) and taxing agencies in other states. In addition to obtaining information from FTB, a survey was distributed to other states through the Federation of Tax Administrators. A total of nine states responded to the survey, six of which stated that they impose a fee. Below are highlights from the survey findings.

- *Amount* – FTB imposes a flat-fee on liabilities greater than \$100. As of July 2009, the fee was set at \$217 for individuals and \$413 for corporations. All other taxing agencies utilized a percentage based fee ranging from 10%-25%.
- *Timing of Fee* – Taxing agencies generally impose a fee when a liability remains unpaid for 90-100 days.
- *Imposed Retroactively* – Taxing agencies with a fee generally applied the fee retroactively to all unpaid liabilities. Prior to imposing the fee, agencies performed outreach to inform taxpayers of the fee and to provide them with an opportunity to avoid it.
- *Length of Time Imposed* – Most taxing agencies indicated that they have imposed a fee for several years. FTB began imposing a fee in 1993, while other states began imposing fees as early as 1988.
- *Taxpayer Compliance* - Neither FTB, nor any of the states responding to the survey, reported an increase in compliance or a decrease in past due liabilities resulting from the imposition of a fee.

IV. Fee Imposition and Collection

a. Calculation of "Actual Collection Costs"

In 2008-09, BOE's, direct personnel costs identified to collection activities was slightly more than \$27.6 million.¹ 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).

b. Determination of When a Fee Will be Imposed

BOE's existing operations generally provide a taxpayer with several opportunities to pay their liability prior to it being assigned to collection staff. Liabilities that remain unpaid are assigned to collection 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 suggested a fee be assessed when a liability remains unpaid for more than 90 days. A majority of taxing agencies imposing a fee take the same approach.

It is recommended that a separate fee be assessed on each past due liability incurred by a taxpayer. In doing so, a taxpayer could be assessed several fees, that is, a separate fee for each liability more than 90 days past due. This approach is equitable since BOE must continue to allocate resources in obtaining payment of the liabilities. Assessing the fee in this manner may also deter a taxpayer from incurring additional liabilities.

¹ Amount is comprised of costs incurred by both SUTD and PSTD. For SUTD, the amount was determined based on a percentage of SUTD's budgeted personnel costs for collections. In FY 2008-09, SUTD was budgeted \$37.5 million for collections of which 68%, or \$25.5 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.)

For PSTD, the cost associated with collections in FY 2008-09 was \$2.1 million. This amount was calculated based on staff hours reported to collection activities (nearly 65,000 hours in FY 2008-09), then multiplying the number of hours (by classification) by the per hour salary rate (including benefits).

It appears to be common practice not to assess a fee in instances where a taxpayer has entered into an installment payment agreement prior to the fee being applied. A fee is, however, usually assessed if the taxpayer later defaults on the agreement.

The Insurance Tax and Motor Vehicle Fuel Tax (gasoline, aviation fuel, and jet fuel) are administered by BOE but collected by other state agencies. Since BOE is not responsible for collecting past due liabilities for these programs, BOE would not assess a fee on these liabilities. Additionally, BOE would not assess a fee on past due liabilities for the Cigarette and Tobacco Licensing Fee (CTLF) program since BOE is able to withhold the issuance of a license to ensure compliance with the CTLF.²

c. Revenue

Imposing a fee will increase the revenue collected by BOE. Assuming BOE begins assessing a fee in April 2011, revenue is estimated to increase by \$4.8 - \$5.9 million in FY 2010-11 and by \$18 - \$20.6 million each year beginning in FY 2011-12. The anticipated revenue increase varies based on whether the fee is flat-rate or percentage based.

The revenue estimates provided assume BOE has statutory authority to obtain payment of the fee through involuntary collection action. The estimates also assume payments received for accounts with such fees will be applied using BOE's existing payment application rules.³ Voluntary payments not specifically directed by a taxpayer at the time of payment will be applied to unpaid collection costs prior to being applied to tax, interest, and penalty.

