



The 2016 Legislative Session convened January 5th. January 31<sup>st</sup> marked the deadline to pass bills introduced in the respective house. Amongst the proposals that will not continue through the process this year include SB 8 (Hertzberg) which spurred a conversation on tax reform with respect to the new economy. The other bill is SB 593 (McGuire) that sought to bolster local efforts surrounding transient occupancy tax revenues from transient residential rentals. We understand some from Senator Hertzberg's SB 8 and Senator McGuire's SB 593 may be introduced (or amended into a bill) at some point in 2016. We commend Senator Hertzberg and Senator McGuire for carrying these "front burner" measures and starting a much needed conversation in California. February 19th is the last day for bills to be introduced, while noting there are exceptions and rule waivers.

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**SECTION 1: 2016-17 STATE BUDGET PROPOSAL HIGHLIGHTS**

The Governor released his 2016-17 State Budget proposal on January 7, 2015 that includes a \$122.6 billion General Fund budget plan that makes significant increases in funding for education, health care and state infrastructure. Here are some initial comments:

**Rainy Day Fund:** The Governor's budget makes a supplemental deposit of \$2 billion into the state's Rainy Day Fund - boosting the balance from 37 percent today to 65 percent of its constitutional target.

**Mandates:** We were informed that the Governor's proposed 2016-17 State Budget mandate suspensions are similar to last year's budget. The Governor's staff indicated as part of a budget briefing that final payments for an "executive order" for the reimbursement of costs incurred in complying with state unfunded mandates prior to 2004 have been made.

**Local Government/ RDA:** The Local Government section of the proposed budget summary reviews the implementation of last year's SB 107 that made numerous changes to the RDA dissolution process, with the most significant short-term change is transitioning successor agencies from a biannual Recognized Obligation Payment Schedule (ROPS) process to an annual ROPS process in 2016.

**Local Government/ Re-Entry Centers:** \$25 million is included in the Budget to provide incentive payments to cities and counties that agree to issue permits for hard-to-site facilities such as re-entry centers and mental health facilities between January 1, 2016 and June 30, 2017. The Administration will work with city and county stakeholders during the spring to develop an allocation methodology while also safeguarding existing permitted facilities.

**Local Wildfire Relief:** The Budget includes funding to support Lake and Calaveras Counties with paying for revenue loss; backfill (\$1.9 million) in response to the losses for the respective fires along with \$2.6 million for a contract with South Lake County Fire and a \$267,000 contract with Calaveras County. These are one time budget items however the Governor stated the State needs to have the funding in place for future incidents.

**State and Local Transportation:** The budget reflects the Governor's transportation package, first outlined last summer, that would provide \$36 billion over the next decade to improve the maintenance of highways and roads, expand public transit, and improve critical trade routes (see Section 4 of this report).

**Managed Care Tax Expiration:** The Governor vetoed various sales tax exemption and income tax measures in 2015 because of the uncertainty with the funding for managed care. The managed care tax expiration this June is amongst the Governor's concerns because it is a critical component of the state's financing for health care. The Budget proposes a tax reform package to extend a federally allowable managed care organization tax. To date, several proposals that would provide sales tax exemptions, and others allowing additional local voter-approved taxes beyond the statutory cap have been proposed (see below). The Governor last year vetoed AB 464 (Mullin) that would have raised the cap for locally-approved transactions and use taxes from 2% to 3% citing concern with multiple tax related measures on the 2016 November ballot.

