Why I Think We are Heading in the Wrong Direction
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Unfortunately, I cannot make Monday's final meeting of the Commission. In the interests of continuing our spirited discussions to do the right thing for the State, I am setting forth my concerns about the direction we seem to be heading.

A. The Big Picture

1. Growing the Tax System

As the California economy recovers from the current recession, history suggests that the incomes of the wealthy will grow faster than the incomes of the lower- and middle- groups. Further, corporate profits are likely to grow faster than sales. The Commission should take this expected growth pattern into account in restructuring the tax system. My Red, White, and Blue Plan, which revitalizes the corporate income tax and eliminates waste and inefficiency in the tax system, will position the State to share in any upturn in the economy. The plans under consideration by the Commission do exactly the opposite.

2. Tax Shift to the Middle-Income Groups

The Commission is discussing a plan that would reduce the personal income tax on the wealthy by approximately $7.5 billion, benefitting around 3% of the top taxpayers. The bottom 81% of the income groups would receive 10% of the reductions.

We are also discussing eliminating the corporate income tax. The corporate income tax introduces a progressive element into the tax system by taxing shareholders, the majority of whom are nonresidents of California. To finance these cuts for the privileged few, the Commission is considering a new tax--the net business receipts tax (NBRT), disguised as a tax on business but intended to be a tax on consumption.

Like any tax on consumption, this new tax will be regressive, but the Commission has not been provided with any distributional analysis. Certainly such an analysis is critical to evaluating the tax. Although it is proposed that the NBRT will replace some or all of the State portion of the sales tax, the base of the new tax is much broader, reaching a panoply of items now exempt, such as food and medicine, and services such as medical, dental, utilities, and housing. These changes are not in the long-term or short-term interests of the State.

Astonishingly, the plan on the table would actually eliminate the medical expense deduction and the child care credit from the personal income tax. I fail to see how either change would further any sensible social policy. The effect is to capture funds from uninsured sick people and workers with child-care responsibilities in order to help finance income tax cuts for the well-to-do.

Eliminating the medical expense deduction will exacerbate the problems of those who have lost their jobs and their health insurance and are paying for needed medical and dental care out of their own pockets. It would also be harmful to unemployed workers or those who have been forced to purchase an expensive COBRA policy to protect themselves and their families from catastrophic medical bills. I am amazed that the Commission, at a time when the whole nation is concerned about the rising costs of health care, is essentially targeting individuals without health-care insurance.

Whatever the merits of the child-care credit in prosperous times, its elimination during a deep recession and high unemployment is baffling. The main purpose of the credit is to give tax relief to single individuals and two-job couples who are working and incurring child care expenses. The recession has hit low- and moderate-income families with young children harder than many other groups. In too many families, the primary income earner has lost a job and has been forced to take whatever low-paying jobs may be available. To replace some of the loss in family income, the parent providing the primary care to their children has been forced into the labor market, typically at a low-paying job. Taking away a credit from these families and thus hitting them with a tax increase when they are suffering seems heartless to me. It is even crueler in the context of a $7 billion reduction in tax for the top 3% of income earners. This solicitude for the wealthy and disregard for others is simply callous.

I am especially troubled by eliminating the corporate income tax, in existence for more than 70 years, and used by 90% of the states, and replacing it with a totally new, regressive tax, never seen before in either California or the world (with the exception of Michigan). In the not-too-distant past, the California corporate income tax was a model for other states to follow. It could become a model again if the reforms proposed in my Red, White, and Blue Plan are adopted. The goal of the Commission should be to revitalize that tax, not eliminate it.

I find it particularly ironic that some Commissioners are proposing that all individuals should pay some amount of income tax, so they realize there is no free lunch. Yet these same Commissioners seem content to eliminate the corporate income tax with its minimum tax.

The Commission has no empirical evidence suggesting that the existing corporate income was hurting the economy (or that the income tax on the wealthy was encouraging them to work less hard or to leave the state in droves). Indeed, a large body of literature suggests the opposite. I am at a loss to explain why we would replace a tried and true tax, the corporate income tax, one that can be rehabilitated, with an unknown tax.

