



# *Defining a New Future for the State*

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**In October 2008, Governor Schwarzenegger signed executive order S-12-08, establishing the bipartisan commission on the 21<sup>st</sup> Century Economy**

### **Mandate of commission**

- Recommend changes to California's tax structure that reflected changes in our economy
  - Shift away from manufacturing and agricultural economy to an information and innovation based economy
  - Reduce the volatility of the State's revenues
  - Create incentives for private industry to increase employment and investment in the State's economy
  - Ensure that tax structure is fair and equitable
  - Promote long-term economic prosperity



## Commissioners represented a broad spectrum of California interests

- **Gerald Parsky**, Chairman, Aurora Capital Group
- **Ruben Barrales**, President and CEO, San Diego Regional Chamber of Commerce
- **Michael Boskin**, Senior Fellow, Hoover Institution and T.M. Friedman Professor of Economics, Stanford University
- **John Cogan**, Senior Fellow, Hoover Institution and Professor of Public Policy, Stanford University
- **William Hauck**, President and Chief Executive, California Business Roundtable
- **Rebecca Morgan**, President, Morgan Family Foundation
- **Curt Pringle**, Mayor, City of Anaheim
- **Edward De La Rosa**, Founder and President, De La Rosa & Company
- **Christopher E`dley, Jr.**, Dean and Professor of Law, Boalt Hall School of Law, University of California Berkeley
- **George Halvorson**, Chairman and CEO, Kaiser Foundation Health Plan and Kaiser Foundation Hospitals
- **Jennifer Ito**, Director of Research, Strategic Concepts in Organizing and Policy Education (SCOPE)
- **Fred Keeley**, Treasurer of Santa Cruz County, Professor of Political Science, California State University, San Jose
- **Monica Lozano**, Publisher and CEO, La Opinion
- **Richard Pomp**, Alva P. Loiselle Professor of Law, University of Connecticut



# *Summary of Recommendations*

## **Recommendations**

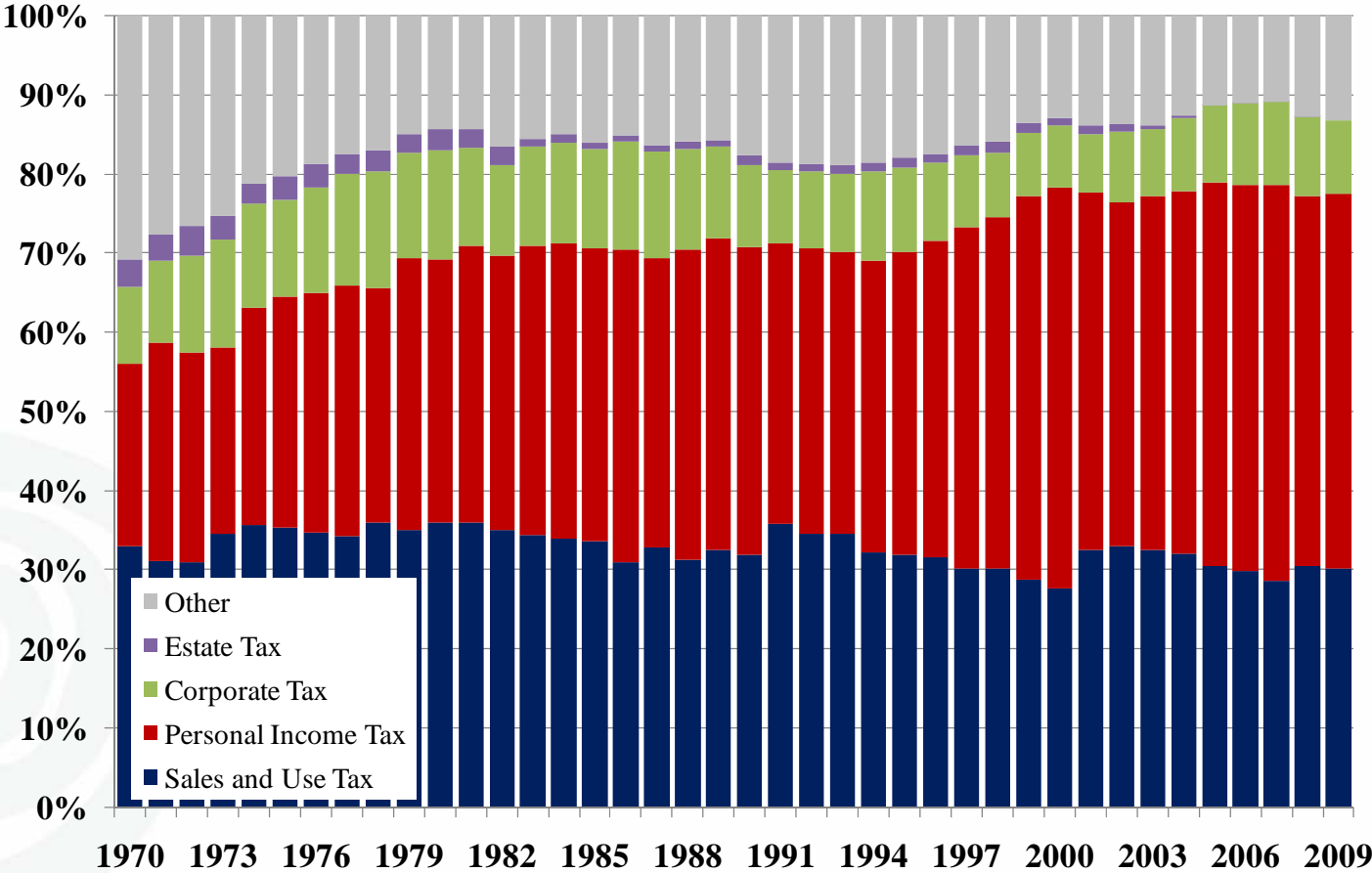
- Reduce and restructure the personal income tax
- Eliminate the corporation tax and the minimum franchise tax
- Eliminate the state general purpose sales tax
- Establish the business net receipts tax
- Establish rainy day reserve fund

