An act relating to taxation.

LEGISLATIVE COUNSEL'S DIGEST

SB 8, as introduced, Hertzberg. Taxation.

The Sales and Use Tax Law imposes a tax on retailers measured by the gross receipts from the sale of tangible personal property sold at retail in this state, or on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer for storage, use, or other consumption in this state. The Personal Income Tax Law imposes taxes on personal taxable income at specified rates, and the Corporation Tax Law imposes taxes upon, or measured by, corporate income.

This bill would state legislative findings regarding the Upward Mobility Act, key provisions of which would expand the application of the Sales and Use Tax law by imposing a tax on specified services, would enhance the state’s business climate and would incentivize entrepreneurship and business creation by evaluating the Corporate Tax Law, and would examine the impacts of a lower and simpler Personal Income Tax Law.


The people of the State of California do enact as follows:

SECTION 1. The Legislature finds and declares all of the following:

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California has long been known as the land of opportunity, the republic of the future. But for too many of its residents the future is receding. Inequality continues to rise — even though California has one of the most progressive tax structures in the nation.

Something more is needed; a new philosophy of governance that focuses on the overall progressive outcome that can be achieved through modernizing our tax system and investing in the means of upward mobility, above all job creating infrastructure and public higher education for our increasingly youthful population.

Beyond these foundations, building and sustaining a middle class means new jobs with good wages. Small businesses, like plumbing contractors, auto repair shops, and restaurants that account for over 90 percent of the state’s businesses and well over a third of all jobs, are a key rung on the ladder of upward mobility. They need a tax policy that will enable them to grow and add employees.

California’s two trillion dollar economy has shifted from being mainly agricultural and manufacturing in the 1950s and 1960s, when the framework of today’s tax system was set, to one based on information and services, which now accounts for 80 percent of all economic activities in the state. To achieve a future as promising as California’s past, we need a tax system that is based on this real economy of the 21st century while ensuring that new revenue is invested in strengthening the ladder of mobility for all our residents.

California of the 1950s and 1960s was governed with an eye towards the future and was renowned for the opportunities that it created for its residents. California’s water system was born during that era and transformed the desert into fertile agricultural land that not only fed Californians but the world. California also constructed its freeway system to more rapidly and safely move people and goods through the state as California became the gateway to the Pacific Rim. California’s higher education system was the envy of all, reaching new heights as the University of California and the California State University grew by six and eight campuses respectively between 1958 and 1965. California’s investment in infrastructure and education paid off as agriculture, aerospace, and then technology boomed and drove California into
the 21st century as the fifth largest economy in the world. As businesses thrived, they created an abundance of middle class jobs that enabled Californians to capitalize on new opportunities to better the standard of living for themselves and their families.

(f) As California’s economy thrived, however, its eye on the future wavered. By the late 1970s, state and local finances became intertwined; the state increasingly used its funds to support traditionally local operations and both state and local governments pulled back on the types of investments needed to help businesses and residents succeed. Today, Californians live with the investments made more than three generations ago. Fifty-five percent of our local streets need to be repaired or replaced. While the state’s water system received some funding in 2014, more is needed to meet the state’s demands.

(g) On a local level, 70 percent of Los Angeles’ water infrastructure is composed of cast-iron pipes, most of which was laid during the early half of the 20th century.

(h) Our financial commitment to kindergarten and grades 1 to 12, inclusive, education has waned. Average Daily Attendance grew anemically by 0.06 percent annually between 2007 and 2011. By 2011, California ranked 43rd in per pupil spending and California’s ADA was $2,580 less than the United States average — the largest gap in 40 years.

(i) California’s commitment to higher education has also receded. In addition to opening professional and economic doorways for students, California’s higher education system is one of our most important economic engines. With almost 60 faculty and researchers who have won the Nobel prize, the University of California has over 3,200 active patents and contributes $33 billion to the California economy annually. The California State University generates an additional $17 billion in economic activity and supports 150,000 jobs in the state. Despite its proven value, California has not been able to maintain higher education accessibility for its residents. In the past 20 years, University of California fees have increased by 434 percent and California State University fees by 300 percent. Moreover, California community colleges, the largest provider of workforce training in the nation, increased fees by 130 percent between 2008 and 2012, leading to over a 20 percent decline in enrollment.
(j) The lack of investment in infrastructure and education has diminished opportunities for Californians and continues to fuel the growing income inequality in California. Since 1970, the poorest 20 percent of Californians have seen their household income grow by just 3.1 percent while the income of the richest 20 percent has climbed 74.6 percent. Since 1987, 71.3 percent of all the gains generated by California’s economy have gone to the state’s wealthiest 10 percent. Moreover, today, California accounts for three of the 10 American cities with the greatest disparities in wealth—San Francisco, Oakland, and Los Angeles.

(k) (1) The Upward Mobility Act would help ensure California’s residents and businesses can thrive in the 21st century global economy by increasing funding by $10 billion dollars for the following programs, as the revenue becomes available:

(A) Three billion dollars to K-14 education. Investing in its residents through education is the foundation on which California has always built its economy. This measure would provide new funds to help rebuild California’s education system at every level. The new revenues will help to rebuild classrooms and be available to help protect classroom spending from pending pension fund demands.

