STATE OF CALIFORNIA

COMMISSION ON THE 21st CENTURY ECONOMY

STATE OF CALIFORNIA

REVENUE & TAXATION

FUNDAMENTAL TAX ALTERNATIVES
Part Three

PUBLIC MEETING

Thursday, July 16, 2009
1:00 p.m. – 4:55 p.m.

University of California, San Francisco
Mission Bay Conference Center
William J. Rutter Community Center
Fisher Banquet Room
1675 Owens Street
San Francisco, California

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A P P E A R A N C E S

COMMISSION ON THE 21ST CENTURY ECONOMY

Commissioners Present

GERRY PARSKY
Commission Chair
Aurora Capital Group

RUBEN BARRALES
President/CEO
San Diego Regional Chamber of Commerce

MICHAEL BOSKIN
Professor
Stanford University

JOHN COGAN
Professor
Stanford University

EDWARD DE LA ROSA
Founder and President
Edward J. De La Rosa & Company, Inc.

CHRISTOPHER EDLEY, JR.
Dean/Professor of Law
Boalt Hall School of Law

GEORGE HALVORSON
Chairman/CEO
Kaiser Foundation

WILLIAM HAUCK
Trustee, California State University
Director
Blue Shield of California & Blue Shield Foundation

JENNIFER ITO
Research, Training, Policy Director
SCOPE

FRED KEELEY
Treasurer, County of Santa Cruz
Professor, San José State University

A P P E A R A N C E S

COMMISSION ON THE 21ST CENTURY ECONOMY

Commissioners Present
continued

MONICA LOZANO
Publisher/CEO
La Opinión

REBECCA MORGAN
President
Morgan Family Foundation

RICHARD POMP
Alva P. Loiselle Professor of Law
University of Connecticut

CURT PRINGLE
Mayor
City of Anaheim

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COTCE Staff Present

MARK IBELE
Commission Staff Director
Board of Equalization

ASHLEY SNEE GIOVANNETTONE

ANTONIO LOCKETT

JESSICA MAR

MICHELLE QUINN
Staff Writer

PHIL SPILBERG
Chief, Financial Research
Department of Finance

MARGIE RAMIREZ WALKER

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A P P E A R A N C E S

Public Testimony

MARY BERGAN
Past President
California Federation of Teachers

RONALD COHEN, CPA
Greenstein, Rogoff, Olsen & Co.

LENNY GOLDBERG
California Tax Reform Association

DOUG HALL

JAMES HALL
Senior Legislature

ANNE HENDERSON
League of Women Voters of California

JEAN ROSS
Executive Director
California Budget Project

WILLIAM SPILLANE
Americans for Fair Taxation

JAMES STEVENS
Air Transport Association

KHORI WHITAKER

ELLEN WU
Executive Director
California Pan-Ethnic Health Network

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A P P E A R A N C E S

Continued

Franchise Tax Board

ANDREA CHANG
Multistate Taxation Bureau
Legal Division
Franchise Tax Board

CARL JOSEPH
Director
Multistate Taxation Bureau
Legal Division
Franchise Tax Board

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Table of Contents

Table of Contents

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BE IT REMEMBERED that on Thursday, July 16, 2009, commencing at the hour of 1:04 p.m., at the University of California, San Francisco, Mission Bay Conference Center, William J. Rutter Community Center, Fisher Banquet Room, 1675 Owens Street, San Francisco, California, before me, DANIEL P. FELDHAUS, CSR 6949, RDR, CRR, in the state of California, the following proceedings were held:

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CHAIR PARSKY: I want to welcome everyone to a meeting of the Commission on the 21st Century Economy. Not all commissioners are here yet, but I want to get us started so that we can try to efficiently have this meeting run until about four o’clock.

And so I think what we’ll do is to start the public comment period for those of you in this meeting. This isn’t a meeting of the Board of Regents of the University of California. That was in another part. They have many of their own issues, all of which I’m familiar with.

But I think what we’ll do is, we’ll start with the public comment, and then I’ll make some introductory comments, and we’ll go right into our presentation and see if I can help frame where we’re going to try to go with respect to this meeting.

And given the time constraints, we'll welcome all presentations in writing for the record. But we'll try to limit the comment period to about a minute. And as I said, we will consider all the materials. But in order -- we don't have a lot of time for this meeting, and so let's see if we can't do that.

COMMISSIONER PRINGLE: Is that a minute apiece, or --

CHAIR PARSKY: We'll try to give everyone a minute.

First, James Stevens.

MR. STEVENS: Good afternoon, Chairman Parsky and Members of the 21st Century Commission on the Economy. I'm Jim Stevens, representing the Air Transport Association, whose members provide over 90 percent of the domestic passenger and cargo air service in this nation.

Joining today are Melinda Yee Franklin from United Airlines and José Luis Sanchez from Southwest Airlines.

We are here today to underscore our opposition to a proposal to introduce a carbon tax or a fuels tax in California.

Last month, Jim May, ATA's president and CEO, sent a letter to Chairman Parsky and the Commission stating our opposition very clearly.

We believe that the tax proposals are estimated to cost the air carriers in excess of an additional $500 million a year, at a time when this industry can ill afford it. Our members reported losses over $55 billion in the last eight years, and additional losses are forecast for this year.

Today, fuel is the airline's largest cost center. We have every incentive to reduce our fuel burn and emissions; and we have done so year after year. The size of our fuel bill often means the difference between profitability and loss in any given year. The carbon or fuel tax will divert millions from our industry that we would otherwise use to continue our purchase of efficient emission aircraft and engines and other engines.

If I may remind you, commercial aviation is vital to California's economy, supporting both tourism as well as the state's residents and businesses. We generate over $186 billion annually in economic activity in this state, and are ultimately responsible for 1.5 million jobs.

The tax would jeopardize our contribution to California's economic growth. California's sales tax this year and the effects of last year's fuel increase have already forced a 16.5 percent decrease in scheduled air service in this state. Imposing new taxes would not reverse this trend.

Finally, commercial aviation is a global industry. The International Civil Aviation Organization is meeting later this year to set aircraft emission standards. That is the appropriate place for such regulation, not the individual 50 states.

For those reasons, the effect of airline modernization, the impact on California's economy, and the global scope of the industry, we oppose the carbon or jet-fuel tax proposal and ask you to reject it.

Thank you very much.

CHAIR PARSKY: Thank you very much.

Next, James Hall.

JAMES HALL: Since we are limited to one minute, in your packet is what we really are going to talk about here.

The interaction between property taxes, capital gains, and the step-up in basis are locking people into their homes. There are over two million homeowners over the age of 60 in the state of California, and that will grow on a continuing basis.

Also, as a result of these restrictions, there are other things that are keeping people in their homes, namely, the reverse mortgages are now a new thing called "equity key" where they want to take part of the appreciation of your home.

And I'm suggesting here to you that capital gains can be modified. In 1997, the Tax Relief Act, a Congressman from Ohio changed and increased the exemption to $500,000. And there is a lot of research done by a Federal Reserve Board member that proved that anything over $500,000 in and around the Boston area was a great reduction in the selling of the property.

[Bell chimed]

JAMES HALL: Is that the end of it?

COMMISSIONER EDLEY: Sorry.

CHAIR PARSKY: The Dean of the Boalt Law School has been asked to keep the chimes going here.

JAMES HALL: Okay, thank you.

CHAIR PARSKY: Please submit the entire piece in writing.

Next is Ellen Wu.

MS. WU: Hello, I'm the executive director of the California Pan-Ethnic Health Network, and I'm here to talk about the implications of the proposals on our community's health.

The wealth and income chasm between the rich and the poor continues to grow. Over the last 25 years, the income of the top earners increased 81 percent, while wages for those low-end of the pay scale have stagnated.

This is especially true for communities of color. The median household for African-Americans, American Indians, Alaska Natives, and Latinos are roughly two-thirds of the median income of whites in California.

And the health consequences of this widening rich-poor gap and rising poverty are apparent. In 1980, the U.S. ranked 14th in the world for life expectancy. In 2007, we ranked 29th. And communities of color are disproportionately impacted by obesity, diabetes, and asthma.

Income effects health at every age, from the beginning of life to adulthood and old age.

Wealth is tied to neighborhood quality, work conditions, food security, access to medical care, and the availability of buffers against stress. Poor adults are three times likely to have chronic disease that limits their activity, twice as likely to have diabetes, and are nearly 50 percent likely to die of heart disease.

In addition, studies have found that life expectancy conforms to a pattern called “social gradient,” in which the more income and wealth people have, the more likely they are to live longer, while people with less income and wealth can expect to live comparatively shorter lives.

For example, people who live in West Oakland can expect to live on average ten years less than those who live in Berkeley Hills.

The bottom line is that these proposals do not make economic, moral, or practical sense. The prosperity of our state and health of our children relies on a progressive tax system that shrinks rather than grows the inequalities between the rich and the poor.

Thank you.

CHAIR PARSKY: Thank you very much.

Jean Ross.

MS. ROSS: Hello. I'm Jean Ross, executive director of the California Budget Project. And I'm mindful of the one-minute limit. I'll make several points, many of which harken back to the testimony that I gave to you earlier this year.

First, in terms of process. I think it would be extremely inappropriate for the Commission to act on formal recommendations today given the paucity of information that's been available to the public. And I think this is somewhat of an awkward situation where we are being asked to talk about proposals prior to the Commission receiving a full briefing from your staff and having discussion. And I think it would be appropriate to have more time for the public to reflect on that.

Second, I think any of the proposals -- or the proposals that have been posted on the Web site as staff proposals as well as some of the discussion among commissioners that would reduce taxes -- personal income taxes on high-income Californians while raising taxes on lower-income households would only serve to widen, as Ms. Wu discussed, an already very wide income gap between high- and middle-income Californians.

I don’t think that is in the best interest of the long-term future of California or California’s economic future.

And thirdly, I think -- and I think some of the modeling that was done for your last meeting is somewhat misleading. I think the proposed changes would have a very detrimental impact on the growth of state tax revenues. And my understanding is that the Commission staff used a flat percentage growth assumption across the income distribution.

Your proposals would lower tax rates on those Californians whose incomes have posted the strongest growth rates consistently over the past several decades, while raising taxes on those Californians who have had no to little growth in their incomes. And so what you’re really doing, by shifting, again, where your tax revenues come, is lowering the growth rate for a revenue source which is over half of California’s general fund tax revenues, which would widen our budget gaps going forward through that shift. And I think, again, given California's --

[Bell chimed]

MS. ROSS: Got the "dong" here -- chronic budget problems, that would only serve to make our problems worse and not better.

Thank you.

CHAIR PARSKY: Thank you very much.

William Spillane.

MR. SPILLANE: Chairman Parsky and Commissioners. We are distributing a letter that you have in your folders, but it's buried in there some place, and I'll be referring to very briefly because I think it answers some of your questions.

California, as you know, is in a race with only New Jersey and New York to the bottom of the barrel as far as business friendliness. We have to reverse that and make it closer to Number 1.

So you have two challenges: You've got the business challenge and then you've got the general-public challenge.

A national sales tax or a retail sales tax is the best, simplest way to do that. You may say that it's regressive. It's not if you add a prebate.

Allow me a few comments.

In the testimony here before you, James Hines, a Michigan economist and NBER member, says -- his comment is: Make the fair tax more logical. And that's on page 2.

Page 3, Chairman Parsky and the Governor lamented the high velocity of revenue in and out. And you'll see that the personal consumption expenditure versus the adjusted gross income is dramatically different.

A consumption tax is much more stable than an income by far. Quarterly changes in revenues from the Rockefeller Institute shows that as well. A sales tax is the way to go.

But not the business net-receipts tax. It's a value-added tax. The business net-receipts tax is a value-added tax. The compliance costs of that are much higher than a retail consumption tax. The compliance costs are much higher. The NRT eliminates pyramiding with the tax, but then we put the sales tax on top of it at the cash register. That's pyramiding to the taxpayer. And it isn't necessary. This is not rocket science. It's really not. And Mr. Cohen will demonstrate that in a moment for you.

The NRT, whatever you want to call it, continues the myth that businesses pay taxes when 71 percent will be passed along, 19 percent go to the employees. Not so good. They're California employees. I could go on.

The way to go is a sales tax with a prebate.

[Bell chimed]

MR. SPILLANE: Take a look at page 6, and you'll see that the prebate makes it progressive. And if we do it on a national basis, the incline would be much greater. Take a look at the prebate under our Web site, FairTax.com -- or FairTax.org. Sorry.

Thank you very much.

CHAIR PARSKY: Thank you.

We thank all of the public comment providers for cooperating in terms of time frame.

Kheri Whittaker.

MR. WHITTAKER: Thanks.

Khori Whitaker.

Chairman Parsky, ladies and gentlemen, I was born in Jamaica but grew up here in Southern California in Riverside. And every January, February, March, April, I had an uncle who was a CPA, and he was a mess during these months. And my mother as well was a mess. And I didn't understand what the issue was. All the receipts and all the paperwork and all the documents each and every year-round this time.

In fact, my mother -- we didn't have that much money growing up, and she actually didn't want to earn more. And she would tell me, if I earn more, they're going to take more. And I didn't understand that. Instead, she took those overtime hours as vacation to spend with us instead of earning more money. And it's because the taxes -- and we have both federal and state -- it's not simple; it's too complex. It creates an uncompetitive business environment. And then also as we're realizing now with the issues in California, with our revenues, it's not stable.

I urge you all on the Commission to be radical. And by "radical," I mean, get to the root of the issue. And the root of the issue is the stability, the competitive nature of the tax -- any tax program that you may recommend.

If you look over the course of the last 20 years, the income that the state has been getting from sales taxes have been relatively even over the course of time, whereas income tax, lots of highs and lots of lows. California does well in the booms and the busts. It seems like -- in the booms, rather, not the busts. But in the boom times, we're doing well. It's like we are depending on bubbles here in California for revenue. We can't do that.

So by implementing a sales tax, a fair tax, you are able to get stable consumption over the course of time. And California is going to be able to get the revenues that we need for our programs.

Thank you very much for your time.

CHAIR PARSKY: Thank you very much.

Ronald Cohen.

MR. COHEN: Hello. I'm Ron Cohen. I'm a tax partner with the CPA firm of Greenstein, Rogoff, Olsen & Company here in the Bay Area. We represent about 2,500 clients, several of them well-named billionaires in the area.

I'm here, you may think a little bit oddly, on behalf of the Fair Tax. I sort of consider this my get-out-of-hell card because I spend my career dealing with the complexity and controversy of the tax system. And so I'm here to talk in this one minute -- it's hard to talk about anything in taxes in one minute -- but I'll tell you that the system is -- on the income tax side is built on laws that are hard to pass, hard to write the laws, and the written word is confusing. The taxpayers suffer. Hardly anyone can produce a tax return without software, which I think is egregious and contrary to what the Founding Fathers of the country would ever want.

And then you get into situations with auditors where the Franchise Tax Board is understaffed, underskilled in some of the areas. And the results that come out of the audits are often arbitrary. So it creates an environment -- and I talk to many business people who said, “Can’t I move my company to Singapore and just get out of this,” between the IRS and the FTB and the rules and regulations that go on and on, creating an uncompetitive environment where they have to become best friends with people like me, their tax CPA and their lawyer, to just function, as opposed to functioning and dealing with what they wanted to do, is build good products, create jobs, and build great companies.

So I thank you very much.

CHAIR PARSKY: Thank you.

Lenny Goldberg.

Welcome, Lenny.

MR. GOLDBERG: My name is Lenny Goldberg, California Tax Reform Association.

CHAIR PARSKY: Welcome back.

MR. GOLDBERG: The third time is a charm, I suppose.

Very quickly, on the proposals that are on the table. On the income tax, the most instructive thing we saw was Phil Spilberg’s chart in the March hearing, which demonstrated that the top 1 percent has almost doubled --

you know -- actually did double through the early 1990s to 2000, almost doubled in their share of the income that they have. That will always be so volatile. Volatility has to be seen, and I urge you to see it this way, as a budget issue, not as a tax issue. As long as income is so maldistributed at the very top end, the income tax will be volatile. There is nothing valuable about lowering that rate. It's really about the distribution of income.

We should be taxing economic rents as a matter of first principle. That would be oil in the state of California, that would be investment property in the state of California, which we undertax and have discussed, and appreciate that you had such an extensive discussion on that.

Finally, I think the corporation tax, the elective single sales and the loss carrybacks are both destabilizing of the corporation tax. And in some ways, in terms of their policies, they're an embarrassment to the state of California. And I think those are the kinds of things, along with other tax expenditures, that you can put on the table.

In a positive sense, it is possible to have a series of discrete recommendations. Example: Broaden the sales tax base, lower the rate if you're looking for revenue neutrality.

There are ways -- eliminate those new loopholes in the corporation tax, perhaps look at business property, sales tax on depreciable manufacturing equipment as a trade-off. There are some discrete trade-offs you can make. You should not trade off the progressivity of the system.

COMMISSIONER BOSKIN: May I ask Mr. Goldberg a question?

MR. GOLDBERG: Pardon me?

COMMISSIONER BOSKIN: May I ask Mr. Goldberg a question?

CHAIR PARSKY: Yes.

COMMISSIONER BOSKIN: So you'd be strongly in favor of the state, so long as it got the appropriate revenue from it, getting the maximum it can out of oil and gas in California?

MR. GOLDBERG: The fact that we don't have an oil severance tax is also an embarrassment.

COMMISSIONER BOSKIN: What about if we don't develop it, and we'll never develop it?

MR. GOLDBERG: Excuse me.

COMMISSIONER BOSKIN: That's got to be even worse than a traditional land tax if we never, ever develop oil and gas in the state.

MR. GOLDBERG: The way all severance taxes are structured and the way -- let me just cite Rand. Rand said no effect on production, no effect on price with regard to a severance tax in California.

COMMISSIONER BOSKIN: Well, there has to be an effect on production if you disallow use. You never use it.

MR. GOLDBERG: The actual -- you're not disallowing use. You're getting --

COMMISSIONER BOSKIN: But we refuse, for example, to develop our offshore oil.

MR. GOLDBERG: With regard to in-state oil development --

COMMISSIONER BOSKIN: How is California ever going to benefit from that fixed resource if we never develop --

MR. GOLDBERG: Actually, with regard to offshore, we will get a ton of revenues for that. We do get --

COMMISSIONER BOSKIN: Exactly.

MR. GOLDBERG: We get a ton of revenues on our state lands. What we don't get is any revenue, to speak of, from our private land, and that's where that oil severance would come in. So we do get it from state lands, absolutely.

CHAIR PARSKY: I think this is a very

interesting dialogue back and forth. Maybe it would be --

COMMISSIONER BOSKIN: I strongly endorse this.

CHAIR PARSKY: We'll get to the endorsements.

Thank you very much, Lenny.

Third time, not quite a charm, but close. That's okay.

COMMISSIONER KEELEY: Charming.

CHAIR PARSKY: Yes, as Fred said "charming." That's good.

Mary Bergan is our last public-comment speaker.

MS. BERGAN: Hello, I'm Mary Bergan. I'm past president of the California Federation of Teachers, perhaps one of the few in the room with enough institutional memory to remember a 1976 tax commission that gave us a majority vote on every tax in the state. With that, we still have their wisdom.

