

**AGENDA
ASSEMBLY BUDGET SUBCOMMITTEE NO. 4
ON STATE ADMINISTRATION**

Assemblymember Juan Arambula, Chair

**TUESDAY, MARCH 10, 2009, 1:30 PM
STATE CAPITOL, ROOM 447**

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ITEMS TO BE HEARD

Note: The legislative analyst's tax administration and federal conformity recommendations will be heard at a subsequent hearing.

ITEM 0860 STATE BOARD OF EQUALIZATION

The Board of Equalization (BOE) administers and collects state and local sales and use taxes, administers a variety of business and excise taxes and fees (including motor fuel taxes, cigarette taxes, and alcoholic beverage taxes), and oversees the administration of the property tax by county assessors. The BOE is governed by a five-member board, consisting of four regionally elected members and the State Controller. The Board is also the final administrative appellate body for personal income and corporation taxes, which the Franchise Tax Board (FTB) administers.

The Governor proposed expenditures of \$456.5 million (\$256.8 million General Fund) and 4,186.5 personnel-years (PYs) of staffing for BOE in 2009-10 – an increase of \$28.5 million, or 6.6 percent (\$17.3 million, or 7.2 percent, General Fund) and an increase of 169.8 PYs (4.2 percent). Much of the staffing increase reflects the annualization of positions added on a partial-year basis in 2008-09, primarily for efforts to reduce the "Tax Gap" – the difference between taxes owed and taxes collected.

2009-10 Budget Act. The budget adopted in February for the BOE differed from the Governor's Budget request in the following two respects:

1. \$13.5 million (\$9.9 million General Fund) was vetoed by the Governor on the basis that that the board should be subject to savings equivalent to that amount that would result from applying the Governor's employee furlough order to BOE staff (see Issue 2, below).
2. \$1.328 million and 5.9 positions that had been requested to implement board regulations imposing distilled-spirit tax rates on flavored malt beverages was deleted (see Issue 3, below).

ISSUE 1: OVERSIGHT—IMPLEMENTATION OF 2008-09 TAX GAP AUGMENTATIONS

The subcommittee approved significant additional resources in the 2008-09 Budget requested by BOE to improve compliance with, and collection of, the Sales and Use Tax (SUT).

The Sales and Use Tax. Existing law imposes the SUT on the sale or use in this state of tangible personal property, absent a specific exemption. The sales tax is imposed on retailers making sales in California, and the use tax is imposed on the purchaser for purchases from out-of-state sellers of taxable goods for use inside the state. The combined sales tax rate in California currently ranges from 7.25% (for counties with no optional local transactions and use taxes) up to 9.25% (for the City of South Gate in Los Angeles County). The combined rate consists of a state General Fund rate of 5 percent, statewide special fund rates totaling 1.25%, a local tax rate of 1%, and local optional rates. On April 1, the statewide General Fund rate will increase to 6 percent pursuant to SB 3 X3, the special session budget revenue trailer bill.

The major augmentations approved in the 2008-09 Budget included the following:

1. **Compliance and Outreach.** This augmentation added \$11.6 million (\$7.5 million General Fund), and 112 three-year limited-term positions (including the extension of 32.8 existing limited-term positions) to identify and register entities that actively engage in business in California and sell tangible personal property without a seller's permit. BOE indicated that this proposal would increase the number of permitted businesses operating in California by about 7,258 per year. Bringing businesses out of the underground economy levels the playing field for compliant businesses and reduces the tax gap. The 2008-09 Budget estimated that this effort would result in additional General Fund revenues of \$38 million in 2008-09 and \$51 million in 2009-10 (plus additional revenues to special funds and local governments).
2. **Other Tax Gap Reduction Efforts.** The 2008-09 Budget included \$13.7 million (\$9 million General Fund) and 127 positions to enhance compliance with the SUT and reduce the Tax Gap. The largest component of this augmentation consisted of 51.5 positions to improve compliance with use tax payment by in-state service businesses when they purchase equipment or supplies from out-of-state vendors. Other staff increases were aimed at improving and expanding audit and collection efforts. The 2008-09 Budget included additional General Fund revenues of \$27.2 million in 2008-09 (plus additional special fund and local government

revenue) and anticipated larger amounts annually thereafter from these efforts.

