



Cal-TaxReports

A Digest of Recent Tax and Spending Developments

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Note from Cal-Tax: We hope you are enjoying this publication. If there are others in your office who should receive this publication, please let us know. Karl@caltax.org.

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LOCAL TAXES:

Santa Cruz County Plans to Keep Levying '911' Tax, Even Though Voters Rejected the Assessment

Santa Cruz County administrators say the county will continue levying a '911' tax on phone lines despite voters' rejection of a November 4 ballot measure that sought to authorize the tax.

Measure B, which failed by 2 percent of the vote, asked residents to replace a \$1.47 monthly "fee" with an equal tax – a response to court cases that have found similar assessments to be illegal taxes in other counties, because the assessment was enacted without the constitutionally required voter approval.

The First District Court of Appeal ruled in May that Union City's '911' assessment was an illegal tax, and many local governments have responded by repealing their similar illegal taxes and/or putting measures on the ballot to seek voter approval of a '911' tax to make it legal.

Santa Cruz County's attorney, Dana McRae, said the county's assessment already has withstood a legal challenge, and added that since the county is not in the First District Court of Appeal's jurisdiction, "There would be no reason for us to follow (the court's ruling)."

So if the county's "fee" is legal, why did county officials seek to replace it with a voter-approved tax? Out of an "abundance of caution," the county attorney said.

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County officials also said the primary motivation for Measure B was a second provision that would have extended the '911' tax to cellular phones.

County supervisors have the power to discontinue the assessment, but have not decided whether to do so, Supervisor Ellen Pirie said. If the supervisors do nothing, the assessment will remain in place. (**Cal-Tax:** The First District court's decision trumps the Sixth District's, which the county prefers, for three reasons: it was published, while the Sixth District's was not; it is more recent; and the state Supreme Court let the First District decision stand by turning down a request to hear the case.) (Source: *Santa Cruz Sentinel*, November 13.)

LOCAL TAXES:

Pico Rivera Spokesman Says City 'Pushed the Envelope' and Intentionally Made City Publications Look Like Campaign Pieces

A spokesman for the city of Pico Rivera says the city knowingly "pushed the envelope" when using tax dollars to campaign for Measure P, a local sales tax increase that passed with 68 percent of the vote in the November 4 election.

Discussing the city's use of \$35,000 in public money to pay for campaign-style mailers that stopped just short of asking recipients to vote for Measure P, spokesman Bob Spencer said: "There are people who criticized us because they looked like campaign pieces. That wasn't by accident. We pushed the envelope, there's no doubt about it."

Mr. Spencer said the city consulted regularly with the city attorney, whose salary also is paid by taxpayers, to ensure that the mailers did not violate the letter of the law against using tax dollars for political campaigns. (**Cal-Tax:** The *Los Angeles Times*, in an October 27 editorial, hit the nail on the head by noting that even if such tactics didn't cross the legal line, they certainly broke faith with the voters. The newspaper said it is "nonsense" for cities to claim that their "educational outreach" pieces aren't intended to influence the voters, saying that believing such a claim would be like believing "all those lawn signs that say 'Obama-Biden '08' are just there to let you know who's on the ballot.")

The city's "educational outreach" included seven mailers sent to 15,000 households, a special edition of a city newsletter, newspaper ads, billboards, a question-and-answer brochure, a "public service announcement" that ran on network television and a special TV show on the city's public access channel. (**Cal-Tax:** We always thought the intent of public access television was to make local government more accessible and accountable to the voters, not to give government officials another forum for campaigning on the public dime.)

The privately funded Yes on P Committee spent \$40,000 – only slightly more than the city spent to advocate for the measure. (Source: *Whittier Daily News*, November 9.)

**WASTE, FRAUD & MISMANAGEMENT:
Your Tax Dollars at Work**

Former Firefighter Collected Disability Payments While Running Marathons. A former San Francisco firefighter is facing criminal charges after collecting \$140,000 in workers' compensation and disability payments while participating in ultramarathons and triathlons. *San Francisco Chronicle* columnists Phillip Matier and Andrew Ross report that 37-year-old Christina Hijjawi is facing felony counts of fraud and attempted perjury, and is scheduled to be arraigned December 3. She was fired after San Francisco's Human Resources Department investigated her claims that a shoulder injury and a thumb injury left her unable to work. The department recorded "telling video footage," the columnists write.

They continue: "It seems her shoulder and thumb weren't bothering her so much that she couldn't compete in some of the toughest athletic competitions around, city officials concluded. Indeed, if Hijjawi were trying to hide her fitness quest, she wasn't doing a very good job. Our own Google search turned up records showing her running marathons in Lake Tahoe, Los Angeles, Honolulu and elsewhere. ... And her biography on another site shows she was taking on even bigger challenges, including the Canada 2005 Ultraman super triathlon competition – in which competitors swim 6.2 miles, ride a bike for 170 miles and run 52 miles, twice the distance of a marathon." (Source: *San Francisco Chronicle*, November 12.)

Sacramento Fire District Ordered to Pay \$674,000 for Retaliating Against Whistleblower. A jury has ordered the Sacramento Metro Fire District to pay \$674,191 in economic damages and pain-and-suffering compensation to a former arson investigator. The district was found guilty of retaliating against the investigator after he reported that a subordinate was allegedly falsifying police reports, making police stops and violating residents' civil rights. The investigator was demoted twice and then forced to retire after he made the allegations, his attorney said. The fire district's insurance company, which is covering legal fees for the case, plans to appeal the jury's decision. (Source: *The Sacramento Bee*, November 13.)

Unions Want Pension Board to Be Overseen by Spending Scandal Figure. The *San Jose Mercury News* reports: "Despite a recent audit that found former San Jose retirement services director Ed Overton oversaw outlandish travel expenses and submitted questionable reimbursement claims before stepping down in 2007, retired city workers want him appointed to the board that oversees their pensions. Mr. Overton was criticized for staying in \$400-a-night hotel rooms during a four-day trip to Chicago and Boston, among other things. An audit found that pension officials failed to document \$50,000 in travel reimbursements and billed the pension funds for \$3,600 in ineligible expenses, including some reimbursements for expenses that never occurred. Still, union representatives have asked that he be put on the board that oversees \$4.5 billion in San Jose's two pension plans. (Source: *San Jose Mercury News*, November 11.)

STATE BUDGET:

Legislative Analyst Sees \$28 Billion Budget Gap for 2009-10 if Legislature Doesn't Fix Current Deficit

New Legislative Analyst Mac Taylor released his office's review of Governor Arnold Schwarzenegger's proposed tax/fee increases on November 11, and also suggested some of his own tax/fee increases to address the state's budget deficit. The analyst said that if no action is taken, the state will have a budget gap of \$27.8 billion over the next 20 months – a major increase over the \$11.2 billion forecast by the governor for this fiscal year.

The analyst called the governor's proposal a "credible plan" as a starting point. On one of the governor's major proposals – a 1.5 percent increase in the state sales tax – the analyst opined that the increase might be too large, and could lead to changes in consumer behavior to avoid the tax. The analyst recommended that the Legislature consider a smaller increase, such as a 1 percent hike.

To avoid draconian solutions to the 2009-10 budget, Mr. Taylor says the Legislature "must take major ongoing action" – reducing base spending and increasing revenues – both to close as much of the current-year gap as possible and to provide a head start on closing the 2009-10 shortfall. However, the analyst says that only \$1 billion in mid-year cuts should be made in the K-12 education budget.

The Legislature has begun its special session to deal with the budget, the state's foreclosure problems, and the status of the Unemployment Insurance Fund (including tax increases on employers to provide more revenue for the fund) and has until November 30 to take action. So far, the only action has been the adoption of rules and election of leaders for the special session, followed by meetings between the legislative leaders and the Governor's Office.

The Senate leadership has stated that the special session's true deadline is November 23, because the legislative counsel requires at least seven days to make changes to its computer system to prepare for the opening of the new session, which begins December 1 with the swearing-in of newly elected lawmakers. (Source: Legislative Analyst's Office report, November 11.)

In other budget news:

Governor's 'Nickel Per Drink' Tax Proposal Clarified. Governor Arnold Schwarzenegger's November 6 alcohol excise tax increase proposal, described by the governor's Department of Finance only as a "nickel per drink" increase effective January 1, has been defined with more specificity. According to proposed legislative language obtained by Cal-Tax, the increase would be assessed the same way as the state's existing alcohol taxes, on a per-gallon basis. (**Cal-Tax:** So much for minimizing taxes by ordering a "drink" the size of an oil tanker!)

The increase would be 53 cents per gallon for beer, \$1.28 per gallon for wine (a 600 percent tax increase) and \$4.27 per gallon for distilled spirits. These would be substantial additions to the current tax of 20 cents per gallon for beer and most wine, and \$3.30 per

gallon for most distilled spirits (and flavored beers, under a Board of Equalization regulation whose legality is being challenged in court). The "nickel per drink" description assumes a variety of standardized drink sizes – for example, a 12-ounce glass of beer or 1.5 ounces of hard liquor. The new tax would raise an estimated \$293 million in six months of the 2008-09 fiscal year.

Golf Industry Not 'Fore' Governor's Sales Tax Proposal. The governor's proposal to extend the sales tax to the cost of golfing has teed off the golf industry and the Monterey County Hospitality Association. The association, whose members already have seen the state's economic problems cut into their business, "will oppose it as strongly as we possibly can," according to its government affairs director. The Northern California Golf Association's headline for an online story about the governor's plan: "Massive tax increase proposed on a beleaguered industry." (Source: *Monterey County Herald*, November 12.)

STATE BOARD OF EQUALIZATION:

Equipment Used to Dispose Waste From Asphalt Manufacturing Not Eligible for MIC

A conveyor belt system used by a taxpayer to dispose of waste is not eligible for the manufacturers' investment tax credit, the Board of Equalization held on a 4-1 vote at its November 12-13 meeting in Sacramento.

The 108-year-old Granite Rock Company of Watsonville said the belt was integral to the manufacturing process, because the making of asphalt concrete and cement requires aggregate rock to be washed, and the waste from this washing must be transported to a disposal site (a canyon, in this instance).

The taxpayer said the coating on the aggregate must be washed off for the asphalt to stick, and washing the rock results in dirty water.

The dirty water is separated from clean water, and the "decimated fine" is hauled by a truck to a belt that transports the waste to the disposal site. Bruce Woolpert, president of the company, said the company wouldn't be washing and transporting the waste if it was not manufacturing asphalt and concrete.

FTB staff attorney Dan Biedler argued that the property was used in a non-qualified mining activity, as the conveyor belt also conveyed "overburden" from the mine. Mr. Woolpert, the company president, said the "overburden" was on the belt only to be used as a drying agent for the "fine."

BOE Member Bill Leonard asked if the Franchise Tax Board believes that equipment used to dispose of waste from a qualified manufacturing plant is not "qualified" property. FTB staff answered, "Correct."

Voting to sustain the FTB were Board Chair Dr. Judy Chu; Board Members Betty Yee and Mr. Leonard; and Marcy Jo Mandel, representing state Controller John Chiang. Voting "no" was Board Member Michelle Steel.

Other developments at the November 12-13 meeting:

Board Is Split on Legislative Proposals. There was a time when most of the board's legislative proposals were adopted unanimously. No more. The four proposals on the Legislative Committee's November 12 agenda were adopted by split votes – three of them on 3-2 votes, the other on a 4-1 vote. The proposals:

- **Increase the Sales Tax Permit Reinstatement Fee.** A board staff recommendation to increase the fee for reinstatement of a revoked seller's permit from \$50 to \$100 was approved by a 3-2 vote. Staff said the fee was increased from \$15 to \$50 in 1986. Mr. Leonard raised the possibility that raising the fee will result in more sellers operating without permits. He said the board's objective is to collect tax, and proposals that make it harder to get a seller's permit are counter-productive. Ms. Steel also voted against the proposal.
- **New 25 Percent Penalty That Board Could Impose for Failure to Provide Information.** Perhaps the most controversial of the four proposals was a plan to authorize board staff to impose a new 25 percent penalty for failure to provide, on a timely basis, all information and documents requested by the board in writing. Board staff, who recommended the proposal, said there has been an increase in taxpayers using delaying tactics. During a discussion period, board staff said the proposal is aimed at large taxpayers that don't provide all electronic records and those that redact information on their documents. Taxpayers would have 60 days to cough up the requested information, according to staff (the time is not specified in the language of the proposal).

Dr. Chu said the board needs a hammer to get documents, and noted that the Franchise Tax Board has the authority being sought by BOE staff.

Mr. Leonard pointed out that many taxpayer appeals stem from small taxpayers who just don't have such records to produce. "How will an auditor know if a record is maintained?" he asked. Both Mr. Leonard and Ms. Steel voted against the proposal.

- **Use Tax on Out-of-State Purchases.** On a 4-1 vote (with Ms. Steel opposed), the board agreed to sponsor legislation that would place further restrictions on the presumption that property purchased and used out of state for less than 12 months is subject to use tax once it is brought into California.

The new language provides that out-of-state LLCs and closely held corporations would be considered California residents if 50 percent or more of ownership interests are held by California residents.

In addition, the BOE is proposing that to bring such property into California for repair and not be subject to the use tax, the repair facility must hold a permit issued by the BOE and must have a county business license. For aircraft, the repair station must be certified by the Federal Aviation Administration or by the manufacturer of the aircraft.

- **Require the FTB to Collect Use Tax.** The board voted 3-2 to revive legislation that would require the Franchise Tax Board to collect use tax on the state income tax return. Such legislation was vetoed in 2007 and failed to pass the Legislature in

the past session. The issues raised by this proposal are whether taxpayers will be informed that they have to keep records of all out-of-state purchases, and whether they will be informed about what is – and what is not – subject to use tax, and how to compute the California tax when a tax is paid to another state. BOE staff suggested that the board simply seek an extension of the existing optional reporting of use tax on the income tax form, since the legislation calling for mandatory reporting failed in the past two years. Dr. Chu suggested changes to the staff proposal to make reporting mandatory, as was proposed in the two failed bills. She argued that the anticipated \$8 million in additional revenue will make the proposal attractive this year. The three-member majority agreed.

Attorney General Isn't Representing BOE's View in Sales Tax Reimbursement

Case. Assistant Chief Counsel Robert Lambert told the board that the Department of Justice is taking action in a sales tax reimbursement case contrary to the board's interest. He asked and received permission to file a separate board *amicus* brief in the *Yablsey v. Cingular Wireless LLC* case.

The case involves a taxpayer's claim that Cingular illegally collected a sales tax on cell phones. Cingular responded that a retailer that follows BOE regulations cannot be held liable for unfair business practices.

The Second District Court of Appeal agreed with Cingular in an August 18 opinion (165 Cal. App 4th 1526). However, at the request of the attorney general, the court vacated its opinion on September 17.

Board staff believes the Department of Justice's Consumer Protection Section made the request because it disagrees with the ruling that retailers should have a "safe harbor" from consumer suits on sales tax reimbursement.

Mr. Lambert said an adverse ruling in this case will interfere with effective administration of the sales tax.

Mr. Leonard pointed out that there is no remedy for a consumer who believes that a sales tax charge is excessive. While he supported the filing of an *amicus* brief, Mr. Leonard said legislation is needed to give taxpayers some avenue to contest what they believe are overcharges.

BOE Building Woes Update. BOE Executive Director Ray Hirsig told the board that the Department of General Services considers the remediation of mold problems on the 23rd and 24th floors of the BOE headquarters building to be complete. The floors, according to DGS (which leases the building to the BOE), are ready for re-occupancy.

The BOE's consultant, Brian Daily of Hygiene Technologies, isn't so sure. He said mold odors had been detected, and he could not say if the floors are ready for re-occupancy, and could not recommend such a step.

Elizabeth Houser, deputy director of the BOE's Administration Department, said DGS has set a mid-January date for completion of remediation of the 22nd floor. She also said the 11th floor will be closed for 10 days between November 18 and December 2 as part of mold assessment and testing in the elevators.

ELECTION UPDATE:

Majority of Tight Races Still Too Close to Call

Ten days after the November 4 election, nearly all of the 39 close races highlighted in last week's *Cal-Taxletter* table of local ballot measures remain too close to call. Several legislative races also remain undecided.

Only two of the local tax measures now appear to have been decided – and both passed. In San Diego County, voters narrowly approved Proposition K, which requires short-term vacation unit rental visitors in Encinitas to pay a 2 percent hotel tax. The measure needed at least a two-thirds vote, and passed with 70 percent in support.

In Siskiyou County, voters approved Measure M, which increases the county's hotel tax from 8 percent to 12 percent. The measure, which needed only a majority vote, has 55 percent support with most of the absentee and provisional ballots now counted.

Some legislative and congressional races also remain very tight as ballot-counting continues (now under the watchful eye of lawyers and others representing the candidates' campaign teams). The vote counts are moving targets, as different numbers are being reported by various parties watching the action at the county level, and the secretary of state's updates lag far behind those provided by news sites.

NEW LEGISLATION:

Recently Introduced Bills of Interest

Two-Thirds Vote for Fees, Other Budget-Related Provisions. [ACA 1XXXX](#) (Plescia) would require increases in state fees to be approved by a two-thirds vote. The measure also would require the legislative analyst to report whether the budget bill is balanced within 72 hours after its passage. If not, the Legislature would have to pass a bill to balance it. The bill also would reduce the vote required to pass the budget bill from two-thirds to a simple majority. Further, local governments would be authorized not to implement unfunded state mandates.

Performance Evaluation of State Programs. [SB 1XXXX](#) (Wyland) would require the state auditor to do a performance evaluation of every state program.

Blast From the Past

"Special spending bills could swell the \$5 billion budget by more than \$100 million – and the same general thinking lies behind many of them. Wiser heads should prevail in the Assembly and Senate and block the bulk of such measures. If not, Governor Reagan should use his veto. It is the height of irresponsibility for legislators to vote for expensive programs knowing there isn't money in the till to pay for them."

Los Angeles Times editorial, June 26, 1967