

STATE OF CALIFORNIA

FRANCHISE TAX BOARD

PUBLIC MEETING

THURSDAY, MARCH 4, 2021

1:30 P.M.

HELD VIA VIDEOCONFERENCE

AND

VIA TELECONFERENCE

REPORTED BY:

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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

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APPEARANCES CONTINUED

STAFF (CONTINUED)

ALLAN LOUCKS

THI LUONG

JOSE ORZOCO

SUCHARITA PAL

VICTORIA RAMIREZ

JENNIFER ROUSSEL

KATHY SHIN

DAN TAHARA

---o0o---

PUBLIC PARTICIPANTS

CHRISTINE GRAB

BEN LEE

California Taxpayers Association

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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

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1 SACRAMENTO, CALIFORNIA

2 THURSDAY, MARCH 4, 2021 1:30 P.M.

3 ---o0o---

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

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

9 MS. CASEY: Yes.

10 Member Vasquez.

11 MEMBER VASQUEZ: Present.

12 MS. CASEY: Member Asmundson.

13 MEMBER ASMUNDSON: Present.

14 MS. CASEY: Deputy-Controller Yvette Stowers.

15 ACTING CHAIRPERSON STOWERS: Present.

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

19 Please stand and join me in the Pledge of
20 Allegiance.

21 (Pledge of Allegiance recited in unison.)

22 ACTING CHAIRPERSON STOWERS: Thank you.

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

25 As FTB continues to follow all appropriate

1 federal, state, and local guidance for public guidance,
2 my fellow board members and I are attending the meeting
3 remotely, and FTB staff is following social distancing
4 best practices.

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

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

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

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

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

23 (No response.)

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

1 Please continue.

2 ACTING CHAIRPERSON STOWERS: Thank you.

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

5 MEMBER VASQUEZ: So moved.

6 MEMBER ASMUNDSON: Second.

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

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

14 Ms. Ramirez.

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

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

25 In 2020, California was severely affected by the

1 COVID-19 pandemic and many devastating wildfires
2 throughout the state. In February and March, California
3 experienced growing trends of the COVID-19 pandemic. On
4 March 19th, all five FTB public counter field offices
5 were closed to ensure the safety of our employees and
6 customers.

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

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

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

22 The FTB field office appointment e-mail link is
23 located on our public website. We respond to the e-mail
24 requests within two business days. Customers coming
25 into the field office public counters are expected to

1 maintain social distancing and follow safety protocols.

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

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

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

21 Despite the many challenges with the California
22 wildfires or the ongoing pandemic, our employees
23 continue to provide excellent service to the citizens of
24 California. Fifteen FTB volunteers assisted a total of
25 662 survivors at the seven local assistance centers.

1 Due to the COVID-19 pandemic, the counties worked
2 with Cal OES and the state agencies to offer virtual
3 local assistance centers for those survivors that are
4 unable to visit a local assistance center in person.
5 This allows survivors to safely have access to the
6 resources they need to help their recovery process.

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

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

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

19 Taxpayers affected by the wildfires that began in
20 August were granted an extension until December 15th,
21 2020, to file 2019 California tax returns and make
22 certain tax payments. This extension applied to the
23 15 counties shown on the slide.

24 For the September wildfires, affected taxpayers
25 had until January 15, 2021, to file and make certain tax

1 payments. This relief applied to the ten counties
2 listed on the slide.

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

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

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

1 disaster losses.

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

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

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

25 Disaster survivors may also receive free copies

1 of their state tax returns to replace those lost or
2 damaged. Taxpayers may complete Form FTB 3516 and write
3 the name of the disaster in blue or black ink at the top
4 of the request.

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

10 ACTING CHAIRPERSON STOWERS: Thank you.

11 Members, do you have any questions or comments?

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

16 ACTING CHAIRPERSON STOWERS: Thank you, sir.

17 We're going to first go to the members.

18 I believe I saw Member Vasquez having a question.

19 MEMBER VASQUEZ: Yes. Yes, Madam Chair.

20 First of all, thank you for that great and
21 informative presentation. I only had just one -- a
22 couple of just short questions. And one of them happens
23 to deal with, as we're advancing and we're doing all
24 these great new processes, especially with new
25 technology, I was just wondering in particular, as we're

1 dealing with the elderly population, in which way they
2 may not be active -- might not have access to all the
3 new technology or the processes or maybe anything even
4 close remotely to that.

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

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

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

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

20 MEMBER VASQUEZ: I appreciate it. Because, you
21 know, as we're -- and it's becoming more and more
22 evident, you know, now that we're in this pandemic, for
23 example, up until this point, we have always talked
24 about the whole digital divide, but it really hasn't
25 surfaced as much as it has now, when everyone is pretty

1 much forced to stay in lockdown. So unless you have
2 that technology at home or access to it, it's very
3 difficult for them to access, you know, especially some
4 of the great things that we're doing.

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

11 EXECUTIVE OFFICER STANISLAUS: Member Vasquez,
12 this is Selvi. The taxpayers can contact us by
13 telephone or by correspondence if they need to reach us.
14 And our phone lines are open, you know, from 8:00 to
15 5:00 every day on weekdays.

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

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

22 And then, two, making sure that we are available
23 at the counter as well so people that literally want to
24 walk in -- and I know that's a little bit of a challenge
25 right now with COVID. But as -- you know, as we start

1 opening up, just wanted to make sure we get that out to
2 the -- especially the senior and the elderly population.

3 ACTING CHAIRPERSON STOWERS: Fair question,
4 Member Vasquez.

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

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

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

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

21 ACTING CHAIRPERSON STOWERS: Perfect. Thank you.
22 Any more questions from the members?

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

25 And it's -- you know, in light of everything

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

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

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

1 difficult times into consideration.

2 MEMBER VASQUEZ: I appreciate it. Thank you.

3 ACTING CHAIRPERSON STOWERS: Thank you.

4 Any more questions from the members?

5 (No response.)

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

9 (No response.)

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

12 Please continue.

13 ACTING CHAIRPERSON STOWERS: Thank you very much.

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

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

25 MS. ROUSSEL: Good afternoon, Madam Chair and

1 Members of the Board. My name is Jennifer Roussel, the
2 EDR2 business director for FTB. And with me today is
3 Jose Orozco, the EDR2 technology director.

4 Today we'll be providing an informational update
5 on the Enterprise Data to Revenue project, known as
6 "EDR2." The last update we provided was in September of
7 2019.

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

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

14 MR. ORZOCO: Thank you, Jennifer.

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

25 Phase 1, known as "Enterprise Data to Revenue" or

1 the "EDR project" was completed in 2015. This project
2 created our new foundational systems, including case
3 management, taxpayer folder, and MyFTB.

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

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

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

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

18 With EDR2, we are focusing on improving
19 efficiencies, compliance, and customer service so we can
20 better serve our taxpayers and continue to address the
21 tax gap. Some of the most important improvements
22 include a new Enterprise case management system, where
23 we will transition our siloed and aging case management
24 systems for audit, legal, filing enforcement, and
25 underpayment onto the Enterprise case management

1 platform. This will give us one case management system
2 for enhanced workload management and allow us to
3 automate current manual processes.

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

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

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

23 And now Jennifer will present our procurement
24 timeline.

25 MS. ROUSSEL: The procurement of a project of

1 this size has been no small task. We have been busy on
2 the procurement for EDR2 since 2016. In 2016, we kicked
3 off the procurement process by starting our initial
4 project planning.

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

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

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

22 Also in 2019, we identified qualified business
23 partners, known as "QBPs." The QBPs were invited to
24 submit conceptual and draft proposals. We evaluated
25 these proposals and met with them to provide critical

1 input to help them refine their proposals. We also used
2 the information to help us refine our RFP.

