STATE OF CALIFORNIA
FRANCHISE TAX BOARD

PUBLIC MEETING

THURSDAY, JUNE 3, 2021
1:30 P.M.

HELD VIA VIDEOCONFERENCE
AND
VIA TELECONFERENCE

REPORTED BY: KATHRYN S. SWANK
CSR NO. 13061

KATHRYN S. SWANK, CSR (916) 390-7731
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APPEARANCES

(All participants appeared via videoconference and teleconference.)

BOARD MEMBERS

BETTY YEE
State Controller
(Chairperson of the Board)

YVETTE STOWERS
Deputy State Controller
(Acting Chairperson of the Board)

ANTONIO VAZQUEZ
Chairperson
Board of Equalization

JAY CHAMBERLAIN
Representative for Keely Bosler, Director Department of Finance

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STAFF

SELVI STANISLAUS
Executive Director

DAWN CASEY
Board Liaison

JOZEL L. BRUNETT
Chief Counsel

SHANE HOFELING
Deputy Chief Counsel

MICHAEL BANUELOS

KATIE FRANK

ROMAN FUENTES

CHERRIE HAYES

THI LUONG
APPEARANCES CONTINUED

STAFF (CONTINUED)

RAY ROUSE
CRISTINA RUBALCAVA
ANN WILSON
RAFAEL ZAYCHENKO

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PUBLIC PARTICIPANTS

CHRISTINE GRAB

---o0o---

AGENDA ITEM 9 PETITIONERS

ROBERT JOHNSON
Crowe LLP,
appearing on behalf of Axos Financial

GLEN JEWEILL
Axos Financial

ANDY MICHELETI
Axos Financial

DERRICK WALSH
Axos Financial

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SACRAMENTO, CALIFORNIA

THURSDAY, JUNE 3, 2021 1:30 P.M.

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ACTING CHAIRPERSON STOWERS: This is the scheduled time for the meeting of the Franchise Tax Board.

Would the Board Liaison please call the role to determine if a quorum is present.

MS. CASEY: Member Vazquez.

MEMBER VAZQUEZ: Present.

MS. CASEY: Member Chamberlain.

MEMBER CHAMBERLAIN: Present.

MS. CASEY: Deputy Controller Yvette Stowers.

ACTING CHAIRPERSON STOWERS: Present.

At least two members or their designated representatives being personally present, there is a quorum, and the Franchise Tax Board is now in session.

Please stand and join me in the pledge of allegiance.

(Pledge of Allegiance recited in unison.)

ACTING CHAIRPERSON STOWERS: Good afternoon.

Welcome to the Franchise Tax Board's virtual Board meeting. As FTB continues to follow all appropriate federal, state, and local guidance for public gatherings, my fellow board members and I are attending
this meeting remotely, and FTB staff is following social
distance best practices.

The public has a right to comment on each agenda
item. For today's meeting, members of the public may
comment via telephone at 1-877-226-8152 with the access
code of 6125923.

Please be aware that there is a short delay
between the web live stream and the live event. If
there are any members of the public wishing to speak on
an item, you may speak when that item is called. You
will have three minutes to address the Board. You will
be asked to identify yourself for the record.

The first item, Members, is approval of the
minutes. We have the minutes of March 4, 2021, Board
meeting.

Is there any -- any member of the public wishing
to speak on this item?

PHONE MODERATOR: Ladies and gentlemen on the
phone line, if you would like to place yourself in queue
for public comment, as a reminder, you may press 1, then
0, at this time.

(No response.)

PHONE MODERATOR: No members of the public are
queuing up at this time. Please continue.

ACTING CHAIRPERSON STOWERS: Thank you, ma'am.
Members, do I have a motion for the approval of the minutes?

MEMBER VAZQUEZ: So moved.

ACTING CHAIRPERSON STOWERS: Is there a second?

MEMBER CHAMBERLAIN: I second.

ACTING CHAIRPERSON STOWERS: Thank you.

There's been a motion and second. Without objection, that will be the order.

The next item, Item 2, is a PowerPoint presentation on 2020 accomplishments presented by Ann Wilson. This is an informational item.

Ms. Wilson.

MS. WILSON: Thank you. Good afternoon, Madam Chair and Board Members.

My name is Ann Wilson, and I'm a proud leader in the Communications Services Bureau.

It is my pleasure to share with you the Department's 2020 accomplishments. What a year. 2020 proved to be one of the most unpredictable and challenging years we have ever experienced. The coronavirus pandemic, economic distress, and the world we live in has given us new perspectives, new working environments, and new challenges.

This year's accomplishments are exceptional, not because of what we accomplished, but how the staff came
together and persevered to accomplish them.

Before we get into our highlight reel, I would like to share some of the tremendous efforts our department mastered during this unprecedented year. We implemented health and safety measures in the workplace. We accomplished full-time teleworkers and remote phone agents. We transitioned to virtual meetings, interviews, and trainings. We postponed the tax filing and payment dates for taxpayer relief. And we implemented new programs and services.

Despite these services, our dedicated employees are committed to FTB's mission of helping taxpayers file accurate and timely tax returns while ensuring no interruption in service. It is my privilege to be a part of the FTB family who has met each obstacle with the ability to adapt, respond, and create innovative processes to support new methods of doing business. My coworkers are nothing short of remarkable. I am confident you too will be inspired by our hardworking employees who exemplify our organizational values. 2020 will go in the record books as a historical year.

Now I invite you to watch our highlights in review.

(Video presentation.)

MS. WILSON: We appreciate you watching the
video. The staff spent countless hours developing that, and it turned out so good.

So I would be happy to answer any questions you might have.

ACTING CHAIRPERSON STOWERS: Thank you very much, Ms. Wilson.

Controller Yee is now online.

So Controller Yee?

CHAIRPERSON YEE: Thank you, Deputy Controller Stowers. And thank you, Ann, for sharing that video.

Let me just check in with our members to see if there are any questions.

MEMBER VAZQUEZ: Yes.

CHAIRPERSON YEE: A comment?

MEMBER VAZQUEZ: Madam Chair?

CHAIRPERSON YEE: Yes. Member Vazquez.

MEMBER VAZQUEZ: Yes. Well, first of all, this is my second viewing of it, and I want to just thank you for that great presentation. I really appreciate the staff — you know, what has been done in the midst of this pandemic and really keeping the services open to the public. It's really amazing, the ingenuity and talent you bring to the table, you know, given these difficult times we had this last year.

And I guess the — then my last comment would
also be just to commend and thank you all for stepping up and answering the Governor's call when you volunteered for this contact -- the contact tracing. I think that was -- it was a great service. I want to thank you all and the staff as well.

MS. WILSON: Thank you so much.

CHAIRPERSON YEE: Thank you, Member Vazquez. Member Chamberlain, any comments?

MEMBER CHAMBERLAIN: No, not at this time. Thank you.

CHAIRPERSON YEE: Okay. Thank you.

Let me add my thanks as well. Obviously, it was an extraordinary year, and I guess as we think about just all of us and our commitment to public service, certainly added demands on the entire team at the Franchise Tax Board, and to see these accomplishments, I will just say, brings abundant pride to, certainly, I think this Board and -- but I hope to the public, who is just dependent on us, you know, just that much more during a year of challenge and, for some people, crisis.

So thank you very much.

MS. WILSON: Thank you.

CHAIRPERSON YEE: Okay. Let me see if there are any members of the public who wish to speak on this item from the teleconference line.
PHONE MODERATOR: Ladies and gentlemen on the phone lines, if you would like to place yourself in the queue for public comment, as a reminder, you may press 1 then 0, at this time.

(No response.)

PHONE MODERATOR: No members of the public are queuing up at this time.

Please continue.

CHAIRPERSON YEE: Thank you very much.

Thank you. Then why don't we move on to our next item, which is Item Number 3. This is another PowerPoint presentation on the 2020 awards. This item will be presented by Ray Rouse, and it is an informational item. Good afternoon, Mr. Rouse.

MR. ROUSE: Good afternoon, Madam Chair and Board Members.

My name is Ray Rouse. I'm an Assistant Chief Counsel in FTB's Legal Division and the co-chair of FTB's Organizational Development Action Committee. I have the pleasure of presenting to you a brief slide show, recognizing FTB's 2020 award recipients. I will be presenting to you the recipients of the following four awards: The Superior Accomplishment Awards, the Sustained Superior Accomplishment Awards, the Supervisory Bonus Awards, and the Large Team Awards.
The Superior and Sustained Superior Accomplishment Awards recognize individual and teams who make significant superior contributions to state government by virtue of exceptional job performance.

The Supervisory Bonus Award recognizes supervisors who demonstrate outstanding job performance and leadership.

The Large Team Award recognizes the accomplishments of members of large teams and projects and their contributions to the department's mission, goals, and values.

You will see on the screen FTB's strategic plan goals for the year 2020. One of the most important reasons for any organization to have a strategic plan is to establish specific goals and provide direction as the organization conducts its business.

These goals, and the missions and values that help achieve them, become even more important during challenging times. Having specific goals that permeate the organization and all of its employees, can keep the organization on task and provide the spark for the creativity, efforts, and dedication needed to get through those challenges.

As we all know, 2020 brought a number of challenges. Our world, including the way we did
business at FTB, was turned upside down by a global pandemic that touched all of our lives in one way or another.

However, FTB employees understand that it's during these challenging times when the public needs us the most. We called on our employees to ensure we were continuing to provide taxpayer-centric service, fairly administering our laws, building a strong organization, and achieving operational excellence. Not surprisingly, and in no small part due to the mission and values that permeate our workforce, our employees answered the call.

Through these tumultuous times, while we all were waiting for the proverbial light at the end of the tunnel, the 2020 award recipients that we are recognizing here today were our light. What makes these recipients even more special is, in a year when all of our employees shined a little brighter, they shrined the brightest, truly inspiring us all and epitomizing what it meant to be public servants when the public needed us the most.

Before we start the presentation, I would like to thank all the family, friends, and staff that photographed our award recipients so we could adhere to all health and safety protocols.

Without further ado, I present to you the
recipients of the 2020 awards.

(Video presentation.)

MR. ROUSE: Thank you for allowing us to present our award recipients to you today. Many of those 350 recipients are listening to this presentation, and we want them to know we are extremely proud of them and their efforts.

I would be happy to answer any questions you have.

CHAIRPERSON YEE: Thank you very much, Mr. Rouse, for the wonderful presentation. It's nice to have a celebratory occasion and really has been a great opportunity to just acknowledge so many who are shining, as you say, a brighter light at the FTB.

Members, are there any questions or comments?

Yes. Member Vazquez.

MEMBER VAZQUEZ: Yes. You know, I would just also like to just reiterate my appreciation for all those recognized today, who -- you know, who went above and beyond the call of duty here in this organization. It's what really makes, I guess, the Franchise Tax Board such a top rate agency moving forward. And -- and just once again to congratulate, you know, all of you who are doing such a great job, and, certainly, I think you are really a real inspiration to all of us. I want to just
thank you all.

CHAIRPERSON YEE: Thank you, Member Vazquez.

Let me just ask for a moment to just say that
under normal circumstances, we would be in an auditorium
that would be filled with our award recipients so that
the Board could publicly acknowledge them in person, and
of course that is not possible today. I know we have
some who are joining virtually, but not all of them.

But I do just also want to say that, again, these
awards, I think, have more meaning this year because of
the unusual circumstances within which all of us are
working.

To the 118 recipients of our superior and
sustained accomplishment awards, these awards are always
special because it is a recognition, also, by your peers
about the outstanding work that is being done by their
other colleagues.

Our Supervisory Bonus Awards, the 19 recipients
of these awards, supervision took a different complexion
last year. So I think to be able to continue to be
effective in terms of providing that guidance and
oversight is really extraordinary under these
circumstances.

Then our Large Team Awards; you know, this work
doesn't stop just because we have other things that are
coming in sideways as challenges. And so I want to
thank the three teams that are being recognized today.

And I'm just going to ask all of the panelists
who are on today -- because we miss this part -- if you
could unmute yourselves, and I just want to share a
round of applause to all of our award recipients.

(Applause.)

CHAIRPERSON YEE: Thank you so much.

And let me just, first of all, turn to -- next
turn to see whether we have any speakers who would like
to -- of the public who wish to speak on this item, on
the teleconference line.

PHONE MODERATOR: Ladies and gentlemen on the
phone lines, if you would like to place yourself in the
queue for public comment, as a reminder, you may press
1, then 0, at this time.

And we do have a comment from Christine Grab.
Please go ahead.

MS. GRAB: Hi. I just have one quick question:
Christine Ostrander won an award for Superior
Accomplishment. She's in the PIP Billing and Collection
Bureau.

I was wondering if this award is tied to amount
of revenue collected in any way.

CHAIRPERSON YEE: Ms. Grab, we -- this is a
section for public comment. We want to thank you for your comment, but we're going to be moving on, on our agenda. Thank you.

PHONE MODERATOR: Thank you.

I have no further public comments in queue at this time.

CHAIRPERSON YEE: Thank you, Operator, for that.

Again, Mr. Rouse, and to all of our awardees, congratulations. This is really a time that I hope we can continue when we are convened in person again to really offer our congratulations in person to all of our awardees. Job well done, everyone. Thank you.

MR. ROUSE: Thank you.

CHAIRPERSON YEE: All right. Let's move on to our next item, and that's Item Number 4. This is a presentation on our -- it's an update on the filing season. And this is a PowerPoint presentation that will be presented by Cherrie Hayes and Roman Fuentes, and this is also an informational item. Good afternoon.

MS. HAYES: Good afternoon, Madam Chair and Board Members. My name is Cherrie Hayes, and I am the Assistant Bureau Director in the Filing Division's Taxpayer Services Contact Center.

Today I am here with Roman Fuentes, from our Accounts Receivable Management Division, to share
information about the unique 2021 filing season.

Every filing season tends to gift us a special set of circumstances, and 2021 delivered. With the COVID-19 pandemic, we knew that the challenges of 2020 would carry into this year to give us an eventful filing season. As always, the Franchise Tax Board sees challenges as opportunities and set to planning for this unique year well in advance of the filing day.

Our update today includes a pandemic operational update, the filing date postponement, updates on essential services that brought changes for both customers and staff, planning efforts to achieve a successful filing season, and highlights of our achievements.

Over the past year, there have been significant changes to how people do business, and FTB was no exception. We made a large shift to accommodate operations during the pandemic. Physical distancing with resulting health and safety was the primary goal as we moved forward. Public counter operations were subject to the direction of the State, along with guidance from the CDC, GovOps, CDPH, and CalHR.

When public counters were closed, customers were provided service by appointment only, and we followed guidelines in place for the health and safety of staff
as well as customers.

On our -- our public counters resumed in-person operations by appointment only on February 1st, 2021, again, following all guidelines to keep staff and customers safe. Appointments were mainly available through telecom, but if customers came to the office, our representatives were to meet their needs or schedule an appointment for a time when representatives could provide assistance.

