

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Dutton Analyst: LuAnna Hass Bill Number: AB 2000  
Related Bills: See Legislative History Telephone: 845-7478 Introduced Date: February 13, 2004  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Abolish Franchise Tax Board/Transfer Duties To Board Of Equalization

### SUMMARY

This bill would abolish the Franchise Tax Board (FTB) and transfer its powers and duties to the State Board of Equalization (BOE).

### PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to combine agencies with the goal of expediting taxpayer protests of deficiency assessments.

### EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2005, and states that certain provisions of the bill regarding the abolishment of FTB and the consolidation with BOE would be operative January 1, 2006.

### POSITION

Pending.

### ANALYSIS

#### FEDERAL/STATE LAW

The Internal Revenue Service (IRS) collects and administers the federal income tax and various other taxes, including employment taxes. Pre-payment tax appeals are adjudicated by the United States Tax Court. Following payment, suits for refund are litigated in U.S. District Court or the U.S. Court of Federal Claims.

Under California law, three separate taxing agencies are involved with the income tax laws:

- Employment Development Department (EDD) administers withholding of California's personal income taxes (PIT) by California employers. The employers withhold PIT from their employee's wages and transmit the withheld amounts to EDD. EDD administers this PIT wage withholding program, along with other employment-based programs.

#### Board Position:

\_\_\_\_\_ S                      \_\_\_\_\_ NA                      \_\_\_\_\_ NP  
\_\_\_\_\_ SA                      \_\_\_\_\_ O                      \_\_\_\_\_ NAR  
\_\_\_\_\_ N                      \_\_\_\_\_ OUA                        X   PENDING

#### Department Director

#### Date

Gerald H. Goldberg

4/9/04

- Franchise Tax Board (FTB) administers California's Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL).
  - FTB collects taxes under the PITL and CTL through withholding from sources other than wages, payment of estimated income taxes, and other types of payments.
  - FTB administers other non-income tax related programs: Senior Citizens Homeowners and Renters Property Tax Assistance program (HRA), child support and other non-tax debt collection programs, Political Reform Audit (PRA), and the Non-admitted Insurance Tax program (NIT). Further, FTB is responsible for developing and implementing the California Child Support Automation System (CCSAS).
- BOE, an agency equivalent that does not report to the Governor, administers property, sales and use, and certain other tax laws. The five-member BOE is vested with the authority to decide administrative appeals of various taxes. These taxes include BOE administered sales, use, and special taxes such as fuel taxes, excise taxes, and environmental fees. In addition, the five-member board hears taxpayer appeals of FTB actions on income tax, corporation tax, and HRA matters.

### THIS BILL

This bill would abolish FTB as of January 1, 2006, and provide that as of that date:

- BOE would be the successor to FTB and would have all the duties, powers, purposes, responsibilities, and jurisdiction of FTB.
- Any action that FTB is a party to would continue in the name of BOE and the substitution of BOE would not affect the rights of the parties to the action.
- The executive officer of BOE would organize its new responsibilities in any manner deemed necessary for the proper conduct of the board's consolidated revenue collection, administration, and enforcement functions.
- FTB civil service staff would be transferred to BOE in accordance with current laws regarding civil service employees.
- All contracts, leases, licenses, or any other agreements to which BOE or FTB would be a party to would remain in full force and effect with BOE assuming all of the rights, obligations, and duties of FTB and the substitution of BOE would not affect the rights of the parties.
- The unspent balance of FTB's budget would be transferred to BOE for the support and maintenance of BOE.
- All books, documents, records, and property of FTB would be transferred to BOE.

By June 30, 2005, BOE would be required to submit a report to the Governor and the Legislature regarding the plan and progress of BOE's assumption of FTB's duties. The report would include recommendations for legislation necessary to more effectively achieve the efficiencies and purposes intended by this bill. These recommendations would include, but not be limited to:

- A strategic plan regarding the assumption of FTB's duties, including the identification of critical issues such as the consolidation of computer systems, telecommunications, and office space.
- Identification of functions that would be easily consolidated, such as administrative functions, document processing, remittance cashing, public service, collection, and physical equipment and facilities.
- Identification of administrative functions that cannot be readily assumed by BOE due to statutory conflicts or inconsistent administrative processes.

This bill also states intent to provide a government organization that ensures centralized, effective, efficient, and impartial revenue collection, administration, and enforcement. In addition, the bill states intent to streamline the agency functions and as 1) expeditiously as is feasible and economical, and 2) in the least disruptive manner so that tax collections are not adversely affected.

