AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 4
ON STATE ADMINISTRATION

ASSEMBLYMEMBER WENDY CARRILLO, CHAIR

TUESDAY, MAY 9, 2023

1:30 PM – STATE CAPITOL, ROOM 447

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We encourage the public to provide written testimony before the hearing. Please send your written testimony to: BudgetSub4@asm.ca.gov. Please note that any written testimony submitted to the committee is considered public comment and may be read into the record or reprinted.

*To provide public comment, please call toll-free number: **877-692-8957 / Access Code: 131 54 47***

VOTE-ONLY CALENDAR

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VOTE-ONLY CALENDAR

VOTE-ONLY ISSUE 1: REMOVAL OF PROVISION 1 – POSITION CONTROL

The Governor's budget includes the elimination of provisional language from the budget act items from the Board of Equalization, the Franchise Tax Board, and the Department of Tax and Fee Administration that required notification to the Joint Legislative Budget Committee if specified positions were redirected from their intended purposes.

BACKGROUND

The Governor's budget includes the elimination of Provision 1 but does not provide any notification or rationale as to why they view this provision as unnecessary at this time for all three departments. The Legislature may wish to consider alternate proposals before removing the Legislative control established in Provision 1 language for specified departments.

Staff Recommendation: Reject Proposal.

7730 FRANCHISE TAX BOARD

VOTE-ONLY ISSUE 2: DIGITAL WORKFLOW MANAGEMENT/LOW-CODE PLATFORM (SPRING FINANCE LETTER)

BACKGROUND

The Administration proposes in an April Finance Letter to provide the Franchise Tax Board (FTB) with $1.83 million, ($1.79 million General Fund and $35,000 special funds), for two permanent positions, one limited-term position, and software costs in 2023-24; $1.55 million, ($1.52 million General Fund and $30,000 special funds), for two permanent positions, one limited-term position, and software costs in 2024-25; $1.91 million, ($1.87 million General Fund and $36,000 special funds), for two permanent positions, one limited-term position, and software costs in 2025-26; and $1.49 million, ($1.46 million General Fund and $28,000 special funds), for two permanent positions and software costs in 2026-27 and ongoing. These resources will replace obsolete legacy and custom-coded solutions and implement a new, enterprise-class low-code service management platform that will reduce risks, sustain legacy integration efforts, and improve service delivery for both internal and external customers.

Staff Recommendation: Approve as Budgeted.

VOTE-ONLY ISSUE 3: MANAGEMENT ENTERPRISE LICENSING AGREEMENT RENEWAL (SPRING FINANCE LETTER)

The Administration proposes in an April Finance Letter to provide the Franchise Tax Board (FTB) $1.83 million, ($1.81 million General Fund and $27,000 Special Funds) in 2023- 24, $1.91 million, ($1.88 million General Fund and $29,000 Special Funds) in 2024-25 and ongoing to establish a fully funded, permanent baseline budget to continue existing licensing and support subscription for existing mainframe software that allows FTB to keep its existing mission critical applications running.

BACKGROUND

FTB's mainframe is essential to the mission-critical accounting and noticing systems and is relied on by all tax processing systems. The mainframe supports application systems essential to the filing, collections, audit, non-filer, and refund processes, websites, and phone lines. All these systems have substantial dependency on the data that resides within the mainframe and processing that is done by the mainframe and therefore, rely on the mainframe to support the efficient, effective, and secure operations of those applications.

The authorized software entitlements, maintenance, and support that allow FTB to perform these operations are licensed through an Enterprise Licensing Agreement (ELA). Historically, FTB partners with California Department of Technology (CDT), and CDT works with the Department of General Services (DGS) to negotiate the contract renewal for software licenses under a common ELA with the goal of achieving volume pricing and lower total cost for the state. The current contract was negotiated by CDT in September 2022.

