

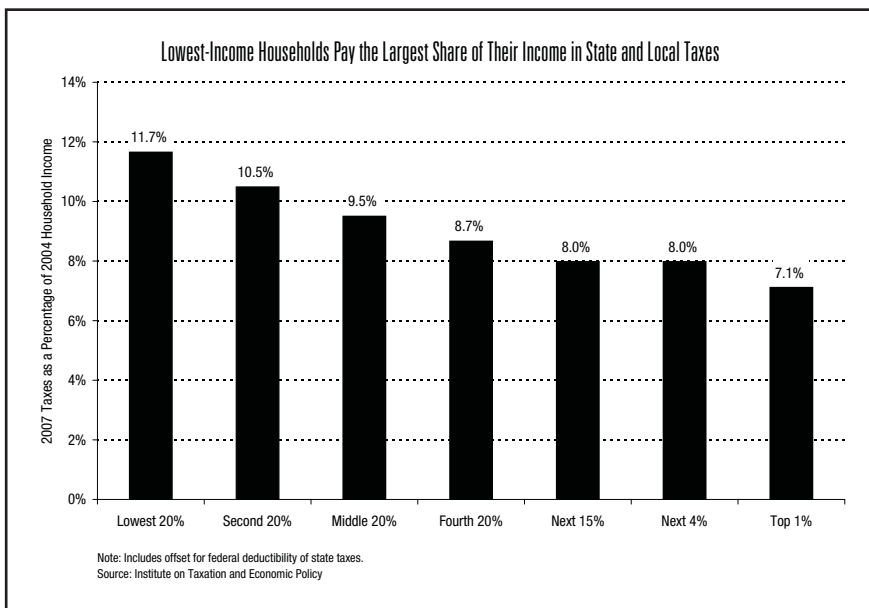
## WHO PAYS TAXES IN CALIFORNIA?

**F**ormer Supreme Court Justice Oliver Wendell Holmes once noted that, “Taxes are what we pay for civilized society.” State and local taxes support our public schools, streets and highways, public hospitals that form the backbone of the state’s trauma care system, parks and beaches, the public health infrastructure that ensures that our food is safe to eat and our water is safe to drink (and that delivers water to homes across California), as well as a range of other services. While the primary purpose of a tax system is to raise the money needed to support public services, tax policy can also serve as an end in itself, providing incentives for taxpayers to engage in desired activity or providing cash assistance to certain individuals. Tax day – the day Californians are required to file their income tax returns – provides an opportunity to look at who pays taxes in California, who doesn’t, and how California’s tax systems compare to those of other states.

### K E Y F A C T S

#### ■ How much do Californians pay in state and local taxes?

Measured as a share of family income, California’s poorest families pay the most in taxes. The poorest fifth of the state’s households, with an average income of \$11,100, spend 11.7 percent of their income on state taxes.<sup>1</sup> In comparison, the wealthiest 1 percent, with an average income of \$1.6 million, spend 7.1 percent of their income on state taxes.



The share of income California's families spend on state and local taxes is a function of the state's highly progressive personal income tax and regressive sales and excise taxes. Higher-income households pay a larger share of their income in income taxes. Lower-income households pay a greater share of their income in sales and property taxes. Households also indirectly pay a portion of the taxes imposed on business through higher prices and reduced corporate earnings. Higher-income households pay a greater share of the corporate income tax, whereas lower-income households pay a greater share of the sales and excise taxes paid by businesses.

■ **Who pays income taxes in California?**

A single mother with one child will have no 2007 state income tax liability unless she earns more than \$39,283. A family of four with two children will have no 2007 state income tax liability unless their income exceeds \$49,083.<sup>2</sup> California's high income-tax threshold – the income level at which an individual or family begins to pay income taxes – is attributable to the increases in the dependent credit enacted in 1997 and 1998. The state's high tax threshold also means that low- to moderate-income families receive minimal or no benefits from the state's various credits, deductions, and other tax benefits, because they have little or no tax liability to offset.

California's Personal Income Tax Thresholds Are High			
	2007 Tax Threshold	2007 Federal Poverty Line	Tax Threshold as a Percentage of the Federal Poverty Line
Single, no children	\$14,667	\$10,787	136%
Married, no children	\$29,283	\$13,884	211%
Head of household, one child	\$39,283	\$14,291	275%
Head of household, two children	\$46,683	\$16,705	279%
Married, one child	\$41,683	\$16,689	250%
Married, two children	\$49,083	\$21,027	233%

Note: Assumes families claim the standard deduction and the renters' tax credit. The 2007 federal poverty line assumes non-elderly householders.

