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

SUBCOMMITTEE NO. 4 Agenda

Senator Maria Elena Durazo
Senator Jim Nielsen
Senator Thomas J. Umberg

Thursday, April 11, 2019
9:30 a.m. or Upon Adjournment of Session
State Capitol - Room 2040

Consultant: Joe Stephenshaw

PROPOSED FOR VOTE-ONLY

PROPOSED FOR DISCUSSION/VOTE

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LEGISLATIVE PROPOSAL

LEGISLATIVE PROPOSALS

Issue 1: Targeted Child Tax Credit

The Subcommittee has received a request that funding for a Targeted Child Tax Credit (TCTC) be included in the budget.

According to the request, there are still nearly one-half a million children who remain in deep poverty in California. These include children living with a parent or a child disability that makes work difficult, parents that are unauthorized immigrants, or parents that face obstacles to work, such as unstable housing, unreliable child care, lack of education, a criminal record, or mental and physical health problems that aren't severe enough to qualify for disability benefits.

The TCTC would supplement the income of the poorest families with children up to the deep poverty threshold. The credit would be administered by the Franchise Tax Board (FTB) and claimed on personal income tax returns. Calculation of the credit would involve two key steps: 1) calculating the net resources of a family, which is based on income from earnings (subject to certain disregards to maintain work incentives) and federal, state, and local public benefits; offset by expenses for such items as out-of-pocket- health care, childcare, and work related commuting expenses, and 2) comparing the net resources total 50 percent of the appropriate California Poverty Measure for the child's family size. The credit is equal to the difference between the two.

The following resources are being requested:

- $290 million for the first-year costs for the credit, which would be phased in starting with families with children under three years of age.
- $3 million for the FTB to administer the program.
- $20 million for outreach.
- $1 million to the Department of Social Services for development, maintenance and publication of the California Poverty Measure.

ISSUES PROPOSED FOR VOTE-ONLY

7600 DEPARTMENT OF TAX AND FEE ADMINISTRATION (CDTFA)

Issue 2: Information Technology Classification Consolidation

Governor's Budget. The Governor's budget requests $1.4 million in 2019-20 and ongoing to implement the State Personnel Board's Information Technology (IT) Classification Plan, which consolidated 36 IT classifications into nine.

Background. In January 2018, the State Personnel Board approved the IT Classification Plan, leading to the consolidation of 36 IT classifications into broader, usable occupational categories. It abolished and transitioned 36 IT classifications into five rank and file IT classes and four IT supervisory/managerial classifications. The new, classifications have alternate ranges that provide for employee retention by increasing levels of work experience and compensation without requiring repetitive examinations. In developing the new IT classifications, the statewide team grouped classifications which have similar functions and/or salaries into one new classification. The consolidation of the classifications results in a salary increase to a little over one-third of the CDTFA staff impacted by this change. The changes to the current classifications took effect on January 31, 2018.

Staff Recommendation. Approve as budgeted.

Issue 3: Settlement and Taxpayers Services Bureau

Governor's Budget. The Governor's budget requests $1.02 million ($643,000 General Fund and $374,000 reimbursements) to convert six limited-term positions, set to expire on June 30, 2019, to permanent in order to continue to address the workload demand within the Settlement Program.

Background. The Settlement Bureau administers the CDTFA's Settlement Program. The Settlement Program conducts administrative settlement negotiations on disputed tax liabilities in the administrative appeals process based on the risks and costs of litigation. Taxpayers are eligible to request settlement consideration at the time they submit a petition for redetermination. Because taxpayers are not required to pay their disputed liabilities in order to file a petition for redetermination, it is critical that settlement cases are accelerated as much as possible to maximize the potential for collecting funds due while businesses are viable and able to pay. Taxpayers who have reached settlement pay the agreed settlement amount either within 30 days of approval of the settlement, or within 12 to 24 months, as needed. The Settlement Program is a streamlined, efficient process for reaching agreement with taxpayers based on the risks and costs of litigation and accelerating voluntary payment of agreed settlement amounts.

In 2016-17, nine Settlement Program positions were made permanent and an additional six positions were approved on a three-year limited-term basis to address the continued taxpayer demand for administrative settlements of civil tax matters in dispute and continue the success of the program in accelerating revenue and completing cases. According to the department, the Settlement Program exceeded estimated accelerated revenue in each year for which the positions were established, and has accelerated an average of more than $134.6 million in revenue annually over the last three fiscal years by reaching settlement agreements with taxpayers based on the risks and costs of litigation on approximately 600 cases per year

Staff Recommendation. Approve as budgeted.

Issue 4: Tax Appeals Assistance Program

Governor's Budget. The Governor's budget requests the reduction of $215,000 General Fund and the transfer of one position to the Franchise Tax Board (FTB) to reflect the transfer of the franchise and income tax component of the Taxpayer Appeals Assistance Program (TAAP) from CDTFA to FTB.

Background. The Board of Equalization (BOE) established the TAAP where participating law schools and law students assist taxpayers with state tax appeals under the supervision of a BOE (now CDTFA) attorney reporting to the Taxpayer's Rights Advocate Office (TRAO). The CDTFA has one Tax Counsel III attorney exclusively assigned to franchise and income tax appeals. The TAAP is an independent program housed within the TRAO which offers free legal assistance to people who cannot afford to pay for legal or tax assistance through law students attending various law schools across California; educating and assisting those taxpayers in voluntarily complying with California's tax laws while minimizing their compliance burden. To accomplish this, participating law schools work with the program to allow law students to assist taxpayers with their state tax appeals under the supervision of an experienced tax attorney. With the restructuring of the BOE and the transfer of the appeals process to the OTA, this workload was initially moved to the CDTFA and currently the CDTFA is transitioning these responsibilities to the FTB to align them with the agency that has jurisdictional responsibility.

Staff Recommendation. Approve as budgeted.

Issue 5: Implementation of Cannabis Tax Regulation

Governor's Budget. The Governor's budget requests $2.9 million from the Cannabis Tax Fund and 13.9 positions in 2019-20 to address workload associated with the Control, Regulate, and Tax Adult Use of Marijuana Act and subsequent implementing legislation.

Background. On June 27, 2017, the Governor and California Legislature approved the Medical and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA), Chapter 27, Statutes of 2017, which established a single system of administration for cannabis laws in California. This legislation contained changes necessary for state licensing entities to implement a regulatory framework, defined a method for collecting and remitting taxes, and addressed consumer and public safety, tax compliance, and cash collection.

On December 21, 2017, the Office of Administrative Law approved the adoption of Cannabis Regulation 3700, *Cannabis Excise and Cultivation Taxes* and Cannabis Regulation 3701, *Collection and Remittance of the Cannabis Excise Tax*. These regulations further defined terms within the law, clarified provisions of the excise tax, established a separate cultivation tax for fresh cannabis plants, and provided guidance on how to collect and remit the excise tax.

To comply with the mandates of the new cannabis tax law and address the additional workload generated from essential enforcement activities, the CDTFA is requesting funding for inspections, legal support, program-related settlement positions, and data collection and analysis of program activity. The increase in staff will ensure CDTFA conducts a sufficient number of field compliance inspections, investigations, and follow up activities needed to deter illegal activity, avoid revenue loss, and provide resources to better facilitate a platform for the exchange of data between other state regulatory agencies.

Staff Recommendation. Approve as budgeted.

7730 FRANCHISE TAX BOARD (FTB)

Issue 6: Administrative Dissolution (AB 2503)

Governor's Budget. The Governor's budget requests $330,000 General Fund ($311,000 ongoing) and five positions to administer the provisions of AB 2503 (Irwin), Chapter 679, Statutes of 2018, which provides for administrative dissolution for certain domestic corporations and domestic limited liability companies.

Background. Prior to the enactment of AB 2503, FTB lacked statutory authority to administratively dissolve business entities that failed to complete the process required to legally dissolve; thus these entities remain on the department's accounting system, continuing to accrue taxes, interest, and penalties. AB 2503 provides two options (FTB-initiated or taxpayer-initiated) for administrative dissolution of qualified entities when there is unpaid minimum franchise or annual tax.

In order to comply with this legislative mandate, FTB is requesting five permanent positions. One position will work the FTB-initiated administrative dissolution workload and three positions will work the taxpayer-initiated administrative dissolution workload. An additional position will provide business entities support.

Staff Recommendation. Approve as budgeted.

Issue 7: Technical Adjustment

Governor's Budget. The Governor's budget requests $378,000 General Fund and two new positions for the Tax Appeals Assistance Program (TAAP) responsibilities that are being transferred from CDTFA.

Background. The TAAP program was originally established by the Board of Equalization (BOE) and with the restructuring of BOE and the transfer of the appeals process to the new California Office of Tax Appeals, this workload moved to the CDTFA. There is not an appropriate alignment for Franchise and Income Tax (FIT) appeal cases to be handled by CDTFA. This proposal requests to transfer the FIT component of the program from CDTFA to FTB.

Staff Recommendation. Approve as budgeted.

Issue 8: HR Discipline

Governor's Budget. The Governor's budget requests $1.4 million ($1.3 million General Fund) and 14 positions in 2019-20 and ongoing to conduct human resource functions and serve as FTB's foundation to allowing FTB to hire, train, and retain staff.

Background. FTB is responsible for administering the income and franchise tax laws for the State of California. Staff process tax returns and payments, issue refunds to Californians, conduct audits and filing enforcement actions, collect debts owed the state and support numerous service functions allowing for each of these compliance activities to occur. As a result of FTB's efforts, FTB programs oversee the administration and collection of over $103 billion (2017-18) in General Fund revenues - over 78 percent of the General Fund account.

