

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

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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

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APPEARANCES CONTINUED

STAFF (CONTINUED)

RAY ROUSE

CRISTINA RUBALCAVA

ANN WILSON

RAFAEL ZAYCHENKO

---o0o---

PUBLIC PARTICIPANTS

CHRISTINE GRAB

---o0o---

AGENDA ITEM 9 PETITIONERS

ROBERT JOHNSON

Crowe LLP,

appearing on behalf of Axos Financial

GLEN JEWELL

Axos Financial

ANDY MICHELETTI

Axos Financial

DERRICK WALSH

Axos Financial

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1 SACRAMENTO, CALIFORNIA

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

3 ---o0o---

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

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

9 MS. CASEY: Member Vazquez.

10 MEMBER VAZQUEZ: Present.

11 MS. CASEY: Member Chamberlain.

12 MEMBER CHAMBERLAIN: Present.

13 MS. CASEY: Deputy Controller Yvette Stowers.

14 ACTING CHAIRPERSON STOWERS: Present.

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

18 Please stand and join me in the pledge of
19 allegiance.

20 (Pledge of Allegiance recited in unison.)

21 ACTING CHAIRPERSON STOWERS: Good afternoon.

22 Welcome to the Franchise Tax Board's virtual Board
23 meeting. As FTB continues to follow all appropriate
24 federal, state, and local guidance for public
25 gatherings, my fellow board members and I are attending

1 this meeting remotely, and FTB staff is following social
2 distance best practices.

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

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

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

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

18 PHONE MODERATOR: Ladies and gentlemen on the
19 phone line, if you would like to place yourself in queue
20 for public comment, as a reminder, you may press 1, then
21 0, at this time.

22 (No response.)

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

25 ACTING CHAIRPERSON STOWERS: Thank you, ma'am.

1 Members, do I have a motion for the approval of
2 the minutes?

3 MEMBER VAZQUEZ: So moved.

4 ACTING CHAIRPERSON STOWERS: Is there a second?

5 MEMBER CHAMBERLAIN: I second.

6 ACTING CHAIRPERSON STOWERS: Thank you.

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

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

12 Ms. Wilson.

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

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

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

24 This year's accomplishments are exceptional, not
25 because of what we accomplished, but how the staff came

1 together and persevered to accomplish them.

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

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

22 Now I invite you to watch our highlights in
23 review.

24 (Video presentation.)

25 MS. WILSON: We appreciate you watching the

1 video. The staff spent countless hours developing that,
2 and it turned out so good.

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

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

7 Controller Yee is now online.

8 So Controller Yee?

9 CHAIRPERSON YEE: Thank you, Deputy Controller
10 Stowers. And thank you, Ann, for sharing that video.
11 Let me just check in with our members to see if there
12 are any questions.

13 MEMBER VAZQUEZ: Yes.

14 CHAIRPERSON YEE: A comment?

15 MEMBER VAZQUEZ: Madam Chair?

16 CHAIRPERSON YEE: Yes. Member Vazquez.

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

25 And I guess the -- then my last comment would

1 also be just to commend and thank you all for stepping
2 up and answering the Governor's call when you
3 volunteered for this contact -- the contact tracing. I
4 think that was -- it was a great service. I want to
5 thank you all and the staff as well.

6 MS. WILSON: Thank you so much.

7 CHAIRPERSON YEE: Thank you, Member Vazquez.

8 Member Chamberlain, any comments?

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

11 CHAIRPERSON YEE: Okay. Thank you.

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

21 So thank you very much.

22 MS. WILSON: Thank you.

23 CHAIRPERSON YEE: Okay. Let me see if there are
24 any members of the public who wish to speak on this item
25 from the teleconference line.

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

5 (No response.)

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

8 Please continue.

9 CHAIRPERSON YEE: Thank you very much.

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

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

17 My name is Ray Rouse. I'm an Assistant Chief
18 Counsel in FTB's Legal Division and the co-chair of
19 FTB's Organizational Development Action Committee. I
20 have the pleasure of presenting to you a brief slide
21 show, recognizing FTB's 2020 award recipients. I will
22 be presenting to you the recipients of the following
23 four awards: The Superior Accomplishment Awards, the
24 Sustained Superior Accomplishment Awards, the
25 Supervisory Bonus Awards, and the Large Team Awards.

1 The Superior and Sustained Superior
2 Accomplishment Awards recognize individual and teams who
3 make significant superior contributions to state
4 government by virtue of exceptional job performance.

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

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

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

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

24 As we all know, 2020 brought a number of
25 challenges. Our world, including the way we did

1 business at FTB, was turned upside down by a global
2 pandemic that touched all of our lives in one way or
3 another.

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

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

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

25 Without further ado, I present to you the

1 recipients of the 2020 awards.

2 (Video presentation.)

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

8 I would be happy to answer any questions you
9 have.

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

15 Members, are there any questions or comments?

16 Yes. Member Vazquez.

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

1 thank you all.

2 CHAIRPERSON YEE: Thank you, Member Vazquez.

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

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

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

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

24 Then our Large Team Awards; you know, this work
25 doesn't stop just because we have other things that are

1 coming in sideways as challenges. And so I want to
2 thank the three teams that are being recognized today.

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

7 (Applause.)

8 CHAIRPERSON YEE: Thank you so much.

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

13 PHONE MODERATOR: Ladies and gentlemen on the
14 phone lines, if you would like to place yourself in the
15 queue for public comment, as a reminder, you may press
16 1, then 0, at this time.

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

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

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

25 CHAIRPERSON YEE: Ms. Grab, we -- this is a

1 section for public comment. We want to thank you for
2 your comment, but we're going to be moving on, on our
3 agenda. Thank you.

4 PHONE MODERATOR: Thank you.

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

7 CHAIRPERSON YEE: Thank you, Operator, for that.

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

13 MR. ROUSE: Thank you.

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

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

24 Today I am here with Roman Fuentes, from our
25 Accounts Receivable Management Division, to share

1 information about the unique 2021 filing season.

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

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

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

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

1 as well as customers.

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

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

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

23 At the same time, we leveraged tools to shift
24 training from in-person learning to virtual classroom
25 with successful results. We note that training

1 continues to take place in virtual environments and has
2 advanced from its early beginnings to now include chat
3 rooms and interactive exercises, while maintaining
4 staffing engagement throughout.

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

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

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

24 FTB worked quickly to share information with the
25 public through both website and media updates, through a

1 news release, and social media. Teams acted quickly to
2 make system changes, allowing customers the extended
3 time for filing and paying their 2020 state income tax
4 returns.

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

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

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

22 The Young Child Tax Credit provided even more
23 support for those with children under the age of six in
24 2019. And now, with the implementation of ITINs for
25 California in 2020, this program is available to support

1 even more low income California residents as they file
2 their 2020 tax returns.

