



September 3, 2009

**Sent By Regular Mail and E-Mail**

comment@cotce.ca.gov

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

**SUBJECT: ONGOING ISSUES REGARDING BUSINESS NET RECEIPTS TAX PROPOSAL**

Dear Chairman Parsky:

The California Chamber of Commerce, on behalf of the below-listed business and employer organizations, is pleased to respond to your request for a follow-up letter on the business net receipts tax (BNRT) proposal, in light of the release of the "Preliminary Overview" document and the BNRT workshop discussions. Thank you for your invitation to provide you with further information and emphasize our continuing concerns.

We appreciate that the Preliminary Overview and workshops answered several of the questions raised by the business community – but, unfortunately, not the most pressing questions. In the attached list of questions, we have addressed in detail the transitional and operational questions that remain to be

addressed, and we have added some additional questions, since the business community analysis of BNRT is ongoing. Overall, several key issues remain that we respectfully urge the Commission to resolve before any vote is taken to advance the BNRT:

- We expect that you will provide an estimated BNRT rate prior to the hearing, but we are a week out from what may be your decision day and still do not have it. In order for Commissioners to understand the impact of this tax on companies and industries, businesses must have the time to calculate how this tax will affect their often complicated operations. Businesses cannot begin to undertake this exercise without knowing the precise rate and the base against which it will be applied. You should allow sufficient time between settling on a proposed rate and base to gain the knowledge on consequences of this new tax from affected businesses and industries.
- Will you have modeled the rate over the past several economic cycles (about ten years) to determine the ability of the BNRT to generate revenue and stem volatility? What is the risk that revenues will substantially deviate from the Commission's projected estimates?
- Is the rate being developed as a result of the Commission's judgment as to what best comprises the base of a BNRT as a matter of tax policy, or did the Commission determine the most appropriate rate for the economy and engineer the base to accomplish that rate?

We appreciate the Commission's strong statements clarifying that only the Legislature, and not an administrative body, would have the authority to set and change the BNRT tax rate. However, we cannot provide a complete analysis of this proposal, nor can any individual company understand this proposal, without knowing the rate and the base to which it applies.

- We will need many more details regarding the proposed deductions that will be available under BNRT. For example, according to the Preliminary Overview, employers would not be able to deduct from revenues the cost of employees, an expense that is allowed under the current corporate income tax system. However, at the workshop, the Commission indicated there was a possibility of a partial deduction for employee costs.
- While we understand the Commission's intent to develop a less volatile tax system, we urge you to likewise give due consideration to tax fairness. Our current tax system is based either on profits, such as the personal and corporate income taxes, or is passed through as a tax on consumption, like the sales tax. By contrast, the BNRT is imposed upon companies even when they are in a loss position, and it cannot be passed on as a transactions tax. We are not aware of any substantial discussion of why the BNRT is a preferable tax policy to the current taxes. (The only other major tax similar to this proposal is the property tax, which as the Commissioners know was the subject of a tax revolt 30 years ago when it became unaffordable for major parts of California society. High inflation then exacerbated the perceived unfairness of the property tax, which could also be the case for a BNRT.) Taxpayers and policymakers deserve more discussion and analysis on this issue.
- As mentioned above, adoption of this recommendation must await analysis of the impact of the BNRT on specific economic sectors, including which sectors will be winners and which losers. For example, businesses with low profit margins and high employee expenses presumably would be especially hard-hit, as would companies in a loss position. Additionally, based on the limited

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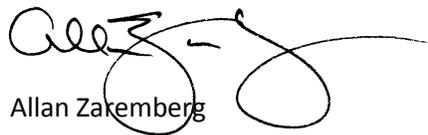
information so far available, it appears the BNRT may shift more of the tax burden onto small businesses, since many pay under the personal income tax system, and would not benefit from elimination of the corporate income tax.

