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California

Tax Commission Issues Last-Minute Details For Sept. 10 Meeting on California Reforms

SACRAMENTO, Calif.—An appointed commission weighing recommended changes to the state's tax system released more than 100 pages of proposed legislative language less than 24 hours before its meeting set for Sept. 10, amid mounting criticism from advocacy groups that the commission is moving too quickly toward momentous changes.

Gerald Parsky, chairman of the 14-member Commission on the 21st Century Economy, had assured fellow commissioners and the public in recent weeks that details of proposed tax changes would be available at least 72 hours before the Sept. 10 meeting in Los Angeles. Instead, the information was posted about 1:30 p.m. Sept. 9.

The commission, appointed last December by Gov. Arnold Schwarzenegger (R) and the Legislature, is facing a Sept. 20 deadline to finalize its report and submit it to lawmakers for their consideration. Schwarzenegger has said he will call a special session of the Legislature this fall to weigh the commission's recommendations.

Framework Set, Details Not Available

The framework of the commission's proposals has been set since early August, but commissioners and interested parties have been waiting for key details contained in the draft legislation, such as tax rates and timetables for phasing in the changes. The draft language calls for repeal of the state corporate and franchise income tax, major modifications to the personal income tax, reduction of the state portion of the sales and use tax, and enactment of a new business net receipts tax.

Commission spokeswoman Ashley Snee told BNA Sept. 9 the delay was due to the complexity of the tax proposals at hand. Commission staff members have worked nonstop to craft the proposals, which were released as soon as possible, she said.

"It is most important to get it done right," Snee said.

Under the draft legislation, the corporate tax would be eliminated in 2012, and the state portion of the sales and use tax would be reduced by 1 percent a year for five years, ending up at 0.75 percent by Dec. 31, 2015.

The personal income tax would be modified to have only two tax brackets, eliminate credits and most deductions, and include a much larger standard deduction.

The PIT rates would be 2.75 percent for income up to \$56,000 for joint filers and \$28,000 for single filers, and 6.50 percent for incomes above those amounts.

Itemized deductions would be limited to mortgage interest, property taxes, and charitable contributions, while the standard deduction would increase to \$45,000 for joint filers and \$22,500 for single filers.

Physical or Economic Presence

A business net receipts tax would be imposed on all businesses with a physical or economic presence in the state. The tax would be calculated by subtracting purchases from gross receipts of a firm, and would apply to all forms of businesses including C corporations, passthrough entities, and sole proprietorships. Financial institutions would either be included using a separate calculation method, or would remain subject to current tax law.

The BNRT would be phased in over five years as the other taxes are phased out, and with a filing threshold of \$500,000 and tax liability threshold of \$250,000. For multistate firms, income would be apportioned using water's edge rules now available to multinational corporations.

Although the commission would leave a final decision about a BNRT rate to the Legislature, two commissioners who have studied the issue most closely said in a Sept. 9 memo accompanying the draft language that they are contemplating a rate of 4.2 percent. The impact of that rate is still being analyzed, Commissioners Christopher Edley and John Cogan said.

The rationale for the changes, especially the new BNRT, would be to broaden the tax base and reduce the crippling volatility of the state's current tax structure, which relies heavily on revenue from the personal income tax, and especially revenue from capital gains and high-income earners.

Rainy Day Fund Boost

The proposal also calls for an increased "rainy day fund" to capture unanticipated or one-time revenues. The reserve fund would hold 12.5 percent of state revenues, an increase from the current target of 5 percent. Suspension of revenue transfers into the reserve fund, withdrawals from it, and allowed uses for the funds would be limited.

Commissioners will debate the proposals at the Sept. 10 meeting, and could cast final votes on the package or wait until another meeting tentatively scheduled for Sept. 14 in Berkeley.

If the commission goes forward with its proposals centered on a new business net receipts tax, it would go against the urging of academics, business representatives, consumer advocates, and at least one member of the commission, who have all said a BNRT should not be included in a final package in the short term.

Critics of the BNRT concept have differing opinions on its potential value, but they all have agreed that California must study the concept much more carefully before calling for such a wholesale change in tax policy.

