AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 4
ON STATE ADMINISTRATION

ASSEMBLYMEMBER WENDY CARRILLO, CHAIR

TUESDAY, MARCH 22, 2022

1:30 PM – STATE CAPITOL, ROOM 447

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. All are encouraged to watch the hearing from its live stream on the Assembly's website at https://www.assembly.ca.gov/todaysevents.

The hearing room will be open for attendance of this hearing. Any member of the public attending a hearing is strongly encouraged to wear a mask at all times while in the building. The public may also participate in this hearing by telephone.

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

VOTE-ONLY CALENDAR

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VOTE-ONLY CALENDAR

7600 CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION (CDTFA)

VOTE-ONLY ISSUE 1: CENTRALIZED REVENUE AND OPPORTUNITY SYSTEM (CROS) MAINTENANCE AND OPERATIONS

The Governor's budget requests $14.4 million in 2022-23 from a variety of fund sources for the Centralized Revenue Opportunity System (CROS) at CDTFA. Of this, $10.6 million is for maintenance and operations, $2.6 million is for final release of revenue-based compensation, and $1.2 million is for operating expenses and equipment (OE&E).

BACKGROUND

The CDTFA administers California's sales and use, fuel, tobacco, alcohol, and cannabis taxes, as well as a variety of other taxes and fees that fund specific state programs. The CROS Project (Feasibility Study Report Project 0860-094) is an information technology modernization effort that has enabled the CDTFA to expand tax and fee payer services, to improve the efficiency and effectiveness of its operations, and to enhance its ability to generate increased revenues reducing the tax gap.

CROS is a tax collection and distribution information technology system approved in 2011 and designed to improve the efficiency and effectiveness of the CDTFA's operations, expand tax and fee payer services, and enhance the CDTFA's ability to generate increased revenues. On August 30, 2016, the CDTFA completed the CROS Project's Procurement Phase and signed an agreement with FAST Enterprises Inc. (FAST) to implement its commercial off-the-shelf software solution, GenTax, as the CROS Solution. GenTax is specifically designed for integrated tax administration and provides full functionality for processes such as registration, returns, payments, refunds, collections, revenue accounting, audit, correspondence, imaging, analytics, and workflow.

The first production release, Rollout 2, included the Sales and Use Tax Program and was implemented on May 7, 2018. The second production release, Rollout 3 included Special Taxes (such as Alcoholic Beverages, Cigarette and Tobacco, and Fuel Taxes) and was implemented on August 12, 2019. The final production release, Rollout 4 included all remaining the CDTFA tax programs and was implemented on November 9, 2020.

The CDTFA requests $14.4 million for OE&E. This includes $13.2 million for FAST compensation as follows:

- $10.6 million for maintenance and operations costs (funds the 2022-23 costs of the maintenance and operations contract and the software licensing contract)
- $2.6 million release of withhold, which is the final 3 percent of the 10 percent withhold (the withhold is revenue-based compensation)

The CDTFA also requests $1.2 million for hardware, software, and training resources needed to support CROS operations. Training resources are needed to provide technical training for staff to ensure they gain key skills in new technologies to support CROS.

STAFF COMMENTS

This funding will provide resources for continued implementation of CROS.

Staff Recommendation: Approve as Budgeted.

7730 FRANCHISE TAX BOARD

VOTE-ONLY ISSUE 2: ENTERPRISE TO DATA REVENUE PROJECT 2

The Governor's budget requests $151.1 million (General Fund) and 17 permanent positions, 23.5 full time equivalent limited-term positions, and 21 permanent-intermittent positions to begin second-year implementation of the Enterprise Data to Revenue (EDR2) project, which is the second phase of the Tax System Modernization (TSM) plan at the Franchise Tax Board.

BACKGROUND

The EDR2 project represents Phase 2 of an enterprise-wide TSM effort to align FTB's IT infrastructure with its strategic business plan. The EDR2 project will continue to significantly improve the department's ability to address the state's annual $10 billion tax gap through strategically planned TSM efforts consistent with FTB's strategic plan.

The EDR2 project is vital to FTB's operations. The technology currently supporting two of FTB's major legacy systems - Accounts Receivable Collection System (ARCS) 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. Implementing the EDR2 project at this time is critical. 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 improve efficiency and provide a better taxpayer experience while increasing revenue.

The EDR2 project follows the California Department of Technology's (CDT's) Project Approval Lifecycle (PAL) Process. The most recent document approved for the EDR2 project was the Stage 4 Project Readiness and Approval (S4PRA). The S4PRA was approved on April 1, 2021 and included the EDR2 vendor selection and project approval.

The EDR2 project's Request for Proposal (RFP) was released on April 30, 2019 on the Cal e-Procure website. In May 2020, FTB received the final proposals with proposed solutions from the bidders. Contract Award to the contractor was made in June 2021. The EDR2 project start date is July 1, 2021.

The EDR2 project plans to achieve the following objectives in 2022-23:

- Utilize the new data analytic tools to support the development of new work including functionality for models, treatment paths, and data visualization (reports and dashboards);
- Perform data analysis and clean-up of the PASS application data prior to the conversion of the data into the EDR2 case management platform;

- Analyze and resolve issues with collection cases that will not convert in an automated fashion prior to contractor's automated conversion from the PIT collection legacy to new system;
- Enhance the ability to successfully select best value cases for compliance efforts and complete quality cases efficiently;
- Ensure new data fields can be captured from paper returns and other stand-alone tax forms to assist with developing potential modeling strategies and business rules which will result in increased revenue;
- Develop and implement Training and Organizational Change Management activities to support FTB enterprise including the field offices who will utilize the systems impacted by the EDR2 project implementation and changes;
- Maintain the data integrity and availability in FTB's tax systems and their ability to perform critical state tax functions;
- Pilot the first implementation of the PIT Professional Audit and Legal Case Management solution;
- Replace the solution that is used by the Underpayment BSOW to identify available assets to levy during the Personal Income Tax involuntary collection cycle; and
- Continued design and development of deliverables to be implemented in future years, including self-services and additional case management solutions

FTB notes that this request is funding for the 2022-23 fiscal year and that a BCP will be submitted each year to cover the costs of the project. According to the FTB, the total cost of EDR2 is estimated to be just over $750 million and will ensure continued collection of over $4 billion in annual revenues. After full implementation, the project is projected to bring in additional new revenues of $300 million annually.

