

FAQ's

1) Who are you and what are your qualifications to launch The Flat Tax Initiative?

A: I am Rex Halverson, a state and local tax attorney with over 31 years of tax experience. I spent 16 years working at Bank of America in their tax department at the World Headquarters building in San Francisco from 1978-94, 3 years in the State Controller's Office as Deputy State Controller – Taxation from 1995-98 where I represented State Controller Kathleen Connell on the BOE and advised her on all FTB issues, 7 years at KPMG LLP, one of the Big 4 Accounting Firms, and the last four years as principal of my own tax consulting firm, Rex Halverson & Associates.

2) What experience do you have in initiatives or in writing tax bills?

A: I have drafted the language of many California tax bills and regulations over my tax career. For example: the bank in lieu tax subvention formula, the acquisition sale leaseback statute and amendments to Title 18, sections 1620, Interstate and Foreign Commerce and 1699, Permits. Additionally, while serving on Governor Deukmejian's Government Efficiency Team on Tax Expenditures and Reform in 1983, I was part of a four man team that evaluated all California taxes and expenditures and I personally proposed the supplemental tax roll to close a loophole in Proposition 13. The proposal was passed into law within 90 days by the state Legislature and raised \$450 million during a severe recession. I have also worked on a statewide initiative as one of 58 county chairpersons.

3) What motivated you to launch this idea?

A: I strongly believe that California's tax structure should be fair and equitable to each and every one of us who reside or visit here. We all have a stake in the future of California and I believe that we can create a tax system that is fair for all.

4) Do you expect the initiative to pass the first time it's on the ballot?

A: I am very pleased to offer the California electorate the opportunity to actually vote on a California Flat Tax Initiative. The opportunity to vote on an initiative such as this has never happened in my lifetime. I want it scrutinized, written about, debated by experts and layman alike, discussed around dinner tables and at work, and then voted on. It would be an historic occasion. We are offering a brand new idea to streamline state government, eliminate withholding, abolish the complicated and intrusive Personal Income Tax (PIT), and dismantle an overly aggressive Franchise Tax Board (FTB), while at the same time, collecting state tax revenue from everyone who lives in or visits the great state of California whether they are a resident, nonresident, visitor, illegal alien, tax cheat or criminal, in order to equally support the infrastructure we all share.

5) Is California's economy more suited for a Flat Tax than other states and why?

A: Yes; California has too many tax agencies, i.e., the FTB, BOE, EDD, SCO and DMV all collect taxes. California is already regarded as business unfriendly and the FTB is

consistently rated amongst the most aggressive tax agencies in the country. With that reputation, businesses and CEOs are choosing to locate elsewhere. Many of them have moved to Nevada or Washington which have no PIT. In addition, our Legislature has recently imposed a 50% interest penalty that is used by the FTB as a hammer in audits. Similarly, the alternative minimum tax (AMT) is also affecting more and more residents. The Legislature has done nothing to stem the tide. **Therefore, we feel that the time is right for citizens of California to take back the tax function and tell the Legislature how they prefer to pay their taxes.**

6) How did you originally compute the Flat Tax rate?

A: I computed the amount of personal income tax that was collected in the latest year in which I could get validated data from available FTB records. That was 2004. I then subtracted out the PIT collected that was related to audits of past tax years as these will continue to be collected by the FTB until the statute of limitations has run for all years, i.e., four years after 4/15/09, the due date for 2008 PIT returns. The result was the approximate amount of tax revenue that would have to be generated by the flat tax in order for the initiative to be roughly revenue neutral.

7) How will the Flat Tax simplify tax collection?

*A: Rather than 15 million personal income tax returns being filed annually, only 1 million sales and use tax returns will be filed annually; and, the latter are already being filed. Thus, you will have **15 million less tax returns** that need to be prepared by individuals, CPAs, accountants, tax attorneys, and business owners. In addition, you will no longer need the FTB tax return processing and audit staff who handle Personal Income Taxes.*

8) The Franchise Tax Board claims a \$30B tax reduction based on 2006 PIT figures. How do you explain this discrepancy?

A: There was a windfall amount of PIT reported and collected in 2005-2007. This windfall is attributable to tax on stock options, the higher millionaires' tax rate, tax amnesty penalties, the Alternative Minimum Tax or AMT, etc. According to the FTB's Annual Report for 2006 part of the increase is due to the fact that returns with reported AGI of \$200,000 or more increased by 15.9% from the year prior. Another \$4.8 billion in revenue is the result of tax amnesty penalties.