COMMENTS

1. The board has indicated that the revenue estimates for these efforts (as well as the costs in 2008-09) have been adjusted downward to reflect delayed implementation due to the unusually late adoption of the 2008-09 Budget, which was not signed until September 23, 2008. The board also has indicated to staff that hiring to implement the compliance and outreach proposal was somewhat delayed, but that seven teams have now been established to identify unregistered retailers
2. The board should update the subcommittee on the status of implementation of these proposals—including, current cost and revenue estimates for the current year and 2009-10 and how these compare with the amounts estimated in the enacted 2009-10 Budget.

ISSUE 2: REVENUE LOSS FROM GOVERNOR'S VETO

As noted above, the Governor's line-item vetoes in the 2009-10 Budget Act included a reduction of \$13.5 million (\$9.9 million General Fund) to the board's budget. The veto message indicated that this action was taken to achieve savings equivalent to that amount that would result from applying the Governor's employee furlough order to BOE staff. As an independent constitutional entity, the board has not complied with the Governor's furlough executive order, and the issue of whether the BOE must comply with the Governor's order currently is in litigation.

Pending Bargaining Agreement Addresses Furlough Issue. Board staff indicate that many BOE employees will be subject to the recent SEIU bargaining agreement with the administration which calls for 1-day-per-month "self-directed" furloughs, along with the elimination of two state holidays (in exchange for two floating personal holidays) and other changes. Shutdowns of state agencies during specified furlough days will no longer occur. Employee wages will be reduced by the equivalent of 1 day per month, but employees will have discretion, in cooperation with management to work a full schedule and take off furlough days at a later time. The self-directed furloughs extend through June 2010. Employees will have until July 1, 2012 to use any deferred furlough days.

According to BOE staff, the savings under the new furlough policy will roughly equate to the veto reduction, assuming that the board implements that new policy under the bargaining agreement, which is anticipated.

Revenue Losses Significantly Exceed Savings

The BOE estimates that the furlough policy (by reducing staff time available for tax administration, audits, and collections) will result in the loss or deferral of \$88 million of revenue, of which \$52 million will be General Fund revenue. Overall, this reflects a loss or deferral of about \$6.50 of total revenue for each dollar of total savings—and a loss or deferral of about \$5.25 of General Fund revenue for each dollar of General Fund savings.

COMMENTS

1. BOE should update the subcommittee regarding the impact of the veto reduction and of the new bargaining agreement and furlough policy, including current estimates of lost and deferred revenues.
2. The Department of Finance (DOF) and the Legislative Analyst's Office (LAO) should comment as to whether they have reviewed BOE's estimates and if they concur or disagree with BOE's assessment of the revenue impacts of the furlough program or have alternatives to propose at this time.

3. **Better Plan Needed.** It would appear that the furlough policy and the BOE veto reduction will lose the state (and local governments) more than \$5 of revenue for each dollar of 2009-10 savings. If so, then an alternative plan is needed that does not result in a net negative budget impact. Staff recommends that the subcommittee direct the BOE to work with its employee groups, the administration, and the LAO to develop an alternative plan for the subcommittee's consideration at a subsequent hearing.

ISSUE 3: TAXATION OF FLAVORED MALT BEVERAGES

The Governor's Budget for 2009-10 included a request for \$1.3 million (General Fund) to implement regulations adopted by the board in April 2008 defining Flavored Malt Beverages (FMBs) as alcoholic beverages that (a) use a fermented malt base (as with beer or ale), (b) are treated to remove the malt characteristics, and (c) to which are added flavorings or other ingredients containing distilled alcohol that constitutes at least 0.5 percent of the final beverage's alcohol by volume. FMBs typically are flavored alcoholic drinks that are sold alongside beer and have similar alcohol contents. Under the regulations, FMBs are taxed at the much higher rates that apply to distilled spirits, rather than as beer or wine. The regulations provide for a rebuttable presumption that all alcoholic beverages, other than wine are distilled spirits (including FMBs). Manufacturers may present evidence to rebut the presumption that their beverage contains distilled alcohol and be taxed as beer. The Governor's Budget included \$38.3 million of additional General Fund revenue related to this budget request.

Industry Reformulates and Rebutts. Manufacturers of the targeted beverages recently have filed rebuttals with the BOE indicating that they have reformulated their drinks to be below the 0.5 percent distilled alcohol threshold for FMBs. Consequently, BOE is unable to apply the higher tax rates to these beverages.

