News and Analysis From the California Taxpayers Association

Vol. VII, No. 19 May 17, 2024

IN THIS ISSUE:

State Budget:

Governor Proposes $18 Billion Business Tax Increase to Reduce Budget Deficit

Governor Gavin Newsom unveiled his May budget revision May 10, presenting a 2024-25 plan with provisions that cumulatively represent an $18 billion tax increase on California businesses over four fiscal years.

Newsom's budget (detailed in proposed budget trail bill language released May 15) proposes to reverse a recent Office of Tax Appeals ruling – resulting in a tax increase – and revive the net operating loss and tax credit limitations used in the past to address budget deficits.

In a report released this morning, the Legislative Analyst's Office advised lawmakers that the governor's plan would "lead to a less equitable tax system" and increase taxes on California businesses approximately $2 billion in 2024-25, increasing to more than $5 billion annually in future years.

Over the three years during which NOL deductions and tax credits would be limited, these and other tax increases would total approximately $18 billion.

Corporate Tax Increase on Foreign Dividends

The OTA's unanimous decision in the *Appeal of Microsoft*, regarding the treatment of foreign dividends included in a taxpayer's apportionment formula, decided a long-running dispute between taxpayers and the Franchise Tax Board, concluding that the FTB has

David Kline, Editor
California Taxpayers Association
1201 K Street, Suite 1600, Sacramento, CA 95814

applied the law incorrectly. The governor's budget summary characterizes the proposed apportionment change as a "clarification of existing law that when a corporation receives income that is excluded from taxable business income, it must exclude this income from its apportionment factor."

As written, Newsom's proposal would apply retroactively as well as prospectively, to taxable years "beginning before, on, or after the effective date of this bill."

Labeled on the Department of Finance website as an "apportionment factor fix," the proposal also includes a statement of legislative intent that it "does not constitute a change in, but is declaratory of, existing law." Additionally, the bill would authorize the FTB to bypass the Administrative Procedure Act when developing regulations, rules, notices, "or any other guidance" pursuant to the legislation.

A Senate budget subcommittee heard testimony on the proposal May 16 but did not vote. The panel's analysis includes this fiscal impact estimate: "The FTB estimates that, without action, around $1.3 billion in refunds are at risk based on similar tax filings from prior years, and there are additional annual prospective refunds of around $200 million due to lower apportionment factors for multi-state and multi-national firms." (**CalTax:** The statement that "refunds are at risk" is misleading. As the OTA correctly ruled, the refunds are required by law. The only "risk" is to companies that were forced to overpay their corporate taxes and then fight for refunds, and now face the additional hurdle of an after-the-fact legislative change designed to allow the state to keep the money.)

Suspension of the NOL Deduction and Limitation on the Utilization of Tax Credits

Newsom proposed prohibiting businesses with annual revenue in excess of $1 million from deducting their net operating losses and limiting usage of business tax credits to $5 million for the 2025, 2026, and 2027 tax years.

The proposal includes a provision to revert back to the current NOL and tax credit laws if cumulative cash receipts from the state's "big three" taxes – the personal income tax, corporate income tax, and sales and use tax – exceed the 2024-25 budget act's forecast by 3 percent or more from May 2024 to April 2025.

The result of these proposals: tax increases estimated by the state to be $900 million in 2024-25, increasing dramatically to $5.5 billion in 2025-26.

The Legislative Analyst's Office warned lawmakers that suspending the NOL deduction would undermine the deduction's positive effects on the state's economy.

"Typically, when a business experiences a NOL, it is allowed to carry forward these NOLs and deduct them from their income in future years," the analyst wrote. "This allows businesses to smooth profits and losses such that businesses with similar profits over time pay similar taxes. Without this smoothing, businesses in riskier or more innovative industries – such as the technology, motion picture, and transportation sectors – could end up paying more taxes than businesses with similar but more stable profits. As such, suspending NOL deductions would lead to a less equitable tax system. While the suspension of NOL deductions has been a go-to budget solution for decades, the frequency at which this approach has been used is now starting to raise questions. Should the Governor's proposal take effect, the state will have disallowed NOL deductions in nearly half of [the] years between 2008 and 2027. At this rate, it seems reasonable to ask whether suspensions have begun to meaningfully undermine the purpose of allowing NOL deductions in the first place."

