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Report to the Legislature on the Impact of the Implementation of AB 63 (2001): Local Government Sharing Program between the Franchise Tax Board and California Cities

By Martha Jones, Ph.D.

Requested by Senator Gilbert Cedillo

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EXECUTIVE SUMMARY

Assembly Bill 63 (Chapter 915, Statutes of 2001) permits the California Franchise Tax Board (FTB) to disclose specified income tax information to tax officials of any California city under a written agreement between the city and FTB. The records disclosed are limited to information identifying taxpayers filing business income from any California city: the taxpayer's address, Social Security or taxpayer identification number, and business activity code. The cities can use the FTB data to identify businesses that might be subject to a local business license fee or tax. The program implemented as a result of the legislation is known as the FTB "Local Government Sharing Program." Under existing law, the provisions of AB 63 will expire on December 31, 2008.

AB 63 was enacted together with AB 205 (Chapter 36, Statutes of 2001).[1] AB 205 clarifies the rules governing when cities may levy business license taxes. It does two things:

- It clarifies that cities and counties are limited in their ability to require employees to get a business license or to pay a business license tax on income earned from an employer.
- It creates a presumption that if a taxpayer reports business income on his or her federal or state return, then that income is also to be classified as business income from the viewpoint of local government. In many cities, the taxpayer with business income may be liable for a local business license tax.

The California Research Bureau (CRB) implemented a project in 2005 to describe how FTB and cities are conducting the AB 63 program, address data security issues, identify the extent of participation by cities, conduct a survey of participating and non-participating cities on the efficacy of the program, chronicle the program's legislative history, summarize examples of local/state/federal data sharing, and obtain feedback from interested organizations on the AB 63 program.

LEGISLATIVE INTENT

AB 63 was sponsored by the City of Los Angeles to enhance enforcement of its existing business license tax law. The intent behind the legislation was that information sharing between the FTB and the City would encourage compliance with the City's tax laws. Business associations generally viewed this bill as an effort to increase compliance and fair sharing of the tax burden, with the ultimate goal of reducing the burden on businesses that currently were complying with the law.

In 2001, it was estimated that the passage of AB 63 would increase the City's revenue by a range of $10 million to $66 million. The City reported a high degree of success with the use of AB 63 data in identifying and registering businesses subject to local business tax. As of January 2006, the AB 63 program had resulted in 56,000 new business

[1] Chapter 4 (commencing with Section 16300), Part I of Division 7, Business and Professions Code.

registrations and had generated over $45 million in new tax revenue. In 2001, the City Council adopted an ordinance that designated 75 percent of the revenue collected pursuant to the program to be used for business tax reform and the remaining 25 percent for affordable housing.[2] This revenue has allowed Los Angeles to initiate meaningful business tax reform, providing over $80 million in tax relief to its businesses. Some of the reforms enacted were the elimination of business taxes on small businesses and elimination of taxes for new businesses for their first two years, a 3.1 percent across the board rate reduction, simplification of the tax code, and reformation of the business tax appeals process. As a result of AB 63, Los Angeles has seen significant improvement in tax compliance and has expressed support for continuing the program beyond the December 2008 sunset date.

The City is sponsoring new legislation SB 1374 (Cedillo, 2006) that would extend the AB 63 program to 2011.

LOCAL GOVERNMENT SHARING PROGRAM DESCRIPTION AND DATA SECURITY

The Local Government Sharing Program supports the business license tax, which is one of the few locally-administered sources of tax revenue available to California cities. Business license tax revenue represents about seven percent of cities' general tax revenues statewide.

The maintenance of data integrity is of prime importance to the FTB. Only city employees that sign confidentiality agreements are allowed access to the data; municipal consulting firms are not allowed to have access. FTB data records are to be maintained by the city for a specified time period before being destroyed. The AB 63 program includes on-site safeguard reviews, which are audits conducted by FTB staff. The first on-site reviews were completed in 2005. FTB reported that the cities provided positive results, generally in line with their expectations and statutory requirements. For the 2005 data, the FTB disclosure office added a "self-assessment questionnaire" into the safeguard review process; this questionnaire assesses a city's ability to ensure that it will keep all information secure before the city receives AB 63 data.

Participating cities reimburse FTB for the cost of providing the AB 63 information. Annual costs for the program have run about $350,000 and include the cost of keying the business activity code, the cost of FTB staff (both to manage the program and the disclosure office), and other miscellaneous expenses. For 2005 data, costs were approximately $280,000.

Cities match AB 63 data against their own business license tax record files and obtain a list of "AB 63 leads," which are names of taxpayers who filed business income on their state/federal return but were not paying local business license tax. Cities then send out

[2] Rubio, Diana. New Year Brings Millions of Dollars in Tax Relief for City Businesses: Mayor, Council members and Business Community Announce Tax Reductions Taking Effect in 2006. *City of Los Angeles Press Release*, January 4, 2006.

notices informing these taxpayers that they may have a local business license tax filing responsibility. Some cities provide taxpayers with a checklist to assess their business tax liability status. For businesses classified as "sole proprietors" (those that file business income using a personal income tax form and a Schedule C),[3] FTB provides cities with the filing address and not the business address. In many cities, this can cause address mismatch issues, as some people file their taxes from one city (perhaps where they live) but have their business located in another.

The methods that cities use to implement the AB 63 program vary considerably. For example, cities can decide how many notices to send, the timing of the notices, and whether to have an amnesty program. Some cities levy back penalties with interest for taxpayers who should have been filing; others do not.

THE EXPERIENCE OF CITIES WITH THE PROGRAM

Of the 478 cities in California, 134 cities purchased AB 63 data for 2001, 2003 and 2004. Some cities obtained the data in multiple years. Contracts are currently being negotiated for 2005 data: 95 cities requested contracts in March 2006. FTB expects that about 65 cities will complete the contract process and purchase the 2005 data.

The California Research Bureau sent a survey to the 134 participating cities and received responses from 116 cities, a response rate of 87 percent. In general, cities that used the data found them to be very useful, but many cities were not able to process them. Compared with other tools used to identify unlicensed businesses, city experiences using AB 63 data were mixed:

- 57 cities said they were able to use the data;
  - 37 cities said the AB 63 data were very valuable (and 21 of these classified the AB 63 data as the most valuable tool);
  - 9 cities said they were useful;
  - 3 cities said it was too early to tell;
  - 8 cities said they were not useful (usually because they already had high tax compliance or because they found the program too costly);
- 59 cities said they were not able to use the data;
- 18 cities did not answer the survey.

The 37 cities that found the data to be very valuable were extremely enthusiastic about this program. Many commented that AB 63 data are the only source of data available for the discovery of some types of businesses. Moreover, the data-sharing program not only generated revenue, but also resulted in improved tax equity and compliance.

Conversely, many cities found they did not have the technical expertise or staff resources necessary to process these data and provide follow-up with taxpayers. Interestingly, a majority of these cities stated that they intend to make the effort to overcome the steep

[3] The Internal Revenue Service form Schedule C is for "Profit or Loss from Business (Sole Proprietor)." http://www.irs.gov/pub/irs-pdf/f1040sc.pdf.

learning curve and use AB 63 data in the future. Some cities said they were waiting for software to be developed that would help them process the data themselves. Many of these cities requested that FTB provide the data in a more user-friendly format. One improvement to the program that was repeatedly requested by cities was for FTB to provide the business address instead of the filing address for sole proprietors. Since many Schedule C returns are now filed electronically, this might be an option to consider in the future. According to FTB, however, the business address is not currently captured in any FTB system and would be very expensive to key.

The 344 cities that did not participate in the AB 63 program were sent a short survey asking why they had chosen to not participate and whether they planned to do so in the future. Of the 113 cities that responded to the survey, 24 did not assess a business license tax. For the 89 cities with a business license tax, the most common reasons for not participating in the program were cost (37 cities) and lack of resources to process the data (45 cities). When cities were asked what changes in the law or improvements in the program would make it more workable for them, the most frequent response was a reduction in the cost. Other changes suggested were for FTB to improve its communication with cities, revise the data format so that the files would be easier to use and hold more workshops to better explain the program.

COMMENTS FROM ORGANIZATIONS

The California Research Bureau received comments from various organizations on whether the legislation should sunset, the way the law was written, the FTB safeguard review process, the way cities are handling FTB data, and the way cities are implementing the program with local taxpayers. These comments are included in Appendix M.

Different groups expressed opinions as to whether AB 63 should be allowed to sunset in 2008, as specified in the 2001 legislation:

Respondents who want to repeal the sunset and extend the program:

- City of Los Angeles (sponsor of the AB 63 legislation)
- California Municipal Revenue and Taxation Association (CMRTA)
- Los Angeles Area Chamber of Commerce
- California Tax Reform Association (CTRA)
- League of California Cities
- American Federation of State, County and Municipal Employees (AFSCME)
- MBIA, MuniServices Company (MMC)

Respondents who want the legislation to sunset in 2008:

- California Association of Realtors (CAR)
- Cal-Tax

Respondents who support the sunset focused on potential problems with the AB 63 program. Concerns due to the disclosure of tax information to local officials included identity theft, the importance of privacy in a self-administered tax system, adverse effects

on the business climate in California, ensuring the security of the data, and not allowing municipal auditing companies access to the data.

LEGISLATIVE HISTORY AND DATA SHARING

The evolution of home-based businesses, private post office operations and executive suites has made identifying businesses operating in a city considerably more challenging. Before the use of AB 63 data, it was sometimes difficult for cities that tax home-based businesses as well as some types of independent contractors to locate those taxpayers. As a result, compliance with the business license tax was often low among these businesses: some taxpayers were simply unaware of their tax obligation; others deliberately were not filing because city tax officials had few means to locate and identify them. The distinction between "running a business" and "earning business income" is important here. Some people who earn business income working at home are not aware that they might have a business license tax responsibility.

To close the tax gap, cities are increasingly turning to data mining and database management techniques. Tax officials are also exchanging some information across agencies. In addition to AB 63 data, this report gives examples of data-sharing/ partnership programs with the State Board of Equalization, as well as historical examples of data sharing between the FTB and California cities. From 1984 to 1999, for example, the City Business Tax Reporting Program mandated that cities with computerized record-keeping systems provide annual business license tax information to FTB, so that FTB could use the data to improve compliance with the state income tax. The information flow was one-way, however - from cities to FTB.

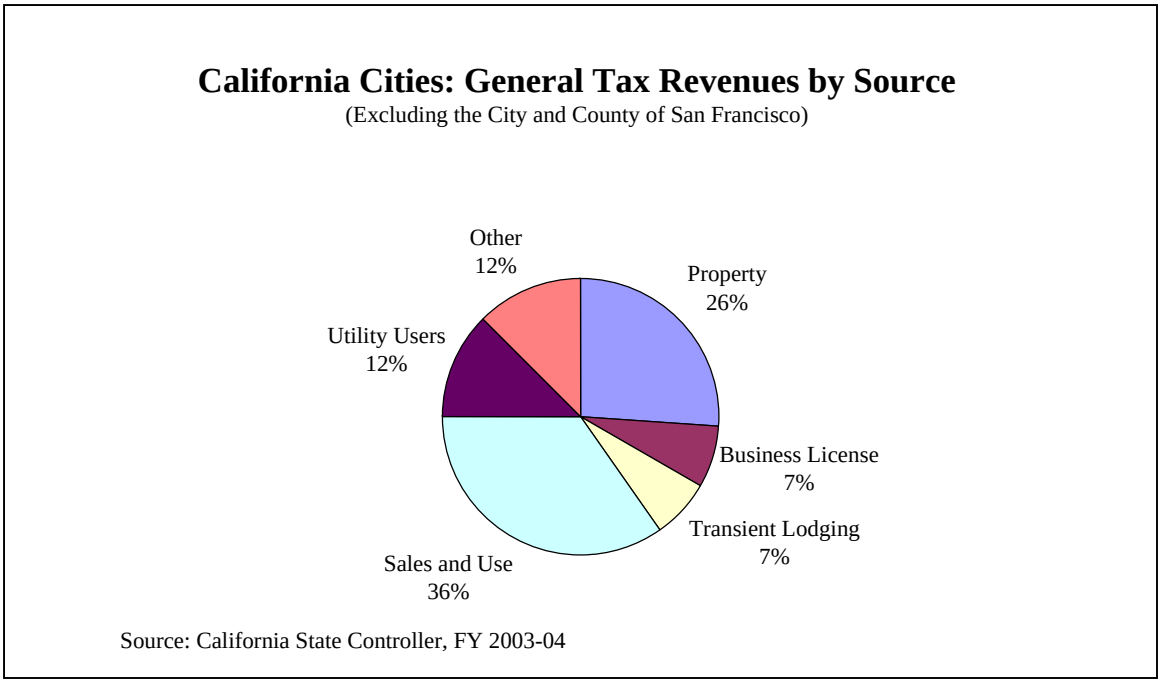
One motivation for the AB 63 program was the cities' desire to have a reciprocal flow of information between FTB and cities. In fiscal year 2005-06, FTB's tax gap enforcement budget provided FTB with an appropriation of $450,000 to reimburse cities for their costs to provide specific business license tax data. Since the exchange of information is beneficial to both parties (FTB and cities), future data exchange programs might be designed with this in mind. Currently, cities are paying $280,000 for FTB data and FTB is paying $450,000 for city data. For many cities, processing the data is costly and difficult for technical reasons. Cities have proposed that a reciprocal exchange of information at no charge to either party, with FTB doing the data processing, is one way to resolve these problems.

CALIFORNIA CITY REVENUES: BUSINESS LICENSE TAX

Increased tax compliance, tax equity and business license tax revenues for California cities are motivations behind the AB 63 Local Government Sharing Program. Over the last 30 years, voter-initiated propositions such as Propositions 13 and 218 have reduced local governments' ability to raise tax revenue. In addition, in the early 1990s, Governor Wilson and the Legislature diverted a large percentage of property tax revenues from local governments to education, often called the "ERAF" shift.[4] This loss of property tax revenues by local governments resulted in increasing dependence on sales tax revenues, which are more volatile.

Business license taxes are one of the few locally-administered sources of tax revenue available to cities. The only other significant source is the transient lodging tax. Chart 1 shows that business license and transient lodging taxes each represent about seven percent of cities' general tax revenues Statewide.[5]

Chart 1



California cities received $864.2 million from business license taxes revenues in 2003-04, a 4.7 percent increase from the previous year (see Table 1). Since 1991-92, these revenues have increased annually between zero and seven percent, although when adjusted for inflation, some years registered real percentage decreases (see Chart 2). As a percentage of general tax revenue, business license taxes have declined from a high of 8.4 percent in the early 1990s to 7.2 percent in 2003-04.

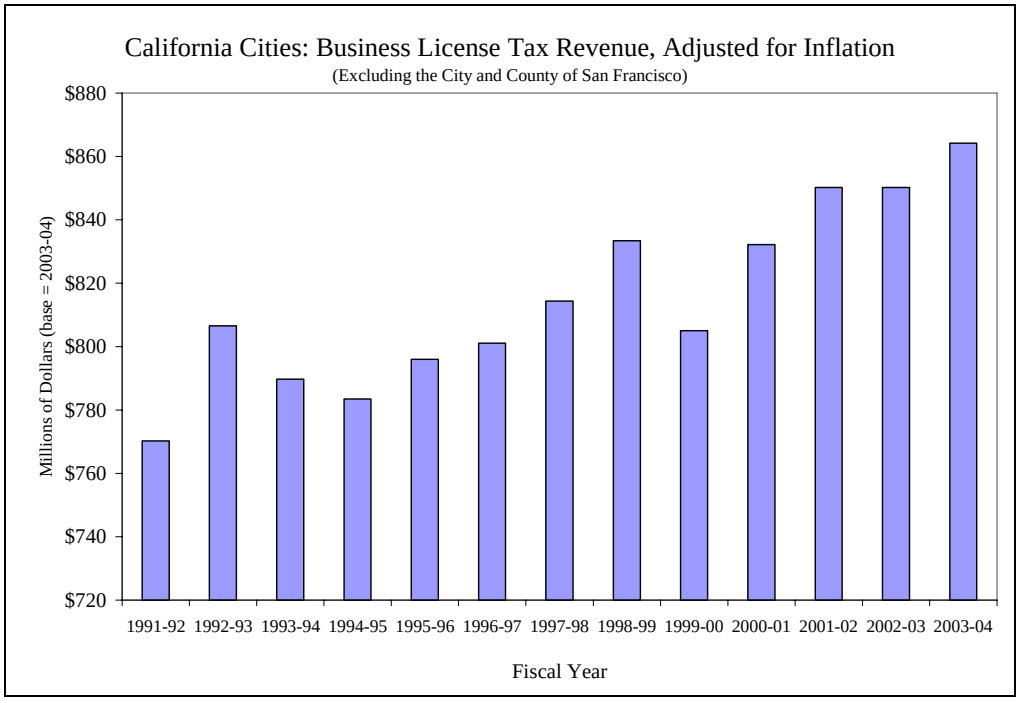
[4] "ERAF" refers to the Educational Revenue Augmentation Fund.
[5] Source: California State Controller, *Cities Annual Report, 2003-04*. May 31, 2006. http://www.sco.ca.gov/ard/local/locrep/cities/0304/0304cities.pdf.

Table 1

City Business License Tax Revenue, Fiscal Years 1991-92 through 2003-04					
Fiscal Year	City Business License Tax (BLT) Revenue (excluding San Francisco)	Annual Percentage Increase	Inflation-adjusted Annual Percentage Increase	Business License Tax as % of General Tax Revenue	Business License Tax as % of General Revenue
1991-92	$559,372,120			7.9	6.2
1992-93	$599,400,697	7.2	4.7	8.4	6.5
1993-94	$600,779,750	0.2	-2.1	8.4	6.6
1994-95	$613,152,433	2.1	-0.8	8.4	6.5
1995-96	$637,369,972	3.9	1.6	8.3	6.5
1996-97	$655,195,171	2.8	0.6	8.2	6.4
1997-98	$676,654,423	3.3	1.7	7.9	6.2
1998-99	$707,247,129	4.5	2.3	7.9	6.2
1999-00	$711,080,533	0.5	-3.4	7.3	5.7
2000-01	$763,884,914	7.4	3.4	7.2	5.6
2001-02	$796,985,907	4.3	2.2	7.5	5.8
2002-03	$825,400,422	3.6	0.0	7.4	5.9
2003-04	$864,208,000	4.7	1.6	7.2	6.0

Source: California State Controller, *Cities' Annual Report*, Figure 1, various years.
Inflation adjustment used the National State and Local Government Purchases Deflator, U.S. Department of Commerce, Bureau of Economic Analysis.

Chart 2



LOCAL GOVERNMENT SHARING PROGRAM

Assembly Bill 63 permitted the Franchise Tax Board to disclose specified California income tax information about businesses located in California cities to tax officials of any California city under a written agreement between the city and FTB. The information disclosed is limited to information identifying the taxpayer: the taxpayer's address, Social Security or taxpayer identification number, and business activity code. These FTB data can be used by cities to identify businesses that might be subject to a local business license fee or tax. Under existing law, the provisions of AB 63 will expire on December 31, 2008.

AB 63 was enacted together with AB 205 (see Appendices A and B).[6] AB 205 creates a presumption that if a taxpayer includes business income with his or her federal or state return, then that income is also to be classified as business income from the viewpoint of local government. Municipal business license ordinances vary across cities, but, in many cases, a taxpayer who files business income on a federal or state return is liable for the local business license tax on that income. AB 205 is significant because it relieves cities from making a determination as to whether a taxpayer earned income as an employee or an independent contractor.[7] Prior to AB 205, cities had to interpret and apply Internal Revenue Service (IRS) standards to each taxpayer in order to make a determination.

AB 205 also limits the ability of cities or counties to require an employee to obtain a business license or home occupation permit, or to impose a business tax or registration fee based on income earned for services performed for an employer in an employment relationship.[8] In general, many independent contractors are liable for local business license taxes, but employees are not.

Pursuant to the provisions of AB 63, the California Research Bureau is required to report to the Legislature on the impact of the implementation of the statute.

INTRODUCTION

Most cities in California have some sort of business license tax. General law cities, those California cities governed principally by the general law of the State, license businesses pursuant to one of two authorities granted by State law. Nearly all general law cities license businesses under Government Code Section 37101, which allows them to license for regulation *or* revenue purposes. Charter cities, those California cities with the power to make and enforce municipal laws subject to the provisions of the city's charter, may rely on the authority to tax and regulate business conduct as established in their charter, provided it is not in conflict with State law. A city's charter may not supersede the

[6] Chapter 4 (commencing with Section 16300), Part I of Division 7, Business and Professions Code.
[7] FTB refers to IRS Publication 1779 to determine whether a worker is an employee or an independent contractor: IRS Publication 1779, "Independent Contractor or Employee…" http://www.irs.gov/pub/irs-pdf/p1779.pdf.
[8] "Employment relationships" are determined by reference to the common law factors reflected in rulings or guidelines used by either the IRS or FTB.

State's authority to exclusively tax and regulate some types of businesses. For example, financial institutions are exempted from local taxation by the California Constitution and only the State may license plumbers (for regulation).

In cities that have a local business license tax, many taxpayers who earn business income are liable for a local business tax. Cities can use AB 63 data to identify taxpayers with business income who may not be filing the local tax. Taxpayers earning business income include various forms of filers: corporations, partnerships, limited-liability corporations, and sole proprietorships. Taxpayers such as large corporations file a business tax return with the IRS and the FTB, using a Federal Employer Identification Number (FEIN) for taxpayer identification. Sole proprietors are different: they file an individual tax return (such as a 1040 form) with the IRS and then attach a Schedule C detailing business income and expenses. Under AB 63, FTB can provide data to cities that identify businesses that filed business tax returns as well as sole proprietors that filed a Schedule C.

FTB officials can readily identify a taxpayer who has filed a Schedule C by the Principal Business or Professional Activity Code (PBA) code, which was added to the California Form 540 as a result of AB 63. A PBA code classifies sole proprietorships by the type of activity they are engaged in. These PBA codes are based on the North American Industry Classification System (NAICS) and are listed on the instructions to Schedule C.[9]

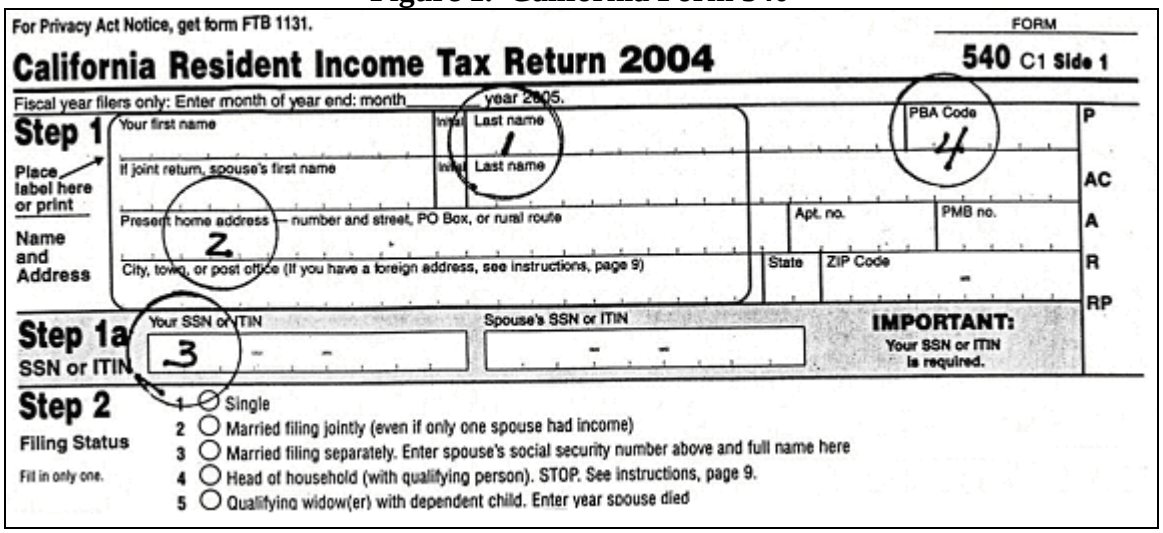
For sole proprietors, AB 63 allows the FTB to disclose the following information from Form 540 to city tax officials (see Figure 1):

1. Taxpayer's name
2. Taxpayer's address
3. Social security number
4. Principal business activity code (PBA code).

For sole proprietors, the address currently provided by FTB to cities is the filing address of the taxpayer (from Form 540), not the business address, which is located on Schedule C. According to FTB, the business address is not provided because it is not currently captured in any of their computer systems and would be very expensive to key (input). The home address was already being keyed by FTB regardless of the AB 63 program, so that has involved no additional cost. It should be noted, however, that since 2001 when AB 63 was passed, technology has changed. Many Schedule C filers now submit their returns electronically, which means that FTB would not have to key these data. Moreover, state law now requires tax preparers to file their returns electronically.[10]

[9] http://www.irs.gov/pub/irs-pdf/i1040sc.pdf.
[10] Revenue and Taxation Code 18621.9, effective 1/1/2004.

Figure 1. California Form 540


For Privacy Act Notice, get form FTB 1131.

FORM

California Resident Income Tax Return 2004

540 C1 Side 1

Fiscal year filers only: Enter month of year end: month year 2005.

Step 1 Place label here or print

Name and Address

Your first name | Initial | Last name

If joint return, spouse's first name | Initial | Last name

Present home address — number and street, PO Box, or rural route | Apt. no. | PMB no.

City, town, or post office (If you have a foreign address, see instructions, page 9) | State | ZIP Code

PBA Code

P AC A R RP

Step 1a SSN or ITIN

Your SSN or ITIN | Spouse's SSN or ITIN

IMPORTANT: Your SSN or ITIN is required.

Step 2 Filing Status

Fill in only one.

1 Single
2 Married filing jointly (even if only one spouse had income)
3 Married filing separately. Enter spouse's social security number above and full name here
4 Head of household (with qualifying person). STOP. See instructions, page 9.
5 Qualifying widow(er) with dependent child. Enter year spouse died

If FTB provided the business address, the AB 63 program could be greatly improved. For cities, the use of the filing address instead of the business address complicates matters. Notices are often sent by City A to taxpayers who file from City A (because they live there), but actually do business in City B (and might be liable for a business license tax in City B). As a result, taxpayers often receive notices from the wrong city.

PROGRAM COSTS

Pursuant to the provisions of AB 63, FTB is reimbursed for the cost of providing the AB 63 information to a city. In the initial year of the program, FTB estimated General Fund implementation costs of approximately $1.6 million, primarily for computer hardware, software and personnel, and second-year costs of $303,383. To comply with the new legislation without unlawfully disclosing IRS taxpayer information, FTB had to create a new database. After the first year, FTB's annual cost of the program has been about $350,000 and is divided among participating cities on the basis of population. The current program costs are $280,000, including $264,000 in personnel costs (which include the keying of the PBA code).

When the program was authorized, FTB requested two personnel years at an annual cost of $150,000. These personnel years were for running the program as well as for the safeguard review process, which included periodic audits to ensure that recipients of the tax information were complying with the statutory confidentiality requirements. A recent internal review of FTB staff costs for the AB 63 program has confirmed that the two personnel years authorized is appropriate.

DATA SECURITY

The maintenance of data integrity is of prime importance to FTB. The information is provided under a reciprocal agreement between the cities and FTB. Cities must complete a written agreement with FTB, and each city employee with access to FTB's data must

sign a Confidentiality Statement, form FTB712 (See Appendix E). This statement attests to the fact that the city employee is aware of the confidentiality of FTB data and of the penalties for unauthorized disclosure. This form must be maintained as long as the city has FTB data, but cities are not required to send the statements back to FTB. They are to produce the statements upon request, for example, during a safeguard review.

Although a city loads FTB tax return data onto its computer system, the data do not belong to the city. Confidential FTB tax information remains the exclusive property of the FTB until the city has "overlaid" the information with its own data. Then the data become "city data." For example, a city receives the FTB CD and loads the data into its system. The city then sends a notice to an individual informing him/her of an obligation to pay business taxes. That individual responds to the city's letter with name, identification (e.g. SSN), and address information. The city enters these data into its system, which "overlays" the data provided by FTB. The name, ID and address information are now "city data"—no longer owned exclusively by FTB, and subject to local ordinances, not State law. If the information is "co-mingled" and the city cannot determine ownership, then it is declared to be FTB data and must be destroyed when the city's contract with FTB expires. FTB is following IRS standards in terms of who owns the data.[11]

There are practical implications of the data-ownership issue. For example, even if a city has a vendor that does mailings for city notices, the vendor cannot sign the confidentiality statement and use the address labels generated by FTB data. AB 63 data cannot be used anywhere other than sending notices. For example, a city cannot use FTB data to fill in missing Social Security/FEIN numbers on their business license records.

A key issue is the requirement that only city employees have access to AB 63 data. The information must be made available to city employees on a "need-to-know" basis; in general, only city business license program employees have access to the AB 63 data provided by FTB. Many cities contract out for their data-processing needs, using consultants/contractors to process their data. Under the Local Government Sharing Program, these consultants are not allowed access to AB 63 data. Several cities have commented that the AB 63 legislation is imposing security requirements that exceed those imposed on cities by any other source of confidential data. Moreover, they exceed the data security requirements the IRS imposes on FTB (e.g. the IRS authorizes the FTB to use contractors).

FTB data records are to be maintained by the city for a specified time period before being destroyed. For the first few years of the AB 63 program, that period was one year, but in 2006, it was lengthened to three years because many cities found that one year was too short for them to process the data and perform the necessary follow-up.

[11] IRS Publication 1075, Tax Information Security Guidelines for Federal, State, and Local Agencies: Safeguard for Protecting Federal Tax Returns and Return Information. http://www.irs.gov/pub/irs-pdf/p1075.pdf.

All records received by the city from FTB and any database created, copies made, or files attributed to the records received must be destroyed within three years of receiving the data. This includes the CD provided by FTB and any data that have been "loaded" onto computer systems, spreadsheets, programs, or any other media. All records received from FTB must be destroyed by the following methods: magnetic media must be degaussed or demagnetized; CDs must be damaged to prevent use; and paper documents containing confidential information are to be shredded.

Confidential data must be maintained in a secure environment, accessible only to the city business tax department, and protected from unauthorized access, use or disclosure. Under California law,[12] it is a misdemeanor for cities to inspect, disclose or use confidential information without a business need to do so. The penalty for each violation is a $1,000 fine, up to six months in jail or both. The FTB suggests the following ways for city employees to maintain FTB data integrity:

- Always lock or shut down your computer when unattended.
- Never let anyone use your User ID or password to logon.
- Use passwords that are not easily guessed.
- Be aware of others around you when looking at confidential information.
- Turn over confidential information on your desk.

