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Informational Hearing on The Response to Recent Terrorist Attacks

Assembly Committee on Revenue and Taxation

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Informational Hearing
on
The Response to Recent Terrorist Attacks

November 14, 2001

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ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
ELLEN M. CORBETT, CHAIR
EIGHTEENTH ASSEMBLY DISTRICT

Summary Report
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THE RESPONSE TO RECENT TERRORIST ATTACKS

Summary Report for the Informational Hearing

Wednesday, November 14, 2001
Oakland Airport
Terminal 1, Mezzanine Level
Oakland, California

INTRODUCTION

On Wednesday morning, November 14, 2001, the Assembly Revenue and Taxation Committee held an informational hearing on responding to recent terrorist attacks. The hearing was held in a conference room at Terminal 1 of the Oakland International Airport from approximately 9:15 AM until 12:00 PM. It was attended by approximately 30 people. Three Committee members heard testimony from fifteen witnesses. Invited witnesses included persons representing the Franchise Tax Board, Board of Equalization, California Research Bureau, Legislative Analyst's Office, California Budget Project, and businesses that have been seriously impacted by the economic slowdown that followed the September 11, 2001 terrorist attacks.

Members who participated in the hearing included:

> Assemblymember Ellen M. Corbett, Committee Chair
> Assemblymember Tom Harman, Committee Vice-Chair
> Assemblymember Barbara Matthews

This final report contains the Committee staff's summary of the witnesses' testimony and a list of findings and recommendations distilled from that testimony. The report also reprints the background paper written by staff before the hearing (refer to the blue pages) and reproduces written testimony submitted by the witnesses (refer to the yellow pages).

THE WITNESSES

Mr. Norm Catelli, Program Specialist II, Franchise Tax Board

Mr. Roger Dunstan, Assistant Director, California Research Bureau*

Mr. Brian Putler, Legislative Bureau Director, Franchise Tax Board

Mr. John Abbott, Supervising Tax Counsel, Board of Equalization

Mr. Eric Miethke, Partner, Nielsen, Merksamer, Parrinello, Mueller & Naylor, LLP*

Mr. Alan Wayne, Regional Director, United Airlines*

Ms. Linda King, Legislative Advocate, Coalition of Independent and Franchisee Rent-A-Car Operators*

Mr. Mark Clement, General Manager, Oakland Airport Hilton

Mr. Tom Edson, President of Lodge, Sierra Pacific Air Transport, Local 1782

Ms. Eileen Scranton, President, Mission Hills Travel-American Express

Mr. Paul Taylor, Chapter President, American Society of Travel Agencies, Northern CA Division

Mr. Mark Ibele, Fiscal and Policy Analyst, Legislative Analyst's Office*

Ms. Delaine McCullough, Policy Analyst, California Budget Project*

Mr. Chris Micheli, Attorney at Law, Carpenter, Snodgrass & Associates*

Ms. Carrie-Lee Coke, Legislative Director, California Manufacturers and Technology Association*

*Written material submitted by this individual is contained in the yellow pages at the end of this report.

FINDINGS

Mr. Norm Catelli, Franchise Tax Board: Mr. Catelli provided a brief overview of the administrative relief granted by the United States Department of the Treasury and the Internal Revenue Service to those affected by the terrorist attacks of September 11, 2001. Much of the information presented by Mr. Catelli is contained in the background paper prepared by Committee staff for the hearing (refer to pages 6 through 8 of the background paper reprinted on the blue pages within the body of this bound report). Mr. Catelli also noted that the IRS set up a toll-free disaster relief phone number for both individuals and businesses wishing to ask questions about the tax relief to which they may be entitled (1-866-562-5227) and established an e-mail address for use by businesses with specific questions about corporate tax relief (corp.disaster.relief@irs.gov). The IRS also announced relief for taxpayers who acquire sizeable amounts of depreciable property during the last three months of their taxable years. The relief was announced in recognition of the fact that many taxpayers time the acquisition and date that depreciable property is placed in service during a taxable year in order to avoid the imposition of relatively unfavorable depreciation rules. The September 11th terrorist attacks prevented many taxpayers from completing the acquisition and service placement of their equipment in time to avoid the less favorable depreciation rules. The IRS acted in order to help prevent taxpayers from choosing to defer their purchases into future taxable years. More information regarding the IRS announcement is contained in Notice 2001-70 (Internal Revenue Bulletin 2001-45).

Mr. Roger Dunstan, California Research Bureau: Mr. Dunstan summarized the actions taken by the Federal Reserve Board to lower the federal funds rate (refer to page 5 of the background paper for details) and the somewhat more symbolic actions taken by the Federal Reserve to lower the discount rate. According to Mr. Dunstan, the rate reductions have spurred a number of home mortgage refinancings but have not resulted in significant decreases in long-term interest rates. Mr. Dunstan also reviewed the actions taken by Congress and President Bush to provide immediate economic relief (refer to pages 5 and 6 of the background paper for details), including the appropriation of $40 billion for national defense and domestic security, as well as the provision of both cash and loan guarantees for airlines.

After noting that the federal government has not yet passed a comprehensive economic stimulus bill, Mr. Dunstan reviewed the primary considerations that the President, House of Representatives, and Senate have agreed must be reflected in any stimulus plan that is eventually adopted. The plan must encourage new household and business spending rather than shifting the timing of spending; it must be sized appropriately (Alan Greenspan has suggested that an appropriate size is in the range of $50 billion, while the President believes that $75 billion is a more appropriate number, and Congressional proposals are in the $75 billion to $100 billion range); and it must impact the economy quickly. The President and legislative leaders have also agreed that the plan should not include any additional, permanent tax cuts or spending increases, recognizing that recessions are short-term rather than permanent. Mr. Dunstan compared and contrasted the major components of the President's proposal, the House of Representatives proposal, and the Senate proposal (refer to Mr. Dunstan's written testimony in the yellow pages of this report) and indicated that federal action is likely before the end of the 2001 calendar year.

In response to a question from Chairwoman Corbett regarding actions the state could take to help stimulate the economy, Mr. Dunstan suggested that any relief enacted by the state be available quickly and appeal to both consumers and businesses. Among the possibilities he mentioned were a reduction in withholding rates (either with or without a tax rate reduction) and a sales tax holiday (either one that is narrowly targeted or one that is broad-based).

<u>Mr. Brian Putler, Franchise Tax Board:</u> Mr. Putler reviewed the administrative action FTB has taken to provide relief to those affected by the attack (refer to pages 8 and 9 of the background paper for more details). Adding to the items summarized in the background paper, Mr. Putler noted that current California law provides for a maximum 90-day postponement of certain filing and payment deadlines. Mr. Putler also announced that the FTB did not send billing notices to any taxpayer with a zip code located in one of the five New York and one Virginia counties the President declared as federal disaster areas.

Mr. Putler also summarized options for additional state tax relief to aid those affected by the attacks (refer to pages 9 and 10 of the background paper for more details). He noted that in order for taxpayers to receive special loss carryforward treatment, the specific disaster must be named in the Revenue and Taxation Code. He also clarified that although FTB has the administrative authority to abate interest for 90 days for individual taxpayers, legislative action is required to grant FTB the same interest abatement authority for corporate taxpayers. Mr. Putler encouraged action early during 2002 in order to provide certainty to affected taxpayers with both state and federal liabilities. Failure of the state to act early during 2002 could result in taxpayers being granted six months relief under federal law, but only three months relief under state law. This is problematic because a taxpayer commonly uses information contained on the federal tax return in order to complete a California tax return.

The FTB is reluctant to recommend any type of relief that has not been adopted by the federal government. Mr. Putler noted pending federal legislation to allow the victims killed in the September 11th attacks the same benefits allowed to military personnel killed in combat zones (H.R. 2884). AB 1122 (Corbett) would provide similar relief at the state level. Chairwoman Corbett noted that she would consider expanding AB 1122 to incorporate additional administrative relief suggested by the FTB and was enthusiastic that other members of the Committee would co-author the bill.

Mr. John Abbott, Board of Equalization: Mr. Abbott summarized the actions BOE has taken to provide tax relief to victims of the attack. In addition to the relief summarized on page 9 of the background paper, Mr. Abbot announced that the BOE has granted a 40-day extension to file for a reduction in assessed value for California taxpayers who believe their business property suffered a decline in value due to a downturn in business attributable to the September 11th terrorist attack. Under the Board's action, applications for property tax assessment reductions may be submitted until December 24, 2001. Without the extension, the due date would have been November 13, 2001.

Mr. Abbott also indicated that the Board would be seeking legislative authority in 2002 to allow it to relieve interest for affected tax and feepayers subject to three of the levies it administers (i.e., tire recycling fee, natural gas surcharge, and ballast water management fee). As noted in the background paper, the Board already has the authority to abate interest for the rest of the taxes and fees it administers.

Mr. Eric Miethke, Nielsen, Merksamer, Parrinello, Mueller & Naylor: Mr. Miethke echoed the comments of Brian Putler by urging state conformity to the expected (yet still pending) federal action to forgive the 2000 and 2001 tax liabilities of persons killed in the terrorist attacks. Mr. Miethke also advocated legislation that would encourage businesses and other entities to make payments to family members of victims who perished in the attacks. He urged legislation allowing any employer or other taxpayer who makes a payment to a survivor to fully deduct that payment and to allow the recipient of the payment to exclude its full value from income. Mr. Miethke also encouraged the state to consider establishing educational trust funds to pay the higher education expenses of victims' children. Mr. Miethke did not have precise estimates of the fiscal impacts of his proposals.

Mr. Alan Wayne, United Airlines: Mr. Wayne spoke as both a representative of United Airlines and as California's legislative coordinator for the Air Transport Association, whose members carry 97% of the passenger and freight nationwide and have more than 70,000 employees in California. He explained that although the airline industry had already begun to experience losses prior to September 11th due to a slowing economy, the industry has been devastated by a sharp decline in both business and leisure travel since September 11th. Passenger travel is down by 30% compared to a year ago, and revenue is down by 40% to 50%. The industry expects to lose over $5 billion during 2001 and $24 billion through June 2002.

Approximately 80,000 airline employees have been furloughed nationwide, including more than 5,000 in California. Airlines have reduced flights by 15% to 20%, and in some cases reservation center personnel are being retained only to inform passengers with prior bookings of the ways in which their itineraries have changed.

United Airlines has furloughed 3,600 employees in California and cut about 240 flights serving the state, representing approximately one-third of its scheduled flights before September 11th. However, nearly 40% of the airline's seats continue to go empty. United is losing $15 million per day.

Mr. Wayne urged the Legislature to consider two alternatives to help United cut its costs in California. First, he asked the Legislature to eliminate, reduce, or temporarily suspend California's jet fuel tax. Second, he urged the Legislature to reduce the airlines' sales tax burden, either by returning to its pre-1991 treatment of sales taxation on common carrier fuel or by completely eliminating the tax. Prior to 1991, California imposed sales tax on the fuel required to propel a plane to its first out-of-state destination (e.g., Sacramento to Chicago), but did not tax the fuel required to propel that same plane to additional destinations in the U.S. (e.g., Chicago to New York). Under current law, California imposes sales tax on all fuel loaded into planes in California that is used to propel the planes to destinations in the U.S. Fuel loaded into planes with international destinations is exempt from sales tax, as it was prior to 1991.

Mr. Wayne concluded with a comment that California was the key to survival for the airline industry.

<u>Linda King, Coalition of Independent and Franchisee Rent-A-Car Operators:</u> Ms. King represents approximately 75 California-owned and operated independent and franchisee/licensee car rental entities with over 20,000 rental vehicles on the road. Like Mr. Wayne, she acknowledged that her industry already suffered from the effects of a weakening economy prior to September 11th. Exacerbating the effects of a weakened economy on the number of cars actually rented, rental rates are the same or lower than they were in 1979, while the cost of cars has increased nearly tenfold. Insurance rates have increased, accident costs have doubled, and rates to finance independent fleets are much higher than the rates that large national fleets must pay.

The events of September 11th affected the car rental agencies severely. Business immediately dropped by 80% and stabilized to a drop of 50% relative to prior levels in September and 35% relative to prior levels in October. Lagging rentals forced early disposal of vehicles with costly penalties. Firms Ms. King represents have been forced to lay off between 30% and 50% of their work forces. Remaining employees have experienced pay cuts and an elimination of employee benefits such as health insurance.

In order to help the industry, Ms. King advocated allowing rental car companies to pass on more charges to their customers (such as vehicle license fees and airport surcharges) and identified certain statutes that need amendment to enable this action. She also encouraged the state to support and stimulate travel in California and sought interim (one- to five-year) low-interest loans to provide working capital for car rental agencies until the market returns to prior levels.

Tom Edson, Sierra Pacific Air Transport Local 1782: Mr. Edson echoed many of Mr. Wayne's comments with respect to airline furloughs. He indicated that 240 members of his lodge had been furloughed on November 1st, and that more furloughs are expected on the next furlough date of December 1st. United may make additional cuts after December 1st once the airline finishes evaluating its staffing needs for its customer call centers. The San Francisco reservation facility is the largest in the state, and workers at that facility are very concerned about their futures.

Mr. Edson articulated specific problems workers face when furloughed. He described a furloughed worker with 21 years of experience with United who received medical benefits for 3 months after being laid off. After that, the cost of his COBRA benefits increased to $591 per month.

Mr. Edson is seeking an extension of unemployment benefits, affordable COBRA benefits for those who have been laid off, and job retraining assistance.

Eileen Scranton, Mission Hills Travel-American Express: Ms. Scranton explained that she has been able to avoid laying off employees by reducing hours and salaries, but that it has taken a tremendous amount of effort for her small business to convince customers to keep their previously booked travel plans and consider new bookings. She hears from people who are very afraid about airport and airline security and noted that it is very difficult to counter the frequent news stories about airport security breaches. Her business is predominantly leisure-oriented rather than business-oriented, but businesses still comprise about 20% of her customer base.

Her suggestions for actions the state could take to help her industry: Provide tax relief to small businesses, relax laws regarding business travel to help get business travelers back into the air, and allowing cruise ships to dock at multiple ports within the state.

Mark Clement, Oakland Airport Hilton: The year 2000 was a record year for the hotel industry, but the slowing economy of 2001 hurt the hotel business even prior to September 11th. Before September 11th, hotels in the Oakland area had experienced a 10% drop in business; hotels in San Francisco had experienced an 18% to 20% drop; and business at hotels in San Jose had dropped by even greater amounts. The hotels that were hardest hit were those that catered to the business traveler. After September 11th, East Bay hotels report drops of 20% relative to prior levels, while hotels in other parts of the Bay Area report drops in the 35% to 40% range. These drop-offs have resulted in a significant number of layoffs.

Mr. Clement expects a relatively slow economic recovery among hotels that serve conventioneers and the recreation and leisure market. He expects a slightly faster recovery among hotels catering to business travel and those near regional airports. In order to help the industry recover, he urges tax relief for businesses that support the travel industry (possibly including a return of the entertainment deduction) and improved health and welfare benefits for those who have been laid off. He expects the industry to be depressed through mid- to late-2002.

Paul Taylor, American Society of Travel Agencies, Northern California Division: Mr. Taylor began by informing the Committee members, consistent with his testimony before the U.S. House of Representatives, that California hosts the home office of more than 300 travel agencies.

Mr. Taylor indicated that the agencies he represents have experienced a 60% to 70% drop in business. Their problems are twofold – not only are they failing to bring in new revenue, they are also having to refund significant amounts of money previously collected from people who are cancelling their bookings. Travel agencies still book approximately 75% of air tickets, and nearly all cruise and tour packages. Mr. Taylor clarified that his industry is not seeking a bailout, but that a cash infusion in the form of low-interest loans and tax relief of the sort advocated by the prior speakers would be helpful.

Discussion Concluding Testimony by Affected Business Representatives:
Assemblymember Corbett asked the panelists about the benefits of offering tax incentives to encourage business travel. Both of the travel agency representatives indicated that leisure travelers comprised the bulk of their businesses; a lot of business travel is booked online or directly through the airlines. Encouraging business travel would be of much greater assistance to the airline industry, because business travelers are the airlines' most dependable source of income. Hotels would also benefit from an increase in business travel, as would car rental agencies. However, Ms. King did indicate that business travelers are more likely to use larger, national firms rather than smaller franchises because the larger car rental firms tend to have more contracts with businesses than the smaller firms. The panel's consensus was that any increase in business travel would have ripple effects that would strengthen the entire travel industry, although the effects on individual sectors of that industry would vary. The panel also concluded that attempts to use the tax code to incentivize leisure travel would likely be cost-prohibitive.

Assemblymember Corbett asked Mr. Abbott if the Board of Equalization had any estimates for the cost of the proposals advocated by Mr. Wayne. According to Mr. Abbott, the major airlines would not benefit from a suspension or elimination of the jet fuel tax, because it is not imposed on commercial carriers. He noted that returning to the pre-1991 sales tax treatment on jet fuel would have cost the state $37.6 million had it been implemented during 2000. However, because the slowdown in the airline industry is causing less fuel to be consumed, the cost to the state during 2002 would likely be lower. Mr. Abbott also noted that completely eliminating the sales tax on jet fuel would have cost the state $153 million if it had been implemented during 2000. Lower fuel sales would reduce that estimate by an amount as yet unknown if the proposal were implemented during 2002.