The most recent CDT's Independent Project Oversight Report, completed in December of 2021, notes that the project is on track and performing as expected and does not identify any needed corrective actions at this point.

STAFF COMMENTS

Staff has no concerns with this proposal.

Staff Recommendation: Approve as Budgeted.

VOTE-ONLY ISSUE 3: ENTERPRISE STORAGE AND FIBER CHANNEL SWITCH REFRESH

The Governor's budget proposes $6.75 million (General Fund) and $4,000 (Special Funds) for the Franchise Tax Board to refresh aging equipment and software approaching end-of-life (EOL) within the enterprise storage system and storage area network (SAN) fiber channel switches.

BACKGROUND

The SAN is a specialized, high-speed network that provides network access to storage utilizing fiber channel switches for data transportation. It provides secure data transportation between servers and enterprise storage systems. SAN is composed of switches, storage elements, and storage devices that are interconnected. These environments support FTB's mission critical applications. One of the main components within the SAN, is the fiber channel switch. It plays an important role in interconnecting multiple storage ports and servers. FTB's current fiber channel switches and software were installed in 2015 and must be replaced as they are reaching EOL. The switches will not have standard manufacturer support after July 2022. However, the manufacturer will support the EOL switches during the migration and installation process for the new switches which will maximize return on investment and prevent the need for a long-term support contract. FTB seeks funding to replace the aging fiber channel switches and software to reduce the risk of failure which would negatively impact FTB's operations. FTB will also update the storage port and servers in this project. The proposed timeline is as follows:

- June 2022 – Department of Finance notifies FTB of approval for project resources
- July 2022 – Bid and award procurement contract including gap coverage for product support through project implementation
- August 2022 – October 2022: Prep work: includes power, wiring, and other data center requirements. Review Logical configuration and verify new topology •
- November 2022 – February 2023: Configure, install, and cutover, Includes verification and stabilization
- March - April 2023 – Final verification, begin M&O, and project closure

STAFF COMMENTS

These resources will allow FTB refresh aging equipment. Staff has no concerns.

Staff Recommendation: Approve as Budgeted.

VOTE-ONLY ISSUE 4: FI$CAL STAFFING

The Governor's budget proposes $856,000 (General Fund) and $32,000 (Special funds) for six three-year limited-term positions and funding for five classification upgrades in 2022-23; $819,000 (General Fund) and $32,000 (Special funds) in 2023-24 and 2024-25; and $67,000 (General Fund) and $2,000 (Special funds) in 2025-26 and ongoing. These resources will conduct accounting, procurement, and budgeting and resource management functions as the department continues to work in the Financial Information System for California (FI$Cal) to comply with statewide accounting, procurement, and budgeting policies.

BACKGROUND

In July 2018, FTB implemented FI$Cal, California's statewide accounting, budget, cash management and procurement system. FI$Cal is the technology solution that provides a single, transparent, and unified financial management system, and is intended for use by most state entities. It implemented revised processes and deployed new required structures and rules that necessitate the collection and categorization of more data. This information is essential to the success of FI$Cal for statewide financial reporting.

FTB's Accounting Section, Procurement Bureau, and Department Resource Oversight and Financial Performance Section have the most prominent role in FI$Cal at FTB and deliver key components of FTB's business operations including accounting, purchasing, budget development and management, financial statements, and departmental and state-level reporting. FTB is fully committed to supporting FI$Cal requirements and proactively worked with FI$Cal and Department of Finance (DOF) to plan, design, and test new processes, procedures, workflows, information hand-offs, and reports. Due to the required FI$Cal workload changes in complexity, timing, and required reviews, FTB staffing was temporarily and permanently augmented in 2019-20. FTB honed its skill with FI$Cal processes and timing and discovered additional complexity to FTB's already complex processes. At this time, FTB continues to experience delays, bottlenecks, and backlogs within FI$Cal processes.

FTB needs additional resources to carry out its fiduciary responsibilities within mandated timeframes, thus FTB proposes to increase staffing by six three-year limited-term positions and funding to upgrade five Associate Operations Specialists to Staff Operations Specialists. While FTB did receive some permanent and temporary resources in 2019-20, which greatly assisted with the FI$Cal workload, the temporary resources have now expired and workload demands continue to increase in workload tasks and review levels. FI$Cal is fully implemented at FTB and FTB has worked diligently to address the deficiencies caused by the FI$Cal implementation. FTB staff are now experienced and beyond the learning phase, thus these resource gaps cannot be overcome with additional experience or training. The remaining needs and demands are permanent and meeting them is unsustainable without additional staffing.

STAFF COMMENTS

These resources will allow FTB meet the timelines to fully implement FI$Cal.

Staff Recommendation: Approve as Budgeted.

VOTE-ONLY ISSUE 5: MICROSOFT LICENSING AGREEMENT (MELA)

The Governor's budget proposes $1.44 million (General Fund) and $60,000 (Special funds) in 2022- 23, $1.64 million (General Fund) and $68,000 (Special funds) in 2023-24, $2 million (General Fund) and $83,000 (Special funds) in 2024-25, and ongoing to establish a fully-funded, permanent baseline budget for FTB's implementation of the state master agreement Microsoft 365 Government Community Cloud (M365 GCC) and enterprise agreements for Microsoft server, development tools, and support (the combined package is hereafter referred to as M365 GCC+).