FTB's current budget allocation is not able to absorb ongoing funding increases associated with this contract without impacting existing business operations. The prior mainframe ELA resulted in annual payments of $2.40 million each year and a lump-sum cost of $4 million the first year. The new ELA results in costs of $4.10 million in FY 2022-23, $4.23 million in FY 2023-24, $4.31 million in FY 2024-25. This creates a funding gap of $1.70 million, $1.83 million, and $1.91 million respectively.

Staff Recommendation: Approve as Budgeted.

VOTE-ONLY ISSUE 4: SECURITY AND ACCESS MANAGEMENT (SPRING FINANCE LETTER)

The Administration proposes in an April Finance Letter to provide the Franchise Tax Board (FTB) $1.81 million, $1.77 million (General Fund) and $35,000 special funds, for two permanent positions, and software costs in 2023-24; $1.55 million, $1.52 million (General Fund) and $30,000 special funds, for two permanent positions and software costs in 2024-25, $1.58 million, $1.55 million (General Fund) and $31,000 special funds, for two permanent positions and software costs in 2025-26 and ongoing to reduce security risk by implementing a solution to add Privileged Access Management (PAM) capabilities and improve login security by integrating multi-factor authentication (MFA) into FTB's public web applications in compliance with Cal-Secure direction.

BACKGROUND

System Access: Privileged Access Management (PAM): Privileged access is a higher level of permission to make changes to a given system, application, or data. PAM is a strategy that includes policies, processes, procedures, and tools that govern how privileged access is controlled. Where appropriate, privileged access is granted to staff, vendors, systems, and applications. PAM helps FTB meet IT security compliance requirements. PAM also reduces the risk of misuse of privileged access, which in turn reduces the risk to FTB's business from the loss of confidentiality, integrity, or availability of systems, applications, and data.

Multi-Factor Authentication (MFA): MFA is a security enhancement that requires at least two pieces of evidence from the registrant when logging into an account and is an important part of any modern authentication method. FTB uses MFA in its employee and vendor authentication but has yet to implement a method in our public web applications with external tax professionals, business representatives, and individual taxpayers. Currently, once accounts are set up, our external applications require only authentication by single factor of a user ID and password combination. This single method is non-compliant with FTB Information Security Policy 9500 Section 215; SAM (State Administrative Manual) Policy 5360, Identity and Access Management Section; Cal-Secure Strategic Plan; and IRS Publication 1075. Adding an additional method of authentication, such as a one-time passcode response where the user must use an additional channel of communication, such as a phone call or text, and reply with a generated code, would significantly improve FTB's login security.

Over the past several years FTB's Technology Services Division (TSD) has consistently been asked to implement changes and adopt new workloads through legislative change or change requests. At the same time, FTB must provide ongoing technical maintenance activities to ensure its systems and related infrastructure are on supported versions and contain the latest security patches so that FTB can continue to safeguard taxpayer information and provide timely return-processing services to a variety of key stakeholders (e.g., taxpayers, tax preparers). These factors have contributed to FTB's TSD struggling to fulfill the responsibility of complying with evolving security policies and standards and reducing departmental security risks and accomplish all other mandated or necessary workloads, negatively impacting the public services supported by the revenue FTB generates.

As a result, FTB has begun a comprehensive review of resources, both positions and tools that support our technology work for all functions. This proposal focuses on resource gaps impacting privileged access and multi-factor authentication.

STAFF COMMENTS

Staff Recommendation: Approve as Budgeted.

ITEMS TO BE HEARD

7730 FRANCHISE TAX BOARD

ISSUE 1: INCOMPLETE NON-GRANTOR TRUSTS

The Governor's budget includes proposed trailer bill language to include the income of an incomplete non-grantor trust in the gross income of the grantor. This would effectively close a tax loophole that allows a grantor to avoid paying California income tax on incomplete non-grantor trust set up in another state.

