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A Report on Tax Agency Information and Data Exchange

LEGISLATIVE ANALYST'S OFFICE

Executive Summary

California has for decades relied on several different state agencies to administer and enforce its taxes. While this system has performed reasonably well in many respects, the multiagency nature of the system is prone to certain inherent problems, difficulties, and inefficiencies. This report focuses on one particular area of concern—namely, the challenges California's tax agencies face within the multiagency framework in sharing the tax-related information and data they need to effectively and efficiently administer the overall tax system.

At the direction of the Legislature, we have worked with the tax agencies to identify a number of near-term steps that could be taken, short of full consolidation and technological integration, that could improve information and data collection and exchange, and thereby aid in tax enforcement and compliance. Specifically, we recommend that the tax agencies:

- Report on those cost-efficient data sharing actions they are planning to undertake or could undertake immediately (that is, which require no additional funding or statutory changes).

- Provide relevant information and recommendations regarding other initiatives that may require legislative actions (such as statutory changes or additional funding).

- Report at budget hearings on an alternative technology approach, such as using software "overlays," to link existing independent tax information systems—including its costs, benefits, and time requirements.

Introduction

The *Supplemental Report of the 2005 Budget Act* directed the Legislative Analyst's Office (LAO), in consultation with the Department of Finance (DOF), to report to the Legislature regarding the characteristics and various issues associated with the state's existing tax information and data systems. This report, prepared in response to that requirement, focuses on the extent of information and data exchange among the state's three main tax administration agencies, and the impediments to and opportunities for increasing the current level of cooperation in this regard. We have focused on information and data gathering and exchange related to the state's three principal tax and revenue sources—the personal income tax (PIT), sales and use tax (SUT), and corporation tax (CT)—with an emphasis on how additional cooperation can serve to improve overall tax compliance as well aid in tax enforcement activities.

The report is divided into the following sections:

- Background and a brief overview of the state's three tax agencies.

- Review of the state's existing taxpayer information systems and data exchange activities.

- Discussion of important considerations regarding tax-related information systems, including organization structures, data accessibility, and new data collection.

- Recommendations to the Legislature regarding improvements to the existing system.

In preparing this report, we have relied extensively on the expertise of the state's tax agencies—the Board of Equalization (BOE), Employment Development Department (EDD), and Franchise Tax Board (FTB)—as well as DOF and various other relevant state agencies. They have provided substantial documentation regarding their existing data and information collection systems, identified areas that could be addressed through additional collections efforts, and suggested alternative means of sharing information among them. They have also provided technical information regarding the multiple information technology (IT) systems used by the tax agencies and other state departments.

Background

Previous Reports on Tax Agencies

Numerous reports have previously been issued regarding the topic of coordination and cooperation among the three tax agencies. The focus of these reports has ranged from relatively minor aspects of increased cooperation (for example, the Strategic Tax Partnership discussed below) all the way to proposals for a full consolidation of the three agencies under "one roof." In between, there have been reports examining the combination of limited aspects of the tax agencies' operations (for example, cashiering and remittance processing) and the expansion of coordination regarding shared tax programs or activities (such as auditing and collections).

Some significant studies and analyses regarding tax agencies occurred in the relatively recent past. Figure 1 (see next page) indicates the subject or focus of major reports that have been produced on the topic in the last 20 years, along with the findings or results (if any) of such analyses.

Restructuring Legislation Has Previously Been Proposed. The tax agencies have also been the focus of a substantial number of legislative proposals. Recent legislative sessions have included proposals to:

- Abolish FTB and BOE and establish a unified department of revenue within the executive branch.

- Abolish FTB and BOE and establish a unified department of revenue as a separate independent entity.

- Combine the three tax agencies—FTB, BOE, and EDD—under a restructured BOE.

- Combine all three agencies while separating the administration of the tax system from its adjudicatory responsibilities.