BACKGROUND

The common tool set FTB offers staff based on work assignments, includes a computer operating system with security features and software applications that enable word processing, note taking, spreadsheets, presentation creation, surveying, diagraming, project management, software development, and communications, such as e-mail, instant messaging, voice conferencing, and team video collaboration. To carry out their revenue generating workloads and provide taxpayer assistance, FTB staff rely on these tools to work as a team, share and mange content, quickly find and connect information, and seamlessly collaborate across FTB. To offer these functions to staff, behind the scenes FTB uses on-premises server software, cloud services, and support tools for implementation, deployment, and trouble shooting. This is FTB's base architecture for productivity software. FTB licenses to support our nearly 6,900 permanent and temporary employees. FTB maintains another 800 licenses for contractors working on projects and to provide licensing to comply with FTB security policy, which requires retention of former employee and contractor data for a period of a minimum of five years.

In June 2014, FTB transitioned from purchasing software bundles and individual products to its first subscription Microsoft Enterprise License Agreement (MELA) with add-ons, which provided additional products such as server software, developer tools, and specialized productivity tools (i.e., Visio and Project).

In June 2019, FTB renewed the subscription and acquired the latest subscription, Microsoft 365 Government E3, with the same add-ons and an upgraded support contract. In early 2021, the California Department of Technology (CDT) reached out to FTB about the feasibility of joining the statewide M365 E5 GCC subscription. After determining business opportunities and costs associated with doing so, key benefits would present for FTB to do this and in June 2021, FTB leveraged the new purchasing model M365 E5 GCC offered through CDT and entered into a new subscription term prior to the existing subscription expiration. Renewing one year early allowed FTB to take advantage of previous subscription credits, leverage the aggregate buying power of the new M365 E5 GCC, and move to a 5-year renewal cycle instead of a 3-year cycle. This state master enrollment (M365 E5 GCC), along with the server, developer, and support tools, is collectively referred to as M365 GCC+ in this document. The decision to move to this new agreement was both financially strategic and feature rich, as this state master enrollment offered significant initial savings and additional feature opportunities, particularly for security tools. FTB was able to transition to the top-tier enrollment (Federal Risk and Authorization Management Program (FedRAMP) certified) to leverage the added security and privacy features, top-tier support, deployment services, and simplified administration. FTB also enhanced its video conferencing and data analytics tools. FTB's current M365 GCC+ architecture includes base productivity tools, server tools, developer tools, and support. It provides a dependable and adaptable base productivity software architecture, cloud computing, and access to the most current versions of Microsoft software. This flexibility enables FTB to upgrade at a pace that aligns with FTB's business needs, such as the increased demand for licenses due to FTB security retention policy and emergency implementations of collaboration tools such as was needed with COVID-19.

For the various purchases comprising the 2014, 2019, and 2021 subscriptions, generally FTB was able to fund these subscription contracts primarily utilizing funds previously used to buy the individual products that were being offered in the MELA bundle, and carry that forward as the baseline.

STAFF COMMENTS

As annual costs increase, FTB will need additional funding to cover yearly costs. Staff has no concerns.

Staff Recommendation: Approve as Budgeted.

VOTE-ONLY ISSUE 6: NETWORK INFRASTRUCTURE REFRESH

The Governor's budget requests $1 million (General Fund) and $42,000 (Special funds) in 2022-23, $3.21 million (General Fund) and $133,000 (Special funds) in 2023-24, and $4.71 million (General Fund) and $198,000 (Special funds) in 2024-25, for the Franchise Tax Board (FTB) to refresh, by way of replacement, a portion of FTB's network infrastructure. Some components of the network are reaching end of life (EOL) beginning May 2023 and some have capacity constraints.

BACKGROUND

FTB's current network infrastructure was put in place by the E-Commerce Portal Infrastructure (EPI) Feasibility Study Report (FSR), as approved by the California Technology Agency (currently California Department of Technology) on January 10, 2007. That effort provided up-to-date network designs, infrastructure, and tools to effectively and efficiently manage, maintain, and enable growth of FTB's network infrastructure, which allowed FTB to increase its internet presence and internal services. Due to EOL announcements and end of capacity equipment, FTB received approval to refresh the network infrastructure in FY 2016-17, and implemented the network refresh in phases (via approved FSR FTB 15-01 and BCP 7730-002-BCP-BR-2016-GB; PIER completed 2/14/2020), which has kept the network healthy. Generally, the network infrastructure refresh is performed in phases every 5-years. Some components of FTB's network infrastructure are again reaching EOL and capacity constraints exist as all physical port connections are in use. When equipment reaches EOL, manufacturers will no longer provide emergency or non-emergency technical support, technical and security patches, software and firmware upgrades, parts, or whole replacements of equipment. The following components are at or approaching EOL or at capacity and proposed for refresh:

1. Firewall appliances – EOL May 31, 2023.
2. Network (Production, Internet, and Core) Switches – EOL March 31, 2024.
3. Edge Switches – EOL March 31, 2024.
4. Load Balancers – EOL April 1, 2025.
5. Next Generation Firewalls (NGFWs) – EOL August 31, 2025.
6. Routers – Maximum port-capacity reached.

Through this network refresh, FTB will replace EOL and at-capacity components of FTB's network infrastructure and will meet expected workload increases and demand for online services through June 2030.

STAFF COMMENTS

Staff has no concerns with FTB's network refresh.

Staff Recommendation: Approve as Budgeted.

