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What to Expect From Tax Reform Efforts 2015-16

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California Budget and Policy Center

The Budget Center was established in 1995 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The Budget Center engages in independent fiscal and policy analysis and public education with the goal of improving the economic and social well-being of low- and middle-income Californians. Support for the Budget Center comes from foundation grants, subscriptions, and individual contributions. Please visit our website at calbudgetcenter.org.



What Should a Good Tax System Do?

- **Adequacy:** Provide an adequate level of revenues on a timely basis.
- **Fairness:** Distribute the cost of paying for public services fairly.
- **Growth:** Promote economic growth and efficiency.
- **Administrative ease:** Be easily administered; and,
- **Accountability:** Ensure accountability and transparency.

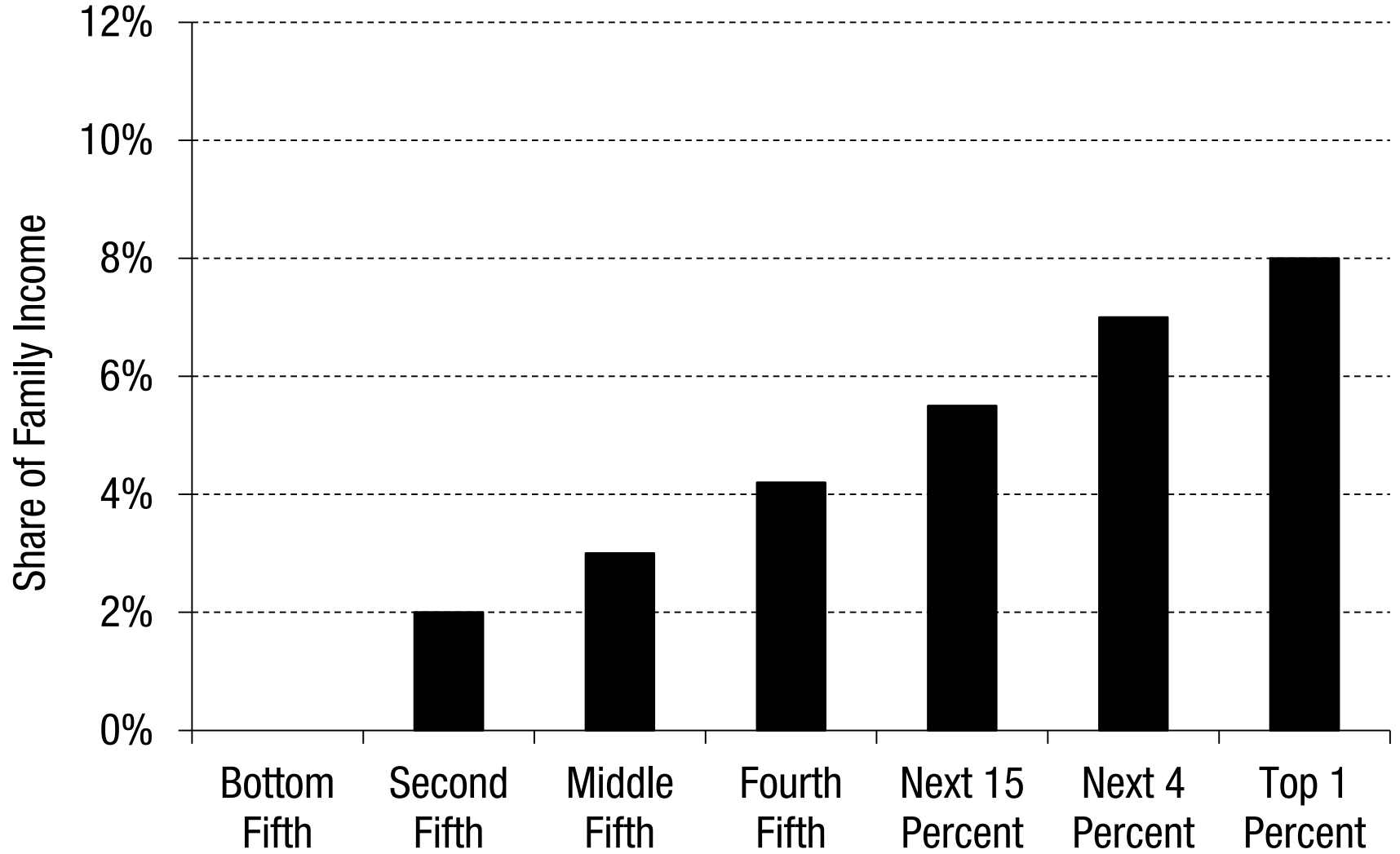


What is a “Fair” Tax System?

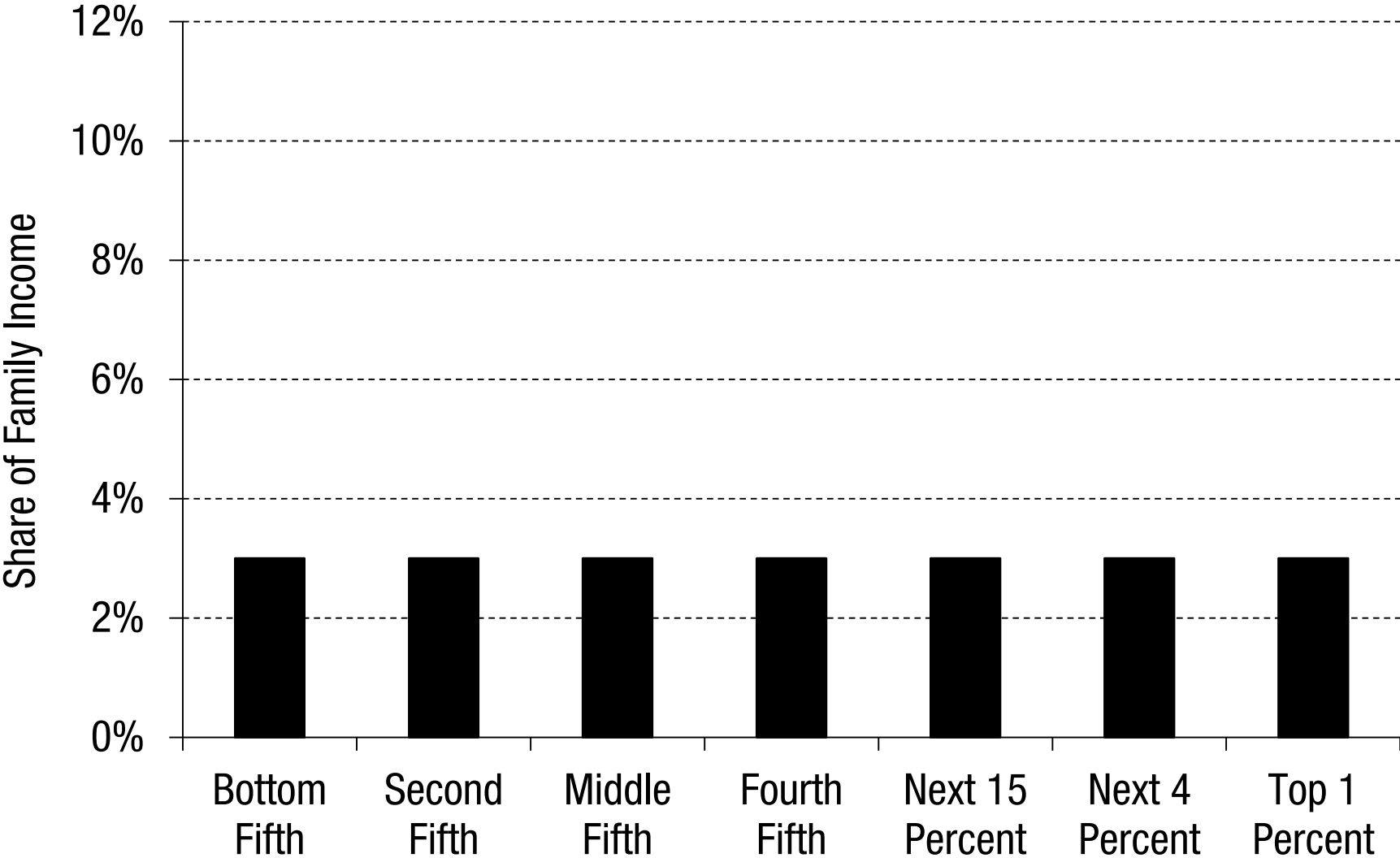
A fair tax system asks taxpayers to contribute to the cost of public services based on their ability to pay.