A funding offset approach could be utilized with the revenue generated by the fee whereby the amounts received would be placed into a separate fund. This fund will be continuously appropriated to BOE to offset the budgeted funding level in the fiscal year following the collection of the fee. Every January, BOE would offset the current year funding with the prior year's fees, reducing the excess funding from the appropriate fund source through a current year budget revision.

This adjustment would occur annually after the first fiscal year the fees are received. By doing so, this will decrease the amount of funding needed from the General Fund and Special Funds to administer BOE's tax and fee programs. This will also allow for BOE staff to continue revenue generating activities, such as traveling to conduct audits when a new fiscal year budget is not enacted timely.

It is important to note, however, that use of continuous appropriation by BOE would require a change in statute. Table 1 provides a summary of the continuous appropriation anticipated based on the revenue estimates for the first four years the fee is imposed.

² Fee would not be assessed on retailers, wholesalers, and distributors but would be assessed on manufacturers.

³ Details regarding the BOE's payment application rules are found in Compliance Policy and Procedures Manual section 707.020.

Table 1 – Continuous Appropriation Using Fees Received

	<u>FY 2010-11</u> <u>(Apr- Jun)</u>	<u>FY 2011-12</u>	<u>FY 2012-13</u>	<u>FY 2013-14</u>
	(\$ in millions)			
Fees Received	\$4.8	\$18	\$19.4	\$20.6
BOE Estimated Budget*	\$472	\$480	\$488	\$495
Prior Year Collection Fee Offset	N/A	-\$4.8	-\$18	-\$19.4
Adjusted GF, SF, & Reimb. Funding	\$472	\$475.2	\$470	\$475.6
AR Cost Recovery Fee Funding		\$4.8	\$18	\$19.4
Total BOE Funding	\$472	\$480	\$488	\$495

*BOE Budget funding is comprised of General Fund, Special Funds, and Reimbursements.

The assumptions made in Table 2 include:

- (1) Allocate Governor's Budget at full base level in the Budget Year.
- (2) True-up in January as part of a mid-year adjustment to the current year funding by applying the amount of fees collected in the prior year and returning the balance to the appropriate fund source.
- (3) Fees are continuously appropriated without regard to spending category, program type, or fiscal year.
- (4) Legislation enacted which provides for a continuous appropriation for fees collected.
- (5) Legislation enacted which allows BOE to obtain payment of fees assessed via involuntary collection action
- (6) System enhancements necessary to assess the fee would be complete by March 2011 and BOE would begin assessing the fee in April 2011. This is a best case scenario and would likely result in the delay or cancellation of other revenue projects.
- (7) Flat-rate fee of \$345 is assessed on each liability greater than \$250.

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 only a portion of the fees imposed will be paid. Imposing a fee is anticipated to increase accounts receivables by \$54.3 - \$77.4 million in FY 2010-11, with total increases of \$94.9 - \$111.2 million through FY 2013-14. The amount of the increase varies based on whether the fee is flat-fee or percentage based.

e. Cost

Imposing a fee will increase the number of taxpayer notices produced and will require augmenting BOE's staffing level. Assuming BOE begins assessing a fee in April 2011, FY 2010-11 costs would be \$314,000 with ongoing costs of approximately \$253,000 beginning in FY 2011-12. First year costs are slightly higher since a greater number of notices will initially be produced as a result of applying the fee on all past due liabilities.

i. Taxpayer Notices

Resources will be required to produce and mail notices to taxpayers informing them of the imposition of the fee. In FY 2010-11, a total of approximately 163,000 notices would be produced. In FY 2011-12 and ongoing, approximately 104,000 notices would be produced. Producing these notices will result in BOE incurring additional costs, specifically: postage, paper, printing, and data services provided by the Office of Technology Services.

ii. Staffing

The staffing level of the Customer Service and Publishing Division (CSPD) would need to be augmented to accommodate the increase in taxpayer inquiries prompted by the taxpayer notices and received by the BOE's call center. Specifically, CSPD's staffing level would need to be increased by 0.5 positions (Tax Technician II classification) each year beginning in FY 2010-11. Blanket funds for the temporary call center help would also be

required for FY 2010-11. The funds required would be relatively minor, equivalent to 0.3 positions at the Tax Technician II classification.

