California State Assembly

Assembly Budget Agenda

Subcommittee No. 5 on State Administration

Assemblymember Sharon Quirk-Silva, Chair

Tuesday, February 18, 2025

Upon Adjournment of Session – State Capitol, Room 447

Items To Be Heard

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7730 Franchise Tax Board - Governor's Trailer Bill Proposals

The following four issues summarize the Governor's January trailer bill proposals under the purview of the Franchise Tax Board.

Issue 1: Military Retirement Exclusion Trailer Bill Language (TBL)

The Governor's budget includes trailer bill language to provide tax relief for California families with members who served in the military and to improve the state's competitiveness in attracting and retaining military retirees to the state.

Specifically, this proposal would, beginning in tax year 2025 and through tax year 2029, exclude from income for state tax purposes up to $20,000 in:

(1) Retirement pay received by a taxpayer from the federal government for services in the uniformed services; and
(2) Annuity payments received by a qualified taxpayer pursuant to a Department of Defense Survivor Benefit Plan.

The income exclusion is available for individuals or heads of household with up to $125,000 in income and joint filers who do not exceed $250,000 in adjusted gross income.

Background. Both federal and California law currently tax military retirement income and survivor benefits as income. Out of the 41 states that impose an income tax, California is the only state without a full or partial exemption. Currently, there are 29 states that fully exempt military retirement pay and survivor benefits while 11 have partial exemptions. The most common partial exemption is to limit the exemption to a specified dollar amount. Idaho has the most generous partial exemption, exempting up to $40,000 of qualified retirement benefits including military retirement pay for single filers and over $60,000 for joint filers. The states with the least generous exemptions include Delaware (up to $12,500 for all filers of age 60 and over; $2,000 if under 60), Vermont (up to $10,000 of exempted income with Adjusted Gross Income limits of $60,000 for single filers; $75,000 for joint filers) and Maryland (up to $12,500 for age 55 and under; up to $20,000 for over 55). Finally, Oregon has a very limited partial exemption that only applies to military service prior to October 1991. As of 2023, California is home to over 141,000 military retirees.

This proposal is estimated to lead to a revenue loss of $130 million in 2025-26, and $85 million ongoing thereafter.

Revenue Losses ($ in Millions)	2025-26	2026-27	2027-28	2028-29	Total
Military Retirement Pay Exclusion with Income Thresholds of $125,000/$250,000	-$130	-$85	-$85	-$85	-$385

LAO Comments:

Provides Some Tax Relief. The partial income tax exclusion of military retirement income would reduce state taxes for 130,000 veterans in the state. The maximum benefit available under the proposal equates to a $600 tax reduction for the average military retiree. The tax savings would be larger for military retirees with higher incomes, most commonly working veterans with nonmilitary wages. Conversely, the tax savings would be smaller for military retirees with minimal tax liabilities.

Moves California More In-Line With Other States. Under the proposal, California would no longer be the only state to fully tax military retirement benefits. Due to the relatively modest exclusion ($20,000) and income limitations, California's tax treatment of military retirement benefits would nevertheless remain among the country's most limited.

Compared to Balance of Factors That Influence Location Decisions, Proposal's Financial Incentive Is Minor. Taxpayers make decisions about where to live and work based on a complex balance of factors that includes job prospects, community preferences, cost of living, climate, quality of government services, and local tax levels. Relative to these broader factors, the proposal's financial incentive is minor. Therefore, the income tax exclusion is not likely to change many veterans' decisions about where to live after their service. As such, the proposal likely achieves little on the administration's stated goal of making the state a more competitive destination for military veterans. That said, under the proposed change, the state would no longer be the only state that fully taxes military retirement income. In this sense, although it is a small financial incentive, the proposal may well improve veterans' perception of California.

Weak Economic Rationale to Exclude Military Retirement Income from Taxation. Providing tax relief to military veterans with retirement income who already live in the state is not likely to provide compelling economic benefits to the state. Tax expenditures are often put forth to encourage certain behaviors or spur economic activity that benefits the state or other groups. Yet neither outcome is likely to occur to a noticeable extent under this proposal. As such, the proposal does not have a strong economic rationale when compared to alternative uses of these funds, either for a different tax expenditure or other state spending. For their part, these alternatives could have positive benefits that should be weighed against the potential benefits of the proposal.

Tax Expenditures Should Clear High Bar. Relative to spending proposals, tax expenditures tend to be reviewed less rigorously once they are adopted. Furthermore, again relative to spending proposals, assessing the effectiveness of tax expenditures is challenging given the limited information the state receives about taxpayers who benefit. As such, proposed tax expenditures should clear a very high bar for adoption.

Considerations: Path Forward Depends on What Legislature Hopes to Achieve. Our assessment is that the economic and fiscal rationale for this proposal is weak. Nonetheless, we recognize that other factors often are relevant to the Legislature's decisions. In assessing the administration's proposal, the Legislature will need to decide if these other factors are enough to support this tax change. If the Legislature simply wants to provide limited tax relief to veterans, that might also improve veterans' perceptions of the state, it could adopt the administration's proposal. If the Legislature instead prefers that this tax expenditure have a clear economic or fiscal rationale, it could reject the administration's proposal.

Panel

- Robin Finnestead, Department of Finance
- Chas Alamo, Principal Fiscal & Policy Analyst, Legislative Analyst's Office

Staff Comments

The Administration put forward this tax exclusion to provide tax relief for California families with members who served in the military and improve the state competitiveness in attracting and retaining military retirees to the state. With all proposals, the Assembly will have to prioritize funding for this tax exclusion against other priorities in the budget.