FTB has over 6,500 permanent and temporary staff positions to perform FTB administrative functions. In recent years, FTB staff has grown and workloads administered by Human Resources (HR) have increased in both number and duration of tasks as well as increased complexity of tasks, processes, and procedures. HR staffing levels are insufficient to maintain necessary and mandated processes on a timely basis to ensure that FTB can hire staff when needed, timely address staff issues, and that FTB conforms to the extensive body of laws and processes governing HR processes. Over the last five years, FTB has increased temporary help in this business area and while that has reduced some impact, this is not a temporary need and trained PI employee retention is causing detrimental impacts to the program. When HR functions are inadequately staffed, negative business impacts will follow whether impact is related to depressed operations, untimely actions jeopardizing due process, inadequate meeting of mandated actions, or increased litigation hazards for the state.

Over the last 25 years, FTB's business operations and staffing levels have increased significantly. FTB's growth in HR staff has not. In the most recent years with new or expanded mandates related to HR functions, FTB's prior strategy of streamlining, automating, and using temporary help is no longer a viable strategy. Additional staff are needed to support FTB's business operations and the work FTB does for Californians.

Due to staffing shortages, FTB has experienced:

- Lengthier hiring processes impacting the ability to timely fill vacancies.
- Inability to timely complete existing or expected future increases in personnel actions.
- Inability to timely complete performance reviews and address employee performance issues which leads to substandard performance in business areas.
- Inability to timely complete mandated reviews of allegations of misconduct as required under federal and state mandates.
- Inability to develop robust employee training programs leading to empowered employees and which support CalHR's statewide competency initiatives.
- Inability to align CalHR competencies to classifications used at FTB and appropriately train staff on these competencies.
- Inability to adequately engage in succession planning as up to 70 percent of FTB's most senior staff is eligible to retire in the next five years.

Staff Recommendation. Approve as budgeted.

ISSUES PROPOSED FOR DISCUSSION/VOTE

7600 DEPARTMENT OF TAX AND FEE ADMINISTRATION (CDTFA)

Overview. The Taxpayer Transparency and Fairness Act of 2017 established the CDTFA in the Government Operations Agency and shifted most of the tax and fee programs previously administered by the Board of Equalization (BOE) to the CDTFA. CDTFA administers numerous tax and fee programs, including the Sales and Use Tax, the Cigarette and Tobacco Products Tax Program, and the excise and cultivation taxes for medicinal and recreational cannabis. The CDTFA also administers the alcohol excise tax and the insurance tax pursuant to agreements with the BOE. Following are the programs within CDTFA's budget:

COUNTY ASSESSMENT STANDARDS PROGRAM. The CDTFA provides administrative services including accounting, budgeting, business services, health and safety, human resources, information technology, labor relations, training, procurement, and contracting to support the BOE's County Assessment Standards program. This program ensures that taxable properties are enrolled and assessed, and that the 58 county assessors assess all properties.

STATE-ASSESSED PROPERTY PROGRAM. The CDTFA provides administrative services including accounting, budgeting, business services, health and safety, human resources, information technology, labor relations, training, procurement, and contracting to support the BOE's State-Assessed Property program. This program is responsible for valuing and assessing inter-county pipelines and properties owned or used by railroads, regulated telephone companies, companies transmitting or selling gas or electricity, and private railroad car companies. Local jurisdictions use the established values for the levy and collection of local property taxes.

TIMBER TAX PROGRAM. This program provides revenue for the Timber Tax Fund. The revenue, less administrative costs, is allocated to the counties where the timber was harvested. The CDTFA administers and collects the Timber Yield Tax, a property tax paid by timber owners when they harvest trees or timber. The CDTFA determines the harvest values of timber and timberland production zone values.

SALES AND USE TAX PROGRAM. This program ensures that all sales and use tax revenues are collected in an equitable and effective manner through accurate reporting of tax liability. This is accomplished by detecting and correcting errors in self-assessments, and promptly collecting amounts determined to be due and economically recoverable. Under this program, the CDTFA administers the following taxes: State Sales and Use Tax, Bradley-Burns Uniform Local Sales and Use Tax, and District Transactions and Use Tax (cities/ counties).

HAZARDOUS SUBSTANCES TAX PROGRAM. These programs provide revenue for the Hazardous Waste Control Account (HWCA) and the Toxic Substances Control Account (TSCA). The fees provide funding to the Department of Toxic Substances (DTS) to regulate hazardous waste in California. Generators of hazardous waste, hazardous waste facilities and certain business organizations, as identified by statute, are subject to the fees. The CDTFA administers the following fee programs in partnership with the DTS: Disposal Fee (HWCA), Generator Fee (HWCA), Transportable Treatment Unit Fee (HWCA), Facility Fee (HWCA), and Environmental Fee (TSCA).

ALCOHOLIC BEVERAGE TAX PROGRAM. This program provides revenue for the Alcohol Beverage Control Fund. The CDTFA collects the excise tax imposed on the sale, distribution, or importation of alcoholic beverages in California. The BOE contracts with the CDTFA to administer this program.

TIRE RECYCLING FEE PROGRAM. This program provides revenue for the California Tire Recycling Account in the California Tire Recycling Management Fund and Air Pollution Control Fund. The fee provides funding to reduce air pollution, landfill disposal, and stockpiling of used tires. The CDTFA administers the program in partnership with the California Department of Resources Recycling and Recovery, and the Air Resources Board.

CIGARETTE AND TOBACCO PRODUCTS TAX PROGRAM. This program provides revenue for the Cigarette Tax Fund, Cigarette and Tobacco Products Surtax Fund, the Breast Cancer Fund, and the California Children and Families First Trust Fund. The program objective is to ensure that all cigarette and tobacco products tax revenues are collected equitably and effectively by ensuring timely reporting and payment of tax liabilities, detecting and correcting errors in reporting, and promptly collecting amounts determined to be due and economically recoverable.

CIGARETTE AND TOBACCO PRODUCTS LICENSING PROGRAM. This program provides revenue for the Cigarette and Tobacco Products Compliance Fund, which is used to implement, enforce, and administer the provisions of the California Cigarette and Tobacco Licensing Act. The purpose of the Act is to reduce tax evasion, smuggling, and counterfeiting of cigarette and tobacco products and stamps. It requires statewide licensing of all distributors, wholesalers, importers, manufacturers, and retailers of cigarette and tobacco products.

TRANSPORTATION FUND TAX PROGRAM. This program provides revenue for the Transportation Tax Fund. Allocations are made from the fund to the Aeronautics Account, Harbors and Watercraft Revolving Fund, Off-Highway Vehicle Trust Fund, Highway Users Tax Fund, and Department of Food and Agriculture Fund. The objective of this program is to ensure that the motor vehicle fuel, jet fuel, various use fuel, and diesel fuel taxes are administered equitably and effectively. Pursuant to the International Fuel Tax Agreement (IFTA), the CDTFA registers interstate truckers whose base state is California. Revenues from this program are used to construct and maintain public roads and mass transit systems, airports and waterways.

OCCUPATIONAL LEAD POISONING PREVENTION FEE PROGRAM. This program provides revenue for the Occupational Lead Poisoning Prevention Account in the General Fund. The funds are used to establish and maintain occupational health and disease prevention programs. Employers in specified Standard Industrial Classification codes with evidence of lead poisoning and who employ 10 or more qualifying employees are subject to the fee. The CDTFA administers the program in partnership with the California Department of Public Health.

INTEGRATED WASTE MANAGEMENT PROGRAM. This program provides revenue for the Integrated Waste Management Account in the Integrated Waste Management Fund. The fees provide funding to respond to potential health and environmental problems at on-site and off-site solid waste landfills, and supports state and local landfill permit enforcement programs. Operators of solid waste disposal facilities that include nonhazardous wood waste facilities are subject to the fee. The CDTFA administers the program in partnership with CalRecycle.

UNDERGROUND STORAGE TANK FEE PROGRAM. This program provides revenue for the Underground Storage Tank (UST) Cleanup Fund in the State Treasury which provides a means for petroleum UST owners and operators to meet the federal and state requirements of maintaining financial responsibility to pay for any damages arising from their tank operations. The Fund also provides money to the Regional Water Boards and local regulatory agencies to abate emergency situations or to cleanup abandoned sites that pose a threat to human health, safety, and the environment, as a result of a UST petroleum release. Revenue is generated by a per gallon fee paid by UST owners who are required to have a permit to own a UST. The fee is collected by the CDTFA.

OIL SPILL PREVENTION PROGRAM. This program provides revenue to the Department of Fish and Wildlife, which is deposited into the Oil Spill Prevention and Administration Fund. Fees are collected on crude oil and petroleum products received in California refineries and marine terminals. The prevention and administration fees provide funding to implement oil spill prevention programs to implement, install, and maintain emergency programs, equipment, and facilities to respond to, contain, and cleanup oil spills, and to fund the Oiled Wildlife Care Network.

ENERGY RESOURCES SURCHARGE PROGRAM. This program provides revenue for the Energy Resource Surcharge Fund and is used to support the State Energy Resources Conservation and Development Commission. The revenue is generated by administering a surcharge on the consumption of electrical energy purchased from an electrical utility. The Energy Resource Surcharge Fund is ultimately transferred into the State Energy Resources and Development Special Account in the General Fund.

ANNUAL WATER RIGHTS FEE PROGRAM. This program provides revenue for the Water Rights Fund. The fees provide funding to the State Water Resources Control Board to support the activities of its Division of Water Rights. The annual fee is collected from water right permit holders based on a schedule of fees adopted each fiscal year by the State Water Resources Control Board.

CHILDHOOD LEAD POISONING PREVENTION FEE PROGRAM. This program provides revenue for the Childhood Lead Poisoning Prevention Fund. The fee funds the Childhood Lead Poisoning Prevention Program, administered by the California Department of Public Health (CDPH), Childhood Lead Poisoning Prevention Branch, which include services such as health care referrals, environmental assessments, and educational activities necessary to reduce a child's exposure to lead and the consequences of the exposure. The CDTFA administers the Childhood Lead Poisoning Prevention Fee on behalf of the CDPH. The CDTFA collects an annual fee from architectural coatings distributors, motor vehicle fuel distributors, and facilities currently reporting releases of lead into ambient air in California. The fee is determined by the CDPH based on the fee payers' market share responsibility for environmental lead contamination.

