

## CA Future of Work Commission Stakeholder Engagement Meeting on CA Tax Policy with Prof. Emmanuel Saez

January 28, 2020

Commissioners John Marshall and Carla Javits met with U.C. Berkeley Professor Emmanuel Saez. Professor Saez gave a brief presentation (attached) which provided an overview of his recent research with Professor Gabriel Zucman documenting the rise of income and wealth inequality in the United States over the past 40 years. Among the key findings of Saez and Zucman's research is that, overall, the U.S. tax system is relatively flat (averaging approximately 28% of pre-tax income) that is regressive at the top. When the health insurance costs are added in the regressivity is much more pronounced, as a "health insurance poll tax" hits lower income Americans much harder.

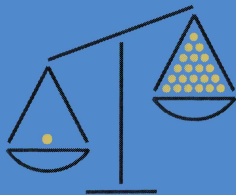
In California, the tax system is more progressive than the U.S. system as a whole, but it could be more progressive and could also be less volatile with the business cycle. To these ends Professor Saez offered several recommendations for California policy makers (see pp. 8-14):

1. A withholding tax on capital gains
  - This is not a new tax but rather an annual withholding of California's existing 13.2% capital gains tax, which goes unpaid when taxpayers leave the state prior to realizing the capital gain.
  - Would reduce any incentive to move away from CA and realize gains in lower tax jurisdictions.
2. Adjusting the state's corporate tax on multinationals to apportion global profits based on CA sales
  - Designed to address the use of global tax havens; U.S. multinationals currently book about 60% of foreign profits in tax havens.
  - Would be relatively easy to implement because CA and other states already use sales apportionment for taxing U.S. profits.
3. Institute a flat tax on all labor costs and business profits, which could replace the regressive sales tax.
  - A 1% tax would generate \$25 billion annually
  - Could be used to fund universal healthcare and/or higher education

In addition to the above proposals which are found in the attached slides, Professor Saez also recommended that the state of California conduct research on income and taxation of 100 billionaires who live in the state in order to get a finer grained analysis of this group.