Figure 1

Tax Agency Restructuring—Recent Major Reports

Date	Reporting Entity	Report Title	Report Focus	Findings/Results
1986	Commission on California State Government Organization and Economy (Little Hoover Commission)	*Review of the Organization and Operation of the State of California's Major Revenue and Tax Collection Functions and Cash Management Activities*	Various administrative activities of Franchise Tax Board (FTB), Board of Equalization (BOE), and Employment Development Department (EDD), State Controller, State Treasurer, Department of Finance, and Commission on State Finance.	Significant duplication of various administrative functions.
1987	State Auditor General (Bureau of State Audits)	*A Study of Consolidating the Cashiering Operations of the State's Three Largest Tax Collection Agencies*	Possible consolidation of cashiering operations of FTB, BOE, and EDD.	Consolidation is not justified based on savings.
1996	Governor's Office	*Competitive Government and Consolidation: A Plan to Streamline California's Tax System*	Agency streamlining, elimination of duplicative functions, increasing administrative efficiencies.	Consideration of various consolidation issues. No final action.
1996	FTB and BOE	*Creating a Department of Revenue: Benefits,Concerns, Issues*	Analysis of a fully consolidated tax agency combining FTB and BOE.	No action.
2004	California Performance Review Commission	Chapter Title: "Consolidate and Upgrade Cashiering in State Taxing Agencies"	Consolidate mail, cashiering, remittance processing, data capture, and image management of FTB, BOE, and EDD.	No action.
2004	California Performance Review Commission	Chapter Title: "The California Tax Commission"	Establish new commission combining FTB, EDD, and certain components of the Department of Motor Vehicles.	No action.
2005	Legislative Analyst's Office	*Tax Agency Consolidation: Remittance and Return Processing*	Emphasize conversion to electronic filing, remittance, and data functions.	No action.

In recent legislative sessions, several pieces of legislation were introduced that relate to the administrative processes at the agencies, including two bills which would have consolidated FTB's operation within BOE's existing administrative structure. While the many past studies and legislative proposals have met with a variety of responses, none of them resulted in any fundamental alterations in the administrative structure of the tax agencies or how they relate to one another.

Focus of This Report

Previous reports regarding the state's three tax agencies have primarily concerned themselves with two aspects of tax collection and administration:

- ***Transparency and Accessibility to Taxpayers.*** The existence of three tax agencies as opposed to one is not solely a state administrative issue; it also poses issues for taxpayers. Many of the past reports have focused on the benefits to taxpayers of a unified agency, as there would be only one entity for tax reporting, returns, and remittances.

- ***Fiscal and Budgetary Impacts.*** Many of the activities carried out by the tax agencies are similar in nature. This is particularly the case regarding some of the more routine and procedural activities such as processing returns, accepting and depositing remittances, and notifying taxpayers of reporting requirements. Many previous reports have focused on the fiscal and budgetary benefits of combining some of these duplicative or overlapping activities.

Unlike past reports, the focus of this report is related to the *compliance and enforcement advantages of increased cooperation and information sharing among the tax agencies.* Compliance and enforcement activities are important for the state's tax system since they help ensure its fairness and integrity and reduce the tax rates necessary to raise a given amount of revenues. Recently, compliance and enforcement issues have become of increasing concern to California—as well as to other states and the federal government—due to a number of different trends and factors:

- Abusive tax shelters have led to increased underreporting of income for tax purposes.

- The growth of the Internet and other forms of remote sales have led to noncompliance with the state's use tax.

- The growth in nonwage income has led to less withholding and a greater reliance on third-party reporting.

These factors—coupled with other features of today's economy such as new and different business ownership structures, information transactions, and the large cash economy—have led to increased concern about the "tax gap" (that is, the difference between taxes legally owed and actually paid to the state). The collection, sharing, and accessibility of tax-related information among tax agencies are seen as primary methods of dealing with the tax gap.

California faces particular difficulties in addressing tax gap issues because of its administrative structure. Virtually unique among the states, California has three agencies that administer the state's three principal sources of General Fund taxes and revenues—the PIT, SUT, and CT. While other states may have multiple departments for relatively minor taxes (such as insurance and excise taxes), in these states one agency—typically a department of revenue—collects the main state taxes. California's multiple tax-agency structure poses a challenge regarding the effective and efficient management of tax information.

On the positive side, however, the widespread availability of electronic information provides new opportunities in addressing tax compliance issues. For PIT, SUT, and CT, electronic remittances and returns are increasingly becoming the norm. In addition, much of current data storage is now in electronic format. This conversion from paper documentation to electronic versions provides an opportunity to streamline the entire compliance and enforcement system, and facilitate additional data collection, sharing, and accessibility among the tax agencies in the process.

California's Tax Agencies

Board of Equalization. The BOE's major responsibilities are to: (1) collect state and local SUT; (2) collect a variety of business and excise taxes and fees, including those levied on gasoline, diesel fuel, cigarettes, and hazardous waste; (3) oversee the administration of the local property tax by county assessors; and (4) assess certain statewide property of utilities and railroads. In addition to its administrative role, BOE also adjudicates tax disputes and appeals. The BOE board serves as the final administrative appellate body for PIT and CT, administered by FTB, as well as for the taxes that it administers. The BOE is governed by a constitutionally established independent board—consisting of four members elected by district and the State Controller.