Similar legislation has been introduced in the Legislature by Assemblymember Ramos:

- AB 53 (Ramos and Pacheco, 2025), similar to this bill, would have excluded from gross income retirement pay received for service in the uniformed services and annuity payments received from a Survivor Benefit Plan.

- AB 46 (Ramos, 2024), similar to this bill, would have excluded from gross income retirement pay received for service in the uniformed services and annuity payments received from a Survivor Benefit Plan. The bill was held under submission on the Suspense File of the Senate Appropriations Committee

- AB 1623 (Ramos, 2022), similar to this bill, would have excluded from gross income retirement pay received for service in the uniformed services and annuity payments received from a Survivor Benefit Plan. The bill was held under submission on the Suspense File of the Assembly Appropriations Committee.

- AB 291 (Seyarto, 2021) and AB 1629 (Seyarto, 2022), would have excluded from gross income survivor benefits and payments received under a Survivor Benefit Plan. Both bills did not pass out of the Assembly by the constitutional deadline.

- AB 2380 (Choi, 2020), would have excluded from gross income survivor benefits and payments received under Survivor Benefit Plans. The bill did not pass out of the Assembly by the constitutional deadline.

The Subcommittee may wish to ask the administration how they will measure the effectiveness of this tax exclusion over the next five years.

Staff Recommendation: Hold Open.

Issue 2: Wildfire Settlements Exclusion TBL

The Governor's budget includes a proposal to exclude from gross income all wildfire settlement payments paid from 2025 through 2029, irrespective of when the fire occurred. While its timing of applicability is different, it aligns with the Federal Disaster Relief Act of 2023 by applying the exclusion to the extent that losses, expenses, or damages compensated by the settlement payment are not compensated for by insurance or otherwise. This proposal would provide certainty on the taxation of wildfire settlements for California families experiencing hardship after a wildfire disaster instead of requiring separate legislation for each separate settlement.

There is no fiscal impact that is budgetarily scored because the bill is prospective and future wildfire settlements are generally not included in the state's revenue forecasts due to the unpredictability and volatility of disasters.

Background: According to the Department of Finance, federal and state tax treatment of settlement claims, absent a specific legislative exception, depend on the type of settlement. Settlements for personal physical injuries or physical sickness are generally not taxable. Settlements for property loss or damages to property are also generally not taxable up to the adjusted cost basis of the property. On the other hand, settlements for emotional distress or mental anguish and settlements for lost wages or lost profits are generally taxable. Whether settlement claims or portions of settlement claims from a wildfire trust fund are taxable depends on the type of settlement and facts and circumstances of the case.

The "Federal Disaster Tax Relief Act of 2023" was enacted on December 12, 2024. The bill allows individuals impacted by a federally declared wildfire disaster and those who received settlements as compensation to exclude that money from their gross income on their federal taxes. The bill is largely retroactive and covers any wildfire disasters federally declared in 2014 or later and applies to payments received from 2020 through 2025. The exclusion only applies to the extent that losses, expenses, or damages compensated by the payment are not compensated for by insurance or otherwise.

Existing law provides gross income exclusions for settlement amounts related to: the 2015 Butte Fire (AB 1249, Chapter 749, Statutes of 2022), the 2017 Thomas Fire (SB 1246, Chapter 841, Statutes of 2022) and North Bay Fires (AB 1249), the 2018 Woolsey Fire (SB 1246), the 2019 Kincade Fire (SB 131, Chapter 55, Statutes of 2023), and the 2020 Zogg Fire (SB 131).

The 2020 Bobcat Fire, 2021 Dixie Fire, and the 2022 Mill Fire are not covered by a gross income exclusion.

Panel

- Robin Finnestead, Department of Finance
- Chas Alamo, Principal Fiscal & Policy Analyst, Legislative Analyst's Office

Staff Comments

A bedrock of tax policy is a consistent application of tax policies to all taxpayers, it is odd, especially in the context of a disaster, that the state would not apply the law the same across all taxpayers.

The Subcommittee may wish to ask the following:

1. Why is the Administration not proactively trying to include all fires?

2. Does the Administration or the FTB have an estimate of the impact to the General Fund of the cost from the previously uncovered fires? What has been the impact on the General Fund from previous fires?

Staff Recommendation: Hold Open**.**

Issue 3: Pass-Through Entity Elective Tax Extension TBL

This proposal extends the Pass-Through Entity Elective Tax (PTET) from 2026 through 2030, subject to a trigger if the federal cap on the state and local tax (SALT) deduction is extended. Additionally, beginning in tax year 2026, it allows business entities to make a late prepayment, subject to a 12.5-percent reduction in the credit generated from the late payment.

If the federal SALT cap is extended beyond 2025, this proposal extends the state's PTET to provide certainty to California taxpayers that it will continue to be available to mitigate the negative federal tax impacts of the federal SALT cap.

Additionally, the proposal allows a taxpayer to make a late prepayment in case of a missed or underpaid June prepayment. The amount of the prepayment that is late is subject to a penalty wherein the generated PTET credit is reduced by one-eighth (12.5 percent), which is intended to incentivize taxpayers to pay their anticipated prepayment amount prior to the deadline.

Background: Under current federal law, as adopted in the 2017 federal Tax Cuts and Jobs Act, California personal income taxpayers are limited to deducting no more than $10,000 of SALT payments on their federal returns. However, business entities can still fully deduct state and local income taxes paid under federal law.

In response, the 2021-22 Budget enacted a new PTET that allows taxpayers who have income from pass-through entities to electively pay a tax at the business entity level and receive a personal income tax credit for the same amount. In so doing, tax liability is shifted from the individual's personal income tax to the business entity and the effect of the SALT limitation is mitigated, with no negative impact to state revenues. The PTET is scheduled to sunset after 2025 along with the federal SALT cap.