Cities must report all unauthorized or suspected unauthorized access, use and/or disclosures to FTB immediately. An incident report must be submitted to FTB that includes:

- Date and time of incident
- Employee name
- Description of incident or circumstance
- Means of discovery

The role of the FTB Disclosure Office is to "Educate, Consult, Review and Assist." The FTB on-site safeguard reviews examine:

- Information security controls
- Physical safeguards
- Confidentiality Statements signed by employees
- Incident reporting process
- Destruction process

An FTB disclosure officer made a presentation to cities on AB 63 data confidentiality requirements at the October 2005 meeting of California Municipal Revenue and Taxation Association (CMRTA) in Garden Grove. The warning at the beginning of the presentation concerning the use of AB 63 data set the tone, "STOP: Use it Appropriately or Lose it Quickly."

[12] Revenue and Tax Code (R&TC) sections 19542 and 19542.1 Government Code section 90005.

The first on-site safeguard reviews were not conducted until 2005, when the FTB disclosure office visited Newport Beach, Long Beach, Anaheim, and Los Angeles. According to FTB, all cities provided positive results, generally in line with FTB's expectations and statutory requirements. FTB officials did make some suggested improvements to local procedures, but did not find any wrongdoing. FTB officials also visited the City of Sacramento, but they were basically asking for input on the process of the safeguard reviews rather than actually performing a review.

For 2005 data, FTB has added a "self-assessment questionnaire" into the safeguard review process. This self-assessment questionnaire, which will be sent to cities before they receive the AB 63 data, assesses a city's ability to ensure that it will keep all information secure. FTB will review the questionnaire before sending the data to any individual city and will work with the city, if necessary, to correct any deficiencies. If the city cannot provide a secure environment for the data, FTB will not send the data to it. As of April 2006, FTB has not yet rejected a city seeking to participate in the AB 63 program, but FTB asserts its strong commitment to providing information only to cities that meet its criteria for secure handling of the data.

Data security issues were addressed in letters received by the California Research Bureau in favor of the sunset of AB 63 legislation in 2008 (see Appendix M). Cal-Tax is concerned that city tax officials cannot ensure that sensitive taxpayer information will not end up in the wrong hands, especially when identify theft scams, due to today's technology, are changing daily and rapidly. The California Association of Realtors (CAR) is primarily concerned that once a city independently confirms the data that has been provided by the FTB, the data becomes the "property" of the city. At that point, the provisions in AB 63 prohibiting the sharing of the data no longer apply. CAR is concerned about the tax information being provided to municipal auditing companies for tax collection purposes.

EMPLOYEE OR INDEPENDENT CONTRACTOR?

The difference between employees and independent contractors is important in determining liability for local business license taxes. In general, employees do not pay local business license taxes, but independent contractors do. IRS guidelines for definitions of employees and independent contractors are reproduced in Appendix D.[13] Pursuant to the provisions of AB 205, cities are relieved from making a determination as to whether a taxpayer earned income as an employee or an independent contractor.

[13] IRS Publication 1779, "Independent Contractor or Employee…" http://www.irs.gov/pub/irs-pdf/p1779.pdf.

SAMPLE TIMELINE FOR 2005 DATA

The AB 63 data program has been in effect for tax years 2001, 2003 and 2004. Data were not provided to most cities in 2002 because of the State budget crisis that year.[14] The contract process for 2005 data began in March 2006 and ended in May 2006. AB 63 data are provided twice each year – once for April 15 filings and again for October 15 filings.[15]

Table 2

Sample Timeline for 2005 Data	
Contract Process for 2005 AB 63 Data:	
March 1, 2006	Contracts emailed to cities
by April 1, 2006	Contracts returned to FTB
April 1-30, 2006	Invoice sent to cities
no later than May 31, 2006	Payment due to FTB
AB 63 Data Availability:	
April 15, 2006	Taxpayers file returns for year 2005
June 2006	FTB provides first CD with 2005 tax data
October 15, 2006	Taxpayers file returns for year 2005
December 2006	FTB provides second CD with 2005 tax data
Source: Franchise Tax Board.	

Of the 95 cities that requested contracts from FTB, 40 cities are new to the program and 55 participated before. If all of these cities complete the contract process, a total of 174 will have participated in the AB 63 program in at least one year since 2001. As of June 2005, FTB expects a final count of about 65 cities in the program for 2005 data.

Table 3

2005 AB 63 Contracts Requested from FTB by City Size as of March 31, 2006	
Population (1/1/2005)	2005
< 25,000 persons	30
> 25,000 and < 50,000	12
> 50,000 and < 100,000	29
> 100,000 and < 250,000	16
> 250,000 persons	8
Total number of cities	95
Source: Franchise Tax Board and CRB calculations.	

[14] The exception was the City of Los Angeles, which did obtain 2002 AB 63 data.

[15] In 2006, FTB moved up the calendar by a few months. In previous years, April 15 data were available on CD in the following August and October 15 data were available in January of the following year.

CLOSING THE BUSINESS TAX GAP – DATA MINING

The business license tax is a locally-administered tax. City license inspectors are responsible for identifying businesses operating within the city limits and collecting the tax. The evolution of home-based businesses, private post office operations and executive suites has made identifying businesses operating in a city considerably more challenging.

Cities are using increasingly sophisticated tools to close the tax gap. Database reconciliation using data-mining techniques is one discovery tool used by many cities. Cities use various sources to obtain leads on entities with business income in their community. Data sharing between state and local levels of government is not new (details of state-local data sharing programs are explained later in this report). For example, cities have partnered with the State Board of Equalization (SBOE) to cross-check sellers' permit files with business license tax files. The resulting file matches can result in the discovery of businesses that should have been licensed (locally), businesses that should have state sellers' permits and also corrections of the location of sellers, which improves the allocation of local sales tax revenue.

The AB 63 data are a new database that lists all taxpayers reporting business income or expenses to the FTB from an address within a certain city. To reduce sales and business tax leakage, cities crosscheck data files:

SBOE sales tax
registration data X Business Licenses =>

Unlicensed Businesses
Misallocated sellers
Unregistered sellers

AB 63 Data
FTB Business Filings X Business Licenses =>

Unlicensed Businesses

Examples of databases used by cities to crosscheck local businesses are listed in Table 4. Some cities have a master ID system in place to crosscheck businesses across databases.

Table 4

Examples of Databases used by City Revenue Officials to Cross-check Businesses	
FTB (AB 63 data) – Schedule C	SBOE sales tax registration data (AB 990)
DBA Fictitious Business Name	Fire Inspections
Sellers' Permit, Sales Tax Filings	Business Whites
Field Inspections	Building permits
Secretary of State Filings	Library late fee charges
Tenant Rosters	Bankruptcy filings
State Licenses (e.g. contractors)	Business and pet licenses
Assessor Rolls	Rental properties, landlords
Special Events	Vendors
Chamber of Commerce	Ticket manager (parking tickets, citations, alarms)
Source: CMRTA and California Research Bureau.	

Cities are not alone in their data-mining efforts. On a regular basis, the FTB uses taxpayer information provided by cities and counties, the Board of Equalization, and the Department of Consumer Affairs occupational license program to identify taxpayers who have a license to operate a business but have not filed an income tax return for a given year. Once identified, the taxpayer is contacted by the FTB and requested to either file a return or notify the department as to why a return was not filed. From 1984-1999, FTB obtained annual business license tax files from cities and counties through the "City Business License Tax Program." In 2005-06, FTB will again be receiving city/county business license tax data for data-mining purposes. These two data-sharing efforts are described later in this report.

Data-mining and database management tools are increasingly used in many areas of government, not just taxation. One example is voter registration. Effective January 1, 2006, the states experienced a change in their voter registration processes. Federal law, the Help America Vote Act of 2002, now requires that states create and maintain statewide voter databases to serve as the central source of voter registration information. In some states, these databases are going to be matched to other databases in attempt to reduce registration fraud. These database policies, for example, will reportedly reject voter registration applications of citizens whose information cannot be matched to the state's motor vehicles database or the database of the Social Security Administration.[16]

CITY IMPLEMENTATION OF THE AB 63 PROGRAM

Participating cities receive a list of taxpayers who reported income as a trade or business and are located in the jurisdiction, as determined by FTB. Both business and individual records (sole proprietors) are provided on a password-protected CD, with the password sent separately by e-mail. The file is a flat file, meaning that no software is on the CD. Using this CD can be a daunting project for cities without extensive information technology (IT) support. According to one Clerk of a small city:

> There are no instructions on how to download or use the information. It seems there is a presumption that an IT person is using the data. It's a flat file that imports easily into Excel. You do have to do a fair amount of formatting depending on what you want. It takes me about 1-2 hours, although it is easier each year. If you were not good at Excel, you'd be up a creek. For someone who's picky like me, the flat file is terrific because I can pick and chose the information I want displayed and format it the way I want. I would guess that many others would like the work done for them. I would think that a brief instruction about an Excel download in the e-mail that sends the password would be very helpful.[17]

FTB does not provide data-comparison or data-mining services. Since the AB 63 data listing has not been compared to any other city data, many of the entries already have business licenses. Each city must do its own analysis.

[16] Justin Levitt and others. *Making the List: Database Matching and Verification Processes for Voter Registration*. New York City: Brennan Center for Justice, March 2006.
[17] CRB Survey of AB 63 Participating Cities, 2006.

From the data provided by FTB, the type of ownership is not explicitly shown but it is possible to infer it:

- Sole Proprietorships file Schedule C and their type of business conduct by Principal Business Activity Code.[18]
- Legal entities report income as a business. Examples of legal entities are: partnerships, limited partnerships, limited liability companies, corporations and trust.

Potential benefits of the AB 63 information are that the list of AB 63 leads can be sizeable. Moreover, AB 63 data give the city the ability to identify businesses that would not show up elsewhere. This is especially true of sole proprietorships, many of which operate out of residences and have no filing requirements with other agencies. In some sense, these data give city officials access to the "underground economy."

AB 63 data have to be matched against existing business license tax records. Any non-matches are considered potential AB 63 leads. Cities match these data in different ways, depending on their level of technological sophistication:

- Manually: Some cities match the AB 63 manually against other data sources. For example, they might print out the AB 63 data file, then look at each data record to see whether the tax ID number (FEIN or SSN) exists in their city business tax file.
- Computer software: Most cities download the AB 63 data into their own software system and electronically match the records. Some cities have ordered special software from vendors to do this procedure. Others have programmers on staff who can do the coding necessary for the matching.

Non-matched records (identified leads) are a list of persons and businesses that filed business income or expenses with the federal/state government from an address within the city, but were not paying local business license tax. Some of the identified leads might be subject to address mismatching issues. In the case of the Schedule C filers, the business address may or may not be the same as the address from which the address was filed. It is possible for a business owner to use a home address in City "A" for mailing the return, but to actually be doing business in City "B."

Municipal business tax codes differ widely, so the percentage of identified leads that might be liable for a local tax vary across cities. For example, some cities exempt entire categories of businesses from their tax, such as residentially-based businesses. Moreover, cities have differing implementation strategies. Cities need to decide how many of the identified leads to send notices to; whether to target certain types of taxpayers; whether to send the notices all at once or on a staggered schedule; and whether to include an amnesty provision or, alternatively, to impose penalties for past non-compliance. To help taxpayers determine whether they are liable for the local tax, some cities have published criteria for business tax assessment. (See Appendix F for an example.)

[18] PBA codes are based on NAICS (North American Industrial Classification System) codes.

The City of Newport Beach has been involved in helping other cities learn to use AB 63 data and has published a guide to using the data. Its publication, *AB 63 Getting Started Guide*, gives the following advice to other cities:[19]

1. Be sure to notify City Council and City Management before sending out AB 63-based notices to taxpayers.
2. Don't send all notices at once if the city does not have the staff to handle these calls and process the influx of new business license tax revenue.
3. Address Mismatching Issues: the FTB keys only the address from which the return was filed. In the case of the Schedule C, there is a place to list the business address, which may or may not be the same as the address from which the address was filed. It is possible for a business owner to use a home address in City A for mailing the return, but actually be doing business in City B.
4. Confidentiality.
5. Targeting Methodology: Start by targeting those who have more indicators of business conduct, such as corporations, LLCs, partnerships, etc. It's more likely that these entities are conducting business in the City if they have represented business conduct to other agencies. Query for business names.
6. Create a set of criteria the business owner can use to determine whether a license is required. The biggest problem with Schedule C filers is educating them about the difference between employees and independent contractors. Many, especially real estate agents, felt they were really employees and should be treated as such.[20] Concerning legal entities, there was a lot of resistance to obtaining a license, especially from general partnerships. These entities can legally exist solely for business purposes and have been issued Federal Employer Identification Numbers (FEIN).
7. Arguments used by general partnerships: "This is a *passive* entity." "It's under the umbrella of Organization X's business license." "I formed this entity for tax relief and you can't tax that; it's not a business."
8. Create a review and hearing process.

[19] City of Newport Beach, Business License Tax Section. *Franchise Tax Board/AB63 Getting Started Guide*, Revised: September 15, 2005.

[20] Municipal codes treat real estate agents differently. The City of Los Angeles, for example, exempts real estate agents by ordinance. Agents are not required to register. The City holds the listing broker liable for the business tax.

AB 63 PROGRAM PARTICIPATION

The Franchise Tax Board provided data to the California Research Bureau on program participation for tax years 2001, 2003 and 2004. The 134 cities listed in Tables 5a and 5b completed the contract process, signed confidentiality agreements with FTB and paid for AB 63 data.

Participation as reported by cities sometimes differed from these FTB records. Because of the two-year lag between the tax year of the data and when the city actually received the data, some cities reported when they received the data. In addition, a few of these cities claimed they never paid for or received AB 63 data from FTB. In some cities, staff turnover was high in the past five years and the current finance director was not aware of previous participation in the AB 63 program.

Table 5a

Cities that Participated Three Times				Cities that Participated Twice			
City	2001	2003	2004	City	2001	2003	2004
El Segundo	X	X	X	Anaheim	X	X	
Emeryville	X	X	X	Livermore	X	X	
Fullerton	X	X	X	Menlo Park	X	X	
Huntington Beach	X	X	X	Morro Bay	X	X	
Los Angeles	X	X	X	Santa Fe Springs	X	X	
Newport Beach	X	X	X	Concord	X		X
Oakland	X	X	X	Corte Madera	X		X
Paso Robles	X	X	X	Fontana	X		X
Piedmont	X	X	X	Fremont	X		X
Riverside	X	X	X	Gilroy	X		X
Sacramento	X	X	X	Inglewood	X		X
San Jose	X	X	X	Montebello	X		X
Santa Barbara	X	X	X	Napa	X		X
Torrance	X	X	X	Ontario	X		X
Union City	X	X	X	Oxnard	X		X
Victorville	X	X	X	Palm Springs	X		X
Vista	X	X	X	Redwood City	X		X
Wasco	X	X	X	Rialto	X		X
				San Dimas	X		X
				San Francisco	X		X
				West Hollywood	X		X
				Artesia		X	X
				Berkeley		X	X
				Beverly Hills		X	X
				Carson		X	X
				Colton		X	X
				Hawthorne		X	X
				Long Beach		X	X
				Santa Monica		X	X
				Vernon		X	X
				Walnut Creek		X	X

Source: Franchise Tax Board.

Table 5b

Cities that Participated Once							
City	2001	2003	2004	City	2001	2003	2004
Alameda	X			Cathedral City		X	
Anderson	X			Cloverdale		X	
Arcata	X			Coalinga		X	
Azusa	X			Fairfax		X	
Bellflower	X			Garden Grove		X	
Benicia	X			Glendora		X	
Chowchilla	X			Hanford		X	
Clearlake	X			Holtville		X	
Clovis	X			Lawndale		X	
Corona	X			Los Gatos		X	
Crescent City	X			Madera		X	
Culver City	X			Mill Valley		X	
Cupertino	X			Milpitas		X	
Danville	X			Monterey		X	
El Centro	X			Oakley		X	
La Habra	X			Palm Desert		X	
La Puente	X			San Bernardino		X	
Laguna Beach	X			San Fernando		X	
Larkspur	X			San Luis Obispo		X	
Live Oak	X			Sausalito		X	
Manhattan Beach	X			South San Francisco		X	
Montclair	X			Apple Valley			X
Moreno Valley	X			Atascadero			X
Norco	X			Atherton			X
Orange	X			Brea			X
Oroville	X			Capitola			X
Port Hueneme	X			Cerritos			X
Rancho Mirage	X			Citrus Heights			X
Rancho Palos Verdes	X			Claremont			X
Ridgecrest	X			Hermosa Beach			X
Rohnert Park	X			La Verne			X
San Anselmo	X			Needles			X
San Gabriel	X			Norwalk			X
San Marcos	X			Palo Alto			X
San Mateo	X			Pasadena			X
Santa Clara	X			Porterville			X
Thousand Oaks	X			Portola			X
Tulare	X			Richmond			X
Vallejo	X			Roseville			X
Yuba City	X			San Rafael			X
				Santa Rosa			X
				Seal Beach			X
				Seaside			X
				Solvang			X
				Westlake Village			X

Source: Franchise Tax Board.

AB 63 PARTICIPATION BY CITY POPULATION

Table 6 shows the distribution of participating cities by population size. About 28 percent of all incorporated cities participated in AB 63 through 2004. Larger cities participated at a higher rate

Table 6

AB 63 Program Participation by City Size (2001, 2003, 2004)			
Population (1/1/2005)	All cities	AB 63 Participants	% of cities in each group participating in AB 63
< 25,000 persons	219	35	16%
> 25,000 and < 50,000	97	35	36%
> 50,000 and < 100,000	99	33	33%
> 100,000 and < 250,000	50	23	46%
> 250,000 persons	13	8	62%
Total number of cities	478	134	28%
Source for population data: Department of Finance.			

Table 7 shows city participation by population size and by year of participation:[21]

- 79 cities participated in 2001
- 54 cities participated in 2003
- 68 cities participated in 2004

- 18 cities participated in all 3 years
- 31 cities participated for 2 years:
    - 5 cities participated in both 2001 and 2003
    - 16 cities participated in both 2001 and 2004
    - 10 cities participated in both 2003 and 2004
- 85 cities participated only one year:
    - 40 cities participated in 2001 only
    - 21 cities participated in 2003 only
    - 24 cities participated in 2004 only

Table 7

AB 63 Program Participation by Year and by City Size			
Population (1/1/2005)	2001	2003	2004
< 25,000 persons	19	15	14
> 25,000 and < 50,000	20	10	13
> 50,000 and < 100,000	18	16	19
> 100,000 and < 250,000	15	6	15
> 250,000 persons	7	7	7
Total number of cities	79	54	68
Source: CRB and California Department of Finance (population data).			

[21] Due to budgetary cuts, the AB 63 Local Government Sharing Program was not offered to most cities in 2002. The exception was the City of Los Angeles, which did receive 2002 AB 63 data.

Table 8 shows the number of cities by population size that participated one, two and three years:

- Out of the 70 cities with population less than 50,000, 54 cities (77 percent) participated only one year.
- The eight cities with the largest populations participated at least two years. Five of them participated all three years.
- The 18 cities participating for all three years are remarkably evenly distributed with respect to population size: there are five small cities (with population less than 50,000 persons) and five large cities (with population over 250,000 persons).
- The majority of cities (85) participated only one year.

Table 8

AB 63 Program Participation by Number of Years and by City Size: 2001, 2003, and 2004

Population (1/1/2005)	1 year	2 years	3 years	Total
< 25,000 persons	26	5	4	35
> 25,000 and < 50,000	28	6	1	35
> 50,000 and < 100,000	18	10	5	33
> 100,000 and < 250,000	13	7	3	23
> 250,000 persons	0	3	5	8
Total number of cities	85	31	18	134

Source: CRB and California Department of Finance (population data).

AB 63 Participation by Revenue Amount

Table 9 shows business license tax revenue per resident, which had a median value of about $10 in 2002-03. Only about 30 percent of cities participating in the AB 63 program had a per-resident revenue figure of less than $10, indicating that these cities tended to earn more in business license tax revenue on average than non-participants.

Table 9

Business License Tax Revenue Per Resident for California Cities, FY 2002-03 by AB 63 Participation

Tax Revenue per Resident	AB 63 Participant Cities		Non-Participant Cities		Total Cities	
	#	%	#	%	#	%
Greater than $500	4	3%	1	0%	5	1%
$100 to $500	4	3%	2	1%	6	1%
$50 to $99	5	4%	5	1%	10	2%
$25 to $49	26	19%	28	8%	54	11%
$10 to $24	50	37%	91	26%	141	29%
Less than $10	40	30%	179	52%	219	46%
NA	5	4%	38	11%	43	9%
Total Cities	134	100%	344	100%	478	100%

NA includes cities with no data (due to no business license tax or non-reporting).
Source: Fiscal Year 2002-03 State Controller Data, CaliforniaCityFinance.com.
State Mean: $51.06 State Median: $9.46
State Minimum Amount: $0.08 State Maximum Amount: $12,193

Table 10 shows similar calculations, but for business license tax revenue as a percentage of general city revenue. These calculations show that business license taxes are a larger percentage of general revenues for AB 63 participants than for non-participants. In 2002-03, the state median percentage was 2.4 percent. Only 32 percent of cities participating in the AB 63 program had less than the median, but 52 percent of non-participant cities did.

Table 10

Business License Tax Revenues as a Percentage of General Revenues for California Cities, FY 2002-03, by AB 63 Participation

Business License Tax Revenue as % of General Revenues	AB 63 Participant Cities		Non-Participant Cities		Total Cities	
	#	%	#	%	#	%
Greater than 10%	10	7%	4	1%	14	3%
5% to 10%	23	17%	32	9%	55	12%
2.5% to 5%	52	39%	95	28%	147	31%
1.3% to 2.4%	34	25%	95	28%	129	27%
Less than 1.3%	10	7%	81	24%	91	19%
NA	5	4%	37	11%	42	9%
Grand Total	134	100%	344	100%	478	100%

NA includes cities with no data (due to lack of a business license tax or to non-reporting).
Source: Fiscal Year 2002-03 State Controller Data, CaliforniaCityFinance.com.
State Mean Across Cities: 3.2% State Median: 2.4%
State Minimum Amount: 0.0% State Maximum Amount: 27.1%

AB 63 Participation by Type of Tax and Cost Rating

Municipal codes for business license taxes differ widely. Some cities have a flat tax; others tax on payroll, gross receipts, square footage, number of employees, or a variety of other possibilities.[22] Some cities tax all businesses the same way; others tax different kinds of businesses using different types of taxes and/or varying tax rates. Some cities exempt various kinds of businesses or have a threshold level of gross receipts before a tax is imposed. Business tax structure matters in a city's decision on whether to participate in the AB 63 program because cities with very low, flat taxes (or low tax rates on gross receipts), for example, might not find the use of AB 63 data to be cost-effective. Cities that use the business license tax more for regulation purposes than for revenue generation might also be less likely to participate in the AB 63 program, or, if they participate, they might be less likely to find the program valuable.

Not all cities in California have a business license tax. Cities are supposed to report local tax revenues to the State Controller, Local Government Reporting Unit, and the revenues

[22] Information on business license taxes and permits for individual cities is at http://www.calgold.ca.gov/ and also on each city's website.

are published in the Controller's local government finance publications.[23] Examples of cities that did not report business license tax revenues over the past decade are: Aliso Viejo, Big Bear Lake, Buellton, Dana Point, Diamond Bar, Dos Palos, Elk Grove, Fillmore, Glendale, Industry, Lafayette, Laguna Hills, Laguna Niguel, Laguna Woods, Lake Forest, Malibu, Mission Viejo, Moraga, Orinda, Palo Alto, Patterson, Poway, Rolling Hills, Tulelake, Williams, Westlake Village, and Windsor. Since two of these cities (Palo Alto and Westlake Village) obtained AB 63 data in 2004, FTB might require cities to directly answer whether or not they have a business license tax as part of the AB 63 contract process.

Tables 11 and 12 compare city tax structures by AB 63 participation using data provided by the California Municipal Revenue and Tax Association (CMRTA) for member cities. Out of 341 members, 211 (62 percent) tax some businesses using a gross receipts tax, 196 (57 percent) have a flat tax and 87 (26 percent) tax the number of employees (see Table 11). About one-third of CMRTA members (117 cities) were participants in the AB 63 program through 2004. Gross receipts taxes are used by a higher percentage of AB 63 participant cities (72 percent) than non-participants (57 percent).

Table 11

Number of Cities Imposing Different Business License Taxes
341 CMRTA Member Cities, by AB 63 Participation

	Taxes imposed by 117 AB 63 Participant Cities	Taxes imposed by 224 Non-Participant Cities	Taxes imposed by 341 CMRTA Member Cities
# Employees	35 (30%)	52 (23%)	87 (26%)
Flat Tax	62 (53%)	134 (60%)	196 (57%)
Gross Receipts	84 (72%)	127 (57%)	211 (62%)
Total Taxes	181	313	494

Source: California Municipal Revenue and Tax Association (CMRTA), 2005 and CRB.

Table 12 provides details on the number and kind of business taxes imposed. About two-thirds of cities had only one type of tax (with "gross receipts only" the most frequently used), but one-third of cities taxed businesses using various combinations of types of business license taxes. Tax structure varied somewhat across cities: a higher percentage of AB 63 participants taxed gross receipts only. Participants also tended to have a more complicated tax structure (two or three types of tax). Among non-participants, a higher percentage had a flat tax only.

This tax structure analysis was repeated using a different sample of cities with similar results. The data used were obtained from the Kosmont-Rose Institute *Cost of Doing Business Survey* (see Appendix I). This annual *Survey* contains information about fees,

[23] http://www.sco.ca.gov/pubs/index.shtml#locgovrep. These revenues have been compiled over time by Michael Coleman at http://www.californiacityfinance.com/BLT03PUB.xls.

Table 12

Tax Structure of CMRTA Member Cities, by AB 63 Participation						
Tax Structure:	AB 63 Participant Cities		Non-Participant Cities		Total Cities	
	#	%	#	%	#	%
# Employees (primarily)	7	6%	15	7%	22	6%
Flat (primarily)	18	15%	69	31%	87	26%
Gross Receipts (primarily)	48	41%	75	33%	123	36%
One Tax (subtotal)	73	62%	159	71%	232	68%
Two Taxes	24	21%	41	18%	65	19%
Three Taxes	20	17%	24	11%	44	13%
Total CMRTA Cities	117	100%	224	100%	341	100%
Total Cities	134		344		478	
Source: California Municipal Revenue and Tax Association and CRB.						

taxes, costs and incentives that affect business in about 350 communities nationwide. In the past few years, *Survey* results have found that local government taxes across the nation are rising as municipalities try to offset budget shortfalls at the state level. The *Survey* also found that cities all across California "are striving to adapt to the fall-out from Proposition 218."[24]

Using data from the *Survey*, Table 13 shows that AB 63 participants tended to have somewhat higher cost rankings than non-participants. The *Survey* ranks cities as Very Low Cost ($), Low Cost ($$), Medium Cost ($$$), High Cost ($$$$), and Very High Cost ($$$$$). The cost ratings provide a consistent means to compare costs in communities based on the six locally- and state-imposed taxes: business, telephone, sales, electric, property and state income. Cities participating in the AB 63 program tended to have a higher cost rating than those that did not participate.

Table 13

Kosmont-Rose Institute Cost of Doing Business Rating, 2004, for 208 California Cities					
Cost Rating	AB 63 Participant Cities		Non-Participant Cities		Total
$ (very low cost)	1	1%	1	1%	2
$$ (low cost)	16	19%	48	38%	64
$$$ (moderate cost)	25	30%	41	33%	66
$$$$ (high cost)	27	33%	27	22%	54
$$$$$ (very high cost)	14	17%	8	6%	22
# Cities rated by Kosmont	83	100%	125	100%	208
# Cities not in survey	51		219		270
Total cities	134		344		478
Source: Kosmont-Rose Institute, *2004 Cost of Doing Business Survey.* *2005 Executive Summary, Cost of Doing Business Survey.*					

[24] http://research.mckenna.edu/rose/order_report.asp?type=2.

AB 63 PARTICIPATION BY COUNTY AND REGION

Most participating cities are located in the Bay Area, the South Coast and the Inland Empire. Table 14 shows city participation by region and Table 15, by county. The counties with more than five cities participating are Los Angeles, Orange, San Bernardino, Riverside, Alameda, Marin and Santa Clara.

Table 14

Regional Distribution of AB 63 Program Participants: 2001, 2003 and 2004

Region	# Cities	AB 63	Number of AB 63 Participating Cities as % of all Cities in the Region
Bay Area	101	39	39%
Inland Empire	48	17	35%
South Coast	132	45	34%
Central Coast	33	9	27%
Far North	49	8	16%
Sacramento Metro	19	3	16%
San Diego	25	4	16%
San Joaquin Valley	62	9	15%
Sierras	9	0	0%
California	478	134	28%

Regions:
Bay Area: Alameda, Contra Costa, Marin, Napa, San Francisco, San Mateo, Santa Clara, Solano, Sonoma.
Central Coast: Monterey, San Benito, San Luis Obispo, Santa Barbara, Santa Cruz.
Far North: Butte, Colusa, Del Norte, Glenn, Humboldt, Lake, Lassen, Mendocino, Modoc, Nevada, Plumas, Shasta, Sierra, Siskiyou, Sutter, Tehama, Trinity, Yuba.
Inland Empire: Riverside, San Bernardino.
Sacramento Metro: El Dorado, Placer, Sacramento, Yolo.
San Joaquin Valley: Fresno, Kern, Kings, Madera, Merced, San Joaquin, Stanislaus, Tulare.
Sierras: Alpine, Amador, Calaveras, Inyo, Mariposa, Mono, Tuolumne.
San Diego: Imperial, San Diego.
South Coast: Los Angeles, Orange, Ventura.

Table 15

AB 63 Program Participation by County: 2001, 2003 and 2004					
County*	# Cities	AB 63	County	# Cities	AB 63
Alameda	14	8	Placer	6	1
Amador	5	0	Plumas	1	1
Butte	5	1	Riverside	24	8
Calaveras	1	0	Sacramento	7	2
Colusa	2	0	San Benito	2	0
Contra Costa	19	5	San Bernardino	24	9
Del Norte	1	1	San Diego	18	2
El Dorado	2	0	San Francisco	1	1
Fresno	15	2	San Joaquin	7	0
Glenn	2	0	San Luis Obispo	7	4
Humboldt	7	1	San Mateo	20	5
Imperial	7	2	Santa Barbara	8	2
Inyo	1	0	Santa Clara	15	7
Kern	11	2	Santa Cruz	4	1
Kings	4	1	Shasta	3	1
Lake	2	1	Sierra	1	0
Lassen	1	0	Siskiyou	9	0
Los Angeles	88	32	Solano	7	2
Madera	2	2	Sonoma	9	3
Marin	11	7	Stanislaus	9	0
Mendocino	4	0	Sutter	2	2
Merced	6	0	Tehama	3	0
Modoc	1	0	Tulare	8	2
Mono	1	0	Tuolumne	1	0
Monterey	12	2	Ventura	10	3
Napa	5	1	Yolo	4	0
Nevada	3	0	Yuba	2	0
Orange	34	10	California	478	134

*Counties with no incorporated cities: Alpine, Mariposa and Trinity.

