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A Brief History of Major Tax Changes in California, 1979-2015

As Originally Produced for

California State Controller Betty T. Yee

& the Controller's Council of Economic Advisors on Tax Reform

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Executive Summary

Since the passage of Proposition 13 in 1978, California has made frequent incremental changes on taxation while relying heavily on personal income tax, and sales and use tax for state revenues.

Any increase or decrease in these taxes directly affects state revenues. Subsequently, the financial health of California relies disproportionately on these two taxes. In years of surplus, the state often increased tax credits and exemptions. In years of deficit, legislators increased tax rates and fees, shifted property tax dollars from cities, counties, and special districts to schools, and found creative ways to negotiate an ongoing structural deficit.

Since 1979, there has not been a major reform of California's tax system, despite a widely acknowledged need that a major overhaul is needed to address the state's bust and boom cycles that lead to structural deficits and revenue surpluses. However, frequent incremental tax change has happened in the decades since Proposition 13 passed, and policymakers and voters have repeatedly played important roles in these changes.

Voter led efforts changed gift and inheritance taxes and indexed personal income tax brackets. At the ballot box, Californians allocated fees to counties and cities, established minimum levels of state funding for schools and community college districts, and taxed tobacco and truck weight. They even changed the approval process for general and special taxes. These changes, and many others, balanced the yearly budget and offered Californians a voice about what is taxed and how.

The Legislature has considered more than 4,600 bills concerning taxation in the last two decades—an average of 245 bills a year. The Assembly took up almost two thirds of these proposals and half of them sought to change personal income tax collections. The number of proposals submitted each year, however, has declined. From a 1995 high of 368, the number of bills introduced dwindled to 85 by 2013.

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A Brief History of Major Tax Changes in California, 1979-2015

Since 1995, the California Legislature has considered more than 4,600 bills concerning taxation. On average, policymakers review 245 bills per year that propose changing the way Californians are taxed. The majority of these bills are considered in the Assembly (62 percent).

Over time, the yearly number of tax bills has declined from 368 bills in 1995 to just 85 in 2013. Personal income tax bills are the most prevalent (2,361; 50 percent), followed by property tax (804; 17 percent) and sales tax (768; 16 percent).[1]

In California, state tax collections are the primary source of state revenue. Two particular taxes, sales and use tax, and personal income tax, historically comprise and account for the majority of all tax revenues collected.[2] The central relationship of these two taxes to the financial health of California means that any change in them may increase or decrease state revenues, and may affect the quality of life for all Californians.[3]

While there have been proposals to reform the state tax system,[4] during the period this history attempts to cover there has not been a successful major reform. According to one scholar, "everyone agrees that tax reform is needed; it's just that they differ on how the tax system should be changed."[5]

Consequently, despite the "push and pull of the marketplace of ideas"[6] about the subject of tax reform, this 36-year history is left with "only minor tweaks to talk about"[7] and offers a summary of those proposals for change successfully enacted by the Legislature or the voters.

Prepared at the request of State Controller Betty Yee, this document presents a brief history of major tax changes in California from 1979 to 2015.[8]

[1] These numbers are from a preliminary review of CalTax data and are most likely understated due to the incomplete categorization of the dataset.

[2] Research suggests that states that seek to pursue an ultimately stable course must include in their revenue streams both a retail sales tax and an income tax. See Herwig Schlunk, "Why Every State Should Have an Income Tax (and Retail Sales Tax, Too)," *Mississippi Law Journal* 78, No. 3 (Spring 2009) 637-703, included in California Research Bureau's Annotated Bibliography – Fiscal Policy and Revenue Structure (Oct. 2015).

[3] John Decker (2009), *California in the Balance: Why Budgets Matter*. Berkeley: Berkeley Public Policy Press, p. 53. Research into the relationship between state fiscal policy and economic performance suggests that the effects of such policies on personal income tax will be contemporaneous. See Victor Canto and Robert I. Webb, "The Effect of State Fiscal Policy on State Relative Economic Performance," *Southern Economic Journal,* 54, No. 1 (July 1987) 186- 202, included in California Research Bureau's Annotated Bibliography – Fiscal Policy and Revenue Structure (Oct. 2015).

[4] Concerning California's tax history, there have been two successful tax commissions which charted major reforms (1906, 1929) and two dramatic changes that took place outside of commissions: the Riley-Stewart initiative (1933) and Proposition 13 (1978). More recently, the California Commission of the 21st Century (2009) made some key recommendations but was not seriously considered. See Steven M. Sheffrin, "Tax Reform Commissions in the Sweep of California's Fiscal History, *Hastings Constitutional Law Quarterly*, Vol. 37, No. 4, Summer 2010, pp. 661-688.

[5] Kirk J. Stark, "Houdini Tax Reform: Can California Escape its Fiscal Straitjacket?." *California Policy Options*, 2011. p.1.

[6] John Decker, phone communication. October 2, 2015.

[7] Darien Shanske, Professor of Law, University of California, Davis, email communication, November 2, 2015. Professor Shanske does, however, identify three broad points about tax reform throughout the time period that may be relevant for the reader to consider: (1) the integration of the post-Proposition 13 state public finance system around education; (2) the consistent earmarking of revenue that serves as "piecemeal reform to earmark more and more of the state budget"; and (3) the continued decline, over time, of the sales tax and the corporate income tax.

[8] The primary published resource relied upon for the preparation of this brief history is David R. Doerr (2000, 2008), *California's Tax Machine: A History of Taxing and Spending in the Golden State*, Sacramento: California Taxpayers Association. Because understandings of the term "reform" can be different depending upon one's perspective, we use the phrase "major tax changes" to factually describe adjustments made to the tax structure over time that were the result of the budget process, legislation or voter approval.

