AGENDA
ASSEMBLY BUDGET SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION

Assemblymember Rudy Bermudez, Chair

TUESDAY, APRIL 1, 2003
STATE CAPITOL, ROOM 447
1:30 P.M.

CONSENT CALENDAR

ITEM	DESCRIPTION
0553	OFFICE OF THE INSPECTOR GENERAL-VETERANS AFFAIRS
0959	CALIFORNIA DEBT LIMIT ALLOCATION COMMITTEE
0965	CALIF. INDUSTRIAL DVLPMT. FINANCING ADVISORY COMMISSION
0971	CALIF. ALT. ENERGY & ADV. TRANSPORT. FINANCING AUTHORITY
2100	DEPARTMENT OF ALCOHOL BEVERAGE CONTROL
2120	ALCOHOL AND BEVERAGE CONTROL BOARD
2150	DEPARTMENT OF FINANCIAL INSTITUTIONS
8620	FAIR POLITICAL PRACTICES COMMISSION
8640	POLITICAL REFORM ACT OF 1974
8940	MILITARY DEPARTMENT

ITEMS TO BE HEARD

ITEM 0860 STATE BOARD OF EQUALIZATION

The Board of Equalization (BOE) administers state and local sales and use taxes. In 2002-03, the board will collect an estimated $26.3 billion of state sales and use tax (SUT) revenue. The board also has a number of other significant tax administration roles. The board also collects a variety of business and excise taxes and fees, including the gasoline tax and taxes on alcoholic beverages and on cigarettes and tobacco products. It oversees the administration of the property tax by county assessors and assesses property owned by public utilities. The Board's elected members also serve as an appellate body for decisions of the Franchise Tax Board concerning personal income and bank and corporation taxes.

The budget proposes total spending of $321.4 million for the board in 2003-04 ($199.2 million General Fund). Spending remains essentially flat compared with 2002-03. Proposed staffing totals 3,552 personnel-years (PYs), a decline of 50.6 PYs (1.4 percent) compared with the current year.

State Board of Equalization
Funding and Staffing
2001-02 through 2003-04
(dollars in thousands)

			CURRENT YEAR		**BUDGET YEAR**		**CHANGE FROM**	
			(Estimated)		***(Estimated)***		**2002-03**	
	2001-02	**(PY)**	**2002-03**	**(PY)**	**2003-04**	**(PY)**	**Dollars**	**(PY)**
PROGRAMS								
Sales and Use Tax	$252,264	3,165	$258,764	3,002	$258,721	2,949	-$43	-53
Alcoholic Beverage Tax	$1,920	21	$2,027	21	$2,048	21	$21	0
Cigarette and Tobacco Products Tax	$8,574	74	$8,994	70	$9,591	73	$597	3
Motor Vehicle Fuel License Tax	$4,191	31	$4,828	41	$4,888	41	$60	0
Diesel and Use Fuel Tax	$16,161	152	$16,673	150	$16,880	150	$207	0
Property Tax	$16,421	194	$16,490	187	$16,744	187	$254	0
Miscellaneous	$12,443	150	$12,254	132	$12,525	132	$271	0
TOTAL PROGRAMS:	**$311,974**	**3,787**	**$320,030**	**3,603**	**$321,397**	**3,553**	**$1,367**	**-50**
General Fund	***$191,009***		***$199,133***		***$199,169***		***$36***	

ISSUE 1: TAX COLLECTION AND AUDIT RESOURCES

The budget does not request any additional resources for BOE SUT audit and collection efforts. Increased sales and use tax revenues would benefit the General Fund and local governments.

COMMENTS:

- The BOE should report on the potential cost-benefit of adding additional staff or other resources to its SUT audit and collection efforts

ISSUE 2: STREAMLINED SALES TAX PROJECT

The LAO recommends that the BOE report at hearings regarding the impact—both budgetary and revenue related—of participating in the Streamlined Sales Tax Project (SSTP) and adopting the project's multi-state agreement.

BACKGROUND

In an effort to simplify various states' SUT systems, 34 states and the District of Columbia have participated in the Streamlined Sales Tax Project (SSTP). The SSTP adopted the Streamlined Sales and Use Tax Agreement in November 2002, which creates a blueprint for a simplified tax collection system and attempts to remove the burden and cost of tax collection from sellers. The agreement addresses issues associated with tax collections, definitions of the tax base, uniformity of tax bases, electronic registration of sellers, simplification of tax rates, simplification of returns and remittances, uniform sourcing rules, as well as other issues. This agreement will now be submitted to the individual states for ratification.

Participating states anticipate that the SSTP agreement will lead to voluntary participation by businesses and the subsequent petitioning of Congress to allow states to require out-of-state collection of their sales taxes. However, It is important to note that the simplification effort would not itself result in states being able to require that out-of-state sellers begin collecting the SUT. Rather, the interstate agreement represents an effort on behalf of the participating states to demonstrate to Congress that the simplified sales tax system does not impose unfair costs on out-of-state businesses and thus would not interfere with interstate commerce. Federal legislation would still be needed that would allow states to require out-of-state sellers to collect the SUT.

COMMENTS:

- Last week (March 26, 2003) the BOE decided to participate in the SSTP in an observer (nonvoting) capacity. SB 157 (Bowen) would authorize California to participate in the SSTP.

- Each participating state has an equal vote in the SSTP, and the SSTP agreement already has been developed without participation by California. Observer participation in the SSTP may be useful, but California's main opportunity to influence interstate SUT collection may be in Congress, which would have to enact legislation to require collection of the SUT in all interstate sales.

- The board should provide the subcommittee with a report on the potential effects of the SSTP agreement, as recommended by the LAO.

ISSUE 3: COLLECTING USE TAX ON THE INCOME TAX FORM

Existing state law requires payment of the use tax by Californians who purchase goods in those cases where the seller has not collected the sales tax. However, use tax payment by individuals is largely unenforced at present. Although a comprehensive and practical solution to this problem will require federal legislation, more could be done to improve voluntary compliance.

One approach would be to include a line on the personal income tax return requiring taxpayers to fill in the amount that they owe for use tax and pay it with their income tax. Although the state currently has no systematic way to verify actual use tax liability for individuals, *any* payment would be more than the state receives at present in most cases. The Franchise Tax Board's (FTB's) income tax instructions currently inform taxpayers about the use tax, but no reporting is required on the income tax return. Instead, the burden is on the taxpayer to file a separate use tax form with the BOE—few do so. Many taxpayers probably would declare some amount of use tax on their income tax return if required to do so rather than sign a the form with a zero declaration under penalty of perjury.

BACKGROUND

The use tax is equivalent to the sales tax, but is paid directly to the BOE by the purchaser in lieu of the sales tax. Purchases that require use tax payment include Internet and mail-order purchases from out-of-state sellers who do not collect California sales tax, purchases made while out of California and then brought home, and purchases of vehicles or vessels from individuals. The BOE's audit program acts to enforce the use tax for business purchases, but there is no regular audit program for individuals, so that the use tax goes largely uncollected, except for vehicles and vessels for which payment of use tax is required for registration.

A number of states have adopted the approach of collecting use tax through their income tax systems.