### IMPLEMENTATION CONSIDERATIONS

This bill does not provide direction for the intended organizational structure. Therefore, until implementation plans and identification of problems are clarified, the magnitude of the consolidation and transfer of duties is unknown. Department staff notes the following concerns:

- This bill would require BOE to report by June 30, 2005, on the plan and progress of BOE's assumption of FTB's duties as of January 1, 2006. If enacted, this bill would be effective January 1, 2005, and it may be difficult for BOE to submit a report by the June 30<sup>th</sup> deadline that would contain comprehensive information.
  - Designing an effective and efficient organizational structure may require an in-depth study comparing and contrasting FTB's and BOE's existing organizational structures, program policies, and procedures.
  - Recent legislation, AB 986 (Horton, Ch. 569, Stats. 2003) requires the Legislative Analyst to report to the Legislature by November 1, 2004, regarding the merits of consolidating specific functions and operations of FTB, BOE, and EDD.

As a result, department staff recommends the author consider amending this bill to require the report and subsequent consolidation of agencies at a later date since implementing the consolidation could rely on information that would be supplied to the Governor and Legislature by the report required by this bill and the report required by AB 986. In addition, there may be insufficient time between the June 30<sup>th</sup> report deadline and the January 1, 2006, consolidation deadline for the Governor or Legislature to act in the event the plan for progress was deemed unsatisfactory.

### **LEGISLATIVE HISTORY**

Appendix A contains a comprehensive listing of legislation regarding the consolidation of state agencies. Notable legislation is listed below.

ACA 22 (Dutra, 2003/2004) would change the name of the five-member BOE to the California Tax Commission (CTC), and require the CTC to collect and administer "taxes on or measured by income." This bill is with the Assembly Rules Committee.

ACA 13 (Leonard, 2001/2002), a constitutional amendment similar to ACA 22 (Dutra, 2003/2004), would have changed the name of BOE to the CTC and required the CTC to collect and administer income taxes. This measure was held in the Assembly Appropriations Committee.

AB 15 (Klehs, et. al.; 1993/94) would have abolished the FTB and transferred its duties and powers to the BOE. Governor Wilson vetoed AB 15. The veto message stated there was an inherent conflict of interest for the BOE to serve as both administrator of the tax system and the appellate body for taxpayer appeals.

## **OTHER STATES' INFORMATION**

Other states have a central taxing authority, commonly named the Department of Revenue, which administers most types of taxes within a state. Several states have independent judicial bodies, such as tax courts or tribunals, to adjudicate tax appeals.

## **FISCAL IMPACT**

As required by this bill, once the agencies are consolidated on January 1, 2006, any unspent FTB budget funds would be transferred to BOE. Presumably, to be consistent with the requirement in this bill of the transfer of FTB's responsibilities and staff to BOE, this would also include the transfer of expenditures attributable to FTB's operations.

Since this bill does not provide clear direction for the intended organizational structure, and until implementation plans and identification of problems are clarified, the magnitude of the consolidation and its impact to FTB's budget is unknown. Ideally, to ensure an accurate cost analysis of consolidation, FTB would need to analyze each function and process in the department in comparison to functions and processes performed by BOE. Such a comparison would allow FTB to identify potential economies of scale for certain functions or processes. However, because of the current differences in organizational structure and the size of each agency, it is anticipated that no immediate savings would be realized. Decisions as to workforce and workload shifts would require extensive planning to limit disruptions in revenue producing activities, which could offset any potential administrative savings.

Therefore, the department's costs to administer this bill cannot be determined at this time. The department will continue to analyze consolidation and its potential fiscal impacts as the bill moves through the legislative process.

## **ECONOMIC IMPACT**

For the fiscal year 2002-03, FTB's programs contributed \$39.5 billion to the General Fund. This contribution represents 55.4% of the total General Fund revenues. The timing of tax revenue receipts as well as disbursements to taxpayers may be impacted by an unknown amount to the extent this bill could disrupt FTB's existing programs.

## **ARGUMENTS/POLICY CONCERNS**

### Pros

- Consolidation, in general, could provide some increased efficiency and reduction of overall costs of state tax administration, given sufficient long-term planning and commitment to changing the existing environment. Current redundancies created by maintaining multiple document and payment processing "pipelines" within FTB and BOE could be eliminated.
- A consolidated department would offer taxpayers and their representatives a single point of contact for the filing of returns, payment transactions, inquiries for assistance, and other customer services. In addition, a consolidated department could further consolidate field office public service operations of the FTB and BOE.

