



August 21, 2009

Mr. Gerald Parsky, Chairman  
Commission on the 21st Century Economy  
c/o State of California Department of Finance  
915 L Street, 8th Floor  
Sacramento, CA 95814

Dear Chairman Parsky:

As the commission is considering several tax revision proposals with the September 20 deadline approaching, we respectfully offer the following observations.

One of the important missions of the commission, as envisioned by the governor's executive order when he established the panel, is to reduce volatility in the state tax structure. Volatility can be addressed by changes to the personal income tax structure. Also, we applaud the inclusion of a "rainy day" fund proposal in the most recent version of the tax package to be considered by the commission; it is the single most important action the state can take to smooth out the ebbs and flows of the state's revenue stream from year to year, thus reducing volatility.

We nonetheless understand that the commission's charge is to address the state's tax structure, and we offer our comments on each of the pending proposals below.

**Business Net Receipts Tax.** With respect to the business net receipts tax (BNRT), we do not have sufficient information to offer a detailed analysis. There are many technical questions surrounding the application of the BNRT. Whether this tax is considered to be good for the state, its taxpayers, and the economy as a whole will depend on the answers to those questions. The most fundamental concern is the actual BNRT rate. Other major issues include apportionment, sourcing, definitions and the treatment of start-up and cyclical businesses. Given the monumental changes that the BNRT would bring to the state's tax system, we believe more time is necessary to study the BNRT and to receive public input once the details of the BNRT are provided.

Several other proposals that have been suggested to the commission should be rejected, as they make the volatility problem worse, will negatively impact the state's business climate and reduce job growth in California:

- **Split Roll.** A split roll would make the property tax much more volatile. Revenues would rise and fall more frequently, as the values of real property rise and fall. Proposition 13 currently works in a counter-cyclical fashion to reduce volatility. When real estate values are growing fast, the acquisition value system moderates the growth in value on the assessment roll. Conversely, when values are falling, the acquisition value system cushions the fiscal impact on local government because the assessed values of many properties are not reduced. Observe the assessment rolls in various counties over the past two years and this phenomenon is apparent. Cal-Tax has completed a recent study ([enclosed](#)) that explains this counter-cyclical effect in more detail and also shows, based on State Board of Equalization statistics, that there has been no shift of the property tax burden to homeowners. Proposition 13 has provided a stable, increasing revenue stream for local government.

- **Oil Severance Tax.** An oil severance tax would create a great deal of volatility if it is a part of the state revenue structure. Revenues would rise and fall as world oil prices rise and fall. Over the past 18 months, oil prices have fluctuated from approximately \$45 per barrel to \$140 per barrel. California already ranks sixth among oil-producing states in taxing oil production; this proposal would make California by far the highest taxing state.
- **Carbon Tax.** We believe a carbon tax also would be a volatile revenue source, for the same reasons that an oil severance tax is volatile. Further, the reason that some advocate such a tax is to provide an incentive to reduce greenhouse gas emissions. However, the state already has a program that mandates the reduction of greenhouse gas (AB 32 of 2006). An incentive is not needed when, as here, the reduction is mandated. Further, due to the greenhouse gas reduction mandate, a carbon tax would be an unreliable revenue source, as it would decline substantially over time.
- **Sales Tax on Services.** We note that there also has been some discussion of expanding the sales tax to services. We would urge the commission to eschew this idea due to its volatility and for other important policy reasons. First, unless business inputs were exempted from such a change, businesses could be motivated to secure services from out-of-state vendors, producing limited revenue and added volatility. Moreover, some services in this state already are subject to tax, such as utility user taxes, 911 taxes/fees on telecommunication services, and gas and electricity charges.

Also, revenues from taxing services would be much more volatile than commonly thought. Many services are luxuries that people can avoid during hard times. For example, attendance at baseball games and other sporting and theatrical events has dropped sharply during the past few months. There also are services that people can do themselves rather than have someone else provide the service for them. During hard times, spending on these "do-it-yourself" services will be reduced, and the imposition of a tax on these services will reduce consumption of these services even more. Richard Rogerson, a professor of economics at Arizona State University, wrote in the NBER Reporter (2009, Vol. 2): "Taxes distort the decision of whether to perform certain activities oneself (which economists refer to as home production) or to purchase them in the market. Important examples of home production include cooking meals, cleaning one's house, and taking care of one's children or other family members. All of these services can also be purchased in the market. Taxes on labor create an incentive for individuals to do more of these activities for themselves, since the time spent on home production is not taxed." For these reasons, we believe expanding sales tax to services is ill-advised.

We are mindful that the commission has been tasked with a difficult assignment, and we appreciate your efforts to provide a forum for a thoughtful and balanced debate. In the course of this debate, we urge you to consider that California needs a healthy economy and common sense budgeting to generate jobs, prosperity and ultimately the tax revenue necessary for fiscal recovery.

Thank you for your consideration,



Teresa Casazza  
President

cc: Commissioners, Commission on the 21st Century Economy  
Mark Ibele, Commission Staff