Under current law, taxpayers are required to make a prepayment in June that is the greater of $1,000 or 50 percent of the taxpayers' PTET liability in the prior year. Late prepayments are not allowed, hence a taxpayer who misses the deadline or underpays the required amount is unable to participate in the PTET for that year, losing the federal tax benefits. This structure was put in place to prevent distortive impacts on fiscal year revenues by aligning the PTET payments made by business entities with the personal income tax estimated payment, which are affected by PTET credit usage.

The proposal does not have any budgetary scoring because the 2025-26 Governor's Budget forecast, consistent with current law, assumes that the SALT cap sunsets at the end of 2025 and, therefore, the PTET would not be operative after tax year 2025.

Finance estimates that in its first three years since its inception in 2021, the PTET has saved California taxpayers approximately $3.5 billion to $4 billion per year on their federal taxes.

Panel

- Nicholas Thomas, Department of Finance
- Chas Alamo, Principal Fiscal & Policy Analyst, Legislative Analyst's Office

Staff Comments

The approval of this tax proposal is consistent with current state policy and provides some certainty for taxpayers moving forward with 2026 tax year before federal action is taken. The implementation of this bill is dependent on the passage of an extension of the federal SALT cap.

Staff Recommendation: Hold Open.

Issue 4: Mandatory Single Sales Factor Apportionment for Financial Institutions TBL

The Governor's budget proposes trailer bill language to remove savings and loan activity, and banking or financial institutions from a three-factor to single sales factor apportionment beginning in tax year 2025.

Multi-state and multi-national corporations pay taxes in California by computing how much of their taxable income is apportioned to California using an apportionment factor that represents its share of business activity in the state divided by its total business activity in the U.S. or in the world. There are different apportionment formulas that can result in a higher or lower apportionment factor depending on the characteristics of a given corporation. The three-factor apportionment formula is calculated using the share of a company's property, payroll, and sales in California divided by its property, payroll, and sales in the U.S. or the world. The single sales factor apportionment formula, on the other hand, is calculated using only a company's sales in California divided by its sales in the U.S. or the world.

Since the passage of Proposition 39 in 2012, most corporations have been required to use single sales factor apportionment for calculating how to apportion their profits to California for state tax purposes. However, financial institutions (including savings and loan businesses), extraction companies (mining and oil and gas businesses), and agricultural producers have since 1994 been subject to a separate apportionment formula than other businesses and were not affected by Proposition 39's requirement to use single sales factor apportionment. Instead, they continued to use three-factor apportionment, which uses a company's payroll and property factors, in addition to their sales factor.

According to the Administration, this proposal aligns financial institutions with most other corporations by requiring them to use single sales factor apportionment beginning in tax year 2025. The single sales factor formula is generally more advantageous to firms with more property and payroll in the state as they can exclude those factors from their apportionment calculation. Conversely, apportionment formulas with more weight on property and payroll, such as the three-factor apportionment, are advantageous to firms that do not locate their property and payroll within the state. Therefore, this proposal to move financial institutions from three-factor apportionment to single sales factor apportionment encourages economic development in California.

Moving savings and loan businesses and financial institutions to single sales factor apportionment is estimated to generate the following multiyear revenue gains:

Dollars in Millions	2025-26	2026-27	2027-28	2028-29	Total
Single Sales Factor for Financial Institutions	$330	$280	$260	$270	$1,140

LAO Comments:

Some Firms Would Pay More and Some Pay Less, but Net Revenue Increase Expected. The Governor's proposal would generate winners and losers among affected firms. Increasing the weight placed on sales (thereby reducing the weight on property and payroll) would reduce the tax burden for firms with a significant physical presence in the state while increasing the tax burden for firms located outside the state but who have a high concentration of California sales. The Administration anticipates the latter effect is larger and, therefore, estimates that shifting financial institutions to SSF will increase revenues by $330 million in the budget year, declining slightly to $270 million by 2028-29.

Firms May Make Strategic Decisions in Response to Change. Businesses impacted by the Governor's proposal could make different location and sales choices that impact economic growth in California. On one hand, SSF may incentivize financial institutions to increase their physical presence in the state, thereby generating new jobs and spending. On the other hand, an increased weight on sales made in California could discourage firms located elsewhere from providing financial services—such as loans—in California, which could negatively affect economic growth.

Empirical Evidence Provides Weak Support for Economic Development Effects. The existing literature does not provide strong support for the claim that shifting to SSF has a meaningful effect on economic development. One reason for this result is that a lot of the benefit of a reduced tax burden on property and payroll accrues to firms already located in-state and do not expand in response to the change. This is also known as a windfall benefit. Another issue in California is the interaction between apportionment and other tax rules. Specifically, when the base corporation tax rate is higher, the incentive provided by SSF to relocate employees and property is smaller. Since California has both a high tax rate for financial institutions and a throwback rule that increases the share of sales attributed to California, the economic development effect of SSF for these firms is reduced.

Rationale for Industry-Specific Exemptions Does Not Apply to Financial Institutions. There are two primary justifications for allowing exemptions from an apportionment formula. First, an exemption may result in fairer apportionment: Businesses in agricultural and extractive industries typically have a fixed production location but may make a relatively small fraction of their sales in California, and thus have a disproportionately low tax liability under SSF even though they benefit from the state's natural resources and public infrastructure. Therefore, apportioning their income via the three-factor method may be more appropriate. Financial institutions do not have the same location dependence and can make sales in California regardless of where they are physically located, so SSF is appropriate from a fairness perspective. Second, some states provide exemptions to apportionment as a tax incentive to specific industries. However, given that financial institutions already have a higher corporate income tax rate (10.84 percent) than the base rate (8.84 percent), it seems unlikely that these businesses would fall into this category.