1979

In the year immediately following the adoption of Proposition 13 on June 6, 1978,[9] policymakers reduced taxes, negotiated a repeal of the inventory tax, engaged in regulatory reform and nurtured the beginning changes to the way the state taxes multinational businesses, eventually to be known more commonly as unitary reform. Voters also played an active role in fiscal change. Passed in a special election (74 percent), Proposition 4 (1979) added Article XIIIB to the California Constitution. [10] This measure established and defined annual appropriation limits on state and local governmental entities based on annual appropriations for the prior fiscal year. Requiring adjustments for changes in cost of living, population and other specified factors, any revenues the (state and local government) received in excess of appropriations permitted were to be returned to taxpayers by revision of tax rates or fee schedules within the two following fiscal years. At the time, experts could not estimate the expected revenue impact of the measure, but they believed that the financial impact depended on whether state and local governments would have access to other appropriations that were not subject to the limitations of the measure.[11]

1980s

Throughout the early 1980s, policymakers maintained a careful balance between revenues and expenditures due to the expected uncertainties from implementing Proposition 13. Additional legislation ensured the continued shift of property taxes to aid local governments on a proportional basis, using an apportionment formula that allocates countywide property taxes to the various county jurisdictions.[12]

During the 1981 budget year, legislators repealed a major package of tax subsidies, and instead of shifting property tax revenues back to schools, they initiated an effort to recapture taxes on business personal property, boats, berths, and possessory interest in space from local government. They increased the gas tax and passed legislation accelerating revenue collections. The recession that began in 1981 continued into 1982, and as voters passed additional inheritance tax relief (Propositions 5 and 6) and partial indexing of state personal income tax (Proposition 7), policymakers negotiated accelerated sales tax collections to increase revenues.

Proposition 5 (1982) amended the tax code to repeal statutes governing gift and inheritance taxes. Expressly prohibited by this measure, gift and inheritance taxes would only be allowed as a state "pickup" tax on decedents' estates at rates set by a schedule of credits for state death taxes in conformity with the Federal tax code. The Legislature was required to provide for both the collection and administration of the "pick up" tax. Voters approved the measure (62 percent) in a primary election.[13] At the time, it was estimated that the measure would reduce state inheritance and gift tax revenues by about $130 million in the current budget year, by $365 million in the subsequent year, and higher amounts in the years after that. Analysts believed that repealing the gift and inheritance taxes would save the state approximately $6 million annually in administrative costs.

[9] For a review of the historical patterns and potential full effects of Proposition 13, see Fred J. Silva and Elisa Barbour. *The State-Local Fiscal Relationship in California: A Changing Balance of Power* (San Francisco, CA: Public Policy Institute of California, 1999), included in California Research Bureau's Annotated Bibliography – Fiscal Policy and Revenue Structure (Oct. 2015).

[10] The measure was supported by Paul Gann, the coauthor of Proposition 13, and Carol Hallett, Assembly Minority Leader and Member of the Assembly, 29th District. It was opposed by the California Tax Reform Association, League of Women Voters of California, and California Labor Federation, AFL-CIO.

[11] Limitation of Government Appropriations California Proposition 4 (1979). http://repository.uchastings.edu/ca_ballot_props/864. Accessed 10/5/15.

[12] Terri Sexton, California State University, Sacramento, email communication. October 23, 2015.

[13] The measure was opposed by the League of Women Voters of California; California State Parent Teachers Association and California Gray Panthers.

However, any resulting reductions in state revenue from these expected savings would result in corresponding reductions in the amount of fiscal relief provided by the state to local governments and schools. [14]

A second initiative aimed at gift and inheritance taxes also passed in 1982. Opposed by the same group that opposed Proposition 5, Proposition 6 (1982) amended the tax code to allow for the "pickup" tax on decedents' estates to be measured by the maximum credit against federal estate taxes allowed by federal law. Further, the combined federal and state estate tax liability could not exceed the federal tax liability for property located in California if a state tax was not imposed. Supported by members of the Assembly, Senate, and the Senate Finance Committee, this measure was passed by voters (64 percent). Estimates prepared by the Legislative Analyst concerning this measure were the same as those for Proposition 5.[15]

Passed by 64 percent of voters in a primary election, Proposition 7 (1982) made possible the partial indexing of state personal income tax. Amending the tax code to allow for graduated state personal income tax brackets, these brackets would then be adjusted annually by applying an "inflation adjustment factor" determined by the percentage change in the California Consumer Price Index. While at the time the full percentage change was applied to selected brackets on a temporary basis, in the current year and going forward percentage changes in excess of three percent would be utilized. The measure was expected to reduce state personal income tax revenues by about $230 million in the current year, twice that amount in the next year, and increasing amounts in the future. Under existing law reductions in revenue would reduce fiscal relief provided to local governments and schools. [16]

In 1982, the Legislature reduced tax subsidies to local government. To balance the budget and ease the decline toward a deficit, legislators used one-time revenues, non-resident taxation, and a ridesharing tax credit. Tax increases, expenditure reductions, and revenue accelerations were measures discussed to mitigate declining revenues and turn the state around in 1983. The budget compromise bill that year included a "carry-forward" of a portion of the deficit, short term borrowing, and further reductions in tax subsidies to local government.

Further efforts in 1984, such as expenditure freezes and reductions, balance transfers from general fund to special funds, another "carry-forward" of the deficit, authorization of short term borrowing, and even more reductions in local government subsidies helped bring the budget back into significant balance and ensure a small surplus. Additionally, a set of supplemental reforms continued this positive trend, including: expenditure reductions and reversions to the General Fund, an increase in the corporate estimated payment percentage, accelerations of collection of withholding receipts from employers, and sales tax prepayments.

Legislators undertook renewed efforts toward federal conformity, closing loopholes, and enacted a trigger mechanism to conditionally increase sales tax.

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[14] Gift and Inheritance Taxes (Proponent Miller). California Proposition 5 (1982). http://repository.uchastings.edu/ca_ballot_props/899. Accessed 10/5/15.

[15] Gift and Inheritance Taxes (Proponent Roger). California Proposition 6 (1982). http://repository.uchastings.edu/ca_ballot_props/901. Accessed 10/5/15.

