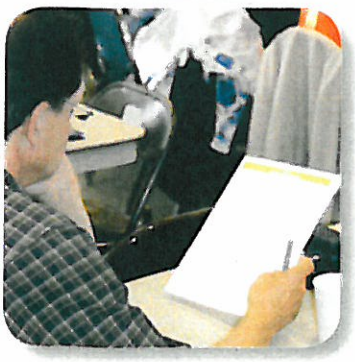
california forward

Discussing Tax Reform

REPORT TO THE COMMISSION ON THE 21ST CENTURY ECONOMY

Five Regional Meetings Convened by *California Forward* January–March 2009



PAYING FORWARD
responsible revenue reform

MAY 2009

The overarching goal of *California Forward* is to improve the quality of life for all Californians by creating more responsive, representative and cost-effective government.

California Forward is pursuing this goal through issue-specific projects to improve California's political, fiscal and governmental systems. A bipartisan Leadership Council selects and guides projects, which link sound policy analysis and meaningful civic engagement to develop proposals and broad coalitions of support. Proposals pursue change through administrative action, legislation or ballot initiatives.

Through this public interest approach, *California Forward* is rallying the ambition, innovation and optimism of Californians to overcome the distrust and partisanship that have thwarted attempts to bolster democracy.

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Executive Summary

The depth of California's fiscal crisis provides an opportunity to reshape our state's revenue system. In January 2009, *California Forward's* bi-partisan Leadership Council launched a new project, *Paying Forward: Responsible Revenue Reform*, with the following objectives:

- Increase civic literacy about state revenues
- Expand the public conversation on tax reform
- Provide feedback to help guide policymakers and the Commission on the 21st Century Economy
- Identify areas of revenue reform that *California Forward* might choose to develop further

Between the end of January and March 2009, five meetings with regional leaders were conducted to provide policymakers, including the Commission on the 21st Century Economy, with informed and thoughtful input from Californians representing a diverse set of regional interests and constituencies. The goal was not to reach consensus but to broaden the conversation about structural revenue reform and bring additional perspectives to the expert policy discussion.

This report provides a summary of findings from the five sessions which included small group dialogue, electronic keypad voting and written comments. The cross section of regional leaders attending represented business, local government, education and a wide range of civic and community organizations; it was a self selected, rather than scientific, sample. Interactive keypads were used as an aid to dialogue, allowing participants to have immediate feedback on group and individual preferences. The findings from the meetings are predominantly qualitative in nature. In addition to the five sessions specifically convened for this purpose, *California Forward* has featured tax reform as a central topic in scores of interactive educational presentations conducted in 2009 around the state to civic groups and ethnic media.

Summary of Findings

Revenue reform can be a tricky topic for public dialogue. Many community conversations about taxes, especially if they include a mix of previously unaffiliated people, stall at the question of how high taxes should or shouldn't be. Among the attendees at each of the five sessions, there were people who are keenly interested in options that would increase revenue for the state and others who are equally interested in pushing back on any tax increase.

The goal of these conversations was to delve beneath these familiar mindsets and gain an understanding of how to frame and conduct a constructive conversation about tax reform. Regional leaders engaged in dialogue about the underlying criteria and principles they would recommend for changes to our state's tax system and provided reactions to some specific tax changes. They were asked to consider the *attributes* of different tax options independent of the

total tax burden because each tax option under discussion was presented in a way that participants could choose between a "revenue raising" and a "revenue neutral" approach.

1. Participants insisted on placing the tax discussion in the larger context of overall fiscal and governance reforms.

Participants were better able to engage in a discussion about tax reform when it was presented in the context of long-term goals (i.e. what are the taxes paying for) plus changes to the state's complete fiscal system. Readiness to consider specific tax options increased after these leaders had an opportunity to express their concerns about the *spending* side of the equation. There appeared to be agreement on many aspects of budget reform (use of a reserve to capture surge revenues, multi-year planning horizon and increased focus on effectiveness).

There also was common ground across all locations on two core vision elements: "Effective and equitable education systems" and "Strong economies and high quality jobs." Many participants expanded the discussion to include broader governance reforms such as term limits and redistricting.

