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California SB 584, Short Term Rental

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Tax Policy Analysis
California SB 584, Short Term Rental
By: Khanh Le and Cheryl Gamat, MST Students

California SB 584, or the "Short Term Rental" tax bill, would impose a new tax and address issues of affordable housing and fair wages for construction workers. The main components of the bill are as follows:\(^1\)

- **Laborforce Housing Financing Act of 2023:** This act defines “Laborforce Housing” as housing owned and managed by specific entities solely for the benefit of residents and households who cannot afford market rent. The residents of these properties would have certain protections.

- **Laborforce Housing Fund:** The bill establishes a fund to be used by the Department of Housing and Community Development for the creation of Laborforce Housing and other housing projects. The fund would be financed by public entities, local housing authorities, and mission-driven nonprofit housing providers.

- **Use of funds:** The use of the tax revenues is restricted to construction or rehabilitation projects. All construction workers involved in these projects must be paid at least the prevailing wage rate, or all contractors and subcontractors must use a skilled and trained workforce to complete the project.

- **Short-Term Rental Tax:** Starting January 1, 2025, the bill imposes a 15% tax on the rental price of short-term rentals in the state. Short-term rentals refer to homes, houses, rooms in homes or houses, or other lodgings that are not hotels, inns, motels, or bed and breakfasts, rented for 30 days or less. The short-term rental facilitator or the operator (depending on who processes the payment) is responsible for collecting this tax.

- **Use of tax revenue:** All revenues from the short-term rental tax, after refunds and administration and collection costs, will be deposited into the Laborforce Housing Fund.

- **Urgency statute:** The bill declares that it is to take effect immediately due to its urgency nature.

The table below provides an analysis of the proposed Short-Term Rental Tax using the AICPA’s 12 guiding principles of good tax policy.\(^2\)

\(^1\) California Legislative Information website (May 2023) SB-584 Labor force housing: Short-Term Rental Tax Law https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202320240SB584.

<table>
<thead>
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<th>Criteria</th>
<th>Does the proposal satisfy the criteria? (explain)</th>
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<td><strong>Equity and Fairness</strong> – Are similarly situated taxpayers taxed similarly? Also consider any different effects based on an individual’s income level and where they live.</td>
<td>Equity: The bill seems to address equity. The creation of laborforce housing is aimed at providing affordable housing for those unable to meet market rates, addressing economic and social disparities. Horizontal Equity: This refers to the equal treatment of taxpayers who have the same ability to pay. SB 584 imposes a 15% tax on all short-term rentals, regardless of location, size, or amenities. While this approach applies a consistent rate across all rentals, it may not account for variations in rental prices, which could result in differing tax burdens for renters with the same ability to pay. Therefore, SB 584 may not fully satisfy the principle of horizontal equity. Vertical Equity: This involves the differential treatment of taxpayers according to their ability to pay, with higher-income individuals able to pay more. SB 584's tax on short-term rentals is likely to have a progressive effect, as short-term rentals are often a luxury and more commonly used by higher-income individuals. Higher rental rates will have a larger amount of short-term rental tax imposed. By using the revenue to support affordable housing initiatives, the tax serves to redistribute income to benefit lower-income households. In this sense, SB 584 may be seen as promoting vertical equity. Fairness: From a fairness perspective, this bill provides additional funding for affordable housing, which could be seen as a fair response to the housing crisis. But fairness can also depend on one's viewpoint. For example, some might argue that it is fair to tax short-term rentals to fund affordable housing, while others might argue it's unfair to place this burden on short-term rental operators or users that may also include low-income renters.</td>
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<td><strong>Certainty</strong> – Does the rule clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined?</td>
<td>Defined Rate: The tax rate is clearly defined as 15% of the rental price of the short-term rental. Defined Base: The base of the tax, short-term rentals, is also well defined in the legislation. The bill describes short-term rentals as &quot;the occupancy of a home, house, a room in a home or house, or other lodging that is not a hotel, inn, motel, or bed and breakfast, in this state for a period of 30 days or less.</td>
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Definitions will be needed for these terms, particularly “bed and breakfast.”

However, the bill does not provide explicit details regarding additional charges, such as housekeeping and other services. Typically, in many jurisdictions, taxes that apply to short-term rentals are calculated based on the total amount charged to the renter, including any mandatory fees and charges associated with the rental. This often includes housekeeping fees, service fees, and resort fees, among others. If such charges are considered part of the cost of the rental and are mandatory for all renters, they are typically included in the taxable amount. However, the treatment of additional charges can vary based on local tax regulations and the specific details of the rental transaction. In some cases, optional or separately itemized charges may be excluded from the taxable amount. Additionally, some jurisdictions may have specific rules for how to handle bundled charges or charges for services that are not directly related to the rental itself.

