

AGENDA
ASSEMBLY BUDGET SUBCOMMITTEE NO. 4
ON STATE ADMINISTRATION

Assemblymember Juan Arambula, Chair

TUESDAY, MARCH 13, 1:30 PM
STATE CAPITOL, ROOM 447

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ITEMS TO BE HEARD

TAX AGENCY INFORMATION AND DATA EXCHANGE

Three state agencies play a major role in tax administration and collection. These are the Franchise Tax Board (FTB), which administers the Personal Income Tax and the Corporation Tax; the State Board of Equalization (BOE), which administers the Sales and Use Tax (SUT), fuel taxes and various other excise taxes and also oversees administration of the local property tax; and the Employment Development Department (EDD), which collects state and federal income taxes and payroll taxes through the withholding process. Each of these agencies maintains multiple information systems that, in most cases, were developed for use by that agency in a specific tax program. In contrast, most states have a single revenue department making information and data exchange between their tax systems easier. Nevertheless, relatively cheap computing power and advances in software provide opportunities for a "virtual consolidation" of the tax agencies in terms of their ability to share and exchange data both to improve collections and reduce the "Tax Gap" and to simplify paying taxes and reduce duplication for taxpayers.

LAO Report. In January, the Legislative Analyst's Office (LAO) released *A Report on Tax Agency Information and Data Exchange*. The report responded to supplemental report language adopted in conjunction with the 2005-06 Budget Act requiring the LAO to examine (1) the extent of information and data exchange among the state's three main tax administration agencies, and (2) the impediments to, and opportunities for, increasing the current level of cooperation in this regard. The language placed an emphasis on how additional cooperation could serve to improve overall tax compliance as well as aid in tax enforcement activities. LAO prepared their report using information provided by the tax agencies.

LAO's Findings

The tax agencies identified a number of short-term steps that could be taken to facilitate the exchange and use of certain tax-related data and information. Specifically, the tax agencies identified a variety of data items which are now being collected by state agencies but which are not being shared. They also highlighted various other sources of information collected by the federal government as well as by private entities that would be of use in improving tax compliance.

Over and above a greater sharing of data that are already collected, LAO identified several programs that could be established that would enhance the ability of the agencies to develop, obtain, and share data. Virtually all of these programs would entail additional funding, primarily for the purpose of addressing technological constraints of existing data systems.

Alternative Approach to Single Taxpayer ID. The Legislature specifically asked LAO to consider the value of developing a single taxpayer identification number to help ease the difficulties tax agencies have in sharing and cross-matching data. Although the use of a single taxpayer ID could greatly simplify things for the taxpayer, LAO found that it raises a number of significant administrative issues, as well as identity-theft concerns. LAO thus concluded that a single taxpayer identification number may not be the most appropriate means of linking the ability of the tax agencies to share data. Instead, LAO found that increasing the ability of the agencies to cross-match taxpayer information using their existing systems in conjunction with an alternative technology approach—with the flexibility, this would maintain for each of the agencies—seems most appropriate.

LAO Recommendations

Based upon their findings in the report and in order to ensure that timely progress is made in the area of information and data sharing, LAO recommends that BOE, FTB, and EDD appear jointly before the budget subcommittees to respond to the report and to identify the following:

1. Those cost-efficient, data-sharing actions they are planning to undertake or could undertake immediately (that is, which require no additional funding or statutory changes).
2. Relevant information and recommendations regarding other initiatives that may require legislative actions (such as statutory changes or added funding).
3. An alternative technology approach, such as using software overlays, to link existing independent tax information systems— including its costs, benefits, and time requirements.

LAO recommends that the three agencies also should collectively identify their preferred means for coordinating data-related decisions and activities amongst themselves, such as use of the already established Strategic Tax Partnership or other alternative approaches.

COMMENTS

The Subcommittee may wish to proceed as follows:

1. LAO presentation of the findings and recommendations in their report, including any assessment that can be made of the potential for improved revenue collection and for tax administration streamlining from improved information sharing systems among the tax agencies.

2. Response by each of the tax agencies (FTB, BOE, and EDD) to the LAO report and specifically addressing the three types of information identified by the LAO above. In particular, the agencies should address what steps can be taken or begun in 2007-08 to begin to develop approaches, such as software overlays, and to develop more consistent formats to incorporate cross-match data in taxpayer IDs? They also should provide their recommendations on the organizational structure needed to develop and coordinate information exchange.

3. Comments by the Department of Finance both in its budget role and from the perspective of the Office of Technology Review, Oversight, and Security.

