Senate Budget and Fiscal Review

Subcommittee No. 5 2010 Agendas

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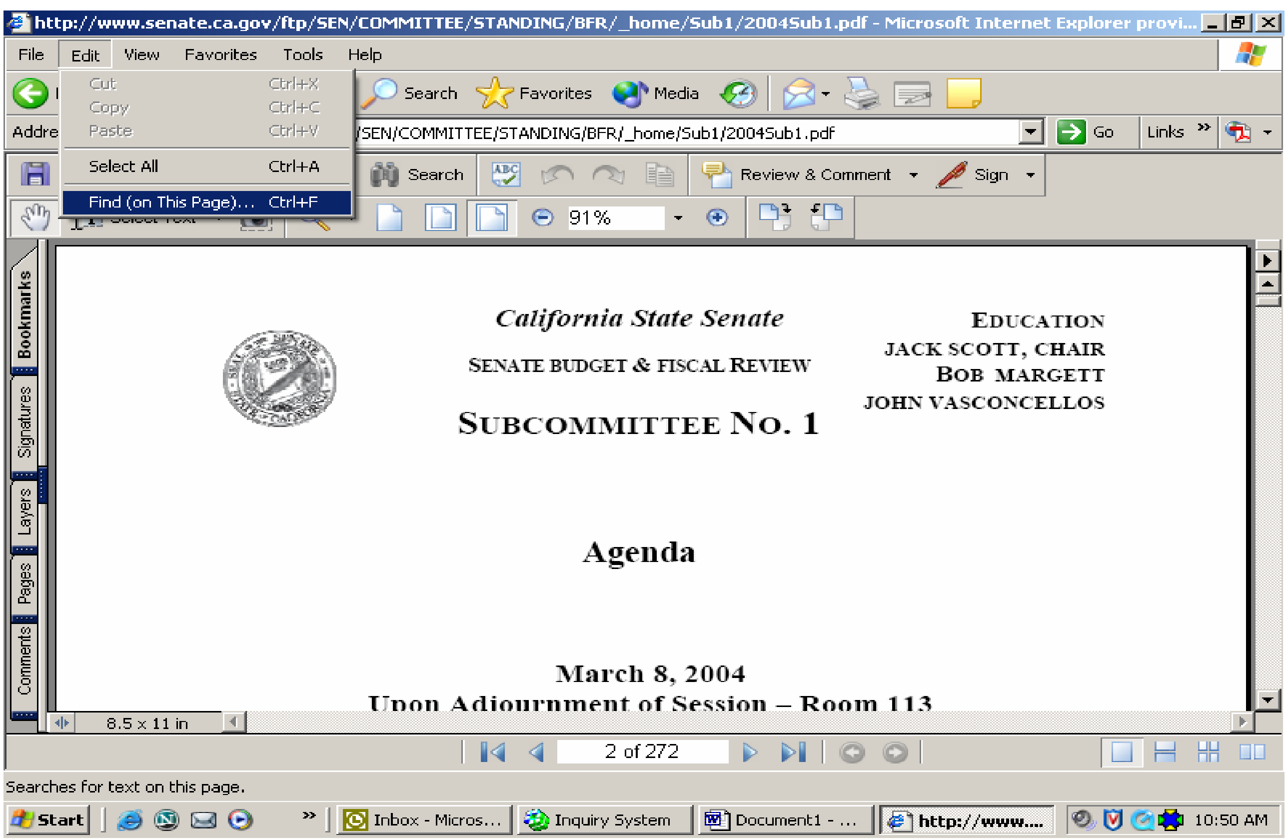

Senate Budget and Fiscal Review—Denise Ducheny, Chair

SUBCOMMITTEE NO. 5 Agenda

Senator Denise Moreno Ducheny, Chair
Senator Robert Dutton
Senator Alex Padilla

Thursday, April 29, 2010
9:30 a.m. or Upon Adjournment of Session
Room 113

Consultant: Kris Kuzmich

Agenda and OUTCOMES

Item	**Department**
0559	Labor and Workforce Development Agency
7100	Employment Development Department
7350	Department of Industrial Relations
	Employee Compensation
	Control Sections 3.60, 3.90, and 8.26

(See Table of Contents on page 2 for a More Specific Listing of Issues)

AGENDA

(Recommended Vote-Only Items indicated by *)

0559 Labor & Workforce Development Agency

Department Overview. The Labor and Workforce Development Agency (LWDA) brings together the departments, boards, and commissions which train, protect, and provide benefits to employees. The LWDA is primarily responsible for three different types of functions: labor law enforcement, workforce development, and benefit payment and adjudication. The LWDA includes the Department of Industrial Relations, the Employment Development Department, the Agricultural Labor Relations Board (heard in Subcommittee #2), and the Workforce Investment Board. The LWDA is funded through reimbursements from those departments. The LWDA provides policy and enforcement coordination of California's labor and employment programs and policy and budget direction for the departments and boards.

Budget Overview. The January Governor's Budget proposes 16.2 authorized positions (no new positions) and $3.131 million ($2.718 million reimbursements and $413,000 Labor and Workforce Development Fund) in expenditures. The Labor and Workforce Development Fund was established to fund efforts aimed at educating employers and employees about their rights and responsibilities under labor law and is supported by revenues from penalty assessments.

	2008-09 (actual)	**2009-10 (estimated)**	**2010-11 (proposed)**
Expenditures	$3,091,000	$2,914,000	$3,131,000
Personnel Years	15.6	16.2	16.2

Issue Proposed for Discussion / Vote:

Issue 1 – Economic and Employment Enforcement Coalition

Governor's Budget Request. The Governor requests to permanently establish 66 positions and ongoing funding of $7.208 million (special fund and reimbursements) for the Economic and Employment Enforcement Coalition (EEEC). (The original EEEC budget request, in 2005-06, was approved as three-year limited term; the 2008-09 EEEC budget request was approved as two-year limited term.)

In addition to LWDA, the other state departments that comprise the EEEC include the Department of Industrial Relations (DIR), Employment Development Department (EDD), and the Contractors State License Board (CSLB). Figure 1 on the next page illustrates the five-year budget history of the EEEC, including the 2010-11 requests from these four departments to make the EEEC permanent. Note, in 2005-06 and 2008-09, one-time expenditures were included in the costs but taken out in subsequent years; the Division of Occupational Safety and Health (DOSH) funding went up significantly in 2008-09 due to the Safety Engineer classifications receiving a pay raise.

Figure 1

	FY 2005-06		FY 2006-07		FY 2007-08		FY 2008-09		FY 2009-10		FY 2010-11	
DEPT	**PYs**	**Funding**	**PYs**	**Funding**	**PYs**	**Funding**	**PYs**	**Funding**	**PYs**	**Funding**	**PYs**	**Funding**
LWDA	0.0	$0	0.0	$0	0.0	$0	1.0	$141,494	1.0	$135,644	1.0	$135,666
DIR - DOSH	13.0	$1,464,621	13.0	$1,420,271	13.0	$1,420,271	13.0	$1,741,298	13.0	$1,741,298	13.0	$1,841,000
DIR - DLSE	16.0	$1,555,571	16.0	$1,503,321	16.0	$1,503,321	16.0	$1,654,438	16.0	$1,654,438	16.0	$1,675,000
EDD	25.0	$2,495,285	25.0	$2,414,285	25.0	$2,414,285	25.0	$2,495,610	25.0	$2,495,610	25.0	$2,638,000
CSLB	11.0	$998,000	11.0	$802,000	11.0	$802,000	11.0	$919,122	11.0	$919,122	11.0	$918,000
TOTAL	**65.0**	**$6,513,477**	**65.0**	**$6,139,877**	**65.0**	**$6,139,877**	**66.0**	**$6,951,962**	**66.0**	**$6,946,112**	**66.0**	**$7,207,666**

Background. Since mid-2005, the LWDA has led the Economic and Employment Enforcement Coalition (EEEC), a federal-state multi-agency partnership formed to combat the worst violators of federal and state labor, licensing, and tax laws operating in the underground economy. The goal of the EEEC is to target violators who operate in the underground economy and assist legitimate businesses that do comply with California law. Within the underground economy, employers utilize various illegal schemes to conceal their true tax liability, as well as reduce their operating costs associated with insurance, payroll taxes, licenses, employee benefits, safety equipment, and safety conditions.

According to the most recent progress report of the EEEC, dated September 2009, EEEC activities throughout the past four years have served to both enforce California's employment and tax laws and educate employers, employees, and the public. As of June 30, 2009, EEEC targeted enforcement sweeps identified 18,728 violations of labor, licensing, and tax laws. These violations represent employers who were using unlawful tactics to achieve an unfair competitive advantage over law abiding employers.

The Administration indicates that making the EEEC permanent will provide the stability necessary to enhance program planning and continued staff commitment to the operation. Many investigators and other staff members have come to closely identify with EEEC and wish to remain as long-term members of the operation. However, they are aware of the current temporary nature of the operation's funding and therefore have little choice but to consider opportunities outside EEEC for employment security and advancement purposes.

Staff Comment. Staff raises no issues with these requests as the Economic and Employment Enforcement Coalition has proven its value to the state. It is also paid for entirely by special funds. Staff notes that implementation is scheduled for July 2010 which will allow for a continuance of the Economic and Employment Enforcement Coalition without disruption.

Staff Recommendation. APPROVE the requests from the Labor and Workforce Development Agency, Department of Industrial Relations, and Employment Development Department as detailed in Figure 2 below. (Note, Subcommittee No. 4 is considering the Contractors' State Licensing Board request at its April 29 hearing.)

Figure 2

Entity/Request	PYs	Funding	Fund Source
LWDA BCP#01	1.0	$135,666	Reimbursements
DIR – DOSH #10-02	13.0	$1,841,000	Uninsured Employer's Benefits Trust Fund
DIR – DLSE #10-02	16.0	$1,675,000	Uninsured Employer's Benefits ($921,000) Trust Fund and Unpaid Wage Fund ($754,000)
EDD BCP #4	25.0	$2,638,000	EDD Contingent Fund ($1,319,000) and Disability Insurance Fund ($1,319,000)
Total	**55.0**	**$6,289,666**	

VOTE: Approved 3-0.

7100 Employment Development Department

Department Overview. The Employment Development Department (EDD) administers services to employers, employees, and job seekers. The EDD pays benefits to eligible workers who become unemployed or disabled, collects payroll taxes, administers the Paid Family Leave Program, and assists job seekers by providing employment and training programs under the federal Workforce Investment Act of 1998. In addition, the EDD collects and provides comprehensive labor market information concerning California's workforce.

Budget Overview. The January Governor's Budget proposes 11,106.7 positions and $26.1 billion in expenditures. This represents a decrease of approximately $4.3 billion, primarily in the Unemployment Fund, reflecting the fluctuation in unemployment benefits expected to be paid out in the budget year relative to the current year, and an increase of $20 million GF related to the Automated Collection Enhancement System which is discussed further below.

	2008-09 (actual)	**2009-10 (estimated)**	**2010-11 (proposed)**
Expenditures	$20,535,512	$30,434,290	$26,117,982
Personnel Years	9,731.2	11,326.9	11,106.7

Issues Proposed for Vote Only (please see summary chart on page 7):

Issue 1 – ARRA Labor Market Information Improvement Grant (FL)

Governor's Budget Request. In an April Finance Letter, the Governor requests expenditure authority of $625,000 (federal grant funds) in 2010-11 to enable EDD to support ARRA investments in energy efficiency and renewable energy industries. This request represents expenditure authority for the second half of these federal grant funds; in March 2010, the Joint Legislative Budget Committee (JLBC) approved a Section 28 request for expenditure authority of $625,000 in 2009-10.

Background. In total, EDD was awarded a $1.250 million (federal funds) ARRA Labor Market Information Improvement Grant. These grants funds will be used to collect, analyze, and disseminate labor market information, and to enhance the labor exchange infrastructure for careers within the energy efficiency and renewable energy industries.

Staff Recommendation. APPROVE.

Issue 2 – Employment Development Department Contingent Fund: Fund Shift to General Fund

Governor's Budget Request. The January Governor's Budget requests a one-time shift of $17.9 million from the Employment Development Department (EDD) Contingent Fund to the GF.

Background. The EDD Contingent Fund is comprised of fine and penalty revenue and is used, among others, to support the administration of the unemployment insurance (UI) program. The Administration is requesting to transfer, on a one-time basis, $17.9 million from this fund to the state's GF. This is the first time this shift has been proposed. The Administration indicates that the shift is warranted because the federal government is currently providing sufficient ARRA funds to support the administration of the UI program. Therefore, the Administration indicates the monies in the EDD Contingent Fund are not needed for UI program administration in 2010-11 and can be shifted to the GF.

Staff Comment. This request accelerates an action that would happen naturally; i.e., the $17.9 million in this request would be transferred to the GF at the end of the 2010-11 fiscal year. In taking this action, staff notes that it is important to acknowledge that the UI program is not over funded per se; rather, the proposed funding level is sufficient to meet current service levels. And, because of the increase in federal ARRA funds in support of UI program administration, there are funds in the EDD Contingent Fund available to be transferred to the GF. The Administration is proposing to do the transfer at the start of the fiscal year because of the current shortfall in the GF. Finally, staff notes that this transfer is proposed as one-time only because federal ARRA support will begin to taper off, thereby necessitating use of the EDD Contingent Fund for UI program administration in 2011-12.

Staff Recommendation. APPROVE.

Summary of Vote Only Issues:

Issue #	Issue Description	Staff Recommendation	Vote
1	ARRA Labor Market Information Improvement Grant	***APPROVED***	***3-0***
2	Employment Development Department Contingent Fund: Fund Shift to General Fund	***APPROVED***	***3-0***

Issues Proposed for Discussion / Vote:

Issue 3 – Unemployment Insurance Automation Projects

Governor's Budget Request. The Governor requests a total of four budget change proposals and two April Finance Letters relative to eleven information technology (IT) projects intended overall to improve service delivery and increase operational effectiveness and efficiency at the EDD. Figure 3 below lists these budget change proposals and April Finance Letters. The projects are detailed further beginning on page 8 in this agenda.

Figure 3

BCP FL #	Title/Description	PYs	Fund Detail
BCP 1*	Automated Collection Enhancement System (ACES)	65	$31.423 million total *[$24.601 million GF; $3.532 million Unemployment Insurance Fund; $3.164 million Disability Insurance Fund; $63,000 Employment Training Fund; $63,000 EDD Contingent Fund]*
BCP 3	Disability Insurance Automation (DIA) Project	47	$34.047 million *[Disability Insurance Fund]*
BCP 5	Unemployment Insurance Modernization Projects: (1) Call Center Network Platform and Application Upgrade (CCNPAU) and (2) Continued Claims Redesign (CCR)		$25.1 million total *[$13.905 million Unemployment Fund and redirection of $11.165 million Unemployment Administration Fund]*
BCP 2	Single Client Database (SCD) Modernization and Alternative Base Period (ABP) Subprojects	123 new and 33 existing	$25.8 million total [$*11.1 million Unemployment Fund and redirection of $14.7 million Unemployment Administration Fund]*
FL	ARRA Unemployment Insurance Modernization Projects: (1) Electronic Benefit Payments (EBP); (2) Identity Management (IdM); (3) Continued Claim Certification Web (CCCW); (4) eApply Modernization; and (5) Unemployment Insurance Forms (UI Forms).	40 existing	$9.079 million *[federal funds]*

*BCP #1 ACES includes two pieces of proposed trailer bill language, one of which is presented in an April Finance Letter, as well as proposed budget provisional language.

Automated Collection Enhancement System (ACES). Initially funded in the 2006 Budget, ACES will provide a fully integrated and automated tax processing solution that will utilize state-of-the-art employer tax collection, storage, audit and account management, and data retrieval technologies. With this new system, EDD will maximize the effectiveness of EDD's tax administration and collection operations. In addition, the proposed system will also collect penalties and back-wages that are due to the Department of Industrial Relations (proposed trailer bill language attached to BCP #1 ACES). The ACES project is benefits-based where the additional revenue generated by the project will offset all project costs thereby minimizing risk for the state. The eight-year total for this project is $93.2 million. <u>The request before the Subcommittee is a one-time augmentation of $31.423 million (Unemployment Insurance Fund and GF) and 65 positions in 2010-11; the ACES program is targeted for implementation by January 18, 2011</u>.

Disability Insurance Automation (DIA) Project. Initially funded in the 2006 Budget, the DIA project will provide greater access to services for claimants, medical providers, and employers by allowing these individuals to use the Internet to submit claims data using a direct electronic interface or through web-based intelligent forms. Scanning/optical character recognition will be implemented to convert remaining paper claims to electronic format. Automated business logic will allow "in pattern" claims to be paid automatically, further increasing service delivery. <u>The request before the Subcommittee is a one-time augmentation of $34.047 million (Disability Insurance Fund) and 47 positions for 2010-11 to provide the fifth year of resources to continue the development of the DIA project, including year two of Systems Integration vendor activities to continue the design, development, and implementation phase of the project</u>.

UI Modernization. First authorized in 2003-04, the Call Center Network Platform and Application Upgrade and Continued Claims Redesign subprojects are intended to modernize UI services, as follows:

1. **Call Center Network Platform and Application Upgrade (CCNPAU)**. The CCNPAU subproject will build a single network infrastructure for EDD's 15 call centers to interact with an intelligent call routing system, thereby reducing call blockage and improving access to services at EDD's call centers, to meet DOL performance guidelines. This project will increase the number of available agents by 1,000 and provide the infrastructure necessary to route calls to specialized agents.
2. **Continued Claims Redesign (CCR).** The CCR subproject will develop an interactive Internet Web site and telephone application that allows customers to file UI claims and recertify on a bi-weekly basis on the Web or by phone. Customers will be able to confirm certification, reopen claims, submit address changes, and receive communications via this application. This solution reduces the amount of workload that must be processed.

In May 2006, the EDD submitted a Special Project report that proposed to merge the two subprojects due to multiple interdependencies. This necessitated refining the scope, schedule, and costs of the combined projects. A subsequent change in procurement strategy also led to some delay. Originally estimated to cost $96 million, project costs have increased to $159 million (all federal funds – $66 million Reed Act funds, $79 million UI base grant funds, and $14 million ARRA funds). The original project schedule went from a completion date of November 2006 to April 2011 (over four years in delays) for CCNPAU, and June 2008 to August 2012 (over four years in delays) for CCR. <u>The request before the Subcommittee for the CCNPAU and CCR subprojects in increased expenditure authority of $25.1 million ($13.905 million Unemployment Fund and redirection of $11.165 million Unemployment Administration Fund) to fund the Systems' Integration vendors' activities during the design, development, and implementation phase of the project</u>.

American Recovery and Reinvestment Act UI Modernization (ARRA UIMOD). ARRA provided states additional UI administration dollars for use toward information technology modernization. California's share was $60 million. The EDD took advantage of these ARRA dollars to begin a variety of modernization projects, the majority of which were included in the department's 2008 Capital Plan. These projects are intended to streamline and improve UI service levels by minimizing manual processing of payments and claims and providing customers with more service options. The EDD has made the SCDB project a high priority, as it creates a flexible database that can be more easily changed to meet future service needs and allow for ABP implementation. The ARRA projects are estimated to take about two years to complete and cost a total of $80 million (using ARRA dollars and Disability Insurance funds) including one-time costs, ongoing costs, and one year of maintenance and operations costs. The ARRA UIMOD projects are described individually below; the per project total cost figure includes one-time costs, ongoing costs and one year of maintenance and operations costs.

1. **Single Client Database (SCDB) Modernization.** Started in May 2009 and totaling $40 million, the SCDB project will replace EDD's out-dated UI/DI database with a modern, relational one that will be easier to maintain, change, and optimize to meet the service needs of business and to respond to legislative mandates, including allowing new business processes, such as the Alternate Base Period, to be implemented efficiently. Project implementation is expected in July 2011.
2. **Alternate Base Period (ABP).** Started in May 2009 and totaling $10 million, the ABP project will implement programming changes to provide an ABP for individuals who do not monetarily qualify for a UI claim using the standard/current base period year by allowing workers to qualify for a UI claim by using an ABP that is based on the most recent four completed calendar quarters at the time of filing a claim. Chapter 23, Statutes of

2009 (ABX3 29), requires ABP implementation by April 2011. ABP is expected to bring an additional $840 million in federal funds to California.

3. **Electronic Benefit Payments (EBP).** Started in April 2009 and totaling $1.9 million, the EBP project will allow for the delivery of UI, Disability Insurance, and paid family leave benefit payments electronically, via direct deposit or electronic payment card, instead of through a paper check. Project implementation is expected in fall 2010.
4. **Identity Management (IdM).** Started in May 2009 and totaling $9.3 million, the IdM program will implement a secure identification and authentication system to provide secure access to UI services online. This solution is a necessary precursor to several of EDD's projects involving Web applications. Project implementation is targeted for September 2010.
5. **Continued Claims Certification Web (CCCW).** Started in March 2009 and totaling $5.1 million, the CCCW project will provide a temporary mechanism that will allow UI beneficiaries to use a Web-based system to recertify their eligibility until the CCR project is complete. Providing this Internet continued claim form will reduce processing of the UI hardcopy continued claim forms that represent the highest volume processing in the UI program. Project implementation is targeted for June 2010.
6. **eApply4UI Modernization.** Started in October 2009 and totaling $9.3 million, the eApply4UI project will expand the types of UI claims EDD can process through its existing eApply4UI Internet application that allows clients to auto-file when staff intervention is not required. Phase 1 is scheduled to implemented by late May 2010.
7. **UI Forms**. Started in December 2009 and totaling $4.8 million, the UI Forms project will expand the number and volume of UI forms being imaged at the Document and Information Management Center and is expected to create efficiencies by having documents and associated correspondence available electronically statewide rather than in hardcopy form in individual offices. Project implementation is targeted for June 2010.

<u>The request before the Subcommittee for the SCDB and ABP subprojects is an increase of expenditure authority of $25.8 million (federal funds), 123 new positions, and 33 existing positions for 2010-11 project activities including programming modifications and project implementation for both subprojects</u>.

<u>The request before the Subcommittee for the EBP, IdM, CCCW, eApply4UI, and UI Forms projects is an increase in expenditure authority of $9.079 million (federal funds) and 40 existing positions, representing the UI program's share of project costs for these five projects. The increase in budget authority is necessary to use the Special Transfers for Unemployment Compensation Modernization funds provided under ARRA.</u>

Staff Comment. With regard to the **ACES project**, this project is modeled after the systems currently being used by the Franchise Tax Board (FTB) and Board of Equalization, both of which experienced significant increases in revenue following their implementations. The ACES project has identified two types of benefits: (1) one-time increased revenue derived from implementation of an interim collection system that will use automated tools and modified business processes on accounts receivable balances that are not currently being actively pursued by a collector and (2) on-going increased revenue derived after full implementation of the proposed solution. ACES is also a benefits based procurement; i.e., the vendor will be paid from the “incremental revenue” produced by the vendor’s solution which is defined as additional revenue above the State’s defined baseline that is attributed to the solution. To avoid over-estimating 2010-11 GF revenues attributed to the ACES project, the DOF has applied a discount factor to the vendor’s revenue projections. Current estimates are that there will be $41.2 million in increased GF revenues; the Administration indicates that this estimate will be revisited in May 2011 after the ACES project has had some experience with actual revenue collections. Staff notes that it is possible that a vendor payment will not be needed in 2010-11 because the vendor may have overestimated the revenue. If that is the case, the EDD will not need the $23 million ($18 million GF) for vendor payments in the ACES project request. Therefore, the request is accompanied by proposed budget provisional language to allow DOF to reduce the ACES project GF appropriation should increased revenue through 2010-11 not fully recoup the state’s sunk costs. Staff notes that this proposed budget provisional language does not include notification to the Legislature; this should be corrected to ensure the Legislature is kept fully informed of the ACES project when it comes on-line in January 2011 and begins collecting revenue.