[16] The voters had a second chance to index personal income taxes to the California Consumer Price Index in 1982. Whereas a similar effort had failed in 1980 (Proposition 9), this revised measure was presented to the electorate for their consideration a couple of years later in 1982. Major support for Proposition 7 came from Howard Jarvis and the Index the Income Tax Committee, the Lieutenant Governor, and a member of the senate. Major opposition came from a group named Californians for a Fair Index, a mathematics professor at California State University, and an assemblymember. Income Tax Indexing. California Proposition 7 (1982). http://repository.uchastings.edu/ca_ballot_props/903. Accessed 10/5/15.

As school finance started to become a more prominent issue, legislators took the following measures:

- Increased the sales tax rate;
- Repealed the candy sales tax exemption;
- Made additional efforts to close loopholes;
- Reduced and repealed numerous personal income tax credits and deductions;
- Accelerated remittances for property tax collections;
- Continued efforts at unitary tax reform;
- Evaluated tax amnesty;
- Developed enterprise zones;
- Considered a flat tax.

Unlike earlier years, there were no budget deficits in the mid-to late 1980s. During this brief 7-year span of positive revenues, policymakers focused on unitary tax and property tax assessment reforms. However, hitting the appropriation limits toward the end of the decade meant tax refunds and school finance again became the primary focus. A couple of key propositions enacted important tax changes in 1986: Proposition 47 and Proposition 62.

Passed with 82 percent of the vote in a primary election, Proposition 47 (1986) changed the California Constitution to provide for the allocation of vehicle license fee taxes to counties and cities.[17] At the time, the state was not required by the Constitution to allocate all revenue from vehicle license fee tax to local governments, only specified portions of the revenues. This measure now required all revenues from these taxes to be allocated to counties and cities, with limited exceptions. The measure was expected to have no direct fiscal effect. Rather, it prevented the Legislature from changing the law to take any portion of vehicle license fees away from counties and cities. However, the state still could reduce other forms of aid to local government or change the existing formula for dividing vehicle license fee revenues between counties and cities.[18]

Proposition 62 (1986) added sections to the government code restricting new or increased taxation and revenue use by local governments and districts. Proposition 62 garnered 58 percent of the vote in a general election and required the following process with regard to taxes: approval by two-thirds vote of legislative body, submission of proposed tax to electorate, and approval by majority of voters concerning the imposition of special taxes, defined as taxes for special purposes. This measure featured language governing election conduct. It was believed that the measure could potentially result in the reduction of tax revenues to local agencies.[19]

Despite a lack of yearly budget deficits, economic volatility,[20] that is, the effect of increases and decreases in revenues, led legislators during this time to establish more rigidity in the budget process to mitigate the volatility. In 1987, to avoid slipping into deficit spending and balance the budget, the notion of

[17] The measure was supported by the California Taxpayers' Association, Santa Clara County President of the California State Sheriffs' Association, and a senator.

[18] Allocation of Vehicle License Fee Taxes To Counties And Cities. California Proposition 47 (1986). http://repository.uchastings.edu/ca_ballot_props/952. Accessed 10/5/15.

[19] The measure was supported by Howard Jarvis and the California Tax Reduction Movement; Deputy Assessor of Los Angeles County, and a senator. It was opposed by the League of Women Voters of California, California Tax Reform Association, and Federated Firefighters of California. Taxation. Local Governments And Districts. California Proposition 62 (1986). http://repository.uchastings.edu/ca_ballot_props/967. Accessed 10/5/15.

[20] For a fairly recent evaluation of state revenue variability using a volatility model, see Thomas Garrett, *Evaluating State Tax Revenue Variability: A Portfolio Approach* (St. Louis, MO: Federal Reserve Bank of St. Louis, February 2006), included in California Research Bureau's Annotated Bibliography – Fiscal Policy and Revenue Structure (Oct. 2015)

the supplemental roll[21] and the end of omnibus trailer bills returned.

The last two years of the decade found legislators trying their best to reverse an impending economic decline. Bills introduced to suspend tax indexing, adopt conformity items, defer the carryforward, and accelerate tax collections were voted down. In their place, a package of targeted tax reductions including sales tax exemptions for bunker fuel, motion picture production services, childcare facilities and senior citizens emerged.

In 1988 school funding was in sharp focus. In a general election, Proposition 98 (1988) passed with 51 percent of the vote. An initiative which amended the California Constitution and the education code to establish a minimum level of state funding for school and community college districts, Proposition 98 included provision for transferring to such districts, within limits, state revenues in excess of State's appropriations limit and exempting these excess funds from the limit. Excess funds were to be used solely for instructional improvement and accountability. Schools were required to report student achievement, drop-out rates, expenditures per student, progress toward reducing class size and teaching loads, classroom discipline, curriculum, quality of teaching, and other school matters. The measure was expected to cost of $215 million for the current year, and would have no excess revenues to transfer to schools and community colleges. Schools would be impacted by the requirement to produce School Accountability Report Cards.[22]

Since the mid-1980s, legislators had been seeking property tax reforms. The waning of the decade witnessed a set of adjustments to these taxes that included changes in:

- Purchase price presumption, full cash value and fair market value;
- Cable television assessment;
- Mining appeals;
- The property tax assessment process.

In 1988, voters increased the tobacco tax. Passed in a general election by 58 percent of the vote, Proposition 99 (1988) amended the California Constitution and the tax code to impose a yearly additional tax upon cigarette distributors for each cigarette distributed. Other tobacco products were subject to this additional tax, equivalent to combined rate of tax imposed on cigarettes. Funds raised by these taxes were earmarked for treatment, research of tobacco-related diseases, school and community health education programs about tobacco, fire prevention, and environmental conservation and damage restoration programs. The funds from this tax were not to be subject to appropriations limits. While this measure would increase revenues by $300 million in the current year and by twice that amount in the second year, these revenues would decline gradually in later years. The measure would not to affect sales and excise tax revenues to local governments.[23]

[21] "The supplemental roll provides a mechanism for placing property subject to Proposition 13 reappraisals due to change in ownership or completed new construction into immediate effect. Changes in ownership or completed new construction are referred to as 'supplemental events' and result in supplemental tax bills that are in addition to the annual property tax bill." For more information see https://www.boe.ca.gov/proptaxes/faqs/suppassessment.htm. Accessed 11/13/15.