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

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

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

21 As mentioned earlier in this presentation, the
22 field public counters experienced impacts as a result of
23 COVID-19. They play a significant role in the success
24 of our filing season by providing an in-person service
25 to assist our customers. We continue to effectively and

1 efficiently manage our operations despite many of the
2 presented challenges. We continue to ensure our
3 processing and contact center operations are efficiently
4 meeting the workload demands from their respective
5 business areas.

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

8 MR. FUENTES: Thank you, Cherrie.

9 Good afternoon, Madam Chair and esteemed Board
10 Members.

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

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

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

19 Within our website, we accommodated over
20 20 million visits. This yielded an increase of more
21 than 7 million visits over the previous year. At FTB,
22 we continue to take every opportunity to promote and
23 improve upon self-service options, including accessible
24 and easy-to-understand information on the web, as well
25 as e-file and online payment options, to name a few.

1 As always, we have alternative service channels
2 available for customers who choose not to engage with
3 self-service options. These include direct phone
4 numbers and in-office appointments.

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

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

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

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

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

23 We processed 3.4 million EITC claims for a total
24 value of \$588 million and 2.9 million of our state
25 income tax filers were recipients of the Golden State

1 Stimulus, for a total value of \$1.8 billion.

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

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

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

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

23 The VITA program started this filing season with
24 scaled back services due to staff and customer health
25 and safety concerns. In late April, we expanded

1 services for both internal and external programs based
2 on the final filing date postponement, as well as
3 complexities related to the American Rescue Plan Act.

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

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

11 The 211 is a general local assistance contact
12 phone number that provides access to essential community
13 services. This year, FTB's VITA program had 81
14 volunteers, including 11 new volunteers in 2021, and
15 2,998 state and federal income tax returns were
16 completed.

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

25 None of our accomplishments can be attained

1 without the contributions of our valuable staff. As a
2 department, it is important that we invest, support, and
3 recognize the efforts of our staff and ensure they are
4 provided with the necessary resources to be successful
5 in performing their job duties.

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

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

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

22 Every employee plays a major role, embraces the
23 changes, and rises to the challenges. Each year we
24 bring our best to provide outstanding services for
25 California taxpayers.

1 I would like to thank you on behalf of the
2 department for allowing us the time to share what we
3 have done and accomplished for the taxpayers of
4 California.

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

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

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

17 Member Vazquez, please.

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

25 MS. HAYES: Thank you for that question, Member.

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

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

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

19 And great question, Member Vazquez.

20 I think, in the past, we have certainly helped
21 taxpayers navigate those tools, and I think what we have
22 seen more and more with the increased numbers who are
23 requiring some assistance is that those tools are being
24 made more prominent as options for taxpayers. And so I
25 appreciate the question.

1 Okay. Other members -- other comments or
2 questions by Members?

3 (No response.)

4 CHAIRPERSON YEE: All right. Thank you.

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

7 PHONE MODERATOR: Ladies and gentlemen on the
8 phone lines, if you would like to place yourself in the
9 queue for public comment, as a reminder, you may press
10 1, then 0, at this time.

11 (No response.)

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

14 Please continue.

15 CHAIRPERSON YEE: Thank you very much.

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

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

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

25 CHAIRPERSON YEE: Thank you.

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

7 Good afternoon, Mr. Hofeling.

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

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

12 I'm appearing before you today to respectfully
13 request the Board's permission to proceed with the
14 formal regulatory process to amend Revenue and Taxation
15 Regulation Section 18001-1. Revenue and Taxation Code
16 18001 section allows a credit to taxpayers for the net
17 income taxes imposed by and paid to another state on net
18 income. This credit is commonly known as the Other
19 State's Tax Credit.

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

25 Regulation section 18001 currently provides

1 detailed rules of how and when to claim the credit and
2 defines the terms used in the statute. In addition, the
3 FTB has previously provided guidance for the credit and
4 the corresponding regulation in FTB's legal ruling
5 2017-01. This included an in-depth analysis of the
6 applicable California case law which explains and
7 defines what is a net income tax for the purposes of the
8 credit.

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

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

21 Staff has held two previous interested party
22 meetings to solicit public input on the proposed
23 amendments and solicited public feedback on our draft
24 language. Public response was received, and we
25 incorporated that response when it was consistent with

1 the underlying statutory and judicial authority.

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

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

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

11 Thank you.

12 CHAIRPERSON YEE: Thank you, Mr. Hofeling.

13 Members, questions or comments?

14 (No response.)

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

18 PHONE MODERATOR: Ladies and gentlemen on the
19 phone lines, if you would like to place yourself in
20 queue for public comment, as a reminder, you may press
21 1, then 0, at this time.

22 (No response.)

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

25 Please continue.

1 CHAIRPERSON YEE: Thank you very much.

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

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

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

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

16 Is there a second?

17 MEMBER CHAMBERLAIN: Yes. I second the motion.

18 CHAIRPERSON YEE: Thank you, Member Chamberlain.
19 Seconded by Member Chamberlain.

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

23 Let me have the clerk call the roll.

24 MS. CASEY: Yes. Member Vazquez.

25 MEMBER VAZQUEZ: Aye.

1 MS. CASEY: Member Chamberlain.

2 MEMBER CHAMBERLAIN: Aye.

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

4 CHAIRPERSON YEE: Aye.

5 Thank you. That motion carries.

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

7 MR. HOFELING: Thank you.

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

15 And let me first turn it over to Thi.

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

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

23 For Fiscal Year 2022-23, we have identified 11
24 concepts for development. The first concept is EDR2.
25 In 2008, FTB began a multiphase project aimed at

1 modernizing systems and achieving a strategic target
2 model.

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

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

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

22 Concept 3 is for identity proofing and online
23 fraud detection. This proposal is requesting positions
24 and funding to address enterprise centralization of
25 taxpayer identity proofing and verification, the

1 monitoring of online activity for the detection of
2 fraud, and identifying fraudulent calls that are made to
3 FTB's interactive voice response system.

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

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

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

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

1 Reform Act.

2 Concept 8 is for section 41 workload expansion.
3 This proposal requests additional resources and funding
4 to address the new reporting requirements that have
5 begun as a result of Revenue and Taxation Code section
6 41.

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

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

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

25 I thank you for your time, and I would be happy

1 to answer any questions you may have.

2 CHAIRPERSON YEE: Thank you very much, Ms. Luong.
3 Questions or comments, Members?

4 MEMBER VAZQUEZ: Just a quick one: I guess
5 it's -- the way you broke it down into the different
6 concepts. I'm looking at -- I guess it's Concept 9,
7 the -- where you are increasing the litigation costs. I
8 guess that's what it falls under.