Assemblymembers Harman and Matthews spoke out regarding the effects of increased security measures on business and leisure travel. Both Members encouraged Mr. Wayne to consider the tradeoffs between increasing passenger comfort through safety measures and decreasing passenger satisfaction through the lengthy delays. Mr. Wayne acknowledged the delicate balancing act between ensuring passenger safety and risking the loss of passengers because the "hassle factor" was so high.

<u>Mark Ibele, Legislative Analyst's Office:</u> Mr. Ibele began by briefly summarizing the findings of the LAO's November Fiscal Outlook report, results of which were announced in Sacramento on the same day as the hearing. The LAO expects the current economic slowdown to have a substantially adverse effect on state revenues. The LAO's current estimates indicate that if no action is taken to shift the mix of state revenues and expenditures, the budget will be $4.4 billion out of balance at the end of 2001-02 and $12.4 billion out of balance at the end of 2002-03.

According to the LAO report, California's economy had begun weakening prior to September 11th. Withholding payments, which are an indicator of current job and wage trends, had decelerated throughout 2001 due to slowing employment and declining wages and stock options, particularly in the high-technology sector. Following the September 11th attacks, the weakness intensified and spread to many other industries, particularly those related to travel and tourism. California, like the nation, is now experiencing a mild recession that the LAO expects will give way to a moderate recovery beginning in the spring of 2002. The LAO does not expect this recession to be as long or as deep as the major recession of the early 1990s, when California's economic recovery was delayed due to a massive restructuring of its defense, banking, and housing industries. However, the LAO acknowledges that their fiscal outlook contains a great deal of uncertainty. First, no one knows how long consumers and businesses will remain cautious in the wake of the September 11th attacks. It is also unclear how stock market volatility will affect short- and long-term consumer confidence and consumer spending.

Regardless of the state's current economic sluggishness, the LAO urged caution. Mr. Ibele indicated that timing and details of any stimulus package are key. Often, because the impacts of tax and spending measures take time to flow through the economy, temporary or targeted stimulus measures may be most effective. In addition, Mr. Ibele reminded those in attendance that state stimulus tools are inherently limited. The state lacks the tools available to the federal government, such as monetary policies and deficit-spending. Furthermore, the full impact of state tax reductions is generally muted due to leakages to out-of-state taxpayers and the federal government.

Mr. Ibele advised that the state's fiscal woes also suggest a cautious approach to an economic stimulus package, because in order for a state tax stimulus to have a measurable effect on the economy, it must be quite large. Such a package will place even more stress on the state budget. Although certain tax stimuli increase private-sector investment, state tax reductions do not generally pay their way. Positive impacts on certain portions of the private sector must be weighed against the repercussions of reduced program spending resulting from the tax cuts. Mr. Ibele suggested that current tax incentives under the personal income tax and bank and corporation tax laws be reviewed for possible elimination of ineffective programs.

In his testimony, Mr. Ibele suggested two general spending options to stimulate the economy – 1) accelerating certain expenditures that were already scheduled to occur, such as appropriations for capital outlay projects, and 2) increasing the use of bond financing. However, these spending options will need to be weighed against the state's bond rating. Ironically, the largest economic stimulus the state realized this year came courtesy of the federal government, when approximately $5.5 billion in federal rebates were sent to Californians. However, many of these rebate checks were saved rather than spent, as Californians were cautious about spending money in a weakened economy.

When questioned by Chairwoman Corbett about state action that would be consistent with his cautionary advice, Mr. Ibele responded that the state could piggy back on federal actions to help spur consumer spending. A sales tax holiday is one option, particularly if the state is seeking to shift spending from mid-to late- 2002 into early 2002.

Delaine McCullough, California Budget Project: Ms. McCullough cited four reasons why her organization believes that tax policy is not the preferred approach to stimulate California's economy at the present time. First, echoing a few points made by Mr. Ibele, Ms. McCullough asserted that because the state budget represents a small share of the state's economy, even a large reduction in taxes would have a very small impact on the economy. This impact is reduced further by the federal deductibility of state taxes (i.e., federal leakage). Second, taxes account for a very small share of the cost of doing business in California. Ms. McCullough cited studies showing that state and local taxes account for between one and two percent of the cost of doing business in the state. Third, tax cuts must be paid for with spending reductions. Unlike the federal government, which can use deficit spending when necessary to bolster the economy, the state is required to balance its budget. While the state does not have a strict balanced budget requirement, the prohibition against long-term borrowing without voter approval represents a de facto balancing requirement. The magnitude of the state's current fiscal woes makes spending reductions a near certainty; as a result, any tax reduction will necessitate a commensurate spending reduction to maintain budget balance. Finally, Ms. McCullough noted that California continues to outperform the rest of the country. Over the past year, California added 103,000 jobs while the nation lost 378,000 jobs. Similarly, the state's share of jobs lost between September and October of 2001 was 1.1% as compared to a share of total jobs equal to 11.2%. By most indicators, California's economy suffered less than the economies in other parts of the country after the September 11th attacks.

Without offering specific suggestions, Ms. McCullough did advise the Committee that a good stimulus package should be effective, fair, temporary, and consistent with long-term policy needs and goals.

Chris Micheli, Carpenter Snodgrass & Associates: Testifying on behalf of California's business community, Mr. Micheli noted that Californians now consider the economy as the top issue facing our state. He cautioned the Committee that the way in which one defines tax expenditures is very important. The business community is promoting tax *incentives* to kick-start the economy, restore consumer confidence, and encourage retention of the business activity the state already has. Tax *relief* is more appropriate for victims of the attacks.

According to Mr. Micheli, businesses must reduce their costs of doing business if they are to survive. Direct, tangible, and immediate benefits are necessary. Since January 1, 2001, the state has lost 76,000 manufacturing jobs, and unemployment has risen from 4.6% to 5.4%. While asserting that tax incentives are of fundamental importance to businesses, he acknowledged that imposition of sunset dates and tests for effectiveness are appropriate.

Mr. Micheli responded to Ms. McCullough's testimony by asserting that taxes have been one factor in businesses' decisionmaking regarding where to invest; business does not claim that they are the only factor. He believes that the federal government will likely take action to stimulate individual economic spending but that additional state action on top of what the federal government provides to stimulate corporate spending would be very helpful. He encouraged the Committee to consider focusing on those industries in which California has the greatest chance of growing, such as high technology and biotechnology.

Discussion Concluding Testimony By Ms. McCullough and Mr. Micheli: Chairwoman Corbett asked how the state might keep people employed during the economic slowdown. Both Ms. McCullough and Mr. Micheli suggested tying incentives to certain employment goals (e.g., basing eligibility for certain financial incentives on the ability of a firm to maintain a certain number of jobs).

Public Comment

Carrie-Lee Coke, California Manufacturers and Technology Association: Ms. Coke advocated a sales tax exemption for manufacturing equipment, basing her organization's support of the proposal partially on the downturn in the state's economy and partially on its use as a long-term competitive measure. She noted that 46 states in the U.S. do not tax manufacturing equipment; California is one of a small number that do. She reminded the Committee that once a business makes a decision to shift its investment from California to another state or country, the company rarely returns to California; when the economy becomes stronger, the company is not around to participate in the economic revitalization.

SUMMARY OF FINDINGS AND RECOMMENDATIONS

Many of those who testified spoke of the precarious economic situations in which both the business community and the state now find themselves. The economic slowdown that began prior to September 11th dramatically worsened after that date and continues to wreak havoc for both public and private entities. A large number and variety of businesses are in financial disarray; some have shut down, while others have been forced to lay off significant portions of their work forces and still others have had to reduce work hours and/or benefits. Industries that have been hardest hit include those in travel and tourism, manufacturing, and high technology. The state is facing a deficit that exceeds $12 billion.

Industry representatives understand that the state's fiscal shortfall will likely restrict the amount of money that is available for a state-supported economic stimulus package. In general, representatives of the travel and tourism industry are less desirous of a financial bail-out than they are of government action to aid those in their industries who have been laid off or had their hours significantly cut. They are also seeking state assistance encouraging leisure and business travelers to return to the roads and the skies.

There seemed to be little consensus on the precise action the state should take to offer economic stimulus when the Legislature reconvenes in January. Suggestions ranged from sales tax holidays to enhanced deductions for business travel to changes in withholding rates to low-interest loans to sales tax exemptions for manufacturing equipment. Many seemed amenable to waiting until the federal government approves a stimulus package to see what form the federal actions take and to base state action on what the federal government ultimately enacts.

If the state were not facing the large revenue shortfalls that have been predicted, swifter state action might have been more strongly advocated. However, all of those promoting state action recognize that such action will have to be weighed against all of the other demands on the state's fiscal resources. As some of the witnesses reminded the Committee, any tax relief enacted in 2002 will likely require reduced spending of a commensurate amount.

Despite the lack of consensus on the form and size of a state economic stimulus package, there was a great deal of support for the state to act quickly and enact administrative tax relief that parallels the relief enacted by the federal government when the Legislature reconvenes in January. Support for prompt state action in this area came from tax agencies, legislative advocates, and the Committee members in attendance.

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Background Paper for the Informational Hearing

Wednesday, November 14, 2001
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Terminal 1, Mezzanine Level
Oakland, California

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INFORMATIONAL HEARING ON

THE RESPONSE TO RECENT TERRORIST ATTACKS

BACKGROUND PAPER

Wednesday, November 14, 2001
9:00 a.m. – 12:00 noon
Oakland International Airport
Terminal 1, Mezzanine Level
Oakland, California

INTRODUCTION TO THE HEARING

On September 11, 2001, four commercial aircraft en route from Boston, Newark, and Washington, D.C. to San Francisco and Los Angeles were hijacked by terrorists. Two of the planes crashed into the World Trade Center, one into the Pentagon, and one into a field in southwestern Pennsylvania. In the days since the attacks, each of us has seen countless hours of shocking footage and heard first-hand accounts from people who were caught in the destruction. Some of us have lost friends or relatives.

The physical results of the attacks are now largely known: 266 passengers and crewmembers on the hijacked aircraft were killed. Two of the tallest manmade structures in the United States – the north and south World Trade Center towers – were completely destroyed. Several nearby structures also collapsed, others were rendered uninhabitable. Nearly 5,000 visitors and workers present in and around the towers are dead. 343 firefighters, 37 Port Authority police officers and 23 New York Police Department officers who rushed to save the initial victims were also lost. The attack completely destroyed one wing of the Pentagon, and 125 Pentagon workers who were caught in that destruction perished. Scenes of the attacks are described by those who have seen the wreckage as surreal, indescribable, unthinkable, and beyond our worst imaginations.

There are, of course, many more victims of the attacks than the unfortunate men, women, and children who perished. The victims' families and friends, the rescue corps whose ranks were severely depleted, firms whose offices were destroyed and files irretrievably lost, and companies who lost co-workers with valuable knowledge. Residents of New York City, Virginia, and Pennsylvania who were traumatized by their proximity to the tragedies. People around the country who have altered their daily lives out of fear that the attacks foreshadow future terrorist acts which could claim more lives. Children who will never know a world without fear of terrorist attack.

And more whose losses have been largely economic:

- The myriad businesses whose revenues have fallen in the wake of the tragedy – airlines that have lost passengers, car rental and travel agencies that have lost customers, restaurants that have lost patrons, hotels and motels whose vacancy rates have increased dramatically;

- Workers who have seen their wages decline and in some cases their jobs taken away -- skycaps whose tips have declined significantly since curbside check-in was limited, hotel and restaurant workers whose hours have been restricted, thousands of airline employees who have been laid off; and

- People who have seen the value of their stock holdings decline precipitously – whose savings, retirement accounts, and whose education nest eggs have lost value in the highly volatile, post-attack stock market.

The list of those affected is almost limitless. The physical, emotional, and economic repercussions of the attacks are almost too enormous to grasp. And yet, the massive outpouring of national spirit, private contributions to victims' funds, and prompt federal relief packages point to a nation that, while shocked and in pain, has already begun to move forward.

The sheer magnitude of those affected and the numerous ways in which they have been and continue to be affected lead to only one conclusion -- any response to the tragedies must be multi-faceted. Recovery and rebuilding will require individuals, neighborhoods, families, communities, businesses, and government to band together.

With this hearing, the Assembly Committee on Revenue and Taxation seeks to identify some of the local impacts of the terrorist attacks. We will hear from some of those who have been affected about the ways in which their lives have changed since September 11th. We will hear from experts about the ways in which federal and state governments have already begun to respond. We will solicit suggestions for additional actions the state can take to help address the damage wrought on September 11th.

The background information that follows in the remainder of this paper is intended to give those who attend the hearing a context into which to place the testimony. The paper contains a list of policy questions the testimony will address, summarizes some of the key fiscal and tax policy actions taken by the federal government since the attacks, describes the tax relief available at both the federal and state levels for those who have been affected by the tragedies, lists additional types of tax relief the state could offer to conform to federal action in this area, provides some examples of the economic impact of the attacks on California residents and businesses, and reviews a series of tax policy principles for consideration by those who wish to recommend state tax relief to strengthen California's weakening economy.

All information contained herein is believed to be correct as of the time of writing. However, because of the rapidly changing nature of America's response to the attacks, this report should be considered a point-in-time snapshot rather than a definitive summary. Interested readers are directed to the reference section at the end of this report for sources of updated information.

POLICY QUESTIONS

We expect testimony offered during the hearing to touch on several key policy questions. The following questions are among those that will be considered:

- Given the significant amount of assistance the federal government is providing to help victims and stimulate the nation's economy, should the state wait to see the effects of federal actions before offering state relief?

- Alternately, would prompt state action act synergistically with federal aid and be more efficient in aiding victims and stimulating the economy?

- With an impending state budget shortfall of unanticipated magnitude, how much money can the state afford to spend to help victims? To fund heightened security measures? To enact tax stimuli intended to strengthen the state's economy?

- What type of state aid will be most effective? Loans? Grants? Rebates? Tax relief? Some combination of these alternatives?

- Which people and which industries are in need of state assistance the most?

- How should the state compare the relative neediness of those requesting aid?

- Should state aid be short- or long-term?

- How (if at all) can the state best determine which businesses would have failed due to the economic downturn that preceded the terrorist attacks? Should the state provide economic assistance only to those companies that would have been financially viable if the terrorist attacks had never occurred?

PRE-EXISTING STATE AND FEDERAL TAX TREATMENT OF COMBAT AND TERRORIST VICTIMS

As heartbreaking and disturbing as the events of September 11th continue to be, they do not represent the first time that events have compelled the federal and state governments to help certain casualties of war and victims of terrorist acts. The following types of state and federal tax relief were already in place at the time of the September 11th terrorist attacks:

- Members of the armed forces who serve in an area that has been designated by the President of the United States as a combat zone are not taxed on compensation they receive for active military service in that zone. The income exclusion begins on the date that the President declares combatant activities to have begun in the zone.

- Members of the armed forces whose compensation is not taxable due to their service in a combat zone are not subject to withholding on that compensation.

- Taxes are waived for active members of the U.S. armed forces who die while serving in a combat zone or as a result of wounds, disease, or injury incurred while serving in a combat zone; for certain individuals who serve in a combat zone whose status is "missing" (e.g., Missing in Action or a Prisoner of War); and for military or civilian employees of the U.S. who die as a result of wounds or injury incurred outside the U.S. in terroristic or military action. For members of the military, taxes are waived for the year in which death occurs and every preceding taxable year back to and including the year in which the individual first served in the combat zone. For individuals who are killed outside the U.S. in a terrorist or military action outside of a combat zone, taxes are waived for the year in which death occurs and the immediately preceding taxable year.

- Spouses of members of the military who are on missing status are allowed to file joint returns for all years in which the spouse remains missing and for the two years immediately following the tax year in which the military spouse dies. When an individual who is missing is officially declared dead, the relevant date for tax purposes is the earlier of the date that the death was officially determined or the date two years following the date that combat activities were officially ended in that zone. However, if the actual date of death of the military spouse is established, that date controls. This tax treatment is more favorable than that available to other individuals whose spouses die, as these individuals are generally allowed to file jointly only in year of death. The ability to continue filing jointly for two additional years is available only if the surviving spouse maintains a residence for a dependent during those two years.

- Persons who serve in a combat zone (but do not die as a result of their service) and their spouses are given six months beyond their service in the combat zone in which to file their income tax returns and to file paperwork in connection with assessments, deficiencies, credits, and refunds.

  California also grants an automatic extension of time for filing a return and paying income tax to an individual serving in the U.S. Armed forces outside of the U.S. and that individual's spouse. The automatic extension applies even if the individual is not serving in a combat zone and continues until six months after returning to the U.S. This unique California provision also extends to several types of administrative actions, including protesting a notice of proposed assessment, appealing the Franchise Tax Board's (FTB) action on a protest, filing a claim for credit or refund, appealing FTB's denial of a claim for credit or refund, and filing an appeal if the FTB fails to act within six months of filing a claim for credit or refund.

ACTIONS TAKEN BY THE FEDERAL GOVERNMENT IN THE WAKE OF THE SEPTEMBER 11TH ATTACKS

Federal Reserve Rate Cuts: On September 17th, 2001 the Federal Reserve Board's Open Market Committee voted to reduce the federal funds rate by 50 basis points (one half of a percentage point). In light of continued stock market weakness and decreasing levels of consumer confidence, the Open Market Committee approved a second 50 basis point reduction on October 2nd, 2001. The September 17th cut reduced the federal funds rate to 3.0%, and the October 2nd cut reduced the rate to 2.5%. On November 6, 2001, the Federal Reserve cut the federal funds rate to 2% as it approved its 10th `interest-rate cut for 2001. The federal funds rate, which is the rate that banks use when they make overnight loans to each other, typically drives other types of interest rates, such as the prime lending rate and home mortgage interest rates. The rate cuts are intended to increase consumer and investor confidence and spur consumer spending. They were accompanied by the Federal Reserve's decision to supply large amounts of cash to domestic financial markets.