MARINE INVASIVE SPECIES PROGRAM. This program provides revenue for the Marine Invasive Species Control Fund and was previously referred to as the Ballast Water Management Program. The fees provide funding to the California State Lands Commission (SLC) Marine Invasive Species Program established to prevent or minimize the introduction and spread of non-indigenous aquatic species into California waters. Owners or operators of qualifying vessels carrying, or capable of carrying, ballast water arriving in a California port from outside California are subject to the fee for each voyage. The CDTFA administers the program in partnership with the SLC.

EMERGENCY TELEPHONE USERS SURCHARGE PROGRAM. This program provides revenue for the State Emergency Telephone Number Account. Revenue generated by this program funds the State's "911" emergency telephone system by administering a surcharge on customers of intrastate telephone and Voice over Internet Protocol (VoIP) communication services.

E-WASTE RECYCLING FEE PROGRAM. This program provides revenue for the Electronic Waste Recovery and Recycling Account in the Integrated Waste Management Fund. The fees collected provide funding for CalRecycle by imposing a recycling fee upon the retail sale or lease of new or refurbished video display devices identified by the Department of Toxic Substances Control (DTSC) as containing hazardous materials. The CDTFA administers the program in partnership with CalRecycle and the DTSC.

LUMBER FEE PROGRAM. This program provides revenue for the Timber Regulation and Forest Restoration Fund. A one percent assessment is imposed on purchases of lumber products and engineered wood products for use in California based on the selling price of the products. The lumber products assessment supports the activities of CALFIRE and helps protect California’s forests.

INSURANCE TAX PROGRAM. This program provides revenue to the Insurance Tax Fund. Revenue is generated from taxes assessed on insurance premiums, underwriting profits from ocean marine insurance, and retaliatory assessments levied on out-of-state insurers. The taxes collected are used to pay refunds or transferred to the General Fund. The BOE contracts with the CDTFA to administer this program.

NATURAL GAS SURCHARGE PROGRAM. This program provides revenue for the Gas Consumption Surcharge Fund to fund low-income assistance programs, cost effective energy efficiency programs, conservation activities, and public interest research and development. The revenue is generated by administering a surcharge on the consumption of all natural gas in California.

PREPAID MOBILE TELEPHONY SERVICES PROGRAM. Operative January 1, 2016, this program provides revenue for the Prepaid Mobile Telephony Services (MTS) Surcharge Fund and the Local Charges for the Prepaid MTS Fund. The revenue funds the State Emergency Telephone Number Account, universal service funds, and local funds. A surcharge is imposed on each consumer of prepaid mobile telephony services at the retail level.

REGIONAL RAILROAD ACCIDENT PREPAREDNESS AND IMMEDIATE RESPONSE PROGRAM. This program would provide revenue to the Governor's Office of Emergency Services, to prepare for and provide immediate onsite response related to a large-scale release of hazardous materials from a rail car or a railroad accident involving a rail car. The revenues are to be deposited into the Regional Railroad Accident Preparedness and Immediate Response Fund. Fees are to be collected from owners of the top 25 most hazardous material commodities transported by rail car within California. The fee would provide funding to pay for the planning, developing, support, and maintenance of various aspects of regional, state, and local emergency response programs, teams, specialized equipment, supplies, and training to prepare for such an occurrence. This program has not started due to litigation.

LEAD-ACID BATTERY RECYCLING FEE PROGRAM. This program provides revenue for the Lead-Acid Battery Cleanup Fund. The fee provides funding for investigation, site evaluation, cleanup, remediation, removal, monitoring, and other response actions at areas within California contaminated due to lead-acid battery recycling facility operations, as well as refund payments, loan repayments, and administrative costs. Lead acid battery manufacturers and consumers are subject to the fees. The CDTFA administers the program in partnership with the California Department of Toxic Substances Control.

CANNABIS TAXES PROGRAM. This program administers the cannabis excise tax and cannabis cultivation tax. The program provides revenue for the California Cannabis Tax Fund, the revenues from which carry out the purpose of the Medicinal and Adult-Use Cannabis Regulation and Safety Act (Act). The purpose of the Act is to establish a comprehensive system to control and regulate the cultivation, distribution, transport, storage, manufacturing, processing, and sale of all cannabis and cannabis products. The cannabis taxes provide funding for youth education and prevention programs, medical research, environmental mitigation efforts, law enforcement, and administration costs for numerous state agencies charged with licensing, regulating, and taxing the cultivation and sale of cannabis.

ADMINISTRATION. This program provides leadership, legal, planning, policy, research, communication, internal audit, equal employment opportunity, and other essential services necessary to support the Department's programmatic goals and objectives. This support includes central administrative services in accounting, budgeting, business services, health and safety, human resources, information technology, labor relations, training, procurement, and contracting. This program also provides administrative and personnel services for the BOE.

Budget. The budget includes $682 million ($361.1 million General Fund) and 4,264.8 positions in 2019-20 to support the department and its programs. The following chart from the Governor’s budget displays prior year, current year, and budget year positions and expenditures.

3-YEAR EXPENDITURES AND POSITIONS †

		Positions			Expenditures		
		2017-18	2018-19	2019-20	2017-18*	2018-19*	2019-20*
6275025	County Assessment Standards Program	14.9	4.8	5.7	$2,784	$2,631	$2,751
6275050	State-Assessed Property Program	17.0	3.3	3.7	3,051	4,513	4,666
6275075	Timber Tax Program	12.7	11.0	11.0	1,556	2,038	2,265
6275100	Sales and Use Tax Program	3,370.0	3,312.1	3,303.1	465,148	567,991	556,267
6275125	Hazardous Substances Tax Program	36.7	39.6	39.6	4,580	5,908	5,913
6275150	Alcoholic Beverage Tax Program	21.1	18.9	18.9	2,845	3,391	3,316
6275175	Tire Recycling Fee Program	16.3	15.3	15.3	1,902	2,129	2,119
6275200	Cigarette and Tobacco Products Tax Program	88.5	128.0	125.3	21,496	31,440	31,206
6275225	Cigarette and Tobacco Products Licensing Program	70.7	65.7	65.7	9,532	10,981	10,994
6275250	Transportation Fund Tax Program	177.0	140.1	140.0	27,561	34,635	33,000
6275275	Occupational Lead Poisoning Prevention Fee Program	7.6	7.0	7.0	872	930	932
6275300	Integrated Waste Management Program	2.7	4.3	4.3	400	632	621
6275325	Underground Storage Tank Fee Program	31.5	24.9	25.0	4,264	4,288	4,304
6275350	Oil Spill Prevention Program	1.8	1.3	1.3	291	382	368
6275375	Energy Resources Surcharge Program	2.2	2.0	2.0	317	393	377
6275400	Annual Water Rights Fee Program	4.8	4.1	4.1	540	539	535
6275425	Childhood Lead Poisoning Prevention Fee Program	1.2	4.3	4.3	197	581	574
6275450	Marine Invasive Species Program	2.6	3.3	3.3	347	545	542
6275475	Fire Prevention Fee Program	20.9	-	-	2,322	-	-
6275500	Emergency Telephone Users Surcharge Program	7.1	11.1	11.0	1,069	1,743	1,718
6275525	E-Waste Recycling Fee Program	26.9	30.5	30.6	3,867	5,237	5,216
6275550	Lumber Fee Program	2.8	12.3	12.5	856	1,279	1,285
6275575	Insurance Tax Program	1.6	1.8	1.8	266	354	355
6275600	Natural Gas Surcharge Program	4.1	3.8	3.7	692	1,166	1,245
6275625	Appeals from Other Governmental Programs	12.3	-	-	2,406	-	-
6275650	Prepaid Mobile Telephony Program	2.8	15.8	13.3	1,261	2,285	2,051
6275675	Regional Railroad Accident Preparedness and Immediate Response Program	0.9	-	-	123	-	-
6275700	Lead-Acid Battery Cleanup Fee Program	5.3	8.4	9.8	627	1,447	1,438
6275725	Cannabis Taxes Program	10.4	15.8	29.6	3,284	5,019	7,557
9900100	Administration	0.1	373.9	372.9	57,055	66,265	65,925
9900200	Administration - Distributed	-	-	-	-56,950	-65,848	-65,508
TOTALS, POSITIONS AND EXPENDITURES (All Programs)		**3,974.5**	**4,263.4**	**4,264.8**	**$564,561**	**$692,894**	**$682,032**

Issue 9: Centralized Revenue Opportunity System (CROS) Project Implementation

Governor's Budget. The Governor's budget requests $24.5 million to continue implementation of the CROS Project in 2019-20. The CROS Project is an information technology modernization effort designed to enable the CDTFA to expand tax and fee payer services, to improve the efficiency and effectiveness of its operations, and to enhance its ability to generate increased revenues reducing the tax gap. This proposal also reflects:

- Reduction of 5.0 permanent positions authorized in the 2012-13 Budget Act.
- Reduction of 2.0 permanent positions authorized in the 2016-17 Budget Act.
- Continuation of year to year funding authorized in the CDTFA's approved FY 2018-19 BCP, including reclassification of select, prior approved permanent positions.

Although this BCP requests funding only for 2019-20, the CDTFA anticipates following future CROS Project related requests:

- 2020-21: $26.0 million
- 2021-22: $18.6 million
- 2022-23: $15.2 million

Background. Over one million discrete businesses currently interact annually with the CDTFA, many involved with multiple tax and fee programs. The CROS Project's objective is to establish an integrated, responsive, and effective tax and fee payer centric solution that will use up-to-date tax collection, storage, account management, and data retrieval technologies to maximize effectiveness of CDTFA's operations through the following activities:

- Replacing legacy mainframe-based revenue and collection information systems with an integrated and automated tax and fee system.
- Providing an enterprise data warehouse.
- Enhancing online services available to tax and fee payers and other stakeholders improving case and contact management reengineering and improving program processes Improving data sharing capability and real-time data access, especially to field staff.
- Enhancing CDTFA's ability to quickly implement legislative, judicial, or electoral changes to tax/revenue codes.