On March 16, 2021, QLess, an automated solution, was deployed, and scheduling became available, allowing customers to schedule an appointment through the FTB public website or with the aid of a contact center agent. To date, we have served over 10,700 customers throughout our offices statewide, using this tool in addition to our other methods.

To meet contact center needs, we ramped up testing new tools and methods to answer calls remotely. With this shift, customer service through the phone channel continued to meet customer service needs for those who weren't able to contact us through other means or preferred to use this method of contact.

At the same time, we leveraged tools to shift training from in-person learning to virtual classroom with successful results. We note that training
continues to take place in virtual environments and has advanced from its early beginnings to now include chat rooms and interactive exercises, while maintaining staffing engagement throughout.

Regarding processing areas, we were able to meet new needs for staff, including physical distancing as well as supporting situations by -- with distance learning by implementing a voluntary swing shift in June 2020. Staff volunteered for this shift allowing us to get enough people on site safely, to meet customer needs and process returns and payments in expected time frames.

In all, FTB did not skip a beat as we powered through these changes, and we have taken great strides in the way our staff provides services without sacrificing customers' experience.

On March 17th, the Treasury Department and the IRS announced the federal income tax filing due date for individuals was postponed from April 15 to May 17, 2021. Shortly after this announcement, FTB followed suit, postponing the income tax filing return and payment due date for individuals for the 2020 tax year to May 17 as well.

FTB worked quickly to share information with the public through both website and media updates, through a
news release, and social media. Teams acted quickly to make system changes, allowing customers the extended time for filing and paying their 2020 state income tax returns.

We also assisted customers who scheduled an electronic fund transfer payment to take place by April 15th. These customers elected to cancel their scheduled payment and establish a new payment date based upon the filing date postponement.

As we began the filing season, we were working diligently on items that had significant impact to taxpayers. These included the Golden State Stimulus program developed to support low income California residents facing a hardship due to COVID-19. The program is available for taxpayers filing with a Social Security Number or Individual Taxpayer Identification Number, or ITIN, and provides between $600 and $1,200 based upon eligibility requirements.

Earned Income Tax Credit, or CalEITC, which continues to provide low income California workers a refund or reduction of tax owed.

The Young Child Tax Credit provided even more support for those with children under the age of six in 2019. And now, with the implementation of ITINs for California in 2020, this program is available to support
even more low income California residents as they file
their 2020 tax returns.

    Another great program was the Volunteer Income
Tax Assistance program that continues to operate to
serve the most vulnerable taxpayers with all the changes
that have come our way.

    Volunteer tax preparers help prepare tax returns
in their communities, both federal and state, so that
these taxpayers could receive all the benefits they were
eligible for.

    As we enter into the filing season each year, we
rely heavily on the services provided by our IT staff.
They play a significant role in the success of the
filing season by ensuring our infrastructure is in place
and ready to take on demand. From our provided online
services for submitting tax returns to making payments,
to expanding our flexibility and taking calls remotely,
to maintenance of our accounting and processing systems,
their provided services are vital for our overall
success.

    As mentioned earlier in this presentation, the
field public counters experienced impacts as a result of
COVID-19. They play a significant role in the success
of our filing season by providing an in-person service
to assist our customers. We continue to effectively and
efficiently manage our operations despite many of the presented challenges. We continue to ensure our processing and contact center operations are efficiently meeting the workload demands from their respective business areas.

And now I will turn it over to Roman to cover the remaining topics of our filing season update.

MR. FUENTES: Thank you, Cherrie.

Good afternoon, Madam Chair and esteemed Board Members.

Thank you for allowing us the opportunity to present this update with you today.

My name is Roman Fuentes, and I'm an Assistant Bureau Director in the Personal Income Tax Collection Contact Center.

We are happy to share with you that our efforts paid off, and this year's filing season was another success.

Within our website, we accommodated over 20 million visits. This yielded an increase of more than 7 million visits over the previous year. At FTB, we continue to take every opportunity to promote and improve upon self-service options, including accessible and easy-to-understand information on the web, as well as e-file and online payment options, to name a few.
As always, we have alternative service channels available for customers who choose not to engage with self-service options. These include direct phone numbers and in-office appointments.

We continue to experience success with our available online services. From 2020 to 2021, we have experienced a 55 percent increase in website visits, with a projected amount of visits to reach 29 million this year.

To date, this year, we have received over 700,000 new MyFTB registration requests.

On May 17th, 2021, we experienced the second highest daily visits in the history of the website at over 438,000 visits.

Lastly, we want to share that the Golden State Stimulus page has been trending in the top two pages with visits since the date of its release.

FTB experienced a strong end to this year's filing season. We processed over 16.9 million e-file and paper returns combined. We processed 11.7 million refunds with an average amount of $986 and we also processed 4.8 million payments.

We processed 3.4 million EITC claims for a total value of $588 million and 2.9 million of our state income tax filers were recipients of the Golden State
Stimulus, for a total value of $1.8 billion.

Our contact centers continue to provide the essential services for our customers and the primary contact centers have produced noteworthy results. Our contact centers answered 353,800 calls this year; we attained an access rate of 61 percent; had an average wait time of approximately ten minutes; and during the week of May 10th through May 17th, our level of access was 61 percent.

Another important component within our contact centers is the chat workload. This alternative communication channel allows our customers to have another method to have their questions answered and issues resolved, without the need of calling the phone center.

Here are some interesting results to share with you today: We answered 51,000 chats this year in which chat provided an additional access channel of service for our customers. Chat customers had an average wait time of approximately 11 minutes.

Now we would like to provide you with information on the 2021 VITA program.

The VITA program started this filing season with scaled back services due to staff and customer health and safety concerns. In late April, we expanded
services for both internal and external programs based on the final filing date postponement, as well as complexities related to the American Rescue Plan Act.

The new COVID-19 plan has customers, internal and external to FTB, providing tax documents through e-mail or Dropbox, along with virtual appointment follow-up.

Outside of FTB, some of our most vulnerable citizens gain access to FTB VITA return preparation by scheduling appointments by dialing 211, for tax document drop-off and prepared tax return pick-up.

The 211 is a general local assistance contact phone number that provides access to essential community services. This year, FTB's VITA program had 81 volunteers, including 11 new volunteers in 2021, and 2,998 state and federal income tax returns were completed.

As we balance the needs of our taxpayers and the health and safety of our employees as the number one priority, customer service for the citizens of California continues to remain at our forefront. As a department, we ensure that taxpayers and tax practitioners have all of the necessary resources at their disposal, so they can file and pay the accurate amount of state income tax due.

None of our accomplishments can be attained
without the contributions of our valuable staff. As a department, it is important that we invest, support, and recognize the efforts of our staff and ensure they are provided with the necessary resources to be successful in performing their job duties.

In the past year, and leading up to this filing season, the FTB family has demonstrated courageous efforts and incredible sense of teamwork to work together as one FTB.

Lastly, our overall objective is for a strong California. California and its citizens are dependent on the services offered and results generated from FTB. As a department, we were up for the task to support our state and, in the end, we rose above the challenges presented to us and we succeeded as a team.

Filing season is our department's prime time of the year. It is our Academy Awards, Oscars, Final Four, World Series, and Super Bowl all rolled up into one. Each year we prepare ourselves with changes to legislation, which lead to downstream impacts and adjustments by staff.

Every employee plays a major role, embraces the changes, and rises to the challenges. Each year we bring our best to provide outstanding services for California taxpayers.
I would like to thank you on behalf of the department for allowing us the time to share what we have done and accomplished for the taxpayers of California.

We appreciate your continued support, and at this time, we would be happy to answer any questions you may have.

CHAIRPERSON YEE: Thank you very much, Mr. Fuentes and Ms. Hayes for the presentation. It has been a remarkable filing season and really appreciate the entire FTB team stepping up in just so many extraordinary ways and continuing to be innovative and creating new opportunities for how to better serve our taxpayers in California.

Members, I would like to entertain any comments or questions at this time.

Member Vazquez, please.

MEMBER VAZQUEZ: Yes, Madam Chair. You know, once again, just thank you for this great presentation. And more of a -- I guess, a comment than a question. But the comment, you know, just moving forward, I would like to know more of what resources are available for taxpayers who are unable to meet their tax liabilities due to this pandemic.

MS. HAYES: Thank you for that question, Member.
During these unprecedented and ever-changing times, a growing number of taxpayers will be faced with financial difficulties. We have several options available for taxpayers to share with their clients who cannot pay their tax bill. Our public website remains up to date and available for everyone 24 hours a day, 7 days a week. We also have public counters that are open for in-person assistance as well as phone and live chat service channels available for customers to receive step-by-step assistance. Tax practitioners also have the tax practitioner hotline to reach out to.

But more specifically, impacted taxpayers can apply for a payment plan or installment agreement. They can ask for delayed collections, bill delay, or hardship. We can look at reduced collection payment amounts, and they can also look into making an offer and compromise.

CHAIRPERSON YEE: Great. Thank you, Ms. Hayes.

And great question, Member Vazquez.

I think, in the past, we have certainly helped taxpayers navigate those tools, and I think what we have seen more and more with the increased numbers who are requiring some assistance is that those tools are being made more prominent as options for taxpayers. And so I appreciate the question.
Okay. Other members -- other comments or questions by Members?

(No response.)

CHAIRPERSON YEE: All right. Thank you.

Let me see if there are members of the public who wish to speak on this item on the teleconference line.

PHONE MODERATOR: Ladies and gentlemen on the phone lines, if you would like to place yourself in the queue for public comment, as a reminder, you may press 1, then 0, at this time.

(No response.)

PHONE MODERATOR: No members of the public are queuing up at this time.

Please continue.

CHAIRPERSON YEE: Thank you very much.

Again, thank you for the update. This is really extraordinary with respect to what's been accomplished, and I know that there are still continuing to be lessons learned that we will carry forward to experience into next year.

And, again, Ms. Hayes and Mr. Fuentes, thank you very much for the presentation.

MS. HAYES: Absolutely. Thank you for your support.

CHAIRPERSON YEE: Thank you.
All right. Members, our next item is Item Number 5. This is a regulation matter. We have Shane Hofeling to -- who is here to request permission to proceed with the formal rulemaking process for a proposed section 18001-1 related to other state tax credits, and this is an action item.

Good afternoon, Mr. Hofeling.

MR. HOFELING: Good afternoon, Madam Chair and Members of our Board.

My name is Shane Hofeling. I'm a Deputy Chief Counsel in our Legal Division.

I'm appearing before you today to respectfully request the Board's permission to proceed with the formal regulatory process to amend Revenue and Taxation Regulation Section 18001-1. Revenue and Taxation Code 18001 section allows a credit to taxpayers for the net income taxes imposed by and paid to another state on net income. This credit is commonly known as the Other State's Tax Credit.

Under RTC section 18001, the credit is only available to taxpayers when the taxes paid to the other state is a tax on net income. If the taxes paid to the other state is a tax on anything other than net income, then the credit is unavailable for them via the statute.

Regulation section 18001 currently provides
detailed rules of how and when to claim the credit and
defines the terms used in the statute. In addition, the
FTB has previously provided guidance for the credit and
the corresponding regulation in FTB's legal ruling
2017-01. This included an in-depth analysis of the
applicable California case law which explains and
defines what is a net income tax for the purposes of the
credit.

Our proposed amendments to the regulation would
clarify the term "net income taxes" for the purpose of
the credit, consistent with FTB's previous ruling and
the authoritative case law on this issue. More
specifically, the amendments would create a subdivision
(a)(2) to the regulation, clarifying that for the
purpose of the credit, a tax is considered a net income
tax only when the tax is imposed on income that is "net
income," as applied to all taxpayers.

The tax that is imposed on items other than net
income would not be considered to be a net income tax
for the purposes of the credit.

Staff has held two previous interested party
meetings to solicit public input on the proposed
amendments and solicited public feedback on our draft
language. Public response was received, and we
incorporated that response when it was consistent with
the underlying statutory and judicial authority.

The regulatory amendment would provide further
guidance confirming the department's interpretation of
"net income tax," as required by the California case
law, and it would provide consistency and clarity for
all taxpayers currently claiming the tax credit.

Accordingly, we respectfully request the Board's
permission to proceed with the formal regulatory process
to amend Regulation section 18001-1.

I'm happy to answer any questions you may have.

Thank you.

CHAIRPERSON YEE: Thank you, Mr. Hofeling.

Members, questions or comments?

(No response.)

CHAIRPERSON YEE: Okay. Hearing none, let me
just see if we have any member of the public who wishes
to speak on this item on the teleconference line.

PHONE MODERATOR: Ladies and gentlemen on the
phone lines, if you would like to place yourself in
queue for public comment, as a reminder, you may press
1, then 0, at this time.

(No response.)

PHONE MODERATOR: No members of the public are
queuing up at this time.

Please continue.
CHAIRPERSON YEE: Thank you very much.

Mr. Hofeling, thank you. I want to just say this has been a matter that I know we have heard a lot of comments on, and I really appreciate the participation by those in our interested parties meetings. And I do believe that this proposed regulation with its appropriate criteria and guidance will provide further clarity and certainly consistent with the -- as you said, the prior FTB ruling as well as the case law that is guiding this particular area.

So with that, do I have a motion on this item?

MEMBER VAZQUEZ: So moved, Chair. I will move to approve the staff recommendation.

CHAIRPERSON YEE: Thank you very much, Member Vazquez. We have a motion by Mr. Vazquez.

Is there a second?

MEMBER CHAMBERLAIN: Yes. I second the motion.

CHAIRPERSON YEE: Thank you, Member Chamberlain.

Seconded by Member Chamberlain.

And the motion is to grant permission to commence the formal regulatory process under the Administrative Procedures Act.

Let me have the clerk call the roll.

MS. CASEY: Yes. Member Vazquez.

MEMBER VAZQUEZ: Aye.
MS. CASEY: Member Chamberlain.

MEMBER CHAMBERLAIN: Aye.

MS. CASEY: Chair-Controller Betty T. Yee.

CHAIRPERSON YEE: Aye.

Thank you. That motion carries.

Very well. Thank you very much, Mr. Hofeling.

MR. HOFELING: Thank you.

CHAIRPERSON YEE: All right. Members, moving on to Item Number 6, this is administrative matters. Two parts to this item: First we will have Thi Luong presenting the 2022-23 conceptual budget change proposals. This is an informational item. Followed by Michael Banuelos, who will be presenting contracts over a million dollars for board approval.

And let me first turn it over to Thi.

MR. LUONG: Good afternoon, Madam Chair, Board Members. My name is Thi Luong, Director of the Financial Management Bureau.

I'm here today to present BCP concepts under development for Fiscal Year 2022-23. If appropriate, we will be returning to the September board meeting with fully developed proposals for your approval.

For Fiscal Year 2022-23, we have identified 11 concepts for development. The first concept is EDR2. In 2008, FTB began a multiphase project aimed at
modernizing systems and achieving a strategic target model.

The first phase, the EDR project, successfully laid the foundation by delivering the infrastructure and software architecture for a consolidated platform with common business functions and services. The current phase, EDR2, will build on this platform by delivering enterprise case management and modeling services for audit, filing, enforcement, and underpayment, as well as expand on taxpayer folder and contact center platform's functionality.

