

STATE OF CALIFORNIA
FRANCHISE TAX BOARD

PUBLIC MEETING

TUESDAY, JULY 12, 2016
GERALD GOLDBERG AUDITORIUM
9646 BUTTERFIELD WAY
SACRAMENTO, CALIFORNIA

REPORTED BY:

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APPEARANCES

BOARD MEMBERS:

BETTY YEE, CHAIRPERSON

YVETTE STOWERS

FIONA MA

ERAINA ORTEGA

STAFF:

SELVI STANISLAUS, EXECUTIVE OFFICER

DAWN CASEY, BOARD LIAISON

PAULA ADAMS

FRED CAMPBELL-CRAVEN

MARCO ESQUIVEL

MICHELLE FALLON

JEANNE HARRIMAN

TOM LoGROSSMAN

JENNIFER ROUSSEL

PETER NGUYEN

NORM SCOTT

ANDREA VanWALLEGHEM

MARY WHEAT

MELISSA WILLIAMS

APPEARANCES CONTINUED

COUNSEL:

JOZEL L. BRUNETT

BRUCE LANGSTON

PUBLIC SPEAKERS:

DAVID DOERR, Cal-Tax

BRAD JOHNSON, SpaceX

DENNIS LOPER, Capital Strategies Group

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SACRAMENTO, CALIFORNIA

TUESDAY, JULY 12, 2016, 1:36 P.M.

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CHAIRPERSON YEE: Good afternoon. This is the scheduled time of the meeting of the Franchise Tax Board.

I'm going to ask the board liaison to please call the roll to determine if a quorum is present.

MS. CASEY: Member Ma?

MEMBER MA: Here.

MS. CASEY: Member Ortega?

MEMBER ORTEGA: Here.

MS. CASEY: Chair/Controller Betty T. Yee?

CHAIRPERSON YEE: Here.

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

The public has the right to comment on each agenda item, and if there are any members of the public wishing to speak on an item, please come forward when that item is called and you will have three minutes to address the board.

The first item, Members, is approval of the minutes. We have the minutes of the March 10th, 2016, board meeting in front of us.

Any proposed changes to the minutes?

Okay. Hearing none, may I have a motion?

(No audible motion.)

Motion by Member Ma.

MEMBER ORTEGA: Second.

CHAIRPERSON YEE: Without objection, the minutes are adopted.

Item number 2 is a filing season update and also an update on the California Earned Income Tax Credit. We have two sub items, which will be presented together.

First will be Mary Wheat with the filing season update, and then Jennifer Roussel with the California EITC update. And the next four items are going to be PowerPoint presentations; we'll direct the audience to the screen behind us, and I will ask my colleagues to move to the viewing table, also known as the "suicide table."

(Laughter.)

CHAIRPERSON YEE: Good afternoon, Mary.

MS. WHEAT: Good afternoon.

CHAIRPERSON YEE: Please proceed.

MS. WHEAT: Good afternoon. My name is Mary Wheat, and I am one of the Assistant Bureau Directors in the Processing Services Bureau.

I've had the pleasure of meeting most of you during filing season for the filing tours, and it's good to see you all again.

My co-presenter today is Jennifer Roussel, and we're going to be covering item number 2, the filing season update and earned income tax update, which will include what we did to prepare for this year's filing season; changes recognized this year; an awesome video with our filing season statistics; and then Jennifer is going to cover some of the challenges and opportunities we faced; and provide information on our fraud program.

Every year the filing season is like a rollercoaster. We plan the ride, we stand in line, we get excited about what's in store for us; we climb the hill by filling our key positions with permanent intermittent, and seasonal staff. We reach the top of the hill after training, just under a thousand employees department-wide on new laws, like EITC and on EDR functionality. And then we start the fun journey of the tax season ride, knowing that we are secure and safe with the planning and processes that we've put in place.

This year we introduced an enhanced MyFTB, which has a new look and feel. It provides taxpayers and tax professionals secure online access to information such as account details, contact information, returns and payments, correspondence, and proposed assessments.

It also provides new self-service features, including the ability to file a power of attorney declaration online; file a nonresident withholding waiver request; initiate a protest or proposed assessment; initiate a message to FTB, with or without an attachment; initiate a secure chat with an FTB representative; skip a personal income tax installment agreement payment; and use a tax calculator to calculate a future balance.

I would like to share two of our biggest achievements this year: It was our first full year of using the new rules and validating tax returns for our new return validation process, and we added transparency about our refund processing time frame to taxpayers.

One of the key components to EDR is return analysis. This allows us to combine processing and analysis for personal income tax return payments into a single application. We can now match, perform a return validation and payment validation and perform our fraud analysis during the front-end processing.

In addition, we've made changes to our external website and phone lines to provide real-time refund processing time frames to taxpayers.

Now we would like to share our filing season statistics with you. The numbers illustrate how hard our staff has worked to serve California taxpayers. We've developed this video to highlight the 2016 filing season successes. I invite you to sit back and see all that we've accomplished this year.

(Video Presentation.)

MS. WHEAT: It was a silently successful filing season.

MS. ROUSSEL: Thank you so much. And we will make sure that you get the video that has all of the speaking with it and the music as well.

So thank you, Mary, very much.

And good afternoon, Board Members. I'm Jennifer Roussel, an Assistant Bureau Director in our Filing Compliance Bureau. And today I'm here to share a bit of information about some of the challenges that California is facing with stolen identity refund fraud, as well as our success in implementing the California Earned Income Tax Credit in California this year.

So first, our challenge. Stolen identity refund fraud. What is it?

Well, that happens when a criminal steals your identity information: Your Social Security number, your name, your address, your date of birth. And they do this for the sole purpose of filing an income tax return to get your refund before you do.

In September 2013, we shared with the board that this was growing, and, unfortunately, it has continued to grow.

In 2010-11, FTB confirmed 2,700 instances of ID theft. In this fiscal year, as of the end of this fiscal year, we have confirmed nearly 21,000 instances of ID theft. In five short years, if you do the math, it was a 700 percent-plus increase.

