Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard D. Roth, Chair
Senator Steven M. Glazer
Senator Janet Nguyen
Senator Richard Pan

Thursday, April 28, 2016
9:30 a.m. or Upon Adjournment of Session
State Capitol - Rose Ann Vuich Hearing Room 2040

Part A

Consultant: Mark Ibele

ITEMS PROPOSED FOR VOTE-ONLY

ITEMS FOR DISCUSSION AND VOTE

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ISSUES PROPOSED FOR VOTE ONLY

7730 FRANCHISE TAX BOARD

Issue 1: E-Commerce Infrastructure Refresh (BCP 002)

Governor's Proposal. The Franchise Tax Board (FTB) requests $3.4 million General Fund and $149,000 special funds in 2016-17, $1.8 million General Fund and $81,000 special funds in 2017-18, and $163,000 General Fund and $7,000 special funds in 2018-19 and ongoing to refresh and expand the internet network infrastructure, which is reaching end of life (EOL) beginning February 2017.

Background. The E-Commerce Portal Infrastructure (EPI) initiative was developed and approved by the Department of Finance (DOF) in 2007, to provide internet network infrastructure and tools to effectively and efficiently manage, maintain and expand FTB's internet network platform. FTB programs rely heavily on this infrastructure to connect all California taxpayers, as well as FTB staff, to taxpayer information on its systems. Currently, 84 percent of taxpayers e-file tax returns, with the volume and associated data expected to continually increase. FTB received 15.1 million electronic returns and processed 4.4 million electronic payments in 2014. This is an increase of seven percent and 10 percent, respectively, over the prior year. FTB currently offers public accessible web applications, which allow FTB's external customers (taxpayers, tax professionals, business entities, and non-tax debtors), access to services using the web. Applications include the following:

- CalFile
- e-file
- My FTB interface
- WebPay
- Direct deposit of refund
- K-1 Filing
- Business entity direct deposit of refund
- Credit cards payments
- Electronic funds transfer

FTB's internet network infrastructure ensures bank deposits are transmitted effectively and expeditiously to the General Fund, to maximize interest earned on timely deposits. The same is true for the timely deposit of refunds electronically transmitted to the taxpayer, thereby avoiding interest payments on refunds. FTB's internet network infrastructure is responsible for distributing workloads across multiple computing resources such as servers, security devices, and other technology systems. Load balancers are an important aspect of FTB's internet network infrastructure, optimizing resource use, maximizing throughput, minimizing response time, and avoiding overloading any single resource. Load balancing ensures workloads are properly sorted and distributed evenly.

Network switches are the high speed devices that receive incoming data and redirect the data to the appropriate computing and system resources. These are crucial for FTB to provide connectivity to mission critical revenue generating systems, such as the Accounts Receivable Collection System (ARCS) and Integrated Non-Filer System (INC). FTB's internet network infrastructure must protect taxpayer privacy and ensure security of taxpayer information. FTB's network must have comprehensive and updated security firewalls in place to ensure the security of its network and mitigate potential breaches. The Network Engineering Services Section installs, operates and maintains the hardware and software that comprises the enterprise internet network infrastructure.

This refresh will update FTB's enterprise Internet network infrastructure through 2023 to meet the enterprise work demands, receive updates and patches, and have access to replacement equipment components. In order to reduce resource constraints, minimize impacts to current FTB network environments, and reduce filing season moratorium constraints, FTB will use a phased approach to refresh the internet network infrastructure.

In addition to the EOL issue, FTB's enterprise internet network infrastructure will not have sufficient capacity to handle the demands of FTB's tax and non-tax programs. Currently 100 percent of the network switch ports are allocated to current servers and technology systems. This is a major concern for FTB's workload growth and will jeopardize FTB's ability to perform its future revenue-generating work for California, as well as offer self-service options to taxpayers. By increasing FTB's internet network infrastructure port capacity, this will meet projected workload increases and demand of mobile devices through June 2023.

Staff Comments. During the budget year, several important components of FTB's internet network infrastructure will be at EOL and will no longer be supported. FTB's programs rely heavily on this infrastructure to securely, reliably and efficiently connect all California taxpayers, as well as FTB staff, to taxpayer information on our systems. Component failure after the end of the support period would lead to an enterprise-wide work stoppage until an emergency replacement of the internet network infrastructure could be completed. As the infrastructure is the backbone of FTB, a failure in the system will affect every division and staff’s ability to perform daily workloads, including: access to systems that accept and process returns, prevent fraud, or assist taxpayers with compliance; initiating due process notices and other system generated correspondence; and functions to allow electronic filing or using FTB's self-service systems to make payments. This freeze in work and prevention of system use would negatively affect FTB's efforts to obtain voluntary compliance and the ability to generate revenue. In addition, once support ends, FTB would no longer receive updates and patches, compromising the security of the network and systems.

Staff Recommendation. Approve as budgeted.

Vote.

0860 BOARD OF EQUALIZATION

Issue 1: Joint Operations Center for Fuel Tax Compliance (BCP 003)

Governor's Proposal. This proposal represents a request to continue Board of Equalization's (BOE's) participation in the Joint Operations Center (JOC) project for national fuel compliance, a program that relates to compliance with California's fuel tax law and the collection of program revenues. The request calls for $296,000 (federal funds) in 2016-17 and ongoing for the conversion of two expiring limited-term business taxes specialist positions to permanent status. The source of annual funding is from Federal Highway Administration funds.

Background. The proposal continues the agency's participation in JOC, which is intended to reduce fuel tax evasion for the participating states. The program provides staff, data and expertise from participating states and the federal government to identify under-reporting, non-reporting and trends in tax evasion. JOC has established a National Data Center and has integrated California data into the national database. In 2009, BOE began the process of analysis and investigation of leads being generated by the data center. In the ensuing years, JOC put its operations into effect and is receiving and combining data from state, federal and private party sources. Analytical tools are being used to identify anomalies, inconsistencies and omissions in the data, and generate leads for JOC audit teams to pursue. Audit teams are currently combining state and federal resources to conduct joint audits and investigations.

Staff Comment. The BOE is committed through a memorandum of understanding to two full-time staff positions. The operations provide both a direct benefit to the state and an indirect benefit, through apportionment of federal dollars collected through the program.

Staff Recommendation. Approve as budgeted.

Vote.

Issue 2: Permanent Establishment of Fire Prevention Fee Positions (BCP 001)

Governor's Proposal. As part of the Governor's budget, the BOE requests $1.4 million (special funds) and 8.6 permanent positions (permanent establishment of expiring limited-term positions) and 7.2 in temporary help positions in Fiscal Year 2016-17 and ongoing. The positions will allow for the BOE to continue processing workload associated with AB 29 x1 (Blumenfield), Chapter 8, Statutes of 2011, First Extraordinary Session, which imposed an annual fee on habitable structures located on property within the State Responsibility Area (SRA) in order to pay for fire prevention activities that specifically benefit owners of the structures within the SRA. Among its provisions, the bill requires the BOE to assess and collect the SRA Fire Prevention Fee on behalf of the Department of Forestry and Fire Protection (CalFIRE).

Background. The BOE received limited-term funding and staffing in 2012-13 and 2013-14 to address SRA fire prevention fee-related workload. The estimated workloads were based on the BOE's experience implementing special tax and fee programs for primarily businesses. Due to the number and non-business nature of the fee-payers of the SRA fire prevention fee, the initial workload was underestimated. In addition, the workload was affected due to delayed initial billings; a higher protest rate and more collection actions than anticipated; errors in the billing data file used to identify fee-payers; and a lower staffing level than originally requested. Due to the volume of workload and the complexity of administering the program, BOE overspent its budgeted amount in 2012-13 by $1.7 million for one billing cycle alone. The BOE hired temporary help full-time equivalents, contracted with the FTB for key data operators, and utilized overtime to assist in processing over 775,000 fire prevention fee billings during the first cycle. Temporary full-time equivalent resources and overtime were used again during 2013-14. The 2014-15 budget converted 42.0 expiring positions to permanent, continued 12.0 as limited-term positions and established 9.7 one-year temporary staff positions and 9.0 new two-year limited term positions, in order to address the ongoing workload. The limited-term positions are set to expire June 30, 2016. This budget request would permanently establish 8.6 positions (of the expiring limited-term positions) and provide 7.2 positions in temporary help. Prior positions were only approved as limited-term to ensure the workload continued, but BOE expects account maintenance transactions, billings, phone advisor and fee-payer inquiries to remain high. Total program revenues are anticipated to be approximately $82 million annually.

Staff Comments. The imposition of the fire fee by the state continues to be a disputatious topic, and therefore the current level of resources may still be a relatively temporary situation. The continuation of resources is warranted under current conditions, but the committee may want the department to prepare a brief report through Supplemental Reporting Language (SRL) regarding the ongoing nature of the workload. Assuming this workload will remain through the 2017-18 budget, the report could be prepared in conjunction with the preparation of the 2018-19 budget.

Staff Recommendation. Approve as budgeted with SRL.

Vote.