- Adoption of this recommendation must also await analysis of the impact on California jobs and the economy. If the BNRT amounts to a tax on employees (because it appears employers will not be able to deduct the cost of employees as they do now), will it motivate companies to outsource jobs to other states and nations? Will it further constrain California's ability to compete for future investments if businesses lose important incentives such as the research and development or enterprise zone credits? What will become of California's ability to compete with other states and countries if the cost of exported California goods becomes substantially higher than goods offered by other states and countries? Additionally, will the cost of doing business increase for Californians, due to higher prices for advertising and other business purchases?

As we emphasized during our workshop testimony, we believe it is crucial for the Commission to take sufficient time to analyze the proposed BNRT, rather than be driven by an arbitrary deadline, so that any vote of the Commission regarding BNRT is an informed vote. Moreover, since the intent of the Commission is to provide any ultimate BNRT recommendation to the Legislature for consideration, and it will be subject to a 2/3 vote of the Legislature for adoption, it is imperative that a thorough analysis and response by impacted sectors also be available for legislative review.

Thank you for your consideration of our concerns and questions, and please do not hesitate to contact us should you have any questions or need further information.

Sincerely,



Allan Zakenberg

California Chamber of Commerce  
Air Transport Association of America, Inc.  
American Council of Engineering Companies of California  
American Fire Sprinkler Association - California Chapters  
Apartment Association, California Southern Cities, Inc.  
Associated Builders and Contractors of California  
Association of California Life and Health Insurance Companies  
California Aerospace Technology Association  
California Apartment Association  
California Automotive Wholesalers' Association  
California Bankers Association  
California Beer and Beverage Distributors  
California Building Industry Association  
California Business Property Association  
California Cable & Telecommunications Association  
California Cattlemen's Association  
California Farm Bureau Federation

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California Forestry Association  
California Grocers Association  
California Hotel and Lodging Association  
California Hospital Association  
California Manufacturers and Technology Association  
California Mortgage Bankers Association  
California Restaurant Association  
California Retailers Association  
California Self Storage Association  
California Taxpayers Association  
Long Beach Area Chamber of Commerce  
Lumber Association of California and Nevada  
Messenger Courier Association for the Americas  
Milpitas Chamber of Commerce  
Motion Picture Association of America  
National Federation of Independent Business  
Pacific Merchant Shipping Association  
Personal Insurance Federation of California  
Redondo Beach Chamber of Commerce & Visitors Bureau  
Santa Clara Chamber of Commerce and Convention-Visitors Bureau  
Securities Industry and Financial Markets Association  
TechAmerica  
TechNet  
Western Electrical Contractors Association  
Western Growers Association  
Western Manufactured Housing Communities Association  
Western States Petroleum Association

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Enclosure

cc: Commissioners, Commission on the 21st Century Economy  
The Honorable Arnold Schwarzenegger  
The Honorable Darrell Steinberg  
The Honorable Karen Bass  
The Honorable Dennis Hollingsworth  
The Honorable Sam Blakeslee

# Business Net Receipts Tax (BNRT) Proposal

## Business Community Questions

As of September 3, 2009

*Please note: These questions replace the initial BNRT questions document provided on August 21, 2009. Comments have been added to this version to reflect questions addressed in the BNRT preliminary overview document (posted on the Commission website on August 24, 2009) or the BNRT workshops held on August 26 and 28, 2009. Additionally, there are new questions that have been added, which have been raised as part of the business community's ongoing analysis of BNRT. Comments are italicized, and additions are underlined.*

### **A. Macroeconomic/Policy Questions (Questions Related to Policy Implications of California Being One of Few States to Have Net Receipts Tax):**

1. Per the founding charges to the Commission by the Governor, how will the BNRT: “Promote the long-term economic prosperity of the state and citizens” or “Improve California’s ability to successfully compete with other states and nations for jobs and investments”?
  - *This was partially addressed by the preliminary overview. Please see the comments/questions under question A.3. below.*
2. How will the BNRT affect specific industry sectors – who will pay more and who will pay less (in combination with changes if any to the current taxes) and how that may affect their inclination to do business in California? Will there be any provisions to minimize any disproportionate negative impact on certain industries, such as adopted by other states that have enacted a variation of a BNRT?
  - *This was partially addressed by the workshop discussion. Please see the comments/questions under question A.5. below.*
3. How will the BNRT affect California’s competitiveness, specifically with respect to domestically-produced goods and services exported at a new higher price and with respect to those same goods and services offered at lower prices by other states and countries?
  - *The preliminary overview asserts that the BNRT will improve competitiveness by reducing multiple taxation on inputs, by reducing marginal income tax rates, and by applying a low rate on “all productivity in the state.” What BNRT and respective tax rates were used, what deductions were assumed, and what sectors were subject to BNRT in order to arrive at this conclusion?*
4. How will the BNRT proposal affect California job creation, since it is, in effect, a tax on employees? Are significant labor union ramifications expected from a tax on employees?