VOTE-ONLY ISSUE 7: IDENTITY PROOFING AND ONLINE FRAUD DETECTION

The Governor's budget requests $3.53 million ($3.45 million in General Fund and $88,000 in Special Fund) 17 permanent positions and 1 limited-term position in 2022-23; $3.07 million ($2.99 million in General Fund and $78,000 in Special Fund) 17 permanent positions in 2023-24 and ongoing to accommodate both new workloads and growth within the critical functions of policy, security, and disclosures that are a part of FTB's business processes utilizing a new identity verification tool for fraudulent calls and a threat behavior analytics tool.

BACKGROUND

The Privacy, Security, and Disclosure Bureau (PSDB) develops and enforces security policies and procedures for the safety of FTB's employees and California citizens, and to ensure the security, confidentiality, integrity, and availability of FTB's information and information systems. These departmental policies and procedures guide staff in the analysis and assessment of security measures for the protection of FTB's facilities and information. They also detect, verify, and prevent unauthorized access to information technology systems, networks, and data.

FTB's Chief Security Officer (CSO) is responsible for the oversight and management of all aspects of information security. The CSO also promotes awareness of privacy and security issues among management and staff and ensures sound security principles are reflected throughout the organization's vision and goals. Subject matter experts within the PSDB provide technical security expertise to the department.

FTB has redirected resources to address online fraud as feasible, as well as utilized two positions requested and received via a 2018-19 BCP, to begin addressing this emerging avenue for fraudulent activity. FTB cannot continue to redirect resources to this workload without ongoing impacts to other critical security areas. Currently, FTB does not have the resources or robust tools to appropriately identify and address all the alerts that are triggered and the alerts are prioritized as High, Medium, and Low. On some days, staff can only timely review a portion of the alerts categorized as 'High'. The additional tools and positions will aid in refining current alert criteria to remove false positives and create automated processes to replace the current manual review processes. These resources and new software tools will ensure FTB, and the State, are well positioned to address significant risks associated with insufficient security protocols and staffing levels.

STAFF COMMENTS

These resources will allow FTB to address identity and online fraud detection.

Staff Recommendation: Approve as Budgeted.

ITEMS TO BE HEARD

7600 CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION
0860 STATE BOARD OF EQUALIZATION
0870 OFFICE OF TAX APPEALS

ISSUE 1: OVERSIGHT OF CALIFORNIA'S TAX DEPARTMENTS

In 2017, the Legislature passed two laws—AB 102 and AB 131—that made major changes to tax administration and appeals in California. The laws created two new departments—the California Department of Tax and Fee Administration (CDTFA) and the Office of Tax Appeals (OTA)—and transferred most of the Board of Equalization's (BOE) duties to these departments. This item will provide an update on California's Tax Departments: CDTFA, OTA and BOE.

PANEL

- Seth Kerstein, Economist, Legislative Analyst's Office
- Nick Maduros, Director, California Department of Tax and Fee Administration
- Mark Ibele, Director, Office of Tax Appeals
- Myriam Bouaziz, Chief Deputy Director, Office of Tax Appeals
- Brenda Fleming, Executive Director, Board of Equalization
- Chris Hill, Principal Program Budget Analyst, Department of Finance

BACKGROUND

The state collects revenue from a variety of taxes and fees. Most state revenue comes from three major sources—the personal income tax, the sales and use tax, and the corporation tax. The state also collects revenues from a variety of other taxes, including taxes on alcohol and on insurance. County governments in California administer the property tax, collecting the funds and distributing them to other local governments.

Tax Administration and Appeals under AB 102 and AB 131

In June 2017, the Legislature passed and the Governor signed AB 102. This law created two new departments—CDTFA and OTA—and transferred all of BOE's statutorily assigned duties to these new departments. The law did not amend the State Constitution, so BOE maintained its constitutional authority over taxes on alcoholic beverages, insurance, and property. In September 2017, the Governor signed AB 131, which further clarified some of the changes made by AB 102.

Tax Administration

CDTFA. Under the new laws, CDTFA administers most of the tax and fee programs formerly administered by BOE. Accordingly, the new laws transferred most of BOE's budget, staff, facilities, and other resources to CDTFA. CDTFA is a department within the Government Operations (GovOps) Agency. The head of the department is a director appointed by the Governor and confirmed by the Senate.

Tax Appeals

OTA. The new laws also created OTA, transferring most of BOE's tax appeal duties to the new office. OTA is now responsible for hearing tax appeal cases formerly assigned by statute to BOE, including personal income, franchise, and sales tax appeals. Unlike CDTFA, OTA is not part of a state agency. Like CDTFA, however, the head of the department is a director appointed by the Governor and confirmed by the Senate. OTA's director reports directly to the Governor.

The new laws directed OTA to hear cases in tax appeals panels, each consisting of three administrative law judges (ALJs). These panels are to hear cases in three locations: Sacramento, Fresno, and Los Angeles. The laws also directed OTA to issue a written opinion for each case decided by the panels within 100 days. Similar to the process that existed with BOE, the laws allowed taxpayers to appeal decisions made by OTA to the trial courts.

Tax Administration and Appeals Prior to the AB 102 and AB 131

Tax Administration

Prior to the new laws, BOE's primary responsibility was to administer the sales and use tax. It also administered dozens of smaller tax and fee programs, including some programs related to property taxes. BOE is headed by a five-member board, with four members elected directly by district, and the fifth—the State Controller—elected on a statewide basis.

FTB administers personal income and corporate taxes and is headed by a three-member board: the State Controller, the Director of Finance, and the chair of the BOE.

Tax Appeals

When taxpayers disagree with the state about the taxes they owe, they can appeal. In the initial steps of the appeal process, taxpayers interact with the same agency that administered the disputed tax. If these initial steps do not resolve the disagreements, taxpayers can have their appeals heard by a quasi-judicial body.

