CALIFORNIA BUDGET PROJECT

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Contact: Lisa Gardiner (916) 444-0500

Tax Commission Plan Would Increase Budget Gaps, Shift Costs to Middle- and Low-Income Californians

Proposals Include Untested Tax

SACRAMENTO - The Commission on the 21st Century Economy's plan to overhaul the state's tax structure relies on an unknown, untested tax, would shift costs to middle- and low-income Californians, and would result in larger budget gaps in the future, according to the California Budget Project and a tax policy expert who is a member of the Commission.

In a call to the media today, Richard Pomp, a professor of law at the University of Connecticut and member of the Commission, and Jean Ross, executive director of the California Budget Project, a nonpartisan public policy research group, are expected to outline the "fatal flaws" in the commission's tax proposals. The Commission's report was due on September 20, but is now expected to head to Governor Schwarzenegger and the Legislature sometime this week.

"These proposals would take a tried and true tax - the corporate income tax - and replace it with a real unknown - the business net receipts tax," said Pomp, who served as the director of a commission that restructured New York's taxes in the 1980s. "It is a move fraught with risk at a time when the state cannot afford to take chances."

Ross added, "These proposals represent a stunning sea change in state tax policy that would increase California's budget deficits and shift the cost of financing public services onto low- and middle-income Californians. With budget gaps expected for the foreseeable future, we should be working to solve our state's problems, not creating larger ones."

The Commission's proposals would reduce state personal income tax collections by reducing the number of rates and the maximum tax rate and eliminating many credits and deductions, such as the child care credit and deductions for medical expenses; eliminate the corporate income tax and the state's share of the sales and use tax; and replace the lost revenues with a new Business Net Receipts Tax (BNRT).

Pomp and Ross criticized the proposals for four main reasons:

- **They would shift the cost of financing public services from high-income to middle- and low-income Californians.** The biggest winners under the Commission's proposals

1107 9th Street, Suite 310
Sacramento, California 95814
P: (916) 444-0500
F: (916) 444-0172
cbp@cbp.org
www.cbp.org

would be the state's millionaires, who would receive personal income tax breaks averaging $109,000 per year. The biggest losers would be middle-income families who might receive a small personal income tax reduction, but who would pay substantially more for goods and services under the BNRT.

- **They would lead to wider future budget gaps.** The Commission's proposals would reduce the state's reliance on fast-growing taxes - such as the personal income tax and corporate income tax - and replace them with the BNRT, which the Commission's own estimates show would grow more slowly over time. At the end of the five-year period covered by Commission estimates, the difference in revenue growth would be substantial, between $4 billion and $7 billion. By way of comparison, the state currently spends about $5 billion per year to support the California State University and University of California systems combined.

- **They rely on a risky, largely untested tax called the BNRT.** The BNRT is a type of "value-added" tax on consumption based on the difference between the amount a business earns from the sale of goods and services and the amount they pay for goods and services that are incorporated into the products they sell. According to a letter submitted to the Commission by some of the nation's top tax policy experts, there is almost no experience in the United States or abroad with a tax similar to that proposed by the Commission. These experts concluded that due to many legal and economic questions, "there are numerous reasons to believe that this is the wrong course for the state to take at this stage."

- **They would hurt the state's economy**. The BNRT penalizes knowledge-based industries that are at the heart of the California economy and creates incentives for firms to outsource jobs overseas and to independent contractors. For example, a media company couldn't deduct the wages paid to editors and reporters when calculating what they would pay under the BNRT, but could deduct the amounts paid to freelancers.

For further analysis of the Commission's proposals and the CBP's alternatives for modernizing the state's tax system, see the CBP's analysis here.

The CBP will hold a media call on the Tax Commission's plan at 11:00 a.m. today. The call is open only to the media. The call-in number is 1-800-290-9461 and the password is Tax Shift. To reserve a space on the call, contact Lisa Gardiner, lgardiner@cbp.org or (916) 444-0500.

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The California Budget Project (CBP) engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. Support for the CBP comes from foundation grants, publications, and individual contributions. Please visit the CBP's website at www.cbp.org.