5. Will the BNRT pressure businesses to reduce California payrolls, especially for California headquarters, in favor of outsourcing or relocating? Will a new BNRT tax structure provide equitable treatment between taxpayers where one taxpayer fabricates an asset in house (presuming there is labor and overhead costs in the fabrication process) vs. another taxpayer that purchases the same asset from a third party? Will the BNRT provide equitable treatment between taxpayers where one taxpayer maintains a staff of employees vs. another taxpayer that maintains a staff of independent contractors?
  - *At the workshop, there was discussion of a possible partial exemption for employee costs in view of low margin, high employee industries. Please provide more detail. As was noted, because the \$500,000 exemption threshold provided in the preliminary overview is based upon gross receipts, many small businesses with low or no profits may still be subject to BNRT. Additionally, business groups testified that small businesses may be subject to double taxation at the entity level since many pay the personal income tax but only corporate income tax is contemplated for elimination. There was also some testimony that the BNRT may be helpful to small businesses. In light of this discussion, will there be an analysis of the small business impact of BNRT?*
6. Will the BNRT result in increased costs of doing business in California as it pushes up the cost of goods and services for vital California industries?
7. Will California allow businesses to disclose the amount of BNRT applicable to a transaction on customer bills? If so, how will itemization be achieved since the BNRT is not a transaction-level tax?
8. Tax incentives: Will any tax credits, exemptions, or deductions to encourage certain activities, such as research and development be available? If not, how will CA be able to compete with most other states and countries that do have tax incentives? Will BNRT adversely impact California's share of federal stimulus programs and unfairly burden California-based companies?
  - *At the workshop, the CalChamber clarified that the current research and development credit applies primarily to labor costs. Does this change the Commission's view on whether a research and development incentive will be incorporated into a BNRT structure? How would making changes to the R&D credit affect job creation and capital investment in the State?*
9. Will there be any assurance that the BNRT rate would not be increased, and if replacing taxes such as the corporate income tax or state sales/use tax, that these taxes will not be brought back, for the foreseeable future?
  - *At the workshop, CalChamber requested that there be modeling forward and back over several business cycles (at least 10 years) to determine what revenues would have been*

*generated in good times and bad if the BNRT had been in place. Does the Commission plan to conduct such modeling?*

10. Regarding whether the BNRT is good policy, what has been the feedback from the business community in states where it has been adopted?
11. Is the BNRT to be formed in a way to be revenue neutral vis a vis the current tax regime in California? What will be the basis for determining this revenue neutrality as the BNRT is supposed to provide a more consistent form of revenue from year to year vs. the corporate income tax, e.g., in determining the target revenue generation will the state be looking at just the past year, a 5 year average, anticipated forecast trends vs. income tax, etc?
12. If the BNRT is to replace corporate income tax and the state portion of the sales tax, why is it a superior alternative to those but not the personal income tax? Is consistency in tax standards/structures between individuals and business a policy goal that has been considered?
13. The State and local government entities are subject to sales tax when they sell goods. Will government entities be subject to the BNRT when they sell goods and services (such as utilities)?
  - *The preliminary overview document indicates that federal, state, and local government entities will not be subject to BNRT. Does the Commission believe it is good policy to shift more of the existing tax burden from government to the private sector?*
14. Under Proposition 42 (Art. XIXB, sec. 1) sales tax on gasoline is constitutionally assured to be used for transportation purposes, but does not itself impose the sale tax on gasoline. If the state portion of the sales tax is repealed, what is the proposal to fund transportation, and provide the type of constitutional protection transportation funding currently enjoys?
15. The Constitution (Art XIII, sec. 34) currently prevents the application of the sales tax to sales of food (except restaurant meals and a few other exceptions). Is it the Commission's intent to apply the BNRT to sales of food, and does it believe that the constitutional prohibition enacted by the voters does not apply to the BNRT?
16. The Legislature committed 0.5% of the state sales tax rate to "realignment," where certain program responsibility was shifted from the state and local level, along with the sales tax funding to pay for it. That 0.5% is not guaranteed in the Constitution. Is it the Commission's intent to repeal the portion of the sales tax rate set aside to pay for realignment?
17. The BNRT and the larger package appears to discriminate based on choice of entity. For example, the one package proposed by the Commission proposes to eliminate the Bank and Corporation tax, but only partially reduce the personal income tax rate (and also eliminate most deductions, throwing reductions in PIT liability into doubt). If you are a corporation, you would only pay BNRT, but if you were a sole-proprietor, partnership or pass-through entity, you would

