

# **Show Me the Money**

## **The Revenue and Tax Structure in California**

- **Gayle Miller, Consultant, California Senate Office of Research**
- **Presentation to Stanford Law School, Class of Professor Joe Bankman, February 25, 2014**

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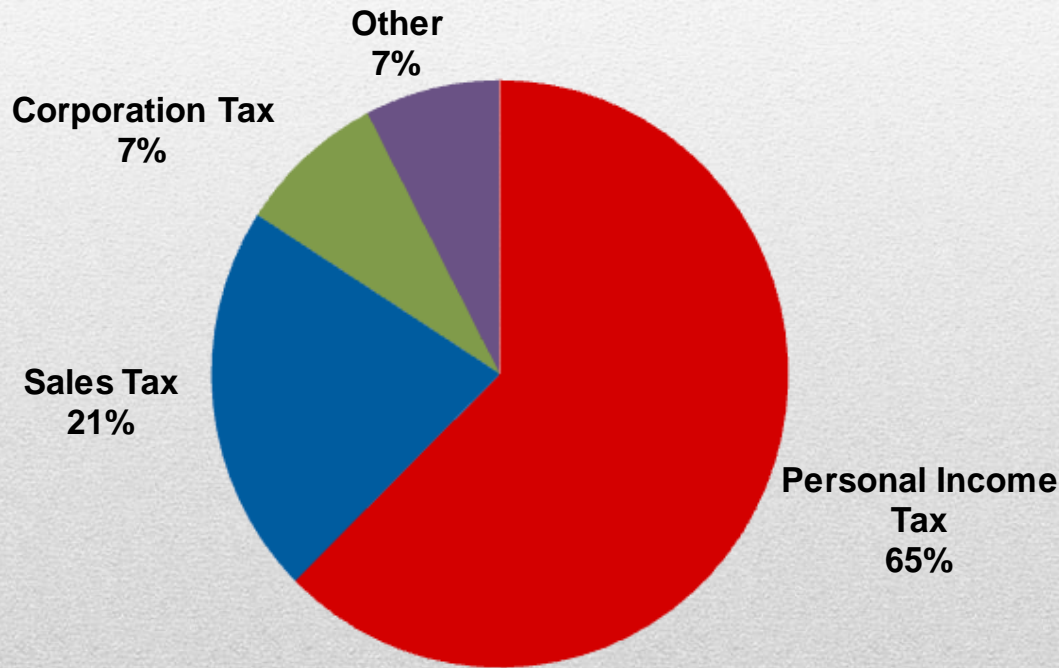
*Data compiled by Jay Chamberlain, Department of Finance, and the Franchise Tax Board's and Board of Equalization's Web sites and annual reports*

# Outline

- Introduction
  - General revenue sources and state tax history
  - What has happened over time?
  - Revenues vs. the economy
  - Sales Tax: rates, general information, why is it declining?
  - Personal Income Tax: revenue volatility, capital gains, and concentration
  - Corporation Tax: another declining revenue source and state law changes
  - California Taxes: policy options
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# General Fund Revenue Sources: 2012–2013

The Big Three Taxes together comprise 93 percent of General Fund revenues and transfers



Of the General Fund revenue sources, Personal Income Tax is by far the largest (\$64 billion in 2012–2013), followed by Sales Tax (\$20 billion in 2012–2013), and Corporation Tax (\$7.5 billion in 2012–2013).

# State Tax History

The state's Big Three Taxes largely were created after the Great Depression in response to the country's economic condition and the economic structure of the time:

**1929: Franchise Tax\***

**1933: Sales Tax**

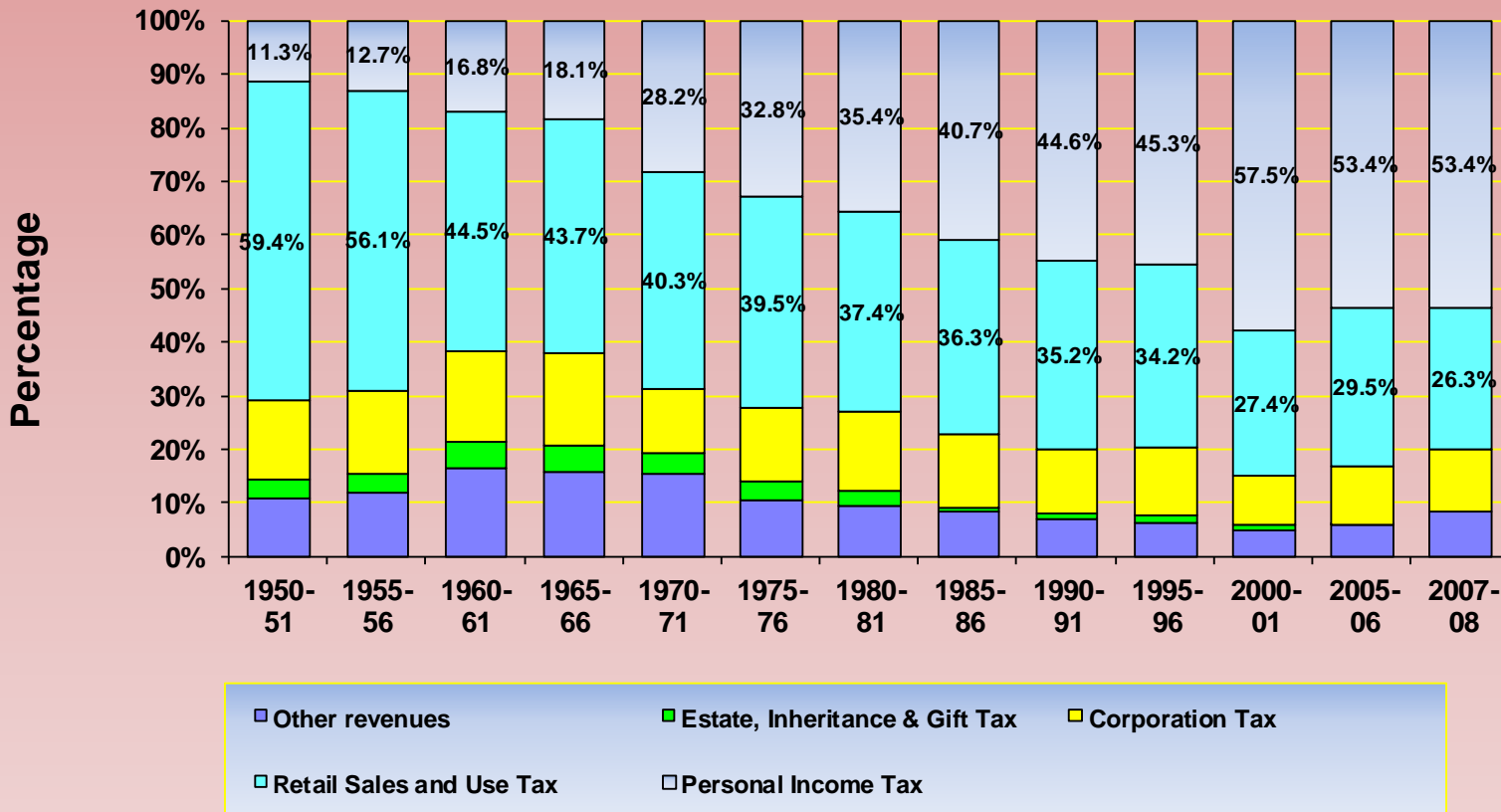
**1935: Personal Income Tax**

**1937: Corporate Tax\***

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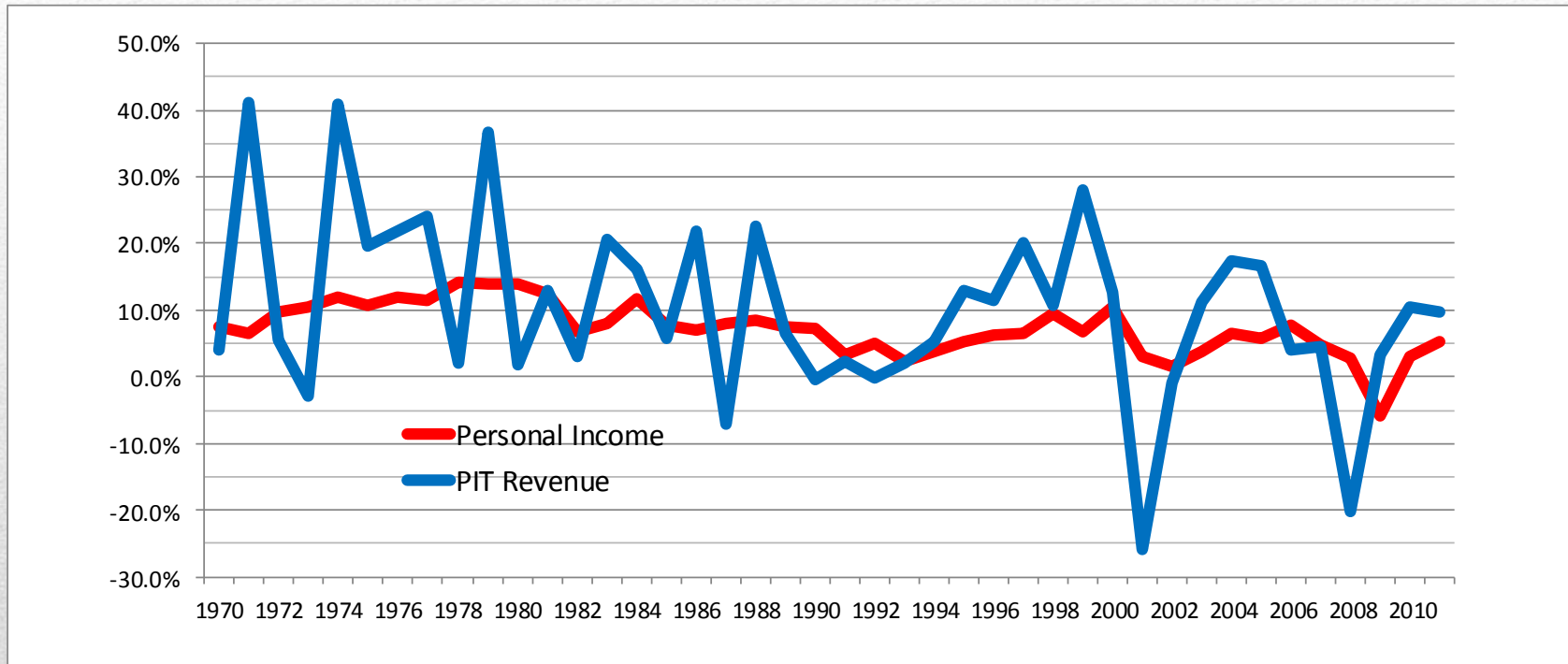
**\*The franchise tax plus the corporate tax combined make up the corporation tax, and have been reported together since 1961–1962.**

# California State General Fund Revenues by Source (Dollars in Billions)



- Over time, the state’s revenue base has moved away from Sales and Use Tax (SUT) and toward Personal Income Tax (PIT). In 1950, SUT was 59.4 percent of General Fund (GF) revenue and PIT was only 11.3 percent. While estate tax data is not available beyond 2008, we know that in 2012–2013, SUT was down to 20.6 percent of GF, and PIT was up to 65.1 percent.
- By 1985 the PIT became the largest GF revenue source and has been increasing its predominance ever since.

