

## **CalTax Year in Review:** **Biggest Tax Battle in Decades Now in Sight**

*The year 2019 was filled with activity in California, as a new governor was sworn in, a new president took the reins at CalTax, and lawmakers – energized by steady increases in state and local tax revenue – worked on a broad range of issues in Sacramento.*

*For most business taxpayers and consumers, though, the most impactful events of the year were the machinations that set the stage for a historic battle over the “split roll” property tax increase that will appear on the November 2020 ballot.*

*Throughout the year, Californians grappled with broad-based issues, headlined by unprecedented growth in the homeless population (including a 30 percent increase in San Francisco alone over the past two years), the high cost of housing and wildfires that impacted many residents and businesses.*

*Also during the past 12 months, the state’s tax appeals process continued evolving, courts issued rulings on several significant tax disputes, and many employers reacted to California’s business tax climate by moving operations and jobs to lower-cost states.*

*As always, the new year begins with more questions than answers. Will California voters protect Proposition 13, the 1978 property tax reform initiative, or will they approve the largest property tax increase in state history? Will elected officials and special interests continue proposing tax increases despite the abundance of revenue from existing levies? Will California’s business costs and cost of living be addressed in meaningful ways?*

*The answers will be known only in hindsight, when we reach the end of 2020. But first, a look back at the highlights of the year just ended ...*

### **New Governor, New Vision**

When he took the oath of office in January, Governor Gavin Newsom made it known that a primary goal was to oppose many of the policies of the Trump Administration. “There is an administration in Washington hostile to California’s values and interests,” the governor said in the opening of his inaugural address, and Newsom’s speeches, press releases and social media posts throughout the year continued to feature strong criticism of the president and his actions.

Newsom also made it clear that his governing style is much different than that of his predecessor, Governor Jerry Brown. Shortly after taking office, Newsom created a “strike force” to recommend changes to the Department of Motor Vehicles, and he ordered new transparency measures for California’s high-speed rail project, taking a more aggressive approach to well-documented problems in the state bureaucracy.

The governor set a goal of building “A California for All” – a phrase that was turned into a logo used on many state websites and all of the governor’s press materials – and announced that his

wife, Jennifer Siebel Newsom, would lead the new Office of the First Partner to focus on “lifting up women and their families, breaking down barriers for our youth, and furthering the cause of gender equity in California.”

The media bristled at some of the administration’s new practices, especially the governor’s penchant for making major announcements via social media rather than in press conferences with reporters present.

### **Focus on Split Roll**

In mid-2019, roughly a year after the proponents of the split-roll initiative qualified a measure for the November 2020 ballot, they filed a new version ([Initiative 19-0008](#)) in an attempt to make the tax hike more appealing to public employee unions whose support was being solicited to fund the initiative campaign – in part by allocating tax-hike revenue to some school districts that would not have received as much funding under the original version.

The initiative, amended again a month after being refiled, would increase taxes on California employers by requiring frequent annual market-value reassessments of commercial and industrial property. CalTax President Robert Gutierrez, co-chair of the campaign to defeat the split-roll initiative, noted that the tax increase would lead to higher consumer prices, higher rent for many small businesses, and job losses for California workers.

Gutierrez also serves on the steering committee of [Fight for Prop 13](#), a coalition launched in July to educate Californians about the importance of maintaining the tax reforms approved by voters in 1978. Gutierrez joined leaders of the National Association for the Advancement of Colored People (NAACP), the California Business Roundtable and other coalition members at an August news conference to announce they collected more than 40,000 petitions signed by California voters asking the governor and other state officials to protect Proposition 13.

Split-roll proponents and financial backers, including the California Teachers Association and the Service Employees International Union, expressed confidence they will collect enough signatures to qualify the new version, at which point they will remove the original from the ballot. They have until April 14 to submit at least 997,139 valid signatures of California voters, and had more than 500,000 in hand as the calendar turned to 2020.

