

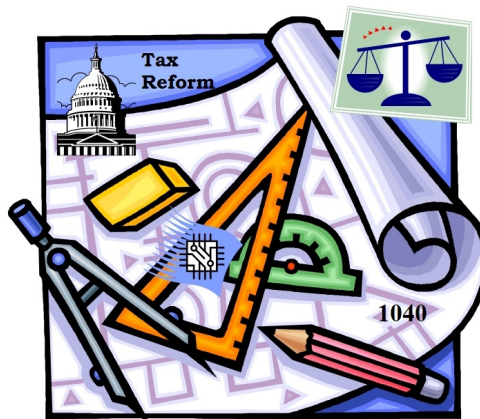
**Informational Hearing
Assembly Revenue & Taxation Committee**

**Alternatives to the Tax Recommendations of
the Commission on the 21st Century Economy**

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Modern Tax Architecture

Outline of Remarks

- I. General observations on recommendations and final report of the Commission on the 21st Century Economy (COTCE)
- II. Principles of good tax policy as a tool for effective tax reform
- III. Reasons for tax reform in California (weaknesses in the tax system)
- IV. Suggestions for reform based on principles of good tax policy
- V. Details on selected reforms

Additional information on the topics covered in this testimony, as well as a blog for comments, can be found at

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I. General Observations on COTCE Recommendations and Report

While the focus of today's hearing is on alternatives to the COTCE recommendations, some general observations about the proposals are relevant to tax reform in general. Summarized below are some strengths and weaknesses of the recommendations.

- (+) Taxes with a broad base and low rate are more likely to meet the principles of good tax policy. For example, fewer deductions, exemptions and credits makes a tax more simple and more neutral (because there are few or no special provisions). The business net receipts tax (BNRT) is similar in formula to an income tax, but only allows offsets (reductions) for purchases from other firms. Thus, the base should be larger than the current income tax base, thereby allowing for a lower rate (the bases are different because one is an income tax and the BNRT is a consumption tax). However, other aspects of this proposal raise some concerns (explained later).
- (+) The BNRT proposal is different from what any state uses today. Thinking outside of the box a bit in a tax reform activity is a good idea as doing so can lead to better discussions and ideas rather than just thinking about rate changes and a few minor tweaks to an existing tax. Of course, something completely different without tested models can create confusion and raise questions that are difficult to answer. Careful attention must be paid to be sure the economic effects are understood. For example, will the BNRT encourage companies to locate property and employees in California or elsewhere? Will it encourage the hiring of contractors rather than employees?
- (+) Creation of an effective Rainy Day fund is appropriate to address the reality that in an economic downturn, it is difficult to generate enough taxes to maintain spending.
- (+) It is good to look at administrative reforms, rather than only reforms to the base and rate structure.
- (-) Some relevant aspects of effective state tax reform were missing or overlooked, such as the following:
 - *Equity considerations:* Tax reform should consider not only revenue neutrality, but also *distributional* neutrality (or explain why the tax distribution should be changed). Replacing a significant portion of the income tax paid by high income individuals with a broad-based consumption tax is unlikely to be distributionally neutral. That is, a portion of the income tax reduction for high income individuals will be made up through BNRT effectively paid by low-income individuals. Consumption taxes, such as the BNRT, are regressive in that they represent a higher percentage of the income of a low-income taxpayer relative to a high income taxpayer. Also, it is not clear who ultimately pays the taxes paid by businesses, such as the BNRT. These taxes are, in effect, ultimately paid by investors/owners, customers and employees.

Reform should also consider existing taxes as a mix. The COTCE report suggests a \$100 minimum tax per person "to ensure that all California residents and businesses participate in the financing of the state's General Fund spending" (p. 47). Given the highly progressive structure of the PIT, many low income individuals do not pay any PIT. However, they use a portion of their income on various types of consumption taxes imposed in California. Data from the US Census Bureau for 2007 indicates the following percentages of income used for state and local taxes for a family of three living in Los Angeles.¹

Total taxes paid as percent of income				
\$25,000	\$50,000	\$75,000	\$100,000	\$150,000
10.8%	6.4%	7.2%	8.0%	9.3%

Also, in evaluating equity, one should not look solely at a dollar minimum of taxes paid, but at taxes as a percentage of income across income categories.

- *State-local fiscal relationship:* State tax reform must also consider the effect on local governments. The principles of a high-quality state revenue system, as formulated by the National Conference of State Legislatures (NCSL), provides that such a system "comprises elements that are complementary, including the finances of both state and local governments."ⁱⁱ Local governments are very dependent on the state government tax rules in many ways. For example, the base of the sales tax that is collected by both the state and local governments, is controlled by state statute. The COTCE recommended replacing the state general sales tax with a BNRT. One rationale for this change is to allow for a simpler and perhaps more effective way to impose a consumption tax that is broader than the current sales tax. The BNRT would apply to all sellers, not only those selling tangible personal property. Also, the nexus standard for the BNRT can be more broad than the physical presence standard currently required for the sales tax. The COTCE proposal to keep the current sales tax base, replacing most of that tax at the state level with the BNRT, provides no relief for local governments to updating their sales tax base or to provide techniques to improve collection of the use tax.
- *Linking tax system with state's goals:* A tax system should support a state's economic, social and environmental goals.ⁱⁱⁱ This objective does not seem to be fully attained by the COTCE recommendations. For example, the BNRT, as a type of value-added tax, taxes wages (that is the value added by any business). The BNRT apportionment approach would tax that added value even if it was not added in California provided the sales were in California. This will likely encourage businesses with California customers to locate labor in low-wage states and perhaps, put downward pressure on California wages.^{iv} Also, given growing income gaps, it is not clear how social goals for the state are improved by increasing taxes on low-income taxpayers while reducing them for high-income taxpayers.^v Finally, given California's ambitious goals for greenhouse gas reduction, it would seem appropriate to consider some type of polluter-pays tax, such as a carbon tax or increased gasoline excise tax.

II. Principles of Good Tax Policy as a Tool for Effective Tax Reform

Following principles of good tax policy can help identify strengths and weaknesses in an existing tax system as well as in proposals for change. There are various formulations of these principles but all have significant commonalities. Two useful sets of principles to consider are the ones prepared by the National Conference of State Legislatures (NCSL) and the American Institute of Certified Public Accountants (AICPA).

The NCSL's set of principles for a high-quality state revenue system are:

- "1. A high-quality revenue system comprises elements that are complementary, including the finances of both state and local governments.
2. A high-quality revenue system produces revenue in a reliable manner. Reliability involves stability, certainty and sufficiency.
3. A high-quality revenue system relies on a balanced variety of revenue sources.
4. A high-quality revenue system treats individuals equitably. Minimum requirements of an equitable system are that it imposes similar tax burdens on people in similar circumstances, that it minimizes regressivity, and that it minimizes taxes on low-income individuals.
5. A high-quality revenue system facilitates taxpayer compliance. It is easy to understand and minimizes compliance costs.

