

## CHAPTER 7

### OVERVIEW OF CALIFORNIA TAX ADMINISTRATION

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#### HIGHLIGHTS

- Franchise Tax Board (FTB)
  - Board of Equalization (BOE)
  - Employment Development Department (EDD)
  - Local Property Taxes
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California's tax system is administered by a number of different state agencies, as well as by county assessors (Table 12). These agencies are charged with implementing tax law, enforcing tax statutes, collecting tax liabilities, and remitting moneys collected to the state's General and special funds and local jurisdictions. Two agencies share responsibility for the "big three" state taxes - personal income, corporation, and sales and use taxes. The FTB administers the personal income and corporation taxes. The BOE administers the sales and use tax. The BOE also serves as an appeals panel for taxpayer disputes with FTB.

This chapter outlines the responsibilities of the various administrative agencies. For additional information or answers to specific questions, please refer to sections of this Reference Book dealing with specific taxes or contact the administering agency.

#### **1. FRANCHISE TAX BOARD**

The FTB administers the Personal Income and Corporation Tax Laws. Together these taxes raised 59.2% of the state's General Fund revenues during 2003-04. The FTB is charged with developing and maintaining compliance, reporting, and payment systems for these two taxes. In addition, FTB administers the Homeowner's and Renters' Assistance programs; performs Political Reform Act audits; and collects delinquent Vehicle License Fees, child support payments, and court-imposed payments. FTB also collects delinquent fees, wages, and penalties for the Department of Industrial Relations.

A three-member board consisting of the State Controller, the Chair of BOE, and the Director of the Department of Finance governs FTB.

**Personal Income Tax.** The personal income tax is a self-assessed tax. Returns are due from individual taxpayers on April 15th for the preceding year for most individuals.

**CHAPTER 7  
OVERVIEW OF  
CALIFORNIA'S TAX  
ADMINISTRATION**

Personal income taxes are withheld from taxpayers' wage and salary income throughout the year. Quarterly estimated tax payments are required on income that is not subject to withholding. The tax liability that exceeds the tax withheld is due together with the tax return on April 15th. Amounts withheld in excess of taxes due can be claimed as a refund or applied to the next year's tax liability on the taxpayer's return.

**Corporation Tax.** Corporation taxes are also self-assessed. Corporation tax returns are due on the 15th day of the third month following the close of the taxable year. Corporations are required to pay estimated taxes in quarterly increments.

**Appeals Process.** After examining a taxpayer's return or conducting an audit, FTB may issue a Notice of Proposed Assessment (NPA) indicating that additional taxes are owed (i.e., that a deficiency exists) for taxes administered by FTB. Taxpayers, whether personal income or corporation tax filers, that dispute a deficiency assessment proposed by FTB can protest and appeal using the following procedures:

- Within 60 days after the NPA (deficiency) is issued, a taxpayer must file a written notice of protest with FTB. The taxpayer is not required to pay any amount under dispute at this time. However, if the proposed deficiency assessment is eventually determined to be owed, interest will accrue from the initial due date.
- The FTB reviews the protest, reviews documentation or holds a hearing as required, and notifies the taxpayer of the disposition with a Notice of Action (NOA).
- Taxpayers who dispute an NOA may appeal to BOE in writing within 30 days after the date FTB mails the NOA to the taxpayer. The BOE will then consider the appeal and, where appropriate, hold a hearing on the appeal. It is not necessary for the taxpayer to pay the tax prior to filing an appeal with BOE. The BOE will either affirm, reduce, or eliminate the deficiency assessment.
- Taxpayers who disagree with BOE's final determination may file suit in Superior Court. However, in all cases other than those involving a determination of residency, the taxpayer must pay the amount in dispute and file a claim for refund with FTB before filing the suit.

The FTB or BOE may abate interest relating to a deficiency assessment to the extent the interest is attributable to an unreasonable error or delay by FTB in performing a ministerial or managerial act. If BOE determines that FTB's action was unreasonable, the taxpayer also may be eligible for reimbursement of reasonable fees and expenses incurred in pursuing the appeal.

**CHAPTER 7  
OVERVIEW OF  
CALIFORNIA'S TAX  
ADMINISTRATION**

Once BOE's determination on the NOA is final and if the amount due remains unpaid, FTB may pursue collection activities. The collection activities may include filing a public tax lien, levying on wages and/or bank accounts, and seizing and selling property. Applicable interest rates on amounts due and on the imposition of penalties are specified in statute.