California Attorney General Xavier Becerra helped the measure by issuing an official title and summary that did not describe it as a tax increase. This caught the attention of the Southern California News Group’s editorial board, which called Becerra’s work “the most disreputable ballot description we’ve seen.” *San Francisco Chronicle* editorial page editor John Diaz wrote that voters deserve a more accurate ballot summary, and “should not accept these insults to their intelligence and independence.”

Key split-roll developments in 2019 included:

- Polls showed that voters do not support a split roll. In November, the Public Policy Institute of California (PPIC) found that only 46 percent of likely voters supported the

split roll, and 45 percent opposed – a drop of eight percentage points since the pollster asked the same question in April. However, among all adults – including those not viewed as likely voters – the PPIC found 55 percent in support of the initiative, 37 percent opposed and 8 percent who said they didn't know.

- The California Assessors' Association [criticized many provisions](#) of the initiative, saying it is "both ambiguous in some sections and overly narrow in other sections," creates "fundamental legal, administrative and financial problems" and "will create significant unintended consequences for ALL property owners, including homeowners and small business owners." In a "[white paper on a 'generic' split roll](#)," the association added that a split roll likely would "have a devastating impact on the operations of California assessors and their ability to deliver quality customer service to taxpayers."
- Santa Clara County Assessor Larry Stone testified at a State Board of Equalization hearing that the "seriously flawed" initiative would be "impossible – not difficult, but impossible – for assessors to implement." Los Angeles County Assessor Jeffrey Prang told the BOE that the measure would require counties to hire hundreds of new employees using a system that is "simply inadequate for the job."
- During a legislative hearing, Senator Bob Wieckowski said lawmakers should consider repealing Proposition 13 entirely as part of their discussions about making housing more affordable and decreasing homelessness in California, stating: "The repeal of Prop. 13 – that would be the discussion."
- Four out of every 10 companies in Los Angeles will consider leaving California if voters approve the split-roll initiative, a Los Angeles County Business Federation [poll](#) found.

## Tax Conformity Comes Into View

On July 1, the first day of the state's fiscal year, Governor Newsom signed [AB 91](#) (Burke), a budget "trailer bill" enacting a tax conformity package his administration championed. Newsom said the legislation, designed to raise revenue to finance an approximately \$1 billion-per-year expansion of California's earned income tax credit (EITC), was part of what he dubbed "The Affordability Budget."

CalTax met with the governor as the administration negotiated the legislation, and played a major role in urging Newsom to shape a conformity package that protected California's business climate. The package that was signed into law did not include the type of anti-business provisions that were enacted in other states.

AB 91 selectively conformed California to federal tax laws, most of which are changes contained in the Tax Cuts and Jobs Act of 2017. Provisions of the conformity package include: Small business accounting method "reform and simplification"; exclusion for student loan debt discharged/canceled due to death or disability; increased contributions to ABLE accounts and 529 rollovers; disallowance of deductions for FDIC premiums; modification to the limit on "excessive employee remuneration"; elimination of net operating loss carrybacks; limitation on losses for taxpayers other than corporations; technical termination of partnerships; limitation of

like-kind exchanges; and elimination of separate 338 elections.

### **Senator Continues to Eye a Tax on Services**

Democratic Senator Bob Hertzberg, a vocal proponent of taxing services, pursued the idea again in 2019 and is expected to continue his crusade, after introducing another “spot bill” stating the intent to impose a services tax.

CalTax has long opposed this tax increase, and is on the steering committee of the campaign opposing Hertzberg’s latest proposal.

A [study](#) released last year by the Council On State Taxation (COST) and its affiliate, the State Tax Research Institute (STRI), found that sales taxes on business purchases accounted for 42 percent of total state and local sales taxes in 2017, causing “a number of economic distortions.” Another [2019 study](#), prepared by Dr. Justin Adams of Encina Advisors LLC for the California Foundation for Commerce and Education, concluded that “a sales tax on business services creates a number of problems for the California economy, the most significant of which is compounded cost increases caused by pyramiding.”