2. As expected, ideology played a large role in overall responses to different tax options.

Those who identified as liberal were more likely to support any of the options proposed and those who identified as conservative were more likely to say they would not support these tax changes. For many participants, fundamental questions about the role of government and the extent to which government should be trusted to use taxpayer funds effectively dominated their thinking during the meeting. But the sessions yielded additional findings that may be useful to policymakers contemplating structural revenue reform.

Three specific tax changes were used as a stepping off point for the discussions: modifying the property tax for non-residential properties (a.k.a. "split roll"), extending the sales tax to more services and introducing a carbon tax. The highest levels of support were for modifying the tax on non-residential properties, especially the idea of more frequent reassessment. Many participants indicated support for broadening the sales tax to non-essential services as long as business-to-business services were excluded. Reaction to the carbon tax aligned with beliefs about the importance of climate change and had the greatest diversity in responses. Reframing the carbon tax as a "fuel tax" and "transportation tax" might have generated a different conversation.

Participants insisted on placing the conversation about revenue reform in the broader context of fiscal and governance reforms.

3. Accountability and reliability emerged as the most important broad principles for revenue reform.

Most participants wanted to achieve reliability from the spending side, rather than by introducing changes to make income tax less volatile. Of note, compared to surveys (such as the recent April 2009 Field Poll), a key difference in these discussions was that the groups appeared to be looking for tax scenarios that spread the burden instead of concentrating it. Most participants were concerned about singling out specific business sectors or segments of the population for taxes.

Concerns about and frustration with the state's fiscal challenges coincided with widespread interest in increasing local governments' authority over revenue – a key approach for increasing "accountability." Various ways of augmenting local control increased willingness to support the different revenue reforms. Additionally, at the group level, there was solid support for increasing local control over property taxes, reversing the shift to state control over allocation of locally collected funds.

Implications

Based on the five regional meetings and feedback from related presentations around the state, the following implications have emerged:

1) Place revenue reform in the context of total fiscal reform.

- Regional leaders were more willing to discuss tax changes after they had weighed in on reforms they feel would make the state's overall fiscal system more trustworthy.
- At a conceptual level, many participants indicated a need to know *what* the taxes are paying for before they can consider their support for a tax.
- The groups indicated a clear preference for addressing stability through the spending rather than the revenue side.

2) Increase local control of revenues

- Participants talked about how state and local taxes are deeply intertwined and they want local governments to have more autonomy and flexibility to meet their revenue needs.
- Support for various tax options increased when conditions were added to direct the new revenue to local purposes.

3) Explore ways to increase accountability

- For some, accountability means paying attention to nexus and placing more direct links between source and use.
- For others, concerned about the high level of restrictions already placed on lawmakers, greater transparency might be an adequate step forward for accountability.

In either case, it appeared that accountability is a critical element in achieving revenue reforms that would be sustainable.

Next Steps

California Forward is:

- Pursuing budget reforms that have features consistent with the interests expressed by the participants
- Developing more detailed tax reform options that build on the group's input about how to increase local control of revenues
- Exploring ways to realign state and local authority to foster accountability for how public funds are utilized

Most participants gave the session clearly positive feedback. They indicated that they appreciated the chance to be informed, interact with other regional leaders and provide input.

California Forward wants to thank all of the co-convenors and attendees who gave generously of their time to enable these regional sessions. We invite their feedback on this report and the next steps we are undertaking as part of an ongoing conversation about how to create a better revenue system in the context of a better governance structure to enhance our state's future.