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

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

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

25 Currently, we are in the final stages of the

1 project approval and procurement process. And we are
2 thrilled to say we have completed our selection process,
3 and we have issued our notification of award to OnCore
4 Consulting, LLC, as the lead business partner of the
5 QBP team that includes CGI Technologies and Solutions
6 Incorporated and Deloitte Consulting, LLP. And we're
7 finishing up the procurement and project approval
8 processes.

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

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

22 MR. ORZOCO: Thank you, Jennifer.

23 We learned some important lessons with EDR1 that
24 we would like to incorporate into EDR2: We learned the
25 importance of ensuring that we involve our security and

1 internal audit teams early in the project, to ensure the
2 solution will meet our compliance requirement and our
3 security requirements; and ensuring that our -- that we
4 document our business processes and maintain the
5 documentations as change occurs; finally, ensuring that
6 we begin organizational change management early in the
7 project to build Enterprise awareness and support.

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

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

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

20 (Video presentation.)

21 MR. ORZOCO: Thank you for watching.

22 On behalf of the Franchise Tax Board, Jennifer
23 and I would like to thank you for your continued support
24 with this important project. This concludes our
25 presentation today.

1 Do you have any questions for us?

2 ACTING CHAIRPERSON STOWERS: Thank you.

3 Members, do you have any questions?

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

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

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

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

25 MS. ROUSSEL: Yes, Member Vasquez. And very,

1 very good point.

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

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

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

19 MS. ROUSSEL: Yes. Fantastic question.

20 So, actually, part of the resource request that
21 you will hear from Jeanne and that we requested in the
22 BCP includes business process management documentation,
23 which is the first step of documenting our current
24 processes and then looking at what we want there to
25 be -- to be as part of the business process

1 reengineering that starts and happens during the
2 project. So part of that will be looking at the user
3 experience and the customer experience to ensure that we
4 don't make them go through steps that they don't
5 necessarily need to and that we make that a much --
6 fluid approach to providing them the information that
7 they so definitely need.

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

10 ACTING CHAIRPERSON STOWERS: Any more questions
11 from the members?

12 (No Response.)

13 ACTING CHAIRPERSON STOWERS: Thank you.

14 Do we have any questions from the members of the
15 public on the teleconference line?

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

20 (No response.)

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

23 Please continue.

24 ACTING CHAIRPERSON STOWERS: Thank you, sir.

25 We are now on Item Number 4, a PowerPoint

1 presentation on FTB Strategic Plan.

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

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

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

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

19 The first, mobile application, was a project that
20 now allows customers to make real-time payments and
21 utilize text messaging via mobile application. And the
22 second, self-service options, was a project that
23 developed self-service options via FTB's public website,
24 again in real-time, as well as provides for interactive
25 voice responses that allow taxpayers to initiate

1 installment agreements for skipping payments and bill
2 payment delays.

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

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

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

23 Our third goal, strong organization, focused on
24 investing in our employees, challenging and empowering
25 them to be experts in their field, and also to help them

1 achieve their full potential. There, again, are two
2 specific successes that today fulfill the best outcome
3 for the department and its valuable employees.

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

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

23 And our fourth goal, operational excellence,
24 focused on optimizing FTB's processes, products, and
25 resources to better serve our customers. There, again,

1 are two specific successes that display the strides that
2 FTB has made in enhancing its operations.

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

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

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

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

22 The first, the California Earned Income Tax
23 Credit. FTB continues to reach out to taxpayers who are
24 eligible for EITC, which provides needed funds to
25 Californians. FTB also partners with the California

1 Department of Community Services and Development to
2 provide grants for promotion of EITC.

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

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

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

22 MR. DOMINGUEZ: Thank you, Allan.

23 Good afternoon, Madam Chair and Board Members.
24 And thank you for allowing me to present our marketing
25 plans for the new 2021-'25 Strategic Plan.

1 So last September, we presented to the Board the
2 draft of the new strategic plan. And since that day, we
3 have completed the necessary touches to the plan, and
4 I'm glad to inform you that it has now been finalized
5 and published.

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

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

20 Now, over the next several months of this
21 rollout, our expectation is to educate everyone on the
22 value that they have and the role they play in FTB's
23 future. We will be engaging our staff with different
24 activities and challenges related to the plan in order
25 to keep them involved and informed about our goals. We

1 also want our staff to recognize how their individual
2 and program area efforts contribute to the success of
3 our strategic plan.

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

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

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

23 Now, lastly, throughout the course of the
24 rollout, we plan to publish articles that highlight some
25 of our accomplishments tied back to the strategic plan.

1 The articles will be posted on our intranet site, in the
2 news section, on the front page.

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

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

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

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

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

25 But other than that, you know, I think it was

1 great.

2 MR. DOMINGUEZ: Thank you.

3 MEMBER VAZQUEZ: Thank you.

4 MR. LOUCKS: Thank you, Member Vasquez.

5 ACTING CHAIRPERSON STOWERS: Thank you.

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

8 PHONE MODERATOR: And ladies and gentlemen on the
9 phone lines, if you would like to place yourself in the
10 queue for public comment, as a reminder, you may press
11 1, then 0 at this time.

12 (No response.)

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

15 Please continue.

16 ACTING CHAIRPERSON STOWERS: Thank you.

17 PHONE MODERATOR: Thank you.

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

22 Please move forward.

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

25 My name is Sucharita Pal. Presenting with me

1 today is my colleague Fernando Castro. As members of
2 the Audit Division, we are pleased to present to you an
3 overview of our newly launched Pathways to Excellence
4 Portal. One of our Audit Division's core priorities is
5 to invest in its staff via training, developing, and
6 engaging them.

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

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

15 Research has shown that individuals obtain
16 70 percent of their knowledge from job-related learning,
17 20 percent through collaboration, and 10 percent from
18 classroom learning.

19 The 37 different technical paths of audit issues
20 currently available on the Pathways Portal promote
21 technical learning through a combination of coursework,
22 experiences, and collaborative opportunities. These
23 paths act as a bridge between starting as a new hire to
24 achieving expert proficiency. We applied best practices
25 for curriculum development and consulted with staff and

1 managers extensively to assess their needs prior to
2 building these paths. The Pathways Portal also houses a
3 compilation of learning tools and available training
4 resources in one location. Staff have the flexibility
5 to pursue any number of paths throughout their career.

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

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

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

25 The technical information is organized

1 sequentially to guide users through preliminary
2 understanding to advanced learning of concepts. The
3 user-friendly portal also provides easy access to
4 important departmental resources through Enterprise and
5 Divisional Connections icons.

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

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

23 Thank you, Madam Chair and Board Members for your
24 time. And now I will hand it over to Fernando to walk
25 you through these pages and the rest of the

1 presentation.

2 MR. CASTRO: Thank you, Sucharita. And thank
3 you, Madam Chair and Board Members, for this opportunity
4 to share.

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

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

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

22 The technical training page is organized similar
23 to the Tool Box and includes various learning resources.
24 These include in-house training, informative news
25 articles, and details about external training related to

1 the technical issue, compiled into one convenient
2 location. This page is a good place to start for anyone
3 interested in learning a new issue.

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

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

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

1 and the State.

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

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

10 ACTING CHAIRPERSON STOWERS: Thank you.

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

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

22 And with that in mind, my question is, can you
23 talk more about FTB's succession planning and training
24 staff to be leaders, mentors, and trainers, to ensure
25 that we can immediately fill these high-level, technical

1 positions that will be left open by experienced and
2 highly technical employees who leave the agency due to
3 retirement?

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

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

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

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

21 MR. CASTRO: Also to support the succession
22 planning is we're making sure to continuous --
23 continuously put effort into recruitment programs to
24 reach out to new staff to join Franchise Tax Board and
25 hopefully keep that influx of fresh auditors coming in

1 to support the staff as they move on, into retirement.

