STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**02/15/07**	Bill No:	**SB 274**
Tax:	**Business Property Income**	Author:	**Dutton**
Related Bills:			

BILL SUMMARY

This bill would abolish the Franchise Tax Board (FTB) and transfer all of its duties and powers to the Board of Equalization (BOE), operative January 1, 2009. This bill would also transfer the tax administrative functions of the Employment Development Department (EDD) and the California Department of Insurance (CDI) to the BOE. The bill would require the BOE to submit a report to the Governor and the Legislature by June 30, 2008, regarding the BOE's assumption of its new duties.

ANALYSIS

CURRENT LAW

Under existing law, the BOE administers, among other things, the following tax and fee programs: sales and use tax, Bradley-Burns uniform local sales and use tax, transactions and use tax, alcoholic beverage tax, cigarette and tobacco products tax, motor vehicle fuel tax, diesel fuel tax, interstate user tax, emergency telephone users surcharge, energy resources surcharge, insurance tax (in part), integrated waste management fee, natural gas surcharge, childhood lead poisoning prevention fee, oil spill response and prevention fee, underground storage tank maintenance fee, use fuel tax, hazardous substances tax, California tire fee, occupational lead poisoning prevention fee, marine invasive species fee, electronic waste recycling fee, timber yield tax and private railroad car tax. The BOE also assesses the property of public utilities and common carriers, and provides certain administrative and oversight functions with respect to the local property tax.

The BOE is comprised of four elected members, one from each equalization district, and the State Controller. The Board itself is responsible for setting the values for state-assessed properties on the Board roll and for hearing appeals of those values. It also hears appeals relating to all of the taxes and fees it administers, as well as the taxes administered by the FTB.

The FTB was created by statute and is comprised of the Controller, the Director of Finance, and the Chair of the BOE. It administers the personal income tax and the corporation tax. In addition, the FTB administers other non-income tax related programs, including the Homeowners and Renters Property Tax Assistance program, child support and other non-tax debt collection programs, Political Reform Audit, and the Non-admitted Insurance Tax program.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position

The FTB and the BOE adopt rules and regulations for the taxes that the respective agencies administer. In addition, the BOE prescribes rules and regulations to govern county assessors when assessing property and assessment appeals boards when equalizing property values.

The EDD was also created by statute. The EDD is responsible for collecting and maintaining significant data regarding employment and wages. The Tax Branch of the EDD manages all administrative, education, customer service, and enforcement functions for the audit and collection of unemployment insurance, disability insurance, employment training tax, and personal income tax withholding.

The CDI regulates, investigates and audits insurance business to ensure that companies remain solvent and meet their obligations to insurance policyholders. The BOE issues assessments and hears insurance tax appeals, and the Controller is responsible for collections and accounting for the insurance tax.

PROPOSED LAW

This bill would add Section 15627 to the Government Code to transfer all of the duties, powers, purposes, and responsibilities, and jurisdiction of the FTB and of the tax administrative functions of the EDD and CDI to the BOE. All statutes and laws prescribing such duties and powers of the FTB, including all rules and regulations, are to continue in force. Any references to the FTB used in any statute, law, rule, or regulation shall hereafter mean the BOE. This bill specifies that any court action in which the FTB, or the tax administration functions to which EDD or CDI is a party on or before January 1, 2009 shall continue in the name of the BOE.

This bill would repeal Part 10 (commencing with Section 15700) of Division 3 of Title 2 of the Government Code related to the establishment and certain duties of the FTB.

This bill would add Section 20.5 of the Revenue and Taxation Code to provide that any references to the FTB shall hereafter mean the BOE.