9 And I am just wondering -- you know, when I was
10 flipping through it, it just wasn't real clear the
11 increase or the percentages. And I'm wondering, is it
12 based on new cases or are these prior years? Is that
13 what's going on?

14 MR. LUONG: Yeah. Thank you for your question,
15 Member Vazquez.

16 The funds are for the Deputy Attorney General's
17 fees. And it's not necessarily a large increase in new
18 cases, but rather more complex cases are raising new
19 issues with the potential for these increased fees.

20 And I would note, as during the presentation,
21 that we did previously submit a Spring finance letter
22 for Fiscal Year 21-22, and we are closely monitoring
23 these costs.

24 And this concept will only move forward for your
25 approval in September, if needed.

1 MEMBER VAZQUEZ: Thank you.

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

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

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

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

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

1 resource ask yet for this concept.

2 MEMBER VAZQUEZ: Thank you.

3 MS. LUONG: You are welcome.

4 CHAIRPERSON YEE: Thank you, Member Vazquez.

5 Ms. Luong, I have a question.

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

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

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

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

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

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

1 you.

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

6 PHONE MODERATOR: Ladies and gentlemen on the
7 phone lines, if you would like to place yourself in the
8 queue for public comment, as a reminder, you may press
9 1, then 0, at this time.

10 (No response.)

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

13 Please go ahead.

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

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

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

24 PHONE MODERATOR: Thank you. And I have no
25 further public comments in queue at this time.

1 CHAIRPERSON YEE: Thank you very much.

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

5 Thank you very much, Ms. Luong.

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

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

11 Pleasure to be here with you today.

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

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

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

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

1 a competitive bid.

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

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

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

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

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

25 Without maintenance and continued migration to

1 vendor-supported software releases, this
2 mission-critical software would be unsupported,
3 inoperable, and without warranty. The department would
4 not be able to perform any of its revenue-generating
5 functions nor many of its various collection-related
6 tasks or administrative tasks that involve our mainframe
7 computer.

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

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

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

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

22 MEMBER VAZQUEZ: Just one quick one. And I think
23 you covered it, as I was going back over my notes in
24 your presentation right now. And it's my understanding,
25 I guess, especially with the -- I guess it's the renewal

1 of the Software AG that this is -- you know, basically
2 you are assuming this ongoing relationship with these
3 vendors and, obviously, this is to upgrade and keep on
4 top of the changes and hopefully to provide better
5 services for the taxpayers moving forward.

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

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

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

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

24 So the cost is just one of many factors that we
25 would look at when we go renew these contracts. It is

1 quite possible sometimes that we can, you know, find
2 products that offer comparable functionality and save a
3 little bit of money, but if it costs more money on the
4 back end to train our people or they are not as stable
5 as the products that we're currently using in our
6 systems, then we have to take that into account too.

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

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

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

24 MEMBER VAZQUEZ: Thank you.

25 CHAIRPERSON YEE: Thank you, Member Vazquez.

1 MR. BANUELOS: Thank you.

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

5 MEMBER VAZQUEZ: I will move the staff
6 recommendation.

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

9 Is there a second?

10 MEMBER CHAMBERLAIN: Yes. I second.

11 CHAIRPERSON YEE: Thank you, Member Chamberlain.

12 I have a motion and a second.

13 Will the clerk please call the roll.

14 MS. CASEY: Member Vazquez.

15 MEMBER VAZQUEZ: Aye.

16 MS. CASEY: Member Chamberlain.

17 MEMBER CHAMBERLAIN: Aye.

18 MS. CASEY: Chair Yee.

19 CHAIRPERSON YEE: Aye.

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

23 PHONE MODERATOR: Ladies and gentlemen on the
24 phone lines, if you would like to place yourself in the
25 queue for public comment, as a reminder, you may press

1 1, then 0, at this time.

2 (No response.)

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

5 CHAIRPERSON YEE: Thank you, Alberta.

6 All right. That motion carries.

7 Thank you.

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

10 CHAIRPERSON YEE: Thank you, Mr. Banuelos.

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

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

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

22 We provided critical services to our internal and
23 external customers; we processed refunds so taxpayers
24 can receive their much-needed refunds; handled millions
25 of returns; assisted thousands of customers by phone, by

1 mail, by live chat, delivered IT support to those in and
2 out of the office, and provided countless other services
3 with the care and expertise that only FTB staff can
4 provide.

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

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

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

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

22 CHAIRPERSON YEE: Thank you very much, Selvi, for
23 the updates, and congratulations on EDR2. That is a
24 major milestone and happy to see the continued progress
25 on that.

1 Members, are there any questions or comments?

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

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

9 Thank you again.

10 CHAIRPERSON YEE: Thank you, Member Vazquez.

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

14 PHONE MODERATOR: Ladies and gentlemen on the
15 phone lines, if you would like to place yourself in the
16 queue for public comment, as a reminder, you may press
17 1, then 0, at this time.

18 (No response.)

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

21 Please continue.

22 CHAIRPERSON YEE: Very well. Thank you.

23 Thank you very much, Selvi, for the comments.

24 Members, our next item is Item Number 8. This is
25 Board Members' Time. And let me turn it over to Members

1 Vazquez and Chamberlain to see if there are any comments
2 that they wish to bring forward.

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

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

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

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

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

25 But I would just mention a few items that have

1 been important to me: They have expanded the Earned
2 Income Tax Credit to taxpayers with ITINs; implemented
3 your part of the Shared Responsibility program; you
4 assisted in and design -- assisted in the design and
5 then you implemented the Golden State Stimulus program.

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

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

19 CHAIRPERSON YEE: Thank you, Member Chamberlain.

20 You enumerated a list of pretty extraordinary
21 accomplishments, and certainly add our thanks to that as
22 well.

23 First let me just say, I want to thank the team
24 at the Franchise Tax Board for even making these virtual
25 meetings possible. I think it's important to continue

1 our business as a Board, and I, too, share Member
2 Vazquez's desire that I hope that we can meet in person
3 sometime soon in the future.

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

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

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

22 The story I want to share is that I had the
23 opportunity to visit our print and mail team all three
24 shifts a few weeks ago. And not only were they very
25 complimentary about the partnership with the Franchise

1 Tax Board, but -- and I know this is true with the
2 Franchise Tax Board and -- as well, but the amount of
3 pride and ownership of being able to help so many
4 Californians who are in need right now, and to do this
5 work just knowing that they are performing, really, at
6 the highest level of public service is something that is
7 not going to ever be lost on me during this time. So
8 thank you for the tremendous partnership.

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

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

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

25 And I just want to say to Dawn, it's been just a

1 tremendous pleasure working with you over these many
2 years.