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

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

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

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

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

18 ACTING CHAIRPERSON STOWERS: Thank you.

19 I actually have a couple of comments or
20 questions.

21 The first question is, can any audit person tap
22 into the portal, or must you be working that? So must
23 you be in a pass-through entity to study pass-through
24 entity, or could you be in multistate and decide you
25 just want to learn something else?

1 MS. PAL: Yes. The way it is designed is anybody
2 within Audit and Legal, as of now, can tap into
3 absolutely any page into the portal. Our plan is,
4 eventually, to open it to the rest of FTB as well so
5 that anybody from collections or wherever, any other
6 department, who wants to know about a particular tax
7 issue or a court case that exists and they can find
8 where it is, they will be able to access that.

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

14 ACTING CHAIRPERSON STOWERS: Perfect.

15 Then my other question is, kind of leading up to
16 that is, I know in the past, FTB has included some of
17 their training material on the website for the public.

18 Is the goal to include this pathway available to
19 the public as well?

20 MS. PAL: Currently, of course, it's not
21 available. But FTB is building an Enterprise Knowledge
22 Library -- I'm not exactly sure of the timeline of
23 that -- and all our manuals, procedure, guidelines,
24 quite a bit of our training material, including
25 Pathways, will move into that library.

1 And then some of it will be accessible to the
2 members of the public as well. We don't know which
3 ones, but the appropriate ones will be accessible. But
4 that will go through all the procedures of deciding what
5 will be actually available. But that's the plan, yes.

6 ACTING CHAIRPERSON STOWERS: Perfect. Thank you.

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

10 PHONE MODERATOR: And ladies and gentlemen on the
11 phone lines, if you would like to place yourself in the
12 queue for public comment, as a reminder, you may press
13 1, then 0 at this time.

14 (No response.)

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

17 Please continue.

18 ACTING CHAIRPERSON STOWERS: Thank you.

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

21 We have Hanna Cho to present a proposed section
22 25137, Alternative Apportion Method Petition Regulation.

23 This is an action item, Members.

24 MS. CHO: Thank you. And good afternoon,
25 Madam Chair and Members of the Board.

1 My name is Hanna Cho, and I'm an attorney in the
2 Legal Division.

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

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

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

23 Other than the guidance set forth in the current
24 regulation language and in FTB Resolutions 2000-10 and
25 2017-01, there is no other formal guidance as to how

1 petitions to the FTB itself should be filed pursuant to
2 section 25137 and how such petitions will be considered
3 by the FTB itself.

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

10 The six major proposed amendments include:

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

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

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

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

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

25 And, six, the addition of the applicability date

1 of the proposed amendment.

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

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

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

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

1 to amend Regulation 25137.

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

4 ACTING CHAIRPERSON STOWERS: Thank you.

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

7 (No response.)

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

13 MS. CHO: Yes.

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

16 MS. CHO: Yes.

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

21 ACTING CHAIRPERSON STOWERS: Thank you.

22 Appreciate that.

23 MS. CHO: Of course.

24 ACTING CHAIRPERSON STOWERS: If there's no
25 comments from members, let's see if we have any comments

1 from the public wishing to speak on this item from the
2 teleconference line.

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

5 Your line is open.

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

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

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

22 ACTING CHAIRPERSON STOWERS: Thank you, Mr. Lee.

23 Any more public comments?

24 PHONE MODERATOR: And ladies and gentleman on the
25 phone lines, if you would will like to place yourself in

1 the queue for public comment, as a reminder, you may
2 press 1, then 0 at this time.

3 (No response.)

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

6 Please continue.

7 ACTING CHAIRPERSON STOWERS: Thank you, sir.

8 Members, do we have a motion on this item?

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

12 ACTING CHAIRPERSON STOWERS: Go right ahead.

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

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

1 consistent with the board resolutions.

2 MEMBER VASQUEZ: Thank you.

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

5 ACTING CHAIRPERSON STOWERS: Is there a second?

6 MEMBER ASMUNDSON: Second.

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

10 We are now on to Item 7, Administrative Matters.

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

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

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

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

1 presentation.

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

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

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

19 Similar to the budget change proposal, this
20 request only notes resources needed for this particular
21 fiscal year. As required with most large projects, a
22 BCP is necessary for each year to request additional
23 resources needed. Please refer to the body of the
24 request to understand if the requested resources are for
25 permanent or an ongoing need or for a limited term in

1 nature.

2 Compensation amounts will be requested annually.
3 These resources requested will ensure that FTB has the
4 appropriate level of resources for a successful first
5 year of the EDR2 project.

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

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

24 This proposal will allow FTB to address the
25 following key issues: FTB will be able to meet required

1 energy efficiency mandates; we will eliminate single
2 points of failure in our operations, thus avoiding
3 unnecessary operational impacts in the event of an
4 issue; it will ensure that equipment is supported by
5 current industry standards and vendor support is
6 available in the event of an emergency; it will also
7 ensure that FTB and our relevant partners, such as DGS,
8 can perform routine maintenance without operational
9 impacts.

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

13 MS. LUONG: Thank you, Jeanne.

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

17 Our third proposal is for the augmentation of
18 \$2 million to FTB's litigation budget with the Attorney
19 General's Office, beginning with Fiscal Year '21-'22 and
20 ongoing in order to defend against tax refund lawsuits.
21 FTB has continued to see increased litigation efforts
22 with their complex tax matters. This augmentation will
23 ensure that we can adequately protect the state's
24 interests in these casings.

25 The final proposal is to increase the spending

1 authority for the asset forfeiture account from \$150,000
2 to \$740,000, beginning with Fiscal Year '21-'22 and
3 annually thereafter.

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

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

11 ACTING CHAIRPERSON STOWERS: Thank you.

12 Members, do you have any comments or questions?

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

15 So right now we're just going to take up 7A1,
16 7A2, and I guess 7A3, and then the fourth one we will do
17 after, right? Is that how it works?

18 ACTING CHAIRPERSON STOWERS: Yes.

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

21 ACTING CHAIRPERSON STOWERS: Okay.

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

25 ACTING CHAIRPERSON STOWERS: I do.

1 MEMBER VASQUEZ: Okay.

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

6 MEMBER VASQUEZ: Okay.

7 PHONE MODERATOR: We do have a --

8 ACTING CHAIRPERSON STOWERS: Is any member --

9 PHONE MODERATOR: -- question.

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

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

14 Your line is open.

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

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

22 FTB told me I would have to sue them. So I did.
23 FTB has yet to deny in court that their withholding
24 practices are unlawful. And in California Civil Code,
25 failure to deny constitutes admission of truth.

1 FTB has unnecessarily run up the attorney costs
2 in our pending litigation by refusing to provide
3 documents that will prove once and for all whether FTB
4 committed fraud. If FTB would have turned over these
5 documents, we would -- we could have requested a summary
6 judgment, and the case would be over by now.

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

11 I have already documented to the Board that FTB
12 has several unlawful schemes in place to overcharge
13 taxpayers. FTB is inviting lawsuits by systemically
14 violating the law. FTB has testified that the
15 \$2 million in taxpayer funds will be used to make sure
16 that FTB can continue committing these crimes against
17 the same taxpayers that they are requesting the money
18 from. This is unconscionable.

19 In the written request, FTB stated that it needs
20 part of the \$2 million to cover plaintiffs' attorneys'
21 costs for cases that FTB knows it will ultimately lose.

22 It is unconscionable that FTB is wasting taxpayer
23 funds by deliberately running up litigation costs
24 instead of settling. Instead of giving FTB more money,
25 the Board should fix the root of the problem by ordering

1 a halt and desist on all of FTB's unlawful activities so
2 that all new lawsuits stop. The Board should order FTB
3 to stop unnecessarily running up costs in pending
4 litigation.

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

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

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

13 Do we have comments from anyone else from the
14 public?

15 PHONE MODERATOR: And ladies and gentlemen on the
16 phone lines, if you would like to place yourself in the
17 queue for public comment, as a reminder, you may press
18 1, then 0 at this time.

