

STATE OF CALIFORNIA
COMMISSION ON THE 21st CENTURY ECONOMY



STATE OF CALIFORNIA
REVENUE & TAXATION

PUBLIC MEETING

Monday, September 14, 2009
11:00 a.m. – 5:20 p.m.

University of California, Berkeley
Joseph Wood Krutch Theater
Clark Kerr Conference Center
2601 Warring Street
Berkeley, California



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A P P E A R A N C E S

COMMISSION ON THE 21ST CENTURY ECONOMY

Commissioners Present

GERRY PARSKY
Commission Chair
Aurora Capital Group

RUBEN BARRALES
President/CEO
San Diego Regional Chamber of Commerce

MICHAEL BOSKIN
Professor
Stanford University

JOHN COGAN
Professor
Stanford University

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

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

GEORGE HALVORSON
Chairman/CEO
Kaiser Foundation

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

JENNIFER ITO
Research, Training, Policy Director
SCOPE

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

A P P E A R A N C E S

COMMISSION ON THE 21ST CENTURY ECONOMY

Commissioners Present

continued

REBECCA MORGAN
President
Morgan Family Foundation

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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

MICHELLE QUINN
Staff Writer

MARGIE RAMIREZ WALKER

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Tax Advisors

ROBERT CLINE
National Director
State and Local Tax Policy Economics
Ernst & Young

A P P E A R A N C E S

Tax Advisors

continued

CARL JOSEPH
Director
Multistate Taxation Bureau
Legal Division
Franchise Tax Board

PATRICK KUSIAK
Franchise Tax Board

PAT LANDINGHAM
Department of Finance

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Public Testimony

BILL ABOUDI
West State Alliance

JAMES BRADY
Vice-Chair
California Black Chambers of Commerce

JULIAN CANETE
California Hispanic Chambers of Commerce

PEDRO CARRILLO

ELIJAH CLAYTON
Tasil

JAMES DURAN
California Hispanic Chambers of Commerce

ANIBAL GUERRERO
Pacoima Chamber of Commerce
Mexican American Political Association
Plaza Community Services

A P P E A R A N C E S

Public Testimony

REY LAZO
Pacoima Chamber of Commerce

EDWIN LOMBARD
California Black Chambers of Commerce

TED NOVAK
Modern Energy Concepts

PATTY SENEAL
International Warehouse Logistics Association

MICHAEL D. SHAW
Legislative Director
National Federation of Independent Business

STEPHANIE WILLIAMS
Western States Good Movement

ELLEN WU
California Pan Ethnic Health Network

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1 by the Governor and the legislative leaders, which was our
2 task.

3 I want to just, once again, thank our staff
4 and the representatives of the Franchise Tax Board, all
5 of whom are here. We gave our staff a rather large
6 assignment coming out of our last week's meeting. And
7 I am personally very aware of how complex it was to make
8 some determinations and preparation for this meeting.
9 And in addition to Mike Genest, who, despite his
10 sunglasses, has been a leader in this effort.

11 Mark Ibele --

12 COMMISSIONER BOSKIN: Ask him why he has to wear
13 the sunglasses.

14 CHAIR PARSKY: Mark Ibele and Pat Landingham
15 have been absolutely fabulous over this weekend, both of
16 you, beyond anyone's imagination in terms of the hours
17 that you spent.

18 We also had some tremendous help from
19 Ernst & Young, Bob Cline and Andrew Phillips, both of
20 whom, throughout the entire weekend and very late last
21 night, worked very hard.

22 I also want to thank, administratively, Margie
23 Walker, Antonio Lockett, and Michelle Quinn, all of whom
24 have worked many, many hours in trying to prepare
25 logistically for these meetings. Many.

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(Applause)

CHAIR PARSKY: And as I said, our representatives of the Franchise Tax Board, led by Carl Joseph, we would not be in a position to make meaningful recommendations without their assistance.

This is our last public meeting. And hopefully we can come together with a set of recommendations that all of us can endorse. That may not be totally possible, but my objective from the very beginning was to see if we couldn't do that.

We have several commissioners who are not here -- Curt Pringle, Monica Lozano, Richard Pomp -- and I know Becky Morgan will be here, but she is not here right now, and Ruben Barrales will also be here, I believe.

And as I indicated at the last meeting, we want to be sure that every commissioner has an opportunity to express his or her support for whatever recommendations we can put forward. So we will work on asking staff from this meeting to develop in detail those recommendations, and see if it can garner the support of each commissioner. And if not, we'll reflect the fact that some commissioners might not have been able to do that. But I remain an optimist in this process. Let's see what we can do.

Another little reminder, that the nature of the

1 recommendations in terms of three sections of our report
2 have been decided and put forward for several meetings
3 now. Without the specifics of what the recommendations
4 are, the structure of the recommendations, the Commission
5 already decided.

6 And so the report would have three sections to
7 it. Two of the three sections will be revenue-related.

8 Section 1 will be recommendations of tax-law
9 changes -- statutory tax-law changes -- that can be acted
10 on by the Legislature immediately.

11 Section 2 would be recommendations of tax-law
12 changes that can be enacted by changes in the State
13 Constitution or by the State initiative process. Both
14 of those will be revenue-related.

15 Section 3 expands the possibility for
16 recommendations to both revenue and non-revenue-related,
17 but areas of reform that commissioners, plural, without
18 necessarily a specific definition yet of how many, but
19 where commissioners feel that there are areas of reform
20 that need to be considered. They may have been discussed
21 extensively here or not, but that commissioners really
22 believe that they need to be considered by others,
23 outside of the context of this commission. And that will
24 give an opportunity for commissioners to expand on what
25 is revenue-related.

1 And we've heard from a number of commissioners
2 on their views of reforms that should be in that category;
3 and we will try to go through those and get a sense of
4 other commissioners about those this morning.

5 I think that the only other introductory
6 comments I want to make are, first of all, to remind
7 everyone one last time -- I do this at every meeting,
8 please don't roll your eyes -- but I think it's very
9 important that we remind everyone, the public and
10 otherwise, of the goals that we had which were
11 established at the very beginning. And those basically
12 are six.

13 We were asked to recommend reforms that would
14 establish a 21st century tax structure that fits with the
15 state's 21st century economy.

16 Second, that would help stabilize revenues and
17 reduce volatility.

18 Third, that would promote long-term economic
19 prosperity of the state and its citizens.

20 Fourth, that would help improve California's
21 ability to successfully compete with other states and
22 nations for jobs and investments.

23 Fifth, that would reflect principles of sound
24 tax policy, including simplicity, efficiency,
25 predictability, stability, and ease of compliance.

1 And finally, that our reforms would help ensure
2 that the tax structure is fair and equitable.

3 Those are the guiding goals or principles that
4 we need to keep in mind with respect to the package of
5 recommendations that we would make.

6 And I would say that, throughout this process,
7 it's become -- first of all, it's quite clear that each
8 individual -- the commissioners here, each individual
9 commissioner brings a very distinct point of view. I
10 think these points of view are reflective of all
11 Californians. Some may be more of an emphasis on one of
12 the objectives and some may be an emphasis on the other.
13 But I think it is especially important, in light of the
14 crisis that we are going through now with respect to
15 current budget problems, that I just want to compliment
16 all the commissioners for the goodwill they have brought
17 to this. I think one of our commissioners expressed at
18 the last meeting that everyone comes to the table with a
19 desire to compromise, but not compromise their basic
20 principles. And I think that's a very good framework
21 for thinking about how we want to approach things. And
22 it may send a similar message from citizens to our State
23 Legislature, which I think would be an important message
24 there.

25 I also want to be sure that people understand

1 that -- and this, I think, is really the unanimous view
2 of this commission -- that given the crisis that exists
3 today, changes in the tax laws that achieve the goals
4 we're talking about are really aimed at allowing the
5 citizens of California to receive from the state benefits
6 and services that they have been promised. And we see a
7 situation out there now that these services and benefits
8 that have been promised to our citizens are not being
9 delivered. And so significant cuts have had to be made,
10 harming a lot of people. And so I think we should bear
11 in mind, every commissioner brings to the table that
12 objective.

13 And finally, I think we should bear in mind the
14 nature of the recommendations that we would be making.
15 And I draw, once again, on a paragraph that was submitted
16 in connection with the part of the proposal as outlined
17 by John Cogan and Chris Edley. And I think that these
18 two sentences, I think, reflect the way in which these
19 recommendations, given the complex nature of them, and
20 given the fact that they may include a new tax that has
21 not been tested, that needs to be looked at. But in
22 their memo, they said:

23 *"We recognize that the business net-receipts*
24 *tax represents an extraordinary change in*
25 *California's tax code. A tax change of this*

1 *magnitude should only occur after the proposal has*
2 *been fully vetted and all of its ramifications*
3 *have been fully assessed by the Legislature and*
4 *the Governor and the public.*

5 *"We believe that the BNRT is sufficiently*
6 *promising to warrant the Commission's*
7 *recommendations that the Legislature and the*
8 *Governor proceed with a public process to fully*
9 *evaluate the BNRT proposed herein; and upon*
10 *satisfactory completion of this process, to enact*
11 *a BNRT into law as part of a proposed package."*

12 I think those three sentences reflect, at
13 least coming out of the last meeting, the will and
14 desire of the Commission if we are to include a tax or
15 a recommendation of a tax of that magnitude.

16 So with that, what I would suggest for structure
17 here, coming out of the last meeting was a desire on the
18 part of the Commission, given the outline of the package
19 that was provided by Chris and John for certain elements
20 of the package, to make sure that the staff went back and
21 assessed the overall consequences of such a package in
22 terms of impacts.

23 And so I think it would be useful for the
24 Commission if we let the staff take us through that part
25 of the package as it came from the last meeting, and then

1 address some of the other elements that are still on the
2 table, that we also need to consider. But to include in
3 this recitation how the staff would ask the Commission
4 to look at those consequences.

5 And so I'll ask Mark to kind of walk us through
6 a series of slides, some of which you will have seen.
7 But it shows at least the makings of a tax package that
8 still does not address a few of the elements that remain
9 for discussion, and remained for discussion at the last
10 session.

11 And I know that Mark and Pat and Bob Cline of
12 EY, I've asked to come forward, not only because they've
13 worked all weekend, but because they have a lot of
14 knowledge in terms of how this material came together.

15 COMMISSIONER EDLEY: They don't look too
16 chipper.

17 CHAIR PARSKY: Well, we're going to send them
18 off, you know, for a vacation there, and then they'll look
19 much more chipper.

20 COMMISSIONER EDLEY: Okay.

21 COMMISSIONER COGAN: Do you have a tax haven in
22 mind?

23 CHAIR PARSKY: There are a few tax havens in
24 this proposal. They've been hidden away, though.

25 Okay, Mark, why don't you take us through the

1 whole package, then we'll pause, come back.

2 I know that John and Chris may have some
3 comments. And then I want to make sure we highlight one
4 aspect of things that ties into what Commissioner Keeley
5 has suggested.

6 But go ahead.

7 COMMISSIONER KEELEY: Mr. Chairman, if I might.

8 CHAIR PARSKY: Sure.

9 COMMISSIONER KEELEY: Thank you.

10 Excuse me, Mr. Ibele, I'm sorry to interrupt
11 here.

12 If I could, Mr. Chairman.

13 I'm looking for some direction from you on the
14 agenda today.

15 Given that the press of business at UCLA the
16 other day meant that many folks who had appeared and
17 submitted blue slips to testify, essentially the lateness
18 of the hour precluded much public testimony and
19 participation.

20 Is it your intent to get to that rather much
21 earlier today in the process, sir?

22 CHAIR PARSKY: I'm sorry. I should have said --
23 maybe this will address that. And I appreciate your
24 mentioning that. We will welcome public comment.

25 My understanding is, there are two members of

1 the public that want to comment. And if that is the case,
2 I think we can do that first.

3 Is that right? I have Michael Shaw and
4 Julian --

5 MR. CANETE: Canete.

6 CHAIR PARSKY: Canete? Is that -- you're --

7 MR. CANETE: I believe there's more than that.

8 Commissioner Keeley, thank you very much for
9 bringing that up.

10 CHAIR PARSKY: Why don't one of you go -- are
11 you ready to comment?

12 MR. CANETE: I want to make sure, all the
13 individuals that did come here, I think we have more than
14 two.

15 CHAIR PARSKY: Well, I've only got two that have
16 signed.

17 Who -- why don't you just let me know how many
18 people would like to comment?

19 *(Show of hands.)*

20 COMMISSIONER COGAN: One, two, three, four,
21 five, six, seven, eight -- at least eight.

22 CHAIR PARSKY: Well, I tell you, we will do this
23 before the lunch break, I promise you that. And we will
24 not make you wait beyond that. But I want to get out on
25 the table the entire package. Then we'll come back --

1 we'll come back, and maybe some of the questions will be
2 answered as the package unfolds. But we only have a
3 relatively short period of time. We will do the public
4 comment before lunch.

5 Okay, so I have now 13 that want to speak.

6 Okay, we'll do that before lunch.

7 Okay, Mark --

8 MR. IBELE: I'm getting some technical advice.

9 CHAIR PARSKY: Well, technical advice is always
10 helpful.

11 MR. IBELE: Okay, I think we're on track here.

12 So let me go through the proposed tax structure
13 for the Commission.

14 This first slide is just an overview of what the
15 proposed tax structure is.

16 Reduce the personal income tax and restructure.

17 Eliminate the corporation tax.

18 Eliminate the state general purpose sales tax.

19 Establish the business net-receipts tax.

20 Initiate a new rainy-day reserve fund.

21 And institute an independent tax appeals dispute
22 resolution body.

23 This is a slide showing the current law. And
24 this includes the major state revenue sources, general
25 purpose and special purpose.

1 Under current law, on the left-hand side there,
2 with the biggest slice being the personal income tax at
3 44 percent, closely followed by the sales and use tax at
4 34 percent.

5 Under the new system, the alternative proposal,
6 business net-receipts tax -- and this is obviously fully
7 phased in here -- of 47 percent, and a personal income
8 tax of about 31 percent. So a substantial reduction in
9 both the sales tax and the personal income tax and the
10 establishment of the business net-receipts tax.

11 When we analyzed the package, we considered
12 these major and proposed state revenues. So this includes
13 not only taxes that are being changed under the proposal,
14 but also other taxes that would simply remain in place.

15 The taxes that are being changed: Personal
16 income tax, sales and use tax, corporation tax. The
17 taxes that remain in place as they currently are, would
18 be the fuels tax, the insurance tax, other excise taxes,
19 and the new tax being the business net-receipts tax.

20 So when we conducted our analysis on the
21 incidence and the distribution by income group, we
22 included all these taxes per the Commission's
23 instructions.

24 In doing the incidence analysis, this is an
25 area that is open to a lot of discussion among economists

1 and analysts. The personal income tax is relatively
2 straightforward. The tax sticks where it hits, and the
3 incidence is on the individual.

4 The same thing -- and that's the assumption that
5 we used in this analysis.

6 For the sales and use tax, at least the
7 consumer portion of this, this we estimated based on
8 personal consumption expenditures that are conducted at
9 the federal level and then applied to California using
10 census data. That's also somewhat straightforward. A
11 little bit more complex than the personal income tax, but
12 still non-controversial.

13 For business taxes, we've relied on our
14 consultant, as the Chair mentioned, Ernst & Young, for
15 the basis of the incidence of the various business taxes.
16 And this includes the business portion of the sales tax --
17 that is, the consumption of taxable items by businesses.
18 It includes the corporation income tax. It includes the
19 business net-receipts tax.

20 *(Commissioner Barrales entered the room.)*

21 MR. IBELE: And the incidence assumptions that
22 we've incorporated here is a long-run perspective. That
23 is, once all the shifting of the various taxes has
24 filtered out and the economy has adjusted. The theory
25 here being that businesses don't pay taxes. Those taxes

1 are typically passed back in terms of labor or passed
2 forward in terms of higher prices or sometimes reduced
3 return to capital.

4 The impacts would be borne, in this incidence
5 analysis, would be borne by California residents or
6 taxpayers outside of the state. Then the mobility of the
7 different factors -- that is, capital and labor -- is an
8 important part of this analysis.

9 So after initially being imposed on business,
10 the tax is shifted to California residents or exported
11 to consumers or factors of production outside of the
12 state.

13 The taxes -- the business taxes, that is -- is
14 shifted back to capital through a reduction in return --
15 shifted back to labor through reduced wages or salaries,
16 and are shifted forward to consumers in terms of higher
17 prices.

18 E & Y, Ernst & Young, has based its shifting
19 assumptions on the level of effective tax rates for each
20 industry in California relative to average rates.

21 And when I finish this slide, Mr. Cline, who
22 is here, can provide additional detail on this process.
23 But the result is that these tax burdens are attributed
24 to California residents as consumers, workers, or
25 investors.

1 And then once we have these incidence
2 assumptions based on the shifting to these three sort of
3 factors or buckets, we attribute these taxes across our
4 income groups for the attribution to labor. We've used
5 wages and salaries. For consumption, we've used the
6 consumer portion. And for capital component, we've used
7 taxable income and dividends.

8 It's an area that is difficult to estimate
9 since the tax has shifted. There is no single unified
10 view of the incidence of business taxes. There's
11 different views on this. And shifts into various
12 incidence assumptions can have large distributional
13 consequences.

14 So based on those assumptions -- and we can go
15 into it in more detail, if you'd like -- but this is what
16 we put together in terms of the changes in -- the tax
17 change for the various income groups for the tax package.
18 And so for the zero to 20, once you take the shifting and
19 the shift to different factors, and you take into account
20 a couple of other things that I mentioned, one, is to
21 nonresidents, that part that's shifted outside of
22 California; and the other being the federal offset, which
23 is basically the deductibility of business taxes against
24 the federal taxes. Primarily, the reduction in the
25 corporate income tax.

1 So for the zero to -- you can read it off
2 here -- the zero to 20, no net change.

3 Twenty to 50 -- these are all in thousands
4 of dollars -- a slight increase.

5 And at the bottom then, the change -- we're
6 basically exporting, under the package, much more of the
7 tax burden than under current law.

8 So the balancer there, the nonresidents and
9 federal offset is about \$6.9 billion.

10 Bob, did you want to add anything to that at
11 this point?

12 MR. CLINE: Mr. Chairman, would you --

13 CHAIR PARSKY: Please go ahead, Bob.

14 MR. CLINE: If I could make a couple of comments
15 about the way of thinking about the incidence analysis.
16 Our responsibility was to take the business tax portion
17 of the current law in California, as well as the proposal
18 for changing taxes, including the business tax piece.
19 And we compared the proposed business tax package with
20 current law, and estimated how the changes in taxes would
21 be distributed to workers in potentially lower salaries,
22 to consumers in potentially higher tax prices, or to
23 investors in lower rates of return on their investments.

24 We also looked at what portion of the taxes
25 could be exported outside of the state of California,

1 through higher prices for products that could be sold
2 outside of California, some of the shifting in terms of
3 customers coming into California and buying output,
4 moving across the state line. We looked at that kind of
5 exporting of the tax burden. And we also looked at the
6 federal offset. What portion of the business taxes would
7 be shifted, in a sense, to the federal-level tax system
8 through higher deductions for California taxes that would
9 reduce federal tax liabilities on the corporate income
10 and the personal income taxes at the federal level.

11 Just a couple comments about the nature of this
12 exercise. We've had some extensive experience in doing
13 this type of estimation. I first did incidence analysis
14 in Minnesota, maybe a decade ago, when the Legislature
15 required the Minnesota Department of Revenue to do
16 estimates of the incidence of state tax changes. And the
17 methodology that we used in doing this work in California
18 kind of grew out of or built on that foundation of the
19 work that has been done extensively in Minnesota. We've
20 also integrated the literature, what economists are
21 saying about the perspective on who pays business taxes.
22 It is a complicated subject and there is room for
23 disagreement. But let me just mention a couple things
24 that are important in the overall analysis.

25 Number one, we look at the whole system of

1 state and local taxes as they fall on businesses in
2 California. And it's not just the taxes that are in play
3 in terms of this proposal, but it's all of the major taxes
4 that are paid by business.

5 We looked at the sum of all those taxes paid
6 by business current law, and then under the proposed
7 package. And it's the change in those two total amounts
8 of taxes on business that is our starting point for the
9 analysis. So it's not tax-type by tax-type in isolation.
10 It's looking at the entire system of business taxes,
11 which I think is the right way to look at it. Business
12 is concerned about the cumulative amount of taxes that
13 they pay, not just a single tax in isolation.

14 The second very important point is that our
15 whole analysis about who pays the taxes depends upon how
16 the California taxes compare to other states. And so our
17 entire methodology looks at effective tax rates, kind of
18 the level of taxes divided by economic activity in every
19 industry in California, and we compare that ratio to the
20 same ratio U.S.-wide, holding all the other states' taxes
21 constant or given.

22 And it's the change in the relative tax rates
23 by industry in California that determines businesses'
24 ability to move the tax somewhere else, either through
25 higher prices or lower wages or lower payments to capital

1 investments or to shift it to the federal government in
2 the sense through the tax deductibility against the
3 federal taxes.

4 And so all of that is driven by this change in
5 the relative prices: How California compares with the
6 rest of the states on business taxes under current law
7 and how California will compare under the proposal. We
8 work all of that through our incidence analysis, and we
9 come up with our estimates of how the tax change --
10 current law to the new proposal -- would be distributed --
11 we call them "the buckets" -- capital, labor, price,
12 changes, and shifting to the federal government through
13 the offset.

14 We try to do it systematically, we try to do it
15 carefully, industry by industry. So there's a lot of
16 information built in there.

17 And I'll just finish then by saying also what
18 happens in this analysis is that you're moving -- if you
19 eliminate the corporate income tax, which most economists
20 and others consider to be a tax on capital investment,
21 and you go to a broader tax base, like a value-added,
22 which is sort of a variation -- it's the approximate way
23 to describe the business net-receipts tax, you're taxing
24 the full value created by a business, not just the capital
25 investment or the return to capital in the business.

1 So you take this broader perspective, that the
2 BNRT is a broader-based tax, and we kind of treat it as
3 a change in the cost of production, and we compare how
4 the taxes imposed on the cost of production in California
5 compare to other states. And that kind of drives our
6 incidence analysis.

7 Mr. Chairman, I don't know if it's helpful or
8 not, but that gives you a brief outline of how we went
9 about doing the incidence analysis.

10 CHAIR PARSKY: Okay, I think it would be helpful
11 if you get through the package, then we'll come back.
12 But save the questions about this element. Because,
13 obviously, this was what most of the weekend was spent
14 trying to -- because I think several commissioners --
15 Jennifer, others -- wanted to see, as difficult as it may
16 be, to predict with precision.

17 We had, and you will show, I know, the impact
18 of the changes in the personal income tax, which I think
19 did address what commissioners had requested. But we
20 didn't have the overall impact, and several commissioners
21 asked for it.

22 So hold on, I know that this will create some
23 questions. But let's get through the entire package and
24 then come back.

25 MR. IBELE: Sure.

1 Okay, this slide shows the effective tax rates.
2 Again, this is for all the major state revenues that were
3 on the previous slide. And this includes those items
4 that Bob mentioned and I mentioned before: The federal
5 deductibility or the federal offset. This also includes
6 transfer payments, such as Social Security, unemployment
7 insurance, veteran benefits, SSI, food stamps, public
8 assistance. And the distributions here are for 2012.

9 So, you know, the noticeable thing here is that
10 we have reductions, or sort of income groups staying at
11 equivalent levels in current law relative to the tax
12 package. And this is the result of basically being able
13 to export much more of the taxes under the proposed tax
14 system.

15 CHAIR PARSKY: Mark, without confusing everyone,
16 just a little bit of an explanation of what "effective
17 tax rates" mean.

18 MR. IBELE: "Effective tax rates" is, what we
19 did is, the overall tax burden from the various taxes,
20 the major taxes, divided by income. And for here, we used
21 California AGI plus the items -- the transfer payments
22 that I mentioned, to get the denominator.

23 CHAIR PARSKY: Okay, go ahead.

24 MR. IBELE: The next slide, this goes into
25 sort of a repeat from last Thursday. This is the

1 personal income tax structure as proposed, two rates:
2 2.75 percent, up to 56,000 for joint filers; and
3 6.5 percent above these levels. The deductions of
4 \$45,000 joint, and the itemized deductions for mortgage
5 interest, property taxes, and charitable contributions.

6 Again, from last Thursday, this is, again, the
7 change. Current law, with respect to the proposed
8 package, this is for residents only. So the \$15 billion
9 reduction there is for only residents. There's an
10 additional change for nonresidents. And this also
11 includes the income tax on high earners.

12 CHAIR PARSKY: Which, under our proposal, would
13 stay in place?

14 MR. IBELE: That's correct. Yes, that's one of
15 the taxes that is not changed.

16 Again, a repeat from last Thursday, showing the
17 effective tax rates and the share of the total, just on
18 the personal income tax.

19 A brief description, we have the Franchise Tax
20 Board here, if there's additional questions on the
21 business net-receipts tax. But this outlines the basis
22 of the tax on gross receipts: All businesses in
23 California, the economic-presence test, unitary method,
24 water's edge.

25 The last bullet there describes or itemizes the

1 phase-in plan for the business net-receipts tax over the
2 five-year period.

3 The tax package phase-in, as outlined currently,
4 is for Year 1, the elimination of the corporation tax,
5 and a reduction in the current law income tax. The
6 reduction of 1 percent in the sales and use tax, general
7 purpose sales and use tax, and the establishment as a --
8 compensating for those reductions in revenues of the
9 business net-receipts tax, which would be about, based
10 on our current analysis, about 1.6 in the initial year.

11 For Year 2, there would be an additional
12 reduction in the current law personal income tax, an
13 additional reduction in the 1 percent sales and use tax,
14 and a compensating increase in the business net-receipts
15 tax.

16 Year 3, there would be a conversion to the
17 personal income tax new structure, as I outlined just a
18 minute ago. An additional reduction in the 1 percent
19 sales tax and a compensating increase in the business
20 net-receipts tax.

21 Year 4, additional reduction in the sales and
22 use tax, increase in the business net-receipts tax.

23 Year 5, similar, with the phaseout of the sales
24 and use tax, the final 1 percent, and the increase in the
25 business net-receipts tax.

1 Now, as part of this process -- it's not
2 outlined here -- but there could be a systematic
3 assessment of the performance of the business net-receipts
4 tax, an adjustment, if that was necessary, of the sales
5 and use tax rate, to make sure that the new system was
6 performing at or equal to the current level of taxation.

7 CHAIR PARSKY: I'd just say that I think the
8 thrust of the Commission desire, coming out of the last
9 meeting, was that any recommendation would include this
10 systematic assessment or safety-valve approach. And we'll
11 go through that concept for everyone. But inherent in
12 this, would be that there would be a technical panel
13 established to make an assessment. It could be annually,
14 it could be at the end of three years. But I think the
15 current thinking or the current suggestion would be
16 annually. And we'll walk through that, as another way
17 to give assurance that what we think will happen with
18 this major new tax is actually happening.

19 I think there is also a desire, however, that --
20 the suggestion would be that, from our perspective, the
21 rate would not get above a certain level. And we'll walk
22 through that once we have had a chance to discuss this,
23 as part of a recommendation.

24 But in addition to a phase-in, this regular
25 reassessment -- or assessment, would be part of the

1 proposal.

2 But why don't you go ahead and finish, and we
3 will come back to that?

4 MR. IBELE: Okay. The last two slides should
5 be familiar.

6 This is the rainy-day reserve fund proposal,
7 which this is unchanged from Thursday, although I
8 understand it's still somewhat under discussion and being
9 refined.

10 And then the tax appeals tribunal proposal for
11 an independent tax body to resolve tax disputes.

12 That is the package.

13 CHAIR PARSKY: Again, that's not the complete
14 package. We still have some issues to discuss as to
15 whether or not other items that have been raised would
16 be included. And I certainly would like questions about
17 any elements of the package, but particularly focusing
18 on what the Commission asks the staff to do.

19 One suggestion I'd like to put on the table for
20 consideration, we had a number of discussions about the
21 existing sales tax on gasoline. And Commissioner Keeley
22 has made a proposal; and in doing this assessment over the
23 weekend, it has become clear that by eliminating -- which
24 the business net-receipts tax on the table would do in
25 conjunction with the state sales tax -- by eliminating

1 the sales tax on gasoline, we would be depriving, if you
2 will, the allocation of those funds to certain elements
3 of transportation.

4 And so one of the things I think we want to
5 think about as part of this proposal, would be to not
6 remove the existing sales tax on gasoline as part of the
7 phaseout of the sales tax and the phase-in of the business
8 net-receipts tax.

9 In modeling, during the course of this weekend,
10 the ability to keep the business net-receipts tax rate
11 at a reasonable lower level, this obviously would have
12 an impact on that. Because if we remove the sales tax
13 on gasoline, what was covered by that would have to be
14 covered by the general reserve fund. So I think we
15 should think about, as part of the proposal, including
16 what Commissioner Keeley, on that aspect of his proposal,
17 has made.

18 John?

19 COMMISSIONER COGAN: One clarifying question,
20 Gerry.

21 Is the sales tax on gasoline included in these
22 numbers?

23 MR. IBELE: No. For purposes of the most recent
24 analysis that we did, we excluded that from the BNRT rate
25 and the base.

1 COMMISSIONER COGAN: Okay.

2 MR. IBELE: So we are assuming that that would
3 stay in place, or a similar tax.

4 COMMISSIONER COGAN: So the sales tax on
5 gasoline -- the current sales tax on gasoline -- its
6 impact is reflected in these, or is not reflected in these
7 numbers?

8 MR. IBELE: We assumed --

9 COMMISSIONER COGAN: The inclusion that remains
10 in law?

11 MR. IBELE: We assumed for purposes of this
12 analysis that the sales tax on gasoline would remain.

13 COMMISSIONER COGAN: Good. Thanks.

14 CHAIR PARSKY: Michael.

15 COMMISSIONER BOSKIN: Oh, this time, you don't
16 have to hold it? Okay. Technological progress.

17 I raised last time the symmetry issue about
18 what to do in the phase-in if the BNRT is raising even
19 more needed revenue than projected. And I haven't seen
20 any response to that. I'd like to see it before I can
21 support the entire process.

22 I think it's quite legitimate to be concerned
23 about insufficient revenues for the state. As I have
24 said and written, we need an effective government that has
25 adequate revenues for a health society.

1 But, again, I think because we've come from an
2 era where we've been -- Sacramento has been in shock and
3 the problems have reverberated for many of our citizens
4 of the collapse of revenues, that we shouldn't just
5 assume that the only way the project can be off is to be
6 too low. So I think we need a mechanism to deal with
7 that.

