The Los Angeles Coalition
A COALITION FOR THE ECONOMY & JOBS IN LOS ANGELES

April 27, 2017

The Honorable Kevin McCarthy
House Majority Leader
House of Representatives
Washington, D.C. 20515

Members of the California Republican Delegation
House of Representatives
Washington, D.C. 20515

Re: Full Preservation of Federal Tax Deductions for State and Local Taxes

As members of the Los Angeles Coalition for the Economy & Jobs (L.A. Coalition) we would all like to express our strong support for the full preservation of federal tax deductions for state and local taxes and urge you to do all that you can to protect them because they play a significant role in supporting America's and California's economies and the vital services our state and local governments provide to all their citizens.

As you may know, the L.A. Coalition was created in 2009 as an independent and bipartisan alliance to bring together leaders from business, labor, academia and nonprofits to advance sound policies that help to responsibly grow the economy and create quality jobs throughout the Southern California region. As a group, the L.A. Coalition represents organizations with hundreds of thousands of workers throughout the state.

As the largest beneficiary of the federal tax deduction, California's state and local governments have been able to implement high levels of taxes in a way that provides essential and appropriate levels of services – education, water and transportation infrastructure, public safety, healthcare, and much more – to nearly 40 million residents, without sacrificing the long-term fiscal health of these governments.

The elimination or reduction of the deduction would most negatively impact California, but it would also adversely affect many of the country's largest state economies and populations, including, New York, New Jersey, Illinois, Pennsylvania, Massachusetts, Maryland, Virginia and Ohio - which are home to more than 40 percent of the U.S. population and account for nearly 47 percent of overall U.S. GDP.

Any law by Congress to generate new federal tax revenues through any limitations or elimination of the deductibility of state and local taxes would also ripple through the U.S. economy and have a large negative impact on our nation's overall economy.

There are many reasons why the preservation of this long-standing federal tax policy is both fair and important; we have summarized just nine reasons below:

1. California's taxpayers pay more in federal income taxes – $1.12 trillion from 2008-2014 – than any other state in the U.S., year after year. In FY 2014, California's taxpayers paid $205 billion to the U.S. Treasury. In return, California consistently ranks within the bottom 10 percent of states that receive the least amount of federal spending on a per capita basis. A 2015 study by the New York state comptroller found that in 2013 Californians paid $9,086 per capita in federal taxes and received $9,040 per capita in federal spending—or about 99 cents of spending for every tax dollar. (This is an improvement: The Tax Foundation found that California received about 78 cents in spending for every tax dollar in 2005, and Census and IRS data showed the state getting back 87 cents on the dollar in 2010.) In comparison, the average state gets about $1.29 in federal money for every dollar it sends to Washington. In the aggregate California pays about 13 percent of all federal taxes and receives only about 11 percent of federal expenditures.

   Eliminating or limiting these tax deductions would severely increase this imbalance by asking California's workers and residents to send more of their income to the federal government, which already disproportionately subsidizes a large block of sparsely populated states with smaller-scale economies and those without a state income tax, like Texas and Florida. California's residents are essentially subsidizing the federal government and many other states, not the other way around.

2. As you know, often the most powerful and lasting innovations have percolated up to the national level from the grassroots politics of state and local governments, the places Justice Brandeis famously called "the laboratories of democracy." Today nearly 64 percent of Americans believe that "more progress" is made on critical issues at the local rather than the federal level, according to a 2015 Allstate/National Journal Heartland Monitor poll. This tax proposal would harm this fundamental element of America's federal system and impinge on the ability of each state and locality to govern effectively.

   Since the U.S. began collecting income taxes in 1913 it has allowed taxpayers to deduct what they pay in state and local real estate, personal property and income taxes. This was a way for the federal government and the Constitution to encourage states to create different tax policies to ensure that adequate programs and services are available to local communities, as determined by local taxpayers. Throughout the years California and those eight other states mentioned above, have used and relied on this long standing policy to build their large-scale economies based upon progressive tax structures and higher levels of government services, provided by a skilled and more unionized workforce, to the benefit of their citizens and their economies. Ultimately, these states and the nearly 125 million Americans in them, have relied on this federal tax policy for more than 100 years and to rip it up is wrong and its negative consequences will be unfair and far reaching.

