REQUEST FOR CONCEPTUAL APPROVAL

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

Fiscal Year 2010 - 2011

TITLE OF PROPOSAL

Underground Economy Joint Enforcement Strike Force (JESF) Augmentation

DIVISION PRIORITY NUMBER	PROGRAM IMPACTED
	Sales and Use Tax Program; Special Taxes and Fees PRograms

SUMMARY OF REQUEST *(including impact if request denied)*

This proposal would create a pilot program to provide additional resources to JESF members to identify high-value investigative targets, provide collaborative investigative intelligence, identify emerging criminal evasion trends, and ensure collaborative investigations. Implementation of this proposal will generate additional revenue, estimated at $7.7 million to the Board of Equalization (BOE) and the Employment Development Department (EDD). This proposal requires a total of $1.32 million in expenditure authority (General Fund and Special Funds): $470,000 and 4.0 positions to BOE and $850,000 and 8.0 positions to EDD to support the collaborative agency effort.

The BOE would like to include funding and an additional 4.0 positions for the Franchise Tax Board (FTB) and 4.0 positions for the Department of Insurance (DOI), but this will require approval by the FTB's Board and DOI's Commissioner.

BACKGROUND/HISTORY

The purpose of JESF is to enhance development and sharing of information necessary to combat the underground economy; improve coordination of enforcement activities; and develop methods to pool, focus and target the enforcement resources of all member agencies. In October of 1993, an Executive Order established the JESF to combat the underground economy by pooling resources and sharing data among the state agencies charged with enforcing licensing, labor and tax laws. On January 1, 1995, Section 329 was added to the California Unemployment Insurance Code, which placed the provisions of the Executive Order into law. The goals of JESF include, but are not limited to: eliminating unfair business competition; reducing the burden on law-abiding citizens and businesses by ensuring that all businesses and individuals comply with the State's licensing, regulatory and tax laws; and reducing the Tax Gap by increasing voluntary compliance with the State's tax laws, thereby, maximizing the State's revenues.

STATE LEVEL CONSIDERATIONS *(including impact to other departments)*

Four of the five BOE Strategic Plan goals are addressed by this proposal: 1) Maximize Voluntary Compliance in BOE Programs by identifying and analyzing areas of non compliance, and developing collaborative approaches to address targeted areas of concern; 2) Improve the Efficiency of BOE's Tax and Fees Programs by creating an environment that encourages innovative and creative ideas for changing and streamlining our business process; 3) Improve the BOE's Organizational Efficiency by enhancing our working relationships with JESF member agencies and stakeholder organizations; and 4) Create an Expanded and Responsive Infrastructure by expanding our external partnerships to explore, use and share best practices that capitalize on the development and implementation of successful models and applications. This proposal is intended to support other agencies in their underground economy efforts.

JUSTIFICATION *(including link to Strategic Plan)*

This proposal supports the agencies in their efforts to: 1) create a central clearinghouse for all complaints related to tax evasion, licensing, labor, etc., 2) provide additional resources to EDD for maintaining and operating a centralized intake, and 3) provide additional resources to BOE and EDD for evaluating allegations, identifying high-value investigative leads, compiling and analyzing complaint intake and prosecution data, and generating reports which identify emerging trends and makes recommendations toward combating California's underground economy. This proposal also requests resources for the establishment of a centralized intake via call routing and web based outputs, while continuing to provide each department an individual presence to taxpayers. These efforts will result in projected revenue of approximately $7.7 million. The benefit to cost ratio is estimated to be 5.8 to 1.

COSTS AND BENEFITS (BUDGET YEAR ONLY – FISCAL YEAR [)

☒ New funding ☐ Continuation ☐ Redirection

COST	REVENUE *(if applicable)*
$ 1.32 Million ($470,000 BOE; $850,000 EDD)	$ 7.7 Million
POSITIONS *(if applicable)*	COST SAVINGS *(if applicable)*
12.0 (4.0 BOE; 8.0 EDD)	$

PREPARED AND APPROVED

PREPARED BY	DIVISION CHIEF APPROVAL
Claud R. Silva	Gil Haas, Jr.
AUTHOR'S TELEPHONE NUMBER	DATE
(916) 323-3964	03/25/10

ACTION

	EXECUTIVE DIRECTOR *(signature)*
☐ Concept Approved ☐ Request Denied	

BOE-870 (6-06)
REQUEST FOR CONCEPTUAL APPROVAL

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

Fiscal Year 2010-2011

TITLE OF PROPOSAL
Collection Enhancement

DIVISION PRIORITY NUMBER	PROGRAM IMPACTED
	Sales and Use Tax Program; Special Taxes and Fees Programs

