

EXECUTIVE BRIEF

STATE BOARD OF EQUALIZATION

Fiscal Year 2009-10

Out-of-State Audit and Registration Program (1032 Program)

Out-of-State Audit Program

Background

Over the past five years, there has been continued growth in the number of out-of-state permits and the number of accounts eligible for audit in the out-of-state offices, with the number of registered accounts growing by more than 10% over the last five years¹. There are currently 179 authorized out-of-state auditors but as a result of the growth in the number of out-of-state accounts combined with limited audit staff resources, there are registered out-of-state companies with nexus in California that are eligible for audit that have not been selected for audit due to lack of audit staff resources. In addition, the out-of-state audit workload continues to grow as the number of registered accounts increases with the workload generated by the 1032 Program, which in turn leads to an increase in accounts eligible for audit in the out-of-state offices for which there are limited staff resources to audit.

The Department estimates approval of expanding the Out-of-State audit program portion of the Budget Change Proposal (BCP) will result in the following increased revenue:

Fiscal Year (FY)	Revenue	Benefit-to-Cost Ratio
FY 2009-10	\$5,460,644	2.7 to 1
FY 2010-11	\$6,978,468	3.9 to 1
FY 2011-12 and Ongoing	\$7,493,444	4.2 to 1

Request

For the Out-of-State audit program portion of the BCP, we are requesting 15.0 permanent positions, including: 3.0 Business Taxes Specialist I, 10.0 Associate Tax Auditors, 2.0 Supervising Tax Auditor Is. The estimated cost is \$2,024,000 for FY 2009-10, \$1,787,000 for FY 2010-11 and ongoing. These positions are being requested to reduce the number of eligible accounts that are currently not being selected for audit.

It is estimated we will be able to fill these positions within two months of the budget being passed, if not earlier. The length of time it takes to fill these positions will be minimized by proactively recruiting candidates earlier. Requested staff will be located in the Out-of-State District area offices. The BOE has continued to evaluate and improve its ability to efficiently increase its out-of-state audit staff. By utilizing support staff provided in the Tax Gap BCP, adopting best audit practices which includes an audit team approach, proactively recruiting candidates earlier, and reconfiguring office space and "hoteling" new audit staff, the BOE has reduced or eliminated the issues that limited the number of audit positions in the Tax Gap BCP.

Current Need

As a result of the growth in the number of out-of-state accounts combined with limited audit staff resources, there are approximately 265 registered out-of-state companies with nexus in California that are eligible for audit that have not been selected for audit due to lack of audit staff

¹ Board of Equalization's (BOE) historical data shows a 10.67% increase in the number of out-of-state permits (31,681 in FY 2002-03 to 35,062 in FY 2007-08) and 9.89 % increase in the number of out-of-state accounts (23,014 in FY 2002-03 to 25,290 in FY 2007-08) eligible for audit over the last five years (FY 2002-2003 compared to FY 2007-2008).

Note: Separate Executive Briefs have been prepared for each of the components in this multi-component Budget Change Proposal.

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resources. The requested positions would provide additional resources to address this unmet audit workload and complete more-out-of state audits.

In addressing the workload associated with the out-of-state audits and in an effort to adjust to changes in the business environment, to refresh and improve our audit program efficiency and to decrease the length of time it takes to complete audits, the BOE is adopting best audit practices. This will include an audit team approach, similar to that used by other state agencies such as the Franchise Tax Board and public accounting firms in the conduct of their audits.

The objective of implementing this approach is to more effectively and efficiently hasten the conclusion of audits, thereby accelerating the recognition and receipt of revenue for the State of California. In addition, this audit team approach will assist in better preparing audit staff to conduct audits. This career development opportunity is important for succession planning purposes and for effectively and efficiently training and preparing audit staff (including new auditors) to conduct more difficult types of audits in the future. This approach will also result in a significant benefit to taxpayers due to the shortened audit timeframe and disruption to taxpayer operations.

Workload to be Addressed

Redirection of audit staff via travel from in state to out-of-state audits is not feasible due to the costs involved in staff traveling from in-state locations to out-of-state audits. In addition, permanent or temporary redirection of in-state audit staff to work on out-of-state audit assignments would have a detrimental impact on in-state audit operations and taxpayer compliance. Having an adequate presence, both in-state and out-of-state, is necessary to ensure a level playing field for all. Reducing in-state auditors to handle this additional out-of-state audit workload would negatively impact in-state taxpayer compliance.

If the requested positions are not approved, the inventory of unselected eligible accounts that would not normally be selected for audit due to the lack of staff resources will continue to grow, which will result in lost revenue to the State of California.

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STATE BOARD OF EQUALIZATION

Fiscal Year 2009-10

Out-of-State Audit and Registration Program (1032 Program)

1032 Program

Background

The Sales and Use Tax Department's Out-of-State District operates a program (1032 Program) that identifies and registers out-of-state sellers with nexus in California who have not voluntarily registered with the Board of Equalization (BOE). The 1032 Program uses leads, usually generated from auditors examining purchases of in-state businesses. The 1032 Program staff researches the leads and determines whether the out-of-state retailer should be investigated for nexus. If nexus exists, the business is registered by staff, required to provide sales figures and report tax going back to the start date of their California nexus. All information is then sent to the appropriate Out-of-State area office for possible audit selection and field investigation. The addition of in-state auditors via the Tax Gap BCP will increase the number of lead referrals to the Out-of-State District 1032 Program. There will be a need for additional investigation and follow-up of these leads, which will ultimately be referred to Out-of-State District audit staff for audits.

Due to understaffing of the 1032 Program, staff has been unable to investigate those situations in which nexus questionnaires were not returned. The 1032 Program has a current backlog of over 5,000 cases requiring additional investigation and follow up. Presently, there is very limited staff time available for redirection from the on-going registration of accounts to work the new 1032 Program leads received from district offices; therefore, the backlog will continue to grow as long as the program remains understaffed. No part-time or temporary staffing has been allocated to work the backlog.

With the addition of these positions, staff estimates the backlog will be cleared within 24 to 38 months. The actual time it will take to clear this backlog is unknown, which is why an estimated range is being provided, as illustrated on page five (5) of the BCP. The time necessary to clear the backlog will vary depending not only on the time dedicated to clear the backlog, but also on the following:

- The number of new leads referred to the district, as a result of the addition of audit staff via the Tax Gap and SCOP BCPs.
- The number of registrations required as a result of the leads referred to the district.
- The number of business leads in the backlog that are no longer operating. (Historically, about 25% - 30% of sales and use tax accounts close each year. According to the U.S. Small Business Association, only two-thirds of all small business startups survive the first two years and less than half make it to four years. Therefore, staff estimates that 25 - 50% of the backlog of leads may no longer be in business.)

While addressing the backlog is important, it is essential that 1032 Program staff timely process new leads and registrations (which are more productive than the older leads), so they do not become part of the backlog. As the backlog is reduced and eventually eliminated, 1032 Program staff will be able to dedicate their time to investigate the increased number of new leads and process the increase in number of registrations due to the full implementation of other Board efforts.

Note: Separate Executive Briefs have been prepared for each of the components in this multi-component Budget Change Proposal.

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However, the growing backlog is only one element of this request. The 1032 Program positions are also being requested to expand and improve the program in order to work untapped and new accounts referred to the program on a continual basis and to work the audits related to this program. The 1032 Program and processes will also be reviewed and evaluated to find opportunities to automate and streamline the processes used.

The Department estimates approval of the 1032 Program expansion will result in the following increased revenue:

Fiscal Year (FY)	Revenue	Benefit-to-Cost Ratio
FY 2009-10	\$2,855,620	3.7 to 1
FY 2010-11	\$3,310,967	4.8 to 1
FY 2011-12 and Ongoing	\$3,465,460	5.1 to 1

Request

For the 1032 Program portion of the BCP, we are requesting a total of 8.0 permanent positions, including: 4.0 Tax Technician III, 1.0 Business Taxes Compliance Specialist, and 3.0 Associate Tax Auditors. The estimated cost is \$771,000 for FY 2009-10, \$684,000 for FY 2010-11 and ongoing.