19 (No response.)

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

22 Please continue.

23 ACTING CHAIRPERSON STOWERS: Thank you, sir.

24 Okay. So I would like to take a motion for this
25 item, and I am assuming that Ms. Asmundson will not be

1 participating?

2 MEMBER ASMUNDSON: I will be abstaining.

3 Thank you.

4 ACTING CHAIRPERSON STOWERS: Thank you.

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

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

10 ACTING CHAIRPERSON STOWERS: Thank you.

11 And I will second that motion.

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

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

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

18 MEMBER VASQUEZ: Yes.

19 And I am comfortable with this, as I was reading
20 through it and talking to staff, with the following
21 condition: And that would be to put on record that
22 there should be regular review of their performance
23 measures on this so at least we are doing our due
24 diligence about how and what is being spent, as well as
25 how much we have increased our capacity in this category

1 as a result of the newer technologies and additional
2 training. It would be easier to justify future
3 increases if the department decides to add on more
4 resources would be my -- I would like to include that.

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

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

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

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

17 ACTING CHAIRPERSON STOWERS: Thank you.

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

21 We would now move onto contracts over a million.

22 MR. BANUELOS: Good afternoon, Madam Chair and
23 fellow Board Members. It's a pleasure to be here with
24 you today. My name is Michael Banuelos, and I'm the
25 director of the Franchise Tax Board Procurement Bureau.

1 And I'm here today to request approval for activities on
2 two contracts over \$1 million.

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

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

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

23 You may recall that at the December Board
24 meeting, I requested and received approval to move
25 forward with the procurement to replace our scanners.

1 We are moving forward with that effort. However, the
2 replacement will take some time. In the meantime, in
3 order to continue operations, it is critical that we
4 continue to maintain our existing scanners.

5 Our existing agreement expires in June 2021. The
6 estimated value of the new contract is approximately
7 \$1.4 million, and we are planning on conducting a
8 competitive bid.

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

12 ACTING CHAIRPERSON STOWERS: Thank you, sir.
13 Members, any comments or questions?

14 MEMBER VASQUEZ: I'm good.

15 ACTING CHAIRPERSON STOWERS: Thank you.

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

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

22 (No response.)

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

25 Please continue.

1 ACTING CHAIRPERSON STOWERS: Thank you.

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

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

6 MEMBER ASMUNDSON: And I will second that.

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

10 Without any objection, that motion passes.

11 Members, do we have a motion on the contract for
12 7B2?

13 MEMBER VASQUEZ: So moved.

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

16 MEMBER ASMUNDSON: I will second that.

17 ACTING CHAIRPERSON STOWERS: I second that
18 motion.

19 Any objections?

20 (No response.)

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

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

24 MR. BANUELOS: Thank you for your time and
25 support today.

1 ACTING CHAIRPERSON STOWERS: Thank you.

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

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

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

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

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

21 Even though we are getting a later start than the
22 past year, as of last weekend, we have processed
23 4.2 million personal income tax returns, with
24 3.9 million of those having been e-filed, 3.1 million
25 refunds, with an average refund of \$998. Better still,

1 2.7 million refunds were deposited directly in the
2 taxpayers' bank accounts. 1.7 million tax payments
3 totaling \$18.7 billion, with 55 percent were made
4 electronically. Also, more than 936,000 California
5 Earned Income Tax Credits have been issued for more than
6 \$184,000,000, and more than 147,000 taxpayers have
7 claimed the Young Child Tax Credits, for a total value
8 of over \$135 million.

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

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

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

21 Thank you, Board Members.

22 ACTING CHAIRPERSON STOWERS: Thank you.

23 Members, do you have any comments or questions?

24 MEMBER VASQUEZ: Just one. Congratulations to
25 Selvi. I know you always go the extra mile and at least

1 in my time -- I guess I'm going on my second year with
2 you -- several things that I have raised and concerns,
3 you have been great in terms of jumping on it and really
4 trying to resolve it as quick and as efficient as
5 possible, and I really want to thank you for that.

6 EXECUTIVE OFFICER STANISLAUS: Thank you, Member.

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

12 EXECUTIVE OFFICER STANISLAUS: Thank you.

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

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

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

21 (No response.)

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

24 Please continue.

25 ACTING CHAIRPERSON STOWERS: Thank you. We are

1 now on to Item Number 9, which is Board Members' Time.

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

4 MEMBER VASQUEZ: Yes, Madam Chair.

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

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

24 So I just wanted to put that out there.

25 ACTING CHAIRPERSON STOWERS: Thank you, sir.

1 Are you aware of the issue, and are you prepared
2 for a response?

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

5 Dan, are you up there now?

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

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

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

21 MEMBER VASQUEZ: Yes. And I just wanted to thank
22 you for that. I know I had conversation with staff, you
23 know, right after it broke and wanted to, once again,
24 commend our leader, Selvi, on that because, you know,
25 you acted on it right away, and you got back to me and,

1 one, explained -- you know, like I think you mentioned
2 earlier and in my conversations, that some of this stuff
3 was, you know, three, four, maybe five years old.

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

10 Thank you.

11 MR. TAHARA: Thank you.

12 ACTING CHAIRPERSON STOWERS: Thank you,
13 Member Vasquez.

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

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

21 (No response.)

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

24 Please continue.

25 ACTING CHAIRPERSON STOWERS: Thank you, sir. I'm

1 going to reserve Board Member Time for Controller Yee
2 till after our recess, which means this is a perfect
3 time for a recess.

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

6 Okay. We are in recess.

7 (Break taken in proceedings:

8 3:05 p.m. to 3:17 p.m.)

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

11 We will reconvene the Franchise Tax Board
12 meeting.

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

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

24 Petitioner Smithfield Packaged Meats Corporation
25 has 30 minutes to make its presentation. Following

1 that, Franchise Tax Board staff will have 30 minutes to
2 respond. And then Petitioner will then have 15 minutes
3 for a rebuttal.

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

6 MR. MUILENBURG: Can everyone hear me now?

7 CHAIRPERSON YEE: Yes, we can hear you.

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

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

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

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

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

24 CHAIRPERSON YEE: You are doing fine.

25 MR. MUILENBURG: Okay. Thanks.

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

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

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

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

21 So understanding the scope of a 25137 petition,
22 that is precisely why we're here; we're asking you to
23 look -- you know, to take a careful listen to the facts
24 that we present and make a determination in your sole
25 authority, right, whether the application of the

1 standard apportionment factor in this specific case, to
2 this specific taxpayer, these specific facts, these
3 specific taxable years, results in, you know, a fair
4 apportionment of business income to the State of
5 California.

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

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

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

22 And then, finally, I want to acknowledge
23 Mr. Daryl Lee and the technology team for -- even
24 despite my questions right now -- for helping us get --
25 so thank you for everyone involved.

1 And, you know, with that, I will turn it over to
2 Mr. Brannan to begin our presentation.

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

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

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

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

24 So we're going to parse this out a little bit as
25 we go through this hearing, but I think the real point

1 in starting with the statute is to say this is the
2 authority. This is the authority that Mr. Muilenburg
3 referred to in his introduction, and it's the authority
4 that we're going to ask you to invoke at the end of the
5 hearing today.

6 So if we can go to slide 3, please.

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

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

21 As you will hear from Mr. Stewart, Smithfield's
22 out-of-state manufacturing activities directly
23 contribute to the income subject to tax by the state.
24 And it's because of that contribution of in the income
25 that those activities should be represented in the

1 apportionment formula here in California. Otherwise,
2 we're taxing -- we're imposing a tax on income on
3 factors that do not reflect the entire business for
4 Smithfield.

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

6 If we could go to slide 4, please.

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

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

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

25 For the years under the consideration, on

1 average, 99 percent of the property and payroll
2 responsible for these advantages resided outside of
3 California.