8 Now, it's self-correcting in the early years.
9 You would just have the sales tax come down more rapidly,
10 or you wouldn't have to lag the sales tax. But at the
11 end, there needs to be something that deals with this
12 in the event that the rainy-day fund, despite our best
13 intentions, proves to be as ineffective as previous
14 attempts along these lines.

15 CHAIR PARSKY: Maybe this would be a good point
16 before we raise questions to outline in a little bit more
17 detail how the safety valve, at least as is being
18 contemplated, would work.

19 MR. IBELE: Okay, we had a suggestion that is
20 been sort of developed, and it's basically a process that
21 could occur -- we've sort of outlined the first three
22 years of the program, where there would be an estimation
23 of revenues that would have been generated under the old
24 system, and then revenues that were generated under the
25 new system.

1 There's a little bit of an issue since under
2 the phase-in plan, the corporation tax would go away.
3 And one idea was to have information returns, which are
4 not a very reliable means to base estimates on.

5 So one option might be, for the last year,
6 where the current law was in effect, to use the most
7 recent returns that were available for all the taxes,
8 agree in advance what the models were to estimate the old
9 system and to compare against the new system, and then
10 to simply update that model for economic or demographic
11 information.

12 An alternative to that old system versus new
13 system, would simply be to look at whether or not the
14 business net-receipts tax has performed up to its
15 expectations during the initial estimation process.

16 What we put together was basically comparing
17 old and new systems. And one idea is to have the
18 estimates of the old and new system be incorporated in
19 the May revision each year for the first, second, third
20 year. It could go through all the five years. That's
21 up to the Commission.

22 And then once -- to have those incorporated in
23 the budget. And then once the actual numbers, the actual
24 revenues are available in December, reconstitute, or have
25 a technical body come together, make a determination of

1 the old and new revenues. And based on their analysis
2 of the models, have a new rate on the sales and use tax
3 come into place that January and adjusted. It could be
4 adjusted, as Commissioner Boskin suggested, to ensure
5 symmetry or there could be some other mechanism.

6 COMMISSIONER BOSKIN: In the intervening period,
7 we do not want to have anything that raises taxes because
8 that would require a two-thirds vote. I think what you
9 want is, you could lag or delay reductions if insufficient
10 revenue is coming in, okay.

11 I think if more than enough revenue is coming
12 in, you might want to be able to speed up reductions.
13 But the main issue that I'm raising is at the end, if you
14 wind up having a big delta.

15 MR. IBELE: What we've developed so far is
16 simply this process, an idea for the process during the
17 three or five years. We haven't addressed the issue of
18 what happens after that.

19 CHAIR PARSKY: We're going to entertain some
20 discussion of that subject, so that we can put forward at
21 least a suggestion.

22 I think it's the Commission desire, if we are
23 to proceed with a recommendation, to have specifically a
24 safety valve, or a reassessment, because of the nature
25 of this new tax. So I didn't hear anyone saying we

1 shouldn't have that in our proposal. The question will
2 be the mechanics of that. And so we'll want to have a
3 discussion about that specifically, and see if we can
4 reach some common ground about it. And there will be
5 some commissioners, I know, that will be concerned about
6 going over the mark, and there will be some commissioners
7 that will be concerned about going under the mark. So
8 we'll have to --

9 COMMISSIONER BOSKIN: Some of us are concerned
10 about both.

11 CHAIR PARSKY: And some that will be concerned
12 about both, I know.

13 COMMISSIONER COGAN: And everybody knows, we're
14 not going to hit the mark.

15 CHAIR PARSKY: I think that's safe. But that
16 is particularly important in terms of suggesting to the
17 Legislature that in evaluating and finalizing such a
18 change in tax, this is an important element.

19 I think it is important that the Commission
20 send a signal that we recognize the difficulties of
21 predicting such a new form of tax, when we don't have any
22 experience on it. We can predict a number of things based
23 on analysis, but we have to suggest that they put in place
24 a mechanism to reassess things.

25 Bill?

1 COMMISSIONER HAUCK: I have a question.

2 CHAIR PARSKY: Why don't we proceed ahead to
3 kind of ask some questions? And we'll come back to this
4 issue of safety valve or system assessment.

5 COMMISSIONER HAUCK: Okay.

6 Mark, I think I understood you to say that
7 these two charts -- the tax package alternative, effective
8 tax rates for 2012, which includes -- I think you said
9 includes all of the --

10 MR. IBELE: That's correct.

11 COMMISSIONER HAUCK: -- taxes on this.

12 So at 2012, you're forecasting what would be
13 an overall rate currently, slightly more than 10 percent
14 being reduced to 8 percent; is that right?

15 MR. IBELE: That's correct.

16 COMMISSIONER HAUCK: I guess, can you talk a
17 little more about the assumptions that you used to get
18 there? As I recall, the forecasts of the Legislative
19 Analyst and the Department of Finance, in 2013, the
20 State was in a difficult financial and budget picture
21 without -- and, in fact, I think it's only by 2013 or by
22 the end of it that we get back, in terms of employment,
23 to the rate that was existent in either 2007 or 2008.

24 Those two don't quite --

25 MR. IBELE: Well, we didn't do anything on the

1 expenditure side, obviously. But for 2012, I think
2 you're basically back at about the 2006 levels in terms
3 of state revenues.

4 COMMISSIONER HAUCK: How would 2006 levels of
5 revenue be adequate to support service needs in 2012?

6 MR. IBELE: Well, what we did here is basically
7 structure a system under the new system, which would raise
8 the equivalent amount of revenues, which is expected to
9 be raised under the current regime.

10 So it may or may not be inadequate to fund the
11 levels of expenditures. That's another -- we're just
12 focused on the revenues and what's expected to be raised
13 on the revenues under current law and under the package.

14 COMMISSIONER HAUCK: Without regard to the
15 spending requirements?

16 MR. IBELE: No, that wasn't our -- right, that
17 wasn't my charge.

18 COMMISSIONER BOSKIN: I think the appropriate
19 way to think about this is the state of the economy, we
20 are trying to average over the cycle or be roughly the
21 same in a normal year. And in 2006, we're fairly well
22 along into a housing bubble centered in California and a
23 housing finance and construction bubble centered in
24 California that peaks in 2007, and then we have a
25 collapse.

1 So getting back to the same, roughly, where we
2 were in 2006, we may not quite be all the way back to full
3 employment, but it's back to revenue levels from a bubble
4 year. So I think that's important to bear in mind, that
5 a normal period would have been maybe 2004.

6 We had a recession in 2001, and had a recovery
7 in 2002, 2003, 2004. So we're well along into an economic
8 expansion and probably above the sustainable state of the
9 economy in 2006.

10 *(Commissioner Morgan entered the room.)*

11 COMMISSIONER HAUCK: I hope you're right.

12 And one other question on the tax phase-in
13 piece. In Year 1, you're eliminating the corporate rate,
14 or the corporate tax, which is currently about nine and a
15 half billion; correct?

16 MR. IBELE: Yes.

17 COMMISSIONER HAUCK: Reducing the PIT?

18 MR. IBELE: 2012, it's \$9.6 billion.

19 COMMISSIONER HAUCK: All right, well, nine and
20 a half is close.

21 CHAIR PARSKY: That's very close.

22 COMMISSIONER HAUCK: Close enough for this
23 purpose.

24 Reducing the PIT and taking a penny off the
25 sales tax, which today is worth somewhere -- or in the

1 neighborhood of \$5 billion.

2 What does that result in, in terms of the BNRT
3 rate in that year? Because you're reducing revenue here
4 by probably in excess of \$15 billion.

5 MR. IBELE: Yes. The PIT reduction would be
6 \$3.2 billion. The corp., 9.6, and the sales tax, 5.5.
7 And the balancing BNRT rate would be about 1.6.

8 COMMISSIONER HAUCK: Okay, thank you.

9 CHAIR PARSKY: John?

10 COMMISSIONER COGAN: A couple questions for Bob.

11 Seeking through the distributional consequences
12 of what we're considering here, if we start with, let's
13 say, elimination of the corporate tax and elimination of
14 the retail sales tax. If we were to replace those
15 revenues with a BNRT and set the personal income tax
16 aside for the moment, would that makes the tax codes more
17 or less progressive?

18 MR. CLINE: As we looked at the results of the
19 incidence analysis, we kind of did that in terms of
20 looking at the change in the distribution by AGI levels
21 step by step as you compared, say, the BNRT to the sales
22 tax. And what we'd found in terms of our model results
23 is that if you looked at the distribution of the BNRT by
24 income level and compared it to the distribution of the
25 sales tax by income level, the BNRT is actually less

1 regressive than the sales tax is.

2 If you were to raise the same number of
3 dollars from the BNRT as you do the sales tax, that
4 revenue-neutral switch would lower taxes by more, at the
5 lower income of the distribution, than at the middle or
6 the upper end of the distribution. And so that pure
7 kind of shift from the sales tax to the BNRT reduces the
8 current regressivity in the overall California state tax
9 distribution.

10 We still think that the corporate income tax is
11 less regressive. It probably still is overall regressive,
12 because a lot gets shifted back to labor and, you know,
13 other ways in which the residents of California are
14 affected. But the sum of the two, if you were to replace
15 the corporate income tax and the sales tax with the BNRT,
16 I think that substitution, if it were dollar-for-dollar,
17 would reduce the regressivity; or if it's slightly
18 progressive, increase the progressivity, whichever way
19 you want to describe it. I think more accurately, it is
20 reducing the current regressivity over a wide income
21 range for the current California tax system.

22 COMMISSIONER COGAN: Right. So then if we take
23 the next step, of taking an equivalent amount of revenues
24 away from the PIT, as we have proposed, by cutting the
25 PIT rates, and adding in another higher rate for the BNRT,

1 then that would go in the other direction?

2 MR. CLINE: It would go in the opposite
3 direction because you're taking the progressive personal
4 income tax and replacing it with another general tax,
5 which is not as regressive as the sales tax, but it is
6 somewhat regressive, so that you get that balanced effect
7 when you make those substitutions. So that what happened,
8 as you saw in the effective tax-rate graph, is that maybe
9 in the first two AGI categories, the two lowest groups,
10 you have virtually no change in their tax liabilities and
11 their effective tax rates; and then you see, because of
12 the income tax reduction versus paying for that with a
13 higher BNRT rate, you start to get the divergence, so
14 that you do get lower effective tax rates compared to
15 current law in the middle- and higher-income brackets.

16 COMMISSIONER COGAN: Got it.

17 So then one way to look at this issue of the
18 BNRT rate, in conjunction with everything else, is if
19 we start with the elimination of the retail sales tax,
20 elimination of the corporate tax, and our PIT reductions,
21 then those three, by themselves, would make the system
22 more progressive or less regressive. And then if we
23 started adding in the BNRT, let's say, at a rate of
24 1 percent and then a rate of 2 percent, as we raise that
25 BNRT level higher and higher up, the system would become

1 more regressive relative to what we would have if we
2 eliminated the three current taxes, or two current taxes
3 and reduce the PIT; right. And so if we start with --
4 again, just to recap -- eliminate the corp., eliminate
5 the retail sales tax, and reduce PIT, we get a more
6 progressive tax code; right? Then we start with a BNRT
7 at a very low rate. And that makes the system a little
8 bit less progressive. As we raise it more, a little bit
9 less progressive. And finally, you'll hit a rate where
10 we will get, in this picture that you have, if you might
11 put it up, Tax Package Alternative Effective Tax Rates.
12 That is, you'll get to a BNRT rate where the lowest income
13 groups are basically held harmless or have essentially
14 the same effective tax rate. But if you were to raise
15 the BNRT rate above that level, then you would actually
16 make the system more regressive, relative to or compared
17 to even the current system.

18 Does that make sense?

19 MR. CLINE: I believe I did follow -- it's
20 tough, I know.

21 COMMISSIONER COGAN: I think it's very, very
22 important --

23 CHAIR PARSKY: Yes, this is a very important
24 discussion.

25 MR. CLINE: Yes. Could I say it a slightly

1 different way, to see if it's in agreement with your
2 perspective?

3 That what happens down in the first two AGI
4 classes, the brackets, is that they're not paying very
5 much in the personal income tax, to begin with. So there
6 aren't really benefits -- significant benefits to them
7 of the reduction in the PIT. So it's the substitution of
8 the BNRT for the sales tax that really affects their tax
9 burdens.

10 If, at the current kind of tax rate, fully
11 phased in, perhaps close to 4 percent BNRT tax rate, what
12 happens is that the sales-tax reduction, which benefits
13 those people in the lowest two AGI categories, is roughly
14 offset by their higher levels. When the final -- when
15 the dust settles and the incidence of the BNRT finally
16 works its way through the system, they're paying about
17 as much more in the BNRT as they got from the sales-tax
18 reduction.

19 If you go up too much -- if you go to a higher
20 BNRT rate, they still aren't getting much from the PIT
21 reduction, but it starts to overwhelm the benefits of the
22 sales-tax elimination for them, and it starts pushing
23 their effective tax rates up compared to current law.

24 So it is that the bottom two bracket results,
25 net results, are sensitive to the level of the BNRT rate.

1 Is that consistent with your --

2 COMMISSIONER COGAN: Yes, yes. I think it's an
3 easier way of looking at it than my convoluted way.

4 MR. IBELE: Let me just add this. I guess if
5 it were above the 4 percent, it would obviously would
6 depend on if you were replacing another tax and what --
7 I mean if -- and that continued to phase out the sales and
8 use tax or you got rid of another tax in order to phase
9 out the BNRT.

10 COMMISSIONER COGAN: Right. So then for those
11 of us on the Commission that are concerned that the BNRT
12 rate would become very, very high and be damaging to
13 California's business sector and to its economy, and for
14 those that want to, on the other hand, assure at the same
15 time that we don't end up with a significant tax increase
16 on lower-income individuals, both of us have an interest
17 then in establishing a cap on that BNRT in our
18 recommendations.

19 I mean, it seems to me that there's a mutual
20 agreement, whether you look at this from the perspective
21 of too high a tax rate destroys economic growth, or
22 whether your principal source of concern is distributional
23 concerns, and you don't want lower-income individuals
24 facing a higher tax burden.

25 Now, can I ask one more question about your

1 level of certainty about these numbers?

2 The way you describe the process that you went
3 through, you mentioned that you had to consider taxes in
4 California, relative to taxes in other jurisdictions.
5 You know, there's hundreds of other jurisdictions. It
6 seems to me that there is probably a considerable amount
7 of uncertainty in these numbers.

8 And I'm wondering if you could give me some
9 quantitative feel for the amount of uncertainty, maybe
10 going back to the chart right before this average tax
11 rate chart, that shows the tax changes by AGI class.
12 You have it neutral, or zero for the zero to \$20,000 AGI
13 group. \$100 million, is that right, for the \$20,000 to
14 \$50,000.

15 I guess what I'm asking is, what's the variance
16 or the standard error, or your level of confidence around
17 the zero and the 0.1?

18 MR. CLINE: Well, I'm uncertain what that
19 measure of uncertainty would be. But let me see if I can
20 respond to your question.

21 I certainly do understand the challenge of the
22 revenue estimations -- just the amount of the legal tax
23 liabilities, old system versus new, the change in those
24 liabilities. But then finally, the ultimate distribution
25 of those liabilities.

1 Now, we were responsible for the business tax
2 portion of the total tax package. So let me comment on
3 some things we've seen in simulating different -- making
4 different assumptions and looking at the incidence
5 analysis.

6 What we've discovered, I think, from the work
7 that we've done, is that there is some uncertainty about
8 the ultimate distribution or the breakout of changes, who
9 is going to pay the BNRT. There's a lot of -- what seems
10 to be sensitive to the assumptions in the model, the most
11 sensitive, is the distribution between higher prices and
12 lower wages. That's really where the trade-off is, and
13 that's where we can come up with different results,
14 depending upon our basic assumptions in the model.

15 But here is why -- one other thing that we
16 thought about in doing these incidence analyses: We
17 looked at the share of labor, the share of wages and
18 salaries accounted for in the two lowest brackets,
19 lowest-income brackets summed to about 24 percent.
20 Consumption in our model, the consumption spending for
21 those two lower brackets sums to about 28 percent.

22 They're different, but they're not hugely
23 different percentages. So if our assumptions change and
24 we move more from consumption to labor, it might make it
25 a little less regressive at the low end, but it's not a

1 big change.

2 So I think in terms of our analysis, that there
3 is some room there in terms of uncertainty about the
4 division between labor and consumption. I think because
5 the amount that could be shifted back to capital is
6 relatively small to start with, it's not really an issue.
7 And both the labor and consumption piece fall on
8 California residents. They just take a different form.

9 So I think, in summary, I will -- we've looked
10 at that switch between labor and consumption, but it
11 doesn't have a large impact on the overall distribution
12 by income categories. You have to do more to the model
13 than alter some of those parameters, determining the
14 labor/consumption split.

15 COMMISSIONER COGAN: Great. Thanks.

16 CHAIR PARSKY: Go ahead. Edward?

17 COMMISSIONER DE LA ROSA: Yes, thank you very
18 much. I've got a question about the dynamics of the
19 model here.

20 And so if the BNRT does not perform as expected,
21 the worst that happens with the sales tax is that it
22 remains at its current level and it's just not reduced?
23 Is that --

24 MR. IBELE: That could be part of the
25 recalibration or true-up mechanism.

1 COMMISSIONER DE LA ROSA: But would it ever go
2 up?

3 MR. IBELE: Not under the -- because that would
4 be part of the existing, the current system.

5 COMMISSIONER DE LA ROSA: Right. So if the
6 BNRT doesn't perform as expected, then we could expect
7 the sales tax to remain unaltered because it only goes
8 down if BNRT revenues are equal to your forecast; is that
9 correct?

10 CHAIR PARSKY: I think one thing you ought to
11 bear in mind is the magnitude of the dollars we're really
12 talking about. I think that revenue estimates can be off.
13 Certainly, the performance of the BNRT could be off.
14 But in order for the sales and use tax to remain on, the
15 magnitude of the dollars -- I mean, it grows from --
16 under projections, it would grow from about \$30 billion,
17 to something in the neighborhood of --

18 MR. IBELE: Well, in 2012, we had about
19 \$26 billion, growing to about \$33 billion.

20 CHAIR PARSKY: Right. And so the BNRT may be
21 off, but I would suggest that to be off by \$33 billion
22 is highly unlikely.

23 COMMISSIONER DE LA ROSA: Okay.

24 COMMISSIONER BOSKIN: It would mean it was
25 collecting like a third of the revenue that was projected,

1 so that would be pretty far off, but...

2 COMMISSIONER DE LA ROSA: Right. Who would have
3 think state revenues would be at their current level this
4 year?

5 COMMISSIONER BOSKIN: I think the mechanism is
6 designed so that it's something like a half a percent of
7 the sales tax may be delayed and may wind up going to the
8 next year. So we're talking about half a percentage
9 point.

10 COMMISSIONER DE LA ROSA: Thank you.

11 CHAIR PARSKY: Go ahead and let Edward finish.

12 COMMISSIONER DE LA ROSA: Well, here's my --
13 the point is, to the extent -- you know, there are many
14 reasons why the BNRT might not perform -- and I'm not the
15 expert about that. But if it didn't, one of the reasons
16 could be that the economy was suffering, in which case,
17 the sales tax would not -- you know, the sales tax
18 wouldn't be reduced. And given that our economy is based
19 largely on consumption, that that might be a constraint
20 to our ability to come back from a prolonged recession.

21 And the only thing that concerns me about that,
22 is that because the sales tax is so regressive, that the
23 people in the bottom income categories would not get
24 relief as quickly as they might, had the forecast been
25 achieved.

1 MR. IBELE: That's true. Of course, if the
2 BNRT is underperforming, it's likely that the other taxes
3 are not performing as expected, either. There would be
4 different dynamics in place. But you could -- and this
5 goes to the discussion of the recalibration and phase-in.
6 You could have, you know, in Years 2 and 3, maybe it only
7 goes down by a half a cent, or maybe it's a quarter of a
8 cent. I don't know what sort of demarcations you want to
9 use, but that would be one option.

10 COMMISSIONER HALVORSON: So the catch-up
11 mechanism, if the receipts tax is off, is to delay the
12 reduction of the sales tax?

13 MR. IBELE: Right, right.

14 COMMISSIONER HALVORSON: And so there could a
15 time period when the total for -- but since it's a year
16 late, there would be a year when the aggregate tax would
17 be greater than projected here, but it would be a
18 catch-up? So over two years, it would be the same?

19 COMMISSIONER BOSKIN: Yes, by the second year,
20 it would be the same.

21 COMMISSIONER HALVORSON: By the end of two
22 years, it would be the same?

23 COMMISSIONER BOSKIN: Yes.

24 MR. IBELE: It could be a delay. Or you could
25 have, as what was sort of -- we've structured in a --

1 at this point, is also to have a true-up, when we actually
2 know what the revenues were in the previous year and
3 adjust the rate on that basis as well.

4 COMMISSIONER HALVORSON: But you can't go back
5 and do a true-up against a sales tax, because the sale
6 has been made. That has to be a future revenue stream.

7 MR. IBELE: Well, but it could be taken into
8 account in setting the rate for the next -- in January,
9 the following year.

10 COMMISSIONER HALVORSON: Yes, that's what I
11 mean.

12 MR. IBELE: Right.

13 COMMISSIONER HALVORSON: Yes, so it would be
14 a delay in reduction because you can't go back and
15 re-collect a sale.

16 MR. IBELE: Right.

17 COMMISSIONER EDLEY: It could be a delay within
18 the fiscal year?

19 CHAIR PARSKY: Absolutely.

20 COMMISSIONER EDLEY: Because you can catch up
21 in the third or fourth quarter with the sales-tax rate,
22 right, which you couldn't do by adjusting an income tax
23 rate because of the administrative differences.

24 But going back to Ed's point earlier, the other
25 thing that's going on here, and I think one of the

1 limitations in our assignment, under this approach,
2 the comparison as to whether or not the BNRT is
3 underperforming is with the revenue that would have been
4 collected under the current tax system.

5 CHAIR PARSKY: Right.

6 COMMISSIONER EDLEY: So if the economy were
7 tanking again -- which, of course, under this
8 administration isn't going to happen, but just
9 hypothetically, if the economy -- if it were going to be
10 a double-dip, then the State is going to be in big
11 trouble. And this doesn't avoid that fact. But the point
12 is, it won't be in any worse trouble than it would have
13 been under current law, and potentially a little less
14 simply because we don't think the BNRT is going to be as
15 volatile as the income tax is.

16 COMMISSIONER DE LA ROSA: Can I just --
17 actually, my -- I was getting at another issue, and that
18 is that in the event that the BNRT doesn't perform as
19 expected or doesn't perform in a way that allows us to
20 reduce the sales tax, does that mean that the people in
21 the top two -- physically, the top two brackets up there
22 are the last ones to get relief? Because the reduction
23 in the sales tax, which affects them proportionately more
24 than it does me, is delayed by a year because the BNRT
25 doesn't -- and that's the only concern -- my guess is

1 that there aren't many people from those brackets in the
2 room here, so I thought I would ask the question on their
3 behalf, and it's just a concern that I have.

4 COMMISSIONER COGAN: Ed, remember, it's
5 symmetric, too; right?

6 CHAIR PARSKY: Yes, it's symmetric.

7 COMMISSIONER COGAN: It's symmetric, right? So
8 if the BNRT performs better than expected in the context
9 that you've raised, the lower-income groups would benefit
10 the first. They'd be the first to benefit.

11 COMMISSIONER DE LA ROSA: Right, absolutely.

12 COMMISSIONER BARRALES: But, John, to go back
13 to what you're talking about, the less regressivity in
14 the BNRT, in the end, those two groups don't really see
15 relief, overall, according to these numbers here; correct?
16 I mean, in the end, the package is less progressive than
17 the current system that we have today; right?

18 COMMISSIONER COGAN: *(Nodding head.)*

19 COMMISSIONER BARRALES: I've got a couple --
20 on the assumptions that you have before us, what is the
21 rate that you're using for the BNRT?

22 MR. IBELE: The rate that we're using that was
23 incorporated in this analysis was 4.01.

24 COMMISSIONER BARRALES: 4.01?

25 CHAIR PARSKY: I think it's safe to say, 4. You

1 could go 4.00001, but that's okay. I think 4 percent is
2 okay.

3 MR. IBELE: We try to be as precise as possible
4 when we're estimating.

5 COMMISSIONER BARRALES: And, Bob, you had
6 mentioned an industry-by-industry analysis.

7 Do you have that? Is that something -- maybe
8 I may have missed it, but I haven't seen that.

9 Are you talking about comparing how California
10 compares to the other states in this package?

11 And you had mentioned industry by industry.
12 I'm wondering if that's information that you have.

13 MR. CLINE: Well, what we did in estimating
14 the incidence distribution, is that we started with the
15 dollar estimate of the total BNRT taxes that would be
16 collected in 2012, and then we made an assumption about
17 how those legal liabilities are distributed by major
18 industry categories. And then we ran that through the
19 incidence model to get the ultimate shifting of the tax.

20 That's only a piece of the information needed
21 to talk about the industry-by-industry changes in the
22 legal liabilities. We did not look at the -- you would
23 have to compare it to the current law --

24 COMMISSIONER BARRALES: By "legal liabilities,"
25 do you mean taxes?

1 MR. CLINE: If you have a corporate income tax
2 that manufacturers are required to pay, the FTB might
3 have estimates of how the current taxes are assigned to
4 the manufacturing industry in terms of who actually files
5 the return and pays the dollars and taxes. And that would
6 be your starting point for doing the incidence analysis
7 of current law as well as the proposed package. But we
8 did not put together the final distribution of the legal
9 liabilities by industry for the proposal.

10 COMMISSIONER BARRALES: Okay, thank you.

11 CHAIR PARSKY: Jennifer?

12 COMMISSIONER ITO: Thanks.

13 I do have a couple questions. The first, just
14 so I can understand how this breaks down in terms of
15 individuals.

16 So what we're saying then for those first two,
17 in the other chart around the tax change by AGI class,
18 so the two income brackets that are really not getting
19 any benefits from this overall proposal accounts for about
20 10 million people. Is that because there are 4.6 million
21 in the zero to 20, and 5.5 million in the 20 to 50,
22 versus is it the 37,000 that are going to get the greatest
23 in the millionaires?

24 MR. IBELE: You know, we have a number of
25 returns under the personal income tax. We actually don't

1 have a number of people. But in terms of the number of
2 returns, it's about 10 million -- is that right?

3 Ten million returns out of 16 million.

4 COMMISSIONER EDLEY: In the zero to what?

5 MR. IBELE: In the zero to 50.

6 COMMISSIONER ITO: Combined, from the zero to
7 50.

8 CHAIR PARSKY: But it doesn't include the
9 nontaxpayers.

10 MR. IBELE: It doesn't include --

11 CHAIR PARSKY: So it's a much bigger group.

12 COMMISSIONER ITO: Much bigger.

13 CHAIR PARSKY: And at least what's on the table,
14 we're not touching the nontaxpayers.

15 COMMISSIONER ITO: Okay. And then for the
16 over a million, it's about 37,000; is that -- yes?

17 MR. IBELE: Yes. Just on the PIT.

18 COMMISSIONER ITO: Okay. And then the second
19 question is around the -- I have a question about the
20 \$6.9 billion that we would basically be exporting some
21 of the tax burden.

22 What is your sense of how that would hold up
23 to legal challenges? And then secondly, the state's
24 ability to actually collect that revenue?

25 MR. IBELE: Well, the 6.9 in exported taxes is

1 really a combination of deductibility from federal income
2 taxes. So it's not a legal question of collecting it,
3 and the amount of shifting that goes on with,
4 particularly, the business net-receipts tax, how much is
5 shifted to investors out of state or consumers in that
6 process. So that's what that figure is.

7 CHAIR PARSKY: I think just stay with this
8 concept, though, a little bit.

9 I think Mark is certainly right, that it's not
10 the legal question so much; but I think it is important
11 to focus on the fact that the benefits that -- if you
12 list benefits -- but the benefits derived from the entire
13 shift of the system away from a dependence on the personal
14 income tax in terms of total dollars, despite, within
15 the personal income tax remaining the progressivity, or
16 giving everyone a reduction; but the benefits of becoming
17 less volatile, and broadening the tax base at lower rates
18 are, in effect, borne by nonresident and federal offset.
19 I think that's at the heart of this chart.

20 MR. IBELE: Yes. I mean, I guess one way to
21 think about it is, we're reducing the personal income
22 tax by some \$17 billion, and we're reducing the consumer
23 part of the sales and use tax, both of which are paid by
24 Californians. And we're shifting away from those to a
25 tax that is -- a large portion of which is exported.

1 COMMISSIONER ITO: Well, actually, and then I
2 have one last question, because we haven't had a lot of
3 time to talk about the reserve or the proposal, as
4 written in the reserve last time. But I was just
5 wondering in terms of, if we are putting together a
6 proposal that, overall, reduces volatility, what the
7 rationale was for proposing a reserve that's so much
8 more regressive than what we had seen before?

9 CHAIR PARSKY: Well, let's pause on that because
10 I do think Chris, I know, and Mike have had an exchange
11 a little bit about how we should characterize that
12 reserve.

13 The objective outlined in the last meeting was
14 to send a message that basically said the issue of
15 volatility needs to be addressed both with a -- at least
16 the message is both with a reduction in the dependence
17 on the personal income tax, and the creation of a real
18 rainy-day fund.

19 How we articulate that, I think we want to make
20 sure everybody understands.

21 So, Mike, do you want to start?

22 COMMISSIONER BOSKIN: Can we come back to me?

23 CHAIR PARSKY: You want to come back? Sorry.

24 Maybe we'll come back to that. We do need to
25 have a complete discussion of that because we want the

1 staff to have some direction on how to finally craft it.

2 Go ahead, Michael.

3 COMMISSIONER BOSKIN: I just want to emphasize
4 that the primary -- the primary appeal of the business
5 net-receipts tax for all its potential issues, of which
6 there are many -- and remember, we're only suggesting
7 this be thoroughly vetted -- we're recommending they
8 thoroughly vet it, not adopt it -- is that this package
9 enables us to deal with the charge that was laid to us,
10 which was to reduce volatility on the revenue side, to
11 have a more pro-growth, pro-competitive tax system,
12 et cetera.

13 If all that works out -- I'm going to say a
14 word or two about that in a second -- and keep one that's
15 still fair -- and I'm going to say a word about that in
16 a second -- we're able to do that without burdening low
17 and lower-middle-income Californians, which I know is a
18 very important thing to a large number of people -- most
19 especially them, but including a large number of
20 commissioners, which is quite a legitimate concern.

