Targeted Taxes

Push for More Taxes Continues Despite State Budget Surplus

Each year, the Legislature considers proposals to increase taxes on a targeted taxpayer. These tax increases are motivated by who the taxpayer is, what the taxpayer makes, or what the taxpayer sells. Currently, Californians are saddled with a slew of taxes that have one common denominator: the taxes are, typically, the highest in the country. Since raising taxes on individual voters is phenomenally unpopular, especially in an election year, targeted taxes are authored with the intent of circumventing the ire of a majority of voters. A targeted tax incurs the opposition of only a single group or industry as opposed to the entire population. Thus, proponents of targeted taxes often favor this approach when seeking increased tax revenue.

Proponents often justify targeting taxes on specific products, industries or behaviors to preclude consumption or alter consumer conduct. Look no further than California's "sin taxes" on tobacco, alcohol and cannabis, for instance. The targeted tax is propped up with an altruistic justification because it taxes "undesirable" products and behaviors. In recent years, however, attempts to levy targeted taxes have crept into new and novel industries such as soda and pharmaceuticals.

Many of the proposed targeted taxes seek to use the revenue generated to fund publicly popular programs, such as treating drug abuse or health-related issues. To the extent targeted taxes succeed at altering consumer behavior, these taxes can be a declining revenue source. Additionally, one taxpayer should not be forced to carry the burden of funding a program that benefits the public at large. Given the state's current $7 billion budget surplus, the need for any new tax is questionable. Despite this, there likely will be several targeted taxes introduced in 2020. Below is a list of some the most recent proposed targeted taxes considered by the Legislature.

RECENT LEGISLATION

• **Soda Tax**. In 2014, the City of Berkeley passed the nation's first tax aimed at sugar-sweetened beverages. Since then, three other California cities—San Francisco, Oakland and Albany—have passed similar taxes. In 2018, the California Legislature preempted local governments from enacting soda taxes until 2031 in a compromise to keep off the ballot a proposal to further tighten local voter approval requirements for tax increases. Despite the preemption, sugar-sweetened beverages remain under siege.

In 2019, the beverage industry successfully fought five bills that sought to curb soda consumption. The bills included a statewide soda tax and a health warning label on sugar-sweetened beverages. The other proposals would have banned large fountain drinks and soda sales near checkout aisles in addition to ending industry-friendly discounting and marketing programs.

In addition, health advocacy groups launched the unsuccessful California Sugar-Sweetened Beverages Tax Initiative, campaigning to pass a statewide 2-cent-per-ounce tax on sugary drinks. Although the initiative did not qualify for the 2020 ballot, it is anticipated the Californians for Less Soda coalition will seek to reverse the 2018 law banning new local soda taxes.

Proponents of the soda tax have attempted to demonize the sugar-sweetened beverage industry and blame it for causing various maladies, including diabetes and obesity. However, instituting a tax on sweetened beverages does not necessarily correlate to changing individuals' choices or lifestyles. Furthermore, the American Beverage Association (ABA) has indicated it wants to work with lawmakers to reduce sugar consumption. The ABA has said it is committed to working with community leaders, legislators and public health groups on meaningful ways to reduce the sugar people get from beverages.

• **Opioid Medication Tax**. In an effort to combat the opioid

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epidemic, Assemblymember Kevin McCarty (D-Sacramento) introduced AB 1468 in 2019. The bill, deemed a job killer by the California Chamber of Commerce, seeks to impose an annual $50 million excise tax on manufacturers and wholesalers that distribute or sell opioid medications in California. Each manufacturer and wholesaler would then be required to report to the California Department of Public Health all opioid medication sold or distributed during a given fiscal year. Based on the reported information, the department then calculates the manufacturer's or distributor's ratable share, which is the individual portion of the collective sum of $50 million the manufacturer or distributor will be required to pay that year. The money is to be allocated to fund opioid prevention and rehabilitation programs.

This excise tax creates a significant cost increase for manufacturers that provide opioids for health care facilities, including assisted living and hospice programs. This cost increase may result in reduced workforce/distribution in California, which along with the excise tax, may ultimately increase the cost of such drugs for patients who are suffering with life-threatening diseases and illnesses, including cancer, and who need opioids the most.

• **Services Tax**. A service tax is a tax levied on service providers for certain service transactions. In reality, the service provider pays the tax and recovers the cost from the customer. Depending on the scope of the services taxed, the service tax could include services provided by lawyers, accountants, consultants, and the list goes on.

Many legislators, and even former Governor Arnold Schwarzenegger, have attempted to address budget volatility by suggesting changes to the tax system. Most recently, Senator Bob Hertzberg (D-Van Nuys) introduced SB 522 to levy a tax on services purchased by businesses. The intent was for "tax reform" or to extend the sales tax to services. This bill makes legislative findings about the need for further efforts to modernize and restructure the state's tax system.

Over the last several years, Senator Hertzberg has introduced five bills to impose a sales tax on services in the State of California. The bills were tabbed by supporters as a vehicle to modernize California's tax structure and curtail the state's infamous budget volatility.

Many economists, however, view service taxes as poor fiscal policy because of their "pyramiding" effect where the tax's costs on services are passed on and repeatedly taxed again through the production chain. These tax costs can snowball rapidly and add serious costs to end-consumers, particularly in services-intensive sectors.

Research for the California Foundation for Commerce and Education found that a 5% sales tax on business services would have the following impact:

- The average cost of a new single-family home would increase by more than $16,500;
- The average construction cost for a new school would increase by more than $17 million; and
- Costs for public infrastructure like roads and bridges would rise by 3.2%.