**SECTION 2: LEGISLATION****Sales & Use Tax**

- **Authorizes a customer to file a claim for refund of excess sales and use tax paid by the customer:** Includes an amount of \$1,000 or greater, allowing the BOE to make a direct refund to the customer **(SB 640/ Beall)**
- **Exemption from taxes for feminine products:** BOE estimates state and local revenue loss of \$20 million **(AB 1561/Garcia)**
- **Exemption from sales and use taxes (includes local) for diapers:** The exemption applies until 2022 for diapers designated 3 or under **(AB 717/Garcia)**
- **Exemption from taxes (includes local) for certain new vehicle sales:** Applies to out-of-state buyers taking delivery in state until 2012 **(SB 680/Wieckowski)**
- **Transactions and use taxes: County of Alameda, County of Contra Costa, and Contra Costa Transportation Authority:** Extends the taxing authority for a transactions and use tax (of 0.5%) from December 2020 to December 2024 for Contra Costa County and the Contra Costa Transportation Authority; the County of Alameda would be included under this bill **(AB 1665/ Bonilla)**
- **Transactions and use taxes: San Bernardino County Transportation Authority:** Authorizes the creation of the San Bernardino County Transportation Authority as the successor agency to the San Bernardino Transportation Committee and provides powers that include the imposition of sales taxes **(SB 892 (Leyva))**

**Shared Economy / Short Term Rentals**

California's hotels are an important segment of the state's economy and 6.8% of all the jobs in the state are directly or indirectly related to the lodging industry to help generate \$7.7 billion in tax revenue for state and local governments American Hotel and Lodging Association).

- See: [http://www.muniservices.com/wp-content/uploads/122815\\_MuniServices\\_Policy\\_Report\\_-\\_Shared\\_Economy\\_-\\_Short\\_Term\\_Rentals\\_-\\_Considerations.pdf](http://www.muniservices.com/wp-content/uploads/122815_MuniServices_Policy_Report_-_Shared_Economy_-_Short_Term_Rentals_-_Considerations.pdf)
- **TOT revenues from transient residential rentals:** Bolsters local effort to regulate land use impacts and collect taxes **(SB 593/ McGuire)** *"Died" (the author may re-introduce another related measure in 2016)*

**Cannabis**

- **Clarification for cities and counties to regulate medical cannabis in their jurisdictions:** Removes the provisions from last year's AB 243 that would have granted the Department of Food and Agriculture the sole licensing authority for medical marijuana authority cultivation if a local cultivation regulation was not in effect as of March 1, 2016. MuniServices supports. **(AB 21/ Bonta)** *Governor's Desk*
- **Training for licensee agents and employees:** Requires a state licensee to institute and maintain a training program for the licensee's agents and employees regarding compliance with the Medical Marijuana Regulation and Safety Act (MMRSA) **(AB 26/ Jones-Sawyer)**
- **BOE advisory group:** Requires the BOE to create a group to examine strategies including point-of-sale systems to improve financial monitoring of cannabis businesses; includes a study requirement with findings and any proposed changes **(AB 1575/ Bonta)**
- **Tax amnesty:** Sets up a tax penalty amnesty program between April 1 to September 30, 2016 to encourage medical cannabis dispensaries to come forward to begin to comply with the tax laws **(SB 567/Gipson)**
- **Cash payments from medical cannabis:** Allows the BOE to accept cash payments for cannabis businesses **(AB 821/ Gipson)**
- **Policing authority for medical marijuana cultivation:** Provides that an exemption from the medical marijuana licensing requirements (for personal medical care, for example) does not limit or prevent local government from exercising its police power authority **(SB 435/Pan)**



### Documentary Transfer Chargers / Property Taxation

- **Property taxation welfare exemption increase:** Increases exemption for religious, hospital, charitable and certain rental properties when criteria is met where the occupants are from lower income households to \$100,000 of tax, with respect to lien dates occurring on and after January 1, 2017 (**SB 678/ Hill**)
- **Commercial and industrial property reassessment:** Proposed “split roll” (**SCA 5/ Hancock**) *Two-Year*
- **Change in ownership:** A change in ownership occurs when 90% of a legal entity's ownership interests transfer in a single transaction (**SB 259/ Bates**) *“Died”*
- **Base year value transfers:** Allows disabled persons or those over the age of 55 to transfer their base year value to a home of greater value within two years of the sale of the original property (**SB 378/ Beall**) *“Died”*
- **Proposed Ballot Initiative: Property Tax Surcharge to Fund Poverty Reduction Programs**  
See: [http://www.muniservices.com/wp-content/uploads/121615\\_MuniServices\\_Policy\\_Update\\_-\\_Property\\_Tax\\_News\\_Inflation\\_Factors\\_\\_\\_Proposed\\_Ballot\\_Initiative\\_\\_\\_New\\_Laws.pdf](http://www.muniservices.com/wp-content/uploads/121615_MuniServices_Policy_Update_-_Property_Tax_News_Inflation_Factors___Proposed_Ballot_Initiative___New_Laws.pdf)

