

STATE OF CALIFORNIA

FRANCHISE TAX BOARD

MEETING

TUESDAY, JUNE 16, 2009

1:30 P.M.

FRANCHISE TAX BOARD

9649 BUTTERFIELD WAY

TOWN CENTER, GERALD GOLDBERG AUDITORIUM

SACRAMENTO, CALIFORNIA

REPORTED BY:

ESTHER F. SCHWARTZ
CSR NO. 1564

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ATTENDEES

FRANCHISE TAX BOARD:

MARCY JO MANDEL
BETTY YEE
TOM SHEEHY

COUNSEL:

GEOFFREY S. WAY

STAFF:

SELVI STANISLAUS
COLLEEN BERWICK
ANNE MILLER
DEBBIE LANGSEA
CAROLE ROUIN
CARL JOSEPH
JEANNE HARRIMAN

PUBLIC SPEAKERS:

ERIC I. MIETHKE

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1 SACRAMENTO, CALIFORNIA

2 TUESDAY, JUNE 16, 2009, 1:35 P.M.

3 ---oOo---

4 ACTING CHAIR MANDEL: Good afternoon. This
5 is the scheduled time for the meeting of the
6 Franchise Tax Board. Will the secretary call the
7 roll to determine if a quorum is present.

8 MS. BERWICK: Member Yee.

9 MEMBER YEE: Present.

10 MS. BERWICK: Tom Sheehy, Chief Deputy
11 Director, for Member Genest.

12 MEMBER SHEEHY: Tom Sheehy on behalf of
13 Michael Genest.

14 MS. BERWICK: Marcy Jo Mandel, Deputy
15 Controller, for Chair Chiang.

16 ACTING CHAIR MANDEL: Present.

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

20 The public has a right to comment on each
21 agenda item. If there are any members of the public
22 wishing to speak on an item, please come forward
23 when that item is called. You will have three
24 minutes to address the Board.

25 The first item today is the approval of

1 minutes.

2 MEMBER SHEEHY: Although I wasn't here, I
3 am happy to move the minutes.

4 MEMBER YEE: I'll second.

5 ACTING CHAIR MANDEL: The motion being made
6 and seconded, I'll join.

7 No objection. Then the minutes are approved.

8 Second item is filing season updates. This is
9 an information item, and Anne Miller will present
10 the item.

11 Anne.

12 MS. MILLER: Good afternoon. I am Anne
13 Miller, and I am Chief of the Filing Division for
14 the Franchise Tax Board. Today I will be providing
15 you a brief overview of the 2009 filing season.

16 This year FTB celebrates its 80th year
17 anniversary as an organization. And I'm proud to
18 state that 2009 adds another successful tax filing
19 season to this legacy.

20 Let's get started by talking about electronic
21 filing, specifically for personal income taxpayers.
22 As of last week, we received and processed over
23 14,000,000 personal income tax returns. Of those
24 14,000,000, 10,000,000 were filed electronically.
25 We've experienced continued and sustained growth in

1 electronic filing. This not only benefits the Board
2 and the 70 percent of Californians who choose
3 electronic filing, because of its convenience, but
4 also, in these tough economic times, it benefits the
5 State due to lower costs and increased accuracy with
6 e-filed returns.

7 In addition, our very own CalFile and
8 Ready Return Programs also enjoyed a very
9 successful year. CalFile and Ready Return are FTB's
10 free electronic direct to government filing
11 programs. This year we have already received
12 225,000 CalFile returns and over 61,000 Ready
13 returns. This number far exceeds our goal for the
14 year. As you may be aware, Ready Return was
15 developed to make tax filing easier for individuals.
16 We use the information we already have, including a
17 previously filed return and the individual's wages,
18 to complete a California State tax return.

19 All the taxpayers need to do is to review it,
20 make any necessary changes and file it, if they
21 choose to do so. When you combine Ready Return with
22 direct deposit, tax filing can't get much simpler.

23 So speaking of direct deposit, that is one
24 convenience, I think, that we also noticed in our
25 statistics this year. Of the 9,000,000 refunds we

1 issued, over 5,000,000 were issued via direct
2 deposit. That puts much needed money straight in
3 the bank accounts of taxpayers.

4 At this point, I would like to take the
5 opportunity to thank The Controller and staff for
6 their hard work in issuing delayed refunds so
7 promptly this year. Hard times call for hard
8 decisions, and I am sure the decision to delay tax
9 refunds was a difficult one.

10 Once we received the green light to issue
11 refunds, FTB and the Controller's office worked very
12 closely together, and we got the refunds out
13 promptly, with no major glitches. The biggest
14 impact FTB saw as a result of the delayed refunds
15 was the increase in questions and calls to our call
16 center.

17 Overall this season, we've issued more than
18 \$7.5 billion worth of refunds; and the average
19 refund is up to about \$800 this year, in comparison
20 with \$725 on average last year.

21 Now let's move to talking about the payments.
22 Although most people file electronically, they don't
23 pay electronically, and that is one of the areas of
24 focus for this year. We encouraged tax preparers to
25 talk with their clients about paying electronically,

1 and we did some improvement there. Some
2 Californians are taking advantage of paying
3 electronically, although most still prefer to pay by
4 check. Of the more than 6,000,000 tax payments we
5 received so far this year, over 1,000,000 were made
6 electronically. And I'm happy to report that that
7 is a 45 percent increase over last filing season.

8 So let's move on now to business entities. So
9 far this year we have processed over 725,000
10 business entity returns, which is a 23 percent
11 increase over last year's total. Better yet,
12 businesses are discovering the benefits of e-file.
13 In fact, we have received over 200,000 returns.
14 That's nearly one out of every four business entity
15 returns are now electronically filed with Franchise
16 Tax Board.