3. The New Net Business Receipts Tax (NBRT)

The NBRT is used only in Michigan, which recently adopted it. Little is known about Michigan's actual experience with this tax. Indeed, Michigan is not yet able to say how much revenue it has even raised from the tax since it went into effect.

As discussed below in Part B, the tax is fraught with difficulties not previously encountered. Significantly, a letter from a group of academic icons to the Commission strongly cautions the Commission about the tax, concluding that it is "an intriguing proposal, perhaps worthy of consideration in future tax reform efforts, but there are numerous reasons to believe that this is the wrong course for the state to take at this stage". The problems with the tax will be more important in California than in Michigan because the suggested rate for the NBRT is likely to be at least four times that of Michigan. Moreover, the Michigan tax is closely integrated with its newly-enacted corporate income tax. The advocates of the NBRT, however, advocate the repeal of the California corporate income tax.

Some of our debate over the NBRT rests on one fundamental misconception. Although the new tax has been described as a "value added tax (VAT)," it is not the kind of VAT used in Europe and throughout the world. That VAT is known as a credit-invoice, transactional value added tax (Japan might be the exception). It is collected at the time of each sale, and widely viewed as a tax on the consumer. It can be thought of as a retail sales tax collected in stages.

The European VAT has two features that are critical to the proper operation of a value added tax. First, imports are taxed. This maintains neutrality between the sale of domestically-produced goods and foreign produced goods. This feature is critical so that domestic producers are not put at a competitive disadvantage. Unfortunately, this feature cannot be incorporated into the NBRT for two reasons. Under the U.S. Constitution, producers outside California cannot be brought under the NBRT unless they have nexus with the State. Any constitutionally acceptable definition of nexus will exclude a large number of producers based in other states as well as foreign countries.

Also, the draft proposal explicitly excludes foreign corporations from the tax by adopting the same water's edge limitation now existing in the corporate income tax. That is a self-inflicted limitation; a constitutionally-imposed limitation is not. Consequently, even if the water's edge rule were eliminated, foreign producers without nexus would still not be taxed. The result as explained below is that California producers will be at a competitive disadvantage.

The second feature that is critical to a value added tax is the rebate of the tax on exports. Exports are exempted from the VAT because they will be taxed when they are sold in the country to which they are imported. Under a transactional VAT, the amount of tax previously paid by the exporter is known and thus can be rebated.

The virtue of this arrangement is that all goods that are sold in a country, whether imported or produced locally, are subject to the same rate of VAT, thus maintaining a level playing field.

The rebate of the VAT is not free of administrative difficulties. Serious fraud issues have emerged in recent years. That said, the rebate is essential for the proper working of the tax.

Unlike the VAT where the amount of the tax previously paid by the exporter is known, that amount is unknowable under the

NBRT. No rebate can be easily administrable. Consequently, California exporters are put at a competitive disadvantage in competing outside the State.

Finally, a common market like the Economic Union in which member states have a similar value added tax designed in conformity to community norms, it is a very different environment from the United States, where only Michigan and California would have NBRTs. This latter point is critical to understanding the possible harm that could result to the California economy from adopting this tax.

4. The Failure of the State's Sales Tax to Reach Numerous Services

The consensus of the members of the Commission is that the California sales tax, compared to other states, taxes few personal services. While most states exempt many types of services, California is well outside the norm. Commissioners seem to agree that some expansion is desirable and I agree. Our disagreement is over how best to achieve that goal.

I would have thought the most logical way of dealing with this under-reliance would have been to identify services whose taxation would be consistent with sound principles of sales tax policy. Those principles suggest that a sales tax should be imposed on services that represent consumption by the end-user rather than a business or investment input; services that are provided locally and do not compete with out-of-state firms, so that consumers will not shift their purchases from California to other states; and services not disproportionately consumed by lower income persons.

