STATE OF CALIFORNIA
FRANCHISE TAX BOARD

PUBLIC MEETING

THURSDAY, MARCH 4, 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

IRENA ASMUNDSON
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

FERNANDO CASTRO

HANNA CHO

ELIAS DOMINGUEZ

JEANNE HARRIMAN


APPEARANCES CONTINUED

STAFF (CONTINUED)

ALLAN LOUCKS
THI LUONG
JOSE ORZOCO
SUCHARITA PAL
VICTORIA RAMIREZ
JENNIFER ROUSSEL
KATHY SHIN
DAN TAHARA

PUBLIC PARTICIPANTS

CHRISTINE GRAB

BEN LEE
California Taxpayers Association

AGENDA ITEM 10 PETITIONERS

BEN MUILENBURG, ESQ., and DERICK BRANNAN, ESQ.
PricewaterhouseCoopers,
appearing on behalf of
Smithfield Packaged Meats Corporation

BRADY STEWART
Smithfield Packaged Meats Corporation
SACRAMENTO, CALIFORNIA
THURSDAY, MARCH 4, 2021 1:30 P.M.

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ACTING CHAIRPERSON STOWERS: Good afternoon. It is 1:30, March 4, 2021. This is the scheduled time for the meeting of the Franchise Tax Board.

Would the board liaison please call the roll to determine if a quorum is present.

MS. CASEY: Yes.

Member Vasquez.

MEMBER VASQUEZ: Present.

MS. CASEY: Member Asmundson.

MEMBER ASMUNDSON: Present.

MS. CASEY: Deputy-Controller Yvette Stowers.

ACTING CHAIRPERSON STOWERS: Present.

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

Please stand and join me in the Pledge of Allegiance.

(Pledge of Allegiance recited in unison.)

ACTING CHAIRPERSON STOWERS: Thank you.

Good afternoon and welcome to the Franchise Tax Board virtual board meeting.

As FTB continues to follow all appropriate
federal, state, and local guidance for public guidance, my fellow board members and I are attending the meeting remotely, and FTB staff is following social distancing best practices.

The public has a right to comment on each agenda item. For today's meeting, members of the public may comment via telephone at (877) 226-8152, with the access code 6125923. Please be aware that there is a short delay between web live stream and the live event.

If there are any members of the public wishing to speak on an item, you may speak when the item is called. You will have three minutes to address the Board. You will be asked to identify yourself for the record.

For the first item, Members, is approval of the minutes. We have the minutes of December 18, 2020, board meeting and Taxpayers' Bill of Rights Hearing.

Is there a member of the public wishing to speak on this item, on the teleconference line?

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

(No response.)

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

ACTING CHAIRPERSON STOWERS: Thank you.

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

MEMBER VASQUEZ: So moved.

MEMBER ASMUNDSON: Second.

ACTING CHAIRPERSON STOWERS: There's been a motion and a second. Without any objection, the motion passes.

Members, the next item is Item 2, a PowerPoint presentation entitled "Customer Service Update," presented by Victoria Ramirez. This is an informational item.

Ms. Ramirez.

MS. RAMIREZ: Good afternoon, Madam Chair, Board Members, and everyone in attendance. My name is Victoria Ramirez, and I'm with the FTB's Public Affairs Office in the Administrative Services Division.

Today, I would like to share with you what FTB has done to help customers during the COVID-19 pandemic at the public counter field offices, how we assisted the community at the local assistance centers, and provide you with an update of the special tax relief for California wildfire survivors.

In 2020, California was severely affected by the
COVID-19 pandemic and many devastating wildfires throughout the state. In February and March, California experienced growing trends of the COVID-19 pandemic. On March 19th, all five FTB public counter field offices were closed to ensure the safety of our employees and customers.

In order to comply with the governor's plan for reopening California and providing essential services to our customers, the five public counter field offices reopened on June 15th to provide assistance to customers by appointment only.

FTB's five public counter field offices were closed on December 7th, due to the regional stay-at-home order. The order was lifted, and the five public counter field offices reopened on February 1st, to assist customers by appointment only.

FTB established an appointment process to allow customers to schedule appointments by calling the field office or by sending an e-mail and include the field office location, the customer's name and telephone number, and the reason for their appointment.

The FTB field office appointment e-mail link is located on our public website. We respond to the e-mail requests within two business days. Customers coming into the field office public counters are expected to
maintain social distancing and follow safety protocols.

We received significant positive feedback from the customers. And from June 15th through December 4th, staff answered over 11,000 telephone calls, responded to over 1,600 e-mails, assisted over 8,800 customers in person, and responded to 180 live chats from September 16th through December 4th.

We are currently working on an online appointment system, allowing our customers to self-serve and schedule an appointment online, using a link which will be located on our external website. We anticipate launching the online service option in mid-March.

As a result of the wildfires, Cal OES requested agency partners to participate at local assistance centers for survivors of the CZU Lightning Complex Fire in Santa Cruz County; the Carmel Fire, Dolan Fire, and River Fire in Monterey County; the Valley Fire in San Diego County; the Slater Fire in Siskiyou County; the Creek Fire in Fresno County; and the Zogg Fire in Shasta County.

Despite the many challenges with the California wildfires or the ongoing pandemic, our employees continue to provide excellent service to the citizens of California. Fifteen FTB volunteers assisted a total of 662 survivors at the seven local assistance centers.
Due to the COVID-19 pandemic, the counties worked with Cal OES and the state agencies to offer virtual local assistance centers for those survivors that are unable to visit a local assistance center in person. This allows survivors to safely have access to the resources they need to help their recovery process.

FTB has information available on the Monterey, Napa, San Mateo, and San Diego virtual local assistance centers located on the counties' external website.

Upon Cal OES's request, we mailed disaster-related materials to be available for survivors at seven local assistance centers: For Napa, Sonoma, San Mateo, Los Angeles, Santa Clara, Trinity, and San Bernardino Counties.

And now I will go into the second part of the presentation about the special tax filing relief that the Franchise Tax Board granted due to the recent wildfires in California.

Taxpayers affected by the wildfires that began in August were granted an extension until December 15th, 2020, to file 2019 California tax returns and make certain tax payments. This extension applied to the 15 counties shown on the slide.

For the September wildfires, affected taxpayers had until January 15, 2021, to file and make certain tax
payments. This relief applied to the ten counties listed on the slide.

Our tax relief was triggered by a combination of declarations issued by the governor and the President, each adding to the list of affected counties. These counties affected by the August and September wildfires were declared by the governor to be disaster areas in his September 25th executive order. The governor also declared states of emergency on September 25th and September 28th. In addition, the President approved a major disaster declaration on August 22nd and October 16th.

This tax relief applied to various tax filing deadlines, including the October 15th deadline extended due date for individuals, and business entities with a due date between August 14th and September 15th. This tax relief did not apply to tax year 2019 personal income tax payments that were due on July 15th.

If an affected taxpayer receives a late filing or late payment penalty notice related to the extended postponement period, they should call the number on the notice to have the penalty abated. FTB's disaster loss web page displays a complete list of all disasters declared by the governor. We provide disaster updates and links to resources, such as help on claiming
disaster losses.

Survivors of major disasters, including wildfires, may claim losses as a state tax deduction. The deduction is assigned to help cover losses not covered by personal property insurance. It lowers a wildfire survivor's taxable income and may result in a refund that can help cover the costs of rebuilding.

Taxpayers may claim a disaster loss in one of three ways: First, they may claim the loss on their original 2019 tax return; second, they may claim the disaster loss for the 2020 tax year when they file their return; or third, if they suffered losses beyond what was covered by their insurance, they can claim that amount by amending their 2019 tax return. The advantage of claiming the disaster loss in a prior tax year is that FTB may issue a refund sooner.

Taxpayers claiming the disaster loss should write the name of the disaster in blue or black ink at the top of their tax return to alert FTB and to expedite any refund. If taxpayers are filing electronically, they should follow the software instructions to enter the disaster information. You can also find additional information and instructions on how to claim disaster losses as a state tax deduction in FTB Publication 1034.

Disaster survivors may also receive free copies of FTB Publication 1034.
of their state tax returns to replace those lost or damaged. Taxpayers may complete Form FTB 3516 and write the name of the disaster in blue or black ink at the top of the request.

In closing, we would like to thank you for your time and attention and let you know that we would be happy to answer any questions you may have about FTB's customer service during the pandemic and disaster relief.

ACTING CHAIRPERSON STOWERS: Thank you.

Members, do you have any questions or comments?

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

ACTING CHAIRPERSON STOWERS: Thank you, sir.

We're going to first go to the members.

I believe I saw Member Vasquez having a question.

MEMBER VASQUEZ: Yes. Yes, Madam Chair.

First of all, thank you for that great and informative presentation. I only had just one -- a couple of just short questions. And one of them happens to deal with, as we're advancing and we're doing all these great new processes, especially with new technology, I was just wondering in particular, as we're
dealing with the elderly population, in which way they may not be active — might not have access to all the new technology or the processes or maybe anything even close remotely to that.

And I was just wondering what we're doing, if anything, to try to accommodate their issues, to make sure that, you know, all these great things that we're doing now, they have access to.

MS. RAMIREZ: Thank you, Member Vasquez. I don't have the answer to that at this moment. I can look into that for you.

Unless, Shane, do you have an answer to that right now?

MR. HOFELING: No. I would say, Member Vasquez, that that is an area that we continually try to make sure that we do reach and find out the perfect avenues to help people with technological issues or the lack of technology to be able to get information. But we will -- (audio malfunction; unintelligible) --

MEMBER VASQUEZ: I appreciate it. Because, you know, as we're — and it's becoming more and more evident, you know, now that we're in this pandemic, for example, up until this point, we have always talked about the whole digital divide, but it really hasn't surfaced as much as it has now, when everyone is pretty
much forced to stay in lockdown. So unless you have
that technology at home or access to it, it's very
difficult for them to access, you know, especially some
of the great things that we're doing.

And I noticed that, really, as -- more and more,
as we're looking at things that are happening around the
whole vaccination issue, but it's also coming to a head
with other departments and other services that we
provide throughout the state. So I just wanted to bring
that up.

EXECUTIVE OFFICER STANISLAUS: Member Vasquez,
this is Selvi. The taxpayers can contact us by
telephone or by correspondence if they need to reach us.
And our phone lines are open, you know, from 8:00 to
5:00 every day on weekdays.

MEMBER VASQUEZ: That's helpful too, yeah. I was
going to mention that.

You know, as much as we're advancing on the
technology front, I'm hoping that we still have, you
know, the old-school -- I guess now you might say phone
lines, right, where people could actually phone in, one.

And then, two, making sure that we are available
at the counter as well so people that literally want to
walk in -- and I know that's a little bit of a challenge
right now with COVID. But as -- you know, as we start
opening up, just wanted to make sure we get that out to the -- especially the senior and the elderly population.

ACTING CHAIRPERSON STOWERS: Fair question, Member Vasquez.

As Selvi said, we do have the 800 line that's open. And even during the peak of tax season, they have extended hours, which I'm sure they will speak about that later in the presentation.

But I'm also concerned about those who don't have the technology that -- you said computers.

So FTB, I'm going to assume that if someone just shows up at the office without an appointment, you guys would, at the very least, assist them in making an appointment so they can come back the following day and provide the necessary services?

EXECUTIVE OFFICER STANISLAUS: Yes, absolutely, Ms. Stowers. If they do walk in, we take care of them immediately, or if we aren't able to take care of them, we do make an appointment time so that they can come back the next day, yes.

ACTING CHAIRPERSON STOWERS: Perfect. Thank you.

Any more questions from the members?

MEMBER VASQUEZ: Just one last one, if I could, Madam Chair.

And it's -- you know, in light of everything
that's happened with COVID, and I know we have deadlines -- and I think, Selvi, you mentioned to me that we're being a little bit lenient on this or trying to be a little bit open. And I was just wondering what, if anything, we're doing in terms of outreaching to the -- especially to the elderly folks that may not have access, once again, to the technology, to find out about how they could make, you know, their payments, for example, in a timely manner. And if, for some reason, they make it late, how -- you know, how are we handling that? You know, because of lockdown, are we being a little bit more flexible on some of those penalties, you know, when they do come in late?

CHIEF COUNSEL BRUNETT: And so did you want me to respond to that? This is Jozel.

Okay. Member Vasquez, yes, that is a good point, and we are getting -- we do have our normal channels that are open. We do provide information on the notices that are sent to taxpayers, giving them all of the options for payment, you know, getting into installment agreements, offers and compromise, whatever may work. And then we do consider all circumstances regarding late payment. We take a look at different -- each situation is factual. But I do understand what you are saying and that these are difficult times, and we are taking
difficult times into consideration.

MEMBER VASQUEZ: I appreciate it. Thank you.

ACTING CHAIRPERSON STOWERS: Thank you.

Any more questions from the members?

(No response.)

ACTING CHAIRPERSON STOWERS: Seeing none, we're now going to see if we have any questions from the public.

(No response.)

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

Please continue.

ACTING CHAIRPERSON STOWERS: Thank you very much.

Just really quick, I would like to just kind of comment just to thank FTB and the staff to continue to provide excellent public service during this troubling time. It's been close to a year, and it's -- to my point of view, it seems like you guys have continued to provide the service needed to all of our constituents, at the same time making sure that staff is protected and safe. So just a big thank you and kudos to you guys.

Okay. We're now on to Item 3. Enterprise Data Revenue 2 Update, presented by Jennifer Roussel and Jose Orzoco. This is an informational item.

MS. ROUSSEL: Good afternoon, Madam Chair and
Members of the Board. My name is Jennifer Roussel, the EDR2 business director for FTB. And with me today is Jose Orozco, the EDR2 technology director.

Today we'll be providing an informational update on the Enterprise Data to Revenue project, known as "EDR2." The last update we provided was in September of 2019.

We are pleased to share that we are on track with the EDR2 procurement process, and we're excited to share our progress with you today.

We would like to start off by providing a little background as to how we got to the EDR2 project, and Jose will cover this information.

MR. ORZOCO: Thank you, Jennifer.

In 2007, FTB created a tax system modernization vision. This vision outlined three large-scale projects over a 30-year period, focusing on modernizing our aging IT systems, implementing business opportunities and objectives, improving taxpayer services, effective compliance, and operational excellence. This 30-year vision is composed of three large-scale projects, each taking approximately ten years to complete, from planning through implementation, with each project building upon the previous.

Phase 1, known as "Enterprise Data to Revenue" or
the "EDR project" was completed in 2015. This project created our new foundational systems, including case management, taxpayer folder, and MyFTB.

Phase 2, known as "EDR2," is the current project that we're providing an update on today.

The primary focus of this project is to move our aging audit, filing enforcement, and underpayment systems onto the new Enterprise platform created in the first phase of EDR.

On average, these systems will be over 22 years old and two of the three are reaching their end of life. Replacing these systems is essential to protecting the revenue for the State of California and continue to provide excellent customer service.

The last phase, EDR3, will focus on replacing our aging accounting systems. We anticipate starting the planning for this final phase in 2026.

With EDR2, we are focusing on improving efficiencies, compliance, and customer service so we can better serve our taxpayers and continue to address the tax gap. Some of the most important improvements include a new Enterprise case management system, where we will transition our siloed and aging case management systems for audit, legal, filing enforcement, and underpayment onto the Enterprise case management
platform. This will give us one case management system for enhanced workload management and allow us to automate current manual processes.

In addition, we will implement a new Enterprise modeling system, where we will transition our siloed systems for audit, legal, filing enforcement, and underpayment onto one Enterprise modeling platform.

This will improve case selection and use new data and modeling strategies to address the tax gap. We will also enhance our claims processing and return verification by using new data matching and new data verification, which will result in improving taxpayer compliance earlier in the return filing process. And we will offer new customer service options such as new communications options, education, and self-service options for our customers.

Finally, as we mentioned earlier, we will replace older, outdated systems by bringing them onto the Enterprise platform created in EDR1. These essential requirements will reduce the number of systems our staff must access to perform their work and reduce the number of antiquated technology products that we must maintain.

And now Jennifer will present our procurement timeline.

MS. ROUSSEL: The procurement of a project of
this size has been no small task. We have been busy on
the procurement for EDR2 since 2016. In 2016, we kicked
off the procurement process by starting our initial
project planning.

And in 2017, we submitted a request for
information to the vendor community so we could get
their ideas and the input on possible solutions to our
strategic business problems.

Then in 2018, we released the projected project
dates to ensure vendors will be aware of important
upcoming deadlines, and we also started the development
of our requests for proposal, which is also known as an
"RFP."

In 2019, we conducted a two-day vendor workshop
to share information about FTB. This was so the vendors
could better understand our current business environment
and technical infrastructure that supports our mission
and goals. We gave the vendors an opportunity to submit
feedback to us on our pre-solicitation draft RFP. We
considered their feedback, and we released the final
EDR2 RFP in April of 2019.

Also in 2019, we identified qualified business
partners, known as "QBPs." The QBPs were invited to
submit conceptual and draft proposals. We evaluated
these proposals and met with them to provide critical
input to help them refine their proposals. We also used the information to help us refine our RFP.