The **ACES project** request also contains two pieces of proposal trailer bill language. The first will authorize EDD to collect penalties and back-wages that are due to DIR. When FTB was given responsibility for these collections it was not provided any additional position authority. Rather, based on workload and resources available, FTB redirected staff to this workload. With the approval of the proposed trailer bill language, and when ACES is on-line, this workload will eventually transfer to EDD. When the transfer is complete, the FTB will redirect its staff back to existing vacancies. Staff notes no issue with this proposed trailer bill language.

The second **ACES project**-related proposed trailer bill language is presented in an April Finance Letter. A key component of the ACES project is the ability to establish non-audit related liabilities prior to year-end reconciliation. Therefore, the proposed trailer bill language would eliminate the requirement that employers file an annual contribution reconciliation form and instead modify the quarterly contribution return of taxable wage information filed by employers to allow the EDD to reconcile taxes paid with taxes due each quarter. Staff notes that establishing liabilities on a quarterly basis will result in earlier billings, earlier filing of liens, or other involuntary collections as well as liability amounts that employers can afford to pay as opposed to larger liabilities over a full year that increase the likelihood of default. Staff notes no concern with this proposal trailer bill language.

With regard to the **DIA project**, staff notes that there was a small delay in start time. This start time delay, however, was intentional to allow the DIA project start time to coincide with UIMOD to create shared services and efficiencies.

With regard to the **SCDB and ABP projects**, as noted earlier, current statute requires ABP implementation by April 2011 and that ABP is expected to bring an additional $840 million in federal funds to California. However, in the latest ABP Quarterly report to the Legislature, for the period October 2009 to December 2009, the EDD reports a five month delay in the SCDB, and commensurate delay in implementing ABP, due to state resource impacts of federal UI extensions. More specifically, the five month delay is attributed to the programming and testing efforts needed to implement the extensions because the same information technology staffing resources are needed to support the federal extensions and the SCDB and ABP subprojects. EDD is indicating that it has identified a potential temporary solution to get the ABP back "on track" to meet the statutory deadline.

More specifically, a proposed database design solution to avoid resource contention with the federal extensions and to allow parallel development has been introduced by the project team and is being reviewed prior to submittal to the Office of the Chief Information Officer (OCIO). This solution would "de-link" the ABP functionality from the completion of the SCDB conversion as a temporary solution until the SCDB can be entirely converted. Once approved by the OCIO, and if the alternative project proposal is successful, the EDD hopes to make up the five months that it is behind schedule and put the project back on track to meet the statutory deadline of April 2011. The EDD indicates that it will provide an update on the status of the de-linking solution in the next ABP quarterly report. Staff notes that this interim solution is likely necessary, especially since the federal government as recently as two weeks ago approved another federal UI extension.

Staff Recommendation. APPROVE the four requests and two April Finance Letters detailed in Figure 3 on page 7 in this agenda; including both pieces of proposed trailer bill language associated with the Automated Collection Enhancement System request; APPROVE the proposed budget provisional language associated with the Automated Collection Enhancement System request with an amendment to ensure notification to the Joint Legislative Budget Committee.

VOTE: Approved 3-0 except for BCP #2 SCDB/ABP which was HELD OPEN pending receipt of cost detail on "de-linking" solution.

Issue 4 – Information Technology Automated Integrity Related Systems (FL #3)

Governor's Budget Request. In an April Finance letter, the Governor requests an increase in expenditure authority of $4.426 million (federal funds) for 16.3 currently unfunded positions to obligate federal Supplemental Budget Request (SBR) funds from the Department of Labor (DOL) for the purpose of funding ten grant projects intended to improve UI information technology security and contingency planning, and implement technological improvements to better serve UI beneficiaries and employers. This request also includes proposed provisional budget language that would require approval from both the Office of the Chief Information Officer (OCIO) and Department of Finance (DOF) in order to expend $2.419 million of the federal SBR funds.

Background. The EDD received $4.426 million in federal SBR funds in September 2009, representing ten separate grant projects intended overall to improve existing EDD activities and implement technological improvements to better serve UI beneficiaries and employers, accommodate large fluctuations in UI workloads, and improve UI program integrity and/or performance. Per federal rules, the SBR funds must be obligated by September 1, 2011, or the state risks losing these funds. Figure 4 on the next page illustrates the ten grants that were approved by the DOL; asterisks denote the three projects (Nos. 3, 7, and 8) that are subject to the proposed budget provisional language:

Figure 4

	PYs	Allocation
Program 21: Tax Collections and Benefit Payments		
1. UIMOD Project/CCNPAU: Call center expansion to provide additional agent capacity in existing call centers.	0.0	$1.006 million
2. Electronic Benefit Payment Project: Education and outreach to UI beneficiaries to avoiding debit card fees.	1.0	$199,000
3. Alternative Base Period: Benefit Claims Inventory System redesign to accommodate the increased workload volumes that are expected as a result of the ABP project.*	11.6	$1.661 million
4. Security training to develop a UI Information Technology Security Awareness Training Program for internet applications software development.	0.0	$156,000 ($100,000 federal funds for contractual services and $56,000 redirected from existing state resources for staff costs)
5. UI Information Technology Continuity Plan for Business to ensure alignment with the State information security policy requirements for disasters plans.	0.0	$213,000 ($150,000 federal funds for consulting services and $63, 000 redirected from existing state resources for staff costs)
6. UI Information Technology Independent Verification and Validation of No. 5 above.	0.0	$147,000 ($94,000 federal funds for consulting services and $53,000 redirected from existing state resources for staff costs)
Program 22: California Unemployment Insurance Appeals Board		
7. Digital Imaging for Appeals to procure a consultant to reengineer and design a new electronic business process for the CUIAB's and EDD's appeals processes. *	0.9	354,000
8. E-CATS or Smart Schedulers to procure a consultant to document and design an electronic case management appeals process at CUIAB and EDD.*	0.8	$404,000
9. Speech to Text Electronic Transcription (STEP) to retrofit 60 existing Administrative Law Judge workstations and reduce the time needed for processing decisions.	0.9	$148,000
10. CUIAB Wide Area Network Re-Design to improve delivery of UI computer services and ensure the quality and speed of service required by current applications.	0.3	$310,000

Staff Comment. In reviewing this April Finance Letter with the EDD, staff raised a general concern about the ability of the EDD to take on additional information technology-related projects given the depth and breadth of projects currently underway and discussed in Issue 3 on page 8 of this agenda. The EDD indicated that these federal grants are for projects in an existing queue (Nos. 4 through 10) or are enhancements of larger projects that have already been approved (Nos. 1 through 3). Further, while it is correct that the projects identified as "existing" by EDD may be technically "new" to the Legislature, they represent relatively small amounts of funding and are consistent with the policy direction the Legislature has provided in recent years for the EDD to seek federal grants to better serve UI beneficiaries and employers by improving existing operations and implementing technological improvements.

As noted above, this request also includes proposed provisional budget language that would require approval from both the OCIO and DOF in order to expend $2.419 million of the SBR funds. Per the proposed language, DOF will notify JLBC after the contract paperwork is completed, but before the contract is approved. This is the standard procedure for information technology projects and it will ensure that the Legislature will be notified before the EDD enters into contracts.

Staff Recommendation. APPROVE April Finance Letter #3.

VOTE: Approved 3-0.

Issue 5 – California Unemployment Insurance Appeals Board

Background. The California Unemployment Insurance Appeals Board (CUIAB) remains subject to a corrective action plan with the Department of Labor (DOL); however, after nine years of federal monitoring and after completing its annual review in July 2009, DOL noted the CUIAB's efforts and investments in staffing and technology are moving the CUIAB in the right direction. For example, in December 2008, California ranked 51 out of 53 states and territories (Guam, Puerto Rico, and Washington DC) on how long it took to process first level appeals. For second level appeals, also known as Board Appeals, California ranked 23 out of 53. In a DOL report released on March 23, 2010, California now ranks 41 out of 53 in first level appeals and 11 out of 53 in second level appeals. While this progress is commendable, the CUIAB still faces significant backlogs.

From 2008 through 2010, California's unemployment rate increased from 7.2 percent to 12.5 percent. With 2,274,000 Californians unemployed, a record number of UI claims were filed and CUIAB experienced a backlog of appeal cases. In September 2009, CUIAB had 94,499 pending first level cases in all programs, (Unemployment, Disability, and Tax disputes). As of March 12, 2010, CUIAB had 83,504 pending cases in all programs. Of this balance, 70,469 pending cases are to resolve disputes regarding UI benefits. As a comparison, in 2008, CUIAB received 344,159 appeal cases; in 2009, CUIAB registered 413,935 appeal cases. With the unemployment rate rising every month since June 2008, in 2010, the CUIAB expects to receive and process more than 450,000 appeal cases.

The CUIAB's work has been further challenged because the federal government has authorized four UI program extensions for workers experiencing long term unemployment. The federal regulations attached to those benefits required treating every request for an extension as a new claim and came with a new set of complex rules. To address this issue, Administrative Law Judges (ALJ) were provided additional training to ensure eligible claimants received extended benefits in a timely manner. As recently as two weeks ago, the federal government authorized a fifth UI program extension.

To address the backlog, CUIAB indicates that investments have been made in staffing, infrastructure, adoption of strategic initiatives, business strategies, and changes to regulations, and long-term planning to improve services to Californians experiencing unemployment and disability. Since January 2009, CUIAB's Board Members have focused their attention on reducing the organization's backlog and preventing delays in the future despite California's record unemployment rate. The CUIAB moved to hire additional ALJs and support staff; the CUIAB now has 285 ALJs and 336 support staff working out of 12 field offices across the state. This represents a 34 percent increase in the number of ALJs hearing cases and a 28 percent increase in support staff. The

CUIAB will be completing another phase of hiring by June 2010 that will add an additional 26 ALJs and 73 support staff. This will help offset losses from an unusually high level of attrition in 2009-10 as over 30 ALJs and 34 support staff have retired or separated from state service.

Staff Comment. It should be noted that no other state handles the number of UI claims as California and if compared against other states, claim filings here would be equivalent to all work completed in Florida, New York, Ohio, New Jersey, Illinois, and Pennsylvania. Staff also acknowledges that the CUIAB has made some improvements on the backlog during an extremely challenging time period, as the CUIAB is facing a consistently high level of new appeals filed by claimants seeking extended benefits and employers contesting claims. As the CUIAB notes, three of the highest months of new appeals on record have occurred in the last six months. All that said, the existing backlog is significant and questions should be raised whether enough is being done and what additional can be done on a going-forward basis.

Committee Questions. Based on the above comments, the Committee may wish the Administration and CUIAB to provide responses to the following questions:

1. What is the current status of the CUIAB's multi-year corrective action plan with the Department of Labor?
2. What is the current case backlog number? What additional strategies or policies have been and/or will be employed to continue to reduce the backlog?
3. What impact will the most recent federal UI extension have on CUIAB claim filings and operations?
4. What types of technological advancements are being considered and/or developed to further expedite workload and allow the CUIAB to better serve the public?
5. How have furlough requirements impacted the timeliness of the appeals process?

Staff Recommendation. NO ACTION.

7350 Department of Industrial Relations

Department Overview. The objective of the Department of Industrial Relations (DIR) is to protect the workforce in California; improve working conditions; and advance opportunities for profitable employment. The DIR enforces workers' compensation insurance laws and adjudicates workers' compensation insurance claims; works to prevent industrial injuries and deaths; promulgates and enforces laws relating to wages, hours, and conditions of employment; promotes apprenticeship and other on-the-job training; assists in negotiations with parties in dispute when a work stoppage is threatened; and analyzes and disseminates statistics which measure the condition of labor in the state.

Budget Overview. The January Governor's Budget proposes 2,725.8 positions and $393.1 million in expenditures. Approximately half of the DIR expenditures are from the Workers' Compensation Administration Revolving Fund, which is increased in the budget year relative to fiscal year 2009-10. The Labor Enforcement and Compliance Fund and the Occupational Safety and Health Fund would increase by $23 million and $5.5 million, respectively, as compared to 2009-10 funding. Additionally, the DIR budget contains approximately $5.9 million GF, which is about $20 million less than in 2009-10 and attributable to DIR transitioning to be funded by special fund sources.

	2008-09 (actual)	2009-10 (estimated)	2010-11 (proposed)
Expenditures	$ 385,789,000	$357,438,000	$393,140,000
Personnel Years	2,534.7	2,714	2,725.8

Issues Proposed for Vote Only (please see summary chart on page 22):

Issue 1 – Employment Training Fund: Fund Shift (BCP #10-08)

Governor's Budget Request. For the Division of Apprenticeship Standards (DAS), the Governor requests the elimination of $3.3 million in Employment Training Fund (ETF) support, with a corresponding increase of $3.287 million in appropriation in the Apprenticeship Training Contribution Fund (ATCF) to backfill the reduction. This request will eliminate all support from the ETF for DAS. This request also includes proposed trailer bill language to eliminate the continuous appropriation for the ATCF.

Background. DAS administers California's apprenticeship law. In 1991-92 and 1992-93 and as a backfill to GF reductions, DAS received an initial appropriation from the ETF. Since that time, the appropriation has increased (for the most part due to General Safety Increase and/or technical adjustments) from the initial ongoing amount of $1.8 million to approximately $3.2 million in 2009-10. Under this request, the ETF funding will be reallocated back to the Employment Training Panel (ETP) to support high-wage and high-skill job creation and retention and the state's key industries and workforce initiatives. This request also includes proposed trailer bill language to remove the continuous appropriation authority for the ATCF. The ATCF has never been continuously appropriated and, because it now supports DAS, it is no longer appropriate for the ATCF to have this authority.

Staff Comment. Returning these funds to the ETP is consistent with the Subcommittee's intent to identify means to further support the ETP and address its current backlog of new contracts needing funding.

Staff Recommendation. APPROVE.

Issue 2 – Managed Care Fund Appropriation Reduction (BCP #10-13)

Governor's Budget Request. The Governor requests to reduce the Managed Care Fund appropriation by $282,000. This reduction is reflective of a decrease in anticipated fund revenue due to a proposed amendment to California Code of Regulations, Section 9779 subdivision (f), to reduce the certification fees relative to the Health Care Organization (HCO) Program. The reduced appropriation level will support the current HCO program staffing costs of approximately $91,000.

Background. The HCO Program was established through Chapter 121, Statutes of 1993 (AB 110), as part of a comprehensive reform of the workers' compensation system. The HCO program was intended to address cost-containment by providing a "managed care" option for medical treatment of injured workers. Due to a variety of factors, including administrative complexity in the HCO enabling legislation and open rating for insurance premiums, managed care failed to grow as had been anticipated. The Administration indicates that it is making this request to reduce the appropriation level, as a result of the reduced fee structure (certification fees will be reduced from $20,000 to $2,500 and from $10,000 to $1,000), in the hope that the reduced fees will renew interest in the program and increase the number of participants. The Administration indicates that the Managed Care Fund is healthy enough to support this request; based on the estimated level of future revenues, it is anticipated the fund can support the proposed level of fees and appropriations for eight years. Finally, the request reflects only a reduced fee structure for the HCO program. Overall workload and the level of service remain unchanged so no position reductions specific to this program are planned.

Staff Recommendation. APPROVE.

Issue 3 – Occupational Safety and Health Fund Loan Repayment (BCP #10-15)

Governor's Budget Request. The Governor requests to extend loan repayment to the GF from the Occupational Safety and Health Fund (OSH Fund) from June 30, 2010 to June 30, 2011.

Background. During the 2009-10 Budget process, the Division of Occupational Health and Safety (DOSH) proposed to completely eliminate its GF support of $24.8 million. In order to achieve this, the proposal included a GF loan request of $14.506 million to provide operating capital for the OSH Fund until the annual assessment revenue was collected (which occurs around March of every year). However, during subsequent budget negotiations last year, trailer bill was adopted to cap the OSH Fund assessment at $52 million annually until July 1, 2013, at which time it will revert back to the June 30, 2009, level adjusted for inflation. With the OSH assessment capped, if DOSH repays its GF loan obligation on June 30, 2010, it would leave the fund insufficient operating revenue until the 2010-11 assessment is received in March 2011. Because of this, DOSH would have to request another GF loan to bridge the gap until the assessment is received. By extending the loan repayment until June 2011, this request provides DOSH with sufficient income to operate for the first nine months of the 2010-11 fiscal year.

Staff Recommendation. APPROVE.

Issue 4 – Workers' Compensation Insurance Enforcement (BCP #10-16)

Governor's Budget Request. The Governor requests three positions for the Division of Labor Standards Enforcement (DLSE) Bureau of Field Enforcement and expenditure authority of $221,000 (Uninsured Employers Benefits Trust Fund, or UEBTF) in 2010-11, and $363,000 (UEBTF) in subsequent years, to comply with Chapter 640, Statutes of 2009 (SB 313), which is effective January 1, 2011, and requires a more complex, comparative analysis method when computing workers' compensation insurance penalties issued by DLSE.

Background. Chapter 640, Statutes of 2009 (SB 313) is intended to provide more effective incentives for employers to maintain state mandated workers' compensation insurance coverage and to eliminate a competitive advantage obtained by those who fail to follow the law (prior to the enactment of Chapter 640, employers may face a penalty that is less than what their workers' compensation insurance costs would have been, thus creating a disincentive to securing coverage). Chapter 640 provides an amended alternative methodology to determine penalties. Chapter 640 further requires that assessments for non-compliance be made using the methodology that provides for the greater assessment amount derived from a comparison calculation using two processes. These new and revised approaches to business practices cannot be absorbed by the DLSE within existing resources; absent the resources in this request, collections of penalties could be jeopardized and DLSE risks diverting existing staff from other required enforcement programs. The additional authority requested in this proposal will be offset by increased deposits into the UEBTF (per Chapter 640, the per-employee assessment was increased from $1,000 to $1,500).

Staff Recommendation. APPROVE.

Summary of Vote Only Issues:

Issue #	Issue Description	Staff Recommendation	Vote
1	Employment Training Fund: Fund Shift	***APPROVED***	***3-0***
2	Managed Care Fund Appropriation Reduction	***APPROVED***	***3-0***
3	Occupational Safety and Health Fund Loan Repayment	***APPROVED***	***3-0***
4	Workers' Compensation Insurance Enforcement	***APPROVED***	***3-0***

The approval of Issue 3, Occupational Safety and Health Fund Loan Repayment, was made with the understanding that ½ t he GF loan will be repaid on June 30, 2010 and the second ½ of the GF loan will be repaid on June 30, 2011.

Issues Proposed for Discussion / Vote:

Issue 5 – Apprenticeship Public Works Law Enforcement (BCP #10-06)

Governor's Budget Request. The Governor requests 2.5 positions and $275,000 (Apprenticeship Training Contribution Fund, or ATCF) in 2010-11, and $275,000 (ATCF) in subsequent years, to enforce apprenticeship labor code requirements on public works projects.

Background. The vast majority of apprentices and programs are in the construction field. In order to encourage the training of apprentices, and to expand apprentice opportunities, statute mandates that contractors on public works projects employ registered apprentices in a ratio of one hour of apprentice labor for every five hours of journeyman labor. Statute further requires that contractors on public works projects make contributions to the ATCF in the amount established in the Prevailing Wage Rate publication for every worker. The ATCF was established in the 2000-01 fiscal year to provide grant funding to apprenticeship programs statewide and to support the overall administration of the program. All penalties assessed by the Division of Apprenticeship Standards (DAS) for non-compliance are deposited into the GF.

DAS reports that the current enforcement case backlog grew significantly from January 2009 to August 2009; an additional 531 cases were received, with approximately 67 percent, or 358, of these cases remaining open. Current estimates indicate that the GF is losing approximately $250,000 per year in fines and penalties due to DAS' inability to sufficiently enforce the apprenticeship wage law. DAS estimates that without the additional resources proposed in this request, an additional 450 cases will go uninvestigated annually. With these resources, DAS will effectively address the backlog, have stronger evidence, and a reduced need to prematurely settle cases as a means to manage workload.

Staff Comment. This proposal may appear similar to BCP #10-12 (Issue 6, page 24 in this agenda) which is a request related to Labor Compliance Program Enforcement of Apprenticeship Law on Public Works Projects. Staff notes, however, that the requests are distinct. This request represents resources for DAS' *overall* enforcement function for *all* public work projects. This workload is not specific to complaints received from Labor Compliance Programs, but it may include investigation of these complaints by DAS. This workload also includes investigating complaints referred from the Division of Labor Enforcement (DLSE), which cannot enforce apprenticeship wage law with the bond funding made available for the compliance monitoring previously performed by LCPs.

Staff Recommendation. APPROVE BCP #10-06.

VOTE: Approved 2-1 with Dutton voting no.

Issue 6 – Labor Compliance Program Enforcement of Apprenticeship Law on Public Works Projects (BCP #10-12)

Governor's Budget Request. The Governor requests 2.5 positions and $362,000 (Apprenticeship Training Contribution Fund, or ATCF) in 2010-11, and $345,000 (ATCF) in subsequent years, to assist in writing new regulations, providing training and evaluation of labor compliance programs (LCPs) that are newly empowered to enforce apprenticeship laws on public works projects and reviewing and assessing penalties as a result of the LCP enforcement action.

Background. Chapter 438, Statutes of 2009 (AB 395) provides authority to awarding bodies that have an approved LCP to assist the Division of Apprenticeship Standards (DAS) in the enforcement of prevailing wage laws and other requirements that apply to apprenticeships in public works projects through the operation of that approved LCP. As currently staffed, DAS is not able to meet this newly created oversight function. The resources in this request will provide additional staff members to adopt regulations and establish an apprenticeship oversight structure for LCPs with respect to apprenticeship labor law enforcement. Additionally, these positions are needed to provide training in apprenticeship enforcement, be available to answer LCP questions about enforcement requirements, and review and assess penalties that occur as a result of a LCP enforcement action.

With regard to training in apprenticeship enforcement, current complaints DAS receives from LCPs are incomplete or are unusable in that: 1) the LCPs fail to provide the required documentation specified in Title 8, CCR section 231, and 2) they refer the minimum situations; for example, a single apprentice appearing to have worked unsupervised for a single afternoon, that may not establish even technical violations and do not warrant the time and expense of an investigation or enforcement. In order to properly conduct apprenticeship enforcement, LCPs need to be trained by DAS to learn apprenticeship requirements and to be able to present completed investigations to DAS for determination of penalties.

Staff Comment. With the enactment of Chapter 438, Statutes of 2009 (AB 395), awarding bodies will now have the authority to enforce the prevailing wage laws that apply to apprenticeships through the operation of their approved LCP. DAS' workload will increase as a result of this change in law; the resources in this request are warranted to ensure Chapter 438 is implemented as intended by the Legislature.

Staff Recommendation. APPROVE BCP #10-12.

VOTE: Approved 2-0 with Dutton abstaining.

Issue 7 – Public Works Compliance Monitoring Unit (FL #10-03)

Governor's Budget Request. The Governor requests 50 positions and expenditure authority of $6.8 million (State Public Works Enforcement Fund, or SPWEF) for half-year funding in 2009-10, and 100 positions and expenditure authority of $9.9 million (SPWEF) in subsequent years, to enable the Division of Labor Standards Enforcement (DLSE) to establish a Public Works Compliance Monitoring Unit to meet the monitoring and enforcement requirements of Chapter 7, Statutes of 2009-10 2nd Extraordinary Session (SBx2 9). This request also contains proposed budget provisional language which states that the resources requested in this proposal shall not be appropriated directly to DIR, but rather shall be subject to the availability of funds as determined by the Director of Finance (DOF) and further requires that any authorization made shall be reported in writing to the Joint Legislative Budget Committee within 30 days of the increase in expenditure authority. Finally, this request also contains proposed trailer bill language to streamline the collection of monies due to DIR.