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

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

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

16 CHAIRPERSON YEE: Okay. Thank you.

17 MS. CARVELL: Thank you so much.

18 CHAIRPERSON YEE: Of course.

19 Member Chamberlain, any comments?

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

24 MS. CASEY: You are welcome.

25 Thank you, Madam Chair and Board Members.

1 It's been a great pleasure and amazing experience
2 and opportunity these past six years, and I am very
3 grateful to have had this.

4 Thank you all.

5 CHAIRPERSON YEE: Thank you. Thank you.

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

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

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

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

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

25 Members, any other comments? Member Vazquez?

1 MEMBER VAZQUEZ: Just -- welcome, and I'm looking
2 forward to the opportunity, hopefully soon, to meet you
3 in person. But with that, wish you nothing but the
4 best.

5 MS. RUBALCAVA: Likewise. Thank you so much.

6 CHAIRPERSON YEE: Member Chamberlain, any
7 thoughts?

8 MEMBER CHAMBERLAIN: Just welcome. Welcome to
9 the Board.

10 MS. RUBALCAVA: Thank you.

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

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

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

19 PHONE MODERATOR: Ladies and gentlemen on the
20 phone lines, if you would like to place yourself in the
21 queue for public comment, as a reminder, you may press
22 1, then 0, at this time.

23 (No response.)

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

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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.)

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2 ---o0o---

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

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

13 Yes. I see them on.

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

18 Let me just lay out the presentations for this
19 particular hearing. Petitioner Axos Financial will have
20 30 minutes to make its presentation. Then the Franchise
21 Tax Board staff will have 30 minutes to respond. And
22 we'll then return to the petitioner, who will then have
23 15 minutes for rebuttal. And with -- if there are no
24 questions by Members, we will proceed.

25 Very well. Thank you.

1 So let me look to -- I believe, Mr. Johnson, are
2 you going to be presenting?

3 MR. JOHNSON: Yes. Thank you.

4 CHAIRPERSON YEE: Thank you.

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

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

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

17 MR. WALSH: He is on -- with -- on my screen.
18 Derrick.

19 CHAIRPERSON YEE: Okay. Thank you. Thank you.
20 All right.

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

24 CHAIRPERSON YEE: All right. Great. Thank you.

25 MR. JOHNSON: Thank you. We appreciate your time

1 and attention and, you know, hearing our -- our case.
2 We want to thank you for that, as well as the FTB staff,
3 who has been very helpful in helping us set up for this.

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

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

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

20 Let's start -- I know you have seen our briefs,
21 but we would like to start out with just a real quick
22 background on the company, and because I think this fact
23 pattern is quite important. We believe that some of
24 the -- the initial rejection that we got from the FTB,
25 you know, cited certain cases and whatnot, that we think

1 had more applicable to different fact patterns and not
2 really this fact pattern. So I really want to highlight
3 this to you one more time.

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

15 Can we go to the next slide.

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

21 Let's go to the next slide, please.

22 So the standard apportionment rules that apply to
23 a bank, they include loans in the property factor and
24 assign those loans based on what is called the SINAA
25 rule to a regular place of business within the state.

1 In our case, unlike a traditional nationwide
2 bank, we don't have those branches across the nation, so
3 no loans go there. Our main place of business is in San
4 Diego and are getting -- and so all the loans are
5 getting assigned to San Diego, as well as -- so the
6 property factor, as well as the pay factor, have no
7 representation in this virtual location or branch.

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

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

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

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

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

24 Though there is, you know, a significant amount
25 of case law on this, and one case law that was very

1 relevant that's -- we think it matches well to our case,
2 is highlighted on the next slide. So can we move to
3 that one? It's the General Mills case.

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

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

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

24 WEBEX TECHNICIAN: All right. It looks like we
25 are having a little bit of internet issues on their

1 side.

2 CHAIRPERSON YEE: All right. Let's see.

3 Let me just check in with the other
4 representatives from Axos Financial.

5 Are any of the other representatives prepared to
6 continue or should we take a short recess?

7 Mr. Jewell or Mr. Walsh, Mr. Micheletti, anyone
8 prepared to continue on the presentation or are we
9 relying on Mr. Johnson to come back online?

10 (No response.)

11 WEBEX TECHNICIAN: I think they were all using
12 the same phone line from within that room.

13 There he is. Okay. He's back.

14 MR. JOHNSON: I am so sorry. I don't know what
15 happened.

16 CHAIRPERSON YEE: That's all right. That's all
17 right, Mr. Johnson. Please continue. We'll incorporate
18 the lost time, just to give you that time back.

19 MR. JOHNSON: Okay. Again, I apologize for that.

20 So I was -- I was talking about General Mills,
21 how it had a relatively small quantitative distortion,
22 but, yet, alternative apportionment was allowed, and
23 it's because of the qualitative components.

24 So if we can move to the next slide.

25 We can talk about what some of those qualitative

1 issues were: We had a statute that was written for a
2 completely different fact pattern. It wasn't written to
3 look at a manufacturing company and hedging and
4 combining those together. It just wasn't written for
5 the fact pattern. So that was a qualitative fact that
6 was highly influential in that case and justified that
7 lower distortion. It didn't apply -- it didn't promote
8 national uniformity. There was potential for huge tax
9 loopholes, and it had an impact on the commerce and the
10 tax collection of the state.

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

13 Let's move to the next slide.

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

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

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

24 We have got internet -- this is internet banking,
25 which is very different than traditional banking. The

1 MTC revised its rules to accommodate for that.
2 California hasn't caught up. We have uncodified
3 California law that states that the FTB should try to
4 find that uniformity across the state and promulgate
5 regs for that. We have got the Internet Tax Freedom Act
6 that puts a higher degree of burden when it comes to
7 double taxation of electronic commerce.

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

12 Can we go to the next slide.

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

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

19 Next slide, please.

20 Let's first talk about internet banking versus
21 traditional banking. Like in General Mills, the fact
22 that the apportionment formula was developed for a
23 business model, traditional banking, that's very
24 different from online banking, is a significant
25 qualitative factor and should be considered in this

1 analysis.

2 Internet banking is qualitatively different than
3 traditional banking. With traditional banking and
4 national -- unlike traditional banking, a national
5 internet bank's website can be run from anywhere in the
6 country, with the website being virtually located in any
7 of all 50 states.

8 Let's go to the next slide.

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

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

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

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

24 Please go to the next slide.

25 This is an analysis -- these companies are drawn

1 right from the taxpayer's proxy statement. These listed
2 as their -- as their competitors. We have listed here
3 all the competitors. These are all traditional banks,
4 not online banks.

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

12 Let's go to the next slide.

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

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

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

23 Let's move to the next slide, please.

24 So we're going to throw one more thing on this,
25 and this is -- the standard rules were written for a

1 different business model.