ITEM 0860 STATE BOARD OF EQUALIZATION

The State Board of Equalization (BOE) is comprised of four members elected specifically to the board from districts 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). The BOE establishes the values of state-assessed property: inter-county pipelines, railroads, and regulated telephone, electricity, and gas utilities. The BOE also hears taxpayer appeals of Franchise Tax Board (FTB) decisions. The following table shows proposed spending by program and total staffing (in personnel-years) for the board:

**State Board of Equalization
Proposed Spending by Program**
(dollars in thousands)

Program	Actual 2005-06	Estimated 2006-07	Proposed 2007-08	Percentage Change
County Assessment Standards Program	\$8,424	\$9,303	\$9,087	-2.3%
State-Assessed Property Program	7,052	7,687	7,674	-0.2%
Timber Tax Program	1,787	2,238	2,240	0.1%
Sales and Use Tax Program	281,856	297,199	299,389	0.7%
Hazardous Substances Tax Program	3,368	4,065	4,405	8.4%
Alcoholic Beverage Tax Program	1,562	1,486	1,723	15.9%
Tire Recycling Fee Program	972	1,077	1,348	25.2%
Cigarette and Tobacco Products Tax Program	14,922	17,133	16,651	-2.8%
Cigarette and Tobacco Products Licensing Program	8,511	9,615	10,070	4.7%
Transportation Fund Tax Program	18,901	20,144	21,865	8.5%
NAFTA Program	422	1,202	1,251	4.1%
Occupational Lead Poisoning Prevention Fee Program	602	667	667	0.0%
Integrated Waste Management Program	325	427	425	-0.5%
Underground Storage Tank Fee Program	2,149	2,180	2,906	33.3%
Oil Spill Prevention Program	225	245	246	0.4%
Energy Resources Surcharge Program	222	241	242	0.4%
Annual Water Rights Fee Program	400	428	419	-2.1%
Childhood Lead Poisoning Prevention Fee Program	467	486	487	0.2%
Marine Invasive Species Program	369	422	418	-0.9%
Emergency Telephone Users Surcharge Program	569	601	606	0.8%
E-Waste Recycling Fee Program	3,817	3,840	4,487	16.8%
Insurance Tax Program	218	202	201	-0.5%
Natural Gas Surcharge Program	361	416	416	0.0%
Appeals from Other Governmental Programs	2,193	2,200	2,196	-0.2%
Administration	34,135	36,904	36,904	0.0%
Less Administration Costs Distributed to Other Programs	-33,495	-36,088	-36,088	0.0%
Total Expenditures (All Programs)	\$360,334	\$384,320	\$390,235	1.5%
General Fund	\$209,928	\$215,984	\$218,135	1.0%
Personnel-Years	3,533.8	3,766.5	3,800.5	0.9%

The Governor's budget proposes \$390.2 million (\$218.1 million General Fund), and 3,800.5 personnel-years (PYs) of staff for the BOE in fiscal year 2007-08, as shown in the table on the previous page. Total funding increases by \$5.9 million (1.5 percent), and General Fund support increases by \$2.2 million (1.0 percent), compared with spending estimates for the current year. Proposed staffing increases by 34 PYs (0.9 percent) from the current-year estimate.

ISSUE 1: ELECTRONIC WASTE RECYCLING PROGRAM

Chapter 863, Statutes of 2004 (SB 50, Sher), imposed, effective January 1, 2005, an electronic waste recycling fee upon the purchase of a new or refurbished electronic device. The fee subsidizes collection and recycling of electronic waste in order to ensure the safe and environmentally sound disposal of these devices. The fee is collected and administered by BOE, and deposited in the Electronic Waste Recovery and Recycling Account of the Integrated Waste Management Fund for use by the California Integrated Waste Management Board. The 2006-07 Budget provided BOE with 72.5 PYs of staff to collect and administer the fee. Of this staffing total, 27.7 expire June 30, 2007.

The board is anticipating a significant reduction in the number of accounts (that is, businesses involved with the fee) in the program in 2007-08, and the budget proposes to eliminate 21.7 of the 27.7 limited-term positions, but extend for two more years the remaining six PYs. The administration's proposal results in a staffing level of 50.8 PYs, a 30 percent reduction from the current year.

LAO Revises Recommendation. The Legislative Analyst's Office (LAO) originally recommended against extending the remaining 6 limited-term PYs on a workload basis. However, the board has provided additional workload justification, and LAO now recommends approval of the budget-staffing request.

Additional Fee Revenue. As a result of the workload review, however, BOE has identified an additional \$1.96 million of fee revenue that will be collected in 2007-08 for support of the E-Waste Recycling Program.

ISSUE 2: INCREASED CONSUMER USE TAX REVENUE

The budget proposes permanent status for six limited-term positions in the Consumer Use Tax Section at a cost of \$313,000 (\$203,000 General Fund and \$110,000 reimbursements) in 2007-08. The primary function of these staff is to discover private sales of vehicles, vessels, and aircraft in which the purchaser owes California Use Tax, but has not paid, or underpaid, the tax. For example, BOE reviews Department of Motor Vehicles (DMV) records to find reports of title transfer by sellers for which DMV has not received Use Tax from the buyer or for which the buyer paid Use Tax on a purchase price substantially less than the amount stated by the seller.

LAO Identifies Additional Revenue. The budget estimates that continuing this staff will generate \$4.3 million in additional General Fund revenues in 2006-07. The administration's revenue estimate reflects anticipated hiring delays and an estimated six-month training period for the staff to learn their job duties. However, LAO points out that these six positions have already been filled and have completed their training period. The BOE and LAO now agree that General Fund Revenues from this proposal will be \$1 million higher (along with \$430,000 in additional local Use Tax revenue).

