CALIFORNIA BUDGET PROJECT

Fatally Flawed:

What Would the Commission on the 21st Century Economy's Recommendations Mean for California?

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The COTCE Proposals:

- Would reduce the growth of state tax revenues, leading to larger, not smaller, budget gaps.

- Shift the cost of paying for state services from high- to low- and middle-income taxpayers.

- Rely on a risky new tax that would penalize businesses that provide high-wage jobs with good benefits.

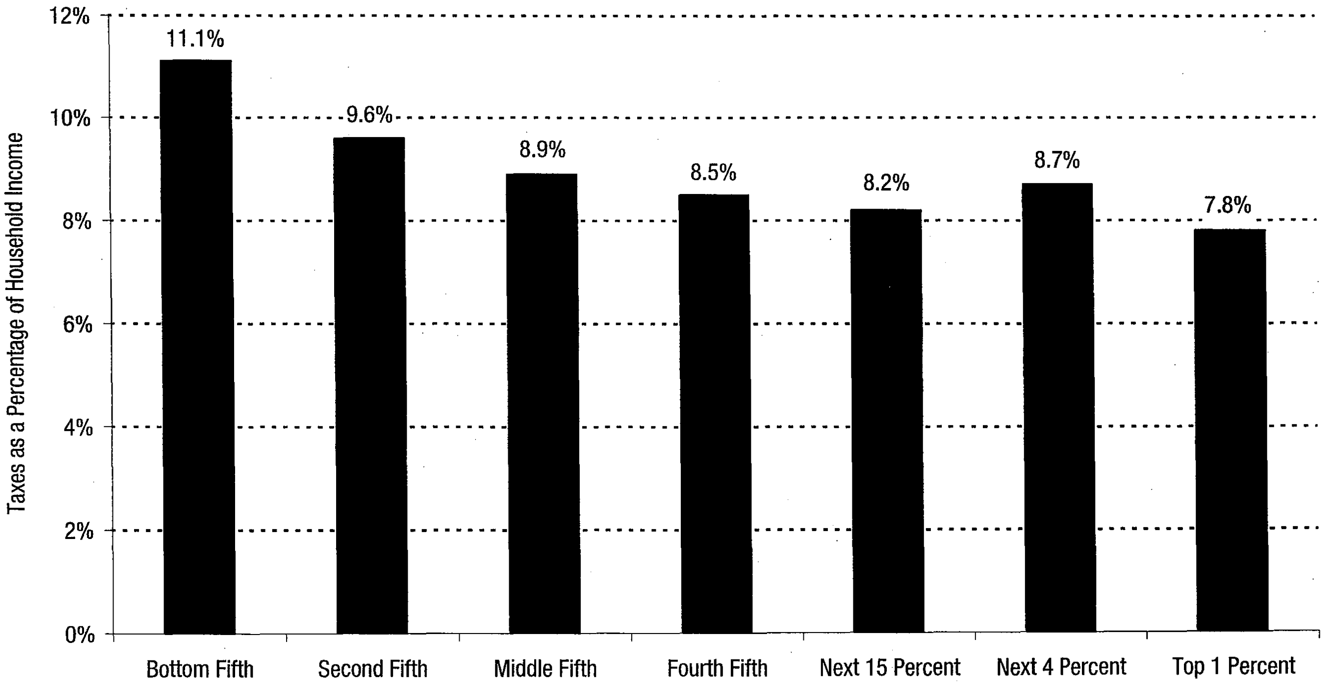
Flawed Assumptions = Flawed Product

- The COTCE proposals stem from two flawed assumptions:
    1. "Volatility" is the source of the state's budget problems and that the solution is to reduce taxes on the very wealthy.