COMMENTS:

- The FTB and BOE have identified a number of implementation issues. For example, allocation of the local portions of the use tax, and whether payments should be credited first to the income tax or use tax. Fairly straightforward solutions would be to allocate local tax based on the zip code and address on the income tax form, and to apply payments first to income tax liability (which is entirely General Fund revenue).

- The subcommittee may wish to direct the BOE and FTB to report back at a subsequent hearing regarding the feasibility of collecting use tax on the income tax form, the revenue potential, and estimated implementation costs.

ISSUE 4: CIGARETTE TAX EVASION

The budget requests an increase of $678,000 ($77,000 General Fund) and 2.8 PYs for enhanced enforcement of cigarette and tobacco product's taxes. This augmentation is to implement the pilot program in Chapter 881, Statutes of 2002 (SB 1701, Peace), which requires BOE to replace the current cigarette stamps and meter impressions with encrypted stamps or meter impressions that can b e read by scanning devices. The budget also includes $294,000 ($34,000 General Fund) in the current year for the startup of this effort.

The budget does not include any additional resources to prevent tax evasion that may occur as a result of the $1.10/pack cigarette tax increase included by the Governor in his Realignment proposal. The BOE estimates that annual revenue loss from evasion of current state cigarette taxes is between $130 million and $270 million.

LAO recommends that the BOE report on the effectiveness of additional investigations programs or enforcement policies in order to reduce the amount of cigarette tax evasion, including the potential effectiveness of the following:

- Increasing investigation activity.
- Participating with other states or federal authorities in border enforcement activities.
- Enhanced penalties for cigarette smuggling and related tax evasion activities.

COMMENTS:

- AB 71 (Horton) would require the registration of cigarette and tobacco products distributors and retailers in order to reduce tax evasion.

- The General Fund currently receives only 10 cents of the total state cigarette tax of 87 cents/pack—the bulk of the funds go to Proposition 10 and Proposition 99 programs. The proposed General Fund increase of $1.10/pack would give the General Fund a much larger stake in reducing evasion.

ISSUE 5: SUPPORT BUDGET INCREASE

The Governor's Budget requests an increase of $680,000 ($455,000 General Fund) for BOE due to higher workers' compensation costs and field office rental increases.

ISSUE 6: LAO OPTION—REDUCE FIELD OFFICE STAFF

The LAO has identified an option to save a total of $1.8 million annually by eliminating public counter staff at certain field offices of both the BOE and the FTB. LAO points out that taxpayers could rely on the call centers operated by the two tax boards.

COMMENTS:

- The LAO should identify the specific reductions at BOE and FTB field offices.

ITEM 0890 SECRETARY OF STATE

(Dollars in millions)

GENERAL FUND		
2001-02	**2002-03**	**PROPOSED 2003-04**
39.2	29.0	27.1

The Secretary of State (SOS) is the Chief Elections Officer and is responsible for the administration and enforcement of election laws. The office is also responsible for the administration and enforcement of laws pertaining to filing documents associated with: corporations; limited partnerships; and the perfection of security agreements. In addition, the office is responsible for the appointment of notary publics and enforcement of notary laws; and the preservation of documents with historical relevance.

ISSUE 1 LAO RECOMMENDATION: FUNDING FOR VACANT POSITIONS

The Governor's budget proposes to augment the Secretary of State's budget by $200,000 to restore funding eliminated in the current year as part of the effort to eliminate vacant positions. The LAO is recommending that the legislature deny the funding increase.

COMMENTS:

The SOS is intending to use the increase in funding to hire student assistants to process a considerable backlog in paperwork submitted by business. Currently the Business Programs Division has approximately 69,000 unprocessed filings. In December 2002 the backlog was 5,000 documents. But since the New Year the backlog has grown at a rate of approximately 1,000 documents a day. The SOS charges business fees for these services, and have stated that this backlog is a result from a decrease in SOS staffing levels at the same time that the new mandates took effect on January 1, 2003.

While the Business Fee fund is a Special Fund supported by fees, any balance remaining in the fund at the end of the year is transferred to the General Fund. Denying this request would have an equal benefit of $200,000 to the General Fund.

ITEM 0890 SECRETARY OF STATE

ISSUE 2 LAO RECOMMENDATION: SET FEES EQUAL TO COSTS

There are estimated to be more than 30,000 common interest developments (CID) (such as condominium associations) in the state. AB 643 (Chapter 117, Statutes of 2002) requires each CID to biennially file basic information, such as address and contact information, with the SOS. This will result in an increased workload for the SOS .

So that the SOS will be able to cover the costs of their program with adequate fees, chapter 117 allows the SOS to charge fees of *up to* $30. However, while only showing a minimal increase in workload, the SOS has proposed to impose that maximum fee for initial filings. It is the recommendation of the LAO that the legislature, through budget bill language, limit the fee in 2003-2004 in order to create a comparable cost to revenue ration. The LAO states that a fee of $5 would generate sufficient revenues for the program.

COMMENTS

Because this is a new program and there are no prior year expenses by which to evaluate costs, the department is proposing to charge the maximum fee level for the first year to ensure that all costs will be covered. However, if the maximum fee of $30, the subcommittee should consider the following issues:

- If there is a surplus at the year's end, will businesses be reimbursed for overcharged service fees?

- What are the options of creating a system by which businesses are allotted a credit for future filings?

- If there is a surplus at the year's end, how will fees be re-assessed?

ITEM 0845 DEPARTMENT OF INSURANCE

(Dollars in millions)

GENERAL FUND		
2001-02	**2002-03**	**PROPOSED 2003-04**
1.0	-	-

The office of the Insurance Commissioner has the responsibility to enforce the insurance law found in the California Insurance Code. The role of the Insurance Commissioner is to regulate the insurance industry, thereby protecting California consumers from abusive insurance practices.

The Department regulates the largest insurance market in the United States with over $80 billion in direct premiums written in the state. In fulfilling its responsibility to protect California's insurance policyholders, the Department conducts examinations of insurance companies and producers to ensure that operations are consistent with the requirements of the Insurance Code and that insurance companies are financially viable and able to meet their obligations to policy holders and claimants. The Department also investigates complaints and responds to consumer inquiries; administers the conservation and liquidation of insolvent and delinquent insurance companies; reviews and approves insurance rates; and is a major contributor in combating insurance fraud.

ISSUE 1: STATUS OF WORKERS COMPENSATION

ITEM 0950 STATE TREASURER AND RELATED FINANCING ENTITIES

The State Treasurer provides banking services to state government with goals to minimize interest and service costs and to maximize yield on investments. The Treasurer has custody of all monies and securities belonging to, or held in trust by, the state; invests state funds; and administers state bond sales and bond redemption and interest payments. The Treasurer also pays warrants drawn by the State Controller and other agencies, and oversees a number of state financing entities.

The Treasurer's proposed budget totals $20.7 million ($6.4 million General Fund) in 2003-04. This represents a decrease of $2.1 million (9 percent) compared with the current year. The table below shows spending and staffing for the period from 2001-02 through 2003-04.

