SB 1372 – OPPOSE

FLOOR ALERT

Date: **August 22, 2014**

To: **Members, California State Senate**

From: **Gina Rodriquez, CalTax Vice President of State Tax Policy**

Subject: **OPPOSITION to SB 1372 (DeSaulnier), as amended August 21, 2014**

The California Taxpayers Association and the organizations listed in this letter oppose SB 1372 (DeSaulnier), which would change the flat corporate tax rate of 8.84 percent (10.84 for banks and financial corporations) on publicly held corporations to a tax rate based on the salaries of each corporation's chief operating officer (COO) or highest paid employee, and its employees.

For taxable years beginning on and after January 1, 2015, SB 1372 would impose a corporate tax rate ranging from 7 percent to 13 percent (9 percent to 15 percent for financial institutions), based on each corporation's "compensation ratio." The bill also would increase the tax rate by

50 percent — to a maximum of 19.5 percent (22.5 percent for banks and financial corporations) — for publicly held corporations that have a specified decrease in full-time employees in the United States, while increasing the number of contracted and foreign full-time employees.

Under the bill, “compensation ratio” means a ratio where the numerator is the amount equal to the greater of the compensation of the COO or the highest paid employee of the taxpayer for the calendar year preceding the beginning of the taxable year, and the denominator is the amount equal to the median compensation of all employees employed by the taxpayer in the United States for the calendar year preceding the beginning of the taxable year.

The applicable tax rate would be computed based on net income for the taxable year, but not less than the minimum franchise tax, where the applicable tax rate is determined as follows:

If the compensation ratio is:	The tax rate is:*
More than 0 times, but not more than 25 times the median worker salary	7.0%
More than 25 times, but not more than 50 times the median worker salary	7.5%
More than 50 times, but not more than 100 times the median worker salary	8.0%
More than 100 times, but not more than 150 times the median worker salary	9.0%
More than 150 times, but not more than 200 times the median worker salary	9.5%
More than 200 times, but not more than 250 times the median worker salary	10.0%
More than 250 times, but not more than 300 times the median worker salary	11.0%
More than 300 times, but not more than 400 times the median worker salary	12.0%
More than 400 times the median worker salary	13.0%
*Add 2% for financial corporations; and add 50% if full-time, U.S. employees are reduced by 10% from prior year and if total contracted workers or foreign employees has increased from prior year	

Finally, the bill requires the additional revenue (estimated at $340 million annually, according to the Franchise Tax Board) from the tax increase to the California Competes Tax Credit Committee (under the Governor's Office of Business and Economic Development, or GO-Biz). The bill directs the committee to award corporate tax credits to firms with "compensation ratios" between 0 and 100, and base the award on the number of jobs created or retained in California; the amount of compensation the taxpayer pays to employees; the amount of the taxpayer's investment in California; and the overall economic impact of the taxpayer's project of business.

KEY POLICY CONCERNS

California is a high-tax state, a fact known across the nation and around the globe. California’s top personal income tax rate of 13.3 percent, top capital gains rate of 13.3 percent, sales and use tax rate of 7.5 percent, and gas tax rate of $0.525 per gallon are the highest in the United States. And California’s corporate tax rate of 8.84 percent is one of the highest in the country. When adding SB 1372’s top rate of 19.5 percent to the 35 percent federal corporate income tax rate (already the highest in the world), companies would face a top marginal rate of 54.5 percent, effectively prohibiting companies from competing in the global market.

California’s anti-business climate is repeatedly in the news and reflected in reports. The Small Business & Entrepreneurship Council recently released their Small Business Index 2014. At No. 50, California is ranked as having the worst state tax system in the country. The sheer number of legislative proposals seeking even more taxes and fees is staggering; and the mere introduction of SB 1372 hurts California’s ability to recruit new businesses, and portrays California’s state government as having a heavy hand in the business of its people.

Specific concerns about this bill are addressed below.

