

**Oversight Hearing:  
Evaluating California's Newest Tax Agencies**

Tuesday, October 8, 2024 – 10:00 a.m.  
State Capitol, Room 126  
Sacramento, CA 95814

**Introduction and Purpose**

California established the California Department of Tax and Fee Administration (CDTFA) and the Office of Tax Appeals (OTA) by enacting AB 102 (Committee on Budget), Chapter 16, Statutes of 2017. AB 102 transferred the administration of several non-constitutionally enshrined tax laws from the State Board of Equalization (BOE) to the CDTFA. Additionally, AB 102 transferred to the OTA responsibility for adjudicating taxpayer appeals under the laws administered by the CDTFA, and state personal income taxes and corporation franchise and income taxes, which are administered by the Franchise Tax Board (FTB). The CDTFA and the OTA are both subject to the control of Governor-appointed, and Senate confirmed, directors. This hearing is intended to update the Committee and Members on the development and operation of the CDTFA and the OTA since their establishment.

**A Brief History of Tax Administration in California**

California's tax administration regime originally developed in the mid- to late-nineteenth century to manage a revenue system almost entirely reliant upon property taxes. During California's first constitutional convention, Southern Californian delegates worried that northern mining interests would use their political influence to shift property taxes onto other regions of the state. Anxiety regarding disparate property tax burdens persisted during the first two decades of California's statehood, culminating in the creation of the BOE, then consisting of the State Controller and two members appointed by the Governor. As its name suggests, the BOE was tasked with "equalizing" property tax assessments among the various counties to fairly apportion the responsibility for funding state government<sup>1</sup>. Subsequently, the BOE was enshrined in the California Constitution following the California Supreme Court's holding that the BOE's statutory power to raise or lower assessments was unlawful<sup>2</sup>. Today, the BOE's five-member

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<sup>1</sup> Simmons, *California Tax Collection: Time for Reform*, 48 Santa Clara Law Review, 279-283.

<sup>2</sup> *Houghton et al. v. Austin*, 47 Cal. 464 (1874).

board, consisting of the State Controller and a representative for each of the BOE's four districts, serves as the only elected body in the nation that considers tax appeals.

In the decades following its establishment in the California Constitution, the BOE saw its administrative responsibilities grow. In the early 20<sup>th</sup> century, the BOE was assigned responsibility for various motor vehicle taxes, including a registration fee for private motor vehicles and a \$0.02 per gallon tax on motor vehicle fuel. The BOE gained additional duties with the passage of the Bank and Corporation Act of 1929 (BCA). Tension arose between the BOE and the State Controller, who both sought responsibility for administering the new bank and corporation income tax. The legislative compromise addressed this impasse by vesting administrative responsibility in a Franchise Tax Commissioner, who was appointed by a special committee comprised of the State Controller, the Director of Finance, and the Chair of the BOE. The compromise additionally assigned the BOE responsibility for adjudicating assessment appeals. A similar pattern arose with the enactment of the Personal Income Tax Act of 1935, with the Franchise Tax Commissioner assigned administrative responsibilities and the BOE charged with hearing appeals. By the early part of the 21<sup>st</sup> century, the BOE had amassed a sweeping range of responsibilities beyond its original property tax functions<sup>3</sup>. These duties included administering the Sales and Use Tax Law, along with various other tax and fee programs, and serving as the administrative appellate body for final actions of the Franchise Tax Board (FTB), the successor to the Franchise Tax Commissioner.

### **Evaluations in the 20<sup>th</sup> Century**

The organic and piecemeal evolution of California's tax system led to multiple efforts to eliminate the BOE or consolidate the state's disparate tax administrative functions. Many, if not most, of these efforts were motivated by concerns that the state's tax system was duplicative, inefficient, and confusing for taxpayers. As early as 1929, the Martin Commission recommended abolishing the BOE and replacing it with a three-member tax commission appointed by the governor. Nearly 80 years later, by 2008, there had been at least 40 attempts to abolish the BOE<sup>4</sup>. These efforts were unsuccessful and multiple agencies were left responsible for administering California's tax system, including the BOE, the FTB, the State Controller's Office, and the Employment Development Department, which is responsible for administering payroll taxes. The complicated web of administering agencies led the Assembly Interim Committee on Government Organization in 1955 to note that California's tax administration system "is characterized by overlapping duplication, financial waste, and diffusion of activities and responsibilities [...] [S]uch adequacy of tax administration as we have in California is in spite of, rather than because of 'organization.'"<sup>5</sup> In its final report, the Committee found that "every comprehensive report on the subject that has been made by objective, unbiased persons who were not part of California's existing revenue administration structure (and whose own positions would therefore not be affected) has endorsed consolidation of the State's major revenue agencies in some form or other. The committee knows of no comprehensive, independent study that has defended the existing organization – or lack of it."<sup>6</sup>

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<sup>3</sup> Simmons, 287-289.