ISSUE 3: SAVINGS FROM ELECTRONIC FILING SHOULD BE IDENTIFIED

The BOE has been converting to electronic technologies in the filing of tax returns and remittances, as well as the processing of these returns. The LAO points out that e-filing has advantages to both taxpayers (minimizing record keeping requirements, increased filing accuracy, and reduced costs) and to tax agencies (decreased processing time, reduced storage costs, fewer staff needed, improved data accuracy, and easier information exchange for enforcement and compliance purposes).

E-filing Reduces Costs. Processing electronically filed returns and remittances costs a fraction of the costs associated with paper documentation, according to the LAO. For example, FTB reports that about 4,800 electronic remittances are processed per staff hour compared with only 62 paper remittances processed per staff hour. A study completed for the BOE in January estimated the average cost of processing paper returns to be \$4.69 and that e-filing has the potential to significantly reduce this cost. In addition to processing savings, additional savings typically occur because the electronic submissions of remittances and returns are more accurate than their paper counterparts, thus requiring less follow-up contact with the taxpayer to correct inaccuracies.

BOE Can Make More Progress. LAO points out that BOE has made some progress in the electronic technologies and automation area but still has a substantial way to go. For instance, BOE just recently implemented electronic filing for single-location taxpayers (which account for a small proportion of total SUT liabilities), and has yet to offer electronic filing options for multiple-location taxpayers. Hence, while the agency receives about 60 percent of total SUT payments through electronic funds transfer, electronic tax filings represent only a small share of total tax returns.

Budget Proposes E-Filing Expansion. The Governor's Budget proposes to expand BOE's SUT electronic filing program to include businesses filing multiple returns and others and to automate the delinquent prepayment process. To accomplish these goals, the administration requests two positions and \$1,460,000 (\$949,000 General Fund and \$511,000 reimbursements) in 2007-08, and three positions and \$431,000 (\$280,000 General Fund and \$151,000 reimbursements) in 2008-09.

No Savings Estimate Associated With this Proposal. The Governor's proposal represents stage three of a plan to move the agency and the taxpayers it serves towards a more electronically integrated business model. However, estimates of savings to the state associated with this electronic migration have yet to be quantified. The administration's proposal indicates that savings associated with this proposal would be identified upon completion of BOE's Tax Return Processing Assessment, at which time the department would develop a cost-savings model that could be applied to the tax return processing areas affected by a reduction in paper return filings. The assessment was completed January 5, 2007, and although savings in either the medium- or long-term have yet to be identified, BOE indicates that it has begun work towards developing a cost-savings model.

LAO Withholds Recommendation Pending Savings Estimate. LAO withholds recommendation on the BOE's electronic filing infrastructure enhancements and recommends that the board report at budget hearings regarding the status of efforts to develop a cost-savings model, together with estimates of medium- and long-term savings and costs associated with increased conversion of existing registrations, tax filings, and manual processing to electronic systems.

COMMENTS

The board should respond to LAO's comments and update the Subcommittee regarding the status of a savings estimate for its e-filing expansion proposal.

