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Todd A. Lard
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April 22, 2011

Bruce Fort
Hearing Officer, Multistate Tax Commission
444 North Capitol Street, NW, Suite 425
Washington, DC 20001-1538

Re: Opposition to "Tax Haven" Amendments in Model Statute for Combined Reporting

Dear Mr. Fort:

The Council On State Taxation ("COST") respectfully submits the following comments and recommendations concerning proposed amendments to Section 1 of the Model Statute for Combined Reporting as released by the Multistate Tax Commission ("MTC") on February 28, 2011. Most importantly, as more fully described below, COST maintains that the "tax haven" classification is unconstitutional as it violates the Foreign Commerce Clause.

About COST

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of 575 major corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

MTC's Proposed Definition for "Tax Haven"

As an initial matter, we applaud the MTC for its efforts to address specific concerns raised by countries the MTC has labeled "tax havens." COST has long opposed any rule that penalizes a taxpayer simply because the taxpayer does business in a certain foreign jurisdiction. The proposal to eliminate the references to the Organization for Economic Cooperation and Development's ("OECD") lists of "tax havens" and "jurisdictions with harmful preferential tax regimes" as the source of the "tax haven" definitional criteria is certainly a step in the right direction. However, COST remains concerned that the subjective criteria contained in Section 1 to classify a jurisdiction as a "tax haven" still violates the Foreign Commerce Clause and is unsound tax policy. We believe the better course of action is to eliminate the "tax haven" criteria entirely.

The MTC "Tax Haven" Criteria Violates the Foreign Commerce Clause

When a state decides to penalize taxpayers for doing business in specific countries—which is the effect of the MTC's "tax haven" criteria—that state violates the Foreign Commerce Clause. The constitutional standard set forth in *Japan Line, LTD v. County of Los Angeles*, 441 U.S. 434 (1979) is clear, state tax measures may not impose a risk of multiple taxation at the international level and may not prevent the federal government from "speaking with one voice" on international policy matters. The subjective criterion that the MTC has proposed to classify jurisdictions as "tax havens" prevents the federal government from speaking with one voice and thus, violates the Foreign Commerce Clause. By allowing states to apply these guidelines subjectively, as many as 50 separate lists of "tax havens" will be generated, making it impossible for the federal government to have "one voice" on this matter. Furthermore, a classification as a "tax haven" by one or many states carries a negative stigma that corporations doing business in those countries are doing something wrong. This can negatively affect federal economic and other relations with listed countries.

Recent attempts by states to label specific jurisdictions as "tax havens" illustrate the impact of such a classification on foreign relations. The Montana Senate recently passed a bill (SB 94) that labeled the Netherlands and Ireland as "tax havens." The Montana Department of Revenue suggested that those two countries be branded as "tax havens" by applying guidelines that are virtually identical to those included in this proposal. When SB 94 passed the Montana Senate and went to the Montana House, the diplomatic response was quick. The Ambassador of Ireland penned the attached letter in strong opposition to the classification of his country as a "tax haven." See attachment "A". When California attempted to enact similar "tax haven" language last year, the diplomatic response was similar. See Attachment "B." It is difficult to see how a state action that clearly agitates specific U.S. partners does not interfere with the federal government's ability to speak with one voice. To be sure, the entire genesis for this project was repeated requests from a specific country on the OECD list for the MTC to alter the rule so that they would no longer be considered a "tax haven."

The fact that the water's-edge election is made at the choice of the corporate taxpayer does not insulate this list of criteria from being unconstitutional. The subjective nature of the MTC's proposed amendment essentially allows states to penalize companies for doing business in certain countries in which the U.S. has diplomatic ties; the federal government is constitutionally authorized and best equipped to deal with issues impacting foreign relations.

The Subjective Nature of the "Tax Haven" Criteria Contradicts the Fundamental Principles of Uniformity

Enabling the states to assign their own values and priorities to the criteria advanced by the MTC creates a thoroughly subjective method of classifying "tax havens." The latitude and unbridled discretion afforded to states by the MTC creates a complete lack of uniformity among states that implement this Proposed Model Statute. One state may classify a jurisdiction as a "tax haven," while another may not. This runs contrary to one of MTC's stated missions in enacting this Proposed Model Statute and also creates greater administrative burdens for states and taxpayers alike.