6. A high-quality revenue system promotes fair, efficient and effective administration. It is as simple as possible to administer, raises revenue efficiently, is administered professionally, and is applied uniformly.
7. A high-quality revenue system is responsive to interstate and international economic competition.
8. A high-quality revenue system minimizes its involvement in spending decisions and makes any such involvement explicit.
9. A high-quality revenue system is accountable to taxpayers.”

The set of principles drafted by the AICPA is similar but also includes the need to minimize the tax gap. This set of principles was used by the California Commission on Tax Policy in the New Economy, which issued its final report in December 2003.^{vi}

Appendix A includes a list and comparison of various formulations of the principles of good tax policy. The principles are used below in identifying weaknesses in California's current tax system and in the suggestions for reform provided below.

III. Reasons for Tax Reform in California (weaknesses in the tax system)

Most of the specific tax problems in California's existing tax structure described below can be solved by fixing the tax base - they cannot be solved with a rate increase. A rate increase would make most of these problems worse.

- **High tax rates:** The state sales tax rate of 8.25% is the highest in the U.S. and even higher if local districts also impose a sales tax (for example, the rate is 9.25% in Santa Clara County). The top personal income tax rate is the highest among the states at 9.55% (10.55% if income exceeds \$1 million). There are benefits to lowering a high tax rate and finding ways to broaden the tax base (what the rate is applied to). People tend to view a low rate tax with fewer deductions and exemptions as being more fair and simple.
- **Equity and fairness often missing:** The sales tax applies only to tangible goods; other consumption items such as digital goods, entertainment and services are tax-free. A consumer must pay tax on a lawn mower, but not on lawn care services. Consumers pay tax on music CDs, but not on songs purchased from online stores or tickets to a concert.
- **Uncollected taxes:** Every year, over \$1 billion of use tax owed to California and its cities goes uncollected. Most people don't even know what a use tax is (which makes it hard to pay it). Different reporting techniques could make it simpler to calculate and pay.
- **Some taxes are hidden (lack of transparency):** While the law says that food (except when eaten outside of the home) is exempt from sales tax, there is sales tax included in the price because the grocery store, distributors and growers/manufacturers all pay sales tax and pass it along to buyers. This is due to the pyramiding nature of the California sales tax. That is, businesses pay sales tax on taxable items (unless purchased for resale). The sales tax paid by businesses is added to the cost of the goods they sell and subject to taxation at the consumer level – thus, there is a tax on a tax. This means that the taxes are really higher than stated and that items that are theoretically tax exempt, such as food, really have some sales tax hidden in their price because the seller has paid sales tax on its taxable purchases. Many states provide sales tax exemption for manufacturing equipment and perhaps also R&D equipment. California provides no such exemptions.
- **Some tax breaks are unfair and too costly:** Some tax deductions and exemptions don't make sense today or are too generous for some taxpayers (usually those with high incomes). Most special deductions, exemptions and tax credits represent subsidies for certain activities or

transactions. It is not necessary in all cases for the state to provide a subsidy when the federal government already provides one or in some cases, there is not need to provide as large a subsidy as provided by at the federal level. For example, federal and state law allows for mortgage interest to be deducted on two homes and on up to \$1.1 million of debt. While there are reasons why the government would want to encourage ownership of a principal residence, there is no reason to encourage or subsidize ownership of a vacation home. Also, even in the Bay Area, the average home doesn't cost \$1.1 million, so why provide an extra deduction to individuals with extra large mortgages?

Also, while the state struggles to figure out how to help those without health insurance, most individuals with employer-provided health insurance get a significant tax break because the employer contribution is tax-free income (that costs California around \$4 billion per year).

Possible reforms should look at (1) reducing these and other generous tax breaks to more reasonable amounts and (2) providing tax breaks using credits rather than deductions to make the benefits more equitable across income groups (a \$100 credit provides \$100 of tax relief to every taxpayer, but a \$100 deduction provides \$2 of benefit to a taxpayer in a 2% tax bracket and \$10 to one in a 10% tax bracket). Also, some of these special rules should have sunset dates to ensure that they are evaluated periodically (see accountability below).

- ***Tax expenditures tend to be overlooked in budgets and spending cuts:*** Special deductions, exemptions and credits represent a form of spending referred to as "tax expenditures." For example, instead of providing a mortgage interest deduction or research tax credit, which reduces the claimant's tax liability, the state could instead write a check for the amount of the savings to the taxpayer. The effect to the taxpayer and the government under either approach is the same. Tax expenditures tend to be enacted permanently and thus, do not have to be regularly reviewed or the funds requested in each annual budget process. Also, there are typically no spending caps placed on these expenditures. That is, if more individuals obtained home mortgages, the state would collect less tax revenues and have no control over that reduction.

The California Department of Finance annually measures the "cost" of tax expenditures. Its 2009-2010 report notes the following total tax expenditures:^{vii}

○ Personal income tax	\$29 billion
○ Corporate income/franchise tax	\$4 billion
○ Sales and use tax	\$8 billion ^{viii}
○ Other taxes	\$90 million

Lack of accountability over tax expenditures means that lawmakers and the public do not know how much the state is spending on economic development and social and environmental programs and what the outcomes are of the expenditures. A unified budget for economic development and other purposes (such as housing and social services) would enable lawmakers and the public to better understand state spending. This approach would require that objectives be stated for special tax incentives and data collected to allow for measurement on the degree to which the objectives are being met.

Additional accountability measures to better ensure that special tax deductions, exemptions and credits are being used as intended include sunset dates and "clawback" provisions.^{ix}

- ***Personal income tax is unstable:*** The largest source of state revenue - the personal income tax, is too volatile. The state is too dependent on a small number of high income individuals continuing to earn high wages, stock options and capital gains so state revenues don't drop. While some argue that this is a good thing because it means that tax revenues will track the economy, the problem is that a small number of individuals contribute a significant amount of the tax base, which is risky for revenue stability.

