STATE OF CALIFORNIA

COMMISSION ON THE 21st CENTURY ECONOMY

ꕥ

STATE OF CALIFORNIA

REVENUE & TAXATION

PUBLIC MEETING

Thursday, September 10, 2009
11:00 a.m. – 6:00 p.m.

University of California, Los Angeles
James West Alumni Center
Collins Alumni Conference Center
325 Westwood Plaza
Los Angeles, California

ꕥ

Reported by: Daniel P. Feldhaus
Certified Shorthand Reporter #6949
Registered Diplomate Reporter, Certified Realtime Reporter

Daniel P. Feldhaus, C.S.R., Inc.
Certified Shorthand Reporters
8414 Yermo Way, Sacramento, California 95828
Telephone 916.682.9482 Fax 916.688.0723
FeldhausDepo@aol.com

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

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

REBECCA MORGAN
President
Morgan Family Foundation
(Appearing telephonically)

A P P E A R A N C E S

COMMISSION ON THE 21ST CENTURY ECONOMY

Commissioners Present
continued

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

CURT PRINGLE
Mayor
City of Anaheim

---o0o---

COTCE Staff Present

MICHAEL C. GENEST
Commission Executive Director
Director of Finance

MARK IBELE
Commission Staff Director
Board of Equalization

ASHLEY SNEE GIOVANNETTONE

LORI HSU

ANTONIO LOCKETT

JESSICA MAR

MICHELLE QUINN
Staff Writer

PHIL SPILBERG
Chief, Financial Research
Department of Finance

MARGIE RAMIREZ WALKER

---o0o---

A P P E A R A N C E S

Tax Advisors

JUNE SUMMERS HAAS
Partner
Honigman Miller Schwartz & Cohn LLP
(Appearing telephonically)

CARL JOSEPH
Director
Multistate Taxation Bureau
Legal Division
Franchise Tax Board

PATRICK KUSIAK
Franchise Tax Board

---o0o---

Public Testimony

GUS KHOURI
California Transit Association

CARL MOREHOUSE
City Council
City of Ventura
and
Southern California Association of
Governments (SCAG)

CHRIS NORBY
Southern California Association of
Governments (SCAG)

MICHAEL D. SHAW
Legislator Director
National Federation of Independent Business

WILLIAM SPILLANE
California State Director
FairTax.org

---o0o---

A P P E A R A N C E S

Presenters

JOHN BOESEL
President and CEO
CALSTART

WILLIAM G. DOREY
President and CEO
Granite Construction, Inc.

---o0o---

Table of Contents

Item	Page
Welcome and Call to Order	
Chair Parsky	8
Presentation of Tax Package	20
Commissioner John Cogan	
Commissioner Christopher Edley	
Presentation of Pollution Tax Proposal	
Commissioner Fred Keeley	148
William G. Dorey President and CEO Granite Construction, Inc.	159
John Boesel President and CEO CALSTART	176
Public Comments	
Carl Morehouse City Council, City of Ventura Southern California Association of Governments (SCAG)	109
Chris Norby Southern California Association of Governments (SCAG)	114
William Spillane California State Director FairTax.org	252
Gus Khouri California Transit Association	254

Table of Contents

Item **Page**

Public Comments *continued*

Michael D. Shaw
Legislator Director
National Federation of Independent Business . 256

Adjournment 259

Reporter's Certificate 260

--o0o--

BE IT REMEMBERED that on Thursday, September 10, 2009, commencing at the hour of 11:10 a.m., at the University of California, Los Angeles, James West Alumni Center, Collins Alumni Conference Center, 325 Westwood Plaza, Los Angeles, California, before me, DANIEL P. FELDHAUS, CSR 6949, RDR, CRR, in the state of California, the following proceedings were held:

(Commissioner Morgan and Ms. Haas appeared telephonically for the meeting.)

CHAIR PARSKY: Becky, are you on?

COMMISSIONER MORGAN: Yes, I am.

CHAIR PARSKY: And, June?

MS. HAAS: Yes, I am.

CHAIR PARSKY: Ladies and gentlemen, I'd like to get started with our public meeting on the Commission on the 21st Century Economy.

We have on the telephone Becky Morgan, who is a commissioner. We also have June Haas, who has been a former commissioner in Michigan, a tax commissioner in Michigan, a lawyer that has been assisting us in evaluating the potential business net-receipts tax.

I know that Ruben Barrales and Curt Pringle will both be here, and they will be joining us shortly.

I think all the commissioners have in their book

an agenda and a number of supporting documents. And we will have a public comment period. I haven't collected all those that wish to make public comment; and so we'll delay starting the public comment until a little bit later.

I just want to make a couple of introductory comments and then talk a little bit about the structure for this session.

As I think all of you know, this Commission was formed by the legislative leadership and the Governor to make recommendations with respect to reform of our tax system in California.

I think I've mentioned at every public meeting that we have held, the overall objectives are goals that we have been requested to keep in mind and test against the recommendations that we will make.

And just to remind people, those included the goal of helping to stabilize state revenues and reduce volatility.

Second, to promote long-term economic growth and job creation for the state and its citizens.

Third, to establish a tax structure that fits with the state's 21st century economy.

Fourth, to improve California's ability to successfully compete with other states and nations for

jobs and investment.

Fifth, that the recommendation should reflect principles of sound tax policy, including simplicity, competitiveness, predictability, and ease of compliance and administration.

And finally, to ensure that the recommendations help the tax structure be fair and equitable to its citizens.

Those goals haven't changed from the time we first began. And I want to thank all of the commissioners for the kind of time and effort everyone has put in to try and to come up with a consensus series of recommendations to try to achieve those goals.

This subject, I think everyone now, if they didn't at the time we began, realize is a very complicated and difficult subject to deal with and, in particular, a difficult subject to deal with to achieve those goals.

Nevertheless, I think it's an incredibly important subject. And I think during the course of this Commission effort, we've seen the difficulties that exist within the state and for the policy leaders or makers in this state with dealing with the revenue side of the California system. And many of the benefits that rightfully should be provided or promised to be provided to our citizens have not been able to be provided because

of the fact that the revenues haven't been there in order to accomplish those objectives. And it's created significant harm to our citizens.

And so I think the effort at the beginning was important, but it's taken on even more importance, as we've seen what can happen. Hopefully, this economic recession won't be repeated. But business cycles happen. And we've seen what can happen under our current system if, in fact, you have a deep recession, which we have all been experiencing: The amount of unemployment that exists and the failure, if you will, on the part of the revenue base to satisfy the objectives and desires of the legislative body.

And so the efforts that this Commission is undertaking, as I said, I think has been important from the beginning. It takes on even more importance. And I think a number of us have indicated the importance of trying to come up with real reform; for reform that needs to be looked at carefully, that needs to be looked at over a period of time.

And in that connection, I would say that our job is not to take the place of the Legislature. The Legislature has continuing responsibility to enact laws for California. The Governor obviously has a critical role in that process. But I do think that we were asked

to provide specific reforms in connection with that, recognizing that the legislative process will take our reforms and will have to go through their normal committee process, their normal evaluation; and that although there has been an indication between the Governor and the legislative leaders, that there is an expectation for whatever reform proposals are recommended, that there will be a vote on them.

I don't think any of the commissioners that I -- and I've talked to everyone -- expects that the reform recommendations will be just taken as is.

(Commissioner Barrales entered the meeting room.)

CHAIR PARSKY: And especially if we continue to contemplate a brand-new form of tax. That, as you will hear this morning, a lot of work has been done on, but that is very complicated and, not having been in existence, needs careful analytical consideration beyond what this commission could possibly have done in the time frame and with the staff that we have.

Despite that, I think you will see very extensive, specific proposals for consideration. And we'll talk more about that.

The final thing I want to remind the Commissioners and the public, at the last meeting we

came together and agreed on a structure for our recommendations. And this has been posted and it has been discussed. But as we enter into this meeting, I want to remind people of that structure and see if, in our discussions today, we can fit all of the recommendations and desires of commissioners into that structure because we agreed that's the way in which we would proceed.

Two basic pieces of material: The recommendations we agreed would fall into three sections.

Section 1, the recommendations of statutory tax-law changes, revenue-related, that can be acted on by the State Legislature immediately, and hopefully endorsed unanimously by the Commissioners.

Section 2, 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.

Section 3, the Commission, hopefully unanimously, but with some clear desire on the part of the Commissioners, to maintain great flexibility, to identify areas of reform, whether they be revenue or non-revenue-related that, in commissioners' views, need to be considered by others outside the context of the Commission in order to achieve comprehensive fiscal reform.

1 That will make up the recommendations that we
2 will hopefully come together to make.
3 Then in addition to that, we agreed on a tax
4 package, in general terms, that would make up sections --
5 at least Sections 1 and 2 of the recommendations -- a
6 package, at least at our last session. And that package
7 would include recommendations relating to the personal
8 income tax and, around that, a simplified rate
9 structure -- two potential rates -- a standard deduction,
10 itemized deductions for mortgage interest, charitable
11 giving, and property taxes.
12 However, the commissioners made it clear at the
13 last meeting that a condition to this proposal, or the
14 part of the proposal that deals with the personal income
15 tax, that all AGI brackets, as shown in our last
16 presentation, would need to receive a reduction in taxes
17 in order to endorse a recommendation surrounding the
18 personal income tax.
19 And if that objective cannot be achieved under
20 the two-rate structure, then consideration would be given
21 to other alternative structures.
22 So a condition to the recommendations you will
23 hear relating to the personal income tax was that all AGI
24 brackets would need to receive a reduction. And there is
25 heightened sensitivity on behalf of many, if not most, of

the Commissioners, to make sure we are cognizant of the distribution impact of changes like that. And that although I think there is a belief that if there is a way to reduce the overall general fund on the dependence on the personal income, that's an objective that we potentially could rally around, but not if it means that the higher-income groups were going to get a reduction at the expense of the middle- or lower-income groups getting an increase.

Second, the corporate tax under this tax package as identified, would be eliminated; that a business net-receipts tax, as previously outlined, would be established; and that the general fund sales tax, a portion of the sales tax going to the general fund, would also be eliminated.

There was a note that Commissioners agreed to, that if we do not recommend the business net-receipts tax, we would consider a recommendation to extend the state general sales tax to services. That was outlined also as part of the package.

In addition, as part of the package and potentially inclusion in Sections 1 or 2, a pollution tax on carbon-based fuels, a split-roll property tax for non-residential property, a royalty on expanded oil drilling, the establishment of a reserve or rainy-day

fund, with a note also that the recommendation would include a dedication of these funds to the general fund only.

And finally, the potential establishment of a new tax dispute resolution forum.

That tax package was agreed to by the Commission as the structure that we would attempt to coalesce around in terms of our recommendations for Sections 1 and 2.

Section 3 could include more than was embodied in that tax package. And if we couldn't reach consensus around any one of the -- all of the elements outlined, then that element could also be included in Section 3. And we will discuss that as we go through here.

But I think I've accurately reflected what we had agreed the approach we would take to our recommendation section. And we have heard from a number of commissioners about items that they are particularly interested in as part of reform outside of this package, as described. And we will air those, discuss those, as we proceed with this meeting.

The only other thing I would say before we go through these elements, is that we said at the last meeting that given the potential for several new taxes -- the business net-receipts tax and the pollution tax -- that we felt that further work, extensive work needed to

be done with respect to both of those.

And I want to thank individual commissioners Chris Edley and John Cogan, with respect to the business net-receipts tax, and Fred Keeley with respect to the pollution tax. That these commissioners helped extensively in preparing for this meeting in connection with those two possible recommendations.

With respect to the business net-receipts tax, we held a planning session which both commissioners participated in, and which staff -- not only our staff, but staff from the Franchise Tax Board, staff from the Board of Equalization, and individual staffs from the legislative leaders -- participated in planning for two public workshops on this new and quite complicated potential tax. And then we conducted public workshops, hearing from a variety of interested parties, affected parties. And several commissioners attended those workshops: Bill Hauck, Jennifer Ito, Edward De La Rosa, Ruben Barrales attended those workshops, as everyone was welcome to. And I thank all of you for doing that.

I also want to thank all the other commissioners for the input that you have given extensive e-mails from all the commissioners in connection with their thoughts and ideas around this.

That gives you, by way of background, the kind

of effort that has been undertaken. And you will see, posted on the Web site, the results of that effort with respect to this entire package.

And, as I said, several commissioners have indicated a desire to consider other recommendations; and we will discuss each of those in connection with this meeting today.

Finally, we have scheduled another meeting, as needed, on Monday at Berkeley. Not without some level of influence from our Dean of the Boalt Law School. But we do have one scheduled. And my only concern about that is, I know that several commissioners are unable to attend that meeting. We will certainly give them access by phone, as we have Becky Morgan today. But we will need to address the fact that several commissioners can't attend that meeting.

My advice would be, let's see where we are as we get through today's meeting, and see what is needed between now and Monday.

And then we have a deadline of submitting our final report on September 20th. And the Governor has indicated that he would like to call a special session of the Legislature to consider the recommendations.

Inherent in that, is a full, extensive legislative session, including extensive hearings and

extensive additional analysis of all elements of any recommendation that we would make.

COMMISSIONER EDLEY: Spell-checking.

CHAIR PARSKY: The dean said "Spell-checking." Yes, I think that's true.

So with that framework, what I'd like to suggest is that we work our way through this package. And my suggestion to begin, would be to turn the discussion over to, first, John Cogan and Chris Edley, who have been extensively involved in the analytical framework for the potential business net-receipts tax.

But before I do that, I just want to acknowledge and thank several members of our staff, because they have worked around the clock in an effort to put this material together.

I think all of you know Mike Genest, Mark Ibele, and Phil Spilberg. All three of these people, all of whom have worked tirelessly to try to pull together a very, very complicated subject.

I also want to give special thanks to Bob Cline of Ernst & Young, who has worked also extensively with us in connection with the business net-receipts tax.

Special thanks go to a number of members of the Franchise Tax Board. Carl Joseph, Pat Kusiak, Doug Powers, and Andrea Chang, all of whom tirelessly worked

to pull together extensive legislative language that has all been posted on our Web site, is available to all the commissioners with respect to these potential changes.

And Pat Landingham -- is that the right way to pronounce it? -- has done an incredible amount of work for us in trying to give as accurate a projection of revenues coming forward.

I can't express enough the kind of voluntary efforts put in by these people.

So with that, I'd like to turn this over to John and Chris.

At the end of this presentation on these elements of the package, all commissioners can ask questions, then maybe we'll take a break, and then we will come back and let commissioners express their views on this element.

COMMISSIONER EDLEY: And then what about the proposals?

CHAIR PARSKY: Then each of the other pieces will be presented in the same context, with questions, and then come back and make comments. So we'll treat each element of the package the same, and we'll try to get through this in the time frame allowed.

COMMISSIONER COGAN: Gerry, thank you very much.

Commissioners, Chris and I have been working for the last month, as Gerry said. We tried to put together a package that we hoped would be able to achieve a unanimous recommendation by the Commission.

We've divided up the presentation of our work. It was divided by the flip of a coin. I won, Gerry lost; and so I get to talk about the tax cuts, and then Chris gets to talk about the tax increases.

But in going through this process, I have to say that I've discovered why I'm not a legislator. Writing tax policy is extraordinarily, extraordinarily difficult. And as I think you'll see, in many ways, some arbitrary decisions have been made, but they're unavoidable.

But let me begin by emphasizing a point that Chris and I mentioned in our memo to you all, and that is that we're confident that this general approach that we are proposing is a good policy for California's economy. But the magnitude of the change that we are considering is so large, I don't think there's ever been a change proposed for California this large in its history, that we don't believe that we should be recommending an up-or-down vote by the Legislature at this juncture.

What we need to have is a process by which the ramifications of the proposal are fully vetted and all the provisions of a new business tax for California have

been fully considered.

And so what we're recommending to the Commission is that you consider this to be a proposal for further inquiry. That is, we believe that the proposal, as offered, warrants your serious consideration and your recommendation. But the recommendation is really to move the process forward at the Legislature. We think this approach is very, very promising, but we realize that it needs a lot more vetting before it's ready for a vote by the Legislature.

So with that in mind, I thought I would start with the personal income tax side of the proposal, and then Chris would move into the discussion of the business net-receipts tax.

Chris, do you want to add anything to start off with?

COMMISSIONER EDLEY: Thanks, John.

I certainly subscribe to exactly every word that John just spoke.

We have put a considerable amount of time into this. In my case, I had a lot of furlough days that I could use for the purpose, even though some of that time was taken up helping draft President Obama's speech last night, especially the parts about bipartisanship.

At this stage of my life, I try to avoid being

involved in quixotic ventures, and this surely looked like that back in October or November when Speaker Bass called me to talk to me about it. And I only agreed to serve because it was the first thing she asked me to do, and I couldn't say no, and because of my confidence in Gerry Parsky's leadership.

But I do think it is absolutely the case that almost as important as putting forward a sound package of proposals, in my mind, is the importance of trying to model good behavior for what strikes me as a rather dysfunctional state of governance in Sacramento.

The spirit of bipartisan struggle that has characterized most of our discussions, I think, is in that vein. And I certainly hope that it can hold until we cross the finish line. But it doesn't mean that everybody's going to be comfortable with what we produce.

The only way to have a package that people could feel reasonably comfortable with is if it did basically nothing. That any effort to try to be bold, particularly bold in the policy directions that I think the State needs for the coming decades, is going to be fraught with uncertainty, and that produces anxiety. And it's also going to require that people compromise their initial strongly felt policy preconceptions. I don't want to disparage them by calling them ideological commitments,

but strong policy preconceptions.

I don't think any of us would have been asked to join this commission but for the fact that we have strong views about public policy that we've held through our professional lives. So part of our challenge is to be willing to engage each other, recognizing that there are those strong commitments, recognizing that there is a lot of uncertainty, but also recognizing that the only way to move forward is to, in good faith, compromise where compromise is necessary and possible, provided we can have a basic level of confidence in our direction. I think that's the nature of politics, that's the nature of complex public policy-making.

John?

COMMISSIONER COGAN: Thank you, Chris.

So let me begin with our little walk-through of the package. And then if, when we get done, if you have questions, we can get Mark and Phil up here and join in with us to try to answer any questions you might have.

I have a little slide deck here that Chris and I will work off. If you'd go to page 2, that summarizes the package. And we do see this as a package. Very important, all the parts fit together. And it would be inappropriate to consider one part in isolation from the others.

And so the package really has four key tax components and one rainy-day fund, which is not really a tax component.

So if you go to the next slide.

Thanks, Michelle.

MS. QUINN: Is that it?

COMMISSIONER COGAN: That's it. Thanks.

So the four key tax provisions are rather sizable and dramatic reduction in personal income taxes across the board.

The second element is elimination of the current corporate income tax code for businesses.

Third, elimination of the state sales tax.

And fourth, to achieve a revenue-neutral package, we would replace the corporate tax and the retail sales tax with a new "business net-receipts tax."

So if you go two more slides.

This slide shows, after all is said and done, how the distribution of revenues changes for the state. And there's only one really important point to make from this chart, in my mind, and that is that the reliance of the State on the personal income tax, which is the most volatile part of our revenue system, declines by about 30 percent. And so the bulk of what we achieve in reductions in volatility comes from reducing the reliance

by the State on the personal income tax and then, to some extent, on the corporate income tax, but primarily, on the personal income tax side.

How much volatility reduction do we get? The next chart shows how much we get.

What this shows is the variance in State revenues, estimated what they would be under the proposed plan, or the plan under consideration, compared to what they actually have been over the period -- I think it's 1996 to 2007. And what this shows, is that we would achieve a 42 percent reduction in the variance in income tax revenues or state tax revenues over this ten-year period. And so the reduction in volatility is quite extraordinary.

So if we go to the next slide -- yes?

COMMISSIONER DE LA ROSA: Can I ask a question?

CHAIR PARSKY: Yes.

COMMISSIONER DE LA ROSA: Is that the volatility of the PIT only or of all state tax revenues?

COMMISSIONER COGAN: All state tax revenues.

COMMISSIONER DE LA ROSA: Thank you.

COMMISSIONER COGAN: All right.

COMMISSIONER BOSKIN: Measured at the coefficient of variation, which is the standard deviation divided by the median.

COMMISSIONER COGAN: Thank you, Michael.

COMMISSIONER DE LA ROSA: I knew that.

CHAIR PARSKY: From one economist, that clarifies it.

COMMISSIONER COGAN: Okay, so if we go to the next, the next slide describes what we have in mind for the personal income tax. We would replace the current complex code with a two-rate system, really a three-rate system.

But the first rate would be 2.75 percent for taxable income, up to $28,000 for single individuals and $56,000 for joint filers.

CHAIR PARSKY: Michelle, could you just go back one more page?

COMMISSIONER COGAN: One more, Michelle.

CHAIR PARSKY: I think you have to go back one page.

COMMISSIONER COGAN: One more.

CHAIR PARSKY: There you are. Stay right there.

COMMISSIONER COGAN: Okay, got it?

CHAIR PARSKY: Yes.

COMMISSIONER COGAN: In any event, then we would replace all of the current tax deductions and tax credits that are in the California personal income tax code, with a more simple approach. For single

individuals, we'd have a standard deduction of $22,500; and for joint filers, a standard deduction of $45,000.

So a way to think about this is that, for a joint filer, your first $45,000 dollars of income is nontaxable. Then the next $56,000 of income, bringing you up to over $100,000 of income, would be subject to a 2.75 percent tax rate.

For joint filers above that $100,000 or $101,000 threshold, you would pay a 6.5 percent rate of taxation.

We would retain the constitutional 1 percentage point addition to the personal income tax code. So the so-called "millionaire's tax" would be retained in the code. So for those with incomes in excess of a million, they would be subject to that tax.

As I said, we would sweep away the current credits and deductions that are in the code, except for three: Mortgage interest, property taxes, and charitable contributions. In addition, above the line, employee benefits, would continue to be excluded from the tax system as they are now.

But at the end of the day, you'd have essentially a three-rate system with very few deductions and no credits. And our hope here is to achieve a very, very simplified tax code, one where you could really fill

out your taxes on a single piece of paper, if not a postcard.

As you know, many on this commission had the idea initially of a flat tax. We moved away from the flat tax, as Chris said, in the interest of achieving some compromise among the various groups. We heard some very strong feelings from people about maintaining progressivity in the code.

And so let me turn to the next slide -- Michelle -- which summarizes the tax reductions that the plan would achieve for various AGI groups. And there are two messages from this.

If you look at the column labeled, "Percentage Reduction," you will see that each and every AGI group receives a reduction in their income tax liability. And if you look at the groups from $75,000 and above, it's pretty much a constant reduction of around 29 to 30 percent across those groups. So these reductions are substantial, they're broad-based, and they apply to each and every income group.

Essentially, this tax change on the personal side that we've proposed preserves the existing degree of progressivity in the code. That is, we have constructed a package that reduces volatility in the code by lessening the State's reliance on the personal

income tax as a source of revenue rather than reducing the proportion of personal income taxes that are paid by the highest income groups.

And so the goal here in constructing this package -- and I think it's a goal that Chris shares -- was to try to get a package that would be acceptable to all of you. And we ended up with one that retains the degree of progressivity in the current code.

And I would say this: There are many people that point to the fact that if you look at people over $200,000 of income, they pay 50 percent of all of the personal income taxes at the current code. Under our revised proposal, those individuals will amount to about 3 percent of all taxpayers would continue to have the burden of about 50 percent of the personal income taxes paid in California.

And so with that, let me stop and turn it over to Chris for any comments he wants to make on the personal income tax side, and then to describe a little bit the new business net-receipts tax.

Chris?

COMMISSIONER EDLEY: Let me make two or three points.

One is that while I have never been a subscriber to the flat tax as a matter of policy, I do, as a general

matter, think that lower marginal rates are better economic policy. Fewer distortions, better incentives for growth. So I think the reduction in the marginal rates is something to be celebrated. That's point number one.

Point number two is, while I'm fully satisfied with the distributional impact of these changes in the PIT, there remains the question of the distributional impact of the package as a whole. And I hope, Gerry, we'll get to talk about that a little bit more in these conversations. We don't have all the data yet, to be candid about it. But just on its face, my concern would be that the PIT is fine; but by implementing a BNRT and eliminating the corporate tax, there is a chance, depending upon your theory about the incidence of these various taxes, there is a chance of losing some of the progressivity of the tax system as a whole. We don't know for sure. And I think even when we have more data, it's still going to be largely guesswork as to the magnitudes involved because there is so much mystery about the ultimate incidence of these various taxes.

Having said that, I would at least like to personally reserve the possibility of coming back to the package as a whole, to tweak it in various places, perhaps in the PIT, to ensure that, especially from the

perspective of, if you will, the blue-collar segment of the income distribution, our progressivity goals are achieved.

And finally, we have not done as much as some would like in terms of making it flat. We have not done as much as some would like in terms of -- I think Michael is going to talk later about the value of trying to bring everybody into the income-tax system; and we have not – we've not achieved that. But I think we've achieved a lot in the package, as a whole, that I hope speaks to the full spectrum of views on the Commission.

Let me plunge into the BNRT quickly, so that we can get to the discussion, if you will. I think the changes in the sales tax, sales and use tax are pretty straightforward. We don't need to review that.

The change in the corporate tax is pretty straightforward. We don't need to dwell on that because we would simply eliminate it if, indeed, we can reach agreement on the BNRT as a substitute revenue source.

So here's the notion of the BNRT, which is a form of subtraction method VAT. So as we've discussed repeatedly, the basic form of it is to take all gross receipts from all sources, and subtract -- that is to say, take a deduction for all purchases from other businesses and then apply the BNRT rate.

Now, just not to hide the ball, we estimate -- the best estimate we have at this point for the package as a whole to balance out and be revenue-neutral, for us to achieve the reductions that John just described in the PIT, eliminate the bulk of the sales tax, the corporate tax, we would need a BNRT rate of approximately 4.2 percent. Approximately 4.2 percent.

Importantly, this would apply to all businesses, doing business in California. In other words, it would apply to businesses even if they are, under current law, pass-through entities. So it would apply to partnerships, LLCs, S-corps. All business entities would pay the business net-receipts tax.

Nonresident firms would pay the business net-receipts tax on their apportioned California receipts and less their apportioned deductions. Nonresident firms would be subject to an economic-presence test, which we are reasonably confident will pass Supreme Court muster.

Using the unitary method, so that related entities would be grouped together for BNRT purposes, an important purpose of the unitary-method test is to make sure that there's some sense to the filing thresholds and the liability thresholds.

And are those on the next page? No.

So just to mention those.

What we have in mind is a liability threshold of $250,000 in net receipts and a filing threshold of $500,000 in gross receipts. So to unpack that.

If you're a small business with less than $500,000 in gross receipts, you don't even need to file, and there's no minimum tax. End of discussion.

If you have more than $500,000 in gross receipts, then you have to file, and you will have tax liability if your net receipts exceed $250,000. And, again, those same thresholds apply to the apportioned California elements of a multistate or a multinational firm.

For that apportionment, John and I are proposing the single-factor sales apportionment that was adopted by the Legislature a couple of years ago, would becoming effective in, what, 2011?

COMMISSIONER COGAN: Right.

COMMISSIONER EDLEY: So, anyway, we're just sticking with that policy adjustment that the Legislature made so recently.

We are proposing that the R & D credit that is a part of the current corporate tax, be included in a modified form in the business net-receipts tax.

And let me be clear about this: While I think John and I agree that we should eschew tax expenditures

and designated revenue streams going to particular purposes, et cetera, as a commission, we viewed the R & D tax credit as somewhat different for a couple of reasons. Not just that it's in current code, because lots of stuff are in current credit code that we're getting rid of, but also because we think in the California economy, the importance of start-up firms and venture capital and high-tech and so forth, the R & D tax credit in combination with this small business attention that we've given through the $500,000 filing threshold and the $250,000 liability threshold will be both substantively and politically useful in the package as a whole.

Now, let me turn to the very important and complicated issue of the phase-in, because I think this is what we've struggled with a lot, trying to address both the issues of equity from the standpoint of business taxpayers, the issue of administrative burden for taxpayers, and our uncertainty -- our necessary uncertainty, our unavoidable uncertainty about the revenues that will be produced by the BNRT in comparison with current law.

So the phase-in that we're proposing is that a phase-in over a five-year period beginning in 2012 with, in Year 1, a BNRT rate of 1.6 percent, which we estimate will be sufficient to eliminate the corporate income tax

and make a significant down payment on reductions in the personal income tax rates, plus some wiggle room. And then that BNRT rate would increase each year until finally set in Year 5. Period, paragraph.

During the course of a year, we have the ability to adjust the sales tax midyear, third or fourth quarter, in order to -- as a safety valve, if it's necessary, to true-up the revenue that's being produced to meet the start of fiscal-year projections in the budget.

Let me just kind of repeat that idea. The notion is that in a given year -- let's say Year 3 -- if the BNRT, established by statute for that year, is not producing revenue adequate to make the package generate the revenue that current law would have generated, predictably, then the sales tax would be adjusted -- the state component of the sales tax would be adjusted in the third or fourth quarter in order to generate any needed revenues to make sure that the package is revenue-neutral in that year, and that we're not underperforming in the production of revenue.

And then finally, I think what we'd like -- I want to confirm with Mark and Phil and John -- but I believe where we left it, was that the notion that the final BNRT rate in Year 5 would be established, informed

by the data from the first three years of tax-return data from the income tax, the sales tax, and the BNRT, to make sure that we are still revenue-neutral as a package; and that the final BNRT rate is producing what we need in order to be revenue-neutral on the downside as well as the upside.

So what we've tried to build in here is a phase-in structure that will produce the revenues as promised, while giving taxpayers and the administrative system the time needed in order to adjust.