Disaster Area Declarations: President Bush issued federal disaster declarations on September 11th and September 13, 2001. The September 11th declaration covers five New York counties, including the Bronx, Queens, Richmond, Kings, and New York (which includes the boroughs of Brooklyn and Manhattan). The September 13th declaration covers Arlington County, Virginia. As federally recognized disaster areas, these jurisdictions and their residents are entitled to special compensation and tax relief.

Measures Signed into Law: The following synopses cover fiscal and tax policy measures passed by Congress and signed by President Bush through November 9, 2001:

H.R. 2882 (Public Safety Officer Benefits bill): Provides for the expedited payment of death benefits to public safety officers who were killed or suffered catastrophic injury as a direct result of the September 11th terrorist attacks.

H.R. 2888 (2001 Emergency Supplemental Appropriations Act for Recovery from and Response to Terrorist Attacks on the United States): Appropriates $40 billion to provide assistance to the victims of the attacks and to deal with other consequences of the attacks, including the costs of: 1) providing federal, state, and local preparedness for mitigating and responding to the attacks, 2) providing support to counter, investigate, or prosecute domestic or international terrorism, 3) providing increased transportation security, 4) repairing public facilities and transportation systems damaged by the attacks, and 5) supporting national security.

H.R. 2926 (Air Transportation Safety and System Stabilization Act): Provides up to $10 billion in federal government-backed bonds that would be issued by air carriers to help offset their cash shortfalls resulting from the terrorist attacks and the aircraft groundings that followed, and to maintain "a safe, efficient, and viable commercial aviation system in the United States". The bonds pledge the full faith and credit of the United States to pay all or part of any of the principal and interest on a loan or other debt obligation issued by a qualifying air carrier. Appropriates $5 billion to air carriers to compensate them for their direct losses resulting from a federal ground stop order issued by the Secretary of Transportation and for their incremental losses incurred between September 11, 2001 and December 31, 2001 as a result of the terrorist attacks. Creates the Air Transportation Stabilization Board to allocate credit instruments among the air carriers who apply. Authorizes the Secretary of Transportation to require any air carrier receiving direct financial assistance under the Act to maintain scheduled air service to any point served by that carrier before September 11, 2001. Authorizes the Secretary of Transportation to reimburse air carriers for incremental, terrorist act-related increases in the cost of aircraft insurance coverage. Extends the due date of airline excise taxes. Authorizes compensation to any individual who was physically injured or to any relative of any individual who was killed as a result of the terrorist-related aircraft crashes. Provides a mechanism by which victims or relatives of victims may apply to the government for compensation, provides for prompt review of each claim and prompt payment of each approved claim, and clarifies that claims may be reduced by the amount of compensation received through other sources (such as insurance, pension benefits, or one of the privately-supported September 11th funds). Limits the liability of each air carrier for compensatory or punitive damages arising from the terrorist-related aircraft crashes. Appropriates $3 billion for airline safety and security in order to restore public confidence in the airline industry.

ADMINISTRATIVE ACTIONS TAKEN BY THE INTERNAL REVENUE SERVICE

In the days immediately following the terrorist attacks, the Internal Revenue Service (IRS) announced several actions it was taking in recognition of the fact that the attacks would have wide-ranging impacts on taxpayers' abilities to timely pay their liabilities. Among the actions taken by the IRS include:

- An extension of due dates for all taxpayers with federal tax obligations. The IRS postponed until September 24, 2001 the due date for all federal tax obligations originally due between September 10, 2001 and September 24, 2001. The postponement covers the filing of returns, the payment of tax (including estimated tax), the filing of claims for refund, the act of making an election, and the filing of other federal tax documents. (IRS News Release No. 2001-63)

- An extension of time in which to file for taxpayers directly affected by the terrorist attacks. Affected taxpayers eligible for this treatment include victims on the airplanes, victims in the Pentagon, victims in the World Trade Center towers, relief workers who are affiliated with a recognized government or philanthropic organization and are assisting in one of the federally designated disaster areas, taxpayers whose place of employment is within the federally designated disaster areas, taxpayers with records maintained in the federally designated disaster areas, and the spouse of an affected taxpayer as long as the spouse uses the married filing jointly status. Details regarding the different categories of time extensions are contained in IRS Notice 2001-61 and summarized immediately below. Taxpayers who take advantage of any of the extensions are instructed to write "September 11th Terrorist Attack" in red ink across the fronts of their returns.

  -- Any affected taxpayer who was granted an extension beyond September 10, 2001 to file his or her 2000 tax return will have until February 12, 2002 in order to file that return. Any affected taxpayer who had failed to pay the full amount of his or her 2000 taxes was subject to penalties between April 17, 2001 and September 11, 2001. These taxpayers will be exempt from penalties for failure to pay during the September 11, 2001 through January 9, 2002 time period. However, the penalty for failure to pay tax will resume accruing if the tax is not paid by January 9, 2002.

-- Any affected taxpayer other than an individual filer whose return was originally due on or after September 11, 2001 and before November 30, 2001 will be given an additional 120 days in order to file his or her return and pay his or her taxes due. In addition, any affected corporation or other entity that was granted an extension to file its 2000 tax return that expired between September 11, 2001 and November 30, 2001 is also granted an additional 120 days in which to file. These taxpayers will be exempt from penalties for failure to pay during the 120 day time period. However, the penalty for failure to pay tax will resume accruing if the tax is not paid within the 120-day time period.

-- Affected taxpayers (including individuals, corporations, estates, and trusts) who had an estimated tax payment due date between September 11, 2001 and January 15, 2002 are allowed to postpone that payment by including the amount with their final estimated payments for the tax year 2001, which are due on January 15, 2002. Affected corporate taxpayers who had an estimated tax payment due date between September 10, 2001 and January 15, 2002 are allowed to postpone that payment until January 15, 2002.

-- The IRS will give taxpayers an additional 120 days in which to make deductible contributions to certain retirement plans and individual retirement arrangements, file Tax Court petitions, file claims for credit or refund of tax, and bring lawsuits upon claims for credit or refund of tax. The postponement applies to acts for which the last day to perform was between September 11, 2001 and November 30, 2001.

-- Taxpayers who have difficulty meeting their federal tax obligations because of disruption in the transportation and delivery of documents by mail or private delivery services resulting from the terrorist attacks and who do not otherwise qualify for the relief awarded to directly affected individuals are given until November 15, 2001 to file returns and make payments that were otherwise required to be made from September 11, 2001 through October 31, 2001.

-- The IRS will also waive penalties for employment and excise tax deposits required to be made by affected businesses between September 11, 2001 and October 31, 2001 if those deposits are made by November 15, 2001. However, this waiver is only available to taxpayers who are unable to meet their deposit obligations because their or their service provider's records, computers, or other essential supporting services were damaged or essential personnel were injured by the attacks

- A reminder to corporations that they may receive early refunds of estimated taxes they have already paid. These refunds could aid filers whose expected profits were reduced or eliminated by the economic slowdown that immediately followed the attacks. Corporations wishing to file for early refunds of estimated tax paid must file by the fifteenth day of the third month immediately following their tax year and before filing their final returns for the year. (IRS News Release Number 2001-90)

- A reminder to taxpayers who suffered property losses because of the September 11th terrorist attacks that they may obtain a quick income tax refund by claiming the losses on amended returns for the 2000 tax year. Both individual and corporate taxpayers who lose property within a presidentially-declared disaster area have the option of claiming their casualty losses on the tax return for the year of the disaster or the previous year. By amending their 2000 returns, a taxpayer can obtain a refund within a few weeks rather than waiting until filing their 2001 tax return in 2002. The IRS also reminded taxpayers that they must reduce the amount of their losses by any insurance or other reimbursements received or expected. (IRS News Release Number 2001-87)

- A waiver of penalties for failing to file certain forms relating to the funding of defined benefits and pension plans. The IRS, Pension and Welfare Benefits Administration within the U.S. Department of Labor, and the Pension Benefit Guaranty Corporation jointly acted to provide relief from penalties related to premiums, reporting, disclosure, and certifications. (IRS Announcement 2001-103)

- A list of charitable organizations that have been granted tax exempt status by the IRS and that were established after September 11th to help attack victims (see Appendix A for a list of these organizations). Persons who contribute to these organizations may treat their donations as charitable contributions subject to the rules regarding deductibility. Persons who receive assistance payments or other compensation from these organizations are not taxed on the value of what they receive. The IRS has also created an expedited procedure that can be used by other attack relief organizations wishing to be granted tax-exempt status (IRS News Release No. 2001-91)

ACTIONS TAKEN BY THE STATE IN THE WAKE OF THE TRAGEDY

Franchise Tax Board Administrative Relief:

Almost immediately after the terrorist attacks, the FTB announced administrative tax relief to aid attack victims. In a press release issued September 18, 2001, the FTB announced the following relief:

- Taxpayers whose estimated tax payments were due on September 17, 2001 were given additional time in which to submit their payments.

- Taxpayers who had previously been given until October 15, 2001 to submit their personal income tax returns (the typical date by which the returns are due for taxpayers who have been granted extensions) were also granted additional time in which to file.

- FTB will not impose penalties during the administrative relief period.

- FTB will waive interest for individual taxpayers, although it lacks the authority to provide the same relief of interest for corporate taxpayers. The agency will seek legislative authority to waive corporate interest early during 2002.

In its press release, the FTB encouraged taxpayers who can file and pay timely to do so. Taxpayers unable to file and pay on time should alert the FTB when they do file by writing in red ink on top of their tax return or payment, "September 11, 2001 Terrorist Attacks".

Board of Equalization Administrative Relief:

On September 25th, the Board of Equalization (BOE; the Board) also announced tax relief for business owners and feepayers directly affected by the terrorist attacks. The Board granted two major types of relief, as follows:

- A one-month extension of time to file and pay taxes or fees. The tax and fee relief is available under all of the tax and fee laws administered by BOE. Those who are eligible for the relief include all taxpayers who were directly affected by the attacks and those whose filings were delayed due to disruption of the United States Postal Service or private mail and freight companies.

- Relief of interest and penalties for those persons unable to pay their taxes and fees in a timely manner. Penalty and interest relief is provided to taxpayers and feepayers under nearly all of the tax and fee laws administered by BOE. Relief from penalties but not interest is available to taxpayers and feepayers subject to the remaining levies (e.g., tire-recycling fee, natural gas surcharge, and the ballast water management fee).

When claiming either of the two types of relief, taxpayers and feepayers must include a statement with their returns that is signed under penalty of perjury and that states the cause for their late filing.

Furthermore, in recognition of the fact that some taxpayers may have lost needed records in the attacks, the Board also offered to provide copies of critically needed BOE tax records to any taxpayer free of charge.

OPTIONS FOR ADDITIONAL STATE TAX RELIEF TO AID THOSE DIRECTLY AFFECTED BY THE ATTACK

As noted above, the state and federal government generally treat compensation of combat and terrorist victims similarly for tax purposes. Furthermore, both federal and state tax agencies have used their administrative authority to authorize tax relief for those directly affected by the September 11th terrorist attacks. If California wishes to provide affected state taxpayers with certainty regarding the tax relief for which they are eligible, legislation must be enacted to accomplish the following:

- Relieve from income tax liability any individual who died as a result of the terrorist acts for the year in which the individual died and the immediately preceding taxable year.

- Clarify that any payments made by either United Airlines or American Airlines to families of victims killed during the tragedy are exempt from state income tax and ensure that any Federal Emergency Management Assistance payments to victims are similarly excluded.

- Extend estimated tax payment deadlines for corporate taxpayers.

- Extend the filing deadline for personal income tax filers who received extensions for their 2000 returns.

- Waive interest and penalties for both personal and corporate filers who were unable to file by the original due dates as a result of the September 11th attacks.

ECONOMIC IMPACTS OF THE ATTACK ON CALIFORNIA RESIDENTS AND BUSINESSES

To date, state officials say they know of 47 Californians who died in the terrorist attacks. According to newspaper reports, several of those killed played key roles in their respective firms. Work/Life Benefits lost its president. MRV Communications Inc. lost its chief financial officer. Amgen Inc. lost an epidemiological researcher who played a critical role in bringing new drugs to market. Together, Boeing Co. and Raytheon Corp. lost seven experienced managers and engineers. Oracle Corp. lost a sales account manager on one of the downed flights; seven additional Oracle employees are among those still missing in the rubble of the World Trade Center. Sun Microsystems lost its software engineering director. Cisco Systems and Applied Materials also lost workers. The personal losses experienced by these firms are incalculable. The economic losses are expected to be huge.

The attacks have also resulted in significant economic losses for other businesses and, in certain cases, entire industries. Although the fiscal plight of the airlines has been the most publicized of the economic impacts, several industries that depend on travelers have also been hard hit.

For example, significant limitations on the ability of travelers to use curbside check-in have cut skycaps' major source of tips. Heightened airport security has limited the ability of non-travelling airport visitors to access shops and restaurants beyond security checkpoints at the airports. That restriction, together with the steep drop-off in passenger travel since the attacks and the increased time that passengers now spend in lines rather than in shops, is costing airport merchants hundreds of thousands of dollars per week and prompting some to lay off workers and reduce employee hours. Nationwide, the airport concession industry stands to lose up to $1 billion in sales through 2001. Parking, shuttle service, and car rental agency revenues are also down. Restaurants report empty tables, and hotels report higher vacancy rates.

Some specific examples culled from Bay Area and Sacramento newspaper reports:

- Oakland International Airport and the businesses that directly rely on it earned $4.5 billion last year. The Oakland Airport Hilton lost $250,000 in the week following the terrorist attacks. Continued lower than normal occupancy rates (less than 50% rather than 90%) will result in losses of millions more.

Despite a temporary surge in demand for rental cars when planes were grounded, Enterprise Rent-a-Car at Oakland's airport has seen business drop by 40% since the attacks. In Oakland, Hegenburger's Restaurant, which sits just a mile from the airport, has seen its business drop off by 25%. The nearby Chevron has seen its sales dip by 30%.

CA1 Services, the company that operates Oakland Airport's concessions, has indicated that several food vendors have asked to reduce their hours. Because 15% of the concessions' business comes from non-passengers, the security checkpoints beyond which only ticketed passengers may pass has had a negative effect on business.

Oakland International Airport has had to shut down its 1,172-space short-term parking lot indefinitely, because new security regulations prohibit parking that is within 300 feet of the terminal. The amount of parking revenue lost as a result of the closure is currently unknown but expected to be significant.

- Airlines and aircraft makers have already announced a total of about 109,000 job cuts and a 20% decrease in flights since the attacks. Nationally, both American and United Airlines has announced they will lay off 20% of their workforces. Although it is unknown how many of those cuts will be made in the Bay Area, it is sobering to consider that United employs 20,000 Bay Area workers. American employs 11,300 workers in California, many of whom are based in San Jose and San Francisco. San Jose International Airport is estimated to be responsible for 75,000 jobs. San Francisco International Airport is the largest employer in San Mateo County.

- An estimated 12 million fewer people will pass through San Francisco International Airport this year than last year, costing the airport and its businesses between $70 million and $90 million. According to the San Francisco Convention and Visitors Bureau, 82% of hotel guests in San Francisco come by air.

  Fewer planes also mean fewer landing fee revenues. The cost to land a fully loaded 747 at San Francisco International is $1,550. With 200 fewer planes arriving each day, the airport expects to lose hundreds of thousands of dollars in landing fee revenue on a weekly basis.

- Shuttle services and cab drivers have also been hard hit. BayPorter Express indicates that business is down at least 20%, causing the company to eliminate overtime and pull its advertisements for new workers.

- At Sacramento International Airport, weekly food and beverage sales have fallen by 28%, retail sales have fallen 23%, parking revenues have plunged 43%, and car rental revenues have declined 31%. Sacramento airport officials estimate an annual revenue loss of $8.5 million based on these declines.

- Planned expansions at San Francisco International, San Jose International, and Oakland International have been delayed in light of fiscal pressures. These expansions include the construction of new runways at San Francisco International and construction of new passenger terminals at San Jose and Oakland International. Adding salt to the wound, Standard and Poor's bond rating agency has placed all airports on a credit watch and will conduct a critical financial review of any airport planning an expansion project.

- According to the Federal Aviation Administration (FAA), business travelers are returning to airports, but leisure travelers have continued to stay away. Travel agencies report that new bookings are down, and some customers who have previously booked travel are canceling, despite financial penalties to do so.

- Smaller commercial aviation airports have also been hard hit, because the FAA's ban on most small aircraft flights is still in effect.

State and local governments are also spending increased amounts to upgrade public safety. For example,

- In the month immediately following the terrorist attack, the California Highway Patrol has spent approximately $6.5 million to increase security at various facilities ranging from bridges to nuclear power plants. Each hour of officer overtime costs $39. Each hour of helicopter surveillance costs $320. Overtime meal expenses equal $42,000 per day. Increased vehicle expenses total $58,500 per day.

- Other state agencies such as the Office of Emergency Services and the Department of Water Resources are also racking up large overtime and equipment bills, which the Governor has committed to paying.

