

Alternative Budget Proposal Pushes For Reform Rather than Simply Cuts

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The California Tax Reform Association made a series of recommendations on revenues for the 2009-10 and 2010-11 budgets, here is their proposal.

I. Double (or more) all revenue projections below. No revenue item is too small to consider, because of the loss of federal matching funds. For example, collecting \$35 million from conformity to federal back-up withholding is worth at least \$70 million in program, and, given 2-1 matches for some programs, may be worth \$105 million.

II. Eliminate money for nothing. We would never tolerate the waste in spending which we tolerate in the tax system. Despite the economy, there are billions in lost revenues, which will have no economic impact, because they provide? Money for nothing? In addition, make no difference in economic decision-making. They simply lose money for the state, leading to cuts in program while generating nothing of value. The LAO lists many of these. We cannot afford these giveaways.

III. Solutions must be considered on a two-year basis. The LAO projects \$15 billion in structural deficit for 2010-11, and the Governor's budget includes at least two years. Revenue, which may not be receivable until 2010-11, must be done now, or we will always be a year behind.

IV. With the early expiration of the taxes on ordinary Californians, the new secret corporate tax breaks must not be allowed to take effect. They will cost \$805 million in 2010-11 (part year) and then rise to a likely \$2.5 billion when fully phased in. People are not against taxes, they are against unfair taxes, especially corporate handouts.

1. Collections: No collection is too small, given federal matches. The numbers below are direct gains, excluding federal match.

1) Amazon nexus issue (AB 178, Skinner, AB 3x 27, Calderon): \$100 million state, \$50 million local. The failure to collect sales tax on remote sales hurts California businesses. This revenue is due and payable as use tax. The only issue is the point of collection. Amazon will start collecting immediately, as they did in NY, and will sue (case dismissed at first level in NY). Even if they ultimately succeed in court, which is doubtful, the tax collected will not be at issue. If California does this along with NY, the Congress will be incented to provide nationwide collection, at potentially \$1 billion for the state and improvement in the suffering local retail climate.

B. Financial Institution Record Match (FIRM): \$33 million, \$100 million on going (Contained in the Assembly budget, a conference item). The banks are no longer opposing, nor should they ever have. It is information sharing which will collect from adjudicated tax debtors, a system which has already worked for child support.

c. Require reporting on difference between book and tax income: Unknown revenue guesstimate of \$50 million. The FTB has attempted to impose a state reporting form's state equivalent of the federal M-3 form. For the difference between book and tax income, which was opposed, delayed and defeated by Chevron. This should be in place, even though we cannot know how much it will generate. Its purpose is to track complex corporate tax sheltering,

particularly the use of offshore shelters and pass-through by the proliferation of controlled foreign corporations.

d. Crack down on abusive tax shelters: Unknown revenue increase, potentially \$40-60 million or more. The Franchise Tax Board has a number of proposals for tightening abusive tax shelter laws. Every one of those should be explored and enacted. The abusive tax shelter loss in California is still in the range of \$500 million to \$1 billion yearly, according to the FTB.

e. Improved business use tax collection: \$620 million full year, if implemented in budget year possible \$310 million (Contained in AB 711, Calderon). All businesses, not just retailers and re-sellers, would be required to register with the Board of Equalization and would be required to report out-of-state purchases and pay use tax. The state is estimated to lose \$775 million in unpaid business use tax, and BOE estimates recovery at 80% of that lost revenue.

f. Conformity to federal back-up withholding: \$35 million a year. Significant income cannot be withheld because of lack of information or other reasons, and is therefore never taxed, particularly for out-of-state earners. The IRS provides for back-up withholding, and California must do the same. Language was contained in AB 1848 (Ma) of 2008.

g. Withholding on independent contractors: Revenue likely to be realized in 2010-11, \$2 billion acceleration (per majority budget in December), \$200 million or more on going. This addresses a major part of the tax gap and has been sought for years as a means of tax enforcement. Although it probably cannot be implemented in the fiscal year, we can no longer afford to ignore this critical enforcement tool.

h. Suspend professional and occupational licenses for tax debtors: \$13-25 million Contained in AB 484, Eng. Those who are licensed by the state get the benefits and must pay their taxes. This is a collection measure of last resort for adjudicated tax debtors that have been successful for child support collections.

i. Deny sales tax refunds to purchasers of worthless accounts: \$42 million. This was originally estimated at \$6 million when it passed, but has cost 7 times the original estimate. Contained in AB 1839 (Calderon) in 2008. The cost of this will rise as defaults rise. Retailers can get sales tax refunds when consumer's default, but the financial institutions, which purchase their debts, should not get the sales tax refunds.

j. Enact LAO recommendations for fee, interest, and penalty modifications: \$12.6 million, growing over time, particularly penalties for baseless overstatements for refunds. Contained in Assembly Sub 4 and Senate Sub 5 budget recommendations.

