

## **CALTAX YEAR IN REVIEW: 2016 – MAJOR TAXES APPROVED AT THE BALLOT BOX**

*The year 2016 was a year of major tax increases – approved not by state lawmakers, but by voters themselves in state and local elections.*

*In the November elections alone, voters approved billions in annual statewide taxes, 167 local tax measures that cumulatively will increase the tax burden by more than \$2 billion annually, and more than \$30 billion in local bonds that will have to be repaid – with interest – through higher property taxes.*

*The largest tax hike on the ballot, Proposition 55, increases personal income taxes by extending high income tax rates originally approved in 2012 as a temporary tax. Under Proposition 55, the rates will continue through 2030, rather than expiring in 2018, costing taxpayers \$4 billion to \$9 billion per year, according to the legislative analyst's estimates. Voters also approved a \$2-per-pack increase in tobacco taxes, for an annual tax increase estimated at \$1.6 billion, and taxes on newly legalized recreational marijuana.*

*However, several attempts to impose massive property tax increases (by wiping out Proposition 13 protections for many property owners) were unsuccessful.*

*The first day of 2017 brought a major tax reduction, as the statewide sales and use tax rate decreased 0.25 percent thanks to the expiration of a sales tax increase that had been approved by voters in 2012. In other good news for many taxpayers, the State Board of Equalization voted in February to reduce the state's gasoline excise tax rate 2.2 cents per gallon, effective July 1, 2016 (however, the BOE also increased the excise tax on diesel fuel 3 cents per gallon).*

*The year also will be remembered for passage of a major government reform – Proposition 54, the CalTax-supported initiative that improves legislative transparency, and stops secretive lawmaking by requiring bills to be posted online for at least 72 hours before a final vote can occur in the Legislature.*

*While the Legislature did not approve direct taxes, it did approve environmental measures that opponents said will make it more costly to live in California, and more difficult to run a business in this state. The main bill in this category was [SB 32](#) (Pavley), giving the California Air Resources Board authority to develop sweeping climate regulations with the goal of reducing greenhouse gas emissions 40 percent below 1990 levels by 2030. The Legislature also earmarked almost \$1 billion in cap-and-trade auction revenue, in the face of litigation that questions the legality of this revenue.*

*Additionally, Governor Jerry Brown in April signed legislation to increase the state's minimum wage to \$15 an hour by 2022 (2023 for small businesses), with subsequent increases for inflation.*

*Despite the many new burdens on taxpayers, California's economy will continue its slow but steady growth, according to a [forecast](#) by the University of California at Los Angeles Anderson School of Management. The economic improvement could help most local*

*governments reap significant gains in property tax revenue, as they did in 2016 thanks to Proposition 13's increases in value of assessed properties.*

*Still, as taxpayers look ahead to 2017, and CalTax enters its 91st year of fighting to stop unnecessary taxes and to improve government efficiency, many questions are in the air: Will Democrats use their newly gained supermajority status in the Legislature to approve taxes and put constitutional amendments on the ballot without any Republican votes? How will the policies of the Trump Administration impact California taxpayers? Will the approach of California's 2018 gubernatorial election prompt any major tax proposals?*

*The answers may be revealed in the 12 months ahead.*

## **Attacks on Proposition 13 Defeated**

When 2016 began, visions of property tax increases danced in the heads of many politicians and special interests.

Former State Board of Equalization Member Conway Collis and others filed an initiative to impose a new property tax on most residential and business properties valued at \$3 million or more, and their campaign secured major funding from the Daughters of Charity, Wall Street investor Joseph Sandberg and several Hollywood producers. CalTax was a leader of the coalition opposing the measure, in conjunction with Californians to Stop Higher Property Taxes, co-chaired by CalTax President Teresa Casazza. After weighing his measure's odds, Mr. Collis dropped the effort in late February.

In the Legislature, where State Senators Loni Hancock and Holly Mitchell had introduced legislation in 2015 stating the intent of the Legislature to enact a split-roll property tax, there was continued talk of increasing taxes on business properties, but the legislation did not advance.

Meanwhile, the nonpartisan Legislative Analyst's Office in September debunked a myth that has long been circulated by those who want to repeal Proposition 13: the erroneous claim that Proposition 13 shifted the property tax burden from business owners to homeowners.

The analyst's finding matched the findings of research conducted by the California Tax Foundation, the nonprofit think tank formed by CalTax in 1980. In 2016, the foundation reported that the share of the property tax paid by homeowners has not increased under Proposition 13 – in fact, it decreased 4 percent from 1979-80 to 2013-14.