8885 COMMISSION ON STATE MANDATES

Issue 1: Funded and Suspended Local Mandates

Governor's Proposal. The Governor's mandate proposal is largely a continuation of the status quo in terms of funded and suspended mandates. The budget proposes expenditures of $45.6 million related to funding non-education mandates. The budget would continue to fund the 16 mandates that were kept in force for 2015-16, the payments on which constitute the bulk of the General Fund cost. In addition, the budget proposes funding a payment of $7.6 million to address the back costs local agencies accrued from 2001 to 2013 in performing activities related to the Public Records Act (PRA) mandate. (In 2014, California voters approved Proposition 42, which placed the PRA in the Constitution and removed the state's ongoing responsibility to fund the PRA mandate). The budget also provides $11,000 to fund the Medi-Cal Eligibility of Juvenile Offenders mandate and $725,000 to fund the State Authorized Risk Assessment Tool for Sex Offenders mandate. Most mandates funded in the budget concern public safety or property taxes. Funded mandates are listed in the following table:

Mandates Funded in Governor's Budget
General Fund
(Dollars in Thousands)

Mandate Title	Amount
Accounting for Local Revenue Realignments	$97
Allocation of Property Tax Revenue	611
California Public Records Act	7,578
Crime Victim's Domestic Violence Incident Reports	166
Custody of Minors-Child Abduction and Recovery	13,328
Domestic Violence Arrests and Victim's Assistance	2,725
Domestic Violence Arrest Policies	8,494
Domestic Violence Treatment Services	2,019
Health Benefits for Survivors of Public Safety Officers	2,943
Medi-Cal Beneficiary Death Notices	26
Medi-Cal Eligibility of Juvenile Offenders	11
Peace Officer Personnel Records	548
Rape Victim Counseling	353
Sexually Violent Predators	5,129
State Authorized Risk Assessment Tool for Sex Offenders	725
Threats Against Police Officers	263
Tuberculosis Control	83
Local Agency Ethics	0
Unitary Countywide Tax Rates	456
Total	**$45,555**

Note: *Italics* indicates that mandate is newly funded in the proposed budget.
Source: Department of Finance

The budget incorporates a total of $884.8 million in savings from maintaining mandate suspensions or deferring payment of claims. Some 56 mandates are suspended under the budget proposal. In addition, payments on another 15 mandates that have been deferred or have expired have been delayed. The savings breakdown is as follows: (1) $260.3 million savings from deferring payment of post-2004 mandate claims for mandates that have since expired or are otherwise not in effect; (2) $607.6 million savings by continuing the suspension of certain local mandates; and, (3) $16.9 million savings from deferring payment on employee-rights mandates in effect. The mandates that are suspended in the budget are shown in the table below.

Mandates Suspended in Governor's Budget
General Fund
(Dollars in Thousands)

Mandate Title	Amount
Absentee Ballots	$49,608
Absentee Ballots - Tabulation by Precinct	68
AIDS/Search Warrant	1,582
Airport Land Commission/Plans	26,854
Animal Adoption	15,713
Brendon Maguire Act	0
Conservatorship: Developmentally Disabled Adults	349
Coroner's Costs	222
Crime Statistics Reports for the Department of Justice	154,937
Crime Victim's Domestic Violence Incident Reports II	2,010
Developmentally disabled Attorney's Services	1,201
DNA Database and Amendments to Postmortem Examinations: Unidentified Bodies	310
Domestic Violence Background Checks	20,627
Domestic Violence Information	0
Elder Abuse, Law Enforcement Training	0
Extended Commitment Youth Authority	0
False Reports of Police Misconduct	10
Firearm Hearings for Discharged Inpatients	157
Grand Jury Proceedings	0
Interagency Child Abuse and Neglect (ICAN) Investigation Reports	73,566
Identity theft	93,960
In-Home Supportive Services II	443
Inmate AIDS Testing	0
Judiciary Proceedings	274
Law Enforcement Sexual Harassment Training	0
Local Coastal Plans	0
Mandate Reimbursement Process	6,895
Mandate Reimbursement Process II	0
Mentally Disordered Offenders: Treatment as a Condition of Parole	4,910
Mentally Disordered Offenders' Extended Commitments	7,222
Mentally Disordered Sex Offenders' Recommitments	340
Mentally Retarded Defendants Representation	36
Missing Persons Report	0
Modified Primary Election	1,817

Not Guilty by Reason of Insanity	5,214
Open Meetings Act/Brown Act Reform	109,788
Pacific Beach Safety: Water Quality and Closures	344
Perinatal Services	2,338
Permanent Absent Voters II	11,907
Personal Safety Alarm Devices	0
Photographic Record of Evidence	291
Pocket Masks	0
Post-Conviction: DNA Court Proceedings	410
Postmortem Examinations: Unidentified Bodies Human Remains	5
Prisoner Parental Rights	0
Senior Citizens Property Tax Postponement	481
Sex Crime Confidentiality	0
Sex Offenders Disclosure by Law Enforcement Officers	0
SIDS Autopsies	0
SIDS Contacts by Local Health Officers	0
SIDS Training for Firefighters	0
Stolen Vehicle Notification	1,117
Structural and Wildland Firefighter Safety Clothing and Equipment	0
Very High Fire Hazard Severity Zones	0
Voter Identification Procedures	10,075
Voter Registration Procedures	2,481
Total Suspended Mandates	**$607,561**

Source: Department of Finance

Background. The proposed funding for non-education mandate payments to local governments is included in the budget of the Commission on State Mandates (CSM). CSM is responsible for determining whether a new statute, executive order, or regulation contains a reimbursable state mandate on local governments, and for establishing the appropriate reimbursement to local governments from a mandate claim. The California Constitution generally requires the state to reimburse local governments when it mandates that they provide a new program or higher level of service. Activities or services required by the Constitution (as opposed to statute) are not considered reimbursable mandates. The Constitution, as amended by Proposition 1A of 2004, generally requires that the Legislature either fund or suspend local mandates. In most cases, if the Legislature fails to fund a mandate, or if the Governor vetoes funding, the legal requirements are considered suspended pursuant to the Constitution. However, one exception to this is payment of costs related to labor relations-related mandates, which may be deferred while still retaining the mandate's requirements. [1]

Mandate reimbursement claims are filed with CSM for the prior fiscal year, after that fiscal year is completed and actual costs are known. The state pays the mandate claims in the following fiscal year. For example, local costs incurred in 2014-15 are reported and claimed in 2015-16, and the state will reimburse locals for these costs as part of the 2016-17 budget. Suspending a

[1] Payments for mandate costs incurred prior to 2004 were allowed to be repaid over time, and statutorily required to be fully paid by 2020-21. As of December 2015, the pre-2004 mandate debt (pursuant to Government Code Section 17617) was paid off as a result of appropriations made in the 2014 Budget Act.

mandate does not relieve the state of the obligation of reimbursing valid claims from prior-years, but it does allow the state to defer payment on these claims. The state owes local governments approximately $1.0 billion in non-education mandate payments. All of this is related to post-2004 mandate claims. In prior years, there have been proposals to repeal certain mandates, but no such repeal is proposed in the budget. Repealing mandates does not offer any additional budget savings relative to suspension; however, if the mandate will otherwise be suspended indefinitely, the repeal of statutory provisions cleans up the code, improves statutory transparency, and provides more certainty to local governments.

Staff Comments. Staff has no concerns with the proposal.

Staff Recommendation. Approve as budgeted.

Vote.

ITEMS FOR DISCUSSION AND VOTE

EARNED INCOME TAX CREDIT

Presenters: **Gail Hall, Franchise Tax Board**
Kristin Shelton, Department of Finance
Ryan Woolsey, Legislative Analyst's Office

Background. The 2015 Budget Act created the Earned Income Tax Credit (EITC), a state refundable tax credit for wage income that is intended to benefit very low-income households. Specifically, the program builds off the federal EITC and establishes a refundable credit for tax years beginning on or after January 1, 2015. The credit is applied to personal income tax liabilities associated with earned wage income (not including self-employment income). The program provides for a credit amount during a phase-in range of earned wage income according to specified percentages based on the number of qualifying children. The phase-in range (for the maximum credit) covers earned wage income of up to $3,290 for individuals without qualifying children, $4,940 for individuals with one qualifying child, and $6,935 for individuals with two or more qualifying children. The Franchise Tax Board (FTB) administers the EITC program.

California's EITC focuses on households with incomes less than $6,580 if there are no dependents and up to $13,870 if there are three or more dependents, with no tax credits earned for wages received above these thresholds. The California program dovetails with the existing federal EITC and matches 85 percent of the federal credits, up to half of the federal phase-in range, and then begins to taper off relative to these maximum wage amounts. As initially estimated, the program was expected to cost $380 million annually, beginning in 2015-16 and benefit an estimated 825,000 families and two million individuals. When adopted the estimated mean household benefit was $460 per year, with the median benefit expected to be in the range or $200 to $250 per year. Based on actual data to date for tax year 2015, the mean credit is $534 with the median credit $202. Maximum credit amounts available range from $214 for participants with no qualifying dependents, to $2,653 for participants with three or more qualifying dependents. The most recent data on the program is shown below.

Earned Income Tax Credit
As of April 2016

Returns with Claimed and Allowed EITC	357,912
Amount of EITC Claimed and Allowed	$182,717,175
Average (Mean) EITC Credit Claim	$534
Median EITC Credit Claim	$202
Range of EITC Credit Claims	$1 - $2,653
First Time Filers	45,587*
Returns with Claimed and Adjusted/Denied EITC	13,016*
Amount of Credits Adjusted or Denied	$5,898,519*

Source: Franchise Tax Board, as of April 23, 2016. * indicates as of April 9, 2016.

Characteristics of California's EITC. With the adoption of the EITC, California joined 25 other states in offering a state-level program for the working poor. Although some variations occur in the design details of individual state programs, all states' programs are based on a percentage of the federal credit. These programs typically match a percentage of the federal credit across the income spectrum that is eligible for the federal credit during the phase-in range, flat range, and phase-out range. Two major features set California's credit apart from those of most other states, as discussed below:

- First, as opposed to matching a set percentage of the federal EITC across the eligible income range, California matches a percentage of the federal credit over just a portion of the federal EITC phase-in range. Specifically, the state program matches 85 percent of the federal EITC amounts up to half of the federal phase-in range and then begins to phase out; California's EITC is fully phased-out when the federal credit reaches its maximum amount. By way of comparison, New York—which has had its own EITC since 1994—offers a refundable state EITC that is pegged at 30 percent of the federal EITC amount over the entire eligible income range. The design of the California credit limits the fiscal exposure to the state and allows for the concentration of available dollars on lowest income earners at a higher credit level.[2]

- Second, California's EITC is not an automatic entitlement. The program is only available if the Legislature and Administration affirmatively determine each year that the state can afford the program. Annually, the state is required to set the adjustment factor (initially set at 85 percent) to determine the amount of the actual credit and specify this in the annual budget act. Unless otherwise specified, the adjustment factor will default to zero percent. This feature distinguishes the state EITC from expenditure programs like California Work Opportunity and Responsibility to Kids (CalWORKs), but also various special tax programs, which typically operate unrestrained by legislation or budget action (except through a two-thirds vote of the Legislature).[3]

EITC Program Impacts. The federal EITC is an unusual assistance program for low-income wage earners in that it generally receives favorable views from economists and policy analysts from across a wide political spectrum. Some view it favorably as a program that shifts resources to lower income households and individuals and acts to lift some populations out of poverty. Others support the program due to the work incentives that are imbedded in the program design. In general, these dual qualities of the program have constituted much of the motivation to adopt similar programs at the state level.