We have not engaged in that debate for two reasons. One is a feeling that a tax on selected personal services is politically infeasible. I have tended to operate under the rule of thumb that what appears to be infeasible at one point in time might turn out to be an attractive compromise at another. It depends on what the alternatives might be.

Second, and more importantly, the NBRT provides a much larger base and is projected to generate enough money, at least at high rates in the range of over 4%, to finance a buydown of the personal income tax (as well as eliminating the corporate income tax, and the state portion of the sales tax).

Revenue projections for a new tax are always tricky, if not wildly inaccurate. They are especially suspect when they are made before any tax has worked its way through the legislative process and before taxpayers become familiar with tax minimization strategies. In the case of the NBRT, revenue estimates are particularly difficult, given its novelty. The experience of Michigan, the only state that has used such a tax is unhelpful. Michigan has not yet been able to determine how much revenue it is obtaining from the tax, despite having operated it for over a year and a half.

I believe we would not be debating the NBRT except for its potential to buydown the income tax. But that revenue comes at the cost of taxing a wide range of goods and services that are now exempt, including utilities, medical, food, legal, and housing.

I doubt anyone would think that the NBRT was a good tax for California if viewed in isolation. To take one example, the NBRT would tax real estate rentals, at least by “businesses,” as well as the sale of homes by “businesses.” As far as I know, it is highly unusual for a state to impose a sales tax on the sale of homes. The states have left to local communities the right to tax homes through a property tax. Because of the restrictions imposed by Proposition 13, the California property tax systematically under taxes property that has been held a long time and over taxes property recently acquired. The proposed NBRT tax on the sale of homes by “businesses” would significantly exacerbate this basic flaw. And I cannot think of a worse time than in the middle of a recession marked by thousands of foreclosures to impose a new tax on the sale of housing by businesses.

To take another example, consider medical services provided by for-profits. Not content to take away the itemized deductions for medicals, some Commissioners are ready to impose a new tax on for-profit medical services as well. I have trouble believing that the Legislature will endorse this double whammy.

As just these two examples indicate, the attractiveness of the NBRT is not that it is a desirable tax in isolation, but rather it is an unfamiliar and non-transparent means to an end that some Commissioners think desirable.

To do all that some want the NBRT to do requires a rate over 4%. In examples provided by the staff, the rate was 4.5%. This rate is four and a half times that of Michigan. As discussed below, the imposition of any new tax, but especially one unseen anywhere in this country but Michigan, and nowhere else in the world, is complicated, time consuming, and fraught with unintended consequences that may be harmful to the California economy. And any proposal to start the rate low and raise it over time would be tantamount to the proverbial killing a lobster by slowly increasing the temperature of the pot.

Finally, looking to Michigan as a role model is odd. No one would think that Michigan could serve as a poster child for a robust economy. The Michigan tax has its roots in the previous Single Business Tax (SBT), which was a response to the problems of a single industry: automobile manufacturing. The successor to the SBT, which serves as inspiration for the NBRT, is a response to Michigan’s constitutional cap on the rate of the sales tax. That neither condition exists in California does not necessarily mean that the NBRT should not be considered, but it is unfortunate that Michigan has no real experience for California to draw upon.

During our deliberations we kept looking to see how Michigan dealt with various problems, even having a distinguished Michigan lawyer and former tax commissioner participate in our discussions. But one important caveat is in order. Although it is reasonable to look to Michigan for drafting suggestions, just because Michigan phrased its statute in a particular manner to deal with a specific problem does not mean that problem was actually solved. It is simply too soon to tell.

B. Problems With the NBRT

1. The Consequences of the $500,000 Filing Threshold

The NBRT increases dramatically the number of potential taxpayers. Proprietorships, LLCs, LLPs, S Corporations, C Corporations, and partnerships would become taxpayers. In order to remove small businesses from having to comply with the NBRT, a laudable goal, a filing threshold of $500,000 in gross receipts has been proposed. In addition, net receipts of $250,000 or less would effectively be excluded from the BNRT through a credit mechanism. The exclusion would be phased-out based on a graduated schedule. For convenience, both of these features will simply be referred as the "exemption."

