CALIFORNIA BUDGET PROJECT

policy points

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WHO PAYS TAXES IN CALIFORNIA?

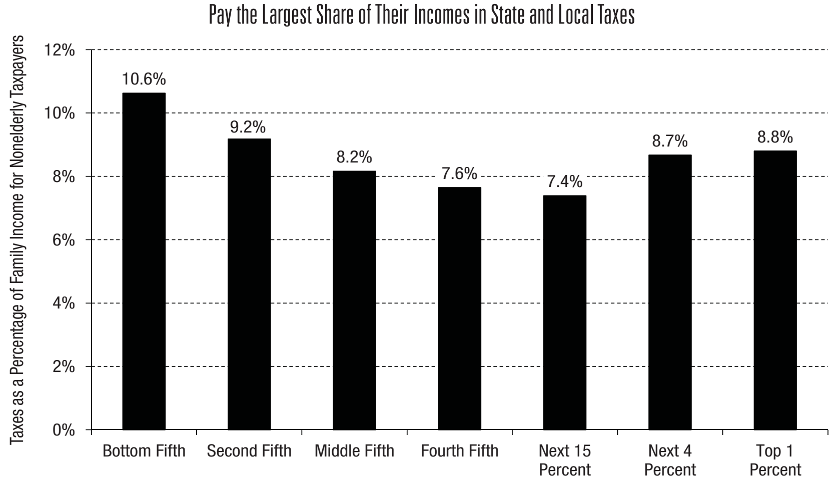
Former Supreme Court Justice Oliver Wendell Holmes once noted that "Taxes are what we pay for civilized society." State and local taxes support our public schools, colleges, and universities; streets and highways; public hospitals that form the backbone of the state's trauma care system; parks and beaches; the public health infrastructure that ensures that our food is safe to eat and our water is safe to drink; 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 system compares to those of other states.

KEY FACTS

- **How much do Californians pay in state and local taxes?**

California's lowest-income families pay the most in taxes, when measured as a share of family income. This is true even after accounting for Proposition 30's temporary personal income tax increases for very wealthy Californians, which took effect in 2012 (described on page 2). The bottom fifth of the state's nonelderly households, with an average income

Even With Proposition 30's Tax Rate Increases, California's Lowest-Income Families Pay the Largest Share of Their Incomes in State and Local Taxes



Note: Includes impact of Proposition 30 temporary tax rates and offset for federal deductibility of state taxes.
Source: Institute on Taxation and Economic Policy

of $13,000, spend 10.6 percent of their incomes on state and local taxes.[1] In comparison, the wealthiest 1 percent of households, with an average income of $1.6 million, spend 8.8 percent of their incomes on state and local taxes. The share of income that California's families spend on state and local taxes is a function of the state's relatively progressive personal income tax and regressive sales and excise taxes. Higher-income families pay a larger share of their incomes in income taxes. Lower-income families pay a greater share of their incomes in sales and property taxes. Families also indirectly pay a portion of the taxes imposed on businesses – through higher prices, for example. Higher-income families pay a greater share of the corporate income tax, whereas lower-income families pay a greater share of the sales and excise taxes paid by businesses.

- **How does Proposition 30 affect the state's tax rates?**

Approved by voters in November 2012, Proposition 30 added three temporary personal income tax brackets – with additional rates of 1, 2, and 3 percent, depending on income – on top of the highest existing rate of 9.3 percent. These rates apply only to very-high-income Californians: single filers whose taxable income exceeds $250,000 and joint filers whose taxable income exceeds $500,000.[2] The rates will be in effect for seven years, from tax year 2012 through tax year 2018. The measure also increased the state sales tax rate by one-quarter cent for four years, from January 1, 2013 through December 31, 2016. Overall, Proposition 30's tax increases are progressive, equal to 1.1 percent of the average income of Californians in the top 1 percent of the income distribution, compared to between 0.1 percent and 0.2 percent of the average income of Californians in each of the bottom four fifths of the distribution.