This bill would also provide the following:

- That the BOE executive officer, with the approval of the Members of the Board, shall organize its new responsibilities in any manner as he or she deems necessary for the proper conduct of the BOE's consolidated revenue collection, administration and enforcement functions.
- That the civil service staff of the FTB, and those related to the tax administrative functions of EDD, and CDI shall be transferred to the BOE in accordance with existing law;
- That any contract, lease, or any other agreement in which the BOE or the FTB, EDD, or CDI is a party would not be voided and shall continue in full force and effect with the BOE assuming all rights, obligations, and duties of the FTB, EDD; and CDI;
- That the unencumbered balance of all money available for spending by the FTB, and EDD and CDI, with respect to the functions transferred to the BOE on and after

January 1, 2009, shall be made available for the support and maintenance of the BOE; and,

- That all books, documents, records, and property of the FTB, and EDD and CDI, with respect to the functions transferred to the BOE, shall be transferred to the BOE.

The bill would require the BOE to submit a report to the Governor and the Legislature by June 30, 2008, on its plan and progress of consolidation. The report shall include the following information:

- A strategic plan to transfer the duties and responsibilities of the FTB and the tax administration duties of the EDD and CDI into the BOE, including the identification of critical issues and the consolidation of computer systems, telecommunications, and office space;
- Identification of those functions that are conducive to consolidation or centralization, including administration, document processing, remittance cashiering, public service, collection, and physical equipment and facilities; and,
- Identification of those administrative functions that, because of statutory conflicts or inconsistent administrative processes of the FTB and the BOE, are more difficult to consolidate.

IN GENERAL

The BOE, FTB, and the Tax Branch of the EDD, in December 1993, formed a Strategic Tax Partnership (STP) to do the following: (1) address any significant differences in policies, procedures, or standards among the state's three taxing agencies; (2) improve service to California's taxpayers; and (3) increase compliance with the state's tax laws. The STP is modeled on the concept of a virtual organization - a network of independent organizations linked to share skills, costs, knowledge, and resources while maintaining their independent organizational forms.

In 1994, the Legislature and the Governor provided additional direction to the STP in the 1994 Budget Act that required the partner agencies to develop a plan for integrating tax information systems and explore joint business ventures to improve sharing of information, increase tax compliance, reduce the reporting burden on taxpayers, and provide greater taxpayer convenience.

The first task of the STP, with participation from the Department of Finance and the Legislative Analyst's Office (LAO), was the development of a strategic plan. The plan identified the STP's vision, shared values, initial joint projects, and served as their road map. Over the years, the STP has accomplished the goals as identified in the plan.

In May 1994, the BOE, FTB, EDD, and the Internal Revenue Service (IRS) formed a task force, known as the "Fed/State Compliance 2000." The task force identified common interests and developed strategies to improve tax compliance, staff training, and taxpayer/tax preparer education. In 1995, BOE became a member of the "Fed/State Partnership" which consists of the State's three taxing agencies—BOE, FTB, EDD, -- and the IRS. The Fed/State Partnership has developed strategies to increase tax compliance, reduce administrative costs, and reduce taxpayer/third party tax burden. To date, the Fed/State Partnership works on improving voluntary and enforced

compliance, reducing taxpayer burden, enhancing service to taxpayers, and allowing both the state agencies and the IRS to perform their duties more efficiently and cost-effectively, while ensuring the protection of taxpayers' rights to privacy and confidentiality.

LEGISLATIVE HISTORY OF TAX AGENCY CONSOLIDATION

The following bills have been introduced over the years that would have proposed to merge the FTB *into* the BOE:

- **AB 1615 (Klehs)**, would have also transferred to the BOE the duties, powers, purposes, responsibilities and jurisdiction of the FTB and the tax administrative functions of EDD and CDI – in substantially the same manner as this measure. The provisions of the bill were amended out in the Assembly Revenue and Taxation Committee.
- **SB 216 (Dutton, 2005-06)**, also similar to this measure, was never heard in committee.
- **AB 2000 (Dutton, 2003-04),** would have abolished the FTB and transferred all of its duties and powers to the BOE. AB 2000 was held in the Assembly Revenue and Taxation Committee.
- **ACA 13 (Leonard, 2001-02)**, would have changed the name of the BOE to the CTC and required the new Commission, in addition to performing the duties of the BOE, to administer and collect taxes on income as prescribed by law. ACA 13 was held in the Assembly Appropriations Committee.
- **AB 15 (Klehs, et al., 1993-94)**, would have abolished the FTB and transferred its powers and duties to the BOE. This bill was vetoed by Governor Wilson. In part, the veto message states, "…I support streamlining government and consolidating the Board of Equalization and the Franchise Tax Board. AB 15 is not the way to accomplish this purpose. The Administration sponsored legislation that would have created a Department of Revenue within the Administration. That approach would avoid the conflict of interest inherent in AB 15, in which the Board of Equalization serves as both administrator of the tax system, as well as the appellate body for taxpayer appeals."
- **AB 3338 (McClintock, 1991-92)**, would have abolished the FTB and transferred its powers and duties to the BOE. This bill failed passage in the Assembly Revenue and Taxation Committee.
- **SB 1052/SCA 22 (Alquist, 1989-90)**, would have abolished the FTB and transferred its powers and duties to the BOE. SCA 22 would have added the Director of Finance to the membership of the BOE. These measures were never heard in committee.

Other bills have also been introduced that would have consolidated the FTB and the BOE into another entity:

- **ACA 14 (DeVore, 2005-06)**, would have renamed the BOE as the CTC and would have expanded the membership to nine members. It would have also required the new CTC, in addition to performing the duties of the BOE, to assume the duties under the personal income tax and corporation tax laws and the administrative review of state tax matter determinations. This measure was held in the Assembly Appropriations Committee.
- **SCA 9 (Ducheny, 2005-06),** would have also renamed the BOE as the CTC and increased the membership to 9 voting members. The CTC would have, in addition to collecting and administering the BOE's current taxes and fees, collected and administered income taxes and any taxes withheld from wages, and conducted administrative review of state tax matter determinations. SCA 9 was never heard in committee.
- **ACA 22 (Dutra, 2003-04),** would have renamed the BOE as the California Tax Board, comprised of 5 voting members and would have transferred the income tax administrative responsibilities to the Board. ACA 22 was held in the Assembly Revenue and Taxation Committee.
- **AB 2794 (Bowen, et al., 1995-96)**, would have abolished the FTB and, except as provided by the Constitution, the administrative authority of the BOE, and would have provided for the transfer of their respective powers and duties to the Department of Revenue (DOR), which this bill would have created. This bill would have also created a Board of Tax Appeals consisting of seven members appointed by the Governor to serve as an appellate body to hear all tax appeals. This bill failed passage in the Assembly Revenue and Taxation Committee.
- **SB 1727/SCA 29 (Kopp, 1995-96)**, would have, among other things, done the following: (1) abolished the FTB and the BOE and transferred their powers and duties to the California State Tax Authority, which this bill would have created; and (2) created a Board of Tax Appeals consisting of seven members appointed by the Governor to serve as an appellate body to hear all tax appeals. Both bills were held in the Senate Appropriations Committee.
- **SB 87/SCA 5 (Kopp, 1993-94)**, would have, among other things, done the following: (1) abolished the FTB and the BOE and transferred their powers and duties to the DOR, which the bill would have created; and (2) created a Board of Tax Appeals. SB 87 failed on the Senate floor. SCA 5 was placed on the Senate inactive file.
- **SB 1829 (Campbell, 1993-94)**, would have, among other things, consolidated the FTB and the BOE and transferred their powers and duties to the DOR, which the bill would have created. The BOE would have provided administrative appellate review of all administrative tax matter decisions made by the DOR. The bill was never heard in committee.
- **SB 2137 (Campbell and Kopp, 1993-94)**, would have, among other things, consolidated the FTB and the BOE and transferred their powers and duties to the DOR, which the bill would have created. This bill would have also provided that the BOE would serve as the administrative appellate review of all administrative tax

matter decisions made by the DOR. This bill failed passage in the Senate Appropriations Committee.