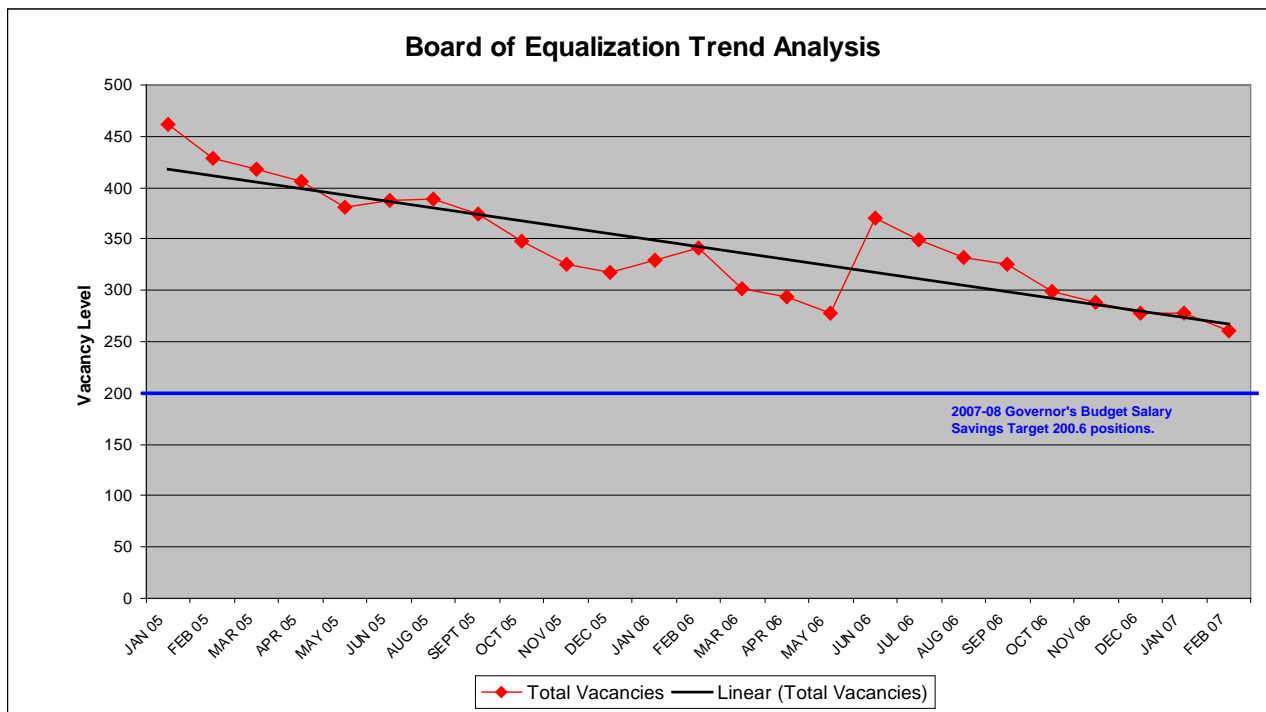
ISSUE 4: UPDATE ON RECRUITMENT AND RETENTION

During its consideration of the tax agencies' budgets last year, the Subcommittee devoted some time to the problem of recruitment and retention, which was resulting in high vacancy rates, particularly among auditors, and which had the potential to adversely affect state revenues. Staff requested the board to update the Subcommittee on the status of its efforts to improve recruitment and retention, and the BOE has provided the following information:

Report by the BOE

The Board of Equalization is pleased to announce the accomplishment of a variety of activities that enhance the agency's ability to recruit and retain a qualified workforce. The figure below shows that since January 2005 there has been a consistent lowering of the vacancy rate, except for periodic vacancy increases resulting from new positions added through the budget.

From Fiscal Year (FY) 2006-07 to date, the average vacancy rate is 7.9 percent, down from 9.2 percent in FY 2005/06. After factoring out the required salary savings, the estimated excess vacancy rate for FY 2006-07 would be 2.9 percent. Of the total vacancies, there were only 38 Tax Auditors, 42 Tax Technicians and 33 Business Taxes Representatives.



Steps That Were Taken. The BOE took several crucial steps to reduce its vacancies and associated salary savings, including the following:

- In consultation with SPB, BOE developed and implemented "Direct Recruitment Events for the high turnover entry-level positions of Tax Auditor, Business Taxes Representative, and Tax Technician in selected district offices.
- BOE implemented a streamlined examination process and recruitment process that initiates contact with candidates immediately upon their successful completion of the on line examination. The Personnel Management Division staff requests official verification of transcripts from the candidates to verify the minimum qualifications and eliminate unnecessary hiring interviews for unqualified candidates who fail to meet the minimum qualifications.
- BOE performed an in depth review of the hiring procedures and practices and identified improvements that could be achieved to expedite the internal processing of hiring documents.
- BOE implemented automatic Hire Above Minimum provisions for new State service hires to Tax Auditor classification as approved by DPA.
- BOE increased the number of agency part time recruiters from 21 to 35 throughout California and in the BOE's out-of-state offices.
- BOE used professional resources of companies such as City Career Fair, Peninsula Job Fair, and Cal Jobs for recruitment in previously untapped markets and placed print advertisements in the California Job Journal, which is read by over 286,000 job seekers each month.
- BOE used the facilities of the Orange County One Stop Job Center and its publicity resources that include 381 partners, such as Veteran Affairs groups, schools, case workers, and job developers.
- BOE implemented examination planning, preparation classes, and other training programs to assist employees in achieving greater success, both in their current positions and for future promotional opportunities.
- BOE identified companies that have announced layoffs (for example Intel) and participated, where possible, in their job fair events.

Future Strategies. The BOE will continue to implement key components of its succession and workforce planning program by: profiling its workforce flow; assessing and improving current recruitment, hiring and retention strategies; identifying, evaluation, and implementing government and industry best practices; researching potential candidate demographics and adapting strategies to attract candidates.

We continue our efforts to partner with the control agencies (i.e., the Department of Personnel Administration and the State Personnel Board) to reform the State's civil service system that includes streamlining and automating current processes.

BOE recently completed preparatory work for the Business Taxes Administrator, Supervisory Tax Auditor, and Business Taxes Compliance Supervisor classification revisions for the potential consolidation of classes. Also, we completed preparatory work for the Tax Technician, Tax Auditor, Associate Tax Auditor, and Business Tax Compliance Specialist to explore the expansion of deeper classes and the possible consolidation of these classes.

COMMENTS

Staff notes that BOE is likely to have excess salary savings from vacancies during the current year. However, if recent trends continue, the board would reduce vacancies down to around 200 (about 5 percent), which is the average number assumed in the budget for 2007-08.

The board should provide the Subcommittee with its assessment of whether the vacancy reduction trend will continue and any barriers that it faces in continuing that trend.