    2. The Commission's recommendations should be "revenue neutral" when implemented.

The Lowest-Income Households Pay the Largest Share of Their Income in State and Local Taxes

Includes the Temporary Tax Increases Enacted in the February Budget Agreement

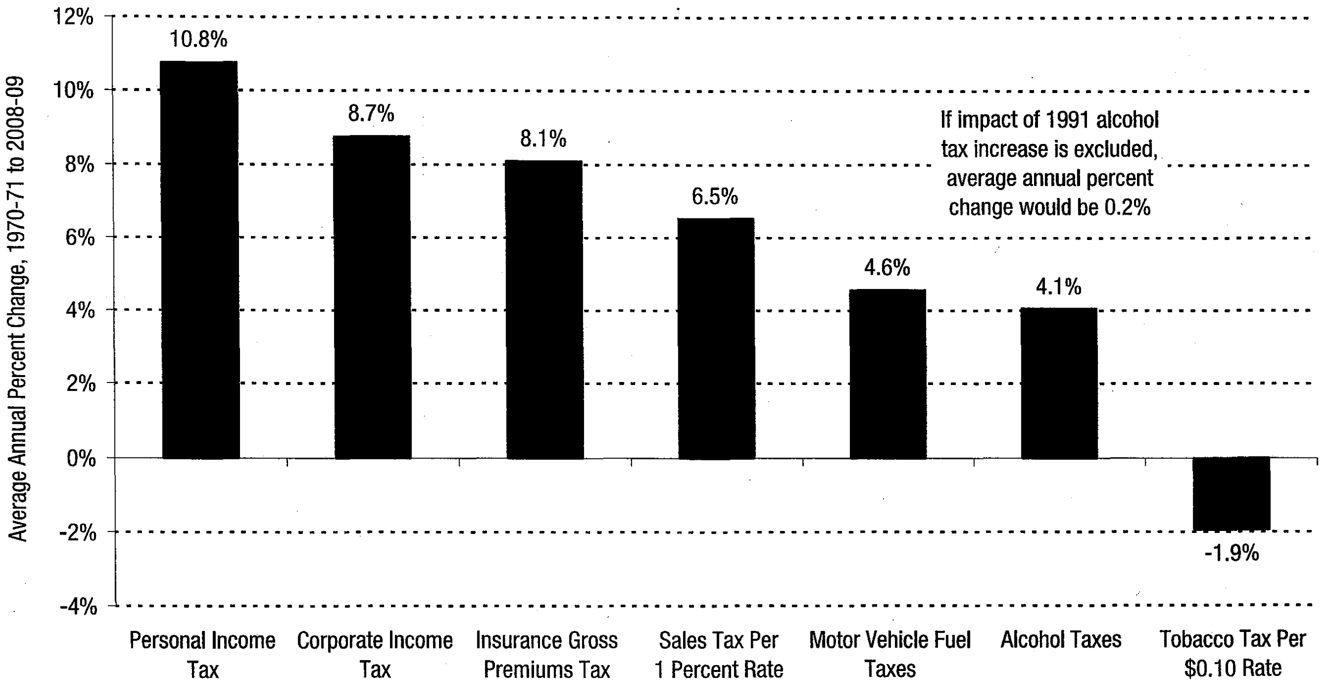


Note: Includes offset for federal deductibility of state taxes.
Source: Institute on Taxation and Economic Policy

What Would the COTCE Proposals Do?

- Reduce personal income tax collections by $15.0 billion by reducing the number of tax rates, lowering the top rate, and eliminating most credits and deductions.
- Eliminate the corporate income tax and $800 minimum franchise tax.
- Eliminate the state's portion of the sales and use tax, except for the sales tax on gasoline (the "Prop 42" tax).
- Replace revenues lost from the reductions and eliminations listed above with a new tax on the net receipts of businesses.