Prior to the new laws, BOE was the quasi-judicial body that heard appeals for state tax programs. The five-member board presided over appeals hearings and ruled on appeals by a majority vote of the board. Taxpayers who disagreed with the board's decisions could have their appeals heard in the trial courts. Tax administration agencies, however, could not appeal the board's decisions.

2022-2023 Governor's Budget

CDTFA. The administration proposes $702.9 million ($372.3 million General Fund) and 4,553.7 FTEs in 2022-23.

OTA. The administration proposes $27.1 million (General Fund) and 117 FTEs 2022-23.

BOE. The administration proposes $32.6 million ($32.1 million General Fund) and 193.6 FTEs in 2022-23.

Provision 1. The Governor's budget proposes to remove Provision 1 from the budgets of CDTFA, BOE and FTB.

Provision 1 was added to the BOE and FTB budgets after a State Audit found that tax agencies redirected audit resources in the 1990s. From 1992-93 through 1997-98, the Legislature added 250 audit positions to BOE's budget and 362 audit positions to FTB's budget. In 1999, the State Auditor found that BOE had redirected half of these positions to a broad array of areas, including tax appeals and assistance to board members. The Auditor also found that FTB had redirected audit positions but could not estimate the number of redirected positions precisely.

In response to the State Auditor's findings, the Legislature added provisional language to the budgets of both BOE and FTB in the 1999-2000 Budget Act that requires any redirections of resources appropriated for audits, collections, or return processing to be approved by the Department of Finance with a 30-day JLBC notification. This requirement, Provision 1, has been included in each subsequent Budget Act. Provision 1 also applies to CDTFA, which administers most of the tax programs formerly run by BOE.

STAFF COMMENTS

Since the passage of AB 102 and AB 131, all three agencies have been working toward implementing their new duties and responsibilities.

The Subcommittee may wish to ask the three entities the following:

- CDTFA: Can CDTFA discuss the successes and challenges since the creation of the new agency? How does CDTFA continue to work with BOE? Can CDTFA discuss their vacancies?
- OTA: Can OTA provide an update on the backlog of cases originally transferred from the BOE to OTA? How many cases are currently at OTA? How has COVID-19 affected the agencies with hearing cases? Has the agency had any issues with posting opinions?
- BOE: Can BOE discuss how they have adjusted their staffing to align with the new scope of work at BOE? What challenges does BOE face with addressing their vacancies?
- Can both CDTFA and BOE discuss why they have requested to eliminate Provision 1?

Staff Recommendation: This is an informational item only.

0870 OFFICE TAX APPEALS

ISSUE 2: ADDITIONAL STAFFING RESOURCES

The Governor's budget includes $2,796,000 (General Fund) ongoing and permanent position authority for the following 15 additional positions: Three Administrative Law Judge III, one Attorney V, one Tax Counsel IV, one Tax Counsel III, one Program Specialist III, one Business Taxes Specialist III, two Associate Governmental Program Analyst, two Staff Services Analysts, one Office Technician (General), one Information Technology Associate, and one Audio-Visual Specialist (Technical) at the Office of Tax Appeals (OTA).

PANELISTS

- Mark Ibele, Director, Office of Tax Appeals
- Myriam Bouaziz, Chief Deputy Director, Office of Tax Appeals
- Seth Kerstein, Economist, Legislative Analyst's Office
- Chris Hill, Principal Program Budget Analyst, Department of Finance

BACKGROUND

The OTA is responsible for hearing and deciding tax appeals arising from taxpayer disputes of actions taken by the Franchise Tax Board (FTB) and the California Department of Tax and Fee Administration (CDTFA). Since it was established, OTA has experienced an increase in appeals, most recently an approximately 40 percent increase in new Franchise and Income Tax (FIT) appeal filings, due in part to collaborative efforts of FTB and OTA to simplify the appeals process for taxpayers. Among several changes driving the increase, FTB this year began mailing out OTA appeal forms and instructions to FIT taxpayers when it sends out its decisions on cases that may be appealed to OTA.

Several positions from the Legal and Case Management divisions were redirected to staff-up the Administration Division when OTA's 2020-21 BCP was denied due to state fiscal constraints resulting from COVID-19. Due to this redirection and additional workload, current staffing levels in these divisions are not sufficient to address ongoing responsibilities. With internal processes more fully developed and workload data more defined, it is apparent that to adequately address its statutory requirements, OTA requires additional resources for the 2022-23 budget year. The requested resources will allow OTA to fulfill its mission of providing an objective and expert forum for tax appeals.

STAFF COMMENTS

Staff has no concerns with these resources.

Staff Recommendation: Approve as Budgeted.

7600 CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION

ISSUE 3: CANNABIS TAXES PROGRAM – ADDITIONAL AUDITORS

The Governor's budget proposes $882,000 Cannabis Tax Fund in fiscal year 2022-23, and $815,000 in 2023-24, and ongoing to provide audit support for the Cannabis Taxes Program (Program).

PANELISTS

- Nick Maduros, Director, California Department of Tax and Fee Administration
- Seth Kerstein, Economist, Legislative Analyst's Office
- Chris Hill, Principal Program Budget Analyst, Department of Finance

BACKGROUND

Proposition 64, the Control, Regulate and Tax Adult Use of Marijuana Act of 2016 (AUMA) and the Medicinal and Adult-Use Cannabis Regulation and Safety Act of 2017 (MAUCRSA) legalized the cultivation, manufacture, and sale of cannabis and cannabis products. The CDTFA is responsible for cultivation tax and excise tax collection, oversight, and enforcement.