This concept will address the resources required for the second year of planning, design, and consultant and professional services that are critical to the success of the EDR2 project.

Concept 2 is for accessibility enhancements for web and form products. This concept will address the resources needed to apply mandated accessibility standards to the website, web applications, tax and business forms, instructions, publications, and tax return displays.

Concept 3 is for identity proofing and online fraud detection. This proposal is requesting positions and funding to address enterprise centralization of taxpayer identity proofing and verification, the
monitoring of online activity for the detection of fraud, and identifying fraudulent calls that are made to FTB's interactive voice response system.

Concept 4 is for the infrastructure refresh project. This proposal requests funding to refresh critical network, hardware and software within FTB's technology infrastructure that supports all of the department's e-commerce and data processing programs, which were originally purchased in Fiscal Year 15-16.

Concept 5 is for the enterprise storage and fiber channel refresh. This proposal requests funding to refresh aging hardware that supports FTB's infrastructure. The refresh will provide updated hardware components, address security compliance, improve performance, and mitigate against the risk of aging hardware.

Concept 6 is Fi$Cal. This proposal requests positions and funding to address the ongoing financial and procurement functionality enhancements and rollouts from Fi$Cal.

Concept 7 is for political reform audits. This proposal requests additional resources and funding for working level auditor classifications that are needed to timely and effectively complete mandated audit workloads, as required in section 90001 of the Political
Reform Act.

Concept 8 is for section 41 workload expansion. This proposal requests additional resources and funding to address the new reporting requirements that have begun as a result of Revenue and Taxation Code section 41.

Concept 9, increasing litigation costs. This proposal is requesting additional funding to FTB's litigation budget with the Attorney General's Office to defend against increasing tax refund lawsuits. Please note that FTB did previously submit a Spring finance letter that was only for Fiscal Year 21-22 to allow additional time to validate the ongoing nature of this need.

Concept 10 is for Microsoft Enterprise License Agreement. This proposal requests funding to allow FTB to transition from the M365 Enterprise 3 Standalone to the M365 Enterprise 5 State of California Master Enrollment Plan.

And finally, Concept 11 is for essential office campus data center upgrades. This proposal requests funding to consolidate and upgrade the department's data center into one raised floor space, refresh end-of-life equipment, and eliminate all single points of failure.

I thank you for your time, and I would be happy
to answer any questions you may have.

CHAIRPERSON YEE: Thank you very much, Ms. Luong.

Questions or comments, Members?

MEMBER VAZQUEZ: Just a quick one: I guess

it's -- the way you broke it down into the different

concepts. I'm looking at -- I guess it's Concept 9,

the -- where you are increasing the litigation costs. I

guess that's what it falls under.

And I am just wondering -- you know, when I was

flipping through it, it just wasn't real clear the

increase or the percentages. And I'm wondering, is it

based on new cases or are these prior years? Is that

what's going on?

MR. LUONG: Yeah. Thank you for your question,

Member Vazquez.

The funds are for the Deputy Attorney General's

fees. And it's not necessarily a large increase in new

cases, but rather more complex cases are raising new

issues with the potential for these increased fees.

And I would note, as during the presentation,

that we did previously submit a Spring finance letter

for Fiscal Year 21-22, and we are closely monitoring

these costs.

And this concept will only move forward for your

approval in September, if needed.
MEMBER VAZQUEZ: Thank you.

And then going back to -- I guess it's Number 7. And I guess it falls under the political reform audits.

And you mentioned there's many positions that are being requested in that. And I'm wondering if that's due to the complexity of, you know, this whole -- I guess the election cycle. You know, it's kind of -- we switched them. And I wasn't -- it wasn't real clear. And I'm just wondering if that has to do a lot with the number of candidates and the audits due to the expansion of the election cycle.

MR. LUONG: Yeah. Thank you for the question.

You are referring to the resource needs. I would note that we are still going through analysis and finalizing what the resource need is for this workload, and we'll be bringing back the fully developed proposal in September.

Perhaps you are thinking about the proposal that was submitted for Fiscal Year 21-22 that we presented last year. That previously proposed BCP did ask for 11 resources. However, due to some pending discussions between Franchise Tax Board and the Fair Political Practices Commission and the anticipated budget situation at the time, we did hold that proposal for future consideration. So we haven't firmed up our
resource ask yet for this concept.

    MEMBER VAZQUEZ: Thank you.

    MS. LUONG: You are welcome.

    CHAIRPERSON YEE: Thank you, Member Vazquez.

    Ms. Luong, I have a question.

    On the section 41 workload expansion, maybe just for members of the public, if you could just expound on what section 41 is. This is the tax credit reporting, right?

    MR. LUONG: Yes. So for -- section 41 essentially requires that as legislation is passed, that FTB also provides some data to create reports in order to make sure that the legislation had the intended impact.

    So in certain cases, it would actually be FTB either providing data to the Legislative Analyst's Office to create the report, to really measure the effectiveness of the legislation.

    CHAIRPERSON YEE: Okay. And the legislation relates to tax credits, right? And kind of their -- their purpose, or whether they have achieved their intended purpose? Is that --

    MR. LUONG: Yes. Yes. They relate to tax expenditures, so it could be credits or reductions.

    CHAIRPERSON YEE: Okay. Got it. Okay. Thank
you.

All right. Seeing no other questions or comments from members, let me just see if there are any members of the public who wish to speak on this item on the teleconference line.

PHONE MODERATOR: Ladies and gentlemen on the phone lines, if you would like to place yourself in the queue for public comment, as a reminder, you may press 1, then 0, at this time.

(No response.)

PHONE MODERATOR: We have a comment on the line from Christine Grab.

Please go ahead.

MS. GRAB: Hi. I was wondering how much the current litigation budget is for FTB and how many Attorney General staff FTB currently is utilizing.

CHAIRPERSON YEE: Ms. Grab, this is -- these are just concepts for upcoming budget change proposals. So I think that question may be more appropriate when we actually see proposals.

So I'm going to just ask that -- we appreciate you calling in and asking your question, but we're going to move on at this point.

PHONE MODERATOR: Thank you. And I have no further public comments in queue at this time.
CHAIRPERSON YEE: Thank you very much.

That was an informational item, so we look forward to these coming back in more detail in September.

Thank you very much, Ms. Luong.

Okay. Next we will move to Michael Banuelos, who is going to present the contracts over $1 million for Board approval.

MR. BANUELOS: Hi. Good afternoon, Madam Chair and fellow Board Members.

Pleasure to be here with you today.

My name is Michael Banuelos and I'm the Director of the Franchise Tax Board's Procurement Bureau.

Today I'm presenting two proposed procurements that will result in contracts over $1 million for the Board's consideration and approval.

Our first request seeks approval to enter into a five-year enterprise license agreement for Microsoft Office 365 for government products. As with most businesses, Microsoft is an integral component of our operations and has become a mission-critical tool.

California Department of Technology has entered into a new enterprise license agreement with Crayon Software, which state departments can leverage. This agreement was awarded to Crayon Software as a result of
a competitive bid.

FTB has a current agreement for Microsoft products also with Crayon Software, which expires in June of 2022. It is important to note that these Microsoft products are offered in varied tier levels, so our current agreement is for Microsoft Office 365 at the G3 level, and the new agreement is going to allow us to transition to a higher level, the G5 level.

After thorough analysis, we have determined it's advantageous for FTB to transition into the new agreement at this time.

Along with increased functionality, the suite of G5 products offers new security and infrastructure components to keep FTB in compliance with state-mandated security requirements, which are critically important.

The proposed new agreement will be for five years and has an estimated total of $18.6 million.

Our second request seeks approval to initiate procurement activities to renew a software maintenance contract for Software AG products in the use in our mainframe computer system. This is a renewal of the contract for tools used to support our mission-critical tax processing systems, including our Taxpayer Information and Business Entities Tax Systems.

Without maintenance and continued migration to
vendor-supported software releases, this
mission-critical software would be unsupported,
inoperable, and without warranty. The department would
not be able to perform any of its revenue-generating
functions nor many of its various collection-related
tasks or administrative tasks that involve our mainframe
computer.

In September of this year, our existing five-year
agreement valued at $7.5 million expires. At the
current time, we are anticipating another multiyear
agreement, possibly within the three- to five-year
range, and the final price will be determined based on a
negotiated process. But we will seek to keep the costs
consistent with what we have in our last agreement.

So at this time, I would respectfully ask for
your approval of these two efforts, and I would be happy
to answer any questions that you may have.

CHAIRPERSON YEE: Thank you very much,
Mr. Banuelos.

Members, any comments or questions on either of
these two contracts?

MEMBER VAZQUEZ: Just one quick one. And I think
you covered it, as I was going back over my notes in
your presentation right now. And it's my understanding,
I guess, especially with the -- I guess it's the renewal
of the Software AG that this is -- you know, basically you are assuming this ongoing relationship with these vendors and, obviously, this is to upgrade and keep on top of the changes and hopefully to provide better services for the taxpayers moving forward.

And it's my understanding -- and correct me if I'm wrong -- you did go through a process, obviously, of looking at other vendors to see if, in fact, there's some savings.

And I think you mentioned it -- I don't know if you mentioned it now. But in my conversation, I think, a couple of days ago, that this seemed to be the best deal at this point in time; is that correct?

MR. BANUELOS: That is correct, sir. I would caveat the cost component. And I will give you some general information.

So I would say here, at FTB, especially with our technology partners, we are just in a constant evolution of at looking at different products for different -- for different things. There's a myriad of things we look at when we're looking at different products: Issues like reliability to our systems, time to implement, user training, etc., the risk to the department.

So the cost is just one of many factors that we would look at when we go renew these contracts. It is
quite possible sometimes that we can, you know, find
products that offer comparable functionality and save a
little bit of money, but if it costs more money on the
back end to train our people or they are not as stable
as the products that we're currently using in our
systems, then we have to take that into account too.

So I believe for this one, every time it comes up
for renewal, which is usually the three- to five-year
period, there is some analysis done to say, hey, are we
still getting the best value for our dollar? Are there
any other products out there that can do this?

And the other thing I would like to mention is
it's a little bit of a -- it's an opportunity cost. I
don't want to speak for our CIO, but our technology
people have so much work on their plate, switching the
products out -- which we can do -- it would come at an
opportunity cost for what other work are we not able to
do because of the resources we're using for that.

So there's a lot of factors that go into
determining when we switch products, but we do
occasionally. When the business case justifies that, we
do. But for this particular one, we have estimated that
it's in our best interest to continue using this.

MEMBER VAZQUEZ: Thank you.

CHAIRPERSON YEE: Thank you, Member Vazquez.
MR. BANUELOS: Thank you.

CHAIRPERSON YEE: All right. Seeing no other questions or comments, is there a motion on these two contracts?

MEMBER VAZQUEZ: I will move the staff recommendation.

CHAIRPERSON YEE: All right. We have a motion by Member Vazquez.

Is there a second?

MEMBER CHAMBERLAIN: Yes. I second.

CHAIRPERSON YEE: Thank you, Member Chamberlain. I have a motion and a second. Will the clerk please call the roll.

MS. CASEY: Member Vazquez.

MEMBER VAZQUEZ: Aye.

MS. CASEY: Member Chamberlain.

MEMBER CHAMBERLAIN: Aye.

MS. CASEY: Chair Yee.

CHAIRPERSON YEE: Aye.

I'm sorry. I neglected to just check in to see if there are any public comment on these items. If there is, we will rescind the motion.

PHONE MODERATOR: Ladies and gentlemen on the phone lines, if you would like to place yourself in the queue for public comment, as a reminder, you may press
1, then 0, at this time.

(No response.)

PHONE MODERATOR: No members of the public are queuing up at this time. Please continue.

CHAIRPERSON YEE: Thank you, Alberta.

All right. That motion carries.

Thank you.

MR. BANUELOS: I want to thank you all for your support.

CHAIRPERSON YEE: Thank you, Mr. Banuelos.

All right. Members, we are on Item Number 7, which is the Executive Officer's Time. And this is the time we hear from our Executive Officer, Selvi Stanislaus. Good afternoon.

EXECUTIVE OFFICER STANISLAUS: Thank you, Madam Chair, and good afternoon, esteemed Board Members.

I want to begin my time today by thanking MyFTB family for the great work they continue to do. Yet again, despite all of the obstacles we faced due to the pandemic, we managed to have another successful filing season.

We provided critical services to our internal and external customers; we processed refunds so taxpayers can receive their much-needed refunds; handled millions of returns; assisted thousands of customers by phone, by
mail, by live chat, delivered IT support to those in and out of the office, and provided countless other services with the care and expertise that only FTB staff can provide.

So Madam Chair and esteemed Board Members, I also want to take a moment to thank you for your support of our EDR2 or IT project.

We are on track to start the project on July 1st of this year, and as we transition from the planning phase to the implementation phase, we are happy to celebrate this critical milestone and believe it should be recognized. The planning and procurement phase for EDR2 was a three-year-long effort with involvement from many people inside and outside of FTB.

We once again specifically want to thank you, our Board. Without your support, we would not be in this excellent position that we are in today to start the most important project for the next five years.

So once again, thank you. We look forward to coming back to our Board with updates on the progress of our EDR2 project. Thank you, Board Members.

CHAIRPERSON YEE: Thank you very much, Selvi, for the updates, and congratulations on EDR2. That is a major milestone and happy to see the continued progress on that.
Members, are there any questions or comments?

MEMBER VAZQUEZ: Yeah. I would just chime in, thanking you as well.

And for me, this has been a real eyeopener this last year, given this -- you know, the pandemic. And I just wanted to praise you and your staff for all the hard work, and the fact you -- and the fact that you guys have been very flexible given these times.

Thank you again.

CHAIRPERSON YEE: Thank you, Member Vazquez.

Let me now turn to see if there are any members of the public who speak to speak on this item on the teleconference line.

PHONE MODERATOR: Ladies and gentlemen on the phone lines, if you would like to place yourself in the queue for public comment, as a reminder, you may press 1, then 0, at this time.

(No response.)

PHONE MODERATOR: No members of the public are queuing up at this time.

Please continue.

CHAIRPERSON YEE: Very well. Thank you.

Thank you very much, Selvi, for the comments.

Members, our next item is Item Number 8. This is Board Members' Time. And let me turn it over to Members
Vazquez and Chamberlain to see if there are any comments that they wish to bring forward.

MEMBER VAZQUEZ: I don't have anything earthshaking, but just, once again, to thank you, again. And I know I'm -- I'm actually kind of looking forward to the day when we can resume back. Because I know we had a conversation at the very beginning, before the pandemic, about rolling out with the mobile unit you have, to get out and do some outreach, and I'm hoping that will happen soon. Maybe if not at the end of this year, maybe at the end of next year.

And that's really about all I have to add at this point.

CHAIRPERSON YEE: Thank you, Member Vazquez.

Member Chamberlain, any comments?

MEMBER CHAMBERLAIN: Yes. So Board Member Miller asked me to say a few things but these also represent my own thoughts.