BACKGROUND

A trust is a fiduciary relationship in which one party, the grantor, gives a second party, the trustee, the right to hold title to property or assets for the benefit of a third party, the beneficiary. There are two broad classifications of ordinary trusts under federal tax law:

Grantor trust. If the grantor retained enough power over the property they transferred to the trust — to manage and dispose of it, even return it to themselves under some circumstances — that they should be treated as continuing to own it, the trust is likely to be classified as a grantor trust. Neither the federal government nor the states treat a grantor trust as a distinct taxable entity. Consequently, all trust income, whether or not it is distributed to beneficiaries, is reported on the grantor’s individual income tax return in the year in which it is realized.

Non-grantor trust. If the grantor truly gave up control over the property when transferring it to the trust, the trust is classified as a non-grantor trust, because the grantor is no longer involved in managing the investment or distribution of the assets. Non-grantor trusts are considered separate, taxable entities under federal and state income tax laws.

In recent years, there has been increased use of an additional type of trust:

Incomplete non-grantor trusts. These trusts differ in that they allow a grantor to appoint a non-resident trustee in a non-income tax paying state to oversee the trust. The trustee has administrative power over the trust, and as a result, the trust is treated as a separate taxable entity from the person who set up the trust. Therefore the grantor does not report the income on their personal return as a California resident, but, unlike a non-grantor trust, the grantor still reserves some power over the assets, such as naming new beneficiaries or changing interests amount the beneficiaries.

Proposed Language. The proposed trailer bill language, for taxable years beginning on or after January 1, 2023, would include the income of an incomplete non-grantor trust in gross income of the grantor for state tax purposes. Preliminary cost estimates from Department of Finance assume a $30 million revenue gain in 2023-24, with revenue gains of roughly $17 million in subsequent years. This policy would likely impact 1,300 taxpayers in first year, then down to around 600 taxpayers after that, assuming behavior changes. Currently only New York has a similar law preventing incomplete non-grantor trusts. This proposal is modeled on the New York solution to address the increasingly aggressive use of incomplete non-grantor trusts to shelter wealth.

	Grantor	***Non-Grantor***	***Incomplete Non-Grantor (ING)***	***Law Change Impact to ING***
Control of Assets	*Retained by Taxpayer*	*Controlled by Trust*	*Substantially Retained by Taxpayer*	*No Change*
Gift Tax Paid	*No*	*Yes*	*No*	*No Change*
Income Taxes Paid to CA	*Paid by taxpayer on personal income tax return*	*Income reported on Trust return as relevant*	*Not reported for CA purposes by any entity if the trustee is a non-resident*	***Paid by taxpayer on personal income tax return (same as Grantor Trust)***

STAFF COMMENTS

The Subcommittee may wish to ask the following:

- Why is FTB requesting this change at this time?

Staff Recommendation: Hold Open.

ISSUE 2: NEW EMPLOYMENT CREDIT EXEMPTION FOR SEMICONDUCTOR COMPANIES

The Governor's budget includes proposed trailer bill language to expand the New Employment Credit for semiconductor companies. The New Employment Credit provides a tax credit for businesses that operate in high-poverty areas and provide long-term employment for specified populations. The proposed budget removes existing geographic restrictions for qualifying semiconductor manufacturing, research, and development firms.

BACKGROUND

The New Employment Credit is a credit allowed against Personal Income Tax and Corporation Tax, for taxable years beginning on or after January 1, 2014, and before January 1, 2026, for hiring qualified full-time employees, as specified in statute, within a designated census tract or economic development area in an amount equal to 35 percent of the qualified wages paid to those employees multiplied by the applicable percentage for that taxable year. A taxpayer claiming the credit must request a tentative credit reservation from the Franchise Tax Board within 30 days of complying with specified new hire reporting requirements.