<sup>4</sup> *Id.*, 291-292.

<sup>5</sup> *Id.*, 279.

<sup>6</sup> *Id.*, 294.

## **Incremental Reform**

In the years prior to the 2017 reform, the BOE faced criticism for an opaque decision-making process that provided insufficient guidance to taxpayers and observers alike. In *City of Palmdale v. BOE*, 206 Cal.App.4th 329 (2012), the Court of Appeal denied the parties' motion to vacate a trial court judgment that faulted the BOE "for rendering a decision without due regard for the statutory and constitutional laws that govern its decision-making." In response, the Legislature passed and the Governor signed AB 2323 (Perea), Chapter 788, Statutes of 2012, which explicitly required the BOE to publish and make available on its website a written opinion with specified information for each decision in which the amount in controversy is \$500,000 or more. Opponents, such as the California Taxpayers Association, the California Chamber of Commerce, and numerous large accounting firms, argued that AB 2323 would increase the number of written decisions on the BOE's website, thereby making those decisions more difficult to find. Opponents additionally argued that the bill's \$500,000 threshold was arbitrary. Proponents, including then-BOE member Michelle Steele and the California Tax Reform Association, echoed Assemblymember Perea's evidence for the bill, noting that the BOE's published formal opinions dropped from an average of 161.5 annual decision in the 1980s to an annual average of 3.2 decisions in the first decade of this century.

## **Growing Impetus behind Comprehensive Reform**

The BOE faced further criticism in the 2010s as a series of reports and audits highlighted various, ongoing issues. A 2010 special report published by the Bureau of National Affairs, Inc., (BNA), examined 70 complex cases argued before the BOE from 2002 through 2009. The average amount in controversy across these cases was \$2.2 million, and publicly available campaign finance data identified \$1.06 million in contributions to BOE members from sources with direct or indirect ties to the 70 cases. BNA found a significant correlation between contribution levels and success before the BOE in these cases. Specifically, the report found that in cases with contribution amounts of \$250 or less, taxpayers won 30 percent of the time. Taxpayers' winning rate increased to 53 percent when contribution amounts were between \$250 and \$16,000. Finally, taxpayers prevailed in 75 percent and 88 percent of cases when the contributed amounts were between \$16,000 and \$50,000 and between \$50,000 and \$137,000, respectively<sup>7</sup>.

Criticism of the BOE's internal administrative practices also arose. A detailed report published by State Controller Betty Yee in November 2015 found that the BOE lacked adequate control over the retail sales tax fund, rendering the BOE unable to detect errors in a timely manner. In one instance, the state General Fund received nearly \$50 million in excess of the appropriate amount, with other funds shortchanged by that amount. This report was followed by a Department of Finance (DOF) audit, released in March 2017. The DOF's audit found that certain BOE member practices intervened in administrative activities and created inconsistencies in operations; breakdowns in centralized processes; and, in certain instances, resulted in activities contrary to state law. Additionally, the BOE had difficulty providing complete and accurate documentation in response to evaluation inquiries, including those related to the informal

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<sup>7</sup> Mahoney, *Campaign Contributions & the California State Board of Equalization*, August 26, 2010, BNA.

establishment of a call center, the creation of an unofficial office location, and the inconsistent use of community liaisons. Finally, despite having dedicated staff and operating budgets of \$1.5 million, some BOE members routinely supplemented their staff by redirecting revenue-generating staff to perform non-revenue-generating BOE member activities. These activities included outreach activities, which had limited nexus with the BOE's core mission, and had increased in recent years.

### **AB 102 through Today**

As a result of the above events, California enacted AB 102 (Committee on Budget), Chapter 96, Statutes of 2023, establishing two new entities responsible for tax administration in the Golden State. The first, the CDTFA was given the administrative responsibility for non-constitutionally stipulated tax and fee programs previously administered by the BOE. The second, the OTA was assigned responsibility for adjudicating appeals under various tax laws administered by the CDTFA and the FTB. AB 102 subjected the two new entities to a Governor-appointed, and Senate confirmed, director and authorized the Governor to appoint a chief deputy director and chief counsel.

Today, with offices located throughout California and in New York, Chicago, and Houston, the CDTFA administers California's sales and use tax, fuel, tobacco, alcohol, and cannabis taxes, among other taxes and fees that fund specific state programs. The OTA, as described above, is the independent appeal body for certain taxes administered by the CDTFA and the FTB. A neutral, three-member panel of tax experts adjudicates every appeal made to the OTA, with appeals heard in Sacramento, Fresno, and Los Angeles. Taxpayers may elect to represent themselves, or be represented, and the OTA's ombudsperson is available to assist taxpayers navigating the appeals process.

This hearing is intended to expand upon the above and provide Committee Members with a detailed overview of the CDTFA's and the OTA's operations in the seven years since their establishment.