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

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

14 MR. STEWART: Yes, good afternoon.

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

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

20 MR. STEWART: Sure. Thank you, Derick.

21 I grew up on a small family farm in Iowa. I
22 attended school at Iowa State University, where I got an
23 undergraduate degree in Agricultural Systems Technology
24 with an emphasis on Agricultural Business and then
25 furthered my education at Michigan State University with

1 a Master's of Science in Leadership and Management.

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

9 MR. BRANNAN: Thank you very much, Brady.

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

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

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

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

1 Thank you.

2 MR. BRANNAN: Thank you, Controller Yee.

3 So I am assuming we're good to go.

4 CHAIRPERSON YEE: Yeah.

5 MR. BRANNAN: Okay. Thank you.

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

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

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

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

25 This strategy is essentially determined at our

1 headquarters that I'm at, here in Smithfield, Virginia,
2 and we focus and apply that strategy across our
3 operating assets within the U.S.

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

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

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

1 that's just validating that process.

2 From a breeding perspective, we also --

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

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

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

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

21 MR. STEWART: You bet.

22 So we actually own genetics within Smithfield.
23 And, again, we have several PhD geneticists that work in
24 terms of our breeding program. They are focused on not
25 only meat quality, so that we can truly produce the

1 right product, at the right place, for the right
2 consumer base, the right composition of those animals,
3 but make sure that those animals have world-class
4 performance in terms of the feed that we provide them,
5 so that they can grow quickly, remain healthy, and
6 convert feed as well.

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

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

14 MR. STEWART: Sure.

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

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

24 MR. BRANNAN: Okay. So thank you.

25 So we have covered kind of the feeding side and

1 the R&D that goes into the feed composition, the
2 breeding or genetic side.

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

6 MR. STEWART: You bet.

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

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

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

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

1 family farms.

2 Could you maybe touch on that for the panel?

3 MR. STEWART: Absolutely.

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

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

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

20 MR. STEWART: Absolutely, Derick.

21 Obviously, it's very important from a logistic
22 standpoint to have these production facilities, these
23 harvest facilities, located close to not only company
24 operations that we talked about earlier, but also the
25 family farms that we just mentioned as well.

1 So these harvest facilities are located close to
2 these family farmers or plants. That's the most
3 economical way for us to truly have an integrated,
4 high-value supply chain. Really, the focus of these
5 harvest plants is to produce, essentially, hogs into
6 pork products that our customers, whether it's retailers
7 or food service institutions, and ultimately customers,
8 truly appreciate.

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

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

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

25 MR. BRANNAN: And pharmaceutical as well, is

1 that --

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

10 MR. BRANNAN: Super. Thank you.

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

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

21 Again, most of our assets, Derick, are located in
22 either the Midwest or in the East Coast. And so,
23 therefore, that's where our focus is in pork production,
24 is making sure we're located close to animals and close
25 to where the grain source is. That's the best way

1 from -- in the end supply chain to ensure we create
2 value with the resources we have.

3 MR. BRANNAN: Great.

4 I have no more questions for you, Mr. Stewart.
5 And I will move into a discussion of the law, unless,
6 Controller Yee, you or the board members have questions.

7 We can't hear you. You might be on mute. I
8 don't want to be presumptuous.

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

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

14 CHAIRPERSON YEE: Yes, Member Vasquez. Please.

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

20 MR. BRANNAN: Go ahead, Brady.

21 MR. STEWART: My apologies.

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

24 MEMBER VASQUEZ: So that's to say that there is
25 some hogs that do come into California that you do

1 process here or you -- or is there any that really come
2 in un-slaughtered, I guess, is my question?

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

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

7 MR. STEWART: Yeah. Sorry.

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

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

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

17 MR. STEWART: Yes, sir.

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

21 CHAIRPERSON YEE: Thank you, Member Vasquez.

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

25 MR. BRANNAN: Thank you very much,

1 Controller Yee.

2 If we could move to the next slide, please.

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

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

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

20 Can we go to slide 7, please.

21 Slide 7, again, back to the statute; if the
22 allocation and apportionment provisions of this act do
23 not fairly represent -- that fairness concept again --
24 the extent of the taxpayer's business activity in the
25 state.

1 So for purposes of distortion, the statute
2 requires us to focus on two things: What is fair and
3 what are the business activities that we need to look at
4 in order to determine what is fair.

5 So we go to slide 8, please.

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

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

14 And what we have here is a quote from California
15 Supreme Court in the McDonnell Douglas case. And it
16 makes very clear what the purpose is, and it helps guide
17 us as to the fairness determination here. And the
18 apportionment of the unitary business formula used must
19 give adequate weight to the essential elements
20 responsible for the earning of the income. The mutual
21 dependency of the interrelated activities in furtherance
22 in the entire business sustains the apportionment
23 process. McDonnell Douglas is telling us that a fair
24 apportionment formula reflects those elements essential
25 for earning of the income subject to tax.

1 The ultimate goal is assessing whether the
2 standard formula fairly represents the company's
3 business activity in California.

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

6 If we can move to the next slide, please.

7 Go to slide 9, please.

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

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

22 These three factors are used to balance each
23 other out, each reflecting a different type of
24 contribution to the business activity and income of the
25 unitary business as a whole.

1 For Smithfield, the relevant business activities
2 for purposes of the distortion analysis include all of
3 the activities responsible for earning the income
4 subject to tax.

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

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

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

19 Let's move to slide ten, please.

20 The leading case in this area is the California
21 Supreme Court case in Microsoft. Microsoft, the court
22 considered whether or not to exclude. Very important
23 difference between Microsoft and the current case,
24 excluding certain activities, specifically treasury
25 activities.

1 The court concluded that the exclusion was
2 appropriate because the treasury activities were
3 qualitatively different from the taxpayer's principal
4 software business and quantitatively distorted the
5 formula. And as a result, now we have this kind of
6 two-pronged -- it's not an analysis, but they are the
7 two key factors in the overall analysis regarding
8 distortion.

9 So let's start with the qualitative distortion
10 discussion.

11 If we could go to slide 11, please.

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

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

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

24 So for that reason, the single-sales factor is
25 qualitatively distortive because it excludes those

1 manufacturing activities from the apportionment formula.

2 Let's go to slide 12, please.

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

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

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

25 You can also see a difference between the

1 single-sales factor apportionment and the three-factor
2 apportionment formula. So between -- the difference
3 between the two ends up being in the neighborhood of,
4 you know, just right at 50 percent if we average, but in
5 the earlier year, significantly higher.

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

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

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

22 So where we're at now, it is distortive for the
23 single-sales factor to ignore -- or excuse me -- for
24 Smithfield's income to be apportioned based only on the
25 single-sales factor. Smithfield makes money, it

1 generates that very income, through efficiencies in its
2 production operations outside the state through the
3 efficiencies of its research and development personnel
4 outside the state. It is not fair for the state to tax
5 those income based only on the market here in
6 California.

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

10 MR. MUILENBURG: Can you hear me again?

11 MR. BRANNAN: Yes.

12 CHAIRPERSON YEE: We can hear you.

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

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

17 CHAIRPERSON YEE: Okay. All right.

18 MR. MUILENBURG: Okay.

19 CHAIRPERSON YEE: Please proceed.

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

22 CHAIRPERSON YEE: Thank you. All right.

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

25 Okay. If we can go to slide 14, please.

1 So as Derick walked you through, you know, the
2 first step is proving distortion. And Mr. Stewart's
3 testimony, along with our analysis of the case law, we
4 believe does just that.

5 And so step two is to identify a remedy.

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

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

25 But I want to summarize sort of -- and the reason

1 for this proposed remedy is really threefold, right?
2 The first -- the first reason is, as you heard the
3 testimony of Mr. Stewart and as Mr. Brannan described
4 the hog business and how we make money on extremely
5 small margins by controlling costs, increasing yield,
6 you know, making better feed, etc.