2009-10 Budget. The 2009 Budget provided DIR with ten positions and a GF loan of $1.3 million to begin work on the Labor Compliance Monitoring Unit, including the regulatory process to establish the fee structure and monitoring standards and conduct an analysis of anticipated project workload. The DIR estimates that, through June 2010, $1.27 million of this GF loan will have been expended.

Background. Public entities that award public works contracts are required to, among other things, obtain and specify applicable prevailing wage rates, take complaints, and withhold contract payments needed to satisfy wage and penalty assessments when a violation occurs. Though public entities have concurrent authority to investigate complaints and enforce statutory prevailing wage requirements, historically these functions have been performed by the DLSE through its own authority to investigate complaints, determine the amounts of wages and statutory penalties due, order the awarding body to withhold those amounts from contact payments, and initiate or defend litigation as necessary to uphold assessments and recover amounts that could not be withheld.

Labor compliance programs (LCPs) were introduced in 1989 as a mechanism for enforcing the prevailing wage rates. LCPs work on behalf of and are paid by public agency awarding bodies either as "in-house" LCPs, run by the awarding body's staff, or by an outside contract with a private entity (third-party LCPs). Prior to 2002, there were approximately 12 LCPs in California. However, as a result of 2002 legislation requiring LCPs in connection with the use of specific bond funds, the number of LCPs in the state swelled to over 400. This dramatic expansion in LCPs turned what was once limited oversight on behalf of DIR into a duty requiring several field staff as well as two senior attorneys.

Chapter 7, Statutes of 2009-10 2nd Extraordinary Session (SBx2 9), overhauled existing law related to the payment of prevailing wages and the monitoring and enforcement thereof. In lieu of monitoring and enforcement by an LCP, Chapter 7 requires awarding agencies to pay a capped fee, not to exceed ¼ of one percent of the bond award, to DIR for compliance monitoring and enforcement on projects that are subject to the fee. Local awarding bodies retain their authority to utilize their approved "in-house" LCPs; under Chapter 7, the use of private third-party party LCPs will largely be eliminated.

Chapter 7 also: (1) expanded the range of projects that are subject to or eligible for this fee-based compliance monitoring and enforcement and (2) provided that the fee for compliance monitoring and enforcement by DIR is prospective only; i.e., it only applies to public contracts awarded after both the fee and the regulatory monitoring standards have been adopted. For contracts awarded prior to that date, any pre-existing LCP requirements will continue to apply. DIR indicates that the regulatory process related to the fee structure and monitoring standards is currently on track to be finalized in July 2010.

This request also includes proposed trailer bill language to amend the Labor Code to streamline collection of monies due DIR for enforcing the prevailing wage requirements on public works projects using bond funds. This portion of the request requires zero augmentation and does not increase staffing. The proposed trailer bill language will make the monitoring and enforcement fee payable by the person or entity that *allocates* bonds funds (as opposed to the *awarding* body). This change will simplify and improve DIR's ability to track and collect fees for bond-funded projects, as DIR will be dealing primarily with state level entities that allocate bond funds as opposed to working with all of the entities that are allocated and then award bond funds. DIR indicates this change will add slightly to the responsibility of those allocating entities (providing additional notice and paying the fee to DIR), while eliminating the associated obligations and expense for awarding bodies.

Staff Comment. Staff notes there are a great deal of uncertainties associated with this request, primarily surrounding the actual project workload. Per the 2009 Budget, DIR conducted an analysis of anticipated project workload, which is represented in part by this request. However, the uncertainties remain. For instance, the timing of bond issues is unknown. While the recently completed bond sale of $4.5 billion will result in workload for DIR, it is not clear when the bond funds will flow and for which projects. Further, just because bonds are issued and the dollars begin to flow, this does not translate to an immediate project start which is what triggers the need for project monitoring and enforcement. Global and/or economic factors could also adversely impact the revenue available in support of this program. However, staff notes that irregardless of these issues, the Labor Compliance Monitoring Unit will face additional workload in 2010-11. Therefore, the structure of this request, wherein expenditure authority is subject to the availability of funds as determined by DOF, provides a measure of control.

Staff also notes that the request provides advance notice to the Legislature of potential future budget issues associated with this new workload. With regard to facilities, DIR indicates the positions associated with this request can be accommodated within current facilities. However, should workload warrant an additional staffing request in 2011-12, it is probable that request will include a facilities component. This request also indicates that DIR is considering the development of a web-based solution to permit electronic submission of certified payroll records to make the monitoring work more efficient. DIR indicates that a Feasibility Study Report will be submitted, with an accompanying budget request for the Legislature to consider, but that this is a long-term project in 2011-12 or beyond. Staff notes that by that point in time there may be potential for DIR to piggyback on the informational technology modernizations projects that EDD is pursuing for shared savings and/or efficiencies.

Staff notes no issue with the proposed trailer bill language to streamline the collection process, as the current statutory construct will lead to an inefficient (and likely more expensive) collection process for DIR.

Staff Recommendation. APPROVE FL #10-03.

VOTE: Approved 2-1 with Dutton voting no.

Issue 8 – Return-to-Work Fund Sunset (BCP #10-14)

Governor's Budget Request. Due to a statutory sunset of January 1, 2010, the Governor requests the elimination of the Workers' Compensation Return-to-Work Fund (WCRTWF) appropriation of $499,000 and the transfer of the $483,000 fund balance to the Workers' Compensation Administration Revolving Fund (WCARF). In addition, the Governor requests to retain one position, which administered the Return-to-Work program, to address the backlog due to the change in business practice from a paper system to a paperless system. This position is, and would continue to be funded, through the WCARF.

Background. The Division of Workers' Compensation (DWC) administers the Return-to-Work program which was originally established by Chapter 6, Statutes of 2002 (AB 749) to promote the early and sustained return-to-work of an employee following a work-related injury or illness. Subsequent legislation [Chapter 34, Statutes of 2004 (SB 899)] amended these same code sections and required the DWC to establish a program to pay workplace modification expense reimbursements from the newly created WCRTWF. Chapter 34 also allowed for transfers from the WCARF. The 2006-07 Budget included a transfer of $500,000 between the two funds to provide funding for approved claim payments as well as provide one position to administer the new program. However, due to the fact that the expanded Return-to-Work program never gained traction, the pertinent section of the Labor Code (139.48) was allowed to sunset on January 1, 2010, hence this request to eliminate the WCRTWF and transfer the appropriation (which is now a fund balance) back to the WCARF.

The Administration indicates that while Labor Code Section 139.48 sunsetted, Labor Code Section 139.7 is still in effect requiring several activities related to the Return-to-Work program, including developing educational guides and materials for employers, employees, and labor unions and conducting training for employee and employer organizations. The position the Governor is requesting to retain would address, in part, this ongoing program workload. Additionally, the position would be utilized to address the current backlog of approximately 14,500 cases comprised of: 1) requests for rehabilitation determination filed prior to the January 1, 2010, sunset date (20 percent); 2) requests for Return-to-Work to respond to violations of requested modified workload adjustments for injured workers returning to work (60 percent); and 3) entry of old rehabilitation cases into the Electronic Adjudication Management System (EAMS) in order that workers' compensation judges reviewing cases have the complete history of the injured worker's case (20 percent).

The Administration indicates that the backlog is partially attributable to the EAMS system, in that the functionality of that system has impacted the DWC workload. More specifically, DWC still accepts paper documents, which must be scanned into the system. Therefore, in requesting to retain this position, the

Administration is requesting to address the outstanding volume of documents that must be scanned into EAMS as well as address the unit's ongoing workload which experienced a rush in new filings prior to the January 1, 2010, sunset date.

Staff Comment. While staff agrees that there is a backlog, it is not clear that retaining the one position on a permanent basis is warranted. Rather, a more prudent approach would be to make the retained position limited term to allow the Legislature to revisit this issue and determine if the DWC's workload justifies this position on a permanent basis.

Staff Recommendation. APPROVE BCP #10-14 but make the retained position two-year limited term.

VOTE: Approved 3-0 with the retained position ONE year limited term..

Issue 9 – Electronic Adjudication Management System I Maintenance & Operation (FL #10-01)

Governor's Budget Request. The Governor requests to redirect 3.5 positions and increase expenditure authority by $918,000 (Workers' Compensation Administration Revolving Fund, or WCARF) in 2010-11, and $624,000 (WCARF) in subsequent years, to continue critical ongoing maintenance activities necessary to the Electronic Adjudication Management System (EAMS), including ensuring that unauthorized access to personal and confidential information is prevented and that medical care and disability payments are provided in a timely fashion.

2009-10 Budget. The Legislature approved $3.6 million (WCARF) and 12 positions to meet the initial maintenance and operation costs of EAMS.

Background. Since August 2008, EAMS has been and will continue to be the system of record for the workers' compensation adjudication system, housing all information and documents relevant to resolving a dispute in a claim for workers' compensation benefits. As such, EAMS is a complex, centralized case management, document management, and reporting system that is accessible through a browser to internal DIR employees in all district and satellite offices and to some external parties. EAMS was developed using "commercial-off-the-shelf" software components, which were integrated to provide a seamless case management process for different, but interrelated units, of the Division of Workers' Compensation (DWC).

In 2003, legislation that created the WCARF declared legislative intent that a sufficient portion of the fund shall be allocated to the development of a cost efficient electronic adjudication system as a priority initiative. The Feasibility Study Report describing this project was approved by the Department of Finance

(DOF) in June 2004. DOF subsequently approved Special Projects Reports in October 2006, after the completion of procurement, and in November 2008. In April 2008, EAMS was the subject of legislative hearings to address constituent concerns, centered largely on outside user access to EAMS and whether DIR purchased a sufficient number of software licenses (the number of users who can use EAMS at any given time). It was reported at that time that the contract for EAMS called for the state to receive 2,500 licenses, with 1,200 of these licenses reserved for internal use, leaving only 1,300 for all of the attorneys, applicants, claims professionals, lien claimants, and others who have a vested interested in the claims and hearing process. DIR submitted the Post-Implementation Project Report on February 10, 2010, in support of its request to DOF to consider EAMS complete and to terminate project reporting.

The Administration indicates that work towards the goal of a paperless operation continues, but that goal has not been fully realized because external users do not have full access to the electronic case file. This lack of full access has resulted in an increased amount of paper processing through scanners, which has created significant backlogs leading to delays of up to 51 days to get a document into the system. Further, the Administration reports this backlog is growing. DIR is currently pursuing the implementation of a bulk filing mechanism for high volume filers which is expected to have a substantial impact on the amount of paper filed at district offices. In addition, the Administration indicates that the EAMS External User Access Project, whose scope and timing is currently under review, will change the structure of the licenses and provide an alternative means of external access (in addition to bulk filing) to further reduce the need for additional licenses.

However, before the necessary changes contemplated by the EAMS External User Access Project can be embarked upon, the Administration indicates that it is imperative that the ongoing critical maintenance and operation needs of the existing system be addressed. The Administration indicates that failure to address these immediate concerns will increase the risk of extended system outage, interrupt benefit delivery to injured workers, and will make it functionally impossible to meet the external demands for user access.

Staff Comment. The external user access issues identified in spring 2008 persist today. External user access is currently granted through a logon by location, not by individual, so that many users at one location have access through a single logon. However, with only 300 of these external user locations available for filing documents electronically, there is insufficient access to meet total external user needs. Staff notes that the original EAMS project scope and design did not envision providing access to all external users. However, having all external users linked into the system and having their filings made electronically will help the EAMS system meet its goal of having DIR move to a completely paperless system and operate as efficiently and effectively as possible. The scope and timing of the EAMS External User Access Project will be clearer once DIR concludes stress/load testing of the existing system which will determine the capacity of the current system to concurrently allow external users access to the system. This stress/load testing will also help inform the scope of the EAMS External User Access Project which will essentially allow DIR to purchase additional licenses and equipment to increase and improve access to the EAMS. Finally, staff notes that this additional project is in actuality a new information technology project whose merits the Subcommittee will consider at a future time after receiving the Feasibility Study Report.

The request before the Subcommittee today is narrow and pertains only to the current EAMS system and ensuring its continued functionality by building on the initial maintenance and operations activities approved in 2009-10. The additional activities attached to this request include ensuring that unauthorized access to personal and confidential information is prevented and that medical care and disability payments are provided in a timely fashion.

Staff Recommendation. APPROVE FL #10-01.

VOTE: Approved 3-0.

Employee Compensation

The Governor's January Budget employee compensation-related requests (detailed below) were heard before the Senate Budget and Fiscal Review Committee on January 28, 2010 during the 8th Extraordinary Special Session. The Legislature approved SBX8 2 which recognized General Fund (GF) savings in the 2010 Budget Act, including $449 million to reflect savings from implementing the five percent reduction to departmental personnel costs resulting from the Governor's Executive Order. Additionally, SBX8 2 recognized $130 million in GF savings to reflect the Operating and Equipment savings resulting from the same Executive Order. The Governor subsequently vetoed SBX8 2. No action was taken on the other components of the Governor's employee compensation-related requests in the Special Session which has since been adjourned.

Background. The state workforce consists of approximately 356,000 personnel years (PYs); a PY is roughly equivalent to one full–time equivalent employee. Total state payroll, including university personnel, is now roughly $24 billion per year. The state's two university systems employ just over one-third of total PYs. Excluding university employees, around $10 billion of GF expenditures, about 12 percent of the 2009-10 Budget, relate to state personnel costs, including payroll and state contributions to employee pensions, health, and other post employment benefits. About two–thirds of this $10 billion in state personnel costs funded by the GF are within the California Department of Corrections and Rehabilitation (CDCR).

Issues Proposed for Discussion / Vote:

Issue 1 – 2010-11 Employee Compensation Proposals

Governor's Budget Request. The Governor requests state employee salary and workforce savings totaling $2.1 billion GF in 2010-11, as illustrated in Figure 5 on the next page. These requests include the "5-5-5" proposal, health care savings proposed trailer bill language, and workload savings related to pre-funding other post employment benefit costs. As noted in Figure 6, the Governor is also requesting an additional five percent reduction for state employee compensation as part of a federal funds "trigger" in the event that the federal government fails to provide $6.9 billion in targeted funding or flexibility measures, across program areas and including health and human services, corrections, and education, that is the basis of the Governor's January budget.

Figure 5

	GF Savings	Control Section	Trailer Bill
"5-5-5" Proposal			
1. Five percent increase in employee pension contributions, reducing employer contributions by a like amount.	$405.8 million	3.60 (d) and 3.90	Yes
2. Five percent reduction to departmental personnel costs via Executive Order S-01-10 requiring agencies and departments to cap the size (reduction of 8,915.7 PYs) and cost of the workforce by July 1, 2010.	$449.6 million	3.90	No
3. Five percent across-the-board salary reduction.	$529 million	3.90	Yes
Health Care Savings			
Authorize state to contract for lower-cost health care coverage either directly from an insurer or through CalPERS.	$152.8 million	No	Yes
Other Post Employment Benefits			
Workload decrease for pre-funding other post employment benefit costs.	$98.1 million	No	No
TOTAL	**$1.635 billion**		
Federal Funds Trigger			
If the federal government fails to provide $6.9 billion in funding or flexibility measures, an additional five percent salary decrease for state employee compensation.	$508.9 million	8.26	No
TOTAL	**$2.1 billion**		

LAO Comment/Recommendation. With regard to the 5/5/5 Proposal, the LAO notes that the pension contribution shift is very risky. There are serious concerns about the legal viability of the Governor's proposal, particularly if the shift is accomplished through the legislative process, instead of through collective bargaining. Courts have repeatedly negated attempts to create substantial savings from altering pension payments for current employees without offering comparable offsetting benefits in exchange. Therefore, the LAO recommends that the Legislature reject the pension contribution shift and instead suggests the Legislature consider pension reform for new employees because, unlike obligations for current employees, the Legislature has much greater flexibility in defining benefits for future employees.

With regard to the unallocated reductions of five percent, presented in the Governor's Executive Order S-01-10 (EO), the LAO notes that unallocated reductions create difficulties for department operations. The 2009 Budget relies on significant unspecified reductions, where departments are using savings from vacancies and attrition to fund their programs within existing appropriations. It is unclear, therefore, if and how departments would achieve these additional proposed reductions, and, if they do achieve them, what state priorities will be stressed and which activities will be sacrificed. Further, unallocated reductions effectively remove the Legislature from the decision-making process, leaving departments to make reductions based solely upon the administration's priorities rather than the Legislature's priorities. The LAO also notes that initiating unallocated reductions only to personnel costs, as the Governor proposes, and not to departmental costs for operating expenses and equipment (OE&E) limits the flexibility departments may have in achieving savings. Savings from OE&E budgets might be achieved through delaying or reducing costs in equipment, supplies, training, travel, postage, personal services contracts, or other operating expenses. In some cases, seeking reductions in personnel costs but not in OE&E may create unintended incentives for departments to seek personal services contracts to complete workload. Therefore, the LAO recommends the Legislature avoid unallocated reductions, particularly for the CDCR. If the Legislature feels that it should reduce the size of the workforce, the LAO recommends that the Legislature weigh its own priorities, carefully analyze the operations of each program and department (including OE&E expenses), and either eliminate or reduce the scope of programs, which often would necessitate reductions in the size of the state workforce.

With regard to the five percent salary reduction, the final piece of the 5-5-5 Proposal, the LAO notes that the Legislature has broad powers, including through budget appropriations, oversight, and legislation, to determine salary levels and benefits for state employees and to review the application of these policies. Further, while the Dills Act governs collective bargaining process for represented employees the LAO notes that the process is dysfunctional in the current unprecedented budget climate. Therefore, the LAO notes that it is virtually impossible for the administration and state employee unions to reach the level of savings assumed in the Governor's budget through bargaining. The LAO indicates that factors contributing to this difficult climate include: (1) the state has little to give and (2) it is the last year of the Governor's term which places the Administration is a poor bargaining position.

The LAO suggests that a salary reduction offers the greatest legislative flexibility. Under the Dills Act, the Legislature has reserved for itself its constitutional powers to appropriate funds and, therefore, the right to set salary levels for represented employees at the level it desires. In addition, because the evergreen law that extends provisions of an expired MOU is statutory, the Legislature may change, amend, or temporarily waive that law along with any other conflicting statutes. The LAO therefore presents several alternatives and recommendations for reducing state employee costs: (1) vary employee pay reductions by employee group to prioritize those positions with important staffing problems, such as uncompetitive pay issues; (2) try to use the collective bargaining process; for instance, the Legislature could adopt across-the-board salary reductions but provide the Administration and bargaining units with some time to develop alternatives; and (3) pay cuts may be permanent or temporary.

With regard to employee heath benefit administration, the LAO notes that the Administration's proposal is a repeat of one proposed in 2009. The LAO indicates that exploring a move of health benefit programs from CalPERS to DPA makes sense. The LAO is skeptical, however, that a transition of the administration of health plans involving hundreds of thousands of employees can be achieved in a one-year timeframe. Furthermore, the Administration assumes large cost savings that would, by necessity, involve large "cost–shifting" (through increased co-payments, deductibles, or similar charges) from the state to employees and retirees. The Governor's proposal provides no meaningful detail on what changes would be implemented in health plans to achieve these considerable savings

Staff Comment. As noted in the introduction, these requests were discussed before the full Senate Budget Committee in January of this year in the context of the 8^{th} Ex Session. The Senate adopted the savings associated with the EO, corresponding OE&E savings associated with the EO, and language stating the Legislature's intent that the first priority for achieving personnel savings under the EO come from administration to avoid negative impacts on the delivery of direct services. These proposals were included in SBX8 2, which was subsequently vetoed by the Governor.

Staff provides the following observations relative to the Governor's employee compensation-related requests:

1. Collective bargaining (Dills Act; 1977) requires the administration to meet and confer in good faith with unions who must also meet and confer in good faith. Through negotiation, the parties reach agreement on MOUs delineating key terms of employment. MOUs must be approved by the bargaining unit and key provisions (i.e., requiring expenditure of funds) must be approved by the Legislature. While 20 of the state's 21 bargaining unit MOUs are currently expired, the law generally provides that provisions of prior MOUs continue in effect (at least until impasse is reached in negotiations).

2. The Governor proposes to implement the salary cut and pension increase notwithstanding existing law. This is proposed both through trailer bill language and language contained in Control Sections 3.90 and 3.60(d), respectively.

3. With regard to the EO, agency and departmental plans were required to be submitted by February 1, 2010, and implemented by March 1, 2010. The Legislature has yet to be provided with a copy of these plans.

4. The proposed health care savings trailer bill language is now contained in SB 919 (Hollingsworth), as amended April 21, 2010. Additionally, as noted by the LAO, this proposal is identical to that proposed in 2009-10

and subsequently rejected by the Legislature; alternative proposals totaling $160.8 million GF savings were adopted in the 2009 budget.

5. Per Control Section 8.26, which pertains to the federal funds trigger, on or before July 15, 2010, the Director of Finance would determine whether, since January 1, 2010, federal legislation has been enacted or federal executive action has been finalized that together result in at least $6.9 billion in additional federal funds known to be currently available and may be legally used on a budgetary or cash basis to offset GF expenditures for the 2010-11 FY. As noted above, if this is not achieved, CS 8.26 grants DOF authority to reduce specific budgets consistent with an unspecified statute.

Staff Recommendation. Staff recommends the following, consistent with the actions taken in the 8th Extraordinary Session:

1. With regard to Executive Order S-01-10: (1) APPROVE savings of $449.6 million GF; and (2) APPROVE a new Control Section to prioritize how departments and agencies shall make the required personnel cuts as well as score an additional $130 million GF savings in Operating Expenses & Equipment. ***Action: Held open pending review of the Administration's Workforce Cap Plans Report which was received by the Subcommittee at today's hearing. The Subcommittee requested the Report be revised so that the "total savings" column is broken down by fund source (i.e., GF, special, federal).***

2. With regard to pre-funding of other post-employment benefits: (1) APPROVE workload savings of $98.1 million GF. ***VOTE: Approved 3-0.***

3. DENY the remainder of the requests, as follows: (1) five percent employee compensation reduction, including Control Section 3.90 and proposed trailer bill language, (2) five percent increase in retirement contributions, including subsection (d) of Control Section 3.60 and proposed trailer bill language; (3) Control Section 8.26; and (4) proposed health care savings trailer bill language. ***VOTE: Approved 2-1 with Dutton voting no.***

SUBCOMMITTEE NO. 5 Agenda

Senator Denise Moreno Ducheny, Chair
Senator Robert D. Dutton
Senator Alex Padilla

Agenda - Part A

Thursday, May 6, 2010
9:30 a.m. (or upon adjournment of session)
Room 113

Consultant: Keely Martin Bosler

Revenues and the Economy

0860 State Board of Equalization

Background. The Board of Equalization (BOE) is one of California's two major tax collection and administration agencies. In terms of its responsibilities, BOE: (1) collects state and local sales and use taxes (SUT) and a variety of business and excise taxes and fees, including those levied on gasoline, diesel fuel, cigarettes, and hazardous waste; (2) is responsible for allocating certain tax proceeds to local jurisdictions; (3) oversees the administration of the property tax by county assessors; and (4) assesses certain utilities and railroad property. The board is also the final administrative appellate body for personal income and corporation taxes, which the Franchise Tax Board (FTB) administers. The BOE is governed by a constitutionally established board—consisting of four members elected by geographic district and the State Controller.

