To: Mr. Mark Ibele, Staff Director
Governor's Commission on the 21st Century Economy

From: Fred Keeley, Commissioner

Re: Request for Revenue and Fiscal Analysis of Potential Tax Changes.

Date: April 17, 2009

Near the end of the Commission's April 9, 2009 meeting at the University of California at Davis, commissioners were asked by Chair Parsky to submit in writing any tax reform or change proposals, in package form if possible, to the Commission staff. The intent, as I remember, is to allow the staff to seek the assistance of the Department of Finance, Board of Equalization, and Franchise Tax Board in modeling the impacts of such changes.

This document contains a package, parts of which I agree with in principle, and others with which I do not agree. I am submitting this package in order to understand orders of magnitude of some of the changes, including my own suggestions, that have surfaced at the Commission, and to be able to have sufficient information to manage towards the principled consensus sought by Chair Parsky.

1. **Capital Gains.** Revenue volatility is expressly mentioned in the Governor's Executive Order S-03-09 establishing the Commission. It has been suggested that revenue volatility could be reduced in a variety of ways, including treating capital gains in some other manner than as ordinary earned income. Would you be kind enough to model what the revenue impact would be of a 1%, 2%, 3%, 4% and 5% reduction in the capital gains tax? Please use at least five years data in this exercise.

2. **Carbon Tax.** The Governor's Executive Order S-03-09 also charges the Commission with presenting recommendations that would "(e)stablish 21st century tax structure that fits with the state's 21st century economy." Given the enactment of AB 32, California's landmark greenhouse gas reduction law, I suggest that the Commission consider recommending a limited form of carbon taxation as follows: a tax levied at the refinery level on the production of gasoline, diesel fuel, and jet airplane fuel, at an equivalent rate of $20.00 per ton of carbon dioxide emissions (I am told that such a pricing would result in approximately 12-16 cents per gallon increase if passed along to the retail level). Would you please model this proposal, and do so for each of the fuels listed? Furthermore, would you please model this proposal based on consumption patterns for the last five years?

3. **Sales Tax – Business Inputs.** The Governor's Executive Order S-03-09 additionally charges the Commission with submitting recommendations that would "Improve California's ability to successfully compete with other states and nations for jobs and investments." Several witnesses, and especially those representing factions of California's robust business community, have suggested that California could be made more competitive if the state would exempt "business inputs" from sales taxation. Would you please model the impact of such a sales tax exemption on state General Fund revenues? Would you please model this based on a five-year period, beginning in tax year 2005-06?

4. **Sales Tax – Services.** Again referencing that portion of the Governor's Executive Order S-03-09 in which he directs the Commission to be especially mindful of the composition of the 21st century economy, it seems appropriate to explore the impacts of expanding the application of the state's existing sales and use tax to at least some set of services. I am making this request based on evidence presented to the Commission that claims that the composition of sales has migrated from being predominately goods and manufacturing with few sales in the service sector, to approximately equal number or value of sales transactions, split between goods and manufacturing, and services. Would you be kind enough to model the revenue impact to the state's General Fund in the following scenarios:

    a. Extending the existing sales and use tax to all 160 services recognized by the National Association of State Budget Officers;
    b. Extending the existing sales and use tax to only those services that are not business inputs, and are not consumed primarily by low- and moderate-income individuals;
    c. Extending the existing sales and use tax to those transactions that are conducted on the Internet, in a manner similar to transactions covered by the Amazon decision in New York. (In all cases, please model the impact on the state's General Fund for the last five years, including the 2008-09 FY.)

5. **Use Tax Compliance.** The Governor's Executive Order S-03-09, at Item 2(f), directs the Commission to make recommendations to "Ensure that (the) tax structure is fair and equitable." It has been suggested that one of the major areas of non-compliance with existing California tax law is in remittance of use tax obligations. While this tax is recognized in the Revenue and Taxation Code, and is noted on the State's Personal Income Tax form, it is rarely collected or paid. Would you please model the impact of estimated revenues lost as a result of failure to pay and failure to enforce this provision of the tax code? Would you please do so for the last five years?

6. **Definition of "Sale" for Non-Residential Property.** Again making reference to the Governor's Executive Order S-03-09, Item 2(f) concerning

fairness, the Commission has received testimony concerning whether or not the State is foregoing revenue from property taxes because the current Revenue and Taxation Code definition of a "sale" that would trigger a reassessment of real property and improvements, is so narrow that it excludes "sales" of non-residential property that would constitute a reassessment if the definition were expanded. Specifically, would you please model the impact on property tax revenue if the definition of a "sale" was to be expanded to include sales such as those displayed on pages 15, 16, and 17 of Richard S. Moon's presentation to the Commission on April 10, 2009? Would you be kind enough to do so for the last five fiscal years?

7. **Permanent Dedicated Funding Source for Resources Agency.** The Governor's Executive Order S-03-09 at 2(d) directs the Commission to recommend changes in laws to "Improve California's ability to successfully compete with other states and nations for jobs and investments." Among other reasons that have been cited for business location, retention and expansion in California, is California's "quality of life." Chief among those qualities are California's outstanding institutions of higher education, the wonderful Mediterranean climate, and the vast variety of natural resources, both in public and private ownership. The Governor and the Legislature have received reports over the last several years that lament the declining revenues available to protect and enhance California's ocean resources, terrestrial resources, air, and water quality. The California Environmental Protection Agency is a classic "command and control" structure, and, thus, has the statutory ability to, for the most part, establish air and water quality standards, and then set fees on the regulated community to achieve such standards. This is not the case for the Resources Agency, which provides primary stewardship of California's ocean and terrestrial resources (Fish & Game Department, Department of Forestry and Fire Protection, Department of Parks and Recreations, etc.). These state governmental entities, in order to comply with existing law, need approximately $650 million per annum above existing funding levels. Would you please model the revenue generating potential of a fee for recordation of any kind on real property that would generate such revenue amounts? Please do so based on the last five years of recordation data (understanding that such data may indicate that the fee level would vary).