- The U.S. Bureau of Reclamation plans to spend an extra $2 million to secure 30 power plants and 20 dams in the western region, including Folsom and Shasta Dams.

- In the first month following the attack, the City of Los Angeles incurred $1.3 million in police overtime and $1 million in other expenses. The Sacramento County Sheriff's Department incurred close to $200,000 in overtime and terrorist-related security costs. Although these and other local governments and government agencies will seek state and federal help to offset some of these costs, some will remain the local governments' responsibility.

- Sacramento International Airport estimates spending $2.5 million this fiscal year for increased security.

These increased costs are being incurred at the same time the state's and many local governments' economies are weakening.

OPTIONS FOR STATE ACTION TO AID THOSE INDIRECTLY AFFECTED BY THE ATTACKS

This Committee hearing will solicit input from several groups regarding the types of state action they recommend to help aid those who have suffered economic losses as a result of the attack. In light of the probability that several who testify will recommend some form of tax relief to stimulate the economy, the following principles of sound tax policy are offered for consideration:

- Every proposal should clearly identify a quantitative goal it seeks to achieve. "Saving 1,000 existing jobs in the travel and entertainment industry" is an example of a quantitative goal. While worthy, the goal of "strengthening the California economy" is too vague for any piece of legislation that carries a price tag.

- Every proposal should contain quantitative measurement criteria and require the preparation of a report intended to help the Legislature evaluate whether the proposal has had its intended effect.

- When contemplating which organizations should be given responsibility for preparing the evaluation reports referenced immediately above, those who propose a tax or fiscal policy change are encouraged to consider the following agencies as valuable resources. The Franchise Tax Board is the state agency responsible for collecting and administering income taxes. The Board of Equalization is the state agency responsible for collecting and administering sales and property taxes. The Employment Development Department collects and administers payroll taxes. The Legislative Analyst's Office and the California Research Bureau are nonpartisan agencies with expertise in the area of tax and fiscal policy.

- Sunset dates should be considered as a way of ensuring that any tax relief is periodically reevaluated by the Legislature and modified as necessary (or eliminated if appropriate) based on the quantitative measurements and reports referenced above.

- The size of the tax and fiscal relief package should be large enough to help revitalize the economy and protect vulnerable taxpayers, yet small enough to ensure fiscal prudence.

- Tax relief should be cost-effective. Relief should not cost more than the economic benefits it is intended to achieve.

- The state should not create economic distortions through its actions. Any business that was not financially viable prior to the attacks should not be propped up by the state simply because it belongs to an industry the state deems worthy of targeted assistance.

- Attempts should be made to coordinate tax proposals with other forms of assistance such as loans, loan guarantees, grants, and rebate programs, because most types of tax relief can only be used by taxpayers with liabilities. For example, a business that fails to make a profit in a given year is unlikely to have a tax liability that year, rendering tax relief less helpful than cash assistance. Similarly, because of California's high taxability thresholds (e.g., $13,000 for single taxpayers with no dependents, $38,000 for a single mother with two children, and $40,000 for a married couple with two children), many of the poorest Californians remain unaided if a tax credit is used to help provide relief to individual taxpayers.

- Those proposing equity-related tax measures intended to help return money to certain individuals or businesses should consider the challenge inherent in using the tax code to offer such relief. Grants, loans, rebates, and other forms of direct assistance can be more carefully targeted and can often be implemented more quickly than tax code provisions. Those considering equity measures are also urged to include sunset dates in their proposals to ensure that public subsidies do not continue beyond recipients' need for them.

- Coordinating tax relief with other forms of state and federal assistance is likely to represent the most efficient use of the state's limited financial resources.

SOURCES OF ADDITIONAL INFORMATION

Information regarding Congressional action in response to the terrorist attacks may be found at **http://www.thomas.gov**. A link to bill information relating to the attacks may be accessed from the Thomas home page.

Information regarding Internal Revenue Service actions to provide tax relief in the wake of the terrorist attack may be found at **http://www.irs.gov**. A link to information relating to the September 11th terrorist attack may be accessed from the IRS' home page.

Information regarding Franchise Tax Board actions to provide tax relief in the wake of the terrorist attack may be found at **http://www.ftb.ca.gov**. A link to information relating to the September 11th terrorist attack may be accessed from the FTB's home page.

Information regarding Board of Equalization actions to provide tax relief in the wake of the terrorist attack may be found at **http://www.boe.ca.gov**. A link to information relating to the September 11th terrorist attack may be accessed from the BOE's home page.

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ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
ELLEN M. CORBETT, CHAIR
EIGHTEENTH ASSEMBLY DISTRICT

THE RESPONSE TO RECENT TERRORIST ATTACKS

Agenda and Witness Materials Submitted to Committee

Wednesday, November 14, 2001
Oakland Airport
Terminal 1, Mezzanine Level
Oakland, California

Assembly
California Legislature

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ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
ELLEN M. CORBETT, CHAIR
EIGHTEENTH ASSEMBLY DISTRICT

AGENDA

INFORMATIONAL HEARING ON

THE RESPONSE TO RECENT TERRORIST ATTACKS

Wednesday, November 14, 2001
9:00 a.m. - 12 noon
Oakland Airport
Terminal 1, Mezzanine Level
Oakland, California

I. OPENING REMARKS
Assemblymember Ellen M. Corbett, Chair
Members of the Committee

II. WHAT THE FEDERAL GOVERNMENT HAS DONE

A. Tax Relief for Victims of the Attack

Mr. Norm Catelli, Program Specialist II, Franchise Tax Board

B. Fiscal Policy Actions to Rejuvenate the Economy and Restore Consumer Confidence

Mr. Roger Dunstan, Assistant Director, California Research Bureau

III. WHAT THE STATE CAN DO FOR VICTIMS

A. Tax Relief for Victims of the Attack

Mr. Brian Putler, Legislative Bureau Director, Franchise Tax Board
Mr. John Abbott, Supervising Tax Counsel, Board of Equalization
Mr. Eric Miethke, Lobbyist, Nielsen, Merksamer, Parrinello, Mueller & Naylor, LLP

B. Representatives from the Business Community and Tourism Industry Discuss the Impact of the Terrorist Attack on Their Operations

Mr. Alan Wayne, Regional Director, United Airlines
Ms. Linda King, Coalition of Independent and Franchisee Rent-A-Car Operators
Mr. Mark Clement, General Manager, Oakland Hilton Airport
Ms. Stephanie Ruby, Hotel & Restaurant Employees Local 2850
Mr. Tom Edson, President of Lodge, Sierra Pacific Air Transport, Local 1782
Ms. Eileen Scranton, President, Mission Hills Travel-American Express
Dr. Marshall Mitzman, PhD, President & CEO, AVIS Rent-a-Car
Mr. Paul Taylor, Chapter President, American Society of Travel Agencies, Northern CA Division
Representative *(Invited but not yet confirmed)* Air Transport Union, Local 1781

C. Use of Tax Relief to Rejuvenate the Economy and Restore Consumer Confidence

Mr. Mark Ibele, Legislative Analyst, Legislative Analyst's Office
Ms. Jean Ross, Budget Project Director, California Budget Project
Mr. Chris Micheli, Lobbyist, Carpenter, Snodgrass

IV. PUBLIC COMMENT

V. CLOSING REMARKS
Assemblymember Ellen M. Corbett
Members of the Committee

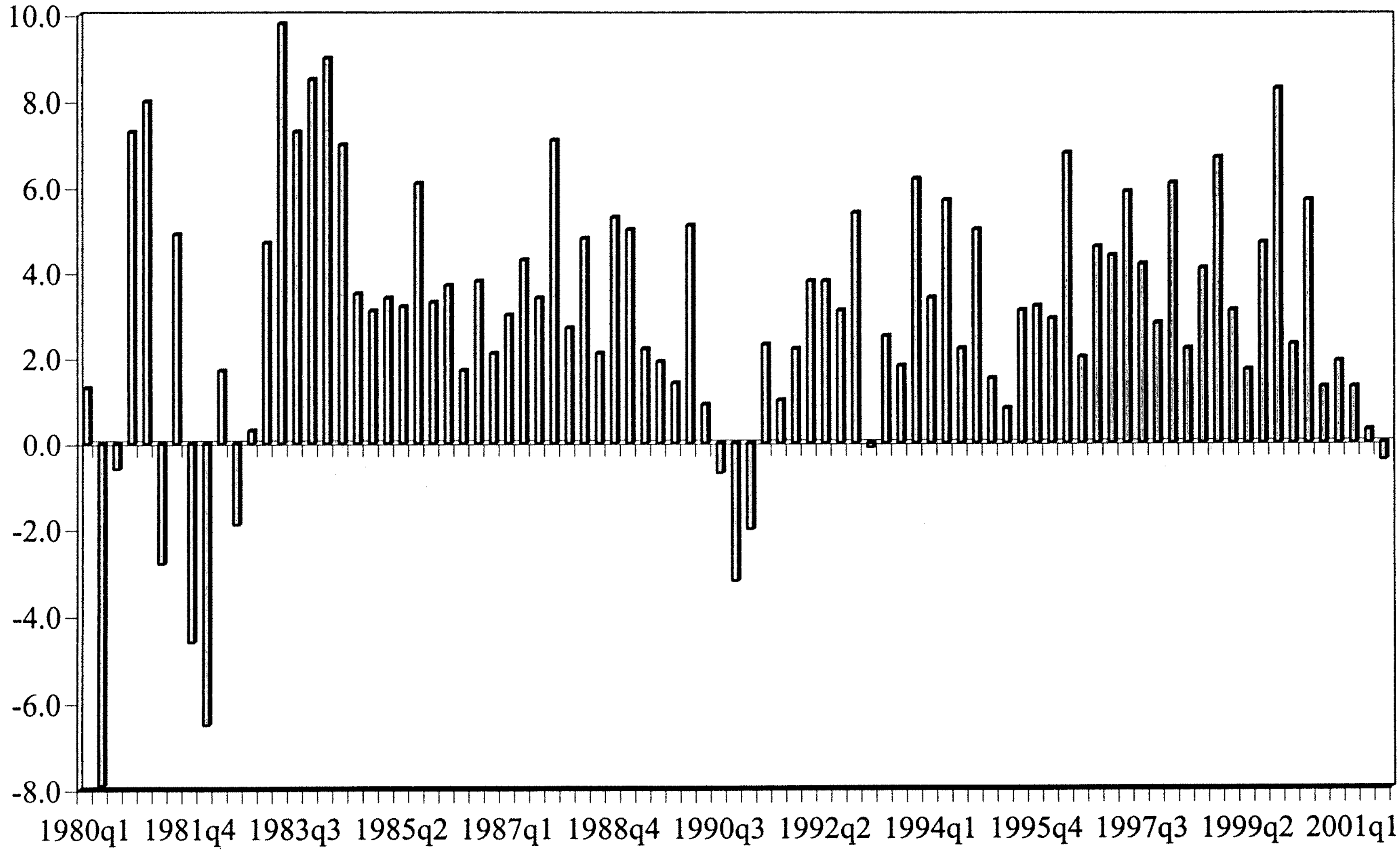
Federal Fiscal Stimulus Plan for the Economy

Roger Dunstan
California Research Bureau
California State Library

Considerations for a Stimulus Plan

- No permanent tax cuts or spending increases
- Encourage new household and business spending
- Stimulus sized appropriately
  - Surplus is shrinking; May $3.1 trillion, August $846 billion, October $53 billion
- Successful stimulus plan must have an impact quickly

Change in U.S. GDP



Existing Stimulus

- $40 Billion national defense and domestic security
- Cash and loan guarantees for airlines
- Federal funds rate has been cut to 2.0 percent
- Discount rate decreased
- Decline in energy prices

President Bush's Plan

- $75 billion current year
- Perhaps $150-300 billion over ten years
- Approximately 90 to 95 percent tax cuts
- Extension of unemployment benefits
- Aid for maintaining health insurance

Tax Changes

- Accelerate reductions for upper brackets from 2004 & 2006 to 2002
- Rebates for low-wage earners who did not get rebates checks
- Three-year tax break allowing enhanced deductions for corporations
- Repeal of alternative minimum tax for corporations

House Version

- $99.5 billion current year
- Aid for maintaining health care
- Extension of unemployment benefits

Tax Changes

- **Accelerate reductions for upper brackets from 2004 & 2006 to 2002**
- **Rebates for low-wage earners who did not get rebate checks**
- **Enhanced deductions for corporations**
- Increase in capital loss deductions
- Carry back of losses
- Eliminate alternative minimum tax for corporations.

Senate Version

- $75 billion current year
- Enhanced deductions for corporations
- Rebates for low-wage earners
- Aid for maintaining health insurance $$
- Expanded unemployment benefits $$
  - Longer period and increased eligibility
- Targeted tax incentives for disaster areas
- Emergency agricultural assistance

Other Possibilities

- Insurance claims for terrorists attacks probably exceed $30 billion
- National sales tax holiday
- Payroll tax holiday
- Administration energy plan
- More funds for disaster recovery and national security--$20 billion
- Myriad of narrowly targeted proposals

"TAX RELIEF FOR VICTIMS OF THE ATTACK"

-O0O-

Testimony Before the Informational Hearing on the response to Recent Terrorist Attacks

by
Eric J. Miethke, Esq.
Partner
Nielsen, Merksamer, Parrinello, Mueller & Naylor

Madam Chair and Members:

Thank you for allowing me the opportunity to speak today. The terrible events of September 11th have touched the lives of all Americans, but have had a direct effect on several California families. Several of our fellow Californians perished either in the catastrophe of the World Trade Center, or on board the airliners hijacked by the terrorists attacking our nation.

Those fallen Californians left behind spouses, children, parents and other dependents. These survivors find themselves in fear for their financial security even while these contend with the grief of losing a loved one. We cannot replace those who have been lost, but we can do something meaningful to ensure that those left behind can pay their mortgages, educate their children and rebuild their lives.

Federal legislation (H.R. 2884) has been introduced to exempt from income tax wages paid in 2000 and 2001 to employees lost in the terrorist action. I am informed that California will most likely conform to that provision when the Legislature reconvenes in January (AB 1129). This is an important first step, but there is an additional possible step to accelerate benefits into the hands of aggrieved survivors now. It is also a step that could be extremely important if, God forbid, another terrorist incident resulting in loss of life occurs.

Let me give you an example of what I mean. You might have heard of the bravery of Todd Beamer, who led the insurrection of passengers against the hijackers on the plane that ultimately crashed in Pennsylvania. Mr. Beamer was an employee of Oracle, California's largest software company. I was contacted by Oracle that same week because the preliminary indication from Oracle's insurance carrier was that there was a question of coverage, because Mr. Beamer's death was via an act of terrorism or war, rather than an accident. In the event the insurer did not pay, Oracle wanted to do the right thing and make a lump sum payment to Mrs. Beamer and their children.

The problem was that such a payment either was a gift or compensation under the tax law. If it were deemed to be a gift, it would be excluded from the gross income of the Beamers (IRC sec. 102)would not be deductible to Oracle. If it were compensation it would be deductible to Oracle but it would also be subject to withholding for income tax purposes (Revenue and Taxation Code section 18661 et seq.), limiting the amount of money that would be placed into the survivors' hands by at least one-third.

Eventually, the issue was avoided because the insurer, like most all insurers with debatable losses resulting from September 11th, honored the policy. But the insurance community has made it known that they cannot afford another event like September 11th, and are either specifically excluding *future* terrorist acts from coverage, or are charging high premiums for inclusion of such a risk. If terrorists should strike again, the financial danger to the victims' dependents is real.

What is needed is legislation that would encourage insurers to in essence act as insurance companies for their employees if traditional insurance coverage fails. By this, the Legislature should consider legislation making it clear that any employer who makes a payment to the survivors of a victim of a terrorist attack can deduct such a payment, while at the same time the survivors who receive the payment would be able to exclude the payment from their gross income or that of the decedent, thus eliminating the withholding requirement. This provision, while simple, would ensure that the victims' families would get the maximum amount of support in the fastest amount of time.

Finally, the Legislature should also consider whether the deduction should not only be available if the company making the payment is the victim's employer, but should be available to anyone making such a benefit payment. At the time, there was reportedly significant interest in Silicon Valley about making such benefit payments to victims' survivors, even though the victims were employees of other companies. The state should do all it can to promote this kind of selfless giving to support the victims of terror and their survivors.

The past few months has shown us the darkest side of humanity, but it has also shown us the best America has to offer. The tax laws of California can be used to foster and enhance the generosity and compassion of its citizens for the victims of terror.

Thank you again for the opportunity to share these thoughts, and I will try to answer any questions you may have.

Informational Hearing on the Response to Recent Terrorist Attacks

Assembly Revenue & Taxation Committee

November 14, 2001

Oakland, California

Comments by:

Alan B. Wayne, Director of Governmental & Public Affairs

United Airlines, Inc.

Madame Chair. Members.

My name is Alan Wayne and I am here today both in my role as Director of Governmental & Public Affairs for United Airlines and as legislative coordinator for California for the Air Transport Association, whose members carry 97 per cent of the passenger and freight nationwide and employ more than 70,000 in California.

I will try to give a very brief overview of the crisis impacting United, California's largest carrier, and the industry as a whole, now just over two months after the unprecedented events of September 11th...