Summary of Expenditures (dollars in thousands)	2009-10	2010-11	$ Change	% Change
Type of Expenditure				
County Assessment Standards Program	$9,193	$10,299	$1,106	12.0
State-Assessed Property Program	6,550	7,265	715	10.9
Timber Tax Program	2,134	2,333	199	9.3
Sales and Use Tax Program	333,161	370,795	37,634	11.3
Hazardous Substances Tax Program	3,979	4,411	432	10.9
Alcoholic Beverage Tax Program	1,422	1,588	166	11.7
Tire Recycling Fee Program	1,443	1,756	313	21.7
Cigarette and Tobacco Products Tax Program	20,211	23,135	2,924	14.5
Cigarette and Tobacco Products Licensing Program	10,655	12,654	1,999	18.8
Transportation Fund Tax Program	21,795	22,989	1,194	5.5
NAFTA Program	355	95	-260	-73.2
Occupational Lead Poisoning Prevention Fee Program	668	742	74	11.1
Integrated Waste Management Program	407	483	76	18.7
Underground Storage Tank Fee Program	3,045	3,253	208	6.8
Oil Spill Prevention Program	231	267	36	15.6
Energy Resources Surcharge Program	224	257	33	14.7
Annual Water Rights Fee Program	393	429	36	9.2
Childhood Lead Poisoning Prevention Fee Program	468	518	50	10.7
Marine Invasive Species Program	436	525	89	20.4
Emergency Telephone Users Surcharge Program	1,387	1,410	23	1.7
E-Waste Recycling Fee Program	4,356	4,767	411	9.4
Insurance Tax Program	488	516	28	5.7
Natural Gas Surcharge Program	614	634	20	3.3
Appeals from Other Governmental Programs	1,272	1,424	152	11.9
Administration	41,600	41,600	0	0.0
less distributed Administration	*-41,183*	*-41,183*	0	0.0
Total	$425,304	$472,962	$47,658	11.2

The *2010-11 Governor's Budget* proposes $473 million in support of BOE operations, of which $266 million is General Fund, with most of the remainder consisting of reimbursements from local governments. The proposed level of support represents a net increase of $28 million General Fund mainly resulting in a restoration of base funding reduced by the Governor's furlough program and a budget proposal to expand the Agricultural Inspection Tax Leads Program. The number of personnel-years (PYs) for BOE is budgeted to increase slightly from 4,317 to 4,368.

Summary of Expenditures (dollars in thousands)	2009-10	2010-11	$ Change	% Change
Funding Source				
General Fund	$238,319	$265,778	$27,459	11.5
Breast Cancer Fund	649	767	118	18.2
State Emergency Telephone Number Account	1,387	1,410	23	1.7
Motor Vehicle Fuel Account, Transportation Tax Fund	20,795	22,642	1,847	8.9
Occupational Lead Poisoning Prevention Fund	668	742	74	11.1
Childhood Lead Poisoning Prevention Fund	468	518	50	10.7
Cigarette and Tobacco Products Surtax Fund	8,128	9,537	1,409	17.3
Oil Spill Prevention and Administration Fund	231	267	36	15.6
Integrated Waste Management Account	407	483	76	18.7
Underground Storage Tank Cleanup Fund	3,045	3,253	208	6.8
Energy Resources Program Account	224	257	33	14.7
California Children and Families First Trust Fund	13,972	16,782	2,810	20.1
Gas Consumption Surcharge Fund	614	634	20	3.3
Water Rights Fund	393	429	36	9.2
Electronic Waster Recovery and Recycling Account	4,356	4,767	411	9.4
Cigarette and Tobacco Products Compliance Fund	648	598	-50	-7.7
Budget Total	*294,304*	*328,864*	*34,560*	*11.7*
Federal Trust Fund	698	442	-256	-36.7
Reimbursements	128,168	141,323	13,155	10.3
Timber Tax Fund	2134	2333	199	9.3
Total	$425,304	$472,962	$47,459	11.2

Tax Gap Reduction Measures

Summary. The BOE estimates that the total tax gap for all its programs is about $1.8 billion. The tax gap is defined as the total tax receipts due to the state less the tax receipts collected by BOE. The tax gap for the sales and use tax, the board's largest tax program, is approximately $1.2 billion. The department has undertaken several initiatives to reduce this tax gap. However, many of those initiatives were thwarted in the current fiscal year given the Governor's baseline reductions to BOE's budget.

1. Employee Furlough Reductions

Background. The BOE's budget was reduced by $41.5 million in the current fiscal year. The Governor vetoed $13.5 million and reduced the board's budget by $28 million on a one-time basis. These reductions were the result of the Governor's decision to force all state departments, regardless of funding source and revenue generating function, to be furloughed for three days per month in the current fiscal year.

The BOE has not shut down operations three Fridays a month and instead has implemented a hard hiring freeze and voluntary leave program in order to remain within budget in the current fiscal year. As a consequence of the budget reduction, the BOE estimates revenue loss/delay of approximately $264 million ($156 million General Fund) in the current fiscal year. The department is now running at a 15 percent vacancy rate, which will likely result in additional revenue reductions in the budget year and beyond due to the time it takes to recruit and train qualified employees.

Governor's Budget. The Governor's budget proposes to restore $13.5 million ($9.9 million General Fund) that was vetoed in the 2009-10 budget act. This restoration will bring BOE back to its pre-furlough staffing levels and will generate $88 million ($52 million General Fund) in additional revenue to reduce the tax gap.

Staff Comments. There was significant discussion last year in this Subcommittee about the inefficiency of furloughing the special fund agencies and revenue generating agencies. Nevertheless, the Governor took actions to reduce the budgets for these agencies to the equivalent of furloughing all employees three days per month. The BOE did have the flexibility to manage how they would reduce expenditures. A report by the Senate Office of Oversight Outcomes dated February 12, 2010, finds that this flexibility may have enabled the board to protect public service better than they could have with strict furloughs.

Staff Recommendation. Staff recommends that the Subcommittee approve this budget proposal.

2. Agricultural Inspection Station Tax Leads

Background. The BOE initiated the pilot Agricultural Inspection Station Tax Leads program in 2006-07. The goal of this program was to help close the tax gap by identifying property entering California without payment of the sales and use tax. The pilot program has been a partnership with the California Department of Food and Agriculture (CDFA) at its Needles border inspection station where CDFA personnel make photocopies of bills of lading (documents issued by carriers that specify goods that have been received for conveyance to a specified consignee) and forward these documents to BOE. The BOE then determines if the entities receiving or shipping are registered with the BOE and will make a determination of whether transactions require additional investigation and possible assessment and collection of taxes and fees that are due.

The pilot program has generated tax leads that have resulted in the collection of over $11 million in additional taxes annually in both 2007-08 and 2008-09. This is about $2 million more than previously estimated by the board.

Governor's Budget. The Governor's budget proposes $6.7 million ($4.4 million General Fund and $2.3 million in Reimbursements from local governments) to make the Agricultural Inspection Station Tax Leads pilot a permanent program and expand it to three additional agriculture inspection stations, including Hornbrook (Oregon border), Truckee (Nevada border - North), and Yermo (Nevada border - South). The proposal would convert 16 limited-term positions to permanent and establishes 42.5 new permanent positions to expand this program.

Funding for this program includes $950,000 for an interagency agreement with CDFA. The BOE estimates that this program will increase revenues and reduce the tax gap by approximately $36.9 million ($24.4 million General Fund) in the budget year, and $44 million ($29.4 million General Fund) ongoing.

Staff Comments. Staff finds that this program is a good first step to closing the tax gap on property entering California that is subject to sales and use tax. However, this program only targets motor vehicle traffic. There is also significant cargo that comes in by rail and by air. At this time the BOE does not have a systematic way of collecting data from these carriers to identify additional leads that would result in additional tax compliance. The BOE indicates that further contacts with industry representatives are required in order to pursue data collection from rail and air carriers.

Staff Recommendation. Staff recommends that the Subcommittee approve this budget proposal.

3. Fuel Tax Compliance

Background. The BOE received resources in the 2007-08 budget act for two efforts related to fuel tax compliance. These efforts are the Joint Operations Center Project for National Fuel Compliance (JOC) and the International Fuel Tax Agreement (IFTA).

The JOC combines staff, data, and expertise from both federal and state governments to collaborate on the identification of under-reporting and non-reporting of fuel taxes. The BOE has committed two full-time positions to work with the JOC pursuant to an MOU with the federal government. The BOE started investigating leads generated by the JOC in the fall of 2009.

California must participate in IFTA or the federal government will discontinue providing matching fuel funds, which amount to about $3 billion annually. The IFTA requires participating states to process tax returns and distribute funds, or send a billing to other jurisdictions by the end of the month following the month in which the return was received. Truckers file IFTA returns and BOE must review these returns and clear exceptions in a timely manner. The State joined IFTA in 1996 and at that time there were approximately 8,000 truckers registering with BOE. Now there are over 22,000 registered truckers with BOE. The State has been cited twice over the past eight years for not submitting timely transmittals. Fines were avoided by adding additional dedicated positions in the 2007-08 budget act.

Governor's Budget. The Governor's budget includes $300,000 in federal funds to continue two 3-year limited term positions to ensure full state participation in the JOC. The State's participation in the JOC essentially pays for itself since participation guarantees $900,000 in federal funds over the next three years.

The Governor's budget also includes $230,000 in federal funds to convert three limited-term positions to permanent to ensure ongoing compliance with IFTA. These positions will ensure the timely processing of returns and send required transmittals to the IFTA to avoid sanctions.

Staff Recommendation. Staff recommends that the Subcommittee approve the federal funding to continue participation and compliance with the JOC and IFTA, respectively.

4. Use Tax Collection - Voluntary Disclosure Program

Background. One of the major components of the tax gap are the sales and use tax liabilities of businesses and individual consumers on products purchased from out-of-state vendors not required to collect the use tax. Programs have been instituted over the years at little cost to allow businesses and individual consumers to self-report use tax owed to the state. The sales and use tax voluntary disclosure program was instituted in 2003 and allowed for a line item on the income tax form for taxpayers to self report use tax that was not paid on items purchased from out-of-state vendors.

The BOE has indicated that this policy has resulted in an estimated $10 million in state and local revenue annually. The cost of this program is approximately $100,000. The 2003 law that implemented the line-item for self-reported sales and use tax is expiring with the 2009 tax year.

Recent legislation, AB 469 (Eng), would have extended the program. In addition, this bill also provided a "look-up" table to assist taxpayers in calculating their tax liability, and a mandatory reporting requirement if the tax was not reported to BOE. The BOE estimated that this bill would have generated approximately $14 million annually. This bill was vetoed by the Governor in 2009.

Legislation is currently pending (AB 2676, Ma) that would extend the line item on the income tax form.

Staff Comments. Staff finds that the existing voluntary reporting mechanism for sales and use tax that has not been paid has helped to close the tax gap at relatively little cost to the state. Furthermore, staff finds that AB 469 (Eng), which was vetoed by the Governor would have taken an additional step towards closing the tax gap by providing a "look-up" table to assist taxpayers in complying with current law related to the use tax.

Staff Recommendation. Staff recommends that the Subcommittee adopt trailer bill language to extend the existing voluntary line for the sales and use tax on the income tax form and direct BOE to develop a "look-up" table to assist taxpayers in compliance with current law. This would safeguard $10 million in state and local revenue that would otherwise be lost and generate an additional $4 million in state and local revenue.

5. Sales Tax Nexus

Background. The Senate passed ABx8 8 (Budget) in March of this year. It would have required certain out-of-state sellers that pay commissions to California firms or residents for sales referrals to collect use tax on their sales to California residents. Under current law, purchases made on the Internet by California residents are subject to the sales and use tax. However, certain retailers (Amazon.com, Overstock.com) that do not claim nexus in California, do not collect this sales and use tax. However, other Internet retailers that maintain brick and mortar in California do collect sales and use tax from California consumers on behalf of the State (for example, Walmart.com, Target.com, and many others).

The BOE estimates that this law change would generate approximately $107 million in the budget year.

Staff Comments. Current law has set up a comparative disadvantage for firms with brick and mortar invested here in California. As discussed in the preceding item, there is a voluntary opportunity to pay the use tax, but there is not a high compliance rate because it is burdensome for the consumer to track these purchases especially when making many small purchases throughout the year.

Given the rise of Internet shopping, this is likely one of the areas where the tax gap has continued to widen. Furthermore, the recent development of tools such as Google Shopping, which allows for comparison shopping on-line actually point out to consumers which goods can be purchased without tax.

The current system is unfair, creates a tax gap, and disadvantages companies that decide to put down brick and mortar in California.

Staff Recommendation. Staff recommends that the Subcommittee adopt trailer bill language similar to the language contained in ABx8 8 to require certain Internet retailers to collect sales and use tax on purchases made by California businesses and consumers and generate $107 million in additional General Fund revenues.

Other Issues

1. Fuel Tax Swap – Administration

Background. A fuel tax swap was proposed in the Governor's 2010-11 budget. The Legislature passed a modified proposal in March 2010 (ABx8 6 and SB 70). With this swap, the 6.0 percent state sales tax on gasoline is eliminated and the excise tax on gasoline is increased to match the revenue loss, which is an increase of 17.3 cents per gallon in 2010-11. Additionally, the sales tax on diesel is increased by 1.75 percent and the excise tax on diesel is lowered by 4.4 cents per gallon. This fuel tax swap, among other things, provided $1.1 billion in General Fund solutions over the 2009-10 and 2010-11 fiscal years to help reduce the budget deficit.

Finance Letter. The BOE is requesting $1.5 million ($138,000 General Fund, $1.3 million Motor Vehicle Fuel Account, and $151,000 in Reimbursements from local government) in 2010-11 to implement the fuel tax swap. The funding would be slightly less ($1.4 million) in 2011-12 due to one-time costs associated with creating new forms, outreach, and data entry. The funding would support 11.5 new positions and overtime related to implementing the tax swap.

The BOE is incurring some costs in the current year and has indicated that it will cover those costs through a one-time redirection of bond debt service payments for the BOE Headquarters building.

Staff Recommendation. Staff recommends that the Subcommittee hold this issue open pending additional information to justify these positions.

2. Headquarters Building—Oversight

Background. The BOE Headquarters Building has a long and expensive history of problems. Construction was completed in 1993. The building has been fraught with construction defects causing water leakage, mold, and falling glass. The building has also experienced major system failures, including plumbing and the elevators. A major project was completed in 2006 to help remedy the problems. However, other problems continue and numerous employee complaints and lawsuits have ensued.

The state has expended $32 million to date to address problems at the building and is projected to expend another $28 million for additional work to bring the building to a functional level.

The State started the process of purchasing the building from CalPERS several years ago. The State Pooled Money Investment Board (PMIB) advanced BOE over $90 million from the PMIB to purchase the building from CalPERS. The PMIB then would be repaid with the proceeds of a lease revenue bond sale. However, bond financing for the purchases was never completed and if the building continues to be in need of major remediation and repair future bond sales may be jeopardized.

Furthermore, the BOE Headquarters building does not adequately meet BOE's space needs. Presently, the maximum occupancy of the building is exceeded by over 500. The overcrowding of the building has resulted in additional strains on the building and reduced employee productivity. However, the Department of General Services (DGS) has indicated that BOE has not pursued a formal request to address the over-occupancy issue. The BOE estimates that this loss in productivity has resulted in annual revenue loss of approximately $22 million.

Last year the Legislature urged the Department of General Services to complete an analysis of options for future action to relocate the BOE as quickly as possible and make plans to sell or decommission the building. The Legislature also redirected $5.9 million of the loan from PMIB that was being used to purchase the building to address some critical repairs at the building. The remediation repairs are due to be completed in 2010-11 and, currently, the plan is to issue lease revenue bonds in the fall of 2010.

Oversight. The BOE and DGS should update the Subcommittee regarding the current plans for addressing the ongoing problems with BOE's Headquarters building.

1730 Franchise Tax Board

Background. The Franchise Tax Board (FTB) is one of the state's two major tax collection agencies. The FTB's primary responsibility is to administer corporation tax (CT) programs and California's personal income tax (PIT). In addition, FTB administers several non–tax–related programs, including the collection of child support payments and other court–ordered payments. The FTB is governed by a three–member board, consisting of the Director of Finance, the Chair of the Board of Equalization (BOE), and the State Controller. An executive officer, appointed by the board, administers the daily operations and functions of FTB.

The Governor's budget proposes $588 million ($552 million General Fund) and 5,040 personnel-years (PYs) in support of FTB's operations. Compared to the current year budget, this represents an increase of $87 million (17.5 percent) in total funding and a General Fund increase of $85 million. The budget proposes increases for several efforts to reduce the state's tax gap.

Summary of Expenditures (dollars in thousands)	2009-10	2010-11	$ Change	% Change
Type of Expenditure				
Tax Programs	$462,244	$548,536	$86,292	18.7
Homeowners and Renters Assistance	1,449	1,611	162	11.2
Political Reform Audit	1,378	0	-1,378	-100.0
Department of Motor Vehicles Collections Program	7,723	8,627	904	11.7
Court Collection Program	11,175	11,758	583	5.2
Contract Work	13,284	14,122	838	6.3
Administration	25,246	28,846	3,600	14.3
less distributed Administration	*-25,246*	*-28,846*	-3,600	0.0
Lease Revenue Bond Payments	3,149	3,146	-3	-0.1
Total	$500,402	$587,800	$87,398	17.5

Summary of Expenditures (dollars in thousands)	2009-10	2010-11	$ Change	% Change
Funding Source				
General Fund	467,091	552,186	85,095	18.2
Motor Vehicle Account, State Transportaiton Fund	2,683	2,997	314	11.7
Transportation Tax Fund	5,040	5,630	590	11.7
Emergency Food Asssistance Program Fund	6	6	0	0.0
Fish and Game Preservation Fund	13	13	0	0.0
Court Collection Account	11,175	11,758	583	5.2
Budget Total	*486,008*	*572,590*	*86,582*	*17.8*
Reimbursements	14,282	15,122	840	5.9
State Children's Trust Fund	11	11	0	0.0
CA Alzheimer's Disease & Related Disorders Fund	11	11	0	0.0
California Seniors Special Fund	4	4	0	0.0
California Breast Cancer Research Fund	7	7	0	0.0
Califonria Peace Officer Memorial Foundation Fund	5	5	0	0.0
California Firefighters' Memorial Fund	7	7	0	0.0
California Fund for Senior Citizens	7	7	0	0.0
California Military Family Relief Fund	6	6	0	0.0
California Prostate Cancer Research Fund	6	0	-6	-100.0
California Sexual Violence Victim Services Fund	6	0	-6	-100.0
California Colorectal Cancer Prevention Fund	6	0	-6	-100.0
Veterans' Quality of Life Fund	6	0	-6	-100.0
California Sea Otter Fund	6	6	0	0.0
ALS/Lou Gehrig's Disease Research Fund	6	6	0	0.0
California Cancer Research Fund	6	6	0	0.0
Municipal Shelter Spay-Neuter Fund	6	6	0	0.0
California Ovarian Cancer Research Fund	6	6	0	0.0
Total	$500,402	$587,800	$87,398	17.5

Tax Gap Reduction Measures

Summary. The FTB estimates that its total tax gap is about $6.5 billion. The tax gap is defined as the total tax receipts due to the state less the tax receipts collected by FTB. The department has undertaken several initiatives to reduce this tax gap. However, many of those initiatives were thwarted in the current fiscal year given the Governor's baseline reductions to FTB's budget.

1. Employee Furlough Reductions

Background. The FTB's budget was reduced by approximately $51 million in the current fiscal year. These reductions were the result of the Governor's decision to furlough for three days per month all state departments regardless of funding source and revenue generating function.

The FTB has not shut down operations three Fridays a month and instead placed its employees on self-directed furloughs in order to remain within budget in the current fiscal year. As a consequence of the budget reduction, the FTB estimates revenue loss of approximately $293 million in the current fiscal year. The total revenue loss is projected to grow to $465 million over the next two years.

The board has taken steps to mitigate revenue loss due to the furloughs, including redirecting staff to revenue generating activities, and limiting the use of vacation and furlough days. The furloughs have forced FTB to reduce and eliminate several activities, including staff training, call center hours, and outreach activities.

Governor's Budget. The Governor's budget restores the funding related to furloughs and also has included $14.7 million General Fund to support the equivalent of 158 personnel years of overtime and temporary help on a one-time basis to help restore revenue lost due to the 2009-10 furloughs. The FTB estimates that it will be able to recover approximately $50 million of the revenues lost due to the furloughs in 2009-10. These additional resources will support activities that FTB was not able to do while being furloughed.

Staff Comments. There was significant discussion last year in this Subcommittee about the inefficiency of furloughing the special fund agencies and revenue generating agencies. Nevertheless, the Governor took actions to reduce these agencies the equivalent of furloughing all state employees three days per month. A report by the Senate Office of Oversight Outcomes dated February 12, 2010, finds that furloughs were relatively more costly for FTB because FTB was required to furlough its employees.

In addition, there seems to be the potential for added future costs related to the furloughs since FTB has had to limit the use of vacation and furlough days in order to accomplish workload. This will result in more employees with larger leave balances that FTB will have to cash out when the employee retires or leaves state service.

Staff Recommendation. Staff recommends that the Subcommittee approve this budget proposal.

2. Tax Gap Enforcement

Background. As mentioned above, FTB estimates the income tax gap to be approximately $6.5 billion. The FTB has undertaken several efforts to try and close this tax gap. In both 2005-06 and 2007-08, tax gap enforcement efforts were augmented and generated approximately $330 million General Fund, which was $82 million more than estimated in the budget proposals. The tax gap enforcement efforts included adding resources to do the following:

- Focus on nonresident withholding within the entertainment industry;
- Mine data in the DMV luxury auto registrations and the IRS Information Return Master File for tax noncompliance leads; and.
- A vendor contract to identify good mailing addresses.

Governor's Budget. The Governor's budget includes $5.4 million General Fund to make permanent 62.2 positions expiring this year and extend for two additional years 14 limited-term positions. These positions will continue the board's ability to mine the DMV luxury auto registrations and IRS Information Return Master File for tax noncompliance leads and fund a vendor contract to identify good mailing addresses. The board estimates that this component of the budget proposal will generate $106 million in revenue in the budget year.

The budget also includes $343,000 to fund five new positions to expand the board's efforts to increase compliance with nonresident withholding. The board plans to focus its efforts on other industries, including: non-residents that own rental properties in California; non-residents that own franchises in California; the trucking industry; the technology sector; and temporary help agencies. The board estimates that this component of the budget proposal will generate approximately $8 million in the budget year, and will grow over the next several years.

Staff Comments. Staff finds that California's income tax gap is significant and has grown over the last several years, especially given the reduced staff productivity attributed to the furloughs. This gap puts an additional burden on those paying their fair share of taxes.

These programs have historically demonstrated cost effectiveness and the FTB estimates that the this budget proposal will have a 20:1 benefit to cost ratio to the General Fund. Given the relatively large benefit to cost ratio, staff finds that it would likely be beneficial to further expand these programs. However, FTB indicates that expansion beyond the level in this proposal would be difficult to accomplish given practical hiring and training constraints.

Staff Recommendation. Staff recommends that the Subcommittee approve this budget proposal.

3. Accounts Receivable Inventory

Background. The accounts receivable inventory has been steadily increasing over the past three years. The PIT accounts receivable inventory has increased by approximately 25 percent and the business entities accounts receivable inventory has increased by over 40 percent. The overall accounts receivable balance as of August 2009 was $8.1 billion, of which $5.5 billion represents collectable inventory. The accounts receivable inventory growth is a result of several factors, including the uncertain economy and the furloughs that have reduced employee hours available to resolve collection cases.

Governor's Budget. The Governor's budget includes $8.2 million to support 111 positions to address the rising accounts receivable inventory balance. The FTB estimates that this proposal will reduce the accounts receivable inventory by approximately $53 million in the budget year growing to over $100 million in 2011-12.

Staff Comments. Staff finds that another casualty of furloughs has been the rising accounts receivable inventory. However, it is unclear that the recent trends in accounts receivable are permanent since they are also partly a result of the current weak economic conditions. It is unclear to staff why this level of resources would be needed on an ongoing basis once the accounts receivable balance was worked down to a lower level.