In addition to augmenting CSPD's staffing level, the staffing level of the Financial Management Division (FMD) would need to be increased to accommodate the increase in workload associated with utilizing a continuous appropriation for the fees collected. Specifically, 1.0 position at the Associate Accounting Analyst level would be required effective April 2011.

V. Technology Impact

Significant programming modifications to BOE's Integrated Revenue Information System (IRIS) and Automated Compliance Management System (ACMS) are required to assess a fee, notify taxpayers of amount due, modify the collection system, and ensure proper tracking of revenue from fees collected to the appropriate fund. In a best-case scenario, the necessary IRIS and ACMS modifications would be implemented by the end of March 2011 and a fee assessed beginning in April 2011. Doing so would require: 1) System modifications to begin in October 2010, after system changes necessary for the first phase of the Fuel Tax Swap Project (AB x8 6) have been completed; and, 2) A redirection of resources from the Electronic Services Expansion Project which would result in a delay and/or a reduction in scope of that project.

High-level, IRIS and ACMS system changes resulting from the imposition of a fee are provided as follows.

a. IRIS Impact

- *Changes to accommodate the assessment of the fee.* System rules for assessing a fee will need to adhere to BOE policies. For example, the fee would not be assessed until a certain time (e.g., 90 days after liability initially billed) and must not be applied to liabilities included in IPAs.
- *Modification to existing IRIS notices.* Notice changes will be required so that taxpayers are informed of the fee prior to it being assessed. Changes may involve modifying notice text and/or the timing of IRIS notices.
- *Creation of additional IRIS notices and reports.* Depending upon BOE policies developed with regard to a fee, additional notices may need to be created. For example, a specific notice might be created and mailed to the taxpayer prior to and/or after the fee is assessed. Reports will need to be modified to include fees to enable tracking and reporting on the collection of the fees.

b. ACMS Impact

- *Changes to accommodate the assessment of the fee.* Changes may be required to ensure fees assessed are properly transferred from IRIS to ACMS.
- *Review and possible revision of collection case assignment rules.* ACMS routes and assigns collection cases to collection staff based on many predetermined rules. The rules will need to be reviewed and revised, as needed, to ensure they coincide with BOE policies with respect to fees.
- *Modification to existing ACMS notices.* Various notices are automatically printed and mailed to taxpayers informing them of their unpaid liability. The text on the notices would likely need to be revised to inform taxpayers of the fee and identify specific actions they may take to avoid the fee. In addition to modifying these notices, collection documents (e.g., Notice of Lien, Notice of Levy) would also likely need to be modified so that the fee can be identified on these notices.

VI. Taxpayer Notification

a. Publicity Efforts to Ensure the Public is Properly Noticed

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

- Modifying the BOE's notices to notify taxpayers that a fee will be assessed if their liability is not paid or they fail to enter into an IPA.
- Printing and mailing notices to taxpayers with unpaid liabilities. The notice would inform taxpayers of the fee and provide details on how the fee can be avoided.

- Including information regarding the fee in the BOE’s Tax Information Bulletin.
- Posting fee details, including Frequently Asked Questions, on BOE’s website.
- Developing and distributing news releases prior to BOE assessing the fee.
- Participating in media interviews.

b. Revision of Publications

BOE has an extensive library of publications available to taxpayers. Although many publications are no longer printed in hardcopy, these publications are updated and made available from the BOE’s website. If BOE began assessing a fee, several publications would need to be revised so that they included information regarding the fee. Some publications, as noted below, would require translation since they are available in additional languages. A preliminary review indicates the following publications would likely need to be revised.