21 So I think that's kind of, in a sense, the
22 beauty of the solution, leaving aside -- the other side --
23 all the warts for future discussion in a minute.

24 If we could go to the other chart on the
25 effective tax rates.

1 So you'll notice, we still have a progressive
2 tax system in effective rates, let alone in the marginal
3 rates and the income tax, which Gerry mentioned.

4 Now, Bob, isn't it the case that in the
5 50-state incidence study, there are very, very, very few
6 states that have an effective tax rate, at the top,
7 higher than in the middle?

8 MR. CLINE: The Institute for Taxation and
9 Economic Policy, ITEP, did a series of studies looking
10 at 50 state tax-incidence analyses. And the latest study
11 I could quickly find from ITEP made the statement that
12 there were only four states in the United States that had
13 effective tax rates at the top end of the distribution
14 of income higher than the effective tax rates for
15 middle-income taxpayers. And those four states were:
16 Vermont, Montana, Delaware -- what's different about this
17 picture -- and California.

18 COMMISSIONER BOSKIN: So it would be a
19 case then, a fortiori, looking at the green line, that
20 still doing that, California would have no worse than the
21 fourth-most progressive tax system?

22 MR. CLINE: It is true that if the tax
23 distribution in California remains with that upward slope
24 after about the \$50,000 range, that it would be one of
25 the very few states in the U.S. that had progressive tax

1 systems. Because most states rely heavily on sales taxes
2 and excise taxes and more heavily on the property tax,
3 you just --

4 COMMISSIONER BOSKIN: Many of them have
5 flat-rate or --

6 MR. CLINE: Have flat-rate income taxes, or
7 they have progressive income taxes that have the highest
8 rate at a very low level of income; so they are, in
9 effect, flat rate taxes. So you very -- there are only
10 that handful, if that many states, that have progressive
11 overall systems.

12 COMMISSIONER BOSKIN: So even at the end of
13 all this and shifting \$7 billion of the tax burden out of
14 state, off of Californians, we'll get less volatility,
15 hopefully some better incentives -- I'm going to say
16 one word about that in a second -- the expense of
17 non-Californians, not at the expense of lower- or
18 middle-income Californians; and we will still have one
19 of the most progressive in terms of the effective rate,
20 and our top tax rate, which would then be -- the top
21 marginal tax rate, which would then be 7.5 percent to
22 6.5, plus the 1 percent in the Constitution, would still
23 be roughly 25 percent higher than the top marginal tax
24 rate in the typical state with an income tax, which tend
25 to vary -- tend to bunch mostly in the 5 to 6, or low 6

1 percent range. There are a few that go higher, New York,
2 for example, and a few others.

3 So it's not like -- so even though it is true
4 that we're making the tax system less progressive, it's
5 still, compared to our peers, is going to be substantially
6 more progressive than the vast bulk of them.

7 Now, let's come back to this issue of the
8 aggregate revenue. Not included in any of this -- if
9 all this works out -- and I would agree with Ed, in
10 particular, that there's a lot of issue about not just
11 the administrative mechanics and the revenue projections,
12 we have to all wonder what this is going to do with the
13 California economy, I think he's quite right to raise
14 that question.

15 The bet is that the elimination of the corporate
16 tax, lowering the sales tax, lowering these marginal rates
17 and the income tax and replacing them with the two rates,
18 despite adding a lot of new business taxpayers, who may
19 turn out to be tax collectors if they can pass it on or
20 not, and the, in effect, extension of a business tax,
21 which may be paid in part by consumers and in part by
22 labor, as well as by business on services, that then
23 unbalance will help the state's competitiveness. That's
24 the overall judgment.

25 And if that's the case, that actually should --

1 other things being equal, the national or global business
2 cycle, we can't control for that, California is deeply
3 integrated into that, should help the economy.

4 So any of the additional revenues coming from
5 that -- now we can argue whether that's a teeny amount
6 or a modest amount, maybe some people would say it's an
7 enormous amount -- I wouldn't, I would say it's more
8 likely to be modest. But all that is still showing up
9 to be spent by the Legislature. There is nothing in
10 anything we're doing other than if it is so substantial
11 that it overwhelms the ten-year trend, some of it will go
12 into the rainy-day fund. But basically, it's free banking
13 of any growth effects, either this year's spending or in
14 the future, with the rainy-day fund; right?

15 MR. IBELE: *(Nodding head.)*

16 COMMISSIONER BOSKIN: Okay, so just adding on
17 to sort of what's in it for the people, for my good
18 friend, Chris.

19 Now, that being said, there are all these issues
20 about will it raise enough revenue? Will it harm some
21 industries or some sectors' competitiveness? Those are
22 quite legitimate. And those are -- and will it be used
23 to grow revenue? Even if we put in a cap at our
24 recommendation, the Legislature might not keep it. They
25 might bust it in the future, all these other things about

1 growing government and so on, all those are big issues.

2 I think we all just have to look at ourselves
3 and say, "Look, does this package accomplish enough good
4 that -- and enough of our concerns are dealt with in some
5 way, they're willing to swallow the stuff, if we were
6 writing it ourselves, we would put in, that isn't going
7 to be in here, okay." And so that's how I think of it.

8 And I think we should spend a bit more time on
9 how it might affect the economy, because I think that is
10 probably -- we have been legitimately concerned, and spent
11 extensive time, and may need to spend more time still, on
12 whether enough revenue will come in. But we really do
13 need to come to a judgment about whether this, on balance,
14 is going to help the California economy. And I don't
15 think we've discussed that quite enough.

16 CHAIR PARSKY: George?

17 COMMISSIONER HALVORSON: Yes. Kind of a general
18 comment/question. If 29 of the top 30 economies in the
19 world use a value-added tax because they think it creates
20 a stability and because it creates a revenue stream that's
21 absolutely dependable and because it seems to be a fair
22 way of collecting money, there's a certain leverage that
23 makes sense for our thinking that kind of points in that
24 direction. I do have a concern about the calculation of
25 the net revenue and whether or not the health-care

1 expenses are included in that calculation and how they
2 are included.

3 One of the things that's true in the world is
4 that everybody else collects taxes to pay for health care.
5 And if we include that as a taxable item, as we're adding
6 value, then we, in effect, will be taxing health care to
7 pay for other things, which will be, again, in direct
8 contradiction to the rest of the world, probably more
9 than a little regressive and possibly, I think, an
10 inappropriate way to do the calculation.

11 And I'm not entirely clear about how you dealt
12 with health-care expenses as you've been calculating the
13 net revenue.

14 The health-care expenses I'm referring to as
15 the amount of money that employers pay to buy health care
16 for their employees.

17 MR. IBELE: When we asked Ernst & Young to do
18 their initial analysis of a business net-receipts tax,
19 we used a fairly traditional description of what a
20 value-added tax is. And as part of that, we did not --
21 ask them not to allow deductions for employee
22 compensation, including health benefits and -- well,
23 payroll taxes and some other items. So as it currently
24 stands, that is not allowable as a deduction based on
25 our current estimates.

1 Now, as to whether that is not the view that
2 the Commission has, that there's another alternative view
3 that it would like to pursue, we can certainly incorporate
4 that as part of the package.

5 COMMISSIONER HALVORSON: I think we should take
6 a look at including an alternative view as part of the
7 package for a number of reasons. One of them being the
8 fact that it does tend to be an expense relating to
9 people's personal health care. And in the world we live
10 in, people can choose to buy a car, they can choose to
11 buy a television set. They don't choose to have cancer.
12 Any expenses relating to cancer are expenses that ought
13 not to be part of the tax base. That ought to be
14 something that is, I think, exempted from the taxable
15 value-add for the organization.

16 The second point on that is that if the
17 health-care reform package is passed that are in front
18 of Congress now, that are in front of both houses of
19 Congress, employers are going to be mandated to offer
20 health coverage. And so it's going to be a mandated
21 expense in addition to being a normal business expense.
22 And the minute it becomes a mandate, I think there's a
23 justification taking it out of the value-add as well.
24 So I would recommend doing that.

25 CHAIR PARSKY: One comment I would make. A

1 number -- several commissioners have expressed a view
2 relating to health benefits, similarly. One suggestion
3 to think about, there are a number of items, policy
4 choices, if you will, that the Legislature, in finalizing
5 an approach to the BNRT, if they so choose to do it, they
6 would have to make. One of the objectives that we had
7 was trying, because of the impact that it has both on
8 business and on the lower-income groups, to keep the
9 BNRT rate as low as we possibly could.

10 The inclusion, if you will -- and in calculating
11 this rate at about 4 percent, we got there, in part, by
12 not allowing a deduction, which would significantly erode
13 the base available to be taxed and, therefore, the rate
14 would have to go up.

15 I think it's more than appropriate to identify
16 in our report areas that we did not include, such as this
17 deduction, that further consideration ought to be given
18 to. But make sure it's clear that there is an interplay,
19 if you will, between rate and exclusion, or rate and
20 policy choices. This would be one.

21 There are -- I'm not saying -- we don't have
22 to identify which, but there are some commissioners that
23 said, "Well, maybe we should consider that the tax should
24 apply to nonprofits." That's not included in this
25 suggestion. But that kind of cuts the other way.

1 COMMISSIONER EDLEY: Not George.

2 CHAIR PARSKY: No. No commissioner is
3 nonprofit...

4 No, no, but my point is, I think it would be
5 more than appropriate to identify.

6 We included in this proposal an R & D credit.
7 And that is included. It doesn't have a large impact
8 on rate, but it was strongly recommended by several
9 commissioners.

10 So I think it's very important and very
11 consistent with our concern about the magnitude of this
12 tax, the complexity of it and its impact and the interplay
13 between rate and these policy decisions to identify many
14 of them.

15 COMMISSIONER EDLEY: Can I, if I may?

16 As I understand it, this is about 10 percent
17 of the base?

18 MR. IBELE: Contributions for health benefits
19 and pensions and payroll taxes is about 10 percent --
20 is that right, Bob?

21 MR. CLINE: The sum.

22 MR. IBELE: The sum of those.

23 COMMISSIONER EDLEY: The sum of those is 10?

24 MR. IBELE: Yes.

25 COMMISSIONER EDLEY: So if we did -- so that

1 would be 0.3, 0.4 added to the BNRT, if we made all of
2 those deductible?

3 MR. IBELE: Correct.

4 COMMISSIONER EDLEY: What is the -- what about
5 the health-care expense deduction in the PIT that we're
6 eliminating? What's the approximate size of that tax
7 expenditure?

8 Just make up a number.

9 MR. IBELE: We don't do that.

10 CHAIR PARSKY: Pat does not make up numbers.
11 I can attest to that over this eight-month period, you
12 know.

13 COMMISSIONER EDLEY: You know, "X," "Y"...

14 MR. IBELE: The health benefits, except for the
15 itemized deduction, are above-the-line deductions. So
16 we're not eliminating those.

17 COMMISSIONER EDLEY: Right.

18 MR. IBELE: So the only one that we're
19 eliminating is the health-care expenses in excess of, I
20 think it's 3 percent; is it?

21 COMMISSIONER EDLEY: I think it's 7.

22 COMMISSIONER COGAN: 7½ percent.

23 CHAIR PARSKY: 7½ percent as well.

24 COMMISSIONER EDLEY: Okay, so that's still
25 above line, that's above line, so we're not getting rid of

1 that.

2 MR. IBELE: Right.

3 COMMISSIONER EDLEY: I mean, this is probably
4 worth thinking about a little bit, because I certainly
5 appreciate the conceptual point about these as
6 compensation items, but I kind of get a headache --

7 CHAIR PARSKY: You do not know the agony that
8 we --

9 COMMISSIONER EDLEY: Yes, but also thinking
10 through the connection with health-care policy more
11 broadly and what's going to go on now with respect to --
12 I hope -- with respect to employer mandates and the like.

13 I mean, there is a middle ground that might be
14 appropriate to consider for Part 3 recommendation, which
15 would be to make half of it -- you know, take 50 percent
16 or something and add 0.2 to the BNRT. So maybe, while
17 we're having coffee or something, that would be worth
18 considering.

19 I would be reluctant to just completely punt to
20 the Legislature and say, "Here's an issue, and you guys
21 figure it out." But -

22 COMMISSIONER BARRALES: Is that what we're
23 doing?

24 COMMISSIONER EDLEY: Isn't that what we're doing
25 generally? Right.

1 CHAIR PARSKY: Well, clearly -- clearly it's
2 important to identify policy choices that need to be
3 made. But I think it is particularly important to
4 recognize the interplay between rate and any of these
5 choices because the rate has such an impact on two areas
6 that are very important to the entire Commission, namely,
7 not -- wanting to encourage business growth, economic
8 development, and job creation, and not penalize the
9 lower-income groups. And both are impacted as the rate
10 moves up. I think we have to identify that and mention
11 these policy areas where commissioners have indicated that
12 that's something that's got to be looked at.

13 COMMISSIONER HALVORSON: Well, there's a sort
14 of reciprocal regressivity in the fact that low-income
15 people have their health benefits as a much larger portion
16 of their income. So to the extent that it's a taxable
17 item, it's actually somewhat regressive in that area as
18 well.

19 And if the federal government does go down the
20 path it's going to go down -- and I think it will because
21 the Massachusetts model seems to be the model we're
22 evolving to as a country -- and it will be like
23 Massachusetts on slight steroids. There's a likelihood
24 that this is going to be a requirement for employers to
25 offer this. And to make it a requirement and then to not

1 give credit to it as an expense, I think, would be
2 inappropriate policy.

3 CHAIR PARSKY: Okay, but my question is, other
4 suggestions around the material -- save the rainy-day
5 fund -- but other questions around the distribution, the
6 impact that we want to be made. And then what I think
7 I would suggest is we allow the public to comment, take a
8 break, and then come back and talk about the balance of
9 the potential package.

10 COMMISSIONER BOSKIN: Maybe Jennifer wants to
11 raise some questions.

12 CHAIR PARSKY: Yes, but I think --

13 COMMISSIONER EDLEY: After the public comment?

14 CHAIR PARSKY: Yes, after the public comment.

15 COMMISSIONER EDLEY: Can I ask a question about
16 the -- I'm sorry, Becky, your light's on. Were you --

17 COMMISSIONER MORGAN: It's been on for a while,
18 yes.

19 CHAIR PARSKY: Okay, and then Fred.

20 COMMISSIONER MORGAN: You're going to do the
21 rainy-day fund later?

22 CHAIR PARSKY: Right after the break.

23 COMMISSIONER MORGAN: Okay, then I'd go on
24 record with Mr. Halvorson about the insurance. If it's
25 going to be mandated, it should be deductible. Otherwise,

1 it's contrary to our goal of a healthy nation.

2 And I'd like to ask some questions. And if
3 later is appropriate, fine. But I wonder -- but I guess,
4 I'll state my question, you can tell me if it's out of
5 line.

6 But I would ask staff if, because of the
7 uncertainty of all of this, in the two years that the
8 Legislature has to vet what we propose, would it be
9 possible to go back to ten years and take real returns,
10 and returns under this proposal, and so that the
11 Legislature, during their process, has more history?

12 MR. IBELE: Well, we have asked the Franchise
13 Tax Board to begin -- they're well into modeling this
14 particular tax using returns, and from the ground up, as
15 you will, we could ask them as part of that process to
16 perhaps reconstruct the behavior of that tax in the prior
17 ten years as well.

18 COMMISSIONER MORGAN: I would think that would
19 be helpful, because what we've been told is these are
20 based on 2007 revenues.

21 MR. IBELE: Right.

22 COMMISSIONER MORGAN: And those are quite
23 different than 2008 and 2010 -- and I suspect what 2010
24 will be.

25 MR. IBELE: Well, it's based on 2007 data,

1 right.

2 COMMISSIONER MORGAN: Right. And so it seems
3 to me, that we need to average that out to be a little
4 more certain of what the future will hold.

5 CHAIR PARSKY: Just one clarification on your
6 comment, Becky, on the health.

7 Is your comment, if the health benefits are
8 mandated, then you feel strongly it should be deducted
9 from the base, irrespective of the rate; but if not, you
10 would feel differently?

11 COMMISSIONER MORGAN: Well, I think if we're
12 moving to trying to have a healthier society, that not to
13 allow employers, whatever their size, to deduct what they
14 pay on behalf of their employees, would be contrary.

15 CHAIR PARSKY: Fred?

16 COMMISSIONER KEELEY: Thank you, Mr. Chairman.

17 Mr. Chairman, let me follow up on the Senator's
18 question and Mr. Halvorson's.

19 You wish to proceed how, on that question?

20 It sounded to me a minute ago as if what you were
21 recommending is that in the drafting of the accompanying
22 legislation that you have here, that the R & D tax credit
23 is included as part of the architecture of the package;
24 and that the health-care question that has been raised by
25 Mr. Halvorson and by Senator Morgan is not addressed. If

1 I understand what Mark said, he gave us a double-negative
2 answer -- you did not ask them not to include it, as I
3 recall, is what you said, in Ernst & Young's calculation;
4 is that correct?

5 MR. IBELE: Yes, that is. It's considered part
6 of compensation in the current modeling.

7 COMMISSIONER KEELEY: So I'm wondering if the
8 Chair would, again, give us some guidance about how you
9 would think we would proceed to resolve that question?

10 I thought what I heard you say is that perhaps
11 you would recommend that we not make a change in the
12 package relative to that particular issue, but that we
13 highlighted in the report, that it's an issue that the
14 Legislature would have to wrestle with.

15 Did I get that right?

16 CHAIR PARSKY: You did.

17 COMMISSIONER KEELEY: Okay. My own particular
18 feeling about it is that that is an important decision
19 to make, it has been raised on previous occasions. It's
20 getting raised again.

21 I don't know what the sense of the Commission
22 is on this; but if I understand the interplay, if we
23 included it, essentially, as a deduction or an exemption,
24 however the Commission should choose to deal with it, that
25 that would have an upward pressure on the BNRT rate; is

1 that correct, sir?

2 CHAIR PARSKY: That's right, in the range of
3 about 0.4 to 0.5.

4 MR. IBELE: That's if we included --

5 COMMISSIONER BOSKIN: No, no, no, not nearly.
6 0.4 is including payroll taxes and insurance and other
7 things.

8 CHAIR PARSKY: Oh, I'm sorry, you're right.

9 COMMISSIONER BOSKIN: It's about 0.2, maybe.

10 MR. IBELE: The health portion is about
11 4 percent or 5 percent erosion in the base, so...

12 CHAIR PARSKY: About 0.2.

13 COMMISSIONER EDLEY: An R & D tax credit, by
14 the way, was about 0.1? Isn't that what --

15 MR. IBELE: Less than 0.1.

16 COMMISSIONER KEELEY: Mr. Chairman, I know that
17 it's your desire not to have votes, necessarily, but to
18 try to discern a sense of the Commission in resolving
19 independent issues, sequential items that come up in
20 front of us.

21 I'm speaking certainly only for myself, I would
22 think that the Commission should, in fact -- I think a
23 compelling case has been made to include this cost in
24 the package. Because I don't understand or at least I'd
25 like to hear the argument for not including this in the

1 calculation, and leaving the question open to the
2 Legislature. I don't think that this is a small or
3 tangential issue. It seems like it's a large and central
4 issue. And so I would, for one, be interested in seeing
5 this included, even if the practical effect of that is
6 to have an upward pressure on the BNRT rate.

7 CHAIR PARSKY: I think it's very legitimate.
8 And I would think before we leave, we'll try to get a
9 sense of the Commission.

10 But I think, Bob, if you could articulate, from
11 the standpoint of the basic BNRT or value-added concept,
12 and why, in the context of that, such an item or other --
13 this item and any other items would not naturally be a
14 deduction.

15 MR. CLINE: Mr. Chairman, I certainly can't
16 comment on the policy question of should it be subtracted
17 or not from a policy perspective; but I could comment on
18 the way economists think about the value-added tax and
19 what the tax base measures or what you're trying to
20 measure.

21 It goes back to kind of a statement that was
22 made very early in the process about the fact that a
23 value-added tax is not a profits tax. Your perspective
24 shifts to -- the basis for taxing business, is the value
25 of government services -- goods and services, provided

1 to citizens as well as the business. And, therefore, one
2 measure of the business use of public services would be
3 the value that the business adds to things it buys from
4 other businesses, and then sells to the final customers.
5 That is a measure of kind of the activity of the business
6 in the state, and it would be a proxy base for determining
7 what tax they ought to pay to contribute to public
8 services.

9 So then you ask, well, how could you actually
10 calculate that activity within the state? And there
11 really are two different ways of doing it, and they should
12 be equivalent. Mathematically, you could probably set it
13 up so you get the same answer.

14 You could take your total revenues that you
15 sell to other -- from your sales, and you subtract your
16 purchases from other companies. And that isolates your
17 value-added or level of activity.

18 It is also true that you could get to the same
19 result by adding up your payments to capital and your
20 payments to labor. But the payments to labor would be
21 everything related to labor: Wages and salaries, pension
22 payments, workers' compensation, uninsurance taxes,
23 health-care insurance purchases. All of that would be
24 part of the compensation paid to labor, in the same way
25 that you would put in all of the payments to capital,

1 whether it's retained earnings or dividends paid or
2 interest paid. That's part of the return to capital.

3 So with that as the perspective of what the
4 base and theory would be under a value-added tax, you
5 start to have the discussion about, well, are there some
6 payments to capital that shouldn't be included, or are
7 there some payments to labor that shouldn't be included?

8 But whether you're doing it as the subtraction
9 method -- total revenue minus your total purchases from
10 other firms -- or you're doing it as the sum to all the
11 payments to capital and labor, you're making the same
12 decision. Are you going to leave out part of value-added
13 from your base because there is some other rationale,
14 outside of the value-added perspective or policy issue
15 that you want to deal with?

16 But I would say it is a variation from what is
17 the conceptual basis of a value-added tax.

18 I hope that I've just --

19 CHAIR PARSKY: Is that helpful?

20 COMMISSIONER EDLEY: I would just add a small
21 thought here, and totally understanding the perspective
22 of economics. Looking at it more like a normal person,
23 however, I just want to note that if we move in the
24 direction with federal policy, as we seem likely, and
25 there is some form of a mandate, I can promise you that

1 California companies are likely to be disadvantaged in
2 the way that's constructed relative to firms in lots of
3 other states. And I say that simply because we have
4 relatively higher health-care costs.

5 So my expectation would be that whatever
6 eventuates nationally is -- while in the aggregate,
7 terrific, I think there's going to be -- there's likely
8 to be some special burdens for California firms, which
9 also kind of militates in favor of our having a BNRT
10 approach to this that gives firms a little bit of relief
11 with respect to their health-care cost expenditures going
12 forward.

13 CHAIR PARSKY: It seems to me -- and we want
14 to think a little bit about this, maybe there's three
15 possible approaches, none of which exclude the
16 identification of this as an issue. It would be
17 identified. One approach would be to leave the proposal
18 as written, with the commensurate indication of the rate
19 that it would result in, approximately 4 percent -- not
20 4.01, but that's okay. That's one approach. But still
21 identify this as an issue of concern by the Commission
22 and one that needs to be addressed.

23 The other is to go the other way, and indicate
24 that the Commission is recommending an allowance of this
25 deduction, but indicate that it affects the rate by

1 approximately 0.2 percent, and that it's something that
2 needs to be -- continued to be addressed.

3 And the third possibility would be to indicate
4 that should the mandate at the federal level occur, the
5 Commission feels strongly that, irrespective, that it
6 should be a deduction. And maybe we want to just think
7 about that. There may be 14 other alternatives. But it
8 seems that we've, in all cases, given the commissioners'
9 concern, we ought to make sure that we address it.

10 COMMISSIONER HALVORSON: One other quick point
11 on that is that one of the value-added tax precepts,
12 typically, is not to double-tax anything. And most of
13 the inputs into health care have already been taxed. The
14 pharma stuff, the technology stuff, the physicians all
15 pay. It's already been taxed. And so we're into a
16 double-taxation mode if we tax it again.

17 CHAIR PARSKY: You were adequately represented
18 by Mr. Cogan in that discussion.

19 Bill?

20 COMMISSIONER HAUCK: One more question of Bob.

21 As you were describing the BNRT, I got that
22 feeling that you were assuming that California businesses
23 would pass on to consumers virtually all of the BNRT. And
24 I wonder whether that's true.

25 And then secondly, if it is, does that speak

1 to what you think about the California economy's
2 competitiveness today, which is to say that our economy
3 relative to others in the country is not competitive?

4 MR. CLINE: Well, our analysis did not look at
5 the competitiveness of California compared to other
6 states. Our incidence analysis did look at the levels
7 of taxes in California on business compared to other
8 states, but we did not do a full-blown competitiveness
9 analysis.

10 But back to your first question, which is the
11 sort of getting at my description of what a value-added
12 tax is in concept. I think the accurate description is
13 that the base for determining your liability is the
14 difference between your total revenue and your total
15 purchases from other firms. It approximates your level
16 of activity, measured in dollar terms, within the state.
17 It's what the firm contributes in addition to what other
18 firms did in creating activity or value-added.

19 But then the next question is, who ultimately
20 bears the burden of that tax that's been calculated on
21 value-added? And I don't want to leave my incidence
22 framework. I'll still come back and say, it's a
23 complicated story, and ultimately, it's divided between
24 consumers through higher prices, labor through lower
25 wages, and capital through lower rates of return on

1 investment, and some being shifted to the federal
2 taxpayers through deductibility. So the incidence doesn't
3 change. So I'm not assuming that the tax is passed along,
4 ultimately and fully in higher prices to consumers.

5 COMMISSIONER HAUCK: I'm wondering here how --
6 in California, I'm wondering a number of things. But
7 among them is how lower wages would go over with many,
8 either businesses, labor organizations, employees, for
9 the recipients of those lower wages in a state where the
10 cost of living is generally higher than it is elsewhere
11 in the country?

12 COMMISSIONER BOSKIN: Well, remember just one
13 thing, it's a sizable fraction of the California corporate
14 tax is borne by California consumers and workers.

15 Conceptually, the easiest way to think about it
16 is, if we are just at the average of all the states, and
17 America was a closed economy, that probably would wind up
18 being borne by capital because it didn't go anywhere,
19 because capital is so mobile across -- even more mobile
20 than labor across state lines and globally. The
21 differential is heavily borne by workers and by consumers.

22 Now, they have an industry model. I can't
23 comment because I haven't seen it. I don't know what
24 industries are going to be able to pass it forward and
25 which aren't. So it depends a lot on the competitive

1 structure with respect to other states and so on.

2 But that being said, there is a net of all
3 this. And it's also the case that the income tax has to
4 be -- employers have to compensate for the income tax.

5 So when a typical multistate employer transfers
6 somebody from Colorado to California, among the things
7 they have to adjust for is the difference in the state
8 income tax. That's done kind of routinely.

9 So there is some compensation. It is an issue,
10 but there is some compensation -- there is some offset
11 would be a better phrase than "compensation." I don't
12 mean to be coining a pun here. But there certainly is
13 an issue.

14 CHAIR PARSKY: I think you all --

15 COMMISSIONER BOSKIN: And the good news is
16 \$7 billion of this has shifted out of the state off of
17 California labor, California capital, and California
18 consumers.

19 CHAIR PARSKY: Another way to look at it or
20 to think about it: The existing system discourages --
21 I think this is a safe statement -- the existing system
22 discourages investment in equipment, in plants, and in
23 productive facilities in California, biased against that
24 capital investment through high corporate rates,
25 et cetera.

1 The new system would remove some of that
2 disincentive for capital investment in capital equipment
3 and, as a result, ought to expand employment and jobs.

4 COMMISSIONER HAUCK: Well, I appreciate the
5 points both of you have made. I would just say that,
6 particularly with respect to your comment, Gerry, that --
7 my guess is that the disincentive with respect to plant
8 and equipment and capital investment in California is at
9 least as much and perhaps more related to the regulatory
10 structure of the state, as well as the uncertainty of
11 doing business here and the time that is required to
12 accomplish something here as opposed to, let's say, one
13 of the other western states. A few years ago, we asked
14 Bain & Company to do some work for us on this subject.
15 And I'm not going to expound upon it at length here; but
16 the conclusions, with respect to the cost of doing
17 business in California that they reached were, compared
18 to the western states, the major -- if you want to call
19 it that -- disincentives first, was the cost of energy
20 in California -- much, much higher on average than
21 elsewhere -- as well as the cost of regulation, the cost
22 of land, workers' compensation.

23 Taxes were not even in the top five or six.
24 I'm not sure they were even on the list.

25 The best example was housing. They did a case

1 study, comparing a housing tract in Arizona versus
2 California. And they were the exact same houses. And
3 it took, in California, more than a year longer to get
4 the approvals that were required for the same quality of
5 housing, the same structure.

6 So I know this is a discussion about taxes,
7 but I think some perspective here is important from the
8 standpoint of, at least as it stands today, the importance
9 of taxation -- business taxation in California in relation
10 to some of these other factors.

11 CHAIR PARSKY: I think you're 100 percent right.
12 And I think it will be very important that we identify
13 the fact that other areas of reform, and particularly,
14 the impediments placed on corporations through the
15 regulatory apparatus, be identified in our report for
16 others to consider.

17 I haven't heard a desire on the part of
18 commissioners to extend this commission to include
19 looking at all of those things. But organizations like
20 California Forward --

21 COMMISSIONER HAUCK: I'm clearly not making that
22 case, either.

23 CHAIR PARSKY: I didn't think so, but I just
24 want to make sure we clarified that.

25 But no one should take away from the discussions

1 we've had, nor from a report that we make, that this is
2 going to solve the question of an environment to promote
3 growth, business development, and, therefore, jobs. But
4 we do have to show the relationship between the
5 recommendations we're making and those overall goals.
6 So although it may be minor in its ultimate achievement
7 of that goal, we still have to measure it against it.

8 If there are no other questions --

9 COMMISSIONER EDLEY: Sorry, Gerry.

10 CHAIR PARSKY: Yes?

11 COMMISSIONER EDLEY: Virtually everything I
12 wanted to raise has been settled except for one issue,
13 and that's the timing of the phase-in of the BNRT.

14 And on this -- I mean, I guess I have to blame
15 Jennifer for tweaking my interest in this particular
16 topic.

17 Why not do a much faster, bolder first and
18 second step with the BNRT, and do more reductions in the
19 other taxes correspondingly? In other words, instead of
20 starting at 1.6 or 2 percent, why not start at 3 percent?