Staff Recommendation. Staff recommends that the Subcommittee approve these positions on a two-year limited-term basis given the accounts receivable inventory growth is partly due to underlying economic conditions that are bound to change.

4. Federal Treasury Offset Program

Background. The Federal Treasury Offset Program (FTOP) is a federal collection tool working in partnership with the Financial Management Services and the Internal Revenue Service, which are bureaus under the US Department of Treasury. The Financial Management Services is the US Government's central collection agency. They administer the FTOP at the federal level that is used to collect federal tax debt, federal non-tax debt, child support debt, and state debt, including state income tax. Federal law provides for the collection of these liabilities, including state tax obligations by the federal government through the reduction in the amount of refunds payable to federal taxpayers. The federal government requires states to offset against state tax refunds any federal obligations.

Currently forty states participate in the FTOP and of all the states that have a state income tax, only California and one other state do not currently submit state income tax debt to the Financial Management Services bureau. In 2008 the Federal Management Services bureau collected more than $380 million in delinquent state income tax on behalf of states through offset of federal income tax refunds and stimulus payments.

In July 2008 FTB began participating in FTOP on a limited pilot basis. In the first 12 months of the pilot, the program has generated 700 taxpayer contacts and collected over $2 million. Upon receiving a Notice of Intent to Offset, many taxpayers chose to submit payment directly to FTB while others were motivated to file previously un-filed, delinquent tax returns.

Governor's Budget. The Governor's budget includes $847,000 General Fund to support 11 positions to phase in the expansion of FTB's FTOP pilot program. The first phase will expand the pilot and begin the design, development, and enhancements of FTB's accounting and collection systems for PIT cases. The second phase will begin the automated transmission of PIT data to the Financial Management Services bureau. Phases three and four will do the same for the Business Entity accounts.

The board estimates that this pilot will generate $6 million in additional revenues in the budget year. The revenues are estimated to grow to over $100 million as the pilot is phased in over the next four years.

Staff Recommendation. Staff recommends that the Subcommittee approve this budget proposal.

5. Enterprise Data to Revenue Project

Background. Recent information technology upgrades have not focused on FTB's filing system and its current system is aging. In order to modernize the board's filing system the board initiated the Enterprise Data to Revenue (EDR) Project. This project will introduce a new Personal Income Tax and Business Entity return processing system including expanded imaging, data capture, and return validation. This will enable FTB to correct erroneous returns in a more timely manner. It will also be more effective at providing data to identify noncompliance patterns and help identify fraudulent activity. This data system will also allow FTB to better prioritize its workload based on highest cost recovery. The FTB indicates that the new system will also expand customer self services. The EDR Project will have a one-time cost of approximately $234 million. It is estimated that this project will achieve revenues of $900 million annually once the project is complete.

The FTB will be using a solution based procurement model to acquire the EDR Project system. The model is based on acquiring innovative solutions to business problems that result in additional tax revenues. These revenue benefits will be shared with the contractor only when additional tax revenues are realized. This way the state will not incur out-of-pocket expenses to compensate the contractor. As FTB gets ready to go out for this procurement it is critical that the processing backlog be cleared up so that they do not undermine the success of the EDR project since a potential contractor would view the backlog as a risk to taking the contract.

Governor's Budget. The Governor's budget includes $6.9 million General Fund and 40 positions to continue the second year of the EDR Project. The positions requested by the Governor for the EDR Project will be used to continue clean up of the return processing backlog.

As a product of clearing out the return processing backlog, the FTB estimates that it will generate nearly $20 million in accelerated revenue in the budget year and over $25 million in 2011-12.

Staff Comments. Staff finds that delaying this project would cost the General Fund in lost revenue between $600 and $900 million if using a net present value calculation. The project has an approved Feasibility Study Report (FSR) and existing supplemental report language requires FTB to report to the Legislature if planned implementation of this project deviates from this plan.

Staff Recommendation. Staff recommends that the Subcommittee approve this budget proposal.

6. Financial Institutions Records Match (FIRM)

Background. In recent years the FTB has pursued the implementation of a Financial Institutions Records Match (FIRM) system to help reduce the tax gap. The FIRM is an information technology project that would require financial institutions doing business in California to match FTB information on delinquent tax and non-tax debtors against their customer records on a quarterly basis. The FIRM is patterned after the FTB's Financial Institution Data Match system, which is a project implemented as a result of federal legislation to identify the assets of delinquent child support debtors.

The Senate passed legislation (ABx8 8, Budget) earlier this year to authorize FTB to implement a FIRM system. The FTB would use the new data collection aid in the collection of debts under the authority of the existing Order to Withhold statutes. The proposal would not impact existing law that provides the applicable constitutional due process protections and appeal rights available in either the audit or collection processes. In addition, ABx8 8 required FTB to reimburse a financial institution for its actual costs incurred to implement FIRM, up to $2,500 for startup costs and no more than $250 per calendar quarter thereafter. This amendment removed bank opposition to this measure. A Feasibility Study Report (FSR) has been completed on this project.

Implementation of the FIRM system is estimated by FTB to generate approximately $35 million with first year implementation costs of approximately $3.2 million. The revenues are projected to grow to over $100 million at full implementation of this project.

Staff Comments. Staff finds that the tax gap continues to be a burden on taxpayers that comply with all the state's tax laws. Staff finds that the FIRM system would help to reduce the tax gap by using a methodology that has been proven in the child support system.

Staff Recommendation. Staff recommends that the Subcommittee adopt trailer bill language similar to the language contained in ABx8 8 to direct FTB to implement the FIRM system and generate $32 million in General Fund revenues in the budget year.

7. Abusive Tax Shelters

Background. Current federal and state law place reporting requirements and restrictions on abusive tax shelters and related transactions designed to avoid taxes. The use of and failure to report such transactions is subject to assessment, substantial penalties, and interest by the FTB up to eight years after the tax return is filed by the taxpayers.

According to FTB, current law suffers from inconsistencies in definitions among various abusive tax shelter provisions, hampering the enforcement of these provisions. The Senate passed ABx8 8 (Budget) in March of this year to eliminate inconsistencies by providing single, consistent definitions for abusive tax shelters. This language would also adopt the federal reportable transaction categories for "transactions of interest" for California purposes, and it provides similar authority to the FTB to determine "transactions of interest" for California income tax purposes.

Under current law, abusive tax shelter penalties can be avoided if a taxpayer that has been contacted by the FTB about such activities files an amended return prior to when FTB issues a deficiency notice. The language in ABx8 8 would have imposed a reduced penalty (50 percent of the full penalty) for taxpayers that file an amended return in these circumstances. The reduced penalty is aimed at encouraging taxpayers to file amended returns and pay taxes owed while maintaining some penalty on taxpayers that had previously used abusive tax shelters.

These statutory changes are estimated by FTB to generate $2 million in additional General Fund revenue in the budget year.

Staff Comments. As mentioned in other parts of this agenda, the state's tax gap is unfair and places additional burden on compliant taxpayers. Good tax collection practices aim to reduce the tax gap and collect taxes that are due to the state. The statute changes included in ABx8 8 (Budget) help to improve tax collection efforts by reducing the ability to use abusive tax shelters to shelter income that should be reported to FTB.

Staff Recommendation. Staff recommends that the Subcommittee adopt trailer bill language similar to the language contained in ABx8 8 (Budget) and generate $2 million in additional General Fund revenue in the budget year.

8. Professional License Suspension

Background. The FTB states that there are approximately 25,000 delinquent taxpayers with a state-issued occupational or professional license. This figure excludes taxpayers that have filed for bankruptcy or those who agreed to a payment installment plan and are working to pay off their tax liability.

Currently there is a due process procedure in place for the FTB to notify an individual of his or her tax liability and the opportunity for the individual to respond or dispute the amount, depending on whether they filed a tax return. If the taxpayer has not filed a tax return and neglected to report income, the FTB sends a Filing Enforcement Letter to the individual specifying his or her estimated tax liability. If the taxpayer has filed a tax return and is audited, the FTB provides the individual with a Notice of a Proposed Assessment and allows him or her 60 days to protest the amount or respond.

If the taxpayer still fails to pay his or her tax liability, the FTB may send the case to collections and send the taxpayer up to three notices of action or corresponding escalation. After this the FTB can file a tax lien against an individual's property or levy and seize property.

The Senate passed ABx8 8 (Budget) this past March to suspend professional licenses only after all due process provisions described above have been completed and the taxpayer does not agree to a payment plan to pay down their tax debt. Prior to the suspension, the taxpayer would be provided with additional notice and given 60 days to satisfy his or her obligation or enter into an installment agreement. The license suspension would be canceled upon compliance with tax obligations.

The FTB estimates that this would generate approximately $19 million in General Fund revenues to reduce the tax gap. There is similar legislation currently pending in the Assembly in AB 2038 (Eng).

Staff Comments. Staff finds that suspending professional licenses would help the FTB to collect taxes owed to the State. This would help in reducing the tax gap and reducing the burden on compliant taxpayers.

Staff Recommendation. Staff recommends that the Senate adopt trailer bill language similar to the language in ABx8 8 that suspends professional licenses of delinquent taxpayers and generates approximately $19 million in General Fund revenues.

Other Issues

1. Data Security and Reliability

Background. Data security and reliability is critical for FTB given the volume of confidential taxpayer data it maintains. The FTB has employed a defense-in-depth strategy to protect this information where multiple layers of defense are placed throughout its information technology system so that if one fails there are others layers that prevent against a security attack.

Furthermore, the FTB's data reliability is being threatened by outdated equipment and software that is out-of-support. For example, the FTB's Enterprise Tape Library System which is critical to providing continuous access to the up-to-date, accurate information that FTB's automated systems rely on is at risk of failure. If this system failed, FTB's productivity could be severely hampered and data security could be compromised.

Governor's Budget. The Governor's budget includes the following information technology related budget change proposals:

- ***Data Security***. $447,000 ($232,000 General Fund) to support five positions to replace five limited-term positions to continue efforts to address internal and external security threats. These positions were previously supported by redirected savings related to e-file that are no longer available.
- ***Enterprise Tape Library Replacement.*** $2.3 million ($2.2 million General Fund) for one time purchases to replace the existing Enterprise Tape Library and to reduce the risk that these items will fail and impact FTB's revenue generating activities.

Staff Comments. The staff requested for data security is responsible for performing compliance monitoring and audits to determine system vulnerability. There is an ongoing need for these resources given the sensitivity of the data maintained by FTB.

Staff Recommendation. Staff recommends that the Subcommittee take the following actions:

- Approve the data security proposal.
- Approve the information technology refresh.

2. Other Budget Proposals and Finance Letters

Governor's Budget. The Governor's budget includes funding for the following budget proposals:

- ***Limited Liability Company Refund Processing.*** $172,000 General Fund to support three limited-term positions for an additional year to complete the processing of refunds resulting from the *Northwest Energetic Services, LLC v. Franchise Tax Board* and the *Ventas Finance I, LLC v. Franchise Tax Board* lawsuits. The *Northwest* lawsuit found that the state's LLC fee on LLCs that had no income attributable to California violated the Commerce Clause of the US Constitution. The *Ventas* lawsuit also found that the state's LLC fee violated the Commerce Clause because the statute did not use a method of fair apportionment to calculate the total income upon which the LLC fee was based. A third lawsuit, *Bakersfield Mall, LLC v. Franchise Tax Board* is ongoing. The LLC fee statute was amended in 2007 to address the court findings.
- ***Court Ordered Debt.*** $903,000 from the Court Collection Account to support the conversion of eight limited-term positions to permanent to support and maintain the Court Ordered Debt Collections Program. State law mandated FTB to offer collections services to all California counties and courts. The FTB has developed and maintained a collections system as a joint venture with contracted staff. However, the contracted staff will be departing and permanent staff are required to maintain this program.

Finance Letter. On April 1 the Governor submitted the following Finance Letter:

- ***Homeowner and Renter Assistance Program Reduction.*** A reduction to FTB's budget of $495,000 General Fund and seven positions to reflect the cessation of the Homeowners and Renters Assistance Program. This program was eliminated by the 2009-10 Budget Act, effective July 1, 2010. The budget proposal would also realign $1.1 million General Fund and three positions to the Tax Program. The FTB indicates that these costs reflect fixed costs that the department will incur despite the discontinuation of this program.

Staff Recommendation. Staff recommends that the Subcommittee take the following actions:

- Approve the Limited Liability Company Refund Processing budget proposal.
- Approve the Court Ordered Debt budget proposal.
- Approve the Homeowner and Renter Assistance Finance Letter.

3. 2010 Homebuyer Tax Credit Workload

Background. On March 22, 2010, the Legislature passed a homebuyer income tax credit (Chapter 12, Statutes of 2010 [AB 183, Caballero]) that had been included in the Governor's January 2010 budget. This bill provides a maximum of $10,000 in tax credit for specified home purchases between May 1, 2010 and August 1, 2011. Specifically, it provides $100 million in credits for the purchase of new homes and $100 million in credits for first-time homebuyers. The FTB estimated that this tax credit would cost the General Fund approximately $69 million in the current and budget year in lost revenues.

This bill was similar to Chapter 11x2, Statutes of 2009 (SBx2 15, Ashburn) that provided $100 million in tax credits for the purchase of new homes and expired March 1, 2010. The credits were actually exhausted well before date the credit expired. The FTB was provided with $265,000 and three positions to implement this and two other tax credits passed as part of the budget package in February 2009.

Finance Letter. On April 1 the Governor submitted a Finance Letter to request $822,000 General Fund to support nine positions in the budget year to administer AB 183 (Caballero). The letter also indicates that $373,000 is needed in the current fiscal year to implement this statute.

Staff Comments. Staff finds that the resources requested to implement this tax credit are in excess of what was utilized to implement similar tax credits in the current fiscal year. It is unclear to staff why the level of resources requested is needed. Furthermore, workload data is lacking to justify these positions and the workload associated with these positions should be limited-term since the tax credit program is not ongoing. Staff does recognize that changes were made in the tax credit that was passed in the current year to expand it to more individuals, thereby increasing FTB's workload.

Staff Recommendation. Staff recommends that the Subcommittee take the following action:

- Approve five of the nine requested positions and make them three-year limited term, thereby saving approximately $160,000.

SUBCOMMITTEE NO. 5 Agenda

Senator Denise Moreno Ducheny, Chair
Senator Robert D. Dutton
Senator Alex Padilla

OUTCOMES

Agenda - Part A

Thursday, May 6, 2010
9:30 a.m. (or upon adjournment of session)
Room 113

Consultant: Keely Martin Bosler

Revenues and the Economy

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-324-9335. Requests should be made one week in advance whenever possible.

0860 State Board of Equalization

Tax Gap Reduction Measures

1. Employee Furlough Reductions

Action. Approved budget proposal.

Vote. 3-0

2. Agricultural Inspection Station Tax Leads

Action. Approved budget proposal.

Vote. 3-0

3. Fuel Tax Compliance

Action. Approved budget proposal.

Vote. 3-0

4. Use Tax Collection - Voluntary Disclosure Program

Staff Recommendation. Staff recommends that the Subcommittee adopt trailer bill language to extend the existing voluntary line for the sales and use tax on the income tax form and direct BOE to develop a "look-up" table to assist taxpayers in compliance with current law. This would safeguard $10 million in state and local revenue that would otherwise be lost and generate an additional $4 million in state and local revenue. **HELD OPEN.**

5. Sales Tax Nexus

Staff Recommendation. Staff recommends that the Subcommittee adopt trailer bill language similar to the language contained in ABx8 8 to require certain Internet retailers to collect sales and use tax on purchases made by California businesses and consumers and generate $107 million in additional General Fund revenues. **HELD OPEN.**

Other Issues

1. Fuel Tax Swap – Administration

Staff Recommendation. Staff recommends that the Subcommittee hold this issue open pending additional information to justify these positions. **HELD OPEN.**

2. Headquarters Building—Oversight

Oversight. No action. Staff and BOE to follow up with environmental agencies about an assessment of the building. BOE to provide Subcommittee with the university study on the building when available this June.

1730 Franchise Tax Board

Tax Gap Reduction Measures

1. Employee Furlough Reductions

Action. Approved budget proposal.

Vote. 3-0

2. Tax Gap Enforcement

Action. Approved budget proposal.

Vote. 2-1 (Dutton)

3. Accounts Receivable Inventory

Action. Approved budget proposal on a two-year limited-term basis given the accounts receivable inventory growth is partly due to underlying economic conditions that are bound to change.

Vote. 2-1 (Dutton)

4. Federal Treasury Offset Program

Action. Approved budget proposal.

Vote. 3-0

5. Enterprise Data to Revenue Project

Action. Approved budget proposal.

Vote. 3-0

6. Financial Institutions Records Match (FIRM)

Staff Recommendation. Staff recommends that the Subcommittee adopt trailer bill language similar to the language contained in ABx8 8 to direct FTB to implement the FIRM system and generate $32 million in General Fund revenues in the budget year. **HELD OPEN.**

7. Abusive Tax Shelters

Staff Recommendation. Staff recommends that the Subcommittee adopt trailer bill language similar to the language contained in ABx8 8 (Budget) and generate $2 million in additional General Fund revenue in the budget year. **HELD OPEN.**

8. Professional License Suspension

Staff Recommendation. Staff recommends that the Senate adopt trailer bill language similar to the language in ABx8 8 that suspends professional licenses of delinquent taxpayers and generates approximately $19 million in General Fund revenues. **HELD OPEN.**

Other Issues

1. Data Security and Reliability

Action.

- Approved the data security proposal.
- Approved the information technology refresh.

Vote. 3-0

2. Other Budget Proposals and Finance Letters

Action.

- Approved the Limited Liability Company Refund Processing budget proposal.
- Approved the Court Ordered Debt budget proposal.
- Approved the Homeowner and Renter Assistance Finance Letter.

Vote. 3-0

3. 2010 Homebuyer Tax Credit Workload

Action.

- Approved six of the nine requested positions (effectively continuing three one-year limited term positions from the tax credits last year and adding three new one-year limited term positions.

Vote. 3-0

SUBCOMMITTEE NO. 5 Agenda

Senator Denise Moreno Ducheny, Chair
Senator Robert D. Dutton
Senator Alex Padilla

Agenda – Part B

Issues Related to Cash

Thursday, May 6, 2010
9:30 a.m. or upon adjournment of session
Room 113

Consultant: Brian Annis

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-324-9335. Requests should be made one week in advance whenever possible.

9620 Cash Management and Budgetary Loans

Item Overview: This budget item appropriates funds to pay interest costs on General Fund borrowing used to overcome cash flow imbalances during the fiscal year. Because receipts and disbursements occur unevenly throughout the fiscal year, the General Fund borrows in most years, even though each budget is balanced when enacted and funds are repaid within the fiscal year. Interest is paid on both internal borrowing (such as cashflow loans from special funds) and for external borrowing (such as Revenue Anticipation Notes (RANs)). This item additionally pays interest costs for budgetary borrowing by the General Fund from special funds. Budgetary borrowing is across fiscal years and is "counted" as a budget solution, whereas cashflow borrowing is not counted as a budget solution (only a cash solution).

Budget Overview: The January Governor's Budget includes $540 million for interest costs on cashflow borrowing and $58 million for interest costs on budgetary borrowing – all General Fund. Of the cashflow amount, $150 million is for internal borrowing and $390 million is for external borrowing. Overall, expenditures in this item are up significantly – a total of $598 million is proposed for 2010-11, versus revised expenditures of $353 million in 2009-10.

(see issues on next page)

Issues for Discussion and/or Vote

1. **Cash Deferrals - Action in the 8th Extraordinary Session:** In the 8th Extraordinary session called by the Governor on January 8, 2010, to address the fiscal emergency, the Legislature enacted AB X8 5 (Committee on Budget) to implement a flexible payment deferral plan for the remainder of 2009-10 and for 2010-11. AB X8 14, enacted two weeks after AB X8 5, made further improvements to the cash management plan. The legislation provides approximately $5 billion in cash flow relief that will reduce the size and cost of the State's short term borrowing. By enacting a 2010-11 deferral plan in February 2010, the legislation provides more predictability for local governments and allows more time for local fiscal planning.

   Detail on AB X8 5 and AB X8 14: The chaptered language provides statutory authorization to defer specific cash payments to schools, universities, trial courts, and local governments. The language specifies maximum deferral amounts and the maximum length of the deferral. Language is also included to "smooth" cash payments to the University of California and California State University so that they are relatively the same each month of the fiscal year. All of the deferrals are limited to the current and budget year only and specified deferrals may be triggered off by findings of the State Controller, the Director of Finance, and the State Treasurer. The language also changes the dates of the bi-annual contributions to the State Teachers' Retirement System. Attachment A to this agenda provides monthly detail on the cash management plan; however, the deferral plan is flexible and specified deferrals may not take place if the state's cash is sufficient.

   Some Spring 2010 Deferrals Triggered-off: Due to favorable cash receipts in December through March, the State Controller, the Director of Finance, and the State Treasurer, were able to certify sufficient General Fund cash resources and turn off certain March/April 2010 cash deferrals. Specifically, in a March 18, 2010, letter, the deferrals for Trial Court operations and the California Community Colleges were "triggered-off" and the payments were made as scheduled. In an April 1, 2010, letter, the deferrals for the California State University and the University of California were "triggered-off" and the payments were made as scheduled.

   Staff Comment: This is an informational issue – the LAO and the Department of Finance can present the information on the attachment and answer any questions. New trailer bill language associated with the special-session action is discussed in the "trailer bill language" issue later in this agenda.

2. **Budget Funding for Interest on General Fund Loans:** As indicated in the introduction to this issue, the Governor requests $598 million General Fund to pay interest in 2010-11. This amount is over $300 million higher than revised estimates of costs for the current year. The table below indicates the interest costs per category across the three fiscal years (in millions):

Type of loan	2008-09 Actual Cost	2009-10 Revised Estimated Cost	2010-11 Estimated Cost
External Cashflow Borrowing	$152.3	$121.3	$390.0
Internal Cashflow Borrowing	$124.9	$150.0	$150.0
Budgetary Loans	$0	$13.0	$58.0
Contingency	$0	$69.0	$0
TOTAL	**$277.2**	**$353.0**	**$598.0**

The 2009-10 funding in the table reflects mid-year adjustments. The amount originally budgeted for 2009-10 was $546.6 million. That amount was reduced to the current estimate after the cost of external borrowing came in significantly below estimates.

Budget Flexibility to Augment Funding: Funds to pay interest for external cashflow borrowing are continuously appropriated, and therefore expenditures may exceed the amount budgeted as necessary. Funds to pay interest for internal cashflow borrowing and to pay interest for budgetary borrowing, are appropriated in the budget act; however, budget bill language allows the Department of Finance to augment the appropriation if needed to pay interest costs. Due to this budgetary flexibility, the Legislature need not build in contingency funding for this item, but rather, can fund at the level of anticipated expenditures.

Deleted Budget Bill Language for Joint Legislative Budget Committee (JLBC) Reporting: The 2009 Budget Act included the following budget bill language (BBL) for Item 9620-002-0001 related to budgetary loans; however, this language is deleted from the proposed 2010 Budget Act:

Provision 2: The Director of Finance shall notify, in writing, the Chairperson of the Joint Legislative Budget Committee within 30 days of ordering the repayment of any loan included within the provisions of this item.

Changes to Budgetary Borrowing: As indicated above, the budget assumes $58 million to pay interest on budgetary borrowing. Small adjustments may be necessary to conform to other budget actions. For example, the January budget assumed General Fund repayment to the Beverage Container Recycle Fund of $153 million over 2009-10 and 2010-11. Action in the 8th Extraordinary Session (AB X8 7) modified the Governor's proposal and should reduce the amount of the loan repayment by about $46 million. The conforming action here would be a reduction in the associated interest of around $5 million in 2010-11.