[22] Major supporters of Proposition 98 included the California Teachers Association, California State Parent Teachers Association, State Superintendent of Public Instruction, and Association of California School Administrators. Opposed to the measure were the Governor, California Commission on Educational Quality, and California Taxpayers' Association. School Funding California Proposition 98 (1988). http://repository.uchastings.edu/ca_ballot_props/979. Accessed 10/5/15.

[23] Major supporters of Proposition 99 included a retired Surgeon General, the American Cancer Society, The Wilderness Society, Attorney General, State of California, American Lung Association, and California Association of School Health Educators and Health Teachers. Opposed to the measure were Paul Gann and the People's Advocate, the Latino Peace Officers Association, a couple of assembly members and the Chair of the Governmental Organization Committee, as well as the Vice Chairman of the Ways and Means Committee. Cigarette and Tobacco Tax. Benefit Fund. Initiative Constitutional Amendment and Statute. California Proposition 99 (1988). http://repository.uchastings.edu/ca_ballot_props/980. Accessed 10/5/15.

As the decade came to a close, the implementation of unitary reform continued. To prevent tax agency abuses and to ensure better service from the Board of Equalization and Franchise Tax Board, a long awaited taxpayer bill of rights passed. To avoid difficulties with federal/state tax conformity, the Governor signed a bill in 1989 to address outstanding issues.

1990s

For 1990, an unexpected decline in revenues required Legislative compromises to raise them. Implementation of withholding on property sales by non-residents, a cut in the renter's credit, revision of policy concerning unclaimed property of Californians who die without legal heirs, and the authorization of counties to impose various taxes were forwarded as remedies. Emphasis on business climate issues resulted in a foreign purchases tax and a push toward diverse business regulations.

Voters weighed in on the congested state of California's transportation system at the ballot box, passing taxes on truck weight fees and fuel. Proposition 111 (1990) was approved by the Legislature and passed with 52 percent of the vote in a primary election. This measure enacted a statewide traffic congestion relief program and updated the spending limit on state and local government to better reflect the needs of Californians in terms of mass transit, health care, services for the elderly, and programs. It included provisions to ensure that school appropriations remain constant and that any excess revenues above the limits are shared between taxpayers and education.[24]

Further tax increases were necessary in the wake of a subsequent downturn in revenues in 1991. Policymakers again worked to reform the property tax shift initiated in 1979. The sales tax rate, vehicle license fees, alcohol and beverage taxes, the alternative minimum tax, and personal income tax rates were increased. Higher income taxpayers were excluded from the renter's credit, net operating loss tax deductions for businesses rose, and small business health insurance tax credits were delayed. Measures to improve the business climate included an extension of the research and development tax credit. Conformity with federal tax policy hiked taxes.

In 1992, efforts to reform the property tax allocation formula continued. Policymakers approved measures to shift property taxes from cities, counties, and special districts to schools. Tax relief for this year was thinner than in previous years, and it included credits and exemptions for forest fire victims, child care facilities, and the blind. Legislators agreed to an estimated tax increase paid by multinational corporations. A roll back of increases on taxes on fuel oil used aboard vessels was achieved.

Once again, the 1993 budget compromise included a shift in property tax from cities and counties to schools to attain fiscal balance. A bundle of measures contributed to this cause, including an extension of the sales tax rate increase that had been set to expire, and the repeal of the renter's tax credit. Additional changes were: spending reductions, cash deferrals, rollover of the deficit, and the shift of special fund monies.

There was legislation to improve business climate, such as:

- Exempting new manufacturing equipment from sales tax;
- Offering income, bank and corporation tax credits for investment in equipment;

[24] Major supporters of this measure were the California Association of Highway Patrolmen, California Chamber of Commerce, Governor, California Taxpayers Association, and American Association of Retired Persons. Opposed to the measure were a Los Angeles County Supervisor, an assemblymember, and an economic consultant. The Traffic Congestion Relief And Spending Limitation Act Of 1990 California Proposition 111 (1990). http://repository.uchastings.edu/ca_ballot_props/1016. Accessed 10/5/15.

- Reducing the tax rate for corporations with 100 shareholders or less;
- Extending the research and development credit;
- Exempting specified gains on sales of small business stock.

Discussion of the nuances of unitary reform returned this year. These discussions were accompanied by increases in the cigarette tax, abatements to local taxes, and the modification of tax treatment of net operating losses.

Secure, adequate funding for public safety at the local level was on the minds of voters in 1993. Passed in a special election with 58 percent of the vote and approved by the Legislature, Proposition 172 (1993) provided a dedicated revenue source for public safety purposes. Revenue would be distributed to cities and counties for police, sheriffs, fire, district attorneys and corrections purposes. The measure generated $714 million in the first year, and $1.5 billion annually, in additional sales tax revenue for counties and cities.[25]

Closure of the budget gap in 1994 was handled by rolling over the deficit, but complicated by short term borrowing and federal/state tax conformity issues. Policymakers passed an adoption credit, considered a new investment tax credit, and recognized a new form of business (the limited liability company). Whereas in prior years policymakers had relied on static revenue models, these models were increasingly incapable of accurately predicting future economic circumstances and dynamic revenue forecasting methods were adopted in their place. [26]

Compromises of a different sort took center stage in the mid-1990s. Increased revenues from 1995-1998 shifted the debate from increasing declining revenues to how to spend surplus funds in the budget. Some legislators thought the extra funds should be returned to tax payers, while others wanted to fulfill unmet needs in existing programs or create new ones. Despite increased funds overall, a lack of consensus caused a set of temporary tax brackets to expire. This led to a significant reduction in income tax revenues.

A key turning point in taxation during this time was the recommendation of a three-year, phased in reduction of personal income, bank and corporation tax rates. Property taxes witnessed significant changes concerning possessory interest in property, escape assessments, interest rates on property tax refunds, and assessment appeals. Confrontations between taxpayers and assessors over assessment practices led to attempts to reform, improve, and standardize how property is assessed for tax purposes.

