

Options for Reforming the State Board of Equalization

LEGISLATIVE ANALYST'S OFFICE

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On Budget Process, Oversight, and Program Evaluation

Hon. Philip Y. Ting, Chair





Current Structure of State Board of Equalization (BOE)

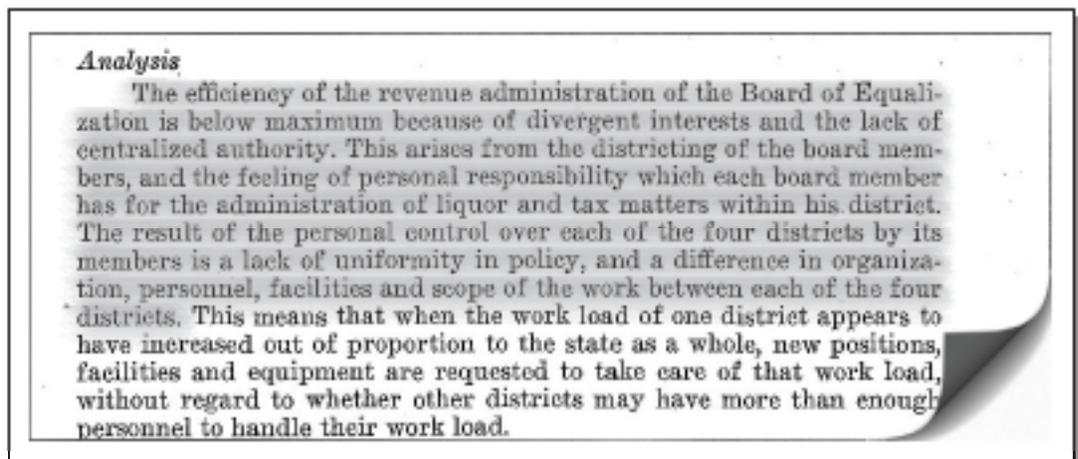
- ☑ ***Elected Board in Charge of State Tax Agency.*** BOE is headed by a five-member board, with four members elected directly by district, and the fifth—the State Controller—elected on a statewide basis. BOE is established by the State Constitution, but the vast majority of its duties are assigned by statute. Statute also authorizes the board to appoint the agency's Executive Director.

- ☑ ***BOE Has Eclectic Mix of Duties and Powers.*** BOE's current organizational structure combines institutional features of three different branches of government:
 - ***Executive Activities.*** BOE runs the Sales and Use Tax Program and many other statewide tax and fee programs, and promulgates related regulations.
 - ***Quasi-Judicial Activities.*** The Board rules on tax appeals for the taxes they administer and for the taxes administered by the Franchise Tax Board (FTB).
 - ***Quasi-Legislative Activities.*** Four of BOE's five board members are elected from geographically distinct districts. Some individual board members regard themselves as representatives of—and advocates for—the constituents who elected them.



Problem For Legislature to Address

- Structure Creates Conflicts.** Under BOE’s current structure, board members are administrators, arbiters, and advocates. It is extremely difficult—if not impossible—for a single entity to perform all of these functions effectively.
- Recent Concerns Notable . . .** The Department of Finance’s (DOF) recent evaluation raised concerns about various aspects of BOE’s operations, such as redirections of staff away from their budgeted purposes. In recent years, some board members, the Legislature, and other observers have expressed concerns about other aspects of BOE’s use of resources, including outreach and communications activities, vacancies, executive pay, furniture acquisition, and the use of office space.
- . . . But Fundamental Problems Are Longstanding.** Although DOF’s evaluation has presented the Legislature with new information about specific activities at BOE, the organization’s fundamental problem—board members’ conflicting roles—is not new. For example, our office discussed this issue in our analysis of the *1949-50 Budget Bill* (displayed below).





Key Decision: What Role Should Board Members Have?

- Could Maintain Current Mix of Roles.** Under this approach, the Legislature would maintain BOE's current organizational structure. The Legislature could use other tools to try to improve BOE's performance in certain areas, such as resource management and tax appeals. These tools include statutory changes, new budgetary restrictions, or reporting requirements.

- Could Emphasize Statewide Nature of Board.** Under this approach, the Legislature would make statutory changes to encourage consistent, uniform statewide tax administration.

- Could Create Greater Separation Between Board and Agency.** Under this approach, the Legislature would make statutory and/or budgetary changes to draw clearer boundaries between the elected board and the administrative agency.

- Could Make Major Changes.** Finally, the Legislature could make major changes to the board's duties. For example, the Legislature could remove most of the board's executive functions or all of its appellate functions through statutory changes.



Options Under Current Mix of Roles



Options Related to Resource Management.

- ***Restrict Board Members' Use of Resources.*** DOF's recent findings cast doubt on BOE's ability to limit board members' redirections of resources away from their budgeted purposes. The Legislature could pass stricter, more extensive statutory language regarding board members' use of resources. However, such language has not always prevented such redirections, so other actions may be necessary. For example, the budget could appropriate resources for board members in a separate line item from resources for the rest of the agency. (This latter approach to budgeting could complement some options described later in this presentation.)
- ***Require Board Members to Report on Their Use of Resources.*** The Legislature could adopt language requiring board members to provide detailed annual reports on their use of staff and other resources—particularly those not budgeted specifically for their use. This reporting requirement could include not only staff redirections but also, for example, the use of agency outreach resources, such as mail and video production services.



Options Related to Tax Appeals.

- ***Require Comprehensive Reports on Appeals.*** The Legislature could require BOE to submit quarterly reports summarizing the outcomes of all of its tax appeals—including those resolved at the staff level.



