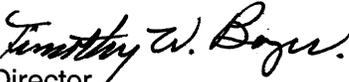


Memorandum

To : Ms. Deborah Pellegrini, Chief
Board Proceedings Division

Date : February 6, 2004

From : Timothy W. Boyer 
Interim Executive Director

Subject: **February 18, 2004, Administrative Agenda Budget Item**

At the February 18, 2004 Board Administrative Agenda (Executive Director's Report Item), please include the attached listing of 2004-05 Finance Letters, which includes a brief descriptive summary of each request and the Finance Letters, as a budget item for the Board Members consideration. With the Board Members approval, the Finance Letters will be forwarded to the Department of Finance for their consideration for inclusion in the FY 2004-05 Budget May Revise package.

If you have any questions regarding the attached list, please contact Ms. Raye Zentner, Deputy Director of Administration at 445-4272 or Ms. Marcia Davey, Chief of the Financial Management Division at 445-3811. Thank you.

TB:ds
g:\costana\04-05bcp\fl\2004-05 Finance Letters Agenda Memo (2-6-04) and summaries.doc
Attachment

cc: Ms. Raye Zentner
Ms. Marcia Davey
Mr. Rene Gutierrez
Mr. Gary Evans
Ms. Joann Richmond
Ms. Robbie Ramirez

Item #R
2/18/04

SUMMARY OF FINANCE LETTERS

Finance Letter No. 1 -- Cumulative Impact of Recent Reductions

The Board of Equalization (BOE) is facing an estimated \$14.3 million shortfall in Personal Services (PS) in the 2004-05 Fiscal Year. Furthermore, due to prior budget cuts, vacancies are not sufficient to achieve the required salary savings of 257.6 PYs (\$13,205,000) in the current fiscal year. The previous budget cuts which contributed to this problem are summarized below:

Effective	Cuts in PS	Cuts in OE&E	Due To:
July 1, 2002	\$6,459,000	\$31,000	2002-03 BCP 11 (General Fund Reduction)
July 1, 2002	\$4,232,000	\$174,000	Budget Act Section 31.60
July 1, 2003	\$12,975,000	\$3,848,000	Budget Act Section 4.10

The solution to this problem would be to lower the salary savings requirement and propose additional funding in the amount of \$14.3 million and 50 auditor and 50 collector positions lost since July 1, 2002. Restoration of these positions will generate \$59.4 million of additional revenue for the General Fund and Local Government.

Finance Letter No. 2 -- Alternative Cigarette Tax Stamps (Placeholder)

This proposal represents a placeholder request for possible additional funds to establish a new contract related to cigarette tax stamps.

In today's market, many packs of cigarettes sold to consumers by California retailers have counterfeit stamps affixed to them. The counterfeit stamps are of such high quality that retailers are not able to easily distinguish them from the authentic stamps. SB 1701 (Chapter 881, Statutes of 2002) requires the Board of Equalization (BOE) to implement a cigarette tax stamp or meter impression capable of being read by a scanning or similar validation device by January 1, 2005. To implement this requirement, the BOE submitted an Invitation for Bid (IFB) in December 2003 inviting qualified suppliers to provide a cigarette tax stamp system necessary to support the administration of the California Cigarette and Tobacco Products Tax Law. The IFB contract award notification is scheduled for February 18, 2004. The BOE's budgeted level for this contract is \$1.3 million annually. Since the award amount is higher than the budgeted level, the approval of this Finance Letter is necessary for additional funding in order to award the contract.

If the Finance Letter is not approved and the project does not proceed, the BOE estimates that as much as \$238 million in cigarette tax revenue evasion will continue due to untaxed cigarettes and counterfeit stamps.

Finance Letter No. 3 -- SB 20 -- Electronic Waste Recycling Act of 2003

The Integrated Waste Management Board has requested that the BOE collect the covered electronic waste recycling fee identified in SB 20 (Chapter 526, Statutes of 2003). Approval of this Finance Letter would allocate additional funds to allow the BOE to implement and administer the provisions of this legislation associated with fee collection. This is a technical adjustment since the 2004-05 Governor's Budget proposes \$5.2 million of funding for the Integrated Waste Management Board to pay another entity to collect this fee.

SUMMARY OF FINANCE LETTERS

Finance Letter No. 4 -- AB 1666 - Cigarette and Tobacco Distributor Twice-Monthly Payment and Reporting Basis

Effective January 1, 2004, AB 1666 (Chapter 867, Statutes of 2003) allows cigarette distributors to elect either a monthly or twice-monthly payment basis for amounts owing for stamps and meter register settings purchased on a deferred basis. AB 1666 also reduces the amount of security required to be posted by a cigarette distributor that defers payments for stamps and meter register settings and elects a twice-monthly payment basis. Additionally, AB 1666 allows tobacco products distributors to elect either a monthly or twice-monthly basis to file a return and remit payment of the amount of tax due based on the distributions of tobacco products and the wholesale cost during the preceding month.

The enactment of AB 1666 has created a new workload and expenditures. Implementation of this bill was a result of budget deliberations that requires the submission of this Finance Letter for necessary funding.

Finance Letter No. 5 -- Department of Motor Vehicles Support Budget Need

Vehicle Code Section 38211 (c) authorizes the Department of Motor Vehicles (DMV) to act as the BOE's agent in the collection of use tax at the time of DMV registration. When a vehicle owner registers their vehicle, DMV requires the owner to pay tax and registration fees for the vehicle. Vehicle Code Section 38211 (c) states that BOE shall reimburse DMV for the costs incurred in carrying out the provisions of this section. DMV provides the administrative duties via an interdepartmental agency agreement with the BOE.

DMV projects higher number of transactions for Fiscal Year 2004-05 at a higher cost per transaction than the current year level. These additional costs are non-absorbable for both agencies. The Department of Finance suggested that this issue be resolved through the submittal of a Finance Letter.

Finance Letter No. 6 -- Department of Justice Support Budget Need

The Attorney General and the Department of Justice (DOJ) provide legal representation to the State's taxing agencies including the Board of Equalization (BOE). Government Code Section 11044 authorizes the Attorney General to charge these client agencies an amount sufficient to recover the costs incurred when DOJ provides these services. Effective April 1, 2004 and thereafter, the Attorney General will increase the rate from \$120 per hour to \$132 per hour for standard attorney services and from \$56 per hour to \$91 per hour for paralegal services. The Department of Justice plans to raise these rates to pay for increased employee retirement costs and to pay for higher Department of General Services rental rates. Funding for AB 71 litigation is also included.

If legal representation from DOJ is restricted or limited because of a lack of funding, the BOE could lose tax cases currently being litigated and the State could lose as much as \$170 million in potential plaintiff awards. This proposal would insure that the BOE would have the same level of DOJ representation.

STATE BOARD OF EQUALIZATION

2004-05 FINANCE LETTERS

TABLE OF CONTENTS

<u>Finance Letter No.</u>	<u>Title of Finance Letter</u>
Finance Letter No. 1	Cumulative Impact of Recent Reductions
Finance Letter No. 2	Alternative Cigarette Tax Stamps (Placeholder)
Finance Letter No. 3	SB 20 - Electronic Waste Recycling Act of 2003
Finance Letter No. 4	AB 1666 - Cigarette and Tobacco Distributor Twice-Monthly Payment and Reporting Basis
Finance Letter No. 5	Department of Motor Vehicles Support Budget Need
Finance Letter No. 6	Department of Justice Support Budget Need

STATE BOARD OF EQUALIZATION

2004-2005 Finance Letters

Current Year Impact

February 18, 2004

TABLE OF CONTENT / SUMMARY

<u>Finance Letter No.</u>	<u>TITLE</u>	<u>Personnel Years</u>	<u>Expenditures (In Thousands)</u>
Finance Letter No. 2	Alternative Cigarette Tax Stamps (Placeholder) *		\$0
Finance Letter No. 3	SB 20 - Electronic Waste Recycling Act of 2003	2.2	900
TOTAL		<u>2.2</u>	<u>\$900 **</u>

* Costs are unknown at this time.