While the attacks on Proposition were defeated in 2016, observers expect them to be renewed this new year.

## **Other Tax Threats in the Legislature**

While no major broad-based taxes were approved during the two-year legislative session that concluded September 1, many were proposed. Lawmakers introduced bills calling for more than \$143 billion annually in higher taxes and fees during the second year of the

2015-16 legislative session alone, according to a [report from the California Tax Foundation](#).

In addition to the split-roll property tax plan, the proposals included: a retail sales tax on services; a tax increase on corporations whose chief executive officers are paid more than the proposal's author deems appropriate; a water tax; a tax on candy and snack foods (which would require a constitutional amendment); and a local tobacco tax (which passed the Legislature, but was vetoed by the governor).

Two major tax threats were proposed, but not introduced as bills: a county-level income tax, in addition to state and federal income taxes; and authorization for the Franchise Tax Board to appeal State Board of Equalization decisions in superior court under trial de novo.

## **The State Budget**

As has become customary in recent years, Democratic leaders and Governor Brown used a secretive process to develop the state budget. A deal was negotiated outside of the Budget Conference Committee's public process, and was approved on June 15, the deadline for lawmakers to approve a budget or forfeit pay.

The 2016-17 budget calls for \$171.9 billion in total special fund and general fund spending, an increase of \$10.9 billion from the current fiscal year.

Two pieces of good budget news were reported near the end of 2016: the legislative analyst reported that the state budget – and budget reserves – are in good enough shape to weather a mild recession without requiring spending reductions or tax increases, and the state controller reported that state revenue collections for the first five months of the fiscal year were almost exactly on target with the projections in the state budget.

## **Tax “Reform”**

State Controller Betty Yee on June 9 released a much-anticipated “tax reform” report from her council of economic advisors. [The report](#) did not include tax recommendations, but was described by the controller as a “contextual framework” for comprehensive changes to the state's tax structure.

One issue frequently cited by reform advocates is the state's financial reliance on income tax from a very small number of very wealthy taxpayers – a reliance that creates volatility, since the income from these taxpayers varies with the ups and downs of the stock market. Statistics released in 2016 by the FTB revealed that in 2014 (the most recent year for which statistics are available), the top 1 percent of income earners in California paid 48 percent of the total state personal income tax burden, and the top 20 percent of income earners – those who make \$91,000 or more per year – account for approximately 90 percent of the state's total personal income tax revenue. The personal income tax brings in more than two-thirds of the state's total revenue.

## Local Tax Developments

Local governments loaded the June and November ballots with tax measures, and also unveiled new ways to add complications and questionable policies to the tax code.

A prime example occurred in June, when a nine-county parcel tax was placed on the ballot and approved, setting a precedent as a “local” tax that covers a huge swath of the state. Had the measure been submitted on a county-by-county basis, it would have failed in four of the nine counties, but voters in those counties had their wishes overwhelmed by high levels of support from the other five counties.

Another parcel tax covering a huge geographic area was approved in Los Angeles County. The countywide parcel tax is based on the square footage of buildings, resulting in some low-income communities paying a larger percentage of the total tax than high-income communities.

## State Board of Equalization

The State Board of Equalization voted February 24 to elect BOE Member **Fiona Ma** as chairman of the board. BOE Member **Diane Harkey** was chosen to serve as vice chair.

In March, the BOE promoted Chief Deputy Director **David Gau** to the position of executive director, and reassigned Executive Director **Cynthia Bridges** to a temporary role as “special consultant.” Ms. Bridges later was hired to serve as an aide to Mr. Horton.

One of the highest-profile appeals decided by the BOE in 2016 involved actor Rob Lowe and his wife, Hollywood makeup artist Sheryl Berkoff. In February, the board sided with the couple in their dispute with the FTB over the basis of a Montecito home they sold in 2005.

In regulatory action, CalTax successfully petitioned the BOE to amend California Code of Regulations Title 18, Section 1525.4, to clarify “useful life” criteria to increase utilization of the manufacturing and research-and-development equipment sales/use tax exemption. Although the Office of Administrative Law (OAL) disapproved BOE’s proposed changes, CalTax worked with the Governor’s Office and lawmakers to bring the issue to the forefront, resulting in agreement from the Governor’s Office to examine and potentially implement various programmatic changes this year.