FEEDBACK ON THE AB 63 PROGRAM

To obtain information about how the AB 63 program has worked since 2001 data were made available, the California Research Bureau surveyed California's 478 cities. Two sets of questions were posed:

- the 134 cities that chose to participate in the AB 63 program in 2001, 2003 or 2004 were sent a detailed survey;
- the remaining 344 cities that did not participate in those years were sent a short survey asking why they had chosen to not participate and whether they planned to participate in the future.

Copies of these surveys are included in Appendix J and Appendix L. Most cities were contacted first by e-mail: the California Municipal Revenue and Tax Association (CMRTA) sent the short survey to all its members and advised them that a more detailed survey would be sent to participating cities. The Franchise Tax Board provided e-mail addresses for participating cities, which were sent the detailed survey. The State Board of Equalization provided mailing labels for all 478 cities in California. Surveys were sent to all cities by U.S. mail, and many cities chose to fax their responses. Participating cities that did not initially respond were sent follow-up e-mails and were also contacted over the phone.

Organizations known to CRB as interested in the program were contacted and their feedback was solicited. Comments from organizations are included in Appendix M.

SURVEY RESULTS FOR PARTICIPATING CITIES

Of the 134 participating cities, CRB obtained feedback from 116 cities, a response rate of 87 percent. About 40 of these cities returned the detailed survey included in Appendix J, and about 25 cities provided answers for most of the questions. It became obvious from e-mail responses, however, that many cities could not answer most of the questions on the detailed survey. Reasons were a lack of time or willingness to fill out the survey, lack of historical data (data were not kept or were inaccessible in storage), lack of ability to track the effects of the AB 63 program (i.e., AB 63 data were not tracked separately from other compliance programs), and lack of experience actually using AB 63 data (many cities purchased the data, but were unable to use them for technical, staffing or cost reasons).

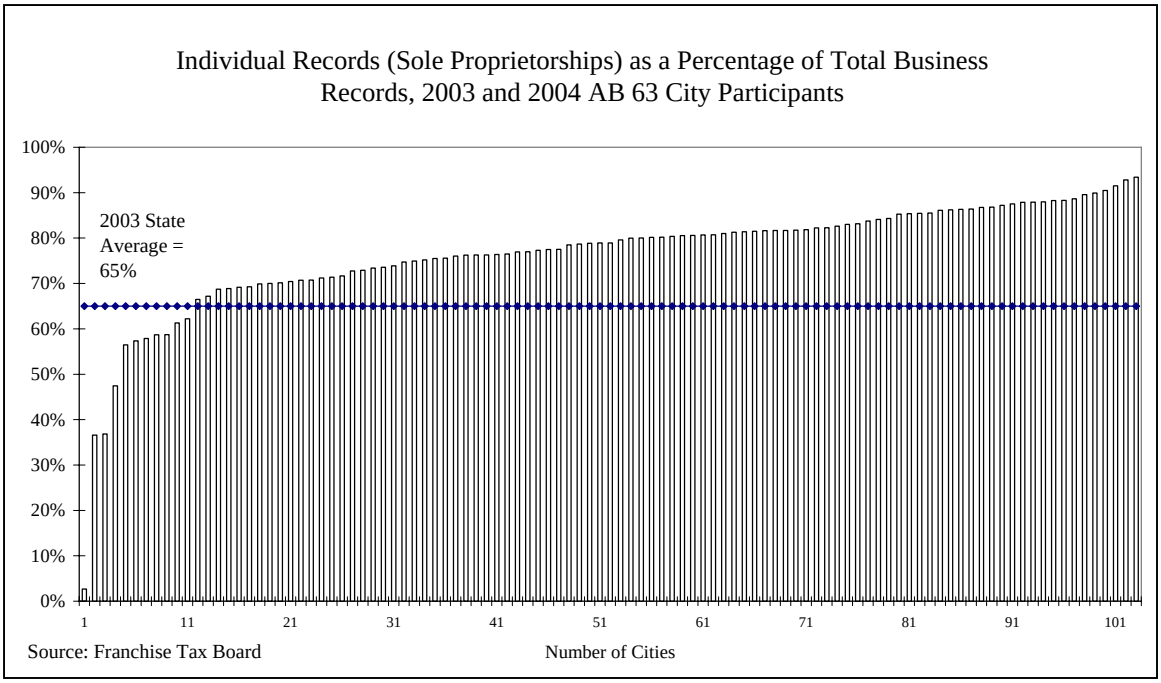
To participating cities that did not respond to the detailed survey, CRB sent out a shorter survey via e-mail (and later over the telephone) that asked whether the city had used the data, whether the data were useful and whether the city planned to use AB 63 data in the future. The responses of participating cities to both the detailed and the short surveys are combined in the following section.

Nature of Tax Filers (Survey, Table A.1)

Cities were asked to provide data on the nature of their tax filers (sole proprietorship, partnership, corporation, LLCs, and other) from 2000 to 2004. AB 63 data identify taxpayers that filed business tax returns (business records) as well as sole proprietors who filed a Schedule C (individual records). For 2003 and 2004, the Franchise Tax Board provided the California Research Bureau with counts of the business and individual records for participating cities.

The number of business records compared with individual records varies widely across cities. Chart 3 shows individual records (sole proprietorships) as a percentage of total records for the cities that participated in the AB 63 program in 2003 or 2004. This percentage ranges from 4 percent in the City of Vernon to 93 percent in the City of Rialto. For most participating cities, sole proprietorships made up between 70 and 85 percent of all 2003 records. For the State of California, sole proprietorships made up 65 percent of total business tax return volume in 2003.[25] Most cities participating in the AB 63 program in 2003 and 2004 had a higher percentage of sole proprietorships than the 2003 state average of 65 percent.

Chart 3



[25] Source: *Franchise Tax Board Annual Report*, 2004. (See Table 40 in the Data Sources for Business Tax Returns section at the end of this report for details.)

Regarding changes in the nature of tax filers over time, it was not possible to draw any general conclusions of trends from the CRB survey data because very few cities supplied 2001 data. Table 16 gives results from several cities. In all but one of these cities, the percentage of sole proprietors stayed about the same or increased slightly over time.

Table 16

Changes in the Nature of Tax Filers between 2001 and 2004		
Survey Results	2001 Sole Proprietors as a % of Total Returns	2004 Sole Proprietorship as a % of Total Returns
Carson	61%	61%
El Segundo	31%	31%
Los Angeles	55%	58%
Moreno Valley	24%	35%
Newport Beach	47%	44%
Oakland	65%	67%
Norwalk	70%	70%
Riverside[26]	46%	46%

Distribution of Tax Burden (Survey, Table A.1)

The distribution of the tax burden was measured by the amount of business license tax paid by each business to an individual city. Most cities reported that the overwhelming majority of their business taxpayers paid less than $500 in business license tax in 2004. For the following cities, over 90 percent of businesses were in this category: El Segundo, Huntington Beach, Montclair, Moreno Valley, Newport Beach, Riverside, San Marcos and Santa Barbara. Examples of cities with 75 percent to 90 percent of their business taxpayers paying less than $500 were: Concord, Oakland, San Francisco, Thousand Oaks and West Hollywood.

Cities were asked to report tax distribution data from 2000 to 2004. This information was requested to track whether the distribution of the tax burden was changing in cities that had successfully used AB 63 data and if the business tax was being paid by increasing numbers of small businesses. Only six cities reported enough data to perform these calculations and none of them showed evidence of a significant increase in the percentage of businesses paying less than $500. The six cities were El Segundo, Montclair, Moreno Valley, Newport Beach, Oakland and Thousand Oaks.

[26] The City of Riverside provided these data for 2002.

City Participation and Data Usage (Survey, Tables A.3 & B.5)

Feedback from participating cities revealed three distinct groups: those that had successfully used the AB 63 data in at least one year, those that had never used the data and those that did not answer the CRB survey. A few cities responded that they did not know about this program and had no record of receiving data from FTB. In many cases, these cities had had significant staff turnover in the past few years and the current staff had not been involved when the data were purchased. The fact that these city finance staff could not locate the CDs with AB 63 data could be seen as evidence that the CDs were destroyed, as required by FTB.

Table 17

CITIES: AB 63 Participation and Data Use: 2001, 2003 and 2004 Data (Survey, Table A.3)			
Used data*	56	Obtained data	134
One year	*37*	*One year*	*85*
Two years	*12*	*Two years*	*31*
Three years	*7*	*Three years*	*18*
Never used data	60		
Never received data/Didn't know	*12*		
Received data, but did not use	*48*		
Cities that answered the CRB survey	116		
Cities that did not answer the survey[27]	18		
Total number of cities	134		
* Cities that have not finished using the data but are in the process of doing so, were coded as having used the data.			

Most of the cities that never used the data obtained the data only one year. Similarly, most cities that did not answer the survey obtained the data only one year.

Table 18

Participating CITIES	Obtained data one year	Obtained data two years	Obtained data three years	Total
Never used data	46	12	2	60
Used data one year	27	7	3	37
Used data two years		9	3	12
Used data three years			7	7
No answer	12	3	3	18
Total	85	31	18	134

[27] The 18 cities that did not respond to CRB survey: Arcata, Beverly Hills, Culver City, El Centro, El Paso de Robles, Fremont, Hermosa Beach, Laguna Beach, Los Gatos, Needles, Oakley, Ontario, Palm Desert, Palo Alto, Ridgecrest, San Luis Obispo, Union City, Wasco.

Since some cities participated in the AB 63 program multiple times between 2001 and 2004, the numbers of completed contracts (201) is greater than the number of cities that participated in at least one year (134).

Table 19

Number of Completed CONTRACTS for AB 63 Data: 2001, 2003 and 2004				
	2001	2003	2004	Total
Used data	25	28	29	82
Never used data	34	14	22	70
Never received data/Didn't Know	9	3	8	20
No answer	11	9	9	29
Total	79	54	68	201

Why did so many cities obtain AB 63 data, but then not use them? The following responses are summarized from participating cities that did not use the data. Detailed responses are included in Appendix K.

Table 20

If your city obtained AB 63 data in one year, but then did not use those data, please explain. (Survey, Table B.5)	Number of Cities
Lack of Staff Resources	26
Technical Problem: File too difficult to manipulate	13
Technical Problem: Software interface or conversion	13
Blame FTB for some reason	14
Wanted Income/Gross Receipts data	3
Never Received Data/Didn't Know About Program	12
Other	32
Note: Some cities checked multiple responses.	

Fiscal Impact: Cost Effectiveness of the AB 63 Program to Cities

The cost effectiveness of the AB 63 program to cities depends on four main factors:[28]

1) The cost of purchasing the data from FTB;
2) The amount of staff time necessary to process the data, send out notices and perform follow-up;
3) The number of leads identified from AB 63 data that turn out to be new business licenses; and,
4) The amount of new business license tax revenue resulting from the new licenses.

The cost of purchasing AB 63 data from the FTB

Cities have to reimburse FTB for AB 63 program costs, which have been about $350,000 annually. For 2005 data, costs are lower (about $280,000). In the first year of the

[28] Source: (1) FTB; (2) survey, Table A.5; (3) survey, Table A.1; and, (4) survey, Table A.4.

program, the City of Los Angeles agreed to pay the full implementation cost and was then reimbursed by FTB after other cities paid their share.

The charge for participating in the AB 63 program is based on city population share among participants. The minimum charge is $500. Across years, costs vary for any individual city depending on how many other cities participate. On average, costs by city population size for the years 2001, 2003 and 2004 were:

Table 21

City Population	Average AB 63 Program Costs
Less than 25,000 persons	$500
25,000 to 40,000 persons	$500 to $1,000
40,000 to 105,000 persons	$1,000 to $2,500
105,000 to 200,000 persons	$2,500 to $5,000
200,000 to 300,000 persons	$5,000 to $10,000
300,000 to 500,000 persons	$10,000 to $25,000
More than 500,000 persons	$25,000 and higher
Source: AB 63 program cost data obtained from the Franchise Tax Board.	

Cost estimate of staff time to process data (Table A.5)

The amount of staff time spent on AB 63 data processing and follow-up depends on:

- the size and complexity of the business community in the city
- the number of identified leads from FTB data
- the exemptions to the local business license tax
- the percentage of identified leads that the city decides to pursue
- the technological sophistication of the city

The technological sophistication of the city is a critical factor when determining the cost of staff time. Since cities are required to process these data without the help of consultants, they need to have IT staff and equipment capable of implementing the program. Many cities ordered AB 63 data from FTB only to find they did not have the capability to process them. Some of these cities have ordered a software interface from an outside vendor to help the city staff process AB 63 data themselves. Several cities indicated they were still waiting for this software to be delivered and installed.

Cities were asked to provide an estimate of staff cost, but only about 10 cities provided this information. Across cities, the number of hours spent varied from cities with full-time employees working all year on AB 63 data leads to a city where one employee spent a total of 24 hours. Another city reported that they stopped processing the AB 63 data file when the staff cost exceeded the original cost of purchasing the data.

The Number of New Licenses

After data records are matched between AB 63 data and a city's existing business license tax files, a list of identified leads is created. These leads are created by matching AB 63 data (which show the receipt of business income) compared to corresponding local data showing that no business license tax was paid. The number of leads depends most importantly on the existing rate of compliance with the local business tax. Some cities reported that the AB 63 data resulted in few leads because compliance with the local business tax was already very high. Cities with lower compliance will have a long list of potential AB 63 leads.

The next step is for the city to decide how many of the AB 63 leads to pursue with notices to taxpayers. This depends on numerous factors, including:

- The exemptions in the city's municipal tax code. If home-based businesses are exempt, for example, the city might send a smaller number of notices to Schedule C filers.
- The staffing capacity of the city to deal with taxpayer questions concerning the notices. Some cities were unable to handle large volumes of calls and inquiries, so they contacted only a sample of the taxpayers, or sent notices out on a staggered schedule.
- The city's chosen level of involvement: some cities sent notices to all identified taxpayers, others filtered the AB 63 leads first and sent notices to those more likely to be larger businesses. Some cities specifically targeted home-based businesses; others did not.
- Whether the business license tax obligation is voluntary or mandatory.
- Politics – City elected officials may make different policy decisions about how aggressively they want to enforce the business license tax.

After first notices were sent to taxpayers, many cities received questions from taxpayers by phone, letters and e-mails. For taxpayers who did not respond to the first notice, many cities followed up using second notices, etc.

Fiscal Impact: The Amount of New Business License Tax Revenue

Cities reporting the successful use of AB 63 data might be expected to result in higher growth rates in business license tax revenue over the last five years than cities that have not had such success or have not participated in the program. An analysis of increases in business license tax revenue for various cities shows that this is not necessarily the case: this revenue source can be volatile and depends on many factors.

Moreover, cities reported using AB 63 data for tax equity goals as well as for revenue augmentation. Large numbers of new business licenses due to AB 63-based notices do not necessarily translate into large amounts of new revenue. The revenue generated depends on the structure of the city's business license tax and on the type of taxpayers involved. If the city's business license tax is a low, flat tax, or if most of the new licenses are for small, home-based businesses, the resulting amount of new business license tax

revenue might not be large. Examples of increases in business license tax revenue from 2000 to 2004 for individual cities are shown in Table 22. All of these cities reported finding the AB 63 data to be valuable. Cities are grouped as follows:

- Cities that participated for the first time using the 2001 data
- Cities that participated for the first time using the 2003 data
- Cities that participated for the first time using the 2004 data

Each group has some cities with percentage increases in revenue of 50 percent or more and then others with less than 20 percent. Cities participating in the first year of the AB 63 program (using 2001 data) did not necessarily have a pattern of higher increases in revenue over the 2000-2004 period than cities that started using the data later. The same pattern holds for other groups of cities, such as cities that never participated in the AB 63 program or cities that participated but did not use the data. Successful participation does not necessarily translate into a large percentage increase in revenue.

Table 22

Percentage Increase in Business License Tax Revenue, 2000-2004, for AB 63 Participants that Found the Program to be Valuable

1st Year Used Data	% Increase in Business License Tax, 2000-2004		1st Year Used Data	% Increase in Business License Tax, 2000-2004	
2001	West Hollywood	55%	2003	Morro Bay	52%
2001	Newport Beach	51%	2003	Sacramento	28%
2001	Piedmont*	39%	2003	Long Beach	28%
2001	Los Angeles	19%	2003	Santa Barbara	26%
2001	Corte Madera	16%	2003	Carson	21%
2001	Oakland	14%	2003	Santa Monica	18%
2001	Huntington Beach	12%	2003	Garden Grove**	13%
2001	El Segundo	4%			
			2004	Riverside*	50%
			2004	Brea*	39%
			2004	San Rafael*	19%
			2004	Walnut Creek	-6%

* For these cities, the 2000 data source was State Controller data, FY 1999-00, and not the CRB survey.
** Garden Grove provided revenue for 2001-2005.

The range of answers concerning the amount of revenue received (and the value of the AB 63 program) is illustrated in the following three examples:

1) The City of San Jose ran a project to improve business license tax compliance from June 2003 to February 2004, and then again from November 2004 to May 2005. They utilized all available lead sources, including the AB 63 data from 2001 and 2003. The project netted the City an additional 3,151 business license accounts for a total of $1.63 million. City tax officials estimated that 80-90% of the notices were based from AB 63 data, so the net result attributed to AB 63 data was about $1.5 million.

2) According to the Revenue Manager of the City of Newport Beach, “To say this program is important to City of Newport Beach is an understatement. Since the

start of the program, we have realized over a 50% increase in our business tax revenue. The number of active licenses has increased from about 13,500 to over 17,000. This program has been critical in the success of our business license division and will continue to be so."

3) The City of Orange paid $3,400 to FTB to acquire their business tax database. The CD ROM, which contained information over one year old, had 6,419 records on it. Computer programmers were able to take these records and cross-reference them with the City's approximate 17,000 active business licenses. Out of the state's records, only 650 did not appear to have a business license. A business license clerk then created and mailed out letters to the 650 addresses. During the subsequent months, the City received hundreds of telephone calls from individuals. Many callers stated they were no longer in business; city staff verified that this was correct. Out of these 650 accounts, the City had 10 individuals pay for a license, totaling $595. The City did not find participation in the AB 63 program to be cost effective.

Fiscal Impact: The Value of AB 63 Data to your City (Survey, Part C)

The CRB survey asked cities: In terms of net revenue benefits, how do AB 63 source data compare to other tools used by your city to identify unlicensed businesses? Please use a scale of 1 (the most valuable) to 5 (not useful) and place an "X" in the appropriate box.

Table 23

Compared to other tools used to identify unlicensed businesses, AB 63 source data are:				
1. (The most valuable tool by a large margin.)	2. (Very valuable, but other tools are just as valuable.)	3. (Useful.)	4. (We obtained the AB 63 data but didn't use them.)	5. (Not useful. We paid for the AB 63 data and used them, but did not find many unlicensed businesses due to AB 63 leads.)
21 cities	*16 cities*	*9 cities*	*59 cities*	*8 cities*
Additional Response: (too early to tell) *3 cities* said they had just started using the data *18 cities* did not respond to the CRB survey.				

Of the 57 cities that used the data and answered this question on the survey, 37 cities (65 percent) found the data to be very valuable (Rating 1 or 2); 21 cities (37 percent) said the data were the most valuable tool by a large margin (Rating 1). Eight cities said the data were not useful. Cities in this category had either high tax compliance to begin with (so they did not have many AB 63 leads to work with), low business license tax rates, or they found the cost of processing the data to be too high relative to the gains from higher tax revenue.

Although 59 cities were not able to use the AB 63 data, 21 of these same cities responded that they would be purchasing the data again in the near future and another 15 cities were considering a purchase. Most cities incur a high start-up cost to learn how to process AB 63 data, but some of these cities made it clear that they intend to make the effort to be able to overcome the steep learning curve and use AB 63 data in the future. Some cities said they were waiting for software to be developed that would help them process the

data. Three of the 59 cities stated they had not used the data yet, but planned to use them in the future. The crosswalk between data valuation and future use of the data is shown in Table 24.

Table 24

Value of AB 63 Data and City Plans to Purchase AB 63 Data in the Near Future						
	Do you plan to use AB 63 Data in the near future?					
Value of AB 63 Data	Yes	Maybe	No	Don't know	No answer to survey	Total Cities
1 - most valuable	21					21
2 - very valuable	13	1	1	1		16
3 - useful	6		2	1		9
4 - didn't use data	21	15	17		6	59
5 - not useful/cost effective	1		7			8
No answer to survey	6*				12	18
Too early to tell	3					3
Total Participating Cities	71	16	27	2	18	134

* Did not provide an answer to the CRB survey, but did start the contract process with FTB for 2005 data.

Future Plans (Survey, Part C)

Table 25

Does your city plan to obtain AB 63 data from the Franchise Tax Board?						
	Yes	Maybe	No	Don't Know	No Answer	Total
Obtain 2005 AB 63 data	54*					
Obtain AB 63 data in subsequent years	71	16	27	2	18	134

*In March 2006, FTB sent contracts for AB 63 2005 data to 95 interested cities. Of the 95 cities, 54 participated in previous years. FTB expects approximately 65 cities to finalize contracts for 2005 data.

Other Comments from Cities (Survey, Part C)

Some cities provided other comments about the AB 63 program. Their comments are summarized below.

(1) Cities' comments on the way the law was written:

- Repeal the sunset provision.
- Extend the authority to access AB 63 data to counties.
- The statute does not define "employee." Define employee to include temporary and part-time staff.
- Authorize contractors who work exclusively with public agencies to assist with the processing of data (similar to authorities established in Rev. & Tax 7056(b)).
- Establish reciprocity between cities and the FTB to exchange data without cost.

- Provide gross receipts data.

(2) *Cities' comments on the way the Franchise Tax Board (FTB) is administering the AB 63 program:*

- The program should be designed so that ALL cities can use the data, not just cities that are technologically advanced. The data should be provided in EXCEL in addition to the current flat file format. Instructions on how to download the data should be included in the e-mail that provides cities the password to open the CD.
- Cities would like the business address and not the home filing address.
- Cities would like FTB to make it clear which address is being provided.
- FTB should reduce the cost of the data.
- Non-city employees, with confidentiality agreements, need to be allowed access to the data.
- The data could be parsed better (separate fields for first and last names, etc.).
- FTB has developed security requirements disparate from those established by the IRS and State Board of Equalization (SBOE). The FTB relies on the legislation's reference to "employee" and the standards imposed on the FTB by the IRS as the basis for their restricting local's use of contractors. However, the IRS authorizes the FTB to use contractors to process confidential IRS data and the SBOE authorizes cities to use contractors to process confidential sales tax data.
- Several cities commented that the State Board of Equalization's data-sharing programs were more user-friendly than the AB 63 program.

(3) *Cities' comments on the FTB safeguard review process:*

- Data security and confidentiality is an issue for FTB. The FTB Disclosure Office reportedly has no prior experience in safeguard reviews of agencies other than FTB. Although participating cities have been paying each year for Disclosure Office costs, the program was three years old before that office made its first contact with locals regarding safeguard standards.

(4) *The way cities are handling FTB data: No comments.*

(5) *The way cities are implementing the program with local taxpayers: No comments.*

City Implementation (Survey, Table A.5)

Most of the cities that were able to use the AB 63 data found them to be very valuable. Table 26 shows detailed AB 63 data for seven cities in 2003. The City of Los Angeles, for example, received 364,616 data records from FTB and sent out 55,096 notices based on the data. As a result, the City obtained 10,857 new licenses, which is 20% of the number of notices sent (the "yield") and a 3% increase in the number of licenses. A large number of these cases, 36,030, are still pending; 9,550 were returned by the Post Office as undeliverable, suggesting they might have gone out of business.

Cities chose different strategies with respect to the number of notices sent as a percentage of existing licenses ("% Pursued"). Of the seven cities listed in Table 26, the City of

Carson sent out the largest percentage of notices (50%) and Santa Barbara pursued the smallest (2%). The percentage of new licenses resulting from the notices, the "yield," varied enormously as well, from 65% for Santa Barbara to 9% for Sacramento.

Table 26

2003: AB 63 Data Leads and Contacts in Your City (Survey, Table A.5)								
#		Carson	Long Beach	Los Angeles	Newport Beach	Sacra-mento	Santa Barbara	Santa Monica
1	Number of existing business licenses	7,150	28,100	356,330	15,828	30,000	13,323	20,004
2	Number of records from FTB, 2003 data[29]	4,723	28,954	364,616	15,721	42,412	17,164	20,439
3	Number of identified leads from FTB data	4,359	20,105	55,096	7,859	42,412		13,211
4	Number of identified leads from FTB data that were exempt	795		5,139	1,372	34,516		6,242
5	Total number of notices sent[30]	3,564	4,317	55,096	5,541	2,442	307	6,969
6	Number of *new* licenses resulting from leads[31]	959	593	10,857	1,614	222	201	1,505
7	Number contacted that were already licensed	1,424	120		187	218	10	280
8	Number contacted that were exempt	437	1,429		778	671		1,393
9	Number contacted that were returned by the Post Office as undeliverable	104	365	9,550	374	12	3	44
10	Number contacted that are still pending	1,599	513	36,030	1,135	1,150		4,126
11	Number of Phone responses to notices				1,084	1,117		5,376
5 / 1	"% PURSUED": Notices / (existing licenses)	50%	15%	15%	35%	8%	2%	35%
4 / 3	exempt/leads	18%		9%	17%	81%		47%
6 / (6+1)	% increase in licenses: new / (new + existing)	12%	2%	3%	9%	1%	1%	7%
6 / 5	"YIELD": new license/notices	27%	14%	20%	29%	9%	65%	22%
7 / 5	already licensed/notices	40%	3%		3%	9%	3%	4%
8 / 5	exempt/notices	12%	33%		14%	27%		20%
9 / 5	returned/notices	3%	8%	17%	7%	0%	1%	1%
10/5	pending/notices	45%	12%	65%	20%	47%		59%
11/5	phone calls/notices				20%	46%		77%

[29] Source: Franchise Tax Board.
[30] Total number of notices sent = number of businesses contacted due to leads from FTB AB 63 data.
[31] Number of *new* licenses resulting from leads = number of businesses contacted that were determined to be subject to the city's business license tax and were not previously licensed.

Table 27 shows similar data for various cities in the first year of using AB 63 data, sorted by the "yield" of the notices. The "yield" ranges from 2% in Orange, a city that did not find these data to be cost-effective, to 65% in Santa Barbara. Most cities had a "yield" between 13% and 32%. Holding the year of participation in the program constant is important, because diminishing returns will eventually set in as a city repeatedly uses these data over time.

Table 27

First Year of Program: AB63 Data Leads and Contacts
Sorted by "YIELD"= New Licenses as a Percentage of Notices Sent Out (Survey, Table A.5)

City	First Year of Program	% Pursued= notices/ existing licenses	% increase in licenses*	"YIELD"= new licenses/ notices	already licensed/ notices	exempt/ notices	returned/ notices	pending/ notices	phone calls/ notices
Orange	2001	4%		2%					
Madera	2004			4%	9%	2%	6%		60%
San Francisco	2001	0%		6%	47%	38%	9%		6%
Sacramento	2003	8%	1%	9%	9%	27%		47%	46%
Brea	2004	4%	1%	13%					
Long Beach	2003	15%	2%	14%	3%	33%	8%	12%	
Riverside	2004	5%	1%	14%	4%	1%	11%		41%
Oakland	2001	41%	6%	14%					
Walnut Creek	2004	10%	2%	19%					
Newport Beach	2001	55%	10%	19%	3%	29%	16%	19%	21%
Rancho Palos Verdes	2001	63%		20%					
San Rafael	2004	2%		20%	4%	4%		60%	
San Marcos	2001			20%	3%	1%	14%	16%	
Santa Monica	2003	35%	7%	22%	4%	20%	1%	59%	77%
Los Angeles	2001	49%	10%	23%			11%	4%	
Carson	2003	50%	12%	27%	40%	12%	3%	45%	
West Hollywood	2001	11%	3%	29%	21%	29%	14%		29%
Menlo Park	2001			32%			30%		
Corte Madera	2001	6%	3%	50%					
Garden Grove	2004	1%	1%	50%					
Santa Barbara	2003	2%	1%	65%	3%		1%		

* % increase in licenses = (new licenses) / (new licenses + existing licenses)

Table 28 illustrates the percentage increase of new licenses over time for Los Angeles and Newport Beach, both of which have experienced diminishing, but still very positive, returns to participating in the AB 63 program.