Collection: The bill clearly states who is responsible for collecting the tax (the short-term rental facilitator or the operator, depending on who processes the payment), which provides certainty about who is responsible for the tax's administration.

Usage of the Tax Revenue: The bill clearly outlines that the tax revenue will go to the Laborforce Housing Fund, which creates certainty about the use of the funds.

The proposal satisfies the principle of certainty. However, it is important to consider how additional charges are typically treated in tax policy and to consult any implementing regulations or guidance that may be issued by the California Department of Tax and Fee Administration (CDTFA) for further clarification.

<table>
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<tr>
<th>Convenience of payment – is the tax due at a time that is convenient for the payor?</th>
<th>California SB 584, the short-term rental tax seems to satisfy this principle based on the following points:</th>
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<td>Collection by Facilitators or Operators: The bill clearly states that the tax is to be collected by the short-term rental facilitator (if they process the payment) or the operator. This means that, for renters, the tax is likely to be included as part of their payment for the rental itself, much like sales tax is</td>
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included in the price of goods at a store. This would make it convenient for renters, as they would not need to calculate and send in the tax separately. It appears that a facilitator might be an entity like AirBnb that would collect for owners who use their platform to find rental customers. This should make collection easier for many short-term rentals.

Defined Rate: The tax rate is clearly defined as 15% of the rental price, which makes it relatively straightforward for facilitators, operators, and renters to understand the amount owed.

**Effective Tax Administration – Are the costs to collect the tax at a minimum level for both the government and taxpayers? Also consider the time needed to implement this tax or change.**

Variety of Rental Situations: The varied nature of short-term rentals could pose challenges for tax administration. For example, it may be difficult to track and collect taxes from individual homeowners who occasionally rent out their homes without use of a platform or website (such as AirBNB) that could facilitate tax collection or who operate informally.

Enforcement: Depending on the size of the short-term rental market in California, enforcing this new tax could potentially require substantial resources, especially if individual homeowners who rent properties are not using a facilitator who would automatically collect the tax.

Burden on Facilitators/Operators: Placing the burden of tax collection on facilitators or operators could result in administrative difficulties or resistance, especially for smaller operators who may not have the resources to handle this additional responsibility.

California SB 584, the short-term rental tax seems to not satisfy the effective tax administration principle

**Information Security – Will taxpayer information be protected from both unintended and improper disclosure?**

California SB 584 does not directly address information security in relation to the new tax on short-term rentals. It does not specify how taxpayer data will be handled, stored, or protected during the tax collection process. However, considering these points, while SB 584 does not directly address information security, the facilitators and operators responsible for collecting the tax, as well as the California Department of Tax and Fee Administration (CDTFA) which is responsible for administering the tax, would still be subject to existing information security regulations.

n/a
Since it is unlikely that owners would need to report confidential data of renters, personal information about renters, such as names, addresses, or other identifying information, is generally not necessary for tax compliance. The focus of the tax is on the occupancy of the short-term rental and the revenue generated from it, not on the individuals renting the property.

### Simplicity - can taxpayers understand the rules and comply with them correctly and in a cost-efficient manner?

Based on the text of California SB 584, some elements of the bill potentially create complexity.

Implementation for Facilitators and Operators: While the mechanism for tax collection is straightforward from the renter’s perspective, it may introduce complexity for the facilitators and operators, particularly for those who do not currently have systems in place for collecting such a tax.

Different Rental Situations: The nature of short-term rentals can be quite diverse, from individual homeowners renting out a room occasionally to businesses that own and rent out multiple properties. This diversity could make the tax more complicated to administer and comply with.

Enforcement: Enforcing this new tax could be a complex task, especially when it comes to individual homeowners who rent properties without a facilitator who would automatically collect the tax.

The proposal does not satisfy the principle of simplicity.

### Neutrality - The effect of the tax law on a taxpayer’s decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.

Potential Distortion of Rental Decisions: The imposition of a 15% tax on short-term rentals could potentially distort the market by influencing decisions related to property rentals. For instance, property owners might choose to shift from short-term rentals to long-term rentals to avoid the tax or increase their prices to pass the tax burden onto consumers. On the consumer side, the increased cost might discourage short-term rentals and impact the tourism industry.