The Project Scope includes:

- Integrating registration, reporting obligations, cashiering, refunds, collection, audit, appeal, accounting and General Ledger functions for all sales and use, special tax and fee programs, and timber tax functional areas into the CRCS Solution;
- Replacing the Integrated Revenue Information System (IRIS), and Automated Compliance Management System (ACMS), as well as Timber Tax legacy systems; integrating enterprise software including Avaya (call center) and Documentum (enterprise content management) software.

On August 30, 2016, the department completed the CROS Project's procurement phase and signed an agreement with FAST Enterprises (FAST) to implement their commercial off-the-shelf software solution, GenTax, as the CROS Solution. GenTax is specifically designed for integrated tax administration and provides full functionality for processes such as registration, returns, payments, refunds, collections, revenue accounting, audit, correspondence, imaging, analytics, and workflow. GenTax meets the CROS Project's objectives to replace the legacy mainframe-based revenue and collection management systems with an integrated tax system that will streamline business processes, improve and expand online services to customers, and use business intelligence to increase revenue opportunities. The agreement is a fixed price contract using a benefits-based compensation model that provides payment to the vendor based on revenue generated by the CROS solution as system components are phased into production. This contract requires FAST to provide the initial funding for:

- The purchase of software, hardware, and contractor resources to configure the software according to CDTFA's needs
- Data center hosting setup and configuration
- Resources to assist with organizational change management activities
- System integration with internal and external systems
- Resources to complete all project plans and deliverables

There are potentially two contracts: the Base Period contract of 65 months (a 53-month implementation period and a 12-month warranty period), and an optional Maintenance and Operations (M&C) contract for 24 months that has an optional 24-month extension. The M&C contract will be exercised at the sole discretion of the CDTFA. Based on analysis that included review of FAST's proposed schedule and deliverables, the department's Integrated Master Schedule, existing project management plans and technical capabilities, CDTFA prepared SPR 4 which planned to implement the CROS Solution with four rollouts, the first to initiate revenue-generating capabilities; the remainder to deploy tax program functionality into production:

- **Rollout 1 -** Data Warehouse and Discovery Programs - Establishes the data warehouse, assesses CDTFA's revenue generating programs, and works to define and implement revenue generating opportunities. (Implemented March 2017)
- **Rollout 2 -** Tax Program Implementation - Implements Sales and Use Tax, Cigarette Retailer License Fee, Covered Electronic Waste Recycling Fee, Lumber Products Assessment, California Tire Fee, Prepaid MTS Surcharge programs. (Implemented May 2018)
- **Rollout 3 -** Tax Program Implementation - implements Alcoholic Beverage Tax, Motor Vehicle Fuel Tax, Underground Storage Tank, Cigarette & Tobacco Products Tax, IFTA, Timber Yield Tax, Jet Fuel Tax, Oil Spill Prevention, Cigarette & Tobacco Products Licensing, Diesel Fuel Tax, Diesel Fuel Tax (exempt bus ops and government entities). Use Fuel Tax programs. (Go Live Date: August 2019)
- **Rollout 4 -** Tax Program Implementation - implements Fire Prevention Fee, Childhood Lead Poisoning Prevention Fee, Natural Gas Surcharge, Hazardous Waste Disposal Fee, Hazardous Waste Generator Fee, Hazardous Substances Tax - RRAPIR, Tax on Insurers, Occupational Telephone Users Surcharge, Marine Invasive Species (Ballast Water) Fee, Hazardous Waste Environmental Fee, Integrated Waste Management Fee, Energy Resources (electrical) Surcharge, Emergency Telephone Users Surcharge (including MTS Direct Sellers), Hazardous Activity Fee, Hazardous Waste Facility Fee, Water Rights Fee programs. (Go Live Date: May 2020)

SPR 4 was approved by the Department of Technology in February 2017. Consistent with SPR 4, the CDTFA submitted and received approval of a 2018-19 BCP that provided funding and temporary help resources needed for the ongoing implementation of the CROS Solution.

Staff Recommendation. Approve as budgeted.

Issue 10: Tax and Fee Program Bureau's Office of Tax Appeals Workload

Governor's Budget. The Governor's budget requests $1.04 million and six permanent positions (five redirected and upgraded vacancies and one new) in 2019-20 ($876,000 ongoing). The CDTFA requests these resources to address the increase in workload for the Legal Division's Tax and Fee Programs Bureau (TFPB) resulting from the new administrative hearing process facilitated by the newly created Office of Tax Appeals (OTA).

Background. The TFPB within the Legal Division is responsible for advising on all of the tax and fee programs administered by the CDTFA. Many of the TFPB's functions involve a high degree of complexity, are time sensitive, are of critical importance to the CDTFA management, and are essential to CDTFA operations. The TFPB's primary functions include the following:

- providing responses to informal and formal legal opinions to tax and feepayers, their representatives, the CDTFA staff and management, and other governmental entities;
- representing the CDTFA in administrative hearings;
- assisting staff with drafting new regulations or amendments to existing regulations;
- assisting staff in the review of legislation;
- providing legal consult on CDTFA forms, publications, manuals, and miscellaneous documents; and,
- Providing legal oversight and support to investigations on matters involving tax evasion and fraud, including criminal tax law matters and implementation of the Cigarette and Tobacco Products Licensing Act of 2003.

The TFPB currently has 14 attorney positions to handle all of these functions related to all of the tax and fee programs administered by the CDTFA. The TFPB currently has a backlog of approximately 40 opinion requests.

With respect to administrative hearings, the TFPB previously represented the CDTFA in oral hearings before the Board Members of the Board of Equalization (BOE). However, the Taxpayer Transparency and Fairness Act of 2017 established the OTA and transferred to the OTA the various duties, powers, and responsibilities of the BOE with respect to appeals hearings, except for those duties, powers, and responsibilities imposed or conferred upon the BOE by the California Constitution. The Act established tax appeals panels and requires each panel to consist of three administrative law judges. Beginning January 1, 2018, the Act requires the panels to conduct the appeals hearings for those duties, powers, and responsibilities transferred to the OTA. As such, beginning January 1, 2018, the TFPB has been representing the CDTFA in all aspects of the administrative hearing process before the OTA.

Administrative Hearings before the BOE. With respect to cases involving legal issues, the TFPB attorneys reviewed the tax and fee payer's files, performed any required legal research, and prepared persuasive oral arguments that advocated the agency's position before the Board members. The total amount of hours that TFPB spent on preparing and presenting a legal case for a hearing was 24 to 40 hours, depending on the complexity of the case. Approximately one-third of the legal cases scheduled for a hearing required the TFPB to draft a reply brief, and the TFPB spent 24 to 40 hours on the reply brief.

With respect to cases involving mostly audit issues, the TFPB provided the required legal support during the hearing, which required a total of three hours for preparation and support. TFPB generally did not prepare or review a response brief for a case that involved mostly audit issues.

In terms of the volume of the TFPB workload related to BOE oral hearings for cases involving legal issues, in FY 2016-2017, the TFPB's internal records provide that 105 oral hearings involving legal issues were completed by TFPB. A significant portion of these cases never actually had an oral hearing due to the tax or fee payer waiving appearance, requesting a postponement, or requesting settlement. The TFPB's internal records also provide that 35 response briefs were completed for cases involving legal issues in FY 2016-2017.

In terms of the volume of the TFPB workload related to BOE oral hearings for cases involving audit issues, the BOE's Public Agenda Notices for FY 2016-2017 provide that approximately 51 Board hearings involving audit issues were scheduled for an oral hearing (in which the TFPB provided legal support). A portion of the cases involving audit cases never actually had an oral hearing due to the tax or fee payer waiving appearance, requesting a postponement, or requesting settlement.

Administrative Hearings before the OTA. Beginning January 1, 2018, oral hearings that were previously heard by the Board members of the BOE are now heard before the OTA. Due to this new administrative hearing process, the total amount of hours that TFPB will spend on a legal case in the OTA administrative hearings process will increase due to the additional tasks and steps associated with the OTA administrative hearings process. Unlike the administrative hearing process with the BOE, due to the proposed OTA regulations incorporating the Administrative Procedures Act, the new process with the OTA is much more formal and requires significantly more time and effort to complete. An opening brief is required of the CDTFA for all cases that are before the OTA, and the TFPB will also participate in all OTA pre-hearing conferences in addition to providing legal representation at all OTA hearings. Further, the proposed OTA regulations lay out a framework that includes the need for the TFPB to prepare declarations, exhibits, and witnesses as well as object to evidence.

- For legal cases, review of the tax and fee payer files, performing any required legal research, and preparation of the opening brief for OTA requires 40 hours; additional briefing (reply brief or supplemental briefing) and responses to OTA requests for additional information requires 16-30 hours; preparation for and participation in the prehearing conference including preparing declarations, witnesses, exhibits, etc. requires 40 hours; and preparation for and participation in the hearing requires 40 hours. Thus, the total hours spent on a legal case in the OTA process will be approximately 150 hours, a significant increase in the hours worked per case.
- For audit cases, in which the TFPB provides all required legal support, review of briefs prepared by the department requires four hours; participation in the prehearing conferences requires eight hours; and participation in the hearings requires eight hours. Again, since the OTA process has more steps, the TFPB will spend more hours providing legal support on audit cases.

