



California's Tax Machine

Second Edition

***A History of Taxing and
Spending in the
Golden State***

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- **Subchapter S.** The package generally (but not completely) conformed to federal changes in the tax treatment of Subchapter S corporations. Such corporations may have up to 75 shareholders (SB 5 and SB 1233).

- **Economic Development.** The Trade and Commerce Agency was required to designate one targeted tax area in which businesses would be eligible for several incentives. The incentives are: (1) credit for sales taxes paid on purchases of manufacturing equipment; (2) a tax credit for hiring disadvantaged workers; (3) expensing provisions – 40 percent – for business equipment; and (4) 100 percent carry-forward of net operating losses. Portions of Tulare County, within the district of Assembly Speaker Cruz Bustamante, met the criteria for being designated as the targeted tax area (AB 1217, Bustamante).

- **Bunker Fuel.** The bunker fuel sales tax exemption was extended until 2003 (AB 366, Havice). Bunker fuel is fuel consumed by vessels after their first out-of-state port stop. A short-lived attempt to tax bunker fuel in 1991 was repealed after it created severe economic dislocations.

- **Conformity With Federal Law.** A comprehensive conformity bill (SB 455, Alpert), was approved and sent to the governor. Among nearly 50 key provisions were an increase in the amount that may be “expensed” by non-corporate small businesses, and changes in individual and corporate estimated tax provisions.

Sinclair Case Opens Proposition 13 Loophole

What is a “fee” and what is a “tax” for the purpose of Proposition 13’s requirement that a two-thirds vote is required for legislative approval of a tax increase?

The California Supreme Court, in *Sinclair Paint Co. v. State Board of Equalization*, 937 P.2d 1350 (1997), overturned trial and appellate courts’ decisions and ruled that a fee approved by a majority vote of the Legislature and imposed on manufacturers of products containing lead was not an illegally approved tax.

The taxpayer argued that the fee was a tax because there was no regulatory process or benefit to the industry.

The court said the fee was a "regulatory" fee imposed to mitigate the adverse effects of the fee payers' operations, and said such fees must bear a reasonable relationship to those adverse effects. The Howard Jarvis Taxpayers Association's Jonathan Coupal said the decision created a significant loophole in the protections of Proposition 13 relative to the imposition of state taxes.

The Stop Hidden Taxes Coalition Is Born

The *Sinclair Paint* decision opened the floodgate for the Legislature and local governments to impose billions of dollars in additional taxes (labeled as fees) by circumventing the voter-approval requirements of Proposition 13 and Proposition 218.

Within a few short years, Californians were hit with a flurry of hidden taxes in the form of majority-vote "fee" measures and bills granting localities the authority to impose taxes without a public vote. The products and services targeted for taxation included diapers, bicycles, prescription drugs, bottled water, phone bills, grocery bags, electric bills, batteries, recorded documents, computers, gaming tables, soda, long-term care facilities, shipping containers, health care programs and cars.

One of the first major efforts by the business community to stop this trend was to sponsor an initiative clarifying the distinction between a regulatory fee and a tax. The proposal was qualified for the November 2000 ballot as Proposition 37. Californians Against Hidden Taxes, a coalition including Cal-Tax, the California Chamber of Commerce and the California Manufacturers and Technology Association, was formed to promote the proposition.

Cal-Tax President Larry McCarthy signed the ballot argument on behalf of the measure. He said that without the voter approval protections in Proposition 37, the Legislature would use fees, instead of taxes, to extract money from taxpayers. The fees, he said, would be attached to many everyday products, such as prescription drugs, cars and telephones.

Labor unions, environmentalist groups, health groups and their allies campaigned against the measure, claiming it was a scheme to force taxpayers to pay for pollution caused by big businesses.

Proponents had trouble raising funds to mount an effective campaign, and on election day, Proposition 37 narrowly failed, receiving 48 percent of the vote.

With the failure of Proposition 37 and no new safeguards in place to restrain "fee" proposals, California experienced an explosion of tax-like fees. During the 2003-04 session, legislators introduced more than 50 hidden tax proposals, and the state legislative analyst recommended five tax-like fees.

Cal-Tax described the 2003 flurry as "the largest tax and fee threat challenge in business memory." From 2004 to mid-2005, the business community filed several initiatives to clarify the two-thirds vote requirement for taxes (some of the measures also included provisions to limit state spending), but none were pursued.

To combat the high volume of taxes masquerading as fees, the business community called for "stepped-up vigilance against hidden taxes" at a press conference in June 2005. At this forum, the groups that had promoted Proposition 37 introduced the newly formed Stop Hidden Taxes Coalition. Managed by Cal-Tax, the coalition consists of a diverse group of more than 60 businesses (including trade associations, taxpayer organizations, private businesses, chambers of commerce and various councils). Its mission is to "raise awareness about and advocate against the misuse of regulatory fee authority."

In recent years, the Stop Hidden Taxes Coalition has played a major role in tracking hidden taxes, testifying against tax-like fees, and alerting the public to potentially costly proposals. Cal-Tax policy analysts frequently represent the coalition at legislative hearings. Since the creation of the Stop Hidden Taxes Coalition in 2005, the introduction and enactment of hidden taxes has dwindled relative to the 2003 explosion (Table 17).

Table 17					
Hidden-Tax Legislation Since the <i>Sinclair</i> Decision					
Hidden Taxes Opposed by	Year	No. of Bills	To Governor	Vetoed	Signed
Cal-Tax	1999-00	10	3	1	2
Cal-Tax	2001-02	16	3	0	3
Cal-Tax	2003-04	51	*12	0	12
Stop Hidden Taxes Coalition	2005-06	28	8	7	1
Stop Hidden Taxes Coalition	**2007	17	7	5	2
*Governor Gray Davis signed eight measures in 2003, and incoming Governor Arnold Schwarzenegger signed four in 2004.					
**First half of a two-year legislative session.					

1998: Taxpayers Get 'Car Tax' Relief

For much of 1998, the battle to reduce or repeal the state's 2 percent "in-lieu" tax on motor vehicles (the "car tax") occupied center stage.

For a number of years after automobiles began appearing on California roads, they were assessed by county assessors. However, there were criticisms of wide variations in value for the same make of car, depending on the county in which the tax was being assessed. This led to a proposed constitutional amendment in 1930 (Proposition 18) that sought to put the state in charge of administering the property tax on cars. This was turned down by a vote of 641,716 "no" vs. 433,860 "yes."

Ignoring the 1930 vote, Governor Frank Merriam, in 1935, proposed that the state impose a vehicle tax in lieu of the property tax. His proposal ran into fierce opposition in the Legislature from local government, several BOE members and members of the "progressive" bloc in the Assembly. They expressed concerns that once vehicles were taxed by the state, the relationship with other forms of property would be lost and the in-lieu tax would end up being higher.