Employment Development Department. The EDD is responsible for administering programs dealing with employment-related services, unemployment insurance (UI), and disability insurance (DI). The department collects UI contributions and employment taxes from employers and collects DI contributions for the DI program. The department is also the agency responsible for collecting PIT withholding on wages and salaries, and interacts directly with FTB in the administration of the PIT.

Franchise Tax Board. The FTB's primary responsibility is to administer California's PIT and CT. The FTB also administers several of the programs, including homeowners' and renters' assistance programs, the collection of child support payments, and other court-ordered payment programs. The FTB is governed by a three-member board, consisting of the Director of DOF, the Chair of the BOE, and the State Controller. The board retains an executive director for the purpose of administering the agency.

Current Tax Information Systems and Their Use

Existing Organizational Mechanisms

Currently, the state's tax agencies exchange data and information in a variety of ways. Information that is public in nature and is thus available to any tax agency—such as information regarding licenses held for certain types of businesses—is provided over agency Web sites or in exchanges between individual tax agencies.

The concerns, however, are with the tax agency data that is sensitive or confidential in nature—such as withholding and wage information reported to EDD by employers. Since each agency has its own procedures governing the process for sharing data and sensitive tax information with another agency, forums have been established to improve coordination of information exchange. A notable multiagency forum that has been established for sharing tax information is the Strategic Tax Partnership (STP)—which includes the state's three main tax agencies and the Internal Revenue Service (IRS) as an adjunct member. It is also referred to as the Federal-State Partnership, which encompasses the Federal/State Compliance Information Sharing Committee and the Federal/State Customer Service Committee. The STP was established in December of 1993, and is used by all three state agencies to coordinate exchange of data among them, including limited access to each agency's online tax system.

One recent, more limited type of formal data sharing that has been put in place involves the new Multi-Agency Form for Offer in Compromise, which can be submitted by taxpayers to the state's tax agencies. Its purpose is to streamline the process allowing taxpayers, under specified circumstances, to negotiate paying a reduced amount of their nondisputed tax liabilities to the state when they are unable to pay the full amount owed. The individual tax agencies—FTB, BOE, and EDD—must still negotiate separately an appropriate amount for the taxes they respectively administer, but one form with various supporting information can be submitted.

Procedures for Sharing Data. The process for sharing taxpayer data across departments has evolved over time. For each of the tax agencies, the process has been somewhat different due to the varying cultures that prevail at each of the agencies as well as the type of data that is collected and used at the agencies. Each of the tax agencies has its own set of privacy and confidentiality principles, which can reflect agency-specific viewpoints but also be affected by certain federal or state laws.

In 1997, the *Reciprocal Agreement for Exchange of Information* was executed by the three tax agencies, which led to the establishment of the *EDD, FTB, and BOE Information Exchange Rules and Guidelines*. This document assigns responsibilities and establishes procedures and standards for the tax agency exchanges. In addition, the recently executed *Federal Information Redisclosure Agreement* with the IRS regarding the use of federal data has simplified the use of certain federally sourced data by allowing the direct exchange of such data among the tax agencies.

For each of the three agencies, there is typically a single point of contact to receive, review, and respond to information or document requests from each of the other two agencies. In most cases, a formal written agreement (usually a memorandum of understanding (MOU) or an interagency agreement) must be executed for each piece of information. The agreements typically accomplish the following: (1) detail how the data will be used and protected, (2) include a confidentiality agreement, and (3) specify the data format and transfer method. In addition, the agreements are typically reviewed by various legal, disclosure, security, procurement, and data resources staff. Some agencies also monitor the use of their data by the other agencies.

Current Information Exchanges

Types of Information. In most cases, the information obtained by one tax agency from another or shared among the tax agencies is raw data rather than a report in prose. As such, each recipient must interpret the data received. Agencies acquire extensive tax-related data from the other main tax agencies, as well as from the State Controller's

Office (regarding estate, inheritance, and gift taxes) and the Department of Insurance (regarding the gross premiums tax). In addition, the tax agencies acquire public records data from numerous other state agencies that assists them in administering and enforcing their taxes. The information currently obtained can be quite broad. For example, the tax agencies incorporate data relating to professional licensing, local business taxes, records of legal actions, as well as various state registration information.

The tax agencies also receive information from local governments and private vendors. For example, the cities and counties provide data from business license tax filings by businesses that operate within their jurisdictions; and vehicle, vessel, aircraft, trucker, commercial, industrial, residential, and real property ownership data is purchased from various private consulting firms.