- FTB and BOE have collaborated on various compliance initiatives since the mid-1990s. Consolidation could further enhance compliance program effectiveness through the use of shared information and resources. Consolidation could allow for greater administrative flexibility. For example, 1) an automatic or freer exchange of information; 2) elimination of duplication of effort; 3) accumulation of small workloads that would make computerized process effective; and 4) integrating the activities common to more than one tax or integrating staff services versus maintaining the present tax-by-tax structure.

### Cons

- In the late 1990s some high-level cost / benefit analyses prepared by department staff reflect concerns about immediate and short-term costs of consolidation offset by potential long-term benefits. Concerns also have been raised over proposals to shift or combine tax data center operations. For example, an FTB staff analysis in 1997 showed that such a shift of data center operations could expose revenue administration operations to considerable risk, could increase FTB costs for mainframe computer operations, and could degrade system performance, thereby increasing the payment of interest on tax refunds and other payments due to taxpayers.
- As stated above under “Federal/State Law,” BOE hears appeals of taxpayers who dispute an FTB action. Under this bill, income taxes, including taxpayer audits, would be administered by BOE, who is also the existing appellate forum for taxpayer appeals. As a result, BOE would control all of California’s income tax policy and taxpayers would no longer have an independent third-party to decide appeals.
- While consolidation may eventually achieve a single administration for the taxing agencies, the functional structure might not be much different than the current tax-by-tax structure. Because the two departments administer different taxes under distinctly different tax and compliance laws, it is unclear if there would be any economies of scale among similar positions. For example a consolidated audit division still may require specialization among auditors because: 1) the degree of complexity varies among state laws; 2) the tax calendars for income and sales and use taxes do not generally agree; and 3) the auditing requirements for one tax differ greatly from the other.
- This bill does not propose a specific organizational structure that would exist under consolidation. A preliminary review of the organizational structure of other states indicate that within a general Department of Revenue some states<sup>1</sup> administer taxes as separate offices, divisions, or bureaus. This bill may result in an organizational structure similar to these other states with a common administrative oversight instead of actual consolidation of the agencies.

### **LEGISLATIVE STAFF CONTACT**

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<sup>1</sup> Indiana, Kansas, Louisiana, Missouri, New York, and South Carolina.

## Appendix A Legislative History

Bill Number	Action	Status
ACA 22 (Dutra, 2003/04)	Create a California Tax Commission/Continue BOE Duties As Well As Administer Income Taxes	Assembly Revenue and Taxation Committee
AB 2000 (Dutton, 2003/04)	Abolish FTB/Transfer Duties and Responsibilities to BOE	Assembly Revenue and Taxation Committee
SB 1424 (Burton, 2003/04)	Replace BOE hearing functions with Tax Court.	Senate Revenue and Taxation Committee
AB 2472 (Wolk, 2003/04)	Replace BOE hearing functions with Tax Court.	Assembly Rules Committee
AB 2794 (Bowen, 1995/96)	Abolish FTB/Create Department of Revenue/Create Board of Tax Appeals	Failed passage from AR&T
SB 1727/SCA 29 (Kopp, 1995/96)	Abolish FTB and BOE/Create State Taxing Authority/Create Board of Tax Appeals	Died in Assembly Appropriations Committee
AB 15 (Klehs, 1993/94)	Abolish FTB/Transfer Duties and Responsibilities to BOE	Vetoed
AB 1026 (Peace, 1993/94)	Abolish FTB/Transfer Duties and Responsibilities to BOE	Amended to no longer impact FTB
AB 2267 (Andal, 1993/94)	Abolish FTB/Transfer Duties and Responsibilities to BOE	Failed to pass out of Assembly by deadline
SB 87/SCA 5 (Kopp, 1993/94)	Abolish FTB and BOE/Create Department of Revenue/Create Board of Tax Appeals	Failed passage/Senator Kopp requested inactive file
SB 1829 (Campbell, 1993/94)	Abolish FTB/Create Department of Revenue	Died in SR&T
SB 2137 (Campbell/Kopp, 1993/94)	Abolish FTB/Create Department of Revenue/Create Board of Tax Appeals	Died in Senate Appropriations Committee