Finally, in 2020, we received the final proposals from the QBPs, and we met with the vendors to provide additional clarification and information regarding the current business environment and technical infrastructure in place at FTB. This was done to ensure that the best and final offers would help support our mission, our organizational goals, and the taxpayers of California.

Throughout this entire process, we have been working closely with our oversight teams, including the California Department of Technology and the Department of Finance. This was to ensure we are meeting the requirements of the project approval life cycle process. This is a collaborative partnership where we work together on all aspects of the procurement and planning phases for the EDR2 project.

And we would like to say a very special thank you to CDT and DOF for partnering with us over the past five years. This partnership has ensured we have a comprehensive plan that includes appropriate oversight and support through the project-planning process and, ultimately, setting us up for success.

Currently, we are in the final stages of the
project approval and procurement process. And we are thrilled to say we have completed our selection process, and we have issued our notification of award to OnCore Consulting, LLC, as the lead business partner of the QBP team that includes CGI Technologies and Solutions Incorporated and Deloitte Consulting, LLP. And we're finishing up the procurement and project approval processes.

As you know, planning is critical for a project of this size. You will hear later today that FTB is requesting funding for Fiscal Year '21-'22 to get us started. We did want to share that the EDR2 is a fixed-cost contract where 30 percent of the payment of the vendor is based upon the State realizing benefits. As such, we expect the project to help increase compliance and bring in more revenue for the State.

As we mentioned earlier, we are on track to get all the necessary approvals to start the project this July. We estimate the project will last 66 months, or five and a half years. That is four and a half years to implement its solution and one year of warranty.

MR. ORZOCO: Thank you, Jennifer.

We learned some important lessons with EDR1 that we would like to incorporate into EDR2: We learned the importance of ensuring that we involve our security and
internal audit teams early in the project, to ensure the
solution will meet our compliance requirement and our
security requirements; and ensuring that our -- that we
document our business processes and maintain the
documentations as change occurs; finally, ensuring that
we begin organizational change management early in the
project to build Enterprise awareness and support.

As a result of these lessons learned, you will
hear later today that we are requesting funding to
support these critical areas of work.

To close our presentation, we would like to show
you a short, two-minute internal video that we use to
kick off our EDR2 communications within -- within FTB to
our staff last month. This video was produced before
the notification of award was issued to OnCore.

You may notice some similarities between our
presentation today and the video. After all, repetition
is critical in the organization's change management
process.

(Video presentation.)

MR. ORZOCO: Thank you for watching.

On behalf of the Franchise Tax Board, Jennifer
and I would like to thank you for your continued support
with this important project. This concludes our
presentation today.
Do you have any questions for us?

ACTING CHAIRPERSON STOWERS: Thank you.

Members, do you have any questions?

MEMBER VASQUEZ: Yes. Madam Chair, once again, I just wanted to thank staff, you know, for this great presentation, and I just have a couple of -- well, one, a comment, and then a question.

And, once again, you know, although we're updating, you know, this legacy system with new phone apps and website, you know, use and hopefully making it as user friendly as possible, I still worry about, you know, those folks that don't obviously have access to this. And then those that do, they may not have -- they might be novice like myself, especially when you get on some of these very sophisticated web pages.

And I was wondering if there's any way to maybe modify our web page so those commonly used pages that people would usually link up to could be kind of the launching pads -- kind of the go-to as we get into -- as they get into our website. And I was wondering if that's a possibility.

And I know you are just kind of working this thing through as we speak, but I would throw that out there.

MS. ROUSSEL: Yes, Member Vasquez. And very,
very good point.

FTB is always looking to try and make sure that our external-facing applications are as usable as possible for the folks that might have some challenges with it, as well as making sure that the information that we share and what's promoted, I would say, up to the web is the first contact for a taxpayer is something that folks use -- that people use on a continuous basis.

So I -- we will continue to keep that in mind as we move forward with the design of EDR2 so that we continue to provide the best service that we can to California.

MEMBER VASQUEZ: And along those lines, I'm wondering -- and you are probably doing this or at least thinking of doing this -- is, are you doing any kind of a testing in terms of the processes that we're using to kind of -- how it all fits into, like, the real-world scenarios, basically?

MS. ROUSSEL: Yes. Fantastic question.

So, actually, part of the resource request that you will hear from Jeanne and that we requested in the BCP includes business process management documentation, which is the first step of documenting our current processes and then looking at what we want there to be -- to be as part of the business process
reengineering that starts and happens during the project. So part of that will be looking at the user experience and the customer experience to ensure that we don't make them go through steps that they don't necessarily need to and that we make that a much -- fluid approach to providing them the information that they so definitely need.

MEMBER VASQUEZ: Great. Thank you. That's all I have.

ACTING CHAIRPERSON STOWERS: Any more questions from the members?

(No Response.)

ACTING CHAIRPERSON STOWERS: Thank you. Do we have any questions from the members of the public on the teleconference line?

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

(No response.)

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

Please continue.

ACTING CHAIRPERSON STOWERS: Thank you, sir.

We are now on Item Number 4, a PowerPoint
presentation on FTB Strategic Plan.

This item is presented by Allan Loucks and
Elias Dominguez. This is an informational item.

MR. LOUCKS: Well, good afternoon, Madam Chair,
Board Members, all attendees. It is nice to be here
with you today.

I am Allan Loucks from FTB's Planning, Project
Oversight, and Risk Management bureau. My cohort, Elias
Dominguez, will be briefing you shortly on the marketing
plans for the new '21-'25 Strategic Plan. For now, I
wish to present to you a few of the many accomplishments
from the 2017 through 2020 Strategic Plan that supported
FTB and the taxpayers of California.

Our first goal, taxpayer centric services,
focused on enhancing our services to help taxpayers
fulfill their tax obligations. There are two specific
successes that today increase that ability for taxpayers
to more easily fulfill their tax obligations.

The first, mobile application, was a project that
now allows customers to make real-time payments and
utilize text messaging via mobile application. And the
second, self-service options, was a project that
developed self-service options via FTB's public website,
again in real-time, as well as provides for interactive
voice responses that allow taxpayers to initiate
installment agreements for skipping payments and bill payment delays.

Our second goal, effective compliance, focused on fairly administering the law to ensure taxpayers filed and paid the correct amount. There are two specific successes again that today increase the ability for California taxpayers to become and remain compliant.

The first, EDD partnership, is a partnership between FTB and the Employment Development Department with the goal of providing timely refunds to wage-earning taxpayers and ensuring that the returns are processed accurately. This effort also includes developing partnerships with the payroll industry. That is, those who provide payroll services to employers and employees.

And the second, bringing taxpayers into compliance, was an effort that enabled FTB the ability to identify segments of noncompliant taxpayers and develop potential strategies to continue to identify methods to bring those taxpayers into compliance with the least burden and cost to both the taxpayer and the State of California.

Our third goal, strong organization, focused on investing in our employees, challenging and empowering them to be experts in their field, and also to help them
achieve their full potential. There, again, are two specific successes that today fulfill the best outcome for the department and its valuable employees.

The first, knowledge transfer, this focuses on identifying critical knowledge throughout FTB toward the prioritization of knowledge transfer. In other words, FTB wants to ensure that the transfer experience and the ability for FTB and its employees to continue to support the mission is seamless, smooth, and transparent. The implementation of the new LEARN platform also adds a component to knowledge transfer for a structured online and collaborative tool for employees and managers to use in planning and monitoring career development.

Then there's the second, the Analyst Development Program. This is a program which focuses on the development of analytical competencies for current Franchise Tax Board analysts and for those who are interested in becoming analysts. Primarily, the program now provides an opportunity for FTB employees to develop analytical skills. And there is now a full and robust website for this program that provides information and resources.

And our fourth goal, operational excellence, focused on optimizing FTB's processes, products, and resources to better serve our customers. There, again,
are two specific successes that display the strides that
FTB has made in enhancing its operations.

The first, electronic liens and releases, is a
government-to-government partnership connecting FTB to
several counties and which provides the ability to
submit liens and releases electronically via a new web
portal.

Second, the user behavior analytics tool, focuses
on the implementation of a program that allows for early
detection of threats and any misuse of FTB's information
systems. This tool provides more accurate intelligence
and threat identification to greatly reduce the impact
of a security incident.

So in addition to the accomplishments I just
mentioned, we also have several partnership, community,
and outreach efforts that have taken place. These
efforts have been a centerpiece for FTB, with the
department striving to make a difference by aiding
others in our community and in government.

Among the many efforts, there are two, again, in
particular that should be mentioned:

The first, the California Earned Income Tax
Credit. FTB continues to reach out to taxpayers who are
eligible for EITC, which provides needed funds to
Californians. FTB also partners with the California
Department of Community Services and Development to provide grants for promotion of EITC.

And the second, Assisting the Employment Development Department. FTB is partnering with EDD, having already loaned over a hundred employees to help address ongoing and essential critical work and backlogs as a result of the COVID 19 state of emergency. This essential work includes employment claims processing, mail operations, call center assistance, and human resources and information technology support.

So what I have presented to you is a wrap-up of the 2017-'20 Strategic Plan. These that I have highlighted were just a few of the many successful accomplishments during the past four years. As you have seen, FTB is continuing to make great strides in its many projects and community efforts.

Thank you so much, Madam Chair, Board Members, and attendees for your time. And I will now pass you to my cohort Elias Dominguez, who will speak to you about the rolling out -- excuse me -- of the new '21-'25 Strategic Plan.

MR. DOMINGUEZ: Thank you, Allan.

Good afternoon, Madam Chair and Board Members. And thank you for allowing me to present our marketing plans for the new 2021-'25 Strategic Plan.
So last September, we presented to the Board the draft of the new strategic plan. And since that day, we have completed the necessary touches to the plan, and I'm glad to inform you that it has now been finalized and published.

As we considered our current environment and trends, we've worked through our action committees, governance council, senior management, and bureau directors to solidify our mission and goals that support FTB's strategics.

With the mixture of employees working from home and some in the office, the emphasis of our rollout this year was to ensure it was inclusive of our entire workforce. We used our in-house design team, photographers, and our employees to capture our culture, our diversity, and our collaborative work environment. We approached this rollout with the intent not just to market it but to educate all staff and raise awareness about our plan, no matter where the workplace might be.

Now, over the next several months of this rollout, our expectation is to educate everyone on the value that they have and the role they play in FTB's future. We will be engaging our staff with different activities and challenges related to the plan in order to keep them involved and informed about our goals. We
also want our staff to recognize how their individual
and program area efforts contribute to the success of
our strategic plan.

The plan is now available on our public website,
and an article was posted on our intranet with a link to
a strategic plan kickoff video, which we produced
in-house, featuring our very own Selvi Stanislaus.

Now, moving forward, our plan is to promote one
goal each quarter. We will be creating posters and
fliers that will highlight each of our four goals to be
displayed across the FTB campus, as well as our field
offices. We will also be posting one article per
quarter to our intranet site throughout this year,
starting this month. Each article will highlight one of
the four strategic plan goals, and the articles will be
written with the intent of connecting the language with
the actual work that our staff does so that they can see
their work manifested in the plan.

And as we have done in the past, we will
implement tools in order to measure staff awareness of
our plan, and we will use these results to make
necessary improvements and adjustment to our rollout.

Now, lastly, throughout the course of the
rollout, we plan to publish articles that highlight some
of our accomplishments tied back to the strategic plan.
The articles will be posted on our intranet site, in the news section, on the front page.

So with that, I want to thank you all so much, Madam Chair and Members. It's been a pleasure presenting to you today. And if you have any questions or comments, we would be glad to answer them now.

ACTING CHAIRPERSON STOWERS: Thank you, Mr. Loucks, Mr. Dominguez.

Members, do you have any questions at this time or comments?

MEMBER VASQUEZ: Yes. Just -- and, actually, mine is more of a comment than a question. But, you know, thanks again. It was a great presentation. And it's great to hear that, strategically, it looks like we're moving forward with some very exciting and innovative new ways to get, you know, our services out there.

But I was just wondering -- and, once again, just more emphasizing, again, which I said earlier, about just the access point, you know, with these new phone apps and self-service options, you know, that the elderly -- that we're constantly thinking about the elderly and their limited resources and access to, especially web-based, services.

But other than that, you know, I think it was...
great.

MR. DOMINGUEZ: Thank you.

MEMBER VAZQUEZ: Thank you.

MR. LOUCKS: Thank you, Member Vasquez.

ACTING CHAIRPERSON STOWERS: Thank you.

Is there any member of the public wishing to speak on this item from our teleconference line?

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

(No response.)

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

Please continue.

ACTING CHAIRPERSON STOWERS: Thank you.

PHONE MODERATOR: Thank you.

ACTING CHAIRPERSON STOWERS: We are now at Item 5. It's a presentation of Audit Pathways to Excellence. This is a PowerPoint presentation presented by Sucharita Pal and Fernando Castro.

Please move forward.

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

My name is Sucharita Pal. Presenting with me
today is my colleague Fernando Castro. As members of
the Audit Division, we are placed to present to you an
overview of our newly launched Pathways to Excellence
Portal. One of our Audit Division's core priorities is
to invest in its staff via training, developing, and
engaging them.

One method the division adopted to address this
priority was to follow the Pathways model that is
increasingly being used by high schools, colleges, and
businesses for increasing knowledge and abilities.

An Audit Pathway is an integrated
cross-functional sequence of experiences, partnerships,
and courses designed for staff to achieve proficiency in
a particular area of tax law.

Research has shown that individuals obtain
70 percent of their knowledge from job-related learning,
20 percent through collaboration, and 10 percent from
classroom learning.

The 37 different technical paths of audit issues
currently available on the Pathways Portal promote
technical learning through a combination of coursework,
experiences, and collaborative opportunities. These
paths act as a bridge between starting as a new hire to
achieving expert proficiency. We applied best practices
for curriculum development and consulted with staff and
managers extensively to assess their needs prior to building these paths. The Pathways Portal also houses a compilation of learning tools and available training resources in one location. Staff have the flexibility to pursue any number of paths throughout their career.

The portal serves multiple audit programs and workloads and brings numerous resources into one place. It is designed with one-stop shopping in mind and will function as a useful reference tool for the entire FTB organization.

We will first discuss the portal area, which houses information related to technical learning. FTB audits tax returns of corporations, pass-through entities, and individuals. Staff can follow the NBA icon to view National Business Audit paths related to the audit of corporations. Alternatively, selecting the IPTE icon directs users to the individual and pass-through entity information.

For the convenience of users, both NBA and IPTE sections follow a similar path-mapping structure and design. Additionally, each area has a foundational knowledge path, which consists of fundamental information all audit staff should acquire to conduct day-to-day office and audit-related operations.

The technical information is organized
sequentially to guide users through preliminary understanding to advanced learning of concepts. The user-friendly portal also provides easy access to important departmental resources through Enterprise and Divisional Connections icons.

Knowledge areas on the portal house a compilation of paths for common audit issues applicable to a particular type of audit workload. The blue interstate icons in the knowledge area represent these issue paths. Each issue path has four supporting pages of which the first one, the landing page, can be accessed from these icons.

The landing page provides a brief explanation of the technical issue. It also provides links to the three resource pages: Knowledge Path, Tool Box, and Technical Training. Each issue path landing page also includes a table of recommended knowledge, which are prerequisite paths for understanding the current issue, and related knowledge, which are other technical paths closely associated with the issue. This allows our staff to adopt a holistic approach when learning an issue.

Thank you, Madam Chair and Board Members for your time. And now I will hand it over to Fernando to walk you through these pages and the rest of the
MR. CASTRO: Thank you, Sucharita. And thank you, Madam Chair and Board Members, for this opportunity to share.

The first resource page is the Knowledge Path. A knowledge path is an outline of the technical issue with subtopics, organized by different levels. These are arranged into a numbered series corresponding to the complexity of the subtopic. 100 is for preliminary understanding, 200 for intermediate, and 300 for advanced level.

Buttons are bookmarked to direct staff to the appropriate level in the outline. Staff can use the outline to guide their knowledge development in an issue over time, eventually reaching expert proficiency.

The Tool Box is a centralized location for legal authority and guidance related to the technical issue. This includes state and federal authority, FTB legal and audit guidance, as well as available judicial guidance. Navigation bookmarks at the top of the page take the user to the different sections within that page.

The technical training page is organized similar to the Tool Box and includes various learning resources. These include in-house training, informative news articles, and details about external training related to
the technical issue, compiled into one convenient location. This page is a good place to start for anyone interested in learning a new issue.

Lastly, the experiences matrix provides outlines and resources for professional development of staff through on-the-job learning and collaboration with others. On-the-job learning includes paths for audit-related skills, professional skill sets, and personal development. You will find suggested soft skills development tools organized into an outline format with corresponding resources. The matrix also includes ideas on how to improve collaboration and project skill sets.

Auditor skill expectations evolve over time with the workload and career responsibilities. Therefore, these experience paths have progressive design similar to the knowledge path we have already discussed. An auditor can continue sharpening their professional skills as needed over time. This completes a general overview of the Pathways to Excellence portal.