# THE TRIUMPH OF INJUSTICE

How the Rich Dodge  
Taxes and How to  
Make Them  
Pay



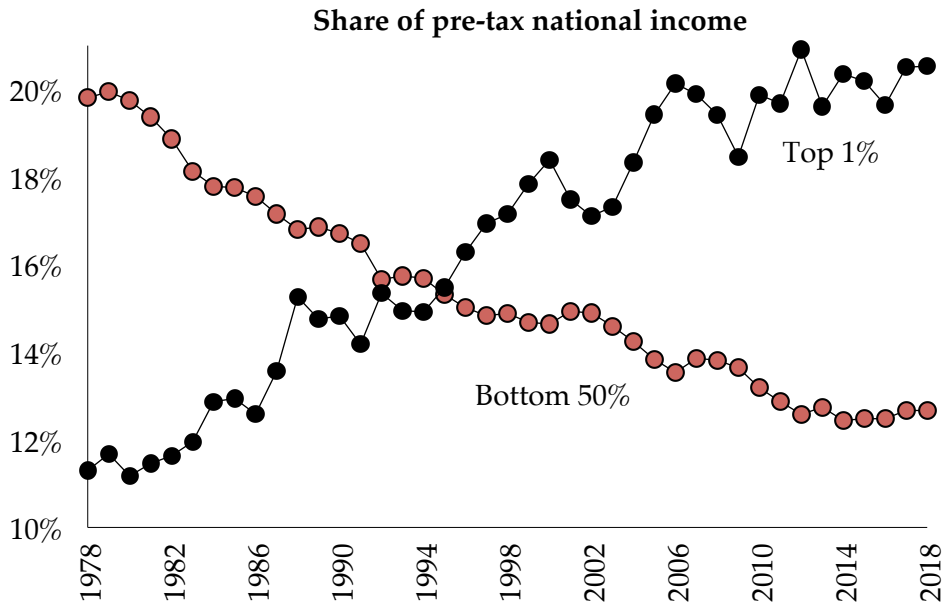
EMMANUEL SAEZ AND GABRIEL ZUGMAN

## Three main novelties:

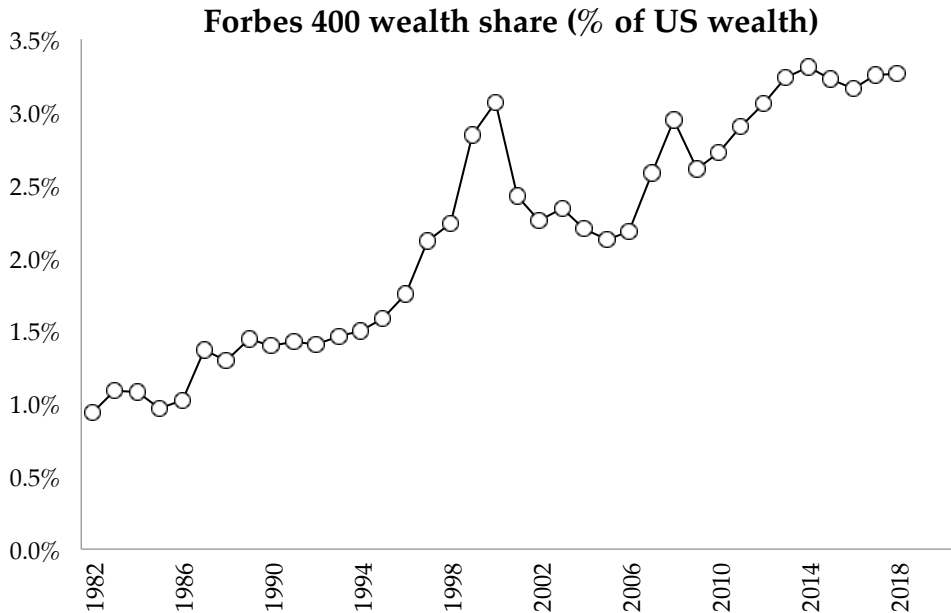
- ▷ How much each social group pays in taxes, from early 20th century to today
- ▷ Elements for a new 21st century tax system
- ▷ Tools for a democratic fiscal debate

[TaxJusticeNow.org](http://TaxJusticeNow.org)

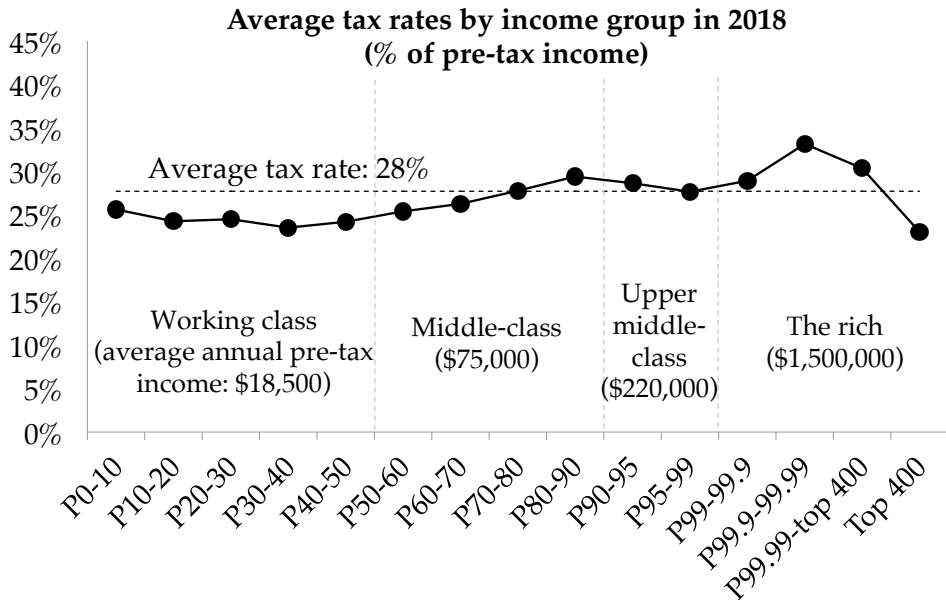
# The rise of income inequality in the United States



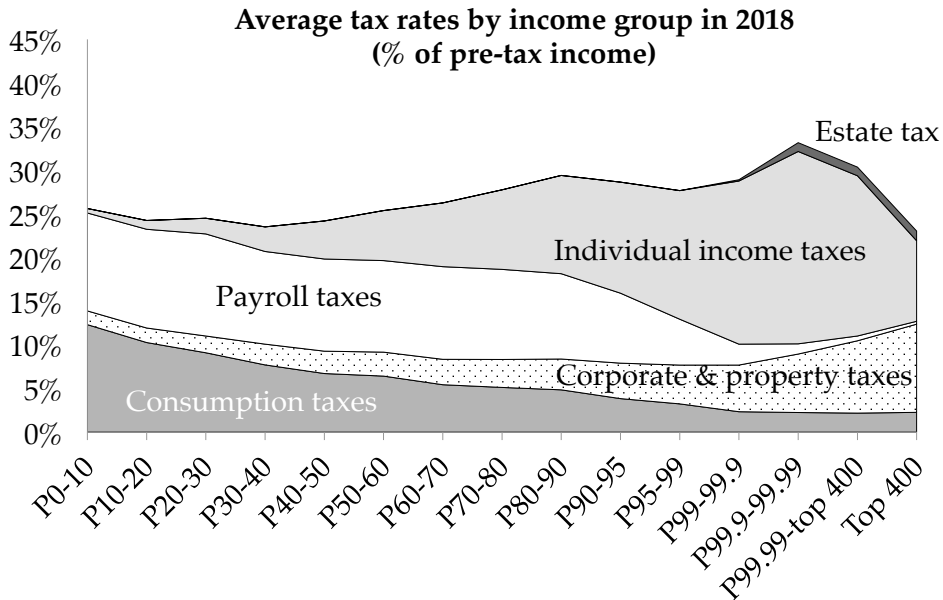
# The growing concentration of wealth at the very top