I would like to just -- I'm reacting to reports of the Commission's work in the paper. And one point that struck me was that you want to come out with a proposal, however it may end up, that is revenue-neutral.

That is a fool's errand. We are currently disinvesting in education, in all of the things that are going to lead to prosperity.

There is nothing in your charge that says you want to be revenue-neutral. In fact, if you want to deal with the 21st century economy, you need to come up with a progressive proposal that puts more revenue into the state of California. We will never return to a robust public sector unless we have more revenue through fair taxes.

Thank you.

CHAIR PARSKY: Thank you very much.

Thank all -- oh, I'm sorry, I didn't have your name.

MS. HENDERSON: Anne Henderson. I signed the list outside, and apparently I didn't fill out a card.

CHAIR PARSKY: Well, why don't you go ahead? It's okay.

MS. HENDERSON: Anne Henderson --

CHAIR PARSKY: As long as you live with the Dean of the Boalt Law School's clink, it's okay.

MS. HENDERSON: Well, I live in Berkeley. I don't know if that helps.

CHAIR PARSKY: That helps a lot.

MS. HENDERSON: I'm the legislative -- the state and local finance director of the League of Women Voters of California. And we have submitted a letter with some detail. But I would just like to say, we've been studying state and local finance since 1969, and we've been through a number of these exercises before.

We have a position that calls for revenues to be both flexible and sufficient to meet changing needs, and to emphasize equity and fair sharing, including ability to pay. And we're very concerned about the direction we're taking. We don't think stability is in that list of concerns. And we'd like to see the tax base broadened, for instance, with sales taxes and other things.

We're concerned about a number of issues I know you have discussed, such as the property tax, getting the commercial -- the nonresidential, commercial off of -- out of Prop. 13. That doesn't make any sense, even as to competition between California businesses.

And we're also particularly concerned about having -- asking you to look at the question of tax expenditures.

I think the Legislative Analyst in a recent report pointed out that they're not -- they're given out without a real clear estimate of what they're going to produce. Then there are not reports that are put together so you can really value it, whether you're getting what you wanted for the state. You're giving away state money. And we don't give -- we think that really needs to be looked at.

And then the basic idea that you can lower them with a majority vote, but you only have to have two-thirds to raise them.

[Bell chimed]

MS. HENDERSON: We don't see how that makes that tax policy.

Thank you.

CHAIR PARSKY: Thank you very much.

Do we have another?

DOUG HALL: Yes, Chairman Parsky, I'm here with my father, James Hall. We were under the assumption there was three minutes. So I just wanted to read real quickly our final recommendation.

CHAIR PARSKY: Okay.

DOUG HALL: It's very simple. Remove --

THE REPORTER: Can you state your name, please?

DOUG HALL: Yes, Doug Hall, and the blog is JamesHall.WordPress.com.

Remove or drastically reduce capital gains for seniors, age 65, when selling their homes, and allow them to move anywhere in California without raising their property taxes.

This legislation would greatly modify the effects of Prop. 13 without a direct initiative to change Prop. 13. The Tax Relief Act of 1997 increased the capital gain exemption to $250,000, up from $125,000 per person when selling a home.

That's 12 years ago. It needs to be changed to serve as a property tax stimulus here in California and other locations in the U.S.

Currently, a surviving spouse can get a step-up in basis. And then when she's deceased, they both get quite a huge exemption. So many people are basically allowed to get a huge capital gains break. We're asking that couples, senior couples are allowed to get that same break.

Thank you.

CHAIR PARSKY: Thank you very much.

I think we have now been responsive to all members of the public that wish to make comment.

Before we move into our discussion for today, I'd just like to make a few general comments.

One of the public speakers said that she was hearing about the Commission from the newspapers. With all due respect to the media, I'm not quite sure that that's the most accurate source for where the Commission is or where the Commission would like to go.

So I think we, as a commission, are sitting at a unique point in history for California. I think we have an opportunity to demonstrate to the public that it is possible for Californians, all of whom have a sincere interest in the future of California, with varying ideological or varying points of view, generally, to come together, and to put forward in the tax area recommendations that demonstrate that you can come together.

We were not formed to try to solve the current budget issue. We also didn't come together as an elected body -- people in an elected body. We came together with a focus on the system of taxation in California that hasn't been reformed or brought of age for a number of years.

And I would just say from my own perspective, everyone on this commission -- every single member on this commission -- has dedicated himself or herself to the common goal of trying to come together, for which I'm very grateful. And there still remains a lot of work to be done. But I remain quite optimistic because of the intelligence level and the commitment on the part of each member of this commission.

And it was important when we formed the Commission that we had people with different points of view, points of view that reflected the difference in California. So that's not something that we should shy away from.

But if we can send a message to the elected politicians in Sacramento that people as diverse as are around here can come together on one of the most complicated and difficult subjects to deal with, but can come together hopefully unanimously, it will set an example.

And I hope all the commissioners and the public recognize that the Governor and the legislative leaders have assured us that our recommendations will be voted on by the Legislature, up or down as a package. That's a unique commitment if we can come together with a set of recommendations unanimously. We may not. That's not to say that it's a foregone conclusion; but it's something that I know everyone on this commission is working toward.

With that introduction, I'd also like to remind everyone -- and I've done this at every hearing -- of the goals that were set out for us as we were looking at making changes. In no particular order and with no goal having any more weight than the other, but they included:

Helping to establish a 21st century tax structure that fits within the state's 21st century economy.

Second, helping to stabilize state revenues and reduce volatility.

Third, helping promote the long-term economic prosperity of the state and its citizens.

Fourth, helping improve the ability to successfully compete with other states for jobs and investments.

Fifth, reflecting principles of sound tax policy, including -- not limited to, but including -- simplicity, competitiveness, efficiency, predictability, stability, and ease of compliance and administration.

And finally -- and as I said, not any one more important than the other -- but finally, ensure that the tax structure that you're recommending is fair and equitable.

Now, those are, I think, very worthy goals. We're going to try, as we proceed forward, to look at recommendations, to make sure that we continually remind ourselves, and that we're able to come up and say that we have attempted to pass all of the recommendations through the prism of those goals.

Now, before we get into today's discussion, and with that kind of background, I'd like to ask the commissioners to consider a structure for recommendations. I have provided the commissioners, and it will be made available to the public, so that we begin to refine the approach that we may take without any foregone conclusion as to what the recommendations would be.

I'm sorry, one other thing I would say. There have been a number of suggestions made in all good faith by a number of commissioners about specific recommendations that could be made. Each and every one of those recommendations is contained in the binders that are distributed here, have been posted on the Web site, and available to the public. And I would urge everyone to read those because they reflect, for those that sought to propose specific things, legitimate work individually done, or it could have been collectively. But they're all a matter of record and they're all in these binders and on our Web site.

Now, with that background, let me say that my suggestion -- and I'd like the commissioners to think about this during the course of the discussion, and then we'll come back and see if the commissioners would agree to this structure.

We would divide our recommendations into two sections but with kind of one overriding principle.

Section 1 would be recommendations of statutory tax-law changes, revenue-related, that can be acted on by the State Legislature immediately, and hopefully -- that's my word -- but hopefully endorsed unanimously by the commissioners. That would be Section 1.

Section 2 would be recommendations of tax-law changes, revenue-related, that can be enacted by changes in the State Constitution or by the state initiative process, and hopefully are endorsed unanimously by the commissioners.

Two guiding principles in both: That they are revenue-related, and my hope that they will be unanimous. I would hate to put the Commission into a situation where one commissioner could basically stop recommendations from proceeding. So I'd like to operate, if we would, under the assumption that we're going to try our best to be unanimous.

In addition, the Commission -- hopefully unanimously -- can identify or will identify areas of reform, non-revenue-related, that need to be considered by others outside the context of the Commission, to achieve comprehensive fiscal reform. It's a recognition that the work of this commission, albeit revenue-oriented, doesn't solve all of the needs for reform. And there are other organizations -- legitimate organizations hard at work at addressing other elements of reform.

Without necessarily taking a position on those efforts, we have every ability -- and I would urge that we consider identifying the areas of such reform that ought to be considered, evaluated, staffed, analyzed by others.

So that's the framework that I hope the

commissioners will consider during the course of this meeting. And then we'll come back to it at the end and see if we have the concurrence of everyone to proceed on that basis and over what time frame.

COMMISSIONER POMP: A point of clarification. This defective mike, I assume -- you have to hold it this time? Oh, my goodness.

CHAIR PARSKY: If your finger gets tired, that's the idea to stop.

COMMISSIONER POMP: That, or if Chris tones me first.

By the nontax, I just want to make it clear, tax administration I would include within good tax policy.

So you're thinking of spending limits and things like that?

CHAIR PARSKY: I am.

COMMISSIONER POMP: Okay, I think that's sensible.

Thank you.

CHAIR PARSKY: Thank you.

Okay, we'll stop on "sensible." That's a good way to stop.

Let's proceed ahead.

Any other comments of any kind any commissioner would like to make?

(No response)

CHAIR PARSKY: Okay, then I'll call on the staff now.

We have identified at the last meeting, and they've been posted on the Web site, two possible packages, packages of reform, that this commission could -- or wanted to consider further. And I will just say by way of introduction that one of the two packages contains a new form of tax: the business net-receipts tax. And so we've had quite a lot of discussion in the past about it.

As the staff reviews Package 1, the staff has done an extensive amount of additional work on a possible business net-receipts tax. We have posted on the Web site a summary of additional description of this tax. I think all of us recognize the risks involved in putting forward any new piece of legislation, let alone a new tax. And so a number of commissioners have indicated concern about how we will go about doing it, how we can get further input.

And I'll have some comments about that if we, as a commission, decide to proceed with analysis of that possible avenue.

But I'll let the staff now walk everyone through each of the two packages. We'll open up for comments, questions, whatever. We'll spend, as I said, quite a bit of time on the business net-receipts tax, then we'll come back around and see if, at the end of this session, there is a meeting of the minds as to how we might proceed.

Thank you.

MR. IBELE: Thank you, Mr. Chair.

We're going to split this into two sections. I'll do the first section with describing the two packages that staff was asked to analyze; and my colleague, Phil Spilberg, will take primary responsibility for the discussion of the business net-receipts tax, with some assistance from the Franchise Tax Board.

We've been asked to evaluate a couple of different packages, as the Chair indicated, that are posted on the Web site. Before we do that, I wanted to revisit a couple of issues that we've discussed in the past. But I thought we should refresh ourselves and keep these in mind as we move forward.

This is a chart you've seen before. It's a familiar slide. But it's important for several reasons. A couple that I want to mention is that we've obviously moved dramatically in the structure of the tax system in the last half a century from about 60 percent reliance on the sales and use tax, in the 1950s, to almost 55 percent reliance on the personal income tax. That is, we have moved from a tax which is largely regressive in the minds of most economists, to one which is progressive across much of the income spectrum. This has had significant impacts on distribution, as the Commission has discussed, as well as the change in the volatility of the state's tax system.

Also a familiar chart -- this is from Phil's presentation at the first meeting in San Diego, indicating how the State's tax portfolio of volatility has increased dramatically. This is somewhat due to the high rates in the personal income tax; but more importantly, it's a reflection of how much more we rely on a personal income tax, as well as the types of income that we now experience in our economy and which are subject to the personal income tax. And that's really what's driving the volatility up, going from the statistic we're using most frequently as the coefficient of variation, which is 0.7 in the 1969 to 1978 period, to almost 1.66 during the 1999-2008 period. A dramatic increase.

Before -- I need another hand here. Really, I'd like to have a third.

Before we go through the tax packages, I thought it would be wise to go through the criteria of evaluation that we've been using. And this is not meant to be exhaustive. It's ideas that we've sort of picked up on from the Commission's discussion, those that we think are worthy of discussion and probably the most important.

The first being economic growth, the potential for a tax program, a tax structure to encourage jobs and investment. And in this area, we look at tax rates, we look at the taxation of business inputs and their respect to whether those are taxed or not.

Moving from an income to a consumption base and also treating businesses equivalently. Service businesses, goods businesses, and so forth. That's the first on our list.

Revenue volatility: We have a very straightforward metric that we've been using for this, and we have estimated this for the different two packages that we're going to be discussing today.

Fairness: You know, we obviously defer to the Commission's wisdom in what is a fair tax. Distribution of the tax burden is certainly one of those considerations. Another one that's not listed, but we've discussed before, is how many people, how many residents of the state contribute to the tax system. That's also an issue of that fairness for many people.

Lastly, at least on this -- again, this is not meant to be complete, but some of those that we thought were most important -- simplicity. To the extent that the new system is more easy to comply with and more easy to administer, that would obviously be a plus for that particular type of structure.

At the Commission's last meeting, we were asked to examine not only those taxes which we were considering changing, which the Commission was looking at changing -- the personal income tax, the sales and use tax, the corporation tax -- but also incorporate all the state revenues in our analysis. So we have included, when we do our distributional and revenue analysis, we have included the personal income tax, sales and use taxes -- at the state level, not just general fund but also special fund -- the corporation tax, motor-vehicle taxes, fuels taxes, insurance taxes, other excise taxes.

And one thing that I should have put on here and neglected to was, as part of the analysis, obviously, any new proposed or contemplated business net-receipts tax. So those would all be included in the analysis.

These are the -- this is the period of time over which we did our analysis --

COMMISSIONER KEELEY: Mr. Chairman, if I could ask a quick question?

CHAIR PARSKY: Sure.

COMMISSIONER KEELEY: Thank you.

Mr. Ibele, quickly, on your previous slide about the major state revenues, the property tax is not on there because?

MR. IBELE: The property tax we considered a local tax, the property tax is raised and it's distributed to the county. And we were given instructions to include state taxes. So property tax is not included, nor is the local portion of sales tax.

COMMISSIONER KEELEY: Sales tax?

MR. IBELE: Bradley-Burns special district taxes, et cetera, et cetera.

COMMISSIONER KEELEY: And out of an interest in characterizing taxes -- you know, when I was in the State Legislature, the property tax, of course, we said, "Well, that's a -- that is a state tax -- rather, a local tax, because it's collected and tax bills are sent out at the local level."

I think you might get -- now that I'm back in local government as an elected county treasurer, I have a different view, of course, and that is, where you stand depends on where you sit. Where I sit now, it sure has the look and feel of something that the locals, in fact, collect, and the state makes the decisions with regard to the allocation.

So I think there is a -- and it may be a definitional issue here that's worthy of some examination, even though it's not, strictly speaking, a state revenue in the same way the PIT is or the state share of the sales tax. I think there's a reasonable argument that the property tax is, at best, a "tweener" that could be on that list, for that reason, because of the State's tremendous involvement in the property tax following Prop. 13 and the allocation thereof.

Thank you very much.

MR. IBELE: I think that is a reasonable interpretation. I've made that argument myself on occasion. But we haven't included --

CHAIR PARSKY: I asked you not to deal with "tweeners." But that's okay, don't worry about that.

MR. IBELE: And the distinction is, it's not an absolute right or wrong. I think on some of the local sales taxes, the Bradley-Burns, which used to be 1.25 percent and is now 1.0 percent, is universal across the state, it's statewide. However, counties do have the option not to participate in that. So we did not include the Bradley-Burns. But you could make an argument on the property tax. But, in any event, it's not included.

These are the revenues from those taxes over our five-year study period. The five-year total for those total revenues is at the bottom, $604 billion.

As we noted in our last meeting, they raised the same amount of revenue but, obviously, the pattern is somewhat different. So we did our distributional analysis, and our volatility -- I'm sorry, not our volatility but some of our other analyses using that 2014 period, and adjust it for the slight difference in revenues for that one year.

COMMISSIONER MORGAN: Mr. Chairman?

CHAIR PARSKY: Yes, go ahead, Becky.

COMMISSIONER MORGAN: What was the basis for doing these projections?

COMMISSIONER COGAN: Assumptions.

COMMISSIONER MORGAN: The assumptions involved. Is this a straight line, or is there some opinion involved with this? How do you get to these future revenue figures? That's number one.

And number two, Mr. Chairman, people even today talked about revenue-neutrality, and that's not in our order. And I'm wondering if that keeps coming up partly because, to get passed by the Legislature by majority vote, we can't be raising taxes with a majority vote. So those are two questions.

CHAIR PARSKY: Well, let's deal with the assumptions first.

MR. IBELE: Yes, the assumptions are based in 2012 off the Department of Finance's economic projections.

And using those, we built in assumptions regarding the different income components -- the sales-tax base and consumer purchases, as well as the other components. So it was grounded in the economic forecast; and then the tax forecast themselves were based on that for different components, using different assumptions.

COMMISSIONER MORGAN: Do you have any information you could share with commissioners about the history of projections by the Department of Finance?

MR. IBELE: We could certainly share that, and we can share the assumptions which we went through this to some degree in our last meeting with the Commission as well.

COMMISSIONER HAUCK: Mr. Chairman?

CHAIR PARSKY: Yes, Bill?

COMMISSIONER HAUCK: Mark --

CHAIR PARSKY: Unfortunately, you've got to keep your finger on there.

COMMISSIONER HAUCK: Yes.

Do these numbers include the business net-receipts tax?

MR. IBELE: These numbers would include -- I should have been more clear. The current law is our basic system now.

COMMISSIONER HAUCK: This is current law? These numbers are off of current law?

MR. IBELE: The heading, the second column over, that says "Current," is current law.

COMMISSIONER HAUCK: Okay, and then --

MR. IBELE: And then "Package 1" is a different type of tax structure, which includes the business net-receipts tax. And Package 2 --

COMMISSIONER HAUCK: How -- okay, we'll stop there.

In light of the fact that the definition of the business net-receipts tax was posted a couple of days ago on our Web site, how were you able to project income from a tax that doesn't exist today and hadn't been defined until, at least for us, until two days ago?

MR. IBELE: I'm going to defer to Phil on this one.

MR. SPILBERG: Sir, let me try.

The way that the estimates were done is to first -- with respect to the business net-receipts tax, is consider that what it is, it's a value-added tax. And the way that it's calculated is for in-state firms, that is basically value-added within California. And for multistate firms is basically they're national value-added, which is apportioned to California.

We had provided to Ernst & Young our economic forecast -- which, by the way, was put together by the State Economist -- and assumed -- let me just sort of backtrack a little bit to the economic forecast.

The economic forecast that we used is -- first of all, it's a common forecast for all estimates, and it sort of assumes that we're starting off at a very low level of the economy in 2012. And then by the time we reach 2016, we are close to full employment. So basically, what we wanted to do was look over an economic cycle and establish revenue-neutrality over that cycle.

So having that economic forecast and then making those general assumptions that what we're going to be taxing is, in essence, value-added, Ernst & Young provided to us with the estimates of the amount of revenue that would be coming from the business net-receipts tax.

COMMISSIONER HAUCK: Can I --

CHAIR PARSKY: Yes, go ahead, Bill.

COMMISSIONER HAUCK: They built -- this is a question -- they built a set of assumptions in order for them to make those projections?