17 Let me wrap up by moving onto customer service
18 and start with our Internet services. In this age
19 of transparency, our web services allow direct
20 citizen to government contact with us 24 hours a
21 day, seven days a week. On line we offer many
22 services, including the ability to check your
23 account, payment information with My FTB account.
24 You can file electronically, pay electronically,
25 check the status of your refund, get forms and

1 instructions.

2 And these services provide outstanding
3 customer service. I am proud of our efforts on
4 putting all this information out for taxpayers to
5 take advantage of in meeting their tax filing
6 obligations. Don't take my word for it. What do
7 the taxpayers think? Well, the top five pages that
8 they visited on our website include your home page,
9 of course, but forms. They have checked their
10 refund status, as far as top five. They also check
11 the individual taxpayer information page and
12 CalFile.

13 But we know not everybody has a computer. In
14 fact, not all questions can be answered on line. So
15 let's talk about FTB's call center. Our taxpayers
16 services center is open from 7:00 a.m. in the
17 morning until 6:00 p.m. in the evening. This year
18 we answered 630,000 calls, which is about the same
19 as last year's number. The tax practitioner hotline
20 answered about 110,000 calls. One of the things
21 that is different this year versus last year is we
22 did increase the wait time, which you may think is a
23 bad thing. But, actually, based on taxpayers and
24 tax practitioner feedback, they'd rather wait on the
25 phone than be busied out.

1 Finally, I would like to talk about the pilot
2 project that we are implementing this month. And
3 this was -- this project idea came to the Board as a
4 recommendation during a taxpayer bill of rights
5 hearing. We've delayed, as result of that
6 recommendation, we've delayed mailing approximately
7 450,000 statements of tax due and return information
8 notices. Return information notices correct the
9 simplest errors that taxpayers make during the tax
10 filing season. The intent of this pilot is to
11 reduce the number of notices that do not reflect
12 timely payments. By extending the release date by
13 approximately three weeks, FTB will have more time
14 to process return payments, based on the huge number
15 of paper payments and returns that we receive during
16 April. This additional time should, in turn, reduce
17 the number -- it will allow us to get more payments
18 processed and should reduce the number of taxpayer
19 calls that we receive, as well as representatives
20 receive because of incorrect notices. We should
21 have the results of the pilot later this year.

22 So to conclude, I am very proud to state we
23 have successfully completed the busiest portion of
24 the 2009 filing season. That concludes my
25 presentation.

1 ACTING CHAIR MANDEL: Thank you, Anne.

2 MS. MILLER: Thank you.

3 ACTING CHAIR MANDEL: So we will have the
4 results of the pilot later this year. We will be
5 able to report on it maybe at the taxpayer bill of
6 rights as a successful taxpayer bill of rights item?

7 MS. MILLER: I think we would have the
8 result by then.

9 ACTING CHAIR MANDEL: The person who
10 suggested it at the bill of rights hearing?

11 MS. MILLER: Was Gina Rodriguez.

12 ACTING CHAIR MANDEL: She is aware that --

13 MS. MILLER: She is very aware.

14 ACTING CHAIR MANDEL: Okay. Great. Thank
15 you.

16 Members, have anything on this item?

17 Thank you, Anne.

18 MEMBER SHEEHY: I have one more thing. I
19 just want to say that I had some concerns that I
20 expressed to the Franchise Tax Board staff about how
21 electronic filings are handled when things go wrong.
22 And since we're -- our state policy is to encourage
23 more and more people to go to e-filing, we are
24 pushing e-filing heavily, I just want to say I think
25 it is important that we have the right procedures in

1 place to deal with things when e-filing goes wrong.

2 I am really pleased that the staff has been
3 working on this. Selvi gave me an update. I'm very
4 pleased to see that the Franchise Tax Board staff is
5 aware of the sensitive issue and working on
6 procedures to make sure that all taxpayers have the
7 opportunity to resolve the issues when electronic
8 filing goes haywire.

9 ACTING CHAIR MANDEL: Thank you.

10 MS. MILLER: Thanks.

11 ACTING CHAIR MANDEL: The next item is Item
12 3, audit update. Also an information item, and
13 Debbie Langsea.

14 MS. LANGSEA: Good afternoon. I am Debbie
15 Langsea, Audits Division Chief of the Franchise Tax
16 Board, and I will be providing a brief update on the
17 audit programs, methods used to streamline our audit
18 processes and current issues impacting our audit
19 workload.

20 This fiscal year, the FTB audit programs will
21 meet or slightly exceed this budgeted revenue
22 projection of \$1.7 billion in net assessments. Net
23 assessments are proposed on audit adjustments to
24 taxpayers reported tax liabilities. Approximately
25 300,000 individuals and 5,000 business returns were

1 audited. About 73 percent or 1.3 billion of audit
2 assessments were for business audits, and the
3 remaining 27 percent were for individual audits.
4 Although significantly more individuals were
5 audited, more audit revenues were from business.
6 However, individual audit results were significantly
7 quicker than business audits. Compared to 2000 and
8 2001, audit assessed revenues have increased by
9 about 46 percent for individuals and 132 percent for
10 businesses.

11 FTB also utilizes several methods, such as
12 closing agreements or shelter initiatives to
13 accelerate the resolution of audits. Legal and
14 audit staff collaborate with taxpayers to resolve
15 issues, such as tax shelters or other complex
16 issues. Closing agreements are formal written
17 agreements entered into between taxpayer and FTB to
18 conclusively establish some aspect of the taxpayer's
19 income liability. Closing agreements may include
20 recurring issues, based on the same fact. FTB staff
21 can finalize undisputed adjustments with taxpayers,
22 and taxpayers gain certainty in correctly reporting
23 issues on their returns.

24 Now shelter initiatives are different.
25 They're generally limited-time opportunity for

1 taxpayers to voluntarily disclose participation in
2 tax shelter transactions and the possibility of
3 reduced penalties or other incentives.

