

As California rapidly approaches the sunset dates for Proposition 30's temporary tax increases, some policymakers are suggesting the time is ripe for comprehensive tax reform. State Controller Betty Yee recently appointed a nine-member panel of economic advisors to review and comment on the practical effects, unintended consequences and prospective alternatives of tax reform proposals. "California needs a tax system that reflects the 21st century economy, is less vulnerable during economic downturns, and is more sustainable, providing greater certainty from year to year," Yee said.¹

Los Angeles Times columnist George Skelton wrote policymakers should respond to "the continuing need for an overhaul of California's tax system to make it less dependent on the unreliable super-wealthy." "The tax system should be rebuilt," he wrote. "It's too old and wobbly to support a vibrant state."²

Over the past several years, various tax reform proposals have been released to accomplish these goals, including:

- The Commission on the 21st Century Economy, appointed by Governor Arnold Schwarzenegger in 2009;
- *Eureka! How to Fix California* by Arthur Laffer and Wayne Winegarden, published by the Pacific Research Institute in 2012; and
- Senate Bill 8 introduced by Senator Bob Hertzberg in December 2014.

The Commission on the 21st Century Economy studied the state's tax code and made recommendations to update and improve the state's revenue system.³ Often referred to as the "Parsky Commission" after Chairman Gerald Parsky, the bi-partisan panel of 14 California business leaders, economists, and policy experts made dozens of specific recommendations in a 400-page report and proposed legislation designed to "Dramatically change the State of California's revenue structure and improve its overall fiscal stability, competitiveness, and prospects for economic growth by significantly reducing tax rates and broadening the tax base."⁴

As a candidate for governor in 2010, Jerry Brown said: "Recently the Parsky Commission took on the difficult task of reviewing California's complicated tax structure and made recommendations for significant change. Unfortunately, no consensus was achieved. While I am fully aware of the difficulties of ever changing our tax structure, I would try again by establishing a similar commission that could build on the hard work already completed."⁵

In *Eureka! How to Fix California*, Laffer and Winegarden argued California is in need of comprehensive tax reform that is fair, efficient and simple. They proposed a flat tax of 5.8% for individuals and businesses to replace the majority of the current tax code, stating, "The first and foremost job to bring California back to prosperity is a total overhaul of California's tax code."⁶

Senator Bob Hertzberg introduced SB 8, The Upward Mobility Act on December 1, 2014. He has described his proposal as a "Tax-reform plan to modernize state taxes."⁷ His proposal would expand the current Sales and Use Tax rate to include services; language in the legislation earmarks \$10 billion in new revenues for various state programs.

Each of these plans has been marketed as "tax reform." But how comprehensive are these proposals? How do these proposals differ on key points and where do they align?

The enclosed table by Forward Observer compares each of these tax reform plans.

A Comparison of California Tax Reform Plans

Proposal	Commission on the 21 st Century Economy	Pacific Research Institute: Eureka! How to Fix California	SB 8 Upward Mobility Act
	<i>“There are numerous ways to make the overall system more reliable and less volatile, both with better budget management and changes to the structure.”⁸</i>	<i>“This complete flat tax would eliminate much of the inefficiency from California’s tax system by both broadening the tax base and significantly lowering the highest marginal tax rates.”⁹</i>	<i>“The Upward Mobility Act will... help make California’s business more competitive by modernizing our tax code.”¹⁰</i>
Sales and Use Tax	The General Fund portion of the Sales and Use Tax would be gradually reduced by 1 percent per year until it is eliminated.	The Sales and Use Tax would be eliminated.	The current Sales and Use Tax rate would be extended to services, excluding the health and education sectors.
Personal Income Tax Rate	A Tax rate of 2.75% would apply to taxable income up to \$56,000 for joint filers and \$28,000 for single filers and a tax rate of 6.5% would be applied for income over that amount.	A single flat tax rate of 5.8% would replace all tax brackets and apply to all income earners.	The impacts of lowering the Personal Income Tax would be examined “When it is clear that new revenues are sufficient to replace any revisions.” ¹¹
Standard Deductions	A standard deduction of \$45,000 would be provided for joint filers and \$22,500 for single filers.	No standard deductions would be allowed.	No changes made to current deductions.
Earned Income Tax Credit	No change.	No change.	\$2 billion in new revenue would be earmarked towards an earned income tax credit for low income families.
Itemized Deductions	Itemized deductions would be limited to mortgage interest rate deductions, property taxes and charitable donations.	Itemized deductions would be limited to mortgage interest rate deductions, charitable deductions.	No change.
Renters Deduction	No change.	Renters would be allowed to deduct their rent on their primary residence from their Personal Income Tax liability.	No change.
Capital Gains Taxes	No change.	All capital gains would be considered income and taxed at the same flat rate of 5.8%.	No change.
Corporation Tax	The Corporation Tax would be eliminated and replaced with a new Business Net Receipts Tax.	The Corporation Tax would be immediately eliminated and replaced with a new Business Value Added tax of 5.8%.	No change.