Additionally, the volume of the workload related to administrative hearings that the TFPB will handle each year will increase under the OTA administrative hearings process. From February 2018 through June 2018, the TFPB completed an average of 10 legal opening briefs per month and reviewed an average of eight audit opening briefs per month. Once OTA begins asking for additional briefing, the TFPB will also complete 10 additional legal briefs (this is assuming that OTA will request additional briefing for all cases for which TFPB filed an opening brief). Also, once OTA begins scheduling pre-hearing conferences and hearings, the TFPB will also prepare for and participate in nine pre-hearing conferences and nine hearings per month, five of which will be legal cases and four of which will be audit cases (this is conservatively assuming that only 50 percent of the cases briefed will have conferences and hearings). Based on these numbers, each year, the TFPB will prepare 120 legal opening briefs, prepare 120 additional legal briefs, review 96 audit briefs, prepare for and participate in 60 pre-hearing conferences for legal cases, prepare for and participate in 48 pre-hearing conferences for audit cases, prepare for and participate in 60 hearings for legal cases, and prepare for and participate in 48 hearings for audit cases.

Staff Recommendation. Approve as budgeted.

7730 FRANCHISE TAX BOARD (FTB)

Overview. The FTB is responsible for collecting personal income tax and corporation tax revenue; operating various collection programs; and conducting field audits for the Fair Political Practices Commission. The FTB's budget includes the following programs:

TAX PROGRAMS. This program administers the Revenue and Taxation Code by reasonably interpreting and impartially applying the legislatively enacted laws that provide a significant portion of General Fund revenue. The Franchise Tax Board is responsible for administering the personal income tax and the corporation tax. Tax program activities include taxpayer assistance and tax return processing, filing enforcement, audits, and tax collection functions. The program also includes the collection and distribution of voluntary contributions to, and on behalf of, certain non-profit charitable organizations.

POLITICAL REFORM AUDIT. This program determines the accuracy and completeness of political statements and reports filed with the Secretary of State, and compliance with disclosures and record keeping requirements. On behalf of the Fair Political Practices Commission (FPPC), and in compliance with the Political Reform Act of 1974, the Franchise Tax Board conducts field audits of state and local candidates, measures committees, lobbying entities, committees supporting and opposing political candidates and statewide measures. These entities are randomly selected by the FPPC and/or meet dollar thresholds.

DEPARTMENT OF MOTOR VEHICLES COLLECTIONS PROGRAM. This program's objective is to increase collections of delinquent motor vehicle license fees, taxes, and penalties on behalf of the Department of Motor Vehicles by utilizing the same collection capabilities that are used to collect the personal income tax.

COURT COLLECTION PROGRAM. This program's objective is to increase collections of delinquent fines, penalties, and orders imposed by, and on behalf of, superior, municipal, and justice courts by utilizing the same automated collection capabilities that are used to collect the personal income tax.

LEGAL SERVICES PROGRAM. This program reimburses the Department of Justice for legal services provided in support of Franchise Tax Board functions.

CONTRACT WORK. This program provides cost-effective goods and services to other governmental entities through contractual agreements. Such goods and services include rental space to on-site childcare and cafeteria entities, data processing services for other governmental entities, and delinquent debt collection services.

ADMINISTRATION. This program provides executive leadership under the general direction of the Franchise Tax Board by directing departmental operations, developing and executing policies, making decisions concerning program operations, and ensuring that the Board's programs and services are carried out in accordance with Government Code Sections 15701 and 15702. This program also provides the Board with the personnel, administration, training, budgeting, and accounting services necessary to ensure that these functions are performed with integrity, efficiency, and fairness.

Budget. The Governor's budget includes $838 million ($802.5 million General Fund) and 5,694.8 positions in 2019-20 to support the department and its various programs. The following chart from the Governor's budget displays prior year, current year, and budget year positions and expenditures.

3-YEAR EXPENDITURES AND POSITIONS

		Positions			Expenditures		
		2017-18	2018-19	2019-20	2017-18*	2018-19*	2019-20*
6280	Tax Programs	5,352.7	5,189.7	5,127.7	$752,122	$803,904	$800,355
6285	Political Reform Audit	11.6	13.0	13.0	1,719	2,035	-
6290	Department of Motor Vehicles Collections Program	65.8	81.1	81.1	7,611	9,439	9,734
6295	Court Collection Program	119.8	112.2	112.2	12,002	13,467	13,747
6300	Legal Services Program	-	-	-	1,898	2,489	2,489
6305	Contract Work	77.9	62.2	62.2	9,633	11,633	11,651
9900100	Administration	271.9	284.6	298.6	29,311	31,892	33,287
9900200	Administration - Distributed	-	-	-	-29,311	-31,892	-33,287
TOTALS, POSITIONS AND EXPENDITURES (All Programs)		**5,899.7**	**5,742.8**	**5,694.8**	**$784,985**	**$842,967**	**$837,976**

Issue 11: Local Area Network (LAN) Infrastructure Refresh Project

Governor's Budget. The Governor's budget requests $5.7 million General Fund and $235,000 special funds in 2019-20 and $12,000 General Fund ongoing to refresh aging equipment and software that is reaching End-of-Life (EOL) and approaching End-of-Service (EOS) within the LAN infrastructure. FTB is also proposing to upgrade throughput (speed) to and from the network core.

Background. Each year, FTB processes more than 19.2 million Personal Income Tax (PIT) returns and 1.9 million Business Entity returns, responds to more than 2.8 million telephone calls, handles over 18 million Internet contacts, and administers the income tax programs that fund approximately 78 percent of the state's general fund revenue each year. To a large extent, FTB's LAN supports many of these transactions and services.

The LAN infrastructure is the heart of the enterprise network supporting FTB's mission critical operations. The LAN infrastructure provides reliability, network security, and scalability throughout FTB. There are approximately 6,000 FTB staff supported on this network. FTB's LAN supports on average 48 million online transactions conducted by taxpayers and 219,000 batch processes per month which uploads taxpayer specific transactional data to FTB's accounting and compliance systems. Batch processes are large numbers of data transactions that run in "batches" without human interaction.

This project seeks funding to replace aging equipment and software that is EOL and approaching EOS and/or hampered by old, inadequate technologies, to reduce the risk that these items will fail and impact FTB's operations. The programs administered by FTB rely heavily on network, and automated systems.

The LAN Infrastructure Refresh Project objective is to refresh the existing EOL and EOS network backbone hardware infrastructure, as well as, upgrade throughput. The overall result of this refresh will reduce the risk that these items will fail or be compromised and impact FTB's processing and compliance activities. The project seeks funding for the following:

- Replace six Distribution Core Layer Switches within each FTB central campus building with Cisco Nexus 7706 (or latest available).
- Replace 90 Access Layer Switches with Cisco Nexus 9400 (or latest available) series for both central campus and field offices.
- Upgrade FTB's network backbone-throughput from 10Gbps to at least 40Gbps.

Staff Recommendation. Approve as budgeted.

Issue 12: Mainframe Enterprise Tape Library Refresh

Governor's Budget. The Governor's budget requests $7.2 million ($6.9 million General Fund and $308,000 special funds) in 2019-20 to purchase the following information technology components: 1) Mainframe Enterprise Tape Library (MF ETL) and Direct Access Storage Devise (DASD) for the central office, and 2) Mainframe Business Class Server (MF CPU) MF ETL and DASD for a secondary off-site location.

Background. FTB's Tier III equivalent Data Center provides mainframe and distributed systems access and the operating storage capacity for FTB to administer its programs successfully. During April 2018 (FTB's individual tax filing deadline), FTB's data center processed approximately 104.2 million online transactions and roughly 250,000 batch processes. Batch processes are large numbers of data transactions that run in batches without human interaction.

The MF ETL and DASD provide the storage infrastructure that is essential to FTB's multiple mission-critical tax and non-tax applications. These applications have a substantial dependency on the data that resides within the MF ETL and DASD and, therefore, rely on the storage environment having sufficient capacity to support the efficient, effective, and secure operations of those applications.

FTB's Central Office Data Center houses a MF ETL that combines virtual and magnetic (physical) tape systems. All applications, business programs, and processes which access mainframe batch and online data (files, catalogs and databases) utilize the MF ETL as a repository for storage, backup and recovery. The ETL tape system has an annual growth rate of approximately 23 percent - the industry standard for mainframe storage is approximately 20 percent annually.

Internally, all system and application data residing on the DASD is backed up to a Virtual Tape Library (VTL), a data storage virtualization technology which represents storage components as tape libraries or tape drives for use with existing backup software. Data in the VTL is subsequently duplicated onto magnetic (physical) tape. These physical tapes are used for long-term data retention and technology recovery purposes. The physical tapes are manually ejected, packed and shipped to a local off-site storage location. As new tapes are shipped off-site the old tapes are returned to FTB to be cleansed and reused. This cycle occurs five days per week. FTB's current technical recovery process can take up to a week compared to the desired recovery period of one to two days.

FTB's MF ETL system consists of two components: virtual tape and magnetic (physical) tape processing. During June 2016, the manufacturer removed FTB's virtual tape library system from the market and support services will be discontinued by December 2019.

In September 2017, an 81BA was approved identifying the need to replace FTB's current ETL system. Since that time, the manufacturer for FTB's DASD hardware has also announced the EOM for the type/model currently in production at FTB and support services will be discontinued in three to four years from the EOM announced date of January 2017.

By replacing the MF ETL, FTB's mission critical systems and applications dependent on mainframe storage processing resources can avoid the following risks:

- Failures in systems that house vital sensitive and confidential taxpayer information, such as the Taxpayer Information System, which is FTB's Personal Income Tax accounting system.
- Inability to recover data after a disaster.
- Inability to timely process tax returns and payments and issue tax refunds, all of which are dependent on accessing system data timely.
- Failure to provide long-term data retention.

Staff Recommendation. Approve as budgeted.

Issue 13: CA Earned Income Tax Credit (CalEITC) Expansion

Governor's Budget. The Governor's budget proposes to more than double the size of the CalEITC program through the following changes:

1. Providing an additional $500 credit for families with children under the age of six.

2. Increasing the maximum eligible earned income so that workers working up to full-time at the 2022 minimum wage of $15 per hour will be eligible for the credit.

