

**Add Government Code Section 12419.14 and Revenue and Taxation Code Section 6836 to authorize the Board of Equalization (BOE) to enter into a reciprocal agreement with the United States Department of the Treasury's Bureau of the Fiscal Service (BFS) to collect delinquent tax debt owed to the BOE by offset of federal vendor payments. In return, allow the federal government to collect delinquent federal non-tax debt by offset of BOE tax refund and vendor payments.**

**Source: Sales and Use Tax Department**

**Existing Law.** Government Code Section 12419.4 provides that the state has a lien for any taxes due the state from any person or entity, upon any and all personal property belonging to such person or entity and held by the state or amount owed to such person or entity by the state. The lien applies to all such property held or such amount owed by an agency of the state while such person or entity owes any taxes to that agency or another agency of the state. This lien does not apply to salary or wages owing to officers or employees of the state. An "offset" procedure is used by BOE as a "last resort" when all other collection avenues have been unsuccessful.

The BFS serves as the federal government's central debt collection agency, and administers centralized offset through the Treasury Offset Program. Pursuant to federal law, offset occurs when the federal government withholds part or all of a debtor's federal payment to satisfy the debtor's delinquent federal or participating state debt. The Treasury Offset Program includes the State Income Tax Program, State Reciprocal Program, and the Unemployment Insurance Compensation Program. In 2008, the California Franchise Tax Board joined the State Income Tax Program, while in 2013, the Employment Development Department began participating in the Unemployment Insurance Compensation Program.

Under federal law, the State Reciprocal Program<sup>1</sup> allows states to enter into reciprocal agreements with the Treasury to collect unpaid state debt by offset of federal non-tax payments and in return, the state collects delinquent non-tax federal debt by offset of state payments. Federal regulation 31 CFR 285.6 sets forth state debt offset requirements under the State Reciprocal Program. State debts must be:

- Delinquent
- Legally enforceable
- More than \$25, or such other amount as Financial Management Service may prescribe, and
- Not secured by collateral subject to a pending foreclosure action
- Not bankruptcy

In addition, Section 285.6 requires federal debt offsets to be contained in the reciprocal agreement. The regulation also specifically excludes from offset:

- Payments exempt under 31 CFR 285.5 (e)(2):
  - Black Lung Part C benefit payments,
  - Tier 2 Railroad Retirement benefit payments,
  - Payments made under the tariff laws of the United States,
  - Veterans Affairs benefit payments,

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<sup>1</sup> Title 31, United States Code, Section 3716; and, Title 31, Code of Federal Regulations, Section 285.6

- Payments made under any program administered by the Secretary of Education under title IV of the Higher Education Act of 1965,
- Payments made under any other Federal law if offset is expressly prohibited by Federal statute,
- Payments made under any program for which the Secretary of the Treasury has granted an exemption, as specified, and
- Federal loan payments other than travel advances.
- Payments due an individual under the Social Security Act;
- Payments due an individual pursuant to Part B of the Black Lung Benefits Act;
- Payments due an individual pursuant to any law administered by the Railroad Retirement Board;
- Federal tax refunds;
- Federal salary payments; and,
- Other payments specified in the reciprocal agreement.

According to the BFS, the types of payments subject to offset under the State Reciprocal Program are primarily federal vendor payments.

Federal law requires state legislation granting states the authority to enter into and abide by the reciprocal agreements. Currently, there are seven states and the District of Columbia that participate in the State Reciprocal Program: Kentucky, Maryland, Minnesota, New Jersey, New York, West Virginia, and Wisconsin. Kansas, Louisiana, and Indiana have enacted legislation and plan to begin participation by the end of 2014.

**This Proposal.** This proposal would authorize the BOE to enter into a reciprocal agreement with the BFS for the offset of federal nontax payments to collect tax debts owed to the BOE and the offset of the BOE's tax refund payments and vendor payments to collect nontax debts owed to the federal government.

Comparable statutes would also be added to the BOE-administered special tax and fee laws.

**Revenue Impact.** Under the State Reciprocal Program, seven states and the District of Columbia have entered into agreements and collected over \$37.7 million in fiscal year 2013. The BFS publishes an annual report that details each states success in collecting delinquent debts. The following table shows delinquent debt collection totals for each state during the fiscal years 2011, 2012, and 2013.

State	FY 2011	FY 2012	FY 2013
District of Columbia	N/A	N/A	\$ 9.8
Kentucky	\$18.7	\$ 6.9	\$ 8.6
Maryland	\$10.2	\$10.9	\$ 8.7
Minnesota	N/A	\$ 0.7	\$ 2.0
New Jersey	\$ 1.9	\$27.4	\$ 2.9
New York	\$ 5.5	\$ 6.6	\$ 4.2
West Virginia	N/A	N/A	\$ 0.5
Wisconsin	N/A	\$ 1.3	\$ 1.0
<b>Total</b>	<b>\$36.3</b>	<b>\$53.8</b>	<b>\$37.7</b>

BOE staff surveyed the seven participating states. Five of the states that responded to the survey indicated that a significant number of taxpayers either pay the liability in full or enter into a payment plan upon receiving the notice of intent to offset letter. New York stated that the revenue received from the actual offsets was the same as the revenue received from taxpayers paying the liability as a result of the offset letter.

