

## Appendix A

### THE TAX PICTURE IN CALIFORNIA

If a picture were drawn of California's tax system, it would be grotesque and misshapen. The impact of state and local taxes is regressive, illogical, wasteful and unfair.

The total revenues raised by state and local taxes in fiscal year 1974-75 were approximately \$22.3 billion, twice the size of the 1968-69 fiscal year tax effort. Although every penny of this gigantic sum will receive budgetary review from some public body each year, the revenue and tax laws which raise this money will not. It is hardly surprising that tax loopholes, shelters and inequities go unnoticed. And, thus, it is not surprising that California's tax system requires a major overhaul, instead of the present piecemeal and casual efforts given to tax reform.

The three major tax sources for government in California are the property tax, the sales and use tax, and the personal income tax. Two of the three, the property tax and the sales and use tax, are regressive.

The combined impact of state and local taxes on the average taxpayer is unfair. Table One demonstrates that a taxpayer in the lowest income brackets pays a higher percentage of income in taxes than does a taxpayer in the high income brackets. Most startlingly, however, is the fact that this graph does not consider the special tax privileges, benefits, or shelters enjoyed by some taxpayers.

The biggest tax in California is the property tax. It will raise

over \$7.3 billion. The sales and use tax raises \$4.7 billion in state and local revenues. The personal income tax, which will raise \$3 billion, runs third. The corporate income tax will raise only \$1.4 billion --- less than the revenue from gasoline and motor vehicle taxes (\$1.5 billion). Inheritance taxes on rich people's fortunes will raise \$233 million.

#### Property Tax:

The property tax, which draws the most media coverage and, thus, political attention is the most regressive of the three major tax sources. Table Two demonstrates the regressivity of the property tax. In addition, the property tax is the single largest revenue source for state and local government.

The reason the property tax is regressive is that it is basically a tax on housing. Since low and moderate income families spend a higher portion of their incomes on housing than do rich families, they pay a higher portion of their incomes in property taxes.

The homeowner--- who gets his or her property tax bill twice a year, or has property tax payments impounded monthly by a bank --- knows how bad the property tax is. Though property tax rates vary throughout the state, the average rate this year is about 12 percent of assessed value or 3% of market value.

The married homeowner with two children in the \$5000 a year income bracket pays 4.8% of his income to property taxes. The same taxpayer, but with a \$50,000 income per year, pays 2.8% of his income to property taxes.

Renters are hit just as hard by the property tax, although they may not realize it because they don't receive a property tax bill.

The landlord is the one who gets the tax bill, but most landlords turn around and include the property tax in the rent bill. So the renter winds up paying the tax in the end.

The Legislature has responded to the property taxpayers' complaints, but in a manner which is neither equitable nor satisfactory. For example, it is axiomatic that renters also pay property taxes, albeit indirectly. Roughly, one-half of all Californians rent their residences. The median income for renters is \$10,200; the median income for homeowners in California is \$18,300. Homeowners' property tax relief costs \$750 million per annum. Renters' property tax relief costs \$125 million.

A second example is the homeowners property tax exemption which saves every homeowner about \$200.00 a year. Every homeowner, no matter how wealthy, receives the benefits of the homeowners' property tax exemption, except welfare recipient homeowners who are specifically prevented by state law from receiving the exemption.

Another example is the senior citizens property tax relief program which is excellent tax relief legislation, but which only helps homeowners over the age of 62, does not include an inflation factor to keep pace with rising assessments, fails to aid the middle income homeowner who is also victimized by the property tax, and does not reach the elderly renter.

The state's property tax relief programs represent a scattergun approach to a difficult problem. They are short term, expensive solutions to the property tax relief issue. The long term solution lies in shifting governmental programs, such as education, Medi-Cal and welfare, off the property tax and onto a progressive tax source like the income tax.

Sales and Use Tax:

The Sales and Use Tax clearly hits the low-income consumer harder than the wealthier consumer (See Table Three). The Sales and Use Tax is generally considered a popular tax because taxpayers do not feel the regressive impact of this tax since it is paid in extremely small increments and appears fair. Because of its relative popularity, the sales tax has been a favorite source of new state revenues in order to fund property tax relief. In effect, the shift is from one regressive tax to another. The homeowner benefits; the consumer suffers. Both deserve a progressive tax system.