Table 28

AB 63 Data Results for the Same City, Across Time				
City	Year	% Pursued = Notices / existing licenses	% Increase in Licenses	"Yield" = New licenses/notices
Los Angeles	2001	49%	10%	23%
Los Angeles	2003	15%	3%	20%
Newport Beach	2001	55%	10%	19%
Newport Beach	2003	35%	9%	29%
Newport Beach	2004	12%	2%	18%

City Implementation (Survey, Table A.6)

In many cities, implementation patterns changed over time as cities improved their programs:

- By 2003 and 2004, most cities did not send all notices at one time. (#1)
- Similarly, notices were no longer sent out to all AB 63 leads, but were more likely to be filtered in some way. (#2)
- In 2001, the majority of cities did not notify local politicians and officials before sending out AB 63 notices. In 2003 and 2004, the majority did notify them. (#7)

Most respondents did not use the FTB data in conjunction with an amnesty program for previously unlicensed businesses. (#5)

Almost all cities followed first notices with second notices or other enforcement tools such as phone calls, field visits, notices of violation, etc. (#8)

Table 29

	City Implementation (Survey, Table A.6)	2001		2003		2004	
		YES	NO	YES	NO	YES	NO
#1	Did you send all AB 63-based notices in each year at one time?	5	6	1	13	2	11
#2	Did you send notices to all potentially unlicensed businesses?	4	6	3	10	4	10
#3	If you sent notices to a subset of potentially unlicensed businesses, did you target those taxpayers whose names include terms indicating business conduct such as “corporations,” “LLCs” and “partnerships?”	5	6	7	6	5	7
#4	If you sent notices to a subset of potentially unlicensed businesses, did you target Schedule C filers, “sole proprietorships?”	5	5	7	5	6	5
#5	Did you use FTB data in conjunction with an amnesty program for previously unlicensed businesses?	2	8	5	8	4	8
#6	Did you charge penalties to previously unlicensed businesses?	5	6	6	7	7	7
#7	Did you notify your City Council and other city officials before sending out the AB 63-based notices?	4	6	9	4	7	6
#8	Did you follow up with second notices or other enforcement tools to those who did not respond to improve compliance?	8	2	11	2	11	2

City Implementation (Survey, Part B)

Only about 25 cities (out of 134 participants) answered the questions on implementation in Part B of the survey. *The cities that responded had all used the data:*

- Cities were split on the issue of voluntary compliance: about half of the respondents said there was no impact of the AB 63 program on voluntary compliance, one third said there was an impact and the rest said that they didn't know: it was too early to tell or too hard to quantify.
- Almost all cities sent out second notices as a follow-up to first notices. Some cities used third notices, final notices (certified mail), phone calls, issuance of Notice of Violations and Citations, lien and collection process, administrative citations.
- Most of these cities did not change their exemptions. Two that did change their exemptions were Los Angeles and Oakland. Because of vocal taxpayer protests concerning low business earnings being taxed, the City of Oakland has introduced an exemption level of $2,500 for small businesses. In Los Angeles, some of the reforms enacted were the elimination of business taxes on small businesses and the elimination of taxes for new businesses for their first two years. In addition, starting January 1, 2006, creative artists have to register for the tax but are exempt if they earn less than $300,000 in gross receipts and report in a timely fashion.
- Most of these cities said that neither restricting data access to city employees nor the one-year time constraint caused problems. These results are misleading, however, because they do not include responses from cities that were not able to use the data, precisely because their consultants could not have access to the data or because they could not process the data within the one-year time frame. As previously mentioned, the one-year period was recently extended to three years by FTB in order to alleviate this problem.

Table 30

	Part B. Other Questions Concerning the AB 63 Program	Yes	No	Don't Know
B.1	Has the ability of the Franchise Tax Board to share tax information with your city had an impact on voluntary compliance with your business tax laws? Yes or No?	8	13	4
B.2	If you used follow-up measures after notices were sent to taxpayers, what kind of follow up? (For example, second notices, phone calls, etc.)	21	1	0
B.3	Have you changed the exemptions to your business license tax due to the AB 63 program? Yes or No?	4	22	0
B.6	Under your contract with the FTB, only city employees can use AB 63 data. Is this a problem for your city?	7	21	0
B.7	Under your contract with the FTB, AB 63 data can be maintained by your city for one year. Is this time constraint a problem for your city?	11	16	1

Taxpayer Response Among Home-Based Businesses (Survey, Table A.7)

Table 31

Table A.7 Taxpayer Response Among Home-Based Businesses[32] Contacted by AB 63 Leads. Did the following statements seem to be true for the *majority* of these taxpayers:				
	yes	no	blank	Total
Contacted taxpayers had not been aware that they had a city business tax liability. Once they understood their liability, they paid the tax without protest.	13	7	3	23
Contacted taxpayers were angry that they were being assessed the tax.	12	11	0	23
Contacted taxpayers were angry that they were being assessed the tax, plus penalty and interest.	10	10	3	23
Contacted taxpayers thought that sharing of tax information between state and local tax officials was standard practice.	11	7	5	23

Other taxpayer reactions. Please specify:

- AB 63 data were two years old before taxpayers were contacted. Many were no longer in business. Lots of complaints.
- Our city shares a border with the City of Los Angeles. Many contacted taxpayers were already paying a business license tax to Los Angeles.
- Notice sent to taxpayers was explanatory and non-accusatory but people didn't read it. Just receiving the letter was considered an insult.
- There have been a few [complaints] here and there, but not very many. The reality is that those who complained are those who just don't like to be caught for not paying taxes.
- "The response of taxpayers to finding out that the city had FTB information was interesting. A number of people complained and some felt the city had no right to the data. But the vast majority expressed no surprise at this. Many taxpayers think that government-taxing agencies regularly exchange information."[33]

The City of Oakland has had a strong taxpayer reaction to the way AB 63 was implemented in that city, especially with respect to the way home-based businesses were treated. A group of taxpayers called the "Rockridge Neighbors for Fair Taxation" have

[32] Businesses that are home-based can have any tax-filing status. Most home-based businesses are sole proprietorships. According to a 1999 survey, 90 percent of home-based businesses were sole proprietorships, 5 percent were S Corporations and 4 percent were partnerships. Source: Pratt, Joanne. *Home-Based Businesses: The Hidden Economy*. Washington, D.C.: U.S. Small Business Administration, Office of Advocacy, March 2000. http://www.sba.gov/advo/research/rs194tot.pdf .

[33] City of Newport Beach, "FTB/AB63 Data: Getting Started Guide." 2005.

protested the tax.[34] According to their website, "We are a group of individuals opposed to the imposition of arbitrary business taxes on self-employed residents of the City of Oakland. Oakland is taxing gross--not net--and is taxing income whether or not it was earned outside the city or even outside the state. It is imposing back-penalties, although it had never sent out taxation notices of any kind."[35]

Two members of this group sent letters to the California Research Bureau concerning the implementation of AB 63 in Oakland. Some of the specific concerns of the group are:

- *Definition of taxable businesses* – is too broad in Oakland. Home-based businesses should not be taxed. Not all Schedule C filers have "businesses."
- *Apportionment of Gross Receipts to Oakland* – The City assumes 30%, which is too high.
- *Regressive tax* – Oakland's $60 minimum tax is regressive.
- *Amnesty* – Punitive interest and penalty charges, even for taxpayers who were unaware of their obligation.
- *Timing and staggering of AB-63-based notifications*. Unfair that some taxpayers received notice before others and therefore paid less in penalties and interest.
- *Shifting of the burden of taxation to small, home-based businesses* – the group suspects this to be the case.
- *Cost-effectiveness of AB 63 program* – The group feels that this is dubious.
- *Non-fiscal impact* – Ill-will created towards city government.
- *Miscellaneous* – Generally, the Oakland city government has been hard to deal with. Different employees give inconsistent answers to the same questions. Mail to the Tax Compliance Unit isn't answered, even certified letters.

Articles on the controversy have been published in both the *San Francisco Chronicle* and the *Oakland Tribune*.[36]

[34] They formed a yahoo group 'biztaxprotest.org.' http://groups.yahoo.com/group/biztaxprotest/.
[35] http://groups.yahoo.com/group/biztaxprotest/.
[36] Clarke, Chuck. 'Big Brother' in Oakland Wants You. *SFGate.com*. July 16, 2004.
Payton, Brenda. Business Tax Irks Freelance Workers. *The Oakland Tribune*. March 30, 2004.
Payton, Brenda. Business Tax Unfair To Some Residents. *The Oakland Tribune*. April 20, 2004.

Characteristics of Businesses (Survey, Part D)

Data on the distribution of businesses, AB 63-based notices and new licenses by type of address provide an idea of the extent to which cities were targeting home-based addresses in their use of AB 63 data. The responses show that different cities are pursuing very different strategies. Few cities responded to this question; in fact, Newport Beach was the only city to provide complete data.

Between 2001 and 2004, Newport Beach data show that a large percentage of new licenses (due to AB 63 leads) were home-based. As a result, "All Businesses" shows an increasing percentage of addresses that are home-based.

Table 32

City of Newport Beach
Distribution of Businesses, AB 63 notices and New Licenses by Address Type

		All Businesses subject to BLT* (as provided in AB 63 data)	Number of AB 63-based notices sent out	Number of new licenses (due to AB 63 data leads)
2001	Home-based	31%	53%	62%
	Commercially-located	69%	37%	30%
	P.O. Boxes	0%	10%	7%
	Total %	100%	100%	100%
	Total Number of Businesses	*10,007*	*7,528*	*1,427*
2003	Home-based	33%	64%	64%
	Commercially-located	66%	28%	30%
	P.O. Boxes	1%	8%	6%
	Total %	100%	100%	100%
	Total Number of Businesses	*10,966*	*5,463*	*1,570*
2004	Home-based	37%	75%	81%
	Commercially-located	62%	16%	14%
	P.O. Boxes	1%	8%	5%
	Total %	100%	100%	100%
	Total Number of Businesses	*11,804*	*2,040*	*363*

*BLT = Business License Tax.

For cities that use AB 63 data repeatedly over time, there can be diminishing returns to the data each year, as more and more taxpayers with business income are brought into compliance with their business license tax obligations. In Newport Beach, the number of businesses increased from 10,007 in 2001 to 11,804 in 2004; over the same period, the number of notices sent and new licenses obtained decreased dramatically. In addition, the percentage of new licenses from home-based addresses increased from 62% to 81%.

Tables 33 and 34 show examples of notices sent and new licenses for a few other cities. Carson and Santa Barbara sent most of their notices to home-based addresses, while San Rafael sent most notices to commercial locations. Oakland changed its strategy markedly between 2001 and 2004: in 2001, 75% of notices were sent to home-based addresses; in 2004, 100% were sent to commercial locations.

Table 33

Distribution of AB 63-based Notices Sent by Type of Address					
	Carson 2003	Santa Barbara 2003	San Rafael 2004	Oakland 2001	Oakland 2004
Home-based	95%	100%	20%	75%	0%
Commercially-located	4%	0%	80%	25%	100%
P.O. Boxes	1%	0%	0%	0%	0%
Total	100%	100%	100%	100%	100%
Number of notices sent	*3,411*	*307*	*125*	*15,684*	*2,496*

Table 34

Distribution of New licenses (due to AB 63 data leads) by Type of Address					
	Carson 2003	Santa Barbara 2003	San Rafael 2004	Oakland 2001	Oakland 2004
Home-based	82%	100%	28%	90%	0%
Commercially-located	18%	0%	72%	10%	100%
P.O. Boxes	0%	0%	0%	0%	0%
Total	100%	100%	100%	100%	100%
Number of new licenses	*959*	*201*	*25 (to date)*	*2,225*	*50 (to date)*

Table 35 shows the percentage distribution of new licenses due to AB 63 leads by economic sector for Carson, Los Angeles, San Rafael and Santa Barbara. In these cities, a large percentage of the new licenses were in services, especially the professional, scientific and technical services. This was especially true in Santa Barbara, 2003, when all notices were sent to businesses in Profession, Scientific and Technical Services.

Table 35

Percentage Distribution of New Licenses (due to AB 63 data leads) by Economic Sector					
NAICS code	Economic Sector	Carson 2003	Los Angeles 2001	San Rafael 2004	Santa Barbara 2003*
44-45	Retail Trade	5%	3%	0%	0%
42	Wholesale Trade	4%	7%	0%	0%
51	Information	0%	6%	5%	0%
53	Real Estate	5%	4%	5%	0%
54	Professional, Scientific & Technical Services	18%	31%	35%	100%
56	Administrative Support, Waste Management, Remediation Services	0%	11%	45%	0%
61	Educational Services	1%	2%	5%	0%
62	Health Care & Social Assistance	13%	3%	0%	0%
71	Arts, Entertainment & Recreation	2%	16%	0%	0%
72	Accommodation & food services	1%	2%	0%	0%
81	Other Services (except Public Admin.)	51%	16%	5%	0%
	Total	100%	100%	100%	100%
	Number of New Licenses	*959*	*20,412*	*20*	*201*

NAICS codes are explained in detail on the U.S. Census Bureau website at: http://www.census.gov/epcd/www/naics.html.
*Santa Barbara sent all AB 63-based notices to the Professional, Scientific & Technical Services Sector.

Several cities submitted data using other industry classification methods. Table 36 shows the percentage distribution of new licenses (due to AB 63 leads) for the City of Riverside. Like the cities listed above, Riverside shows most new licenses in the services sector, but a lower percentage of these new licenses went to professional services.

Table 36

Percentage Distribution of New Licenses, Riverside, 2004		
Economic Sector	Businesses	New licenses (due to AB 63 leads)
Retail	18%	26%
Wholesale	3%	5%
Professional Services	7%	3%
General Services	35%	47%
Other Businesses	37%	19%
	100%	100%
Number of New Licenses	*19,393*	*132*

Newport Beach was the only city that provided complete information by economic sector for all businesses, AB 63-based notices, and newly licensed businesses (see Table 37). Compared with all businesses, the sectors with higher percentages of AB 63-based notices sent out and also newly licensed businesses were

- Real Estate
- Professional, Scientific & Technical Services
- Arts, Entertainment and Recreation
- Other Services (except Public Administration)

Table 37

City of Newport Beach
2004 Number of Businesses by Economic Sector

NAICS code	Economic Sector	All businesses subject to BLT*	AB 63-based notices sent out	Newly-licensed businesses (due to AB 63 data leads)
44-45	Retail Trade	18%	6%	3%
42	Wholesale Trade	6%	3%	4%
51	Information	NA**	2%	3%
53	Real Estate	14%	24%	20%
54	Professional, Scientific & Technical Services	17%	35%	45%
56	Administrative Support, Waste Management, Remediation Services	26%	6%	5%
61	Educational Services	1%	3%	3%
62	Health Care & Social Assistance	10%	5%	4%
71	Arts, Entertainment & Recreation	3%	7%	6%
72	Accommodation & Food Services	4%	1%	1%
81	Other Services (except Public Admin.)	1%	10%	7%
	TOTAL	100%	100%	100%

* Business License Tax **NA Not available.

SURVEY RESULTS FOR NON-PARTICIPATING CITIES

Of the 344 cities that chose to not participate in the AB 63 program in 2001, 2003 or 2004, 114 cities responded to the CRB survey. Twenty-five of these cities did not levy a business license tax. The 89 cities with a business license tax answered a short survey:

1. Why has your city chosen not to obtain AB 63 data? (some cities gave multiple responses)
    a. Cost – 37 cities (42%)
    b. Lack of resources to process the data – 45 cities (51%)
    c. Waiting until the data have been proven effective in other cities – 11 cities (12%)
    d. Other – 21 cities (24%) Examples of responses:
        - No need for the AB 63 program: Using a consultant is most cost-effective for some cities. Some smaller cities said compliance with business license tax already high; others said their flat tax did not bring in much revenue so the AB 63 program would not be cost-effective.
        - City was unaware of the AB 63 program.
        - Three cities complained that FTB had not responded to them in a timely manner, so they weren't able to participate in the AB 63 program.
        - Local politics: Business license tax compliance is voluntary. City council reluctant to authorize staff to enforce.
        - Some cities are not able to process the data themselves and are waiting for software (under development by their consultants) that will help them process the AB 63 data themselves.

2. Does your city plan to obtain AB 63 data for 2005 or in the future?
    a. Yes – 23 cities (26%)
    b. No – 26 cities (29%)
    c. Maybe – 39 cities (44%)

3. If you would like to participate but find the current program to be unworkable for your city, what changes in the law or improvements in the program's administration would you like to see?
    - The most frequent response was that the program was too costly. Cities requested that FTB reduce the cost of the program. (8 cities)
    - Other changes suggested to FTB: Better communication with cities; Change the data format so that the data are easier to use; Hold more workshops to better explain the program;
    - Some cities want FTB to provide taxpayer income/gross receipts.

4. How does your city calculate business tax liability? (multiple responses possible)
    a. Gross Receipts – 51 cities (57%)
    b. Number of Employees – 35 cities (39%)
    c. Square Footage of Business – 11 cities (12%)
    d. Flat tax – 45 cities (51%)
    e. Other (please specify) – 2 cities

FEEDBACK FROM ORGANIZATIONS

Organizations with a known interest in the AB 63 program were contacted by the California Research Bureau for feedback on the program. Most of these organizations had registered support or opposition to AB 63 in 2001. Other organizations that provided comments are denoted with an asterisk (*).

Organizations were asked to comment on the AB 63 program. This might include comments on:

- The way the law was written.
- The way the Franchise Tax Board (FTB) is administering the AB 63 program.
- The FTB safeguard review process.
- The way cities are handling FTB data.
- The way cities are implementing the program with local taxpayers.

Most letters received addressed the sunset provision in AB 63 (2001). Copies of these letters are included in Appendix M.

Organizations that want the legislation to sunset in 2008 are:

California Association of Realtors (*)
Cal-Tax

Organizations that want the sunset repealed and the program extended are:

City of Los Angeles
California Municipal Revenue and Tax Association
Los Angeles Area Chamber of Commerce
League of California Cities
California Tax Reform Association
American Federation of State, County and Municipal Employees (*)
MBIA Municipal Services Company

Organizations contacted that did not respond:

Howard Jarvis Taxpayers Association
Central City Association of Los Angeles
Valley Industry and Commerce Association
Writer's Guild of America, West, Inc.
Consulting Engineers and Land Surveyors of California

An additional group that contacted the California Research Bureau was the "Rockridge Neighbors for Fair Taxation," which provided comments concerning how the program has been working in the City of Oakland. The comments of this group are summarized in an earlier section of this report.

LEGISLATIVE HISTORY

Data-sharing programs between the FTB and cities are not new. Previous data-sharing programs, as well as the series of bills that led up to passage of AB 63 and AB 205, are described in this section.

CITY BUSINESS TAX REPORTING PROGRAM (1984-1999)

The 1984 Amnesty Act enacted the City Business Tax (CBT) Reporting Program (Chapter 1490, Statutes of 1984, Revenue and Taxation Code, 19286.8). Cities with computerized record-keeping systems provided annual business license tax information to FTB. The program was created for the purpose of identifying individuals and businesses that were not complying with California's personal and corporate income tax filing and reporting requirements.[37] Of the 472 incorporated cities at the time, roughly 440 had a business tax. In 1998, 283 cities provided city business tax information to FTB. A list of data elements provided is included in Appendix H.

Because the 1984 legislation created a state-mandated local cost, a city's costs to provide the business license tax information to FTB were to be paid by the state. Over the years, there was reportedly concern that the method used to calculate the state-mandated cost resulted in inflated payments to cities, thereby reducing the program's effectiveness (from the state's perspective).[38]

The CBT Reporting Program was repealed as part of the budget by AB 1005, which was chaptered on July 6, 1999. At the time, FTB estimated that termination of the program would cause a loss of $28 million for the 1999 tax year and would save the state $5.7 million in reimbursements of mandated costs.[39]

An attempt to re-establish the CBT program in a different form was SB 1030 (1999, Polanco). This bill would have required that business license tax information be furnished to the Department of Industrial Relations and stated the intent of the Legislature with respect to combating the expansion of the "underground economy." The local tax information was to be for the use of the Joint Enforcement Strike Force on the underground economy. Nonpayment of taxes on underground economic activity was estimated to be an unacceptable $3 billion in 1993 by Executive Order W-66-93, based on an estimated California underground economy of $60 billion. The bill also provided that if the Commission on State Mandates determined that the bill contained costs mandated by the state, reimbursement for those costs should be made pursuant to

[37] This section was repealed and re-enacted in 1993, Revenue and Taxation Code 19556. Then the section was repealed in 1999 by Statutes of 1999 chapter 67, § 40 (AB 1105).
[38] SB 1030, Bill Analysis, Senate Rules Committee, 9/8/99.
[39] AB 385 Bill Analysis, Judi Smith, Assembly Revenue and Taxation Committee, June 2, 1999.

statutory provisions.[40] SB 1030 was vetoed by Governor Davis. His veto message noted that this bill would impose a reimbursable state-mandated local program and would likely result in annual General Fund costs of $9 million. Although the bill would increase tax revenues, these revenues probably would not offset the General Fund costs. Moreover, the Governor had recently signed AB990, which established a data-sharing program between the Board of Equalization and cities. He asked that the BOE share the information with FTB, so that the objective of SB 1030 would be accomplished.

PILOT DATA MATCHING PROGRAMS: FTB AND LOS ANGELES, 1995 AND 2001

The City of Los Angeles engaged in using FTB data in 1995 and 2001 as part of its Amnesty Programs. In 1995, the City provided the FTB with local business license tax data and FTB matched state business income tax records against those of the local file. Then the FTB sent out notices to business taxpayers who had not filed a local tax. The FTB sent notices to business filers only (filers with an FEIN) and not to sole proprietors. FTB did not provide the City with the list of taxpayers who had received notices and taxpayers were unaware that the City didn't know to whom the notices had been sent. The City's response to these notices was mostly done by telephone. There was no significant reaction from the public to these notices and they were not widely reported in the local press. The Outreach Program in 2001 alluded to the fact that AB 63 was coming and encouraged unregistered businesses to come forward during the amnesty period.

An exact estimate of the revenue generated in the Amnesty Programs due to FTB data cannot be made because revenue was not broken down related to FTB data versus other Amnesty filings. The revenue generated from the Amnesty Program was close to $20 million in 1995 and approximately $17 million in 2001.

PILOT DATA MATCHING PROGRAMS: FTB AND SAN JOSE, 1998

The City of San Jose engaged in a pilot program using FTB data, as part of its Business Tax Amnesty Program, which ran during the fourth quarter of 1998. FTB sent notices on behalf of San Jose to all business tax filers whose information did not match San Jose's database. The actual mailings of notices began about a week prior to the initiation of the program. FTB mailed out several thousand notices a week during the amnesty program.

The City Manager held a news conference to kick off the program. There were a limited number of articles in the press, and several TV and radio stories broadcast about the amnesty. Bill inserts were included in the utility bills that the City sent to its residents. In some of the news coverage, the data from FTB were also mentioned. The City

[40] Notwithstanding Section 17610 of the Government Code, if the Commission on State Mandates determines that this act contains costs mandated by the State, reimbursement to local agencies and school districts for those costs shall be made pursuant to Part 7 (commencing with Section 17500) of Division 4 of Title 2 of Government Code. If the Statewide cost of the claim for reimbursement does not exceed $1,000,000, reimbursement shall be made from the State Mandates Claims Fund.

reportedly received either none or very few complaints regarding the use of the data and considered the program to be a total success.

The City generated $1.5 million from a total of 6,642 businesses during the amnesty program. Of the 6,642 businesses that registered, 18% (1,196) were attributed to leads provided by the FTB. The dollar figure recovered using FTB data was $407,187, or 22% of total revenue.

AB 63-RELATED BILLS

In addition to improved local tax compliance and revenue generation, a basic idea behind AB 63 was reciprocity: California cities wanted to share data with FTB (information to flow from cities to FTB *and* from FTB to cities) and not be limited to a one-way flow of information from cities to the state. Figure 2 shows a schematic history of bills related to AB 63 from 1984 to 2006. These bills include: (1) data-sharing programs between FTB and the cities (the flow of information is indicated with an arrow =>); (2) bills concerning the local taxation of independent contractors and employees and also the creation of a presumption between federal, state and local filing; and (3) bills preventing cities from levying a business license tax on certain groups of taxpayers (such as creative artists or home-based workers). See Appendix G for detailed descriptions of each bill.

AB 63 data provide local tax officials a way to discover sole proprietors, many of whom work out of their homes. In some cities, home-based businesses are exempt from business license tax, but in many cities, the business tax must be paid by every person engaged in any of the businesses specified by the ordinance, whether a person operates a "store" or operates "out of their home." This distinction between running a business and having business income is important. Some taxpayers with business income are not aware that they are liable for the business license tax. Others are aware but do not pay, precisely because cities had few means of finding them.

From 1997 to 2001, proposed bills evolved from exempting all home-based businesses, to exempting some home-based businesses, to not exempting any. In the end, AB 205, which was co-joined to AB 63, created a presumption: if a taxpayer had filed state and federal taxes as a business (i.e. with business income and expenses), that taxpayer would have the same filing status at the local level as well. Local governments are able to exempt certain classes of taxpayers from the business license tax, or, for that matter, not have a business license tax at all, but broad exemptions are not legislated from Sacramento. The debate on exempting home-based businesses (pros and cons) is discussed in Appendix G.

Figure 2. State and Local Data Sharing: AB 63-Related Bills

1. Data sharing: State income tax & local business license tax

1984 Amnesty Act enacted the City Business Tax Reporting Program. Information on who was paying business license tax was reported to the FTB. (1984-1999)
Cities => FTB

AB 701 (1997, Caldera)
FTB => Charter Cities
Information on who was paying State business income taxes;
No exemptions

AB 385 (1999, Knox)
FTB=> Charter Cities
Information on who was paying State business income taxes.
Exemption: creative artists

AB 1005 (1999, Jackson)
CHAPTERED & ENACTED
Repeal R & T § 19556 (City Business Tax Reporting Program)

SB 1030 (1999, Polanco)
Re-establish the City Business Tax Reporting Program.
Cities => Dept. of Industrial Relations

AB 1992 (2000, Cedillo)
Substantially similar to AB 63 (2001, Cedillo)
FTB => Any City

⇔

AB 83 (2000, Cardenas)
Chaptered, not enacted.
Substantially similar to AB 205 (2001, Koretz)

AB 63 (2001, Cedillo)
CHAPTERED & ENACTED
FTB => Any City
No exemptions; Sunset 2008

⇔

AB 205 (2001, Koretz)
CHAPTERED & ENACTED

SB 1347 (2006, Cedillo)
FTB => Cities & Counties

2. Bills concerning local taxation of employees and independent contractors and also the creation of a presumption between federal, State and local tax filing:

3. Bills preventing cities from levying a business license tax or fee or other regulatory requirement on home-based workers:

AB 2065 (1998, Cardenas)
Prevent cities or counties from levying business license taxes on any *home-based* writer, musician, director, or *other* creative artist as specified.

AB 83 (2000, Cardenas)
As introduced, this bill would have prohibited a city or county from requiring business licenses or permits or imposing taxes on specified income earned from *work performed in the home* as reported on IRS form 1099-MISC.
This bill was revised and ultimately concerned the taxation of local employees and independent contractors.

EXAMPLES OF DATA SHARING: LOCAL-STATE-FEDERAL

Existing California law prohibits unlawful disclosure or inspection of any income tax return information except as specifically authorized by statute. The law authorizes FTB to disclose certain tax return information to the Commissioner of Internal Revenue of the United States; other California tax officials, such as the Board of Equalization, the Employment Development Department, the Controller, and the Department of Motor Vehicles; the Multistate Tax Commission; the tax officers of another state; and the tax officials of Mexico, under specified conditions.[41] For these types of disclosure, the statute does not include the kinds of specific restrictions that are required for disclosure to local California tax officials under AB 63.

California law also permits FTB to respond to requests for tax-return information from local taxing authorities with respect to a specific taxpayer. The request must include an affidavit signed under penalty of perjury stating that the information requested (1) relates to an investigation of the tax identified in the request and (2) will be used in the ordinary performance of the requesting authority's duties. However, a city may not know the identity of a taxpayer operating an unlicensed business and therefore would not have the information necessary to provide an affidavit.[42]

DATA SHARING BETWEEN THE FTB AND CALIFORNIA CITIES

This section describes three programs in which tax data have been shared between local jurisdictions and the FTB: (1) Cities provided business license tax information to FTB (1984-1999); (2) the Local Government Sharing Program (AB 63) (2001-2008); and, (3) FTB is to acquire business license tax information from cities as a result of the 2005 tax gap enforcement initiative.

(1) City Business Tax Reporting Program (1984-1999). According to the Statutes of 1984, Chapter 1490, Revenue and Taxation Code, 19286.8, cities with computerized record-keeping systems provided annual business license tax information to FTB. The program was created for the purpose of identifying individuals and businesses that were not complying with California's personal and corporate income tax filing and reporting requirements.[43]

(2) AB 63 – Local Government Sharing Program: Participating cities pay FTB $280,000 for access to specified state income-tax information.

(3) In fiscal year 2005-06, the FTB's tax gap enforcement budget provided the FTB with an appropriation of $450,000 to reimburse cities for their costs to provide specific business license tax data. The FTB is currently contracting with cities interested in sharing their data.

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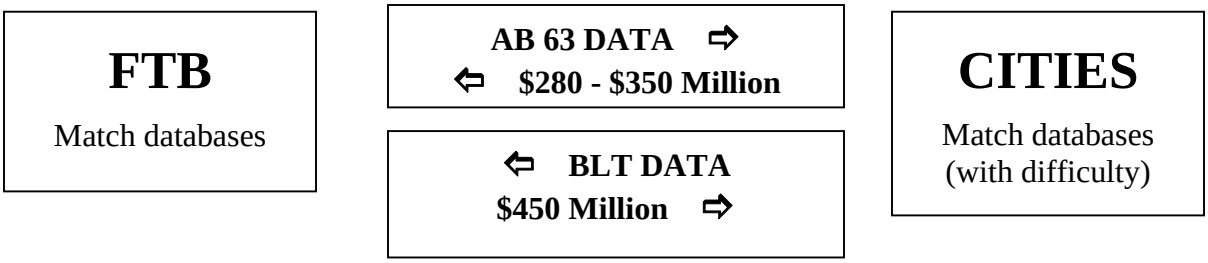
[41] Revenue and Taxation Code 19551 (a), 19551 (c).
[42] Revenue and Taxation Code 19551 (b).
[43] This section was repealed and re-enacted in 1993, Revenue and Taxation Code 19556. Then the section was repealed in 1999 by Stats 1999 ch 67 § 40 (AB 1105).

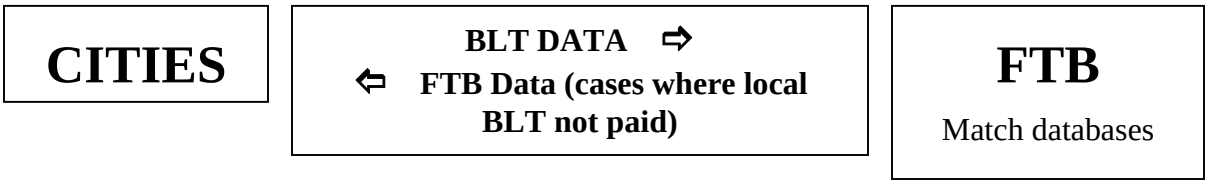
To summarize the last two programs: under AB 63, FTB sends its list of business taxpayers to participating cities, and then cities try to match their local records against the state file. Many cities have trouble performing this matching exercise (for technical reasons) and then have problems contacting the appropriate taxpayers because FTB provided the address of the filer instead of the business address. Meanwhile, at the same time, cities are sending their business license tax files back to FTB, where FTB matches the local files against FTB income tax records. Money and data are flowing in both directions.

Figure 3. Current Data-Sharing Situation



One way to simplify the system would be for cities to send their business tax file to FTB using a standardized file format. Then FTB could perform the matching exercise for the cities: FTB could keep the list of taxpayers that had paid a local business tax but not the state income tax for its own tax compliance purposes; FTB could send the list of taxpayers that had paid the state tax but not the local tax to the cities. An important point is that FTB is doing the matching anyway, even under the current data-sharing situation.

