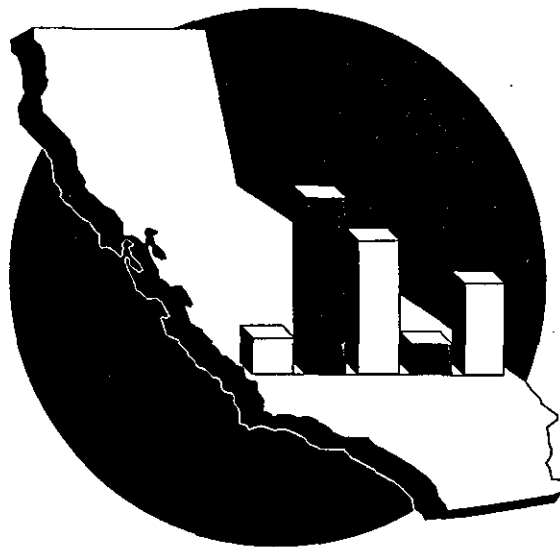


CALIFORNIA'S TAX STRUCTURE



LAO
50 years of service

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Presented to:
**Senate Revenue
and Taxation Committee**



California's Governments Levy A Wide Variety of Different Taxes

Taxes are the largest source of income for California's state and local governments. The figure summarizes the major taxes levied in California at both the state and local levels.

At the state government level:

- Major taxes and licenses account for over 98 percent of total General Fund revenues and transfers and over 93 percent of total state revenues.
- In addition to the taxes shown, the state collects motor vehicle license and registration fees, including weight fees.
- The state also collects a variety of other taxes and fees, including fish and game taxes, regulatory taxes and fees, and fees and charges to cover the cost of services to the public.

At the local government level, property taxes are by far the largest source of tax revenues.

State Taxes	Rate	Description
Personal Income	Marginal rates of 1 to 11 percent; AMT ^a rate of 8.5 percent	For the 1994 tax year, married couples who earn less than \$16,084 pay no tax. The 11 percent top rate applies to a couple's taxable income in excess of \$429,858.
Sales and Use Taxes	6 percent ^b	Applies to the final purchase price of tangible items.
Bank and Corporation Taxes—General Corporations	9.3 percent ^c ; AMT rate of 7 percent	Applies to the net income earned by corporations doing business in California.
Bank and Corporation Taxes—Financial Corporations	11.1 percent; AMT rate of 7 percent	Applies to the net income earned by financial corporations. A portion of the tax is in lieu of local personal property or business taxes.

Continued



State Taxes	Rate	Description
Vehicle Fuel Taxes	18 cents per gallon of gasoline or diesel fuel	Tax is collected from fuel distributors or wholesalers. Equivalent taxes are levied on other types of vehicle fuels.
Insurance Tax	2.35 percent	Tax is assessed on the gross premiums received by most types of insurance companies.
Alcohol and Cigarette Taxes	Wine and beer: 20 cents per gallon; Sparkling wine: 30 cents per gallon; Spirits: \$3.30 per gallon; Cigarettes: 37 cents per pack	Tax is collected from manufacturers or distributors.
Estate/Inheritance/Gift Taxes	0.8 to 16 percent	The estate tax is a "pickup" tax to take advantage of the maximum state credit allowed against the federal estate tax. The inheritance and gift taxes apply only to deaths and gifts prior to Proposition 6.
Horseracing License Fees/Taxes	0.5 to 6.45 percent	Fees/taxes are levied on amounts wagered.

Local Taxes	Rate	Description
Property Taxes	1 percent (plus amounts to pay off voter approved debt)	Tax is levied on the assessed value (usually based on purchase price plus a maximum annual inflation factor of 2 percent) of most real estate and various types of personal and business property (such as boats, airplanes, and business equipment).

Continued



Local Taxes	Rate	Description
Local Sales and Transaction Taxes	1.25 to 2.75 ^d percent	Collected with state sales and use tax. Revenues go to cities, counties, and special-purpose taxing districts.
Vehicle License Fees	2 percent	Tax is applied to original purchase price less depreciation as determined by statute. Tax is collected by the state and distributed to cities and counties.

^a AMT refers to the Alternative Minimum Tax.

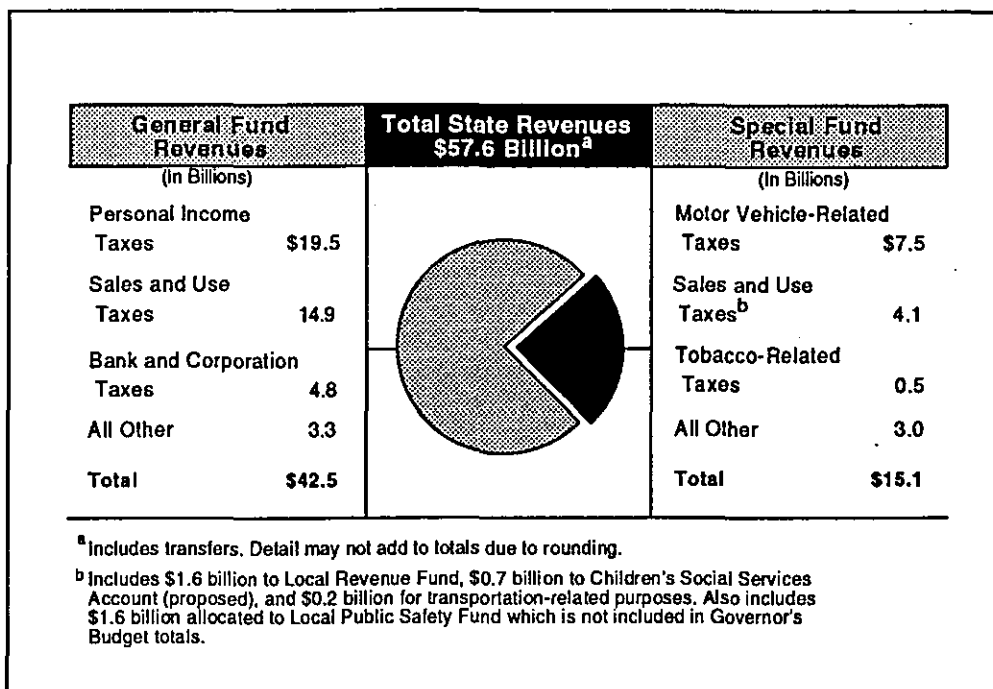
^b This rate includes all state-imposed tax rates including rates levied for program realignment and local public safety.

^c Sub-Chapter S corporations have a 1.5 percent tax rate.

^d Maximum allowable combined rate, except maximum is 3.00 percent in San Francisco and 3.25 percent in San Mateo County. Currently, the highest actual local rate in the state is 2.50 percent in San Francisco.