### **SECTION 3: PREPAID MOBILE TELEPHONY SERVICES REVENUES (AB 1717) REGULATION APPROVED**

The public hearing for proposed Prepaid Mobile Telephony Services (Prepaid MTS) Regulations 2460, 2461, and 2462; and proposed amendments to Emergency Telephone Users Surcharge Regulations 2401, 2422, and 2413, were approved on January 26. MuniServices, through the cooperative efforts of participating cities, spent five years working with the wireless industry, retailers, the Governor's office, the BOE, the CPUC, and the Legislature in developing a solution for a complicated problem for collecting existing revenues from “prepaid wireless.” We conservatively expect our client UUT cities to experience a 15 to 20% increase in their wireless UUT once the state program is fully functioning. The regulation now goes to the Office of Administrative Law for an expected approval.

### **SECTION 4: GAS TAX/ TRANSPORTATION / ROAD MAINTENANCE**

#### California Road Charge Pilot Program – Study on Road Charging Rather Than a Gas Tax to Fix Roads

The California Road Charge Pilot Program established by State law in 2014 (SB 1077) is to test the feasibility of mileage-based user fees. The State is trying to determine if a fee of up to a few pennies per mile would be more effective at raising revenue for road projects than the state gas tax of 36 cents a gallon. The State is now seeking 5,000 volunteers to participate in the pilot program. (See: [http://www.dot.ca.gov/road\\_charge/](http://www.dot.ca.gov/road_charge/)).

#### Legislation

**Proposed Road Maintenance and Rehabilitation Program: AB 1591/Fraizer** would create the Road Maintenance and Rehabilitation Program to address deferred maintenance on the state highway, and local street road system. Over the next 10 years, the state faces a \$59 billion shortfall to adequately maintain the existing state highway system, in order to keep it in a basic state of good repair. Cities and counties face a \$78 billion shortfall over the next decade to adequately maintain the existing network of local streets and roads. Statewide taxes and fees dedicated to the maintenance of the system have not been increased in more than 20 years, with those revenues losing more than 55 percent of their purchasing power, while costs to maintain the system have steadily increased and much of the underlying infrastructure has aged past its expected useful life. California motorists are spending \$17 billion annually in car repair bills, which is more than \$700 per driver, due to the state's roads. The below is a preliminary review of the revenue and allocation aspect of the bill; we are working to understand the mechanics:

**Revenues:** Increases the gas tax by 22.5 cents (\$3.3 billion annually); Imposes a \$38 VLF (\$1.254 billion annually); and Imposes a \$165 vehicle fee on zero emission vehicles (\$16 million annually)

**Allocations:** 5% to counties that approve a transaction and use tax on or after July 1, 2016 for transportation (\$228.5 million annually); 47.5% to the State Highway Operation and Protection Program (SHOPP) (2.17 billion annually); 47.5% to local streets and roads (\$2.17 billion annually)



### Governor's 2016-17 Proposed State Budget Transportation Priorities

The Governor's package of revenues will be split evenly between state and local transportation priorities. The ten year funding plan will provide a total of \$36 billion for transportation with an emphasis on repairing and maintaining existing transportation infrastructure. It also includes a significant investment in public transit. Specifically, the proposal includes annualized resources as follows:

**Road Improvement Charge:** \$2 billion from a new \$65 fee on all vehicles, including hybrids and electrics

**Stabilize Gasoline Excise Tax:** \$500 million by setting the gasoline excise tax beginning in 2017-18 at the historical average of 18 cents and eliminating the current annual adjustments. The broader gasoline tax would then be adjusted annually for inflation to maintain purchasing power

**Diesel Excise Tax:** \$500 million from an 11 cent increase in the diesel excise tax beginning in 2017-18. This tax would also be adjusted annually for inflation to maintain purchasing power

