
# California's Tax & Revenue System Isn't Fair for All

## People with Lowest Incomes Pay Larger Share of Income in Taxes than Most Other Income Groups

**MARCH 2022** | BY KAYLA KITSON

Californians need quality public health and schools, access to affordable housing and clean water, and safe roads and neighborhoods along with many more services to live and thrive – no matter one's zip code. Accordingly, the state's tax and revenue system must raise adequate revenue to cover the services provided by state and local governments *and* make ongoing investments to meet the needs of Californians. However, policy choices of the past and present shape whether revenues are equitably raised and who is contributing a fair share of their income to California's revenue. State policymakers can make the tax and revenue system more equitable by strengthening taxation of Californians with high incomes and wealth while providing more support to Californians with low incomes and Californians of color who have been blocked from income- and wealth-building opportunities.

This *5 Facts* explains main concepts associated with tax equity and illustrates how elements of California's tax and revenue system further or impede the goals of economic and racial equity for households, communities, and the state.

# 5 Facts

1. Taxes Can Be Progressive, Proportional, or Regressive — Depending on How They Impact People Across Income Levels

2. California’s Personal Income Tax Is Highly Progressive, Asking the Most from Those with the Highest Ability to Pay

3. California’s Sales and Excise Taxes Are Regressive, Asking the Most from Those with the Least Ability to Pay

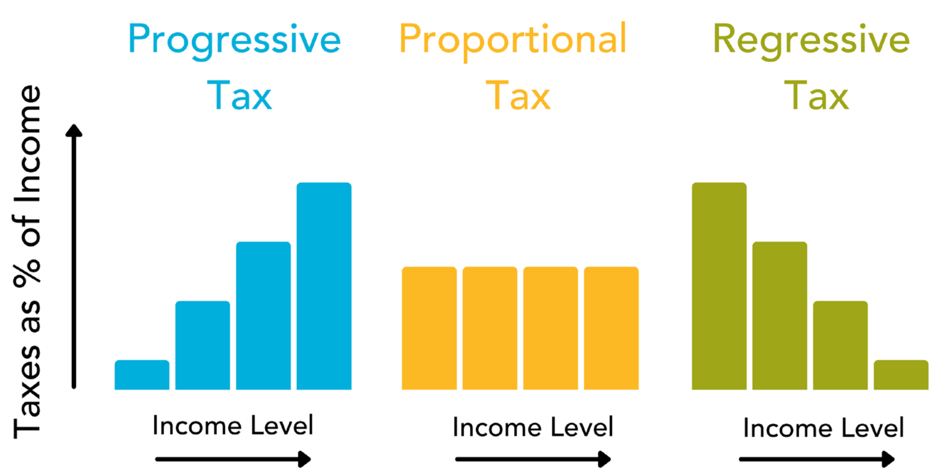
4. California’s State and Local Tax System Could Be More Progressive

5. California’s Tax System Rewards Wealth but Doesn’t Tax Wealth

## 1 Taxes Can Be Progressive, Proportional, or Regressive — Depending on How They Impact People Across Income Levels

A key aspect to tax equity is how a tax — or a tax system as a whole — impacts households across income levels. One way to measure this is by comparing *effective tax rates* — meaning the share of one's income paid in a tax — of people in different income groups. A tax is considered *progressive* when households with higher incomes have higher effective tax rates than those with lower incomes. The opposite of a progressive tax is a *regressive* tax. With regressive taxes, people with lower incomes have higher effective tax rates than people with higher incomes. Finally, a tax is considered *proportional* when people at all income levels have the same effective rates. Progressive taxes are the most equitable taxes, since they ask the most from people who have the most ability to pay.

People with lower incomes must spend larger shares of their income just to meet their basic needs, leaving them with less ability to pay taxes. For example, **almost 6 in 10 low-income California households spend more than half of their income on housing alone, compared to just 2% of high-income California households.**[1] In other words, after covering the basics, Californians with lower incomes have much smaller portions of their total incomes available to pay taxes than higher-income Californians. It follows that a fair tax system should take a smaller fraction of the income of low-income households.