Options Under Current Mix of Roles

(Continued)

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- **Strengthen Laws Regarding Financial Conflicts of Interest.** Under current law, board members cannot participate in adjudicatory decisions involving parties who have contributed \$250 or more to them in the prior 12 months. However, behested payments—donations to nonprofits solicited by officials—are not subject to these restrictions. Furthermore, these statutes do not address payments made outside of the 12-month window. The Legislature could strengthen these requirements in a variety of ways, such as extending the restrictions beyond 12 months or applying them to behested payments.
 - **Address Ex Parte Communications.** Current statutes establish few limits on contact between board members and parties awaiting hearings before the board. Furthermore, BOE regulations direct board members to “remain accessible” at all times, which may be consistent with a view that board members should act as quasi-legislators. However, ex parte communications—which occur outside of formal hearings—may impede impartial adjudication of tax appeals. The Legislature could restrict these communications.
 - **Change FTB Appeals Process.** Current law does not provide a clear mechanism for FTB to appeal BOE decisions. Under some interpretations, this may be possible through a process that requires a majority vote of FTB’s board. However, two of the three members of FTB’s board—the BOE chair and the Controller—also are members of BOE’s board. As a result, they could decide whether to appeal their own rulings—a clear conflict of interest. The Legislature could clarify the process for FTB to appeal BOE rulings. At the same time, the Legislature could address the conflict by changing the composition of the Franchise Tax Board to reduce or eliminate the overlap between the two boards.



Options for Emphasizing Statewide Nature of Board

- Remove District-Specific Duties From Statute.*** Government Code Section 15623 requires each board member to “investigate” BOE’s tax administration within the district that elected him or her. As worded, the statute does not place clear limits on an individual board member’s involvement in the agency’s administrative activities within his or her district. The Legislature could make major changes to this statute (for example, prohibiting board members from investigating individual tax cases on their own) or simply repeal it altogether.

- Vest Powers in the Board as a Whole, Not in Individual Members.*** BOE currently assigns some responsibilities to individual board members that have no meaningful connection to the four geographic districts. For example, each board member is responsible for one of BOE’s four offices that serve out-of-state taxpayers. The Legislature could specify in statute that all of the board’s duties and powers are collective, not individual. For example, the Legislature could prohibit individual board members and their personal staff from examining taxpayers’ records.

- Restrict Individual Board Members’ Interactions With Agency Staff.*** Even if they lack explicit statutory powers, individual board members could try to direct agency staff on an informal basis. The Legislature could prohibit individual board members and their personal staff from directing agency staff.



Options for Distancing Board From Agency

- Restrict Board's Interactions With Agency Staff.*** In addition to placing limits on individual board members, the Legislature could further prescribe the manner in which the board collectively could interact with agency staff. For example, statutes could require board members and their personal staff to communicate directly with agency staff only at the board's public meetings, perhaps with some limited exceptions related to the scheduling and planning of such meetings.
- Prohibit Board From Interfering With Tax Administration and Personnel Decisions.*** The Legislature could place explicit limits on the extent to which board members and their personal staff involve themselves in various aspects of agency operations, including personnel matters and the day-to-day operations of the agency's tax and fee programs.
- Limit Board's Power Over Executive Staff.*** The Legislature could limit the board's power to hire and fire the agency's Executive Director and other members of the executive team. For example, statute could set a fixed term for the Executive Director, during which the board could dismiss him or her only under narrowly defined circumstances.
- Maintain Physical Separation Between Board Members and Agency Staff.*** The 2016-17 Budget Act and the Governor's 2017-18 proposal contain provisional language directing the administration to relocate board members into a single state-owned space when their current leases expire. The Legislature could consider whether it wants to maintain some physical distance between this space and the office space occupied by agency staff, such as the BOE headquarters building.



Options For Making Major Changes

- Limit Board's Administrative Duties.*** Through statutory changes, the Legislature could reassign most of BOE's executive functions to existing agencies or to a new entity. The State Constitution and statutory voter initiatives assign a few programs to BOE—such as the Alcoholic Beverage Tax Program—but these activities make up a small share of the agency's current workload.

- Remove Board's Appellate Duties.*** BOE's appellate functions are statutory. The Legislature could instead assign these duties to another entity, such as a specialized tax court.

- Consolidate Tax Agencies.*** The Legislature could consolidate most of the tax functions of BOE, FTB, and the Employment Development Department (EDD) into a single Department of Revenue, with an Executive Director appointed by the Governor. Our office has recommended moving in this direction since the 1940s. That said, consolidation would be a difficult undertaking that could result in added spending in the near term.

- Amend Constitution to Eliminate Board Member Elections.*** The Legislature could submit a constitutional amendment to voters to make the board appointed rather than elected—or simply to eliminate the board altogether.



BOE's Constitutional Duties

- Property Taxes.** The state constitution requires BOE to perform several duties related to property taxes, including:
 - Participate in decisions regarding the timber exemption (Article XIII, Section 3[j]).
 - Review, equalize, and adjust certain assessments of local governments' real property (Article XIII, Section 11).
 - Equalize counties' property tax assessment levels (Article XIII, Section 18).
 - Assess property taxes on certain properties (Article XIII, Section 19).

- Other Taxes.** The state constitution requires BOE to:
 - Assess the insurance tax (Article XIII, Section 28[h]).
 - Assess and collect excise taxes on alcoholic beverages (Article XX, Section 22).

- Resources Devoted to Constitutional Duties.** BOE's constitutionally required programs cost \$27 million in 2016-17—about 4 percent of the agency's budget.