MR. SPILBERG: With respect to the model that they used, we have a representative of Ernst & Young over here, so he can speak more directly to your question. But it wasn't a model that they specifically built for this purpose. They had already a model that they had previously developed. And they calibrated that model to the California economy. And, again, along with our economic growth assumptions, they made the calculations.

COMMISSIONER HAUCK: Mr. Chairman, I would suggest that if we are going to pursue this possibility, that the Commission ought to have every piece of information we possibly can have about that model so that it can be subjected to other scrutiny, and let other folks react to it to determine whether the forecasted revenue and the impacts of it are as they apparently are in this model that is more generic.

CHAIR PARSKY: I should have probably elaborated a little bit on my initial commentary.

If it's the will of this Commission at the end of this meeting to continue to explore this new tax, we have not had enough of a process for anyone to be comfortable that we could propose or recommend this tax. And so I'd like to come back to that once we have at least had concurrence that it's worth continuing to pursue. If it is, then I have some suggestions about how we might do it to be responsive to your point.

John?

COMMISSIONER COGAN: Just to clarify, Phil. In constructing these estimates, you had to make a lot of detailed, kind of policy choices to construct the net-receipts tax, how to treat outside-of-state sales, how to deal with transition issues, and so forth.

So maybe when you get to describing the net-receipts tax later on in your presentation, you could walk us through what big decisions you -- or big -- yes, I guess we'll call them "decisions" for now that you all made, just to construct a number. But I think what's got Bill a little bit concerned and probably some other commissioners is, we've got numbers and we don't have a policy; but, more importantly, it's the Commission that will decide the policy down the road.

MR. IBELE: Commissioner --

COMMISSIONER COGAN: And we want to make sure we understand what policy generated the budget-neutral numbers that you got.

MR. IBELE: Commissioner Cogan, that's a very good point. We did make some, we'll call them tentative choices, in terms of coming up with the revenue analysis that we've done so far. And those would all be obviously in the Commission's purview, to make the decision. And we'd highlight those for you as we go through.

COMMISSIONER EDLEY: That's what you posted just the other day; wasn't it?

MR. IBELE: Yes, that's correct. That's correct.

MR. SPILBERG: Let me just also add to that, as far as the revenue estimates that you're seeing in front of you, they do not -- they're somewhat generic in the sense. They did not specifically take into account transition issues, they do not specifically take into account the kind of behavioral changes that one would build into a proposal that goes into effect on a particular year and would be scored by, for example, the Franchise Tax Board.

This is -- this point is our estimates, which do not include any of that -- any of these considerations. They are totally static.

COMMISSIONER MORGAN: May I have my second question answered, please, relative to why the issue of revenue-neutrality keeps coming up and how we're going to deal with that? And if we look out to 2016, I don't see this taking into account population growth, inflation growth, and full employment, which was just mentioned.

How do you come -- why do we come up with the same amount over a five-year period? Is that a net present value or how are we supposed to interpret this? Because certainly, with more population, inflation, et cetera, there will be growth and the need for more revenues.

MR. SPILBERG: The estimates you see in the table are actually cash-flow estimates. They do take into account population growth, they do take into account inflation. They're basically the consequence of an economic forecast that we received from the State Economist that take into account the economic growth that you would expect through 2012, and then economic growth that would lead you toward full employment by 2016.

CHAIR PARSKY: Okay, Mark?

COMMISSIONER POMP: Mr. Chair, I have a quick question.

What rate was used in making the projection?

MR. SPILBERG: For the net business receipts tax?

COMMISSIONER POMP: Yes.

MR. IBELE: For Package 1, the rate is about 3.3 percent.

COMMISSIONER POMP: Mr. Chair, let me just endorse your earlier comments. I mean, having done some revenue estimation in an earlier lifetime, you put two of us in a room, you get three different estimates. And they can differ widely. And I would encourage us, if we go down that path, that these numbers be carefully vetted once we have decided on policy decisions, rates, et cetera.

COMMISSIONER EDLEY: It doesn't matter how many people you put in the room; the issue is, how many of them do you let out.

CHAIR PARSKY: Well, at this stage, we have 14. And I'm not sure the room is quite big enough for everyone. So we're working on the size of the room.

No, again, let me make sure it's understood. The staff, with a lot of outside help, has taken on a rather enormous task, because it was the will, if you would, of the Commission to explore the possibility of broadening the tax base in California through a business net-receipts tax.

That may not be the ultimate decision of this Commission; but in the spirit of really trying to look at major tax reform, I think it's a worthwhile exercise. But the exercise, in one sense, has just begun. Before we would be in a position to concretely recommend the exact nature of such a tax, we would need more time. And we would need a much more detailed process. And there may be differences of opinion in terms of estimating; but the public needs to be aware, fully, of the possibilities, experts need to be engaged; the business community and labor need to be involved. But I do think that in terms of significant reform, it's a worthwhile exercise for this body.

Now, as I said, we will come back at the end of this session and see if we want to continue this process, which would incorporate significantly more work.

Yes, Curt?

COMMISSIONER PRINGLE: If I could.

I mean, it's interesting to question what the projections are. We certainly need to know some of the assumptions. But in terms of modeling, we are, in this sense, being comparative of various systems. And the assumptions are the same in each of those comparisons.

If our job is to figure out if we can find any entity that can be precise, and hit it right on the head in terms of what those assumptions are, the answer is no, we're not going to be precise.

For example, I believe Finance's estimate for the personal income tax, when the budget was signed for the 2008-09 budget, was 19 percent off as to what the personal income tax actually raised in that year.

Is that because Finance was wrong in their assumptions? Yes. But, in fact, it was because the economy changed and circumstances affected it.

But if we were comparing package to package at that time, we'd be using the same assumptions. So, you know, yes, the unknown here is the business net receipts; but everything else is based upon a comparative analysis between the two packages, not between -- are we going to hit it dead-on in terms of what will each package raise.

I mean, I think part of our charge, and under -- I believe it is part of our charge because both -- all of the entities that selected the members of this commission talked about revenue-neutrality being a part of this discussion, people can raise revenues or lower revenues by adjusting the rates through a legislative process. But our job wasn't to focus on how to get a package that raised a lot more money or a lot less money; but ours was at least to present a package that is somewhat equal, and then let the legislative branch, through the negotiations with the executive, determine if they want to raise more money or not. So I'm not afraid of the concept of revenue-neutrality. But in this context, this is a comparative model between the packages, and that's what I'd like to see.

So I can understand that, and I can see how the business net-receipts tax and the other modifications in each package will play. And even though I'm a bit concerned about seeing a chart that talks about revenue volatility, and that is one of the expressed charges within the Executive Order and, in fact, it seems to me that we haven't diminished much of the revenue volatility, or as much as we probably could because each package is still very reliant upon the personal income tax.

But those are my thoughts, Mr. Chairman.

CHAIR PARSKY: Thank you.

Why don't you proceed ahead, Mark?

MR. IBELE: Okay.

Speaking of revenue volatility, let me give away part of the story here. This is an analysis of the three -- the two packages and current law. The period of time that we analyzed current law is slightly different than in the earlier chart. It has a coefficient of variation of 1.48.

Package 1, large reduction in volatility. Commissioner Pringle is correct. I should mention that each of the -- under current law, Package 1 and Package 2, they all raise approximately the same amount from the personal income tax, around $55 billion to $56 billion.

The reason for the big drop in volatility in Package 1 is because of the business net-receipts tax. And I'll describe the various packages. But in this particular package, you're replacing a sales and use tax, a large component of it, and the corporation income tax. And the business net-receipts tax is a very stable source of income.

And in Package 2 --

COMMISSIONER BOSKIN: So -- one second. What is not just the economic assumptions, what is the assumption about the distribution of income and the distribution -- the functional and size distribution of income going forward? Because, clearly, that’s been a big part of why the state’s revenue has become so much more volatile from your earlier materials, right, that we rely on. We’ve had a much more concentrated -- income tax has become a much larger fraction of what’s going on, and it relies on volatile income sources. So aside from we’re going to still be in a slack economy in 2012 and we’ll get to full employment in 2016, what assumptions went on about what happened to the distribution of income, what happened to the functional distribution income, how much is still coming from variable pay, what are capital gains? Where’s all that? So how can you compare the packages without that?

MR. SPILBERG: So let’s talk about the economic forecast again and how a depressed economy -- how it’s reflected in incomes relative to a robust economy. Basically, in a depressed economy, non-wage sources of income are depressed, much more so than wages. So in 2012, where we’re starting off, we have a distribution of income which is less concentrated than certainly it was in 2008, when we had the peak, basically, of our boom and capital gains were very high.

So two thousand- -- we don’t have the precise matrix, but those can be provided. But in 2012, you have a relatively -- well, you still have a concentrated system because wealth has become more concentrated over time, as has income. But it's substantially less so than it was in 2008.

We have the growth in the economy toward 2016. By 2016, we reach close to full employment. However, we're assuming that capital gains do not reach the same peak that they did in 2008. Again, I don't have the precise numbers, but they are lower. As far as other non-wage income sources, they do go back up to serve a traditional percentage, as they are during a peak period.

COMMISSIONER BOSKIN: Okay, thanks, Phil. That's helpful. But I think it would be even more helpful, in addition to that description, to go back and redo this analysis here and the revenue analysis for an historical period over the last X years. So we see in the boom of the late nineties and the collapse of the early 2000s the fairly neutral years, business cycle, the middle years of 2003, forward, et cetera. And then during the housing bubble of 2005, '06, '07, '08, what's going on, and we could take a look at that, and we can get some -- I think that would be very helpful for all of us.

MR. SPILBERG: This certainly can be done. Just keep in mind that there is a cyclical trend, and there is also a systemic trend over time. So those will affect the numbers.

COMMISSIONER BOSKIN: Yes, I think we're all aware of that. But at least those are based off of -- and had we had a different tax system, we would have had a somewhat different economy, but that's a whole 'nother story. But at least those are off of facts rather than double projections.

CHAIR PARSKY: I think at one point we did say that although, in analyzing the issue of the impact on revenue-neutrality, or not -- that is looking forward, looking forward and would need to be analyzed for one year, and then potentially for over a three-year period, that would go on as if we are going to propose legislation, in any event.

We also said that we wanted to be in a position to look backwards -- back X number of years to be able to compare the analysis, so I think --

MR. IBELE: We can do that.

CHAIR PARSKY: I think that would be very helpful.

COMMISSIONER POMP: I have one comment I'd like to see, too.

When you project growth in wages, capital gains, do you use the same growth rate for across the board and not by bands of income?

MR. IBELE: Well, we used different growth rates for different components of income.

COMMISSIONER POMP: But having said that, it's across the board?

MR. IBELE: Yes.

COMMISSIONER POMP: So that wages will grow at the same rate for everyone?

MR. IBELE: For each of the -- yes, so the only differentiation would be the types of income, the different income groups received.

COMMISSIONER POMP: Right, which maybe is the best you can do, but unrealistic. Unless you think the upper-income folks are having the same increase in their wages that low-income people are, which is belied by the data, so…

MR. IBELE: Well, it was an assumption. It doesn't reflect what happened in the past. But it seemed reasonable to do working forward. When we go back and look at history and do this sort of backcasting, we would obviously take those different growth rates into account.

MR. SPILBERG: And we'd be happy to share historical trends in per-return growth rates in wages and other sources of income. We do have that information.

CHAIR PARSKY: One more thing, Mark, before we turn to Package 1. One more time on an explanation of this chart to non-economists. Just explain what this chart means to non-economists.

MR. IBELE: This basically --

COMMISSIONER EDLEY: The one on the left is taller.

CHAIR PARSKY: No, that's to a lawyer. I didn't say a "lawyer."

MR. IBELE: It's basically an indication of the relationship of the growth in taxes with respect to its variability. And what's a --

CHAIR PARSKY: We'll let you think about that for a while.

MR. IBELE: I'm looking for a good metaphor, and I'm not coming up with one right now.

CHAIR PARSKY: We'll let you come back to that.

MR. IBELE: Okay.

CHAIR PARSKY: I do think -- look, there have been a number of discussions and --

COMMISSIONER BOSKIN: Oversimplification, Mr. Chairman? An oversimplification is something about what happens to tax revenue when income fluctuates -- the economy fluctuates rather than when it's stable. To get beyond that, you're talking about statistical terminology.

COMMISSIONER PRINGLE: Got it.

CHAIR PARSKY: Okay. The mayor says he got it. It's enough. Okay.

Let's go on to Package 1. We're going to come back to the subject of volatility.

MR. IBELE: I'll be prepared.

CHAIR PARSKY: Okay, go ahead.

MR. IBELE: Okay, Package 1, this is what was posted on the Web site.

The structure of this is a personal income tax with a uniform tax rate of 6 percent. There are a standard deduction of $15,000 for single taxpayers, $30,000 for joint filers. There are itemized deductions for mortgage interest, property taxes, and charitable contributions which are phased out as you reach a certain income level.

This eliminates the corporate income tax. It eliminates the state sales tax, which is this 5 percent rate. And it imposes the net-receipts tax at the rate that I mentioned before of about 3.3 percent.

We looked at this, and in terms of some of the goals of the Commission. In terms of economic growth, you're eliminating the corporation tax, reducing personal income tax rate, which would tend to encourage investment, improve efficiency in the overall tax system. This would be broadening the base through putting in place business net-receipts tax. This would improve efficiency of the system whether or not it's replacing the corporation tax or the sales and use tax because of the low rate; and it would treat businesses neutrally: service businesses, goods-based businesses, and so forth.

And another item would be eliminating the sales tax -- the state portion of the sales tax on business -- I'm sorry, reducing -- eliminating the state sales tax would reduce the taxes on business inputs. There would still be the local sales tax.

In terms of volatility, substantial reduction, as we noted on the previous page, primarily due to the new tax and the drop in the tax rate on the personal income tax side.

In terms of fairness, you can evaluate these. It does reduce the progressivity of the tax system. On the other hand, it increases the number of taxpayers that pay under the personal income tax.

Simplicity: Certainly reducing the number of personal income tax rates is a simplifying component of this. On the other hand -- well, in addition, it eliminates the corporation tax, one of the more complex taxes to comply and administer. On the other hand, it does add a new tax which would, at least in the short-term, add to the complexity of the tax system.

COMMISSIONER BOSKIN: Can I just make one quick comment about the number of taxpayers?

That's under the income tax. But this package also eliminates the sales tax.

MR. IBELE: It would --

COMMISSIONER BOSKIN: So a lot of people are paying sales taxes, including lower-income people who pay no income taxes because they're under the current deductions, et cetera, would have their state sales taxes eliminated.

MR. IBELE: That's right.

CHAIR PARSKY: Chris?

COMMISSIONER EDLEY: I'm not quite sure how you want to organize the discussion, Gerry, but I wanted to ask about the local sales tax and ask about a different way of handling that.

Do you want to hold that until they presented both packages and then open it up for that sort of --

CHAIR PARSKY: Yes, I think if we let them get through both packages -- we do have a little bit more extensive discussion that's needed on the business net-receipts tax just so everyone understands where things are, and some of the preliminary thoughts provided by the staff on that subject. But then we have to come back around and open it up for all, questions including those.

Okay?

COMMISSIONER MORGAN: So clarification on the two packages can wait until both have been presented?

CHAIR PARSKY: Right.

Go ahead, Mark.

MR. IBELE: Okay, the next chart, this is just a very simple pie chart, comparing the current law, where the taxes would come from, and under Package 1.

As I indicated, they raise approximately the same amount on the personal income tax side -- we haven't lessened our reliance on that -- and basically, replacing the corporation tax and a good portion of the sales tax with the new business net-receipts tax.

This is the analysis that we did. And this is for the entire package with the standard deduction. This indicates –- and you can look at either the shares or the effective tax rate for the -- the effective tax rate, the current is in the green, which at the very lowest is higher. And Package 1 is in the purple.

CHAIR PARSKY: What colors are you looking at?

I forgot, blue and gold --

MR. IBELE: That's for the bars, yes, yes.

So the lower-income group, primarily because of the large exemptions -- standard deductions, rather, that we have, active benefits from this package, the effective rate is somewhat higher for the middle-income groups, between $20,000 to $100,000. And there’s a crossover at that point. And then there are lower effective tax rates at the top of the -- from $100,000-plus.

In terms of the distributions, staff did our internal work on the personal income tax and the household portion of the sales tax. We relied on Ernst & Young and an incidence model that they have for the business taxes, where they basically attribute the taxes themselves to the different factors -- labor, capital, and consumption. And then take into account the amount of those, a proportion of those taxes that are actually exported to other states -- or outside of California, I should say. Then we use California tax return information and consumption expenditures to develop the estimates on the distribution.

COMMISSIONER HALVORSON: Could I ask a quick question?

Zero to 20 right now pays what? How do we read this chart? Zero to 20 pays what in taxes, and which taxes are they?

MR. IBELE: This particular chart includes all those taxes that are listed -- they’re listed right here. It includes these taxes, plus the business net-receipts tax. So the zero to 20 group, that would be their share of those tax components.

COMMISSIONER HALVORSON: So to the extent that they paid, they wouldn't pay an income tax, but they would pay a sales tax --

MR. IBELE: They would pay a sales tax --

COMMISSIONER HALVORSON: This would be the equivalent percentage of their income that they would pay because of the sales tax?

MR. IBELE: Sales tax, their portion of the corporation tax, motor-vehicle taxes, fuels taxes, insurance taxes, and other excise taxes. All those components -- all those particular taxes, either through --

COMMISSIONER HALVORSON: So this would be direct and indirect taxes paid by people in that population?

MR. IBELE: That's right. Not just personal income taxes, not just the household portion of the sales tax, but all their share of the taxes that we have put into this particular model.

COMMISSIONER HALVORSON: So if it's all of the share -- if the sales tax goes away, that piece goes away. There's an indirect tax that's embedded in somebody else's pricing mechanism, that piece does not automatically go away?

If it's an indirect tax --

MR. IBELE: Yes, yes, yes.

COMMISSIONER HALVORSON: If it's an indirect tax, there's no direct mechanism then for removing that. If you eliminate a sales tax, it's gone; right? But if you eliminate an indirect tax through somebody else's property tax that's being passed on to someone or whatever, that's an indirect tax, and we don't know for a fact what will happen to that cash flow.

MR. IBELE: Well, the theory here is that if it's an indirect tax -- if it's a tax on business, business either -- that tax is either borne by owners of the business or it's passed on, on higher prices, or it's shifted back in terms of lower wages. So somebody ends up -- some group of taxpayers ends up bearing the burden of that tax. And that's --

COMMISSIONER HALVORSON: Yes, ultimately, whoever buys a good, in the end, pays the tax. So when -- the tax always flows through so whoever is the final purchaser pays the accumulated taxes that are in that production route, just because that's the nature -- because it has to come from somewhere, the money has to come from somewhere, and that money includes that. And so I get that.

But what I'm curious about is if there is an embedded business tax in there, and the businesses have worked that into their pricing, and that tax goes away for the businesses, we don't know for a fact whether or not the businesses will remove that from their pricing at a level that would affect the customers from zero to 20.