Because businesses under the exemption would be free of the tax, there will be an incentive for purchases to be made from these firms rather than from taxable firms. That is, purchases from exempt firms will carry no NBRT; purchases from others will, interfering with efficiency and neutrality. How much of interference depends on numerous factors, but increases with the rate of the tax. What may be tolerable at Michigan's 1% rate might be intolerable at rates more than four times that. I note that one of the examples developed by the staff uses a fact pattern in which a 4.5% NBRT rate converts to a 30% corporate income tax rate. Analysts worry about corporate tax rates far lower than 30% in terms of their negative effects.

2. The NBRT is Biased in Favor of Exempt Independent Contractors and will Discourage the Hiring of Employees

The NBRT properly disallows a deduction for wages. It properly allows a deduction for payments to independent contractors. The temptation will be for firms to shift their purchase of services to independent contractors and away from employees, perhaps by severing their relationships with existing employees and hiring them back as independent contractors.

To be sure, if the independent contractor were subject to the NBRT and passed the amount of the tax forward to the purchaser, a firm purchasing services should be neutral between the use of employees or independent contractors. However, the exemption means there will a class of independent contractors that will be outside the NBRT. They will not have a tax to pass forward. Because their compensation would be deductible, they become cheaper to use than employees.

Under the assumptions above, a group of 100 former employees re-hired as independent contractors and earning $500,000 will save a firm $2.25 million (4.5% X $500,000 X 100). I do not know whether that magnitude of savings will affect actual behavior, but it is obviously a concern.

This bias in favor of exempt independent contractors exacerbates an existing problem today whereby independent contractors are generally cheaper than employees. An employer will save on medical benefits, pension benefits, unemployment insurance, social security taxes, and the like by using independent contractors.

Because of this, the proper classification of a labor-provider—independent contractor versus employee—is already a constant source of litigation and of particular concern to the unions. Nor is it in the interests of the State to bias the system in favor of using independent contractors who are often outside the traditional safety nets in economic downturns. The exemption, which may be required to avoid overwhelming the system with new taxpayers, exacerbates the problem. And the higher the rate, the worse the problem.

3. The NBRT is Biased in Favor of Out-of-State Vendors not Having Nexus with California

If a firm's only decision were to use an exempt California independent contractor or hire a California employee, the amount of in-State labor might not decline, as the former would substitute for the latter. And there would be no incentive to use out-of-state independent contractors.

Where a California independent contractor is taxable, it will either have to absorb the NBRT itself, converting the NBRT to a tax on labor, or try to pass it on. If it tries to pass it on, a California firm has the option of using out-of-state independent contractors who might not be subject to the NBRT.

For example, consider the decision a firm faces in hiring a California consultant subject to the NBRT, or one based in Nevada. Assume the firm will meet with the consultant periodically at the consultant's office and receive the final briefing and report there. Further assume the Nevada consultant does not solicit business in California and does not have any property, representatives, agents, or employees in California.

A taxable California-based consultant who tries to pass on the NBRT will become more expensive than the Nevada-based consultant (all other things being equal). Consequently, the firm will have an incentive to hire out-of-state companies and vendors.

It has been suggested that this situation is solved because the NBRT adopts an economic presence nexus standard. Assuming a court will accept that nexus standard as the relevant one, rather than the more restrictive physical presence standard, the question is one of how that standard would be applied. There is no U.S. Supreme Court case on point. The only state cases discussing economic nexus (none from California) have involved situations in which the out-of-state taxpayer was either continuously soliciting in the taxing state (e.g., credit card companies), or was viewed as using intangible property in the state to generate income (e.g., the licensor of a trademark).

I do not believe that the Nevada consultant under the facts above would have economic nexus with California. If the Nevada consultant whose only contact with California was that its customer was based in California were viewed as having economic nexus with the State, so would I sitting in Connecticut talking on the phone with a California client (and of course billing by the word). So would any out-of-state vendor that loaded its goods onto a California firm's trucks for use back in California. So would exporters around the world have economic nexus. This view of economic nexus would simply rewrite everything we think we know about the concept.