Elimination of the Bad Debt Sales Tax Deduction

The governor additionally proposed to eliminate the bad debt sales tax deduction for a lender or retailer's affiliate – a tax increase estimated by the Department of Finance to be approximately $25.3 million in 2024-25, increasing to $50.6 million per year beginning in 2028-29.

Corporate Tax Rate Increase and Other Tax Increases Under Consideration?

During his May 10 press conference, Newsom repeatedly stated that he does not support "general tax increases." At one point, he expressed frustration that reporters continued to ask him about taxes after his numerous statements of opposition.

Asked specifically why he isn't proposing an increase in California's corporate tax rate, Newsom said: "When considering the 8.84 percent corporate tax – which is the highest, arguably, depending on how you analyze it, in the country – no, I'm not prepared to increase taxes. We have among the highest tax rates in the United States of America for high wage earners, we have among the highest tax rates, as I noted, for corporate taxes. … I feel strongly that we have to live within our means."

To address revenue volatility, Newsom unveiled a proposal to establish a new budget account to capture "excess revenue" from capital gains and limit appropriations until that revenue materializes.

Other Budget Provisions

The governor's revised budget calls for $288.1 billion in total spending, down from the $291.5 billion that Newsom proposed in January, and significantly down from the $310.8 billion approved last year for the 2023-24 budget despite many indications that it was not sustainable relative to the state's revenue.

TAX INCREASE	2024-25	2025-26	2026-27	2027-28	TOTAL
Bad Debt	$25,300,000	$50,600,000	$50,600,000	$50,600,000	$177,100,000
Energy	$22,000,000	$17,000,000	$17,000,000	$17,000,000	$73,000,000
Foreign Dividends	$1,300,000,000	$200,000,000	$200,000,000	$200,000,000	$1,900,000,000
Suspension of NOL Deduction / Credit Limitation	$900,000,000	$5,500,000,000	$5,900,000,000	$3,600,000,000	$15,900,000,000
TOTAL TAX INCREASE IN 2024 MAY REVISE					**$ 18,050,100,000**

California State Budget Changes (in billions)			
Fiscal Year	January Proposal	May Revision	Enacted in June
2018-19	$190.3	$199.2	$201.4
2019-20	$209.1	$213.5	$214.8
2020-21	$222.2	$203.3	$202.1
2021-22	$227.2	$267.7	$262.5
2022-23	$286.4	$300.7	$307.9
2023-24	$296.9	$306.4	$310.8
2024-25	$291.5	$288.1	TBD

Newsom pegged the deficit at $27.6 billion for 2024-25 (after adjusting for $17 billion in "early action" items signed into law in April) and $28.4 billion in 2025-26.

The budget calls for using approximately $21.5 billion from state reserves and cutting approximately $32.8 billion in spending over two years – including $19 billion that was appropriated for new spending in recent years but hasn't been spent yet, and now will be withdrawn.

Newsom also wants to eliminate 10,000 state positions that currently are not filled – part of what his office described as making California government "more efficient, leaner, and modern – saving costs by streamlining procurement, cutting bureaucratic red tape, and reducing redundancies."

The Legislature has until June 15 to approve a budget bill or forfeit their pay until a budget is passed.

Senate Appropriations Committee:

Digital Advertising Tax and Carbon Tax Measures Advance to Senate Floor

The Senate Appropriations Committee approved a digital advertising tax (SB 1327, Glazer) and a carbon tax on California businesses (SB 1497, Menjivar) on May 16, sending both to the Senate floor.

