CALIFORNIA
▪ BUDGET PROJECT ▪

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SHOULD CALIFORNIA REPEAL THE 'CAR TAX'?

A burgeoning budget surplus prompted the Governor to call for a 75 percent reduction in the state's vehicle license fees (VLF). The Governor's proposal reduces the VLF by 50 percent on January 1, 1999 and an additional half on January 1, 2002 for a total reduction of 75 percent at a cost of $995 million in 1998-99, $2.04 billion in 1999-00, and $3.6 billion in 2002-03. The Governor's May Revision estimates that current (1997-98) and budget (1998-99) revenues will be $4.2 billion above the January forecast. Yet, all signs point toward caution. The VLF provides $3.9 billion in local government revenues, nearly equal to the projected surplus. Moreover, a significant fraction of the current surplus is one-time in nature.

How Does The Vehicle License Fee Work?

Motor vehicles are subject to a license fee equal to 2 percent of a vehicle's market value. Market value is determined by the vehicle's purchase price adjusted over time for depreciation. Vehicles are depreciated over an eleven-year period ranging from 100 percent of market value for the first year ownership to 15 percent of market value during the eleventh year of ownership. For example, the tax on a new $35,000 sport utility vehicle is $700. The tax on a five-year old family sedan that cost $15,000 at purchase would be $180. Used cars are valued at market value at the time of sale and then depreciated over eleven years.

How Much Would It Cost To Reduce The VLF? Where Does The VLF Go?

1998-99 VLF collections are projected to total $3.894 billion.[1] Of this amount, 24.33 percent is distributed to counties to fund programs transferred to local government as part of the 1991 shift known as realignment. The remaining 75.67 percent is distributed to cities and counties, except for a relatively small amount (approximately $200 million) that is used to pay the cost of collecting and distributing the tax. Most of the non-realignment VLF is divided equally between cities and counties and then distributed on the basis of population. 18.75% of the non-realignment funds are distributed through special payments, primarily to cities that levied low or no property taxes prior to Proposition 13 (the "lows and nos").

Eight Reasons Why Repealing The VLF Is A Bad Idea

1. ***Spending someone else's money.*** While the legislature has the authority to repeal the VLF, virtually all VLF revenues go to local government. Unless the legislature backfills local governments' loss, the state's gain is local governments' pain. The VLF provides approximately 10 percent of cities' tax revenues and 25 percent of counties' tax revenues. The property tax shifts of 1992 and 1993 are a major reason why the state currently has a surplus. In the absence of these shifts, the state would still be in a deficit position.

[1] This does not include $36 million in trailer coach VLF that is deposited in the state General Fund.

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2. ***Backfill revenues provide less security to local government.*** In 1986, the voters passed Proposition 47, constitutionally dedicating VLF revenues to cities and counties. The legislature can modify the distribution between cities and counties, but cannot divert the VLF to the state, to schools, or for other purposes. Even if the state provides a backfill out of the current surplus, many local governments fear the state would take it back in the event of a future state shortfall, whereas VLF revenues must be distributed to cities and counties.
3. ***Sending money to Washington***. Taxpayers who itemize deductions can deduct VLF for federal income tax purposes. Repealing a state tax that is deductible for federal tax purposes is an inefficient means of providing tax relief to Californians. A family in the 28 percent federal tax bracket will pay $28 more in federal taxes for each $100 they save in VLF.
4. ***Replacement revenues would be subject to Proposition 98, increasing the cost of backfill.*** Repealing the VLF will not affect the amount of money that goes toward K - 14 education. However, revenues transferred to cities and counties as a backfill are subject to Proposition 98. As a result, the full cost of the backfill would be borne by programs funded out of non-Proposition 98 General Fund revenues. In tight budget years, funds used for a backfill would be in direct competition with support for Higher Education, Public Safety, and other areas of discretionary spending and would limit the legislature's ability to provide additional funds to move schools closer to the national average in per pupil spending.
5. ***Repealing the VLF would endanger realignment.*** In 1991, policymakers agreed to transfer a number of health, mental health, and social service programs from the state to county government along with a dedicated funding source to cover program operating costs. Realignment was designed to allow counties to tailor program design to local needs and is widely considered a success. The initial realignment legislation contains a "poison pill" reversing the realignment transfer under certain situations. A less than complete backfill could endanger realignment and result in litigation that would invoke the poison pill.
6. ***An unknown portion of the current surplus is one-time in nature.*** Analysts assume that 1997 personal income tax collections are abnormally high due to increased realization of capital gains in response to last year's federal tax changes. Capital gains rate reductions, such as that enacted by last year's federal tax bill, typically result in a one-time increase in tax collections. While the economy remains strong, most forecasters predict a slow down within the next several years that could leave the state with insufficient resources to pay for current levels of public services.
7. ***The cost of the 1997 tax package nearly doubles in 1999-00.*** On the last day of the 1997 legislative session, the legislature approved a substantial tax package in anticipation of the current surplus. The most costly aspects of last year's tax cut are backloaded. That is, their cost increases over time. Last year's tax cuts cost an estimated $593 million in 1998-99. However, revenue losses nearly double to $1.086 billion in 1999-00.
8. ***Surplus projections include tax increases and spending reductions; ignore future years' costs.*** The Governor's Budget uses $489 million in prior years' federal TANF block grants to fund CalWORKs. In order to maintain the same level of Welfare-to-Work and child care services in 1999-00 and beyond, state spending must increase by the same amount. The Governor also assumes repeal of the renters' tax credit, a $540 million tax increase primarily affecting low income households, and making permanent the elimination of CalWORKs cost-of-living adjustments and grant reductions, for a total savings of $287 million.