21 And here's the argument in favor of doing that:
22 If there are going to be dynamic adjustments in firm
23 behavior that have important consequences longer term for
24 revenues, et cetera, I think the sooner we get a signal
25 of that through implementation of the BNRT, the better.

1 And so instead of starting out gently, I'd say, okay,
2 we're really doing this, but then give offsets in the
3 sales and the PIT and the corporate to still make the
4 package revenue-neutral, and still the same kind of
5 truing-up with the sales tax and so forth.

6 It doesn't seem to me there's any magic about
7 the 1.6, except that we just wanted to have firms
8 experience this as sticking a toe in the water. But I
9 don't think we really gain much by that; and I think we
10 might lose important information by going too slowly.
11 So that's what -- am I wrong about this?

12 Mark?

13 COMMISSIONER MORGAN: Could I just say that
14 if we're allowing the Legislature two years to vet this
15 process, I'm not sure whether it's 1.6 or 2 or 3 is going
16 to make a difference.

17 COMMISSIONER EDLEY: Right.

18 COMMISSIONER MORGAN: Because they will set the
19 rate.

20 COMMISSIONER EDLEY: Right. That's true.

21 And in that sense, I think that what we could
22 do is -- I mean, we ought to think about what makes more
23 sense in terms of developing that information, testing
24 out what dynamics there might be in a new system.

25 COMMISSIONER BOSKIN: Chris, I think you raise

1 an interesting point, and you may well be right, that we
2 would get more information if we had a 3 percent the first
3 year rather than 1.6.

4 I think this is heavy -- there is this old
5 phrase that when you're approaching somewhere, your view
6 of it depends on where you came from. And I think a lot
7 of this is the shell shock about revenue and the desire
8 to have this go gradually because there's so much fear
9 that you could be off, and the State could be off for a
10 year, and so on and so forth.

11 COMMISSIONER EDLEY: Right, right.

12 COMMISSIONER BOSKIN: And so I think that was
13 the spirit in which it was done. But you raise a
14 conceptual point --

15 COMMISSIONER EDLEY: But now we have such a
16 brilliant strategy for dealing with that short -- oh,
17 and I should say, we have more confidence in our strategy
18 for dealing with the revenue mismatch in the nearer term
19 than in the longer term.

20 COMMISSIONER BOSKIN: You're certainly right
21 about that.

22 COMMISSIONER EDLEY: Let's get on with the
23 nearer term so that the Legislature could have confidence
24 that the system is performing as intended.

25 CHAIR PARSKY: Well, I think we ought to think

1 about that during our break and come back, because I think
2 that the assumption was that most commissioners would
3 want a gradual move, and the difference between 1.6 and 3
4 is dramatic. But I think we ought to think about that.

5 Certainly a five-year phase-in program has been
6 on the table, and I thought was the view of most, if not
7 all of our commissioners. So we ought to think a little
8 bit about that as to whether or not we want to -- still
9 leave the five-year program, but maybe move it more
10 rapidly in the earlier years than the later years for the
11 reasons Chris mentioned.

12 COMMISSIONER EDLEY: Let me state the concept
13 a little more clearly, maybe, that when we get to the
14 Year 4/5 at the end and the technical panel and the
15 Legislature make a final cut, hopefully the technical
16 panel, I'm assuming this is not going to require any
17 two-thirds votes in Year 3 or 4 or whatever to make this
18 happen. So when you get to the end of the transition
19 period and you make your last adjustments, you're going
20 to have three solid years of data, and I think it would
21 be better if that's three years of data based on a real
22 rate, a real BNRT rate that people took seriously, that
23 firms really were reacting to and so forth, rather than
24 kind of an itty-bitty rate, that maybe they weren't paying
25 too much attention to as to how they were doing. That's

1 kind of the idea.

2 COMMISSIONER COGAN: So, Chris, one way to think
3 about this is that the phase-in reflects our level of
4 certainty about -- or uncertainty about the consequences
5 of what we're doing.

6 COMMISSIONER EDLEY: Right.

7 COMMISSIONER COGAN: And when the Legislature,
8 as Becky said, gets through vetting this proposal, over
9 a number of years -- a year and a half, two years,
10 whatever it is -- they're going to be a lot more certain
11 about the consequences of this proposal. And some of that
12 uncertainty is going to go away. And so I'm thinking,
13 like Becky is, no matter what we do, if the system works
14 reasonably well -- if we say a five-year phase-in, that
15 reflects our level of uncertainty.

16 The Legislature, by the time it gets through,
17 if it has more certainty as a consequence of having two
18 years to analyze the system before enacting it into law,
19 they're going to be more comfortable with a three-year
20 phase-in. And I'm not saying we should stay with a
21 five-year. I would have no trouble going to a three-
22 or four-year, starting at two or three. Just thinking
23 that -- the reason for the phase-in is that you're not
24 really sure -- one reason is, you're not really sure
25 about the consequences of the new policy.

1 The other reason for a phase-in is to give
2 employers time to adjust to the changes.

3 And what I would worry about with a 3 percent
4 rate is, you're shocking them into making very sizable
5 adjustments, not easing their way in. But, again, that's
6 a little -- just 2 percent, 3 percent. It's not something
7 that I'm very comfortable with making a judgment to say
8 that 2 percent is the right initial rate, or 3 percent --

9 COMMISSIONER BOSKIN: Mr. Chairman, may I make
10 a suggestion which I hope will be able to garner unanimous
11 support on the phase-in?

12 I think Chris has raised a really interesting
13 and good question, and John has made -- and Becky have
14 made -- very good comments.

15 It seems to me what we could do is write this
16 up -- we've done this a cautious phase-in, but also in
17 the report say -- or in an alternative, if, indeed, you
18 have enough confidence after the vetting, that you might
19 want to proceed more rapidly and start at 2 or 3 percent
20 and phase in over three years. I think that's a very
21 good point.

22 I don't know that we should wind up trying to
23 lay out an alternative on Chris' schedule --

24 COMMISSIONER EDLEY: That's fair enough.

25 COMMISSIONER BOSKIN: -- and then vote on either

1 one; but I think we should highlight this as something
2 we ought to consider, because I think he's raised a good
3 point.

4 CHAIR PARSKY: I think that's a good suggestion.
5 Let's think about that.

6 Okay, what I'd like to do now is, before we take
7 a break, we have 14 speakers. What I'd like to suggest
8 is the following: Consistent with -- Fred can correct me
9 and Becky can correct me -- but consistent with some of
10 the approach taken at times by the Legislature, I'd like
11 to limit the public comments to one minute. However,
12 we will take in full submission all of the comments in
13 writing, we will post them, and we will make them
14 available to the public.

15 That should take us 20 or about 15 minutes, so...

16 COMMISSIONER KEELEY: Mr. Chairman?

17 CHAIR PARSKY: Yes?

18 COMMISSIONER KEELEY: Mr. Chairman, again, I'm
19 not trying to be argumentative with you. I imagine some
20 people who are going to testify, waited six or more hours
21 in L.A. and did not testify because time ran out. Not
22 that there wasn't any intention not to let them testify.

23 Today, we said that we would have a brief
24 discussion of the package asking clarifying questions
25 and, instead, we got deeply into points of view and so

1 on -- which is fine. And we told folks that we would
2 start public testimony at 1:00. It's now 1:30.

3 I would suggest that, at this stage in our
4 proceedings, that giving people maybe three minutes to
5 testify and provide -- it seems to me this is a quite
6 refined package now, and this is our last opportunity to
7 hear from the public.

8 COMMISSIONER EDLEY: It's also our last
9 opportunity to make a decision, Fred.

10 COMMISSIONER MORGAN: Could we assure the public
11 that we've read their letters?

12 CHAIR PARSKY: Yes.

13 COMMISSIONER MORGAN: So if it's the same person
14 testifying that sent a letter, that maybe not so much --

15 CHAIR PARSKY: Let me augment that.

16 With respect to anyone that has already
17 testified before us, no more than one minute. With
18 respect to anyone that has submitted in writing their
19 views, no more than one minute. With respect to anyone
20 else, three minutes.

21 Let's proceed.

22 COMMISSIONER KEELEY: Thank you, Mr. Chairman.
23 Thank you.

24 CHAIR PARSKY: Julian Canete.

25 And if you could indicate, have you testified

1 before, have you submitted anything in writing before?
2 Because it will allow Mike Genest to keep track of the
3 time.

4 MR. CANETE: I have not on both issues. I have
5 not.

6 I'm Julian Canete, and I'm chief operating
7 officer of the California Hispanic Chambers of Commerce.
8 We're a network of over 65 local Hispanic chambers and
9 business associations throughout California. And through
10 that, we represent the interest of over 720,000 Hispanic
11 businesses.

12 First of all, we applaud the Commission's
13 efforts, as it is a monumental one.

14 You've been given the responsibility of
15 bringing California's tax structure into the 21st century,
16 stabilizing revenues, reducing volatility, promoting the
17 long-term prosperity of our state and its citizens, and
18 improving California's ability to compete with other
19 states and countries for jobs and investments in a sound,
20 efficient, and predictable way, though we feel we have
21 some issues with some of the proposals.

22 The business net-receipts, corporate and
23 personal income tax changes aren't so much reform as a
24 shuffling California's enormous tax burdens from one party
25 to another. And the Commission's lengthy discussion about

1 covering our revenue shortfalls indicating volatility is
2 likely to remain an issue.

3 Proposed changes are most likely to hit small
4 businesses. Our members the hardest. And because many
5 are already at risk, any direct or indirect tax increases
6 could drive them out of business and force them to lay
7 off workers.

8 Furthermore, proposals for increasing the state
9 excess tax on gasoline or imposing the severance tax on
10 California oil production are unlikely to decrease
11 volatility; and that gas and oil prices are, by nature,
12 extremely volatile. On top of that, increasing the excise
13 tax will drive fuel prices up by billions and an oil
14 severance tax will discourage instate production, thus
15 reducing tax revenues, killing jobs, driving energy
16 prices higher, and increasing our dependency on foreign
17 imports.

18 We have also been following other policy
19 initiatives, known to be AB 32, which now promises to
20 increase energy costs and other business expenses by
21 billions. It was especially troubling to us that this
22 commission spent a lot of time discussing a so-called
23 pollution tax on gasoline with emphasis on fighting
24 global warming.

25 With all due respect, we feel that the

1 discussion and the proposals are inconsistent with the
2 Commission's goals, and especially since the tax is
3 already being contemplated as part of the AB 32
4 implementation.

5 Now, if you're advocating two separate carbon
6 taxes, that's even worse for California's small businesses
7 and consumers.

8 Commissioners, our members are not large
9 corporations or special interests, but they represent
10 hundreds of thousands of California jobs and support
11 families and communities throughout our great state.
12 We hope that you will fully consider the consequences to
13 them before finalizing your recommendations.

14 Thank you.

15 CHAIR PARSKY: Thank you very much. And thank
16 you for staying within the three minutes.

17 Next, Michael Shaw? Michael Shaw?

18 Michael, you've testified three times before us.
19 One minute, please.

20 MR. SHAW: I'll give you thirty seconds.

21 CHAIR PARSKY: That would be great.

22 MR. SHAW: I just want to briefly reiterate
23 some of our concerns.

24 We do have serious questions about the business
25 net-receipts tax and the effect that that would have on

1 small business. I won't repeat what's been said before.

2 The more rapid implementation of the business
3 net-receipts tax causes us even greater concern because,
4 A, we have no idea what this is going to do exactly. I
5 mean, we have some estimations that have been done but,
6 of course, we don't know the real-world impact. We think
7 a more progressive implementation, if that's what the
8 Commission chooses to go forward with, would certainly be
9 the wiser course of action. But, of course, we do think
10 that far more analysis needs to be done. And I appreciate
11 the Commission's acknowledgment of that through the
12 legislative process, and it accelerating the opportunities
13 there.

14 I did want to point, obviously -- and this was
15 mentioned briefly earlier -- one of the Commission's
16 primary principles is that of jobs and competitiveness
17 with other states and nations. We feel that that has been
18 given less attention with regard to this package than the
19 issues of volatility, stability of revenue, and some of
20 those other issues. And we would certainly encourage a
21 lot more of that.

22 California, as you know, has an 11.9 percent
23 unemployment rate. And if we are doing anything that is
24 going to jeopardize that, that certainly is not going to
25 help us improve that situation. And we believe that jobs

1 are certainly something that's incredibly important to
2 improving our economy and the State's revenues overall.

3 Thank you.

4 CHAIR PARSKY: Thank you very much.

5 Next, we have Edwin Lombard.

6 Edwin, you have --

7 MR. LOMBARD: I have submitted written comments
8 before. I just simply want to make a few points, and I'll
9 move on.

10 CHAIR PARSKY: Please go ahead.

11 MR. LOMBARD: I'm a small business advocate.

12 I represent the California Black Chambers of Commerce
13 throughout the state, the Black Business Association, and
14 the Black Business Council.

15 Our businesses and our community can't afford
16 any new tax increases, period. It's particularly
17 troubling that you're thinking about new taxes on
18 gasoline, diesel, and on oil extraction, but according
19 to the paperwork, are intended to keep the prices of gas
20 high.

21 The Air Resources Board and others have found
22 that higher prices on gas directly affects the
23 lower-income and minority communities more than anyone
24 else. I want you to really take consideration of this
25 when you continue on this portion of your hearing.

1 CHAIR PARSKY: Thank you very much.

2 I cannot read this so I'll hold it for a minute.
3 James Duran.

4 MR. DURAN: I'll start out by saying, how about
5 those Bears in the last two weeks?

6 CHAIR PARSKY: I'm sorry. Hold on one second.
7 Next on deck is Patty Senecal. If you could
8 just come up and be ready.

9 Go ahead.

10 MR. DURAN: Thank you.

11 I said earlier, how about those Bears? Over
12 110 offensive points in the last two weeks. Wait until
13 USC comes to town.

14 CHAIR PARSKY: Is that the Chicago Bears or
15 some other Bears?

16 MR. DURAN: Your guess. We're in Berkeley.

17 My name is James Duran. I'm the chair of the
18 Legislative Action Committee of the California Hispanic
19 Chambers of Commerce. My committee has been increasingly
20 concerned that in the midst of the worst recession since
21 World War II, the Legislature and various appointed
22 agencies and commissions seem more interested in finding
23 ways to generate more revenue -- that's a code word for
24 taxes -- instead of pursuing real reform that will make
25 our businesses competitive, save and create jobs, and get

1 our economy moving again.

2 We understand that your goals included improving
3 California's competitiveness, improving our long-term
4 prosperity, and reforming the tax structure. Instead,
5 we're hearing about higher fuel taxes and new taxes on
6 oil production and a business net-receipts tax that is
7 vague at this point but has left a lot of unanswered
8 questions about how it will impact small business,
9 consumers, and the transportation sector.

10 Let me talk about the fuel and the oil taxes
11 for a minute. Raising taxes on gasoline and diesel by
12 billions of dollars a year and possibly risking Prop. 42
13 funds in the process seems to be in direct contradiction
14 with their goals of improving our competitiveness and
15 prosperity. If there's one thing that just came about
16 that everyone can agree on, it's that gas prices and gas
17 taxes are too high already.

18 We are worried the Commission doesn't seem to
19 have consulted with other government bodies about other
20 tax plans they are working on.

21 Have you spoken with CARB about AB 32? If so,
22 you'd know they were talking about pollution taxes on
23 fuel and a low-carbon fuel standard which will cost the
24 public billions, not to mention requiring billions in
25 improved investments and green buildings and technologies.

1 Other states are luring our jobs and businesses
2 away for obvious reasons. They are friendlier towards
3 businesses and have a more reasonable tax structure.

4 Yet instead of emulating the many fiscally
5 responsible examples of those other states, the only thing
6 the commissioners seem interested in copying is their
7 oil-severance taxes which, by the way, would make our
8 taxes on oil companies the highest in the state and
9 contribute to overall business job costs and job losses.

10 These are only a few of the serious deficiencies
11 in this process so far.

12 This weekend, the *San Jose Mercury* news asked,
13 how can the commissioners make a responsible
14 recommendation without themselves having more answers?
15 That's a good question, and one we hope you will answer
16 before finalizing your report.

17 And here are a couple of comments from the
18 *Mercury News* editorial this weekend.

19 There's no information about the impact on
20 jobs or who would pay more, and there's no analysis of
21 whether it would place a greater burden on the poor. And
22 lastly -- I'll have two other minor comments -- one is,
23 I don't like the term "BNRT." It sounds like "beaner
24 tax." And for substantive issues, a lot of them came up
25 today -- or lots of substantive issues, I'd heard poor or

1 inadequate answers based on not well-thought-out
2 assumptions. So I'm very concerned that you guys are
3 about to make very significant policy decisions that are
4 going to rule for the rest of many of our lives, to a
5 Legislature which doesn't appear prepared to do very much
6 at this point in time.

7 Thank you.

8 Go Bears.

9 CHAIR PARSKY: Thank you very much.

10 Go Bears.

11 Okay, Patty Senecal, then Bill Aboudi, then Ted
12 Novak. If you'd all get in line.

13 MS. SENECA: Okay, thank you. My name is
14 Patty Senecal. I represent the International Warehouse
15 Logistics Association. Those are the 3PL, the logistics
16 providers that handle the goods that come through the
17 ports for distribution, warehousing, and outbound
18 shipping, and also Harbor Truckers for Sustainable
19 Future, out of L.A./Long Beach.

20 The point that I would like to address is
21 Number 4 in the Governor's Executive Order that talks
22 about improving California's ability to successfully
23 compete with other states for jobs and investments.

24 I did go to the UCLA hearing. I want to read
25 a couple of comments because after six hours, we didn't

1 get to speak. So a couple of my members, one is Mike
2 Lightman, president of Harbor Truckers.

3 Quote:

4 *"During the state's worst freight*
5 *recession, the forecasted economy recovery years*
6 *down the road, a pollution tax is not something*
7 *California should be addressing. California*
8 *already has the toughest environmental*
9 *regulations on trucking in the country, if*
10 *not the world, and puts us at an enormous*
11 *competitive disadvantage with companies in*
12 *other states where taxes aren't as high and*
13 *the business climate is friendlier. Our*
14 *organization has been working to promote*
15 *strategies that will reduce emissions and bring*
16 *back cargo and jobs to California ports. But*
17 *this multibillion-dollar tax on gasoline and*
18 *diesel will punish California companies and*
19 *send freight to more other ports that are*
20 *friendlier."*

21 Another one of our members, he is expressing
22 apprehension about the ability to pass business costs
23 on in this climate:

24 *"Every year, it gets harder to break even.*
25 *I don't know how we can absorb a doubling of*

1 *fuel tax in this economy when freight volumes*
2 *are down 30 percent."*

3 Another comment is:

4 *"Double taxation with increased utility*
5 *costs, diesel and gasoline costs, and then*
6 *taxes again on the high-priced products will*
7 *virtually assure that California loses more*
8 *jobs to other states."*

9 So of concern to us and of mention by a few
10 others, is the fact the competitive analysis that was
11 mentioned earlier should be something that should be
12 looked at. Our ports have, since 2005, been losing cargo
13 to other gateways. Canada has taken a lot of freight
14 off the West Coast. We've had a lot of cargo moved
15 elsewhere by rail. Our ports in L.A./Long Beach at times
16 year-to-date are off 20 to 30 percent. Our volumes are
17 down. That's cargo that's gone. And when cargo leaves
18 and we make arrangements for distribution centers and
19 long-term leases are signed, it doesn't come back just
20 like that. So we need to look at a long-term strategy
21 here for port competition.

22 We lose jobs in the supply chain from cargo
23 diversion. We've lost dock-worker jobs, truckers,
24 distribution centers, railroad workers, and then all the
25 vendors we support with fuel and catering and, you know,

1 et cetera, office supplies.

2 Another great concern to us is the low-carbon
3 fuel standard that CARB is moving towards. The
4 reformulation of California fuel, our fuel costs are
5 going to be higher at the base price as we move into the
6 low-carbon fuel standard. And then another tax on top
7 of that, on top of that.

8 So, again, competitiveness. We know we're
9 heading into higher utility rates, with renewable
10 portfolio standard. Higher utility rates on top of fuel
11 cost.

12 A quick comment on changing behavior. I've read
13 a lot of materials, and it talks about punishing us, to
14 change our behavior. With goods movement, cargo
15 specifically, it's very difficult to change our behavior
16 because cargo can't use a bike path, cargo can't get on
17 the BART, cargo can't carpool, okay? We don't have a lot
18 of alternatives for us. And when our customers tell us,
19 "I need it delivered now" -- Why? -- because the retailer
20 issues a penalty if you don't deliver goods on time --
21 how are we going to move freight? We don't have a lot
22 of alternatives. And punishing us means we just pay more
23 due to this tax.

24 I would encourage you to look at the whole
25 system to improve California's ability to successfully

1 compete with other states and other ports --
2 underline "other ports." We're going to compete for
3 business; it's a new era for us. Capital is mobile and
4 so is cargo. Cargo is extremely mobile. And these
5 competitiveness issues for us are very real. And every
6 business, from Oakland to San Diego, L.A/Long Beach has
7 been impacted by cargo diversion, including,
8 unfortunately, our exports.

9 I would be very interested in having you look
10 at a competitive analysis to achieve your goals and go
11 beyond just taxes and look at the supply chain. What's
12 happening to our goods movement industry is, we have CARB
13 regulations, trucks, trailers, forklifts, lighting, solar
14 is in our future, the low-carbon fuel standard is coming,
15 and other business costs are escalating for us as well.
16 And so, again, when we are approaching these goals,
17 depending on how you approach it is where you come from.
18 We come from business and we are extremely concerned that
19 just isolating a tax without looking at the whole picture
20 of how we compete in this economy is something that really
21 needs to be done.

22 Thank you.

23 CHAIR PARSKY: Thank you very much.

24 Bill Aboudi, then Ted Novak, then Ellen Wu.

25 Go ahead.

1 Have you testified before?

2 MR. ABOUDI: No.

3 CHAIR PARSKY: And you haven't submitted
4 anything in writing?

5 MR. ABOUDI: My head is spinning right now.
6 This is --

7 COMMISSIONER EDLEY: You get used to it.

8 CHAIR PARSKY: That's okay.

9 MR. ABOUDI: Yes, I guess so. But I'm going to
10 tell you what I don't get used to is people abusing the
11 truckers constantly. We get dumped on all the time, and
12 that's why I'm here.

13 My name is Bill Aboudi. I'm with a trucking
14 company at the Port of Oakland called AB Trucking. We
15 just actually had the deadline for the CARB retrofit.
16 That's a disaster waiting to happen. We'll find out by
17 the end of the year.

18 But, you know, constantly, when I hear that
19 you're considering an 18¢-a-gallon increase, it's like,
20 when is it going to stop? Do you need a whole bunch of
21 truckers to just surround you guys here, to get you to
22 understand? Enough is enough.

23 I have to compete with trucking companies that
24 come out of Reno. And I'm going to give you real figures.

25 I actually charge \$1,400 to Reno. I compete

1 with a trucker that comes out of Reno and charges \$700.

2 How the hell am I going to compete, being in California?

3 So some of the problems that I have, there's

4 a lot of promises, there's a lot of recommendations.

5 Somebody is going to do the right thing. The right thing

6 is not going to be done. We need to eliminate a lot of

7 bull, basically.

8 580 we paid for, the freeway. Trucks can't use

9 it. We're having to be jammed in traffic here in the

10 Bay Area.

11 Why are people picking on truckers?

12 We pay a sales tax. I think in your brochure,

13 it said 8+. In Oakland, it's 9.75, to be exact.

14 We pay parking tax for trucks, 18½ percent tax.

15 We pay the heavy-fuel tax, \$550 to be able to

16 haul containers out of the Port of Oakland. We pay taxes

17 on everything.

18 Workers' comp. It went down, now it's going

19 back up again.

20 When is it going to stop? Do I need to move

21 out of California? Where are you going to get the taxes

22 from? You need people to generate taxes. But if you

23 overtax them, you're not going to have them here.

24 We need to do work. The economy is down.

25 I actually hire formerly incarcerated people

1 that work for me. I train them. I put them to work. I
2 have 12 trucks. I actually had to shut down six trucks.
3 I had to stop my training program. The economy is bad.
4 You guys need to realize it. You need to come out to the
5 Port of Oakland where there's 3,000 truckers, 90 percent
6 of them are independent contractors that can't be here,
7 that can't sit here. They don't get paid to be here.
8 They're working. They can't express the anger that we'll
9 feel once they hear about the 18¢ tax that you guys are
10 talking about. Enough is enough on truckers. Think about
11 it.

12 Small businesses is what makes this country
13 great, and you guys are trying to take us down under.

14 So we need the mentality. Change. Change the
15 thinking process. Let's help businesses grow.

16 You know, we have a lot of labor right now
17 that's hitting us at the port. Labor is -- well, we'll
18 define it: Unions at the Port of Oakland on the trucking
19 side is 3 percent. So if they're sitting in front of
20 you, they're giving you testimony, it doesn't mean
21 anything. You come out to us and you see the 97 percent,
22 and we'll give you reality.

23 And just one last comment. Your last slide.
24 Tribunal? You're going to set up? I feel like a Nazi
25 being in California. You're going to set up a tribunal

1 so I have to defend myself? I haven't done anything
2 wrong. I live in California, for God's sake.

3 Thank you.

4 COMMISSIONER BOSKIN: Can I just clarify? I
5 need to clarify something.

6 Sir? Sir? I'm sorry if we weren't clear in
7 what we wrote. But the basic idea is now, if you have a
8 tax dispute with the Franchise Tax Board, they're not
9 only demanding you pay them, but they are the judge and
10 jury.

11 What we want to do is set up an independent
12 facility so they can't be judge and jury, as well as
13 demanding you pay them. That's all.

14 MR. ABOUDI: Every day in my business -- I mean,
15 every day I get a notice that somebody has authority to
16 go through my books and tax me. I've never heard of a lot
17 of these taxes.

18 I'm a businessperson. I just want to run a
19 small business in California. Can we just, like, be
20 very simple? I mean, you tax me -- when I went through
21 the fuel tax, I'm paying tax, and then on top of that,
22 I'm paying tax on top of that. It makes no sense.

23 Keep it nice and simple. We just want to run
24 our business. I don't want to be -- how many attorneys
25 do we have here?

1 I don't want to be an attorney.

2 CHAIR PARSKY: We have one dean of the law
3 school.

4 I hope we recorded all that testimony because
5 I think you qualify for the next commission, guaranteed.

6 Ted Novak, then Ellen Wu, then Stephanie
7 Williams.

8 MR. NOVAK: I'm Ted Novak. I'm the owner of a
9 small business in California. We specialize in helping
10 transportation warehouses to conserve on their energy,
11 through lighting and other means.

12 And I just wanted to go on record that I'm
13 opposed to the excise tax increase on diesel.

14 I've already seen, in my business, the impact
15 of the taxes that are hurting the transportation business
16 now.

17 Our business, personally, is down 90 percent
18 because we're meeting with these businesses -- the
19 warehouse and transportation. And the paybacks that
20 we're showing them for energy conservation is between
21 two and five years, and they're giving us the kind of
22 response that we don't even know if we're going to be in
23 business two to five years from now. So we don't want to
24 make any long-term investments on energy conservation
25 because everything is so unstable right now.

1 So I think that really hurts not just the
2 trucking industry, but you can see the effect that it has
3 down the line.

4 So -- the other thing that I did -- that I have
5 heard in feedback, is the same kind of feedback that you
6 heard right now, is that they're feeling the pinch from
7 out-of-state truckers who aren't under some of the
8 regulations that they are under. And so they're actually
9 considering, on these warehouses, that they either
10 long-term lease or own, they're actually considering
11 relocating out of state. And so they don't want to make
12 any long-term investment into that facility that they're
13 in now.

14 Thank you very much for your consideration.

15 CHAIR PARSKY: Thank you very much.

16 Ellen Wu, then Stephanie Williams, then
17 Mr. Guerrero.

18 MS. WU: Hi. I'm Ellen Wu, the executive
19 director of the California Pan Ethnic Health Network.
20 And I'm here to talk about the implications of these
21 proposals on low-income communities of color and the
22 health of these communities.

23 Our communities have already felt the burden
24 of our State's failure to create a progressive and
25 equitable tax system through the \$30 billion cuts in

1 critical services that they had received.

2 Here are just a few examples of how these
3 proposals will worsen inequity in California.

4 Currently, the lowest-income households pay a
5 larger share of their incomes in state and local taxes
6 than higher-income households. Under this proposal,
7 massive cuts would be awarded to those incomes above
8 \$100,000 and virtually nothing to the 62 percent of
9 taxpayers with incomes up to \$50,000.

10 Economic analyses show that most of the BNRT
11 would be passed along to consumers in the form of higher
12 prices for such things like taxing child-care and
13 groceries to compensate for lower personal taxes for the
14 wealthy. Trading low-income citizens' ability to provide
15 for their families with a tax break for the wealthy.

16 And I did hear the conversation earlier today
17 about really creating a healthy state and healthy
18 communities. And Dr. Halvorson knows about this, too,
19 that these consequences of widening the rich-poor gap
20 have proposed impact on our community's health.

21 Poor adults are three times as likely to have
22 a chronic disease that limit their activity, twice as
23 likely to have diabetes, and nearly 50 percent as likely
24 to die of heart disease.

25 Children from less-affluent families are more

1 likely to experience conditions that limit their health
2 and ultimately their life chances. Inadequate or delayed
3 health care, physical inactivity, poor nutrition, insecure
4 or substandard housing, and exposure to toxins, high lead
5 levels, and violence.

6 In addition, studies have found that life
7 expectancy conforms to a pattern called the "social
8 gradient," in which the more income and wealth people
9 have, the more likely they are to live longer. For
10 example, people who live in West Oakland can expect to
11 live on average ten years less than those who live up
12 here in the Berkeley Hills.

13 The bottom line is, is this proposal does not
14 meet the needs of California's 21st century economy. It
15 does not close our budget deficit, and instead, will
16 contribute to growing inequality and poor health. The
17 prosperity of our state and health of our children relies
18 on a progressive tax system that shrinks rather than
19 grows the inequalities between the rich and the poor.

20 Thank you.

21 CHAIR PARSKY: Thank you very much.

22 Stephanie Williams, Mr. Guerrero, and Mr. Lazo.

23 MS. WILLIAMS: I have not spoken before and I
24 have not filed comments.

25 My name is Stephanie Williams, and I

1 represent --

2 CHAIR PARSKY: Have you testified before?

3 COMMISSIONER EDLEY: She said no.

4 MS. WILLIAMS: Yes, I just said that, yes.

5 CHAIR PARSKY: You did?

6 MS. WILLIAMS: I have not testified before, and
7 I have not filed comments.

8 CHAIR PARSKY: Thank you.

9 MS. WILLIAMS: Although, I'd like to put this
10 fuel price attachment into the record, since I haven't
11 filed before.