- Publication 17 – *Appeals Procedures* (English, Spanish)
- Publication 54 – *Tax Collection Procedures* (Chinese, Vietnamese, Korean, Spanish)
- Publication 73 – *Your California Seller’s Permit* (English, Spanish, Chinese, Vietnamese, Korean, Farsi, Thai)
- Publication 75 - *Interest and Penalties*

VII. Alternatives

a. Flat-fee

Under this alternative, a flat-rate fee of \$345 would be applied to each liability greater than \$250 that remained unpaid for more than 90 days. The fee would not be imposed on liabilities of \$250 or less since BOE’s staffing level and existing workload limits the resources expended on low-dollar liabilities. Costs incurred by BOE on such liabilities would likely be significantly less than \$345. Table 2 provides a summary of the fees assessed, revenue received, and benefit/ cost of imposing a flat-rate fee.

**Table 2 – Summary of Fees, Revenue, and Costs (FYs 2010-14)
 Flat Rate Fee of \$345 per Liability Assessed on Liabilities > \$250
 With Statutory Collection Authority**

	FY 2010-11 (Apr – Jun)	FY 2011-12	FY 2012-13	FY 2013-14
Fees Assessed Balance	\$54.3 million	\$77.1 million	\$86.7 million	\$94.9 million
Revenue Received	\$4.8 million	\$18 million	\$19.4 million	\$20.6 million
Costs Incurred	\$314,000	\$253,000	\$253,000	\$253,000
Benefit / Cost	15.3 :1	71.1 :1	76.7 :1	81.4 :1

Fees Assessed Balance– Represents a cumulative total including new fees assessed in the Fiscal Year plus the uncollected ending balance from the previous year less payments received in Fiscal Year.

Revenue Received – Represents payments received in the Fiscal Year. FY 2010-11 estimates assume system changes are implemented by March 2011 and BOE begins assessing the fee in April 2011. An implementation date of March 2011 is a best case scenario and would require other revenue projects to be delayed or cancelled.

Costs Incurred – These are costs for generating taxpayer notices when the fee is assessed and additional staff for the BOE’s Information Center. Costs incurred in processing fee waiver requests are not reflected in the cost estimates above.

i. Pros

- Allows BOE to recoup costs incurred by its collection program. In 2008-09, BOE's direct personnel costs identified to collection activities was slightly more than \$27.6 million.
- Increases revenue by \$4.8 million in FY 2010-11 and \$18 - \$20.6 million per year beginning in FY 2011-12.
- Provides an estimated benefit/cost of 81.4:1 in the fourth year.
- Allows BOE to assess the same fee to all past due liabilities.
- Provides parity between BOE and FTB since FTB assesses a flat rate fee.
- Allows the cost recovery of the accounts receivable to offset the cost of administering the programs by decreasing the amount of funding needed from the General Fund and Special Funds.
- Allows the cost recovery amount to offset BOE's budget appropriation in the fiscal year following the collection of revenue through a continuous appropriation.
- Allows BOE staff to continue revenue generating activities, such as traveling to conduct audits, when a new fiscal year budget is not enacted timely. Such activities would be possible through a continuous appropriation.
- Allows BOE to reduce expenditures incurred for late payment penalties due to delayed budget enactment from being paid out of the General Fund working appropriation. Funds for such expenditures would be provided through a continuous appropriation.

ii. Cons

- Requires resources to: 1) Develop and implement the necessary changes to BOE's policies and procedures; 2) Produce and mail taxpayer notices, and; 3) Modify BOE's computer systems (IRIS and ACMS); and, 4) Augment staffing of the CSPD and the FMD.
- Creates potential additional workload on an ongoing basis since the fee will likely prompt questions and complaints from taxpayers. Additional workload would also be created if taxpayers were able to request a waiver of the fee.
- Requires statutory changes to allow for continuous appropriation of revenue generated by the fee.
- Requires statutory change to utilize collection tools to obtain payment of the fees assessed. Without this authority, anticipated fee revenue would be significantly lower.
- Increases the amount of BOE's accounts receivables by nearly \$95 million over four years.
- Increases in voluntary compliance may not be realized by imposing a fee; the BOE already assesses penalty and interest on past due liabilities.

b. 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 the flat-rate fee alternative, 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.