SUMMARY OF REQUEST *(including impact if request denied)*

This request is to enhance the State's ability to address its increasing accounts receivable balance. A Joint Collections Collaboration Task Force (JCCTF) would be established to identify and evaluate current collection tools, technologies, methods and best practices. BOE will take the lead on the JCCTF and invite representatives from the Franchise Tax Board, Employment Development Department, Department of Motor Vehicles, and the Secretary of State to participate. A consultant will prepare a report of JCCTF findings/recommendations and facilitate JCCTF meetings. These activities require seven two-year limited term (LT) positions and consultant services. In addition, this request would enhance BOE's on-going collection activities as well as implement the consultant report recommendations. This proposal in total requires $7.9 million in expenditure authority (General and Special Funds, and Reimbursements) for 79 positions, including the seven LT positions, and operating expenses/equipment.

BACKGROUND/HISTORY

There exists opportunity within the agencies to identify, modify or implement collection mechanisms or tools that utilize standardized collection protocols to provide uniformity in collection practices and techniques.

The BOE's accounts receivable balance continues to increase and is currently over $1 billion. A key aspect of improving the collection of taxes and fees is the ability to utilize the most efficient collection tools and for staff to have access to and exchange current and complete information.

STATE LEVEL CONSIDERATIONS *(including impact to other departments)*

This proposal is consistent with the BOE's Strategic Plan which will result in increased revenue for California; identify and evaluate current tools and collection methods utilized by participating agencies and private industry; integrate our services internally and with other agencies and organizations to help create a seamless experience for our customers; implement effective audit and collection modeling to ensure ease of compliance; and expand our external partnerships with other entities and organizations to share best practices that capitalize on the development and implementation of successful models and applications. This request will also allow the BOE to more effectively work with other tax agencies to improve its information data.

JUSTIFICATION *(including link to Strategic Plan)*

The BOE and the participating agencies are in a unique position to take advantage of lessons learned from other tax agencies and private industry. This effort is in concert with all our current on going collection efforts and is based on marginal productivity. BOE estimates that implementation of this proposal will reduce the tax gap by increasing collection of account receivables to maximize the State's general and special fund revenues by approximately $38 million for just the BOE portion of the activity. The benefit to cost ratio is 4.8 to 1 in the first year, 5.3 to 1 in the second year, and 6 to 1 in the third and on-going years.

COSTS AND BENEFITS (BUDGET YEAR ONLY – FISCAL YEAR [2010-2011])

☒ New funding ☐ Continuation ☐ Redirection

COST	REVENUE *(if applicable)*
$ 7.9 million	$ 38 million
POSITIONS *(if applicable)*	COST SAVINGS *(if applicable)*
79	$

PREPARED AND APPROVED

PREPARED BY	DIVISION CHIEF APPROVAL
Trista Gonzalez	
AUTHOR'S TELEPHONE NUMBER	DATE
(916) 445-1469	3-26-10

ACTION

	EXECUTIVE DIRECTOR *(signature)*
☐ Concept Approved ☐ Request Denied	

BOE-870 (6-06)

REQUEST FOR CONCEPTUAL APPROVAL

STATE OF CALIFORNIA

BOARD OF EQUALIZATION

Fiscal Year 2010-2011

TITLE OF PROPOSAL

Collections Cost Recovery Fee

DIVISION PRIORITY NUMBER	PROGRAM IMPACTED
	Sales and Use Tax Program; Special Taxes and Fees Programs

SUMMARY OF REQUEST *(including impact if request denied)*

This proposal requests resources to implement a "Collections Cost Recovery Fee" which would be imposed on delinquent tax and fee liabilties and is intended to: 1) Reduce the number of past due liabilities by encouraging prompt payment to avoid the fee; and 2) Allow the Board of Equalization (BOE) to recoup costs incurred in working past due liabilities. The fee would only be imposed after providing tax and fee payers an opportunity to voluntarily comply by remitting payment in full or entering into an installment payment agreement. This proposal requires $869,151 in Budget Year (including one time information systems modifications to accommodate fee assessment and processing) and $69,110 on-going to produce notices to taxpayers both before and after the fee is imposed.

