



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	06/21/11	Bill No:	<u>Assembly Bill 1307</u>
Tax Program:	Sales and Use Special Taxes and Fees	Author:	Skinner
Sponsor:	BOE	Code Sections:	see below
Related Bills:		Effective Date:	01/01/12

BILL SUMMARY

This Board of Equalization (BOE)-sponsored bill would do all the following:

- Authorize the BOE to request the Contractor's State License Board for a denial or suspension of a contractor's license for failure to resolve any outstanding BOE-related final tax or fee liabilities. (*Business and Professions Code Section 7145.5*)
- Require the BOE to operate and implement a Financial Institution Records Match system in cooperation with the Franchise Tax Board (FTB), by requiring financial institutions to match their customer records against the BOE's database of taxpayers with delinquent tax, fee or surcharge liabilities under the BOE's programs, in order to enhance BOE's ability to collect delinquent liabilities. (*Government Code Section 15624*)
- Authorize the BOE to refuse to issue a seller's permit to any person who has an outstanding liability with the BOE and has not entered into an installment payment agreement, as specified. (*Revenue and Taxation Code Section 6070.5*)
- Allow the BOE to use the new employee registry information maintained by the Employment Development Department (EDD) for tax enforcement purposes. (*Unemployment Insurance Code Section 1088.5*)

ANALYSIS

IN GENERAL

This bill is sponsored by the BOE in order to provide additional incentives for taxpayers to pay their outstanding BOE-related tax and fee liabilities and to enhance the BOE's ability to collect those liabilities.

California's tax system is one based on the principal of voluntary compliance. Most taxpayers that report their tax and fee liabilities to the BOE are honest and generally comply with the tax laws. However, the BOE's number of taxpayers with overdue accounts receivables, as well as the overall balance, continues to increase - further complicating the state's budget woes. Within the last three-year period, the BOE's accounts receivable balances for unpaid *final* liabilities (liabilities that are due and not under appeal) have nearly doubled. As of the end of 2010, these outstanding liabilities totaled over \$1.5 billion.

Recent economic turmoil is one factor contributing to this increase. However, other reasons include the fact that some businesses purposefully fail to remit the tax, such as

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when a taxpayer diverts the sales tax reimbursement collected from a customer for his or her own purposes instead of remitting the tax to the State. Those businesses that fail to pay their tax liabilities have in many cases an unfair competitive advantage over taxpayers who comply with the law and pay their fair share.

In general, the tools the BOE has in current law to provide incentives for taxpayers to timely pay their tax and fee liabilities and to assist the BOE in collecting delinquent tax or fee liabilities include:

- The imposition of penalties and interest on the amount of the late tax or fee payment.
- The authority for the BOE to revoke a taxpayer's seller's permit for failure to pay outstanding sales and use tax liabilities.
- The opportunity for taxpayers to enter into affordable installment payment plans.
- The authority for the BOE to issue an Order to Withhold (OTW) to any third-person in possession of funds or properties belonging to the debtor, such as bank accounts, rental income, or accounts receivables, which, in turn, requires that third person to submit to the BOE all the debtor's cash or cash equivalents that would satisfy the OTW.
- The authority for the BOE to use Earnings Withholding Orders (EWO) to collect delinquent tax liabilities for which a state tax lien is in effect. An EWO is a continuing wage garnishment based on a percentage of a debtor's earnings, not to exceed 25 percent of disposable income. The EWO remains in effect until the total amount owing has been paid, or the order has been withdrawn.
- The authority for the BOE to issue a warrant to seize property and convert it to cash to satisfy a debt. Warrants are enforced by a marshal. "Till-tap" or "keeper" warrants are warrants served by the California Highway Patrol or the local sheriff that allow them to enter a tax debtor's business and take possession or personal property or collect the contents of the cash registers.
- In addition to the preceding, a statutory tax lien automatically arises by operation of law, which is a claim upon real and personal property for the satisfaction of a tax debt. The lien is in force for 10 years, unless the liability becomes satisfied or a Notice of State Tax Lien is recorded with a county recorder's office or the Secretary of State. The recording of the notice provides notice to all parties of the debt against real and personal property belonging to the tax debtor and located in the California county where recorded.