2) Money for nothing? Giveaways with no economic impact, a.k.a. waste, fraud and abuse in the tax system.

a. Eliminate the ability to shelter income in offshore tax havens: \$40 million in 2009-10, \$130-160 million on going (Contained in AB 1178, Block). The ability to park revenue in offshore tax havens, with no economic activity other than tax avoidance, loses substantial revenue while gaining nothing for the California economy. Tax havens should be considered part of the water's edge, as some other states do.

b. Cancel new enterprise zones and phase out the program: Per LAO recommendation, \$100 million initially, growing over time. A definitive econometric study has demonstrated this program to be useless in creating jobs. Other reports

have shown major fraud and abuse of an outdated statute which can be manipulated by taxpayers.

Wal-Mart gets major benefits for its distribution centers without even providing health benefits, thereby costing state dollars. Repealing the entire program would raise \$400 million.

c. Eliminate capital gains break for exchanges of commercial property: \$350 million, per LAO recommendation. These exchanges are made for the federal tax benefits, not state benefits, and exchanges for out-of-state property? An incentive to launder capital gains out of state? Causes \$50 million in revenue losses every year. This is a tax dodge that has nothing to do with investment, in which brokers specialize in arranging tax-free transfers.

d. Enact oil severance tax at 9.9%, per Governor's proposal: \$1 billion a year. A definitive study of oil severance tax in California demonstrates no effect on either price or production. Every place in the world but? Progressive? California taxes oil production. We have left billions on the table, and can no longer afford to.

e. Tighten statutory change of ownership rules: Over \$1 billion, in 2010-11, increasing over time. Changes of ownership rules for investment property are full of loopholes, so that many properties legally change ownership without reassessment and companies can manipulate a system to their benefit. Much of this revenue, pursuant to Proposition 1A, would go to local government as increased property tax. Estimates have varied widely on this, but estimates by the BOE from doing this in the 1990's was at \$1-2 billion back then, and the number should be larger now.

f. Eliminate? Nowhere income? Loophole: \$65 million. Companies can treat asset sales and purchases differently for state and federal law, allowing avoidance of state tax. Requiring treatment to be the same, as we do for other tax law, would eliminate the failure to report this tax.

g. Eliminate the new loopholes placed secretly in the past two budgets: \$805 million in 10-11 (DOF estimate), growing to as much as \$2.5 billion annually. The combination of elective single sales, loss carry-backs and credit sharing threatens to swamp the corporate tax, and should be eliminated before it takes effect. It is a boon for tax manipulation to a degree, which is embarrassing to the state of California, and has to be stopped before it takes effect. [3][3]

H. Increase Subchapter S tax rate to 2.5%: \$600 million. With federal law changes, Subchapter S corporations are no longer small companies but large corporations, which pay only 1.5% in corporation taxes. When California permitted S corporations to form, it required a 2.5% entity level rate, later lowered to 1.5%. There are no economic impacts of increasing the entity level tax, since the use of the S form is a matter of tax convenience.

I. Eliminate the deduction/exclusion of subsidized parking: \$100 million, per LAO proposal. We have long argued that the employer deduction/employee exclusion is a subsidy for individual driving, counter to the state's environmental policies. The deduction/exclusion is counterproductive, and its elimination would send the correct environmental signals.

j. Continue the corporate credit limitation to 50% of tax liability: \$400 million. (Contained in AB 1452). California has the highest research and development credit in the country that leads to the zeroing out of tax liability for many profitable companies. Profitable companies should pay some level of taxes for their use of resources in California, and this temporary limitation should become permanent.

3) Taxes supported by the public

a. Raise top bracket on income tax: \$3-5 billion, depending on rates and brackets. The reason that the wealthy bear a high percentage of the income tax is because the top 1% holds a disproportionate amount of the income, up from 14% in 1993 to 25% in 2006. There is no evidence of impact on economic activity from raising the top rates and establishing new brackets.

B. Increase Alcohol fee (or tax): 10 cents/drink would raise \$1.4 billion. Contained in AB 1019, Beall. An estimated \$8 billion in public costs have been identified with alcohol abuse, including law enforcement, health care, hospital and trauma care, court costs, child abuse, domestic violence and foster care. Arguably, a fee could back out significant state and local costs, but a general fund tax would be more appropriate.

c. Broaden the sales tax base to include commodities identified as intangible: \$2-4 billion. Governor's proposals were similar but included some labor services. Entertainment, amusement parks, professional sports, golf, ski resorts, hotels? The rental of facilities? Should be subject to sales tax. Such electronic purchases as digital downloads, cable TV and other electronic access should be subject to sales tax as well. Higher figure includes sales tax on telecommunications, proposed in the early 1990's by Governor Wilson.

a) The California Tax Reform Association (CTRA) is a small non-profit organization based in Sacramento, California. CTRA has advocated for many years for fair taxes in the context of a healthy public sector. CTRA is primarily supported by labor, public health, education, and law enforcement groups.

b) Posted on June 05, 2009 Comments Your Suggestions here just was sent to a key California legislator. Will be sharing with others now, and hope I have your permission to repost elsewhere (reading fair use soon as I hit send).

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