So I just want to say that I'm very grateful to the staff and management at FTB who have, again, gone above and beyond what -- what could normally be expected in these very trying times. The FTB has been asked to do so very much, a lot of which we have already talked about today.

But I would just mention a few items that have
been important to me: They have expanded the Earned Income Tax Credit to taxpayers with ITINs; implemented your part of the Shared Responsibility program; you assisted in and design -- assisted in the design and then you implemented the Golden State Stimulus program.

And you did all this while dealing with delayed due dates and last-minute tax changes, including significant changes to both state and federal tax law that were adopted even as tax returns were being filed. I know that that's added a lot of stress on you. So -- and of course you did all this while having to adapt your working environment.

So I know that these events put a lot of stresses on probably every corner of Franchise Tax Board. We're very appreciative of your efforts and are comforted, Selvi, knowing that you have such a talented and hardworking team to help the State through good times and bad times.

CHAIRPERSON YEE: Thank you, Member Chamberlain. You enumerated a list of pretty extraordinary accomplishments, and certainly add our thanks to that as well.

First let me just say, I want to thank the team at the Franchise Tax Board for even making these virtual meetings possible. I think it's important to continue...
our business as a Board, and I, too, share Member Vazquez's desire that I hope that we can meet in person sometime soon in the future.

Secondly, just continuing the progress. You know, to hear about the EDR2 milestone, to just hear the phenomenal success of this filing season, given all of the circumstances that Member Chamberlain just enumerated.

And I just wanted to share a story, if I could. You know, we have a number of, you know, additional proposals that we are implementing in concert with Franchise Tax Board, other state agencies, the Controller's Office, really through the availability of additional revenue to the State of California and, certainly, the relief funds coming from the federal government.

And, you know, our work at the Controller's Office is heavily reliant on the programmatic implementation agency, and I just want to express our thanks to the partnership we have had in getting our -- the Golden State Stimulus payments out.

The story I want to share is that I had the opportunity to visit our print and mail team all three shifts a few weeks ago. And not only were they very complimentary about the partnership with the Franchise
Tax Board, but -- and I know this is true with the Franchise Tax Board and -- as well, but the amount of pride and ownership of being able to help so many Californians who are in need right now, and to do this work just knowing that they are performing, really, at the highest level of public service is something that is not going to ever be lost on me during this time. So thank you for the tremendous partnership.

Members, I do also want to share a little bit of a bittersweet piece of news, and this is always the time where, as we think about people who are making transitions in the organization -- this is not a retirement, however. So this is good.

But I have the privilege of saying thank you and farewell to our own Board Secretary Dawn Casey. Dawn has been just a tremendous part of our team as our Board Secretary for over 6 years. During this time, Dawn has played an integral role during our Board meetings and has been an invaluable resource to this Board.

However, Dawn's skills and talents are needed in other areas of the Franchise Tax Board, and so while Dawn will be missed at our Board meetings, know that this is not a goodbye, that we will see her later in her new capacity.

And I just want to say to Dawn, it's been just a
tremendous pleasure working with you over these many years.

And we will miss your kindness, we're going to miss your assistance, and your hard work, and extend all best wishes for you in your new capacity at the Franchise Tax Board. So thank you.

And let me turn it over to the other members if they wish to offer comments.

MEMBER VAZQUEZ: Yes. I would just like to give those thoughts as well. And just barely got to know Dawn now. And I understand you're moving on, but I understand that maybe we will -- our paths may cross again, because it looks like you are still going to be involved with the Franchise Tax Board. And wish you all the best.

CHAIRPERSON YEE: Okay. Thank you.

MS. CARVELL: Thank you so much.

CHAIRPERSON YEE: Of course.

Member Chamberlain, any comments?

MEMBER CHAMBERLAIN: I would just say thank you. And thank you for putting up with the temporary board members who don't -- who have to kind of figure things out. I appreciate all your assistance.

MS. CASEY: You are welcome.

Thank you, Madam Chair and Board Members.
It's been a great pleasure and amazing experience and opportunity these past six years, and I am very grateful to have had this.

Thank you all.

CHAIRPERSON YEE: Thank you. Thank you.

And now I have the privilege of welcoming our new Board Secretary, and that is Cristina Rubalcava. And Cristina currently serves as the Litigation Coordinator from the Franchise Tax Board's Legal Division, where she tirelessly works to maintain and coordinate the FTB's litigation with the Attorney General's Office and the California courts.

She will bring her finely honed skills in her new role as our Board Secretary. And to Cristina, I just want to say welcome. We are excited to begin working with you and looking forward to many great Board meetings to come.

MS. RUBALCAVA: Thank you so much. Good afternoon, Madam Chair and Board Members.

Especially thank you for the introduction. I'm extremely excited and honored to be able to be part of the Board meetings.

CHAIRPERSON YEE: Great. Thank you. We look forward to working with you.

Members, any other comments? Member Vazquez?
MEMBER VAZQUEZ: Just welcome, and I'm looking forward to the opportunity, hopefully soon, to meet you in person. But with that, wish you nothing but the best.

MS. RUBALCAVA: Likewise. Thank you so much.

CHAIRPERSON YEE: Member Chamberlain, any thoughts?

MEMBER CHAMBERLAIN: Just welcome. Welcome to the Board.

MS. RUBALCAVA: Thank you.

CHAIRPERSON YEE: Although, I want to challenge you, Member Chamberlain. The presence is not temporary. Very integral -- Department of Finance is a very integral part of this Board. So thank you.

All right. We will look forward to just working together and hopefully, like I said, in person soon.

Are there any members of the public who wish to speak on this item, on the teleconference line?

PHONE MODERATOR: Ladies and gentlemen on the phone lines, if you would like to place yourself in the queue for public comment, as a reminder, you may press 1, then 0, at this time.

(No response.)

PHONE MODERATOR: No members of the public are queuing up at this time.
Please continue.

CHAIRPERSON YEE: Thank you very much.

All right. Thank you very much, Members.

This concludes the business portion of our meeting. We are now scheduled for a break. Let me just suggest that we take a 15-minute break, after which we will come back to address Item Number 9, which is a section 25137 petition. So why don't we recess the meeting for 15 minutes, and we will be back at, how about, 3:05.

Thank you, everyone.

(Break taken in proceedings.)

---o0o---
25137 PETITION HEARING - AXOS FINANCIAL

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CHAIRPERSON YEE: All right, Members, let us reconvene this meeting of the Franchise Tax Board. Let me just be sure all of our members are back. Very well. Thank you. Thank you very much.

We have now moved on to Item Number 9. And this is a section 25137 petition to the Board by Axos Financial. On behalf of the petitioner, Axos, is -- appearing before us is Mr. Robert Johnson, Mr. Glen Jewell, and Mr. Derrick Walsh. I believe all three are on.

Yes. I see them on.

And then appearing on behalf of the Franchise Tax Board staff will be Katie Frank and Rafael Zaychenko. And I believe both of you are on. Very well. Thank you.

Let me just lay out the presentations for this particular hearing. Petitioner Axos Financial will have 30 minutes to make its presentation. Then the Franchise Tax Board staff will have 30 minutes to respond. And we'll then return to the petitioner, who will then have 15 minutes for rebuttal. And with -- if there are no questions by Members, we will proceed.

Very well. Thank you.
So let me look to -- I believe, Mr. Johnson, are
you going to be presenting?

MR. JOHNSON: Yes. Thank you.

CHAIRPERSON YEE: Thank you.

MR. JOHNSON: Madam Chair, Honorable Members of
the Board, my name is Robert Johnson, and I'm with Crowe
LLP.

I will be presenting -- representing the
taxpayer, Axos Financial, in this proceeding. I am
joined today by officers of Axos Financial: Andy
Micheletti. He is the CFO; Derrick Walsh, who is the
Chief Accounting Officer; and Glen Jewell, who is the
VP -- Glen Jewell, who is the VP of Taxation.

CHAIRPERSON YEE: Great. Mr. Johnson, let me
interrupt you for a minute. I'm sorry, my screen does
not show Mr. Micheletti. But he is on?

MR. WALSH: He is on -- with -- on my screen.

Derrick.

CHAIRPERSON YEE: Okay. Thank you. Thank you.

All right.

MR. JOHNSON: We're all in the same conference
room here, so you may be able to even hear them from my
computer.

CHAIRPERSON YEE: All right. Great. Thank you.

MR. JOHNSON: Thank you. We appreciate your time
and attention and, you know, hearing our -- our case. We want to thank you for that, as well as the FTB staff, who has been very helpful in helping us set up for this.

So can we move to the next slide. So what we're petitioning is 24 -- or 25137 relief. All right. And we understand the burden of proof is on the taxpayer to provide clear and convincing evidence, you know, that extraterritorial income is being taxed, that there's some distortion in the apportionment factor, and that an alternative apportionment factor would be appropriate.

So kind of what we want to do in this proceeding is start to put things on the scale of justice. All right. And at the end of this proceeding, we will be asking you of course to determine, did the things that we put on that scale reach our burden of proof to show that, you know, the apportionment factor, as applied to Axos, is distortive.

But we would like to -- can we move to the next slide.

Let's start -- I know you have seen our briefs, but we would like to start out with just a real quick background on the company, and because I think this fact pattern is quite important. We believe that some of the -- the initial rejection that we got from the FTB, you know, cited certain cases and whatnot, that we think
had more applicable to different fact patterns and not really this fact pattern. So I really want to highlight this to you one more time.

All right. So Axos Bank is a federally chartered bank that provides internet banking solutions for personal and business banking needs. All right. The bank's thrift charter allows it to operate in all 50 states; it's a national bank. They have depository and loan customers nationwide. But the physical locations, as a bank, you know, they really don't have your traditional branches. Rather, they have their headquarters in San Diego; they have some physical locations in Nevada, in Utah, and New York, but primarily here in San Diego.

Can we go to the next slide.

But so what this, though, is, this is the primary place of business. You are looking at it. This is the website. They don't do business like a traditional brick-and-mortar bank, where you walk in, and you, instead, go into a website.

Let's go to the next slide, please.

So the standard apportionment rules that apply to a bank, they include loans in the property factor and assign those loans based on what is called the SINAA rule to a regular place of business within the state.
In our case, unlike a traditional nationwide bank, we don't have those branches across the nation, so no loans go there. Our main place of business is in San Diego and are getting -- and so all the loans are getting assigned to San Diego, as well as -- so the property factor, as well as the pay factor, have no representation in this virtual location or branch.

So it's kind of just the high level background of our company.

Let's move to the next one, which is going to be more -- let's -- again, a high level analysis of the law.

So an alternative apportionment method may be allowed if the standard apportionment method provisions do not fairly represent the taxpayer's activity in the state. Right?

This acts as a safety valve to ensure that apportionment formula, when applied to a particular fact pattern, fairly apports income to the state.

And we know there's no bright line test here. Like we said, we got to throw all that evidence on that scale of justice. And it's up to you to determine, did we meet or exceed that?

Though there is, you know, a significant amount of case law on this, and one case law that was very
relevant that's -- we think it matches well to our case,
is highlighted on the next slide. So can we move to
that one? It's the General Mills case.

Now, it's probably one of the most recent cases
this -- on this item, on this subject, and I think it
does have some good application here.

The taxpayer applied the statutory formula. The
FTB proposed alternative -- an alternative formula. And
the FTB was successful in applying an alternative
formula even though the average difference between what
was the statutory formula and what was proposed only had
about a 4.4 percent increase as an average over the
period. And it -- and the reason for this is that --
and General Mills makes this clear. It's not just a
quantitative analysis. There's also a qualitative
analysis that needs to be done. Let's move to the next
slide, please.

Here's the fact pattern of General Mills: They
looked at seven years -- I'm sorry, six years here. And
the distortion on a quantitative -- from a quantitative
analysis ranged from 8.1 percent to 1.3 percent. That's
an average of 4.4 percent. You know -- and most people
would think --

WEBEX TECHNICIAN: All right. It looks like we
are having a little bit of internet issues on their
CHAIRPERSON YEE: All right. Let's see.
Let me just check in with the other representatives from Axos Financial.
Are any of the other representatives prepared to continue or should we take a short recess?
Mr. Jewell or Mr. Walsh, Mr. Micheletti, anyone prepared to continue on the presentation or are we relying on Mr. Johnson to come back online?
(No response.)
WEBEX TECHNICIAN: I think they were all using the same phone line from within that room.
There he is. Okay. He's back.
MR. JOHNSON: I am so sorry. I don't know what happened.
CHAIRPERSON YEE: That's all right. That's all right, Mr. Johnson. Please continue. We'll incorporate the lost time, just to give you that time back.
MR. JOHNSON: Okay. Again, I apologize for that. So I was -- I was talking about General Mills, how it had a relatively small quantitative distortion, but, yet, alternative apportionment was allowed, and it's because of the qualitative components.
So if we can move to the next slide.
We can talk about what some of those qualitative
issues were: We had a statute that was written for a completely different fact pattern. It wasn't written to look at a manufacturing company and hedging and combining those together. It just wasn't written for the fact pattern. So that was a qualitative fact that was highly influential in that case and justified that lower distortion. It didn't apply -- it didn't promote national uniformity. There was potential for huge tax loopholes, and it had an impact on the commerce and the tax collection of the state.

Those same fact patterns apply here, as well as a few other qualitative matters.

Let's move to the next slide.

So in our case, we provided Exhibit A, which shows that Axos's state tax rate is 300 percent of a traditional bank.

We have applied -- we have provided Exhibit B, showing that Axos is being taxed on 120 percent of its income.

But apart from that quantitative analysis, we have also -- we have got the same fact pattern as General Mills. We have standard rules written for a different business model.

We have got internet -- this is internet banking, which is very different than traditional banking. The
MTC revised its rules to accommodate for that.
California hasn't caught up. We have uncodified California law that states that the FTB should try to find that uniformity across the state and promulgate regs for that. We have got the Internet Tax Freedom Act that puts a higher degree of burden when it comes to double taxation of electronic commerce.

And we're asking for something that gives us complete or much better national uniformity and it closes the tax loopholes that are potential in this scheme.

Can we go to the next slide.

So, again, going back to the scale of justice -- let's move on to the next one.

We're going to now -- let's throw onto this scale the various items we want you to consider. And at the end of the day, it will be up to you to decide, did we meet that burden of proof? I believe we did.

Next slide, please.

Let's first talk about internet banking versus traditional banking. Like in General Mills, the fact that the apportionment formula was developed for a business model, traditional banking, that's very different from online banking, is a significant qualitative factor and should be considered in this
Internet banking is qualitatively different than traditional banking. With traditional banking and national -- unlike traditional banking, a national internet bank's website can be run from anywhere in the country, with the website being virtually located in any of all 50 states.

Let's go to the next slide.

The banking apportionment rules were developed to apportion income of a traditional brick-and-mortar bank. A traditional bank and mortar [sic] -- a traditional national bank would take loans and allocate it out to its branches, which are nationwide. An internet bank doesn't have branches nationwide; it's got one virtual branch. Very different.

