Senate Budget and Fiscal Review—Holly J. Mitchell, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard D. Roth, Chair
Senator Steven M. Glazer
Senator Scott Wilk

Thursday, April 27, 2017
9:30 a.m. or upon adjournment of Session
State Capitol – Rose Ann Vuich Hearing Room (2040)

PART B

Consultant: Mark Ibele

ITEMS FOR DISCUSSION AND VOTE

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ISSUES PROPOSED FOR DISCUSSION AND VOTE

7730 FRANCHISE TAX BOARD

Department Overview: The Franchise Tax Board (FTB) is one of the state's two major tax collection agencies and administers the personal income tax and the corporation tax programs, the largest and third-largest contributors to the state's revenue, respectively. The department also performs some non-tax collection activities, such as the collection of court-ordered payments, delinquent vehicle license fees, and political reform audits. The FTB is governed by a three-member board, consisting of the Director of Finance, the chair of the Board of Equalization, and the State Controller. An executive officer, appointed by the board, manages the daily functions of the department.

Budget Overview: The Governor's budget proposes expenditures of $745 million ($713 million General Fund) and 6,195 positions for FTB. This represents a continuation of a substantial increase in support for the agency, compared to the 2009-10 fiscal year, but a slight decrease from the current year funding level of $765 million. Expenditures have grown substantially from $533.1 million in 2009-10, due primarily to reinstating some of the budget reductions from earlier years as well as new programs. The budget reinstatements were made to reverse negative revenue impacts of the prior Administration's statewide cuts and furloughs, which included the state's tax collection agencies. In addition, the budget calls for augmentations for specific tax compliance programs and technology improvements related to the department's revenue collection activities. Recent budget increases have also been the result of funding for the Enterprise Data to Revenue (EDR) project, a benefits-funded project.

Issue 1: Earned Income Tax Credit – Oversight

Program Background. In SB 80 (Committee on Budget and Fiscal Review), Chapter 21, Statutes of 2015, the Legislature created the Earned Income Tax Credit (EITC), a state refundable tax credit for wage income that is intended to benefit very low-income households. Specifically, the program builds off the federal EITC and establishes a refundable credit for tax years beginning on or after January 1, 2015. The credit is applied to personal income tax liabilities associated with earned wage income (not including self-employment income). The program provides for a credit amount during a phase-in range of earned wage income according to specified percentages based on the number of qualifying children. For the tax year 2015, the phase-in and phase-out income ranges (which are adjusted annually) are shown below:

- No qualified children: Phase-in – $1 to $3,300; Phase-out – $3,301 to $6,579
- One qualified child: Phase-in – $1 to $4,950; Phase-out – $4,951 to $9,879
- One qualified child: Phase-in – $1 to $6,950; Phase-out – $6,951 to $13,869

For the 2015 taxable year, the maximum California EITC ranged from $214 for an eligible individual with one qualified child to $2,653 for an eligible individual with three qualified children. The FTB administers the EITC program. The California program dovetails with the existing federal EITC and matches 85 percent of the federal credits, up to half of the federal phase-in range, and then begins to taper off relative to these maximum wage amounts.

Program Performance. As initially estimated, the program was expected to cost $380 million annually, beginning in 2015, and benefit an estimated 825,000 families and two million individuals. When adopted, the estimated mean household benefit was $460 per year, with the median benefit expected to be in the range or $200 to $250 per year. Based on actual data to date for tax year 2015, as of December 2016, the mean credit is $519, and the median credit is $202. The most recent final data on the program for tax year 2015 is shown below.

Earned Income Tax Credit
Tax Year 2015
As of December 31, 2016

Returns with Claimed and Allowed EITC	385,546
Amount of EITC Claimed and Allowed	$200,293,222
Mean EITC Credit Claim	$519
Median EITC Credit Claim	$202
Range of EITC Credit Claims	$1 - $2,653
First Time Filers	73,290
Returns with Claimed and Adjusted/Denied EITC	37,104
Amount of Credits Adjusted or Denied	$26,109,046

Source: Franchise Tax Board.