Unresolved concerns about property taxes and assessment practices led voters to pass a measure that limited the authority of local governments to impose taxes and property-related assessments, fees, and charges. Passed by 57 percent of voters in a general election, Proposition 218 (1996) enacted a constitutional amendment that requires the approval of a majority to increase general taxes and reiterated that two-thirds of voters must approve any special taxes. Assessments, fees, and charges must be submitted to property

[25] Major support for the measure included the Orange County Sheriff-Coroner, a senator, the California State Sheriffs' Association, Los Angeles Police Department, Los Angeles County Sheriff, California Police Chiefs' Association, and California Fire Chiefs' Association. Opposed to the measure were a couple of assemblymembers and the Center for the California Taxpayer. Local Public Safety Protection and Improvement Act of 1993. California Proposition 172 (1993). http://repository.uchastings.edu/ca_ballot_props/1087. Accessed 10/5/15.

[26] A more recent use of a dynamic panel-data model to develop a measure of business cycle related revenue gap is featured in Sunjoo Kwak, "The Dynamics of State Fiscal Behavior Over the Business Cycle: Are State Fiscal Policies Procyclical?" *The American Review of Public Administration* 44, No. 5, (September 2014) 550-574, included in California Research Bureau's Annotated Bibliography – Fiscal Policy and Revenue Structure (Oct. 2015).

owners for approval or rejection, after notice and public hearing. Assessments are limited to the special benefit conferred. Fees and charges are limited to the cost of providing the service and may not be imposed for general governmental services available to the public. Revenue losses in excess of $100 million a year were expected as a result of the measure, and long term losses even greater.[27]

Cuts to the bank and corporation tax and a set of targeted tax measures were negotiated in the wake of renewed budget difficulties in 1996. Included in this set of business-related measures were:

- Increases in the research and development credit and small business expensing;
- Standardization of the rate associated with the exclusion of foreign dividends;
- Exemption of aircraft repairs from sales tax;
- Reduction of the minimum franchise tax on new small businesses;
- Extension of the investment credit for manufacturers.

Individuals saw increases in the amount they could claim for long term medical care expenses and insurance costs. Federal/state tax conformity addressed moving issues, valuation of assets at recent market price ("mark-to-market" accounting), and corporate owned life insurance policies. Continued concern about aggressive enforcement by tax agencies led to legislation that favored business climate issues for exhibitors who visit California for trade shows. The source tax for non-resident former California pensioners was terminated this year.

Success with collective compromise in 1997 meant that the budget package passed on time. It featured an increase in the credit for dependents and an exemption for the alternative minimum tax. The budget included measures aimed at federal/state tax conformity focused on the research and development tax credit, capital gains, and corporations with 100 shareholders or less. Policymakers expanded the income limits deductible in individual retirement accounts and passed a variety of incentives aimed at fostering economic development. Business climate measures extended the bunker fuel sales tax exemption and authorized a capital investment incentive for qualified manufacturing facilities.[28]

Tax issues in 1998 focused on the vehicle license fee and a host of other measures. Rising revenues led policymakers to again negotiate a compromise between spending the increase and distributing the surplus back to taxpayers. This year, reaching a compromise took longer than the year before. The budget included a number of tax relief provisions:

- Reduction of the minimum tax for small businesses;
- Increase in the research and development credit;
- Expansion of manufacturers investment credit;
- Exemption for property used in production services for film and video;
- Increase in deduction for health insurance for the self-employed;

[27] Major supporters of the measure included the Howard Jarvis Taxpayers Association, Consumers First, Paul Gann's Citizens Committee, California Taxpayers Association the Council of Sacramento Senior Organizations, and Alliance of California Taxpayers and Involved Voters. Opposed were the League of Women Voters of California, California Police Chiefs' Association, California Fire Chiefs' Association, Congress of California Seniors, California Teachers Association, and California Association of Highway Patrolmen. Voter Approval for Local Government Taxes. Limitations on Fees, Assessments, and Charges. California Proposition 218 (1996). http://repository.uchastings.edu/ca_ballot_props/1138. Accessed 10/5/15.

[28] For an in-depth perspective on how policymakers may work to reduce revenue variability from business cycle swings, see Russell Sobel and Gary A. Wagner, "Cyclical Variability in State Government Revenue: Can Tax Reform Reduce It?" *State Tax Notes*, August 25, 2003, 569, included in California Research Bureau's Annotated Bibliography – Fiscal Policy and Revenue Structure (Oct. 2015).

- Permanent extension of employer child care credits;
- Sales tax exemption for property used in space launches;
- Modification of enterprise zones;
- Equal tax treatment of perennial plants used in food production.

Important legislation passed to ensure the internet would remain tax free for 10 years, expand a use tax incentive for farmers to keep their land in agricultural use, and authorize a formula for the assessment of possessory interests for airlines. Federal/state conformity legislation involved the estate tax interest rate.

Conversely, voters focused on using a tax on tobacco to fund programs on smoking prevention and early childhood development. Exempt from the Proposition 98 requirement that dedicates portion of general tax revenues to schools, Proposition 10 (1998) was passed by 50 percent of voters in a general election as a constitutional amendment. To provide funding for state and county commissions and programs, monies were raised by an additional $.50 per pack tax on cigarette distributors and an equivalent increase in state tax on distributed tobacco products. The initiative created a state commission to provide information and materials and to formulate guidelines, and created county commissions to develop strategic plans with an emphasis on the new programs. New revenues for early child development from the measure were expected to amount to $400 million the first year, and $750 million annually to be allocated to the new state and county commissions for the new program.[29]

As the decade came to a close,[30] the vehicle license fee tax cut was increased, along with the credit for research and development. Whereas previously small businesses were required to pay a minimum franchise tax, this tax was completely eliminated. The tax exclusion for capital gains was made permanent and the deduction for health insurance for the self-employed was increased in conformity with federal tax policy.