Although Axos may have a similar national clientele as a traditional national bank, its electronic commerce in banking is subject to income tax on California at a higher rate than similar banks.

Exhibit A is -- you know, illustrates that point. So let's -- let's go to the next slide.

We're going to throw one more thing onto this scale, which is Exhibit A.

Please go to the next slide.

This is an analysis -- these companies are drawn
right from the taxpayer's proxy statement. These listed
as their -- as their competitors. We have listed here
all the competitors. These are all traditional banks,
not online banks.

You can see, their effective rate is 7 percentage
points lower than Axos Bank's. That's a 300 percent
distortion compared to them, which is -- this is just an
indicator that the apportionment formula was built for
national banks. It was for traditional banks, not for
an internet bank, and can significantly distort the
income of an internet bank.

Let's go to the next slide.

We're going to throw one more thing on the scale,
and that's our Exhibit B. So let's move to Exhibit B,
the next slide.

And this is -- we're basically taking all the tax
returns of Axos Bank, adding them up, and our total
apportionment factor is -- it clearly shows double
taxation. So 120 percent of their income is being
subject to tax.

As you can see, this is primarily due to
California property factor.

Let's move to the next slide, please.

So we're going to throw one more thing on this,
and this is -- the standard rules were written for a
different business model.

Next slide, please.

So back in 1987, California adopted the current rules. What didn't exist in 1987? Internet banking. These rules were meant for brick-and-mortar banks, and they were written for that intention. But when these rules, written for a different banking model, are applied to internet banking, you know, an internet bank has a virtual branch, and it doesn't have the brick-and-mortars. And so instead of loans being spread out among the client -- you know, among the nation, it is instead all sucked back to where your headquarters are, causing the distortion that we're seeing here.

The same things happens with payroll because you could put the payroll all in that one place, easily moved. You can easily move one place versus national branches that are across the country.

Let's move to the next slide, please.

All right. We're going to throw one more thing on there, and that is the MTC rules.

Next slide, please.

Okay. So in 2014, when internet banking -- by this time, internet banking had become more -- much more commonplace. All right? And so the MTC saw that the old SINAA rules were not -- were causing a problem
because of online banking. All right. This comes exact -- you know, from their project description of why they needed to change the rules. They say these changes are caused -- these changes were caused by -- both the deregulation of the industry as a result of the appeal of Glass-Steagall and by technological innovations that allow financial institutions to provide a full range of service, such as mortgage loans and credit card application processing, credit approval, and account servicing entirely online.

WEBEX TECHNICIAN: All right. We're going to pause here. It looks like they are having the same issue.

CHAIRPERSON YEE: Okay.

EXECUTIVE OFFICER STANISLAUS: So this is Selvi, Controller.

Do we want to call the taxpayers and maybe they can call in as opposed to doing the video?

MR. JOHNSON: Can you guys hear us?

CHAIRPERSON YEE: We can hear you now.

MR. JOHNSON: Sorry about that. So are we on slide 22. Is that right?

So the MTC made these changes because they believed that loan servicing rules, based on SINAA, didn't fairly reflect the income of an online bank.
Most states currently do not apply SINAA and do not use the three-factor formula. But California hasn't revised its apportionment rules to address the inequities that this causes to an online bank or at least the inequities caused to Axos at this point.

So let's move to the next slide, then.

I don't see -- oh. I can see -- mute that.

All right. So we're going to throw one more thing on here, and this is uncodified California law.

Let's go to the next slide, please.

So this uncodified California law, this states that the Franchise Tax Board shall adopt regulations dealing with apportionment, allocation, and income with respect to banks and financial corporations. This law is specific to banks and financial corporations that considers the laws and regulations of other states, with an objective of preventing multiple taxation or circumstances where income is taxed to no state.

So when it comes to the banking industry, I think there's higher level of scrutiny on this. You know -- and at the time when this was first enacted, California followed it and adopted the MTC regs. Since then, they went away from the MTC regs and then -- or I shouldn't say they went away from the MTC regs. The MTC changed and California didn't follow suit.
So I think this is just one more thing to throw onto that scale to consider, for your consideration.

Let's move to the next slide.

Now we're going to throw the Internet Tax Freedom Act on the scale.

Please go to the next slide.

So the Internet Tax Freedom Act prohibits states from asserting multiple or discriminatory taxes on electronic commerce, and, therefore, it should be considered and factored into this analysis.

When a national internet bank is required to use a higher apportionment factor than a national traditional bank, with the same client base, it is being taxed at a higher rate and violates Internet Tax Freedom Act as a discriminatory tax.

Additionally, the Internet Tax Freedom Act says you can't have multiple taxation with regard to -- or that there's higher level of scrutiny for multiple taxation, and that is defined to include -- multiple tax is defined to include income taxes.

So let's move to the next slide, please.

So let's throw one more thing on there, and it's national uniformity. It is something that should be pursued, and General Mills said it should be a factor that should be considered.
Next slide, please.

You know, since -- since the regs that we are -- are used are not following the MTC, there's less national conformity. Most states -- most of the states don't -- aren't requiring property and payroll factors. They look only to sales factors.

And a single sales factor, which is what we do propose, would result in the highest amount of national uniformity. It would avoid multiple taxation and avoid any nowhere sales as well.

Next slide, please.

All right. One last thing we're going to put on top of all of this. And that -- the -- that this scheme allows for some big potential tax loopholes. And -- and General Mills said that's something we need to consider.

Let's go to the next slide. Let's talk about that.

Applying the rule of 25137-4.2 to an internet bank not only is distortive and cuts against national uniformity, it is also susceptible to manipulation and taxpayer loopholes. For an internet bank, a single sales factor would create consistency based on the bank's customers.

Under the current banking apportionment rules, it would be relatively easy for an internet bank to
manipulate the rules by moving servers and a relatively small number of people to a tax saving state to assign all loans to that state.

If a company like Axos were to do something like that, they would get a much lower tax than what they are requesting in this alternative apportionment, but we believe that this is the fair thing to do.

Can we go to the next slide.

So, you know, we kind of, you know, laid onto those scales of justice all of the items that we think would justify alternative apportionment. And so this slide covers, what are we proposing? Well, what we're proposing is something very simple, and it actually removes every single one of those items on that scale.

What we're proposing is using single sales factor. It creates 100 percent apportionment since all the states use a similar revenue sourcing method. We won't have any nowhere source sales. It -- but we would have no discriminatory or multiple taxation of e-commerce, a hundred percent apportionment, and avoiding double taxation, it goes much closer to national conformity, and it's not prone to tax avoidance schemes.

With a single sales factor, for us to -- I mean, you can't just move out of state. You would have to
move all your customers. All right. And so it creates
you know, to me, much better tax policy, and I think
it's consistent with the ruling of General Mills.

Now, we do believe a single sales factor is the
best alternative. However, we are willing to listen to
other alternatives and -- as a second alternative, if
the -- if the Board doesn't like a single sales factor,
we would be open to using the MTC rule, which merely
throws out the loans from SINAA -- you know, throws out
the SINAA rules and throws the loans of the property
factor.

So that's all I have for you. Let me just
summarize, though, one last slide.

So just next slide, please.

So in summary, we believe that an all facts and
circumstances approach should be used. We put all of
the facts and circumstances on the scale of justice.
We'll let you decide.

Internet banking and traditional banking are very
different animals. A formula developed for traditional
banks doesn't clearly reflect the income of an internet
bank. The MTC recognized this and they changed things.
The FTB has not yet corrected the problem even though
uncodified law directs the FTB, with regard to banks
specifically, to adopt apportionment regulations,
considering the laws and regulations of other states, with an objective of preventing multiple taxation.

The FTB should consider that the Internet Tax Freedom Act also places a higher degree of scrutiny on multiple taxation when it comes to electronic commerce.

Exhibit A shows 120 percent of the bank's income is being taxed.

Exhibit B shows that Axos state tax rate is more than 300 percent of its traditional bank competitors. The standard formula does not lead to national uniformity. The proposed formula does. The standard formula, which applies to an internet -- when applied to an internet bank leaves itself open to tax loopholes and would be detrimental to predictability of the state's income. And the single sales factor resolves all of these issues.

Thank you.

CHAIRPERSON YEE: Thank you, Mr. Johnson.

Let me now turn to the -- actually, to the extent you have a bit of time left, do the other representatives want to make any comments with the time left?

MR. WALSH: Sure. Can you guys hear me? This is Derrick Walsh.

CHAIRPERSON YEE: Yes, Mr. Walsh. We can hear
you.

And I know the Board Secretary will keep us on time. But because we had the technological problems, I want to just give you an opportunity to utilize your full time.

MR. WALSH: I appreciate that. Thank you, Mrs. Yee.

Yeah. The one thing that we wanted to also touch on and reflect is the -- obviously we've been through the back and forth of our petition and the response by the FTB. And some of the cases that they addressed in their response really, we don't feel, are very applicable.

CHAIRPERSON YEE: We just lost your volume here. Mr. Walsh, we're not able to hear you.

WEBEX TECHNICIAN: I think they have hung up that phone. And so as soon as Mr. Johnson comes back online, we'll probably hear his audio come back.

CHAIRPERSON YEE: Okay.

WEBEX TECHNICIAN: It definitely looks like they are having some connectivity issues there.

CHAIRPERSON YEE: Probably not even able to hear me.

WEBEX TECHNICIAN: Well, I think they just got the message. It looks like we see it on their face now.
Mr. Walsh, could you give us a thumbs-up if you can hear us speaking to you?

(No response.)

WEBEX TECHNICIAN: No. Okay. So Mr. Johnson just dropped out, so that tells me he's resetting.

CHIEF COUNSEL BRUNETT: We are at 22 minutes. And we will give them this extra time, Controller, for this time that we're off.

CHAIRPERSON YEE: Sounds good, Ms. Brunett.

WEBEX TECHNICIAN: Mr. Walsh, can you hear us? If you can, give us a thumbs-up. Okay. He can hear us. So now we have communication. We have lost about three minutes ago, to be honest with you.

MR. WALSH: You lost me a couple of minutes ago. Okay.

CHAIRPERSON YEE: Mr. Walsh, I understand that you are at the 22-minute mark, so you have about eight minutes.

MR. WALSH: All right. Probably only need about three minutes.

So where -- can you just help me understand where I lost you?

CHAIRPERSON YEE: I think start from the top, because we're --

MR. WALSH: Okay. We'll start from the top.
CHAIRPERSON YEE: Because you tried to thread a
thought and you -- we definitely lost your volume.

MR. WALSH: Okay. So the -- one of the things I
wanted to address was the -- in the back and forth with
the Franchise Tax Board, through our letter of process,
one of the things that they highlighted were a few
different cases: Finnigan, Tosco, Merrill Lynch, which
I'm sure you will hear about momentarily here.

What I wanted to speak to those items -- that we
don't believe those really are applicable. While those
facts and circumstances of those cases may be -- may be
factually accurate, we do not believe they are relevant
to the case of Axos Bank and that they don't carry the
same facts as Axos Bank. So they lose that relevancy
and that they -- that Axos, as an internet bank, as a
branchless bank, really performs a lot of its business
in a very different way than the cases that -- that were
discussed as far as Finnegan, Tosco, and Merrill Lynch.

I mean, in Tosco, it's an oil and gas company
that has physical reserves, gas reserves, in the ground,
and just doesn't -- sorry.

MR. JOHNSON: Equate well.

MR. WALSH: It doesn't equate well. Thank you.

It doesn't equate well to the business products that we
are providing in regards to being an internet bank.
And then -- so that's one comment in regards to
the -- some of the considerations of other cases.

In regards to -- to give you a better flavor for
how Axos Bank does business, and thinking through the
SINAA factor, and the challenge that we have in, how do
we apply SINAA to Axos, how do we obtain our customers?
Think about the solicitation factor. And where do these
customers come from?

Many of them come from a website. So some come
directly through the website. They -- they are
searching online. They go to Google. They are in New
York, Minnesota, Florida. They go to Google, and they
are transacting with us virtually, over the internet.

And, similarly, we may have third parties that
are located throughout the U.S. that may introduce us to
these customers, but same sort of idea. They are
sitting in their homes, throughout the U.S. They are
either, again, on the website or they are on the --
potentially on the phone. But a lot of the business is
fully virtual now, virtually website-oriented, and it's
all being done electronically. And none of it is
necessarily -- it makes it a challenge for us to apply
the SINAA guidance.

And that's been -- that's been the trouble that
we've been having when we take a step back and look at,
how does this really make sense for an organization like Axos?

So hopefully you can still hear me this time. I'm about up. Let me just double check with the rest of the team to see if there's anything additional that the team wants to add.

I think we'll call that our conclusion, and we can move over to the FTB, or back to you, I guess, Ms. Yee.

CHAIRPERSON YEE: Great. Thank you very much, Mr. Walsh. And to Mr. Johnson, you will have time on rebuttal.

Let me turn to the Franchise Tax Board for its response. You will have 30 minutes.

MS. FRANK: Good afternoon, Board Members. My name is Katie Frank. With me is Rafael Zaychenko, and together we will be representing the Franchise Tax Board.

Currently at issue, like Taxpayer mentioned, is whether Revenue and Taxation Code section 25137 can be invoked to allow Taxpayer to use an alternative apportionment formula.

Section 25137 provides that if the standard allocation and apportionment provisions do not fairly represent the extent of the taxpayer's business activity
in this state, then an alternative formula may be employed.

In order to invoke section 25137, the party requesting relief -- in this case, the taxpayer -- has the burden of proving by clear and convincing evidence that the standard formula does not fairly represent the taxpayer's business activities in the state, and that the proposed alternative is reasonable.

For the reasons I will go into detail later, Taxpayer has failed to meet its burden of proof. For one, Taxpayer has failed to show, by clear and convincing evidence, that the standard formula does not fairly represent its business activities. Taxpayer argues that since it operates over the internet, the standard formula distorts the measure of its business activities. However, Taxpayer has failed to provide evidence to support this assertion.

Second, Taxpayer's other arguments as to why section 25137 should be invoked have previously been rejected by courts or the Board of Equalization as irrelevant to the question of whether the apportionment formula fairly represents the taxpayer's business activities. Specifically, arguments of a purported better formula, arguments of alleged multiple taxation, and arguments pointing to large quantitative distortion
metrics alone have all been rejected by case law as means to show that the standard formula is not a fair representation of one's business activities.

And before I go on, I would like to first discuss the purpose of the apportionment formula and how section 25137 relates.

For multistate taxpayers that operate in and outside a state, states are permitted to tax a share of that multistate taxpayer's total business income. So if the income is viewed as a pizza, this state only taxes a slice of that pizza. And the apportionment formula is who determines the size of the slice of the income and what the state can tax. And this formula is computed based on looking at the business activities in a state that generate the business income compared to total business activities everywhere.

The more business activities attributed to the state, the larger the slice that a state can tax; whereas, the smaller amount of business activities, the smaller the slice.