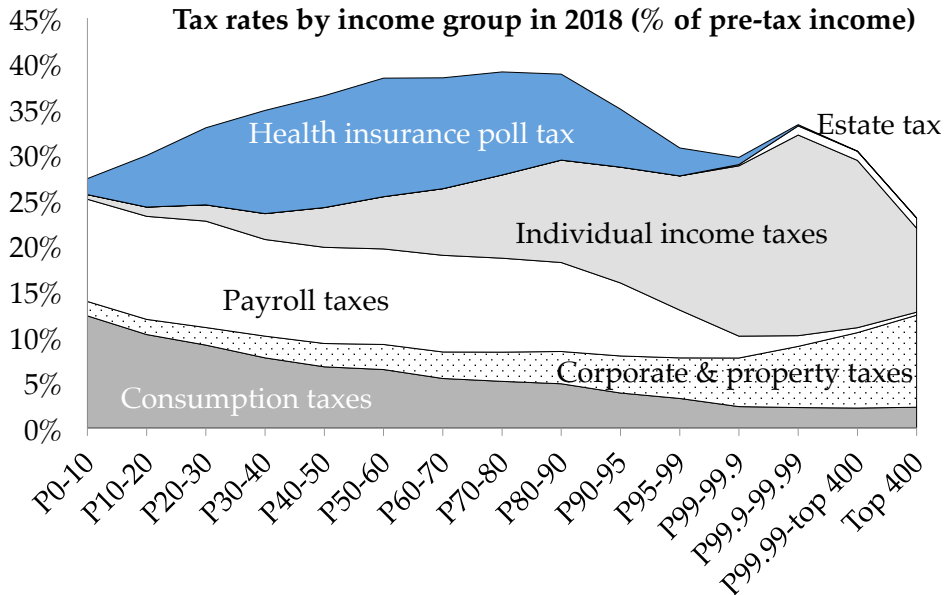
# The US tax system today: A giant flat tax regressive at the top



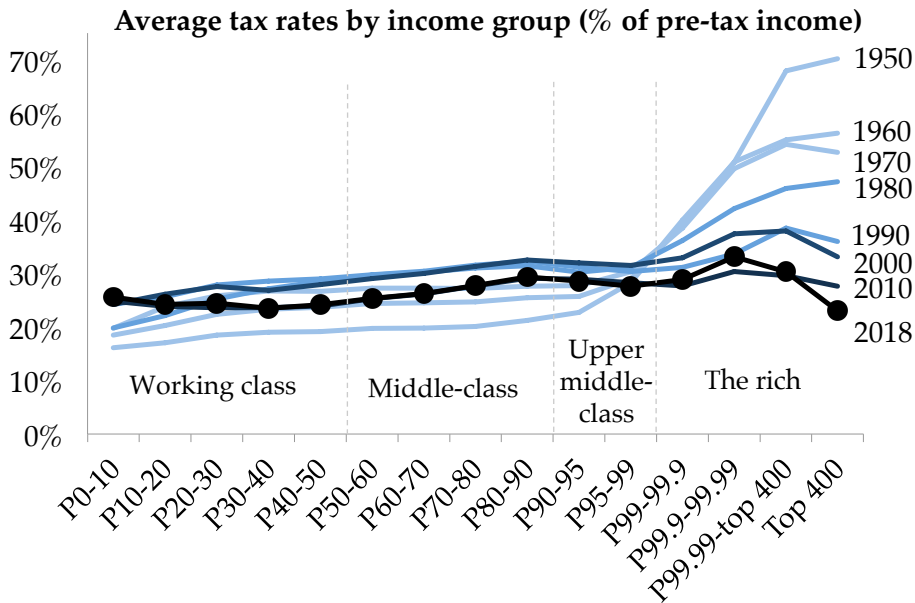
# The US flat tax: Composition by type of tax