### **Newsom Urges Lawmakers to Take Long View of Budget**

Even after the Legislature and governor increased state spending considerably, the state has an estimated \$7 billion surplus available in 2020-21, and nearly \$26 billion in reserve accounts, the nonpartisan Legislative Analyst’s Office (LAO) [reported in November](#).

Newsom proposed a \$209 billion state budget during his first week in office, and urged the Legislature to be prudent and prepare for a possible economic downturn. In this instance, Newsom acknowledged, he sounded much like his predecessor.

The state spending plan did grow, however, as the year went on. The governor increased the budget to \$213.6 billion in his May revision, and in June signed the \$214.8 billion spending plan sent to him by the Legislature. By comparison, the prior budget totaled \$199.6 billion.

Newsom noted that the budget includes Proposition 98 education spending totaling \$81 billion in state and local funds, making public education the top spending priority. The plan contains “the highest amount of money ever put into our K-14 education system,” the governor said.

Near the end of 2019, Assembly Democrats released a 2020-21 budget “[blueprint](#)” that doesn’t explicitly call for increased taxes or fees, and cites the legislative analyst’s recommendation to limit increases to less than \$1 billion in ongoing annual spending and \$4 billion in total annual spending.

This year’s budget process will begin soon, as the governor has a January 10 deadline to submit a budget proposal to the Legislature.

### **“Soak the Rich” Proposal Fades**

The California School Boards Association (CSBA) filed a “soak the rich” ballot initiative late in the year, but withdrew the proposal ([Initiative 19-0023](#)) one day after the Legislative Analyst’s Office [said](#) it could prompt high-income taxpayers to leave the state, resulting in less funding for many public services. Even before the analyst’s report was unveiled, supporters of the split-roll initiative pressured the CSBA to drop the income tax measure, concerned that having two major tax increases on the November ballot would prompt voters to oppose both.

The CSBA initiative proposed three tax hikes: An additional 5 percent corporation tax (3 percent for S corporations) on net receipts over \$1 million, an additional 2 percent personal income tax on income over \$1 million and under \$2 million, and an additional 3 percent personal income tax on income over \$2 million (which would bring California’s top PIT rate to 16.3 percent). While the association dropped its initiative, it indicated that it still plans to lobby the Legislature to approve income tax increases.

### **Visions of Tax and Fee Increases**

During the first year of the 2019-20 legislative session, state lawmakers proposed \$20.4 billion in annual taxes and fees, of which more than \$4.4 billion were signed into law, the nonpartisan California Tax Foundation revealed in its [Tax and Fee Report](#). The approved increases include a renewal of California’s managed care organization tax dependent upon federal approval, two cellphone surcharges and a renewal of a surcharge on electricity ratepayers.

The legislative analyst reported that revenue from the three largest taxes – the personal income tax, sales tax and corporation tax – increased 30 percent from 2012-13 to 2018-19 (in 2018-19 dollars), helping the state achieve its operating surplus and large reserves.

Still, some lawmakers indicated plans to continue pursuing tax increases in the new year. Senator Wieckowski, for example, said he will renew his push for legislation to increase taxes on in-state energy producers via an oil and gas severance tax ([SB 246](#)).

There was one notable exception to the tax-increase trend, as several lawmakers voiced support for efforts to reduce taxes on retail sales of cannabis. Assembly Member Rob Bonta said a tax reduction would “increase tax revenue overall” by encouraging black-market cannabis businesses to become legitimate taxpaying businesses. Later in the year, however, the California Department of Tax and Fee Administration announced an increase in cannabis tax rates.

### **Reviewing Legislative Activity**

One of the biggest tax policy changes enacted by the Legislature and governor was a requirement that online marketplace facilitators collect sales and use tax as outlined in the U.S. Supreme Court’s *South Dakota v. Wayfair* decision ([AB 147](#), Burke, subsequently amended by [SB 92](#), Senate Budget and Fiscal Review Committee).