12 CHAIR PARSKY: Absolutely.

13 MS. WILLIAMS: My name is Stephanie Williams,
14 and I represent the Western States Goods Movement
15 Alliance. You saw three of our members testify just
16 recently. We also represent Harbor Sustainable Truckers
17 out of Long Beach/L.A., and the Western State Alliance.

18 Our association is an environmentally
19 responsible goods-movement coalition whose mission is to
20 facilitate the transportation sector successfully to a
21 low-carbon economy.

22 The State Air Resources Board is currently
23 recovering \$78 million in AB 32 fees to pay for the
24 analysis, meaning, the state's AB 32 greenhouse-gas goals.
25 Carbon taxes were dismissed in favor of cap-and-trade.

1 Upstream, caps on refineries and utilities who must reduce
2 petroleum and diesel and substitute natural gas,
3 electricity, feedstock for solar and wind, are expected
4 to increase fuel and electricity costs by 25 percent.

5 How can a carbon tax incentivize a heavy-duty
6 truck to change its behavior? It can't.

7 The behavior this tax proposal attains is
8 transfer of the goods movement sector out-of-state when
9 diesel prices rise in California. Computer software
10 programs used by trucks direct them to fill up out of
11 state when prices reach a certain point. The only thing
12 that this proposal will do is move more goods-movement
13 jobs out-of-state in favor of states who have lower taxes.

14 Trucks travel 1,800 miles on a single fuel.
15 That means there's nine states in two countries in that
16 range. A proposal of this magnitude will do nothing but
17 move California jobs out of state.

18 Thank you.

19 CHAIR PARSKY: Thank you very much.

20 Mr. Guerrero?

21 MR. GUERRERO: Good afternoon. Buenos tardes,
22 Commissioners.

23 No, I have not testified before.

24 My name is Anibal Guerrero. I drove a few hours
25 last week trying to get to the UCLA meeting, and then a

1 few more hours waiting for the public comments that was
2 supposed to happen at the beginning of the meeting. I
3 was disappointed that the public, like me, did not have
4 an opportunity to speak at the publicly noticed time.
5 But a couple of local politicians were given a special
6 place on the agenda, out of respect for the value of
7 their time.

8 Most of the other members of the public, who
9 were not so fortunate, had to leave before public comment
10 was finally permitted at close to about six o'clock.

11 This is what I've got to say: I wear a lot of
12 hats in my community, in the San Fernando Valley. I'm
13 involved in the Pacoima Chamber of Commerce; I'm involved
14 in the MAPA Chapter, Mexican American Political
15 Association; and I serve on the board of Plaza Community
16 Services, a nonprofit that works to improve the quality
17 of life in our community: Education, senior services,
18 et cetera.

19 These affiliations have shown me with great
20 clarity that the current recession does not discriminate
21 from sector to sector or different areas. Virtually
22 everyone is suffering: Businesses, nonprofits, families,
23 seniors, schools.

24 What's also evident and documented by government
25 stats is that the Latino community has been hit

1 particularly hard, and higher taxes aren't going to solve
2 these problems.

3 Well, one proposal I find particularly
4 interesting is the tax -- the pollution tax on gas we
5 may be asked to consider. There are plenty of fees,
6 taxes, and other funding mechanisms that already are in
7 place to address pollution, including AB 32. And at a
8 time when many in our community must depend on
9 welfare, our priorities are necessarily a little
10 different. In times past, many of us supported higher
11 taxes to pay for services for our communities. But our
12 tax -- excuse me, but our taxes have kept going up and our
13 quality of life hasn't improved in most cases. Instead,
14 we're seeing whatever gains we've worked hard for slip
15 away.

16 Government has been able to provide the benefits
17 it's promised despite the fact it keeps raising taxes.

18 We appreciate the hard work you're doing. The
19 size of the challenge before you is tough. But we're more
20 inclined to support initiatives that make government a
21 more efficient steward of the revenues it already gets,
22 rather than raise taxes to avoid making tough or
23 responsible divisions.

24 Gracias.

25 CHAIR PARSKY: I just want to apologize for the

1 delay that occurred in Los Angeles.

2 Have you had a full opportunity to express
3 yourself now?

4 MR. GUERRERO: I have.

5 CHAIR PARSKY: Thank you.

6 Next, Mr. Lazo, and then Mr. Carrillo and
7 Mr. Clayton.

8 MR. LAZO: Good evening. My name is Reynaldo
9 Lazo. I'm here today on behalf of the Pacoima Chamber of
10 Commerce, of which I am a board member, and a small
11 business owner.

12 We tried to address the Commission last week in
13 Los Angeles, but we were unable to wait for seven hours to
14 share our concerns with you.

15 My chamber feels strongly about the work you
16 are doing and the potential consequences it may have for
17 our members and small businesses. So I've traveled to
18 Berkeley today to try again.

19 Sitting through last Thursday's meeting, we got
20 a pretty good idea of where you're headed. And we are
21 afraid your proposals will be harmful to the small
22 businesses that make up our membership.

23 Ideas you discussed include to raising the
24 state tax on gasoline and diesel fuel, introducing a
25 net-receipts tax on businesses, taxing California oil

1 production, and changing the way business properties are
2 taxed.

3 Any of these proposals are likely to cost small
4 businesses a lot because no matter how it's packaged or
5 who the taxes are allegedly aimed at, we'll wind up
6 paying for it. It will either come directly out of our
7 own pockets, in the case of gas tax, or passed through to
8 us from others who have to pay for it in the case of an
9 oil-production tax, for example.

10 You can't raise taxes in one sector or in one
11 or two industries and not have it impact everyone else.

12 Our members are feeling the pain of this
13 recession. Layoffs at our member companies are, for the
14 record, high unemployment statistics for California,
15 especially among communities of color. The San Fernando
16 Valley, with its large Latino population, is suffering
17 disproportionate levels of unemployment and loss of
18 employees.

19 This is consistent with what's being experienced
20 in other minority-intensive areas, like Southeast
21 Los Angeles.

22 None of us who can afford to have
23 employees would like -- those of us who can afford to
24 have employees would like to keep them. Those of us who
25 haven't had to close our doors are trying to hang on

1 until this economy turns around.

2 We understand you are under a lot of pressure
3 to meet the deadline for submitting your report to the
4 Legislature, but we hope that you won't use that deadline
5 as an excuse to avoid developing your recommendations for
6 real reform, and not for raising taxes to plug the budget
7 hole in the short-term.

8 Thank you.

9 CHAIR PARSKY: Thank you very much. And I
10 really appreciate, on behalf of this commission, your
11 coming back and speaking after waiting in Los Angeles.

12 Mr. Carrillo?

13 MR. CARRILLO: Pedro Carrillo, Mr. Chairman.

14 And I'm just going to -- I'm one of the same
15 party. We did a little pilgrimage today, you know.
16 It's hard enough for us to come up here and speak in
17 public. That's not what we do. We don't get paid to do
18 that, okay?

19 So I'm just going to ask you, Mr. Chairman,
20 that when we're doing our public testimony and we write
21 down our notes and we're nervous here, the snickering
22 sometimes, for me, I interpret it as maybe you're laughing
23 at us or maybe our issues aren't as important as they
24 should be.

25 But I'm going to say something, Mr. Chairman.

1 I'm going to go ahead and go through my notes and I'm
2 going to try to be as clear as possible. But I
3 appreciate -- I would just appreciate that when you heard
4 our comments, that maybe you didn't carry on back there
5 because I get a different interpretation of what that
6 means to me. Okay?

7 CHAIR PARSKY: I hear you. We've tried to show
8 as much respect as possible.

9 MR. LAZO: One of my colleagues is here -- and
10 you're both back there laughing and shucking and jiving
11 and pointing, and it's hard enough for us to come up here
12 and be heard. You've already limited our time, you've
13 already -- we didn't get a chance to do it at UCLA.
14 You've apologized, and that's fantastic. But when we're
15 up here, if it's three minutes, look at me, listen to us,
16 and please, Mr. Chairman, if I may.

17 CHAIR PARSKY: Please proceed.

18 MR. CARRILLO: The issue that I am most
19 sensitive to today is the fact that our communities,
20 and those are the communities of color that we all come
21 from -- Morro Heights, Southeast Los Angeles, the
22 San Fernando Valley -- the unemployment rates there are
23 not the 12 percent that were recited today. They're 17,
24 18, and 19 percent. And so when you're talking about
25 addressing an issue, resolving a budgetary issue by

1 slapping another tax, specifically what you're calling
2 a pollution tax, on top of everything else, and you're
3 making a reform, what that means to me in a community of
4 color, is that I'm going to create a bigger
5 transit-dependent community that's not going to have the
6 money to call Meals on Wheels, is not going to have the
7 money to get on the bus, is not going to have the money --
8 we saw a little microcosm of what raising transportation
9 fees -- because that's what I call it -- is in our
10 community.

11 When gasoline shot up to over four bucks, we
12 had seniors that couldn't ride the bus anymore. We had
13 nonprofits that could no longer afford to pay the
14 gasoline, to get grandma and grandpa to the park services
15 so they could get something to eat. We didn't have a
16 solution for the small businesses that closed during
17 those three or four months when gasoline spiked.

18 I just want to bring your attention to everyone
19 else that lives in the state of California, that doesn't
20 have the luxury to pay 12 bucks and come to UC Berkeley,
21 or 10 or 15 bucks to park at UCLA and live just to work.
22 Those are the people who have not voiced their concerns
23 here. Those are the people -- I mean, I know you have a
24 heck of a job to do and I know you're like just -- your
25 time is just of the essence, but the people who can't

1 come here are the people that have to work two jobs. And
2 that's why I was really upset last week when I had five
3 or six people who said, "Look, I don't want to go because
4 I have to work." I said, "Man, this is really important
5 and they're really going to want to hear you." And when
6 that blew up, they were just, "You see? I told you so."

7 So I just want to bring your attention to the
8 people that don't get paid to come here and, you know,
9 be scholarly. There are some working-class Americans out
10 there in communities of color, where I came from, that
11 need to hear what's going on here, and you need to be a
12 little more sensitive to that.

13 That's all I have to say.

14 CHAIR PARSKY: Excuse me, stay right there for
15 a minute.

16 Have you had an opportunity to look at, review
17 the proposal as a whole that we are discussing?

18 MR. CARRILLO: I have. In fact, as of a couple
19 of weeks ago, when this became a more pressing issue, I
20 have had a chance to start downloading and interpret some
21 of this stuff.

22 CHAIR PARSKY: Great.

23 MR. CARRILLO: It's a little complicated; I'm
24 not an expert.

25 CHAIR PARSKY: I'm not expecting that. But

1 I just want to clarify so we understand your point of
2 view -- and, again, I apologize for not hearing it out,
3 and please apologize to any of your colleagues.

4 If our proposal did not include the pollution
5 tax, how do you feel about the rest of the proposal?

6 MR. LAZO: Sir, I don't know enough about it.
7 It's very scary. My whole life I've known that there's
8 base taxes. When I go to my accountant at the end of the
9 year -- and I'm a small businessman, too -- I leave it to
10 her. She tells me, "Pedro, this is what we have to do.
11 Here's where you have to come back. Here's where you
12 have to cut back."

13 So regular Joes like me can't sit here and say,
14 "You know, if you" -- you guys were talking about -- last
15 week, you were talking about impacting on profits, you
16 were talking about how it was going to impact -- I don't
17 know what restructing a whole new tax system is going
18 to -- I don't know what that impact is going to be. I
19 don't know that you know what it's going to be. It's
20 really scary. It's scary to say, "Oh, yes, let's just
21 scrap it and start with a whole new system, because we
22 have something new called BNRT." That is a very scary
23 concept to me, okay.

24 And then you hear things like getting taxed
25 twice, and then you go, "Well, shoot, I live in an area

1 that already pays a heck of a lot of money. Hey, the
2 City of L.A. has taxes for everything"; right?

3 And so, you see, to a common guy like me, you
4 know, I picked out the pollution tax because I saw what
5 happened when gas went to 4.00 and 4.25 and 4.50. I saw
6 how the communities that we live in had a heck of a time
7 trying to get mobile. But there was no solution.

8 CHAIR PARSKY: It seems pretty clear that,
9 among other things, your concern and a number of your
10 colleagues' concerns, are that you're taxed too much now,
11 that you're basically paying too much tax and maybe not
12 getting what you think you deserve from the government.

13 Is that at the heart of what you're saying?

14 MR. CARRILLO: I think that is part of what
15 I'm saying. The other part that I want to be clear is
16 that I believe that there are communities in the state of
17 California that are going to be disproportionately
18 impacted by what you're doing here today. So I want you
19 to focus -- I love those questions about -- last week,
20 what's going to happen to nonprofits? What's the impact
21 on cities and counties and bond rates? And everything
22 revolves around a current tax system that we've been used
23 to all of our lives. And now, in a relatively short
24 amount of time, you're going to dismantle it and
25 systematically implement something new. That's my

1 interpretation, Mr. Chairman. That's my interpretation.

2 CHAIR PARSKY: I appreciate it. But just to
3 clarify, we're not going to implement anything. We're
4 here to make a recommendation which will be decided on,
5 which will be aired, which will go through the entire
6 legislative process.

7 So, please, tell your colleagues that weren't
8 able to make this trip, this is not a commission that
9 can act. This is a body of volunteers that can only
10 recommend. And I can assure you that everyone around this
11 table is just as concerned as you are with the way the
12 current system has deprived you and others, right now
13 in this budget crisis, of many of the services that you
14 deserve and that you were promised.

15 So our perspective is, can we make some
16 recommendations that will help ensure that your children
17 and your grandchildren get the services they're promised.

18 But I really appreciate your coming. And I
19 don't take offense at all to the comments that you've
20 made.

21 COMMISSIONER MORGAN: Mr. Chairman, I wonder --
22 I get the impression that most of the people that
23 testified are from the small business community, not the
24 corporate world that we tend to think of.

25 And I wonder if there's an awareness of the

1 \$500,000 automatic deduction from business taxes? And
2 do we, as a commission, have any way of knowing how many
3 small businesses would benefit from that deduction?

4 CHAIR PARSKY: Well, we have done some analysis
5 of that. Maybe we'll come back.

6 Sensitivity towards the impact on small business
7 was a very high priority for this commission, and remains
8 that. And so we have statistics on the number of small
9 businesses that would be outside, entirely, the need to
10 file and, therefore, to pay any of this tax.

11 And we'll go through that after the break.

12 MR. LAZO: Thank you for your time.

13 CHAIR PARSKY: I appreciate it.

14 Mr. Clayton?

15 MR. CLAYTON: Hello. My name is Elijah Clayton.

16 And I'm here today to represent The Alliance for
17 Self-Improvement and Leadership, and Sickle-Cell Health
18 Network Community. We are an Oakland-based nonprofit
19 that focus primarily on health and wellness within our
20 communities, which are typically underserved and face
21 additional challenges as a result.

22 Before now, I had not heard a lot of discussion
23 about the human impact that will be caused as a result of
24 this Commission's recommendations, and that's troublesome
25 within our community.

1 Health care is a huge issue, but it doesn't --
2 it's a huge issue. It didn't seem to be on the radar
3 until now. This is a problem, the State's budget crisis
4 caused cuts in health care and services to the people
5 who need them the most. But the proposals you have been
6 talking about don't seem likely to do anything to make
7 that situation any better and could very well make it
8 worse. Providing relief for the terminally ill is worthy
9 of consideration, but may wind up shifting more costs to
10 others who lack access to affordable quality health care.

11 If you raise taxes on small businesses on the
12 services they provide or the products they use, that
13 probably means that they'll cut jobs or go out of business
14 all together. That means they'll be paying less or no
15 taxes, and won't be providing benefits like health care
16 to their employees. Their laid-off workers won't be
17 paying taxes. Instead, they'll be looking to take taxes
18 from the government as they sign up for unemployment,
19 welfare, and food stamps, and are forced to go to the
20 emergency room for basic health care.

21 The whole idea of a pollution tax on gas is an
22 interesting one, but ultimately, it will wind up costing
23 the communities we serve, who are already impacted by
24 mental illness, more to get to where they need to go.
25 It will cost more for ambulances and municipal emergency

1 services. Higher transportation costs also drives up the
2 cost of food for the clients that we service, a real
3 problem in communities where poor nourishment is already
4 an issue.

5 Similarly, the net business receipts tax you
6 talked about will probably price a lot of goods and
7 services out of the hands of folks who can barely afford
8 them now.

9 I want to make it clear, I'm not here to
10 advocate for you to raise taxes to pay for health care or
11 anything else for underserved communities. Those programs
12 are important. But if they come at the price of jobs,
13 higher taxes, and higher costs for the bare essentials,
14 they're not going to do those communities any good.

15 The best prescription for healthy communities
16 and a healthy economy, when people have jobs with good
17 benefits, they can afford to access quality health care,
18 particularly individuals who are suffering from mental
19 illness, social-health illness or a debilitating disease.

20 They can't feed their families well and shelter
21 them in decent housing. If this commission can figure
22 out how to move our economy in that direction, the tax
23 fees should take care of themselves.

24 CHAIR PARSKY: Thank you very much.

25 Our last speaker, I must say I've asked for

1 assistance in identifying the name.

2 Who is signed up -- oh, could you just pronounce
3 your name?

4 MR. BRADY: James Brady.

5 CHAIR PARSKY: Sorry?

6 MR. BRADY: James Brady.

7 COMMISSIONER EDLEY: Simple.

8 CHAIR PARSKY: Oh, simple.

9 COMMISSIONER EDLEY: Straightforward.

10 CHAIR PARSKY: You have --

11 COMMISSIONER EDLEY: Elegant writing.

12 CHAIR PARSKY: -- elegant writing.

13 MR. BRADY: Well, thank you.

14 CHAIR PARSKY: I couldn't say it any better.

15 Can you read that?

16 COMMISSIONER EDLEY: Yes. He must be a
17 physician.

18 MR. BRADY: Thank you very much.

19 Again, my name is James Brady, and I'm a small
20 business owner and vice-chair for the California Black
21 Chambers of Commerce.

22 Like most small business owners, I've had to
23 make adjustments just to keep up in today's economy.

24 Our costs have been going up and up, and it's not always
25 easy to pass that on to my customers and still remain

1 competitive.

2 The tax increases the Legislature passed earlier
3 this year didn't help matters, either.

4 I'm concerned that you might be looking at
5 California economic problems on a macro scale, without
6 taking a realistic look at how your recommendations are
7 going to work at the micro level, how they'll impact
8 small businesses like mine, my customers' jobs, and our
9 future in the state of California.

10 I mentioned that I own a small business. Under
11 most circumstances, I would be just excited to hear about
12 opportunities in a green economy and the future in the
13 state of California. But I'm having trouble understanding
14 why last week's Commission hearing became a forum for
15 promising billions of dollars in gas tax increases to
16 fight global warming.

17 We have an entire agency, the California Air
18 Resources Board, that has hundreds of employees, working
19 on that new bill AB 32.

20 My take on this is that our gas taxes will be
21 raised more than enough through CARB without any help
22 from the tax commission.

23 Now, I want to say one thing loud and clear:
24 I am for the elimination of corporate tax in California.
25 That, you could take that away, and I think you could

1 make a lot of people happy.

2 CHAIR PARSKY: Based on the public testimony,
3 that's a little nugget in this equation.

4 MR. BRADY: Understood, understood. But it's
5 a great concern to small business owners, particularly
6 those in the start-up phase.

7 New taxes are not the answer, whether they're a
8 tax on fuel, business services, oil production, business
9 services, products business, and consumer products that
10 they buy, so anything else you can call it without -- or
11 call it whatever you wanted.

12 The tax commission business has been largely
13 conducted in private without the benefit of input from
14 people who will actually have to live with what you
15 recommend today or in the future, assuming the Legislature
16 adopts your plan.

17 So I would make, certainly -- do your very best
18 to make the very best recommendations you can to the
19 Legislature. Because a lot of people, they come from
20 different areas or walks of life in the state of
21 California, that may not really understand the true
22 impact of what you're proposing.

23 So the very idea that people seem to think that
24 we are not in a recession in California, this economy is
25 still in the tank. And as a small business owner that

1 does business with the state, and you get paid an IOU,
2 it's not a good feeling.

3 So we want to prevent bankruptcies in the
4 future, and we want to certainly continue to encourage
5 people to start small businesses in the state of
6 California because that is the backbone of this state.

7 And I would just strongly, strongly encourage
8 you to take a step back for a moment, think about this
9 economy, you know, whether there's health care, whether
10 there's water, whether there's gasoline, or all of the
11 other issues that are affecting us today as small business
12 owners, as well as people that live in the state of
13 California.

14 We are up to here in taxes. So let's start to
15 take a look at tax credits. Maybe we should be thinking
16 about giving a tax credit to small businesses as opposed
17 to raising taxes, and I think particularly in the
18 enterprise zones or in any other creative ways that you
19 can come up with that will make a huge impact into the
20 lives of the small business owners in the state of
21 California, because we cannot continue to pass that on
22 to our customers.

23 Thank you very much.

24 CHAIR PARSKY: Thank you very much.

25 That concludes, I think, our public-comment

1 period.

2 Let's take a 20- to 30-minute break, and then
3 we'll resume.

4 Thank you.

5 *(Midday recess from 2:16 p.m. to 3:13 p.m.)*

6 CHAIR PARSKY: I think what we'd like to do is,
7 we've gone through at length this morning the package of
8 recommendations that would be included in Sections 1 and
9 2. We have a little bit more work to do on making sure
10 we understand, or give staff direction to understand how
11 the rainy-day fund would be described. And we may need
12 to do some more work on that.

13 Just to circle back around and for people to
14 think about, the issue of the -- within the BNRT -- and
15 it's important again to remind everyone the nature of
16 the introduction I read about what we're going to be
17 suggesting about the BNRT, as outlined by Chris Edley and
18 John Cogan, would be an introduction to that part of the
19 recommendations.

20 I think that one issue -- and we'll make a
21 suggestion to come back around on it -- with respect to
22 health-care benefits, the way the proposal now exists,
23 those benefits within the BNRT, like all other elements
24 of compensation, would not be a deduction. And it would,
25 as sitting there, allow us to recommend that the BNRT rate

1 not exceed 4 percent based on what's on the table.

2 I think at the least, the discussion this
3 morning would suggest that we would want to identify this
4 as an issue that concerns the Commission as to its
5 treatment and that further work needs to be done, further
6 analysis needs to be done by the Legislature around this
7 issue, should they proceed the way we're recommending with
8 the BNRT.

9 And we could add to that that if a federal
10 mandate were established, that the Commission view would
11 change, and that we would suggest that they include a
12 deduction for this item and accept the potential for
13 the BNRT rate rising to 4.2 percent. That's one way to
14 articulate the nature of the recommendation that I'd like
15 you to think about. That's what I would suggest coming
16 out of this morning and concerns back and forth.

17 And we'll make sure everyone has a chance to
18 comment.

19 The second comment or suggestion I would make
20 is -- and we don't need all of these now, but I know a
21 number of commissioners are concerned about areas as the
22 Legislature explores the BNRT of the issues beside this
23 that need to be explored by the Legislature. And I would
24 welcome -- not necessarily here, but submissions as
25 quickly as possible to staff of areas that, in addition,

1 we should identify, such as how existing depreciation
2 should be treated under the BNRT. And there are a number
3 of areas. Whether or not -- and, again, we'll wait to
4 hear, but some may have the view that exempting all
5 nonprofits is something that should be explored, whether
6 that's the right policy.

7 So I think we should be open to identifying
8 areas that are not in the proposal, but that commissioners
9 believe further analysis impact should be undertaken.

10 Next, I would say that there's been a lot of
11 discussion about the phase-in. And I'd suggest that the
12 staff be asked to continue on a five-year phase-in
13 program, and identify in some detail the technical panel
14 that would do the assessment. And I'd ask Chris and
15 John to work extensively with the staff on the language
16 related to what the technical panel will be asked to
17 certify in order for the sales tax to continue to decline
18 as the BNRT increases.

19 But for purposes of drafting, I'd suggest that
20 the outlines of what the staff come forward with remain,
21 namely, that Year 1 would include an elimination of the
22 corporate tax; a down payment, if you will, on the
23 personal income tax, leaving the current system in place,
24 but reducing the reduction -- or taking some of the
25 reduction, approximately 20 percent, or a little over

1 \$3 billion, from the personal income tax through that
2 reduction.

3 So the personal income tax would come down,
4 the existing system would stay in place, and the magnitude
5 of the reduction would be approximately 20 percent. And
6 the sales and use tax would come down at 1 percent subject
7 to this yearly technical assessment. Approximately --
8 approximately losing or needing to make up in the BNRT
9 approximately \$9.5 billion to \$10 billion on the corporate
10 tax, approximately \$6 billion on the sales and use tax,
11 and approximately \$3 billion or \$3.2 billion on the
12 personal income tax, which will result in about a
13 1.6 percent rate in the first year in order to adjust
14 for those, with this technical safety-valve reassessment
15 concept coming into being each of the years, and then
16 we would move from there.

17 That combination of adjustments would, from a
18 regressive/progressive state, ought to pretty closely
19 balance out because the magnitude of the corporate tax
20 would be the greatest, then the sales and use tax, then
21 the personal income tax, in each of those early years.

22 But some work that needs to be done on making
23 sure it's clearly defined, everyone should have an
24 opportunity to review that; but I'd ask John and Chris
25 to refine that. But I think all the Commission is

1 concerned about making sure it's an adequate transition,
2 that it's done gradually, that we have a safety valve
3 because of the unintended consequences or revenues that
4 might or might not be achieved by the business
5 net-receipts tax.

6 There are some other areas within the business
7 net-receipts tax that we will want, as I said, to
8 identify. But I will leave that to individual
9 commissioners to identify some of those areas that they
10 remain concerned about and need further analysis.

11 Chris?

12 COMMISSIONER EDLEY: I just want to be clear to
13 everybody and emphasize the last thing that Gerry said
14 about the balancing of the income, sales, and corporate
15 tax components of the phase-in, in a way that does not
16 create any wrenching change in the progressivity, because
17 I think that's somewhat important substantively, but
18 definitely important optically that both during the
19 transition as well as in the end state, we have the
20 distribution parameters acceptable.

21 CHAIR PARSKY: Let me just pause there.

22 That's kind of the approach I would recommend
23 with respect to what was discussed before.

24 I would like to -- keep that in mind. We'll
25 come back and see where we are.

1 COMMISSIONER EDLEY: So can I push you on the
2 health issue?

3 CHAIR PARSKY: You may. You can push me on any
4 of the issues.

5 COMMISSIONER EDLEY: And I recognize that this
6 is -- we know that the Legislature is going to decide
7 everything; right? So this is more of a question of how
8 we lean and whether we have enough of a consensus to lean
9 in a particular direction.

10 And as I hear the discussion, I think we may
11 have a consensus that it would be preferable that we
12 lean in favor of deductibility with respect to employer
13 contributions on health care and that we think about
14 whether that can be accommodated within, say, a 4.2 BNRT;
15 and if not, whether there is an offset that we could take
16 with respect to NOLs or something else that would still
17 keep us within that 4.2 -- underneath that 4.2 percent
18 BNRT.

19 So I think it may be useful if you want to
20 informally poll folks, especially those who are not here,
21 to give the staff clearer guidance on how they ought to
22 draft up the recommendation.

23 And let me just say, I think, conceptually,
24 it can be argued either way in terms of what makes most
25 sense, and which position on the deductibility makes more

1 sense for that. But in terms of a business burden and
2 in terms of the incentives for providing health coverage,
3 I'd definitely err on the side, at this juncture, in favor
4 of including it within our package and then let the
5 Legislature move in a different direction if national
6 policy suggests.

7 CHAIR PARSKY: Michael?

8 COMMISSIONER BOSKIN: Yes, I respect that, but
9 I respectfully disagree. I think the appropriate thing
10 to do in a value-added tax is not to differentiate among
11 types of compensation, for one.

12 But more importantly, I think everything we
13 remove will be the floor that the Legislature is going to
14 remove. And I'm very, very nervous that they will start
15 exempting everything that we think there's any question
16 about, and we'll wind up with a 6 percent BNRT, which is
17 unfeasible.

18 So I'm in favor of having the cleanest one
19 available on the list of the concerns and issues.

20 CHAIR PARSKY: Edward, how do you feel on just
21 this subject?

22 COMMISSIONER DE LA ROSA: I think it's an
23 important issue. I think we had a discussion about it
24 over the lunch table, and I think it's an important issue.
25 And I recognize --

1 CHAIR PARSKY: Hit your button, microphone.

2 COMMISSIONER DE LA ROSA: And I recognize,
3 Michael, that you mentioned about sort of the setting a
4 precedent that can be expanded upon as a larger body
5 considers this. But I think that this is a very
6 important issue for California and California businesses.
7 And as an employer, I recognize how important it is. So
8 I felt like I would be in favor of that, Chris.

9 CHAIR PARSKY: Ruben?

10 COMMISSIONER BARRALES: Well, I'm concerned
11 about the rate, the overall rate. I think it needs to be
12 lower.

13 I'm also concerned about what we're doing in
14 terms of, you know, John and Chris working too hard in
15 the next few hours or days on the transition. Because I
16 really think the value that we bring as a commission in
17 terms of recommendation aren't going to be the specifics
18 of a transition that may never happen. I think it's more
19 the idea of this whole package and to try to promote this
20 idea, even more than the specifics of it.

21 And I think, as Michael alluded to, I think a
22 cleaner version of this package, with all of these
23 issues -- health care and my beloved, you know, R & D
24 research and all of that being things to consider. But
25 say, "Here's a package that we think makes sense, to look

1 at, to consider, to poke, and to deflate or whatever, or
2 build up." But I think it's really -- from my
3 perspective, I'd rather discuss the framework than a lot
4 of these things that are going to get decided the way the
5 Legislature decides things. And Becky and Fred know
6 better than I how that happens.

7 So I'm much less --

8 COMMISSIONER EDLEY: Where is that dartboard?

9 COMMISSIONER BARRALES: But I really think --
10 again, I'm more concerned about an overall recommendation.
11 I think -- and this isn't just my perspective -- but I
12 think the most we're going to be able to do -- and which
13 is a lot -- is to say, "Hey, this is not perfect. We
14 don't even know what it is exactly, but we want you to
15 consider it. And as clean as possible, I think, would be
16 most useful.

