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July 31, 2003

Hon. Bill Lockyer
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Tricia Knight
Initiative Coordinator

Dear Attorney General Lockyer:

Pursuant to Elections Code Section 9005, we have reviewed the statutory initiative relating to the vehicle license fee (File No. SA2003RF0027).

Background Information

Vehicle License Fee (VLF) Rate. The VLF is an annual fee levied in-lieu of the local property tax, and based on the depreciated value of the vehicle as set forth in statute. The VLF is collected by the state and allocated to local governments—cities and counties—based on population. In 1998, the Legislature began a series of reductions in the effective VLF rate, resulting in a decrease in the fee from 2 percent of the depreciated value to 0.65 percent, representing an overall decline of 67.5 percent. Based on 2001-02 data, the average VLF for an automobile owner is approximately $70. (The average VLF would be approximately $210 based on the 2 percent rate.) For individual taxpayers who itemize deductions and business taxpayers, the VLF is deductible from income—resulting in a lower tax liability than would otherwise occur.

VLF Revenues and Backfill. As a component of the VLF reduction, the state agreed to compensate—or "backfill"—local governments for their revenue losses from the General Fund. The state General Fund backfill, plus the amount still collected under the VLF from vehicle owners, are together equal to the amount that would have been collected under the 2 percent VLF rate. For 2002-03, the VLF backfill amount was approximately $4 billion and the VLF collected from vehicle owners was approximately $1.9 billion, for a total of $5.9 billion going to local governments

Increase in VLF and Elimination of VLF Backfill. Under current law, the VLF rate is to be increased (with a corresponding decrease in the VLF backfill) any time the state has "insufficient moneys" to make such backfills. The Department of Finance made a determination in June 2003 that the state would have insufficient moneys for 2003-04. As a consequence of this determination, the General Fund backfill payments ended, and beginning October 1, 2003, the VLF is scheduled to return to the full 2 percent rate.

Provisions of the Initiative

The initiative reduces the annual VLF to $1 per vehicle, which would result in annual revenues of approximately $30 million. The VLF backfill—which is currently based on a 2 percent VLF rate—would therefore be based on a VLF rate of only $1, resulting in the practical elimination of the VLF backfill.

Fiscal Effects of the Initiative

Vehicle Owners' Savings. The measure would result in tax relief for vehicle owners by reducing the basic VLF rate from 0.65 percent of the vehicle's depreciated value to $1. However, for years in which the insufficient moneys provision would have been in effect, the measure would reduce the rate from as much as 2 percent of the vehicle's depreciated value to $1. Thus, annual savings to vehicle owners in 2004-05 could range from approximately $2 billion (in normal budgetary times) to as much as $6.5 billion (in difficult budgetary times).

State Fiscal Effects. Under current law, the state is required to backfill the difference between the 2 percent statutory VLF rate and the 0.65 percent rate paid by vehicle owners—or approximately $4.5 billion in 2004-05. This measure would result in decreased annual state expenditures of approximately $4.5 billion, as the state would have only a minor backfill requirement. In the event, however, that the state had insufficient moneys to make future backfill payments (which under current law would trigger an increase in the VLF), the General Fund savings would be $0 since no backfill would have been required in those cases.

The state would also experience increases in personal income tax (PIT) and corporation tax (CT) revenues due to a decrease in VLF-related deductions and the corresponding increase in taxable income. Revenue gains to the General Fund from increased PIT and CT revenues would be roughly $200 million annually.

Local Government Fiscal Effects. As a result of the virtual elimination of the VLF and the VLF backfill, local governments would experience reduced revenues of approximately $6.5 billion annually.

Summary. The measure would have the following major fiscal effects:

- Annual state savings of up to $4.5 billion and additional income tax revenues of roughly $200 million annually.
- Local government revenue losses of approximately $6.5 billion annually.

Sincerely,

Elizabeth G. Hill
Legislative Analyst

Steve Peace
Director of Finance