**Income Tax Settlement Authority.** The FTB also has authority to settle civil tax matters in dispute without using the normal appeals process. Settlement authority applies to both personal income and corporation tax disputes. The FTB settlement authority is patterned on federal settlement authority and is intended to provide an alternative to the cost and risks inherent in litigation.

After reaching an agreement with a taxpayer, FTB staff will recommend settling the case. For all cases involving reductions of tax or penalties in excess of \$7,500 for 2003 and indexed for inflation beginning January 1, 2004, the Attorney General must advise in writing whether a recommended settlement is reasonable. Unless a recommended settlement is specifically rejected by a majority of FTB, it is deemed approved.

For cases involving reductions of tax or penalties of \$7,500 or less, the settlement may be approved by FTB's Executive Officer and Chief Counsel jointly without review by the Attorney General or FTB.

All settlements involving reductions of taxes or penalties in excess of \$500 become matters of public record.

## **2. BOARD OF EQUALIZATION**

The BOE administers the sales and use tax, a number of business taxes and environmental fees, property taxation of public utilities, and has oversight responsibility for local property tax administration. The Board itself consists of four elected members and the State Controller. The Board also adopts regulations necessary to implement the taxes and fees it oversees.

**Sales and Use Tax.** The BOE collects the sales and use tax from retailers and distributes revenues due to the state and to local jurisdictions. The BOE also administers transactions and use taxes for local jurisdictions on a contract basis, collecting a small portion of the revenues as an administrative fee.

The BOE routinely audits taxpayers to determine whether sales and use taxes are accurately reported. If BOE determines that there is a deficiency, it must provide the taxpayer with written notice of the determination. The taxpayer may file for redetermination within 30 days. After a petition for redetermination is made, a hearing before the BOE is held.

**CHAPTER 7  
OVERVIEW OF  
CALIFORNIA'S TAX  
ADMINISTRATION**

**State-Assessed Property.** The BOE assesses property owned by public utilities operating in multiple counties. The BOE assigns a value to the property in each county and allocates that value to individual county assessors, who are responsible for levying and collecting any property taxes due. Disputes over values assigned to state-assessed properties may be taken to the Board members for a formal hearing.

**Other Taxes.** The BOE is also responsible for administering and collecting a number of other taxes and fees, which are collectively known as BOE's "Special Taxes and Fees". These taxes and fees include the Motor Vehicle Fuel Tax, Diesel Fuel Tax, Use Fuel Tax, Alcoholic Beverage Tax; Cigarette and Tobacco Products Tax; Energy Resources and Emergency Telephone Users Surcharges, Hazardous Waste Taxes and Integrated Waste Management Fees, Tire Recycling Fees, Lead Poisoning Prevention Fees, Oil Spill Fees, the Timber Yield Tax, and the Private Railroad Car Tax. Payers of these taxes and fees are subject to the same appeals process outlined for the Sales and Use tax.

**Settlement Authority.** The BOE has been granted settlement authority to help resolve disputes involving sales and use taxes and the various special taxes noted above. The BOE's settlement authority is similar to that described above for FTB (i.e., settlements involving reductions of tax or penalties not exceeding \$5,000 may be approved by BOE's executive director and chief counsel jointly, while larger settlements must be approved by the Attorney General).

### **3. EMPLOYMENT DEVELOPMENT DEPARTMENT**

The EDD administers the Unemployment Insurance (UI), Employment Training Tax (ETT), and State Disability Insurance (SDI) tax programs. In addition, EDD is responsible for ensuring that personal income taxes are withheld from wage and salary income of workers.

**Unemployment Insurance.** Unemployment Insurance taxes are levied on the first \$7,000 of income for covered employees each year. The tax is paid by the employer and collected by EDD. If EDD assesses a deficiency against an employer, the taxpayer has 30 days to petition for reassessment. This petition is reviewable by an Administrative Law Judge and may be appealed to the Unemployment Insurance Appeals Board.

**Employment Training Tax.** Regardless of their UI tax rate, all employers are assessed an additional 0.1% as an employment training tax, except for those employers with a negative reserve account balance.

**State Disability Insurance.** State disability insurance (SDI) is paid by employees. Employees who work for multiple employers and earn income in excess of the wage base may file for a refund of excess contributions on the taxpayer's income tax return.