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

15 Number 2, as I think we all know, I mean, the
16 three-factor evenly weighted formula was used for over
17 25 years in California as the standard apportionment
18 formula. It has been changed three times since then,
19 which I'm sure we'll get into. But, you know, I believe
20 there's an inherent fairness there, knowing that it's
21 been used for 25 years and that some states, you know,
22 using unitary combined, continue to use a formula of
23 that nature.

24 Obviously there are a lot of good reasons for
25 going to a single-sales factor with a market state like

1 California. It's understandable; you don't want to
2 penalize companies for investing in the state. But,
3 nonetheless, you know, when we're talking about
4 fairness, something that worked for 25 years, it
5 certainly has some fairness history to it.

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

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

22 That is our community. Those are our
23 competitors. I think it's known to all parties that
24 companies at Smithfield directly competes with our using
25 that formula with the permission of the State of

1 California. Now, it's likely due to different
2 organizational structures that causes them and FTB staff
3 size to meet the regulation as opposed to us. But
4 nonetheless, you know, when we're talking about
5 fairness, once again, we're talking about a formula that
6 is used for 25 years as the standard and continues to be
7 used in what can only be described as Smithfield's, you
8 know, business area, that being agricultural.

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

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

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

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

22 MS. SHIN: Good afternoon, Board Members. My
23 name is Kathy Shin, Tax Counsel IV, with the Franchise
24 Tax Board's Legal Division. Accompanying me is Laurie
25 McElhatton, Attorney V. Together, we represent the

1 staff of the Franchise Tax Board in this matter.

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

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

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

19 The single-sales factor is the standard
20 apportionment method for the years at issue. It was
21 passed by the voters by Proposition 39, which mandated
22 that beginning from January 1st, 2013, most multistate
23 businesses, other than those in certain enumerated
24 industries, determined their California source of income
25 by using the single-sales factor, which the U.S. Supreme

1 Court upheld as constitutional over 40 years ago in the
2 Moorman case.

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

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

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

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

23 After due consideration, Smithfield's variance
24 request was denied. Smithfield filed a current position
25 requesting the Board's review of the variance request.

1 Smithfield is the world's leading vertically
2 integrated pork processor and hog producer that markets
3 a wide variety of pork products, both domestically and
4 internationally. As you just heard, it has a highly
5 sophisticated manufacturing operation that includes a
6 network of both self-owned and third-party-owned hog
7 farms. Smithfield operates these hog farms like a
8 high-tech assembly line for hog production, which are
9 used as raw material for the finished pork products.

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

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

24 Nothing has changed in that respect, even with
25 the enactment of the single-sales factor. Yet, the

1 reason why we are here today is because the single-sales
2 factor, compared to the method used prior to Prop 39,
3 increased Smithfield's income source to California, as
4 it did for other out-of-state businesses.

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

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

17 However, Smithfield does not qualify because its
18 gross business receipts from agricultural business
19 activity -- that is, hog farming -- fell far short of
20 50 percent of the total as required. In fact,
21 Smithfield produced insignificant amount of gross
22 business receipts from the hog production segment that
23 generated most internal sales, which are explicitly
24 excluded from the definition of "qualified business
25 receipts."

1 Smithfield processed and used most of the hogs
2 produced as raw material for the pork product segments,
3 which are the profit centers that generated the lion's
4 share of Smithfield's gross business receipts.
5 Accordingly, since it does not qualify for the
6 three-factor formula, Smithfield must use the standard
7 single-sales factor method for sourcing of apportionable
8 business income to this state.

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

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

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

1 0.17 percent of the gross receipts generated from this
2 state.

3 In the discussion that follows, we will show:

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

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

12 Three, the distortion case Hans Rees, with the
13 80 percent apportionment to a single state was not
14 analogous to the current case, with 7.7 percent
15 apportionment;

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

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

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

1 be remedied.

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

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

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

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

22 It then relies on the numerical difference, what
23 the law sets as its tax liability and what Smithfield
24 argues its tax liability should be, to assert that the
25 standard formula does not fairly represent its business

1 activity in this state. But just because an application
2 of an alternative formula will reduce the amount of
3 income sourced to a particular jurisdiction, it does not
4 follow that the standard formula does not represent the
5 extent of the taxpayer's business activity in that
6 jurisdiction.

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

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

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

23 The court held such argument fails to demonstrate
24 that the single-sales factor produced an unfair result.
25 Instead, what is required is evidence to establish a

1 basis for comparing the taxpayer's actual income in Iowa
2 with the income apportioned to Iowa under the
3 single-sales factor. But in the absence of such
4 evidence, the court had no grounds to assume that the
5 three-factor formula produced a result equivalent to the
6 taxpayer's actual income from activities in Iowa.

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

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

22 Similarly, in the current case, Smithfield's
23 argument, based on the difference between two
24 apportionment methods and the resulting tax liabilities,
25 fails to demonstrate that the standard single-sales

1 factor method resulted in an unfair reflection of
2 Smithfield's activity in this state, keeping in mind
3 that both methods are intended to only provide a rough
4 approximation of the actual income earned in a
5 particular state.

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

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

24 In the current case, by contrast, the
25 single-sales factor attributed 7.67 percent of

1 Smithfield's income to California, a far cry from the
2 80 percent in Hans Rees.

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

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

20 Smithfield marketed its products worldwide, and,
21 as a result, the single-sales factor sourced the income
22 broadly to most states; most, if not all, 50 states, as
23 well as to foreign. Therefore, the current case clearly
24 is not analogous to Hans Rees and is certainly not on
25 all fours with that case, as asserted by Smithfield.

1 Here, Hans Rees does not support Smithfield's
2 argument that the application of the single-sales factor
3 resulted in an unfair reflection of its in-state
4 business activity.

5 Fourth, Smithfield also incorrectly relies on the
6 qualitative and quantitative analysis contained in the
7 2006 California Supreme Court case Microsoft and 2012
8 California Court of Appeal case General Mills.

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

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

21 Fifth, Smithfield inappropriately challenges the
22 construct of the single-sales factor apportionment. It
23 asserts that the single-sales factor results in an
24 unfair reflection of its in-state business activity
25 because its out-of-state production costs, as reflected

1 by property and payroll, are omitted from the formula
2 used to apportion its business income.

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

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

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

20 In summary, under section 25137, it is
21 Smithfield's burden to prove, by clear and convincing
22 evidence, that the approximation provided by the
23 single-sales factor formula is not a fair representation
24 of its business activity in this state before a relief
25 can be granted. But faced with the significant burden

1 of proof, Smithfield argues to use the three-factor
2 formula for which it does not legally qualify rather
3 than explaining why the single-sales factor is unfair.

4 Accordingly, Smithfield has failed to provide
5 requisite evidence, let alone clear and convincing
6 evidence, that the single-sales factor does not fairly
7 represent the extent of its business activity in this
8 state.

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

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

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

1 section 25137.

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

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

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

1 from the sales factor.

2 In contrast, Smithfield has not and cannot
3 identify a problem with the single-sales factor method
4 because it is functioning as intended by appropriately
5 measuring Smithfield's relative market activity, which
6 is pretty much the only activity it has in California.
7 Instead of first showing that the single-sales factor is
8 distortive, as required under the prong of section
9 25137, Smithfield works in reverse by comparing its
10 preferred three-factor method to the single-sales factor
11 to argue that the single-sales factor is unfair.

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

23 Smithfield asserts that the single-sales factor
24 is unfair because the apportionment percentage under the
25 three-factor method is 54 percent lower and it

1 circuitously argues that the three-factor formula should
2 be applied as a reasonable remedy to cure the distortion
3 created by comparing the two methods in the first place.

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

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

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

25 Whereas Smithfield advocates a position that is

1 contrary to the clear directive of the California
2 voters, Smithfield's position is also contrary to the
3 uniformed application of the law because it is not
4 different from any other business with significant
5 operations located outside of California.