Also, the BOE’s Business Taxes Committee thrice rescheduled the release of its second discussion paper relating to technology transfer agreements (TTAs). The paper is in response to the California Supreme Court’s January decision to deny the BOE’s petition to review the Court of Appeal’s ruling in *Lucent Technologies Inc. v. State Board of Equalization* (2015) 241 Cal.App.4th 19 (Case No. B257808), involving the taxation of licensing fees to use switching software transferred in storage media pursuant to TTAs.

CalTax asked BOE to consider three principles as it deliberates regulatory changes: a reasonableness test, ease of administration and market neutrality.

## Franchise Tax Board

The election of Ms. Ma to chair the BOE also gave her a seat on the Franchise Tax Board. **State Controller Betty Yee** and **Department of Finance Director Michael Cohen** remained on the three-member FTB.

Each year, the FTB examines the tax sections of the California Code of Regulations for potential changes. This year, much of the agency's focus was on refund claim procedures and imposing requirements that overreached statutes – including the requirement for filing amended returns (instead of refund claim letters) accompanied by all supporting documentation. CalTax provided oral and written comments as part of the stakeholder process, and met with key members of the FTB advocating to make the proposed requirements optional instead of mandatory.

CalTax also testified at the FTB Taxpayers' Bill of Rights annual hearing and lobbied the members to sponsor cleanup legislation to retain the October 15 partnership return extended due date, which was changed to September 15 by default interaction between existing law and legislation enacted in 2016.

## New Faces

In addition to the personnel changes at the BOE, there were some key moves in other agencies in 2016 that will impact California tax policy.

In the Legislature, the Assembly elected **Assemblyman Anthony Rendon**, a Democrat from Los Angeles County, as the new speaker of the house (a decision announced in 2015, but made official in 2016). He appointed **Assemblyman Sebastian Ridley-Thomas**, also a Democrat from Los Angeles, as chair of the Revenue and Taxation Committee, succeeding **Assemblyman Phil Ting**, who was appointed chair of the Assembly Budget Committee.

The November election gave the state 22 new legislators in the Assembly and nine new faces in the Senate, and also gave Democrats a supermajority for the 2017-18 legislative session. In what became the most closely watched legislative race, Democrat **Josh Newman** defeated Republican Assemblywoman **Ling Ling Chang** by a narrow margin in the Senate District 29 race. The win increased the number of Democrats in the Senate to 27 – the number of votes needed to pass tax increases and other bills requiring two-thirds approval. Democrats hold 55 seats in the Assembly, one more seat than needed to meet the two-thirds threshold.

**Oksana Jaffe**, the chief consultant to the Assembly Revenue and Taxation Committee for the past eight years, and **Gina Rodriguez**, CalTax Vice President of State Tax Policy, both joined KPMG as directors of state and local tax issues in the Sacramento office.

Near the end of the year, the governor appointed **Xavier Becerra**, a Democratic member of the U.S. House of Representatives, to succeed California Attorney General **Kamala Harris**, who was elected to the U.S. Senate.

## In the Courts

The death of U.S. Supreme Court Justice Antonin Scalia in February left a vacancy on the nation's high court, and raised questions about the fate of several major cases.

In the long-running income tax dispute between Nevada inventor **Gilbert Hyatt** and the Franchise Tax Board, the U.S. Supreme Court affirmed a Nevada Supreme Court ruling in favor of Mr. Hyatt, except with respect to the amount of damages. The decision means that the specific findings of liability against the FTB – that the agency committed fraud and engaged in intentional infliction of emotional distress upon Mr. Hyatt during a residency audit – stay in place. The decision allows the Nevada courts to award damages for those violations of Nevada law, but with the same \$50,000 limit that would be applied if the FTB were a Nevada state agency.

The U.S. Supreme Court also played a role in setting California tax policy when it declined to review the ***Gillette* decision**.

The high court deadlocked 4-4 on ***Friedrichs v. California Teachers Association***, involving the power of public employee unions to compel government workers to pay dues against their will. The deadlock had the effect of affirming a lower court ruling that allows the practice to continue.

In another significant case, the Fourth District Court of Appeal issued a published decision that may pose a serious threat to taxpayer protections in local tax elections. In ***California Cannabis Coalition v. City of Upland***, the court opined that the sections of Propositions 218 and 26 that apply to taxes “imposed” by local government do not apply to taxes created via a local initiative. The California Supreme Court will review the decision.

## Government Waste

A project that went \$115 million over budget, a \$60 million courthouse that sits unused, and a spending scandal that prompted the resignation of the University of California at Davis chancellor were among the [Top 10 Examples of Government Waste in 2016](#) released October 20 by CalTax. In one of the cases, the state government spent \$10.2 million on an anti-drug program for prisons, but afterward, drug use *increased* at the prisons targeted by the program.