# US tax system looks regressive when factoring health insurance premiums



# The shrinking progressivity of the US tax system





# California tax policy challenges

- ▷ CA top 1% income share higher than US wide
- ▷ CA tax system progressive (relative to other states) but highly cyclical
- ▷ Limited fiscal capacity with existing tax instruments ...
- ▷ ... that hampers CA public policy ambitions (health, education)
- ▷ I propose 3 CA tax improvements: I. better tax on capital gains, II. better tax on multinationals, III. broad income tax to boost fiscal capacity

# I. Improving CA income tax: Withholding tax on capital gains

- ▷ Realized capital gains are a big and progressive tax revenue component ... but very volatile
- ▷ Tax is deferred until realization (forever if taxpayer dies or leaves the state before realization)
- ▷ Better system: apply withholding tax on stock of unrealized capital gains with credit upon realization
- ▷ Example: 1% annual withholding tax on stock of unrealized gains above \$10m
- ▷ Makes CA tax revenue from capital gains less volatile

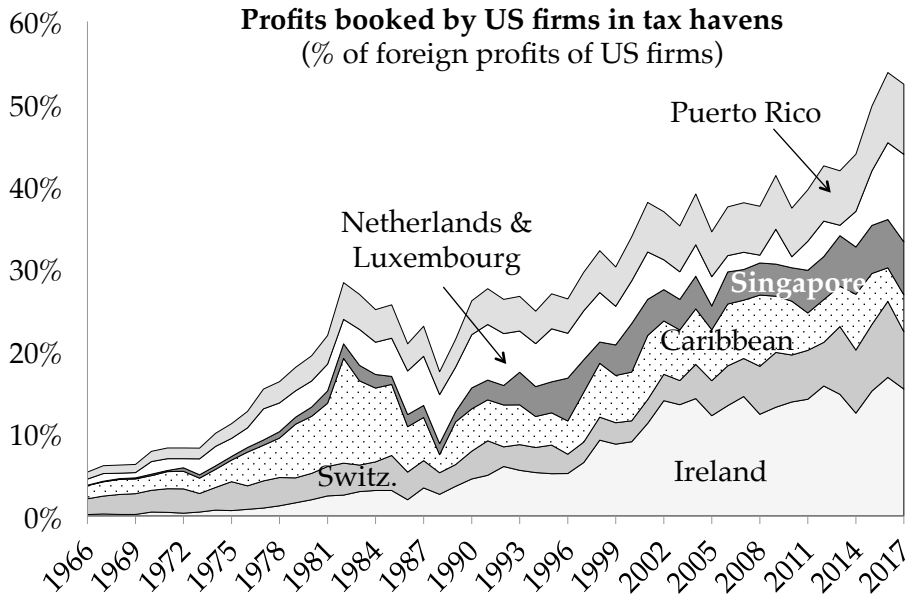
# I. Withholding tax on capital gains: Mark Zuckerberg example

- ▷ Zuckerberg's wealth is \$80B almost all of which is unrealized capital gains on Facebook shares
- ▷ Zuckerberg would pay 1% of \$80B = \$800m each year and build up pre-paid withholding taxes
- ▷ When he realizes gains, he pays the CA 13.2% income tax but gets credit for CA taxes already withheld
- ▷ Reduces incentives to move to realize gains outside CA
- ▷ Would make CA billionaires pay taxes commensurate with their true income

## II. Corporate tax on multinationals: apportion global profits based on CA sales

- ▷ US multinationals book about 60% of foreign profits in tax heavens
- ▷ CA could tax multinationals based on global profits apportioned to CA sales (used to do it before 1986)
- ▷ Apple sells 10% of its products in CA  $\Rightarrow$  10% of Apple global profits should be taxed in CA
- ▷ Federal government already collects information on profits booked in each country for each multinational
- ▷ CA (and other states) already use sales apportionment for taxing US profits

## II. Letting tax evasion fester: The case of the corporate tax



### III. Funding the CA welfare state with a broad income tax at source

CA faces limits on raising revenue using existing taxes (top income tax rates are high, sales+excise taxes are regressive, Prop 13 limits property taxes)

#### **Solution: a broad base income tax at source**

- ▷ Base: all labor costs + business profits (exempts retirement and transfer income)
- ▷ Flat rate with no deductions: \$25B per point of tax
- ▷ Administered by businesses and employers
- ▷ Better than payroll tax (which exempts capital income) and VAT (which exempts savings, and finance, health, education sectors)

### III. Funding the CA welfare state with a broad income tax at source

1) Broad income tax could replace **regressive sales taxes** (at state and local level)

2) Could fund **Universal Health Care**

⇒ Low and medium workers gain: private health insurance “poll tax” replaced by flat rate income tax

3) Could fund better **higher education**

CA should compete with other states based on quality education and not low taxes

Ability to attract paying out-of-state talented students is a huge advantage CA could exploit