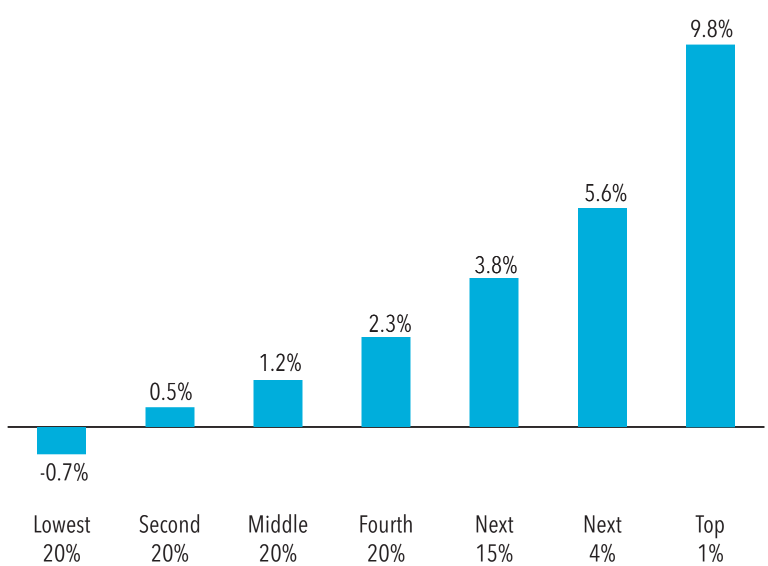
## 2 California's Personal Income Tax Is Highly Progressive, Asking the Most from Those with the Highest Ability to Pay

Californians with higher incomes pay a larger percentage of their income in personal income taxes than people with lower incomes because higher portions of income are subject to higher tax rates.[2] In other words, high-income people face the highest effective tax rates with regard to the personal income tax. Additionally, the state has two *refundable tax credits,* the California Earned Income Tax Credit (CalEITC) and the Young Child Tax Credit, that provide refunds to families with very low incomes, creating a negative effective tax rate for them. The personal income tax is the state's largest revenue source.

The **progressive structure of the personal income tax also improves racial equity, since Latinx and Black Californians have lower average incomes than white Californians due to racist policies and practices in employment, education, and every other facet of society**.[3] As a result, the effective state personal income tax rate is lower on average for Latinx and Black families (3.6% and 4.0%, respectively) than for white families (5.0%).[4]

### California's Personal Income Tax Is Highly Progressive

California Personal Income Tax as a Share of Family Income, by Income Group




Note: Chart reflects total state and local taxes enacted through 2020 as a share of 2015 income for non-elderly taxpayers. Breaks between income percentile groups are: 20%: $23,200; 40%: $39,100; 60%: $62,300; 80%: $112,900; 95%: $261,300; 99%: $714,400.
Source: Institute on Taxation and Economic Policy

## 3 California's Sales and Excise Taxes Are Regressive, Asking the Most from Those with the Least Ability to Pay

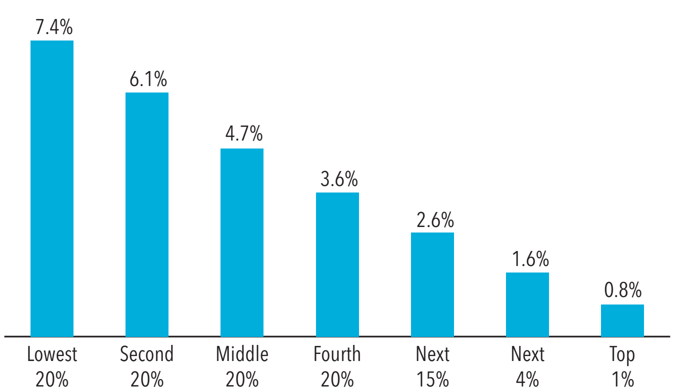
In contrast to the personal income tax, the sales and use tax is regressive. **This is because people with lower incomes need to spend larger shares of their income to cover basic needs, so sales taxes take up larger shares of low-income households' budgets.** The sales and use tax is the state's second-largest revenue source.