Elimination of the "Tax Haven" Criteria is the Preferred Solution

The MTC Income and Franchise Tax Uniformity Subcommittee considered several options to overcome the difficulty of tying the "tax haven" definition to an OECD list. One possible option explored was the elimination of the "tax haven" criteria entirely. Given the abundance of tools to combat tax abuses as well as the federal enforcement of abuses, we question whether special treatment of "tax haven" countries is necessary at all. Given all of the negative implications of labeling "tax havens," we think this is the best court for amending the current rules.

Conclusion

COST appreciates the MTC's interest in fine tuning uniform legislation in order to ease the tax administrative burden of both the states and taxpayers. Unfortunately, the MTC has chosen to support changes to the unitary combined reporting statute that is arguably unconstitutional. For the reasons above, COST opposes the adoption of subjective criteria that states apply in order to classify certain jurisdictions as "tax havens."

Yours Truly,

Todd A. Lard

Attachment A

AMBASÁID NA HÉIREANN
TELEPHONE: (202) 462-3939
FAX: (202) 232-5993

EMBASSY OF IRELAND
2234 MASSACHUSETTS AVE., N.W.
WASHINGTON, D.C. 20008

Subject: Senate Bill 94

21 April 2011

To all members of the Montana Senate and House of Representatives,

I am writing to you on behalf of the Government of Ireland in the context of Senate Bill 94.

We were surprised to learn that this draft legislation groundlessly labels Ireland and the Netherlands 'tax havens'. This has no State, Federal or international precedent.

Ireland is not a 'tax haven'. Ireland is in full compliance with all applicable international standards and frameworks, including those of the OECD and European Union.

Ireland also has a successful and stable Double Taxation Agreement in place with the United States.

Ireland is not a nominal-tax or a no-tax jurisdiction. We have a corporate tax rate of 12.5% applied transparently to domestic and international companies. This is not the lowest corporate tax rate even within the European Union. Ireland is not in any sense a tax secrecy jurisdiction. We do not seek to attract brass-plate investments to Ireland, but substantive operations of US and other global companies seeking to enter a European market of 500 million consumers. US companies employ some 100,000 Irish people in these high value operations vital to their global success.

In return Irish companies employ over 80,000 Americans across all 50 States, including Montana. Ireland is 13th largest source of international investment to the United States.

We believe that this legislation could undermine the mutually-beneficial business links between Ireland and Montana.

Ireland has enjoyed a rich and valued relationship with the State of Montana since the founding of the State. I was proud in the last year alone to announce concrete support from the Government of Ireland for the work of the University of Montana to further explore and celebrate the rich history of those links between our people.

It is therefore doubly disappointing that this legislation was moved, without any consultation or engagement with the Irish authorities.

I would ask all of you to consider these points as you deliberate on this draft legislation.

Yours Sincerely,

Michael Collins
Ambassador of Ireland

Attachment
B

AMBASSADOR
OF THE
REPUBLIC OF SINGAPORE
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April 20, 2010

Mr Michael Mundaca
Assistant Secretary for Tax Policy
Department of The Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Mr Mundaca

Please find enclosed a letter from the Office of the Singapore Consul-General in San Francisco addressed to the California State Senate and California State Assembly. The letter outlines Singapore's views on California's Assembly Bill 1178.

CHAN HENG CHEE

enc.