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Proposal	Commission on the 21 st Century Economy	Pacific Research Institute: Eureka! How to Fix California	SB 8 Upward Mobility Act
Minimum Franchise Tax	The \$800 minimum franchise tax would be eliminated.	The \$800 minimum franchise tax would be eliminated.	No change.
Cigarette Taxes	No change.	The general fund portion of cigarette taxes would be eliminated.	No change.
Alcohol Taxes	No change.	The general fund portion of alcohol taxes would be eliminated.	No change.
Gas and Diesel Fuel Taxes	No Change.	All gas and diesel fuel taxes would be eliminated.	No change.
New Business Taxes	A new Business Net Receipts Tax (BNRT) would be created to replace the state Sales and Use Tax and would be phased in over a five year period and capped at 4% of a business's gross receipts minus their purchases from other tax paying businesses.	A new Business Value Added (BVA) tax would be instituted to replace the corporation tax and Sales and Use Tax. The BVA would be capped at 5.8% of a business's total revenue minus their purchases from other tax paying businesses.	Would "Evaluate the current corporate income tax to determine whether it is meeting its intended purpose." ¹²
Small Business Exemptions	The BNRT would contain an exemption for small businesses with less than \$500,000 in gross annual receipts.	No change.	Would exempt small business with under \$100,000 in gross sales from a service Sales and Use Tax.
Research and Development Credit	A credit for research and development expenses would be provided against businesses' BNRT liabilities.	No change.	No change.
Enterprise Zones	Recommends an evaluation and reduction of 2009 enterprise zone programs.	Lower BVA tax rates would be established in the poorest regions of the state to encourage job growth.	No change.
Amnesty	An independent tax dispute forum would be established to resolve disputes between tax filers and state.	A tax amnesty program would be created with the goal of helping tax evaders re-enter the tax system.	No change.
Impact on State Revenue	A technical review panel would annually review the performance of the BNRT and recalibrate the transition process to ensure revenue neutrality.	The authors calculate a 5.8% flat tax and income generated from the BVA tax would provide the same average annual state and local revenue from 2000 to 2008. ¹³	While SB 8 specifically earmarks \$10 billion in new spending, estimates by the State Board of Equalization show a potential revenue increase of \$122.6 billion. ¹⁴

Endnotes

- 1 California's State Controller's Office, "CA Controller Launches Expert Panel to Analyze Tax Reform Proposals from Varied Perspectives," April 22, 2015. http://www.sco.ca.gov/eo_pressrel_16183.html
- 2 *Los Angeles Times*, "Don't extend tax-the-rich Prop. 30; overhaul the whole tax system." April 29, 2015 <http://www.latimes.com/local/politics/la-me-cap-taxes-20150430-column.html>
- 3 Commission on the 21st Century Economy, *Final Report*. September 2009. http://www.cotce.ca.gov/documents/reports/documents/Commission_on_the_21st_Century_Economy-Final_Report.pdf
- 4 Commission on the 21st Century Economy, *Final Report*, September 2009. Page 41.
- 5 Forward Observer, "Campaign Promises of Jerry Brown." http://www.fwdobserver.com/templates/images/Brown_Promises_2010.pdf Originally found at <http://www.jerrybrown.org/sites/default/files/Budget%20Plan.pdf>
- 6 Laffer and Winegarden, *Eureka! How to Fix California*. Pacific Research Institute, 2012. Page 145.
- 7 Office of Senator Bob Hertzberg, "Sen. Bob Hertzberg, author of tax-reform plan to modernize state taxes, responds to state tax study released today." April 14, 2015. <http://sd18.senate.ca.gov/news/4142015-sen-bob-hertzberg-author-tax-reform-plan-modernize-state-taxes-responds-state-tax-study>
- 8 Commission on the 21st Century Economy, *Final Report*, September 2009. Page 30.
- 9 Laffer and Winegarden, *Eureka! Page 150*.
- 10 SB 8, Section 1, Paragraph L http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201520160SB8
- 11 SB 8, Section 1, Paragraph P
- 12 SB 8, Section 1, Paragraph E
- 13 Laffer and Winegarden, *Eureka! Page 160*.
- 14 California Board of Equalization Revenue Estimate, April 14, 2015. <http://www.boe.ca.gov/legdiv/pdf/ServicesRevEstimate.pdf>. Also see <http://www.boe.ca.gov/legdiv/pdf/Servicesfactsheet2015.pdf>

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