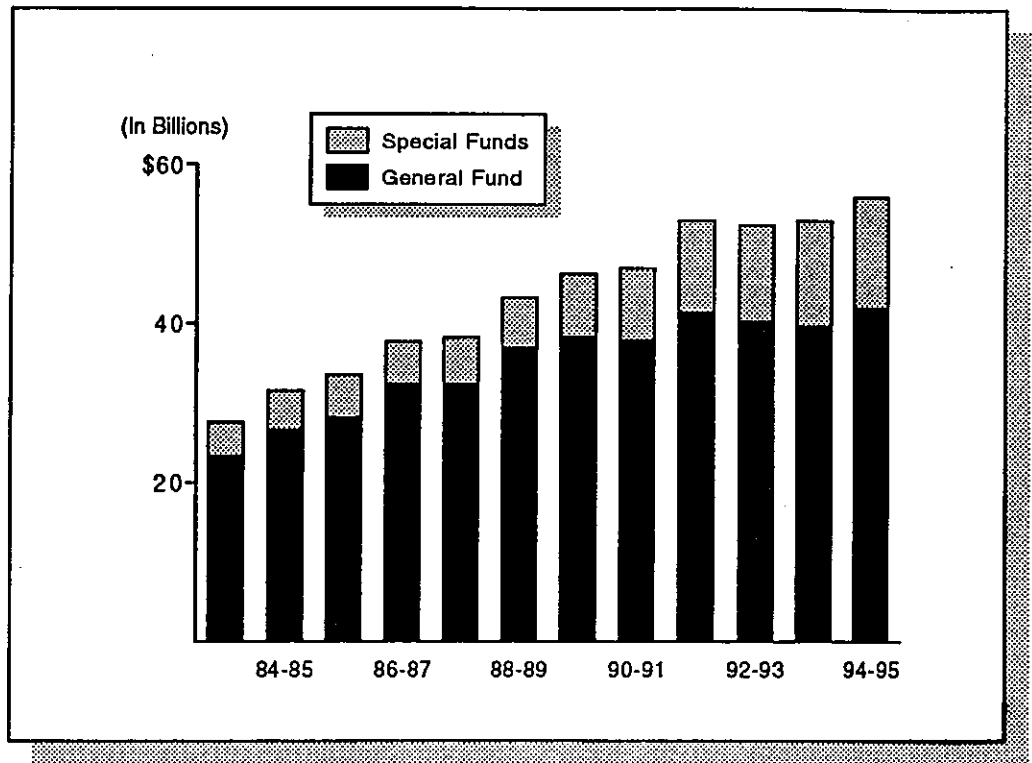
State Revenues in 1995-96



- General Fund revenues account for nearly three-fourths of total revenues.**
- Personal income taxes are the largest individual revenue source—over one-third of total revenues and 46 percent of General Fund revenues.**
- Special funds are usually earmarked for specific purposes, such as transportation funding. Motor vehicle-related levies account for half of all special fund revenues.**



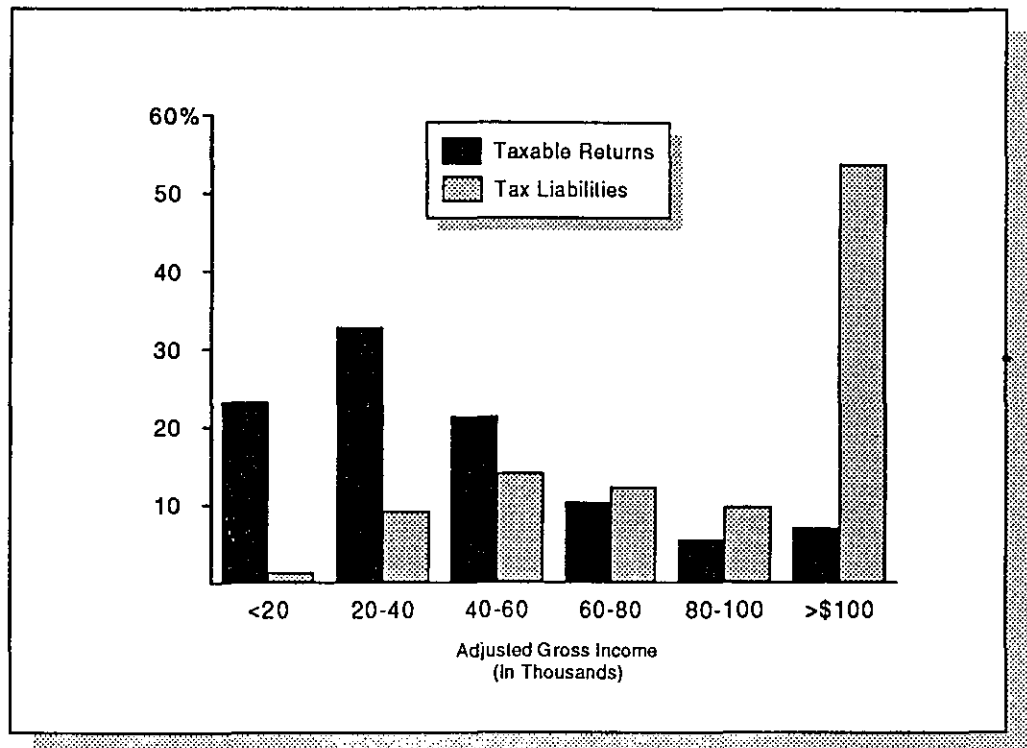
State Revenues Excluding Transfers 1983-84 Through 1994-95



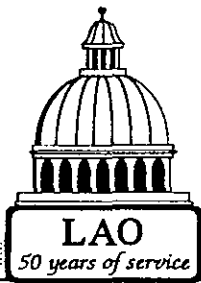
- ✓ Total state revenues have experienced little overall growth over the past four years.
- ✓ During the past 12 years, however, total revenue growth has averaged 6.6 percent.
- ✓ Average growth since 1983-84 has been faster for special fund revenues than for General Fund revenues—over 11 percent versus 5.5 percent.



Personal Income Taxpayers and Tax Liabilities By Income Class—1992



- California has a highly progressive personal income tax structure, meaning that as one's taxable income rises, so does one's average tax rate.
- The progressivity of the tax structure, when combined with the distribution of taxable income, determines the distribution of California's personal income tax burden.
- In 1992, the top 10 percent of taxpayers paid nearly 60 percent of all tax liabilities, and the top 1 percent of taxpayers paid almost 30 percent of all liabilities.



Sales and Use Tax Rates Imposed in California

	Current Law	Proposed
State		
General Fund	5.00%	4.78%
1991 program realignment (Local Revenue Fund)	0.50	0.50
Local Public Safety Fund ^a	0.50	0.50
1995 realignment proposal (Children's Social Services Account)	—	0.22
Totals, state	(6.00%)	(6.00%)
Local		
Uniform local taxes ^b	1.25%	1.25%
Optional local taxes ^c	1.50	1.50
Totals, local	(2.75%)	(2.75%)
Statewide maximum rate	8.75%	8.75%

^a These revenues are not shown in the Governor's Budget totals for the budget year, current year, or last half of 1993-94.

