

# Taxing Decisions

A few states are dipping their toes into new revenue streams.

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BY LOUIS JACOBSON

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**A**cross the country, in blue states and red, governors and lawmakers are avoiding tax increases like the plague. If they're not cutting taxes outright, they're at least promising not to raise them.

In New Hampshire, the GOP-dominated legislature introduced a constitutional amendment to prohibit an income tax. In Oklahoma, the Republican governor has a proposal to reduce, and then eliminate, the state income tax. In Oregon, a Democratic governor kept his promise to propose a budget with no tax increases. West Virginia's Democratic governor and Legislature are in the process of phasing out a food tax entirely. In Massachusetts, the Democratic legislature has rejected a Democratic governor's proposal to hike the tobacco tax and close loopholes on candy and soda taxes. The Republican-dominated Indiana legislature went so far as to give residents a refund.

The confluence of deep-seated voter aversion to taxes, years of ideological gains by supply-siders, and fears that

raising taxes could endanger the fragile economic recovery have most states dodging any serious consideration of tax increases. There's also less pressure as the recovery continues, albeit unevenly.

In the last two legislative sessions, however, a few states have tested the waters, and they are among the country's largest. In those states that are either considering tax increases now or have recently enacted them, efforts have been driven by politicians in both parties.

◆ In California, Democratic Governor Jerry Brown, stymied by a failure to secure the required two-thirds vote in the Legislature, is asking voters to approve a ballot measure to increase the income tax on high earners and the sales tax. It will be a high-stakes vote: Brown's proposed FY 2013 budget is premised on the measure passing in November, with "trigger cuts" to take effect if it fails at the ballot box.

◆ In New York, Democratic Governor Andrew Cuomo and a Legislature under split control faced expiration of a tax on high earners. They agreed to legislation that restructured the tax categories, hiking taxes for the state's richest while easing the tax burden for many of those further down the income chain.

◆ In Maryland, a bid by Democratic Governor Martin

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—HARVEY ENGLANDER, LOS ANGELES POLITICAL STRATEGIST

O’Malley to raise gasoline taxes fizzled, but lawmakers and the governor agreed on income tax hikes instead. After initially adjourning in April without enacting anything, a special session in May produced a tax increase on people earning \$100,000 or more and couples earning \$150,000 or more.

◆ In Nevada last year, Republican Governor Brian Sandoval took heat from some in his own party for extending a series of business taxes that had been scheduled to expire.

◆ In Ohio, Republican Governor John Kasich proposed increasing severance taxes to as high as 4 percent on oil and natural gas drillers in his state, possibly generating \$1 billion by 2016. The plan, however, has stalled in the GOP-controlled legislature.

◆ In Arkansas, the Democratic-controlled legislature voted, by lopsided margins, to let voters decide whether to raise the sales tax by a half-cent to fund highway infrastructure improvements. It will be on the November ballot.

◆ Finally, in Kentucky, Democratic Governor Steve Beshear established a commission consisting primarily of private-sector leaders to review the overall fairness and adequacy of the state’s tax system. Recommendations are due later this year.

### Fiscal Dynamics

Colorado offers an example of the fiscal dynamics at work. The state was a pioneer in the tax-restricting policy known as TABOR and will, in 12 years, generate only enough sales, income and other general tax revenue to pay for “the three largest programs in the general fund—public schools, health care and prisons,” according to a study by the University of Denver Center for Colorado’s Economic Future. “There will be no tax revenue for public colleges and universities, no money for the state court system, nothing for child-protection services, nothing for youth corrections, nothing for state crime labs and nothing for other core services of state government.”

Some believe this is what should be happening with government—the “starve the beast” approach. Others, however, are deeply concerned. The “doomsday budget” in Maryland that would have taken effect if the legislature and the governor failed to agree on terms became a key point of leverage. It would have “cut heavily into education—not just higher education, but elementary and secondary, as well as into other programs,” says Roy T. Meyers, political scientist at the University of Maryland-Baltimore County.

