February 15, 2023

The Honorable Alex Lee
California State Assembly
1021 O Street, Suite 6330
Sacramento, CA 95814

Subject: CalTax OPPOSITION to AB 259 and ACA 3 (Lee), as introduced on January 19, 2023

Dear Assembly Member Lee**:**

The California Taxpayers Association and the organizations listed below respectfully oppose AB 259 and ACA 3, which together seek to impose a wealth tax – the first of its kind in the United States. ACA 3 would expand the assets that the Legislature is authorized to tax to include household furnishings, artwork, and other tangible and intangible personal property and would establish a differential tax rate for the personal property, stocks, bonds, and investments of certain taxpayers. AB 259 would impose a tax of 1.5 percent on taxpayers with a worldwide net worth in excess of $1 billion, or in excess of $500 million in the case of a married taxpayer filing separately. Although portrayed as a "billionaire tax," the proposal would impose a 1 percent tax on taxpayers with a worldwide net worth in excess of $50 million, or $25 million in the case of a married taxpayer filing separately. CalTax has the following concerns:

Erodes California's General Fund Tax Base. A wealth tax in California would encourage a select group of Californians to relocate to any of the 49 states that do not tax savings, household furnishings, personal effects, and other assets, and could lead to a significant reduction in personal income tax revenue from these individuals and an erosion of the state's tax base.

The top 1 percent of high-income taxpayers accounted for 49.1 percent of the PIT revenue received by the state in the 2020 tax year. Since the PIT generates approximately half of the state's general fund revenue, this equates to the top 1 percent of earners paying approximately one-quarter of the general fund revenue that pays for schools, health care, and other vital programs. Imposing a wealth tax on these high-income taxpayers would prompt many of them to move out of California, which would decrease PIT revenue that supports these important programs.

Additionally, a wealth tax could diminish California's sales and use tax revenue. California's sales and use tax is applied to the purchase price of tangible property in state or for use in state, such as cars, electronics, furniture, and other products. Luxury items purchased by wealthy residents generate a significant amount of sales tax revenue – relied on by local governments to provide critical services. If Californians relocate purchases to other states as a result of AB 259, state and local governments could see a decline in this important source of revenue.

Competitive Disadvantage. If this legislation is enacted, California would be the only state in the country to impose this type of tax on accumulated assets. This tax targets the most mobile individuals in the world, and Californians subject to a wealth tax could easily move to any of the 49 other states that do not impose such a tax, taking with them their income, investments, charitable donations, and consumer spending. Additionally, entrepreneurs would be dissuaded from investing and growing their businesses in the state. California would lose vital tax revenue that is needed to fund the many important policies and programs championed by the Legislature.

Less Corporate Tax Revenue if Fewer Headquarters Are in California. A wealth tax could result in a decline in corporate income and franchise tax revenue, since corporations would pay less California tax on investment income and other types of nonbusiness income if corporate management functions and commercial domicile were relocated outside of the state. Under Revenue and Taxation Code section 25120(b), a commercial domicile "means the principal place from which the trade or business of the taxpayer is directed or managed." Typically, this has been interpreted to mean the location where the corporate management functions are located, which is where real control exists with respect to the business activities of the corporation.

If a majority of executives of a business relocate outside of California, this could shift where corporate management functions are located, and thus impact whether the business is domiciled within California. Although there are special rules for certain types of nonbusiness income, in general, nonbusiness income is fully allocated to a business' commercial domicile. If the commercial domicile is not California, the state could lose out on taxes on this nonbusiness revenue.

Wealth Is Volatile, and Riches Can Be Made and Lost in Seconds. A wealth tax would be applied to the value of stocks at the end of the taxable year, but the value could be vastly different by the next day – if not within seconds. There are numerous examples of sudden, massive decreases in the stock price of major corporations, along with sudden, massive decreases in major shareholders' net worth. While the existing income tax applies to actual realized gains and losses, a wealth tax would apply to paper gains or losses based on the value at a single moment in time, making the tax completely unpredictable for both the taxpayers and the government. One of the central elements of a sound tax structure is stability. The state, schools, and communities cannot rely on revenue that changes within days or seconds.

Impossible to Administer Under Current Administrative Structure. California's income tax applies not just to compensation for 9-to-5 jobs, but also to realized gains on investments, dividends, licensing agreements, royalties, profits from real estate sales, and other income sources. The Franchise Tax Board administers income tax laws to ensure that taxpayers pay their tax obligations, and imposes a variety of very substantial penalties on those who attempt to evade taxes.