The FTB prepared a very thoughtful memo on what nexus standard would apply to the NBRT. That memo concluded that it was likely that an economic presence standard would apply. The FTB was not asked, however, to apply that standard to the type of situations raised above. It is one thing to opine that a court would apply an economic nexus standard; it is quite another to opine on how that standard would apply to particular fact problems.

4. The NBRT Provides Sellers Based in Other States or Countries an Advantage over California Sellers

Any seller outside California, whether based in another state or in a foreign country, not having nexus with California will have a competitive advantage over California sellers. The California seller will have to pay the NBRT on the sale; its non-California seller will not. As long as nexus does not exist, a French producer of wines, for example, will be able to sell in California without paying the NBRT; its competitor from Napa Valley will be at a tax disadvantage. No one can believe this is a sensible policy for the State. The VAT solves this problem by taxing imports the same as locally produced goods. Because of constitutional constraints, California cannot achieve the same level playing field.

5. The NBRT Puts California Firms Selling Outside the State at a Competitive Disadvantage

The value added taxes around the world rebate the tax on exports. Under a credit-invoice transactional value added tax, a rebate is possible because the amount of tax paid on a firm's purchases is known. The NBRT presents the opposite situation and thus puts California exporters at a disadvantage.

Assume a California-based firm sells all of its goods or services in other states or countries. Because of the single factor sales apportionment formula being proposed, the firm will pay no NBRT on its sales. But assume it buys its business inputs from taxable California vendors. The NBRT paid by those vendors will then be embedded to some extent in the purchase price. The deduction for its inputs under the NBRT will do it no good. In competition with sellers based in other states (except for Michigan) and other countries, the California vendor is at a disadvantage, providing a reason for the exporter to buy its inputs from exempt out-of-state providers. (This same disadvantage is unlikely to occur with respect to a corporate income tax because of its common use by 90% of the states, which underscores the irony in some Commissioners being willing to eliminate that tax, and substitute the NBRT.)

Besides the incentive to buy from exempt out-of-state vendors, there will be pressure on exporters to reorganize their normal business activities in order to be able to deduct their purchases against taxable net receipts. They might merge with, or buy, NBRT taxpayers, or generate their own California sales. I would never underestimate the prowess of the California tax and accounting bars, among the best in the country. But one of the traditional goals of tax policy, efficiency and neutrality, would be undercut as businesses restructured themselves solely because of the NBRT.

C. Nonissues in the Design of the NBRT: Playing Politics

I am dismayed at the number of issues that have been included in the draft of the NBRT that are not an inherent part of the structure of the tax. The answer seemed to be "this is what is needed to sell the tax."

I do not view that as our role. We should put forth as pure a tax as possible. There will be plenty of time to play politics by the Legislature. And this raises a special and unique problem with a tax like the NBRT.

The unfamiliarity with the concept of the NBRT will virtually ensure the tax will be riddled with special provisions. Legislators need to have a good feel for how a tax should be structured in order to evaluate and resist the pleas by lobbyists and special interests. If, for example, a lobbyist were to ask that the income tax be changed to allow a deduction for vacations, a legislator would have no trouble recognizing that request as falling outside the normal rules and structure of an income tax. It would be evaluated as a special plea, not one dictated by the normative structure of the tax.

The NBRT, by comparison, is an opaque and nontransparent tax that defies easy characterization. Talking about the proper treatment of financial institutions, for example, quickly deteriorates into an esoteric and fairly inaccessible discussion. Multiply that many times over, and the proper treatment of numerous transactions and activities under the NBRT will remain mysterious except to the cognoscenti. Under those circumstances I fear that legislators will have trouble sorting through the inevitable arguments made on behalf of special interests. I have no confidence that the integrity of the NBRT will remain intact. Indeed, one can easily imagine an incentive being introduced for salary paid to employees, special rules for the payment of interest, the wholesale exclusions of certain industries or types of services, and so forth.