** Reimbursements: \$900

**2004-2005 Finance Letters
Budget Year Impact**

February 18, 2004

*****FUNDING SUMMARY*****

FUND	Finance Letter No. (\$ In Thousands)						TOTAL BCPs
	1	2	3	4	5	6	
GENERAL FUND (0001)	\$11,440			\$30	\$550	\$138	\$12,158
SPECIAL FUNDS							
BREAST CANCER FUND (0004)				1			1
EMERGENCY TELEPHONE (0022)							-
MOTOR VEHICLE FUEL (0061)							-
OCCUPATIONAL LEAD (0070)							-
CHILDHOOD LEAD (0080)							-
CIGARETTE & TOBACCO (0230)				14			14
CIGARETTE AND TOBACCO PRODUCTS COMPLIANCE FUND (3067)						50	50
OIL SPILL PREVENTION (0320)							-
INTEGRATED WASTE (0387)							-
UNDERGROUND TANK (0439)							-
ENERGY RESOURCES (0465)							-
CA CHILDREN AND FAMILIES FIRST TRUST FUND (0623)				13			13
TIMBER TAX (0965)							-
SUBTOTAL SPECIAL FUNDS	-	-	-	28	-	50	78
FEDERAL FUNDS (0890)							-
REIMBURSEMENTS (0995)	2,860		3,100		137	34	6,131
GRAND TOTAL	<u>\$14,300</u>	<u>\$0 *</u>	<u>\$3,100</u>	<u>\$58</u>	<u>\$687</u>	<u>\$222</u>	<u>\$18,367</u>

* Costs are unknown at this time

**2004-2005 Finance Letters
Current Year Impact**

February 18, 2004

*****FUNDING SUMMARY*****

FUND	Finance Letter No. (\$ In Thousands)						TOTAL BCPs
	1	2	3	4	5	6	
GENERAL FUND (0001)							\$0
SPECIAL FUNDS							
BREAST CANCER FUND (0004)							-
EMERGENCY TELEPHONE (0022)							-
MOTOR VEHICLE FUEL (0061)							-
OCCUPATIONAL LEAD (0070)							-
CHILDHOOD LEAD (0080)							-
CIGARETTE & TOBACCO (0230)							-
OIL SPILL PREVENTION (0320)							-
INTEGRATED WASTE (0387)							-
UNDERGROUND TANK (0439)							-
ENERGY RESOURCES (0465)							-
CA CHILDREN AND FAMILIES FIRST TRUST FUND (0623)							-
TIMBER TAX (0965)							-
SUBTOTAL SPECIAL FUNDS	-	-	-	-	-	-	-
FEDERAL FUNDS (0890)							-
REIMBURSEMENTS (0995)			900				900
GRAND TOTAL	<u>\$0</u>	<u>\$0 *</u>	<u>\$900</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$900</u>

* Costs are unknown at this time

STATE BOARD OF EQUALIZATION

2004-2005 Finance Letters

Budget Year Impact

February 18, 2004

TABLE OF CONTENT / SUMMARY

<u>Finance Letter No.</u>	<u>TITLE</u>	<u>Personnel Years</u>	<u>Expenditures (In Thousands)</u>
Finance Letter No. 1	Cumulative Impact of Recent Reductions	100.0	\$14,300
Finance Letter No. 2	Alternative Cigarette Tax Stamps (Placeholder) *		0
Finance Letter No. 3	SB 20 - Electronic Waste Recycling Act of 2003	33.6	3,100
Finance Letter No. 4	AB 1666 - Cigarette and Tobacco Distributor Twice-Monthly Payment and Reporting Basis	0.5	58
Finance Letter No. 5	Department of Motor Vehicles Support Budget Need		687
Finance Letter No. 6	Department of Justice Support Budget Need		222
	TOTAL	<u>134.1</u>	<u>\$18,367 **</u>

* Costs are unknown at this time.

** General Fund: \$12,158/Special Funds: \$78/Reimbursements: \$6,131

**STATE BOARD OF EQUALIZATION
FISCAL YEAR 2004-05
FINANCE LETTER NO. 1**

TITLE OF PROPOSED CHANGE:
CUMULATIVE IMPACT OF RECENT REDUCTIONS

SUMMARY OF PROPOSED CHANGES:

The State Board of Equalization (BOE) faces an estimated \$8.5 million shortfall in Personal Services in the 2004-05 Fiscal Year. Since July 1, 2002, the BOE has lost a total of \$23,666,000 in personal services and \$4,053,000 in operating expense and equipment. These reductions result in insufficient resources to pay for unfunded employee costs and to meet collective bargaining requirements. Due to this lack of adequate funding it has become necessary to keep revenue-generating positions vacant in order to produce required salary savings. However, keeping revenue-generating positions vacant has resulted in lost revenue for the State and Local Government. Therefore, we recommend approval for \$8.5 million in additional funding to compensate for the salary savings positions reduced pursuant to Section 4.10 of the Budget Act of 2003. We further recommend approval to restore personal services of \$5.8 million and 100 positions (50 auditors and 50 collectors) to protect the BOE's ability to raise revenue of \$59.4 million for the General Fund and Local Governments.

FISCAL IMPACT:

	Appropriation No.			Dollars (in Thousands)		
	(Org)	(Ref)	(Fund)	Past Year	Current Year	Budget Year
Existing Program:	0860	001	0001	\$ 176,659	\$ 171,261	\$ 171,261
	-	-	-	\$	\$	\$
	-	-	-	\$	\$	\$
	-	-	-	\$	\$	\$
Reimbursements	0860	501	0995	\$ 82,709	\$ 81,139	\$ 81,139
			TOTAL	259,368	252,400	252,400
Positions				3,328.0	3,157.8	3,157.8
Personnel Years				3,200.0	3,036.3	3,036.3
Proposed Changes:	0860	001	0001	\$	\$	\$ 11,440
(by appropriation)	-	-	-	\$	\$	\$
	-	-	-	\$	\$	\$
	-	-	-	\$	\$	\$
Reimbursements	0860	501	0995	\$	\$	\$ 2,860
			TOTAL	\$	\$	\$ 14,300
Positions						100.0
Personnel Years						100.0

For EDP requests, include date Special Project Report (SPR) or Feasibility Study Report (FSR), approved _____.

State Board of Equalization

Administration Department

Cumulative Impact of Recent Reductions

Fiscal Year (FY) 2004-05

A. Nature of Request

The State Board of Equalization (BOE) faces an estimated \$8.5 million shortfall in Personal Services in the 2004-05 Fiscal Year. Since July 1, 2002, the BOE has lost a total of \$23,666,000 (equivalent to 374.5 personnel-years) in personal services and \$4,053,000 in operating expense and equipment. Because of these recent reductions, funding is insufficient to pay for unfunded employee costs and to meet collective bargaining requirements. Since BOE must keep revenue-generating positions vacant to generate salary savings the State and Local Governments have lost revenue. If approved, this request would generate as much as \$59,400,000 in revenue for the State and Local Government.

B. Background/History

In the Budget Act, the BOE is a "category" budget. Specifically, the Legislature and the Governor provide a discrete appropriation for BOE's personal services budget. (The Legislature and the Governor provide a separate appropriation for BOE's operating expense and equipment budget.) Unlike other state agencies, BOE cannot freely move appropriated funding from BOE's operating expense budget to address any shortfalls in its personal services budget.

The BOE is facing an approximate \$8.5 million shortfall in personal services. In part, the shortfall is due to the following reductions resulting in insufficient vacancies to achieve the required salary savings of 309.9 pys and \$16,153,000 in the 2004-05 fiscal year.

- Effective July 1, 2002, the BOE lost \$6,459,000 (equivalent to 146.0 personnel-years) in personal services and \$31,000 in OE&E per 2002-03 BCP No. 11 (General Fund Reduction).
- Additionally, effective July 1, 2002, the BOE lost \$4,232,000 (equivalent to 87.5 personnel-years) in personal services and \$174,000 in OE&E per Section 31.60.
- Effective July 1, 2003, the BOE lost \$12,975,000 (equivalent to 141.0 personnel-years) in personal services and \$3,848,000 in OE&E per Section 4.10.
- Past OE&E reductions have already eliminated any flexibility.

C. State Level Considerations

STRATEGIC PLAN CONFORMITY:

The mission of the BOE is to serve businesses and the public through fair, effective, and efficient tax administration. The BOE does this by:

- Interpreting and applying tax and fee laws correctly, consistently, and fairly;
- Collecting and allocating revenues as required by law;
- Assessing and allocating property values as required by law;
- Educating and assisting tax and fee payers to comply voluntarily, while minimizing their compliance burden;
- Providing high-quality customer service, using well-qualified staff and state-of-the-art technology;
- Achieving program objectives at the lowest possible cost.

An augmentation to the Board's budget will help the BOE reach these goals, specifically in collecting and allocating revenues, interpreting and applying the tax and fee laws correctly, and to maintain an audit program to ensure that the correct amount of tax is paid and to further educate tax and fee payers.

D. Justification/Analysis of All Feasible Alternatives

Alternative 1:

Lower the BOE's salary savings requirement by \$8.5 million and authorize personal services restoration of 100 positions (\$5.8 million) for Sales and Use Tax Department positions reduced pursuant to Section 4.10 of the Budget Act of 2003.

Pros:

- Avoids adverse impact to operations in support of taxpayer services.
- Provides funding to accommodate mandatory expenditures.
- Allows the BOE to fill revenue-generating positions.
- Generates \$59.4 million in revenue for the State and Local Government.

Con:

- Requires an augmentation to the General Fund.

D. Justification/Analysis of All Feasible Alternatives (Continued)

Alternative 2:

Lower the BOE's salary savings requirement from 309.9 pys (\$16,153,000) to 146.8 pys (\$7,653,000) and approve funding in the amount of \$8.5 million to compensate for the 50 auditor (\$4.25 million) and 50 collector (\$4.25 million) salary savings positions lost since July 1, 2002.