A couple of little details:

Net operating loss carry-forwards, which are important to many businesses, the notion is that those would be used during this period and they would die. That's to say, your net operating losses accumulated under the corporate income tax would wither away over this five years as the corporate tax itself disappears. There would be carry-forwards under the BNRT. Different tax, still the possibility of.

Now, maybe I –- should I subside there, and we'll get into the details -- more details in the conversation?

Mark or Phil, any big things about the BNRT I should put out on the table at this point, or, Gerry, before we get to the discussion?

CHAIR PARSKY: The only other thing I would add there, and then I just want to cover one other element, is that it is contemplated in this transition period which, as Chris mentioned, wouldn't start until 2012, that in the first year, the corporate income tax would have been eliminated. And, therefore, the use of the tax -- of any NOLs wouldn't be usable against that tax, which will have been gone.

And so what we are contemplating or what we are suggesting for review by the Legislature, is that we would allow those companies that had accumulated losses to continue to utilize them over a 20-year period against the BNRT, with a limitation that the BNRT liability, in any given year, wouldn't be reduced by more than 5 percent. That's a way in which we would accommodate, if you will -- or suggest accommodating those businesses that had accumulated NOLs.

COMMISSIONER EDLEY: Can I just -- and let me just say a little bit about the reasoning there.

We heard from so many witnesses and in so many letters about the importance of these NOLs on balance sheets, especially in the high-tech field and for start-ups, that we were loathe to kind of wipe out that, at least balance-sheet value wholesale.

On the other hand, we are transitioning to a

new form of tax. And NOLs will continue to be available for federal tax liability purposes. So what we're really trying to do here is strike a balance in the equities. That's all there is to it.

And, look, let me say something -- if I can put my -- speaking as a Democrat, why this --

CHAIR PARSKY: You're a Democrat? Are you a Democrat?

COMMISSIONER EDLEY: Believe me, yes, I am -- and not one of those blue-dog Democrats, either. I'm a real Democrat.

In fact, I'm a tax-and-spend Democrat, but…

So here's why I like the BNRT -- and I'm speaking to my Democratic colleagues here: First of all, I think it's good economics to have a VAT as opposed to a profits tax.

Secondly, I think it's good economics to have a lower marginal rate than our current corporate tax does.

Third, I think it's great politics for Democrats to vote to eliminate the corporate income tax, especially if it's in the context in which the aggregate progressivity of the tax structure can be maintained.

Fifth -- fifth? Fifth, frankly, this is the only part of the package that, to me, speaks to the 21st century, because it's broadening the tax base to

include services, which we know is going to be the growing part of the economy, and doing so at a low tax rate, doing so in a way that is neutral with respect to the form of the business, to reduce the gaming that occurs as between partnerships and LLCs and S corps and C corps and so forth. And I would wager that, while Europe has been using a VAT forever -- the world has been using VATs forever, the U.S. is not, but I believe that this is the future. Certainly on the commercial, on the business side, and ultimately, I hope on the individual side. So for all of those reasons, as a Democrat, I think that this package makes a great deal of sense.

CHAIR PARSKY: Just one other comment I would make, or make sure that people keep in mind. The phase-in approach is gradual. It's over a five-year period. And, obviously, if the Commission chooses to recommend this, it's a recommendation for the Legislature to go through extensive hearings on a subject that is new and is transforming.

The only other thing I would add before we turn to questions, as part of this part of the package, we've had discussions back and forth -- and there are very different views on this Commission -- on the subject of volatility, and whether or not volatility can be addressed on the revenue side, i.e., of the personal income tax

being the most, the largest component, and the capital-gains part, along with bonuses and stock options as contributing the most to that side; and, on the other hand, the expenditure side, in particular, the creating a reserve fund.

Rather than continue the debate in terms of one or the other, part of this package is the next element on this screen, and would be included if the Commission so supported as in Section 2 of the recommendations, is the establishment in conjunction with this new system of a rainy-day fund, because I don't think anyone believes that the recommendations made will eliminate all volatility.

You saw the chart that would show how volatility could be reduced, but we still will have within the personal income tax, for instance, capital gains and stock options and bonuses that may fluctuate as the economy fluctuates. So part of the package and part of the recommendation is the establishment of a clear, strong rainy-day fund as outlined, and is further outlined in some detail.

So we would increase the target for the reserve from 5 percent of revenues to 12½ percent of revenues. Require the revenues above a ten-year trend to be deposited into reserve. Restrict the Governor's ability

to suspend transfers in the reserve. Transfers into the reserve could only be suspended when revenues are insufficient to provide spending at the prior year's level, adjusted for the changes in population and inflation. Create more stringent controls for the withdrawal of reserve funds. Reserve funds could only be used for natural disasters and to maintain spending levels -- spending at prior year's level, adjusted for changes in population and inflation.

And this recommendation, which we would hope and urge that the Legislature vote to place on the ballot for a constitutional change, would be part of the package that we would request.

And so in combination with the changes made in the personal income tax, I think the recommendation would go a long way, if you will, if not get to almost parity, with removing volatility from our system, and allow the policymakers to, with a high level of precision, predict the availability of funds over periods of time in the general fund, out of which it's their responsibility to decide how money would be spent. That's this part of the package.

Okay, let's just pause. And let's ask commissioners -- let's divide up our dialogue into kind of two parts. Let's start with questions.

And I'll ask the representatives of the Franchise Tax Board -- Mark, Phil, Mike -- to be available where John, Chris, certainly I won't be able to answer questions.

And, Becky, you'll be given permission, too, as we go through this. If you would just hold on for a little bit, we will see who around the table have questions.

COMMISSIONER MORGAN: I'm still here. I have two questions when it's my turn.

CHAIR PARSKY: We'll call on you for sure.

We'll start with Monica.

COMMISSIONER LOZANO: Thank you, Gerry.

And I'll save my observations and comments for that section. But I do just want to recognize all the hard work that's gone into this and thank those of you that led us through the presentation.

So because the reduction in the personal income tax works in tandem with the new business net-receipts tax, I've got questions about how the rates were set. Because -- and John, this is probably for you or our speakers -- so it's 2½ and 6½ on the PIT, but the materials that we've gotten as it relates to the business has gone from 3 to 4½ to 4.2. And so it appears that you first set the rates for the personal income tax and then

are modifying the business net-receipts rates to fill in. But if you could just help me understand how you are setting these rates, what the ultimate goal is, obviously, is to maintain neutrality on the revenue side. But just spend some time on rate-setting, please.

COMMISSIONER COGAN: Thank you, Monica.

I don't think there was a conscious decision to start with a 6.5 percent rate and then figure out residually what the BNRT rate would be.

The problem with the BNRT rate -- and this is a concern, I think, that everybody has -- is that there's an awful lot of uncertainty about what the estimate means and how certain we are about the estimate that we've come up with. What we have right now is a preliminary estimate.

The preliminary estimate is, as you said, right now in the range of a little bit above 4 or 4.2. But as the estimators go back and review it in the context of the rest of the package, if that rate rises, that would be a cause for very serious concern about the BNRT.

The benefit of the BNRT is that it's a broad base and, more importantly, a low rate.

The concern that a lot of commissioners have is if that rate starts creeping up, then you have washed away the major economic benefit of the package.

And so as far as I'm concerned, if as the staff finalizes that rate estimate, if that rate were to begin to creep up significantly, I think we'd have to go back and look at other parts of the package, which might include the income tax rates. But where we stand right now -- and I know an awful lot of work has gone into it -- is to try to get a reasonably solid estimate of the BNRT rate. And it's somewhere in the neighborhood now, we think, of 4.2. Maybe a little bit less, maybe a little bit more. But you can see the uncertainty. It's not nailed down.

COMMISSIONER LOZANO: So, and I worry about the adjusting along the way. Because one thing I heard you say is that, in fact, we would use the sales tax to fill in any resulting lower revenues being collected.

And so as this thing plays out -- and I understand there's a transition period -- I'm particularly concerned about not having set a rate, or at least a consensus within the group that should it go beyond a certain point, we'd bring the entire package. Because it all has to work in tandem, I'm very concerned about it.

CHAIR PARSKY: One thing I would say about the process that was undertaken with respect to the personal income tax, we started with the goal -- with several goals: Simplification and reducing the overall dependence

that the general fund has on the PIT, and then added to it everyone getting a reduction.

And so the variables in that equation relate to: Are you going to retain deductions and credits and not simplify things? How are you going to set the standard deduction? And how are you going to set the rates, the three rates?

And so they are variables. And each time you've got a run, if you will, on what impact you had to assess were we accomplishing all of those goals. And this is where we settled on a proposal that would accomplish all of those goals. And we went through a myriad of different iterations, many of which got increases for some levels and left. So it wasn't -- I mean, it was all around those objectives.

The BNRT rate, if you will, drives a lot of concern for those of us that have looked at it because of the uncertainty of predicting a new form. That's why this transition is so important, that's why we have been thinking about how we could potentially embody an entity to reevaluate the interplay between the sales and the BNRT. But you've identified -- but that's how the personal income tax rates were determined.

COMMISSIONER EDLEY: So I want to tell a different story. Some of this has a nice Rashomon kind

of quality to it. So here's what I thought I was experiencing. What I thought I was experiencing was that a bunch of whackos to the right, like Parsky, said they wanted as flat a tax as possible, as simple a tax as possible, with marginal rates as low as possible.

CHAIR PARSKY: You people up there, don't use the word "whacko," unless you put a smile around it from the media.

COMMISSIONER EDLEY: W-H-A-C-K- -- no, so -- right.

And so then what I was saying is, look, you can have as much of that as you want, provided you don't do damage to progressivity, which was the main horse that I was fighting with.

So Gerry very -- doing very well said, "Okay, let's come up with some options, and let's see how much of the simplification, and how much of the rate reduction we can do, conditioned upon making sure that everybody gets a tax cut, and overall progressivity is sort of in the ballpark."

And so I really see it as -- I really see where we came out as the product of these balancing of values to --

CHAIR PARSKY: And I will now let Michael Boskin talk about how I damaged him in this process.

But go right ahead.

COMMISSIONER BOSKIN: I'm going to save that for the second set of generics. I'm going to honor your request and stick to specific questions.

But I think I can help answer why the sales tax is the wiggle factor. It's the only tax that's easily adjusted late in the tax year.

CHAIR PARSKY: That's right.

COMMISSIONER BOSKIN: So, for example, in the third quarter and the BNRT is raised, it looks like it's going to be a little bit short, you can have the sales tax come down a quarter percent rather than a half cent, right, without having it go up and, therefore, be a tax increase and get into all that sort of stuff.

COMMISSIONER EDLEY: As opposed to the lag that the income tax filing --

COMMISSIONER BOSKIN: So, now, there's still the issue at the end of five years of this BNRT rate. So that's a clarification.

But picking up on what Monica said, you know, we are met at a time of revenue collapse and great fiscal stress, and we are charged with dealing with kind of a long-run tax structure. And I think, inevitably, we've been heavily influenced by the climate in which the State has found itself in recent times, sadly, for various

reasons. We might not agree on all the reasons, but some of them are pretty self-evident.

But it seems to me one of the things that's important as we look out to something that's going to start in 2012 -- which hopefully will be pretty close to normal economic times rather than late in a recession or early in a recovery or something of that sort; and the years, a five-year phase-in and going forward and all that sort of stuff -- is to contemplate that things might be very different than you're thinking about now.

So my first question is, what happens if the BNRT or any of these other things produce more revenue than was projected? All the attention has been on what happens if it's less.

COMMISSIONER COGAN: So the idea might --

COMMISSIONER BOSKIN: But it's only if it's above a ten-year trend line, and so it's unclear if the projection is equal to the ten-year trend line.

So if the projection is below the ten-year trend line, you could produce more and it won't go into the rainy-day fund. So I think we need some clarification of that.

COMMISSIONER COGAN: So I think what we tried to do is whatever that revenue-neutral amount is that we project -- and I think it would be as under the current

system, adjusted year by year for economic conditions -- I think the slack variable has to be the sales tax rate. And that is, if we're producing more revenue -- and I get your point -- if we're producing more revenue than we have estimated, then the question becomes, should the priority be to reduce the sales tax or put the money into the rainy-day fund.

Now, from my standpoint, I would have the sales tax reduction during that transition period. That's just one commissioner. It's a very good question.

COMMISSIONER BOSKIN: And there's also the question at the end.

COMMISSIONER EDLEY: Before we get to the end --

COMMISSIONER BOSKIN: There's also the question at the end.

COMMISSIONER EDLEY: Before we get to the end, it seems to me that just as a matter of legislative procedure, if we want a package that can be adopted by a majority vote, that it's going to have to be scored as revenue-neutral over the scoring window, which I think means the barometer is -- so the barometer is whether or not our package is producing the revenues that, at the beginning of the year, one would have forecast under current law. And if that turns out to be high -- I mean, if what current law would have produced is above the

ten-year average, then, it seems to me, it would go into the rainy-day fund. Because what we've said is, it's going to be revenue-neutral with respect to current law. If current law were going to generate a surplus, quote, unquote, then our package would produce that same surplus.

A rainy-day provision is what tells us that you don't spend it, you put it into the rainy-day fund.

COMMISSIONER BOSKIN: I think that's great, but I really think it has to be laid out because both the current law and the alternative less-volatile proposal are very still quite sensitive to economic issues. So we can try to sort of lay that out.

CHAIR PARSKY: True.

COMMISSIONER BOSKIN: I have another quick comment.

CHAIR PARSKY: Proceed.

COMMISSIONER BOSKIN: Number one, I take it from the write-up that we have settled on expensing rather than depreciation?

CHAIR PARSKY: Yes.

COMMISSIONER BOSKIN: Just to make that clear.

Third, it would really appreciate --

CHAIR PARSKY: I should say "settled," that it's recommended.

COMMISSIONER BOSKIN: Settled in our estimate,

as part of the recommendation.

CHAIR PARSKY: Right.

COMMISSIONER BOSKIN: Not that it's law.

COMMISSIONER EDLEY: And, of course, no deduction for depreciation. So expensing initially and then no deduction for depreciation.

COMMISSIONER BOSKIN: So then there's a statement in here in describing fairness that we've reduced the number of taxpayers. Could somebody please explain that calculation to me? You're talking about there will be several hundred thousand more business entities that are now filing -- they're either tax collectors if they pass it forward, or taxpayers, if they're bearing part of it. Is that what you have in mind? But we're not counting the many millions of people that are being removed from the sales tax rolls supporting the general fund?

Referring to under "fairness." Under "fairness," there's a statement that there will be an increase in the number of taxpayers.

MR. IBELE: That should apply to the personal income tax.

COMMISSIONER BOSKIN: Okay, okay.

I would like to see a calculation before I vote on anything of the number of Californians and the fraction

of Californians who are not paying -- who will not, under our proposal, pay either income taxes or general fund sales taxes. I asked for that before, and it seems never to get produced.

CHAIR PARSKY: We should definitely provide that.

I would also say that in the exchange back and forth during the course of the last several months, a number of commissioners had requested that we include in the personal income tax recommendation that there be established a minimum tax that everyone in California should pay. There is a large percentage of Californians under the current system and under the proposed system that would not pay tax. And a number of commissioners recommended that.

We, collectively, have not recommended that for this package. And, again, it was part of a desire on our part -- Chris, John, and I -- to put something forward that we hoped everyone could coalesce around, recognizing that purity wasn't possible for each and every commissioner.

Okay, next, Jennifer?

And these are questions.

COMMISSIONER ITO: Right. And I just want to appreciate, again, the time and effort you guys have put

into this. And I've been going -- approaching this with an open mind. And I still have a couple questions. I have two questions in particular just to put out there. I mean, the perspective that I come, and my concerns and my tentativeness about supporting something around which there's a lot of risk and uncertainty, my concern is more thinking about the revenue impacts in the ten and 20 years. And my concern being on the flip of Michael is about the unintended consequences of shifting from a tax structure shifted away from income and more towards consumption and where we're going as an economy and as a nation, if we're moving away from consumption and more towards savings. My concerns come from more of what's happening with the -- what is going to happen with the underlying economy.

And so my one question is around, so are we saying that at the end -- so I'm not as concerned with the five-year transition, but my question is, are we saying that at the end of five years, that's when we'll set the rate for the business net-receipts tax and it will be fixed from there?

COMMISSIONER COGAN: Well, I can tell you the way I was thinking about it, is that we would set an ultimate business tax rate in what we send to the Governor and the Legislature, and treat that as our best

recommendation at this point. But not to leave it as something to be determined by the Legislature and the Governor.

And so our recommendation would be for a specific -- and I would hope it to be sort of an upper limit on any BNRT that we would think would be acceptable.

And my sense is, by the way, after five years, at that point we should have the experience at that point to know whether this thing is working. And if it's not producing the kind of revenues -- if it's falling short of the revenues that the current system would produce, then I would think there would be a complete relook at whether this is, in fact, the right way to go or what adjustments have to be made in the code. That's my view.

COMMISSIONER EDLEY: I have a slightly different view, perhaps. And I would really like to hear from the staff on this.

The way I think about it is that suppose that we're at the start of Year 5, and we're looking back at the data from Years 1, 2, and 3, including the income in PIT data and the corporate income tax data, and so forth, so we have a pretty good sense now of how all these things interrelate in practice as opposed to modeling -- at least a better sense. And let's say the BNRT is underperforming. Then your choices are to build into the

legislation something automatic, so that you plus-up the BNRT rate to hit the mark. That's Option 1.

Option 2 would be, you plus-up revenues with the sales tax or the corporate income tax, or some form of the corporate income tax, such as a surtax on federal corporate income tax. You compute your corporate income tax anyway, for federal purposes, just multiply by .2 or something, and that would go to the State to try to get the revenues in line.

Or Option 3, sunset the whole thing and make the Legislature go back to square one.

Now, so sort of as between those, I thought the simplest thing would be to build into this an automatic mechanism so that the BNRT rate might be moved up or down by some limited amount in order to level things out. But I can imagine those other two options, and I'm really kind of agnostic as between them. I would not fiddle with the PIT. It would have to be one of the taxes, I suppose, that's imposed on business entities; hence, either the sales tax or something related to the federal corporate tax liability.

And let me just say, I would link it to the federal corporate income tax liability because these firms are going to have to fill that out, anyway -- at least the ones that are not pass-throughs would not have to fill

that out, anyway.

I mean, nothing is perfect, but I just don't see how to --

CHAIR PARSKY: Well, one thing to think about, a phase-in program that would work something along the following lines:

In Year 1, we would make a determination on the level of BNRT rate that we would anticipate would be necessary to deal with the complete program in the year 2012. That's a year that specific data and projections will have already been made by the Department of Finance. That will result in a rate not yet to be finalized, but around 4 percent, maybe a little bit less.

We'll have to see what that is. Let's just say for argument's sake that the conclusion is 4 percent. And we would suggest to the Legislature for further effort, that getting to that rate, from our standpoint, needs to be done on a phased approach to all of these taxes over five years.

And in Year 1, we would seek the elimination of the corporate tax entirely, costing "X." Let's just say, for argument's sake, that that is between $9.5 billion and $10 billion -- we'll have to refine that -- and a down payment on the reduction in the personal income tax, leaving the current system in place but just giving a

reduction in everyone's taxes as currently set, as if we didn't make any change, of about 20 percent. That would cost -- and the estimate would be somewhere in the range of $3 billion or $3.2 billion as --

COMMISSIONER BOSKIN: That's 20 percent of our reduction, not 20 percent of their current tax liability.

CHAIR PARSKY: No, 20 percent of the reduction we ultimately would be seeking. The $15 billion that was shown here.

And 1 percent of the 5 on the sales and use tax. That would result in a much lower rate in that year than the 4 percent that we would ultimately say is targeted.

It might result in this 1.6 that you mentioned. We have to refine that. But it would be a very low rate.

And in Year 2, we would have the same sort of system: A down payment on the reduction in the personal income tax, and the potential for another reduction of 1 percent in the sales and use tax. And at each point in that cycle, or in that year, we have this flexibility on the adjustments in sales and use tax to see.

Year 3, we would put in place the, quote, new system on the personal income tax, and we would have another potential 1 percent reduction in the sales and use tax, with some element of flexibility. That would

have left us with 2 percent left for Years 4 and 5 in the sales and use tax to be reduced, and an incremental amount of rate to be put in place for the business net-receipts tax.

We could at that point recommend that a disinterested tax group make an evaluation of the revenues that have come in and not, and make a recommendation with respect to how to get to the ultimate rate on the BNRT and the sales and use tax which are left to be adjusted.

Now, Michael's point isn't quite dealt with, either in Years 4 or 5, which is what happens if the revenues of the BNRT are so much greater than anticipated, and it doesn't get picked up, if you will, in the definition of the "*rainy-day fund*." Some of your colleagues may like that a lot, but it's not dealt with precisely.

But I do think we need to suggest -- the Legislature is going to refine this, without any question. But I think we should suggest the sensitivity we have on the lack of precision on predictability of how the rate on the BNRT would work in producing revenue. And I know there will be concerns from the business community, from other commissioners, that suggesting that the rate on the BNRT would get above a certain level, that will cause concern.

And the Legislature, in their infinite wisdom, they obviously can do what they wish. But from this Commission's standpoint, I think we should be sensitive on that subject.

On the other hand, we also want to be sensitive on the fact that we need to produce a revenue-neutral set of recommendations. So I think we need to think about that.

COMMISSIONER BOSKIN: I couldn't agree more.

I think Jennifer and Monica made very important and useful points. I would add that even if we did not have a BNRT -- this is made much worse, or much more -– "worse" is a bad word -- it's much more salient because this is a new tax and there's more uncertainty.

CHAIR PARSKY: Yes.

COMMISSIONER BOSKIN: But even if we just had, as an alternate proposal, extend the sales tax to services and reduce the corporate rate and the income tax rates down to something like other states, rather than being outlier, go to the median. That would be a much less radical proposal, would help reduce volatility, do some of these other things. We'd still have the same thing because we're not sure what would happen out there.

COMMISSIONER EDLEY: Right.

COMMISSIONER BOSKIN: So the Legislature would

still have to true something up and raise or lower or do it, whatever the pressures would be.

COMMISSIONER EDLEY: Can I try, Gerry?

It seems -- I think there are three buckets of issues here.

One question is, what do you do about underperformance or overperformance of the BNRT relative to current law; right? So that's the revenue-neutrality issue.

The second question is, what do you do about underperformance or overperformance of the package relative to the ten-year average? That's the rainy-day fund issue.

COMMISSIONER BOSKIN: Right.

COMMISSIONER EDLEY: The third question is, if you've got a problem with respect to Category 1, the revenue-neutrality criteria, how do you do the true-up or the true-down in order to get back to revenue neutrality? And that's how, as in using which tax rate, on which tax, and how in terms of institutionally who has the authority to do it. So that's kind of 1, 2, 3A, 3B, in my mind.

And what I was suggesting in response to Michael's earlier point, is that if current law out in Year 4 would have produced a boon in revenue because

we've had the Obama surge --

CHAIR PARSKY: Be careful.

COMMISSIONER EDLEY: Okay, Year 2, the Obama surge, okay. All right, so --

CHAIR PARSKY: Put that in the "wacky" category up there.

COMMISSIONER EDLEY: Okay, so in Year 3, we have a surge in revenue under current law but not under, with our package, then I think you have to true-up the rates in our package somehow in order to mirror current law, and then put the excess above the ten-year average into the rainy-day fund.

COMMISSIONER BOSKIN: But this is all designed, however, to be kind of neutral over the business cycle.

COMMISSIONER EDLEY: That's right.

COMMISSIONER BOSKIN: So I don't think you can say, there's a boom. God, we really have buyer's remorse now. We have a more stable tax structure, so there's not a huge amount of revenue flowing in from capital gains and stock options, so we have to raise other tax rates.

COMMISSIONER EDLEY: Well, no.

COMMISSIONER BOSKIN: Suppose there's a double-dip. We won't blame it on Obama. Just suppose it happens, okay? Then what are you going to do? The revenues collapse further, but they're going to be more

under our proposal than they would have been. Are you going to then start cutting our proposal? I think it's totally symmetric. I think you can't get into that.

COMMISSIONER EDLEY: Well, but what do we do about the requirement of revenue neutrality over the scoring window?

(Commissioner Pringle entered the hearing room.)

CHAIR PARSKY: I just would separate in your mind the need for revenue neutrality that the Legislature may decide to do for purposes of voting from -- let's just say that the -- because that's a projection. They have to determine, based on the proposal, whether over a one-year period or a three-year period or a five-year period, whatever they determine they believe is revenue-neutral, then they can decide how they want to vote. Separate that from actual performance that occurs once the law is enacted. And that is an issue that I think a recommendation needs to take into account adjustments if we were wrong, not because of revenue neutrality, but we were wrong on the amount of revenue that was to be generated. And you can have a variable in the transition period to get there. If at the end of five years, fully phased in, there was nothing wrong, but in the next five years something happened, the Legislature would have to act as they are forced to do now.

So I just would separate out the issue of revenue neutrality as determined from the beginning from some pause at the end of three years or some pause where, because of the uncertainty of this tax, somebody would need to determine the balance of the implementation of the phase-in program, in order to try to achieve the level of revenue that you anticipated.

COMMISSIONER EDLEY: This is really hard. It may be time for a break.

CHAIR PARSKY: Okay, well, let's just finish some questions.

And then, Jennifer, did you have --

COMMISSIONER ITO: No.

CHAIR PARSKY: Edward?

COMMISSIONER DE LA ROSA: Thank you, Chairman. And thank you also Commissioners Cogan and Edley for all the work that you did, for this package. It's a great structure. And I'm not sure exactly how we're going to arrive at a consensus, and I'm sure that many parts of the package are going to be discussed today, and I'm counting on Monday as well. But I had a question about one particular part of it -- well, let me back up.

I'm very happy to see that the concepts like rainy-day fund made it into this package, given the fact that we had to interpret really what the Governor's

directions were and things of that nature. And I'm very happy to see that there's been an effort, I guess, to broaden the tax and lower the rate. I think that's a great development.

And, Chris, really, this whole effort, the comment that you made about making a big part of the structure relevant to the 21st century economy is, I think, very important as well. And I was worrying about that earlier today as we walked in here.

But I want to go back to this personal income tax change by AGI class, and I think that there was one question. And I'm sure when you all were meeting, you discussed this many times over. But I feel compelled to answer that. And by my count, there's about 7 million returns if you go up to $75,000 of income, which is about half of the number of returns in California. And those returns are not participating as fully as people in the other categories are in the reduction in the tax burden when you measure the personal income tax.

When you consider that these people will also be subject to sales taxes, I guess, and other taxes as well, I'm concerned about really what the total tax burden would be on them relative to the rest of the group once a plan like this is put into effect.

And I believe that Jean Ross, when she made a

presentation one day, gave us a table that demonstrated what the total tax burden is by quintile, I believe, for people. And I know that there was some questions about the methodology. And, of course, if there's somebody that has a better way of measuring, I'd be more than happy to see that slide as well. But it seems to me that it would take just a small reduction in the tax break that is given to the group making from $200,000 through infinity, to cover an effort to give an equal break to the people making up to $75,000.

And I just wondered if that's an important thing for this group to consider before we arrive at the final plan or not, but it was something that jumped out at me when I took a look at this.

CHAIR PARSKY: Well, I do think John -- just to remind you of John's point, and that is that the standard deduction needs to be taken into account first. So what we're really talking about are individuals' or families' joint returns that are at $105,000 that ticks into the tax.

We've tried a lot of different models and to try to make sure that everyone gets a reduction. And it is clear that the progressive nature of the personal income tax is not altered dramatically.

If you look at the top two categories of tax

returns, $200,000 through infinity, you have about -- I don't know about infinity, we'll leave that to Michael Boskin to decide -- but about 500,000 returns constitute that group. And that group is paying the vast bulk of the taxes before and after. Before and after.

So on the issue of progressivity relating to the PIT, this was an important effort as we've gone through this. A number -- several commissioners wanted us not only to demonstrate that the PIT was constituting a smaller percentage of the overall general fund, but that the progressivity of the PIT was substantially reduced. And that's not accomplished -- the second half is not accomplished here.

Becky, did you have a question?

COMMISSIONER MORGAN: Thank you. I want to thank Maria and all for letting me come in by phone.

I guess so I understand, this would take place in 2012, which means five years is 2017, eight years from now. That's two terms of a new governor and probably 80 percent of all legislators that will be voting on this hopefully will be gone because of term limits. So I guess I would suggest that this is a very good outline, but it's probably going to change. But all the work that's been done I think sets a great foundation.

Now, just a couple questions on the PIT. As I

understand, there will be no carryover for charitable deductions. You take what you give in one year; and then if you give more, you can't carry it over? Or is there no limit on what you can deduct?

CHAIR PARSKY: I'm not quite sure I understand that.

COMMISSIONER EDLEY: If deductions exceed gross revenues.

CHAIR PARSKY: Oh, right.

COMMISSIONER EDLEY: If deductions exceed gross revenues, you would have a carryover --

COMMISSIONER COGAN: The PIT.

COMMISSIONER EDLEY: Oh, I'm sorry, are we talking about the PIT?

COMMISSIONER POMP: We should all have that problem, by the way.

COMMISSIONER MORGAN: I'm sorry. I can't hear.

CHAIR PARSKY: Carl, do you have an answer to that question?

MR. KUSIAK: I'm Pat Kusiak with the Franchise Tax Board.

The language drafted, that was drafted related to charitable deductions, essentially creates charitable deductions under the new approach, just as they are treated under the old law. There's no change.

COMMISSIONER MORGAN: Okay, so there is no limit on what you can deduct for charitable contributions, assuming you give it away?

MR. KUSIAK: To the extent there is no limit under current law, there would be no limit under the new law. There are some limits under current law, but they're very narrow in scope.