Red, White and Blue Plan

Richard Pomp, a member of the commission and a law professor at the University of Connecticut, released his own proposal Sept. 4, which he called the Red, White and Blue Plan. In his introduction to the plan, he said the commission has not heard credible evidence that the corporate income tax should be repealed, or that the unknown and untested BNRT should take its place. He said he is likely unable to vote for key elements of the proposal on the table. Instead, he called on the commission to consider a plan that would:

- adopt a severance tax to be levied on oil extraction in the state;
- create an independent tax court to adjudicate disputes between taxpayers and state tax agencies and eliminate the requirement that taxpayers pay their disputed tax before disputing their assessments;
- eliminate several corporate tax provisions adopted in 2008 and 2009 creating a single-sales factor for multistate apportionment, net operating loss carrybacks, and tax credit sharing among members of unitary groups;
- publish the names of publicly traded corporations receiving more than \$5 million in tax expenditures a year and the nature of those expenditures; and
- publish the names of publicly traded companies and the amount of California corporate income tax they have paid.

Also to be discussed at the Sept. 10 meeting is a proposal from Commissioner Fred Keeley to impose a new "pollution tax" of 18 cents a gallon on purchases of gasoline and diesel fuel, to be indexed with inflation, to discourage the use of fossil fuels and increase state revenue (168 DTR H-4, 9/2/09).

Tax Academics Urge Caution

Meanwhile, a group of nine tax policy academics wrote to the commission Sept. 5 urging members to delay any recommendations for enactment of a new BNRT because it raises too many difficult questions. Instead, they recommended modifications to the existing sales tax that would achieve the same goal of the BNRT—creating more of a value added tax—without the complications and possible unintended consequences.

The group said the sales tax should be modified to cover selected retail services and exclude business purchases, with continued efforts to include cross-border retail purchases in the tax base to the extent allowable under federal law. Kirk Stark, law professor at the University of California, Los Angeles, and a signatory to the letter, told BNA Sept. 9 that because the federal government does not impose a value-added tax, on which the BNRT is modeled, California would be the only subnational entity in the world with its own VAT-type tax. The implications for multijurisdictional taxpayers and California-only taxpayers need much more study, he said.

“Slapping apportionment onto a net receipts tax doesn't magically convert it to a value-added tax,” Stark said. “For one state to sort of go its own way is exceptionally tricky.”

Early Warnings Not Heeded

Several of the signatories testified before the commission in meetings over the past nine months about the complications of the BNRT, but “despite the early warnings”

the commission appears to be going forward with the idea, Stark said. “The commissioners deserve a lot of credit for trying to come at this in an innovative way, and it would be an extraordinary contribution to come up with this for consideration down the road, but not for immediate legislative consideration,” Stark said.

Other signatories to the letter include Joseph Bankman of Stanford University School of Law, Walter Hellerstein of the University of Georgia School of Law, Charles McClure of the Hoover Institution and Stanford University, and Steven M. Sheffrin of the University of California, Davis, Economics Department.

In addition, a coalition of 44 business groups led by the California Chamber of Commerce continued to press for more answers from the commission, and urged members to delay recommendations on the BNRT proposal. In a Sept. 3 letter,

the coalition said although commission members and staff have answered some of their dozens of questions, the businesses said they are not prepared to endorse the plan on the table.

Without knowing the details such as the BNRT rate and base on which it would be applied, businesses cannot assess its impact, the group said.

Business Community Not Convinced

"We are not aware of any substantial discussion of why the BNRT is a preferable tax policy to the current taxes," the coalition said. "Taxpayers and policymakers deserve more discussion and analysis on this issue."

Kyla Kristoffersen, a lobbyist for the chamber, declined to comment further on the delay in release of the detailed commission proposal Sept. 8, beyond saying the arguments and questions raised in the Sept. 3 letter were still valid.

Jean Ross, executive director of the California Budget Project, told BNA Sept. 9 she has been frustrated by the lack of transparency and late release of information to the public in advance of the Sept. 10 meeting and others held in recent months. CBP submitted written comments to the commission Sept. 3 arguing that the BNRT proposal would slow, not increase, growth in tax revenues so that budget gaps would widen in the future. At the same time, the proposal would shift a greater tax burden from high-income earners to low- and middle-income earners, CBP said.

"It is very clear that they're not seeking public comment, despite concerns from stakeholders," Ross said. "The end product will not be well-thought out and not be well-vetted ... It will be the product of a flawed process."

The commission meeting is scheduled for 11 a.m. Sept. 10 at UCLA, James West Alumni Center, Collins Alumni Conference Room, 325 Westwood Plaza, Los Angeles. It will be webcast at www.cotce.ca.gov.

A tentative meeting has been scheduled for 11 a.m. Sept. 14 at UC Berkeley, Joseph Wood Krutch Theater, Clark Kerr Conference Center, 2601 Warring St., Berkeley.

By Laura Mahoney

More information, including the draft legislative language and descriptions of the proposals to be discussed Sept. 10, is available online at www.cotce.ca.gov.

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