

# Client Alert.

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## California Franchise Tax Board's Financial Institution Record Match ("FIRM") Program Gains Traction

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Pursuant to a budget trailer bill chaptered into law on March 24, 2011, the California Franchise Tax Board ("FTB") has the authority to operate and administer the Financial Institution Records Match ("FIRM") program.<sup>1</sup> Governed by California Revenue and Taxation Code section 19622, FIRM is an automated data match program which will be used by the FTB to identify accounts of delinquent tax debtors held at financial institutions doing business in California.<sup>2</sup> Modeled after the Financial Institution Data Match program,<sup>3</sup> which is mandated by federal law for the collection of delinquent child support debts and also administered by the FTB, FIRM is an enforcement tool that will be used to collect delinquent taxes and non-tax debts of individuals and business entities.<sup>4</sup>

To effectuate the FIRM program, financial institutions must provide to the FTB on a quarterly basis the name, record address and other addresses, social security number or other taxpayer identification number, and other identifying information for each delinquent tax debtor.<sup>5</sup> Under the current draft regulation, financial institutions can comply with the FIRM program by one of two methods.<sup>6</sup> Under the first method, a financial institution will submit a data file to the FTB containing records of all open accounts held by the financial institution.<sup>7</sup> FTB will then match this information against its own records.<sup>8</sup> This method is only available to financial institutions that do not have the technical ability to process the data exchange or the ability to employ a third party to process the data exchange.<sup>9</sup> Under the second method, the FTB will furnish delinquent tax debtor files to the financial institution.<sup>10</sup> The financial institution will match the information

<sup>1</sup> SB 86 (Stats 2011, ch. 14); Cal. Rev. & Tax. Code § 19266.

<sup>2</sup> Cal. Rev. & Tax. Code § 19266(a)(1).

<sup>3</sup> See Cal. Rev. & Tax. Code § 19270 et seq.

<sup>4</sup> Current state law authorizes the FTB to issue an Order to Withhold ("OTW") to collect delinquent tax liabilities. An OTW can be issued to any third person in possession of funds or properties belonging to a tax debtor. Upon receipt of an OTW, the recipient is required to freeze the tax debtor's assets in its possession and remit to the FTB all cash or cash equivalents held that will satisfy the amount of the OTW. At a recent FTB interested parties meeting, an FTB representative stated the OTW process with respect to financial institutions will remain unchanged and anticipated that once the first FIRM data exchange is completed in April and May 2012, the FTB will begin to issue OTWs sometime in June 2012. (Summary of Interested Parties Meeting, Regulation § 19266, Financial Institution Record Match, August 16, 2011.)

<sup>5</sup> Cal. Rev. & Tax. Code § 19266(c)(1).

<sup>6</sup> Draft Regulation § 19266, available at [http://www.ftb.ca.gov/law/intParty/draft\\_reg\\_section\\_19266\\_092711.pdf](http://www.ftb.ca.gov/law/intParty/draft_reg_section_19266_092711.pdf).

<sup>7</sup> *Id.* at section (d)(1).

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at section (d)(2).

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against its open accounts and submit a file of matched records to the FTB.<sup>11</sup> While third-party vendors can be hired to facilitate the data exchanges,<sup>12</sup> each financial institution doing business in California is required to complete an election form which establishes its participation in the FIRM program and identifies the chosen method of data matching.<sup>13</sup>

Noncompliance may not be a viable option—the new legislation has some sharp teeth to it for those who choose not to comply. Specifically, the FTB can institute civil proceedings to enforce compliance and any financial institution that willfully fails to comply will be assessed a penalty of \$50 for each record not provided, subject to a \$100,000 limitation for any calendar year.<sup>14</sup> However, the penalty will not be applied if the FTB finds the failure to comply was due to reasonable cause.<sup>15</sup>

Despite the strict compliance requirements, some relief is available. For example, the FTB can exempt a financial institution from participating in the FIRM program if it determines the financial institution's participation would not generate sufficient revenue to be cost-effective for the FTB.<sup>16</sup> Under the draft regulation, there is a temporary exemption for financial institutions holding less than 250 accounts, subject to certain exceptions.<sup>17</sup> The FTB can also temporarily suspend a financial institution from participating in the FIRM program if the financial institution provides the FTB with a written notice from the appropriate banking authority that the financial institution is determined to be undercapitalized, significantly undercapitalized, or critically undercapitalized under the applicable regulations.<sup>18</sup> In addition, financial institutions participating in the program are entitled to reimbursement for actual costs incurred to implement the FIRM program.<sup>19</sup>

After two interested parties meetings, the FIRM program is quickly gaining traction in California. During the first interested parties meeting on August 16, 2011, the FTB discussed processes, procedures, and the necessary components of proposed regulatory provisions required to implement the program. Thereafter, FTB staff developed the draft regulatory provisions which were discussed during the second interested parties meeting held on September 27, 2011. During this last meeting, an FTB representative stated the FTB intends to submit the proposed regulation to the three-member Franchise Tax Board at the upcoming December 1, 2011 meeting and request permission to proceed to the formal regulation process under the California Administrative Procedures Act.

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<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at section (c).

<sup>13</sup> *Id.* at section (e).

<sup>14</sup> Cal. Rev. & Tax. Code §§ 19266(f)-(g).

<sup>15</sup> Cal. Rev. & Tax. Code § 19266(g).

<sup>16</sup> Cal. Rev. & Tax. Code § 19266(a)(2)(C).

<sup>17</sup> Draft Regulation § 19266 section (j)(1). Other financial institutions can apply for temporary exemptions so long as it provides sufficient detail for the FTB to evaluate their request. (*Id.* at section (j)(2).)

<sup>18</sup> Cal. Rev. & Tax. Code § 19266(a)(2)(D).

<sup>19</sup> Cal. Rev. & Tax. Code § 19266(i). The reimbursement is capped at \$2,500 for one-time start-up costs and \$250 per calendar quarter for data matching costs. (*Id.*)

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