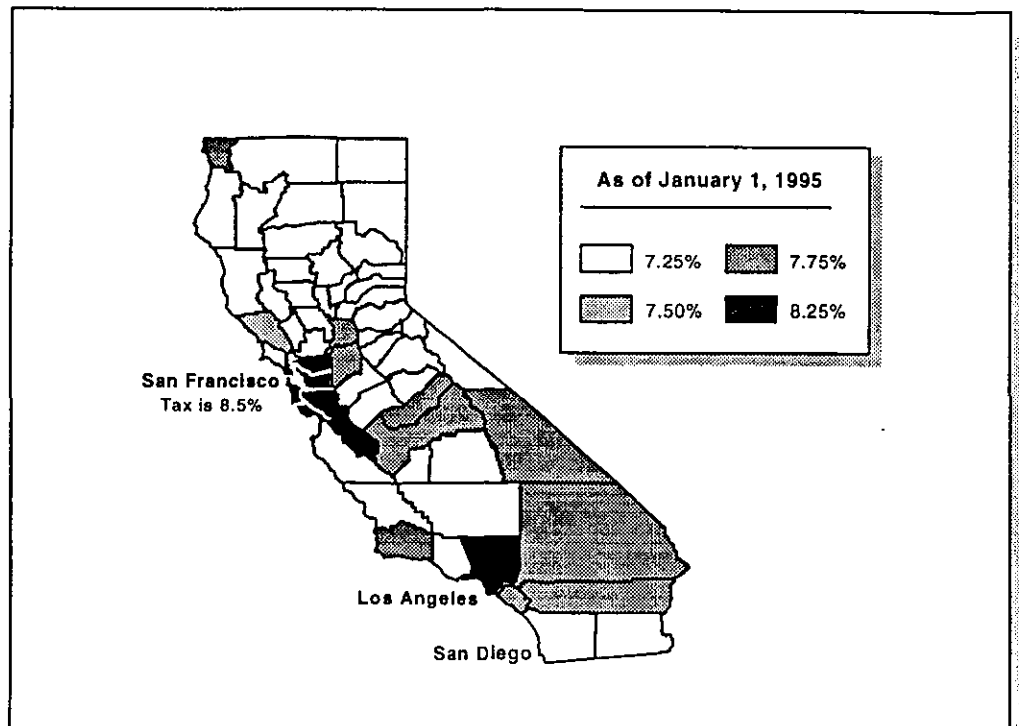
^b Levied in all counties.

^c Maximum allowable combined rate, except maximum combined rate is 1.75 percent in San Francisco and 2 percent in San Mateo.

- The overall sales and use tax rate actually consists of a number of different individual rates of tax.
- The maximum statewide rate is 8.75 percent, and the minimum is 7.25 percent.
- The Governor's realignment proposal would shift 0.2215 cents of the state sales tax to localities to pay for children's social services.



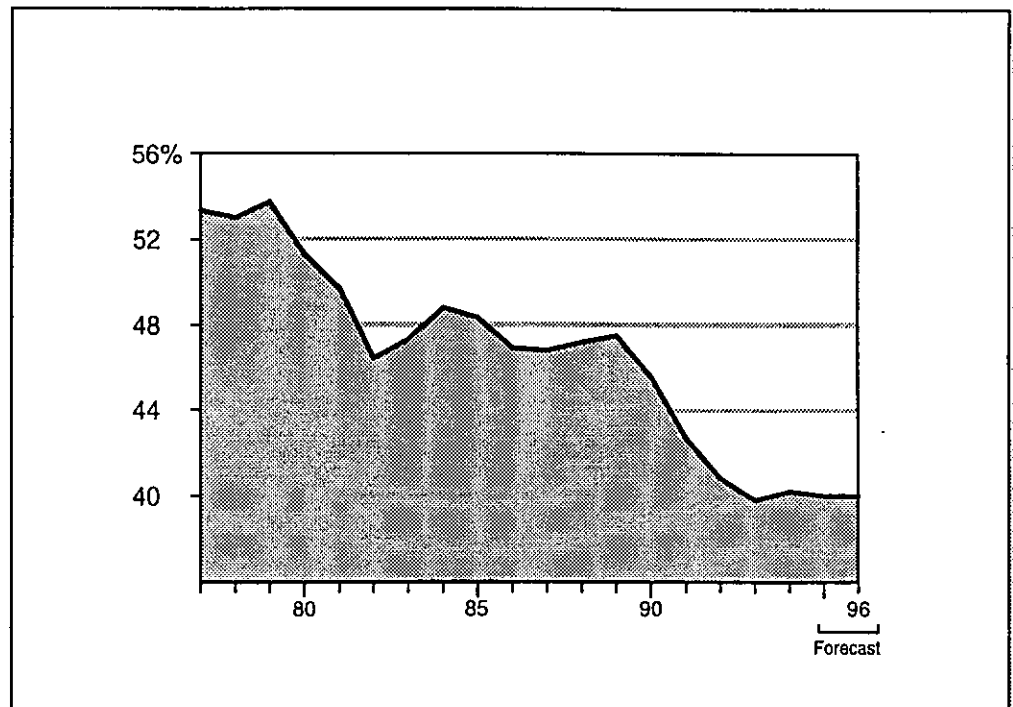
Sales Tax Rate Variations by County



- ✓ Sales tax rates vary by county because of the optional sales taxes which localities can choose to levy.
- ✓ Existing sales tax rates range from 7.25 percent in counties with no optional taxes, to 8.5 percent in the City and County of San Francisco.
- ✓ San Mateo and San Francisco can impose an additional 0.5 percent and 0.25 percent rates, respectively, beyond the 8.75 percent maximum statewide rate.