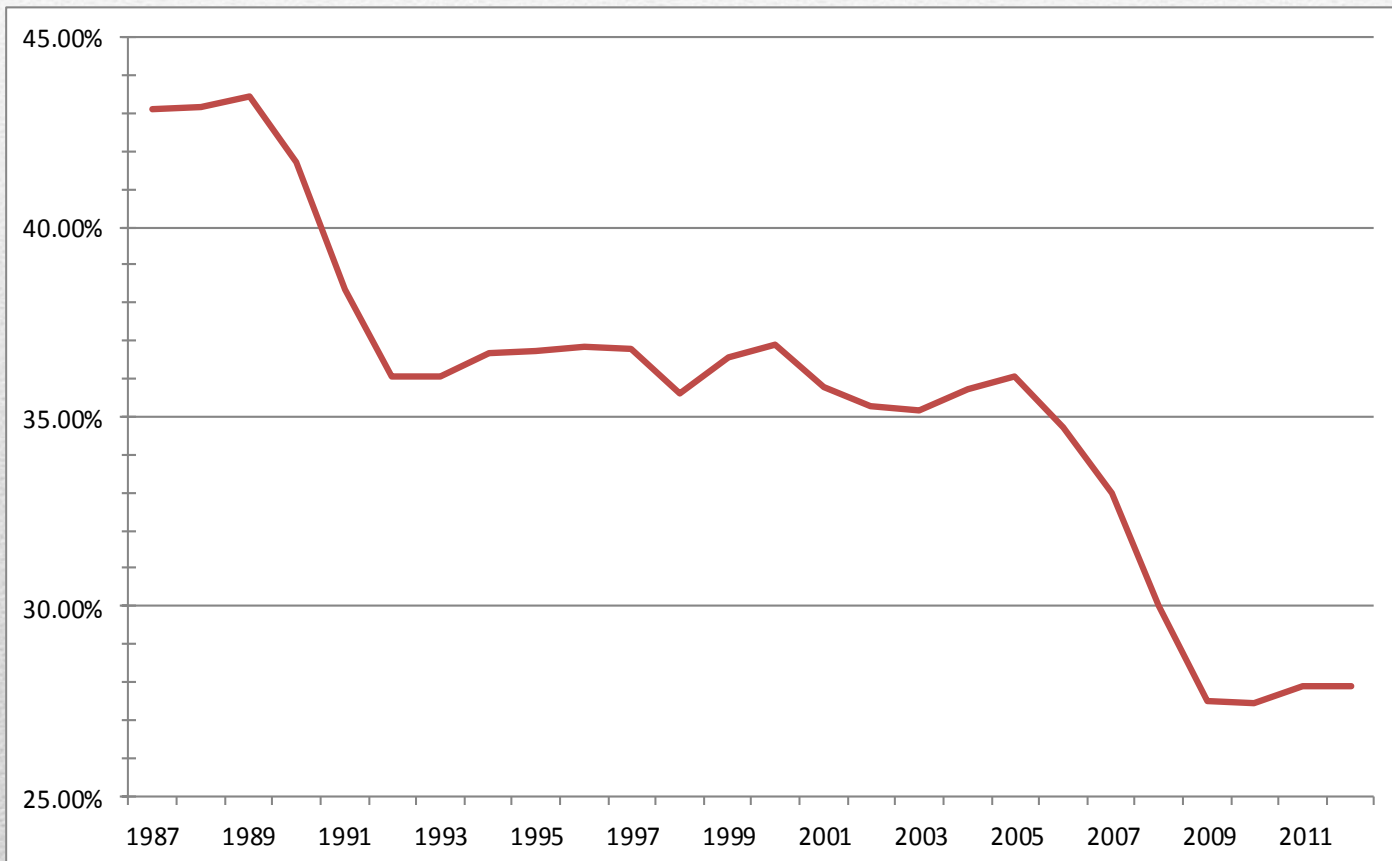
# Revenues Are More Volatile Than the Economy: 1970–2012



**Growth in Personal Income is used to measure the strength of the economy. As this chart shows, there has been a lot of economic fluctuation since 1970, with annual growth (the red line) at times as high as 15 percent, and, most recently, even showing a 5 percent decrease during the Great Recession. However, the year-to-year change in state revenues (the blue line) is much more pronounced than the economy overall.**

# SALES TAX—Taxable Sales as a Percentage of Personal Income: 1987–2012

The state sales tax, established in 1933, is imposed on tangible personal property. While there have been many exemptions to the tax (prescription drugs, food, tractors, manufacturing), there has been almost no change in the base.



**Taxable sales have been declining as a percentage of personal income.**

# History of Statewide Sales and Use Tax

Effective Date	End Date	State Rate	Local Rate <sup>1</sup>	Combined Rate
1/1/13	Current	6.50% <sup>2</sup>	1.00%	7.50%
7/1/11	12/31/12	6.25% <sup>2</sup>	1.00%	7.25%
4/1/09	6/30/11	7.25% <sup>2</sup>	1.00%	8.25%
7/1/04	3/31/09	6.25% <sup>2</sup>	1.00%	7.25%
1/1/02	6/30/04	6.00%	1.25%	7.25%
1/1/01	12/31/01	5.75%	1.25%	7.00%
7/15/91	12/31/00	6.00%	1.25%	7.25%
1/1/91	7/14/91	4.75%	1.25%	6.00%
12/1/89	12/31/90	5.00%	1.25%	6.25%
4/1/74	11/30/89	4.75%	1.25%	6.00%
10/1/73	3/31/74	3.75%	1.25%	5.00%
7/01/73	9/30/73	4.75%	1.25%	6.00%
7/1/72	6/30/73	3.75%	1.25%	5.00%
8/1/67	6/30/72	4.00%	1.00%	5.00%
1/1/62	7/31/67	3.00%	1.00%	4.00%
7/1/49	12/31/61	3.00%		3.00%
7/1/43	6/30/49	2.50%		2.50%
7/1/35	6/30/43	3.00%		3.00%
8/1/33 <sup>3</sup>	6/30/35	2.50%		2.50%

<sup>1</sup> The Bradley–Burns Uniform Local Sales and Use Tax Law was enacted in 1955. The law authorizes counties to impose a sales and use tax. Effective January 1, 1962, all counties had adopted ordinances for the Board of Equalization to collect the local tax (Tehama County did not conform from 1/1/65 to 9/30/65).

<sup>2</sup> Effective July 1, 2004, the rates on a sales tax return do not match these rates; this is due to changes of the funding procedure involving sales, local, and property taxes implemented as a result of the March 2, 2004, voter approval of the Economic Recovery Bond Act.

<sup>3</sup> Sales tax only. The use tax was effective July 1, 1935.