State Treasurer
Spending and Staffing Trends
(dollars in thousands)

				Change from 2002-03	
	2001-02	**2002-03**	**2003-04**	**Amount**	**Percent**
General Fund	$12,225	$8,659	$6,424	-$2,235	-25.8%
Reimbursements and other funds	15,892	14,109	14,291	182	1.3%
Budget totals	$28,117	$22,768	$20,715	-$2,053	-9.0%
Staffing (PYs)	222.6	228.3	228.3	--	--

The Treasurer's budget proposal includes a funding shift of $613,000 from the General Fund to reimbursements for services as a result of a realignment of administrative costs. Other reductions include elimination of one-time expenditures, elimination of vacant positions, and travel reductions.

No issues have been raised regarding the budget request for the Treasurer's Office.

ISSUE 1: LOANS FROM FINANANCING AUTHORITIES

The budget proposes the following two loans of $3 million each to the General Fund:

- Item 0956, California Debt and Investment Advisory Commission (CDIAC), California Debt and Investment Advisor Commission Fund.
- Item 0968, California Tax Credit Allocation Committee, Tax Credit Allocation Fee Account (a loan of $27 million was provided in the current year).

Under accompanying Budget Bill and Trailer Bill language, the General Fund will repay these loans with interest by October 1, 2005 or sooner if required to meet the needs of the lender programs.

COMMENTS:

- LAO has identified an option for a potential $2.5 million increase in the CDIAC loan—from $3 million to $5.5 million. The Treasurer's Office or CDIAC should address the feasibility of this increase.

ITEM 1100 CALIFORNIA SCIENCE CENTER
ITEM 1105 AFRICAN AMERICAN MUSEUM

(Dollars in millions)

GENERAL FUND		
2001-02	**2002-03**	**PROPOSED 2003-04**
14.8	12.9	13.0

The California Science Center is an educational, scientific and technological center administered by a nine-member board of directors appointed by the Governor. It is located in Exposition Park, a 160-acre tract just south of the central part of Los Angeles, which is owned by the State in the name of the Science Center. In a number of State-owned buildings, the Science Center presents a series of exhibits and conducts associated educational programs focusing on scientific and technological developments of the State. In addition, the Science Center, through the Park Manager, is responsible for maintenance of the park, public safety and parking facilities.

The California African American Museum preserves and displays the contributions of African Americans to the arts, science, religion, education, literature, entertainment, politics, sports, and to the history and culture of California and the world. The Executive Director and staff, in cooperation with the seven-member Board of Directors, administer this educational program to promote awareness and understanding of the accomplishments and contributions of African American culture and heritage. The program consists of permanent, temporary and traveling exhibits, lectures, seminars, films and cultural presentations. The African American Museum Foundation supports some of these activities.

ISSUE 1: LAO OPTION: ELIMINATE GENERAL FUND SUPPORT

The LAO has provided the legislature with the option of eliminating general fund support for the California Science Center and the African American museum.

COMMENTS

The department should respond to the impact that eliminating general fund support will have on their programs.

ITEM 1700 DEPARTMENT OF FAIR EMPLOYMENT AND HOUSING

ISSUE 1: 20-PERCENT BASE REDUCTION

The budget proposes a reduction of $3.1 million (General Fund) and 45 PYs related to the closure of two field offices (San Bernardino and Ventura) and a reduction of the Los Angeles office. The reduction will affect the investigation and processing of employment discrimination claims.

Mid-Year Reduction Action. The Governor proposed and the Legislature approved a mid-year General Fund reduction of $889,000 and 11PYs (a 5 percent reduction). The proposed budget year reduction would increase the cut from 5 percent to 20 percent.

COMMENTS:

- The department should identify the effects of the proposed additional reduction.

ISSUE 2: LAO OPTION TO ELIMINATE DEPARTMENT

The LAO has identified an option of eliminating the department and the Fair Employment and Housing Commission for an additional General Fund savings of $12.6 million (department) and $1.2 million (commission). LAO points out that federal agencies, such as the Equal Employment Opportunity Commission (EEOC) and the Department of Housing and Urban Development (HUD) also handle employment and housing discrimination claims.

The department points out that California law includes a number of protections that are not afforded in federal law. The department also conducts a significant amount of work on behalf of the federal government (and receives payment for this). Furthermore, the department cites impending federal budget cuts at the EEOC as a threat to that agency's ability to continue to process its existing workload.

COMMENTS:

- The department should respond to the LAO option for its elimination.

ITEM 1705 FAIR EMPLOYMENT AND HOUSING COMMISSION

The commission is a quasi-judicial body that adjudicates employment and housing civil rights complaints brought by the Department of Fair Employment and Housing. The commission also enforces the state's medical and family-leave laws. The Governor appoints the seven members of the commission. The budget proposes $1.3 million ($1.2 million General Fund) for the commission in 2003-04. This represents a reduction of $43,000 and 1 position from the current year. Current-year amounts include a mid-year reduction of $23,000.

ISSUE 1: LAO OPTION TO ELIMINATE COMMISSION

The LAO has identified an option of eliminating the Department of Fair Employment and Housing and the commission for an additional General Fund savings of $12.6 million (department) and $1.2 million (commission). LAO points out that federal agencies, such as the Equal Employment Opportunity Commission (EEOC) and the Department of Housing and Urban Development (HUD) also handle employment and housing discrimination claims.

COMMENTS:

- This issue is discussed under the Department of Fair Employment and Housing.

ITEM 1730 FRANCHISE TAX BOARD

The Franchise Tax Board (FTB) collects state personal income taxes and bank and corporation taxes for the State of California. In 2002-03, the board will collect an estimated $39.3 billion in tax revenues from individuals, banks and corporations. In addition, FTB administers the Senior Homeowners and Renters' Tax Assistance Program, provides processing services through contracts with other governmental agencies, and performs audits and field investigations of campaign statements and lobbyist reports authorized by the Political Reform Act. The board also collects delinquent child support payments in cooperation with the Department of Child Support Services.

For 2003-04, the budget proposes total spending of $445.2 million ($402.8 million General Fund) for the FTB. This represents a reduction of $16.5 million (3.5 percent) from the current year estimate. Almost all of the reduction is in General Fund support. Proposed staffing of 5,466 personnel-years (PYs) declines by 148.9 PYs (2.7 percent) compared with the current year.