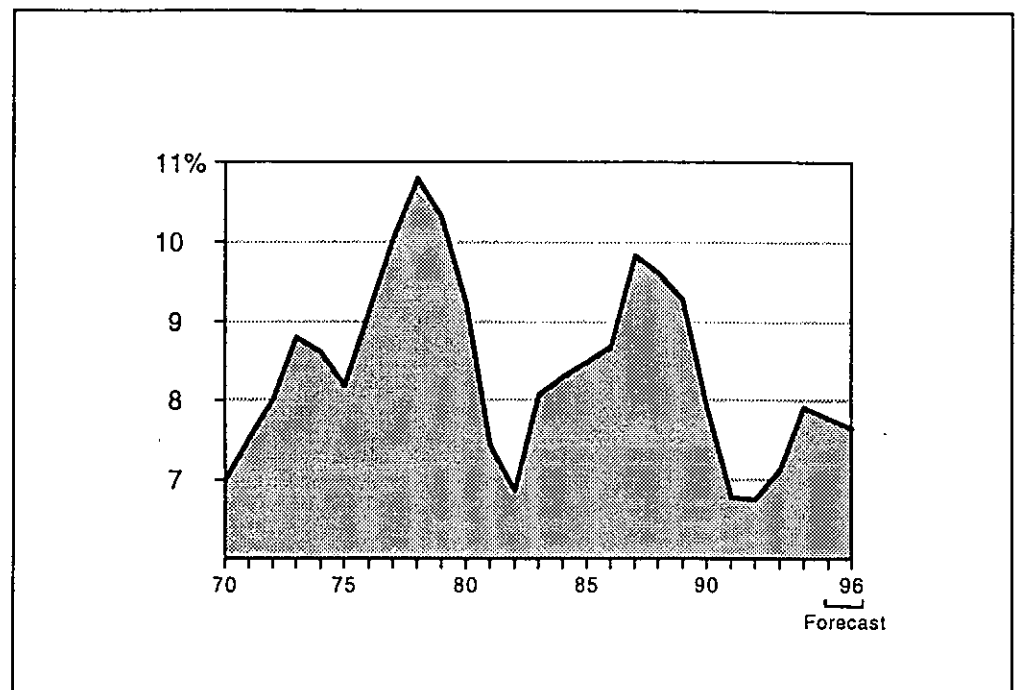
Taxable Sales As a Percent of Personal Income Has Declined Over Time



- ✓ **Taxable sales as a percent of personal income generally has followed a downward trend over the past 15-plus years.**
 - The ratio stood at 53 percent in 1977. It is estimated to be 40 percent in 1994, 1995 and 1996.
 - This decline has occurred in large part because of increased spending on services.
 - Future growth in sales tax revenue will be constrained to the extent that services continue to expand in importance.
- ✓ **California taxes fewer services than most states.**



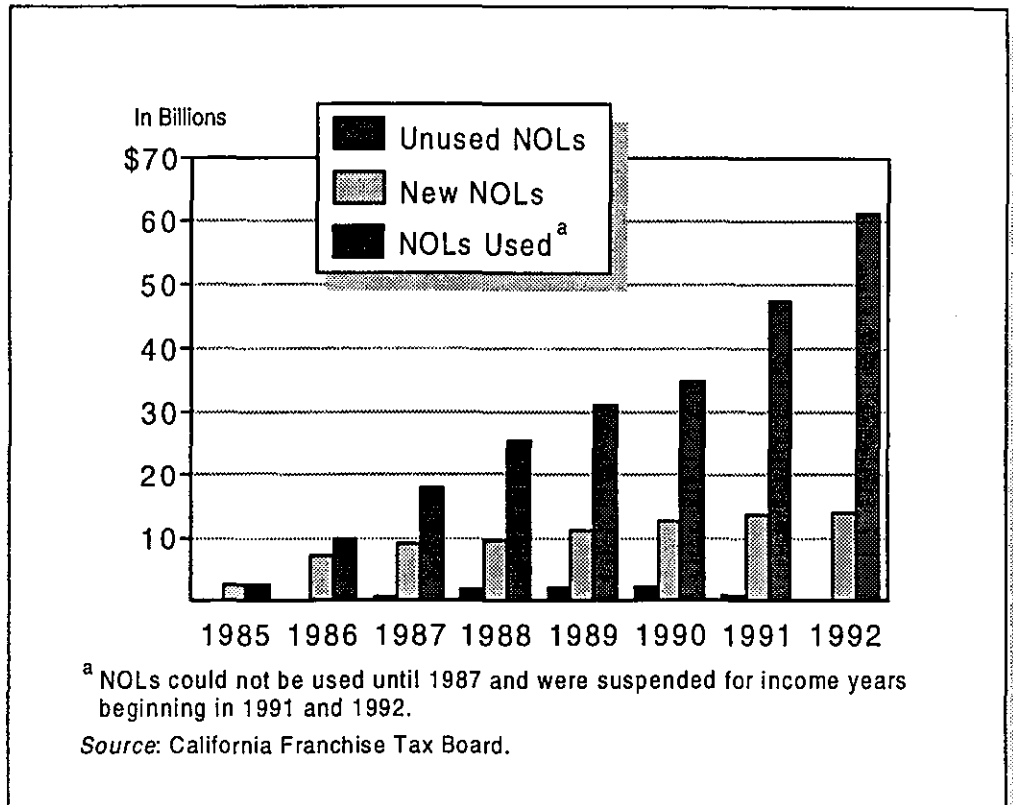
Taxable California Corporate Profits As a Percent of Personal Income—Continued Softness



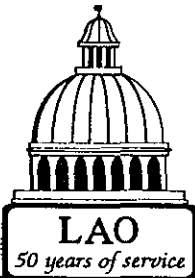
- ✓ The corporate profits ratio hit an all-time low in 1991-92, due to the recession.
- ✓ The current post-recession snapback has been weaker than in previous recoveries.
- ✓ There are a number of factors which may explain the recent softness in corporate profits. These include the recession, changes in industry mix, business relocations, and taxpayer noncompliance.



Net Operating Losses Will Constrain Revenue Growth



- ✓ The stock of unused carryforward net operating losses (NOLs) has the potential to significantly reduce bank and corporation tax revenues.
- ✓ As of 1992, the unused NOL stock totaled over \$60 billion. About 80 percent of this unused stock involves active corporations.
- ✓ Each \$1 billion of NOLs deducted can reduce tax revenues by over \$90 million.



State Revenue Effects of the Tax Reduction Proposal 1995-96 Through 1998-99

State Revenue Effects	1995-96	1996-97	1997-98	1998-99	Four-Year Total
Personal Income Tax					
Continuation of high-income tax brackets after 1995	\$0.3	\$0.8	\$0.9	\$1.0	\$3.0
Phase-in of 15 percent tax cut	-0.4	-1.5	-2.7	-3.6	-8.3
Net effect	(-\$0.1)	(-\$0.7)	(-\$1.9)	(-\$2.7)	(-\$5.3)
Bank and Corporation Tax					
Phase-in of 15 percent tax cut	-\$0.1	-\$0.4	-\$0.7	-\$1.0	-\$2.3
Total State Revenue Effect	-\$0.2	-\$1.1	-\$2.6	-\$3.6	-\$7.6