Pros:

- Avoids adverse impact to operations in support of taxpayer services.
- Provides funding to accommodate mandatory expenditures.
- Allows the BOE to fill revenue-generating positions as turnover allows.

Con:

- Requires an augmentation to the General Fund.

Alternative 3:

Absorb the costs within the BOE baseline funding. Due to the recent reductions from the BOE budget, either salary savings or a deficiency request must accommodate a personal service shortfall.

Pro:

- Requires no additional expenditure authority.

Cons:

- Requires the BOE to absorb an \$8.5 million shortfall in personal services to accommodate costs which could require layoffs.
- Creates an adverse impact to operations in support of taxpayer services if the expenditures of other personal services or necessary operating expenses are frozen to generate savings to accommodate these costs.
- Statutes, constitutional provisions, and court decisions prevent the BOE from diverting resources paid for by one fund to accomplish the requirements of another fund. (For example: According to the Timber Tax Law, Timber Taxes could not be diverted to fund non-Timber Tax programs. Also, Article 19 of the State Constitution states that Motor Vehicle Fuel Tax Account could not be used to fund non-Motor Vehicle Fuel Tax account programs.)
- Diversion of resources from one funding source to another will cause the fund to lose the resources and fall short of generating the estimated revenues.
- Results in revenue loss by keeping additional positions vacant; thereby, further exacerbating the state fiscal crisis.

D. Justification/Analysis of All Feasible Alternatives (Continued)

Alternative 4:

Do not approve this proposal.

Pro:

- Requires no additional General Fund expenditure authority.

Cons:

- Results in revenue loss by keeping additional positions vacant; thereby, further exacerbating the state fiscal crisis.

E. Timetable

Effective: July 1, 2004.

F. Recommendation

Recommend Alternative 1. Therefore, we recommend approval for \$14.3 million in additional funding to compensate for the salary savings positions reduced pursuant to Section 4.10 of the Budget Act of 2003 and the restoration of personal services of 100 positions (50 auditors and 50 collectors).

G. Fiscal Detail

See attached "Fiscal Detail" schedule.

**BUDGET CHANGE PROPOSAL
 FISCAL DETAIL
 FISCAL YEAR 2004-05
 (\$ in Thousands)**

Title of Proposed Change: Cumulative Impact of Recent Reductions

Program/Element/Component: Sales and Use Tax Program

	Personnel Years		Current Year	Budget Year
	CY	BY		
TOTAL SALARIES AND WAGES <i>_a/</i>		100.0		\$4,932
Salary Savings Restoration				8,500
NET TOTAL SALARIES AND WAGES		100.0		13,432
Staff Benefits <i>_a/</i>				868
TOTAL PERSONAL SERVICES		100.0		\$14,300

OPERATING EXPENSE AND EQUIPMENT

- General Expense
- Printing
- Communications
- Postage
- Travel--In-State
- Travel--Out-of -State
- Training
- Facilities Operations
- Consulting & Professional Services: Interdepartmental
- Consulting & Professional Services: External
- Stephen P. Teale Data Center
- Data Processing
- Equipment
- Other Items of Expense: (Specify Below)

_a/ See page 9 of 9 for itemized staff benefits and classification detail.

	<u>Current Year</u>	<u>Budget Year</u>
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TOTAL OPERATING EXPENSE AND EQUIPMENT

	_____	_____
--	-------	-------

TOTAL EXPENDITURES (State Operations)

	_____	\$14,300
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Source of Funds

General Fund	(0001)		\$11,440
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Special Funds:

Breast Cancer Fund	(0004)		
State Emergency Telephone	(0022)		
Propane Surcharge Fund	(0051)		
Motor Vehicle Fuel	(0061)		
Occupational Lead Prevention Fund	(0070)		
Childhood Lead Poisoning Prev. Fund	(0080)		
Cig. and Tobacco Prod. Surtax Fund	(0230)		
Oil Spill Prevention and Admin. Fund	(0320)		
Integrated Waste Management	(0387)		
Underground Storage Tank Fund	(0439)		
Energy Resources Programs Account	(0465)		
CA. Children and Families First Trust Fund	(0623)		
Timber Tax Fund	(0965)		
Gas Consumption Fund	(3015)		

Federal Funds

Other Funds

Reimbursements	(0995)		\$2,860
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**DETAIL OF STAFF BENEFITS
AND PERSONAL SERVICES**

Staff Benefits Detail:	<u>Current Year</u>	<u>Budget Year</u>
	<i>(Whole Dollars)</i>	
OASDI		\$188,600
Health Insurance		256,100
Retirement		366,000
Workers' Compensation		41,000
Industrial Disability Leave		2,700
Non-Industrial Disability Leave		6,200
Unemployment Insurance		4,300
Other		2,900
TOTAL		\$868,000

<u>Classification</u>	<u>Positions</u>		<u>Salary _b/</u>	<u>Amount</u>	
	<u>CY</u>	<u>BY</u>		<u>CY</u>	<u>BY</u>
Sales and Use Taxes					
Associate Tax Auditor		50.0	\$49,320		\$2,466,000
Business Taxes Compliance Specialist and Business Tax Representative		50.0	\$49,320		2,466,000
Blanket Funds:					
Overtime (Various)					
Temporary Help					
TOTAL SALARIES AND WAGES		100.0			\$4,932,000

_b/ The salary is the minimum step of the salary range for the stated classification.

**STATE BOARD OF EQUALIZATION
FISCAL YEAR 2004-05
FINANCE LETTER NO. 2**

TITLE OF PROPOSED CHANGE:

Alternative Cigarette Tax Stamps (Placeholder)

SUMMARY OF PROPOSED CHANGES:

This proposal represents a placeholder request for possible additional funds to establish a new contract related to cigarette tax stamps.

In today's market, many packs of cigarettes sold to consumers by California retailers have counterfeit stamps affixed to them. The counterfeit stamps are of such high quality that retailers are not able to easily distinguish them from the authentic stamps. SB 1701 (Chapter 881, Statutes of 2002) requires the Board of Equalization (BOE) to implement a cigarette tax stamp or meter impression capable of being read by a scanning or similar validation device by January 1, 2005. To implement this requirement, the BOE submitted an Invitation for Bid (IFB) in December 2003 inviting qualified suppliers to provide a cigarette tax stamp system necessary to support the administration of the California Cigarette and Tobacco Products Tax Law. The IFB contract award notification is scheduled for February 18, 2004. The BOE's budgeted level for this contract is \$1.3 million annually. Since the award amount is higher than the budgeted level, the approval of this Finance Letter is necessary for additional funding in order to award the contract.

If the Finance Letter is not approved and the project does not proceed, the BOE estimates that as much as \$238 million in cigarette tax revenue evasion will continue due to untaxed cigarettes and counterfeit stamps.

**STATE BOARD OF EQUALIZATION
FISCAL YEAR 2004-05
FINANCE LETTER NO. 3**

TITLE OF PROPOSED CHANGE:

SB 20 - Electronic Waste Recycling Act of 2003 (Placeholder)

SUMMARY OF PROPOSED CHANGES:

This proposal represents a draft placeholder request for Senate Bill (SB) 20 – Electronic Waste Recycling Act of 2003. Costs for this proposal are pending final review.

This proposal requests \$900,000 (Reimbursements) and 2.2 PYs in FY 2003-04, \$3,100,000 (Reimbursements) and 33.6 PYs in FY 2004-05, and \$4,948,000 (Reimbursements) and 60.0 PYs in FY 2005-06 and ongoing years to implement, administer, and enforce the provisions of SB 20 - Electronic Waste Act of 2003 (Chapter 526, Statutes of 2003). Effective July 1, 2004, SB 20 imposes a fee upon a retailer's first sale of a "covered electronic device" to a consumer. (Covered electronic devices include televisions, computer monitors and other electronic goods containing hazardous components to the environment.) SB 20 requires a retailer selling this type of product in California to collect this fee from the consumer in specified amounts that will support a waste recycling program established by the California Integrated Waste Management Board. The California Integrated Waste Management Board would enter into an interagency agreement with the State Board of Equalization (BOE) for collection of the Covered Electronic Waste Recycling Fee.

**STATE BOARD OF EQUALIZATION
FISCAL YEAR 2004-05
FINANCE LETTER NO. 4**

TITLE OF PROPOSED CHANGE:

AB 1666 - Cigarette and Tobacco Distributor Twice-Monthly Payment and Reporting Basis

SUMMARY OF PROPOSED CHANGES:

This proposal requests \$58,000 (\$30,000 General Fund, \$1,000 Breast Cancer Fund, \$14,000 Cigarette and Tobacco Products Surtax Fund, and \$13,000 CA. Children and Families First Trust Fund) and 0.5 Personnel Year in FY 2004-05 and \$44,000 (\$22,000 General Fund, \$1,000 Breast Cancer Fund, \$11,000 Cigarette and Tobacco Products Surtax Fund, and \$10,000 CA. Children and Families First Trust Fund) in FY 2005-06 to successfully implement and administer the provisions of AB 1666 - Cigarette and Tobacco Distributor Twice-Monthly Payment and Reporting Basis (Chapter 867, Statutes of 2003). Effective January 1, 2004, AB 1666 allows cigarette distributors to elect either a monthly or twice-monthly payment basis for amounts owing for stamps and meter register settings purchased on a deferred basis. AB 1666 also reduces the amount of security required to be posted by a cigarette distributor that defers payments for stamps and meter register settings and elects a twice-monthly payment basis. Additionally, AB 1666 allows tobacco products distributors to elect either a monthly or twice-monthly basis to file a return and remit payment of the amount of tax due based on the distributions of tobacco products and the wholesale cost during the preceding month. AB 1666 creates a non-absorbable, limited-term workload for the Board of Equalization and additional resources are needed to successfully implement and administer this legislation.