CONSUL GENERAL OF THE REPUBLIC OF SINGAPORE
SAN FRANCISCO

19 April 2010

The Honorable Darrell Steinberg
President Pro Tempore
California State Senate
State Capitol, Room 205
Sacramento, CA 95814
Fax: (916) 323-2263

The Honorable John Perez
Speaker
California State Assembly
State Capitol, Room 219
Sacramento, CA 95814
Fax: (916) 319-2146

The Honorable Lois Wolk
Chair, Revenue and Taxation Committee
California State Senate
State Capitol, Room 4032
Sacramento, CA 95814
Fax: (916) 323-2304

The Honorable Marty Block
Member
California State Assembly
State Capitol, Room 3132
Sacramento, CA 95814
Fax: (916) 319-2178

Dear Sirs and Madam,

AB 1178

I write to express the concern of the Singapore Government over AB 1178, a bill requiring corporations in California that elect to file a Water's Edge combined report to include income from a "tax haven" country or jurisdiction. I am particularly concerned that AB 1178 relies on a list of tax haven countries that includes Singapore.

The United States and Singapore enjoy a multifaceted, strong and substantive relationship. In the economic realm, the United States is Singapore's 3rd largest trading partner and we are your 13th largest trading partner. Bilateral investments, which amounted to $119 billion in 2008, sustain thousands of jobs. Over the years, we have developed a mutually beneficial relationship. This relationship is mirrored in our close and friendly ties with the great state of California, evident in the robust trade that in 2009 made Singapore California's 12th largest export market.

I have highlighted the close economic ties between Singapore and the United States because it helps illustrate a point that I wish to underscore: that Singapore is not a tax haven by any universally accepted definition. A tax haven jurisdiction would not have enjoyed the high level of trade, investment and commercial relationship that Singapore

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has with the United States. In fact it is well established internationally that we are not a tax haven. Singapore has a diversified and substantive economy, with manufacturing being our main economic contributor, complemented with strong logistics and financial services sectors. These are important characteristics that tax havens do not possess.

Singapore takes our role as a responsible tax jurisdiction seriously. We have substantially implemented the new internationally agreed Standard for the exchange of information for tax purposes in comprehensive tax treaties. We are also playing an active role in the Global Forum on Transparency and Exchange of Information, an intergovernmental body that ensures jurisdictions implement the internationally agreed Standard effectively.

I would also like to point out that Singapore is not cited on any current list of tax havens. The "John Doe" list of GAO-09-157 cited in support of AB 1178 is not a list of tax havens. This point was made clear by the United States Department of the Treasury in its letter to the GAO, which states specifically that the "John Doe" list "... *was not at all intended to suggest a general list of jurisdictions that the Treasury Department and IRS consider tax havens*". Furthermore, the "John Doe" list is irrelevant to AB 1178, as the problem the "John Doe" list sought to deal with pertained to individuals, not foreign subsidiaries of US corporations.

We respect the authority of the California legislature to propose measures that impact California whether on matters of taxation or spending. However, given the global impact of this bill, particularly its adverse implications on existing and potential international and bilateral tax frameworks, we urge the legislature to continue abiding by the tried and tested Water's Edge Election that has served California and its trading partners so well. The avoidance of double taxation accruing from the Water's Edge Election lays a firm, predictable foundation on which companies can make investment decisions that ultimately benefit California with job growth. AB 1178 would reduce the competitiveness of multinational companies in California and may lead to the unintended consequence of these companies moving out of California. We respectfully urge you not to change the Water's Edge Election and to reconsider moving AB 1178 forward.

Yours sincerely,

JEE SEE HENG

cc:

The Honorable Arnold Schwarzenegger
Governor of California
State Capitol
Sacramento, CA 95814
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The Honorable Mimi Walters
Vice Chair, Committee on Revenue and Taxation
California State Senate
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The Honorable Elaine Alquist
Member, Committee on Revenue and Taxation
California State Senate
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The Honorable Roy Ashburn
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The Honorable Alex Padilla
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The Honorable Anthony J Portantino
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The Honorable Chuck DeVore
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The Honorable Charles M Calderon
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The Honorable Joe Coto
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The Honorable Brian Nestande
Member, Committee on Revenue and Taxation
California State Assembly
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The Honorable Lori Saldaña
Member, Committee on Revenue and Taxation
California State Assembly
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British
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13 April 2010

The Honorable Darrell Steinberg
President Pro Tem
California State Senate
State Capitol, Room 205
Sacramento, CA 95814

The Honorable Lois Wolk
Chair, Revenue and Taxation Committee
California State Senate
State Capitol, Room 4032
Sacramento, CA 95814

Dear Senator Steinberg and Senator Wolk,

I have been instructed to express the United Kingdom's serious concern over **Assembly Bill 1178** which is, I understand, currently being considered by the Senate's Revenue and Taxation Committee.