- **E-commerce issues:** Most of our tax rules and systems today were not designed with the electronic-commerce model in mind. E-commerce raises tax issues not adequately addressed by existing rules and presents some possible technological simplifications for tax administration. There is not enough focus at federal and state government levels on how tax laws and systems need to be modernized to address e-commerce taxation issues. These issues include how to source the income from goods transferred electronically and for use in more than one jurisdiction, as well as determining if nexus exists for income and sales tax purposes. The Internet and e-commerce have also made some of the existing tax rules on telecommunications outdated.^x
- **Tax administration:** Administration of California's tax system is spread over three separate agencies – the Franchise Tax Board, the State Board of Equalization and the Employment Development Department. Prior proposals for consolidation and streamlining should be explored to see if there are savings and efficiencies that might be gained from consolidation of the offices.
- **Strategy lacking:** It is not clear from looking at California's tax system and budget what California's goals are. For example, in February 2009, the budget act included a single sales factor to incentivize businesses to locate here, but also increased the sales tax rate by one percentage point making it more costly to purchase equipment in the state. Also, despite aggressive goals for reducing GHG emissions, the budget excluded a proposed 12 cent gasoline excise tax increase.
- **City and state conflicts:** Cities don't share in the state income tax and are very dependent on sales tax revenues. So cities tend to want big retailers that generate sales tax (and low-wage workers who usually already have housing - they live with someone else) while the state would prefer employers with a high-paid workforce (who tend to need housing which is costly for cities to support). Also, much of the local revenues are controlled in some manner at the state level. Property taxes are allocated per state rules and the base of the sales tax is controlled by state law as is the maximum rate that can be imposed by local governments.
- **Chokeholds on the tax legislative and budget process:** California has numerous budget problems which often lead to shortfalls and delays in getting balanced budgets passed. California is one of just a few states that requires a supermajority (2/3) vote in the legislature to pass a budget and to increase any taxes. This results in stalemates and the minority party having a lot of control. Another budget problem is that the legislature doesn't control the entire budget due to a variety of tax and spending restrictions, many of which are constitutional provisions made by the voter initiative process. For example, the legislature may not subject most food to sales tax because voters added a constitutional provision prohibiting it. Finally, there is a tendency to earmark new taxes to specific spending when often, it is the type of spending (such as for education or health care) that should be from the General Fund.

IV. Suggestions for Reform Based on Principles of Good Tax Policy

Given the weaknesses in California's tax system, possible reforms over the next several years could include:

1. Broadening the sales tax base to include more types of personal consumption and using the revenues to lower the rate and to gradually reduce pyramiding in the system (such as by adding equipment exemptions for businesses).
2. Simplifying use tax compliance and educating taxpayers about the use tax.
3. Re-evaluate whether California should modify its sales and use tax law so it can join the Streamlined Sales & Use Tax (SSUTA) project. Assuming Congress will eventually allow adopting states to collect sales tax from remote (non-present) vendors, this may be the best approach to the growing problem of trying to collect use tax.

4. Gradually reducing or phasing-out various tax expenditures in the personal income tax that are too high or not justified.
5. Add accountability measures to most tax expenditures to be sure they are meeting their intended purpose and are reviewed regularly.
6. Consider polluter pays taxes, such as an oil severance tax, a higher gasoline excise tax (currently 18¢/gallon) and a sales tax on utilities generated from non-renewable sources.
7. Evaluation of the efficacy of the gasoline excise tax that is assessed on each gallon of gas. As more consumers buy more fuel efficient vehicles, but continue to drive the same distances, the taxes collected may not be sufficient to maintain roads. Several years ago, Oregon, recognizing this impending problem, began a study of alternatives. California should do the same.
8. Consider federal tax rules and proposals. There are several ways that California can benefit from encouraging the federal government to make certain tax reforms and from ensuring that the California fiscal system is best utilizing federal incentives.

The federal government is focused on reducing its tax gap, although it is moving slowly. Efforts to reduce the federal tax gap should also benefit California. California should join with other states to work with Congress to encourage more information reporting and other reforms that will reduce the tax gap.

Some federal tax incentives might not be fully utilizable by Californians because parts of our fiscal system are not poised to take advantage of them. A review should be made to identify these areas. One example are the various federal tax benefits for higher education incentives, such as the Hope Credit and the American Opportunity Tax Credit. Low tuition costs at community colleges might result in students and their families not being able to claim the maximum federal benefit. In a report years ago, the Legislative Analyst's Office referred to this type of situation as a reverse subsidy in that Californians were unable to claim the full federal benefit because California tuition at some public schools was lower than the federal benefit.

Short-term: Given the roughly \$20 billion budget shortfall anticipated for 2010 and 2011, a good question is whether tax reform can be enacted in time to address this immediate problem. Some of the reforms noted above could be started in 2010. Additional tax changes to consider include:

- Tax amnesty – several states have already done this in 2008 and 2009. This means that many individuals and businesses have already studied their potential tax liabilities and may be waiting for a California amnesty so they can "come clean." While amnesties can lead to continued expectations of them, they can work well to address a budget shortfall and can get taxpayers "back into the system."
- Encourage the FTB and BOE to develop and pursue compliance and settlement initiatives that may accelerate outstanding and contested liabilities. An initiative in North Carolina was reported to have brought in \$427 million.^{xi}
- Make permanent the rule for having a use tax line on the income tax forms as it makes compliance simpler.
- Review sin taxes and consider raising rates that are lower than most other states use. For example, the California cigarette tax is 87¢/pack while several states impose a tax of \$2/pack or more.^{xii} As the economy improves, these taxes could be reduced or the revenues used instead to lower the sales tax rate.
- Start an accountability program for tax expenditures. As noted earlier, the California tax system includes over \$40 billion of annual "tax expenditures." Many of these deductions, exclusions, exemptions and tax credits have been in the tax law for years and little data is gathered on whether they are meeting their intended purpose. In tough economic times when

governments are looking at where to make reductions in direct spending, they are remiss if such analysis does not also consider the spending buried in the tax system as "tax expenditures."

A few states are taking action on finding ways to add accountability measures to address tax expenditures. In August 2009, Oregon added sunset dates to many of its expenditures forcing them to be examined in the near future (HB 2067). The rationale expressed by the House Majority Office was that the number of tax expenditures – 380, was getting large. They also noted that the "cost" of the expenditures (over \$30 billion per biennium), was greater than spending for education, health care and public safety combined.^{xiii} A proposal in Florida (SB 216; 2009) calls for a review of sales tax exemptions. In October 2009, Missouri Senator Crowell called for a study of tax expenditures.^{xiv} In January 2010, the Iowa Department of Management issued a report – "State of Iowa Tax Credit Review Report" which makes recommendations for increased accountability of the state's 35 tax credits.

Creating a systematic and regular approach to evaluating tax expenditures will add fairness to the system as well. Taxpayers will see that all expenditures are subject to the same review criteria. The process will also make the tax system more transparent by making more information available on what special rules exist, how they are used, and whether they are meeting their intended purposes. Any new tax incentives should be created with accountability measures included.

V. Details on Selected Reforms

Below are more details on the sales/use tax and personal income tax reforms described earlier.

