



## WHO IS CALIFORNIA FORWARD?

- We want to reform state government so it is more responsive and closer to the people it serves
- Non-partisan, nonprofit
- Created in 2008 by five major California foundations →
- Combat state dysfunction and reshape the future of CA by changing the way government operates



1. The California Endowment
2. The Evelyn and Walter Haas, Jr. Fund
3. The William and Flora Hewlett Foundation
4. The James Irvine Foundation
5. The David and Lucille Packard Foundation



## CALIFORNIA TAX AND FISCAL REFORM PROPOSALS AND THEIR PROSPECTS

- A. Measures to raise taxes:
  - 1. Income and sales tax
  - 2. Property tax/splitting the assessment roll
- B. Measures to revise state fiscal processes:
  - 1. The state budget making process
  - 2. The spending limit and vote requirements for fees/taxes

3



## TAX MEASURES

### GOVERNOR BROWN'S PROPOSAL

*Objective: Improve Fiscal Balance*

- Adds three new income tax rates:
  - 10.3% ^ \$250,000/\$500,000
  - 10.8% ^ \$300,000/600,000
  - 11.3% ^ \$500,000/\$1,000,000
- Increases state sales tax by .5%
- Revenue estimate depends on the assumptions (\$4.8 B to \$6.9 B)
- Tax increases are temporary and provide revenue for 5 budgets through the 2016-17 fiscal year
- Money goes to the General Fund

4



## TAX MEASURES

### ADVANCEMENT PROJECT'S PROPOSAL

*Objective: Increase funding for K-12 and early childhood education*

- Significant changes in income tax rates across the income ladder
- 85% of the proceeds go to K-12 education
- 15% of proceeds go to early childhood education
- Small help to state fiscal condition by paying off state school bonds
- Revenue estimate approximately \$10 B depending on assumptions



## TAX MEASURES

### CA FEDERATION OF TEACHERS' PROPOSAL

*Objective: Increase funding for a variety of state and local programs*

- Adds Income tax rates for income <\$1 million and \$2 million
  - Revenue estimate is \$5 – \$6 billion depending on assumptions
- 60% to education  
25% to children and senior services  
10% to public safety  
5% to local road and bridges



## TAX MEASURES

### SPLIT PROPERTY TAX ASSESSMENT ROLL PROPOSAL (MYSTERY SPONSOR)

*Objective: Bring non-residential property assessment closer to market value*

- Places non-residential property on a three year reassessment cycle
- Exempts up to \$1 million personal property
- Doubles the homeowner exemption
- Raises \$4 billion per year for the state General Fund

7



## CALIFORNIA FISCAL REFORM PROPOSALS AND THEIR PROSPECTS

- Revise the state budget-making process
- Revise that spending limit and vote requirements for fees/taxes
- Revise the vote requirements for certain fees

8



## REVISING THE STATE'S FISCAL AFFAIRS

### CALIFORNIA FORWARD'S PROPOSAL

*Objective: Revise state and local budget processes to focus on results; Increase authority to integrate local services*

- Establishes a state multiyear results based budgeting system
- Major new programs identify a means of finance
- Public programs should work collaboratively, with a focus on performance
- Programs should be transparent and accountable for results



## REVISING THE STATE'S FISCAL AFFAIRS

### CAL-TAX AND THE HOWARD JARVIS TAXPAYERS ASSOC. PROPOSAL

*Objective: Revise the state spending limit*

- Resets the spending limit base year to 2010-11
- Changes the allocation of money that is in excess of the limit; Reprioritizes use of surplus revenues to pay down debt
- Clarifies the two-thirds legislative approval for tax increases (Prop. 26 fix)
- Major fiscal effects: probably limits growth in state spending over time



## REVISING VOTE REQUIREMENTS FOR CERTAIN FEES

### ENVIRONMENTAL GROUPS' PROPOSAL

*Objective: Allow the Legislature to raise fees for environmental regulatory processes.*