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[2] The difference in fiscal impacts is significant. New York's EITC results in an expenditure/revenue reduction of $994 million annually (on a personal income tax base of about $40 billion), whereas California's EITC is expected to result in an expenditure/revenue reduction of $380 million (on a personal income tax base of over $80 billion).

[3] For many tax programs, this annual uncertainty would tend to inhibit the very behavior the tax program is designed to encourage. For example, a research and development tax credit that was subject to annual fiscal assessment and budget decisions could undermine the intent to stimulate long-term investments in research and development. Similarly, subjecting the EITC to annual budget appropriations could potentially subvert the intended work incentive of the program.

The design of the EITC is relatively straightforward; however, the impacts of the EITC - conceptually and empirically - are far from simple or unambiguous. In particular, the work incentives of the program depend on numerous factors, including whether the recipient is in the phase-in or the phase-out range, marital status and the presence of a second worker, and interactions with prevailing wages or social welfare programs. For example, theoretically and empirically, the program would act as a work incentive (by increasing the hourly return) during the phase-in period and result in no work incentive during the flat phase. Over the phase-out range, theory would suggest that there would be a work disincentive; empirically, however, the actual impact on work hours appears to be slight. Over the entire range of program eligibility, the work incentive is (almost) never negative,[4] but during the phase-out range, the incentive to work is reduced for every additional dollar earned. The design of the California program is such that it phases-out while the federal program is still phasing-in, thus avoiding the disincentive that occurs with respect to the federal program during its phase-out period.

Annual Budgetary Appropriation. California has a significant number of tax programs that are designed to accomplish a variety of goals. Generally, for personal income taxes and corporation taxes, these tax programs include tax credits, income deductions or other special tax treatment. The programs are typically designed either to encourage particular types of behavior or provide generalized tax relief. The research and development (R&D) tax credit (available under the personal income tax and the corporation tax) is an example of the former, while the dependent exemption credit (available under the personal income tax) is an example of the latter.

Until recently, virtually all of California tax programs were not subject, through statute or other means, to any cost limitation. Given that such special tax treatment is considered to be a matter of legislative grace, the programs could always be limited or eliminated by the Legislature; however, this would require a two-thirds vote since it would result in an increase in the tax burden on a taxpayer. In recent years, the Administration and the Legislature have become more circumspect about the granting of tax preferences, with recent programs subject to either allocation through an annual cap on credits or by means of a sunset date. There is also some past experience with programs that automatically ‘trigger’ off if a specified event occurred. The former manufacturer’s investment credit (MIC) is an example of this.

These approaches are a means to simultaneously limit the state’s fiscal exposure, deal with the asymmetry of voting requirements, and facilitate an evaluation of the program’s effectiveness. With the EITC, the state has instituted a new means of ensuring protection of the state’s fiscal condition. Under the measure, the Administration must annually set the adjustment rate which determines the amount of the tax credit, with an effective rate of zero if no other rate is specified. This approach differs from virtually all other state tax programs, and creates substantial uncertainty for individuals and households that participate in the program.[5] Other than the few

[4] One exception is the area in which the participant loses eligibility for certain programs such as CalWORKs, CalFresh (formerly food stamps) and California Medical Assistance (Medi-Cal). The loss of these programs due to increased earnings can place the household in a negative marginal position with respect to additional work.

[5] One of the hallmarks of a good tax system is that it provides certainty to taxpayers and avoids short-term, sudden or capricious adjustments that can affect liabilities. An annual budget decision that affects tax liabilities (even negative liabilities) runs counter to this. Some argue that EITC participants lack the sophistication to track such

programs adopted in recent years, all other state tax programs change independently of state budget considerations.

Self-Employment Income. Under the adopted program, income eligible for calculating the amount of the EITC is limited to salaries and wages that are subject to withholding. In particular, self-employment income is not considered as part of earnings eligible for the EITC. The principal reason for this exclusion, according to the Administration, is the potential for large amounts of improper payments to participants who claim a larger credit than for which they are eligible. One of the primary means by which to misrepresent income—based on the federal experience—is through the misreporting of self-employment income. Unlike self-employment income, wages and salaries incorporate a more comprehensive paper trail to verify income.[6] The federal EITC, by contrast, includes self-employment income in the EITC definition of income. The federal program includes as income: wages, salaries, tips, and other taxable employee pay; union strike benefits; long-term disability benefits received prior to minimum retirement age; and, net earnings from self-employment.

Unlike California's approach, most other states with an EITC mimic the federal income eligibility standards. California's approach to ensure the reliability of payments is a fiscally reasonable approach, in that it helps ensure the program retains its integrity and only benefits those for whom the program was designed. On the other hand, the design certainly excludes others whom the program is intended to benefit. Many low-income earners have part-time occasional employment that results in income that is not subject to withholding. In fact, it is more than likely that some otherwise eligible individuals may rely solely on such income and thus are precluded from participating in California EITC program altogether.

During last year's legislative discussions, the possibility of including self-employment income was raised, but resisted by the Administration. In response, the Legislature required that the FTB, which administers the program, issue a report on the feasibility of including such income in the earned income calculation. The aspect of the report requirement is in supplemental language and states:

> *After implementation activities have been completed for the California EITC, the Franchise Tax Board shall explore methods that could be considered to allow self-employment income to be included as earned income while protecting against improper payments. This information shall be provided to staff of the budget committees.*

The FTB indicates that the report regarding self-employment income will be completed and submitted to the Legislature by April 30, 2016, and the board is prepared to address this issue at the hearing. Based on the considerations and issues developed in this report, the Legislature may consider measures that would broaden the earned income definition used for the EITC. This

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consistency; however, it seems questionable to ignore basic tax policy because taxpayers affected might lack sophistication.

[6] Independent contractor income may be reported on a Form 1099, but the enforcement of this requirement is spotty and the resulting data often incomplete, inaccurate or missing.

would have the dual effect of expanding the program to include currently ineligible individuals as well as increasing the credit for some who currently participate in the program. This consideration would entail, in part, weighing the benefits of expanding the scope of the program against any potential increase in abuse of the tax program.

Periodic Payments. Like the federally-sponsored EITC, California's EITC is structured and administered through the tax system. Any EITC amount due to a participating individual is remitted as a refund or payment pursuant to an annual state income tax return filing. There are numerous advantages to such an approach. For example, the administrative costs and complications are minimized by using an already-established framework and potential abuses are likely to be constrained. In addition, the one-time payment facilitates 'forced' savings or, alternatively, allows recipients to make larger purchases on necessities such as car repairs or appliances.

There are drawbacks to this annual payment approach, however. With respect to the intended work incentive, a single lump sum is more likely to be perceived by participants as a simple income transfer as opposed to a wage subsidy with a direct link to work participation, thus potentially weakening the work incentive effect. In addition, while the program may force savings, it does so at the expense of consumer preferences, preventing a participating household from relying on the subsidy for regular budgeting purposes. Finally, the annual payment facilitates an outflow of benefits to commercial tax preparers that charge interest on refund anticipation loans on EITC participants' tax filings.

One option to the annual payment is some version of periodic payment approach. This alternative has been explored through research, pilot projects, and at the federal level. For example, beginning in 1978, the federal EITC had an optional program whereby EITC participants notified their employer that they were eligible for the EITC. The Internal Revenue Service (IRS) then conducted a preliminary approval process and calculated the amount of the eligible subsidy to be included in the participant's regular paycheck. The additional pay was financed by employers by reducing the amount of their withholding and tax payments to the IRS. The periodic payment program was severely undersubscribed and was discontinued by Obama Administration as part of the 2010 budget.

Since the discontinuation of the federal program, there have been additional proposals regarding a periodic payment system. The Chicago EITC Periodic Payment Pilot, administered by the Center for Economic Progress and the city government, involves a program that pays participants one-half of their anticipated EITC in four installments over the course of the year. Unlike the federal program, the payments are made directly rather than included in the participants' paychecks. According to preliminary indications, the program has been administered successfully, with a very small percentage of participants in an overpayment situation. In addition, the program has resulted in reduced fiscal stress for the participants (compared to the control group) as measured by debt accumulation, interest payments and late fees. There are numerous other periodic payment versions that could be adapted to serve California's needs.

Staff Comments. California's current EITC program is an important, although rather modest, investment in improving the economic situation of the state's low-income wage earners. At this point, there is not enough data to ascertain the degree of success in reaching the intended population, but data compiled through April 23, 2016 indicate that the number of participants and credits awarded may fall short of estimates. The Legislature may want to discuss expanding, broadening and improving the program as one of the means to improve the outlook for this population, and, in this process, consider further actions and potential pilot projects with respect to the alternatives presented here. For example, in its report, the FTB highlights a number of important issues with respect to including self-employment income for purposes of the EITC. Including this form of income would substantially broaden the population that benefits from the program

Regarding the annual appropriation, the Legislature might consider the following reforms that address this issue:

- The Legislature could change the law to simply place the EITC on par with the vast majority of other special tax programs by establishing a positive non-zero adjustment factor (at a specified rate) in statute and allow the program to expand (or contract) as determined by eligibility standards.[7] A rate lower than 85 percent could be selected, in order to provide additional fiscal protection to the state. This rate could always be enhanced should fiscal conditions permit and legislative prerogatives dictate.

- If some additional fiscal limits were deemed advisable, the Legislature could establish in statute a specified adjustment rate for a certain period of time, for example, a five year period. This approach would provide some certainty to participants in the program, but also provide some fiscal protection to the state in the event of an economic downturn or other source of budgetary stress.