When it comes to refund fraud, our priority is to get the correct amount to the correct person. We continue to partner with the IRS, other states, and industry, to learn the newest mechanisms for fighting fraud and, most importantly, share information on a daily basis with each other to stop fraud. We also participate in the current IRS Security Summit, if you are not aware of that.

We will be making more improvements to our detection methodologies to limit the impact to honest taxpayers properly claiming their refunds. However, these refunds could suffer delays because of the nefarious actions of those who commit refund fraud.

As these criminals become more sophisticated, we may need to slow down our processes in order to ensure the correct refund goes to the correct person and not to the criminal.

As with many other industries, fraud is a huge concern for us. We will continue to keep you updated on the challenges that we're facing and how we are going to meet those challenges.

And, as always, we appreciate your support in the fight against this ever-growing threat.

Now on to a much brighter topic: That's Earned Income Tax Credit. We are very honored to share our efforts this year to implement the California Earned Income Tax Credit.

First, we would like to thank you for all of your support you provided during our first year administering this tax credit. This year has been exciting, and, truly, we are very proud to be a part of implementing this credit and bringing it to California's families. It was not an easy task, but as is normal for FTB, we were up for the challenge.

To give you a taste of the effort involved, we wanted to provide you with some statistics about the project and the implementation effort itself. We had two co-implementation managers -- myself and Mary. We were joined with 16 subteam leads, some of which are in the audience. These teams focused on facilities and making sure we had the seats to put the new people in, as well as tax forms, procedures, training, system changes, and education and outreach. These subteams officially consisted of over 115 representatives from the different business areas. However, not everybody was on those subteams. It took a tremendous effort from across the organization to implement this, and everybody at FTB was instrumental in delivering the final forms, marketing products, procedures, and systems.

And we would like to take a moment to thank those folks that might be in the audience today that had any part in implementing EITC. So thank you very much.

(Applause.)

MS. ROUSSEL: So, through the hard work and the dedication of FTB staff, the Governor, the California Legislature, the many support organizations, and especially the Board, we were able to help approximately 383,000 families get \$189 million of credit this year. 90 percent of those families received their refunds within seven to ten days. It was an exceptional success.

And each of these returns went through a series of automated validation steps to ensure that the credit went to the right people, including manually reviewing and stopping over \$15 million from going into the wrong hands.

As always, FTB is never 100 percent satisfied and we're looking to improve how we do things. So with our EITC program we will be looking at next season -- and we already are planning for it -- we are making improvements to our process to make us more efficient at processing the claims as they come in, as well as more effective at stopping improper payments.

So thank you very much for your support and, at this time, we would be glad to take any questions you might have.

CHAIRPERSON YEE: Thank you both very much for the update and presentation.

First, I have to just express congratulations and kudos to the entire team. Obviously with a new program like Cal EITC, without a lot of ramp-up time, it was really phenomenal, the results of the first-year efforts.

I also want to add my congratulations and thanks to my colleague, Board Member Ma, who really took a lot upon herself and time just to be on the ground, doing the outreach, and helping to be sure that our volunteers were on site to prepare returns.

But this is an all-team effort, and I think a lot of lessons learned, but also, most heartening is just the ability to provide that relief to families in need.

So thank you all the way around.

With that, let me open it up for comments or questions.

MEMBER MA: Yes. I would also like to thank the FTB for all of your outreach. I know we started a little bit late with the Cal EITC, and so this year, we hope to start sooner. And I know you are all working on it.

And I want to thank Controller Yee for starting this effort through the BOE, and we've just been trying to continue in the efforts.

If you could just talk a little bit about the October 15th deadline and what we're doing to outreach to more folks who may be eligible, to claim this credit? If you can just talk about that.

MS. ROUSSEL: Definitely.

So I know that there's a tremendous amount of effort that we'll be putting in, to ensuring that our website has the most, latest information on the Earned Income Tax Credit, and we will continue to partner with the organizations that we have for EITC throughout this last year to make it successful.

MEMBER MA: I thought you guys were going to send out letters?

MS. ROUSSEL: Oh, I'm so sorry. Yes. Thank you. Good reminder.

Yes, we are doing outreach. It is a direct mailer that we're sending. We did a pilot of 400 that went out as of July 1st to notify taxpayers that actually filed a return with California already, but did not claim the credit, and they appear to qualify.

So we started that with a small pilot. We will continue that effort through the month of August, where we are notifying anywhere -- it's going to be up to 55,000, but it's somewhere in that range -- where we will send a direct letter to them to let them know that they appear to qualify for the Earned Income Tax Credit, and we provide a way for them to actually file and claim that credit very simply and easily with us. And so we're prepared to actually process all of those claims as they come in.

CHAIRPERSON YEE: Thank you.

Any other comments?

Okay. Thank you very much for the update and presentation.

We're now on item number 3, which is the Franchise Tax Board Strategic Plan. This is another informational item. We'll direct the audience to the screen again for the PowerPoint. We have Michelle Fallon to present this item.

Good afternoon.

MS. FALLON: Well, good afternoon. I am here to present to you an information item, just to give you an update on the progress of the development of our new strategic plan that covers years 2017 through 2020.

Here is a picture of our current plan. It's about to expire in December. And as we began building this year's plan, we started thinking about this plan that's available on our website, and we started thinking about those 23 pages and about what was in those 23 pages: Things like our history, the process we went through to build the strategic plan, and the principles of tax administration.

And then we thought, is this something our audience was really interested in?

As we contemplated that, we came to the conclusion or the consensus that, perhaps, cutting out all the noise, and getting straight to the heart of the matter with a two-page document, front and back, that was a better approach moving forward.

For the sake of the traditionalists, though, we do plan to keep all of the information on our website -- the other 21 pages that we plan on cutting out -- but when you print the new strategic plan, it is going to be very printer-friendly, like you see up here on the first page. It has lots of printer-friendly white space, and it will only have the most critical information so that the audience can immediately see and get the gist of what FTB's strategic direction is.