- *Allows the legislature to raise fees with a majority vote for environmental and public health regulatory activities*
- *The fee must bear a reasonable relationship to the cost of the activity financed by the fee*

11



## THINKING AHEAD ABOUT THE FUTURE OF TAX POLICY

- High reliance on the income tax while sales tax base continues to narrow with higher tax rates
- Nellen Rules of Sound Tax Policy continue to be violated by the Legislature
- California Forward and The Think Long Committee are committed to engaging in a community dialogue on issues of state/social tax policy

12



# ADVICE FOR LATE OCTOBER...



13



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## California - Governor's Proposed Budget

### The Budget of Uncertainties:

- Assumes receipt of \$7 billion from income and SUT increases not yet approved by voters
- Revenue \$3 billion higher than LAO's predictions
- Assumes \$2 billion in PIT growth
- Assumes \$1 billion SUT growth
- Couple billion of fund shifts and deferrals



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## Governor's Proposed Budget

Deep cuts, yet 7% General Fund spending increase



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## Governor's Proposed Budget

If voters reject tax increase, then trigger cuts...maybe

Program Reductions	Amount (in millions)	Percent of Trigger
Schools (Proposition 98)	\$4,836.9	89.74
Universities (UC & CSU)	400.0	7.42
Courts	125.0	2.32
Forestry and Fire Protection	15.0	0.28
Flood Control	6.6	0.12
Fish and Game	3.5	0.06
Parks	2.0	0.04
Department of Justice	1.0	0.02
<b>Total Ballot Trigger Cuts</b>	<b>\$5,390.0</b>	<b>100.00%</b>



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## Governor's Proposed Budget

### Tax-Related Proposals:

- **Mandatory Single Sales Factor**
- **Cap-and-Trade**
- **Unemployment Insurance – New Employer Surcharge**
- **Mini Tax Agency Consolidation**
- **FIRM Expansion**



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# REFORMING CALIFORNIA'S SALES AND USE TAX LAW



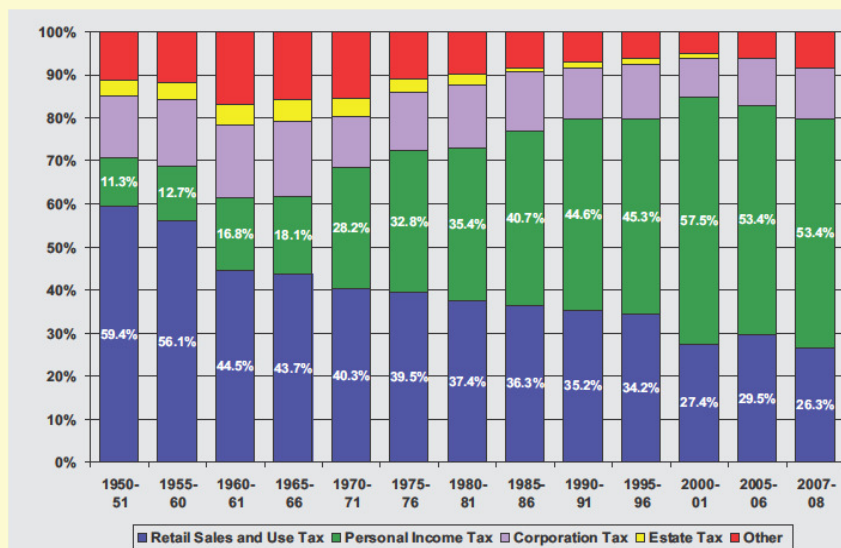
## Current Law: An Overview

- California's Sales and Use Tax (SUT) Law imposes a sales tax on *retailers* for the privilege of selling tangible personal property (TPP), absent a specific exemption.
- The tax is based upon a retailer's gross receipts from TPP sales in California.

