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December 14, 2007

Hon. Edmund G. Brown Jr.
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Krystal Paris
Initiative Coordinator

Dear Attorney General Brown:

Pursuant to Elections Code Section 9005, we have reviewed the statutory initiative relating to state taxation (A.G. File No. 07-0080).

BACKGROUND

Residential and commercial property in California is subject to a local ad valorem property tax rate of up to 1 percent annually, plus any additional tax needed to pay off voter-approved indebtedness. For owner-occupied housing, the base value on which this tax is levied is reduced by a $7,000 homeowner's exemption.

The state also levies a personal income tax (PIT) on the California income of individuals and noncorporate businesses, such as sole proprietors and partnerships. The rates of the tax range from 1 percent to 9.3 percent, depending upon the taxpayer's income level. An extra 1 percent tax is levied on the portion of taxpayers' incomes greater than $1 million. The PIT allows various deductions from income and credits against any tax owed, including a credit available to renters whose adjusted gross income is $50,000 or less.

PROVISIONS OF THE INITIATIVE

Increases the Homeowner's Exemption. The measure raises the homeowner's exemption, beginning with the 2009-10 fiscal year, from $7,000 to the lesser of 25 percent of the full value of a dwelling or $100,000. After 2009-10, the $100,000 cap is adjusted annually for inflation.

Increases the Renter's Credit. The renter's credit is currently equal to $120 for married taxpayers filing jointly, heads of household, and surviving spouses; and $60 for other taxpayers. For taxable years beginning on or after January 1, 2009, the measure triples the amount of these renter's credits and indexes them annually for inflation beginning in 2010.

FISCAL EFFECTS OF THE INITIATIVE

Reduction in Property Taxes

We estimate that this measure would reduce property taxes by approximately $3 billion per year. The measure would increase state General Fund costs by an equivalent amount, because the state is constitutionally required to reimburse local governments for these reduced revenues.

Impact on Personal Income Taxes

This measure would produce two offsetting effects on PIT collections.

Increase in Renter's Credit. The increase in the renter's credit from this measure would reduce PIT collections by approximately $150 million annually.

Reduced Property Tax Deductions. The reduction in property taxes described above would result in a reduction in property tax itemized deductions reported on PIT returns. This would result in increased PIT revenues of approximately $200 million annually.

Summary of State and Local Fiscal Effects

This measure would have the following major fiscal effects:

- Increase in state costs of approximately $3 billion annually to compensate local governments for reduced property tax collections.
- Net increase in state personal income tax revenues of approximately $50 million annually from increases in the renters' credit and decreases in property tax deductions.

Sincerely,

Elizabeth G. Hill
Legislative Analyst

Michael C. Genest
Director of Finance