The financial carnage as the Wall Street Journal called it recently as the horrific third quarter results were released by the airlines has been and continues to be well-reported and accurately reported. A sharp fall-off in business and leisure travel driven by a weakened economy, security concerns, the anthrax scare and the "hassle" factor have combined to depress industry passenger traffic by 30 per cent compared to a year ago, and revenue by 40 to 50 per cent. And that was before the tragedy of this past Monday and its potential impact on a jittery public.

The current fourth quarter will be worse, with industry net losses expected to exceed $5 billion for the year 2001. Industry experts predict some $24 billion in revenue or cash losses through next June 2002, and the ripple effect of this on the tourism industry -- hotels/attractions/rental cars, -- is significant.

The personal toll has also been enormous -- some 80,000 airline employees furloughed nationwide, including more than 5,000 in California, and 15% to 20 % reductions in flight departures and a scaling back of capital and non-capital expenditures to try to stem the bleeding.

For United Airlines, we have taken the painful steps of furloughing some 15,000 of our 100,000 employees, including some 3,600 in California alone. We have cut 700 daily flights systemwide or about one-third of our product, including about 240 serving California, in an effort to match capacity to demand. However, we are still experiencing load factors in the low 60 percentile, meaning nearly 40 per cent of our seats are empty.

In fact, United is losing $15 million a day. This was reflected in a loss of $1.1 billion in the recent quarter, the worst in United's 75-year history. To overcome that and simply breakeven we need an 89 per cent load factor, that is the percentage of seats filled. Yes, some airplanes are actually full, but the yields – what the average passenger pays -- are depressed due to fare sales that sadly are not attracting volumes or coming close to offsetting our rising costs.

Given this, what can the legislature do or consider? United and the industry are working very hard to stabilize our financial situation. Every expenditure is under scrutiny. United and the industry must reduce its cost of doing business if it is to survive.

Costs in California, particularly in the area of sales and use taxes on jet fuel, are the second highest in the U.S. after Florida and just ahead of New York…and both those states have legislation pending that would eliminate the tax. We strongly ask that the Committee consider eliminating, reducing, or temporarily suspending California's jet fuel tax when you reconvene in January.

A second and related area is the issue of the sales and use tax paid for jet fuel burned after the first out-of-state destination by aircraft originating in California. In 1991, the State reversed the longstanding tax policy of exempting fuel consumed in essence beyond the borders of California as part of a budget settlement. This is worth some $30 million annually to the carriers. In the ensuing decade, this same exemption has been restored for others like ships and rail, but not airlines. Simply, we believe it is a matter of fairness. Again, we need your active consideration.

The airlines strongly supported legislation dealing with these two issues that was carried in recent years by Assemblymembers George Runner and Pat Wiggins and Senator Mike Machado. The bills made some progress, but eventually stalled. Studies have been done showing the economic stimulus that would be triggered from such legislation would more than offset any revenue loss.

We plan to try again. The urgency is apparent.

United and the industry consider California one of the keys to our survival. It is the most populous state in terms of service, employees and investment. We need your help to keep it that way.

Thank you.

***

Linda A. King and Associates
Claims Management, Inc.
(619) 233-8034
2044 FIRST AVE., SUITE 200 • SAN DIEGO, CALIFORNIA 92101-2079
FAX (619) 233-4516

We represent approximately 75 California owned and operated independent and franchisee/licensee car rental entities with over 20,000 rental vehicles on the road.

This industry was already struggling prior to September 11, 2001:

a) rates are the same or lower than 1979 when a $25,000 car cost $3,000
b) insurance rates have steadily increased
c) accident costs have more than doubled
d) financing from 6-11%; far more than the rates manufacturers give to their affiliated car rentals or large national fleets
e) employment laws in California cost employers far more than other states.
f) **Vehicle Licensing Fees (VLF)**
g) airport charges, other CC § 1936 limitations.

Effects of terrorism since September 11, 2001:

a) Business immediately dropped 80%. Averaged a 50% drop in September 2001, 35% in October 2001
b) Lagging rentals forced early disposal of vehicles with costly penalties
c) Rental rates down 1/3 for existing rentals.
d) Reservations not coming in.
e) Forced to lay-off between 30-50% of work force. Pay cuts for remaining employees. Had to eliminate employee benefits- ie health insurance, pension plans, etc.

How can California Assembly help NOW:

1. VLF

    a) Save VLF pass-thru - do not let CC § 1936 sunset 12/31/01. Can mean as much as 2% to operators bottom line.
    b) Protect VLF offsets - extend the life of SB1070 indefinitely.

2. Allow airport surcharges to be passed through to travelers renting cars from airports - most other states allow this.

3. Support and stimulate California travel.

4. Provide Interim (1-5 year) low interest loans for working capital until market returns.

STATEMENT OF THE

AMERICAN SOCIETY OF TRAVEL AGENTS

FOR INCLUSION IN THE

HEARING RECORD
Before the

CALIFORNIA
ASSEMBLY COMMITTEE ON REVENUE AND TAXATION

ON

RESPONSE TO RECENT TERRORIST ACTS

Submitted by:

Paul Taylor
ASTA President for the
Northern California Chapter
Westmoor Travel Service, Inc.
1255 S. Mary Avenue
Sunnyvale, CA 94087

November 14, 2001

TESTIMONY OF THE

THE AMERICAN SOCIETY OF TRAVEL AGENTS, INC.

Before the

UNITED STATES HOUSE OF REPRESENTATIVES

HOUSE SMALL BUSINESS SUBCOMMITTEE
ON
REGULATORY REFORM AND OVERSIGHT

Presented by:

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October 11, 2001

Testimony of the American Society of Travel Agents

Federal Aid for Travel Agencies

Mr. Chairman, members of the Committee, my name is Bonnie Adams. I am the owner of Lewiston Travel Bureau in Lewiston, Maine. I thank you for this opportunity to speak to you on behalf of the American Society of Travel Agents ("ASTA") and the nation's travel agents.

ASTA offers this testimony for Congress' continuing deliberations with respect to the impact of the September 11 terrorist attacks on the travel industry. Our testimony differs somewhat from that of the airlines that testified before us in that we are concerned here not only with the airlines, but also with the directly related industries that are either an essential part of the airlines' ability to perform or are directly dependent upon their ability to perform.

When the airlines testified, their basic message seemed to be: take care of our needs and everyone else will then be better off too because we'll be able to continue flying. No doubt that is true: everyone will benefit if the airline industry keeps operating.

But it is far from the whole truth. In reality many people will not be better off even if the airlines continue to fly. Their businesses and careers in the travel business will have been destroyed – completely and definitively – and for the same reasons that brought the airlines before Congress and for the same reasons that the Congress, before hearing from anyone else, approved a $15 billion aid package for the airlines. These are the businesses and careers of people who had nothing to do with airline security or government surveillance of suspected terrorists. They are, typically, very small, family-owned businesses who arrange most of the air travel bought by Americans and also almost all the packaged tours and cruises, along with sizeable shares of the hotel rooms and car rentals sold in the United States.

They are firms who have been brutalized by the airlines over the past five years through a succession of compensation reductions that have reduced the average domestic commission rate from 10 percent in early 1995 to 3.75 percent in August, 2001.[1] The revenue results of this are depicted in Exhibit A to this testimony.

These actions have forced travel agents to shift costs to their customers in the form of service fees in order to maintain the air travel product line in their business. Other agencies simply stopped selling airline tickets, and still others, as would be expected, either failed or simply exited the industry for good.

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[1] These actions were accompanied by other steps designed to increase agency costs and impair agencies' ability to maintain customer relationships, much of which was described in a 1999 complaint to the Department of Transportation, as yet not acted upon.

The travel agency industry has shrunk from 23,937 firms in 1994 (the peak) to18,334 firms at the end of August, 2001 (decline of 23 percent).[2] See Exhibit B to this testimony. The air travel business done by travel agencies, including the hybrid Internet-based firms, has, however, increased from $53 billion the year before the first commission cap to more than $76 billion in the year 2000. See Exhibit C to this testimony. Air travel still represents 54 percent of the travel agency product mix and agencies still account for about 75 percent of the air travel sold in the United States.

The aggregate savings to the airlines in avoided commission expense for the entire period is in the tens of billions. Conversely, the impact on travel agencies was to weaken them as they struggled to make up for the lost commission revenue by shifting product mix to emphasize more profitable lines of business like cruises and tours. The move to cruise selling was recently met by a cruise industry reduction in commissions paid on the air portion of air-sea packages. And the recession of 2001 further cut into business travel, reducing still further the financial benefits of selling airline tickets and further impairing the financial condition of many travel agencies.

In addition, travel agencies that continue to sell air transportation must use a computerized reservations system to locate and book most seats. Most of the four remaining CRS systems are still substantially owned by airlines. Because their airline owners used them unfairly to prejudice the purchase of air travel in favor of the owners, the federal government regulates the CRS's and to some extent the airlines that own or participate in them. The contracts that CRS's impose on travel agencies typically require the agency to pay penalties if the number of segments booked falls below specified productivity thresholds.

The thresholds have several consequences. Travel agencies may harm their business if they attempt to book lower, and typically non-commissionable, fares from Internet web sites because they don't get CRS segment credits for such bookings. In recession, which we were having prior to September 11, agencies are harmed by both loss of business and loss of segment bookings. In the post-attack situation faced by agents, they must seek relief, the grant of which is entirely discretionary with the CRS's, from the segment thresholds.

Despite a formal request from ASTA, the four CRS's have announced relief measures, through the end of the year.

The point of all this is that the travel agency industry was, just like the airlines, already struggling with a severe financial problem when the attacks of September 11 brought a virtual halt to the sale of travel in all forms. They are caught between the hammer and the anvil: no new business, commissions recalled on previously sold business that was not performed or is being cancelled, and penalties for failing to make CRS booking thresholds.

---

[2] As reported by the Airlines Reporting Corporation.

Travel agents and at-home retailers of travel services number about 300,000. We estimate job losses in the 100,000 range if immediate action is not taken to help them. Travel agencies typically do not have meaningful cash reserves nor do they own assets that could be made available as collateral for regular bank loans. Having been completely ignored by the airlines, they have nowhere to turn but the federal government.

We are not here just because travel agencies are being destroyed. We are well aware of the breadth and depth of the economic damage that the September 11 attacks have imposed on our economy and that there are other claimants to federal relief with powerful equities to cite. We well understand the central role that airlines play in our country's economy and can understand that federal relief was necessary to sustain the industry until government leadership returns to the traveling public its sense of confidence in the security of air travel. From the beginning ASTA supported a rational and equitable relief package that will help deliver a rapid return to full operations by the airline industry.

The term "airline industry" is, however, something of a fiction. That which we call the airline industry is in truth an economically integrated collection of related but independent businesses with highly specialized skills, experience and expertise.

One of the most important of those essential components is the travel agency. Travel agencies are important not only because they dominate the statistics. That fact points to a deeper truth: the traveling public continues to demand the services of travel agencies in preference to other modes of purchasing.

This is not an accident and not a result of lack of choices. The public uses travel agencies because the agencies provide what the public needs in the way of information, counseling and transaction services for air travel, and, of course, for other forms of travel as well.

At ASTA we say "without a travel agent, you're on your own" and the American public agrees.

During the terrible days immediately following the September 11 attacks, America's travel agencies were again there for their clients. And they were there for others in need as well. Across the country, travel agents were in their offices trying to help the many thousands of people stranded by the nationwide airport closure. Many of them provided free assistance to people who had bought their tickets on the Internet and had no one else to contact for help.

Travel agents performed these services because they were the only people who could. At the same time they watched their businesses collapse. ASTA has many reports of agencies whose gross earnings for the week including September 11 were less than

$50. This is normally the peak season for holiday bookings. That business is at a standstill. Even large group bookings made for travel months in the future are being cancelled. The details of a small sample of these stories are set out in Exhibit A to this testimony.

It is a fact that in this unprecedented situation there was no substitute for the travel agent for tens of thousands of people who needed help. It is a fact that the nation's travel agencies face the same unprecedented financial crisis that the airlines face and are as deserving and needful as the airlines of assistance from the federal government. Finally, it is a fact that without travel agencies, the nation's travel industry, airlines included, simply cannot function. The airlines and their web sites cannot handle the volume of calls to assist consumers with the myriad of services that professional travel agents have provided and that account for the public's continuing preference for agencies. In the current situation, in particular, the services of professional agents with expertise in travel option analysis are going to be crucial to bringing the public back to the airways. Consumers are going to want and need people to talk to, preferably people they know but at least a human being with real knowledge of the system, the new rules and the requirements for achieving safe and expeditious travel. The only people available to fulfill that function are travel agencies. Recovery will remain an illusory myth for a very long time to come if travel agencies are not there to connect and serve the customer and the airline.

Some of the dimensions of the financial problem facing travel agencies are:

> Between September 11 and September 17, 2001, agencies lost an estimated $364 million due to the virtually total cessation of new sales and the recall by airlines of $73 million in air commissions on pre-September 11 sales for which transportation could not be provided.
>
> Agencies are losing about $26 million in airline sales-related revenue per day ($16 million in lost commissions, $10 million in lost fees per day)
>
> Agencies lose about $25 million per day in revenue from hotel sales ($6.3 million), car rentals ($4.3 million), cruises ($10.2 million), tours, rail and other miscellaneous sales ($4.6 million).
>
> For the four weeks following the attacks, we estimate total losses for all product lines at $1.36 billion.
>
> Estimate loss of air commissions alone through the end of the year 2001 estimated at $800 million.
>
> For the period through the end of 2002, estimated total loss for all product lines will exceed $4 billion.

Detailed projections of the effects for the balance of 2001 and for 2002 are set out in Exhibit D to this testimony.

The travel agency industry differs fundamentally in structure from that of the airlines. While there are some large firms in our industry, the overwhelming size of these businesses is "very small." In the 28,939 retail agency locations in the United States at the end of August, the average number of agency employees was six, with a median of five. Eighty-two percent are women. Just under 55% of ASTA's agency members have annual gross sales of $2 million or less.

In normal times, these small businesses handle an enormous volume of air travel. Through July of this year travel agencies sold $47 billion in airline tickets, averaging $297 million per day. Travel agencies have processed over 113 million airline sales transactions so far this year.

This business has shrunk to almost nothing since September 11. See Exhibit A. The impact on air sales passes directly through to affect the remaining 46 percent of travel agencies' product lines. Without air transportation the sale of cruises, which operate on a sustainable basis out of 13 ports in the United States, becomes almost impossible, even if the demand is there (and it is not). Hotel occupancy and car rentals are also directly and hugely dependent upon the delivery of passengers by air transportation. The tour industry uses buses for moving large numbers of travelers around, but many of them must get to the departure points using air travel. If air travel doesn't happen, these other sales don't happen either.

It is imperative that Congress provide travel agencies with financial relief comparable in nature to that given to the airlines. Given the magnitude of the short term losses and the uncertainty of near-term recovery, we seek $4 billion in no-interest or low-interest loans to be made available to travel agencies as soon as possible. These funds will help assure that irreplaceable travel agency services will not be cut off to the public when they need them the most.

Travel agencies need immediate cash infusions with a plan that includes these elements:

- Immediate cash to stabilize businesses, which may not be there by the time a more elaborate stimulus package is debated.
- Economic Disaster Loans that are industry-based not regional or size based.
- No-interest or low-interest loans below the current disaster loan level of 4% for SBA qualifying businesses.
- Loans should be based on the ability to repay not collateral.
- Loan forgiveness for agencies on the verge of bankruptcy.
- Loan abatement on both interest and principal to help travel agencies get back on their feet for SBA qualifying businesses.

Help us get back on our feet, and we'll help you get America moving again.

Finally, we want to address briefly the subject of the national recovery from the September 11 attacks. There is substantial consensus that potential travelers are still unsure whether it is safe to travel and experts' predictions for the end of that state of insecurity are grim. We have explained why we believe that federal assistance to travel agencies will assist the recovery and why allowing widespread failure of agencies will prolong the recovery. But beyond that, there is another fundamental point that is not apparently being made.

The government continues to release reports on a daily basis about the continuing presence of terrorists in our midst and about the evidence being collected about not only the September 11 attacks but about other unfulfilled threats. No doubt the people's "right to know" is involved here, but we respectfully suggest that the release of this kind of information by the federal investigation of terrorism is doing nothing meaningful to bring terrorists to justice but is contributing materially to the public's sense that it is still not safe to travel. The fundamental goal of restoring air travel, and thereby stimulating the economy as a whole, cannot be accomplished until the government makes up its collective mind that the details of the investigation, however, interesting, should be maintained confidentially until it is essential to make them public.

All the travel industry's efforts to encourage the public to travel may go for nothing if counteracted on a daily basis by non-essential government disclosures having the opposite effect.

Finally, ASTA believes the government should lead the way with public service announcements about travel safety. ASTA is ready to work with the government, as well as other industry interests, to get that positive campaign underway.

ASTA appreciates the opportunity to have presented its views, and remains at the Committee's disposal to assist in any way it can.

Respectfully submitted,

Bonnie Adams
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EXHIBIT A

TRAVEL AGENCIES IMPACTED BY AFTERMATH OF TERRORIST ATTACKS

(Excerpts of messages from travel agencies)

AGENCY spent most of last week servicing clients who needed travel rearrangements. Our net air income for the week was $38.97. We have 5 front line agents and a small supporting staff. Our clients seem to appreciate all the work we are doing for them.

AGENCY ... employs three full time agents. Last week my net income from air sales were $32.21....we have written one air ticket since Monday.... a ground operator for incentive groups ... yesterday, they had all of their fall groups cancel....Another ground operator here ... has had 9 incentive groups cancel ....