pay both BNRT *and* personal income tax. What are the Commission's plans to address this discrimination? Has the Commission considered the impact of the BNRT proposal on those industry sectors hit particularly hard in the recession, e.g., construction and real estate, which are made up of many companies organized as sole proprietorships or pass through entities?

- *The preliminary overview document and workshop discussions addressed that the BNRT would be only an entity-level tax. However, the question of double-taxation on any business that pays the personal income tax still remains unaddressed.*
18. Will the BNRT be deductible against a corporation's federal income tax liability? How about an individual who has BNRT flowed through to them from a sole proprietorship or pass-through entity? Will BNRT be deductible against their federal personal income tax?
  19. State and Local government currently share the administrative costs of the sales tax system by function and by share of revenue received by each. If the state portion of the sales tax is reduced or eliminated, will the costs of administering the sales and use tax system be shifted to local government?
  20. Will the BNRT apply to those in the business of selling real property, or is it pre-empted by Article XIII A, sec. 3 of the State Constitution? If not pre-empted, does the Commission envision applying the new tax to those in the business of renting apartments and houses?
  21. Other states that have implemented something similar to a BNRT have been compelled to do so because of a structural flaw in their existing tax system (Texas- constitutional ban on personal income tax creating incentive for business reorganizations as partnerships; Michigan- constitutional limitation on their sales tax rate). California has no similar structural flaw. What is the compelling policy reason to adopt the BNRT?
  22. The BNRT proposal, as currently understood, would tax the sale of "necessities" that are currently exempt under the sales tax, including food, housing, prescription medicines, utilities, day care and elder care and educational services. What data has the Commission reviewed that shows that the BNRT will not be regressive?

**B. Operational and Transitional Questions (Questions Related to Information that Companies Will Need to Determine Change in Tax Liability and Cost of Doing Business in CA if BNRT Imposed):**

1. First and foremost, what is being proposed? Many of the details of the plan keep changing, or have not been specified
2. What will the rate be? Who will have authority to set and modify the rate? Will any kind of surcharge be associated with the new tax rates (like Michigan's MBT surcharge of 22%)? Will all taxpayers be subject to the same rate?