The 2017 Budget Act included resources for the CDTFA to implement AUMA. The Program received 19.7 positions (15.8 redirected positions) and $2.7 million in funding to update the CDTFA's legacy computer program, for print and mail services, and for compliance functions, including registration and collections. The MAUCRSA, Chapter 27 of the Statutes of 2017 (SB 94), established a single system of administration for cannabis laws in California. This legislation included changes necessary for state licensing entities to implement a regulatory framework pursuant to both MCRSA1 and AUMA. The legislation also defined a method for collecting and remitting taxes, addressed consumer and public safety, tax compliance, and cash collection.

In 2018-19 the CDTFA received limited-term funding to implement MAUCRSA; $2.5 million in funding to address the cash acceptance requirement and establish a north coast cash acceptance office in Humboldt County. During this budget cycle, legislative changes revised the registration requirement to only include distributors. This resulted in a 2017-18 reduction of 7.4 positions.

In 2019-20 the CDTFA received limited-term funding for 13.9 positions, and $2.9 million for personal services and operating expenses and equipment to address cannabis enforcement activities. These positions were for inspectors under the CDTFA'S Investigations Division along with positions in the Legal Division.

In 2020-21 the CDTFA received funding for 28.5 continuing permanent positions, 10 new permanent positions, and 1.3 temporary help positions. The continuation of limited-term resources allowed the CDTFA to maintain the same level of program support. The CDTFA focused new resources on increasing compliance, of which 2 positions were for compliance auditing.

The CDTFA currently has more than 2,000 cannabis excise tax accounts. In addition to having more cannabis distributors than expected, there has been substantially more noncompliance than anticipated.

STAFF COMMENTS

The cannabis excise tax and the cultivation tax are deposited into the Cannabis Tax Fund, which is then distributed for various purposes as required by Proposition 64. The Cannabis Tax Fund revenue is distributed in three Allocations. Revenue collected in a given fiscal year is first distributed to Allocations 1 and 2. After the distributions to Allocations 1 and 2, the remaining revenue is carried over to the next fiscal year and distributed to Allocation 3.

Pursuant to the Governor's budget estimates, for the 2021-22 fiscal year, after distributions to Allocations 1 and 2, the balance is approximately $595 million, which is carried into the 2022-23 fiscal year for Allocation 3 disbursements. The balance from 2020-21 that was carried over to provide the Allocation 3 disbursements for the 2021-22 fiscal year was approximately $670 million. This represents an estimated $75 million less available for Allocation 3 programs in 2022-23 as compared to 2021-22. The Administration estimates that cannabis tax revenues will be $786.8 million in 2022-23, an increase of $78.9 million from 2021-22.

The Subcommittee may wish to have the Department of Finance discuss who makes the decisions for Allocation 1, and how they can be changed?

Staff Recommendation: Hold Open.

ISSUE 4: HOPE ACT: CALIFORNIA ELECTRONIC CIGARETTE EXCISE TAX

The Governor's budget proposes $1.4 million E-Cig Fund for 5.5 positions and 9,253.5 hours in 2022-23, $1.2 million for 3.8 positions and 12,026.5 hours in 2023-24, and $1.4 million for 3.5 positions and 15,253 hours in 2024-25 for mandated workload associated with SB 395, the Healthy Outcomes and Prevention Education (HOPE) Act.

PANELISTS

- Nick Maduros, Director, California Department of Tax and Fee Administration
- Seth Kerstein, Economist, Legislative Analyst's Office
- Chris Hill, Principal Program Budget Analyst, Department of Finance

BACKGROUND

Beginning July 1, 2022, the California Electronic Cigarette Excise Tax (E-Cig Tax) (Chapter 489 of the Statutes of 2021(SB 395)) imposes a new 12.5 percent tax upon purchasers on the sales price of electronic cigarettes for use in California. Retailers are required to collect the E-Cig Tax from the purchaser at the time of the retail sale of an electronic cigarette. Additionally, SB 395 authorized a General Fund loan of $3 million to be deposited into the California Electronic Cigarette Excise Tax Fund (E-Cig Fund) in fiscal year 2021-22 for the purpose of implementing the E-Cig Tax.

Implementation costs in 2021-22 include $2.5 million in contract services for reprograming CDTFA's Centralized Revenue Opportunity System (CROS). The new tax requires the CROS functional areas be built by July 1, 2022, and adding this function is currently underway. Additional 2021-22 costs included 0.8 positions in Audit Support, and 2,629.5 overtime hours in various units to implement updates, notify taxpayers, and respond to inquiries from the public.

Additional workload related to the administration of the E-Cig Tax falls under the following categories:

- **Compliance.** To ensure compliance with the E-Cig Tax legislation, CDTFA is mandated to perform registration and licensing, return processing, and collection functions. Every Cigarette Tobacco Product Tax Law (CTPTL) licensed retailer making sales of electronic cigarettes is required to report and pay the tax on these products, including out-of-state retailers with direct sales to California consumers. Team members will process returns, reports, schedules, payments, interest and penalty relief requests, review overpayments, issue refunds, and provide customer service for this new tax program.

- **Audit.** Team members are required to verify and audit registered retailers that sell electronic cigarette products to ensure the correct amount of tax was imposed, collected, and paid on the sale of electronic cigarette products. CDTFA strives to audit 3 percent of the taxpayer base on a three-year cycle.

- **Collections, Refunds, and Appeals.** As with any other tax program, a certain percentage of returns will be delinquent. Taxpayers who file non-remittance, partial remittance, or late returns, will incur CDTFA billings and be subject to collection actions. It is also estimated that 1.3 percent of the taxpayer base will file a claim for refund and a portion of the audit assessments of the new tax will result in petitions for redetermination. Team members will engage in active collection activities, handle refunds and process requests for relief from interest and penalty, and handle all aspects of the appeals process.

- **Return Processing.** CDTFA will design and develop new tax returns for the E-Cig Tax program. System programming changes are required to allow payments and proper fund allocation to the new fund. Team members are responsible for critical tax return and payment processing, reports, account maintenance, account billing adjustments, and desk review activities.