**Cap and Trade:** \$500 million in additional cap and trade proceeds

**Caltrans Efficiencies:** \$100 million in cost saving reforms

### **SECTION 5: THE CHANGING ECONOMY AND TAX REFORM**

#### Expanding the Tax Base

SB 8 (Hertzberg) is "dead" with respect to the legislative process. We understand that the author plans, at the appropriate time, to introduce a substantially drafted measure (*Sacramento Business Journal*). It has been reported that eighty percent of California's economy is now providing services, not goods, and most of these services are untaxed. Based on a conversation reported in the *Orange County Register* where Senator Hertzberg spoke during an Orange County Taxpayers Association meeting late October 2015 he referenced the following components for a proposal: **Levy and to whom:** A maximum 5 percent tax on services, such as those provided by attorneys, accountants, engineers and architects. Exempted would be education, rent, health care and utilities, as well as services provided by businesses with under \$100,000 in gross revenues. The new revenue would replace some of the more volatile revenue derived from income taxes, particularly those from the wealthy. **Income tax:** The top state income tax rate of 12.3 percent would be reduced to 9.3 percent, and there would also be a cut in the rate for individuals making less than \$100,000 and couples making less than \$200,000. **Business income tax:** Businesses with less than \$1 million in sales would be exempt from the current 8.8 percent business income tax. An April 2015 study by the BOE discusses and estimate of potential revenue to be derived taxation of currently non-taxable services.

<http://www.boe.ca.gov/legdiv/pdf/ServicesRevEstimate.pdf>.

#### Considerations / Reforms

- **Leakage:** Leakage from internet sales (E fairness)
- **Pooling:** End pooling of online retail sales, third party vehicle sales made at DMV, and lower threshold to \$100,000 from \$500,000 on out of state sales
- **Self accrual:** Lower self accrual of use tax on construction projects from \$5 million to \$1 million
- **Sales tax distribution:** Remote sales in California (CA based internet sales) (possibly split 75/25)
- **Modernize** Broaden to services, on-line travel companies & vacation rentals, digital downloads, flexible to future changes
- **Destination sourcing:** Allocate local sales tax to the destination of buyer for all on-line retail sales
- **Exemptions:** Adopt criteria and sunset. Note: There are hundreds of exemptions; the cost to locals is \$3.2 billion. Revenue lost is BOE estimates using data from outside sources. Data is not available for the majority of exemptions, and remain unknown. A list (last published in July 2014) is available in Sales and Use Tax: Exemptions and Exclusions (Publication 61). The BOE also has a series of questions and answers about the application of sales tax. Refer to <http://www.boe.ca.gov/sutax/sutexempt.htm>.



### Next Steps on Tax Reform (League of Cities Revenue and Taxation Committee)

The League of California Cities adopted strategic goals for 2015, including a focus on the new economy to “Update the Local Government Tax Structure to Respond to the New Economy.” The League’s Revenue and Taxation Committee had briefings in 2015 on trends and issues regarding sales tax and property tax. In a January 15, 2016 review prepared by League Fiscal Consultant Michael Coleman (CaliforniaCityFinance.com) several considerations were outlined including:

- **County and State Pool Use Tax Allocations:** Should changes be made to update the BOE’s allocation practices to better allocate local sales and use taxes to the specific jurisdiction where use of the product first occurs?
- **Sales and Use Tax Base:** Should the sales tax “base” (transactions to which the sales tax applies) be broadened to include additional goods and/or services?
- **Tax Rebate Agreements:** Should agreements that shift revenue among local jurisdictions and rebate tax revenues to corporations and consultants be limited?
- **Sales Tax Sourcing Rules:** Should sales tax “sourcing rules” (definition of where the location of sale occurs) be changed?

MuniServices principals are part of an active a sub-group with League Staff to address these issues. Fran Mancina, MuniServices Vice President of Government Relations, was re-appointed in 2016 to the League’s Revenue and Taxation Committee and will continue to collaborate with stakeholders during this process.