Budget Action. The funding for this request was removed, without prejudice, in the 2009-10 Budget Act, based on the apparent ineffectiveness of the new FMB regulation.

COMMENTS

1. BOE should update the subcommittee regarding the status of the industry reformulations and rebuttals.
2. BOE staff indicates that the board will discuss the status of this program at its March 17th meeting, and that the board will consider submitting a scaled-down Finance Letter request to the administration for approximately \$300,000 to verify reformulations.
3. Staff notes, that the Legislature could, through tax legislation, impose a higher tax on FMBs regardless of the source of their alcohol. The BOE's regulatory approach was based on the structure of the existing alcoholic beverage tax law.

ISSUE 4: HEADQUARTERS FACILITIES

The 2009-10 Budget Act includes an augmentation of \$5.7 million (\$3.3 million General Fund) to establish 6 permanent positions and to relocate about 500 employees from the current Sacramento headquarters building at 450 N Street, including the establishment of 6 permanent positions to handle the relocation and also for leasing and relocation work at other BOE sites. The budget estimates that the annual cost of this proposal will grow to \$8.5 million in 2010-11 and subsequent years.

Background. The HQ building has a long, sad, and expensive history of problems. Construction was completed in 1993. The original owner was CalPERS, and the state leased the building on behalf of BOE. The state purchased the building several years ago because financing a purchase appeared more cost-effective than the ongoing lease payments. However, the building has a history of construction defects causing water leakage, mold, and glass falling out of the building curtain wall. A major project to replace the curtainwall glass and seals and to remediate areas of water leakage was completed in 2006. Leakage problems, other building system problems and employee complaints of building-induced illness continue nevertheless. According to BOE, bond financing for the purchase never was completed due to the ongoing problems and temporary financing from the Pooled Money Investment Account remains in place (adding to the state's cash-flow difficulties).

Occupancy Exceeds Desirable Level. The BOE indicates that the recommended maximum occupancy for the building is 2,200 and that estimated occupancy will exceed this level by 415 in the current year. Furthermore, the 2009-10 budget funds an additional 173 BOE positions (although not all of these will be at headquarters), prior to any impact of the Governor's veto.

The board indicates that leasing additional space and reducing crowding is necessary to maintain employee productivity and morale and to protect the health and safety of employees because the building's HVAC and other systems are being stretched and because remediation of ongoing problems requires continually shifting employees out of the areas affected by the remediation work.

COMMENTS

- 1) The board (or the Department of General Services, as appropriate) should summarize for the subcommittee the history of the building, the current occupancy levels, and the specific components of its budget proposal, including addressing the following issues:

- a) How much has been spent or committed to date on repairs or remediation for the headquarters building? Are significant additional projects contemplated or needed, and, if so, how are they funded?
 - b) What is the current occupancy of the building? How many employees are housed in the annex, and was the annex taken into account in the estimate of a desirable maximum occupancy of 2,200? How many employees have been relocated, either permanently or temporarily, to other facilities in Sacramento, such as the Franchise Tax Board (FTB)?
 - c) Why are six *permanent* positions needed?
 - d) The proposal appears to call for training the new employees and then development of occupancy and moving plans, as well as evaluation of leasing opportunities prior to actually leasing additional space or moving employees—when does the budget assume that these tasks will be completed, leases signed, and employees relocated?
 - e) What is the budget assumption about the cost of leased space? Given the current commercial real estate market in Sacramento, can the lease rate assumption be reduced?
- 2) The headquarters facilities needs and costs also should be reevaluated in light of the alternative savings plan that will be developed in response to Issue 2, above.
 - 3) Could BOE make use of space at the FTB currently devoted to the Homeowners and Renters Assistance Program (discussed below under the FTB budget)?

ISSUE 5: VOLUNTARY DISCLOSURE PROGRAM

The 2009-10 Budget Act includes \$126,000 (\$87,000 General Fund) to establish one permanent position to reinstate the Use Tax Voluntary Disclosure Program. This program sunset on January 1, 2008, but was reinstated by AB 3079 (Committee on Revenue and Taxation) of 2008. Under the program, California purchasers of taxable goods who voluntarily come forward and pay unpaid use tax liability receive the benefit of a three-year statute of limitations for unpaid use tax, rather than the normal eight-year period.

The BOE estimates that this proposal will increase revenue by \$2.5 million annually—almost a 20-to-1 benefit/cost ratio.