2 Next slide, please.

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

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

18 Let's move to the next slide, please.

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

21 Next slide, please.

22 Okay. So in 2014, when internet banking -- by
23 this time, internet banking had become more -- much more
24 commonplace. All right? And so the MTC saw that the
25 old SINAA rules were not -- were causing a problem

1 because of online banking. All right.

2 This comes exact -- you know, from their project
3 description of why they needed to change the rules.
4 They say these changes are caused -- these changes were
5 caused by -- both the deregulation of the industry as a
6 result of the repeal of Glass-Steagall and by
7 technological innovations that allow financial
8 institutions to provide a full range of service, such as
9 mortgage loans and credit card application processing,
10 credit approval, and account servicing entirely online.

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

14 CHAIRPERSON YEE: Okay.

15 EXECUTIVE OFFICER STANISLAUS: So this is Selvi,
16 Controller.

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

19 MR. JOHNSON: Can you guys hear us?

20 CHAIRPERSON YEE: We can hear you now.

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

23 So the MTC made these changes because they
24 believed that loan servicing rules, based on SINAA,
25 didn't fairly reflect the income of an online bank.

1 Most states currently do not apply SINAA and do not use
2 the three-factor formula. But California hasn't revised
3 its apportionment rules to address the inequities that
4 this causes to an online bank or at least the inequities
5 caused to Axos at this point.

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

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

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

10 Let's go to the next slide, please.

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

19 So when it comes to the banking industry, I think
20 there's higher level of scrutiny on this. You know --
21 and at the time when this was first enacted, California
22 followed it and adopted the MTC regs. Since then, they
23 went away from the MTC regs and then -- or I shouldn't
24 say they went away from the MTC regs. The MTC changed
25 and California didn't follow suit.

1 So I think this is just one more thing to throw
2 onto that scale to consider, for your consideration.

3 Let's move to the next slide.

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

6 Please go to the next slide.

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

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

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

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

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

1 Next slide, please.

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

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

11 Next slide, please.

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

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

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

24 Under the current banking apportionment rules, it
25 would be relatively easy for an internet bank to

1 manipulate the rules by moving servers and a relatively
2 small number of people to a tax saving state to assign
3 all loans to that state.

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

8 Can we go to the next slide.

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

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

24 With a single sales factor, for us to -- I mean,
25 you can't just move out of state. You would have to

1 move all your customers. All right. And so it creates
2 you know, to me, much better tax policy, and I think
3 it's consistent with the ruling of General Mills.

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

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

14 So just next slide, please.

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

19 Internet banking and traditional banking are very
20 different animals. A formula developed for traditional
21 banks doesn't clearly reflect the income of an internet
22 bank. The MTC recognized this and they changed things.
23 The FTB has not yet corrected the problem even though
24 uncodified law directs the FTB, with regard to banks
25 specifically, to adopt apportionment regulations,

1 considering the laws and regulations of other states,
2 with an objective of preventing multiple taxation.

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

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

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

17 Thank you.

18 CHAIRPERSON YEE: Thank you, Mr. Johnson.

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

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

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

1 you.

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

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

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

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

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

19 CHAIRPERSON YEE: Okay.

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

22 CHAIRPERSON YEE: Probably not even able to hear
23 me.

24 WEBEX TECHNICIAN: Well, I think they just got
25 the message. It looks like we see it on their face now.

1 Mr. Walsh, could you give us a thumbs-up if you
2 can hear us speaking to you?

3 (No response.)

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

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

9 CHAIRPERSON YEE: Sounds good, Ms. Brunett.

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

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

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

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

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

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

25 MR. WALSH: Okay. We'll start from the top.

1 CHAIRPERSON YEE: Because you tried to thread a
2 thought and you -- we definitely lost your volume.

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

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

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

22 MR. JOHNSON: Equate well.

23 MR. WALSH: It doesn't equate well. Thank you.
24 It doesn't equate well to the business products that we
25 are providing in regards to being an internet bank.

1 And then -- so that's one comment in regards to
2 the -- some of the considerations of other cases.

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

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

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

24 And that's been -- that's been the trouble that
25 we've been having when we take a step back and look at,

1 how does this really make sense for an organization like
2 Axos?

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

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

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

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

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

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

23 Section 25137 provides that if the standard
24 allocation and apportionment provisions do not fairly
25 represent the extent of the taxpayer's business activity

1 in this state, then an alternative formula may be
2 employed.

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

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

18 Second, Taxpayer's other arguments as to why
19 section 25137 should be invoked have previously been
20 rejected by courts or the Board of Equalization as
21 irrelevant to the question of whether the apportionment
22 formula fairly represents the taxpayer's business
23 activities. Specifically, arguments of a purported
24 better formula, arguments of alleged multiple taxation,
25 and arguments pointing to large quantitative distortion

1 metrics alone have all been rejected by case law as
2 means to show that the standard formula is not a fair
3 representation of one's business activities.

4 And before I go on, I would like to first discuss
5 the purpose of the apportionment formula and how section
6 25137 relates.

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

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

21 And states have wide latitude in choosing an
22 apportionment formula, with the constitution not
23 requiring a single formula for the state. For this
24 reason, there are multiple constitutional formulas.
25 However, in some situations, a constitutional

1 apportionment formula does not measure the business
2 activities in the state as intended to be measured, such
3 that that slice is not a fair representation of business
4 activities conducted in the state. When this occurs,
5 this is referred to as resulting in distortion, and
6 section 25137 can be invoked.

7 An example of this is when a formula is measured
8 by the amount of property in a state, payroll in a
9 state, and sales in a state, compared to property,
10 payroll, and sales everywhere. The apportionment
11 factors must be causally related to the income being
12 apportioned. If a taxpayer has no property, then the
13 formula is not causally related to that, and, thus, not
14 fairly reflected business activities. So in that case,
15 there's distortion and the property factor is removed.
16 However, it's important to note, when determining
17 whether section 25137 can be invoked, this section does
18 not allow deviation from the normal formula simply
19 because one purports to have a better approach.

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

25 Now, turning to Taxpayer's activities; its

1 combined reporting group is engaged in banking and
2 financial activity. Most of Taxpayer's combined
3 reporting group is attributed to Axos Bank, which is a
4 federally chartered bank that conducts operations over
5 the internet and serves customers nationwide, with the
6 banking segment operating from the headquarters located
7 in this state, specifically, San Diego, California.

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

15 The legislative intent was affirmed again in
16 2009, specifically when general corporations moved to
17 the single sales factor formula. The legislative
18 history shows that the California Legislature
19 specifically intended for businesses that derive more
20 than 50 percent of the receipts from banking and
21 financial activity to remain using this three-factor
22 formula. And the three factors consist of an evenly
23 weighted sales, property, and payroll.

24 Also at issue are the apportionment rules
25 applicable to banks and financial corporations within

1 Taxpayer's combined reporting group. As Taxpayer
2 mentioned, it specifically takes issue with the
3 requirement that loans be included in the property
4 factor, and loans are assigned to the state in which the
5 loans have a preponderance of substantive contacts.