## Rare Bit of Good News for Unemployment Insurance

The California Employment Development Department (EDD) reported in October that the deficit in the California Unemployment Insurance Fund is projected to be \$3.9 billion by the end of the year – down from \$6.4 billion at the end of 2015 – and that the UI fund is expected to end 2018 with a positive balance of \$2 billion. The EDD noted that the fund hasn't ended the year in the black since 2008. It had a deficit of \$8.6 billion at the end of 2014.



## California Jobs and the Business Climate

California once again fared poorly in national rankings related to taxes and the business climate:

- California's combined state and local tax burden ranks fourth highest in the nation, the Washington, D.C.-based Tax Foundation reported January 20.
- In its [annual report](#) on the relative levels of taxation in the 50 states, *Kiplinger* said in late August that California "tops our least-friendly list, thanks to a combination of high income taxes and hefty taxes on purchases and gas."
- California ranks 48th out of the 50 states in terms of business tax climate, according to the 2017 edition of the [State Business Tax Climate Index](#), released September 28 by the Tax Foundation.
- In CNBC's 10th annual ranking of "[America's Top States for Business](#)," California ranked 32nd overall, but finished dead last in the category of "business friendliness."
- California is the third-worst state for small businesses, according to the [Small Business Friendliness Survey 2016](#), released by Thumbtack, a business that connects consumers with skilled professionals in the United States.

Additionally, the [2016 Economic Forecast Update](#) presented by the A. Gary Anderson Center for Economic Research at Chapman University revealed that the city of Los Angeles has lost 20 percent of its manufacturing jobs since 2007.

Many stories reported in 2016 illustrated the impact of the state's business climate:

The Coca-Cola Company announced that it will close its Odwalla beverage production plant in Dinuba; Carl Karcher Enterprises announced that it is moving its headquarters from Carpinteria, California, to Nashville, Tennessee; American Apparel announced it was eliminating approximately 500 jobs in Los Angeles; Pegasus Foods, a Los Angeles-based company that supplies food for several popular chain restaurants, will build a 325-employee manufacturing facility in Texas; Jamba Juice announced that it is moving its headquarters from Emeryville to Texas;

Jacobs Engineering Group, a Fortune 500 firm, is moving its corporate operations from Pasadena to Dallas; C&S Propeller is moving from Covina to Fort Worth; Hiji Brothers Inc. closed three businesses in California; General Magnaplate, which manufactures parts used in the aerospace industry, is closing its facility in Ventura facility, citing California's business climate;

Ashley Furniture HomeStore announced that it will close two plants in Colton, and is transferring the production work to other states; Competitive Edge Research & Communications is moving its call center from California to Texas; and after 25 years in business, the owner of Almost Perfect Book Store in Roseville closed the store, saying

the added expense from the state's minimum-wage increases made it impossible to continue.

The *San Jose Mercury News* reported in June that individuals, as well as companies, are moving. "A growing number of Bay Area residents – besieged by home prices, worsening traffic, high taxes and a generally more expensive cost of living – believe life would be better just about anywhere else but here," the newspaper reported.

### **2018 Election Campaigns Already Under Way**

State Treasurer John Chiang, Lieutenant Governor Gavin Newsom, and former Los Angeles Mayor Antonio Villaraigosa all announced that they are Democratic candidates for the 2018 gubernatorial election.

Potential candidates who said they are unlikely to run include wealthy environmental activist Tom Steyer, a Democrat who had been labeled a "job-killing hedge fund manager" by a union leader; Republican San Diego Mayor Kevin Faulconer, who subsequently was said to be considering a run; and Republican Ashley Swearengin, outgoing mayor of Fresno.

State Board of Equalization Chair Fiona Ma and Assemblyman Mike Gatto of Los Angeles, both Democrats, threw their hats in the ring for the 2018 election for state treasurer.

### **In Memory**

**Kirk West**, who served as president of the California Taxpayers Association from 1974 to 1982, and as president of the California Chamber of Commerce from 1986 to 1997, died June 2 following a battle with cancer. He was 79.

Cancer also claimed former CalTax Vice President and General Counsel **John Sullivan**, who died in February.

**State Senator Sharon Runner**, who returned to the Legislature last year following a double lung transplant, died June 14 at her home in Lancaster.

**Tom Hayden**, a liberal social activist, author and former state lawmaker, died October 23 at the age of 76.