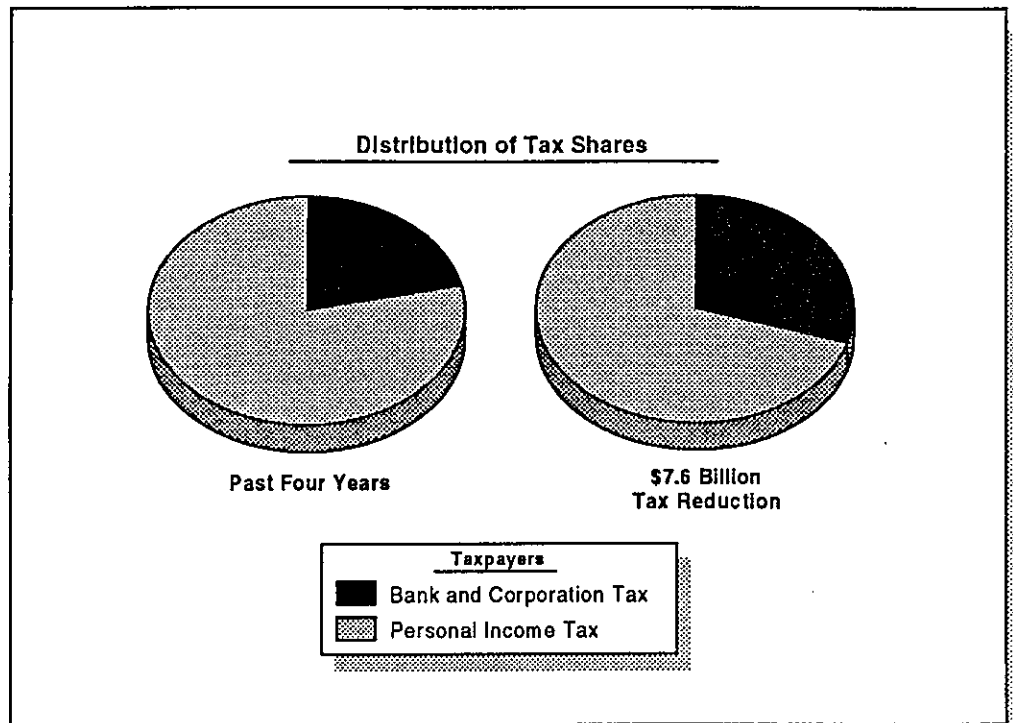
^a Source: Department of Finance. Detail may not add to totals due to rounding.

- The tax proposal has two parts:**
 - Extension of the 10 percent and 11 percent personal income tax brackets that are scheduled to expire after 1995.
 - A 15 percent phased-in income tax reduction for individuals and businesses.

- The budget estimates a total net cost of \$225 million for 1995-96 and \$7.6 billion through 1998-99.**



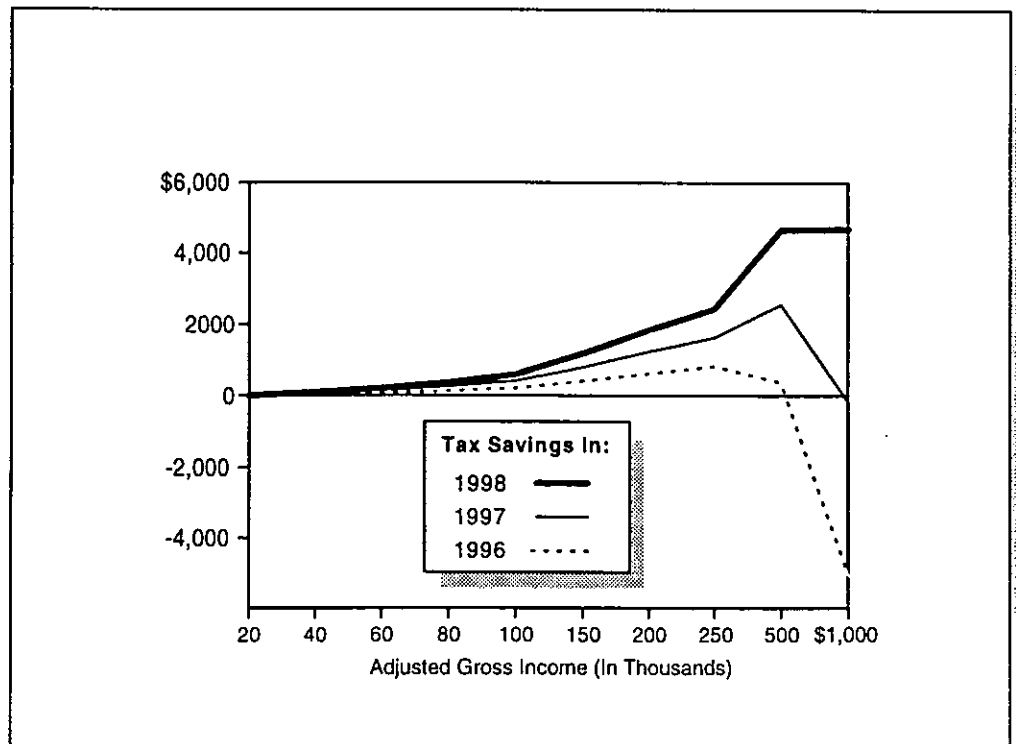
Distribution of Net Tax Reduction 1995-96 Through 1998-99



- Personal income taxpayers receive over 70 percent of net benefits.
- Personal income tax share of net benefits is less than its share of current-law taxes because of extension of high-income brackets.



State Tax Effects of Proposal On Individual Taxpayers By Year and Income Class 1996 Through 1998



- Benefits to taxpayers vary widely by year and income level.
- High-income taxpayers will initially pay more.
- Eventually, higher-income taxpayers get most of the benefits.



Savings From Tax Reduction Proposal 1996 Through 1998

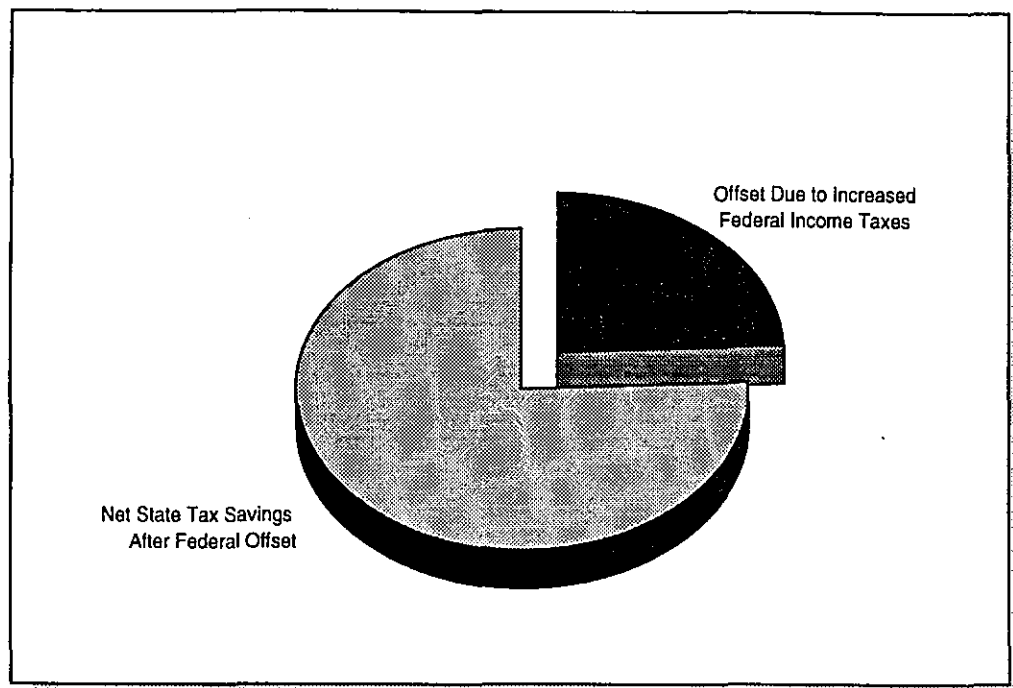
Adjusted Gross Income	1996		1997		1998	
	State Tax Savings	Net Tax Savings	State Tax Savings	Net Tax Savings	State Tax Savings	Net Tax Savings
\$20,000	\$0	\$0	\$0	\$0	\$0	\$0
40,000	34	29	66	56	96	82
60,000	74	63	142	121	206	175
80,000	130	94	252	181	365	263
100,000	210	151	407	293	593	427
150,000	410	283	807	557	1,193	823
200,000	628	402	1,244	858	1,849	1,276
250,000	826	529	1,639	1,049	2,441	1,563
500,000	384	232	2,562	1,547	4,666	2,818
1,000,000	-5,078	-3,067	-175	-106	4,896	2,957