AGENCY had a net revenue stream of $154 last week in an office of 4 full time people. Monday, September 17 we sold one airline ticket and no sales to Europe (our primary destination). Normally we receive 20 to 30 leads for European travel over the weekend ... this week we have 2 leads. On Monday we also cancelled 6 passengers on escorted tours to China - representing more than $5000 in lost commission income for October. AGENCY will be laying off at least two people at the end of this week.

Normal ARC week 100,000, last week less than 7,000 or gross income of 600. Lost in excess of 50,000 in tours prepaid and ready to go. Have waived fees for reaccommodations of people stranded. 12 full time people with 1 part time person. I figure it cost me about 9,000 loss to operate last week.

Out of last weeks business, over 60% of what we did transaction wise was refunds. 75% of the call volume were from stranded passengers or calls from the emergency bank. We are taking calls daily from people who are [squeamish] about traveling. This is having a significant impact on our agency and if things do not change within 30-45 days, we will need to reduce hours and layoff agents to help us get through. This normally is our booking season for fall break and the holidays and as all agencies December traditionally is our slowest month.

AGENCY fared better than we did - we gave back more than we made resulting in a negative of $90.49!

Arc Report Ending Sep 16, 2001 26 Sales and 17 Refunds; in Addition $9000.00 Paid in Full on a Tour on Monday, Canceled on Tuesday. Several Other Trips Cancelled for Travel in October and Even for Christmas. Unfortunately the Phone Isn't Ringing for New Business to Compensate for the Cancellations.

AGENCY spent most of last week and the first part of this week assisting clients who could not get through to the airlines. Since September 11, 2001 we have processed $31,098.32 worth of air refunds and $19,889.00 in tour and cruise cancellation refunds.

Since a large portion of the tour bookings were for inbound tourism, our commission income losses are approximately $13,400.00 for last week alone. We see very little confidence with consumers in our area, as we are having people cancel their travel plans for December, January and February. We are trying to change their minds, but everyone seems to be to depressed to think about travel right now.

AGENCY's agents spent 98% of their time last week servicing clients affected by this incident. We charge a processing fee for refunds and decided not to make an exception in this case. The only income we had last week was due to our processing fees, which totaled $1398.00. Any other commission income was negated by commission given back on refunds. Bottom line is that we lost money last week. That was not enough money to support 1 part-time and 4 full-time agents. This week will be even worse. There's very little income being generated and we will lose a lot of income due to the many tours that people have cancelled.

Our agency has reduced all employees to ½ their regular hours (3 full time & 2 part employees). Owners will work without pay. Bill must be paid & there is no income.... Cancelled trips this week along amount to over $50,000.

If I have to close my businesses 8 people ... will lose their jobs and the service we have provided to over 10,000 local residents and businesses over the last six years will cease.

AGENCY is a family operated agency .... Air sales for the past week were down over 60 percent. Air cancellations equaled sales leaving us with air sales almost equal to zero. Leisure bookings have come to a virtual halt with $15,000 in cancellations for packages under deposit. All calls this morning have centered about cancelling ticketed air and cancelling leisure travel scheduled to depart in the next few weeks. Total income for this office since September 11 has been negative. All activity has centered about getting clients home, rescheduling, and cancelling. No sales for future .....

Since the Sept. 11, we have sold only 2 airline tickets. No tours and no cruises ...

EXHIBIT A

International vs. Domestic Commissions

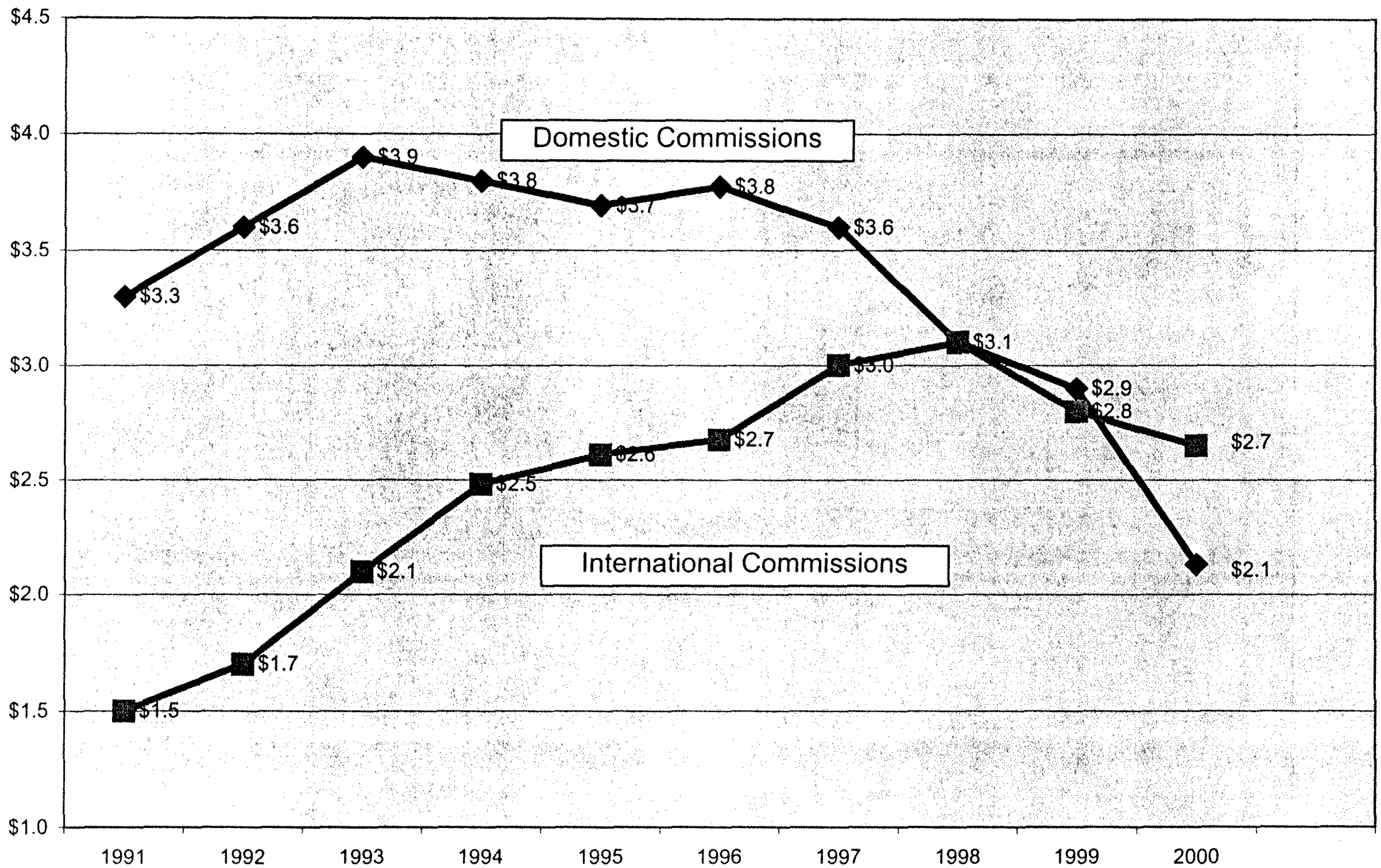


EXHIBIT B

Total Agency Firms

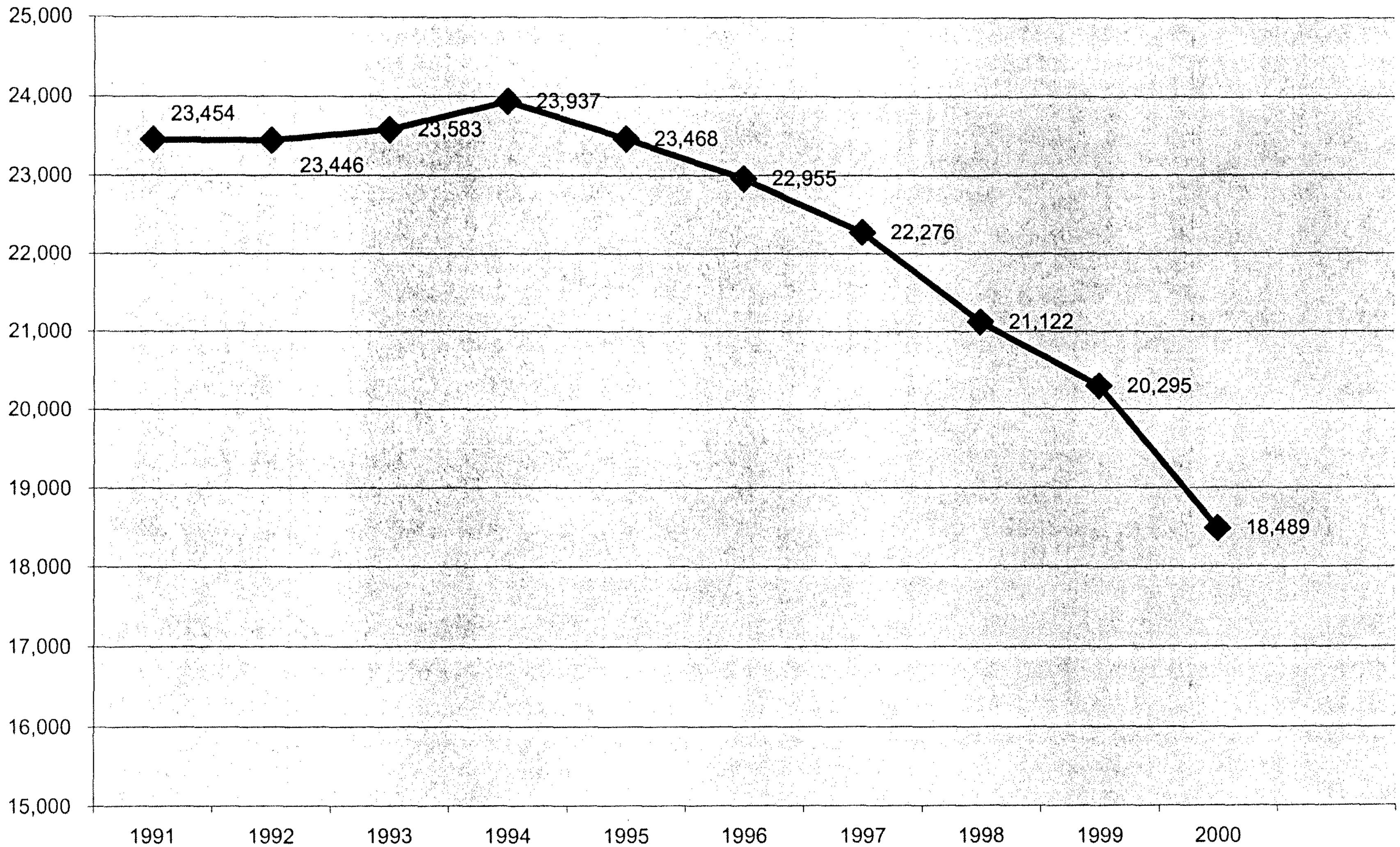
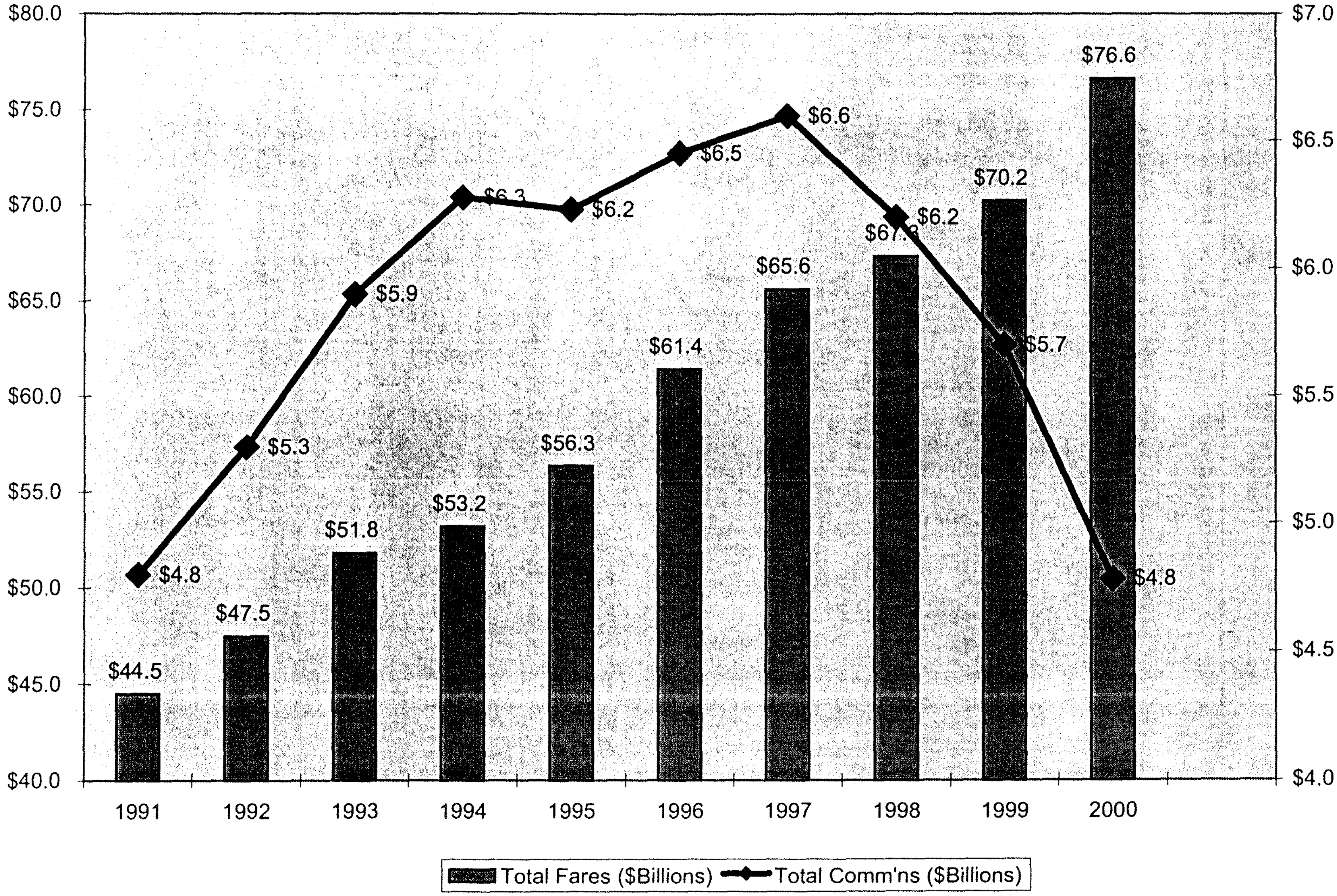
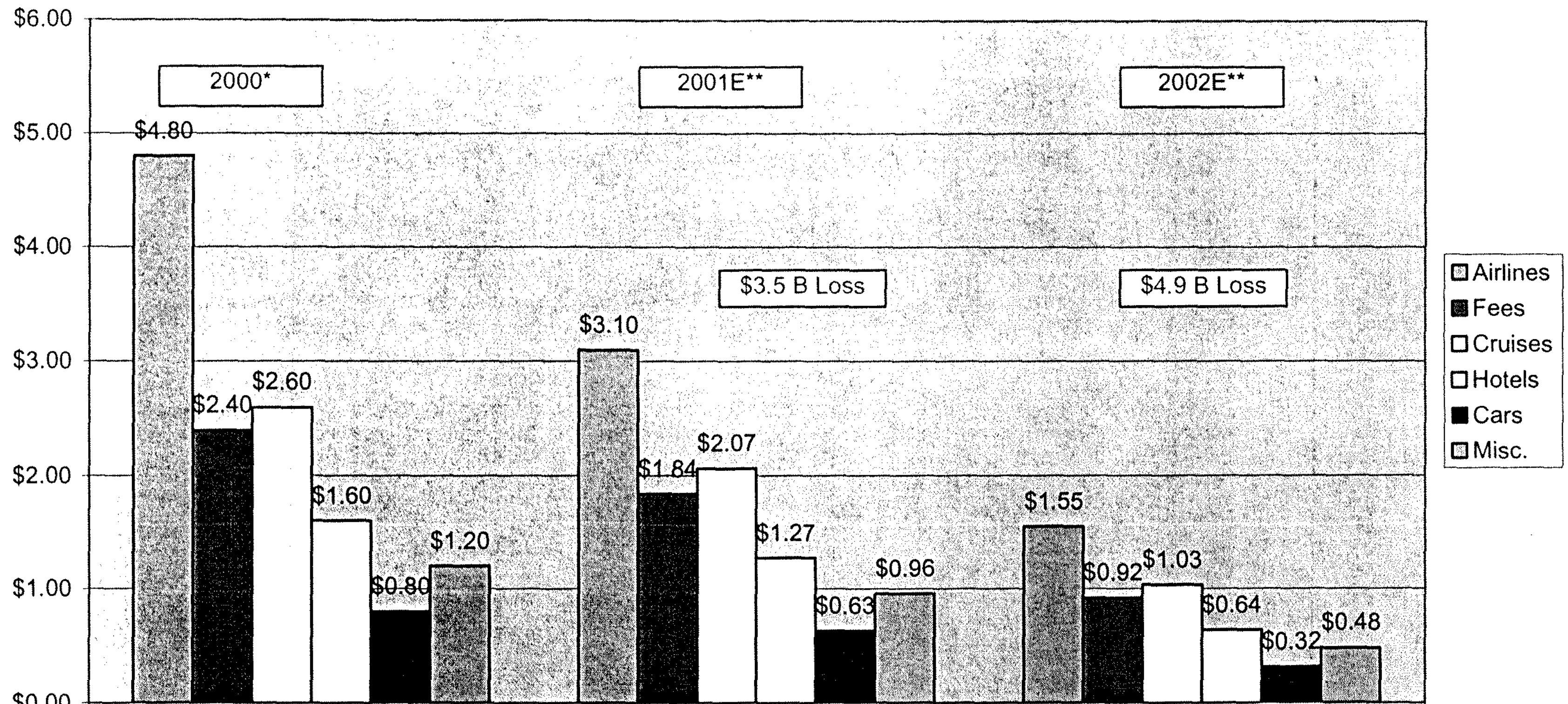