MR. IBELE: Well, the ability of business to either pass it on in higher prices or shift it back in terms of labor costs and/or -- to the extent that it's borne by capital depends upon the markets and the type of business, there are different industries that would operate. And it depends upon whether you're operating in national markets or in California markets.

In something like a sales tax on businesses -- that is, businesses go in and they buy a piece of equipment, they pay sales tax on it, there is a -- and this is part of our consultant's model -- there's an incidence approach whereby they may be able to pass some of that on in higher prices, they may be able to shift some of it back in terms of lower wages. Some of it may be borne by the owners of the business.

If you remove a tax, the same thing would work in reverse. And they would be subject to the competitive pressures that any other business would be, which would affect their ability to either shift back or pass forward any kind of tax like that.

COMMISSIONER HALVORSON: Thank you.

COMMISSIONER POMP: Can I have a point of clarification, Mark?

If you put up “Tax Package 1, Tax Change by AGI Class” -- the next one, if you will.

So this is the entire package?

MR. IBELE: This is the entire package.

COMMISSIONER POMP: And so see if I’m reading this right. So we’re talking approximately a $7 billion increase on people making between $20,000 and $200,000, and $4.4 billion decrease on people making over -- what? $200,000 --

MR. IBELE: Over 200.

COMMISSIONER POMP: -- up.

Is that the right way to read this?

MR. IBELE: Yes.

CHAIR PARSKY: Yes, that’s the right way to read it.

COMMISSIONER EDLEY: Which is why we’re going to suggest it.

CHAIR PARSKY: In his usual tradition, Chris is kind of a little ahead of us all, but that’s okay.

COMMISSIONER EDLEY: In the fullness of time.

CHAIR PARSKY: In the fullness of time.

Proceed ahead.

I think Richard has covered that chart well.

MR. IBELE: Okay, this is Package 2. This has the personal income tax rates of 3.75, up to $25,000 for single, up to $50,000 joint, and 7 percent at incomes higher than that.

The same standard deduction: $15,000 and $30,000.

Again, itemized deductions for mortgage interest, property taxes, charitable contributions, again, phased out at higher-income levels. And as I'll point out later, the phase-out has some effect but not a great deal effect on the overall distributions. It reduces the corporation tax rate to 7 percent, which is equivalent to the top rate in this particular package, under the personal income tax. And it also imposes a new fuels tax.

This is -- the effect on -- or as we evaluated these based on a criteria, somewhat similar reduction in tax rates for personal and corporate income would encourage investment, tend to encourage investment. A new tax on fuels would raise business costs.

A moderate reduction in the volatility, primarily due to the rate drops in the corporate income tax and the personal income tax.

Again, on the fairness, very similar to Package 1. It reduces progressivity somewhat. Increases the number of taxpayers bringing them on the tax rolls with respect to the personal income tax.

Simplicity: Again, a reduction in the personal income tax rates, a number of personal income tax rates.

And the new fuels tax would add some complexity, although it's very similar -- or could be very similar in its design to our existing gasoline and diesel tax.

COMMISSIONER PRINGLE: Mr. Chairman, if I could, real quick.

CHAIR PARSKY: Yes.

COMMISSIONER PRINGLE: On this one then, the new fuels tax is the plug number; right? That is what makes up the reduction in the other areas?

CHAIR PARSKY: Maybe translate that into specifically, what is the new fuel --

COMMISSIONER PRINGLE: That was the second question.

CHAIR PARSKY: Yes. Describe the new fuels tax, and then how much revenue is assumed it would raise.

COMMISSIONER EDLEY: And is it hedged with severance tax or is it just --

COMMISSIONER PRINGLE: Yes, what is the fuels tax and where is it applied and what is the rate that you used in your assumptions?

Thank you for allowing me to be clear.

MR. IBELE: The fuels tax is equivalent to $20 per ton of carbon for transportation fuels, which translates into 18¢ a gallon for gasoline, diesel, and aircraft fuel.

CHAIR PARSKY: And that results in about $3 billion?

MR. IBELE: I'll have to find my sheet. It's about $3.3 billion in 2014.

CHAIR PARSKY: Right.

And so, again, just so that it's clear, the magnitude of the increase people would feel when they pulled up to fill their gasoline tank would be what?

MR. IBELE: 18¢ a gallon, which is the same as our current gas tax, excise tax on fuels.

COMMISSIONER PRINGLE: And then, Mr. Chairman, if I could continue.

Presently, are those the only three areas where a fuels tax are presently applied in California?

MR. IBELE: I'll have to check.

COMMISSIONER PRINGLE: Do we impose a bunker fuels tax in California?

MR. IBELE: We've gone back and forth on bunker fuels. But I believe at this time we don't tax bunker fuel.

COMMISSIONER PRINGLE: And the policy decision that was made, why that would not be included here is what policy decision?

MR. IBELE: We didn't make a policy decision. This was based on Commission direction.

COMMISSIONER PRINGLE: So the Commission directed that it would apply to gas, diesel, and airplane fuels; is that correct?

CHAIR PARSKY: That was the proposal that the staff was asked to include and evaluate by commissioners.

COMMISSIONER COGAN: What's a "bunker fuel"?

MR. IBELE: A bunker fuel, it's really the stuff that's left over after all the refining is done. And it's used in ships. It's used in ships, transportation ships, oceangoing ships.

COMMISSIONER PRINGLE: In that, for example, one would somehow characterize a fuels tax as a carbon tax. Bunker fuels, does it have the highest degree of greenhouse-gas emissions?

MR. IBELE: I don't know precisely. I know that it's pretty dirty stuff.

COMMISSIONER HALVORSON: I think that's true. I think that's the worst polluters, are the seagoing ships.

COMMISSIONER PRINGLE: Yes, thank you. I actually -- I did want to bring this up. Of course, I'm not an advocate for bunker fuels or airline fuels or any of those. But I did want to hear where a decision was made and how that decision was made as it applied to the overall fuels tax, just to understand what the basis is for the discussion, is all.

CHAIR PARSKY: Well, what we have tried to do throughout the process is to incorporate, as much as we could, requests coming from commissioners as to tax policy or taxes that ought to be considered. I don't think there was any alternative suggested under this heading.

COMMISSIONER BOSKIN: I have suggested an alternative.

CHAIR PARSKY: I'm sorry, I don't think there was an alternative of fuels tax. I know you have an alternative that's coming, I am waiting. But let's give it the right audience.

Proceed.

MR. IBELE: Yes, on this particular tax -- on this particular package, I should say -- the carbon tax was not the plug. We used –- we initially started out with the 4 percent and the 7 percent rates on this particular package. And to make it revenue-neutral, we reduced the lower rate for the personal income tax to lower the amount of money that was raised in this particular package.

COMMISSIONER POMP: Mr. Chair, a question.

When I look at the total -- I think it's the subsequent slide, Mark -- the tax change by AGI -- continue, if you will -- the next one.

And -- the next one, please.

And that is for the entire package?

MR. IBELE: That's the entire --

COMMISSIONER POMP: That's what?

MR. IBELE: Yes.

COMMISSIONER POMP: Should it add up to zero, the pluses and the minuses, or not?

MR. IBELE: No, because this is a comparison with current law. And the total of the ––

MR. SPILBERG: 2014.

MR. IBELE: 2014, yes.

Maybe I can come back to that. And let me --

COMMISSIONER POMP: The second question may be easier.

Who made the decision that we should leave charitable contributions in but not the medical?

CHAIR PARSKY: No one made a decision individually. But coming out of the last meeting, these were the two packages that I summarized as I thought was a consensus of the Commission to go into this analysis.

Any commissioner can seek to propose his or her individual view and see if we've got consensus around including it in further analysis.

COMMISSIONER POMP: Let me just raise --

COMMISSIONER HAUCK: Which page are you on?

COMMISSIONER POMP: In both packages -- in both packages, there were itemized deductions for mortgage property and charitable. I didn't see medical there. Now, maybe that was an oversight, maybe it is there, but -- it's not?

Okay, so I would just raise the logic of giving an itemized for a charitable, which might not have anything to do with California, versus denying someone a medical. I'm not sure I would draw that line.

COMMISSIONER BOSKIN: I think we have the following numerical conundrum. If we go to revenues for major taxes -- these are all done for year 2014; right, Phil?

MR. SPILBERG: Yes.

COMMISSIONER BOSKIN: So you get $1 billion more in 2014 -- not quite a full employment year in Package 1 and 2 than you do in current law, and these are changes relative to current law. So when you add up the distribution of the tax burden, it should add up to $1 billion more; right? The change -- some of the changes should be $1 billion more than the current law. But they shouldn't be zero because you're collecting a little bit more. But they shouldn't differ by considerably more than a billion dollars.

MR. IBELE: Well, the difference -- and we can do the calculation. But the distributions were just done on California residents and didn't include the exported portion of the business taxes, which would be the discrepancy between the distribution --

COMMISSIONER BOSKIN: Aha, okay. Fine.

COMMISSIONER EDLEY: Nice save.

MR. IBELE: I knew I was right. I just wasn't quite sure why.

CHAIR PARSKY: Both these fellows are brilliant. As the clock was ticking, we didn't run out of time. You're okay.

MR. IBELE: I know I've still got the volatility thing hanging out there, but…

CHAIR PARSKY: Okay, proceed ahead.

MR. IBELE: I think we went through this, our sort of take, on the criteria that we've used. I don't know if we flip through that fairly quickly, just a description of the different taxes. Again, you know, we're raising about the same amount from the personal income tax.

The distribution is not dramatically different.

A little bit -- because of the change in the rate, the lower-income group doesn't benefit as they did under Package 1.

The crossover point between the effective tax rates for the two is a little bit lower in Package 2.

One of the things that we looked at in this particular package was -- and I know this was of some interest to some of the commissioners -- was the issue of phase-outs, which we, unlike in current law, we phase out many deductions beginning at about $310,000, and phase them down to a 20 percent residual.

We phased these out under this particular plan totally, so that by half a million, you lost all the deductions. So at that point, people reverted to, or could revert to a standard deduction.

The distribution -- and this shows the Package 2 with the phase-out, the difference is about $400 million more with this particular package.

Without the phase-out, we lose a little bit of revenue, because higher-income individuals, taxpayers, would continue to benefit from the deductions.

The distribution, however, is very similar. It looks very much like this, although there's a little bit of -- a little lower effective tax rate at the upper end.

And these distributions here -- and, again, this is for personal income tax only -- indicate that -- you know, that the phase-out issue only affects the top income groups there.

And I think that's what we have in terms of slides.

CHAIR PARSKY: Well, before we turn to a discussion of where we are with each of these packages, I just want to be sure -- and, again, we won't use this session for too detailed of discussion of the business net-receipts tax, but I do want you to go through for the Commission exactly the work that you have done to date on that subject and, for illustrative purposes only, what you included in doing your calculations, so that any questions can be raised about that. We'll talk a little bit about how we operate going forward.

COMMISSIONER MORGAN: May we ask a couple of questions on these two packages before we get into business?

CHAIR PARSKY: Well, the only reason I was hesitating is Package 1 does include this business net-receipts tax. So I just want to make sure -- again, this is not meant to be an open discussion of, you know, "This should be in," "That should not be in." I just want to make sure --

COMMISSIONER MORGAN: No, it's not an opinion, it's a question.

The Package 2 that I took home from our last meeting also had the business net-receipts tax in it as it was presented at our last meeting and on which I made notes. So that was a question.

And reducing the sales and use tax by 1 percent was also on the chart for our last meeting. And I see that that has been omitted on this one. And is this just for balancing purposes or --

CHAIR PARSKY: No, no. I think these packages were at least what we took away from the last meeting and posted on the Web site.

I think if you look at the Web site, you'll see that these packages -- the business net-receipts tax was clearly not part of Package 2. That, I'm quite confident of.

COMMISSIONER MORGAN: That's true. That's what came to me by e-mail this last week. It did not include that. But at the meeting that I attended last month, the sales-tax issue and the business net receipts under Package 2 were included. And I don't remember discussions about the fact that they were going to be removed. That's my only point.

CHAIR PARSKY: I think, Becky, if you look back to June 23rd, or something even a little earlier, you will see a communication that describes what came out of the meeting. And I'm happy to share it with you at the break.

COMMISSIONER MORGAN: I know we don't approve or disapprove minutes at this meeting, but okay.

CHAIR PARSKY: Okay, just a little bit of time on just describing the work that you have done, who you've involved to date on the business net-receipts tax, and the preliminary assumptions that you have put in, which are described on the Web site presentation, just so the Commission can understand how much has been done; and then we'll get into how much more needs to be done.

MR. IBELE: Okay. On the business net-receipts tax, that was part of our arrangement with Ernst & Young to do a modeling of that for the state of California. They've been involved in the tax in both Michigan, and a type of receipts tax, business receipts tax, gross receipts tax in Ohio.

And on that, following that sort of more economic-based exercise, we've been engaged both with Leg. Counsel and the Franchise Tax Board in discussing what some of the parameters of this tax would be.

We've had discussions with the Department of -- what they refer to as the Department of the Treasury in Michigan, which is their Department of Revenue, discussions with two attorneys in Michigan that are familiar with their tax, which in some ways is similar to what the Commission has discussed for California; in some ways, very dissimilar. But they've gone through many of the same -- gone through many of the same issues that we're going through here. They have chosen to go in a different direction, maybe, in terms of the design of the tax, but some of the policy questions that they had and some of the administrative questions are similar. And I believe the Franchise Tax Board has had additional discussions with their Department of Revenue and the two attorneys that I mentioned in Michigan as well.

In the part of this process, we developed, with the assistance of the Franchise Tax Board -- and I would ask them to come up to the table, if they can, to provide some backup legal questions if we need it.

COMMISSIONER EDLEY: Mark, is that -- the thing that you posted, do we have that in our books?

MR. IBELE: It should be under Tab 9.

MR. SPILBERG: Yes, the document that you're looking for, it's in Tab 9. And the easiest way to find it is if you actually turn to Tab 10, and then go two tabs back from that.

MR. IBELE: It's an integrative process.

MR. SPILBERG: Yes, go to Tab 10 and then go two back.

MR. IBELE: Did everybody find it?

So that's --

COMMISSIONER PRINGLE: Can you state the question again, please?

MR. SPILBERG: Do you really want me to?

Yes, you go to Tab 10, and then within each tab, they're the subtabs. So go within that, just go two back, and that's going to be sort of the beginning of that document.

MR. IBELE: So that's what we've done to date. And, again, I want to emphasize that in our discussions with the people in Michigan, as well as our own tax experts here, we have made -- or given tentative direction in terms of what we thought at the time might be good choices to make. But there are obviously a lot of policy decisions and policy calls that the Commission needs to be aware of.

So we're going to -- probably the best way to proceed is to go through the information sheet that we had posted and is out there in the public. And Phil is going to do that.

MR. SPILBERG: Thank you.

And let me just go through this information sheet. And I hope -- does everyone have that information sheet in front of them right now? Good.

So what I'm going to do is just briefly describe what staff has put together, the description of the business net-receipts tax that we have put together.

And let me start off by saying that while income taxes are obviously taxes on income, the business net-receipts tax is a tax on consumption. It's sort of similar like a sales tax -- just a little bit similar to that. It's a sales tax, if it's assumed to exclude business purchases -- in other words, there's an exclusion on business purchases, would be a tax on consumption. Instead of an exclusion on business purchases, the business net-receipts tax allows a deduction for business purchases. So it ends up with basically a very similar base to that of a sales tax, but it's a value-added tax. A sales tax collects all the tax at the very end. A value-added tax collects the tax over the course of the production process. So that's sort of the similarities and differences of a sales tax and a business net-receipts tax.

You're looking at an information sheet. And the information sheets include the work of staff that has been performed over the last few weeks. We have received excellent technical support from the Franchise Tax Board, and Andrea Chang and Carl Joseph are here with me, and they will answer maybe some of the more technical questions that you have after I'm finished with this description.

We've had a lot of discussions. Mark alluded to some of those. The Franchise Tax Board has had internal discussions. We have had discussions with academics and staff from outside of the state.

What I'm going to do is actually read through this information sheet. But I'm hoping that you would let me go through this information sheet before questions, because otherwise, I think we could get very much -- we could get bogged down.

CHAIR PARSKY: And then I'll come back, Phil, and we'll talk a little bit about process. Because in the span of just this afternoon, it's going to be difficult, if not impossible, for commissioners to understand all the implications of this.

COMMISSIONER KEELEY: Mr. Chair?

CHAIR PARSKY: Yes?

COMMISSIONER KEELEY: Might I just suggest an alternative?

This is the one document that has been up for a while on the Web site. And can we assume that everyone has read it, rather than the staff reading it to us, and move some place beyond having somebody read something to us that we've already all read?

Phil, this isn't -- I'm not unhappy with what you're suggesting, I just think it's ––

COMMISSIONER PRINGLE: Or your reading ability.

COMMISSIONER KEELEY: Or your reading ability.

Yes, thank you, Mr. Mayor.

It's just in the interest of time.

CHAIR PARSKY: John?

COMMISSIONER COGAN: You might be able to just highlight the most important decisions that a commission like this would have to confront in thinking about a sales tax.

MR. SPILBERG: Sure, I could do that. Okay.

Okay, I will try to highlight some of the decisions that were reached over here. But certainly to the extent that I missed some of those that the commissioners are interested in, we can cover those afterwards through answers to questions.

The first decision is that we excluded from the business net-receipts tax banks and financials and insurance companies. And the reason that we did that, is that the taxation of financial products and financial companies under a value-added tax is very complicated. And, indeed, in most places where a value-added tax is administered, there are separate rules and separate treatment for financial companies and financial products.

So we have basically followed that practice over here.

We would continue to tax insurance companies under the gross premiums tax; and we would continue, in this proposal, to tax banks and financials under the corporate franchise tax as it exists right now.

We have to deal with special entities, such as regulated investment companies, RICs -- those are mutual funds -- and also regulated mortgage investment conduits, RMICs, which, in essence, package mortgages into financial instruments. And there's a new type of special entity called a FASIT, financial asset securitization investment trust, which also packages short-term financial paper, basically.

We decided -- staff decided that those special entities are basically packaging financial products and, therefore, should be excluded from the business net-receipts tax. However, we have included REITs, real estate investment trusts, within the tax. And the reason for that is that REITs basically manage property -- are permitted to manage properties. And in so doing, they do far more than just sell financial instruments.

COMMISSIONER EDLEY: Phil, You're not concerned that in it –- I'm sorry, you're not concerned -- should I wait?

I'll wait. I'll wait.

CHAIR PARSKY: Identify the broad issues.

MR. SPILBERG: Okay, we’ve elected to -- first of all, to combine entities, commonly owned entities into unitary groups as they are for the corporate franchise tax, income tax.

However, the combination for the business net-receipts tax is far broader than it is for corporation income tax. And the reason is that we have basically the same tax that’s going to be paid by a broader group of businesses. So we’ve included within the unitary groups: corporations, partnerships, limited liability companies, and sole proprietorships. Basically, all businesses that are commonly owned would need to combine their activities within this business net-receipts tax entity, and file one return, one tax return that basically would calculate the combined tax.