4 FTB Notice 2008-4 on BOB and ESOP accelerated
5 about \$50,000,000 in cash payments by about one to
6 three years. Another method is the use of
7 self-compliance letters sent to taxpayers when FTB
8 has information indicating potential noncompliance.
9 Self-compliance letters provide tax information and
10 allow taxpayers to voluntarily comply before an
11 audit is conducted. FTB uses self-compliance
12 letters for, typically, high noncompliance issues,
13 such as tax shelters, certain expenses and
14 unreported income.

15 About two or more years in audit assignment
16 stage, the response rate for those participating has
17 been about 60 percent. Finally, FTB is also
18 partnering with other federal and state agencies to
19 share information and has proven the effectiveness
20 of our audits. For example, FTB participated with
21 other states and the IRS to exchange information.
22 And New York state maintains a database on
23 potentially all tax shelters.

24 FTB uses BOD scales and use tax audit results
25 to propose audit adjustments, and uses EDD

1 information to verify income tax information. And,
2 finally, FTB auditors collaborate together on team
3 audits to consult with legal staff, reviewers of
4 subject matter experts to facilitate audits.

5 Now, emerging issues impacting audit workloads
6 include issues like the large corporate underpayment
7 penalty. Effective December 19, 2008, corporations
8 that understated their tax liability by more than
9 \$1,000,000 were subject to a 20 percent
10 understatement penalty. For prior taxable years
11 2003 to 2007, taxpayers could file amended returns,
12 reporting and paying additional taxes by May 31st,
13 2009, to reduce the likelihood of incurring
14 penalties for these taxable years.

15 As of June 2009, FTB received approximately
16 \$2.7 billion dollars in payment from about 150
17 corporations and exceeded its original estimate of
18 \$1.4 billion. These amended returns on payments are
19 still being validated. We also anticipate that
20 corporations may file claims for refunds for those
21 payments which will impact our audit workload.

22 FTB has also received claims for refunds in
23 connection with the litigation on limited liability
24 company fees. LLC claims for refunds, similar to
25 the Northwest Energetic Services, who conducted no

1 activities in California, Benson, who conducted
2 activities inside and outside California, and
3 Bakersfield Mall, who allegedly conducted all
4 business activities within California.

5 Now FTB recently issued FTB Notice 2009-4 to
6 inform LLCs, with substantially the same factor
7 situations as Benson, that FTB will begin processing
8 claims. FTB will use the information contained in
9 Schedule R to calculate the available refund, if
10 any. Or if the taxpayer decides to use an
11 alternative method, they can file the 2008 limited
12 liability company income work sheet completed for
13 each tax year that is filed by August 20th, 2009.

14 FTB will begin faxing acknowledgements for
15 those faxes received from taxpayers and begin
16 processing the refunds.

17 Now, as far as the Northwest type claims,
18 about 90 percent of those claims have been completed
19 to date. And since Bakersfield Mall is still
20 pending in trial court, no action will be taken with
21 these types of claims yet.

22 Finally, FTB continues to identify abusive tax
23 shelters and reports tax shelter disclosure
24 requirements to encourage taxpayers and promoters to
25 disclose activity. This year about 150,000,000 was

1 assessed on tax shelter audits, including penalties.
2 We continue to prioritize our workloads to address
3 noncompliance issues and seek methods to become more
4 effective.

5 This concludes the briefing on the audit
6 programs.

7 Thank you.

8 ACTING CHAIR MANDEL: Thank you.

9 Any questions from members?

10 MEMBER SHEEHY: I have a questions. So,
11 in the beginning of your presentation you talked
12 about the 1.7 billion of net assessments. How much
13 of that is likely to actually turn into cash that we
14 collect?

15 MS. LANGSEA: Typically, the 1.7 billion
16 does reflect some of the payments that were received
17 as 2.7 billion paid by taxpayers as a result of the
18 corporation understatement penalty. So some of that
19 has been paid in advance. We have not completed all
20 of our audits.

21 ACTING CHAIR MANDEL: Are you asking about
22 our general sustained rate?

23 MEMBER SHEEHY: Yeah. The 1.7 billion of
24 the net assessments.

25 MS. LANGSEA: It ranges between 50 to 70

1 percent, depending on if they are older tax years or
2 versus new tax years.

3 MEMBER SHEEHY: Has that sustained rate
4 been pretty static or has it been changing at all?

5 MS. LANGSEA: There has been some changes
6 over the years. Typically, in the past it probably
7 was a little higher, about 70 percent. It has
8 fluctuated a little bit.

9 MEMBER SHEEHY: Thank you.

10 MS. LANGSEA: A lot due to claims that have
11 been filed.

12 MEMBER SHEEHY: Thank you.

13 MEMBER YEE: One question. I think with my
14 good colleague, Mr. Sheehy, I am curious as to
15 whether increasing the change in workload associated
16 with some of these emerging issues that we add on,
17 the understatement percentage, the LLC fees, do you
18 contemplate any additional resources that will be
19 required?

20 MS. LANGSEA: It does require to redirect
21 our resources. Those workloads that we planned to
22 do, we will not be able to do some of the other
23 audits that were planned. It does mean that we have
24 to dedicate our resources to the large corporation
25 underpayment penalties first before we can resume

1 the other workload. So, yes.

2 MEMBER YEE: Thank you.

3 MS. LANGSEA: You're welcome.

4 ACTING CHAIR MANDEL: Thank you, Debbie.

5 MS. LANGSEA: Thank you.

6 ACTING CHAIR MANDEL: The next item this is
7 Item 4, regulation matters. Proposed Regulation
8 25137-8, motion picture and television producers,
9 distributors, and television networks. Staff report
10 and possible Board approval. We have Carole Rouin
11 and Carl Joseph.

