



April 14, 2021

The Honorable Miguel Santiago
California State Assembly
State Capitol, Room 6027
Sacramento, CA 95814

The Honorable Lorena Gonzalez
California State Assembly
State Capitol, Room 2114
Sacramento, CA 95814

The Honorable Ash Kalra
California State Assembly
State Capitol, Room 2196
Sacramento, CA 95814

The Honorable Alex Lee
California State Assembly
State Capitol, Room 2170
Sacramento, CA 95814

Subject: CalTax Opposition to AB 1253 (Santiago, Gonzalez, Kalra and Lee), as amended on March 25, 2021

Dear Assembly Members Santiago, Gonzalez, Kalra, and Lee:

The California Taxpayers Association and the signed organizations oppose AB 1253, which would increase taxes on sole proprietors and high-income earners by imposing a personal income tax surcharge at varying rates. Beginning January 1, 2021, the surcharge would impose the following rates in addition to California's existing highest-in-the-nation income tax:

- 1 percent on taxable income between \$1,181,484 and \$2,362,967.
- 3 percent on taxable income between \$2,362,968 and \$5,907,419.
- 3.5 percent on taxable income \$5,907,420 or greater.

The California Taxpayers Association is a nonpartisan, nonprofit association formed to support good tax policy, oppose unnecessary taxes and promote government efficiency. Established in 1926, CalTax is the oldest and largest group representing California taxpayers.

AB 1253 would bring California's top personal income tax rate to 16.8 percent. This would decrease our competitiveness even more by setting the top rate far beyond those in the 49 other states (the states with the next-highest top rates are Hawaii at 11 percent, New Jersey at 10.75 percent and Oregon at 9.9 percent; Texas, whose state officials actively recruit California employers to relocate, does not impose a personal income tax). CalTax and the signed organizations oppose AB 1253 for the following reasons:

Income Tax Is a Volatile Revenue Source. California's personal income tax is extremely volatile – largely because most of the tax (including taxes on capital gains) is paid by a relatively small base of California's highest-income earners.

According to data from the enacted 2020-21 budget, 43.5 percent of California's tax and fee revenue comes from the personal income tax, and the most recent data from the Franchise Tax Board shows that under California's steeply progressive tax structure, 0.5 percent of tax filers in California reported income of \$1 million or more, but paid 40.1 percent of the total income tax dollars collected by the state. Most of the income reported by California's upper-income filers is related in some way to capital investments, rather than wages and salary income.

Because of the state's disproportionate dependence on high earners, the state's revenue stream follows the boom-and-bust cycles of the stock market. This bill would increase the dependence on high earners and put the state in an even more precarious position for the next recession.

Increasing Taxes Would Adversely Impact Sole Proprietors. As noted, this tax increase would set the top marginal rate at 16.8 percent, which would directly affect Californians who operate businesses and file under the Personal Income Tax Law (PIT). California should encourage businesses to grow and create jobs here, not impose new taxes that inhibit their ability to thrive in this state. When a larger portion of business income is paid in taxes, less is available for job creation, employee benefits, and expansion. The COVID-19 pandemic is having a devastating impact on California workers, and the number of unemployment insurance claims has shattered the previous record high. Now more than ever, California needs to look for ways to improve its business climate so jobs can be preserved, and Californians can go back to work when the pandemic is over.

Capital Gains Lock-In Effect. Unlike the federal government, California does not have a more favorable tax rate for capital gains. Rather, capital gains are taxed as ordinary income; therefore, our tax on capital gains is the highest in the nation. With higher personal income taxes, the additional tax paid on capital gains can be significant, particularly when a taxpayer is in an "alternative minimum tax" position and is unable to get a federal deduction for state taxes paid.

This bill would further encourage the "lock-in" effect that causes taxpayers to reduce sales of assets, particularly stock. As an example, if a stock is providing a dividend of 4 percent, and the investor is seeking a 4 percent return, it will be less financially desirable to sell the stock and invest in another, due to the reduction of the principal because of increased taxes. Therefore, there will be less capital to invest, and an investor would have to buy a potentially riskier stock with a higher dividend payout to get the same return. Studies have concluded that the "lock-in" effect reduces the amount of capital for investment, particularly for new start-ups and companies in emerging sectors.

Tax Increase May Impact Elderly Homeowners Who Are Not Wealthy. Californians who sell homes they have lived in for many years and who have a low tax basis may use the capital gains exclusion, but still have substantial gains to report. These taxpayers would be hit with higher tax liabilities under this legislation. For example, if an elderly couple sells the Silicon

Valley home they have lived in for 35 years, they may have to report a gain over \$1 million, thus subjecting them to at least a 14.3 percent tax rate under the measure. The resulting tax increase disproportionately impacts retired taxpayers on fixed incomes who may be relying on the one-time proceeds of the home sale to pay for food, medicine, and living expenses for many years into the future.

For these reasons, CalTax and the organizations listed below respectfully oppose this legislation.

Sincerely,



Dustin Weatherby
Policy Advocate
California Taxpayers Association

On behalf of...

California Taxpayers Association
Bay Area Council
Building Owners and Managers Association of California
California Attractions and Parks Association
California Beer and Beverage Distributors
California Business Properties Association
California Chamber of Commerce
California Farm Bureau Federation
California Land Title Association
California Retailer's Association
California Southern Cities Apartment Association
Coalition of Sensible Taxpayers (Marin)

East Bay Rental Housing Association
Family Business Association of California
Fountain Valley Chamber of Commerce
International Council of Shopping Centers
Kern County Taxpayers Association
NAIOP of California, the Commercial Real Estate Development Association
Official Police Garages Association of Los Angeles
Orange County Apartment Association
Orange County Taxpayers Association
San Gabriel Valley Economic Partnership
Silicon Valley Leadership Group