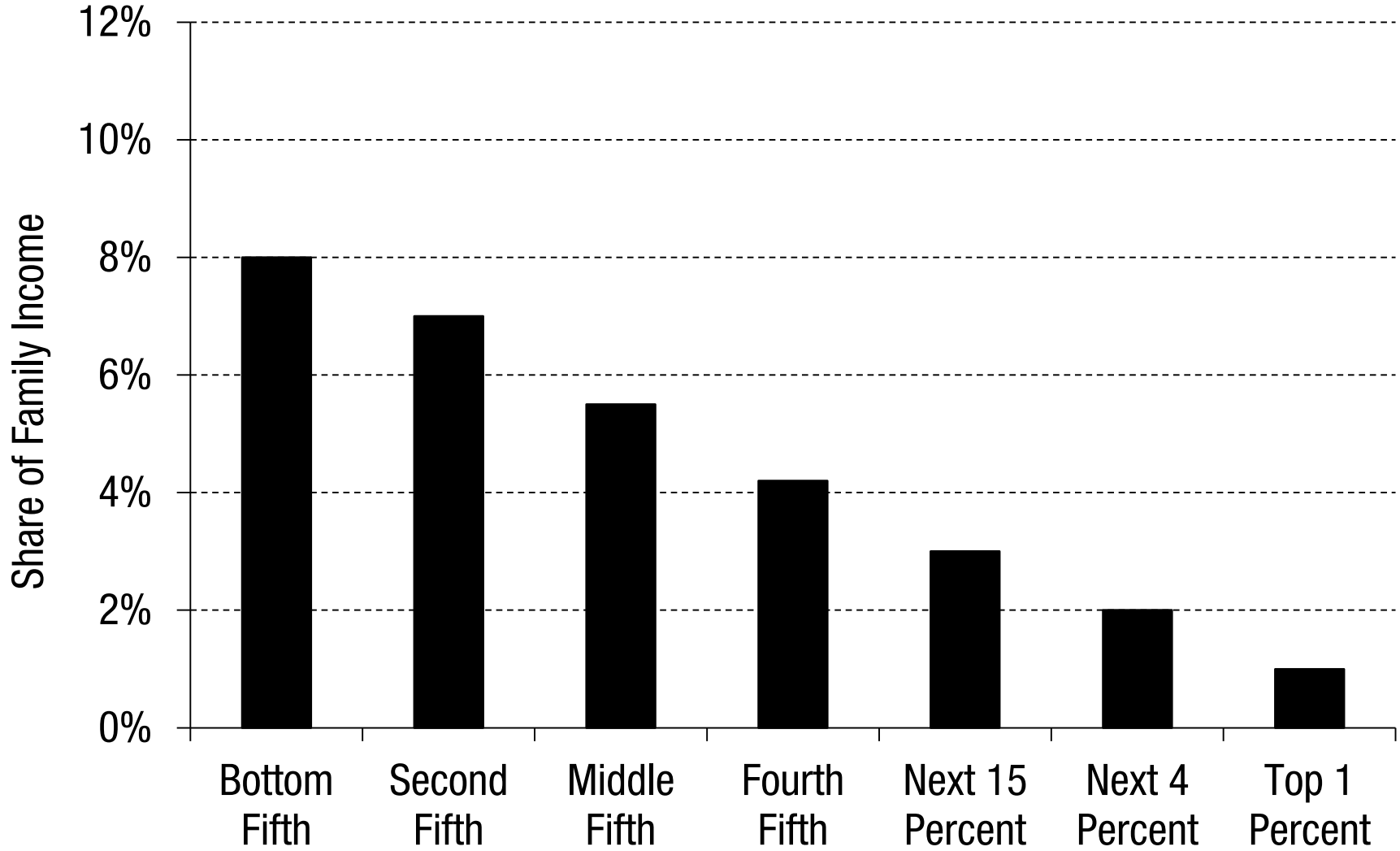
A Progressive Tax



A Proportional or "Flat" Tax

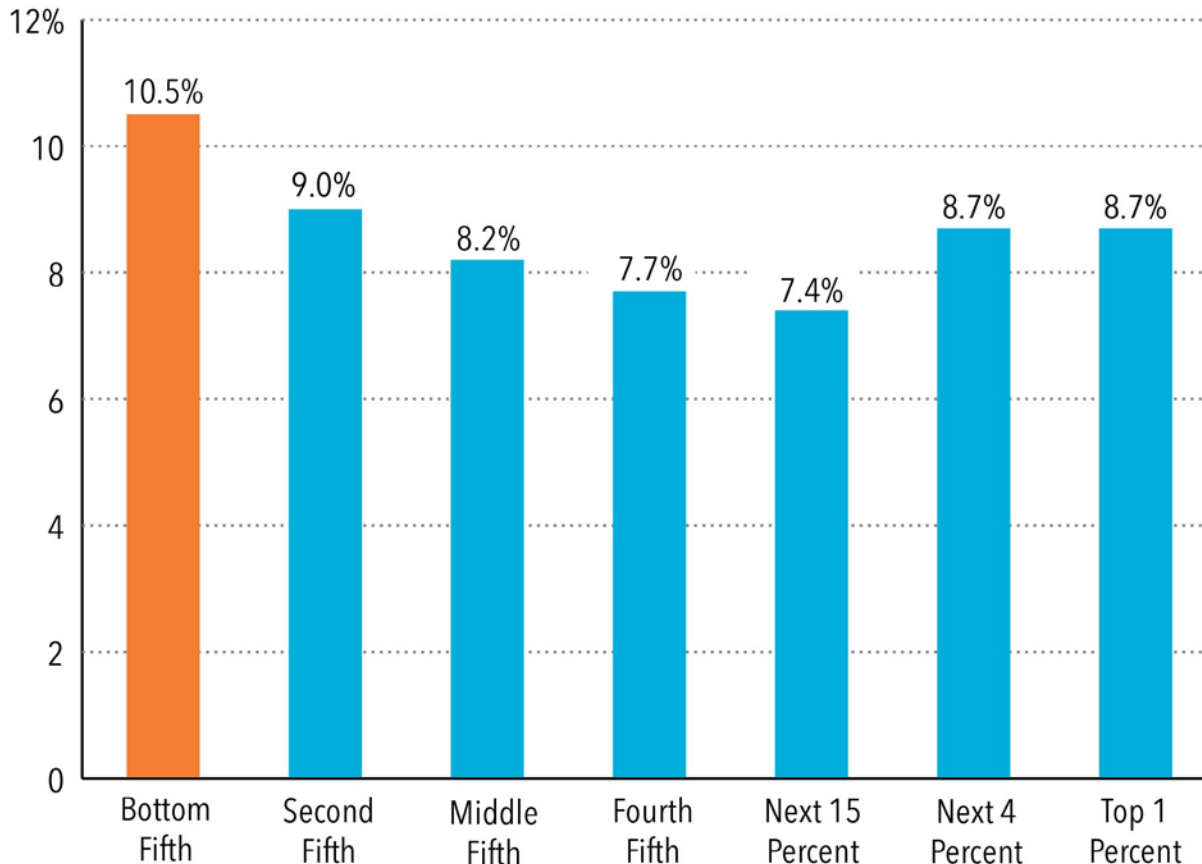


A Regressive Tax



California's Lowest-Income Families Pay the Largest Share of Their Incomes in State and Local Taxes

