FRIENDS COMMITTEE ON LEGISLATION OF CALIFORNIA

October 7, 2009

To: Assembly Member Ron Calderon, Chair, Assembly Revenue and Tax Committee
Senator Lois Wolk, Chair, Senate Revenue and Tax Committee
Senate President Pro Tempore Darrell Steinberg
Assembly Speaker Karen Bass

Re: Report from the Commission on the 21st Century Economy

Dear Elected Officials,

The Friends Committee on Legislation of California (FCLCA) has reviewed the September 2009 report from the Commission in the 21st Century Economy and writes to express the following concerns.

FCLA favors a more equitable tax burden; therefore, we oppose the Commission's proposal to reduce the personal income tax rates. The Commission is proposing a massive shift in the burden for funding government services from the wealthiest income earners to the middle class and lower income earners at a time when the gap between high incomes and lower incomes is widening.

Though California's state income tax is progressive, overall our state tax burden is regressive, with people at the lower end of the economic scale paying a larger portion of their incomes in taxes than people with the highest incomes. Aside from this moral imperative, from a purely economic point of view, progressive taxation makes good sense. Progressive taxation encourages demand as people at the higher end of the income scale are less likely to change their consumption habits in response to higher levels of taxation. On the contrary, people at the lower end of the economic ladder do change their consumption habits dollar for dollar in response to changes in their disposable income.

While much has been said about the volatility of the personal income tax, we view this as a budgeting problem more so than a taxation problem. California's personal income tax has served the state well despite fluctuations. Over the long run, our state has realized considerable growth in personal income tax collections. Rather than reducing the personal income tax rate, a portion of revenues collected from the personal income tax could be set aside in a reserve to help balance the state's budget during economic downturns.

FCLCA is concerned that the proposed Business Net Receipts Tax (BNRT) could result in fewer (and lower-paying) jobs in California. Net receipts is computed as the

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difference between gross receipts and purchases from other firms, the residual being largely composed of employee wages and benefits. While our understanding is perhaps over-simplified, the BNRT is essentially a tax on wages and benefits, which would no longer be deductible as a business expense. As a result, the BNRT creates a financial incentive for businesses to contract out their labor.

Finally, the Commission's proposals could increase our state's structural budget deficit. According to the California Budget Project, the consultant hired to advise the Commission on the BNRT estimated that a 6 percent BNRT would raise $56.5 billion by fiscal year 2013-2014, while the revenue lost due to the repeal of the corporate income tax is estimated at $58 billion. The Commission is recommending a BNRT of only 4 percent. As a result, this proposal is not revenue neutral. Moreover, the recent economic crash demonstrates that we need to go beyond revenue neutrality and seek additional revenues.

FCLCA fully concurs with the need to modernize California's outdated tax system; however, we do not have the experience of other states and/or a large body of empirical evidence upon which the Legislature could evaluate the BRNT. The BRNT could result in severe unintended consequences and is, therefore, a risky proposition.

We urge the Legislature to:

- repeal corporate income tax breaks granted in the September 2008 and February 2009 budget agreements
- pass legislation to charge sales taxes on internet sales (current law puts local businesses at a competitive disadvantage because they have to collect sales taxes while internet sales from businesses with no physical presence in California are exempt)
- impose an oil severance tax (California is the only major oil producing state that does not impose a severance tax)
- consider extending the sales tax to nonessential services while lowering the sales tax rate (this would broaden the sales tax base and recognizes that California's economy has shifted considerably from a manufacturing to a service economy).

Sincerely yours,

Jim Lindburg

JIM LINDBURG
Legislative Director