Tax returns for the 2016 tax year are not completed, but program participation and credit usage also show undersubscription to the program, as indicated in the table provided below.

Earned Income Tax Credit
Tax Year 2016
As of April 1, 2017

Returns with Claimed and Allowed EITC	245,534
Amount of EITC Claimed and Allowed	$138,957,431
Mean EITC Credit Claim	$566
Median EITC Credit Claim	$214
Range of EITC Credit Claims	$1 - $2,706
First Time Filers	67,427
Returns with Claimed and Adjusted/Denied EITC	NA
Amount of Credits Adjusted or Denied	NA

Source: Franchise Tax Board.

The FTB is required to report to the Legislature regarding the participation in the program. As indicated above, actual participation is below original estimates, and the revenue impact of the program is also substantially below expectations. Preliminary data for the most recent tax year, also indicate that participation and usage are below expectations. The FTB is also required to provide a report to the Legislature regarding the success of the California EITC program (alone and in combination with the federal EITC) in lifting families out of deep poverty (defined as family income of less than 50 percent of the poverty threshold).[1] The report indicates that of the 385,546 tax returns that were allowed an EITC claim, 301,000 were categorized as living in deep poverty (based on adjusted federal AGI). The California EITC moved 23,000 of these families out of deep poverty; the combined impact of the California EITC and the federal EITC raised 94,000 families out of deep poverty.

Outreach Efforts. Last year, in the May Revision, the FTB requested $2 million for education and outreach efforts related to the California EITC. This amount was incorporated in the final budget. In its outreach efforts, FTB collaborated with a wide breadth of government and non-government agencies to develop a detailed communication plan to reach California taxpayers who might qualify for both the federal and state credits. Efforts included compilation and analysis of demographic information regarding the targeted population, web support activities, a direct mailer campaign to California taxpayers who did not have a state filing requirement but may qualify for the new California EITC credit, and educational outreach to taxpayers, tax professionals, legislative staff, and other groups.

Staff Comment. The FTB should provide an overview of the program, outline the findings of its report to the Legislature, and discuss the outreach efforts carried out in the current year. Despite efforts to reach the intended population, analysis suggests that a significant proportion of the population that is eligible for the program has not participated and additional outreach resources may be called for. There are a number of strategies that could be used to address this gap, including additional outreach, increased efforts by community organizations, incorporation of county offices in the outreach, and expanded free tax preparation. The subcommittee members may want to ask the FTB, as well as Department of Finance (DOF), about the effectiveness of last year's outreach resources and whether additional resources would be warranted this year. There are also substantive policy approaches to revising the program that could be considered, including increasing the allowable income of participants or expanding it to account for self-employment income.

Staff Recommendation: Information item.

Issue 2: New Employment Credit – Oversight

Program Background. In 2013, the Legislature created a New Hiring Tax Credit (now known as the New Employment Credit (NEC)) for employers' taxable years beginning on or after January 1, 2014, and before January 1, 2021. To obtain a credit the business must:

- Hire a qualified full-time employee on or after January 1, 2014.

[1] For 2015, the poverty threshold in annual income was $12,082 for an individual, $15,391 for two people, and $24,257 for four people.

- Pay qualified wages attributable to work performed by the qualified full-time employee in a designated geographic area.

- Receive a tentative credit reservation from the FTB (within 30 days of complying with the Employment Development Department (EDD) new hire reporting requirement) for that qualified full-time employee.

- Annually certify each qualified employee.

The credit is based on 35 percent of qualified wages, on wages between 150 percent and 350 percent of minimum wage, with the wage range increasing over time due to increases in the minimum wage rate. In order to generate an allowable credit, the qualified taxpayer must have a net increase in its total number of full-time employees working in California, when compared to its base year, both based on annual full-time equivalents. A qualified taxpayer must meet the following criteria:

- Engaged in a trade or business within a designated geographic area.

- Not engaged in any excluded businesses, including temporary help services, retail trades, those primarily in food services, alcoholic beverage places, theater companies, dinner theaters, casinos, and casino hotels unless the business is considered a small business.