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

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

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

25 I will first turn to the payroll factor.

1 The payroll factor is intended to reflect the
2 contribution of employees that give rise to
3 apportionable business income. The purpose of this
4 factor has not changed in importance since the advent of
5 the internet, nor is there any legal authority to
6 support the notion that there's been a change in this
7 factor.

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

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

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

21 The --

22 MS. SARILLE: Excuse me. Katie?

23 MS. FRANK: Yes.

24 MS. SARILLE: I'm sorry. I got off track.

25 What slide are you on?

1 MS. FRANK: I'm on the payroll factors.

2 MS. SARILLE: Sorry. Give me a second.

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

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

6 MS. SARILLE: Okay. My screen shows slide 13.
7 Okay. I'm not able to go back one. So I'm stuck at
8 slide 13. I'm sorry.

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

11 There we go. Okay.

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

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

25 All right. Now moving on to the property factor.

1 So this factor is intended to reflect the
2 income-producing effect of capital invested in the
3 taxpayer's trade or business. Again, this -- the
4 purpose of this factor has not changed due to the advent
5 of the internet.

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

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

22 So like the conclusions found with the payroll
23 factor, there is no evidence since Taxpayer operates
24 over the internet the formula results in distortion.
25 Rather, the formula is merely reflecting where

1 Taxpayer's actual business activities occur.

2 Now, looking at the formula in totality.

3 So you can move on to the next slide.

4 There you go.

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

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

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

20 First, Taxpayer points to other purported better
21 apportionment formulas as evidence that the current
22 formula does not fairly represent its business
23 activities. Taxpayer argues that since numerous other
24 states use something other than an evenly weighted
25 three-factor formula, the single sales factor would be a

1 better approach to ensuring uniformity. Also, Taxpayer
2 points to the Multistate Tax Commission's formula, which
3 has removed loans from the property factor, as evidence
4 that another formula should be used.

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

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

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

20 Now, as to the Multistate Tax Commission's
21 formula. Taxpayer argues it was revised to remove loans
22 from the property factor because the distortive effect
23 on internet banking. However, the regulatory history
24 shows that the member states participating in that
25 revision process were largely concerned with being able

1 to administer the SINAA rules. This can be seen within
2 the hearing officer report.

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

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

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

22 Also, as stated before, states have a wide
23 latitude to choose an apportionment formula, so while
24 the apportionment formula is designed to prevent
25 multiple taxation due to only attributing a slice of

1 income to a state, it may be the case that when two
2 states impose different formulas, this may result in an
3 overlap in taxation or it might result in less than a
4 hundred percent of income being subject to taxation.
5 But this is merely the interaction of two different tax
6 regimes, and it's permitted by constitutional law.

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

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

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

25 Also, there is no prohibited multiple taxation.

1 The Internet Tax Freedom Act defines this as "any tax
2 that is imposed by one state on the same or essentially
3 the same electronic commerce that is also subject to tax
4 by another state without a credit."

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

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

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

24 Well, one, there's no evidence that the effective
25 tax rate differences are due to the three-factor

1 formula. It could be due to numerous items.

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

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

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

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

20 And in this case, there is no evidence that since
21 Taxpayer conducts its business over the internet, that
22 the formula results in distortion. Rather, the property
23 and payroll factors are just as important in generating
24 business income for businesses that operate over the
25 internet as they are for traditional banks.

1 Moreover, any assertion that the property and
2 payroll factors should reflect the place in which the
3 customers are located is merely an assertion that the
4 sales factor should duplicate -- should be duplicated.
5 And that's counter to the underlying purpose of having
6 separate factors in the measure.

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

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

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

22 Let me just do a check on time.

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

25 MS. ZAYCHENKO: None for me at this time.

1 CHAIRPERSON YEE: Okay. Very well. Thank you
2 very much.

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

5 Mr. Johnson, do you want to --

6 MR. JOHNSON: Oh, hi. Thank you.

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

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

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

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

24 We're not arguing that any one of our facts gets
25 us there. What we're saying is, when you consider all

1 of the facts together, we think that there's clear and
2 convincing evidence that, in our case, more is being
3 taxed in California than is reasonable to Axos
4 Financial. All right.

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

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

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

21 The MTC changes. I think they referred to some
22 historical documents that showed the -- the reason was
23 for administrative purposes. There's nothing out there
24 historically that says that. I think they called up
25 someone at -- at the MTC on a private call, which we

1 were not part of, and they got some insight of what this
2 person thought the reasons for it was.

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

9 All right. We showed you the numbers.
10 300 percent greater than a national bank with the same
11 clientele. 120 percent clearly being double taxed. We
12 aren't saying with each of these items -- we look at the
13 Internet Tax Freedom Act. We aren't asking you to judge
14 on the Internet Tax Freedom Act and whether that makes
15 this invalid. We're saying include that on your scale.
16 We're saying include it on the scale.

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

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

24 Do you guys want to add to that?

25 MR. WALSH: Yeah.

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

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

12 WEBEX TECHNICIAN: It does. It sure does.

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

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

17 MR. WALSH: Can you guys hear me?

18 CHAIRPERSON YEE: Yes. We can now.

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

21 CHAIRPERSON YEE: I can hear you.

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

24 MR. WALSH: Yeah. I was highlighting the SINAA
25 factor --

1 CHAIRPERSON YEE: Yeah.

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

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

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

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

24 And then the other topic I just wanted to touch
25 on was the -- there was some references to Supreme Court

1 rulings or other historic court cases that date back to
2 the mid-1990s or time periods that really, once again,
3 aren't relevant to an organization and a business model
4 and a entire industry that didn't even really get
5 started until the early, early 2000s/late 1990s, and
6 really didn't come into its own until the early 2010s.

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

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

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

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

25 So I thought that her comments, in a large way,

1 are supporting our position that we need relief relative
2 to exactly how this works. Whether we use a single
3 revenue or whether we use all three, we have listed both
4 as options, but it is really the property, including
5 loans in the property factor, that is the difficult part
6 of the position.

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

9 Anything else in conclusion?

10 MR. JOHNSON: I think we have covered it.

11 CHAIRPERSON YEE: Okay.

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

14 CHAIRPERSON YEE: Great. Thank you very much.

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

17 Member Vazquez, please.

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

20 I guess it was Katie who was making the
21 presentation?

22 CHAIRPERSON YEE: Yes. Uh-huh. Ms. Frank.

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

1 please?