Apportionment: We have chosen, for multistate corporations, to attribute tax or income -- I’m sorry, revenues to California using apportionment. We have explored other mechanisms for doing this attribution across states, but we come back to the one that has been used for the income tax, that will continue to be used for income tax, and that’s apportionment.

We would be using sales as the apportionment mechanism. So it’s referred to by many as “single sales factor apportionment."

The numerator of that apportionment would be sales in California. The denominator would be U.S. sales. So the corporation would attribute their sales, their revenues to California, by taking their U.S. revenues, and then using that formula to apportion or attribute revenues to California.

We determined that -- we determined that if there was an embedded, basically, incentive that is a consequence of using apportionment as a way of attributing tax across jurisdictions to incentivize investments outside of California, purchases outside of California -- and I can sort of demonstrate that with a simple example. And just keep in mind that it's a simple example. It's very -- it's somewhat abstract.

If we have, let's say, a firm, a California firm, that has a million dollars of revenues in California, that company potentially could zero out its California revenues by purchasing an asset from outside of California. The way that the base for the tax is calculated is, you take your revenues and subtract out your purchases. So we have a California company that basically has a million dollars of revenues in California, and does a purchase from outside of California, so it basically fully offsets its revenue from California, and would report in that year zero business net receipts tax.

Let’s say in Year 2 that firm sells that asset from outside of California. The way that apportionment works is that it would -- first of all, the base of the tax would be its overall sales, which in this case would be $1 million of its sales -- ongoing sales in California, and another million from the sale of this property from outside of California, but then this would be multiplied by the apportionment ratio, which in this case we have the $1 million of sales in California divided by $2 million of sales U.S.-wide.

So you have $2 million of revenue times the apportionment, which is one-half; and you end up back at $1 million of the revenues that was actually earned in California. So you have sort of this embedded incentive for doing purchases from outside of California. And it’s a problem for assets.

Now, for a business net-receipts tax, a consumption-based tax, the treatment that you would want is to expense basically asset purchases in the year of purchase. But in order to deal with this incentive, to mitigate that incentive, we decided that it was necessary to expense this property over several years. And we have decided -- we basically decided that one way of doing that would be, in essence, to rely, at least for depreciable property, on federal depreciation lives for depreciable assets. The Internal Revenue Code, the IRC, uses the modified accelerated cost recovery system, MACRS. It is already a sort of an accelerated method relative to economic depreciation.

What we have decided -- what has been provided to you in this document is expensing over half of the maker's life.

So, for example, for a three-year property, under MACRS, the property for this business net-receipts tax would be expensed in one and a half years.

The same goes for depletable property and for amortizable property. In all these instances -- in all these cases, instead of the expensing occurring in the year of purchase, it would be expensed over half of the life that is currently permitted for the IRC.

I think those are the most important elements

Well, Mark put down a couple more things.

The question is, what is the breadth of the group, the business group, that we'd want to include.

For income tax purposes, for -- while California allows actually a worldwide unitary group and allows a water's-edge election that is for corporations, for the purpose of this, for administration purposes, we've chosen just a water's-edge group.

COMMISSIONER HALVORSON: Could I make a comment?

I've owned a couple of small businesses in my day, and it strikes me that this is getting complicated enough that it would be really hard to both monitor and do if you run a small business. The minute you get multiple rules in multiple years and keeping track of acquisition, doesn't it seem like it would be more -- both kind of complicated and kind of easy to game?

MR. SPILBERG: Well, if you own multiple businesses, you would have to file one tax return for --

COMMISSIONER HALVORSON: No, no, I just said in the past I have, so I've had some experience with accounting with small businesses. Right now, I don't own any small businesses.

But having owned some small businesses, you want the simplest possible tax situation, administrative situation you can come up with. And you don't want to spend much of your time -- and you can't spend much of your time -- doing a lot of different kinds of bookkeeping. And when you add layers of recordkeeping and different values for different things, and a year and a half for this, at first blush, it seems complicated.

MR. SPILBERG: Well, that's certainly something we'd want to explore. We would want to go through, basically, the real-world experiences of people like you, and see how that would apply to your situation.

COMMISSIONER BOSKIN: Mr. Chair?

CHAIR PARSKY: Phil, any other –- and again, we'll come back a little bit in terms of how complicated this is and what we need to do about it.

COMMISSIONER BOSKIN: I do have a couple questions.

CHAIR PARSKY: Let's just step back a minute, and let's ask some questions on a general level. Then we'll come back around. I'm sorry, the only other thing I wanted to mention is that the staff, Franchise Tax Board, a number of helpers have not only been going through this extensively, and we did seek advice from -- several people have been very involved at Michigan, in the Michigan net-receipts tax. They also have started a process of attempting to draft what legislation might look like in connection with such a tax, but it's still quite preliminary.

Okay, and again, I don't think we should try to get too deep into the weeds, but I think general questions about this or -- as deep as you want, but general questions about the kinds of decisions, any comments commissioners might make about process, please go ahead.

Michael?

COMMISSIONER BOSKIN: I just want to ask –-

that's right, I've got to hold it down.

I just want to ask a couple of questions.

First of all, what do we know about the deductibility of these taxes against federal taxes, particularly given that we're going to be applying them to a wide range of entities that are not subject to -- that may be taxed under the personal tax at the federal level and so on and so forth. So what do we know about deductibility? That's the first question.

MR. SPILBERG: Well, this would be a business tax. So it would be deducted against business income for federal income tax purposes, whatever federal entity you happen to be. All these kind of -- all taxes such as these are deductible for federal purposes.

COMMISSIONER BOSKIN: Okay, what's going on with global sales? What's going on with global sales? We've got an apportionment factor which has to do with American sales and California sales.

So if we had two firms that were identical in their gross receipts --

CHAIR PARSKY: Go ahead, speak up.

COMMISSIONER BOSKIN: We've got two firms that are identical in their gross receipts and identical in their sales in California, but one of them happened to sell all of its outside stuff to Japan and the other happened to sell all of its outside stuff to Florida, okay, they'd be taxed quite differently.

MR. JOSEPH: I'm Carl Joseph. I'm in the Franchise Tax Board Legal Department.

I don't think that's what Phil envisions. I think he envisions a system similar to what we have now, where you would have -- the distinction is whether or not the corporation or the entity is itself a U.S. entity that makes the sale. The fact that they sell to Florida or Japan or anywhere else, it will all end up --

COMMISSIONER BOSKIN: Well, he described it as a relationship of your sales in California to your sales in the rest of the United States.

MR. JOSEPH: Yes, and that's not quite technically correct. It's all of the sales everywhere by an entity that's formed in the United States.

COMMISSIONER BOSKIN: I'm glad to hear that.

CHAIR PARSKY: If Michael is less worried, that's a very good thing.

COMMISSIONER BOSKIN: And lastly, have you done any analysis of what different apportionment factors would mean for the tax? So if you would mean by who ultimately paid it and what the incentive effects would be, because one of the people who testified to us in San Diego has pretty strong opinions about that and believes that this really wouldn't wind up being a tax on consumption, but being a tax on employment in California, and it would be better to have a payroll factor.

I know that the business community has wanted a sole sales factor for all sorts of reasons. And I'm not going to take a position on that. But it seems to me before we just kind of go ahead and do this, we need to get a lot of analysis about the apportionment factors.

MR. SPILBERG: Yes, we have not done this analysis yet, but that's certainly something that we would like to do.

COMMISSIONER BOSKIN: I think that's probably high on the list if we continue down this road.

COMMISSIONER POMP: Mr. Chair?

CHAIR PARSKY: Yes, Richard?

COMMISSIONER POMP: First, I want to commend Carl and Angie on this enormous amount of work. The last time I saw Angie, I think she was either cross-examining me or taking my deposition.

So this is a much better way to see you.

CHAIR PARSKY: Would you like to switch seats with her? She'll go ahead and --

COMMISSIONER POMP: She's a charming person, so I'm happy to sit next to her.

Let me ask you a question, first of all. What are the general differences between what we have here and what Michigan does?

MS. CHANG: I think one of the main things is, if you turn to page 2 of the outline of the proposed business net-receipts tax -- before I start, I would like to clarify that the role of FTB in this matter was very limited. We were tasked with identifying the potential issues and to bring them to their attention, and to describe the pros and cons of possible decisions that would have to be made.

So, anyway, going back to the differences --

CHAIR PARSKY: I can assure you, we'll get you much more involved if we take another step. So that's perfectly okay.

MS. CHANG: Okay. So going back to the differences, the main differences between Michigan and this proposal, as I see them, are the fact that in Michigan, they allow the -- they do not have a system to expense a certain purchase over several years. It has to be expensed in the year of purchase. However, in Michigan, they do not allow any carryovers of the excess amount of the purchase over the sales amount. So, for example, in the example that Phil gave before, if you have gross receipts of a million dollars and you have purchases of a million and a half, Michigan would say, "Well, you can take the entire purchase in the year you made it, but you're limited to $1 million. You can't carry over the other half million to the following year." And that's how they mitigate some of the potential manipulation that you might have.

And another difference is that they, too, use a single sales factor apportionment formula, but they define "gross receipts" differently for purposes of the tax base versus sales for purposes of the sales factor.

So, for example, in the situation that Phil described, where you could wipe out your California net-receipts tax base of $1 million by purchasing a million dollars, and it happened to be a building in a different state, the way that Michigan would deal with that would be to say that does not go into your sales factor because it was a big, occasional sale that doesn't reflect what you're really in the business of doing.

MR. JOSEPH: Another difference is the extent of purchases from other businesses. Our explanation to us as to what Phil was looking at, was to get rid of as much business input as possible. And this particular system that you see here has much larger purchases from other business deductions than the system in Michigan does. The biggest one being services acquired from other firms. That's not a deduction in Michigan.

So I think from an economic perspective, you know, perhaps it does get rid of that problem of pyramiding inputs a little better, but it is different than what they did in Michigan.

MR. SPILBERG: Yes, let me also say one more thing. The Michigan system doesn't pretend to be a net-receipts tax or a value-added tax. It is, in fact, a gross receipts tax, with allowance for some purchases. And, for example, within their revenue base, they include interest income, which is something that simply does not belong in a value-added tax.

COMMISSIONER BOSKIN: And if you don't expense, it really isn't a value-added tax.

MR. SPILBERG: It doesn't -- it's not precisely a value-added tax, but it's somewhere in between a value-added tax and an income tax, much closer to a consumption base than it is to an income base.

MS. CHANG: And I also wanted to remind the Commission that Michigan had different concerns from what we might have here because they still have a corporate income tax, as well as a sales tax.

COMMISSIONER POMP: And, Carl, just following up on your response to Michael's questions. If you receive two different corporations identical in every respect in what they're doing in California, are you saying that the foreign corporation will be treated differently from the U.S. corporation?

MR. JOSEPH: Yes. Well, what Phil's determination of utilizing a water's-edge return would do, it would -- if there were unitary affiliates of one of those entities that was, in fact, based outside the U.S., not a U.S. corporation, yes, it would not be in that return. Whereas the corporation where it was all U.S. corporations would have everybody in the return. That's true.

COMMISSIONER POMP: Okay, but there's really no reason to track what we do in the income tax, necessarily. This is not an income tax.

MR. JOSEPH: That's true, absolutely. And it's -- California is certainly in the minority, as you're well aware, of states that will do worldwide combined reporting.

COMMISSIONER POMP: Michigan's rate is 1 percent, if I remember. And I think the revenue estimates that we've been doing were about three times as high -- or more, 3.4 percent.

Is that right, Phil, when I asked before -- Mark?

MR. IBELE: About 3.3.

COMMISSIONER POMP: So 3.3 versus 1 percent.

Let's take royalties. Royalties are part of our base; is that right, Phil?

MR. SPILBERG: Yes, it is.

COMMISSIONER POMP: Okay, I get a royalty check. I would be subject to this tax. And to apportion it, however, I would have to know information I now don't have and I'm not sure the publisher would give me, and that is my California sales.

So what do I do?

MR. JOSEPH: Well, inherent in your assumption is that you're getting that royalty through a business, because I don't think that we're talking about just an individual taxpayer --

COMMISSIONER POMP: Well, I'm in the business of publishing a case book.

MR. JOSEPH: Right. Well, what I think Phil's intention here is -- and stop me if I'm wrong -- is they want to pick up the sales-factor rules that were passed by the Legislature recently. And for royalties, that rule is where the underlying intangible is utilized. And so the question you're asking, essentially, is would you have to figure out where the underlying thing that you are receiving the royalty for was utilized by -- perhaps the end user, perhaps by a manufacturer or something like that? And the question is, yes, you would, under the corporate tax system for a corporation or a partnership or something like that, under the new system. And so, yes, it would be the same.

You may well have to look for information you don't currently have. We have not fleshed out those rules at this point, though.

COMMISSIONER EDLEY: No, I'm sorry, the underlying tangible is the copyright --

MR. JOSEPH: Yes, that's correct.

COMMISSIONER EDLEY: -- which is wherever the publisher is domiciled.

MR. JOSEPH: It could be the publisher or it could be --

COMMISSIONER EDLEY: Not where the sales take place.

MR. JOSEPH: -- or it could be the market.

It depends on -– we haven't had a chance to go through the regulatory process on those new rules that were just developed, or just put in place by the Legislature.

But that is exactly right, that is the dichotomy. You could stop at the publisher or you could carry on through to find the market, so to speak, for that item that's produced utilizing the intangible that you -– in this case, Mr. Pomp -– actually put in the time and effort to develop.

That's harder, obviously. It may require information from third parties that you may or may not have the ability to get. We have not gone down that road and held those interested-parties meetings. And we don't really have an opinion on that at this point. It's all very new to us. But I think in other states, there are states –- and Rick would probably know –- that have, in fact, stopped at the printer or the manufacturer, as opposed to going all the way through to the underlying customer.

COMMISSIONER EDLEY: That's right. And then do you force the publisher to do the apportionment rather than the author?

COMMISSIONER POMP: Yes, but the publisher may not tell me anything.

MR. SPILBERG: One thing that I failed to say in my introduction to this, is that there is a $500,000 de minimis in this provision. So as long as your --

COMMISSIONER POMP: What are you suggesting, Phil –-

MR. SPILBERG: As long as –-

COMMISSIONER POMP: -- about my book?

CHAIR PARSKY: Richard?

COMMISSIONER BARRALES: Not until you get your movie rights.

CHAIR PARSKY: We're going to make it into a movie, Richard, for sure.

MR. SPILBERG: I took as a given it was successful.

CHAIR PARSKY: John?

COMMISSIONER COGAN: Thank you all for your work. It's really quite substantial.

I have a question to follow up on Michael's question, and it has to do with incentive effects and labor taxes. So let's suppose we have a company that's operating in Tahoe City, and it has a choice of purchasing -- hiring some laborers from California to work, or it can hire a firm located in Incline Village to provide those services.

The tax treatment, if I've got it right, is that if you hire the workers from California directly, they will not be deductible from your receipts. But if you hire these workers from a firm located in Incline Village -- or, heck, even in California, for that matter -- then the expenses would be deductible against your receipts.

Is that right, or not?

MR. SPILBERG: If you are using direct labor -- in other words, your own employees to perform the work, then it would not be deductible.

COMMISSIONER COGAN: Right.

MR. SPILBERG: If you're hiring, basically, them as independent contractors or through a firm that would otherwise be also subject to this business net-receipts tax, then it would be deductible.

COMMISSIONER COGAN: Right, right.

So it seems that that creates some incentive then to hire services through firms rather than to hire employees directly; right?

MR. SPILBERG: It would only to the extent that that firm was not itself subject to the business net-receipts tax.

COMMISSIONER COGAN: That's why I used the Incline example; right? So if it's a firm outside of California, then that firm escapes any taxation, unless that state has a similar tax.

MR. SPILBERG: That's true. But then you obviously have to look at the tax picture that that firm outside of California, the total set of taxes from outside of California has.

COMMISSIONER COGAN: Right. So the reality is, in some sense, that the policy creates some incentives to go outside the state to hire services that you might otherwise obtain from employees within the state. And the question might be, how large is that incentive.

Another question I have is, is there any way that you see of mitigating that incentive? Because it does seem to me that this tax has aspects of an employment tax, in that regard. California employment tax.

So is there a way that anybody has thought of to maybe mitigate the incentive effects of that?

MR. SPILBERG: Now, we have not gone through that process --

COMMISSIONER COGAN: Right.

MR. SPILBERG: -- of trying to mitigate this type of expense.

But you're absolutely right. To the extent that the price that that firm that is in California would have to pay for the employees that it hires from outside of the state, is the same as it would pay the employees as employees within the state, then it would have an incentive to hire the outside-of-state employees through that firm, through that arrangement. But, of course, that is the assumption, would that price be the same.

COMMISSIONER COGAN: Right.

COMMISSIONER POMP: I mean, the way to handle it is to limit the deduction only if the payee is registered under this tax in California. And that may raise constitutional issues, so…

COMMISSIONER MORGAN: Could I take that with research and development also? Under this plan, would it be wiser for a company to have their research and development work done on a consulting basis through another firm rather than have it done by employees?

MR. SPILBERG: Well, it goes back to, if the firm that does the R & D work, if it is itself subject to that business net-receipts tax, then they would have to pay a tax when it provides that service to the firm that is the recipient of the R & D.

So the answer is that if the research and development would be provided by employees within that firm, yes, you'd not get a deduction for that. But if you basically hire a firm that provides that R & D to you, that firm, itself, is going to have to pay a business net-receipts tax if it is located in California.

COMMISSIONER MORGAN: I understand that. It's just that I see a whole restructuring of business because most R & D is done now within the larger companies by their employees. And under this, that's not deductible, where they could have a deduction from gross receipts if they hire an outside research firm. And I just am foreseeing a lot of restructuring of how companies do their business.

MR. SPILBERG: I don't think that that would be --

COMMISSIONER EDLEY: Phil, can I try to help out here? I'm sorry for the interruption. But if we're talking about a tax rate of 3.3 percent, that's a pretty small incentive, it seems to me. And whoever you'd be purchasing the services from, if they're going to be making more than 3 percent profit on it, it would be a wash, plus the inconvenience, et cetera. I wonder, as a practical matter, how serious this outsourcing incentive would be.

COMMISSIONER MORGAN: You're talking about money to the state, in total.

COMMISSIONER EDLEY: No, the cost -- the cost to your business of not being able to deduct the R & D, the cost to you would be equal to the 3.3 percent of that R & D.

COMMISSIONER COGAN: Right.

COMMISSIONER EDLEY: And if you purchased the R & D as a service from outside, they'd have to be making less than 3 percent profit, and otherwise have the same cost structure.

COMMISSIONER MORGAN: And my comment was more about the fact that you have engineers and researchers working on the payroll now for these companies. I'm talking tax is one issue. But I think our suggestion should be reflective of what we want our society to look like. And you have a different type of employment if this is the tax policy.

COMMISSIONER COGAN: And, Chris, your point is well taken, that the lower the tax rate is, the less we have to worry about these incentive effects of creating incentives to outsource everything outside the state that you can.