Sources of Information. The largest single sources of information and data that are exchanged are from the tax agencies themselves. For example, FTB receives 12 separate data files from BOE—including reports on sales tax audits, lists of entities that have filed for seller's permits, and the names of partners in businesses with dual ownership. Similarly, BOE receives or shares 17 separate data files from FTB—such as trucker ownership information for motor vehicle fuel auditing and bank and financial corporation tax return filers lists. The EDD is also involved with sharing tax agency information from BOE and FTB. For example, EDD provides BOE with lists of all active employers with 50 or more employees.

Data gathered from other state agencies is wide-ranging and includes information from various boards and commissions of the state. For example, the Department of Motor Vehicles (DMV), Department of Consumer Affairs (DCA), and Secretary of State (SOS) are all sources of certain valuable information for FTB, BOE, and EDD—such as occupational licensing information provided to EDD by DCA, the voter registration file that SOS provides BOE, and copies of vehicle and undocumented vessel registrations sent by DMV to BOE. (Appendix A provides a list of the main state agencies that provide data to the tax agencies.) Local government sources are used most heavily by BOE, and include county assessors, city licensing boards, and county courts. The BOE also uses data from private local sources—including individual credit information from various banks and credit bureaus.

Uses of Information. Typically, the information collected by the tax agencies and gleaned from other sources is used to verify or confirm representations made by the taxpayer and improve compliance with the state's tax laws. For example, data on employers' names and business applicants for a seller's permit are shared amongst the agencies to ensure that businesses are filing for the appropriate tax programs. In other cases, checks are made against data banks to help ascertain whether the correct amounts are being reported for tax purposes.

Additional Sources and Types of Information. Despite the substantial information sharing that already occurs, each of the tax agencies has identified numerous examples of additional data that are already being collected but not shared that would be useful for tax compliance purposes. For instance, as discussed later is the report, the agencies have identified additional data sources that they believe would be useful in their compliance efforts. Whether the sharing of such information should actually occur, however, depends on such factors as the specific types of data involved, what the associated costs and benefits would be, and the current impediments that agencies face in gaining access to these data. The latter range from statutory issues to the expenses involved in such transfer and exchange. For example, timber yield tax data that FTB previously requested from BOE, once obtained, did not result in additional revenue to FTB large enough to offset the costs that BOE incurred to provide the data.

Existing Technology Issues

System Compatibility Within Agencies. For each of the agencies, the individual systems for collecting, compiling, and storing data for tax compliance and enforcement purposes have evolved over a period of time and in a piecemeal fashion. For example, FTB's major technology applications were developed using different programming languages, relying on a number of different platforms (for example, mainframe computers versus desk-top applications), and are supported by different state storage systems. As audit and collections-related information needs have demanded greater flexibility in a system's ability to interface with other systems, each agency has adjusted its technology direction and compatibility capabilities with other systems on an "as needed" basis.

System Flexibility. The varied flexibility of the systems and technologies that exist *within* FTB and the other agencies can pose significant problems. For example, their incompatibility often means that separate individual programs—or "interfaces"—are necessary to enable the data to be shifted among the various systems. The BOE has consolidated much of its information within a program called Integrated Revenue Information System, but this does not include all taxes that it oversees, or all of the data with respect to those taxes that are part of the system.

System Compatibility and Flexibility Among Agencies. The above compatibility and flexibility issues that exist are compounded when information is shared *among* the three tax agencies. In FTB's case, some headway in this area has been made through its Integrated Nonfiler Compliance (INC) system, which associates income-related data to individuals and business taxpayers. Similarly, EDD has begun roll-out of its Automated Collection Enhancement System, which will address business opportunities identified in the department's Tax Collection and Customer Service programs.

Electronic Data Storage and Retrieval. In addition, there are substantial differences among the tax agencies with respect to how far they have developed and implemented electronic data processing. For EDD, much of the filing and processing has been converted into electronic form, which increases the accessibility of the data for compliance purposes. The FTB has also pushed electronic filing and as a result has increased its ability to use automated processes for compliance and enforcement purposes. The BOE, by comparison, has not made as much progress in this regard—partly due to the number of taxes it administers and the number of entities on whose behalf it collects taxes.

Finally, on the positive side, we would note that the tax agencies themselves—despite the technology issues they face—are often far ahead of other agencies with respect to their implementation and use of electronic data technology. For example, the format of the data collected by FTB is often on magnetic tape or obtained through online (Internet or Intranet) access. In contrast, data provided to FTB from other agencies is often on diskettes, CD-ROMs, as well as older technologies such as microfiche. Some data is still provided to the agency on paper—a format that is costly to use for cross-referencing purposes since the data must be manually entered into the recipient's audit and/or collections systems.