## **Ideas Worth Noting**

- Permit additional offshore leases
- Implement oil severance tax

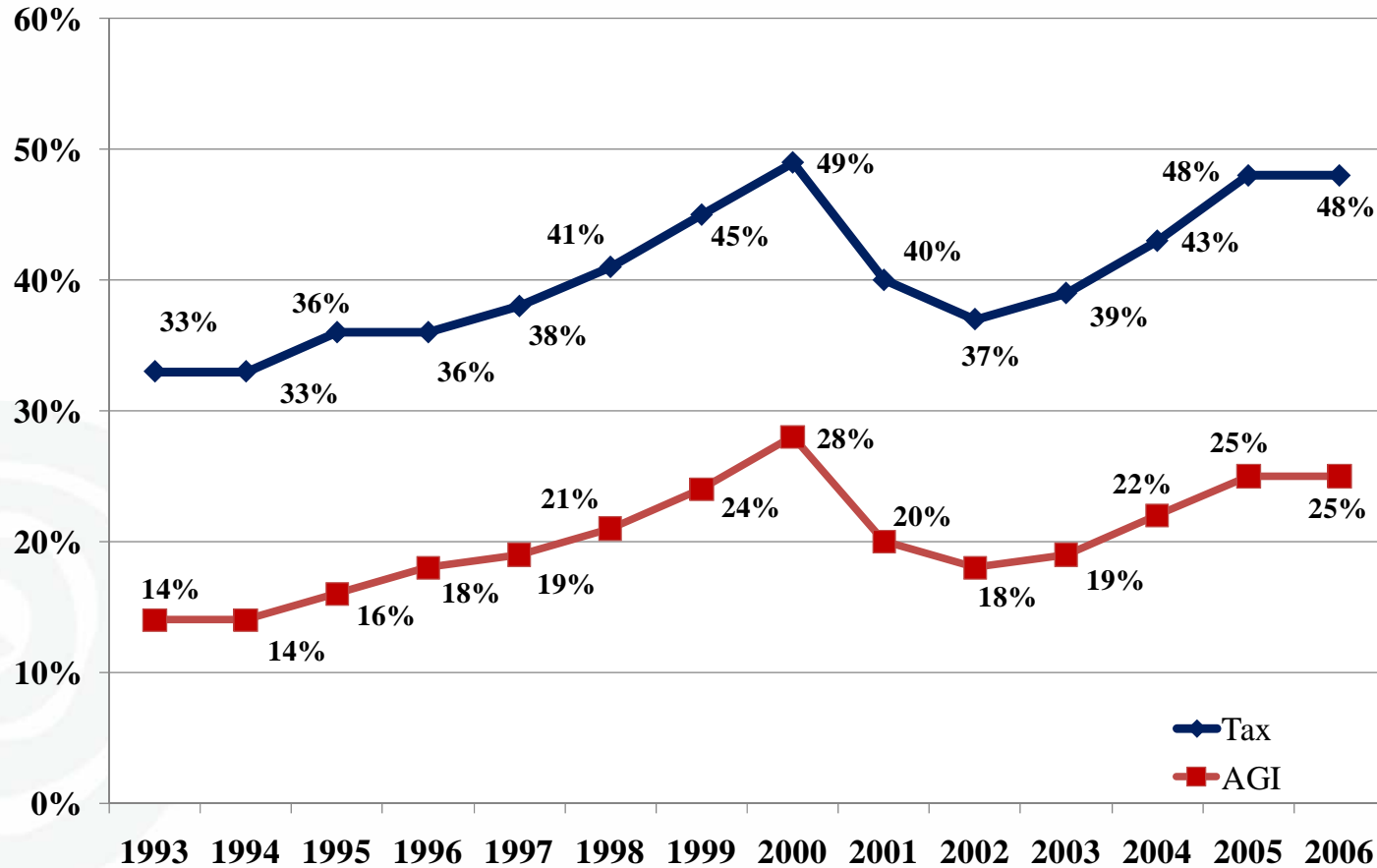


California State Revenue by Source



\*Source: California Dept of Finance, COMPARATIVE YIELD OF STATE TAXES, 1970-71 THROUGH 2010-11

## Shares of AGI and Personal Income Tax Paid by Top 1% of Taxpayers



\*Source: Commission on the 21<sup>st</sup> Century Economy Report, Sept 2009, pg, 14



# Proposed Personal Income Tax Structure

## Two rates

- 2.75% Tax rate
  - Single: up to \$28,000
  - Joint: up to \$56,000
- 6.5% Tax rate – anything above

## Standard deductions

- Single: \$22,500
- Joint: \$45,000

**Itemized deductions limited to mortgage interest, property tax and charitable contributions**

<b>Tax Package Alternative Tax Changes by AGI Class (In billions of \$)</b>	
\$0-\$20	\$0.0
\$20-\$50	\$0.1
\$50-\$75	-\$0.2
\$75-\$100	-\$0.6
\$100-\$200	-\$2.0
\$200-\$1,000	-\$1.7
Over \$1,000	<u>-\$2.6</u>
<b>Total Resident</b>	<b>-\$7.0</b>
<b>Nonresidents and Federal Offset</b>	<b><u>\$6.9</u></b>
<b>Total</b>	<b>\$0.0</b>



## *Business Net Receipts Tax (BNRT)*

- Business gross receipts from all sources less purchases from all other businesses times BNRT rate

*Gross Receipts – Purchases from Other Firms = Net Receipts*

*Net Receipts \* BNRT Rate = BNRT Liability*

- Applies to all businesses doing business in California
- Commission recommended a max BNRT tax rate of 4%
- Phase-in BNRT rate and increasing over the phase-in period