MR. SPILBERG: Yes, outside the state, that's true. But within the state, it's not a problem in the sense that to the extent that you contract out from a firm to do your R & D in California, that firm is going to have to, on the sales that it --

COMMISSIONER EDLEY: Yes, but it's not a revenue problem for the state. But Becky's point is, it's a problem for the company, having to restructure. And just the question is, can you keep the rate low enough so that's really pretty trivial compared to the diseconomies of breaking yourself up and restructuring.

COMMISSIONER MORGAN: And the rate of 3.3 is different than what we looked at last month of 2.77.

Why is that?

MR. SPILBERG: My point, just to sort of follow up, the point is that the company that's going to be selling to you that service, that R & D service, it’s going to be paying at that same 3.3 percent tax. So it’s actually going to be selling that R & D for more than if you use employees. So it basically washes in that kind of situation.

COMMISSIONER COGAN: Only if both are located in California?

MR. SPILBERG: Only if they’re located in California.

MR. JOSEPH: If the out-of-state company -- I’m a California company and I hire the out-of-state company to do services for me. If those services are over $500,000, they’re a taxpayer in this system. Because the rule says: If you have over $500,000 worth of receipts assigned to California, they’d be a taxpayer, anyway.

COMMISSIONER POMP: Yes, and you’re saying, even if they do everything in Nevada, you’re going to claim as a taxpayer --

MR. JOSEPH: Yes.

COMMISSIONER POMP: -- and you know they’ll raise an issue of economic nexus which has not been resolved by the U.S. Supreme Court.

MR. JOSEPH: That’s true. The batting average is pretty good though in the states that have taken it all the way.

COMMISSIONER POMP: We have not had the Supreme Court chime in yet so…

COMMISSIONER EDLEY: But $500,000 --

COMMISSIONER POMP: But something that would be as clear-cut –- you know, it's a pretty clean line, not doing anything in California, doing everything in Nevada. It's $33,000 per million tax savings. That covers an hour of my time, so...

CHAIR PARSKY: That's not what you told me.

COMMISSIONER POMP: I thought it was just Bill.

CHAIR PARSKY: Bill?

COMMISSIONER HAUCK: Mr. Chairman, I'd like to suggest that if we were going to pursue this, that in whatever analysis that is done, that we anticipate a range of rates. Because I would expect that if we installed this tax in California, there would be immediate pressure to increase the rate in order to increase revenues to the state. And I think the questioning reflects all of our concerns about the impact of jobs and job growth in California. The last thing I think we want to do is to force jobs outside of California as a result of building an economic incentive to do so into the tax system.

CHAIR PARSKY: There's no question about that.

And let me -- I'll come back in a second and see if we can't summarize where we are.

I just wanted the Commission and the public to understand that in the spirit of trying to see whether or not we could really recommend major reform, I think there was at least a desire on the part of the Commission to look at two alternative ways -- maybe they blend -- but two alternative ways to incorporate in our tax base an element of the economy that is not part of it, namely the service part of the economy.

And there are alternative ways to go to do this. One way to go is to take the existing sales tax and extend that to services. That's been tried, and it has not yet succeeded. That doesn't mean it can't. And I'll talk a little bit in a minute to see if we can have a consensus in terms of where we might want to go.

This is another way to accomplish that result, and to move the system more toward a consumption-oriented tax than exists today.

It's a policy decision. It's very much part of what a commission like this should step back and decide. The details of this are quite significant. And I for one am quite concerned that we not just recommend something without giving enough time and enough detail to understand what it is that the consequences of what we're recommending, because if we decide to recommend this, we will expect the Legislature to act on it.

So I'll come back in a second. But just now kind of generally, I want to make sure that we haven't cut off any commentary -- not just on this, but on either of the two packages -- and, again, let's try to make these brief, but I want to make sure everyone has an opportunity to comment, and then I'd like to step back and see if I can't make a suggestion of where we might want to go.

Yes, Edward?

COMMISSIONER DE LA ROSA: Yes, I've got one question on both packages, and that has to do with the phase-out of deductions. And this is a little bit different than the orientation that we've been taking during this question-and-answer session. But what is the logic behind phasing out deductions at higher-income levels? And in particular, charitable deductions. Because I think that, in my opinion, there's a lot of charitable deductions that are given by higher-income taxpayers, higher --

COMMISSIONER BOSKIN: Actually, half of all charitable contributions come from the top two federal income tax brackets.

COMMISSIONER DE LA ROSA: Right. So I don't think if we're supposed to think about these kinds of issues, but it concerns me that there might be some kind of –- some big --

CHAIR PARSKY: It's a subject that concerns a number of commissioners, I can certainly say that. And you might just recite the interrelationship between that phase-out concept and the use of the standard deduction.

MR. IBELE: Sure. I was just asking Phil if he was aware of a policy reason for the phase-out, and he said he didn't know of one. I'm not sure of one, either. And, in fact, we don't phase out all of the deductions currently. We have phase-outs, but we don't phase out the medical and property loss, casualty loss. And California basically conformed to the feds on this phase-out, although our income for current law, our income starting points are much higher.

In the models that we presented, the interaction is that when we have the phase-outs, basically we assume that the taxpayer would continue to use the deductions as long as they were greater than the -- if they were filing jointly, greater than $30,000. And when they were below that, they would flip over and use the standard deduction. And that's why in our distributions for -- well, I refer to Package 2, our distributions on the effect of that, was not particularly large in a revenue sense, because the $30,000 is a very generous deduction. So the distributional impact of phase-outs or no phase-outs was not particularly apparent, except at the very upper end.

COMMISSIONER POMP: I mean, if you want to know the policy behind the federal phase-out, they were looking to get a little better progressivity into the tax. And they felt that the incentive effects weren't going to be that serious because people had the wherewithal to give the charitable contribution and would probably continue to do so. So it's not a complete phase-out. You know, it's a recapturing of some of the benefit driven by revenue, driven by equity considerations.

CHAIR PARSKY: You might ask some of your colleagues at the University of Connecticut whether they still feel that way in today's environment.

COMMISSIONER BOSKIN: I certainly agree with Richard that they were driven by revenue and equity considerations, but I think there's a very large difference between charitable contributions and other deductions that have to do with yourself.

There are many studies of the price elasticity of giving to charity which is affected by the deduction, because the price becomes one minus the marginal rate for every dollar that you give. Martin Feldstein and I did a bunch of these for the Filer Commission in the 1970s. We included higher than one; we included less than one. But if it's around one, it means that every dollar that you don't deduct would have gone to charity. So it's just a transfer from the charity to the government with the person as a withholding device. That's very different from phasing out a dollar or something where you spend it yourself.

CHAIR PARSKY: John?

Chris?

COMMISSIONER EDLEY: Two things. One is, with respect to the NRT. It seems conceptually possible -- I guess I'm asking, is it possible as a practical matter to convert the revenue associated with the local sales tax in a jurisdiction into a local increment to the net-receipts tax, so that one could eliminate the -- so that one could eliminate the local -- the sales tax entirely?

MR. IBELE: I think, conceptually, it can be done. With the local sales tax --

COMMISSIONER EDLEY: And, again, I want to emphasize that this is in a context in which we're going to have a multiyear phase-in, in which we're slowly building up the NRT, et cetera, but…

MR. IBELE: I think there's a couple issues I can think of whether or not you'd give local jurisdiction the option to adopt this particular tax or not. You know, they certainly have the ability to sort of vote in different rates on the sales tax.

There's the issue of jurisdictions. Where does the sale -- where does the company operate? Where does the sale take place? How would you allocate that? By market or by -- what was the other alternative?

So, I mean, I think conceptually that it does raise --

COMMISSIONER EDLEY: I give up. I give up.

CHAIR PARSKY: Yes, I'm sorry, Curt, go ahead.

COMMISSIONER PRINGLE: But I will add two statements.

I think that is a great challenge. But also constitutionally, it requires a two-thirds vote of that local entity to have a local tax. So even if you were going to have a straight-off swap of the dollar amounts exactly the same, it requires a two-thirds vote of the people within every city in California to be able to do that because that is a local tax. And to increase or modify any local taxes, this would be an increase in a new tax and you would eliminate an old. But it would require in every single city in the state, there would be a vote of the people and require two-thirds vote.

Additionally, every self-help county in the state that has a locally-imposed transportation tax or other means, those were voted specifically as that sales tax piece. And those would individually have to all be voted requiring a two-thirds vote of each of those county electorates to be able to do it, so…

COMMISSIONER EDLEY: Requirement is different from the Prop. 13 two-thirds thing in the Legislature?

COMMISSIONER PRINGLE: Well, that is part of the two-thirds requirement and 218 requirement. Prop. 218 requiring a local entity to get a two-thirds vote to impose a local tax.

COMMISSIONER EDLEY: I guess what I'm saying is, if we're swapping the NRT for some other state taxes and we are assuming that this can be done by majority legislation --

COMMISSIONER PRINGLE: That tax-neutrality argument doesn't apply –-

COMMISSIONER EDLEY: That's what I was asking --

COMMISSIONER PRINGLE: -- to a local government imposing a new tax.

COMMISSIONER EDLEY: -- that it's not.

COMMISSIONER PRINGLE: Even if it would -- their new tax would eliminate an old tax, it would basically wash.

COMMISSIONER EDLEY: Okay.

COMMISSIONER PRINGLE: But that doesn't apply to those local governments.

COMMISSIONER EDLEY: Got it. Got it.

MR. IBELE: I guess the other -- I just wanted to add one more thing.

COMMISSIONER EDLEY: It's dead, it's dead. I feel like an idiot. You're going to rub it in? Don't rub it in. Please, I'm very sensitive.

CHAIR PARSKY: Keep going, Mark.

COMMISSIONER EDLEY: The second thing --

MR. IBELE: Were you going to gong me?

[Bell chimed.]

COMMISSIONER EDLEY: The second thing is, I have to say that I remain a little uncomfortable with the distributional data that we saw from both the first and the second packages. And I guess what I'm wondering is that, as we go forward from today -- and I hope to continue down the path with the NRT, I hope –- I'd like to have a little bit of discussion to hear from the other commissioners about why the simplification of the rate structure should be such a high public-policy priority as opposed to -- because in my own view, the complexity issue, which is what people keep raising, doesn't come from the number of brackets, it comes from all the deductions and the credits and the exclusions and the phasing in and the phasing out, et cetera. It's not about the rate structure.

Now, if there's a separate argument that the marginal rates are too high for economic reasons or efficiency reasons or something, okay, that's fine, we can have that discussion, and maybe there's a way to change the rate structure on that basis. But I guess I really want to understand what we're getting in public-policy terms for deviating from the current distribution of tax burdens reflected in the current structure of the PIT.

Does everybody see what I'm saying? Because -- and let me just add that if the concern is just with the marginal rates, then I think what we should think about is, should we increase the NRT a little bit and have a rate reduction on the PIT for everybody.

So I'm, frankly, at a loss to understand what my colleagues are really after in this regard.

CHAIR PARSKY: If any colleague would like to answer that, that's okay.

COMMISSIONER POMP: I would, sure.

CHAIR PARSKY: Go right ahead, Richard.

COMMISSIONER POMP: And let me try to do it with just a simple, little story.

Mr. Chair, you're in business, and so I come to you, and I'd say, "Gerry, how would you like to swap your business for my business?"

And you say, "Okay, Rick. What do you have?"

And I say, "Well, I have something, but I haven't really thought through all of what I have."

And you say, "Okay, how much revenue do you make?"

I say, "Well, I don't really know because I haven't made any of these major decisions, and I haven't had the business through a business cycle yet. And, boy, there's a lot of unknowns. But let's swap."

And you would look at me like I was nuts. And that's exactly the way I view any proposal to take something unknown and swap it for something known -- which you're never going to get back in a state with a two-thirds requirement. So you might as well say, "We're going to eliminate the sales tax," which 45 other states have. It's not like this is an idiosyncratic tax in any way. And for what? I mean, I'm sort of mystified by that whole way of thinking.

And the dean's points, I think -- I mean, how would you be interviewed and defend a $7 billion increase on the middle class? People who may have been recently laid off, working two or three jobs. You're going to tell them what, it's to reduce volatility? Which from day one I've suggested is not a tax issue but a spending issue.

COMMISSIONER PRINGLE: Mr. Chairman?

CHAIR PARSKY: With all due respect, I thought you were answering his question.

COMMISSIONER POMP: Oh, yes. Do you agree?

CHAIR PARSKY: It's perfectly okay. I mean, you can have whatever frolic and detour you want, but it was supposed to answer his question.

COMMISSIONER POMP: Well, I think I did with a little story.

CHAIR PARSKY: No, I don't think so.

Let's keep going and then we'll see if we can come back.

Curt?

COMMISSIONER PRINGLE: Right. I don't quite think that. The point, I think, though -– my point is -- and this may be just the clear distinction between a perspective on tax policy, but the level of progressivity in the personal income tax in California to some of us is so extreme that not only does it make us vulnerable because of what we've seen in earlier charts in terms of such a great percentage of the general fund in California is dependent upon such a small number of people, that that alone, I think, challenges us not only on some of the basic premise of why we're here, to address volatility and establish a tax structure for the future, not just say, "This is the way we are today and we're concerned about modifying where we are today," and possibly looking at a different structure, which any new structure would always be a new structure, without the data and the information we have, and that's why we're trying to flesh that out.

I guess one of my concerns, though, is that even in this new package, we have the same degree of reliance upon the personal income tax as we do presently. And there is no volatility in the property tax in California. There's very little volatility, even during a very difficult economic time, in the sales tax in California. The business net-receipts tax will be even less volatile than that. But the greatest degree of volatility we have in the tax structure, one of the things that is in our charge is to address volatility, good or bad, how it affects where those dollars may go. The volatility rests on the personal income tax.

And my position is that it is stronger for us because it doesn't create a punitive effect on people making more money through that economic cycle. That's why some of us have always supported fewer steps along that process and a flatter tax system. But inherently within your question, I would have a hard time that saying one tax rate necessarily across the full spectrum is the only way to go. Because, in fact, even in Package 1, there are two tax rates: Zero and 6 percent. In Package 2, there are three tax rates: Zero, 3.75, and

7 percent. So in every one of those, there are multiple rates.

And when you do have such a progressive system -- some like it, some don't like it as much -- what it gets to is, it makes it very hard to argue for a flat rate because you will be reducing, at the very high end, and that means everyone else has an increase. I get that, and that's one of the insidious aspects of having a progressive system, because it's always hard to unravel from that degree of progressivity.

But it hasn't gotten us security, it hasn't gotten us a strong economy, and it hasn't gotten us the ability to count on revenues from year to year.

So I think just for the long-term health of this state and understanding where our revenues are coming from, that level of progressivity is challenging to me. And that's -- be it one rate or two or three, I would certainly be open to that discussion. But figuring out how to adjust it and balancing it with other resources, I think adds to the security and the long-term health of the state. That is where I'm coming from with the concept of creating a flatter personal income tax.

CHAIR PARSKY: I think that appropriately frames the discussion.

COMMISSIONER EDLEY: Yes, there's the debate right there.

CHAIR PARSKY: I think that's an appropriate way to frame the discussion.

Now, let me see if I can make a suggestion. Assuming for the moment that the commissioners would support the nature of the recommendations we would make as described at the beginning of this meeting, and which you have a description of, as a way of proceeding forward, it seems that the concerns that are expressed, on the one hand, about increasing the burden on the middle class at the expense of the higher-income group need to be taken into account; and the desire, on the other hand, to be less reliant on the personal income tax need to be taken into account.

I'd suggest the following -- again, under the umbrella of the type of recommendations that we would ultimately make: That we would continue to explore adjustments in the personal income tax. That could include three rates or maybe even leaving all of the rates, but under the condition that all brackets would get a reduction. There would be no increase in any bracket.

But I would urge that we stick with zero -- some number that would be lower than 3.75, I don't know the exact levels we would have to take it to, but it would be about 2.5 percent and 7, and see if we can't, under that that adjusted structure, give every tax bracket a reduction.

COMMISSIONER EDLEY: What would the NRT have to be in order to make that --

CHAIR PARSKY: And make it -- we start there.

If we are not satisfied with that, we should look at, still under the personal income tax, an adjustment in the capital-gains rate, suggested by one or more commissioners. But that could be part of the ongoing analysis of the personal income tax. That would be part of a package on the PIT -- personal income tax.

Second, we would continue to analyze -- not be afraid -- we would not be afraid of proposing a new tax that had never been adopted in California just because it was new.

Under kind of that guideline, with all due respect to the University of Connecticut -- under that guideline, we would never do anything new.

COMMISSIONER POMP: That's a total distortion, Gerry. I was talking about swapping. That was the whole purpose of my story.

CHAIR PARSKY: Well, I haven't finished –-

COMMISSIONER POMP: Swapping.

COMMISSIONER EDLEY: That's a distortion, too, Richard, because you know we're talking about a phase-in, you know we're talking about doing additional due diligence before we make up our minds ––

CHAIR PARSKY: I'm sorry, I --

COMMISSIONER POMP: Package 1 talked about eliminating the sales tax.

CHAIR PARSKY: Wait, wait, I haven't finished. I haven't finished. I haven't finished.

So we would continue to explore.

Now, exploration of this tax will require significant additional work. We would need to invite in a range of organizations, respondents who might be impacted by such a tax. And the staff and individual commissioners would be invited to participate, but it wouldn't be essential that every commissioner sit in on every session to hear input, but everyone would be invited. No session would take place without commissioners being invited in order to get input on the impact that such a tax would have, the legislative drafting process, with the help of the Franchise Tax Board, because they've indicated that they haven't been as engaged as they would like to be -- and we'll try to correct that -- we will go through an extensive process to try to come back, answering these questions.

As an adjunct with that -- because we might not be successful. The Commission might decide, "I'm sorry, but the business net-receipts tax was a good idea, but we don't want to move in that direction." As an alternative, the sales and use tax would continue to be on the table for extension to services. That we could decide as an alternative to a new business net-receipts tax, that we would take on the challenge of extending it to all services.

Next, we would have on the table the elimination of the corporate income tax, to be decided, but it would be part of this package.

Next, we would include a fuels tax -- gasoline, diesel, jet fuel -- as described.

COMMISSIONER PRINGLE: Bunker fuel.

CHAIR PARSKY: I don't know whether bunker fuel is in and out. We'll let that for a subsequent --

COMMISSIONER EDLEY: Anything Curt wants.

CHAIR PARSKY: My sense is in addition -- in addition –-

Becky, are you taking notes here? Becky? Please.

COMMISSIONER MORGAN: A few.

CHAIR PARSKY: Okay, I'm joking with you, Becky. I'm going to give you the June 26th memo. I guarantee you, I'll give it to you.

Anyway, fuels tax would be included and two other things: The split roll on the property tax would be on the table as part of this package, suggested by one or more commissioners. A severance -- permitting incremental drilling for oil in California and the application of a severance tax on that would be ––

Well, how would you describe it, Michael?

COMMISSIONER BOSKIN: Yes, maybe to collect zero revenue from all the offshore stuff we don't drill. There is more than enough there by the federal government's estimates to basically swap what we're doing with the fuels tax. So it just seems silly. But just the equivalent in revenue, does it have to be a severance tax? It could be bonuses and royalties, but it's the same revenue --

CHAIR PARSKY: I'm trying to stay within the context of taxes.