12 If you will give us a report on that. We do
13 have one speaker on the item.

14 MS. ROUIN: Thank you. I am Carole Rouin.
15 I am here to request permission to proceed with the
16 formal rule making process on the adoption of
17 Regulation Section 25137-8, relating to the motion
18 picture, television, film producers, distributors,
19 and television networks.

20 Section 25137-8 was adopted in 1982. It
21 provides special apportionment means to address the
22 unique aspects of the motion picture and television
23 industries. Since 1982, the industries have
24 undergone significant changes. In the television
25 industry, technology has changed. Networks are

1 producing various types of programming. They are
2 transmitting them via digital signals to satellites.
3 They are accessed by affiliates to reach subscribers
4 around the county.

5 Similarly, in the motion picture industry, in
6 1982 the focus was on major studios. There was no
7 inclusion of independent film distributors, and they
8 are not covered by the existing regulations. At one
9 time, major studios controlled almost all stages of
10 production and distribution. Now those functions in
11 those corporate forms are changing. We have
12 separate entities that need to be included. As a
13 result, the existing regulation simply doesn't
14 reflect the industry as it exists today.

15 The Multistate Tax Commission provides model
16 regulations. In 1996, it amended its regulations to
17 include a model regulation covering television and
18 radio broadcasters. We have made the language in
19 the proposed amendment consistent with that model
20 regulation. We also have our own regulation,
21 25137-12, which was adopted in 1995. It addresses
22 the print media industry. And we have also made
23 changes to be consistent with that regulation as
24 well as suggestions that have been made by
25 interested parties.

1 To provide greater clarity in the existing
2 rules, advertising revenue is not specifically
3 identified as part of all gross receipts which are
4 assigned by regulation. This, again, is conforming
5 to language that was set forth in MTC regulation in
6 1996, and it's conformity with 25137-12, our own
7 regulation for print media, as well as Department's
8 existing rules. Amendments also identified
9 distributors as now being covered in this
10 regulation. It redefines film to include news and
11 sports films, which were produced for telecasts, and
12 identified the new technology that is now commonly
13 used.

14 We held interested parties meetings on January
15 8th of 2008 and May 15th of this year to solicit
16 public comment. We also had two telephonic working
17 parties meetings with members of the industry so
18 that we could discuss the proposed changes. All the
19 comments that we have received were posted on the
20 FTB website for public review.

21 The proposed amendment, 25137, would become
22 effective on or after January 1st, 2010.

23 So to conclude, staff is requesting that we
24 can simply begin that initial formal rule making
25 process.

1 ACTING CHAIR MANDEL: We have one speaker,
2 Eric Miethke, for the Motion Picture Association of
3 America. And, Eric, as you come up.

4 Carol, because you mentioned it in your intro,
5 about the one item, advertising revenue, as that
6 being what the Department's view had been.

7 We did receive a letter, Mr. Miethke, from you
8 for the MPAA in The Controller's Office. And I do
9 have a suggested revision in response to that, and
10 maybe I should mention it before you start.

11 MR. MIETHKE: In the interest of time, if
12 you think that you would like to do that, please
13 do.

14 ACTING CHAIR MANDEL: Let's just see. It
15 is your understanding that this one item in the
16 regulation, that is the department's view that the
17 advertising revenue is currently covered by existing
18 regulation, that is why, in the staff explanation,
19 which was just a staff -- as I understand, that is
20 staff's write-up of what things are in this proposed
21 regulation. When you say it makes no substantive
22 change in two different paragraphs, that is staff's
23 view. And there may be some taxpayers who agree and
24 some taxpayer who maybe disagree.

25 So the suggestion will just be on the

1 explanation and those three paragraphs, which I
2 think are five and six and nine. They are five, six
3 and nine, I don't think; they are five, six and
4 nine. That would be sort of combining the last two
5 sentences, but have joining them the phrase "and, in
6 the Department's view, though some taxpayers
7 disagree," and then strike "this revision." It
8 would be "and, in the Department's view, though some
9 taxpayers disagree," makes some substantive change
10 to the regulation. The subject is at the beginning
11 of the sentence. There seems to be some discomfort
12 in some quarters --

13 MR. MIETHKE: Let me just identify myself
14 for the record. My name is Eric Miethke. I am with
15 Nielsen, Merksamer, Parrinello, Mueller & Naylor
16 here in Sacramento. Today, we are representing The
17 Motion Picture Association of America.

18 I think you have accurately described the
19 problem, Ms. Mandel, which is that, certainly, the
20 industry worked closely with staff and, again, I
21 want to thank staff for the process. We've gone
22 through a bunch of very difficult issues. It's been
23 very much a consensus building project and valuable.

24 With regard to prospectivity, we would agree
25 that expressed inclusion of advertising revenue

1 within the apportionment of this special regulation
2 is appropriate. The issue, of course, is what about
3 open years. I think it would be our desire or goal
4 that we would like this regulatory process to
5 neither prejudice or benefit anybody who has a
6 viewpoint one way or another on what the status of
7 the law was prior to the effective day of this
8 regulation. That is what we are trying to reach.
9 So that no one can say, by enacting this regulation,
10 the Board confirmed this position about the past.
11 Because there has been no clear guidance. There is
12 no regulation on point and no case on it. It is a
13 very much open issue.

14 That's what we are trying to achieve. I think
15 your words are great. A step forward in that
16 direction. I haven't shared that with the members
17 of the association, but I think that goes a long way
18 towards accomplishing what they were trying to
19 accomplish.

20 ACTING CHAIR MANDEL: If the Board takes
21 the action today on the regulation, this would just
22 be the start of a formal rule making process, and
23 people would be free to make whatever comments they
24 might have about the regulation in that formal
25 process and, you know, there would be responses to

1 it.

2 MR. MIETHKE: We recognize and appreciate
3 that. This is kind of an odd duck in the sense that
4 the regulation, as presented to you today, actually
5 is perfectly fine. We would support the Board going
6 forward today.