The committee narrowly approved Senator Steve Glazer's digital ads tax legislation. The bill initially fell short of the majority vote needed to clear the seven-member committee and was placed on call until the end of the hearing, when it finally was approved with a 4-2 tally.

Democratic Senator Steven Bradford cast the deciding vote, but only after making it clear that he was doing so to allow the author more time to address his "great concerns regarding this measure."

SB 1327 would impose a tax of 7.25 percent of the taxpayer's revenue for digital advertising services in California on businesses with at least $2.5 billion in such revenue and would use the revenue to fund tax credits for journalists. Glazer has estimated that the tax – which he characterizes as a "data extraction mitigation fee" – would cost taxpayers roughly $1 billion per year.

CalTax is leading a coalition opposing the bill, noting that if the tax were to survive legal challenges over its violations of federal law and the U.S. Constitution, it would harm the economy by increasing advertising costs for small businesses.

The chair of the Appropriations Committee announced that the bill will be amended to "define terms and make clarifying changes, modify funding allocations, and add coauthors." The amendments are expected to be in print within days.

The committee also approved Senator Caroline Menjivar's SB 1497, which would establish a tax, ostensibly to recover past and future climate costs, to raise revenue for programs directed toward "disadvantaged communities" and "strategies to increase employment opportunities and improve job quality." While SB 1497 is dubbed the "Polluters Pay Climate Cost Recovery Act" and describes the charge as a "cost recovery demand," it is a tax under state law.

"Given the state's large deficit, the Legislature should explore ways to stimulate economic growth to generate additional tax revenue under the current tax structure, and should be especially wary of creating new programs or burdening the economy with unnecessary new taxes," CalTax wrote in a letter of opposition.

SB 1497, which previously cleared two policy committees, was approved on a party-line vote.

In other action by the committee:

Committee Approves Bay Area Tax Increase Measure. SB 1031 (Wiener), a CalTax-opposed bill authorizing additional local taxes in the nine-county San Francisco Bay Area, was approved with a 5-2 party-line vote, with Democrats in support and Republicans opposed.

Committee Approves Bill Giving Unemployment Insurance Benefits to Striking Employees. SB 1116 (Portantino), allowing striking employees to qualify for unemployment insurance benefits, was approved with a 5-2 party-line vote, with Democrats in support and Republicans opposed.

Wildfire Payment Exclusion Advances. SB 946 (McGuire), authorizing an income exclusion for amounts received as a California qualified wildfire loss mitigation payment, was approved unanimously.

Tax Credit for Fire-Prevention Expenses Is Held by Committee. SB 952 (Dahle), authorizing an income tax credit for specified amounts spent to reduce a home's fire risk, was held by the committee.

Property Tax Assistance Measure Is Held by Committee. SB 1013 (Bradford), offering property tax assistance for descendants of enslaved persons, was held by the committee.

Budget Transparency Bill Stalls in Committee. SB 1114 (Niello), requiring state agencies to make specified budget and personnel disclosures on their websites, was held by the committee.

Assembly Appropriations Committee:
Single-Payer Health Care Bill Held in Committee

Legislation proposing a government-run single-payer healthcare system in California, requiring hundreds of billions of dollars' worth of new taxes, died May 16 when it was held by the Assembly Appropriations Committee (AB 2200, Kalra).

CalTax was part of a very large coalition of opponents. In a letter to lawmakers, the coalition noted that AB 2200 "would create a new and exorbitantly expensive government bureaucracy, which would control and finance a state-run health care system (CalCare), ultimately resulting in significant economic disruption, uncertainty, and job loss in California."

The legislation did not include any tax increases to fund the expansion of government, but included provisions stating that the new healthcare system would not take effect until the system "has the revenues to fund the costs of implementing the act." The additionally stated the Legislature's intent to "develop a revenue plan" that would take into consideration the anticipated federal dollars that would be available for the system.

The author of the bill, Assembly Member Ash Kalra, said he is "deeply disappointed the Assembly Appropriations Committee failed to recognize the significant cost-saving potential of AB 2200."