COMMISSIONER MORGAN: Okay, because there are limits federally.

And then on the chart that has all the numbers of taxpayers and the percentages and the reduction in tax, those numbers are from 2007 or are they in 2014?

COMMISSIONER BOSKIN: They're from 2014.

COMMISSIONER MORGAN: So these are the estimates for five years from now?

COMMISSIONER BOSKIN: Yes.

COMMISSIONER MORGAN: Okay. And on the business, did I hear correctly, because it was one of my questions, that there is no deduction for depreciation?

COMMISSIONER BOSKIN: To expense the first-year expenses.

CHAIR PARSKY: Well, you have, in the current year of purchase, full expensing.

COMMISSIONER MORGAN: Okay, full expensing.

COMMISSIONER BOSKIN: Because there's nothing

left to depreciate.

COMMISSIONER MORGAN: Okay. Then I would just want to go on record, in case there's not time to get back, with Michael Boskin and anybody else that would come on board, that I think every person in California, that is working in California, should have a stake in our state. And that stake is best represented by having a minimum tax, whether it be $50 or 1 percent of AGI or something.

And it's been my experience as an elected official, that when you're charged $5 at a health clinic, you take care of your health better, or a minimum charge at a museum where people show up. I just really would ask for a consideration of a minimal contribution in appreciation of what the State provides.

CHAIR PARSKY: Okay, thank you.

Yes, John?

COMMISSIONER COGAN: Say, Ed, you know, you raised a good point, you know, about the distributional effects, because they are lower, the tax reduction proportionately is lower for the lowest groups. But I'd guess I'd ask you to look at it just a little bit differently, if I could.

If you look at the $20,000 to $50,000 group, the tax burden that they now have -- income tax burden --

is $196. So that's $4 a week.

If we wanted to get their proportionate reduction down by 25 percent, then we reduce it by a dollar. And so we reduce it from $4 a week to $3 a week. And so to make a distributional table look good, the question is, how important is it to have a $1-a-week reduction in some group's income tax? And I'm just hoping that you look at it a little bit like that as opposed to just be thinking that everybody has got to get an equal, proportionate reduction. Just a different perspective.

CHAIR PARSKY: Monica?

COMMISSIONER LOZANO: Thank you. I just have one more question --

COMMISSIONER MORGAN: Take it down under $2 a week or $1 a week.

CHAIR PARSKY: Wait, Becky, you've got to –- wait and let me call on you because you're not around the room. So I will call on you if you have further questions.

COMMISSIONER MORGAN: Okay.

CHAIR PARSKY: Go ahead, Monica.

COMMISSIONER LOZANO: I just have a question on an issue that's not referenced in the materials, but it does refer to insurance companies. And we had had a

conversation earlier about financial institutions, and they are now, I understand, covered under this. And I'd like to have some clarification about those entities as they relate to the business tax now.

CHAIR PARSKY: Oh, I'm sorry. The financial companies is an area of continuous concern. We struggled. And anyone looking at implementation of the business net-receipts tax I think will struggle with how to deal with pure financial companies.

And so what we are suggesting is that they -- the suggestion would be that they be included under a different -- a type of calculation that addresses -- and I'll let Carl talk about it in a little bit more detail -- but addresses the net interest income for these entities.

Although I am sure that we could have a lengthy discussion among economists, in particular, as to whether or not the value-added tax concept really does apply in any way to financials.

So we are suggesting that they would be included, but with a notation that further study of this needs to be undertaken by the Legislature to determine whether or not they should be included -- and I think there is a note in -- I'm not sure, Mark, page 2, page 3?

COMMISSIONER LOZANO: There's a footnote, but

it doesn't refer.

CHAIR PARSKY: At least I remember reading Mark's note that indicated something along those lines.

COMMISSIONER EDLEY: It is just to leave current law. Leave current law.

CHAIR PARSKY: Right. One alternative is to leave them subject to current law. The argument the other way is that we are eliminating the corporate tax entirely, to leave it in place for one body. Michigan took a little different approach there.

But, Carl, did you have any other comments about that subject?

MR. JOSEPH: Sure. The first comment I'd make is in regard to insurance companies. Insurance companies are not part of the BNRT. They pay the gross premiums tax in California. They're exempted under the Constitution from paying other taxes. So they're in their own little world already.

As for the financials, what the Commission has struggled with is the concept of having all taxpayers within one system versus having a second special, or a bold system, whichever way you want to go, for financial companies. And there are a lot of issues related to having them on a separate system or having them taxed under the old system. Because one of the concepts that

is part of the BNRT is the unitary method. And in a unitary method, it is quite normal for there to be financials and general corporations in the same group. And so when you have two groups that are having their either income or net receipts calculated as a group because they are functioning as a unitary enterprise, it gets a little bit tricky as to how to tease them apart to pay two different taxes, such that you can end up with a system that's not prone to gaming, not prone to having big swings, based upon one being measured by income, one being measured by receipts.

So at this point, what the Commission received some input on from various economists, was that it was possible to put the financials into the BNRT if you gave them, as an item of receipts, interest income and as an item of deduction, interest paid. Because that is in relation to their services that they are providing as a financial.

So as it's written now, there are -- there's a special definition for what is a "financial." And if you fall into that category of being a financial, then you have an additional item of interest receipts, but you also have an additional deduction that other corporations don't get. That's how it's put forth at this point. But, obviously, you heard from Chair Parsky, there are other

ways to look at this.

CHAIR PARSKY: Fred?

COMMISSIONER KEELEY: Thank you, Mr. Chairman.

Mr. Chairman, let me start with thanking you and Commissioner Edley and Commissioner Cogan for all the hard work that you've put into this. I know this is compound, complex, difficult; and you folks have put in front of us a thoughtful package, and a package that I'm glad we are going to debate and discuss it. And also thanks to the staff for their fine work which went on day and night, I'm sure, to get this in front of us today.

Mr. Chairman, let me ask a couple questions about how the personal income tax recommendation that you're making would treat a couple of issues. Under current law in California, Social Security income is exempt.

Is it your thought that Social Security income would be exempt from personal income tax under the new architecture that you're proposing?

CHAIR PARSKY: Yes.

COMMISSIONER COGAN: Yes.

COMMISSIONER KEELEY: Good. Thank you.

Let me ask also, do you believe, Mr. Chairman, it would be possible to have, for the Commission, on Monday or before Monday, a couple of things? One is an

analysis by income by decile of the tax burden currently and the tax burden of this package as proposed? Would that be possible for us to see that?

COMMISSIONER COGAN: Are you talking about the PIT or are you talking about total?

COMMISSIONER KEELEY: Total package. Is it possible?

COMMISSIONER COGAN: *(Nodding head.)*

COMMISSIONER KEELEY: So Mr. Cogan is saying "yes."

CHAIR PARSKY: I will tell you that in terms of how demanding that is and how much certainty can surround that, it needs to be caveated extensively.

COMMISSIONER COGAN: You know my views. You know my view on how reliable any such estimates from the BNRT are with respect to distribution. I think I've made it before. I would discount them very, very heavily.

And for those that are concerned about the distributional consequences, I would put 80 percent of my weight on that personal income tax calculation, and then factor in, perhaps, some retail sales tax. But I don't think we have enough at all in the way of hard information to give you a reliable estimate of the full distributional consequences. But it can be done.

COMMISSIONER KEELEY: I think that's fair,

John, that we understand the high degree of variability or accuracy or whatever it might be. But I do think it's a fair question to ask for that.

And I'll look at every footnote that qualifies it. I think that's fair enough. But I do think it's also fair to ask how that would look.

COMMISSIONER COGAN: The numbers will appear very fuzzy.

COMMISSIONER KEELEY: Thank you.

A couple of other questions.

When you were wrestling with the architecture of the BNRT, I know that, simultaneously -- and we'll hear later -- that some of us were wrestling with how to put together a pollution tax. And I know in that conversation, the issue arose as to what the effect on transportation -- what effect there would be on transportation, specifically Article 42 -- or excuse me, Proposition 42, as it relates to the sales tax on gasoline in California. And if there's a reduction or an elimination of the sales tax, how that Prop. 42 funding source, which is relied upon heavily in California for transportation, what your thoughts would be about either replacing that or offsetting those Prop. 42 funds in some way, which are directly tied to the sales tax on gasoline?

CHAIR PARSKY: You raise an important issue.

Our thoughts were that, apart from the potential decision to proceed with a pollution tax, that dealing with how the general fund revenues would be spent was not the purview of this commission. And, therefore, if there was no dedicated state sales tax on gasoline, that allocation of revenue would have to be independently decided by the Legislature out of the general fund, because there wouldn't be a sales tax at the state level on gasoline.

If, in the discussion of a pollution tax, that is the desire on the part of the Commission, and through Proposition 42, those funds would automatically be dedicated to transportation, that would relieve -- if the rest of the package was included, that would relieve that burden on the general fund, and might enable us to recommend a lower rate on the business net-receipts tax.

COMMISSIONER PRINGLE: Could I interrupt you just a second, Mr. Chairman?

I would like to reserve -- first off, to all of you, I want to apologize for being late. We had the kickoff of D23, the largest Disney Expo in the world was launched this morning. So I wanted to make sure, if you would like to join the 45,000 people who are in Anaheim over the next three days for D23, please do so. It will

be exciting.

COMMISSIONER EDLEY: Can I move we recess?

COMMISSIONER PRINGLE: Yes, you're more than welcome to.

CHAIR PARSKY: What happened to you guys in the 45,000? That would have been a much better thing to witness.

COMMISSIONER PRINGLE: So what I would also like, Mr. Chairman is, I know we are going to hear after our break a presentation on the pollution, carbon gas/fuels tax concept. And I'm very open to hearing that, because I do have some specific interests that Mr. Keeley may find interesting about this exact issue. And I'd like to be able to reserve this time. Because this probably isn't the right time for that, but I would like to be able to talk about it at that time.

CHAIR PARSKY: Okay.

COMMISSIONER KEELEY: Thank you, Mr. Chairman. Mr. Chairman, a couple of other quick questions.

With regard to the exemptions that have been proposed in the package relative to the BNRT, I am interested in hearing the reasoning for exempting the nonprofit entities that you did include, what the reasoning is for that.

As I understand it, nonprofits are subject to

taxation currently and subject to sales taxation.

And I'm wondering what the reasoning was for providing an exemption for nonprofits in general, and specifically, health care and education?

CHAIR PARSKY: Why don't you begin, and then I'll pick up?

MR. KUSIAK: The direction from at least the working group that was dealing with the BNRT, essentially was aware of the fact that exempts and various exempt entities are generally exempt on their income tax but are subject to tax on what's referred to as "unrelated business tax."

What's been retained is the notion of an unrelated business receipts. So in that context, exempt entities would continue to pay tax on unrelated business receipts. So essentially, the structure was established to be comparable to what the current income tax rules are, but to require exempts who would otherwise be paying unrelated business tax on unrelated business income, will now be paying business net-receipts tax on their unrelated business net receipts.

COMMISSIONER KEELEY: Thank you. I appreciate that.

Let me ask another question on the financials again. I understand, having served on the insurance

committee, the way insurance companies are taxed on their premiums as opposed to being covered in some other way in California.

So they would continue because they have a constitutional privilege there, they continue to enjoy that privilege, unless we had some other idea about what their privilege should be or not be.

But as we move into the financials, where Graham-Leach-Bliley essentially tore down a lot of the walls between financial institutions, what banks used to look like and what insurance companies used to look like, and this and that, I am interested in how the financials -- and I know the question was asked earlier, but I'm -- at least as one commissioner, I'm not clear on how they are -- how, what is being proposed, would change their tax obligation for financials? How would it change it?

MR. JOSEPH: Well, when you say "How would it change it," obviously, they'd go from an income-tax base to a net-receipts tax base.

COMMISSIONER KEELEY: Right.

MR. JOSEPH: So from the standpoint of how they would calculate their tax, they'll be calculating it on a much different basis than they calculate it now. Obviously, the rate's different as well.

One thing we did talk about a lot, which you bring up here, is the world has changed a bit as to who is a financial. So the definition of "financial" that is contained within the new BNRT is different than the old rules that we had under the corporate code, in that it picks up the definition of "financial institutions" that was put together by the Multistate Tax Commission.

One of the things that does, is it essentially treats anybody owned, directly or indirectly, through a bank holding company structure, which is the new way of doing things, will be deemed to be a financial institution. Which the old rules that we had from 30 years ago, case-law rules, would not allow us to do that.

So we will have better parity between various competitors in the financial industry, in that they will all use the same base for net receipts, which is not necessarily the case now under the income tax.

As to whether they'll pay more or less, I have not seen any distributional data about how the actual tax calculation for any sort of standardized financial institution would be in relation to what they would be paying under the income tax. I have not seen anything like that.

COMMISSIONER KEELEY: Mr. Chairman, again, if

it's a reasonable request -- if it's not a reasonable request, I understand we shouldn't do it -- but if it's a reasonable request between now and Monday, when we meet again, I would at least be interested in seeing what that means, especially as it relates to, if we are, in fact, making a significant change in the tax on banks and we are now redefining and modernizing our definition to include financial services so that it's consistent with the national definition, I would be interested in knowing what that does relative to the tax obligation when we do those two things together. We eliminate the bank and corp. tax, we redefine what constitutes a financial service entity, and they are no longer subject to the bank and corp. tax but are now going to be subject to business net-receipts tax. I would be interested in seeing what happens there.

And since Commissioner Edley -- period, paragraph -- was able to wave his bonafides, as a good liberal Democrat, what I'll say in my own case, is that my observation, having served in the Legislature and watching nationally the recent turmoil we're going through financially and economically in this country, that the old phrase about privatizing the profits and socializing the problems seems pretty clear in the case of the bank and financial services industry. That they were very

pleased to take all the private profits when things were going well and when things didn't go well, be the first ones in line to ask that we socialize their problem and provide them with extraordinary amounts of bail-outs.

Now, whether that's good public policy or not, this commission probably doesn't want to get into it. I'm not necessarily opposed to the idea of having recapitalized the banks. I'm not sure that that was an awful thing. But I am interested, because it is within the purview of this commission to see how we treat banks and financial services. Because you've just indicated, we're not just making one change here for them, not for them, involving them; we're making three changes that would involve them. And I would like to see how that affects what their obligation is. So if you'd be kind enough to do that, I think that would be helpful.

CHAIR PARSKY: Mark, what do you think about the data that might be available over the next 48 hours?

MR. IBELE: It's a reasonable question. I'm not sure what we're going to be able to do before Monday.

Just in terms of estimating, the Franchise Tax Board, which provides the estimates on bills and statutory changes and so forth, is still in the process of putting their estimating model together. And that won't be ready for some time.

What I would ask is, maybe get a clarification on what's actually been requested, and then maybe we can speak with our consultant during the break and see if there's some way that we can come up with something before Monday.

CHAIR PARSKY: Well, I think -- you correct me if I'm wrong, Fred -- but I think what Fred is seeking relates somewhat to the objective of the rate and the definition that we set for the financials, namely, generally speaking, to put them in somewhat the same position, albeit hard to determine, that they might have been under the corporate tax.

Now, what I think Fred is asking is, if you applied the existing tax and system of definition, it would produce "X." As you change the definition and apply a new system and rate, does it achieve "X" or does it achieve something different?

COMMISSIONER EDLEY: But you're looking for examples, not revenue estimates; right?

COMMISSIONER KEELEY: Chris, what do you mean by "examples"? Help me with that.

COMMISSIONER EDLEY: Examples. Case examples. Institution A, B, C. Under current law, they'd pay this; under the proposal, they'd pay that; right? As opposed to saying, for the sector as a whole --

CHAIR PARSKY: I see your point.

COMMISSIONER EDLEY: -- what are the total revenues that are projected; right?

Both, you'd like both; right?

COMMISSIONER KEELEY: Well, I think there's a general understanding. How about I talk during the lunch break, and we see if we can --

COMMISSIONER EDLEY: Okay, because the example is going to be easier.

COMMISSIONER KEELEY: -- if we can agree on what can be brought back to the Commission in that regard. But I do think it's a worthwhile sector analysis for us to look at.

Mr. Chairman, I have one last question, if I could.

The issue of a BNRT -- and I'd be interested in the response of any of you who have been working a lot on this -- the BNRT has been talked about as looking and feeling a lot like a value-added tax. And oftentimes, the reference is made to the European Union as perhaps the broadest market where that applies, and that there's not so many applications of this in the United States. One of the reasons it's been talked about in the literature, is that you need a -- there's a real value, if you will, in having cross-market uniformity, for

example, in the European Union or throughout the United States, among and between all the states, if they had such a thing.

That causes me to ask the question of, when you look at the European Union, one of the arguments that's been made historically in the European Union for having a value-added tax, is that they also have a very healthy, robust social-service network, a social-service system below it. And so those are often linked in the literature. And California has just gone through, of course, a pretty serious dismantling of at least some portions of the social safety network in California due to the budget issue.

I'm wondering if that issue came up at all during your discussions about the -- again, oftentimes, the parallel is drawn to the European Union, but there is two component parts to that conversation, typically. And I'm wondering if that was at all of issue to you or it came up during your discussions?

Thank you, Mr. Chairman.

COMMISSIONER COGAN: Fred, that's a very good question.

And I guess I'd say, it did come up, but really in the context of volatility. I think we've all seen what the volatility has resulted in for a lot of social

programs that people care about -- for education. And the connection then is having a more stable revenue source would prevent those kinds of dislocations, and those kinds of cuts that we've seen in the last six to eight months in California.

So I think it's in that connection that the real gain in terms of social programs from a BNRT is stability and as a way of avoiding the traumatic cuts that we've seen in the recent months. And so I think that's the connection.

Not so much in the European connection. I think the Europeans, they fund an awful lot of their social welfare programs through a payroll tax, in addition to a BNRT. But I do think it's very important when we consider the relative benefits of a BNRT, we think about it in the context of what happens to social programs when we have a highly volatile revenue source.

COMMISSIONER KEELEY: One last question about that –- oh, I'm sorry, Chris.

COMMISSIONER EDLEY: Can I just -- I just want to add. The other thing, frankly, that was on my mind, and maybe it's the sixth reason why I favor the BNRT, my sense is that because of the broad base, because it's a broad measure of -- a much broader measure of economic activity, that I think this is going to grow over time,

it's going to produce revenue over time as the economy grows more reliably than the income tax, but especially more reliably than the corporate income tax.

Now, that said -- and I hope none of the Republicans here heard that, when I said that --

CHAIR PARSKY: We closed our ears.

COMMISSIONER EDLEY: Jennifer's point, I think, is a really interesting one, that if, optimistically, we think that there's going to be kind of a secular shift away from consumption towards savings which, you look at the public-sector deficits and you look at the unfunded pensions, you've got to hope that something of that sort is going to take place -- it's that kind of an argument against the BNRT as a long-term growth in revenue.

And I'd certainly -- don't quote me on this, but I kind of defer to economists' views on that, if I get to pick the economist. But I could imagine an argument also that to the extent that if there's more saving, less consumption, that that would also have an impact on corporate profits and perhaps on employment levels.

So given all of that uncertainty, I still would sense that the broader measure of economic activity is going to produce better for us over the long haul.

COMMISSIONER KEELEY: My very last, last

question would be this: When you folks were wrestling through the issues and you came up with -- and I think -- I like that what you did on the issue of volatility is that you did, I think, fairly reflect the two schools of thought or belief systems in play on the Commission: One which says that volatility can be addressed through dealing with the income tax, and another school of thought here on the Commission is, volatility can be dealt with through a rainy-day fund. And so you did both. Because I think those are belief systems. There's not a right or wrong. It's a belief system issue, which is the way you would want to go about dealing with that. And I appreciate it.

I was wondering if the following idea got debated and, if so, what you all thought about it? And I suspect we'll have a little bit of a debate about this either later today or on Monday. But one way to look at that volatility, the belief system I have, is that you would leave the personal income tax alone; you would make the changes you're suggesting in the State Constitution relative to a much more aggressive rainy-day fund and not give every legislator and the Governor the combination to the lock that they could use anytime they chose to. But also that within that, that what you could do over at the personal income tax, is that you could treat capital gains

somewhat differently. Because we currently, as you all know, treat it as ordinary earned income.

And I wonder if you discussed the idea, for example, put more reliance on the rainy-day fund, don't do much with the personal income tax, except as it relates to capital gains; and maybe there, do something like this take the capital-gain obligation and spread it out over two or three years, when somebody has an obligation like that, and say, "We'll try to flatten out that one-time revenue spiking into the system," and causing more volatility on the upside of the business cycle by, for example, saying for two or three or four or five years, you can take that one-time obligation you have and spread it out. Maybe there is a pooled-money interest rate that you would pay as a taxpayer, whatever the State Treasurer's earning, something like that.

But did something like that come up? Was that a part of the discussion?

Thank you very much. That really is my really last question. Thank you.

CHAIR PARSKY: John, I'll let you comment.

But there's no question but that that possibility has been thought about and discussed throughout the Commission period.

But, John, do you want to make some comments?

COMMISSIONER COGAN: Just a couple comments, Fred.

I think the gain in reduced volatility that comes from focusing on the capital gains -- I can't remember what the precise number was, Mark and Phil, but as I recall, it was relatively modest. And I'd be concerned about -- as much as I favor this rainy-day fund, I'd be very, very concerned about whether it alone can do the job or whether it could do 80 percent of the job.

We have an awful lot of experience at the federal level, we have a lot of experience at the state level, across the various states with these types of institutional mechanisms designed to prevent a legislative body from spending money that they have. And I can't think of one that has worked consistently over time at the federal level or at state levels to prevent the kind of volatility that we need to prevent if we're going to deal with this problem of ratcheting up and ratcheting down government spending.

So my view, just as one commissioner, is I like the idea of a rainy-day fund, but I don't think we should bet the ranch on it. And in some sense, that's what we'd be doing if we left the income tax code in place.

COMMISSIONER EDLEY: And I'd just say that I've

raised these issues a couple of times. And you just heard the sort of unreasonable intransigence that I faced every single time that I raised the issue. But I think also in the full group, raised the issue of income-averaging of some sort once or twice, and it fell like a lead balloon, so…

CHAIR PARSKY: Well, I will say that we did hear testimony that doesn't take into account what you just said about capital gains. But we did hear testimony about the magnitude of the reserve that would be necessary if we just went the route of the rainy-day fund and we experienced the period we've experienced.

And I think the estimate was that about 30 percent -- 25 to 30 percent of the general revenue fund would have to be reserved in order to deal by itself in that. And maybe that would be acceptable to some, but I don't think that's -- I think the conclusion was, that's not practical. And so that's the evolution of the thinking. Let's try to deal with both and not bet everything on the rainy-day fund, but recognize that changes in the personal income tax to accomplish these objectives can't solve the problem, either.

COMMISSIONER BARRALES: Mr. Chairman?

CHAIR PARSKY: Okay, Ruben?

COMMISSIONER BARRALES: I've just got a couple

questions.

First of all, I do want to thank the three amigos for all your work on that.

CHAIR PARSKY: Did you get that, from "whacky" to "three amigos"? Write that down up there.

COMMISSIONER BARRALES: But also to Fred and Richard, I know you both have done a lot, and have your proposals as well.

And in all of those proposals, there is something for everyone, I think, to oppose, and then there are a few things that we might want to support as well in all of these.

I've got two questions. One relates to the inevitable question that we'd all have on the business net-receipts tax is, it's labeled as a "tax on labor." And what I'd like to do is kind of get on the table what, you know, is the perspective there. And also to help me think through -- and this is part of the same question -- how does this new system help or how does it aid California's competitiveness in the 21st century and moving forward?

There are a lot of competing interests in terms of trying to put something together -- less volatility, revenue neutrality, and all that. And I'm just –- I'm struggling with, how does this new system make our state

any more competitive than the current system?

And so I'd appreciate your thoughts on that. And then I might as well throw in my second question, and this will be it.

Why not -- and I've come 180 degrees on this -- but why not, instead of a brand-new tax that's kind of a value-added tax, kind of not, or the one that people are familiar with -- why not lower the rate on the existing sales tax, broaden the reach of the existing sales tax, and approach the system from that perspective?

COMMISSIONER COGAN: So, Ruben, let me take that one at a time and focus on the labor question. I think it's a very good question. It's one that we heard from the business community over and over again.

Isn't this a tax that would result in a disincentive to hire workers? Or as Chris once put it: Hire robots instead of people.

And I think where people come from is they say, "Look, you're getting to expense your capital equipment, but you don't get to deduct your labor compensation and, hence, you've created disincentive." And it turns out that that's just not so.

One way to think about it is that --

COMMISSIONER EDLEY: That's a lie.

CHAIR PARSKY: Now, now. Not from the gallery,

no matter what.

COMMISSIONER COGAN: So maybe the way to think about it, Ruben –- and Mike might want to chime in on this as well -- but the value of that deduction that's lost for labor is, every dollar of labor expense, now you lose 4¢ that you would have had if the BNRT rate is 4 percent, a deduction that you would have had, right, 4¢. And so the value of the deduction lost is 4¢ on each dollar for labor.

On capital, as it turns out, you're going to be paying the BNRT when you purchase some capital equipment. Because the BNRT taxes the labor, if you will, that went into the creation of that piece of capital equipment. And so the price of capital reflects, as does the price of labor, the BNRT creating no tendency to substitute towards machines and away from labor.

And I think the reality of it is that what these value-added taxes do that economists like, is that they place all of the inputs of production on a common tax basis, and that's why people support it.

Why is it good for California? The answer I could give you is that, look, you're taking a state that has the highest corporate tax rate, 8.8 percent, and you're knocking that down, we hope, down to just over 4 percent.

We think that that change in the tax rate is going to be more than sufficient to make California a much more attractive place for businesses to do business.

We think that the greatest deterrent to economic activity is the tax rate that we apply to success. And by getting that tax rate, by cutting it in half on success, we think we're going to attract a lot more successful businesses to California. So that would be my answer.

COMMISSIONER EDLEY: Well, the only thing I'd -- I was going to say something about the sales, but also I think a way that I think about the labor issue, as I'm sure you could imagine was a major concern of mine, is that when I, as a firm, buy the widget that I need in order to produce washing machines, and I buy the widget, the workers who constructed the widget, those wages are not going to be deducted by the widget manufacturer. But the value that's added by that labor -- the economic input of that labor into the widget is going to be deducted by me when I buy the widget as a business input.

So in that sense, the tax system, as a whole, is, in fact, allowing a deduction for the contribution of labor to the production.

The other thing I'd add is that with respect to the capital, on the one hand, it is expensed when it

comes in, when I buy it, a piece of equipment, but I don't get a deduction for the depreciation, which you do under the income tax. And, of course, when I sell the used piece of machinery later on, the revenue gained from the sale of that used piece of equipment is included in my tax base. And I'll pay a BNRT on any gain that I get from selling that -- depreciated now -- that used piece of equipment. So I think it sort of works -- I am confident that it works out, and I don't think it skews things away from labor at all.

The alternative that you mentioned regarding the sales tax, I think it's very, very important that everybody keep in mind that it's either the BNRT or the status quo or expanding the sales tax to cover services. And the difficulty with expanding the sales tax to cover services, even if you lower the rate, is, you'll remember from our plenary discussion, that when you look at that list of services that would have to be included, the politics of that are daunting, but then also the revenues produced by the sales tax after you deduct business inputs simply aren't as rich as what we get from the BNRT base.

Do you guys have that handy? But we lose a substantial amount of revenue from expanding the sales taxes, expanding the sales to services when we deduct business inputs.

MR. IBELE: That's true. I don't have the exact figures with me.

COMMISSIONER POMP: If you tax a new service, you can't lose. You don't tax business inputs, but you can't lose revenue.

COMMISSIONER EDLEY: No, but I'm saying, in other words, by allowing the deduction for the business inputs, you lose about 30 percent of it overall, so --

COMMISSIONER POMP: But if you tax a service --

CHAIR PARSKY: Wait, let's take it one at a time.

I think that one point is, if you felt that the taxation of business inputs under the current system is a policy that you don't think is a good policy, and so part of a change would be not to allow a deduction -- don't change to services for the moment, just allow a deduction or a reduction in business inputs, not taxing it twice, it would reduce the revenue that's created by the current tax system by about 50 percent.

Now, extending the sales tax to services, if you could extend them to all services, would increase the revenue. But the policymakers of California have failed continuously to do that.

COMMISSIONER EDLEY: The bottom line is, we can't see a scenario in which expanding the sales tax

would generate enough revenue to do what we would like to do in terms of PIT reductions and the corporate income tax reductions.

CHAIR PARSKY: Mike -- I'm sorry, go ahead, John.

COMMISSIONER COGAN: Ruben, one additional thing, though, that Chris has said, when you extend the services tax, the retail tax to services, if you exempted the business-to-business sales, you'd be exempting an awful lot of service activity. And that's one other reason why the revenue gain from that extension turns out to be quite modest.

COMMISSIONER EDLEY: And federal deductibility?

COMMISSIONER COGAN: Yes, one of the other things is that if you extend this retail sales tax to services, and you don't exempt business-to-business transactions, you will get a lot of revenue. But a lot of that will come from cascading of tax upon tax. And that's a worry, and it's avoided by the BNRT.

COMMISSIONER BOSKIN: And the greater reliance on the sales tax would reduce the –- it would cause a federal tax increase for Californians because the nonbusiness sales taxes are generally not deducted, whereas virtually all of the BNRT would be.

CHAIR PARSKY: Okay, two more commissioners

have questions: Richard and then Curt. And then there are two members of the public that made a special trip here. I just want to give them an opportunity to speak, and then we'll break.

Richard?

COMMISSIONER POMP: What time are you planning to break, Gerry? Because I'm not going to be here Monday. I've made a special trip here every meeting. That's three days: One day out, the meeting, one day back. And so I would like to be able to get my questions on the table, so…

CHAIR PARSKY: Okay, well, we'll let you go with your questions.