# Impacts of Proposed Changes in Sales and Use Tax

## Components of the Statewide Sales and Use Tax Rate

Jurisdiction (Fund)	Purpose	Rate
State (General Fund)	Directed to State's General Fund (Total General Fund is 6%)	4.75%
State (Local Revenue Fund, SLRF)	Directed to State's General Fund (Total General Fund is 6%)	0.25%
State (Local Public Safety Fund, LPSF)*	Directed to State's General Fund (Total General Fund is 6%)	1.00%
State (General Fund, ASUT)	Directed towards state's Fiscal Recovery Fund to pay off Economic Recovery Bonds (2004)	0.25%
State (Fiscal Recovery Fund)	Directed to Local Public Safety Fund to support local criminal justice activities (1993)	0.50%
Local (County Transportation Fund)	Directed to Local Revenue Fund to support local health and social services programs (1991 Realignment)	0.50%
Local (City or County Operations)	.25% Directed to county transportation funds .75% Directed to city and county operations	1.00%
<b>Total Statewide Base Sales and Use Tax Rate</b>		<b>8.25%</b>

\*Pursuant to revenue and taxation code sections 6051.7, 6201.7 (Operative 4/1/2009)

\*\*Funds unaffected by proposed decrease in sales tax

\*\*\*Source: California State Board of Equalization, Detailed Description of the Sales & Use Tax Rate

## *Proposed Rainy Day Reserve Fund Proposal*

- Increase the target reserve percent
  - Increase: from 5% to 12.5% of state revenues
  - Require that revenues above 10-year trend to be deposited in the reserve
- Restrict the Governor's ability to suspend transfers to reserve fund
  - Exceptions: fund transfers to reserve fund can only be suspended when tax revenues are insufficient to cover spending at prior years level (adjusted for population increases and inflation)
- Stricter controls for fund withdrawals
- Funds can only be used for:
  - Natural disasters
  - Maintain prior year spending



## *Tax Package Phase In*

### **Year 1**

- Eliminate corporate tax
- Reduce personal income tax
- Reduce sales and use tax by 1%
- Establish business net receipt tax

### **Year 2**

- Reduce personal income tax
- Additional reduction of 1% in sales and use tax
- Increase business net receipts

### **Year 3**

- Conversion to new personal income tax
- Additional reduction of 1% in sales and use tax
- Increase business net receipts

- As of 1/1/12, sales and use tax revenues generally deposited into the State's General Fund will be reduced by 1%
- Beginning 1/1/16, the BOE would only impose those sales and use taxes that generate revenues deposited in special funds
- Tax on sale, storage, use or consumption of motor vehicle, diesel, and other fuel would not be reduced



### **Year 4**

- Additional 1% reduction in sales and use tax
- Increase business net receipt tax

### **Year 5**

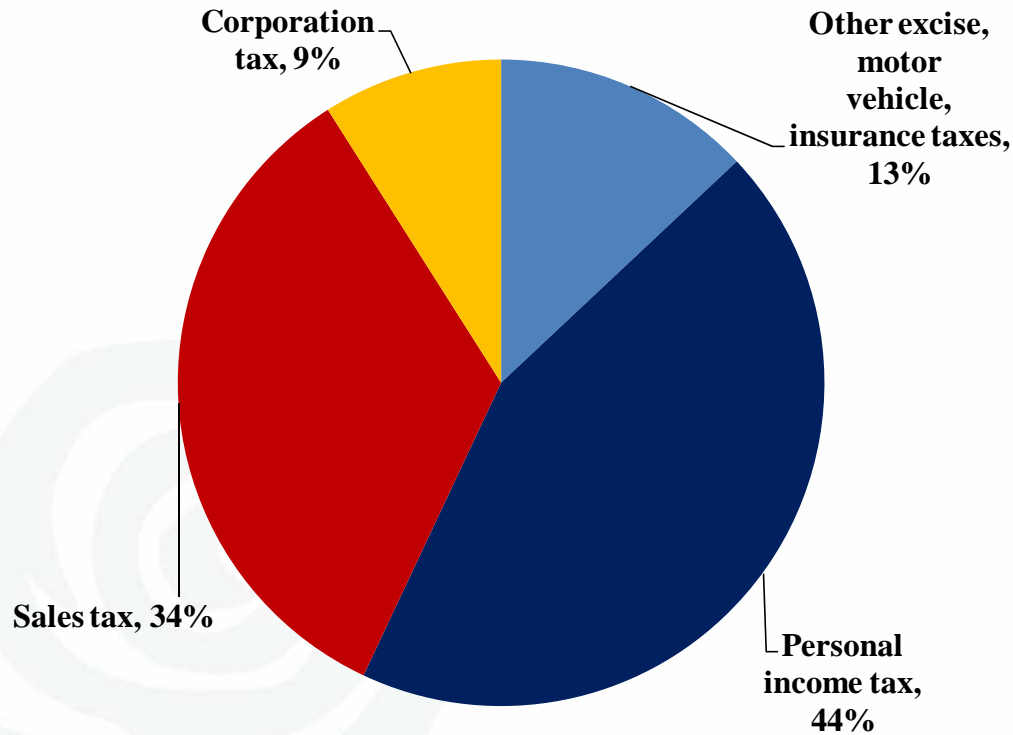
- Additional reduction of 1% in sales and use tax
- Final increase business net receipts