Tax Commission Proposals Would Reduce the State's Reliance on High Growth Taxes, Increase Reliance on Slow Growth Revenue Sources



Note: 2008-09 revenues estimated.
Source: CBP analysis of Legislative Analyst's Office data

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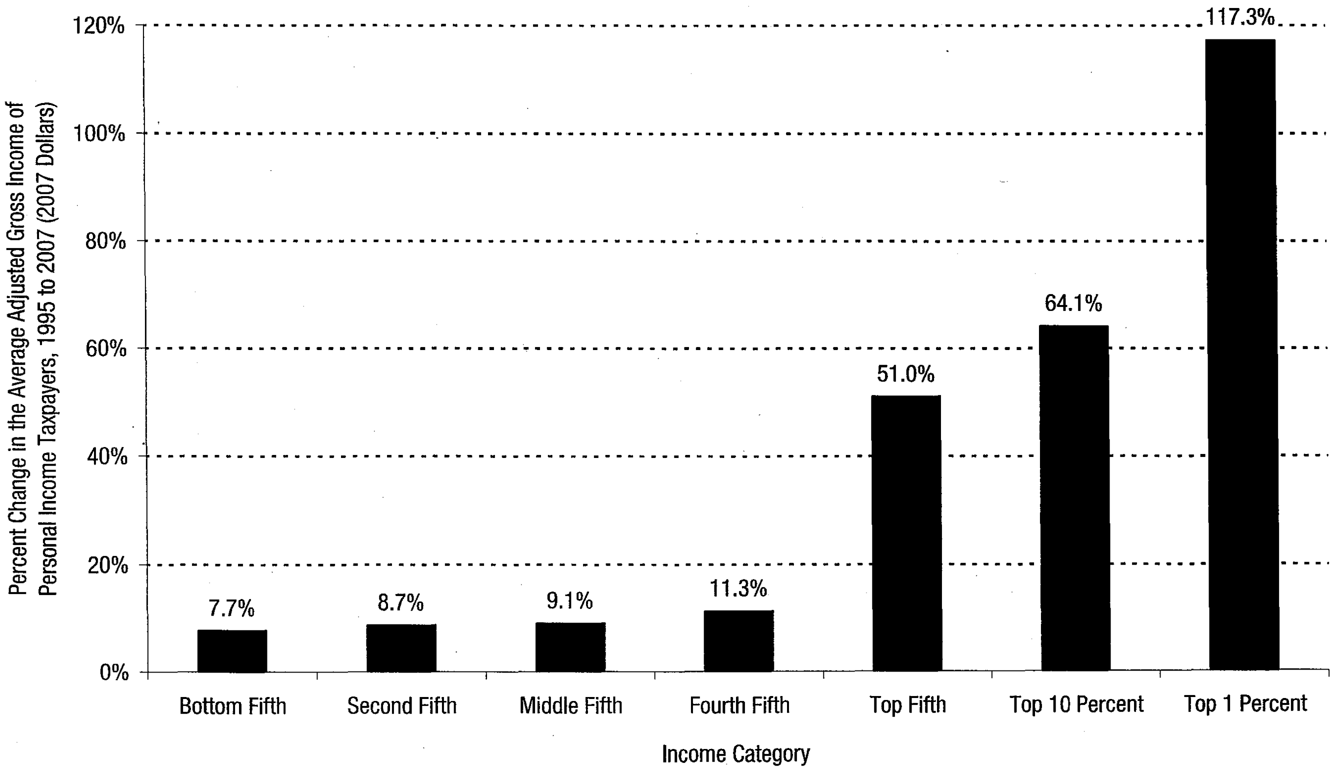
The Average Adjusted Gross Income of the Top 1 Percent More Than Doubled, 1995 to 2007