This bill reminds us of similar attempts to widen the tax base which the State of California tried to put in place in the 1980s. We believed then that such measures were essentially a 'tax grab' and we believe now that such a description can be applied to AB 1178. This measure is, in our view, completely contrary to internationally-accepted tax principles since it would impose double taxation on UK companies and affiliates, something the Water's Edge Election was sensibly introduced to avoid.

Furthermore, the methodology underlying this measure is suspect. The list of so-called 'tax havens', taken from GAO-09-157, was clearly drawn up for another purpose and cannot simply be transferred at will into measures such as AB 1178. Indeed, we note that the US Treasury has specifically said that the list in the Annex to the GAO document "... was not at all intended to suggest a general list of jurisdictions that the Treasury and the IRS consider tax havens". And companies would be required to petition the Franchise Tax Board to show that they are engaged in the active conduct of trade or business, in order to be deemed as not being subject to tax from income derived from, or attributable to, the so-called tax havens (which, incidentally, include some key UK and US trading partners such as Switzerland, Singapore and Hong Kong). This means that companies are presumed guilty until they can prove themselves innocent.

I have been asked to make clear that the United Kingdom fully supports the drive for transparency in financial issues which the G20 has championed. But we feel strongly that measures such as this are not the way to further that agenda.

On 10 February 2010 I, along with several of my Consular colleagues, provided information to Senator Correa's Senate Select Committee on California-European Trade. I noted that US affiliates of UK companies provide some 909,000 jobs in the US, of which 94,000 are in California. This represents about 16% of the total number of jobs provided by US affiliates of

foreign companies, and puts us in second place behind the Japanese. 23,000 of these Californians are employed in manufacturing. Senator Correa asked what more California could do to attract foreign companies. My answer was that 'California needs to avoid placing too many barriers in the way of investment'. I noted that there was a higher cost of doing business in California compared to some other states in the US and that we had actually heard of companies who are moving out of California. I specifically mentioned the level of taxes levied in California, both in terms of amounts and complexity, as a factor. Any new tax burden, such as that intended under AB 1178, will undoubtedly have an effect on California's ability to attract new investment, including from the UK.

I note that AB 1178 has also met substantial criticism from the Organisation for International Investment (OFII), a body representing an extremely impressive selection of major international and US companies, and from a grouping of Cal-Tax, the California Bankers' Association, California Chamber of Commerce and other serious players. I expect that you will also be receiving representations from some of my Consular Corps colleagues, whose governments are equally concerned about the implications of the measure.

I am copying this letter to the Governor, Senator Correa, Assembly Speaker Perez, and Assemblyman Marty Block. I should be most grateful if the offices of Senator Wolk and Senator Correa could circulate this letter to the other members of their Committees as they consider appropriate.

Yours sincerely,

Julian Evans
HM Consul General
San Francisco

Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Embassy of Switzerland in the United States of America

The Honorable Arnold Schwarzenegger
Governor of California
State Capitol
Sacramento, CA 95814

The Honorable John Perez
Speaker of the California State Assembly
State Capitol, Room 305
Sacramento, CA 95814

The Honorable Darrell Steinberg
President Pro Tempore
of the California State Senate
State Capitol, Room 205
Sacramento, CA 95814

The Honorable Lois Wolk
Chairperson of the Revenue and Taxation
Committee of the California State Senate
State Capitol, Room 4032
Sacramento, CA 95814

Washington, D.C., April 9, 2010

Legislative Proposal AB 1178

Dear Sirs and Madam:

I am writing to express my government's concern about a bill introduced by Assembly Member Marty Block (AB 1178) which was recently approved by the California State Assembly. It stipulates that corporate income earned in certain countries may be included in California income for tax purposes. As a result, such income would be subject to double taxation.