2000s

Surplus monies in the budget drove the reductions, increases, extensions, and exemptions that continued into 2000. A prominent feature during these years was the use of trailer bills as a vehicle for making tax changes. Spending increases and tax reductions continued and the Legislature accelerated phased-in car tax reductions. Tax trailer bills in 2000 included:

- Increase in the research and development credit;
- A tax credit for teachers based on years of service;
- A tax credit for child care expenses for low and middle income taxpayers;
- An increase in the net operating loss that could be carried forward for businesses;
- A tax credit for donation of land to public agencies and non-profits;
- Property tax relief for low income seniors;
- A tax credit for persons needing long term care;
- A sales tax exemption in rural areas for purchases of machinery and equipment;

[29] Major supporters of the measure were the I Am Your Child Campaign, American Cancer Society, California School Boards Association, and a former Surgeon General of the United States. Opposed to the measure were the Alliance of California Taxpayers & Involved Voters, California Manufacturers Association, a school board member, a physician, a teacher, and a business owner. State and County Early Childhood Development Programs. Additional Tobacco Surtax. California Proposition 10 (1998). http://repository.uchastings.edu/ca_ballot_props/1162. Accessed 10/5/15.

[30] For a characterization of state and local finance since Proposition 13, see Michael A. Shires, *Patterns in California Government Revenues Since Proposition 13* (San Francisco, CA: Public Policy Institute of California, 1999), included in California Research Bureau's Annotated Bibliography – Fiscal Policy and Revenue Structure (Oct. 2015).

- Taxable income exclusion of graduate level school assistance.

Other tax bills featured: the expansion of innocent spouse relief, an increase to the tire tax, and capping of the tax on boxing and wrestling admissions. Efforts aimed to ensure conformity of state taxes to federal taxes were not passed. Efforts to tax electricity generators, based on consumer cost of electricity, failed.

Although the budget was balanced in 2001, anticipated shortfalls caused uncertainty. Despite this uncertainty, a substantive package of tax reforms passed. These included a restructuring of the sales tax "trigger" mechanism and sales tax exemptions for:

- Liquid petroleum gas purchased through main gas supply pipelines;
- Farm and forest machinery and equipment;
- Diesel fuel used in farming and food processing;
- Thoroughbred horses used for breeding.

The appeals process for property taxes changed, allowing owners more time to appeal. Property tax relief increased for low income seniors. Other efforts at property tax reform, such as taxes on electricity generators and efforts to allow trials to start from the beginning of the process (*de novo*) in property tax appeals, failed.

2001 is notable as the beginning of the "structural deficit" in California's budgetary history. This term relates to the difference between projections of revenues and expenditures in the context of normal and cost of living increases, as well as automatic spending formulas built into the budget.[31]

Unsustainable spending of temporary tax revenues, the "auto-pilot" nature of initiatives, collective bargaining contracts, cost of living increases, debt service costs, and an added decline in revenues in the early 2000s brought on by the structural deficit forced legislators to find additional ways to balance the budget.

In 2002, a rapidly rising structural deficit caused a general suspension of spending. Tax increases were proposed for cars and cigarettes. Budget negotiations stalled, and the budget did not pass until August. The following measures enacted in 2002 reflected this continuing concern about the structural deficit:

- The net operating loss "carry forward" deduction was suspended;
- Suspension of the teachers tax credit;
- Withholding on stock options and benefits increased;
- Real estate sales tax withholding expanded to include state residents;
- Limited amnesty to delinquent taxpayers;
- Bad debt losses at banks were actualized.

Businesses were affected. Workers compensation benefits and unemployment insurance premiums increased. Deductions for executive salaries and lobbying expenses were denied in conformity with federal tax law.

In 2002, more funding was needed for California's transportation system. This resulted in a sales and use tax measure on vehicle fuel, which provided increased revenues for public transit, streets, roads, and highways. Approved by the Legislature and passed by 69 percent of voters in a primary election, Proposition 42 (2002) required that state sales and use taxes revenues on sale of motor vehicle fuel were to be used for public transportation, city and county street and road repairs and

[31] See Robert D. Ebel, ed., *The Oxford Handbook of State and Local Government Finance*, New York: Oxford University Press, 2012, included in California Research Bureau's Annotated Bibliography – Fiscal Policy and Revenue Structure (Oct. 2015) for a more complete evaluation of the persistent problems of state and local deficits in governmental fiscal systems.

improvements, and state highway improvements. The measure required a two-thirds vote of the Legislature to suspend or modify percentage allocations of revenues. The measure was expected to raise $1.4 billion in the first year, with revenues increasing in the following years.[32]

An even higher estimated structural deficit in 2003 led to continued concern. Again, the solution focused on the car tax, which was increased administratively despite legislative opposition. Lack of a trailer bill meant that tax changes were part of the budget package. Besides the increased car tax, parcel taxes on real property in rural areas rose, water rights holders now paid an annual tax, and hunters and fisherman were hit with increases in licensing fees. How best to tax services received stakeholder attention during 2003, but the idea did not catch on.

Further, legislators passed bills to curb the use of tax shelters and underreporting of taxes, increased the sales tax on television sets and computer monitors, and sought to charge employers new taxes on health care. They tried to require local governments to fund public pension obligations with property tax increases, to make changes to how multinational corporations account for former domestic enterprises, and have owners of non-residential property pay higher taxes.

Reduction of the premium costs for workers compensation insurance followed in 2004 as legislators sought to make California friendlier for business. In response to the structural deficit situation, policymakers reduced spending and increased borrowing to keep the state budget in balance. Legislators managed to again shift property tax monies away from local governments to the schools to meet the state's educational needs, suspend tax credits for teachers and natural heritage, and alter taxation of property purchased outside of California to benefit the state. Efforts to increase the property tax rate on commercial property to benefit schools received attention but did not move forward.

Tax amnesty was in focus in 2004. Passed as part of the trailer bill package, taxpayers could obtain waivers for late payment penalties if they cleaned up any unreported taxes, if they participated in an installment repayment plan. Attempts to forestall the expiration of the manufacturers' investment tax credit on the cost of new manufacturing equipment were unsuccessful.