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Source: Franchise Tax Board

The Proposed Personal Income Tax

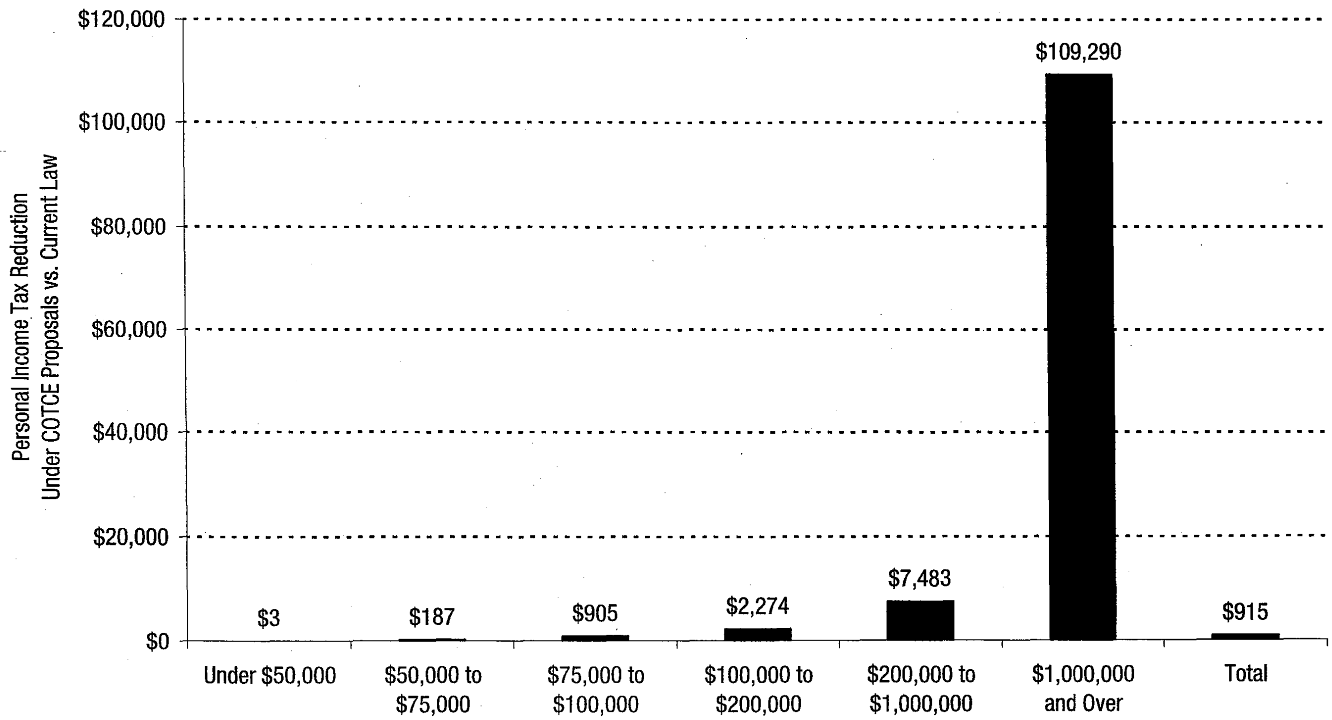
- Two rates: 2.75 percent for taxable incomes up to $56,000 married ($28,000 single) and 6.5 percent for incomes above those amounts.
- Eliminate all deductions and credits except for the mortgage interest, property tax, and charitable contribution deductions.
- Provide a standard deduction of $45,000 for joint filers and $22,500 for single filers.

COTCE Proposal Would Give Large Tax Breaks to the Wealthy						
	Percentage of Tax Returns	Average Tax Per Return, COTCE Proposal	Average Tax Per Return, Current Law	Average Tax Reduction Per Return	Percentage of Tax Reduction	Cumulative Share of Tax Reduction
Under $50,000	62.2%	$104	$108	$3	0.2%	0.2%
$50,000 to $75,000	10.9%	$1,102	$1,289	$187	2.2%	2.4%
$75,000 to $100,000	7.9%	$2,126	$3,031	$905	7.8%	10.2%
$100,000 to $200,000	15.9%	$5,186	$7,459	$2,274	39.5%	49.7%
$200,000 to $1,000,000	2.8%	$19,417	$26,900	$7,483	23.1%	72.8%
$1,000,000 and Over	0.2%	$238,127	$347,417	$109,290	27.2%	100.0%
Total	100.0%	$2,268	$3,183	$915	100.0%	

Note: COTCE proposal estimates are based on projected 2014 adjusted gross income.