Given that, it is imperative that we draft a tax that honors and is consistent with the core concepts of the NBRT, not load it down with compromises. If we do not present a pure tax, so that people understand what this new and strange NBRT is all about, we have failed in our role to educate. The lower we set the bar, the lower will be the benchmark against which future deals will be made. And I am afraid that as drafted, we have not only dragged the bar down, but helped confuse the NBRT with an income tax.

The following are what I find particularly egregious.

1. The R and D Credit

I was disappointed to see a knee-jerk reaction of including R and D credits in the NBRT just because they were included in the corporate income tax. The R and D credit is a quintessential tax expenditure. We have heard much testimony about the cost of tax expenditures and their problematic nature. The R and D credit should be analyzed as a spending program: what is it costing the State and what is California receiving in return. The R and D credit may be invaluable or it may be a waste of money. Or perhaps it needs to be refined and refigured.

I do not know the answer to these questions and we have not heard any detailed testimony directed at evaluating the R and D credit. Because critical questions remain unanswered, how can we recommend the State continue to spend money in this area? One of our goals should be to ferret out potential inefficiency in the tax system, not to automatically continue what may be wasteful spending.

2. The Problem of Unused NOLs under the Corporate Income Tax

If the corporate income tax were to be eliminated, taxpayers might have NOLs that they had not yet used. A policy decision has apparently been made to carryover these NOLs to the NBRT. I do not understand the logic of doing so.

An NOL under the corporate income tax carries forward a loss from an earlier period to offset income in a future period. If the tax were eliminated, corporations have received exactly what they would have received with their NOLs—no tax on their future income. Indeed, not paying *any* corporate income tax whatsoever in the future is better than not paying *some* corporate income tax, which is all the NOL promised. Accordingly, I see no problem that the NBRT needs to address.

Nor do I see any connection between the NBRT and the unused NOLs under an income tax. For example, suppose in flush times California decided to use a surplus to eliminate the corporate income. Would taxpayers argue that they should be allowed to carryover an NOL against other taxes, say the sales tax? Would the

State feel it should write a check to a corporation to reimburse it for an unused NOL? The corporation has already been reimbursed by the nontaxation of its future income. The logic does not change just because the NBRT is the financing mechanism for eliminating the tax.

3. The Problem of Nonprofits

The draft of the NBRT exempts nonprofits but taxes their unrelated business activities, which is undefined. The discussion we had at our last meeting indicated that the goal was to carryover the treatment of nonprofits under the income tax.

If the NBRT is viewed as a value added tax, as it proponents suggest, I would have thought that the sales tax rather than the income tax would be the starting point for inspiration. Under the California sales tax, nonprofits both pay and collect sales tax. Consequently, it is not obvious why they should be automatically exempt under the NBRT.

I appreciate that many nonprofits might not be suitable NBRT taxpayers. But many compete with for-profits in the marketplace. My starting point would be to examine those areas of competing firms to see whether it is inequitable, inefficient, and an interference with neutrality to make the for-profit an NBRT taxpayer, but not its non-profit competitor. I would also determine whether the goals of a value added tax would be advanced by including a subset of nonprofits in the base. I believe that many value added taxes around the world include some nonprofits in the base.

D. Summary and Conclusion

The NBRT has potentially fatal defects. It excludes certain producers based in other states and in foreign countries, thus giving them an edge in competing against California producers in the California market. It puts California exporters at a disadvantage when competing in other states and foreign countries. Value added taxes that are used throughout the world do exactly the opposite: they tax imports the same as domestic goods and exempt exports. Proposing a tax for California that is diametrically opposite to that used throughout the world and that puts California-based producers at a disadvantage is baffling.

If these disadvantages were not enough, the $500,000/$250,000 exemption provides firms with an incentive to hire exempt California independent contractors rather than California employees, exacerbating an already existing trend.