- Not engaged in a sexually-oriented business.

- Hires qualified full-time employees (unemployed, veteran, EITC participant or ex-offender) who work at least an average of 35 hours per week and meet other specified wage requirements.

Over the past few years the FTB has publicized the availability of the NEC via various outreach efforts. Nevertheless, credit usage has fallen well short of estimates for the program. For tax year 2014, $3.9 million in NECs were claimed, and for tax year 2015, $1.7 million in credits were claimed. When the program was enacted, FTB estimated that $22 million in claimed credits for tax year 2014, and $69 million for claimed credits in tax year 2015.

The February 2017 FTB report to the Legislature suggests that the low rate of participation is potentially due to the complexity and multiple standards for the new program, the requirement that employers attempt to claim the credit without a reservation, and taxpayers continuing to use other credits for which they have qualified. The FTB cites a number of policy changes that would potentially address the under-subscription, comprising the following:

- Expand the existing geographic limitations for employers.

- Loosen eligibility requirements for employees.

- Reduce the required wage rate to less than150 percent of the minimum wage.
- Discontinue the requirement that employers reserve credits
- Expand the types of businesses that can qualify for the credit.
- Increase the amount of the credit percentage provided.

Staff Comments. The FTB should provide the committee with a synopsis of its report findings and comments on the advantages and disadvantages of the various options it provides to improve utilization. The program is too new (and underutilized) to provide a decent array of data which could be analyzed to estimate program effectiveness; however, this process of evaluation should be commenced once a basis of analysis has been compiled. The effectiveness of a tax credit program is – after all – not how many credits have been provided, but rather how many jobs have been generated as a result of the program

Staff Recommendation. Informational item.

Issue 3: California Competes Tax Credit Reviews (BCP)

Governor's Proposal. The FTB is requesting $1.7 million (General Fund) in 2017-18, and $1.6 million (General Fund) in 2018-19 and 2019-20, to administer its required activities under the California Competes Tax Credit (CCTC) program. Limited-term funding is requested to allow FTB to extend four existing limited-term positions and hire ten additional limited-term compliance staff to perform mandatory reviews of awarded tax credits.

Background. Tax credits awarded by the CCTC are available through 2017-18. Each contract lasts for five years and for each of those five years, the taxpayer must meet milestone commitments. In addition, the taxpayer must maintain the milestone commitments for an additional three years after the contact is over. FTB is required to review every business with a contact that has over $2 million in gross receipts, in order to confirm compliance with the credit agreement. CCTC indicates that the program may be extended, although that remains unknown at this point. Given this uncertainty, only limited-term funding has been requested.

Staff Comment. The activities required by the program do call for continued temporary funding for the next few years, and any additional required funding can be determined at a later date. The requested resources are warranted to ensure proper compliance with the awarded credits. The program allows for recoupment of credits if employers do not perform according to the contract, and the monitoring of performance is a key part of compliance efforts.

Staff Recommendation. Approve as budgeted.

Vote:

Issue 4: Court Ordered Debt Collection (BCP)

Governor's Proposal. The FTB is requesting $1.1 million (Court Collection Account) to convert seven temporary collection positions to permanent, and three-year, limited-tern funding for an additional 11 positions for the Court Ordered Debt (COD) program. The resources will be used for continue the collection services and eliminate the backlog of cases. Funding for the program comes from the account to which the proceeds are deposited. The proposed resource increase is estimated to produce revenue of $3.8 million in 2017-18 and $9.4 million in 2018-19.

Background. The FTB COD program was established as a pilot program in 1994, and designed to provide a statewide presence for collecting a variety of debts owed to certain state and local entities. The program was made permanent in 2004 and expanded to include counties and courts statewide. Debts collected by the program includes court fines and fees, court-appointed counsel fees, vehicle code violation fines, civil assessments, probation fines, and victim restitution fines and orders. The program efforts support numerous county and state funds and the client base has grown from 66 to 80 clients since 2010-11. The FTB COD program bills clients the operating costs of the program, not to exceed 15 percent of the amounts collected.

Staff Comment. Staff has no concerns with the proposal.

