Date: April 21, 2021

To: Members, Assembly Housing and Community Development Committee

From: Peter Blocker, Vice President of Policy

Subject: OPPOSITION to AB 71 (Luz Rivas), as amended on March 25, 2021

The California Taxpayers Association and the organizations listed in this letter oppose AB 71, a proposed $2.4 billion-a-year tax increase on California businesses and residents. This bill would significantly increase taxes by requiring taxpayers who make a water's-edge election to include in their gross income 50 percent of global intangible low-taxed income and 40 percent of the repatriation income of affiliated corporations. Taxpayers that experience a tax increase under these provisions would be prohibited from utilizing business tax credits to offset more than $5 million of the new liability. Global intangible low-taxed income also would be included in a taxpayer's gross income for purposes of the Personal Income Tax Law.

There is no doubt that homelessness in California should be addressed, but AB 71 creates new problems rather than solutions, and we therefore must oppose this bill for the following reasons:

Imposes an Unnecessary Tax. This bill would impose a tax increase at a time when California businesses already pay some of the highest taxes in the country. California's corporate income tax rate is the highest among the Western states and one of the highest in the nation. According to the Washington, D.C.-based Tax Foundation, California's business tax climate ranks second-worst in the United States. After comparing the costs of operating in California vs. other states, many employers left our state in 2020. The relocation of these companies and their employees to lower-cost states has a major impact on state and local tax revenue, causes unemployment for workers who cannot move to the new location, and is a sign that California must find ways to be more competitive.

The Tax Is Retroactive and Disadvantages U.S. Corporations. The tax on repatriated income is retroactive, reaching back to a one-time event from 2017-18. There is no possible way that taxpayers could have foreseen that they would have to pay taxes on income they reported years ago. Taxing income from years in the past should be flatly rejected.

Taxing companies that repatriate income back to the United States puts U.S.-based companies doing business in California at a substantial disadvantage to foreign corporations that do not bring income back to the United States. The additional costs from this proposal will be borne by U.S.-based businesses, and will be a significant disadvantage for companies in a competitive market.

Effectively Undermines the Water's-Edge Election. Prior to the enactment of the water's-edge election, the United Kingdom, Japan, Canada, and other trading partners were outraged by California's method of taxing multinational companies, which led these foreign governments to call for significant retaliatory actions against California and the United States unless corrective measures were adopted. This outrage led to the creation of California's water's-edge election in 1986 with passage of SB 85 (Alquist). The water's-edge election has been a success in ensuring that California is allowed to tax profits derived from or attributable to California, while California businesses that have operations here and abroad are not over-burdened with reporting nor penalized for their California investments. At the same time, our trading partners are satisfied by California's water's-edge election because their constituents are not being unreasonably burdened or taxed by a sub-state, thus easing the tensions of a potential trade or tax war. Following passage of the creation of the water's-edge election, *The Sacramento Bee's* editorial board wrote in August 1986: "(S)omething had to be done about California's unitary taxing method – not because it is unfair or inefficient, but because the nation's most important trade partners object to it violently. Its mere existence provokes foreign policy problems for the nation (which Congress and the president are itching to resolve if California doesn't) and hinder foreign investments in the state." AB 71 would bring back many of these tax fights, effectively undermining the benefits of the water's-edge election.

Worsens the Competitive Disadvantage for Employers Who Stay in California. As businesses will be unable to mitigate the proposed increase in corporate taxes, they will look to other alternatives to lower their costs. Since California is a state with a high cost of doing business, taxpayers will look to lower total operating costs by relocating to lower-cost jurisdictions or suspending expansion of business activities within California.

The relocation of these companies and their employees to lower-cost states has a major impact on state and local tax revenue, causes unemployment for workers who cannot move to the new location, and is a sign that California must find ways to be more competitive. The companies that remain will be placed at a tremendous competitive disadvantage. Their only response will be to reduce or not increase wages and benefits for their workers, and move new hires to lower-cost jurisdictions to stay competitive. A thriving economy is the best source of growing revenue for important government programs, but by chasing jobs away, this proposal would hurt rather than help.

Jobs Are Vital. Californians are sensitive to the problems noted above, as illustrated by the Berkeley IGS Poll's finding that 78 percent of voters "agreed that taxes in California were already so high that they were driving many people and businesses out of the state." The seriousness of this problem was made clear in 2020 when pioneers in the technological revolution – founders of a signature industry that spawned the appellation "Silicon Valley" and made California the world's tech leader – decided to move elsewhere specifically because of California's high costs and the threat of even higher taxes on the horizon. If the state's only response is a tax increase, other employers will be far more likely to join the exodus.

Additionally, California's anticipated 2021 unemployment rate average of 8.5 percent is still higher than pre-COVID lows of 3.9 percent and the overall U.S. unemployment. Jobs are vital for individual California workers and to our state economy – especially in light of the pandemic. Every new job created in California provides income for the worker and increased revenue to the state through the existing tax structure.

Budget Has Record Surplus and Tax Windfall. Governor Gavin Newsom's January budget has record reserves of $22 billion, including $15.6 billion in the state's Rainy Day Fund. Additionally, California is estimated to have a $15 billion revenue windfall from higher-than-anticipated tax revenue. Tax receipts are so high that for just the second time in nearly 40 years, California may find itself in a position where tax refunds may be required under the Gann Limit. In short, tax increases are not necessary.

We encourage the Legislature to increase the revenue available for important programs not by increasing taxes, but by helping California employers recover from the pandemic, rehire workers and return to the activities that filled the state's tax coffers and reserves.

For these and other reasons, CalTax and the organizations listed below strongly oppose AB 71.

Sincerely,

California Taxpayers Association
AdvaMed
Bay Area Council
California Association of Winegrape Growers
California Attractions and Parks Association
California Beer and Beverage Distributors
California Building Industry Association
California Business Properties Association
California Cable & Telecommunications Association

California Cattlemen's Association
California Chamber of Commerce
California Fuels & Convenience Alliance
California Grocers Association
California Hotel & Lodging Association
California Independent Petroleum Association
California League of Food Producers
California Life Sciences Association
California Manufacturers & Technology Association
California Mortgage Bankers Association
California New Car Dealers Association
California Restaurant Association
California Retailers Association
California Trucking Association
Central Valley Business Federation
Contra Costa Taxpayers Association
Council on State Taxation
Family Business Association of California
Greater Irvine Chamber
Hotel Council of San Francisco
Kern County Hispanic Chamber of Commerce
Kern County Taxpayers Association
National Association of Mutual Insurance Companies
North Bay Leadership Council
North Orange County Chamber
Opportunity Stanislaus
Orange County Business Council
Orange County Taxpayers Association
Oxnard Chamber of Commerce
Personal Insurance Federation of California
San Fernando Valley Chamber
San Gabriel Valley Economic Partnership
San Mateo Area Chamber of Commerce
Securities Industry and Financial Markets Association
Silicon Valley Leadership Group
TechNet
Tri County Chamber Alliance
West Coast Lumber & Building Material Association
Western Growers Association
Western Manufactured Housing Communities Association
Western States Petroleum Association
Wine Institute

cc: The Honorable Luz Rivas, California State Assembly
cc: The Honorable Richard Bloom, California State Assembly
cc: The Honorable David Chiu, California State Assembly
cc: The Honorable Buffy Wicks, California State Assembly