FRANCHISE TAX BOARD
PROGRAM FUNDING AND STAFFING
(dollars in thousands)

	Actual 2001-02		Estimated 2002-03		Proposed 2003-04		Change from 2002-03	
	PY	Dollars	PY	Dollars	PY	Dollars	PY	Dollars
Tax Programs	4,683.1	$363,883	4,774.3	387,476	4,610.7	$378,678	-163.6	-$8,798
Homeowners and Renters Assist.	65.0	6,070	64.0	6,440	62.6	6,426	-1.4	-14
Political Reform Audit	17.2	1,323	16.9	1,355	16.5	1,359	-0.4	4
Child Support Collections	201.0	16,327	205.3	16,562	205.5	15,350	0.2	-1,212
Child Support Automation	122.2	28,080	114.6	28,049	111.9	19,164	-2.7	-8,885
DMV Collections	66.0	5,194	57.0	5,257	55.6	5,126	-1.4	-131
Court Collection Program	35.2	3,808	33.7	3,494	57.7	5,665	24.0	2,171
Contract Work	57.1	5,875	59.7	5,676	62.5	6,037	2.8	361
Lease Revenue Bond Payments		7,421		7,382		7,350	0.0	-32
Administration - Distributed	277.3	(22,670)	289.4	(23,437)	283.0	(22,919)	-6.4	518
Totals	5,524.1	$437,981	5,614.9	$461,691	5,466.0	$445,155	-148.9	-$16,536

Funding Sources	2001-02	2002-03	2003-04	Change	Percentage Change
General fund	$397,157	$418,159	$402,788	-$15,371	-3.7%
Motor Vehicle Funds	5,194	5,258	5,126	-132	-2.5%
Court Collection Account	3,808	3,494	5,665	2,171	62.1%
Reimbursements	31,707	34,704	30,136	-4,568	-13.2%
Other	115	76	1,440	1,364	1794.7%
Totals	$437,981	$461,691	$445,155	-$16,536	-3.6%

ISSUE 1: MANDATORY E-FILING BY TAX PREPARERS

The budget includes a reduction of $1.4 million (General Fund) and 50.5 PYs because of reduced tax return processing workload resulting from requiring e-filing by all tax professionals who file 100 or more tax returns annually. This proposal requires legislation to impose penalties on tax preparers who do not comply. The Legislature rejected this proposal in the 2002-03 budget due to concerns about eliminating taxpayers' choice of filing method.

LAO recommends the following two additional savings proposals related to tax preparers:

- Reduce the threshold for mandatory e-filing from 100 returns/year to 50 returns/year for additional savings of $140,000 and 5.5 PYs in 2003-04.

- Impose an annual fee on tax preparers for use of the special tax practitioners' telephone hotline. This would save the General Fund $1 million annually.

BACKGROUND

The FTB indicates that 60 percent of personal income taxpayers currently file using a tax preparer. The board also is expanding its direct e-filing options on its web site for taxpayers who prepare their own taxes.

COMMENTS:

- The California Society of Enrolled Agents (CSEA) has raised a number of objections to the proposal for mandatory e-filing by tax preparers. Examples of potential problems that have been identified with the proposal include the following:

- Tax preparers have no control over those taxpayers who object to e-filing.

- Some forms and schedules cannot be e-filed.

- Some taxpayers simply send their information to their preparer who then sends the completed forms to the taxpayer to review, sign, and file. The requirement for practitioner e-filing may require additional filing steps for these taxpayers.

- FTB indicates that the hotline provides useful information to tax preparers that also helps to prevent errors and reduce FTB processing costs. However, FTB also indicates that it is examining the feasibility of charging practitioners for "custom" services, such as providing updates of client estimated payments.

ISSUE 2: INTEGRATED NONFILER COMPLIANCE (INC) PROGRAM

LAO recommends an augmentation of $800,000 for 14 additional positions to expand the NIC Program in order to increase General Fund revenue by $4.4 million. The expansion would reduce the threshold for the program from $200 down to $100 of estimated tax liability.

The overall objective of FTB's non-filer compliance program is to ensure that businesses and individuals required to file tax returns in California carry out this obligation. The FTB's program uses a variety of automated and manual processes to achieve tax compliance from nonfilers. Program Has Recently Been Improved. The FTB has recently completed improvements to its nonfiler compliance program, resulting in cost savings and greater efficiencies. The new system will allow for the integration of more data into the system and lead to the identification of an additional 100,000 non-filers. The program is also expected to reduce unnecessary taxpayer intrusion by reducing the number of erroneous notices, assessments, and collection actions that have occurred in the past as a result of incomplete or inaccurate data.

Current Program Should Be Expanded. At this point, FTB has indicated that a lower threshold than $100 would only be marginally effective.

LAO Recommendation. Given the state's fiscal position currently, we recommend that the Legislature provide additional funding to FTB in the amount of $800,000, in order to expand the INC program and recognize an additional $4.4 million General Fund revenue in the budget year.

BACKGROUND

The INC Program is part of the FTB's overall nonfiler compliance program and receives federal tax returns from the Internal Revenue Service (IRS) for the last three years, wage information from the Employment Development Department, as well as various other data. By analyzing these data in an automated fashion, FTB can determine whether the records from these sources indicate that a federal return was filed or income was earned, and yet no state income tax return was filed.

FTB has recently completed development and implementation of the INC Program. The 2003-04 budget includes a reduction of $11.8 million from deleting one-time costs of the INC Project in 2002-03. In 2003-04, the project will be funded at its ongoing baseline level of $5.3 million.

Currently, once a non-filer has been identified and the data indicate that a tax liability of at least $200 is owed, the non-filer is sent correspondence from FTB about the need to file. Reducing the threshold from $200 to $100 would result in FTB contacting an estimated 120,000 additional non-filers. The non-filers would be sent a series of communications until payment is made or alternative arrangements are made with the FTB. The FTB estimates that these additional contacts would generate an additional $4.4 million in 2003-04. The overall cost of the expanded program is $800,000, resulting in a benefit-cost ratio in excess of 5:1.

COMMENTS:

- The FTB indicates that it agrees with the LAO figures and that it could implement the recommendation.

ISSUE 3: TREASURY OFFSET PROGRAM

LAO recommends that FTB report on the feasibility and cost-effectiveness of participating in the existing Treasury Offset Program in order to reduce tax collection costs and increase revenues to the General Fund.

BACKGROUND

Federal law provides for federal collection of various past due liabilities owed the state—including state tax obligations—through offsets against federal tax refunds. In return, the federal government requires states to offset certain federal obligations against state tax refunds.

Currently, 25 states participate in the Treasury Offset Program (TOP) and have reciprocal arrangements with the IRS with respect to tax delinquencies. California does not currently participate. The FTB performed a study in 1998 and determined that participation was not cost-effective for California, due to the specific requirements and limitations of the TOP.

COMMENTS:

- The FTB indicates that it continues to monitor TOP requirements, but the program remains too restrictive and costly to warrant participation.

ISSUE 4: INTEGRATED AUDIT SYSTEM

The FTB indicates that it expects to submit a Feasibility Study Report (FSR) for this project in May, begin a pilot in January 2004, and select a vendor and begin the project by April 1, 2005. The project will enhance FTB's audit system capabilities in order to tie together audits of related individuals, partnerships and corporations.

Benefit Funding. After development of the initial proposal and contract requirements, the project will be funded from the additional revenue produced—rather than standard contract payments. Consequently, the state will not need to provide cash up front for this project.

COMMENTS:

- The FTB should report to the subcommittee on the potential additional revenue from the Integrated Audit System, and the potential timing of that revenue. Could implementation be accelerated?

ISSUE 5: ABUSIVE TAX SHELTERS HIDE BILLIONS

Recently, the Internal Revenue Service (IRS) has identified billions of dollars of federal corporate tax liability that has been evaded through the use of abusive tax shelters. These tax shelters are marketed and structured by the major accounting firms, investment banking firms, and specialized promoters, who receive large fees in return. They tend to involve complex sham deals with offshore entities in tax-haven countries. Business Week, for example, reports in its March 31st edition that Enron used these types of tax shelters to achieve $2.02 billion in tax savings form 1995 through 2001.