^a Data are for a married couple filing jointly, with two children and average itemized deductions for their income level. Negative amounts reflect tax increases. Net savings equals state savings adjusted for related increases in federal income taxes (resulting from lower itemized deductions).

- Net tax savings will be less than total state tax savings because federal tax liabilities will rise.
- A married couple with 2 children and income under \$20,000 would receive no benefits.
- A similar household with income of \$1 million would pay more taxes in both 1996 and 1997, but have savings in 1998.



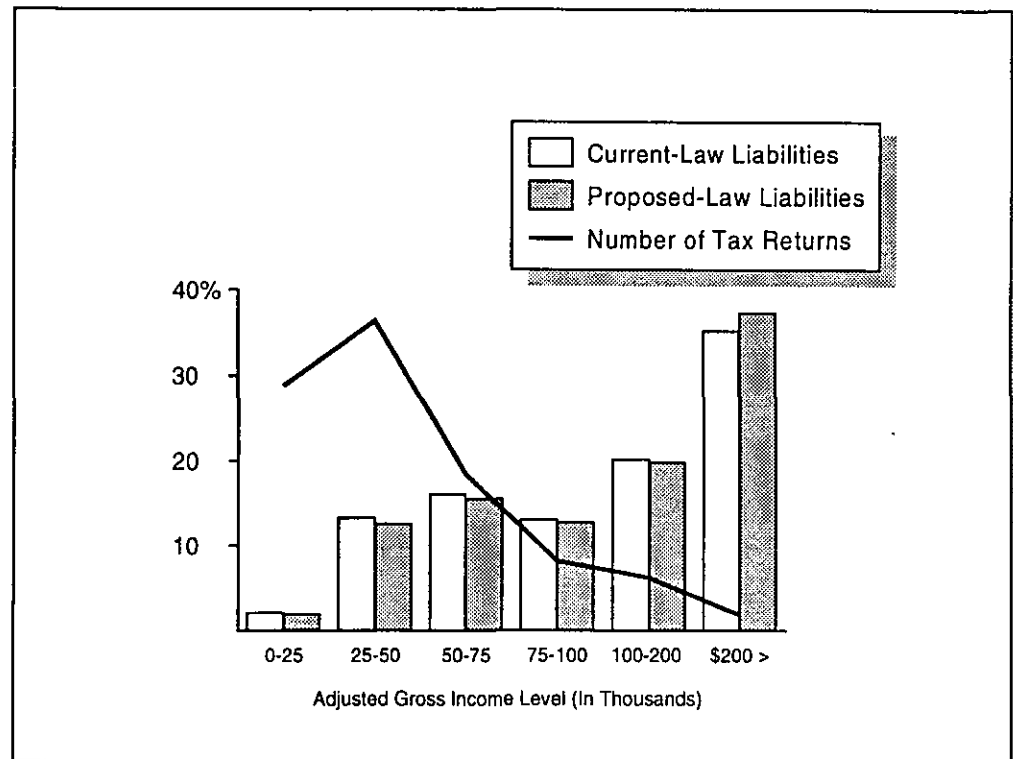
Total Versus Net State Tax Savings For Individuals and Businesses 1996 Through 1998



- About one-fourth of state tax savings will be paid to the federal government as increased federal income taxes.
- Federal taxes will increase because federal itemized deductions for state income taxes paid will fall.



Taxpayers and Tax Liabilities By Income Class—All California Residents 1998 Tax Year



- Taxpayers with income below \$200,000 will pay a smaller share of total tax liabilities in 1998 under the proposal.
- Higher-income taxpayers will pay a larger share of 1998 total tax liabilities than under current law.



Average Tax Rates Decline Under the Governor's Proposal

Adjusted Gross Income	Current Tax Law	Proposed Tax Law	Percentage Decline
\$0-25,000	0.77%	0.60%	22.1%
25,000-50,000	2.44	2.02	17.2
50,000-75,000	3.67	3.10	15.5
75,000-100,000	4.78	4.09	14.4
100,000-200,000	6.33	5.43	14.2
200,000-500,000	8.13	7.15	12.1
500,000-1,000,000	8.80	8.16	7.3
1,000,000 and over	9.08	8.92	1.8
Totals	4.43%	3.87%	12.6%

^a Rates are for all filing statuses (California residents only).

- By 1998, average tax rates (tax as a percent of income) fall for all taxpayers under the proposal.
- The statewide average tax rate falls by nearly 13 percent.
- However, the percentage decline in average tax rates becomes less as income rises.
- This means that the personal income tax structure becomes more progressive under the proposal.



Marginal Tax Rates For Western and Major Industrial States^a 1994

Personal Income Tax

California		1%-11%	
Other Western States		Other Industrial States	
Hawaii	2-10%	Massachusetts	5.95% income; 12% interest, dividends, capital gains
Oregon	5-9	New York	4-7.875
New Mexico	1.7-8.5	Ohio	.743-7.5
Idaho	2-8.2	New Jersey	1.7-6.58 ^b
Utah	2.55-7.2	Michigan	4.4
Arizona	3.25-6.9	Illinois	3
Colorado	5	Pennsylvania	2.8
Alaska	none	Florida	none
Nevada	none	Texas	none
Washington	none		

Corporate Income Tax

California		9.3%	
Other Western States		Other Industrial States	
Alaska	1-9.4%	Pennsylvania	10.99% ^b
Arizona	9	Massachusetts	9.5
Idaho	8	New Jersey	9 franchise; 7.25 income
New Mexico	4.8-7.6	New York	9
Oregon	6.6	Ohio	5.1-8.9
Hawaii	4.4-6.4	Florida	5.5
Colorado	5	Illinois	4.8
Utah	5	Michigan	2.3
Nevada	none	Texas	4.5 net taxable earned surplus
Washington	none ^c		

^a Percentages shown are general rates. Special rates may apply to certain categories of taxpayers.