EXHIBIT C

Commissions Vs. Fares



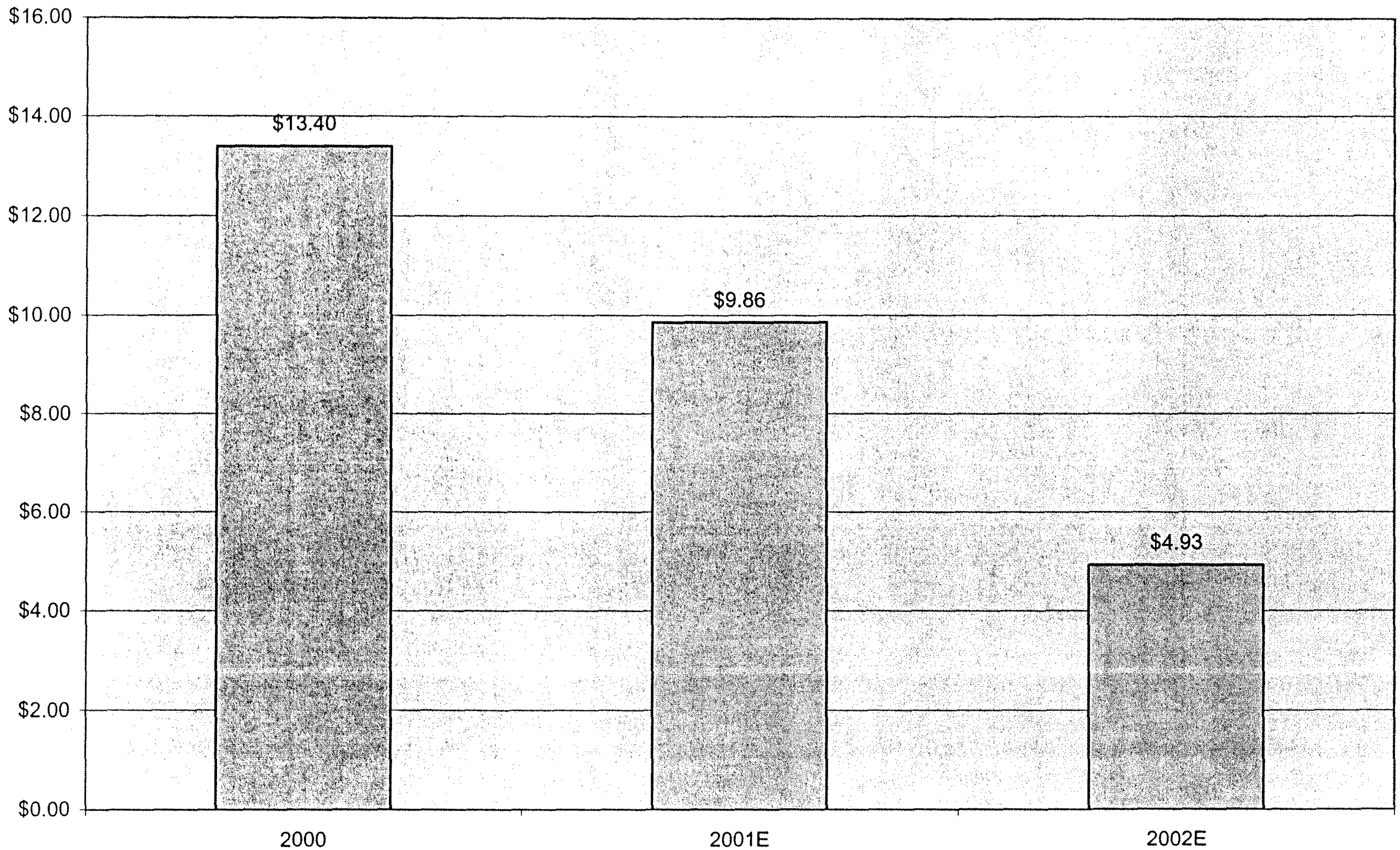
Travel Agency Industry Revenue Projections ($Billions)



	2000	2001E	2002E
Airlines	$4.80	$3.10	$1.55
Fees	$2.40	$1.84	$0.92
Cruises	$2.60	$2.07	$1.03
Hotels	$1.60	$1.27	$0.64
Cars	$0.80	$0.63	$0.32
Misc.	$1.20	$0.96	$0.48

*All air data based on ARC statistics. All other data based on 2000 Travel Agency Survey, Travel Weekly and ASTA's Service Fee Survey.
** Loss based on 2000 revenue streams compared to estimated revenues.

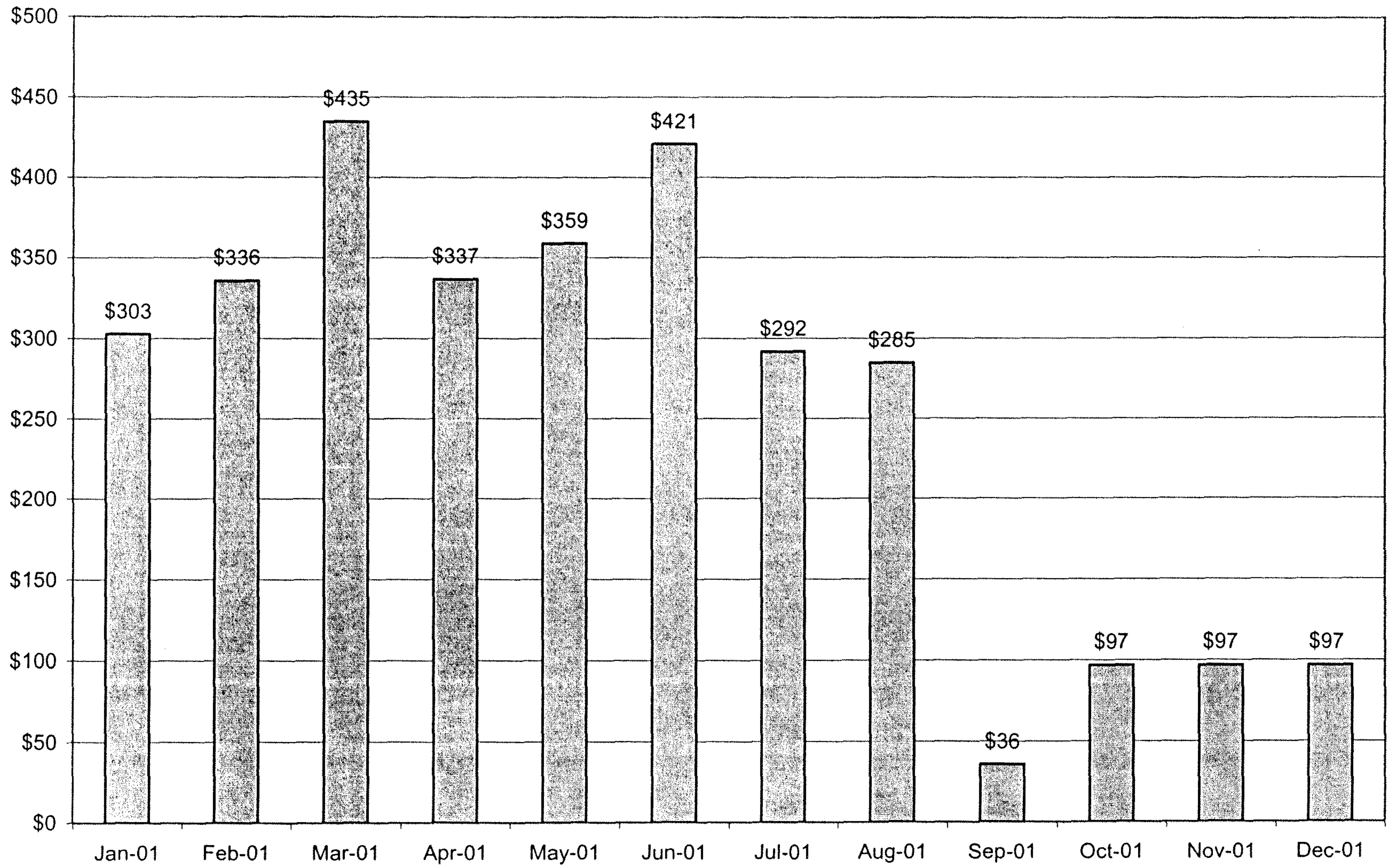
Travel Agent Revenue Projections 2000 - 2002 ($Billions)



Travel Agent Net Revenue ($Billions)

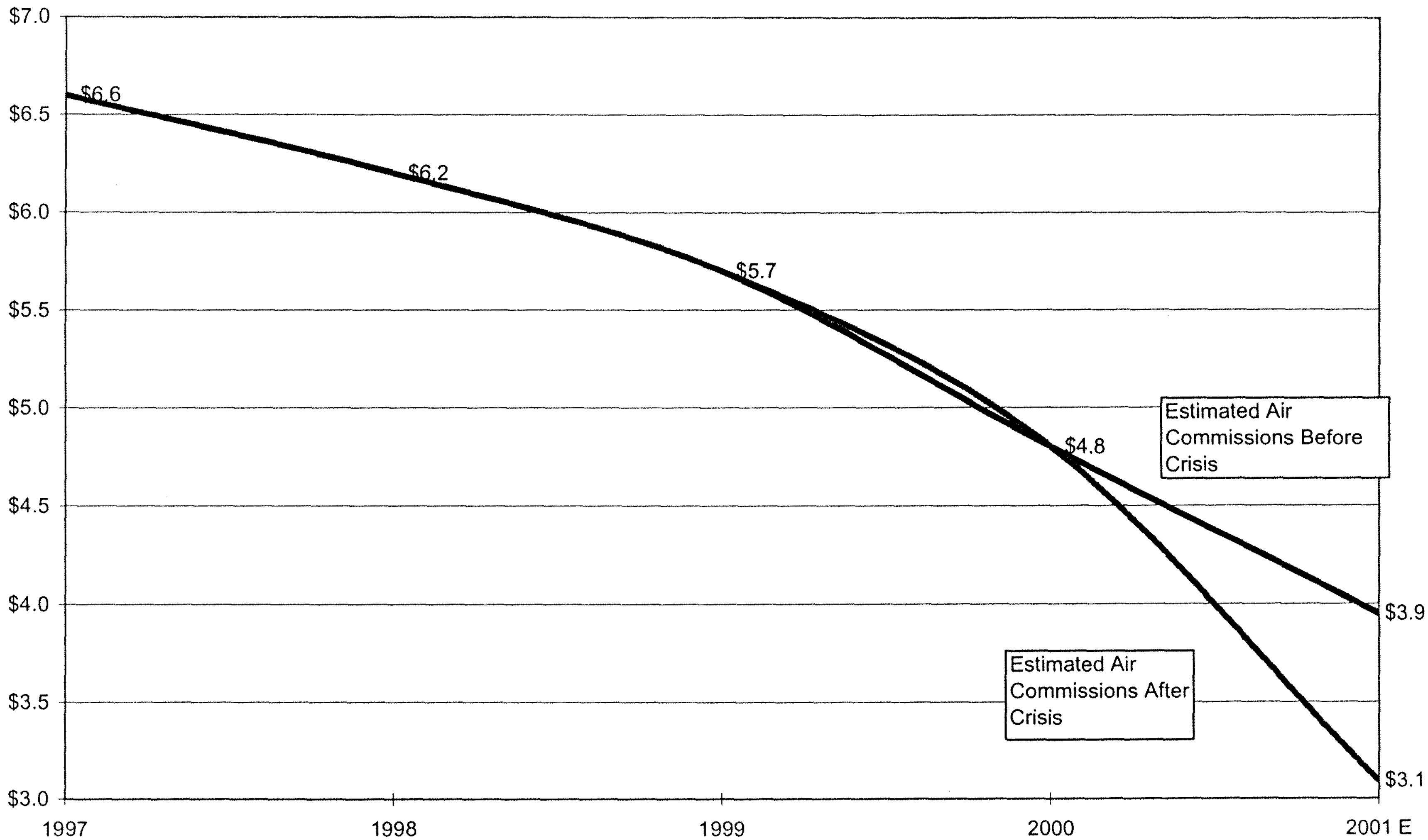
	2000	2001E	2002E
Airlines	$4.80	$3.10	$1.55
Fees	$2.40	$1.84	$0.92
Cruises	$2.60	$2.07	$1.03
Hotels	$1.60	$1.27	$0.64
Cars	$0.80	$0.63	$0.32
Misc.	$1.20	$0.96	$0.48
	$13.40	$9.86	$4.93

Monthly Agency Air Commissions 2001 ($Millions)



Based on Montly Statistics From the Airlines Reporting Corporation (ARC).

Travel Agency Air Commissions 1997 - 2001E



LAO
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Informational Hearing On the Response to Recent Terrorist Attacks

Presented To:

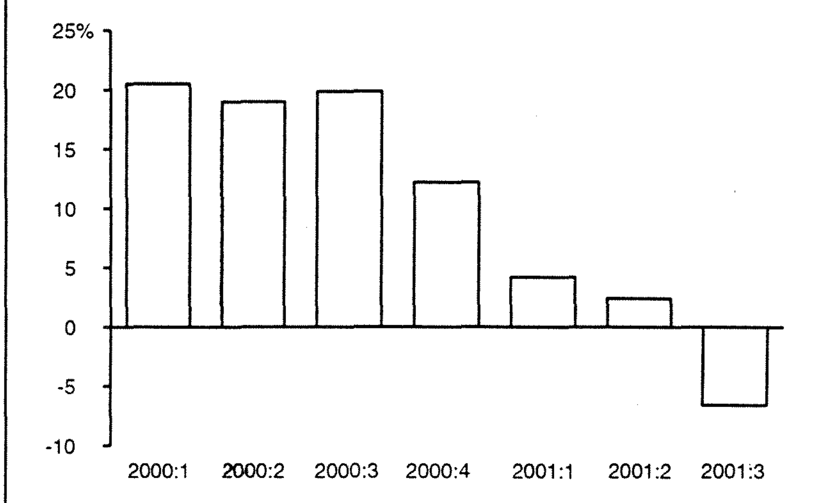
Assembly Committee on Revenue and Taxation

National and State Economies Now in a Mild Recession

- ☑ Prior to the September 11 attacks, California had been experiencing economic softness.

- ☑ For example, withholding payments, which are an indicator of current job and wage trends, have been decelerating throughout 2001 (see chart below), due to slowing employment, wages, and declining stock options, particularly in the high-tech industries.

Year-Over-Year Percent Change in Withholding, By Quarter



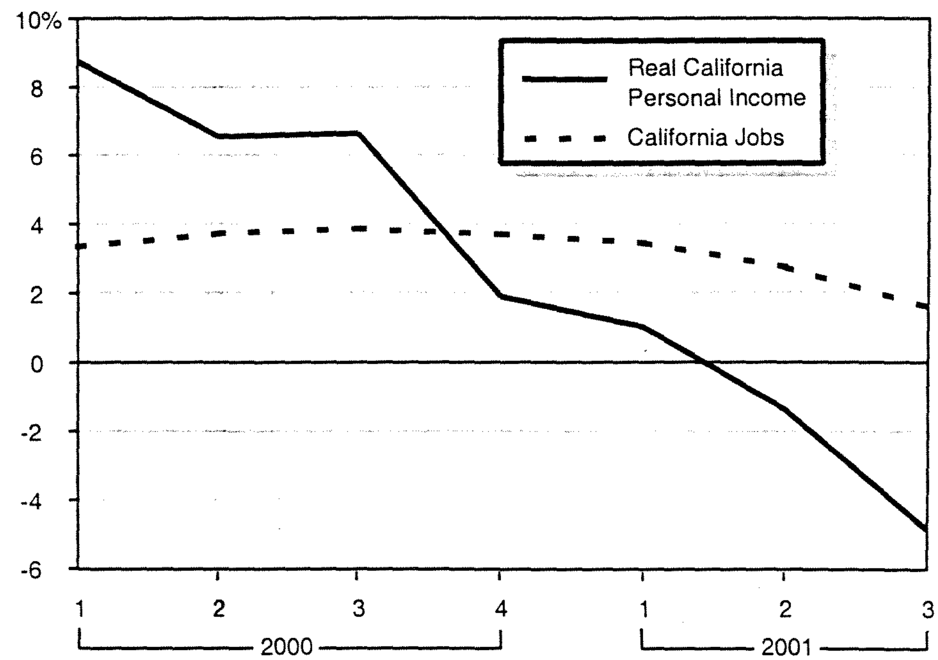
- ☑ Following the September 11 attacks, however, weakness has intensified and spread to many other industries, particularly those related to travel and tourism.