Among other things, the legislation defines “doing business in California” for the purposes of collecting sales and use taxes as having at least \$500,000 in cumulative sales or deliveries into

California in the preceding 12 months, and defines a “marketplace facilitator” as the retailer selling or making the sale of the tangible personal property sold through its marketplace (thus responsible for collecting and remitting sales and use tax for each transaction). The legislation superseded regulations promulgated by the CDTFA that would have among other things, authorized retroactive tax collections.

Several major tax threats were introduced, but were stopped in the Legislature or vetoed thanks to strong opposition from taxpayers. These measures included:

- A proposed constitutional amendment ([ACA 1](#), Aguiar-Curry) that would have made it easier to pass local taxes by lowering the vote threshold from two-thirds to 55 percent for taxes and bonds that fund infrastructure and housing, and another that would have reduced the vote threshold similarly for local parcel taxes put on the ballot by school districts ([SCA 5](#), Hill).
- A bill that would have applied the False Claims Act to claims, records or statements under the Revenue and Taxation Code, and would have authorized individuals to pursue independent legal action ([AB 1270](#), Mark Stone).
- Legislation ([SB 468](#), Jackson) that would have required the state to create a review board to evaluate business “tax expenditures” – credits, deductions and more – and recommend to the Legislature whether tax incentives should be repealed, modified or continued. An early version of the bill would have eliminated the research-and-development tax credit and water’s-edge election, but the bill was amended due to pressure from CalTax and the business community.
- A bill that would have exempted local governments from placing a statement on the local ballot of the cost of a tax increase if the measure proposed a “tiered tax,” a bond or a tax with a rate structure “that cannot be accurately included in the ballot statement” ([SB 268](#), Wiener).

Some of the measures are eligible to be revived this year, while others would have to be reintroduced in a new form.

With taxpayer support, some tax policy improvements were signed into law, including:

- [SB 790](#) (Senate Governance and Finance Committee), a CalTax-sponsored bill clarifying the circumstances in which the Franchise Tax Board would be required to grant a partnership’s request to make an election different from their federal election to ease state reporting and compliance.
- [SB 92](#) (Senate Budget and Fiscal Review Committee), which in addition to the *Wayfair* provisions contains provisions from [SB 344](#) (McGuire) that streamline appeals for specified taxpayers at the Office of Tax Appeals by allowing those appeals to be heard by one administrative law judge rather than the current three-ALJ panel. Additionally, the bill authorizes a two-year sales and use tax exemption for feminine hygiene products and diapers used by small children.

The Legislature also placed a \$15 billion education bond on the March 2020 ballot.

### **Keeping an Eye on the Legislature**

There were no leadership changes in the Assembly or Senate, but several notable changes occurred:

- Assembly Member Brian Maienschein, a four-term lawmaker reelected in November 2018 as a Republican, reregistered as a Democrat, and former Assembly Republican Leader Chad Mayes filed to run for re-election with no party preference. These actions left the Assembly with 61 Democrats, 18 Republicans and one independent. For items requiring a two-thirds vote, 54 votes are needed.
- The Legislature hired Gabriel Petek as the new legislative analyst. Petek, former credit analyst for S&P Global Ratings and former budget analyst for the city of Boston, succeeds Mac Taylor, who retired after 40 years in the office, including 10 years at the top post.
- Democrat Lena Gonzalez – a member of the Long Beach City Council – was elected to fill a Senate vacancy created when Senator Ricardo Lara was elected state insurance commissioner in 2018.
- Assembly Member Brian Dahle was chosen to fill the vacancy left when Senator Ted Gaines was elected to the State Board of Equalization in 2018. In a special election to fill the vacancy left by Dahle, voters chose his wife, Republican Megan Dahle.
- Republican Senator Jeff Stone resigned November 1 to take a position in the Trump administration.
- Democratic Assembly Member Joaquin Arambula of Fresno took a leave of absence after he was charged with child abuse, and returned to the Capitol after being acquitted by a jury.
- Assembly Member Sabrina Cervantes became the first California legislator in state history to give birth to triplets while serving in office.

### **Local Governments See Growth in Property Tax Revenue**

Property assessments grew 6 percent statewide in 2019, continuing several years of strong growth that translate to steady annual increases in property tax revenue for local government.