FISCAL IMPACT:

	Appropriation No.			Dollars (in Thousands)		
	(Org)	- (Ref)	- (Fund)	Past Year	Current Year	Budget Year
Existing Program:	0860	- 001	- 0001	\$ 4,082	\$ 3,936	\$ 3,936
	0860	- 001	- 0004	\$ 124	\$ 124	\$ 124
	0860	- 001	- 0230	\$ 1,892	\$ 1,901	\$ 1,901
	0860	- 001	- 0623	\$ 1,674	\$ 1,670	\$ 1,670
Reimbursements	0860	- 501	- 0995	\$ ---	\$ ---	\$ ---
	TOTAL			7,772	7,631	7,631
Positions				74.4	71.5	71.5
Personnel Years				71.5	68.7	68.7
Proposed Changes: (by appropriation)	0860	- 001	- 0001	\$	\$	\$ 30
	0860	- 001	- 0004	\$	\$	\$ 1
	0860	- 001	- 0061	\$	\$	\$
	0860	- 001	- 0230	\$	\$	\$ 14
	0860	- 001	- 0623	\$	\$	\$ 13
Reimbursements	0860	- 501	- 0995	\$	\$	\$
	TOTAL			\$	\$	\$ 58
Positions						0.5
Personnel Years						0.5

For EDP requests, include date Special Project Report (SPR) or Feasibility Study Report (FSR), approved _____.

STATE BOARD OF EQUALIZATION

EXCISE TAXES AND FEES DIVISION

AB 1666 - Cigarette and Tobacco Distributor Twice-Monthly Payment and Reporting Basis

Fiscal Year (FY) 2004-05

A. Nature of the Request

The Cigarette and Tobacco Products Tax Law requires all distributors that are required to be licensed by the Board of Equalization (BOE) to furnish a minimum \$1,000 security deposit. Additionally, a cigarette distributor that defers payments for stamps or meter register settings must furnish a security deposit of at least 70 percent of, but not more than twice the amount of the stamps and meter register settings for which payment is deferred. Most security is posted in the form of a security bond. According to the California Distributors Association, insurance companies have been forced to raise their rates and reduce their policies since September 11, 2001. If available, an average bond has risen from under 4 percent to over 6.5 percent of its value. Additionally, large judgments against cigarette and tobacco manufacturers, such as Philip Morris, and RJR Nabisco, have had an adverse impact on insurance companies. Although most judgments have been lowered or dismissed, insurance companies continue to be concerned and the price of security bonds has increased. If bonds were unavailable, the cash requirements of all distributors would be difficult to meet as a roll of stamps typically costs over \$26,000.

AB 1666 (Chapter 867, Statutes of 2003) was enacted to assist distributors in meeting security requirements. AB 1666 authorizes cigarette distributors to elect either a monthly or twice-monthly payment basis for amounts owing for stamps and meter register settings purchased on a deferred basis. AB 1666 also reduces the amount of security required to be posted by a cigarette distributor that defers payments for stamps and meter register settings and elects a twice-monthly payment basis. Additionally, AB 1666 allows tobacco products distributors to elect either a monthly or twice-monthly basis to file a return and remit payment of the amount of tax due based on the distributions of tobacco products and the wholesale cost during the preceding month. Implementation of this bill allows the BOE to track accounts that elect a twice-monthly reporting basis for processing on the Special Taxes Automated Revenue System (STARS) and the Revenue Database Consolidation (RDC) Project. AB 1666 will result in an increase in the number of returns processed and will create a non-absorbable, limited-term workload for the BOE. Additional resources are needed to successfully implement and administer the provisions of this legislation.

B. Background/History

Current Cigarette and Tobacco Products Tax Law imposes an excise tax (currently at the rate of 87 cents per package of 20) on each pack distributed. Through the use of stamps or meter impressions, distributors pay the cigarette tax imposed with respect to the distribution of cigarettes. An appropriate stamp or meter impression is required to be affixed to, or made on, each package of cigarettes prior to distribution of the cigarettes. There is also a surcharge on tobacco products that is equivalent to the combined rate of tax on cigarettes. The current surcharge rate for FY 2003-04 is 46.76 percent of the wholesale price.

B. Background/History (Continued)

Cigarette Distributors

BOE currently contracts with Bank of America to sell cigarette tax stamps to licensed distributors, collect the payment for stamps, and remit the money to BOE. Cigarette distributors desiring to defer payment for stamps and meter impressions are also required to furnish security bonds equal to, not less than, 70 percent of the amount and not more than twice the amount of the purchase of stamps and meter register settings for which payment may be deferred. Once a cigarette distributor provides the required security to purchase stamps or meter register settings on a deferred-payment basis, BOE staff sets the distributor's credit limit and provides written authorization to the Bank of America. Payment for all deferred payment purchases of stamps and meter register settings made during each calendar month must be made to the Bank of America by the 25th day of the calendar month following the month in which the purchases were made.

AB 1666 amends the Cigarette and Tobacco Products Tax Law to reduce the amount of security required by a licensed cigarette distributor desiring to defer payments for stamps or meter register settings who and elects to make deferred payments on a twice-monthly basis. Under AB 1666, the amount of security required would be equal to not less than 50 percent and no more than twice the amount of the distributor's purchase of stamps and meter register settings for which payment may be deferred. If the distributor chooses the twice-monthly payment basis to lower their security requirement, the payments would be due as follows:

- The first monthly remittance would be due on or before the 5th day of the month. The amount due would be equal to either one-half of the total amount of those purchases of stamps and meter register settings made during the preceding month, or the total amount of those purchases of stamps and meter register settings made between the first day and the 15th day of the preceding month, *whichever is greater*.
- The second monthly remittance would be made on or before the 25th day of the month for the remainder of those purchases of stamps and meter register settings that were made in the preceding month.

Additionally, AB 1666 allows a cigarette distributor that elects to make deferred payments on a twice-monthly basis to file a report on or before the 5th day of the month with respect to his or her distributions of cigarettes and purchases of stamps and meter register settings. Cigarette distributors that elect a monthly reporting basis file on or before the 25th day of the month with respect to his or her distributions of cigarettes and purchase of stamp and meter register settings.

B. Background/History (Continued)

Tobacco Products Distributors

AB 1666 also addresses distributors of tobacco products. Under current law, each distributor of tobacco products is required to file a return and remit taxes owed on or before the 25th day of each month with respect to distributions and wholesale cost during the preceding month. AB 1666 allows a distributor of tobacco products to elect to file a return and make payment of the tax due on either a monthly or a twice-monthly basis. If a distributor elects a twice-monthly basis, the distributor would be required to file two returns and make two remittances during the month following the month during which the tobacco products were distributed. The returns and remittances are due as follows:

- The first monthly return would be filed, together with the first remittance of tax, on or before the 5th day of the month for those distributions of tobacco products that occurred between the first day and the 15th day of the preceding month.
- The second monthly return would be required to be filed, together with the second remittance of tax, on or before the 25th day of the month for those distributions of tobacco products that occurred between the 16th day and last day of the preceding month.

AB 1666 creates a non-absorbable, limited-term workload for the BOE and additional resources are needed to implement this legislation. The provisions of AB 1666 remain in effect through December 31, 2006. On or before January 1, 2006, the Legislative Analyst Office is required to prepare a report to the Legislature on the economic impact of this bill. The report would include an evaluation of the BOE's ability to collect cigarette tax revenues, additional revenues (if any) generated by the twice-monthly payment program, and the ability of distributors to access security bonds.

C. State Level Considerations

As required by Budget Letter #03-05 (2004-05 Budget Preparation Guidelines), this proposal addresses the enacted provisions of AB 1666 (Chapter 867, Statutes of 2003).

Strategic Plan Conformity:

This proposal is consistent with the BOE's strategic plan. Specifically, this proposal conforms to:

- Issue 2- Modernizing Tax Compliance Practices, Strategy 3- Identify and analyze areas of noncompliance and develop approaches to address targeted problem areas, while maintaining customer-service awareness; and Strategy 4- Pursue changes to the tax laws to make them more relevant to current and evolving business practices.

D. Justification/Analysis of All Feasible Alternatives

Alternative 1- Provide the required resources to implement AB 1666.