### **SECTION 6: FEDERAL PROPOSALS**

#### Internet Tax Freedom Act

A one year extension (to October 1, 2016) of the ITFA moratorium was included in the Omnibus Spending bill, which Congress adopted and the President signed in December 2015. Although there may still be an attempt to put a permanent ITFA ban in the Trade bill, it appears that there is enough opposition in the Senate to prevent that from happening. The US Conference of Mayors’ sent the following to MuniServices in December 2015: “The Conference of Mayors opposes the permanent extension of the Internet Tax Freedom Act and feels it should be allowed to expire. To tax or not to tax Internet access is a decision that should be made at the state and local level. We will continue to urge that any short-term extension of ITFA of more than a year, be combined with (HR 2775, The Remote Transactions Parity Act) RTPA which will help state and local governments collect an estimated \$26 billion annually due on remote sales.” A proposed permanent Internet Tax Freedom Forever Act (S 431) would also have a very significant adverse impact on cities’ existing UUT on telecommunications.

On October 22, 2015 Senator Feinstein sent a letter to ranking members in the Senate with concerns that a permanent prohibition would hurt local governments, especially in California; the Senator asked for consideration to protect existing voter-approved taxes on telecommunication networks.

**Reasons for a California Local Voter Approved Requirement Exception:** California is the only state with a voter-approval requirement (Proposition 218) and that has local excise taxes on telecommunications.

- **Limited Exception:** No other state but California has both a voter approval requirement and a local telecommunication tax (UUT).
- **Limited Scope:** California exception only applies to telecommunications, and does not touch other provisions in ITFA.
- **Congress should respect tax decisions of local voters:** Whether viewed as a matter of “states rights” or a fundamental exercise of democracy, California local tax ballot measures should be treated as valuable or “sacrosanct” by Congress.
- **Voter approval requirement of California law achieves goal of ITFA:** California local voters have effective tools under state law to defeat or repeal local tax laws that are perceived as excessive or expansive.



- **California exception is technology neutral:** California exception seeks to achieve technology neutrality in taxation and competitive fairness among telecommunication providers.
- **California exception focuses on preventing loss of existing taxes:** California local telecommunication taxes will be significantly reduced if ITFA becomes a permanent ban, as traditional telephone converts to broadband. California seeks to avert future losses, and restore past losses, with a limited exception to ITFA.
- **California exception in a moratorium is beneficial.** A California exception to an ITFA moratorium would allow for a limited “experiment” in one state to demonstrate actual tax revenue consequences, rather than imagined or exaggerated ones. Measurable results from such an “experiment” would, thus, aid Congress in evaluating the financial impact of a permanent ban or partial repeal of ITFA.

### [The Remote Transactions Parity Act/ MuniServices HR 2775 Impact Analysis](#)

HR 2775, The Remote Transactions Parity Act, is bipartisan legislation that would not impose a new tax, but would enable state and local governments to compel retailers to collect and remit sales taxes on online sales, which are already owed to them under current law. HR 2775 is similar to the proposed Federal Marketplace Fairness Act of 2015 (S. 698) that would permit states to require vendors with more than \$1 million in gross receipts from remote sales to collect sales tax on purchases made by state residents if the state adopts and implements specified simplification requirements. Both S. 698 and HR 2775 are supported by MuniServices, the National League of Cities, Government Finance Officers Association, National Association of Counties, and the US Conference of Mayors. MuniServices prepared an impact analysis that was distributed via the CSMFO if some form of HR 2775 were enacted.

*Estimates for quarterly retail e-commerce sales as per the US Census bureau (CB15-133 published November 17, 2015).*

- **Estimate:** Adjusted for seasonal variation, but not for price changes, was \$87.5 billion, an increase of 4.2 percent ( $\pm 0.9\%$ ) from the second quarter of 2015.
- **Total retail sales:** Estimated at \$118.5 billion, an increase of 1.2 percent ( $\pm 0.2\%$ ) from the second quarter of 2015.
- **E-commerce sales:** Increased 15.1 percent from the third quarter of 2014. Accounted for 7.4 percent of total sales.