Figure 4. Simplified Data-Sharing Situation



If the address mismatch problem could also be resolved, city implementation of the AB 63 program would be vastly improved. Technology has evolved since AB 63 was passed in 2001. According to state law effective January 2004, all tax preparers must file their tax returns electronically.[44] Most Schedule C filers hire tax preparers. In the case of e-filers, therefore, FTB has the business address in electronic format, so there would be no need to key in these data. Even though the business address is in an electronic format, however, it is not currently captured within any FTB systems, and therefore is currently not available.

IRS data on business e-filers are available by zip code for sole proprietorships and by county for other business entities. (See "Data Sources for Business Tax Returns" section at the end of this report).

[44] Revenue and Taxation Code 18621.9, effective 1/1/2004; Penalties for noncompliance: R&T 19170.

DATA SHARING BETWEEN THE STATE BOARD OF EQUALIZATION AND CITIES/COUNTIES

(1) *Joint Local Jurisdiction/Board of Equalization Registration Program:*

Effective January 1, 2000, AB 990, Chapter 908, Statutes of 1999 added Sections 6066.3 and 6066.4 to the Revenue and Taxation Code. AB 990 provided cities and counties with the statutory authority to obtain sellers' permit application information from retailers desiring to engage in business in their jurisdiction. This information could then be submitted to the Board to determine whether a seller's permit was needed. This statutory change enabled cities and counties to obtain seller's permit application information from retailers desiring to engage in business in their jurisdictions and to submit that information to the Board. The Board was then required to accept that information as a preliminary application for a seller's permit and as notice to the Board for purposes of redistributing local tax.

The purpose of this partnership relationship among cities, counties and the Board is to make sure sellers of tangible property have sellers' permits. The proper registration of a retailer ensures that sales and use tax revenues are reported, thereby financially benefiting the state as well as the local jurisdictions. The proper allocation of local sales tax dollars between jurisdictions is a second rationale for data sharing.

As of March 2006, six counties and 131 cities signed agreements to participate in the AB 990 program. As part of registering under AB 990, the local jurisdiction receives a quarterly registration CD containing registration information. Unlike AB 63, provisions in the AB 990 program do not prohibit cities from sharing AB 990 data with consultants.

Through June 30, 2002, additional revenues of $227,868 were generated from persons not previously registered with the Board at a cost of $26,481. This translated into a benefit of $8.60 to every $1.00 of cost. In addition, the registration records of numerous accounts were corrected, resulting in reallocation of local tax to the proper jurisdiction. For the fiscal year ending June 30, 2002, approximately $2,646,858 was reallocated at a cost of $134,465.

AB 990 included a sunset provision, but it was deleted in SB 1062 (Chapter 471, Statutes of 2003). According to the provisions of SB 1062, the authorizations in AB 990 have been extended indefinitely. Table 38 shows that 56 of the 134 cities (40 percent) that participated in the AB 63 program with FTB through 2004 also participated in the AB 990 program with the Board.

Table 38

Number of Cities Participating in AB 63 (2001, 2003, & 2004) and AB 990 Programs				
		AB 63		
		Participate	Not Participate	Total
AB 990	Participate	56	75	131
	Not Participate	78	269	347
	Total	134	344	478

(2) *Monthly Local Sales and Use Tax Registration and Allocation Information provided to cities and counties by the State Board of Equalization:*

The Board provides cities and counties with monthly CDs listing records of businesses in their jurisdictions that are issued a seller's permit. Local jurisdictions then notify the Board of businesses that were issued a business license but do not appear on the seller's permit list. The Board publishes Pamphlet 28, "Tax Information for City and County Officials" to aid local jurisdictions in this process.[45] In addition to registration data, the Board supplies allocation information that indicates how much local tax is paid by each taxpayer to each jurisdiction. Before the Board can supply the information, the jurisdiction's governing body must pass a resolution, indicating which local officials may receive the information and indicating they will keep the information confidential.

DATA SHARING BETWEEN THE IRS AND LOCAL JURISDICTIONS

For the IRS to share federal tax information with a local jurisdiction, the local government needs to qualify as a taxing agency according to the Internal Revenue Code, which means it has to administer a local income tax on wages or income and have a population in excess of 250,000. No data-sharing agreements exist between the IRS and any cities in California because these cities do not administer an income tax or otherwise meet the definition of a "state" agency, (See 26 U.S.C. 6103(b)(5)).[46] Many California cities levy a business license tax on gross receipts, but this type of tax does not make the city qualify as a tax agency per statute. Because cities in California are not considered legal recipients of federal tax information, the IRS cannot share federal tax data with cities in California; however, the IRS can always receive information from these cities. The IRS, however, cannot provide any information about what actions were taken as a result of the information provided.

An example of a city with an IRS data-sharing agreement is Columbus, Ohio. For taxpayers in and around Columbus, figuring out where to pay municipal income taxes can be a challenge because Ohio allows people's mailing address to differ from the city in which they live. According to a recent article in the *Columbus Dispatch*, when city auditors compare IRS tax information to city tax filings, they find the most discrepancies in outlying areas. When auditors find someone who has not paid, they check back six years and work out a plan to get the taxes paid. "There is no doubt that it can be confusing at times," [Columbus auditor] Dorrian said. "But it is the taxpayer's

[45] http://www.boe.ca.gov/pdf/pub28.pdf.

[46] See also, California Revenue and Taxation Code § 17041.5 …no city, county, city and county, governmental subdivision, district, public and quasi-public corporation, municipal corporation, whether incorporated or not or whether chartered or not, shall levy or collect or cause to be levied or collected any tax upon the income, or any part thereof, of any person, resident or nonresident. This section shall not be construed so as to prohibit the levy or collection or any otherwise authorized license tax upon a business measured by or according to gross receipts.

responsibility to know where they live…and finding non-filers is a very significant source of revenue."[47]

Table 39 shows examples of cities that administer a local income tax:

Table 39

Examples of Cities Administering a Local Income Tax, 1999-2000	
Alabama: Birmingham Indiana: Center, Fort Wayne, Indianapolis, Washington, Wayne Kentucky: Lexington, Louisville Maryland: Baltimore Michigan: Detroit, Grand Rapids Missouri: Kansas City, St. Louis	New Jersey: Newark New York: New York City, Yonkers Ohio: Akron, Cincinnati, Cleveland, Columbus, Dayton, Toledo Pennsylvania: Philadelphia, Pittsburg Washington D.C.
Source: United States Census Bureau, Government Finances, 1999-2000. The cities listed had population of 125,000 or more. The State of Delaware also has some municipalities that tax income, but no cities were large enough to be included in this list. In three states, Indiana, Kentucky and Maryland, counties also administer local income taxes.	

[47] Jodi Andes and Dean Narciso, "City-tax Notice Catches Many Off Guard; Given Days to File, Outlying Residents Speak Up." *The Columbus Dispatch*. Columbus, Ohio, April 18, 2006.

DATA SOURCES FOR BUSINESS TAX RETURNS

FTB PERSONAL AND BUSINESS TAX RETURNS

For the 2003 taxable year, 13.6 million California Resident Personal Income Tax returns were filed, of which 2.4 million (17.7%) reported activity from sole proprietorship businesses. Compared with other business entities, sole proprietorships comprise 65 percent of tax returns. Of the 2.4 million sole proprietorships, 1.8 million (75.5%) realized a total net profit of $44.6 billion, or an average profit of $24,556, while nearly 600,000 (24.5%) realized a total net loss of $5.5 billion, or an average loss of $9,310.

Table 40

California: Personal and Business Tax Return Volume, 2003		
Resident Personal Income Tax	13.6 million	
Of which, Sole Proprietorships	*2,407,852*	*17.7%*
Tax Returns from Business Entities:		
Sole proprietorships	2,407,852	65%
C corporations	320,833	9%
S Corporations	268,477	7%
Partnerships	183,544	5%
Limited Liability Companies	134,559	4%
Estates and Trusts	301,567	8%
Tax-Exempt Organizations	84,526	2%
Total	3,701,358	100%
Source: *Franchise Tax Board Annual Report*, 2004.		

Chart 4

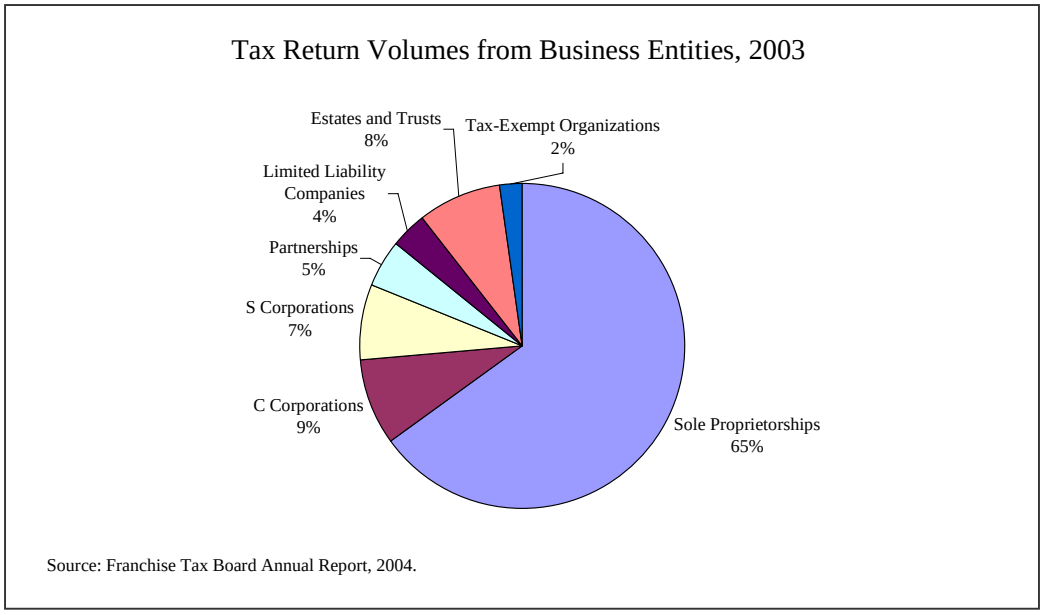


Table 41 shows the 2003 Sole Proprietorships according to major industry type, with service industries italicized. The various service industries comprised about 50 percent of sole proprietorships.

Table 41

California, Sole Proprietorships by Major Industry, 2003 Taxable Year			
Nature of Business Known		2,026,780	84%
	Professional, Scientific & Technical Services	379,257	16%
	Other Services (except public administration)	329,123	14%
	Retail Trade	222,972	9%
	Health Care & Social Assistance Services	185,138	8%
	Real Estate	159,994	7%
	Administrative Support, Waste Management, Remediation Services	148,633	6%
	Construction	144,362	6%
	Arts, Entertainment & Recreation Services	121,689	5%
	Transportation and Public Utilities	95,953	4%
	Finance Investment and Insurance	64,947	3%
	Accommodation & Food Services	43,875	2%
	Wholesale Trade	40,047	2%
	Manufacturing	35,941	1%
	Information	35,860	1%
	Agriculture, Forestry, Fishing and Mining	18,989	1%
Nature of Business Unknown		381,069	16%
Total		2,407,849	100%
Source: Franchise Tax Board Annual Report, 2004, Table B-5. These categories are based on the North American Industry Classification System.			

For each major industry type, percentages of adjusted gross income attributable to sole proprietorships are displayed in Table 42 and Chart 5. For all industries, about 24 percent of adjusted gross income was from sole proprietorships. Industries with the largest percentages were construction (42%); finance, insurance and real estate (36%); and transportation and public utilities (33%).

Tax return volumes and liabilities for sole proprietorships from 1994 to 2003 are shown in Chart 6 and Chart 7. Between 1995 and 2000, the number of returns grew by 16 percent and the tax liability more than doubled. The recession in 2001 resulted in a large drop in both the number of returns (-8%) and the tax liability (-26%). By 2003, the number of returns for sole proprietorships rebounded and surpassed the 2000 level, but the total tax liability was still below the level attained in 1999.

Table 42

Adjusted Gross Income Attributable to Sole Proprietorships, 2003 ($ millions)			
Industry Type	Adjusted Gross Income (AGI)	Sole Proprietorship Income	% AGI from Sole Proprietorship
Agriculture, Forestry, Fishing and Mining	$2,483.9	$27.6	1.1%
Construction	$7,326.9	$3,062.1	41.8%
Manufacturing	$2,172.4	$484.1	22.3%
Services	$87,018.0	$20,304.7	23.3%
Trade	$14,865.1	$2,410.8	16.2%
Finance, Insurance and Real Estate	$23,149.4	$8,233.4	35.6%
Transportation and Public Utilities	$3,325.9	$1,106.8	33.3%
Information	$3,359.9	$307.3	9.1%
Nature of Business Unknown	$18,230.0	$3,193.1	17.5%
Total	$161,931.5	$39,129.9	24.2%
Source: *Franchise Tax Board Annual Report*, 2004, page 49.			

Chart 5

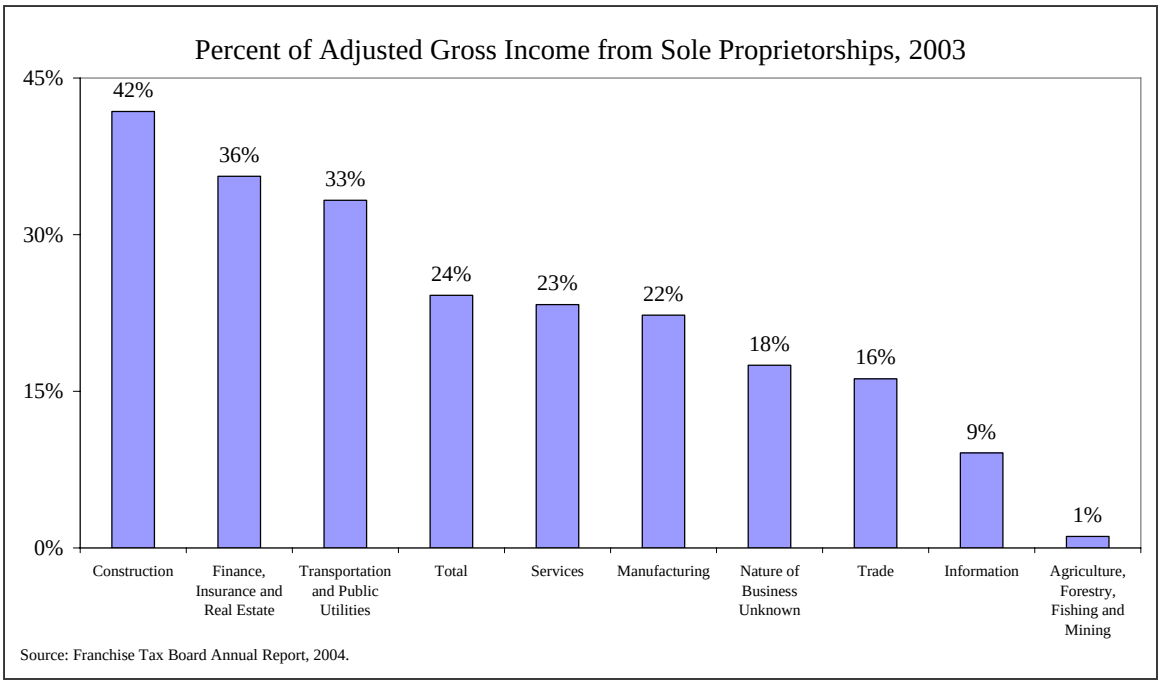


Chart 6

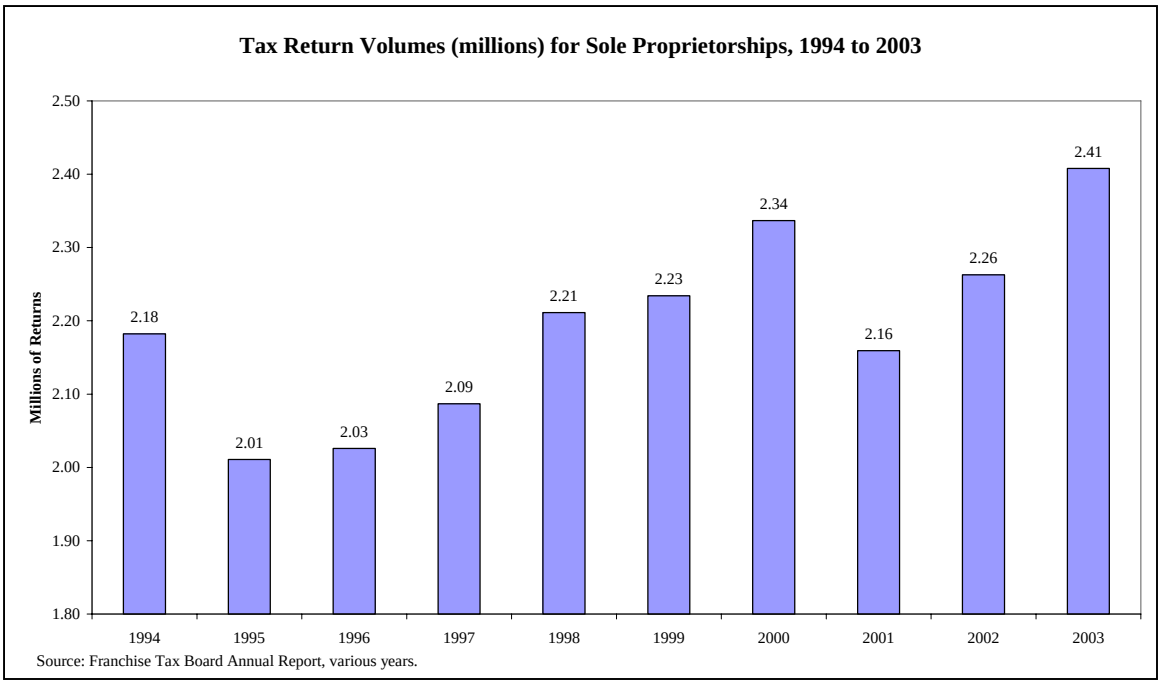
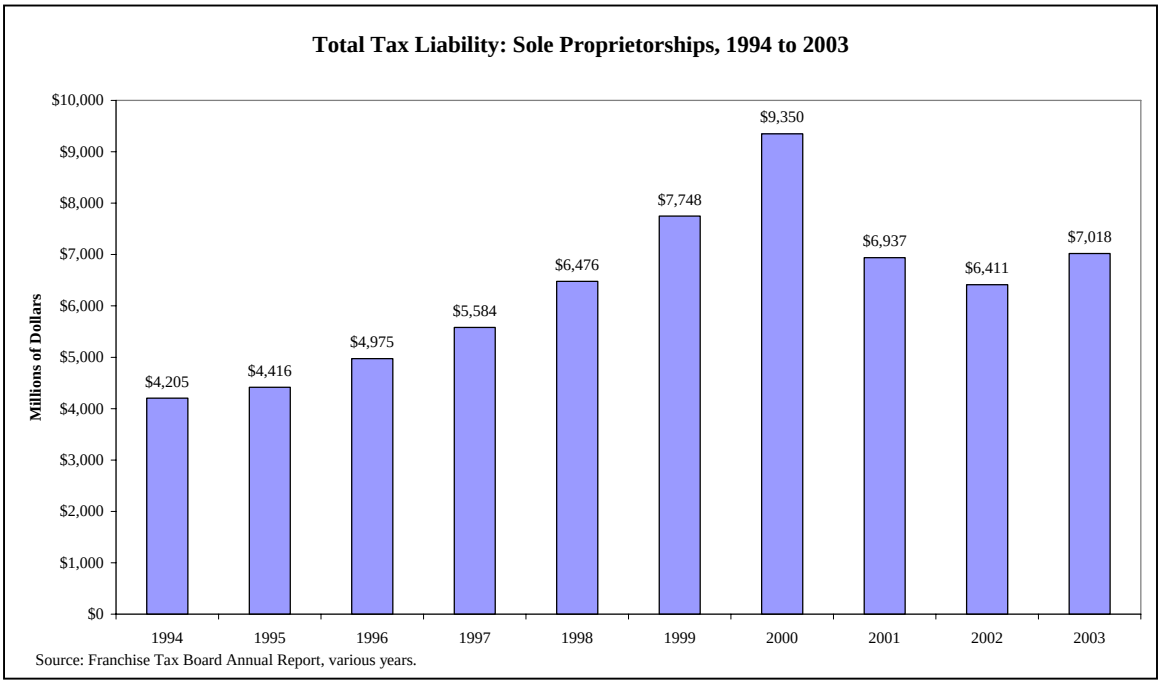


Chart 7



IRS DATA: SOLE PROPRIETORSHIPS AND OTHER BUSINESS RETURNS

A second source of data on business tax returns is the IRS. The advantage of IRS data is that they are available at the county level for business returns and at the zip code level for individual returns (and therefore Schedule C filers). Table 43 shows an example of the kinds of data available from "e-File Demographics" for the nation and for California.

Table 43

Counts of Individual and Business Returns, Tax Year 2003		
Individual Returns by Zip Code	United States	California
Count of Zip Codes	50,435	3,464
EROs with Approved EFIN's	239,545	31,376
Total Active EROs	212,554	29,014
Number of Returns	127,084,129	14,453,950
Total Prepared Returns	76,408,051	9,521,540
Paper	65,594,441	6,927,872
e-file	57,720,082	7,261,537
Average AGI	$47,714	$54,104
Total Number of Refunds	103,258,464	11,338,550
Average Refund	$2,421	$2,692
EITC	21,433,014	2,384,943
Single	55,232,396	6,496,339
Married Joint	50,611,400	5,648,096
Head of Household	18,746,782	2,125,295
Number of Schedule C	18,977,519	2,495,240
Number of Schedule F	1,976,980	66,662
Age <30	28,888,219	3,145,259
Age 30-44	37,124,207	4,521,384
Age 45-60	36,167,395	4,151,820
Age >60	24,681,762	2,601,406
Direct Deposit	49,727,594	4,851,605
Business Returns By County	USA Totals	California
Partnership	2,510,191	290,807
Corporation	2,280,791	304,773
S - Corporation	3,474,943	243,518
Total	8,265,925	839,098

ERO: Electronic Return Originator.
EFIN: Electronic Filing Identification Number.
Schedule C: Profit or Loss from Business.
Schedule F: Profit or Loss from Farming.
AGI: Adjusted Gross Income.
EITC: Earned Income Tax Credit.
Source: e-File Demographics. Publication 3496 (Rev.6-2005)
http://www.irs.gov/taxpros/providers/article/0,,id=141177,00.html.

CENSUS DATA: EMPLOYERS AND NON-EMPLOYERS

A non-employer business is one that has no paid employees, has annual business receipts of $1,000 or more ($1 or more in the construction industries), and is subject to federal income taxes. Non-employers are self-employed persons operating unincorporated businesses, and may or may not be the owner's principal source of income. Because non-employers account for only about 3 percent of business receipts, they are not included in most business statistics and reports from the U.S. Census Bureau's Economic Census or County Business Patterns.[48]

Nearly three quarters of all U.S. business firms had no payroll in 2003 and California's share of non-employers (74%) was about the same as the national average. Table 44 shows the regional distribution. The California county with highest percentage of non-employers was Riverside (79%); the county with lowest percentage, Mono (67%).

Table 44

Number of Employers and Non-Employers, California by Region, 2003

Region	Non-employer	Employer	Total	% Non-employer	% Employer
San Joaquin Valley	151,335	59,103	210,438	72%	28%
Bay Area	487,170	185,948	673,118	72%	28%
Far North	74,389	28,171	102,560	73%	27%
San Diego	201,671	74,903	276,574	73%	27%
Central Coast	95,176	35,346	130,522	73%	27%
Sierras	14,028	5,061	19,089	73%	27%
Sacramento Metro	122,056	43,218	165,274	74%	26%
South Coast	1,025,683	336,514	1,362,197	75%	25%
Inland Empire	209,535	59,073	268,608	78%	22%
Regional Total	2,381,043	827,337	3,208,380	74%	26%
Statewide		135	135	0%	100%
California	2,381,043	827,472	3,208,515	74%	26%

Source: County Business Patterns, 2003 http://censtats.census.gov/cbpnaic/cbpnaic.shtml?
For regional groupings of counties, see Table 14.

Chart 8 shows the number of non-employers from 1997 to 2003, which is increasing steadily over time. This pattern differs from that of California sole proprietors (Chart A.3), which responded more to the business cycle.

[48] The universe of non-employer establishments is created annually in conjunction with identifying the U.S. Census Bureau`s employer business universe. If the Census Bureau receives information through administrative records that a business has no paid employees, then the business becomes part of the potential non-employer universe. Name, address, industry classification, and receipts are available for each potential non-employer establishment. These data are obtained chiefly from the annual business income tax returns filed with the Internal Revenue Service (IRS) and maintained in the Census Bureau's Business Register. http://www.census.gov/epcd/nonemployer/view/covmeth.htm; http://www.census.gov/epcd/nonemployer/view/define.html.

Chart 8

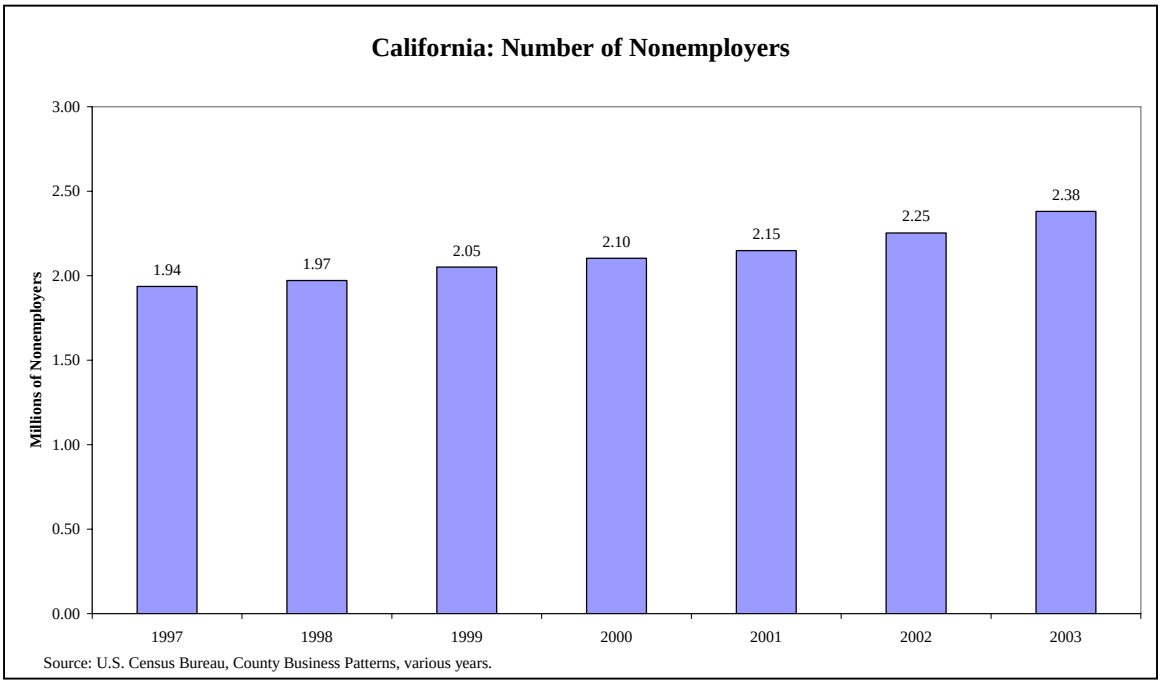


Table 45

Non-Employer Statistics by Industry, 2003, Sorted by the Number of Establishments				
Economic Sector (NAICS code)	Establish-ments	Receipts ($1,000)	Establish-ments	Receipts ($1,000)
Total for all sectors (00)	2,381,043	$123,945,582	100%	100%
Professional, scientific, and technical services (54)	428,688	$19,127,527	18%	15%
Other services (except public admin.) (81)	332,038	$9,785,252	14%	8%
Real estate and rental and leasing (53)	272,070	$27,779,981	11%	22%
Health care and social assistance (62)	220,718	$7,291,738	9%	6%
Retail trade (44-45)	216,945	$11,919,422	9%	10%
Construction (23)	179,774	$11,995,348	8%	10%
Administrative support & waste management & remediation services (56)	173,682	$4,544,871	7%	4%
Arts, entertainment, and recreation (71)	139,063	$4,268,978	6%	3%
Transportation & warehousing (48-49)	94,195	$5,587,202	4%	5%
Finance and insurance (52)	83,870	$7,533,111	4%	6%
Wholesale trade (42)	55,535	$6,071,826	2%	5%
Information (51)	47,686	$1,953,347	2%	2%
Educational services (61)	45,209	$723,111	2%	1%
Manufacturing (31-33)	41,572	$2,525,992	2%	2%
Accommodation and food services (72)	32,285	$1,924,798	1%	2%
Forestry, fishing & hunting, and agricultural support services (11)	12,764	$657,016	1%	1%
Mining (21)	3,819	$203,193	0%	0%
Utilities (22)	1,130	$52,869	0%	0%
Source: United States Census Bureau, County Business Patterns, 2003.				

Tables 45 and 46 show employer and non-employer statistics by industry, sorted by the number of establishments. Between employers and non-employers, the biggest difference is the importance of the real estate industry, which is ranked third among non-employers and tenth among employers.

For 2002, the Census Bureau makes some of these detailed industry data available by county and also by "economic place," which is census terminology for the places for which data are presented in the 2002 Economic Census. Economic places are incorporated places with 2,500 or more inhabitants, and towns and townships of 10,000 or more in selected states.

Table 46

Employer Statistics by Industry, 2003, Sorted by the Number of Establishments

Industry Code Description (NAICS code)	Number of Employees for week including March 12		Annual Payroll ($1,000)		Total Establishments	
Total (00)	12,991,795	100%	$520,597,420	100%	827,472	100%
Retail trade (44-45)	1,592,087	12%	$39,384,726	8%	110,506	13%
Professional, scientific & technical services (54)	1,159,053	9%	$64,354,117	12%	101,121	12%
Health care & social assistance (62)	1,477,149	11%	$56,238,269	11%	90,038	11%
Construction (23)	808,013	6%	$33,304,468	6%	70,333	8%
Other services (except public administration) (81)	572,785	4%	$13,779,544	3%	69,948	8%
Accommodation & food services (72)	1,197,880	9%	$17,466,984	3%	67,732	8%
Wholesale trade (42)	794,340	6%	$40,649,466	8%	59,137	7%
Finance & insurance (52)	673,798	5%	$46,807,107	9%	47,929	6%
Manufacturing (31-33)	1,510,049	12%	$67,751,831	13%	46,919	6%
Real estate & rental & leasing (53)	295,717	2%	$11,290,584	2%	44,027	5%
Administrative support, waste management, remediation services(56)	980,716	8%	$26,647,803	5%	39,874	5%
Information (51)	515,192	4%	$37,767,828	7%	20,624	2%
Transportation & warehousing (48-49)	447,703	3%	$16,877,905	3%	19,184	2%
Arts, entertainment & recreation (71)	276,864	2%	$10,556,673	2%	17,174	2%
Educational services (61)	291,560	2%	$8,758,372	2%	10,015	1%
Management of companies & enterprises (55)	283,673	2%	$22,616,398	4%	4,571	1%
Unclassified establishments (99)	6,309	0%	$139,399	0%	4,014	0%
Forestry, fishing, hunting, and agriculture support (11)	24,724	0%	$729,216	0%	2,303	0%
Utilities (22)	66,035	1%	$4,463,484	1%	1,205	0%
Mining (21)	18,148	0%	$1,013,246	0%	818	0%

Source: United States Census Bureau, County Business Patterns, 2003.