Statutory authority may be needed to provide BOE the ability to collect the fee through involuntary collection actions, and to allow fees collected to be used to offset BOE's budget appropriation in the following fiscal year. With the statutory change, BOE (cont'd below)

BACKGROUND/HISTORY

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 (i.e, accounts receivables, or "ARs"). 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." On September 29, 2009, the Department of Finance (DOF) issued Budget Letter 09-37 which provides additional direction with regard to GC section 16583.1. The Budget Letter stated, in part, that "Departments are encouraged to adopt practices, when feasible, that will help prevent ARs from occurring and encourage prompt collections to prevent delinquent ARs."

A survey of other California state agencies and taxing agencies in other states revealed that imposition of a recovery fee appears to be fairly common. Six of nine taxing agencies responding to the survey, including the Franchise Tax Board (FTB), impose such a fee.

STATE LEVEL CONSIDERATIONS *(including impact to other departments)*

This proposal is consistent with the BOE's Strategic Plan, Goal 1, "Maximize Voluntary compliance in BOE's Programs" and will result in increased revenue for California. The FTB has imposed a "Collection Cost Recovery Fee" since 1993.

SUMMARY CONT'D:

estimates revenues at $4.1 million the first year and $21-22 million on-going. Without the statutory change, revenues are estimated at $1.4 million the first year and $4-6 million ongoing.

JUSTIFICATION *(including link to Strategic Plan)*

This proposal supports BOE's Strategic Plan and DOF's Budget Letter 09-37. This would allow BOE to recoup costs incurred in working past due liabilities which is particularly important given the State's budget shortfalls in recent years. Continuously appropriating the funding would allow a decrease in the general and special funds appropriations to BOE's annual budget.

In reviewing the implementation priority and timeline, assuming a best case scenario, system enhancements to assess the fee would be completed by March 2011. The revenue and cost estimates provided assume BOE begins assessing the fee in April 2011. The first year benefit to cost ratio is lower due to one-time implementation costs. The on-going average benefit to cost ratio, with statutory authority to collect this fee through involuntary collection actions, is 315 to 1. Without this authority, the three-year average ratio is 83 to 1. Attachment A, Background Paper, provides program details.

COSTS AND BENEFITS (BUDGET YEAR ONLY – FISCAL YEAR 2010-2011)

☒ New funding ☐ Continuation ☐ Redirection

COST	REVENUE *(if applicable)*
$ 869,151 (BY); $69,110 (BY+1)	$ 4.1 million (BY); $21.8 million (BY+1)
POSITIONS *(if applicable)*	COST SAVINGS *(if applicable)*
To be determined	$

PREPARED AND APPROVED

PREPARED BY	DIVISION CHIEF APPROVAL
Marc Alviso	
AUTHOR'S TELEPHONE NUMBER	DATE
(916) 445-2198	March 30, 2010

ACTION

	EXECUTIVE DIRECTOR *(signature)*
☐ Concept Approved ☐ Request Denied	

Attachment A

Board of Equalization
Background Paper

Collections Cost Recovery Fee

I. Issue

Should BOE assess a Collections Cost Recovery Fee ("fee") on past due liabilities? If so, how should the fee be calculated and when should it be assessed?

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. 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."

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. Statutory Provisions – Collection of Fee

Although GC 16583.1 provides the BOE with statutory authority to impose the fee, the statute does not provide authority to obtain payment of the fee through involuntary collection action (e.g., liens, levies, wage garnishments). Legislation is required to provide the BOE with the statutory authority to collect this fee through involuntary collection actions.

III. Research - Other States/Agencies

To identify alternatives for imposing a fee, information was obtained from the Franchise Tax Board (FTB) and the Employment Development Department (EDD). EDD does not currently assess a fee on past due liabilities and a decision has not been made as to whether or not they will begin assessing one. EDD's program area is not currently taking any action with regard to imposing a fee. However, EDD's Administration/Legal departments are looking into the legislation. EDD may decide to pursue a regulation clarifying how the fee is determined and assessed.

Fees on past due liabilities are imposed by the 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 (FTA). A total of nine states responded to the survey, six of which stated that they impose a fee.

a. Amount of Fee Imposed

FTB imposes a flat amount fee. The fee amount is calculated by identifying the total cost of FTB's collection program, reducing the total amount by costs associated with voluntary compliance, then dividing the result by the number of taxpayers for which FTB assessed the fee in the prior year. Next, the fee amount calculated is averaged with the fee amount for the prior four years to arrive at a five year average. The amount of FTB's fee is calculated and revised annually so that the fees assessed do not exceed FTB's collection costs.