In terms of content, between the old and the new plans -- so you can see from this table what we've cut out and pared way down -- in the new plan we still kept the basics: Our values, the mission, our principles, and our goals.

And now that we've talked a little bit about the form of the new plan, I would like to talk to you about the substance and talk about what's in the plan.

You may remember this next picture from our last strategic plan. And I brought it back today because the mission and the goals and the foundational principles are really not changing; they are going to remain consistent from the last plan to this new one.

The wording may change a bit here and there and the strategies underneath each goal are absolutely going to change. But we really felt that the goals, still, were representative of what we needed to do, moving forward.

So let's take a look at the first page of the new plan in its draft form. Let's go back to that, and let me walk you through what that looks like.

The first thing you may notice at the top is our new logo. And the next thing you will see is a tag line: Supporting our state, building our future. The executive management team wanted to include a short statement that spoke to FTB's purpose. Since FTB is responsible for a very significant portion of the state's general fund, we do play a big part in funding the state's priorities, and we at FTB are very committed to the state. We're all Californians here. And we kind of take pride in the ability to participate in funding priorities for the state and be part of that process.

Next, in the gray box, in the middle of the page, you will see our mission statement, which we were recently challenged to shorten since hardly any of us could remember what it was, when asked. So we refined it down to just two things: The "what" and the "why." What we ask taxpayers to do and why we ask them to do it.

So our mission is to help taxpayers file tax returns timely, accurately and to pay the correct amount of tax; to fund services important to California.

Below the gray box to the left, you will see our foundational principles. Now, these haven't changed since our last strategic plan, and if you recall that Parthenon picture, those boxes that were underneath the goals, underneath the pillars, those are those foundational principles. We felt so strongly about

these foundational principles, because, honestly, if we can't get this stuff right, nothing else is going to work for us.

So this is going to carry forward into the next plan.

To the right of the foundational principles are the organizational values. Like our foundational principles, our success at FTB hinges very much on our culture.

So here's the first page again. It very much sets the stage for the back side of the document, which is going to include our goals and our strategies.

But the second page is very much under construction, as we perfect our wording and continue to refine our strategies.

So I'm going to take you back to the Parthenon and remind you that these are still going to be our four goals, and they may be worded differently, again, but, overall, they are going to stay the same. But the strategies aren't depicted in this graphic, as you can see, which is a good thing because they are going to be changing.

But what I would like to do right now is just take you through a couple slides that will tell you how our strategies are going to be working, as we move from the old plan to the new plan.

So for the first goal, Taxpayer-Centric Services. The old plan was really centered on how -- how we can improve customer service. Under the new plan, we are attempting a huge paradigm shift to focus on customer experience, or something we call CX.

This is a very, very different concept than customer service, because CX looks at the customer's journey of interactions when dealing with an organization, not just one individual touch point. It looks through the customer's eyes, not how we perceive things. It actually goes out and asks the customer. It's a methodical, best practice approach that improves customer satisfaction while increasing compliance revenue and efficiencies. What more could you want, right?

The next goal is Effective Compliance. For effective compliance we really wanted to move forward and try and understand, or leverage our data to help us understand our taxpayers a bit better, which you might notice it fits nicely with our CX strategy. In other words, we're thinking that that data might help us to understand the difference between a taxpayer who is purposely choosing to be noncompliant, or following the red path, and one who just maybe needs a little bit of education and outreach to understand how their situation fits into the tax code.

So this whole concept again fits nicely with our first goal, and we have another couple strategies I wanted to talk about, even though I can't give you the exact wording.

Another one has to do with targeting the most egregious areas of tax abuse and finding ways to customize our actions, through some of these segments, to improve overall compliance.

And finally, we plan to engage more with our tax community and government partners to get their feedback on compliance trends and other issues of common interests.

There's a lot going on there.

Our next goal, Strong Organization: In our last plan, we formalized a talent management program, and our HR director, Paul Ogden, presented the ten components that make up this program in March of last year. Under the new strategic plan, we're going to focus on just four of those ten components through 2020. Rrecruit, hire, retain, and engage.

In a few moments, my friends Paula and Andrea are going to be up here, and they are going to show you some pretty shocking statistics about retirement age here at FTB, and you are going to see why that strategy is exactly on target with where FTB needs to be.

Our last goal, Operational Excellence, is all about making sure that we are optimizing our resources to do all we can to support our processes, products, and services.

You know, our executive team has always been very good about sharing resources. They are not possessive of their organizations. But what we really want to do, moving forward, is focus on enterprise metrics and making sure that we're managing both our people and our budgeted dollars in the way that most benefits the department.

Those metrics are also going to help us identify ways or areas that we can still optimize operations, because now we will have the data in order to make those kinds of decisions.

So there you have it. In summary, this is what our new plan looks like at the 50,000-foot level, and we're looking forward to bringing the full, vetted, and complete plan back to you in December for reviewing, and we have a lot to look forward to. We really appreciate your support to this process.

And now, I would love to answer any questions you have.

CHAIRPERSON YEE: Thank you, Michelle.

Comments? Yes?

MEMBER ORTEGA: I just had a question. If you could talk a little bit about the internal process that you are using with staff to come up with the final language that you bring back to us.

MS. FALLON: Sure.

Under our governance structure, we have action committees. Each of our action committees are tied to each of these goals and also the projects and strategies that support these goals.

So the action committees have been meeting and talking about what they wanted to do strategically moving forward. And then, overall, we've been meeting with the executive management team to talk about how all of this fits together into a holistic plan.

So we met, originally, to agree to the fact that we didn't really feel like our mission needed to change conceptually. We also agreed that the goals did not need to change; they still very much made sense.

It was just a fact of changing the strategies and how we wanted to move forward.

Does that make sense?

MEMBER ORTEGA: Thank you.

CHAIRPERSON YEE: Thank you.

Member Ma?

MEMBER MA: So I was wondering if you hired any outside consultants or anyone to help with your logo, your branding, or your strategic plan.