In the San Francisco Bay Area counties alone, the value of taxable property grew to \$1.8 trillion – a 6.6 percent increase over last year. In Los Angeles County, Assessor Prang reported “record growth and new all-time highs in real estate and business property values across the county” – growth of 6.25 percent over the prior year, to reach \$1.604 trillion in total net value.

### **CalTax Foundation Publishes New Edition of Tax Chart Book**

In April, the California Tax Foundation published the newest edition of [\*California Tax Facts: An\*](#)



[Overview of the Golden State's Tax Structure](#), an 84-page publication that presents data from the state tax agencies in colorful charts and graphs, and includes descriptions and definitions to help Californians understand the state and local taxes they pay.

## **Courts Take a Look at Local Taxes**

Voters approved 45 of the 55 tax and bond measures on local ballots in 2019.

The most prominent local tax measure was Measure EE, a parcel tax placed on the ballot by the Los Angeles Unified School District and supported by Los Angeles Mayor Eric Garcetti, public employee unions, Governor Newsom and at least four Democratic candidates for president.

On June 4, voters soundly rejected the tax. Measure EE needed approval from at least two-thirds of the voters, but fell 20 percentage points short of passage.

The campaign was funded by unions, several wealthy individuals and businesses that often bid for public works contracts in Los Angeles. Supporters of the measure raised approximately five times more money than opponents.

Along with CalTax, opponents included the Los Angeles Business Federation, the California Business Roundtable, the Howard Jarvis Taxpayers Association, and several others. Opponents argued that the tax would increase the cost of living in Los Angeles and would harm the economy.

The annual parcel tax on properties within the large school district would have been imposed at a rate of 16 cents per square foot of buildings and structures, for 12 years.

Measure EE was altered after being placed on the ballot, without a public vote of the school board. The original wording specified that only "habitable" properties would be subject to tax, but the wording was changed to apply to other properties as well. A legal challenge was made moot by the result of the election.

Additionally, schools and other government agencies improperly used tax dollars to assist the Yes on Measure EE campaign. Schools posted large campaign-style banners, and the mayor and other elected and appointed officials wore large "Measure EE" buttons on their lapels while on the job. Taxpayers are hopeful that the California Fair Political Practices Commission, the state's election and campaign finance watchdog, will crack down on such behavior. In 2019, the commission opened an investigation into claims that San Francisco transportation agencies illegally used tax dollars to campaign for a ballot measure that increased tolls on seven bridges.

An ongoing issue was whether special taxes could be approved without the two-thirds vote required by the state constitution. At the trial court level, judges in different counties disagreed on the issue. The highest-profile ruling occurred in July, when a judge allowed San Francisco to evade the two-thirds requirement for two special taxes, agreeing with the city's interpretation of the 2017 California Supreme Court decision in *California Cannabis Coalition v. City of Upland* to say that a ballot measure initiated by the public is not subject to the vote requirements imposed



by Proposition 218.

The Court of Appeal now will hear the dispute, which involves Proposition C of June 2018 (taxing the lease of commercial property for landlords with annual gross receipts of more than \$1 million, to fund childcare and education) and Proposition C of November 2018: (a gross receipts tax imposed on businesses with more than \$50 million in gross annual receipts within San Francisco, to fund programs relating to homelessness).

Other trial court decisions on the topic included:

- [\*Wayne Nowak v. The City and County of San Francisco\*](#), in which a San Francisco taxpayer is challenging the approval of Proposition G, a parcel tax to fund teacher salaries that received 60.7 percent of the vote in June 2018. Although the measure failed to receive a two-thirds vote, the measure was deemed approved, as City Attorney Dennis Herrera issued a memorandum opining that the *Upland* decision allowed majority-vote approval of special taxes placed on the ballot via an initiative. Although this case has not yet been argued or decided in the San Francisco County Superior Court, a similar case, [\*Howard Jarvis Taxpayers Association, et al. v. The City and County of San Francisco\*](#) was decided in 2019, with the court ruling that a simple majority was sufficient to pass a citizen-initiated measure.
- [\*City of Fresno v. Fresno Building Healthy Communities\*](#), in which the proponents of Measure P, the "Fresno Clean and Safe Neighborhood Parks Tax," argued that the tax could take effect even though only 52 percent of the voters supported it in the November 2018 election. A Fresno County Superior Court judge disagreed, finding that the measure needed a two-thirds vote.
- [\*Howard Jarvis Taxpayers Association, et al. v. County of Yuba, et al.\*](#), in which the Yuba County Superior Court struck down a sales tax increase that was presented to voters as a majority-vote measure but in fact was a special tax requiring a two-thirds vote for passage. Measure K, a 1 percent sales tax increase with revenue earmarked for public safety, garnered just 53 percent of the vote in a November 2018 election.
- [\*Jobs & Housing Coalition v. City of Oakland\*](#), in which an Alameda County Superior Court judge ruled that Measure AA, a parcel tax to fund education, is unenforceable because it didn't receive a two-thirds vote. After the measure failed to receive the two-thirds vote threshold specified by the city attorney, the City Council voted to authorize the measure. "Allowing Measure AA to be enacted with less than two-thirds of the votes would constitute a fraud on the voters," Judge Ronnie MacLaren said, noting that ballot materials prepared by the city "unambiguously advised voters that Measure AA would require two-thirds of the votes to pass."

## Observing the Tax Agencies

### Office of Tax Appeals

The Office of Tax Appeals, launched at the beginning of 2018 to hear income and business tax appeals formerly heard by the State Board of Equalization, ramped up by hiring eight additional administrative law judges to hear cases, and improved its website and video streaming of hearings.

The new ALJs were former Franchise Tax Board attorneys Cheryl Akin, Scott Ewing, Patrick Kusiak, Andrea L.H. Long and Richard Tay; former BOE attorney and OTA tax counsel Josh Lambert; and former CDTFA attorneys Josh Aldrich and Suzanne Brown.

Some of the major appeals in 2019:

- The OTA denied the FTB's petitions to rehear appeals decided by the BOE in 2017 in favor of Nevada inventor Gilbert Hyatt, former National Football League star Keyshawn Johnson and Bank of America.
- The OTA rejected the FTB's narrow interpretation of *Swart Enterprises Inc. v. Franchise Tax Board* (the Court of Appeal ruling that rejected the FTB's broad definition of "doing business" within California for tax purposes), opining that the pro-taxpayer precedent applies broadly ([The Appeal of Jali LLC](#), following up on the late 2018 decision in [The Appeal of Satview Broadband Ltd.](#)).
- The agency heard an appeal on whether the gain from an S corporation's sale of goodwill, recognized by a nonresident personal income taxpayer, should be sourced to California. The hearing for *The Appeal of the 2009 Metropoulos Family Trust and the Evan D. Metropoulos 2009 Trust* was held in late July, but an opinion has not yet been released to the public.
- Under market-based sourcing laws, an Arizona resident who received income from writing screenplays for California-based production companies must pay California tax on the income, the OTA ruled in [The Appeal of Blair S. Bindley](#), marked precedential.
- In several opinions, the OTA rejected the FTB's longstanding interpretation of when a "demand penalty" may be imposed, finding that the tax agency has expanded the penalty by ignoring the plain wording of its own regulation.

In other action, OTA Director Mark Ibele said the agency is working on a process for granting a closed hearing, which is a requirement set forth in legislation ([AB 131](#), Chapter 252, Statutes of 2017). Absent specific circumstances that warrant closing a hearing, oral hearings will be open to the public. The OTA also is implementing the requirements of [AB 92](#), part of the 2019-20 state budget that will allow for one administrative law judge rather than three to decide an appeal. This alternative process is a means to address small cases more efficiently, and will be at the option of the taxpayer.

Ibele also instituted an OTA Advisory Committee made up of members of the taxpayer community, including CalTax Tax Counsel Ben Lee.