**Paid Family Leave.** Paid Family Leave insurance extends disability compensation to cover individuals who take time off of work to care for a seriously ill child, spouse,

**CHAPTER 7  
OVERVIEW OF  
CALIFORNIA'S TAX  
ADMINISTRATION**

parent, or domestic partner, or to bond with a new child. The programs cover approximately 13 million California workers. Beginning January 1, 2004, employers are required to deduct the Paid Family Leave contributions from the wages of employees who are covered by the SDI program. Benefits will be payable for Paid Family Leave insurance claims commencing on or after July 1, 2004.

**Personal Income Tax Withholding.** The EDD's tax branch administers the reporting, collection, and enforcement of personal income tax withholding. "Withholding" represents the money that employers are required to hold back from employees' wages. Amounts withheld are based on each employee's W-4 or DE-4, forms that are on file with each employer and which contain information regarding the tax status of the employee.

#### **4. INSURANCE GROSS PREMIUMS TAX**

Three agencies share responsibility for administering the Insurance Gross Premiums Tax - the Department of Insurance, BOE, and State Controller. The Department of Insurance issues permits for each class of insurance, processes returns, and audits taxpayers. The BOE issues assessments, processes petitions, and hears appeals. The State Controller makes refunds and collects delinquencies and penalties.

#### **5. LOCAL PROPERTY TAXES**

Property taxes are assessed and collected at the local level for all property except that held by public utilities. Property held by public utilities is assessed by BOE.

Property is assessed annually as of 12:01 A.M. each January 1. On this date, any taxes due become a lien on the property. Property owners can appeal the value of their property by filing an application for change in assessment with the Board of Supervisors or assessment appeals board between July 2 and September 15 each year for properties on the regular roll. Supplemental and escape assessments must be appealed within 60 days of the date the notice of change in assessment is mailed.

The Board of Supervisors of each county serves as a BOE for locally-assessed property to assure comparable valuation of property. Assessment appeals go before the Board or the assessment appeals board, if one exists in that county. Decisions of the county may only be appealed to court in certain limited circumstances: arbitrariness, lack of due process, abuse of discretion, failure to follow standards established by law, or for other specified reasons. Legal actions must be filed in Superior Court within six months after a claim for refund is denied by the county board.

The BOE oversees local assessment practices and develops standards for local assessment. In addition, BOE periodically evaluates the performance of individual county assessors.

## **6. MOTOR VEHICLE TAXES**

The Department of Motor Vehicles (DMV) administers the vehicle license, registration, and weight fees. The FTB is responsible for collecting delinquent vehicle license and registration fees. These fees are paid annually at the time of vehicle registration. The

trailer coach (mobilehome) fee is administered by the Department of Housing and Community Development and is also paid annually. The Motor Carrier tax is levied by the Public Utilities Commission (PUC) and is paid quarterly. Motor Carrier tax appeals are filed with and heard before the PUC.

## **7. STATE CONTROLLER**

The State Controller administers and collects the Estate Tax. This tax is levied as a portion of the federal tax. The tax is due on the date of death and becomes delinquent after nine months.

## **8. TAXPAYERS' BILL OF RIGHTS**

In 1988, the Taxpayers' Bill of Rights was enacted in California to set certain standards for tax administering agencies and provide taxpayers with protection against unreasonable action. Specific provisions of the Bill of Rights include:

- Establishment of Taxpayers' Rights Advocates in FTB and BOE;
- Requiring state agencies to respect the confidentiality of taxpayer information;
- Setting standards for hearing and appeals procedures;
- Defining conditions under which taxpayers can receive reimbursement for fees and expenses incurred while pursuing an appeal; and
- Restricting the types of property and the conditions under which property may be sold to satisfy a tax levy.