Currently, our team has established a maintenance plan to ensure that the information contained in this portal is always current and accurate. We continue to work with FTB's accessibility team to ensure the portal meets the accessibility requirements of the department.
and the State.

We remain committed to building additional paths for the various audit areas. The ultimate goal for this portal is to ensure this remains a robust resource for the department and an effective tool for the long-term development of Audit Division staff.

We thank you for your time and allowing us to present to you today. We're happy to answer any questions you might have.

ACTING CHAIRPERSON STOWERS: Thank you.

Members, do you have any comments or questions at this time?

MEMBER VASQUEZ: Yes. Just -- actually, I have a comment, then just a quick question. And my comment, first, you know, is I want to thank you for the presentation, and I recognize the importance of a professionally competent workforce to address future challenges. Right? I appreciate FTB's efforts in especially addressing the looming retirement wave by investing in their workforce to mitigate the loss of experience and knowledgeable staff.

And with that in mind, my question is, can you talk more about FTB's succession planning and training staff to be leaders, mentors, and trainers, to ensure that we can immediately fill these high-level, technical
positions that will be left open by experienced and
highly technical employees who leave the agency due to
retirement?

MS. PAL: One of -- thank you, Member Vasquez, for the question.

Yes. FTB is very aware of this requirement, or of the "Silver Tsunami," as we speak, and is very much focused on developing its staff. And as one of those tools, we have created the Pathways Portal, which is being built with the help of all our experienced staff, who are contributing to the information into this portal. So that's one of the ways.

But we do have a variety of training programs in place. We have various workshops that take place within FTB for our staff. So we are constantly in the process of doing job knowledge transfer.

So, absolutely, you are right. And this is one of the things we are very focused on, to make sure that as staff retire, our -- our current staff will be able to step into their shoes.

MR. CASTRO: Also to support the succession planning is we're making sure to continuous -- continuously put effort into recruitment programs to reach out to new staff to join Franchise Tax Board and hopefully keep that influx of fresh auditors coming in
to support the staff as they move on, into retirement.

MEMBER VASQUEZ: Yeah, I think that was key. I was just thinking that's probably key, to try to get as many in now so we can take advantage of that wealth of knowledge that you have right now.

And I see that, you know, throughout the state, you know, that -- with just different departments and organizations, you know, that they are getting hit real hard with, you know, all these incentives to retire early, but we're losing -- you know, it's kind of like a brain drain on a lot of corporations and government agencies.

Thank you. Thank you for doing your job. And hopefully it's a smooth transition as we get the new generation in.

MR. CASTRO: We hope so. Thank you, Member.

MS. PAL: We hope so. Thank you, everyone.

ACTING CHAIRPERSON STOWERS: Thank you.

I actually have a couple of comments or questions.

The first question is, can any audit person tap into the portal, or must you be working that? So must you be in a pass-through entity to study pass-through entity, or could you be in multistate and decide you just want to learn something else?
MS. PAL: Yes. The way it is designed is anybody within Audit and Legal, as of now, can tap into absolutely any page into the portal. Our plan is, eventually, to open it to the rest of FTB as well so that anybody from collections or wherever, any other department, who wants to know about a particular tax issue or a court case that exists and they can find where it is, they will be able to access that.

So since it's still very new and -- we are still building some paths along the way, so we haven't opened it to the rest of the department. But all of Audit and all of Legal already have access to this portal -- to all of the portal.

ACTING CHAIRPERSON STOWERS: Perfect.

Then my other question is, kind of leading up to that is, I know in the past, FTB has included some of their training material on the website for the public. Is the goal to include this pathway available to the public as well?

MS. PAL: Currently, of course, it's not available. But FTB is building an Enterprise Knowledge Library -- I'm not exactly sure of the timeline of that -- and all our manuals, procedure, guidelines, quite a bit of our training material, including Pathways, will move into that library.
And then some of it will be accessible to the members of the public as well. We don't know which ones, but the appropriate ones will be accessible. But that will go through all the procedures of deciding what will be actually available. But that's the plan, yes.

ACTING CHAIRPERSON STOWERS: Perfect. Thank you.

Well, let's see if we have any member of the public wishing to speak on this item from our teleconference line.

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

(No response.)

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

Please continue.

ACTING CHAIRPERSON STOWERS: Thank you.

We're now moving on to Item 6, Regulation Matters.

We have Hanna Cho to present a proposed section 25137, Alternative Apportion Method Petition Regulation.

This is an action item, Members.

MS. CHO: Thank you. And good afternoon, Madam Chair and Members of the Board.
My name is Hanna Cho, and I'm an attorney in the Legal Division.

We are seeking the Board's permission to proceed with the formal regulatory process to amend California Code of Regulations Title 18, section 25137, subsection (d). I will briefly discuss why there is a need for the regulation, what the regulation does, and our process of working with the public in developing the regulation.

As background, Revenue and Taxation Code section 25137 permits a taxpayer to petition the FTB itself for the use of an alternative apportionment method if the standard allocation and apportionment provisions do not fairly reflect the extent of a taxpayer's business activity in California, such as the petition you will consider later today during the petition hearing.

Regulation 25137(d) currently provides that in cases deemed appropriate, the FTB may elect to hear and decide petitions filed pursuant to section 25137 and that consideration of said petitions will be heard in open session at a regularly scheduled meeting.

Other than the guidance set forth in the current regulation language and in FTB Resolutions 2000-10 and 2017-01, there is no other formal guidance as to how...
petitions to the FTB itself should be filed pursuant to
section 25137 and how such petitions will be considered
by the FTB itself.

The reason for the proposed amendments is to
provide procedural guidance to practitioners and the
taxpayer community for filing petitions to the FTB
itself pursuant to section 25137 and to provide guidance
for ex parte communications, which are intended to be
consistent with the aforementioned FTB resolution.

The six major proposed amendments include:

One, the modification of subsection (d) to
streamline the subject matter and to become an
introductory paragraph to the procedural amendments that
follow it;

Two, the addition of definitions of key terms
used throughout subsection (d) of the regulation;

Three, the additions of procedures, conditions,
and deadlines related to filing a petition to the FTB
itself, pursuant to section 25137;

Four, the addition of procedures related to
hearings on petitions to the FTB itself filed pursuant
to section 25137;

Five, the addition of the ex parte communication
rule and the procedures related to it;

And, six, the addition of the applicability date
of the proposed amendment.

There have been four interested parties meetings held on this regulation project. The purpose of the IPMs were to elicit public input regarding the potential amendments to the regulation. The feedback received from practitioners and the taxpayer community led to four iterations of the proposed regulation language.

In addition, following public comments received at the fourth IPM, staff determined that the filing of a section 25137 petition would not be deemed an administrative remedy that would be required to be exhausted before a taxpayer could seek further administrative or judicial relief.

The latest draft of the proposed regulatory language was posted, along with the 20-day notice, on the FTB regulatory activity page on December 29, 2020. Following this last public posting, in response to a comment made by interested parties, staff made one non-substantive change to improve clarity with respect to the proposed amendment by replacing the word "within" to "by the later of" in subsection (d)(2)(B).

These changes, as well as all of the proposed amendments, are reflected in the documents provided in your materials. Again, we request the Board's permission to proceed with the formal regulatory process.
to amend Regulation 25137.

Thank you. And, at this time, I am happy to answer any questions you may have.

ACTING CHAIRPERSON STOWERS: Thank you.

Members, do you have any comments or questions at this time?

(No response.)

ACTING CHAIRPERSON STOWERS: I just want to restate what you said: That staff has determined that filing a petition before the Board would not be required or would not be deemed to be required to exhaust all of your administrative remedies?

MS. CHO: Yes.

ACTING CHAIRPERSON STOWERS: Could you just state that one more time for the record, please.

MS. CHO: Yes.

Staff has determined filings of section 25137 petitions will not be deemed an administrative remedy that is required to be exhausted before seeking further administrative or judicial relief.

ACTING CHAIRPERSON STOWERS: Thank you.

 Appreciate that.

MS. CHO: Of course.

ACTING CHAIRPERSON STOWERS: If there's no comments from members, let's see if we have any comments
from the public wishing to speak on this item from the teleconference line.

PHONE MODERATOR: Yes. And we do have a question from the line, a Ben Lee.

Your line is open.

MR. LEE: Thank you. Good afternoon, Madam Chair and Members of Board.

My name is Ben Lee, and I am tax counsel for the California Taxpayers Association. The California Taxpayers Association thanks the Franchise Tax Board and their staff for all their hard work on this regulatory project. However, we would like to reiterate our concern that the proposal, as currently written, does not properly address issues surrounding the protection of confidential taxpayer information, as we mentioned during previous IPMs on this topic.

We look forward to continuing to work with the agency and staff on this issue as it keeps moving -- sorry -- through the regulatory process and would like to once again thank the Franchise Tax Board for considering our comments.

ACTING CHAIRPERSON STOWERS: Thank you, Mr. Lee. Any more public comments?

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

   (No response.)

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

   Please continue.

ACTING CHAIRPERSON STOWERS: Thank you, sir.

Members, do we have a motion on this item?

MEMBER VASQUEZ: Madam Chair, before I move it, I
just had a quick question for Ms. Cho, if she's still on
the line there.

ACTING CHAIRPERSON STOWERS: Go right ahead.

MEMBER VASQUEZ: And it's just in regards to the
testimony we heard from Ben -- I guess it was Ben Lee
from the Tax Cal group on the confidentiality issue. I
just wondered if she had a comment on that or a
response.

MS. CHO: Regarding confidentiality, yes, of
course taxpayers' concern regarding confidentiality and
the protection of proprietary information is very
important to us. This regulation, however, is intended
to provide procedural guidance for the filings of
petitions under 25137 and for related ex parte
communications. It is not intended to address every
circumstance covered under Bagley-Keene. And this is
consistent with the board resolutions.

MEMBER VASQUEZ: Thank you.

With that, Madam Chair, I will move the staff recommendation.

ACTING CHAIRPERSON STOWERS: Is there a second?

MEMBER ASMUNDSON: Second.

ACTING CHAIRPERSON STOWERS: With there being a motion and a second to move staff recommendation, without objection, the motion passes.

We are now on to Item 7, Administrative Matters.

First, we have Jeanne Harriman and Thi Luong presenting 2021-'22 Spring Finance Letters for Board approval. Then we have Michael presenting contracts over $1 million for Board approval.

MS. HARRIMAN: Good afternoon and hello. My name is Jeanne Harriman, Chief Financial Officer for the Franchise Tax Board.

As noted today, Thi Luong and I will be presenting four Spring Finance Letter proposals for your approval. I will be discussing the first two, and Thi will present the remainder, all are resource requests necessary for the '21-'22 fiscal year.

The first Spring Finance Letter proposal relates to resources requested to support the first year of the EDR2 project, which you heard about in an earlier
presentation.

The resources requested in the Spring Finance Letter are in addition to those requested in the budget change proposal that your board approved in September, which was incorporated into the January budget.

Now that the procurement phase is wrapping up, this Spring Finance Letter reconciles any additional resources needed for '21-'22 above those previously requested. This proposal asks for $32.8 million in additional funding, including the funding for one additional permanent position, the remainder being relevant and covering the compensation costs due to the vendor.

As noted before, EDR2 is scheduled to start July 1st of 2021 and will ensure that FTB is able to replace critical compliance systems, as well as implement new enhancements to our operations and customer service channels.

Similar to the budget change proposal, this request only notes resources needed for this particular fiscal year. As required with most large projects, a BCP is necessary for each year to request additional resources needed. Please refer to the body of the request to understand if the requested resources are for permanent or an ongoing need or for a limited term in
Compensation amounts will be requested annually. These resources requested will ensure that FTB has the appropriate level of resources for a successful first year of the EDR2 project.

The second proposal presented for your approval is a capital outlay budget change proposal allowing FTB to upgrade our data center. This proposal requests a total cost of $20.3 million over three fiscal years. This project will upgrade FTB's critical infrastructure at its Central Office Campus, to address a series of modifications and upgrades designed to improve our data center operations, reliability, and energy efficiencies.

FTB data center is a 24-by-7 operation, 365 days a year. It houses FTB's critical IT infrastructure necessary for FTB to provide critical services to California. As a result of that, FTB's return and payment processing services have a goal of zero downtime because they are utilized by California taxpayers throughout the year and almost 6,000 FTB staff in processing 21 million returns, 14 million payments, along with all of FTB's compliance and customer service functions.

This proposal will allow FTB to address the following key issues: FTB will be able to meet required
energy efficiency mandates; we will eliminate single
points of failure in our operations, thus avoiding
unnecessary operational impacts in the event of an
issue; it will ensure that equipment is supported by
current industry standards and vendor support is
available in the event of an emergency; it will also
ensure that FTB and our relevant partners, such as DGS,
can perform routine maintenance without operational
impacts.

Thank you for your time today. At this time, I
will refer to Thi to provide you additional information
on the remaining two proposals.

MS. LUONG: Thank you, Jeanne.

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

Our third proposal is for the augmentation of
$2 million to FTB's litigation budget with the Attorney
General's Office, beginning with Fiscal Year '21-'22 and
ongoing in order to defend against tax refund lawsuits.
FTB has continued to see increased litigation efforts
with their complex tax matters. This augmentation will
ensure that we can adequately protect the state's
interests in these casings.

The final proposal is to increase the spending
authority for the asset forfeiture account from $150,000 to $740,000, beginning with Fiscal Year '21-'22 and annually thereafter.

FTB's Criminal Investigation Bureau would use these funds for costs associated with criminal investigation law enforcement activities such as additional training and equipment.

At this time, we would like to ask for your approval and would be happy to answer any questions that you may have.

ACTING CHAIRPERSON STOWERS: Thank you.

Members, do you have any comments or questions?

MEMBER VASQUEZ: Just a quick -- more of a procedural question, Madam Chair.

So right now we're just going to take up 7A1, 7A2, and I guess 7A3, and then the fourth one we will do after, right? Is that how it works?

ACTING CHAIRPERSON STOWERS: Yes.

MEMBER VASQUEZ: Okay. Because I am good with the 1, 2, and 3.

ACTING CHAIRPERSON STOWERS: Okay.

MEMBER VASQUEZ: And -- but I don't know if you need to open this up to the public or what before we move.

ACTING CHAIRPERSON STOWERS: I do.
MEMBER VASQUEZ: Okay.

ACTING CHAIRPERSON STOWERS: Okay. So you are saying you are good with 1, 2, and 3. But we're going to be taking up 1, 2, 3, and 4 after we open it up to the public. So let me open it up to the public first.

MEMBER VASQUEZ: Okay.

PHONE MODERATOR: We do have a --

ACTING CHAIRPERSON STOWERS: Is any member --

PHONE MODERATOR: -- question.

ACTING CHAIRPERSON STOWERS: -- on the public line wishing to speak on this item?

PHONE MODERATOR: I apologize. We do have a question from the line of Christine Grab.

Your line is open.

MS. GRAB: My name is Christine Grab, and I am an individual taxpayer.

In 2017, I asked Franchise Tax Board to end their unlawful practice of withholding estimated tax payments made via credit elect and to refund me the $15,000 in penalties that were fraudulently imposed as a result of this unlawful business practice.

FTB told me I would have to sue them. So I did. FTB has yet to deny in court that their withholding practices are unlawful. And in California Civil Code, failure to deny constitutes admission of truth.
FTB has unnecessarily run up the attorney costs in our pending litigation by refusing to provide documents that will prove once and for all whether FTB committed fraud. If FTB would have turned over these documents, we would -- we could have requested a summary judgment, and the case would be over by now.

I was forced to file a motion to compel, and we have an extra hearing scheduled in May. This case will likely drag on into 2022, and the lawyer fees will be sky-high by the time it is over.

I have already documented to the Board that FTB has several unlawful schemes in place to overcharge taxpayers. FTB is inviting lawsuits by systemically violating the law. FTB has testified that the $2 million in taxpayer funds will be used to make sure that FTB can continue committing these crimes against the same taxpayers that they are requesting the money from. This is unconscionable.

In the written request, FTB stated that it needs part of the $2 million to cover plaintiffs' attorneys' costs for cases that FTB knows it will ultimately lose. It is unconscionable that FTB is wasting taxpayer funds by deliberately running up litigation costs instead of settling. Instead of giving FTB more money, the Board should fix the root of the problem by ordering
a halt and desist on all of FTB's unlawful activities so
that all new lawsuits stop. The Board should order FTB
to stop unnecessarily running up costs in pending
litigation.

Board members, please remember that it is us
taxpayers who pay your salaries. Your loyalty lies in
protecting your constituents. I do not think it will
fare well for you.

MS. CASEY: Excuse me. Your time is up.

ACTING CHAIRPERSON STOWERS: Thank you, Ms. Grab.
We're moving on. We understand your comments, but your
time is up.

Do we have comments from anyone else from the
public?

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

(No response.)

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

Please continue.

ACTING CHAIRPERSON STOWERS: Thank you, sir.
Okay. So I would like to take a motion for this
item, and I am assuming that Ms. Asmundson will not be
participating?

MEMBER ASMUNDSON: I will be abstaining.

Thank you.

ACTING CHAIRPERSON STOWERS: Thank you.