3. In 2014-15, California's taxpayers paid more than $124 billion in state and local taxes, which were used to pay for municipal government, school systems, public safety, education, healthcare, water and transportation projects, economic and workforce development and much more. Repealing this deduction would undermine a state's ability to tax and it would also radically raise the effective rate of the state's taxation on income. This would be a harsh tax increase for taxpayers in those states. By sharply reducing the amount of after tax income Californians are earning, it would eventually force state and local public officials to re-evaluate their local tax structures, which would in turn lead to reductions in state and local government services, programs, and public employment levels, as well as increased tuition rates at state universities and colleges.

4. The nine states mentioned above have strong economies with higher living expenses, including higher costs for housing and real estate taxes, as well as higher state and local taxes. As a result, a broad range of taxpayers in these states inevitably take a larger percentage of these federal itemized deductions to help offset their higher costs and taxes. Pease limitations, mortgage interest limitations, personal exemption phase-outs and the alternative minimum tax have already gradually weakened the deductions effect and further limitations would force middle to high income earners to bear a significant share of its overall impact. More specifically, both the House Republican and White House plan to eliminate the deduction would place a disproportionately larger tax burden on a significant population of taxpayers in higher-tax rate and higher-income states, such as California and New York, since state deductions constitute the majority of itemized deductions, ranging from 52-62 percent, for taxpayers subject to the proposed limitation.

5. These taxes are <u>mandatory</u>, which further distinguish them from voluntary deductible payments, like charitable contributions or mortgage interest. If federal tax deductions end or are reduced substantially as the Tax Blueprint and White House plan have proposed, there is <u>no way individual taxpayers can lessen the harsh impact, except by moving out of California</u> and other states that have a higher cost of living and taxes. California's most successful entrepreneurs and professionals would also be more incentivized and motivated to move their businesses and firms to states with no or low income taxes, like Florida and Texas, which already have the lowest per capita state tax burden on their own citizens, and are rewarded with more federal dollars relative to their residents' federal tax contribution. In return they don't provide as high a level of government services and programs to their overall population as California does.

6. Limiting or capping deductions <u>would raise taxes for and truly impact California's middle class</u>, who already pay a state tax rate that is higher than what millionaires pay in 47 other states. For 2014, the California Franchise Tax Board received 15.6 million filed returns and approximately <u>30 percent of those returns (not just the "2 percent") reported deducting state and local taxes</u> on their federal returns. Nearly 90 percent of those six million filers who earn up to $200,000 annually will see their taxes go up significantly if these deductions are disallowed for every taxpayer. For example, a married California couple filing a joint return with an AGI of $150,000 would have an <u>increase</u> of $3,450 in federal taxes.

7. A growing segment of California's taxpayers are thriving during the state's economic resurgence and the highest earners are already paying a marginal state tax rate of 13.3 percent. A limitation or elimination of these federal deductions would push their effective state tax rates substantially higher. For self-employed entrepreneurs and owners of partnerships or limited liability companies who already pay double FICA taxes, this means that their combined federal and state effective tax rate would climb to <u>almost 60 percent</u>. This is unfair, excessive and an unequal burden to impose on taxpayers in just a few states.

8. California is the world's 6th largest economy (it was the 9th largest in 2013) by itself. An elimination or reduction of the federal deductibility of state and local taxes would impact California more than any other state. The estimated loss to California's taxpayers would be moe than $100 billion. Losing these deductions and these funds would <u>significantly impede California's economy, employment and job-creating sectors</u>, during a time in which more than 1.6 million California residents are looking for work. A combined negative impact on California and those eight states mentioned above, would have a <u>negative impact on the overall U.S. economy</u> and its employment levels. This would in turn reduce federal tax revenues. Without an accurate cost projection of this ripple effect, policymakers cannot really make an informed decision.

9. If state and local taxes are not deductible at the federal level, then every Californian and every American who lives in a high-tax and high-property value state will be at an even more severe and unfair economic disadvantage compared to other Americans. They will have to pay federal income tax effectively on taxes they must pay and income they do not get to keep. Also, the effective federal tax-rate for high-tax states will be that much higher, which violates the spirit of the equal protection clause, if not the law.

We are urging the entire California Congressional delegation to do what's right for California and the United States: preserve the federal income tax deduction for state and local taxes that has been the law for over 100 years and respectfully request that you put party loyalty aside and oppose a policy that would hurt millions of citizens throughout the United States and in our great state.

Thank you for your leadership on behalf of California and please feel free to contact Russell Goldsmith the Chair of the L.A. Coalition, Michael Kelly the executive director or any of us listed below to discuss this vital issue.