- **SB 23 (Kopp, 1991-92)**, would have, among other things, done the following: (1) abolished the FTB and the BOE and transferred their powers and duties to the DOR which the bill would have created; and (2) created a Board of Tax Appeals. This bill failed to move out of the Senate.
- **SB 1695 (Kopp, 1991-92)**, would have, among other things, done the following: (1) abolished the FTB and the BOE and transferred their powers and duties to the DOR, which the bill would have created; and (2) created a Board of Tax Appeals. SB 1695 was sent to interim study. The Assembly Revenue and Taxation Committee held an oversight hearing on February 24, 1992, which reviewed specific issues related to consolidating the FTB and the BOE into a DOR. The issues discussed included: administration, audit, collections, return processing, legal divisions/appeals process, facilities, and data processing. It was noted in the hearing that the state's budget crisis made consolidation less attractive at the time due to its costs and complexities.
- **SB 1395 (Kopp, Ayala, et al., 1989-90)**, would have, among other things, done the following: (1) abolished the FTB and the BOE and transferred their powers and duties to the DOR, which the bill would have created; and (2) created a Board of Tax Appeals. This bill failed passage in the Senate Appropriations Committee.

Other measures have been introduced in the past to transfer the CDI's tax administrative functions to the BOE:

- **SB 896 (Speier, 1999-00),** which would have transferred the insurance tax audit and return processing functions from the CDI to the BOE. The bill died in the Senate.

- **SB 956 (Rosenthal, 1997-98),** which would have also transferred the insurance tax audit and return processing functions from the CDI to the BOE. The provisions of the bill were amended out in the Assembly Revenue and Taxation Committee.

COMMENTS

1. **Sponsor and purpose**. This measure is sponsored by Board Member Bill Leonard. The author's office notes that consolidating the BOE, FTB and the tax functions of the EDD and CDI would result in a more efficient, convenient tax agency providing more uniform tax policy and administration as well as administrative savings. The reorganization would place tax functions under a body that is elected by the voters every four years.

2. **LAO conducted a study regarding consolidation of certain functions of the BOE, FTB, and EDD.** Chapter 569, Statutes of 2003 (AB 986, Horton), directed the LAO to prepare a report that addresses issues related to the partial consolidation of FTB, BOE and EDD. The legislation mandated that the LAO report to the Legislature regarding the possible consolidation of payment and document processing of these three agencies. Specifically, based on information provided by the tax agencies, the

LAO was required to determine if it would be beneficial to consolidate the management and control of these operations.

In its January 2005 report, the LAO concluded that consolidation of the tax agencies' payment and documentation processing activities could in the medium- to long-term generate some annual cost savings and interest earnings through elimination of duplicative functions and increased efficiencies. However, the report indicates that the state would have to incur significant net costs in the short term to achieve these savings. In addition, the report indicates that such benefits are likely to be less than benefits from increasing electronic processing. The LAO recommended that low priority be given to consolidation of payment and document processing functions in favor of steps to increase electronic processing.

3. **The California Performance Review (CPR) also made its final recommendations to the Governor.** The Governor, by executive order, created the CPR to conduct a focused examination of California state government and to formulate and recommend practical changes to government agencies, programs and operations in order to reduce total costs of government operations, increase productivity, improve services, and make government more responsive and accountable to the public.

   As part of the Governor's process to decide which CPR recommendations to pursue, Governor Schwarzenegger formed the CPR Commission. The Commission is independent and bipartisan consisting of leaders in the public, private, and non-profit sectors. In its November 2004 report, the Commission agreed with the recommendation that the tax administration functions, such as collection and monitoring, should be consolidated from the different tax collection agencies in order to streamline processes and enhance operations.