COMMISSIONER POMP: That's fine. I'll start then so we don't waste any more time.

COMMISSIONER EDLEY: Or you could go first after the break.

COMMISSIONER POMP: I could go first after the break. That's fine, too.

CHAIR PARSKY: We have on our schedule to make sure we get through the rest of the tax package that we are due to discuss.

And I would say, Richard -- and I appreciate all the questions. You have a lot of expertise. We did hold a special conference with you and the staff to go

through a number of your questions. And so I hope that that was informative. And I'm happy to have you repeat every one of them. But I hope that was informative to give you an idea of what this tax is.

But please proceed.

COMMISSIONER POMP: I'll start after lunch. So let's make sure our public speaker gets heard.

CHAIR PARSKY: Okay, Curt?

COMMISSIONER PRINGLE: Again, I apologize for not being here, but, in fact, Mr. Chairman, I spoke extensively with you over the last couple of days, so I think I understand some of what has been presented, as with my conversations with Mr. Cogan and others.

I am very positive towards the package as it moves forward. And a couple of the things that I think are important to put on the table is, Fred references his legislative service quite often, and I will just share the fact that I have served longer in the Legislature than Fred. And I may not have as complete of memory, but I do remember the 5 percent across-the-board tax cuts that Governor Wilson proposed in 1995 and 1996. It was a 5 percent reduction, both on the corporate rate, as well as the personal income tax rate.

Some may wonder whatever happened to that 5 percent cut. It was provided for business, and it

wasn't provided for individuals, mainly because the Democrats in the Legislature opposed the personal income tax cut and accepted the bank and corp. tax cut. One of those weird dichotomies that if you step back and look at it, I think we now, through this process, seeing the full element of all of the tax policy, may not necessarily make those types of decisions, but there's still the political, philosophical contradictions that are out there.

But at that time, there were very few people arguing in the Legislature for the personal income tax cut, and there were plenty that were arguing for a corporate tax cut. And I do think that, you know, from my perspective, I want to share that I don't think that we should beat around the bush. That, at least through the direction of this package, there has been a shifting of the taxpayer obligation in this state from a broader-based tax base to the individual. And there's an emphasis within this package of shifting that obligation back from the individual to business.

I am a good card-carrying conservative Republican; and I am not ashamed, embarrassed, or concerned about that. But I also know that when I get multiple letters from the business community, I understand why, because there is a shifting from the individual's

percentage burden of what they are obligated to pay, both on the personal income tax and sales tax, which we're dramatically reducing, to a business net-receipts to fill that hole. And I can accept that. I understand that. But I also want to make sure that we hear, in context, that we don't have a cavalcade of individual taxpayers out here to come forward as representatives of individuals to say thankfully, finally, since -- be it 1995 or ten years before that, when other personal income tax reductions were presented -- they've really not had that level of personal income tax reduction.

But I do believe that part of our challenge today and maybe Monday, when all of you meet, will be to contemplate the biggest decision, and that is changing elements of the tax code to this extent: What if we're wrong? And I know right before I walked in, I checked with Jennifer, and I know there was some brief discussion of making sure we set up a system by which we are checked, and that there is a backstop put in place as the phase-in occurs to establish some entity by which there could be a review to ensure that we didn't miss something or that the unintended consequences, the action, or the burden to business may be too great, or the burden to individual industries may not have been calculated.

And I do want to make sure, Mr. Chairman, as

I've told you before, I'm really concerned about having this review board established in our report after three years of the phase-in implementation. We stop, we preset who we think should be on it in terms of making sure it's partisanly balanced; that we do get a chance to ensure that some of these challenges that we've placed to our staff today, challenges to determine what the tax rate and the tax policy are in eight years, that, in fact, we can reassess in a couple, to see if that actually has played out. And if there is a terrible mistake, there for that moment in time, things can be relieved and backed away from that.

I think our tax policy today has many elements, the tax code has many elements of terrible mistakes. And that's why every year there are hundreds of bills introduced in the Legislature to modify our tax code. So for some reason, people to think we propose a grand, sweeping package, that nothing will ever happen to it again, is silly. That the tax policy we have today, many of the things that have caused many of the problems have been the changes that have been instilled by the Legislature during my legislative service, and certainly during Fred's, but also decades before that and decades after.

So to somehow think that everything we do has

to be perfect today and it will never be checked and there will never be a process or there will never be a modification, that's just not the case.

So, one, I'd like to put it in here so that there is a chance for that review. And I think that is to our ultimate value.

And finally, I'll say that I would like to suggest, even though I like the concept of a business net-receipts, I would like to ensure that it doesn't get over a certain level. And I personally hit that level at about 4 percent.

So as we start phasing this in, if we get to that 4 percent in terms of this annual recalibration and we can't eliminate all of the state sales tax by the end of the phasing in, when we hit the 4 percent BNRT, I don't have any problem with leaving behind a percent or a half percent or 1½ percent or whatever that may be, because that is part of the definition of "revenue neutrality," isn't it? That when we really do know the value of this tax, that we are ensuring that it is revenue-neutral, and we do stop at a point. And if we leave behind at that point in time, the sales tax would be the only other element of the pooled reductions that would be catching that increase in the BNRT. If we leave behind a portion of the sales tax, to me, I would feel

comfortable with that in a process of phasing in.

And finally, as a local elected official, Ruben, one of the biggest challenges I think we all will have, if there is a contemplation of expanding sales tax to service, is what it will look like in this state. I think I shared at a previous meeting. But every single city in the state of California would have to vote to expand or add a sales tax to services. The state can add a sales tax to service and they can do that statutorily. There's no constitutional restriction on that. That could happen. But to make sure the rate of the -- the rate in Orange County right now is 8¼ percent for a purchase of a car. If you went to get a new set of tires at your car dealer, if the City of Anaheim didn't impose their local sales tax, the tax on the tires would be 8¼ percent, but I would have to have a two-thirds voted by the city council and a two-thirds vote of the public to impose that sales tax on service. So it would be 7¼ percent for that car dealer to pay on the service to put on my tires.

But the County of Orange has a half-cent sales tax for transportation. Every county, every self-help county in this state would have to revote and authorize. Otherwise, you would have varying tax rates by one provider of service, a car dealer in this case for putting

on new tires, you'd have varying tax rates from city to city, county to county. You would have potentially hundreds of tax rates that could apply.

COMMISSIONER BARRALES: You have that now with sales tax rates in different counties.

COMMISSIONER PRINGLE: Yes, the only difference you have today in California is the ability the Legislature gave to counties to raise the sales tax for specific purposes. So, yes, from county to county. But, in fact, a city to city, neighboring cities, all individual votes, 435 cities in California would each be required to have a two-thirds vote, or else they would have a staggering sales tax within their city -- within their city, and within the retailer within their city, would have to have two separate logs as to what is for services and what is for goods. Those are the complicated challenges of a system that we also need to ensure is simple enough so people understand, let alone the business community that's being asked to collect that tax.

CHAIR PARSKY: Thank you.

I know everyone is waiting for a break.

Let me suggest that we ask Carl Morehouse and Chris Norby, who have patiently waited here and I know are a part of the City Council of the City of Ventura -- and the supervisor -- is that right? -- and vice-chair, to

make public comment. And then we'll take a break for a brief lunch.

MR. MOREHOUSE: Good afternoon, Mr. Chair. Okay, am I on now?

CHAIR PARSKY: You're on.

MR. MOREHOUSE: Okay, great.

Thank you, Chair and Commissioners for accommodating us for this time. I will tell you this chafes against my egalitarianism because all these other people have been waiting patiently to testify, and I apologize to them, as if my time was any more important than theirs.

However, I think it's a perfect segue to step up behind the last comments by Mayor Pringle. I come before you as wearing many hats. I am the immediate past mayor of the City of Ventura and a current council member. I sit on the Ventura Council of Governments, on the Local Agency Formation Commission, I formerly sat on the Ventura County Transportation Commission; but most importantly, I come to you today in my capacity as a regional council member representing the cities of Fillmore, Ojai, Santa Paula, and Ventura on the Southern California Association of Governments where I chair the policy committee for the community and environmental and housing development, of which I am in front of you as specifically a chair of a

subcommittee of that.

Throughout the formation of the Senate Bill 375 by President Pro Tem of the Senate, Darrell Steinberg -- I will, by full disclosure, also tell you I'm a practicing land-use planner, and I'll be going to the State Planning Conference, which will begin this weekend –- as one of these things that chafes at us. Throughout the formation of 375, the intent was to try to link land use and transportation, a very prudent idea for those of us who are in the planning profession.

The one part of the component that he purposely left out, and I understand why, was he forgot the fact that every city has to pursue, as you are seeing here with yourselves, a form of revenue stream, and that is driven to the fiscalization of land use.

There is not one elected official, I believe anywhere, who would be happy to build the housing that is required by the State Department of Housing Development, and add more constituents to scream at them on a meeting night for money, when they're hunting for money to pay for the ones that are already screaming at them. So the process is, we tend to build big box stores, retail outlets. And many of you have read in my deputy mayor Bill Fulton's book, *The Reluctant Metropolis*, where he talks about "Sales Tax Canyon" in Ventura.

After beating that gong for some time, I was able to convince many of my peers on SCAG to form a subcommittee to do the very kind of thing you've been doing: Analyze the problems with the revenue stream, particularly as it relates to the fiscalization of land use.

I've been fortunate to have as my vice-chair Chris Norby, who has already come and testified in front of you in April.

Now, again, to show bipartisanship, we are not only in different parties and have pretty strong feelings in the similar vein, but he also was a county supervisor and I'm a representative of the city.

So the Fiscalization of Land Use Committee met a couple of weeks ago, and they've asked me to quickly read into the record for you the conclusions from that committee that they want to forward to you and present to you also: A Conceptual Framework for Local Government Finance Reform. Because the one thing we want to remind you as you go through your deliberations, is please keep in mind that every citizen in the state of California resides in a city, the 485 cities referenced by the mayor, or the 58 counties.

So very quickly, if I may.

"On behalf of the Fiscalization of Land

Use Subcommittee of the Southern California Association of Governments, I enthusiastically applaud the Commission on the 21st Century Economy's efforts at stabilizing, modernizing, and rationalizing state and local government revenue.

"We've reviewed your current draft proposal and are supportive of its general direction and many of its tax policy concepts. We urge the Commission, however, to consider the implications of any reform package on local government finance. It is at the local level where so many valuable services are delivered and where government meets the people. A focus of local government finance is in keeping with the Commission's mandate to suggest changes to state and local revenues that will result in a revenue stream that is more stable and reflective of the California economy.

"Examination and explanation of the local implications of the proposed business net-receipts tax will be especially important.

"SCAG's Fiscalization of Land Use Subcommittee is made of local elected officials from around the Southern California region,

home to roughly half of the state's population. We've been evaluating various fiscal reform concepts with the goal of providing more stability and fairness to local government revenue. As our name suggests, we are particularly interested in confronting the fiscalization-of-land-use phenomenon and removing the perverse incentives that the current system of local government finance creates for land-use planning and development in our communities.

"To encourage more balanced development and an end to the chase for sales-tax dollars, we've studied a range of reform options and have developed a framework for reform that would allow cities to voluntarily exchange some of their sales tax revenue stream for a greater share of local property taxes. This would incentivize the full spectrum of land uses rather than the current bias towards retail development.

"We also believe a split-roll adjustment to the property tax law allowing periodic reassessment of commercial properties should be considered by the voters.

"I've also submitted a memo summarizing our reform framework for further information. The reform concept SCAG is pursuing appear to be compatible and consistent with the direction of your commission. The objectives of our respective efforts could not be more complementary. I hope that we can work together as the ideas we have exchanged evolve from concept to legislation.

"Thank you again for your efforts in serving the people."

Let me just put on a very personal note. I've watched with great interest as a student of public administration and political scientist, your deliberations up here. I know how difficult they are. And I laud you in your efforts, and I hope that you can continue. And thank you, and may the good Lord provide you with the wisdom for coming up with a very good recommendation.

Thank you for accommodating my time.

CHAIR PARSKY: Thank you very much.

MR. NORBY: Far from waiting patiently, Mr. Chair, we've been fascinated and grateful that those such as you are engaged in this policy effort.

Oftentimes, in programs like this, it's the staff talking to each other and those on the committee

sort of nodding heads and then wanting to put a final imprimatur on this. But we're thankful for this process and we're excited by it at SCAG. We're looking at local government revenue, trying to defiscalize it.

I reported to you at Davis. We looked at a number of proposals you've been chewing on. But the one that we have, which is the most politically palatable, has not to do with sales-tax sharing, which I originally thought was where we were going to do, but then you have to fight with the high and low sales tax cities, even if you even it out just in terms of doing the growth.

But allowing cities voluntarily to give up all of their local sales tax revenue -- not lower the tax, but give up the revenue to the State in exchange for a higher percentage of their property tax. Trade it one for one. And then the city isn't worried about the big boxes. The city is not incentivizing retail. In fact, the city values all of its property taxpayers, including residents, equally.

And this is the one that we're focusing on. Now, we're still talking about sales-tax sharing, we're still talking about the split roll. I personally don't think that's a good idea or it's necessarily going to happen. But the allowing of cities to voluntarily do this, I think would have a profound effect on local

government. It's something that the Legislature could do without a vote of the people. It wouldn't allow any tax increases. It would allow simply the way that local government relates to land use by equalizing revenue and defiscalizing it.

Thank you.

CHAIR PARSKY: Thank you all very much.

MR. MOREHOUSE: Finally, as a reminder, let me quickly hand out city pins for the City of Ventura so you all know and remember in the back of your mind about local governments.

CHAIR PARSKY: I'm not sure any of the commissioners will get any more than that through this process. So take your pin here.

We're trying to -- it's two o'clock now. Let's take a 30-minute break, come back. We are going to offer Richard Pomp a chance for further questions. Then we need to move to a discussion of the pollution tax and a discussion of the royalty on potential oil drilling. And then we'll try to come back around and see where we are.

Thank you.

COMMISSIONER BOSKIN: How long?

CHAIR PARSKY: Thirty minutes.

(Midday break 2:00 p.m. to 2:50 p.m.)

CHAIR PARSKY: We'd like to start now. And what

we're going to do is, Commissioner Pomp is the last questioner for this part of the tax package that we've been discussing. And then we'll turn to several other elements of the package that I'd like to come back around and get a sense from the commissioners where they are in their thinking, and then we'll see where we go from here.

So, Richard, why don't you proceed with questions?

COMMISSIONER POMP: Yes, thank you, Gerry.

I've got a bunch of questions, I think -- and this is going to be a judgment call for you. I think if we stop after every question and have people give an answer, it may run a little longer than what you want.

I've had the benefit of sitting next to John at lunch, and that was very useful. That will help short-circuit some of the questions I have.

So if you're happy with that format, I'll just put stuff on the table. And then afterwards, people can respond or not.

And I think, for the record, as long as we're doing a mea culpa, I am not a registered Democrat, so… I'm not even -- not of any kind.

Let me start with two fallacies that I think are very important to clear up. One is, just because a certain income group pays the lion's share of a tax, it

does not follow the tax is progressive. That's a fallacy. I can have a regressive tax; and if I have so many wealthier people than poor people, they will still pay the lion's share, even under a regressive tax. So you can't use that to look at progressivity or regressivity.

The second fallacy: What we are talking about the NBRT has nothing to do with Europe. Europe has what is known as a "credit invoice transactional value-added tax." It is a retail sales tax collected in stages. That is not what we are talking about here. There's only one country in the world that arguably has something similar to what we're doing here, and that's Japan. It's not even clear it's similar. So that's the second point.

The European experience, when everyone is in the system, as is true in the economic union, the world looks very different from the world we are debating here where, with the exception of Michigan, we're going to be the only state with an NBRT. That does put our vendors at a competitive disadvantage. When they buy things and pay an NBRT and then export it, the single factor means they won't pay any NBRT on the sales proceeds received on the export, but they will have NBRT embedded in the cost of the good that's being exported. They will compete in the U.S. market with everyone from other states that do not

have this tax.

This is why there is value in having a tax system that's not out of step with other states, and that's why I really am somewhat skeptical about our eliminating the corporate income tax, a tax we've had for about 70 years; a tax that 90 percent of the states have; and a tax for which we have not heard any empirical data has negative consequences on the California economy.

Now, maybe the basic reason it doesn't is that very few corporations pay it. I'd like to know more about that. I've proposed a plan that has at least the potential of turning that around.

But I want to rehabilitate and reinvigorate the corporate income tax. I would never give up a tax that's part of the mainstream of the U.S. economy. I think that's a big mistake.

Marginal tax rates. In general, sure, I subscribe to the philosophy that a lower marginal tax rate is better than a higher one. That debate has basically occurred in the context of the federal system, where you have rates approaching, with the phase-outs, 50 percent. And people don't appreciate -- I'm sure people on the Commission appreciate it because they probably pay it. But, you know, what Congress did, rather than raise nominal rates, was take away our personal

exemptions or itemized deductions, you throw on the AMT, and you could easily be pushing 50 percent. That's a debate --

CHAIR PARSKY: Rich, I don't mean to interrupt, but if you could separate your remarks. You'll have an opportunity to make statements, but just separate your remarks from questions that we have the staff --

COMMISSIONER POMP: This is a question, but the staff is not going to be able to answer it.

CHAIR PARSKY: Okay.

COMMISSIONER POMP: Is there any evidence that the marginal tax rate of the California income tax has had ill effects on the economy?

And you can answer this by introspection, Gerry. You're very hardworking. Are you going to work any harder if we lower your marginal tax rate? I'd doubt it. I mean, I just can't believe it. I can't believe other people on this panel will work harder. So I'm a little skeptical about what we're going to get in return from lowering marginal tax rates.

My question is, is there any evidence? And I'll leave that one for people to deal with.

But I have a combination of comments --

COMMISSIONER PRINGLE: Mr. Chairman, I would like you to answer his question: Would you work harder?

CHAIR PARSKY: Well, it's hard for me to assess that issue in connection with the pay I am receiving for this commission. If it was taxed at a little higher rate, I might work a little bit less. But given that, I'm not sure -- Richard, I would only say to you that I thought at several commission meetings you, as a commissioner, said that, among other things, that lowering the rates and expanding the tax base were positive things that you could see happening in California. And that was a statement you made. I don't know quite how you would implement that, but I'd be interested.

COMMISSIONER POMP: Implementing is no harder than what you're thinking about implementing or we're thinking about implementing with the NBRT.

I would eliminate waste and inefficiency. I might start with tax expenditures that can survive a cost-benefit analysis.

If we agree that something should be eliminated because there is no empirical support that it does anything that overcomes the loss in revenue, I would use that revenue, and I would be happy to lower the rate of that particular tax.

COMMISSIONER EDLEY: Are you reading any news coverage of what happens in Sacramento? In what universe do you think the State Legislature would do what you're

suggesting?

COMMISSIONER POMP: The same universe that's going to say they're not going to do the NBRT, so you could read the politics the way you want and I'll read it the way I want. But I would like to at least talk about what the right answer is. You know, there's plenty of room in the Legislature to play, "Let's make a deal." I'd like to talk about what the right answer is. I think we should be role models on this commission. And you could go ahead and read whatever the politics are that you think they are. But we're not going to get anywhere debating politics.

CHAIR PARSKY: Let's just focus on questions.

COMMISSIONER POMP: Right.

Next question: Half of the reduction in the personal income tax, which is about seven or seven and a half billion dollars, goes to about 3 percent of the taxpayers.

And I guess my question is, was that in order to reduce volatility or is that a combination of reducing volatility and hoping to get some favorable incentives built into the personal income tax so people would invest more in California or work harder and things like that?

And, you know, for me, that's a very skewed distribution, half to 3 percent of the taxpayers. I'd

like to know why. I'd like to know why the itemized deduction for medicals was eliminated, as well as the child-care credit. I mean, I don't really understand.

We have an R & D credit that we're proposing in the BNRT, a credit for which at least -- I don't read politics, I read the economic literature and empirical studies. And I find that there is no empirical evidence that the R & D credit pays for itself. So we're willing to do something for which there's no empirical evidence and we're eliminating a child-care credit. I mean, I don't understand that kind of trade-off, and I don't understand -- and I did listen to the President's speech last night. It's hard for me, in the light of that speech, to understand how we are eliminating an itemized deduction for medicals. People who are losing jobs or losing medical benefits and are no longer covered by insurance; they're paying for stuff out-of-pocket. I don't understand how we're not taking that into account.

I would like to see, along with the additional data that others have asked for, I'd like to see the winners and losers in each of these income groups. Because I am curious how many of the losers ends up paying more tax under this proposed system -- and we know there will be some -- are going to do that because of the elimination of the medical deduction and child-care

credit. And that should be knowable.

So I also have trouble thinking about this whole package without knowing the incidence of the NBRT. And I know it's tricky and I know we also had a consultant who gave us some best guesses as to the incidence effect. And I believe about 70 percent was going to have the incidence of a sales tax.

Working with that, I would like to see sort of the omnibus incidence effects. I have trouble thinking about one part of that. And I appreciate John's remarks about how may we know more about one tax than the other. But nonetheless, I'd like to at least see our best estimate, perhaps using our consultant's prediction that it will have the effect, the NBRT, at least to the degree of 70 percent as a sales tax. And so I'd like to see what that does.

We're reducing the tax on the wealthy, which is going to be the largest-growing sector when the economy turns the corner. This has been true in all other periods of time. We are moving to a consumption tax which, with the difficulty of obtaining debt financing, we're seeing a falloff in consumption. The Feds are likely to move to a consumption tax to finance the deficits and health care. They're going to be squeezing consumption, would be at least my guess. It seems to me, it's sort of the wrong

time to be eliminating a corporate income tax.

Profits grow very fast as you come out of a recession. So we are eliminating a tax on a fast-growing revenue base; we're cutting taxes on the wealthy, a fast-growing revenue base; and we are moving to what is likely to be a slow-growing revenue base. That just doesn't make good sense to me.

I'd also like to know -- and this is for the staff -- this is easily knowable -- how did they grow income from current year to 2014? Was the same growth factor used for each income group?

And that, I suppose, is an easy "yes" or "no."

MR. SPILBERG: The way that income was grown was by basically form of payment. So there were capital gain growth rates, there were wages and salary growth rates and the other sources of income. And because those sources of income are distributed differently across the distribution, you would have different growth rates across the distribution.

COMMISSIONER POMP: So a higher growth rate was used for capital gains than for wages?

MR. SPILBERG: Yes, it was.

COMMISSIONER POMP: Okay. And, again, let me add my compliments to everyone else's kudos for the enormous work of the staff, including the drafting of a

bill -- or at least some parts of a bill, though I understand we're not going to propose that, and I don't know how we could vet it -- but an enormous amount of work went into that.

One of the things I worry about, Gerry, with the NBRT: When it comes to an income tax, the Legislature has a pretty good idea of what the right answer is. If I come in and I'm lobbying; and I say, "Oh, you know, vacation should be deductible because I can show you evidence it increases productivity," a legislator may consider that, but they will at least know it's not part of the structure of an income tax. You don't give a deduction for personal consumption like vacations.

There is no one who understands what the normative structure of the NBRT really should be. And I am sure debates that our working group had indicate, in many cases, you just don't know what the right answer is: Financials, insurance. It's difficult -- nonprofits. And I am just afraid that while we might like something that's theoretically pure, it is going to come out like Swiss cheese out of the legislative process. People are going to come in and they're going to go, "Look, this is really unfair to labor. You don't get a deduction for labor. You've got to do something about it." And I'm willing to bet you something will be done about labor.

Now, we heard some sophisticated arguments about how labor really isn't treated more favorably than capital purchases. The premise of those arguments was that the producer of the capital good was subject to the NBRT. That is a European argument, where you can be somewhat assured that in a large economic union, the provider will be subject to the NBRT, or what's equivalent, the transactional value-added tax.

There is no assurance here. California is going off on this on its own.

If I go over to some other state, buy capital equipment, put it in my truck, bring it back to California, I don't believe that the supplier of that is subject to the California NBRT.

COMMISSIONER EDLEY: That's a risk.

COMMISSIONER POMP: It's a risk -- I think it's more than a risk. It's a risk I think I would take on a contingency basis. I mean, if someone comes to me --

CHAIR PARSKY: You'll be paid the same amount of money you're getting for serving on this commission for that.

COMMISSIONER POMP: Well, until we win it, that's right.

If someone comes to me in Connecticut and asks for an opinion letter on the NBRT and I do all my services

in Connecticut and then I e-mail them or Fed Ex them or fax them the results of my services, I don't believe I am an NBRT payer, and I don't believe any known theory of economics nexus makes me an NBRT payer. If that's true, everyone going to --

CHAIR PARSKY: Well, let's just pause on that for a minute. Let's just pause.

COMMISSIONER EDLEY: Yes.

CHAIR PARSKY: Because I'd like Carl to just talk about the work that was done by the Franchise Tax Board in preparation of a memo relating to the constitutionality -- of potential constitutionality.

COMMISSIONER EDLEY: Gerry, I think that what Richard just said is unexceptional in terms of the applicability. The question is, how many transactions of that sort would actually occur.

He's just saying, there wouldn't be any economic nexus if all the business takes place in Connecticut. I think that's clearly true.

The question is, how many people would drive across state lines in order to consummate the deal and thereby get out from under it? And I think it would be a trivial fraction.

COMMISSIONER POMP: Most people call me and don't drive, so very easy to call today.

COMMISSIONER EDLEY: Frankly, I'm less worried about you than I am about --

COMMISSIONER POMP: Than Nevada.

COMMISSIONER EDLEY: Nevada, yes, exactly.

COMMISSIONER POMP: And then we -- the NBRT --

CHAIR PARSKY: Let's just -- Carl, make a few comments here.

MR. JOSEPH: Okay. Well, we were asked by the Commission to do some work in that area about what the possibilities are, about the constitutionality of an economic-presence-type nexus standard. And we reviewed the cases that have been decided -- at the state level, mind you. It's never been at the Supreme Court. And, you know, we came to the conclusion that it's most likely that this is okay.

Now, granted, bad facts can make for bad law. And one transaction with you, Richard, on the service contract in Connecticut would probably not be the case that ends up in front of the Supreme Court.

Nonetheless, if you had a taxpayer who was providing services of a significant quantity to California taxpayers and was availing themselves of the California market, I think that, at least the cases at the state level have indicated a rather strong prevalence on the state's part, that there is no physical presence necessary

to apply the tax.

COMMISSIONER POMP: And the key phrase was "availing themselves of the California market." I don't think Carl is suggesting I avail myself of the California market when I sell to a customer who takes a good, picks it up in a truck, and brings it back to California.

Are you suggesting that's availing myself? If so, everyone's availing themselves of the California market. Anyone who sells inventories to a California purchaser, who comes and loads it up on a truck and goes --

CHAIR PARSKY: Okay, Richard, Richard, Richard.

COMMISSIONER POMP: So, all right.

CHAIR PARSKY: Richard, hold on. Let's -- you went through all of these questions in a conference call with the staff.

COMMISSIONER POMP: But not with the commissioners.

CHAIR PARSKY: I know. It's okay.

COMMISSIONER POMP: So what difference does it make?

CHAIR PARSKY: I'd like you to try to focus on some issues here that bother you, and then let the Commission know whether or not you would support, in any

form -- any form whatsoever, with any conditions attached, an exploration of a business net-receipts tax or not.

COMMISSIONER POMP: The issue of nexus is the 900-pound gorilla in the room, Gerry. I mean, that is the -- you're either going to have an incentive for offshore outsourcing or you're not.

And the fact that I express these same views with the staff, that's not the same thing as sharing them with the commissioners.

So let me -- in the interest of time, you know, how to think about nonprofits. You can't just say they're treated this way under an income tax and, therefore, we're going to carry over that treatment to a value-added tax. You have to start from thinking about what a value-added tax means. You can't just assume that the correct treatment under an income tax follows into a value-added tax.

NOLs --

CHAIR PARSKY: Just pause on that.

You would tax nonprofits under a BNRT?

COMMISSIONER POMP: I did not say that. I'm saying –-

CHAIR PARSKY: Well, what are you saying?

COMMISSIONER POMP: I'm giving you a thought process of how to think about it, that --

COMMISSIONER EDLEY: We did. We did. And it's a hard question. We came up with a recommendation. Tell us what you think would be a better recommendation.

COMMISSIONER POMP: I was not privy to your discussions, so -- but I will say this: I know what the wrong answer is. The wrong answer is to assume that what we do in the income tax is the right answer under a value-added tax.

COMMISSIONER EDLEY: It wasn't an assumption. It was the sense that -- I'm sorry, it wasn't an assumption, Richard. It was a sense of, well, the Legislature has clearly made a decision that a certain class of activity is going to have tax-favored status. And even though this is a different form of tax, we were kind of thinking what would be more consistent with the previous policy judgment's balances that were struck in the Legislature. And at least what John and I thought, and I think Gerry agreed, that you could do on the one hand, on the other hand; but we thought that the better of the argument was, if the Legislature wanted to favor them under Tax System A, the Legislature would probably also prefer to favor them under Tax System B. And as a policy matter, it could go either way. So that was our reasoning process.

I'd love to be educated, though.

COMMISSIONER POMP: Here's my initial starting point: I may decide under an income tax that the concept of income has no rigorous meaning when applied to a certain kind of activity -- maybe a charitable activity, do I count donations as income, are they gifts which are traditionally exempt under an income tax? I might decide that the notion of income doesn't apply to a nonprofit and, therefore, I will exempt it from a tax on profit.

That doesn't mean that a nonprofit doesn't generate value-added. It may or may not. You know, that's a debate worth having. What kind of nonprofit? What are they doing? Are we going to be discriminating between a for-profit provider of that good or service and a nonprofit provider of that good or service? Those are legitimate questions to have.