COMMENTS

1. **Fund Through Redirection.** Given that only one position is needed for this program, it should be funded through redirection. Clearly there are many revenue-related activities at BOE that have a smaller return, and diverting one position would not have a significant impact on other major operations of the board.

ITEM 1730 FRANCHISE TAX BOARD

The Franchise Tax Board (FTB) administers the personal income tax (PIT) program and the corporation tax (CT) programs. The department also performs some non-tax collection activities, such as the collection of court-ordered payments and delinquent vehicle license fees. The FTB is governed by a three-member board, consisting of the Director Finance the Chair of the Board of Equalization, and the State Controller. An executive officer, appointed by the board, manages the daily functions of the department.

The Governor's Budget proposed expenditures of \$560.3 million (\$524.4 million General Fund) and 5,259 positions for FTB – a decrease of \$6.1 million (\$10.4 million General Fund) compared with estimated 2008-09 spending. The reduction reflects the completion of the Child Support Automation Project to the transfer of ongoing implementation to the Department of Child Support Services. The reduction also reflects a shift in the budgeting of Political Reform Act audits.

2009-10 Budget Act. The budget adopted in February for the FTB differed from the Governor's Budget request in that the amount was reduced to eliminate (without prejudice) \$3.9 million for the Enterprise Data to Revenue (EDR) Project (discussed in Issue 4, below).

Tax Refunds Delayed

FTB indicates that due to the state's cash-flow problems, as of March 3rd it had accumulated 3.3 million PIT refunds totaling \$2.2 billion and 10,000 business entity refunds totaling \$150 million. The State Controller has announced that he will begin to pay tax refunds this week. The state begins to accrue an interest payment liability on any tax refunds delayed past May 31st (for timely-filed returns).

ISSUE 1: OVERSIGHT—IMPLEMENTATION OF 2008-09 TAX GAP AUGMENTATIONS

The Legislature approved FTB requests for a total of \$17.6 million and 224 positions in the 2008-09 Budget for a variety of activities intended to improve compliance and collection of the PIT and the CT. FTB estimated that these efforts would generate \$104 million in additional revenue in 2008-09 and larger amounts annually thereafter.

COMMENT

The FTB should briefly review the components of last years Tax Gap augmentations and update the subcommittee on the status of their implementation—including current cost and revenue estimates for the current year and 2009-10, and how these compare with the amounts estimated in the enacted 2009-10 Budget, progress in hiring and filling new positions, and the effect on implementation of the unusually late adoption of the 2008-09 Budget, which was not signed until September 23, 2008.

ISSUE 2: REVENUE LOSS FROM FURLOUGH PROGRAM

Unlike the BOE, the FTB is under gubernatorial control and consequently implemented the Governor's furlough program. The administration, however, did allow FTB leeway to modify the program by adopting self-directed furloughs, rather than shutting down the department two Fridays per month, which would have severely disrupted audit and collection activities, as well as taxpayer services. The FTB is now implementing the recent which calls for 1-day-per-month "self-directed" furloughs, as provided under the recent SEIU bargaining agreement with the administration. Employee wages will be reduced by the equivalent of 1 day per month, but employees will have discretion, in cooperation with management, to work a full schedule and take off furlough days at a later time. The self-directed furloughs extend through June 2010. Employees will have until July 1, 2012 to use any deferred furlough days.

Revenue Losses Significantly Exceed Savings

According to FTB staff, the savings under the self-directed furlough policy will be roughly \$20 million. However, FTB also estimates that the furlough policy (by reducing staff time available for tax administration, audits, and collections) will result in the loss or deferral (primarily loss) of \$260 million of revenue. The department estimates, based on experience thus far with employee timing of self-directed furloughs, that about half of the revenue loss will occur in 2009-10 and the remainder of the loss will be spread over the subsequent two years. Overall, this reflects a loss or deferral of about \$13 of revenue for each dollar of savings.

COMMENTS

1. FTB should update the subcommittee regarding the impact of the veto reduction and of the new bargaining agreement and furlough policy, including current estimates of lost and deferred revenues.
2. The Department of Finance (DOF) and the Legislative Analyst's Office (LAO) should comment as to whether they have reviewed FTB's estimates and if they concur or disagree with FTB's assessment of the revenue impacts of the furlough policy or have alternatives to propose at this time.