With respect to periodic payments versus lump-sum payment, while this could require substantial development at the state level, the benefits to participants could be a significant and increase the impact of the state's modest program investment. A starting point could be an assessment of both the need and the demand for such a program. For example, for the 2012 tax year, five states (Georgia, Florida, Massachusetts, Minnesota and New York) included with their EITC application process a series of questions designed to obtain information about these issues. They included questions regarding: desirability of advance and deferred periodic payments; preferred payment frequency; participants' most fiscally stressed months; and households' abilities to meet unexpected payments or fees. Some of these states are in the process of designing periodic payment pilot programs.

Staff notes that subsequent to the original estimates, FTB was able to examine 2012 tax year IRS data at the micro level to project the number and distribution of taxpayers anticipated to be covered under the EITC program. Based on the newly available IRS micro data, the number of

[7] While this would not provide the automatic fiscal protection in current law, the Legislature could still change the rate if fiscal conditions necessitated this (such as when the Legislature suspended the ability of businesses to use the net operating loss provisions during the past recession).

households is now projected to be approximately 600,000, benefiting approximately 1.3 million individuals. This represents a substantially smaller universe that the 825,000 households and two million individuals assumed in the original estimate. FTB indicates that although the population has declined, the change in the revenue reduction/expenditure estimate is roughly the same because the population now excluded in the revised estimate would only have had small credit amounts. Staff has requested additional information regarding the cost estimate from FTB because of the significant change in the population base.

Staff Recommendation. Information Item.

7730 FRANCHISE TAX BOARD

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

Budget Overview: The Governor's budget proposes expenditures of $748.1 million ($715.5 million General Fund) and 6,082 positions for FTB. This represents a continuation of a substantial increase in support for the agency, compared to the 2009-10 fiscal year, but just a slight increase from the current year funding level of $744.6 million. Expenditures grew from $533.1 million in 2009-10 due primarily to reinstating some of the budget reductions from earlier years as well as new programs. The budget reinstatements were made to reverse negative revenue impacts of the prior Administration's statewide cuts and furloughs, which included the state's tax collection agencies. In addition, the budget calls for augmentations for specific tax compliance programs and technology improvements related to the department's revenue collection activities. Recent budget increases have also been the result of funding for the Enterprise Date to Revenue (EDR) project, a benefits-funded project discussed below.

Issue 1: Enterprise Data to Revenue Project (BCP 001)

Governor's Proposal. The FTB requests 198 positions and $68 million General Fund ($53.3 million vendor payment) in 2016-17 and $61.4 million General Fund ($27 million vendor payment) in 2017-18 to support the maintenance and operations of the EDR project and support ongoing operational programs. The final year for the EDR project is 2016-17. The great majority of the requested positions are temporary help for data capture, return mail, and return analysis. The new positions will be largely devoted to data capture and scanning and receiving.

The proposal also requests an ongoing augmentation to support ongoing expenditures, beginning in 2018-19, associated with maintaining and refreshing new hardware and software implemented as a result of the EDR project. The resources are needed to support EDR's cost for workload growth, maintenance, operations, and hardware/software needs, as outlined in the Department of Technology's maintenance and operations (M&O) plan guidelines, covering a five-year timeframe from 2016-17 through 2020-21. Exercising the M&O option allows for significant savings estimated at about $12.5 million in the budget year. The resources will allow FTB to:

- Exercise the EDR contract M&O options for 2016-17 and 2017-18.
- Refresh EDR hardware/software and purchase EDR M&O hardware, software, and third-party party maintenance and support 2016-17 through 2020-21.

- Perform major version upgrades of the security database in 2016-17, and case management and data stage software in 2017-18.

- Increase FTB program resources to support full adoption and usage of the new EDR tools.

- Upgrade information technology position classifications for increased knowledge levels required for M&O.

- Provide compensation payments to the vendor in 2016-17 and 2017-18.

Background: The FTB processes more than 15 million personal income tax returns and one million business enterprise returns annually. Its operations are heavily reliant on effective storage and use of data from a variety of sources. The continuation of the EDR project is expected to fund the technology-intensive portion of the project. FTB indicates that the initial revenues generated by the EDR project were primarily from adding staff to process the current backlog of business entity returns and begin collection correspondence in order to accelerate revenue. Beginning in 2011-12, substantial revenues were generated by the EDR project proper.

The EDR project has three major goals. First, it seeks to capture all tax return data in an electronic form. Second, the project will integrate the various existing "siloed" tax databases at FTB into a data warehouse. Third, the project will enable FTB to add third-party data (for example, county assessor data) to its data warehouse. The FTB asserts that the EDR project will allow it to substantially improve detection of underpayment and fraud in order to collect taxes from those who are not paying the full amount that they owe. In addition, FTB indicates that the project will enable it to improve service and give taxpayers better access to their tax records.

The project includes the following improvements to FTB's systems that process personal income tax and business entity tax returns:

- An underpayment modeling process that is integrated with the Accounts Receivable Collections System and Taxpayer Information System.

- An enterprise data warehouse with data search and analysis tools.

- A taxpayer records folder that is accessible to the taxpayer and allows taxpayers and FTB staff to access the information.

- Re–engineered business processes—including tax return imaging, data capture, fraud and underpayment detection, tax return validation, filing enforcement, and other audit processes—and integration of these business processes with existing tax systems.

- Improved business services at FTB, such as address verification, issuance of notices, and a single internal password sign-on for IT systems.

Contractor payments for system development and implementation are conditioned on generating additional revenue that will more than cover the cost. This approach is intended to protect the state and give the contractors a strong incentive to develop the project in a manner that produces significant revenue quickly. The FTB has used this approach previously. FTB's benefits-funded approach made use of revenue gains from reducing the business entity backlog to more than offset costs in 2009-10 through 2012-13. Cleaning up the backlog was a necessary condition to efficient project development. In subsequent years, there have been large increases in annual revenue gains that are directly attributable to the project. For 2010-11 through 2013-14, revenue projections were $444 million, but actual revenue generated was $863 million. Through June 2015, revenues of $1.8 billion have been generated as a result of the project. Revenue generated from the EDR project is anticipated to be between $973.4 million and $1.2 billion for 2016-17 and between $968.7 million and $1.2 billion for 2017-18. FTB expects that the projected $4.0 to $4.7 billion of additional revenue through the life of the project (to 2017-18) will be realized.

As of June 30, 2015, the EDR project is 81 percent complete and is approaching the last year and warranty period. Since the project is now near completion, an assessment of the actual on-going needs to perform the maintenance and operations post-project for 2016-17 through 2020-21 has been completed. The FTB indicates the proposed changes are necessary for the project to sustain its on-going annual $1 billion revenue projection once the state takes over the full maintenance and operations of the EDR solution post-project. The project continually undergoes a thorough review and approval process, as well as scheduled reporting at appropriate milestones. As of June 30, 2015, the EDR project has also completed eight major releases on time and is on-track to deliver its one remaining release on schedule. To date, the project is on schedule with all deliverables and revenue generation.

Staff Comments. The net benefit of this project has ramped up quickly. As noted above, the project began to produce significant net revenues starting in 2011-12. The FTB has among the best track records in California state government for the successful development and implementation of major information technology projects. FTB projects have experienced some delays and cost increases in certain phases, although these problems generally have not prevented successful timely completion of overall project phases. The committee may ask the LAO and CalTech to comment on the project. The department has provided strong management of the implementation of EDR, to date. Nevertheless, given the sensitive nature of the project, and its direct relevance to revenue collection for the state, the committee is wise to provide continual oversight of the project.

Staff Recommendation. Approve as budgeted.

Vote.

Issue 2: Accounts Receivable Management Program (BCP 003)

Governor's Proposal. The FTB requests $8.2 million (General Fund) and 101 permanent positions, representing the continuation of limited-term positions, associated with working down the existing inventory of accounts receivable. The current positions will expire June 30, 2016. These positions were originally approved on a two-year, limited-term basis in 2010-11. The revenue resulting from the continuation of these positions for an additional two years is expected to be $108.2 million in 2016-17, $106.1 million in 2017-18, and $104.0 million in 2018-19.

FTB's tax collection activities involve collection of accounts receivable, and include automated billing and collection activities, notices, levies, attachment of assets, and routing accounts to collector. FTB's accounts receivable inventory has increased substantially over the last few years, from $5.4 billion in 2007 to $8.5 billion in 2011; as of July 1, 2015, inventory remained at about this level. The portion of the inventory "available to collect" has declined somewhat, from $5.7 billion in 2011 to $4.6 billion in 2015. The inventory in accounts receivable increased substantially during the years when the agency's resources were curtailed due to furloughs, work force reductions, and other forms of retrenchment during the previous Administration.

Staff Comments: The department has provided data and other information justifying the need for continued enhanced accounts receivable resources. The extension of the limited-term positions will continue an existing successful program, with a benefit to cost ratios of about 13 to one in the budget year. When these positions were extended in 2012, FTB indicated that it expected efficiency improvements to occur in the future. FTB has noted previously that continuing efforts will reduce the accounts receivable inventory, and this to some extent has occurred. From 2011 to 2015, the 'available to collect' inventory has decreased as a proportion of the total accounts receivable, indicating that the additional resources have been used effectively. A key factor in generating additional revenue from these accounts receivable activities is FTB's ability to work the receivables as soon as they become due and payable and enter the collection system. As accounts age, the tax liabilities become increasingly difficult to collect and the costs associated with collection activities increase. Given this, the committee may want to question the department regarding the future design of its accounts receivable program and, in particular, how technology improvements can address the ongoing inventory.

Staff Recommendation: Approve as budgeted.

Vote.