$400 Million Currently in FTB Audits. The FTB indicates that it is currently auditing cases that it believes involve abusive tax shelters with California tax liabilities totaling about $400 million. In addition, the IRS is targeting tens of billions of dollars of unpaid federal tax liabilities from abusive corporate tax shelters. As the IRS issues assessments in these cases, many also will result in California tax assessments.

COMMENTS:

- The FTB should provide the subcommittee with a summary of the current status of its efforts to recover revenue lost to abusive tax shelters and the potential timing of additional revenue.

- The massive scale of the abusive tax shelters, their complexity and sophistication, pose new challenges for tax enforcement. The FTB should comment on the adequacy of its legal tools and audit and collection resources for this task.

ISSUE 6: FEE FUNDING FOR POLITICAL REFORM AUDITS

The budget proposes a General Fund savings of $1,359,000 in 2003-04 by replacing General Fund support for Political Reform audits with fee funding. Under the Political Reform Act of 1974, FTB conducts compliance audits of randomly chosen candidates and other political entities. The new fees would be levied on candidates, lobbyists, lobbying firms, lobbyist employers, and certain political committees. The new fee requirement would be imposed by Trailer Bill language.

COMMENTS:

- The FTB should provide the subcommittee with a specific description of how the new fee mechanism would work.

ISSUE 7: OTHER BUDGET PROPOSALS

- The FTB budget also includes the following budget change proposals:
- Reduction of $451,000 and 4.7 PYs for outreach activities.
- Reduction of $1.1 million in various program savings and out-of-state travel.
- Augmentation of $1.1 million for the full-year cost of implementing real estate withholding.
- Augmentation of $813,000 for initial moving expenses and costs for the Department of General Services associated with FTB's Phase III Building Project.
- $518,000 to continue 6 investigative positions for the Underground Economy Pilot Project.
- $422,000 to extend for two years the tenure of four limited-term legal positions to address backlogged protest cases.
- Increase of $2 million (special fund) and 24.8 PYs to serve additional counties under the Court Collections Program.
- Reduction of $2 million General Fund and increase of $940,000 from federal reimbursements for the Child Support Replacement Project.
- $355,000 from reimbursements from cities to fund 4.4 positions to provide tax information to city business tax officials to assist in the collection of city business license taxes pursuant to AB 63 (Cedillo) of 2001.

ITEM 2240 DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

The Department of Housing and Community Development (HCD) is California's principle housing agency. HCD's duties and responsibilities are focused on two main areas:

1. Administering state and federal housing, finance, rehabilitation, and economic development programs with an emphasis on meeting the needs of low-income and other disadvantaged groups; and

2. Analyzing, enforcing, and participating in the development of building codes and ensuring manufactured home construction standards meet federal and state statutory requirements.

Table 1 shows the budget's proposed spending and staffing changes for the department for the 2001-02, the current year and 2003-04.

Table 1

Department of Housing and Community Development

Proposed Spending and Staffing

(Dollars in Thousands)

				Change from 2002-03	
	2001-02	2002-03 [a]	2003-04	Amount	Percent
General Fund	$91,706	$15,126	$13,356	-$1,770	-11.7%
Bond Funds, special funds, and other financing sources	$98,965	$306,574	$509,328	$202,754	66.1%
Federal Funds	$114,683	$124,433	$124,495	$62	--
Totals, all funds	**$305,354**	**$446,133**	**$647,179**	**$201,046**	**45.1%**
Staff (personnel-years)	**520.4**	**486.6**	**507.3**	**20.4**	**4.2%**

[a] Assumes mid-year reduction of $1.3 million (General Fund) to the Emergency Housing Assistance Program, which was not adopted.

Total proposed spending for 2003-04 increases by $201 million (45.1 percent) to a total of $647.2 million. The increase in proposed spending, as well as the increase in current-year spending is from bond funds authorized by Proposition 46, the Housing and Emergency Shelter Trust Fund Act of 2002, approved by the voters in November 2002. Programs supported by the new bond funds account for $285 million of spending in the current year and $455 million of proposed spending in 2003-04. The staffing increase of 20.4 personnel-years is for implementation of bond fund programs.

After taking into account the rejection of the mid-year reduction to the Emergency Housing Program, proposed General Fund spending declines from $16.4 million to $13.4 million and primarily funds assistance to emergency shelters and operation of migrant farmworker housing.

Previous Joint Hearing. The subcommittee held a joint informational hearing with the Housing and Community Development Committee on March 13th, at which a number of HCD and other housing-related budget issues were reviewed.

PROPOSITION 46 HOUSING BOND OVERVIEW

The voters approved Proposition 46 at the November 2002 General Election. This bond act authorizes the state to issue $2.1 billion of general obligation bonds to fund 21 housing programs. The major bond allocations, as identified by the Legislative Analyst's Office (LAO), are as follows:

- **Multifamily Housing Program's ($1.11 billion).** These programs generally provide local governments, nonprofit organizations, and private developers with low-interest (3 percent) loans to finance multifamily housing projects, such as apartment buildings. Projects must reserve a portion of their units for low-income households for a period of 55 years. Infill projects near existing public services (such as public transportation) have funding priority.

- **Homeownership Programs ($405 million).** These programs encourage homeownership for low- and moderate-income homebuyers. Most of the funds are to provide downpayment assistance to homebuyers through low-interest loans or grants. Typically, eligibility for this assistance is based on the household's income, the cost of the home being purchased, and whether it is the household's first home purchase.

- **Farmworker Housing ($200 million).** These funds provide loans and grants to the developers of housing for farmworkers. Program funds are used for both rental and owner-occupied housing.

- **Other Programs ($385 million).** Additional funds are allocated for the construction of homeless shelters, incentive payments to cities and counties based on their approval of housing units, provision of mortgage insurance for high-risk homebuyers, and capital needs of local code enforcement departments.

While the Department of Housing and Community Development (HCD) will administer most of the programs, some of the programs will be administered by the California Housing Finance Agency (CalHFA).

Funds to Be Spent Over Several Years. For the programs with larger allocations of funds (such as the multifamily housing and CalHome programs), the administration proposes to award funds over as many as seven years. For some programs, such as the multifamily program, once the funds are awarded to a project, they would not be disbursed until many months later—at the time construction was completed.

Some Programs Have Limited Time Periods. For many of the funded programs, the measure limits the length of time available for the funds to be spent. After a specified length of time—between 18 and 48 months—a program's unspent funds would be reallocated to a different housing program.

ISSUE 1: PROPOSITION 46 BOND PROGRAM ADMINISTRATION COSTS

The HCD budget includes 40 positions and $3.5 million from bond funds for administration and implementation of these programs in 2003-04. The administration also has provided an overall staffing plan for Prop. 46 that totals $85 million through the life of the bond programs (4.05 percent of the bond proceeds). In some cases, projects require compliance monitoring for up to 55 years.