Audience and Methodology

The regional meetings were co-convened with local leadership organizations, predominantly representing business interests. Recruiting was conducted so that all "three E's" (economic, environment and equity) were represented in the discussion:

- **January 28 — Fresno**
  Co-Hosted by the California Partnership for the San Joaquin Valley
- **February 18 — Los Angeles**
  Co-Hosted by the Los Angeles Area Chamber of Commerce
- **March 2 — San Diego**
  Co-Hosted by the San Diego Regional Economic Development Corporation
- **March 17 — San Jose**
  Co-Hosted by Joint Venture: Silicon Valley Network
- **March 19 — Santa Cruz**
  Co-Hosted by the Santa Cruz Chamber of Commerce, Action Pajaro Valley and the Community Foundation of Santa Cruz County

Reponses from a total of 217 participants were recorded via interactive keypads across the five meetings. Demographic results were provided in real-time in order to capture a sense of the diversity of interests and constituents in the room. It was a self-selected, not a scientifically constructed, sample. As can be seen on the table below, attendees were most likely to be Caucasian and over 45. Across the sessions, the total audience skewed to liberals. This was not by design and it should be noted that interactive dialogue sessions tend to attract participants who more likely to self-identify as liberals. In San Diego, conservatives and members of the Republican Party were the predominant participants.

GENDER

Male	55%
Female	45%

AGE

44 and under	26%
45 and older	74%

ETHNICITY

Caucasian	79%
Hispanic/Latino	9%
Asian American	4%
All Other	8%

SECTOR

Business	28%
Education	17%
Local/Regional Government	13%
Civic/Philanthropic	14%
Community-Based/Other	16%

POLITICAL IDEOLOGY

Very Conservative	5%
Somewhat Conservative	16%
Middle of the Road	25%
Somewhat Liberal	31%
Very Liberal	22%

Participants were asked: "Which sector do you most identify with"? Because the co-convenors were business-oriented groups, the largest segment was business, followed by education, civic groups and local government. Other attendees represented a range of organizations such as community-based services, labor, agriculture, environmental and faith-based groups.

The majority of participants indicated that they feel familiar with state fiscal issues, with 35% describing themselves as "extremely or very well-informed" (9 or 10 on scale of 1-10) and 37% as "somewhat well-informed" (8 on 10-point scale).

Meeting Design

Participants provided input via group discussion, interactive keypad voting and written comments on participant workbooks. The format of the meeting evolved slightly over the five sessions but was consistent in the key questions that were included. The agenda focused on:

- Context for Revenue Reform
  - Vision and obstacles
  - Overall thoughts on fiscal reform
  - Criteria/Values that should drive revenue reform
- Feedback on specific revenue reform options, along with the opportunity to generate conditions/modifications for each
  - Options to reduce volatility – spending side or income tax adjustments
  - Extend the sales tax to more services
  - Introduce a carbon tax
  - Modify the non-residential portion of the property tax
- Input on the state/local relationship and local ability to modify revenues including vote thresholds

The specific revenue options people were asked to consider were selected in January 2009 based on the initial work of the Commission on the 21st Century Economy and other expert discussions. They were not presented as recommendations of either *California Forward* or the Commission, but as a way to explore options across the major types of revenue.

The results of the keypad voting in each session were used as a way to provide participants with instant feedback about where the group was coming out on various discussion items. With the exception of Santa Cruz with 113 voting attendees, the meetings had very small samples and participants were cautioned to view the vote averages as providing directional information rather than absolute values. Participants were able to view the distribution of votes on the 10-point scale to see how much "diversity" was embedded in each average. Reactions to the keypads were uniformly positive due to the instant feedback.

Findings in Detail

Context for Reform

a) Vision & Obstacles

The first of the five meetings seeking input on revenue reform took place in Fresno under the co-sponsorship of the California Partnership for the San Joaquin Valley. This organization has forged a shared vision for their work and the discussion of revenues took place in that context. In the second meeting, co-sponsored by the Los Angeles Chamber of Commerce, the participants had not had the occasion to create a larger shared context for revenue reform. In the balance of the meetings, *California Forward* began each session by asking participants to consider the vision they wanted for California's future, including specific elements as well as obstacles.

The top two priority elements for a vision for California's future across all locations were:

- Effective and equitable education systems
- Strong economies and high quality jobs

The third ranked item was public safety in San Diego, environment in San Jose and health care in Santa Cruz. The environment was in the top five out of ten elements for all three groups. These rankings are not based on a scientific survey and should be considered only as a way to create a shared focus and context for the discussion of revenue reform.