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

A single parent with one child will have no 2012 state income tax liability unless he or she earns at least $42,392. A married couple with two children will have no 2012 state income tax liability unless their income is at least $53,336.[3] 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 thresholds mean 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

	2012 Tax Threshold	2012 Federal Poverty Line	2012 Tax Threshold as a Percentage of the 2012 Federal Poverty Line
Single, no children	$15,769	$11,945	132%
Married, no children	$31,537	$15,374	205%
Head of household, one child	$42,392	$15,825	268%
Married, one child	$45,311	$18,480	245%
Head of household, two children	$50,738	$18,498	274%
Married, two children	$53,336	$23,283	229%

Note: Assumes tax filers claim the standard deduction and the renter's credit. The federal poverty line assumes nonelderly householders.
Source: Franchise Tax Board and US Census Bureau

- **How much does the typical California family earn?**

California's 2011 median *household* income, the income at which half of all households earned more and half earned less, was $53,367.[4] The median income for all California personal income *tax filers* was $33,933 in 2010, the most recent year for which data are available, while the median income of Californians filing joint tax returns was $65,772.[5]

■ **How do California's tax collections compare to those of other states?**

Total "own source" revenues raised by state and local governments are the broadest measure of state and local revenues.[6] In 2009-10, the most recent year for which data are available, California ranked 15th among the 50 states in total own source revenues as a percentage of personal income. California ranked 11th with respect to state taxes as a percentage of personal income in 2010-11, up from 21st in 2008-09. This change reflects higher revenues from temporary increases in the personal income tax, which expired on December 31, 2010, and in the sales tax and Vehicle License Fee, which expired on June 30, 2011. California ranks relatively high with respect to personal and corporate income tax collections, and relatively low with respect to tobacco 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 (2009-10)	15	16.51%	15.65%
Total State and Local Taxes (2009-10)	10	11.30%	10.57%
State Taxes (2010-11)	11	7.24%	6.00%
Local Taxes (2009-10)	23	4.44%	4.71%
State Personal Income Tax (2010-11)	6	3.13%	2.05%
State Corporate Income Tax (2010-11)	4	0.60%	0.32%
State and Local General Sales Taxes (2009-10)	19	2.61%	2.37%
State General Sales Tax (2010-11)	23	1.92%	1.86%
State and Local Property Tax (2009-10)	24	3.53%	3.68%
State Motor Fuels Taxes (2010-11)	22	0.35%	0.32%
State Tobacco Tax (2010-11)	46	0.06%	0.14%
State Alcoholic Beverage Sales Taxes (2010-11)	42	0.06%	0.14%

Note: US excludes the District of Columbia.
Source: CBP analysis of US Bureau of Economic Analysis and US Census Bureau data.

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

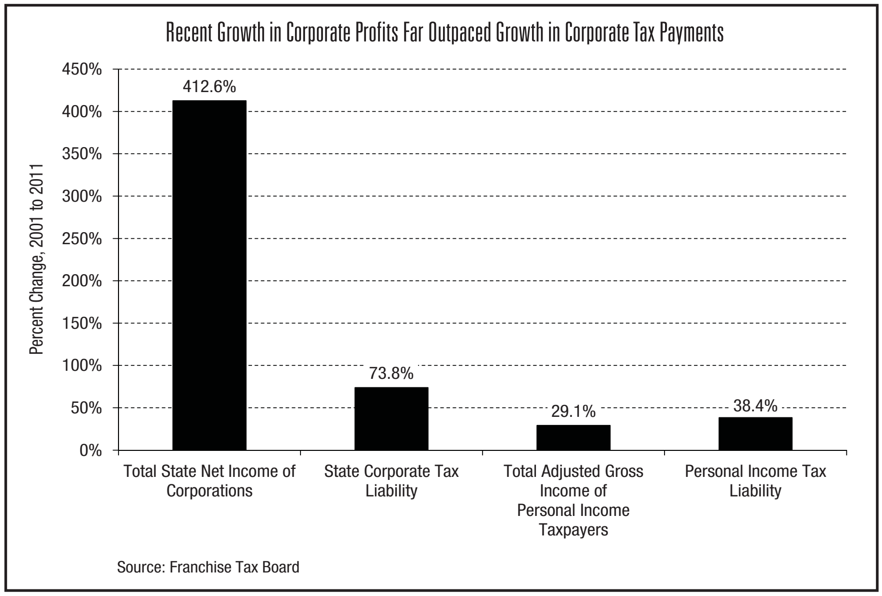
Over the past three decades, the cost of funding state services has shifted from corporations to personal income tax filers. The Department of Finance estimates that personal income tax receipts will provide 64.8 percent of General Fund revenues in 2012-13, up from 37.7 percent in 1981-82.[7] Meanwhile, corporate tax receipts are expected to provide 8.1 percent of General Fund revenues in 2012-13, down from 13.3 percent in 1981-82. New, increased, and expanded corporate tax breaks implemented in recent years, along with the 1996 corporate tax rate reduction, are responsible for the decline in the share of state revenues provided by the corporate income tax.