Average Percentage of Family Income Paid in State and Local Taxes



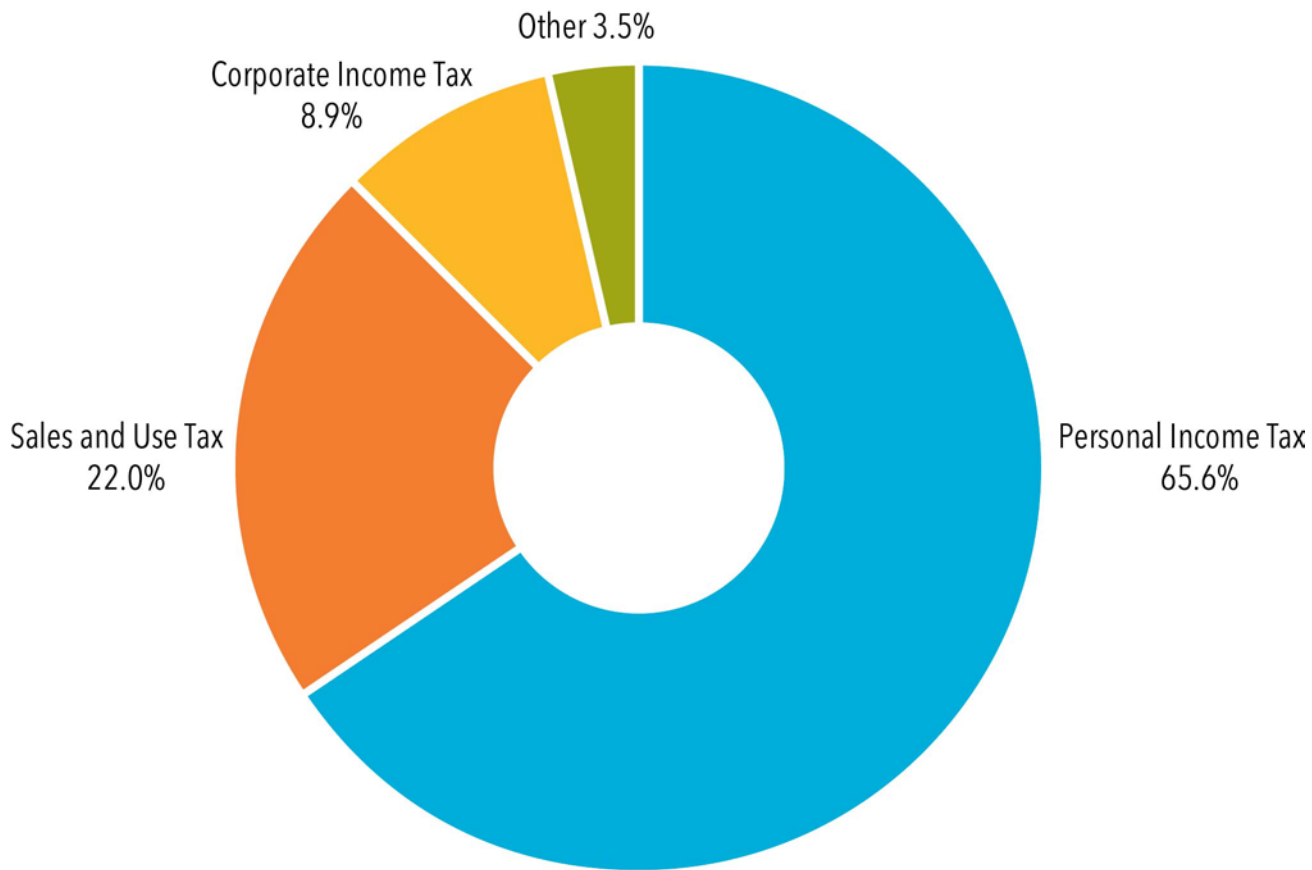
Note: Data are for nonelderly taxpayers only and include the impact of Proposition 30 temporary tax rates and the offset for federal deductibility of state and local taxes.