Participants wrote about and discussed the obstacles they feel are impeding the state's ability to act on its highest priorities. Several factors were cited consistently across all locations:

- The state's chronic fiscal problems
- Highly partisan politics
- Unwillingness to face choices on the part of policymakers and the public
- The unintended consequences of initiatives and "ballot-box budgeting"

Many participants focused on the 2/3 supermajority required to pass the state budget and also to pass taxes as a significant obstacle. A smaller, but vocal, minority was adamant about keeping the 2/3 threshold. And some supported a sequential approach: "No change on 2/3 until redistricting and changed term limits."

Many participants volunteered that Proposition 13 has created serious challenges for local governments and is an obstacle that needs to be addressed. On the other hand, a few were quick to defend Proposition 13.

In Fresno and San Jose, another obstacle discussed was that fragmented jurisdictions with diffuse responsibilities make it hard to hold anyone accountable. In all locations, there were unprompted observations that the challenges of fiscal reform need to be considered in the context of other governance changes such as redistricting, term limits, campaign finance reform and other measures that might lead to more responsible and effective state decision-making processes. Several participants called for a multi-pronged "system-wide" approach to fiscal reform

that addresses changes in how policymakers are elected and work together as well as the policy guidelines they work with.

b) Overall Thoughts on Fiscal Reform

As the meetings evolved, it became clear that participants were more ready to engage in a discussion about revenue options after they had had a chance to express their concerns about the *spending* side of the equation and discuss possible reforms. While this was true in all of the sessions, it was particularly evident in the final meeting in Santa Cruz where participants were invited to share open-ended suggestions about their "goals for fiscal reform" and there was an extremely high level of responses. Several interrelated themes emerged across the sessions:

- Multi-year budgeting – "Get government out of reactive crisis mode." Many specifically asked for a two-year budget cycle; some wanted a longer time frame.
- Pay-as-you-go approach – "Live within our means as each of us must."
- Evaluating programs based on objectives and effectiveness.
- Increased public education/input/transparency.

Another topic of fiscal reform that emerged in the discussions was the extent of discretion that state lawmakers should be allowed. This was a common issue with disparate responses. Some participants favored tighter definitions between source and use because they are concerned that the "temptations for elected politicians are too great" without this type of discipline. On the other hand, some believe that "mandated links hamstring lawmakers." Some commented that the principle of a link between source and use sounds good in theory but would be hard to implement for policy areas such as K-12 education or higher education.

c) Values/Criteria for Revenue Reform

Participants in the first four meetings were asked to evaluate the importance of five commonly cited criteria for revenue reform (and the participants in the fifth meeting in Santa Cruz shared their perspective on values via written comments). The values they were asked to consider were:

- Reliability – grows with the economy and is relatively predictable
- Equity – based on people's ability to pay
- Fairness – people in the same situation are taxed the same way
- Efficiency – easy to administer and easy to understand
- Accountability – link between which entity levies a tax and which one spends the money, clarifying who is responsible for outcomes

It should be noted that in the first meeting in Fresno, "equity" and "fairness" were combined into a single factor that received the highest level of importance from the group. But it was clear that participants ascribed different meanings to the term "equity" by itself and, therefore, "equity" and "fairness" were separated in subsequent sessions. As a distinct concept, "fairness" was the highest rated criteria in San Jose. Both factors had high ratings in all locations except San Diego where "equity" was rated lower than all other factors.

Accountability stood out for many of these groups, receiving the highest level of importance in Los Angeles and San Diego and the second highest level in Fresno. Accountability had several facets. For some, it is about trusting that the revenues would be allocated as anticipated. For others, it specifically deals with a tighter link (nexus) between the levying entity and the end use of the funds. In either case, the interest appeared to be in defining and assigning clearer responsibility for the effective use of taxes.

Reliability got the next highest rating in these locations and was also important to the participants in San Jose. The idea that funds would be sufficient and predictable was seen by most as crucial. Participants were given a choice of increasing predictability of state funds by:

a) Making adjustments to the income tax that would reduce reliance on the highest income earners and their capital gains (the main source of volatility), or

b) Capturing "surge" revenues in good economic times in a reserve fund that would be used when the economy was producing less tax revenue.