## Franchise Tax Board

Governor Newsom appointed Gayle Miller, a Democrat from Sacramento, as chief deputy of policy at the California Department of Finance – a position that placed her on the FTB as a representative of Department of Finance Director Keely Bosler.

## State Board of Equalization

State Board of Equalization Members Ted Gaines (District 1), Malia Cohen (District 2), Tony Vazquez (District 3) and Mike Schaefer (District 4) were sworn in January 7 by Governor Newsom – the first time since 1882 that the agency had a full turnover of the district-elected members.

Cohen was elected chair for the calendar year, and thus served on the FTB. Vazquez is slated to be chair, and the BOE's representative on the FTB, in 2020.

The board hired Brenda Fleming as executive director, a position that holds a great deal of authority over staff and administrative decisions under the 2017 legislation that reconstituted the state's tax agencies.

At the BOE's monthly meetings, board members took extensive testimony from county assessors and BOE staff on various aspects of the property tax system, and continually scrutinized existing procedures to ensure they are as efficient as possible, and fair and understandable for taxpayers. To advance these goals, the board additionally held informational hearings in San Diego and San Jose, and is planning two additional informational hearings for this year.

The BOE also began including a public comment period at every meeting, and updated its website to comply with accessibility requirements.

In November, Schaefer made history by becoming the oldest constitutional officer in state history Schaefer, passing Secretary of State Frank M. Jordan, who was roughly 81 years and seven months old when he died in office.

## California Department of Tax and Fee Administration

Activity at the California Department of Tax and Fee Administration included:

- Robert Tucker was appointed general counsel in September. He had served as the CDTFA's assistant chief counsel since 2017, and previously was assistant chief counsel at the BOE.
- The agency hired William Hain, former manager of the BOE's Compliance and Technology Section, as its new taxpayers' rights advocate and small business liaison.
- Governor Newsom issued an [executive order](#) directing the CDTFA to include nicotine content in the calculation of the existing tax on electronic cigarettes, and to make other changes that he said are intended to reduce youth vaping.

## **Through the Prism of the Courts**

Notable decisions from the courts in 2019 included:

- California's statutory taxing scheme doesn't discriminate against interstate commerce by providing a benefit to in-state businesses that is not available to out-of-state businesses, the Fifth District Court of Appeal ruled in [\*Abercrombie & Fitch Co. et al., v. California Franchise Tax Board\*](#). The taxpayer argued that the Revenue and Taxation Code discriminates against interstate businesses because it allows "intrastate unitary businesses to choose whether to compute their tax using the combined reporting method or the separate accounting method," while interstate companies are required to use the combined reporting method.
- The Franchise Tax Board had immunity from being sued in Nevada by inventor Gilbert Hyatt, the U.S. Supreme Court ruled May 13, overturning an award of damages to the taxpayer after a Nevada jury found the FTB guilty of committing fraud against Hyatt during a residency audit. In its 5-4 decision in [\*Franchise Tax Board of California v. Hyatt\*](#), the high court said the FTB committed "egregious conduct," but found that a state may assert sovereign immunity as a defense against suits filed in another state's courts. The decision overruled a 40-year-old precedent set in *Nevada v. Hall*. The FTB and Hyatt remain in litigation in Nevada, however, over how the Supreme Court's ruling should be implemented.
- The Legislature overstepped its authority in 2016 when it passed legislation allowing the use of tax dollars for political campaigns, the Third District Court of Appeal ruled in [\*Howard Jarvis Taxpayers Association et al. v. Gavin Newsom, et al.\*](#)

### **Unemployment Insurance Fund Surplus a Sight for Sore Eyes**

California's Unemployment Insurance Fund is projected to have a \$3.4 billion balance by the end of 2021, the California Employment Development Department reported. This is good news for employers, as employment taxes automatically increase by billions of dollars a year when the UI Fund is in the red.

### **California in the Rearview Mirror**

California continued to lose businesses to other states in 2019, and observers noted that the state's business climate got worse as this year began, when state and local minimum-wage increases took effect.