Staff Comment: Since the last couple of years have also been very difficult budget years requiring high levels of cashflow borrowing, and interest rates continue to be low, the Administration should indicate why the estimated interest cost is over $300 million higher in 2010-11. The Administration should also indicate why they propose to delete the JLBC reporting language. Small adjustments may be necessary to conform to other budget actions in the area of budgetary borrowing. Finally, the amount of 2009-10 contingency funding should be reduced to reflect additional General Fund savings.

Staff Recommendation: Restore the JLBC reporting language. Request that with the May Revision, the Administration shares assumptions behind the updated 2010-11 interest estimate with Committee Staff.

Vote:

9625 Interest Payments to the Federal Government

Item Overview: This budget item provides expenditure authority for the payment of interest to the federal government for federal funds held in State accounts. Under federal law, interest is sometimes required for the period between when federal funds are deposited in a state account and the disbursement of the funds for the program purpose.

Budget Overview: The Budget includes $30 million General Fund and about $1 million in special funds for interest payments. This is the same level of funding approved with the 2009 Budget Act; however, the Department of Finance has since reduced the estimate of 2009-10 General Fund interest costs from $30 million down to $5 million. The table below, with data from the Governor's Budget, shows the three-year costs (in millions):

Type of loan	2008-09 Actual Cost	2009-10 Revised Estimated Cost	2010-11 Estimated Cost
General Fund cost	$13.9	$5.0	$30.0
Other funds cost	$0.3	$1.0	$1.0
TOTAL	**$14.2**	**$6.0**	**$31.0**

Issues for Discussion and/or Vote

1. **Funding Level and Budget Control Language:** As indicated above, the Administration requests $30 million General Fund, and about $1 million in special funds, for interest payments to the federal government. In past budgets, provisional language in the budget bill has allowed the General Fund amount to be augmented by up to $10 million, and for the special fund amount to be augmented by up to $1 million – both after 30-day Joint Legislative Budget Committee (JLBC) reporting. The language proposed this year would remove any caps on augmentations, but would retain 30-day JLBC reporting.

   Staff Comment: Since interest rates continue to be low, the Administration should indicate why the estimated interest cost is $25 million higher in 2010-11. The Administration should also indicate why they propose to remove the statutory caps on funding augmentations. Due to the budgetary flexibility to augment funding, the Legislature need not build in contingency funding for this item, but rather, can fund at the level of anticipated expenditures.

   Staff Recommendation: Hold open for the May Revision, when updated estimates from the Administration may be available. Request that the Administration share assumptions behind the updated 2010-11 funding estimate with Committee Staff.

9600 Debt Service General Obligation Bonds and Commercial Paper

Item Overview: Debt service payments are continuously appropriated, and therefore not appropriated in the annual budget bill. This item in the Governor's Budget Galley displays the estimated debt service costs for each General Obligation bond (GO bond). Some bond costs are offset by special funds or federal funds – primarily by the transportation debt service fund. Other bonds are "self liquidating," or have their own dedicated revenue (i.e., the Economic Recovery Bonds receive a quarter-cent of the sales tax) – the self-liquidating bonds are not included in this item.

Budget Overview: The January Governor's Budget includes $5.0 billion in General Fund costs for GO debt service and related costs. In addition to this amount, $951 million in debt costs are funded from other funds (i.e., $929 million is from the transportation debt fund that is associated with the fuel swap in the special session). Finally, federal bond subsidies, through the Build America Bonds (BABs) program, provide $224 million in 2010-11. The table below, with data from the Governor's Budget, shows the three-year GO bond costs (in millions, excluding self-liquidating bonds):

	2008-09 Actual Cost	**2009-10 Revised Estimated Cost**	**2010-11 Estimated Cost**
General Fund cost	$3,791	$4,834	$5,010
Other funds cost	$282	$200	$951
Federal subsidy (Build America Bond Program)	$0	$158	$224
TOTAL	**$4,073**	**$5,192**	**$6,185**

The table above excludes a Legislative change made in the 8th Extraordinary Session – the fuel swap (AB 8X 9, Committee on Budget) increased the 2009-10 funding from the transportation debt service fund by $162 million above the Governor's proposal, which results in General Fund savings of that same amount.

(see issues on next page)

Issues for Discussion and/or Vote

1. **Overview of GO Bonds and Bond Debt:** As indicated in the introduction to this issue, the January budget includes $5.0 billion General Fund to pay GO bond debt in 2010-11. Attachment B of this agenda summarizes all the voter-approved GO bonds that currently have debt service. The table also provides a summary of overall budget authority and the status of sale and repayment for all bonds.

   Federal Stimulus Program - Build America Bonds (BABs): BABs are taxable municipal bonds that carry special tax credits and federal subsidies for either the bond issuer or the bondholder. BABs were created as part of the American Recovery and Reinvestment Act (ARRA) that President Barack Obama signed into law on February 17, 2009. Since the federal BABs program was implemented, Treasurer Lockyer has sold about $10.7 billion in GO bonds using the BABs program. For these BABs, the federal government will pay California a cash subsidy equal to 35 percent of the interest costs – which over the life of the bonds will total to about $7.9 billion.

   Staff Comment: Representatives from the State Treasurer's Office, the Department of Finance, and the LAO are available to discuss the BABs subsidies and other budget issues associated with GO bonds.

   Staff Recommendation: This is an informational issue.

2. **Administration's Cash Management Plan for GO Bond Revenues:** On April 27, 2010, the Department of Finance released Budget Letter 10-09, which lays out a new Administration plan for the management of GO bond proceeds. The Budget Letter indicates that as a result of the recent successful GO bond sales and other factors, departments are now able to plan on having bond proceeds at specific times of the year. The plan anticipates $6.4 billion in proceeds from fall 2010 bond sales and $6.7 billion in proceeds from spring 2011 bond sales. Departments are provided their individual level of cash proceeds in each six-month period, and are able to move forward with new projects with the funding specified in the plan. The plan will be updated semi-annually. Attachment C of this agenda is the Administration's bond cashflow plan.

   Staff Comment: Representatives from the State Treasurer's Office, the Department of Finance, and the LAO are available to discuss the Cash Management Plan for GO Bonds.

   Staff Recommendation: This is an informational issue.

Cash-Related Trailer Bills

Summary of proposals: The Administration has proposed various pieces of trailer bill language related to cash. The first issue below is suggested clean-up to action already taken in the 8th Extraordinary Session. The remaining issues are Administration proposals from the January Budget and from April Finance Letters.

Issues Suggested for <u>Vote Only</u>:

1. **Clean-up to Special Session Cash Measures**: Additional amendments have been suggested by the Administration and other parties to clean-up or clarify the cash-related measures adopted in the 8th Extraordinary Session (AB X8 5 and AB X8 14). Specifically, the proposed language would: (1) clarify the process for school districts to apply for a hardship waiver to be excluded from any deferrals in 2010-11, and (2) create a hardship waiver process for the deferral of Highway User Tax Account (HUTA) apportionments to exempt a city that has bonded against the HUTA apportionment, as specified.

   Staff Comment: Staff is not aware of any concerns with this language.

   Staff Recommendation: Approve as placeholder language.

2. **Tax Credit Allocation Fee Account Reclassification**: In a January proposal, the Administration requests language to reclass the Tax Credit Allocation Fee Account, such that any General Fund cashflow borrowing will require an interest payment. The Department of Finance indicates that is a technical fix and this type of special fund should receive interest under state law. Since the fund balance is relatively small (about $4.2 million) any additional General Fund interest costs would be minor.

   Staff Comment: Staff is not aware of any concerns with this language.

   Staff Recommendation: Approve as placeholder language.

Issues Suggested for <u>Vote Only</u> continued:

3. **State Treasurer's Office – Local Agency Investment Fund fees:** In an April request, the Administration proposes language to adjust the limitations on administrative cost recovery for the Local Agency Investment Fund (LAIF). The LAIF is a voluntary program created in 1977 as an investment alternative for California's local governments and special districts. The LAIF program offers local agencies the opportunity to invest idle funds and earn a competitive yield using the investment expertise of the Treasurer's investment staff at no additional cost to the taxpayer. LAIF has nearly 3,000 participants and nearly $25 billion in investments.

   Existing law allows the Treasurer's Office to deduct up to one half of one percent of the LAIF earnings to cover reasonable costs it has incurred in carrying out the provisions of the program. This has historically left enough of a buffer for the Treasurer's office to fully cover the annual costs of administering the program, approximately $1.8 million. Recently, however, because of market conditions and lower balances, the fee revenue at the cap is only producing about $200,000.

   Staff Comment: This proposal would raise the cap 0.5 percent to 5.0 percent. Reimbursement of administrative costs is already limited in current law to "the reasonable costs incurred in carrying out the provisions" to operate LAIF. LAIF has added only one staff position in the past ten years, despite doubling their investment amounts.

   Staff Recommendation: Approve as placeholder language.

4. **State Treasurer's Office – Past Due Bond Redemption:** In an April request, the Administration proposes language to allow the State Treasurer to redeem matured bonds and coupons that are ten years or more past their call date when presented for payment by the bondholder. Currently, for matured bond and coupons retrieved ten-years past their call date, claims must be paid through the Victims Compensation and Government Claims Board (VCGCB). The Board is authorized to assess a 15 percent surcharge on those matured bonds and coupons that are redeemed through their existing process. The Board has recently begun charging that fee to the Treasurer's Office. This language would allow the Treasurer to avoid that fee and move the bond work in-house. The Treasurer suggests this proposal will result in General Fund cost avoidance of up to $665,000 by the Treasurer absorbing the bond reimbursement workload instead of reimbursing the VCGCB.

   Staff Comment: No concerns have been raised with this proposal.

   Staff Recommendation: Approve as placeholder language.

Issues Discussion and Vote:

5. **Federal Funds for Statewide Indirect Costs**: In a January request, the Administration proposes language to allow the Director of Finance to reduce a department's budget and transfer associated funds to the Central Service Cost Recovery Fund, the General Fund, or both, in the case where a department has not collected indirect cost funding from the federal government. For a federally-funded program, the federal government allows the state to direct a portion of the federal funds to cover the proportional centralized administrative costs of the state. The transfer authorized by this action would occur, if in the judgment of the Director of Finance, a department has not collected indirect cost funds from the federal government, regardless of the reason.

   Staff Comment: It is unclear if uncollected federal indirect cost funds are a problem for California – the Department of Finance should speak to the problem they are trying to solve with this language. To the degree federal funds are under-collected, this proposal could result in relief to the General Fund as department budgets would be cut with related state funds shifted to the Central Service Cost Recovery Fund or the General Fund. Since the amount that "should have" been collected from the federal government is subjective and relies on the Director of Finance, amendments may be warranted to limit the amount of any budget reduction and to add a sunset and reporting requirement.

   Staff Recommendation: Hold open for further analysis.

6. **Prompt Payment Act:** In a January request, the Administration proposes language to revise the Prompt Payment Act, which defines deadlines for the State to timely pay invoices and pay refunds. Current law requires payment of an undisputed invoice within 45 days and undisputed refunds within 31 days. This language would standardize the timeline, and make both deadlines 45 days. Current law requires late payment penalties for certain small and nonprofit businesses to accrue at 0.25 percent of the amount due, per calendar day. This equates to an over 90 percent annual interest rate for these small businesses and nonprofit organizations. The proposed language would change the penalty to accrue at 10 percent above the United States Prime Rate on June 30 of the prior business year.

   Staff Comment: This language would reduce the State's costs in the case of undisputed refunds that are paid more than 31 but less than 45 days after receipt of the notice. This bill would also reduce the state's penalty costs for late payment of bills to certain small and nonprofit businesses.

   LAO Recommendation: The LAO recommends that the Legislature approve the proposed trailer bill. The legislation would consolidate code provisions, thereby reducing potential administrative confusion about the state's late payment penalties. Penalties owed to certain small businesses and nonprofit organizations for late payments would remain substantial and still deter late payments by state departments, but these payments would be reduced to a much more reasonable level.

   Staff Recommendation: Approve as placeholder language.

-- Attachment A --

Maximum Deferrals under ABX8 5 and ABX8 14 in 2010-11 -- Amounts assume no shift in timing of deferrals (though specified shifting is allowed with legislative notification)

(Dollars in Millions--Reflect Month End Cumulative Effect)

		July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	March	April	May	June
	<u>Programs under the Three Deferrals Pattern (July, October, and March, with 60-90-60 days of deferrals, could shift 30 days)</u>												
1	K-12	$ 2,500	$ 2,500		$ 2,500	$ 2,500	$ 2,500			$ 2,500	$ 2,500 *		
2	Cities and Counties: ($1b cap)												
	HUTA	50	100	150	200	250	300	350	400	450			
	Prop 63 Mental Health	300	300	300	300	300	300	300	300	300	300	300	
	Other Programs	650	600		500	450	400			250	250		
3	SSI/SSP to federal government	217	217		217	217	217			217	217		
4	Trial Courts	42	42		42	42	42			42	42		
	<u>Programs with Unique Patterns</u>												
5	Community Colleges	200	200	200						100	100		
6	UC--smoothing**	84	185	293	322	352	353	354	371	174	-52	-86	-12
7	UC-$500m deferrals (existing authority)	250	500	500	500	500	500	500	500	500	500	500	
8	CSU--smoothing**	63	120	219	270	317	365	425	485	558	454	227	
9	CSU-$250m deferrals	227	250	250	250	250	250	250	250	250			
10	STRS				-315		-141				(456) ***		
	Cumulative Total	$4,583	$5,014	$1,912	$4,786	$5,178	$5,086	$2,179	$2,306	$5,341	$4,311	$941	-$12

Based on 2010-11 Governor's Budget cashflow projection.
* The last deferral must be paid on April 29, 2011
** As compared to 2010-11 Governor's Budget cashflow projection.
*** Change April 1 payments to April 15.

-- ATTACHMENT B --
GENERAL OBLIGATION BONDS & COMMERCIAL PAPER DEBT OF THE STATE OF CALIFORNIA
(Dollars in Thousands)

Fund	Bond Act	Final Maturity	General Obligation Bonds As of January Governor's Budget Authorized	Unissued	Outstanding	Redeemed	2010-11 Budget Cost
	LEGISLATIVE, JUDICIAL, EXECUTIVE						
6032	Voting Modernization (2002)	2018	$200,000	$64,495	$82,185	$53,320	$3,273
	Total, Legislative, Judicial, Executive		$200,000	$64,495	$82,185	$53,320	$3,273
	BUSINESS, TRANSPORTATION & HOUSING						
0703	Clean Air & Transp Improv (1990)	2039	$1,990,000	$174,580	$1,011,435	$803,985	$121,989
0714	Housing & Homeless (1990)	2023	150,000	-	3,800	146,200	879
6037	Housing and Emergency Shelter (2002)	2039	2,100,000	260,140	1,690,900	148,960	178,948
6066	Housing and Emergency Shelter (2006)	2039	2,850,000	2,161,625	688,375	-	133,621
6053	Highway Safe, Traffic Red, Air Qual, Port Sec (2006)	2039	19,925,000	13,859,140	6,045,585	20,275	608,449
0756	Passenger Rail & Clean Air (1990)	2022	1,000,000	-	292,710	707,290	88,651
6043	Safe, Reliable High-Speed Passenger Train Bond Act (2008)	2019	9,950,000	9,691,605	258,395	-	13,459
0653	Seismic Retrofit (1996)	2039	2,000,000	-	1,554,790	445,210	146,487
	Total, Business, Transportation & Housing		$39,965,000	$26,147,090	$11,545,990	$2,271,920	$1,292,483
	NATURAL RESOURCES						
0722	Ca Park & Recreational Facil (1984)	2029	$370,000	$1,100	$32,765	$336,135	$9,794
0721	Ca Parklands (1980)	2024	285,000	-	6,490	278,510	2,315
0707	Ca Safe Drinking Water (1976)	2027	175,000	2,500	12,405	160,095	4,540
0707	Ca Safe Drinking Water (1984)	2027	75,000	-	6,715	68,285	1,991
0707	Ca Safe Drinking Water (1986)	2030	100,000	-	36,370	63,630	5,413
0793	Ca Safe Drinking Water (1988)	2036	75,000	2,015	39,110	33,875	5,054
6001	Ca Safe Drinking Water (2000)	2039	1,970,000	282,145	1,539,905	147,950	140,415
6051	Ca Safe Drinking Water (2006)	2039	5,388,000	4,103,385	1,283,695	920	138,956
0786	Ca Wildlife, Coast, & Park Land Cons (1988)	2032	776,000	7,330	207,550	561,120	37,295
0734	Clean Water (1970)	2011	250,000	-	1,000	249,000	533
0734	Clean Water (1974)	2011	250,000	-	1,985	248,015	1,108
0740	Clean Water (1984)	2024	325,000	-	25,440	299,560	5,988
6029	Clean Water, Clean Air, and Parks (2002)	2039	2,600,000	676,740	1,886,595	36,665	126,244
0716	Community Parklands (1986)	2022	100,000	-	10,935	89,065	3,616
0748	Fish & Wildlife Habitat Enhance (1984)	2033	85,000	-	9,325	75,675	2,372
0720	Lake Tahoe Acquisitions (1982)	2017	85,000	-	5,310	79,690	2,344
0402	Safe, Clean, Reliable Water Supply (1996)	2039	995,000	114,630	735,180	145,190	61,557
0005	Safe Neighborhood Parks (2000)	2039	2,100,000	210,675	1,673,795	215,530	114,666
0742	State, Urban & Coastal Park (1976)	2029	280,000	-	6,630	273,370	1,248
0744	Water Conserv & Water Quality (1986)	2031	150,000	21,060	46,575	82,365	3,329
0790	Water Conserv (1988)	2036	60,000	8,735	28,185	23,080	6,865
	Total, Natural Resources		$16,494,000	$5,430,315	$7,595,960	$3,467,725	$675,643
	ENVIRONMENTAL PROTECTION						
0737	Clean Water & Water Conserv (1978)	2028	$375,000	$0	$8,365	$366,635	$1,978
0764	Clean Water & Water Reclam (1988)	2029	65,000	-	32,910	32,090	4,075
6031	Water Security, Coastal & Beach Protection (2002)	2039	3,440,000	1,187,625	2,189,515	62,860	154,056
	Total, Environmental Protection		$3,880,000	$1,187,625	$2,230,790	$461,585	$160,109
	HEALTH AND HUMAN SERVICES						
6046	Children's Hospital Projects (2004)	2039	$750,000	$87,720	$657,425	$4,855	$73,462
6079	Children's Hospital Projects (2008)	2039	980,000	685,350	294,650	-	41,809
	Total, Health and Human Services		$1,730,000	$773,070	$952,075	$4,855	$115,271
	YOUTH AND ADULT CORRECTIONAL						
0711	Co Corr Facil Cap Expend (1986)	2022	$495,000	$0	$63,430	$431,570	$20,441
0796	Co Corr Facil Cap Expend & Youth Facil (1988)	2030	500,000	-	163,010	336,990	37,020
0725	Co Jail Cap Expend (1981)	2011	280,000	-	2,650	277,350	853
0746	New Prison Construction (1986)	2034	500,000	-	31,930	468,070	10,520
0747	New Prison Construction (1988)	2029	817,000	3,170	173,815	640,015	78,266
0751	New Prison Construction (1990)	2029	450,000	605	107,350	342,045	46,047
	Total, Youth and Adult Correctional		$3,042,000	$3,775	$542,185	$2,496,040	$193,147

-- ATTACHMENT B --
GENERAL OBLIGATION BONDS & COMMERCIAL PAPER DEBT OF THE STATE OF CALIFORNIA
(Dollars in Thousands)

Fund	Bond Act	Final Maturity	General Obligation Bonds As of January Governor's Budget Authorized	Unissued	Outstanding	Redeemed	2010-11 Budget Cost
	EDUCATION--K-12						
0794	Ca Library Constr & Renov (1988)	2031	$75,000	$2,595	$27,855	$44,550	$6,150
6000	Ca Library Constr & Renov (2000)	2039	350,000	40,785	274,970	34,245	22,793
0119	Class Size Reduction K-U Pub. Ed. Facil (1998) K-12	2034	6,700,000	11,860	5,203,775	1,484,365	450,370
0657	Public Education Facil (1996) K-12	2035	2,025,000	12,965	1,295,375	716,660	167,695
6036	Public Education Facil (2002) K-12	2040	11,400,000	886,090	9,856,360	657,550	720,904
6044	Public Education Facil (2004) K-12	2040	10,000,000	2,091,915	7,728,165	179,920	474,408
6057	Public Education Facil (2006) K-12	2039	7,329,000	4,474,755	2,847,360	6,885	245,884
0739	School Bldg & Earthquake (1974)	2026	40,000	-	22,645	17,355	2,462
0789	School Facilities (1988)	2011	800,000	-	108,275	691,725	40,339
0708	School Facilities (1990)	2033	800,000	-	296,880	503,120	60,864
0745	School Facilities (1992)	2036	1,900,000	10,280	863,155	1,026,565	91,048
0743	State Sch Bldg Lease-Purch (1984)	2011	450,000	-	5,000	445,000	3,414
0743	State Sch Bldg Lease-Purch (1986)	2011	800,000	-	26,800	773,200	15,394
0776	1988 School Facil Bond Act (Nov)	2033	800,000	2,255	184,175	613,570	67,058
0774	1990 School Facil Bond Act (Jun)	2033	800,000	2,125	226,265	571,610	68,114
0765	1992 School Facil Bond Act (Nov)	2035	900,000	1,789	417,724	480,487	52,093
	Total, Education--K-12		$45,169,000	$7,537,414	$29,384,779	$8,246,807	$2,488,990
	HIGHER EDUCATION						
0574	Class Size Reduction K-U Pub. Ed. Facil (1998) Hi-Ed	2038	$2,500,000	$0	$2,171,560	$328,440	$178,071
0782	Higher Education Facil (1986)	2011	400,000	-	9,000	391,000	4,012
0785	Higher Education Facil (1988)	2033	600,000	-	125,155	474,845	58,410
0791	Higher Education Facil (Jun 1990)	2033	450,000	2,110	123,305	324,585	39,952
0705	Higher Education Facil (Jun 1992)	2033	900,000	5,805	478,950	415,245	49,406
0658	Public Education Facil (1996) Hi-Ed	2033	975,000	37,465	678,215	259,320	58,902
6028	Public Education Facil (2002) Hi-Ed	2039	1,650,000	8,820	1,586,055	55,125	94,631
6041	Public Education Facil (2004) Hi-Ed	2039	2,300,000	186,105	2,076,560	37,335	149,315
6048	Public Education Facil (2006) Hi-Ed	2039	3,087,000	966,700	2,118,860	1,440	163,511
6047	Stem Cell Research and Cures (2004)	2029	3,000,000	2,083,455	916,545	-	88,749
	Total, Higher Education		$15,862,000	$3,290,460	$10,284,205	$2,287,335	$884,959
	GENERAL GOVERNMENT						
0768	Earthquake Safety & Public Bldg. Rehab (1990)	2029	$300,000	$12,410	$184,870	$102,720	$30,311
6052	Disaster Prep and Flood Prevent (2006)	2039	4,090,000	3,030,420	1,059,110	470	115,325
0701	Veterans' Homes (2000)	2039	50,000	975	40,345	8,680	1,962
	Total, General Government		$4,440,000	$3,043,805	$1,284,325	$111,870	$147,598
	Total, All Agencies (excluding self-liquidating and BABs)		**$130,782,000**	**$47,478,049**	**$63,902,494**	**$19,401,457**	**$5,961,473**
	Additional budget cost covered by federal Build America Bond (BABs) subsidies						**$224,000**
	PAYMENT / GENERAL FUND SAVINGS						
	Transportation Debt Fund payment						-$929,088
	Natural Resources Loan payment						-$22,063
	Total, General Fund Savings						**$951,151**
	TOTAL 2010-11 GENERAL FUND COST						**$5,010,322**
	SELF-LIQUIDATING BONDS (no General Fund cost)						
	Ca Water Resources Dev (1959)	2024	$1,750,000	$167,600	$498,665	$1,083,735	$76,436
	The Economic Recovery Bond Act	2023	15,000,000	-	8,359,805	6,640,195	782,437
	Veterans Bonds	2042	4,210,000	1,163,610	1,086,300	1,960,090	76,908
	Total, Self-Liquidating Bonds		$20,960,000	$1,331,210	$9,944,770	$9,684,020	$935,781
	Total General Obligation Bonds		**$151,742,000**	**$48,809,259**	**$73,847,264**	**$29,085,477**	**$7,121,254**