"No cost estimates are available for this bill," the Assembly Appropriations Committee's analysis stated. The analysis indicated that the new healthcare system would cost the taxpayers from $392 million, but claimed that the overall cost of healthcare would be "lower than overall spending under the existing system" because Californians' payments to private insurers would be eliminated.

"We fundamentally disagree that government systems are more efficient than private businesses and that a single-payer system would be less costly than the current private system," the coalition of opponents wrote in response.

In other action by the committee:

ACA 1 Implementation Measure Approved Despite Costs. AB 2813 (Aguiar-Curry), making various changes to ACA 1, a constitutional amendment that would lower the vote threshold for special taxes if approved by voters in the November election, was approved with an 11-4 vote and now goes to the Assembly floor. Opponents argued that the intent of the bill "is to further the purposes of ACA 1, which repeals one of the most important protections in Proposition 13 by lowering the existing two-thirds vote threshold for both local bonds and special taxes to 55 percent for a myriad of purposes."

The committee's analysis noted that the bill would create "estimated local costs of an unknown amount, but potentially significant statewide, to local agencies to appoint and support a citizens' oversight committee."

"This bill requires a local government to, without expending proceeds derived from the ACA 1 bonded indebtedness or ACA 1 special taxes, provide the citizens' oversight committee with necessary technical assistance and administrative assistance in furtherance of its purpose and sufficient resources to publicize the conclusions of the citizens' oversight committee," the analysis continued. "These costs are likely not reimbursable by the state unless otherwise determined by the Commission on State Mandates."

Committee Nixes Measure Disallowing Deduction on Second Homes. AB 1932 (Ward), disallowing the mortgage interest deduction for second homes, was held by the committee.

Tax Relief for Student Loans Stalls in Committee. AB 2312 (Wallis), doubling (from $2,500 to $5,000) the limitation on the above-the-line personal income tax deduction for interest paid on a student loan, was held by the committee. This bill is opposed by the union-affiliated California Tax Reform Association, which argued that the bill would "disproportionately benefit" higher-income individuals "regardless of what type of degree they held, whether they went to a public or private university, and whether they work in a specialized or public service field."

Extension of CAEATFA Exclusion Is Held by Committee. AB 2400 (Luz Rivas), extending the sunset date of the sales and use tax exclusion for certain manufacturing and clean-energy projects administered by the California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA), was held by the committee. The bill would have extended the exclusion's expiration date from January 1, 2026, to January 1, 2031.

Assessors:

Los Angeles County Assessment Roll Expected to Top $2 Trillion, Prang Reports

Los Angeles County Assessor Jeffrey Prang reported May 15 that the county's assessment roll is anticipated to increase approximately 4.75 percent over the 2023 value, marking 14 consecutive years of growth and breaking the $2 trillion mark for the first time.

Prang's report to the Los Angeles County Board of Supervisors noted that the data is preliminary and that "there are several factors that are subject to change as my staff continues to work diligently to process all assessable values and exemptions prior to roll closure." The assessment roll is due July 1, but Los Angeles and many other counties typically request 30-day extensions due to the size and complexity of the job of valuing every locally assessed property in the county.

A preliminary report is typical in Los Angeles, as the number provides an estimate that the Board of Supervisors can use when preparing the county's annual budget.

"It has been a challenging few years as the local and national economies respond to a variety of factors, whether it be residential or commercial," Prang said. "Our analysis indicates that property values are going to grow for the 14th consecutive year, which is good news for property owners and for local government because they rely on property taxes to pay for vital public services. However, sales volume declined significantly in 2023 and commercial properties, especially downtown Los Angeles, have actually experienced huge declines in value."

Changes in ownership are projected to contribute the most to 2024 growth, adding more than $51.8 billion in value (more than half of the 4.75 percent growth). The inflation adjustment mandated under Proposition 13, and set at the maximum 2 percent for this year, is the second-most significant factor, adding an estimated $39 billion to the roll. New construction is next, adding an estimated $6 billion.