MS. FALLON: Boy, I would love to answer that question.

No, we did not. And the reason I'm loving to answer that question is, our very own Sharon Rabang actually created that logo for us, and she did a fantastic job.

So if you are here, Sharon, well done, you.

And as far as the strategic planning process, we just have very talented staff here who work together as a team, and we all really do work well together and so we didn't have a need to hire a consultant.

And I think also, if I can say, too, that we had a very good framework, working from the last plan, which we did not use a consultant there either.

CHAIRPERSON YEE: Okay. Thank you, Michelle.

I just had one question. And that is, how was input from external stakeholders -- and I am thinking about, particularly, the practitioner community integrated into this and at what point did they provide input?

MS. FALLON: We have not yet gotten to that process, but that is part of the plan, and it's going to be coming soon. We're going to be seeking input from the CPAs and the enrolled agents and also our advisory board.

CHAIRPERSON YEE: Great. Thank you.

Other comments, members?

Wonderful. Great work. Thank you very much, Michelle. Thank your team.

All righty. Let's move on to item number 4, which relates to the Franchise Tax Board's Enterprise Risk Management Program. This is another informational item. I will ask the audience to focus on the PowerPoint on the screen. This will be presented by Andrea VanWallegghem and Paula Adams.

Good afternoon.

MS. VANWALLEGHEM: Good afternoon. My name is Andrea VanWallegghem, and together, with Paula Adams, we'll be presenting information about Franchise Tax Board's Risk Management Program.

Risk management has been a focus in both the private and public sector due to many high profile business scandals, such as Enron and Halliburton just to name a few. As a result, there's been a heightened concern and focus on risk management and the recognition that entities need a framework to effectively identify, assess, and manage risks. We know that every entity faces uncertainty, which presents both risks and opportunities.

The challenge we face as an organization is determining how much uncertainty or risk we're willing to accept. Enterprise risk management allows management to effectively deal with the uncertainty and the associated risk and opportunities in order to continue to add value.

FTB has recognized the importance of risk management early on, and we've had an enterprise risk management process in place for quite some time now.

There are many different risk management frameworks and methodologies out there to manage risks. FTB has created a framework to address risk management that allows us to be both flexible and responsive to risks. And we accomplish our risk management through our governance structure. That includes our Governance Council, our action committees, and our senior management.

Our governance structure allows us to focus on departmental risks that may impact FTB's strategic goals. This ensures that the impacts of risk crossing organizational lines are identified and appropriate mitigation strategies are implemented.

We are continuously working to improve our processes and awareness surrounding risk management. And because we have such a robust risk management program, we've been able to easily comply with enterprise risk assessment mandates, such as the State Leadership Accountability Act, or SLAA, as it's commonly referred to. SLAA is the result of legislation that was passed in 2015 to change the Government Code sections that were originally called the Financial Integrity and State Manager's Accountability Act, or FISMA.

SLAA requires management to be responsible for timely detecting, correcting, and the ongoing monitoring of risks.

Agency risks are required to be reported to the Department of Finance every odd numbered year, as well as posted to our external website.

At this time, I would like to turn over the presentation to Paula Adams, who will present FTB's SLAA risks that we reported to the Department of Finance last year.

MS. ADAMS: Thanks, Andrea.

Good afternoon. Before I begin talking about FTB specifically, let's take a quick look at the top five risks reported through SLAA at the statewide level: Succession planning, FI\$CAL conversion, insufficient monitoring of internal process, data security, and level of funding sources.

Not surprisingly, when FTB reported our four SLAA risks to the Department of Finance, about half of them correlate with what you see on this top five list, and that's what I would like to cover with you today.

Our first risk is enterprise workforce planning. Just like many other departments across California, FTB also acknowledges workforce planning as a significant risk. In fact, as Michelle stated, our statistics are a little frightening. Right now, 20 percent of our 5,000-plus employees can retire today.

And if you are looking at just managers and supervisors, a little over half of them are either planning or dreaming of retirement because they are all eligible now.

But before reaching retirement age, many of those have been actively planning for several years now on how to pass along our critical institutional knowledge to our future leaders.

Here are some of the ways that we are doing this.

First, we are changing the way we recruit and hire using social media and other online tools. We're working with other departments and the community to expand recruitment and hiring strategies by expanding partnerships with other state agencies and local colleges for targeted recruitment of key skill sets.

We're developing marketing materials to show prospective employees the full benefits and potential of state service.

We're educating prospective employees on the hiring process with how-to workshops and outreach events.

Internally, we're creating knowledge transfer opportunities, such as, we sponsor an enterprise-wide coaching and mentoring program. We've had, for years, the management development program for our leaders. We have a program for analysts called Growing Leaders At All Levels. We sponsor job shadowing, collaboration, and on-the-job training, and we're even developing a knowledge transfer tool to create a share-what-you-know culture.

And in addition, we're finding new ways to increase employee engagement using surveys and focus groups.

Another risk is data security and privacy. FTB takes this risk very seriously. We enforce strong information security policies. We perform internal and external vulnerability assessment, and we perform security, intrusion, and detection monitoring activities. The risk of an intentional act threatens the confidentiality, integrity, and privacy of taxpayer data.

A very real example is in the area of tax return fraud.

This last year, FTB joined a nationwide effort to protect taxpayer refunds by preventing fraud, tax theft, and other abusive practices. According to the IRS, ID theft and other criminal schemes, involving fraudulently filed tax returns, are becoming more common.

Our internal controls are just as rigid as external controls. Every year employees go through a security and disclosure training and sign several documents verifying that they understood the information presented to them.

We've created eye-catching internal security campaigns that show the unwanted benefits of disclosing information, and others that award employees who behave as security champions by following all the security and disclosure guidelines and encouraging their peers to do the same.

Our next risk that I would like to cover is our customer service levels. During the year, customer service levels may not be adequate to meet the demands of taxpayers and taxpayer representatives. Limited resources can have a negative impact on our call centers, our correspondence, and other service channels that interface with FTB's customers. Over 60 percent of the contacts that we receive from our service channels are from taxpayers looking for assistance to resolve a tax liability.

