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GAVIN NEWSOM
Governor

AMY TONG
Secretary, Government Operations Agency

NICOLAS MADUROS
Director

December 1, 2024

Honorable Scott Wiener, Chair
Joint Legislative Budget Committee
1020 N Street, Room 553
Sacramento, CA 95814

Attention: Mr. Hans Hemann

Re: Supplemental Report Requirement Item 0860-001-0001 from the 2002, 2006, 2010 & 2011 Budget Acts Annual Report on Sales and Use Tax Audit and Collection Activities, Statewide Compliance & Outreach Program, and Audit Selection Improvements for Fiscal Year 2023-24

Dear Chairman Wiener:

The Supplemental Report requirement from the 2002 Budget Act (Item 0860-001-0001) requires an Annual Report on Sales and Use Tax Audit and Collection Activities. The 2006 Budget Act requires the report to include the outcomes of certain audit selection improvements. The 2010 Budget Act expands the 2002 and 2006 requirements to incorporate reporting the average and marginal benefit-to-cost ratios for the audit and collection activities. In addition, the 2011 Budget Act requires a report on the performance of the Statewide Compliance & Outreach Program. The combined report is to be provided to the Chair of the Fiscal Committee in each house of the Legislature and the Chair of the Joint Legislative Budget Committee by December 1, 2024.

The Annual Report on Sales and Use Tax Audit and Collection Activities, Statewide Compliance & Outreach Program, and Audit Selection Improvements for Fiscal Year 2023-24 is attached. If you have any questions, please contact me at 1-916-309-8300.

Sincerely,

A handwritten signature in black ink, appearing to read "Nicolas Maduros".

Nicolas Maduros
Director

NM:ck

Enc: Annual Report on Sales and Use Tax Audit and Collection Activities, Statewide Compliance & Outreach Program and Audit Selection Improvements for FY 2023-24

cc: Mr. Hans Hemann, Joint Legislative Budget Committee, (Hans.Hemann@sen.ca.gov)
Legislative Analyst Office (LAO.Secretary@lao.ca.gov)
Ms. Sue Parker, Chief Clerk of the Assembly, (Agency.Reports@asm.ca.gov)
Ms. Erika Contreras, Secretary of the Senate, (Senate.AgencyReports@sen.ca.gov)
Legislative Counsel Bureau (agency.reports@lc.ca.gov)
Ms. Teresa Calvert, Department of Finance, (Teresa.Calvert@dof.ca.gov)
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CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION

**Report Based on Supplemental Report Requirement
from the 2002, 2006, 2010, & 2011 Budget Acts (Item 0860-001-0001)**

**SALES AND USE TAX AUDIT AND COLLECTION ACTIVITIES,
STATEWIDE COMPLIANCE & OUTREACH PROGRAM,
AND AUDIT SELECTION IMPROVEMENTS FOR FY 2023-24**

December 1, 2024

Sales and Use Tax Audit & Collection Activities, Statewide Compliance & Outreach Program and Audit Selection Improvements

BACKGROUND

The Supplemental Report of the 2002 Budget Act requested an annual report on Sales and Use Tax Audit and Collection Activities. In addition, the Supplemental Reports from the 2006 and 2011 Budget Acts required updates on Audit Selection Improvements and the Statewide Compliance and Outreach Program which are also included in this report.

The 2002 Budget Act requests the following information: (a) description of the methodological approach used to conduct its audit and compliance activities; (b) the number of hours and costs associated with direct audit and compliance activities, as well as supporting (overhead) activities; (c) the revenues associated with its audit and compliance activities; and (d) the data regarding the revenue and cost impacts associated with any increase or decrease in resources devoted to the audit and compliance activities. Items (b), (c), and (d) are to include prior-year actual data, current-year estimated data, and budget-year projected data.

The 2006 Budget Act requests a description of, and the outcomes associated with, the following audit selection enhancements: (a) utilizing new Clementine software; (b) putting U.S. Customs data into the audit selection database; (c) extending the time allowed for audit selection; (d) sharing information with local field offices on claimed deductions; (e) making greater use of data from the Franchise Tax Board's (FTB's) Integrated Nonfiler Compliance (INC) database; and (f) utilizing North American Industry Classification System (NAICS) to identify under-reporters. Several of these audit selection enhancements were incorporated into routine audit selection methods. The 2006 Budget Act also requests we identify other audit selection improvements to assist in closing the Tax Gap.