COMMISSIONER BOSKIN: Those are, but those are widely considered taxes everywhere else in the world. And in the Gulf Coast, they don't have the title "tax," nor does the "vehicle license fee" have the phrase "tax" in it.

CHAIR PARSKY: We're going to ––

COMMISSIONER BOSKIN: So just the equivalent -- the equivalent revenue. We can call it a tax, if you want. Equivalent revenue.

CHAIR PARSKY: Okay. In addition -- and I need a little bit of help here because I really want to stay within the context of what we said -- there’s been significant commissioner interest in the establishment of a reserve fund. Some people refer to it as a rainy-day fund, but a reserve fund. Because although some commissioners may think that the volatility issue can be addressed in the tax system, and other commissioners think that the volatility issue can be addressed in the rainy-day reserve concept, I think that I would just put on the table that you may need both in the context of addressing volatility. So I think that a clear, for wont of a better expression, hard reserve, keyed to some definition, or trigger, we would keep on the table as something that can come forward out of this commission.

COMMISSIONER BOSKIN: As long as the “hard” is capitalized, italicized, and in bold, not the current leaky bucket in our so-called rainy-day fund.

CHAIR PARSKY: Michael, I knew where you were coming from. “Hard” was meant there to be intentional.

And finally, although it doesn’t fit exactly within the definition of revenues, because it has been so supported by the Commission, the concept of a new, adequate tax resolution dispute process -- tax courts --

a resolution process would be included and would be put on the table.

Those would either fit -- some combination of that would either fit into Category 1, which would be statutory law changes, revenue-related, that can be enacted by the Legislature immediately; or Category 2, which might need constitutional law change or ballot-initiative change.

That's the package that I would recommend. And then I'll come to the "in addition" clause in a second. But that's the package that I would recommend, is a melding of the two and gives us, I think, an opportunity to try to seek unanimity and proceed forward.

It can't be done by July 31, that's pretty clear. So I would suggest -- and I don't want to put it off so that we can't give the Legislature an opportunity to act, let's put it that way. So I'd like to be able to get this done before September 15th, when I think the Legislature may decide to recess earlier or later. But at least it's on the table that they would recess September 15th for the rest of the year.

And I would like to at least be able to look them in the eye and say, "You have some recommendations for major reform from the broadest cross section of people, and we expect you to act on it."

Now, that's a big challenge, but that's what I would suggest. And, obviously, there will be some refinements within this. But that's a package.

In addition, we would welcome suggestions from commissioners that are not revenue-related, that could be included in another section of the report, that we wouldn't take a position on other than that other bodies need -- or should be looking at reform in those areas as part of fiscal reform.

I would hope that we would reach unanimity about what should be included in that. It's not a position of the Commission, we wouldn't have staffed it, but we would say, "This needs to be addressed." And hopefully, we can reach unanimity on what could be included in that section.

COMMISSIONER KEELEY: Two things, Mr. Chairman.

CHAIR PARSKY: That's my suggestion.

COMMISSIONER KEELEY: Mr. Chairman?

CHAIR PARSKY: Yes.

COMMISSIONER KEELEY: Thank you, Mr. Chairman.

Mr. Chairman, thank you very, very much. I think that the proposal that you've made speaks to several issues that commissioners have been wrestling with since the inception of our task. It also reflects the evolution of the thinking of commissioners and the opportunity that we've had to evaluate the various proposals that have been put on the table to date.

I very much appreciate your inclusion of a number of the items that were distributed publicly, to the Commission and to others over the weekend for consideration. So thank you very much for that.

I think that what you've outlined is a good proposal. I wonder if I might suggest two or three other -- not elements of the proposal, but two or three other concepts with regard to how we might proceed. So this is process as opposed to content.

First of all, I imagine that what you will be doing, if the Commission is of a consensus mind to want to do what you just described -- and I would certainly add my voice as an "aye" vote on that or a "yes" to what you've recommended, that you'll be asking the Governor for an extension of our term as a commission for some 45 or 60 days or some other number of days so that we can continue to do that.

I know in at least the case of my appointing authority, which is the President Pro Tem of the Senate, the President Pro Tem of the Senate has told me personally that he thinks that that is a very worthwhile request for you to make and that, at least in his mind, that the Commission is working diligently and in good faith to get to a consensus product.

Secondly, Mr. Chairman, I'm wondering if, at this stage, where we're really pivoting now, and we're going from a time where we were in the expanding-universe phase and looking at all kinds of options, and now we are narrowing those, we've got, in essence, the known universe of items that we would like to consider for evaluation, and how we might mix and match those into a consensus product. I wonder if we might also change a bit of how we work in the following regard:

One, that the agendas and the packets and all of the material that is made now available to members -- or excuse me, to commissioners and the public on the day of the meeting, that we could have an agreement that all of that material would be available, at a minimum, 72 hours in advance, which the mayor advises me is the Brown Act requirement.

Is that right, Mr. Mayor, 72 hours in advance?

COMMISSIONER PRINGLE: Right.

COMMISSIONER KEELEY: And if we might adopt that as a practice so that the interested public, as well as the commissioners, would have an opportunity to look at things in advance. I think it also might change the nature and the character of the conversation at the Commission meetings in terms of the utility or the utilization of our time that is available. So rather than being briefed as much and asking questions that are kinds of clarifications, we might get quicker into the give-and-take of deliberation about what kind of package -- in essence, the public negotiation function. So I'm wondering if that might work for you and might work for the staff.

I'm not trying to -- let me tell you what I'm not trying to do: I'm not trying to increase the pressure on the staff to produce product earlier. However much time you and the Chair decide you need to produce product, that's fine. Just don't set the meeting until you've got -- you know that you can do that and have the product done. So I hope the staff is not taking this as a slight to them at all. I have great respect for you, and you know that. This is about timing of access to information.

I wonder if also, Mr. Chairman -- I very, very much like the idea of essentially working groups. When Mr. Mayor was the Speaker of the Assembly and he had the task of working in Big 5 and trying to negotiate budgets and so on, one of the common practices in the Legislature at the Budget Committee, at the Big 5, is to establish working groups all the time. It's a, "Why don't you, you, and you go off and work on this particular issue, come back in two days and have a response for us? Why don't we get the Department of Finance, and so on and so on to sit down with three people and do this and that?"

I think that that could be -- if I understand -- if that's in the spirit of what you're describing, I think that is enormously beneficial.

I also know that because we're a public body, we need to do our work in public. We should examine, obviously, how those notices would be made and who -- but I think that's a very, very good idea. I think there's a lot of work that can be done well in that context.

I do want to make sure that I understand something that you said, Mr. Chairman, because you and I had a very, very productive conversation yesterday for a couple of hours here in San Francisco, and I appreciated your time and every courtesy that you extended to me. If I understand what you're managing towards you in addition to -- or what we're managing towards in addition to consensus, is a report which would be structured in such a way that the Legislature could immediately pull out of that: "Here are the recommendations for action by the Legislature" in statutory -- written in bill language essentially by Leg. Counsel once we've agreed on what we're trying to do here, what our final product is.

As you and I discussed, the Legislature doesn't have the power to enact a statute any more than they do to enact a constitutional amendment. They can pass a bill and send it to the Governor and the Governor can decide whether or not they sign it. So there is -- the Legislature doesn't have any independent power that way. They work in concert with the executive branch to enact legislation.

The Legislature does the same thing with regard to constitutional amendments, although its partner in that deal is the electorate as opposed to the Governor. So I want to make sure I understand what you're suggesting. You're suggesting that those items that the Legislature can act on statutorily and the Governor can sign would be in one category; then constitutional amendments, if we suggest any -- or we suggest any actions which would require for them to be enabled, that they would require a constitutional amendment, that would be in a second, an additional section.

Understanding -- and this is the point of clarification I'd like to seek with you -- if we made such recommendations, because a way to enact that is for the Legislature on two-thirds vote of both houses to place that on the ballot, that we would also have that in bill form. So if the Legislature chose to go ahead and do that, they could do that. Alternatively, folks who are interested in putting those on the ballot would have ready-made language and may want to go forward with it.

Am I right on that, how you would see that?

CHAIR PARSKY: Yes.

COMMISSIONER KEELEY: Thank you very much.

The other issue I want to seek clarification, because I thought I understood it yesterday and I think I understand it today, based on your characterization, the notion of a rainy-day fund -- rather than me put words in your mouth -- your thought with regard to a rainy-day fund is that it would fit where, if we got to a consensus and that was part of it, where would that fit in the report, in your mind?

COMMISSIONER EDLEY: May I comment on that before you commit yourself? Because I don't want to disagree with you after you speak. I'd rather you disagree with me.

CHAIR PARSKY: I would be honored if you would go ahead. And I'm going to assign you the task of calling this whatever you would like to call it.

COMMISSIONER KEELEY: You can assign the task of writing it.

COMMISSIONER EDLEY: A tax revenue suspense account -- no, I don't know. I'll figure out something.

Look, I think I've mentioned in one or two of these meetings the idea, at least, at a conceptual level, of income averaging, as we used to have in federal taxes some years ago. I have no idea what you folks did out here in California. But it was in the federal tax code. And the point of the federal –- and the point of, obviously, of the income averaging is to ease the impact of income volatility on the tax bill, faced by the taxpayer.

Well, in my mind, conceptually, creating something like a rainy-day fund in which a certain portion of receipts above the trend line in revenue are sequestered is a very similar thing. I mean, you're not benefiting the taxpayer; but in terms of what becomes available to the general fund, it has the same effect. So I think it's at least a kissing cousin to a revenue measure as opposed to an expenditure measure. It's certainly not dictating that funds be spent for particular purposes. It's, rather, controlling what kinds of revenues are available to the state government for expenditure.

Now, the implementation of a moving-average kind of strategy for figuring out what's volatile and what's not, I'm advised by staff, is quite complicated. Because, for example, capital gains -- just figuring out what the number is can lag by 18 months to two years before you actually know what the number was. But if you did use regression analysis of some sort and you went back long enough so you'd get over the course of a business cycle, I think that would be an appropriate way to identify the peaks and valleys around the trend.

So I would urge that we conceptualize a rainy-day fund in the type font prescribed by Brother Boskin; that we include that in Gerry's Category 1 as a statutory measure related to revenues. Period, paragraph.

I think there's a very interesting and difficult question about how to make the lock on this lock-box impregnable. And I think if we could find some really good and experienced lawyers to help us out on that question, we should absolutely do that. It can't just be the same old thing. I think we'd have to do this in a way that we could, in good faith, say really has some differences to it from the way the state has handled this in the past.

I'll subside now.

COMMISSIONER BARRALES: Mr. Chair, just so I better understand. We talked about a rainy-day fund and now this lock-box. I would be more intrigued, if I understand correctly, what we're talking about is a spending cap, I think? Is that not what we're talking about?

CHAIR PARSKY: No, what we're talking about is coupling the tax-law changes with a requirement that revenues would be sequestered, if you will, temporarily off of a formula to be spent when the revenues dropped below a certain level.

COMMISSIONER BOSKIN: Let me take an example to make it simple. And this isn't exactly how we do it, but I've thought about this, and this is an oversimplification of getting at where Chris wants to about making it hard and fast and careful.

Suppose you had a ten-year average, rolling a previous historical average of the ratio of revenues to some -- to population, inflation or personal income or something of that sort. And then whenever revenues exceeded a certain percentage above that –- say, 3 percent more than that or whatever -- 5 percent or whatever it happens to be -– okay, it would go into the rainy-day fund first and could only be used for certain purposes, one of which would obviously be for years when it fell below the average to make up the difference.

You could also use it to quickly retire long-term debt to enable you to have the capacity to deal with this in other years. If it got large enough, you could have a tax cut or something or one-time capital spending or something like that. That's the basic conception that we have in mind.

COMMISSIONER HAUCK: That was essentially

Proposition 1A on the May 19 ballot. Separate the tax implications of Prop. 1A, the premise was exactly the one that Michael is suggesting.

And I would add, Chris, that if you try to do this statutorily, I don't care what lawyer you get to do it, it will be attackable by the Legislature subsequently.

You could put an extraordinary vote requirement there --

COMMISSIONER EDLEY: Yes, that's what I had in mind.

COMMISSIONER HAUCK: -- like the suspension of Prop. 98, for example. That certainly would make it much more difficult.

CHAIR PARSKY: If we're staying with the rainy-day fund, then Fred hasn't quite finished yet. But go ahead, John.

COMMISSIONER COGAN: Yes, if you want to have a rainy-day fund that at least has some chance of being preserved from the Legislature, you've got to do it through the constitutional process. You can't allow a vote -- and I have to tell you this, Chris, I don't care what kind of majority rule you put in place. In an economic downturn, when the money is sitting there in a honeypot, and the choice is between spending it or not spending it, they'll spend it. And so my sense would be, it would be best to think about your proposal more as a constitutional change, which could not be undone in any way by a vote of the Legislature. Just give it some thought.

COMMISSIONER EDLEY: I agree with that. I agree with that, John. But what I actually –- I didn't want to go on for too long. But what I would prefer is that we recommend both the statutory measure in Category 1, but also recommend that it be codified in the Constitution and put it in Category 2, so that we would actually do both.

CHAIR PARSKY: Let's just think a little bit more about which category it fits in. The concept is the one I wanted to make sure it was out there.

But finish, Fred.

COMMISSIONER KEELEY: Thank you, Mr. Chairman.

Mr. Chairman, still on the issue of process, I wonder if what we also might be able to do is with regard to the types of revenue that we're looking at, where we're looking at capital gain and BNRT, sales, split roll, carbon tax, and so on, I wonder if there might be a way to develop a minimum uniformity of information and presentation, understanding that all taxes are different in certain regards, and so there would be a lot of unique information that the staff would provide. But I wonder if there’s a half a dozen common notions that we might ask for in terms of presentation on all of these issues?

For example -- and I don’t pretend this is the right list or an exhaustive list -- for example, progressivity and regressivity. Every time we look at a tax, we know the answer to if it’s at that -- progressivity and regressivity, the rate and the base, which -- am I right -- is that also called “incidence”? Is the base “incidence,” is that right? Or across the base, you have incidence; is that it?

COMMISSIONER BOSKIN: That’s ultimately where that gets shifted.

COMMISSIONER EDLEY: Who ends up paying the burden?

COMMISSIONER KEELEY: Who actually pays it?

What I’m trying to get at is four or five ways that we get a presentation on any item or concept that is a change in a tax, a new tax, raising or lowering the rate, the base, or whatever; that we receive that information in a uniform way on everything, so that what we can do then, if you combine that concept with getting information in advance and having working groups and so on, then I think both interested commissioners and interested members of the public can begin doing their own dialing and saying, “Well, if that rate, instead of

3.3 was 2.5, and then over here on this tax it was 1.6, and then if it applied to this group instead of there," you could start putting together the kinds of things that, maybe for Chris, for example, when he's concerned about the progressivity or regressivity issue, then he can start building something -- a package that he can see is making sense to him.

And I'm wondering, Mr. Chairman, if that might be an additional request for that kind of uniformity might be very helpful, I think, to the commissioners and the interested public.

Let me conclude with two quick comments.

One is, prior to this meeting, at the direction of the President Pro Tem of the Senate, I had two meetings that were held in Sacramento, and asked for the participation of the Board of Equalization staff, the Franchise Tax Board staff, and the senior staff at the Assembly and Senate Revenue and Taxation Committees, as well as a number of academics. The people who participated in those, were participating not with regard to positions of the agencies or the committees, but as resources to the Commission, to help understand things. I want to thank them all very, very much for their participation. And I suspect that they will do more, but I want to thank them for their participation.

And lastly, Mr. Chairman, I want to thank you again for the way you have structured your recommendation. And I hope that this -- what I've suggested here is helpful in that regard.

Thank you, Mr. Chairman.

CHAIR PARSKY: John?

COMMISSIONER COGAN: Gerry, look, I think the direction that you've outlined here is really quite good. And I would only amend what Fred said in a couple of ways.

One is, on this tax dispute resolution issue, it seems like we would want to have the same kind of process that we have for the net-receipts tax. That is, I think it's a pretty complicated question when you get down to it, so you might want to think about a working group or something that, over the next months, would flesh it out a little bit, since I think it's a lot more complicated --

CHAIR PARSKY: You're saying, on the net-receipts tax?

COMMISSIONER COGAN: No, no, no. On the dispute resolution.

CHAIR PARSKY: Oh, on the dispute resolution?

COMMISSIONER COGAN: Yes, yes.

COMMISSIONER EDLEY: What's the right model? Richard might know.

Richard, do --

CHAIR PARSKY: Well, I think on that one --

COMMISSIONER POMP: There has been a submission to us from the ABA on that. So there is a model.

CHAIR PARSKY: Yes, right.

COMMISSIONER COGAN: Right, there is one model.

COMMISSIONER POMP: It's from the ABA. It's not a bad model, so…

CHAIR PARSKY: We can make sure that that's circulated around again.

COMMISSIONER COGAN: Right.

CHAIR PARSKY: I do think this idea of working groups, dealing with the components is a good idea.

COMMISSIONER BOSKIN: I think the thing that this is pretty –– the thing that ABA submitted is fairly close to sort of the typical thing done in most states other than California.

COMMISSIONER COGAN: So then I have a question on distribution. You know, when I look at these distributional numbers, when we look at income tax distributional changes, I have a lot of confidence that we're measuring things pretty well.

When we get to corporate taxes, when we get to net-receipts taxes, I'm a lot less confident that what we're measuring bears any relationship to reality and whether we would know it or not. And so I'm wondering, as we think about getting down to the final strokes, how would commissioners feel about putting a lot of weight on the personal income tax distribution in making your judgments about the distributional consequences of these policies, and a lot less weight on the net-receipts tax distributional outcome, the corporate tax distributional outcome? Not that we would throw it out, but if we could have these separated, so those things that we are relatively confident about, we have in one pot, and then those things that we're not so confident about, that we sort of assign maybe a lower weight to them or something, but keep them separate.

COMMISSIONER BOSKIN: You would add the sales tax into the confident one; right?

COMMISSIONER COGAN: Yes, right, right.

That's just a suggestion as we proceed down to the final strokes.

CHAIR PARSKY: Monica?

COMMISSIONER LOZANO: Gerry, the only comment is very similar because what I thought I heard you say in your summary remarks is that you would add a review of the capital gains. And I prefer -- because we've done so much work already -- on seeing the relationship between the personal income and the net-receipts tax -- I'd like to continue on with that, to see what adjusting those two do independently of throwing in this third variable of capital gains, which I think we should look at, but let's continue to look at this, first focused on the personal income tax --

CHAIR PARSKY: I had only suggested that because I'm hoping that adjustments that would be made in the personal income tax, with the guideline of achieving a reduction in tax burden, or a reduction in taxes for each of the brackets, would satisfy commissioners that we could proceed.

If that doesn't, then I was trying to fall back on something that might still attempt to address within the personal income tax some elements of the volatility, and there were suggestions made that the capital gains. But my strong urging is that we try to get to a unanimous recommendation on making changes overall, and seeing how it blends in with the business net-receipts tax and the corporate tax elimination.