The bill would not only have a detrimental effect on affiliates of foreign companies that are headquartered, incorporated or primarily located in one of the countries concerned, but would also provide a strong disincentive for doing business in California. The new bill would likely turn out to be disadvantageous to California's economy and might hurt employment in the medium and long term. There are about forty Swiss-affiliated companies in California with well over 30,000 employees. That encompasses firms in a broad variety of industries, such as food, pharmaceuticals and computer technology.

I am particularly concerned about the fact that bill AB 1178 relies on a list of "tax haven" countries that includes Switzerland. This list was published in a report of the U.S. Government Accountability Office (GAO) in December 2008, based on a listing of jurisdictions originally compiled by the U.S. Internal Revenue Service (IRS) and drawn up in the context of an inquiry about the use of credit cards. Thus the latter listing had a very specific purpose and was not intended as a general list of "tax havens." As the GAO report further states, there is no agreed-upon definition of a "tax haven."

According to the OECD, Switzerland is deemed to be fully cooperative in fiscal matters. Switzerland has adopted the OECD standard on information exchange and recently concluded revised tax treaties with most of its major trading partners, including the United States. It has a comprehensive tax system with a fiscal quota higher than that of the United States. The Swiss withholding tax on dividends and interest paid to non-residents is one of the highest worldwide.

In general, I do not believe that blacklisting particular jurisdictions and penalizing companies affiliated with them is an effective means of ensuring tax compliance.

Given these considerations and in light of the substantial presence of Swiss companies in California, I urge you to reconsider bill AB 1178.

Sincerely,

Urs Ziswiler
The Ambassador of Switzerland to the United States

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Switzerland.

cc: U.S. Representative Wally Herger.
U.S. Representative Edward R. Royce.
State Senator Lou Correa.
State Senator Loni Hancock.
State Senator Carol Liu.
State Senator Patricia Wiggins.
State Senator Leland Yee.

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Switzerland.

Grand Duchy of Luxembourg

Consulate General
San Francisco

The Honorable Darrell Steinberg
President pro Tem
California State Senate
State Capitol, Room 205
Sacramento, CA 95814

April 12, 2010

Subject: Comments AB 1178

Dear Senator Steinberg:

On behalf of the Government of Luxembourg, I am writing to voice my concern with regard to AB 1178, a bill that would require income derived from or attributable to business activities in a "tax haven country" to be included in a water's edge combined report in the State of California.

The Government of Luxembourg is highly concerned about modifying the water's edge election, an international agreement wherein California endeavored to avoid double taxation of overseas income of corporations that must file California tax returns. Taxation of overseas income was the consequence of mandatory worldwide combination reporting that existed prior to the water's edge election, which was a major issue for European and Asian countries and their multinational businesses.

My Government considers that AB 1178, if enacted, runs contrary to the intent of the water's edge election, the objective of which is to ensure that corporations are taxed based on operations within the water's edge of the United States. The water's edge election provides assurance that the Californian affiliates of foreign-based companies and the foreign affiliates of California-based companies filing on a water's edge basis in California will not be taxed on the same income, both in a foreign country in which they are doing business and in California.

The water's edge election is a compromise rule reached between European and Asian countries and the United States Federal Government. It is applicable to both federal and state income and property tax. My Government considers it inappropriate for an individual State to unilaterally enact legislation that has the effect of modifying the arrangement that was brokered by and has been relied upon by all the parties. If California were to do so, it would potentially erode the water's edge system, undermine the stability of the international tax regime and hamper economic and trade relations between long standing partners.

One Sansome Street, Suite 830, San Francisco, CA 94104 - Tel: (415) 788-0816 - Fax: (415) 788-0985 - Email: sanfrancisco.cg@mae.etat.lu

The Luxembourg Government is sensitive to California's desire to avoid international tax evasion by taxing income earned by California based corporations in "offshore tax haven" jurisdictions. However, existing provisions already allow California to capture tax revenue based on the activity of affiliates in foreign jurisdictions. A federal provision, known as Subpart F, requires that companies doing business in the Unites States report certain types of income associated with foreign activity. This provision is designed to prevent corporations from avoiding paying taxes on passive income earned offshore. Although this is a federal provision, California taxes a portion of Subpart F income reported at the federal level.