It is estimated the district will be able to fill these positions within two months of the budget being passed, if not earlier. The length of time it takes to hire will be minimized by proactively recruiting candidates earlier. Requested staff will be located in the Out-of-State District area offices. Facility issues, if any, will be resolved by reconfiguration of office space and use of "hoteling" of audit staff as needed.

Current Need

Understaffing of the 1032 Program, combined with the fact there has been a continual increase in out-of-state sellers with nexus in California over the last several years has resulted in a backlog of 5,000 cases requiring additional investigation and follow up. The backlog is growing and will continue to grow without the additional requested positions.

The requested positions will further improve and expand the program and find better methods to automate and streamline the program and processes used. With additional staff, these positions will be able to better handle the increasing workload. Staff will review and investigate leads faster, follow up on nexus questionnaires sooner, contact taxpayers by telephone that do not respond to the questionnaires, expedite billings, determine if permits are required, and register taxpayers earlier. In addition, with these new positions in place, staff will be able to better maintain and improve the database of new leads and perform Internet research to determine if registration is required.

Workload to be Addressed

Positions are currently being redirected when possible to help with the 1032 Program. However, this is to the detriment of other district functions (e.g., registration). If registration staff is redirected to work the 1032 Program leads, processing of out-of-state taxpayer registrations will be delayed. Permanent or temporary redirection of existing Out-of-State District audit staff to work on the 1032 Program related audit assignments would have a detrimental impact on Out-of-State District audit operations.

If the requested positions are not approved, the 1032 Program will not end; however, without the increase in 1032 Program staff, nexus leads for which the district does not receive a response will not be handled, the backlog will continue to increase and will increase more rapidly due to the impact of Tax Gap, and related audits will not be selected/completed, all of which will result in lost revenue to the State of California.

Note: Separate Executive Briefs have been prepared for each of the components in this multi-component Budget Change Proposal.

**STATE BOARD OF EQUALIZATION
FISCAL YEAR 2009-10
PROPOSAL No. XX**

TITLE OF PROPOSED CHANGE:

Out-of-State Audit and Registration Program (1032 Program)

SUMMARY OF PROPOSED CHANGES:

This proposal requests \$2,795,000 (\$1,817,000 General Fund and \$978,000 Reimbursements) in Fiscal Year (FY) 2009-10 and \$2,471,000 (\$1,606,000 General Fund and \$865,000 Reimbursements) in FY 2010-11 and ongoing to establish 23.0 permanent positions to address the out-of-state workload currently not being met and to close the estimated \$2.0 billion tax gap. This proposal generates immediate revenue, as the out-of-state audits have been consistently productive. There has been a continued growth in accounts eligible for audit in the out-of-state offices. The analysis indicates that an increase of out-of-state auditors would produce additional productive audits. Moreover, the number of unregistered out-of-state sellers with nexus in California continues to grow each year. Expanding the Board of Equalization's (BOE) program that registers these sellers with nexus in California would produce additional revenues and increase compliance.

The BOE estimates that this proposal will produce increased revenue benefits of approximately \$8.3 million in FY 2009-10, \$10.3 million in FY 2010-11, and \$11.0 million in FY 2011-12 and ongoing. Therefore, the long term ongoing benefit-to-cost ratio of this proposal is 4.4 to 1.

STATE BOARD OF EQUALIZATION

Fiscal Year 2009-10

Out-of-State Audit and Registration Program (1032 Program)

A. Nature of Request

This proposal requests \$2,795,000 (General Fund \$1,817,000 and Reimbursement \$978,000) in Fiscal Year (FY) 2009-10 and \$2,471,000 (General Fund \$1,606,000 and Reimbursement \$865,000) in FY 2010-11 and ongoing to permanently establish 23.0 positions to address workload associated with the out-of-state audits and the registration of out-of-state sellers with nexus¹ in California. The BOE estimates that this proposal will produce increased revenue benefits of approximately \$8.3 million in FY 2009-10, \$10.3 million in FY 2010-11, and \$11.0 million in FY 2011-12 and ongoing. Therefore, the long term ongoing benefit-to-cost ratio of this proposal is 4.4 to 1.

Of the 23.0 total positions requested, 18.0 positions will address workload associated with the out-of-state audits for which there are insufficient audit staff to work the assignments. Although all these positions will focus their attention on the out-of-state audits, 3.0 Associate Tax Auditors are specifically being requested as a result of the workload generated from the Out-of-State Registration Program (1032 Program) and the out-of-state businesses with nexus in California. The remaining 15.0 are specifically being requested as a result of the inventory of unselected eligible accounts that would not normally be selected for audit due to the lack of staff resources. Major reasons for the outstanding inventory of unselected productive eligible accounts is a continuing increase in the number of out-of-state registered accounts, a corresponding increase in accounts eligible for audit, and limited staff resources. In addition, changes in the business environment in which our audit staff work have impacted our audit processes, procedures, and the length of time and resources needed to complete audits.

In addressing the workload associated with the out-of-state audits and in an effort to adjust to changes in the business environment, to refresh and improve our audit program efficiency and to decrease the length of time it takes to complete audits, the Board of Equalization (BOE) is adopting best audit practices. This will include an audit team approach, similar to that used by other state agencies such as the Franchise Tax Board and public accounting firms in the conduct of their audits.

Under a team approach, sections of the audit are divided between the team members and the team is lead by a high-level auditor. The team of auditors is assigned to the specific case; therefore, they are more focused on completing the assignment. Team members have a vested interest in completing the audit, and there is peer pressure and team competition that has a positive influence on moving the audit forward.

The objective of implementing this approach is to more effectively and efficiently hasten the conclusion of audits, thereby accelerating the recognition and receipt of revenue for the State of California. In addition, this audit team approach will assist in better preparing audit

¹ California's nexus provision is set forth in Revenue and Taxation Code (RTC) section 6203. A retailer engaged in business in California within the meaning of section 6203 must collect the applicable use tax from its California customers and remit that tax to the Board. If a person does not come within the provisions of RTC section 6203, California cannot require it to collect this state's use tax from that retailer's California purchasers (a retailer may, of course, voluntarily register to collect California's use tax).

staff to conduct audits. This career development opportunity is important for succession planning purposes and for effectively and efficiently training and preparing audit staff (including new auditors) to conduct more difficult types of audits in the future. This approach will also result in a significant benefit to taxpayers due to the shortened audit timeframe and disruption to taxpayer operations.

The remaining 5.0 positions will enable the BOE to address unmet workload in its 1032 Program, which registers out-of-state sellers with nexus in California. This unmet and increasing workload is also a result of the continued increase in the number of out-of-state taxpayers with nexus in California².

In addition, with the anticipated increase of audit staff due to the Tax Gap Budget Change Proposal (BCP) and the Statewide Compliance Outreach Program (SCOP), it is expected there will be an increasing number of referrals to the Out-of-State District 1032 Program. Therefore, there will be a need for additional investigation and follow-up, some of which will ultimately be referred to Out-of-State District audit staff for field investigations or audits.

Under the Tax Gap BCP No. 2 (FY 2008-09), the BOE was authorized to establish 29.0 permanent positions to expand the BOE's out-of-state audit program. Although projected audit workload would support additional audit positions, the Tax Gap BCP was limited to 29.0 permanent positions. This decision was not based on the availability of productive audits but based on the BOE's ability to recruit, hire, train, house, and provide personnel services for additional qualified auditors. The BOE has continued to evaluate and improve its ability to efficiently increase its out-of-state audit staff. By utilizing support staff provided in the Tax Gap BCP, adopting best audit practices which includes an audit team approach, proactively recruiting candidates earlier, and reconfiguring office space and "hoteling" new audit staff, the BOE has reduced or eliminated the issues that limited the number of audit positions in the Tax Gap BCP.