Source: Franchise Tax Board and US Census Bureau

■ **How much does the "average" California family earn?**

California's 2006 median *household* income, the income at which half of all households earned more and half earned less, was \$55,319.<sup>3</sup> The median income for all California personal income *taxpayers* was \$35,390 in 2006, the most recent year for which data are available.<sup>4</sup> The 2006 median income of taxpayers filing joint returns was \$66,810.

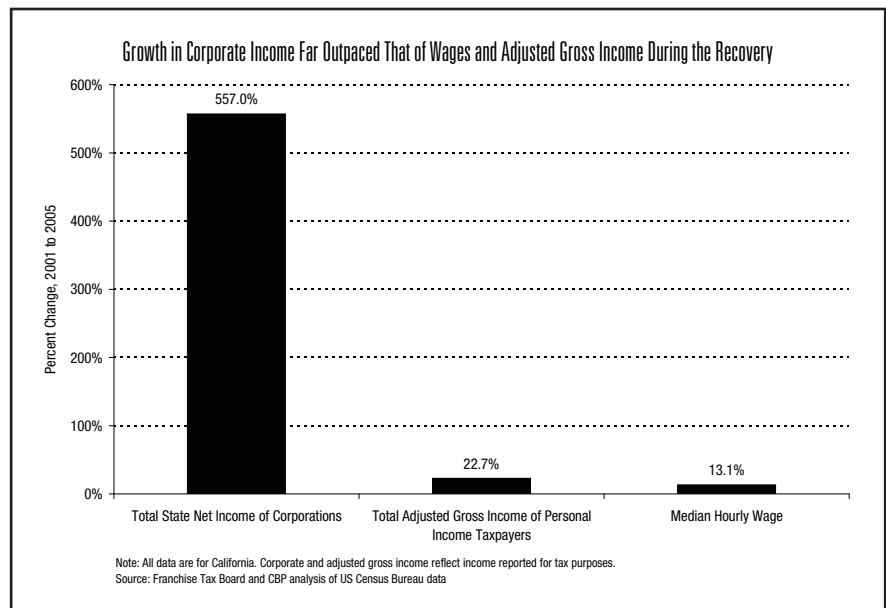
■ **Who pays the corporate income tax in California?**

Small businesses pay a very small share of the corporate income tax. While 651,059 corporations filed tax returns, the 1.9 percent with taxable incomes of \$1 million or more paid 86.9 percent of the 2005 tax.<sup>5</sup> The most costly corporate tax credit is the Research and Development (R&D) Credit. In 2005, 1,847 corporations claimed \$953.4 million in R&D credits, averaging \$516,206 per firm.<sup>6</sup> Overall, relatively few corporations claim the state's various tax credits. In 2005, fewer than 1 percent of the state's corporations claimed *any* of the state's tax credits.

■ **Growth in corporate profits has far outpaced that of personal income.**

A number of recent research reports have documented the rise in corporate profits and decline in the share of national income accounted for by wages and salaries.<sup>7</sup> While comparable data are not available for California, the data that are available show that the recent growth in corporate profits reported for California tax purposes far exceeds that of

income reported by individual taxpayers. Between 2001 and 2005, the most recent year for which data are available, the total adjusted gross income of California's personal income taxpayers increased by 22.7 percent. In contrast, the net profits reported by corporations for California tax purposes increased more than sixfold, rising by 557.0 percent.



## ■ Is California a high tax state?

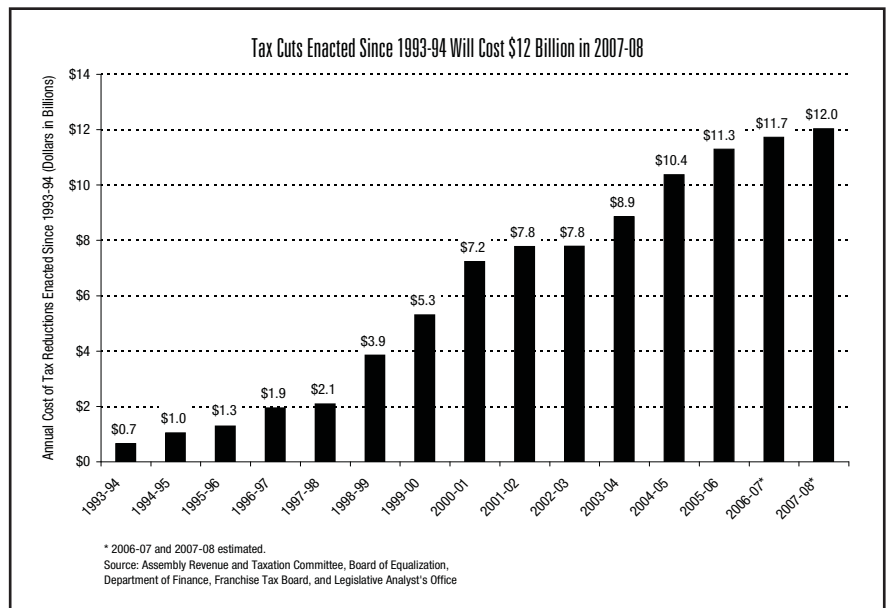
California is a moderate tax state. In 2005-06, California ranked 13th among the 50 states with respect to state taxes as a percentage of personal income and the state ranked 18th with respect to total "own source" revenues – the broadest measure of state and local revenues – raised by state and local governments in 2004-05, the most recent year for which data are available. California ranks relatively high with respect to personal and corporate income tax collections. The state ranks relatively low with respect to property, vehicle fuel, and alcoholic beverage taxes.