At the group level, the clear preference across all locations was to address volatility from the spending side rather than modify income taxes to reduce fluctuations in state income. Many participants – especially in San Jose and Santa Cruz – strongly affirmed the progressive nature of the state's income tax. Alternately, some in San Diego and a few in Santa Cruz floated comments about wanting to explore a flat income tax as an approach to stability.

The participants volunteered other revenue reform criteria/values:

- In all locations, there were frequent statements that taxes should not get in the way of economic growth. "Don't increase the burden on businesses, especially in a bad economy." Participants in San Jose were skeptical that there is a tax structure that could be "benign" to business; the participants in Los Angeles were more optimistic that it was possible.
- Some asked for simplification of the tax code, especially those closest to the system who had to think about implementation and compliance issues.
- In Fresno, there was a call for increased enforcement. In Santa Cruz, there was also interest in compliance as well as concerns about not being able to capture revenue from the underground economy.

Reaction to Specific Tax Reform Options

Participants were asked to consider three potential reform options that have been part of the discussions at the hearings of the Commission on the 21st Century Economy and have been frequently discussed by tax reform experts. These options were not selected as recommendations of *California Forward* or the meeting's co-sponsors but rather as a way to have participants weigh in on choices that cover a range of tax policy issues. The options were:

- **Extend the sales tax to more services** – based on the premise that services are growing more quickly than retail goods.
- **Introduce a carbon tax** – based on the concept of a tax that could help environmental goals while raising revenue.
- **Make changes to non-residential property taxes** – potentially to capture more income and/or to create a fairer "playing field" between new and longstanding businesses.

Attendees were invited to consider each of these as either a way to raise new revenue or to think about them as "revenue neutral" (structured in such a way that the total tax burden does not increase). They also were asked to think about "conditions" they might place on each option that could increase their willingness to support it.

Following group discussion, participants rated each option on a scale of 1 to 10. They then volunteered conditions to vote on (also using the same 10-point scale). Because the conditions were generated by the participants in all of the sessions and hence varied (except for the last meeting in Santa Cruz which used the most popular conditions from the preceding meetings due to the large size of the group and time constraints), analysis of the conditions is mostly qualitative. Many participants also shared thoughts about the options and conditions via comments in their workbooks.

Most of the participants self-identified as being knowledgeable about state finances and were familiar with the tax options under discussion. Yet, many also expressed that they were on the "front end" of the public conversation about tax reform because the options being considered were very general, because they wanted to consider how political and economic fiscal conditions were evolving for the state and they were looking for more information on the economic impact of different revenue options. [As a general backdrop to the meeting, *California Forward* issued a paper by Steve Levy on future economic trends in California.] In Los Angeles in particular, but also in San Diego and Santa Cruz, participants indicated interest in "balanced" information about the potential impacts on business. Additionally, many asked for more information from other states. As one participant in Los Angeles said: "California is unique, but are we so unique that we can't learn from other states?"

Overall Reactions

At the group level, none of the three options gained strong support. Reactions to these revenue reforms aligned markedly with participants' ideology. Those identifying as "very liberal" tended to give each option a high rating and conservatives tended to give each, especially the carbon tax, low levels of support.

For each of the three revenue reforms, attendees had the opportunity to consider an explicitly "revenue neutral" version that would keep the total taxes collected at the same level. In the case of the sales tax, the option was presented as: "For example, extending the sales tax to services tied to retail goods and entertainment could drop the rate on all currently taxable items by ½ ¢."

SUPPORT FOR TAX OPTIONS BY IDEOLOGY
(10 = highest support on 1-10 scale)

Ideology	N	MODIFY COMMERCIAL PROPERTY TAX	INTRODUCE A CARBON TAX	EXTEND SALES TAX TO SERVICES	
				Overall	If drop rate
Very Liberal	48	8.8	7.9	8.8	5.5
Somewhat Liberal	67	7.8	7.1	7.8	5.9
Middle of the Road	54	6.1	5.9	6.1	5.4
Somewhat Conservative	35	5	3.8	5	4.7
Very Conservative	11	4.8	3	4.8	6.9

Important Note: These are extremely small group sizes and these data are provided here as an illustration of the range of responses, not as a statement about absolute levels of support.

