



ORANGE COUNTY BUSINESS COUNCIL



KernTax Facts Through Research

Date: May 22, 2026
 To: Members, California State Legislature
 From: Peter Blocker, Vice President of Policy
 Subject: **OPPOSITION to Governor’s 2026-27 May Revision Tax Proposals**

The California Taxpayers Association and the organizations listed above respectfully oppose proposals included in the Governor’s 2026 May Revision that would raise taxes by \$8.637 billion through July 2028. Taken together, these proposals represent a significant expansion of California’s tax base that will increase costs for consumers, harm small businesses, undermine investment, and weaken the state’s economic competitiveness.

At a time when affordability remains one of the most pressing challenges facing Californians, these proposals move the state in the wrong direction.

The proposed taxes undermine affordability, weaken competitiveness, and risk lasting damage to California’s economy.

Expansion of Sales Tax to Services and Digital Products

The May Revision proposes to expand California's sales tax to digital goods and services, including software and Software-as-a-Service (SaaS). This marks a fundamental departure from California's longstanding tax framework, which has applied sales tax only to tangible personal property.

Digital software is outside the sales tax base because California's sales tax was built to tax tangible personal property, not services or intangibles. A boxed software purchase is a sale of physical property, but SaaS is often an ongoing service relationship involving hosting, updates, cybersecurity, support, and access over time.

Rather than targeting consumption, this proposal increases costs on essential operational tools used by employers, embedding higher prices throughout the economy.

If California wants to modernize its tax code, that conversation should be broad, neutral, and focused on competitiveness — not a targeted multibillion-dollar tax increase on the basic tools businesses use to operate. Consumption trends have changed since the sales tax was created. The goal of the sales tax is to tax final consumption — the proposal does not tax final consumption in the same manner that a retail purchase does. By taxing business inputs such as software and services, the proposal introduces significant tax pyramiding — where taxes are applied at multiple stages of production. As a result, Californians will face higher costs for everyday goods and services, worsening the state's affordability crisis.

Permanent Limitation on Incentives to Invest in the California Economy

The May Revision proposes to permanently limit taxpayers' ability to claim tax credits.

Through years of trial-and-error research and long days spent turning ideas into groundbreaking consumer products, California companies led the world into a technological age. Thanks to California-grown technology, the state has continued to lead the nation in creating new technologies to assist the state in reaching its ambitious climate goals. The policy decisions made in this budget year will determine where major investments are made as new innovations and artificial intelligence breakthroughs change what the world looks like tomorrow.

The permanent limitation would include:

- **Research-and-Development Tax Credit.** As California businesses develop new greenhouse gas reduction methods, vaccines for emerging diseases, methods to utilize artificial intelligence, and other new technologies, the proposed limit erodes California's leadership in cutting-edge innovation.

The R&D credit supports labor expenses, supplies, and materials (except equipment) used for research performed in California. R&D involves highly compensated research jobs that boost personal income, sales, and property tax revenue for the state. This investment also creates jobs that benefit California's universities and colleges.

The provisions to limit the R&D tax credit come at exactly the wrong time. California is the national leader in artificial intelligence, software, and advanced research, and Silicon Valley remains the center of that ecosystem. These proposals deliver a double whammy to that leadership by both limiting the R&D incentive that supports innovation and increasing taxes on the digital and AI tools that businesses across the economy are now working to adopt. At the very moment companies are deciding where to build, scale, and commercialize the next generation of technologies, California should be reinforcing its innovation advantage—not making it more expensive to invent, invest, and grow here.

These costs will not remain on paper. When tax policy raises the cost of research, development, and technology adoption, businesses respond by delaying projects, reducing expansion plans, and cutting payroll. That means fewer opportunities for the engineers, scientists, software developers, and researchers who drive California's innovation economy. At a time when labor pressures are already straining the talent pipeline for high-skill technical workers, policies that discourage investment in research and advanced technologies will make workforce reductions more likely and weaken the state's long-term competitive position.

- **Incentives for Hiring California Workers.** This proposal would limit the utilization of tax credits that promote the employment of Californians, including the Hiring Credit (RTC Section 23621), Hiring Credit for Employees in Designated Census Tracts (RTC Section 23626), and the GO-Biz Hiring Tax Credit (RTC Section 23689). Hiring credits encourage businesses to increase employment in the state. At a time when California's unemployment rate is the third highest in the United States, hiring credits are a powerful tool to help Californians find jobs.
- **Incentives for Filming Motion Pictures and Television Productions in California.** This proposal limits the utilization of the qualified expenditures for the Production of Qualified Motion Pictures (RTC Sections 23685, 23695, and 23698). These tax credits promote and incentivize film and television projects within the state of California. By limiting these tax credits, California is pushing taxpayers and the industry to move operations out of the state, undoing the important work the Legislature and state officials have done in recent years to stop runaway production. Every production creates jobs for writers, camera operators, wardrobe specialists, caterers, office staff, and many other workers – and Californians need these jobs.

Managed Care Organization Tax

The proposed Managed Care Organization (MCO) tax illustrates a broader concern with this budget's approach to financing: while framed as a mechanism to support Medi-Cal, it in practice imposes significant new costs on health plans that will be passed through to employers in the form of higher premiums and reduced benefits. As one of several tax-related proposals, it contributes to the cumulative burden on California employers who already face some of the highest costs in the nation. Increasing taxes on health coverage only drives up the cost of doing

business, making it harder for employers to provide affordable benefits to their workforce, and ultimately undermining the state's economic competitiveness.

Conclusion

California is facing an affordability crisis, persistent economic uncertainty, and intense competition for jobs and investment. In that environment, the Governor's May Revision moves in the wrong direction. These proposals would broaden the tax base, raise costs on essential business inputs, weaken incentives to invest and hire in California, and ultimately pass higher costs on to consumers, workers, and employers.

This is not the time to make California more expensive—particularly for the industries driving its future. Limiting R&D incentives while increasing taxes on digital services and AI-related business tools compounds the burden on Silicon Valley, the broader tech sector, and businesses across the state working to adopt artificial intelligence. The likely result is reduced investment, slower innovation, and increased pressure on employers to scale back hiring or high-skill jobs. The Legislature should reject these proposals and instead pursue policies that maintain affordability, support innovation, and strengthen California's long-term competitiveness.

For these reasons, we respectfully urge rejection of the May Revision tax proposals. Now is not the time to raise taxes in California.

On behalf of...

California Taxpayers Association
Association of California Life and Health Insurance Companies
Biotechnology Innovation Organization
California Business Properties Association
California Chamber of Commerce
California Manufacturers & Technology Association
Computer & Communications Industry Association
Contra Costa Taxpayers Association
Council on State Taxation
CTIA
Family Business Association
Howard Jarvis Taxpayers Association
Kern County Taxpayers Association
Orange County Business Council
TechNet