This bill would provide additional tools that would assist the BOE in reducing its growing outstanding accounts receivable balances from taxpayers' failure to remit the taxes that are owed, and would assist in reducing the unfair competitive advantage these tax debtors have over law-abiding taxpayers. The following provides a specific discussion with respect to each provision in this bill:

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Denial or Suspension of a Contractor's License
Business and Professions Code Section 7145.5

CURRENT LAW

Under Business and Professions Code (BPC) Section 24205, a taxpayer's alcoholic beverage license is automatically suspended if the taxpayer is at least three months delinquent in the payment of sales or use or alcoholic beverage taxes or penalties. The suspension remains in effect until those liabilities are paid.

Existing Vehicle Code Sections 11617 and 11721 allow the Department of Motor Vehicles to automatically cancel a dealer or lessor-retail license when the BOE has revoked or suspended the licensee's seller's permit. (Sales and Use Tax Law Section 6070 of the Revenue and Taxation Code authorizes the BOE to revoke or suspend a taxpayer's seller's permit whenever the taxpayer fails to comply with any provision of the Sales and Use Tax Law, including failing to pay sales or use taxes that are due.)

Existing BPC Section 7145.5 allows the Contractor's State License Board (CSLB) to refuse to issue, reinstate, reactivate, or renew or to suspend a contractor's license for the failure of a licensee to resolve any outstanding final liabilities, including taxes, penalties, interest, and any fees assessed by the CSLB, the FTB, the EDD, or the Department of Industrial Relations (DIR). The BOE is not listed as one of the agencies to which Section 7145.5 applies.

Therefore, under current law, the CSLB is not authorized to suspend or deny a contractor's license for a licensee's failure to pay any BOE-related outstanding taxes, penalties, interest, or fees.

PROPOSED LAW

This bill would amend BPC Section 7145.5 to authorize the CSLB to refuse to issue, reinstate, reactivate, or renew or to suspend a contractor's license for failure to resolve any outstanding BOE-related final tax or fee liabilities, provided the CSLB's registrar has mailed a preliminary notice to the licensee at least 60 days prior to the refusal or suspension that indicates that the license will be refused or suspended by a date certain.

BACKGROUND

Although a licensee's failure to pay the BOE's liabilities is not within the statutory authority provided under BPC Section 7145.5 that would allow the CSLB to suspend or deny a contractor's license, existing BPC Section 7071.17(b) and (e) does provide an alternative, albeit very cumbersome approach. Under this section, the registrar of the CSLB may suspend a contractor's license for any "unsatisfied final judgment that is substantially related to the construction activities of a licensee ... or to the qualifications, functions, or, duties of the license." In order to request a suspension under this provision, the CSLB would require the BOE to submit an abstract of judgment relating to the contractor's liability as a condition for the registrar to initiate the proceeding to suspend the license.

However, the procedure available under this provision would require that the BOE first file a request for judgment in a Superior Court, obtain the judgment, and then file an abstract of the judgment with CSLB – a cumbersome process. And, CSLB does not use this procedure on a routine basis. Therefore, CSLB staff has recommended that the

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BOE pursue legislation to amend BPC Section 7145.5 in a manner as this bill proposes to do.

The BOE currently has over 90,000 delinquent sales and use tax accounts. Of this amount, over 1,700 accounts represent outstanding final liabilities of construction contractors (750 of which are closed accounts, with nearly \$42 million in unpaid delinquencies, and 950 of which are active accounts, with nearly \$10 million in delinquencies). These amounts do not include accounts in bankruptcy, in installment payment agreements, or in the appeals process.