Issue 3: Customer Service Resources (SFL 001)

Governor's Proposal. The FTB requests $7.7 million (General Fund) and 85 positions for 2016-17, and $7.1 million (General Fund) and 93 positions for 2017-18, and ongoing to enable the department to effectively transact business with taxpayers, interacting in ways that are convenient for them and providing information allowing taxpayers to meet their tax filing and payment obligations. FTB indicates the existing service levels for its customer service channels are below desired standards. This proposal seeks resources to enhance service levels for self-service channels on the web and personal service channels including phone, electronic mail, live chat, and correspondence. The proposal calls for six positions associated with website technology accessibility; 24 positions related to the taxpayers services center and registration; 15 positions for written correspondence; 24 positions for power of attorney issues; and 15 positions (and eight converted from temporary in 2017-18) for live chat.

Background. In its role as one of the state major tax collection agencies, FTB seeks to provide customer service at the first point of contact to resolve their tax questions in a timely manner and therefor minimize departmental costs. If taxpayers cannot reach FTB for assistance, they make multiple contacts through different customer service channels and issues may migrate to the more costly involuntary non-compliance collection activities. FTB provides customer service through four existing primary channels:

- 24/7 website based and electronic self-service applications and programs.
- Taxpayer service contact center available via telephone.
- Interactive live chat via the internet.
- Personalized written correspondence (including power of attorney forms and correspondence on account issues.

FTB indicates that the service levels and response times in its customer service channels are unacceptable, as demonstrated by the following:

- FTB is unable to answer almost one million calls offered annually, between 50 percent and 60 percent of calls.
- In the last several years, FTB has seen the response time to address taxpayers written questions increase to between six to eight months.
- FTB lacks resources to support compliance with state and federal regulations regarding accessibility standards of FTB's applications and website pages.

During 2014-15, data from FTB's customer service channels and staff indicate the following: 14.8 million visits to FTB's website; 1.5 million taxpayers assisted by FTB's automated telephone system; 941,000 of 1.8 million calls to FTB's Taxpayer Assistance Line answered;

165,000 calls answered on Tax Practitioner Hotline; 110,000 live chats hosted; 163,000 pieces of correspondence completed (backlog of 63,000). The majority of these contacts relate to the following: 13 million notices and letters mailed to taxpayers; one million return information notices correcting amounts reported on a return and/or reducing the taxpayer's refund amount; 1.5 million statements of taxes due correcting amounts reported on a return and requesting payment of additional tax; one million requests or demands for a tax return from potential non-filers based on information available to FTB and over 650,000 notices of proposed assessments subsequently issued to these non-filers; 18 million personal income tax returns and 1.7 million business entity returns processed.

In the previous decade, FTB has been actively pursuing enhancements to its customer service channels to address taxpayers' needs as well as enhance levels of service without additional resources. FTB has deployed numerous website applications and tools to manage personal customer service channels. These are heavily utilized by taxpayers to gain information. Since 2011, the visits to FTB's website have increased by almost 78 percent. However, the FTB indicates that it has not been able to enhance service levels for those taxpayers that still need assistance after utilizing our self-service options. FTB has found that taxpayers still desire a high level of personal service for the following reasons:

- The taxpayer's tax issue is complex and they just need to receive assistance from an agent so they know they are addressing it correctly.

- Some taxpayers are not willing to manage their financial affairs without talking with an agent to ensure they are addressing issues correctly and minimizing penalties and interest.

- In a recent 2015 study by the Pew Research Group, a substantial proportion of adults do not have access to, or for other reasons, do not use the internet.

Staff Comments. FTB has aggressively pursued less personnel-intensive means of providing access to taxpayers to address questions, concerns and account issues. In particular, its provision of electronic services (information and filing) serve as good examples of what can be done with technology to make government work more efficiently. The data and other information provided as part of the budget request – especially data related to calls that were not addressed – provide evidence of the value of additional resources. However, the thrust of the current budget proposal works against the direction the department is working towards overall. Staff's concerns relate to the fact that there will continue to be shifts in the manner in which taxpayers obtain information and assistance, and the direction of these shifts will be towards electronic provision and automated systems – not direct personal assistance. In addition, there are new programs that have been introduced – for example, the Earned Income Tax Credit (EITC – the concerns about which would be expected to decline over time. Thus, staff recommends that the committee approve a portion of the positions requested on a permanent basis with a portion of the request granted on a limited-term basis, with provisional language allowing continuation of the limited-term positions upon presentation of the justification and a 30-day notice to the Joint Legislative Budget Committee (JLBC). Draft BBL for such a continuation is as follows:

> *Of the funds appropriated in this item, $4,715,000 shall be available to fund the equivalent of 63 positions through the 2018-19 fiscal year for staffing various customer service channels. The Franchise Tax Board may convert this funding to permanent funding with corresponding position authority for 63 permanent positions subject to approval of the Department of Finance, not sooner than 30 days after notification in writing to the chairpersons of the fiscal committees of each house of the Legislature and the Chairperson of the Joint Legislative Budget Committee.*

Staff Recommendation. Approve six positions for website technology accessibility and 24 positions for power of attorney activities on a permanent basis, and all other positions requested on a three-year limited-term basis, with additional BBL allowing for continuation of the limited-term positions presentation of the justification and a 30-day notice to the JLBC.

Vote.

0860 BOARD OF EQUALIZATION
7730 FRANCHISE TAX BOARD

Presenters: Michelle Pielsticker, Board of Equalization
Jeanne Harriman, Franchise Tax Board
Brian Weatherford, Legislative Analyst's Office

Issue 1: Branch and Field Offices – Oversight

Background: California has two major tax administration and collection agencies, the Franchise Tax Board (FTB) and the Board of Equalization (BOE).

- The FTB is under the purview of the Operations Agency and is governed by a three-member board, comprising the Director of Finance, the State Controller and the chair of the Board of Equalization. FTB administers and collects the personal income tax and the corporation tax (franchise and income), which together are expected to generate revenues of $91.7 billion in the current year, representing approximately 76 percent of General Fund revenue.

- The BOE is governed by an independent board, comprising four members elected from equally-populated districts across the state and the State Controller. The board is a quasi-judicial elected body, and serves as appellate entity for state taxes and as the administrative agency for taxes and fees under BOE purview. Taxes and fees under BOE administration include: sales and use taxes, motor vehicle fuels taxes, cigarette and tobacco taxes, alcoholic beverage tax, and various other specialized taxes and fees.[8]

Each of the agencies maintains field offices throughout the state. These offices serve two primary purposes; first, they provide office space for state employees who serve as auditors and other tax professionals with the agency; and, second, they provide a local facility to address questions or requests for information from tax- and fee-payers. For BOE board members, one of the offices is designated as the member's district office. Thus, assuming the offices are located in appropriate areas of the state, they can ease access to the public for the purposes of providing general information or addressing specific account issues. The table below lists FTB and BOE offices that are open to the public and presents data indicating public visits over the most recent five year period.

[8] Other taxes and fees are; timber yield tax, state-assessed property tax, private rail car tax, tire fee, lead poisoning fee, electronic waste recycling fee, emergency telephone users surcharge, energy resources electrical surcharge, fire prevention fee, various hazardous waste fees, lumber products assessment, ballast water fee, natural gas surcharge, led poisoning fee, oil spill prevention fee, railroad accident fee, underground storage tank fee, water rights fee. Many of the specialized taxes and fees are levied on or collected from a limited number of entities.

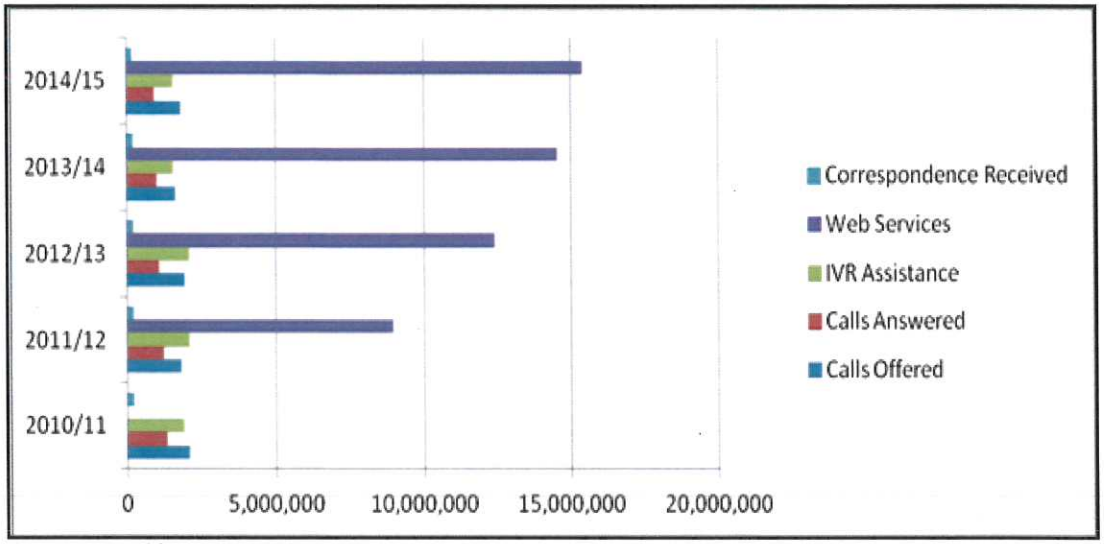
California Tax Collection Agencies
Number of Office Visits to Public Branch Offices
2010-11 through 2014-15

