Businesses Hit with Over $9 Billion in Tax Increases and Accelerations in 2008 and 2009 Budget Deals

As a result of the September 2008 and February 2009 budget agreements, our organizations believe it is important for decision-makers to have an understanding and appreciation of the impact of recently-enacted budgetary tax law changes on the California business community.

Because of tax changes adopted as part of the 2008-09 Budget in AB 1452 (Ch. 763, 2008) and SBX1 28 (Ch. 1, 2007-08), as well as ABX3 3 (Ch. 18, 2009-10) for the 2009-10 Budget, California businesses will pay over $9 billion more in taxes during the next 2 budget years. These increases were done through a combination of tax increases, borrowing, and acceleration of tax revenues from businesses in the next 2 years and beyond.

While some offsetting reforms were also adopted, many companies investing in jobs and operations in California – or attempting to recover from the economic downturn – will suffer permanent harm from these tax increases.

September 2008 Tax Increases and Accelerations

1. Strict Liability Penalty that Punishes Reasonable Tax Disputes (SB 28x)
Estimated to raise $1.4 billion from businesses in first year

This imposed a new, 20% strict liability penalty in addition to all existing penalties, which applies to "understatements" of tax liability of $1 million or more. It applied retroactively to tax year 2003, with a May 31, 2009 deadline, and, prospectively, is permanent. No other state has this penalty. It applies even to reasonable taxpayer behavior where there is no culpability, forcing companies to overpay their taxes every year, to take into account amounts reasonably in dispute or outside of their control, in order to ensure no 20% penalty is imposed. Overpayments will eventually be partially refunded, but the state will have received a low-interest loan from businesses, with no deadline for refunds.

2. Limit on Research & Development Tax Credit and Enterprise Zone Program Credits (AB 1452)
Estimated to raise $900 million from businesses

This bill imposed a two-year limit on the use of all business tax credits, including research and development and enterprise zone credits, California's only remaining statewide investment incentive tax credits. For tax years 2008 and 2009, these credits are capped at one-half of the taxpayer's liability, with only very small businesses exempted. This limitation will result in a mid-stream change and tax increase for companies who made investment decisions and plans in reliance upon them. Credits that could have been used during the limitation period are permitted to be carried over, but the lost time-value of money to companies is permanent.

California Chamber of Commerce
Building Owners and Managers Association
California Aerospace Technology Association
California Bankers Association
California Grocers Association
California Independent Grocers Association
California Manufacturers and Technology Association
California Retailers Association
California Taxpayers Association
California Broadcasters Association
California Business Properties Association
Council on State Taxation
International Council of Shopping

Centers
Long Beach Area Chamber of Commerce
National Association of Industrial and Office Properties
TechNet
Tech America

Offsetting Improvement: Effective January 2010, tax credits (but not enterprise zone credits per SB 28x) may be shared among a related group of affiliate or subsidiary companies, referred to as "unitary utilization." This will help some but not all companies, due to individual circumstances.

3. Suspension of Net Operating Loss (AB 1452)
Estimated to raise $1.6 billion over two years

This bill suspends for two years, tax years 2008 and 2009, the ability of businesses and individuals to deduct net operating losses (NOL). Very small businesses are exempted. The NOL deduction gives businesses more flexibility to manage losses they experience within timeframes and cycles that differ from the arbitrary and rigid government tax filing deadlines. The suspension will directly impact marginally profitable businesses attempting to emerge from losses due to increased tax liability and reduced cash flow.

Offsetting improvement: After the 2-year suspension period, treatment of losses will partially conform to federal carryover and carryback, which benefits some but not all companies, due to individual circumstances.

4. Accelerated Estimated Tax Payments (SBX1 28)
Estimated to raise $2.3 billion from businesses

Beginning January 2009 and ongoing, business and individual taxpayers must pay more of their estimated taxes earlier in the year. Instead of 4 payments of 25%, the first two payments will be 30% and the last two 20%. This will reduce cash flow for independent contractors and other businesses, small and large.

5. Accelerated Limited Liability Company Fee (AB 1452)
Estimated to raise $360 million from businesses

Limited liability companies (LLCs) must pay their annual fees during the first six months of the current tax year, beginning January 2009 and permanently thereafter. A 10% penalty will be assessed if businesses underestimate. The new fee deadline will result in a double payment of the fee in the early part of 2009 – the prior year's LLC fee and the current year's fee are due. This will pose a hardship for small companies with limited cash flow. Also, LLCs must accurately estimate the following year's fee liability, or be subject to a 10% penalty.

February 2009 Tax Increases

The February 19, 2009 State Budget included $12.5 billion in tax increases in ABX3 3 (Ch. 18, 2009-10), including over $3.5 billion impacting the California business community.

1. Sales and Use Tax Rate Increase (ABX3 3)
Estimated to raise $2 billion from businesses

Businesses in this state pay over 40% of the sales tax. The budget accord increased the sales tax rate starting April 1 by a full one cent in order to raise almost $6 billion over the next two years, of which businesses will pay roughly $2.4 billion.

2. Vehicle License Fee Increase (ABX3 3)
Estimated to raise $425 million from businesses

Businesses in this state pay approximately twenty-five percent of the VLF. The budget agreement increased the VLF rate to 1.15% starting May 19 in order to raise about $1.7 billion on an annual basis, of which businesses will pay about $425 million annually.

3. Personal Income Tax Rate Increase (ABX3 3)
Estimated to raise $1 billion from businesses

Many businesses in this state are organized as limited liability companies, Subchapter S corporations, and partnerships, among others, all of which pay under the Personal Income Tax Law. As such, these businesses will also pay the increases in the PIT rates of .25%. Almost all will now pay the highest marginal rate of 9.55% for the 2009 and 2010 tax years (which does not include the 1% surcharge for mental health funding). As such, the business community will pay over $1 billion during this two-year tax increase.