- **Administration, Implementation, and Administrative Support.** The E-Cig fund requires numerous analyses for maintenance, reconciliation, producing interim statements and preparation of special reports, and monitoring critical cash flow by the Accounting Branch. In addition, CDTFA must develop new online returns (electronic filing only), create new online instructions, and update forms, publications, letters, and webpages. Numerous outreach materials will be distributed and published. Team members will train and provide technical advice to other CDTFA team members and the public.

STAFF COMMENTS

CDTFA is mandated to implement, administer, and collect the new E-Cig Tax effective July 1, 2022. Retailers are required to file and remit the E-Cig Tax to CDTFA. The resources are reasonable, however, staff recommends holding the item open.

Staff Recommendation: Hold Open.

7730 FRANCHISE TAX BOARD

ISSUE 5: EARNED INCOME TAX CREDIT FOSTER YOUTH EXPANSION, YOUNG CHILD TAX CREDIT, AND OUTREACH

This item will cover the Governor's proposal on the Earned Income Tax Credit Foster Youth Expansion, the Young Child Tax Credit and outreach funding.

PANELISTS

- Colby White, Department of Finance
- Brian Weatherford, Principal Fiscal & Policy Analyst, Legislative Analyst's Office
- Alissa Anderson, Senior Policy Analyst, California Budget & Policy Center
- Anna Hasselbad, Director of Public Policy, United Ways of California
- Annette Kunze, Legislative Services Bureau Director, Franchise Tax Board
- Jeanne Harriman, Chief Financial Officer, Franchise Tax Board

BACKGROUND

EITC Foster Youth Expansion. The Governor's budget includes a new refundable credit for young adults who have been in the foster care program. This proposal provides an additional $1,000 credit for individuals who have been in the foster care system at some point at age 13 or older and who are now at least 18 but 25 or younger, and who otherwise qualify for the CalEITC. This proposal is expected to cost roughly $20 million ongoing General Fund.

YCTC. The Governor's budget includes a proposal to expand the Young Child Tax Credit (YCTC) to families that file returns without income, but otherwise quality for this credit, and proposes to index the credit to inflation starting in the 2022 tax year, which will prevent the erosion of its value. This expansion of the YCTC is expected to cost about $55 million ongoing General Fund. The cost of indexing will depend on the level of inflation and will compound over time, for the 2022 tax year, the cost of indexing is estimated at $19 million.

The California YCTC was expanded in the 2019 Budget Act to include a refundable young child tax credit not to exceed $1,000 per qualified taxpayer per taxable year. In the 2020 Budget Act, ITIN filers became eligible for this credit.

Currently, in order to claim the YCTC, a taxpayer must claim at least $1 of earned income. The YCTC is a refundable credit, this means that if the amount of a taxpayer's EITC is greater than his or her liability before applying the credit, then the state pays the taxpayer that difference.

The state's EITC has been indexed for inflation since its inception, and the Franchise Tax Board (FTB) annually adjusts the income thresholds and credit amounts for inflation, similar to the adjustment made for the federal EITC, although the state uses a California-specific inflation index. The YCTC has not been indexed for inflation and under current law loses value each year as a result. Estimates from the California Budget and Policy Center note that absent any changes, the credit would buy approximately 35 percent less than it did when introduced in 2019.

Outreach. The budget package also includes $10 million for education and outreach to expand awareness of the EITC.

STAFF COMMENTS

The Governor's budget proposes important yet modest expansions to the EITC and YCTC. Staff supports the concept of expanding the EITC to Foster Youth, but will evaluate the EITC Foster Youth expansion once trailer bill language is available.

Last year, the budget provided resources for economic relief through the Golden State Stimulus (GSS). To date, the GSS I provided 4.5 million payments for a total of $2.8 billion and GSS II provided 8.33 million payments for a total of $6 billion in economic relief.

This year, the Legislature will have to make decisions between competing priorities that range from further expanding the EITC and YCTC to providing tax relief through other programs. Staff notes that the GSS framework has proven successful in targeting tax filers with earned income, and that new tax relief program should build on its success rather than create a new program in a new department. Any new program will have to also address those who need assistance but do not have earned income.

For EITC and YCTC, the Legislature should focus on how to increase the uptake in the program. One way to do that is through outreach. But this year the Legislature should focus on connecting outreach with an outcome. Should outreach be focused on connecting tax filers with free filing assistance? Should outreach focus on building up the VITA sites that faced many challenges during the pandemic?

The Legislature may also want to address free filing options in general. What can the state do to streamline the process? Is an auto-filled return feasible? Removing barriers to filing and creating an outreach program with goals may help to increase the uptake in EITC and YCTC.

Finally, for the YCTC proposal that allows taxpayers with zero income – the Subcommittee may wish to ask DOF to explain the mechanics of how the filing would work?

- To claim the YCTC, would a person who is on SSI, or DI, have to file a federal return or just calculate the federal return? Who will help with this filing and how will outreach be done to those who will now qualify for the YCTC?

Staff Recommendation: Hold Open.

ISSUE 6: SECTION 41 WORKLOAD EXPANSION

The Governor's budget requests $657,000 (General Fund) and four permanent positions in 2022-23; $610,000 (General Fund) in 2023-24; $760,000 (General Fund) and one permanent position in 2024-25; and $749,000 (General Fund) in 2025-26, and ongoing for the Franchise Tax Board. This will allow the Economical and Statistical Research Bureau (ESRB) to manage the increasing workload due to the volume of bills with a Revenue and Taxation Code (R&TC) Section 41 reporting requirement.