All I'm suggesting is, an answer under an income tax doesn't necessarily carry over.

COMMISSIONER EDLEY: I think that's absolutely right. But I think that we may have a disagreement on the conceptual clarity behind section 501(c) of the IRC. I don't think it's all about confusion about what is or isn't income.

COMMISSIONER POMP: Well, it may not be totally.

COMMISSIONER EDLEY: Right.

COMMISSIONER POMP: All right, that's fine. I

agree, it may not be all about that. All I'm suggesting is, when you move to a different kind of tax base, one has to rethink these from scratch.

NOLs -- when you think about an NOL in the corporate income tax, what does the NOL say? The NOL says that, "I will shelter a future amount of income from taxation, equal to the NOL."

If we're going to eliminate a corporate income tax, the system has kept its promise. Not only have we sheltered an amount of income from taxation equal to the NOL, we've sheltered all income from the NOL.

We've kept our promise. There's no logical reason why that NOL should be carried over into a completely different tax, a value-added tax.

COMMISSIONER EDLEY: Here would be the logic: The logic would be that anytime one constructs a transition strategy in moving from one tax structure to another tax structure, part of it is about logic, part of it's about a sense of what's equity, and part of it pays attention to what are people's reliance interests. Part of it is a concern about a disruption in markets, et cetera.

And I think putting all of those things together, it's not just a matter of logic, it's a notion that you have firms that have been constructed with a

certain expectation about stability in the tax system and what it's going to look like, and they may have expectations about having an asset on their books that will be valuable if they're acquired by another corporation, et cetera.

And while it doesn't seem reasonable to try to preserve 100 percent of all of that value, nor does it seem to me reasonable to think that it should simply evaporate with the adoption of a different tax structure.

So, again, I think that this is a matter of just trying to reach some agreement about what's a reasonable way to strike a balance as you're trying to craft a transition between, from one system to another.

COMMISSIONER POMP: And I guess the way to test that theory is, if we were just to eliminate the corporate income tax, without any kind of financing mechanism that could be tied to it, like the NBRT -- we just decided in a flush time to eliminate the corporate income tax, would the State really be thinking of reimbursing people for NOLs which they have gotten the benefit of and that there will be no future income -- all income to be taxed?

COMMISSIONER EDLEY: I absolutely think the State would think about it. As to whether or not they'd actually do it, I'd have my doubts simply because it would be far less practical in a situation in which taxes were

disappearing, I mean, whatever planet that is.

COMMISSIONER BOSKIN: Well, it would have been nice if we were convened during a period of robust revenues and we could have a tax cut along with a reform. That would make everybody's life easier.

But I think, Richard, one of the main differences between NOLs and other fluctuating income, is that many businesses have extremely cyclical revenues and extremely cyclical profits. Therefore, there will be times they are negative.

We don't reimburse them. Our tax system is asymmetric. It stops at zero, okay. It's unlike, my income is X one year and 2X another. I may wind up in a higher tax bracket, and there's an issue about whether averaging ever made sense, et cetera. But if it's "minus X" one year and "2X" the next year, and it's averaging "X," I'm not being taxed on that. I never get to take advantage of the fact that I had "minus X." I should have gotten a refund on my taxes and I didn't. It's being carried over.

COMMISSIONER POMP: So you're saying that if I operate in a loss position for my entire history and then go out of business, I'm entitled to a refund of the taxes I never paid?

COMMISSIONER BOSKIN: No. No, no, no. There

has to be some practical limit, sure.

COMMISSIONER POMP: And finally, on the minimum tax, I mean, if you really believe everyone should pay a minimum tax, we, I think, are eliminating the minimum tax on LLCs, corporations, and every other entity.

I happen to think there should be a minimum tax, at least on business entities. I think in recognition of their use of the infrastructure, there should be a minimum tax. And I don't understand the logic of eliminating it.

COMMISSIONER BOSKIN: But not on people?

COMMISSIONER POMP: People, I think, is a little harder because we have an ability-to-pay notion when it comes to people.

And I also think there's something more subtle with work, that minimum tax will be collected through withholding. And most people become completely oblivious to taxes collected through withholding.

And what the focus groups show -- and you can do this through introspection -- most people know the refund they got from the IRS and they know the check they wrote when they sent in their return, they are hard-pressed to tell you what the total amount of their personal income tax was actually paid over the course of the year, so -- and I have a feeling this would be the same thing with people.

COMMISSIONER EDLEY: Do you have a sense of, if there were a minimum tax, what it should be?

It's currently, what, $800?

MR. JOSEPH: Yes.

COMMISSIONER EDLEY: $800 on the bank and franchise tax?

COMMISSIONER POMP: I would just continue it. People are used to it, so…

Anyway, Gerry, I have more, but I could see no one has patience.

CHAIR PARSKY: Well, Richard, let me just say this: I know that you have a lot of experience in these areas, and I know that you've proposed an alternative way to look at what the Commission should do.

Inherent in what you have suggested, I think -- although part of the text of what you've suggested included an open mind with respect to the BNRT and an open mind in terms of adjusting the personal income tax rates. But it sounds like your mind is closed -- and that's perfectly okay, you're welcome to, and should, carry forward your own personal views irrespective of whether the rest of the Commission reaches consensus.

Just so that everyone understands, your approach, I gather -- tell me if I'm wrong -- would be to leave the personal income tax all alone? Don't touch

that tax?

COMMISSIONER POMP: No. As my memo suggested, I can certainly accept, in the interest of trying to reach a consensus, a distributionally acceptable reduction. 50 percent of the reduction to 3 percent to the taxpayers is not acceptable to me.

CHAIR PARSKY: No, no, I was just reading from the summary of your plan --

COMMISSIONER BOSKIN: What about the taxes that are already being paid? They're paying 50 percent of the taxes.

COMMISSIONER POMP: Yes.

COMMISSIONER BOSKIN: So we're keeping the distribution of the tax burden the same, basically.

COMMISSIONER POMP: And you're giving half of the about $7 billion reduction to 3 percent of the taxpayers.

COMMISSIONER BOSKIN: Who pay half the income taxes.

COMMISSIONER POMP: And I've suggested that the percentage someone pays of the total tax does not address the distributional issue. I could --

CHAIR PARSKY: Well, we just have a disagreement about that.

COMMISSIONER POMP: You're talking of more

wealthy people.

COMMISSIONER BARRALES: Can I ask, Mr. Pomp, what would your proposal be? How would you distribute that?

COMMISSIONER POMP: I don't see -- I mean, I have heard no testimony, no evidence -- I don't think the Commission has heard any -- that there are negative consequences from the existing personal income tax in California.

COMMISSIONER BOSKIN: Charles McLure, James Hines, and Roger Gordon all testified to the high marginal tax rates in California, personal and corporate, being a disincentive to invest in, expand businesses in, locate in California, and were one source of California's competitiveness problems which were part of our charge. They are the second and third items of our charge by the Assembly and Senate leaders and the Governor.

Now, research --

COMMISSIONER POMP: If you notice --

COMMISSIONER BOSKIN: I totally agree that when you try to pinpoint a study just of California, it becomes a needle in a haystack. That becomes very hard.

COMMISSIONER POMP: And I cited studies, Gerry, in my memo, about how marginal rates had no effects in these other --

CHAIR PARSKY: Your memo has been distributed to the public. The public has your memo.

I was trying to understand as a commissioner what it is you're asking this commission to do in response to their charge. And it sounds like -- it sounds like you don't have a plan for changing the personal income tax. That wasn't one of your seven points.

COMMISSIONER POMP: That is correct. I accept that.

CHAIR PARSKY: Okay, I just wanted to make sure we've got it clear, so everybody understands.

COMMISSIONER POMP: But I do not have a closed mind to something that is more distributionally acceptable.

CHAIR PARSKY: No mind is ever closed permanently.

COMMISSIONER POMP: Of course.

CHAIR PARSKY: No mind.

The points that you raise in your memo, however, that relate to the corporate income tax -- and there are several -- in terms of provisions that you thought were included, that were not appropriate by the California Legislature, and the publishing of the names of publicly traded corporations who received expenditures, as well as the publishing of the names of corporations that paid

the corporate tax -- all of those suggestions would be unnecessary if we eliminated the corporate tax.

COMMISSIONER POMP: Not the tax expenditure one.

CHAIR PARSKY: Well, on the tax expenditure, I think we've made it clear that our charge was not to deal with expenditures. But I would just like to ask you the question: Would you want to identify tax expenditures under the personal income tax as well?

COMMISSIONER POMP: I might. You know, John and I were talking at lunch. Put us in a closed room, we'll come up with a list of tax expenditures that we think are worth --

CHAIR PARSKY: Okay, I think everyone --

COMMISSIONER BOSKIN: Would you also like to list every Californian that is exempted from the income tax?

COMMISSIONER POMP: Individuals have a right to privacy that corporations that are publicly traded, that file voluminous SEC reports, do not have. And that's why my proposal was limited to publicly traded corporations.

CHAIR PARSKY: Okay, listen, you have a lot of expertise. You're perfectly entitled to your views. I think everyone understands the direction you would like to go.

If, between now and September 20 you decide to go in a different direction, I'd like you to let all the commissioners know, because we are still seeking unanimity around this table. But it's clear that the direction that is being outlined is not a direction you'd like to go in.

I would only urge that you look at, extensively, the magnitude of work that's been done, and that you listen to the balance of the presentation that is going to be made by Commissioner Keeley and Commissioner Boskin, and see if, out of all of that, you can find your way to support a proposal by all the commissioners that isn't a take-it-or-leave-it proposal, but is an attempt to be at reform and a request of the Legislature to take this effort seriously.

COMMISSIONER EDLEY: I'm sorry, Gerry, can I just ask a question procedurally? I'm very interested in supporting three of Richard's recommendations. That regarding a severance tax, the independent tax court, and ending the pay-to-play.

At what point would you propose that we talk about those --

CHAIR PARSKY: Two of those: The independent tax court and the pay-to-play concept is part of our discussion today, and will be one of the potential recommendations for this commission. It was identified

as part of the tax package earlier.

COMMISSIONER EDLEY: Right.

CHAIR PARSKY: And it will be.

The severance tax issue will be also addressed, but I think in the context of -- and I'm not quite sure I understand exactly what it would apply to -- but it will certainly -- this severance tax, do you want to explain that a little bit?

COMMISSIONER POMP: Yes. It is, I think, in use by every state in the country that has substantial natural resources. By severing it, it is the bringing of the resource to the surface. It differs from the royalty proposal of Michael, but it's similar in that it applies to natural resources.

There have been bills filed in the past in California that are a very good starting point for this. The Commission would have to decide what a good rate would be. But the groundwork has been done. I didn't repeat in my memo, but the groundwork's been done.

CHAIR PARSKY: We'll discuss that in the context of Michael's -- yes.

COMMISSIONER LOZANO: I have one question also.

CHAIR PARSKY: Yes.

COMMISSIONER LOZANO: The comment about the deductions -- and I do recall in one of our commission

meetings, we talked about medical benefits -- medical care. And could you describe for us why that was not included in our package?

CHAIR PARSKY: Well, we started with the notion that there would be no deductions. That's one starting point.

I think Richard commented that he would favor that, that there would be no itemized deductions at all. Start just with AGI. And discussion around the table was that that wasn't something that the entire Commission could coalesce around. And so we started down the list of things that could be included in itemized deductions.

I think -- my recollection is that it was the property tax, in effect, taxing a tax, was something that a number of commissioners said didn't make sense.

And then we identified, and for the last two Commission meetings had on the table, these three itemized deductions. That's not to say that the medical deduction isn't available at the federal level, because it still would be -- and child care and a number of other things. And it is important not only to look at these tax proposals as a package, but also see the interrelationship between the changes made here and the federal tax, which we will certainly comment about.

But I thought that there was the ability to

achieve full consensus, but including only those items.

COMMISSIONER POMP: They were all deductible at the federal, so that doesn't distinguish the medical from any of the others.

COMMISSIONER EDLEY: What was the revenue loss associated with the health-care deduction? Do you guys remember?

CHAIR PARSKY: I think -- did we identify the revenue loss relating to the health-care deduction?

COMMISSIONER EDLEY: I remember, way back earlier we did.

CHAIR PARSKY: I think earlier, we did.

MR. IBELE: I don't recall. I can check the transcript.

COMMISSIONER POMP: It just seems to me, Gerry, it looks very callous on our part to take away a child-care credit, deduction for medicals, and leave a charitable, for example. And that just, I don't think, sells well.

COMMISSIONER BARRALES: I thought we weren't supposed to do medical?

COMMISSIONER POMP: I wouldn't have any of them. As Gerry correctly stated, I certainly would prefer moving the AGI. But if we're not going to do it, then I don't understand the line we're drawing.

CHAIR PARSKY: Okay. Let's --

COMMISSIONER HAUCK: Gerry?

CHAIR PARSKY: Bill?

COMMISSIONER HAUCK: It's pretty clear to me that I erroneously relied on our meeting going from eleven o'clock until four o'clock today. I mean, I have an obligation I've got to see to.

We also have a number of people, according to what you've said, who would like to address this commission; and I'd like to hear them. So what I'd like to suggest is that we let those people make whatever presentation they have to make. It's also clear that we are going to have another meeting on Monday. And however it proceeds, we could cover what we don't cover today as we begin on Monday.

So I'd like to suggest that we hear from the folks that have sat here all day, listening to this mostly erudite discussion, so that they have an opportunity to say what they would like to say.

CHAIR PARSKY: I couldn't agree with you more.

Okay, thank you all very much for this discussion of this aspect of the potential set of recommendations.

I would like to now turn to the balance of the tax package identified that we were going to be

considering. And I want to remind everyone of the framework, again, that we agreed would be included in Sections 1 and 2, off of this specific two-page tax package.

Let me just ask the commissioners one question in connection with that. We did not hear, since the last meeting, any individual commissioner with a presentation or incremental additional work on the inclusion in Sections 1 or 2 of the split roll. And so I would ask of the commissioners if it would be acceptable to move that item away from consideration within Sections 1 and 2, which is what we're talking about.

Would any commissioner have objection to that?

(No response)

CHAIR PARSKY: Okay. Then that leaves us for discussion the pollution tax, which I'd like to turn to now, and introduce -- and have the discussion led by Fred Keeley. And I know he has several people that have supported putting this effort together. And we'd like to have a full discussion of this.

COMMISSIONER KEELEY: Mr. Chairman, thank you very, very much. I really appreciate it.

I would, by way of a piece of housekeeping business, if members want to find this -- if commissioners, rather, want to find this -- take a look

at Tab 9, and the next-to-last blue sheet of paper -- your next-to-last piece of blue paper in Tab 9, that should start with a piece of paper that says, "Petroleum Fuels Pollution Tax: Rationale and Process," if we're all at the same place.

Okay, and what follows behind that is draft legislation from Legislative Counsel on this matter.

So now I've got you focused on the item.

Let me frame this issue up this way; and if I could, if I could ask Bill Dorey, the president and CEO of Granite Construction to join us at the witness table, and John Boesel from CalSTEP to also join us.

(Mr. Dorey and Mr. Boesel came to the witness table.)

COMMISSIONER KEELEY: Okay, thank you.

Mr. Chairman and Commissioners, during the course of our discussion and deliberations, we have discussed the idea of a pollution tax or, as Mr. Dorey always wants me to call it, a "green fee." So that sounds a lot like golf, but I'm willing to do it, anyway.

The idea here is this: We have discussed this idea, from time to time, and that is that California has taken a lead in the nation, among all the states in the United States, with regard to addressing the issue of greenhouse gas emissions. And most significantly, through

the passage of Assembly Bill 32, and the passage and enactment of Senate Bill 375. And what these said was that California, irrespective of what the federal government may or may not do, that California would put itself in a position and make commitments to reduce its greenhouse gas emissions to 1990 levels, and that it would do it over a relatively short period of time. And that the Air Resources Board and the California Energy Commission and the Office of Planning and Research and others in the executive branch would develop strategies for dealing with that in accomplishing that emission reduction. And they are working to do exactly that.

There is a considerable body of opinion which says that in order to achieve those emission-reduction goals, it will also be essential for California to price the burning of fossil fuels at a level that will cause two things to happen: One is a level of consumption would be reduced; and secondly, that we would send a signal into the marketplace that we are going to internalize the cost of burning gasoline and diesel fuel, so that those costs no longer fall onto the general public by way of public health costs, reductions in agricultural productivity, and so on. And that it would also send a signal that California is the place where venture capital, together with intellectual capital, together with entrepreneurial

spirit and risk-taking, would help move global climate-change solutions to market. Whether that is different types of fuel or different types of vehicles or any other imaginable solutions, that one of the key ingredients to making that happen is to price fossil fuels appropriately so that the costs are internalized.

So the proposal in front of you has two features to it that I'd like to draw to your attention.

First is, it is a tax. It takes the existing excise tax on gasoline, which is 18¢ in California, which was adopted in 1990, with no indexing for inflation. So we have essentially lost the purchasing power of that 18¢. It adds a new 18¢ to it, and then indexes that with growth over the next ten years; so that we get to a place fairly quickly where California has priced the burning of those fossil fuels to cover the internalizing of the cost, to price it to internalize those externalized costs we have now; and secondly, to send essentially signals into the marketplace that will start adjusting behavior.

That is one side of this proposal, and that is, raise the excise tax, raise it for ten years into the future.

The other side is, what do you do with that money?

Now, I understand that, strictly speaking, the

Commission has steered away from wanting to get terribly involved in expenditures. And I understand that.

Let me explain a couple of things about this. To some extent, we cross that line a little bit in the BNRT discussion and others, because there's places where you're going to want a certain kind of credit here or a certain kind of credit there. Well, those are expenditures under budgeting.

This goes far beyond that. I understand that. But here's the reason that it goes beyond that: Article XIX of the State Constitution governs all of the expenditure of this money -- all of the expenditure of this money. It has to be any expenditure of any money raised through the state excise tax on gasoline. It has to be consistent, the expenditure has to be consistent with Article XIX of the Constitution.

And so what the working group tried to do -- and we met on August 12th and had a lengthy agenda that's in your packet. We again met on August 18th, and we again met on August 25th. And it was a large group of people. It was folks from the Assembly and Senate Revenue and Taxation committees, the Speaker's office, the President Pro Tem of the Senate's office, the Franchise Tax Board, Board of Equalization, interested parties from the business community, interested parties from local

government, from transit, from transportation agencies, and so on.

And what we did was, we looked at the current situation relative to underinvestment in California in our infrastructure. And we said, if we are going to be competitive in the 21st century, one of the things that has to happen is that our transportation and transit systems need to be as modern as our ideas are and as our aspirations are.

Secondly, is there a way that, while raising this tax, we can relieve some of the pressure on the state general fund? And we found that the answer to that is yes. There's about a half a billion dollars a year right now, spent from the general fund to retire general obligation funds approved by the voters for transit and transportation.

We would propose to take the first half billion of this and pay those bonds instead of general fund, thus relieving a little bit of the pressure on the general fund.

We also understand that AB 32 and SB 375 are the law of California; and that, as a commission, we should be pursuing the enforcement and the robust enactment of those and realization of those aspirational goals contained in those two measures.

So we have some funds that are consistent with Article XIX of the Constitution that would be appropriated for AB 32 and SB 375 compliant purposes. But the vast bulk of the money raised -- and it would start at about three and a half billion dollars a year, and by Year 10, be somewhere up around $13 billion to $15 billion a year -- the vast bulk of that would be split evenly between State Caltrans appropriations -- we're not going to micromanage that. The Legislature is not going to micromanage that. They have a huge, billions and billions of dollars of backlogged projects and maintenance and repair and so on. This would provide a steady, dedicated funding source to try to claw away at that backlog. And so do local governments. They are responsible in the City of Berkeley for maintaining all of their county roads. In Santa Cruz County, we have 610 miles of county road in the unincorporated area. I don't know what it is in Anaheim, but it's a lot of city road. And they have precious little resources to be able to maintain the existing system, much less make improvements.

So the idea here is to really attack this issue from two points of view using tax policy. One is the pricing signals, and the other is the expenditure side, consistent with Article XIX of the Constitution.

And the two folks that have been very kind

today to show up and provide some additional information, first, I'd like to introduce Bill Dorey, who is the president and CEO of Granite Construction. They're a very large construction firm based in a very small town, Watsonville, in Santa Cruz County. And Bill Dorey and I have known each other for a very long time. And we just talked two or three weeks ago about this topic. And as Bill likes to tell anybody who will listen, he thinks this is the first time he and I have agreed on anything, so…

But Bill has a presentation, and then John Boesel will have one, and then I'll introduce John in a moment.

Thank you, Mr. Chair.

MR. DOREY: So do I have to keep pushing this?

CHAIR PARSKY: Unfortunately, I think so.

MR. DOREY: All right, Fred is right, my name is Bill Dorey, and I'm the CEO of Granite Construction Company. And we build roads, streets, dams, tunnels, transit facilities from Alaska to New York City. We are headquartered in a very unlikely place, and that's Watsonville, California. There's about 30,000 people that live there. That's where we started. Our California contractor's license is number 89, to give you an idea of how old this company is.

I have been absolutely fascinated by this discussion today. I arrived at about eleven o'clock today. I've listened to all the testimony. And I can tell you, there are some very smart people dealing with a very complicated question. And I am thankful that you are all here, and I'm thankful that you've given me the opportunity to testify.

I am not going to try to solve the tax-structure problems which the state of California has.

CHAIR PARSKY: We would welcome that, if you could do that.

MR. DOREY: I would not begin to be able to, I think, weigh in on the task that you all have in front of you. I am, however, going to trying to help you think through transportation and the volatility and the certainty that transportation does -- the volatility that we don't need and the certainty that we do need from a funding standpoint.

The work that we have done at Granite and the work that we have done through Transportation California, which is an agency who was very instrumental in the passage of Proposition 42, as well as the Proposition 1B bond, transportation bonds recently, the work that we've done was entirely independent of what Fred has been doing. And that's, I think, really the coincidence in this, to

some degree.

I realized what he was doing about three weeks ago. I did call him and suggest to him that this is probably the first time he and I had ever been in alignment on any subject; that we ought to talk about this. And what you will hear from Fred is, he is coming at this, I think, largely from an environmental perspective. And where I am coming at this, is a need to build the infrastructure and maintain the transportation system that we currently have and build a system for the future.

Okay, so let's get right into this. California is not investing adequately in its infrastructure. I don't think that anyone would argue with that. All you need to do is drive around this state and compare what we have in California with what other states are doing and have built, and I think you will conclude that we are simply not doing that.

And I'm going to try to walk you through a case for this. Not my words, certainly not Granite's words, but words of commissions, like yours, that have dealt with this problem at the state level and from third parties that have weighed in.

California needs an additional $3 billion annually simply to address the maintenance and

rehabilitation of our system. This is from Caltrans. This is their five-year and ten-year maintenance program. This is what Caltrans is saying.

In addition -- and this is really startling -- transportation is woefully underfunded. California's ten-year underfunded needs are currently estimated by the Governor's Commission on Transportation to be $160 billion through a ten-year period.

And this finding occurred in 2005. And if you were to ask Caltrans to update this number -- and I've done this, by the way -- that number is roughly $200 billion today. So it's an enormous need. It's an enormous need, and I think an enormous challenge that we all have as Californians.

As Fred suggested, the tax on gasoline in California was last increased in 1990. In 1990, it was 9¢ a gallon. It went from 9¢ to 18¢ over a period from 1990 to 1994, and has not been increased since then.

It's not indexed to inflation. So the public record would indicate that it's lost a third of its purchasing power since 1994. I would argue that it's been a lot more than that, and it's simply inadequate today.

And while this is the subject that I'm intimately interested in and I believe I know something

about, it's a small part of the question that you all are dealing with.

Proposition 42 is another funding source that California depends on. It is a sales tax on gasoline. And that is something that you all are dealing with. My understanding is that the sales tax in the state of California, you are contemplating eliminating that. If that occurs, 8¢ -- roughly 8¢ a gallon that finds its way through the general fund and back into transportation will disappear. So there may be some very instrumental, unintended consequences that would occur to transportation funding if the sales tax is eliminated.

Now, I'm not suggesting that the sales tax can't be eliminated. All I'm suggesting is, it needs to be replaced. And, roughly, the equivalent would be about 8¢ a gallon.

Proposition 1B is the bond funds that were passed recently --

COMMISSIONER PRINGLE: Excuse me, Mr. Chairman.

I need to clarify just one of those points, sir, if I could.

MR. DOREY: Sure.

COMMISSIONER PRINGLE: Under Prop. 42, I understand the sales tax for what you're talking about. But you say 8¢ a gallon.

So it's not 100 percent of the state sales tax that goes for transportation?

MR. DOREY: No.

COMMISSIONER PRINGLE: So what percentage --

MR. DOREY: This is a bit of a black box. And I'm not sure that I can explain it entirely. Maybe Fred can help mere.

COMMISSIONER PRINGLE: But maybe the staff could?

MR. DOREY: But if you do the arithmetic – if you do the arithmetic, at three bucks a gallon times 20 million gallons a year, it's $60 billion times 5 percent, is $3 billion. And only a billion and a half of it is finding its way back into transportation. And there's something called the "spillover funds."

Does that answer the question at this point?

COMMISSIONER PRINGLE: No.

Mark or Phil, could you tell me what I'm --

MR. IBELE: Let me see if we can get a clarification on that, and I'll have to come back to it. I don't have an immediate response.

COMMISSIONER PRINGLE: If you could get back to me later in that discussion. Because under Prop. 42, all the money of sales tax, the state's share, goes for transportation. How it is --

MR. IBELE: Right. How it's divided between local governments and the state.

COMMISSIONER PRINGLE: Right, that's the question I need to have answered.

MR. IBELE: Okay.

MR. GENEST: Would you like an answer to that? Because I happen to know that answer.

CHAIR PARSKY: Are you going to answer it?

MR. GENEST: Well, I probably know this answer in more detail. He's correct. The spillover is, it's a very complex mechanism. But it takes money that if it wasn't for the spillover rule, would have gone into Prop. 42. And it takes it before Prop. 42 is calculated. So Prop. 42 is still 5 percent of the -- well, it's currently 5¼ -- but it's 5 percent of the price of gas per gallon, the price. And then that would all go into Prop. 42, except some of it gets into this other mechanism called a spillover, and that's why there's a differential.

But I would remind you, your proposal says that you're going to eliminate the state sales tax that's general purpose. And what I mean by that is, you're not going to eliminate the sales tax on gasoline. And that will continue to go to Prop. 42.

CHAIR PARSKY: Is that distinction understood?

COMMISSIONER PRINGLE: No, it's not.

CHAIR PARSKY: Okay, well, then say it one more time, Michael.

COMMISSIONER PRINGLE: Nor was any of the other part of his explanation.

CHAIR PARSKY: Let's take them in pieces.

COMMISSIONER KEELEY: Mr. Chairman, let me just say, that this is the issue I raised this morning under the BNRT, which is -- and asked as a placeholder that you would address this, sometime we could deal with this between now and Monday, which is, if you eliminate the sales tax in its entirety -- and that's the proposal -- and replace it with the BNRT, then the sales tax on gasoline would need to -- in order to preserve the Prop. 42 funding, you would need to replace that somehow. Now, you could either earmark --

CHAIR PARSKY: Explain -- it's a distinction between the excise tax and the sales tax; is that what you're driving at?

MR. GENEST: No, those are two separate taxes here. But what we're talking about here –- at least it's my interpretation of the written proposal that was presented this morning, in those words where it says, "Eliminate the general purpose sales tax at the state level." I'm assuming that doesn't mean the sales tax as it applies to gasoline, because that's tied up in an

initiative. You could not change that by statute. And your proposal is supposedly just going to deal with statutory changes, unless the one case where you're putting it under the Constitution. But your tax proposal was statutory only.

If so, you can't touch 42, so you can't eliminate the sales tax on gasoline.

COMMISSIONER PRINGLE: Well, Mr. Chairman, I would like to have a complete legal opinion on that specific point, because I believe Prop. 42 talks about the sales tax on gasoline. It doesn't create a separate tax that is defined as a sales tax on gasoline. It applies to the sales tax that is in the statute.

You just suggested, Mr. Genest, that it's gone up to 5¼ percent, therefore, whatever the Legislature may set as the tax rate, those dollars under Prop. 42 go for a transportation account. But what if the Legislature set, as a tax rate, at zero?

MR. GENEST: I think you're right. You could actually -- I misspoke. You could actually eliminate the entire sales tax. But my interpretation of the words in the proposal, when it says, "Eliminate the state general purpose sales tax," I was assuming -- maybe I'm incorrect -- that you intended to keep the sales tax on gasoline so that you don't interfere with the operation

of Prop. 42. Now, maybe I'm wrong for your intention.

COMMISSIONER EDLEY: I should speak for my intention. My intention was to do whatever it is Curt wants to do, if only I could figure out what that is.

MR. GENEST: Well, that would be what he would want to do.

COMMISSIONER EDLEY: But, seriously, you want to preserve that money going to --

COMMISSIONER PRINGLE: Yes, I do. I personally want to preserve it. And I think that's what we're hearing from all the transportation advocates.

But, Mr. Chairman, I'm not a lawyer. I might be one of the few not here that's a lawyer. But I don't believe what we just heard is correct. I believe that Prop. 42 talks specifically about the sales tax that is collected on gasoline, whatever the rate is that is the state portion of the sales tax.

Prop. 42 did not redefine the sales tax on gasoline as a non-general tax. That sales tax is still the general tax applied to all commodities of purchase. Therefore, I am concerned that, Mike, you may be reading more into this; and I think the concern of the transportation community is, in fact, that if sales tax went to 20 percent, they would have a lot more money for transportation. We're not arguing that. But if it went

to zero, they'd have no money for transportation. And that's what their argument is.