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APPENDIX A: AB 63 (2001, CEDILLO)

BILL NUMBER: AB 63 CHAPTERED
BILL TEXT

CHAPTER 915
FILED WITH SECRETARY OF STATE OCTOBER 14, 2001
APPROVED BY GOVERNOR OCTOBER 14, 2001
PASSED THE ASSEMBLY SEPTEMBER 13, 2001
PASSED THE SENATE AUGUST 30, 2001
AMENDED IN SENATE JUNE 13, 2001

INTRODUCED BY Assembly Member Cedillo

DECEMBER 6, 2000

An act to add and repeal Section 19551.1 of the Revenue and Taxation Code, relating to taxation.

LEGISLATIVE COUNSEL'S DIGEST

AB 63, Cedillo. Taxation: disclosure.

Existing law prohibits the disclosure of any information concerning any taxpayer by the State Board of Equalization, the Franchise Tax Board, and the Director of Employment Development to any person, except as specifically authorized by statute. It permits the disclosure of certain information by the Franchise Tax Board to the Commissioner of Internal Revenue of the United States, other California tax officials, the Multistate Tax Commission, the tax officers of another State, and the tax officials of Mexico, under specified conditions.

This bill would, until December 31, 2008, additionally permit, under specified conditions, the disclosure of tax information to tax officials of any city. The bill would require that the Franchise Tax Board be reimbursed its cost of providing this information to a city, as specified.

This bill would require the California Research Bureau to make a report to the Legislature, by December 31, 2005, regarding the impact and effect of the bill.

This bill would also provide that it will become operative only if this bill and AB 205 are both enacted and become effective on or before January 1, 2002.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. Section 19551.1 is added to the Revenue and Taxation Code, to read:

19551.1. (a) The Franchise Tax Board may permit the tax officials of any city to obtain tax information pursuant to subdivision (a) of Section 19551.

(b) The information furnished to tax officials of a city under this section shall be limited as follows:

(1) When requested pursuant to a written agreement, the taxing authority of a city may be granted tax information only on taxpayers with an address as reflected on the Franchise Tax Board's records within the jurisdictional boundaries of the city who report income from a trade or business to the Franchise Tax Board.

(2) The tax information that may be provided by the Franchise Tax Board to a city is limited to a taxpayer's name, address, social security or taxpayer identification number, and business activity code.

(3) Tax information provided to the taxing authority of a city may not be furnished to, or used by, any person other than an employee of that taxing authority.

(4) Section 19542 applies to this section.

(5) Section 19542.1 applies to this section.

(c) The Franchise Tax Board may not provide any information pursuant to this section until all of the following have occurred:

(1) An agreement has been executed between a city and the Franchise Tax Board, that provides that an amount equal to all first year costs necessary to furnish the city information pursuant to this section shall be received by the Franchise Tax Board before the Franchise Tax Board incurs any costs associated with the activity permitted by this section. For purposes of this section, first year costs include costs associated with, but not limited to, the purchasing of equipment, the development of processes, and labor.

(2) An agreement has been executed between a city and the Franchise Tax Board, that provides that the annual costs incurred by the Franchise Tax Board, as a result of the activity permitted by this section, shall be reimbursed by the city to the board.

(3) Pursuant to the agreement described in paragraph (1), the Franchise Tax Board has received an amount equal to the first year costs.

(d) This section does not invalidate any other law. This section does not preclude any city or, city and county, from obtaining information about individual taxpayers, including those taxpayers exempt from this section, by any other means permitted by State or federal law.

(e) This section shall remain in effect only until December 31, 2008, and as of that date, is repealed.

SEC. 2. The California Research Bureau shall, by December 31, 2005, report to the Legislature regarding the impact and effect of Section 1 of this act.

SEC. 3. This act shall only become operative if this act and Assembly Bill 205 of the 2001-02 Regular Session are both enacted and become effective on or before January 1, 2002.

APPENDIX B: AB 205 (KORETZ, 2001)

BILL NUMBER: AB 205 CHAPTERED
BILL TEXT

CHAPTER 36
FILED WITH SECRETARY OF STATE JULY 5, 2001
APPROVED BY GOVERNOR JULY 4, 2001
PASSED THE ASSEMBLY JUNE 25, 2001
PASSED THE SENATE MAY 30, 2001
AMENDED IN SENATE MAY 22, 2001
AMENDED IN SENATE MAY 7, 2001
AMENDED IN ASSEMBLY APRIL 16, 2001
AMENDED IN ASSEMBLY MARCH 29, 2001

INTRODUCED BY Assembly Members Koretz and Cardenas
(Coauthors: Assembly Members Aroner, Correa, Negrete McLeod, Richman, and Washington)
(Coauthors: Senators Johannessen and Kuehl)

FEBRUARY 9, 2001

An act to add Chapter 4 (commencing with Section 16300) to Part 1 of Division 7 of the Business and Professions Code, relating to business licensing.

LEGISLATIVE COUNSEL'S DIGEST

AB 205, Koretz. Business licenses and fees: employment relationship.

Existing law authorizes cities, including chartered cities, in the exercise of their police power and for the purpose of regulation, to license any kind of business not prohibited by law transacted and carried on within the limits of their jurisdictions, and to fix the rates of the license fee and provide for its collection, according to specified criteria.

This bill would prohibit any city, including a charter city, city and county, or county, from requiring an employee to obtain a business license or home business occupation permit for, or imposing a business tax or registration fee based on income earned for services performed for an employer by the employee in an employment relationship, as specified.

This bill would become operative only if AB 63 is enacted and becomes effective on or before January 1, 2002.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. Chapter 4 (commencing with Section 16300) is added to Part 1 of Division 7 of the Business and Professions Code, to read:

CHAPTER 4. EMPLOYMENT ACTIVITIES

16300. (a) Notwithstanding any other provision of this part, Chapter 1.5 (commencing with Section 7284) of Part 1.7 of Division 2 of the Revenue and Taxation Code, or Chapter 3 (commencing with Section 37100) of Part 2 of Division 3 of Title 4 of the Government Code, no city, including a charter city, city and county, or county may require an employee to obtain a business license or home business occupation permit for, or impose a business tax or registration fee based on income earned for services performed for an employer by the employee in an employment relationship as determined by reference to the common law factors reflected in rulings or guidelines used by either the Internal Revenue Service or the Franchise Tax Board. When there is a dispute between a city, city and county, or county and a taxpayer, the manner in which a taxpayer reports or reported income to the Franchise Tax Board or the Internal Revenue Service shall create a presumption regarding whether the taxpayer performed services for an employer as an employee, or operated a business entity. For purposes of this section, "income" includes income paid currently or deferred and income that is fixed or contingent.

(b) Nothing in this section shall be interpreted to limit the authority of a city, city and county, or county to adopt and enforce zoning, health and safety ordinances, or regulations that define and limit activities that are permissible within its jurisdiction for the purposes of health, safety, welfare, and the provisions of applicable noise ordinances.

APPENDIX C. DISCLOSURE - PENALTIES

Revenue and Taxation Code

19542. Except as otherwise provided in this article and as required to administer subdivision (b) of Section 19005, it is a misdemeanor for the Franchise Tax Board or any member thereof, or any deputy, agent, clerk, or other officer or employee of the State (including its political subdivisions), or any former officer or employee or other individual, who in the course of his or her employment or duty has or had access to returns, reports, or documents required to be filed under this part, to disclose or make known in any manner information as to the amount of income or any particulars (including the business affairs of a corporation) set forth or disclosed therein.

19542.1. (a) Except as otherwise provided by this article, it shall be unlawful for any person described in Section 19542 to willfully inspect any confidential information furnished or secured pursuant to this part, Part 10 (commencing with Section 17001), or Part 11 (commencing with Section 23001). For purposes of this section, "inspection" means any examination of confidential information. Any willful unauthorized inspection or unwarranted disclosure or use of confidential information by the persons described in Section 19542 is a misdemeanor.

(b) The Franchise Tax Board shall notify a taxpayer of any known incidents of willful unauthorized inspection or unwarranted disclosure or use of his or her confidential tax records, but only if criminal charges have been filed for the willful unauthorized inspection or unwarranted disclosure.

19542.3. Any person who willfully divulges or makes known software, as defined in paragraph (1) of subdivision (d) of Section 19504.5, to any person in violation of Section 19504.5 is punishable by imprisonment in the county jail not to exceed one year, or in the State prison not to exceed five years, at the discretion of the court or by fine of not more than five thousand dollars ($5,000), or by both the fines and imprisonment, at the discretion of the court, together with the costs of investigation and prosecution.

APPENDIX D. INDEPENDENT CONTRACTOR OR EMPLOYEE?

IRS Publication 1779

Which are you?

For federal tax purposes, this is an important distinction. Worker classification affects how you pay your federal income tax, social security and Medicare taxes, and how you file your tax return. Classification affects your eligibility for employer and social security and Medicare benefits and your tax responsibilities. If you aren't sure of your work status, you should find out ***now****. This brochure can help you.*

The courts have considered many facts in deciding whether a worker is an **independent contractor** or an **employee**. These relevant facts fall into three main categories: *behavioral control; financial control;* and *relationship of the parties*. In each case, it is very important to consider all the facts—no single fact provides the answer. Carefully review the following definitions.

Behavioral Control

These facts show whether there is a right to direct or control how the worker does the work. A worker is an employee when the business has the right to direct and control the worker. The business does not have to actually direct or control the way the work is done—as long as the employer has the right to direct and control the work. For example:

- **Instructions –** if you receive extensive instructions on how work is to be done, this suggests that you are an employee. Instructions can cover a wide range of topics, for example:
  - how, when, or where to do the work
  - what tools or equipment to use
  - what assistants to hire to help with the work
  - where to purchase supplies and services

If you receive less extensive instructions about what should be done, but not how it should be done, you may be an **independent contractor**. For instance, instructions about time and place may be less important than directions on how the work is performed.

- **Training –** if the business provides you with training about required procedures and methods, this indicates that the business wants the work done in a certain way, and this suggests that you may be an **employee**.

Financial Control

These facts show whether there is a right to direct or control the business part of the work. For example:

- **Significant Investment –** if you have a significant investment in your work, you may be an **independent contractor**. While there is no precise dollar test, the investment must have substance. However, a significant investment is not necessary to be an **independent contractor**.
- **Expenses –** if you are not reimbursed for some or all business expenses, then you may be an **independent contractor**, especially if your unreimbursed business expenses are high.

- **Opportunity for Profit or Loss** – if you can realize a profit or incur a loss, this suggests that you are in business for yourself and that you may be an **independent contractor**.

Relationship of the Parties
These are facts that illustrate how the business and the worker perceive their relationship. For example:

- **Employee Benefits** – if you receive benefits, such as insurance, pension or paid leave, this is an indication that you may be an **employee**. If you do not receive benefits, however, you could be either an **employee** or an **independent contractor**.
- **Written Contracts** – a written contract may show what both you and the business intend. This may be very significant if it is difficult, if not impossible, to determine status based on other facts.

When You Are an Employee

- Your employer must withhold income tax and your portion of social security and Medicare taxes. Also, your employer is responsible for paying social security, Medicare, and unemployment (FUTA) taxes on your wages. Your employer must give you a Form W-2, *Wage and Tax Statement*, showing the amount of taxes withheld from your pay.
- You may deduct unreimbursed employee business expenses on Schedule A of your income tax return, but only if you itemize deductions and they total more than two percent of your adjusted gross income.

When You Are an Independent Contractor

- The business may be required to give you Form 1099-MISC, *Miscellaneous Income*, to report what it has paid to you.
- You are responsible for paying your own income tax and self-employment tax (Self-Employment Contributions Act – SECA). The business does not withhold taxes from your pay. You may need to make estimated tax payments during the year to cover your tax liabilities.
- You may deduct business expenses on Schedule C of your income tax return.

IRS

Department of the Treasury
Internal Revenue Service

www.irs.gov

Publication 1779 (Rev. 1-2005)
Catalog Number 16134L

APPENDIX E: CONFIDENTIALITY STATEMENT

State of California **Franchise Tax Board**

Confidentiality Statement

Confidential tax return information is protected from disclosure by law, regulation, and policy. Information security is strictly enforced. Violators may be subject to disciplinary, civil, and/or criminal action. Protecting confidential tax return information is in the public's interest, the state's interest, and the city's interest.

A city employee is required to protect the following types of information received from the Franchise Tax Board:

- Taxpayer name
- Taxpayer address
- Taxpayer social security number or taxpayer identification number
- Principal business activity code

A city employee is required to protect confidential information by:

- Accessing or modifying information only for the purpose of performing official duties.
- Never accessing or inspecting information for curiosity or personal reasons.
- Never showing or discussing confidential information to or with anyone who does not have the need to know.
- Placing confidential information only in approved locations.
- Never removing confidential information from your work site without authorization.

As a city employee, you are required to know whether information is protected. If you have any question regarding whether particular information is confidential, check with your department's project coordinator.

Unauthorized inspection, access, use, or disclosure of confidential tax return information is a crime under state laws, including but not limited to Sections 19542 and 19552 of the California Revenue and Taxation Code and Section 502 of the Penal Code. Unauthorized access, inspection, use, or disclosure may result in either or both of the following:

- State criminal action
- State and/or taxpayer civil action

You are reminded that these rules are designed to protect everyone's right to privacy, including your own.

I certify that I have read the confidentiality statement printed above. I further certify and understand that unauthorized access, inspection, use, or disclosure of confidential information may be punishable as a crime and may result in disciplinary and/or civil action being taken against me.

Name	
Signature	Date

FTB 712 (NEW 09-2001)

APPENDIX F: EXAMPLE – BUSINESS ASSESSMENT

City of Newport Beach
Revenue Division
PO Box 1768, Newport Beach, CA 92658-8915

REQUEST FOR BUSINESS ASSESSMENT

This entity may not be subject to the City of Newport Beach Business License Tax. If you believe such is the case, please complete this form and return it in the envelope provided. Include a contact name and phone number so we may contact you if we need additional information. You will receive a Notice of Determination by mail following the review of this form indicating the reviewer's decision regarding the business license requirement for this entity. * Please do not include attachments of any sort. *This form must be received by the date articulated on the notice in order to avoid imposition of penalties.*

Name: _____ File No: _____

Telephone: ( ) _____ Email: _____

Please check all that apply to the entity noticed.

- ☐ This entity has filed a return with the Franchise Tax Board (FTB) as a business or trade indicating a Newport Beach address.
- ☐ This entity has registered with the Secretary of State as a Corporation, LLC, LP, indicating the principal address is in Newport Beach. Circle the status of the entity.
  - Active
  - Dissolved; Canceled; Converted Out; Suspended; Forfeited; Surrender; Merged Out; Expired. Indicate date on which this status was obtained. _____.
- ☐ This entity has obtained an Employer Identification Number from the IRS.
- ☐ This entity claims office deductions or business expenses for commercial or residential based businesses for a Newport Beach address.
- ☐ This entity/person has received compensation on a Form 1099 for services rendered in Newport Beach.
- ☐ This entity is operated, managed or controlled from a Newport Beach address.
- ☐ This entity represents to the public by advertisement, business cards, business letterhead, and (or) a business phone number indicating or associated with a Newport Beach address.
- ☐ The Agent for Service of Process is located in Newport Beach.
- ☐ This entity uses an accountant's or an attorney's address indicating Newport Beach.
- ☐ This entity is recognized as a tax-exempt organization. (Attach proof of exemption)
- ☐ This notice was sent to a W2 (salaried) employee. Please complete and return the form D0504-W2 (Employee Certification), available from the City web site www.city.newport-beach.ca.us/revenue
- ☐ This entity was dissolved. Must evidence and attach proof of dissolution.
- ☐ A Newport Beach Business License has already been issued to this legal entity.

  (Note: A Newport Beach business license is unique to the entity)

  License No. BT _____ Expiration: _____
- ☐ This business does not operate in Newport Beach. Please list the complete address where it operates and, where applicable, the license number for the city in which it operates. *This information will be forwarded to the city listed for their review.*

Address	*City*	*State*	*Zip Code*

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct of my own knowledge. I understand any statements made herein will be verified.

_____ Signature _____ Printed Name

OFFICE USE ONLY

Date Received _____ Determination: ___ Upheld ___ Exempt Reviewer _____

Form R0504-ASMT Rev 2004-04

Overview of the Review / Appeal Process

If you feel you received a notice in error, or if you do not believe you or your business is subject to the business license requirement, you may take the following actions:

1. Request for Business Assessment (this form). The Request for Business Assessment provides the opportunity for you to give additional facts about your business conduct which could prove you or your business is not subject to business license requirements in Newport Beach.
   Upon review of your response, you will receive a written Determination, notifying you of the findings.
2. Administrative Hearing. If you are not satisfied with the findings of the Business Assessment review, you can request an Administrative Hearing by completing Form R0504-WSF (Written Statement of Facts). Your facts and documentation will be reviewed and you may be invited to present the facts in person to a Hearing Officer. *In order to request a hearing, you must pay the full license tax and any penalty amounts articulated.* If the Hearing Officer finds in your favor, the City will refund *all* monies paid within two weeks.

Instructions for Completing Form R0504-ASMT

- For each notice you received, complete a separate form. If you list multiple file numbers on the same form, it will be returned, with no extensions of deadline.
- Provide the name, telephone number and/or email address of the person who can be reached should clarification be required.
- Check each box that applies to your business. This is critical in determining whether a license is required or not.
- Be sure to attach any supporting documents, as requested, depending on what box you checked.
- Sign and print your name.

AB 63 / Franchise Tax Board Frequently Asked Questions (FAQs)

Q: Why did I receive a FTB notification?
A: Our records show that you are reporting some type of business activity to the FTB using a Newport Beach address. This indicates you may be operating a business in the City that has not yet obtained a Business License Tax certificate.

Q: I do some minor consulting on a part-time basis. Do I have to get a Business License?
A: Yes, businesses both large and small are required to obtain a Business License Tax Certificate to be in compliance with the Municipal Code. If the consulting work is performed as an independent contractor and attributable to a location within the City limits, such as your residence, a tax liability exists.

Q: My business entity (Corporation, LLC, Partnership, etc) is entirely passive and/or dormant and it is just paying a minimum tax to the Secretary of State. Is it required to get a license?
A: Probably. If your business entity represents business conduct to the public at large (such as through letterhead, the receipt of rent checks, etc) in addition to being registered as active with the Secretary of State and reporting on a business return with the FTB and IRS, it will need a license.

Q: I am not doing "business." What does the City of Newport Beach consider to be a business and why do they think I am operating one?
A: Most activities conducted within the City with continuing and regular activity are considered engaging in business and subject to business tax. Specifically, City Municipal Code defines business as: ""Business" shall mean arts, professions, trades and occupations in all and every kind of calling, whether or not carried on for profit. (Municipal Code §5.04.10)

State law (Business and Professions Code §16300) requires cities to use the way a taxpayer reported income to the IRS and Franchise Tax Board to determine whether the taxpayer performed services as an employee or as a separate business entity. A person who is an employee and whose only compensation is reported on a Federal W-2 is not in business and is not subject to the business tax.

Q: Why hasn't anyone told me about this requirement before?
A: The City is diligent in notifying those who require a license. However, due to limited resources, the Revenue Division is unable to identify and notify all persons requiring a license at the same time. Please note, however that the requirement to obtain a license exists, notwithstanding notification, or any lack thereof.

Q: I live in Newport Beach, but my business is located outside the city limits. What are my liabilities for the City of Newport Beach?
A: As long as all business activity is conducted outside the City of Newport Beach, there is no need to obtain a City of Newport Beach Business License.

APPENDIX G. LEGISLATIVE HISTORY DETAIL

AB 63 and the Bills Leading Up to It (1997 – 2000)		
Bill	Intent of bill	Outcome
AB 701 (1997, Caldera)	Permits FTB to provide the taxing authority of a charter city with tax information on taxpayers located within that city.	Vetoed by Governor
AB 2065 (1998, Carde-nas)	In the original version, this bill would have prevented cities from taxing persons working at home provided certain specified conditions do not occur. Prevent cities (including a city and county) from levying business license taxes and fees, and from imposing various other regulatory requirements, on writers, musicians, directors and creative artists who work at home. This prohibition would not apply in cases where the individual: • Has more than one employee in the home. • Has more than two business-related deliveries at home per day. • Has more than one client visit at home per day. • Advertises to the public at large.	Held in the Senate Committee on Revenue and Taxation without a vote
AB 385 (1999, Knox)	Similar to AB 701 (Caldera, 1997), however, AB 385 prohibits the FTB from sending information to cities for taxpayers who are creative artists,[49] unless the taxpayer is notified that the information will be released and the taxpayer fails to certify to the FTB within 90 days that he or she is a writer, musician, director or other creative artist.	Approved by Assembly but failed passage in Senate Rev. and Tax. Committee
SB 1030 (1999, Polanco)	Re-establishes the City Business Tax Reporting Program in the Department of Industrial Relations.	Vetoed by Governor
AB 83 (2000, Carde-nas)	As introduced, this bill would have prohibited a city or county from requiring business licenses or permits imposing taxes on specified income earned from work performed in the home (as reported on an IRS Form 1099-MISC) unless that person has: a) filed a fictitious business name statement; or b) regularly solicits business at the person's home by advertisement. As chaptered, this bill prohibits a city or county from requiring business licenses/permits imposing taxes on income earned from work performed in the home. Specified income includes income earned for services performed for an employer by an employee.	Chapter 1070, Statutes of 2000 Not Enacted
AB 1992 (2000, Cedillo)	Authorizes the FTB to provide tax information to a city subject to a written agreement between the city and the FTB. Only city employees may use this information. The bill also authorizes the FTB to impose fees to recover its start-up and ongoing costs from cities. The bill references penalties for unlawful disclosure of tax information. (AB 1992 was contingent upon enactment of AB 83.)	Died on the last night of 99-00 session; Assembly failed to concur on Senate Amendments

[49] Creative artists include taxpayers who identified their federal principal business or professional activity code for federal income tax reporting purposes as either 711510 (encompassing independent writers, artists, and performers), or any successor code encompassing the same categories.

Concerns Raised in Bills Leading up to AB 63

One set of concerns related to proposed exemptions for home-based businesses (or, for home-based creative artists only).[50] The following examples from bill analyses in the late 1990s, show arguments in support of an exemption:

- Artists, writers, musicians, actors and others argue that they traditionally work as the labor pool for the entertainment, publishing and music industries. Persons engaged in such work mostly receive income as independent contractors and do not operate businesses. Workers so employed do not advertise and create little foot or vehicular traffic. In many instances, such individuals work under collective bargaining agreements regulated under federal law. These workers place no burden on city services and thus should not be burdened by local taxes.
- Supporters are concerned with the trend among some cities to impose new taxes on home-based businesses because they think these taxes will have a chilling effect on the activities of various creative artists and professionals.
- These taxes, fees and regulatory requirements on home-based creative activities violate First Amendment rights of the people involved by requiring individuals to obtain permits and licenses before they engage in expressive activities.
- Supporters pointed to the exemption for café musicians as precedent for this bill. Since café musicians were not operating a business "in the common meaning of the word," the Legislature exempted all such café musicians from municipal taxation and therefore such exemption should apply to writers and other creative artists.

Examples of arguments in opposition of exempting home-based businesses:

- Local land use decision makers need to control and regulate home-based businesses. The League of CA Cities asserts that in some areas, up to one-third of businesses are home-based enterprises. These entities have a tremendous impact on the community and the vitality of cities in which they are located. Vehicular traffic does increase, there's a demand for city services, and an increased demand for refuse services. To have this particular segment of business exempted from local regulation and fees would have a devastating impact on city revenues, neighborhood quality of life and local control.
- Tax equity issues: As originally drafted, this bill affected all home-based workers. After the bill was narrowed to a small group of business activities (certain creative artists), three tax-equity issues arise that "seem to strain the equity principle of sound tax policy."[51]
    - #1: Why should certain classes of workers be subject to tax while others aren't? Writers vs. software designers? Creative artists vs. business consultants?
    - #2: Why should a home-based activity be treated differently than the same activity conducted in an office or other commercial location?

[50] Bill Analysis AB 2065, Martin Helmke, July 22, 1998, Senate Revenue and Taxation Committee; Bill Analysis AB 83, Hubert Bower, 5-12-99, Assembly Committee on Local Government.
[51] Bill Analysis AB 2065, Martin Helmke, July 22, 1998.

    - #3: The bill only applies to municipal taxes and fees, not those levied in unincorporated areas. Why should the same activity be taxed differently depending on location?
- Is it appropriate for the Legislature to reduce local revenue-gathering authority? Should the local legislative or initiative process address the concerns of home businesses that have a small or minor impact on local infrastructure or services?
- As the economy evolves with technology and other unpredictable factors, we may reach a point where more people work at home than in a traditional office environment. Exempting certain local taxpayers would limit another source of revenues to local governments without any provision for compensation. Local governments have had increasing difficulties raising revenues to pay for local services because of measures such as Proposition 13, the Educational Revenue Augmentation Fund (ERAF), Proposition 218, and reductions in Vehicle License Fees. Governments have legitimate and important government interests in permitting and licensing business, including public safety concerns. By requiring permits and licenses, a city can maintain a record of what commercial activity is being conducted in relation to where people live.
- Given that the IRS treats independent contractors as businesses by requiring such individuals to pay quarterly estimated tax, should such individuals be treated differently by local entities?
- Would the enactment of this bill set a troubling precedent that may ultimately be detrimental to local government? Wouldn't other types of home businesses also want this exception? Isn't the reason for the exemption of creative artists really that they simply don't want to be taxed?

A second set of concerns related to State-local tax data sharing and privacy. "Income tax returns are held on a strictly confidential basis by the FTB, since the success of our tax system relies on a delicate cooperation between the taxpayer and the tax agency, and any perceived breach of confidentiality could diminish income taxpayers' enthusiasm for providing full and accurate information to the State. At a deeper level, there is the question of just how effective citizens want tax authorities to be. We want our tax collectors to be efficient, but do we want them to be all-efficient and omnipresent? Close administrative linkages among States, with the IRS, and with other countries have troubled some people. To open a direct link to State tax returns for the benefit of hundreds of municipal tax officials may be seen as an erosion of the right to privacy."[52]

A third set of concerns were administrative and concerned the fact that, for sole proprietors, the address provided by FTB to the city was to be the filing address and not the business address.

[52] Bill Analysis for AB 385, Martin Helmke, June 2, 1999 Senate Revenue and Taxation Committee.

APPENDIX H: CITY BUSINESS LICENSING PROGRAM (1984-1999)

Source: California Administrative Code Supplement, Register 87, No. 11 (March 14, 1987), Office of Administrative Law

§ 19286.8 Title 18
(p. 1500.150) (Register 87, No. 14 4-4-87)

Personal Income Tax

19286.8. City Business Tax Information.

(a) Definitions. The following definitions apply for purposes of this section:

(1) Business tax. An amount imposed by a city as either a condition to, or in connection with transacting business in the city. The amount may be flat, or may be measured by gross receipts, gross income, number of employees or any other similar basis. A business tax does not include fees or charges for services furnished by the city, such as police, fire, sewers, building inspection, sanitation, etc.

(2) Federal Employer Identification Number (FEIN). The identifying number assigned by the Internal Revenue Service.

(3) State Employer Identification Number (SEIN). The identifying number assigned by the Employment Development Department of the State of California.

(4) Board of Equalization Sales Tax Account Number (BEAN). The identifying number assigned by the Board of Equalization of the State of California.

(5) State Contractors' License Number. The identifying number assigned by the State Contractors' License Board of the State of California.

(6) City Business Classification Code. The identifying code assigned by a city to each licensed business for classification purposes.

(7) Standard Industrial Classification (SIC) Code. A standardized structural coding for identifying industries as developed by Internal Revenue Service, Office of Information and Regulatory Affairs in the Office of Management and Budget.

(b) Information Reporting Requirements. This regulation applies only to cities which maintain or have access to a computerized recordkeeping or information system with respect to business taxes. Information described in this section is required to be furnished by Section 19286.8 of the Revenue and Taxation Code and must be used exclusively for State tax enforcement purposes. Information furnished does not become a public record and shall not be open to the public for inspection.

(c) The information required to be reported includes the following:

(1) Name of the business subject to the tax.

(2) Mailing address of the business and street address if different from mailing address.

(3) Owner(s) name.

(4) Owner(s) address.

(5) Federal employer identification number (FEIN), if the business is a partnership or corporation, or owner's name and social security number for all others. State employer

identification number (SEIN) may be used in lieu of the federal number (FEIN) if the federal identification number is not known.

(6) Ownership type, e.g., sole proprietorship, corporation or partnership.

(7) Amount of annual business tax and, if applicable and available, amount of gross receipts.

(8) Basis for tax determination, e.g., gross receipts or flat rate.

(9) Frequency of payment of business taxes or renewal of right to do business.

(10) Date business commenced, if during current reporting period.

(11) Date business ceased or ownership changed, if during current reporting period.

(12) Type of business activity. City business classification code or Standard Industrial Classification (SIC) Code.

(d) The following information is also to be furnished if available:

(1) State sales tax number (BEAN).

(2) State contractor's license number.

(e) The business tax information will be reported to the Franchise Tax Board on an annual basis in the form, manner and time established by the Franchise Tax Board.

NOTE: Authority cited: Section 19253, Revenue and Taxation Code. Reference: Section 19286.8, Revenue and Taxation Code.

HISTORY:

1. New Section filed 9-9-85 as an emergency; effective upon filing (Register 85, No. 37). A Certificate of Compliance must be transmitted to OAL within 120 days or emergency language will be repealed on 1-7-86.
2. Repealed by operation of Government Code Section 11346.1 (g) (Register 87, No. 2).
3. New section filed 4-2-87 as an emergency; effective upon filing (Register 87, No. 14). A Certificate of Compliance must be transmitted to OAL within 120 days or emergency language will be repealed on 7-31-87.