Endless cuts to business taxes can reduce revenues for

## Building a Better Government

New York Governor Andrew Cuomo (D) is riding high in the polls. He's prepared to spend some of his political capital on the challenging—and possibly thankless—task of reorganizing state government to make it more efficient.

Cuomo first proposed a 20-member panel known as the Spending and Government Efficiency (SAGE) Commission in early 2011 and secured a place for it in the budget. The commission's stated goal is to “modernize and right-size state government, improve performance, increase accountability and save taxpayers' money.” It's billed as the first major redesign of state government since 1927.

The panel is getting “lots of emphasis” from the governor, says Gerald Benjamin, a political scientist at the State University of New York at New Paltz.

The commission was charged with delivering final recommendations by June 1. Even before the official deadline, it had made a number of recommendations, including merging the Bridge Authority with the Thruway Authority, combining some back-office activities, using reinsurance to increase capital available for affordable housing, and making energy efficiencies.

Much of the feedback so far has been cautiously optimistic.

The New York Observer editorialized that “state government desperately needs a housecleaning. Mr. Cuomo made administrative reform one of his top campaign promises in 2010. This is not a particularly sexy issue—few hearts beat faster when they hear the words ‘administrative reform’—but it is absolutely vital for the state's fiscal health.”

But Ken Brynien, president of the New York State Public Employees Federation, cautions that the commission's insularity leaves it at a disadvantage. “It is a mistake to believe that a group of private sector CEOs and not-for-profit administrators operating in a vacuum can make informed recommendations about changes in state agency operations,” Brynien says.

“The most informed people, and the ones who should be on the SAGE Commission, are the people who actually do the work, and the unions who represent them. But we were not invited to participate on the commission. So instead, we are in the position of having to lobby against any bad ideas they recommend.”

Others are more hopeful. The commission “could provide a roadmap for changes in service delivery that are long overdue—if they are done,” says Lawrence Levy, dean of the National Center for Suburban Studies at Hofstra University.

“The truth is that change, real change, is hard and can take time to do right.”

states yet provide little business growth, in the view of some policymakers. Ken Fergesen, a past president of the Oklahoma State Chamber of Commerce, recently noted that, while a relatively low-tax system is important for businesses, it's not always their first priority.

“When we called on CEOs of Fortune 500 companies, their first questions were about quality of life, not about tax rates,” Fergesen wrote. “They were concerned about educational and cultural opportunities for their employees.”

### Taxes Meet Mixed Reception

Polls indicate the degree of public support for new tax increases varies widely.

California voters appear to favor the governor's ballot measure. A February Field Poll put support at 58 percent, while a March poll by the Public Policy Institute of California found 52 percent backing. The polls found sharp divisions between Demo-

cratic and Republican views of Brown's proposal.

“While state tax increases face the dual challenges of voter distrust and partisan differences, most Californians support a tax increase on the wealthy and tax increases to avoid more cuts to local schools,” says Mark Baldassare, PPIC's president and CEO.

Meanwhile, New York voters supported the tax hike on high earners by a 3-to-1 margin in a Siena College poll last October, and by April, Cuomo's job performance rating was approaching two-thirds positive, according to a Siena poll.

Other efforts, by contrast, are starting in a hole. The sales tax proposal to build roads in Arkansas faces steep challenges, according to a March poll by Hendrix College. The ballot measure there trails 42 percent to 51 percent.

In general, says Harvey Englander, a veteran political strategist in Los Angeles, “Voters want more services, or at least basic services. They don't understand why their tax money appears to not be getting things done—like paving the streets, keeping libraries open or having smaller classrooms. They are upset at public employee pensions but don't understand the underlying concepts. They don't trust the people they have elected.”

Others maintain, however, that new taxes are the last thing voters need.

“Total state spending will have increased by \$31 billion since the recession began” under Governor Brown's plan, says California Senator Bill Emmerson (R), vice chair of the Budget and Fiscal Review Committee. “Increasing taxes on Californians who are already struggling to make ends meet while coping with a high unemployment rate is the wrong approach to addressing our state's fiscal problems. We must enact government reforms, such as a spending cap and fixes to our unsustainable pension system, to get our state back on the right fiscal track.”