9) What is the total sales and use tax rate under the Flat Tax Initiative?

A: It is 5.5% higher than your current state and local tax rate. Currently the rates vary between 7.25 and 8.75%. Thus, add 5.5% to those figures. The rate will vary between 12.75% and 14.25% depending on the place of sale or use.

10) Why didn't you submit your initiative language to your Legislator so that it could go through the normal Legislative process and be debated by the California Legislature?

A: The Legislature is historically resistant to change and not usually willing to give voters the chance to vote on important issues, like the PIT and the ever growing state bureaucracy.

11) Why a flat tax calculated on gross receipts rather than a flat income tax based on federal Taxable Income (TI) or federal Adjusted Gross Income (AGI)?

A: Because you can do away with state personal income tax withholding and perhaps cut the state bureaucracy by as many as 5,000 of the FTB's current 6,000 employees. That is a staff reduction of 83% at FTB.

12) How did you come up with the estimated 5,000 staff cut within the FTB? Do you really think this number is achievable?

A: Yes; I think so. A staff reduction of 5,000 FTB employees amounts to an 83% reduction. The bulk of the work done at the FTB involves the PIT rather than corporate income/franchise taxes. Annually, approximately 15 million PIT returns are filed. That is to be compared to just 1.2 million corporate tax returns. Thus, 93% of all returns handled by the FTB annually are PIT returns and only 7% are corporate income tax returns. The latter are far more complicated; which is why 93% of all FTB employees cannot be laid off if the Flat Tax Initiative is passed by voters.

13) Are there risks/downsides to the state and its citizens by not adopting the Flat Tax Initiative?

*A: If we do nothing, the wealthiest amongst our population will continue to leave the state and take up residence elsewhere. They will also move their companies when it makes good business sense. That trend must be stopped. With the Flat Tax Initiative, everyone wins except those citizens who currently pay no state PIT, including tax cheats, drug dealers and illegal aliens and others who intentionally do not pay their fair share to support the infrastructure of California. As for the poor, I am very reluctant to advocate raising their taxes; however, **a critical aspect of the Flat Tax Initiative is that it does not tax housing (rentals or home ownership), food, or prescription medicines.** Thus, the only increases that the poorest of our populace will have to pay will be related to clothing, school supplies, gasoline, furniture and vehicle purchases or leases. The latter two items are typically financed over several years, which would mitigate the burden, and as for clothing and school supplies, I would advocate that the Legislature grant sales tax "holidays" just before children go back to school. These are not insurmountable problems for our Legislature. As for the increase in sales tax on gasoline and toys, a family of four will only shoulder an estimated increase in tax of \$94 per year, roughly \$8 per month or 25 cents per day.*

14) Will the Flat Tax be deductible on an individual's federal Personal Income Tax Return?

A: Under current law, sales tax is deductible through the end of 2009 but it is expected to be made permanent.

15) How does your Flat Tax plan differ from the Flat Tax systems in other states?

A: It depends on the state, but most importantly, it is a flat tax on gross receipts rather than the traditional flat tax based on your federal liability, gross income, adjusted gross income, or taxable income. If our Flat Tax Initiative was calculated on gross income or adjusted gross income or taxable income, the FTB would still have a role in PIT, withholding would still be required and the AMT might remain in place. I might add that a couple of states tax only interest and dividend income rather than all personal income. A tax on interest and dividend income would shift the tax burden disproportionately onto the elderly. Thus, while

many other alternative flat tax plans are intriguing, I believe that the Flat Tax Initiative has more benefits for the citizens of California.

16) Has a flat tax been successful in other states?

A: The following states do not have a PIT: Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming, however, there is no evidence to suggest that the respective governments in each of these states has found it difficult or impossible to fund essential services with the tax dollars currently raised. In addition, the following states tax only dividend and interest income: New Hampshire and Tennessee.

17) Can you provide an economic analysis proving that the state's revenue collected under the Flat Tax will equal or surpass the amount that is collected under the current PIT laws?

A: It will not be equal. My goal was to lower taxes and cut government spending. However, in answer to your question, roughly \$5 billion of revenue is raised for every 1% increase in the sales and use tax rate. In 2006, the FTB reported that the total tax liability that was reported by individuals in the 14,087,896 returns filed for that year was \$43.13 billion. A 5.5% sales and use tax rate increase should approximately equate to \$27.5 billion in revenues. Thus, the shortfall is in the range of \$16 billion. I might add that sales and use tax revenues have historically risen 7 to 11% annually.