■ **How does the growth in corporate income compare to the growth in individual taxpayers' income?**

A number of research reports have documented the rise in corporate profits and decline in the share of national income accounted for by wages and salaries.[8] 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 the growth of income reported by individual taxpayers. Between 2001 and 2011, the most recent year for which data are available, the total adjusted gross income of California's personal income taxpayers increased by 29.1 percent. In contrast, the net profits reported by corporations for California tax purposes increased by 412.6 percent (see chart, page 4).

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

California's largest businesses pay by far the greatest share of the corporate income tax. While 738,224 corporations filed tax returns, the 1.6 percent with taxable incomes of $1 million or more paid 87.0 percent of the 2010 corporate income tax.[9]



- **What are the state's most expensive corporate tax credits?**

The most costly corporate tax credit is the Research and Development (R&D) Credit. In 2010, 3,069 corporations claimed $1.8 billion in R&D credits, an average of $586,571 per firm.[10] The most widely used corporate tax credits are the state's Enterprise Zone Hiring and Enterprise Zone Sales and Use Tax Credits, with 5,856 corporations claiming $459.0 million in 2010, an average of $78,389 per firm. Overall, relatively few corporations claim the state's various tax credits. In 2010, just 1.7 percent of corporations filing taxes in California claimed *any* of the state's tax credits. Even so, the state lost an estimated $6 billion in potential revenues due to corporate tax expenditures – spending through the tax code in the form of tax exemptions, deductions, credits, and exclusions – in 2012-13. Revenue loss from tax expenditures as a percentage of actual revenues collected is substantially greater for the corporate income tax than for the personal income tax or the sales and use tax.[11]

Tax Expenditures as a Percentage of Revenues Collected, 2012-13

State Taxes	Revenue (Millions)	Revenue Reduction Attributable to Tax Expenditures (Millions)	Tax Expenditure Revenue Loss as a Percentage of Total Revenue
Corporate Income Tax	$7,580	$6,000	**79.2%**
Personal Income Tax	$60,647	$33,000	**54.4%**
Sales and Use Tax	$20,714	$10,000	**48.3%**
TOTAL	$88,941	$49,000	**55.1%**

Source: Department of Finance

- **Who doesn't pay taxes in California?**

Estimates suggest that California loses around $10 billion annually in income tax revenues alone to individuals and businesses that don't pay their taxes or pay less than the taxes they actually owe.[12] In addition, some California households that file personal income tax returns owe no tax. These include some high-income households that benefit from tax breaks. In 2010, the most recent year for which data are available, 2,135 of the 609,199 taxpayers who reported incomes of $200,000 or more paid no California personal income tax.[13] The number of high-income "no tax" returns more than tripled between 1997 and 2010, rising from 579 to 2,135.