ISSUE 5: OTHER GOVERNOR'S BUDGET PROPOSALS

The 2007-08 Governor's Budget for BOE also includes the following proposals:

- **U.S Customs Program.** The Governor's budget proposes \$1.1 million (\$696,000 General Fund) to expand the U.S. Customs Program from five positions to 16.5 positions. This Program collects California import data from the Department of U.S. Customs and Border Protection and matches it against sales and use tax records that California-based purchasers provide to the BOE. When the records comparison indicates a purchaser failed to pay use taxes on an imported product, collection activities are initiated. The BOE estimates the additional positions will generate \$15.2 million in revenues in 2007-08, of which \$9.4 million will accrue to the General Fund and \$5.8 million to local governments.
- **Tobacco Products Manufacturer and Importing Licensing.** The budget requests \$1.15 million (\$181,000 General Fund) and 7.7 PYs (2-year limited-term) in 2007-08 to implement AB 1749 (Jerome Horton) enacted in 2006. AB 1749 eliminated the 2010 sunset date for provisions of the California Cigarette and Tobacco Products Licensing Act of 2003 (AB 71, Jerome Horton), which required BOE to license manufacturers, distributors, wholesalers, importers, and retailers of cigarette and tobacco products in the state. AB 1749 also requires manufacturers to file detailed monthly transaction reports with BOE and provides distributors some additional payment flexibility for cigarette and tobacco products taxes. The board estimates that ongoing costs will decrease to \$683,000 starting in 2008-09. Most of the cost of this proposal will be borne by Proposition 10 and Proposition 99 funds, which receive most of the revenue from the cigarette and tobacco products taxes. However, BOE estimates that this cost will be more than offset by increased revenue (\$3.4 million annually from excise taxes and \$800,000 in state and local sales tax). The budget also includes a substantial shift of funding for the existing Cigarette and Tobacco Products Tax Program. One-time retailer payments required by AB 71 will be depleted during the current year, resulting in a shift of about \$6.8 million of ongoing program costs to the funds that receive cigarette and tobacco products tax revenue—primarily the Prop. 10, Prop 99 funds, and the General Fund. This shift had been anticipated, given the one-time nature of the retailer fee. The board also indicates that it is revising its estimate of the cigarette "tax gap" as recommended by the Bureau of State Audits, but that the annual amount of uncollected cigarette and tobacco products taxes is likely to be in the range of \$160 million to \$200 million.

- **Motor Fuels Tax Proposals.** The BOE budget request includes the following proposals related to its administration and collection of motor vehicle fuel taxes:
 - **NAFTA/IFTA Hosting of Mexican Truckers.** The Governor's budget proposes \$842,000 in federal funds and 8.4 PYs to implement an interim program under which BOE temporarily maintains International Fuel Tax Agreement (IFTA) accounts for Mexican motor carriers who will begin operating in the state pursuant to the North American Free Trade Agreement (NAFTA). IFTA is an agreement among the contiguous 48 states and several Canadian provinces that simplifies the payment of taxes on fuel that is used in more than one state or province. Under this program, BOE uses federal funds to maintain IFTA records for Mexican carriers until Mexico has qualified to perform this service itself. This program was proposed in last year's budget, but implementation has been delayed. The program and federal funding are expected to continue for several years.
 - **Fuel Tax Compliance Projects.** The budget requests \$974,000 in federal transportation funds and 2 positions in order to (1) participate as a member of the Joint Operations Center for National Fuel Tax Compliance, (2) fund contract programming staff in a two-year project to enhance the Automated Schedule Processing System used for fuel tax reporting, which will enhance revenues by \$3 million annually when completed, and (3) to participate in additional federal/state task forces and committees.
 - **Motor Vehicle Fuel Tax Audits.** The Governor's budget requests an augmentation of \$715,000 (Transportation Tax Fund) and five positions to perform additional audits of fuel suppliers. The board estimates an increase of \$4.5 million in fuel tax revenues from the audits in 2007-08 increasing to \$14 million annually in subsequent years.
- **Expanded Environmental Fee Program.** The budget requests \$483,000 (fee reimbursements) and five positions to implement expansions to the Environmental Fee Program. Budget trailer legislation in 2006 (AB 1803, Committee on Budget) expanded the types of businesses subject to the state's environmental fee, which supports the Department of Toxic Substances Control, to include limited liability companies, limited partnerships, limited liability partnerships, general partnerships, and sole proprietorships.

COMMENTS

Staff is not aware of any issues or concerns raised regarding these proposals.

ITEM 1730 FRANCHISE TAX BOARD

The Franchise Tax Board (FTB) consists of the State Controller, the Chair of the State Board of Equalization (BOE), and the Director of Finance. The FTB administers the Personal Income Tax and the Corporation Tax. FTB also assists other departments and programs in the collection of delinquent debts, including delinquent child support payments (in cooperation with the Department of Child Support Services). As shown in the table below, the budget proposes total spending of \$623.4 million (\$518 million General Fund) and 5,175 personnel-years (PYs) of staff for support of the FTB in fiscal year 2007-08. Total proposed spending declines by \$139.9 million (18.3 percent) from the current year, including a General Fund spending reduction of \$44.2 million (7.9 percent). Staffing grows slightly—by 17.9 PYs, or 0.3 percent. The overall spending decrease primarily reflects a \$145.8 million (\$48 million General Fund) decline in funding for development and initial implementation of the California Child Support Automation System (CCSAS), as the development work winds down and ongoing operations are the responsibility of the Department of Child Support Services (DCSS). The budget anticipates federal certification of the system in 2008-09, which will end the assessment of \$220 million of annual federal penalties against the state. The budget includes a \$198 million savings in 2007-08 due to accrual of the reimbursement of 90 percent of the state's prior-year penalty upon federal certification.