Most liberal participants did not favor the revenue neutral option when broadening the sales tax; they wanted to raise additional revenue. For some of the conservatives, especially in San Diego, the revenue neutral option did increase their willingness to support extending sales tax to more services

somewhat but overall levels of support were still lukewarm. In the discussion and written comments, concerns were raised that broadening the tax base would just give the government a larger base for raising taxes in the future. Additionally, the potential ½ ¢ rate drop (if services tied to retail goods and entertainment were taxed) was not seen as a "significant" enough offset to those who were concerned with the negative impacts of the tax.

SUPPORT FOR TAX OPTIONS BY SECTOR (10 = highest support on 1-10 scale)				
Sector	**N**	**MODIFY COMMERCIAL PROPERTY TAX**	**INTRODUCE A CARBON TAX**	**EXTEND SALES TAX TO SERVICES**
Business	61	5.3	4.6	4.7
Local Government	29	7.4	7.4	7.6
Civic	30	8.3	7.0	7.3
Education	37	7.2	8.6	6.5

Important Note: These are extremely small group sizes and these data are provided here as an illustration of the range of responses, not as a statement about absolute levels of support.

Business-identified participants were less likely to indicate support for the revenue reform options under discussion than other sectors. Of note, the business participants in the Los Angeles meeting skewed Democratic in their party affiliation and the San Diego business attendees were almost uniformly Republican. Business affiliation appeared to be a more dominant factor than party or ideology in how Los Angeles attendees approached the issues.

Extend Sales Tax to More Services

Only the group in San Jose showed solid support at a level of 8 or higher for broadening the sales tax. There were also high levels of support in Fresno under the condition the tax would be confined to entertainment and that the revenue raised stayed local. Other locations had averages in the 5-6 range, with wide diversity in the total range of responses..

Some were surprised by the extent of the state economy's shift from goods to services. Others were already aware of the questions surrounding whether and how to extend the sales tax to services. Participants were given three sample "slices" of services that could be charged a state sales tax:

What services might be charged a state sales tax? Examples:

a) Services connected to a retail product (e.g., salons, auto repair, appliance repair) = $1.2 billion

b) Events (e.g., entertainment, sports, concerts, etc.) = $1.0 billion

c) Business to business services (e.g., legal, technology services, etc.) = $3.2 billion

Estimates from Board of Equalization

Across all locations, there were concerns about taxing business-to-business services among both liberals and conservatives. It was the lowest rated option of the entire discussion in Los Angeles. Many were concerned that it would be "double taxation."

Taxing entertainment appears to elicit the least resistance of the three featured segments. The Los Angeles meeting showed higher levels of support for taxing entertainment than the other services under consideration. It should also be noted that representatives from the entertainment industry attended that meeting and made a case after the vote for why they believe the tax would be detrimental to the economy. The condition that generated the highest increase in support was a suggestion in Fresno to extend the sales tax to entertainment and to keep the receipts for local uses.

Placing a condition that only "non-essential" services be taxed increased support across all locations.

Some wanted to explore ways to make this tax less regressive. The one condition that uniformly increased support for extending the sales tax to services across all locations was to tax "non-essential" services. There were differing views about what were discretionary services – but there appeared to be universal agreement that housing and medical services were in the essential category. A few others suggested that services like day care or repairs might also fall into the "essential" category.

Most groups expressed as much or more interest in taxing digital goods as services as a way to align with the current economy. There was interest across all locations, especially in San Diego and Santa Cruz, in equalizing transactions so that "brick and mortar retailers" would not be at a disadvantage.

Carbon Tax

Of the three options, the carbon tax generated the widest range of opinions. Some felt gas taxes were already too high and a burden on the cost of doing business. Others noted that California's gas prices and taxes are low compared to Europe.