And states have wide latitude in choosing an apportionment formula, with the constitution not requiring a single formula for the state. For this reason, there are multiple constitutional formulas. However, in some situations, a constitutional
apportionment formula does not measure the business
activities in the state as intended to be measured, such
that that slice is not a fair representation of business
activities conducted in the state. When this occurs,
this is referred to as resulting in distortion, and
section 25137 can be invoked.

An example of this is when a formula is measured
by the amount of property in a state, payroll in a
state, and sales in a state, compared to property,
payroll, and sales everywhere. The apportionment
factors must be causally related to the income being
apportioned. If a taxpayer has no property, then the
formula is not causally related to that, and, thus, not
fairly reflected business activities. So in that case,
there's distortion and the property factor is removed.

However, it's important to note, when determining
whether section 25137 can be invoked, this section does
not allow deviation from the normal formula simply
because one purports to have a better approach.

So while there are a variety of appropriate
formulas, once a state adopts a constitutional formula,
section 25137 can only be invoked upon showing that
specific formula results in an unfair representation of
business activities.

Now, turning to Taxpayer's activities; its
combined reporting group is engaged in banking and financial activity. Most of Taxpayer's combined reporting group is attributed to Axos Bank, which is a federally chartered bank that conducts operations over the internet and serves customers nationwide, with the banking segment operating from the headquarters located in this state, specifically, San Diego, California.

Now, as to the standard formula at issue, it consists of an evenly weighted three-factor formula. The California Legislature specifically intended for businesses that derive more than 50 percent of their gross receipts from banking and financial activities, such as Taxpayer's combined reporting group, to use this three-factor formula.

The legislative intent was affirmed again in 2009, specifically when general corporations moved to the single sales factor formula. The legislative history shows that the California Legislature specifically intended for businesses that derive more than 50 percent of the receipts from banking and financial activity to remain using this three-factor formula. And the three factors consist of an evenly weighted sales, property, and payroll.

Also at issue are the apportionment rules applicable to banks and financial corporations within
Taxpayer's combined reporting group. As Taxpayer mentioned, it specifically takes issue with the requirement that loans be included in the property factor, and loans are assigned to the state in which the loans have a preponderance of substantive contacts.

The relevant factors for determining substantive contacts include the state in which there's solicitation, investigation, negotiation, approval, and administration of the loans have occurred. And these are called the SINAA factors, and these are essentially the activities that are connected to the generation and the administration of the loans.

Now turning back to the three-factor formula at issue, the U.S. Supreme Court has provided that this is a long accepted methodology to measure the business activities attributed to a state. Due to this, one must prove, by clear and convincing evidence, that it's not functioning as intended to approximate a taxpayer's business activities.

In this case, Taxpayer argues that since the three-factor formula was put in place before the advent of the internet, it doesn't reflect its internet business. Taxpayer specifically takes issue with the property and payroll factors.

I will first turn to the payroll factor.
The payroll factor is intended to reflect the contribution of employees that give rise to apportionable business income. The purpose of this factor has not changed in importance since the advent of the internet, nor is there any legal authority to support the notion that there's been a change in this factor.

Here, the banking segment operations are largely run from the bank's headquarters in this state, so the employees that give rise to apportionable business income are largely located in California.

Taxpayer argues that since it operates over the internet, it's unfair that most of its payroll be assigned to the state, whereas a traditional bank has employees located in branches throughout the country, near the bank's customers.

However, this is not evidence of distortion. This is merely a representation of where business activities are located, which give rise to apportionable business income.

The --

MS. SARILLE: Excuse me. Katie?

MS. FRANK: Yes.

MS. SARILLE: I'm sorry. I got off track. What slide are you on?
MS. FRANK: I'm on the payroll factors.

MS. SARILLE: Sorry. Give me a second.

Is that slide 13 up on the screen? Am I in the right place?

MS. FRANK: No. Sorry. So you are on slide 12.


Okay. I'm not able to go back one. So I'm stuck at slide 13. I'm sorry.

MS. FRANK: Oh. You know what? It's the next slide.

There we go. Okay.

All right. So the taxpayer conducts its activities over the internet. It doesn't change the importance of the employees that generate the business income.

Also, by arguing that payroll should be assigned to where the bank's customers are located -- which Taxpayer was arguing in its presentation -- Taxpayer appears to be arguing that the payroll factor should duplicate the sales factor which reflects the location of its market. However, that's simply not the purpose of the payroll factor, and allowing relief based on that would run counter to the purpose of having a separate payroll factor in the measure of business activities.

All right. Now moving on to the property factor.
So this factor is intended to reflect the income-producing effect of capital invested in the taxpayer's trade or business. Again, this -- the purpose of this factor has not changed due to the advent of the internet.

And as stated before, loans are included in the property factor and assigned to the state based on the SINAA factor. As applied to Taxpayer, the loans are largely assigned to California because that is where Taxpayer's business activities occurred that gave rise to the SINAA factors.

Taxpayer again argues that it's distortive that its activities are assigned to one state, whereas traditional banks have their loans assigned where their branches are located throughout the country. Taxpayer also argues that it's distortive since it has similar clientele as traditional banks. However, assigning loans to the state is merely a reflection of where the business activities are located that gave rise to the loans, and the property factor also is not intended to duplicate the sales factor.

So like the conclusions found with the payroll factor, there is no evidence since Taxpayer operates over the internet the formula results in distortion. Rather, the formula is merely reflecting where
Taxpayer's actual business activities occur.

Now, looking at the formula in totality.

So you can move on to the next slide.

There you go.

Looking at the formula in totality, there's no evidence to show Taxpayer's activities are not fairly represented by the standard formula. Again, the legislature intended for banking and financial businesses, such as Taxpayer's combined reporting group, to measure their business activities using the three-factor formula. And this is a long-accepted methodology.

When looking at Taxpayer's activities, it's clear that the formula is merely measuring where those activities actually occurred.

Now, turning to Taxpayer's other arguments that it alleges proved distortion. As mentioned before, these have been rejected by courts or the Board of Equalization.

First, Taxpayer points to other purported better apportionment formulas as evidence that the current formula does not fairly represent its business activities. Taxpayer argues that since numerous other states use something other than an evenly weighted three-factor formula, the single sales factor would be a
better approach to ensuring uniformity. Also, Taxpayer points to the Multistate Tax Commission's formula, which has removed loans from the property factor, as evidence that another formula should be used.

However, arguments of a purported better approach have been rejected as means to show an apportionment formula results in distortion. Rather, one must show that the standard formula does not fairly reflect one's business activities.

States are given wide latitude in creating apportionment formulas, so because other states have adopted something other than the three-factor formula is not necessarily dispositive that California's formula is distortive.

Also, it should be noted that if Taxpayer is arguing that granting it will -- a single sales factor will achieve uniformly, not all states have a single sales factor for banks and financials, so the uniformity that Taxpayer's advocating for is not attainable.

Now, as to the Multistate Tax Commission's formula. Taxpayer argues it was revised to remove loans from the property factor because the distortive effect on internet banking. However, the regulatory history shows that the member states participating in that revision process were largely concerned with being able
to administer the SINAA rules. This can be seen within
the hearing officer report.

As such, it wasn't the inclusion -- inclusion of
loans was per se distortive as to internet banking;
rather, that the SINAA rules were difficult to apply.
However, in this case, Taxpayer has provided no evidence
in difficulty in administering the SINAA rules. And in
fact, its activities largely occur in California,
supporting the fact that the SINAA -- that the SINAA
rules would assign loans to this state.

Taxpayer also argues that there is multiple
taxation due to California imposing a different formula
than other states and this results in distortion.
Taxpayer contends this also is in violation of the
Internet Tax Freedom Act.

Assertions on multiple taxation are not relevant
to whether the California apportionment formula fairly
represents Taxpayer's business activities in this state.
Nevertheless, the apportionment formula is designed to
prevent multiple taxation since it ensures California --
California only taxes a slice of the income.

Also, as stated before, states have a wide
latitude to choose an apportionment formula, so while
the apportionment formula is designed to prevent
multiple taxation due to only attributing a slice of
income to a state, it may be the case that when two states impose different formulas, this may result in an overlap in taxation or it might result in less than a hundred percent of income being subject to taxation. But this is merely the interaction of two different tax regimes, and it's permitted by constitutional law.

The U.S. Supreme Court has also noted, when reviewing similar arguments, that there's no way of knowing which state is the cause of double taxation. So even if there is double taxation, there's no evidence that California's tax regime is the cause.

I'm moving on to the Internet Tax Freedom Act. The taxpayer points to this provision as evidence that multiple taxation is prohibited and evidence of the standard formula is distortive. As stated before, assertions on multiple taxation (unintelligible) are irrelevant to the question of whether the formula fairly represents the business activities in this state.

Nevertheless, even if relevant, it's clear the Internet Tax Freedom Act does not apply. This act prohibits discriminatory or multiple taxation upon electronic commerce. But here, the apportionment formula is not discriminatory since it's applied in the same manner to traditional banks and internet banks.

Also, there is no prohibited multiple taxation.
The Internet Tax Freedom Act defines this as "any tax that is imposed by one state on the same or essentially the same electronic commerce that is also subject to tax by another state without a credit."

Since this involves an apportioned tax, which only taxes a slice of the income, by its very nature, it's not a tax on the same or essentially same activity. If Taxpayer is asserting that the Internet Tax Freedom Act prohibits any overlap in taxation that may result to the interaction of two different but constitutional formulas, then that interpretation would run afoul of constitutional law.

Specifically, the constitution does not require a single apportionment methodology of the states. However, to prevent any double taxation, that would require a single formula be adopted, and that would undermine constitutional principles. For this reason, Taxpayer's interpretation cannot be accepted.

I'm moving on to Taxpayer's other argument. Taxpayer points to its effective tax rate and argues that that demonstrates distortion of the standard formula. Taxpayer pointed to this along with the argument that it's subject to multiple taxation.

Well, one, there's no evidence that the effective tax rate differences are due to the three-factor
formula. It could be due to numerous items.

Second, quantitative metrics alone are just simply not sufficient to invoke section 25137. Rather, the question is whether the formula leads to an unfair reflection of business activities. For this reason, this metric is not dispositive.

That's -- for all the reasons I discussed, Taxpayer has failed to prove, by clear and convincing evidence, that the standard formula does not fairly represent the extent of its business activities. For this reason, the alternative formulas proposed are not reasonable.

And before I conclude, I would just like to highlight some closing items for you.

Now, once a state has adopted a constitutional formula, such as the three-factor formula, it must be applied unless clear and convincing evidence demonstrates it's not a fair representation of the taxpayer's business activities.

And in this case, there is no evidence that since Taxpayer conducts its business over the internet, that the formula results in distortion. Rather, the property and payroll factors are just as important in generating business income for businesses that operate over the internet as they are for traditional banks.
Moreover, any assertion that the property and payroll factors should reflect the place in which the customers are located is merely an assertion that the sales factor should duplicate -- should be duplicated. And that's counter to the underlying purpose of having separate factors in the measure.

Also, arguments of purported better formulas, alleged multiple taxation, and pointing to large quantitative metrics alone are not sufficient to invoke section 25137. Due to this, Taxpayer has failed to meet its burden of proof to invoke an alternative formula. And, lastly, denying Taxpayer's request would affirm the legislature's intent that banks and financial combined reporting groups continue to apportion their income using a three-factor formula. For all these reasons, FTB respectfully requests that Taxpayer's petition be denied.

Thank you for your time, and I would be happy to answer any questions you may have.

CHAIRPERSON YEE: Thank you, Ms. Frank, for the response.

Let me just do a check on time.

Mr. Zaychenko, any further comments before we turn back to the petitioner?

MS. ZAYCHENKO: None for me at this time.
CHAIRPERSON YEE: Okay. Very well. Thank you very much.

Let me then return back to the petitioners. You have 15 minutes on rebuttal.

Mr. Johnson, do you want to --

MR. JOHNSON: Oh, hi. Thank you.

So I guess I would like to start saying, it sounds like the gauntlet or the test being thrown out is that -- is that -- is an impossible thing to meet based on those standards.

You know, we -- we -- we showed that -- you know, the scales of justice? All right. It feels like what's happening is we're putting a factor in for consideration, and then they are myopically looking at that one factor and saying, "Nah, it doesn't do it."

They take it off the scale.

And they put another factor and put it on there for consideration. They look at that one myopically and say, "Nah, that doesn't cut it either. Take it out. Let's put another one on."

And so myopically taking one point by one and determining if that one on its own is clear and convincing evidence.

We're not arguing that any one of our facts gets us there. What we're saying is, when you consider all
of the facts together, we think that there's clear and convincing evidence that, in our case, more is being taxed in California than is reasonable to Axos Financial. All right.

And, you know, they get into this idea of, well, the payroll factor is for one reason; the property factor is for another reason. At the end of the day -- I mean, general corporations have single sales factor. There's no principle out there that says, you have to have a property factor; you have to have a single -- a payroll factor. The governing principle is, is the ultimate result equitable to the client? Is it fair? Is it reasonable? All right. Is it a reasonable approximation of the income that is earned, that is earned in the state?

And we say no, we don't believe so.

You know -- yeah. If you look at any one thing, uniformity. Perfect uniformity, no. Does it get us to better uniformity? Absolutely, yes. That's what we should be trying to achieve.

The MTC changes. I think they referred to some historical documents that showed the -- the reason was for administrative purposes. There's nothing out there historically that says that. I think they called up someone at -- at the MTC on a private call, which we
were not part of, and they got some insight of what this 
person thought the reasons for it was.

But all the public statements out there about the 
reason it was changed was because the change in online 
banking, that the online -- that the old regs were not 
practicable when applied to online banking. And that 
reason that it's -- the fact that it was unpracticable 
leads to a distortive outcome, in our case especially.

All right. We showed you the numbers.

300 percent greater than a national bank with the same 
clientele. 120 percent clearly being double taxed. We 
aren't saying with each of these items -- we look at the 
Internet Tax Freedom Act. We aren't asking you to judge 
on the Internet Tax Freedom Act and whether that makes 
this invalid. We're saying include that on your scale. 
We're saying include it on the scale.

They are saying, no, we're taking -- we're going 
to nitpick this one at a time, remove them all.

We're just saying, please consider all of this. 
And I think when you look at everything together, I 
don't think you can reach a conclusion that there's no 
extraterritorial income of Axos being taxed in 
California.

Do you guys want to add to that?

MR. WALSH: Yeah.
To add to -- to add to something Ms. Frank showed in her slide, and kind of further illustrated the challenge that -- this is Derrick Walsh, Chief Accounting Officer -- further illustrated the challenge that I illustrated the earlier, spoke to earlier, was, in applying the SINAA factor, as a virtual organization is very challenging for us and is not administratively easy. And so I think that kind of makes the point that this -- this three-factor --

CHAIRPERSON YEE: It looks like we have some technological difficulty again.

WEBEX TECHNICIAN: It does. It sure does.

CHAIRPERSON YEE: Okay. Let's just be patient. I'm sure they will come back on.

WEBEX TECHNICIAN: I think they realized it at this time.

MR. WALSH: Can you guys hear me?

CHAIRPERSON YEE: Yes. We can now.