So let's call for a motion on 7A1, Enterprise Data to Revenue, Phase 2; 7A2, Data Center Upgrades; 7A3, Increasing Litigation Costs.

MEMBER VASQUEZ: I will move staff recommendations on 7A1, 7A2, and 7A3.

ACTING CHAIRPERSON STOWERS: Thank you.

And I will second that motion.

And with abstaining from the Department of Finance, that motion passes 2/0.

The other item is 7A4, Asset Forfeiture Account Increase.

Mr. Vasquez, you expressed some concern with that one?

MEMBER VASQUEZ: Yes.

And I am comfortable with this, as I was reading through it and talking to staff, with the following condition: And that would be to put on record that there should be regular review of their performance measures on this so at least we are doing our due diligence about how and what is being spent, as well as how much we have increased our capacity in this category.
as a result of the newer technologies and additional training. It would be easier to justify future increases if the department decides to add on more resources would be my -- I would like to include that.

And with that, I would be able to move it.

ACTING CHAIRPERSON STOWERS: I would go ahead and second that motion.

Let me ask staff, do you guys already have something in place to evaluate the effectiveness of this fund or of this division?

MS. HARRIMAN: Hi. I will answer that question. Thank you for the question. And we are happy to work to provide information to you to ensure that you understand the extreme value of this program in and of itself and how they are expending these levels of funds. So we are happy to do that.

ACTING CHAIRPERSON STOWERS: Thank you.

With there being a motion from Mr. Vasquez, a second by myself, without any objections, the motion passes 2/0.

We would now move onto contracts over a million.

MR. BANUELOS: Good afternoon, Madam Chair and fellow Board Members. It's a pleasure to be here with you today. My name is Michael Banuelos, and I'm the director of the Franchise Tax Board Procurement Bureau.
And I'm here today to request approval for activities on two contracts over $1 million.

Our first request is related to the renewal of software maintenance on our suite of PEGA products. PEGA software is a core component of our Enterprise Data to Revenue Solution. PEGA is used for case management and workflow activities. PEGA is one of the critical components -- (audio malfunction; unintelligible).

Our existing maintenance agreement expires on June 30, 2021. We are planning a one-year agreement for approximately $1 million and we anticipate using the Department of General Services Software Licensing Program to conduct the procurement.

Our second request seeks approval to initiate a procurement for hardware and software support for IBML and iCapture products. IBML are the scanners used to scan paper tax returns and taxpayer correspondence, and iCapture is the software that is used to collect the data. These tools are part of our scanning solution that have allowed us to scan upwards of 70 million pages of documents a year and deposit billions of dollars into the State's bank accounts.

You may recall that at the December Board meeting, I requested and received approval to move forward with the procurement to replace our scanners.
We are moving forward with that effort. However, the replacement will take some time. In the meantime, in order to continue operations, it is critical that we continue to maintain our existing scanners.

Our existing agreement expires in June 2021. The estimated value of the new contract is approximately $1.4 million, and we are planning on conducting a competitive bid.

These are the two agreements I am presenting for your approval, and I would be happy to answer any questions you may have.

ACTING CHAIRPERSON STOWERS: Thank you, sir.

Members, any comments or questions?

MEMBER VASQUEZ: I'm good.

ACTING CHAIRPERSON STOWERS: Thank you.

Okay. Let's see if we have any questions from our teleconference line from the public.

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

(No response.)

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

Please continue.
ACTING CHAIRPERSON STOWERS: Thank you.

Members, do we have a motion for approval of the contracts?

MEMBER VASQUEZ: I move the staff recommendation on 7B1.

MEMBER ASMUNDSON: And I will second that.

ACTING CHAIRPERSON STOWERS: There's been a motion and a second for staff to approve the contract for 7B1.

Without any objection, that motion passes.

Members, do we have a motion on the contract for 7B2?

MEMBER VASQUEZ: So moved.

ACTING CHAIRPERSON STOWERS: There's been a motion by Member Vasquez. Is there a second?

MEMBER ASMUNDSON: I will second that.

ACTING CHAIRPERSON STOWERS: I second that motion.

Any objections?

(No response.)

ACTING CHAIRPERSON STOWERS: Okay. Motion by Mr. Vasquez, second by Ms. Stowers.

Without objection, the motion passes, 3/0. Okay.

MR. BANUELOS: Thank you for your time and support today.
ACTING CHAIRPERSON STOWERS: Thank you.

We're now on to Item 8, Executive Officer Time.

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

I want to start by thanking my FTB family for the great work they did to make last year successful and recognize the hard work they continue to do. I also want to thank our Board for their continued guidance and leadership, which has been so instrumental in navigating FTB through the many challenges this past year.

For my time today, I would like to share a few highlights that show a start to the 2021 filing season.

FTB began accepting e-file returns, CalFile returns, and web payments on January 4th, 2021, for the new tax year. We saw a surge in e-file returns once the IRS officially began -- began accepting returns on February 12th. This is preliminarily due to the use of software that relies heavily on federal tax return information as a starting point for taxpayers to e-file their California tax returns.

Even though we are getting a later start than the past year, as of last weekend, we have processed 4.2 million personal income tax returns, with 3.9 million of those having been e-filed, 3.1 million refunds, with an average refund of $998. Better still,
2.7 million refunds were deposited directly in the taxpayers' bank accounts. 1.7 million tax payments totaling $18.7 billion, with 55 percent were made electronically. Also, more than 936,000 California Earned Income Tax Credits have been issued for more than $184,000,000, and more than 147,000 taxpayers have claimed the Young Child Tax Credits, for a total value of over $135 million.

As we all know, last year, we postponed several tax deadlines to July 15, so we don't have a true comparison of this year versus last year's numbers. Nevertheless, we anticipate another successful filing season. Our peak filing season will continue for another eight weeks.

Also, our staff is trained and ready to handle the incoming volume so we can meet our customer service and process time frames.

So once again, I'm very, very proud of our employees and the work they continue to do, and I'm looking forward to this 2021 filing season.

Thank you, Board Members.

ACTING CHAIRPERSON STOWERS: Thank you.

Members, do you have any comments or questions?

MEMBER VASQUEZ: Just one. Congratulations to Selvi. I know you always go the extra mile and at least
in my time -- I guess I'm going on my second year with you -- several things that I have raised and concerns, you have been great in terms of jumping on it and really trying to resolve it as quick and as efficient as possible, and I really want to thank you for that.

EXECUTIVE OFFICER STANISLAUS: Thank you, Member.

MEMBER ASMUNDSON: I just wanted to add my thanks for the entire staff at FTB. Their professionalism and deep knowledge and willingness to go above and beyond every single day is really helping the state of California. So thank you.

EXECUTIVE OFFICER STANISLAUS: Thank you.

ACTING CHAIRPERSON STOWERS: Thank you, Members. Thank you, Selvi and your staff.

Is there any member of the public wishing to speak on this item from the teleconference line?

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

(No response.)

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

Please continue.

ACTING CHAIRPERSON STOWERS: Thank you. We are
now on to Item Number 9, which is Board Members' Time.

Members, are there any other items that you would like to bring forward during this time?

MEMBER VASQUEZ: Yes, Madam Chair.

I just had one, more of a follow-up, and I have been in conversation with staff and Selvi on this issue. And I just wanted to, once again, thank them for their response on some of my questions and more for just the public, though -- and you all probably have heard and seen some of the press that came out, I guess it was last month. And it's my understanding that some of that was -- you know, it goes back several years, maybe ten years old, but somehow it resurfaced in this investigative report that took place on -- I don't know if it was on Channel 2 or 5 or whatever, whatever media station grabbed it.

And I just wanted to get it out there and actually give staff the opportunity to answer some of those allegations, basically. Because it's my understanding that a lot of that has been dealt with, and they have put in some measures, hopefully, that will avoid some of those issues and problems, especially in contacting state employees moving forward.

So I just wanted to put that out there.

ACTING CHAIRPERSON STOWERS: Thank you, sir.
Are you aware of the issue, and are you prepared for a response?

EXECUTIVE OFFICER STANISLAUS: Yes. So we have Dan Tahara, who will be responding pretty soon.

Dan, are you up there now?

MR. TAHARA: Yes. Thank you, Selvi. And thank you, Board Members. I am Dan Tahara. I am the Public Information Officer here at the Public Affairs Office.

Regarding the inquiry that came up over the media over the last few weeks, you are correct, it was an issue that spanned back in 2017, and it is an issue that our Legal Division and our Collections Department all work together to find a solution on. So that issue was corrected.

But we do remain committed as a department as a whole to still look at our collections program and try to make improvements to make sure that we do collect the right amount of money from the right amount of people and reduce the number of errors that are occurring. So it is definitely a high priority for us.

MEMBER VASQUEZ: Yes. And I just wanted to thank you for that. I know I had conversation with staff, you know, right after it broke and wanted to, once again, commend our leader, Selvi, on that because, you know, you acted on it right away, and you got back to me and,
one, explained -- you know, like I think you mentioned earlier and in my conversations, that some of this stuff was, you know, three, four, maybe five years old.

And in terms of the current situation, you folks seemed to have turned the ship and are avoiding -- trying to minimize it. I know, you know, there's still that, you know, human error that possibly could happen down the road. But I believe it will be, hopefully, very far and few moving forward.

Thank you.

MR. TAHARA: Thank you.

ACTING CHAIRPERSON STOWERS: Thank you, Member Vasquez.

Let's see if there's any member of the public wishing to speak on the item from the teleconference line.

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

(No response.)

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

Please continue.

ACTING CHAIRPERSON STOWERS: Thank you, sir. I'm
going to reserve Board Member Time for Controller Yee till after our recess, which means this is a perfect time for a recess.

I am showing 3:05 by my clock. We will take a ten-minute recess and return at 3:15.

Okay. We are in recess.

(Break taken in proceedings: 3:05 p.m. to 3:17 p.m.)

CHAIRPERSON YEE: Good afternoon, everyone. I'm Betty Yee.

We will reconvene the Franchise Tax Board meeting.

I know that we ended at Agenda Item 9, but at this time, let us move to Agenda Item 10. And this is a section 25137 petition to the Board by Smithfield Package Meats Corporation.

Appearing on behalf of Smithfield Packaged Meats Corporation is Ben Muilenburg -- and I believe he's on the phone and not on camera; is that correct? -- as well as Derick Brannan from PricewaterhouseCoopers and Mr. Brady Stewart from Smithfield. Appearing on behalf of the Franchise Tax Board staff will be Kathy Shin and Laurie McElhatton.

Petitioner Smithfield Packaged Meats Corporation has 30 minutes to make its presentation. Following
that, Franchise Tax Board staff will have 30 minutes to respond. And then Petitioner will then have 15 minutes for a rebuttal.

Mr. Muilenburg, I believe you are presenting, and you may proceed.

MR. MUILENBURG: Can everyone hear me now?

CHAIRPERSON YEE: Yes, we can hear you.

MR. MUILENBURG: Okay. I apologize. I'm having some sound issues on my computer.

I appreciate it. Thank you, Madam Chair, and Honorable Members of the Board.

My name is Ben Muilenburg. I'm with PwC here in Sacramento, California. I'm joined today by my colleague, Mr. Derick Brannan, also with PwC in Sacramento. Collectively, Mr. Brannan and I represent the taxpayer in these proceedings, Smithfield Foods.

We are also joined today by Mr. Brady Stewart. Mr. Stewart is the chief manufacturing officer of Smithfield Foods, and he is here in a fact witness capacity and, you know, here to provide some background on Smithfield Foods' business operations, as well as answer any questions that the board members may have.

Are we getting an echo or anything, or am I okay?

CHAIRPERSON YEE: You are doing fine.

MR. MUILENBURG: Okay. Thanks.
So before I turn it over to Mr. Brannan and Mr. Stewart to go through our case in chief, I wanted to just take a second to -- you know, to accurately state, sort of, the reason for these proceedings today and narrowly focus kind of what our request is of your board.

You know, we're asking the Franchise Tax Board to exercise its sole authority to grant Smithfield Foods' request to use an alternative apportionment methodology in determining the amount of income attributable to California during the 2014 to 2017 taxable years.

So inherent in that very limited, narrow ask is precisely what we're not requesting. We're not asking your board to reach a legal conclusion that would have broader application to the taxpayer community as a whole.

Similarly, we're not asking your board to overrule any of the legal conclusions derived by Franchise Tax Board staff in this specific case, with this taxpayer, and in these taxable years.

So understanding the scope of a 25137 petition, that is precisely why we're here; we're asking you to look -- you know, to take a careful listen to the facts that we present and make a determination in your sole authority, right, whether the application of the
standard apportionment factor in this specific case, to
this specific taxpayer, these specific facts, these
specific taxable years, results in, you know, a fair
apportionment of business income to the State of
California.

In the event that you agree that it does not, we
want to remind you that you have the authority under
California law to remedy this unfairness by invoking a
key statutory failsafe provision in California law.

Once again, you know, we appreciate your time and
attention today, and I want to thank you and everyone at
the FTB. And really quick, before I pass it along, I
want to thank you, Board Members, and your staff as well
for facilitating this today. I know this wasn't ideal.
We were hoping to be in person with everyone, and we
really appreciate all the efforts that were made to get
to that point.

In addition, I want to extend that thanks to
Ms. Brunett and her staff and the Chief Counsel's office
for keeping us apprised of updates on that issue. I
really appreciate that.

And then, finally, I want to acknowledge
Mr. Daryl Lee and the technology team for -- even
despite my questions right now -- for helping us get --
so thank you for everyone involved.
And, you know, with that, I will turn it over to Mr. Brannan to begin our presentation.

MR. BRANNAN: Thank you, Ben. And I'm going to make sure everybody can hear me okay too. So far, I haven't had any issues. I'm crossing my fingers as we go.

Good afternoon, Controller Yee and Board Members. Very much appreciate your time this afternoon, and it's time to jump right in.

If we can go to slide 2, please, I would appreciate it.

You know, what we're starting with here is the statute, section 25137. And the case, at the end of the day, it's about the facts and it's about this statute. The whole discussion should focus on this statute. We are going to refer back to it again and again, and that's why we start with it here today. And you can see in the -- called to question is, do the standard apportionment provisions fairly represent Taxpayer's business activity? And, if so, Taxpayer gets to petition the Franchise Tax Board for an alternative remedy. And then, you know, examples of those remedies are listed.

So we're going to parse this out a little bit as we go through this hearing, but I think the real point
in starting with the statute is to say this is the
authority. This is the authority that Mr. Muilenburg
referred to in his introduction, and it's the authority
that we're going to ask you to invoke at the end of the
hearing today.

So if we can go to slide 3, please.

Smithfield's position is very straightforward.
Under the standard single-sales factor apportionment
formula, Smithfield's out-of-state activities,
specifically the manufacturing and production
activities, are ignored under the standard formula
today. But as a result, the formula overstates the
impact to the California marketplace and does not fairly
represent Smithfield's business activities in California
for apportionment purposes.

It's really that straightforward. We have a lot
of things to talk about and maybe to provide greater
context, but at the end of the day, absent
representation of those manufacturing activities, the
standard apportionment formula is not fair.

As you will hear from Mr. Stewart, Smithfield's
out-of-state manufacturing activities directly
contribute to the income subject to tax by the state.
And it's because of that contribution of in the income
that those activities should be represented in the
apportionment formula here in California. Otherwise, we're taxing -- we're imposing a tax on income on factors that do not reflect the entire business for Smithfield.

So let's talk a little bit about the facts.

If we could go to slide 4, please.

What you have here is a very, very high-level description of the pork industry. And this is not from Smithfield. It's from one of the academic authors that covers the industry. And I'm going to repeat it because in drives Smithfield's business; it describes what they do.

Profit margins in hog farming are tantalizingly small, but narrow advantages multiplied over large volumes of hogs translate into potentially decisive competitive advantages.

This is about manufacturing advantages. That's what they are talking about. Smithfield is the world's largest pork processor and hog producer. Consistent with the nature of the hog farming business, Smithfield creates these small, narrow advantages through its manufacturing and production operations. And that's why those factors are important for purposes of the apportionment formula.

For the years under the consideration, on
average, 99 percent of the property and payroll responsible for these advantages resided outside of California.

In order to fully appreciate how or why our proposal is fair, it's also important to understand how Smithfield does business. And in order to do that, we have asked Mr. Brady Stewart to make himself available for the board members today. And, you know, we'll go ahead and see if we can get him on screen right now. I think he might already be on. And I'm going to start asking him some questions.

Mr. Stewart, could you confirm that you can hear me and see everything, please?

MR. STEWART: Yes, good afternoon.

MR. BRANNAN: Perfect. Thank you, Mr. Stewart.

You know, for purposes of the testimony you are about to give, could you please provide a little background on yourself, your education, and professional background?

MR. STEWART: Sure. Thank you, Derick.

I grew up on a small family farm in Iowa. I attended school at Iowa State University, where I got an undergraduate degree in Agricultural Systems Technology with an emphasis on Agricultural Business and then furthered my education at Michigan State University with
a Master's of Science in Leadership and Management.