In 1997, the California Taxpayers' Bill of Rights 2 was enacted to conform California's income and franchise tax laws to the federal Taxpayers' Bill of Rights 2 and in so doing to expand the protection afforded to taxpayers. The California Taxpayers' Bill of Rights 2 was extended to California's Sales and Use Tax Law in 1998 and to California's special taxes and fees in 1999. Some of the many provisions of the Taxpayers' Bill of Rights 2 include the following:

- The burden of proving correctness of information provided on third-party information returns (e.g., W-2s or 1099s) may shift to FTB once the taxpayer

**CHAPTER 7  
OVERVIEW OF  
CALIFORNIA'S TAX  
ADMINISTRATION**

complies with certain conditions;

- Interest attributable to unreasonable errors or delays caused by FTB or BOE staff performing a ministerial or managerial act may be abated;
- Taxpayers have an additional five days to pay deficiency assessments after receiving a notice and demand;
- A levy must be released if made in violation of FTB or BOE administrative procedures or if it is in the state's best interest to do so;
- Taxpayers' litigation costs and appeal expenses may be reimbursed;
- Taxpayers may sue the state for damages if FTB or BOE staff intentionally entice a taxpayer's representative to provide information about the taxpayer by offering to settle the representative's tax liability;
- Taxpayers qualifying to file a joint return may file such a return even though prior separate liabilities of the taxpayer's spouse may be unpaid;
- Payers of interest, dividends, or wages must include their telephone number in the information report they file;
- Delinquent taxpayers must be given annual notice of their delinquency;
- Notice of termination of an installment payment agreement as well as the basis thereof must be mailed to the taxpayer 30 days prior to termination;
- The FTB must make a reasonable attempt to contact a taxpayer if it cannot locate a taxpayer's account within 60 days of receiving payment;
- Enrolled agents are deemed as third-party recordkeepers for purposes of relating to issuance of subpoenas;
- The FTB regulations may apply retroactively only in specified circumstances; and
- Mail sent through IRS-designated private delivery services are considered as if sent via the U.S. Postal Service.

In 1999, California conformed its personal income and corporation taxes to many of the provisions of the federal Taxpayer Bill of Rights 3, enacted by Congress in 1998 as part of the Internal Revenue Service Restructuring and Reform Act. A few examples of California's conformity to the federal Taxpayer Bill of Rights 3 include:

**CHAPTER 7  
OVERVIEW OF  
CALIFORNIA'S TAX  
ADMINISTRATION**

- Innocent spouse relief;
- Suspension of interests and penalties if FTB does not notify a taxpayer about amounts owed;
- Prohibition against FTB using financial status to determine unreported income;
- Requirement that FTB notify taxpayers before notifying third parties regarding the determination or collection of the taxpayer's liability;
- Requirement that FTB release a wage levy if tax is uncollectible;
- Limitation on FTB selling principal residences to satisfy unpaid liabilities; and
- Waiver of early withdrawal penalties when retirement plans are levied.

**CHAPTER 7  
OVERVIEW OF  
CALIFORNIA'S TAX  
ADMINISTRATION**

**TABLE 11**

**TAX ADMINISTRATION RESPONSIBILITIES**

<b><u>Tax</u></b>	<b><u>Responsible Agency</u></b>
Alcoholic Beverage Tax Tax Collection Licensing & License Fee Collection	Board of Equalization Department of Alcoholic Beverage Control
Corporation Tax	Franchise Tax Board
Cigarette and Tobacco-Related Products Tax	Board of Equalization
Emergency Telephone User's Surcharge Rate Setting Tax Collection	Department of General Services Board of Equalization
Estate Tax	State Controller
Gasoline, Diesel, Use Fuel Taxes	Board of Equalization
Insurance Gross Premiums Tax Permit Issuance Tax Assessment Refunds & Penalty Collection	Department of Insurance Board of Equalization State Controller
Motor Vehicle License Fee Administration Collection (delinquencies only)	Department of Motor Vehicles Franchise Tax Board
Motor Vehicle Registration Fee	Department of Motor Vehicles
Motor Carrier Tax	Public Utilities Commission
Paid Family Leave	Employment Development Department
Personal Income Tax (PIT) PIT Withholding	Franchise Tax Board Employment Development Department

CHAPTER 7  
OVERVIEW OF  
CALIFORNIA'S TAX  
ADMINISTRATION

TABLE 11

(Continued)

<u>Tax</u>	<u>Responsible Agency</u>
Private Railroad Car Tax	Board of Equalization
Property Tax	
Assessment	County Assessors Office
Standards Development	Board of Equalization
Public Utility Property Tax	Board of Equalization
Sales and Use Tax	Board of Equalization
State Disability Insurance Department	Employment Development
Timber Yield Tax	Board of Equalization
Unemployment Insurance Tax Department	Employment Development
Weight Fees	Department of Motor Vehicles