



## **BUDGET UPDATE**

**July 12, 2011**

The State Controller has released the cash-flow numbers for the month of June and the good news is that total revenues exceed the estimates for the May Revision by \$440 million. The bad news is that it is \$350 million less than the revenue estimates used in the newly signed budget. Regardless the Budget is done, for now, and the Legislature will take their Summer Recess beginning Friday and ending August 15<sup>th</sup>.

The Administration has expressed an interest in working on the Health and Human Services realignment details during the recess. We'll be heavily involved in those meetings and will keep you apprised of outcomes as well as let you know of needed input.

**Debt Outlook:** Standard & Poor's raised its outlook for California's rating to "stable" from "negative" on Thursday indicating that the enactment of the 2012-13 budget was likely to mitigate the recurrence of the State's cash deficiency over the next two years. California received the negative outlook designation in August of 2009, primarily based on concerns about the State's inadequate cash-flow.

Due to passage of the Budget, the State will now be able to issue revenue anticipation notes to help with cash-flow until tax revenue arrives in spring of 2012. According to State Treasurer Bill Lockyer, the State plans to sell \$5 billion in notes in August. This rating upgrade also bodes well for the fall sale of general obligation bonds that are needed to fund school, water, and transportation projects; however, there is no word yet from the Treasury on the size of this offering.

S&P's report noted that court challenges and federal approvals remain for many of the enacted budget solutions:

- \$1.7 billion for the elimination of redevelopment agencies
- \$2.4 billion in solutions requiring federal approval – mostly Medi-Cal
- \$200 million from the "Amazon" tax
- \$358 million for the increase in vehicle license fees of \$12 per vehicle which anti-tax advocates are touting as contrary to Proposition 22
- \$2.1 billion from the re-bench of Proposition 98 which must be approved by voters

California retains an A-minus rating, the lowest of any of the 50 states.

**Property Tax Deferral Program:** On Friday, the Governor vetoed ABX1 34, a budget trailer bill resurrecting the Senior Citizens and Disabled Citizens Property Tax Postponement Program. The program, which was suspended in 2009, allowed seniors and people with disabilities to use a

loan from the State to pay their property taxes, avoiding the risk of foreclosure. The State placed a lien on the loan recipient's home, ensuring the future repayment of the loan upon sale of the home, most often after the homeowner's death. The program, created in 1977, cost the State \$38.4 million in 2009-10 when the housing market collapsed and foreclosures increased. Since suspension of the program, funds from repayment of the loans have gone directly to the General Fund. The Governor's veto message stated that the Department of Finance estimates that the program would cost \$19.3 million during the 2011-12 fiscal year and \$30 million thereafter, making reimplementing of the program fiscally unwise. AB 1090 is pending in the Senate which would allow counties to make the loans, but previous legislation failed when the lending industry opposed the repayment of county taxpayers ahead of other lien-holders.

**Fire Fee:** ABX1 29, another budget trailer bill, was signed into law on Friday. It creates a new fee of \$150 on structures in State Responsibility Areas located mostly in rural areas. Simply, the fee will be charged to rural residents for fire prevention. The measure is expected to raise \$200 million annually, but will likely face legal hurdles as the bill was passed on a majority vote and taxpayer groups are questioning the legality of the fee. The Governor noted the uncertainty in his signing message stating, "Revenues may not materialize," and directed that further clarifying legislation was needed to ensure that, "legal, programmatic, and implementation issues" are addressed.

**Redevelopment:** The California Redevelopment Association and the League of Cities is dotting the "i's" and crossing the "t's" on its lawsuit challenging the constitutionality of ABX 26/27. The suit will be asking the California Supreme Court for an immediate stay of these bills, and challenge that these bills violate the will of the voters when they approved Prop 22.

Within the Capitol attention has focused on the July 8<sup>th</sup> policy committee deadline, and discussion of the rumored third RDA bill has been eerily absent. With the passage of ABX 26/27 there were commitments that a third "policy" bill on redevelopment would be crafted to address the concerns expressed by members who begrudgingly voted for these bills. The general outline of this third bill would waive the increased payment to schools if the project area met yet to be specified standards for infill development and furtherance of sustainable community's strategies goals. We expect conversations to pick-up on this proposal over the summer recess.

**Tax Initiative:** One of the outstanding items from budget negotiations is what exactly will be on the ballot come November 2012? After Governor Brown's efforts to extend the VLF and sales tax rates fell short, he has not announced his approach moving forward. Labor groups have begun to discuss their preferences and are doing the polling to determine their final strategies. The California Labor Federation and California Federation of Teachers have publicly mentioned several ideas that they're kicking around:

- A 1 percent hike on the top 1 percent of earners, which has been polling extremely well
- Increasing corporate taxes
- Closing loopholes on corporations

- An oil severance tax
- An additional tobacco tax
- Proposition 13 reform which would increase property taxes on businesses (split roll)

Another approach the Service Employees International Union is taking is to try to overcome the 2/3 vote requirement for raising taxes by helping to elect legislators who would support taxes. Moderate Republicans with labor ties in competitive districts would be the most likely candidates. Business groups may boost their efforts in an attempt to avoid tax campaigns targeting particular industries.

**Amazon Tax:** One of the most widely discussed budget trailer bills Governor Brown signed into law is ABx1 28, otherwise known as the “Amazon” tax. The goal of the measure is to increase tax collections (about \$200 - \$300 million annually) from online retailers and level the playing field between those online companies and stores with a “brick and mortar” presence in California. It does not affect online retail customers.

Retail sales are generally subject to California sales tax, and stores are required to collect and remit the sales tax to the state. In most cases, the store collects the sales tax from the customer but even if it doesn't, it is still responsible for paying it. If a retailer does not have a connection to California – an out-of-state online retailer for instance, it is not responsible for the sales tax. The buyer, however, is expected to pay it when they file their tax returns.

ABX1 28 expands the requirements of certain online sales:

- A retailer that has a subsidiary or sister company that performs services in California in connection with products sold by the retailer, it is now responsible for collecting California sales tax. For instance, one Amazon subsidiary in California designed the Kindle, therefore, Amazon should be collecting California sales tax on purchases.
- If a retailer has an agreement with a person in California (an affiliate) who refers purchasers to the retailer - through a link on a blog or website, for example - and receives a commission or other fee, those sales are subject to California sales tax. In retaliation, both Amazon and Overstock.com have discontinued their relationships with their 25,000 California affiliates.

California businesses or consumers, who sell their products through out-of-state online retailers, are not affected by the new law as they are already required to collect sales tax.

Thus far it appears Amazon is refusing to charge sales tax which is due to the State at the end of October and the possibility of filing a lawsuit against the law is under discussion. On Friday, Amazon filed a referendum with the State Attorney General asking voters to overturn the new law as early as February. Once a title and summary are approved, Amazon will be required to collect more than 500,000 signatures to qualify the referendum for the ballot. If the referendum qualifies for the ballot it will face opposition from many California businesses who

contend that online retailers have an unfair advantage in being able to charge lower prices for the same items solely because they don't have to pay sales tax.

***Muni-Bankruptcy Bill Takes a Detour:*** Last week the Senate Committee on Governance & Finance, under the direction of Chair Lois Wolk, gutted AB 506 (Wieckowski) & referred the measure back to the Rules committee. Some county advocates fear that while the bill is not moving forward in its current form, it could end up being rewritten in the last minutes of session with little public opportunity to review.