18) What are the reported tax liability figures on PIT returns each year according to the FTB?

<u>A: Tax Year</u>	<u>PIT Liability Reported</u>
2007	\$46.6 B
2006	\$43.13 B
2005	\$36.10 B
2004	\$30.37 B
2003	\$28.57 B
2002	\$31.28 B
2001	\$40.37 B
2000	\$33.10 B

19) Why does the Flat Tax Initiative include a corporate tax rate reduction for C corporations and S corporations doing business in California?

A: Because a sales and use tax rate increase will impact every purchase of tangible personal property by California corporations; and, these same corporations remain subject to franchise/income taxes. A tax increase on corporations doing business in California is not fair and would only make the business climate in our state worse. It is important to understand that businesses do not pay taxes, they pass the taxes along to consumers, i.e., you and me.

20) How is this initiative pro-business?

A: It lowers the corporate income tax rate from 8.84% to 7% which is close to the mean or average of all corporate rates in the country. It also has a corresponding tax rate reduction for Subchapter S corporations. It lowers their tax rate from 1.5% to 1.2%. In addition, it

includes a sales tax manufacturing exemption. Of the 45 states with a sales and use tax, I believe approximately 40 have a manufacturing exemption of one kind or another. Thus, California was out of conformity with the other states. These pro-business changes will keep businesses vibrant in our state, keep jobs here and make these businesses more competitive with other companies in this country and around the world.

21) What potential effects could this initiative have on California's budget in the years to come? That is, will the Flat Tax initiative reduce General Fund revenues?

A: Although I initially envisioned that the initiative would be revenue neutral, in fact, it will reduce the general fund revenues now enjoyed by the State legislature. I don't apologize for that. In my opinion, the legislature needs spending reform. But, the Flat Tax will also allow the Legislature to better budget because projected sales and use tax revenues are more predictable than PIT and remitted to the state monthly.

22) Who will the Flat Tax initiative help? Does it specifically target the wealthy or the underprivileged? Aren't the poor hurt since a higher percentage of their income must be spent on consumables?

A: The elimination or reduction of taxes imposed on individuals and companies should encourage companies to locate here, thereby creating more jobs here. It will encourage savings and hard work. All in all, it should be very positive for California. It doesn't specifically target any one particular group. Everyone living or visiting here will pay the same state sales and use tax rate. The wealthy will continue to buy more expensive automobiles and pay a correspondingly higher amount of sales tax. As for the poor, it is important to note that owned or rented housing is not taxable under the sales and use tax. In addition, neither food nor prescription medicines are taxed. Only clothing, school supplies, vehicles, furniture and toys will be subject to the new tax rates. Vehicles are usually financed over a period of 5-7 years so the sales and use tax impact is spread over a number of years. As for clothing and school supplies, I believe the legislature should enact sales tax holidays for clothing so that the poorest of our citizens can plan to buy necessary items on these dates and avoid any sales or use tax. This is not uncommon in other states with higher sales and use tax rates.

23) This initiative would eliminate the problem of income tax cheating and evasion in California. What room is there (if any) for cheating and tax evasion under the Flat Tax system?

A: Make no mistake; there is a Tax Gap (the difference between taxes owed and taxes paid) on the sales and use side as well as on the personal income tax side. The Tax Gap on the sales and use tax side is estimated at 4% or \$2 billion but this is far less than the \$6.4 billion Tax Gap on the PIT side. Some retailers will always cheat, but those that are caught by the BOE will be denied sellers permits; thus, they will not be allowed to sell and cheat again.

24) How substantial will the state's savings be from the resulting FTB cutbacks in employees?

A: Tens of millions, if not hundreds of millions of dollars, due to savings in payroll, office space, desks, chairs, equipment, computers, software, state cars, pensions, etc. But this will

take years to materialize as the FTB will no doubt shift many of its employees around to bolster their corporate franchise/income tax side and other responsibilities that the FTB has been charged with.

25) Doesn't California overly rely on the PIT for revenue because of Proposition 13 and other things?

A: California does overly rely on the PIT to balance its budget, and the bulk of the PIT revenue is coming from its wealthiest individuals, but that's why I'm doing this in the first place. If all of us do not share the burden of state government costs more equitably, we have no real stake in what our government does or spends our tax dollars on.

26) Explain how the Flat Tax will eliminate the state's "inherently volatile revenue swings" each year. Doesn't revenue from sales tax also fluctuate up and down?