The sales tax in California is at an all-time high of 6 percent (6½ percent in BART counties). When first enacted in 1933, the sales tax was only 2½ percent. In addition, there are especially high sales taxes --- called "excise taxes" --- on gasoline, cigarettes and liquor.

Moreover, the sales tax is riddled with exemptions which provide unnecessary tax breaks. For example, caviar and cosmetic surgery are exempt from the sales tax.

Currently, income tax payers who itemize deductions can deduct sales taxes paid from their taxable income. But that doesn't help the majority of moderate income Californians who are hardest hit by the sales tax and who claim the standard deduction. One alternative for sales tax relief is a credit on the state income tax, with the largest credit going to those with the smallest incomes. Eight states, including Massachusetts, Colorado, Hawaii and Vermont, already have such a credit.

Personal Income Tax:

The Personal Income Tax is the state's only progressive tax,

but it is underutilized. California's income tax accounts for only 13.5% of all governmental revenues.

The income tax is undermined and distorted by deductions, preferential tax treatments, undeclared income, incentives and disincentives and sheltered income. We know, for example, that Ronald Reagan paid no state income tax for two years, and Reagan is not a poor man.

A typical example is preferential treatment of capital gains, the tax term for profits from the sale of real estate, corporate stock or other assets. A dollar earned from hard labor is taxed fully, yet only half of the profit from these capital investments is taxed. This \$100 million loophole provides absolutely no incentive to investment. Even if it did encourage investment, the tax benefit is not restricted to investments in California. Most certainly, the loophole is unfair to the general taxpayer who must pay higher taxes to make up the lost state revenue.

California's income tax rates are also in need of improvement. When the state income tax was first enacted in 1935, the rates ranged from 1 to 15 percent of income. Now the highest rate is 11 percent, which is lower than the top tax rate in some other states. This means that the marginal tax rate is no higher on a millionaire than on a single person earning \$15,500.

#### The Federal Tax Impact:

The federal tax system must also be considered. The average Californian pays more in federal taxes than he or she does in combined state and local taxes. The total state and local tax effort raises \$22.3 billion while Californians pay \$30 billion in federal taxes.

## Possible Benefits

# A Close Look at the Tax Justice Bill (SB 540)

### 1 Raise marginal rates for high income people.

The present rate schedule levies a flat 11% marginal rate on all income above \$31,000. We would add additional income brackets as follows:

\$ 34,000 to \$ 37,000	at 12%
37,000 to 40,000	at 13%
40,000 to 43,000	at 14%
43,000 to 46,000	at 15%
46,000 to 50,000	at 16%
50,000 to 60,000	at 17%
60,000 to 70,000	at 18%
70,000 to 80,000	at 19%
80,000 to 100,000	at 20%
100,000 to 150,000	at 21%
150,000 to 250,000	at 22%
250,000 and over	at 23%

Note that these are marginal rates. The overall effective rates will be much lower. For example, the effective rate on a \$50,000 income person who pays at a marginal rate of 11% under current law is only 5.5%.

### 2 Establish a refundable tax credit.

Like the present renters' credit, this credit would be refundable. People with no tax liability would still receive the credit as a supplement to their income tax refund. Like the Senior Citizens Property Tax Assistance, this credit would be progressive—the lower the person's income, the larger the credit. The largest refund, \$150, would go to those making less than \$4,000. The credit decreases in increments of \$15 per \$1,000 of income. So a person with an income between \$4,000 and \$4,999 would receive \$135 credit; one who earns from \$5-5,999 would get \$120 credit, and so on. Persons with incomes over \$15,000 would be ineligible for the credit.

### 3 Reinstate the intangible property tax.

A 0.4% tax would be imposed on personally held intangible property in excess of \$30,000. Currently,

homeowners and renters pay annual property taxes equal to about three percent of the fair market price of their residences. Everybody pays this tax because everybody lives somewhere. But property that is concentrated in the hands of a very small percentage of the population, like stocks, bonds and franchises, is tax free. We propose a small tax of 0.4%, the maximum allowed by the State Constitution, and exempt entirely those people owning less than \$30,000 of such property and the first \$30,000 for those who own more. An intangible tax was levied in California until the early part of this century.