Franchise Tax Board	2010-11	2011-12	2012-13	2013-14	2014-15	% Δ
Sacramento	24,935	22.393	20,594	21,775	17,508	–29.8
Oakland	16,054	13,744	10,400	14,064	14,755	-8.1
San Francisco	14,869	13,464	10,160	11,980	13,457	-9.5
Los Angeles	15,912	20,012	19,105	16,947	16,313	2.5
Santa Ana	14,054	17,478	15,214	14,649	16,579	18.0
San Diego	14,468	19,007	18,110	14,469	14,026	-3.1
Total	100,292	83,727	93,583	93,884	92,638	-7.6
Board of Equalization	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**% Δ**
Fresno	11,516	12,534	7,528	7,388	6,475	-43.8
Bakersfield	6,017	6,480	3,712	9,293	8,138	35.3
Sacramento	20,446	18,305	11,262	10,804	10,006	-51.1
Redding	6,303	3,690	2,945	2,884	2,714	-56.9
Santa Clarita	NA	NA	NA	825	4,138	NA
Rancho Cucamonga	NA	NA	NA	NA	NA	NA
San Francisco	8,274	7,580	4,173	3,768	2,809	-66.1
Oakland	12,948	10,965	6,228	6,282	5,846	-54.9
San Jose	13,355	13,215	9,411	8,749	7,522	-43.7
Salinas	4,812	4,284	2,540	2,818	3,438	-28.6
Santa Rosa	6,687	6,323	4,378	4,052	3,185	-52.4
Fairfield	2,422	2,174	740	1,136	1,304	-46.2
Norwalk	39,007	38,675	28,462	25,188	22,905	-41.3
Glendale	26,935	25,894	17,846	14,345	10,929	-59.4
West Covina	22,877	22,092	16,208	15,692	17,873	-21.9
Ventura	5,608	5,591	3,475	3,187	3,095	-44.8
Culver City	23,739	23,543	13,801	19,237	10,594	-55.4
Irvine	24,710	23,964	18,455	15,464	11,746	-52.5
Riverside	21,308	21,446	15,701	14,601	13,143	-38.3
Rancho Mirage	3,913	3,313	2,416	2,368	2,263	-42.2
San Diego	13,349	20,015	11,028	10,829	9,404	-29.6
San Marcos	8,164	NA	NA	NA	NA	NA
Total	282,390	270,083	180,309	178,910	157,527	-44.2

Source: Franchise Tax Board and Board of Equalization

The data indicate a significant drop in the number of visits, especially for BOE public offices, which declined over 40 percent. Public offices are offices are not the only means of reaching customers, however, and lower-cost approaches have developed in recent years. Both FTB and BOE have pursued opportunities that minimize costs while retaining accuracy and responsiveness for the tax-paying public. In particular, both agencies have focused on web-based services and automated response telephone systems. As indicated in the table data, these efforts have been rewarded, as such efforts are likely to have been at least partially responsible for the drop in visitation to the district offices of both tax agencies. As an example of this transition, the chart below indicates the growth in web services at FTB just over the last five-year period.

Franchise Tax Board
Customer Service Channels Chart

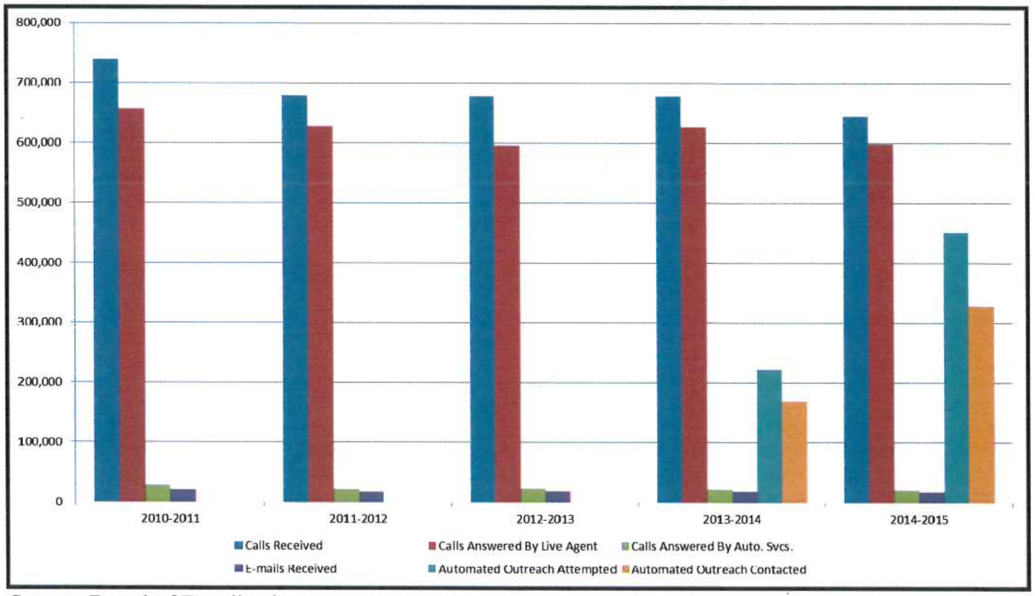


Source: Franchise Tax Board

Although not reflected in the field office table above, FTB has coupled its pursuit of technology-based outreach, customer services and filing, with the aggressive pursuit of savings through reducing the number of field offices. Up to 2003 and earlier, FTB had 19 offices, nine of which were accessible to the public. Between 2004 and 2006, it closed seven offices and between 2006 and 2008 closed three public service counters. As shown in the table, FTB has 12 district offices, six of which have public access. Along with this process, FTB has consolidated its staffing resources in the remaining offices. FTB's in-roads regarding e-filing are also significant. For tax year 2010, e-file accounted for 78 percent of personal income tax returns and 37 percent of business entity returns; for the tax year 2014, e-file percentages had climbed to 81 percent and 70 percent, respectively.

BOE is also beginning to make progress in shifting to a technology-based means of providing customer service. The chart below shows the shift towards automated outreach, although the number of automated responses lags well behind live agent contact (among the most expensive means of contact, other than face to face.) Although not tracked on this chart, BOE reports that the number of website hits has increased from about 50,000 in 2013-14 to almost 80,000 in 2014-15.

Board of Equalization
Customer Service Channels Chart



Source: Board of Equalization

Staff Comments. While both FTB and BOE are responsible for the administration and collection of state taxes and fees, they have a very different customer base and must tailor their respective public access programs somewhat differently. FTB collects from a vastly greater number of taxpayers but likely benefits from a high degree of homogeneity across the taxpayer population and significant participation by tax professionals. However, the issues associated with the personal income and the corporation tax that FTB administers can be quite technically complex and legally nuanced, requiring significant exchange of information. Taxes and fees administered by the BOE may often be somewhat less technically complex, but are levied on or collected by a varied group of entities with significantly different degrees of sophistication and tax knowledge. In the case of both agencies, access to accurate and timely information is vital for the process.

Incumbent upon each agency is ensuring taxpayer access to information in the most effective manner possible, as well as easing the burden of filing and payment responsibilities. The FTB has pursued aggressively various electronic means of providing information and assistance to taxpayers, including web-based solutions and automated telephonic systems. This effort, along with changes in the taxpaying base, has facilitated a reduction in the number of district offices that the agency has had to maintain. Even with the reduced number of offices (six), visitation has declined over the 2010-11 through 2014-15 five-year period by 7.6 percent. Meanwhile, FTB indicates that from 2011-12 through 2014-15, contacts for web services increased from under 10 million to over 15 million. FTB's Spring Finance Letter requests additional funding to improve services provided through these electronic and or automated means. The growth in the number of electronic tax filings is also an indication of the FTB successful embrace of electronic services.

BOE has provided information which indicates that there has been some trend towards electronic filing; however, given the BOE more diverse base of taxpayers, the incorporation of electronic means of filing and information dissemination is somewhat slower and more uneven across the tax base. BOE currently provides e-filing for some special taxes and sales and use taxes, which account most tax filings. About 95 percent of sale and use tax returns are e-filed, and there has been an increase in special tax filings from 5,271 in 2010-11 to 42,489 in 2014-15. Special taxes include cigarette and other tobacco products and motor vehicle fuel taxes. The Emergency Telephone Program will begin e-filing in October of this year and BOE's plan is to expand e-filing as a part of the Centralized Revenue Opportunity System (CROS) project in the future.

What is difficult to reconcile is technology advances allowing for growth in e-filing and web-based services at BOE, coupled with an actual increase in the number of physical offices maintained by the agency. In fact, as indicated in the table, the number of offices has increased while the number of visitations has actually declined by a significant percentage. While the agency certainly does not want to restrict or curtail public access by closing needed field offices, the state should also ascertain that access is provided by the most efficient means available. In addition, decisions regarding the location of offices appear somewhat counter-intuitive in some instances. Based on information available to staff, the agency specifically choose to locate the new office in Rancho Cucamonga when two existing field offices are within 25 miles of that city. There are several other cities of comparable size with much longer drives to the nearest field office.

The committee may interested in whether the agencies are meeting customers' demands for assistance and information in the most efficient and effective manner possible. Constructing (or renting) physical facilities present significant capital costs to the state and maintaining these facilities requires additional operating expenses and substantial personnel costs. Although there may be additional physical presence required by BOE because of the nature of its diverse responsibilities and varied customer base, the committee may be concerned that the state is getting the largest benefit for its invested customer service dollars. Delivering web-based information and providing filing opportunities electronically incur costs that are a fraction of those associated with maintaining a physical presence. In addition, the committee may be interested regarding the dispersion of offices around the state, and whether they actually reflect the distribution of the customer base.

Staff Recommendation. Information item.

0860 BOARD OF EQUALIZATION

Presenter: Edna Murphy, Board of Equalization

Department Overview. The State Board of Equalization (BOE) is comprised of five members - four members each elected to the board on a district basis, and the State Controller. The BOE administers the sales and use tax (including all state and local components), oversees the local administration of the property tax, and collects a variety of excise and special taxes (including the gasoline tax, insurance tax, and cigarette and tobacco products taxes) and various fees (including the underground storage tank fee, e-waste recycling fee, and fire prevention fee). The BOE establishes the values of state-assessed property, including inter-county pipelines, railroads, and regulated telephone, electricity, and gas utilities. The BOE also hears taxpayer appeals of BOE-administered taxes and fees and FTB decisions on personal income and corporation taxes.

Budget Summary. The Governor's budget proposes resource support of $598.3 million ($319.3 million General Fund), and 4,667.5 positions for the BOE in fiscal year 2016-17. The budget proposes total level funding and a slight General Fund support increase, compared with spending estimates for the current year. Proposed staffing in the budget would increase by 48 positions from the current-year estimate. The department’s budget request relate largely to the extension of existing programs and services.