My first 18 years of my career has all been in
the meat business, whether it be for Smithfield or for a
previous company that Smithfield ended up buying. And,
currently, I serve as the chief manufacturing officer
for Smithfield, where I am essentially responsible for
the execution of strategy and the management operations
for the Indiana supply chain for Smithfield Foods.

MR. BRANNAN: Thank you very much, Brady.

And I'm going to ask if we could move to slide 5,
which you will see, Controller Yee and Board Members, is
just, obviously, a very high-level outline of what
Mr. Stewart is going to speak to.

The years before the Board for consideration are
really 2014 to 2017, and I'm going to ask you to kind of
focus your testimony there and -- (background noise;
unintelligible) -- maybe just point that out.

Could you provide a brief overview of
Smithfield's business operations, with a focus on those
years perhaps.

CHAIRPERSON YEE: Excuse me, Mr. Stewart. Before
you respond, may I ask for the parties, except for
Mr. Brannan and Mr. Stewart, if you are not speaking, to
please place yourself on mute. We have a lot of
background noise.
Thank you.

MR. BRANNAN: Thank you, Controller Yee.

So I am assuming we're good to go.

CHAIRPERSON YEE: Yeah.

MR. BRANNAN: Okay. Thank you.

Mr. Stewart, if you could provide a brief overview of Smithfield's business operations, please.

MR. STEWART: Our primary focus and strategy is really to provide a farm-to-fork strategy where essentially we raise livestock or purchase livestock, we harvest those animals, and essentially provide products to our consumers and customers across not only the United States but also the world as well.

Primarily, we focus on an operational excellence strategy, where there is a commodity business that has small margins, so we need to add value along every single point of the supply chain.

Margins in hog production is very, very low. Margins in generalized commoditized meat production is typically low. And so through operational excellence, we focus at every single point within that supply chain to make sure we're able to extract value that otherwise has a very limited return on invested capital and low margins within that commodity marketplace.

This strategy is essentially determined at our
headquarters that I'm at, here in Smithfield, Virginia, and we focus and apply that strategy across our operating assets within the U.S.

Smithfield hog production essentially raises livestock. And so that incorporates the feeding of livestock, where we procure grain; so corn, soybean, other materials like amino acids and lysine that we formulate.

We have some nutritionists that work for us. They are PhD nutritionists. And essentially they are working on low-cost formulations to help essentially create a low-cost formula. So every pound of meat that we ultimately produce has the lowest total cost going into it, thus the opportunity to extract value out of, again, what is otherwise a commodity market, which is pork production.

In addition to the use of our research and development team that helps validate -- through assets we have in North Carolina and Missouri and Iowa, we validate that we, in fact, have the right nutritional balance. It does, in fact, perform from a daily gain standpoint and a feed conversion standpoint that we really create lean meat products that helps drive value as well. So that validation occurs at what we call "commercial test herd" or "research farms." Again,
that's just validating that process.

From a breeding perspective, we also --

MR. BRANNAN: I will interject for you a second, Mr. Stewart.

And I would encourage, if the board members have questions -- certainly Mr. Stewart will be available, you know, at the end of the presentation. But if you have questions in the middle, please -- you know, this is really about providing the facts for you, if you have any questions.

CHAIRPERSON YEE: Okay. I think what we'll do is I will allow -- actually, let me just say for the members, if you do have questions, just feel free to unmute and interject. We have got the presentation before us on the screen. So that might be the best way to recognize you. Okay.

MR. BRANNAN: So Mr. Stewart, I will let you move on. Then, absent questions, I will ask that you move on to kind of the breeding side of the operation, which is obviously very important to Smithfield.

MR. STEWART: You bet.

So we actually own genetics within Smithfield. And, again, we have several PhD geneticists that work in terms of our breeding program. They are focused on not only meat quality, so that we can truly produce the
right product, at the right place, for the right
consumer base, the right composition of those animals,
but make sure that those animals have world-class
performance in terms of the feed that we provide them,
so that they can grow quickly, remain healthy, and
convert feed as well.

So this breeding program that I mentioned in our
genetics are, again, validated by our commercial test
herds and our research and development farms as well to
make sure that that performance truly does drive value
through that commodity marketplace.

MR. BRANNAN: Where are the herds located,
Mr. Stewart?

MR. STEWART: Sure.

So, primarily, our genetic herds are located in
Texas and North Carolina. Our actual sow herds, which
would be what's commonly known as, basically, the mother
pigs that produce offspring, they are primarily located
in the East Coast.

So more than half of our total animals are
located in North Carolina, South Carolina, and Virginia.
And then, subsequently, we do have animals in Iowa,
Missouri, and in a few other Midwestern states as well.

MR. BRANNAN: Okay. So thank you.

So we have covered kind of the feeding side and
the R&D that goes into the feed composition, the
breeding or genetic side.

And now, you know, when it comes to actually
raising the hogs, would you kind of describe that aspect
of the -- you know, kind of the integration here?

MR. STEWART: You bet.

Again, focusing on everything that goes into pork
production, such as ventilation, barn design, feeder
design, we validate, through our research and
development group, understanding the differences in
feedstuffs across the regions we operate is truly
important.

Obviously, most of the grain in the United States
is produced in Midwestern states. I may be biased
because I am an Iowa farm boy, but -- at heart. But
that's low grain cost, and so there's a real reason we
truly raise animals in the Midwest.

And, again, we raise animals in the East Coast.
We have a customer base here in the East Coast, and
we've got production systems that we're integrated with,
with terminal markets where we buy grain in
North Carolina, Virginia, along with those Midwestern
states as well.

MR. BRANNAN: So Mr. Stewart, I know Smithfield
has some of its own farms, but you also rely heavily on
family farms.

Could you maybe touch on that for the panel?

MR. STEWART: Absolutely.

We have procurement activities where we buy animals from family farmers. The largest state we actually buy from would be Iowa. We also buy out of South Dakota, Nebraska. We buy some animals in Missouri. And then there are family farmers in the East Coast as well, in North Carolina, and Virginia, that we procure animals from.

All these animals have to come through a quality assurance program called "Pork Quality Assurance" just to ensure that they meet the standards of our customers as well.

MR. BRANNAN: So once they are mature hogs, then we get into the harvesting plant is the label that we're using. And could you talk about, you know, the point of the investment, if you will, that Smithfield makes in those plants?

MR. STEWART: Absolutely, Derick.

Obviously, it's very important from a logistic standpoint to have these production facilities, these harvest facilities, located close to not only company operations that we talked about earlier, but also the family farms that we just mentioned as well.
So these harvest facilities are located close to these family farmers or plants. That's the most economical way for us to truly have an integrated, high-value supply chain. Really, the focus of these harvest plants is to produce, essentially, hogs into pork products that our customers, whether it's retailers or food service institutions, and ultimately customers, truly appreciate.

The way that we extract value out of these animals is based on what the commodity markets allow for and how we're able to essentially test out different ways to run our operations through our operational excellence, cut the animals up appropriately, and ultimately make sure that we have the right value composition in place so the right cuts go to the right consumers.

MR. BRANNAN: So it's not just, you know, pork as I imagine in the grocery store? You do a lot more than that in some of those plants, correct?

MR. STEWART: We do. So it's always vacuum-packaged products as well. We do have some beef items that we produce as well. And so it's really a mix of all items in industrial channels, deli channels, and then retail and food service as well.

MR. BRANNAN: And pharmaceutical as well, is
MR. STEWART: That's correct. We have several pharmaceutical channels. So we produce byproducts out of submucosa, if you will, that ultimately go towards the production of heparin. We produce some heart valves that end up being used for heart valve replacements in actual humans. And there's a variety of other pharmaceutical products that come from skin and other items as well.

MR. BRANNAN: Super. Thank you.

And we have covered -- you know, in the time we have, we're trying to cover the high points here. And I think the last point is, is, obviously important to the -- you know, to the issue for the board members to decide on. But during the years that we are discussing, what was Smithfield's, kind of, California manufacturing or production presence?

MR. STEWART: Their presence was extremely small. You know, it's close to 1 percent during that time frame. So very, very minimal.

Again, most of our assets, Derick, are located in either the Midwest or in the East Coast. And so, therefore, that's where our focus is in pork production, is making sure we're located close to animals and close to where the grain source is. That's the best way
from -- in the end supply chain to ensure we create value with the resources we have.

MR. BRANNAN: Great.

I have no more questions for you, Mr. Stewart. And I will move into a discussion of the law, unless, Controller Yee, you or the board members have questions. We can't hear you. You might be on mute. I don't want to be presumptuous.

CHAIRPERSON YEE: That's all right. Let's just pause for a moment and see if any of the members have questions at this juncture.

MEMBER VASQUEZ: Just one real quick one, Madam Chair.

CHAIRPERSON YEE: Yes, Member Vasquez. Please.

MEMBER VASQUEZ: In the presentation, it sounds like all the -- really, the production -- when you are saying "production," I'm assuming, you know, all these slaughtering of these hogs is done, really, outside of California; is that correct?

MR. BRANNAN: Go ahead, Brady.

MR. STEWART: My apologies.

Yeah, the vast majority is outside of California. We have a very, very small presence in California.

MEMBER VASQUEZ: So that's to say that there is some hogs that do come into California that you do
process here or you -- or is there any that really come
in un-slaughtered, I guess, is my question?

MR. STEWART: So during the -- I'm sorry. Go
ahead, Derick.

MR. BRANNAN: No. I was going to encourage you
to go ahead and respond, Brady.

MR. STEWART: Yeah. Sorry.

Yeah. So during the years of 2014 to 2017,
essentially there was no real activity in California.
There was one small plant that was not harvesting
animals.

Smithfield did purchase an asset in Vernon,
California, in 2017, that we did to harvest some hogs
that -- during that period of time.

MEMBER VASQUEZ: Was that the old Farmer John's
in Vernon?

MR. STEWART: Yes, sir.

MEMBER VASQUEZ: Okay. That's all I have for
right now. And I will let you finish, and then I will
get into some other questions.

CHAIRPERSON YEE: Thank you, Member Vasquez.

Let me -- Mr. Brannan and you will go ahead and
complete your presentation. We want to make sure you're
allotted the full 30 minutes for your presentation.

MR. BRANNAN: Thank you very much,
Controller Yee.

If we could move to the next slide, please.

So moving onto the law -- and we have laid the foundation through Mr. Stewart's testimony and kind of the factual review, and there's really -- I mean, to my understanding, there's no factual dispute on the record. But Mr. Stewart is here. He's available to respond to any questions.

So the law -- you know, slide 6, it's distortion and a remedy. And what we're talking about here is it's two parts. First, it's on the taxpayer. We accept that happily, the challenge of proving to the board members that there is distortion in this case because of the unfair reflection of business activities.

And once we have convinced you of that distortion, then it is up to us to provide a reasonable remedy. So it's a two-step process, and so we're going to focus the next few slides on what is distortion and why there is distortion in this case.

Can we go to slide 7, please.

Slide 7, again, back to the statute; if the allocation and apportionment provisions of this act do not fairly represent -- that fairness concept again -- the extent of the taxpayer's business activity in the state.
So for purposes of distortion, the statute requires us to focus on two things: What is fair and what are the business activities that we need to look at in order to determine what is fair.

So we go to slide 8, please.

And what happens is in order to determine fairness, we look at -- and the case I will direct us along this path, which is, what's fair is based on what's the purpose of the apportionment formula in the first instance?

In other words, if you -- if the apportionment formula is accomplishing its goal, then that's fair. If it's not accomplishing its goal, then it's not fair.

And what we have here is a quote from California Supreme Court in the McDonnell Douglas case. And it makes very clear what the purpose is, and it helps guide us as to the fairness determination here. And the apportionment of the unitary business formula used must give adequate weight to the essential elements responsible for the earning of the income. The mutual dependency of the interrelated activities in furtherance in the entire business sustains the apportionment process. McDonnell Douglas is telling us that a fair apportionment formula reflects those elements essential for earning of the income subject to tax.
The ultimate goal is assessing whether the standard formula fairly represents the company's business activity in California.

And so what you see here is this is a guidance for fairness.

If we can move to the next slide, please.

Go to slide 9, please.

So it's fairness of what? It's the fair representation of the business activities. And, fortunately, we have -- it's a very long-standing decision by the Board of Equalization in the appeal of Merrill Lynch.

And in that case, the FTB was speaking to distortion. And what the Board said is, when we're talking about distortion, business activity encompasses more than simply the alternative revenue-generating items which are reflected in the sales factor. It also includes the activities of the employees, as reflected in the payroll factor, and the use and availability of real and tangible and intangible property as reflected in the property factor.

These three factors are used to balance each other out, each reflecting a different type of contribution to the business activity and income of the unitary business as a whole.
For Smithfield, the relevant business activities for purposes of the distortion analysis include all of the activities responsible for earning the income subject to tax.

The management, research and development, feeding, breeding, raising, and harvesting operations are interdependent and all contribute to the generation of income subject to tax in California. They should not be carved out for purposes of fair apportionment.

The standard single-sales factor formula takes this company, Smithfield, the world's largest hog producer, in its industry-leading production activities -- all of the R&D, all of the technology that Mr. Stewart spoke to -- and treats them as somebody who is simply a meek reseller in California.

The formula ignores what Smithfield is doing outside the state, and that's not a fair reflection of their business activities.

Let's move to slide ten, please.

The leading case in this area is the California Supreme Court case in Microsoft. Microsoft, the court considered whether or not to exclude. Very important difference between Microsoft and the current case, excluding certain activities, specifically treasury activities.
The court concluded that the exclusion was appropriate because the treasury activities were qualitatively different from the taxpayer's principal software business and quantitatively distorted the formula. And as a result, now we have this kind of two-pronged -- it's not an analysis, but they are the two key factors in the overall analysis regarding distortion.

So let's start with the qualitative distortion discussion.

If we could go to slide 11, please.

As indicated by the verbiage in Microsoft and also the subsequent appellate court case of General Mills, qualitative distortion is determined by reference to the taxpayer's principal corporate business purpose or its main line of business.

In Microsoft, its software, they kicked out treasury receipts. In General Mills, it was the sale of cereal, and they kicked out hedging receipts.

In this case, Smithfield's plant personnel are Smithfield's main line of business. We can't separate any aspect of it and expect to achieve a fair apportionment.

So for that reason, the single-sales factor is qualitatively distortive because it excludes those
manufacturing activities from the apportionment formula.

Let's go to slide 12, please.

Quantitative distortion. I mean, here's kind of where the rubber meets the road. This is the traditional quantitative analysis. And what you can see, over the four years under consideration by the panel, is extremely low: On average, roughly 1 percent California property percentage, California payroll percentage, and then a sales factor percentage that, you know, moves up from 6.6 up to a size 8.8 in 2017.

If you want balance, we don't get that from these numbers. What you get is what we talked about at the very beginning. And by focusing exclusively on the sales factor, you get an overemphasis, an overweighing in the sales activities in a relative underweighing of the actual manufacturing and production activities that generates Smithfield's income. The same income that California want to tax here today.

We have given -- we provided a tier -- you know, dividing them by three. In other words, at the end of the day, we'll talk a little bit about a three-factor formula as a possible relief provision. And the goal of that is to balance out the various aspects of Smithfield's business operations.

You can also see a difference between the
single-sales factor apportionment and the three-factor
apportionment formula. So between -- the difference
between the two ends up being in the neighborhood of,
you know, just right at 50 percent if we average, but in
the earlier year, significantly higher.

Now, if we change to the next slide, please,
slide 13.

What you see here is a -- the same numbers -- the
same numbers for Smithfield in the second column in from
the left in a quantitative comparison. These are the
identical measures used in the Microsoft case, third
column -- in the General Mills, fourth column -- to
determine that there was quantitative distortion for
those cases to support application of section 25137.

In our case, the percentage reduction, the
apportionment factor, is north of 50 percent in all but
one of the years. And you can see that in all but the
fourth year, we exceed the standards set by Microsoft in
their discussion of quantitative distortion, and in
every year clearly exceed the quantitative distortion
metric set by the General Mills case.

So where we're at now, it is distortive for the
single-sales factor to ignore -- or excuse me -- for
Smithfield's income to be apportioned based only on the
single-sales factor. Smithfield makes money, it
generates that very income, through efficiencies in its production operations outside the state through the efficiencies of its research and development personnel outside the state. It is not fair for the state to tax those income based only on the market here in California.

I will turn it over to Mr. Muilenburg to discuss appropriate remedies. And I think Ben is available on the phone still at this point.

MR. MUILENBURG: Can you hear me again?

MR. BRANNAN: Yes.

CHAIRPERSON YEE: We can hear you.

Let me just check with the clerk about -- on time, please. Can I have a time check?

MR. MUILENBURG: If it helps, Madam Chair, I need two minutes to finish.

CHAIRPERSON YEE: Okay. All right.

MR. MUILENBURG: Okay.

CHAIRPERSON YEE: Please proceed.

MS. CASEY: We're good on time. Five minutes more.

CHAIRPERSON YEE: Thank you. All right.

MR. MUILENBURG: Well, now I've got to fill three minutes.

Okay. If we can go to slide 14, please.
So as Derick walked you through, you know, the first step is proving distortion. And Mr. Stewart's testimony, along with our analysis of the case law, we believe does just that.