Source: Institute on Taxation and Economic Policy



The Personal Income Tax Is Projected to Account for Nearly Two-Thirds of California's General Fund Revenues

Projected 2015-16 General Fund Revenues and Transfers = \$114.6 Billion



Note: Reflects total projected General Fund revenues, including a \$1.2 billion transfer to the state's rainy day fund in 2015-16 as a result of Proposition 2, the ballot measure passed by voters in November 2014.

Source: Department of Finance



Reform Options: Extending Proposition 30 (or something similar)

Extending income tax rate increases on the state's highest earners and sales tax rates.



Proposition 30 (2012)

- **Temporary increases in the personal income tax (PIT):**
 - Added three new PIT rates for the highest-earning Californians;
 - The new rates expire at the end of 2018.
- **Temporary increases in the state sales tax rate:**
 - Increased the sales tax rate by ¼ cent;
 - The increased rate expires at the end of 2016.
- **Additional revenues:** Estimated at \$6 billion annually (likely higher given recent economic growth), declining in later years due to sales tax rate expiration.



Reform Options: Extending the Sales to (Some) Services

Current proposal would exclude education and health services; also includes changes to the state income tax system.



Senator Hertzberg's Proposal

- **Extend the state sales tax to (some) services:**
 - Exclude health care, education, and small businesses (undetermined asset threshold).
- **Adjust income tax rates:**
 - Reduce income tax rates on highest income earners;
 - Increase income tax rates on some higher-income earners;
 - Reduce corporate tax rates (& increase minimum wage)
- **Additional Revenues:** Estimate of \$4-10 billion annually (depending on the expiration of Prop. 30), allocated to:
 - Earned Income Tax Credit (EITC);
 - Local governments (infrastructure); and,
 - Higher education.



Reform Options: Corporate Property Tax Reform

Reforming the current property tax system to bring most commercial properties up to market value.