Staff Comments. As noted in the previous issue, the BOE is unique in state government as an elected board with quasi-judicial powers that also administers one of California’s major tax agencies, responsible for collecting almost $30 billion in General Fund revenues alone. The combination of administrative, political and adjudicatory responsibilities of the board raises numerous organizational issues that are of particular importance given the sensitive and confidential nature of the tax area. Given the sensitivity of the charge assigned to the agency, it is vital that the state’s tax laws be administered in a fair and impartial manner.

To an overwhelming extent, California taxpayers voluntarily comply with the state’s tax laws, and such compliance is based, in part, on taxpayers’ perception of the fair administration of the system. This widespread compliance with the state’s tax laws, in turn, preserves the integrity of the state’s tax and revenue system. The line between administration and elected representatives should be a clear one, in order to preserve the fairness and impartiality of the tax system. This is of particular importance in the areas of auditing, collections and disputes over penalties and liabilities. The committee may wish to pursue questions relating to the organizational structures and administrative controls at BOE that ensure the continued impartial administration of the tax and fees administered by the agency.

Staff Recommendation. Informational issue.

Issue 1: Appeals Division Business Taxes Program and Settlement Workload (BCP 002)

Governor's Proposal. The Governor's budget includes a request from BOE for $5.1 million ($3.3 million General Fund) and 22 permanent positions (representing the continuation of 22 limited-term positions expiring June 30, 2016) and eight new permanent positions for 2016-17 to address the increase in combined incoming workload for the appeals program and settlement program. The positions include tax attorneys, business taxes specialists, and tax technicians.

Background. The appeals and settlement programs both perform legal services in cases where taxpayers can dispute tax and fee liabilities. The appeals program holds appeals conferences and prepares independent and neutral legal review of business tax disputes that arise once a billing has been issued by the agency and the taxpayer has, in response, filed a petition for reconsideration. Until the appeals process is completed, taxes cannot be collected on the disputed liability, and therefore it is critical to accelerate appeals cases as much as possible in order to move cases to a collectible state and maximize the potential for collecting amounts owed.

The appeals program conference holders, including attorneys or auditors, conduct appeals conferences in which the agency and the taxpayer present their arguments to the conference holder and the conference holder collects evidence regarding the legal and factual issues in each appeal. The conference holder then drafts a decision and recommendation setting forth the facts and contentions of both parties, analyzing the facts and contentions in light of the applicable law, and recommending a resolution with respect to the issues presented and the liability. A taxpayer may either accept the decision or further appeal its case to the five-member board. If the taxpayer or the agency requests an appeal, the conference holder reviews the request for reconsideration and then issues a supplemental decision and recommendation.

The settlement program conducts administrative settlement negotiations on disputed liabilities based on the risks and costs of litigation. Taxpayers are eligible to request settlement consideration at the time they submit a petition for reconsideration. As with an appeal, because taxpayers are not required to pay their disputed liabilities in order to file a petition for redetermination, it is important 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 or 24 months. Attorneys and auditors performing this work review audit case files, analyze the risks and cost of potential litigation, propose appropriate settlement ranges to reviewers for approval, conduct negotiations, draft settlement agreements, and prepare Attorney General and executive management memorandums recommending settlements for the five-member board or executive management approval.

Beginning in 2007-8 there was a significant and sustained uptick in appeals and settlement requests. Additional resources were added on a pilot basis effective October 1, 2010, to address significant increases in incoming workload that began in 2007-08. The then-existing staffing was divided roughly equally between the appeals and settlement programs, with auditors and attorneys conducting appeals conferences and holding settlement negotiations with taxpayers who had entered the appeals process. The positions for the pilot were originally established to work a backlog of cases; however, the incoming workload for the appeals and settlement programs as a whole has increased throughout the initial four-year pilot and the subsequent two-year continuation. The workload history for appeals and settlements is shown in the table below:

Board of Equalization
Appeals and Settlements Cases
207-08 through 2014-15

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Beginning Inventory	695	699	1017	1387	1407	1586	1603	2011
Incoming Cases	834	1092	1260	1208	1449	1466	2001	2514
Completed Cases	830	774	890	1188	1270	1449	1593	1751
Ending Inventory	699	1017	1387	1407	1586	1603	2011	2774

BOE states that the significant growth in incoming workload for the appeals and settlement programs has created a gap between the amount of work to be done and the workload capacity of the programs. This has caused a backlog of cases to develop as demand for appeals and settlement services continues to increase. BOE indicates that the increases are believed to be related to the 2007-08 recession, as well as increased outreach by the agency to improve taxpayer education as to available options for resolving disputed tax liabilities.

Staff Comments. The BOE seems unable to provide an adequate analytically-based explanation for the increase in appeals and settlement cases. While there was an uptick in cases that coincides with the recent recession, there was no corresponding easing or even leveling off of cases before the board. In fact, as indicated in the data, for the most recent years for which data are available, the increases were 36 percent in 2013-14 and 25 percent in 2014-15. The issue here is that in not being able to attribute the increase to particular factors, it is not apparent whether the increases and higher level represent the new normal or are some relic from shorter-term economic conditions and tax issues. Given this, it would seem to make sense to approve continued funding for the 22 existing (and otherwise expiring positions) and approve funding for an additional eight staff, but on a limited-term basis for three years. This approach provide the resources to address the current and anticipated workload, as well as allowing for the budgetary flexibility to continue this funding during budget discussions for 2019-20, if necessary.

Staff Recommendation: Approve the conversion of existing 22 limited-term positions to permanent and approve three-year limited-term funding for addition eight positions.

Vote.

Issue 2: Regional Railroad Accident Preparedness and Immediate Response (SFL 003)

Governor's Proposal: In a Spring Finance Letter, the State Board of Equalization (BOE) requested $821,000 and 2.4 positions in 2015-16; $475,000 and 1.3 positions in 2016-17; and $278,000 and 1.3 positions in 2017-18 and ongoing from special funds to administer the provisions of SB 84 (Committee on Budget and Fiscal Review) Chapter 25, Statutes of 2015. SB 84 authorizes a new fee, the Regional Railroad Accident Preparedness and Immediate Response (RRAPIR) fee, to be imposed on owners of the 25 most hazardous material commodities at the time that hazardous material is transported by loaded rail car in California. The workload includes registering feepayers, processing returns, collecting fees, and processing audits and appeals. BOE is requesting permanent resources due to the difficulties in hiring and retaining staff in limited-term positions.

Background. The BOE has entered into an interagency agreement with the Office of Emergency Services (OES) to establish and implement and collect the RRAPIR fee on behalf of the OES. The collection of the fee is scheduled to begin October 1, 2016. Fee revenue is to be deposited in the Regional Railroad Accident Preparedness and Immediate Response Fund, with a portion of the deposited funds used for administrative expenses. The OES has agreed to provide the BOE $821,000 for fiscal year 2015-16, for costs to establish and implement the new fee collection program. BOE's implementation costs include: (1) one-time contract programming resources and data center services necessary to add a new fee program to the BOE's Integrated Revenue Information System (IRIS) and Automated Collection Management System (ACMS); and (2) funding for BOE positions and operating expenses for work involved in the implementation of the RRAPIR fee collection program. This request is for ongoing resources to administer and maintain the new RRAPIR fee program and be in compliance with the requirements of SB 84. The fee is levied on owners of the 25 most hazardous material commodities, as identified in regulations adopted by the OES, contained in or on a rail car transported by rail in California and is assessed on the number of loaded hazardous material rail cars transported within the state. The bill requires the OES director to establish a fee schedule based on each loaded rail car.

Staff Comments. Staff is supportive of this proposal, which provides reasonable staff resources for a legislative priority. The additional resources in the initial year correspond with registering fee-payers, an activity that should naturally tail-off as the fee becomes an established levy.

Staff Recommendation. Approve as budgeted.

Vote.

Issue 3: State Controller's Office Review of Board of Equalization Internal Accounting and Administrative Controls - Oversight

Presenters: Julia Findley / Edna Murphy, Board of Equalization
Jeffrey Brownfield, State Controller's Office

Background. From the second quarter of 2011 through the 4th quarter of 2013, BOE erroneously allocated sales tax revenue derived from gasoline sales to the General Fund instead of to special funds. During early 2014, a private consulting firm contacted BOE and raised a concern that the Local Public Safety Fund did not receive the correct cash allocations related to gasoline sales. BOE's internal auditor subsequently examined BOE's records and determined that when the fuel tax swap legislation took affect (which required BOE to change its methodology for allocating revenue derived from the sale of gasoline) there were two accounting errors that resulted in a misallocation of revenue:

- Incorrect reversal entries made in three quarters – total sales were reversed instead of only the state General Fund portion.

- Reversal entries were made in the wrong quarter – one quarter too early and before actual sales data was available

In July 2014, BOE notified the Department of Finance (DOF) that there had been a misallocation of funds in the Retail Sales Tax Fun (RTSF) As a result of this misallocation, the General Fund was attributed $343 million more in tax revenues than it should have received. During July 2014, DOF staff analyzed the issue and assessed the BOE proposed solution. In early August, DOF, BOE, and the State Controller's Office (SCO) agreed on a course of action to remedy the problem and the SCO made the adjustment to General Fund in August 2014.

The SCO initiated an audit of the BOE's internal accounting and administrative controls completed in November 2015. The SCO reviewed the internal accounting and administrative controls of the BOE's financial management and reporting practices over the BOE's RSTF, Office Revolving Fund (ORF), accounts receivable cycle, and apportionment and allocation processes for the period of July 1, 2013, through April 30, 2015.

SCO identified material internal control weaknesses over the RSTF revenue allocation process that have led to improper distributions to the various fund allocations. It noted the following in regard to the RSTF:

- Inadequate internal accounting and administrative controls to appropriately allocate money in the RSTF;

- Inaccurate adjustments of fund allocations in quarterly true-ups;

- Improper allocations of the additional sales tax on diesel fuel;

- Improper allocations of Department of Motor Vehicles (DMV) Use Tax; and

- Improper allocations of Franchise Tax Board (FTB) Use Tax;

In addition, SCO noted that the BOE's RSTF accounts receivable balance is inaccurate. Further, SCO identified control weaknesses over the BOE's ORF and specifically noted the following in regard to the ORF:

- Receivables were not collected in a timely manner;

- Claims were not scheduled for prompt reimbursement;

- Office revolving funds were improperly used, and there was a lack of supporting documentation for some payments;

- Controls over salary advances were inadequate; and

- Controls over travel advances and travel reimbursement claims were inadequate.