7 What is odd is this additional piece, what
8 would maybe become at some point, at some point I
9 stress, might become part of some legislative
10 history when someone some years from now, when we
11 are all hopefully doing other things, that someone
12 looked back and said, "I wonder what they meant by
13 that?"

14 We are trying to take the extra step to be
15 careful. We appreciate your sensitivity to the
16 issue. Whatever you can do to help on that would be
17 appreciated.

18 ACTING CHAIR MANDEL: Does staff have a
19 thought on the words?

20 MS. ROUIN: I would say we would be glad to
21 include the language. I think it is important on
22 this issue.

23 MEMBER SHEEHY: I have some questions. So,
24 I think what you are suggesting is fine. For the
25 record, I don't have a copy of it, so I don't know

1 exactly what it is.

2 I am particularly hung up on that because this
3 is just -- really, what you're talking about doing
4 is amending a staff description. So what I wanted
5 to understand, and make sure I understand this as we
6 move forward in making the regulation, what
7 regulations exist under current regulatory law that
8 govern how the apportionment issues will used for
9 advertising income? What exists today?

10 MS. ROUIN: We have regulation 25137-8
11 which is before you today. This deals with the
12 motion picture and television industry. We have
13 25137-12 which deals with the print media industry.

14 When they were both -- from their inception,
15 the one in 1982, the other in 1995, they were still
16 very separate entities. Now sometimes they overlap.
17 They're sometimes referred to as the media driven
18 industry. And I think getting consistency in
19 regulation is what we are trying to do here, which
20 is very important.

21 MEMBER SHEEHY: Has the Franchise Tax Board
22 ever had a case or has there been any rulings at
23 all, has somebody apportioned their income under one
24 method and they've been challenged on that and found
25 they had to do it another way? Is there any

1 clear-cut way for the industry today, looking at tax
2 years 200- -- I'm assume this would only affect tax
3 years 2010 going forward. Is there any clear-cut
4 way for the industry to know with respect to tax
5 year '09 and prior how they should apportion their
6 income?

7 MR. JOSEPH: From the standpoint of the
8 television industry, we have had guidelines going
9 back to the 70s about how they should apportion
10 their income, utilizing an audience factor. In all
11 that time we never had a case up until about a year
12 ago, maybe two years ago, six months, where a
13 taxpayer has raised this issue. Prior to that, we
14 never had a dispute. I think the vast majority of
15 the industry has been happy to have all their income
16 be apportioned utilizing the method that is set
17 forth in the regulation.

18 Only recent has it been questioned that the
19 term used in the reg, all gross receipts from film,
20 film including TV shows, does not include
21 advertising. That is a very recent argument. In
22 all the time before that, there has never been a
23 case. Because there's never been a dispute, that I
24 am aware of, where this has been raised in either
25 the Appeals Board or litigation or anything like

1 that. That this is not clear. So that is why, in
2 part, we believe this to be nonsubstantive. It's
3 just never been an issue up until challenged by a
4 few people that think it could be.

5 MEMBER SHEEHY: Has there been more than
6 one regulatory code section that has been used for
7 apportionment or just in one?

8 MR. JOSEPH: Well, we have special industry
9 apportionment regulations for numerous industries.
10 These just being two of them. There are quite a few
11 others. Where the normal rules for apportionment do
12 not work for that industry, the industry has worked
13 with the Franchise Tax Board historically, all the
14 way back to the 70s, to do an alternative method
15 through the reg, the regulations, that better
16 apportion the income for that industry. That
17 includes anything from financial corporations to
18 commercial fishing to railroads to what you have
19 here today. So there are quite a few of those in
20 the code to deal with the unique, specific problems
21 of those industries.

22 MEMBER SHEEHY: I'm going to try to go
23 about this another way.

24 The staff report says the proposed amendment
25 to this code section would become effective for

1 taxable years on or after January 1st, 2010. That
2 is what it says.

3 MR. JOSEPH: That's correct.

4 MEMBER SHEEHY: It doesn't say anything
5 about the prior years.

6 MR. JOSEPH: That's correct.

7 MEMBER SHEEHY: Is there any possibility
8 that more than one methodology is being used for
9 prior years.

10 MR. JOSEPH: Yeah. We have at least one
11 litigant --

12 MEMBER SHEEHY: Is there only one entity
13 that has challenged this? Does this involve one
14 entity, one company?

15 MR. JOSEPH: One, possibly two.

16 MEMBER SHEEHY: One, possibly two?

17 MR. JOSEPH: Yes.

18 MEMBER SHEEHY: Thank you. That is really
19 what I trying to get at.

20 MR. JOSEPH: Sorry.

21 MEMBER SHEEHY: You gave me a very thorough
22 answer. I would just say that I would want to make
23 sure of two things going -- when these regulations
24 are ultimately adopted going forward, I'd want to
25 make sure we don't do anything with respect to the

1 prior years, that we don't take any action going
2 forward that, with respect to the prior years, that
3 would result in the state losing income that they
4 otherwise would have got. And I want to make sure
5 -- I think it is important for us to consider in
6 adopting this regulation, that with respect to the
7 prior years, that we don't also put a situation
8 where companies in good faith were apportioning the
9 income under what they thought were acceptable rules
10 and regulations, that they now are disadvantaged.

11 So I realize that now is probably not the time
12 to do this, since we are not actually doing to
13 regulations. Just talking about giving
14 authorization. But I would like the concept of
15 having some sort of appropriate no-inference clause
16 put in the regulation for prior or years in order to
17 protect the state as well as to protect taxpayers.
18 That would be my preference. I realize now is not
19 the time to do that. I want to get that on the
20 record. I think it is important to be fair and
21 protect our assets that we do that.