As of July 2009, FTB's fee amount was set at $217 for individuals and $413 for corporations. In terms of accounts to which FTB assess a fee, 85% are individual accounts and 15% are corporate accounts. As a result, FTB's overall *weighted* average fee amount is $246. FTB's fee is assessed at the account level.

None of the other states responding to the survey utilized a flat fee. Instead, the states impose percentage based fees calculated on the amount of the total liability (e.g., including penalty and interest) remaining due at the time the fee is imposed. The fee percentages varied from 10% (Florida) to 25% (Minnesota and Kentucky), with an overall average of 20%.

b. Time at Which Fee is Imposed

Based on the survey responses, agencies imposing a fee generally do so 90-100 days after the original bill date of a liability. FTB applies the fee after a liability has gone through its automated collection process, which involves mailing notices to the taxpayer and initiating automated collection actions (e.g., auto lien, auto levy). Although the amount of time an account is in the automated process varies, the process is generally complete between 90-100 days at which time the fee is assessed. Similarly, most other states reported that they assessed a fee 90 days following the date a liability was originally billed. Kentucky reported the shortest imposition time by assessing their fee 45 days after the original bill date of a liability.

c. Fee Imposed Retroactively or Prospectively
At question is whether or not states imposed the fee only on new liabilities incurred *after* a certain date or whether they imposed the fee on *all* past due liabilities, including those incurred prior to the fee existing. Both the FTB and the state of North Carolina (NC) imposed the fee retroactively to all existing, unpaid liabilities, including those that were incurred prior to the fee being in existence. Prior to assessing the fee, both FTB and NC notified taxpayers with unpaid liabilities and afforded them an opportunity to avoid the fee by paying the liability or entering into an installment payment agreement. Although Texas (TX) has not yet begun assessing a fee, they plan to do so soon and have stated that it will be imposed retroactively. NC and TX were the only states that responded to this survey question; it is unclear whether or not other states that impose a fee did so retroactively.

d. Types of Liabilities Fee is Imposed Upon
Agencies imposing a fee on past due liabilities appear to assess the fee very broadly by applying it to most, if not all, unpaid liabilities. FTB assesses a fee on liabilities of $100 or greater. Minnesota only assessed a fee on liabilities owed to agencies other than the Department of Revenue (DOR) that were referred to the DOR for collection; the fee is not applied to taxes and fees administered by the DOR. TX will only apply a fee to liabilities referred to an outside vendor for collection.

All agencies imposing a fee provide taxpayers with an opportunity to avoid the fee. The fee can be avoided by the taxpayer either by paying the liability in full or entering into an installment payment agreement prior to the fee being assessed.

e. Length of Time Fee Has Been Imposed
FTB began imposing a fee in 1993. Most states assessing a fee have done so for several years. A fee was instituted in Kentucky in 1988, with Minnesota and Georgia following in the early 1990's. Florida only recently began assessing a fee beginning in September 2009.

f. Taxpayer Outreach
FTB mailed notices to all impacted taxpayers prior to the fee being imposed. While FTB may have performed additional outreach, details regarding it were not available since the fee was instituted 16 years ago.

In NC, the fee was established at the same time other changes were being made, including an Internet listing of delinquent taxpayers. The overall project, termed "Project Collect," included an outreach effort consisting of a press conference and letters to taxpayers with past due liabilities. The letters informed taxpayers of the fee and provided information on how the fee could be avoided (i.e., pay in full or enter into an installment payment agreement). NC extended its office and telephone hours to accommodate the increase in taxpayer inquiries resulting from their outreach efforts.

g. Pros and Cons of Assessing a Fee
Overall, there appears to be one potential benefit to assessing a fee in that the fees collected may help support the compliance activities necessary to obtain payment of delinquent liabilities. NC stated that assessing a fee has been very beneficial since the fees collected have funded many projects and positions.

