

- *How Do the Budget's Compare? A Comparison of the Governor's Revised Proposal and Legislative Tax Plans:*¹

Revenues:

The Governor's May revision assumes a \$3.3 billion deficit bond sale and accrues \$1.9 billion in revenues to be received after July 1, 2009 for the 2008-09 budget. He proposes that fees paid by LLCs (limited liability corporations) be accelerated to generate \$360 million in 2008-09. He proposes to change the sales and use tax law regarding vessels and vehicles to raise \$21 million. The Governor also proposes \$564 million in loans from special funds to the state's General Fund.

The Budget Conference Committee proposal suspends businesses ability to claim net operating loss deduction for three years to generate \$1.1 billion and extends the time losses to be carried forward from 10 to 20 years. It increases (restores) the corporate income tax rate to 9.3% to raise \$470 million. It suspends inflation adjustments of the tax brackets to generate \$815 million. It reduces the dependent tax credit from \$294 to \$94 for those who file jointly and also for those who are the heads of households with an adjusted income exceeding \$150,000, raising \$215 million. It increases (restores) the 10% and 11% tax brackets for taxpayers with taxable incomes in excess of \$321,000 and \$642,000, respectively, to raise \$5.6 billion. The Committee's proposal would enact measures to increase collections of existing taxes by \$1.5 billion.

Lottery:

The Governor proposes \$15 billion in bonds to be repaid by leasing and updating the state's lottery. Nearly \$5.1 billion of the bond proceeds would be used to fill this year's budget gap, while the rest would go toward a reserve linked to a new spending cap and other changes to the budget process. However if the lottery bond sale were blocked, a one-cent increase in the sales tax would be applied.

The Conference Committee proposal rejects the Governor's lottery proposals.

- *Gov.'s Staff Exploring New Taxes:*²

As the state budget picture worsens, business groups are being asked what levies might be acceptable. Although Governor Schwarzenegger continues to publicly oppose new taxes, the state cannot balance its budget with a cuts only approach while having a shortfall totaling as much as \$15 billion. Therefore, his administration is increasingly looking into possible tax increases. Staff members are seeking reactions from business and special interest groups about proposed tax hikes totaling billions of dollars to help close the shortfall. The range of options under consideration include: sales taxes on lawyer and accountant services, high-end services (golf lessons, personal-training, etc.), takeout coffee, and other prepared foods. In addition, taxes on services such as green fees, ski lift, movie, theater, sporting and amusement tickets as well as mechanic,

landscape, and hairstylist (service professionals) services are being considered. The Governor has also proposed leasing the state lottery to a private firm. However, many are skeptical as to how much revenue this would raise and how quickly.

- *Dan Walters: Tax Reform Gets A Boost From California's Budget Crisis:*³
It is becoming more apparent that there is a mutual consensus growing among civic leadership and state politicians that the state-local tax system is a major contributor to the budget crisis. The revenue system is not consistent with a changing economy, as the tax structure was devised in the 1930s and then eroded by a series of ballot initiatives in the 1970s and 1980s. The Governor and Assembly Speaker Bass agree on the need for a bipartisan tax-modernization commission to evaluate tax reform proposals that would better serve California. The current system generates a surplus in good times attracting overspending while creating large budget deficits when an economic downturn strikes.
- *Jean Ross: Tax Hikes Must Be Part Of Budget Fix:*⁴
The primary tool of financing public services is California's progressive personal income tax. California's tax system does not raise enough money to support the services that Californians want, which creates problems during economic downturns. Most state spending is directed toward education, health care, and prisons.
- *California Tax Proposals Target Beer-Loving, Pornography-Watching Yacht Owners:*⁵
Democratic lawmakers are searching for new revenue options as alternatives to broad sales or income tax hikes that will help balance the state budget and moderate the proposed cuts to schools and health care. Some taxes under consideration include taxes on adult entertainment (AB 2914), beer, plastic grocery bags (AB 2829), iTunes downloads (AB 1956), gas guzzlers (AB 2388 & AB 2638), yachts, and Internet purchases. Republicans have vowed to stop any tax hikes.
- *California Budget Cutters Look At Tax Breaks:*⁶
As is expected, there are conflicting ideas as to how to solve the budget, Democrats want a balance of program cuts and increased revenues, and GOP lawmakers advocate cuts only. Elizabeth Hill concluded that tweaking some state tax policies could produce \$2.7 billion annually. Tax experts maintain tax cuts (tax expenditures) can be a powerful tool to encourage spending and stimulate the economy; however, the benefits of "priming the pump" in this way must be weighed against the loss of funding for public programs (i.e., public education and public health).
- *LAO Revenue-Raising Proposals:*⁷
The LAO makes several recommendations regarding taxes, which in total would increase the state General Fund revenues by \$2.7 billion in 2008-2009.