Under this alternative, the BOE will require \$58,000 in FY 2004-05 and \$44,000 beginning in FY 2005-06 through FY 2006-07 to implement the provisions of AB 1666. The following summary outlines BOE's resource needs.

Excise Taxes and Fees Division (ETFD) Compliance Section

Currently, 48 of approximately 235 cigarette distributors purchase tax stamps and meter register settings on a deferred basis. With a lower security requirement, ETFD Compliance staff estimates that 100 distributors will choose to defer payments for stamps and meter register settings and elect to make those payments on a twice-monthly basis. ETFD Compliance staff will manually track, type and send monthly schedules to these accounts. Every distributor desiring to purchase tax stamps or meter register settings on the deferred payment basis must request the ETFD Compliance staff to set the maximum amount of purchases the distributor may have unpaid at any time and the amount of the required security bond. The maximum amount of stamps and meter register setting purchases for which the distributor may defer payment can't exceed one and one-half times the distributor's average monthly tax liability based on the distributor's six previous month's experience. In the case of a distributor not previously authorized to make deferred payment purchases or a distributor whose business has changed substantially, the maximum amount will be set at one and one-half times the estimated average monthly tax liability. Upon setting the distributor's credit limit, ETFD Compliance staff will provide written authorization to Bank of America regarding purchase limits of the distributor.

AB 1666 also allows distributors of tobacco products to elect to file a return and make payment of the tax due on either a monthly or a twice-monthly basis. If a distributor elects a twice-monthly basis, the distributor would file two returns and make two remittances during the month for tobacco products distributed in the preceding month. There are approximately 900 tobacco products distributors accounts. ETFD Compliance staff estimates 100 accounts (10%) will elect to make two remittances during the month. To accommodate these accounts, a twice-monthly reporting basis will be established and maintained. ETFD Compliance staff will track, type and send approximately 1,080 additional returns annually. The additional returns will result in an additional 216 delinquencies and 108 billings issued. The following is a summary of ETFD Compliance section workload (see Exhibit I, page 10, for detailed calculations):

Compliance Tasks	FY 2004-05	FY 2005-06 Through FY 2006-07
Account Maintenance/Credit Limits, Reporting Basis Changes	118	31
Return Processing	710	710
Billings/Refunds	62	62
Revocations/Suspensions	5	5
Collections	108	108
Total Hours Required	1,003	916
Total Positions/Overtime Hours Required:		
0.5 Tax Technician III (1,800 hours/Position)	900	900
Tax Technician III (Overtime hours)	103	16

D. Justification/Analysis of All Feasible Alternatives (Continued)

Alternative 1- Provide the required resources to implement AB 1666. (Continued)

In addition, ETFD will need to amend the current Bank of America cigarette stamp contract. BOE currently contracts with Bank of America to sell cigarette tax stamps to licensed distributors, collect payments of stamps, and remit the payment to BOE. Payment for all deferred payment purchases of stamps and meter register settings made during each calendar month must be made to Bank of America by the 25th day of the calendar month following the month in which the purchases were made. Under AB 1666, if a distributor elects the twice-monthly payment option, payments must be made on the 5th day and the 25th day of the calendar month following the month in which purchases were made. Thus, Bank of America will have more payments to process and accounts to reconcile. This additional workload will require a contract amendment of \$10,000.

Mail Services, Cashier and Data Entry Units

The following table summarizes the duties, tasks and overtime hours required by the Cashier and Data Entry Units.

Unit and Tasks	FY 2004-05 through FY 2006-07 Hours
Mail Services Unit - Responsible for processing incoming and outgoing mail.	
Mailing Machine Operator II	3.0
Office Assistant	0.5
Cashier Unit - Responsible for opening, sorting and batching incoming mail, encoding and depositing payments (1,080 returns/108 payments). _a/	
Office Assistant – (84 items processed/hr)	14.0
Data Entry Unit – Responsible for key entering data from documents and transferring the data to the mainframe database (Integrated Revenue Information System). Each return requires approximately 142 keystrokes; AR payment documents require approximately 35 keystrokes. _b/ All documents for Special Taxes are key entered twice for verification purposes.	
Key Data Operator (8,000 keystrokes/hr)	39.0
Total Overtime Hours Required	56.5

Footnotes:

_a/ $1,080 + 108 \text{ (items/year)} / 84 \text{ (items processed/ hr)} = 14.1 \text{ hours}$

_b/ Returns:

$1,080 \text{ (returns/year)} \times 142 \text{ (keystrokes)} \times 2 = 306,720 \text{ (total keystrokes/year)}$

$306,720 \text{ (total keystrokes/year)} / 8,000 \text{ (keystrokes/hr)} = 38.3 \text{ hours}$

AR Documents:

$108 \text{ (documents/year)} \times 35 \text{ (keystrokes)} \times 2 = 7,560 \text{ (total keystrokes/year)}$

$7,560 \text{ (total keystrokes/year)} / 8,000 \text{ (keystrokes/hr)} = .95 \text{ hours}$

D. Justification/Analysis of All Feasible Alternatives (Continued)

Alternative 1- Provide the required resources to implement AB 1666. (Continued)

Enactment of AB 1666 will not have an impact on cigarette tax revenues. However, AB 1666 allows cigarette distributors to elect a twice-monthly payment basis for deferred purchases of stamps and meter register settings. This could result in the BOE depositing payments approximately 20 days earlier for either 50 percent of the total purchases of stamps and meter register settings purchased during the previous month or the total amount of such purchase during the first 15 days of the previous month whichever is greater. Thus, there is a potential for increased interest to the state on those deposited payments. Additionally, AB 1666 also allows tobacco distributors to file a return and make payments of the tax due on a twice-monthly basis. In addition, there is a potential for increased interest to the state on those earlier deposited payments.

Pros:

- Ensures mandated workload is performed.
- Additional interest revenue due to accelerated deposits of payments.

Cons:

- Costs associated with implementation.

Alternative 2- Absorb workload within other BOE programs.

Under this alternative, the BOE would have to divert funding and resources from other programs to implement this legislation.

Pros:

- No authority is needed to request resources.

Cons:

- Statutes, constitutional provisions, and court decisions prevent the BOE from diverting controlled special funds to pay for other unrelated programs. (For example: According to the Timber Yield Tax Law, timber yield taxes could not be diverted to fund non-Timber Tax programs. Also, Article 19 of the State Constitution states that Motor Vehicle Fuel Tax account could not be used to fund non-Motor Vehicle Fuel Tax account programs.)
- Due to major reductions to the BOE's budget, the workload associated with AB 1666 can't be absorbed within the baseline budget. For example, Section 31.6 of FY 2002-03 eliminated 87.5 positions from the BOE's budget. BCP No. 11 FY 2002-03 also abolished 146 positions. Section 4.1 of FY 2003-04 reduced BOE's budget by \$16.1 million in General Fund (\$16.8 overall) and 141 positions.

Alternative 3 - Do not approve the authority to establish resources to implement this legislation.

Pro:

- No additional workload.

Con:

- Legislation will not be implemented.

E. Timetable

Resources are needed starting July 1, 2004 through December 31, 2006 to successfully implement and administer the provisions of AB 1666.

F. Recommendations

It is recommended that Alternative 1 be approved and that the BOE be authorized funding for \$58,000 in FY 2004-05 and \$44,000 beginning in FY 2005-06 through FY 2006-07. By providing the resources in Alternative 1, the BOE will successfully implement and administer the provisions of AB 1666.

Summary of the total Personal Services need:

Division/Unit	FY 2004-05		FY 2004-05 through FY 2006-07	
	Positions	Overtime	Positions	Overtime
Excise Taxes and Fees Division	0.5	103	0.5	16
Mail Services Unit		3.5		3.5
Cashier Unit		14		14
Data Entry Unit		39		39
Totals	0.5	159.5	0.5	72.5

Summary of Costs:

Item	FY 2004-05	FY 2005-06 through FY 2006-07
Personal Services	\$27,000	\$24,000
Operating Expense and Equipment	26,000	\$16,000
Total Direct Cost Costs	\$53,000	\$40,000
Redirect Existing Support Cost	5,000	\$4,000
Total Cost of Proposal	\$58,000	\$44,000

G. Fiscal Detail

See attached "fiscal detail" schedules.