The 2010 Budget Act expands the above 2002 and 2006 Supplemental Report Language requirements to incorporate reporting on the average and marginal benefit-to-cost ratios of all its audit and compliance activities.

The 2011 Budget Act requires a report on the performance of the Statewide Compliance and Outreach Program. The report shall include, but not be limited to, a schedule of authorized positions, vacant positions, expenditures, and revenues attributable to the program.

This combined report is due to the Chair of the Joint Legislative Budget Committee (JLBC) and Chairs of the Fiscal Committees of the Legislature by December 1st of each year with copies provided to the Department of Finance. This report was designed in consultation with the Legislative Analyst's Office (LAO) and the California Department of Tax and Fee Administration's (CDTFA) Business Tax and Fee Division (BTFD) and Field Operations Division (FOD).

SALES AND USE TAX PROGRAM OVERVIEWS

BTFD and FOD are responsible for planning, organizing, and directing the CDTFA's sales and use tax programs which includes: 1) registration of taxpayers, 2) processing tax returns, 3) auditing accounts and 4) collecting taxes receivable. Total California sales and use tax revenue reached

Sales and Use Tax Audit & Collection Activities, Statewide Compliance & Outreach Program and Audit Selection Improvements

\$79.56 billion in fiscal year 2023-24 with 1,036,695 registered master consolidated and single location accounts filing 2.4 million returns annually. The CDTFA encourages voluntary tax law compliance and offers sales and use tax assistance through its Sacramento Headquarters and 19 field offices located across the state. The staff in the department's New York, Chicago, Houston, and Western States - Sacramento Out-of-State field offices perform audits of taxpayers located outside California who are registered to do business in this state.

Audit Program (Exhibit I)

FOD maintains the Audit Program to ensure businesses report neither more nor less tax than required by law. The audit program also educates taxpayers on the proper application of sales and use tax allowing them to report more accurately in the future. The audit program operates on a three-year cycle and is designed to include the largest taxpayers and other accounts which will maximize the productivity of the audit staff. In fiscal year 2023-24, the sales and use tax audit program disclosed deficiencies (less refunded amounts) of \$518.8 million with a direct benefit-to-cost ratio of 4.0 to 1.

Compliance Program (Exhibit II)

The CDTFA's Compliance Program includes a number of programs which are discussed below. In fiscal year 2023-24, these programs generated nearly \$1.1 billion in revenue with a direct revenue benefit-to-cost ratio of 8.0 to 1.

All functions of the CDTFA are directed toward the collection of all amounts due under the revenue and taxation laws the CDTFA administers. The compliance programs examine sales and use tax returns to investigate discrepancies, create billings, make adjustments to amounts reported, process refunds, or take other actions as warranted by examination. In addition, the CDTFA works closely with state and federal agencies to identify use tax due via the desk-review process.

Statewide Compliance and Outreach Program (SCOP)¹

The revenue from SCOP is reported as a part of both the Audit and Compliance Programs. The goal of this program is to provide outreach, educate business owners on their sales and use tax responsibilities, and increase tax compliance. In fiscal year 2023-24, SCOP performed 66,091 permit checks and registered 66 businesses which were found operating without seller's permits. In addition, 123 sub-locations were added to existing permits, and 513 leads were referred to audit. These permit checks also resulted in 14,301 taxpayer registration updates. SCOP had 161 authorized positions of which 5 were vacant. In fiscal year 2023-24, SCOP generated \$127.2 million in revenue and incurred \$14.1 million in costs.

COLLECTION WORKPLAN METHODOLOGY

Collection risk scores are automatically calculated when a new collection case is created in Centralized Revenue Opportunity System (CROS). A combination of these collection risk scores are used to calculate an overall collection risk score. Collections with higher risk scores are prioritized to receive more attention than those with lower risk scores. CROS offers enhanced

¹ The SCOP revenue is the sum of the SCOP audit revenues under Field Operations (Exhibit I) and the SCOP amended returns under Compliance Program (Exhibit II).

Sales and Use Tax Audit & Collection Activities, Statewide Compliance & Outreach Program and Audit Selection Improvements

collection strategies (including automated collection actions programmed based on collection policies) and improves the assignment and prioritization of collection cases. CROS allows the CDTFA greater flexibility in assigning work and adjusting workloads for greater efficiency. In addition, accounts which have been written off and under 30 years old are resurrected once new assets are located.

AUDIT SELECTION METHODOLOGY

BTFD and FOD perform audit selection annually. The audit selection methodology is designed to maximize the marginal productivity of the audit program by identifying the most productive accounts for audit. The selection process is a cooperative effort between team members in CDTFA's Headquarters and field offices. This selection process continues to evolve as new technologies and information become available.

AUDIT SELECTION IMPROVEMENTS

As audit selection improvements are incorporated into the normal audit selection process, they are no longer included within this report.

Business Analytics Unit (BAU)

In December 2023, the Return Analytics Project evolved into the Business Analytics Unit (BAU), providing a significant advancement in our approach to tax compliance. BAU continues to harness the power of external agency data, combined with CDTFA's proprietary data, to proactively identify potential tax deficiencies.

To enhance our analytical capabilities, BAU collaborates closely with the Data Analysis Section (DAS). This partnership enables us to acquire additional relevant external data sources and leverage DAS's expertise in complex data extraction queries.

By continuously expanding the range of industries and refining our business rules, BAU ensures that our analytics remain accurate and effective. Our Outreach team plays a crucial role in validating these analytics through direct taxpayer engagement.

The efforts of the BAU team have yielded substantial results, demonstrating a significant improvement in the efficiency and timeliness of tax recovery efforts.

FIELD OPERATIONS DIVISION - AUDIT PROGRAM

Exhibit I

SALES & USE TAXES

AUDIT PROGRAM ⁽⁶⁾⁽⁷⁾

WORKLOAD	2023- 2024				2024- 2025 ⁽⁸⁾				2025- 2026			
	ACTUAL - Audit Element of Galley				ESTIMATED - Audit Element of Galley ⁽⁸⁾				ESTIMATED - Prorated Costs Based on Change in Hours			
	HOURS		TOTAL	REVENUE / ACTUAL PYs	HOURS		TOTAL ⁽⁹⁾	REVENUE / AUTHORIZED PYs	HOURS		TOTAL	REVENUE / AUTHORIZED PYs
DIRECT	SUPPORT / OVERHEAD	DIRECT			SUPPORT / OVERHEAD	DIRECT			SUPPORT / OVERHEAD			
FIELD OPERATIONS												
ROUTINE AUDITS (SELECTED)	617,586		617,586	\$ 654,978,332	872,300		872,300	\$ 725,748,000	872,300		872,300	\$ 759,332,000
DISCOVERY (Field Billing Order)	12,392		12,392	\$ 49,052,339	12,400		12,400	\$ 54,352,000	12,400		12,400	\$ 56,868,000
REFUNDS (SELECTED)	40,510		40,510	\$ (66,531,303)	40,500		40,500	\$ (71,229,000)	40,500		40,500	\$ (74,589,000)
AUDIT ACTIVITIES ⁽¹⁾	670,488		670,488	\$ 637,499,368	925,200		925,200	\$ 708,871,000	925,200		925,200	\$ 741,611,000
REFUND CLAIMS ⁽²⁾	39,464		39,464	\$ (119,623,376)	39,500		39,500	\$ (128,071,000)	39,500		39,500	\$ (134,111,000)
FIELD SUPPORT		545,161	545,161			617,900	617,900			617,900	617,900	
STATEWIDE AUDIT ACTIVITY	709,952	545,161	1,255,113	\$ 517,875,992	964,700	617,900	1,582,600	\$ 580,800,000	964,700	617,900	1,582,600	\$ 607,500,000
HQ AUDIT ACTIVITY	815	-	815	\$ 893,658								
TOTAL AUDIT ACTIVITY	710,767	545,161	1,255,928	\$ 518,769,650								
PYs				717.69				899.65				899.65
FIELD PERSONNEL SERVICES			\$ 114,273,678			\$ 130,572,000				\$ 130,572,000		
FIELD OPERATING EXPENSE			\$ 18,493,759			\$ 17,283,000				\$ 17,283,000		
SUT HQ SUPPORT HOURS		291,037				332,600				332,600		
PYs				157.14				179.58				179.58
HQ PERSONNEL SERVICES			\$ 27,219,351			\$ 27,079,000				\$ 27,079,000		
HQ OPERATING EXPENSE			\$ 531,114			\$ 3,422,000				\$ 3,422,000		
TOTAL HOURS	710,767	836,198		874.83	964,700	950,500		1,079.23	964,700	950,500		1,079.23
DIRECT PYs												
DIRECT AUDIT COST			\$ 160,517,902			\$ 178,356,000				\$ 178,356,000		
INDIRECT SUPPORT UNITS:												
LEGAL			\$ 26,335,915			\$ 22,389,000				\$ 22,389,000		
TAXPAYER RECORDS			\$ 842,032			\$ 1,237,000				\$ 1,237,000		
TECHNOLOGY SERVICES			\$ 2,621,733			\$ 3,197,000				\$ 3,197,000		
CROS - Centralized Revenue Opportunity System			\$ -			\$ 985,000				\$ 985,000		
CDTFA OVERHEAD			\$ 16,864,300			\$ 21,966,000				\$ 21,966,000		
INDIRECT COSTS			\$ 46,663,981			\$ 49,774,000				\$ 49,774,000		
TOTAL AUDIT COST & DIRECT PYs			\$ 207,181,883	874.83		\$ 228,130,000		1,079.23		\$ 228,130,000		1,079.23
AUDIT COST BENEFIT ⁽³⁾			Total	3.1		Total		3.1		Total		3.3
			Direct	4.0		Direct		4.0		Direct		4.2
NET REVENUE			\$ 518,769,650			\$ 580,800,000				\$ 607,500,000		
CANCELLATIONS ⁽⁴⁾			\$ 85,423,058			\$ 94,080,000				\$ 98,434,000		

Footnotes

- Audit Activities include the accounts selected for audit and investigations handled by the audit staff.
- Refund Claims are claims for refund assignments referred to the field audit staff to work. These assignments were not selected for audit.
- The Total Audit Cost Benefit is Audit Activities divided by the Total Audit Cost. The Refund Claims amount and Cancellations are not considered.
The Direct Audit Cost Benefit is the Audit Activities divided by the Direct Audit Cost. The Refund Claims amount and Cancellations are not considered.
- Cancellations are an estimate of the reduction to the audit billings which will occur during the appeals process.
- Audit revenue fluctuations from year to year are primarily due to the result of large audits over \$5 million.
 - In 2023-24, there were nine large audits for \$81.5 million.
 - In 2024-25, based upon the current audits in process, it is estimated there will be 13 large audits for \$117.5 million.
 - In 2025-26, the audit revenue is based upon historical averages.
- The methodology used to calculate costs and PYs is updated to provide a more accurate representation of the Audit Program overall.
- Loaned employees' time is recorded accurately within the report when the timesheets are completed correctly.
- The Estimates for the PYs and Costs are projections and represent what is set aside for the Department, should the entire budget be expended, which includes all anticipated positions and filled vacancies. The Department makes such calculated projections so the budgeted amounts can be allocated throughout the fiscal year. Revenue estimates are based on historical averages and take potential hours increase into consideration.

This report does not address the Investigation Bureau's costs or revenue associated with the Sales and Use Tax Program, and therefore does not include the cost of the Investigations Bureau.