A: Revenue from sales and use tax does fluctuate but not nearly as much as the personal income tax revenue that has wildly fluctuated as a result of stock options being granted to senior corporate executives.

27) Will raising the sales and use tax significantly discourage consumerism in California? Will the new higher cost of tangible personal property encourage out-of-state purchasing and therefore an outflow of money from the state?

A: Yes, however people will not drive out of state to fill their cars with gas or buy clothing, etc. unless they live on the border of Oregon. With regard to the purchase of vehicles, vessels and aircraft, which are the most expensive items of tangible personal property, consumers simply cannot buy them out of state and bring them into California without being subject to California use tax. Notwithstanding, I do think there will be more internet purchases from out of state retailers and sellers. But these purchases are also subject to California's use tax. Our Board of Equalization will figure a way to stay on top of the changing marketplace.

28) Do you have any taxpayer groups or companies that have endorsed your initiative?

A: We have received the endorsement of The National Taxpayers Union.

29) How many signatures do you need to place this on the ballot?

A: 433,971 signatures will be required to qualify the initiative.

30) Why do you think voters in California will embrace this idea now?

A: Everyone is sick of hearing about tax cheats and the electorate wants to have a voice as to the tax laws that apply to them. The Franchise Tax Board has become a huge and expensive bureaucracy for collecting tax dollars. Those tax dollars can be collected far more efficiently by retailers as part of our sales and use tax. It just makes good sense. Why have multiple tax bureaucracies? California has at least five, i.e., the FTB, BOE, EDD, SCO and DMV. In addition, the FTB is already known as one of the most aggressive in the nation which hurts both our business climate and jobs and causes our wealthiest citizens to move or at least consider moving to states without an income tax like Nevada, Washington, Texas and Florida. This outflow must be stopped. We need those people as they are the ones that run companies, donate money to charities, hospitals, museums, theaters, symphonies, etc. We should be doing everything we can to encourage them to stay here. Most importantly, I think

people will want to switch to a pay as you go system with no surprises on April 15th each year, no auditors chasing them up to 4 years after the tax return was filed, or going through their garbage cans to locate receipts and no tax collectors chasing them for up to 30 years to collect on tax liens.

31) What is so unfair with the current PIT?

A: Currently, 83% of all PIT is paid by those with an AGI of 100,000 or more and 91.3% of the PIT is paid by households with an AGI of \$70,000 or more. The top 1% of returns accounted for 47.5% of all tax liability. The top 5% paid 67.9% of all tax.

32) How likely is it that California eventually switches to a Flat Tax system?

A: In my opinion, the citizens of California are looking for a new idea and a simpler way of collecting the tax revenue. Any new tax collection system must be less complicated, less intrusive, must promote savings, promote hard work and make jobs more secure. Furthermore, I believe that Californian's are tired of tax cheats, drug dealers, undocumented workers and the like who intentionally do not pay their fair share of taxes. We all want a system that is fair, and The Flat Tax Initiative accomplishes all of these things.

33) Explain why the sales tax rate is much lower in the initiative than in actuality?

*A: The current state and local tax sales and use tax rates are contained in no fewer than ten different statutes. The Flat Tax requires only a change in the **state tax rate** and not the local district, city, or county rates. The amendment language uses the fewest words possible using the existing statutes that have been enacted by our Legislature and signed into law. Since no change is made to the local tax rates, the rate reflected in the initiative only relates to the state tax rate. You must add the local rate to the state rate to compute the total sales and use tax rate that will be applicable to your purchases of tangible personal property.*

34) What if the initiative is not successful this year? Will you try again?

A: Yes; but, the language may change.

35) Do you have any other initiatives planned?

A: Yes; many more. For instance, I believe that we need to combine the BOE, FTB, EDD and tax functions of the SCO into a single tax agency.

36) What do you think it will cost to get this on the ballot and actually win on election day?

A: I anticipate that it will take roughly \$1,000,000 to \$2,000,000 to qualify the initiative for the ballot and another \$10,000,000 to \$20,000,000 in advertising to make Californians aware of the provisions and their impact.

37) How can someone volunteer to support the Flat Tax Initiative?

A: You can call, email or fax us with your name, address and telephone number and sign up as a volunteer to gather signatures, lend support, assist with publicity, organize parties to get the word out, act as a county chairperson or just contribute funds to the effort once we form the "California Flat Tax Initiative Committee."