Addressing the issues related to technological compatibility and flexibility is not insurmountable. According to each of the agencies, the technology for sharing information is there, and significant strides could be made in this regard. The question, however, often comes down to one of resources and payoffs. For instance, to devise and implement a new system that allows for seamless gathering and exchange of information would be expensive for the state—easily in the high tens of millions of dollars. Nevertheless, as discussed below, there exist means such as the introduction of various software interfaces by which the state could satisfactorily address many of the technology-related problems that have been raised in a cost-beneficial manner.

Improving Information Collection and Exchange—Options and Considerations

The problems faced by the state with respect to gathering, compiling, and sharing tax information among the three tax agencies are a result of numerous factors. However, as discussed above, the principal factors that impede the gathering and free flow of information most relevant for tax compliance purposes are related to *organizational* issues and *technological* issues. Each of these can be approached from both a short- and longer-term perspective.

A longer-term perspective would allow for a fundamental rethinking of how the state views the three tax agencies and their relative roles, and would likely include certain changes in their basic responsibilities and structure. It would also allow for a more comprehensive approach to addressing tax-related technology issues, including the possibility of undertaking significant outlays to invest in the types of IT projects that would enable tax-related information and data collection and exchange to be accomplished in the most effective and cost-efficient manner.

In contrast, a shorter-term perspective would focus on more-limited and less-expensive steps that could be taken to ease the gathering, exchange, and storage of tax data and information without fundamentally changing the current tax agencies themselves or undertaking large IT projects. These more short-range solutions often relate to such actions as relatively minor changes in data sharing protocol, needed statutory changes, or alterations to existing technology.

Below, we first discuss the options and considerations for improving tax-related data collection and exchange from a longer-run perspective, followed by the shorter-run horizon.

Long-Term Considerations

Organizational Structures

One of the most important considerations for the Legislature is how to arrive at an organizational structure or an institutional mechanism for its overall tax system that overcomes some of the shortcomings associated with California's multiple tax-agency structure—principally, its lack of system compatibility, its inflexibility, and inconsistency in the agencies' integration of electronic data storage and retrieval. Toward that end, there are a number of specific areas where additional cooperation and coordination would be useful. These include:

- ***Representing California Before Federal Agencies and Other States.*** Establishing a single entity for purposes of outside negotiations would allow greater opportunities for obtaining and sharing information and eliminating barriers against information flows. In the past, additional MOUs with a nonstate partner (such as the federal government) were often required for one California tax agency to share data with one of the other two agencies. Recent progress has enabled all three tax agencies to be included on MOUs that FTB establishes with IRS.

- ***Functioning as a Unified Taxing Agency With Respect to Taxpayers.*** This would eliminate much of the confusion that exists for individuals and businesses in determining exactly with whom tax filings should be made, taxes paid, and questions asked.

- ***Functioning as a Single Agency With Respect to Information Flows.*** This would allow the agencies to more freely share information and data among themselves. Currently, there are often more restrictions regarding sharing of state-level information within California than, for example, the sharing of federal information among the tax agencies.

- ***Operating as One Agency With Respect to Resource Development and Deployment.*** This would facilitate undertaking projects that benefit overall tax compliance—regardless of the particular agency involved. Currently, there is often little or no incentive for any of the state's individual tax agencies to take steps in gathering or sharing data or information that benefits one of the other agencies, other than that it may be good for the public.

What Steps Might Be Taken? If the state were to "start from scratch" and institute a completely new tax system, probably the most logical approach to dealing with the above issues would be to establish a single department of revenue to oversee the administration and enforcement of all of the state's different taxes. At various times in past decades, the LAO and others have in fact recommended that the state move in this direction. However, the current system has evolved in a quite different fashion, and to institute a single consolidated tax agency at this juncture would require overcoming substantial policy, organizational, and fiscal hurdles. There are, however, some options to addressing the above issues short of full consolidation that could nevertheless produce many of the same benefits.

- ***Option 1: Make Greater Use of the Strategic Tax Partnership.*** Under this model, the existing STP would be used to negotiate data sharing agreements with other entities such as the federal government and other states, and propose additional data gathering for each of the agencies that might benefit the other tax agencies. One possible structure would be to have a representative on the STP from each of the tax agencies and one from the administration. One potential drawback with the STP approach involves whether a satisfactory process could be arrived at for making timely group decisions.

- ***Option 2: Have One Agency Represent the State in Outside Dealings.*** Under this model, one of the three tax agencies would be the primary contact for outside sources of information. This process would include giving this lead agency additional authority with respect to the other agencies. The drawback to this approach is that any one tax agency would not know in detail the intricacies and data requirements of the other two agencies.