BOE estimates that approval of this proposal will result in the following increased revenue and benefit-to-cost ratios (see Exhibit I - Revenue and Cost Summary, and Exhibit II - Revenue Analysis):

Fiscal Year	Revenue	Benefit-to-Cost Ratio
FY 2009-10	\$8,316,264	3.0 to1
FY 2010-11	\$10,289,435	4.2 to1
FY 2011-12 and Ongoing	\$10,958,904	4.4 to1

Approval of this proposal will allow the BOE to more proactively address the segment of the growing tax gap associated with businesses headquartered out of state with nexus in California. In addition, this proposal will generate new state revenue without increasing taxes, enhance overall voluntary tax compliance and level the playing field for registered businesses with nexus in California. Denial of this proposal will result in continued revenue loss for the state and will allow the tax gap to increase by not addressing the unmet audit and registration workload of out-of-state taxpayers with nexus in California.

² BOE historical data shows a 10.67% increase in the number of out-of-state permits (31,681 in FY 2002-03 to 35,062 in FY 2007-08) and 9.89 % increase in the number of out-of-state accounts eligible for audit (23,014 in FY 2002-03 to 25,290 in FY 2007-08) over the last five years (FY 2002-2003 compared to FY 2007-2008).

B. Background/History

The BOE is committed to a philosophy of service and accountability to the public, whose interest is best served through sound administration of the tax laws. This can be most effectively accomplished through programs that enable and encourage people to voluntarily comply with the laws. The BOE's Out-of-State District's audit and 1032 Programs are ways in which we provide assistance and information to the out of state area tax paying public while, at the same time, providing a fair and firm enforcement program that ensures taxes are reported properly.

Out-of-State Registration Program (1032 Program)

The Out-of-State District operates a program that identifies and registers out-of-state sellers with nexus in California who have not voluntarily registered with the BOE. This program is referred to as the "1032 Program."

The 1032 Program uses leads, usually generated from auditors examining purchases of in-state businesses. When an auditor discovers that a taxpayer is making untaxed purchases subject to use tax from an out-of-state vendor, the auditor prepares a lead (Form BOE-1032, *Information on Out-of-State Retailers*), which is then directed to the 1032 Program. The 1032 Program staff researches the leads by using a nexus questionnaire (BOE-790) and determines whether the out-of-state retailer should be investigated for nexus. If nexus exists, the business is registered by staff, required to provide sales figures and report tax going back to the start date of their California nexus. All information is then sent to the appropriate Out-of-State Area office for possible audit selection and field investigation.

Historically, BOE's 1032 Program staff receives over 1,100 BOE-1032 leads per month. Approximately 37% of the leads provided are new taxpayers requiring contact. The other 63% are leads on businesses that have already been investigated or the taxpayer is already registered.

The number of registered out-of-state sellers with nexus in California continues to grow each year with statistics showing an increase in seller's permits over the last five years. This statistic indicates there are more and more out-of-state sellers with nexus in California. Over the last three fiscal years, the number of accounts registered by staff under the 1032 Program (based on investigations in which nexus questionnaires were received during this period) increased 33% (from 319 in FY 2004-05 to 425 in FY 2006-07).

Due to understaffing of this program, the 1032 Program staff has been unable to investigate those situations in which nexus questionnaires were not returned (approximately 22% of questionnaires are not returned). As a result, the 1032 Program has a current backlog of over 5,000 cases requiring additional investigation and follow up. Currently, there is very limited staff time available for redirection from the on-going registration of accounts to work the new 1032 Program leads received from district offices; therefore, the backlog will continue to grow at a rate of approximately 90 backlog leads per month as long as the program remains understaffed. No part-time or temporary staffing has been allocated to work the backlog.

With the addition of these positions, we estimate the backlog will be cleared within 24 to 38 months:

Timeframe (Approximate)	Activities	
Current and ongoing		
Months 1 - 2	<ul style="list-style-type: none"> • Hire and train one (1) BTCS and four (4) TT IIIs on 1032 Program and database registration system. • Investigate all new leads to conclusion to avoid backlog from increasing. • Process related registration of taxpayers. 	Review and evaluate program processes for identification and implementation of opportunities to automate, streamline, and gain program efficiencies. 
Months 3 – 6	<ul style="list-style-type: none"> • Review all backlog leads and complete Internet research to determine if still in business. • Continue to investigate all new leads to conclusion to avoid backlog from increasing. • Process related registration of taxpayers. 	
Months 7 – 12	<ul style="list-style-type: none"> • Investigate backlog leads still found to be in business. • Continue to investigate all new leads to conclusion to avoid backlog from increasing. • Process related registration of taxpayers. 	
Months 13 to a range of 24 to 38 months. (Maximum time to clear backlog, estimated timeframe of 24 – 38 months ³)	<ul style="list-style-type: none"> • Continue to investigate backlog leads still found to be in business. As time progresses, the number of backlog cases, and staff time to investigate the backlog, will be reduced. • Continue to investigate all new leads to conclusion to avoid backlog from increasing. As time progresses, the number of leads referred to the 1032 Program will increase with the addition of audit staff via the Tax Gap and SCOP BCPs. Since the number of backlog cases should be reduced, staff resources will be redirected to investigate the increased number of leads received. • Process related registration of taxpayers. 	

The actual time it will take to clear this backlog is unknown, which is why an estimated range is being provided in the above table. The time necessary to clear the backlog will vary depending not only on the time dedicated to clear the backlog, but also on the following:

- The number of new leads referred to the district, as a result of the addition of audit staff via the Tax Gap and SCOP BCPs. During the initial implementation of Tax Gap/SCOP BCPs, which will be over two fiscal years, it will take six months to a year for the 1032 Program to see the full impact of the increase. During this time, the 1032 Program staff will make a concentrated effort to reduce the backlog, as well as continue to investigate current leads referred to the group.
- The number of registrations required as a result of the leads referred to the district.
- The number of business leads in the backlog that are no longer operating. It is difficult to know how many businesses in the backlog are still operating, thus it is difficult to know how long it will actually take to clear the backlog. Historically, about 25% - 30% of sales and use tax accounts close each year. According to the U.S. Small Business Association, only two-thirds of all small business startups survive the first two years and less than half make it to four years. Therefore, staff estimates that 25 - 50% of the backlog of leads may no longer be in business.

³ Assuming a backlog at 7/1/09 of 6,600 leads, if 50% of business leads in the backlog are no longer operating and staff dedicates 25% of the time to investigating the leads still in business, it would take approximately 24 months to clear the backlog. If 27.5% of businesses are no longer operating and staff dedicates the same percentage of time to investigating the leads still in business, it would take approximately 34 months to clear the backlog. If staff dedicates 20% of the time to investigating these leads and all other assumptions remain the same, it would take approximately 27 to 38 months to clear the backlog.

While addressing the backlog is important, it is essential that 1032 Program staff timely process new leads and registrations (which are generally more productive than the older leads) so they do not become part of the backlog. Even with these new positions, there will be a limited number of staff to handle new leads, registration, and resolution of the backlog. Management of this workload will require a balancing of staff resources among these functions. An increase in staff time to one of these functions (e.g., working on the backlog) will result in a corresponding decrease in another function (e.g., working of current leads or registering taxpayers).

As the backlog is reduced and eventually eliminated, 1032 Program staff time will be reduced in this function and increased in the investigation of new leads and processing of registrations, which are expected to increase due to the full implementation of the Tax Gap and SCOP BCPs and resulting increased leads from audit staff.