STATE BOARD OF EQUALIZATION
EXCISE TAXES AND FEES DIVISION - COMPLIANCE SECTION
AB 1666 - CIGARETTE AND TOBACCO DISTRIBUTOR TWICE MONTHLY PAYMENT AND REPORTING BASIS

	FY 2004/05			FY 2005/06 +		
	<u>Occurrences</u>		<u>Hours</u>	<u>Occurrences</u>		<u>Hours</u>
ACCOUNT MAINTENANCE						
Taxpayer Inquiries	286	10 Minutes	48	12	10 Minutes	2
Reporting Basis Change	60	7 Minutes	7	12	7 Minutes	1
Security Maintenance	50	15 Minutes	13	50	15 Minutes	13
Credit Limit Authorization	100	30 Minutes	50	20	30 Minutes	15
			<u>118</u>			<u>31</u>
PROCESSING						
Type & Send CP Returns/Create Return Shell	1080	15 Minutes	270	1080	15 Minutes	270
Type & Send CR Schedule/Create Schedule Shell	1200	15 Minutes	300	1200	15 Minutes	300
Maintain Mailing Log	24	30 Minutes	12	24	30 Minutes	12
Taxpayer Inquiries on Returns	228	10 Minutes	38	228	10 Minutes	38
Return Review of Additional Tax Returns	1080	5 Minutes	90	1080	5 Minutes	90
Schedule Review for Additional Monthly Schedules	0	5 Minutes	0	0	5 Minutes	0
			<u>710</u>			<u>710</u>
BILLINGS/REFUNDS						
Delinquencies Issued	216	5 Minutes	18	216	5 Minutes	18
Clear Delinquencies	108	5 Minutes	9	108	5 Minutes	9
Issue Billings	108	15 Minutes	27	108	15 Minutes	27
Taxpayer Inquiries	54	5 Minutes	5	54	5 Minutes	5
Issue Refunds	11	15 Minutes	3	11	15 Minutes	3
			<u>62</u>			<u>62</u>
REVOCATIONS/SUSPENSIONS						
Revocation Notice Issued	11	5 Minutes	1	11	5 Minutes	1
Revocation Correspondence	6	30 Minutes	3	6	30 Minutes	3
Revocation Hearing Research	1	45 Minutes	1	1	45 Minutes	1
			<u>5</u>			<u>5</u>
COLLECTIONS						
Collection Cases	108	1 Hour	108	108	1 Hour	108
			<u>108</u>			<u>108</u>
				<u>140</u>		
GRAND TOTAL HOURS			<u>1,003</u>			<u>916</u>
<u>POSITION AND OVERTIME REQUESTED:</u>						
Tax Technician III (1,800 per position)			0.5			0.5
Overtime			103			16

ASSUMPTIONS:

235 Cig Distrib Accts

909 Tobacco Distrib Accts

1,144 Total Accounts

100 Expected Number of Cig Distrib Accounts on Deferred Credit with passage of AB 1666 (1st year)

20 Expected Number of Cig Distrib Accounts on Deferred Credit to Add/Change (on-going)

90 Expected number of Tob Prod Distrib Accounts to remit twice monthly return and payment (10% of Accounts).

1,080 = 90 x 12 additional CP returns

1,200 = 100 x 12 Schedule C (manually track 100 CR accts on twice monthly basis to allow for reporting on 5th of month)

216 20 % Delinquency Rate

108 Billings Issued

**BUDGET CHANGE PROPOSAL
 FISCAL DETAIL
 FISCAL YEAR 2004-05
 (\$ in Thousands)**

Title of Proposed Change: AB 1666 - CIGARETTE AND TOBACCO DISTRIBUTOR
 TWICE-MONTHLY PAYMENT AND REPORTING BASIS

Program/Element/Component: 45 Cigarette and Tobacco Products Tax Program
 45.10 Registration of Taxpayers/45.2 Processing Tax Returns and Reports
 45.5 Collecting Taxes Receivable

	<u>Personnel Years</u>		<u>Current Year</u>	<u>Budget Year</u>
	<u>CY</u>	<u>BY</u>		
TOTAL SALARIES AND WAGES _a/		.5		\$21
Salary Savings _b/				
NET TOTAL SALARIES AND WAGES		.5		21
Staff Benefits _a/				6
TOTAL PERSONAL SERVICES		.5		\$27
 OPERATING EXPENSE AND EQUIPMENT				
General Expense				\$20
Printing				
Communications				1
Postage				
Travel--In-State				
Travel--Out-of-State				
Training				1
Facilities Operations				3
Consulting & Professional Services: Interdepartmental				
Consulting & Professional Services: External				
Stephen P. Teale Data Center				
Data Processing				1
Equipment				
Other Items of Expense: (Specify Below)				

_a/ See page 13 of 14 for itemized staff benefits and classification detail.
 _b/ Given BOE's high salary savings requirements, salary savings is deleted in order to be able to hire this staff.

	<u>Current Year</u>	<u>Budget Year</u>
TOTAL OPERATING EXPENSE AND EQUIPMENT		\$26
TOTAL DIRECT COST		\$53
Redirected Existing Support Cost _c/		\$5
Total Proposal		\$58

Source of Funds

General Fund	(0001)		\$30
Special Funds:			
Breast Cancer Fund	(0004)		1
State Emergency Telephone	(0022)		
Propane Surcharge Fund	(0051)		
Motor Vehicle Fuel	(0061)		
Occupational Lead Prevention Fund	(0070)		
Childhood Lead Poisoning Prev. Fund	(0080)		
Cig. and Tobacco Prod. Surtax Fund	(0230)		14
Oil Spill Prevention and Admin. Fund	(0320)		
Integrated Waste Management	(0387)		
Underground Storage Tank Fund	(0439)		
Energy Resources Programs Account	(0465)		
CA Children and Families First Trust Fund	(0623)		\$13
Timber Yield Tax Fund	(0965)		
Gas Consumption Fund	(3015)		
Federal Funds			
Other Funds			
Reimbursements	(0995)		

_c/ Existing support costs will be redirected through the Planning Estimate process.

**DETAIL OF STAFF BENEFITS
AND PERSONAL SERVICES**

Staff Benefits Detail:

Current Year Budget Year
(Whole Dollars)

OASDI		\$1,600
Health Insurance		1,800
Retirement		2,500
Workers' Compensation		300
Industrial Disability Leave		
Non-Industrial Disability Leave		
Unemployment Insurance		
Other		
TOTAL		\$6,000

<u>Classification</u>	<u>Positions</u>		<u>Salary</u>	<u>Amount</u>	
	<u>CY</u>	<u>BY</u>		<u>CY</u>	<u>BY</u>
Property and Special Taxes Department					
Excise Taxes and Fees Division:					
Tax Technician III _d/		.5	\$32,609		\$17,100
Blanket Funds:					
Overtime (Various)		(.1)			3,900
Temporary Help					
TOTAL SALARIES AND WAGES		.5			\$21,000

_d/ 0.5 limited-term position effective 7/1/04 through 12/31/06.

SUMMARY OF PROPOSED CHANGES

	<u>Current Year</u> (\$ in Thousands)	<u>Budget Year</u> (\$ in Thousands)	<u>Budget Year + One</u> (\$ in Thousands)
Proposed Equipment:			
N/A			
Total			
Proposed Contracts:			
General Expense (Bank of America Contract)		\$10	\$10
Total		\$10	\$10
One-Time Costs:			
General Expense		\$8	
Communications		1	
Data Processing		1	
Total		\$10	
Future Savings:			
N/A			
Total			
Full-Year Cost Adjustments:			
N/A			
Total			

**STATE BOARD OF EQUALIZATION
FISCAL YEAR 2004-05
FINANCE LETTER NO. 5**

TITLE OF PROPOSED CHANGE:

DEPARTMENT OF MOTOR VEHICLES SUPPORT BUDGET NEED

SUMMARY OF PROPOSED CHANGES:

The Department of Finance has directed the Board of Equalization (BOE) to submit this Finance Letter. This proposal requests \$687,000 (\$550,000 General Fund and \$137,000 Reimbursements) to avert a potential revenue loss. For FY 2004-05, the Department of Motor Vehicles (DMV) estimates a higher number of transactions and plans to charge a higher cost per transaction to BOE when DMV collects the vehicle use tax on BOE's behalf. This budget augmentation will provide adequate funding for the projected volume and cost per transaction increase.

FISCAL IMPACT:

	Appropriation No.			Dollars (in Thousands)		
	(Org)	- (Ref)	- (Fund)	Past Year	Current Year	Budget Year
Existing Program:	0860	- 001	- 0001	\$ 176,659	\$ 171,261	\$ 171,261
	_____	- _____	- _____	\$ _____	\$ _____	\$ _____
	_____	- _____	- _____	\$ _____	\$ _____	\$ _____
	_____	- _____	- _____	\$ _____	\$ _____	\$ _____
Reimbursements	0860	- 501	- 0995	\$ 82,709	\$ 81,139	\$ 81,139
			TOTAL	<u>259,368</u>	<u>252,400</u>	<u>252,400</u>
Positions				<u>3,328.0</u>	<u>3,157.8</u>	<u>3,157.8</u>
Personnel Years				<u>3,200.0</u>	<u>3,036.3</u>	<u>3,036.3</u>
Proposed Changes:	0860	- 001	- 0001	\$ _____	\$ _____	\$ 550
(by appropriation)	_____	- _____	- _____	\$ _____	\$ _____	\$ _____
	_____	- _____	- _____	\$ _____	\$ _____	\$ _____
	_____	- _____	- _____	\$ _____	\$ _____	\$ _____
Reimbursements	0860	- 501	- 0995	\$ _____	\$ _____	\$ 137
			TOTAL	<u>\$ _____</u>	<u>\$ _____</u>	<u>\$ 687</u>
Positions				_____	_____	_____
Personnel Years				_____	_____	_____

For EDP requests, include date Special Project Report (SPR) or Feasibility Study Report (FSR), approved _____.