MR. GENEST: I think it's a question of, what does the proposal actually mean. You could do a couple of things --

CHAIR PARSKY: I think we need to come back on that. But let's, just so that I understand what, in making the assumptions about the amount of revenues that would be necessary to fill the general fund from elimination of the sales tax, what did the staff assume was happening with respect to the sales tax on gasoline that presumably was dedicated?

MR. IBELE: We included the general 5¢. That would include the sales of gasoline, too, within those numbers.

Now, if you went in the direction of keeping that dedicated portion, you'd have a business charging one sales tax rate on gasoline sales, and non-gasoline sales a different rate, which is one complication.

CHAIR PARSKY: But you assumed what Curt was assuming, that --

MR. IBELE: Yes.

CHAIR PARSKY: -- in effect, that although the words said, for purposes of the general fund, you assumed that the sales tax, as applied to gasoline, as well as

everything else, would be gone?

MR. IBELE: Would be gone, that's correct.

CHAIR PARSKY: Okay, that clarifies it.

What the assumption was, it doesn't mean it has to be the recommendation.

COMMISSIONER KEELEY: Understood.

So as we get back to Mr. Dorey, I'd like to, again, request a placeholder on this question, so that the existing sales tax on gasoline, which is how I understand it is calculated, there is the price of the product, there is the federal excise tax, there's the state excise tax. You add those three up and apply the state sales tax to it to decide how much per gallon; is that correct? Did I do that right? So it's the price of the product, plus federal excise, plus state excise, multiplied times the state sales tax rate. And that generates the Prop. 42 funds.

MR. IBELE: That's correct.

COMMISSIONER KEELEY: Okay. So that issue we have to continue to deal with sometime between now and Monday.

Back to Mr. Dorey, because what we are talking about, so members are clear about it, we are talking about increasing the state excise tax. Not the sales tax. But we do need to address this through your BNRT proposal.

Mr. Dorey?

MR. DOREY: Thank you.

And I think one of the distinctions between what I'm here to talk about and what I heard from you all most of the day is, this concept of revenue-neutral. I might as well get this on the table. I'm not here to talk about revenue-neutral. What I'm here to try to ask you to think about, as we conceive this tax program, potential tax program, that we address the need for additional funding in transportation. And certainly, the first place to start that is to keep from losing the current funding.

Proposition 1B was passed by the voters about three years ago, and it was a bond fund that raises about -- today, about $4 billion per year.

The problem with Proposition 1B is, number one, we have not been able to sell the bonds recently, so that program is not working, and it will phase itself out in about two or three years.

To put it into perspective with the other taxes that fund transportation currently in California, it is worth about 20¢ a gallon. So that's just a reference point for you all.

Okay, so this is a busy slide. And I actually thought about not including this. But I think it's important because there's a lot of conversation today

about whether or not a tax on fuel or a fee on fuel is something that's sustainable. So this is, once again, Caltrans information. And if you look on the left side of this chart, 2010, about 28 million registered vehicles are in the state of California. And if you walk down that same line, 15 years from now, it's expected there will be 36 million registered vehicles in California. And we clearly need to prepare for that.

Vehicle miles traveled would go from 362 billion miles in 2010, to almost 500 billion miles in 2025.

And here is where it gets interesting, and here is where I think Fred may disagree with this, but this is, once again, Caltrans information. It's probably directionally close, and that is, that the average fuel economy in 2010 -- including trucks, by the way -- is about 18½ miles per gallon. It is not expected to significantly go down. In fact, according to Caltrans, it's going to stay pretty much the same. So fuel consumption will go up over the next 15 years if you believe Caltrans.

So I think the conclusion here is the user fee will be a reliable transportation funding source for the foreseeable future.

So this is, once again, a very busy slide. I'm not going to spend a lot of time on it, and I'm not here

to advocate that we adopt a European-style taxing program on fuel in this country. But I think it's important for this commission to recognize what others are doing as it relates to fuel taxes.

And this was out of the *New York Times*, 2008, so it's a little dated; but I think the message is still very, very appropriate. The United States, if you look at the left side, that's price at the pump. In June of 2008, it was about 4 bucks. And you can look down that line, on the left side, and see what fuel was costing elsewhere around the world. It was in the neighborhood of $8.50.

The next line over is price excluding taxes, $3.51 in the United States, and basically about $3.50 throughout the balance of the world. So that tax on fuel in the United States is about 50¢ a gallon, compared with about $5 a gallon most everywhere else.

Taxing fossil fuels, rather than subsidizing renewable energy sources, provides Americans with the most incentive to reduce consumption and switch to another fuel. And that's where Fred is coming from. I believe that. I suspect we would not get an argument from anyone on the Commission. It's pretty simple economics. And I think we saw that in place when fuel got to $4. People all of a sudden, including me, were concerned about

something I hadn't been concerned with in some time, and that was the efficiency of my automobile. So it's not a bad thing. But I'm not here to talk about the environment, I'm here to talk about transportation and getting people efficiently from one place to another.

Having said that, I have chastised Fred a little bit for his pollution tax slogan. I don't think it's a pollution tax. I do think it's just about the greatest tax you can come up with.

So let's talk a little bit about the economics around raising fuel taxes -- or any kind of tax, for that matter, to invest in transportation.

Once again, most of this information is from an organization called TRIP, which is who CNN calls when they want to get unbiased information about what it costs the average motorist to deal with certain inefficiencies in transportation.

CHAIR PARSKY: You're sure CNN looks for unbiased information?

MR. DOREY: I don't know about that.

COMMISSIONER EDLEY: Gerry wants to know who Fox calls.

MR. DOREY: I think they all call this. They all call TRIP. TRIP is the authority.

CHAIR PARSKY: We have to lighten things up a

little bit. It's okay.

MR. DOREY: I appreciate that.

Congestion costs the urban traveler about $750 in wasted fuel efficiency per year. If you believe that, then there is a real argument for trying to improve our system.

California's crumbling roads which, by the way, Caltrans will acknowledge are near the bottom -- from the standpoint of their condition, near the bottom of the list in the United States, costs the average motorist $590 in vehicle maintenance per year that otherwise could be reduced.

So -- I love this slide from the standpoint of how dramatic it is. Once again, this is a third-party analysis.

"Deficient roadway conditions contribute to more than one-half U.S. fatalities. More than drunk driving, more than speeding or failing to use seat belts."

So there is a need to improve our system that goes beyond just the economics involved, that goes beyond just the quality of life. It goes to the safety of the traveling motorist. It costs the nation $217 billion which, by the way, is pretty close to what the U.S. government spends federally on transportation construction in this country.

Okay, so let's talk a little bit about what's happening from a demographic standpoint. You all probably all know this. I'm sorry to bore you with it. But California's population is expected to grow 16 percent over the next ten, 11 years. Vehicle miles traveled is expected to grow 29 percent over that same period. And California's vehicle miles traveled is growing ten times faster than lane miles are being constructed.

I am not here to suggest that we need to build roads all over this state; but I am here to suggest that we need to improve the safety, improve the condition of our current systems, and build some public transportation that is appealing enough that people will actually use it.

So here's the fun part of this: If I were to ask you -- and I've done this with lots of different groups -- if I were to ask you what's it going to cost you, as a driver, California -- the average California driver to raise the gasoline tax 1 cent, and ask for a quick answer without any consideration -- any thinking, really, about it, and the typical answer that I've gotten when I've asked this question, is $100, $200. 1¢ in the average motorist's mind is worth $100 or $200.

So here's the arithmetic, here are the facts: The average driver drives 12,400 miles a year in a car that gets 22 and a half miles to the gallon and buys

554 gallons of gasoline per year. And every penny is worth $5.54 a year, or 46¢ a month.

10¢ is worth $4.60 a month. It's about the price of a six-pack of bottled water.

50¢ in gas is only $23 a month, or about $275 per year. And for $275 a year, you could make an impact on that $750 in congestion costs and the $590 a year in maintenance costs on your automobile.

So it's really free if the agencies and the engineers and the construction companies are efficient and get the job done. And I'm here to tell you, as part of that construction community, the agencies, the engineering companies, and the construction companies of this country can do a remarkable job of improving our transportation system.

So the questions I have, maybe for you all and for the Legislature and those that are really going to weigh in on this matter, are what is a world-class transportation system worth, how much would it save, how much time would it save, how would it impact the quality of life, which I think is very important. And the truth is, what in the heck is the alternative?

We don't have an option but to deal with this problem.

So these are my conclusions, these are the

conclusions that my company has reached, these are conclusions that Transportation California has reached; and I see the conclusion is somehow actually not in the picture, so I guess I can maybe make one up here.

CHAIR PARSKY: Well, you fit right into this Commission. That's okay. Don't worry.

COMMISSIONER EDLEY: We feel like we're in a tunnel.

MR. DOREY: If $16 billion -- if you believe the Governor's Commission on Transportation in 2005, unfunded needs were $16 billion a year, 19 billion gallons a year, including the diesel and trucks and so forth, is 84¢ per gallon is needed.

And it's not 84¢ a gallon ten years from now, Fred, it's 84¢ a gallon today.

So I would encourage us to think about that, to think about what we can do in this tax structure, what we can do to put California in a competitive environment from the standpoint of getting people around.

All user fees should be indexed to inflation beginning immediately.

And here's the interesting one -- and the Finance folks, I think, on the Commission will appreciate this -- whatever we do, we don't need to wait for that revenue to come in to begin the process. The state of

Florida is doing this regularly today, where they do what's called gap financing. And they'll put a bid out to do, say, a $100 million project over two years, and they will say to the prospective bidders, "We're going to pay you over four," or, "We're going to pay you over five."

So what the construction community then is obligated to do, is get into the institutional investment arena, arrange to have that financing gapped -- arrange for gap financing, go build that job in two years, get paid, and the institutional investor then will stand ready to receive payment over five or six years, and the financing is all considered.

So I think this is an important subject. And I think the important thing maybe for you all to think about as you contemplate this, is how does this fit into what you're all dealing with? And I think this is it: There is an opportunity here to take transportation completely out of this debate. To take it out of the budget debate, take it out of the funding debate, take it out of what would be characterized as the tax structure that you all are considering, and turn it completely into a user fee for very little money.

$23 a month per driver, 275 bucks a year would raise 50¢, which would go a long way to really

affecting -- properly affecting the challenge that we have.

So I would leave you with that. I appreciate -- really appreciate the opportunity to be here. And I hope you'll consider these views as you contemplate this very complex problem.

Thank you.

CHAIR PARSKY: Thank you.

Fred?

COMMISSIONER KEELEY: Thank you, Bill, very, very much.

And, Mr. Chairman, if I could now introduce John Boesel from CalSTEP. And he will provide a brief testimony on this matter as well.

Thank you.

MR. BOESEL: Thank you, Fred.

Chairman Parsky and Members of the Commission, my testimony is being circulated now.

I'm the president and CEO of CALSTART. We're a not-for-profit corporation, headquartered in Pasadena, with offices in the San Francisco Bay Area. Our goal in life is to help improve air quality, cut greenhouse gas emissions, reduce dependence on oil, and improve our energy security, and create tremendous new economic opportunities for people in the state by serving as a

catalyst and a strategic broker for the clean transportation technology industry.

We work with an array of companies, representing all the different technologies: Batteries, hybrid systems, biofuels, natural gas, hydrogen fuel cells, clean diesel, more efficient internal combustion engines.

We believe there are many paths to the future. We definitely feel we are building a 21st century industry and, therefore, are very appropriate for consideration by your commission.

I was very honored to be part of a similar blue-ribbon commission effort that we launched in 2005, called the "California Secure Transportation Energy Partnership," CalSTEP. And basically what we did was, we were created to help develop a model plan, to make California a state where our independence on the volatile international market was reduced; and we are keeping more of our energy dollars here in the state of California.

We were fortunate enough to have on that Commission President Reagan's Secretary of State, George Shultz, Stanford economist Jim Sweeney, executives from DaimlerChrysler and Volvo Car Corporation; Andrew Littlefair, the CEO of Clean Energy, Boone Pickens' company; Neil Koehler, the CEO of Pacific Ethanol; Dr. S.M. Shahed from Honeywell and 2002 SAE, Society of

Automotive Engineers, national president; Tim Carmichael, a leading clean-air environmental advocate; then Dr. Beverly Scott, who was the general manager of the Sacramento Regional Transit District; a couple of different clean tech investors; and Commissioner Fred Keeley.

We actually had the luxury of spending that 18 months working in our blue-ribbon commission to develop recommendations related to the transportation sector. And we finally, in January of 2000, released this report here. And we developed and proposed several recommendations, many of which have been adopted.

One of them was very similar to the low-carbon fuel standard which the Governor proposed. We had a measure similar to Senator Steinberg's SB 375. We are still working with the insurance commissioner on adopting pay-as-you-drive insurance.

And then also, this then-Speaker Nunez adopted our recommendation for providing funding for projects in California. And he proposed AB 118, which the Governor signed into law.

One of the key measures that we did propose, that frankly has not yet been adopted, was something called the "Energy Security Tax Realignment and Relief Program." And that was basically, everybody on this

commission felt that if the price of oil started to drop again, we would see less investment coming into this industry and less activity, less progress toward our goal.

So we felt that if the world oil price started to drop, then a slow but steady increase in the gas tax should be implemented in California.

We proposed a penny a month for ten years. So basically, you get $1.20 after ten years. And we felt that this was something that industry could plan around -- plan for and take into consideration. And I think this measure is very similar to the measure that has been put forward by Fred Keeley today.

What's happened since we proposed this idea is, a lot of other people have come on-board and really supported similar concepts. And, in fact, right now, the Alliance for Automobile Manufacturers, representing ten different car companies, is recommending to Congress that a floor on the price of gasoline be adopted, and that floor be set at $3.50 a gallon.

That's really a big-C change.

Thomas Friedman in the *New York Times* writes almost weekly on this topic. He calls for a patriot tax.

When California's best-known venture capitalist went to Congress and testified before Senator Boxer's

committee earlier this year, he also called for a floor on the price of gasoline.

And another chairman of the Council of Economic Advisors, under President Bush, one Mr. Mankiw, also has endorsed the concept of taxing gasoline.

COMMISSIONER BOSKIN: That would be Bush II, just to correct you.

MR. BOESEL: I'm sorry. Excuse me, Bush II. Excuse me, sir.

And then so we just look at some of our member companies, and we know that you take a company like ISE in San Diego, that's trying to become a leader in developing heavy-duty hybrid propulsion systems. If they can estimate that the price of gasoline will be at a certain price, they know that their payback on their product will be better than if the price were low. Therefore, they're going to have more success selling that product in the marketplace.

California has a number of very exciting next-generation biofuel companies. Their business plan always improves when they can cite and have some evidence for a higher price of gasoline. And when that business plan improves, they attract more investment. So I think this policy will help drive this industry forward in California.

Lastly, I just want to say that the Governor's Executive Order, beyond AB 32, which was the 15 percent below 1990 levels by 2020, the Governor's Executive Order calls for an 80 percent reduction below 1990 levels by 2050. That's enormous. It bucks all trends over the last decades of population growth and carbon output.

So if we're really going to change things, we certainly need the regulations, like the Pavley bill, the low-carbons fuel standard. But having that pricing at the pump is critical.

Thank you very much.

CHAIR PARSKY: Thank you very much.

Fred --

COMMISSIONER KEELEY: Mr. Chairman, I'd be glad to conclude.

CHAIR PARSKY: No, no, I wanted to make sure that in your conclusion, you summarized the nature of the tax that's being suggested and the direction for the revenues.

COMMISSIONER KEELEY: Thank you, sir.

Mr. Dorey and Mr. Boesel, thank you both very, very much for spending a day with us.

Mr. Chairman, on page 1 of the document that the working group prepared for the Commission, it goes through each one of the objectives that the Governor

outlined for us in terms of what our task is here relative to the entire tax package that we'll be considering.

I do believe that, with a very straight face and based on the kind of testimony that you've heard today, that each and every one of the Governor's objectives for us is met through this particular proposal.

And, Mr. Chairman, I will summarize exactly what that is. You would take the existing excise tax on gasoline in California, which is 18¢ a gallon, add another 18¢ a gallon. Then every year thereafter, for ten years, you would take that 18¢, increase it by the California Consumer Price Index, and 7¢. You would do both of those things. So that where you would end up is essentially where Mr. Dorey would like us to end up tomorrow, it will take us ten years to get there, but we would get there.

The expenditures are all governed by Article XIX of the Constitution. And in the draft legislation that you have in front of you, it would use the first half billion to offset general fund obligations to retire transit and transportation bonds.

The next, roughly, half billion would be used for those activities, consistent with Article XIX, that are also contained in AB 32 and SB 375, which are those sort of new and creative approaches to reducing greenhouse gas emissions, but they have to be done in compliance

with Article XIX, so they have to be done in terms of streets and roads and highways.

Then you would take essentially the remaining funds, which is the vast bulk of the money that this would raise, and you would split it evenly between Caltrans and local governments for maintenance, repair, and improvement of the state highway system and the local government system.

What it would also do, is that it contained -- the bill that we have submitted to you also contains a provision that asks the Legislature to develop a mechanism which would allow for a refund to low-income individuals to reduce the regressivity of this tax.

We had wrestled with this and ultimately concluded that we could not do that in this bill because of the restrictions contained in Article XIX of the Constitution.

We had Legislative Counsel in all of our meetings, and Legislative Counsel wrote the bill that we have here so that it is, in fact, in compliance with Article XIX of the Constitution, as well as all other provisions of the Constitution. That was the one issue that we have to punt on to the Legislature, is how to effectuate a rebate. But the provision for that is in the statute.

Mr. Chairman, I really appreciate your indulgence in allowing me and Mr. Dorey and Mr. Boesel to make a lengthy presentation on this. I want to thank all of the folks who were involved in the working group on this, and your kindness in posting this on the Commission's Web site when it was available. I appreciate it.

Thank you, Mr. Chairman.

CHAIR PARSKY: Thank you very much.

And I also want to pay special thanks to all the people that worked hard on this proposal. It was a gargantuan effort.

I think what I'd like to do, if it's all right, is to ask Michael Boskin to comment or describe another proposal that is on the table. Then we'll come back. I want to make a few comments about the dispute resolution form that is part of the package.

But I'd like to then ask for comments or questions about each of these.

But, Michael, why don't you go ahead and --

COMMISSIONER PRINGLE: Excuse me, Mr. Chairman, about each of what? Of this pool of things?

CHAIR PARSKY: Yes, this pool of things.

We've had an opportunity on the first part, but I think --

COMMISSIONER PRINGLE: All right, I can wait on this because I do have some comments.

CHAIR PARSKY: Right. You'll have that opportunity.

COMMISSIONER KEELEY: Thank you very much.

MR. DOREY: We're done?

CHAIR PARSKY: Yes. You're welcome to stay. In fact, if you really want to help the Commission on the rest of our activities that we're doing, we'd welcome it. It's perfectly okay. But we really thank you very much.

MR. DOREY: I appreciate it. If there's anything more that we can add to this discussion, we'd be happy to do it.

Thank you all very much.

CHAIR PARSKY: Thank you.

Michael?

COMMISSIONER BOSKIN: Yes, I had two things. Let me go over them very, very quickly.

The first one, the minimum tax. One of the very disturbing things about the proposal is the removal of millions of people, millions of Californians, from paying any contribution to the state general fund and, therefore, contributing to, even in a trivial way, a tiny way, the financing of the collective commonwealth public services.

I personally prefer a 1 percent minimum tax. And Becky has mentioned $100, or $50, which would be $2 a week, or $100.

I think it is the single biggest mistake that has been made in tax policy, has been to remove large numbers of people from any responsibility for financing government. While certainly ability to pay needs to be one of the criteria, benefits principle is another. Virtually all such individuals and families benefit from roads, from our security, from our schools. And I could go on and on and on. But the fact of the matter is, it is very troubling, and it is dangerous, literally dangerous in a democracy to create a situation where we are going to be heading towards 50 percent of the population paying no taxes.

They'll be paying local sales taxes, I agree with that, but they won't be paying state sales taxes or state income taxes into the general fund. And California's already apparently first in the fraction. It excludes from its income tax, among the 41 states that have an income tax, according to the Tax Foundation. And I think this is a very explosive thing, politically, and dangerous and unwise. It's basically making half -- between 40 and 50 percent of the population kind of totally severing any tie between taxes and spending for

them, and I think that's a very bad idea. So that's one proposal.

The second one I will speak to very briefly. I did not bring the CEO of Chevron here. But it seems to me to be perhaps the single-most foolish thing the State does, to have this ban on offshore oil. It is quite sensible to be extremely concerned about the environment. So any exploration and drilling offshore should be done under extremely strict environmental standards. But compared to 1969, when the Santa Barbara spill unfortunately happened, the energy industry has moved on. All of the State's resources could be accessed from onshore, because you can now go seven miles from onshore to offshore; and California only has full rights over the first three miles.

All the acreage beyond that, which is federally owned, in every other part -- and the other oil-producing areas, like especially the gulf, the federal government shares the revenues three-eighths with the states.

Now, some portion of that goes to the local counties, the counties along the border, like it would be Santa Barbara and L.A. and so on -- and Santa Cruz, if there's any oil off there that Fred would like to get some of the money on to pay for roads.

But the single-most glaring thing about all of

this to me is, that's never going to be accessed. So you think about the worst thing you can think of, someone sadly dies, the money in their checking account, they can't find any relatives. At least that money goes to the state.

In this case, it's just going to lay there forever. This is the only source of revenue that not a single taxpayer would complain about. They want the right to be able to do it, and they're willing to share the revenue with the State. It is about the only tax we could think of -- royalty tax, whatever you want to call it -- the revenues the State would get from this, are the only revenues that cause no economic distortions, because that oil isn't going anywhere else -- or natural gas, or whatever it is.

So the proposal is -- and because it depends the price of oil, worth $71 in the worst recession in a quarter century, God knows if it's going to go back up to $140; but over a span of time, it's likely to be considerably higher than it is right now. In some years, it will collapse and others it will be higher, et cetera.

It seems to me, it would be the height of folly that the State doesn't even explore what it could get out of all this. So the proposal is to suggest the Governor

and the Legislature allow offshore drilling under the best feasible commercial terms for the state under extremely careful environmental safeguards. This would generate from a few billion dollars to many tens of billions of dollars, depending on all of that. But it seems to me to be, number one, the height of arrogance to suggest that the State shouldn't even consider the opportunity cost of leaving it there forever.

And with all the needs we have to just say that we're going to not even think about the possibility under strict environmental regulation, accessing what such other environmental Neanderthals as the British, the Norwegians, and the Dutch, who go after every molecule they can possibly find, that we somehow are going to rule that out, it seems to me, to be about the single-most foolish, backing it up from a commonsense policy perspective despite -- I mean, I understand it draws great emotions and it mobilizes environmental lobbies and energy lobbies and all that sort of stuff. It just seems to me to be the height of folly for us not to consider the State ever getting the benefit of that revenue.

And if what Fred and these gentlemen would like to see in our environmental future, getting away from oil, it means it will stay forever and eventually we'll have something else. I think that's 50 or 100 years off, not

five. But, in any event, leaving it there and never getting any of the revenue, it seems to me would be a great, great sin to the state.

CHAIR PARSKY: Okay, let's just pause here and ask questions.

COMMISSIONER BOSKIN: And by the way, I should say because of the uncertain revenue, I suggest that the revenues go into the rainy-day fund, and they come out that way. So they can find one-time expenditures, they can add to the reserve, they can lessen the need for other taxes to be diverted there, et cetera, et cetera, et cetera. But it's not totally predictable, so it's just an additional source of revenue. So in that sense, that's important to mention.

CHAIR PARSKY: Okay, Chris, and then I'll ask Curt to come back because I know he's got some comments or questions.

Chris?

COMMISSIONER EDLEY: Yes, with respect to Michael's -- I mean, I will say that I followed everything you said except your sort of suggestion that there is something wrong with folly, because this being --

CHAIR PARSKY: Because we are engaged in it, is that why?

COMMISSIONER EDLEY: Now, you tell me.

COMMISSIONER BOSKIN: It undermines a lot of Shakespeare's plays.

COMMISSIONER EDLEY: It does.

I guess what I really don't understand is the analysis with respect to the sort of the skin in the game, small D, democratic point regarding paying taxes. Specifically, paying income taxes, in the sense that if the issue really is, small D, democratic engagement, do you feel like you have a stake in the decisions that are being made, do you feel like you have a stake, even in the structure of the tax system?

Then I'd say that, on the one hand, people certainly have a stake in whether or not there are revenues to produce the services upon which they depend. But even putting that to one side, wouldn't the logic of your position be satisfied if everybody filed a return, but then people for some ways up the income distribution got a refundable credit, as opposed to having a positive tax obligation? They'd certainly still have a stake in what tax policies are. So that's one question.

And then I was going to go to the oil-tax issue. But if you want to --

COMMISSIONER BOSKIN: Yes, there are two separate things here. I think Richard and others have rightly said, they're issues of the salience, what people

have in their mind about whether they're paying something, if it's withholding, or whether they're paying something when they go buy a pair of jeans, et cetera and so on. So one point is, this participation, in that sense.

The other thing is, if we actually reduce the price of expanding government spending to zero, people will demand more government without limit because they pay nothing. And even though it's tiny, it's important for people to understand that if the government grows, it may be worth it, that there will be some small consequence for them. So that's my point.

COMMISSIONER EDLEY: But my proposal satisfies that; right? Because if I'm getting, let's say, a $250 refundable credit but I support the expansion of government, I would have -- I would logically be concerned that my $250 refundable credit is going to disappear. So I have a stake in what decisions are being made. Don't spend more money on prisons, save my $250 refundable credit.

And let me -- I'm not making an academic point here, because I'm also interested in whether or not we can tweak the progressivity of our PIT strategy, especially kind of in the zero to $80,000 range. If we can tweak that by taking revenues, such as the revenues that might come from a severance tax or royalty on new

drilling, and putting that into a refundable credit.

And so I don't find your argument that people need to have skin in the game all that compelling; but what I'm wondering is, just on your logic, would people still --

COMMISSIONER BOSKIN: The logic is the total size of spending. They should have a stake in the total size of spending.

Everybody has a stake in trying to get as much as they can of whatever the size of the pie is going to them, as refundable credits or as subsidies for alternative energy or for subsidies, as Richard probably points out, for some of these breaks that are probably unnecessary in the corporate tax. Everybody's going to try to maximize that.

But for any given level, you should have a stake that if it goes up, you pay something. That's kind of a basic minimal proposition. It won't be very much in this situation. It will be a couple of bucks or 4 bucks a week or something like that. But, in any event, it's something rather than nothing.

COMMISSIONER EDLEY: Well, I guess I'd just have to say not proven. Because it still seems to me that even people who are positively paying taxes still could be in favor of more government spending if they

1 think that they will be beneficiaries of it.
2 COMMISSIONER BOSKIN: There's no doubt. I'm
3 not disagreeing with that at all. I'm just saying, if
4 the price to them is zero, they have no incentive
5 whatsoever to even care about a cost-benefit analysis
6 because the cost to them is zero. There's just no
7 positive cost whatsoever to them.
8 COMMISSIONER KEELEY: Mr. Chairman, if I may,
9 just make one comment?
10 Mr. Boskin, to follow up on Chris' point, I
11 think what's happened as part of your argument, is that
12 you've isolated the personal income tax, and said that
13 folks don't pay that, and therefore -- and then you've
14 gone on to talk about whether they have a stake in their
15 government, and how much it spends and what it does, and
16 so on.
17 But, quite frankly, low-income folks pay sales
18 tax, they pay gas tax, they pay excise taxes -- they pay
19 all kinds of taxes. And the fact that they don't pay an
20 income tax or they have --
21 COMMISSIONER BOSKIN: You don't get correctly
22 what I said, Fred. I'm sorry.
23 COMMISSIONER KEELEY: Oh, I'm sorry.
24 COMMISSIONER BOSKIN: I made very clear that
25 we're removing many millions of people from paying the

State's general fund sales tax, on top of not paying the income tax. That's the problem.

COMMISSIONER KEELEY: Well, if I understand the BNRT proposal correctly, everything that is currently taxed under the sales tax will continue to be taxed under the BNRT, and a whole range of activities and transactions --

COMMISSIONER BOSKIN: There is a great --

COMMISSIONER KEELEY: If I might finish -- if I might finish -- a whole range of activities that are currently not taxed, will be taxed under the BNRT.

But I'm trying to go to the -- if I understood the intellectual impact of your argument, it's that people need to pay taxes in order to have an appreciation for what those taxes purchase and what their government is doing with it. And I simply wanted to make the point that I think poor people, low-income people, pay taxes and probably pay a larger portion of their income in various and sundry taxes than others already, irrespective of what happens on the PIT or what we do with the BNRT or the sales tax.

COMMISSIONER BOSKIN: I don't see your arithmetic. But leaving that aside --

COMMISSIONER KEELEY: Okay.

COMMISSIONER BOSKIN: Leaving that aside, I

think there are big issues about who will wind up paying the BNRT. And it certainly will be hidden.

No one is talking about somebody walking in and getting a sales tax added on top of something. It will be embedded in the price. So we're basically removing millions and millions of people from having any direct contact with the general fund and anything they do that pays for the general financing of state services, even on a trivial basis. That is a big worry for me, and I think it's going to be a big worry for a lot of other people.

COMMISSIONER DE LA ROSA: Can I say something?

CHAIR PARSKY: Okay, but, Chris --

COMMISSIONER EDLEY: That's all right if we're on this subject.

CHAIR PARSKY: Okay, go ahead, Edward.