2 MS. FRANK: Yeah.

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

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

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

21 So in the case of General Mills, they had hedging
22 activity that was engaged -- that the taxpayer didn't
23 engage in for-profit purposes, which was qualitatively
24 different from the main line of business. In that case,
25 the court said that these hedging activities, with this

1 very large amount of receipts, overwhelmed the factor,
2 the sales factor, and -- in relation to the amount of
3 income being produced, and they could be removed. The
4 hedging activity could be removed or reported at net.

5 So there are two examples there.

6 MEMBER VAZQUEZ: And I appreciate that.

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

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

12 MEMBER VAZQUEZ: Whoever can answer it.

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

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

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

23 MR. WALSH: Can you specify whether you are
24 talking about Axos Financial? What -- can you repeat
25 your question, please? Let's repeat the question.

1 MEMBER VAZQUEZ: I'm talking about the loan
2 processing operation. What is assigned to California
3 versus other states?

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

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

8 MEMBER VAZQUEZ: Yes.

9 MR. JOHNSON: Yeah. It's -- it's like
10 98 percent. Oh. A hundred percent.

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

15 MR. JOHNSON: Right. So going back to it, I
16 think it meets the General Mills qualitative definition
17 of an "overwhelming amount." And it's basically
18 100 percent and really drives that property factor to a
19 distortive amount. And that's why we're asking for the
20 removal of that or the removal of the factor all
21 together.

22 MEMBER VAZQUEZ: Thank you.

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

25 What appeal of process do the -- or what -- I

1 guess the -- what rights do these folks have in the
2 appeal rights moving forward after our decision?

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

5 MEMBER VAZQUEZ: Okay. Thank you.
6 That's -- I'm good for right now.

7 CHAIRPERSON YEE: Thank you, Member Vazquez.
8 Member Chamberlain, any questions before I pose
9 mine?

10 MEMBER CHAMBERLAIN: Yeah. I guess -- I guess
11 what I would like to ask Mr. Johnson -- or I don't know.
12 Is Mr. Johnson -- can you hear me?

13 MR. WALSH: Yes. We can hear you.

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

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

23 And my understanding of distortion is that it has
24 to be more of a sort of -- there's something about the
25 actual way you are measuring -- you are measuring the

1 apportionment of income that is incorrect.

2 And it seems like -- and it seems like that the
3 120 percent, that's just matter of how the various
4 states have set up their different systems, and some
5 taxpayers are going to get taxed at 80 percent, some at
6 120, and it just sort of depends on how things end up.
7 But there's nothing -- that doesn't say there's anything
8 particular -- necessarily wrong about any of those
9 particular formulas. It's just that there's an
10 unfortunate outcome that the states are not -- are not
11 coordinated.

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

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

1 wrong. All right.

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

5 We have showed you indication that problems are
6 being caused here. We're being taxed on more than
7 120 percent of our income. That in and of itself, does
8 that -- does that win the case? Maybe not.

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

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

17 MR. WALSH: And to get to your question around
18 the distortion structure, that's where we highlighted
19 the -- how the property factor is treated and that the
20 property factor is treated differently in California and
21 the -- and the challenges that we face with the -- with
22 the SINAA idea, with the SINAA idea, and how we even
23 would treat these loans and the -- and the solicitation
24 of our customers and different -- different -- the
25 different stages along the SINAA codification as far as

1 whether that is something that is counted in California
2 as well as multiple other states, whether that's
3 something that most -- most other banks don't have to
4 deal with that, because they have their branches.

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

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

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

20 MR. WALSH: Yeah. I mean --

21 MR. JOHNSON: Online banking versus traditional
22 banking.

23 MR. MICHELETTI: Maybe a dollar amount or a rough
24 dollar amount, you know, kind of application would help
25 to understand the magnitude of that. When we look at

1 our -- actually what property, plants, and equipment we
2 have in California, we're probably talking about less
3 than \$10 million bucks or thereabouts.

4 MR. WALSH: Correct. Yeah.

5 MR. MICHELETTI: When you look at how many loans
6 we have, we have 14 billion. So -- so that 14 billion
7 in loans has been added to our property factor as though
8 it is a plant, property, and equipment. So the
9 10 million of actual infrastructure versus the
10 14 billion of loans that's getting added in, because all
11 of our people are here, is what causes that massive
12 distortion.

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

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

22 MEMBER CHAMBERLAIN: I guess I would just say I'm
23 not -- it seems to me it's distortive if -- if it is
24 incorrect, if it is never correct to assign a loan to
25 where the -- where the loan is serviced. And it

1 doesn't -- I don't see that -- I don't see where there's
2 distortion in a way that our current apportionment
3 factor works right now.

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

13 MR. WALSH: Let me add one other aspect.

14 (Unintelligible cross-talk.)

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

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

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

25 The -- so this is another way to consider it:

1 The SINAA factor, the first four functions of it, are a
2 very short amount of time compared to the life of a
3 loan. So if you are doing a 30-year loan, it's taking
4 you 30 to 45 days to fund that loan, and then you are
5 servicing that loan for the next 30 years.

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

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

14 MEMBER CHAMBERLAIN: Okay. Thank you.

15 CHAIRPERSON YEE: Thank you, Member Chamberlain.

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

22 I want to just kind of get a sense of -- since
23 Axos became an entity -- so traditionally you were
24 filing under the three-factor apportionment formula.
25 And I know that when we look at 25137, which does allow

1 us to look at a departure from the -- this approach,
2 that it's on a pretty limited basis.

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

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

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

21 And many of these things, sure, have been around
22 for a while, but the speed and trust in the markets --
23 and this is seen across the financial services
24 industry as far as the amounts of virtual transactions
25 that are occurring and that consumers are now trusting

1 more different virtual transactions methods, that they
2 are transacting more over the internet with us than
3 ever, and that full customer interactions are occurring
4 over the internet, through uses of chat bots, through
5 uses of electronic e-mails or portals, that customers
6 are filling out their entire documentation online; they
7 are no longer mailing things in. They are doing their
8 entire transaction online, and there's not a kind of
9 physical aspect or picking up the telephone aspect
10 that -- and that has been one of the significant changes
11 over the last few years.

12 CHAIRPERSON YEE: Okay.

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

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

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

24 CHAIRPERSON YEE: Okay. So your business has
25 continued to be your business over the years.

1 And -- and -- so I want to talk about the SINAA
2 factors for a moment. So we talked a lot about
3 solicitation. And you have just described, Mr. Walsh,
4 the consumer experience, with respect to, you know,
5 interacting with Axos online.

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

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

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

25 And so we -- we pay through the -- through Google

1 to track and advertise to you if you Googled "mortgage,"
2 something of that nature.

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

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

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

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

21 CHAIRPERSON YEE: Okay. Okay.

22 I do want to make a comment with respect to the
23 comparisons with competitors on the effective tax rate.
24 And it's -- it's one where I'm not going to give a lot
25 of credence just because we don't fully understand the

1 business models of all the competitors and, certainly,
2 some of the relevant tax treatments they may be subject
3 to. So I want to just put that out there. And, you
4 know, it really does have to do with the nature of the
5 business activity, and so I want to kind of keep the
6 focus on that.