Since the enactment of legislation in 1990 (Ch. 1386, AB 2282, Eastin), the CSLB has been authorized to suspend or refuse to issue or renew a contractor's license upon notification of a contractor's failure to resolve all outstanding final liabilities imposed by the DIR, EDD, and FTB. The purpose of that bill was to establish joint enforcement action among the three agencies in order to enforce collection of taxes and compliance with the laws, and to create a level playing field for business competition.

In 1993, by Executive Order, the Joint Enforcement Strike Force (JESF) was established to combat the underground economy. The JESF is comprised of several agencies including the CSLB, DIR, EDD, FTB, and BOE. Reports indicate that the underground economy imposes burdens on businesses that comply with the law and properly pay tax obligations. Reports also indicate that while these agencies have authority to enforce liens and warrants to collect outstanding liabilities, these collection tools are ineffective against taxpayers who primarily operate on a cash basis because current information on their assets or income is unavailable.

Similar to EDD and FTB, the BOE finds that some delinquent contractors do not respond to its usual enforcement actions. Suspension or denial of a contractor's license would be a last resort collection method. When the BOE is unable to convince a contractor to pay its outstanding liability in full or to enter into an installment payment agreement, and when no other collection tools are effective, then the BOE would consider requesting CSLB to deny or suspend a contractor's license.

This provision is a duplicate of a BOE-sponsored measure considered last year ([AB 2332](#) (Eng)). Although approved by the Legislature, Governor Schwarzenegger vetoed AB 2332, stating:

“Not resolving outstanding financial liabilities is a serious offense, but this bill is unnecessary. The BOE already has at its disposal a number of enforcement actions that it can take against contractors that are delinquent on tax payments. This bill proposes to shift some responsibility for tax collection from the BOE to a Board that is designed to protect the safety and well being of consumers.”

COMMENT

This additional collection tool would only be used as a last resort effort to bring a contractor into compliance. Before the contractor's license is suspended or denied under this provision, the law would require that the CSLB's registrar provide a preliminary notice to the licensee of its intent to suspend or deny on a date certain at least 60 days prior to the date of the suspension or denial.

This bill is not intended to shift any responsibility for the BOE's tax collection efforts to the CSLB. Instead, it would give the BOE an additional collection tool that would also serve as a strong incentive for delinquent contractors to resolve their outstanding *This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.*

liabilities. The use of this collection tool would place the BOE on equal footing with FTB and EDD, and promote joint enforcement action among the three tax collection agencies.

AB 1424 (Perea) would also amend Section 7145.5 of the Business and Professions Code. As the bills progress, consideration should be given to adding double-joining provisions so that neither bill chapters out the other.

<p style="text-align: center;">Financial Institutions Record Match <i>Government Code Section 15624</i></p>
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CURRENT LAW

Current federal law (Sections 666 and 669A of Title 42 of the United States Code and Sections 466 and 469A of the Social Security Act) mandates the Financial Institution Data Match (FIDM) for the collection of delinquent child support debts. This process involves the matching of child support obligors with financial institution customer records in order to identify and levy the obligor's funds. The FTB is the agency in California responsible for collecting child support debts, as well as corporate franchise and state income taxes. Federal law currently prohibits the information received through FIDM to be used for any purpose other than child support collection, thereby making this potentially valuable collection resource unavailable for use in franchise and income tax collections by the FTB.

To allow use of this type of data in the collection of franchise and income tax debts, the Legislature recently passed a budget trailer bill, which the Governor signed on March 24, 2011 (SB 86, Ch. 14, Budget and Fiscal Review Committee). This bill, among other things, added Section 19266 to the Revenue and Taxation Code to require the FTB to coordinate with financial institutions doing business in this state to establish a financial institution record match system (FIRM) using automated data exchanges to the maximum extent feasible. The process will be very similar to the federal FIDM process described previously. However, since FIRM is a separate program, its use will not be restricted to child support collections but, rather, will apply to FTB's delinquent franchise and income taxes.