LAO RECOMMENDATION

LAO recommends a total reduction of $13 million (bond funds) in *planned* bond program administration costs over the life of the program in order to free up this amount for program spending. LAO indicates that most, if not all, of these savings would be after 2003-04. Based on its experience operating the farmworker, self-help, and CalHome programs over the past few years, the department proposes spending 10.1 percent, 9 percent, and 6.1 percent, respectively on administrative costs. LAO believes the department should be able to spend less on administrative costs for these programs. Specifically, LAO recommends that administrative costs for each of these bond-funded programs should be capped at 5 percent. The statute establishing the Emergency Housing Assistance Program (EHAP) limits administrative costs to 4 percent of total funds. The administration, however, proposes to spend 4.6 percent of the $195 million EHAP bond allocation on administration.

The bulk of the $13 million reduction would be in the Farmworker Housing Program—the Department proposes spending $10.1 million (10.1 percent) of the $200 million allocation for this program on administration.

COMMENTS:

The department indicates that ongoing monitoring costs for most of the bond programs will be covered, at least in part, out of interest earnings on loans made with bond funds. The farmworker housing program has used grants, and therefore has not had any supplemental funding source for ongoing monitoring costs. However, HCD also indicates that it is exploring the use of low-interest loans for farmworker housing projects that qualify for tax credits and may be able to reduce the amount of bond funds.

- The department should explain why its plan proposes higher administrative costs for the programs cited by the LAO and address whether it is possible to reduce them

ITEM 2240 DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

ISSUE 2: SUBSTITUTION OF BOND FUNDS FOR GENERAL FUND

LAO Option. The LAO has identified an option to generate General Fund savings by substituting Proposition 46 housing bond funds for General Fund monies appropriated in prior years for housing programs. These funds have been committed to specific projects, but have not yet been disbursed.

HCD Identifies Potential Funding Shift of $40 million to $65 million. The department indicates that the amount of committed, but undispersed, General Fund money was $217 million at the end of February. As an option, the LAO suggests that the Legislature could replace these General Fund dollars in the various housing programs with bond funds. The department notes that Proposition 46 changed or imposed new requirements for a number of programs. Projects in those program areas may not qualify for bond funding. However, HCD has identified about $65 million of the undisbursed project funds in programs for which Proposition 46 did not impose new requirements (primarily Farmworker Housing and CalHome). The department anticipates that the total amount of undisbursed funds will decline to about $150 million by July 1, 2003, which would include about $40 million for the Farmworker Housing and CalHome programs.

COMMENTS:

- **Precedent in Midyear Actions.** SB 19X appropriated a total of $44.1 million from Propositions 40 and 50 park and water bond funds to replace an equivalent amount of General Fund money that had been previously appropriated for Wildlife Conservation Board projects.

- **Administration Reviewing Proposal.** The Department of Finance and HCD currently are reviewing the inventory of housing projects with undisbursed funds to determine which ones legally may be shifted to bond funds.

ITEM 2240 DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

ISSUE 3: PLANADA MIGRANT SERVICES CENTER

The LAO recommends the use of Proposition 46 housing bond funds to finance the reconstruction of the Planada migrant farmworker housing facility in Merced County.

BACKGROUND

The state owns about two dozen migrant farmworker housing centers. The HCD's Office of Migrant Services contracts with local entities to operate these facilities. For the past decade, the department has been implementing a reconstruction plan to renovate the facilities (through a combination of funds from the federal government, the General Fund, and bonds). One center—the Planada facility in Merced County—is still awaiting funding. Due to the budget situation, the roughly $6 million in General Fund dollars scheduled for this project was deferred in the current year, and the Governor again proposes to defer the funding in the budget year. Due to its physical condition, the center will not be able to operate past the summer of 2003 without reconstruction. Even if reconstruction occurs, the center will have to close for up to two years to complete the work. The department operates owns three other centers that serve the Merced region—these are in Merced, Los Banos, and Atwater/Livingston. Two of these facilities are reopening this year after completion of renovations.

LAO points out that Proposition 46 includes a $25 million set-aside to build housing for migrant farmworkers. Under the program's existing statutory authorization, however, only local governments and nonprofit organizations are eligible for the funds. LAO believes that the reconstruction of the Planada facility is consistent with the intent of the program. And recommends legislation to provide bond funds for this project.

COMMENTS:

- **$4.1 million Needed.** The amount of state money needed to reconstruct the Planada Center is $4.1 million, according to HCD. Federal funds will pay for the remainder of the total $6 million cost.

- **Staff Option.** The department argues that it would like to have an opportunity to evaluate other proposals for the bond fund set-aside before committing funds to the Planada Center. The subcommittee may wish to adopt Trailer Bill language to allow the state-owned Planada Center to compete with local and nonprofit projects for the set-aside funds. This approach would allow the Planada Center project to receive bond funds if it compares favorably with other projects in terms of cost-effectiveness and need.

ITEM 2240 DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

ISSUE 4: RENT INCREASE FOR MIGRANT HOUSING

The budget proposes a reduction of $625,000 (General Fund) in local assistance funding for the Office of Migrant Services Program to be offset by a rent increase for migrant farmworkers. The proposal would increase daily rents by 26 percent--from an average of $7.78 currently to $9.78 in 2003-04 (equivalent to $293.40 per 30-day month).

HCD indicates that the last rent increase occurred in 1997-98, and that it believes that rent would not exceed 30 percent of family income after the proposed rent increase.

COMMENTS:

- **Increase exceeds inflation.** Inflation (measured by the GDP deflator) between1997-98 and 2003-04 will total 11.4 percent, as estimated by the Department of Finance. The proposed rent increase is more than twice as much.

ISSUE 5: EMERGENCY HOUSING ASSISTANCE PROGRAM (EHAP)

The budget proposes to reduce funding for EHAP from $5.3 million in the current year to $4 million in 2003-04 (General Fund). This program provides grants to local governments and nonprofit organizations that operate homeless shelters. Proposition 46 includes bond funding *for capital costs* of homeless shelters. EHAP provides *operating* funds.

Mid-Year Reduction Rejected. The Governor's mid-year reductions proposed this reduction in 2002-03. This proposal was not adopted, so that current-year funding remains at $5.3 million.

BACKGROUND

The department indicates that EHAP generally provides less than 15 percent of the total operating budgets of homeless shelters—federal and local funds, foundation grants, and donations provide the bulk of operating costs. HCD allocates EHAP money on a county basis. The proposed reduction would reduce the size of those allocations and the individual shelter grants by about 25 percent.

Funding History. EHAP was funded at $2 million annually in 1998-99 and 1999-00, then increased to $14 million and $13.3 million in 2000-01 and 2001-02, respectively. Current-year funding is $5.3 million.

COMMENTS:

- **Impact of Cut.** According to the department, shelter operating costs per bed per night average $4.50, so that the $1.3 million reduction would reduce the average number of beds available per night by 791, on a statewide basis, if support from other funding sources remains constant.

ITEM 2240 DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

ISSUE 6: REGIONAL HOUSING NEEDS ASSESSMENTS MANDATE

As with all other state-mandated local programs, the 2002-03 Budget Act appropriated only $1,000 for the regional planning mandate—in effect deferring (with interest) cost reimbursements to local governments. For 2003-04, the Governor proposes to again defer mandate cost payments throughout the budget. During this deferment, local governments are still required to follow the statutory requirements, and the state continues to accumulate a financial liability for the mandated costs. According to LAO, the deferred liability for this mandate for 2002-03 and 2003-04 will total about $5 million.