In 2014, the BOE submitted a file of delinquent tax and fee debts which met the criteria established under federal law. The BFS then conducted a simulated test match of BOE delinquent tax and fee debts to federal vendor payments for the months of June, July, August, and September 2014. The results of the simulation revealed the following:

Test Month	Number of Offsets	Total Offset Amount	Average Monthly Payment*
June 2014	239	\$764,318	\$3,198
July 2014	190	\$376,313	\$1,981
August 2014	139	\$345,631	\$2,487
September 2014	160	\$627,285	\$3,921

\*Average monthly payment is calculated by dividing the total offset amount by the number of offsets.

Based on an average monthly offset amount of \$528,387,<sup>2</sup> this proposal would generate approximately \$6.3 million annually in offset payments. In addition, when BFS conducted the simulation, they were unable to match BOE tax and fee debts against non-treasury disbursed payment databases, such as the United States Department of Defense payments. According to the BFS, a simulation of these databases typically results in additional offsets of approximately 15% to 25%.

**Administrative Costs.** The estimated costs to implement this proposal includes one-time costs between \$400,000 and \$1.2 million to modify existing computer systems to incorporate new offset program requirements and processes. Moreover, BOE estimates ongoing costs between \$450,000 and \$550,000 annually for six positions to maintain database of delinquent debtors, perform data matching of federal vendor payments to BOE tax and fee liabilities, review partially matched offsets, process refunds of erroneous offsets, resolve objections to offset procedures, answer telephone inquiries, and prepare forms and reports to process and track offsets.

*Section 12419.14 is added to the Government Code to read:*

12419.14. (a) (1) The Controller shall, upon execution of a reciprocal agreement between the State Board of Equalization and the United States Department of the Treasury's Bureau of the Fiscal Service, offset any federal nontax obligation due to the United States Department of the Treasury's Bureau of the Fiscal Service from a person or entity, against any refund under the Sales and Use Tax Law, Motor Vehicle Fuel Tax Law, Use Fuel Tax Law, Cigarette and Tobacco Products Tax Law, Alcoholic Beverage Tax Law, Energy Resources Surcharge Law, Emergency Telephone Users Surcharge Law, Hazardous Substances Tax Law, Integrated Waste Management Fee Law, Oil Spill Response, Prevention, and Administration Fees Law, Underground

<sup>2</sup>[(764,318+376,313+345,631+627,285)/4]=\$528,387]

Storage Tank Maintenance Fee Law, Fee Collections Procedures Law, and Diesel Fuel Tax Law, or vendor payment owed to that person or entity.

(2) Standards and procedures for submission of requests for offsets shall be as prescribed by the Controller in conjunction with the State Board of Equalization.

(3) Payment of the offset amount shall occur only after other offset requests for debts owed by a person or entity to this state have been satisfied in accordance with the priority established under Section 12419.3.

(b) The Controller shall deduct and retain from any amount offset pursuant to this section an amount sufficient to reimburse the Controller and the State Board of Equalization for their administrative costs of processing the offset payment.

(c) For purposes of this section, "vendor payment" means any vendor or contractor payment made by this state to any person for goods or services provided to the State Board of Equalization. Vendor payment shall not include a person's salary, wages, or pension, and any payment excluded from offset pursuant to the reciprocal agreement between the State Board of Equalization and the United States Department of the Treasury's Bureau of the Fiscal Service.

*Section 6836 is added to the Revenue and Taxation Code to read:*

6836. (a) (1) The board may enter into an agreement with the United States Department of the Treasury's Bureau of the Fiscal Service that provides for offsetting of a sales and use tax refund against a federal nontax obligation. The agreement shall provide for offsetting a federal nontax payment, as authorized by federal law, against a delinquent sales and use tax debt. The agreement shall provide that the United States Department of the Treasury's Bureau of the Fiscal Service may deduct a fee from each administrative offset and sales and use tax refund offset.

(2) Offsets to collect state and other entity obligations under Government Code Section 12419.3 shall occur before a sales and use tax refund offset.

(b) For purposes of this section, "administrative offset" is any offset of a federal nontax payment to collect a delinquent sales and use tax debt and "sales and use tax refund offset" is any offset of a sales and use tax refund, issued pursuant to Section 6901, to collect a federal nontax debt.

(c) For purposes of this section, a delinquent sales and use tax debt means an amount owed to the board which is all of the following:

(1) Based on a determination made under Article 2 (commencing with Section 6481) or Article 3 (commencing with Section 6511) of Chapter 5 deemed final pursuant to Article 5 (commencing with Section 6561) of Chapter 5, or that is "due and payable" under Article 4 (commencing with Section 6536) of Chapter 5, or self-assessed by the taxpayer.

(2) For an amount of tax delinquent for more than 90 days.

(d) For purposes of this section, a delinquent sales and use tax debt does not include any of the following:

(1) A delinquency that is under litigation in a court of law.

(2) A delinquency for which payment arrangements have been agreed to by both the taxpayer and the board and the taxpayer is in compliance with the arrangement.

(3) A delinquency for which the taxpayer has filed for bankruptcy protection pursuant to Title 11 of the United States Code.

(e) Prior to submitting a delinquent sales and use tax debt for administrative offset, the board shall provide a preliminary written notice to the debtor or debtors liable for the tax. If within 60 days after issuance of the notice, the debtor or debtors do not remit the amount due or make arrangements with the board for payment of the amount due, the tax delinquency shall be submitted for administrative offset.

(f) The board may charge a debtor a fee for the processing of a sales and use tax refund offset or the processing of an administrative offset. The fee is a separate debt and may be withheld from any offset or refund.