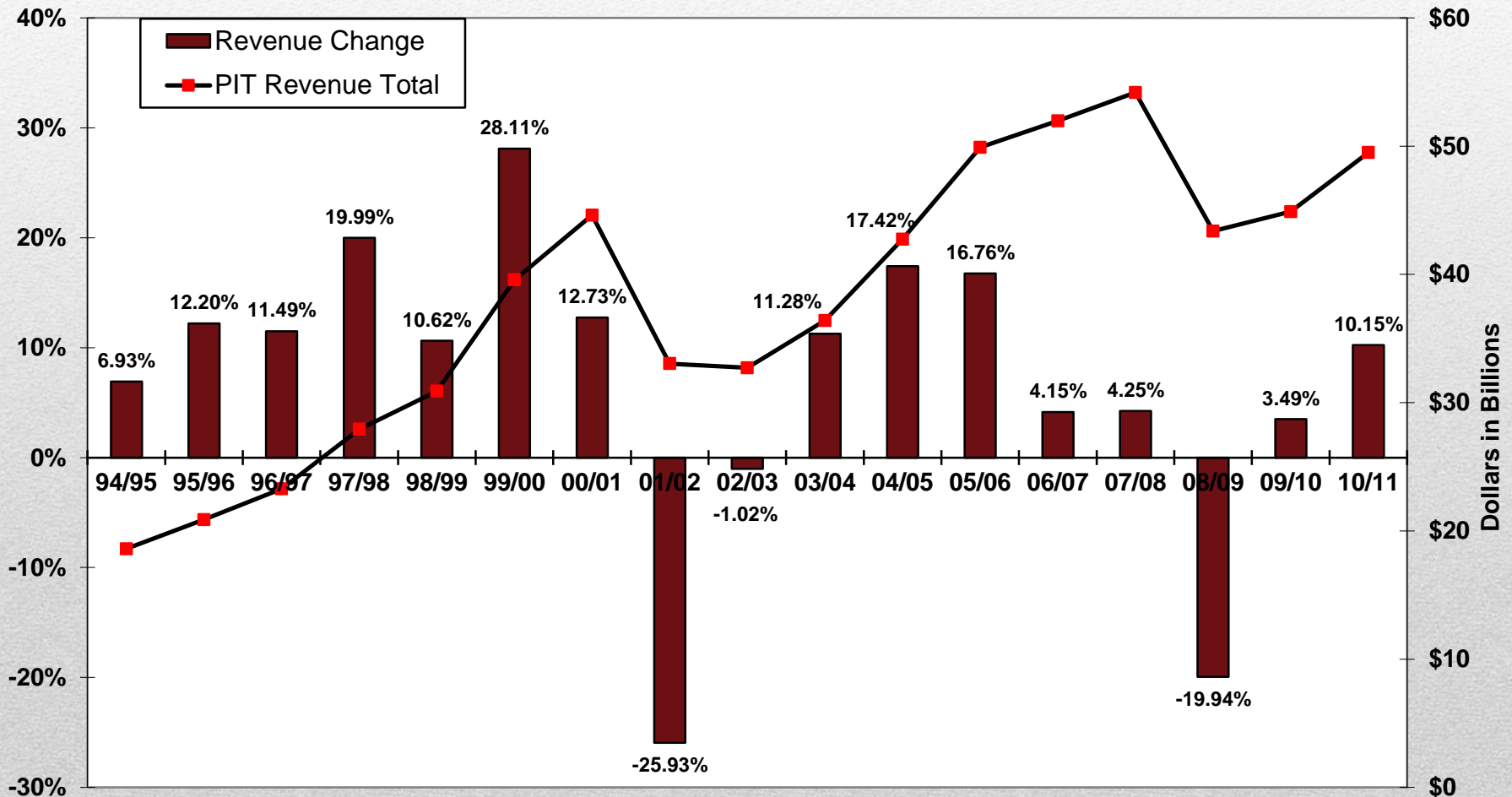
# Current Sales and Use Tax Allocation

Rate	Jurisdiction	Purpose	Authority
3.6875%	State	Goes to State's General Fund	Revenue and Taxation Code Sections 6051, 6201
0.25%	State	Goes to State's General Fund	Revenue and Taxation Code Sections 6051.3, 6201.3 (Inoperative 1/1/01 to 12/31/01)
0.25%	State	Goes to State's Fiscal Recovery Fund, to pay off Economic Recovery Bonds (2004)	Revenue and Taxation Code Sections 6051.5, 6201.5 (Operative 7/1/04)
0.50%	State	Goes to Local Public Safety Fund to support local criminal justice activities (1993)	Section 35, Article XIII, State Constitution
0.25%	State	Goes to State's Education Protection Account to support school districts, county offices of education, charter schools, and community college districts	Section 36, Article XIII, State Constitution (Operative 1/1/13 to 12/31/16)
0.50%	State	Goes to Local Revenue Fund to support local health and social services programs (1991 Realignment)	Revenue and Taxation Code Sections 6051.2, 6201.2
1.0625%	State	Goes to Local Revenue Fund 2011	Revenue and Taxation Code Sections 6051.15 and 6201.15
1.00%	Local	0.25% Goes to county transportation funds 0.75% Goes to city or county operations	Revenue and Taxation Code Section 7203.1 (Operative 7/1/04)
<b>Total:</b>			
7.50%	State/Local	Total Statewide Base Sales and Use Tax Rate	

Cities and counties may increase the sales tax by up to 2 percent, only if approved by voters. According to the Board of Equalization, the average statewide rate is 8.37 percent.