3. **Better Plan Needed.** It would appear that the furlough policy and will result in a cumulative loss of \$13 dollars of revenue for every dollar of savings (and a loss of about 6-to-1 in 2009-10 alone). If so, then an alternative plan is needed that does not result in a net negative budget impact. Staff recommends that the subcommittee direct the FTB to work with its employee groups, the administration, and the LAO to develop an alternative plan for the subcommittee's consideration at a subsequent hearing.

ISSUE 3: ENTERPRISE DATA TO REVENUE PROJECT

As noted above, \$3.9 million of funding and 58 positions requested for this project were deleted (without prejudice) in the 2009-10 Budget Act. That action reflected concern that this is the initial request for a major new data integration project at FTB that would cost about \$300 million (through 2016-17) to implement. On the basis of the state's fiscal condition, LAO has recommended deferral of project development (but approval of other components of this request). However, the FTB also estimates that the project will generate about \$2.8 billion of additional revenue over that time, and that ongoing net revenue would be in excess of \$900 million annually.

EDR Budget Proposal and Project Description

The 2009-10 EDR budget proposal consists of \$3.9 million (General Fund) and the addition of 58 positions (phased in over the year) for FTB to (1) resolve an existing backlog in business entity return processing and collections correspondence, (2) hire additional staff and consultants to document FTB's business processes as a precursor to development of the EDR Project, and (3) begin planning for the EDR project, including issuing a request for proposals. The FTB estimates that the proposal will increase General Fund revenue collected in 2009-10 by \$4 million and by \$14 million in 2010-11, primarily by adding staff to process the current backlog of business entity returns in order to accelerate collections. The EDR project would take approximately seven years to implement and, once completed, would replace several older FTB information technology systems and streamline other existing systems. The FTB estimates the project will incur costs of \$318 million during implementation (2008-09 through 2017-18) with annual costs thereafter estimated to be \$14 million.

Main Goals. The EDR Project has three major goals. First, it seeks to capture all tax return data in an electronic form. Second, the project will integrate the various existing "siloes" tax databases at FTB into a data warehouse. Third, the project will enable FTB to add third-party data (county assessor data, for example) to its data warehouse. The FTB asserts that the EDR Project will allow it to substantially improve detection of underpayment and fraud in order to collect taxes from those who are not paying the full amount that they owe. In addition, the FTB indicates that the project will enable it to improve service and give taxpayers better access to their tax records.

Project Components. The project includes the following improvements to FTB's systems that process personal income tax (PIT) and business entity tax returns:

- An underpayment modeling process that would be integrated with the Accounts Receivable Collections System and Taxpayer Information System.
- An enterprise data warehouse with data search and analysis tools.
- A taxpayer records folder that is accessible to the taxpayer and allows taxpayers and FTB staff to access the information.
- Re-engineering of existing business processes—including imaging of tax returns, data capture, fraud and underpayment detection, tax return validation, filing enforcement, and other audit processes—and integration of these enhanced business processes with FTB's existing tax systems.
- Improved business services at FTB such as address verification, issuance of notices, and a single internal password sign-on for its IT systems.

Benefit-Funded Approach. FTB indicates that it plans to finance the EDR Project using a benefit-funded approach. Contractor payment for system development and implementation will be conditioned on generating additional revenue that will more than cover the cost. This approach is intended to protect the state and also gives the contractors a strong incentive to develop the project in a manner that produces significant revenue quickly. The FTB has used this approach previously.

LAO Recommends Approval of Backlog Processing, But Deferral of Project Development

The LAO agrees that the EDR Project would improve and streamline existing IT systems and business processes at FTB. But LAO points out that the project would come with a hefty price tag. Given the state's fiscal condition, LAO recommends postponement of the pre-procurement activities associated with the EDR project. LAO recommends, however, that the Legislature approve 50 positions (phased in over 2009–10) requested to process the backlog in the business entity workload at a cost of approximately \$2.5 million (compared with the request for \$3.9 million). Because all of the funding for this request was deleted from the 2009-10 Budget Act, this recommendation now requires a \$2.5 million augmentation. LAO recommends approval of these positions on a two-year limited-term basis, rather than as permanent staff, because the staff would process an existing backlog, rather than an increase in annual ongoing workload. LAO points out that these positions can be authorized independently of the IT project and are expected to accelerate \$3.8 million in General Fund revenues in 2009–10, increasing to \$14 million in accelerated General Fund revenues in 2010–11.