COMMISSIONER DE LA ROSA: Well, I'm sympathetic to the argument. But I think that I would argue that there are many people in the state of California that don't really understand what kind of benefit they're getting from the personal income taxes that they pay today, and that includes rich people.

COMMISSIONER BOSKIN: No, I would include a lot of rich people in that, too, by the way.

COMMISSIONER DE LA ROSA: I'm very serious about this. And I think that, it seems to me that there's

another angle to that issue, and that has to get to the notion of citizenship. You know, and I don't know that that adjustment helps promote citizenship. You know, I just think -- I think that many of the people that we're talking about are just trying to get by. And I don't think they feel like they have any control over what the Legislature does with their tax dollars. In fact, I don't think that they think very much about where their tax dollars go.

And so that causes me to question –- and I appreciate the fact that you offered that explanation, because I've thought a lot about this, about this linkage between the tax dollars that you pay and the services or the infrastructure that you get back. But I'm a little bit skeptical that taxing the lower-income quintiles, I guess, of some representative amount causes them to feel as though they have a stake in the government that they didn't have before, and that it adds to their notion of citizenship. I think they'll feel resentful about that tax, like they feel resentful about the taxes that they have to pay today. And that's my opinion.

CHAIR PARSKY: Chris, you had some questions for Fred?

COMMISSIONER EDLEY: I guess for both of them. Fred, how do you deal with the revenue-neutrality issue

for a package as a whole? Or is there a way to deal with the --

COMMISSIONER KEELEY: Well, if I understand how it works it -- and Mr. Genest, I need a little help on this -- make up an answer that will make me happy, would you, please?

CHAIR PARSKY: Go to it, Michael.

COMMISSIONER KEELEY: Mr. Genest, I don't know how you score funds that are restricted. So, for example, the excise tax on gasoline, which is restricted by Article XIX, I don't know if you call that "general fund revenue," and I also don't know whether we are scoring this package as revenue-neutral relative to the general fund or how we're treating special funds. I just don't know how we're doing that.

MR. GENEST: Well, unfortunately, that is a tax, so the proceeds of a tax, if you raise the tax, it's not revenue-neutral. And in the sense of the Legislative Counsel scoring it, they'll call that a super-majority bill even though it's a tax increase, even though it's dedicated.

It would, however, it sounds to me –- and you can check with Mr. Parsky -– but I think it fits into Category 3. I don't know that Category 3 is necessarily restricted to revenue-neutral. I'm not sure of that.

But it can't be scored revenue-neutrally. I don't see how you could.

CHAIR PARSKY: Let's put aside for the moment where it fits, but -- John?

COMMISSIONER COGAN: Fred and Curt, part of your proposal, Fred was to replace some of the lost sales tax revenue on gasoline, Prop. 42 revenue, and so there's not an issue there of revenue neutrality, I don't think. And so I'm sympathetic to the idea.

One concern I have is, are there other earmarks of retail sales or any other tax that we're proposing to modify that would be affected by the elimination of the retail sales tax or the corporate tax? Is there any other that you can think of?

I just don't want to have a lot of people, claimants coming in, saying -- demanding equal treatment if we were to go down this road.

MR. IBELE: I was going to say no, but Mike just mentioned the spillover impact on the sales tax.

COMMISSIONER COGAN: Do you want to elaborate on it a little bit?

CHAIR PARSKY: Briefly, Michael.

MR. GENEST: It's hard to be brief.

It's money that ends up to the benefit of the general fund through a circuitous route, and it starts out

as sales tax on gasoline, and it gets spilled over into this strange formula -- it's not worth going over how, I don't think. So there is an impact on the general fund.

If you eliminate –- if you just eliminate the sales tax on gasoline all together, which is -- I guess I was mistaken, I thought that was not what you were proposing. But if that's what you're proposing, then you have to have some other revenue to replace that.

And I think, Mark, you've made that calculation already or --

MR. IBELE: Well, no. And we've included the whole 5¢, 5 percent in our calculations.

CHAIR PARSKY: So presumably, when everything was fully phased in, it would make up for it, but not have designated where to go. But it would make up for the loss in the sales tax, or revenue related to the sales tax on gasoline.

MR. IBELE: Right, right.

MR. GENEST: So the spillover thing, no one can predict it -- because of the way the formula works, no one can predict whether it will exist as a revenue five years from now.

COMMISSIONER PRINGLE: So, Mr. Chairman, that is not an issue. It just is -- once Prop. 42 was passed, according to Mr. Genest's earlier discussion, there was

this opportunity where money went into the general fund, and then flowed into the general fund for other transit uses or other transportation functions or such. But the point of the matter is, it's never been something calculated until the last couple of years, but it's still tied directly to the sales tax on gasoline.

So I think your question, John, was, are there other types of dedicated portions of the sales tax. And I think Prop. 42 is the only area where there is a dedication of a --

COMMISSIONER COGAN: General --

COMMISSIONER PRINGLE: -- general fund use, even though we have dedicated sales taxes, but we're not proposing to eliminate them.

You know, this piece goes here or this piece goes there. The 1 percent of personal income tax for mental-health programs and things like that, we're not looking to challenge any of those. So those are dedicated. But they have not been included in the list of reductions.

CHAIR PARSKY: This has but that didn't.

COMMISSIONER KEELEY: Mr. Chairman, you did ask me a question about the revenue-neutrality question.

Let me say a couple of things about that, and I hope that, to quote Gerry Parsky, all I'm asking you

to do is just think about this. Just think about this.

CHAIR PARSKY: Does that go with the cowboy outfit?

COMMISSIONER KEELEY: Just think about this.

Revenue neutrality -- I'd like to make two points on it. Number one -- and I'm sorry to be such a broken record on this -- but that is a concept that the Governor has spoken about but is not in the Executive Order. And so I don't believe that we are bound by that.

I especially don't think we're bound by it, now that -- when you and Commissioner Cogan and Commissioner Edley made your visits to Sacramento last week, and over the weekend when I talked to the President Pro Tem of the Senate, and it was disclosed that the leadership and the Governor are no longer imagining that there will be a package sent to them that they will then -- in bill form, that they will then put upon the floor of the Assembly and the Senate and ask for an up-or-down vote.

If we were still bound by that, then I think the revenue-neutrality issue is much stronger. But the fact that it's neither in the Executive Order, nor does the strategy for implementation any longer involve an up-or-down vote, I think what we should do is submit the package we think is the best package for California.

Now, I'll make this argument again on Monday,

but I strongly encourage the Commission, when we put this package together -- and this is the phrase that I learned in the Legislature –- and, Commissioner Edley, there are some good things to learn in the Legislature.

COMMISSIONER EDLEY: Yes.

COMMISSIONER KEELEY: Listen to your enthusiasm –- but here's one. Here is one.

COMMISSIONER EDLEY: Name a half.

COMMISSIONER KEELEY: I'll name one, and that is, I think the people -- and I would certainly include Senator Morgan and Speaker Pringle in this, when they were in the Legislature, that you should always be working towards a principled compromise, and you should never ask the other person to compromise their principles.

And I think the best work -- and you may say that the Legislature doesn't do much good work, but when it does, it's good work and its best work. It's when they follow that, I believe. And I think that that's what the Chair has asked us to all do for the last eight months, is to see where we can reach a principled compromise without compromising our principles.

And I will revisit this topic and ask the commissioners when we are stretching to find that principled compromise, that this is one of the pieces that goes in Recommendation Section 1.

And rather than taking you through all those arguments today, I would simply like to put a placeholder in to be able to do that at some point on Monday.

Thank you, Mr. Chairman.

COMMISSIONER EDLEY: May I try to make a constructive suggestion here?

Fred, I would hope that you and Curt would consider that if there were a way to disaggregate your proposal so that there's a piece of it that is intended to merely ensure that we don't vitiate the purpose of Prop. 42 –- 19, 40 -- 76?

COMMISSIONER KEELEY: 42.

COMMISSIONER EDLEY: Yes, thank you. That we don't vitiate the purpose of Prop. 42. In other words, that we preserve the current flow dedicated to transportation, and have revenue neutrality in that sense, I would strongly support including that within Category 1.

The aspiration that goes beyond that, to provide the additional revenues, I think the policy case for it is very strong. But, frankly, I think the two-thirds requirement makes it, from my point of view, not acceptable as part of the core package because I really would prefer, notwithstanding Richard's injunction that we try to hold off political considerations as much as possible, I really would prefer that we present the

Legislature with something that moves us towards the future but that can be adopted by majority vote rather than two-thirds vote.

COMMISSIONER KEELEY: I would be glad to do that. Mr. Chairman, I'd be glad to work on that over the next few days.

Let me make two comments on that.

Number one, the Prop. 42 sales-tax problem that is now identified, is a problem that occurred because there is a proposal to eliminate the state sales tax. Not that I made a proposal -- okay. So I know, in part, what's being asked, is that I solve a problem that got created elsewhere in this, but I'm perfectly willing to work on that. It's not a new concept to me.

But secondly, I think there are many ways to address that. For example, we could say, let's take a corresponding -- this is what occurs to me now -- don't eliminate the bank and corp. tax. There's $9 billion. Don't eliminate that.

And, you know, my proposal is three and a half billion dollars in the first year. So, I mean, I'm willing to examine the package and look at it so that we can find a way to get to revenue neutrality.

I would not like to take all of the work done on this particular aspect of our proposal and say that it

is the thing that is causing the imbalance in revenue neutrality. Everything is related to everything else in this proposal.

So maybe what I can do is in Year 1, 2, 3, 4, and 5, show you a way to get three and a half billion in the first year, 3.75, et cetera, et cetera, without vitiating the proposal I've made, while still protecting Prop. 42, which is an issue over in the sales tax.

And I suspect where I'm going to go with that is to try to look at the bank and corp. tax. But I will be glad to do it. I'll take it in earnest effort at it. I'll do my best. I'll meet with these folks about it.

COMMISSIONER BOSKIN: You should save your time, Fred. I think what's going to happen, and it's very clear, if we're going to deal with it, there will be some carve-out to deal with it. Your proposal should rise or stand on its own. I don't think you should be burdened with how they do all this other manufacturing.

COMMISSIONER PRINGLE: Mr. Chairman, if I could.

CHAIR PARSKY: Curt, do you have a comment?

COMMISSIONER PRINGLE: First off, what I would propose is that the proposal gets voted on separately. And if it needs to be added into some other portion of our report, I personally don't think it should be a part of Track 1.

What I am going to suggest maybe shouldn't be a part of Track 1, either, maybe it should be a part of Track 3, and just making sure that when the Legislature sees our package, they realize that we are aware of this interplay with transportation funds.

And all I would suggest, Chris, is to support a per-gallon gas and diesel tax and excise tax that would increase within the phase-in period to equate directly year by year through that phase-in period with the reduction in sales tax. So all we are doing is creating a gas tax, which on this side is protected under Article XIX of the Constitution, that says it can be used only for transportation purposes, anyway.

And as we reduce the sales tax, we increase the gas tax proportionately, so that the one protection that's in place on Prop. 42, which is constitutional based on the sales tax, is that sales tax goes down, you increase the gas tax and you are falling under another constitutional protection under Article XIX.

You could do it directly revenue-neutral within the phase-in period of our proposal.

You know, I don't necessarily ask that that be a part of our Number 1, Track 1. Just make sure that the Legislature knows that we are concerned about that, and it should be a part of Track 2.

COMMISSIONER EDLEY: That's sort of what I had in mind. And I at least -- personally, I would support that in Track 1.

COMMISSIONER POMP: Mr. Chair, I have a quick question for the good doctor.

Michael, what you were describing is what you would call a tax on economic rents; is that right? The royalty is essentially an economic rent?

COMMISSIONER BOSKIN: There are a variety of ways to think about it, yes. But these are on state and federal lands; they're not on private property.

COMMISSIONER POMP: Right.

And would you say a severance tax is a tax on economic rents as well?

COMMISSIONER BOSKIN: It depends on how it's imposed and where it's imposed, but it could be.

COMMISSIONER POMP: It could be?

COMMISSIONER BARRALES: I have a question.

CHAIR PARSKY: Ruben?

COMMISSIONER BARRALES: I just want to clarify. When we talk about net neutrality, the elimination of the state general fund portion of the sales tax, just to be clear, the Prop. 42 dollars net that is still in our proposal; in other words, it's not identified, but it still is as it phases in?

CHAIR PARSKY: Yes, right.

COMMISSIONER BARRALES: So it wouldn't require any additional tax above and beyond the proposal that was made this morning but, rather, potentially, if it's important, a designation of some other fund?

CHAIR PARSKY: Right, right.

COMMISSIONER BOSKIN: Well, if it was done in the way Curt suggested, if his numbers were correct, an 8¢ increase in the excise tax in Year 5 to compensate for the reduction in the sales tax, et cetera, that would mean that you would need less money in the general fund because the money wasn't being diverted. It had the gas tax. So you could have a slightly lower BNRT, or you can use the revenue for something else.

CHAIR PARSKY: That's the relevant relationship.

COMMISSIONER BOSKIN: You could do more on the income tax, you could do other things, right.

COMMISSIONER PRINGLE: Mr. Chairman, one additional thing. And there's a lot of talk about what is a two-thirds vote and what is not. I just would like to suggest -- I believe it's all a two-thirds vote. And I don't believe that is an insurmountable task to get two-thirds vote at the Legislature if we proceed, as you suggest, Mr. Chairman, and try to build a strong consensus among this group.

I don't know if the Legislature will put in as much work, or individual members of the Legislature will. Certainly some members will, as we all have. But I believe if they see the interplay and the value with the construction of it, a two-thirds vote is something I think one protects us.

So we shouldn't just argue that everything we do should be a majority vote because, in fact, if you pull out any single piece -- for example, an excise tax can't be written in the same bill, I don't believe, as many of the other taxes that are. The BNRT may not necessarily be in the same bill. So it's kind of a bill-by-bill distribution. And if one bill increases any more, then, in fact, it could be a two-thirds vote. So you have got to be very careful as to -- you can't tie seven bills together and say that, "That is a package; therefore, they're all tax neutral together." It is a bill-by-bill inquiry as to the tax neutrality of that. And there have been many challenges on the whole concept of what is two-thirds and what is majority.

I think we all talk about, we want it all tax neutral for a lot of reasons, but I also think it would protect our package -- our overall package to be complete if we don't just assume that it's going to be a majority vote product.

COMMISSIONER POMP: What is the window for neutrality? I mean, let's say that there is this majority vote. Neutral over what period?

CHAIR PARSKY: Well, there has to be an assessment made by the Legislative Analyst's Office over the first year of implementation, and then over either a three-year or five-year assessment of neutrality.

I would just step back a minute and ask the Commission to focus on the interplay of the package as a whole.

What I think is very important is that we continue to look at this package together.

The staff has been attempting to assess that package in a way that is revenue-neutral. And I think it's very important that the message not go to the Governor and the Legislature that this Commission is saying "Pick and choose," but, rather, "Look at the package as a whole." And that's what I'd ask us to stay focused on.

Let me just suggest one other thing, and then I'm going to come back and ask everyone to think about. Think about.

For those of you that thought that we were going to just vote today, I hope that I don't disillusion you given the exchange that's gone on.

I just want to make one other comment. A proposal that is in your package that you can look at, if you haven't already, would be the establishment of a tax appeals tribunal or a dispute resolution forum. The proposal simply would say that California should create an independent body with tax expertise to resolve disputes between the State and taxpayer. A taxpayer should be able to appeal for a ruling from the independent tribunal prior to having to pay the tax bill in question.

Relatively simply, with a lot of explanation.

Throughout the Commission process, whenever this was raised, it received a significant amount of support. And so I would think that the Commission would want to continue to keep that on the table as a possible part of Section 1, which the State could enact. And there is a rationale and a background piece in the materials about it that I want you all to think about.

What I would suggest -- and we have still remaining the public comment period, which I intend to stay for; however, I know a number of commissioners we have extended beyond their time frame. But I would suggest the following for the Commission to think about between now and Monday, or between now and September 20th, which is the final day at which this Commission expires or our report is due. My suggestion would be that the

Commission think about the package of changes that was first described -- first described by Chris and John as a package of changes that we could support, hopefully unanimously, that we could support, with the caveat that was really contained -- with a couple of further analyses that need to go on, that need to be aired clearly.

COMMISSIONER EDLEY: And let's be clear about what exactly those are.

CHAIR PARSKY: One, it seems to me, that we need to attempt, with all the caveats that are embodied in it, attempt to have the staff suggest to us and discuss the overall distribution or incidence impact of the package as a whole.

We've seen, at least from the staff, supported by a number of us, the impact of the changes in the personal income tax alone. And we may have disagreements. But I think many of the commissioners have indicated that that retains the progressivity of the current personal income tax portion. But what we haven't discussed -- and there's a lot of caution about this -- because of the difficulty with precision, passing judgment on the incidence of the BNRT in particular. But, nevertheless, I think we need to have before this Commission a discussion of that. That needs to happen.

Second, it seems to me that we need to --

COMMISSIONER EDLEY: "Safety valve."

CHAIR PARSKY: -- make sure that there is a more detailed description of what I think is properly referred to as a "safety valve."

I think there is unanimous -- there is considerable Commission concern about the unintended consequences of the package as described. And one suggestion that I think is worth having work done, is how could we create a specific safety valve --

TELEPHONIC VOICE: *"Pardon the interruption. Your conference contains less than three participants at this time."*

CHAIR PARSKY: Okay. Are all of you not listening?

Okay, I'm joking, I'm joking.

And the suggestion made is that something along the lines of at the end of Year Three, having had three years of transition from 2012 through 2014, when there still is left and in place a relatively low BNRT rate, and still at least -- and we may want to refine this a little bit -- still left, at least 2 percent of the sales and use tax left to be reduced, that we would think about designating a group of tax experts within the combination of the Department of Finance and the Franchise Tax Board, we'll come up with something --

COMMISSIONER BOSKIN: Including outside people?

CHAIR PARSKY: It might include outside people, but we'll suggest something -- and I'd welcome any thoughts along that line -- that would determine the sales tax would be proposed to be reduced and the BNRT increased, unless this group determined that the anticipated revenue was not there and, therefore, the sales tax potential should not be reduced as designed. Something along those lines. And I would welcome input over the course of the next few days on that.

But we need to come back with a mechanism for a safety valve in case our anticipation doesn't bear fruit.

And then people should step back and assess the nature of the recommendation that is being made for the package as a whole. And I want to come back to the elements that are still on the table. But with respect to the package that would include -- that potentially would include a business net-receipts tax, I draw everyone's attention to the memo that John and Chris wrote -- and I'll just read the paragraph:

"We are confident that the tax package is the right course for California. We also recognize that the BNRT represents an extraordinary change in California's tax code. A tax change of this magnitude should only occur after the proposal has been fully vetted and all

of the ramifications fully assessed by the Legislature and the Governor and the public. We believe" -- and this could be the Commission –- *"We believe that the BNRT is sufficiently promising to warrant the Commission's recommendation that the Legislature and the Governor proceed with a public process to fully evaluate the BNRT proposal, and upon satisfactory completion of the process, to enact the BNRT into law as part of the proposed package."*

Something along those lines would introduce any recommendation that would include the package; but that what I'd like you to think about, the Commission would still be seeking, at the end of that process, a vote on the package as a whole.

I think that may offer a way for an appropriate level of sensitivity to the magnitude of this suggestion, the magnitude of the reform.

Now, in addition, between now and Monday, we still have to decide how the proposal, outlined by Fred Keeley and the proposal outlined by Michael Boskin -- or proposals -- fit in. Should they be -- is it a sense of this Commission that they should be included in Section 1, or should they be, if enough Commission concurrence doesn't occur, should they be included in Section 3?

COMMISSIONER POMP: Do you mean to include a

severance tax proposal as well?

COMMISSIONER LOZANO: I only heard -- I heard initially it had to do with the progressivity and the lower income, which is a comment on something already before us.

CHAIR PARSKY: Right, right.

COMMISSIONER LOZANO: The only real proposal is on the offshore drilling and the royalties.

CHAIR PARSKY: Yes, I think Michael was clearly making the point that his support, if you will, for the proposition that's on the table is in question because it doesn't include a minimum tax. And so --

COMMISSIONER BOSKIN: I'm not the only commissioner in that situation.

CHAIR PARSKY: And so commissioners need to think about that, as to whether or not, in the spirit of compromise, they can support the proposal without it.

But in addition to that, the proposal on additional offshore oil and the proposal with respect to a pollution tax, needs to be considered. A severance tax, as suggested, was not part of the tax package, but could be part of Section 3.

COMMISSIONER POMP: Michael's is part of the tax package?

CHAIR PARSKY: Yes.

COMMISSIONER BOSKIN: Yes.

COMMISSIONER POMP: When was that?

CHAIR PARSKY: If you look at the two-page --

COMMISSIONER BOSKIN: For several meetings now.

CHAIR PARSKY: For several meetings and that I distributed by e-mail three times -- three times. It is contained in that.

COMMISSIONER EDLEY: Okay, but that's not to say that -- I guess what I was hoping is that there would be an opportunity for people to -- I mean, without getting into Robert's Rules or anything -- that there would be an opportunity for people to propose adding or deleting something from a core set that we know there's strong consensus around. So, for example, it seems to me that there is not --

COMMISSIONER BOSKIN: I think what you mean is, refining the core package, is that -- more or less. I mean, several people have raised the purpose. Did you want to refine the core package; is that what you're talking about? Or do you want to add a new thing in it?

COMMISSIONER EDLEY: Well, I think I mean refinement.

CHAIR PARSKY: Correct. I certainly would think that.

COMMISSIONER EDLEY: I mean, look, let me just

be candid. Let me be candid. I think that -- and maybe this is best left to sort of some one-on-one discussions. But I think that we -- at some point, I think we need to have at least an informal show of hands or something to see whether or not there is sufficient support -- if you want to include -- Michael's thing about the minimum tax was not included in the motion that John and I made.

CHAIR PARSKY: And was not included in a recitation of the tax package.

COMMISSIONER EDLEY: Okay.

CHAIR PARSKY: That's why I interpreted it as raising concerns about his support for --

COMMISSIONER BOSKIN: It's also -– it, like your refundable thing, is a refinement of the tax --

COMMISSIONER EDLEY: That should be considered, and we ought to see whether or not there are the votes for it. That's right.

With respect -- and I agree with it.

Then with respect to the drilling, et cetera -- I have to get smarter -- this is off the record because --

CHAIR PARSKY: Did you hear that up there?

COMMISSIONER EDLEY: -- I'm supposed to be a law school professor who once taught tax. I've got to be smarter on the relative merits of the severance tax

versus royalty tax, and also I'd like to have a conversation about whether Michael's proposal could be amended so that he's not changing environmental policy, but merely setting up, if you will, a standby tax, so that if at some point there is additional drilling on state or federal lands, then this is the tax rate that would exist. It would already be there, it wouldn't require a new two-thirds vote, but it would already be there. So it would be a standby tax that would be created, should the State's policies with respect to drilling would otherwise change. That sounds to me pretty good. And I'd be very interested in considering that as part of Track 1. And we could talk about what would happen with the revenue, should that ever be –- should that ever eventuate.

As to whether it's a royalty or a severance, I am agnostic, and would just like these two guys to arm wrestle and tell us which one --

COMMISSIONER POMP: Just consider mine a refinement of Michael's, that's all.

CHAIR PARSKY: Yes, that's fine. If seen in the context of a refinement of Michael's proposal, we'll take them up one at a time. That seems appropriate.

COMMISSIONER EDLEY: But then let me just -- since I'm on a roll here, let me suggest --

CHAIR PARSKY: You're doing great.

COMMISSIONER EDLEY: The reason that -- I would like a little clarity –- for us to all have a little bit of clarity on the Curt-versus-Fred issue, for the following reason is. I think that if --

CHAIR PARSKY: They've been going at it for years. For years.

COMMISSIONER EDLEY: But so, for example, if we could have something along the line that Curt suggests, that essentially tries to hold constant the public policy goal of Prop. 42 in the way that Curt suggested, doing violence to the rest of our package only in the sense that it creates a carve-out from what would otherwise be flowing into the general revenues, I again personally would be supportive of that as being part of the package.

But then to the extent that that happens, then I think what remains of Fred's policy goals needs to be framed in a clear-enough way that it could be considered, at least for purposes of Track 3. And I thought kind of signaling that now would at least allow Fred and others who are like-minded to do the work between now and Monday to actually shape that -- to shape that.

Does that make any sense? Do you see what I mean?

In other words, I don't want to be in a

situation --

COMMISSIONER KEELEY: I'm not clear.

COMMISSIONER EDLEY: I don't want to be in a situation on Monday in which your full proposal gets shot down, so to speak. I think that's the technical term. I haven't served in the Legislature, but…

COMMISSIONER KEELEY: That's the term. That's the polite term.

CHAIR PARSKY: Not at the Commission, only at the Legislature.

COMMISSIONER EDLEY: And we're in a situation in which Fred's full proposal gets shot down. Curt's proposal gets accepted and there is no opportunity for us to consider the missing piece of Fred's proposal in the context of a --

CHAIR PARSKY: I think the way --

COMMISSIONER BOSKIN: I think the intention has been that if things that have been on the table don't survive "1," they will be considered in "3."

CHAIR PARSKY: Absolutely.

COMMISSIONER BOSKIN: They may or may not survive.

CHAIR PARSKY: Absolutely.

COMMISSIONER BOSKIN: And maybe some people won't vote for "1," if their thing isn't in "3."

CHAIR PARSKY: No, I think that is true. But I think that's exactly right. I would –

COMMISSIONER KEELEY: Mr. Chairman, I thought that --

COMMISSIONER COGAN: You wanted clarity. You wanted clarity on the proposal.

CHAIR PARSKY: I was interpreting, Fred, that your proposal would stay intact, and it will be considered by the Commission, a first, as part of Section 1.

COMMISSIONER KEELEY: Okay.

CHAIR PARSKY: If enough support for that proposal doesn't exist, then it will be considered as part of Section 3 as a whole.

COMMISSIONER KEELEY: Okay, now, let me ask a question about that. I'm not sure I have a big disagreement with that, but it depends on the answer to the next couple of questions.

So let me ask you to think about this, Mr. Parsky --

CHAIR PARSKY: "Gerry."

COMMISSIONER KEELEY: There are -- oh, you're not going to take me down that path.

CHAIR PARSKY: Bob Hertzberg said to take you down that path.

COMMISSIONER KEELEY: To take me down that path.

There are aspects of the core package that three commissioners have been working on that are very hard for me to choke down. So let me be specific.

I think, for example, that what is being proposed relative to the personal income tax is, in my judgment, not the best policy foot that we could put forward.

I think that I like the way that you have feathered together -- the three of you have feathered together very nicely, I think, the idea of stepping across the adoption and implementation of a BNRT. I think it's varied, I think it's conservative, meaning careful and thoughtful. Whether it's a good idea, I like this idea of creating a safety valve and so on.

The bank and corporation tax component, I'm a little lost on why it even is a good idea to do that, to zero that out. It's $10 billion in the general fund. I understand you can shift most of those folks over. I'm still unclear on what the impact is on the bank and financial services sector who, in my judgment, have, shall we say, we don't have any problem in California attracting the bank and financial services sector into the state of California. So there is no reason to create any economic incentives, in my judgment, for them to come here. They're already here. They're going to continue

to do business here. We're the sixth, eighth, tenth largest economy in the world. They're going to be here. So I don't understand that. But I'm willing to do a lot of stretching on this.

But let me try to do this this way: I am very appreciative and deeply respect the work that the three of you have done. It is the work that the three of you have done with the full knowledge and participation of a lot of other commissioners and a lot of people in the public. And you've put a good package on the table. I don't agree with all of it.

The PIT is particularly troubling to me. The idea that we are going to -- however you slice it and cut it, the fact of the matter is, the PIT will provide, the way it is structured, this reduction will provide a very big tax relief for the wealthiest people in California, in my judgment. It will provide some benefit to all PIT payers, but it will provide the biggest benefit to those who need it the least in my judgment. That's my judgment about it.

So I'm not taken with that.

I could be convinced that as part of the package that included this tax that I have advanced, that has been -- you and I agreed there would only be one workshop entity, and it would be focused on what you folks did.

But you and I talked about the opportunity to have a working group. And so we had a very public process, and it involved a lot of people, it had the same structure you had, in the sense of having a pre-meeting and two very public meetings, developing a written report a week and a half ago, plus legislation. I feel like we played by the rules and submitted things in good faith.

The idea that it's now either in Bucket 1, if there's sufficient support, or Bucket 3 if not, I'm okay with that, provided we can have that conversation about all aspects of the package then.

CHAIR PARSKY: We should.

COMMISSIONER KEELEY: And I'm not trying to be argumentative.

I'm saying, I have trouble with the PIT. So if that pertains to everything in the package, then I'm okay with it pertaining to the thing that I'm in love with. And I think that's just simple fairness around here.

COMMISSIONER PRINGLE: You're not supposed to fall in love with your bills.

COMMISSIONER KEELEY: I know. That's why I had to leave the Legislature, because I kept falling in love with my bills.

That's the first thing they tell you in the

Legislature: Don't fall in love with your bills. The second thing is, don't talk when a microphone is on.

But some people only paid attention to the first rule and not the second one, apparently.

Yes, kick them while they're down.

So if there's a way, Gerry --

CHAIR PARSKY: Where's Hertzberg? He's around here somewhere.

COMMISSIONER KEELEY: If you just would think about which, because if you're asking, frankly, some of the more progressive folks on the Commission to stretch, to go here with something that, on the PIT -- I understand how it's being -- how the sizzle was being put out there, but there is also a reality of what's being proposed on the PIT. I might be able to choke that regressivity down if we are doing something on this excise tax, which I think -- I mean, unless somebody tells me I'm wrong on this, I think we've made a pretty compelling case how this fits every single one of the Governor's objectives, every single one that he outlined.