And so step two is to identify a remedy.

And the point of, you know, once again, putting the statute up for your review is to identify the fact that, really, the authority under the statute is rather broad here, right? The goal is to promote fairness and to make the apportionment commensurate with the activities in the state. In order to do so, you consider things such as separate accounting; the exclusion of any one or more factors; (c), which obviously we're going to focus on, the inclusion of one or more additional factors, which we'll fairly represent; or as (d) mentions, you know, the employment of any other method to effectuate an equitable allocation.

So if we go to slide 15 -- and I think, you know, in reading our briefs you will identify that what we're requesting is an equally weighted three-factor formula. And there's a quote here from a John Deere case that identifies the three-factor formula and why it's inherently reasonable.

But I want to summarize sort of -- and the reason
for this proposed remedy is really threefold, right? The first -- the first reason is, as you heard the testimony of Mr. Stewart and as Mr. Brannan described the hog business and how we make money on extremely small margins by controlling costs, increasing yield, you know, making better feed, etc.

The three-factor formula, by bringing a property and payroll, you know, marker back into the system, we're reinstating those activities that we have identified as being absolutely core to our business. We're putting it back in the factor, and we're giving them, you know, a say again in how income is apportioned to California. So for this industry and this taxpayer specifically, it's the right -- it's the right remedy.

Number 2, as I think we all know, I mean, the three-factor evenly weighted formula was used for over 25 years in California as the standard apportionment formula. It has been changed three times since then, which I'm sure we'll get into. But, you know, I believe there's an inherent fairness there, knowing that it's been used for 25 years and that some states, you know, using unitary combined, continue to use a formula of that nature.

Obviously there are a lot of good reasons for going to a single-sales factor with a market state like
California. It's understandable; you don't want to penalize companies for investing in the state. But, nonetheless, you know, when we're talking about fairness, something that worked for 25 years, it certainly has some fairness history to it.

And then lastly, you know, again, as I mentioned at the beginning, we understand precisely the scope of this proceeding and what your board can adjudicate and what they cannot.

You know, we continue to have a disagreement with the Franchise Tax Board on whether we're actually required under the law as a qualified business activity to use a three-factor formula. But in California, the California legislature specifically carved out a number of industries, including agricultural industry, that it's going to require to use a three-factor formula, despite all of the subsequent changes to the apportionment factor. And the thought there is that, you know, the legislature thought about this and had reasons for continuing to allow the use of the three-factor formula for the agricultural community.

That is our community. Those are our competitors. I think it's known to all parties that companies at Smithfield directly competes with our using that formula with the permission of the State of...
California. Now, it's likely due to different organizational structures that causes them and FTB staff size to meet the regulation as opposed to us. But nonetheless, you know, when we're talking about fairness, once again, we're talking about a formula that is used for 25 years as the standard and continues to be used in what can only be described as Smithfield's, you know, business area, that being agricultural.

So with that, you know, we'll ask, you know, for any questions or, otherwise, you know, pass the -- pass the presentation over to the Franchise Tax Board. We really appreciate everyone's attention. And, again, Mr. Stewart is here, as well as Mr. Brannan and myself, to continue this discussion and answer any questions.

CHAIRPERSON YEE: Thank you very much, Mr. Muilenburg and Mr. Brannan, Mr. Stewart.

At this time, Members, let me just have the Franchise Tax Board present, and we'll have questions after their presentation.

Okay. And so we will have Kathy Shin and Laurie McElhatton.

MS. SHIN: Good afternoon, Board Members. My name is Kathy Shin, Tax Counsel IV, with the Franchise Tax Board's Legal Division. Accompanying me is Laurie McElhatton, Attorney V. Together, we represent the
staff of the Franchise Tax Board in this matter.

California, in section 25137 of the California Revenue and Taxation Code, authorizes variances from the standard apportionment formula when the formula does not fairly represent the extent of the taxpayer's business activity in this state.

The California Supreme Court, in the Microsoft case, established a two-prong test whereby the party invoking section 25137 has the burden of proving, by clear and convincing evidence, that the approximation provided by the standard formula is not a fair representation, and its proposed alternative is reasonable.

In so doing, the California Supreme Court emphasized that the statutory touchstone remains an inquiry into whether the formula fairly represents a unitary business's activities in a given state, and when it does not, the relief provision may apply.

The single-sales factor is the standard apportionment method for the years at issue. It was passed by the voters by Proposition 39, which mandated that beginning from January 1st, 2013, most multistate businesses, other than those in certain enumerated industries, determined their California source of income by using the single-sales factor, which the U.S. Supreme
Court upheld as constitutional over 40 years ago in the Moorman case.

California is not alone. A large majority of the states have done the same. So far, a total of 27 states plus the District of Columbia have enacted the single-sales factor method, and an additional seven states have enacted an elected single-sales factor apportionment.

Therefore, 35 out of 46, or about 76 percent of the jurisdictions that have a corporate income tax mandate or allow the use of the single-sales factor method in sourcing of their income.

The current petition stems from Smithfield's claim for refund, asserting that it qualified to use the equally weighted three-factor formula for agriculture, which was denied after an audit examination, because its business activity did not qualify for such treatment.

As a secondary position, Smithfield filed a variance request to use the same three-factor formula, arguing that the single-sales factor did not fairly represent the extent of its business activity in this state.

After due consideration, Smithfield's variance request was denied. Smithfield filed a current position requesting the Board's review of the variance request.
Smithfield is the world's leading vertically integrated pork processor and hog producer that markets a wide variety of pork products, both domestically and internationally. As you just heard, it has a highly sophisticated manufacturing operation that includes a network of both self-owned and third-party-owned hog farms. Smithfield operates these hog farms like a high-tech assembly line for hog production, which are used as raw material for the finished pork products.

Smithfield also engages in significant quality control and research activities related to the hog production and maximizes profits by controlling these as well as other production costs, which are essential for the success of any manufacturing business.

Smithfield has most of its operations located outside of California and negligible levels of employees and capital investments located within California. But what Smithfield does have and always had in this state is a flourishing market activity. It has been successful in tapping into the ready consumer that this state provides. Therefore, Smithfield's primary business activity in this state consists of selling products.

Nothing has changed in that respect, even with the enactment of the single-sales factor. Yet, the
reason why we are here today is because the single-sales factor, compared to the method used prior to Prop 39, increased Smithfield's income source to California, as it did for other out-of-state businesses.

Smithfield argues that instead of the standard single-sales factor, which applies to most multistate enterprises, they should be allowed to use the three-factor formula for agriculture, pursuant to section 25128, because its primary activity is hog farming.

Section 25128 prescribes an equally weighted three-factor apportionment formula, consisting of property, payroll, and sales if an apportioning business derives more than 50 percent of its gross business receipts from a qualified business activity, one of which is agriculture.

However, Smithfield does not qualify because its gross business receipts from agricultural business activity -- that is, hog farming -- fell far short of 50 percent of the total as required. In fact, Smithfield produced insignificant amount of gross business receipts from the hog production segment that generated most internal sales, which are explicitly excluded from the definition of "qualified business receipts."
Smithfield processed and used most of the hogs produced as raw material for the pork product segments, which are the profit centers that generated the lion's share of Smithfield's gross business receipts. Accordingly, since it does not qualify for the three-factor formula, Smithfield must use the standard single-sales factor method for sourcing of apportionable business income to this state.

The single-sales factor apportionment method approximates a taxpayer's business activity in a given state based on the taxpayer's relative market activity. A single-sales factor is calculated by dividing the gross receipts a taxpayer generated in California by the gross receipts it generated everywhere.

This method resulted in an average of 7.7 percent of Smithfield's apportionable business income being sourced to California for 2014 through 2017, the years at issue.

During the four years at issue, on its original return, Smithfield reported a total California franchise tax liability of about $7 million using the single-sales factor method, while generating a total of $4 billion of gross receipts through its operations in this state. Therefore, Smithfield's self-assessed tax liability under the single-sales factor method was only
0.17 percent of the gross receipts generated from this
state.

In the discussion that follows, we will show:

One, Smithfield cannot argue to use the
three-factor formula rather than the single-sales factor
based on the lower tax liability as proof of distortion;

Two, the Moorman case, which specifically upheld
the single-sales factor formula as applied to an
out-of-state manufacturer, illustrates Smithfield's
burden of proof under section 25137, which it failed to
meet;

Three, the distortion case Hans Rees, with the
80 percent apportionment to a single state was not
analogous to the current case, with 7.7 percent
apportionment;

Four, the qualitative and quantitative analysis
for distortion in the Microsoft and General Mills cases
is not applicable to the current case;

Five, an apportionment formula is a rough
approximation used to source the income and does not
have to reflect all income-generating activities to be
fair.

Lastly, under the second prong of section 25137,
the three-factor formula cannot be a reasonable
alternative without the first showing of distortion to
be remedied.

Under the first prong of section 25137, Smithfield asserts that the single-sales factor formula is unfair because it does not reference the contribution made by capital and labor in the production of its income.

Therefore, rather than sourcing 7.7 percent of its business income to California under the single-sales factor, Smithfield seeks to source 3.5 percent under the proposed alternative three-factor formula, which will be discussed in greater detail later.

First, to satisfy the first prong of the test, Smithfield's evidence must clearly and convincingly show that the income sourced to the state under the standard single-sales factor formula does not fairly reflect its business activity in this state.

However, Smithfield, instead, relies on the rearguing of its erroneous position that its primary business activity -- business is hog farming and, therefore, it is entitled to use the alternative three-factor formula.

It then relies on the numerical difference, what the law sets as its tax liability and what Smithfield argues its tax liability should be, to assert that the standard formula does not fairly represent its business
activity in this state. But just because an application of an alternative formula will reduce the amount of income sourced to a particular jurisdiction, it does not follow that the standard formula does not represent the extent of the taxpayer's business activity in that jurisdiction.

Accordingly, Smithfield fails to provide the requisite evidence, let alone clear and convincing evidence, to satisfy the first prong of the test.

Second, the U.S. Supreme Court, Moorman -- court case Moorman is instructive in illustrating Smithfield's burden of proof. In that case and the current case, the taxpayer argued that Iowa's single-sales factor was distortive because it apportioned to Iowa the income earned from its manufacturing activities in Illinois. However, the court ruled the taxpayer failed to demonstrate that the single-sales factor of 20 percent produced an unfair result.

In so holding, the U.S. Supreme Court specifically addressed the taxpayer's argument that its tax liability would be substantially less if Iowa employed a three-factor formula.

The court held such argument fails to demonstrate that the single-sales factor produced an unfair result. Instead, what is required is evidence to establish a
basis for comparing the taxpayer's actual income in Iowa with the income apportioned to Iowa under the single-sales factor. But in the absence of such evidence, the court had no grounds to assume that the three-factor formula produced a result equivalent to the taxpayer's actual income from activities in Iowa.

In upholding the single-sales factor method, the court acknowledged that single factor formulas generally will not produce a figure that represents the actual profits earned within the state but that the same is true of the three-factor formula. In fact, both will occasionally over-reflect or under-reflect income attributable to the taxing state.

Yet, despite this imprecision, the court had repeatedly refused to impose strict constitutional restraints on state selection at a particular formula. The court instructed that apportionment is employed as a rough approximation of a corporation's income that is reasonably related to the activities conducted within the taxing state and that the states have wide latitude in the selection of apportionment formulas.

Similarly, in the current case, Smithfield's argument, based on the difference between two apportionment methods and the resulting tax liabilities, fails to demonstrate that the standard single-sales
factor method resulted in an unfair reflection of
Smithfield's activity in this state, keeping in mind
that both methods are intended to only provide a rough
approximation of the actual income earned in a
particular state.

Third, Smithfield incorrectly attempts to
analogize to a 90-year-old U.S. Supreme Court case, Hans
Rees. In Hans Rees, the single-factor formula based on
property resulted in the attribution of about 80 percent
of the income to a single state. The court held that
the evidence tended to show that North Carolina had
applied a method that operated so as to reach profits
were in no just sense attributable to transactions
within North Carolina. The court admonished North
Carolina that the entire net income of a multistate
enterprise should not be apportioned to a single state.

More recently, the U.S. Supreme Court, in the
Container case, compared Hans Rees to Moorman and
pointed to Hans Rees as a case so outrageous as to
require reversal, suggesting that the facts of that case
transgressed even the wide latitude afforded the state
in the selection of an apportionment method as held in
Moorman.

In the current case, by contrast, the
single-sales factor attributed 7.67 percent of
Smithfield's income to California, a far cry from the 80 percent in Hans Rees.

Moreover, in Hans Rees, North Carolina's single factor formula was based on property, which tends to concentrate the sourcing of income only to states where the taxpayer is physically located as evident in that case, whereas the single factor formula in the current case is based on sales, which reflect the taxpayer's intentional participation in the market and, consequently, more widely sources the income to where Taxpayer's customers are located.

Accordingly, the single-sales factor method works to prevent the problem identified by Hans Rees of over-attributing income earned throughout the many states to a single state and thereby, as a corollary, preventing the under-attribution of income to the rest of the states. The reasonableness of the single-sales factor apportionment as applied is apparent in this current case.

Smithfield marketed its products worldwide, and, as a result, the single-sales factor sourced the income broadly to most states; most, if not all, 50 states, as well as to foreign. Therefore, the current case clearly is not analogous to Hans Rees and is certainly not on all fours with that case, as asserted by Smithfield.
Here, Hans Rees does not support Smithfield's argument that the application of the single-sales factor resulted in an unfair reflection of its in-state business activity.

Fourth, Smithfield also incorrectly relies on the qualitative and quantitative analysis contained in the 2006 California Supreme Court case Microsoft and 2012 California Court of Appeal case General Mills.

In those cases, the courts first determined that there were qualitatively different gross receipts from two revenue streams included in the sales factor, which combine to produce distortion. In the current case, there is only one type of gross receipts from the sale of pork products.

Accordingly, because the qualitative analysis is not applicable in this case, the quantitative analysis contained in those cases also does not apply to the current case and does not prove that the single-sales factor resulted in an unfair section of Smithfield's in-state business activity.

Fifth, Smithfield inappropriately challenges the construct of the single-sales factor apportionment. It asserts that the single-sales factor results in an unfair reflection of its in-state business activity because its out-of-state production costs, as reflected
by property and payroll, are omitted from the formula used to apportion its business income.

Smithfield argues instead that an apportionment formula must take into account all of its income-producing activities in order to fairly represent the extent of its business activity in this state.

Never mind that this argument does not constitute actual evidence of the single-sales factor's unfairness. Its underlying premise is also wrong because an apportionment formula is not designed to measure or reflect all income-generating activities of a taxpayer. Instead, as described previously, it is designed to approximate a taxpayer's income attributable to, or in other words, sourced to a given state.

Moreover, while recognizing that both the single-sales factor and three-factor formula may fail to reflect some factors that are causally related to the generation of income, the U.S. Supreme Court has explicitly approved both methods.

In summary, under section 25137, it is Smithfield's burden to prove, by clear and convincing evidence, that the approximation provided by the single-sales factor formula is not a fair representation of its business activity in this state before a relief can be granted. But faced with the significant burden
of proof, Smithfield argues to use the three-factor formula for which it does not legally qualify rather than explaining why the single-sales factor is unfair. Accordingly, Smithfield has failed to provide requisite evidence, let alone clear and convincing evidence, that the single-sales factor does not fairly represent the extent of its business activity in this state.

In point of fact, Smithfield cannot prove distortion because the single-sales factor is fair as applied. Smithfield's intentional participation in California's market resulted in about $1 billion per year in California sales, while having negligible levels of property and payroll in California.

Accordingly, Smithfield's activity in the state was pretty much limited to selling products. It had very little of any other in-state activities to be considered. Therefore, in view of California's market potential for consumer products of 12 percent based on population, 7.7 percent apportionment is fair.

Even though Smithfield has failed to meet its threshold burden of proving distortion under the first prong of section 25137, for the sake of argument, we will now discuss why Smithfield's proposed alternative is not reasonable under the second prong of
section 25137.

Putting aside the fact that Smithfield's activity does not legally qualify for the three-factor method, in order to prove that it is a reasonable alternative, Smithfield must show that the three-factor formula will ameliorate the purported unfairness caused by the single-sales factor, and Smithfield must do so with clear and convincing evidence.

However, as discussed earlier, Smithfield has failed to provide evidence of unfairness or distortion of the single-sales factor and, thus, it is simply impossible to devise a remedy for the yet unidentified and unknown distortion.

The Microsoft case provides an apt illustration. As noted earlier, the California Supreme Court held in that case that distortion in the sales factor was created under section 25137 by the inclusion of qualitatively different gross receipts from two different revenue streams. The court reasoned that the inclusion of the treasury receipts at issue was preventing the sales factor from functioning properly by measuring the taxpayer's participation in the market for its good and services. Accordingly, the court granted a remedy that addressed this specific problem, which was to exclude the redemption amount of the treasury receipt.
from the sales factor.