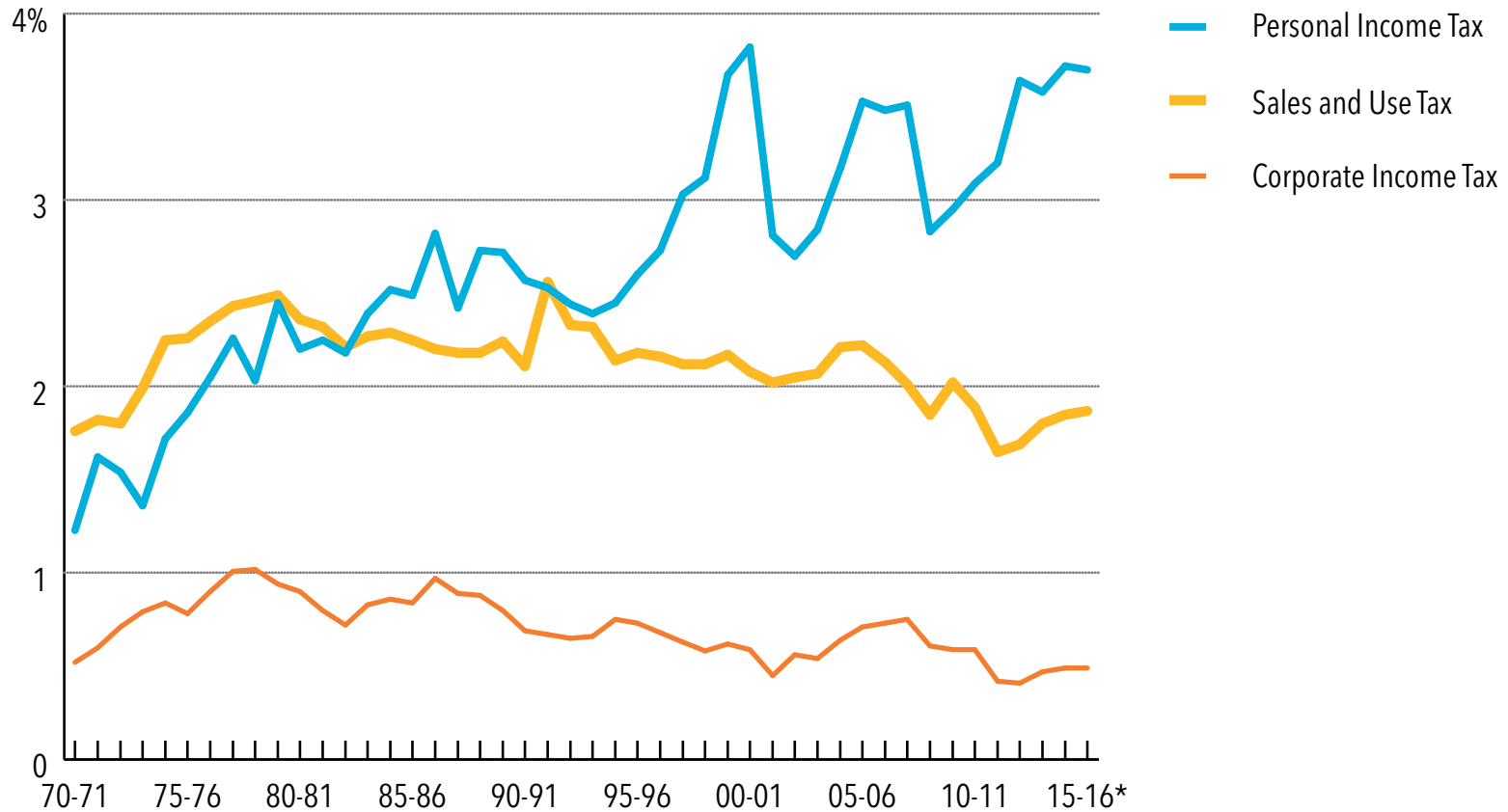
Corporate Property Tax Reform

- **Goal:** Bring commercial property up to market value (no change in rate).
- **Exemptions:**
 - Small businesses (up to \$500,000); phase-in for owner-operators with over 25% change in assessed value;
 - Residential property: homeowner-occupied and rental;
 - Commercial agricultural property.
- **Implementation:** Oldest properties reassessed first, phased in over several years.
- **Additional revenues:** Estimated at \$8-10 billion annually at full phase-in, allocated to:
 - School districts through a special fund;
 - Cities, counties, special districts via existing law;
 - Reimburses assessors for direct costs.



Personal Income Tax Revenues Have Continued to Grow While Sales and Corporate Income Taxes Declined

Major State Taxes As Percent of California Personal Income



Note: 14-15 revenues are estimated and 15-16 revenues are projected as of the 2015-16 May Revision.

Source: Department of Finance



The Big Variable: What Will the Governor Do?

Lead, follow, or stay out of the debate?



Other Proposals

- **Severance tax**
 - A tax on natural resource extraction (oil, natural gas);
 - California is the only state without a significant severance tax (state fee + county ad valorem).
- **Cigarette tax**
 - Per capita consumption declining since 1970s, but...
 - California's rate is lower than most other states.
- **Marijuana tax:** Potentially attached to a ballot measure to fully legalize marijuana in California.





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