Qualified employer requirements:

- Must be engaged in a trade or business in California within the designated geographic area.
- Hires qualified employees
- Obtains a tentative credit reservation for the qualified employees
- Pays qualified wages
- Is not in an excluded business
- Has a net increase in jobs

Qualified employee requirements:

- Hired on or after the employee's work location was made part of the designated geographic area
- Performs at least 50 percent of his/her services in the designated geographic area
- Receives starting wages that exceed 150 percent California minimum wage at the time of hire
- Is hired for full-time work (paid hourly wages for an average of at least 35 hours per week, or is salaried and paid for full-time work)
- Meets 1 of the following qualification categories at the time of hire:
    - Unemployed for the previous 6 months or more
        - Unemployed means not receiving wages, not self-employed, and not a full-time student

        - If the employee completed a college or similar program, the completion date must have been at least 12-months prior to date of hire
    - Veteran, separated from the U.S. Armed Forces within the previous 12 months
    - Received the federal Earned Income Credit in the previous taxable year
    - Ex-offender convicted of a felony
    - Current recipient of CalWORKS or county general assistance

Current Usage.
The most recent FTB report, published March 1, 2021, reported that taxpayers have reported $3.6 million claimed on 2019 tax year returns, and $3.9 million claimed on 2020 tax year returns. The 2020 totals do not include all fiscal-year filers. In that report, FTB also noted that reasons for the low uptake of the credit may include the geographic limitations, restrictive eligibility, wage, and business types, among other things.

Federal CHIPS Act.
In 2022, President Biden signed into law the CHIPS and Science Act of 2022. This law provides $50 billion in investments through the U.S. Department of Commerce for a suite on investments in semiconductor research, development, and manufacturing. Most states are making state level investments that would better position semiconductor companies within their state to receive a portion of these competitive investments.

This proposal is part of the state's overall CHIPS Act strategy which aims to incentivize semiconductor companies to invest in California-based operations. In, addition to this proposal, tools have been developed through the Governor's Office of Business and Economic Development to help companies ensure they are meeting federal requirements. Semiconductor companies may also be eligible for the California Competes Tax Credit, the Research and Development Tax Credit, or workforce training programs.

Proposed Language.

For taxable years beginning on or after January 1, 2023, and before January 1, 2026, the proposed language would allow a taxpayer engaged in semiconductor manufacturing or semiconductor research and development, who apples for federal funding or related federal tax credits would be able to claim the new employment credit and for these specific taxpayers:

- Eliminates the requirement that the new employment be located within a designated census tract or economic development area.
- Allows the taxpayer to request a tentative credit reservation from the Franchise Tax Board on or before the last day of the month following the close of the taxable year for which the credit is claimed, instead of within 30 days of complying with specified new hire reporting requirements.

Self-certification and verification process

Applicants are not required to show proof of application in the first year because the timing for CHIPS Act funding being made available has not yet been announced, however competing for federal funds under the CHIPS Act requires firms to show proof of state incentives received. These proposed changes under the new employment credit are intended to help California semiconductor companies meet federal application requirements.

Specifically, a taxpayer can claim a credit for a qualified employee for up to 5 years, however, to receive the credit after the first year, the taxpayer would need to show proof that they applied, if requested by the FTB.

- To qualify, a company must fall under the North America Industry Classification System (NAICS) code 3344, which is "Semiconductor and Electronic Component Manufacturing," and they would also be subject to the other credit requirements. The definition and requirements for a "qualified employee" are unchanged for the semiconductor industry as the purpose of this proposal is to incentivize semiconductor companies to invest in California while helping vulnerable populations find good jobs.
- Firms operating with a 3344 NAICS code would be able to operate throughout the state as opposed to within a designated geographic area or former enterprise zone, as is currently required. For tax year 2023 they would need to reserve a credit within a month of their taxable year ending as opposed to within 30 days of making a qualified hire. After tax year 2023, these taxpayers would have to make a reservation under the normal timeline.

STAFF COMMENTS

There are several proposals from the semi-conductor field. The California Competes Tax credit along with the California Competes grant program. How will this tax credit attract more of the semi-conductor industry as opposed to the California Competes Grant program?

Why does the proposal only propose to eliminate the geographic boundaries for the semi-conductor industry? Where does the State anticipate that the semiconductor business will land in California.

Staff Recommendation: Hold Open.