Franchise Tax Board Proposed Spending by Program (dollars in thousands)

Program	Actual 2005-06	Estimated 2006-07	Proposed 2007-08	Percentage Change
Tax Programs	\$423,391	\$463,451	\$473,025	2.1%
Homeowners and Renters Assistance	5,786	6,317	6,321	0.1%
Political Reform Audit	1,474	1,695	-	-100.0%
Child Support Automation	199,333	253,898	108,138	-57.4%
Department of Motor Vehicles Collections Program	5,704	6,286	6,339	0.8%
Court Collection Program	6,037	10,572	12,603	19.2%
Contract Work	8,170	13,779	13,816	0.3%
Administration (costs distributed to other programs)	(23,006)	(25,134)	(24,993)	-0.6%
Lease Revenue Bond Payments	6,898	7,281	3,114	-57.2%
Total Expenditures (All Programs)	\$656,793	\$763,279	\$623,356	-18.3%
General Fund	\$503,223	\$562,159	\$517,959	-7.9%
Personnel-Years	5,281.4	5,156.6	5,174.5	0.3%

The following FTB issues raised by the LAO in their Analysis of the 2007-08 Budget will be deferred to a later hearing so that the LAO may evaluate additional information recently provided by the FTB:

1. Reallocation of Tax Gap Efforts
2. Restoration of Customer Service Levels
3. Augmentation of Legal Support for Abusive Tax Shelter Enforcement

ISSUE 1: ADDITIONAL SAVINGS FROM E-SERVICES

The LAO points out that information provided by FTB indicate ongoing growth in electronic filing of returns and remittances. This growth has occurred as a combined result of statutory mandates for tax practitioners as well as a natural migration from paper to electronic filing by individual and business taxpayers as society becomes increasingly computer oriented. The department reports that it expects 9 percent annual growth in electronic remittances through 2008, and 4 percent to 7 percent annual growth in electronic returns over the same period.

Reflecting the growth in electronic filings and remittances—and the large savings associated with the use of this technology—the department's budget for processing has been reduced almost every year since 2001-02. These annual reductions ranged from \$400,000 to about \$1 million.

The 2007-08 budget includes savings of \$298,000 due to increased electronic filing for the Personal Income Tax (PIT). However, no budget reductions were proposed related to increased electronic remittance processing or reductions in mailed and printed tax forms and booklets due to more use of online forms and other information. The board is also expanding the Business Entities E-File (BEEF) system, but did not account for any savings associated with increased electronic filing of BEEF returns.

LAO Recommends \$500,000 Reduction to Capture Savings. Based on information provided by FTB, LAO recommends a reduction of \$500,000 for 2007-08 to account for savings associated with increased use of business-entity electronic return processing, electronic remittance processing, and associated reductions in the amount of paper printing and mailings.

COMMENTS

The FTB indicates that it would prefer to retain the savings in order to offset the potential impact of the unallocated reduction that is proposed in the Governor's Budget (\$100 million in Control Section 4.05 plus an additional \$46 million that the administration proposes to offset the cost of the recent arbitration award to correctional officers).

The Department of Finance should inform the Subcommittee of the amount of FTB's potential share of the unallocated reductions and what steps the administration would take to avoid the loss of revenue.

ISSUE 2: READY RETURN TO BECOME MORE LIKE AN EXPRESS LANE

The FTB board has directed its staff to implement a form of "Ready Return" for the 2007 tax filing season, which would affect the FTB 2007-08 budget. The board estimates the cost of implementing Ready Return to be \$442,000. However, the board also estimates some offsetting savings due to reduced errors for a net cost of \$346,000 (General Fund), which will be redirected from other activities related to tax filing.

Background--Ready Return Pilot. The previous Ready Return pilot project involved mailing selected taxpayers a suggested return already filled in by the FTB, which the taxpayer could sign and file. However, taxpayers were not required to use the prepared return and could choose (and many did) to prepare and file their own returns. Ready Return was intended for taxpayers with the simplest tax situations—only wage income and the standard deduction, for example. Filing status was based on the previous year's tax return. An analysis by the FTB determined that there was very little difference (on average) between the amount of income that taxpayers reported on their federal return and the amount the FTB had identified on Ready Returns for those taxpayers who opted to use Ready Return. However, FTB did not evaluate whether Ready Return taxpayers had filing status or other changes in their circumstances that should have resulted in a different amount of tax. For example, a single taxpayer may have married, or had a child (or incurred childcare costs), or bought a house. The Ready Return packet sent to the taxpayers in the pilot included caveats about such changes, but the extent to which the participating (generally lower-income) taxpayers had such changes is unknown.

