November 9, 2009

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 proposed statutory initiative related to the taxation of persons over the age of 55 (A.G. File No. 09-0045).

BACKGROUND

Personal Income Tax. The state levies a personal income tax (PIT) on the California income of individuals who reside in the state. Tax rates 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' income that exceeds $1 million. In 2007, California residents paid about $50 billion in PIT.

Property Tax. California's local governments levy a property tax on property owners. Statewide, the average property tax rate is 1.1 percent of the assessed value of property (a base 1 percent rate, plus additional amounts to pay off voter-approved debt). In 2006-07, Californians paid about $44 billion in property taxes, with almost 40 percent of this amount (about $17 billion) paid by homeowners for their owner-occupied home. Under California's property taxation system, owners who purchased their home years ago typically pay less property taxes than newer purchasers. Some local governments also levy parcel taxes and Mello-Roos taxes on property owners. The dollar amount of parcel and Mello-Roos taxes charged to property owners may vary by type or size of parcel, but these taxes are not to be imposed on an ad valorum basis.

Estate Tax. California's estate tax is collected as a portion of the federal estate tax in the form of a deduction for state estate taxes. Because the deduction is not currently in effect, the state does not collect revenue from this source. Under current federal law, however, the federal estate tax will be revised in 2011. If the deductions for state estate taxes are restored, then California will collect its portion of the estate tax and raise roughly $850 million in 2010–11 (a half-year effect) and $1.8 billion in 2011–12 and annually thereafter.

Proposal

The measure exempts all residents, beginning January 1 of the year *after* their 55th birthday, from "all forms of State of California income and property taxes." While the terms of the measure are not clear, we assume this exemption would apply to all personal income, property, parcel, and Mello-Roos taxes paid by residents over age 55. The measure also exempts heirs from any form of estate tax if the decedent was over age 55 at the time of his or her death.

Fiscal Effects

The measure makes major changes in the state and local tax system. Some of these changes could generate significant behavioral and economic responses from taxpayers. For example, people under 55 years of age might transfer property or income to spouses or other family members over 55 years old to avoid taxation. In addition, more people over age 55 might move to (or stay in) California, increasing the number of residents exempt from these taxes. In addition, as discussed below, data on taxation of Californians over 55 years old is limited. Given factors such as these, the fiscal estimates provided below are subject to considerable uncertainty.

Impact on State Taxes

Approximately 28 percent of adults in California are 55 years of age or older. While data regarding PIT paid by residents over 55 (and their spouses) are not readily available, research indicates that their incomes tend to be somewhat higher that other Californians.

Under this measure, residents over 55 would be exempt from all personal income taxation. In addition, some residents under 55 would pay lower PIT because their spouse's income would be exempt from taxation. Based on these factors, we estimate that the measure would reduce personal income taxes paid by California residents by about 30 percent—roughly $15 billion annually based on 2007 PIT collections.

The state also would receive fewer revenues from the planned future reactivation of the federal estate tax. This is because the measure exempts from taxation the estates of residents after they turn 55 years of age. Most Californians live for at least 55 years. As a result, the measure likely would virtually eliminate any estate tax revenues the state would receive from the reactivation of the federal estate tax.

Impact on Local Taxes

Limited data are available on the amount of property, parcel, and Mello-Roos taxes paid by California residents over 55 years of age. For these reasons, it is difficult to determine the revenue reduction that would occur from the proposed tax exemption.

Overall, we estimate that up to 20 percent of California property values would be exempt from taxation under this measure, reducing California property tax revenues by between $5 billion and $10 billion annually. This estimate is based on the assumption that residents over 55 years old own a roughly proportional share of owner-occupied housing and other noncommercial property.

Impact on State-Local Programs

The significant revenue reductions associated with this measure could trigger comparable reductions in state and local program spending. In particular, the measure would affect K-14 education's constitutionally mandated funding formula. The measure would reduce the minimum funding guarantee under the California Constitution (known as Proposition 98). This change would occur because the Constitution generally links the minimum funding amount to overall state revenues—and the measure's exemptions would reduce state revenues.

Summary of Fiscal Effect

The measure would have the following major fiscal effects:

- Annual state revenue losses of $15 billion or more due to new exemptions on personal income and estate taxation.
- Annual local government revenue losses of $5 billion to $10 billion due to new exemptions on property taxes.

Sincerely,

Mac Taylor
Legislative Analyst

Michael C. Genest
Director of Finance