Overall, FTB brings in over 70 percent of the revenue for the state general fund. Over 83 percent of our taxpayers voluntarily comply with the tax laws and timely file tax returns and meet payment obligations.

Keeping our customer service levels up plays a huge role in maintaining voluntary compliance rates. One key mitigation strategy for this risk was to request additional resources. And with your support,

FTB was successful in getting the additional resources starting July 1st, and FTB is excited for the opportunity that these resources will provide to our taxpayers.

FTB continues to monitor all service channels for response times and adjust our agile workforce to ensure timely and accurate communication to the public, whether it be through our call centers, our chat, our correspondence, or secure e-mail.

And finally, our last risk on the SLAA report is the inability to timely recover critical systems and services. If FTB's critical IT services and systems are disrupted, this could potentially result in a negative impact to customer service and our revenue producing activities.

So that we can be prepared to resume operations as soon as possible, FTB conducts annual exercises to prepare for both business resumption and disaster recovery. FTB takes a proactive approach to potential services -- or sources of disruption, which could include loss of power, equipment failure, loss of access to the facility, or loss of key personnel.

One example that FTB has implemented to mitigate some of our operational impacts in case of a disruption in service is through cloud technology. FTB now stores our static webpages in the cloud. Static webpages typically consist of standard forms and information about basic services that can quickly be displayed and are available to continue business operations in the event of an incident.

This summarizes our top FTB risks and, at this time, Andrea and I would be happy to answer any questions you may have.

CHAIRPERSON YEE: Thank you very much for the update.

Questions, Members?

Wonderful. Thank you.

I will just, first of all, thank you for all the work on this. Obviously, this was a big, ongoing, sustained focus with respect to the business of the FTB. And I hope you will feel welcome and not shy about coming to the board for any enhanced role that we as a board can take in addressing the responses to the risks that you have identified.

Thank you.

Our next item is item number 5 and this relates to the Market Based Rules Task Force. Another informational item that -- we have a PowerPoint for this item as well, to be presented by Melissa Williams and Peter Nguyen.

Good afternoon.

MR. NGUYEN: Good afternoon. My name is Peter Nguyen, and I'm an audit manager for the National Business Audit Program, Southern California region.

I've been asked by senior management to lead the Market Based Rules Task Force. My co-presenter is Ms. Melissa Williams. She's a Tax Counsel IV and she's also the principal author of the Market Based Rules Regulations. We are here to present to you on item number 5, the Market Based Rules Task force. We will cover all the changes that created the task force -- the considerations for the task force and the solutions.

At this time, I will hand it over to Ms. Melissa Williams. She will be discussing the law changes that created the task force.

MS. WILLIAMS: Good afternoon, everyone.

The Franchise Tax Board Market Based Rules Task Force came into being as a result of two fairly recent law changes that are significant departures from prior laws on the same subjects. Those law changes are the introduction of economic nexus and the introduction of market based rules for the assignment of sales of services and intangibles.

The purpose of the task force is to address all the issues that arose with the introduction of those new laws. We'll talk about nexus first.

To understand just how significant the changes to the nexus law were, we need to review the nexus law in effect prior to the recent change. Before 2011, physical presence of the taxpayer or its agents - in this state was required. Economic nexus was not yet a legal concept in the state of California.

2011, forward, along with physical presence, nexus now includes economic nexus. Economic nexus is determined by monetary threshold amounts of sales, property, and payroll. If a taxpayer reaches the threshold amount for any of these categories, that taxpayer has nexus with California and is potentially subject to California taxation.

This is true, despite the fact that the taxpayer may not have physical presence with the state of California.

In other words -- and I'm just going to say it a different way -- taxpayers who do not have physical presence in California may still have nexus with California by virtue of the economic nexus laws.

Okay. Now we're going to talk about the sales factor. Prior to market based rules for sales of services and intangibles, a multistate corporation would assign a sale according to the location of the greater costs of performance that produce the income. 2013 forward, we have a single sales factor formula which is mandatory for most multistate taxpayers. This formula uses market based rules for the assignment of sales of services and intangibles.

Market based assignment of these type sales is drastically different than the cost of performance method of assignment for these type of sales.

In many situations, the difference is commercial domicile, under cost of performance rules, versus market states, under market based rules. This means that some taxpayers, who, for years, have assigned sales of services and intangibles to one state, and filed a return in only that state, based upon the cost of performance rules, may now have to file a return in many states, including California, based on the new market based rules.

California's new market based assignment rules look at the taxpayer's market here in California. In general, the market based rules provide, sales of services are assigned to where the benefit of the service is received. And sales of intangibles are assigned to a location of the use of the intangible.

These new market based rules have the important dual functions of, number 1, determining California sales of services and intangibles for purposes of ascertaining the threshold amounts under the new economic nexus rules; and, number 2, providing the market based rules for sales of services and

intangibles for the new mandatory single sales factor, a portion of the formula applicable to multistate corporations.

At this time, I would like to hand off the presentation to my colleague, Peter.

MS. NGUYEN: Thank you, Melissa.

Taxpayers never before subject to taxation suddenly find themselves subjected to California taxation because of a new economic nexus rule. As a result, they find themselves trying to sort out the new market based rules. The market based rules are new and the taxpayers are unfamiliar with some of the concepts.

The first concept is determining where the benefit of the service is being received. This includes, determining what is the benefit and where is it being received.

Second, determining where the intangible is being used. For example, in a case involving a patent, it is difficult to determine where an intangible is being used and during what time period. It also raises the question: does the seller even know where the buyer is going to use the intangible?

We have cascading rules for sales of other than tangible personal property, but the hardest one is reasonable approximation. We have to determine and agree to what is a reasonable approximation of the location of where the benefit of the services is being received or where the intangible is being used.

Sometimes we have to resort to using California population over total population as a reasonable approximation. But does population reasonably reflect the true market?