- *At the workshop, the Commission clarified that, in any event, only the Legislature would have the authority to set and modify the BNRT rate. Will this be expressly stated in any written BNRT proposal?*
3. Which taxes will the BNRT replace and to what degree, e.g., all or a portion of the PIT, corporate, sales and use tax, LLC fees, other?
- *The preliminary overview indicates there will be a five-year phase in of BNRT, accompanied by reduced personal and corporate income tax rates and a reduced sales tax rate, followed by elimination of the corporate and state sales tax rate. What will the phase-in rates be? How much of the state sales tax rate will ultimately be eliminated given Constitutional limitations?*
4. What entities are subject to the BNRT, e.g., corporations, partnerships, LLCs, sole proprietorships, Subchapter S corporations, nonprofits, other? What entities will be excluded, if any?
- *The preliminary overview document states that all business entities will be subject to BNRT, except insurance companies subject to the gross premiums tax and unrelated business activities of exempt institutions. It states that all government entities and non-profits will be exempt and small businesses with \$500,000 or less in California gross receipts.*
5. Are all industries subject to the BNRT, e.g., healthcare, leasing, staffing, transportation? Specifically, will insurers, subject to the premium tax, be subject to BNRT? Will financial institutions be subject to BNRT? Will there be any provisions to minimize any disproportionate negative impact on certain industries? Will there be any exemptions for small businesses?
- *The preliminary overview document states that all business entities will be subject to BNRT, except insurance companies subject to the gross premiums tax and unrelated business activities of exempt institutions. It states that all government entities and non-profits will be exempt and small businesses with \$500,000 or less in California gross receipts.*
  - *Because the preliminary overview provides different options with respect to application of BNRT to financial institutions, this is still unclear. To what extent and in what manner will financial institutions be subject to BNRT? If financial institutions are subject to BNRT, will regulated investment companies (RICs) be excluded? If financial institutions are not subject to BNRT, will tax credits and the NOL deduction still be available?*
  - *At the workshops, there was some discussion that the \$500,000 gross receipts small business exemption may be modified. In light of this discussion, please provide the modified exemption threshold, if any, for small businesses.*

6. What is the basis for the imposition of the BNRT, e.g., doing business, incorporated, or making sales in California, doing work outsourced to you by a California company, other?
  - *The preliminary overview indicates that the basis will be the economic presence test. Since FTB staff acknowledged in its 8-21-09 analysis that the constitutionality of applying the economic presence test to BNRT cannot be definitively determined from current precedent, does this change the Commission's view on the merits of the BNRT proposal with respect to stability and anticipated revenue?*
7. What will be the method of computation, e.g., separate company filing, combination or consolidation, other? Will there be a single mandatory filing method for all entities or will the taxpayer be allowed a choice of filing methods?
  - *The preliminary overview states that the unitary method will apply.*
  - *The preliminary overview indicates that water's edge basis will be mandatory. Will the Commission confirm that it intends for a water's edge basis to be mandatory? If so, what is the reason for removing the current election?*
  - *The preliminary overview also indicates that water's-edge rules would be re-written to include all activities in so-called tax haven jurisdictions overseas in the water's-edge return. How does the Commission propose to reconcile this change with the fundamental principle of the water's-edge election which is to ensure that corporations are taxed based solely on operations within the water's-edge of the United States, and also given that the current water's edge rules were designed to prevent retaliation from foreign countries that would come from disrupting international tax conventions?*
8. Please confirm whether receipts and deductible expenses are to be calculated on a GAAP (financial book) basis or a federal tax basis.
9. If the BNRT is computed on a combined basis, how will tax liability be apportioned, e.g., joint and several liability, "intrastate apportioned," other? Will companies be excluded from this tax based upon P.L. 86-272?; will either Joyce or Finnegan apply?
  - *The preliminary overview states that single sales factor apportionment and the Finnigan Rule will apply. We note that the recent FTB analysis states that it is their belief that P.L. 86-272 does not apply; does the Commission intend to adopt that finding?*
10. If replacing all or a portion of existing taxes, what will be the transition rules for going from one tax system to a new one, e.g., unclaimed tax credits, NOL carryback and carryforward, unclaimed depreciation on existing assets, other? Specifically, will R&D tax credits earned under the existing regime be allowed as credits against the BNRT? How about the Enterprise Zone Program tax credits? Will there be any limitations and, if so, how will they be computed?