22 MS. JOSEPH: Absolutely.

23 MEMBER SHEEHY: That is all I have, Madam
24 Chair.

25 MEMBER YEE: I am ready to make a motion,

1 Madam Chair, to adopt the staff recommendation to
2 begin the formal rule making process and to amend
3 the staff explanation of the proposed draft.

4 MEMBER SHEEHY: I will second the motion.

5 ACTING CHAIR MANDEL: The motion was made
6 and seconded. I will make that unanimous.

7 That will be the Board order.

8 Thank you very much.

9 ACTING CHAIR MANDEL: The next item is Item
10 5, administrative matters. We have Jeanne Harriman,
11 who is the new Director of Financial Services
12 Bureau, is going to present the item.

13 MS. HARRIMAN: Good afternoon. My name is
14 Jeanne Harriman, Director of the Financial
15 Management Bureau. I am here today to discuss Item
16 5 related to administrative matters.

17 Item 5a relates to contracts over \$1,000,000
18 with a star two, and we are requesting your approval
19 to proceed forward on those contracts today.
20 Throughout this discussion on the contracts, I will
21 also be discussing how Executive Order 99 and those
22 contracts, and be aware of those. And any approvals
23 proceeding forward today from those will, of course,
24 be contingent on final approval in that Executive
25 Order.

1 The first contract under discussion relates to
2 a workload growth proposal that we have put forward
3 through various processes the state has of BCPs.
4 We're looking to purchase additional servers and
5 other components necessary to manage the continual
6 upswing in electronic data we have, whether it's
7 related to electronic file returns or data that we
8 use to detect and deter noncompliance. That
9 contract costs \$1,000,040. It has been approved to
10 proceed forward through various efforts internally,
11 as well as OICO. That does involve '9 spend
12 funding, so the impact the executive order has on it
13 simply deals with May and June and the 15 percent
14 cut that is potentially going to be imposed on this
15 particular contract.

16 The second contract deals with the
17 necessity and critical needs of Franchise Tax Board
18 to convert our staff over to Microsoft Office 2007.
19 Currently, the majority of our staff operates on the
20 platform Microsoft Office 2000. As of July 2009,
21 Microsoft will cease to support that, which exposes
22 us to potential severe security risks and taxpayers
23 putting forward potential threats to our software
24 because of that. The contract for that was
25 originally 14-45 that has now been reduced to 14-22,

1 1.422 million, as a result of the Executive Order
2 0909, to renegotiate the contracts. That, of
3 course, is '09, '08-09 funds. So we are looking
4 forward to move forward with that, with the purchase
5 this year. Again, the exercise under the Executive
6 Order 0909 will ultimately determine how we move
7 forward with that.

8 ACTING CHAIR MANDEL: Thank you.

9 Are there any questions on the two contracts?

10 Is there a motion?

11 MEMBER SHEEHY: Excuse me, Madam Chair.

12 Can we split the question? I would like to -- I
13 would like support the first one, and I'm going to
14 abstain on the second one.

15 ACTING CHAIR MANDEL: Sure.

16 MEMBER YEE: I will move approval of the
17 first contract.

18 MEMBER SHEEHY: I will second.

19 ACTING CHAIR MANDEL: Okay. And make that
20 unanimous.

21 The first contract is approved.

22 Okay. Second contract.

23 MEMBER YEE: I will move approval.

24 ACTING CHAIR MANDEL: I will second.

25 MEMBER SHEEHY: I will abstain on that.

1 ACTING CHAIR MANDEL: That is two-0, with
2 the Chief Deputy Director abstaining.

3 Thank you.

4 MS. HARRIMAN: I am to present to you the
5 facilities action requests that we have pending.
6 The first one asks to participate, and your approval
7 is requested to forward this.

8 The first one asks for approval to participate
9 in a statewide rent reduction task force that is
10 being sponsored by DGS. The next ten years we have
11 75 percent of our leased space moved to soft term.
12 We are looking to take advantage of the current
13 market out there with reduced rental rates.

14 The second request was a request to expand our
15 customer command center service room, which has
16 exceeded its capacity. That has been approved by
17 DGS. It is fully funded by the rent reserves that
18 we post every month through our normal rental
19 payment. There is no use of general funds to
20 accommodate this request. And upon your approval,
21 this will be submitted to the office of the Chief
22 for his approval as well.

23 ACTING CHAIR MANDEL: Any questions or
24 comment on these?

25 MEMBER YEE: I will move approval of both

1 of these items.

2 ACTING CHAIR MANDEL: Are you voting?

3 MEMBER SHEEHY: I will second.

4 ACTING CHAIR MANDEL: We will register
5 three-0, unanimous on the -- what?

6 MS. HARRIMAN: State's facilities actions.

7 ACTING CHAIR MANDEL: -- State's Facilities
8 Actions. Thanks.

9 The next thing we have is concept BCPs.

10 MS. HARRIMAN: The next item on the agenda
11 is 5c. Is information only. It relates to the
12 proposed budget change proposal. We will be
13 bringing it back to the Board for approval.

14 Again, these proposals have currently been
15 developed without consideration for the recent
16 budgetary actions related to potential layoffs and
17 furlough days. Those items will be factored into
18 any budget change proposal we do bring forward.

19 With that being said, the first proposal that
20 we are bringing forward has to do with tax gap
21 efforts. We are looking to seek additional
22 positions as well as funding for various items
23 related to compliance activities, both in audit,
24 filing, enforcements and collection that deals with
25 additional data, whether we're using it differently

1 than we do now or whether we will be acquiring
2 different data to use, and we are also looking to
3 expand our existing programs in the bankruptcy area,
4 withholding source area, as well as in the audit
5 area related to transfer price issues.