We believe that option 1 is preferable because it will maximize coordination and encourage group buy-in of all initiatives undertaken, while at the same time provide for efficient delegation of responsibilities among the partners.

Technology Issues

Even if a suitable organizational structure were settled upon involving the tax agencies, this action would by itself not address the problems involving information and data sharing that are primarily technological in nature. This is important because the technological hurdles that the agencies face in terms of sharing information are considerable. Various stand-alone systems have been established within each of the agencies for dealing with data and other information. In some cases, these have been joined through various interfaces. However, as we indicated previously, each of the agencies has adapted and changed its IT to meet its own needs rather than with a view towards overall tax and revenue efficiency for the state.

Recently, broader access to BOE and EDD has been granted by FTB to its INC system, which contains significant tax-related data and information. Nevertheless, there is also significant information that has not been incorporated in the system and access to the system is still somewhat limited at this time. In addition, the system resides with and is under the control of FTB, limiting the ability of other agencies to add to or improve the quality of the information that it contains. However, progress that has been made in sharing the information on this system could pave the way to additional tax-agency cooperation.

There are several possible solutions from the broad perspective to the technological issues related to information gathering and sharing. Each solution would also need to address under what circumstances data would be edited or augmented by different users, and who would actually control access to the sites. Two potential approaches are:

- ***Single Information "Silo."*** Under this model, all current information would be compiled and loaded into a single silo of data that would be available to all three tax agencies. This approach would be potentially the most efficient of the solutions but also would require a significant outlay of resources to convert existing data and commit to a single format for new data.

- ***Enterprise Strategy.*** Under this model, a software overlay would be put into place on top of the existing tax systems, which would allow for access to all of the existing tax information systems. This overlay would provide the access point for all users and would avoid the necessity of having to convert existing systems to a single system. (See accompanying box for more information.) Note, however, that a common data format would still be needed for common data elements.

Sharing of Data Through Interfaces

An important aspect of current data sharing between tax agencies involves the use of computer data interfaces. Each tax agency has many existing interfaces—not only *between* itself and other departments, but also between databases *within* each department.

What Are Interfaces?

A computer data interface basically allows one system to access the contents of another system. There are new technologies available that facilitate information-sharing networks, thereby replacing multiple interfaces with a software "overlay." This alternative approach allows each department to control which data are passed to a "center point," where each department has its own dedicated file space. This means that the data are not commingled into one file. Rather, common data elements can be linked across these file spaces so that data can be shared.

The fact that the data are not commingled is particularly important since some laws and regulations prohibit this. Thus, departments can define whatever subset of their own records are to be made available for sharing purposes, and it is only this information that is identified when a search is performed by other agencies—not the sensitive and comprehensive detailed departmental records themselves.

The technology is available to improve data sharing among state departments. For example, available on the market today are commercial off-the-shelf software products that would enable agencies to share data by creating and growing an information-sharing network while at the same time maintaining necessary and reliable data security. This can be achieved without the cost and effort required to maintain multiple interfaces or adopt a common denominator among disparate systems, such as a single taxpayer identification number.

Short-Term Considerations

Additional Data Sharing and Collection

In the shorter term there are a number of steps that the state could take to further advance the sharing of existing information and data among the tax agencies. Administrative action to facilitate data sharing can resolve several issues. In some other cases, additional resources, legislative actions, or statutory changes would be required.

The tax agencies provided instances of data items which are now being collected by state agencies but which are not now being shared. Figure 2 summarizes this information, showing the agency collecting the data, what the information would be used for, and the barriers to sharing the information. For instance, EDD has an interest in (1) online access to FTB's database to verify wages reported on income tax returns and (2) data on registered employers from both the Department of Insurance and the Department of Industrial Relations to produce audit leads. In both cases, an MOU would be needed between agencies to achieve these ends. In addition to the items listed in Figure 2, there are other sources of information collected by the federal government as well as by private entities. In these cases, however, either substantial legal barriers or cost barriers exist, and thus we have not included them in the figure.