However, the growing backlog is only one element of this request. The 1032 Program positions are also being requested to expand and improve the program in order to work untapped and new accounts referred to the program on a continual basis and to work the audits related to this program. The 1032 Program and processes will also be reviewed and evaluated to find opportunities to automate and streamline the processes used.

Even though it is understaffed, this program has been tremendously successful at generating approximately \$5.8 million annually. The requested positions will further improve and expand the program. With additional staff, these positions will be able to better handle the increasing workload and eliminate the existing backlog. Staff will review and investigate leads faster, follow up on nexus questionnaires sooner, contact taxpayers by telephone that do not respond to the questionnaires, expedite billings, determine if permits are required, and register taxpayers earlier. In addition, with these new positions in place, staff will be able to better maintain and improve the database of new leads and perform Internet research to determine if registration is required. Likewise, the 1032 Program processes will be reviewed and improvements implemented to increase the efficiency of this program.

If the positions requested are not made permanent, after the backlog is worked, a new backlog will develop and staff will be unable to improve and streamline the 1032 Program. The only way to keep current on working the 1032 Program leads is to work them on an on-going basis, especially since the number of leads are anticipated to increase on a permanent basis as a result of the BOE efforts stated above that are expected to result in more 1032 Program referrals. Positions are currently being redirected when possible to help with the 1032 Program. However, since there is very limited staff time available, this is to the detriment of other district functions (e.g., registration). If registration staff is redirected to work the 1032 Program leads, processing of registrations will be delayed.

During the last three and a half years, staff dedicated to the BOE's 1032 Program has registered over 1,346 accounts. Expanding the BOE's 1032 Program that registers sellers with nexus in California by adding 5.0 positions will produce additional revenues, increase the level of compliance, and streamline the program and processes used.

1032 Program Related Audit Work

The requested 3.0 audit positions are to conduct necessary field investigations including audits relating to the 1032 Program. The Out-of-State District audit program receives information on the registration and reporting of taxpayers through the 1032 Program. This

information is reviewed for possible audit activity based on the type of business, search of the Internet and other resources, and questionable reporting (e.g. possible underreporting of sales activity). Over the last three years, on average, 26.4% of the accounts registered under this program have been referred for audit or investigation. Due to understaffing, 1032 Program staff has been unable to investigate those situations in which nexus questionnaires were not returned. The BOE believes a higher audit potential may result from the further investigation of non-responses.

The addition of auditors will increase the number of lead referrals to the 1032 Program regarding out-of-state companies with nexus in California. As a result, there will be a need for additional investigation and follow-up, which will ultimately be referred to Out-of-State District audit staff for field investigations or audits.

Out-of-State Audit Workload

Unselected Audit Work

Each year during the audit selection process, there are eligible audit accounts that are not selected for audit because of staffing limitations. Based on FY 2008–2009 audit selection information there are approximately 265 eligible audit accounts that were not selected for audit.

Out-of-State Audits			
Workload	Eligible Audits not selected for audit (FY 2008-09)	Hours Per Case (average of ATAs and BTSIs)	Total Hours Required per Year
Audits	265	107	28,355
Total Hours Required Per Year			28,355
Additional Auditors Needed to fulfill workload (28,355 / 1,400)			20.25

We expect this trend to continue even with the increased audit staff provided in the Tax Gap and SCOP BCPs. The additional audit positions requested in the Tax Gap and SCOP BCPs were identified to address the additional workloads established by the new and expanded programs and to reduce the inventory of accounts selected for audit. This BCP is requesting staff to reduce the number of eligible accounts that are currently not being selected for audit and address the increased workload from the expanded 1032 Program.

The BOE recognizes that not all of the non-selected audits will be productive or that the number of non-selected audits will be consistent from year to year. However, out-of-state accounts are increasing by approximately 10% each year. The requested positions in this BCP will allow the BOE to reduce the number of these accounts significantly each year.

Redirection of staff via travel from in state to out-of-state audits is not feasible due to the costs involved in staff traveling from in-state locations to out-of-state audits. In March 2008, at the request of a Board Member, Department staff conducted a cost-benefit analysis for closing Out-of-State District area offices and having audit staff travel from in-state to taxpayers' headquarters located outside of California. The analysis disclosed that it is more effective and economical to have auditors housed within close proximity to out-of-state taxpayers rather than have staff continually traveling from California. In addition, permanent or temporary redirection of in-state audit staff to work on out-of-state audit assignments would have a detrimental impact on in-state audit operations and taxpayer compliance.

Having an adequate presence, both in-state and out-of-state, is necessary to ensure a level playing field for all. In our voluntary tax system, most taxpayers comply because it is the right thing to do. Unfortunately, some taxpayers comply only because they believe they will get caught if they do not. Reducing in-state auditors to handle this additional audit workload out-of-state would negatively impact in-state taxpayer compliance.

C. State Level Considerations

Given the current economic slow growth rate in California as well as the state budgetary situation, it is vital to increase revenues for California. The approval of this proposal will generate new state revenue without increasing taxes; it will also enhance overall voluntary tax compliance and level the playing field for businesses with nexus in California. Denial of this proposal will result in continued revenue loss for the state and the tax gap will continue to increase.

This BCP is consistent with the BOE's Strategic Plan to maximize voluntary compliance in BOE's programs, to improve the efficiency of BOE's tax and fee programs, and to create an effective and responsive infrastructure. Increasing BOE's follow-up on nonresponsive leads and increasing audit presence in the field will result in more equitable taxation between noncompliant taxpayers and taxpayers who voluntarily comply with the State's tax laws. This proposal places no new burdens on compliant businesses.

There are three major outcomes that support the added 1032 Program and audit coverage for our out-of-state accounts:

Improve Voluntary Compliance

Follow-up contact with taxpayers who failed to respond to questionnaires sent as a result of nexus leads is essential to maximize voluntary compliance. A sufficient audit presence is also necessary. Having an audit presence in these other states and following-up are essential steps in ensuring these companies have access to our agency and a better understanding of the requirements to remit the appropriate taxes to demonstrate that compliance is an important business decision. In addition, businesses that do not fully understand California law are provided relevant information during staff contacts to assist them with related issues and concerns.

Improve Tax and Fee Program Efficiency

Out-of-state audits have consistently been a productive means of producing revenues. Businesses with nexus in California will be contacted earlier and information will be disseminated sooner to businesses on how to properly collect and remit tax owed.

Create an Effective and Responsive Infrastructure

Business is continuing to change. The use of the Internet for e-commerce and the emergence of a global economy present the opportunity for continual growth. As such, businesses with nexus in this state increase and this proposal continues to address that growth.

Additional 1032 Program and audit staff is required to maximize voluntary compliance from out-of-state businesses with nexus in California. The addition of positions are one step in ensuring companies with nexus in California have access to our agency and are educated regarding their responsibilities for registering, reporting and paying their taxes.

D. Justification/Analysis of All Feasible Alternatives

Each alternative addresses the out-of-state workload currently not being met. Without the increase in 1032 Program staff, leads in which the district does not receive a response will continue not to be handled. Expanding the 1032 Program will produce additional revenues (see revenue analysis Exhibit II) and increase the level of compliance. Without these positions, the backlog of over 5,000 cases requiring additional investigation and follow-up will continue to grow and it is expected that it will grow more rapidly as a result of additional leads that will be provided by the addition of audit staff due to the Tax Gap. Without the increase in 1032 Program-related audit staff, audit leads from the 1032 Program referrals, as well as increased leads from other identified sources will not be able to be completed. Without the increase in other out-of-state audit staff, it is anticipated that the inventory of unselected eligible accounts that would not normally be selected for audit due to the lack of staff resources will continue to grow.

The requested positions and related resources are critical to the BOE's ability to collect additional sales and use tax revenues and level the playing field for registered businesses with nexus in California.