With respect to cons, two have been identified. First, assessing a fee will increase a department's overall outstanding accounts receivables. This will occur since many taxpayers will either be unable or unwilling to resolve their liability and will, therefore, be assessed the fee. Second, implementing a fee will require resources necessary to establish policies and procedures and to enhance BOE's systems to accommodate the fee. System changes required will need to be scheduled and prioritized with other system enhancements previously identified and planned. Depending on the policies and procedures adopted, the fee may increase BOE staff's workload (e.g., processing fee waiver requests) on an ongoing basis.

h. Did Timely Payments Increase?
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. Two of the states stated that the amount of unpaid liabilities have actually increased since they began imposing a fee. The increase in past due liabilities could be the result of the overall downturn in the economy in recent years and may not have been the direct result of the fee imposition.

IV. Fee Amount

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. While the BOE has significant latitude in determining how the amount of the fee is determined, the fees assessed are intended to cover the direct personnel costs incurred in working collection cases.

There are two primary approaches that can be utilized with respect to the fee amount, flat fee or percentage based fee. Each of these alternatives has pros and cons.

a. Flat Fee
Using a flat fee approach, the same dollar amount fee is assessed to all liabilities, regardless of the dollar amount of a taxpayer's past due liability. As mentioned previously, the fee assessed by FTB is a flat fee. Based on preliminary SUTD data, if BOE were to impose a flat fee, a fee of $230 would be assessed on each past due liability.

b. Percentage Based Fee
With respect to fees imposed by other states, percentage based fees appear to be the standard. Of the six states with fees, all of them use a percentage based fee ranging from 10% to 25%. Percentage based fees allow the amount of the fee to be tied to the overall amount of the liability. A larger fee would be assessed to larger liabilities which, in turn, could motivate such taxpayers to come into compliance to avoid such a fee.

If a percentage based fee were pursued, preliminary data indicates the fee would be assessed at 7.0% of the liability amount remaining due after 90 days. Another alternative for assessing a percentage based fee involves the establishment of a maximum, or "capped," fee amount. If BOE were to cap the fee at $50,000 per liability, the fee would need to be set at 8.1%. A cap of $50,000 was identified since it is anticipated that BOE's costs incurred with working a past due liability would rarely exceed this amount.

V. Fee Imposition and Collection

a. Calculation of "Actual Collection Costs"
GC section 16583.1 requires that the fee assessed be reasonable and not exceed actual collection costs incurred. In 2008-09, SUTD's budgeted, direct personnel costs identified to

collection activities were nearly $37.5 million.[1] Approximately 68% of collection staff's time was spent on billed accounts receivable cases. As a result, $25.5 million in personnel costs are attributed to staff time spent working past due liabilities. The total sum of fees assessed by SUTD each year should cover, but not exceed, the $25.5 million in costs.

b. Determination of When a Fee Will be Imposed

While BOE has options for determining how the fee is calculated and when it is assessed, BOE would only assess fees to those taxpayers that failed to comply voluntarily and for which intervention by staff was necessary. BOE's existing operations generally allow taxpayers an opportunity to pay their liability prior to it being assigned to collection staff. As a result, it is suggested BOE assess a fee in instances where a liability remains unpaid after 90 days. A majority of taxing agencies imposing a fee take the same approach.

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

c. Impact of Accounts Receivable Balances

Imposing a fee will result in an increase in SUTD's accounts receivable balances. The extent of the increase will vary depending on how the fee amount is calculated and whether the fee is only imposed prospectively or imposed retroactively as well. Provided below are estimates of the increase in the SUTD's accounts receivables that could occur as a result of a fee being imposed.

i. Imposed Prospectively

Based on data from November 2008 through October 2009, each year the fee would likely be applied to approximately 110,000 unpaid liabilities (on 39,000 accounts) totaling more than $363 million. The total fees imposed each year would cover SUTD's collection costs related to accounts receivable cases, currently $25.5 million.

ii. Imposed Retroactively

Prior to assessing a fee retroactively, taxpayers would be notified and provided with an opportunity to avoid the fee by paying their liability in full or entering into an installment payment agreement. Afterwards, the fee would be imposed on all liabilities 90 or more days past which are not included in an installment payment agreement. Current data indicates that the fee would be applied to approximately 180,000 unpaid liabilities (on 65,000 accounts) totaling nearly $913.7 million. Assuming the flat fee amount and percentages calculated using FY 2008-09 data was applied to all of these liabilities, the total of all fees assessed would range from $41.4 million to $64.1 million. The total amount of fees assessed varies depending on whether the fee imposed is a flat fee, percentage based fee, or a percentage based fee with a cap. Table 1 summarizes the various scenarios using accounts receivable data as of October 31, 2009.