Sales and Use Tax

Problem	Principles Not Achieved	Possible Reforms
Base is too narrow	<p><i>Equity</i> – some of the exemptions are more likely to apply to higher income taxpayers due to the expensive nature of the consumption, such as personal services, live entertainment and digital goods.</p> <p><i>Neutrality</i> – exemptions, such as for digital goods, can distort decision-making as to how to purchase an item.</p> <p><i>Simplicity</i> – special rules create complexity. Having fewer exemptions should simplify the law.</p>	Broaden the base to include more types of personal consumption.
Rate is too high.	<p><i>Equity</i> – the sales tax is regressive.</p> <p><i>Minimum tax gap</i> – evasion and avoidance are more likely to occur when tax rates are high.</p> <p><i>Economic efficiency</i> – high rates discourage consumption which can adversely affect the state economy, such as by encouraging manufacturers to locate elsewhere.</p>	Lower the rate by broadening the base.
Not all use tax is collected.	<i>Minimum tax gap</i> – not all of the tax owed is collected.	Simplify compliance.
Pyramiding.	<i>Neutrality</i> – pyramiding can affect decision-making such as by encouraging businesses to	Base broadening should avoid expansion to items

	<p>locate in a state that provides more exemptions. Pyramiding can also encourage greater vertical integration.</p> <p><i>Transparency</i> – consumers are in effect paying some amount more than the sales tax stated on their receipt.</p> <p><i>Equity</i> – capital-intensive firms have a higher tax burden than labor-intensive firms.</p>	<p>most likely purchased by businesses.</p> <p>Businesses should gradually become exempt from paying sales tax.</p>
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Why broaden the sales tax base: Ten reasons for broadening the sales and use tax base and the benefits to be obtained:

1. *Opportunity to lower our high tax rate:* This could make the state more attractive to businesses and make the tax less regressive.
2. *Equalize varying forms of personal consumption:* Economically, there is no reason not to tax all consumption under a sales tax.
3. *Fix poorly designed exemptions:* Exemptions for necessities of life, such as food and utilities, are poorly targeted, making them more expensive to the state than needed and making the system less equitable. For example, not only is milk tax exempt, but also soda and an expensive gourmet block of cheese.
4. *Address base erosion:* Consumption patterns have changed yet the tax base has not. For example:
 - a. According to the Legislative Analyst's Office, in 1981, 48% of consumption was of items subject to tax. That figure dropped to 38% by 2005.^{xv}
 - b. Many items previously purchased as taxable tangible personal property are today purchased as non-taxable digital goods, such as music, books and software. This erodes the sales tax base.
5. *Improve distribution of the tax burden:* Changes in consumption are not consistent across income groups which makes the sales tax more regressive and unfair. For example, higher income households have greater access to broadband than do lower income households which makes it easier and more likely that the higher income households will buy certain goods in digital form rather than taxable tangible form.^{xvi} Also, per the 2006 consumer expenditure data from the Bureau of Labor Statistics, the average expenditure on entertainment was \$1,500 if one's income was under 470,000. However, it was \$7,600 if one's income was over \$150,000.^{xvii}
6. *Make the sales tax a more stable tax:* A broader base makes a tax less volatile.
7. *Keep up with other states:* Broadening the base will bring California's sales tax more in line with other states that tend to tax more services. Some states have changed their tax base to include digital goods, such as New Jersey in 2006 and more recently, North Carolina, Wisconsin, Kentucky and Vermont. A broader sales tax base in other states can adversely affect California because the other states may be able to lower their rate and/or use the revenue for business tax incentives.
8. *Improve economic development at the local level:* A broadened base may help cities make better land use and economic development decisions because they won't be incentivized as they are today to only want retailers that sell tangible personal property.
9. *Need for periodic review:* Exemptions should be reviewed regularly to be sure they are still warranted and if so, that they are working as intended. Tax bases should reflect the current economy. This was well stated in a 1967 report of the Ohio Tax Study Commission: "Insofar as possible, a tax or tax structure should be capable of growing with the economy of the state and

should be revised from time to time so as to correspond with the true makeup of that economy as it develops and changes.”

10. *Reduce complexity and improve fairness:* A broader base would better enable the sales tax to meet the principles of simplicity, neutrality, efficiency and fairness.

Broadened sales tax versus the BNRT:

One rationale for the BNRT is that it might serve as a non-pyramiding substitute for a broadened sales tax and be easier to administer. While both the sales tax and BNRT are consumption taxes, there are differences in their operation, including the following:

- **Transparency:** The sales tax is clearly noted on a customer's invoice while it will not be clear how the BNRT is passed along to customers, employees and investor/owners.
- **Perceptions and Complexity:** The BNRT is very similar to a subtraction method VAT. That form of VAT is used in Japan and was used in Michigan, but the vast majority of VATs used in the world are credit invoice VATs which operate more similarly to a retail sales tax. The sales tax is used in almost all states in the US. Thus, there is widespread familiarity with the sales tax and almost none with the subtraction method VAT. Also, the formula for the BNRT looks more like that of an income tax than a sales tax. However, because it is a consumption tax, there is no deduction for wages and fixed assets are generally expensed rather than depreciated. This form raises concerns that the BNRT is a tax on labor. The COTCE suggested an R&D credit and some type of offset for employer-provided health benefits. These provisions would result in some portion of labor costs being allowed for the BNRT which is contrary to the economic premise of this type of consumption tax. The BNRT also exempts small businesses. The subtraction method VAT previously used in Michigan included several types of credits and exemptions. The retail sales tax includes some product exemptions but none based on size of the seller, and no credits. In addition, the BNRT base must be apportioned to California which requires recordkeeping beyond knowing the destination of a sale. Thus, the BNRT has many more complexities than does the retail sales tax.
- **Nexus:** The BNRT includes an economic nexus approach. Under this approach, a business is subject to the BNRT if it is domiciled in California, has sales in California of \$500,000 or more (or 25% of its total sales), has real and tangible property in the state of \$50,000 (or 25% of its total property), *or* it has \$50,000 of employee compensation paid in California (or 25% of total compensation paid). This nexus approach (also called "factor presence" nexus) is broader than the physical presence standard required for sales tax or the approach of Public Law 86-272 that applies to income taxes for taxpayers selling tangible personal property. Under the PL 86-272 approach mandated by federal law, a non-domiciled business with no property in the state will not be subject to income tax in a state if its only activities are taking orders that are approved and filled from outside of the state. Because the BNRT is neither a sales tax or income tax, it is not subject to the physical presence or PL 86-272 standards.