Panel

- Nicholas Thomas, Department of Finance
- Rowan Isaaks, Economist, Legislative Analyst's Office

Staff Comments

This proposal was considered by the Subcommittee last year as a budget solution but was not ultimately adopted as part of the final budget because there was not adequate time for public input on the proposal.

Staff Recommendation: Hold Open

7730 Franchise Tax Board

Issue 5. AB 518 Data Sharing for CalFresh

The Governor's budget proposes an augmentation of $161,000 (General Fund) and one permanent position in 2025-26 and $154,000 (General Fund) in 2026-27, and ongoing to implement Assembly Bill 518 (Wicks, Chapter 910, Statutes of 2024) by facilitating the distribution of data to California Department of Social Services (CDSS) in accordance with federal and state laws and FTB's policies and procedures.

Background. Among its provisions, AB 518 authorizes the FTB to share data with the California Department of Social Services (CDSS) for the purpose of improving the administration of CalFresh, increasing CalFresh participation, measuring the impact of CalFresh, and increasing access to critical public health and poverty-alleviating services and other services and benefits available to low-income individuals.

Existing California law permits the Franchise Tax Board (FTB) to release individual tax information to specific state agencies. Agencies must have a specific reason for requesting the information, including investigating items of income disclosed on any return or report, verifying eligibility for public assistance, locating absent parents to collect child support, or locating abducted children.

Existing federal law establishes the Supplemental Nutrition Assistance Program (SNAP), known in California as CalFresh, under which supplemental nutrition assistance benefits allocated to the state by the federal government are distributed to eligible individuals by each county. Existing law also authorizes the California Department of Social Services (CDSS), under CalFresh provisions, to administer outreach programs and adopt rules and regulations requiring counties to conduct outreach programs to the extent permitted by federal law and eligible for federal financial participation.

AB 518 requires FTB to partner with CDSS to identify data-sharing opportunities, and to provide data where appropriate and as supported by statute. This work requires both external engagement with CDSS and internal coordination between FTB's business areas.

Panel

- Thi Luong, Franchise Tax Board
- Rowan Isaaks, Economist, Legislative Analyst's Office
- Cynthia Elmore, Finance Budget Analyst, Department of Finance

Staff Comments

The requested resources will allow FTB to share data with CDSS under AB 518. Staff has no concerns will the requested resources and recommends approval on a future vote-only calendar.

Staff Recommendation: Hold Open.

Issue 6: Asset Forfeiture Account Spending Authority Increase

The Governor's budget includes an increase in spending authority for the Asset Forfeiture Account for Fiscal Year (FY) 2025-26. FTB is requesting to increase the spending authority from $740,000 to $2,500,000 to purchase permissible resources for FTB's Criminal Investigation Bureau (CIB) activities that support our strategic goals.

Background. FTB's CIB is made up of sworn peace officers who serve the people of California by investigating violations of the Revenue and Taxation Code in a manner that maintains public confidence and encourages compliance. CIB participates on various federal, state, and local task forces that investigate financial crimes and has had equitable sharing agreements with the US DOJ, US DOT, and the CA DOJ. Participation in these task forces and agreements has allowed FTB to receive an equitable share of assets seized in criminal activities in which FTB aided.

One investigation of significance that CIB participated in involved Rabobank National Association, which was found guilty of felony conspiracy for obstructing regulators and concealing deficiencies in its anti-money laundering program. Rabobank was ordered to forfeit $368,701,259 in FY 2018-19, of which FTB received its equitable share totaling more than $20 million dollars. The success of this investigation is the main source of FTB's Asset Forfeiture Account balance of $21,513,212 (as of June 2024).

On October 30, 2024, FTB was notified by the US DOJ and DOT that because it is not an independently funded law enforcement agency, FTB is no longer eligible for continued participation in the Equitable Sharing Programs. This means, no new funds will be added to the account, however, FTB may expend all federal shared funds currently on hand for permissible purposes by June 30, 2026.

Panel

- Thi Luong, Franchise Tax Board
- Rowan Isaaks, Economist, Legislative Analyst's Office
- Cynthia Elmore, Finance Budget Analyst, Department of Finance

Staff Comments

The Subcommittee may wish to ask the following:

- Will FTB be able to expend all the federal shared funds before the June 30, 2026 deadline with this requested change?
- What can FTB use the equitable sharing program funds for?

Staff Recommendation: Hold Open.

Issue 7: Enterprise Data to Revenues Project Phase 2

The Governor's budget requests an augmentation of $107,075,000 and the full time equivalent of 42.0 permanent positions, and 4.0 limited-term positions for the fifth-year implementation of the Enterprise Data to Revenue (EDR2) project, which is the second phase of the Tax System Modernization (TSM) plan. The resources received from this proposal will allow FTB to continue supporting the optimization of business processes throughout the EDR2 life cycle.

Background. The Franchise Tax Board (FTB)'s legacy systems are using outdated technology and need modernization. In fiscal year (FY) 2025-26, FTB will be entering the fifth year of the Enterprise Data to Revenue Project 2 (EDR2)'s project implementation. EDR2 is vital to FTB's operations. The technology currently supporting two out of three of FTB's major legacy systems (Accounts Receivable Collection System (ARCS), Integrated Nonfiler Compliance (INC), and Professional Audit Screening and Support System (PASS)), which annually allow FTB to collect over $4 billion in compliance revenue, are nearing end-of-life and will no longer be supported after December 31, 2025. Replacing these systems before they reach end-of-life will ensure FTB business operations generating significant compliance revenue for the state will not experience any critical failures. Additionally, the EDR2 project will deploy new tools to assist taxpayers in complying with their obligations as well as enhance FTB's compliance activities.