How Does California Compare? Revenues as a Percentage of Personal Income			
	California Rank	California	US
Total State and Local Own Source (2004-05)	18	16.51%	15.79%
Total State and Local Taxes (2004-05)	16	11.23%	10.93%
State Taxes (2005-06)	13	7.98%	6.66%
Local Taxes (2004-05)	32	3.69%	4.44%
State and Local General Sales Taxes (2004-05)	16	2.88%	2.62%
State and Local Property Tax (2004-05)	38	2.61%	3.35%
State General Sales Tax (2005-06)	20	2.31%	2.14%
State Motor Fuels Taxes (2005-06)	45	0.24%	0.34%
State Tobacco Tax (2005-06)	42	0.08%	0.14%
State Alcoholic Beverage Sales Taxes (2005-06)	41	0.02%	0.05%
State Individual Income Tax (2005-06)	3	3.67%	2.30%
State Corporate Income Tax (2005-06)	6	0.74%	0.45%

Source: US Bureau of Economic Analysis and US Census Bureau

## ■ How have California's tax policies changed over time?

Over the past three decades, the cost of funding state services has shifted from corporate to personal income taxpayers. Forecasters estimate that personal income tax receipts will provide 54.9 percent of General Fund revenues in 2008-09, up from 35.4 percent in 1980-81. Corporate tax receipts are expected to provide 11.6 percent of General Fund revenues in 2008-09, down from 14.6 percent in 1980-81. New, increased, and expanded corporate tax breaks and the 1996 corporate tax rate reduction are responsible for the decline in the share of state revenues provided by the corporate income tax. Tax cuts have limited growth in state revenues as a whole, with tax cuts enacted since 1993 reducing 2007-08 General Fund revenues by an estimated \$12 billion.



## ■ Who doesn't pay taxes in California?

In 2005, the most recent year for which data are available, 520,567 taxpayers reported incomes of \$200,000 or more. However, 1,597 of these households paid no California personal income tax.<sup>8</sup> How did they do it? The largest tax breaks claimed by "no tax" households include enterprise zone tax credits, miscellaneous deductions, and the R&D Credit. The number of high-income "no tax" returns more than tripled between 1996 and 2005, rising from 510 to 1,597.

*MacKenzie Smith and Jean Ross prepared this Policy Points. The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, individual donations, and subscriptions. Please visit the CBP's website at [www.cbp.org](http://www.cbp.org).*

## ENDNOTES

- <sup>1</sup> Institute on Taxation and Economic Policy. Reflects 2007 tax laws and 2004 income levels and offset for federal deductibility.
- <sup>2</sup> California Franchise Tax Board. Assumes families claim the standard deduction and the renters' tax credit. The figure for a family of four is for a married couple.
- <sup>3</sup> US Census Bureau.
- <sup>4</sup> Personal communication with Franchise Tax Board (April 11, 2008).
- <sup>5</sup> California Franchise Tax Board, *Annual Report 2006*, p. 161.
- <sup>6</sup> California Franchise Tax Board, *Annual Report 2006*, p. 159.
- <sup>7</sup> See, for example, Aviva Aron-Dine and Isaac Shapiro, *Share of National Income Going to Wages and Salaries at Record Low in 2006: Share of Income Going to Corporate Profits at Record High* (Center on Budget and Policy Priorities: March 29, 2007) downloaded from <http://www.cbpp.org/8-31-06inc.htm> on April 2, 2007.
- <sup>8</sup> California Franchise Tax Board, *Annual Report 2006*, pp. 18-19.