PL 86-272 was enacted in 1959 and is outdated in only applying to businesses that sell tangible personal property. Congress has had proposals for the past several years to modernize it. The current proposal is H.R. 1083 (111th Congress). If enacted, this bill would basically require a physical presence before a state could impose an income tax or "other business activity tax" on a business. This latter type of tax is defined as "any tax in the nature of a net income tax or tax measured by the amount of, or economic results of, business or related activity conducted in the State." It would not include a sales or similar transaction tax. Arguably, the BNRT is an "other business activity tax" and if enacted, H.R. 1083 would prohibit California from using the economic nexus approach.

Given the likelihood that P.L. 86-272 will be updated in the near future, the BNRT is a riskier proposition if it cannot be imposed on businesses with very limited physical presence in the state.

California would be better off keeping the sales tax and perhaps modifying its sales tax law to be able to join the Streamlined Sales & Use Tax (SSUTA) project. Congress also has proposals before it that would allow SSUTA states to require remote (non-present) vendors to collect the state's sales tax. This would reduce the use tax gap that currently exists in California.

Suggestions for what to add to the base:

1. The digital equivalent of currently taxed tangible personal property – music, books, off-the-shelf software – items that are downloaded from the Internet, but used just as we'd use the tangible equivalent.
2. Services that are primarily produced and consumed in the state by individual consumers, such as entertainment, lawn care services, health club memberships, club admissions, dry cleaning, pet care, and other personal services. In gradually expanding the base, the starting point could be services of businesses that already collect sales tax because they also sell tangible personal property, such as auto repair shops and beauty salons. The initial expansion should also reach high cost, luxury consumption items such as live entertainment, sports tickets and green fees.
3. Household utilities. While this is currently exempt as a necessity of life, the larger one's house, the more likely the utility bill is large. Thus, this exemption is overly broad in that it is exempting utilities beyond what could be called a necessity of life expenditure. To provide relief, the sales tax could be applied to the monthly charge that exceeds what the expense would be for a 1,200 square foot home with four inhabitants. Alternatively, relief could be given to low-income individuals through a refundable income tax credit.

Implementation ideas: Certainly, there are challenges and costs of broadening the base. First, change in general is never easy. Broadening the base means that something that wasn't taxed yesterday is taxed today. Needless to say, that's not popular. However, a rate reduction and education as to why the base was broadened should help.

Also, more businesses will have to collect sales tax which involves new compliance costs. These businesses should be given a refundable credit to help offset the start-up costs. Also, the changes should be implemented over a sufficient time period to give businesses time to get ready to collect and for the Board of Equalization to provide assistance. The recently failed services tax in Michigan was enacted in October 2007 and effective on December 1. That is not enough time for businesses newly subject to collection to get ready.

Compliance costs for vendors and administrative costs for the BOE can be lessened with efforts to simplify compliance through the use of technology and fewer reporting periods.

There could be adverse effects to some local governments – there are likely to be winners and losers. Depending on what is added to the base, the amount of the rate reduction and a city's current mix of taxable items before and after, some cities might see a reduction in sales tax collection. It would be helpful if some transitional relief could be provided to such cities.

Another cost would occur if the broadened base included items primarily purchased by businesses. This would make pyramiding in our system worse than it already is. It might also lead to a loss of business in this state. Broadening of the base should focus on items mostly used by individual consumers so as not to make the pyramiding problem in our system any worse.

Depending on how the base is broadened, some of the revenue might be needed to provide targeted relief to low-income taxpayers. For example, if the base were broadened to include all food (although a change would be needed to the California Constitution to permit this), a refundable income tax credit should be provided for relief for low-income individuals and to reduce the regressivity of the change.

Finally, lessons can be learned from states that have recently expanded their sales tax base, such as New Jersey, North Carolina and Wisconsin.

How to improve use tax compliance:

- Expand efforts to educate the public on what the use tax is, its importance and how to pay it. Perhaps pop-up ads should be placed at high volume Internet sites.
- Make permanent the use tax line on income tax forms as this is a simpler way to pay the tax relative to having to file separate forms.
- Enact an alternative computation method for consumers to allow them to use a BOE-created table where the taxpayer determines their use tax liability based on their income. If a consumer prefers, they can keep receipts to determine the actual amount of use tax owed. The table approach should also require the actual use tax amount on any purchase that exceeds \$1,000. Similar approaches are used in New York, Michigan and Maine. AB 1957 as amended on March 25, 2008 called for the use tax table option, but was not enacted.

Personal Income Tax Reforms

The principles of equity, simplicity and neutrality could be better met in the PIT by eliminating or reducing special deductions, exclusions and credits that are too generous or no longer needed. This change would also broaden the PIT base which would somewhat reduce the volatility of this tax. Phasing-out or reducing California deductions or exclusions that conform to the federal rule still leaves the individual with their existing, full benefit in computing their federal income tax.

A sampling of possible expenditures that could be phased-out or reduced are noted in the following table. An evaluation should be made of all tax expenditures in the PIT (as well as for other taxes).

Tax Expenditure	Revenue Loss 08/09 (millions) <small>xviii</small>	Explanation	Critique	Possible Improvement
Home mortgage interest deduction	\$5,200	The CA rule is based on federal law. Individuals who itemize their deductions are allowed to deduct mortgage interest on a principal residence and one other home (such as a vacation home). The debt limit is \$1 million of acquisition debt and \$100,000 of home mortgage interest.	While there are societal and economic reasons for a government to encourage home ownership, the rule is too broad. The deduction applies to two homes rather than just a principal residence. Also, \$1 million of acquisition indebtedness is much greater than the median home price. Finally, the allowance of a deduction for interest on home equity indebtedness is unfair in that it provides a technique for homeowners to obtain deductible mortgage interest that is not available to someone who does not own a home.	<ol style="list-style-type: none"> 1. Gradually phase-out the deduction for interest on home equity indebtedness over a five year period. 2. Gradually reduce the debt limit for acquisition indebtedness until it becomes 80% of the median home price in the geographic region. Adjust the limit annually, but only for debt on new acquisitions. 3. Gradually phase-out the deduction for home mortgage interest that is not for a principal residence. 4. Consider converting a