^b Rates effective January 1, 1995.

^c Levies a business and occupation tax.

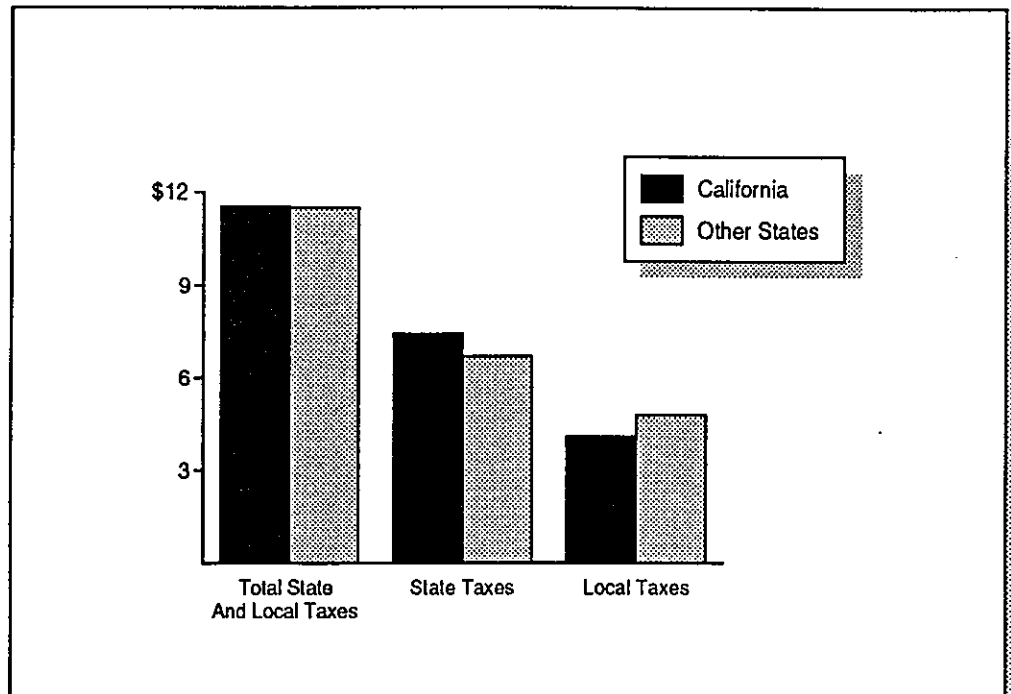


How California's Tax Rates Compare

- California has one of the most progressive tax structures among western and industrial states.
- California's marginal tax rates for low income individuals are among the lowest; however, high income Californians are taxed at one of the highest marginal rates among western and industrial states.
- California's corporate tax rate is comparable to many other major industrial states, but is one of the highest among neighboring western states.
- Tax rates are only one element of a tax structure. Other factors that should be considered when making interstate comparisons include deductions, exemptions, exclusions, and credits.



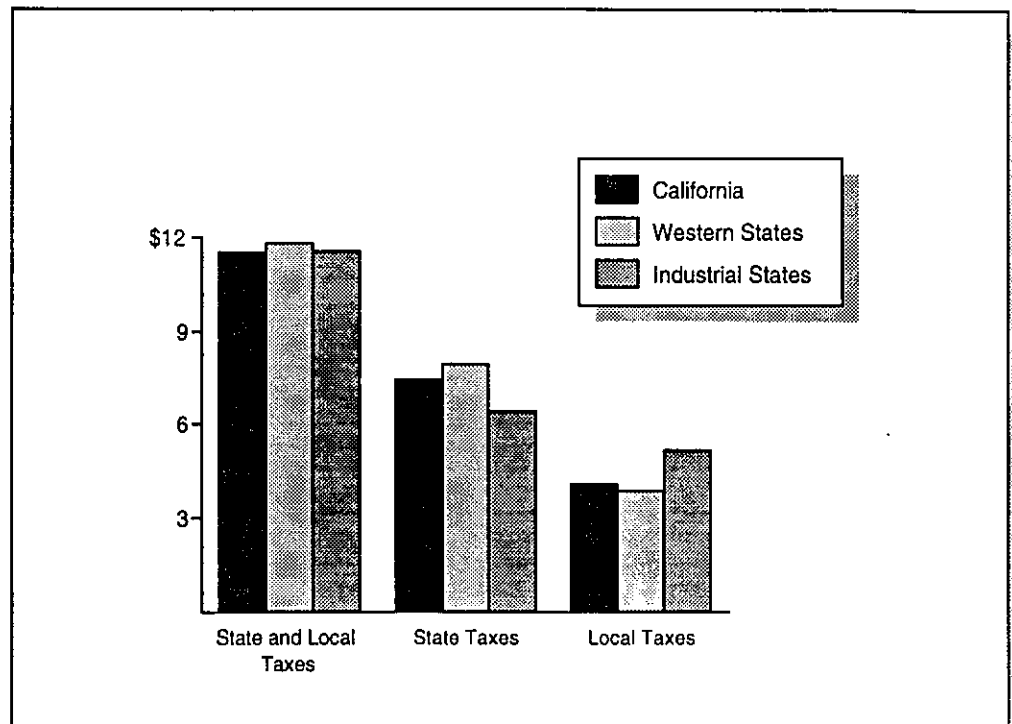
California Is About Average In Terms of Total Taxes Per \$100 Personal Income 1991-92



- ✓ Based on U.S. Department of Commerce data for 1991-92 (the most recent available), California state-local taxes per \$100 personal income are slightly above (less than one-half of one percent) other states.
- ✓ California state taxes are about 11 percent above and local taxes are about 14 percent below other states.