Respectfully,

Russell Goldsmith
Coalition Chairman &
City National Bank
Chairman & CEO

Michael H. Kelly
Executive Director
The L.A. Coalition

David Bohnett
Principal
Baroda Ventures LLC

Elise Buik

Elise Buik
President & CEO
United Way of Greater Los Angeles

Dr. Jane Close Conoley
President
Cal State Long Beach

Pedro J. Pizarro
President and Chief Executive Officer
Edison International

Thomas Priselac
President & CEO
Cedars-Sinai Health System

Stewart Resnick
Chairman & President
The Wonderful Company

Lynda Resnick

Lynda Resnick
Co-Owner
The Wonderful Company

Sean O. Burton
CEO
CityView

Jon F. Vein
Former Co-founder & CEO
MarketShare

Ronald L. Olson

Ronald L. Olson
Partner
Munger, Tolles & Olson LLP

Steven J. Olson
Partner
O'Melveny & Meyers

Jonathan Woetzel
Senior Partner
McKinsey & Company
Director: McKinsey Global Institute

Dianne F Harrison

Dianne Harrison, PhD
President
Cal State Northridge

George Kieffer
Partner
*Mannatt, Phelps & Phillips**, LLP***

Andrew McDonald
Senior Managing Director &
Market Leader
Cushman & Wakefield of California, Inc.

Barry Meyer
CEO
North Ten Mile Associates

Art M. Gastelum
President & CEO
Gateway Science & Engineering

Mitchell T. Kaplan

Mitchell T. Kaplan
President & Co-Founder
The Kaplan Stahler Agency

Richard Katz
CEO
Richard Katz Consulting

Skip Keesal
Partner
Keesal, Young & Logan

Matthew Toledo
Publisher & CEO
The Los Angeles Business Journal

Maria Elena Durazo
General Vice President for Immigration, Civil
Rights, and Diversity
UNITE HERE International

Marc B. Nathanson.
Chairman
Falcon Waterfree Technologies

Gary J. Freedman

Gary J. Freedman
Partner
Ervin Cohen & Jessup LLP

Sherry Lansing
CEO
The Sherry Lansing Foundation

Ambassador
Robert (Bob) H. Tuttle
Co-Managing Partner
Tuttle-Click Automotive Group

Ranjan Goswami
Vice President - Los Angeles & Sales-West
Delta Air Lines

Miguel Santana
President & CEO
The L.A. County Fair Association

David L Frankel
Partner
McKinsey & Company

Robert A. Jernigan
Managing Principal
Gensler

Ed Roski
Chairman & CEO
Majestic Realty

Mickey Kantor
Partner
Mayer Brown

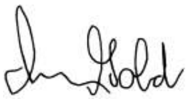
Mark *Helm*
Partner
Munger, Tolles & Olson LLP

Victor J. Coleman
Chairman and CEO
Hudson Pacific Properties, Inc.

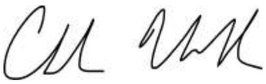
Chris Silbermann
Managing Partner
ICM Partners

Cliff Gilbert-Lurie
Senior Partner
Ziffren Brittenham LLP

Leslie Gilbert-Lurie
Author and Civic Leader



Irwin Gold
Executive Chairman
Houlihan Lokey



Charles Hirschhorn
President
AXS TV

Alan C. Hostrup

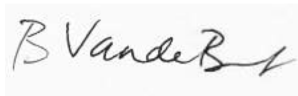
Alan C. Hostrup
President and CEO
YMCA of Metropolitan Los Angeles

Bruce Ferguson

Bruce Ferguson
President
Otis College of Art and Design

Moctesuma Esparza

Moctesuma Esparza
CEO
Maya Cinemas North America, Inc.

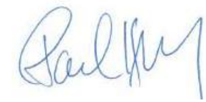


Ben Van De Bunt
Principal
Cypress Creek Renewables
Guthy-Renker
Paramount Equity
FHR
Inspire Energy
Rosewood Homes

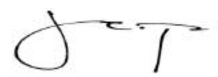
Art Bilger

Art Bilger
Founder & CEO
Working Nation

Bill Allen
President & CEO
LAEDC



Paul Keller
Founding Principal & CEO
Mack Urban LLC



Francisco C. Rodriguez, PhD
Chancellor
Los Angeles Community College District