But even if no exemption existed, there would still be a problem. If all California independent contractors became subject to the tax and tried to pass the tax forward into their fees, firms would then have an incentive to purchase the services of exempt out-of-state persons. If taxable California independent contractors were forced to absorb the tax to prevent this shift of jobs to out-of-state persons, the NBRT would have been converted from what is intended to be a consumption tax into a tax on income.

The NBRT also exempts all non-profits, including those that compete against for-profits, thus introducing yet another inequity and inefficiency into the economy. The tax also incorporates what may be inefficient tax expenditures.

The only reason we are discussing the NBRT, which taxes a panoply of currently exempt goods and services (food, utilities, housing, medical) is because of its revenue potential, which enables it to finance a buydown of the personal income tax, reduce the sales tax, and eliminate the corporate income tax. My problem is that I do not know why this is a good tradeoff. There is no empirical evidence (as opposed to anecdotal) that these taxes are harming the State's economy at present. And even for those who think these changes would be good, the question is whether the cure is worse than the disease.

I also do not understand why we are looking to make the State's tax system more regressive. I do not know why we are wishing to shift the tax system more towards consumption and away from faster growing bases, such as corporate profits and income.

Further, rosy revenue projections are likely to evaporate once the Legislature attempts to address the problems inherent in the tax. We have already set the bar low by building into the NBRT giveaways that do not belong in the design of a value added tax. That will serve as the starting point for more giveaways. And we can only fear the wonderful new world of tax minimization strategies when a state adopts a tax never seen before, except in Michigan, which cannot even tell us how much they have raised from it.

The greater the base erosion, the more the rate will have to be raised and the greater the corresponding distortions, competitive inequities, and inefficiencies. What may be tolerable at Michigan's 1% rate becomes intolerable at some range of higher rates.

There may well be workarounds or solutions to the problems above. We have not had time to explore those. Upon further reflection, some of the potential problems might disappear, although others might well surface.

I understand we are going to recommend that the Legislature take the NBRT under advisement. We have been encouraged to describe the tax as "promising." I cannot do that until I see how the defects that undermine the tax could be dealt with. Whether the tax is "promising" depends on whether the competitive advantage we are bestowing on foreign producers can be eliminated; whether the disadvantage we are imposing on California exporters can be eliminated; whether the incentive to use exempt independent contractors over employees can be addressed; and whether the incentive to use nontaxable out-of-state firms can be solved.

I fully understand the well-intentioned desire to solve the State's tax problem with something new and different, something bold. My Red, White and Blue Plan does not claim to have found the Holy Grail, but it has the potential of having the Legislature once again control the State's tax base, rather than surrendering that power to lobbyists and tax lawyers and accountants. Unlike a tax like the NBRT, we know were the bodies are buried with the existing taxes. What is needed is the will to dig them up. If that will is lacking, then our efforts will have gone in vain.

As explained in my earlier memo, by publishing by name of corporation the amount of each tax expenditure it receives over a certain amount, we will replace the midnight deals with sunlight and transparency. By adding one more item to the long list of financial data that publically traded corporations submit to the SEC and the public—the amount of the California corporate income paid—we will help stiffen the backbone of those wishing to resist attempts to gut the tax. Unless the Legislature re-takes control of the tax base, this Commission is likely to just be the first in a series. Sooner or later, the Legislature has to recognize that "we have met the enemy and it is us."

These changes will help ferret out waste and inefficiency in the tax system and improve neutrality, and equity. The potential revenue raised might approximate what would be raised by the NBRT after it winds its way through the Legislature. In the interest of compromise, I would be happy to have all new revenue that would be raised from restoring the integrity of the corporate income tax be used to lower the rate. Similarly, I would be willing to have the revenue raised from eliminating any tax expenditures implemented through other taxes to be used to lower the rate of that respective tax.

Whatever we do as a Commission, the taxpayers of this State deserve to challenge their taxes in a forum that is perceived to be fair and unbiased, before persons with proven experience and knowledge of state taxation. They deserve to be able to challenge their taxes without first paying them. For decades, they have been able to do so federally. We should provide the same opportunities in California by ending pay-to-play and adopting an independent tax court.