The EDR2 project's Request for Proposal (RFP) was released on April 30, 2019. In May 2020, FTB received the final proposals with proposed solutions from the bidders. Contract Award to the contractor was made in June 2021 and the project began July 1, 2021. Since then, FTB's State and vendor staff have been planning, designing, and implementing various pieces of the multi-year project. Following the statewide process to support funding for larger projects, an annual Budget Change Proposal is required for new costs related to that year.

Panel

- Roger Lackey, Franchise Tax Board
- Rowan Isaaks, Economist, Legislative Analyst's Office
- Cynthia Elmore, Finance Budget Analyst, Department of Finance

Staff Comments

Staff has no concerns will the requested resources and recommends approval on a future vote-only calendar.

Staff Recommendation: Hold Open.

7600 California Department of Tax and Fee Administration

Issue 8. AB 3128 Unflavored Tobacco List

The Governor proposes $3.5 Million in 2025-26 for CDTFA to implement AB 3128 (Chapter 849, Statutes of 2024) and SB 1230 (Chapter 462, Statutes of 2024), which enact the Unflavored Tobacco Product List and includes enforcement authority for flavored tobacco products and tobacco product flavor enhancers. Once the Department evaluates the actual impact resulting from the legislation, particularly regarding enforcement, CDTFA will recommend and request the necessary resources such as fee adjustments and additional spending authority.

CDTFA has identified workload costs of $3.3 million in 2024-25, $5.5 million in fiscal year 2025-26 and 2026-27, and $3.1 million in 2027-28 and ongoing from the Compliance Fund. Resources for implementation work of $3.3 million in 2024-25 and $2 million in 2025-26, will be absorbed by CDTFA, thereby reducing the request for the identified workload costs.

Background. California's existing law, SB 793 (Chapter 34, Statutes of 2020) prohibits tobacco retailers or any of their agents or employees, from selling, offering for sale, or possessing with the intent to sell or offer for sale, a flavored tobacco product or a tobacco product flavor enhancer. The CDTFA is not currently authorized to seize flavored tobacco products unless excise taxes have not been paid, nor does CDTFA currently have access to a comprehensive list of products to identify unflavored tobacco products.

The passing of AB 3218 and SB 1230 will impact nearly 30,000 cigarette and tobacco account holders, including retailers, wholesalers, and distributors, and will provide CDTFA with the authority to properly implement and administer the mandate of AB 3218. The hazardous waste destruction component of seizing illegal products is the costliest part of this process. The destruction process involves destroying illegal product, through an external vendor, four times a year at two different warehouses.

CDTFA noted in its analysis of AB 3218, that a combination of lower-than-expected penalty revenues and the contract requirements necessary to destroy the seized products, could create pressure to increase licensing fees or obtain other General Fund support to keep this program operating and the Compliance Fund solvent. While AB 3218 allows for a penalty per individual package, it is unclear how much revenue will be generated. Since any additional revenue is unknown, the costs related to this work create a structural imbalance (expenditures exceed revenues) in the Compliance Fund.

LAO Comments:

CDTFA's Enforcement Activities. CDTFA is spending substantially fewer resources on its tobacco programs than it was before the pandemic. In 2018-19, the tax program had 75.6 filled positions, and the licensing program had 64.3 filled positions. In 2023-24, these programs had 53.2 and 41.9 filled positions, respectively.

Licensing Inspections and Citations Have Declined. Over the last few years, two key measures of the licensing program's enforcement activities have declined. The number of inspections conducted in 2022-23 and 2023-24 was 52 percent lower than in 2020-21 and 2021-22. Over the same period, the number of citations issued dropped by 24 percent. These drops are particularly striking given that staff concerns about COVID-19 exposure likely diminished substantially over that period.

Seizures Have Remained Roughly Constant. In contrast to inspections and citations, the number of tobacco seizures grew by 3 percent. CDTFA reports that it has developed a more targeted approach, focusing the diminishing number of inspections on retailers who are more likely to be out of compliance. Consistent with this, the citation rate and seizure rate per inspection have grown substantially. This makes each inspection more productive but also more resource-intensive due to the staff time associated with enforcement actions.

Many Possible Explanations for Trends in Citations and Seizures. As noted above, one explanation for the growing citation rate and seizure rate is that CDTFA is targeting its inspections more efficiently. Another possibility, however, is that the underlying rate of compliance has declined. This could occur for a variety of reasons. For example, due to the flavor ban or other factors, consumer demand for illicit tobacco products could be growing over time. If so, this could make noncompliance more lucrative for businesses, leading to lower compliance, which in turn could drive up the citation rate and seizure rate per inspection

Proposal Sets Up Decision Next Year. The Cigarette and Tobacco Products Compliance Fund had a $2 million surplus in 2023-24 and entered 2024-25 with a $12 million balance. In principle, these resources, together with the proposed augmentation, should cover the cost of implementing these laws without any need to redirect resources away from other aspects of the licensing program. This, however, is only a temporary solution. In 2026, the Legislature will need to decide how much to appropriate for this program on an ongoing basis. It also will need to assess whether the new penalty revenues are sufficient to maintain the fund's structural balance. If not, the two main alternatives are (1) a statutory increase in licensing fees, or (2) cuts to other aspects of the licensing program.

Proposal Heightens Concerns About Hiring and Retaining Inspectors. Under the Governor's proposal, CDTFA should have adequate budgetary authority to take on the new statutory responsibilities without detracting from its existing responsibilities. In practice, however, budgetary authority might not be the most binding resource constraint. CDTFA has struggled just to fill tobacco enforcement positions provided under its existing appropriations. This calls into question how much of the proposed spending actually will materialize. We are concerned that these responsibilities ultimately could spread existing enforcement resources even more thinly.