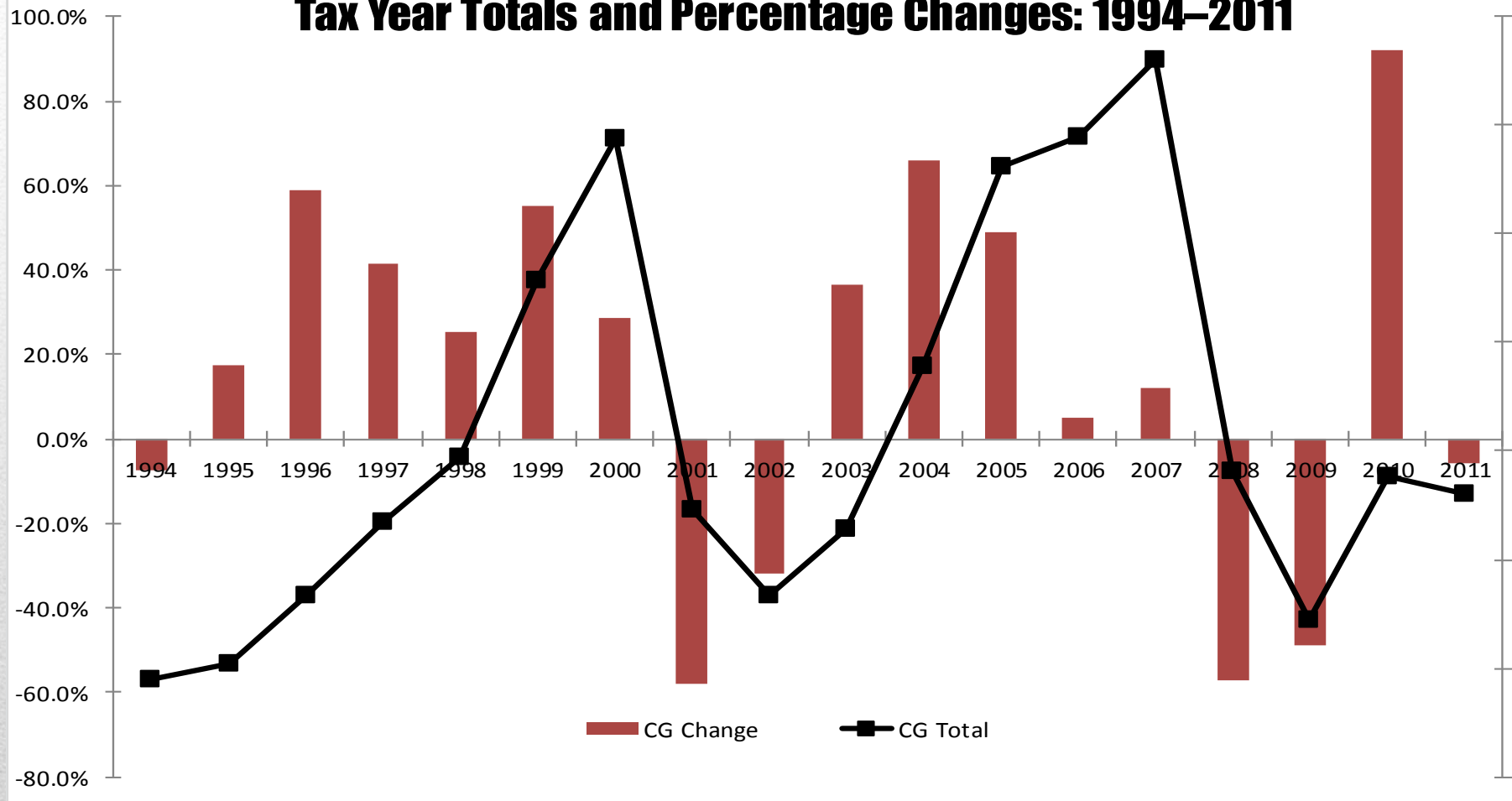
# Personal Income Tax Revenue: Percentage Changes and FY Totals

This chart illustrates volatility. The lines represent the *actual* revenue from the personal income tax each year. The bars represent the *percentage change* in the tax revenue.



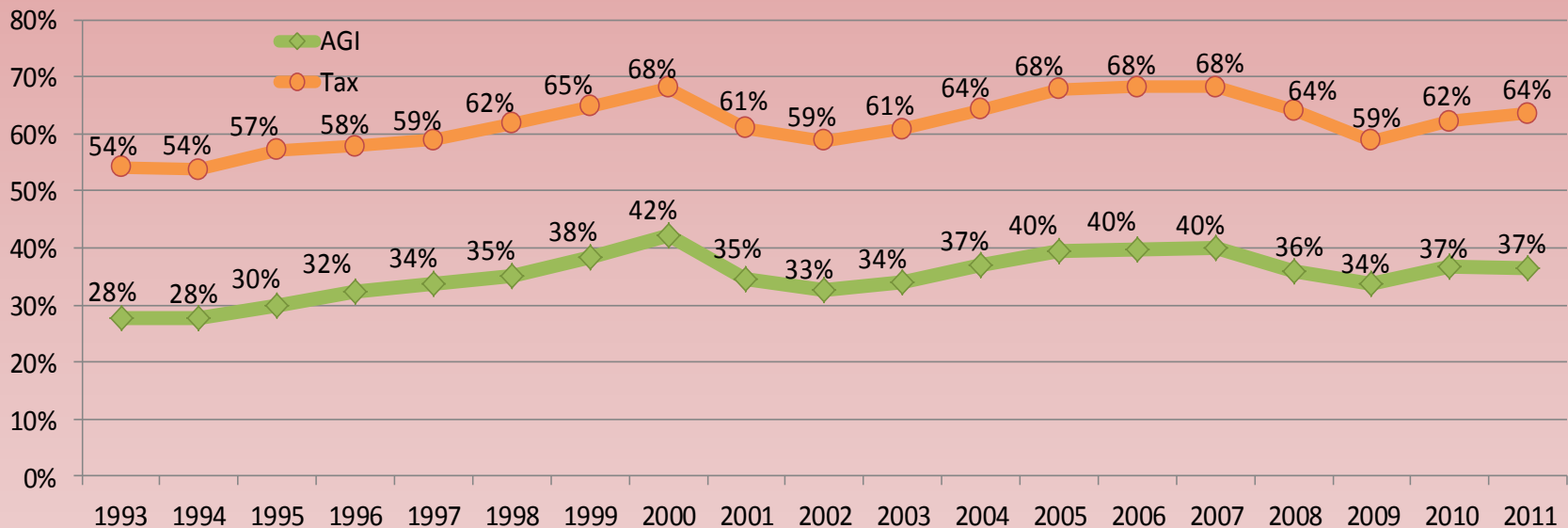
# Income From Capital Gains

## Tax Year Totals and Percentage Changes: 1994–2011



Capital gains (the gains from assets an individual chooses to sell) are difficult to predict and estimate. This chart illustrates how significantly the revenue from capital gains changes each year. The bars represent the changes; the lines represent the annual revenue. For example, capital gains have regularly grown by 20 percent or more; in 2010 they grew by 100 percent.