				reduced and targeted benefit to a tax credit rather than a deduction so it provides an equivalent benefit regardless of tax bracket. ^{xix}
Exclusion of employer contributions to health plans	\$3,700	Employers who pay for all or part of an employee's health insurance plan may deduct that cost. The benefit is not taxable to the employee.	While there are advantages to the government of more people being covered by health insurance, this provision is generous. There is also a rule that allows self-employed individuals to deduct qualified health insurance costs. Arguably, these rules are inequitable because the government benefit is not provided to everyone – only employees or self-employed who get health insurance coverage from their employer.	Allow an exclusion for only 75% of the employer-provided health insurance. Employers would need to report the amount of the benefit on Form W-2. Alternatively, the benefit could be reduced with a greater reduction for higher income individuals to target the relief (subsidy) to those who need it the most.
Exclusion of capital gains on sale of a principal residence.	\$1,000	Homeowners are allowed to exclude up to \$250,000 (\$500,000 if married filing jointly) of the gain from the sale of their principal residence if they have owned and lived in the home for at least 2 of the prior 5 years. The rule may only be used once in a 2-year period. This provision may be used more than once in a lifetime though.	This rule is arguably too generous. While it is not uncommon for many homeowners in California to have gains of \$500,000 on their home sale, the structure of the rule incentivizes individuals with more than one home to take advantage of this significant tax break. For example, a married couple who own a personal residence and a vacation residence can sell the personal home and exclude the gain and then move into the vacation home for at least 2 years prior to selling it and exclude that gain as well (up to \$500,000). They can do the same with rental homes they may own (although the portion of the gain from depreciation will be taxed and gain allocated to "non-qualified" use is not excludable). This rule provides a significant tax break to those owning a home and an even greater tax break to those who own more than one home or who buy and sell homes several times in their lifetime with large gains.	Reduce the exclusion amount or change the provision to a lifetime exclusion, adjusted for inflation.

			<p>In 2007, the 110th Congress included a provision in the original version of the mortgage debt relief bill (H.R. 3648) to reduce the generous nature of the home sale gain exclusion (the provision was removed from the bill that was enacted). H.R. 3648 would have exempted gain attributable to periods of non-qualified use from the gain exclusion rule. Some type of cut back to the gain exclusion rule would bring greater equity to the income tax.</p>	
Exclusion of Social Security benefits	\$2,100	<p>The federal income tax requires some individuals to pay tax on up to 85% of their Social Security income depending on their income level. Low-income taxpayers do not need to include any Social Security income. California does not tax any Social Security income.</p>	<p>There seems to be no good reason why California would want to exclude income that the federal government taxes when the test for inclusion is based on income. Some other states also exempt Social Security income, but others, such as Colorado and Connecticut, do not.</p>	<p>Phase-out this exclusion gradually over a 5 year period.</p>
Exemption for senior citizens	\$130	<p>A tax exemption (credit) is allowed for individuals age 65 or older. The credit was worth \$98 in 2009.</p>	<p>This tax benefit is poorly targeted as it applies to almost all seniors regardless of need. The phase-out of the exemption starts at income levels well above the poverty level. For 2007, these phase-out ranges were \$155,416 if single and \$310,837 if married.</p>	<p>Change the credit to be a range based on income levels with the credit completely phased out for seniors with income of a specified dollar amount that is far lower than current law, adjusted annually for inflation. For example, the credit could be \$99 for those with income under \$25,000, \$60 for those with income below \$50,000, \$30 for those with income below \$75,000 and zero for all others.</p>

Policy Approach to Analyzing Tax Systems

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Overview: This analysis is based on testimony presented by Professor Nellen on 4/21/03 to the Commission on Tax Policy in the New Economy,^{xx} at the California State Capitol Building in Sacramento, CA. It is based on the AICPA Tax Policy Concept Statement 1 – *Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals*. The ten principles laid out in that statement are compared to frameworks used by other groups including government agencies and tax reform panels. The comparison list has subsequently been expanded. The purpose is to illustrate that there is a core set of tax principles that can effectively be used to evaluate tax proposals and existing tax systems. At the state and local level, additional principles may be included such as the possible effect on interstate competition.

Tax Policy Perspectives: Analyses of tax systems almost always looks at tax principles as criteria for understanding and critiquing tax systems. The principles are typically the same although terminology, emphasis and sequencing may differ. Listed below are some examples of tax system analyses that have applied principles of good tax policy and effective tax systems.

American Institute of Certified Public Accountants (AICPA) – Tax Policy Concept Statement 1 – *Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals*.
<http://ftp.aicpa.org/public/download/members/div/tax/3-01.pdf>.

This report, issued in 2001, lays out ten principles of good tax policy that had been used by lawmakers and others for decades, if not centuries. The purpose of the statement was to provide a tool for policymakers to evaluate existing tax rules or systems, as well as reform proposals to determine where improvements were needed to make the rule or system more effective. The ten principles are summarized below.

- **Equity and Fairness** - Similarly situated taxpayers should be taxed similarly.
- **Certainty** - The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined.
- **Convenience of Payment** - A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer.
- **Economy in Collection** - The costs to collect a tax should be kept to a minimum for both the government and taxpayers.
- **Simplicity** - The tax law should be simple so that taxpayers can understand the rules and comply with them correctly and in a cost-efficient manner.
- **Neutrality** - The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.
- **Economic Growth and Efficiency** - The tax system should not impede or reduce the productive capacity of the economy.
- **Transparency and Visibility** - Taxpayers should know that a tax exists and how and when it is imposed upon them and others.

- **Minimum Tax Gap** - tax should be structured to minimize non-compliance.
- **Appropriate Government Revenues** – The tax system should enable the government to determine how much tax revenue will likely be collected and when.

Joint Venture: Silicon Valley Network - In 2001, the Tax Policy Group of Joint Venture: Silicon Valley Network turned the AICPA's 10 principles into a workbook to help elected officials and others in applying the 10 principles to analyze tax proposals. In doing so, they reorganized the 10 principles into three categories as follows (<http://www.jointventure.org/PDF/taxworkbook.pdf>):

- Fairness
 - Equity and Fairness
 - Transparency
- Operability
 - Certainty
 - Convenience of Payment
 - Economy of Collection
 - Simplicity
 - Minimum Tax Gap
 - Appropriate Government Revenues
- Appropriate Purpose and Goals
 - Neutrality
 - Economic Growth and Efficiency

Joint Committee on Taxation – *Description and Analysis of Proposals To Replace the Federal Income Tax*, JCS-18-95, 6/5/95, pages 58 – 59. <http://www.house.gov/jct/s-18-95.pdf>

Excerpt:

“Analysts generally judge tax systems in terms of how well the tax system answers four different questions.

- First, does the tax system promote or hinder economic efficiency. That is, to what extent does the tax system distort taxpayer behavior? Does the tax system create a bias against the domestic production of goods and services? To what extent does it promote economic growth?
- Second, is the tax system fair? Does the tax system treat similarly situated individuals similarly? Does the tax system account for individuals' different capacities to bear the burden of taxation?
- Third, is the tax system simple? Is it costly for taxpayers to determine their tax liability and file their taxes?
- Fourth, can the tax system be easily administered by the government and can it induce compliance by all individuals? Is enforcement costly? Can some individuals successfully avoid their legal liabilities?