Without the requested resources, the BOE cannot fully serve the needs of out-of-state business owners and perform the necessary registration, compliance, audit and enforcement functions to ensure that all out-of-state businesses with nexus in California properly report their tax liabilities and do not continue to cause significant losses of tax revenue to the state.

Alternative 1 - Approve 23.0 permanent positions to address the out-of-state audit workload currently not being met as well as the workload associated with the registration of out-of-state sellers with nexus in California. The estimated cost to implement this alternative is \$2,795,000 for FY 2009-10, \$2,471,000 for FY 2010-11 and ongoing (see Exhibit III for position description and workload justification).

The out-of-state audit workload continues to grow as the number of registered accounts increases with the workload generated by the 1032 Program. This in turn leads to an increase in accounts eligible for audit in the out-of-state offices. The number of unregistered out-of-state sellers with nexus in California that are registered as a result of the 1032 Program continues to grow each year. Over the last three fiscal years, the number of unregistered accounts with nexus in California that were found as a result of 1032 Program staff investigation increased 33% (from 319 in FY 2004-05 to 425 in FY 2006-07). Additional staff dedicated to the BOE's 1032 Program will help find and register more of these sellers. There has been a continued growth in accounts eligible for audit in the out-of-state offices. Over the last five fiscal years, the number of accounts eligible for audit in the out-of-state district has increased 9.89%.

In order to address the increase in out-of-state audit and 1032 Program workload, the following positions are requested (see Exhibit I for cost and revenue summary):

Classification	FY 2009-10 and ongoing Effective 07/01/09
Out-of-State Audit Work Load	
Sales and Use Tax Department – Out-of-State District Office	
OH (Sacramento)	
Associate Tax Auditor	3.0
Business Taxes Specialist I	1.0
OHA (Chicago)	
Associate Tax Auditor	4.0
Business Taxes Specialist I	1.0
Supervising Tax Auditor I	1.0
OHB (New York)	
Associate Tax Auditor	3.0
Business Taxes Specialist I	1.0
Supervising Tax Auditor I	1.0
Total Out-of-state Audit Workload	
	15.0
1032 Program	
Tax Technician III	4.0
Business Taxes Compliance Specialist – Lead/Reviewer	1.0
Associate Tax Auditor (OH/OHA/OHB respectively)	3.0
Total 1032 Program Workload	
	8.0
Total Positions Requested (Out-of-State Audit and 1032 Program)	
	23.0

Pros:

- Generates up to \$11.0 million annually by FY 2011-12 and ongoing after estimated refunds, cancellations, and uncollectible accounts.
- Provides on-going resources to increase the BOE's 1032 Program, to reduce the backlog of leads not currently being addressed, and to investigate and follow-up on the increasing number of leads referred to the program.
- Provides on-going resources to increase the audit program and to reduce the number of eligible accounts currently not being selected for audit.
- Provides audit resources to investigate or audit the increasing number of referrals through the 1032 Program.
- Increases compliance (registration and reporting) by approximately 170 accounts per year of businesses with California nexus that are headquartered outside California.
- Provides resources to increase the BOE's presence in the field.
- Creates a level playing field for California businesses.
- Provides resources to address a segment of the tax gap.

Cons:

- Requires funding of \$2,795,000 million in FY 2009-10, \$2,492,000 million in FY 2010-11, and ongoing.

Alternative 2 – Approve 23.0 positions on a three-year limited-term basis to address out-of-state audit workload currently not being met as well as the workload associated with the registration of out-of-state sellers with nexus in California. The estimated cost to implement this alternative is \$2,795,000 for FY 2009-10, \$2,471,000 for FY 2010-11 and 2011-12.

This alternative requests adding, on a limited-term basis, additional staff to address out-of-state audit workload currently not being met as well as the workload associated with the registration of out-of-state sellers with nexus in California.

Pros:

- Generates \$8.4 million in FY 2009-10, \$10.3 million in FY 2010-11 and \$11.0 million in FY 2011-12 after estimated refunds, cancellations, and uncollectible accounts.
- Provides resources to increase the BOE's 1032 Program, to reduce the backlog of leads not currently being addressed, and to investigate and follow-up on the increasing number of leads referred to the program.
- Provides resources for three years to increase the audit program and to reduce the number of eligible accounts currently not being selected for audit.
- Provides audit resources to investigate or audit the increasing number of referrals through the 1032 Program.
- Increases compliance (registration and reporting) by approximately 170 accounts per year of businesses with California nexus that are headquartered outside California.
- Creates a level playing field for California businesses.
- Provides resources to address a segment of the tax gap.

Cons:

- Requires funding of \$2,795,000 in FY 2009-10, \$2,471,000 in FY 2010-11 and 2011-12.
- Addresses the 1032 backlog only temporarily as the program will, once again, become understaffed.
- Addresses the number of eligible accounts currently not being selected for audit only temporarily, as the out-of-state audit program will, once again, become understaffed.
- Program efficiencies will not be fully implemented.
- Will result up to \$11.0 million in less revenue after FY 2011-12 and ongoing than Alternative 1.
- Out-of-state staffing levels will not effectively address the unmet out-of-state audit workloads.

E. Facility/Capital Consideration

Requested staff will be located in the Out-of-State District area offices. There are currently sufficient facilities to house the requested staff. However, any additional facility issues, if any, will be resolved by reconfiguration of office space and use of "hoteling" of audit staff as needed. Additional office space will not be needed for the new positions.

F. Outcomes and Accountability

The outcome of approving this proposal will be measured by increased audit revenues as well as by increased number of accounts registered and associated revenues from the 1032 Program for out-of-state businesses with nexus in California.

G. Timetable

Staff can be hired and begin training in July 2009.

July 2009 – June 2010	July 2010 – June 2011 and ongoing
<ul style="list-style-type: none"> • Hire, train, 23.0 new permanent positions. • Mail questionnaires for leads in the 1032 Program. • Follow-up on non-responses. • Increase registration of businesses with nexus in California. • Conduct field investigations. • Conduct audits. • Investigate noncompliant taxpayers. 	<ul style="list-style-type: none"> • Continue to mail questionnaires for leads in the 1032 Program. • Continue follow-up on non-responses. • Continue increase in registration of businesses with nexus in California. • Conduct field investigations. • Conduct audits. • Investigate noncompliant taxpayers.

H. Recommendation

Alternative 1 is recommended. An additional 23.0 positions are being requested (\$2,795,000 million in FY 2009-10, \$2,471,000 million in FY 2010-11, and ongoing) to maximize collection of all the tax revenue due to the state of California, increase revenue for the General Fund, and encourage self-compliance. This proposal would:

- Provide an increased audit presence out-of-state that discourages non-compliance and protects the current and future tax base.
- Assure compliant taxpayers that California is taking steps to “level the playing field” by closing the tax gap, thus minimizing the competitive disadvantage.
- Generate additional tax revenues needed to fund state and local operations.

If the BOE does not address the growing audit workload, California’s effort to reduce the tax gap will be undermined. Compliant businesses will increasingly be at a disadvantage when competing for business with noncompliant competitors. In our voluntary tax system, most taxpayers comply because it is the right thing to do. Unfortunately, some taxpayers comply only because they believe they will get caught if they do not. Other taxpayers comply after word gets out that there is a greater presence of auditors in the field and auditing a greater portion of businesses.