4. **Proponents of consolidation of the agencies have argued the following points on previous proposals:**

   - **Consolidation would reduce administrative costs in the long-term.** It would reduce administrative costs, since it would result in the consolidation of administrative and staff services, including personnel and training. Also, it would avoid duplication of collection efforts, fiscal duties, and mailing costs. Data processing operations could be consolidated. Proponents state that consolidation of the data processing operations of the tax agencies could provide for improved information management and produce economies of scale.

   - **Consolidation would provide uniform tax policy and administration.** It would assure Californians greater uniformity in the audit, compliance and appeals processes and provide an opportunity to simplify and reduce regulations, and to reduce and standardize the number of taxpayer reports that need to be filed.

   - **Consolidation would benefit taxpayers.** Consolidation could enhance taxpayers' ability to conduct business by: (1) reducing the confusion over which

agency is responsible for a particular tax issue; and (2) reducing correspondence with, or travel to, state tax agencies. Also, consolidation can lead to coordinated taxpayer assistance programs that would provide taxpayers with comprehensive information about taxes in California.

- **Audits could be consolidated.** Some proponents argue that if the tax administration were consolidated into one agency, all taxes could be audited at the same time.
- **Elected officials tend to be more responsive than an appointed body.** Proponents have argued that a consolidated tax agency should be administered by an elected body because elected officials are more responsive to the people than appointed officials. Section 15623 of the Government Code requires Board Members to investigate the administration, enforcement, and operation within their districts, of all laws in which the administration and enforcement if vested with the BOE. As such, it is the Board Members' job to represent taxpayers and to make sure that BOE's tax programs are administered uniformly. With a representative tax administration, taxpayers can go directly to their Board Member for help with tax matters.

5. **The following arguments have been made against similar previous proposals:**

- **There is no overwhelming reason to consolidate.** In an overall view of the arguments in favor of and against merging the taxing agencies, it appears there is no overwhelming reason to do so. The tax agencies are operating efficiently, and in today's environment, modern technology actually makes physical merging less critical. California has an outstanding record in the field of tax collection and administration. Since it is unclear whether the merge would result in significant improvements, it appears that it may not be warranted to incur the significant costs of merging or to risk any loss of revenue during the period of conversion.
- **Whether economies of scale would be realized is questionable.** Opponents of similar proposals in the past have noted that the contentions of greater economy are largely illusory. Unless certain programs were curtailed, there would still be essentially the same staff requirements and space requirements. As pointed out by the LAO, enhancing the electronic processing of returns and payments should be given priority over merging.

6. **A strategic plan should contain levels of integration and time frames for consolidation.** This bill requires the BOE to submit a report to the Governor and the Legislature on its plan and progress of consolidation by June 30, 2008. The report is to include a strategic plan on consolidating all of the operations of the FTB into the BOE, as well as the tax administrative functions of EDD and CDI. The bill does not provide sufficient detail of how the agencies would consolidate. The bill should require that the plan identify specific goals for integrating operations, including levels of integration, and contain timeframes to reach these goals.

COST ESTIMATE

According to the LAO's January 2005 report, a potential long-term savings exists associated with the partial physical consolidation of the agencies' payment and document processing activities by reducing duplication, streamlining staffing, and making more efficient use of existing capital.

However, the LAO points out that these savings are likely to be achievable only through an up-front investment by the state in additional systems that allow the agencies' separate and distinct processes to function in a consolidated fashion. In addition, given that the agencies are at different levels of technological advancement, the LAO report notes that considerable additional investment may be necessary to avoid losing the technological edge that some agencies have achieved in their processing functions.

The amount of these savings could not be determined without an extensive, detailed study.

REVENUE ESTIMATE

This bill in and of itself would not affect the state's tax revenues. In general, the transfer of the tax collection and administration responsibilities of the FTB, EDD and CDI to the BOE would not appear to have any effect on the state's revenues. It is possible, however, that a decrease in revenue could be experienced during the period of conversion as a result of the requirement to spend staff time developing the procedures for the new agency.

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