The design of a tax system involves tradeoffs between these different goals. Measures designed to ensure compliance may increase the complexity of taxation for individual filers. Measures designed

to promote simplicity may create distortions in individual choice of investments. Measures designed to promote growth may alter the distribution of the tax burden.”

Government Accountability Office (GAO) – *Understanding the Tax Reform Debate: Background, Criteria and Questions*, GAO-05-1009SP (9/05); <http://www.gao.gov/new.items/d051009sp.pdf>.

Excerpt:

“Long-standing” criteria for evaluating tax policy:

1. Equity – including principles of:
 - a. Ability to pay
 - i. Horizontal equity
 - ii. Vertical equity
 - b. Benefits received
2. Economic Efficiency
 - a. Efficiency costs include (1) taxes owed, (2) “efficiency cost” (costs that reduce well-being – effect of taxes on decisions to do or not to do something), and (3) compliance costs.
3. Combination of simplicity, transparency, and administrability
 - a. Simplicity:
 - i. Compliance burden
 - b. Transparency of
 - i. Tax calculations
 - ii. Logic behind the rules
 - iii. Tax burden
 - iv. Compliance
 - c. Administrability
 - i. Processing returns
 - ii. Enforcing the law
 - iii. Providing taxpayer assistance

National Conference of State Legislatures (NCSL) – A set of nine principles were developed by a bipartisan group of legislators, staff and people from both the public and private sectors in 1991.^{xxi}

These principles of a “high-quality state revenue system” are:^{xxii}

“Principles of a High-Quality State Revenue System:

1. A high-quality revenue system comprises elements that are complementary, including the finances of both state and local governments.
2. A high-quality revenue system produces revenue in a reliable manner. Reliability involves stability, certainty and sufficiency.
3. A high-quality revenue system relies on a balanced variety of revenue sources.
4. A high-quality revenue system treats individuals equitably. Minimum requirements of an equitable system are that it imposes similar tax burdens on people in similar circumstances, that it minimizes regressivity, and that it minimizes taxes on low-income individuals.

5. A high-quality revenue system facilitates taxpayer compliance. It is easy to understand and minimizes compliance costs.
6. A high-quality revenue system promotes fair, efficient and effective administration. It is as simple as possible to administer, raises revenue efficiently, is administered professionally, and is applied uniformly.
7. A high-quality revenue system is responsive to interstate and international economic competition.
8. A high-quality revenue system minimizes its involvement in spending decisions and makes any such involvement explicit.
9. A high-quality revenue system is accountable to taxpayers.”

California Legislative Analyst’s Office – *The 2003-04 Budget Bill: Perspectives and Issues – The Governor’s Tax Proposal: Evaluation and Alternatives*, February 2003, http://www.lao.ca.gov/analysis_2003/2003_pandi/pi_part_5a_taxes_anl03.html.

“Excerpt (Figure 2)

Essential Criteria for Evaluating The Governor’s Tax Proposals:

- *Growth Performance*—Will the new tax revenues grow along with the economy and/or the program responsibilities they are expected to fund?
- *Reliability and Volatility*—Are new revenues raised by the taxes relatively stable over time or are they excessively volatile and difficult to predict?
- *Distributional Effects*—Is the additional burden or “incidence” from the increased taxes distributed among taxpayers in a manner that the Legislature believes is appropriate?
- *Tax Administration*—Are the new taxes simple to collect and administer or do they add additional complexity to the existing administrative structure?
- *Federal Interaction*—Would the increased taxes be deductible for federal purposes, allowing the state to “shift” some of the additional tax burden to the federal government?
- *Economic Climate*—What effects are the proposed tax increases likely to have on the business climate and overall economic activity?”

Washington State Tax Structure Study Committee – *Tax Alternatives for Washington State: A Report to the Legislature*, November 2002, Chapter 2 <http://dor.wa.gov/Content/AboutUs/StatisticsAndReports/WAtaxstudy/wataxstudy.htm>.

The charge of the committee was to study Washington’s existing tax structure and recommend alternatives to improve the system. The extensive report issued in 2002 begins with an explanation of tax principles for a “well-designed tax system.” It also explains the existing structure and where it does and does not meet the tax principles. The study also explains various constraints to change that exist in the U.S. and state constitutions and local government funding limitations. Such constraints are important in reform efforts as they are limitations that likely can’t be changed.

Various proposals are analyzed including major ones such as replacing a portion of the tax structure with some type of value-added tax or adding a state income tax (currently, Washington imposes no income tax). Incremental proposals such as continuing to impose an estate tax even after repeal of the federal tax, are also made. Additional proposals include extending the sales tax to consumer services, compensating vendors for collecting the sales tax, periodically reviewing exemptions and business incentives, and exempting construction labor from the sales tax. Each proposal made is analyzed in terms of it would allow the system to better meet the tax principles and what problems it might create in terms of not completely meeting particular tax principles.

The tax principles used to guide the committee's work were as follows.^{xxiii}

- Adequacy/stability/elasticity
- Equity/fairness
- Economic vitality and harmony with other states
- Economic neutrality and efficiency
- Transparency and administrative simplicity
- Home ownership

Hawaii 2001-2003 Tax Review Commission – Report, 2003,
http://www.state.hi.us/tax/trc/docs2003/trc_rpt_2003intro.htm.^{xxiv}

The Commission used a set of principles for “sound tax policy” provided by the National Conference of State Legislatures (NCSL) that were compiled in 1988 with input from lawmakers and academics. The five principles are:

- 1) Provision of appropriate revenues – this principle focuses on sufficiency, stability and certainty of revenues produced.
- 2) Neutrality
- 3) Equity
- 4) Easy and economical to administer
- 5) Accountability – the focus is at three key levels: (i) taxpayers being accountable for paying their taxes, (ii) tax agencies accountable to administer and enforce the tax laws efficiently and fairly, and (iii) lawmakers accountable for the integrity of the tax laws.

Note: The NCSL list was expanded to nine principles by 2007 (see earlier description and chart below).

Comparing Sets of Tax Principles

As noted above, reports of governments and various tax organizations and committees have used a set of tax principles to analyze tax structures and tax proposals. A logical question arises from looking at all of this – is there a common set of principles? The answer is yes. While terminology and layout may vary, the concepts are the same. Some reports either ignored a principle that others used or did not find it to be as important, perhaps, in its particular analysis. The following chart helps to illustrate the similarities among the principles utilized.