Staff Recommendation. Approve as budgeted.

Vote:

8860 DEPARTMENT OF FINANCE

Department and Budget Overview: The Department of Finance (DOF) serves as the Governor's chief fiscal policy advisor and promotes long-term economic sustainability and responsible resource allocation. The DOF's budget for 2017-18 is $75.2 million, roughly equivalent to the current year, with a position authority of 448.

The primary functions of the Department of Finance are to:
- Prepare, explain, and administer the annual financial plan for the state.
- Establish fiscal policies for all state departments.
- Analyze proposed legislation for fiscal and policy impacts.
- Monitor and audit expenditures to ensure compliance with the law, standards, and policies.
- Analyze the fiscal impact of information technology projects.

Issue 1: State Public Works Board Expense Account (TBL)

Governor's Proposal. The DOF is proposing budget trailer bill language to streamline the process for the State Public Works Board (SPWB) expenses by establishing a revolving expense account within the Public Buildings Construction Fund (PBCF). In addition, the language would provide technical cleanup to fix outdated references to accounts that are not used.

Background. The State Building Construction Act of 1955 authorizes that all money received by the SPWB must be deposited to the credit of the PBCF. The PBCF requires three separate accounts to be maintained, including a construction account, a revenue account, and a sinking fund account. This trailer bill would eliminate the outdated reference to the three accounts and create an expense account within the fund to pay administrative fees and insurance, excluding debt service payments, for the lease-revenue bond program.

Currently, each time an invoice is received for a service provided on behalf of SPWB, that invoice generates a need to prorate and allocate the portions of that invoice relevant to each participating department in a bond series and create multiple bill invoices for each invoice received. The expense account will create administrative efficiencies by automatically depositing departmental funds within 30 days of the enactment of the annual budget, from which each invoice would be directly paid without additional actions required. It is anticipated that there will be approximately 20 invoices per year instead of the current approximate 1,000.

Staff Comment. Staff has no concerns with the proposed language.

Staff Recommendation. Adopt the proposed statutory change.

Vote:

Issue 2: Reduction in Lease Revenue Bond Authority (TBL)

Governor's Proposal. The proposal would eliminate excess authority from the County Youthful Offenders Facilities Financing Program. All eligible projects have received awards from the Board of State and Community Corrections (BSCC); therefore this authority is not needed.

Background. Existing law authorizes the SPWB to issue up to $300 million in lease-revenue bonds to finance the construction of local youthful offender rehabilitative facilities. The BSCC issued awards to counties through a competitive process. The entirety of the $300 million was allocated to counties. Subsequent to the awards, Tulare and San Diego relinquished portions of their awards, and Riverside County increased its award. The proposed language would readjust the authority to reflect the actual awards made to counties.

Staff Comment. Staff has no concerns with the proposed language.

Staff Recommendation. Adopt the proposed statutory change.

Vote:

Issue 3: California Environmental Quality Act Responsibility (TBL)

Governor's Proposal. The trailer bill language would specify that neither SPWB nor DOF would need to provide further work to comply with the California Environmental Quality Act (CEQA). The proposal would clarify existing law and the Administration indicates that it will not constitute a change in existing law.

Background. Currently, budget bill provisional language specifies that SPWB and DOF do not need to act further to comply with CEQA, since this activity is routinely conducted by the department undertaking the project. Language to this effect is routinely included in capital outlay appropriations. The trailer bill language will codify this provision so that it need not be added for every new project proposed in the budget, and to ensure consistency in the administration of the state's capital outlay program. The Administration indicates that state department pursuing the project is still required to comply with CEQA.

Staff Comment. Given that there is little, if any link to the budget, staff recommends this issue be referred to the appropriate policy committee to address any concerns the proposal may raise. The area is a sensitive one and warrants additional review. In particular, since the proposal states that it is declaratory of existing law, the code section or cases should be cited to validate this. In addition, according to CEQA Net, neither the SPWB nor DOF are listed as lead CEQA agencies on projects, so it is not clear why the redundancy would occur.

Staff Recommendation. No action on the proposed language.

Vote: