



Cal-Taxletter

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STATE BUDGET: Budget Still Stalled in Senate

California is still without a state budget, 34 days into the fiscal year. This makes it the fifth longest overdue budget in history. The all-time late budget was 67 days for Gray Davis' 2002-03 budget.

On July 21, the budget bills ([SB 77](#) and [SB 78](#), both by Senator Denise Ducheny) fell two votes short of passage (25-14). On August 1, Senate President Pro Tempore Don Perata again tried to get the Senate to approve the Assembly budget, and this time the budget fell one vote short. Republican Senator Abel Maldonado voted for the measure because, he said, Governor Arnold Schwarzenegger promised that he would use his line-item veto to reduce the \$700 million current operating deficit to zero.

Senate Republican Leader Dick Ackerman said, "We are not quite there yet." After Democrats defeated a motion by Senator Tom McClintock to meet August 2 to continue to work on the budget, Senator Perata indicated he was not going to compromise further, and he recessed the Senate until further notice. Senators were allowed to return to their

districts. "I'm done," he said. The Senate also rebuffed an attempt by Republican senators to take up amendments that would have allowed bills to be paid during the budget impasse.

On August 3, *Sacramento Bee* columnist Dan Walters weighed in on the budget impasse, saying, "The fact the budget is more than a month overdue is not the most shameful aspect. It is that (the governor) and most legislators are willing to enact another deficit budget at a moment when revenues are flattening and the gap is destined to widen."

Senate Republicans on July 22 suggested \$842 million in reduced spending from the \$145 billion 2007-08 spending plan approved by the Assembly (0.6 percent of the total) to bring the estimated \$699 million deficit in the Assembly plan to zero. Negotiations between Assembly Democrats and Republicans had reduced the current deficit from \$2.7 billion to \$699 million.

Mr. Perata has refused to let the Senate vote on the proposed Republican spending reductions. On August 1, Senator Dennis Hollingsworth tried to amend them into [AB 191](#) (Assembly Committee on Budget), but Democrats, after some confusion, refused to suspend the rules to allow the amendments to be offered.

On July 20, Mr. Perata, who earlier had locked several senators *out* of their offices, locked the entire Senate *in* the chambers overnight, reminding Capitol old-timers of the time Assembly Speaker Jesse Unruh locked up Republicans overnight in 1963. Reporter Lou Cannon, in his book "Ronnie and Jessie," observed, "The profoundest effect of the lockup was on Unruh himself ... failure in the lockup lay less in a conflict of values than the extremity of the tactic that inevitably subjected (him) to ridicule."

Ruptured was bipartisan goodwill for working out a compromise, as Senator Perata called Republicans who want a balanced budget with current year revenues a bunch of "terrorists." Not to be outdone, Democratic Senator Sheila Kuehl said, "It's egregious when 15 white men with money hold up the budget for 37 million people."

Senator Perata has tried to spin the impasse as a battle between Republican senators and the Republican governor, although the big-ticket item on the Senate Republican laundry list of budget changes – \$300 million in savings from conforming the CalWorks welfare program to federal requirements – originally was proposed by the governor.

The federal 1996 reform act signed by then President Bill Clinton requires welfare recipients to participate in education, job training or counseling or to get a job within five years, or federal aid will end at that time. California did not end aid when a family refused to participate. Senate Republican Leader Dick Ackerman said, "If California fails to comply with federal work requirements, the state faces federal sanctions of roughly \$150 million in 2008-09. That penalty will grow to \$389 million in the next five years." Democrats contend that the reduction will hurt children. It is not known whether the governor still supports his original budget proposal. He is urging Senate Republicans to vote for the Assembly budget, but promises to use his line-item veto to cut it further.

Compounding the problem of engaging in a rational discussion on the budget is the fact that few know what actually is being proposed. There still is no independent analysis of the Democrats' budget (**SB 77**) or the Assembly budget (**SB 77** and **SB 78**). The

legislative analyst, who routinely pontificates about the state's "structural deficit" when not much else is going on, and who analyzes the governor's budget in minute detail, has not produced analyses of either the Democrats' budget or the Assembly budget, and has been totally silent for the last month. However, there must be an "underground" analysis of the budget that we have not seen. Surely, those pushing for immediate passage of the budget would not be doing so unless they have an analysis of what the proposals will do.

Apparently, the only public analysis of the budget comes from one of its foes, Senator Tom McClintock. According to the senator, "The budget is virtually certain to produce an actual dollar shortfall of \$2.006 billion." Here is Senator McClintock's break-down of the proposed spending plan:

- **\$699 million – Shortfall at outset**
- **\$330 million – Failure to account for prison guard contract offer:** *The administration has already placed \$330 million on the bargaining table in contract discussions with the CCPOA, and the actual costs are likely to rise well beyond this level. The budget simply takes no account of this expense.*
- **\$190 million – Overstatement of property taxes:** *The Legislative Analyst's Office has already warned that the property tax assumptions of the budget are unrealistic and overstated.*
- **\$184 million – Overstatement of tribal gaming revenues:** *The LAO has already warned that the tribal gaming revenue assumptions in the budget are unrealistic and overstated.*
- **\$603 million – Failure to account for May/June revenue shortfall:** *Even though the state's revenues fell \$603 million short of budgeted projections in May and June, the budget assumes they were received anyway.*

Second, the budget employs several devices amounting to \$1.167 billion that also clearly fall into the definition of deficit finance, by either pushing expenditures due in the current year to the next fiscal year, or accelerating revenues due in the next fiscal year into the current one. Although they will not affect the state's cash flow, they certainly will add to the state's deficit:

- **\$300 million – Postponement of payment to local governments for mandate relief:** *Although the state is obligated to pay for these mandates, the budget pushes them into the next fiscal year to avoid paying them this year.*
- **\$357 million – Acceleration of tobacco securitization funds:** *The budget accelerates tobacco securitization funds that were scheduled to pay 2008-09 ... settlement costs into the 2007-08 fiscal year to pay for general fund spending.*
- **\$250 million – Diversion of "Williams" School Facility Repair funds:** *The budget also raids the "Williams" School Facility Repair Fund for general fund expenditures, creating an obligation to repay the "loan" in subsequent years.*

- **\$260 million – EPSDT [Early Periodic Screening, Diagnosis and Treatment program] prior-year deficiency deferral:** The budget defers \$173.4 million of a \$260.2 million prior-year (2003-06) deficiency to 2008-10 and scores the 2007-08 \$87 million appropriation as a prior-year expenditure.

I would therefore classify the actual deficit in the current budget at \$3.173 billion. This assumes there is no deterioration in the state's economy, despite alarming job figures announced on Friday. We need to bear in mind that this budget is predicated on the assumption that state revenues will grow at a robust rate of 5.8 percent this year – compared to the 2.4 percent growth we experienced this past year. Thus, these are "best case" numbers.

Unfortunately, it doesn't end here. There are also several highly questionable and shaky assumptions amounting to \$2.865 billion in the budget that will require a substantial reserve in order to protect the state from insolvency in the budget year. Specifically:

- **\$709 million – Escheated property:** The budget is predicated on receiving \$709 million in escheated property – despite the fact that the state's unclaimed properties program is currently blocked by a federal court order. Further, the revenues projected in the budget from the escheatment of property make it obvious that the state does not believe that its proposed reforms will significantly increase the return of seized property, and thus it is unlikely the injunction will be lifted any time in the foreseeable future.
- **\$200 million – 'Limited Liability' court case:** The state has lost this case in the lower courts and is ignoring the strong likelihood it will lose at the appellate level. Its liability is conservatively estimated at \$200 million.
- **\$176 million – Unallocated reductions:** The budget once again assumes the governor will make \$176 million in unallocated reductions, despite his failure to make most of the unallocated reductions as directed in past budgets.
- **\$300 million – Medi-Cal FFACT waiver:** The state's Medi-Cal FFACT [Family Planning, Access, Care and Treatment] program is currently operating by virtue of a federal waiver, and I am told there is significant reason to believe that waiver will not be renewed. If that occurs, the state will have to support the program entirely with state-only funds, increasing state obligations accordingly.
- **\$980 million – Ed Fund sale:** The budget is predicated on the sale of the state's Ed Fund, which guarantees federal student loans. Not only does this action require federal approval that has not yet been granted, it assumes \$980 million in revenue although the fund has never been appraised, and sources tell me the actual valuation is likely to be one fifth of that amount.
- **\$500 million – CalSTRS court order:** The state is currently under court order to pay \$500 million of the \$558 million adverse judgment arising from its failure to fund CalSTRS [the California State Teachers' Retirement System]. The state is appealing the ruling, but is ignoring the very strong likelihood that it will have to discharge this obligation during the budget year.

Also, I consider this a "best case" analysis, considering, as just one example, the LAO's warning that the administration has under-budgeted to meet its current obligation to pay health benefits to retired employees and continues to ignore the analyst's warning that it needs to set aside \$6 billion annually to fully fund this obligation. Under these circumstances, I believe that at the very minimum, the state must begin the fiscal year with a 3 percent budget reserve.

Although the budget's architects boast a \$3.4 billion budget reserve, it needs to be remembered that a year ago, that reserve was roughly \$10.5 billion. What remains today is unlikely to be sufficient to fund the contingencies discussed above.

In short, in order to produce a genuine balanced budget with a minimum prudent reserve, additional spending reductions of at least \$2.893 billion would have to be made, bringing general fund spending to \$100.067 billion – or \$8.352 billion MORE than we spent as recently as FY 2005-06.

The budget changes suggested by Senate Republicans, and their rationale for such changes, are as follows:

Senate Republican Budget (Dollars in millions)	2007-08 Savings	Comments
Implement CalWORKS reform package	\$300.0	Implements the governor's proposal limiting grants for non-compliant recipients, including fleeing felons, non-citizens and those who fail to comply with basic requirements.
Defer implementation of SB 437, self-certification of income	\$15.3	Simply delaying the implementation of this new program expansion will save millions in staff and caseload work without impacting existing Healthy Families or Medi-Cal benefits. This program should be revisited when the structural deficit is fixed.
Eliminate 6,000 excess vacant positions	\$50.0	Does not eliminate any 24-hour care and public safety positions. This eliminates the slush fund for bureaucracies and will not affect services.
Public transit transfer to offset transportation-related debt service	\$100.0	While paying down the debt services, public transit still will receive \$1.8 billion.
Reduce county single allocation funding	\$45.0	Received \$230 million increase without any performance requirements. This proposal leaves \$185 million block grant for counties.
Expand San Diego County's project statewide to investigate welfare fraud	\$35.0	A pilot program that uses investigators uncovered fraud and welfare cheats. One in four applicants was found to be fraudulent.
Proposition 36 reduction	\$120.0	The program that funded Proposition 36 expired in 2005. To the extent that counties believe this is a worthwhile effort, they can pay for it.
Funding increase for Drug Courts	-\$60.0	Increase funding to existing Drug Court programs. Drug Courts provide better oversight and monitoring of drug felons than other programs.
Implement semi-annual reporting within CalWORKS	-\$12.0	Changing CalWORKS reporting requirements will simplify the process by making programs more consistent, and will adjust grants to appropriate levels.

Senate Republican Budget (Dollars in millions)	2007-08 Savings	Comments
Actuarially sound rate for Medi-Cal managed care	\$53.1	The administration is implementing a new Medi-Cal managed care rate methodology that will ensure that managed care plans receive fair rates. Therefore, this augmentation is unnecessary.
Restore governor's Employment Development Department contingent fund transfer	\$27.0	The budget already includes hundreds of million of dollars for other job-service type programs, which makes this program unnecessary.
Implement Federal Deficit Reduction Act for minor consent	\$18.9	By implementing federal Law, the state will continue to receive a federal match for these health services. This will not eliminate services to anyone eligible for Medi-Cal, but simply would ensure that those who receive services are eligible for them.
Contain county Medi-Cal administration salaries	\$18.4	The state has provided salary increases that average more than 6 percent annually from 1998-2006. Maintaining county salaries at the current level for one year is a reasonable option.
Reduce the Department of Parks and Recreation maintenance budget	\$15.0	The Department of Parks and Recreation has focused on purchasing new properties in lieu of maintaining existing state parks. It is not reasonable to expect taxpayers to pay additional funds to maintain current park facilities when this is not a priority of the department.
Suspend new Medi-Cal county outreach program	\$15.1	Reducing general fund dollars for a new outreach program that became operational in the spring should not significantly impact counties and will not impact beneficiaries.
Legislative augmentation for county Adult Protective Services	\$12.0	Maintains the governor's proposal for Adult Protective Services. The administration has provided adequate resources for this program.
Department of Corrections and Rehabilitation – Inmate Dental Program staffing adjustment	\$10.2	This is an unnecessary funding increase when there are 151.5 vacant existing dental positions. Implementation will be delayed due to difficulty in hiring.
Department of Corrections and Rehabilitation – Reduce augmentation for facility maintenance and repair	\$10.0	Deferring \$10 million of \$46 million augmentation recognizes CDCR's inability to utilize these funds in a timely manner.
Department of Corrections and Rehabilitation – Probation pilots	\$10.0	The state should not be implementing new pilot programs during these tough fiscal times.
Legislative augmentation for county equipment replacement	\$9.4	Given the need to fund current programs, the county should not be focusing on replacing existing equipment.
Eliminate funding for University of California operations in Mexico	\$7.0	The state currently funds a UC facility in Mexico. When students are facing tuition increase, it is important to focus the university's resources in California.
Department of Corrections and Rehabilitation – Division of Juvenile Justice Program (DJJ) space augmentation	\$6.5	Given declining population at DJJ, there is no rationale for new modular buildings.
Delete state earmark for UC Labor Union Institute	\$6.0	The state should not use taxpayer funds to help a special-interest group.
Agricultural Labor Relations Board	\$5.0	This is an inappropriate use of state funds to help unionize private-sector employees.

Senate Republican Budget (Dollars in millions)	2007-08 Savings	Comments
Department of Corrections and Rehabilitation – Consolidated Information Technology Infrastructure Program, Phase II delay	\$4.4	The augmentation should be held, since the project is likely to be delayed.
Property tax administration grants	\$3.5	The state cannot subsidize local administrative costs at a time when it is trying to protect core programs and services.
Department of Corrections and Rehabilitation – Division of Juvenile Justice infrastructure migration	\$3.0	The need to replace computers is unnecessary when DJJ is declining in population and institutions are closing.
Courts' Self-Help Program expansion	\$2.5	It is not fiscally prudent to implement new programs while the state is trying to protect core programs and services.
Legislative augmentation for Naturalization Services Program	\$2.0	Services already are provided under the Department of Education.
Delay Science Center expansion	\$2.0	The Science Center receives private funding, and those funds should be used to cover any expansion.
Continue funding for UC Scripps Institute of Oceanography at current level	\$1.5	Program augmentation should wait until the structural deficit is fixed.
2006-07 augmentation for auditor positions related to unclaimed property fund	\$1.4	The courts have suspended this program. The state could save \$1.4 million if it wasn't auditing banks, financial institutions, and other organizations looking for abandoned property that can't be escheated anyway.
State staff and consultant costs for green building (AB 32)	\$1.2	Making all state buildings "green" could be very costly and premature, since state regulations have not been implemented.
Continue existing funding for Public Library Foundation	\$1.0	Program augmentation should wait until the structural deficit is fixed.
Department of Justice-Climate change litigation funding	\$1.0	Legislative augmentation for climate change litigation. This augmentation is premature, since state regulations have not been implemented.
Cannery Business Park replacement furniture	\$1.0	There is no sound justification for replacing usable furniture.
Board of Equalization: sales and use tax pilot projects (\$400,000)	\$0.4	This pilot project does not result in any increased revenue to the state, but is a wasteful attempt to find audit leads.
Department of Industrial Relations: Licensing and registration positions for car wash oversight (\$365,000)	\$0.4	The appropriate funding source for this program is the Car Wash Workers Fund, not the General Fund.
State Coastal Commission – Augmentation for Coastal Commission webcast	\$0.2	This webcast is not a critical state government function.
Total Savings	\$842.4	

STATE BUDGET:**Budget Trailer Bills: Big Policy Changes; No Public Hearings; Two Pass**

The Assembly on July 20 approved 15 budget trailer bills that no one had seen prior to their passage. However, only 14 made it to the Senate as a notice of reconsideration was placed on one. Most make significant policy changes, but the public has been shut out of the process. Not one of the bills has been subject to a public hearing. Of the 14, the Senate took up 13 on July 21. Senators approved two ([SB 90](#) and [91](#)), while the other 11 failed to garner the required two-thirds vote for passage (reconsideration was granted). Senate President Pro Tempore Don Perata did not allow the other 39 senators to vote on [SB 98](#) (economic stimulus).

While most of the 15 trailer bills have an Assembly floor analysis ([SB 90](#) and [SB 98](#) did not), the Senate has not yet posted a floor analysis on a single one.

Sacramento Bee columnist Dan Walters wrote on July 27:

"Initially, trailer bills were just boring bits of legislative ephemera. But politics being what they are, someone eventually noticed that the trailers, drafted and enacted quickly and secretly, made them perfect vehicles for 'lowballing' other stuff.

"Trailer bills have proliferated, filled with provisions that either have nothing to do with the budget or change it in mysterious ways, and are routinely enacted without any analysis of their effects, much less any opportunity for outside input. They are, moreover, 'urgency' bills that take effect immediately upon being signed by the governor."

A summary of the 15 trailer bills:

Transportation Funding. [SB 79](#) (Senate Budget and Fiscal Review Committee), related to transportation funding, attempts to repay Proposition 42 loans that were made by the General Fund for the 2007-08 fiscal year and to repay general obligation bond debt for transportation-related bonds. Among other things, beginning in 2008-09, the bill permanently allocates half of all sales tax "spillover" revenue to the Mass Transportation Account created by the bill to provide funding that otherwise would come from the General Fund. In addition, the bill establishes due dates for repayment of Proposition 42 loans from 2003-04 and 2004-05 to conform to the repayment due date of June 30, 2016 in Proposition 1A. The bill prevents a \$2.2 million decrease in funding to the Bicycle Transportation Account and at the same time changes the fee structure for motor carriers to raise revenue for the California Highway Patrol's inspection of trucks at terminals. The change in structure would substantially increase fees on some carriers, depending on terminal fleet size.

Education. [SB 80](#) (Senate Budget and Fiscal Review Committee) makes various changes relating to education and education funding. Of note, it reauthorizes until 2011 the statewide STAR test for second grade, keeping it from expiring this year. Additionally, there will be no more french fries for poor kids, as funding for school-provided free and reduced-price meals will be conditioned on higher nutritional standards, prohibiting fried foods and foods containing artificial trans fats. Funding for school meals will be based on

the median statewide meal cost, rather than the average cost. The bill continues to defer \$588 million in K-14 expenditures from one fiscal year to the next, in this case, from 2007-08 to 2008-09.

Prison Funding. [SB 81](#) (Senate Budget and Fiscal Review Committee), related to funding for prison construction and rehabilitation programs, implements public safety components of the 2007-08 budget. Among various provisions, the bill prohibits non-violent youthful offenders from entering state custody, requiring them to remain in county care. The bill further requires non-violent youthful parolees to become county responsibilities. In addition, the bill provides annual block grants and local assistance planning grants to counties for local programs providing for the care and custody of non-violent youthful offenders, as well as for preparing to serve this population, and it provides competitive grants to counties for programs addressing youthful offender special populations. The bill also authorizes \$100 million in lease revenue bonds for new local youth offender facilities, and it ensures that the \$50 million appropriation in [AB 900](#) (Solario) is used for in-prison rehabilitative services and provides for two probation pilot programs in Alameda County and an unspecified urban county. Notably, the bill contains a state concession fee reduction for prison telephone services, expected to reduce general fund revenues by \$6.5 million annually, but also to reduce the cost to inmates' families of maintaining contact with their loved ones.

Court Facilities Funding. [SB 82](#) (Senate Budget and Fiscal Review Committee), related to funding for construction of court facilities, requires, among other things, the Judicial Council to develop performance expectations for court facility proposals. The bill also requires the state director of finance to follow certain guidelines when considering court construction proposals that involve public-private partnerships, and restricts the Judicial Council's ability to jeopardize existing construction projects through new funding requests from the State Court Facilities Construction Fund. Additionally, the measure removes the sunset on the 20 percent state surcharge imposed on criminal fines – essentially a tax on a fine – and consolidates the Division of Firearms and the Division of Gambling Control into the Division of Law Enforcement, within the Department of Justice.

Health Funding. [SB 83](#) (Senate Budget and Fiscal Review Committee), providing funds for health-related agencies and programs, contains at least 33 provisions, most of which involve noncontroversial, administrative changes or extensions of existing programs. Of note, however, according to Dan Walters, is the bill's "gift for personal injury lawyers and medical care providers, creating a higher standard of damages when providers seek payment from a third party for services covered by the Medi-Cal program." Mr. Walters notes that "Gov. Arnold Schwarzenegger has vetoed two bills to that effect, saying they would encourage lawsuits and drive up medical costs." The bill also extends an administrative penalty of up to \$17,500, usually applied to violations that involve immediate threat of serious injury to the patient, to violations related to discount pricing and charity care. In addition, the bill extends the quality assurance fee for skilled nursing facilities by one year, which is intended to offset general fund costs. The measure repeals the requirement of a federal waiver before accelerated enrollment of children in the Medi-Cal program and continues the existing 5.5 percent cap on the growth of Medi-Cal reimbursement rates through 2008-09.

Human Services Funding. [SB 84](#) (Senate Budget and Fiscal Review Committee), related to funding of the human services portion of the budget, calls for, among other things, a suspension of incentive funding to counties for child support collection efforts, suspension of payments to local child support agencies, and suspension of the COLA adjustment for CalWORKS recipients for the 2007-08 fiscal year. The bill also calls for certain programmatic expenditures, such as authorizing legal immigrants who are aged, blind or disabled to naturalize but continue receiving cash assistance benefits until they receive SSI benefits or have exhausted all appeals for the initial SSI application. Existing law permits aged, blind and disabled legal immigrants who are not naturalized citizens, to continue receiving cash assistance even when they have received an unfavorable decision from the Social Security Administration regarding SSI.

Environmental Funding. [SB 85](#) (Senate Budget and Fiscal Review Committee) relates to funding for the natural resources and environmental portions of the 2007-08 budget. Among other more noncontroversial provisions, the bill prohibits California Air Resources Board funds from being used for adoption of GHG emission-reduction strategies and specifies that the funds may be used only for evaluation and assessment of those strategies. According to Dan Walters, this bars the board from implementing the "market-based" approach to curbing greenhouse gases. It also authorizes the city of Santa Cruz to acquire a state park, and discourages the state from acquiring electricity from fossil fuels. Other provisions include granting authority to the Department of Water Resources to impose cost-share requirements on local governments for levee repair and modifications, imposing reporting requirements on Proposition 1E-funded flood control projects and on state agencies' GHG emission levels and mitigation efforts, and requiring the Department of Water Resources to comply with GHG performance standards when procuring energy.

Unclaimed Property, Miscellaneous Provisions. [SB 86](#) (Senate Budget and Fiscal Review Committee) contains provisions requiring the controller to notify owners of unclaimed property that has escheated to the state. Within 165 days of getting the property, the controller must notify owners of \$50 or more. The notification must be sent to the address furnished to the controller by the entity escheating the property, but, if a Social Security number is included, the controller also must check with the FTB for a more current address. Other changes made by the bill include provisions allowing government agencies to have unfilled positions for 12 months, rather than 6 months, before the controller is required to abolish them. The bill also gives a private organization veto power over future design (and therefore cost) of any new building to be occupied by the state.

(Cal-Tax: The latter provision is particularly objectionable, for a variety of reasons. The non-profit organization, the U.S. Green Building Council [which is not a U.S. government agency], could set standards so they cost more, to benefit its members. There is no public accountability for the actions of the group. Since Cal-Tax is a non-profit organization, the principle here is the same as if the Legislature put Cal-Tax in charge of approving all future state building standards.)

Tax Hike Proposal. [SB 87](#) (Senate Budget and Fiscal Review Committee) repeals the teachers' tax credit, revises procedures for assessing fractionally owned aircraft, requires owners (public and private) of airports to provide information to assessors on aircraft using the airport, and requires the State Board of Equalization to modify the annual business property statement with information on the use tax. The fractional aircraft

provision is proving to be controversial. It raises property taxes by \$28 million. Additionally, some taxpayers are objecting to provisions requiring the aircraft to be assessed to the manager in control of the fleet instead of the owners of the aircraft. The provisions that intrude the use tax on business property statements also are causing concern. Since it is a very difficult chore for taxpayers to file the property statements on a timely basis, any additional changes to the property statement are not viewed with enthusiasm. With respect to the repeal of the teachers' tax credit, it is scored as a \$165 million tax increase. However, since the tax credit has been suspended for several years, it is not an actual tax increase over last year.

Transportation Bond Money Spending. [SB 88](#) (Senate Budget and Fiscal Review Committee) designates the administrative agencies for each of the programs funded by the voter-approved \$19 billion transportation bond (Proposition 1B). The most significant provision in the bill is an appropriation of an additional \$350 million for local streets and roads. It also establishes the Goods Movement Emission Reduction Program for the distribution of Proposition 1B air-quality funds for the replacement or retrofit of vessels, locomotives and heavy-duty trucks.

One provision piquing interest of pundits is Section 8879.64(b), which allocates \$150 million to cities with a population over 3.5 million. This is a special appropriation to Los Angeles to upgrade traffic signals.

Sale of Student Loan Guarantee Program. [SB 89](#) (Senate Budget and Fiscal Review Committee) authorizes the sale of the student loan guarantee program (known as the Ed Fund). This was proposed by the governor in the May "Revise."

Technology Projects. [SB 90](#) (Senate Budget and Fiscal Review Committee) requires the state's chief information officer to approve and oversee information technology projects, plans and policies. This bill passed the Assembly on a 66-11 vote July 20 and passed the Senate by a vote of 25-13 on July 21. It now awaits the governor's signature or veto.

Sale of the State Student Loan Guarantee Program. [SB 91](#) (Senate Budget and Fiscal Review Committee), which has been approved by both the Assembly and Senate, is contingent on the sale of the student loan guarantee fund (Ed Fund) as proposed in **SB 89**, which has not yet been approved by the Senate. If the Ed Fund is sold, this bill repeals provisions of law allowing the Student Aid Commission and Ed Fund to participate in the federal Family Education Loan Program.

Charter Schools. [SB 92](#) (Senate Budget and Fiscal Review Committee) prohibits the State Board of Education from renewing a statewide charter school. It also appropriates \$18 million to help construct charter school facilities. The bill passed the Assembly by a 46-31 vote on July 20. However, Assemblyman John Laird noticed reconsideration, so the bill has not yet been transmitted to the Senate.

According to Dan Walters, the purpose of the ban is to block the Board of Education from allowing Green Dot Charter Schools in Los Angeles from going statewide. According to sources, this provision was inserted in the bill at the last minute by Democratic staffers, at the urging of Assembly Speaker Fabian Nunez.

The Green Dot operation, which runs 10 charter high schools in Los Angeles and has won approval to open 10 more, presents major political problems for Democrats. According to a July 24 story in the *New York Times*, the schools are run by a non-profit group headed by Steve Barr, a former Democratic fundraiser. The schools have signed a contract with a new teachers' union, the Association de Maestros Unidos, and they pay salaries competitive with Los Angeles Unified, but without tenure. The *Times* quotes A.J. Duffy, head of the United Teachers of Los Angeles, as saying, "We could have and probably should have organized the Green Dot schools. They started with one charter school, now have 10, and in short order they'll have 20 schools in Los Angeles, with all the teachers paying dues to a different union. And that's a problem."

Economic Stimulus Package. [SB 98](#) (Senate Budget and Fiscal Review Committee) was amended July 20 to incorporate several tax provisions. These are:

- **Sales Tax Exemption for Clean Marine Fuels.** Low-sulfur fuel sold to vessel common carriers for use in the vessel's main or auxiliary engine is exempt from sales tax until June 30, 2013. This provision is similar, if not identical, to [AB 846](#) (Blakeslee).
- **Sales Tax Exemption for Jet Fuel Used in Air Common Carriers.** Initially, the amount paid by air common carriers for fuel for domestic flights above \$1.93 per gallon is exempt from sales tax. A larger exemption will be phased in after July 1, 2009 under certain conditions.
- **Research-and-Development Credit.** The research-and-development credit provisions provide complete conformity to the federal alternative incremental research credit. (See additional comments regarding drafting error below.)
- **Movie Tax Credit.** A tax credit of 12 percent for specified wages paid and property purchased for production of qualified motion pictures, with an additional 3 percent for specific types of motion pictures, will be available through 2013. The aggregate amount of credits is capped at \$70 million per year, and will be allocated by the California Film Commission. The legislation also allows companies to sell credits that are attributable to independent films. This provision is similar to [SB 740](#) (Calderon).
- **Commercials Tax Credit.** A 12 percent credit for specified incremental qualified production costs of commercials is established, with the aggregate amount of credits capped at \$5 million per year. The bill authorizes the sale of credits attributable to independent productions to unrelated third parties.
- **Alternative Apportionment Formula.** For tax years beginning January 1, 2009 or thereafter through 2013, taxpayers may elect to increase their sales factor in the corporate tax apportionment formula by one for each \$250 million of new investment in this state, up to two in any one year. This provision, similar to provisions found in [AB 1591](#) (Ma), allows the additional sales factor for increased investment, but does not include the property and payroll "throwout" aspects of **AB 1591**. **SB 98**, however, limits the bill by its definition of "qualified taxpayer" as follows: "Qualified taxpayer" means a taxpayer that is a member of an apportioning

trade or business, other than a trade or business that derives more than 50 percent of its "gross business receipts" from a savings and loan activity, a banking or financial business activity, a real estate activity classified in Subsector 531 of the North American Industry Classification System 2002 Edition, or an insurance activity that is subject to tax under this part.

Senator Perata declared this bill "dead on arrival" in the Senate, after the Assembly approved it 51-19 on July 20. He is refusing to allow the Senate to vote on the measure.

The research-and-development tax credit provision contains a major drafting error that sunsets the entire tax credit at the end of 2013. Speaker Fabian Nunez and Assembly Republican Leader Mike Villines, in a July 20 letter, pledged to correct the drafting error upon return from summer recess. If the Senate passes **SB 98**, which is not at all certain, given Senator Perata's opposition, it is not known whether senators also would agree to legislation correcting the mistake, although it would seem logical to do so.

LEGISLATIVE UPDATE:

Governor Signs Six Tax-Related Bills

Governor Signs Bill Requiring Estate Administrators to Notify FTB. [**AB 361**](#) (Ma), requiring that the personal representative or attorney for an estate notify the Franchise Tax Board of the administration of the estate no later than 90 days after letters of administration are issued, was signed by the governor and chaptered July 20.

New Law Addresses FTB Collection of Unpaid Fines. [**AB 367**](#) (De Leon), which decreases from \$250 to \$100 the maximum amount of unpaid fines and penalties that courts may refer to the FTB for collection after being delinquent for 90 days, and which deletes obsolete provisions relating to local comprehensive collection programs, was signed by the governor July 27.

New Law Makes Procedural Changes to Business Improvement Districts. [**AB 1208**](#) (Silva), making procedural changes to current laws allowing Business Improvement Districts and Multi-Family Improvement Districts to impose assessments on property, was signed by the governor and chaptered July 20.

'Clean-Up' Measure for Assessment of Cable TV Franchises Is Signed Into Law. [**AB 1715**](#) (Assembly Utilities and Commerce Committee), making technical, non-substantive changes in statutes relating to the assessment of cable television franchises, was signed by the governor and chaptered July 20.

Redevelopment Time Limit Notification Gets Governor's Approval. [**SB 437**](#) (Negrete McLeod), requiring redevelopment agencies to report their project areas' time limits in their annual reports and implementation plans, was signed by the governor and chaptered July 20.

New Law Corrects Cross References for Personal Services Deduction. [**SB 1044**](#) (Senate Committee on Revenue and Taxation), which corrects cross references in statutes relating to the disallowance of deductions for failure to report payments for personal

services, was signed by the governor July 27. The bill was sponsored by the Franchise Tax Board.

For a complete list of Cal-Tax's Top 25 Tax Issues, click [here](#).

COURTS:

County Isn't Immune From Suit Over Misallocation of Tax Revenue, State Supreme Court Rules

The California Supreme Court has ruled that Tulare County is not immune from a suit challenging the county's misallocation of revenue to local taxing entities.

Tulare argued that it was immune from suit under Government Code Section 860.2, which grants immunity from liability for injury resulting from acts or omissions "in the interpretation or application of any law relating to a tax."

In an opinion filed July 19, the state's high court ruled that the defendant's failure to meet its statutory obligation to correctly allocate tax revenue to other public entities is not an "injury" within the meaning of the statute. Further, the statute is intended only to shield public entities from money damages for torts, the court stated. Here, the plaintiff – the city of Dinuba – sought compliance with a statutory duty that happened to result in the payment of money, but did not seek monetary damages.

The court concluded that Dinuba had the right to amend its complaint to state a cause of action for a court order that seeks "to compel the performance of an act which the law specially enjoins, as a duty resulting from an office, trust, or station."

The case is *City of Dinuba v. County of Tulare*.

BALLOT INITIATIVE UPDATE:

Proponents Turn in Signatures for Measure to Relax Term Limits

Proponents of a measure to relax state lawmakers' term limits turned in more than 1.1 million signatures to the secretary of state July 23, and with a cushion of more than 400,000 over the required number, the initiative appears likely to win a spot on the February ballot.

The measure, sponsored by legislative leaders who would have their terms extended, would appear on the same ballot as the presidential primary. If approved by voters, it would clear the way for otherwise termed-out lawmakers to throw their hats into the June legislative primaries. Supporters include the California Chamber of Commerce and the California Teachers Association.

Current term limits provide that a lawmaker can serve up to three two-year terms in the Assembly, and up to two four-year terms in the Senate, for a total of 14 years. The initiative would allow most lawmakers to serve up to 12 years, but they could serve all of

the time in a single house. However, some get a longer term. Senator Don Perata, for example, could be allowed to serve 18 years.

State and national groups that support term limits are opposing the initiative. They argue that the measure's main goal is to extend the terms of current lawmakers. They also note that under the current system, many term-limited Assembly members are unsuccessful in attempts to win election to the Senate or another office, and for these lawmakers, the initiative would result in a doubling of their time in office.

Signatures for the measure were turned in nearly one month after the fiscal year began without a state budget, and many political observers believe the missed budget deadlines and ensuing legislative squabbles will make voters less likely to relax term limits. (Source: *Orange County Register*, July 24.)

In other initiative news:

Initiative to Create State-Run Online Poker Site Enters Circulation. An initiative that would create a state-owned Internet poker site, with 90 percent of profits going to local governments for road repairs and 10 percent to combat gambling addiction, has been cleared for circulation, Secretary of State Debra Bowen announced July 27. The proposal would allow people age 21 and older to play online poker, with players allowed from any state or locality where the law does not prohibit participation. The site would be run by a director appointed by the governor, and it would use games that are "similar to prevailing online and live poker room practices." The state would keep a small percentage of each pot.

Poker games like Texas Hold 'Em and Omaha have been very popular with online players, but a federal anti-gambling law enacted late last year has resulted in many online poker rooms shutting their (virtual) doors to U.S. players.

The initiative was submitted by Anthony Sandstrom, a San Diego poker player who estimates that his idea could generate \$40 million to \$500 million a year, to be used specifically for filling potholes and cracks in existing roads. Mr. Sandstrom also believes motorists would save hundreds of dollars a year on vehicle maintenance and repairs, since there would be fewer potholes.

"I am just a guy who wants to play poker at home when I don't feel like making an hour drive to a cardroom or casino," Mr. Sandstrom writes on his web site, at www.caonlinepoker.org. "I am going to make a mighty effort to make safe, legal, and accessible online poker possible."

He also notes that "throughout history, presidents, generals, members of Congress, Supreme Court justices and average citizens have enjoyed playing poker." He adds: "Unlike casino gambling, poker is a game of skill. It is a game of patience, mathematics, psychology, and observation." (**Cal-Tax:** Under the Poker to Fix Potholes Initiative, out-of-state players could provide the money to fix roads in your neighborhood. However, since paid signature-gatherers are not being used, the odds of this initiative qualifying for the ballot are about the same as the odds of getting two royal flushes in a row. If the initiative somehow qualifies for the ballot, it is likely to face mighty opposition from established gaming interests.)

Seventeen Measures Now in Circulation. There now are 17 initiatives in circulation, with another 16 pending with the attorney general, and one (the legislative leaders' plan to change term limits) undergoing a signature count, the secretary of state reports. Two measures (addressing community college funding and transportation funding) have been approved for the February ballot, and one (dealing with high-speed rail) has earned a spot on the November 2008 ballot.

LICENSE TO SPEND – YOUR BOND DOLLARS AT WORK: Bay Area College Board Criticized for Handling of Bonds Backed by Parcel Tax

In June of 2006, Bay Area voters approved a parcel tax increase to cover a \$390 million bond for improvements at the four schools in the Peralta Community College District (Berkeley City College, the College of Alameda, Laney College and Merritt College). The bond, Measure A, included language requiring a citizen oversight task force to make sure the tax dollars aren't squandered.

At its July 17 meeting, the Peralta Board of Trustees announced that \$35.2 million has been allocated so far. The *Berkeley Daily Planet* reported that "while there have been no allegations that any of this money was spent for anything other than projects authorized by the bond measure, there have been complaints by the media, board members, and college staff that up until now the district has maintained no publicly published running total of bond projects and expenditures, with fears that new projects might be added to the list without regard for planned projects perhaps being knocked off."

The newspaper also reported that the district's general services director unveiled a 25-page report with a chart describing how district officials planned to allocate the remaining \$354.8 million, with amounts based on square footage of buildings in line for renovation – a formula not mentioned in Measure A or in previous public board discussions. After a trustee raised questions, the general services director quickly said the figures were "tentative numbers."

While the ballot measure was not specific about allocation levels, some provisions were spelled out clearly to voters. The measure states: "Proceeds from the sale of bonds authorized by this proposition shall be used only for the construction, reconstruction and/or rehabilitation of college facilities including the furnishing and equipping of college facilities or acquisition or lease of real property for college facilities and not for any other purpose, including teacher and administrator salaries and other college operating expenses."

And the ballot argument in support of Measure A, signed by Congresswoman Barbara Lee, Assemblywoman Wilma Chan, Berkeley Mayor Tom Bates and others, said: "Measure A cannot be used to pay District salaries or administrative costs and will include guaranteed annual audits and a citizen's oversight committee."

The oversight committee, which Measure A says "shall be established within 60 days of the date when the results of the election appear in the minutes of the Board," has not been formed. The July 13, 2006 minutes of the college district's board of trustees indicate that the results (75 percent of voters in support) were announced at that meeting, and

that "An oversight committee will be convened soon," but the *Daily Planet* reports that almost a year after that deadline, only six of the committee's seven members have been chosen, and no meetings have been held. The remaining slot is to go to a representative of a recognized association representing local taxpayers, according to the district's vice chancellor.

A search of the district's job openings reveals that the measure's ban on using the bond money for salaries may be less stringent than voters were led to believe. A July 17 posting on the district's web site described an advertised position as being "funded by Measure A funds." The position is for a buyer in the district's administrative center, with pay as high as \$6,227 a month (almost \$75,000 a year). The job description says the worker will perform "a wide variety of professional level duties pertaining to the purchases of goods and services for the District."

(Sources: *Berkeley Daily Planet*, June 26 and July 25; Text of Measure A; Peralta Community College District web site and minutes of June 13, 2006 Peralta Board of Trustees meeting.)

(Cal-Tax: As governments at every level increasingly turn to bond measures, voters must be vigilant about following the money after the election is over. When voters approve new taxes and new spending based on promised oversight and tight controls, they deserve follow-through from the officials who proposed the spending. And the school district in this example should have found time to establish the oversight commission before it found time to start spending the money.)

LOCAL TAXES:

Stockton Will Appeal Ruling That 911 Phone Tax Is Illegal

The Stockton City Council voted July 24 to appeal a court ruling that its 911 telephone tax is illegal. The 4-2 vote came after Councilman Steve Bestolarides urged his colleagues to support the court's ruling, saying, "It was an illegal tax – we owe the public to adhere to the laws."

At issue is a \$1.70 monthly charge on telephone users that was expected to raise \$5.2 million this year to finance the city's 911 emergency dispatch system. The tax has taken \$11.8 million from telephone users since its adoption by the City Council in 2004.

Ruling on a suit brought by phone companies, taxpayers and taxpayers' advocates, San Joaquin County Superior Court Judge Lesley D. Holland said in June that the charge is an illegal tax because it was not approved by the voters (see the [Cal-Taxletter](#) of June 15, 2007).

City Attorney Ren Nosky said "serious legal questions" remain about the charge, but also claimed that the city has "sound arguments." The attorney also said an appellate court's ruling on a similar case in Union City could help guide Stockton's actions. In April 2006, the Alameda County Superior Court invalidated Union City's 911 tax because it was not approved by voters.

The case is *Kari Andal v. City of Stockton*. Mrs. Andal is the wife of former Board of Equalization Member Dean Andal, who currently is running for Congress. (Source: *Stockton Record*, July 25.)

In other local tax news:

Ventura Voters to Decide Whether to Hang Up the Phone Tax. The Ventura City Council voted July 23 to let voters decide whether or not to maintain a telephone tax that collects \$2.8 million a year from residents. On November 6, voters will decide whether to update a 40-year-old utilities tax that includes references to obsolete phone services, and to replace it with a new tax that accounts for new phone technology. The tax rate would be reduced from 5 percent to 4.5 percent.

Three council members voted against the plan because they preferred an alternate proposal that would have kept the tax rate at 5 percent. The measure requires a simple majority to pass. If the measure is not approved, the existing tax will continue, but city officials indicated that the tax law has become unfair due to changing technology, and is ripe for being wiped off the books by the courts.

Prior to putting the tax measure on the ballot, the City Council spent an unknown amount of tax money to hire a consultant to poll potential voters. The poll, which described the measure to respondents in very rosy terms, found that 71 percent of voters were likely to support the proposal. (Source: *Ventura County Star*, July 24; City of Ventura Administrative Report, July 18.)

Ceres Residents to Vote on Proposed Sales Tax Hike. Voters in the Stanislaus County city of Ceres will decide in November whether to increase the city's sales tax by one-half percent, with the hoped-for revenue increase of \$2 million to \$3 million a year paying for more police officers, firefighters and equipment for public safety workers.

The Ceres City Council voted unanimously July 24 to put the tax hike measure on the November 6 ballot. The special-use tax requires a two-thirds majority for approval. The increase would take Ceres' sales tax from 7.375 percent to 7.875 percent.

Before putting the "Ceres Police, Fire, 911 Emergency Response Local Control Measure" on the ballot, city officials paid for two phone polls to gauge public support. The first poll found that 53 percent of respondents supported the idea, but the second, taken six months later, after campaigning by city officials, found 77 percent of respondents in support. (Source: *Modesto Bee*, July 23 and July 25.)

Alameda Supervisors Certify Election Results, Making Property Tax Hike Official. Alameda County supervisors on July 24 certified the results of an election that will result in a \$1.5 million-a-year property tax increase in the county. The tax can be increased up to 3 percent a year without another vote.

In the all-mail election, ballots went to 302,000 property owners, and 26 percent responded within the 45-day balloting period. Of the 78,948 ballots received by the county, 77,653 were deemed valid and counted, while 1,295 were deemed invalid (primarily because voters forgot to sign their ballots). The tax was supported by 73 percent of the voters (56,677 in favor vs. 20,976 opposed).

Tax bills mailed in October will include the tax hike of \$4.08 for each single-family home in unincorporated areas and 12 cities in the county, with the money intended to pay for vector control. In Oakland, the increase amounts to a 57 percent hike in the vector control tax paid by property owners. Commercial, industrial and agricultural property owners will pay varying rates, depending on the size and type of property. (Source: *Inside Bay Area*, July 25.)

Oakland Hospital Wants \$300 Million Parcel Tax on February Ballot. Children's Hospital Oakland is collecting signatures for a parcel tax increase that would cost Alameda County property owners an estimated \$300 million over 30 years, with the money going toward construction of a new facility for the private institution. The hospital is hoping to put the measure on the February ballot.

If approved by two-thirds of the voters, the proposal would create a tax of \$24 per year for residential property owners, \$100 for medium-sized commercial property and \$250 for large commercial property. The poor and homeowners aged 65 and older would be exempt. Under the terms of the measure, Alameda County would borrow \$300 million to give to the hospital up front, and the parcel tax would be used to repay the loan over 30 years.

County supervisors are miffed at the sponsors, saying the Board of Supervisors should have been consulted before the signature-gathering began, and also noting that the hospital has not guaranteed in writing that the new facility would be built in the area. A Berkeley health official said there have been rumors that Children's Hospital plans to leave the area. (Source: *Contra Costa Times*, July 20.)

West Sacramento Voters to Decide Fate of \$59 Million School Bond. Trustees of West Sacramento's Washington Unified School District are putting a \$59 million bond measure on the November 6 ballot. Among other things, Measure S would fund a new K-8 "school model for teaching children" and a performing arts theater for a high school now under construction in the city, *The Sacramento Bee* reports. Under the new school model, elementary schools would expand to eighth grade. School officials told the newspaper this system would create "a more nurturing school environment where older students mentor younger students and stay longer with the same teachers, principals and classmates." The measure needs 55 percent of the vote to pass. (Source: *The Sacramento Bee*, July 27.)

Controversial Ross Valley Flood Fee May Be Rescinded. Marin County Supervisor Hal Brown told the *Marin Independent Journal* on July 30 that the election approving a flood fee in Ross Valley may be rescinded. District officials invalidated 21 percent of the ballots, which changed the outcome. Mr. Brown said he will decide in the next 10 days whether to rescind the county ordinance creating the fee. The election was conducted by a private Berkeley consulting firm, MIC Inc.

Mr. Brown apparently is most worried about a suit by the Marin United Taxpayers Association to invalidate the fee. The suit could take years to resolve, he said.

San Anselmo lawyer Fred Green paid for a manual recount of the ballots, and that recount determined that if the unsigned ballots had been counted, the proposed fee would have lost by 147 votes. He said he also plans to sue because the ballot failed to adequately alert voters that they had to sign it. (Source: *Marin Independent Journal*, July 31.)

Burlingame Elementary Puts \$48.3 Million School Bond on November Ballot.

Voters in Burlingame in November will decide the fate of a \$48.3 million bond issue placed on the ballot by the Burlingame Elementary School District board. School board president Dave Pine said, "I think it is very likely we will see success at the polls." The measure will increase property taxes by \$30 per \$100,000 of assessed value. (Source: *San Mateo County Times*, August 2.)

Pacific Grove Going After Taxpayers in a Big Way. The Pacific Grove City Council on August 1 decided three tax increases are even better than one. On a 5-2 vote, the council put three measures on the November ballot. They are: a one-half percent sales tax, which will extract \$650,000 more from taxpayers; a \$120 parcel tax, which will extract \$720,000 more from taxpayers; and an increase in business license taxes, which will extract \$240,000 more from taxpayers. Mayor Don Cort said the alternative to the tax increases would be cuts in services. (Source: *Monterey County Herald*, August 2.)

Menefee School District Puts Bond on February Ballot. In Riverside County, Menefee Elementary School District trustees voted 3-1 on July 24 to place a \$30 million bond on the February ballot. If the measure is approved, property taxes will go up \$17.90 per \$100,000 of assessed value. School board member Rita Peters opposed the proposal. "You're talking about seniors on fixed incomes," she said. (Source: *Riverside Press-Enterprise*, July 25.)

PUBLIC EMPLOYEE PENSIONS AND BENEFITS: Retroactive Pension Benefits Being Challenged in Orange County

The Orange County Board of Supervisors voted unanimously July 31 to begin an effort to rescind retroactive pension increases approved for sheriff's deputies in 2002 by a different panel of supervisors.

Supervisor John Moorlach is leading the charge, arguing that the retroactive benefit amounted to an illegal gift of public funds. "An illegal contract can and must be rescinded," Mr. Moorlach's chief of staff told supervisors at the hearing.

Under the deal approved by previous supervisors, Orange County sheriff's deputies may retire at age 50 with 3 percent of their highest year of pay, multiplied by their years of service. That agreement added a percentage point retroactively to the years of service – a provision that county officials say has created as much as \$550 million in extra pension costs over 30 years. Rescinding the retroactive part of the agreement would save the county nearly a quarter of its \$2.3 billion in unfunded pension liabilities.

Reed Royalty, president of the Orange County Taxpayers Association, praised Mr. Moorlach for delving into the matter. "OCTax believes retroactive benefits are a gift of public funds that is unwise, illegal, or both," Mr. Royalty stated. "We said that to the Board of Supervisors in 2002, but we were unable to stop that board from granting the benefit."

Public employee unions are fighting the move, and have argued that it would not be legal to change past agreements reached in collective bargaining. Mr. Royalty disagreed, stating, "OCTax believes the Constitution trumps an illegal contract."

The Lincoln Club of Orange County also supports the effort to rescind the retroactive benefits. Club President Richard Wagner said: "It is not as if the pension gifts violate only one section of the (California) Constitution, and it's not as if those violations are not clear. The fact is, the gifts violate three sections, and each of those violations is, in our opinion, beyond question."

Supervisors are scheduled to vote September 18 to decide whether to move forward by hiring lawyers to seek an injunction that would relieve the county of payment obligations for the retroactive portion of the agreement.

San Diego Union-Tribune blogger Chris Reed wrote on August 2 that a 2002 deal made by the San Diego County Board of Supervisors may be open to a similar challenge, adding: "In O.C., the retro spikes were limited to one category of employees. In San Diego County, they were all given such spikes by a bafflingly generous board."

(Sources: *Los Angeles Times*, August 1; *San Diego Union-Tribune* blog, August 2; Lincoln Club press release, July 25; Orange County Taxpayers Association statement, July 31.)

PROPERTY TAXES:

Few Improvements Needed in Santa Cruz County Assessment Practices

In its assessment practices report on Santa Cruz County, released July 31, the State Board of Equalization is making 12 recommendations for improvement, and County Assessor Gary Hazelton agrees with most.

Overall, the board found the assessor's operations to be sound. The assessor has an effective administration program, the major portions of his real property assessment program are well-managed, and he has made major improvements to his business property program. The average assessment ratio in the county was found to be 99.29 percent.

Of the areas needing improvement, the issue of most significance is that the assessor does not annually review all welfare exemption claim forms filed by existing claimants.

Another concern is the valuation of possessory interests. According to the board, "The assessor often does not identify the essential factors applicable to the valuation of each taxable possessory interest. Without this information, the assessor may be unable to either (1) properly establish the base year value of a taxable possessory interest, or (2) if the base year value is properly established, monitor the value in subsequent years."

In the county, there are more than 1,300 taxable possessory interests, with an assessed value of \$72.2 million in 2005-06. Marina slips at the Santa Cruz harbor and hangers rented month-to-month at the Watsonville airport comprised 80 percent of the total. For

these month-to-month interests, the assessor uses a three- or four-year term of possession and revalues them on an annual basis.

Revenue and Taxation Code Section 61(b)(2) provides that a renewal of a taxable possessory interest during the reasonably anticipated term of possession used by the assessor to value that interest does not cause a change in ownership until the end of that term. According to the board, "By revaluing month-to-month taxable possessory interests annually, the assessor has revalued property that has not undergone a statutory change in ownership. The result is that increases in the assessed values for these interests may exceed the 2 percent annual maximum allowed by Article XIII A of the California Constitution."

Another problem found by the board is that when utilizing the income approach to value taxable possessory interests, the assessor capitalizes the estimated rent without making any deductions for management or other operating expenses incurred by the public lessor.

According to the board, "Failing to recognize appropriate lessor expenses may result in an overstatement of the full cash value of a taxable possessory interest."

Mr. Hazelton says extensive mainframe computer programming will be required to comply with the law in assessing month-to-month possessory interests. This will be included in the new system currently being developed. He said he has changed procedures to recognize lessor expenses.

The assessor has adopted the Assessors' Association "percent good" factors for the value of business property, but not for computers, according to the report.

Also, Mr. Hazelton is offsetting an escape assessment for one year with a reduction in value for a different year. He says he has reduced this practice, but not eliminated it, because it is more economical and more understandable for taxpayers. Revenue and Taxation Code Section 533 allows escape assessment for one year only to offset refunds in taxes for the same year. According to the board, "The assessor has no authority to offset escaped assessments in one year with reduced assessments in another year. In addition, section 506 provides that the tax rate applicable shall be that tax rate to which the property would have been subject if it appeared upon the affected roll year. By offsetting the assessments before the application of the tax rate for each year, the net tax liability for the entire audit period is incorrect."

PROPERTY TAXES:

Del Norte County Assessment Practices in Good Shape

Former Del Norte County Assessor Jerry Cochran is gone, but not forgotten. A State Board of Equalization Assessment Practices Report, released July 31, is testimony to the great job Mr. Cochran was doing at the end of his long tenure.

According to the board, Mr. Cochran effectively managed the major aspects of the property assessment program, including change-of-ownership and new construction. The board also reported that "overall, the business program is well managed." Del Norte

County's assessment roll increased 25 percent between fiscal years 2001-02 and 2005-06, with no increase in staffing.

The board report makes a few minor recommendations for improvement. The only significant problem was in the area of possessory interest, where the board found incorrect assessments. Among other things, the assessor's office assessed a possessory interest in government-owned manufactured homes, which are personal property and not subject to possessory interests pursuant to a 1958 court decision (*General Dynamics Corp. v. County of Los Angeles*). Additionally, when using the income approach, the assessor's office incorrectly used gross income, rather than net income. Also, possessory interests were not reviewed for declines in value.

New Assessor Louise Wilson says she concurs with board recommendations on improving possessory interest assessments, and she said corrections have been made.

PROPERTY TAXES:

Shasta County Assessment Practices Report Contains Few Recommendations

A State Board of Equalization Assessment Practices Report for Shasta County contains only eight recommendations for improvement, and all are relatively minor. Shasta is one of several counties that have new assessors, and the report is a credit to the work done by former Assessor Chris Andrews.

According to the board, "In the area of real property, we found that the assessor is effectively managing the change-in-ownership and new construction programs, and overall, the personal property/audit section is well managed." An innovative program instigated by the assessor is pre-printing of a claimant's *Organizational Clearance Certificate* number on the welfare exemption claim form mailed to established claimants. This has streamlined the processing of claims within the assessor's office.

With respect to mineral property, the board found that the assessor is using the quantity of minerals sold as the annual production volume in the valuation of the mineral rights. The proper procedure is to use the quantity produced, instead of the quantity sold. In some years, it is likely that sales will include some stockpiled ore. Stockpiled ore is exempt from property taxation as minerals, because it already has been severed from the earth. New Assessor Leslie Morgan said she will make certain that the annual production volume is based on the annual quantity produced.

NEW WINE IN OLD BOTTLES:

Recently Amended Bills

Change-of-Ownership Statements. [AB 402](#) (Ma), requiring owners or tenants of cooperative housing projects and other similar properties to file a change-of-ownership statement on request of the assessor, was amended August 1 to provide that the request contain a notice informing occupants who do not have an ownership interest in the property to forward the notice to the owner. The amendment was suggested by Cal-Tax.

Car Tax Exemption for National Guard Members. [AB 418](#) (Saldana), exempting from the car tax ("vehicle license fee") vehicles owned by National Guard members deployed to locations outside the state, was amended July 25 to tighten up language and to create a new code section rather than amend an existing one. (**Cal-Tax:** The amendments appear to avoid chaptering out problems with Senator Dave Cogdill's [SB 386](#).)

Fire Protection Tax Credit. [AB 424](#) (Gaines) was amended August 1 to strike out previous provisions and add language establishing a 25 percent tax credit for the cost of removing brush and other flammable vegetation around a qualified property. The credit is capped at \$2,000. This proposal obviously is in response to the devastating fire at South Lake Tahoe in late June, where combustible materials contributed to the destruction of many houses.

Movie Tax Credit. [SB 740](#) (Calderon), establishing a 12 percent tax credit (either as a credit or refund of sales tax or as an income or corporation tax credit) for qualified production costs of movies, was amended July 25. Among other things, the amendments: (1) remove reference to the taxpayer's "commonly controlled group" and instead refer to the taxpayer's "affiliated corporation"; (2) remove the definition of "budget"; (3) specify that "employee fringe benefits" means amounts allocable to qualified wages; (4) specify that minimum and maximum budget amounts refer to production budgets; (5) define "production budget" and "production period"; (6) remove reference to "qualified taxable property" and "qualified taxable service" and instead refer to "qualified property" and "qualified services"; (7) specify that qualified services must be subject to the California sales and use tax; (8) clean up language regarding assignment of credits; (9) grant regulatory and rule-making authority regarding the credit to the California Film Commission instead of Franchise Tax Board; and (10) require the FTB to accept the tax credit amounts as determined by the California Film Commission.

Cigarette Tax Increase. [SCA 13](#) (Torlakson), increasing the cigarette tax by \$2.10 per pack of 20 to raise funds for health-related purposes, was amended July 25. The amendments specify that, in addition to tobacco-cessation and lung cancer research, revenue from the new excise tax shall be allocated to children's health care, general health care and to offset reductions in the Cigarette and Tobacco Products Surtax Fund and the Breast Cancer Fund resulting from reduced consumption of cigarettes attributable to the new tax. (**Cal-Tax:** Kudos to the legislative counsel and Senator Torlakson for recognizing this exaction as a tax, rather than trying to promote it as a fee.)

WASTE, FRAUD & MISMANAGEMENT: Your Tax Dollars at Work

State Report Blasts Waste and Mismanagement at Los Gatos Elementary School District. Affluent school districts are not immune from waste and mismanagement. A July 26 report from the state's Fiscal Crisis and Management Assistant Team blasted the Los Gatos (Santa Clara County) Elementary School District for wasting tax dollars.

Among the findings:

- **Missing Inventory.** According to the report, "Inventory documentation was provided indicating that \$281,597.11 of computer-related equipment, consisting

of Cisco switches, routers and Apple Macintosh computers, was not accounted for between fiscal years 2004-05 and 2005-06." This documentation was produced from a review of purchase orders and a comparison of those purchase orders to the 2006 inventory completed by the district's outside consultant.

No documentation records are available to determine whether a large amount of inventory was ever received. This consists of an additional \$54,677, for a total loss of \$336,274.11 in a two-year period. Interviews indicated that employees in the district's business office were instructed to pay invoices based on verbal approval that the equipment had been delivered. The district was unable to produce any proof of delivery, such as reports or vendor records indicating when or to whom the equipment was delivered.

- **Bond Money Misspent.** Roughly \$743,000 of a \$91 million school bond was spent for technology equipment that does not appear to be authorized by the bond issue. Further, a percentage of salaries and benefits for employees in the technology and food service departments was charged to the bond fund.
- **Equipment Storage Inadequate.** According to the report, "Various equipment, some of which the district considers to be surplus, is stored in large boxes or stored outside and exposed to environmental deterioration."
- **Irregular Bidding and Contract Practices.** Contracts and change orders for various construction projects and vendors were not bid in accordance with the Public Contract Code. Several change orders were for more than 10 percent, and the increase was 20 percent for a \$385,000 contract with Ludlow Inspection Service.
- **Administrators' Vacation.** District administrators get 23 days of vacation, 13 holidays, 13 sick and personal necessity leave days and three floating holidays. The state audit team found discrepancies between the information in some of the personal leave worksheets and corresponding calendars. According to the report, "The finding regarding payroll irregularities and leave tracking should be classified as a reportable condition."

School officials said they were concerned about how the report will affect the effort to renew a \$290 parcel tax, according to the *San Jose Mercury News*. Scott Mosher, a district parent, said, "We need to move forward with the parcel tax campaign." District Superintendent Suzanne Boxer-Gassman said the district has taken steps to tighten internal controls. Wendy Dillingham, president of the Los Gatos Teachers Association, told the *Los Gatos Daily News* that the school board and superintendent should have been aware of what was going on. She added that the district has not been open about the problems. (Sources: "Extraordinary Audit of the Los Gatos Union Elementary School District" by FCMAT; *San Jose Mercury News*, July 30; and *Los Gatos Daily News*, July 27.)

UC Regents Give Go-Ahead to Unneeded Law School. The University of California Board of Regents on July 19 gave the go-ahead to build a law school at UC Irvine despite objections from the California Post-Secondary Education Commission that the state doesn't need another public law school. Without debate, the regents voted unanimously to proceed with construction of the school.

The education commission, a state entity funded by taxpayers to provide independent advice to policy makers, argued that the state doesn't need more lawyers, that the costs (\$70 million for construction, plus \$16 million in annual instructional costs and \$2.9 million a year for maintaining a public library) are not justified and that the existing UC law schools in Los Angeles, Berkeley, Davis and San Francisco are sufficient.

UC Irvine's web site includes a list of questions and answers about the proposed law school, but the site carefully sidesteps the question of how much it will cost taxpayers. The site says only that the school "will be funded through professional student fees, campus enrollment growth and private gifts."

The education commission report points out a potential problem: "It is possible that the Legislature and the Governor might not support expending scarce State operational and capital funds for growth in a doctoral professional program that lacks a public need." (Sources: *Los Angeles Times*, July 20; California Postsecondary Education Commission report, March 20-21, 2007; UC Irvine web site.) (**Cal-Tax:** When the UC regents ask for money in the state budget, they should be required to first answer questions about this spending decision.)

Accused of Misusing School Resources, Former Superintendent Gets Taxpayer-Funded Lawyer. The former superintendent of the Capistrano Unified School District, charged by an Orange County grand jury with using school resources and records for political purposes, is asking the taxpayers to pay his \$400-an-hour legal fees.

James Fleming, who retired in August 2006 after 15 years as superintendent, has pleaded not guilty to charges that he used school resources to create two "enemies lists" of political opponents during and after a 2005 recall effort. The lists included names of parents who solicited signatures for the recall, along with information on their children who attended school in the district. One woman claims her son was left out of a school video and denied an elementary school award as retribution for her participation in the recall attempt.