Impact on Different Property Owners: The tax also impacts different actors in the market differently. It might be easier for large rental platforms or operators, who already have systems in place for handling tax collection, compared to smaller operators or individual homeowners.
Competitive Balance: Because the tax applies only to short-term residential rentals and not to traditional lodging establishments like hotels or motels, it could distort the competitive balance in the lodging market. While many cities impose transient occupancy taxes on short-term rentals, the proposed state rate might be higher or lower and affect decisions of tourists and others on where to stay for short-term rental needs.

Since bed and breakfasts are excluded, owners who rent out frequently on Airbnb, for example, are likely to start offering breakfast. If there is no specific definition of bed and breakfast businesses, this could be abusive if providing an automatic coffee maker and leaving frozen pastries in the freezer to be warmed in the microwave, for example, would convert the property into a bed and breakfast.

Thus, while the proposed bill might help raise funds for affordable housing (an important goal in itself), it might not fully align with the principle of tax neutrality due to its potential to distort economic decisions in the rental and lodging markets.

| Economic growth and efficiency – will the tax unduly impede or reduce the productive capacity of the economy? | Increased Funding for Affordable Housing: By creating a new source of funding for laborforce housing projects, the bill could potentially stimulate economic activity in the construction sector and contribute to the supply of affordable housing, which is a significant issue in many parts of California. A more adequate supply of affordable housing could, in turn, benefit economic growth and efficiency by helping to ensure that workers can afford to live near where jobs are located. The proposal seems to satisfy the principle of economic growth and efficiency |
| Transparency and Visibility – Will taxpayers know that the tax exists and how and when it is imposed upon them and others? | Clearly Defined Tax and Rate: The bill clearly defines what constitutes a short-term residential rental and sets a specific tax rate (15% of the rental price), which contributes to transparency. Ideally, owners will let renters know of the tax ahead of reserving the rental space. Collection Mechanism: The tax is collected by the short-term rental facilitator or operator at the point of transaction, which makes the tax visible to the consumer at the time of payment. | + |
Specific Use of Funds: The revenue generated from the tax is directed to a specific purpose - the Laborforce Housing Fund. This transparency about the use of tax revenues can contribute to public understanding and acceptance of the tax.

The proposal seems to satisfy the principle of transparency and visibility.

| Minimum tax gap – is the likelihood of intentional and unintentional non-compliance likely to be low? Is there any way people may intentionally or unintentionally avoid or evade this tax or rule? | Collection by Facilitators or Operators: The fact that the tax is to be collected directly by facilitators or operators at the point of transaction could help to minimize the tax gap, as it does not rely on individual renters to report and remit the tax. The facilitator’s role in collecting the tax can enhance compliance, as it centralizes the collection process. However, the bill does not provide specific guidance on how tax collection will be handled for operators who do not use facilitators. Clear collection mechanisms and guidance for both facilitators and independent operators are essential to minimize the tax gap. Enforcement and Compliance Measures: The effectiveness of the California Department of Tax and Fee Administration (CDTFA) in administering and enforcing the tax would also be crucial in minimizing the tax gap. If robust mechanisms are put in place to ensure compliance and detect evasion, the tax gap could be minimized. The bill does not provide explicit details on compliance measures, such as reporting requirements, audits, or penalties for non-compliance. Compliance measures are crucial to encourage taxpayers to pay the correct amount of tax and deter evasion. Clear compliance measures, coupled with effective enforcement, can help minimize the tax gap. The proposal seems to satisfy the principle of minimum tax gap as it provides a framework for the collection and enforcement of the tax on short-term rentals. However, enforcing a tax on short-term rentals can be challenging due to the diversity of local regulations, incomplete information, and the informal nature of some rentals. With a combination of information sharing, collaboration with rental platforms, outreach, penalties, incentives, data analytics, and collaboration with local governments could help improve compliance and reduce the tax gap. | + |

<p>| Accountability to taxpayers – Do taxpayers have access | Several elements in California SB 584 seem to align with this principle: | +/- |</p>
<table>
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<tr>
<th>Question</th>
<th>Response</th>
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| to information on tax laws and their development, modification and purpose; is the information visible? | Specific Use of Funds: The bill clearly outlines that the revenues from the tax are to be deposited into the Laborforce Housing Fund and used for the creation of Laborforce Housing and related projects. This specificity provides transparency about how the tax revenue will be used.  