LAO Recommends that FTB Report on the Benefits of A "Pilot" to Use Existing Tax Return Data to Increase Tax Revenues

Most PIT tax returns—68 percent or 10.4 million were filed electronically in 2007, but only 16 percent (229,000) of business entity tax returns were filed electronically. The remainder of the tax returns were filed in a paper format. Only a portion of the information from paper-filed tax returns is scanned and keyed into FTB's systems in order to make it available to FTB staff electronically. Because the two processes—electronic filing and hard-copy paper filing—result in two different levels of access to taxpayer information, FTB has limited itself to using only a portion of the electronically-filed tax return data in its automated systems. Therefore, the rest of the information (including all of the tax schedules) that FTB receives from taxpayers is only used in FTB's manual—and more cumbersome—audit and collection processes.

Maintaining Parity between Electronically-Filed and Paper Tax Returns. The reason for this seemingly counterproductive policy is that extracting more data from electronically filed tax returns (and therefore applying more automated fraud and underpayment testing to those returns) would discourage electronic filing and result in substantial increases in paper filing, which is cumbersome and expensive for FTB to handle. Consequently, FTB and other tax agencies generally follow a policy of parity in the amount of data that they routinely extract from electronic and paper returns for their information processing systems.

A major component of the proposed EDR Project is imaging of paper returns in order to allow full electronic data capture of the information in those returns. Accomplishing this would then also allow full use of the information from electronically filed tax returns.

LAO Has Modified Their Original Recommendation. LAO originally recommended that the Legislature direct FTB to use all of the tax return information that it receives electronically in its automated audit and collection systems—rather than limiting itself to the same data that is available from paper tax returns. The FTB estimated that using the electronically filed data in this manner would increase General Fund revenues by approximately \$20 million beginning in 2009–10 and require 17 additional permanent staff at a General Fund cost of \$1.1 million. However, this recommendation would have eliminated parity and resulted in a shift back to paper filing. Based on subsequent discussions with FTB and the Internal Revenue Service (IRS), LAO has revised its recommendation.

LAO now recommends that the subcommittee direct the FTB to report on the costs and benefits of a "pilot" to use additional data from electronically-filed tax returns from a specific group of taxpayers. Parity would be maintained by shifting resources to additional auditing of paper tax returns filed by this group.

COMMENTS

1. Both LAO and the FTB agree that addressing the backlog of business entity returns is worthwhile. Furthermore, addressing the backlog is a necessary step in EDR Project development, according to the FTB. Consequently, the issue in contention is about \$1.4 million of the budget request, which would be used primarily to document FTB's existing business practices and data systems to lay the initial groundwork for the EDR Project.
2. FTB's benefit-funded approach makes use of revenue gains from reducing the backlog to offset costs in 2009-10 through 2012-12. However, these gains can be accomplished regardless of whether project development goes forward. In subsequent years, the estimates in the project's Feasibility Study Report (FSR) indicate large increases in annual revenue gains that would be more directly attributable to the project. From 2012-13 through 2016-17 annual revenue gains increase from \$80.9 million to \$934 million, while annual costs increase from \$58.8 million in 2012-13 to a peak of \$111.6 million in 2014-15 and then decline to \$14.1 million (essentially the annual ongoing continuing cost) by 2014-15.
3. Because the net benefit of this project (as estimated in the FSR) ramps up quickly and becomes very large, the net present value loss to the General Fund that results from delaying the project by one year is somewhere between \$600 million and \$900 million (depending on discount rate). The investment required to avoid this loss is about \$24 million over the next three years (disregarding revenue from backlog reduction). As noted above, the project begins to produce significant net revenues starting in 2014-15. Of course, these calculations critically depend on the accuracy of both the estimates and the schedules in the FSR.
4. The FTB has, perhaps, the best track record in California state government for the successful development and implementation of major information technology projects. However, FTB projects have experienced some significant delays and cost increases, although these problems generally have not prevented successful completion. LAO bases their recommendation for deferral of project development on the scarcity of budget resources, not on any faults that they have identified with the EDR Project or any lack of confidence in FTB's ability to carry it out.

5. The Department of Finance continues to support the FTB budget request.
6. The "pilot" proposed by LAO is not intended as a test, but rather would be a small-scale version of the more universal data capture component in the EDR Project.

