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Recommendations to Achieve Revenue Sufficiency

CALIFORNIA WORKING FAMILIES POLICY SUMMIT

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This briefing paper presents a range of tax policies available to address California's ongoing budget crisis. The state's budget problem is caused not only by the recession and "spending," but also because of major failures in the tax system.

1. Correct failures in the California tax system that exist in no other state (would generate several billions).

a. Enact the oil severance/production tax (would generate \$1 billion +). California taxes oil at 60 cents a barrel whereas all other states, and everywhere in the world, tax it at about \$6 and up. Even including corporate and other taxes on oil companies, we still tax oil at the lowest rate in the country. If we estimate 175-200 million barrels of production per year at an added \$6 tax per barrel, more than \$1 billion in revenues would be available – with no impact on prices or production since prices are determined by the world market and are many multiples of production costs.

b. Terminate the election of the single sales factor (\$850 million-\$1 billion). Whatever the other arguments about basing the income of multi-state corporations only on sales in California (i.e., not including payroll and property), allowing these corporations to choose *each year* which formula they use to report income to California is an indefensible embarrassment, existing in no other state. It allows manipulation of the corporation tax and ironically short-circuits the alleged economic development benefits of using the single sales factor. The current estimated cost is way above the estimate when it passed.

c. Adopt a statute to change how commercial property is assessed. (billions, depending on how it is done). California is the only state in the nation that assesses commercial property based on "a change of ownership" (language of Prop. 13). Due to the complexity of commercial property ownership (LLC's, REIT's, partnerships, private equity holdings, trusts, etc), this approach is confusing, unenforceable, and full of loopholes. All other states assess commercial property taxes based on market values. Real reform of the commercial property assessment could generate billions and is critical to state-local realignment, infrastructure finance, and many more issues—including, ironically, improving the regulatory climate for new development.

2. End useless tax expenditures and close costly tax loopholes (1 billion +). The following tax expenditures are demonstrably useless in terms of any benefits for the California economy or jobs created in California.

a. Enterprise Zones (\$500 million). Enterprise zones were originally designed to give out tax benefits to businesses for locating in depressed areas of the state and for hiring the poor. However, a definitive study has demonstrated the uselessness of this program in terms of creating jobs. Other reports, including one from the Legislative Analyst's Office (LAO), have described its extensive failures as policy.

b. Like-kind exchanges for commercial property (\$350 million). Profits from the sale of commercial property are currently exempted from capital gains tax. Research from the LAO indicates that this state tax break has little or no positive impact on investment in the state. Worse, the tax break is also available for out-of-state investment (which if repealed, would raise \$50 million).

c. Offshore tax havens (\$150 million). Huge tax sheltering in offshore tax havens is well-documented. Legislation to end the use of this tax shelter moved successfully (though partially) through the Assembly in 2010.

d. Net operating loss carry-backs (small at first, up to \$200+ million). This new tax loophole gives corporations that take losses the ability to get tax refunds for taxes paid in prior years. This provision has no economic development justification. If it had been in effect in 2009, it would have rewarded the banks.

3. Expand the tax base in a fair manner (several billions). There are many taxable items which should be included in the tax base for reasons of fairness or, in the case of the Vehicle License Fee, parity with other property.

a. Add entertainment, admissions, hotels, parking, and facilities use to the sales tax base (\$1-2 billion). These items are mistakenly classified as “services” but actually involve temporary rental of space—e.g., golf course use, ski lift tickets, amusement parks, professional sports events, etc. Many states include these items in their sales tax base, but California does not. In fact, because these items are not taxed at the state level, many hotel and admissions taxes are imposed locally.

b. Increase the Vehicle License Fee (VLF) to 1% (\$1 billion). The VLF is supposed to be a property tax on automobiles, but went from 2% (twice Prop. 13’s rate) to .65, or 2/3 of the rate. Resolving this issue at 1% should have been done long ago, and reflects depreciated value of the auto so is not particularly regressive. The reimbursement to local government from the Schwarzenegger VLF cut now costs the state \$6 billion a year, a cost from which the state has never recovered.

c. Collect taxes on electronic commerce (\$150 million +). As in New York, California should require Amazon.com to collect sales and use taxes as a result of the many points of contact (nexus) in the state. Absent this policy, California-based businesses that collect sales taxes are disadvantaged. Though it is doubtful that Congress will act, if California were to address this internet/interstate sales issue, Congressional action on this issue would be more likely, with \$1 billion in revenues generated for California.

4. Adopt taxes that are popular with voters (\$5-8 billion). Voters have always supported sin taxes, and in polls have also supported increasing the top tax brackets paid by the wealthy.

a. Restore higher taxes for the top tax brackets, as adopted in the Governor Wilson era (\$4-6 billion). The recent federal decision to extend the Bush tax cuts means that the top 1% of wage earners in California will save \$6 billion, and the top 5% will save a combined \$20 billion. An opportunity now exists for the state to increase taxes on the highest wage earners while these individuals will still see net tax reductions.

b. Increase sin taxes: Cigarettes and alcohol (\$1-2 billion). Legislative and ballot proposals for cigarette taxes were recently proposed to raise \$1 billion, while alcohol taxes have been proposed in the range of \$500 million to \$1 billion.

5. Restore majority vote rule through a proposal to address the 2/3 vote for revenues. We have long suggested a constitutional amendment (“Taxpayer right to Vote/Double Majority”) by which a majority of the Legislature could put a tax measure on the ballot for majority approval by the voters. A 2/3 vote requirement would still be required for taxes voted on directly by the Legislature.