No proposed tax increase is guaranteed to overcome the public's unwillingness to shell out more of their earnings—and their reluctance to fund government initiatives of which they're skeptical. But some proposals are more likely to be accepted than others.

Here are some ways the recent tax-hike proposals have minimized opposition and maximized voter goodwill.

◆ **Focus on the rich.** In the Occupy Wall Street era, some states are finding that targeting high earners can be politically palatable. The plan passed in New York certainly fits this demographic, creating a new top tax bracket and forestalling the expiration of the temporary “millionaires' tax.” So does Maryland's, affecting roughly the top 14 percent of taxpayers.

Brown's ballot measure in California would also target the wealthy—those earning more than \$250,000, roughly the top 1 percent of filers—for an income-tax hike that expires in seven years. The measure also would raise the sales tax for four years, however, which would represent a broader hit to taxpayers.

◆ **Be creative.** Cuomo and legislative leaders found a solution that allowed both parties to save face: Upper-income taxpayers would pay less than they would have if the existing millionaires' tax had been extended outright, but more than they would have if it had lapsed.



Senator  
Bill Emmerson (R)  
California

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—SENATOR BILL EMMERSON (R), CALIFORNIA

Political leaders in Albany “were desperate for revenues, even Republicans, since there was a huge deficit and they didn’t want to cut health and education spending,” says Lawrence Levy, a Hofstra University professor who specializes in New York politics. “A millionaires’ tax polled very high, so, voila, political kumbaya.”

◆ **Let the voters decide.** For legislators, increasing a tax is always politically easier if the voters do it—though in California, Brown had no alternatives. Democrats and Republicans in the Golden State are on different planets on tax policy, and with a two-thirds requirement in the Legislature for raising taxes, he was stymied.

“In general, legislative Democrats seem to believe additional expenditure cutbacks are not viable and would threaten important public services, particularly education and social services,” says Jason Sisney, deputy legislative analyst with the California Legislature’s Legislative Analyst’s Office. “By contrast, legislative Republicans are opposed to tax increases, given the softness of the state’s economy.”

Englander said there are “very few Democrats” in the California Legislature “who will seriously question the status quo, and there are fewer Republicans who are willing to compromise on just about any issue.” This made a ballot measure the only plausible approach.

Arkansas lawmakers, meanwhile, also went the ballot-measure route and deferred a ballot measure to the voters, though judging by the wide margins of passage in the state House and Senate, their decision to do so was more of a matter of choice than it was in California.

◆ **Extend taxes rather than impose new ones.** In Nevada, Governor Sandoval is pushing to delay the expiration of business taxes despite a backlash among some fellow Republicans. “He’s lined up support from several conservative legislators and it appears that for now the taxes will not sunset,” says Eric Herzik, a political scientist at the University of Nevada at Reno.

A major reason for Sandoval’s decision was to avoid another round of cuts to education and health care in a state that had been hit hard by the recession, says Herzik. For some conservatives, “the incessant mantra of ‘no new taxes’ has come up short in terms of having any positive effect on the state’s economy,” he says. “Thus, legislators are cautiously moving to extend current taxes.”

## California’s Prop 13 Challenged

Could a key provision of Proposition 13, the landmark tax-limitation measure that has profoundly shaped California’s fiscal picture since voters passed it in 1978, be near its end?

Charles Young, a former chancellor of UCLA, and William Norris, a former federal appeals judge, hope so. They have filed a lawsuit seeking to overturn one of Proposition 13’s key provisions—a two-thirds requirement for the Legislature to increase taxes. The two-thirds requirement has been controversial for years because it allows a minority to block fiscal action in the Legislature. Depending on one’s point of view, the supermajority requirement either has been a major impediment to the smooth functioning of government or a needed brake on excessive taxation and spending.

The argument Young and Norris are making hinges on whether the proposition was an “amendment” or a “revision” that changed the “basic plan” of government. To pass, amendments require only a majority vote of the people. A revision, however, requires a supermajority in both legislative chambers and voter approval.

The suit argues Proposition 13 was a revision because it “restructured California’s basic governmental plan by granting a minority in either house of the Legislature veto power over the majority’s exercise of the core legislative power to raise revenue by taxation.”