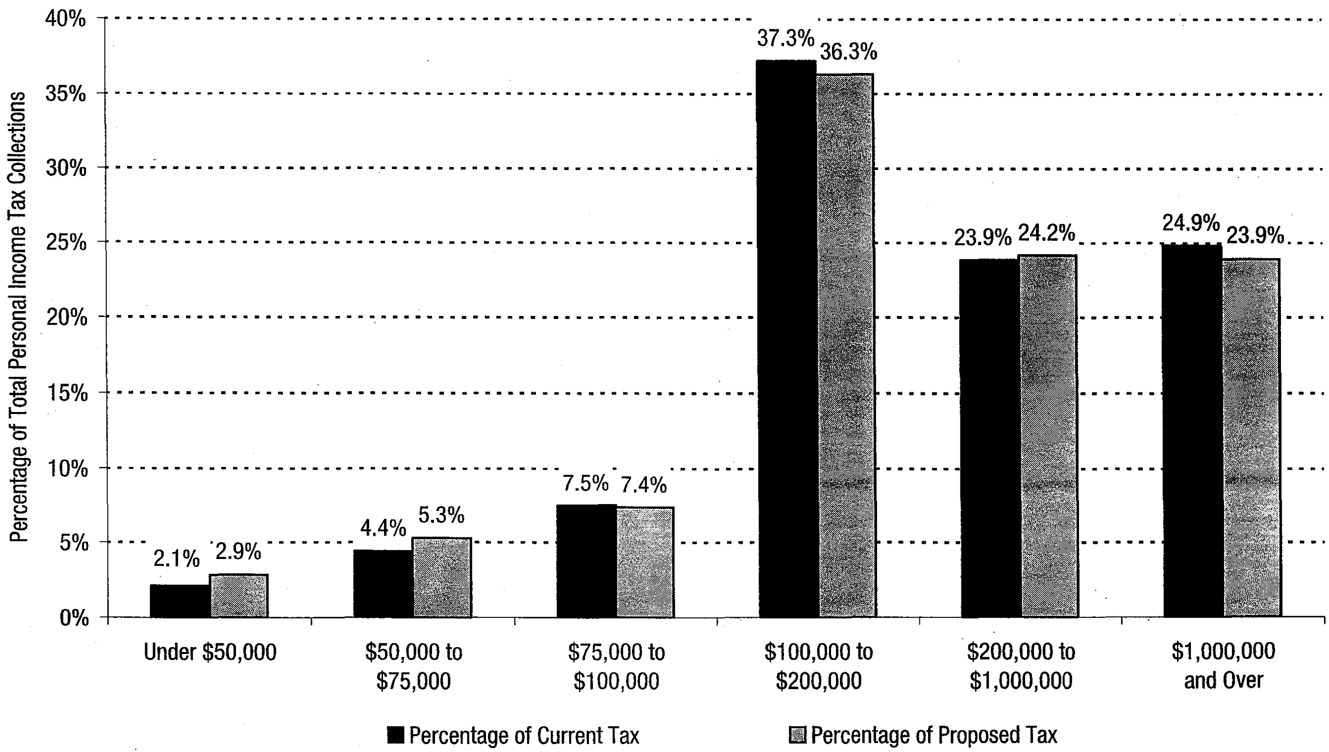
Source: Commission on the 21st Century Economy

