



## California Tax Reform Association

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To: Commission on the Twenty-First Century Economy

From: Lenny Goldberg, California Tax Reform Association

Re: Recommendations for action

The following is a set of recommendations written in the interest of seeing a productive outcome to the Commission's deliberations. While one of our major recommendations—reassessment of commercial property—has been well heard, though apparently rejected, we believe there are other issues which the Commission should consider.

1. **Broaden the sales tax base.** We believe this recommendation has unanimous support in concept, although implementation is always resisted by those with an interest in the product to be taxed. Our views on broadening the base are as follows:
  - a. Include digital downloads and electronic commerce in the tax base. Whether on-demand TV, iTunes downloads, purchases of on-line software, electronic books, etc., all of these downloads have a tangible basis, are taxable in other forms (e.g. cd's, books, software, video rentals), and should be included in the tax base when Californians purchase them. Telecommunications, video and text are all digital transmissions and should be taxed similarly, including internet services. Comment: this is a fundamental part of the 21<sup>st</sup> century economy which should have been explored in greater depth by this Commission.
  - b. Include the temporary rental of space in sales tax base, e.g. entertainment, admissions, hotels, ski resorts, golf courses, parking lots, self-storage, docking facilities, amusement parks, etc.—all of which involve the use of tangible property as a consumption item.
  - c. Take aggressive action to enforce nexus from large out-of-state internet retailers (AB 178, Skinner), recommend that California join the Streamlined Sales and Use Tax Agreement (SSUTA), and urge Congress to pass legislation providing for destination-based taxation for interstate commerce. Comment: Again, this is significant in terms of the changes wrought by the 21<sup>st</sup> Century Economy.
  - d. Explore the labor services which are appropriate to add to the tax base without distortions or over-taxation. Comment: our view is that labor is already taxed substantially, include income and payroll taxes and the provision of benefits such as healthcare. However, there may be areas of labor services which are appropriate to tax, particularly at lowered rates.

2. **Repeal new corporate loopholes not yet in effect and eliminate sales tax on depreciable manufacturing equipment as a revenue-neutral improvement in tax policy re: business investment**
  - a. Eliminate loss carry-backs: \$500 million. (AB 1452 of 2008) The ability to carry-back losses exacerbates volatility and is destabilizing as fiscal policy. In a downturn, companies will get refunds for taxes already paid and spent, at a time when cuts in program are required.
  - b. Limit the use of credits to zero out income/reinstate limit on credit sharing: \$500 million (AB 1452). The legislature allowed credit-sharing in the absence of hearings, and provided on a temporary basis that no more than 50% of net tax liability shall be eliminated annually by the use of credits. Our view is that either approach would limit sheltering, and particularly support the continuation of the credit limitation at no more than 50% of tax liability.
  - c. Eliminate elective single-sales factor as a method of apportionment. \$800million to \$1.5 billion (AB/SB 3x 15). The yearly election is a tax-gaming opportunity, and single sales itself provides tax rewards irrespective of investment or level of economic activity.
  - d. In place of a, b, and c, above, provide a sales tax exemption for depreciable manufacturing equipment placed in service in NAICS codes generally including manufacturing, and excluding utilities, oil and telecommunications. This change would actually reward investment by the manufacturing sector at the time it is made, not speculate on whether new investment will be made based on new tax formulas. Revenue neutrality among the above items should be worked out.
  
3. **Elimination of large gaps in the tax system and inappropriate tax breaks.** Revenue could be applied in various ways, including to underfunded programs and services.
  - a. Oil severance at 9.9% (Governor's proposal): \$1 billion. California is the only place in the world without direct taxation of oil production. Such a tax is a tax on pure economic rents, with, as Rand analysis concluded, no effect on price or production. California's heavy oil costs about \$20/barrel to produce, including embedded taxes, and sells at roughly \$60/barrel. This tax would collect roughly \$6/barrel.
  - b. Eliminate enterprise zone program: \$500 million. A recent definitive study by NBER/PPIC demonstrated that this program has no discernible impact on employment and no real benefits. This is a pure case of money for nothing.
  - c. Eliminate like-kind exchanges of commercial property: \$350 million, per LAO proposal. These exchanges can be done out-of-state with CA tax benefits, losing potential revenue forever, and are undertaken for federal tax purposes, not the state benefits.
  - d. Place offshore tax havens in the water's edge/require worldwide combined reporting: \$150-\$700 million. In a global economy, the easy access by multinational corporations to offshore tax havens has no economic function, and should be eliminated.
  - e. Tighten change of ownership definition for property assessment: \$1-2 billion. The current system is loophole-ridden, allowing properties to change ownership entirely without reassessment.