The 2005 Budget Act included language limiting Ready Return to continuation of the pilot with an expenditure cap of \$215,000 and stated that continuation beyond 2005-06 should be subject to legislation.

Changes Planned for 2007-08. Significant changes are planned for implementation in 2007-08. Basically, the FTB will no longer mail filled-in tax returns to taxpayers. Instead, Ready Return will be incorporated into the FTB's on-line filing system. When a taxpayer initiates on-line filing, the system will determine whether they meet the initial criteria for Ready Return. However, before going to a Ready Return, the taxpayer will first be asked a series of question designed to determine if there have been any changes in their situation since the previous tax year. If not, then they will pass through to a tax return loaded with their wage information and a tax calculation that they can review and submit. If they indicated that changes in their situation have occurred, then they would need to proceed through the normal on-line filing process.

These changes will mean that Ready Return would become more of an "Express Lane" for on-line filing by taxpayers with very simple tax situations that have not substantially changed. As such, it would be an extension of the FTB's ongoing efforts to facilitate on-line filing by performing calculations for taxpayers and making available to them, information, such as wages, that FTB already has.

COMMENTS

The FTB should describe its 2007-08 plans for Ready Return, differences from the pilot project, and the potential number of taxpayers who will use it.

The FTB should inform the Subcommittee as to the basis of its board's decision to proceed with the revised Ready Return project and its objectives.

The FTB also should identify the projects that will have funding diverted to cover the cost of Ready Return and whether this cost would be ongoing or one-time.

The Department of Finance (as a member of the FTB board) should indicate whether it supports the FTB's plans.

ISSUE 3: IMPROVING PARTICIPATION IN THE EARNED INCOME TAX CREDIT

The Earned Income Tax Credit (EITC) is a refundable federal tax credit available to qualified low-income workers. The amount of the credit varies from \$412 for single workers with incomes under about \$12,000 up to \$4,536 for low-income working families with three children. In addition, many families can qualify for the refundable federal Additional Child Tax Credit of up to \$1,000 per child. These federal tax credits can provide a significant income supplement to low-income working families.

However, many families who qualify for these credits do not claim them, resulting in the loss of many millions of dollars of federal funds that are available to help support California families. Another problem is that some unscrupulous tax preparers charge exorbitant fees for preparing claims. The tax forms and worksheets required to claim these low-income tax benefits are complex and can appear intimidating to the average taxpayer. In some cases, local governments and community organizations have stepped in to offer free or low cost tax help to low and moderate-income families focused on the EITC. One example is the Greater Los Angeles EITC Campaign Partnership, sponsored by the Los Angeles Children's Planning Council with the City of Los Angeles, Los Angeles County, and other partners.

Qualifying families may claim the EITC retroactively for up to three years, so there is a large potential to recover unclaimed credits.

The FTB web site and tax booklet mention the EITC and refer taxpayers to the Internal Revenue Service EITC web site for assistance.

COMMENTS

1. The FTB should describe its current efforts to facilitate legitimate claiming of these federal tax credits by California families. What more could be done in terms of outreach and information?
2. Would it be feasible for the FTB to play a more active role in making taxpayers aware of the EITC and the Additional Child Credit and possibly assisting them in claiming those credits? For example:
 - Would it be feasible to incorporate an EITC estimator in the FTB's e-filing system that would automatically notify taxpayers that they appear to qualify for the EITC or Additional Federal Child Credit and, if they indicate that they have not already claimed those credits, provide an estimate of the amount along with some instructions about how to go about filing the appropriate federal tax forms?
 - Would it be feasible for FTB and the State Controller to include a note with refund checks to lower-income working families to remind those taxpayers about the EITC and Additional Federal Child Credit?

ISSUE 4: UPDATE ON RECRUITMENT AND RETENTION

During its consideration of the tax agencies' budgets last year, the Subcommittee devoted some time to the problem of recruitment and retention, which was resulting in high vacancy rates, particularly among auditors, and which had the potential to adversely affect state revenues. Staff requested the board to update the Subcommittee on the status of its efforts to improve recruitment and retention, and the FTB has provided the following information:

Report by the FTB:**Status of Auditor Attrition**

Our Audit Program has experienced a 5-6% Attrition Rate in the last 6 months. 42 of the 708 auditors, program specialists and related administrators have either moved on or retired

- 26 of the 42 (or 4%) of staff has moved on
- 16 of the 42 (or 2%) has retired

The audit staff that has moved on has gone to:

- The IRS or other Government agency (receiving a 10-25% pay increase)
- The private sector (receiving a 100% pay increase)

Historical Attrition

- FY 04/05 – a reduction of 36 audit staff
- FY 05/06 – a reduction of 37 audit staff
- FY 06/07 – a reduction of 26 audit staff YTD
 - Retirements are up 400% from FY 05/06
 - We will lose 45 audit staff this year if current attrition rate continues