17 CHAIR PARSKY: George?

18 COMMISSIONER HALVORSON: A quick comment. One
19 of the questions to think about is, is it a form of
20 compensation, is health care a form of compensation, or
21 is it something that should be an entitlement for everyone
22 in the country? Should we have a basic public policy that
23 says, "Nobody has cancer, and as a result of that, goes
24 bankrupt and loses their home"? And that would argue for
25 health care being considered something that everybody

1 should have, not something that is a gift or an
2 entitlement or a separate agenda.

3 And I think anything that creates a barrier to
4 everyone having coverage is bad policy. So I don't think
5 of it as a form of compensation.

6 I think as we evolve at the national level and
7 make it a mandate, I think that's going to be clear public
8 policy for the country as well.

9 CHAIR PARSKY: John?

10 COMMISSIONER COGAN: So I agree with Chris that
11 on the merits or on the substance, I think it could go
12 either way. If we do not make it deductible, then, it
13 seems to me, that we are double-taxing it, and we're not
14 treating it like any other purchased input. But I've
15 heard Mike's arguments about compensation being treated
16 the same, all forms of compensation being treated the
17 same. And so I could see on a substantive matter like
18 this how it could go either way.

19 I guess on balance, it comes down to me, I
20 would prefer to have it deductible, because I think the
21 double-taxation issue is really important here. But like
22 Ruben, I have a bigger concern about the rate. And so if
23 the trade was to make it deductible but to increase the
24 rate to 4.2 percent, I guess I would say, don't increase
25 the rate and don't make it deductible. That's a

1 trade-off.

2 But I would like to see us maybe work a little
3 bit more on finding a way to offset making health care
4 deductible; to keep the BNRT rate around 4 percent.

5 Chris mentioned NOLs would be one thing we could
6 look at. Perhaps some adjustment there. Maybe there's
7 other adjustments. But I think the cap on the rate at
8 4 percent, I think is an extremely important signal that
9 the Commission can send to the Legislature.

10 I also think that offsetting any deduction with
11 a corresponding change that keeps the rate the same is
12 another important signal to send to the Legislature.
13 That's how they should conduct their business, not allow
14 that rate to go above 4 percent. So that's where I come
15 out.

16 CHAIR PARSKY: Fred?

17 COMMISSIONER KEELEY: Thank you, Mr. Chairman.

18 I also think that Chris has framed it right,
19 and I think it's a close call, and you can go either way
20 on this.

21 I think if I can add any value to this part of
22 the conversation, it would be this: That I think that
23 when the core element of this package is the BNRT, and
24 it goes to the Legislature, that we should be very real
25 about what that BNRT is capable of including and what it

1 will be capable of excluding when the Legislature gets
2 around to the business of wrestling with it.

3 I'm not sure that if we kept it out, that the
4 BNRT would be taken as seriously. My concern about
5 taking this issue, and us not wrestling with it and not
6 putting it, frankly, where, I suspect, the Legislature
7 will settle on it -- which is I suspect they will settle
8 on it as being deductible -- I think we're better to do
9 that, to put it in.

10 The other issue is, with regard to the rate,
11 I think that we would not want to be in a position where
12 we suggest something where we were able to keep the rate
13 at or below a certain optical or psychological level by
14 taking this issue, which is so important, so high-profile
15 nationally, and essentially punting it to them. Because
16 then I think the reaction may be that we didn't include
17 it so that we could keep the rate at a certain level,
18 so that they have the unhappy job of acknowledging the
19 reality of its deductibility, and the political imperative
20 of that; and then they're stuck with dealing with a rate
21 that is above the rate that we suggested.

22 So I think the checkers move on this would be,
23 don't put it in. The chess move on this, I think, is,
24 acknowledge that it should be deductible.

25 That would be my advice.

1 CHAIR PARSKY: Thank you.

2 Becky?

3 COMMISSIONER MORGAN: I think most of it has
4 been said. I think recognizing that this is a 2012 issue
5 for the Legislature to focus on, that if there's some way
6 that we could put some certainty into the formula to the
7 Legislature, that would be very helpful.

8 If we want to increase employment and encourage
9 businesses to stay or expand in California, any certainty
10 that we can put in it at this time would be helpful,
11 which speaks to basically capping the rate and hoping it
12 wouldn't have to be that by 2012 because things had turned
13 around.

14 CHAIR PARSKY: Jennifer?

15 COMMISSIONER MORGAN: As far as the health
16 issue, I think that's a toss-up, depending on what else
17 is deducted.

18 CHAIR PARSKY: Jennifer?

19 COMMISSIONER ITO: I don't know where we are in
20 the tally here.

21 CHAIR PARSKY: It's not a tally. I'm trying to
22 make sense out of it.

23 COMMISSIONER ITO: I think at this point, I lean
24 towards deducting health care. My concern overall with
25 this new tax is the impact that it may have on

1 labor-intensive industries and kind of the downward
2 pressure on wages. So I think to the extent that we can
3 encourage good-quality jobs and employer-provided health
4 care regardless of what happens at the federal level, I
5 would support any kind of mechanism that encourages
6 employer-provided health care.

7 CHAIR PARSKY: Bill?

8 COMMISSIONER HAUCK: I would lean towards making
9 it deductible as well for all of the reasons that have
10 been cited.

11 I want to ask you -- I want to make a broader
12 point, but I don't want to introduce it at the wrong time,
13 so...

14 CHAIR PARSKY: That's fine. We'll come back
15 around. You will certainly be able to.

16 COMMISSIONER EDLEY: So you have all the
17 guidance you need here?

18 CHAIR PARSKY: Yes.

19 Let me suggest this: The analysis that has
20 been done with respect to the 4 percent rate wasn't done
21 with absolute fine-tuning precision; and it varied based
22 on certain things in, out, around between 3.95 and 4.01.

23 My suggestion is, over the course of the next
24 day and a half, if we can figure out a way, given the
25 purity of the proposal, to include it as a deduction,

1 and only it, and still stay within a credible cap of
2 4 percent, that that sounds like it's the will of the
3 Commission.

4 COMMISSIONER MORGAN: "Only it"? Are you
5 dropping out things like R & D?

6 CHAIR PARSKY: No, no, I was dropping out other
7 forms of compensation, which you could argue should be
8 included as well.

9 COMMISSIONER MORGAN: Right, right. This is
10 really a public-policy issue, not a tax issue.

11 CHAIR PARSKY: Right. So let us do a little bit
12 more work.

13 I will tell you, having seen all the runs and
14 all the analysis that was done -- and Mark and Pat were
15 tireless -- tireless over the course of this weekend,
16 along with Bob's help -- it's not precision.

17 So let us see what we can do for two-tenths of
18 a point in order to accommodate the will of the Commission
19 on this subject.

20 COMMISSIONER EDLEY: If it costs too much, you
21 might consider a gas tax on ambulances.

22 CHAIR PARSKY: You know, the Boalt Law School is
23 increasing fees at will.

24 COMMISSIONER EDLEY: Let's not discuss that now...

25 CHAIR PARSKY: I don't know whether you wanted

1 to get into that.

2 COMMISSIONER EDLEY: No, no, no.

3 CHAIR PARSKY: Okay, let's -- with that,
4 let's -- we're going to come back to this part of the
5 proposal. But I would like to deal with the issue of the
6 pollution tax and the royalty on offshore drilling, as to
7 whether or not -- and we will deal with the minimum tax,
8 too. But those two things were on the table. A lot of
9 work was done, a lot of thoughts have been done. And the
10 question is, should they be included in this package that
11 we've outlined this morning in some detail?

12 First, Fred, your views.

13 COMMISSIONER KEELEY: Thank you, Mr. Chairman.

14 Mr. Chairman, am I right, it's about a quarter
15 to 4:00, approximately?

16 CHAIR PARSKY: Twenty of.

17 COMMISSIONER KEELEY: Twenty of?

18 If you would be kind enough, I think I mentioned
19 to you when we came back from lunch, I teach a class at
20 San José State that starts at 6:00. I have to be there
21 tonight. And the Oakland Raiders are playing Monday night
22 football, so I have to drive through their traffic to get
23 to class. So I will be leaving right at four o'clock in
24 order to make sure that I get to class on time.

25 If I could be permitted a couple minutes to --

1 CHAIR PARSKY: Certainly.

2 COMMISSIONER KEELEY: Thank you very much.

3 I will not reiterate my arguments for the
4 pollution tax. I would hope that that tax finds its way
5 into Bucket 1.

6 I understand that it is highly unlikely that
7 that would happen, and that it is more likely that it
8 will be in Bucket 3.

9 I understand -- and Mr. Chairman, I appreciated
10 at UCLA the opportunity to raise the issue of the Prop. 42
11 implications on sales tax as it relates to the BNRT
12 proposal and the elimination of the sales tax. And the
13 folks that I worked with, Josh Shaw and Arianna Von Meurs
14 and others on Friday to submit to you a possible way to
15 go on that, that team was pleased to be able to be of
16 some assistance, irrespective of how the pollution-tax
17 issue comes out, we were glad to have been of some
18 assistance to you in that regard.

19 Mr. Chairman, as I understand it, we will not
20 get together again, and that what members --

21 CHAIR PARSKY: It's very disappointing to me.
22 However, we have not scheduled a meeting.

23 COMMISSIONER KEELEY: So, Mr. Chairman, if I
24 could be -- I'll just make some remarks then.

25 First of all, I'd like to thank the staff so

1 very, very much for their outstanding work. This has
2 been an extraordinary undertaking. From where we started
3 at the beginning of this to where we are now, the staff
4 has been exceptionally good. And that should be no
5 surprise for people who interact with the people at the
6 Department of Finance and Board of Equalization, Franchise
7 Tax Board, the Speaker's office, the Pro Tem's office, the
8 Leg. Analyst's office, and so forth. These people are
9 top-flight thinkers and analysts, and they've provided
10 enormous support to this commission. And I want to thank
11 them each individually for that.

12 Mr. Ibele, thank you especially, and your team,
13 for your wonderful work, and Mr. Genest.

14 Mr. Chairman, I'd like to extend to all of the
15 colleagues here what an honor and privilege it is to
16 serve with all of you on this body.

17 I want to thank Commissioners Cogan and Edley
18 in particular for the extensive amount of very, very hard
19 work that they continue to do to this very moment, and I
20 suspect will do over the next few days on this.

21 And to you, Mr. Chairman, this is not an
22 enviable position that you have to try to take and
23 reconcile belief systems, irrespective of personalities,
24 resolving belief-system differences where it's possible
25 to do so and how to find that; thank you very, very much

1 for your excellent work.

2 Here is my take on this: My take is that the
3 package, the core package in my judgment will, I suspect,
4 have a majority support on this commission. I believe
5 that that will be the case. And for that, you deserve a
6 great deal of credit, Mr. Chairman.

7 I will not be one of the folks who signs the
8 document when it goes to the Legislature and the Governor.

9 I respect the work done by the Commission, but
10 I cannot agree with the conclusion. In my judgment,
11 there were other ways we could have gone, there were
12 other proposals made that might have been somewhat or
13 significantly better than the track that we've gone down.

14 I am not trying in any way, shape, or form to
15 disparage the individuals who have done such good work on
16 it. I am taking on the issue of the substance of the
17 proposal that is in front of us.

18 I think there's two fundamental problems with
19 it. One is, I don't think that in this state, at this
20 time, any regressivity makes sense. There is simply no
21 showing that has ever been made to this commission of any
22 data or any information that upper-income individuals
23 are fleeing California because of our tax structure. In
24 fact, PPIC has documented the opposite, and the opposite
25 is that low- and moderate-income people are leaving the

1 state because of the high cost of living.

2 I don't think, in my judgment, that revenue
3 volatility is a tax question. I appreciate that we have
4 dealt with it both in the recommendations as a tax
5 question and as a spending issue. And I appreciate that.
6 And that acknowledgment is very, very helpful, and I think
7 it's also very realistic. And I also understand that
8 reasonable people can reach different conclusions on how
9 you best deal with volatility.

10 And I think maybe there is a way to deal with
11 volatility through tax policy. I don't think essentially
12 giving no relief or actually increasing the burden on
13 ten million tax filers at the bottom end of the system
14 is really the way to go on this.

15 I do believe that one of the difficulties that
16 this report will likely have when it arrives at the
17 Legislature is, where is, in fact, the support for it?
18 Where is the support for the core package? It has been
19 difficult during the last two and a half months to
20 identify any support.

21 Now, I understand that there is never a
22 constituency for taxes; there's only a constituency for
23 what taxes buy. So when you have a tax commission and all
24 you're doing is dealing with are what should the tax rates
25 and bases be and so on, it is, by definition, an

1 extraordinarily difficult exercise to have anyone approach
2 the microphone and say, "My goodness, that's a grand
3 idea," because you're not dealing with what is it you get
4 to buy. Do I get better education, do I get better health
5 care, do I get something -- you know, what do I get for
6 this? So it's, per se, a very, very difficult
7 undertaking.

8 But I do think that there is a stunning lack of
9 any visible, organized or unorganized, support within the
10 community that the plan -- and, again, I'm not going to
11 motives and I'm not going to individuals, I'm going to
12 the essence of the plan -- what the problem the plan
13 attempts to solve -- competitiveness, volatility, ease
14 of administration, et cetera -- I don't believe it gets
15 there. And I don't believe it gets anywhere close to
16 where we want to be.

17 And so I won't be signing it, but it is solely
18 based on the merits of the proposal in front of us. I
19 think that everyone has functioned in good faith,
20 attempting to get the best package that they can,
21 advocating strongly for what they believe in and their
22 belief system tells them they need to do.

23 My belief system tells me, not that I can't
24 make a compromise. I think the only way to be effective
25 in public policy is a willingness to make a compromise.

1 And I'm very comfortable with making principled
2 compromises.

3 This issue, to me, is more fundamental than
4 that. I think that it does not -- the package that's put
5 out there, in my judgment, does not solve the problem
6 that we are trying to solve and, in my judgment, there
7 were other ways to get there.

8 Mr. Chairman, again, let me conclude by thanking
9 you and all of the other commissioners. This has been an
10 honorable process, and I thank you for every courtesy that
11 you've extended.

12 CHAIR PARSKY: You're welcome.

13 Let me suggest that with respect to the
14 pollution tax, I don't sense there is any support for
15 including it in Section 1.

16 Do I hear anything different?

17 *(No response)*

18 CHAIR PARSKY: I also don't sense that there's
19 any support for including it in Section 3.

20 Do I hear any difference?

21 *(No response)*

22 CHAIR PARSKY: Okay, let's move on.

23 Next would be the oil, the tax on oil for new
24 drilling.

25 COMMISSIONER BOSKIN: Let me just say that,

1 obviously, there are people who feel strongly on both
2 sides of this issue.

3 My main point is that California is virtually
4 the only place on earth that doesn't exploit its energy
5 sources and reap the revenue from it, under extremely,
6 carefully guarded, strict, environmental procedures.

7 Most of the rest of the world and most of the
8 rest of the country try to exploit every molecule and
9 get every dollar they can. And this is going to be an
10 issue for the state for a long time. It's leaving
11 potentially leaving a lot of resources on the table.

12 Again, I'm not looking to make any radical
13 changes in environmental policy. This should be under
14 very strict environmental safeguards. And I'm sure it
15 will not be included in Section 1.

16 I would hope that people would adopt the
17 standard that it's reasonable to raise the issue for
18 consideration in Section 3, for the State to see whether
19 it makes sense to enhance its offshore drilling and reap
20 the revenue under very strict and environmental
21 safeguards.

22 CHAIR PARSKY: On that subject, do I sense the
23 commissioners in support of including that item in
24 Section 3?

25 COMMISSIONER EDLEY: I support it.

1 COMMISSIONER BARRALES: I support it in
2 Section 3.

3 COMMISSIONER BOSKIN: There's several. I mean
4 Curt did and some other people.

5 CHAIR PARSKY: Yes, we will have to seek the
6 concurrence there. But with Chris' support, and Ruben and
7 Bill and John --

8 COMMISSIONER COGAN: *(Raising hand.)*

9 CHAIR PARSKY: -- and George, I think we have
10 a basis for including it in Section 3.

11 Next is the concept of a minimum tax that has
12 been raised by several commissioners. We did not include
13 that in our Section 1.

14 The issue -- and maybe we should just have a
15 brief discussion of whether or not the concept, to be
16 defined, should be included in Section 3.

17 COMMISSIONER EDLEY: Mr. Chairman, can I --
18 Mr. Chairman? I mean, Gerry.

19 Look, I don't -- I personally remain very
20 skeptical about the logic focusing on whether or not
21 people, as a matter of, small "D," democratic theory,
22 need to be paying in income tax in order to feel that
23 they have a stake in the structure of the revenue system
24 or the performance of their government given the other
25 flow of obligations and rewards that attach.

1 So while I'm personally skeptical about it,
2 I do think that it is an idea that's worth the
3 Legislature's debating it.

4 I guess the caveat, though, is, that I think it
5 also ought to be combined with the issue of some kind of
6 a minimum tax. And I assume we're talking about
7 de minimis -- relatively de minimis, some kind of a
8 minimum tax with respect to firms as well as individuals.

9 And I think on that basis the Legislature ought
10 to think about both of those. Not a minimum tax on firms
11 that is as substantial as under the current franchise tax.
12 But on that basis, I think I would support including it
13 in Part 3.

14 CHAIR PARSKY: Michael and Becky, could you
15 just comment on what it would be that you would be
16 suggesting?

17 COMMISSIONER BOSKIN: I think we should
18 basically outline qualitatively that there should be a
19 small minimum tax on all people and firms, because
20 certainly firms are getting the benefit of a lot of the
21 services that the states provide; and that it should be
22 designed to be minimally disruptive to their economic
23 health, but basically be designed for them to be
24 participating and be aware that they're participating in
25 financing the government.

1 And we've talked about 1 percent or \$50 or \$100
2 or something of that sort. And I haven't really thought
3 through what the appropriate number would be for a firm,
4 but we're talking about a hundred or a couple hundred
5 bucks. We're not talking about many thousands of dollars.

6 Just to establish the principle, to get a debate
7 going on the principle: Should everybody be participating
8 in financing the government in some way?

9 CHAIR PARSKY: Becky?

10 COMMISSIONER MORGAN: I, of course, as you know,
11 agree with Michael that the benefits of this state should
12 have a buy-in by all its residents -- a stake in the
13 state. And so the people feel they're contributing to
14 their children's education, the roads that they drive on,
15 et cetera, et cetera.

16 I perhaps have a philosophical disagreement
17 with Chris that people don't need to pay to appreciate.

18 Just from my experience of people paying \$5 for
19 health care at a clinic as a stimulus to keep them out of
20 the emergency room or people pay \$2 to come to an event
21 and they come in greater numbers than if it were free,
22 it's my feeling that, psychologically, people like to feel
23 like they're contributing. And so I think that a minimum
24 tax -- and I think it could be worded in such a way that
25 we ask the Legislature to explore the right amount of a

1 minimum tax.

2 Michael has suggested 1 percent of net receipts,
3 and I said \$50, \$100 for individuals. But without putting
4 a number on it, maybe we could say that we encourage the
5 Legislature to explore the concept of everybody making a
6 contribution to the benefits of living in California.

7 COMMISSIONER BOSKIN: Mr. Chairman, may I make
8 one last comment?

9 CHAIR PARSKY: Yes.

10 COMMISSIONER BOSKIN: For the sake of
11 consistency and good governance of our Commission, we have
12 adopted the revenue-neutrality standard. If either of
13 these two proposals in Section 3 -- if they get in
14 Section 3, actually eventuated the latter, the minimum
15 tax would raise a small amount of revenue, oil revenue
16 could be substantial at any point -- at some point in the
17 future. That it ought to be --

18 COMMISSIONER EDLEY: Retroactive stipends to
19 the members of the Commission?

20 COMMISSIONER BARRALES: So moved.

21 COMMISSIONER BOSKIN: I think that there ought
22 to be just some statement that these ought to be netted
23 out and appropriate use made of them through the rainy-day
24 fund or something of that sort.

25 COMMISSIONER MORGAN: Just so I can understand,

1 if I may ask one question on your overall proposal. You
2 said to phase-in the reduction in the PIT at 20 percent.
3 So, for instance, the top rate that the Legislature just
4 increased in, what, June or July, to 9.55, you take
5 20 percent of that, or those that are paying a 7 percent
6 rate, you say can reduce 20 percent of that or what?

7 CHAIR PARSKY: Well, first of all, we would
8 start in 2012 --

9 COMMISSIONER MORGAN: I understand.

10 CHAIR PARSKY: -- so that the temporary
11 increases would have ended. And then there would be a
12 calculation made as to what the existing system -- we
13 wouldn't change the existing system -- would need to do
14 adjustment of all the existing system equally to produce
15 about 20 percent less of a revenue loss, or about
16 \$3 billion --

17 COMMISSIONER MORGAN: Yes.

18 CHAIR PARSKY: -- than otherwise would have.
19 That's what will be written up.

20 COMMISSIONER MORGAN: Just as I hear people over
21 and over say, "Keep it simple."

22 CHAIR PARSKY: Yes, I hear that.

23 COMMISSIONER MORGAN: You have to hire an
24 accountant to do it under the old system and under the new
25 system.

1 COMMISSIONER HALVORSON: A quick -- sorry.

2 CHAIR PARSKY: Before we turn to that, I just
3 want to see if we can't get through Section 3. And we'll
4 come back.

5 COMMISSIONER MORGAN: Well, that only figured
6 in because I was wondering, you know, what we were
7 anticipating people paying in 2012.

8 COMMISSIONER KEELEY: Mr. Chairman, a quick
9 question?

10 CHAIR PARSKY: Yes.

11 COMMISSIONER KEELEY: A quick question.

12 Senator, could I ask you a quick question?

13 As a matter of principle, the issue that you
14 raise with respect to the personal income tax, certainly
15 low-income folks pay -- you mentioned have a stake in
16 their education, have a stake on the roads that they
17 drive on. So low-income folks pay gasoline tax, which
18 directly funds the roads. Low-income folks pay a sales
19 tax on gasoline which is restricted by Article XIX of the
20 Constitution, Prop. 42, so that goes there. They pay
21 sales tax now, and they will pay BNRT going forward,
22 which are general fund sources. And the sales tax
23 obviously is the second largest source of the general
24 fund. So they are paying.

25 I'm just wondering why it is that you think

1 that they would need to pay a personal income tax if they
2 already have a stake in the game by paying sales tax and
3 gas taxes and so on for general-fund activities?

4 COMMISSIONER BARRALES: We're abolishing the
5 sales taxes?

6 COMMISSIONER MORGAN: Well, because, one, up to
7 \$20,000 net, they pay nothing.

8 If somebody is making \$45,000 -- or \$50,000 and
9 they get a family deduction of \$45,000, right off the top,
10 they only have \$5,000 of income. And I'm saying --

11 COMMISSIONER KEELEY: I guess I'm asking a
12 slightly different question.

13 COMMISSIONER MORGAN: -- if they're not paying
14 income tax.

15 COMMISSIONER KEELEY: No, no, I'm asking a
16 different question.

17 I'm wondering why it's important to you -- you
18 said that you think low-income folks should -- you know,
19 if people had a stake in it, if they pay taxes for
20 education, if they pay taxes for roads, if they pay taxes,
21 then they have more of a stake in it, in what their
22 government does.

23 Well, poor people do that already. They pay
24 gas tax and sales tax, both of which go for roads and
25 education.

1 Why is it necessary for us to establish some
2 minimum tax paid by low-income folks when they already
3 have that -- it seems like the assumption you're making
4 is, unless you pay personal income tax, you don't have a
5 stake in the general-fund world or you don't have a stake
6 in education, you don't have a stake in transportation.
7 I'm just wondering --

8 COMMISSIONER MORGAN: Perhaps I'm talking more
9 from a psychological standpoint than a public-policy even.
10 But April 15th is a tax date. People know they pay gas
11 tax, but it's every time they fill up, and it's less
12 specific.

13 COMMISSIONER KEELEY: Okay, so you're not
14 arguing that --

15 COMMISSIONER MORGAN: But when they get to
16 income tax, they say, "I pay \$50. You know, I contributed
17 to the state one time in a one-time knowing way."

18 COMMISSIONER KEELEY: Okay, thank you very much.
19 Thank you, Mr. Chairman.

20 CHAIR PARSKY: John?

21 COMMISSIONER BOSKIN: This proposal does remove
22 the sales tax for the general fund, so they would no
23 longer be paying anything. There will be many millions
24 of people who pay zero -- literally zero into the general
25 fund. Now, the gas tax, you're certainly correct, but

1 that goes to transportation. So for all the other
2 non-transportation services, they'd be paying nothing.

3 And with respect to the BNRT, there's an issue
4 of who winds up paying it. Perhaps some will get passed
5 forward in higher prices. But that's certainly kind of
6 an invisible thing. I mean, you're not filling out a
7 form, you're not identifying it with this. You're just
8 paying a bill, where it's not even separately enumerated.

9 CHAIR PARSKY: John?

10 COMMISSIONER KEELEY: Could I just complete this
11 thought? Let me make sure I understand it.

12 Michael, are you suggesting that there is some
13 evidence or some study or something that shows that
14 low-income people don't appreciate the public education
15 their children receive because they're not paying enough
16 in taxes?

17 COMMISSIONER BOSKIN: Not at all. I never said
18 that at all. I just said, they will have a stake in
19 decisions about how much is spent and the nature of it
20 and how the revenue is raised if they're participating
21 in the tax system.

22 COMMISSIONER KEELEY: And you don't think
23 they're participating in the tax system if they pay sales
24 tax and gas tax?

25 COMMISSIONER BOSKIN: They're not going to pay

1 sales tax if our proposal is adopted, Fred.

2 COMMISSIONER KEELEY: Well, they'd be paying
3 BNRT.

4 COMMISSIONER BOSKIN: I'm sorry -- I'm sorry,
5 number one, it's unclear they will. Some modest portion
6 of it will go forward into higher prices. A lot of it
7 will be borne by factors of production and capital and
8 labor. Some of it will be exported outside the state.
9 That's number one.

10 Number two, the way the BNRT works, no one is
11 even aware that there is a separate tax. To the extent
12 they'll be paying some small portion of it, it will be in
13 the price of the good. And the way this is done, unlike
14 the current sales tax where it's added, it will just be
15 embedded in the price. People will never even see that
16 they're paying it.

17 COMMISSIONER KEELEY: Thank you.

18 Thank you, Mr. Chairman.

19 *(Commissioner Keeley left the meeting room for*
20 *the day.)*

21 CHAIR PARSKY: John? I just wanted to let John
22 comment.

23 COMMISSIONER COGAN: So I think Mike's got it
24 exactly right, that a minimum tax does give individuals
25 a stake in their government.

1 When I think of one of the values of the gas
2 tax, and since it's directly related to roads, financing
3 roads, bridges, highways, it does give people a sense
4 that they have a stake in the gas tax and they have a
5 stake in the quality of roads. And it's a nice fit.

6 And so I think in the context of our proposal,
7 where the retail sales tax goes away, I do think it's
8 appropriate to have some sort of minimum tax, at least
9 subject to further consideration.

10 Now, having said all that, Chris and I worked
11 very hard to try to accommodate every commissioner's
12 concern about the distributional consequences for our
13 policy. And so it would seem to be that a minimum tax
14 would sort of undo all that work, and so it doesn't
15 belong in Category Number 1.

16 COMMISSIONER MORGAN: We aren't asking for that.

17 COMMISSIONER COGAN: Right, and, therefore, you
18 know, it's fine with me if it goes into Category 3.

19 Chris' amendment that we accompany it a with a
20 minimum tax on businesses is a little bit problematic for
21 me for the same reason. In Part A, we have eliminated the
22 minimum tax on business, and then we seem to be stepping
23 on ourselves. But in the interest of accommodating the
24 other members, I would support that as well.

25 COMMISSIONER EDLEY: What a guy.

1 COMMISSIONER COGAN: And then Michael raised the
2 final point, which is what do we do with the revenues?
3 What recommendation do we have with respect to the
4 revenues that might be generated from either of these two
5 minimum taxes? And it does seem to me we don't want to
6 be in a position of using these taxes to increase the size
7 of government. I think we have held pretty fast in our
8 sort of commitment that the conservatives wouldn't use
9 this commission to reduce the size of government; and
10 those on the other side wouldn't use the commission to
11 increase the size of government.

12 And so I would say that we have to have some
13 sort of sense about how we would reduce other taxes if
14 the minimum tax were to go into effect.

15 And my preference would be to reduce the BNRT
16 rate, but that's just a throw-away, if you will.

17 CHAIR PARSKY: George?

18 COMMISSIONER HALVORSON: Mr. Chairman, two very
19 quick comments. One of them relative to the sense of
20 value.

21 I actually saw some interesting research a
22 number of years ago that showed that in mental-health
23 treatment, patients with a copay were much more likely
24 to take the advice of the therapist than patients who
25 didn't have a copayment. There was actually a sense of

1 purchase. And a \$10 co-pay was sufficient to cause people
2 to take advice at a higher level than free. So just a
3 pure FYI.

4 But my more serious point is, we need to make
5 sure that we don't actually increase the size of the
6 government beyond the revenue. I'm not sure how small
7 this tax is going to be. But I've set up files many
8 times. And if you have to set up a billing file for
9 10 million people and administer the billing file for
10 10 million people and send out bills and reconcile and
11 do all this stuff, you've now added a whole bunch of
12 work to the process, and administrative expense. And I
13 would hope that we would somehow make sure that this
14 isn't net-net.

15 I mean, we may not have to deal with the revenue
16 issue because net-net, it may be a zero increase to the
17 state because the expense we're adding is equivalent to
18 the revenue we're getting. So I'm not sure what kind of
19 numbers we're talking about, but we should be very careful
20 to do this in the most elegant, simple way, and not add
21 to the administrative expense of California.

22 CHAIR PARSKY: With that caveat, would you be
23 inclined to support including this as amended?

24 COMMISSIONER HALVORSON: With that caveat.

25 COMMISSIONER BARRALES: I don't know if it's

1 the same caveat. But I'm not supportive of the minimum
2 tax on firms, if one of our points was that firms under
3 a certain amount wouldn't file, be exempt. So now,
4 basically we're taking that away.

5 Also, I would not support any kind of allocation
6 formula. In other words, I would use it to help keep --
7 if you were going to help collect that tax, in light of
8 what George said, it may not be a net revenue gain,
9 anyway. But what I'm trying to say is, I don't want to
10 develop systems for spending this money that would be
11 brought in. In other words, I would take it to reduce
12 your business net-receipts tax rate or keep your
13 net-neutral figure.