Figure 2

Information Now Collected That Could Be Shared Among the Tax Agencies

Requesting Agency	Information and Data Involved	Use of Data	Source of Data	Barriers Limiting Data Sharing
Franchise Tax Board (FTB)	County property data, online access.	Identify taxpayer property.	Board of Equalization (BOE)	Technology barriers.
FTB	County recorder information.	Identify taxpayer property.	Counties	Technology barriers, costs.
FTB	Expired/renewed driver's license data and vehicle registration data.	Skip tracing/ asset identification.	Department of Motor Vehicles (DMV)	Technology barriers, costs, memorandum of understanding (MOU) required.
FTB, BOE	Verification of social security numbers (SSNs).	Verify SSNs of taxpayers with multiple or unknown SSN.	DMV, Social Security Administration	Statutory authority, legislation required.
BOE	Electronic report of sales information on sales of new and used vehicles.	Data would be used for audit selection and verification purposes.	DMV	Legislation required.
BOE	Listings of tangible personal property.	Data would be used to assist with audit selection and identify tax shortages.	Counties	Technology barriers, costs.
BOE	Listing of warehouses tied to out-of-state persons.	Data would be used to establish currently unrecognized sales and use tax liabilities.	Employment Development Department (EDD)	Technology barriers, costs.
BOE	Listing of large businesses with numerous employees.	Identify noncompliant employers.	EDD	Technology barriers, costs.
BOE	Uniform method to allow property tax appraisers to report findings to BOE.	Data would be used to establish tax liabilities.	Counties	Costs, legislation required.
BOE	Purchases of large quantities of construction material likely to have been brought in from out of state.	Data would be used to determine possible use tax liabilities.	Cities	Costs.

Continued

Requesting Agency	Information and Data Involved	Use of Data	Source of Data	Barriers Limiting Data Sharing
BOE	Listings of businesses in each city with business license.	Data would be matched with BOE registration to identify taxpayers without permits. Would also be used as a lead related to use tax liabilities.	Cities	Costs.
BOE	Form 1099s.	Various purposes.	FTB	Costs.
BOE	Electronic copies of vehicle and vessel registration and driver's license documents.	Data would be used for assessment and collection of use tax liabilities.	DMV	Legislation may be required to procure electronic reporting and/or imaging of hard copy documents.
BOE	Listings of personal property tax assessments for aircraft and vessels.	Data would be used for assessment of use tax liabilities and as a collection tool to locate assets.	Counties	Potential legislative change to require counties to collect data in a standardized format and send electronically to BOE.
BOE	International Fuel Tax Agreement (IFTA) files.	Produce audit leads.	DMV	Costs.
BOE	International Registration Plan files.	Compare with IFTA registration and perform joint audits.	DMV	Legislation required.
EDD	Crossmatch of registered employers between EDD, Department of Insurance (DOI) and Department of Industrial Relations (DIR).	Produce audit leads.	DOI and DIR	MOU required.
EDD	Periodic listing of new construction permits or mechanic liens from cities and counties, and new and existing city business licenses.	Detect unregistered employers, income tax nonfilers, unregistered businesses subject to sales and use tax.	Cities and counties	Costs.
EDD	Access FTB's Integrated Nonfiler Compliance database to verify wages reported on income tax returns.	Personal Income Tax abatement process and locating delinquent taxpayers or assets.	FTB	MOU required.

Over and above a greater sharing of data that are already collected, the tax agencies have suggested several programs that could be established that would enhance the ability of the agencies to share data. These proposals are shown in Figure 3 (see next page). Virtually all of these programs would entail additional budgetary funding, primarily for the purpose of addressing technological constraints of existing data systems. For example, EDD listed enhancing its Tax Accounting System cross-reference functionality in order to improve detection of unemployment insurance rate manipulation.

The Issue of a Single Tax Identification Number

Among the proposals to ease the difficulties tax agencies have in sharing and cross-matching data is the development of a single taxpayer identification number. The issue of a common tax identification number has been considered numerous times in the past. A team made up of representatives from BOE, EDD, and FTB last examined the issue in a 1977 joint publication of the STP. The report, entitled *Tax Entity Identification Numbers: Common Identifier Issue*, recommended that the common identifier not be pursued due to costs as well as legal and legislative issues.

Figure 3

Information and Data Sharing Programs That Could Be Initiated Among the Tax Agencies

Beneficiary Agency	Data Sharing Program Involved and Use of Data	Source of Data	Barriers Limiting Data Sharing
EDD	Enhance EDD's Tax Accounting System cross-reference functionality to automatically identify existing employers who have multiple accounts or purchase existing businesses in order to identify large shifts in payroll between accounts/businesses for unemployment insurance rate manipulation detection.	EDD	Costs.
EDD	Automate ability to perform ratio analysis of industrial averages of income/sales to expense accounts (income tax return data) to detect underground economy cash payments and money laundering/third party payer schemes.	EDD	Costs.
BOE, EDD, FTB, DOI, and DIR	Develop central website and data warehouse for data sharing of informant leads to use in identifying tax evaders.	BOE, EDD, FTB, DOI, and DIR	MOU required, costs.
BOE, EDD, and FTB	Upload imaged bank information collected from tax deposits and payments into a data pool that could be shared by BOE, EDD, and FTB for collection of delinquent taxes.	BOE, EDD, and FTB	MOU required, costs.
BOE	Require reporting of wholesale sales for specific industries or based on dollar amount thresholds to improve audit selection and verification.	Designated industries would have new reporting requirements	Legislation required to place additional reporting requirements on certain businesses.