3. Changing the phase-out formula so that taxpayers earning income at the upper end of the credit structure will receive significantly higher credit amounts.

4. Exploring how to allow workers to receive a portion of their credit in monthly payments, as opposed to receiving the credit in one lump sum at the end of the year.

5. $5 million one-time through the Office of Planning and Research to provide matching funds to nonprofits, community-based organizations, or governmental entities that provide increase awareness of the state's CalEITC and free tax preparation assistance to eligible families and individuals.

The Governor's budget estimates that these changes are expected to provide $600 million in additional benefits and to allow 400,000 additional families to benefit from the credit. In total, the expanded program is expected to provide $1 billion in credits to 2.4 million families.

Background. According to research by the California Budget and Policy Center, state Earned Income Tax Credits (EITCs), like California's, are important tools for boosting economic security among working families. By piggybacking on the federal EITC, these state credits further boost families' incomes, helping them to better make ends meet. In addition, state EITCs may enhance the federal EITC's well-documented benefits to children, families, and communities. Research shows that the federal EITC reduces poverty, encourages work, may improve families' health, boost children's school achievement, increase children's future earnings, and boosts California-based businesses and the state's economy.

In SB 80 (Committee on Budget and Fiscal Review), Chapter 21, Statutes of 2015, the Legislature created the CalEITC, a state refundable tax credit for wage income that is intended to benefit very low-income households. Specifically, the program builds off the federal EITC and established a refundable credit for tax years beginning on or after January 1, 2015. The credit is applied to personal income tax liabilities associated with earned wage income. The program provides for a credit amount during a phase-in range of earned wage income according to specified percentages based on the number of qualifying children.

SB 106 (Committee on Budget and Fiscal Review), Chapter 96, Statutes of 2017, expanded CalEITC. This legislation expanded the state EITC to allow previously ineligible self-employed workers to qualify for the state EITC, and raised the credit's income eligibility limits so that workers higher up the income scale would qualify. This legislation better aligned CalEITC with the federal EITC and ensured that the state credit incentivizes all types of paid work.

SB 855 (Committee on Budget and Fiscal Review), Chapter 52, Statute of 2018, expanded the CalEITC to working individuals who are aged 18 to 24 or over age 65, by revising the age range for the definition of an "eligible individual." Additionally, SB 855, expanded the qualifying income range for the EITC so that employees who have one or more dependents, and who are working up to full-time at the 2019 minimum wage of $12 per hour, would qualify for the credit. Approximately $420 million in EITC is expected to be granted to over two million households this year. The following chart shows state EITC claims and aggregate credits for each year that the credit has been available.

EITC Claims and Amounts		
Tax Year	**Claims**	**Amount**
2015	386,000	$200 million
2016	386,000	$205 million
2017	1.5 million	$348 million
2018 (estimated)	2.2 million	$420 million

As displayed on the chart below, for the 2018 tax year, the credit is available to California households with adjusted gross incomes of up to $16,750 if there are no qualifying children, and up to $24,950 if there is one or more qualifying children.

Number of Qualifying Children	CA Maximum Income	CalEITC (up to)	IRS EITC (up to)
None	$16,750	$232	$519
1	$24,950	$1,554	$3,461
2	$24,950	$2,559	$5,716
3 or more	$24,950	$2,879	$6,431

[1]

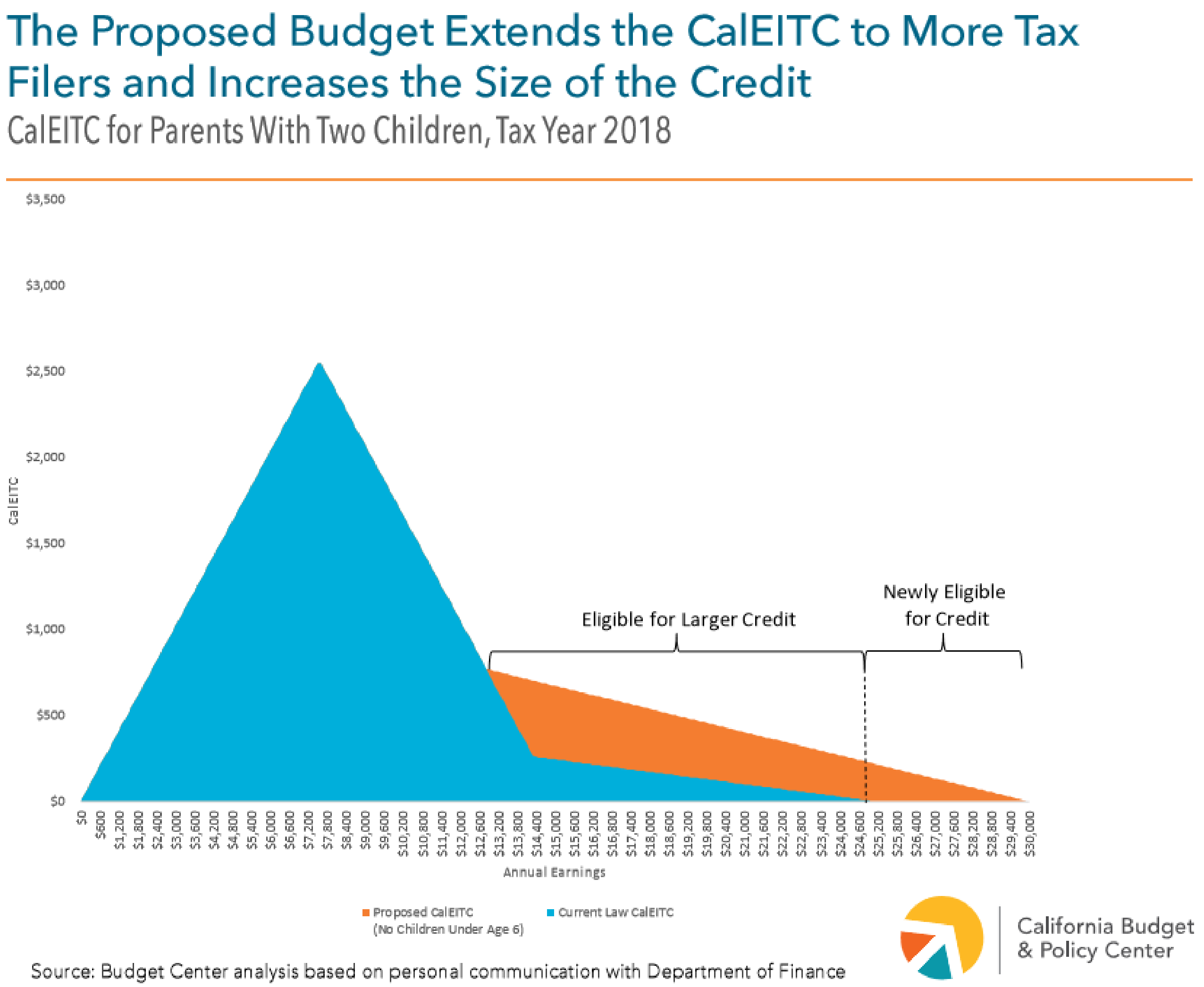
You qualify for the CalEITC for the 2018 tax year if you meet all of the following requirements:

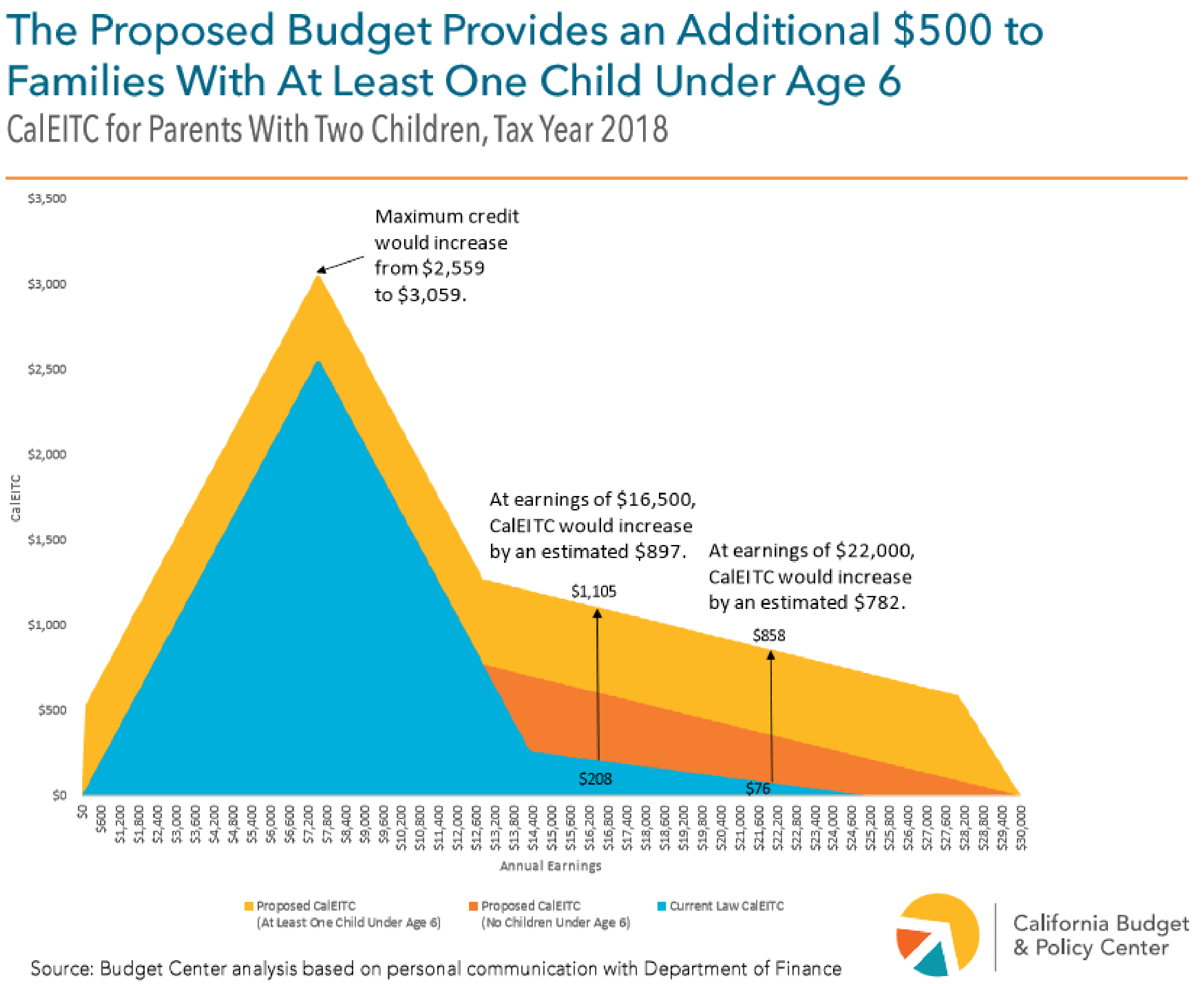
- You have wages, self-employment income and adjusted gross income within certain limits.
- You, your spouse, and any qualifying children each have a Social Security Number issued by the Social Security Administration that is valid for employment.
- You do not use the "married/RDP filing separately" filing status.
- You lived in California for more than half the tax year.