This line of argument was used unsuccessfully by opponents seeking to overturn California’s Proposition 8, which banned same-sex marriage. The state Supreme Court, in a 6-1 ruling, rejected their argument, stating the marriage ban didn’t “make a far-reaching change in the fundamental governmental structure or the foundational power of its branches.” This court ruling clarified the boundary between amendments and revisions and motivated Young and Norris to file the suit.

If the supermajority provision of Proposition 13 were to fall, it would have far-reaching consequences to the balance of power between the state and localities, and for how revenue is raised. Legal experts warn, however, that courts are often unwilling to overturn something that’s been in place for more than three decades—particularly if it’s already been affirmed in court. Indeed, that’s what the Los Angeles County Superior Court ruled and why the case is now in the appeals stage.

Howard Jarvis Taxpayers Association—the anti-tax group named after Proposition 13’s creator—is defending the measure. One of its allies, the Pacific Legal Foundation, argues that Proposition 13 is in no way a major “revision” of government. In an amicus brief, the foundation also points out that in the original case against Proposition 13, “the entire initiative was clearly upheld by the court.”

University of California at Berkeley law professor Jesse Choper says that, although the case being made by Young and Norris is “not a crazy argument,” he doubts the provision will be overturned.

California-based Democratic strategist Garry South agrees. “Prop 13 has been litigated to death, and I don’t see any reasonable prospect that it will be overturned.”

Extending expiring tax provisions hasn’t worked everywhere. The California Legislature’s failure to extend a temporary bump in income, sales and vehicle license fee rates that took effect in 2009 pushed Brown to seek approval from the voters.

◆ **Choose targets carefully.** When Ohio’s Kasich, one of the nation’s most fiscally conservative governors, considered how to raise taxes, he zeroed in on the natural gas industry—a booming

new sector that's poised to use fracking and other technologies to tap into the Utica Shale formation. Kasich wants to use proceeds from the severance tax to cut more broad-based taxes, including income and small-business taxes.

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—REPRESENTATIVE RICK RAND (D), KENTUCKY

their initial disagreement over general fund revenues—doubled the “flush tax,” a fee on septic and sewer systems in the Chesapeake Bay watershed. The proceeds will finance wastewater treatment and other water infrastructure, and also allows counties to levy taxes to support stormwater management. These concrete benefits, combined with a long-standing sentiment among Marylanders to protect the bay, means the provision probably has some degree of voter support, Meyers said.

◆ **Consider a broad overhaul.** One of the few tax approaches with

◆ **Make the benefits tangible.** That's what the Arkansas proposal to fund transportation does. “It's never easy to sell a tax, but there's a clearly established need in the state for an improved highway system, and we think voters will be receptive to that,” says Randy Zook, president and CEO of the Arkansas State Chamber of Commerce. Still, he acknowledged, “it will be a tough sell and a close call.”

In Maryland, lawmakers—despite

the potential to garner support from both sides of the aisle is the notion of thoroughly overhauling, rather than tinkering with, the tax structure. That's essentially what Beshear is trying to do in Kentucky.

“In our state, there's always some sort of talk about tax reform, and when you go through an economic downturn like we just did, it exposes deficiencies in your tax code,” says Representative Rick Rand (D), a member of the Tax Commission. “The governor felt it was important that we convene a panel to work through it and build consensus for some form of tax reform.”



Representative  
Rick Rand (D)  
Kentucky

### Uncertainty Persists

Still, there's no guarantee that any of these tax increases across the country will pass.

In Minnesota, for example, Democratic Governor Mark Dayton proposed increasing the state's top income tax bracket temporarily—to 13.95 percent, the highest in the nation—as part of a \$4.1 billion overall tax hike. But he's been stymied by a GOP-controlled Legislature that has staunchly blocked his agenda.

Carleton College political scientist Steven Schier says if Democrats win control of the Legislature in 2012, “some forms of tax increases, perhaps those proposed by Dayton, become much more possible. But as long as the GOP controls one chamber, such increases are far less likely.”