On the other side of the ledger, decline-in-value reassessments removed an estimated $2.1 billion from the roll.

The $2.09 trillion estimated total net value translates into more than $20 billion in property tax dollars for the county government, including public education, first responders and healthcare workers.

Waste, Fraud & Mismanagement:
Many Departments Drastically Exceed Overtime Budgets, San Francisco Controller Reports

Several departments within San Francisco's local government have drastically exceeded their budgets for overtime work – with one agency 1,367 percent above its overtime budget – the controller of the consolidated city and county reported May 14.

The controller's Nine-Month Budget Status Report shows that while the city as a whole is slightly under its overtime budget (at 91 percent of the budgeted amount through April 27, with roughly two months left in the fiscal year), overtime spending is running at 1,367 percent of the budgeted amount in the City Attorney's Office, 623 percent in the retirement department, and 235 percent within the Board of Supervisors.

Overtime is exceeding the budget by 151 percent in the Municipal Transit Agency, 149 percent in the airport, 129 percent in Public Works Department's "annual operating funds" category, 272 percent in the juvenile probation department, 228 percent for port workers, and 144 percent in the District Attorney's Office.

At the other end of the spectrum, the Controller's Office had the lowest overtime usage, at 9 percent of the amount budgeted for the year.

suggestions for changes in writing by June 12. The document includes details on how comments should be sent.

Tax Trivia:

How Many Current Lawmakers Were Alive When UDITPA Bill Was Signed?

Governor Gavin Newsom recently proposed a measure purporting to be "declaratory of existing law" (Revenue and Taxation Code section 25120) with regard to what receipts are included in the sales factor for water's-edge taxpayers, overturning an Office of Tax Appeals ruling. How many of California's current 120 lawmakers were alive in April 1966, when Governor Pat Brown signed the statute whose legislative intent would be "clarified" by the new proposal?

a. 22
b. 32
c. 42
d. 52
e. 62

(Answer on the last page.)

Blast From the Past:

Approaching End of 1937 Session, Legislators Consider 'Gin Marriages' and Other Issues

"California's legislature started the 12th week of its spring session today facing action on a handful of controversial issues and 1,000 or more bills which meant little to the average person. Methods of settling labor disputes, liberalization of old age pensions, a renewal of the fight on tideland oil drilling, creation of a bureau to control venereal diseases, changing the administration of unemployment relief, legalization of dog racing, repeal of the three-day 'gin marriage' law and scores of appropriations bills were outstanding among the measures remaining to be considered. With May 28 set as the adjournment date, each house hoped to clean up its own bills this week."

> — *Marysville Appeal-Democrat*, May 17, 1937. "Gin marriage" laws were approved in many states during the Prohibition era to require a waiting period between getting a marriage license and marrying. California's three-day waiting period was signed into law in 1927 and repealed in 1943 – after a string of failed attempts dating back to immediately after the law took effect. The California Jewelers Association, formed in 1933, was a strong advocate of repealing the law. A May 14, 1943, editorial in *The Ripon Record* called the law "another great experiment [that] has found to be wanting," and added: "Nevada law makers had more brains and used them to her own great advantage when she saw her chance to clean up on license fees, marriage ceremonies and hotel bills, which should have gone into our own treasury."

Tax Trivia Answer: c. 42. The existing legislation (AB 11, Petris, Chapter 2 of the Statutes of 1966) was described in the Franchise Tax Board's 1966 Annual Report as "the most important piece of corporate tax legislation enacted in recent years."

CONTACT US

Robert Gutierrez
President & CEO

David Kline
Vice President of Communications & Research

Peter Blocker
Vice President of Policy

Joan Armenta-Roberts
Sales Tax Consultant

Bart Baer
Chief Tax Counsel

Lexey Chandler
Associate Director of Membership & Operations

Tobias Wolken
Policy Advocate

Annie Lor
Publications & Website Specialist