LAO Recommendations. The LAO makes the following recommendations with respect to the Regional Housing Assessment mandate:

Eliminate the mandate for cities and counties. Local governments have broad discretion to interpret the level of effort required, and, as a result, claim costs vary tremendously by jurisdiction. Moreover, LAO states that the mandate does not ensure compliance with state housing element requirements.

Suspend the mandate for regional councils of governments COGs. The regional housing planning process is not very effective at ensuring the construction of affordable housing or obtaining compliance with state law. As a result, LAO recommends suspension of the COG mandate requirement pending the enactment of reforms to the process.

BACKGROUND

Mandate for Regional Housing Assessments. Chapter 1143, Statutes of 1980 (AB 2853, Roos), significantly expanded the requirements of local housing elements by requiring additional analysis of local housing needs, particularly in relation to housing by income group. Each community is assigned numeric housing development goals by income (that community's "fair share" of housing) through a process administered by regional councils of government (COGs).

Chapter 1143 was passed after the constitutional amendment requiring mandate reimbursements for state-required activities. The state, therefore, is required to reimburse local governments for the cost of the implementation of this regional planning mandate. (The state does not pay for other portions of the housing element process in place prior to Chapter 1143.) Specifically, the state is required to pay COGs, cities, and counties for the following expenses:

- ***Regional COGs.*** Reimbursable costs include expenses related to the administrative costs of distributing the region's total housing goals to individual communities, including public meetings and any necessary revisions.

- ***Cities and Counties.*** Reimbursable costs include expenses related to reviewing the COGs' allocation and examining a variety of specialized housing factors in their housing element.

Costs Much Greater Than Budgeted. LAO indicates that from 1998-99 through 2001-02, a total of $3.5 million was appropriated through the budgets for this mandate. To date, $9.9 million in claims have already been submitted for reimbursement for those years. In other words, the costs for the allocation process have been about three times the amount that the Legislature expected. LAO also indicates that about 75 percent of the costs are associated with claims from cities and counties.

Tremendous Variation in Claim Costs. LAO has found that the amounts of the mandate cost claims vary tremendously—even for claims from similarly sized jurisdictions. For instance, the City of Corona in Riverside County submitted claims totaling about $13,000 over a two-year period, but the City of Moreno Valley (a similarly sized city also in Riverside County) submitted claims of about $265,000—20 times the amount of Corona's claims.

High Claims Do Not Ensure Compliance. Jurisdictions can still seek reimbursements even if they fail to bring their housing elements into compliance with state law. For example, Corona's housing element is currently in compliance with state law, but Moreno Valley's element is out of compliance—despite Moreno Valley spending much more on mandated activities.

Process Needs Improvement. Almost half of communities are not in compliance with state law, and some communities do not make an effort to obtain compliance. There are few incentives or sanctions to encourage local government compliance and accountability. Moreover, in its current form, the process is only a planning exercise. Little follow-up effort is made to ensure that the plans are followed and affordable housing is actually built.

COMMENTS:

- Local governments have generally have not objected to deferral of mandate reimbursements, but they request a date certain for repayment.

- AB 1158 (Lowenthal) has been introduced to revise the Local Housing Assessment process.

ITEM 2240 DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

ISSUE 7: EMPLOYEE HOUSING PROGRAM FEES

The budget proposes a $721,000 (General Fund) savings for the Employee Housing Program to be offset by a like increase in regulatory fees charged to employers who maintain the employee housing.

The program inspects employer-provided housing to ensure compliance with state standards. The fee increase would be imposed in November 2003. Currently, employer fees cover $189,000 of the program cost.

COMMENTS:

- Impact on Compliance. Increasing the regulatory fee charged to employers could reduce their willingness to provide employee housing and their level voluntary participation in the inspection program.

ITEM 2240 DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

ISSUE 8: INDIAN ASSISTANCE PROGRAM FUNDING SHIFT

The budget proposes to shift $220,000 of the $330,000 General Fund support for the existing Indian Assistance program to the California Indian Assistance Fund. This new fund would be authorized in Trailer Bill Legislation and receive revenue from existing Gaming Compact allocations in the Gaming Special Distribution Fund.

COMMENTS:

- The purpose of the Gaming Special Distribution Fund is to mitigate impacts of gaming.
- Gaming revenues support gaming tribes, and they fund allocations to nongaming tribes. An alternative to the state designating gaming funds to support HCD's program would be to provide HCD with reimbursement expenditure authority, Tribes could then determine whether to "purchase" assistance from HCD in grantwriting.

ITEM 2240 DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

ISSUE 9: OTHER PROPOSALS

The HCD budget also includes the following proposals:

- Reduction of 1 position and $110,000 from the Code Enforcement Outreach Program.
- Reduction of 1 position and $107,000 from the Office of Migrant Services Program.

No issues have been raised regarding these proposals.

ITEM 8955 DEPARTMENT OF VETERANS' AFFAIRS

(Dollars in millions)

GENERAL FUND		
2001-02	**2002-03**	**PROPOSED 2003-04**
14.8	12.9	13.0

The Department of Veterans Affairs has three primary objectives: (1) to provide comprehensive assistance to veterans and dependents of veterans in obtaining benefits and rights to which they may be entitled under State and federal laws; (2) to afford California veterans the opportunity of becoming homeowners through the medium of loans available to them under the Cal-Vet farm and home loan program; and (3) provide support for California veterans homes where eligible veterans may live in a retirement community and where nursing care and hospitalization are provided.

ISSUE 1: LAO RECCOMENDATION: FEE INCREASE SHOULD BE BROADENED

The Governor's budget has proposed to raise fees for domiciliary wing residents of California Veterans homes by 7.5 percent. In light of increases in operation costs of Veterans homes and to ensure equity in the fees paid by all residents, the LAO recommends that the fee increase be extended to both Intermediate Care Facility (ICF) residents and Skilled Nursing Facility (SNF) residents. Under the LAO proposal, member fees for ICFs (now set at 65 percent of their income) and SNFs (70 percent of their income) would increase to 72.5 percent and 77.5 percent, respectively.

The LAO is also recommending that the payment limits now imposed on fee collections for the effects of 24 percent inflation since 1994.

BACKGROUND

In order to meet the needs of California's aging veteran population, the State operates three Veteran's homes located in Yountville, Chula Vista, and Barstow, which together, house almost 1,900 Veterans. All three homes maintain the capacity to offer three levels of service: domiciliary living quarters for veterans who both live independently or require some assistance with day-to-day living; Intermediate Care Facilities (ICF's) for veterans with ongoing, daily medical needs; and Skilled Nursing Facilities for veterans whom require intensive, daily medical care. Costs accrued by offering these services are covered in part by member fees (14 percent) with General Fund Support (52 percent) and reimbursements and federal trust funds (34 percent) making up the remainder.

Member fees for residents are based on the individual level of care that they receive and their income. Domiciliary residents pay 47.5 percent of their income in member fees up to $1,200 monthly cap. Residents living in ICFs pay 65 percent of their income in member fees up to a $2,300 monthly cap and residents living in SNFs pay 70 percent of their income up to a $2,500 monthly cap.