Excise taxes, which are taxes on specific goods including gasoline, alcohol, and tobacco, are also highly regressive. Like sales taxes, excise taxes hit people with lower incomes hardest since any money they spend on items subject to excises taxes will generally make up a larger share of their overall budgets compared to high-income people. In addition, since excise taxes are generally based on the volume of the purchase rather than the price, people at all income levels pay the same tax on a given amount of a product, whether they buy an economical brand or a more expensive brand.[5]

The 20% of California families with the lowest incomes pay 7.4% of their incomes in combined state and local sales and excise taxes, compared to 0.8% for the richest 1%. Again, because Black, Latinx, and many other Californians of color are more likely to have low incomes than white Californians, regressive taxes like sales and excise taxes exacerbate racial inequity.

### California's Sales and Excise Taxes Are Regressive

California State and Local Sales and Excise Taxes as a Share of Family Income, by Income Group

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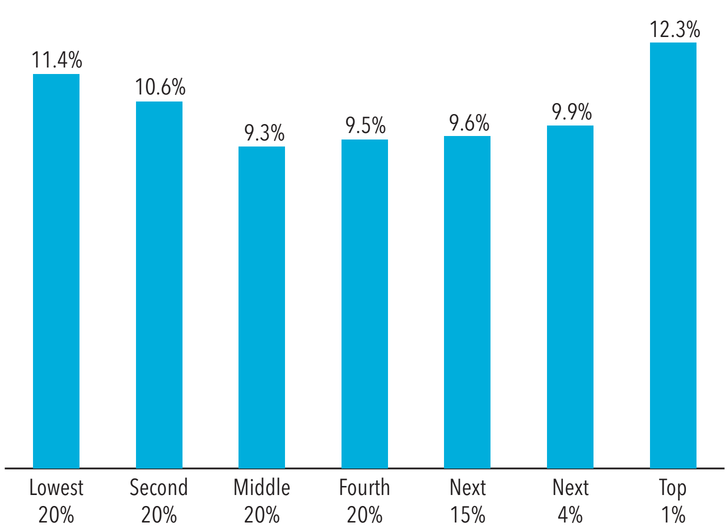
Source: Institute on Taxation and Economic Policy

## 4 California's State and Local Tax System Could Be More Progressive

The overall impact of the state and local tax system on Californians is determined by the combination of the progressive personal income tax and regressive sales and excise taxes, as well as other taxes levied by the state and localities — most notably corporate income taxes and local property taxes. **The combined impact is a state and local tax system that is regressive for people with lower incomes and progressive for people with very high incomes**. The richest 1% of California tax filers pay the largest share of their income in state and local taxes (12.3%), but the 20% of filers with the lowest incomes pay the next highest share (11.4%). While the richest Californians pay a smaller portion of their income in sales, excise, and property taxes than any other group, it is made up for by the larger share of their income that goes to income taxes. Conversely, while the bottom 20% of Californians on average get money back from the personal income tax system via refundable tax credits, this is not enough to make up for paying larger shares of their income in sales, excise, and property taxes.

### Very High-Income and Low-Income California Taxpayers Pay Largest Shares of Income in State and Local Taxes

California State and Local Taxes as a Share of Family Income, by Income Group

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Source: Institute on Taxation and Economic Policy

## 5 California's Tax System Rewards Wealth but Doesn't Tax Wealth

Wealth inequality is even more pronounced than income inequality, and racial wealth gaps are larger than racial income gaps. Many **state tax policies contribute to wealth inequality and racial wealth gaps by providing substantial tax benefits to families who have assets like homes and retirement plans** — such as the deductions for mortgage interest and property taxes, the partial tax exemption on the proceeds of home sales, and tax-privileged retirement accounts. Black, Latinx, and other people of color receive less of these tax benefits because — due to structural racism and discrimination — they are less likely to be homeowners, to be in jobs with access to employer-sponsored retirement plans, and to have the financial means to save or invest in assets.[6] At the same time, accumulated or inherited wealth is not taxed in California. Policymakers can eliminate or limit tax benefits that most advantage wealthy families and explore other options to better tax Californians who have amassed large amounts of wealth. The resulting revenues could then be directed to investments that help families who have been shut out from wealth-building opportunities achieve economic security and build wealth.