The statewide minimum wage increased \$1 per hour (to \$13 for companies with at least 26 employees and \$12 for smaller businesses), and some cities went further.

In Mountain View, for example, the new minimum wage is \$16.05 per hour. Many cities passed laws in 2019 that will increase their mandatory minimum wages this year on July 1.

Another major factor impacting California jobs is a new labor law that took effect January 1. [AB 5](#) (Gonzalez) codifies provisions of the California Supreme Court decision in *Dynamex*

*Operations West Inc. v. Superior Court of Los Angeles*, dramatically redefining the distinction between independent contractors and employees. The law, which has been challenged in court and is targeted by a ballot initiative filed in October, makes it difficult for a Californian to qualify as an independent contractor, thus triggering minimum wage requirements and other laws that apply to employees. On the last day of the year, a federal judge temporarily blocked the provisions from affecting independent truckers after truckers filed a suit earlier in the year.

Additionally, California's gasoline tax increased 5.6 cents per gallon in 2019, bringing state taxes and fees on gasoline to 61.2 cents per gallon – overtaking Pennsylvania as the state with the highest gas tax in the nation. According to the legislative analyst, California's cap-and-trade auction increases the price of gasoline an additional 11 cents per gallon. The federal excise tax another 18.4 cents per gallon to the cost at the pump.

Even before these laws took effect, California had the [third-worst business tax climate](#) in the nation, topping only New Jersey and New York, according to the Washington, D.C.-based Tax Foundation.

There were many businesses that decided to move jobs to other states, including:

- Mitsubishi Motors North America moved its U.S. headquarters from California to Tennessee, resulting in the loss of approximately 200 California jobs.
- Uber Technologies, headquartered in San Francisco, is opening an office of at least 3,000 employees in Dallas, Texas.
- Charles Schwab, which has been headquartered in San Francisco since its founding, is moving its home office to Westlake, Texas.
- Lending Club is moving 350 jobs from San Francisco to Utah.
- Berkley International, a company founded in Carson, California, broke ground on an 82,000-square-foot manufacturing facility near Reno, Nevada.

California's high taxes also influence individual decisions, as illustrated by a comment from baseball star Bryce Harper's agent, who said state income tax was a factor in Harper's decision to sign with the Philadelphia Phillies – the largest contract in baseball history, at \$330 million over 13 years – rather than the San Francisco Giants.

### **Feds Won't Turn Blind Eye to SALT Workarounds**

In June, the U.S. Department of the Treasury issued final rules preventing "charitable contributions" made in exchange for state tax credits from circumventing the \$10,000 limit on state and local tax deductions.

The Tax Cuts and Jobs Act of 2017 placed the \$10,000-a-year limit on SALT deductions. Some lawmakers in California and other states responded with various proposals to allow taxpayers to

“donate” funds to schools and other government agencies in return for state income tax credits – thus providing the same revenue to the state and the same impact on the taxpayers’ wallets for state tax purposes, but allowing taxpayers to deduct the full amount of “contributions” for federal tax purposes.

### **On the Lookout for Government Waste**

Unfortunately for taxpayers, 2019 was another big year for government waste and mismanagement.

Examples included:

- A managed care plan in San Joaquin County spent more than \$103,300 in taxpayer funds to provide coffee for its employees from 2015 to 2018 – one of several “questionable expenditures” uncovered by the state auditor.
- The California Lottery spent more than \$240,000 on unallowable costs and \$64,000 on questionable spending from July 2014 through June 2018, State Controller Betty Yee [found](#).
- Ten state agencies reviewed by the state auditor cumulatively wasted more than \$20 million by buying workers’ compensation insurance that was more expensive than necessary, the [auditor reported](#) November 21.
- The city of Los Angeles spent approximately \$150,000 on security cameras, then left the equipment sitting idle in a storage cabinet, investigative reporter David Goldstein discovered.
- The California Department of Fish and Wildlife spent \$5.7 million in fee revenue inappropriately, the state auditor [reported](#).
- The Oakland Unified School District spent \$600 for a car wash – and the car never got washed.