State Board of Equalization

Sales and Use Tax Department

DEPARTMENT OF MOTOR VEHICLES SUPPORT BUDGET NEED

Fiscal Year (FY) 2004-05

A. Nature of Request

Vehicle Code Section 38211 (c) authorizes the Department of Motor Vehicles (DMV) to act as the Board of Equalization's (BOE) agent in the collection of use tax at the time of DMV registration. When a vehicle owner registers their vehicle, DMV requires the owner to pay tax and registration fees for the vehicle. Vehicle Code Section 38211 (c) states that BOE shall reimburse DMV for the costs incurred in carrying out the provisions of this section. DMV provides the administrative duties via an inter-agency agreement with the BOE.

During FY 2004-05, the BOE will experience a funding deficiency of \$687,000 as a result of an increase in the DMV's charges to the BOE for collecting the use tax. Without an augmentation, it is anticipated that the increase in charges would be significant enough to adversely impact the BOE business operations. The Department of Finance has directed the BOE to submit this Finance Letter to address the funding augmentation need.

B. Background/History

During FY 2002-03, DMV processed approximately 2.3 million use tax transactions and collected use tax revenues of approximately \$567 million. These revenues support State and local government programs. The use tax collection is part of a pre-established DMV vehicle/undocumented registration process requirement. It is prudent and efficient for the DMV to continue having this administrative responsibility since the DMV has 170 field offices and the computer programming in place to collect the use tax.

In an effort to contribute toward the State's General Fund shortfall, BOE's budget was reduced by \$4.4 million during FY 2001-02, and by \$ 6.5 million during FY 2002-03 including the elimination of 235 positions. In addition, BOE's budget was reduced by an additional \$16.8 million during FY 2003-04 including the elimination of 141 positions. This Finance Letter identifies a fiscal pressure that could have an adverse revenue impact to State and local governments if not provided for with additional resources. The BOE does not have the flexibility in its budget to absorb the increased costs of \$687,000 for this nondiscretionary expenditure for the DMV interdepartmental agency agreement.

C. State Level Considerations

STRATEGIC PLAN CONFORMITY:

This proposal is consistent with the following BOE Strategic Plan Issues and Strategies:

Issue 1 – Demonstrating Quality Services and Best Value

Strategy 4: Expand partnering efforts with the public and private sectors to capitalize on cost-effective methods to gather, use, and/or share information.

D. Justification/Analysis of All Feasible Alternatives

Alternative 1

Approve funding of \$687,000 beginning in the budget year to accommodate the budgetary impact of DMV’s increased charges.

The increased DMV charges are based on an increase in its workload volume and an increase in the charge-per-item to process the workload. The chart below details the cost increase:

Summary of requests:

	Rate	Estimated Transactions Per Year	Total Cost
Current	\$2.40	2,368,333	\$5,684,000
Proposed	\$2.621	2,430,610	\$6,370,629
Total Need Rounded to 1,000s (Shortfall)			\$687,000

Pros:

- Avoids adverse impact to operations in support of taxpayer services.
- Provides funding to accommodate mandatory expenditures.
- Protects the General Fund revenue base.

Con:

- Requires an augmentation of General Fund.

Alternative 2

Absorb the cost within the BOE baseline funding.

Pros:

- Requires no additional expenditure authority.
- Allows interdepartmental agency agreement to continue.

D. Justification/Analysis of All Feasible Alternatives (Continued)

Alternative 2 (Continued)

Absorb the cost within the BOE baseline funding.

Cons:

- Creates a significant funding shortfall of \$687,000 for the BOE.
- Creates an adverse impact to operations in support of taxpayer services if the expenditures of other personal services or necessary operating expenses are frozen to generate savings to accommodate these costs.
- Results in revenue loss by keeping auditor positions vacant; thereby, further making the state fiscal crisis worse.

Alternative 3

Absorb the cost within the DMV Baseline Funding.

Pros:

- Requires no additional expenditure authority.
- Allows interdepartmental agency agreement to continue.

Con:

- DMV cannot absorb the increased cost related to the collection of use tax pursuant to Article 19, Section 2 of the California Constitution, which restricts the use of motor vehicle revenues to State administration and enforcement of laws regulating the use operation, or registration of vehicles used upon public streets and highways of this State.

E. Timetable

Effective July 1, 2004.

F. Recommendation

It is recommended that Alternative 1 be approved and that the BOE be authorized additional funding of \$687,000 beginning in the budget year to avert a potential revenue loss. Taxpayer services, and in turn revenue, would be adversely affected if BOE is forced to redirect monetary resources that would otherwise be used to support revenue operations.

G. Fiscal Detail

See attached "Fiscal Detail" schedules.

**BUDGET CHANGE PROPOSAL
 FISCAL DETAIL
 FISCAL YEAR 2004-05
 (\$ in Thousands)**

Title of Proposed Change: DEPARTMENT OF MOTOR VEHICLES SUPPORT BUDGET NEED

Program/Element/Component: 30 Sales & Use Tax Program/30.20 Processing Tax Returns

	Personnel Years		Current Year	Budget Year
	CY	BY		
TOTAL SALARIES AND WAGES				
Salary Savings				
NET TOTAL SALARIES AND WAGES				
Staff Benefits				
TOTAL PERSONAL SERVICES				

OPERATING EXPENSE AND EQUIPMENT

- General Expense
- Printing
- Communications
- Postage
- Travel--In-State
- Travel--Out-of -State
- Training
- Facilities Operations
- Consulting & Professional Services: Interdepartmental
- Consulting & Professional Services: External
- Stephen P. Teale Data Center
- Data Processing
- Equipment
- Other Items of Expense: (Specify Below)

687

Finance Letter No. 5

	<u>Current Year</u>	<u>Budget Year</u>
TOTAL OPERATING EXPENSE AND EQUIPMENT	<hr/>	<hr/> \$687
TOTAL EXPENDITURES (State Operations)	<hr/> <hr/>	<hr/> <hr/> \$687

Source of Funds

General Fund	(0001)	\$550
Special Funds:		
Breast Cancer Fund	(0004)	
State Emergency Telephone	(0022)	
Propane Surcharge Fund	(0051)	
Motor Vehicle Fuel	(0061)	
Occupational Lead Prevention Fund	(0070)	
Childhood Lead Poisoning Prev. Fund	(0080)	
Cig. and Tobacco Prod. Surtax Fund	(0230)	
Oil Spill Prevention and Admin. Fund	(0320)	
Integrated Waste Management	(0387)	
Underground Storage Tank Fund	(0439)	
Energy Resources Programs Account	(0465)	
CA. Children and Families First Trust Fund	(0623)	
Timber Tax Fund	(0965)	
Gas Consumption Fund	(3015)	

Federal Funds

Other Funds

Reimbursements	(0995)	\$137
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SUMMARY OF PROPOSED CHANGES

	<u>Current Year</u> (\$ in Thousands)	<u>Budget Year</u> (\$ in Thousands)	<u>Budget Year + One</u> (\$ in Thousands)
Proposed Equipment:			
Total	_____	_____	_____
	=====	=====	=====
Proposed Contracts:			
Interdepartmental Contracts:			
Services by Department of Motor Vehicles		\$687	\$687
Total	_____	_____	_____
	=====	\$687	\$687
	=====	=====	=====
One-Time Costs:			
Total	_____	_____	_____
	=====	=====	=====
Future Savings:			
N/A			
Total	_____	_____	_____
	=====	=====	=====
Full-Year Cost Adjustments:			
N/A			
Total	_____	_____	_____
	=====	=====	=====

**STATE BOARD OF EQUALIZATION
FISCAL YEAR 2004-05
FINANCE LETTER NO. 6**

TITLE OF PROPOSED CHANGE:

Department of Justice Support Budget Need

SUMMARY OF PROPOSED CHANGES:

This proposal requests \$222,000 (\$138,000 General Fund, \$50,000 Cigarette and Tobacco Products Licensing Fund, and \$34,000 Reimbursements) in FY 2004-05. Effective April 1, 2004 and thereafter, the Attorney General will increase the rate from \$120 per hour to \$132 per hour for standard attorney services and increase the rate from \$56 per hour to \$91 per hour for paralegal services. Funding for possible AB 71 litigation is included. The Attorney General and the Department of Justice (DOJ) provide legal representation to the State's taxing agencies including the Board of Equalization (BOE). Government Code Section 11044 authorizes the Attorney General to charge these client agencies an amount sufficient to recover costs incurred when the DOJ provides these services. Funding approval will ensure that DOJ continue to provide legal representation to the Board.