### 4 End the percentage depletion allowance for minerals.

Treat oil, gas and some fifty other minerals like any other business. Limit depletion to actual cost.

### 5 Impose a severance tax on minerals and timber.

A 2% severance tax would be imposed on minerals and timber to encourage conservation of scarce resources. Currently, the percentage depletion allowance encourages extraction.

### 6 Eliminate preference income.

Preference income is the privilege given to income from capital gains, stock options, excess investment interest, and accelerated depreciation. Tax income from these items along with wages at ordinary rates. Exclude the first \$1,000 of income from capital gains from taxation thus providing an investment incentive for moderate income taxpayers, those with incomes of about \$20,000 or less. This provision will close the largest loopholes in the state income tax but prevent any tax increase on the small investor and can actually provide an investment incentive by making the first \$1,000 of capital gains tax free. Homes would be exempted from any capital gains taxes.

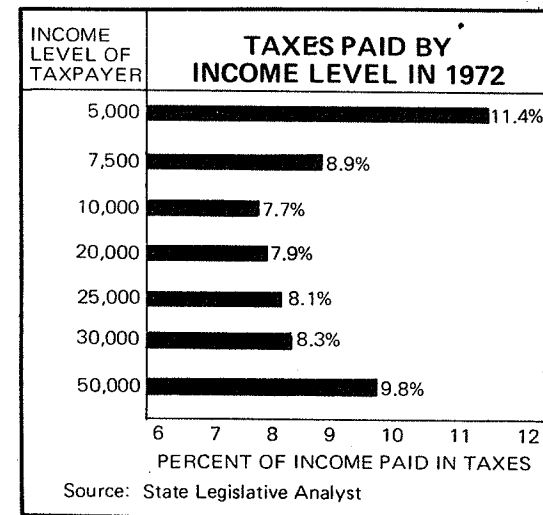
### 7 Double the exemption credit for single taxpayers.

Single people would be allowed to claim a \$50 exemption credit, the same as married couples.

### 8 Tax capital gains at death.

This closes the most glaring loophole which today permits income from property sold after the owner's death to escape taxation.

## Who Benefits Now?



The present property, sales and income tax structure works against modest income taxpayers. A California taxpayer making \$5,000 ends up paying a higher proportion of income to state and local government than a person making \$50,000.

The Tax Justice Bill will turn the system right side up.

From the Reader of the Conference on Alternative State & Local Public Policies held June 10-13, 1976 in Austin, Texas. The reader was edited and compiled by Derek Shearer, California Public Policy Center Los Angeles, California and Lee Webb, Professor of Public Policy, Goddard College Plainfield, Vermont.

This item was made available by the Cornell University Library.

From Collection #6756, Conference On Alternative State And Local Policies Records.

### **Copyright and Permissions**

Most of the items included in the Reader on Alternative Public Policies were published without copyright notice and hence entered the public domain upon initial publication. Some of the items found in the Reader are still subject to copyright. In some cases, even after extensive research efforts, we were unable to identify a possible rightsholder. We have elected to place the items in the online collection as an exercise of fair use for strictly non-commercial educational uses.

The Cornell University Library provides access to these materials for educational and research purposes and makes no warranty with regard to their use for other purposes. Responsibility for making an independent legal assessment of an item and securing any necessary permissions ultimately rests with persons desiring to use the item. The written permission of the copyright owners and/or holders of other rights (such as publicity and/or privacy rights) is required for distribution, reproduction, or other use of protected items beyond that allowed by fair use or other statutory exemptions. There may be content that is protected as "works for hire" (copyright may be held by the party that commissioned the original work) and/or under the copyright or neighboring-rights laws of other nations.

The Cornell University Library would like to learn more about these materials and to hear from individuals or institutions having any additional information about rightsholders. Please contact the Division of Rare and Manuscript Collections in the Library at: <http://rmc.library.cornell.edu>.