Source: January Governor's Budget

2010 Spring Bond Sale Plan

Attachment
BL 10-09

Agency	Estimated* Cash Need for Fiscal Year 10-11	Final Spring 2010 Bond Sales	Planned Fall 2010 Bond Sales	Estimated* Cash Need for Fiscal Year 11-12	Planned Spring 2011 Bond Sales	Planned Fall 2011 Bond Sales
Existing Projects (Started prior to Spring 2010)						
CIRM - Grants	$ 57,717,000	$ 42,717,000	$ 15,000,000	$ 218,569,000	$ 218,569,000	$ -
CIRM - Loans	$ 11,332,000	$ 11,332,000	$ -	$ 51,256,000	$ 51,256,000	$ -
CCCCO	$ 452,880,650	$ 226,360,717	$ 226,519,933	$ 168,535,726	$ 168,535,726	$ -
ARB	$ 67,471,793	$ 33,740,000	$ 33,731,793	$ 3,103,945	$ 3,103,945	$ -
UC - State-Owned	$ 47,210,924	$ 23,605,462	$ 23,605,462	$ 22,038,472	$ 22,038,472	$ -
UC - BAB State-Owned	$ 5,445,454	$ 5,445,454	$ -	$ 227,897	$ 227,897	$ -
CSU	$ 72,063,993	$ 36,032,653	$ 36,031,340	$ 6,314,142	$ 6,314,142	$ -
CHFFA	$ 284,856,929	$ 131,590,000	$ 153,266,929	$ 480,731	$ 480,731	$ -
Polluiton Control Auth.	$ 16,900,000	$ 16,900,000	$ -	$ 5,423,624	$ 5,423,624	$ -
HCD	$ 606,955,000	$ 606,955,000	$ -	$ 480,113,988	$ 480,113,988	$ -
Caltrans - State-Owned	$ 64,094,205	$ 32,035,000	$ 32,059,205	$ 115,980,007	$ 115,980,007	$ -
Caltrans - Nov Starts	$ 47,589,863	$ 23,795,000	$ 23,794,863	$ 183,077	$ 183,077	$ -
Caltrans - Grants Non-Ex	$ 6,740,123	$ 3,375,000	$ 3,365,123	$ 28,815,671	$ 28,815,671	$ -
Caltrans - State-Owned Non-Ex	$ 151,259,727	$ 75,630,000	$ 75,629,727	$ 335,306,630	$ 335,306,630	$ -
Caltrans - Grants	$ 8,471,093	$ 4,240,000	$ 4,231,093	$ 8,899,068	$ 8,899,068	$ -
Resources	$ 766,238,749	$ 372,796,989	$ 393,441,761	$ 256,335,045	$ 256,335,045	$ -
DWR	$ 1,083,738,951	$ 669,707,199	$ 414,031,752	$ 654,282,756	$ 654,282,756	$ -
Water Board	$ 154,654,245	$ 79,685,457	$ 74,968,788	$ 74,586,349	$ 74,586,349	$ -
Library	$ 25,062,896	$ 16,320,837	$ 8,742,059	$ 1,971,000	$ 1,971,000	$ -
Public Health	$ 117,001,511	$ 78,171,256	$ 38,830,255	$ 26,614,561	$ 26,614,561	$ -
Existing Projects (Started spring 2010 New Starts)						
CIRM			$ 29,666,000		$ 150,000,000	$ -
Caltrans P116			$ 20,188,138		$ 67,277,500	$ -
Resources			$ -		$ 87,298,636	$ -
Existing Projects (Started fall 2010 New Starts)			$ -			$ -
HSR			$ -		$ 345,212,000	$ -
Caltrans P1B			$ -		$ 722,000,000	$ -
Caltrans			$ -		$ 781,000,000	$ 781,000,000
Resources			$ -		$ 75,000,000	$ -
DWR (New)			$ -		$ 361,874,785	$ -
DWR (Future)			$ -		$ 326,989,654	$ -
Total Existing	**$ 4,047,685,106**	**$ 2,490,435,023**	**$ 1,607,104,221**	**$ 2,459,037,689**	**$ 5,375,690,264**	**$ 781,000,000**
New Projects						
CIRM	$ 87,617,000	$ 57,951,000	$ -	$ 185,237,000	$ 35,237,000	$ -
CAL EMA	$ 96,240,000	$ 96,240,000	$ -	$ -	$ -	$ -
ARB	$ 237,575,000	$ 237,575,000	$ -	$ 236,782,397	$ 236,782,397	$ -
UC	$ 106,610,714	$ 106,610,714	$ -	$ 38,343,472	$ 38,343,472	$ -
OPSC	$ 2,328,470,131	$ 1,351,385,000	$ 977,085,131	$ -	$ -	$ -
Streets and Roads	$ 535,206,000	$ 400,000,000	$ 135,206,000	$ -	$ -	$ -
CHFFA	$ 101,085,000	$ 101,085,000	$ -	$ -	$ -	$ -
Polluiton Control Auth.	$ 2,134,165	$ 2,134,165	$ -	$ -	$ -	$ -
HCD	$ 292,819,000	$ 227,100,835	$ 65,718,165	$ 103,760,000	$ 103,760,000	$ -
Caltrans - P116	$ 95,188,138	$ 75,000,000		$ 67,277,500	$ -	$ -
Caltrans - P1B	$ 1,025,000,000	$ -	$ 1,025,000,000	$ 722,000,000	$ -	$ -
Resources	$ 940,595,256	$ 641,822,438	$ 298,772,818	$ 290,995,453	$ 203,696,817	$ -
DWR	$ 447,914,326	$ 53,649,977	$ 394,264,349	$ 361,874,785	$ -	$ -
Water Board	$ 26,457,864	$ 26,457,864	$ -	$ 12,034,701	$ 12,034,701	$ -
Public Health	$ 30,552,984	$ 30,552,984	$ -	$ -	$ -	$ -
Library	$ 2,000,000	$ 2,000,000	$ -	$ 3,000,000	$ 3,000,000	$ -
Total New	**$ 6,355,465,578**	**$ 3,409,564,977**	**$ 2,896,046,463**	**$ 2,021,305,308**	**$ 632,854,387**	**$ -**
Future Projects						
CAL EMA	$ 98,230,845		$ 98,230,845	$ 98,230,845	$ 98,230,845	$ -
CCCCO	$ 4,752,000		$ 4,752,000	$ 14,841,000	$ 14,841,000	$ -
HSR	$ 493,160,000		$ 493,160,000	$ 573,385,000	$ 228,173,000	$ -
Polluiton Control Auth.	$ 7,500,000		$ 7,500,000	$ 7,500,000	$ 7,500,000	$ -
Caltrans - P1B	$ 605,000,000		$ 605,000,000	$ 1,562,000,000	$ -	$ -
Resources	$ 244,787,643		$ 244,787,643	$ 391,798,535	$ 316,798,535	$ -
DWR	$ 411,402,352		$ 411,402,352	$ 326,989,654	$ -	$ -
Total Future	**$ 1,864,832,840**	**$ -**	**$ 1,864,832,840**	**$ 2,974,745,034**	**$ 665,543,380**	**$ -**
Grand Total	**$ 12,267,983,524**	**$ 5,900,000,000**	**$ 6,367,983,524**	**$ 7,455,088,031**	**$ 6,674,088,031**	**$ 781,000,000**
Excess Bond Capacity		$ 1,100,000,000	$ 632,016,476		$ 325,911,969	$ 6,219,000,000

* Departmental needs based on point-in-time surveys sent to Finance in February 2010.

SUBCOMMITTEE NO. 5 Agenda

Senator Denise Moreno Ducheny, Chair
Senator Robert D. Dutton
Senator Alex Padilla

OUTCOMES

Agenda - Part A

Thursday, May 6, 2010
9:30 a.m. (or upon adjournment of session)
Room 113

Consultant: Keely Martin Bosler

Revenues and the Economy

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-324-9335. Requests should be made one week in advance whenever possible.

0860 State Board of Equalization

Tax Gap Reduction Measures

1. Employee Furlough Reductions

Action. Approved budget proposal.

Vote. 3-0

2. Agricultural Inspection Station Tax Leads

Action. Approved budget proposal.

Vote. 3-0

3. Fuel Tax Compliance

Action. Approved budget proposal.

Vote. 3-0

4. Use Tax Collection - Voluntary Disclosure Program

Staff Recommendation. Staff recommends that the Subcommittee adopt trailer bill language to extend the existing voluntary line for the sales and use tax on the income tax form and direct BOE to develop a "look-up" table to assist taxpayers in compliance with current law. This would safeguard $10 million in state and local revenue that would otherwise be lost and generate an additional $4 million in state and local revenue. **HELD OPEN.**

5. Sales Tax Nexus

Staff Recommendation. Staff recommends that the Subcommittee adopt trailer bill language similar to the language contained in ABx8 8 to require certain Internet retailers to collect sales and use tax on purchases made by California businesses and consumers and generate $107 million in additional General Fund revenues. **HELD OPEN.**

Other Issues

1. Fuel Tax Swap – Administration

Staff Recommendation. Staff recommends that the Subcommittee hold this issue open pending additional information to justify these positions. **HELD OPEN.**

2. Headquarters Building—Oversight

Oversight. No action. Staff and BOE to follow up with environmental agencies about an assessment of the building. BOE to provide Subcommittee with the university study on the building when available this June.

1730 Franchise Tax Board

Tax Gap Reduction Measures

1. Employee Furlough Reductions

Action. Approved budget proposal.

Vote. 3-0

2. Tax Gap Enforcement

Action. Approved budget proposal.

Vote. 2-1 (Dutton)

3. Accounts Receivable Inventory

Action. Approved budget proposal on a two-year limited-term basis given the accounts receivable inventory growth is partly due to underlying economic conditions that are bound to change.

Vote. 2-1 (Dutton)

4. Federal Treasury Offset Program

Action. Approved budget proposal.

Vote. 3-0

5. Enterprise Data to Revenue Project

Action. Approved budget proposal.

Vote. 3-0

6. Financial Institutions Records Match (FIRM)

Staff Recommendation. Staff recommends that the Subcommittee adopt trailer bill language similar to the language contained in ABx8 8 to direct FTB to implement the FIRM system and generate $32 million in General Fund revenues in the budget year. **HELD OPEN.**

7. Abusive Tax Shelters

Staff Recommendation. Staff recommends that the Subcommittee adopt trailer bill language similar to the language contained in ABx8 8 (Budget) and generate $2 million in additional General Fund revenue in the budget year. **HELD OPEN.**

8. Professional License Suspension

Staff Recommendation. Staff recommends that the Senate adopt trailer bill language similar to the language in ABx8 8 that suspends professional licenses of delinquent taxpayers and generates approximately $19 million in General Fund revenues. **HELD OPEN.**

Other Issues

1. Data Security and Reliability

Action.

- Approved the data security proposal.
- Approved the information technology refresh.

Vote. 3-0

2. Other Budget Proposals and Finance Letters

Action.

- Approved the Limited Liability Company Refund Processing budget proposal.
- Approved the Court Ordered Debt budget proposal.
- Approved the Homeowner and Renter Assistance Finance Letter.

Vote. 3-0

3. 2010 Homebuyer Tax Credit Workload

Action.

- Approved six of the nine requested positions (effectively continuing three one-year limited term positions from the tax credits last year and adding three new one-year limited term positions.

Vote. 3-0

SUBCOMMITTEE NO. 5 Agenda

Senator Denise Moreno Ducheny, Chair
Senator Robert D. Dutton
Senator Alex Padilla

Agenda - Part A

Thursday, May 13, 2010
9:30 a.m. (or upon adjournment of session)
Room 113

Consultant: Keely Martin Bosler

Item **Department** **Page**

Revenues and the Economy

Recent Tax Policy Changes

1. 2008 Tax Policy Changes

Background. The 2008-09 Budget package contained tax policy changes that temporarily suspended some corporate income tax expenditures for the 2008 and 2009 tax years and also made permanent corporate income tax cuts prospectively starting in the 2010 tax year.

The corporate tax expenditures suspended temporarily for the 2008 and 2009 tax years are as follows:

- **Limit Tax Credits.** The 2008-09 budget package temporarily limited the amount of business tax credits that could be used to reduce tax liability in the 2008 and 2009 tax years. Use of credits would be limited to 50 percent of the taxpayer's state tax liability. This increased General Fund revenues by approximately $890 million in 2008-09 and $415 million in 2009-10. Taxpayers with net business income of less than $500,000 were exempted from this limitation. The limitation affected the application of various business tax credits, including the Research and Development credit, the Enterprise Zone credit, and Low-Income Housing credits.

- **Suspend Net Operating Losses.** The 2008-09 budget package suspended net operating loss (NOL) deductions for the 2008 and 2009 tax years, except for taxpayers with net business income of less than $500,000 in either year. A NOL occurs when certain tax-deductible expenses exceed taxable revenues in a tax year.

The 2008-09 budget package also included prospective corporate tax cuts. These permanent tax cuts are as follows:

- **Unitary Group Credit Sharing.** Beginning in the 2010 tax year, corporations that accumulate business tax credits would be able to assign all or a portion of any unused credit to an affiliated corporation that is a member of the same combined reporting group. With respect to credits earned in tax years beginning before July 1, 2008, the assignee corporation would have to have been a member of the group from at least June 30, 2008, through the year of assignment. For credits earned subsequently, the assignee corporation must be a member of the group in the year that the credit is earned through the year in which the assignment occurs. This tax policy change will result in a loss of General Fund revenues of approximately $315 million annually starting in the 2010-11 budget year.

- **Extend NOL Carry Forward Period and Allow for Carrybacks.** Beginning in 2010, taxpayers will again be able to carry forward NOLs. Current law allows for a 10 year carry forward period for losses incurred before 2008. The budget package further expanded the NOL carry forward period from 10 years to 20 years for losses incurred after January 1, 2008. Furthermore, the budget package also authorizes NOL carry backs for losses incurred in 2011 or later tax years. The carrybacks will be applicable to offset taxable income back to 2006. The carry back provision will phase in, with 50 percent of any 2011 NOLs available for carry back, 75 percent of any 2012 NOLs, and full carry back for NOLs in subsequent years.

Staff Comments. Staff finds that current law allows corporations to carry forward NOLs for ten years thereby giving corporations the opportunity to average their tax liabilities over a reasonable time period. Staff finds that the policy to allow for carrybacks is duplicative of the carry forward policy, which essentially provides the same tax savings. However, the carryback policy will compound fiscal difficulties for the state in the budget year, and next several fiscal years, because the state will be forced to refund previously paid taxes at a time when the economy is still in recovery and the state's revenues are still recovering.

2. 2009 Temporary Tax Policy Changes

Background. The 2009-10 Budget package contained four temporary tax increases. The duration of the tax increases was dependent on voter action on Proposition 1A (May 2009), which was defeated by the voters. The level of the Personal Income Tax (PIT) surcharge was dependent on a trigger mechanism related to the level of federal stimulus funds received by the State to offset General Fund expenditures. The federal funds received were less than the trigger level so a higher surcharge was implemented for the 2009 and 2010 tax years. The temporary tax increases enacted as part of the 2009-10 Budget Act are detailed below.

Sales and Use Tax:

- **Temporary 1 percent Increase on State Sales and Use Tax.** The State Sales and Use Tax rate was increased from 5 percent to 6 percent effective April 1, 2009. The increase will sunset on June 30, 2011. The Governor's budget estimates that revenues from the additional 1 percent are expected to generate $4.2 billion in the current year and $4.5 billion in the budget year.

Personal Income Tax:

- **Temporary 0.25 percent Surcharge.** A PIT surcharge of 0.25 percent was enacted effective with the 2009 tax year. The surcharge will sunset at the conclusion of the 2010 tax year. The Governor's budget estimates that this surcharge and the reduced dependent credit (next bullet) will result in $4.2 billion in additional revenues in the current fiscal year, which fall to about half that amount in the budget year.

- **Temporary Reduction in Dependent Exemption Credit.** The dependent exemption credit was reduced from $309 to $99 per dependent effective with the 2009 tax year. The exemption credit will return to the higher value after the conclusion of the 2010 tax year.

Vehicle License Fee:

- **Temporary 0.5 percent Increase.** The rate of the vehicle license fee (VLF) was increased from 0.65 to 1.15 percent of a vehicle's value. The increase became effective May 19, 2009 and will sunset on June 30, 2011. The increase from 0.65 to 1 percent went to benefit the General Fund and 0.15 of the increase was transferred to the Local Safety and Protection Account to fund local law enforcement programs. The Governor's budget estimates that revenues from this source to the General Fund will be $1.4 billion in the current year and $1.5 billion in the budget year.

Staff Comments. Staff finds that the four temporary tax increases will generate approximately $8 billion in the budget year. The PIT surcharge and dependent exemption credit are due to expire at the end of the 2010 tax year. The Sales and Use Tax and Vehicle License Fee increases are due to expire at the end of the budget year. The expiration of these tax increases will result in a sizeable budgetary gap in the 2011-12 budget year.

The PIT rate ranges from 1.25 percent to 9.55 percent depending on income (this includes the temporary surcharge). Individuals with $92,698 or more in taxable income in 2009 paid the highest PIT rate. In addition, taxpayers with taxable income over $1 million pay an additional 1 percent surcharge, making their effective tax rate 10.55 percent in the 2009 and 2010 tax years.

Staff finds that the PIT surcharge was regressive in that it raised taxes the same amount at every income tax bracket. This means that proportionally an individual paying tax in the lowest bracket saw their rate increase by 25 percent, while an individual with $1 million in taxable income saw their rate increased less than 2.5 percent.

As referenced above, the VLF is currently 1.15 percent of the market price of the vehicle, but will return to 0.65 percent on July 1, 2011. The VLF has historically been 2 percent of the market price of the vehicle. The State Constitution requires that 0.65 percent of the VLF be allocated to local governments.

The Sales and Use Tax is currently approximately 8.25 percent and can be up to 2 percent higher depending on the local jurisdiction since locals can generally levy an additional 2 percent through the transactions and use tax. Currently, the Sales and Use Tax is made up of the following components: 6 percent to the General Fund; 0.5 percent dedicated to local governments; 0.5 percent dedicated to local public safety services; 1 percent Bradley-Burns Uniform Local Sales and Use Tax with 0.25 percent dedicated to county transportation funds and 0.75 percent for city and county operations; 0.25 percent dedicated to paying costs associated with the Economic Recovery Bond Act.

3. 2009 Tax Expenditures (Tax Cuts and Credits)

Background. The 2009-10 budget package contained four new tax expenditures.

Corporation Tax Cuts and Credits:

- **Elective Single Sales Factor.** Created a permanent ***elective*** single sales factor for apportionment of business income across states. In contrast, prior law averaged a business's proportion of sales, property, and payroll in California (with the sales factor double-weighted) to apportion the California share of multi-state business income. Under this new tax policy, corporations can elect to allocate net income for California tax purposes under the old formula or 100 percent to sales. Businesses that proportionally have fewer sales in California relative to property and payroll will see their taxable income in California fall.

  This change will go into effect for the 2011 tax year, so no General Fund revenue loss was attributed to the current fiscal year. However, the FTB estimates that the State will lose $240 million in General Fund revenues in the budget year related to this corporate tax cut. The revenue losses related to this policy change are expected to grow to $900 million by 2012-13.

- **Motion Picture Production Tax Credit.** Created a tax credit of $100 million per year for five years for in-state production of motion pictures. This credit is estimated by DOF to reduce revenues by $23 million in the budget year. The FTB estimated that ultimately this credit would reduce revenues by $175 million annually until the credits are exhausted.

- **Small Business Job Tax Credit.** Provided $400 million in additional tax credits to provide $3,000 for each qualified new hire at a small business (businesses with 20 or fewer employees). The DOF estimates that the General Fund loss associated with this credit was $17 million in 2008-09, $330 million in 2009-10, and will be $50 million in the budget year.

Personal Income Tax Credit.

- **Homebuyers Tax Credit.** Provided $100 million in tax credits for homebuyers purchasing qualified new homes. Each qualified homebuyer can receive a tax credit up to $10,000, which can be claimed over three tax years in equal amounts annually. The DOF estimates that the General Fund loss associated with this credit was $11 million in 2008-09, $23 million in 2009-10, and will be $23 million in the budget year.

Staff Comments. Staff finds that the four tax cuts included in the 2009-10 budget package will cost the General Fund approximately $353 million in the current year and will cost the state $336 million in the budget year. The General Fund revenue loss related to the elective single sales factor tax policy change will continue to grow in future budget years to over $900 million, thereby adding to the budgetary gap likely created by the expiration of the temporary taxes enacted as part of the 2009-10 budget package.

Allowing corporations to choose the formula they apportion income for tax purposes gives a comparative advantage to out-of-state corporations that have high sales, but low property and payroll invested in California. By allowing the corporation to elect the formula it uses to calculate tax owed, the corporation can then choose the calculation that is most advantageous to their situation. Furthermore, staff finds that if a tax policy of a mandatory single sales factor was elected it would encourage investment in payroll and property here in California, thereby advantaging companies with large "on the ground" investments in California.

Staff finds that generally it is difficult to determine the efficacy of the three tax credits that were enacted last year. It is unclear how or if these tax credits motivate economic activity (investments in film, hiring, and purchasing new homes) that would otherwise occur absent these credits.

Furthermore, homeownership is already clearly a state and federal goal given the numerous tax exclusions that already exist, including the deductibility from income of mortgage interest on first and second homes for state and federal purposes; the exclusion from income of certain capital gains on the sale of a home for state and federal tax purposes; and the deductibility from income of property taxes for state and federal tax purposes. Furthermore, there were significant federal tax credits for homebuyers made available as part of the recent economic stimulus package.

4. 2010 Tax Expenditures (Cuts and Credits)

Governor's Budget. The Governor's 2010-11 budget proposal included the following new tax credits to the personal income tax and corporate tax, respectively:

- **Homebuyers Tax Credit.** A homebuyer's income tax credit of $10,000, including $100 million in credits for the purchase of new homes and $100 million in credits for first-time homebuyers.
- **Green Technology Credit.** A sales tax exemption for the purchase of green technology manufacturing equipment.

Recent Legislative Actions. The tax credits proposed by the Governor in his January budget proposal were passed by the Legislature on March 22, 2010 following deliberations on the Governor's mid-year budget proposals. The homebuyer's tax credit was contained in AB 183 (Caballero) and the green technology credit was contained in SB 71 (Padilla). The homebuyer's tax credit is capped at $200 million, including $100 million for the purchase of new homes and $100 million for first-time homebuyers. The green technology sales and use tax exemption on manufacturing equipment is not capped, but would sunset on January 1, 2021.

The bills are both expected to reduce revenues in the current and budget years, including $69 million in lost revenues from the homebuyer's tax credit and minimal impacts related to the green technology legislation. Staff finds that the Governor's budget did not score the revenue impacts of these proposals.