Additionally, policymakers sought to increase the size of the General Fund reserve as a buffer against future economic uncertainty and passed a legislative constitutional amendment that would have increased size of state "rainy day" fund from 5 percent to 12.5 percent of the General Fund. The proposed measure called for a portion of the yearly deposits from the increase to be saved in a special fund for potential and future economic downturns. It allowed for any remaining funds to be available in an emergency for education, infrastructure, and debt repayment. The measure would provide $16 billion in higher revenues the first year, and increased revenues thereafter. While the measure was believed to stabilize state spending, it also meant greater budgetary spending to balance out potential temporary tax relief, debt and borrowing, as well as infrastructure projects. The measure,

[32] Major supporters of Proposition 42 included the California Highway Patrol, California State Automobile Association, California Organization of Police and Sheriffs, California State Office of Emergency Services, a former member of the California State Board of Education, and President California Taxpayers' Association. Opposed to the measure were the California Teachers Association, Congress of California Seniors, Health Access of California, California Tax Reform Association, Latino Issues Forum, and California State Firefighters' Association. Transportation Congestion Improvement Act. Allocation of Existing Motor Vehicle Fuel Sales and Use Tax Revenues for Transportation Purposes Only. California Proposition 42 (2002). http://repository.uchastings.edu/ca_ballot_props/1200. Accessed 10/5/15.

Proposition 1A (2004), was rejected by 65 percent of voters.[33]

In 2005, a reduced structural deficit initially meant significant reductions in proposed spending, but incoming higher revenues eliminated the need to make cuts. This year, minor changes in taxation took place in the form of a conformity bill and a bill changing the way commercial aircraft is assessed.

The budget passed on time in 2006 in spite of a continuing structural deficit, the result of unexpected higher revenues. The earlier suspension of the teacher tax credit continued. Changes were made to the way property (vehicles, boats, and planes) purchased outside of California is taxed. Bills requiring the development of property tax assessment valuation tables as well as joint income tax status for registered domestic partners passed. Initiatives that failed to become laws included: taxing the rich to pay for universal preschool, taxing cigarettes and oil produced in California to subsidize energy alternatives, a statewide parcel tax to fund education, and increasing business taxes to fund political campaigns.

Budget negotiations in 2007 were strained and late. The teacher tax credit ended, changes in taxation of fractionally owned aircraft were negotiated as well as changes in how to tax limited liability companies. Vehicle registration fees increased. Foster children were included in the parent-child definition when reassessing property tax and change-of-ownership. Reform legislation passed for the unclaimed property program. This legislation required the state to notify owners when assets are seized.

Revenues declined in 2008. An inability to effectively estimate the size of the budget's structural deficit led to continued turmoil. Tax changes this year included:[34]

- 20 percent penalty on corporate taxpayers with unpaid tax liabilities;
- Business tax credits reduced to aggregate of 50 percent of tax liability;
- Suspension of net operating loss carryforwards for the current and next fiscal year;
- Acceleration of the percentage of estimated tax payments;
- Elimination of property tax relief for low income seniors and Californians with disabilities.

Significant differences between structural deficit projections caused continued consternation during the 2009 budget process. It led to the passage of legislation that severely cut programs and services. Homeowners received some assistance by the authorization of a homeowner's tax credit.

The following temporary two year tax changes were passed:[35]

- Increase in sales tax rate by 1 percent;
- Increase in personal income tax rate by .25 percent;
- Increase in car tax rate to 1.15 percent;

[33] The measure was supported by the California Taxpayers' Association, California State Sheriffs' Association, California Secretary of Education, California Chamber of Commerce, Senior Advocates League, and California Alliance for Jobs. Major opposition to the measure included the Congress of California Seniors, California Faculty Association, Consumer Federation of California, Health Access California, United Nurses Associations of California/Union of Health Care Professionals, and Older Women's League of California.
State Budget. Changes California Budget Process. Limits State Spending. Increases "Rainy Day" Budget Stabilization Fund. California Proposition 1a (2009). http://repository.uchastings.edu/ca_ballot_props/1294. Accessed 10/5/15. For a summary of the relationship between state and local fiscal concerns from Proposition 13 to Proposition 1a, see Elisa Barbour, *State-Local Fiscal Conflicts in California: From Proposition 13 to Proposition 1A* (San Francisco, CA: Public Policy Institute of California, December 2007), included in California Research Bureau's Annotated Bibliography – Fiscal Policy and Revenue Structure (Oct. 2015).

[34] "A Year Dominated by Tax Talk, but Overt State Tax Increase Proposals Are Rejected, CalTax Year in Review: 2008," http://www.caltax.org/Year_in_Review_2008.pdf. Accessed 10/30/15.

[35] "For Tax and Fiscal Policies, 2009 was a bad year, CalTax Year in Review: 2009," http://www.caltax.org/Year_in_Review_2009.pdf. Accessed 10/30/15.

- Reduction of the dependent exemption credit;
- A gross premium tax of 2.35 percent enacted on selected managed care health plans.

Businesses were affected by the temporary suspension of the net operating loss for two years, a new employee hiring credit, and a new film production credit. To provide for proper acknowledgement of the parent/subsidiary relationships that exist among companies, business tax credits concerning the unitary nature of companies were changed. The credit could be assigned, for tax purposes, to other members of the same reporting group.

2010-present

The unrelenting structural deficit from previous years signified the continuance of spending cuts into 2010. Legislators engaged in vigorous efforts to find ways to increase revenues. In turn, taxpayers sought to limit legislator's attempts to increase taxes by making sure that tax-like fees received the same level of scrutiny as taxes. At the voting booth, for example, Proposition 26 (2010) mandated a supermajority to pass a range of fees, charges, levies, and tax allocations that previously only required a simple majority. This proposition required certain state and local fees, specifically those that impact society or the environment as a result of the potential fee payer's business activities, to be approved by a two-thirds vote.[36] The purported impact of this change was decreased revenues in the range of billions of dollars per year, along with anticipated repeals of taxes and fees that would cost the General Fund an additional $1 billion per year.