6 ACTING CHAIR MANDEL: Do members have
7 questions on any of these, unless you want to hear
8 them all first.

9 MEMBER SHEEHY: Whatever your pleasure is,
10 Madam Chair.

11 ACTING CHAIR MANDEL: You're on a roll.

12 MS. HARRIMAN: Two and three on the list
13 have to do with limited liability companies and
14 economic stimulus package. Those deal with the
15 limited liability corp uses that are pending before
16 the court, particularly the constitutionality of the
17 fees charged against limited liability companies.
18 We do continue to have work related to those cases.
19 One case, Bakersfield Mall, is still pending before
20 the court. That will not be resolved for a bit of
21 time yet. We are continuing to ask for additional
22 resources to make sure those claims, when the
23 court's decision are final, are handled
24 appropriately and expeditiously.

25 The third priority has to do with economic

1 stimulus package and has to do with the recent
2 credits enacted that the Legislature related to the
3 movie correction credits, the jobs credit and the
4 employee credit. All of which are allocated credits
5 or require extensive upfront work, which is
6 different than what we usually manage where we
7 manage the credits as it is claimed on the return or
8 in the audit universe.

9 The next proposal on there has to do with our
10 contact centers. We continue in this environment to
11 look for the right level of access that our phone
12 lines should have. Once that is determined, we will
13 be looking to supplement our additional staff in
14 that area to fill up all the level access so, when
15 they call us, they can get us. So they're
16 accurately filing their returns.

17 The last proposal has to do with court order
18 set programs. In the near future, in July, we will
19 be finalizing the new IT application called CODE.
20 That deals with the collection, and at that point
21 contracted staff will exit, and we are looking to
22 replace current IT resources that are limited-term
23 positions to permanent positions so that application
24 can continue to be supported through its life.
25 Additionally, those positions are fully funded, not

1 through the general fund, but through the actual
2 program itself, through the fees that are collected
3 because of the criminal or traffic violation or
4 other active that the individual did.

5 ACTING CHAIR MANDEL: Your staff is working
6 up all of these BCPs to come back for Board approval
7 at our next meeting; is that right?

8 MS. HARRIMAN: That's right.

9 ACTING CHAIR MANDEL: We received a written
10 comment on one of these items. You'll take this
11 comment into consideration as you move forward on
12 this.

13 MS. HARRIMAN: That is on court order, that
14 one?

15 ACTING CHAIR MANDEL: Yes.

16 MS. HARRIMAN: We have that, and we are
17 looking at it now. We will certainly include that
18 in the deliberative process.

19 ACTING CHAIR MANDEL: Any questions or
20 comments from Members on any of them?

21 MEMBER YEE: I was just going to note the
22 correspondence received, as well.

23 ACTING CHAIR MANDEL: Mr. Sheehy?

24 MEMBER SHEEHY: No.

25 ACTING CHAIR MANDEL: Thank you, Jeanne.

1 We are now on Item 6, Executive Officer's
2 time. So, Selvi, anything?

3 EXECUTIVE OFFICER STANISLAUS: Nothing to
4 report.

5 ACTING CHAIR MANDEL: Great. We are now on
6 Board Members' time, Item 7. This is the Members'
7 opportunities to raise other matters of interest.
8 And the first matter of interest that we have is for
9 Lynnette. Where is Lynnette?

10 Come on down. For those of you, you may or
11 may not know, this is the last scheduled Board
12 meeting before Lynnette Iwafuchi retires.

13 So, Lynnette, I don't want to make you feel
14 old. It would make me feel old, but since he is not
15 here, I will tell a joke on The Controller. He also
16 doesn't like me to say that I am older than him, but
17 I am.

18 When you first walked through FTB door's in
19 1975, he was 13 years old, and he was playing with
20 his Hot Wheels in the family room. Not going to go
21 there.

22 MEMBER SHEEHY: You are in big trouble,
23 Marcy.

24 ACTING CHAIR MANDEL: You know that is
25 said, whether willingly or unwillingly, you became a

1 role model for female coworkers at FTB,
2 demonstrating how quickly times change. When
3 Lynette was hired, women were not expected to rise
4 through management. Not just here. It was 1975.
5 It was kind of everywhere. Wasn't it? We were not
6 singled out for management roles.

7 Lynette confidently climbed through the ranks
8 from auditor to Assistant Executive Officer. Your
9 tenacity, dedication, intelligence and good humor
10 are attributes to admire and will be missed on your
11 well deserved retirement.

12 I would publicly thank you on behalf of The
13 Controller as well. I know he would have liked to
14 have been here for this. He always enjoys these
15 events. But for your 34 years of state service,
16 public service is more than accepting
17 responsibility. Being ethical and productive, those
18 are skills that will make you successful in any
19 career. But in public service, you are serving the
20 people. You're acknowledging that serving every
21 citizen, whether rich or poor, young or old, is an
22 honorable profession. That providing courteous,
23 considerate service is an unspoken badge of honor to
24 be worn daily.

25 On behalf of The State Controller, fellow

1 Board Members and millions of California taxpayers,
2 I want to thank you for your service and
3 congratulate you on your retirement. And I think,
4 now that I see what's in this
5 resolution/proclamation, I need to really let
6 everybody know what it says. I think it was more
7 fun than what I just said.