[1]Source: FY 2008-09 budget. SUTD's total budgeted personnel costs identified to collections was $42.5 million, less $5 million associated with cases involving legal actions not subject to active collections. Approximately 32% of collection staff's time spent on obtaining delinquent tax returns. Remaining 68% is spent on accounts receivable cases. $37.5 million x 68% = $25.5 million. Costs identified only represent direct personnel costs and is exclusive of allocated overhead and expenses that is normally included in the overall Collection program element cost identified in BOE's budget.

Table 1 – Collections Cost Recovery Fees Assessed Retroactively

Type	Flat Fee	% Based Fee	% Base Fee with Cap
Fee Amount	$230 per liability	7.0% fee	8.1% fee with $50,000 cap
Total Fees Assessed	$41.4 million	$64.1 million	$59.7 million

d. Revenue

While a fee will increase SUTD's accounts receivable balances, a fee will also increase the revenue collected by BOE. Assuming the fee is imposed both retroactively and prospectively, the fee is anticipated to increase revenue by $1.4 – 5.8 million per year during each of the first four fiscal years it is assessed (see Table 2).[2] The revenue estimates also assume payments received for accounts with such fees will be applied using BOE's existing payment application rules. 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. (Details regarding the BOE's payment application rules are found in Compliance Policy and Procedures Manual section 707.020.)

A funding approach could be utilized wherein the revenue generated by the fee is continuously appropriated in BOE's budget, offsetting BOE's General and Special Funds budget appropriation in the fiscal year following the collection of the fee. Every January, an adjustment would be made to BOE's current year budget appropriations in the amount of fees collected in the prior year. 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 2 provides a summary of the continuous appropriation anticipated based on the revenue estimates for the first three years the fee is imposed with the accompanying statutory changes.

[2] Revenue estimate for FY 2010-11 is $1.4 million, which is a partial year since this assumes BOE would not begin assessing the fee until April 2011.

Table 2 – Continuous Appropriation Using Fees Received

	FY 2010-11 (Apr - Jun)	FY 2011-12	FY 2012-13	FY 2013-14
	($ in millions)			
Fees Received	$4.1	$21.0	$21.5	$21.8
BOE Estimated Budget*	$472	$480	$488	$495
Prior Year Collection Fee Offset	N/A	$4.1	$21.0	$21.5
Adjusted GF, SF, & Reimb. Funding	$472	$475.9	$467	$473.5
AR Cost Recovery Fee Funding		$4.1	$21.0	$21.5
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) System enhancements can be completed 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.

VI. Technology Impact

The extent to which assessment of a fee will necessitate changes to the BOE's Integrated Revenue Information System (IRIS) and Automated Compliance Management System (ACMS) is dependent upon the policies developed for imposing the fee. Regardless of the manner in which the fee amount is calculated, IRIS and ACMS system changes will be necessary so that the fee is appropriately applied. 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). Additionally, if the decision was made to not assess the fee if a taxpayer entered into an installment payment agreement, the system must recognize this so that the fee is not assessed. Last, a new liability category for "fees" may be required since existing liability categories in IRIS are limited to "Tax," Interest," and "Penalty."

- *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.

VII. 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. If the decision was made to assess the fee prospectively, the outreach effort would be more limited and likely include:

- Modifying the BOE's notices to inform taxpayers that a fee will be assessed.
- Including information regarding the fee in the BOE's Tax Information Bulletin.
- Posting fee details, including FAQs, on BOE's website.

A greater level of outreach would be required if BOE were to assess the fee retroactively to all outstanding liabilities. Outreach activities would include those listed above, in addition to other activities, such as:

- 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.
- Developing and distributing news releases prior to BOE assessing the fee.
- Participating in media interviews.
- Creating posters regarding the fee and displaying them in BOE offices.

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. A preliminary review indicates the following publications would likely need to be revised.

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

VIII. Alternatives

a. Flat Fee

Based on preliminary SUTD data, if BOE were to impose a flat fee, a fee of approximately $230 would be assessed on each liability remaining unpaid after 90 days. The fee would be assessed on any unpaid liability, even if the liability is composed of only interest and/or penalty amounts. This approach is suggested since collection staff's time is required to resolve a liability, regardless of whether or not the underlying tax liability has been paid.