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

12 Under these facts and Smithfield's logic, a
13 uniform treatment of Taxpayer would require that the
14 three-factor apportionment of 69 percent be applied to
15 now-California-based Smithfield instead of the
16 7.7 percent under the single-sales factor.

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

1 the single-sales factor as such.

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

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

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

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

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

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

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

22 CHAIRPERSON YEE: That's all right.

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

25 MR. BRANNAN: I'll go ahead, and I'll kick it off

1 the best I can here.

2 CHAIRPERSON YEE: All right.

3 PHONE MODERATOR: Let me just jump.

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

6 MR. MUILENBURG: Yes.

7 Can you hear me?

8 CHAIRPERSON YEE: Yes.

9 PHONE MODERATOR: Yes.

10 Please proceed.

11 MR. MUILENBURG: Okay.

12 MR. BRANNAN: Thank you.

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

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

19 I'm going to address the comments made about
20 whether or not the three-factor is appropriate in light
21 of, you know, whether or not we qualify for an
22 agricultural exception. I think there was also the
23 statement made about what is the appropriate standard
24 when determining what is a fair reflection. And then
25 also, I want to talk a bit about, you know, our

1 comparison method and whether or not that proves
2 distortion. And then I'm going to have Derick speak to
3 Moorman and Hans Rees and some of the case law that was
4 mentioned, if that's okay with everyone.

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

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

24 You know, contrast that with what the State would
25 have you believe -- and I believe Ms. Shin said a number

1 of times the only in-state activity the taxpayer had was
2 its market activity, and therefore, you know, how can
3 the market activity be wrong?

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

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

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

24 Well, that produces what is an absolute integral
25 part of the apportionment methodology, the whole body of

1 law, and reduces it to a spellchecker of sorts. And,
2 right, the only time you have a lack of fair
3 apportionment is if there's a math error or a formula
4 error or something in your -- in your apportionment
5 factor on your R-7 -- or sorry -- Schedule R.

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

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

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

22 And you just heard earlier today that, you know,
23 there's a 25137 regulation proposal that's going to
24 clarify things. I mean, certainly the FTB knows how to,
25 you know, write new law and make its position known to

1 the public, but nothing has changed since then. So, you
2 know, we take -- we take, you know, issue with our case
3 law, you know, being Merrill Lynch and McDonnell Douglas
4 not being relevant as far as the business activity.

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

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

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

23 I mean, what we're doing is reproducing what's
24 been done in the case law. And, again, this is a
25 continuing theme. We've put forth cases. We've put

1 forth quantitative tests that have been conducted by
2 California Supreme Court and California appellate courts
3 and we're comparing our numbers to those numbers, not
4 based on tax difference but based on apportionment
5 change, when what we view as core business activities
6 are somehow excluded from consideration and how we make
7 money.

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

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

24 Mr. Brannan.

25 MR. BRANNAN: Sure. Thank you very much.

1 A couple of points -- and it's a little troubling
2 for me because there's a couple of statements from the
3 FTB, and they were -- stated in the briefing, and we
4 hear them again today. But the idea is that we haven't
5 provided evidence and we're relying somehow exclusively
6 on a percentage comparison to prove distortion.

7 Well, let's go back.

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

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

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

1 this case.

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

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

15 Let's talk a little bit about Hans Rees and
16 Moorman. Those are U.S. constitutional cases, and they
17 certainly guide the consideration of these issues. But
18 we can't sit there and say Hans Rees gives us a bad
19 example or Moorman doesn't apply. I don't really care.
20 And I'm sorry to be so dramatic. But the bottom line
21 is, Microsoft says there is a state standard for
22 distortion, and that standard is fairness. And that
23 standard is guided by state authorities, like John Deere
24 and like McDonnell Douglas. That's how we determine
25 whether it's distortive or not in California.

1 We don't have to look to Moorman or Hans Rees.
2 Microsoft made it clear that is a federal constitutional
3 standard. But that's not the standard we're focusing
4 on. We started this presentation by focusing on the
5 statute. We would ask that the FTB limit their
6 discussion of that point.

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

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

25 So last point -- and this is frustrating because

1 we saw a lot of hypothetical points raised by the FTB's
2 presentation. And that's kind of one of the problems
3 here, because what the FTB is doing is you're presenting
4 a parade of horrors for the State. There's monsters
5 in the closet. They are not there.

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

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

22 So Hans Rees constitutional standard, Moorman
23 constitutional standard. I think I have covered it.
24 You know, I apologize for getting a little agitated
25 here, but you can tell it's an issue that I feel

1 passionate about. So thank you for your patience, and I
2 think I will leave you with that.

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

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

7 MEMBER ASMUNDSON: I have no questions at this
8 time.

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

11 CHAIRPERSON YEE: Please, Member Vasquez.

12 MEMBER VASQUEZ: The first one is to the
13 petitioner.

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

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

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

22 MEMBER VASQUEZ: In the brief.

23 MR. MUILENBURG: Okay.

24 CHAIRPERSON YEE: Yes. The section of the
25 California apportionment and tax profile.

1 MR. BRANNAN: Sure.

2 I think page 11 says that --

3 MEMBER VAZQUEZ: Yes, that's it.

4 MR. BRANNAN: I think page 11 mirrors the
5 information -- and if it doesn't, I will just apologize
6 in advance -- it's on --

7 MR. MUILENBURG: Derick, it's the same as -- yep.
8 Yep. Go ahead.

9 MR. BRANNAN: -- on slide 12?

10 MR. MUILENBURG: Yes.

11 MR. BRANNAN: And then you want to go ahead and
12 pick it up? Ben's a lot more nimble with numbers than I
13 am.

14 MR. MUILENBURG: That's right. What you see on
15 page 11 of our opening brief is what is reproduced on
16 slide 12 of our presentation today. And what that is,
17 is a comparison, you know, between the single-sales
18 factor apportionment formula as filed and what would be
19 the apportionment, you know, result through a
20 three-factor formula, what we're requesting in our -- in
21 our relief.

22 MEMBER VASQUEZ: I thought it was the same as the
23 slide, but the numbers seem different. I don't know if
24 you have the slide still available.

25 MR. MUILENBURG: I do, yep. I'm looking at them

1 side by side. I think what happened is --

2 MEMBER VASQUEZ: They are the same figures?

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

5 MEMBER VASQUEZ: Okay.

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

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

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

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

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

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

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

24 MR. BRANNAN: I don't know.

25 Mr. Stewart, if you are still on and if you know.

1 If you don't know, that's certainly something we can get
2 an answer to pretty quickly, I imagine. I'm guessing we
3 do. That would make sense. I'm not sure I would be
4 doing anything here without it. But I don't know.

5 MR. STEWART: Yeah.

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

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

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

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

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

21 And I guess what struck me, as you were talking
22 about the nature of the company and the business, is I
23 was trying to look for kind of the unusual fact
24 situations. And I understand that, you know, there are
25 different segments of the business and where those

1 activities are located and the revenue that's generated.

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

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

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

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

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

1 get that.

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

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

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

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

25 But Controller Yee, I mean, yes, we're different.

1 And if I take ten steps back, we're all manufacturers
2 and nobody is different. But what this case is about,
3 it's the facts and the facts surrounding Smithfield's
4 business operations.

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

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

19 CHAIRPERSON YEE: Sure.

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

24 I do take issue with the idea that anything under
25 12 percent, anything under a population is, therefore,

1 reasonable because shouldn't the State get 12 percent of
2 everything. That's not the right inquiry. That's not
3 the right thing to be looking at. But we are
4 considering the market.

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

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

24 CHAIRPERSON YEE: Okay. I understand that.
25 Thank you.

1 A couple of questions for the Franchise Tax
2 Board, if I may.

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

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

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

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

25 But I can't help but to think about -- so the

1 liability that we're talking about here is really driven
2 by, I guess, the income that's actually, I guess,
3 generated, right, from the consumer market here in
4 California.