14 CHAIR PARSKY: Please bear in mind what we're
15 talking about here is Section 3, which the Commission
16 is not recommending. This is not a commission
17 recommendation. This is a recommendation by enough
18 commissioners to warrant someone else looking at it.
19 So there should be no refinement, if you will, in a
20 recommendation that's coming from this commission. This
21 is not at all a commission recommendation. But we did
22 say that anything that came into Section 3 ought to have
23 enough requisite support, generally defined as at least
24 five commissioners of which one, at least, was from the
25 opposite appointment as the four others, if it happened

1 to go that way.

2 But it's not a recommendation of the Commission.
3 Jennifer?

4 COMMISSIONER ITO: I appreciate that, and I know
5 you probably don't even have to ask me where I stand. But
6 I just wanted to go on the record, just for my own
7 conscience, that I do not support a minimum tax. And I
8 don't know if the underlying assumption is that if folks
9 aren't paying into this tax on April 15th, that they'll
10 always vote for an increase in taxes. I don't know if
11 that's an unstated fear.

12 But I just -- I need to go out on record that
13 I don't appreciate this. And I've fought against a flat
14 tax. And for me, this moves towards the version of doing
15 a head tax, which I just am vehemently opposed to. So I
16 just want to go on record.

17 CHAIR PARSKY: Your views were definitely known,
18 and this is very consistent with it.

19 Bill?

20 COMMISSIONER HAUCK: No.

21 CHAIR PARSKY: No comment.

22 Okay, I'd like everyone -- I mean, it sounds
23 like it's possible to include this. I want to be sure
24 that I've got the views -- or Edward?

25 COMMISSIONER DE LA ROSA: Well, I mean, since

1 we're counting it up. I guess I'll weigh in, too.

2 I really respect the examination of this issue.

3 I have spoken out on this issue once before.

4 I really, in my opinion, I think that the people
5 in the bottom brackets don't reside there voluntarily.

6 And I think that the people that are desirous of being
7 good citizens and are one day going to get out of there
8 and they'll pay their tax and so will their kids; and the
9 ones that don't make it out of there, I'm not sure that
10 taxing them is a way to make them better citizens, really.

11 So I feel as though I won't be able to support this one.

12 CHAIR PARSKY: I would certainly like to get
13 the views of those that are not here on this subject,
14 because I think it's pretty close. So if you'll let me
15 do that.

16 Recognizing it's not going into Sections 1 or 2,
17 and we have to be careful about how we articulate the
18 lead-in there, we'll come back to everybody.

19 I want to raise a few others for Section 3
20 quickly before we come back and have one discussion of
21 the rainy-day fund, then I'd like Bill to comment on the
22 overall proposal that we're contemplating bringing
23 consensus around.

24 I'd just like to get a feel for -- these ideas
25 have been suggested by Becky and are worthy, at least,

1 of hearing and maybe people won't be able to react
2 immediately. But these would be potential Section 3
3 ideas.

4 COMMISSIONER MORGAN: And could I just say,
5 Gerry, reminding people that Section 3 said, "Will
6 identify areas of reform to be considered."

7 CHAIR PARSKY: People should -- I reminded
8 everyone at the beginning of each meeting. I hope
9 everyone keeps that in mind.

10 One concept was to consider changing the
11 Constitution to discontinue 58 county offices of
12 education.

13 COMMISSIONER MORGAN: Since that was my idea,
14 in adding up what 58 county offices of education spend,
15 it's \$5 billion two years ago. And I've said before that
16 if you can save money, it's like finding money.

17 And my proposal was that we go to the voters
18 to take that requirement out of the Constitution. It
19 doesn't say to go to the voters to do away with county
20 offices. But the committee on -- a commission similar to
21 this -- on education, whose report is sitting on a shelf
22 somewhere, recommended perhaps regional offices. But I,
23 having been in education all my life, just don't see why
24 Los Angeles or San José, as big as they are, need to have
25 an additional overlay for them to be able to provide

1 special education and professional development, which are
2 the only two statutory requirements for county offices of
3 education.

4 So this would just say, 1865 may not apply to
5 the 21st century.

6 CHAIR PARSKY: I should have said that any ideas
7 that don't reach Section 3 but that were submitted by
8 commissioners are part of the record of this commission.
9 And so you and others would be on record of having
10 suggested it.

11 Any support for that concept?

12 *(No response)*

13 CHAIR PARSKY: Okay, next is incentivizing --

14 COMMISSIONER COGAN: Mr. Chairman, let me say,
15 I have a little bit of familiarity with the issue; and
16 I really do think, Becky, this is a very, very good idea,
17 and something definitely for California to pursue.

18 Having said that, it really is outside the
19 purview of the Commission's work, is the way I think
20 about it. And that would be my reason for saying, let's
21 keep it out of Section 3. It just seems so non-germane
22 to the tax question that we're really responsible for.
23 But I think it's a great idea.

24 COMMISSIONER EDLEY: I agree with John on that,
25 but I would throw -- at the next commission, just worrying

1 about this.

2 CHAIR PARSKY: One-thousandths share.

3 COMMISSIONER EDLEY: 1,000 school districts is
4 also ridiculous. It's absolutely ridiculous.

5 CHAIR PARSKY: Well, that's the second.

6 COMMISSIONER HAUCK: Yes, we've been --

7 COMMISSIONER MORGAN: Gerry has that from me,
8 too.

9 CHAIR PARSKY: Well, that's the second. The
10 second recommendation is, incentivize school districts to
11 merge.

12 COMMISSIONER EDLEY: Maybe into counties.

13 COMMISSIONER HAUCK: Mr. Chairman, I'd say for
14 the record, both of these recommendations have previously
15 been made. The Constitution Revision Commission made
16 both these recommendations. And you can see how far they
17 got. A thousand school districts in California makes no
18 sense at all; and these county offices of education,
19 especially in the Constitution, don't make any sense,
20 either. But I agree with John, they're not central to the
21 work of this group.

22 CHAIR PARSKY: Okay, I want to make sure that
23 every commissioner who had ideas, those ideas are heard.

24 Next -- and I say this with a little
25 trepidation, excuse this for the moment, representatives

1 of the Franchise Tax Board, however, the recommendation
2 was combining the Franchise Tax Board and the Board of
3 Equalization.

4 Both organizations gave tremendous, tireless
5 support to this effort. So raising this subject is not
6 meant in any way as a lack of appreciation for the effort
7 that was put in by everyone there, but...

8 COMMISSIONER HAUCK: This has also been
9 recommended? You eliminate -- not "eliminate" -- but
10 you eliminate constitutional offices in the Board of
11 Equalization, which probably makes some sense, and you
12 merge the two in some fashion, into a Department of
13 Revenue; and that recommendation has been on the books
14 for 40 years and still hasn't been done.

15 CHAIR PARSKY: John?

16 COMMISSIONER COGAN: So I say, let's keep that
17 recommendation on the book.

18 You know, it does seem to me that this one is
19 very germane to our mission, very similar to the tax court
20 proposal that we've adopted.

21 And so I would say it's perfectly appropriate
22 for Category 3, if not Category 1, and I guess maybe
23 Category 2 would be appropriate, since this involves a
24 constitutional change. And I do think it makes sense to
25 have a single revenue entity at the state level, like we

1 have at the federal level.

2 CHAIR PARSKY: Any -- we're talking about
3 Section 3 right now. I'd like to kind of leave it in
4 Section 3, if at all.

5 Michael?

6 COMMISSIONER BOSKIN: Yes, I'm strongly
7 supportive for all the reasons stated. I think it makes
8 a lot of sense. It's always made a lot of sense.

9 I don't want to exaggerate how much this will
10 improve things because many of the functions of each will
11 have to continue in the successor organization. But, in
12 any event, I think it's a good idea.

13 CHAIR PARSKY: Any other thoughts?

14 COMMISSIONER BARRALES: Can we put these guys
15 in charge, though?

16 CHAIR PARSKY: Carl -- we'll put Carl in charge
17 of the merger.

18 COMMISSIONER COGAN: Carl, you can write it up.

19 CHAIR PARSKY: In the private sector, mergers
20 happen if the people at the top want it to happen, and
21 then it's all around who's going to be the CEO.

22 Is it that kind of thing, Ruben, do you think?

23 COMMISSIONER BARRALES: Yes, there you go.

24 CHAIR PARSKY: Any other support?

25 COMMISSIONER EDLEY: Yes, I support it on the

1 condition that they're merged into the Air Resources
2 Board, which I think -- because we want to get Fred on
3 board.

4 CHAIR PARSKY: For purposes of --

5 COMMISSIONER EDLEY: I support it. I support
6 it.

7 CHAIR PARSKY: For purposes of today, it looks
8 like we have some support for including this in Section 3.

9 The last item -- and, Becky, you correct me if
10 I missed any -- but the last item is to make the revenue
11 from Proposition 172 be made visible, so the public knows
12 how much is spent in total on public safety and as a
13 percentage of the budget.

14 COMMISSIONER MORGAN: This was a recommendation
15 that came to us, like, our second meeting from Eric
16 Milky -- what's his name?

17 COMMISSIONER HAUCK: Miethke.

18 COMMISSIONER MORGAN: Miethke, yes. And it
19 seems to me that the public should know what's being spent
20 in each department, each category.

21 And for some reason, this proposition -- again,
22 the voters said that it shall just go to public safety.
23 And I'm told by Eric that it doesn't have to be included
24 in the annual budget.

25 CHAIR PARSKY: How do people feel on this issue

1 of, is it within the purview of the Commission?

2 (No response)

3 CHAIR PARSKY: I don't sense overwhelming
4 support.

5 I think that item, although worthy of
6 consideration, wouldn't fall within Section 3.

7 Okay, let's now return --

8 COMMISSIONER HALVORSON: Mr. Chairman?

9 CHAIR PARSKY: Yes?

10 COMMISSIONER HALVORSON: There was the one other
11 point that I've raised a couple of times, and that's the
12 issue of multiyear budgets.

13 CHAIR PARSKY: Yes, I should have said that --
14 and I will circulate this -- there is to be a Chairman's
15 message, which I will craft. And included in that
16 message, I would anticipate acknowledging some of the
17 work going on, which I think is extremely important work,
18 by organizations such as California Forward. And in
19 connection with that work, consideration of multiyear
20 budgeting, issues surrounding whether there should be a
21 two-thirds vote on the budget, not necessarily the tax,
22 and other areas like that, which I will circulate around,
23 I would anticipate including in the overall message.

24 And I'd, obviously, want everybody to approve
25 that, but that's what I was anticipating doing as part

1 of -- I've had a chance to meet a number of times with
2 Bob Hertzberg and others. And Bill, of course, and Fred
3 Keeley are on that. So I think it is important to
4 acknowledge that work, and that's where I think that
5 would fit in.

6 COMMISSIONER HALVORSON: That might be a good
7 place for it.

8 I think 3 would also -- I think either place.

9 But I think to attempt to run an economy of
10 this size without having a multiyear financial plan and
11 also a multiyear capital plan is bizarre and completely
12 unacceptable. I think that we ought to have a much better
13 long-term planning process than we have now; and there
14 ought to be a sense of where the state of California is
15 going to be three to five years from now relative to
16 infrastructure and a whole series of things. And if we
17 don't have that, we're going to be constantly surprised
18 by things that should never surprise us. So I actually
19 feel quite strongly about that.

20 And I think that also helps a little bit with
21 the volatility issue, because when you know what's coming
22 down the road, you can plan for it. And the whole revenue
23 agenda makes more sense.

24 COMMISSIONER MORGAN: I second that.

25 COMMISSIONER BARRALES: I support that in

1 Section 3.

2 CHAIR PARSKY: John?

3 COMMISSIONER COGAN: George, can I ask you a
4 question about what you mean by "multiyear budgeting"?
5 Do you mean that we'd have two-year appropriations?

6 COMMISSIONER HALVORSON: No, the politics of
7 elected officialdom I think make it impossible to do more
8 than a single-year budget. There's all kinds of reasons
9 why.

10 I think what we need, though, is a three- to
11 five-year --

12 COMMISSIONER COGAN: Window.

13 COMMISSIONER HALVORSON: -- budget. That we
14 need to have -- it should come from the Governor's office,
15 it should come from an official department, and it should
16 say, "Here's what we expect the expenses of the State of
17 California to be over this time frame," and they do some
18 projections, but a more formal sort of thing that says,
19 "We have this many miles of road in California. We're
20 going to have to sustain those, and here's what it's going
21 to look like over time to sustain that. Here are how
22 many prisons we have, here's how many students we have,
23 here's the schools we're going to have." And basically
24 do a multiyear budget that then the Legislature must look
25 at in the context of the annual budget.

1 COMMISSIONER COGAN: So you have --

2 COMMISSIONER HALVORSON: Right now, I don't
3 think that big-picture-look happens. So everything is
4 down a silo and everything is sort of situational, and
5 we don't have a sense that if we take money from here,
6 we're not going to have enough money for bridges there.
7 And so I think a longer-term view and a requirement that
8 it be updated in a formal way annually --

9 COMMISSIONER EDLEY: But this would not have
10 legislative force.

11 COMMISSIONER HALVORSON: But it would not be
12 binding. You cannot make it binding -- I can't imagine
13 a process of making it binding; but you can make the
14 process binding that says you must look at it and speak
15 in the context of it annually.

16 COMMISSIONER COGAN: I think that's a very good
17 idea. And I certainly would support it, at least in the
18 letter, and would have no objection to it going into
19 Section 3.

20 I will say this: The federal government used
21 to have annual budgeting, you know, back in the seventies.
22 And then they felt we should account for the long-term.
23 And so then they went to annual appropriations but a
24 three-year budget arises, so you could see the full
25 effects of all these appropriations. And then they went

1 to five years in the early eighties. In the early
2 nineties, they went to ten years. And in between the
3 two, the national debt has gone up to \$9 trillion. It
4 hasn't exactly worked out as planned. So I'm a little
5 bit skeptical about whether it will work or not. But I
6 think it's a good idea to have them look at the long run,
7 at least.

8 COMMISSIONER HAUCK: Gerry, let me just add
9 that California Forward has already made these proposals.
10 They are in front of the Legislature as of now.

11 Secondly, the crucial piece of this is more
12 frequent review of revenues and expenditures and a
13 rebalancing process that occurs at a point where, when
14 the State's in financial trouble, it's not so deeply in
15 trouble that they can't politically solve it.

16 What happens now is, you adopt a budget,
17 30 seconds later it's out of balance, and then you don't
18 do anything about it for 12 months. Well, that's
19 impossible in terms of the kind of numbers that this
20 state deals with.

21 So the multiyear planning is important, and we
22 need to do it. But the more frequent review of spending
23 and revenue, as you do in any other enterprise, is really
24 what will keep this within some manageable limits, along
25 with an effective rainy-day fund.

1 CHAIR PARSKY: One thing that might be helpful
2 then is, Bill, if you could supply to the staff what
3 actually has been submitted to the Legislature.

4 COMMISSIONER HAUCK: Sure.

5 CHAIR PARSKY: We will include it in the
6 appendix, and I will acknowledge it in the transmittal
7 letter.

8 Okay, let's go back -- and I know Bill wants
9 to make some comments about the proposal -- but before we
10 just do that, between Mike and Chris, the rainy-day fund
11 concept, have you both discussed that a little?

12 COMMISSIONER EDLEY: Yes. And we've agreed to
13 discuss it some more.

14 CHAIR PARSKY: Okay, the concept is there.

15 COMMISSIONER EDLEY: Yes.

16 CHAIR PARSKY: And I think the open -- and,
17 Mike, do you want to describe it for everyone? Because
18 we didn't have a chance to describe it. Just briefly
19 describe what it is we're discussing and what needs to be
20 refined.

21 MR. GENEST: Two basic ideas: One is to require
22 money to go into the fund, two different ways that will
23 happen; and then put restrictions on the money coming out
24 of the fund, the effort being twofold: First, to prevent
25 the Legislature from spending money during surge years

1 when there's a lot, as we did in 2000; and second, to set
2 that money aside so that it's available for times like
3 this in a rainy-day fund.

4 It needs a constitutional amendment if you're
5 going to bind the Legislature -- they can't bind their
6 own hands.

7 So the specifics of depositing the money are
8 modeled very closely after provisions that have already
9 been put on the ballot by the Legislature, and there are
10 two pieces. There is a 3 percent annual contribution
11 that's required, 3 percent of general fund revenue, and
12 then there is this idea of setting a long-term trend line,
13 ten-year trend, a simple multiple regression analysis,
14 or 20-year regression analysis, that is. And then if
15 we're getting revenue coming in over the trend, it must
16 go into this fund. And if it's under the trend, then
17 under certain circumstances, we can take money out of the
18 fund.

19 So that gets us to what are those circumstances.
20 The money can come out of the fund when it exceeds
21 12½ percent, but it can only be used for one-time purposes
22 when it comes out that way. But it can also come out in
23 years like the one we're in which the revenues from the
24 general fund are not anticipated to be high enough to
25 maintain spending at the prior-year level, plus an

1 adjustment for population and inflation. So this is a
2 way of leveling off spending and smoothing out the ups
3 and downs of the budget.

4 COMMISSIONER EDLEY: So let me tell you the two
5 concerns that I have. One is that I'm very concerned in
6 this context about carrying forward the previous judgment
7 in the Legislature about the mandatory 3 percent
8 contribution. And I think the simplest way to say this,
9 is that if you look at increases -- if you look at the
10 long-term trend, then I think it's appropriate to say
11 that revenues in excess of the long-term trend should go
12 into the rainy-day fund unless you've already filled up
13 the fund. That's fine.

14 The problem is that if your revenues are in
15 excess of the current services requirement, and yet still
16 not up to the long-term trend, then, it seems to me,
17 inappropriate to have the 3 percent mandatory requirement.

18 But I think that the contribution of the
19 rainy-day fund ought to only attach once you get above
20 the long-term trend.

21 Now, this slows down the pace of putting money
22 into the long-term fund, into the rainy-day fund. On the
23 other hand, we're going up to 12.5 percent. So once we
24 are making contributions, it's going to be a healthier
25 fund. That strikes me as a reasonable sort of trade-off.

1 To put it more pointedly, if we're still below
2 the long-term trend in revenues, I don't want to tax the
3 general fund in order to fill up the rainy-day fund --
4 yet. I want to wait until we get above the long-term
5 trend. So that's point number one.

6 Point number two is -- and I haven't had a
7 chance to raise this yet with Mike because I'm a little
8 bit concerned with making sure that the definition
9 of "current services" is sector-specific. So that, for
10 example, if we're talking about health-care costs or
11 corrections-sector costs, and those are ahead of CPI, I
12 wouldn't want to use the -- the CPI wouldn't want to use
13 a general GDP deflator or CPI, because that wouldn't
14 actually reflect current services sector by sector, so...

15 COMMISSIONER BOSKIN: There is a state and local
16 government goods deflator. There's a separate one for
17 state and local government that you can get from BEA.

18 COMMISSIONER EDLEY: Right. So the question
19 would be whether, in terms of computing current services,
20 using an aggregate deflator of that sort as opposed to
21 looking at the mix in our budget, whether or not that
22 that's -- it may not be an adjustment that's worth making.

23 But I just have a little bit of agita about that.

24 COMMISSIONER BOSKIN: I think your point about
25 state and local services being different from the general

1 consumption basket is a good one.

2 COMMISSIONER EDLEY: Right, and maybe that's all
3 I need, is to make sure we're not using the reasons to --

4 MR. GENEST: When it was originally drafted, the
5 reason it was drafted with the California CPI is because
6 that's a published Bureau of Labor Statistics time series.

7 The GDP deflator is not published at a state
8 level, so you would be using the national.

9 COMMISSIONER EDLEY: It's a national.

10 COMMISSIONER BOSKIN: It's an aggregate, but
11 it's for state and local services and --

12 MR. GENEST: Right, but it's for the entire
13 nation. So the CPI is not great because it doesn't
14 measure the specifics of the government. But you do have
15 it specifically for California.

16 The GDP deflator is not great because it does
17 measure government, but it doesn't measure specifically
18 California. So we picked one.

19 COMMISSIONER EDLEY: So we're going to meet in
20 a bar down on Telegraph, if anybody wants to join us.

21 COMMISSIONER MORGAN: Chris, my concern is
22 that --

23 COMMISSIONER BOSKIN: You get some of each.

24 COMMISSIONER EDLEY: You can average the two.

25 COMMISSIONER MORGAN: Chris, my concern is this

1 proposal has to go on the ballot.

2 COMMISSIONER EDLEY: Yes.

3 CHAIR PARSKY: Yes.

4 COMMISSIONER MORGAN: And the biggest complaint
5 you hear about all these propositions is how complex they
6 are. And let's not make it so complicated by dividing
7 things up that the voters say, "I don't understand this,
8 so I'm voting no."

9 COMMISSIONER EDLEY: Well, I think that for
10 purposes of ballot language and so forth, I would just
11 say something about current services.

12 COMMISSIONER MORGAN: I was hoping to use
13 revenue from the previous year plus population inflation,
14 appeals to me.

15 COMMISSIONER EDLEY: Yes, I would just have to
16 look at what the difference is between that and using
17 something that's more accurate than inflation.

18 If you said "cost of services" or something
19 like that, that would be fine. But it's just a question
20 of the definition.

21 And I would also say that eliminating the
22 3 percent mandatory requirement would simplify it. So
23 that part would simplify it.

24 COMMISSIONER MORGAN: But do you put in
25 3 percent if there's no increase in the revenue, plus

1 population inflation? Do you put in 3 percent first?

2 I thought that --

3 COMMISSIONER EDLEY: No.

4 COMMISSIONER MORGAN: -- the percentage was
5 only if you had it available.

6 COMMISSIONER EDLEY: No.

7 MR. GENEST: The way it was originally drafted,
8 you could waive the 3 percent whenever you're in a
9 situation where you're transferring money out of the fund.
10 So that's the time you wouldn't do 3 percent.

11 COMMISSIONER EDLEY: And what we're talking
12 about -- my concern is not with respect to spending out
13 of the fund, it's with respect to transferring money from
14 the general fund, into the rainy-day fund.

15 COMMISSIONER HAUCK: You could also reduce the
16 percentage. The 12½ percent was not derived in any magic
17 formula, believe me.

18 COMMISSIONER EDLEY: Yes.

19 CHAIR PARSKY: Well, I think your first concern
20 was not having the 3 percent apply until you've reached
21 the overall --

22 COMMISSIONER EDLEY: Trend, trend line; right.

23 CHAIR PARSKY: -- trend. Then the 3 percent can
24 be triggered.

25 COMMISSIONER EDLEY: Well, then I think you're

1 just saying, you're chopping off the top, and putting that
2 into the fund.

3 CHAIR PARSKY: Right.

4 COMMISSIONER EDLEY: It could be less than
5 3 percent, it could be more than 3 percent.

6 CHAIR PARSKY: Right, right. So you would do
7 away with the mandatory 3 percent?

8 COMMISSIONER EDLEY: I would do away with the
9 mandatory 3 percent. I like the idea of a larger
10 rainy-day fund, provided the Legislature, in fact, gets
11 to spend a long-term trend.

12 The larger rainy-day fund -- again, assuming
13 it's enforceable and so forth -- I think would help us
14 avoid the blood in the streets that we're experiencing
15 now in terms of the constant state services and what that
16 does in particular to the neediest Californians, so...

17 COMMISSIONER HALVORSON: Mr. Chairman, I have
18 a slightly different thought that sort of, I think,
19 mildly leans in that direction. But when you look at the
20 volatility issues we have on revenue in the state, all
21 the volatility seems to be in the highest tax bracket and
22 highest income people. It's the capital gains, and
23 that's where you can see the fluctuation year to year.
24 And we spend on the good years and cut budgets in the bad
25 years. But that's the volatility level. So that's one

1 comment.

2 The second comment, I have a hard time imagining
3 that the Legislature would accept a reduction in the
4 highest tax bracket on a personal income tax. Just listen
5 to the rhetoric of the regressivity. And that's going to
6 be a really challenged agenda for the Legislature to deal
7 with.

8 And if I could wave a magic wand over the whole
9 thing, I would take the proposal that we have here in its
10 entirety and add one thing to that, and that would be that
11 if we kept the -- for the highest-income people, kept the
12 old tax bracket and took the difference between this
13 proposal of the highest tax bracket and put that entire
14 amount into the rainy-day fund and put strict rules about
15 how it could be taken out, the challenge to that is, it
16 increases the total tax burden for California, which is
17 a violation of our rule.

18 But in terms of the clean and elegant solution
19 to the whole thing, if we take the part that's most
20 volatile and use that as the smoothing mechanism and
21 smooth everything else out, get to a value-added tax on
22 everything else, get to a flatter income tax on everything
23 else, everybody else in the picture, and then use that to
24 smooth volatility in the future, that would seem to be a
25 better solution. But I don't know the politics of how

1 it could get from here to there.

2 CHAIR PARSKY: We're going to save that for the
3 Commission you're going to chair next.

4 But the question is, can the two of you --

5 COMMISSIONER BARRALES: I've got a concern
6 about that. I think the minimum 3 percent is important.
7 I think the rainy-day reserve fund, although I know it
8 deals with -- not the revenue side, but the other side
9 of the equation, is key to the whole package.

10 And I think the concern is that it's not going
11 to be strong enough. And so if you take off from the
12 beginning, you take off the mandatory 3 percent
13 requirement, I think that adds to that perception.

14 So I think it's an important component.

15 CHAIR PARSKY: But do you acknowledge that --
16 expressing the 3 percent -- that this notion of it not
17 come into play until you've exceeded the trend line?

18 COMMISSIONER BOSKIN: Isn't it self-netting?
19 I mean, if you put the 3 percent in and you're able to
20 take it out, it's just nets.

21 COMMISSIONER EDLEY: No.

22 COMMISSIONER BOSKIN: Why not?

23 COMMISSIONER HAUCK: You're talking more
24 restrictions on taking it out.

25 COMMISSIONER BOSKIN: Well, that's true. That's

1 true.

2 COMMISSIONER EDLEY: I mean, look, I mean,
3 putting aside the politics in here and whether it could
4 be supported, I just -- my own judgment is that one of
5 the reasons that 1A went down -- well, I think the major
6 reason 1A went down is just because everybody hates
7 Sacramento. But the other reason is, I think it was so
8 easy to characterize it as an expenditure cap.

9 I think that if you leave the 3 percent in, then
10 what you're basically saying -- then I think the simplest
11 interpretation of that is that even if we are producing
12 revenue equal to the long-term trend, we're going to
13 prohibit the Legislature from spending all of it. And
14 I think that that -- in other words, that's the smaller
15 government agenda. I will not support a smaller
16 government agenda. And I think that probably a pretty
17 healthy chunk of the Legislature would not support a
18 smaller government agenda, either.

19 So that's why I'm saying, long-term trend,
20 what's above that can go into the rainy-day fund. But
21 when you're still below that, you're still trying to
22 climb out of the hole, as it were, then I think the
23 Legislature ought to be able to try to fulfill its
24 commitments as legislated.

25 COMMISSIONER HAUCK: Gerry, might I suggest that

1 if Chris and Mike could agree on some language, I'll be
2 fine with it.

3 COMMISSIONER COGAN: Chris, let me ask a
4 question: Let's suppose you could take that 3 percent
5 and put it to get reduction, so we didn't have an issue
6 of smaller or bigger government? It's just whether we're
7 going to take that 3 percent and devote it to current
8 programs, or whether we're going to use that 3 percent to
9 pay off the debt that we have imposed upon the populace.
10 What's your sense? Do you think that takes away -- does
11 that take away your concern about --

12 COMMISSIONER EDLEY: Absolutely -- absolutely
13 not, no.

14 Now, if you want to talk about what you do with
15 the rainy-day fund itself, fine. But what I'm saying is,
16 the whole point of saying that we're trying to measure
17 things off of the long-term trend is to say that that
18 long-term trend represents the amount of current spending
19 that we think is appropriate for the Legislature to engage
20 in responsibly.

21 What you want to avoid is -- and what, de facto,
22 you are labeling expenditures above that long-term trend
23 as irresponsible.

24 So I want to spend up to that -- am I not
25 making sense, or I'm just being an idiot? I'm sorry.

1 COMMISSIONER COGAN: No, I'm not saying it's
2 irresponsible.

3 COMMISSIONER EDLEY: Imprudent?

4 COMMISSIONER COGAN: No, no. In fact --

5 COMMISSIONER EDLEY: Knuckle-headed?

6 COMMISSIONER COGAN: More prudent to set that
7 money aside for the downturn that you know is going to
8 come.

9 COMMISSIONER EDLEY: And I guess what I'm
10 saying, is that it is prudent to set it aside for the
11 downturn you know is coming once you've gotten up to the
12 trend line.

13 Until you're up to the trend line, I think the
14 Legislature has made a commitment to provide a certain
15 level of services, and it's legislated a set of
16 commitments. And I don't think it's imprudent to live up
17 to those commitments, provided you're at the trend line.

18 COMMISSIONER COGAN: Yes, and there's no
19 difference of opinion there, except I would say that we
20 have a lot of unfunded commitments in the form of debt
21 that California is sitting on now; and maybe would be
22 prudent to use that 3 percent to pay down some of that
23 debt.

24 It's not a question of smaller government or
25 bigger government or whether we have a commitment to

1 spending; it's just --

2 COMMISSIONER EDLEY: I'm perfectly willing to
3 let the Legislature decide in any given year to allocate
4 a chunk of the general fund to reduce long-term debt,
5 plus-up the pension funds, repair bridges -- whatever it
6 wants to do. I'm just saying, that's a general fund
7 appropriation decision, not something that I would
8 support locking into a constitutional rainy-day fund.

9 COMMISSIONER COGAN: Let me ask you this, Mike:
10 What was the thinking in the Legislature and in the
11 Governor's office about the 3 percent?

12 COMMISSIONER EDLEY: Let me stop right there.

13 COMMISSIONER COGAN: I mean, somehow did they
14 agree to put this on the ballot; right?

15 MR. GENEST: Quite frankly, I think it's just
16 an artifact of a previous proposition, Proposition 57,
17 which created this really shaky rainy-day fund which
18 really didn't work. And they set a 3 percent transfer
19 for that.

20 And I've tried to, in recent days -- let me see
21 if I can remember where the 3 percent itself came from.
22 I think that goes back to almost an irrelevant
23 calculation. There used to be a rule in Sacramento that
24 the Legislative Analyst posited that every year's budget
25 should have a 3 percent reserve.