Similar to FTB, the fee amounts would need to be examined and recalculated on an ongoing basis, most likely, once a year. The fee amount would then need to be adjusted to reflect the current collection costs incurred by BOE.

i. Pros

- Allows BOE to recoup costs incurred by its collection program.
- Allows BOE to assess the same fee to all past due liabilities.
- A continuous appropriation would allow the cost recovery amount to offset BOE's budget appropriation in the fiscal year following the collection of revenue.
- 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.
- A continuous appropriation will allow BOE staff to continue revenue generating activities, such as traveling to conduct audits, when a new fiscal year budget is not enacted timely.

ii. Cons

- A fee may not prompt voluntary compliance as the BOE already assesses penalty and interest on past due liabilities.
- Assessing a fee will increase the amount of BOE's accounts receivables.
- Statutory changes would be required for the BOE to obtain payment of fees assessed through involuntary collection action (e.g., liens, levies, wage garnishments).
- 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).

- May create 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.
- Statutory changes would be required to allow for continuous appropriation of revenue generated by the fee.

b. Percentage Based Fee

By using a percentage based fee, the fee amount would vary based on the amount of the unpaid liability; a larger fee would be assessed on larger liabilities and smaller fee assessed on smaller liabilities. If a percentage based fee were pursued, current data indicates the fee would need to be assessed at 7.0% of the liability amount remaining due after 90 days. The average unpaid liability is $3,279 and would, therefore, result in an average fee of $230 being assessed under this alternative.

Since the fee is percentage based and is not capped, the fee amount could be substantial in some cases. Data indicates that fees exceeding $50,000 would likely be assessed to more than 50 liabilities each year. Based on data from November 2008 through October 2009, the largest unpaid liability that became 90 days past due over this period had a balance of $6.3 million. By utilizing a fee percentage of 7.0%, a fee in excess of $443,000 would be imposed on this liability.

i. Pros

- Allows BOE to recoup costs incurred by its collection program.
- A percentage based fee is more equitable since greater resources are generally needed to resolve large dollar liabilities.
- May be more likely to encourage voluntary compliance on larger liabilities since the fee amount imposed would be greater in comparison to a flat fee amount.
- A continuous appropriation would allow the cost recovery amount to offset BOE's budget appropriation in the fiscal year following the collection of revenue.
- A continuous appropriation will allow BOE staff to continue revenue generating activities, such as traveling to conduct audits, when a new fiscal year budget is not enacted timely.

ii. Cons

- A fee may not prompt voluntary compliance as the BOE already assesses penalty and interest on past due liabilities.
- The fee will increase the amount of BOE's accounts receivables.
- Statutory changes would be required for the BOE to obtain payment of fees assessed through involuntary collection action (e.g., liens, levies, wage garnishments).
- 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).

- May create 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 waiver of the fee.
- Statutory changes would be required to allow for continuous appropriation of revenue generated by the fee.

c. Percentage Based Fee – With $50,000 Cap

Similar to Alternative b, under this alternative the fee amount would be based on a percentage of liability amount remaining due after 90 days although the fee amount would be limited, or capped, at $50,000. A cap of $50,000 is suggested since we anticipate that, overall, BOE's collection costs associated with working a past due liability would rarely exceed this amount.

Since the fee amount is capped, the percentage used to calculate the fee would be slightly higher than that used under Alternative b. Specifically, the fee would be assessed at 8.1% of the unpaid liability. The average unpaid liability is $3,279 and would, therefore, result in an average fee of $266 being assessed under this alternative. A fee set at 8.1% of the unpaid balance results in a flat fee being assessed on unpaid balances of $617,284 or greater.[3] Capping the fee prevents the fee on a single liability from being excessive. Based on current data, a capped fee of $50,000 would likely be assessed to more than 50 liabilities each year.

[3] $50,000 / 8.1% = $617,284

Tables 3A and 3B summarizes the anticipated fees assessed, revenue generated, and costs incurred under this recommendation during the first three years.

Table 3A - Summary of Fees, Revenue, and Costs (FYs 2010 – 2014) Without Collection Statutory Authority Change

	FY 2010-11 (Apr – Jun)	FY 2011-12	FY 2012-13	FY 2013-14	
Fees Assessed Balance	$65.4 million	$86.8 million	$105.2 million	$122.5 million	
Revenue Received	$1.4 million	$4.4 million	$5.5 million	$5.8 million	
Costs Incurred	$869,151	$69,110	$69,110	$69,110	
Benefit / Cost	1.6 : 1	63 : 1	78.9 : 1	83.4 : 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.