I. Fiscal Detail

See attached “Fiscal Detail”

Revenue and Cost Summary			
Out-of-State Audit and Registration Program (1032 Program)			
<u>Combined Out-of-State Audit Workload and 1032 Program</u>			
	<u>FY 2009-10</u>	<u>FY 2010-11</u>	<u>Ongoing</u>
Positions	23.0	23.0	23.0
Anticipated Revenues	\$8,316,264	\$10,289,435	\$10,958,904
Expenditures	2,795,000	2,471,000	2,471,000
Benefit/Cost	3.0	4.2	4.4
<u>Out-of-State Audit Workload</u>			
	<u>FY 2009-10</u>	<u>FY 2010-11</u>	<u>Ongoing</u>
Positions	15.0	15.0	15.0
Anticipated Revenues	\$5,460,644	\$6,978,468	\$7,493,444
Expenditures	2,024,000	1,787,000	1,787,000
Benefit/Cost	2.7	3.9	4.2
<u>1032 Program</u>			
	<u>FY 2009-10</u>	<u>FY 2010-11</u>	<u>Ongoing</u>
Positions	8.0	8.0	8.0
Anticipated Revenues	\$2,855,620	\$3,310,967	\$3,465,460
Expenditures	771,000	684,000	684,000
Benefit/Cost	3.7	4.8	5.1

Revenue Analysis
Out-of-State Audit and Registration Program (1032 Program)

Revenue for Out-of-State Audit Workload

Revenue was estimated based on the results expected to be generated from adding new and experienced auditors to the Out-of-State District field offices. Tracking of entry-level auditors shows that these auditors do not achieve full productivity until after their second year of auditing. Based on a 2002 Sales and Use Tax Department study (the results of this study are considered to be current and no additional study has been conducted), on average, the entry-level auditor produces revenue at 25% of full production the first year and 81% of full production the second year, and 100% by the third year.

The 13.0 auditors hired to satisfy the additional Out-of-State audit workloads will be hired at two different levels; 10.0 positions at the Associate Tax Auditors (ATA) level and 3.0 positions at the Business Tax Specialist I (BTSI) level. The audits conducted by the 10.0 ATA are of the medium-size business and less complex than the audits conducted by BTSIs. Based on historical data, staff estimates that the revenue for these positions will be at the margin⁴, which is \$271,040 for ATA level audits per auditor. Staff estimates each newly-hired Associate Tax Auditor will generate \$67,760 (25% x \$271,040) in revenue the first year, \$219,542.40 (81% x 271,040) the second year, and \$271,040 the third and subsequent years.

The 3-year marginal revenues average assessment amounts were reduced to account for estimated refunds, cancellations, and uncollectible accounts.

Out-of-State Audit Improvements – New Auditors	Revenue FY 2009-10	Revenue FY 2010-11	Revenue FY 2011-12 and Ongoing
Revenue from ATAs Hired in FY 2009-10 10.0 Positions Effective 7/1/09	\$677,600 ^(a)	\$2,195,424 ^(b)	\$2,710,400 ^(c)

^(a) 10 x \$271,040 x 25% = \$677,600

^(b) 10 x \$271,040 x 81% = \$2,195,424

^(c) 10 x \$271,040 x 100% = \$2,710,400

Out-of-state auditors hired at the BTSI level will be promotional hires and are expected to achieve full productivity once they are hired. Using actual average audit assessments per out-of-state auditor from FY 2006-07, staff estimates each new BTSI will generate \$1,594,348 in revenue.

The FY 2006-07 average assessment amounts were reduced to account for estimated refunds, cancellations, and uncollectible accounts.

Out-of-State Audit Improvements – Experienced Auditors	Revenue FY 2009-10	Revenue FY 2010-11	Revenue FY 2011-12 and Ongoing
Revenue From BTS I Hired In FY 2009-10 3.0 Positions Effective 7/1/09	\$4,783,044 ^(d)	\$4,783,044 ^(d)	\$4,783,044

^(d) 3 x \$1,594,348 = \$4,783,044

⁴ The marginal revenue is calculated using the average audit assessments per out-of-state auditor for the medium-size business for the last three fiscal years taking into account the optimum audit coverage for available accounts at the ATA level classification eligible for audit.

Revenue for BOE's 1032 Program

Revenue for the out-of-state workload associated with the 1032 Program was estimated based on the actual results from the last three and a half years. FY 2004-2005 to January 31, 2008, the 1032 Program consisted of 3.6 to 5.5 positions. During this period for this 1032 Program, the BOE successfully registered 1,346 accounts and collected \$21 million dollars in payments. Thus, each position registered approximately 85 accounts per year for total payment per account registered of \$15,602. This does not include the revenue generated from these taxpayers' future tax return payments.

The BOE realizes that adding positions to investigate non-responsive leads may not give the same results, but if the BOE were to be able to register at least 50% of the 85 average registered accounts, the result would equate to approximately 42.5 accounts registered for each additional position. The number of registered accounts will most likely be greater than 50% as staff is able to complete the backlog of cases from prior accumulated leads.

Actual Revenues from Current 1032 Program

1032 Program (OH) Actual #'s	FY 2004-05	FY 2005-06	FY 2006-2007	FY 2007-08 thru 1/31/08	Total
Actual Registered Accounts	319	308	425	294	1,346
Tax Payments	\$6,100,000	\$3,500,000	\$8,600,000	\$2,800,000	\$21,000,000
Positions Per Year	3.60	4.00	5.50	5.50	—
Average Accounts Registered Per Position (Actual Registered Account / Positions Per Year)	88.61	77.00	77.27	53.45	85 (Avg. per FY) ^(e)

^(e) Sum of average accounts registered per position divided by 3.5 FYs

Projected Revenues from Expanded 1032 Program

1032 Program	Registered Accounts Per Additional Position	Average Payments Per Account Registered	Total Revenue Per Position per FY	Total Revenue for 4 PY's Per Fiscal Year
Additional Tax Tech III Hired FY 2009-10 Estimated Registration at 50% of Current (4 TTIII Positions)	42.5	\$15,602	\$663,085	\$2,652,340
Computations: [amounts rounded]	(85 x 50%)	(\$21M / 1,346)	(42.5 x \$15,602)	(4 PY's x \$663,085)

Projected Revenues from Expanded 1032 Program

Out-of-state 1032 Program – TT III	Revenue FY 2009-10	Revenue FY 2010-11	Revenue FY 2011-12 and Ongoing
Total Revenue from Tax Tech III hired in FY 2009-10 (4.0 Positions) effective 7/1/09	\$2,652,340	2,652,340	2,652,340

Revenue for the 1032 Program Related Audit Work

The 3.0 auditors hired as a result of the 1032 program workloads will be hired at the Associate Tax Auditor (ATA) level. The audits conducted by these 3.0 ATAs are the same as the audits conducted by the ATA auditors under additional Out-of-State audit workloads above. These audits are of the medium-size business and less complex than the audits conducted by BTSIs. Based on historical data staff estimates that the revenue for these positions will be at the margin \$271,040 for ATA level audits per auditor. Staff estimates each newly-hired Associate Tax Auditor will generate revenue of \$67,760 (25% x \$271,040) the first year, \$219,542.40 (81% x 271,040) the second year, and \$271,040 the third and subsequent years.

The 3-year marginal revenues average assessment amounts were reduced to account for estimated refunds, cancellations, and uncollectible accounts.

Revenue for the 1032 Program Related Audit Work	Revenue FY 2009-10	Revenue FY 2010-11	Revenue FY 2011-12 and ongoing
Revenue from ATAs hired in FY 2009-10 3.0 Positions effective 7/1/09	\$203,280 ^(f)	\$658,627 ^(g)	\$813,120 ^(h)

^(f) 3 x \$271,040 x 25% = \$203,280

^(g) 3 x \$271,040 x 81% = \$658,627

^(h) 3 x \$271,040 x 100% = \$813,120

Total revenue for these efforts is estimated at the following levels:

Out-of-state Audit and 1032 Program Revenue	Revenue FY 2009-10	Revenue FY 2010-11	Revenue FY 2011-12 and ongoing
Revenue from ATAs (Out-of-state Audit)	\$677,600	\$2,195,424	\$2,710,400
Revenue from BTS I (Out-of-State Audit)	\$4,783,044	\$4,783,044	\$4,783,044
Revenue from Tax Tech III (1032 Program)	\$2,652,340	2,652,340	2,652,340
Revenue from new ATAs (1032 Program)	\$203,280	\$658,627	\$813,120
Total Revenue	\$8,316,264	\$10,289,435	10,958,904

Position Description and Workload Justification**SALES AND USE TAX DEPARTMENT (SUTD)****Field Operations Division**

The SUTD Field Operations Divisions plan, organize, direct, and control all administrative activities and the Sales and Use Tax registration, collection and audit functions of the district field offices, including the Out-of-State District, which has offices in Sacramento, New York, Chicago, and Houston. As part of the registration function, the Out-of-State District has a program known as the 1032 Program. This program registers sellers with nexus in California. The 1032 Program is an effective tool that is important to BOE's overall audit process and successfully reduces the gap of unregistered out-of-state sellers with nexus in California. The 1032 Program staff are headquartered in the Out-of-State District Office in Sacramento.