*Reduce the Dependent Credit:*⁷

Making the personal exemption credit and the dependent credit the same dollar amount would create a revenue gain of \$1.3 billion in 2008-09 and a \$1.1 billion raise in 2009-10.

*Eliminate the Senior Credit:*⁷

In addition to their regular personal exemption, seniors receive an extra credit, which if eliminated, would create a revenue gain of \$125 million in 2008-09 and \$130 million in 2009-10.

*Eliminate Partial Exclusion of Capital Gains on Small Business Stock:*⁷

Eliminating this partial exclusion of the capital gains on small business stock would produce approximately \$55 million revenue gains in both 2008-09 and 2009-10.

*Limit Net Operating Loss Deductions:*⁷

Net operating losses can be carried over to the next year and paid back when the companies' income is positive, which reduces the tax liabilities. If these deductions are restricted to 50% of the taxpayer's income in a given year, it would create a revenue gain of \$330 million in 2008-09 and \$410 million in 2009-10.

*Limit the Research and Development Credit:*⁷

Limiting the amount of credit that can be claimed in any one year to two-thirds of a taxpayer's liability would increase revenues by \$335 million in 2008-09 and \$290 million in 2009-10.

*Phase Out Enterprise Zone Programs:*⁷

If the recent redesignations of EZs are canceled and all future extensions are denied, there will be revenue gains of nearly \$100 million in 2008-09 and \$120 million in 2009-10.

*Eliminate Exclusion for "Like-Kind" Out-of-State Property Exchanges:*⁷

Many capital gains involving real estate go untaxed. If the income tax exclusion for capital gain were eliminated on like-kind exchanges involving out-of-state commercial property, the increase in revenues would be roughly \$25 million in 2008-09 and \$50 million in 2009-10.

*Eliminate Exemptions for Industry-Specific Equipment:*⁷

Currently, farm, post-production activity, and timber harvesting equipment are exempt from the state Sales and Use Tax (SUT). If these tax exemptions were eliminated, there would be a revenue gain of \$143 million in 2008-09 and \$46 million in 2009-10.

*Eliminating the SUT and excise tax exemption on diesel fuel for farming activities:*⁷

This would create a revenue increase of \$73 million in 2008-09 and \$75 million in 2009-10. A statutory change would be required in order to deposit the revenues into the General Fund.

*Eliminate Exemption for Leasing of Films:*⁷

There is currently an exemption on the leasing of motion picture and television films and tapes from SUTs. If the exemption were eliminated, there would be revenue gains of \$65 million in 2008-09 and \$70 million in 2009-10.

*Eliminate Exemption for Custom Computer Programs:*⁷

If the exemption for the sales of custom computer programs from SUTs were eliminated, there would be an increase in revenues of \$53 million in 2008-09 and \$48 million in 2009-10.

*Adopt One-Year Use Tax Standard on Selected Out-of State Purchases:*⁷

If the one-year standard is reinstated, which determines when items purchased out of state are subject to the use tax, there would be a \$21 million gain in revenues beginning in 2008-09.

- *Policy Points, 2007: Who Pays Taxes In California:*⁸

In California the poorest fifth of the households' with an average income of \$11,100 will spend 11.7% of their income on state and local taxes. This compares to the wealthiest 1% with an average income of \$1.6 million spending 7.1% of their income on state and local taxes. California ranks high in corporate, sales and personal income taxes and low in property, alcohol, and vehicle fuel taxes when comparing to the rest of the country. State tax cuts since 1993 have limited the growth in state spending. It is estimated that \$12 billion in annual revenues for the 2007-08 General Fund were lost through the enactment of tax cuts between 1993 and the present.

- *Is California A High Tax State? (2007):*⁹

Our state and local tax burdens are only slightly above the national average. California has the extremes of the highest top-bracket personal income tax rates and the lowest personal income tax rates for low-income residents. California also has an above average share of residents who receive stock option and capital gains income. Prop 13 significantly affects the composition of taxes; without it there would likely be higher property and lower personal income tax rates, more comparable to other states.

- *Tax Policy for the 21st Century: Resolving California's Long-Term Structural Deficit:*¹⁰

For California's future, a thoughtful reform of the tax system and resolving the state's structural deficit are necessary. This article suggests solutions to major flaws in the tax system.

*Loophole-Ridden And Irrational Non-Residential Property Tax:*¹⁰

To finance an increasingly inadequate infrastructure and local government, non-residential property should be periodically reassessed at market value; this would raise \$3-4 billion annually.

*The State's Narrow Sales And Use Tax Base:*¹⁰

Including services such as ski resorts, amusement parks, and gyms in the sales tax base and taxing internet sales of commodities and commodity rentals consistently with other sales would raise \$3-4 billion annually.

*Weakness In Personal Income Tax Base And Rate Structure:*¹⁰

Federal income tax cuts have provided large savings to the highest-income taxpayers, but have lead to state budgetary losses. Restructuring the top bracket could recapture some of those losses -- raising roughly \$3 billion annually on an ongoing basis.