**Sales tax intended to be reduced only if the BNRT performs as expected**

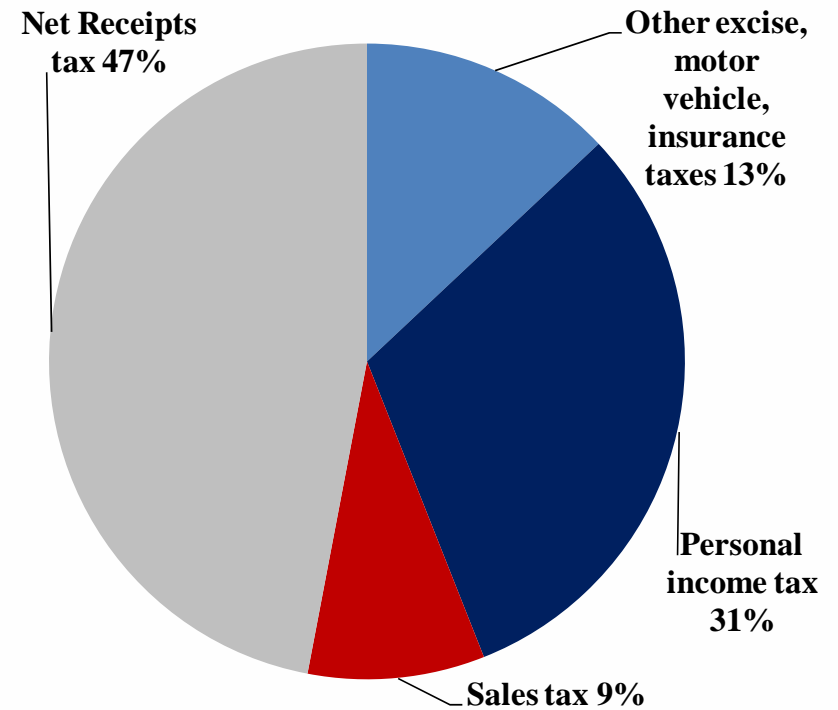


# Effects of Commission's Tax Package

## Current



## Proposed



\*Comparison does not include Tobacco, Estate Inheritance and Gift, Alcoholic Beverages and Motor Vehicle Fuel Taxes

\*\*Source: Commission on the 21<sup>st</sup> Century Economy Report



- Concerns were expressed about certain aspects of the plan
  - Revenue neutrality
  - No consensus about whether volatility is a problem
  - Progressive and regressive nature of changes to PIT
  - Reliance on an untested BNRT
- Commissioners generally believed that it is a good idea to lower sales tax and apply it to a broader range of services
  - Local Government revenues are relatively unaffected by the plan
  - Would reduction of the State's portion of the sales tax cause an administrative burden on local governments?
  - Any distribution of BNRT receipts to local governments were not contemplated

## *Status of the COTCE Plan*

- Report was sent to the Governor on September 29, 2009
- Report was heard in the Committees of Revenue and Taxation in the State Senate and Assembly
  - 4 informational hearings were held
  - No legislator stepped forward to introduce a bill
- Deadline to introduce a bill is Friday, February 19
- Major ideas in the COTCE plan were not included in the Governor's 2010/11 budget