In September, school trustees agreed to pay nearly \$8,000 to Mr. Fleming's lawyer as the superintendent was being investigated by the grand jury. The payments ended in March, but Mr. Fleming now is asking for additional tax dollars. Trustees are scheduled to consider the request at their August 13 meeting. (Source: *Orange County Register*, May 25 and July 23.)

Taxpayers Get Speared by Asparagus Festival. Taxpayers in Stockton paid \$526,299 for this year's Asparagus Festival – a sum larger than the \$437,108 the event raised for charity. The bulk of the cost was a \$310,935 charge for city police to provide security. City officials said the cost was worth it, and pointed to a trade group's study that claimed the festival has a \$19 million positive economic impact on the area. Prior to 2004, the event was held at another location in San Joaquin County, and the county charged the festival organizers for its services – roughly \$150,000 in 2002, for example. The city lured the festival downtown by offering to provide police and other services at no cost to organizers – a deal the *Stockton Record* calls "a luxury most events are not afforded." (Source: *Stockton Record*, July 23.)

POTPOURRI:
Symposia, Sightings, Salutes & Snafus

Will Assemblywoman Richardson Be Available for Further Budget Votes? Barring the largest upset in political history, Assemblywoman Laura Richardson will be elected to Congress on August 21 to fill the Southern California seat left vacant by the death of Congresswoman Juanita Millender-McDonald. So will she be available to vote on a new budget bill if one emerges after the Legislature returns to work August 20? In 2005, Congresswoman Doris Matsui was sworn in just two days after being elected to fill a vacancy left by the death of her husband. But the California State University Legislative Report of July 9 states that in Ms. Richardson's case, "The official canvass will be completed by August 31 and the election results will be certified by September 29." In other words, the length of the budget impasse may determine whether Democrats will need an additional Republican vote to provide the needed two-thirds majority in the Assembly.

OAL Approves BOE's Tipping Regulation. The Office of Administrative Law has approved amendments to [Sales Tax Regulation 1603](#), clarifying how sales tax applies to restaurant tips (see [Cal-Taxletter](#) of March 23, 2007). The regulation is effective August 15.

BOE Notices Regulation on Seizure of Tobacco Products. A proposed amendment to a State Board of Equalization regulation related to the seizure of cigarettes and tobacco products ([Regulation 4703](#)) has been scheduled for a public hearing September 11 at 1:30 p.m. at the board's Sacramento headquarters. According to the board: "**Regulation 4703** outlines the situations when cigarettes or tobacco products may be seized under certain statutes and that such seized products are forfeited to the state unless a timely petition for release of seized property is filed. The regulation further describes what evidence can be provided that may result in the return of seized property. The proposed amendments specifically provide that licensed distributors are excluded from seizures of unstamped cigarettes (including cigarettes stamped with another state's tax stamp) and further clarify that in the absence of an applicable exemption from tax or other lawful possession of unstamped product under the Revenue and Taxation Code ... unstamped cigarettes and/or untaxed tobacco products are subject to seizure."

New Rules for Tax Appeals Finally Ready for BOE Regulatory Hearing. After a couple of years of intensive work and a number of interested parties meetings, the proposed new rules for tax appeals before the State Board of Equalization finally have reached the formal regulatory process. A public hearing on the comprehensive, six-article proposal is scheduled for September 11 at 1:30 p.m. at the board's Sacramento headquarters.

The proposed Rules for Tax Appeals replace the Rules of Practice that were adopted in the 1990s.

According to the board, the new rules "codify important procedures not currently contained in the Rules of Practice, reorganize the rules for the Board's appeals processes in a more logical manner, and generally explain the Board's appeals processes as plainly and comprehensively as possible."

Another Local Sales Tax Allocation Regulation Before the BOE. Cities are continuing to fight each other over the distribution of the use tax. The battle is a zero-sum game, because if one jurisdiction gains, others lose. This makes it particularly difficult for board members, who will be praised by winners and vilified by losers.

The latest skirmish before the board will be a public hearing on September 11 on amendments to [Regulation 1802](#) that make more of the use tax subject to distribution to a single taxing jurisdiction rather than allocated to multiple jurisdictions through a pool.

Currently, **Regulation 1802** provides that when the order for the property is sent by the purchaser directly to an out-of-state location and the property is shipped directly to the purchaser in California from a point outside this state, the transaction is subject to the local use tax of the jurisdiction where first functional use is made. If such a transaction is \$500,000 or more, then retailers are required to report California use tax directly to the jurisdiction of first functional use. Amendments are proposed that would eliminate the requirements that the order is made directly with a retailer outside this state and the property is shipped directly to the consumer from outside this state. On any transaction of \$500,000 or more, if the seller is required to collect the local use tax on the transaction, the seller also is required to report the local use tax revenue directly to the jurisdiction of first functional use. Persons who voluntarily collect use tax under [Regulation 1684](#) may, at their own discretion, report use tax revenues on such transactions directly to the jurisdiction of first functional use.

This proposal is the staff recommendation that was adopted at a meeting of the board's Business Taxes Committee on May 31.

The hearing will begin at 1:30 p.m. in Room 121 at the board's Sacramento headquarters.

SCHWARZENEGGER ADMINISTRATION: Who's New or Leaving

Recent personnel moves include:

Assistant State Fire Marshall: Tonya Hoover, a Republican from Concord, has been appointed assistant state fire marshal. Since 1998, she has been fire marshal for the Orinda-Moraga Fire District.

Blast From the Past

"Property tax levies have increased almost eight times as fast as the population in the past twenty years. Total assessed valuations have more than doubled in each of the last two decades, but even at that, the levies have jumped twice as fast."

— "Tax Levies Reach \$2,889,735,512," *The Tax Digest*, Second Quarter 1964.

Coming Up

- August 13
Location: **FTB INTERESTED PARTIES MEETING**
Golden State Room, FTB World Headquarters, Butterfield Way, Sacramento, 10 a.m.
Subject: Regulations on withholding at the source.
- August 14
Location: **STATE BOARD OF EQUALIZATION MEETING**
Room 121, 450 N Street, Sacramento, 9:30 a.m.
Subject: The agenda for this meeting was unavailable at press time, but, in addition to the usual income and sales tax appeals, the board is expected to deal with proposed [Property Tax Rule 474](#), separating oil refinery fixtures into a separate appraisal unit. This regulation was earlier rejected by the Office of Administrative Law. The board also is expected to discuss budget change proposals to implement portions of the tax gap strategic plan that require additional resources.
- August 17
Location: **FTB REGULATORY HEARING: TREASURY FUNCTION**
Golden State Room, Franchise Tax Board's World Headquarters, Butterfield Way, 10 a.m.
Subject: This is the long-awaited formal regulatory hearing on Regulation 25137(c)(1)(d). The regulation excludes from the sales factor income from intangible assets held in conjunction with a company's treasury function. The regulation was developed at two interested parties meetings.
- August 20
Location: **SENATE APPROPRIATIONS COMMITTEE HEARING**
Room 4203, State Capitol, 10 a.m.
Subject: Among bills on calendar are [AB 8](#) (Nunez), the 7.5 percent payroll tax on employers for health care; [AB 83](#) (Lieber), requiring the state to pay a share of the cost of property tax administration; [AB 402](#) (Ma), extending the parent-child change-of-ownership exemption to foster children, and revising change-of-ownership reporting for housing cooperatives; [AB 843](#) (Eng), increasing penalties on non-homeowners for failing to file a change-of-ownership statement; [AB 969](#) (Eng), requiring taxpayers to report use tax on income tax forms without being informed of the need to keep records of purchases this year; [AB 1277](#) (Benoit), relating to corporate dividend elimination rules; and [AB 1617](#) (DeSaulnier), limiting delivery of cigarettes to California residents.
- August 20
Location: **ASSEMBLY REVENUE AND TAXATION COMMITTEE HEARING**
Room 126, State Capitol, 1:30 p.m.
Subject: [SB 105](#) (Migden), relating to taxation of registered domestic partners.

- August 22 **ASSEMBLY LOCAL GOVERNMENT COMMITTEE HEARING**
Location: Room 447, State Capitol, 1:30 p.m.
Subject: [ACA 8](#) (De La Torre), the League of Cities' version of eminent domain law revisions.
- August 20-23 **NORTHERN CALIFORNIA ASSESSORS' ASSOCIATION CONFERENCE**
Location: Plumpjack Squaw Valley Inn, Olympic Valley, CA
- August 23 **POST-EMPLOYMENT BENEFITS COMMISSION MEETING**
Location: Santa Clara County
Subject: A review of proposed solutions in California and the nation.
- August 24 **ORANGE COUNTY TAXPAYERS RIGHTS MEETING**
Location: Rancho Santiago Community College, 2323 N. Broadway, Santa Ana, 9:30 a.m.
Subject: BOE Member Michelle Steel is sponsoring this event to discuss aspects of the "tax gap" plan.

NOTE TO SUBSCRIBERS: THE NEXT CAL-TAXLETTER WILL BE PUBLISHED AUGUST 24, 2007.