*Erosion of Corporate Tax Base:*¹⁰

Reforming corporate tax sheltering, ineffective incentive programs, and measurements of true profits attributable to California could generate \$2 billion annually.

- *New Jersey Plastic Surgery Tax:*¹¹

Those seeking cosmetic surgery will now pay a 6% tax on procedures. The state also passed a 3.5% gross receipts tax on physician-owned surgical centers.

- *Aiming To Fix Tax Woes Before The Next Crisis Hits:*¹²

In an interview with Assembly Speaker Karen Bass, the speaker points out that her main goals are tax reform and the state's structural budget deficit. California's revenue system depends on whether the top 10% of the population has a good year, paying virtually 80% of the state's income taxes. The top 1% pay 48% of the income tax, up from 33% in 1993. Since 1993, the bottom 20% have not paid more than one-tenth of 1% of state income taxes.

Sales taxes in California currently contribute 27% of the General Fund revenues.

Between 1981 and 2005, the percent of California's consumption subject to the sales taxes dropped from 48% to 38%. The sales tax system was designed for the mid-20th century "goods" economy; since then, our economy has shifted from consumption of goods to services making the need for tax reform that much more compelling.

- *Budget Fix Could Raise Sales Taxes:*¹³

In a recent LA Times interview, Governor Schwarzenegger described the slow progress on budget reform, saying the state is in a severe cash crisis. Current legislative negotiations would balance the state budget by borrowing revenue from dedicated taxes -- \$1.1 billion the voters set aside for transportation projects, \$1.4 billion set aside for local governments under Proposition 1A, and \$200 million for early childhood development approved by the voters in Proposition 10. The Governor expressed dismay at the prospect of this return to borrowing money and the Legislature's unwillingness to establish rainy day reserves to allay future budget crises. He predicted the need to increase state sales taxes to repay the special fund borrowing and resulting state indebtedness. Democrats pointed out the Governor cut vehicle license fees by \$6 billion shortly after assuming office, a major contributor to the state's budget crisis. California

now ranks last in a recent Pew Foundation report (a D+) in its capacity to address and resolve its own budget crises.

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¹ How Do the Budgets Compare? A Comparison of the Governor's Revised Budget Proposal and Legislative Spending Plans, California Budget Project (July 11, 2008) at www.cbp.org

² As the state budget picture worsens, business groups are being asked what levies might be acceptable. Schwarzenegger publicly continues to oppose new taxes, Evan Halper, Gov.'s Staff Exploring New Taxes, Los Angeles Times (May 1, 2008) at www.latimes.com

³ Dan Walters: Tax Reform Gets A Boost From California's Budget Crisis, The Sacramento Bee (May 21, 2008) at www.sacbee.com

⁴ Jean Ross: Tax Hikes Must Be Part Of Budget Fix, The Sacramento Bee (June 8, 2008) at www.sacbee.com

⁵ Democratic lawmakers search far and wide for new revenue to balance the state budget, though Republicans have vowed to stop any tax hikes, California Tax Proposals Target Beer-Loving, Pornography-Watching Yacht Owners Los Angeles Times (May 8, 2008) at www.latimes.com

⁶ Judy Lin, California Budget Cutters Look At Tax Breaks, The Sacramento Bee (March 23, 2008) at www.sacbee.com

⁷ 2008-2009 Budget Perspectives and Issues: LAO Revenue-Raising Proposals, Legislative Analyst's Office (February 10, 2008) at www.lao.ca.gov

⁸ Policy Points, 2007: Who Pays Taxes In California (California Budget Project, April 2007) at www.cbp.org

⁹ Is California A High Tax State? (Center for Counting Study of the California Economy -- CCSCE, October 2007) at www.ccsce.com

¹⁰ Tax Policy for the 21st Century: Resolving California's Long-Term Structural Deficit (California Tax Reform Association, January 6, 2005) at www.policyarchive.org

¹¹ New Jersey Plastic Surgery Tax Sets Bad Precedent: Bills Pushed Through at the 11th Hour with No Public Debate, American Society of Plastic Surgeons (June 30, 2004) at www.plasticsurgery.org

¹² George Skeleton, Aiming To Fix The Tax Woes Before The Next Crisis Hits (July 14, 2008) at www.latimes.com

¹³ Evan Halper, Budget Fix Could Raise Sales Taxes, Los Angeles Times (July 18, 2008) at www.latimes.com In a companion piece, the reporter notes the concern that wealthy California citizens would relocate to avoid the proposed tax increases that would set the top income tax bracket at twice the national average and two to three percentage points higher than the next highest brackets in Iowa, Oregon, Vermont and Rhode Island. Halper, Plan Raises Taxes on the State's Wealthiest, Los Angeles Times (July 18, 2008) at www.latimes.com