Although some may view targeted taxes to be more politically expedient, it turns out that California voters were not too keen on this idea. A statewide voter survey by the CalChamber after the November 2018 election found that voters by a 3 to 1 margin opposed new taxes on services like lawyers, lawn care, or automotive repair—even if applied only to businesses.

• **Oil/Severance Tax**. A severance tax is a state tax imposed on the extraction of non-renewable natural resources that are intended for consumption in other states. These natural resources include crude oil, condensate and natural gas, coalbed methane, timber, uranium, and carbon dioxide.

California has never imposed a tax on the extraction of fossil fuels. Instead, state and local taxes and fees are applied to oil and natural gas producers in California, including:

- Local ad valorem taxes on extraction equipment;
- Local ad valorem taxes on value of recoverable oil and gas in the ground;
- Personal and corporate income tax based upon profits earned in California;
- Annual regulatory fees paid to support the Division of Oil, Gas, and Geothermal Resources—renamed the California Geologic Energy Management Division (CalGEM) on January 1, 2020—in the Department of Conservation. The fees are calculated on an annual basis according to the division's estimated annual budget and the total amount of assessable oil and gas produced in the prior year.
- Oil Spill Prevention and Administration Fee, not to exceed $0.05 per barrel, upon persons owning crude oil when it is received at a marine terminal from within the state.
- Sales tax on the equipment purchased and used to extract oil and gas.

Since 1990, at least seven severance tax bills have been proposed. Most recently, Senator Bob Wieckowski (D-Fremont) introduced SB 246, tagged as a CalChamber job killer. Under this proposal, known as the Oil Industry Levy Act, 10% of the average price/barrel of oil or 10% of the average unit of natural gas would be taxed. Collected revenue would be deposited in the state General Fund. According to the Western States Petroleum Association, California's energy industry already pays about $42 billion in federal, state and local taxes.

Should a bill like SB 246 be passed and signed into law, it would certainly increase California consumer gas prices, which already are the highest in the nation. As of October 2019, the national average cost of gas is $2.65 per gallon—but in California, it is $4.18 per gallon.

• **Tire Tax**. In 2019, Assemblymember Chris Holden (D-Pasadena) introduced AB 755, the California Tire Fee: Stormwater Permit Compliance Fund. The bill, a CalChamber job killer, unfairly targeted one type of taxpayer—purchasers of tires—to fund programs to mitigate the impacts of zinc in stormwater. Specifically, AB 755 aimed to increase the California Tire Recycling Act tire fee by $1.50. This translated to an increase in the tire change fee from $1.75 per tire to $3.25 per tire. The additional revenue would have gone into the state's Stormwater Permit Compliance Fund, created by AB 755, to pay for "competitive grants for projects and programs for municipal storm sewer system permit compliance requirements that would prevent or remediate zinc pollutants caused by tires in the state."

Stormwater pollution is problematic; however, there are many contributors to stormwater pollution other than tires. Specifically, in the case of zinc pollutants, zinc can appear in stormwater due to galvanized metal surfaces, including roofs, fences, gutters and downspouts, light poles, steps, and storm sewers; motor oil and hydraulic fluid exposed on the ground; certain emissions; moss control herbicides; certain types of paints; and wood preservatives.

• **CEO Compensation/Corporate Tax**. Senator Nancy Skinner (D-Berkeley) proposed one of the steepest tax increases ever contemplated in California when she introduced SB 37, another CalChamber job killer, in 2019. Based upon the proposed legislation, for certain companies, the bill would have increased California's corporate tax rate—already one of the highest in the nation—to 22.26%. This amounts to a staggering increase of about 150%.

If SB 37 passes, California will have the highest corporate tax rate in the country and the highest or second highest tax rates nationally for income taxes, sales taxes and motor vehicle fuel taxes. This will undoubtedly discourage companies from remaining, locating, relocating or further investing in the state.

California currently imposes a flat 8.84% income tax on all corporations (10.84% for banks and financial corporations). SB 37 requires that for taxable years beginning on or after January 1, 2020, the rate for corporations with net income of $10 million or more be revised to instead impose a tax rate from 10.84% to 14.84%. For financial institutions, the rates range from 12.84% to 16.84%. These rates, for both corporations and financial institutions, are based on the compensation ratio of CEOs to employees of the organization.

SB 37 further seeks to increase the tax rate by another 50%—to a maximum of 22.26% (24.26% for banks and financial corporations)—for publicly held corporations that have a specified decrease in full-time employees in the United States while increasing the number of contracted and foreign full-time employees.

Although the bill is attempting to address outsourcing and alleged wage disparity within some corporations or financial institutions, driving businesses out of the state through a punitive tax proposal could harm California workers by costing them their jobs when their companies attempt to offset the costs of higher taxes by reducing the companies' presence in California. Further, executive pay is already subject to tax limits. A publicly traded corporation is prohibited from deducting more than $1 million per year in compensation paid to CEOs and the most senior executive officers. The exemption for commission and performance-based pay was eliminated recently as well.

LEGISLATIVE ACTION IN 2020

Despite Californians' general opposition to increasing general taxes in most circumstances, the 2020 Legislature will inevitably propose additional targeted tax increases. The authors of the bills proposing a tax on sugar-sweetened beverages, opioid medications and oil have indicated their willingness to continue pushing these agendas.

CALCHAMBER POSITION

Targeted taxes are regressive and harmful to consumers. The targeted taxes increase the cost of doing business in California and those costs are naturally passed on to consumers by way of increased prices and job losses.

Any tax increase should be broad-based and shared by all so that the financial impact is mitigated, and so that voters have a greater ability to hold elected leaders accountable for the programs funded by these tax increases.

In addition, the state's $7 billion budget surplus makes questionable the need for any new taxes.

Staff Contact
Preston Young
Policy Advocate

preston.young@calchamber.com
January 2020