The following charts from the California Budget and Policy Center show how the CalEITC is expanded by the Governor's proposal. The first chart gives the example of the increase to the base credit for

[1] https://www.ftb.ca.gov/individuals/faq/net/900.shtml

families with two children and the second chart shows the impact of the additional $500 for families with at least one child under the age of six.





Outreach and Tax Preparation Efforts. EITC outreach has been an increasing focus of the program. Some reasons for this include that: 1) estimates have shown that every year California leaves $2 billion of unclaimed EITC money on the table; 2) research suggests that outreach around state-level EITCs increases uptake of the Federal EITC; 3) about one-third of the EITC eligible population turns over each year; 4) workers move into and out of eligibility based on changes in their marital, parental and financial status; 5) three out of five who receive the credit use it temporarily, for one or two years; and 6) you must claim the credit to receive it. Over 50,000 working people filed California taxes in 2017 and failed to claim the credit. Many people who qualify for the credit and are eligible for up to $6,000 fail to simply file taxes because they make below the required income threshold.[2]

Additionally, data has shown that the majority of families who've claimed the CalEITC have not received the full benefit of the credit because they've paid commercial tax preparers to file their taxes. In 2017, 56 percent of families claiming the CalEITC paid a preparer (not including families who purchased software to file), according to the FTB. CalEITC recipients' high reliance on

[2] https://caleitc4me.org/eitc-facts/

commercial preparers is not surprising considering that nearly two-thirds of Californians who claim the federal EITC pay to file — the second-highest share in the nation, according to the Brookings Institution. Expanding free tax preparation services would allow more families to receive their full tax refunds and better target California's investment in the CalEITC to the families it's intended to reach.[3]

The Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) volunteer programs provide free assistance to individuals who need help completing federal and state income tax returns. Assistance is limited to full-year residents because nonresident and part-year resident returns can be complex. Assistance is generally available from February 1 through April 15th. The VITA program specializes in assisting taxpayers with disabilities, those with low to limited income, and non-English speaking taxpayers. The TCE program provides free income tax assistance for middle- or low-income taxpayers, giving special attention to those aged 60 and older.

In recognition of the need for outreach efforts, the Legislature and the Governor provided $2 million in 2016-17 and 2017-18, for a CalEITC outreach grant program to reach the 10 target counties with the estimated highest potentially eligible number of households, as well as one small rural and one statewide grant pool. In total, there were 15 grantees with grants ranging from $55,000 to $300,000.

In order to increase outreach capabilities, the 2018-19 budget included $5 million for increased awareness, $4.9 million for free tax preparation assistance to eligible families and individuals, and $100,000 for evaluation of the most effective outreach strategies.

In its outreach efforts, FTB has collaborated with a wide breadth of government and nongovernmental agencies to develop a detailed communication plan to reach California taxpayers who might qualify for both the federal and state credits. Efforts included compilation and analysis of demographic information regarding the targeted population, web support activities, a direct mailer campaign to California taxpayers who did not have a state filing requirement but may qualify for the new CalEITC credit, and educational outreach to taxpayers, tax professionals, legislative staff, and other groups.

Legislative Analyst's Office (LAO). In their analysis of the Governor's proposal, the LAO suggests that there are three basic criteria that can be used to evaluate proposals to modify the CalEITC. First, how does the proposal affect poverty in the state? Does the proposal target those in deep poverty (those with income less than half of the poverty level)? Second, how does it affect work incentives, both for people who have to decide whether to enter the formal labor market and for people who are already working but are considering switching from part time to full time or vice versa? Third, what does the proposal cost, in terms of both revenue and additional compliance and administration? With these questions in mind, following are a couple of the alternatives that the LAO has suggested:

- Target Benefits to Those in Deep Poverty and Encourage More People to Enter Workforce. Rather than focusing on encouraging those already in the labor force to work more hours, the Legislature may wish to expand the EITC to create a stronger incentive for people to enter the workforce and provide larger benefits to those in deep poverty. The Legislature could do this by

[3] California Budget and Policy Center, Expanding Access to Free Tax Preparation Services Is Essential to Making the CalEITC a Success, Alissa Anderson, May 3, 2018

extending the credit's phase-in range at the current credit percentages. This would both (1) increase the maximum benefit and (2) increase the income at which workers qualify for the maximum benefit. For example; assuming the Legislature wanted to expand the EITC by $600 million—as in the Governor's proposal—it could increase both the peak EITC benefit and the income at which the maximum benefit is reached by 42 percent. Almost the entire benefit of this proposal would go to workers currently below the poverty line and provide larger benefits to those near deep poverty.

- Expanded Child Care Tax Credit Could Be an Alternative to Proposed $500 Credit. Rather than providing a $500 credit for workers with at least one dependent under the age of six, the Legislature could consider expanding the existing tax credit for child care expenses. Currently, the state credit is modeled on the federal credit, which reduces workers' taxes up to a certain amount based on child care costs. Prior to 2010, the state credit was refundable. At the time, the average credit amount for filers making less than $40,000 a year was $368. Today, workers with less than $40,000 of income receive very little benefit because these workers typically do not owe state taxes and the credit is not refundable.

Staff Comment. Further Expansion to the State EITC to Working Immigrants. The Governor's budget proposal will provide a significant boost to low-income working Californians and should be given strong consideration by the Legislature. However, advocates continue to point out that there remains a group of working Californians that do not have access to the credit — immigrants who file taxes with a Social Security Number or Individual Taxpayer Identification Number (ITIN). Numerous advocacy groups have pointed out that immigrants contribute about one third of California's gross domestic product and are vital to California's economy, yet many low-income working immigrant families who are struggling to make ends meet are excluded from the state EITC. Immigrants who use a federally assigned ITIN to file their tax returns are not currently eligible. Additionally, those who lose immigration relief, such as Deferred Action for Childhood Arrivals (DACA) and Temporary Protected Status, due to federal action against immigrants will no longer qualify for the EITC. This exclusion can negatively impact adults and children alike, as many immigrants live in mixed-status households with U.S. citizen children who may not benefit from the CalEITC because of their parents' immigration status. According to the California Budget and Policy Center, the poverty rate for children of immigrants in working families is more than twice the rate for other kids in working families (24 percent vs 11 percent). The center also presents the following points related to working immigrants in California:

- Like other California residents, undocumented immigrants pay taxes that support state and local services. The state's undocumented immigrants are estimated to pay more than $3 billion annually in state and local taxes.

- Undocumented immigrants pay income taxes in addition to sales and excise taxes and local property taxes. Many undocumented immigrant households file income tax returns using ITINs, and many others have income taxes withheld from their wages.

- Policymakers can reduce poverty and economic hardship for immigrants and their children by allowing income-eligible immigrants who file income taxes using ITINs or any federally assigned Social Security Number to claim the CalEITC.

Periodic Payments. Periodic payments, such as monthly, would smooth payments and help recipients cover ongoing expenses such as food and housing. However, periodic payment methods come with more complexities. An overarching issue regarding periodic payments is which entity would best be in a position to effectively administer a periodic payment program. This could be the FTB but could equally be assigned to an agency with more specific knowledge of the identified population. An effective periodic payment system would require addressing the following administrative components:

- **Enrollment.** Enrollment entails identifying and recruiting potential participants in an EITC periodic payment program and then verifying their eligibility to participate based on a set of objective factors.

- **Disbursement.** Disbursement involves identifying the entity responsible for the disbursement (e.g. financial institution or tax agency) as well as the frequency of the payments to the participating individual.

- **Communication.** Communication ensures that inaccuracies inherent in an income supplement program (such as income changes or "life" changes) can be corrected midstream, thus minimizing the monetization of these errors.

- **Reconciliation.** Reconciliation involves the year comparison of advanced payments and final credit amount eligibility, which could occur in conjunction with the filing of the annual tax return with the FTB.

One of the primary questions regarding a periodic payment structure is whether the payments are deferred or advanced. The California Budget and Policy Center points out that a deferred payment, which allows filers to receive their credit as monthly payments after filing their taxes, presents no financial risk. This could function as a savings tool for filers who are financially stable enough to defer their refunds. However, they suggest that deferring payments should be optional because some filers may need or prefer a lump-sum payment. In contrast, an advanced payment, which allows filers to receive their credit as monthly payments before filing their taxes, presents significant financial risk. Filers eligible for credits large enough to justify advanced payments work part-time and/or part-year, making it difficult to predict their income in advance. This could lead to a large overpayment of the credit, which filers would then have to pay back, because small changes in income can cause large changes in credit.