## Where Do Sales Taxes Fit in the Overall Budget Picture?

- The SUT represents the state's second largest source of General Fund (GF) revenues.
- Nevertheless, the past 60 years have seen a dramatic reduction in the state's reliance on the SUT and a corresponding increase in its reliance on personal income tax revenues.
- In FY 2011-12, SUT revenues are estimated to comprise 21% of the state's GF revenues, down from nearly 60% in FY 1950-51.

### California State Revenues by Source



Source: Commission on the 21st Century Economy, 2009 Report

## Why the Decreased Reliance?

- The SUT Law was enacted in a very different era.
- In the 1930s, California's economy was largely dominated by manufacturing and agriculture, and residents mostly bought and sold tangible goods.
- It made sense to impose the tax on sales of TPP – personal property that may be “seen, weighed, measured, felt, or touched . . . .”

## A New Era, A New Economy

- Over the past 80 years, California's economy has seen a dramatic increase in the service and technology sectors, resulting in a significant erosion of the SUT base.
- As a result, the ratio of taxable sales to income is currently about 35%, compared to 55% in 1980.

## Expanding the Base

- Expanding the SUT to cover “digital equivalents.”
- Taxing Selected Services.
  - California currently imposes a tax on only 21 services, while some other states tax nearly all services (e.g., Hawaii and New Mexico).

## Prior Administration’s Proposal

- In his budget proposal for FY 2009-10, Governor Schwarzenegger proposed extending the SUT to the following services:
  - Appliance and furniture repairs.
  - Vehicle repairs.
  - Veterinarian services.
  - Amusement parks, sporting events, and golf courses.(Revenues estimated at \$1.154 billion per FY.)

## Think Long Committee for California

- Reduces the sales tax on goods from 5% to 4.5%.
- Expands the sales tax to services at a rate of 5% to 5.5%.
- Exempts education and medical care from the new tax on services.
- Provides unspecified relief to those with low incomes.

## Think Long Committee for California (Continued)

- The service tax *rate* would be “phased-in” over a two year period.
- The service tax would apply to all purchases – both personal and business.

## Policy Considerations for Any Service Tax Proposal

- Administrative Feasibility
  - How difficult will it be for the Board of Equalization (BOE) to identify new taxpayers?
  - Should the tax be extended first to businesses already registered with the BOE?
  - Time and resources will be needed to draft new regulations, train staff, register new taxpayers, and inform the public of the change in law.
  - Delayed implementation?

## Policy Considerations (Continued)

- Avoiding Perverse Incentives
  - Will taxing a particular service encourage consumers to purchase the service out-of-state?
  - For example, if a service tax were imposed on financial advising, many customers would have a large incentive to purchase these services out-of-state.

## Policy Considerations (Continued)

- Avoiding the Taxation of Services Purchased by Businesses
  - Any service tax paid by a business will be factored into the prices it charges for goods and services, which, in turn, may be subject to taxation.
  - This results in consumers paying a tax on a tax (i.e., pyramiding), making the tax system less transparent.
  - Could also inadvertently hurt small businesses.

## Policy Considerations (Continued)

- Promoting Progressivity
  - California's SUT is already inherently regressive, because lower-income individuals typically spend a larger percentage of their earnings on taxable goods.
  - May wish to consider taxing services primarily consumed by higher-income earners (e.g., golfing, skiing, etc.).

## Policy Considerations (Continued)

- Assistance for Newly Registered Service Providers
  - ▣ Adoption of a refundable tax credit to help cover the costs of getting ready to collect the tax.

## Policy Considerations (Continued)

- Mechanics of Broadening the Base
- Two Main Options:
  - ▣ The comprehensive approach
  - ▣ The targeted approach

## What are the Benefits?

- Promotes fairness, stability, and economic neutrality.
- Revenue.
  - Could prevent cuts to vital services and/or
  - Provide funds to reform other areas of tax law.
- Prevention of higher rates, with their attendant drawbacks (e.g., tax-motivated interstate shopping).

## Contact Information

M. David Ruff, Principal Consultant  
Assembly Committee on Revenue & Taxation  
david.ruff@asm.ca.gov  
(916) 319-2098