Millionaires Would Receive Six-Figure PIT Cuts



Source: Commission on the 21st Century Economy

Millionaires Would Pay a Smaller Share of the PIT Under the COTCE Proposal



Source: Commission on the 21st Century Economy

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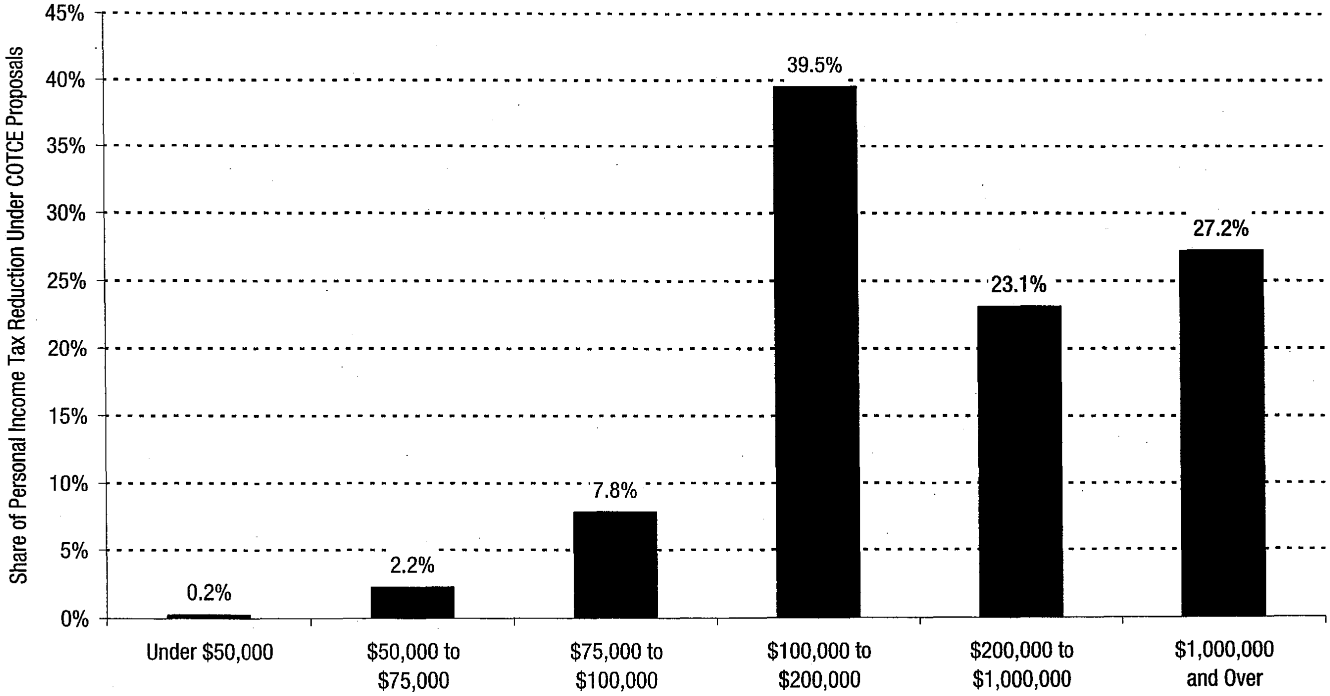
Largest Tax Cuts Would Go to High-Income Californians

Does Not Take Into Account Higher Prices or Lower Wages Resulting From the BNRT



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Source: Commission on the 21st Century Economy

The BNRT Is Essentially a Tax on Wages and Benefits

- The proposed BNRT would be imposed as a percentage of a business' gross receipts from the sale of goods and services minus the purchases from other firms.
- The COTCE proposes an exemption for businesses with gross receipts below $500,000 and would provide a credit for research and development.
- The tax would be imposed on a "water's edge" basis.

Gross Receipts – Purchases From Other Firms

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Net Receipts

What's Included in Net Receipts?

- Wages and salaries
- Health, pension, and other employee benefits
- Payroll taxes
- Profits
- Result: Profitable firms that pay high wages and offer good benefits will pay a larger share of their gross receipts as taxes than would low-margin businesses that pay low wages and offer no benefits.