ISSUE 3: DATA SHARING TRAILER BILL LANGUAGE

The Administration proposes trailer bill that includes a proposal to extend data sharing between the Franchise Tax Board, the California Department of Social Services, and the Department of Health Care Services to support unique or joint efforts on outreach and education associated with the California Earned Income Tax Credit.

BACKGROUND

Additionally, this language modifies the outreach requirements for employers to notify employees, and the California public assistance programs to notify their clients, twice annually as to the California and the federal Earned Income Tax Credit, as well as the existence of other federal or state tax credits supporting lower income Californians and providing information on how these individuals can file a tax return for free.

STAFF COMMENTS

Staff has no concerns with extending the data sharing provisions in order to continue to expand outreach efforts for the CalEITC.

Staff Recommendation: Adopt Placeholder Trailer bill language.

ISSUE 4: FILM AND TELEVISION TAX CREDIT ADMINISTRATION (SPRING FINANCE LETTER)

The Administration proposes in an April Finance Letter to provide the Franchise Tax Board (FTB) $154,000 (General Fund) and 1.0 position in 2023-24; $721,000 General Fund and 4.1 positions in 2024-25; $767,000 (General Fund) and 5.3 positions in 2025-26; $292,000 (General Fund) and 2.0 positions in 2026-27 and ongoing to implement the expansion of Film and Television Tax Credit. These resources are critical to successfully implement the Administration's proposal for the expansion of the Film and Television Tax Credit.

Since the Spring Finance was provided, the FTB has further refined their request and is no longer requesting resources in the 2023-24 year.

BACKGROUND

The Governor's budget includes a proposal to extend the Film and Television Tax Credit Program, and earmark $330 million for film and TV tax incentives each fiscal year starting in FY 2025-26 through FY 2030-31. The difference between the current program and the proposed program is that the proposed program would allow for the credit to be refundable. The new program would be operative for taxable years beginning on or after 1/1/2025 and before 1/1/2030.

Administrative Services Division:

- Information Technology Associate (ITA): $6,000 for overtime in FY 2024-25

The Communications Services Branch (CSB) manages FTB's external website and creates accessible tax forms and instructions. CSB is requesting overtime funding for an ITA to perform form design services, including updating existing tax forms and creating a new tax form.

Filing Division:

- Associate Tax Auditor (ATA): One 18-month limited-term position (10/1/2024 through 3/31/2026)
- Information Technology Specialist I (IT Spec I): One 18-month limited-term position (10/1/2024 through 3/31/2026)
- Program Specialist II (PS II): One 18-month limited-term position (10/1/2024 through 3/31/2026)
- Program Specialist I (PS I), Associate Operations Specialist (AOS), Staff Operations Specialist (SOS): $81,000 for overtime in FY 2024-25
- Principal Compliance Representative (PCR): One permanent position (effective 10/1/2025)

The Filing Division is responsible for implementing the proposed Film and Television Tax Credit Program changes into the appropriate tax forms and instructions, preparing and processing returns received, manually analyzing returns that have issues identified during processing, as well as resolving customer/taxpayer questions regarding the credit. The Filing Division is requesting three positions for workloads that prepare the division for the implementation of the new refundable credit, and one position for the processing of the returns claiming the new refundable credit.

Technology Services Division:

- IT Spec I: One one-year limited-term position (7/1/2023 through 6/30/2024)
- IT Spec I: Three one-year limited-term positions (1/1/2025 through 12/31/2025)
- IT Spec I: One permanent position (effective 1/1/2025)

The Technology Services Division requests one one-year limited term position to analyze, code and test the Film and Television Tax Credit reservation system. In addition, three one-year limited term positions will analyze, code and test changes to our return analysis and tax accounting systems, which is required to support this important legislative change. Finally, one permanent position will analyze, code, and complete the ongoing maintenance and monitoring of the refundable Film and Television Tax Credit processing functionality and data.

STAFF COMMENTS

This item should be considered in conjunction with the larger Film Tax Credit proposal.

Staff Recommendation: Hold Open.