CITY NATIONAL BANK
The way up.

COMMISSION ON THE 21ST CENTURY ECONOMY
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TESTIMONY BY RUSSELL GOLDSMITH
CHAIRMAN AND CEO
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Introduction

Mr. Chairman and members of the committee: Good morning. My name is Russell Goldsmith, and I am the Chairman and Chief Executive Officer of City National Bank.

I commend the entire commission for agreeing to a set of principles that should guide tax reform:

- Establishing a 21st century tax structure for the state's 21st century economy;
- Stabilizing state revenues and reducing volatility;
- Promoting the long-term economic prosperity of the state and its citizens;
- Improving California's ability to compete with other states and other nations for jobs and investments;
- Reflecting principles of sound tax policy – principles like simplicity, competitiveness, efficiency, predictability, and ease of compliance and administration; and,
- Ensuring that our tax structure is fair and equitable.

With tax policy, these principles are a good place to start.

I would like to address two things this morning. One is the proposed business net receipts tax and whether or not it should be applied to banks. I'd also like to briefly emphasize the importance of establishing a fair and equitable tax system that promotes job creation and economic growth throughout California and does not put our state at a competitive disadvantage.

Banks and the Business Net Receipts Tax

First, let me tell you something about City National Bank, the wholly owned subsidiary of City National Corporation, which is headquartered here in Los Angeles and is listed on the New York Stock Exchange.

After 55 years in California, City National is backed by nearly $18 billion in total assets. We provide banking, investment and trust services through 64 offices, including 15 fullservice regional centers, mainly in Southern California and the San Francisco Bay Area, plus offices in Nevada and New York City. City National and its eight majority-owned investment affiliates also manage or administer close to $48 billion in client investment assets.

Our company employs about 2,700 men and women, nearly all of whom live here in California.

City National now pays annual corporate income tax at a rate of 10.84 percent to the state of California. As we understand it, the commission is proposing to phase out the current corporate income tax and replace it with a business net receipts tax.

I believe you have essentially four alternatives under consideration.

The first is a net receipts tax calculation, which, under the commission's general rule, would exclude items such as interest income, interest expense, dividend income and compensation costs.

Our understanding is that this net receipts tax proposal would <u>exempt</u> banks, and we agree that banks should be exempted. City National and virtually all banks earn most of their revenue from the loans made to businesses, entrepreneurs and consumers. If interest income and expense were excluded, it would essentially operate tax-free, which is not equitable. Nor, I'm sure, is that your intent.

Recognizing that banks cannot be taxed under its general rule, the commission has proposed three alternative tax computations:

1. A modified business net receipts tax – presumably one that would include interest income and expense;
2. A net income tax that excludes compensation expense; or
3. The net income tax under current law.

The first alternative – a modified net receipts tax – raises several concerns:

For one thing, banks are fundamentally different from manufacturers and even other service companies. A bank's cost of goods is what it pays for money, so any fair receipts tax calculation for our industry would have to include interest income and expense for they are part of the cost of the commodity we rent – money.

It should also take into account all the costs to banks to have money to rent. After all, a bank's inventory consists of cash, and we obtain it by borrowing money, paying for deposits and raising capital.

A net receipts tax calculation for banks would also have to include the provisions set aside for potential and real credit losses. That "waste" is also a cost of our product.

Credit risk and loss is a cost of doing business that should logically also be deducted from net receipts. Otherwise, loans could become more expensive and harder to get.

The second tax alternative cited by the commission would exclude deductions for compensation expense. But that would make it more expensive to hire people, and it's something I can't imagine the state would even want to consider at a time when employers are under pressure and the jobless rate is roughly 12 percent. A tax like this would, in effect, penalize disproportionately all of those people-intensive, labor-intensive California companies that are providing much-needed jobs to Californians.

A bank like ours, for example, does not succeed by buying and selling goods – not in any traditional sense, anyway. At City National, we have succeeded by adding, retaining and rewarding people who deliver sound advice and earn the trust of their clients. If a new tax system made that more difficult, it would be harder to grow, harder to create jobs and harder to compete with banks headquartered outside California.

How each of these options would affect City National is something we won't be able to fully understand until we know what tax rates will be applied. Right now, though, we would be inclined to support the current system because it taxes banks like ours in proportion to their financial success.