AICPA	Joint Committee on Taxation	GAO	NCSL	CA Legislative Analyst's Office	Washington	Hawaii
Equity and fairness	(2) Is the tax system fair?	Equity	(4) Treat individuals equitably; minimizes regressivity and taxes on low-income individuals	Distributional effects	Equity/fairness	Equity
Certainty	(4) Can the tax system be easily administered?		(2) Certainty; number and types of changes kept to minimum.			Easy and economical to administer
Convenience of payment					Transparency and administrative simplicity	
Economy of collection		Administrability	(6) Promotes fair, efficient and effective and professional administration	Tax administration		
Simplicity	(3) Is the tax system simple?	Simplicity	(5) Easy to understand and minimizes compliance costs			
Neutrality	(1) Does the tax system promote or hinder economic efficiency?		(8) Minimizes effect on spending decisions; any influences are explicit		Economic vitality and harmony with other states Economic neutrality and efficiency	Neutrality
Economic growth and efficiency		Economic efficiency	(7) Responsive to interstate and	Growth performance	Home ownership ^{xxv}	

			international competition (3) Broad bases and balanced variety (mix) of revenue sources to improve competitive relative to other states	Economic climate		
Transparency and visibility		Transparency	(9) Accountable to taxpayers; information on proposals publicized and debated.		Transparency and administrative simplicity	Accountability
Minimum tax gap	(4) Can the tax system be easily administered?					Easy and economical to administer
Appropriate government revenues			(2) (3) Stability of revenues with mix of taxes. (2) Sufficiency so budget is balanced. (1) Complementary elements including finances of both state and local governments	Reliability and volatility Federal interaction	Adequacy/stability/elasticity	Provision of appropriate revenues
AICPA	Joint Committee on Taxation	GAO	NCSL	CA Legislative Analyst's Office	Washington	Hawaii

- ⁱ U.S. Census Bureau, Table 435; www.census.gov/compendia/statab/2010/tables/10s0435.xls.
- ⁱⁱ NCSL, "Principles of a High-Quality State Revenue System," principle 1; <http://204.131.235.67/programs/fiscal/fpphqsr.htm>.
- ⁱⁱⁱ See Nellen, "California Tax Changes: Math versus Strategy," *California Progress Report*, 12/08; <http://www.californiaprogressreport.com/site/?q=node/1127>.
- ^{iv} Many factors affect location decisions for busiensses including the corporate income tax apportionment rules in other states, tax incentives, availability of an appropriate workforce and other costs.
- ^v For information on the likely effect of the COTCE PIT proposals on different income categories, see California Budget Project, "COTCE Proposals Would Increase Budget Gaps, Tax Low- and Middle-Income Californians," 9/22/09; http://www.cbp.org/pdfs/2009/CaliforniaBudgetBites/090911_CBP_Analysis_Cotce_proposals.pdf.
- ^{vi} California Commission on Tax Policy in the New Economy; <http://www.library.ca.gov/crb/catax/>.
- ^{vii} California Department of Finance, Tax Expenditure Report 2009-2010, p. 4; http://www.dof.ca.gov/research/documents/Tax_ExpenditureRpt_09-10.pdf.
- ^{viii} The tax expenditure for the sales and use tax does not include revenue "lost" due to consumption items that are not part of the tax base under California law. That is, the California sales and use tax applies to tangible personal property. If there is a statutory exemption for any tangible personal property, such as food, it is a tax expenditure. There is no tax expenditure for services because they are not legally part of the tax base.
- ^{ix} For further information, see Nellen, "Calls for Accountability – Will it help the overall incentives process?" *Journal of Multistate Taxation and Incentives*, June 2009, p. 18. Also see information at the website of Good Jobs First, <http://www.goodjobsfirst.org/>.
- ^x See The Taxation of Telecommunications in California in the Information Age, by James E. Priege, Terri A. Sexton, and Annette Nellen, California Policy Research Center, April 2003; <http://www.iga.ucdavis.edu/Research/CSLT/Publications/TaxationofTelecommunicationsPaper.pdf>.
- ^{xi} Gary Robertson, "NC collects bigger-than-expected revenue bonus," *The Atlanta Journal-Constitution*, 1/6/2010; http://www.ajc.com/business/nc-collects-bigger-than-268231.html?cxntlid=daylf_artr.
- ^{xii} The Tax Foundation website has a chart comparing sin taxes among the states and the District of Columbia at <http://www.taxfoundation.org/taxdata/show/245.html>.
- ^{xiii} Statement of Oregon House Majority Office, 3/26/09; <http://www.jcdemocrats.org/node/492>.
- ^{xiv} State Senator Crowell, "Dear Colleague" letter, 10/26/09; <http://www.missourinet.com/wp-content/uploads/2009/10/Crowell-Letter.pdf>.
- ^{xv} Analysis of AB 9 (2005-2006), the Assembly Revenue & Taxation Committee (4/22/05); available by search at <http://www.leginfo.ca.gov/bilinfo.html>.
- ^{xvi} In March 2006, 21% of households with income below \$30,000 had broadband access while 68% of households with income over \$75,000 had such access. Horrigan, Pew Internet and American Life Project, *Home Broadband Adoption 2006*, (May 2006), page 3; available at http://www.pewinternet.org/pdfs/PIP_Broadband_trends2006.pdf.
- ^{xvii} US Bureau of Labor Statistics, "Consumer Expenditures in 2006, Table 3 – Higher income before taxes: Average annual expenditures and characteristics, Consumer Expenditure Survey, 10/08' available at <http://www.bls.gov/cex/csxann06.pdf>.
- ^{xviii} Department of Finance, Tax Expenditure Report 2009-2010; http://www.dof.ca.gov/research/documents/Tax_ExpenditureRpt_09-10.pdf.
- ^{xix} This was proposed by President Bush's Advisory Panel on Federal Tax Reform, Final Report, 11/05 pg. 73; http://www.taxpolicycenter.org/newsevents/trp_recommendations.pdf.
- ^{xx} The Commission used the AICPA version of the principles in their final report; <http://www.library.ca.gov/crb/catax/>.
- ^{xxi} Scott Mackey, *Tax Policy Handbook for State Legislators*, NCSL, 12/97, pg. 7.
- ^{xxii} NCSL, *Principles of a High-Quality State Revenue System*, updated 6/07; <http://204.131.235.67/programs/fiscal/fpphqsr.htm>.
- ^{xxiii} The principles were provided to the committee in ESSB 6153 (likely some type of legislative directive).
- ^{xxiv} Hawaii's Tax Review Commission, 2005-2007 used the following principles: fairness, efficiency, simplicity, transparency and accountability, adequacy and stability, and competitiveness; http://www.state.hi.us/tax/trc/docs2007/trc_rpt_2007intro.htm.

^{xxv} This principle is an unusual one in that it is so specific or narrow. It appears that the state has made this such an important goal that it is something to be followed in the design of their tax system to help ensure that individuals are able to “purchase and maintain a home consistent with their standard of living” (page 5).