Section 19266 requires that, on a quarterly basis, financial institutions must provide the FTB with the name, record address and other addresses, social security number or other taxpayer identification number, and identifying information for each delinquent tax debtor as identified by the FTB who maintains an account at the financial institution as defined. Financial institutions may not disclose to the account holder, depositor, co-account holder, or co-depositor that their identifying information has been received and furnished to the FTB. The FTB has estimated that this provision will generate additional collections of its taxes of \$37 million in 2011-12 and \$30 million in 2012-13.

PROPOSED LAW

This bill would add Section 15624 to the Government Code to require the BOE to operate and implement a FIRM system as described in Revenue and Taxation Code Section 19266 utilizing automated data exchanges to the maximum extent feasible, and in cooperation with the FTB.

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Under this provision, the BOE would provide its tax debtor information to the FTB, and the FTB would, together with its data on tax-debtor information, exchange this data about these tax debtors with the financial institutions. It would require the financial institutions to match its customer records against the BOE's database of individuals with final tax, fee, or surcharge liabilities under all the programs administered by the BOE.

COMMENT

Because of the budget crisis, key public services are facing potential cuts. State tax agencies must do a better job of employing modern collection techniques and information technology to collect tax liabilities. Implementing FIRM would accomplish this by requiring financial institutions to match its customer records against the BOE's database of individuals with final tax liabilities. Most of the revenue collected by the BOE comes in voluntarily; however enforced collection actions, such as notices of levy sent to the tax debtors' banks, are required when efforts to gain voluntary compliance from taxpayers have been exhausted.

If the BOE were to be included in FTB's FIRM processes, the result would be more efficient collections of delinquent liabilities. BOE staff would have accurate "real-time" financial information, which would stop the BOE from sending levy notices to incorrect financial institutions. Also, BOE staff time spent in researching tax debtors' banking information would be reduced.

<p style="text-align: center;">Refusal of Seller's Permit <i>Revenue and Taxation Code Section 6070.5</i></p>
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CURRENT LAW

Under existing law, Revenue and Taxation Code Section 6005 defines a "person" to include, among others, any individual, firm, partnership, joint venture, limited liability company, association, corporation, or any other group or combination acting as a unit.

Section 6066 requires every person desiring to engage in business as a seller within this state to apply for a seller's permit with the BOE. There is no fee for obtaining a seller's permit and the permit is valid indefinitely as long as the applicant maintains a business as a seller and is in good standing with the BOE.

Under Section 6070, whenever any person fails to comply with any provision of the Sales and Use Tax Law, including timely payments of amounts due, the BOE may revoke the person's seller's permit. However, before revoking a seller's permit, the BOE is required to provide a 10-day advance written notice to the taxpayer of the time and place of a hearing to be held and the taxpayer must show why the permit should not be revoked. This provision specifies that the BOE shall not issue a new permit after the revocation of a permit unless it is satisfied that the holder of that permit will comply with the provisions of the Sales and Use Tax Law.

Section 6069 requires a seller whose permit has been previously suspended or revoked to pay a reinstatement fee of \$100 to the BOE for the renewal or reissuance of a permit.

Section 6701 provides the BOE with the authority to require that a person file a security deposit with the BOE whenever it deems it necessary to insure compliance with the Sales and Use Tax Law. A security deposit is generally requested in cases where the taxpayer has a history of noncompliance. The maximum amount of security the BOE

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may require, however, is \$50,000, and it must be released by the BOE after a three-year period in which the person has filed all returns and paid all tax to the state.

Under Business and Professions Code Section 22971 (which is under California's Cigarette and Tobacco Products Licensing Act of 2003, administered by the BOE), the terms "control" or "controlling" are defined to mean possession, direct or indirect, of the power:

- (A) To vote 25 percent or more of any class of the voting securities issued by a person.
- (B) To direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, as specified; however, no individual shall be deemed to control a person solely on account of being a director, officer, or employee of that person.