In contrast, Smithfield has not and cannot identify a problem with the single-sales factor method because it is functioning as intended by appropriately measuring Smithfield's relative market activity, which is pretty much the only activity it has in California. Instead of first showing that the single-sales factor is distortive, as required under the prong of section 25137, Smithfield works in reverse by comparing its preferred three-factor method to the single-sales factor to argue that the single-sales factor is unfair.

Smithfield argues that the three-factor method reflects its in-state activity more fairly than the single-sales factor. This is not the right inquiry under section 25137. The California Supreme Court, instead, explicitly held that the threshold question is whether Smithfield, as the petitioner, has carried its burden of proving that the standard method failed to fairly reflect its business activity in California. The question is not whether the proposed alternative method, or any other method for that matter, is more fair than the standard method.

Smithfield asserts that the single-sales factor is unfair because the apportionment percentage under the three-factor method is 54 percent lower and it
circuitously argues that the three-factor formula should be applied as a reasonable remedy to cure the distortion created by comparing the two methods in the first place.

Again, Smithfield cannot simply compare the result of any two methods and point to the difference as proof of distortion. It also cannot use this difference to show that the second method is a reasonable alternative to the first method.

Under the second prong of section 25137, a relief in the form of a reasonable alternative may be granted if and only if Smithfield first proves that the single-sales factor is unfair under the first prong, which it has not.

For many years, the California legislature chose the four-factor apportionment with double-weighted sales as a standard method. However, the California voters overturned that method when Prop 39 was enacted and mandated that the tax liability of most multistate enterprises be determined using the single-sales factor method, which explicitly excludes consideration of property and payroll. The FTB seeks to enforce that mandate here, as it upheld that legislative mandate when the four-factor method was enacted over the three-factor method.

Whereas Smithfield advocates a position that is
contrary to the clear directive of the California voters, Smithfield's position is also contrary to the uniformed application of the law because it is not different from any other business with significant operations located outside of California.

Finally, for illustration purposes, let us pretend that Smithfield is a California-based company with 99 percent of its property and payroll located in California and the same 7.7 percent California sales. This would result in 69 percent apportionment under the three-factor method.

Under these facts and Smithfield's logic, a uniform treatment of Taxpayer would require that the three-factor apportionment of 69 percent be applied to now-California-based Smithfield instead of the 7.7 percent under the single-sales factor.

So in this hypothetical, the 69 percent apportionment under the three-factor is more fair or, put differently, is 7.7 percent under the single-sales factor unfair, because 69 percent is nearly nine times greater? No. Because a comparison of two methods does not prove distortion. Both the single-sales factor and three-factor methods are presumptively valid and fair. Therefore, either may be used by a state as a standard apportionment method, and the California voters chose
the single-sales factor as such.

Taxpayers who can demonstrate the single-sales factor method does not fairly reflect their business activity in California will be allowed an alternative apportionment method, but Smithfield has not met its burden of showing the single-sales factor does not fairly reflect its business activity in California.

For all these reasons, the staff respectfully requests your board to deny Smithfield's petition for a variance from the single-sales factor formula.

Ms. McElhatton and I are happy to answer any questions that you may have. Thank you.

CHAIRPERSON YEE: Thank you very much, Ms. Shin, for the presentation on behalf of FTB staff.

Let me return to the petitioners and allow you 15 minutes for rebuttal. And then we will open it up for member questions and discussion.

MR. BRANNAN: Mr. Muilenburg, are you going to be able to speak?

We're having those technology issues. I apologize for that.

CHAIRPERSON YEE: That's all right.

Mr. Muilenburg, are you on the line? I don't see him.

MR. BRANNAN: I'll go ahead, and I'll kick it off
the best I can here.

CHAIRPERSON YEE: All right.

PHONE MODERATOR: Let me just jump.

Is this Mr. Muilenburg on this phone line right here?

MR. MUILENBURG: Yes.

Can you hear me?

CHAIRPERSON YEE: Yes.

PHONE MODERATOR: Yes.

Please proceed.

MR. MUILENBURG: Okay.

MR. BRANNAN: Thank you.

MR. MUILENBURG: I'm sorry. I'm switching back and forth between technologies. I apologize. Appreciate everyone's patience.

Okay. So, yeah, you know, because Derick and I are not in the same place, I'm going to try to road map it a bit so we can split this up.

I'm going to address the comments made about whether or not the three-factor is appropriate in light of, you know, whether or not we qualify for an agricultural exception. I think there was also the statement made about what is the appropriate standard when determining what is a fair reflection. And then also, I want to talk a bit about, you know, our
comparison method and whether or not that proves
distortion. And then I'm going to have Derick speak to
Moorman and Hans Rees and some of the case law that was
mentioned, if that's okay with everyone.

Okay. So, you know, I think if you read the
briefs, you will notice that this is a point of
contention between the Franchise Tax Board and the
taxpayer; you know, this idea of what it means to be
business activity and what should be analyzed when
determining whether something is a fair reflection. And
the taxpayer's position is that when 25137 came into law
in 1966, since that date, it has not been changed. It
has not been altered, you know, by a statutory amendment
or any amendments to any of the statutes that may call
to 25137.

Therefore, the case law that we provided -- you
know, the McDonnell Douglas case, the Merrill Lynch
case -- that talk about what a fair reflection of
business activity is and what it means and what the
standard is for determining, you know, distortion; those
are still relevant law. And, frankly, we're waiting to
hear the State's position on why that would not be the
case.

You know, contrast that with what the State would
have you believe -- and I believe Ms. Shin said a number
of times the only in-state activity the taxpayer had was
its market activity, and therefore, you know, how can
the market activity be wrong?

We're not saying that a three-factor formula
needs to be considered for every taxpayer; we're not
saying that property and payroll needs to be in the
factor every single time you determine a fair
apportionment. You know, however, in this case, based
on the facts and based on what we went through, all of
our business, you know, inputs that drive business
income occur outside of the state of California.

And back to the standard, you know, if you recast
the term "business activity" to mean "market," then, you
know, I don't know -- we don't have our slide deck up
anymore, but if you return to the statutory law it
essentially would say is, if the apportionment and
allocation provisions, which we know currently are
single-sales factor in market, do not fairly reflect the
business activities which the FTB would determine to be
market, then a distortion petition may be granted.

So essentially what the State is saying is, if
the market doesn't reflect the market, then the Board
should step in and do something.

Well, that produces what is an absolute integral
part of the apportionment methodology, the whole body of
law, and reduces it to a spellchecker of sorts. And, right, the only time you have a lack of fair apportionment is if there's a math error or a formula error or something in your -- in your apportionment factor on your R-7 -- or sorry -- Schedule R.

So, you know, I think it's important to note that nothing has changed. The apportionment factors have changed.

As Ms. Shin mentioned, you know, we have had three changes since 1966: We went to mandatory -- or double-weighted sales; we went to an elective single-sales factor, you know, regime; and then a mandatory regime, as she correctly points out, which was the proposition, you know, voted on by the state of California -- or the people of California.

But at no time -- in any one of those changes, there could have been a reference to 25137, saying when you are now determining what is fair, you should now only look to the market, right, because we have a new apportionment factor, and it's just market. Those changes weren't made.

And you just heard earlier today that, you know, there's a 25137 regulation proposal that's going to clarify things. I mean, certainly the FTB knows how to, you know, write new law and make its position known to
the public, but nothing has changed since then. So, you know, we take -- we take, you know, issue with our case law, you know, being Merrill Lynch and McDonnell Douglas not being relevant as far as the business activity.

And then -- and then as far as the agricultural exception, I think I addressed that earlier. I mean, we continue to have a disagreement there. We're not saying we want a three-factor formula because we're in the agricultural community. We're saying a three-factor formula, when you consider our facts, is inherently reasonable because it brings in the activities that generate our business income, and in addition, it's reasonable because our competitors are using a similar formula and, you know, that puts us on an uneven playing field.

And then finally, before I hand it over to Mr. Brannan, I'll just talk about some of the other cases.

I heard a number of times that Taxpayer's intent to show a tax difference between two methodologies and, therefore, show distortion because it's a certain percentage away, and they want the lower tax.

I mean, what we're doing is reproducing what's been done in the case law. And, again, this is a continuing theme. We've put forth cases. We've put
forth quantitative tests that have been conducted by
California Supreme Court and California appellate courts
and we're comparing our numbers to those numbers, not
based on tax difference but based on apportionment
change, when what we view as core business activities
are somehow excluded from consideration and how we make
money.

So, you know, we are setting the cases. We're
comparing our numbers to those numbers. We agree,
Microsoft and General Mills is not a perfect fit, but,
you know, in every distortion I have seen, that's the
beginning, and the discussion of qualitative and
quantitative always continues. So, you know, we fit
within that framework for illustrative purposes.

But our core argument has been and always will be
the statute, right? The statute says does the
apportionment formula fairly reflect the business
activities? When you define "business activities" to be
everything important to us to make money, single-sales
factor, in our case -- in our extreme case, does not
fairly reflect those activities because it gives
absolutely no weight to our production activities out of
the state.

Mr. Brannan.

MR. BRANNAN: Sure. Thank you very much.
A couple of points -- and it's a little troubling for me because there's a couple of statements from the FTB, and they were -- stated in the briefing, and we hear them again today. But the idea is that we haven't provided evidence and we're relying somehow exclusively on a percentage comparison to prove distortion.

Well, let's go back.

Mr. Stewart provided evidence -- real, live evidence -- about where the manufacturing activities take place. And it's not a function solely of percentage comparisons. It's a function of the facts. This whole thing is driven by the factual analysis and whether the apportionment formula reflects the activities that give rise to the income subject to tax. And the single-sales factor does not do that in a fair manner for Smithfield.

Now, as far as the methodology used that compares percentages, as Mr. Muilenburg just pointed out, we're using the same comparisons in the case law.

Please, FTB, show me some case authority that shows that what we're doing is wrong, because there isn't any. We're doing our best to apply the standard as articulated by the California Supreme Court. Two of the many factors to be considered are the qualitative and quantitative measures. We have applied those in
this case.

Yes, the facts are different. We owned that in the beginning. We own our burden of proof. We accept that. But this case is an extreme example that shows that if less than 1 percent of the property and payroll is in the state for most of these years, and those factors are the ones giving rise to the income subject to tax, that's the whole point of apportionment.

No, we're not mounting a global attack on the single-sales factor. No. We are looking at Smithfield. That's what Mr. Muilenburg said in the very opening comments; we are looking at Smithfield. Nobody else. We are looking at the statute. We're looking at the language of the statute.

Let's talk a little bit about Hans Rees and Moorman. Those are U.S. constitutional cases, and they certainly guide the consideration of these issues. But we can't sit there and say Hans Rees gives us a bad example or Moorman doesn't apply. I don't really care. And I'm sorry to be so dramatic. But the bottom line is, Microsoft says there is a state standard for distortion, and that standard is fairness. And that standard is guided by state authorities, like John Deere and like McDonnell Douglas. That's how we determine whether it's distortive or not in California.
We don't have to look to Moorman or Hans Rees. Microsoft made it clear that is a federal constitutional standard. But that's not the standard we're focusing on. We started this presentation by focusing on the statute. We would ask that the FTB limit their discussion of that point.

So let's talk about Moorman. Moorman said there is nothing inherently wrong with a single-sales factor. Great. We don't dispute Moorman. The court also said in Moorman -- and this is really critical to the presentation you have heard today -- Moorman said, and, Taxpayer, you failed today because you didn't provide separate accounting data to show that the single-sales factor apportionment formula was unconstitutional, that it breached income generated outside the borders of the state. And that's why the taxpayer lost in Moorman. It wasn't -- it wasn't -- you know, in comparison to our case, we're focusing on fairness in our statute.

And if you want to focus on what was wrong with Moorman or what the taxpayer did wrong, we have cured that here today by providing the testimony from Mr. Stewart. We have shown, we have demonstrated, how income is generated by manufacturing activities outside the state.

So last point -- and this is frustrating because
we saw a lot of hypothetical points raised by the FTB's presentation. And that's kind of one of the problems here, because what the FTB is doing is you're presenting a parade of horribles for the State. There's monsters in the closet. They are not there.

I have -- we have one taxpayer and four members of the Board here today. That taxpayer is Smithfield Foods. Smithfield Foods generates the majority of the income that California wants to tax through its tremendous, fabulous, world-class efficiencies outside the state. And the formula ignores that. And for that reason, the formula, as applied to Smithfield -- Smithfield only -- is unfair, and there should be some accommodation.

We should be looking for a remedial formula to correct that error. Whether the number would go up or down if it's three-factor or one-factor, that's really -- even though the courts haven't looked at that, that's really not critical. What's important is that the factors that give rise to the income are not in the apportionment formula.

So Hans Rees constitutional standard, Moorman constitutional standard. I think I have covered it. You know, I apologize for getting a little agitated here, but you can tell it's an issue that I feel
passionate about. So thank you for your patience, and I
think I will leave you with that.

CHAIRPERSON YEE: Thank you, Mr. Brannan. Thank
you, Mr. Muilenburg and Mr. Stewart.

At this time, let me open it up for questions
from the members.

MEMBER ASMUNDSON: I have no questions at this
time.

MEMBER VASQUEZ: I have a couple really quick, if
I can, Madam Chair.

CHAIRPERSON YEE: Please, Member Vasquez.

MEMBER VASQUEZ: The first one is to the
petitioner.

Can you explain the table you have on page 11 in
this brief? And I'm assuming that came from Smithfield
folks.

MR. BRANNAN: I'm going to pull that table up
real quick.

MR. MUILENBURG: I'm sorry. Are you referring to
the page 11 in our presentation today or the written
record, one of the briefs filed?

MEMBER VASQUEZ: In the brief.

MR. MUILENBURG: Okay.

CHAIRPERSON YEE: Yes. The section of the
California apportionment and tax profile.
MR. BRANNAN: Sure.
I think page 11 says that --
MEMBER VAZQUEZ: Yes, that's it.
MR. BRANNAN: I think page 11 mirrors the
information -- and if it doesn't, I will just apologize
in advance -- it's on --
MR. MUILENBURG: Derick, it's the same as -- yep.
Yep. Go ahead.
MR. BRANNAN: -- on slide 12?
MR. MUILENBURG: Yes.
MR. BRANNAN: And then you want to go ahead and
pick it up? Ben's a lot more nimble with numbers than I am.
MR. MUILENBURG: That's right. What you see on
page 11 of our opening brief is what is reproduced on
slide 12 of our presentation today. And what that is,
is a comparison, you know, between the single-sales
factor apportionment formula as filed and what would be
the apportionment, you know, result through a
three-factor formula, what we're requesting in our -- in
our relief.
MEMBER VAZQUEZ: I thought it was the same as the
slide, but the numbers seem different. I don't know if
you have the slide still available.
MR. MUILENBURG: I do, yep. I'm looking at them
side by side. I think what happened is --

MEMBER VASQUEZ: They are the same figures?

MR. MUILENBURG: They are the same figures. They are, yes.

MEMBER VASQUEZ: Okay.

MR. MUILENBURG: And if there's a transcription, I apologize. But I don't see one currently.

Oh, I -- I do see one. I apologize. 2016. The sales factor numbers. The rest are -- the rest are the same. My apologies.

MEMBER VASQUEZ: Is the four-year average the same? I thought it was different on the four-year average, too.

MR. MUILENBURG: So the four-year average is not computed on our presentation today.

MEMBER VASQUEZ: Oh, is that what it was? Okay.

MR. MUILENBURG: So there's an extra column, and there's a small rounding error as well. I apologize for that.

MEMBER VASQUEZ: All right. And this is a -- this is a question you probably can answer as well, too, is currently, do -- do you folks have a food and agricultural permit for California?

MR. BRANNAN: I don't know.

Mr. Stewart, if you are still on and if you know.
If you don't know, that's certainly something we can get an answer to pretty quickly, I imagine. I'm guessing we do. That would make sense. I'm not sure I would be doing anything here without it. But I don't know.

MR. STEWART: Yeah.

MEMBER VASQUEZ: Yeah. I was looking through it, and I didn't see it. Maybe I missed it.

MR. STEWART: I apologize. I do not have that handy for those given years.

MEMBER VASQUEZ: Okay. And then I think the other questions I had, you answered in the presentation. I'm good for right now. Thank you.

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

I have a few questions, if I may. And I think my first question really speaks to just the provision specified in section 25137 that allows for a departure from the allocation apportionment provisions of the section, and it's meant to be limited and for only specific cases.

And I guess what struck me, as you were talking about the nature of the company and the business, is I was trying to look for kind of the unusual fact situations. And I understand that, you know, there are different segments of the business and where those
activities are located and the revenue that's generated.

   But I guess, when we look at unusual fact situations, we generally look at them as being, you know, fairly unique but also non-recurring. And so I'm just trying to just get a sense of, you know, how you would describe, I guess, the business activities that would -- at least in these years, that may have been different or unique.

   But this is the business that still continues today though, yes?

   MR. BRANNAN: Yes. And Controller Yee, thank you for the question.

   There's really a couple of things. And, you know, I hate to do the lawyer thing, but, you know, the Microsoft court did actually consider the idea of whether distortion was only supposed to be limited to kind of unique and non-recurring circumstances. And they rejected that, and they acknowledged that there could be recurring situations that a standard apportionment formula could be addressed. So that would be response number one.