### [Wireless Tax Fairness with a California Exception \(H.R. 4287\)](#)

**H.R. 4287** would bar states and localities from imposing new discriminatory taxes on cell phone services, providers, or property. As drafted the measure includes an exclusion to protect local governments with local voter-approved measures. For several years, the wireless industry has sought a moratorium on new wireless taxes. This law, as originally written, would affect cities that have not yet obtained voter approval of a modern telecom ordinance, and it would also affect a city with a modern ordinance that wished to go to the voters for a tax increase. Three years ago, MuniServices worked extensively with the California League of Cities and their D.C. lobbyists to obtain an amendment (H.R. 4287) that would exclude voter approved local taxes from the moratorium (California exception). The “voter approval” exclusion came about as the result of numerous letters that our client cities sent to the California delegation.

### [Protecting Locals’ Borrowing Costs for Infrastructure Financing \(H.R. 2209\)](#)

**H.R. 2209** will protect locals and states from higher borrowing costs for public financing infrastructure projects. The bill makes a classification change to “High Quality Liquid Assets” in order to prevent increased borrowing costs for the state and local governments as banks will likely demand high interest rates on yields on the purchase of municipal bonds during times of nation economic stress. The American Society of Civil Engineers estimates a \$3.6 trillion cost to state and local governments over the next five years to meet our nation’s infrastructure needs. The National League of Cities, Government Finance Officers Association and US Conference of Mayors are among the lead stakeholders supporting this bi-partisan legislation.

**SECTION 7: FAA RULING & USE OF LOCAL JET FUEL REVENUES (2017 COMPLIANCE REQUIREMENT)**

An FAA re-interpretation of a ruling requires states and locals to target jet fuel revenue for the benefit of airports, or lose federal revenues. The rule does not apply to taxes in effect on December 31, 1987 including the local Bradley Burns 1.25% rate or the 4.75% state general fund rate in effect at the time. MuniServices continues to receive questions on this issue including how local voter-approved transactions and use taxes are treated, even if they are approved for a specific purpose. The Department of Finance indicated its understanding that “the FAA’s opinion is that any tax, regardless of whether it was intended by voters for a specific non-aviation purpose, if the tax is levied on aviation fuel, that aviation-fuel-related revenue must be dedicated to aviation purposes.” Impacted jurisdictions and the State were required to submit an ‘action plan’ to the FAA by the December 8, 2015. We anticipate continued activity at the State level during the 2016 Session (action is to be determined). We encourage clients to continue contacting their State and Congressional representatives with any concerns or comments with respect to new FAA requirement. See [http://www.muniservices.com/wp-content/uploads/112315\\_MuniServices\\_Policy\\_Update\\_-\\_FAA\\_Ruling\\_on\\_Use\\_of\\_Jet\\_Fuel\\_Revenues\\_\\_\\_Sample\\_Draft\\_Action\\_Plan\\_\\_Final.pdf](http://www.muniservices.com/wp-content/uploads/112315_MuniServices_Policy_Update_-_FAA_Ruling_on_Use_of_Jet_Fuel_Revenues___Sample_Draft_Action_Plan__Final.pdf)

**SECTION 8: STATE MORATORIUM, UNTIL 2020 ON LOCAL TAXES OF CLEAN ENERGY RESOURCES**

**AB 792** (Chapter 534, Statutes of 2014/ Mullin) became effective by imposing a moratorium until 2020 on local taxation of electricity derived from clean energy resources such as solar, and certain types of cogeneration and fuel cells, and where the resource is located on the user’s property. MuniServices is working to verify whether state agencies “certify” certain resources are “clean” per AB 792, how a city should keep track of these resources if they become taxable in 2020, and how the CPUC is proposing to address the metering of solar as well as the additional costs that such resources impose on the overall system. All of these issues are complex in nature, but are very important as “clean resources” will be a growing segment of electrical generation in the future in California. The ability to collect UUT on all forms of electricity, regardless of technology, will depend on how well we anticipate and address the practical issues of metering and tax collection of all forms of electric generation.

**SECTION 9: SEAPORT INFRASTRUCTURE FINANCING DISTRICTS**

**AB 63** (Chapter 793, Statutes of 2015/ Hall) provides new financing options to our ports. Seaports may now work with local cities and counties to create local Seaport Infrastructure Financing Districts, which can underwrite revenue bonds in anticipation of future tax revenues generated from growth in the flow of cargo through California’s seaports.