Potentially Violates U.S. Constitution. SB 1372 would penalize a company for increasing its foreign footprint, likely in violation of the U.S. Commerce Clause. *Japan Line, Ltd. v. County of Los Angeles* (1979) 441 U.S. not only addresses facial discrimination, but two additional limits: Impairing the United States from speaking with one voice, and creating a substantial risk of double taxation. Also, *Kraft Gen. Food v. Iowa Dept. of Revenue* (1992) 505 U.S. 71 addresses discrimination and a heightened bar imposed on impairment of foreign commerce.

Disproportionately Affects Retailers. SB 1372 would disproportionately affect retail companies where much of the workforce is comprised of sales associates in entry-level positions. Using median worker compensation as the denominator for corporate tax liability hurts business models that primarily are composed of large numbers of customer service representatives. These businesses would be less competitive at attracting capable COOs if they were forced by tax law to cut executive wages in half.

Executive Pay Already Is Subject to Tax Limits. A publicly held corporation generally is not allowed a deduction for compensation in excess of $1 million paid to any covered employee (chief executive officer and four other highest paid officers) under IRC Sec. 162(m), to which California conforms. The magnitude of deductions being forfeited by public corporations for the sake of executive compensation is in the billions, effectively increasing these companies' tax liabilities and decreasing corporate profits.

Burdens Both Shareholders and Labor. Research shows that a corporate tax increase burdens both shareholders and labor. A Tax Foundation study finds that the corporate tax falls predominately on labor. Even a recent report by the Joint Committee on Taxation, a nonpartisan committee of the U.S. Congress, found that 25 percent of the corporate tax falls to labor, with 75 percent going shareholders. At some point, a tax increase on large corporations ends up as a tax increase on individuals, either through less economic growth, lower wages, higher prices, fewer jobs or decreased returns in their retirement accounts.

Creates a Competitive Disadvantage. Higher corporate tax rates put California companies at a tremendous competitive disadvantage that is likely to worsen as other states and nations reduce rates to encourage their own economic growth. Corporate tax rates play a major role in determining whether companies will invest capital in any given location. Unfortunately, SB 1372 will hurt opportunities in all of these areas.

Establishes a Punitive Tax System. It would be improper for the state government to use the threat of draconian tax hikes to attempt to influence private-sector salaries. The state should be trying to reduce California's tax burden, so that businesses will thrive and more Californians will be able to find good-paying jobs, rather than using the heavy hand of government to interfere in private companies' pay structures. Applying different tax rates to two different companies with the same amount of net income because their compensation ratios differ ignores the sound tax principles of fairness and equity.

Conclusion. California is a high-tax state, with some of the steepest tax rates in the nation. For businesses seeking to create jobs for Californians by locating or expanding in the state, taxes are a major obstacle. California has the third-worst state business tax climate in the nation, according to reports from the Tax Foundation, a national tax research organization that tracks state taxes; and its tax system is dead last, according to the Small Business & Entrepreneurship Council. SB 1372 would add to California's reputation as an anti-business state.

For the foregoing reasons, the organizations listed below strongly oppose SB 1372.

California Taxpayers Association
Air Logistics Corporation
Associated Builders and Contractors of
California
Associated General Contractors of California
California Apartment Association
California Bankers Association
California Chamber of Commerce
California Grocers Association
California Manufacturers and Technology
Association
California Restaurant Association
California Retailers Association
California Tank Lines, Inc.
Chemical Transfer Co.
Council on State Taxation
El Dorado Land Holdings, LLC
Kern County Taxpayers Association
National Federation of Independent Business
Orange County Business Council
Orange County Taxpayers Association
Pharmaceutical Researchers and
Manufacturers of America (PhRMA)
Silicon Valley Leadership Group
Superior Tank Wash Inc.
TechAmerica
TechNet
West Coast Leasing, LLC
West Coast Lumber & Building Material
Association

cc: The Honorable Mark DeSaulnier, California State Senate