Oversight of Funds: The fact that the funds are managed by the Department of Housing and Community Development could contribute to accountability, assuming that there is adequate oversight and reporting on how the funds are spent. 

Reasoning for Using Funds for Housing: The bill does not provide a detailed explanation of why these funds are specifically allocated to the housing fund. However, the focus on laborforce housing may be intended to address housing affordability and accessibility challenges faced by households with low or moderate incomes. By directing tax revenue from short-term rentals to laborforce housing, the bill may aim to address housing disparities and support equitable access to housing. 

The bill also does not explicitly explain why this particular tax was chosen over other funding mechanisms. The decision to tax short-term rentals at 15% may be based on the perceived impact of short-term rentals on housing availability and affordability or the desire to generate revenue from the growing short-term rental market. Policymakers may have determined that this tax aligns with the goal of supporting Laborforce housing. However, a more comprehensive explanation and justification for this tax choice would enhance accountability to taxpayers. |
| Appropriate government revenues — will the government be able to determine how much tax revenue will likely be collected and when? | Revenue Generation: The bill introduces a new 15% tax on short-term rentals, which could generate significant revenues. The size of the short-term rental market in California is substantial, and if the tax is effectively administered and collected, it could provide a meaningful source of revenue.  

Specific Use of Funds: The bill clearly states that the generated revenue will be used for the Laborforce Housing Fund, which finances housing projects for residents and households unable to afford market rent. This aligns the generation of revenue with a specific governmental responsibility—providing affordable housing. |
The proposal seems to satisfy the principle of appropriate government revenues. However, SB 584 earmarks the tax revenue from short-term rentals for the Laborforce Housing Fund. While earmarking can help ensure that funds are used for their intended purposes, it may also reduce budgetary flexibility. If the revenue generated by the tax exceeds the needs of the housing fund, it may result in an accumulation of unused funds. Conversely, if the tax revenue falls short, it may be challenging to find alternative funding sources for the housing projects. Policymakers should consider the potential risks and benefits of earmarking and whether it aligns with broader budgetary and policy priorities.

The above analysis shows that the California SB 584, or the "Short Term Rental" bill meets most of the twelve good tax policy principles. The proposal fails to meet principles of effective tax administration, simplicity and neutrality.

Overall, while the bill makes attempts to align with the principles of good tax policy, its effectiveness will depend largely on its implementation and the balance it strikes among competing interests. The potentially different impacts on various stakeholders, such as renters, operators, and housing beneficiaries, as well as the administrative capacity of the government, should be considered for a comprehensive understanding of its alignment with good tax policy principles. As always, in-depth policy analysis should involve consultation with experts and thorough consideration of the specific context and relevant data.

Some modifications of the bill can be made to meet principles of effective tax administration, simplicity and neutrality:

- Offer resources, support, and education to facilitators and operators to help them understand and fulfill their tax collection and remittance responsibilities.
- Ensure that the process for remitting the tax to the state is as straightforward as possible, which will reduce administrative burden for facilitators and operators. This might involve creating an online portal or system specifically for this purpose.
- Simplify the language and definitions within the bill as much as possible. The more clearly defined and understandable the language, the easier the bill will be to administer and comply with.
- Consider adjusting the tax rate or providing exemptions for certain types of short-term rentals to minimize distortions to the market. The current flat rate might disproportionately affect lower-priced rentals, potentially discouraging them.
- If possible, structure the tax collection process so that it doesn't unduly burden any specific group (like individual homeowners or small facilitators) more than others.
• Establish partnerships with major short-term rental platforms like Airbnb, VRBO, and Booking.com. These platforms can share data about rental listings, operators, and transaction volumes, helping the CDTFA identify operators who should be collecting the tax. This can improve compliance and reduce administrative burdens for both the state and operators.

• Local governments often have their own Transient Occupancy Taxes (TOTs) and business license requirements for short-term rentals. The CDTFA can work with local governments to share information on registered short-term rental operators and any taxes they’ve collected.

• Reimbursing or providing incentives to short-term rental operators and facilitators for their efforts to collect and remit the tax may help mitigate the administrative burden and encourage compliance with the tax.

• Provide clear guidelines and resources for short-term rental operators and facilitators to understand their tax obligations and facilitate compliance.

• Even though it is unlikely that confidential data of renters would be required, it is important for operators and facilitators to be mindful of data privacy and security requirements when handling any personal information. This includes complying with applicable data protection laws and ensuring that personal data is stored and transmitted securely.