The Governor is proposing to reverse Chapter 118, Statures of 2001 (SB 742 Escutia) that reduced member fees from 55 percent of each member's monthly income to 47.5 percent but did not change the ceiling on fees of $1,200 per month. Subsequently, this proposal would raise fees only for domiciliary residents by 7.5 percent and would not affect the ceiling on fees of $1,200 per month.

ITEM 8965 VETERANS' HOME - BARSTOW

ISSUE 1: CURRENT STATUS OF BARSTOW HOME

The Home was opened in 1996 with a 400-bed capacity. It contains 122 SNF beds, 58 Intermediate Care facility (ICF) beds, and 220 domiciliary beds. The Home had converted 55 of its domiciliary beds to a Residential Care Facility for the Elderly (RCFE) in 1999 but surrendered that license in November of 2002. The United States Department of Veterans Affairs (USDVA) does not recognize the RCFE level of care and considers such beds to be domiciliary beds.

Licensing teams found the care in the Skilled Nursing Facility to be substandard in 1999. New admissions to the skilled nursing facility were prohibited at that time. In the year 2000, a resident's death triggered a licensing survey that concluded with seven separate citations including two "AA" citations. The "AA" citations are the most serious level of citations indicating that the facility was contributing to inadequate care of residents. As a result, the Home lost all federal payments, including Medicare, Medi-Cal and USDVA per diem payments. The loss amounted to $5.5 million.

The Home contracted with various SNF consultants, and a licensed private SNF Company to manage the SNF as well as changing the internal management structure. Additionally, the Home offered recruitment and retention bonuses approved by the legislature to critical nursing classifications and changed the administrative leadership. In January of 2002, the Home regained certification and concomitant federal reimbursements.

From April 2002 through October 2002, the newly appointed Undersecretary retained top rated long-term care clinical consultants to assess the Barstow SNF. Tailored training was provided for many of the identified problems, however, the lack of staff resources and attention on a consistent basis resulted in little improvement. In August of 2002, a new SNF administrator was appointed and in September a new Director of Nursing was appointed. In October the organization was restructured to provide increased autonomy to the SNF administrator to operate that portion of the Home. In December 2002 a resident expired from medication toxicity resulting in personnel actions and the issuance of another "AA" citation in January 2003. Other potentially negative incidents are under review by the Department of Health Services and the District Attorney's Office.

COMMENTS:

The department should respond to the current status of the Barstow Veterans' Home.

ITEM 9100 TAX RELIEF

The state provides tax relief—both as subventions to local governments and as direct payments to eligible taxpayers—through a number of programs contained within this budget item. These are distinct from "tax expenditures," such as tax deductions, exemptions, and credits, which reduce tax liability. Some of the tax relief expenditures in this item, however, are amounts paid to local governments to offset some or all of their revenue loss due to a tax expenditure.

The budget proposes total 2003-04 tax relief of $1.6 billion, of which $627 million is appropriated in the budget bill. The remaining $987 million is budgeted for the "realignment portion of the Vehicle License Fee (VLF) "backfill," which is distributed to localities and budgeted through a continuous appropriation.

VLF Backfill Reduction Rejected. The Governor's Mid-Year reductions proposed eliminating the general-purpose portion of the VLF backfill. The Legislature rejected that proposal and, instead, approved a mid-year package that contemplates the activation of the VLF "trigger" to suspend all VLF backfill payments in 2003-04 and restore the VLF revenues to local governments.

After the VLF backfill, the second largest tax relief program shown in the budget is the homeowners' exemption ($420 million). This program, which is required by the State Constitution, grants a $7,000 property tax exemption on the assessed value of owner-occupied dwellings, and requires the state to reimburse local governments for the resulting reduction in property tax revenues. The exemption reduces the typical homeowner's taxes by about $75 annually. In order to accommodate the expected growth in the number of homeowners claiming the exemption, the Governor's budget proposes an increase of $5.4 million, or 1.3 percent, over the amount budgeted for 2002-03. Senior Citizens' Property Tax and Renters' Assistance ($195.8 million) provides once-a-year assistance checks to low-income seniors and disabled persons who either own a home or rent a dwelling in California.

ISSUE 1: WILLIAMSON ACT OPEN SPACE SUBVENTIONS

The budget proposes a General Fund savings of $39 million by eliminating subventions that partially reimburse local governments (primarily counties) for property tax losses under Williamson Act Open Space contracts. Since the contracts are non-cancelable under most circumstances, eliminating the subvention would result in uncompensated tax losses to local governments.

LAO RECOMMENDS PHASE-OUT. LAO recommends an alternative approach by reducing 10-percent of the subvention amounts each year. Under this approach the General Fund savings would be $3.9 million in 2003-04 and gradually increase to the full $39 million over ten years.

BACKGROUND

The Williamson Act allows cities and counties to enter into contracts with landowners to restrict their property to open space and agricultural use. In return for the restriction, the property owner pays reduced property taxes because the land is assessed at lower than the maximum level. The amount of the state subvention to localities is based on the acreage and classification of land under contract, rather than the actual reduction in local property tax revenues.

The contracts entered into between local governments and property owners are rolling ten-year contracts (20 years in a Farmland Security Zone) that are typically renewed each year for an additional year. In the event the contract is not renewed, the tax on the property gradually returns over a ten-year period to the level at which comparable but unrestricted land is taxed.

Williamson Act contracts exist in 52 counties and seven cities and cover more than 16.3 million acres of land. Subventions range from $1 per acre for nonprime agricultural land outside of a Farmland Security Zone to $8 per acre for land within three miles of a city's sphere of influence in a Farmland Security Zone.

Proposition 13 Undermined Original Rationale for Program. Prior to Proposition 13, property was regularly reassessed at its current market value. As development encroached on farmland, its assessed value rose based on its development potential. In some cases, property tax bills rose to a point where farming was no longer economical and farmers were forced to sell out to developers. The Williamson Act allowed landowners to agree to maintain their land in farming or open space in exchange for limiting assessed values to the land's agricultural value. Under Proposition 13, however, increased development potential does not result in a reassessment unless the land is sold and that higher value is reflected in the sale price. In most cases, the program now serves as a small subsidy to agriculture and rural communities, and it continues to have a limited preservation effect by delaying development in some cases.

COMMENTS:

- **Total State Costs of About $100 million.** The tax relief subventions are only one part of the state's financial participation in the Williamson Act. According to the Senate Local Government Committee, the General Fund also spends more than $60 million annually to backfill public schools for their property tax revenue losses through Proposition 98 and other school financing mechanisms. The total state cost of the program, therefore, is on the order of $100 million annually.

- **How Cost Effective?** Most of the land under contract is not under imminent threat of development. Furthermore, the property tax reduction is proportionately least for land that is bought and sold based solely on its agricultural value. The highest percentage reductions go to landowners that purchase land for much more than its purely agricultural value—for example, foothill ranches whose aesthetic value far exceeds their value for grazing or timber. Although the state may have an interest in maintaining such land in open space, it is not clear whether the property tax benefit provided by the Williamson Act serves more as an incentive or a windfall in these cases.

- **Local Governments Would Bear the Burden.** Local governments point out that it is unfair for the state to unilaterally terminate its subvention commitment while they must honor their contracts with landowners.