Panel

- Nick Maduros, Director, California Department of Tax and Fee Administration
- Jason Mallet, Chief Financial Officer, Financial Management Division, CDTFA
- Seth Kerstein, Economist, Legislative Analyst's Office
- Cynthia Elmore, Finance Budget Analyst, Department of Finance

Staff Comments

The LAO raises a number of questions that the Subcommittee may wish to ask:

- What are the major ways that consumers obtain untaxed tobacco products? What strategies do CDTFA and other law enforcement partners use to address these avenues for tax evasion?
- Why has the number of tobacco inspections declined so much?
- We have seen workload trends presented in terms of total inspections, seizures, citations, and appeals. The Administration has noted that these measures can be difficult to interpret. For example, when CDTFA seizes a retailer's noncompliant products, this counts as one seizure, regardless of the total amount of product seized. Can the administration provide workload measures that account for some of these limitations?
- What steps has the administration taken to improve recruitment and retention of tobacco enforcement personnel? What additional steps could be taken?
- What will happen if CDTFA cannot expand its tobacco enforcement workforce despite its growing responsibilities? How could the department could modify its approach to enforcement to manage this situation?

Staff Recommendation: Hold Open.

Issue 9: Centralized Revenue Opportunity System (CROS) Maintenance and Operation

The California Department of Tax and Fee Administration includes $9.3 million in 2025-26 and 2026-27. The request includes $6.1 million in contract services for maintenance and operations (M&O) and $3.2 million for the GenTax Software License. This request will fund the use of the vendor FAST who has advanced knowledge of the system and thousands of site-specific technical configurations that support day-to-day changes and prompt maintenance of the system. In addition, the vendor will assist with the most complex GenTax application system changes, program updates, and monitoring services

Background. CROS is an information technology modernization effort that enabled CDTFA to expand tax and fee payer services, to improve the efficiency and effectiveness of its operations, and enhanced ability to generate increased revenues reducing the tax gap.

The current M&O contract is based on two, 2-year optional periods for contract services. The first period was executed August 17, 2021, through August 16, 2023, and the second period is August 17, 2023, through June 30, 2025, to align with the state fiscal year. Near the end of the term for the current contract, CDTFA and FAST will need to negotiate an ongoing contract to continue the M&O services.

CROS was implemented using FAST Enterprises' GenTax, a commercial-off-the-shelf (COTS) proprietary software. With GenTax being a proprietary COTS software and the need to customize specific tax program requirements, CDTFA must retain vendor support to assist with program updates and complex changes to the system. A budget augmentation is necessary to fund the continued M&O costs associated with CROS.

CDTFA will continue to work in partnership with FAST staff in implementing day-to-day changes and enhancements. CDTFA supports California’s state and local government finance system by administering 41 tax and fee programs that generated revenue of $96.2 billion in 2022-23. In addition to the $65.2 billion in state revenue, CDTFA distributed more than $31 billion to California’s counties, cities, and special tax districts.

Panel

- Jason Mallet, Chief Financial Officer, Financial Management Division, CDTFA
- Seth Kerstein, Economist, Legislative Analyst’s Office
- Cynthia Elmore, Finance Budget Analyst, Department of Finance

Staff Comments

The requested resources will ensure that CDTFA continues to administer 41 tax and fee programs. Staff has no concerns will the requested resources and recommends approval on a future vote-only calendar.

Staff Recommendation: Hold Open

0950 State Treasurer's Office

Issue 10: Jesse Unruh Building Relocation Costs

The State Treasurer's Office (STO) requests a one-time General Fund augmentation of $735,000 for relocation costs associated with its transition back to its headquarters, the Jesse Unruh Building, located at 915 Capitol Mall, Sacramento. STO staff members are scheduled to return to the Jesse Unruh Building in fall 2025. The STO will manage the relocation of approximately 516 staff members, equipment, and office furniture. In addition, funds are needed for IT network equipment essential for establishing the Local Area Network (LAN), Wide Area Network (WAN), and network security infrastructure at the renovated headquarters. The required funding is not included in the DGS Jesse Unruh Building Renovation Project costs.

It is further requested that provisional language be added to this item as follows to conform to this action:

> *3. Of the amount provided in this item, $735,000 is provided on a one-time basis to cover the cost of relocating staff and building contents to the State Treasury Building. Notwithstanding any other law, the Director of Finance may authorize expenditures in excess of the amount provided, if deemed necessary but not sooner than 30 days after notification in writing of the necessity therefor is provided to the chairpersons of the fiscal committees in each house of the Legislature and the Chairperson of the Joint Legislative Budget Committee, or not sooner than whatever lesser time the chairperson of the joint committee, or the chairperson's designee, may in each instance determine.*

Background. The STO is headquartered in the state owned, DGS managed, Jesse Unruh building located at 915 Capitol Mall in Sacramento. DGS submitted a FY 2021/22 Capital Outlay Budget Change Proposal (COBCP) in January 2021 requesting $123M in funding from the Public Buildings Construction Fund for the design-build phase of the Jesse Unruh Building Renovation Project. DGS submitted a COBCP in May 2022 to request an additional $63M related to the renovation. The project required that STO tenants move from the Jesse Unruh building to a temporary swing space to facilitate this renovation. Now that renovations to the building are expected to be completed by fall of 2025. Consequently, the STO is requesting $735,000 to meet this need.

LAO Comments:

The Legislature should expect future expenses related to STO's relocation. In particular, the department expects higher lease costs (paid to DGS) after their move.