The LAO made similar observations in regards to whether periodic payments could made in advance or deferred. Specifically, the LAO observed that providing the payments in advance compared to a deferred payment likely would be more helpful to the recipients. Advance payments would create some challenges, however. In particular, workers receiving the EITC have incomes that often vary from one year to another. Accurately estimating the amount of the EITC in advance is difficult and in many instances, the state may either under- or overestimate the correct amount to provide workers in a given year. Consequently, a method to true-up the difference—potentially by adjusting the following year's credit—could be necessary. Attempts by the state to recoup over payments could create hardships for those affected. Program design should balance the benefit amounts with avoiding inaccuracies and large overpayments.

These Administrative issues notwithstanding, some advocates have pointed to the outcomes of an EITC Periodic Payment Pilot in Chicago in which participants were given most of their EITC quarterly through a mailed check or direct deposit. A 2015 Center for Economic Progress report detailing the pilot concluded that:

- The monthly injections of cash were used mainly on necessities.
- Periodic payments helped people save money.
- Nearly all participants preferred regular payments.

Continued Outreach and Free Tax Preparation. While the Governor's proposal includes a $5 million investment for increased EITC awareness and Free Tax Preparation Services, moving these resources to the OPR as the Governor has proposed could set back the progress made in this area as the FTB has Administered this part of the program for since inception and developed a level of expertise and experience that would likely be lost in such a transition. Alternatively, the Legislature should consider ways to strengthen education and outreach, such as ongoing funding in lieu of one-time commitments, which would maximize the benefit of resources in these areas by allowing the programs that deliver these services to plan for and sustain the desired level of services. Additionally, it is of note that FTB is evaluating efforts to increase program take-up. Given the funding that has been added by the Legislature the last few years and the FTB's efforts, the Legislature may wish to continue the focus on outreach and tax preparation as part of this year's budget deliberations to ensure that program goals are being realized.

Staff Recommendation. Hold open.

Issue 14: Tax Conformity

Governor's Budget. To pay for the expanded CalEITC program, the Administration is proposing conformity to several federal tax law changes mainly impacting business income. In 2017, the federal government adopted sweeping changes to the tax code for corporations and individuals. The Administration proposes taking into consideration federal law changes and how differences between California law and federal law may create unnecessary administrative burdens to both taxpayers and the FTB. Differences between federal and state systems can be especially difficult for individuals and small businesses. The Governor's budget proposes conformity to several key provisions that on either administrative burden or policy grounds are beneficial to California. These provisions include flexibility for small businesses, capital gains deferrals and exclusions for Opportunity Zones, and limitations on fringe benefit deductions, like-kind exchanges, and losses for non-corporate taxpayers, among others. These conformity provisions are expected to generate approximately $1.7 billion in 2019-20.

Background. At the end of 2017, President Trump signed into law the Tax Cuts and Jobs Act (TCJA), passed with solely Republican support in Congress. The TCJA — the most extensive revision of the tax code since 1986 — primarily cuts taxes for the wealthy and corporations while increasing the federal deficit by $1.9 trillion over 10 years, putting at risk funding for services that support low- and middle-income families. There is much in the TCJA for advocates of tax fairness to dislike, including the large cut in the corporate tax rate (from 35 percent to 21 percent), the new deduction for income from "pass-through businesses," and the reduction in the top personal income tax rate. All of these changes will lead to massive federal revenue losses. However, the new law also includes some reasonable changes that raise federal tax revenue in order to partially offset these losses, including limiting federal tax breaks that are costly, unfair, or economically inefficient. California now has the opportunity to increase state revenue by adopting (or "conforming to") some of these provisions.[4]

In their review of the Governor's proposal, the LAO points out that many states' income tax laws refer to or otherwise incorporate federal tax laws. When federal tax laws change, the tax laws of some states automatically conform to the change (this is sometimes called "rolling conformity"). Other states reference the federal law as of a particular date. If such states wish to conform to subsequent changes in federal law, their Legislatures must update the "static conformity" date in their tax laws. PIT laws in 19 states conform automatically and 23 must act to conform their PIT laws (nine states do not have a PIT). If a state with rolling conformity does not want to conform to any particular provision, their Legislatures must pass laws to specify the difference.

In 2018, most states that levy a state PIT took some legislative action to conform to the federal changes made in December 2017. While some states adopted most of the changes, other states updated their conformity dates in state law—for example, New York on a rolling basis and Virginia on a static basis—but decoupled from many of the major federal changes. Only Arizona, California, and Minnesota have not acted in response to the federal changes.

The LAO further points out that states conform to the federal tax code for several reasons. By using the federal definition of income as a starting point to calculate state tax liability, states may reduce the compliance burden on tax filers and reduce errors. Additionally, referring to federal tax laws allows state administrators and filers alike to rely on federal regulations, judicial rulings, and tax filer guidance from the Internal Revenue Service. The federal interpretations generally are more detailed and extensive than what any individual state could produce. Furthermore, conformity provides consistency among states' tax laws. This benefits those filers who pay taxes in multiple states and reduces the effects of tax policy on taxpayer behavior. Lastly, conformity enhances state compliance activities by allowing states to benefit from federal tax filer audits and use federal tax data.

Following the last major overhaul of the federal tax laws in 1986, California passed legislation in 1987 to selectively conform to federal changes by changing the specified date of conformity, affirmatively conforming or partially conforming to some provisions, and specifically not conforming to certain other federal changes. In addition, this legislation also reduced state tax rates, increased the personal exemption credit, and increased the standard deduction. The state Legislature has sometimes passed conformity legislation several years after changes in federal law. For example, the most recent major tax conformity change was AB 154 (Ting), Chapter 359, Statutes of 2015, which changed the specified date of conformity from January 1, 2009 to January 1, 2015.

The following chart from the LAO displays the components of the Governor's conformity proposal and the estimated revenue impact.

[4] California Budget and Policy Center, California Can Raise Revenue for New Investments in an Unexpected Way — By Adopting Parts of Last Year's Federal Tax Giveaway, Kayla Kitson, February 19, 2019

Assessment of Governor's Conformity Proposal as of March 1, 2019

Conformity Provision	Effects of Change	LAO Assessment	Estimated Revenue Effect[a] (In Millions) 2019-20	2020-21
Limits Non-Corporate Business Losses	Business owners with a loss over $250,000 would be unable to deduct the entire amount in the current year. For fewer than 100,000 filers, conforming would increase tax payments in the current year and reduce payments in future years.	+	$1,200	$850
Eliminates NOL Carrybacks	Eliminates NOL carrybacks—which currently allow a filer to claim a refund of taxes paid for up to two years prior. Conforming may increase state fiscal certainty.	+	$200	$210
Changes Like-Kind Exchange Rules	Eliminates like-kind exchanges of personal property. Conforming would mean that filers could no longer defer capital gains on personal property.	+/-	260	200
Limits Deductions for Fringe Benefits	Changes rules regarding business deductions for entertainment, food, and transportation expenses. Conforming would somewhat increase business taxes.	+	200	160
Increases Flexibility for Small Business Accounting	Increases to $25 million the annual revenue threshold for certain tax accounting rules. Conforming would eliminate differences between state and federal law that increase tax compliance costs for some small businesses.	+	-$220	-$100
Opportunity Zones	Allows filers to defer capital gains if those profits are reinvested in "green technology" or "affordable housing" investments in Opportunity Zones.	N/A	-80	-80
Eliminates Separate Section 338 Election	Eliminates differences between state and federal law regarding the tax treatment of corporate mergers and acquisitions.	N/A	70	65
Limits Deductions of FDIC Premiums	Limits the deduction of deposit insurance premiums paid by banks.	N/A	65	55
Expands limits on excess employee compensation.	Eliminates the performance-based compensation exception from limits on excessive employee compensation and expands the number of employees affected.	N/A	43	37
Repeals "Technical Termination" of Partnerships	Changes tax rules that apply when there is a significant change (more than 50 percent) in the ownership of a partnership.	N/A	10	5
Treatment of Student Loans Discharged on Account of Death or Disability	Excludes the discharge of student loan debt in case of death or disability from income.	N/A	-1	-1
Allows Increased Contributions to ABLE Accounts	Changes some rules regarding contributions to an ABLE account. The maximum total contribution of $14,000 per year remains unchanged.	N/A	—	—
Allows Rollovers to ABLE Accounts	Allows an individual with a disability to convert a "Section 529" educational savings account to an ABLE account without penalty.	N/A	—	—
Estimated Net Change in Revenue			**$1,746**	**$1,401**

[a] We use estimates provided to us by the Franchise Tax Board. In some cases, the estimates differ by the low tens of millions of dollars from those cited by the Department of Finance. There may be minor differences in assumptions.

ABLE = Achieving Better Life Experiences; FDIC = Federal Deposit Insurance Corporation; and NOL = Net Operating Loss.

Legend

+	The arguments in favor of conforming are somewhat stronger than those against.
+/-	There are good arguments both in favor and against conforming.
-	The arguments against conforming are somewhat stronger than those in favor.
N/A	Not applicable. Not included in Legislative Analyst's Office analysis.

Staff Comment. The Governor should be commended for prioritizing such a significant increase to the state's EITC program in his budget proposal. As conforming to changes in federal tax law is a common practice, utilizing revenue gains from conformity to allow for the expansion is a reasonable approach. However, as the LAO points out, estimates of the revenue impacts of expanding the state EITC and possible conformity actions are subject to significant uncertainty. In addition, the impacts of these different changes likely would deviate from each other over time. For example, the cost of the EITC could vary based on the economy. Additionally, the LAO suggests that revenues raised by conformity actions could change as taxpayers respond to any new incentives. The Legislature should ensure that, in tying expansion of the state EITC to tax conformity, the program isn't harshly impacted by future variations in the realization of revenue from any of the conformity changes.

Staff Recommendation. Hold open.