PROPOSED LAW

This bill would add Revenue and Taxation Code Section 6070.5 to the Sales and Use Tax Law to provide that the BOE may refuse to issue a seller's permit to any person who has an outstanding liability with the BOE and has not entered into an installment payment agreement.

In addition, the bill would authorize the BOE to refuse to issue a seller's permit if:

- (a) the person desiring to engage in or conduct business as a seller within this state is not a natural person or individual, and
- (b) any person "controlling", as defined in Business and Professions Code Section 22971, the person this is desiring to engage in or conduct business as a seller within this state has an outstanding final liability with the BOE.

The bill would require the BOE to provide a notice to the person who applied for a seller's permit who was refused a permit pursuant to this provision, a notice, as specified, and allows the person to request reconsideration that will afford the person a hearing, as specified.

COMMENTS

1. **This provision is intended to give the BOE more discretion in issuing seller's permits to taxpayers that have outstanding, unpaid, delinquent tax liabilities with the BOE**, and to provide those taxpayers with a sound, reasonable incentive to take care of these outstanding liabilities by requiring them to simply enter into, and comply with, an installment payment agreement, as a prerequisite to obtaining a new seller's permit. This would allow the BOE the discretion to withhold issuing a permit to a person under the most common scenarios the BOE encounters involving taxpayer non-compliance.

This provision would apply when a taxpayer applies for a new seller's permit while failing to resolve an outstanding tax debt with the BOE under his or her current seller's permit account. It could also be used when the BOE revokes a taxpayer's seller's permit because of the taxpayer's noncompliance with the law, and the taxpayer applies for a new seller's permit under a different type of entity.

For example, if the original seller's permit was held by a sole proprietor and that permit was revoked by the BOE because of the taxpayer's noncompliance with the Sales and Use Tax Law, current law does not allow the BOE to refuse to issue a

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seller's permit if the sole proprietor creates a corporation and applies for a seller's permit under the name of the corporation.

However, any taxpayer with a non-final liability, such as one under appeal, would still be able to obtain a new seller's permit while continuing to exercise the rights and remedies available to all taxpayers with non-final liabilities.

2. **This provision would also give taxpayers a right for a hearing.** To ensure fair treatment of taxpayers, this provision would provide that any person denied a seller's permit under this provision, due to an outstanding final liability, would be granted a hearing regarding the manner. Such a hearing would be consistent with hearings that taxpayers currently avail themselves of when the BOE is contemplating revoking a taxpayer's seller's permit under current statutory authorization. These hearings are typically handled at the district office level by the administrator of that district office. Under this provision, the person denied a seller's permit would be required to file a written request for reconsideration within 30-days of the written notice of denial.
3. **Installment payment agreements take into account a taxpayer's financial situation.** An installment payment agreement allows taxpayers to pay their debt in full in smaller, more manageable payments. Installment payment agreements generally require equal monthly payments, and the amount of an installment payment is based on the amount a taxpayer owes and his or her ability to pay that amount. If the liability is over \$5,000, taxpayers are required to submit a financial statement to help the BOE determine the amount a taxpayer can pay. If a taxpayer's financial situation changes to a degree necessary to change the installment amounts, whether it improves or worsens, the BOE will make necessary adjustments to the amounts required to be paid.

New Employee Registry Data

Unemployment Insurance Code Section 1088.5

CURRENT LAW

Under existing law, Unemployment Insurance Code Section 1088.5 requires all employers to report information on newly hired or rehired employees who work in this state to the EDD within 20 days following the date the employee is hired. The information to be reported includes the employee's full name, address, social security number, and first date the employee worked. An employer is also required to report its business name and address, state employer identification number, and federal employer identification number. This EDD report is generally referred to as the "new employee registry."

Under Section 1088.5, the new employee registry information may only be used for programs administered by the EDD, FTB, public assistance programs, worker's compensation programs, and enforcement of child support obligations. Under current law, the BOE is *not* authorized to use the new employee registry.