In 2010, the Legislature passed the following minor set of changes in a set of trailer bills:[37]

- Suspension of the net operating loss carryover and carry back;
- Adjustments to the 20 percent penalty on corporate taxpayers with unpaid tax liabilities;
- Changes to the way intangible sales are sourced for tax purposes;
- Services provided by nursing homes and other similar service providers subject to tax;
- Reporting of use tax from personal income tax made permanent;
- Increase in liquor license fees;
- Homeowners' tax credit reauthorized.

Further cuts and funding shifts from the state to the counties took place in 2011. As the state sought to overcome the impacts of the Great Recession, much discussion took place about tax reform options to promote fiscal recovery.[38] Concerning taxes, the Legislature passed a new sales tax for online retailers.[39] Additional

[36] For an in-depth review of the debate concerning taxes vs. fees and how best to navigate the policy issues surrounding Proposition 26, see Joseph Henchman, *How Is the Money Used? Federal and State Cases Distinguishing Taxes and Fees* (Washington, D.C.: Tax Foundation, March 2013), Kurtis J. Swope and Eckhard Janeba, "Taxes or Fees? The Political Economy of Providing Excludable Public Goods," *Journal of Public Economic Theory* 7, no. 3 (2005): 405-26., and *Understanding Proposition 26: A Sponsor's Guide to California's New Tax Structure* (Sacramento, CA: California Taxpayers Association, August 2011), included in California Research Bureau's Annotated Bibliography – Fiscal Policy and Revenue Structure (Oct. 2015).

[37] The measure, which received close to 53 percent of the vote, was supported by the California Taxpayers Association, Howard Jarvis Taxpayers Association, Wine Institute, and Americans for Tax Reform. Opposed were the California Tax Reform Association, League of Women Voters of California, American Lung Association, Sierra Club, Peace Officers Research Association of California, California League of Conservation Voters, and California Association of Professional Scientists, as well as numerous other health, environmental, civic, public safety, labor, education, consumer and government organizations. "Taxpayers Send Message of 'No New Taxes' to Capitol as Gimmick-Filled State Budget Unravels, CalTax Year in Review: 2010," http://www.caltax.org/Year_in_Review_2010.pdf. Accessed 10/30/15.

[38] Discussion of the options before California in 2011 concerning tax reform are encapsulated in Joseph Henchman, "Recent State Tax Reforms in the United States and Opportunities for California at a Time of Fiscal Challenge," testimony, February 2, 2011, before California Senate Select Committee on Recovery, Reform and Realignment, included in California Research Bureau's Annotated Bibliography – Fiscal Policy and Revenue Structure (Oct. 2015).

[39] For more information on the tax treatment of internet purchases, see Ronald C Fisher, *State and Local Public Finance,* New York and London: Taylor & Francis Group, 2016, included in

legislation promoted conformity between the state and federal tax codes.

A central topic of economic policy discussion in 2012 was the issue of raising revenues through tax increases. Although a number of propositions on the ballot would increase taxes, a key initiative, Proposition 30, successfully raised much needed revenues. Passed by 55 percent of voters in a general election, the constitutional amendment imposed the following temporary measures:

- Increased taxes on individual earnings over $250,000 for seven years;
- Increased sales tax rates by .25 percent for four years;
- Allocated temporary revenues to K-12 schools and community colleges;
- Barred the use of temporary funds for school administrative costs;
- Guaranteed funding for public safety services affected by realignment.

The measure was expected to increases revenues over the future by around $6 billion on an annual basis. Additional funds would be available from this measure for state budget programs.[40]

In addition to the tax increases associated with Proposition 30, there were a few other tax related measures in 2012:[41]

- Extension of the sales tax exemption on marine fuel;
- Imposition of a local car tax in San Francisco;
- A new state tax on fire prevention went into effect;
- A tax on lumber and engineered wood products.

Higher than expected revenues in 2013 led to a renewed discussion among lawmakers about how best to spend these excess funds. Specifically concerning taxes, the following measures were part of an economic development plan that the Governor proposed and approved after the state budget passed in June: [42]

- Sales and use tax exemption for manufacturing, and research and development equipment;
- Employment tax credit via Franchise Tax Board;
- Investment and employment tax credit via the Office of Business and Economic Development.

Legislation did not pass this year to bring federal and state tax structures into conformity. In 2013, significant debate occurred about the possibility of a split-roll property tax system. But no legislation was passed to support it or to make changes to Proposition 13.

Budget negotiations in 2014 went smoother than in previous years. Higher than expected collections of personal income tax were a welcome surprise. Tax changes in 2014 included:[43]

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[40] The broad base of supporters of the measure included the Governor, League of Women Voters, California Democratic Party, California Teachers Association, California State Council of Service Employees, California School Employees Association, American Federation of Teachers, California Federation of Teachers, and a whole host of public safety associations. Major opposition included the Howard Jarvis Taxpayers' Association, Small Business Action Committee, California branch of the National Federation of Independent Business, California Republican Party, and Sacramento Taxpayers Association.Temporary Taxes to Fund Education. Guaranteed Local Public Safety Funding. California Proposition 30 (2012). http://repository.uchastings.edu/ca_ballot_props/1309. Accessed 10/5/15.

[41] 'Governor's Tax Initiative Dominated 2012," CalTax Year in Review," http://www.caltax.org/resources/2012_year_in_review.html. Accessed 11/2/15.

[42] "2013 – The Gathering Storm," CalTax Year in Review, January 3, 2014," http://caltax.org/resources/2013_year_in_review.html. Accessed 10/30/15.

[43] "An Anticlimactic Election Year ends with Growing Talk of Future 'Tax Reforms,' CalTax Year in Review: 2014," http://caltax.org/resources/2014_year_in_review.html. Accessed 10/30/15.

- Exemption of space flight property from local taxes;
- Extension of income exclusion for discharged debt on a principal residence;
- Increase in the tax credit for “California Competes”;
- Expansion/extension of film and television tax credits;
- Transparency measure for parcel taxes;
- Tax credit for California-based Department of Defense bomber project;
- Expansion of the aerospace tax credit;
- Conformity to the Federal definition of limited liability companies employees;
- Businesses were required to file tax returns electronically.

Unsuccessful proposals for new taxes in 2014 were: carbon tax, oil production tax, and increased corporation taxes.