- ☑ Thus, California—as well as the rest of the nation—is now in a mild recession.

☑ ***Slowdown's Effect on Income More Pronounced Than for Employment.*** As shown in the chart below, personal income adjusted for inflation has declined more rapidly than employment. This has significant adverse implications for the state budget.

Recession's Impacts–Mild Job Losses But Severe Income Declines

Year-Over-Year Percent Change, by Quarter



Recovery Expected Early Next Year—But Uncertainties Abound

☑ ***Consensus Outlook.*** The national recession will give way to a moderate recovery beginning next spring.

☑ ***California to Follow Nation.*** We expect that California's economy will emerge from its downturn when national spending recovers.

- This is not like the early 1990s, when recovery was delayed because California was undergoing massive restructuring in its defense, banking, and housing industries.

☑ ***Huge Uncertainty Regarding Outlook.***

- No one knows how long consumers and businesses will remain cautious in the wake of the September 11 attacks and the current problems being experienced with mail delivery.
- It is unclear how the stock market decline will "play out" in terms of its effects on consumer confidence and spending in this state.

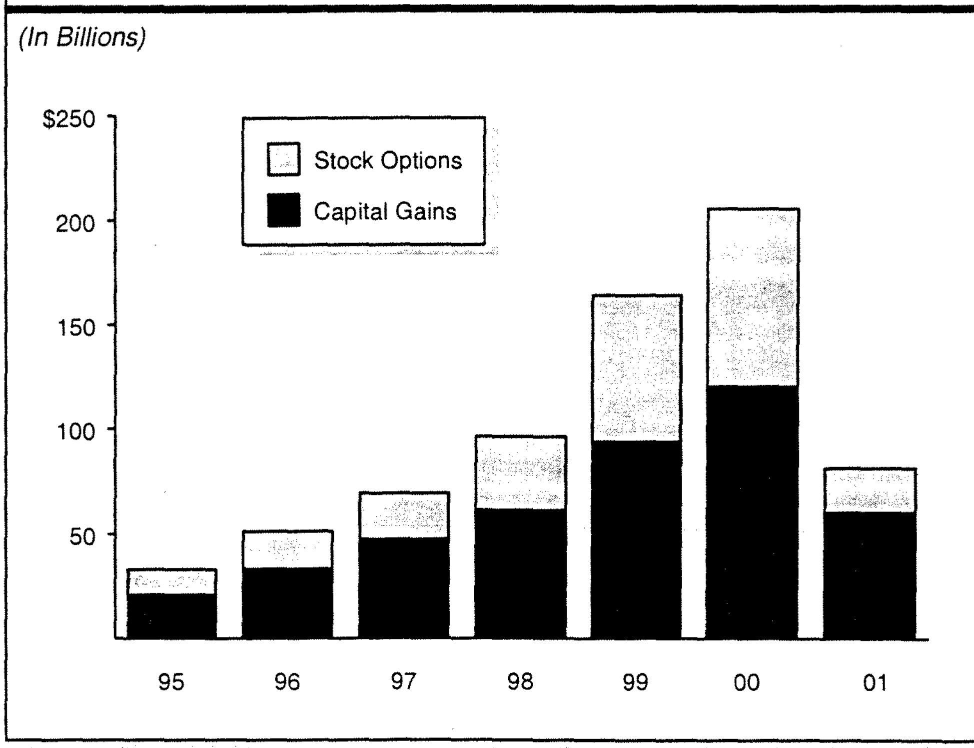
Budget Will Be Hit Hard

- ☑ The economic slowdown—even if relatively mild—will have a substantial adverse effect on state revenues, which are highly sensitive to the economy.

- ☑ This effect will be magnified by the major stock market declines that have occurred, particularly in the high-tech industries.

  - The stock market declines are particularly significant since capital gains and stock options accounted for more than 22 percent ($17 billion) of state revenues in 2000-01 and were estimated to total $12 billion this year. The chart below shows the pattern of realizations since 1995.

Capital Gains and Stock Options Tumble in 2001



Budget Will Be Hit Hard *(continued)*

- ☑ Revenue receipts for the May-through-October period are running over $1.2 billion below estimates. Monthly shortfalls will likely expand in the months ahead, easily exhausting the projected current-year reserve of $2.6 billion.

- ☑ Prior to the recent deterioration in revenues, the 2002-03 budget was already facing a $3.7 billion "operating shortfall" (that is, expenditures in excess of revenues).

- ☑ The LAO's current estimates indicate that the operating shortfall for 2002-03 will be $8 billion. The cumulative deficit will be $12.4 billion.

- ☑ Given the severe budget constraints facing the state next year, it will be important to carefully weigh the benefits of any proposed economic relief or stimulative measures against the budgetary costs involved.

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State Economic Stimulus—Cautionary Notes

- ☑ ***Timing and Details Are Key.*** Often times, tax and spending stimulus measures take time to have any effect. Temporary or targeted stimulus measures may be the most effective.

- ☑ ***State Tools Are Inherently Limited.*** The state lacks the tools available to the federal government, including monetary policies and general deficit-financed spending policies for non-capital outlay purposes.

- ☑ ***Benefits From State Tax Reductions Are Diluted Due to "Leakages."*** The full impact of state tax reductions is generally muted due to leakages to out-of-state taxpayers (through out-of-state spending) and the federal government (due to increased federal taxes).

- ☑ ***Effective Tax Stimulus Can Be Expensive.*** For state tax stimulus measures to have a sizeable effect on the economy, they must be quite large, resulting in additional stress on the state's budget.

- ☑ ***Inefficient or Inappropriate Tax Expenditures Could Be Eliminated and Used to Finance Tax Stimulation or Other Measures.*** In the current year, it is estimated that tax expenditures related to state programs total $30 billion. Programs vary in their effectiveness and cost efficiency.

- ☑ ***Despite Providing Private-Sector Economic Stimulus, State Tax Reductions Do Not Generally Pay Their Way.*** Positive impacts on the economy must be weighed against the negative economic effects of reduced government spending caused by the tax cuts, and the repercussions of curtailed program spending.

- ☑ ***General Spending Options.*** Two broad spending-type options include (1) accelerating certain expenditures that would otherwise occur, such as appropriations for capital projects, and (2) the increased use of available bond financing.

Is Tax Relief the Best Way to Boost the California Economy?

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Why Tax Policy Is Not the Preferred Approach

- The state budget accounts for a small share of the state's economy.
- Taxes account for a very small percentage of the cost of doing businesses.
- Tax cuts must be paid for with spending reductions.
- California is not at a competitive disadvantage in the current downturn.

The State Budget Accounts for a Small Share of Economic Activity

- The state budget accounts for a relatively small share of economic activity (gross state product) – 6.9 percent in 1999-00.
- Thus, even a large reduction in taxes would have a very small impact on the economy.
- The impact of state tax reductions is further minimized due to the fact that state taxes are deductible for federal tax purposes.

Taxes Account for a Very Small Share of the Cost of Doing Business

- State tax incentives will do little reduce the overall cost of doing business.
- Studies show that state and local taxes account for 1 to 2 percent of the cost of doing business. Even a large reduction will have a minimal impact on businesses' bottom line.
- As previously mentioned, the deductibility of state taxes for federal tax purposes minimizes the value of any state tax reduction (for corporations, 35 percent of the benefit of a state incentive is lost).

Tax Cuts Must Be Paid for With Spending Reductions

- While the federal government can provide countercyclical aid by deficit spending, the state cannot.
- While the state does not have a strict balanced budget requirement, the prohibition against long-term borrowing without voter approval requires that the budget be in rough balance.
- Due to the magnitude of the projected deficit, it is clear that significant spending reductions will be needed to balance next year's budget.
- As a result, any new tax reduction will require a commensurate reduction in spending.

California is NOT at a Competitive Disadvantage

- California continues to outperform the rest of the country.
- Over the past year, California added 103,000 jobs while the nation lost 378,000 jobs. Similarly, the state's share of jobs lost between September and October was 1.1 percent as compared to a share of total jobs of 11.2 percent.
- By most indicators, the California economy suffered less than other parts of the country in the wake of the September 11 attack.

What Should a Good Stimulus Package Do?

- Economist argue that a good stimulus package should be effective, be fair, be temporary, and be consistent with long term policy needs and goals.
- Professor Joseph Stiglitz, 2001 Nobel Prize winner in economics, recently examined options for states in the current downturn and concluded that, " a reduction in government spending on goods and services is thus likely to be more harmful to the economy in the short run than an increase in taxes or a reduction in transfer program spending."

Proposals Do Not Measure Up

- Tax reductions will not pay for themselves. The dynamic estimating model created at the request of the business community shows this persuasively.
- Proposals are too small to have an impact, but costly enough to require significant spending reductions.
- Many are permanent, not temporary, and thus will not serve to motivate short term economic activity.
- Most fail the fairness test and reward those who reaped large gains during the 1990s, but do nothing for those who were left behind.
- Proposals are not tied to maintaining jobs or improved economic well being for California workers.

Cal-Tax Digest

February 2001

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State Taxes

The Role of Tax Incentives

By Chris Micheli, David R. Doerr and Fred Main

For a long time, the California Legislature has been struggling with the issue of whether tax incentives are effective. More recently, legislators have been examining methods of ensuring greater accountability with tax incentives. Some are pursuing a fundamental policy proposal that all tax incentive legislation contain a sunset clause, measures to determine the effectiveness of tax incentives and public disclosure of taxpayer information.

While there are competing demands on state revenues, and there should be accountability in tax policy, a "one-size-fits-all" approach is poor tax policy. The California Legislature, where deemed appropriate, makes selective reporting requirements now. In fact, the business community supports such efforts on specific provisions.

We also need to be competitive with other states. While broad tax relief is always preferable, it is not always fiscally possible. Targeted tax incentives are less of a drain on the state's General Fund and they promote competitiveness with other states.

The business community does not object to periodic review of tax incentives. In fact, this already occurs. There is a regular Legislative Analyst's Office report on Tax Expenditure Programs. Also, the Franchise Tax Board provides an annual listing of all tax credits and the number of taxpayers claiming the credits, as well as the total amount of credits claimed.

Most of the tax law benefits have been provided to personal income taxpayers. The major tax breaks available to personal income taxpayers are:

- Home mortgage interest deduction ($3 billion).
- Employer contributions to employee pension plans ($2.6 billion).
- Dependent exemption credit ($1.3 billion).

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Chris Micheli is an attorney and lobbyist for Carpenter Snodgrass & Associates.

David R. Doerr is chief tax consultant for the California Taxpayers' Association.

The largest corporate tax incentive is the manufacturers' investment credit (MIC), which provides $365 million annually in tax relief.

Examining Effectiveness
It is actually quite difficult to determine with great certainty the effectiveness of tax policy changes. Moreover, there are a number of concerns relating to making a determination of effectiveness and collecting the raw data to analyze to make such a determination. For example, who establishes the criteria? Are the criteria the same with all legislation? How is the data collected? How is the data evaluated?

In some cases, it will be necessary to actually contact the individual taxpayers and ask probative questions: "As a result of this change in the law, did you make additional purchases?" "Did you hire new people?" To what secondary level should we examine dynamic effects?

Sunset Dates
One of the fundamental concerns of imposing sunset dates is that it is difficult for businesses to plan for the future. In fact, a sunset date can render a tax incentive meaningless when taxpayers, dealing with an early sunset date, will be loath to invest on a long-term basis. Such sunset dates simply allow the opponents of tax incentives to make the argument that the incentive will only benefit the businesses that were going to invest anyway.

As a result, the Legislature has wisely used this approach on a selective basis. Some measures that were subject to a sunset date, but later made permanent, include the research and development tax credit, as well as the treatment of the employee stock ownership plan.

Provisions that automatically expired due to sunsets in California law and have not been reinstated include the tax credit for employer-subsidized transit passes, the Los Angeles Revitalization Zone (LARZ), and the credits for solar energy equipment and jobs.

Many opponents of tax relief simply miss the boat by arguing that all tax cuts must provide incentives.

Selected Studies
Despite protests from some groups opposed to corporate tax incentives, a number of such measures have been studied. For example, the research and development tax credit has been recently studied.

A 1998 study by Coopers & Lybrand found that, at the federal level, the R&D tax credit is such a powerful incentive that it will ultimately pay for itself due to its impact on productivity gains and economic growth, which thereby increase federal revenue.

Good Tax Policy

Many opponents of tax relief simply miss the boat by arguing that all tax cuts must provide incentives. Changes in tax laws are not always designed to provide an incentive to growth. They are also meant to underwrite the costs of socially desirable activities or to produce equity in tax statutes.

For example, while the MIC and R&D tax credits are meant to stimulate economic growth, the child-care credit is not. Certainly we are not trying to "incentivize" or encourage people to have additional children. Moreover, some proposed tax law changes are matters of tax equity, such as interest rate equalization, treatment of net operating losses, etc.

Worker Benefits

Workers are benefiting by businesses being more competitive in the global marketplace. High-tech and biotech industries, in particular, are creating high-wage, high-skilled quality jobs for Californians. Good wages and benefits are needed for all California workers, but you cannot mandate those in exchange for tax cuts. Otherwise, there will be a disincentive to invest.

With a tight labor market, businesses are competing for fewer available workers. As a result, they are responding with more generous and more creative compensation packages for their employees.

Business Tax Incentives Warranted

While California bank and corporation tax revenues have remained at about $5 billion annually for several years (due to a number of factors including the significant decline in the state's average corporate apportionment factors, as well as credits), it is these businesses that have created the record number of jobs over the past five years that has led to record employment levels.

Also, these businesses have provided generous stock options and market values that have made people wealthy, that have also increased personal income tax (PIT) revenues. Since 20 percent of PIT revenues are related to stock capital gains, California should want to ensure that companies continue to do well so that their stock values keep growing. The portion of capital gains receipts from sales of stock and the exercise of stock options is due to corporations performing well. This trend needs to be encouraged.

California must continue fostering a positive business climate. Employment levels in this state are at an all-time high with businesses hiring a record number of people. This business expansion has been fostered in part by tax incentives adopted in the 1990s.

California faces continued competition from other states. Others continue to entice California businesses with economic incentives to lower the cost of doing business in their states. To encourage a dynamic business climate, favorable tax policies need to be a part of the product mix.

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A S S O C I A T I O N

November 14 hearing Before the California Assembly Revenue and Taxation Committee
Statement by
California Manufacturers and Technology Association

Manufacturers Need Economic Stimulus: Sales Tax Exemption

Manufacturing and technology strength is essential to a strong California economy. Historically, our state has been a world leader in these industries, which include electronics, biotechnology, aerospace, food processing and the production of goods of every description. A strong manufacturing base brings high paying jobs and produces an enormous positive ripple effect in the state's economy. A sales tax exemption of the purchase of capital equipment would quickly stimulate economic growth in this sector.

Manufacturing, however, is in trouble in California. As reported in the Department of Finance' October Bulletin, manufacturing employment in California declined by more than 10,000 jobs in September and by 63,000 jobs during the past year with high tech jobs being the hit the hardest. According to just released data from the National Venture Capital Association (NVCA), venture capital investment in the Bay Area during the 3rd quarter of 2001 has dropped 74 percent from its high in the 2nd quarter of 2000.

We have now entered into the recession anticipated for several months and exacerbated by the September 11 terrorist attacks. In fact, the recession was anticipated first by certain bell weather producers in the manufacturing sector (for example the declines in demand experienced by packaging producers was a strong indication early in the year of the slow down). Enabling manufacturing companies to choose California as their place for investing in modernization or expansion would strongly stimulate the state's economy.

The extent of a manufacturing presence in this state is directly tied to the how California compares with other places as a site choice. Numerous conditions are considered each time a company decides where to expand an existing site or build a new facility but cost and only cost is the decisive factor. Our companies are continuously wooed nationally and internationally by jurisdictions eager to welcome them with multiple attractions. Historically, our state was successful in this competition; today, however, we see the consequences of the gradual movement of our industry away from California. The aerospace sector has moved most of its investment to other states as have sectors of the computer industry. Once manufacturing jobs are lost, they do not easily return as the capital outlay required for building a new facility is enormous and the new site entails a deep financial commitment.

California is an expensive place to do business. Wages, workers compensation, litigation, taxes, environmental regulation are all cost expenses in our state. One of the most important and conspicuous costs analyzed for site location decisions are taxes. In business, cutting cost and profits are all about margins. A percentage point difference can be the dispositive factor in a decision or in a success or failure. Marginal costs make or break a company.

California taxes the purchase of equipment (via sales or use tax) used in the manufacturing process. Forty-six states do not impose any sales tax on equipment or fully rebate any such tax paid. Of the 46 states, about 15 also provide income tax credits to companies which invest in new facilities or in expansion of existing facilities. While the existing MIC law allows some (profitable) manufacturers partially to offset their sales/use tax liability, California's tax burden in this regard is one of the worst four in the country. We are roughly on a par with Alabama; only South Dakota and Wyoming impose a full tax. Similarly, many of our competitors states also exempt telecom equipment in order to encourage rapid deployment of information technology infrastructure.

We therefore strongly urge policymakers to eliminate the sales tax on manufacturing and telecommunications equipment. Such a stimulus would have a direct economic effect. It would increase productivity and would increase jobs. The slippage problem which concerns scholars of economic policy whereby foregone revenue is not put to productive use in the private sector is absent in that the incentive is directly connected to the basic engine of economic growth: increased production.

Thank you for your attention and consideration.