APPENDIX I: BUSINESS LICENSE TAX DATA, KOSMONT SURVEY

Data from the *2004 Kosmont-Rose Institute Survey* were used to analyze business license tax structure for California cities. The Kosmont-Rose and CMRTA data sources (see Tables 11 and 12) were not always consistent in their categorization of taxes levied for the same city. Of the 193 cities with a business license tax that were surveyed by Kosmont-Rose, 122 cities (63 percent) taxed some businesses using a gross receipts tax, 114 cities (59 percent) had a flat rate tax and 88 cities (46 percent) taxed the number of employees. The percentages for the gross receipt and flat taxes are about the same as the CMRTA sample (see Table 11), but the percentage taxing the number of employees is higher in the Kosmont data (46 percent) than in the CMRTA data (26 percent).

Table I.1

Number of Different Business License Taxes (BLT) 193 California Cities with BLT Surveyed by Kosmont-Rose, by AB 63 Participation			
Business License Tax Structure	Taxes Imposed by 82 Participant Cities	Taxes Imposed by 111 Non-Participant Cities	Taxes Imposed by 193 Surveyed Cities that Impose a BLT
# Employees	35 (43%)	53 (48%)	88 (46%)
Flat Rate/Other	45 (55%)	69 (62%)	114 (59%)
Gross Receipts	57 (70%)	65 (59%)	122 (63%)
Payroll Tax	5 (6%)	1 (1%)	6 (3%)
Source: Kosmont-Rose Institute, *Cost of Doing Business Survey*, 2004.			

Table I.2

BLT Structure of Cities Surveyed by Kosmont-Rose, by AB 63 Participation						
Business License Tax Structure	AB 63 Participant Cities		Non-Participant Cities		Total	
	#	%	#	%	#	%
# Employees (primarily)	4	5%	10	9%	14	7%
Flat Rate/Other (primarily)	3	4%	14	13%	17	9%
Gross Receipts (primarily)	25	30%	27	24%	52	27%
Payroll (primarily)	1	1%	0	0%	1	1%
One Tax (subtotal)	33	40%	51	46%	84	44%
Two Taxes	38	46%	43	39%	81	42%
Three Taxes	11	13%	17	15%	28	15%
Surveyed Cities with Taxes	82	100%	111	100%	193	100%
No Taxes or Fees[53]	2		7		9	
Cities not in Survey	50		226		276	
Total Cities	134		344		478	
Source: Kosmont-Rose Institute, *Cost of Doing Business Survey*, 2004.						

[53] Cities with no business license taxes or fees (among cities surveyed) – Aliso Viejo, Calabasas, Diamond Bar, Encinitas, Industry, Mission Viejo, Palo Alto, Rancho Santa Margarita, Westlake Village.

Table I.2 shows that only about 44 percent of cities in the *Survey* had primarily one tax (compared with 68 percent in the CMRTA sample, see Table 12). In both samples, "gross receipts only" was the most frequently used tax for cities with one tax. A higher percentage of AB 63 participants primarily taxed gross receipts only compared with non-participants and a lower percentage had a flat tax only.

Comparing Business License Tax Rates Across Cities

Details on business license taxes in 177 California cities are available from the *1998 Kosmont Survey*. These are of interest because the analysis included a comparison of business license tax rates. In 1998, 90 percent of surveyed communities in Southern California and 95 percent in Northern California had some sort of business license tax. Slightly more than half of these cities primarily taxed businesses on the basis of gross receipts. In 1998, *Kosmont* found that business license tax rates in Central and Northern California as a whole were substantially more costly than in Southern California.

Table I.3

Tax Profile of California Communities and Counties, 1998		
	Southern CA	Central and Northern CA
Number of communities surveyed	118	51
Counties (unincorporated area)	6	2
Total	124	53
% of communities/counties with:		
Some sort of business tax	90%	95%
Transient occupancy tax	94%	100%
Utility tax	42%	49%
Parking tax	4%	6%
Type of business taxes		
Gross Receipts	52%	54%
Employee-based	29%	29%
Flat tax/other method	18%	15%
Payroll	0.2%	2%
Source: Kosmont *Cost of Doing Business Survey*, 1998.		

Table I.4

Median Business Tax Rates as a Percentage of Gross Receipts (on the first $10 million in gross receipts), 1998		
Primary Tax Categories	Southern CA	Central and Northern CA
General Office	0.014%	0.022%
Professional	0.025%	0.036%
Retail	0.016%	0.024%
Wholesale	0.012%	0.016%
Manufacturing	0.014%	0.012%
Personal Service	0.018%	0.020%
highest median rates	City of Los Angeles	San Francisco & San Mateo Peninsula
lowest median rates	City of Orange	Silicon Valley
Source: Kosmont *Cost of Doing Business Survey*, 1998.		

APPENDIX J: SURVEY TO PARTICIPATING CITIES

PART A GENERAL INFORMATION ON YOUR CITY'S BUSINESS LICENSE TAX AND ITS PARTICIPATION IN THE AB 63 PROGRAM

Please complete for all years:

Table A.1 General Information on Businesses in your City					
	2000	2001	2002	2003	2004
Total amount ($) of business license tax collected					
Number of businesses known to your city					
Number of business licenses					
Number of sellers' permits					
Nature of Tax Filers:					
Sole Proprietorship					
Partnership					
Corporation					
Other Business					
Distribution of Tax Burden by the Amount of Business License Tax (BLT) paid to your City					
Number of businesses paying less than $500 in BLT to your city					
Number of businesses paying more than $500 & less than $1,000 in BLT					
Number of businesses paying more than $1,000 & less than $75,000 in BLT					
Number of businesses paying more than $75,000 & less than $150,000 in BLT					
Number of businesses paying more than $150,000 in BLT					

Table A.2 How does your city calculate business tax liability?		
	yes	no
Gross Receipts		
Number of Employees		
Square footage of business		
Other. Please specify:		

Table A.3 Your City's Participation in the AB 63 Local Government Sharing Program						
	2001		2003		2004	
	yes	no	yes	no	yes	no
Did your city obtain AB 63 data from the FTB?						
Did your city actually use these data as a tool to identify potentially unlicensed businesses?						

Table A.4 Revenue Collected from New Licenses			
Total amount of business license tax revenue collected from new licenses. Please include the cumulative revenue across years of businesses identified through the use of AB 63 data. (So the 2004 total might include revenue from businesses discovered in 2001 and 2003, for example). These revenues include license fees and penalties.			
2001	2002	2003	2004

Please complete for the years your city participated in the AB 63 program.

Table A.5 AB 63 Data Leads and Contacts in your City			
	2001	2003	2004
Number of identified leads from FTB data			
Number of identified leads from FTB data that were not subject to business license tax			
Total number of notices sent (= number of businesses contacted due to leads from FTB AB 63 data)			
Number of ***new*** licenses resulting from leads (= number of businesses contacted that were determined to be subject to the city's business license tax and were not previously licensed)			
Number contacted that were already licensed			
Number contacted that were exempt			
Number contacted that were not exempt but were not pursued further for any reason			
Number contacted that were returned by the Post Office as undeliverable			
Number contacted that are still pending			
Number of phone responses to notices (if tracked)			
How much staff time was spent on AB 63 data processing and follow-up? If possible, provide a cost estimate in $.			

Please complete for the years that your city participated in the AB 63 program

Table A.6 Questions on FTB Safeguard Review and Your City's Program Implementation							
	2001			2003		2004	
	YES	NO		YES	NO	YES	NO
Did you send all AB 63-based notices in each year at one time?							
Did you send notices to all potentially unlicensed businesses?							
If you sent notices to a subset of potentially unlicensed businesses, did you target those taxpayers whose names include terms indicating business conduct such as "corporations," "LLCs" and "partnerships"?							
If you sent notices to a subset of potentially unlicensed businesses, did you target Schedule C filers, "sole proprietorships"?							
Did you use FTB data in conjunction with an amnesty program for previously unlicensed businesses?							
Did you charge penalties to previously unlicensed businesses?							
Did you notify your City Council and other city officials before sending out the AB 63-based notices?							
Did you follow up with second notices or other enforcement tools to those who did not respond to improve compliance?							

Table A.7 Taxpayer Response Among Home-Based Businesses Contacted by AB 63 leads. Did the following statements seem to be true for the *majority* of these taxpayers:		
	yes	no
Contacted taxpayers had not been aware that they had a city business tax liability. Once they understood their liability, they paid the tax without protest.		
Contacted taxpayers were angry that they were being assessed the tax.		
Contacted taxpayers were angry that they were being assessed the tax, plus penalty and interest.		
Contacted taxpayers thought that sharing of tax information between State and local tax officials was standard practice.		
Other taxpayer reactions. Please specify:		

PART B. OTHER QUESTIONS CONCERNING THE AB 63 PROGRAM.

B.1 Has the ability of the Franchise Tax Board to share tax information with your city had an impact on voluntary compliance with your business tax laws? Yes or No? If yes, please explain.

B.2 If you used follow-up measures after notices were sent to taxpayers, what kind of follow up? (For example, second notices, phone calls, etc.)

B.3 Have you changed the exemptions to your business license tax due to the AB 63 program? Yes or No? If yes, please explain.

B.4 If your city obtained AB 63 data in one year, but then chose not to obtain the data the following year, why did you choose not to participate?

B.5 If your city obtained AB 63 data in one year, but then did not use those data, please explain.

B.6 Under your contract with the FTB, only city employees can use AB 63 data. Is this a problem for your city? If so, please identify the problem(s) and explain.

B.7 Under your contract with the FTB, AB 63 data can be maintained by your city for one year. Is this time constraint a problem for your city?

PART C. THE VALUE OF AB 63 SOURCE DATA TO YOUR CITY

In terms of net revenue benefits, how do AB 63 source data compare to other tools used by your city to identify unlicensed businesses? Please use a scale of 1 (the most valuable) to 5 (not useful) and place an "X" in the appropriate box.

Compared to other tools used to identify unlicensed businesses, AB 63 source data are:				
1. (The most valuable tool by a large margin)	2. (Very valuable, but other tools are just as valuable)	3. (Useful)	4. (We obtained the AB 63 data but didn't use them.)	5. (Not useful. We paid for the AB 63 data and used them, but did not find many unlicensed businesses due to AB 63 leads.)

Overall, how important is this program to your city?

Future plans: Does your city plan to obtain AB 63 data from the Franchise Tax Board:

	yes	no
Obtain 2005 AB 63 data		
Obtain AB 63 data in subsequent years		

Do you have any other comments about the AB 63 program? This might include comments on:

- The way the law was written,
- The way the Franchise Tax Board (FTB) is administering the AB 63 program,
- The FTB safeguard review process,
- The way cities are handling FTB data,
- The way cities are implementing the program with local taxpayers.

PART D: CHARACTERISTICS OF BUSINESSES

PART D.1 Please complete for the years your city participated in the AB 63 program				
Year	Number of Businesses by Type as Provided in AB 63 Data:	All businesses subject to BLT*	Number of AB 63-based notices sent out	Number of new licenses (due to AB 63 data leads)
2001	Home-based			
2001	Commercially-located			
2001	P.O. Boxes			
2001	Total			
2003	Home-based			
2003	Commercially-located			
2003	P.O. Boxes			
2003	Total			
2004	Home-based			
2004	Commercially-located			
2004	P.O. Boxes			
2004	Total			

*BLT = Business License Tax

PART D.2 Please complete for the years your city participated in the AB 63 program. *Note: if your data system does not use NAICS codes but does use PBA codes or another classification scheme, please provide this type of breakdown by the sectors that you use.*					
Year	NAICS code	Number of Businesses by Economic Sector:	All businesses subject to BLT	AB 63-based notices sent out	Newly-licensed businesses (due to AB 63 data leads)
2001	42	Wholesale Trade			
2001	44-45	Retail Trade			
2001	51	Information			
2001	53	Real Estate			
2001	54	Professional, Scientific & Technical Services			
2001	56	Administrative Support, Waste Management, Remediation Services			
2001	61	Educational Services			
2001	62	Health Care & Social Assistance			
2001	71	Arts, Entertainment & Recreation			
2001	72	Accommodation & food services			
2001	81	Other services (except public administration)			

PART D.2 (Continued)					
Year	NAICS code	Number of Businesses by Economic Sector:	All businesses subject to BLT	AB 63-based notices sent out	Newly-licensed businesses (due to AB 63 data leads)
2003	42	Wholesale Trade			
2003	44-45	Retail Trade			
2003	51	Information			
2003	53	Real Estate			
2003	54	Professional, Scientific & Technical Services			
2003	56	Administrative Support, Waste Management, Remediation Services			
2003	61	Educational Services			
2003	62	Health Care & Social Assistance			
2003	71	Arts, Entertainment & Recreation			
2003	72	Accommodation & food services			
2003	81	Other services (except public administration)			
2004	42	Wholesale Trade			
2004	44-45	Retail Trade			
2004	51	Information			
2004	53	Real Estate			
2004	54	Professional, Scientific & Technical Services			
2004	56	Administrative Support, Waste Management, Remediation Services			
2004	61	Educational Services			
2004	62	Health Care & Social Assistance			
2004	71	Arts, Entertainment & Recreation			
2004	72	Accommodation & food services			
2004	81	Other services (except public administration)			

Please provide contact information for the person filling out this survey:
Name:
Position:
Phone number:
E-mail:

Please return this survey to Martha Jones, mjones@library.ca.gov (916) 653-6742, by **February 1, 2006**. Brian Cote, a student assistant at the Research Bureau, will be helping me compile the results of this survey. He can be reached at (916) 653-7843, bcote@library.ca.gov . Thank you very much for your assistance with this survey.

The California Research Bureau (CRB) provides information and non-partisan research to the Legislature and the Governor's Office. Examples of reports done by CRB are online at: http://www.library.ca.gov/html/statseg2a.cfm.

AB 63 is available online at:
http://www.leginfo.ca.gov/pub/01-02/bill/asm/ab_0051-0100/ab_63_bill_20011014_chaptered.pdf.

APPENDIX K: SURVEY RESPONSES – PARTS B AND C

This appendix gives selected responses for questions in Parts B and C of the detailed survey sent to participating cities. The responses are "selected" because answers of simply "yes" or "no" are not included in this listing.

B.1 Has the ability of the Franchise Tax Board to share tax information with your city had an impact on voluntary compliance with your business tax laws? Yes or No? If yes, please explain.

Yes	8
No	13
Don't Know	4

Selected Responses
No, most of the data were for home-based sole proprietors. These are exempt in our city municipal code.
Nothing noticeable. It is too early to tell.
To early to tell & we only reviewed and sent letters to a small portion of the total list.
We are unable to measure the effect of sharing tax information on voluntary compliance.
Yes, partly by word of mouth to other non-licensed businesses.
Yes. Reduction in unlicensed businesses. For 2003 there were more LLC's and less other type businesses.
Yes. Tax preparers and tax consultants are advising their clients as to City business licensing requirements and advising them to voluntarily comply in order to avoid penalties.
Yes. The AB 63 program is high profile and has raised the awareness level of small businesses, home based businesses and independent contractors who conduct business in our city. This is evidenced by the increased number of taxpayers appearing at the various public counters requesting information for the registration of their business activities. Voluntary compliance has increased due to increased awareness of business tax. For example, accountants and tax preparers will inform clients of business tax.
Yes. Although we can't quantify the increase in voluntary compliance, anecdotally, our customer service has noticed an increase in unsolicited new applications and our new business license revenue has dramatically increased.
Yes. Brought a greater awareness of the licensing and tax requirements in our jurisdiction.
Yes. Less unlicensed businesses.
Yes. Once a business knows it is required, they generally comply.

B.2 If you used follow-up measures after notices were sent to taxpayers, what kind of follow up? (For example, second notices, phone calls, etc.)

Yes	21
No	1
Don't Know	0

Selected Responses
1st notice, 2nd notice, 3rd/Final notice/telephone
2nd notice, 3rd notices (certified mail); Code enforcement follow up
2nd Notices
2nd notices and phone calls if possible
2nd/3rd notices.
Computer generated follow-up at specific intervals including written and phone.
Each potential unregistered business was sent up to three letters depending on their response or lack thereof. The three letters were a "Notification Letter", "Final Notice Letter" and "Assessment Letter". Responses that were not conclusive were followed up with telephone calls for clarification of their status related to a possible business tax liability.
Final notices, phone calls, field visits and issuance of Notice of Violations and Citations.
None
Our process included issuing a 'Final' delinquent notice and if no response received, we would then proceed with our lien or collection process.
Second and third notices and phone calls if number listed.
Second Notices
Second Notices
Second Notices
Second Notices
Second notices are planned.
Second notices only. No further pursuit.
Second notices, phone calls, filed collections, small claims filings, write-off to collection agency
Second notices; notices of violation
Up to three additional notices were sent to non-responsive taxpayers.
We send follow-up notices several times, then bill them for the time they were in business. Commercial/Industrial businesses that remain unlicensed are cited by Code Enforcement if they do not obtain the business license.
Yes. The City sends second notices and mails Administrative Citations, when warranted, for non-compliance.

B.3 Have you changed the exemptions to your business license tax due to the AB 63 program? Yes or No? If yes, please explain.

Yes	4
No	22
Don't Know	0

Selected Responses
No, although we have gotten a better understanding of how some of the companies operate (holding companies, property ownership companies, etc.).
No, have always exempted most home-based businesses
Yes, in the process of changing.
Yes, the City Council adopted a small business exemption which exempts from the minimum business tax businesses physically located in the City whose world-wide gross receipts do not exceed a certain threshold.
Yes. We have initiated a small business exemption. Any business that has gross receipts of less than $2,500 may apply for this exemption.

B.4 If your city obtained AB 63 data in one year, but then chose not to obtain the data the following year, why did you choose not to participate?

Selected Responses
Data from 1st year could not easily be extracted and compared to business license data
FTB sent notice to wrong person and notice was lost in our office
Our budget did not allow for the upfront cost of the project.
The subsequent data request was not sent to the appropriate individual by FTB.
Data were not utilized.
Our city participated to obtain 2004 tax data, but unfortunately we were unable to utilize the data due to staff shortage. Once we become fully staffed we will probably continue to participate in the program.
The data received did not include the business name and location of the business. Further, negotiations to purchase the file fell through. The contract was sent to an employee who had already left the office, and hence, was never signed. Since FTB did not receive a timely response, FTB assumed that our city was not interested.
Costs too much money. It looks like we spent $1,500 on AB 63 (not including staff time and postage) and we only brought in $1,120.
Program ensured future compliance; issue with home-based notices (individual returns); unable to share data with consultant (vendor)
It was difficult to compare the data to our database because the data had not been normalized and scrubbed to meet our data standards so the exceptions were too great to warrant staff time to resolve.
We missed the cut off deadline for submitting the signed contract.
Staff not in place to follow program.
Data not cost effective. We have a full-staffed BLT division that has worked hard in the past to bring everyone into compliance. No need for the AB 63 program.

B.5 If your city obtained AB 63 data in one year, but then did not use those data, please explain.

	Number of Cities
Lack of Staff Resources	26
Technical Problem: File too difficult to manipulate	13
Technical Problem: Software interface or conversion	13
Blame FTB for some reason	14
Wanted Income/Gross Receipts data	3
Never Received Data/Didn't Know About Program	12
Other	32

Selected Responses
The data accessed seems to be inconsistent. There was not an efficient way to extract the data and generate reports effectively. It needed dedicated resources to implement the use of data for revenue generation.
Data from 1st year could not easily be extracted and compared to business license data
Due to the difficulties in matching up the records, we didn't use the data at all.
We obtained data in 2001, but were swamped with a software conversion. We were also short-staffed.
We have been short-staffed and in the middle of a software conversion.
Implemented a new system over a three-year period and was not able to use [the AB 63 data] as much as we would like.
Business license tax person did not have time.
Did not have sufficient staff to work with the data.
City Council changed its position on using the data.
We did not use the 2001 tax year data due to staff turnover. We have not yet used the 2004 data due to workload issues, we plan to use the data in the next few months.
Attempted to use it, but the total hits from FTB mapped to the total number of licenses on our database. There was no easy way to find exceptions because the data had not been scrubbed and normalized to meet our data standards.
We only used a small portion of the data received for 2004 due to staff time.
Received the CD but weren't able to use the data. Our IT person couldn't read the CD. SUGGESTION: Use EXCEL file format
We did not use the data as our sales tax consultant is HDL and we depend on them for follow-up.
Don't know. Person who ordered the data no longer works for the city
We have used the AB 63 data in the past. This year we did not. Our city is small, and many of the businesses that were discovered with AB 63, we already had code enforcement cases on. Most of the businesses that showed up seemed to be home occupations. It can be very time-consuming to examine the data, and some discoveries were made. We probably will use the data in the future, but not this year.
We have not had time to use the AB 63 data due to time/staffing issues.
Wanted a better indication of true nature of business. Also wanted volume of retail sales activity.

Tried to use it but wasn't in a format that they could download into a database. They did manage to read the CD and get the FTB data into EXCEL format. But the fields that were provided weren't what they wanted…they wanted the business address, not the address of the filer. So they didn't use the data. Also, the way the FTB business names were coded didn't match the names in their files. Person who worked on data no longer with the city.
We signed up but I don't remember ever receiving the data.
We have no staff.
We have received the AB 63 data the last couple of years, but we do not have staff available to process it. There is only one person (me) in the business license division. I am hoping to acquire new software this year that perhaps will make it easier to process the data.
He thinks they never received the data from FTB. He checked with their business license tax staff and also their IT staff. None of these people ever saw a CD from FTB with AB 63 data. The only possibility…their Finance Director recently retired. Maybe he received the CD and never did anything with it. This would be very unlikely though.
Lack of staff time. Also, we have MBIA Muni Financial do our sales tax audit.
To the best of my knowledge, we have been enrolled in the program but never seem to have received the data from the FTB. It finally looks like we are going to get the data this year.
While we are AB 63 participants, we have been waiting (for a really long time) for our software provider [Knowles-McNiff] to create a program that will read the information and match it to our files.
Although we did purchase the information in 2004, we never used it at all since we were under-staffed at the time, and going through a software conversion. The information has remained locked in the vault and has never been used in any way.
We purchased the program the first year, I believe. It didn't provide enough detail information to really be of use, so we opted not to repurchase.
It seems that our city has received this survey in error. We have not obtained AB 63 data from the FTB. The City did plan to use this program in 2005 but never officially signed the agreement because the data did not provide gross receipt figures.
The city has purchased the Franchise Tax Board information in the past and barely used it. The business license clerk found it hard to read and it was not easy for us to compare the tax information to our business license system. The first year we tried to use it, but found it difficult. We continued to purchase the information because the business license software company said they had a way to take the Franchise information and automatically cross reference it with our business license data. We were not able to get it running and have decided to try it one more time. If the city can't get the Franchise Tax information to be useful to us this time, the city may not purchase it in the future.
Due to our new system implementation, our record only goes back to FY 02-03. Per our record, we didn't receive the report from FTB since then and didn't use the data. Per our cashier who's been here for the past 5 years, she didn't receive the report from FTB. Again, we don't have or could not locate the record indicating that we paid for the data back in 2001 since we had new finance system [installed] a couple years ago.
2004 is the first year that our city signed up for the AB 63 program. Due to staffing

shortages we have not been able to use the data yet or contact possible businesses within our City. We believe the program will help us in the future. We are going to sign up for the 2005 program.
We no longer use the data, but when we did, I was never able to access the data even though I contacted the FTB for assistance...
Forgive me but I am not familiar with AB 63. Could you please explain?
Our city has never been able to properly access the data from the discs that have been sent by the FTB. Further, based upon our current program software, we would be unable to use the data in a meaningful way to automatically cross-reference businesses in our database. I believe the HdL (our software provider) is currently working on an automatic cross-reference program to take the FTB data and our City's data base to verify the existence of a new business. This software enhancement will not be ready for quite some time.
The City purchased the data in 2004, I believe, but has not utilized it yet simply we don't have the time and resources to compare the data with our business license system yet. I don't have any experience to report. We still intend to use data hopefully this year. Even though the data may be outdated, but I assume it will still be useful for comparison purpose.
The Intern that started working on this project left for another job, and we have not been able to fulfill the task with our current small workforce.
Although we participated in AB 63 (paid for the data), we never used the info, primarily because of a staff shortage.
Our Director is not interested at this time in purchasing the 2005 data. Since he and I both just started here in 2003, we are not aware of the City's participation in the AB 63 program or the purchase of the 2001 data. We have a lot of new personnel here so there really isn't anyone that would know. Sorry I cannot help you on the return of the survey.
The information received in 2001 was never pursued...not sure why not.
We have never used it.
Never contracted for the 2004 data and never received these data.
No, too time-consuming
Due to a miscommunication with FTB, our city never participated in the AB 63 program. We received a contract to participate in 2004. We filled it out and sent it to the FTB. After a prolonged period, we contacted them only to be told it was too late to participate (receive the information); they claim they never received the signed contract. Therefore, we have never participated in the program, but recently received a new contract in which our city intends to execute.
The AB 63 data came late, even though it was ordered early. It was too late and wasn't helpful at all. We didn't use the data.
We could not use the AB 63 effectively because we did not have the staff available to compare the data with our licensing software manually. Now that we have an interface with our licensing software, we will be able to use AB 63 data.
Our Town participated for one year only. Unfortunately, we were unable to set time aside to work with the data. We are a very small department and have only one person to process business licenses and that person also has other duties. I wish it were otherwise. During the last few years, the Town has experienced and is still having financial shortfalls due to the State and Health costs. Positions are not being filled when

vacated and we are deferring maintenance costs. We are a small town 13,000 pop with a small business district. It's unfortunate that we don't have the manpower because the data could increase our revenues! One problem with the data was that the file gives the address of the filer and not the address of the business.
We had some questions for our attorney's office before proceeding regarding how this info and our municipal code related to developer LLC's and certain corporations. We are still awaiting an answer.
No. Staffing issues, only one person works on the business license tax and there simply wasn't enough time to use the information
We did not use the data. My staff person was not able to find the time to use it.
No, haven't used data yet. Programmers need to do work (to match AB 63 data to their existing BLT files) and haven't had time. They're working on it though, and when they are ready with their program, the city will use the AB 63 data.
No, haven't used data. Our IT has set up the data base, but they have staffing problems and don't have a business license staff person who can use the data.
No. Data format not easy to use. Want data provided in EXCEL.
No. Staffing issues/lack of staff. The business license department ran out of time.
Our city did purchase AB 63 the first year. But there was so much data and no bodies to manually compare the data to our business license program. So, we did not use it. However, I would like to find out the cost for our city to try again this year to utilize the information.
No one in our city knew what to make of your survey and knew nothing about AB 63.
We haven't had the time or the manpower to use this tool. It is a helpful tool, we have looked at it, but not to any extent for it to be useful, so will probably opt out this year and not participate.
Lack of in-house IT expertise. Had wanted to turn the data over to MBIA but was precluded from doing so by the terms of the contract. May not renew next year if this is not changed.
It was purchased before I came on board and I am not sure what to do with it.
We did not use the data. Data format was not useable unless manually compared to our Business licenses, etc. City may purchase software from HdL Companies to reformat data depending on the expense.
I'm the new Finance Director. What is AB 63? We probably are not using it, is my guess….Upon further inquiry, my original hunch was confirmed, our city has never used the AB 63 data.
I looked everywhere for the AB 63 CD and could not find it. Nor do we know if we ever used it.

B.6 Under your contract with the FTB, only city employees can use AB 63 data. Is this a problem for your city? If so, please identify the problem(s) and explain.

Yes	7
No	21
Don't Know	0

Selected "Yes" Responses
Yes, It would be most helpful and cost-effective for us to allow an outside contractor to review the data and provide us with a list of leads. This is done in other areas – for example sales tax – and it would benefit the City a great deal by taking this project off city staff. Unfortunately, with city staff limitations, we are only getting through part of the data sent by FTB (only 35% of tax returns were reviewed for 2003).
We have not been able to analyze even half of one year's data. If we could use contractor staff, with signed confidentiality agreements, data would be more useful.
We would have liked to use an outside source because of staff reduction. If we could have used an outside source, we could have used all the data.
Yes, it would be nice to have the flexibility to have an outside consultant help. We have made due with our city employees, but if certain key staff left, it may be difficult for the city to maintain this project.
Yes, a contractor processes our license and renewals of licensed accounts. They also enforce our ordinance and discover unlicensed businesses.
Yes. The level of effort required to process and use the AB 63 data, especially during the first year's use of the data, is significantly greater than available staff. Later periods require much lower levels of effort, tailing off over a 3-5 year period to a level which can be accommodated by existing staff. City policy is to utilize consultants with appropriate qualifications whenever there are time- or effort-limited tasks, rather than adding staff for which there is only limited or temporary need. The State Board of Equalization recognizes the contribution which such tax consultants/auditors can make to City finance and has authorized the use of such consultants for sales tax auditing services upon adoption of an authorizing resolution. The same authorization by the Franchise Tax Board would enable greater utilization of this program and the data.
Yes. For other lead sources, the City contracts with a third party to compare the lead source against existing licenses and leads, which prevents the transmission of notices to businesses previously contacted or licensed. City staff does not have the resources to make these comparisons for AB 63 data without the aid of the third party. Consequently, many notices have been erroneously [sent], which increases the load on the Inspectors and Customer Service staff.
Yes. It might be more cost-effective to contract the service out.

B.7 Under your contract with the FTB, AB 63 data can be maintained by your city for one year. Is this time constraint a problem for your city?

Yes	11
No	16
Possibly	1

Selected "Yes" Responses
Possibly. We may not have sufficient time and resources to contact everyone, including second notices and citations.
Yes, Due to a new system implementation, we did not use the data extensively and based on that, a longer time would be been useful. Going forward, if we get annual data, one year should be fine.
Yes, Loosening this time constraint will afford us the opportunity to more fully pursue all leads from AB 63 data.
Yes – for 2 of the years, we did not even get through the data before the year ran out. The data is also useful for historical reference after the year runs out – we use it to verify start dates, to bill non-renewed delinquent accounts and to verify closures (for closeout billings). Additionally, keeping the data longer would permit us to provide more consistent handling of the businesses from year to year. For example, we inadvertently sent notices to businesses in 2003 that we had exempted in 2001. We have worked around that at this point, but if we could keep the data, it would make the job more efficient.
Yes, due to staffing it is difficult to review all the data and get letters out. When we send out notices to business and get no response and further investigating is needed this can add a lot of time.
Yes, it would be nice to be able to use the data for 3 years instead of 1 year, so we could store and track businesses FTB history, and make a case for why they owe for back years, if they were not licensed.
Yes, sometimes it takes much longer due to small staff.
Yes, sorting through the file has been a manual process. Therefore, going through the file may take more than a year.
Yes, we cannot complete our analysis in one year.
Yes. It takes many months to check the list and send out the letters. We were unable to send second notices to some of those at the beginning of the list because time had lapsed by the time we were able to get back to them.
Yes. We would like to use the previous year's data for comparison purposes. Besides, it may take time to follow-up.
YES. With [a large number of new] entities to contact, it is difficult for the inspectors to initiate contact with these people in addition to ensuring existing work is handled.