PANELISTS

- Jeanne Harriman, Chief Financial Officer, Franchise Tax Board
- Brian Weatherford, Principal Fiscal & Policy Analyst, Legislative Analyst's Office
- Colby White, Department of Finance

BACKGROUND

In 2014, SB 1335 introduced Section 41 into the Revenue and Taxation Code (R&TC). This legislation required any bill, introduced on or after January 1, 2015, that would authorize a personal income or corporation tax credit, to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the credit.

In 2019, AB 263 expanded Section 41 reporting requirements to include all tax expenditures. A tax expenditure is defined as a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by the state. As a result of AB 263, beginning on January 1, 2020, data must be collected on any new tax expenditure bills in order to provide a standard method for the Legislature to periodically evaluate whether tax expenditures are providing the intended benefit to the State and its taxpayers.

As the department which receives tax information, most new bills now direct the FTB to provide relevant data to a designated entity, such as the Legislative Analyst's Office, to evaluate the benefits of the tax expenditure and complete the Section 41 report. Additionally, FTB could be the responsible entity to evaluate the tax expenditure as to its stated goal and issue a Section 41 report. Section 41 reports include analysis of data and baseline measurements to be collected and remitted in each year the tax expenditure is in effect. This allows the Legislature to measure the change in performance indicators which ultimately shows the goals, purpose, and objectives of the tax expenditure are being met.

R&TC Section 41 is a new mandatory workload that ESRB does not have the resources to address. When Section 41 was initially enacted, reporting requirements were limited to tax credits. However, recent legislation has expanded the requirement to include all tax expenditures. Tax credit data is easier to collect as it is generally reported as a line item on the tax return, and the data is captured by FTB during return processing. Data for other tax expenditures, such as deductions, is more difficult to collect. Individual deductions are rolled up into other line items and not reported on its own because that level of calculation is not necessary for return processing. In these instances, ESRB must build a data capture interface and related databases to store the data. The data is then manually keyed in order to generate reports. FTB notes that the department had no departmental costs associated with AB 263 when it passed as the bill adds requirements for future bills. However, now that approximately 10 tax expenditures have been enacted that require some form of data collection, analysis, distribution to subject matter delegates or the drafting of a report, FTB notes that these mandated activities support the need for additional resources. Currently FTB is re-directing staff to absorb several hundred hours of staff time annually to complete the one or two reports required to meet Section 41 requirements.

This request is based on FTB estimates that with each session the Legislature will pass at least four new tax expenditure bills encompassing R&TC Section 41 requirements that will require FTB to collect and distribute data to a delegate responsible to draft the Section 41 report or FTB will be required to draft a report. The FTB requests an IT Supervisor and an Administrator that would allow ESRB to address its span of control issues and support the workload metrics over time. Additional Data Specialists and IT Specialist are requested to allow FTB to code and capture information or to analyze the data and produce the reports FTB is responsible for on the performance measures and specific outcomes of the tax expenditure legislation.

STAFF COMMENTS

The Subcommittee may wish to ask FTB if there is a more efficient way to provide the Legislature with metrics on tax expenditure bills with Section 41 requirements?

Can FTB discuss how their reports are presented to the Legislature and how the metrics in the reports are reviewed?

Staff Recommendation: Hold Open.

ISSUE 7: TAX PAYMENT FLEXIBILITY FOR LOW-AND-MODERATE-INCOME HOUSEHOLDS AND INNOVATION HEADQUARTERS CREDIT

This item will discuss the Governor's proposal for the Tax Payment Flexibility for Low-and-Moderate Income Households as well as the Innovation Headquarters Credit.

PANELISTS

- Colby White, Department of Finance
- Brian Weatherford, Principal Fiscal & Policy Analyst, Legislative Analyst's Office

BACKGROUND

Tax Payment Flexibility for Low-and-Moderate-Income Households. The Governor's budget provides additional flexibility for certain taxpayers in meeting tax obligations, specifically, for tax years 2019, 2020, and 2021, families with less than $150,000 in adjusted gross income ($75,000 for individuals) will be given until September 30, 2023, to pay any personal income tax liability for those years and will be relieved of any penalties and interest related to delayed filing or delayed payment. Participating taxpayers would be allowed to make installment payments. Late penalties and interest would again apply to outstanding amounts, if any, at the end of the program.

FTB currently has authority to enter into an installment agreement (IA) with any taxpayer upon either a determination of an inability to pay a liability in full or a determination of financial hardship. For those with the inability to pay in full, the current IA statute requires FTB to enter into IAs with taxpayers that meet specified criteria, including that they have personal income tax liabilities of $10,000 or less and have indicated an inability to pay the debt in full and meet other criteria such as having filed prior year returns and committing to remain in compliance in the future for the terms of the agreement. All of these criteria are shown as being met with the filing of an installment application which serves as the taxpayer's self-attestation that they have met the criteria. FTB also has the discretion to enter into an IA for liabilities in excess of $10,000. FTB generally enters into an IA for up to five years with the taxpayer's self-attestation of a financial hardship if the liability is less than $25,000. For liabilities of $25,000 or more, FTB asks for documentation to support a financial hardship.

Innovation Headquarters Credit. The Governor's budget includes a proposal for a new Innovation Headquarters Tax Credit to provide an additional $250 million per year for three years for qualified companies headquartered in California that are investing in research to mitigate climate change.

According to the Governor's Budget Summary, the new credit is for companies investing in activities and technologies that mitigate climate change and are headquartered in California. The Innovation Headquarters Credit is proposed to be administered by the Franchise Tax Board, and would be in place from 2022 through 2024, and is designed to target a revenue loss of roughly $250 million per year for three years.

STAFF COMMENTS

There are no additional details on these proposals. Absent trailer bill language, it is difficult to evaluate these programs at this time.

Staff Recommendation: Hold Open.

*** PUBLIC COMMENT ****