Status of Audit Vacancies

- 100 vacancies (in April 2006)
- 45 vacancies (in March 2007, with plans to hire 8 staff)
- Our goal is to fill all existing vacancies with the June 2007 hiring class

FTB Efforts to Improve Audit Recruitment and Retention

- In early 2006, we doubled our audit recruitment staff, which in turn:
 - Increased our visibility on college campuses
 - Increased the number of qualified applicants for Internet Tax Audit exam
 - In November 2006, we implemented an Internet Tax Auditor exam

- We already have 450 candidates on list vs. 250 candidates in previous years
- The open Associate Tax Auditor (ATA) list is complete
 - We are hiring our first new class ever of ATA's in Spring, 2007
- We are constantly monitoring our audit workloads for changes in complexity to justify promotions, and have increased the number of audit promotions since the beginning of this fiscal year.
- We are currently working with BOE and EDD on joint task forces addressing:
 - Hiring new auditors at the top step of the Tax Auditor range
 - Coordinating recruitment efforts to optimize hiring pool and the use of recruitment funds.
- In January 2007, an additional step was added to the auditor, program specialist, and administrator classifications to improve our ability to retain long-term employees. Although this may increase auditor longevity overall, it is unlikely that this step is having any current effect on attrition numbers. We are proposing a deep-class of Tax Auditor and ATA classes to SPB and DPA this spring.

Current Recruitment and Retention Efforts in Collections

We currently have one full-time recruiter representing Collections. We are making every effort to increase our visibility throughout the state. We have a presence at University business programs, job fairs, career fairs. This has resulted in a 20% increase in applications received over the last 18 months.

The Compliance Representative Exam is planned to go on line in March/April 2007.

- A new certification list will be issued weekly.
- Collections currently has an Employee Retention Taskforce
 - Captures vacancy/turnover rate data from FY 2002/03 forward
 - Conducts exit interviews upon employees leaving area or agency
 - Exit interview information is utilized for staff retention planning

Is there a Backlash in Collections Due to Audit Classification Receiving a Raise?

- No - Although this was previously a concern, it was addressed by giving a raise to the Administrative series
 - Revising the Principal Compliance Representative (PCR) classification salary has been under discussion, as it is very similar to Audit's Program Specialist classification. A study was conducted to potentially request a deeper class for the PCR series. Specifically, a request for a deeper class was made for the PCR II class. Although the study has been completed, it has not yet left the department.

COMMENTS

The FTB should provide the current vacancy rates for audit and collection staff and compare them with last year.

What is FTB's overall salary savings percentage so far this year and how does it compare with the amount assumed in the Governor's Budget for 2007-08 (5.9 percent)?

ISSUE 5: OTHER GOVERNOR'S BUDGET PROPOSALS

The 2007-08 Governor's Budget for FTB includes the following additional proposals:

- **E-Commerce Portal Infrastructure.** The budget requests \$1.5 million (General Fund) and one position to replace the current Internet infrastructure at the Butterfield Way campus in Sacramento and provide redundancy to accommodate growth and provide enhanced dependability and security in the FTB's e-commerce programs. These programs facilitate taxpaying by providing 24/7 online filing services both to tax professionals and individuals, as well as other capabilities previously done by mail or phone. This request represents year one of a three-year project with total costs expected to be \$4.5 million. The budget also includes a separate request for \$298,000 to provide a single point of control over the FTB's internet servers.
- **Public Disclosure of Delinquent Taxpayers.** The budget requests one limited-term position and \$144,000 (General Fund) to implement AB 1418 (Horton) of 2006. This legislation requires the FTB to compile a list of 250 taxpayers with the largest delinquencies over \$100,000 and to make the list public on a quarterly basis (the same requirement also applies to BOE). The FTB estimates that this action will result in collection of \$30 million of additional General Fund revenue in 2007-08 and \$5 million annually thereafter.
- **Elimination of Tax Clearance Certificate Requirement.** The budget recognizes a General Fund savings of \$1.3 million and a reduction of 18 positions due to the enactment of AB 2341 (Villines), which eliminated a requirement for businesses to obtain a tax clearance when they closed down and in some cases suspends liability for the annual or minimum franchise tax.

COMMENTS

Staff is not aware of any issues or concerns raised regarding these proposals.

ITEM 9100 TAX RELIEF

The Governor's Budget includes a total of \$689 million for the Tax Relief item in 2007-08. This is a slight increase from estimated spending in the current year of \$682 million (all General Fund). The largest component of tax relief spending is for constitutionally-mandated subventions to local government to replace property tax revenue lost due to the homeowners' exemption.

- **Senior Citizens' Tax Relief Programs.** The budget provides a total of \$203.5 million to fund Senior Citizens' Property Tax Assistance and Deferral Programs and Senior Citizens' Renters' Assistance in 2007-08. This is the same amount as estimated current-year spending on these programs. However, provisional language included each year allows for augmentation by the Director of Finance, if necessary, subject to legislative notification.
- **Williamson Act.** The Governor's budget fully funds Williamson Act subventions for open space preservation at \$39.1 million.

COMMENTS

Staff is not aware of any issues or concerns raised regarding this item.