**"Policymakers can eliminate or limit tax benefits that most advantage wealthy families and explore other options to better tax Californians who have amassed large amounts of wealth."**

## Conclusion

There are many dimensions to ensuring that a tax system equitably generates the revenue needed for Californians to care for their families, build healthy communities, and contribute to a strong economy. Policymakers need to consider how any tax policy could have disparate effects on Californians by income, wealth, and race/ethnicity — as well as other factors not discussed in this fact sheet, such as gender, family structure, and income source.

The state's current tax and revenue system is not fair for all Californians. People with the lowest incomes should not be paying larger shares of their incomes in state and local taxes than most other income groups, and the state's tax policies should work to narrow racial wealth gaps, not widen them.

California policymakers can make the tax and revenue system more equitable. This includes ensuring that Californians with high incomes and wealth pay their fair share to support critical state services, providing further support for Californians with low incomes — such as by increasing and expanding refundable tax credits and making other tax credits refundable to benefit more low-income households — and eliminating or reforming tax benefits that primarily help wealthy Californians. Moving toward more robust taxation of Californians with higher income and wealth would also generate revenues that can be spent equitably to help more low-income households and Californians of color live and thrive, and expand opportunities to build wealth for themselves, their children, and their communities.

[1] Aureo Mesquita and Sara Kimberlin, *Staying Home During California's Housing Affordability Crisis* (California Budget & Policy Center, July 2020), https://calbudgetcenter.org/resources/staying-home-during-californias-housing-affordability-crisis/. Data are for 2018. "Low-income California household" is defined as a household with income below 200% of the federal poverty threshold — roughly $51,000 for a family of four in 2018 — and "high-income California household" is defined as a household with income of at least four times the federal poverty threshold — roughly $102,000 for a family of four in 2018.

[2] California's personal income tax rates range from 1% to 13.3%. The top rate for each tax bracket, or range of income, is only applied to the amount of income that exceeds the income threshold for that bracket.

[3] Carl Davis, Marco Guzman, and Jessica Schieder, *State Income Taxes and Racial Equity: Narrowing Racial Income and Wealth Gaps with State Personal Income Taxes* (Institute on Taxation and Economic Policy, October 2021), 11, https://itep.sfo2.digitaloceanspaces.com/State-Income-Taxes-and-Racial-Equity_ITEP_October2021.pdf; Adriana Ramos-Yamamoto and Monica Davalos, *Confronting Racism, Overcoming COVID-19, and Advancing Health Equity* (California Budget and Policy Center, February 2021), https://calbudgetcenter.org/resources/confronting-racism-overcoming-covid19-advancing-health-equity/.

[4] Davis, Guzman, and Schieder, *State Income Taxes and Racial Equity*, 11-12. Tax agencies do not collect racial or ethnic information, so the Institution on Taxation & Economic Policy estimates effective tax rates by race/ethnicity by combining tax data and US Census Bureau American Community Survey data using a methodology explained here: https://itep.org/itep-tax-model/iteps-approach-to-modeling-taxes-by-race-and-ethnicity.

[5] Meg Wiehe et al., *Who Pays: A Distributional Analysis of the Tax Systems in All Fifty States* (Institute on Taxation and Economic Policy, October 2018), 19-20, https://itep.sfo2.digitaloceanspaces.com/whopays-ITEP-2018.pdf.

[6] Kayla Kitson, *Promoting Racial Equity Through California's Tax and Revenue Policies* (California Budget & Policy Center, April 2021), 5, https://calbudgetcenter.org/resources/promoting-racial-equity-through-californias-tax-and-revenue-policies; Kayla Kitson, *Tax Breaks: California's $60 Billion Loss* (California Budget & Policy Center, January 2020), 6-8, 10-11, https://calbudgetcenter.org/resources/tax-breaks-californias-60-billion-loss.