

# California Tax Gap Strategies

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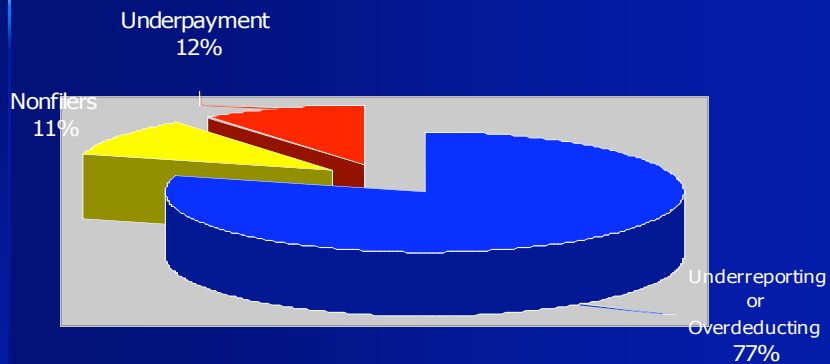
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## Size of the Tax Gap

- **Federal Tax Gap**
  - **Estimate for 2001 tax year**     **\$290.0 B\***
- **California Income Tax Gap**
  - **1985 estimate**     **\$2.0 B**
  - **2004 estimate**     **\$6.5 B**

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## Tax Gap Components



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## Tax Gap: An Intractable Issue

- The tax gap across history.
- Tax gap data is incomplete, making it hard to take effective action.
- Enforcement brings in additional revenue but has not significantly reduced the tax gap.

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## Abusive Tax Shelters and VCI

- FTB sought ideas to close the tax gap and collect additional revenue.
- Most ideas had little overall impact.
- The Voluntary Compliance Initiative
  - Increased SOL and penalties.
  - Provided amnesty for participants.
  - \$1.4 billion in revenue, 1,200 participants
  - Showed that new ideas can make a big impact.

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## Other Recent Tax Gap Actions

- Amnesty
- Out-of-state sham incorporations
- California Tax Shelter Resolution Initiative

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## Tax Gap Symposia

- Held to identify ways to cut the tax gap.
- Included IRS, tax professionals, FTB.
- Strategies:
  - Use more data and data matching.
  - Make complying easier, noncompliance more difficult.
  - Pursue abusive preparers, promoters, and transactions that conceal tax liabilities.
  - Convey positive messages about societal benefits of tax compliance.

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## After the symposia - the need for a plan

- Ideas were still largely tactical.
- 2005/06 Tax Gap BCP 0.5% of California's annual tax gap.
- We needed a clear articulation of the tax gap issues, root causes, and what can be done to address them.
- Strategic plans have driven FTB action on key issues.

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## Tax Gap Planning Objectives

- A more holistic, strategic approach to addressing the tax gap.
- Clarify direction and get internal consensus on our approach to the tax gap.
- Articulate to stakeholders the need to reduce the tax gap.
- Build support for resources and policies needed to reduce the tax gap.

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## Planning Process

- Brought in outside experts, reviewed literature.
- Large planning group included staff and managers involved in tax gap efforts.
- Identified tax gap segments and root causes.
- Identified goals, initiatives and actions to address root causes.
- Sought and incorporated input from Board and stakeholders.

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## Plan Overview

- **Balanced between "soft" and enforcement oriented approaches.**
- **Improve Confidence in the Tax System.**
  - Determine ways to increase Californians' confidence in tax administration.
  - Recognize honest taxpayers' contribution.
- **Reduce Burden and Complexity.**
  - Make it easier for taxpayers to file and pay.
  - Reduce burden and legal complexity.

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## Plan Overview, continued

- **Make It Harder to Cheat.**
  - Use more data and better data mining.
  - Improve information return reporting.
  - Increase enforcement speed and coverage.
- **Level the Playing Field for Businesses.**
  - Focus on sectors where tax cheating hurts honest businesses.
  - Coordinate actions against businesses that cheat.

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## Plan Overview, continued

- **Support High Standards in the Tax Professions.**
  - Make practitioner misconduct unprofitable.
- **Become More Innovative in Attacking the Tax Gap.**
  - Develop expertise to fight tax cheating.
  - Continually develop new ideas to reduce the tax gap.
  - Work with outside experts to build research capabilities.

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## Why “Soft” Approaches Matter

- **Taxpayer confidence in the tax system increases compliance, e.g., transparency and perceived fairness.**
- **Burden and complexity contribute to the tax gap.**
- **Innovation is key to reducing the tax gap.**

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## **Enforcement is Still Needed**

- **Enforcement helps ensure everyone pays, shows that cheating doesn't pay.**
- **Deterrence is important.**
- **Helps reduce cynicism.**
- **It brings in revenue we otherwise wouldn't collect.**

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## **Critical Success Factors**

- **Partnerships are key to the plan's success.**
- **Leverage efforts by IRS and other states.**
- **Seek input from taxpayers and tax professionals.**
- **Obtain sufficient resources use them wisely.**
- **Obtain better metrics to determine success.**

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## Next Steps

- Get Board approval of the plan.
- Increase transparency, outreach, and build partnerships with stakeholders to increase confidence.
- Seek funding and begin implementing initiatives.
- Identify changes as needed.

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## Thank you!

### Questions?

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