ISSUE 4: UNNECESSARY FUNDING FOR ADMINISTRATION OF SENIOR HOMEOWNERS AND RENTERS ASSISTANCE PROGRAM

The FTB budget includes \$6.4 million in the current year and \$6.5 million in 2009-10 (all General Fund) for administration of the Senior Homeowners and Renters Assistance Program. This program provided annual payment to low-income seniors and disabled renters and homeowners. Although the program continues to be authorized in law, the Governor eliminated all funding for payments in the 2008-09 Budget Act, and no funding for payments was included in the Governor's Budget for 2009-10 or in the 2009-10 Budget Act.

The FTB indicates that it continued to include administrative funding in its budget in the event that funding was restored for the assistance payments. The department also indicates that some ongoing administrative work is needed to process claims for prior years and to maintain the existing data systems (if the Legislature wishes to retain the option to reinstate the program in the future without having to recreate these systems).

COMMENT

1. FTB should explain how, or whether, it is using the \$6.4 million budgeted for program administration in the current year.
2. FTB should identify the amount it needs in 2009-10 to process prior-year claims and the amount needed to maintain systems.

ITEM 9100 TAX RELIEF

This budget item now includes two programs that make payments to local governments to help defray revenues lost as a result of tax relief programs.

1. Homeowners' Property Tax Relief Subventions (\$444.6 million)
2. Subventions for Open Space / Williamson Act (\$34.8 million)

Subventions to offset local revenue loss from the Homeowners' Property Tax Relief program are constitutionally required. The Governor's Budget proposed no funding for Open-Space subventions in 2009-10, but funding was restored in the 2009-10 Budget Act. However, no funding has been provided for the Senior Citizen Homeowners or Renters Tax Assistance payments (there also is no funding for these programs in the current year as a result of the Governor's veto of funding in the 2008-09 Budget Act). In addition, SB 8 X3 (the 2009-10 General Government Trailer Bill) indefinitely suspended, as requested by the Governor, the Senior Citizen Property Tax Deferral Program as of February 20, for a General Fund savings of \$6.5 million in the current year and \$32 million in 2009-10.

ISSUE 1: IMPACT OF THE ELIMINATION OF THE SENIOR CITIZENS PROPERTY TAX DEFERRAL PROGRAM
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The Senior Citizens Property Tax Deferral Program has enabled homeowners with annual household incomes below \$35,500, and who are at least 62 years old, blind, or disabled, to postpone their property tax payments. The state makes the property tax payments on the homeowners' behalf, and is reimbursed when the home is sold, or the qualifying occupants cease their residency. The deferral program is a loan program earning interest, 5% interest for fiscal year 2008, and is secured by a lien on the property. Each year the program is a net-zero program, in that the amount paid out is less than the amount collected on loan repayments. The program is administered by the State Controller.

At staff's request the State Controller's Office (SCO) has provided the following information about the incomes of the seniors making use of the program and the amount of annual property tax that the program has allowed them to defer.

Household Income	# of Claims	Property Taxes Postponed						
		0-\$500	\$501-\$1,000	\$1001-\$1500	\$1501-\$2000	\$2001-\$2500	\$2501-\$3000	>\$3,000
0-\$5,000	76	2	10	16	8	7	2	31
\$5,001-10,000	380	27	86	65	50	50	22	80
\$10,001-15,000	1792	176	468	423	236	168	100	221
\$15,001-20,000	1225	87	198	240	177	152	106	265
\$20,001-25,000	943	31	138	176	150	122	79	247
\$25,001-30,000	570	18	62	89	107	68	57	169
\$30,001-35,500	275	4	23	41	36	28	31	112
Total	5261	345	985	1050	764	595	397	1125

Based on the information provided in the table above, 1,204 of the seniors receiving a property tax deferral—23 percent of the total--had household incomes (including any SSI/SSP grants) under \$20,000 and property tax bills of \$2,000 or more. Without the deferral program, it is likely that many of these low-income seniors will not be able to pay their property tax bill. Although counties cannot force a tax sale until taxes are delinquent for five years, lenders can immediately start foreclosure proceedings on properties for non-payment of property taxes, and 60 percent of deferral participants reported having a mortgage.

COMMENTS

1. SCO should describe the program and indicate how they have informed program participants of the demise of the program, and whether they are aware of any specific problems caused by the suspension of the deferral program. Also, SCO should describe any options that they have developed to continue to provide the most essential property tax deferrals at a lower state cost.