FISCAL IMPACT:

	<u>Appropriation No.</u>			<u>Dollars (in Thousands)</u>		
	<u>(Org)</u>	<u>- (Ref)</u>	<u>- (Fund)</u>	<u>Past Year</u>	<u>Current Year</u>	<u>Budget Year</u>
Existing Program:	0860	- 001	- 0001	\$ 176,659	\$ 171,261	\$ 171,261
	0860	- 001	- 3067	\$	\$ 5,598	\$ 8,161
		-	-	\$	\$	\$
		-	-	\$	\$	\$
Reimbursements	0860	- 501	- 0995	\$ 82,709	\$ 81,139	\$ 81,139
	TOTAL			259,368	257,998	260,561
Positions				3,328.0	3,157.8	3,157.8
Personnel Years				3,200.0	3,036.3	3,036.3
Proposed Changes:	0860	- 001	- 0001	\$	\$	\$ 138
(by appropriation)	0860	- 001	- 3067	\$	\$	\$ 50
		-	-	\$	\$	\$
		-	-	\$	\$	\$
Reimbursements	0860	- 501	- 0995	\$	\$	\$ 34
	TOTAL			\$	\$	\$ 222
Positions						
Personnel Years						

For EDP requests, include date Special Project Report (SPR) or Feasibility Study Report (FSR), approved _____.

State Board of Equalization

Legal Department

DEPARTMENT OF JUSTICE SUPPORT BUDGET NEED

Fiscal Year (FY) 2004-05

A. Nature of Request

The Attorney General and the Department of Justice (DOJ) provide legal representation to the State's taxing agencies including the Board of Equalization (BOE). Government Code Section 11044 authorizes the Attorney General to charge these client agencies an amount sufficient to recover the costs incurred when the DOJ provides these services.

Effective April 1, 2004 and thereafter, the Attorney General will increase the rate from \$120 per hour to \$132 per hour for standard attorney services (e.g. 10% increase). The Attorney General will increase the rate from \$56 per hour to \$91 per hour for paralegal services (e.g. 62% increase).

For fiscal year 2004-05, the BOE requires \$172,000 to pay for this increase. The DOJ budget area reports that the increase will pay for higher employee retirement costs and for higher Department of General Services rental rates. DOJ reports that the new rates reflect revised workload and responsibility as well as updated analysis of reimbursable charges. In addition to the rate increase, BOE requires an estimated \$50,000 for litigation related to the provisions of AB 71 – the California Cigarette and Tobacco Licensing Act of 2003 (Chapter 890, Statutes of 2003).

This is a technical adjustment. The BOE's Legal Division reports that without the same level of legal representation, the State could be at risk for as much as \$170 million in adverse decisions.

B. Background/History

The DOJ provides legal services for different tax and employment law cases to the Board's Legal Division. The DOJ and BOE have an interagency agreement valued at \$930,000 for FY 2003-04 for these services.

In an effort to reduce the State's General Fund shortfall, BOE's budget was reduced by \$4.4 million during FY 2001-02, and by \$6.5 million during FY 2002-03 including the elimination of 235 positions. In addition, BOE's budget was reduced by an additional \$16.8 million during FY 2003-04 including the elimination of 141 positions. This Finance Letter identifies a fiscal pressure that could have an adverse revenue impact to State and local governments if additional resources are not provided. The BOE does not have the flexibility in its budget to absorb the projected increase costs of \$222,000 for this nondiscretionary expenditure for the DOJ interdepartmental agency agreement.

B. Background/History (Continued)

If legal representation from the DOJ is restricted or limited because of a lack of funding the BOE could lose tax cases currently being litigated. The BOE's Legal Department estimates the potential damages awarded to plaintiffs in these current cases could be over \$170 million. In addition, the BOE's Legal Department reports losses in some of these cases could result in tax law changes, which would substantially reduce the future revenue stream to the State.

C. State Level Considerations

STRATEGIC PLAN CONFORMITY:

This proposal is consistent with the following BOE Strategic Plan Issues and Strategies:

Issue 1 – Demonstrating Quality Services and Best Value

Strategy 4: Expand partnering efforts with the public and private sectors to capitalize on cost-effective methods to gather, use, and/or share information.

D. Justification/Analysis of All Feasible Alternatives

Alternative 1

Funding of \$222,000 beginning in the budget year to accommodate the budgetary impact of DOJ's increase charges and the increase litigation costs related to AB 71.

Funding approval will ensure that the DOJ continues to provide legal representation to the Board's Legal Department.

The chart below details the cost increase:

Summary of requests:

	Estimated Base Hours for 2003-04 Contract	Current Hourly Rate	2003-04 Contract Amount	Proposed Hourly Rate	Proposed 2004-05 Contract Amount	Shortfall
Attorneys	6,496	\$120	\$779,564	\$132	\$857,520	\$77,956
Paralegals	2,686	\$56	\$150,436	\$91	\$244,459	\$94,023
Sub-total			\$930,000		\$1,101,979	\$171,929
Litigation costs related to AB 71						\$50,000
Total Request (Rounded to the 1,000s)						\$222,000

D. Justification/Analysis of All Feasible Alternatives (Continued)

Pros:

- Ensures that all cases involving BOE are properly defended and resolved, which will result in fairness and equality for taxpayers, BOE employees, local government, and other entities.
- Assures compliance with the requirements of Government Code 11044.
- Assures compliance with the provisions of AB 71.

Con:

- Requires a budget augmentation.

Alternative 2

Absorb the cost within the BOE baseline funding.

Pros:

- Requires no additional expenditure authority.

Cons:

- Creates a significant funding shortfall of \$222,000.
- Creates an adverse impact to operations in support of taxpayer services if the expenditures of other personal services or necessary operating expenses are frozen to generate savings to accommodate these costs.

Alternative 3

Do not fund increased DOJ charges.

Pros:

- Requires no additional expenditure authority.

Con:

- If BOE is restricted to the existing level of funding, the State risks adverse decisions in current cases with potential losses of over \$170 million and law changes which would reduce the future revenue stream to the State.

E. Timetable

Effective July 1, 2004.

F. Recommendation

We recommend that Alternative 1 be approved and that the BOE be authorized additional funding of \$222,000 beginning in the budget year to avert potential adverse decisions.

G. Fiscal Detail

See attached "Fiscal Detail" schedules.

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BUDGET CHANGE PROPOSAL
 FISCAL DETAIL
 FISCAL YEAR 2004-05
 (\$ in Thousands)

Title of Proposed Change: Department of Justice Support Budget Need

Program/Element/Component: Various Programs and Elements

	Personnel Years		Current Year	Budget Year
	CY	BY		
TOTAL SALARIES AND WAGES				
Salary Savings				
NET TOTAL SALARIES AND WAGES				
Staff Benefits				
TOTAL PERSONAL SERVICES				

OPERATING EXPENSE AND EQUIPMENT

- General Expense
- Printing
- Communications
- Postage
- Travel--In-State
- Travel--Out-of -State
- Training
- Facilities Operations
- Consulting & Professional Services: Interdepartmental
- Consulting & Professional Services: External
- Stephen P. Teale Data Center
- Data Processing
- Equipment
- Other Items of Expense: (Specify Below)

222

	<u>Current Year</u>	<u>Budget Year</u>
TOTAL OPERATING EXPENSE AND EQUIPMENT		\$222
TOTAL EXPENDITURES (State Operations)		\$222

Source of Funds

General Fund	(0001)		\$138
Special Funds:			
Breast Cancer Fund	(0004)		
State Emergency Telephone	(0022)		
Propane Surcharge Fund	(0051)		
Motor Vehicle Fuel	(0061)		
Occupational Lead Prevention Fund	(0070)		
Childhood Lead Poisoning Prev. Fund	(0080)		
Insurance Fund	(0217)		
Cig. and Tobacco Prod. Surtax Fund	(0230)		
Oil Spill Prevention and Admin. Fund	(0320)		
Integrated Waste Management	(0387)		
Underground Storage Tank Fund	(0439)		
Energy Resources Programs Account	(0465)		
CA. Children and Families First Trust Fund	(0623)		
Cig. and Tobacco Prod. Tax Fund	(0623)		
Timber Tax Fund	(0965)		
Gas Consumption Fund	(3015)		
Cigarette and Tobacco Products	(3067)		\$50
Compliance Fund			
Federal Funds			
Other Funds			
Reimbursements	(0995)		\$34

SUMMARY OF PROPOSED CHANGES

	<u>Current Year</u> (\$ in Thousands)	<u>Budget Year</u> (\$ in Thousands)	<u>Budget Year + One</u> (\$ in Thousands)
Proposed Equipment:			
N/A			
Total	<hr/>	<hr/>	<hr/>
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
Proposed Contracts:			
Interdepartmental Contracts:			
Services by Department of Justice		\$172	\$172
Services by Department of Justice - Related to AB 71		50	50
Total	<hr/>	<hr/>	<hr/>
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
One-Time Costs:			
N/A			
Total	<hr/>	<hr/>	<hr/>
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
Future Savings:			
N/A			
Total	<hr/>	<hr/>	<hr/>
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
Full-Year Cost Adjustments:			
N/A			
Total	<hr/>	<hr/>	<hr/>
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>