Taxation and the California Economy

As you weigh the various alternatives, I would ask you to give particular attention to establishing a tax system that promotes job creation and economic growth and does not hurt California's competitive position with other states.

This is a particular concern of mine. Last year, I had the privilege of chairing the Los Angeles Economy & Jobs Committee. It was a panel of 26 leaders from business, labor, education and the non-profit sector. Mayor Antonio Villaraigosa called us together and asked us to recommend ways of building more economic opportunity for the people of Los Angeles.

California is the eighth largest economy on earth because it is the manufacturing center of the United States, the entertainment capital of the world and our nation's gateway to Latin America and the Pacific Rim, and because it is the birthplace of modern technology and the nation's leading producer of everything from agriculture and aerospace to biomedicine and toy design. All of these industries employ large numbers of men and women. They would be hurt by a business receipts tax that did not encourage employment but instead rewarded not hiring – or even firing – people. In these perilous times, every job is precious and under pressure. California must protect – not penalize -- them.

This is especially true for California, with its unique entrepreneurial culture that produces spectacularly innovative and globally competitive companies like Apple, Facebook and Google.

California attracts more venture capital than any other state by far. A lot of smaller VC-backed entrepreneurs go through lean years, but they employ a lot of people nevertheless. We certainly don't want to risk losing these companies to other states.

A few years ago, Mark Zuckerberg left Cambridge, Massachusetts and chose to grow Facebook in the Silicon Valley. Out here he found both the financial resources and the human capital needed to take Facebook forward. But where will the next Mark Zuckerberg go if he's losing money while growing and hiring people and he has to pay a net receipts tax? Will he come to California or choose another compelling location?

Too often, our economy and its businesses are taken for granted by government. But government needs to foster economic growth and job creation. California needs to add enough jobs to keep pace with a population that is growing by about 500,000 a year.

It's also true that growing businesses produce more tax revenue for the state. In a report called Growing California's Regional Economies, Peter Weber concludes that a 1 percent increase in California's economic output would add between $2.5 billion and $5 billion in new tax revenue. As businesses invest and hire more workers, the tax base expands and our state receives more money.

Crafting tax reform should be like practicing medicine: The first rule is to do no harm. Mr. Chairman, I appreciate your willingness to hear what I and others have to say about some of the tax proposals that have been suggested. A number of organizations have already weighed in and raised questions about the business net receipts tax. I would underscore four questions:

- How would the proposal affect the tax liabilities of California's leading industries?
- Would it negatively influence perceptions and/or the realities of doing business in this state?
- Would a net receipts tax encourage job creation or provide incentives to scale back employment? Or move jobs out of California?
- How would the tax affect prices and California's ability to compete with other states and countries?

I'm confident that the answers to these and other questions will become clearer as the net receipts tax proposal continues to take shape and you focus on these complex issues in more detail, and that's why I commend you for holding this workshop today and giving me this opportunity to speak with you.

Besides the business net receipts tax, I'm sure you have analyzed dozens, if not hundreds, of revenue-raising alternatives by now. So I'll take only a few moments to underscore a few other good ideas that deserve your careful consideration. They would increase revenue, but not at the expense of job creation or California's competitive position vis-à-vis other states.

One idea is an oil extraction tax, something that other oil-producing states already have enacted. California is a major oil-producing state, and an extraction tax is not going to drive production elsewhere. Oil prices are set on the world market, so a tax here in California should have no impact on what consumers pay at the pump. If Alaska can impose a 25 percent tax on oil production so as to avoid having a personal income tax, surely California can have a tax to lower income tax rates.

We also could raise several billion dollars by restoring the vehicle registration tax to a fairer, more competitive level, comparable to what it was seven years ago.

For decades, California's economy has been the envy of the world. The talent and resources, industries and entrepreneurs that set our state apart are as rich and compelling as they ever were. But all of us must do more to foster a strong economy, and that has to start with a set of tax policies that are sound, fair, equitable, competitive, and designed to protect the jobs we have and promote the job-creating investments needed to succeed in today's highly competitive global economy.

In particular, every economy, including California's, needs a strong banking system – as the current recession has demonstrated. The net receipts tax is not the right method for banks to pay their fair share for California.

Thank you, Mr. Chairman. Now, I'd be happy to take your questions.