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

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

20 And so I think what this means to me is that this
21 really does have relevance with respect to just what the
22 particular business model is, from one company to
23 another. I mean, you just can't have kind of a uniform
24 kind of a rule that necessarily is going to result in
25 the same outcome for everyone.

1 So -- and I think that was one of the things that
2 certainly struck me with respect to the whole MTC
3 process. And while they did establish a rule,
4 California has not conformed to that rule, and I think
5 the only way you get national uniformity is, frankly,
6 with a federal law. So I'm not sure that we can help in
7 that regard.

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

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

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

24 I just kind of want to get a sense of, you know,
25 the relevance of that case. Because it is one that I

1 wasn't putting front and center with respect to trying
2 to determine just what was appropriate here in this
3 matter.

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

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

8 MS. FRANK: Yeah. So it is different.

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

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

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

25 Here, they are actually arguing that they're

1 whole business activity is different, not just an income
2 stream. And so there really -- it -- it's not an apt
3 comparison to the General Mills case.

4 CHAIRPERSON YEE: Okay. Thank you.

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

7 CHAIRPERSON YEE: Yes. Go ahead.

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

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

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

24 MS. FRANK: Can I respond?

25 CHAIRPERSON YEE: Yes. Ms. Frank, please.

1 MS. FRANK: Okay. So I think the big difference,
2 too, are the loans are the main generating income item.
3 Whereas, hedging, it had no income, really.

4 CHAIRPERSON YEE: Right.

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

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

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

22 MR. JOHNSON: Real quick.

23 I did just want to make one more point about
24 General Mills. We do think it's applicable. I think I
25 have a difference of opinion of Katie on that. I think

1 she's taking a very narrow interpretation of the case.
2 I think the case, as we listed in our PowerPoint, you
3 know, very -- very similar points is what we're making.

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

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

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

18 MR. WALSH: And one thing to add on to what Katie
19 was saying with regards to the loans being considered in
20 the sales factor. I guess wouldn't that also be
21 considered disproportionate where we're having to
22 consider these loans as both sales in the -- in the
23 sales factor, as well as property in the property
24 factor, and that we're getting double taxed on those
25 portion of loans that are in California?

1 CHAIRPERSON YEE: Ms. Frank, do you want to
2 respond to that?

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

6 MS. FRANK: Right. Yeah.

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

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

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

21 MS. FRANK: Yeah. Those are reflecting,
22 essentially, the contribution of the market in relation
23 to the loans, which Taxpayer was arguing was essentially
24 important, and they are getting a reduction there
25 because they have a large amount of customer base in

1 California; I believe it's almost 50 percent.

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

7 CHAIRPERSON YEE: Mr. Walsh, any other thoughts?

8 MR. WALSH: Yeah.

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

16 Let me say it this way. Let me talk about the
17 loans that are not in California in the sales factor.
18 So those loans that are not in California in the sales
19 factor are taxed by other states. That makes sense.
20 Right? But then you take those same loans, and we're
21 getting taxed on them in California because of the --
22 because of the SINAA aspects. They are being included
23 into that property factor, and that's where there's a
24 challenge for us, as an organization, that that just
25 doesn't -- it doesn't make sense. It doesn't seem like

1 fair application of the -- of the tax guidance, where we
2 should get penalized because we figured out a good
3 business model as to how to -- (unintelligible) --
4 because we figured out a good business model --

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

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

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

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

19 MR. WALSH: Sure.

20 We have got employees all throughout the U.S.
21 Certainly, headquarters is here in California, and so we
22 have got about 600, 700 employees in California. We
23 have got a number of employees, over a hundred, in Las
24 Vegas, Nevada. We have employees in Utah; in Kansas
25 City; in Omaha, Nebraska; Columbus, Ohio; in the New

1 York metropolitan area. So that is the -- the location
2 of our employees throughout the U.S.

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

7 UNIDENTIFIED SPEAKER: From 2015 to 2020, the
8 percentage of employees in California has decreased from
9 95 to 70 percent.

10 MR. JOHNSON: Okay. Did you hear that?

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

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

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

18 UNIDENTIFIED SPEAKER: Or 82.

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

20 CHAIRPERSON YEE: Okay.

21 UNIDENTIFIED SPEAKER: (Unintelligible.) In
22 California.

23 MR. WALSH: In California.

24 CHAIRPERSON YEE: In California? Okay.

25 And that was through 2018?

1 MR. WALSH: Correct.

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

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

6 Other questions, Members, or comments?

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

9 CHAIRPERSON YEE: Yes.

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

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

13 CHAIRPERSON YEE: Yes.

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

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

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

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

24 UNIDENTIFIED SPEAKER: The process was started a
25 couple of years ago, I guess, with COVID and things like

1 that. Things got delayed. But I think that the refund
2 claims have been filed.

3 MEMBER VAZQUEZ: Thank you.

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

6 Seeing or hearing no other comments or questions
7 from Members, thank you very much for the presentations.

8 That concludes the hearing. I want to take a
9 five-minute recess, if I could, while we take this
10 matter under submission and we will come back and see if
11 there's further deliberation before we decide. All
12 right. So --

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

14 CHAIRPERSON YEE: Thank you. We appreciate your
15 patience.

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

18 (Break taken in proceedings.)

19 CHAIRPERSON YEE: Let us reconvene.

20 Any further discussion on this matter?

21 (No response.)

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

24 MEMBER VAZQUEZ: Yeah. I would like -- yeah. I
25 will make the motion. But you know what? Let me just

1 preface it with a comment first and then we can go from
2 there.

3 You know, in sitting back and looking at all of
4 the facts and listening to both sides of this issue, you
5 know, I would have to side with the staff on this since
6 the law is -- you know, clearly states what the
7 conditions are for this type of institution under
8 section 25128. Under the law, the taxpayer may petition
9 to use the alternative formula. They may represent
10 their business's activity more accurately under section
11 25137. However, the law clearly states that it is up to
12 Petitioner to prove clearly and convincingly that the
13 FTB and the Franchise Tax Board's methodology is unfair.

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

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

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

25 The -- the only thing is that, you know, having

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

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

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

14 Is there a second?

15 MEMBER CHAMBERLAIN: I second that motion.

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

18 And let me ask for the roll to be called.

19 MS. CASEY: Member Vazquez.

20 MEMBER VAZQUEZ: Aye.

21 MS. CASEY: Member Chamberlain.

22 MEMBER CHAMBERLAIN: Aye.

23 MS. CASEY: Chair Yee.

24 CHAIRPERSON YEE: Aye.

25 Thank you. That motion carries.

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
License No. 13061