Our solutions: We have created an FTB Market Based Rules Task Force. The task force provides a forum for discussing market based rule issues and to provide guidance to the staff. It also ensures that there's a consistent approach to the market based rule issues. It identifies and provides training to our staff and it also provides update to our audit manuals. We also have the regulation process in which we seek public input through interested party meetings. We will also provide education and outreach. This include articles and presentations at conferences.

Lastly, the use of closing agreements. What is in the best interest of the state and the taxpayer to resolve their issues?

For example, in a case involving a food processing patent, where a large multinational corporation purchased a corporation, mainly for a patent, there's a question as to when and where the patent was going to be used by the multinational corporation. Was it going to be used throughout the United States or in a selective market?

In this particular case, we entered into a closing agreement where we made a reasonable estimate as to when, where, and how much of the patent would be utilized.

This concludes our presentation and we are available for your questions.

Thank you.

CHAIRPERSON YEE: Thank you very much to both of you.

Questions, Members?

MEMBER ORTEGA: I have a question.

CHAIRPERSON YEE: Yes, Member Ortega?

MEMBER ORTEGA: These kinds of issues that come up, where a determination needs to be made or an agreement has to be reached, are they often identified by the taxpayer or by FTB staff? How does the conflict or the confusion that needs to be resolved come up?

MS. WILLIAMS: The taxpayer representative contacted us.

MEMBER ORTEGA: Thank you.

CHAIRPERSON YEE: Comments?

Let me ask a question. So the education and outreach, can you talk about that a little bit? Obviously, the reach is pretty broad in terms of who we're trying to contact in that effort. What are the strategies for that?

MS. NGUYEN: In terms of education and outreach, we have tried to educate the public in terms of our filing requirement, in terms of the market based rule law changes.

In addition, there's been a few occasions where we have had presenters at various conferences to answer questions.

CHAIRPERSON YEE: All right. Thank you. Thank you for being proactive on this too, because, obviously, there are a lot of unresolved issues that we'll need to get more clarity on. So I appreciate the role of the task force in that effort.

Are there other comments on this one?

Okay. Thank you both for the update.

MS. WILLIAMS: Thank you.

CHAIRPERSON YEE: Thank you.

Okay. We have -- next item is item number 6. These are regulation matters. We will now have the board members move back to the dais and prepare to hear from Fred Campbell-Craven with the alternative apportionment method petition procedures on the subitem.

This item, as I said, has two subitems. We will start with first subitem.

And welcome, Mr. Campbell-Craven.

MR. CAMPBELL-CRAVEN: Thank you. Good afternoon. I'm relieved to see that this chair is not as close as member Ortega's was. I was a little concerned.

CHAIRPERSON YEE: We had our back.

MR. CAMPBELL-CRAVEN: So good afternoon. I'm Fred Campbell-Craven an Assistant Chief Counsel in the legal division and director of the Multistate Tax Bureau. I'm coming to you today to request permission from your board to begin the interested parties meeting process to meet with taxpayers and

tax practitioners and possibly draft proposed regulatory language that might be promulgated to outline procedures for submitting and processing 25137 petitions.

As you know, Revenue and Taxation Code 25137 states that when the standard allocation and apportionment provisions of the Uniform Division of Income for Tax Purposes Act don't fairly represent the extent of the taxpayer's business activity in California, the taxpayer may petition for the use of an alternative method to accomplish an equitable allocation or apportionment of its income to this state.

So it's a safety valve, if you will, available to taxpayers who believe that application of the standard rules to their business model would not result in a fair or equitable allocation of income to California commensurate with their business activity in this state.

In FTB Board Resolution 2000-10, your board delegated to staff the authority to consider, grant, or deny petitions to use alternative formulas under Revenue and Taxation Code section 25137.

We typically work closely with taxpayers filing such a petition, and all discussions fully maintain taxpayer privacy. If a taxpayer is not satisfied with staff's determination, it has the right, and can request, that the three-member board consider the petition in an open session at a Franchise Tax Board meeting. At this point, matters become public.

In recent years, the number of taxpayers interested in using alternative apportionment methodologies under the authority of Revenue and Taxation Code section 25137 has increased. In addition, staff has received an increasing number of inquiries about the procedures to follow in submitting 25137 petitions.

For these reasons, staff believes that formal regulatory guidance would be helpful in assisting taxpayers with submitting petitions for relief under section 25137.

So again, I'm requesting authority from your board to begin the interested parties meeting process. Staff anticipates holding an initial interested parties meeting to discuss various procedures that might be followed in submitting and processing a petition, and then working with members of the public to draft proposed regulatory language.

Once we've got all that worked out with the taxpayer community, staff would anticipate returning to your board to present proposed language and to request permission to move into the formal rulemaking process under the Administrative Procedures Act.

Thank you. And I would be happy to try to answer any questions you may have.

CHAIRPERSON YEE: Thank you, Fred.

We do have one public speaker on this item. Let me welcome David Doerr. You have three minutes. Good afternoon.

MR. DOERR: Thank you very much.

Cal-Tax is a big supporter of the interested parties process, and we look forward to participating in that. It's better that taxpayers and board staff work together rather than work apart. So this is good.

But on this issue, on 25137, I think that maybe there's a bigger issue here, because we still don't see how we can view the relationship of 25137 with a single sales factor formula, and whether staff would

ever take the position that single sales factor formula is distortive. And we think that's an important clarification that would be a benefit to both sides.

CHAIRPERSON YEE: Thank you.

Would you respond?

MR. CAMPBELL-CRAVEN: I think probably the answer is, with any rule, in any walk of life, one size never fits all. And it probably remains to be seen what the impact of the new rules might be.

I know, from personal experience, I continue to get inquiries. We continue to work with taxpayers. And we would most definitely welcome Mr. Doerr's participation in the process.

CHAIRPERSON YEE: Good. Thank you.

Questions?

Member Ma.

MEMBER MA: Yeah. I do have a couple questions.