Based on its review, SCO determined that the BOE has a combination of weaknesses in internal control over the RSTF and ORF such that there is a reasonable possibility that a material misstatement in financial information, impairment of effectiveness or efficiency of operations, and/or noncompliance with provisions of laws, regulations, and policies will not be prevented, detected, and/or corrected in a timely manner.

Staff Comments. The SCO audit and evaluation noted some serious lapses in the internal control functions of BOE. This evaluation was initiated, at least in part, by concerns related to the agency misattribution of revenues. The result of this was a one-time reduction in General Fund of hundreds of millions of dollars that was mistakenly directed. At the conclusion of its review, the SCO stated "We strongly recommend that the BOE develop a detailed corrective action plan within six months of this report to address the issues noted…" SCO indicated that it would review the action plan and determine whether a follow-up is necessary. Staff is not aware of the extent to which BOE has respond to the various items identified in the review or implemented corrective actions. The committee may want to pursue questions related the status of BOE action plan and next steps, given that the six month period ends in May 2016.

Staff Recommendation. Information item.

8885 COMMISSION ON STATE MANDATES

Department Overview: The Commission on State Mandates (CSM) is a quasi-judicial body created for the purpose of determining state-mandated costs. The objective of the CSM is to impartially hear and determine if local agencies and school districts are entitled to reimbursement for increased costs mandated by the state, consistent with Article XIII B, Section 6 of the California Constitution. The CSM consists of the director of Finance, the State Controller, the State Treasurer, the director of the Office of Planning and Research, and a public member and two local government representatives appointed by the Governor and approved by the Senate.

The CSM is responsible for determining whether a new statute, executive order, or regulation contains a reimbursable state mandate on local governments, and for establishing the appropriate reimbursement to local governments from a mandate claim. The Constitution generally requires the state to reimburse local governments when it mandates that they provide a new program or higher level of service. Activities or services required by the Constitution are not considered reimbursable mandates. The Constitution, as amended by Proposition 1A of 2004, requires that the Legislature either fund or suspend local mandates. In most cases, if the Legislature fails to fund a mandate, or if the Governor vetoes funding, the legal requirements are considered suspended pursuant to the Constitution.

Issue 1: Reasonable Reimbursement Methodology for Mandate Claims (TBL)

Governor's Proposal. The Administration's mandate proposal would require State Controller's Office (SCO) to audit all mandate reimbursement claims used in the development of any new reasonable reimbursement methodology (RRM), which is one approach to reimbursing local governments for mandate costs. The Administration proposes this amendment based on its concern that the claims used to develop a particular RRM overstated actual costs. RRM proposals must use cost information from one of three sources: a representative sample of eligible claimants; information provided by local government associations; or, other projections of local costs. Under the Administration's proposal, if a proposed RRM uses cost information based on claims filed by local governments to the SCO, those claims would have to be audited before being used to develop a general allocation formula. An RRM developed through means other than claims data would not face this requirement.

Background. Local governments can submit claims for mandates costs reimbursement based on the actual costs of the required activities or the CSM can adopt a RRM. The Legislature created the RRM process in 2004 with the intent to streamline the documentation and reporting process for mandates. An RRM allows local governments to be reimbursed based on general allocation formulas or other approximations of costs, rather than detailed documentation of actual costs. The Department of Finance (DOF), SCO, affected local governments, or an interested party may propose an RRM. Generally, when an RRM is proposed, the CSM cannot modify it, but must either adopt or reject the proposal. To be adopted by the CSM, an RRM must meet the following conditions:

- Use cost information from one of the following: a representative sample of eligible claimants; information provided by local government associations; or, other projections of local costs.

- Consider the variation in costs among local governments to implement the mandate in a cost-efficient manner.

- Be consistent with the mandated activities identified in the CSM's parameters and guidelines.

Once an RRM is submitted to the CSM for consideration, DOF, SCO, or affected local governments may file comments with the CSM. These comments are part of the administrative record and may outline the parties' support or opposition to the proposal. The parties may submit comments again after the CSM releases a proposed RRM decision. DOF has regular voiced concern that RRM may not be based on audited claims. There are currently six active mandates that have an RRM.

LAO Comments. The intent of the Legislature in establishing the RRM process was to reduce local governments' burden of documenting actual mandate costs, as well as reduce the work of state officials in reviewing and paying associated claims. But the RRM process has been seldom used to date. LAO notes that there are already several opportunities for DOF or other interested parties to weigh in on whether an RRM proposal meets the requirements of state law, and the proposed audit requirement likely would lengthen the process for developing an RRM. As a result, it could become more difficult for local governments to propose RRMs based on claims data in the future. Moreover, an increase in SCO's audit workload potentially could strain that department's resources in the future. LAO recommends caution in considering actions that could make the process less beneficial for local governments. For example, if the state suspends fewer local government mandates than it does today, there may be more RRM proposals. As one alternative, the SCO could be required to audit just a sample of the claims used for an RRM.

Staff Comments. The proposal is intended to avoid potentially inflated mandate claims, but could result in causing additional problems such as delays, reporting burdens and disincentives for the RRM process. In addition, the proposal would impose new auditing activities on the SCO with no additional resources. Given the potential unintended consequences of the proposed language, staff recommends no committee action at this time.

Staff Recommendation. Hold open.

Vote.

9210 Local Government Financing

Item Overview. The state provides general-purpose revenue to counties, cities, and special districts when special circumstances occur. The Local Government Financing program includes those payments to local governments where the funds may be used for any general government purpose as well as funds for one-time, designated purposes.

Issue 1: Revenue Loss Due to Wildfires (BBL)

Governor's Proposal: The Governor's budget proposes funding of $1.9 million General Fund one-time in 2016-17 to backfill property tax, sales and use tax, and transient occupancy tax revenue losses that Calaveras and Lake counties, and the special districts located in those counties, will incur due to wildfires last year. The accompanying budget bill language (BBL) requires that the counties submit to Department of Finance (DOF) a claim detailing the losses prior to being issued a warrant by the State Controller. The amount of reimbursement will not exceed $596,000 for Calaveras County and $1.3 million for Lake County.

Background. In 2015, Lake and Calaveras counties suffered significant financial losses due to two separate wildfires. The fires burned more than 145,000 acres combined and destroyed more than 2,000 homes and other structures. Earlier this year, the Legislature appropriated $105 million in funding to support fire recovery and debris removal for Lake and Calaveras counties. In another budget item, the Administration proposes additional relief by covering $2.9 million in CalFIRE contract costs for the two counties.

Staff Comments. Staff has no concerns with the proposal.

Staff Recommendation. Approve as budgeted.

Vote.

Issue 2: Local Law Enforcement Reimbursement (BBL)

Governor's Proposal. The budget includes $10.0 million for reimbursement of costs associated with AB 953 (Weber), Chapter 466, Statutes of 2015, which calls for tracking and reporting of stops by local law enforcement. The budget bill language indicates that the funds are to be awarded based on a schedule to be provided by the DOF and acceptance of the funds would preclude the local government from filing a claim for these costs with the Commission on State Mandates (CSM).

Background. The adopted statute requires the Attorney General to establish the Racial and Identity Profiling Advisory Board, which is directed, among other duties, to investigate and analyze state and local law enforcement agencies' racial and identity profiling policies and practices across geographic areas in California and make publicly available its findings and policy recommendations. The measure requires each state and local agency that employs peace officers to annually report to the Attorney General, data on all stops conducted by the agency's peace officers, and require that data to include specified information, including the time, date, and location of the stop, and the reason for the stop. The measure was identified as a state-mandated local program by Legislative Counsel. Whether the required activities constitute a reimbursable mandate (and if so, what are the allowable costs) will be determined by the CSM.

Staff Comments. Staff is aware that the proposal, as currently reflected in the budget, remains a work in progress. There are a number of questions that arise from the basic outline, however. These include the basis on which funds are to be allocated and, more fundamentally, whether local governments conducting state-mandated activities can actually be precluded from receiving constitutionally protected expense reimbursements or can waive the right to claim such reimbursements. This concern would be particularly relevant if the funds are accepted but prove inadequate to fully cover the allowable expenses established through the mandate process. Staff recommends that this item be held open.

Staff Recommendation. Hold open.

Vote.

Issue 3: Hard-to-Site Facilities (BBL and TBL)

Governor's Proposal. The Governor proposes $25.0 million (General Fund), budget bill language (BBL) and trailer bill language (TBL) relating to hard-to-site state facilities. The funds will be dedicated to siting incentive payments to cities and/or counties that approve, between January 1, 2016 and June 30, 2017, new long‑term permits for hard‑to‑site facilities that improve public safety and support the criminal justice system.

Background. Local governments have sole control over land use, zoning and permitting within their communities. When local communities are reluctant to allow the operation of programs for the rehabilitation of offenders in the criminal justice system, this local authority has slowed the ability of the state and local governments to provide meaningful rehabilitation programs. The appropriation would be used for siting costs related to such activities as substance use disorder treatment, mental health, and reentry programming.

LAO Comments. In its review of the proposal, LAO notes that it lacks significant details with respect to a full definition of the eligible facilities, specifics as to how the grants would be applied for and awarded, the amount of funding that could be received, and whether both state and local facilities would be eligible. In addition, the LAO indicates that there are no statewide data that shed light on permitting challenges, nor regarding local government costs. The office suggests a more targeted approach that would use state funds for specific mitigation measures on a case by case basis.

Staff Comments. The Administration has provided neither data nor other information regarding the magnitude of the problem, and the proposal itself, as currently formulated, remains rather inchoate. The proposed trailer bill language is intent language regarding the program. However, staff understands that the Administration is continuing to work with stakeholders to flesh-out the details of the proposal.

Staff Recommendation. Hold open.

Vote.