1 Maybe that was the origin, I don't really know.
2 But 57 just kind of got picked up into 1A.

3 COMMISSIONER COGAN: So one way to think about
4 this -- I don't want to push you here too far, Chris --
5 but one way to think about this, is that this thing has
6 been agreed to by the Assembly and the Senate with
7 Prop. 57, the sort of 3 percent concept of as --

8 COMMISSIONER HAUCK: And 1A.

9 COMMISSIONER COGAN: And then it was agreed to,
10 again, several years later, in the form of 1A.

11 And so I guess I'm wondering if both houses of
12 the Legislature has thought that this is a prudent idea.

13 Should we throw out that idea? And I'm
14 thinking, boy, just to me, it makes sense to -- in that
15 context -- to ratify this proposal with set-aside money
16 for a rainy day?

17 COMMISSIONER EDLEY: Look, I'm just a country
18 lawyer, but it does seem to me that in the ballot package
19 of last May, you had not only the compromises reflected in
20 the structure of 1A itself, including the, what, 5 percent
21 for the fund? I mean, we're going up to 12 -- we're going
22 up to 12.5 percent. So already by going up to
23 12.5 percent, we're saying that the previous legislative
24 deal, we're trying to improve upon it.

25 The second point is that the specific

1 construction of 1A was in a broader political context
2 that involved trying to get to "yes" on a budget. And
3 there were lots of puts and takes across party lines and
4 ideological lines in that. And I think to single out
5 this particular feature of 1A and omit what was going on
6 with respect to funding of health care or what was going
7 on with respect to other taxes doesn't quite capture the
8 nature of the deal.

9 So what I would say is that the only fair --
10 strike that.

11 I think the fairest thing to pull from the
12 previous legislative history, is that there is some
13 support for some kind of a rainy-day fund and that the
14 specific parameters have to be massaged, given the
15 political context of the moment.

16 So having said that, I think here is where we
17 are: We're trying to put the state's tax system on a
18 more solid footing with respect to the volatility issue
19 going forward. We think we've reduced volatility by about
20 40 percent already. We think we can do a significant
21 amount beyond that if we have in place a rainy-day fund.
22 But our notion of revenue neutrality has been to think in
23 terms of what's the long-term trend in resources that
24 ought to be available to be spent. And we've talked about
25 how to true it up, how to make sure that we have

1 appropriate production revenue by the BNRT.

2 To now go back and say, "I'm sorry, you can't
3 get 100 percent of the long-term trend for the general
4 fund. You can only get 97 percent, because we want to
5 constitutionally earmark 3 percent of that -- 3 percent
6 of that, we want to constitutionally earmark 3 percent
7 of that for debt reduction or for pension contributions
8 or for whatever, I just think -- I think it's really a
9 non-starter when, at least from my side of the aisle, so
10 to speak, the concern is, are we producing enough revenue
11 to fund government services.

12 COMMISSIONER COGAN: One final comment.

13 You know, it's so rare that our Legislature
14 agrees to anything, much less something by a two-thirds
15 vote. And they've done it twice in the last decade on
16 this issue. And so it seems to me that we shouldn't
17 reject what they have done, even though I agree with you,
18 Chris, that it's in the context of other political issues.

19 Maybe a compromise on this would be to have a
20 firm recommendation for all elements of the proposal,
21 except for the amount that would go into the rainy-day
22 fund automatically, on an annual basis. And to leave that
23 open and to say to the Legislature any number between zero
24 and 3 percent is fine with this commission.

25 COMMISSIONER EDLEY: Well, let me ask you this:

1 Would you accept an amendment that would have the
2 3 percent in the form of an addition to the BNRT rate?

3 No, of course not. No, of course not, right.

4 I don't want to have it come in the form of a
5 reduction in health-care services.

6 COMMISSIONER COGAN: Remember, down the road,
7 if they were to use it, forget reduction. I mean, down
8 the road, remember that there's going to be less of an
9 interest burden on the annual general fund budget.

10 COMMISSIONER EDLEY: If it's that smart a
11 decision, then I think we should have confidence that
12 the Legislature will, of its own, make that appropriation
13 out of the general fund in order to --

14 COMMISSIONER BOSKIN: So the state has --

15 COMMISSIONER DE LA ROSA: The state generates
16 \$16 for every dollar of debt service due, when you don't
17 count funds available, and you just count annual revenues.

18 When you had funds available, it gets up to
19 30 times.

20 So the burden of debt service -- this is really
21 a fallacy. The burden of debt service on the State's
22 revenues is not really that great.

23 COMMISSIONER MORGAN: But how come that --

24 COMMISSIONER COGAN: For every dollar of debt
25 service you --

1 COMMISSIONER DE LA ROSA: After setting aside
2 money for schools, the State's got \$16 out of operating
3 revenue for every dollar of debt service coming due.

4 When you include funds available for the debt service,
5 which are account balances, it goes up closer to \$30.

6 COMMISSIONER COGAN: Right.

7 COMMISSIONER DE LA ROSA: So, you know, you
8 can --

9 COMMISSIONER BOSKIN: Could I just --

10 COMMISSIONER DE LA ROSA: So I think that
11 establishing a priority for payment of something like
12 paying down debt is -- I don't know that that's the
13 biggest burden on the state's revenues.

14 COMMISSIONER COGAN: And you wonder why there's
15 such a huge debt.

16 COMMISSIONER BOSKIN: There is, however, the
17 following arithmetic fact: For every dollar of debt, the
18 state is going to have to pay a present value of a dollar
19 of taxes to fund it, period. That's arithmetic. That's
20 not ideology, that's just arithmetic.

21 COMMISSIONER DE LA ROSA: Right. And the State
22 borrows it a very low-interest rate, so...

23 COMMISSIONER BOSKIN: Chris' point is more on
24 the time pattern --

25 COMMISSIONER EDLEY: That's right.

1 COMMISSIONER BOSKIN: -- rather than the
2 aggregate over a long time, when it will all wash, okay,
3 if we've got the trend set at the appropriate level and
4 the present values would all wash of taxes and spending,
5 when the averages will work out.

6 COMMISSIONER DE LA ROSA: That's really a good
7 deal for taxpayers, though. Because when you discount
8 that dollar at the State's cost of capital, it's around
9 5 percent. When you discount the dollar at the cost of
10 capital for taxpayers that pay into that, they have a
11 higher than a 5 percent discount rate. So the dollar of
12 tax that I pay in the future is actually leveraged by the
13 fact that the State has borrowed money.

14 COMMISSIONER BOSKIN: Well, you've got a good
15 point. The main difference there --

16 COMMISSIONER DE LA ROSA: It's a very good
17 point.

18 COMMISSIONER BOSKIN: The main difference is,
19 again, the thing that makes the package attractive,
20 which is that there's the federal tax exemption for
21 municipal bonds, which is the main difference for this.
22 Otherwise, they'd be equated for risk. And, of course,
23 California is in deep doo-doo right now with respect to
24 the latter.

25 So I think this is all an issue --

1 COMMISSIONER MORGAN: Gerry, could we get an
2 agreement that this should go on Section 2 and go to the
3 voters?

4 CHAIR PARSKY: No, no.

5 COMMISSIONER EDLEY: Oh, we know that. It's
6 definitely going --

7 CHAIR PARSKY: It is clearly a Section 2 item.
8 Maybe I could suggest --

9 COMMISSIONER EDLEY: I'd be willing to be an
10 agnostic about all the parameters and just say: There
11 ought to be a rainy-day fund, period, that's fine with me.
12 But I have very serious concerns about something that
13 basically says, going forward, the Legislature gets from
14 the general fund 97 percent of the trend line as opposed
15 to 100 percent of the trend line.

16 CHAIR PARSKY: Well, what if --

17 COMMISSIONER BARRALES: Won't the trend line
18 change, though, over time, Chris, if you --

19 COMMISSIONER BOSKIN: The maximum would be
20 97 percent of the trend line for four years, because
21 then you'd be at the 12 percent. And, of course, then
22 the money comes back in a downturn. So I just want to
23 make sure that I understand this. This is exclusively --
24 or I think it's a legitimate issue -- this short-run time
25 pattern. Especially given this may wind up going in from

1 slightly below full unemployment or below the trend line;
2 right?

3 COMMISSIONER EDLEY: And the true is in reverse
4 as well? You want to fill it up, you want to front-load
5 the filling up -- since there's a 12.5 percent of revenue
6 cap, you're trying to -- you want to -- the proposal is
7 to front-load the filling up; right? So you fill it up
8 sooner than later --

9 COMMISSIONER BOSKIN: Right.

10 COMMISSIONER EDLEY: -- by having the 3 percent
11 contribution kick in, even before you get to the long-term
12 trend?

13 COMMISSIONER BOSKIN: Yes, but that's my point.

14 COMMISSIONER EDLEY: No, but what I'm saying
15 is --

16 COMMISSIONER BOSKIN: And you get that back
17 later, so the point is, you're concerned about it being
18 front-loaded, especially given we may wind up starting
19 from below.

20 COMMISSIONER EDLEY: Right. And if it's merely
21 a question of timing, I guess I would say that in response
22 to the people who want to front-load it, why are you
23 making such a big deal? This is just a question of
24 timing. Wait to fill it up until we've gotten to the
25 long-term trend line.

1 COMMISSIONER MORGAN: When did we get to this
2 3 percent? I thought what I heard Mike say was, what goes
3 into the reserve is whatever is above the previous year's
4 revenue, plus population growth, plus inflation growth.
5 And it might be a half a percent, it might be 5 percent.

6 COMMISSIONER BOSKIN: No, no, there were two
7 parts. The 3 percent automatic, and then there was --

8 COMMISSIONER MORGAN: But do we have to put a
9 percentage in our recommendation?

10 COMMISSIONER BOSKIN: -- then there was stuff
11 above the trend line until it got filled up.

12 CHAIR PARSKY: And the 12½ is the limit.

13 COMMISSIONER BOSKIN: Yes. In any event, since
14 I think Chris has stated his objection, maybe he and Mike
15 can work on this and we can deal with this telephonically
16 or something. It's important --

17 CHAIR PARSKY: Let me suggest this, and then --

18 COMMISSIONER BOSKIN: He's made his point, and
19 it's a legitimate point, different of us may put different
20 weight on the short-term versus long-term aspects of this.
21 But we just have to either deal with it or do something.
22 But I don't think we're --

23 CHAIR PARSKY: Why don't I suggest --

24 COMMISSIONER BOSKIN: All the concerns are on
25 the table now, and I think we should just think about it

1 and figure out what to do about it.

2 CHAIR PARSKY: Let me suggest that we draft the
3 proposal without a reference to the 3 percent; but we
4 indicate that there are commissioners that have expressed
5 a desire --

6 COMMISSIONER EDLEY: For the mandatory
7 contribution.

8 CHAIR PARSKY: -- for a mandatory contribution.
9 And we can use 3 percent or not use 3 percent.

10 COMMISSIONER BOSKIN: I think the one case for
11 it -- I think Chris' point is quite legitimate. Look,
12 I favor smaller government, but on everything I'm kind of
13 equal, no change, and I'm prepared to live with that. So
14 I think he's got a legitimate point.

15 However, I think the one point is that the
16 credibility of the rainy-day fund is so low, given the
17 history, that there's some value to sort of forcing
18 something. So maybe there's a compromise or there's some
19 language or something like that.

20 COMMISSIONER EDLEY: And I think -- I agree with
21 everything that Michael said, except that I think the
22 implication of the credibility problem is different. I
23 think that if you force the 3 percent contribution before
24 you get up to the trend line, it will create incredible
25 political incentives for evasion of the requirement.

1 I think it's much easier to say that it's
2 fair -- it's fair both to the taxpayers and to the people
3 who are the beneficiary of services, it's fair to tip
4 the excess revenues into the rainy-day fund after you've
5 gotten to the trend line. So that's --

6 CHAIR PARSKY: I think we can develop some
7 language that will accommodate commissioners' concern that
8 this rainy-day fund not be viewed as watered down. I
9 mean, I think we should express --

10 COMMISSIONER BARRALES: Right, it needs to be
11 real.

12 CHAIR PARSKY: -- the fact that commissioners
13 felt that a mandatory -- commissioners, not all -- felt
14 that consideration should be given to a mandatory
15 contribution, irrespective of the trend line; but that
16 the proposal would be agnostic on the issue of 3 percent.

17 COMMISSIONER BARRALES: So we all agree at
18 3 percent? Okay.

19 CHAIR PARSKY: No.

20 Okay, Bill?

21 COMMISSIONER HAUCK: Could I --

22 CHAIR PARSKY: Bill?

23 Sorry.

24 COMMISSIONER DE LA ROSA: That's all right.

25 COMMISSIONER HAUCK: Somebody else?

1 CHAIR PARSKY: No.

2 Proceed. Go ahead.

3 COMMISSIONER HAUCK: For the record, anyway,
4 this is -- I'll make it as short as possible, given the
5 circumstances.

6 Chris referred to quixotic adventures the other
7 day at his advanced age. My advanced age is beyond his.
8 And I've been involved in a lot of these. And I tell you
9 what: This one's going to cure me.

10 CHAIR PARSKY: We'll compare notes when this
11 is over.

12 COMMISSIONER HAUCK: Well, I've got a longer
13 track record.

14 COMMISSIONER COGAN: None of us are going to
15 take Gerry Parsky's call.

16 COMMISSIONER HAUCK: I want to say that with
17 respect to the BNRT, I respect the work that's been done
18 by Chris and John. I think their memo was fair, I think
19 it was balanced. I think the work that's been put in by
20 other folks -- the staff and others -- has been really
21 outstanding work, as has been referred to earlier.

22 I'm just, frankly, not convinced that it's the
23 direction that California should go in. I really don't
24 know whether it is or it isn't.

25 And I think it may merit -- it may merit

1 substantial additional study. And if that's true, the
2 last place I'd probably put it is in the Legislature,
3 because I don't think it's going to get the kind of
4 study that you all have been talking about.

5 As I listened to John and to Gerry, Chris, and
6 Michael the other day conducting what at sometimes was a
7 very difficult discussion to follow with respect to this
8 BNRT, I was asking myself, "I wonder how many members of
9 the Legislature could even follow a portion of this
10 discussion, not to mention the entire discussion?"

11 I think this is an idea that is nowhere near
12 cooked. I think we've had pretty good intellectual
13 dissent that is -- if it's not equal, it's close to equal
14 to the intellectual power that's been put into this,
15 especially from John and from Chris, and which, as I say,
16 I have a lot of regard for.

17 I don't know what an alternative would be. I
18 could think of a couple, but I don't think they'll be
19 acceptable in terms of how to really provide the kind of
20 additional work that needs to be done.

21 I think a lot of our discussion, which is based
22 on a whole series of assumptions that none of us -- or at
23 least that I have not been able to verify, let's put it
24 that way -- may turn out to be true, may not turn out to
25 be true; that the ultimate -- if this were to go forward,

1 the BNRT go forward, the ultimate rate is going to be a
2 function of lots of factors that we don't have any control
3 over.

4 And it's not clear to me, especially, what kind
5 of impact this proposal will have on individual kinds of
6 businesses, ranging from sole proprietors to major
7 corporations.

8 We've really not had, except in a couple of
9 instances, in testimony before the Commission, any case
10 examples or modeling, both backward and forward, as to
11 what impact this is going to have.

12 We have no idea really what impact it will have
13 on start-up businesses. And to this day, I'm not sure
14 what percentage of businesses in California are at the
15 level of \$500,000 in revenue or less.

16 So as I say, I'm sure you all are not surprised
17 by what I'm saying. The effort that's been put in here
18 on this, I think from the beginning, this commission was
19 asked to do an impossible job. It probably ought to have
20 involved both revenues and expenditures. We've had a fair
21 amount of discussion; we just had a discussion related to
22 expenditures. But it hasn't been integrated into the work
23 of this group.

24 And in terms of the time period, there's been
25 nowhere near enough time to do the kind of job in a

1 complex state like we have here in California.

2 A value-added tax -- I'm no expert on any of
3 this, but it's at least my understanding that where it's
4 used in Western Europe, it's much more like a sales tax,
5 where you can state it at the bottom of an invoice, and
6 the business can pass the expense along or choose not to.

7 We're talking about a proposal here that would
8 not permit that. It would not be transparent to the
9 consumer, even though ultimately the consumer probably
10 would bear a fair percentage of the tax that's required
11 to be paid. So I'll leave it at that.

12 I wish I were convinced that this is the way
13 to proceed, but I'm just not convinced. I don't think
14 that there's been enough work with respect to the
15 consequences of the proposal for us to have the kind of
16 confidence in this tax that seems to be embedded in the
17 discussion that we've been having, not just today but
18 before today as well.

19 CHAIR PARSKY: Well, I hope that you will look
20 at the package as a whole. And it will be clear that
21 the recommendation that is sought from all of the
22 commissioners is a recommendation to seriously consider.
23 And you may not like the Legislature, but we were asked
24 to recommend something to the Legislature and the
25 Governor.

1 So, look, I think the package as defined is
2 the package that we will circulate to all of the
3 commissioners.

4 I'm hoping that -- there are 14 commissioners.
5 Fred Keeley will not support the package, so we have 13.

6 I'm hoping that we can have 13 that will support
7 the package, not to act on -- this is not a recommendation
8 to act on.

9 We recognize, as well as anyone, that we didn't
10 have the time, nor capacity to explore all elements. But
11 we have had enough time to say that the overlying problems
12 that exist within California require thinking out of the
13 box.

14 The notion that coming forward with reforms to
15 nibble around the edges is not going to make things any
16 better. It will only make things worse. And so this
17 package will get aired. But I think in terms of trying
18 to address all of the concerns of the commissioners --
19 individual commissioners -- from trying to deal with
20 issues of volatility, trying to deal with issues of
21 fairness and the distribution impact, trying to deal with
22 what would encourage economic growth and job creation,
23 trying to deal with what the 21st century economy was
24 about, these, in some ways, are somewhat conflicting
25 goals. So it's like Jell-O: You push at one end and

1 you've got another end.

2 But this Legislature should get a signal from
3 a broad cross section of people, that business as usual
4 is not acceptable.

5 What's going on in Sacramento is not acceptable.
6 They are dysfunctional. And so in combination with a
7 lot of reform proposals that are coming -- for a
8 constitutional convention, for multiyear budgeting, for --
9 I mean, the same thing could be said about California
10 Forward, that there wasn't enough time, there wasn't
11 enough resources to really think through all of the
12 consequences of the bills you've submitted to the
13 Legislature. But that's not a reason for dedicated,
14 intelligent people not to say, "Look at this."

15 Every single effort at tax reform, historically,
16 that was of major -- was, as leaked, as out there, was
17 rejected. You can go back to any -- whether it's
18 Democratic reform or Republican reform at the federal
19 level, immediately.

20 As one idea was out there, "No, that's not a
21 good idea."

22 I think inherent in this proposal is a signal
23 to the entire populace, and certainly the Legislature:
24 Please hold your fire. Please don't reach a conclusion
25 without further analysis, because no one else has come

1 up with a way to deal with the objectives that were set
2 forth by this commission.

3 And if people like the way the current system
4 is functioning, just ask around, and you will see how much
5 people dislike what's on the table.

6 So I recognize, I'm just as concerned as Bill
7 or Jennifer or anyone -- I've talked to every single
8 member of this commission individually -- we all share
9 concern about unintended consequences of a reform proposal
10 of this magnitude -- everyone. But rather than sit back
11 and throw up our hands and basically say, "Well, we just
12 don't have enough time to figure anything out," I would
13 ask you all to consider sending a message that says,
14 "Explore this. Explore this," because we've really
15 attempted to address all of the goals mentioned.

16 So with that, I hope we can secure 13 signatures
17 on this report. If we can't, I hope we can secure 12.
18 If we can't, I hope we can secure 11. And if we can't,
19 I hope we can secure 10.

20 I, for one, will sign this report. And if I'm
21 all by myself, that's okay.

22 But, no, seriously, this has been an incredible
23 joint effort. Not complete, no question. But everybody
24 around this table, in one way or another, has made an
25 effort.

1 And so I would just urge you, look at it, it's
2 going to get refined with the help of all of the people
3 here, but certainly John and Chris have taken an
4 incredible amount of time at exploring this new form of
5 tax. So take a look at it, and hopefully we'll have more
6 than one signature, and, hopefully, ten, 11, or 12 -- or
7 13.

8 COMMISSIONER HALVORSON: Could I offer a couple
9 of thoughts at this point?

10 CHAIR PARSKY: Sure.

11 COMMISSIONER HALVORSON: My sense is that if
12 we send the Legislature a message that says, "You really
13 need to be thinking about this whole tax situation
14 differently, and here's some ways that you might look at
15 it, and here's some very creative ideas," and everybody
16 else in the world uses a value-added tax and California
17 should be looking at that, and we've done a bunch of
18 thinking, what that might look like, and instead of having
19 it nailed down as an "X" amount this year, an "X" amount
20 that year, and here's all the pieces and it all flows
21 together, if we go back and literally make an agenda for
22 the Legislature to get smarter on the topic, I think we
23 might be better off than trying to nail it down too
24 finitely. Because I don't think they're going to accept
25 the finite nailing down, anyway.

1 And I think what we really want to do is get
2 people thinking, because we haven't managed -- because
3 it is a hopeless task. We haven't managed to come up with
4 a thing that we can all sit and look at and say, "Every
5 single one of these pieces cross-checks, fits, and works."

6 But we also know that the current system is
7 broken, and needs to be fixed. And it really would be
8 good to look creatively at a value-added sort of tax that
9 replaces all of those other taxes. It could be a nice,
10 clean revenue source; and so if we could make that point
11 in a persuasive way and then urge them to do that. I
12 think if we do that, I think we would be not as well
13 served by getting real specific on the flat tax.

14 I think if the State of California was ready to
15 go to a flat tax, and I looked at some of those original
16 data points, I mean, that's one agenda. But to go to a
17 flat tax that's not really a flat tax, and it has pieces
18 of a flat tax, but it's kind gradated. By the time you
19 finished doing all of that work, the elegance of a
20 classic flat tax goes away, and what we've got is a
21 semi-progressive, semi-regressive challenged agenda.

22 And we might be better off being much more
23 ambiguous on that side of the agenda and say that a nice
24 thing we could do if we get the value-added tax right
25 would be, again, not going back to the Legislature with

1 numbers as specific, but going back with a general
2 direction and say it would be really good if we could
3 resolve some of these issues, identify the issues and say
4 that a really good value-added tax might get there, but
5 not push too far down that road. Because I don't think --
6 I haven't heard from any audience anywhere, any sense,
7 that people are willing to step away from the extreme
8 progressivity of California's tax system. And for us to
9 go forward, recommending that that happen -- I think you
10 might --

11 CHAIR PARSKY: Hold on. We're not recommending
12 that happen.

13 COMMISSIONER HALVORSON: Okay.

14 CHAIR PARSKY: Let's make it real clear,
15 because --

16 COMMISSIONER HALVORSON: It's a change in the
17 mix. I realize it's a change in the mix; and, actually,
18 I understand that where it is not changing from as
19 progressive to regressive because there are different
20 ways that the money flows in.

21 CHAIR PARSKY: Right.

22 COMMISSIONER HALVORSON: But that piece hasn't
23 been made as clearly as it needs to be made to convince
24 the people who would need to be convinced that it's true.

25 CHAIR PARSKY: And more work certainly has to

1 be done.

2 But it is not fair. It is unfair to
3 characterize what is being suggested as turning a
4 progressive system into a regressive system.

5 COMMISSIONER HALVORSON: And I don't think it
6 is. I really don't think it is. What I think it is, I
7 think some very hard work has gone into this process. I
8 feel a lot smarter myself about the whole tax issue. But
9 I think it could easily be perceived, depending on how
10 we come forward right now, it could be perceived as that;
11 and, therefore, dead on arrival. And if we actually want
12 to move the ball forward in any piece of this, we should
13 figure out which pieces we can move and go there. That's
14 my thought.

15 CHAIR PARSKY: Okay.

16 COMMISSIONER BOSKIN: I understand where George
17 is coming from, but I don't quite agree.

18 I certainly think we need to convey in the
19 report and the recommendation an appreciation for what we
20 don't know, as well as what we know. An appreciation for
21 the uncertainty. But I think giving just a general
22 qualitative statement to the Legislature would basically
23 get us nowhere, get them nowhere. Okay, so what are they
24 going to have? Start a hearing?

25 I think we at least have to lay out a template.

1 "Look, there are a variety of ways to do this. Here's
2 something that we've done," you know, and they have to be
3 adjusted. But here, and it's a carefully-constructed
4 compromise among Republicans and Democrats where each of
5 them is getting some things and protecting other things
6 that they think are important.

7 And I think if we just make a qualitative
8 statement -- so that's -- if it all pans out, it's doable,
9 okay. But, in any event, we've at least shown that
10 conservatives are willing to swallow a VAT, and a huge
11 revenue source, or are willing to swallow removing more
12 people from the tax rolls.

13 People who would have described themselves here
14 as liberals are prepared to accept some reduction in the
15 marginal tax rates, so long as the poor and lower- and
16 middle-income are held harmless, and not just the income
17 tax.

18 COMMISSIONER EDLEY: Proud liberals.

19 COMMISSIONER BOSKIN: Proud liberals, okay, and
20 proud conservatives. Proud whatever you want to call
21 yourself, whatever I call myself.

22 I don't actually wake up in the morning and say,
23 "As a conservative, this is what I should think." I try
24 and analyze each problem, and maybe I would describe, on
25 balance, my views that way. And I'm sure you do the same

1 thing.

2 So my basic point is, I think there is great
3 value -- you've emphasized this, Mr. Chairman -- but I
4 think it is certainly appropriate and, in fact, necessary
5 for us to convey, you know, a sense that we have not had
6 sufficient time and sufficient resources to fully develop
7 all these things, to kick all the tires, so we're starting
8 a process, not ending it.

9 CHAIR PARSKY: Chris?

10 COMMISSIONER EDLEY: I agree with Michael.
11 And I was very much with the spirit of George's remarks,
12 except for the part about the flat tax.

13 In my experience --

14 COMMISSIONER HALVORSON: You support the flat
15 tax?

16 COMMISSIONER EDLEY: My experience with things
17 of this sort is that Gerry and some others have told me,
18 referred to this, but my all-time favorite *New Yorker*
19 cartoon from I think sometime back in the sixties, and
20 there's this picture of this graying sort of bureaucrat
21 sitting behind a big desk, office desk, and there are
22 three boxes. And one box says, "In," and there's a stack
23 of papers. And another box says, "Out," and there's
24 another stack of papers. And then there's a third box
25 that says, "Too hard," and the paper is piled up like

1 this, right. And this problem is too hard, this problem
2 is definitely too hard. So what typically happens when
3 you're doing policy advocacy with the Legislature, of
4 course, is that if you leave it in generalities as
5 academics are wont to do, you go in and you have your
6 meeting and you leave your piece of paper, and it
7 immediately goes into the round file. In part, because
8 the issue is hard and they're busy, and they don't have
9 the wherewithal to think through the 20 steps that would
10 be needed to take the general policy prescription and
11 make it concrete enough to actually act, actually
12 legislate.

13 And certainly the most effective advocates, the
14 most effective lobbyists, in my judgment, are ones who are
15 willing to pull out a sharp pencil and suggest what the
16 language would be, what the particulars would be, at least
17 so that you've been able to get them to the starting place
18 of the conversation.

19 And that's the spirit in which I take what we've
20 been wrestling to do. It's to point, in general terms,
21 as George suggests, to the features of a way forward with
22 the tax system, but to then do enough work with a sharp
23 pencil to really help them get going -- to really help
24 them get going, with the full expectation that the
25 legislative process will work its way, but that at least

1 we've been specific enough so that they don't immediately
2 just take the report, take the recommendations, and put
3 them into the round file.

4 And I do agree with Michael that in trying to
5 use our sharp pencils here, where I hope we've been able
6 to provide some sort of service, is by being explicit
7 with each other about the differences in values and
8 perspectives, because the legislators are going to have
9 those same differences that they're going to have to
10 figure out how to grapple with if they're going to get
11 beyond first base.

12 And so we've tried to do that in a way that we
13 think can help them get past first base, even though we
14 can't figure out what it looks like to actually slide
15 into home.

16 I never give sports metaphors. I apologize.

17 I think that the difficult issue for all of us
18 is the uncertainties here, and moving beyond the status
19 quo is always fraught with uncertainties. And the bolder
20 the move, the more the uncertainty.

21 So certainly you try to design the package with
22 enough safety valves, et cetera, that you try to mitigate
23 the uncertainty. And I think we've gone a ways towards
24 doing that. But there's still this residual. It is a
25 new tax and the uncertainties that just go along with it.

1 So at the end of the day, I think what each of
2 us has to think about and what the Legislature would have
3 to think about, the public would have to think about is,
4 is there enough potential upside here, and have we done
5 enough to mitigate the risks on the downside, that it's
6 worth trying to do this in order to move the country
7 forward?

8 Now, whether you're talking about health care
9 or climate change or tax reform, there's going to be
10 uncertainty.

11 One of the big problems with Sacramento is that
12 the status quo has so -- there's so much inertia and the
13 system is so stuck, that they can't figure out a way
14 forward. And it's not just because of partisanship, but
15 it's the way partisanship interacts with uncertainty that
16 makes it impossible to move forward.

17 And I really hope that we can overcome that. I
18 mean, I've said enough before about what I think the good
19 features of this package are from my perspective as a
20 proud liberal; and it absolutely is not the tax system
21 that I would design if I were czar. It absolutely is not.
22 But I do think that, on balance, it's good for the values
23 that I care most about, and I think good for California's
24 future. And I'm willing to swallow some other things in
25 order to try to move things forward, at least to the

1 next stage, the next stage being the full debate in the
2 Legislature.

3 CHAIR PARSKY: Okay, well, listen, I want to
4 thank everyone on this commission. And I would just urge
5 you to take a look at the draft as it comes around.
6 Obviously, live by your own principles. But I do think
7 that if, as broad a cross section of this group sends a
8 signal that it's worthy to consider, it will put the
9 Legislature on notice that change needs to happen as far
10 as the tax system is concerned.

11 And so, as I said, I can't thank you all enough
12 for all your hard work and for your consideration. I
13 can't think of a better group to represent as many
14 different points of view as possible, and yet you all
15 came with the notion that you were willing to compromise
16 without compromising your principles, which I think is
17 the important thing.

18 So thank you all very much.

19 MR. BOSKIN: Thank you, Mr. Chairman.

20 *(The final meeting concluded at 5:20 p.m.)*

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REPORTER'S CERTIFICATE

I hereby certify:

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

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

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

IN WITNESS WHEREOF, I have hereunto set my hand on the 17th day of September 2009.

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