8 It is a giant, giant thing. It has a fabulous
9 picture of Lynnette. It has a proclamation and
10 pictures of other people being happy and fun at FTB
11 with thanks for the memories. And the official
12 words say:

13 Whereas, in June 1975, the movie *Jaws* made us
14 afraid to swim at the beach, and the Captain and
15 Tennille crooned *Love Will Keep us Together*, an
16 energetic Lynnette Louise Iwafuchi began what was to
17 become a long, fruitful and historic career with the
18 Franchise Tax Board, and

19 Whereas, during Lynn Iwafuchi's 34 years with
20 FTB, she rose through the ranks from Auditor to
21 Assistant Executive Officer, continually accepting
22 responsibility, demonstrating leadership and being a
23 role model for many women desiring to promote within
24 FTB ranks, and

25 Whereas, Lynnette Iwafuchi has served --

1 You have a typo in what you gave me -- you
2 know, if Lynnette approved it, this would not have
3 happened.

4 Whereas, Lynnette Iwafuchi has served five
5 Governors and five Controllers, capably served two
6 FTB Executive Officers, and through her calm
7 demeanor and unique management style helped ease its
8 transmission from the Goldberg years to the
9 Stanislaus administration, and

10 Whereas, Lynnette broke ground by becoming
11 the first female division chief, the second female
12 Assistant Executive Officer, the first Chief Deputy,
13 and the Chair of the first Women's Advisory Council,
14 and

15 Whereas, Lynnette Iwafuchi tirelessly sought
16 to continually improve, modernize and lead FTB
17 toward integrating technology to ease the burden of
18 tax filing for the millions of California taxpayers,
19 and was instrumental in the successful
20 implementation of the statewide child support
21 automation effort, and a veritable alphabet soup of
22 FTB acronyms, including INC, ARCS, TI, BETS, PASS,
23 and

24 Therefore, be it proclaimed, this 16th day of
25 June 2009, that we, the three members of the

1 Franchise Tax Board, are pleased to extend our
2 appreciation for all of Lynnette's contribution to
3 the State of California, and congratulate her on the
4 occasion of her retirement, and wish her and her
5 family a happy, healthy and well deserved
6 retirement.

7 MEMBER SHEEHY: I have a few more words I
8 would like to say. I want to join and thank you for
9 your many years of state service. The example that
10 you set is really a wonderful one. And the
11 proclamation that you have there acknowledges you
12 served under two Executive Directors, Jerry Goldberg
13 and now Selvi Stanislaus. And while you were here
14 at FTB, we went through an amazing technological
15 boom around this state, and really around the world,
16 and as a result of all that, FTB's integration of
17 all that technology has turned this organization
18 into one of the premier tax collection agencies in
19 the United States, which is just excellent.

20 And the standard of excellence that you built
21 during your time here is a great legacy for you to
22 leave to all of your coworkers. Congratulations on
23 that. We are very proud of you.

24 MEMBER YEE: I would like to add my
25 acknowledgement of Lynnette. I was in high school

1 when she started here. I am a little bit older. I
2 want to underscore what you had alluded to in terms
3 of the many firsts that Lynnette has accomplished.
4 And certainly for us as aspiring women executives
5 and for women executives at FTB, you have been a
6 tremendous role model for them, Lynnette. More
7 importantly, you didn't serve kind of from 30,000
8 feet high. You were right here on the ground the
9 whole time. You had the great ability to be a
10 visionary for this organization as well as
11 on-the-ground problem solver. For that, I'll always
12 be in tremendous debt to you as well as many
13 taxpayers of California and your colleagues here.

14 The one thing personally that I will miss
15 coming to the meetings and comparing the shoes that
16 we were wearing. Congratulations.

17 MS. IWAFUCHI: I had a speech, but I won't
18 use it. It's really been an honor to -- I just want
19 to say it has been a real honor to serve FTB and a
20 privilege to spend 34 years, a career, here. And
21 for those of you that were working at Franchise Tax
22 Board and those that don't, this has truly been a
23 career in public service. My commitment has been to
24 the citizens of California and to the FTB.
25 Throughout the years, my goal has not been a

1 position or ranking in the Franchise Tax Board, but
2 rather to make a difference. And I hope that I had
3 an affect on many employees in the department and
4 made it possible for them to see what a great place
5 this is.

6 Franchise Tax Board is a department of
7 integrity, a department that's been this way since
8 the day I walked in. That is why I stayed. There
9 are many opportunities that I was given over the 34
10 years, and they are not necessarily because that I
11 am Lynnette, but because I was at the right place at
12 the right time or had the right people support me or
13 they saw something in me that I had and gave me the
14 opportunity that I was able to do.

15 I am leaving this place with mixed emotions.
16 Some of you may think I am getting out of Dodge
17 because of what is going on, but I really do have
18 mixed emotions. I want to thank Selvi for keeping
19 me on when she came on. I think that I am leaving
20 the greatest management team you could have, the
21 great's staff that the Franchise Tax Board. And
22 everyone who walks these doors every day does the
23 best job they can do. Management staff has marketed
24 me. They're as committed as I am to this day, and
25 they have a grin and bear attitude to maintain the

1 morale of employees through the very hard times.

2 With that, I say thank you, Selvi, the rest of
3 my team and every one at FTB and to the Board
4 Members for allowing me to have a really great 34
5 years. There is more to come, and I'm going to have
6 a good time.

7 ACTING CHAIR MANDEL: At this time the
8 Board is going into closed session to discuss the
9 items listed on the public agenda.

10 (Board in closed session.)

11 ACTING CHAIR MANDEL: The Board met in
12 closed session and discussed pending litigation.

13 We are adjourned.

14 (Meeting concluded at 2:55 p.m.)

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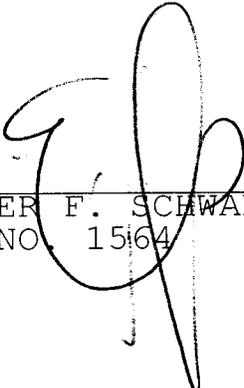
REPORTER'S CERTIFICATE

STATE OF CALIFORNIA)
)
COUNTY OF SACRAMENTO) ss.

I, ESTHER F. SCHWARTZ, certify that I was the official Court Reporter for the proceedings named herein, and that as such reporter, I reported in verbatim shorthand writing those proceedings;

That I thereafter caused my shorthand writing to be reduced to printed format, and the pages numbered 3 through 45 herein constitute a complete, true and correct record of the proceedings.

IN WITNESS WHEREOF, I have subscribed this certificate at Sacramento, California, on this 20th day of June, 2009.



ESTHER F. SCHWARTZ
CSR NO. 1564