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

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

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

25 And I would suggest to you that the contrived

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

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

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

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

1 lot of things going on here.

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

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

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

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

24 MR. MUILENBURG: Yeah. I would say that's
25 precisely -- so I am going to return to the agricultural

1 exception not because we're arguing for that. Again, I
2 understand the scope here. But the California
3 legislature determined that this three-factor formula is
4 appropriate for the agricultural community. And there's
5 a lot of reasons for that, and the main one being that,
6 just as Mr. Stewart described, I mean, they need to be
7 located next to their feed lots, they need to be located
8 next to their contract farmers, they need to be able to
9 accomplish economies of scale, how they make money. The
10 idea that because they are vertically integrated and
11 sell an end product, they, all of a sudden, no longer
12 have those same concerns that the legislature thought
13 enough of to specifically exempt when we went to a
14 double-weighted sales factor in 1993? That's the part
15 we have trouble with.

16 And we're not saying we want the mandatory use as
17 a matter of law, though. You know, we'll argue in a
18 different forum for that. What we are saying is when we
19 have described, based on the correct interpretation of
20 business activities, that we don't believe the result is
21 fair, that our -- that our proposed remedy is reasonable
22 because the California legislature says it's reasonable
23 for businesses like ours that are stuck to certain
24 geographies. That was the consideration, you know, when
25 determining what is a fair reflection.

1 So yes, we're vertically integrated. Yes, the
2 California market, you know, provides us with sales.
3 You know, again, there are probably other markets where
4 we can make more money just because of a lack of
5 regulation and, you know, closer to our, you know,
6 production facilitates, less transportation costs, etc.
7 So we're not ignoring the market. We want it to be a
8 part of a complete system that analyzes how we make
9 money.

10 CHAIRPERSON YEE: Yeah. I understand and
11 appreciate that.

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

19 And I would say, you know, this is always the
20 tricky part when we're citing case law. I mean, the
21 facts and circumstances are different from case to case.
22 And so -- which is why I haven't wanted to kind of focus
23 on the percentages. I really wanted to understand the
24 business. And you have all done a great job of really
25 walking me through that.

1 And if we're truly focused on, you know, the
2 income that's generated here in California, I mean, I
3 think it's a pretty discrete -- it's pretty discrete
4 what we're looking at here in terms of how the liability
5 is determined.

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

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

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

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

21 As far as this notion of income-generating
22 activities and its relationship to the apportionment
23 factor, if I may geek out and be a little academic, we
24 use the -- in California, we source income based on
25 formula apportionment method, Uniform Division of tax --

1 of Income for Tax Purposes Act, UDITPA. And so under
2 section 25137, it's a different inquiry. Under 25137,
3 there is a burden of persuasion and proof on the
4 petitioner to demonstrate that the California income
5 does not fairly -- is not fairly reflected by the
6 standard apportionment formula.

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

16 And a portion of that is sourced to California,
17 using an apportionment formula. And in California, we
18 have chosen, as the objective measure that the
19 apportionment formula is based upon, the taxpayer's
20 relative market activity, not just California market
21 activity. But, remember, it's numerator over
22 denominator; California market activity versus market
23 activity everywhere. But that is just used. And it
24 only needs to be a rough approximation, by the way, of
25 the taxpayer's income to be sourced to California.

1 So I don't know if that answers your question,
2 but there you go.

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

5 CHAIRPERSON YEE: Yes, please.

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

15 And, again, the fact -- and we're not going to
16 get into the exception, but the fact that we choose to
17 slaughter the animals and sell, you know, cuts to the
18 supermarket versus the competitor sells the live animal,
19 the fact that the State of California is fine treating
20 those two different, where there is not a difference in
21 the statute. Everything that causes that distinction is
22 in the regulation. The statute relies on federal
23 determinations of what farming is and that includes the
24 raising of pigs, cattle, etc., for slaughter. That's
25 all in the statute. The regulation talks about vertical

1 integration, talks about, you know, sales companies, all
2 these things that the Franchise Tax Board has cleaved
3 that distinction.

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

8 CHAIRPERSON YEE: Thank you.

9 Just check in with my -- with the other members.
10 Any other questions, Members?

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

13 CHAIRPERSON YEE: All right. Thank you.

14 Just trying to go through all my notes from the
15 testimony. Hang on one second.

16 I am also fine as well.

17 Let me just turn to the petitioners.

18 Any concluding remarks?

19 MR. BRANNAN: Not from me.

20 Mr. Muilenburg?

21 MR. MUILENBURG: Not for me either.

22 I want to thank everyone for your time.

23 CHAIRPERSON YEE: Thank you.

24 MR. BRANNAN: Agree. Thank you very much for the
25 time.

1 CHAIRPERSON YEE: Thank you.

2 Ms. Shin, you all right?

3 MS. SHIN: Thank you very much.

4 CHAIRPERSON YEE: Okay. Thank you.

5 Members, this is before us.

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

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

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

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

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

25 CHAIRPERSON YEE: Okay. All right. Thank you,

1 Member Vasquez.

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

4 Is there a second?

5 MEMBER ASMUNDSON: I will second that.

6 CHAIRPERSON YEE: Okay. Seconded by
7 Member Asmundson.

8 Please call the roll.

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

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

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

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

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

18 CHAIRPERSON YEE: Yes.

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

21 MS. CASEY: Yes.

22 Member Vasquez.

23 MEMBER VASQUEZ: Aye.

24 MS. CASEY: Member Asmundson.

25 MEMBER ASMUNDSON: Aye.

1 MS. CASEY: And Chair Controller Yee.

2 CHAIRPERSON YEE: Aye.

3 Thank you very much, Members. That motion
4 carries.

5 Thank you, everyone.

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

9 Any comments by any of the members?

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

12 CHAIRPERSON YEE: Yes, Member Vasquez?

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

15 CHAIRPERSON YEE: Yes. Start over again, please.

16 MEMBER VASQUEZ: Are you able to hear me now,
17 Madam Chair?

18 CHAIRPERSON YEE: Yes, we can.

19 MEMBER VASQUEZ: I think you are muted.

20 CHAIRPERSON YEE: No, I'm on.

21 MEMBER VASQUEZ: Oh, okay.

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

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

25 MEMBER VASQUEZ: Okay. Am I cutting out?

1 Because earlier, I got cut off during the presentation,
2 but then now --

3 CHAIRPERSON YEE: We can hear you now.

4 MEMBER VASQUEZ: Are you able to hear me now?

5 CHAIRPERSON YEE: Yes.

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

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

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

20 CHAIRPERSON YEE: Okay. I appreciate that.

21 Thank you.

22 Let me echo that sentiment. I mean, I hope that
23 many of you feel the optimism that I feel about the
24 trajectory that we're on, that hopefully we can be able
25 to meet again in person. And we will look forward to

1 that in June, and hopefully that could be a possibility.

2 But very much appreciate the ability to continue
3 the business of this board virtually and to be able to
4 allow the public to engage. And so I'm just very, very
5 thankful to the staff for making sure that that can
6 continue.

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

17 So really appreciate the work of the staff.

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

20 (No response.)

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

23 MEMBER VASQUEZ: Thank you.

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And thank you, staff.

CHAIRPERSON YEE: Thank you.

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

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1 CERTIFICATE OF REPORTER

2
3 I, KATHRYN S. SWANK, a Certified Shorthand Reporter
4 of the State of California, do hereby certify:

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

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

14 IN WITNESS WHEREOF, I have hereunto set my hand
15 this 18th day of March 2021.

16
17
18
19
20 /s/ Kathryn S. Swank
21 KATHRYN S. SWANK, CSR
22 Certified Shorthand Reporter
23 License No. 13061
24
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