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Panel

- Karma Manni, Chief of Fiscal Services, Administration Division, STO
- Naraj Sardana, Application Management Section Manager, Information Technology Division, STO
- Greg Bruss, Principal Program Budget Analyst, Department of Finance
- Tuyen Le, Finance Budget Analyst, Department of Finance
- Alexander Bentz, Economist, Legislative Analyst's Office

Staff Comments

The 2021 Budget Act included $1.2 million for relocation costs to move out of the Jesse Unruh Building and the 2022 Budget Act included an additional $266 million in funding for relocation costs with provisional language for additional costs. The requested resources are consistent with the past request.

Staff Recommendation: Hold Open.

Issue 11: Expenses and Equipment True-Up, Personal Services True-Up, and Support Application Development

This item summarizes three budget change proposals by the STO for resources related to expenses and equipment true-up and support application development for the STO's IT division.

Background.

1. *Expenses and Equipment True-Up.* The State Treasurer's Office (STO) Information Technology Division (ITD) requests an ongoing appropriation and corresponding funding augmentation of $520,000 ($312,000 General Fund and $208,000 Central Services Cost Recovery Fund) to its operating expenses and equipment (OE&E) budget to address the critical gap between actual recurring IT operational expenses and the current allocated OE&E budget. This request seeks to resolve a significant budgetary gap resulting from underfunding in the current OE&E allocation, ensuring the retention of essential security technologies and tools, and supporting ITD's transformation efforts, including cloud adoption and modernization initiatives.

2. *Personal Services True-Up.* The State Treasurer's Office (STO) Information Technology Division (ITD) requests an ongoing appropriation augmentation and corresponding funding increase of $536,000 ($322,000 General Fund and $214,000 Central Services Cost Recovery Fund) to fully fund personal services costs for all 42.5 authorized positions.

3. *Support Application Development.* The State Treasurer's Office Information Technology Division (STO-ITD) requests expenditure authority, and corresponding reimbursement funding, to support the growing application development, modernization, and hosting needs of the Boards, Commissions, and Authorities (BCAs) under the purview of the Treasurer. The additional funding will cover new application development, operations, and cloud hosting costs, specifically through Microsoft Azure, to meet the digitization and modernization objectives of BCAs. The total request for the budget year is $869,000 (Special Fund), with $444,000 in ongoing reimbursement authority.

LAO Comments:

Proposals Fund Already Approved Personnel and Activities. The governor's proposals do not fund any new positions or programs. In previous years, the department funded these programs with existing funding from other areas within their budget. Therefore, we note that the proposed funding increase will likely not result in additional programs or services.

Seek Details on Previous Savings. We recommend that the Legislature seek additional information on the savings used in previous years to fund the activities mentioned in this proposal. This will allow the legislature to weigh this proposed funding increase against likely cuts if this proposal is not approved.

Panel

- Naraj Sardana, Application Management Section Manager, Information Technology Division, STO Greg Bruss, Principal Program Budget Analyst, Department of Finance
- Tuyen Le, Finance Budget Analyst, Department of Finance
- Alexander Bentz, Economist, Legislative Analyst's Office

Staff Comments

The Subcommittee may wish to ask the following:

1. Per the LAO comment, can the STO provide information on the savings that were used in previous years to fund these activities and what will the STO not be able to fund without a true up of funds?

Staff Recommendation: Hold Open

0971 California Alternative Energy and Transportation Financing Authority

Issue 12: Position Authority Augmentation

The California Alternative Energy & Advanced Transportation Financing Authority (CAEATFA) requests seven (7) permanent positions using existing funding from a 2022-23 Budget Change Proposal which provides support and technical assistance for the California Hub for Energy Efficiency Financing (CHEEF) program. The increased staffing resources will enhance the support for CAEATFA's demanding infrastructure needs. All requested positions will be funded with existing appropriation authority.

Background.

To assist the State of California's ambitious renewable energy efficiency goals, the California Public Utilities Commission (PUC) authorized the establishment of the California Hub for Energy Efficiency Financing (CHEEF) program in 2013 to help leverage ratepayer and private financing by using new and innovative strategies to attract and leverage private capital. Since then, the CHEEF program has greatly evolved from a new and inexperienced program to a robust and sophisticated one. The CHEEF program has successfully created a centralized platform to serve as an open-market infrastructure to encourage additional private capital investment for energy efficiency and demand response measures. With the rapidly growing multiple market sectors (GoGreen Home, Business and Multifamily), the CHEEF program outgrew the staffing level needed to sustain and accommodate the growth.

The CHEEF program is experiencing a surge in consumer and lender participation. In direct relation to this increase, the administrative support for this program has become more complex and demanding. Additionally, CAEATFA has received $30,000,000 in additional funding from the California Energy Commission (CEC). The department anticipates receiving additional funding from the federal National Clean Investment Fund (NCIF) to implement the expansion of financing for green energy upgrades, which is in alignment with the current CHEEF program.

The current 19 permanent positions allocated to support the program is inadequate to meet the growing needs and demands of the program. This proposal requests additional seven (7) positions beginning in FY 2025-26 to support the continuity of operations and to address the steady increase of administrative support activities related to the CHEEF programs as well as any additional new program(s). The requested positions will use existing funding authority approved from a 2022-23 Budget Change Proposal. CAEATFA proposes to fund the requested seven (7) positions by redirecting approximately $1,347,000 currently used for the Electric & Gas Industries Association (EGIA) contract.

The 2022-23 BCP included $27.4 million for 2022-23 through 2026-27, and requested five permanent staff positions.

Budget Request FY 2022/23 – FY 2026/27
(Dollars in thousands)

BY FY 2022/23	BY+1 FY 2023/24	BY+2 FY 2024/25	BY+3 FY 2025/26	BY+4 FY 2026/27	Total
$6,011	$5,554	$5,448	$5,193	$5,239	**$27,445**

According to CAEATFA, the increased staffing will allow the time for programmatic and monitoring of the process, bringing visibility to any issues the lenders or borrowers may have, the feasibility of the program both fiscally and administratively, and the positive outcomes the programs are creating. The positions requested will execute the work from various permanent workloads, including marketing, research, position control, data analyses, contracts, invoices, processing, quality assurance, etc.