How long is this process normally? If the taxpayer would like an alternative calculation, what is the expectation?

MR. CAMPBELL-CRAVEN: Well, it can come to us from a variety of areas. It can come through audit or it can come through legal directly. Quite often, we will work with tax practitioners, before they file a petition, to try to address some of the issues and questions that might arise.

Having said that, we try to complete the actual petition within one year. If taxpayers are in a situation where they have a filing coming up, we work as hard as we can to try to expedite matters.

MEMBER MA: And then once you come up with an alternative formula, are other players in the industry applicable or able to use this alternative formula, if they are doing similar type of business?

MR. CAMPBELL-CRAVEN: It's on an individual facts and circumstances basis. And the facts of the business model being considered are considered confidential, and you can see why, I'm sure.

MEMBER MA: Okay.

MR. CAMPBELL-CRAVEN: We have to be very careful not to betray a taxpayer's business practices to competitors, frankly. And so those proceedings are held in strictest confidence, and then if the taxpayer does not like what staff is recommending, then it has the right to go to your board. Then it must disclose and it becomes a public discussion at that point.

MEMBER MA: I see.

So each company in an industry would have to come separately and ask for an alternative formula?

MR. CAMPBELL-CRAVEN: That's correct, yes.

MEMBER MA: Okay.

MEMBER STOWERS: Can you comment about some of the other, just, regulations that you have, industry-special regulations?

MR. CAMPBELL-CRAVEN: That's correct.

Under 25137, there's a general provision and then there are a number of recognized special industries that have regulations under themselves. So under a special industry Reg, say, like for the print industry or something like that, that is regarded as the standard rule.

So if somebody wants to deviate from those special industry regulations, they could also bring a 25137 petition.

MEMBER STOWERS: And then if a taxpayer does a petition for 25137, is it indefinite, or do you set a time frame to apply the regulation for five years? Ten years? 15 years?

MR. CAMPBELL-CRAVEN: They will ask for a specific time period, and then we'll rule on that. Of course, facts can change over time. Business models can change. And we can't really prognosticate what's going to happen in the future.

CHAIRPERSON YEE: Thank you.

Other comments, Members?

Okay. Hearing none, we have a request to proceed to the interested parties meeting for the proposed regulation.

(No audible motion.)

Motion by Member Ma.

MEMBER ORTEGA: Second.

CHAIRPERSON YEE: Second by Member Ortega.

Without objection, that motion carries.

Thank you very much.

And speaking about a special industry rule, Item 6B will speak for us. And let's see. We now have Tom LoGrossman and Norm Scott on the Space Transportation Activities Apportionment Section of 25137 Regs.

And good afternoon.

MR. LoGROSSMAN: Good afternoon, Members of the Franchise Tax Board.

My name is Thomas LoGrossman, tax counsel. And with me is Norm Scott, Deputy Chief Counsel for Multistate and Business Entity Tax. And we are presenting staff's request for permission from your board to enter the formal rulemaking process, under the Administrative Procedures Act, to adopt a regulation addressing the apportionment of income on space transportation companies.

At its meeting on March 24th, 2015, your board authorized staff to convene one or more interested parties meetings to discuss the possible regulatory effort for the apportionment and allocation of income derived from space transportation activities.

At the interested parties meeting, which was held July 9th of 2015, staff exchanged ideas on how space transportation activities should be defined, what kind of issues participants felt needed to be addressed in a regulation, and for details as to how the space transportation industry worked.

The meeting was well attended, and input was received that allowed staff to undertake the process of drafting proposed regulatory language. Staff took that information and then developed language that was presented for discussion at a second interested parties meeting, which was held on April 13th of 2016.

One of the key issues discussed during the meeting was the definition of space transportation activities, which will control the scope of the proposed regulations. As a result of the second interested parties meeting, staff amended the language further and we now believe we have reached an approach that will be workable for both industry and the state of California.

The language included new briefing materials as a proposed special industry apportionment regulation, which is modeled on existing space transportation industry apportionment regulations. Under the language provided, apportionment of the taxpayer sales factor will be based on both the mileage and a launch factor.

In conclusion, staff thanks the members of the public for their collaboration with the staff throughout the informal process, and we would like to say that we will continue to work with the public through the formal process.

And at this time, we would like to formally request from the board permission to begin the rulemaking process under the Administrative Procedures Act, and I'm happy to answer any questions.

CHAIRPERSON YEE: Thank you both very much. We do have two speakers on this item. I believe two. We have Mr. Dennis Loper and also Mr. Brad Johnson. You will each have three minutes.

MR. LOPER: Thank you, Chairwoman Yee, Board Members. I would just like to thank the staff. Since we started this process just over a year ago, it's been very collaborative. They have worked hard at trying to make sure that our questions and concerns were answered.

We obviously didn't always agree, nor should we. But I think it's been a great collaborative process and I really do appreciate the staff's report.

Thank you, and I would like to introduce the CFO of SpaceX, Mr. Brad Johnson.

MEMBER MA: Thank you.

MR. JOHNSON: Good afternoon, Madam Chairwoman and honorable board members.

I'd Brad Johnson, CFO of SpaceX. And I'm appearing on behalf of the company.

SpaceX is a private space transportation company based in Hawthorne, California, that designs, manufactures, and launches rockets and spacecraft. It is contracted by the United States government, private entities, and foreign agencies to provide transportation services to space.

The private space transportation industry has grown at a tremendous pace since our inception in 2002 and is expected to continue to grow rapidly over the course of the next decade. Given the nascent nature of the industry, there has been a dearth of guidance from a tax perspective.

This, combined with California's new market based sourcing method for servicing income, has further compounded uncertainty for taxpayers in the industry, with respect to California income tax apportionment.

This regulation project is very important to create certainty for our industry. SpaceX would like to thank the FTB legal department for their diligent work in drafting the regulation and for their open communication with industry representatives during the interested parties process.

Thank you.