# Shares of Adjusted Gross Income (AGI) and Personal Income Tax (Tax) Paid by Top 5 Percent of Taxpayers: 1993–2011

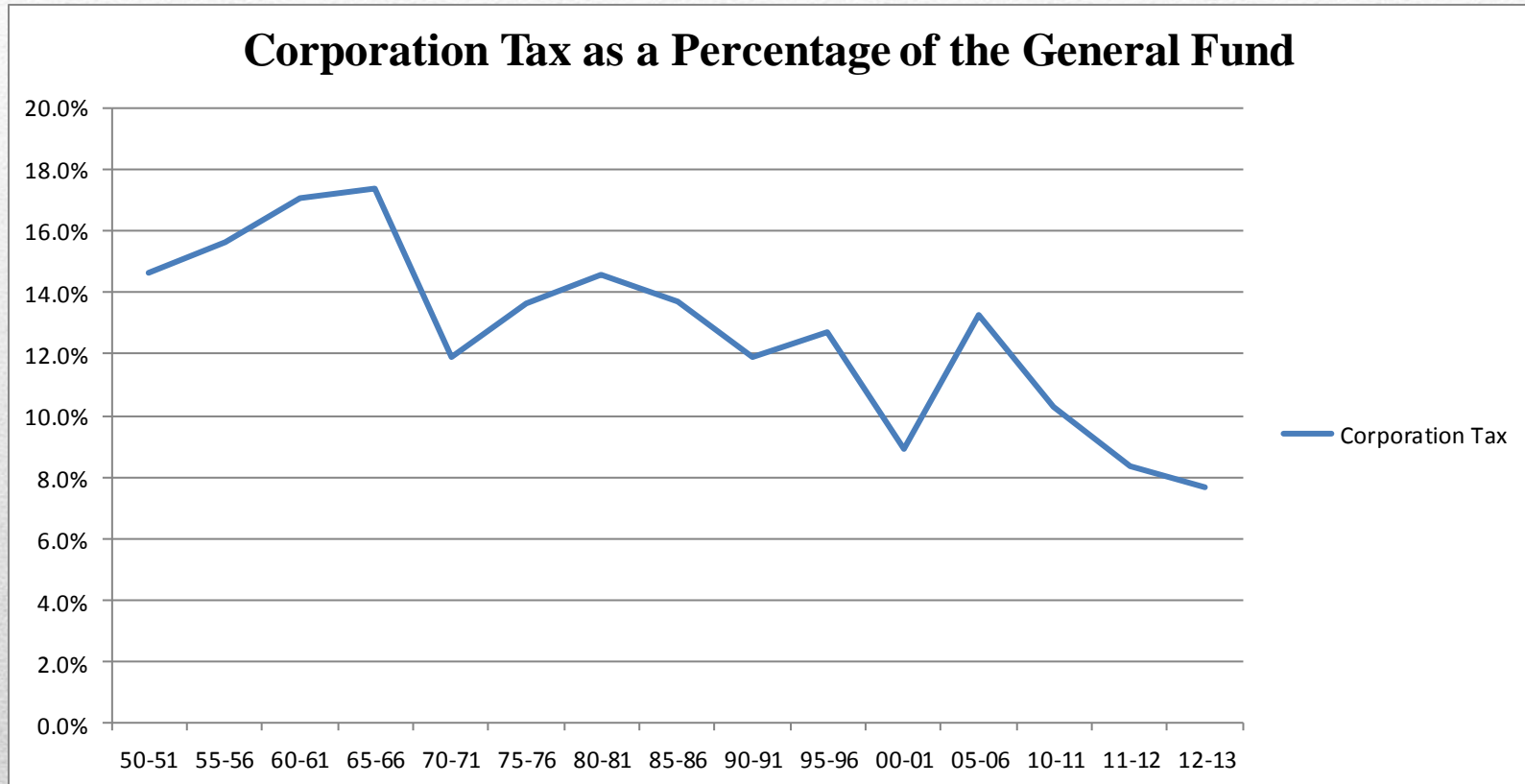


**This chart illustrates the increasing progressive nature of the personal income tax (PIT). In 1993, 5 percent of the population accounted for 54 percent of the PIT revenue; in 2000, it accounted for 68 percent.**