Part C. Overall, how important is this program to your city?

Selected Responses
Very important.
Very important to locate unlicensed businesses. Unfortunately at this time I do not have the staff time to dedicate. We will continue to participate in the program in hopes of revenue recovery.
The information received from AB 63 appeared to be extremely valuable, however, about the time we actually received the information, we were going through several internal changes. We were installing a new business license program and going through some personnel changes. By the time we were actually in a position to utilize the information it was coming up on 18 months old. As much as we wanted to use the information we felt that the information was old enough that it would be awkward to go after the businesses. The majority of the useful information appeared to be in the home-based businesses, which are many times invisible. This information would be invaluable in finding them. Our city is strong in support of the program and we look forward to utilizing the most current information.
It's important. It's another source of information.
Not useful
Very important
I would love to be able to work this program to its fullest, but we are now a very poor city with limited resources (labor and cost).
This program is very important. We are looking forward to using the 2004 data we just received.
Don't know since we never used it.
We expect it to bring in a significant portion of revenue once we get it linked with our new system and are able to electronically import data and send notices.
Extremely important. It is the only good way to find underground businesses being operated from the home.
The program has increased compliance significantly by adding registrations.
NA. Did not receive data [from FTB].
The program is worthwhile and productive for our efforts.
To say this program is important to the City is an understatement. The numbers we provided in the first part of the survey evidence how valuable this program is. Since the start of the program, we have realized over a 50% increase in our business tax revenue. The number of active licenses has increased [by about 25%]. This program has been critical in the success of our business license division and will continue to be so.
The program is very important to our city. This program does not generate the most revenue from previously non-compliant businesses in the city.
This [program] is critical to our success.
This program allows us to identify businesses that might otherwise go unlicensed. This is especially true of home-based businesses that are difficult to identify by other inspection means.
Overall, this program is an additional source to verify and/or locate unregistered businesses. Further, it fosters intergovernmental relations, which is important as well.
Very useful tool to find home-based businesses.
This program is extremely important to the City's ability to accurately and easily identify entities operating businesses within the City and require their compliance with business tax requirements. It is a unique data source whose value cannot be overstated.
Useful for general businesses. Not so much for individual returns.
The program required too much staff time to be useful. We have purchased a listing from another vendor that compares our database to other agency, public and private databases to

identify potential violators that is more useful. They have identified a reasonable amount (1,600) of exceptions for staff to follow up by letter and phone calls to bring them into compliance.
The program has proved to be very helpful. We have used it to find unlicensed businesses, generating added revenue to the City. We have also used the data as additional evidence of conducting business in our city (where we already suspected the business was in town). We have used it to verify closures and determine start dates on businesses, which saves hours of phone calls and annoying questions to business owners. I cannot think of one other information source that is as useful right now.
Very important, it is the best resource for identifying home-based businesses and independent contractors.
Not cost effective. Not useful. We have a full-staffed business license tax division that has worked hard in the past to bring everyone into compliance. No need for the AB 63 program.
Our experience with AB 63 was that: 1. The data might not be complete. For example, the first disk (probably received in 2004) contained 8,992 records, whereas the second disk received on 1/18/05 (we never received a third disk so far) contained 12,041 records. We were not sure why there was such a big increase in the number of records. Unless we see some consistency in the data, we cannot determine how important or useful this program is to us. 2. We were not able to determine which year the data on each of the two disks pertain to, since such information was not indicated anywhere.
On a final note, we are certain that the sharing of FTB data not only helps our city but many cities across California. Therefore, please help us to continue receiving these data.
AB 63 data were helpful during our audit in identifying some businesses not reporting Business Taxes to our city. However, the vast majority of the "businesses" identified were hobby-type activities. It was very time-consuming to track down all of the leads for small tax dollars. Lots of phone calls and letters back and forth to determine if they even owed the minimum tax for hundreds of individuals.
Very valuable.
We did use it and did not find it to be very beneficial in terms of discovery.
Our city ran a project to improve business license tax compliance from June 2003 to February 2004, and then again from November 2004 to May 2005. They utilized all available lead sources, including the AB 63 data from 2001 and 2003. The project netted the City an additional 3,151 business license accounts for a total of $1.63 million. City tax officials estimated that 80-90% of the notices were based from AB 63 data, so the net result attributed to AB 63 data was about $1.5 million.

Part C. Do you have any other comments about the AB 63 program?

Selected Responses
The AB 63 data is an excellent source for identifying unlicensed businesses. But the media to transfer the data in a usable format is an impediment for Cities who do not have many resources. We participate in a similar program AB990 with the State BOE for seller's permit registration. But the program came with the software application that downloads the monthly data and it allows queries and searches and even transferring data files into EXCEL. It would really be helpful for smaller cities who do not have many resources and are not as proficient in the computer data exchange if AB 63 provides the application to be able to better manage the data. In our case we had to get into the list for our IT department to look at it and be able to design a program that will allow the staff to use the data. I believe the other Cities such as Newport Beach and Los Angeles they have staff that are intense on the use of the technology while we do not have that capability at the moment. The program should be designed so that ALL cities can easily use the data and also provide trainings on the basics of the AB 63.
It would be helpful if were able to receive the address on line E of Schedule C, so that we would know if the business address is in another jurisdiction so that we wouldn't send letters to the taxpayer and cause undue hard feelings when they have a license in the jurisdiction that their business is located.
We didn't use the data the first year it came out, but we are very much looking forward to using the 2004 data we just received. I would like to get the data sooner. I would like to see financial information included. I would also like to have the data longer than one year, and I would like the ability to hire a contractor to process the data. We currently use a consulting business to process our sales tax data.
The city should send data back to FTB and have no cost to either agency. Having to get funding every year is difficult.
Two changes are required: 1) Data need to be available for more than one year. 2) Non-City employees, with confidentiality agreements, need to be allowed access. We cannot use permanent staff for this temporary workload.
The Data Sharing Program has proven to be one of the most reliable and is the only independent source available to California's local governments evidencing whether a taxpayer performed services as an employee or as an independent contractor. It has reduced taxpayer expense by eliminating the need for locals to conduct the protracted IRS process to determine such status. The Program has helped reduce the need for local tax increases and improved tax equity by revealing an element of the underground economy previously hidden from local tax administration. Local tax administration's application of this new source of information has forced a greater understanding of the nuances of State and federal tax laws in the context of local business tax requirements. Discretion in the approach to enforcement has been instrumental in this city's success in applying the FTB data. Frequent communication with elected officials and business

organizations within the community about the City's use of the data and its value has significantly reduced opposition to the City's use of confidential taxpayer information. Taxpayer response has been unexpected, with most of our customers surprised to learn that city's access to FTB data for taxpayers within its jurisdiction is only recent.

Data security and confidentiality was an issue for the FTB for the seven years locals lobbied for bills to create this program, and remains a significant FTB issue today. The FTB Disclosure Office reportedly has no prior experience in safeguard reviews of agencies other than the FTB. And although participating cities have been paying each year for the Disclosure Office costs, the program was three years old before that office made its first contact with locals regarding safeguard standards. I believe this contributed to the FTB's development of security requirements disparate from those established by the IRS and State Board of Equalization. The FTB relies on the legislation's reference to "employee" and the standards imposed on the FTB by the IRS as the basis for their restricting local's use of contractors. However, the IRS authorizes the FTB to use contractors to process confidential IRS data and the SBOE authorizes cities to use contractors to process confidential sales tax data. Moreover, the statute does not define "employee."

Many cities have been hesitant to budget taxpayer money to purchase information collected at taxpayer expense on a relatively untested new program. Moreover, because cities can not use the contractors they use for processing other business tax sources of discovery, they have not been able to process the FTB data using existing staff. Others too have been reluctant to ramp up for a new program that sunsets in two years. This year, the FTB has an appropriation ($450K) to acquire business tax data from cities in the same year they are charging cities ($340K) to provide them data. This exchange of taxpayer dollars to provide data the public believes is already being exchanged is inefficient and unnecessary.

I believe several changes to the program are necessary to improve both the participation and effectiveness of this program. Specifically, I recommend:

- Repeal the sunset provisions
- Extend the requirement to destroy data from one year to three
- Define "employee" to include temporary & part-time staff
- Authorize contractors who work exclusively with public agencies to assist with the processing of data (similar to authorities established in Rev. & Tax 7056(b))
- Extend the authority for counties and the one city and county in the State that impose a business tax to obtain the data
- Establish reciprocity between cities and the FTB to exchange data without cost

I would suggest that the cost for the program be abated if the participating city provides the data file back to FTB. Also, we would like to screen out potentially exempt businesses, which the 2003 file contained a significant amount. Further, if we can obtain the # of employees of the businesses, this would be of great value.

The data could be parsed better, i.e., separate fields for first and last names, etc.

The value of the program to cities in increased taxpayer compliance and increased tax revenues is extremely significant. The "sunset" provisions threaten to curtail this valuable resource at a time when other revenue streams, such as local Utility Users Tax,

are threatened by federal legislation. At the same time, the State Board of Equalization is looking to cities to share their business tax data so as to enhance the SBOE's audit of retail businesses. The AB 63 data enhances the cities ability to assist the State in fully capturing this revenue stream. The FTB could improve its follow-up to cities which asked to participate in the program and filed timely by insuring that the State contracting and purchasing office complete processing of the contracts and issue invoices in a timely manner.
FTB is providing info by zip code, not census tracts. The City of LA mails AB 63 letters to businesses in our city. Fallout comes to us.
We would like gross receipts data
The CD is password protected with password sent separately in e-mail. There are no instructions on how to download or use the information. It seems that there is a presumption that an IT person is using the data. It's a flat file that imports easily into EXCEL. You do have to do a fair amount of formatting depending on what you want. It takes me about 1-2 hours although it is easier each year. If you're not good at EXCEL, you'd be up a creek. For someone who's picky like me, the flat file is terrific because I can pick and chose the information I want displayed and format it the way I want. I would guess that many others would like the work done for them. I would think that a brief instruction about an EXCEL download in the e-mail that sends the password would be very helpful.
One major problem that I realized after mailing, somewhat threatening, letters to those on the list is the address we receive from AB63 is the home address of business owners (usually) *NOT* the business address reflected on the Schedule C (or other tax form reporting business activity). We had many upset business owners that reflected a correct business address on their tax form that was not in our city. It is impossible to determine whether the address from the AB63 data is the actual business address or just a mailing address for official mail.

APPENDIX L: SURVEY TO NON-PARTICIPATING CITIES

At the request of the Legislature, the California Research Bureau is preparing a report regarding the effects of AB 63 (2001, Cedillo) Revenue and Taxation Code 19551.1, which permits, under specified conditions, the disclosure of tax information by the Franchise Tax Board (FTB) to California city tax officials. These FTB data can be used by cities as a tool to identify businesses that might be subject to their local business license tax.

Only about 30% of California's cities have chosen to participate in the AB 63 local government-sharing program and obtain FTB data.

If your city participated in this program in 2001, 2003, or 2004, you should have received a detailed survey from Martha Jones at the California Research Bureau. If you have not received this survey, please contact Martha Jones at mjones@library.ca.gov phone: (916) 653-6742.

If your city levies a business license tax and did **not** participate in the AB 63 program in 2001, 2003, or 2004, could you please answer the following four questions by **January 27, 2006**:

1. Why has your city chosen not to obtain AB 63 data?
    a. Cost
    b. Lack of resources to process the data
    c. Waiting until the data have been proven effective in other cities
    d. Other (please specify)

2. Does your city plan to obtain AB 63 data for 2005 or in the future?

3. If you would like to participate but find the current program to be unworkable for your city, what changes in the law or improvements in the program's administration would you like to see?

4. How does your city calculate business tax liability?
    a. Gross Receipts
    b. Number of Employees
    c. Square Footage of Business
    d. Flat Tax
    e. Other (please specify)

APPENDIX M: FEEDBACK FROM ORGANIZATIONS

Organizations with a known interest in AB 63 legislation were contacted by the California Research Bureau for input concerning the program. Most of these organizations had registered support or opposition to AB 63 in 2001. Other organizations that provided comments are denoted with an asterisk (*).

Organizations that provided feedback:

City of Los Angeles
California Municipal Revenue and Tax Association
Los Angeles Chamber of Commerce
California Tax Reform Association
Cal-Tax
California Association of Realtors (*)
1. E-mail correspondence from Christopher C. Carlisle
2. Document describing Municipal Auditing Companies

MBIA MuniServices Company
League of California Cities
American Federation of State, County and Municipal Employees (*)

Organizations contacted that did not respond:

Howard Jarvis Taxpayers Association
Central City Association of Los Angeles
Valley Industry and Commerce Association
Writer's Guild of America, West, Inc.
Consulting Engineers and Land Surveyors of California

Letters of support for the SB 1374 (Cedillo, 2006) legislation from various cities were also received by Senator Cedillo but are not included in this report.

ANTOINETTE CHRISTOVALE
DIRECTOR of FINANCE

CITY OF LOS ANGELES

CALIFORNIA

OFFICE OF FINANCE
200 N. SPRING ST.
ROOM 220 – CITY HALL
LOS ANGELES, CA 90012

(213) 978-1782

ANTONIO R. VILLARAIGOSA
MAYOR

March 31, 2006

Martha Jones, Ph.D., Economist
California Research Bureau
California State Library
Via email: mjones@library.ca.gov

RE: AB63

Dear Ms. Jones:

As a subscriber of the AB63 program with the Franchise Tax Board the City of Los Angeles has realized unprecedented success with AB63 data in identifying and registering businesses subject to local business tax. Since 2002, Los Angeles has received four years (2001-2004) of tax data through the AB63 program, which has resulted in 56,000 new business registrations and has generated over $45 million in new tax revenue to date. In this regard Los Angeles is a strong proponent of removing the "Sunset Clause" of December 31, 2008, related to AB63.

It is important to note that none of the AB63 revenue is used for general fund purposes. In 2001, the City Council adopted an ordinance, which designated 75% of the revenue be used for business tax reform and the remaining 25% for affordable housing. This revenue has allowed Los Angeles to initiate meaningful business tax reform providing over $80 million in tax relief to its businesses to date. Some of the reforms enacted were the elimination of business taxes on small businesses and elimination of taxes for new businesses for their first two years, a 3.1% across the board rate reduction, simplification of the tax code, and reformation of the business tax appeals process.

Prior to initiating the AB63 program, Los Angeles had low taxpayer compliance. This is especially true since our business tax is a self-reporting tax, that is, businesses are required to submit their taxable measures annually. We found that many businesses were paying their fair share while others whether knowingly or unknowingly, were not in compliance. As a result of AB63, we've seen significant improvement in tax compliance and feel strongly that the program should continue beyond the December 2008 sunset date.

Los Angeles as a legislative sponsor of AB63 has been a strong proponent of adhering to the guidelines, protocols, pertaining to confidentiality issues set forth by the Franchise Tax Board as to the administration of the AB63 program. The Franchise Tax Board has conducted a safeguard review process with Los Angeles. This review proved beneficial in that it reaffirmed the process Los Angeles has developed in using AB63 data as one that is in compliance with contractual requirements set forth by the Franchise Tax Board.

If you have any questions or need additional information, please call me at (213) 978-1774.

Sincerely,

Antoinette D. Christovale
Director of Finance

AN EQUAL OPPORTUNITY-AFFIRMATIVE ACTION EMPLOYER

California Municipal Revenue & Tax Association

March 31, 2006

Martha Jones, Ph.D.
Senior Economist
California Research Bureau, California State Library
900 N St., Suite 300
P.O. Box 942837
Sacramento, California 94237-0001

Re : **AB 63 Data Sharing Program**

Dear Ms Jones :

The California Municipal Revenue & Tax Association (CMRTA) was a co-sponsor of the 2001 Senator Cedillo bill (AB 63) that created the Franchise Tax Board's Data Sharing Program. We believe the exchange of information between tax authorities is an integral element of efficient and equitable tax administration.

The Data Sharing Program has proven to be a valuable tool in identifying businesses subject to local business taxes in California cities. Propositions 62 and 218 significantly limits local government's ability to create new or increase existing taxes. As a result, cities have been forced to become more efficient in their administration of existing tax revenues, including business license taxes. The Data Sharing Program created the opportunity for cities to collect millions of dollars in new business license taxes without increasing tax rates.

Tax agencies sharing data to improve compliance is not a new concept. Data exchanges between federal and state tax agencies, between states, and between state and local tax agencies have existed for decades. For fifteen years the California Legislature mandated a program that required California cities to provide business license tax data to the FTB that proved to be very profitable to the FTB in identifying non-filers. Data sharing by tax agencies is effective, efficient and expected by taxpayers.

The CMRTA enthusiastically supports the FTB Data Sharing Program created by AB 63 and welcomes the opportunity to address any questions the California Research Bureau may have regarding this valuable program.

Sincerely,

Pamela Blythe

Pamela Blythe
President
CMRTA

Los Angeles Area
Chamber of Commerce

June 26, 2006

Senator Gilbert Cedillo
State Capitol, Room 5100
Sacramento CA 95814

Re: Support for SB 1374 (Cedillo) – Tax Administration

Dear Senator Cedillo:

On behalf of the Los Angeles Area Chamber of Commerce, I write to express our support for SB 1374, which would extend the sunset date of existing law from December 31, 2008 to December 31, 2010. This legislation allows cities to effectively collect outstanding local business license taxes, provide fair and equitable enforcement of tax laws and maintain the privacy of taxpayers.

Through AB 63, the City of Los Angeles and 94 other cities have already benefited from detecting unregistered businesses that have not paid the requisite taxes. Since its implementation in 2002, the City of Los Angeles has recovered over $36 million in what would have been unrealized tax revenue. This revenue far exceeds the program's annual $225,000 cost and has largely kept the burden of unpaid taxes from reaching law-abiding citizens and businesses.

California must continue to ensure taxpayer data security while at the same time identifying those businesses who seek to avoid their tax liability. This legislation addresses both issues in a way that is cost-effective and equitable. By extending the sunset date of AB 63, cities will be able to continue collecting this vital revenue and ensure a level playing field for all California businesses.

For these reasons, the Los Angeles Area Chamber of Commerce respectfully urges you to support SB 1374. If you have any questions, please feel free to contact me or Public Policy Manager Samuel Garrison at 213.580.7568.

Thank you for your consideration.

Sincerely,

Rusty Hammer

Rusty Hammer
President & CEO

California Tax Reform Association
717 K Street, Suite 510, Sacramento, CA 95814
Ph: 916.446.4300 Fax: 916.444.6611
Email: info@caltaxreform.org
http://www.caltaxreform.org

March 23, 2006

The Honorable Gil Cedillo
State Capitol, Room 5100
Sacramento, CA 95814

RE: SB 1374: SUPPORT

Dear Senator Cedillo:

The California Tax Reform Association (CTRA) supports your bill, SB 1374, relating to tax information sharing.

It is our understanding that this effort has been successful in helping cities to collect taxes which are lawfully owed to cities. The Franchise Tax Board, in cooperation with the IRS, has a substantial data base, and tax collection has always been a cooperative effort on an inter-agency basis. We believe, based on the evidence, that the program should continue, and we support the effort to do so.

Please to not hesitate to contact me at (916) 446-4300 if you have any questions or comments about our position.

Sincerely,

Lenny Goldberg
Legislative Advocate

cc: Senate Revenue and Taxation Committee

January 27, 2006

Martha Jones, Ph.D.
California State Library
Library Courts Building
Post Office Box 942837
Sacramento, California 95814

Subject: Cal-Tax SUPPORT for the Sunset of AB 63 of 2001 (Cedillo)

Dear Dr. Jones:

Thank you for the opportunity to allow the California Taxpayers' Association to provide written comments about the expiration of AB 63 (Cedillo) of 2001, that allows the Franchise Tax Board to disclose to tax officials of any city -- a taxpayer's name, address, Social Security or taxpayers' identification number, and principle business activity code.

Given the magnitude and ease of identify theft, we believe this disclosure of information to city tax officials should be allowed to sunset on December 31, 2008, as indicated in the bill. According to the Federal Trade Commission, approximately 10 million people in the U.S. had their identification stolen last year. We are concerned that these tax officials cannot ensure that sensitive taxpayer information will not end up in the wrong hands, especially when identify theft scams, due to today's technology, are changing daily and rapidly. Even worse, identify theft is growing "faster than the government can keep up with," as reported on *CNN Prime Time News*, during a special report on the subject on January 26, 2006.

Another purpose of keeping taxpayer information confidential is to ensure taxpayer compliance with our self-administered tax system. As the State degrades this privacy policy, taxpayer compliance will suffer, and taxpayer resentment with grow. A non-disclosure policy is also consistent with the California Constitution's recognition of the importance of privacy among its citizenry.

We are also concerned that this type of legislation opens "Pandora's Box" for additional types of taxpayer information to be exposed through legislation, including:

- SB 1496 of 2004 -- that would have required the public disclosure of corporate tax returns for publicly traded companies; and more recently:

- SB 234 of 2005 -- that would subject a vast amount of confidential information related to sales tax appeals to public scrutiny, and
- AB 1418 of 2005 -- that would require the State's tax agencies to publicize the 250 biggest tax delinquencies.

We are also concerned that these harmful disclosure proposals will stymie economic growth by discouraging business investment in California. At a time when this State needs to attract new investment, including businesses that can grow jobs to improve our economy and our fiscal condition, extending the time period of an anti-confidentiality measure heads in entirely the wrong direction. It instead sends the message that California has little regard for or no interest in protecting vital taxpayer information of its citizens and businesses.

We hope you will encourage the Legislature to allow AB 63 to sunset.

Sincerely,

Lisa Martin
Associate Director of Legislative Affairs/
Senior Policy Analyst

Lisa Martin
Sr. Policy Analyst/Associate Director of Legislative Affairs
California Taxpayers' Association
lisa@caltax.org
(916) 930-3105
(916) 441-1619 fax

E-mail from the California Association of Realtors:

1/20/06

Martha,

Thank you for the opportunity to provide comments for purposes of the California Research Bureau report on AB 63 (Cedillo) which allows the FTB to provide taxpayer information to cities.

We are primarily concerned about what happens with the information once it is provided to the cities. Two points:

1. In talking with Laurie Rhea at the FTB (thank you for the contact information by the way) I learned that once a city independently confirms the data that has been provided by the FTB the data becomes the "property" of the city. At that point, the provisions in AB 63 prohibiting the sharing of the data no longer apply. Clearly, a city would not be able to independently confirm the data – and, thus, skirt the protections contained in AB 63 – but for the data having originally been provided to the city by the FTB.

2. As you will recall, we are concerned about the tax information being provided to municipal auditing companies (MACs) for tax collection purposes. I have received an oral legal opinion (and have requested a written opinion) from Legislative Counsel that a city cannot authorize a MAC to gather taxpayer information from taxpayers. Counsel's reasoning is that since the city is prohibited from turning over tax information to such a contractor, the city can't authorize the contractor to gather from taxpayers that which the city couldn't turn over to the contractor directly.

As I mentioned to you when we spoke, we are concerned about insuring the confidentiality and security of tax data, as well as the propriety of cities authorizing private entities to act as tax collectors.

Please call me if you have any questions.

Christopher

Christopher C. Carlisle
Legislative Advocate
California Association of REALTORS
980 Ninth Street, Ste. 1430
Sacramento, CA 95814
(916) 492-5200
(916) 492-5203 Direct
(916) 444-2033 FAX
email: christopherc@car.org

Document submitted by the California Association of Realtors. The section of the document relating to the limitations imposed by AB 63 is included here.

Municipal Auditing Companies

Limitations imposed by AB 63 (Cedillo, 2001). This bill signed into law allows the FTB to disclose certain tax information to tax officials of any city. Cities contract under this bill to receive leads about the business activities of residents, corporations and other entities within their jurisdiction. Cities match the FTB data with their own business license records. Businesses that are not found in the city's databases are regarded as unlicensed businesses which are subsequently notified for purposes of registration and collection. The information exchanged consists of taxpayer name, taxpayer address, taxpayer social security number or taxpayer identification number and principal business activity code (PBA Code). Currently, more than 100 California cities are currently using the program because it allows them to discover new sources of income.

If the city you live in is using AB 63 and has contracted or intends to contract with an auditor, the following clause of the bill should be brought up to the attention of the City council and city attorney:

> *(3) Tax information provided to the taxing authority of a city may not be furnished to, or used by, any person other than an employee of that taxing authority.* (Revenue and Taxation Code, Sec. 19551.1)

Technically speaking, the FTB data furnished to the city **cannot be used by any other person than a city employee.** That is, an independent contractor, such as an auditing company, has no authority to use or handle FTB provided business data. If a city where to comply with the law, it would need to keep the FTB data separate from their own business license data. The city cannot say that the independent contractor is acting as an employee of the city since the contracts it signs with auditors contain detailed clauses specifying that **independent contractors are not city employees**. Moreover, the FTB has the authority to audit contracting cities and they would like to know if there has been an illegal use of the data. This all means that if the city wants to contract an auditor, they can do so, but the city should not share the FTB data with anyone.

If you require more information or would like to discuss this paper please contact Erika Andrew at (213) 739-7396 or ErikaA@car.org.

MBIA
MuniServices Company

1400 K Street, Suite 212
Sacramento, CA 95814

February 15, 2006

Ms. Martha Jones, Ph.D.
California State Library
P.O. Box 942837
Sacramento, CA 94237

Dear Ms. Jones:

Thank you for your January 6, 2006 request of MBIA MuniServices Company (MMC) to provide written comments to the Library concerning the impacts of AB 63 (2001, Cedillo). Additionally, MMC appreciates the time you took to discuss with me directly on this very important topic as well as the chance to provide a review of the Company's current revenue enhancement and consulting products and services that are available and offered to the public sector nationally. MMC has been following legislation impacting AB 63 and are aware of the study. We understand that a "wrench" about who may use the data and who may access the data has been introduced as a consideration in your study.

First and foremost, as we have discussed MMC and its alleged treatment of confidential taxpayer data were the subject of a public document published by the Realtor's statewide group. I have attached relevant communications from third parties addressing the Realtors' claims and as the communications show the Realtors have failed to provide any evidence supporting their allegations.

MMC recognizes the heightened concerns about security in today's information oriented world, as evidenced by numerous federal and state laws governing information privacy such as the Gramm-Leach-Bliley Act and California's Information Practices Act, to name a few, and treats all confidential information with an extremely high level of security and confidentiality. MMC's security precautions are numerous and even its public website, which contains no confidential data, has never been compromised or "hacked."

MMC is aware that the AB 63 program has become an instrumental tool for many California cities to identify businesses that *might* be subject to local business tax. Closing the 'tax gap' is a goal that cities and counties have long stood for and MMC has been a partner to assist local governments in identifying existing revenues that should be collected from entities doing business in California.

MMC defers specific questions on the way cities are handling AB 63 Franchise Tax Board data and the way the program is implemented in respective jurisdictions to the California Municipal Revenue and Tax Association and its local government members since they are more intimate with the processes.

However, MMC recommends that the study consider in its analysis I.R.C §6103 (n) which addresses the ability of "certain other persons." to have access to tax return information for purposes of tax administration. These may be useful analogs for analyzing whether consultants should be allowed access to AB 63 data.

Sincerely,

Fran Mancia
Director of Government Relations
MBIA MuniServices Company

LEAGUE OF CALIFORNIA CITIES

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Phone: 916.658.8200 Fax: 916.658.8240
www.cacities.org

April 18, 2006

Senator Mike Machado
Chair, Senate Revenue and Taxation Committee
State Capitol, Room 408
Sacramento, CA 95814

RE: SB 1374 (Cedillo) Tax administration: taxpayer information: disclosure.
Notice of Support

Dear Senator Machado:

The League of California Cities supports SB 1374 regarding the State and Local Government Tax Sharing Program. This measure will repeal the sunset date on existing law that allows cities to continue in their tax discovery efforts by allowing the Franchise Tax Board (FTB) to share taxpayer information. The current statute will sunset in 2008.

Existing law allows the tax officials of any city to obtain tax information on taxpayers within that city's jurisdiction from the Franchise Tax Board. This information includes the name, address, social security or tax ID number, and business activity code of taxpayers with an address within the city's jurisdiction that reports income from a trade or business to the Franchise Tax Board. An agreement must be executed between the Franchise Tax Board and a city that will have that city pay for the first-year costs to furnish this information and for any annual costs that the FTB may incur.

The State and Local Government Tax Sharing Program has helped many cities to identify businesses that are not paying local taxes – resulting in millions of dollars recouped. Over 95 cities are currently participating in the program. This program does not result in new taxes on businesses; rather it ensures that existing taxes are being paid as appropriate.

For these reasons, the League supports SB 1374.

Sincerely,

Dan Carrigg
Legislative Representative

cc: Members, Senate Revenue & Taxation Committee
Bob Becker, Consultant, Senate Republican Caucus
Sue Blake, Director of Legislation, Governor's Office of Planning and Research

AFSCME®
in the public service

March 27, 2006

TO: The Honorable Mike Machado, Chair
and Members of the Senate Revenue and Taxation Committee

RE: Senate Bill 1374 (Cedillo)—AFSCME SUPPORT

The American Federation of State, County, and Municipal Employees (AFSCME), AFL-CIO, would like to inform you of our **support** of **Senate Bill 1374**, as introduced.

AFSCME supports Senate Bill 1374, relating to tax information sharing.

It is our understanding that this effort has been successful in helping cities to collect taxes which are lawfully owed to cities. The Franchise Tax Board, in cooperation with the IRS, has a substantial data base, and tax collection has always been a cooperative effort on an inter-agency basis. We believe, based on the evidence, that the program should continue, and we support the effort to do so.

Please join us in supporting Senate Bill 1374.

Should you have any questions regarding our position on this matter, you may contact me at your earliest convenience. AFSCME also reserves the right to change its position in the event of further amendments.

Sincerely,

Willie L. Pelote, Sr.
Assistant Director of Political Action, International

Cc: committee consultant(s)
WLP/mr

1121 L Street • Suite 904 • Sacramento, California 95814-3926 • (916) 441-1570 • (916) 441-3426 FAX

American Federation of State, County and Municipal Employees, AFL-CIO