(B) Two billion dollars to the University of California and the California State University. Similarly, the measure would restore investment in California’s prized higher education system, essential to upward mobility for Californians. Revenues would be split evenly between the University of California and the California State University.

(C) Three billion dollars to local governments. Investing in local governments will more closely connect Californians to the government spending that occurs on their behalf and support the new realignment burdens on local government. Moreover, additional guaranteed funding to provide additional public safety, parks, libraries, or local development, will allow local governments to best meet the specific needs of their particular communities.

(D) Two billion for a new earned income tax credit for low-income families. The Upward Mobility Act would establish a refundable earned income tax credit to help low-income families offset the burden of the proposed sales and use tax on services.

(E) Small business and minimum wage relief. This measure would enhance the state’s business climate, create jobs, and
incentivize entrepreneurship by evaluating the current corporate
income tax to determine whether it is meeting its intended purpose
while at the same time linking changes to a more reasonable
minimum wage.

(2) Because this funding would be guaranteed, school districts,
community colleges, the California State University, the University
of California, and local governments would be able to securitize
the revenues to make essential long-term investments, just as is
the case with real property taxes.

(I) The Upward Mobility Act will fund these programs to enable
the upward mobility of our residents and to help make California’s
businesses more competitive by modernizing our tax code. The
underlying problem is, while California’s economy has evolved,
its tax system failed to keep up with the times. Over the past 60
years, California has moved from an agriculture and manufacturing
based economy to a services based economy. As a result, state tax
revenues have become less reliant on revenues derived from the
Sales and Use Tax on goods and more reliant on revenues derived
from the Personal Income Tax. In 1950, the Sales and Use Tax
comprised 61 percent of all state revenues; today, it accounts for
about 30 percent. The Personal Income Tax accounted for 12
percent of total state revenues in 1950; today, it accounts for more
than 60 percent.

(m) Moreover, California’s General Fund tax collections are
heavily dependent on the earnings of its top earners. This has led
to dramatic revenue swings year over year. During the dot-com
economic boom of the 1950s through the early part of the 21st
century, state revenues soared by as much as 20 percent in a single
year. However, as personal incomes tumbled during the Great
Recession, state revenues plummeted disproportionately. These
swings in revenue have led to the suffering of California’s
residents. Essential services, such as health care and child care for
low-income families, were cut at a time when they were needed
most. In addition, the state cut billions of dollars to education,
including adult vocational and literacy education, which could
have helped low-income families recover from the recession.
Relying on the wealthiest taxpayers to support California’s needs
is outdated and dangerous fiscal policy. Not only does it increase
the uncertainty of tax collections, but there is evidence that
California’s high tax rates may be driving high income earners out of the state, which only deepens revenue shortfalls.

The economy has shifted away from the production of goods to services. Since 1966 sales of taxable goods, as a share of the economy, have been cut in half. Today services represent 80 percent of California’s economy. Expanding the Sales and Use Tax to cover services removes a significant inequitable aspect of the tax code, implicitly favoring consumer spending on services over goods. Currently the sale of a TurboTax software disk is taxed, whereas a consumer who instead paid H&R Block would escape taxation. In essence, those who produce goods such as software or machinery are supporting those who produce services and information. Taxing only goods and not services when our economy has been so fundamentally transformed makes no sense and is manifestly unfair. This has to change.

The Upward Mobility Act seeks to make three broad changes to the tax code:

1. Broaden the tax base by imposing a sales tax on services to increase revenues. Local jurisdictions would not be authorized to increase sales tax on services, as they now can do with the sales tax on goods. Though the new revenues would be collected by the state, the ownership of those funds allocated to local government under this measure will be controlled by local government using traditional allocation mechanisms. Health care services and education services would be exempted from the tax, and very small businesses with under $100,000 gross sales would be exempted from the sales tax on services.

2. Enhance the state’s business climate and incentivize entrepreneurship and business creation by evaluating the corporate income tax to determine whether it is meeting its intended purposes, including whether it is born equitably among California’s businesses and what impact it has on the business climate, while at the same time linking changes to a more reasonable minimum wage.

3. Examine the impacts of lowering and simplifying the Personal Income Tax while maintaining progressivity. The measure’s goal is to reduce the income tax rates imposed under the Personal Income Tax for low-and middle-class-income households so that families earning $100,000 pay only $1,000. The income tax rate for top earners may also be reduced in a
manner that balances fairness with mitigating adverse impact to
both state revenues and competitiveness. The obligation of top
earners with regard to other tax obligations for top earners,
including Proposition 63, would remain intact.
(p) In order to ensure fiscal responsibility, the Upward Mobility
Act’s revenue reduction provisions would be phased in only when
it is clear that new revenues are sufficient to replace any revisions
to the personal income tax and corporate tax.
(q) As the revenues secured by Proposition 30 expire, California
policy decisionmakers must determine new long term ways to
provide for state residents. The Upward Mobility Act will increase
opportunities for California’s businesses and create an upward
mobility ladder for California residents. Moreover, the Upward
Mobility Act will realign the state’s outdated tax code with the
realities of California’s 21st century economy.