SpaceX has reviewed the proposed regulation language and supports it, as drafted, and, therefore, we respectfully request that your board vote to start the formal regulatory process under the Administrative Procedures Act as a necessary prerequisite to promulgate this proposed regulation.

Thank you for your time, Madam Chairwoman and honorable board members.

CHAIRPERSON YEE: Thank you very much.

Okay. Questions? Comments?

Okay. We have before us the question of whether we will be authorizing the beginning of the formal regulatory process under the Administrative Procedures Act.

Is there a motion?

MEMBER ORTEGA: Move approval.

CHAIRPERSON YEE: Okay. Motion by Member Ortega.

(No audible second.)

Seconded by Member Ma.

Without objection, that motion carries.

Thank you all very much. Thank you for all the great work with the industry.

Our next item is item number 7. These are administrative matters, and we will have Marco Esquivel presenting the 2017/2018 proposed budget change proposals. This is not an action item; it's for information only.

Good afternoon.

MR. ESQUIVEL: Good afternoon.

My name is Marco Esquivel. I'm the director of the Financial Management Bureau here at the Franchise Tax Board.

I will be presenting information on FTB's proposed BCPs for fiscal year 17/18 for your information, with the understanding that we will be returning to solicit your approval of these BCPs at the September board meeting.

At this time, many of these proposed proposals remain under development and final position counts, as well as dollars, are not available, as shown on the chart.

Our first proposal requests an augmentation to cover fiscal year 17/18 through fiscal year 19/20, three fiscal years, for the replacement of FTB's phone system which reaches end of life and will have no support services available as of March 2018. FTB's phone system is critical to FTB's operations. A failure after end of life could severely affect both internal and external customers. If the system is not replaced, the FTB runs the risk of catastrophic failure for its telecommunication infrastructure.

The next proposal will request new permanent positions and conversion of temporary help positions to permanent positions for the court ordered debt collection program.

The permanent resources are necessary to continue to provide collection services as well as address the backlog of accounts. This proposal is also projected to increase revenue for the courts.

The third proposal requests permanent positions that will replace expiring three-year limited term positions for our audit program. The current positions will expire on June 30th, 2017. The permanent positions will continue to work all administrative resolution processes for undocketed protests within the appropriate time frames, while sustaining practical inventory levels.

The work is ongoing in nature, and these resources are critical to the continued success of working with the taxpayers to resolve protests and appeals.

Our final proposal will request limited term funding to allow FTB to extend four limited term positions set to expire June 30th, 2017, and hire ten new additional limited term staff to perform mandatory reviews of awarded agreements through the required statutory period of AB 93, which is the California Competes Tax Credit. The California Competes Tax Credit was created under the Governor's 2013 Economic and Development initiatives. It is the income tax credit available to businesses that want to come to California or stay and grow in California.

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

CHAIRPERSON YEE: Questions, Members?

Okay. Seeing none, we look forward to the full proposals coming before us. Thank you very much.

Okay. Our next item is item number 7 [sic]. And this is the executive officer's time. And I look to Selvi Stanislaus to provide a couple points to the board.

EXECUTIVE OFFICER STANISLAUS: Thank you, Madam Chairwoman and honorable board members.

For my time I would like to extend two invitations to come and celebrate with my employees. The first is on August 17th at noon. It's our first multicultural food and arts fair.

As you can guess, there will be cultural art exhibits and samples of ethnic foods. The highlight for you will be sitting in this very auditorium, watching our employees share their talents. It's not on the

agenda, but I'm sure will be plentiful supply, will be smiles, laughter and great memories. And I will be sharing some Sri Lankan food with all of you as well.

So moving on to the second item, that's going to be on August 24th. It's a two-for-one celebration highlighting the incredible teamwork at FTB, who launched two major programs in the last year. The first is our EDR, Enterprise Data to Revenue. As you know, it's already improving the way we do business. So after more than five years, it's finally winding down. So with all the support the Board has given, please join us for this celebration.

And our second celebration is going to be the state's first ever Earned Income Tax Credit, which has been a big success.

So thank you for your support, Board, and I look forward to seeing all of you on both days.

MEMBER MA: Thank you very much, Selvi, for the invitations.

It will be a wonderful time of celebration for both.

Thank you.

Move on to item number 8 [sic], which is Board Members' Time.

Do Board Members have any comments at this point?

No?

Okay. I will just make a couple brief comments. One, just, really, congratulations to the entire FTB. I look forward to another successful filing season. And I think we're seeing the fruits of the labor, with all of the resources and tools that we have to really support the effort of each year, this year particularly, especially with the status of EDR and also the launch of Cal EITC. Just very, very tremendous work by the staff.

And then, secondly, I know, there's starting to be some increased interest with respect to the income tax receipts to the state. And I think many pause with a little bit of concern about the three consecutive months of income tax receipts not meeting expectations.

And so we're going to take a look at that from the Controller's office and have a research question coming to the Franchise Tax Board's way with respect to just taking a historical look on the trend of income tax receipts, particularly as we look at June becoming more of a prominent month. I'm pleased to report that we have met or surpassed the annual budget projections but, certainly, on a month-to-month basis, are beginning to see only tightening and some slowing. So that's to come.

And I think we probably can provide a little bit of public information about the trends that we've been seeing in that regard. So that will be forthcoming.

Other -- other notes by members?

Okay. Seeing none, at this time, the Board will be going into closed session to discuss pending litigation and we're going to ask the audience to please remain seated while the board members exit, and we will return after the closed session.

Thank you.

(Break taken in proceedings from 2:46 p.m. to 3:07 p.m.)

CHAIRPERSON YEE: We'll reconvene the meeting of the Franchise Tax Board.

The board met in closed session and discussed pending litigation.

And with that, seeing no other comments, we are adjourned.

Thank you very much.

(Proceedings concluded at 3:08 p.m.)

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CERTIFICATE OF REPORTER

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

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

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

IN WITNESS WHEREOF, I have hereunto set my hand this 26th day of July 2016.

/s/ Kathryn S. Swank_____

KATHRYN S. SWANK, CSR

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