3-YEAR EXPENDITURES AND POSITIONS [1]

		Positions			Expenditures		
		2023-24	2024-25	2025-26	2023-24*	2024-25*	2025-26*
0850	California Alternative Energy and Advanced Transportation Financing Authority	24.3	10.0	10.0	$5,511	$38,327	$7,921
TOTALS, POSITIONS AND EXPENDITURES (All Programs)		**24.3**	**10.0**	**10.0**	**$5,511**	**$38,327**	**$7,921**

ORGANIZATIONAL UNIT Classification	POSITIONS Filled 2023-24	Authorized 2024-25	Proposed 2025-26	EXPENDITURES Actual 2023-24 (Salary Range)	Estimated 2024-25	Proposed 2025-26
Administration						
Exec Director	1.0	1.0	1.0	$12,261-13,662	$163,944	$163,944
Staff Services Manager II Supervisory	1.0	1.0	1.0	7,420-9,219	110,628	110,628
Staff Services Manager I	0.7	1.0	1.0	6,760-8,398	95,214	99,976
Associate Governmental Program Analyst	3.0	3.0	3.0	5,684-7,114	235,243	242,730
Executive Assistant	1.0	1.0	1.0	4,461-5,583	66,996	66,996
Staff Services Analyst	1.0	2.0	2.0	3,640-5,916	98,412	100,596
Office Techn (Typing)	1.0	1.0	1.0	3,609-4,518	43,488	45,657
Temporary Help	15.6	21.0	21.0	(1,197,552)	1,576,132	1,643,174
Overtime	-	-	-	(1,670)	-	-
TOTALS, AUTHORIZED POSITIONS	**24.3**	**31.0**	**31.0**	**$1,946,026**	**$2,390,057**	**$2,473,701**
Regular/Ongoing Positions	*8.7*	*10.0*	*10.0*	*746,804*	*813,925*	*830,527*
Temporary Help	*15.6*	*21.0*	*21.0*	*1,197,552*	*1,576,132*	*1,643,174*
Overtime	-	-	-	*1,670*	-	-

LAO Comments:

The proposal does not request new funding. However, the current funding authority expires after 2026-27, meaning the positions will require new funding authority in future years. We recommend that the legislature consider the future of the program before approving an expansion of permanent positions.

Panel

- Christina Sarron, Executive Director, CAEFTFA
- Matthew Westbrook, Staff Finance Budget Analyst, Department of Finance
- Alexander Bentz, Economist, Legislative Analyst's Office

Staff Comments

Staff notes that although the positions are requested as permanent, CAEATFA will have to return to the Legislature in 2026-27 for additional resources to fund the five positions authorized in 2022-23 plus the additional seven included in this proposal.

The Subcommittee may wish to ask the following:

1. Can the department and/or DOF explain the difference between permanent positions included in the galley under "3 Year Expenditures and Positions" and Permanent Positions captured under "Temporary help"? Why are the majority of positions for CAEATFA under temporary help?

Staff Recommendation: Hold Open.

0981 California Achieving a Better Life Experience (CalABLE)

Issue 13: Eligibility Expansion Outreach

The Governor's budget includes a request for $182,000 (General Fund) ongoing for the addition of one Associate Governmental Program Analyst (AGPA) at the California Achieving a Better Life Experience Board (CalABLE), in response to federal changes in age eligibility. The AGPA would allow CalABLE to develop a marketing, outreach, and public education program for newly eligible people with disabilities.

Background. Since 2018, CalABLE has provided low-cost, tax-advantaged savings and investment accounts for individuals with disabilities. CalABLE is California's implementation of the federal Stephen Beck Jr. Achieving a Better Life Experience (ABLE) Act, signed into law in 2014. The purpose of ABLE accounts is to allow eligible individuals with disabilities to save and grow their wealth without affecting access to benefits. Individuals can make nondeductible cash contributions to a CalABLE account owned by themselves or by other eligible persons.

Funds in a CalABLE account are exempt from the standard means tests for state and federal benefits. For example, persons receiving Supplemental Security Income (SSI) can typically have no more than $2,000 in cash or savings, but funds in a CalABLE account are exempt up to $100,000. Without a CalABLE account, it can be very difficult – if not impossible – for many individuals with disabilities to save for major living or disability expenses, such as a vehicle, a service animal, or a rental deposit.

To be eligible for a CalABLE account, an individual can be any age, but they must have a disability that began before the age of 26, and the disability must be listed as eligible for disability benefits by the Social Security Administration. Because of changes in federal law, the number of eligible individuals will rise significantly. The ABLE Age Adjustment Act, signed in December 2022, will increase the maximum age of disability onset from 26 to 46 beginning in 2026. In California, the National Disability Institute's projections reflect more than 700,000 new potential account holders – an increase of 50 percent. At present, CalABLE has four total staff to run administrative and programmatic operations. There are two AGPAs dedicated to outreach, including one that specializes in Spanish-language communication.

Panel

- Thomas Martin, Executive Director, CalABLE
- Greg Bruss, Principal Program Budget Analyst, Department of Finance
- Francisco Mata, Finance Budget Analyst, Department of Finance
- Alexander Bentz, Economist, Legislative Analyst's Office

Staff Comments

Because of the limited staffing at CalABLE, the requested resources are justified to address the increased workload and recommends approval on a future vote-only calendar.

Staff Recommendation: Hold Open.