13.0 Associate Tax Auditors (Out-of-State District field positions – 10.0 Positions for the Out-of-State Audit and 3.0 Positions for the 1032 Program Workloads)

ATAs will be utilized to conduct audits, prepare audit reports, and conduct specialized audit procedures and techniques to address the out-of-state audit workloads currently not being met. Responsibilities include examining taxpayers' books and records and determining the appropriate amount of tax due, determining the appropriate test or statistical sampling methodology, preparing working papers to support audit findings, issuing billings as needed, and explaining audit findings to taxpayers or their representatives. ATAs will also be responsible for investigating and auditing the additional referrals generated from the 1032 Program. The auditor may be involved in the appeals process related to audits or field billing orders including petitions for redetermination and hearings. The table below provides the estimated workload for these positions.

Workload Detail					
Classification	Activity	Time Measure		On-going Activities	
		H = Hours	Time Per Occurrence	Occurrences Per Year	Total Hours
Assoc. Tax Auditor (ATA)	Conduct ATA level audits, investigate and audit the referrals generated from the 1032 Program, and prepare audit reports including related activities. ⁽¹⁾	H	81.69	246.37	20,125.96
	Total ATA Hours				20,125.96
	Total ATA Positions Requested (1,400 Hours Per Position)⁽²⁾				13.0

⁽¹⁾ The average was compiled from out-of-state statistics for the last three fiscal years (FYE 2005, 2006 & 2007). "Audits" include deficiencies, refunds, and no change audits. The total out-of-state accounts eligible for audit that have not been selected or assigned at the ATA level per FY averaged 246.37 audits. The average time per year to complete these audits is approximately 81.69 hours per audit. It is anticipated the additional audit workload not being met that would be completed by an ATA would take similar time.

⁽²⁾ Note: $20,125.96/1,400 = 14.38$ - these numbers include three (3) ATAs that are being requested to address the referrals for the 1032 Program. Over the last three years, on average, 26.4% of the accounts registered under this program have been referred for audit or investigation. Staff requested will address approximately 75% of the referrals which historically has been the most productive audits of these referrals. Accordingly, the total PY's requested is 13.0.

3.0 Business Taxes Specialist I (Out-of-State District field positions- Out-of-State Audit Workloads)

The BTSI will be utilized to prepare audit reports, conduct the most difficult and complex audits, typically consisting of the largest industrial corporations in the

United States, including use of specialized audit procedures and techniques to address the out-of-state audit workloads currently not being met. The BTSIs are expected to work with limited supervision; to lead and review the work of lower level auditor staff. These auditors may also be involved in the appeals process related to their complex audits or field billing orders including petitions for redetermination and hearings. The table in the next page provides the estimated workload for these positions.

Workload Detail					
Classification	Activity	Time Measure		On-going Activities	
		H = Hours	Time Per Occurrence	Occurrences Per Year	Total Hours (Time per Occ. x Occ. Per yr)
Business Taxes Specialist I (BTS I) field auditors	Conduct BTS I audits and prepare audit reports ⁽³⁾	H	216.76	18.33	3973.21
	Total BTS I Hours				3973.21
	Total BTS I Positions Requested (1,400 Hours Per Position field auditors)				2.8

⁽³⁾ The average was compiled from out-of-state statistics for the last three fiscal years (FYE 2005, 2006 & 2007). "Audits" include deficiencies, refunds, and no change audits. The total out-of-state accounts eligible for audit that have not been selected or assigned at the BTSI level per FY averaged 18.33 audits. The average time per year to complete these audits is approximately 216.76 hours per audit. It is anticipated the additional audit workload not being met that would be completed by a BTSI would take similar time.

2.0 Supervising Tax Auditor I (Out-of-State Audit Workloads)

Audit Supervisors will be classified at the Supervising Tax Auditor I level within the SUTD due to the classification of positions supervised. These positions will directly supervise auditors in the Out-of-State District offices, in their efforts to ensure taxpayers are reporting the correct amount of tax due. Typical supervisor responsibilities include providing technical and administrative direction to staff that will conduct audits, supervising auditors conducting medium size out-of-state audits, meet with taxpayers to resolve non-concurred audit issues, review auditors' audits to ensure proper and efficient techniques are being used, and review auditors' correspondence to taxpayers and representatives. The supervisor will be involved in the appeals process related to audits or field billing orders including petitions for redetermination and appeals conferences. Other duties include ensuring established policies and procedures are followed, providing guidelines, addressing personnel issues and other supervisory functions as needed. The table below provides the estimated workload for these positions.

Workload Detail					
Classification	Activity	Time Measure		On-going Activities	
		H Hours	Time Per Occurrence	Occurrences Per Year	Total Hours
Audit Supervisors (STA I)	Directly supervise audit employees, including report preparation, field discussions, problem resolution, including audit referrals from the 1032 Program and monthly activity reports.	H	Variable	Variable	1800
	Confers with taxpayers and their representatives	H	Variable	Variable	180
	Review and approve time reports, expense claims.	H	Variable	Variable	100
	Coordinate hiring, training and conduct personnel evaluations.	H	Variable	Variable	540
	Review audit reports, schedules and correspondence	H	Variable	Variable	540
	Prepares for and attends conferences and hearings	H	Variable	Variable	180
	Monitor, input, and retrieve information from various data sources	H	Variable	Variable	260
	Total Field Supervisor STA I Hours	H			3600
	Total STA I Positions Requested (1,800 Hours/Position)				2.0

4.0 Tax Technician (TT) III (1032 Program) - 4.0 New Positions

To handle the additional workload for the 1032 Program, staff will be classified at the TT III level in the Sacramento Out-of-State District office. TT IIIs will review and investigate leads, send nexus questionnaires, send billings, process non-duplicate leads, determine if permits are required, and register taxpayers. Other responsibilities will include maintaining the database of new leads, contacting taxpayers by telephone that do not respond to the questionnaires, and doing internet research to determine if registration is required, issue estimated billings when necessary, and assisting taxpayers to determine the measure of past tax. TT IIIs will also support program field staff as needed for the sales and use tax program. In addition, TT IIIs may serve in a lead capacity over lower level TTII's performing initial review of leads. The table below provides the estimated workload for these positions.

Workload Detail					
Classification	Activity	Time Measure		On-going Activities	
		H = Hours	Time Per Occurrence	Occurrences Per Year	Total Hours (Time per Occ. x Occ. Per yr)
Tax Tech III	Investigate 1032 Program leads via nexus questionnaire ⁽⁴⁾	H	2	5,617	11,234
	Registration, assistance and schedule review	H	4.75	377	1,791
	Sub Total Tax Tech. III Hours	H			13,025
	Sub Total Tax Tech III Positions (1,800 Hour/Position)⁽⁵⁾				7.2
	Investigation of non-complying taxpayers ⁽⁶⁾	H	2	1,736	3,472
	Investigating nexus questionnaires returned with marginal responses ⁽⁷⁾	H	2	1,001	2,002
	Registration, assistance and schedule review	H	4.75	171	812
	Sub Total Tax Tech. III Hours	H			6,286
	Sub Total Tax Tech III Positions requested (1800 Hour/Position)⁽⁸⁾				3.5
	Total Tax Tech III Positions (7.2+ 3.5)				10.7
	Less current staffing				-6.5
	Total requested				4.2

(4) Represents the number leads investigated by the current program plus the additional leads expected with the increase in audit staff under Tax Gap and SCOP by July 1, 2009.