- *The preliminary overview is not clear on whether NOL and credits will be available during and after the transition period.*

11. What will be the tax base for BNRT?:

- *Overall, with respect to the base and deductions, the preliminary overview provides some general information and differentiates treatment of nonfinancials and financials. However, details are not spelled out. Additionally, in some cases, different options are provided for the Commission to choose, but the exact direction remains unclear for taxpayers. Therefore, most of the below questions still apply.*
- Please define a California “receipt.”
  - i. Will receipts include the gross proceeds from sales of noninventory property or just the net gain on sale?
  - ii. Do receipts for either tax base or apportionment factor include treasury receipts? If yes, will there be a deduction for investments purchased with receipts, e.g., stocks/debt instruments? Correspondingly, what would be the treatment of loan proceeds or contributions to capital?
    - *The preliminary overview indicates gross receipts excludes treasury receipts for nonfinancials but this remains unclear for financials.*
  - iii. Would receipts for purposes of the tax base include monies collected on behalf of others, e.g., excise taxes?
  - iv. Will gross receipts be adjusted or reduced for any of the following?:
    - Returns and allowances
    - Discounts or allowances from gross billings pursuant to contractual terms (e.g., in the health care industry, pricing adjustments related to health care services provided to Medicare or Medicaid patients or pricing adjustments related to managed care contracts)
    - Uncollectible revenues (e.g., bad debts)
    - Services for which no payment is expected (e.g., pro bono services or charity care)
- What purchases from other firms may be deducted?
- Will all taxpayers be subject to the same deductions?

- With respect to payments for labor and capital, how is “profits (retained or paid out)” defined?
- Will any payroll costs and depreciation expenses be deductible?
- Will an employer’s purchases of health care and other employee benefits be deductible?
- With respect to treatment of capital purchases and capital expenditures for the production of property, will immediate expensing be allowed?
- Will there be a depreciation deduction for real property?
- Will all goods and services be allowed as a deduction?
- Will marketing and promotion costs be deductible?
- Will the expenses incurred for the acquisition or right to use intangible property be allowed as a deduction?
- If a combined return is required what types of inter-company transactions (if any) will be excluded from the tax base or apportionment calculation? If combined reporting is not required, what would be the treatment of inter-company interest and dividends?
- Will there be any deduction allowed for taxes paid either to other states or California, e.g., property, excise, etc.?
- Will payments for property include payments for intangibles, rents and royalties?
- Are inventories excluded from the calculation, i.e., no addback of inventories? Correspondingly, will there be a first year deduction for inventories that are carried on taxpayers’ books as of the time the BNRT goes into effect? As a related concept to the above inventory question, will there be any FAS 109 relief and how will that be determined?
- Will businesses be allowed to include interest, taxes and other carrying costs as part of the cost of purchases?
- What will be the treatment of treasury stock purchases? If thrown out, will it be a deduction from gross receipts when purchased?
- With respect to specific industries/goods/services, will the following be deductible?
  - i. Programming costs paid by cable companies to other firms?

- ii. Similar to Michigan and Texas, will labor costs be deductible for staffing or service companies?
  - iii. Will food purchased for resale?
  - iv. Prescription drugs purchased for resale?
  - v. Is software included with amortizable assets (7 ½ year writeoff) or depreciable (usually a 3-year writeoff)?
  - vi. Revenue for Medicare and Medicaid?
  - vii. Similar to Texas, costs of providing uncompensated care or care to the indigent?
  - viii. Health care claims and the cost of the prescriptions paid by health plans and insurers?
  - ix. Will pass through revenues of public utility companies be included in the base subject to the BNRT? Will the timing of utilities' regulatory recovery be considered in the transition provisions?
12. Sales factor: Is the tax base apportioned to CA using a single sales factor?
- *The preliminary overview indicated that single sales factor would be used.*
13. Tax incentives: Will there be any tax credits, exemptions, or deductions to encourage certain activities? For example, will the research and development (R&D) tax credit be available? Will Enterprise Zone tax credits still be available? Would taxpayers be able to use previously generated R&D credits under the BNRT system? Would California alter the R&D credit rules in any way?
- *The preliminary overview is not clear on whether credits, exemptions, or deductions will be available during and after the transition period.*
14. Net operating losses: Will there be a deduction, and if so, can they be carried forward or carried back? Additionally, how will they be apportioned, allocated, or shared?
- *The preliminary overview is not clear on whether the NOL deduction will be available during and after the transition period.*
15. What kind of administrative burdens will be imposed on taxpayers to transition to the new tax regime?