Those favoring a carbon tax tended to support it for the anticipated environmental benefits and because it would send a "price signal" to reduce the use of carbon. Most of these supporters thought a "gas" or "fuel" tax would be easier to administer than a tax on fossil fuels that starts at the wholesale level and continues through the supply chain. Some asked if the existing gas tax could be used as a vehicle. Others were interested in taxing all fuel (i.e., diesel, jet, gas, etc.)

The average rating for a carbon tax was the lowest in San Diego. Support increased significantly (from a 4.4 to 8.8 on a 10-point scale) when the condition was added that a carbon tax in California not duplicate a federal carbon tax.

Most of the conditions generated across the groups clustered into two categories: allocating the revenues from a carbon tax to a specific environmental purpose, or creating some kind of offset/credit for low-income families. In Fresno, support increased under the condition that revenue would be dedicated to air quality remediation. In San Diego, allocating carbon tax revenues to mass transit increased support. In San Jose, there was interest in allocating these potential revenues to support development of alternative energy technologies.

In Santa Cruz, the concept of dedicating the carbon tax to environmental purposes did not increase support. In that location, the proponents of a carbon tax think it should be used for "all

essential services" while the critics, many of whom are skeptical that climate change is a man-made phenomena, do not support creating a tax that could be "based on a lie." Input from most locations suggests that a different kind of conversation might have taken place if the question of a carbon tax had been reframed as a discussion of a "fuel tax" or a "transportation tax."

The idea of creating some kind of offset for low income Californians to reduce the regressive nature of a carbon tax, say on gasoline, was popular in the San Jose discussion. In Santa Cruz, that offset was framed as making the tax revenue neutral which decreased support from the carbon tax supporters who wanted the funds to be available for essential services.

Modify Non-Residential Property Tax

Of the three options, this one had slightly higher levels of support – averaging about 7 out of 10 across locations, compared to an average of 6 for the other two. With the exception of the San Jose participants who were more likely to favor broadening the sales tax, this was the highest rated of the options.

Those not favoring changes to commercial property taxes expressed concern about its impact on business. Sample comments from Santa Cruz were:

"I would consider it when commercial property owners are doing better."

"Can we exclude small businesses under a certain amount?"

A participant in the San Jose discussion, Santa Clara County Assessor Larry Stone spoke to the administrative challenges of a "split roll" (similar to the testimony he provided at the April 2009 meeting of the Commission on the 21st Century Economy).

In general, it appeared that those supporting a "split roll" want to explore increased frequency of reassessment versus increasing the tax rate for non-residential properties. They noted that residential properties are more likely to be reassessed on regular basis than commercial properties. Some participants indicated interest in learning more about what triggers a "sale" for reassessment purposes. This conversation started in the Los Angeles session and carried through to more explicit discussion and vote in Santa Cruz. The vote on "redefining what constitutes a 'sale' for commercial properties" in Santa Cruz received the highest level of people rating it an 8, 9 or 10 among all of the tax options considered (59 percent); it should be noted that 24% gave it a 1, 2 or 3.

Many who support some application of a "split roll" appeared to be motivated by either the ability to increase revenue and/or issues of "fairness" so that newer businesses would not be placed at a disadvantage versus older businesses. In San Jose, one of the participant-generated conditions offered to make this principle more explicit was a tax break for newer businesses that are creating more jobs and/or new revenue versus older businesses, but that received less support than the basic "split roll" – possibly because the way the basic "split roll" would work is better understood.

Other modifications to the "split roll" raised by the participants included: transition it in; a five-year exemption on investment in new property; and, keeping funds local. Support for modifying the property tax received a high level of support in Fresno with the condition that the funds raised would be applied to local infrastructure. Alternately, in Santa Cruz, a condition designed to make assessment of non-residential property at full market value revenue neutral by dropping the tax rate received little support.

Whether to modify the non-residential property tax stimulated discussion about broader concerns relating to Proposition 13 in all locations. A few participants were adamant that there should be no

changes to Proposition 13 but many others articulated concerns about the measure's unintended consequences and the need for increased flexibility. In most locations, participants liked the idea of limiting the discussion to non-residential properties. In Santa Cruz and San Jose, some asked to have residential property thrown into the mix too. Participants in the San Jose meeting indicated strong support for "changing Proposition 13 to be more fair but still predictable." Some of the comments from Santa Cruz expressed an interest in taxing owners of similar properties equally so that they would be paying their "fair share" of public services.