COMMISSIONER BOSKIN: Could I ask for two additional pieces of information that are maybe a bit more quantitative than the qualitative stuff we've gotten thus far in this regard from the staff?

One would be to look at the net change in the number of taxpayers, including the sales tax; and secondly, the net change in the amount of federally deductible California taxes.

So, I mean, if we switch from a partially nondeductible tax, like the sales tax, to a net-receipts tax, that may be -- that is deductible, that may be saying, we're shifting some of our burden to the Feds, which would be a good thing for California.

If we are lowering the income tax and spreading the sales tax to services, whatever other good it may do, we may wind up increasing California's tax burdens and reducing our -- and increasing our federal tax burden, which just seems to me is not a wise thing to do.

COMMISSIONER PRINGLE: I think that's --

CHAIR PARSKY: Curt, I know that we've held this too long, but you have a comment on that?

COMMISSIONER PRINGLE: Yes, and I will --

COMMISSIONER ITO: I have a comment and a question afterwards.

COMMISSIONER PRINGLE: And I will apologize, as I'm going to try to catch this flight at some point in time.

But I worry, Mr. Chairman, that your one word that you used may not necessarily mislead but mischaracterize what our next step is in terms of looking at all of these various taxes. That you talked about creating -- or that being in a package.

I didn't spend as much time with you as obviously you spent with Fred, but I would --

CHAIR PARSKY: We'll leave it to another time.

COMMISSIONER PRINGLE: And that also applies to his wife.

COMMISSIONER COGAN: (*Tapping on glass*.)

COMMISSIONER PRINGLE: But a lot of this discussion is based upon a Package 1 context. And yet you have suggested other items that were not a part of that, such as a fuels tax of some sort, a split-roll property tax, some additional type of revenue generation off of additional oil exploration and such.

Is that right?

CHAIR PARSKY: That's correct.

COMMISSIONER PRINGLE: But you have not suggested that they would all be a part of a package? What you had suggested is, these items will be the taxes that we consider, get more information on, and then when we come back, have another review of how they all may or may not fit, or how they all may or may not be of long-term benefit as a tax structure; and then a package will be put together from them. So when you suggested or characterized it as a package, your intention isn't that they're all going to be in a package? They're all going to be presented back to us with further evaluative information; is that correct?

CHAIR PARSKY: Yes, and with the desire to seek unanimity around the package we would present.

So if those people that would seek to include a fuels tax or a tax on oil exploration -- new oil exploration or on the split roll, that the unanimity of the Commission wouldn't proceed on any or all of those; they would be withdrawn from the package.

COMMISSIONER PRINGLE: Right. I mean, I know Joel Fox quickly posted his tweet, and then --

CHAIR PARSKY: Who is Joel Fox? I don't know Joel Fox.

COMMISSIONER PRINGLE: But the question is, when you said "package," those are not a part of any package that we are proposing. What you have presented is the taxes we should concentrate on is just -- are just the collection of taxes that we may derive a package from as something we want to do the full evaluation in our final meeting?

COMMISSIONER BARRALES: I think we want to refer to it as the "Curt Pringle Tax Package."

COMMISSIONER PRINGLE: That's fine. I would be happy to craft that for you, Mr. Barrales.

COMMISSIONER BOSKIN: I think we were leaving open those other things becoming part of a package if we didn't agree on stuff without them and they could be mixed and matched in various ways, or rejected or whatever.

COMMISSIONER PRINGLE: Right. I just wanted to make sure that it's not characterized that that is a package that we are trying to craft from --

COMMISSIONER COGAN: You got that, Joel? You got that?

COMMISSIONER PRINGLE: And also, though, I'd like to just suggest that I do have an aversion of a creation of a commission, and then somehow decisions are made in smaller groups. Therefore, I understand and respect the concept of ideas coming forward; but I don't think they should come forward on the core purpose of what we're here for, and that is, to put together a package that we will build consensus behind.

So in areas that may be on your Section 2 or 3, be it the tax resolution group and those things that we haven't spent time discussing, I personally don't have any problem with crafting a proposal by one to ten members -- well, we can't get over our quorum -- but, anyway, something short of a quorum -- crafting something to present to us, because we haven't really heard all of that yet. But on all the stuff we have been working on, I have a little challenge to say that an individual, carved-out collection of subgroup should be making a recommendation back to the whole. I think the purpose of a commission is taking all the value of the 14-member input and having it as a complete discussion.

So in areas of crafting a rainy-day or revenue-limitation fund or whatever it is or a tax-dispute group, having groups put something together like that, I don't have a burden with that -- I don't have a problem; but I do have a problem with somehow we're crafting separate tax plans that we're going to bring forward as some -- I don't think we ever build a consensus that way, that's what I'm concerned about. And I would like to have that level of discussion available for all members of the Commission to participate in.

CHAIR PARSKY: I think that's valid.

The only area that I am concerned about drawing those lines, is the business net-receipts tax, because it requires an extensive amount of ongoing work to present to the Commission for final decision. That's the only one.

I do not think it's appropriate to have a working group put packages together. That's not the appropriate job of a working group.

I do think in these areas like you mentioned, it would be very helpful to have a working group craft what a rainy-day fund would look like or what a dispute resolution recommendation would look like.

But the business net-receipts tax is a different issue, it seems to me, because we need to involve -- we need to have, in effect, hearings or discussion groups from the outside.

COMMISSIONER PRINGLE: Sure.

CHAIR PARSKY: And so I'm going to offer to commissioners who are willing to participate and listen to those -- we won't make any decisions other than things that will be on the table. I mean, the staff didn't make decisions, in one sense; but they did make decisions in putting something on the table.

COMMISSIONER PRINGLE: Yes, right.

CHAIR PARSKY: You can't proceed with a new tax without that.

COMMISSIONER PRINGLE: And I appreciate that distinction. And I'm just but one Commission member. But in that regard, I do think there's value in having public view. I mean, if we record a workshop with experts and have it online and notify everybody that if they wish to hear it or participate or monitor it, that's available to them, I think all of those types of things, if we are hashing out the NRT, or whatever it's called, then I think we should make it at least accessible for folks to see that.

CHAIR PARSKY: We will do that.

COMMISSIONER PRINGLE: A couple -- two other quick points. I do think that -- I mean, I'm going to struggle with understanding how the split roll plays in the context of our job. Property tax is a local tax. I understand the majority of property taxes go to support schools. I understand the schools are the responsibility of the state. I get all that.

I'm just saying that does not allow for, in my opinion, my legal opinion, the proper tax neutrality requirements of trading one tax for another under state law because it's not a local tax. You are eliminating a portion of a state tax, and you're contemplating backfilling it with a local tax that cannot be -- it limits -- it is one of those types of taxes that's going to be very hard to put in any package. So if we want to step back and say, "All of our package is going to be subject to a vote of the people," then that is the decision we may want to collectively make.

I think it means that everything gets voted down, because a vote of the people makes it easy for anybody to take a shot at any single element of a package and to pull it apart. Therefore, any split roll is going to be a part of a -- be a constitutional change. And everything, if it were pinned on -- hinging upon the revenue derived from it and changing the way Prop. 13 interacts with state government, then everything we do is going to be subject to a vote of the people. And I think that challenges our task here in terms of the reality of what we may propose to be adopted by the Legislature.

And finally, I do have a concern about presenting a package that the Legislature will seriously consider -- not that they're not serious. But, in fact, I think we're getting very late in our time scheduling here to get something that could be seriously considered by the Legislature before the end of their legislative session which, in odd years, is September 15th.

I would like to try, but I will just -- I should probably have said this to you privately, Mr. Chairman -- I'd also say something very daring and probably inappropriate -- maybe we should think about asking for an extension of some time, even to the end of the year, so that our proposal, when it is made, comes back with the Legislature being able to address it and contemplate it, as opposed to what I was mentioning to the Chairman earlier, to drop something in the Legislature too late at the end of the year, when they won't consider it, means it sits there for three months and gets beat up by everybody who has some gripe with some piece. And, therefore, when the Legislature does reconvene to talk about it, it's already bloodied and bruised.

Maybe we could get -- if we do think we could submit by the middle of September, asking the Legislature to hold hearings through the fall so that they are at least engaged in it as opposed to just leaving it on their doorstep and saying "good-bye."

So those are a few of my thoughts. And thank you very much, Mr. Chairman.

CHAIR PARSKY: Thank you.

I'd like to think a little bit more about what you just said. I think it's worth thinking about.

COMMISSIONER ITO: I have a question.

CHAIR PARSKY: One more.

Jennifer?

COMMISSIONER ITO: So I have a question about -- I think it makes sense to kind of divide up the sections of our recommendations. But I do have a question about how that's going to impact the analysis. Because if I'm looking at the scenario, if the changes that we are suggesting under the statutorial Section 1, if those get approved, but then we have a second set of recommendations that are constitutional amendments that don't get approved, what is that overall impact going to be?

(Commissioner Pringle exited the meeting room.)

COMMISSIONER ITO: Because we're making –- you know, in our discussion today, we're talking about implementing some new taxes, to swap out others, and to mix and match. So if we are moving ahead as a total package, yet it's broken up, what then -- I'm just worried about then what that could mean in the long-term.

CHAIR PARSKY: I do think that's a very legitimate concern.

I think inherent in Category 2 would be a -- any recommendations that fit Category 2, we would ask the Legislature to act on it, in a sense, of approving them for the ballot.

As we evolve this combination of taxes, we may find that there's only -- we'll see -- that there's only one proposal, namely the reserve fund, that requires going to the ballot.

COMMISSIONER EDLEY: And the split roll.

CHAIR PARSKY: Like I say, we may find that as we evolve through, the package of recommendations would only include that which would be quite complementary to a set of recommendations that the Legislature could act on. So there have been several suggestions made, including the split roll and including the severance tax that we're going to have to discuss some more.

If we can't reach unanimity on those as well as maybe the fuels tax, where I know there's differences of opinion, maybe those taxes fall away, and we're left with a set of tax recommendations that can be approved immediately by the Legislature, and a concept of a real, hard, rainy-day fund that can be put on the ballot. But we'll see.

COMMISSIONER ITO: One other amendment --

COMMISSIONER KEELEY: Ms. Ito, if I might just respond also on that point.

I just checked with one of the speakers, staff folks who is here and does a lot of the taxes, budget issues. And my recollection from serving on the Legislature, there may be some drafting possibilities here for dealing with your issue that may have to do with -- double-joining issues, contingent enactment issues. There's some drafting strategies to try to get to that issue. So I think perhaps we could work with that as a concept as well.

Thank you.

COMMISSIONER ITO: And then just one other, as a Commission member who is concerned about -- who likes the progressivity of our tax structure. You outlined two options as we continue to explore adjustments to the personal income tax, the three brackets, and all brackets getting a reduction and the other alternative being around the adjustment in capital gains. I mean, I would like to throw out there a third, which is keeping the current structure, yet a possibly overall reduction.

CHAIR PARSKY: Inherent in the discussion -- in the comment about having all brackets was that.

COMMISSIONER ITO: Okay.

CHAIR PARSKY: That was the reason for that possibility. Because I sensed that there were some commissioners that wanted to take a look at that approach. It would still be a more simplified personal income tax because we would have reduced a number of itemized deductions. So it would still be more simplified, but we're leaving on the table both possibilities.

COMMISSIONER EDLEY: Gerry, there's something critically important to me that we haven't mentioned. We got a -- Mark dutifully sent around a note, indicating that it violates the Opening Meeting law. In the opinion of the Attorney General, or somebody in the Attorney General's office, it violates the Open Meeting law for a commissioner to send an e-mail to all the other commissioners, even if that is posted for the public.

I've got to say, that's the most idiotic thing that I have heard of since I got to California. And the competition is tough for that distinction. So it's very important for me to understand whether there is a civil penalty, a fine, for violating the Open Meetings Act because if there isn't, some judge is going to have to enjoin me from sending e-mail to fellow commissioners.

CHAIR PARSKY: I think you will find that there's more flexibility than that. And we'll send around -- we'll send around a little description of how you can communicate to your fellow commissioners.

COMMISSIONER EDLEY: Thank you.

COMMISSIONER POMP: Mr. Chair?

CHAIR PARSKY: Have we --

COMMISSIONER POMP: I need a point clarified.

I'd like to work with our discussion, the elements, and maybe put together a possible package for unanimity. You're not saying that we can't play with what we've talked about; are you?

CHAIR PARSKY: I'm saying that we've all agreed that we will deal with revenues only.

COMMISSIONER POMP: Right.

CHAIR PARSKY: We're not going to deal with expenditures.

COMMISSIONER POMP: Right, that's fine.

CHAIR PARSKY: So that's Guideline Number 1.

COMMISSIONER POMP: Right.

CHAIR PARSKY: Number 2, we're going to deal with the elements of taxation outlined.

COMMISSIONER POMP: Right.

CHAIR PARSKY: Right, and we're going to do further analysis of the business net-receipts tax, because a number of commissioners are contemplating including that in lieu of the sales tax and/or the corporate income tax.

COMMISSIONER POMP: I understand. But I guess what I'm saying, if I want to put together a package with some people and attempt to reach unanimity, I am free to try and do that?

COMMISSIONER EDLEY: You just can't tell any of us.

COMMISSIONER POMP: I just can't –- right, right.

CHAIR PARSKY: You have to communicate in Connecticut. And other than that, you're free.

COMMISSIONER POMP: And Chris is far too negative for me to want to communicate with him.

CHAIR PARSKY: And my suggestion is, in order to start with unanimity, start with the gentleman next to you; and if you achieve unanimity between the two of you, we want to hear it.

COMMISSIONER POMP: We are closer than you might think.

COMMISSIONER BARRALES: Whether or not it breaks the law.

CHAIR PARSKY: Secondly -- that won't break the law.

COMMISSIONER POMP: I would like to see if there's any empirical data, rather than anecdotal, about the effect of the personal income tax on the California economy, so I have not seen any yet. If there is, I'd like to, you know, have the staff make that available, so…

COMMISSIONER BOSKIN: You should send around the Milken Institute study. It's not the kind of empirical study that I think that Richard is referring to, but it gets to that.

COMMISSIONER POMP: Well, and plus whatever other studies there might be.

CHAIR PARSKY: We'll get you some data on that subject.

Okay, are we okay in proceeding this way?

COMMISSIONER KEELEY: One last question, Mr. Chairman.

Mr. Chairman, the only aspect of this that -- well, there's probably a thousand aspects I'm not clear on, but I totally agree, as you know, with what we've agreed to this afternoon.

I would like to explore with you what level of analysis or presentation the staff is going to now provide, now that we have essentially said, "This is the universe. If it's inside the box, that's fine; if it's outside the box, it doesn’t get talked about anymore.” We’ve now got the universe defined.

The same kind of analysis that was put into -- or a similar kind of analysis that was done for the BNRT, is that now going to be done, or some level of analysis done with regard to carbon fuels and the other issues that are now the known universe or the constellation of planets that are in this solar system that we’re dealing with? What is the staff going to do with regard to that on a going-forward basis, sir?

CHAIR PARSKY: Well, we have three forms of tax that are still on the table that would require extensive analysis. The fuels tax or -- with all due respect, the fuels tax, split roll, and the severance tax on new oil drilling. On each of those, I would like all the commissioners, in the spirit of proceeding, to step back and see if they believe unanimity could be achieved about including those.

As of the moment, I think everyone thinks it can. But I want everyone to think about that.

It would take extensive additional work -- not so much on the fuels tax, but the split-roll property tax would take an extensive amount of additional analytical work by the staff, which we can ask the staff to do. And I think our Commissioner Boskin that suggested the new form of severance tax needs to describe it in a little more detail so the staff can know what to analyze.

COMMISSIONER HALVORSON: What, technically, is a severance tax?

CHAIR PARSKY: Well, I think it's described as, we would permit new drilling for oil, and there would be a royalty fee, severance -- however you wanted to describe it -- applied to every bit of oil newly drilled.

COMMISSIONER HALVORSON: So a drilling tax?

CHAIR PARSKY: As I said the name.

So I would just ask -- and I will be in touch with people -- I'd just ask you to think about that; but I do think in particular -- in particular, I think Commissioners should think about the analytical work that they want the staff to do on the split-roll property tax. That, we have not analyzed in great depth. And it would take a significant amount of work -- which we can commission, and would. But subject to that, the rest of the package, the analytical work is very much ongoing. And I don't think it would take a lot of incremental staff work to put together exactly -- I mean, I think the staff has done some of this on the fuels tax already, and would do more -- to be in a position to discuss it in the same position as the personal income tax and the sales and use tax and so forth.

COMMISSIONER MORGAN: Mr. Chairman, I'm concerned, as was, I believe, Curt Pringle, about the timing. If we extend our work until September 15th, the Legislature will be in recess. And it will be -- our recommendation will be battered and bruised, as he said, by the time they get back in January. So either we have to not wait that long to get our recommendations going forward, or we have to wait much longer, until the Legislature is back in session in January, it seems to me. Because I, for one, would not like to see our recommendations hanging out there for three months.

CHAIR PARSKY: John?

COMMISSIONER COGAN: Becky, I've got to disagree with you. It seems to me that when you're proposing, if we were to get to this point, a massive overhaul of the California tax system, I think you want it to sit out there for a long time. Let people get fully -- a full understanding of what's in it and what it does. I don't think it's right to think about a proposal like this as one we can rush through the system before everyone figures out what's in it.

I'm also mindful of something that Bob said when he briefed us on the net-receipts tax. He went through a time-line of how long it took in Michigan and how long it took in other states to get it through. And it was on the order of 18 months or so. And so my sense is, even though we'd like to have the Legislature move quickly on something, my sense is the reality of it is it's not going to be that quick, nor should it be.

COMMISSIONER MORGAN: And I'm not trying to rush it. I'm just saying, what is our expectation? And if we want it to be fully debated in the Legislature, then let it hang. But that being the case, it would be my prediction that we'd better not make very many recommendations. Because when it is debated for a long period of time, there will be more "no" votes.

CHAIR PARSKY: Well, my only reaction is, it will be impossible for us to come up with meaningful, well-thought-through recommendations by July 31. That's not --

COMMISSIONER MORGAN: I agree.

CHAIR PARSKY: That's not possible. But I do think we want to think a little bit about what date after that.

I do think that the Legislature may -- will want to hold hearings without enacting anything. That's their prerogative and obligation. And may take place post-September 15th. I don't know. I will have some discussions about that and come back to everybody.

Okay, are we okay with proceeding this way?

COMMISSIONER COGAN: Thank you, Mr. Chairman.

CHAIR PARSKY: Thank you all very much.

(The meeting concluded at 4:55 p.m.)

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REPORTER'S CERTIFICATE

I hereby certify:

That the foregoing proceedings were duly reported by me at the time and place herein specified; and

That the proceedings were reported by me, a duly certified shorthand reporter and a disinterested person, and was thereafter transcribed into typewriting; and

That the foregoing transcript is a record of the statements of all parties made at the time of the proceeding.

IN WITNESS WHEREOF, I have hereunto set my hand on the 20th day of July 2009.

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DANIEL P. FELDHAUS
California CSR #6949
Registered Diplomate Reporter
Certified Realtime Reporter