FY 2010-11 costs assume 8,369 hours system modifications (programming) at $90 per hour , $108,809 in costs associated with generating notices, and other minor implementation costs.

Costs identified for FY 2011-12, 2012-13, and 2013-14 are costs associated with generating taxpayer notices when the fee is assessed.

Costs incurred in processing fee waiver requests (if allowed) are not reflected in the cost estimates above.

Table 3B - Summary of Fees, Revenue, and Costs (FYs 2010 – 2014) With Statutory Collection Authority Change

	FY 2010-11 (Apr – Jun)	FY 2011-12	FY 2012-13	FY 2013-14	
Fees Assessed Balance	$65.4 million	$84.1 million	$85.8 million	$87.1 million	
Revenue Received	$4.1 million	$21.0 million	$21.5 million	$21.8 million	
Costs Incurred	$869,151	$69,110	$69,110	$69,110	
Benefit / Cost	4.7 : 1	303: 1	311 : 1	315: 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 the 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.

FY 2010-11 costs assume 8,369 hours system modifications (programming) at $90 per hour , $108,809 in costs associated with generating notices, and other minor implementation costs.

Costs identified for FY 2011-12, 2012-13, and 2013-14 are costs associated with generating taxpayer notices when the fee is assessed.
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.
- Estimated benefit/cost of 83.4:1 in the fourth year without statutory changes; and 315:1 with statutory changes.
- A percentage based fee is more equitable since greater resources are generally needed to resolve large dollar liabilities.
- Capping the fee amount prevents the fee amount from being excessive.
- May encourage greater voluntary compliance in comparison to a flat fee since the fee amount imposed on many liabilities would be greater.
- A continuous appropriation would allow the cost recovery amount to offset BOE's budget appropriation in the fiscal year following the collection of revenue.
- A continuous appropriation will allow BOE staff to continue revenue generating activities, such as traveling to conduct audits, when a new fiscal year budget is not enacted timely.

ii. Cons

- BOE already assesses penalty and interest on past due liabilities; a fee may not prompt voluntary compliance.
- Will increase the amount of BOE's accounts receivables.
- Statutory changes would be required for the BOE to obtain payment of fees assessed through involuntary collection action (e.g., liens, levies, wage garnishments).
- 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).
- May create 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 waiver of the fee.
- Although state agencies now have the *general* authority to assess a fee, BOE may want to obtain express authority via the legislative and/or regulatory process prior to imposing a fee.
- Statutory changes would be required to allow for continuous appropriation of revenue generated by the fee.

<u>d. No Fee</u>
Do not establish or impose a fee.

i. Pros

- Avoids increasing the amount of BOE's accounts receivables.
- Does not require 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).

- Avoids additional workload with respect to questions, complaints, and waiver requests (if accepted) imposing a fee could generate.

ii. Cons
- BOE would not recoup costs incurred by its collection program.
- It would not provide parity with FTB.

IX. Recommendation

Staff recommends BOE implement Alternative C - Percentage Based Fee - With $50,000 Cap

Additionally, we recommend the fee be imposed retroactively after giving impacted taxpayers sufficient opportunity to avoid the fee (i.e., pay liability, enter into IPA). The BOE must pursue legislation that would allow the fees to be subject to existing, involuntary collection actions (e.g., liens, levies, wage garnishments). Additionally, the BOE should pursue legislation that would provide for a continuous appropriation for the fees collected. Such legislation would increase the amount of revenue generated by the fee, and reduce the amount of BOE's annual General and Special Funds appropriation by the amount of revenue collected. This course of action is suggested for the following reasons:

- Imposition of a fee on past due liabilities is becoming more common. FTB has imposed a fee for 16 years. Several other states also impose a fee and have done so for many years.
- Utilization of a fee to cover personnel costs associated with the collection of past due liabilities is equitable. The fee would be assessed on past due liabilities for which BOE must expend resources.
- A percentage based fee is equitable since greater resources are generally expended to collect larger dollar liabilities.
- Capping the fee prevents the fee amount from being excessive.
- Imposing the fee retroactively is equitable and reasonable since BOE resources have been, and will continue to be, expended on efforts to collect these liabilities.
- Estimated benefit/cost of 83.4:1 in the fourth year without statutory changes; and 315:1 with statutory changes.