   Response number 2. Clearly, there's some requirement that the facts and circumstances of a particular case merit departure from the standard formula, and they have to be somehow different. So we
get that.

But I think that the couple of high-level points for, you know, Smithfield -- you know, one, any business that does manufacturing outside the state, you know, at the certain level of abstraction, could be just like Smithfield. I think that's kind of the heart of your question. And our response is, you know, two and three.

One, Smithfield is -- in my words, they are the Henry Ford of the pork industry. They created efficiencies by the very nature of their operations outside the state. They don't -- they clearly realize money when they sell into this state. But pork is a commodity. Nobody makes money on the sales side of this alone.

So here, right off the bat, we have a couple of unique circumstances: You have -- the pork industry is a commodity industry; two, you have got resources dedicated to feed, to breeding, to how we cage and farm, to, you know, literally every aspect of the hogs operation.

And I see -- Brady, raise your hand. I can't tell if you would like to comment. Or if I am doing okay, I can keep going. I just don't want to leave that out.

But Controller Yee, I mean, yes, we're different.
And if I take ten steps back, we're all manufacturers and nobody is different. But what this case is about, it's the facts and the facts surrounding Smithfield's business operations.

And I'm not going to run from the numbers, the numerical comparison, the ones that we did in perfect alignment with Microsoft and General Mills that show the difference between the standard formula and the proposed formula. You know, contrary to what is suggested by the FTB, that's not the only basis for our case. The basis for our case are the facts as presented by Mr. Stewart. But one of the factors that the courts tell us we're supposed to consider are those relative percentage comparisons, and that's why we put them in our case. But I think there's a lot of reasons why we're different.

MR. MUILENBURG: And if I can dovetail really quickly on that --

CHAIRPERSON YEE: Sure.

MR. MUILENBURG: -- you know, I -- as you know, we're asking for an equally weighted three-factor formula. We're not ignoring the market that is the state of California.

I do take issue with the idea that anything under 12 percent, anything under a population is, therefore,
reasonable because shouldn't the State get 12 percent of 
everything. That's not the right inquiry. That's not 
the right thing to be looking at. But we are 
considering the market.

But, you know, the other things is, you know, we 
can't stress this enough, a commodity business, I don't 
know that I have ever seen a Smithfield commercial. And 
I apologize, Mr. Stewart, if that's something I am just 
missing. But in addition, I think there are a lot of 
brands in the grocery store that you would not know that 
Smithfield owns.

So it's not that the marketing and the sales 
factor is driving our business activities here, because 
this is -- this is something that's going to get the 
same price everywhere. If anything, we incur additional 
trucking and transportation costs to get our product 
into the state of California. What we are trying to do 
is continually reiterate that based on the facts, we 
make money by -- by production efficiencies. And we're 
very concerned in this specific case, for this specific 
taxpayer, in this specific industry that those 
activities need to be considered in a fair apportionment 
factor.

CHAIRPERSON YEE: Okay. I understand that.

Thank you.
A couple of questions for the Franchise Tax Board, if I may.

So I know that we look at the sales factors as kind of a measure of the market. And to the extent that the taxpayer is contending that you're positioned -- that the standard apportionment formula should only fairly reflect the market, that would probably make, I guess, 25137 somewhat superfluous.

But the question is, I guess, hypothetically speaking, if the company's sales factor included gross receipts that appeared to be distortive, could the existing single-sales factor be successfully challenged?

MS. SHIN: Yes. The answer is yes. As I ended my presentation, if a taxpayer is able to show, by clear and convincing evidence, that the actual income earned is unfairly reflected by the single-sales factor, of course, yes.

CHAIRPERSON YEE: Okay. And I guess what I want to do is kind of go back -- and thank you. I actually find this case fascinating because I have learned more about this industry that I did not know before. So it's fascinating and certainly understand what Smithfield has done to continue to produce quality and certainly have a competitive advantage.

But I can't help but to think about -- so the
liability that we're talking about here is really driven by, I guess, the income that's actually, I guess, generated, right, from the consumer market here in California.

So -- and I guess what's troubling to me is that's a big number. I mean, I get that you have a lot of activity outside of the state, but in terms of just your reporting to the SEC and just, you know, what the FTB noted in terms of -- what is it? -- between the 81 and 84 percent of your revenue is generated by the three, you know, pork product segments, I guess I just have to ask, you know, why is that -- excuse me -- and then I believe the hog production activity was -- actually generated some money as well, but it is -- most of the amount was from the intersegment sales.

So I -- tell me -- tell me why we ought not be looking at that for the petitioner.

MR. BRANNAN: I think there's a couple of responses to that. One, we don't have a problem if you look at it. There's no shocking answer. But I think, when you carve that out of context -- I mean, the truth is that Smithfield is the world's largest pork producer, and it's very, very easy to find big numbers associated with Smithfield.

And I would suggest to you that the contrived
figures that have been presented here are really not
that meaningful. We could come up with large numbers,
take that number and multiply it, and we could attach it
to activities outside the state. And I would be happy
to provide a supplemental submission. And, really, it
would dwarf the numbers that Ms. Shin put up on the
board.

So we're dealing with large numbers, and that's
why the relative percentages are the ones that we really
ought to focus on.

So, you know, that's kind of point number one.
These are contrived. These are fictional. You don't
find any of those numbers in any of the cases. That's
kind of — well, let's get back to the core values. You
know, I appreciate the revenues, I appreciate the
percentages.

But the apportionment formula, though, at the end
of the day, it's about reflecting those factors that
give rise to the income. And the income in this case is
because of the nature of Smithfield's business; it's not
the market, it's a commodity business. They don't make
money because they sell their products — you know, as a
general rule, sell their products for more money in
California. They basically are selling at a market
rate. It's why people hedge in pork bellies. There's a
lot of things going on here.

But at the end of the day, you know, again, I'm going to use that -- they make money because they have used their research centers, their scientists develop better feed. And so when they give it to their hogs, the hogs grow bigger. And when they sell those hogs, they can sell them for more money based on weight. That's the difference.

And the numbers that are -- that we're throwing around and billions of dollars of revenue and whatever, I mean, I can give you some numbers, too, and they will show the same story outside the state.

CHAIRPERSON YEE: All right. So let me just -- you've raised something, Mr. Brannan, I wanted to just ask for both Franchise Tax Board and Smithfield, and that is I don't think there's any disagreement that you are kind of somewhat of a vertically integrated company. And so to the extent that all of those activities outside the state kind of accrue to kind of the robust sales in California, I mean, that counts for something, yes?

MR. BRANNAN: I will go ahead and -- go ahead, Ben.

MR. MUILLENBURG: Yeah. I would say that's precisely -- so I am going to return to the agricultural
exception not because we're arguing for that. Again, I understand the scope here. But the California legislature determined that this three-factor formula is appropriate for the agricultural community. And there's a lot of reasons for that, and the main one being that, just as Mr. Stewart described, I mean, they need to be located next to their feed lots, they need to be located next to their contract farmers, they need to be able to accomplish economies of scale, how they make money. The idea that because they are vertically integrated and sell an end product, they, all of a sudden, no longer have those same concerns that the legislature thought enough of to specifically exempt when we went to a double-weighted sales factor in 1993? That's the part we have trouble with.

And we're not saying we want the mandatory use as a matter of law, though. You know, we'll argue in a different forum for that. What we are saying is when we have described, based on the correct interpretation of business activities, that we don't believe the result is fair, that our -- that our proposed remedy is reasonable because the California legislature says it's reasonable for businesses like ours that are stuck to certain geographies. That was the consideration, you know, when determining what is a fair reflection.
So yes, we're vertically integrated. Yes, the California market, you know, provides us with sales. You know, again, there are probably other markets where we can make more money just because of a lack of regulation and, you know, closer to our, you know, production facilitates, less transportation costs, etc. So we're not ignoring the market. We want it to be a part of a complete system that analyzes how we make money.

CHAIRPERSON YEE: Yeah. I understand and appreciate that.

And I guess what I would say about the California legislature is that, you know, certainly, in terms of whether we regard Smithfield as an agricultural business activity, I guess -- I mean, they were pretty specific about the thresholds that are in the statutes. So I mean, for me, I'm kind of putting that issue aside and then just kind of looking at the case law.

And I would say, you know, this is always the tricky part when we're citing case law. I mean, the facts and circumstances are different from case to case. And so -- which is why I haven't wanted to kind of focus on the percentages. I really wanted to understand the business. And you have all done a great job of really walking me through that.
And if we're truly focused on, you know, the income that's generated here in California, I mean, I think it's a pretty discrete -- it's pretty discrete what we're looking at here in terms of how the liability is determined.

So I'm going to ask Ms. Shin to respond, and then I will probably follow up with another question.

MS. SHIN: So I would like to make two points, if I may.

As far as the taxpayer's or the petitioner's hog farming activity is concerned and section 25137 that allows for a three-factor formula, it's -- you know, the petitioner is not a hog farmer, as you pointed out. It is a vertically integrated, sophisticated company that produces pork products. This is what they do. This is what the petitioner said.

For instance, the hog farms that they have are -- they have described it as a network of hog farms, which is like a high-tech assembly line. This is how they describe it. So I just wanted to note that.

As far as this notion of income-generating activities and its relationship to the apportionment factor, if I may geek out and be a little academic, we use the -- in California, we source income based on formula apportionment method, Uniform Division of tax --
of Income for Tax Purposes Act, UDITPA. And so under
section 25137, it's a different inquiry. Under 25137,
there is a burden of persuasion and proof on the
petitioner to demonstrate that the California income
does not fairly -- is not fairly reflected by the
standard apportionment formula.

So an apportionment formula at issue is a rough
approximation that is used to source income. And so it
doesn't have to reflect all income-generating
activities, to be fair, but a taxpayer's
income-generating activities is considered under the
formula apportionment method because a portion of the
taxable income base that goes into that method includes
and reflects all income-generating activities of the
taxpayer. So that's the income base.

And a portion of that is sourced to California,
using an apportionment formula. And in California, we
have chosen, as the objective measure that the
apportionment formula is based upon, the taxpayer's
relative market activity, not just California market
activity. But, remember, it's numerator over
denominator; California market activity versus market
activity everywhere. But that is just used. And it
only needs to be a rough approximation, by the way, of
the taxpayer's income to be sourced to California.
So I don't know if that answers your question, but there you go.

MR. MUILENBURG: May I respond quickly, Madam Chair?

CHAIRPERSON YEE: Yes, please.

MR. MUILENBURG: I think I would say not only are we hog farmers, we're the world's largest hog farmers. I mean, you talk about vertical integration and, you know, the production of pork products; if we weren't raising the pigs, we would have a bunch of factories where nothing was going on. You know, Smithfield is the largest producer of pork, from growing -- and Mr. Stewart, I'm sure, could talk about this for days.

But we are absolutely hog farmers.

And, again, the fact -- and we're not going to get into the exception, but the fact that we choose to slaughter the animals and sell, you know, cuts to the supermarket versus the competitor sells the live animal, the fact that the State of California is fine treating those two different, where there is not a difference in the statute. Everything that causes that distinction is in the regulation. The statute relies on federal determinations of what farming is and that includes the raising of pigs, cattle, etc., for slaughter. That's all in the statute. The regulation talks about vertical
integration, talks about, you know, sales companies, all these things that the Franchise Tax Board has cleaved that distinction.

But, again, we're not here to talk about that. We take offense to the idea that we're not hog farmers. We're the world's largest hog farmers, and it's an absolute, you know, essential part of our business.

CHAIRPERSON YEE: Thank you. Just check in with my -- with the other members. Any other questions, Members?

MEMBER VASQUEZ: No. I'm good right now, Madam Chair.

CHAIRPERSON YEE: All right. Thank you. Just trying to go through all my notes from the testimony. Hang on one second. I am also fine as well. Let me just turn to the petitioners. Any concluding remarks?

MR. BRANNAN: Not from me. Mr. Muilenburg?

MR. MUILENBURG: Not for me either. I want to thank everyone for your time.

CHAIRPERSON YEE: Thank you.

MR. BRANNAN: Agree. Thank you very much for the time.
CHAIRPERSON YEE: Thank you.

Ms. Shin, you all right?

MS. SHIN: Thank you very much.

CHAIRPERSON YEE: Okay. Thank you.

Members, this is before us.

Does anyone need to take a break before we discuss it any further or take up the action -- take up the item?

MEMBER VASQUEZ: I'm good either way, Madam Chair. Whatever your pleasure is.

CHAIRPERSON YEE: Okay. Seeing no desire to have to take a break, is there a motion on the item?

MEMBER VASQUEZ: Yes. You know -- for me, you know, I think the staff pretty much laid it out in terms of, it's pretty much left up to the petitioner to state -- to make their case. And I just didn't -- just, to me, it just didn't come clear. And I think our staff did such a great job in really breaking it down and getting into the particulars. And it's my understanding, at the end of the day, the petitioner still has other avenues to appeal this.

So I'm going to agree with the staff's recommendation to sustain the FTB staff denial of the taxpayer's petition and just move it.

CHAIRPERSON YEE: Okay. All right. Thank you,
Member Vasquez.

We have a motion by Member Vasquez to deny the petition, sustaining the Franchise Tax Board.

Is there a second?

MEMBER ASMUNDSON: I will second that.

CHAIRPERSON YEE: Okay. Seconded by Member Asmundson.

Please call the roll.

MS. CASEY: You want me to call the roll for —

CHAIRPERSON YEE: Yes. We have a motion by Member Vasquez, seconded by Member Asmundson.

MS. CASEY: Okay. We have a motion by Member Vasquez, second by Member Asmundson.

CHAIRPERSON YEE: Right. And that's to sustain the Franchise Tax Board and deny the petition.

MS. CASEY: To sustain the Franchise Tax Board and deny the petition.

CHAIRPERSON YEE: Yes.

CHIEF COUNSEL BRUNETT: Dawn, can you call the roll with the board members, please.

MS. CASEY: Yes.

Member Vasquez.

MEMBER VASQUEZ: Aye.

MS. CASEY: Member Asmundson.

MEMBER ASMUNDSON: Aye.
MS. CASEY: And Chair Controller Yee.

CHAIRPERSON YEE: Aye.

Thank you very much, Members. That motion carries.

Thank you, everyone.

Let me just, at this point, move back to Item Number 9 before we adjourn. And this is Board Members' time.

Any comments by any of the members?

MEMBER VASQUEZ: I would just make -- you know, I kind of -- (audio malfunction) --

CHAIRPERSON YEE: Yes, Member Vasquez?

MEMBER VASQUEZ: -- our staff -- I broke up a little bit.

CHAIRPERSON YEE: Yes. Start over again, please.

MEMBER VAZQUEZ: Are you able to hear me now, Madam Chair?

CHAIRPERSON YEE: Yes, we can.

MEMBER VASQUEZ: I think you are muted.

CHAIRPERSON YEE: No, I'm on.

MEMBER VASQUEZ: Oh, okay.

I would just like to, in closing -- I'm sorry.

CHAIRPERSON YEE: You are cutting in and out. So I'm not sure.

MEMBER VASQUEZ: Okay. Am I cutting out?
Because earlier, I got cut off during the presentation, but then now --

CHAIRPERSON YEE: We can hear you now.

MEMBER VASQUEZ: Are you able to hear me now?

CHAIRPERSON YEE: Yes.

MEMBER VASQUEZ: Okay. Let me see if I can get -- let me see if I can get this in.

I just wanted to take this opportunity to thank the Franchise Tax Board staff and their efforts in making these hearings as smooth and as professional as possible. They always make it easier for myself, especially on a lot of these materials and the presentations and just the in-depth briefing that we get as we move forward, and I just wanted to acknowledge and appreciate that from the staff. And I look forward to seeing everybody again in June.

And I know we actually had -- we had remarks from the members before you were able to join us, Madam Chair, so I will turn it back to you.

CHAIRPERSON YEE: Okay. I appreciate that.

Thank you.

Let me echo that sentiment. I mean, I hope that many of you feel the optimism that I feel about the trajectory that we're on, that hopefully we can be able to meet again in person. And we will look forward to
that in June, and hopefully that could be a possibility. But very much appreciate the ability to continue
the business of this board virtually and to be able to allow the public to engage. And so I'm just very, very
thankful to the staff for making sure that that can continue.

And then, of course, we're in tax filing season. And I know that for many Californians who are struggling this year, an extremely important year for all of us. I know, Member Vasquez, you will be doing the same. But in terms of just the outreach that we're going to need to do to be sure that we are assisting our taxpayers as they need to do -- to have assistance, file their returns, but more importantly, to be able to participate in many of the benefits and relief that are available to them.

So really appreciate the work of the staff.

Any other business to come before the Board at this time?

(No response.)

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

MEMBER VASQUEZ: Thank you.
And thank you, staff.

CHAIRPERSON YEE: Thank you.

(Proceedings concluded at 5:03 p.m.)

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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 18th day of March 2021.

/s/ Kathryn S. Swank
KATHRYN S. SWANK, CSR
Certified Shorthand Reporter
License No. 13061