- **How many Californians pay sales tax on goods purchased from outside the state?**

California loses more than $1 billion each year in unpaid sales taxes on goods purchased from outside the state when online retailers refuse to collect the taxes owed on consumers' purchases.[14] Consumers and businesses are still legally obligated to pay the taxes for these purchases, but few do because they are unaware that they owe the tax. In 2010, just 78,000 out of 14.8 million taxpayers paid the tax when they filed California personal income tax returns.[15] Retailers outside the state failed to collect $795 million in these taxes from consumers and $350 million from businesses in 2010-11, according to estimates from the Board of Equalization.[16]

For a comprehensive overview of California's tax system, see the California Budget Project publication* Principles and Policy: A Guide to California's Tax System *(April 2013), available at www.cbp.org.

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, subscriptions, and individual donations. Please visit the CBP's website at www.cbp.org.

ENDNOTES

1 Institute on Taxation and Economic Policy. Reflects 2010 income levels and offset for federal deductibility of state taxes.

2 The 9.3 percent rate now applies to taxable income between $48,943 and $250,000 for single tax filers and between $97,885 and $500,000 for joint tax filers. The new 10.3 percent tax rate applies to single filers' taxable income between $250,001 and $300,000 and joint filers' taxable income between $500,001 and $600,000; the 11.3 percent tax rate applies to single filers' taxable income between $300,001 and $500,000 and joint filers' taxable income between $600,001 and $1 million; and the 12.3 percent tax rate applies to single filers' taxable income above $500,000 and joint filers' taxable income above $1 million. An additional 1 percent rate applies to taxable income above $1 million. The revenues from that 1 percent rate are dedicated to mental health services in accordance with Proposition 63, approved by voters in 2004.

3 Franchise Tax Board. Assumes families claim the standard deduction and the renter's credit. The figure for a married couple is for a joint return.

4 US Census Bureau. This was down from a high of $59,821 in 2006.

5 Franchise Tax Board, *2011 Annual Report – Statistical Appendix Tables,* Table B-6.

6 The term "own source revenues" refers to general revenue from state and local governments' own sources. This category includes state and local taxes, "current charges," and "miscellaneous general revenue." The current charges subcategory is composed of revenues attributable to higher education, school lunch sales, hospitals, highways, airports, parking, ports, natural resources, parks and recreation, housing and community development, sewers, and solid waste management. Miscellaneous general revenue is composed of interest earnings, revenue attributable to special assessments and the sale of property, and other general revenue.

7 Department of Finance, *Governor's Budget Summary 2013-14,* Schedule 8 (January 2013).

8 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) and California Budget Project, *On the Edge: California's Workers Still Face the Toughest Job Market in Decades* (September 2011), pp. 29-30.

9 Franchise Tax Board, *2011 Annual Report – Statistical Appendix Tables,* Table C-8.

10 Franchise Tax Board, *2011 Annual Report – Statistical Appendix Tables,* Table C-7.

11 Sales tax expenditures are exclusions of certain items, such as food and prescription medicines, from the sales tax. Department of Finance, *Tax Expenditure Report 2012-13,* pp. 45-54.

12 Franchise Tax Board, "Tax Gap" (no date), accessed April 4, 2013, at https://www.ftb.ca.gov/Tax_Gap/index.shtml.

13 Franchise Tax Board, *2011 Annual Report – Statistical Appendix Tables,* Table B-4A.1.

14 Board of Equalization, *Revenue Estimate: Electronic Commerce and Mail Order Sales* (December 6, 2010), downloaded from http://www.boe.ca.gov/legdiv/pdf/e-commerce-11-10.pdf on April 4, 2013. Californians who purchase taxable goods from outside of the state through the Internet or by phone or mail owe "use tax" in an amount equal to what they would have paid in sales tax had the purchase been made from a retailer in California. Since the sales and use taxes are complementary, they are often referred to simply as the sales tax.

15 Franchise Tax Board, *Revenue Estimating Exhibits* (May 2012), Exhibit A-4, pp. 1 and 4.

16 Board of Equalization, *Revenue Estimate: Electronic Commerce and Mail Order Sales* (December 6, 2010), downloaded from http://www.boe.ca.gov/legdiv/pdf/e-commerce-11-10.pdf on April 4, 2013.