# Historical Personal Income Tax Rates

Tax Rate	1935-42 Taxable Income	1943-48 Taxable Income	1949-51 Taxable Income	1952-58 Taxable Income	1959-66 Taxable Income				
1.0	Up to \$ 5,000	Up to \$ 10,000	Up to \$ 5,000	Up to \$ 10,000	Up to \$ 5,000				
2.0	5,000 to 10,000	10,000 to 15,000	5,000 to 10,000	10,000 to 20,000	5,000 to 10,000				
3.0	10,000 to 15,000	15,000 to 20,000	10,000 to 15,000	20,000 to 30,000	10,000 to 15,000				
4.0	15,000 to 20,000	20,000 to 25,000	15,000 to 20,000	30,000 to 40,000	15,000 to 20,000				
5.0	20,000 to 25,000	25,000 to 30,000	20,000 to 25,000	40,000 to 50,000	20,000 to 25,000				
6.0	25,000 to 30,000	\$ 30,000 and over	\$ 25,000 and over	\$ 50,000 and over	25,000 to 30,000				
7.0	30,000 to 40,000				\$ 30,000 and over				
8.0	40,000 to 50,000								
9.0	50,000 to 60,000								
10.0	60,000 to 70,000								
11.0	70,000 to 80,000								
12.0	80,000 to 100,000								
13.0	100,000 to 150,000								
14.0	150,000 to 250,000								
15.0	\$ 250,000 and over								
Tax Rate	1967-72 Taxable Income	1973-85 Taxable Income	1986 Taxable Income	1987-90 Taxable Income	1991-92 Taxable Income				
0.0			Up to \$ 3,420						
1.0	Up to \$ 4,000	Up to \$ 4,000	3,420 to 10,420	Up to \$ 7,300	Up to \$ 8,788				
2.0	4,000 to 7,000	4,000 to 7,000	10,420 to 15,620	7,300 to 17,300	8,788 to 20,828				
3.0	7,000 to 10,000	7,000 to 10,000	15,620 to 20,840						
4.0	10,000 to 13,000	10,000 to 13,000	20,840 to 26,160	17,300 to 27,300	20,828 to 32,870				
5.0	13,000 to 16,000	13,000 to 16,000	26,160 to 31,420						
6.0	16,000 to 19,000	16,000 to 19,000	31,420 to 36,660	27,300 to 37,900	32,870 to 45,632				
7.0	19,000 to 22,000	19,000 to 22,000	36,660 to 41,860						
8.0	22,000 to 25,000	22,000 to 25,000	41,860 to 47,120	37,900 to 47,900	45,632 to 57,670				
9.0	25,000 to 28,000	25,000 to 28,000	47,120 to 52,360						
9.3				\$ 47,900 and over	57,670 to 200,000				
10.0	\$ 28,000 and over	28,000 to 31,000	52,360 to 57,580		200,000 to 400,000				
11.0		\$ 31,000 and over	\$ 57,580 and over		\$ 400,000 and over				
Tax Rate	1993 Taxable Income	1994 Taxable Income	1995 Taxable Income	1996 Taxable Income	1997 Taxable Income				
1.0	Up to \$ 9,332	Up to \$ 9,444	Up to \$ 9,662	Up to \$ 9,816	Up to \$ 10,032				
2.0	9,332 to 22,118	9,444 to 22,384	9,662 to 22,898	9,816 to 23,264	10,032 to 23,776				
4.0	22,118 to 34,906	22,384 to 35,324	22,898 to 36,136	23,264 to 36,714	23,776 to 37,522				
6.0	34,906 to 48,456	35,324 to 49,038	36,136 to 50,166	36,714 to 50,968	37,522 to 52,090				
8.0	48,456 to 61,240	49,038 to 61,974	50,166 to 63,400	50,968 to 64,414	52,090 to 65,832				
9.3	61,240 to 212,380	61,974 to 214,928	63,400 to 219,872	\$ 64,414 and over	\$ 65,832 and over				
10.0	212,380 to 424,760	214,928 to 429,858	219,872 to 439,744						
11.0	\$ 424,760 and over	\$ 429,858 and over	\$ 439,744 and over						
Tax Rate	1998 Taxable Income	1999 Taxable Income	2000 Taxable Income	2001 Taxable Income	2002 Taxable Income				
1.0	Up to \$ 10,262	Up to \$ 10,528	Up to \$ 10,918	Up to \$ 11,496	Up to \$ 11,668				
2.0	10,262 to 24,322	10,528 to 24,954	10,918 to 25,878	11,496 to 27,250	11,668 to 27,658				
4.0	24,322 to 38,386	24,954 to 39,384	25,878 to 40,842	27,250 to 43,006	27,658 to 43,652				
6.0	38,386 to 53,288	39,384 to 54,674	40,842 to 56,696	43,006 to 59,700	43,652 to 60,596				
8.0	53,288 to 67,346	54,674 to 69,096	56,696 to 71,652	59,700 to 75,450	60,596 to 76,582				
9.3	\$ 67,346 and over	\$ 69,096 and over	\$ 71,652 and over	\$ 75,450 and over	\$ 76,582 and over				
Tax Rate	2003 Taxable Income	2004 Taxable Income	2005 Taxable Income	2006 Taxable Income	2007 Taxable Income				
1.0	Up to \$ 11,924	Up to \$ 12,294	Up to \$ 12,638	Up to \$ 13,244	Up to \$ 13,654				
2.0	11,924 to 28,266	12,294 to 29,142	12,638 to 29,958	13,244 to 31,963	13,654 to 32,370				
4.0	28,266 to 44,612	29,142 to 45,994	29,958 to 47,282	31,963 to 49,552	32,370 to 51,088				
6.0	44,612 to 61,930	45,994 to 63,850	47,282 to 65,638	49,552 to 68,788	51,088 to 70,920				
8.0	61,930 to 78,266	63,850 to 80,692	65,638 to 82,952	68,788 to 86,934	70,920 to 89,628				
9.3	\$ 78,266 and over	\$ 80,692 and over	82,952 to 999,999	86,934 to 999,999	89,628 to 999,999				
10.3			\$ 1,000,000 and over	\$ 1,000,000 and over	\$ 1,000,000 and over				
Tax Rate	2008 Taxable Income	2009 Taxable Income		2010 Taxable Income		2011 Taxable Income		2012 Taxable Income	
1.0	Up to \$ 14,336	1.25	Up to \$ 14,120	1.25	Up to \$ 14,248	1.0	Up to \$ 14,632	1.0	Up to \$ 14,910
2.0	14,336 to 33,988	2.25	14,120 to 33,478	2.25	14,248 to 33,780	2.0	14,632 to 34,692	2.0	14,910 to 35,352
4.0	33,988 to 53,642	4.25	33,478 to 52,838	4.25	33,780 to 53,314	4.0	34,692 to 54,754	4.0	35,352 to 55,794
6.0	53,642 to 74,466	6.25	52,838 to 73,350	6.25	53,314 to 74,010	6.0	54,754 to 76,008	6.0	55,794 to 77,452
8.0	74,466 to 94,110	8.25	73,350 to 92,698	8.25	74,010 to 93,532	8.0	76,008 to 96,058	8.0	77,452 to 97,884
9.3	94,110 to 999,999	9.55	92,698 to 999,999	9.55	93,532 to 999,999	9.3	96,058 to 999,999	9.3	97,884 to 500,000
10.3	\$ 1,000,000 and over	10.55	\$ 1,000,000 and over	10.55	\$ 1,000,000 and over	10.3	\$ 1,000,000 and over	10.3	500,000 to 600,000
								11.3	600,000 to 999,999
								13.3	\$ 1,000,000 and over

# Corporation Tax



During the mid-1990s there was a decline in the corporation tax; the tax increased again from 2000–2007. Since then, the tax has stagnated again.