Other Options Surfaced

Participants shared their thoughts about other types of taxes to consider. The most frequently suggested option was to tax Internet sales. There was a sense that all transactions should be treated equally and that significant distortion is occurring due to the absence of a tax on Internet sales and very little compliance with the state's use tax.

In Santa Cruz, comments surfaced about reducing exemptions on the state's income tax to make it more "fair." Some perceived current deductions that favor higher income Californians as undercutting the progressive nature of the tax. In general, the progressive structure of the state's income tax was supported by most of the attendees across all locations, with the exception of some participants in San Diego and Santa Cruz who expressed interest in a flat tax.

A few participants raised the discussion of "sin" taxes on items such as tobacco, alcohol and pornography. Most participants indicated an understanding that these kinds of taxes would not raise as much revenue as the other options under consideration, but there was articulation of the benefit of taxing goods and behaviors that increase public costs. In Santa Cruz, a few recommended resource depletion taxes: oil severance, timber harvest, and mining. Others suggested raising the gas tax, noting that it hadn't been raised since the early 1990's.

In San Diego and San Jose, some participants suggested phasing out the personal property tax for business.

The State/Local Tax Relationship

The impact of changes to the state's revenue system on local government and services was top of mind for many. Not only the participants representing local government, but local business and community leaders who are focused on regional governance and economic development brought the local angle into the discussion of the reform options.

Each meeting concluded with some questions about the level of community control over revenue. Of many possible options, two preliminary directions were considered:

a) Whether to give local communities more control over how their property taxes are allocated

b) Whether to modify local vote thresholds to make it easier – or more difficult – to pass local taxes

Giving local governments more discretion over the allocation of local property taxes received very strong levels of support in Fresno and San Diego, and solid support in Los Angeles from most of the participants – a few were concerned about equity issues. This topic was covered qualitatively in San Jose and Santa Cruz where more local control was also supported. This comment in Los Angeles captures some of the rationale for shifting control locally:

"Putting decision makers closer to the issue of priority eliminates the need to convince those far away from the issue."

Others spoke about the need for greater flexibility in allocations as well as frustration with state bureaucracy.

On the topic of local vote thresholds, participants were given options that included "reversing" the current levels of 2/3 for a special tax and a majority vote for a general tax. In general, participants in Fresno and San Jose indicated support for changing to a majority vote for special taxes while those in San Diego and Los Angeles were slightly more likely to prefer a 55% to a 50% threshold for special taxes.

There was no support for increasing the local vote threshold to 2/3 for general taxes. In fact, this item generated the lowest levels of any item voted on in the meetings at most locations.

Continuing the Conversation

PUBLIC ATTITUDES TOWARD LOCAL CONTROL

In May 2008, Viewpoint Learning conducted six daylong research dialogues for *California Forward* with randomly selected Californians. Their perspectives on issues relating to state/local authority were similar to the findings in the 2009 regional meetings:

- 70% supported giving more control over property tax income to local government.
- 78% agreed that giving local government more control over programs would ensure that tax money is spent in ways that reflect community needs.
- 54% supported the idea of reducing the 2/3 vote requirement to 55% to pass local taxes and bond measures.

Among many of the attendees, there appeared to be a sense of wanting to continue this conversation about tax reform and expand who participates. Representative comments:

- Greater involvement of young people: "You can't design the future unless you listen to the future."
- Make the information more accessible to a broad audience; include basics about what our taxes pay for.
- Involve more low and middle-income folks.
- Frame the issue to include those who want to cut taxes as well as those who want to raise them.
- Ask people to make tougher choices.

Parallel to the fiscal reforms attendees discussed was the notion that the public had a responsibility to make those reforms work. This comment from Santa Cruz summed up that sentiment:

"Elected leaders should know the public's priorities as well as the performance of agencies and act accordingly. The public needs guts to oust legislators when they don't perform."

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