Furthermore and finally, the Luxembourg Government must take exception to being categorized as a "tax haven" jurisdiction. Indeed, the combined corporate income tax rate at the state and municipal levels in Luxembourg amounts to a total of at least 28,5%, depending on the level of municipal business tax, significantly higher than in many other jurisdictions not qualified as a tax haven in the list referred to in AB 1178. In addition, the Luxembourg Government has signed on May 20, 2009 a tax information exchange protocol with the United States of America under which it commits to follow the transparency standards set forth by the international community, notably the Organization for Economic Cooperation and Development (OECD). This protocol has been approved by the Luxembourg Parliament on March 17, 2010 and awaits approval by the U.S. federal legislature.

Today, Luxembourg does not appear on any current list of tax haven jurisdictions. Quite to the contrary, it appears on the current OECD "white list" of compliant countries. The "John Doe" list referenced in AB 1178 is not intended as a list of tax haven jurisdictions but rather constitutes a list of countries that were asked by the Internal Revenue Service to provide information about individual tax payers - not foreign affiliates - using financial institutions in those jurisdictions. This list is therefore inappropriate as a basis for exceptions under the water's edge elections system. This conclusion is shared by the US Department of the Treasury in its comments on the draft report "International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions" prepared by the General Accountability Office (GAO-09-157, p.55-56).

To conclude, it is the view of the Government of Luxembourg that, to facilitate a positive environment for foreign trade and investment, the states should act in a manner that is consistent with prior commitments made by the state and federal Governments to their trading partners. By modifying or enacting exceptions to the water's edge compromise, California would be reneging on those commitments.

For the foregoing reasons, the Luxembourg Government respectfully urges you to reconsider moving this legislation forward.

Sincerely,

Georges Schmit
Consul General of
The Grand-Duchy of Luxembourg

Same letter addressed to:

The Honorable Arnold Schwarzenegger, Governor of California
The Honorable John Perez, Speaker, California State Assembly
The Honorable Marty Block, California State Assembly
The Honorable Anthony J. Portantino, Chairman, Assembly Revenue & Taxation Committee
The Honorable Chuck DeVore, Vice Chair, Assembly Revenue & Taxation Committee
The Honorable Jim Beall, Jr., Member, Assembly Revenue & Taxation Committee
The Honorable Chalres Calderone, Member, Assembly Revenue & Taxation Committee
The Honorable Felipe Fuentes, Member, Assembly Revenue & Taxation Committee
The Honorable Brian Nestande, Member, Assembly Revenue & Taxation Committee
The Honorable Diane L. Harkey, Member, Assembly Revenue & Taxation Committee
The Honorable Lori Saldana, Member, Assembly Revenue & Taxation Committee
The Honorable Joe Coto, Member, Assembly Revenue & Taxation Committee
The Honorable Lois Wolk, Chair, Senate Revenue & Taxation Committee
The Honorable Mimi Walters, Vice Chair, Senate Revenue & Taxation Committee
The Honorable Elaine Alquist, Member, Senate Revenue & Taxation Committee
The Honorable Roy Ashburn, Member, Senate Revenue & Taxation Committee
The Honorable Alex Padilla, Member, Senate Revenue & Taxation Committee

CC:
Ms. Julia King, Assembly Republican Consultant, Revenue & Taxation Committee
Ms. Oksana Jaffe, Chief Consultant, Assembly Revenue & Taxation Committee
Mr. Colin Grinnell, Consultant, Senate Revenue & Taxation Committee
Ms. Gayle Miller, Consultant, Senate Revenue & Taxation Committee
Ms. Therese Twomey, Consultant, Senate Revenue & Taxation Committee
Mr. Steve Shea, Policy Consultant, Senate President pro Tem Darrell Steinberg
Mr. Pedro Reyes, Policy Consultant, Assembly Speaker John Perez
Ms. Jennifer Kent, Policy Consultant on Revenue & Taxation, Governor Schwarzenegger