Based on a preliminary analysis, the fee would be set at 8.0%. The average unpaid liability is \$3,135 and would, therefore, result in an average fee of \$250 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 \$625,000.⁴ Based on current data, a capped fee of \$50,000 would likely be assessed to more than 50 liabilities each year.

⁴ \$50,000 / 8.0% = \$625,000

Table 3 summarizes the anticipated fees assessed, revenue generated, and costs incurred under this alternative during the first four years.

**Table 3 – Summary of Fees, Revenue, and Costs (FYs 2010-14)
 Percentage Based Fee with \$50,000 Cap
 With Statutory Collection Authority**

	FY 2010-11 (Apr – Jun)	FY 2011-12	FY 2012-13	FY 2013-14
Fees Assessed Balance	\$77.4 million	\$99.1 million	\$105.2 million	\$111.2 million
Revenue Received	\$5.9 million	\$21.5 million	\$21.6 million	\$22 million
Costs Incurred	\$314,000	\$253,000	\$253,000	\$253,000
Benefit / Cost	18.8 : 1	85 : 1	85.4 : 1	87 : 1

Fees Assessed Balance– Represents a cumulative total including new fees assessed in the Fiscal Year plus the uncollected ending balance from the previous year less payments received in Fiscal Year.

Revenue Received – Represents payments received in the Fiscal Year. FY 2010-11 estimates assume system changes are implemented by March 2011 and BOE begins assessing the fee in April 2011. An implementation date of March 2011 is a best case scenario and would require other revenue projects to be delayed or cancelled.

Costs Incurred – These are costs for generating taxpayer notices when the fee is assessed and additional staff for the BOE's Information Center. Costs incurred in processing fee waiver requests (if allowed) are not reflected in the cost estimates above.

i. Pros

- Allows BOE to recoup costs incurred by its collection program. In 2008-09, BOE's direct personnel costs identified to collection activities was slightly more than \$27.6 million.
- Increases revenue by \$5.9 million in FY 2010-11 and \$21.5- \$22 million per year beginning in FY 2011-12.
- Provides an estimated benefit/cost of 87 : 1 in the fourth year.
- 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 a flat-fee amount.
- Allows the cost recovery amount to offset BOE's budget appropriation in the fiscal year following the collection of revenue through a continuous appropriation.
- Allows the cost recovery of the accounts receivable to offset the cost of administering the programs by decreasing the amount of funding needed from the General Fund and Special Funds.
- Allows BOE staff to continue revenue generating activities, such as traveling to conduct audits, when a new fiscal year budget is not enacted timely. Such activities would be possible through a continuous appropriation.
- Allows BOE to reduce expenditures incurred for late payment penalties due to delayed budget enactment from being paid out of the General Fund working appropriation. Funds for such expenditures would be provided through a continuous appropriation.

ii. Cons

- Requires resources to: 1) Develop and implement the necessary changes to BOE's policies and procedures; 2) Produce and mail taxpayer notices, and; 3) Modify BOE's computer systems (IRIS and ACMS); and, 4) Augment staffing of the CSPD and FMD.
- Creates additional potential workload on an ongoing basis since the fee will likely prompt questions and complaints from taxpayers. Additional workload would also be created if taxpayers were able to request waiver of the fee.
- Requires statutory to allow for continuous appropriation of revenue generated by the fee.
- Requires statutory change to utilize collection tools to obtain payment of the fees assessed. Without this authority, anticipated fee revenue would be significantly lower.
- Increases the amount of BOE's accounts receivables by more than \$111 million over four years.
- Increases in voluntary compliance may not be realized by imposing a fee; the BOE already assesses penalty and interest on past due liabilities.

VIII. Recommendation

If a fee is imposed, staff recommends a flat-rate fee be applied to liabilities greater than \$250 that remain unpaid for more than 90 days. A fee should not be imposed in instances where a taxpayer has entered into an installment payment agreement prior to the fee being imposed. An analysis indicates a flat-fee of \$345 per liability would result in increased revenue of \$4.8 million in FY 2010-11 and \$18 - \$20.6 million per year beginning in FY 2011-12.