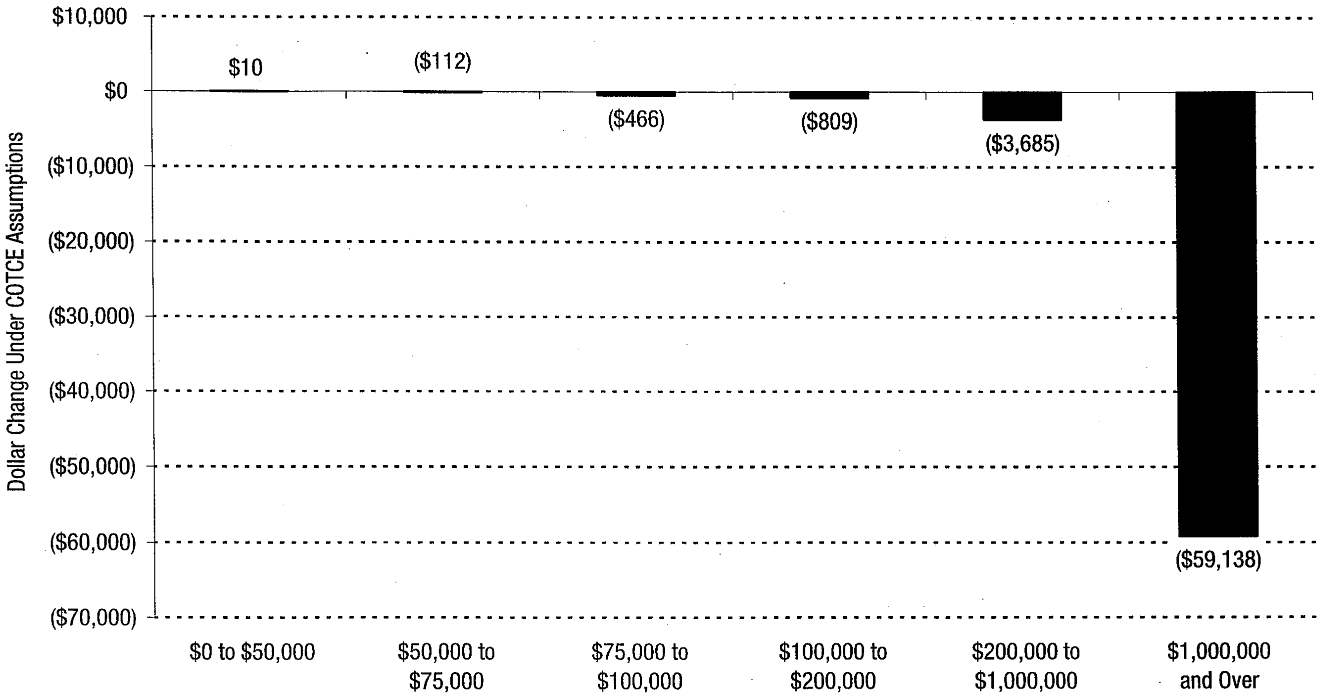
Issues and Concerns With the BNRT

Experts argue that the BNRT:

- Would create incentives for businesses to outsource and offshore jobs.
- Would create incentives for businesses to reduce wages and benefits. The consultant hired by the COTCE states that 19 percent of the tax would be passed on to workers as lower wages.
- Would be a hidden tax that would be passed on to consumers in the form of higher prices. The COTCE consultant states that 71 percent of the tax would be passed on to consumers in the form of higher prices.

Low-Income Californians Will Pay More Under COTCE Assumptions

Disparities Likely To Be Greater Under Reasonable Assumptions of the Impact of the BNRT