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PROPOSED LAW

This provision would amend Unemployment Insurance Code Section 1088.5 to authorize the BOE to use information in the new employee registry for tax collection and enforcement purposes.

BACKGROUND

In 1996, the federal Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) was signed into law. The primary purpose of PRWORA is to provide a strengthened child support enforcement program that locates non-custodial parents and enforces child support orders. One key provision of PRWORA related to child support orders is a requirement that all states have a program to report timely information about newly hired and rehired employees.

In 1997, pursuant to the federal PRWORA legislation, California enacted legislation (Ch. 606, AB 67, operative July 1, 1998) to establish a new employee registry. The purpose was to aid in the collection of debts of individuals who were able to avoid collection because the employer quarterly return information reported to EDD was received too late to be used as an effective collection information resource.

Also, because of the effectiveness of the new employee registry, in 2003, the FTB sponsored legislation to use the registry for its non-tax debt collection programs. AB 1742 (Ch. 455, Stats. 2003, Committee on Revenue and Taxation) authorized the FTB to use the registry when pursuing non-tax debt collection such as vehicle registration dishonored check collection, delinquent fines imposed for labor law violations, and court-ordered debt collection.

In 2007, at the direction of the Legislature, the Legislative Analyst Office, in consultation with the Department of Finance, prepared a report on the challenges facing California's three tax agencies and the need to engage in information and data sharing to effectively and efficiently administer the overall tax system. This report, entitled *A Report on Tax Agency Information and Data Exchange*, focuses on how increased cooperation and information sharing among the tax agencies can serve to improve tax compliance and enforcement activities.

The report points out how compliance and enforcement issues have become of increasing concern to California due to a number of different trends and factors. For example, the growth of the Internet and other forms of remote sales has led to the noncompliance with the state's use tax. These factors, coupled with other features of today's economy such as new and different business ownership structures and the large cash economy, have led to increased concern about the tax gap. The report goes on to say that the collection, sharing, and accessibility of tax-related information among agencies are seen as primary methods for dealing with the tax gap.

In addition, the report describes how the state's tax agencies currently exchange data and information. However, despite the information sharing that already occurs, each of the tax agencies has identified additional information now collected, but not shared, that would be useful to the other agencies for tax compliance purposes.

COMMENT

This provision would assist the BOE in locating missing taxpayers and possibly garnishing the wages of taxpayers that are delinquent in their payment of BOE-administered taxes or fees. Currently, the BOE uses the EDD's online wage and

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employment information which is based on quarterly employment returns filed by employers. Even though this information is available to the BOE shortly after the end of each quarter, this information is relatively old when compared to the new employee registry information (four to six months more current). According to the FTB, the new employee registry has been a valuable enforcement resource in allowing that agency to identify delinquent taxpayers and begin collection action shortly after those taxpayers have started a new job. The BOE believes this information could be valuable for its collection efforts as well.

COST ESTIMATE

The BOE would incur some minor administrative costs related to the FIRM provision, but absorbable costs to administer the remaining provisions.

REVENUE ESTIMATE

The following provides a breakdown of the anticipated increases in collections for each provision:

- **Denial or Suspension of a Contractor's License.** Increases the BOE's ability to collect on \$51 million in outstanding state and local sales and use tax liabilities owed by construction contractors.
- **Financial Institutions Record Match.** When fully implemented, increases collections of \$12.3 million annually primarily from state and local sales and use tax liabilities. The additional revenue would be derived from greater timeliness in sending notices of levy to banks with accounts held by tax debtors discovered through FIRM and from efficiencies gained by reducing the search time for the collection of assets.
- **Refusal of Seller's Permit.** Minor increases in the collection of state and local sales and use tax liabilities due to taxpayers entering into installment payment agreements, with the potential to increase over time as more taxpayers enter into installment payment agreements.
- **New Employee Registry Data.** An increase of \$500,000 in collections of outstanding liabilities primarily in the Sales and Use Tax program.

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