This report is subject to discussions with the Legislative Analyst's Office

FIELD OPERATIONS DIVISION and BUSINESS TAX AND FEE DIVISION - COMPLIANCE

Exhibit II

SALES & USE TAXES

COMPLIANCE PROGRAMS ⁽⁵⁾⁽⁶⁾	2023-2024				2024-2025 ⁽⁷⁾				2025-2026			
	ACTUAL - Compliance Element of Galley				ESTIMATED - Compliance Element of Galley				ESTIMATED - Prorated Costs Based on Change in Hours			
	HOURS		TOTAL	REVENUE / ACTUAL PYs	HOURS		TOTAL ⁽⁸⁾	REVENUE / AUTHORIZED PYs	HOURS		TOTAL	REVENUE / AUTHORIZED PYs
DIRECT	SUPPORT / OVERHEAD	DIRECT			SUPPORT / OVERHEAD	DIRECT			SUPPORT / OVERHEAD			
WORKLOAD												
COLLECTIONS												
DIRECT HOURS	700,523		700,523	\$ 842,291,729	882,200		882,200	\$ 1,060,736,000	882,200		882,200	\$ 1,060,736,000
SUPPORT HOURS		412,511	412,511			519,400	519,400			519,400	519,400	
TOTAL ⁽⁹⁾	700,523	412,511	1,113,034	\$ 842,291,729	882,200	519,400	1,401,600	\$ 1,060,736,000	882,200	519,400	1,401,600	\$ 1,060,736,000
OTHER COMPLIANCE PROGRAMS												
DIRECT HOURS	360,157		360,157	\$ 253,845,553	422,029		422,029	\$ 297,525,929	422,029		422,029	\$ 297,526,000
SUPPORT HOURS		69,970	69,970			63,967	63,967			63,967	63,967	
TOTAL	360,157	69,970	430,128	\$ 253,845,553	422,029	63,967	485,996	\$ 297,525,929	422,029	63,967	485,996	\$ 297,526,000
ALL COMPLIANCE PROGRAMS TOTAL	1,060,680	482,481	1,543,162	\$ 1,096,137,282	1,304,229	583,367	1,887,596	\$ 1,358,261,929	1,304,229	583,367	1,887,596	\$ 1,358,262,000
PYs ⁽²⁾				737.12				901.20				901.20
FIELD PERSONNEL SERVICES		\$ 97,203,747				\$ 118,356,000				\$ 118,356,000		
FIELD OPERATING EXPENSE		\$ 19,875,476				\$ 20,702,000				\$ 20,702,000		
SUT HQ SUPPORT HOURS	66,493				68,500				68,500			
PYs			125.48				128.55				128.55	
HQ PERSONNEL SERVICES		\$ 18,665,890				\$ 18,958,000				\$ 18,958,000		
HQ OPERATING EXPENSE		\$ 1,207,138				\$ 2,944,000				\$ 2,944,000		
TOTAL HOURS	1,060,680	548,975			1,304,229	651,867			1,304,229	651,867		
DIRECT PYs			862.60				1,029.75				1,029.75	
DIRECT COST		\$ 136,952,250				\$ 160,960,000				\$ 160,960,000		
INDIRECT SUPPORT UNITS:												
CASHIERS		\$ 66,275				\$ 166,000				\$ 166,000		
CUSTOMER SERVICE CENTER		\$ 1,290,826				\$ 1,409,000				\$ 1,409,000		
DATA ENTRY		\$ 138,716				\$ 189,000				\$ 189,000		
LEGAL		\$ 4,428,505				\$ 5,161,000				\$ 5,161,000		
MAILROOM		\$ 154,129				\$ 262,000				\$ 262,000		
TAXPAYER RECORDS		\$ 25,431				\$ 31,000				\$ 31,000		
TECHNOLOGY SERVICES		\$ 8,493,289				\$ 9,251,000				\$ 9,251,000		
CROS-Centralized Revenue Opportunity System		\$ 1,555,927				\$ 2,639,000				\$ 2,639,000		
SPECIAL PROCEDURES		\$ 771				\$ 1,000				\$ 1,000		
CDTFA OVERHEAD		\$ 12,318,703				\$ 18,571,000				\$ 18,571,000		
INDIRECT COSTS		\$ 28,472,572				\$ 37,680,000				\$ 37,680,000		
TOTAL COST & DIRECT PYs		\$ 165,424,823	862.60			\$ 198,640,000	1,029.75			\$ 198,640,000	1,029.75	
COMPLIANCE COST BENEFIT ⁽³⁾		Total Cost	6.6			Total Cost	6.8			Total Cost	6.8	
		Direct Cost	8.0			Direct Cost	8.4			Direct Cost	8.4	
NET REVENUE			\$ 1,096,137,282				\$ 1,358,261,929				\$ 1,358,262,000	
CANCELLATIONS ⁽⁴⁾			\$ 8,250,278				\$ 9,936,000				\$ 9,936,000	

Footnotes

- Total Hours and Revenue for Collections only.
- PY's and Costs represent all Compliance activities.
- Total Cost Benefit is the Total Compliance Revenue divided by the Total Compliance Cost. Cancellations are not considered. The Direct Compliance Cost Benefit is the Total Compliance Revenue divided by the Direct Compliance Cost. Cancellations are not considered.
- Cancellations are reductions to the net revenue during the fiscal year. These include adjustments, cancellations, redeterminations, scheduled write-offs, and refunds. Applies to Other Compliance Programs only, not Collections.
- To adhere to reporting requirements, Compliance Programs are summarized on the FY 2023-24 Supplemental Report.
- Loaned employees' time is recorded accurately within the report when timesheets are completed correctly.
- The Estimates for PY's and Costs are projections and represent what is set aside for the Department, should the entire budget be expended, which includes all anticipated positions and filled vacancies. The Department makes such calculated projections so the budgeted amounts can be allocated throughout the fiscal year. Revenue estimates take into consideration the potential increase in hours worked. These projections are based upon the entire budgeted amounts being expended.
- For 24/25 these estimates do not include any consideration for PYs that may be swept for budget drill.

This report is subject to discussions with the Legislative Analyst's Office