(5) Staff requested to maintain current 1032 program, while working the additional audit leads generated: $13,025 / 1,800 = 7.2$ PY's.

(6) 22% of the leads do not reply to BOE's questionnaires and require further follow-up. This also includes working on existing backlog cases.

(7) 25% of the leads sent back indicate that nexus does not exist but indicate that further investigation is warranted.

(8) Staff requested to expand 1032 program and to address backlog.

1.0 Business Taxes Compliance Specialist (1032 Program)

A Business Taxes Compliance Specialist will be utilized due to the nature, complexity, and independence required to perform these duties. This position will be located in the Sacramento Out-of-State District office. The Compliance Specialist will independently lead and conduct the review of the TT III's work under the 1032 program. The table below provides the estimated workload for this position.

Workload Detail					
Classification	Activity	Time Measure		On-going Activities	
		H = Hour	Time Per Occurrence	Occurrences Per Year	Total Hours
Business Taxes Compliance Specialist (BTCS)	Review work load ⁽⁹⁾	H	1	1,404	1,404
	Work/Complete difficult cases ⁽¹⁰⁾	H	10	82	820
	Prepare reports/status requests ⁽¹¹⁾	H	1	24	24
	Conduct staff meetings/training ⁽¹²⁾	H	2	24	48
	Total BTCS Hours				2,296
	Total BTCS Positions Requested (2,296/1800 = 1.28)				1.0

(9) BTCS reviews 25% of leads each year: $5,617 \times 25\% = 1,404$

(10) 15% of cases requiring registration become difficult to complete. BTCS will work with taxpayer attorneys/representatives, write nexus or taxability opinion letters, and request advice from our Tax Policy Division and/or Legal Department (Registration by TT III positions – $548 \times 15\% = 82.2$)

(11) Biweekly workload status reports (broken down by staff member) will be distributed to staff and management

(12) Biweekly staff meeting and/or training sessions will be conducted.

STATE OF CALIFORNIA
 BUDGET CHANGE PROPOSAL--FISCAL DETAIL
 STATE OPERATIONS
 FISCAL YEAR 2009-10
 (Dollars in Thousands)

Title of Proposed Change: Out-of-State Audit and Registration Program (1032 Program)
30 Sales and Use Tax - 30.1 Registration of Taxpayers/30.3 Auditing Accounts/
Program/Element/Component: 30.5 Collecting Taxes Receivables

	PERSONNEL YEARS			CY	BY	BY + 1
	CY	BY	BY + 1			
TOTAL SALARIES AND WAGES <i>_a/</i>		23.0	23.0		\$1,474	\$1,474
Salary Savings		-1.2	-1.2		-74	-74
NET TOTAL SALARIES AND WAGES		21.8	21.8		1,400	1,400
Staff Benefits <i>_a/</i>					518	518
Distributed Administration <i>_b/</i>						
TOTAL PERSONAL SERVICES		21.8	21.8		\$1,918	\$1,918
OPERATING EXPENSE AND EQUIPMENT						
General Expense					\$288	\$41
Distributed Administration						
Printing						
Communications					24	16
Postage						
Travel--In-State						
Travel--Out-of -State					333	333
Training					16	16
Facilities Operations					181	143
Consulting & Professional Services: Interdepartmental						
Consulting & Professional Services: External						
Department of Technology Services						
Data Processing					35	4
Equipment						
Other Items of Expense: (Specify Below)						

_a/ See page 23 of 24 for itemized staff benefits and classification detail.

_b/ Represents Distributed Administration costs resulting from this BCP. The Distributed Administration costs for existing BOE programs will reflect a corresponding decrease which will be addressed in the Planning Estimate process.

	<u>CY</u>	<u>BY</u>	<u>BY + 1</u>
TOTAL OPERATING EXPENSE AND EQUIPMENT		\$877	\$553
TOTAL EXPENDITURES (State Operations)		\$2,795	\$2,471

Source of Funds

General Fund	(0001)	\$1,817	\$1,606
Special Funds:			
Breast Cancer Fund	(0004)		
State Emergency Telephone	(0022)		
Motor Vehicle Fuel Account	(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)		
Federal Trust Fund	(0890)		
Timber Tax Fund	(0965)		
Gas Consumption Surcharge Fund	(3015)		
Water Rights Fund	(3058)		
Elec. Waste Recovery and Recycling Acct.	(3065)		
Cig. and Tobacco Prod. Compliance Fund	(3067)		
Federal Funds			
Other Funds			
Reimbursements	(0995)	\$978	\$865
Net Total Augmentation (Source of Funds)		\$2,795	\$2,471

**DETAIL OF STAFF BENEFITS
AND PERSONAL SERVICES**

Staff Benefits Detail:	(Whole Dollars)		
	<u>CY</u>	<u>BY</u>	<u>BY + 1</u>
OASDI		\$107,100	\$107,100
Health Insurance		166,443	166,443
Retirement		237,958	237,958
Workers' Compensation		571	571
Industrial Disability Leave		1,001	1,001
Non-Industrial Disability Leave		724	724
Unemployment Insurance		214	214
Other		3,692	3,692
TOTAL		\$517,703	\$517,703

Classification <u>a/</u>	Positions			Salary Range	<u>b/</u>	Amount		
	<u>CY</u>	<u>BY</u>	<u>BY + 1</u>			<u>CY</u>	<u>BY</u>	<u>BY + 1</u>
Sales and Use Tax:								
Out-of-State - Sacramento								
Associate Tax Auditor		3.0	3.0	\$68,316		204,948	\$204,948	
Bus. Taxes Specialist I		1.0	1.0	78,168		78,168	78,168	
Associate Tax Auditor (1032 Program)		1.0	1.0	68,316		68,316	68,316	
Bus. Taxes Compl. Spec. (1032 Program)		1.0	1.0	61,104		61,104	61,104	
Tax Technician III (1032 Program)		4.0	4.0	39,036		156,144	156,144	
Out-of-State -Chicago/New York								
Associate Tax Auditor		7.0	7.0	68,316		478,212	478,212	
Associate Tax Auditor (1032 Program)		2.0	2.0	68,316		136,632	136,632	
Bus. Taxes Specialist I		2.0	2.0	78,104		156,208	156,208	
Supvr. Tax Auditor I		2.0	2.0	67,152		134,304	134,304	
TOTAL SALARIES AND WAGES		23.0	23.0			\$1,474,036	\$1,474,036	

a/ All permanent positions effective 7/1/09.

b/ The salary is the mid-step of the salary range for the stated classification.

SUPPLEMENTAL INFORMATION

Dollars in Thousands

	<u>Current Year</u>	<u>Budget Year</u>	<u>Budget Year + One</u>
Proposed Equipment:			
N/A			
Total	<u> </u>	<u> </u>	<u> </u>
Proposed Contracts:			
N/A			
Total	<u> </u>	<u> </u>	<u> </u>
One-Time Costs:			
General Expense		\$247	
Communications		8	
Facilities Operations		38	
Data Processing		31	
Total	<u> </u>	<u> \$324 </u>	<u> </u>
Future Savings:			
N/A			
Total	<u> </u>	<u> </u>	<u> </u>
Full-Year Cost Adjustments:			
N/A			
Total	<u> </u>	<u> </u>	<u> </u>