# Historical Corporation Tax Rates

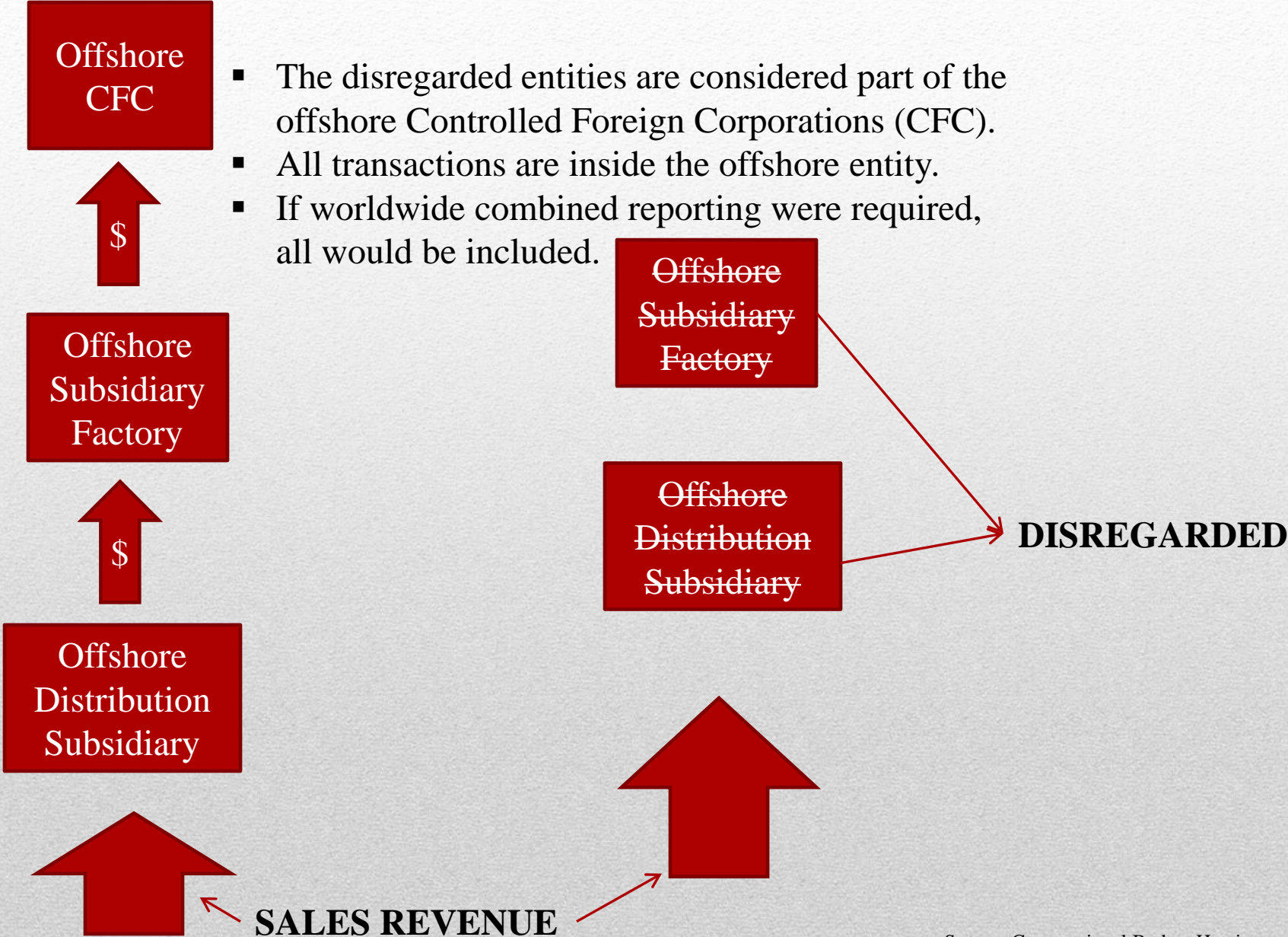
Type		Taxable Year (Calendar Year Basis)						
		2006	2007	2008	2009	2010	2011	2012
<b>I.</b>	<b>General Corporations</b>							
	a. Tax Rate	8.84%	8.84%	8.84%	8.84%	8.84%	8.84%	8.84%
	b. Minimum Franchise Tax	\$ 800	\$ 800	\$ 800	\$ 800	\$ 800	\$ 800	\$ 800
	c. Alternative Minimum Tax	6.65%	6.65%	6.65%	6.65%	6.65%	6.65%	6.65%
	d. Preference Tax	-	-	-	-	-	-	-
<b>II.</b>	<b>S Corporations</b>							
	a. Tax Rate	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
	b. Financial S Corp. Add-on, In-lieu Rate	2%	2%	2%	2%	2%	2%	2%
	c. Composite Rate	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
	d. Minimum Franchise Tax	\$ 800	\$ 800	\$ 800	\$ 800	\$ 800	\$ 800	\$ 800
	e. Excess Net Passive Income Tax	8.84%	8.84%	8.84%	8.84%	8.84%	8.84%	8.84%
	f. Built-in Gains Tax	8.84%	8.84%	8.84%	8.84%	8.84%	8.84%	8.84%
<b>III.</b>	<b>Banks</b>							
	a. General Franchise Tax Rate	8.84%	8.84%	8.84%	8.84%	8.84%	8.84%	8.84%
	b. Add-on, In-lieu Rate	2%	2%	2%	2%	2%	2%	2%
	c. Composite Rate	10.84%	10.84%	10.84%	10.84%	10.84%	10.84%	10.84%
	d. Minimum Franchise Tax Rate	\$ 800	\$ 800	\$ 800	\$ 800	\$ 800	\$ 800	\$ 800
	e. Alternative Minimum Tax	8.65%	8.65%	8.65%	8.65%	8.65%	8.65%	8.65%
	f. Preference Tax	-	-	-	-	-	-	-
<b>IV.</b>	<b>Other Financial Corporations</b>							
	a. General Franchise Tax Rate	8.84%	8.84%	8.84%	8.84%	8.84%	8.84%	8.84%
	b. Add-on, In-lieu Rate	2%	2%	2%	2%	2%	2%	2%
	c. Composite Rate	10.84%	10.84%	10.84%	10.84%	10.84%	10.84%	10.84%
	d. Minimum Franchise Tax	\$ 800	\$ 800	\$ 800	\$ 800	\$ 800	\$ 800	\$ 800
	e. Alternative Minimum Tax	8.65%	8.65%	8.65%	8.65%	8.65%	8.65%	8.65%
	f. Preference Tax	-	-	-	-	-	-	-
<b>V.</b>	<b>Corporations Subject to Income Tax</b>							
	a. Tax Rate	8.84%	8.84%	8.84%	8.84%	8.84%	8.84%	8.84%
	b. Alternative Minimum Tax	6.65%	6.65%	6.65%	6.65%	6.65%	6.65%	6.65%
	c. Preference Tax	-	-	-	-	-	-	-

# Recent Corporate Tax Legislation

(Dollars in Millions)						
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Credit Sharing (beginning 2010)	-271	-254	-209	-220	-230	-238
Elective Single Sales Factor (beg. 2011)	-355	-883	-962	-992	-1,031	-1,071
Proposition 39: Mandatory Single Sales Factor (beg. 2013)	0	0	317	928	1,036	1,023
Economic Development Tax Credits (beg. 2014)	0	0	0	89	177	270
All Other	739	293	-140	-44	136	273
Total	113	-844	-994	-239	88	257



This chart illustrates **STATELESS INCOME**, where corporations legally disregard entities for tax purposes.



# California Taxes

## Policy Options—Does California's Tax Structure Make Sense in the 21<sup>st</sup> Century?

1. Should the sales tax base be expanded?
  2. Should the sales tax include digital downloads, etc.?
  3. Should the sales tax rate be reduced?
  4. Is revenue volatility bad? Or is it a spending problem (high spending/high liabilities)?
  5. Is the decline in the corporation tax compensated for by the increase in the personal income tax?
  6. Should California capture any offshore income?
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