And if we're going to then debate where is the tax neutrality, then everybody should be at risk who has proposed something here.

And so I'm willing -- you know that I'm willing to stretch and try to find a way to make it work and all

of that. I would just say, please don't single the excise tax out as sort of: Well, if you can get the support for it, we'll put it in Bucket 1, otherwise, it goes in "3." I think we need a little more mixing to test the veracity –- or not the veracity, I'm sorry, that's the wrong word -- strike that. No, because that's not what I meant.

COMMISSIONER EDLEY: I understand what you meant.

COMMISSIONER KEELEY: I didn't mean honesty. I meant, the viability politically here at the Commission of the other ideas, too.

CHAIR PARSKY: I think your point is very well taken. And I'd like the commissioners to think about, over the weekend, how compromise can be reached. For some, it may mean that the package can be supported as is, with these refinements, as long as it includes the excise tax. For others, it might mean, well, they could support it as long as it includes the royalty or severance tax.

So I think we need to think about the package that is still on the -- the only thing we've taken off the table is the split roll, because when people -- that no one supported.

But you're right, I was trying to outline, certainly, some further work that needs to happen, that

needs clarification on this safety-valve concept and the distribution impact. But I didn't mean to suggest we treat one thing one way and the other part of the package another. They will be viewed the same.

COMMISSIONER KEELEY: Thank you, Mr. Chairman.

CHAIR PARSKY: Michael.

COMMISSIONER BOSKIN: I'd like to make one quick comment for my colleagues on the panel that Fred has described as progressives. I use that as a scientific description, not as an epithet. And I respect that point of view.

And I just want to make it clear, since there seems to be this notion that somehow progressives are getting shortchanged in this, let me tell you what conservatives are -- again, a scientific description –- are being asked to do.

Let me just --

COMMISSIONER PRINGLE: No, no.

COMMISSIONER BOSKIN: Let me just make this comment. I don't mean to give --

COMMISSIONER BARRALES: Do we have to go over it to get your point?

COMMISSIONER BOSKIN: No, but I'm just saying, we're adding -- first of all, we're creating a new tax with a very broad base, that everywhere else in the world

has been used to grow government substantially. We're being asked to remove millions of Californians contributing to the general fund --

CHAIR PARSKY: Why do you think he supported it?

COMMISSIONER BOSKIN: -- and we're adding a large number of non-C-corp businesses as tax collectors and, to some extent, taxpayers, among many other things. So I think the proper way to view this is, there are lots of puts and takes. Each of us are going to have to decide whether we can support this whether --

CHAIR PARSKY: That's true.

COMMISSIONER BOSKIN: I mean, I'm being asked -- I'm giving a lot even to get near the package that's being discussed, to be honest, okay. I'm keeping an open mind and, you know, I've gone a long way on a lot of my principles.

Maybe Becky and I are the only ones that feel strongly about a minimum tax, et cetera. I don't know what they are.

But I'm just saying, you have to be aware that on the other side, people have given a lot already to get to this area, as have people on your side have given to get to this area, and Chris and John are doing a fabulous job in trying to work it out.

Whether in the end we'll all be able, or the

vast bulk of us in both parties will be able to support a package remains to be seen. I hope it's the case. I certainly have been working towards that and have been trying to do it. But I just don't want to leave the impression that it's only the people that describe themselves as liberal Democrats or as progressives that are having a hard time with any of this, because the conservatives are being asked to give up a lot to do this in the name of getting some improvement in volatility and incentives, and so on. You're getting a lot out of this as well as giving, as are we.

COMMISSIONER PRINGLE: Mr. Chairman, I'd like to figure out how I could give today as opposed to give on Monday. And that is –- and I know how much I've given. And, actually, the package that we've seen has spent the last three months fleshing it out, understanding it better, talking about phasing. And, you know, there are people that like that, people that don't like the package.

And I like the package that was presented by Mr. Edley and Mr. Cogan. I think there's ways to enhance it and make it better, such as the review period and other elements. The issue regarding the gas tax that I suggested, it doesn't need to be in the first phase, even though I think it would probably be smart because it would necessarily reduce the BNRT amount, which I hope

that we could cap at 4 percent.

But my challenge is, as you know, I'm not going to be here Monday, and I want to ensure there's a mechanism by which I can record the things I support and I won't list the things I oppose because it takes support to get something accomplished. So I'd like to figure out what mechanism by which we could establish that today.

So I, for one -- and I don't know anybody else's travel plans, I just know my wife's, and I have to be with her.

CHAIR PARSKY: I wouldn't suggest otherwise. I've talked to your wife extensively. She's not prepared to go alone.

Let me come back and say, I also wanted to say that Ruben arranged a call with a number of business interests that were very concerned about the package that is being suggested. It kind of further illustrates that there are a series of potential compromises that are going on here. And I revert back to Fred's comment about compromise without compromising your principles.

And the only thing I would say is that, at a time when most Californians think Sacramento -- rightly or wrongly, but Sacramento is dysfunctional --

COMMISSIONER KEELEY: Rightly.

CHAIR PARSKY: -- that no one seems to be able

to compromise, all I would say to commissioners between now and September 20th, is to think about the notion that if, as broad a cross section of different points of view as are represented around this table, can find a way to reach concurrence and compromise, it will send an incredible signal to Sacramento that basically says, "This is what the people really want you to be doing." So I just would bear that in mind.

In terms of the process, I am very concerned at making sure every single commissioner has the ability to express his or her views in the report. In the report. And there is a little bit of an issue about commissioners that will not be here, or potentially can't be here on Monday -- be at Berkeley on Monday, and may not either -- and even if they were on the phone, how that would work. So I want to think a little bit more about this and consult with counsel.

But my thought was -- is -- that we will see on Monday if, as close to unanimity around the table as possible, without, quote, formally voting, can be achieved. And if it can, the draft recommendation section will be prepared. And each commissioner would be asked, after reading it, to either sign the report or not sign the report. It's up to them. And therefore every single commissioner would be able to express his or

her view on the recommendations without violating any issues of the public law or any of that.

But I would not be comfortable if we had four commissioners -- and I tried, believe me, I have tried every single day between now and September 20, including the weekends, to see if we could get every commissioner in the room; that wasn't achievable. I think this would clearly at least satisfy me from the fact that every commissioner was as respected as every other one in their views.

And I've had an opportunity to talk to every single commissioner. I want to continue that discussion, to make sure that there is a full understanding of each commissioner's view in that regard. But that would be my suggestion of how to get to a point of issuing a report.

COMMISSIONER POMP: So, let me see if I understand. So if you can't get unanimity, there will be a report, and then people will sign on or not?

CHAIR PARSKY: Well, I'm hoping that coming up on Monday there is a consensus without a vote around the table of those who are there, that will permit the staff to draft a report reflecting that view. Those people -- and presumably, the people in the room -- would say "Yes." I mean, we will have an opportunity to see if the words reflect the consensus.

But the commissioners that are not there or who are on the phone and not in a public place, will still be given an opportunity not to sign that report if it doesn't reflect their views.

COMMISSIONER POMP: And will be given a chance to explain why.

CHAIR PARSKY: You are always given a chance to explain why.

COMMISSIONER POMP: The question is, whether it will be incorporated into the report.

CHAIR PARSKY: Richard, I anticipate that your letter supporting the report can be included, as all of your comments have been included. If that's what you are looking for, we'll ask the Commission if they would think that that's appropriate.

But I would like to try to avoid, if we could, because of the message we're trying to send to Sacramento, I'd like to avoid having to reflect a vote with a minority group named. If we can't avoid it, we can't avoid it.

COMMISSIONER PRINGLE: Mr. Chairman, first off, there will be the main package in Section 1, as you suggested; correct?

CHAIR PARSKY: Right.

COMMISSIONER PRINGLE: And your drive is to get the maximum number of members, if not unanimity or

consensus, or whatever other words you used. I would like to suggest that there should not be a minority report offered on Section 1. I mean, that is --

CHAIR PARSKY: Well, I put Section 2 with it because Section 2 is the rainy-day fund, and so those two sections are linked.

COMMISSIONER PRINGLE: Right. I mean, the point is, if the people that do not choose to sign it, the lack of their support is the lack of their support.

I think what we do is, I also would extend it to Section 3. I mean, I believe that people would have -- maybe you're seeking a majority of the people on this board to recommend items for Section 3. I think if every other member outside that majority -- let's say there's 14 members here, that means if eight voted for Mr. Keeley's plan, I don't think it's appropriate to have then six letters of why they think Mr. Keeley's plan is bad included in the report.

I mean, the way you have partitioned it is to say, this is the overwhelming majority on Sections 1 and 2, and that's why they're here, and the signatures represent those people who support it. Section 3 will be other proposals that may have just a simple majority of this body, and an articulation as to why that simple majority feels that's important, and their signatures

will represent that, too.

I think if we start allowing for contrary submissions, what you'll do is you'll fill the whole report up with objections, and you'll have more objections than --

COMMISSIONER BOSKIN: I have a very much simpler view of Section 3. I think the action is going to be around Sections 1 and 2 because of the rainy-day fund.

CHAIR PARSKY: Right.

COMMISSIONER BOSKIN: There are some very strongly held views about some other things. I think if there is some modest support, we can decide if that is eight or five -- or more than one person, obviously, whatever that number is -- you can just have a section that said, "Here are a variety of proposals that some commissioners thought were very important and worthy of consideration by the Governor or Legislature that neither commanded overwhelming support to be included in Section 1. And even if there are people opposing them, let some commissioners oppose, and then just have them in there. You don't have to have everybody sign every individual thing. That's silly.

CHAIR PARSKY: I kind of feel something like that.

COMMISSIONER BOSKIN: I think a process like

that rather than trying to avoid having days of wrangling about the wording of some --

COMMISSIONER PRINGLE: And, Dr. Boskin, you're talking about your point just in Section 3, though, where there may be a collection, more than one and possibly less than a majority, that say these are other ideas of Commission members.

COMMISSIONER BOSKIN: That's right.

COMMISSIONER PRINGLE: So it's not portraying that the Commission is supporting that position, that's what I --

COMMISSIONER BOSKIN: Right, that's the idea. No one would -- therefore, no member of the Commission who either didn't support it or strongly opposed it would be portrayed as having supported it. And there would just be a list of things in there that we had worked on, that some commissioners supported, did not commend -- that we think that some commissioners think should be commended for consideration by the Governor and Legislature, that did not rise to the level of substantial-enough support to be included. And, indeed, there were some commissioners who opposed them, that's all. And then there would just be a list. And at least those questions would be raised without any need to have like a Supreme Court opinion, where every single subsection had, 6-to-3 on this thing,

but 5-to-4 on that, and 7-to-2 on that.

No disrespect.

COMMISSIONER EDLEY: Jeez.

COMMISSIONER BOSKIN: I know they will all be 9-0, when you're the chief justice.

COMMISSIONER LOZANO: Yes, I just want to -- I also don't want to register votes. I think that the package should go forward with a significant or substantial majority, and it should reflect that.

I would be -- I don't think we should have minority opinions or opposing opinions. I think the body has had enough opportunity to deliberate. They were on the record if we're not supportive of certain aspects of this.

I am concerned about this Section 3 now. Because what I thought we had originally said is that, yes, if ideas have come forward that don't fit in "1" or "2" that reflect a -- I don't know -- it's not consensus, and it's certainly not the majority -- but if there are opinions that are --

COMMISSIONER BOSKIN: There needs to be a minimum. There needs to be a minimum number of people.

COMMISSIONER LOZANO: But there has to be a minimum.

COMMISSIONER BOSKIN: It can't be just one

person or a couple.

COMMISSIONER LOZANO: It can't be one or two. That's what I think.

COMMISSIONER BOSKIN: It has to be several.

COMMISSIONER EDLEY: May I make a proposal, sir?

CHAIR PARSKY: Well, I made one, which I didn't get too much response for.

COMMISSIONER EDLEY: Right, so can I try an alternative.

COMMISSIONER PRINGLE: Define the number of people.

COMMISSIONER EDLEY: Right. That's what I'd like to do.

COMMISSIONER LOZANO: 30 percent. I would say five -- four or five, something like that. 30 percent.

COMMISSIONER EDLEY: What I would suggest is that -- look, two things: With respect to Section 3, I would prefer that these be ideas where all of us are saying, even if we disagree with it, this is a serious idea and we really think the Legislature ought to mull it over.

COMMISSIONER BOSKIN: Even if we disagree with it.

COMMISSIONER EDLEY: This deserves to be on the --

COMMISSIONER BOSKIN: I'm unlikely to vote for Fred's proposal, but it's a serious proposal.

COMMISSIONER EDLEY: And so with that in mind, then what I would suggest for Part 3, is that a proposal goes in Section 3 if it has five votes or more, of which at least one must be of the other party.

COMMISSIONER KEELEY: The other appointees?

COMMISSIONER EDLEY: Of the other party.

COMMISSIONER LOZANO: Of the other appointees?

COMMISSIONER KEELEY: You mean appointees?

COMMISSIONER LOZANO: Yes, appointees.

COMMISSIONER KEELEY: A Governor's appointee and the Legislative appointee.

COMMISSIONER EDLEY: Whatever, yes. Fine, fine.

CHAIR PARSKY: There's no party representative.

COMMISSIONER EDLEY: Oh, yes. Okay, yes, I forgot excuse me. So, yes, thank you -- no, no.

COMMISSIONER COGAN: Yes, yes. You mean "yes."

COMMISSIONER EDLEY: I do? Okay, I do.

Okay, so that would be my first suggestion.

But the second is, the second idea --

COMMISSIONER PRINGLE: Actually, I like that. That's good.

COMMISSIONER EDLEY: But then the other thing I would say, I have to say -- maybe this is the academic

in me, but I'm really uncomfortable with anything that even has the appearance of gagging people who have invested all this time in this thing and have a point of view, have a concern, even if it's an isolated one.

And what I would suggest for those is they simply be in an appendix, and that they are not in Part 3 but they be in an appendix. In essence, what we're doing is we are lending the Commission's publishing capacity to let folks who have views; and then I would just try to prevail upon everybody in the spirit of the enterprise, not to take advantage of that in order to undermine the collective effort.

But I guess I just don't --

COMMISSIONER PRINGLE: Who is the editor of the spirit for the enterprise?

COMMISSIONER EDLEY: The individual. The individual. And I --

COMMISSIONER PRINGLE: Really?

COMMISSIONER BOSKIN: We're looking for Captain Kirk somewhere, I think.

CHAIR PARSKY: Well, why don't we think about this a little bit?

I would just urge everyone to think about the notion that -- a couple of things: Think about the fact that the report will have maximum effect and command

serious consideration if it includes all of the commissioners.

I think that the voice to those that just can't agree with the compromised package is expressed by not signing on to the report.

COMMISSIONER KEELEY: Mr. Chairman?

CHAIR PARSKY: But I do think –- again, and I have made this suggestion for people to think about -- that less than a majority of commissioners should permit something to be in Section 3.

I had requested -- reminded all Commissioners -- by e-mail, that if you had items to be included potentially in Section 3, please provide them to the staff in descriptive form, I think we said by August 24th. And I will tell you that there were not a long array of full descriptions to be included in Section 3.

Now, I don't want to quell anyone's verbosity, but --

COMMISSIONER EDLEY: Creativity, you mean. Creativity.

CHAIR PARSKY: Or creativity. But most all of what would potentially be included in Section 3 have been discussed today. There is nothing floating around there.

And the only question really is, and I do think a measure of whether it should be included is, do enough

commissioners think it's worthy of serious consideration by others than the Commission.

COMMISSIONER BOSKIN: Even if they oppose it?

COMMISSIONER EDLEY: Yes, exactly.

CHAIR PARSKY: Yes.

COMMISSIONER KEELEY: Mr. Chairman, if I might?

CHAIR PARSKY: Yes.

COMMISSIONER KEELEY: Thank you, Mr. Chairman.

First, there's an evolution going on here, and that's why we meet, is to have our thinking evolve both in form and in substance. And I think there's an evolution going on here now in terms of form of the report. My recollection is that, I thought what you sent out by e-mail defining what would be in the three categories, I sent you back an e-mail about -- there was literally a one-word change that I was interested in you making. But I thought you captured it well there, that essentially the first category were those things that could be enacted by the Legislature and the Governor, and no further action was needed. So that means limited to statute.

Number 2 --

CHAIR PARSKY: And revenue-related.

COMMISSIONER KEELEY: Yes. Oh, yes, yes, absolutely.

And Bucket 2 were those things that the Legislature and the Governor could not enact on their own. For example, constitutional amendments that need to be ratified by the voters.

And then Bucket 3, as I recall, were those items that had come to our attention, which neither were in A or B, but would be good for the fiscal soundness of the State, and that you were seeking --

CHAIR PARSKY: For others to consider.

COMMISSIONER KEELEY: -- for others to consider. And that's -- for example, and I then stimulated California Forward, that Mr. Hauck and I are on, to submit their 10-point package for inclusion in Number 3.

So it sounds like maybe that one's changing a little bit, Bucket 3, a little bit.

Here's something I'd ask literally for you to think about, because I don't think this is the time for us to make it easier on each other to get Buckets 1 and 2 figured out. I think this is the time to make it hard on us to do that. I think this is the time where, rather than saying, "Don't worry about it. You'll get your thing in Number 3, somehow it will be in the report and don't worry about it," you didn't say that.

CHAIR PARSKY: No.

COMMISSIONER KEELEY: I'm just saying, I don't

think we should relieve ourselves of any pressure at this point. I think you should push us harder to get to this consensus.

This is the real hard work, today and Monday is the real hard work for us, where we're going to see -- we're not hearing from others. You know, we finished that stuff, the input is over. We're now seeing, what can we do together.

CHAIR PARSKY: Agreed.

COMMISSIONER KEELEY: Where can we stretch with each other?

And I'm trying to send as loud and clear a signal as I can, I'm willing to take the very good work that you've done; and even though I have principled disagreements on the PIT, I am willing to go there if what happens is that -- and this is the give and take we should all engage in -- I think that this fuels tax, pollution tax, green fee, whatever we want to call it, I think it's a very meritorious proposal that fits absolutely into the charge that we were given by the Governor.

And again, so what goes in Bucket 1 is really critical. It's met the highest standards of the Commission, it's had to, you know, run through a gauntlet, it's had to change if people wanted it to change.

There's all kinds of things that are going to have to happen. And I would ask you to put more pressure on us to get to an agreement, not less.

CHAIR PARSKY: I will do everything I can over the next few days to do just that.

Okay. We definitely will have a meeting. We will also have the ability, under the guidelines, to talk about for anyone who can't be at the meeting to plug in by phone, and we will treat the voting issue the way I described so that that doesn't do any injustice to individual commissioners who can't be there.

And I just want to ask -- Curt, did you have something? You're poised, I know.

COMMISSIONER PRINGLE: Yes -- no, I did, because I don't want you to close down. One, I am not going to be in a place where I can answer a phone on Monday --

CHAIR PARSKY: Okay.

COMMISSIONER PRINGLE: -- or to spend eight hours on it.

CHAIR PARSKY: It will take us exactly one hour.

COMMISSIONER PRINGLE: All I want to do, though, is just state now however the number of tallies that we need to get, I do -– I've spent time with Dr. Boskin, I do support his concept of some minimal personal income tax, if it's referenced that way. I also support his offshore

oil, find all the money you can, even though it grows the state budget. I'm not all excited about it, but I do enjoy that concept.

And as I stated before, I support the proposal as presented by Dr. Edley and Mr. Cogan on the package.

So I just wanted to make sure you know where I'm coming from. And I would certainly like to look at the other ideas as they are presented, possibly in greater detail within the package. But that's -- if you want to tally up where those things are, that's where I'm at.

CHAIR PARSKY: Thank you. I really appreciate you saying that, Curt.

COMMISSIONER POMP: Let me just add, I am not in a place where I can call on Monday, either.

And let me reinforce what Chris said. I don't think you want to be viewed as having stifled dissent. I think we have an obligation to the Legislature, as well as other legislatures around the country who are going to be watching this, to encourage a candid and open exchange of views. And that would mean explaining, should it come to that -- I hope it doesn't -- but should it come to that, explaining why people felt they just couldn't go along, so…

CHAIR PARSKY: All I would ask is that -– and I know this may be semantics -- I would ask that you

refrain from pointing directions at me. I'm not making any decisions for the Commission. I'm trying to get the commissioners to decide what it is they would like to do.

So we'll come to a conclusion in terms of how the report should be structured as a commission, as we have come to everything.

Okay, Monica?

COMMISSIONER LOZANO: Well, I'm not I'm going to be there, either, on Monday. So let me just generally say --

CHAIR PARSKY: I'm only talking to you, have no fear.

COMMISSIONER LOZANO: Yes, I know we will talk, and so --

COMMISSIONER EDLEY: Where are you guys all going?

CHAIR PARSKY: Well, there's a group going, they're going to Cancun.

COMMISSIONER POMP: Can we get on that cruise ship?

COMMISSIONER EDLEY: I want to be on that commission.

COMMISSIONER LOZANO: Anyway, I'm generally supportive, and I want to thank all the work. I think Package 1 is really a very strong step forward.

I am not inclined at this moment to support the inclusion of a minimum tax for all Californians. I am also not inclined to support the other proposal on the offshore drilling revenues only because I don't know enough. And so if we can get more information about how that would work and whether or not it's an extension of what currently is in place in terms of -- so that I just need more information.

I would want us to articulate a ceiling on the business net-receipts tax. I'm concerned about the rate and the way it works in tandem, so I'd encourage you to do that. And I'm also very appreciate of what you're going to do in terms of analyzing the entire package as it relates to progressivity. So I want to get that back to us.

And everything else, without going through my long list of notes, I think we've been very consistent with the ideals. I think we've worked with the small-business community to help identify what their concerns are.

Fred, I like your proposal. And I especially like it as it relates to the sales tax and how those two will play off of each other.

I'm concerned about it actually becoming an additional tax burden. And I want to better understand

how that works. So just right now, I'm feeling generally fairly supportive of that well.

CHAIR PARSKY: Thank you very much for those views.

I just want to ask, are there any members of the public that are still here -- there's a method to my madness here but -- yes, sir?

MR. SPILLANE: I'm one.

CHAIR PARSKY: Go right ahead.

MR. SPILLANE: I thought you were taking --

CHAIR PARSKY: I'm trying to see if there's anyone that would like to speak.

MR. SPILLANE: Yes, sir.

CHAIR PARSKY: Go ahead.

MR. SPILLANE: Okay.

COMMISSIONER EDLEY: A couple of us have to leave for planes. Can we get at least some reassurance -- I really want to make sure that those of us who have to leave get the benefit of at least a digest of what the public comments are going to be?

CHAIR PARSKY: Yes.

COMMISSIONER EDLEY: Because these folks have waited all day.

CHAIR PARSKY: No, no, and I'm prepared to stay with them without any question. We'll make sure that

there's a record of what they submitted.

COMMISSIONER DE LA ROSA: Before we go, though, do you think we're just going to meet for four hours?

CHAIR PARSKY: I am very anxious --

COMMISSIONER DE LA ROSA: I'm happy to stay later.

CHAIR PARSKY: No, no, no, I'm very anxious to, on Monday, stick to our time frame. I'm going to try to talk individually to everyone, to see what can be done to advance that, but I didn't anticipate that this would end on time because of the discussion we're on. But I think we're getting close to knowing whether or not it's something that can be supported or not.

COMMISSIONER DE LA ROSA: That's great. Just a point of information.

CHAIR PARSKY: Yes, sir. And I know you've made comments at several of our meetings, but please go ahead. I'd like to limit it to a minute, if it's all right.

MR. SPILLANE: Seven hours' wait for the minute. Thank you, sir.

My name is Bill Spillane, and I'm with Americans for Fair Taxation.

I've given you two hard copies and one electronic copy of the solution to what you're talking about.

Two issues: Number one, any income tax is highly volatile. When a person loses their job, the tax revenue from that person goes to zero. However, he still eats and he still pays his rent or whatever. So if you use a sales tax in lieu of an income tax, you won't have such an unstable revenue source in California. That's a huge solution.

Now, then, regarding the BNRT, that's a great way to lose jobs for California, that's a great way to discourage investment in California because you're going to be adding a price increment on top of California-produced prices. And our high-value producers want to export not only within the states, but abroad. And this is not WTO-compliant. You will not be able to, quote, border-adjust it, rip that tax out in order to export broadly in the world, and they'll be uncompetitive.

Do you want uncompetitive business here in California? Of course, not. You want to encourage business. You want to encourage investment. So you need to not tax business because they're a source of jobs and revenue. The BNRT does that nicely, but it's something that's added to the prices. That's very counterproductive and makes all of our businesses uncompetitive worldwide and U.S.A.-wide.

Follow the examples of Texas and Florida. It's

not complicated.

Please read the letter again, all the solutions are in here. It does justice to the Governor's goals, every single one of them. And if the goals are simply not to be given lip service, this is the solution, a simple sales tax.

And, by the way, on page six, you'll see that, with a rebate, it's progressive. There's the scale of the progressiveness of this tax with a pre-bate, which is a rebate of taxes in advance to the people that need it. That's very simple.

That's all I have to say.

Thank you very much.

CHAIR PARSKY: You're welcome.

Next, could you just introduce yourself? Because I have a whole list here but I'm not sure.

MR. KHOURI: Absolutely, sir.

Thank you, Mr. Chair, Members. Gus Khouri on behalf of the California Transit Association. I'll be very brief.

I appreciate the hard work that the Commission's put in.

Just very briefly on the pollution tax, the sales tax, and transit needs in general.

With respect to the sales tax, let's start with

that first. As far as the impact, if you lower the sales tax, it would impact Proposition 42, the sales tax on gasoline; the sales tax on diesel, which goes to transit; the sales tax on the back 9¢ through the 1990 gas tax increase of the excise tax; as well as the spillover mechanism that Mr. Genest spoke about earlier. So that's all basically the base funding for public transportation in the state.

As you all know, it's been well-documented, funding for public transportation has been virtually eviscerated on the state level. Operations funding has been eliminated until at least the 2012-2013 fiscal year. So that makes our job that much more difficult in trying to comply with the state's mandates of reducing greenhouse gas emissions, with yourselves as part of the solution.

Yes, we have received money through Proposition 1B and through the federal stimulus package. That is for capital expenditures. So we actually need the money to be able to operate the trains and the buses. And as you see here in Los Angeles at six o'clock in the evening, as you will see shortly, congestion is horrible. So we're trying to move people that much more efficiently, we're trying to reduce traffic congestion, move the elderly, school children that much more efficient. There's absolutely no way that we're going to be able to

raise $200 billion over the short-term. As you saw, it was a difficult effort just to generate $20 billion through Proposition 1B in 2006.

So transit operations, if nothing else, that you hear me say is definitely of the greatest importance.

With respect to Mr. Keeley's proposal, I very much appreciate the efforts, sir, that you're trying to. I very much appreciate the collaboration that you've engaged the association in.

We would like to see transit capital be addressed as some of the proposed expenditures. Specifically, with respect to the SB 375 components.

So thank you very much. I appreciate everybody's time. And I look forward to working with the commission.

CHAIR PARSKY: Thank you very much.

MR. SHAW: Thank you, Mr. Chairman and Members of the Commission. I will be brief as well, as I have spoken on a couple of occasions before.

I do wonder if my agreeing with Mr. Keeley --

COMMISSIONER KEELEY: State your name.

MR. SHAW: Michael Shaw, at the National Federation of Independent Business.

I do wonder if my agreeing with Mr. Keeley on a number of things today is a sign of how long this meeting

has gone, or --

COMMISSIONER KEELEY: You've lost your mind.

CHAIR PARSKY: But here are a lot of people that agree with Mr. Keeley.

MR. SHAW: Yes, there are, and very, very smart people as well.

CHAIR PARSKY: About football teams, baseball teams.

COMMISSIONER KEELEY: That's right.

MR. SHAW: Excuse me, I wanted to mention a few things as you consider putting together this proposal for consideration next week.

We do find, as representing small businesses, the disparity in eliminating the corporate tax while preserving the personal income tax. And I know that there's discussion about how this all works out in the wash. And, obviously, those numbers we have yet to see to fully understand. And we are willing to reconsider how we feel about this. However, on the face of it, it seems very disparate treatment. Because, first, small businesses, 80 percent file in the personal income-tax system. So when you add to that the business net-receipts tax, for the personal income tax filers, and you only have the business net-receipts tax on the corporate side, that seems unfair treatment.

We would also recommend that the thresholds mentioned in the draft proposals be indexed. Because as we've seen in other states such as Michigan, that has come back to bite them in the rear, so to speak, on a number of occasions, both with the single business tax that they had previously, as well as the current Michigan business tax. They don't have indexing of their thresholds.

The business and net receipts phase-in sales tax phaseout kind of formula is something that is of concern, obviously not knowing what the rates will be. We do appreciate the Commission's discussion on that today with regard to reviews and finding ways to balance that as well.

I do have one additional concern with regard to all these changes of conformity with federal law. Because as we move more towards the value-added tax or business net-receipts tax and we can argue whether or not those are similar in principle, but it is moving away from federal law in terms of the conformity with our income tax system we have today. And so that is something that we do need to consider. Because while the state component may become more simple and easier to comply with as a result of these proposals, which I think is questionable as well, it does complicate the state-federal

relationship. So for a small business filing their taxes at the federal level, they're now going to have to redo all these calculations, and that's going to change things for them as well. Now, we'll add more time and commit a higher cost for them.

I wanted to thank you for the time as well and for the excellent staff work of Mr. Ibele and the rest of the members.

CHAIR PARSKY: Thank you all very much.

I think with that, our meeting is concluded.

Thank you all very much.

(The meeting concluded at 6:00 p.m.)

--oOo—

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 13th day of September 2009.

_____

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