Source: Commission on the 21st Century Economy

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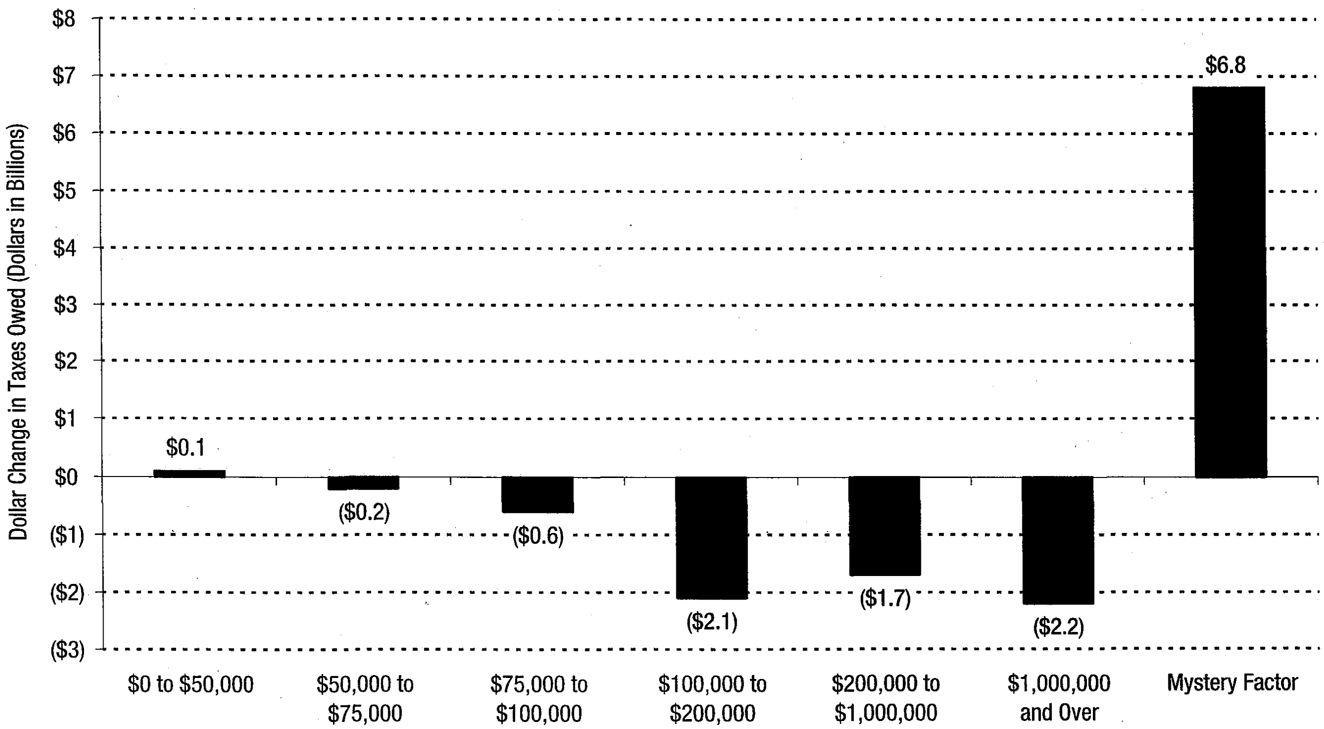
The Numbers Don't Add Up

- The COTCE recommends that the BNRT rate not exceed 4 percent.
- In 2013-14, the revenues lost due to the repeal of the corporate income and state sales tax and reduction in the personal income tax would equal roughly $58 billion using modest growth assumptions.
- The consultant hired to advise the COTCE on the BNRT estimates that a 6 percent BNRT rate would raise $56.5 billion.

More Numbers That Don't Add Up

- The COTCE claims that $6.8 billion will be "exported" to nonresidents and the federal government.
- But to the extent the BNRT is passed on to consumers in the form of higher prices, the value of businesses' ability to deduct the BNRT from their federal income taxes will be canceled out by higher gross receipts.
- The COTCE estimates fail to take into account the fact that Californians who itemize their federal personal income tax deductions will pay more to the federal government if they pay less to the state. Since the BNRT will be paid by businesses, individual consumers won't be able to claim federal deductions for the share of the BNRT they pay through higher prices.

COTCE Proposals Assume That $6.8 Billion Would Come From Nonresidents and Federal Offsets



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Source: Commission on the 21st Century Economy

Tax Policy Experts Have Raised Significant Questions

- A letter signed by nine prominent tax policy experts raises serious legal and policy issues:
  - California firms will have a limited ability to pass the BNRT on to out-of-state customers.
  - The state's ability to impose the tax on out-of-state firms that sell into the California market would likely be subject to legal challenge.
  - These experts conclude that "there are numerous reasons to believe that this is the wrong course for the state to take at this stage."

What Should Be Done To Modernize California's Tax System?

- Extend the sales tax to selective services and lower the sales tax rate.
- Aggressively pursue collection of sales taxes owed on electronic purchases under existing law and encourage Congress to overturn the Quill decision.
- Impose an oil severance tax.
- Repeal the corporate income tax breaks included in the September 2008 and February 2009 budget agreements.