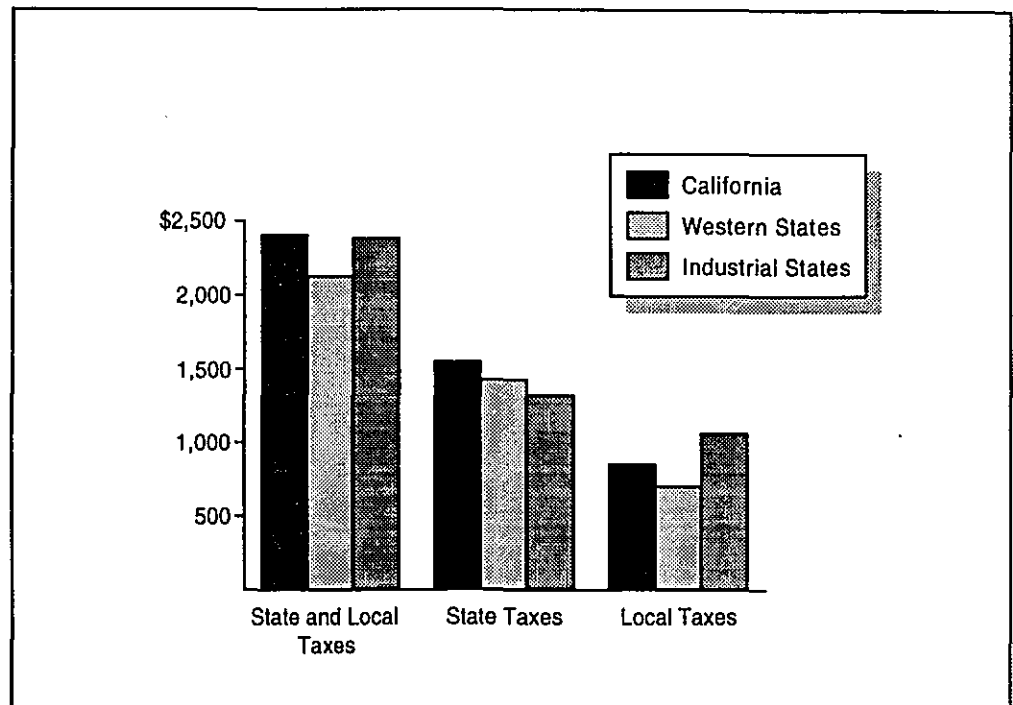
California Tax Revenues Per \$100 Personal Income Compared to Other Western and Industrial States—1991-92



- California's state-local taxes combined per \$100 personal income are below the average of other western and industrial states.
- California ranks between other western and industrial states in terms of both state taxes and local taxes.



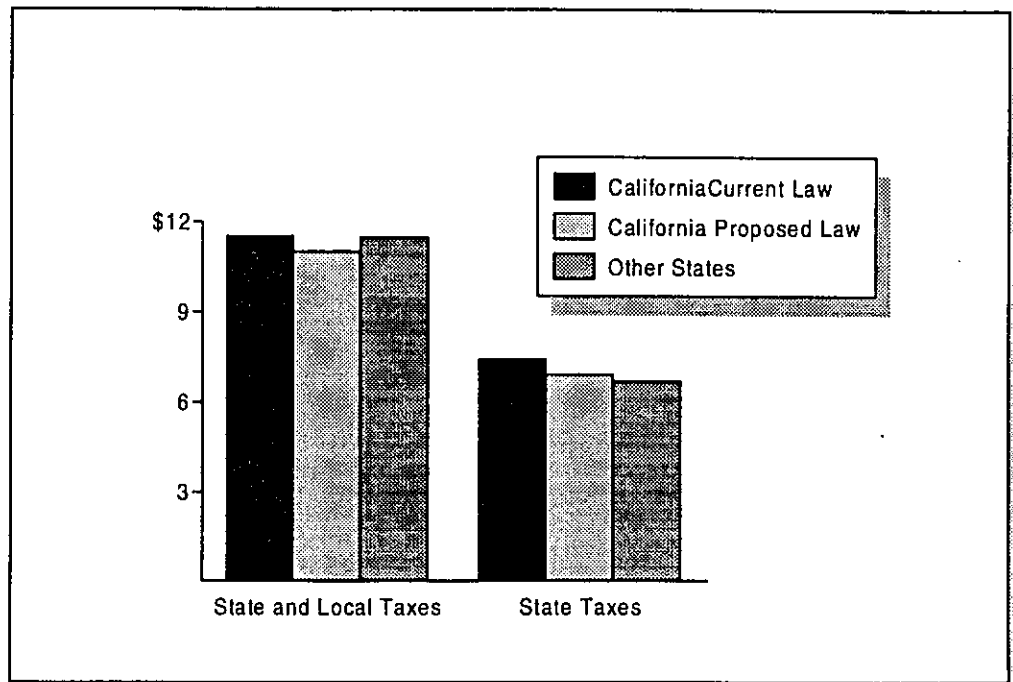
California Tax Revenues Per Capita Compared to Other Western and Industrial States—1991-92



- In per capita terms, California taxes exceed the average of other western states.
- California state-local taxes per capita combined are comparable to other industrial states— somewhat higher for state taxes and lower for local taxes.



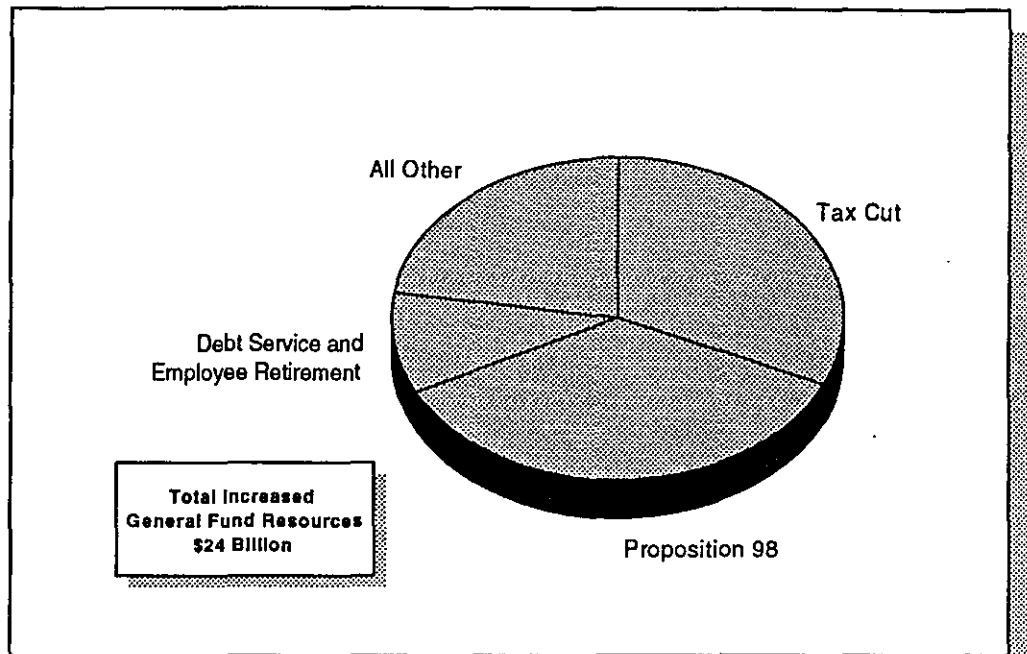
Illustrative Effect of Tax Proposal on Taxes Per \$100 Personal Income 1991-92



- Had the tax proposal been in effect in 1991-92, California state-local taxes would have switched from being slightly above (less than one-half of a percent) to somewhat below (4 percent) the average.



Distribution of Increased Resources 1995-96 Through 1998-99



- Assuming moderate economic and revenue growth, we estimate there will be \$24 billion of increased General Fund resources over the next four years than if revenues stayed at their 1994-95 level.
- The tax proposal would absorb nearly one-third of these new resources.
- Proposition 98 funding would decrease by \$3.9 billion as a result of the tax reduction.