What’s Going on in California Tax

GREG TURNER
SPECIAL COUNSEL
SHEPPARD MULLIN RICHTER & HAMPTON LLP
A Short Time Ago... 5/7/2009 (LAO)
California and Louise (2010)

They’ll never take us to bankruptcy court!
What Shapes CA Tax Policy?

1. Don’t Tax You, Don’t Tax Me, Tax the Fellow Under the Tree.
2. The Initiative Process (Direct Democracy or Shackling Government?)
3. The State and Local Fiscal Co-dependency Relationship
The Industrial Initiative Complex

1. Proposition 13 (Property Tax Reform) (1978)
2. Proposition 98 (Minimum School Funding) (1988)
5. Proposition 25 (Budget Reform) (2010)
6. Proposition 26 (Fee Reform) (2010)
   a. SUT: .25%
   b. PIT: 10.3%/250k | 11.3%/$300k | 12.3%/$500k | 13.3% $1m
### STATE

<table>
<thead>
<tr>
<th>Tax</th>
<th>Rate</th>
<th>Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Income</td>
<td>Marginal rates of 1% to 13.3%</td>
<td></td>
</tr>
<tr>
<td>Sales and Use:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>General Purpose</td>
<td></td>
<td></td>
</tr>
<tr>
<td>State Rate for</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local Programs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporation</td>
<td>8.64% of California net income</td>
<td></td>
</tr>
<tr>
<td>Fuel</td>
<td>36¢ per gallon of gasoline</td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td>2.95% of gross premiums</td>
<td></td>
</tr>
<tr>
<td>Vehicle License Fee</td>
<td>0.66% of depreciated value</td>
<td></td>
</tr>
<tr>
<td>Cigarettes</td>
<td>87¢ per pack</td>
<td></td>
</tr>
<tr>
<td>Alcoholic Beverage</td>
<td>Varies—20¢/gallon for beer and wine to $6.60/gallon for spirits</td>
<td></td>
</tr>
</tbody>
</table>

### LOCAL

<table>
<thead>
<tr>
<th>Tax</th>
<th>Rate</th>
<th>Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property</td>
<td>1% of assessed value, plus rate for voter-approved debt</td>
<td></td>
</tr>
<tr>
<td>Sales and Use:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Levied Statewide</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Levied Locally</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Utility</td>
<td>Commonly, 5% of utility charges</td>
<td></td>
</tr>
<tr>
<td>Hotel</td>
<td>Commonly, 10% of hotel charges</td>
<td></td>
</tr>
<tr>
<td>Business</td>
<td>A flat amount or based on business’ gross receipts</td>
<td></td>
</tr>
<tr>
<td>Property Transfer</td>
<td>Typically 0.11% of transferred property value</td>
<td></td>
</tr>
</tbody>
</table>

**Amount of Revenue Raised**

- $10 billion
- $1 billion
GROWING RELIANCE ON PERSONAL INCOME TAX

THE BIG PICTURE
Increasing reliance on income taxes

Note: Excludes transfers and bond proceeds
Data source: Legislative Analyst’s Office
Personal Income Tax Much More Volatile Than Economy

Percent Change From Prior Year

- Personal Income Tax
- Personal Income
California Residents' Taxable Net Capital Gains by Year
(In Billions, Adjusted for Inflation, 2014 Dollars)
Top 1 Percent of Income Earners Paid Half of Income Taxes in 2012

Top 1 Percent Share of:
- Personal Income Tax Payments
- Income

Source: Franchise Tax Board
SHIFT FROM GOODS PRODUCING TO SERVICE-BASED ECONOMY

Goods-Producing vs. Service-Based Jobs by Share of Employment

Analysis: Bay Area Council Economic Institute
Sales and Use Taxes
Levied for State and Local Purposes

Average Statewide Rate
8.44%

Optional local rates (statewide average)
0.94%

City and county operations (1%)
1.25

and county transportation (0.25%)

Public safety
0.50

(Proposition 172, 1999)

Health and human services programs (1991 realignment)
0.50

Criminal justice programs
1.06

(2011 realignment)

Temporary rate (Proposition 30, 2012)
0.25

State general purpose rates
3.94

General Fund (baseline)

* Until the state pays off its deficit-financing bonds in mid-2015, the city
and county operations rate is 0.75%, with the remaining 0.25% dedicated
to state deficit financing bond payments.
California's Average Sales Tax Rate Has Increased Over Time
Housing Construction Recovering Slowly

Residential Building Permits, Thousands of Units

Single-Family

Multiunit
Poverty Much Higher in California Under Alternative Measure

Percentage of Population Living Below Poverty Threshold From 2011 Through 2013
California’s public pension systems are underfunded at historic levels

CA State Controller’s Office
California's Major Metros Are All Less Affordable Than the Average U.S. Metro

Median Share of Household Income Spent on Housing, 2013

Los Angeles
San Diego
Riverside-San Bernardino
Santa Ana-Anaheim
Fresno
Oakland
Sacramento
Bakersfield
San Francisco
San Jose
Other States' Major Metros

20 22 24 26 28 30%
Issues and Trends

Reforming Tax Incentives
  ◦ Gone:
    ◦ Redevelopment
    ◦ Enterprise Zone TC
  ◦ IN
    ◦ Film Tax Credit
    ◦ CA Competes Tax Investment
    ◦ R & D Tax Credit
    ◦ SUT Exemption for Manufacturing Equipment
    ◦ Solar Property Tax Exemption

Reforming Tax Administration
  ◦ Process
  ◦ Penalties
Issues and Trends

Tax Reform? Split Roll / Taxing Services / Flattening out PIT?

Market sourcing

Dealing with Intangibles

Whatever it is, it’s likely going to the Ballot.
How Much More General Fund Revenue If There Were No Tax Expenditures?

(2014-15, Static Estimates)

Actual Revenue\(^a\): $110 Billion

Other Income and Sales Tax Expenditures: $55 Billion

Food Sales Tax Exemption
Employer Health Contribution Exclusion
Mortgage Interest Deduction
Employer Pension Contribution Exclusion

\(^a\) Excludes transfers in and out of the General Fund.
\(^b\) Definitions of tax expenditures vary. For more information, see accompanying text.