MR. WALSH: Okay. Where did I lose you? Sorry. Can you hear me?

CHAIRPERSON YEE: I can hear you.

Why don't you go back. I know you were refuting the Franchise Tax Board's application of the formula.

MR. WALSH: Yeah. I was highlighting the SINAA factor --
CHAIRPERSON YEE: Yeah.

MR. WALSH: -- so I will recap that really briefly.

The SINAA factor and that's the -- as spoken to earlier, it is a challenging -- challenging aspect for a virtual bank to apply.

The example referenced earlier, with regards to the solicitation of customers, is not happening necessarily in California; that is a happening on an -- online, at computers, at the customer's -- the customer's site.

And the -- further to that, especially as we move to more cloud servers, you can make the argument, okay, where are the servers located? That might be where you would tie it to. Well, now they are a little bit more nebulous, as you use Amazon web services or Microsoft servers that are located -- do you have me unmuted there? So on these servers that are located throughout the U.S., that if you are going to then try and point to that, that poses a challenge. It just makes it administratively challenging to apply these fact -- this fact -- this structure of the tax guidance to an organization like Axos Financial.

And then the other topic I just wanted to touch on was the -- there was some references to Supreme Court
rulings or other historic court cases that date back to
the mid-1990s or time periods that really, once again,
aren't relevant to an organization and a business model
and a entire industry that didn't even really get
started until the early, early 2000s/late 1990s, and
really didn't come into its own until the early 2010s.

And so a lot of these -- a lot of these rulings
or references don't have great applicability to a
financial services organization, banking products being
delivered over the internet, that -- that they are --
the historic past references to these don't consider
that sort of business model.

Anything else you had, Rob, or Andy, that you
want to touch on?

MR. MICHELETTI: No. The -- the final point I
would make of Franchise Tax Board is citing the MTC
reasons for changing their allocation method. And she,
in fact, said the sales investigation factors are, in
fact, too hard to apply. That's why they changed the
rules.

And we're basically saying, we have the same
situation here, that applying those rules in an internet
organization is -- it really can't be done in the way
they were traditionally designed to be applied.

So I thought that her comments, in a large way,
are supporting our position that we need relief relative to exactly how this works. Whether we use a single revenue or whether we use all three, we have listed both as options, but it is really the property, including loans in the property factor, that is the difficult part of the position.

CHAIRPERSON YEE: All right. Thank you, Mr. Johnson.

Anything else in conclusion?

MR. JOHNSON: I think we have covered it.

CHAIRPERSON YEE: Okay.

MR. JOHNSON: So if you have any questions, we would be happy to address those.

CHAIRPERSON YEE: Great. Thank you very much.

Members, I'm going to open it up for comments and questions.

Member Vazquez, please.

MEMBER VAZQUEZ: I have a couple of questions. Let me start with staff first.

I guess it was Katie who was making the presentation?


MEMBER VAZQUEZ: What would be required in the case of this taxpayer to meet the clear and convincing standard of proof? Are you able to elaborate on that,
please?

MS. FRANK: Yeah.

So there's a variety of different scenarios where the formula has been found to be distortive. So one example is -- let's see -- it's a three-factor formula involving a property, payroll, and sales. And the taxpayer has no property in its -- in -- no property activity.

The factors are supposed to be causally related to the generation of income. But when you have a factor with no activity, there's no causal relation and so there's no fair representation by that -- that factor. In that case, the formula results in distortion and the formula can be removed.

Another example, in line with the General Mills case, which the taxpayer brought up in its presentation: So when there are certain instances where a taxpayer will have an income stream and -- and that income stream will produce incredibly large receipts. And that income stream is qualitatively different.

So in the case of General Mills, they had hedging activity that was engaged -- that the taxpayer didn't engage in for-profit purposes, which was qualitatively different from the main line of business. In that case, the court said that these hedging activities, with this
very large amount of receipts, overwhelmed the factor, the sales factor, and -- in relation to the amount of income being produced, and they could be removed. The hedging activity could be removed or reported at net.

So there are two examples there.

MEMBER VAZQUEZ: And I appreciate that.

And what is the actual percentage of the taxpayer's loan processing operation that are assigned to California versus other states?

MR. JOHNSON: Is that a question for us? Or --
sorry.

MEMBER VAZQUEZ: Whoever can answer it.

MR. JOHNSON: It would be, as -- as she said, an overwhelming amount. It would be 100 percent, consistent with the General Mills qualitative difference of an overwhelming amount.

MEMBER VAZQUEZ: What's an "overwhelming amount"? Are you saying it's a hundred percent in California versus other states?

MR. JOHNSON: Of the loan -- I'm sorry. Of the loans, I think there's maybe 2 percent that goes to another state. Is that about right?

MR. WALSH: Can you specify whether you are talking about Axos Financial? What -- can you repeat your question, please? Let's repeat the question.
MEMBER VAZQUEZ: I'm talking about the loan processing operation. What is assigned to California versus other states?

MR. WALSH: Are you talking about personnel or are you talking about loans?

MR. JOHNSON: Of the loans? How much of the loans are assigned to California?

MEMBER VAZQUEZ: Yes.

MR. JOHNSON: Yeah. It's -- it's like 98 percent. Oh. A hundred percent.

MR. WALSH: A hundred percent, of which many are also pulled into other states, resulting in over a hundred percent in that property factor that Axos has to pay.

MR. JOHNSON: Right. So going back to it, I think it meets the General Mills qualitative definition of an "overwhelming amount." And it's basically 100 percent and really drives that property factor to a distortive amount. And that's why we're asking for the removal of that or the removal of the factor all together.

MEMBER VAZQUEZ: Thank you.

And then I guess a question -- this is maybe more of a question for Katie.

What appeal of process do the -- or what -- I
guess the -- what rights do these folks have in the
appeal rights moving forward after our decision?

    MS. FRANK: Oh, they can appeal it to a court and
so this matter can continue on.

    MEMBER VAZQUEZ: Okay. Thank you.

    That's -- I'm good for right now.

    CHAIRPERSON YEE: Thank you, Member Vazquez.

    Member Chamberlain, any questions before I pose
mine?

    MEMBER CHAMBERLAIN: Yeah. I guess -- I guess
what I would like to ask Mr. Johnson -- or I don't know.

    Is Mr. Johnson -- can you hear me?

    MR. WALSH: Yes. We can hear you.

    MR. JOHNSON: Yeah. I'm sorry. We lost the
video, but I can hear you.

    MEMBER CHAMBERLAIN: Yeah. So I guess what I
want to understand -- I mean, it sounds like you are
saying the distortion is that -- is that you are paying
more than -- that you are paying more than the average
tax paid by your competitors or that you are paying more
than your -- your -- more than a hundred percent of your
income is being taxed.

    And my understanding of distortion is that it has
to be more of a sort of -- there's something about the
actual way you are measuring -- you are measuring the
apportionment of income that is incorrect.

And it seems like -- and it seems like that the 120 percent, that's just matter of how the various states have set up their different systems, and some taxpayers are going to get taxed at 80 percent, some at 120, and it just sort of depends on how things end up. But there's nothing -- that doesn't say there's anything particular -- necessarily wrong about any of those particular formulas. It's just that there's an unfortunate outcome that the states are not -- are not coordinated.

MR. JOHNSON: But I -- so you brought up -- you brought up a really good point I would like to address, and that is, you know, distortion. How do you determine that? I mean, with these kind of cases, what's the baseline? What is the starting point? There is none. It's almost a fiction that you are creating, right? What is the absolute right number? That's a matter of opinion to a lot of different people.

So what we are providing to you is indicia that not of what is the actual, absolutely right number that should go to California, but an indicia -- lots of indicia to consider to show that what's happening currently isn't right. All right. That's the first question, is what is happening currently, right or
wrong. All right.

And we provided a lot of -- one is, you know, the MTC has said these factors don't cause problems when applied to online banking. They changed it.

We have showed you indication that problems are being caused here. We're being taxed on more than 120 percent of our income. That in and of itself, does that -- does that win the case? Maybe not.

We're showing that 300 percent is that -- there are factor -- that our tax rate is 300 percent of a national bank.

Do any one of these win the case for us? Maybe not. But we're asking you to look at the whole fact pattern together, and I don't think you can reach the conclusion that -- that we're using the correct methodology.

MR. WALSH: And to get to your question around the distortion structure, that's where we highlighted the -- how the property factor is treated and that the property factor is treated differently in California and the -- and the challenges that we face with the -- with the SINAA idea, with the SINAA idea, and how we even would treat these loans and the -- and the solicitation of our customers and different -- different -- the different stages along the SINAA codification as far as
whether that is something that is counted in California as well as multiple other states, whether that's something that most -- most other banks don't have to deal with that, because they have their branches.

And the whole idea of SINAA was to put customers in branches so that it is equitable throughout the United States. Without a branch footprint, in a virtual place that we are today, there is no way to put these customers in their different locations that a -- that a branch-filled bank has.

So when you talk about a branchless bank, all of a sudden, it's a very different fact set and the way the guidance is structured does not fit well. It's a poor application of that guidance towards a virtual, branchless bank. And so that's our -- that's our challenge with how it distorts our -- our business.

MR. JOHNSON: And that point, as Katie mentioned, we need a qualitative difference here. And it's clearly a huge qualitative difference the way that --

MR. WALSH: Yeah. I mean --

MR. JOHNSON: Online banking versus traditional banking.

MR. MICHELETTI: Maybe a dollar amount or a rough dollar amount, you know, kind of application would help to understand the magnitude of that. When we look at
our -- actually what property, plants, and equipment we
have in California, we're probably talking about less
than $10 million bucks or thereabouts.

MR. WALSH: Correct. Yeah.

MR. MICHELETTI: When you look at how many loans
we have, we have 14 billion. So -- so that 14 billion
in loans has been added to our property factor as though
it is a plant, property, and equipment. So the
10 million of actual infrastructure versus the
14 billion of loans that's getting added in, because all
of our people are here, is what causes that massive
distortion.

And those loans -- you know, we do have loans at
the companies in California, but we have a large amount
of our loans outside of California. And, frankly, if a
hundred percent of our loans is outside of California,
we still get a 14 billion allocation in the property
factor because everybody is here in San Diego, and no
one is anywhere else.

So hopefully that gives you the sense of the
magnitude of the distortion.

MEMBER CHAMBERLAIN: I guess I would just say I'm
not -- it seems to me it's distortive if -- if it is
incorrect, if it is never correct to assign a loan to
where the -- where the loan is serviced. And it
doesn't -- I don't see that -- I don't see where there's
distortion in a way that our current apportionment
factor works right now.

MR. JOHNSON: Yeah. Well, we aren't -- we aren't
making the argument that -- I mean, that -- you are
absolutely right. That's the way the current
apportionment factor works right now. All right. And
we're not -- we're not arguing that that's not the case.
We're arguing, when that is applied to us, it creates an
unfair situation. All right. And so, I mean, we can't
argue that that's not the way the apportionment factor
works right now. All right. That's --

MR. WALSH: Let me add one other aspect.
(Unintelligible cross-talk.)

MR. JOHNSON: -- result in an unfair treatment.

MR. WALSH: Let me add one other aspect to what
you are saying, Mr. Chamberlain, as far as the
distortive.

Our loan servicing function actually sits in Las
Vegas, Nevada. So to the idea of what you said, the
servicing of the loans, the idea that the lifetime of a
loan, the loan servicing function is actually what
treats -- what handles our customers the vast majority
of the time.

The -- so this is another way to consider it:
The SINAA factor, the first four functions of it, are a very short amount of time compared to the life of a loan. So if you are doing a 30-year loan, it's taking you 30 to 45 days to fund that loan, and then you are servicing that loan for the next 30 years.

So we're getting distorted in that factor because we're actually applying 30 years' worth of work in Las Vegas, Nevada, that is getting applied to California, even though all of our servicing employees sit in Las Vegas, Nevada, for that administrative function of servicing the loans.

So I would say that is an example of how this is distortive.

MEMBER CHAMBERLAIN: Okay. Thank you.

CHAIRPERSON YEE: Thank you, Member Chamberlain.

I have a series of questions. And first, let me just say, I appreciate the presentation by both sides. And certainly, as the petitioner outlined from the outset that acknowledged that the burden of proof is on the petitioner in terms of the substantiation of an alternative formula.

I want to just kind of get a sense of -- since Axos became an entity -- so traditionally you were filing under the three-factor apportionment formula. And I know that when we look at 25137, which does allow
us to look at a departure from the -- this approach, that it's on a pretty limited basis.

And I just kind of wanted to get a sense of like what -- what, if anything, changed in your -- either your business activity or your business model? Because it's -- it's got to be -- in my mind, it's got to be something that's pretty unique and something nonrecurring and that would give rise to having us look at a different way of allocation and apportionment.

MR. WALSH: I'd say there's a couple of things: One, we have -- we did open up operations in Las Vegas, Nevada, a couple of years ago to start servicing the loans in that location.

Another factor would just be the evolution of internet banking and that we -- previously we may have spent a lot more time on the phone with customers. Even though we have always had the website, it was done a lot more -- it was done a lot more telephonically, and over the last few years, there's been a significant shift in virtual transactions.

And many of these things, sure, have been around for a while, but the speed and trust in the markets -- and this is seen across the financial services industry as far as the amounts of virtual transactions that are occurring and that consumers are now trusting.
more different virtual transactions methods, that they are transacting more over the internet with us than ever, and that full customer interactions are occurring over the internet, through uses of chat bots, through uses of electronic e-mails or portals, that customers are filling out their entire documentation online; they are no longer mailing things in. They are doing their entire transaction online, and there's not a kind of physical aspect or picking up the telephone aspect that -- and that has been one of the significant changes over the last few years.

CHAIRPERSON YEE: Okay.

MR. JOHNSON: And I will add to that, it sounded like the question was, why now? Why didn't you ask for this earlier?

And, you know, I guess, because we just hadn't yet. You know, we're focused on making the business work and I don't -- I don't think there was a point where it was clearly okay and that, at some point, it became distortive.

But I know that from the years that we are requesting, forward, we think that the alternative method would be better.

CHAIRPERSON YEE: Okay. So your business has continued to be your business over the years.
And -- and -- so I want to talk about the SINAA factors for a moment. So we talked a lot about solicitation. And you have just described, Mr. Walsh, the consumer experience, with respect to, you know, interacting with Axos online.

But talk a little bit about, like, where your centralized underwriting and your closing processes take place and kind of the other factors around the SINAA activities.

MR. WALSH: Yes. Those factors generally take place either online or it depends on where the -- where the employees may sit. Certainly, especially more recently, with the pandemic, there may be employees all throughout the U.S., who might be performing the underwriting or approval, but our centralized office is in San Diego, as has been noted.

And so oftentimes that's what causes it to get pulled back even though we may have team members throughout the U.S. performing functions. And then, as I noted on the solicitation side and the investigation side, that a lot of that is even being done without team members. Those are being done by automated bots, automated marketing that flags that you Googled "mortgage."