ACA 3 authorizes the FTB and the Department of Justice to administer and collect taxes that would be imposed under this proposal. Currently, the Department of Justice has no tax collectors, appraisal staff, or any other personnel who would be capable of administering and collecting such a tax. The only government entities with property appraisal expertise are California's 58 county assessors and the State Board of Equalization, which are not tasked with any administrative duties by AB 259 or ACA 3. These offices also are experiencing staffing problems and do not have expertise in appraising all of the types of property targeted by AB 259. While the FTB has some of the brightest experts in taxation and a diligent team of tax collectors and administrators, the agency is not structured to administer a wealth tax that contains levies beyond income taxation.

Under this legislation, taxpayers and the FTB would face substantially increased administrative burdens. Both parties would have to calculate the taxpayer's "wealth" annually, which would be an arduous, costly, and imprecise task. Taxpayers and tax agencies would be mandated to provide valuations of things that may be impossible to accurately appraise, on every personal effect, including a privately held company, works of art, and even clothing and furniture. This would be impractical, as even appraisal experts are likely to disagree dramatically on the current market value of a painting, for example, and there is no reason to believe that California's tax auditors would have the ability to determine an accurate value. It is likely that this could lead to more disputes between taxpayers and the tax agencies, which would add to the administrative costs and burdens for both.

Unconstitutional Four-Year Trailing Nexus. The proposed wealth tax creates newly defined residency requirements, including trailing residence and temporary residence, that would subject former California residents who leave the state to the new tax, even if they are no longer present in or connected to the state whatsoever. Taxpayers could argue that by having such a burdensome "exit tax," the state is attempting to deter residents from leaving, in violation of the constitutional right to travel. Furthermore, taxpayers could argue that by taxing nonresidents who no longer have nexus with the state, this tax places a large, impermissible burden on interstate commerce. Without any connection between the taxpayer and California, taxpayers also could challenge the law for violating the Due Process Clause of the U.S. Constitution. This draconian and novel tax would be ripe for constitutional challenges on multiple grounds.

Disproportionately Affects Certain Businesses. The trailing tax nexus applied to California residents, part-year residents, and nonresidents engaged in business on a temporary basis would disproportionately affect certain industries. For example, California has remained one of the largest producers of movies and television programs, largely due to the continued investments and tax credits the state has provided the industry. However, if the taxes contained in AB 259 are approved, high net-worth directors and actors would be dissuaded from operating in California because a several-month film project could result in a four-year wealth tax burden. Other industries would be similarly impacted and could decide to cease doing business in California.

Inappropriately Expands False Claims Act. California's False Claims Act authorizes the attorney general and private attorneys to sue individuals who knowingly submit false statements or documents to obtain money or property from the state, and to collect a portion of the damages if they are successful. Although the False Claims Act has never applied to taxation because of important policy considerations, AB 259 proposes applying it to claims, records, or statements associated with the wealth tax, which significantly adds to the burdens and costs associated with this proposed tax.

California's tax agencies already are equipped with an arsenal of tools to combat fraudulent tax statements. For example, the FTB has at its disposal 79 different penalties, including a fraud penalty imposed at the rate of 75 percent of the disputed amount. Unnecessarily extending the False Claims Act to enforcement of the new tax created by AB 259 would expose taxpayers to frivolous lawsuits by private attorneys under the guise of tax enforcement. For example, a taxpayer may attempt to make a good-faith estimate of the current market value of a one-of-a-kind item, and a private attorney may challenge the valuation on subjective grounds.

Prevents Tax Rebates to Middle-Class Californians. In 1979, voters approved Proposition 4, which added Article XIIIB to the California Constitution to establish an appropriations limit on state and local governments. If, in two consecutive years, California has revenue that cannot be appropriated because of the "Gann Limit," the state must split the revenue between taxpayer rebates, Proposition 98 spending, and appropriations in specific areas. ACA 3 would circumvent the Gann Limit, effectively preventing tax relief to low-income and middle-class Californians despite the state taking in billions of dollars from the wealthiest Californians.

For the foregoing reasons, CalTax and the signatories listed below must respectfully oppose AB 259 and ACA 3.

Sincerely,

Peter Blocker
Vice President of Policy
California Taxpayers Association

On behalf of…

California Taxpayers Association
Affordable Housing Management Association, Pacific Southwest
Apartment Association of Orange County
Bay Area Council
Building Owners and Managers Association
California Building Industry Association
California Business Properties Association
California Business Roundtable
East Bay Rental Housing Association
Family Business Association of California
Financial Services Institute
NAIOP, the Commercial Real Estate Development Association
National Federation of Independent Businesses
Southern California Rental Housing Association
West Coast Lumber and Building Material Association

cc: The Honorable Ash Kalra, California State Assembly