Furthermore, as noted in the previous item, the efficacy of these tax credits is difficult to determine. Would the homebuyers receiving the credit make the same decision to invest without the tax credit? Would green technology manufacturers also make investment decisions in California absent this credit?

Options for Tax Policy Changes

Options for Delaying Tax Policy Changes

1. Governor's "Trigger" Proposals—Delay Corporate Tax Cuts

Governor's Budget. The Governor's budget proposal includes trailer bill language to extend or delay for one year corporate tax cuts that were adopted in the past two budgets if $6.9 billion in federal funds are not secured prior to July 15, 2010. These revenue-raising proposals are part of the Governor's "trigger" proposals that would also eliminate and severely reduce several health and human services programs. The corporate tax cuts the Governor proposes to delay are as follows:

- **Extend Suspension on use of NOLs.** The 2008-09 Budget Act suspended for 2008 and 2009 the use of net operating losses (NOLs). The Governor's trigger proposal would continue the suspension in 2010 for $1.5 billion in additional revenue in the budget year.
- **Slow Phase-in of NOL Carrybacks.** The Governor's trigger proposal would lower to 30 percent the first year phase-in for carrybacks of NOLs for $20 million in additional revenue in the budget year. The 2008-09 Budget Act allowed for 50 percent carryback in 2011.
- **Delay Credit Sharing Among Related Companies.** The 2008-09 Budget Act allowed credits to be shared within a unitary group beginning in 2010. The Governor's trigger proposal would delay the sharing until 2011 for $315 million in additional revenue in the budget year.
- **Delay Elective Single Sales Factor Apportionment.** The 2009-10 Budget Act allowed for single sales factor election beginning in 2011. The Governor's trigger proposal would delay this election until 2012 for $240 million in additional revenue in the budget year.
- **Reduce Dependent Exemption Credit.** The 2009-10 Budget Act reduced the dependent exemption credit from $309 to $99 per dependent for 2009 and 2010. The Governor's trigger proposal would extend the reduced credit to 2011 for $430 million in additional revenue in the budget year.

LAO Alternative. The LAO presented an alternative to the Governor's trigger proposal related to revenues. Their approach would be to extend or delay these provisions for two years in recognition of the budget challenge created by the loss of $10 billion in temporary taxes in 2011-12.

The LAO also proposes to permanently align the dependent exemption credit with the personal exemption credit, which is a linkage that existed prior to 1998.

In addition, the LAO proposes to delay the single sales factor apportionment and make it mandatory. The LAO indicates that allowing businesses to choose their method of taxation is poor tax policy.

Staff Comments. Staff finds that adopting the Governor's trigger proposals would result in $2.5 billion in additional revenues in the budget year. This revenue would help to solve the significant budget problem in a balanced approach that includes cuts and some revenue options. Furthermore, staff finds that in most cases the tax cuts being delayed are new and would reduce taxes on corporate entities at a time when major cuts are being made to core state functions, including education and health care.

Options for Broadening Tax Bases

Background. Tax expenditures are generally revenue a government foregoes through the provisions of tax laws that allow for (1) deductions, exclusions, or exemptions from the taxpayers' taxable income; (2) deferral of tax liability; or (3) preferential tax rates. Unlike budgetary expenditures, tax expenditures are generally not subject to an annual review process to assess their effectiveness or benefits. As a result, unless sunset provisions or performance measures are explicitly incorporated in the authorizing legislation, tax expenditure programs generally continue regardless of their policy merits or effectiveness. California forgoes approximately $50 billion in revenue annually due to tax expenditures.

The LAO has put forward recommendations to eliminate or reduce several of the dozens of tax expenditures that exist in California tax law.

1. Tax Incentive Areas

Background. Tax incentive areas including enterprise zones, manufacturing enhancement areas, targeted tax areas, and local agency military base readjustment areas are selected for tax incentives based largely on socioeconomic characteristics and the prevailing level of economic distress. Extensive tax benefits are available for each of these areas including hiring credits, sales and use tax credits, accelerated depreciation, net interest deduction for lenders, expanded use of net operating loss carryforwards, and the carry forward of unused credits. The tax benefits vary depending on the designation of the area.

The total revenue impact on the state of these tax incentive areas is over $400 million. The hiring credit is the most expensive for the state in terms of forgone revenue and accounted for over half of the corporate tax revenue reduction. Also, the vast majority of the tax benefits from the tax incentive areas flow to large companies with assets of $1 billion and more.

LAO Recommendation. The LAO has indicated that the academic literature on geographic tax incentives is mixed. Overall, the weight of research suggests that the response of these tax incentive areas may be small in general and may result in revenue losses that are significant relative to the benefits received. The LAO has recommended eliminating all tax incentive area programs, since they have been found to be relatively ineffective. This would lead to approximately $400 million in additional revenue in the budget year.

2. Like-Kind Exchanges

Background. A like-kind exchange can involve the exchange of one business for another business, or one real estate investment property for another real estate investment property without paying personal income taxes on the capital gains that have accrued. Investors who make repeated exchanges over time accumulate these capital gains, and taxes are to be paid when the investor eventually sells the property. However, many investors use the like-kind property exchange tax exemption as a way of permanently avoiding taxation. This is accomplished by trading properties, sometimes several times and never actually selling the property. When the investor dies, the property is transferred to their heirs at the current-market price. Therefore, the gains made by the original investor are never taxed.

LAO Recommendation. The LAO has recommended eliminating favorable treatment of like-kind exchanges since many investors are using the like-kind property exchange tax exemption to avoid ever paying taxes on cumulated capital gains. Eliminating this exemption would generate approximately $350 million in additional revenue in the budget year.

3. Employer Contribution Exemptions

Background. Under current law, employer contributions for up to $50,000 in employee life insurance policies and employer-provided parking benefits up to $230 per month are excluded from the employee's income for tax purposes. Each of these exclusions result in approximately $100 million in lost revenue to the state. Federal exemptions also exist for both life insurance and employer-provided parking.

LAO Recommendation. The LAO recommends eliminating both of these exclusions citing that there is no justification for favoring life insurance and parking over other forms of compensation. Furthermore, the LAO notes that there is no corresponding exclusion available for self-employed people, so the provision distorts the market for life insurance by extending benefits to one group but not a similarly situated group. The LAO also notes that the parking benefit may be contrary to other efforts by the state to discourage solo car commuting and promote less polluting forms of transportation.

4. Small Corporation Stock Exclusion

Background. State law excludes one-half of the capital gains earned on the sale of small corporation stock. To qualify for this benefit, stock must be for corporations that operate in California and must be held at least five years by the taxpayers.

LAO Recommendation. The LAO recommends eliminating the exclusion of gains on small corporation stock for savings of approximately $20 million. The LAO notes that there is little evidence that this exclusion has any impact on small corporations' ability to access capital.

Staff Comments. Staff finds that this tax expenditure program gives preferential treatment to small corporations over other small businesses.

5. Senior Exemptions

Background. California grants a yearly nonrefundable personal income tax credit of $198 to persons age 65 or over. This is double the personal exemption credit provided to other adults. Furthermore, the state also exempts social security income from state taxation.

LAO Recommendation. The LAO recommends conforming the senior exemption to the personal exemption, which is $99. (The dependent credit was also reduced for two years in 2009 to the same level as the personal exemption.) The LAO sees no policy rationale for treating seniors differently than other adults. The LAO is also recommending taxing one-half of Social Security income given there is no policy rational for treating social security income different from other retirement income.

Staff Comments. Staff finds that these tax breaks were implemented to alleviate the tax burden on seniors in California since many live on a fixed income. However, staff would note that these exemptions are applied to all seniors and are not limited to seniors in certain income categories.

6. Products Sold by Healthcare Professionals and Veterinarians

Background. Under current law, veterinarians and some healthcare professionals are not required to collect sales taxes when they sell certain products related to their professional service. They do, however, pay sales taxes when they purchase the products. As a result, the state does not receive sales taxes on the mark-up charged to patients. This arrangement, therefore, provides a partial sales tax exemption to these products. For example:

- Chiropractors can sell vitamins, minerals, dietary supplements, and orthotic devices without collecting sales tax.
- Optometrists can sell eyeglasses, frames and lenses without collecting sales taxes.
- Podiatrists can sell prosthetic materials and inlays without collecting sales taxes.
- Licensed hearing aid specialists can sell hearing aids without collecting sales taxes.
- Producers of X-ray films or photographs can sell materials and supplies without collecting sales taxes.
- Pharmacists can sell replacement contact lenses without collecting sales taxes.
- Veterinarians can sell drugs and medicines without collecting sales taxes.

LAO Recommendation. The LAO recommends that the partial sales tax exemption for the products above be eliminated to generate approximately $80 million in additional revenues in the budget year. The LAO sees no policy rationale for special treatment of these purchases especially when some of these purchases are more costly than the service provided by the professional. The LAO also indicates that the products described above are already subject to sales tax at the wholesale level – when they are sold to the healthcare professional or veterinarian. Therefore, it is unclear why they would be considered “necessity of life” which is a sales tax exemption for prescription medicines.

Options for Targeted Tax Increases

1. Oil Severance

Background. An oil severance tax is a levy on every barrel that oil producers take out of the California ground. Currently, California does not levy a general tax on this production. The state produced approximately 218 million barrels of crude oil in 2008. At a barrel price of approximately $70 a 6 percent tax would generate over $1 billion annually.

In 2006 a proposition was defeated by voters that would have applied a 6 percent levy on oil production for alternative fuel production. The Governor proposed a 9.9 percent levy in this 2009 budget proposal.

LAO Comments. The LAO indicates that there are several policy rationales for an oil severance tax. First is the idea that the current generation should compensate future generations for the irretrievable loss of a nonrenewable natural resource. Second, since oil fields cannot relocate to another state, taxes have less of an effect on business production decisions as long as owners can earn a reasonable rate of return on their investments. The LAO cites that research indicates that severance taxes tend to affect production less than other business taxes do. Other rationales for an oil severance tax are that oil production should share in the cost of the environmental problems caused by the burning of oil products.

The LAO ultimately recommended rejecting the Governor's 2009 proposal because it singled out only one class of nonrenewable resources (natural gas and nonfuel minerals were exempt) and would likely make the overall revenue system even more volatile than the current system.

Staff Comments. Staff finds that California is the only state of 22 major oil producing states that does not assess such a levy on oil production. However, California does tax oil reserves as property and differences in overall tax structures make it difficult to compare tax burdens on the oil industry directly.

Given the difficult choices presented by the budget deficit. The Legislature may wish to consider this option given research that indicates that oil severance taxes have fewer economic impacts than other business taxes.

Furthermore, California consumes approximately 15 billion barrels of gasoline per year. Therefore, it is unlikely that a tax on 1.5 percent of our total consumption would have a demonstrative impact on fuel prices in California.

2. Vehicle License Fee

Background. The vehicle license fee is assessed on all vehicles, excluding trailer coaches and mobile homes. Currently the rate is 1.15 percent of the market value of the vehicle until July 1, 2011, at which time the rate will return to 0.65 percent. As mentioned earlier in this agenda, this rate was increased temporarily in the 2009-10 budget package and 0.15 percent was dedicated to local law enforcement programs. Proposition 1A of 2004 established in the State Constitution that all revenues collected at the rate of 0.65 percent be allocated to local governments. Historically, the VLF rate was 2 percent.

LAO Recommendation. The LAO has suggested aligning the VLF with local property tax rates, which are approximately 1 percent. This would generate approximately $1.3 billion.

Staff Comments. Staff finds that increasing the VLF from the 0.65 percent level to the historic 2 percent level would generate nearly $4.8 billion in additional revenues in 2011-12 after the temporary increase expires.

3. Alcohol Tax

Background. The Governor proposed in his 2009 budget proposal to increase the alcohol excise tax by 5 cents per drink. This proposal would have generated approximately $740 million in additional revenues in the budget year. Current law establishes the alcoholic beverage tax as a per-gallon excise tax collected on the sale, distribution, or importation of alcoholic beverages in California. Rates for this tax were last raised in 1991. Rates differ by type of alcohol. Currently, state law levies a tax of 0.20 cents on each gallon of beer and most types of wine and $3.30 for a gallon for most types of distilled spirits.

LAO Recommendation. The LAO agreed with the Governor’s 2009 proposal to raise taxes on alcohol given that the costs associated with drinking far outstrip revenues generated by the excise tax. Furthermore, the LAO found that the proposed increase would result in a relatively modest increase to the consumer—25 cents for a bottle of wine, 30 cents for a six-pack of beer, and about $1 for a bottle of distilled spirits.

The LAO further recommended that the Legislature take additional actions to equalize the tax rates among different alcoholic beverages. Currently wine has the lowest tax burden on a per drink basis and is taxed well below the national average.

Staff Comments. Staff finds that California taxes beer slightly above the national average. Wine is taxed at a rate that is 64 cents below the national average and distilled spirits are taxed 45 cents below the national average.

Staff finds that the Legislature may want to consider this tax option given the budget deficit and the relatively modest impact to the consumer on a discretionary item.

4. Rate Increase on Top Income Brackets

Background. The personal income tax rate is currently 9.55 percent for individuals that make over $92,698 (this amount is indexed and adjusted annually). This includes the 0.25 percent temporary surcharge enacted as part of the 2009-10 budget package. Taxpayers with taxable income over $1 million have an effective tax rate of 10.55 percent given the 1 percent surcharge added by Proposition 63 (Mental Health Services Act).

Staff Comments. Staff finds that even with the surcharge the top tax bracket is still slightly below the highest tax brackets in place in 1995, when the maximum tax brackets were 10 and 11 percent. Staff finds that restoring the highest tax brackets to 1995 rates for two years would generate approximately $4.7 billion in additional revenues.

Staff finds that there are numerous ways to modify the existing income tax brackets to generate additional tax revenue, including further differentiating the rates paid for incomes between $92,698 and $1 million. Currently, all taxpayers with taxable income in this range pay the same tax rate.

Staff finds that one option is similar to changes recently enacted by the federal government to raise the income tax rates for taxpayers with taxable income over $250,000, while reducing the tax rates for taxpayers with taxable income below this amount. The additional revenues generated by this option would depend on how ultimately the rates were structured.

Other Revenue Options

1. Independent Contractor Withholding

Background. Under existing law, employers are required to withhold a portion of wages paid to their employees and remit the withheld amounts to the Employment Development Department (EDD), which administers the reporting, collection, and enforcement of specified state taxes subject to withholding. This withholding requirement greatly improves compliance with California's income tax law. The withholding requirement does not apply to payments made to independent contractors.

Research by the Franchise Tax Board (FTB) has revealed significant inconsistencies and non-compliance related to independent contractor payments. Currently, the IRS requires businesses making payments to independent contractors in excess of $600 per year to file Form 1099-MISC. However, there are significant concerns and inaccuracies with this reporting source.

Recent Legislative Proposals. In recent years, the Legislature has considered requiring businesses and governmental entities to withhold 3 percent of payments they make to independent contractors exceeding $600 each year consistent with the federal reporting requirement.

The FTB estimates that this requirement would improve tax compliance by approximately $300 million annually. The withholding would also serve to accelerate tax collections in the first year, which would generate approximately $1.3 billion in revenue acceleration in the budget year.

Staff Comments. Staff finds that there have been concerns raised that the $600 threshold is too low and may cause significant compliance burden for small businesses. Other options that could be considered by the Legislature include, increasing the threshold for payments to independent contractors. Staff finds that increasing the threshold would reduce the compliance burden for small business and would not result in a significant reduction in revenue collected as a result.

Other Tax Cuts

Background. There has been considerable debate in the Legislature regarding the efficacy of tax cuts in stimulating the economy and creating additional jobs and additional taxable income. In general, the impacts of specific tax policies are difficult to isolate and there is no conclusive evidence that tax expenditures do directly change corporate or individual behavior. Numerous efforts by DOF and the LAO have attempted to better quantify secondary impacts of tax law changes. In response to 1994 legislation, UC Berkeley developed a dynamic revenue model. The model determined that the most optimistic gains from tax expenditures were: 18 percent from corporation tax reductions; 8 percent from sales tax reductions; and 1 percent from personal income tax reductions.

Below is a list of tax expenditures (credits and cuts) being pursued by Republican authors via the legislative process. They are included here for a general discussion regarding new tax expenditures in the current budget context.

1. Veterans Hiring Tax Credit

SBx6 7 (Denham)—Veterans Hiring Tax Credit. This bill gives a tax credit to private sector employers who hire veterans. Specifically, if the veteran hired is retained at least 120 hours a tax credit of 25 percent of the first year wages up to $6,000 would be earned by the taxpayer. Qualifying veterans include individuals that have: (1) been discharged from active duty at any time during the 5 year period ending on the hiring date; and (2) received unemployment compensation under state law for not less than 4 weeks during the one year period ending on the hiring date.

There are thousands of veterans returning home to California and author asserts that this incentive will encourage the private sector to employ veterans. This bill has also been introduced as a regular session bill (SB 1056).

Staff Comments. Staff finds that an existing hiring tax credit already exists at the federal level that provides for a tax credit of up to $9,000 if the employee is a qualified veteran receiving Food Stamps or disabled.

Fiscal Impact. The FTB estimates that this bill would result in $170 million in revenue loss in the budget year. This revenue losses are estimated to grow to around $200 million in 2012-13.

2. Work Opportunity Tax Credit

SBx6 11 (Dutton)—Work Opportunity Tax Credit. This bill would provide a tax credit to employers who hire someone who is either on CalWORKS, parolees, probationers, veterans, or receiving unemployment benefits. The taxpayer may claim a credit equal to 25 percent of wages paid by the taxpayer that worked between 120 and 400 hours during the taxable year and 40 percent of wages paid on employees that worked at least 400 hours, up to $6,000 in wages.

Staff Comments. Staff finds that this bill borrows eligibility criteria from the enterprise zone program, but allows for any business in the state that employs a qualified employee to claim this tax credit. The tax credit is smaller than the one used by the enterprise zone program, but again is unlimited throughout the state.

Fiscal Impact. The FTB estimates that this bill will result in revenue losses of $3.5 billion in the budget year. The revenue losses are estimated to grow to $4 billion in 2011-12.

3. Sales and Use Tax Exemption—Manufacturing and Software Production Equipment

SBx6 8 (Dutton)—Sales and Use Tax Exemption, Manufacturing and Software Production Equipment. This bill would provide a partial exemption (state General Fund only) from the Sales and Use Tax from the purchase of tangible personal property to be used 50 percent or more in: (1) any stage of manufacturing, processing, refining, fabricating, or recycling of property; and (2) research and development for software production.

Fiscal Impact. The BOE estimates that this bill will result in revenue losses of $600 million in the budget year and may grow to $1 billion in 2011-12.

4. Research and Development Tax Credit

SBx6 9 (Dutton)—R&D Tax Credit. This bill would increase personal income tax and corporation tax credits related to research and development. First, it would increase the credit for qualified research expenses from 15 percent to 20 percent. Second, this bill would also increase the State’s alternative incremental research credit (AIRC) percentages to equal the federal percentages currently in effect—3 percent, 4 percent, and 5 percent. The federal AIRC does not apply to expenses paid or incurred after December 31, 2009, as this program was terminated at the federal level.

The author hopes this bill will help to spur investment and innovation by businesses in California.

Fiscal Impact. The FTB estimates that this bill would result in revenue loss of $90 million in the budget year.

5. Capital Gains Tax Reduction

SBx6 10 (Dutton)—Capital Gains Tax Reduction. This bill would reduce the long term capital gains by half for a capital asset purchased between 2009 and 2012 if the asset is held for three years. The author indicates that this incentive will spur investment in California.

Capital gains are generally taxed at ordinary income tax rates, which will be 9.3 percent in 2012, which is the first year that a capital asset can be sold and benefit from the reduced tax rate under this bill.

Staff Comments. Staff finds that relatively few low-and moderate-income taxpayers report income from capital gains. For example, even though taxpayers with $50,000 or less in adjusted gross income comprised 67 percent of all tax returns filed, they constituted only 3 percent of all returns with income from capital gains. Therefore, staff finds that this tax reduction would result in most benefits accruing to the most affluent California residents.

Fiscal Impact. The FTB estimates that this bill would cost approximately $6 million in 2011-12 and would grow to over $500 million in fiscal year 2013-14. There are no projected impacts on revenues in the budget year from this bill.

6. Health Savings Account

SBx6 13 (Dutton)—Health Savings Account. This bill would conform California tax law to federal income tax law by allowing equivalent state tax deductions for contributions to Health Savings Accounts (HSAs).

The author finds that this bill would encourage long-term savings for health care expenses.

Fiscal Impact. The FTB estimates that this bill would result in revenue loss of $65 million in the budget year.

7. New Car Sales Tax Reduction

SBx6 5 (Hollingsworth)—New Car Sales Tax Reduction. This bill would allow the value of a used vehicle trade-in to be deducted from the purchase price of a new vehicle for purposes of calculating sales tax.

The author finds that this bill would spur vehicle sales in California and improve the environment since new cars are on average, safer and cleaner running than older models.

Fiscal Impact. The BOE estimates that this bill would result in revenue losses of $494 million, including $326 million in state General Fund revenue.

8. Eliminate Corporate Penalty

SBx6 6 (Hollingsworth)—Eliminate Corporate Penalty. Law changes enacted in the 2008-09 budget package established a 20 percent penalty for corporate taxpayers that understate their taxes by $1 million or more. This bill would repeal that penalty.

The author indicates that the penalty leads companies to over-estimate their taxes to avoid the penalty, which reduces the amount of cash companies, have on hand for investment.

Fiscal Impact. The FTB estimates that this bill would result in revenue losses to the state of $760 million in the budget year.

9. Education Tax Credit

SB 985 (Dutton)—Education Tax Credit. This bill would create a tax credit for employers and employees for 50 percent of the costs of job training or advanced education. The author indicates that this will help employees attain higher pay and career advancement, while helping employers develop a highly-skilled workforce.

Fiscal Impact. A fiscal analysis of this bill was not available at the time this agenda was completed.

Senate Budget and Fiscal Review—Denise Moreno Ducheny, Chair

SUBCOMMITTEE NO. 5 Agenda

Senator Denise Moreno Ducheny, Chair
Senator Robert D. Dutton
Senator Alex Padilla

OUTCOMES

No Actions were taken on Part A of this agenda at the hearing.

Agenda - Part A

Thursday, May 13, 2010
9:30 a.m. (or upon adjournment of session)
Room 113

Consultant: Keely Martin Bosler

Item **Department** **Page**

Revenues and the Economy

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-324-9335. Requests should be made one week in advance whenever possible.

Recent Tax Policy Changes

1. 2008 Tax Policy Changes

2. 2009 Temporary Tax Policy Changes

3. 2009 Tax Expenditures (Tax Cuts and Credits)

4. 2010 Tax Expenditures (Cuts and Credits)

Options for Tax Policy Changes

Options for Delaying Tax Policy Changes

1. Governor's "Trigger" Proposals—Delay Corporate Tax Cuts

Options for Broadening Tax Bases

1. Tax Incentive Areas

2. Like-Kind Exchanges

3. Employer Contribution Exemptions

4. Small Corporation Stock Exclusion

5. Senior Exemptions

6. Products Sold by Healthcare Professionals and Veterinarians

Options for Targeted Tax Increases

1. Oil Severance

2. Vehicle License Fee

3. Alcohol Tax

4. Rate Increase on Top Income Brackets

Other Revenue Options

1. Independent Contractor Withholding

Other Tax Cuts

1. Veterans Hiring Tax Credit

2. Work Opportunity Tax Credit

3. Sales and Use Tax Exemption—Manufacturing and Software Production Equipment

4. Research and Development Tax Credit

5. Capital Gains Tax Reduction

6. Health Savings Account

7. New Car Sales Tax Reduction

8. Eliminate Corporate Penalty

9. Education Tax Credit