And so we -- we pay through the -- through Google
to track and advertise to you if you Googled "mortgage," something of that nature.

And then you come in, you sign in, you go through -- so there's a lot of that's being done completely online, where you are filling out an application, doing all of that, without touching a person at all. It's all being done electronically, and there is no interaction with the people.

And then, ultimately, I touched on the administration is being done in Las Vegas.

MR. MICHELETTI: On the people side, just to add, you know, beyond COVID, we do have a team in India that does the underwriting. So the underwriting team in India, you know, provides decisioning through -- through their process. So they are really not here in California, but then they are not employees, they are independent contractors.

So there's a lot of the underwriting decisions that are getting made outside of California, in a vast majority of, particularly, the high volume products.

CHAIRPERSON YEE: Okay. Okay.

I do want to make a comment with respect to the comparisons with competitors on the effective tax rate. And it's -- it's one where I'm not going to give a lot of credence just because we don't fully understand the
business models of all the competitors and, certainly, some of the relevant tax treatments they may be subject to. So I want to just put that out there. And, you know, it really does have to do with the nature of the business activity, and so I want to kind of keep the focus on that.

You know, relative to the MTC rule, you know, I know that -- and just, by the way, I know Ms. Frank was, you know, citing from, I think, all public documentation. I mean, the MTC had a pretty extensive process in terms of this rule change, and it was the public hearing officer's report and recommendation that I think she was citing from.

But, you know, you are looking to actually take out the loans from the property factor. And I think one of the working group participants, particularly on the industry side -- actually it's cited that that -- that taking out loans was, in fact, what caused the distortion.

And so I think what this means to me is that this really does have relevance with respect to just what the particular business model is, from one company to another. I mean, you just can't have kind of a uniform kind of a rule that necessarily is going to result in the same outcome for everyone.
So -- and I think that was one of the things that
certainly struck me with respect to the whole MTC
process. And while they did establish a rule,
California has not conformed to that rule, and I think
the only way you get national uniformity is, frankly,
with a federal law. So I'm not sure that we can help in
that regard.

But what I'm trying to establish here is just
what's been different. And I understand the online
nature, but, frankly, when we look at the SINAA factors,
when we look at -- I mean, to me, there's a --
traditional versus online banking is a bit of a
distinction without a difference, because we still are
kind of looking at the same factors and how they should
be incorporated into how we look at the allocation and
apportionment.

So I -- I mean, I guess the other question I had
is for the Franchise Tax Board, if I could.

I know that when we look at case law, that
certainly the petitioners have cited that, you know,
these are not relevant and they tend to be dated
decisions. But with respect to -- it's the petitioner's
citation of the General Mills case.

I just kind of want to get a sense of, you know,
the relevance of that case. Because it is one that I
wasn't putting front and center with respect to trying
to determine just what was appropriate here in this
matter.

MS. FRANK: Did you want me to explain the
General Mills case and how it relates?

CHAIRPERSON YEE: Yeah. And how it relates or
doesn't relate. Yeah.

MS. FRANK: Yeah. So it is different.

So in that case, they were looking at a specific
income stream, specifically hedging activity, and they
were comparing that to the rest of the business
activities, and they were examining whether that
specific income stream essentially distorted the measure
of the regular trader business activities.

And they found that the hedging receipts were so
large in relation to a very small amount of income to --
actually, in some years, no income they operated -- they
had a loss for hedging activity. They found that those
receipts really overwhelmed the rest of the receipts
from the general trade or business, and so that they
essentially distorted the measure of the sales factor,
and it distorted that measure of computing that income
or that slice of income in which the state could tax.

So it's really different from what we have here.

Here, they are actually arguing that they're
whole business activity is different, not just an income stream. And so there really -- it -- it's not an apt comparison to the General Mills case.

CHAIRPERSON YEE: Okay. Thank you.

MR. MICHELETTI: If we may ask for a rebuttal, a quick one.

CHAIRPERSON YEE: Yes. Go ahead.

MR. MICHELETTI: The distortion comes from the property factor growth on the loan balance sheet. So as a business gets bigger, the lending side continues to be significantly larger and getting bigger and bigger relative to the $10 million infrastructure investment.

So my argument is that with a single location in a single stream, without a view to where all of those factors are done, that we will continue to have an endless, disproportionate growth of the loan factor overwhelming the property factor, meaning the loan portion of the property factor. So if we grow to a hundred-billion-dollar bank, we will still -- we will have a hundred billion dollars added into the property factor, when our property is still only $10 million.

So the concept of the size of the distortion, we do think, is relevant. That's the only point.

MS. FRANK: Can I respond?

CHAIRPERSON YEE: Yes. Ms. Frank, please.
MS. FRANK: Okay. So I think the big difference, too, are the loans are the main generating income item. Whereas, hedging, it had no income, really.

CHAIRPERSON YEE: Right.

MS. FRANK: So it wasn't really reflected in the apportionable tax base. Where these loans, that is their business. And so it isn't necessarily, per se, distortive to include those loans in the property factor.

And also, the taxpayer is touching on that, you know, its loans are made to, you know, customers throughout the country. And they are not being -- and they are not getting representation across the country, but they are getting representation in that -- in the sales factor.

The loans' activities are reflected also in the sales factor at the location of property or customers, depending on the type of loan. But -- so there is reflection in that regard. It's not all necessarily assigned to -- based -- assigned based on the SINAA factors.

MR. JOHNSON: Real quick.

I did just want to make one more point about General Mills. We do think it's applicable. I think I have a difference of opinion of Katie on that. I think
she's taking a very narrow interpretation of the case. I think the case, as we listed in our PowerPoint, you know, very -- very similar points is what we're making.

It was written for a fact pattern for which it was -- you know, the statute was written for a fact pattern that was not at all consistent with the fact pattern of General Mills, i.e. mixing hedging transactions with manufacturing transactions.

Our case is the same in that we have a statute that was written back before internet banking ever existed, for traditional banking to assign loans to brick-and-mortar -- to brick-and-mortar branches. That doesn't exist today.

We think that that is a material difference and that, therefore, it does have application, and that a Mills -- and that a General Mills, you know, application would be applicable here.

MR. WALSH: And one thing to add on to what Katie was saying with regards to the loans being considered in the sales factor. I guess wouldn't that also be considered disproportionate where we're having to consider these loans as both sales in the -- in the sales factor, as well as property in the property factor, and that we're getting double taxed on those portion of loans that are in California?
CHAIRPERSON YEE: Ms. Frank, do you want to respond to that?

I don't believe it's a double taxation issue, but it's reflective of the nature of the business activity related to the loans. Yes?

MS. FRANK: Right. Yeah.

MR. JOHNSON: Our point would be that with respect to a traditional bank for which the regs were written --

CHAIRPERSON YEE: Mr. Walsh, I've got to ask -- Mr. Walsh, I'm going to ask you to do one thing: I want you to keep us focused on your operation and not compared to the traditional bank. I mean, I have to tell you, I'm having a really hard time just kind of staying focused just on your operation. So tell -- and I heard the question loud and clear. So I want Ms. Frank to have an opportunity to respond, and then I will give you a chance to rebut if you need to.

Katie, the question about the sales factor and property factor for the loans.

MS. FRANK: Yeah. Those are reflecting, essentially, the contribution of the market in relation to the loans, which Taxpayer was arguing was essentially important, and they are getting a reduction there because they have a large amount of customer base in
California; I believe it's almost 50 percent.

But -- so it's measuring two different, essentially, measures of business activity, and it's not double counting. And one is the customer and the other one is their contribution of capital there -- with their loans.

CHAIRPERSON YEE: Mr. Walsh, any other thoughts?

MR. WALSH: Yeah.

The one commentary, just kind of restating it in a different manner was -- Mr. Micheletti was covering earlier, is that the idea that these are distorting the property factor as we grow and that those loans that are already receiving consideration in that sales factor are getting that consideration for taxation in the sales factor, and then they also get consider -- sorry.

Let me say it this way. Let me talk about the loans that are not in California in the sales factor. So those loans that are not in California in the sales factor are taxed by other states. That makes sense. Right? But then you take those same loans, and we're getting taxed on them in California because of the -- because of the SINAA aspects. They are being included into that property factor, and that's where there's a challenge for us, as an organization, that that just doesn't -- it doesn't make sense. It doesn't seem like
fair application of the -- of the tax guidance, where we
should get penalized because we figured out a good
business model as to how to -- (unintelligible) --
because we figured out a good business model --

CHAIRPERSON YEE: Mr. Walsh, are you -- you are
cutting out a bit.

MR. WALSH: (Unintelligible.) So that's --
that's the point. A better business model. So because
of that, we're getting double taxed on these -- on these
sales, on these loans, over not only, arguably, in
California, but also throughout multiple states.

CHAIRPERSON YEE: Okay. Let me -- we haven't
talked a lot about the payroll factor, which is
obviously reflected -- reflective of business activities
through your employees.

Talk a little bit about where your employees are
and what's been happening with the growth and your
number of employees.

MR. WALSH: Sure.

We have got employees all throughout the U.S.
Certainly, headquarters is here in California, and so we
have got about 600, 700 employees in California. We
have got a number of employees, over a hundred, in Las
Vegas, Nevada. We have employees in Utah; in Kansas
City; in Omaha, Nebraska; Columbus, Ohio; in the New
York metropolitan area. So that is the -- the location
of our employees throughout the U.S.

CHAIRPERSON YEE: And have the numbers
of employees -- have the numbers of employees been
increasing? Or did it increase, I guess, during the
years in question?

UNIDENTIFIED SPEAKER: From 2015 to 2020, the
percentage of employees in California has decreased from
95 to 70 percent.

MR. JOHNSON: Okay. Did you hear that?

CHAIRPERSON YEE: Say that again. That was very
soft.

So between -- actually, between 2015 and 2018, I
think, are the years in question.

MR. WALSH: Correct. And so the -- the
percentage of employees has decreased from 95 down to,
was it 79?

UNIDENTIFIED SPEAKER: Or 82.

MR. WALSH: Down to 82. Down to 82 percent.

CHAIRPERSON YEE: Okay.

UNIDENTIFIED SPEAKER: (Unintelligible.) In
California.

MR. WALSH: In California.

CHAIRPERSON YEE: In California? Okay.

And that was through 2018?
MR. WALSH: Correct.

UNIDENTIFIED SPEAKER: And we gained (unintelligible) during that time period.

CHAIRPERSON YEE: All right. I think those are the extent of the questions I have for now.

Other questions, Members, or comments?

MEMBER VAZQUEZ: Yeah. Madam Chair, just one more quick one.

CHAIRPERSON YEE: Yes.

MEMBER VAZQUEZ: And I think you kind of touched on it.

I noticed, you know, the claim goes back to 2015.

CHAIRPERSON YEE: Yes.

MEMBER VAZQUEZ: Or -- on some of these cases. Is there a statute of limitations on this?

MR. WALSH: I will let the Franchise Tax Board, I guess, address that.

UNIDENTIFIED SPEAKER: We filed a protective claim for refund. The statute of limitations no longer applies.

MR. WALSH: So to repeat that, we filed a protective claim for refund, so the statute of limitations no longer applies.

UNIDENTIFIED SPEAKER: The process was started a couple of years ago, I guess, with COVID and things like
that. Things got delayed. But I think that the refund claims have been filed.

MEMBER VAZQUEZ: Thank you.

CHAIRPERSON YEE: All right. Thank you, Member Vazquez.

Seeing or hearing no other comments or questions from Members, thank you very much for the presentations. That concludes the hearing. I want to take a five-minute recess, if I could, while we take this matter under submission and we will come back and see if there's further deliberation before we decide. All right. So --

MR. WALSH: Thank you. We appreciate your time.

CHAIRPERSON YEE: Thank you. We appreciate your patience.

So why don't we reconvene at 4:50. Okay. Thank you.

(Break taken in proceedings.)

CHAIRPERSON YEE: Let us reconvene. Any further discussion on this matter?

(No response.)

CHAIRPERSON YEE: Okay. Seeing none, is there a motion?

MEMBER VAZQUEZ: Yeah. I would like -- yeah. I will make the motion. But you know what? Let me just
preface it with a comment first and then we can go from there.

You know, in sitting back and looking at all of the facts and listening to both sides of this issue, you know, I would have to side with the staff on this since the law is -- you know, clearly states what the conditions are for this type of institution under section 25128. Under the law, the taxpayer may petition to use the alternative formula. They may represent their business's activity more accurately under section 25137. However, the law clearly states that it is up to Petitioner to prove clearly and convincingly that the FTB and the Franchise Tax Board's methodology is unfair.

I understand that the petitioner may be paying more taxes because of their business model, and other states may be under a different apportionment methodology.

But in California, as I'm looking at this, you know, they stated it -- you know, over 80 percent. Well, I guess it might even be close to a hundred percent of their business is in California.

I'm -- I'm going to have to go with the staff recommendation here and support the staff's recommendation on this.

The -- the only thing is that, you know, having
said that, I guess moving forward, because I'm sure we are going to see more of this now with the pandemic, and, you know, we're probably going to see less and less folks using the old traditional brick-and-mortar type of operation and business. And so it's something that we should, well, I guess maybe bring it up to the legislators and they may need to look at some new legislation moving forward.

But as it stands now, I just -- I just can't see how I can go against the staff recommendation on this one. So I would like to move the staff recommendation.

CHAIRPERSON YEE: All right. Member Vazquez -- Member Vazquez moves to deny the petition.

Is there a second?

MEMBER CHAMBERLAIN: I second that motion.

CHAIRPERSON YEE: Thank you. Member Chamberlain seconds the motion.

And let me ask for the roll to be called.

MS. CASEY: Member Vazquez.

MEMBER VAZQUEZ: Aye.

MS. CASEY: Member Chamberlain.

MEMBER CHAMBERLAIN: Aye.

MS. CASEY: Chair Yee.

CHAIRPERSON YEE: Aye.

Thank you. That motion carries.
Really appreciate everybody's patience on this case. Certainly presented a lot of interesting factors and appreciated your comments, Member Vazquez, in terms of what it portends potentially going forward.

So that has concluded the hearing.

Any other business to come before the board?

(No response.)

CHAIRPERSON YEE: Okay. Seeing and hearing none, this meeting is adjourned. Thank you very much, everyone.

MEMBER VAZQUEZ: Thank you.

MEMBER CHAMBERLAIN: Thank you.

(Proceedings concluded at 4:54 p.m.)

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KATHRYN S. SWANK, CSR  (916) 390-7731
CERTIFICATE OF REPORTER

I, KATHRYN S. SWANK, a Certified Shorthand Reporter of the State of California, do hereby certify:

That I am a disinterested person herein; that the foregoing proceedings were reported in shorthand by me, Kathryn S. Swank, a Certified Shorthand Reporter of the State of California, and thereafter transcribed into typewriting.

I further certify that I am not of counsel or attorney for any of the parties to said proceedings nor in any way interested in the outcome of said proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand this 22nd day of June 2021.

/s/ Kathryn S. Swank
KATHRYN S. SWANK, CSR
Certified Shorthand Reporter
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