EDD=Employment Development Department; BOE=Board of Equalization; FTB=Franchise Tax Board; DOI=Department of Insurance; DIR=Department of Industrial Relations; and MOU=Memorandum of Understanding.

At the current time, there are a number of separate numerical identifiers that are assigned to taxpayers in California. This is so because each of the three tax agencies uses a separate process for assigning numbers. For example, FTB relies mainly on numbers assigned by the federal government and SOS—principally social security numbers and federal employer identification numbers (FEINs). The board also uses its own taxpayer identification number for businesses incorporated out of state, as they do not have an identification number from SOS. The EDD relies on federal numbers as well, but also issues its own identifiers in order to separate and identify each employing unit for UI purposes. Finally, BOE has numerous tax and fee programs and assigns its own numbers.

The use of a single taxpayer identification number could greatly simplify things for the taxpayer, however, it raises a number of administrative issues. One of the issues is that the tax agencies differ widely in their assignment and reassignment of numbers. The FTB relies on federal numbers, which generally stay with individual taxpayers over time. For employers, however, a new FEIN may or may not be issued, depending upon the circumstances. The EDD does not issue a new number for changes in a business's ownership, while BOE usually does. The BOE may issue a number of identification numbers for businesses with multiple locations. In addition, there are differences in the treatment of identification numbers when entities merge, are sold, or cease operations.

In view of the multiple numbers and the multiple ways in which agencies treat these numbers, and the necessity of tracking any federal changes, a single taxpayer identification number may not be the most appropriate means of linking the ability of the tax agencies to share data. Instead, increasing the ability of the agencies to cross-match taxpayer information using the existing system—with the flexibility it maintains for each of the agencies—seems most appropriate. This is consistent as well with the current consensus view of the tax agency staff.

Possible Next Steps for Legislature

Although tax agency consolidation would facilitate the collection and exchange of tax information, this option would involve major legal and organizational changes—and major costs—to implement. The agencies believe—and we concur—that there exist more modest and cost-effective measures that would achieve some of the same results. To that end, the agencies have identified a number of short-term steps that could be taken to facilitate the exchange and use of certain data and information by the tax agencies. (These steps are shown in Figures 2 and 3.)

Given the intense use of information systems by each of the agencies, some of the short-term steps would require technical solutions and a commitment of resources. In other cases, however, information exchange could be facilitated through relatively simple organizational, administrative, or statutory changes. In order to ensure that timely progress is made in the area of data sharing, we recommend that the Legislature direct the tax agencies to appear jointly before the budget committees when the 2007-08 budget is being reviewed to:

- Report on those cost-efficient, data-sharing actions they are planning to undertake or could undertake immediately (that is, which require no additional funding or statutory changes).
- Provide relevant information and recommendations regarding other initiatives that may require legislative actions (such as statutory changes or added funding).
- Report on an alternative technology approach, such as using software overlays, to link existing independent tax information systems—including its costs, benefits, and time requirements.

In discussing these matters, the agencies should also collectively identify their preferred means for coordinating data-related decisions and activities amongst themselves, such as use of the already established STP or other, alternative approaches.

Appendix A

State Agencies Providing Data to California's Tax Agencies

Agricultural Labor Relations Board
Air Resources Board
Alcoholic Beverage Control
Board of Equalization
Board of Guide Dogs for the Blind
Board of Chiropractic Examiners
California Conservation Corps
California Horse Racing Board
California Integrated Waste Management Board
California Youth Authority
Department of Child Support Services
Department of Consumer Affairs
Department of Corrections and Rehabilitation
Department of Fish and Game
Department of Food and Agriculture
Department of Health Services
Department of Housing and Community Development
Department of Industrial Relations
Department of Insurance
Department of Justice
Department of Motor Vehicles
Department of Real Estate
Department of Social Services
Department of Toxic Substances Control
Employment Development Department
Franchise Tax Board
Lottery Commission
Public Utilities Commission
Secretary of State
State Bar of California
State Controller's Office
State Lands Commission
State Water Resources Control Board
Wildlife Conservation Board
Workers' Compensation Insurance Rating Bureau

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This report was prepared by Crystal Taylor and reviewed by Dave Vasché, with contributions from Mark Ibele. The Legislative Analyst's Office (LAO) is a nonpartisan office which provides fiscal and policy information and advice to the Legislature.

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