Toward a Fair and Adequate Revenue System: Emerging Tax Proposals in CA

POLICY INSIGHTS 2018
SACRAMENTO, CA
MARCH 22, 2018

calbudgetcenter.org
What does the federal GOP tax bill mean for California?
The recently enacted federal tax bill mainly benefits corporations and high-income households.

President Trump signed the tax bill in December 2017. Many of its provisions – mainly affecting taxes paid on personal income – expire after 2025.
The Tax Bill Primarily Benefits Corporations and High-Income Households

• The federal tax bill delivers most of its benefits to the already well-off in a number of ways. For example, the bill:
  — Permanently cuts the top corporate income tax rate from 35% to 21%.
  — Creates a 20% deduction, through 2025, for income from “pass-through” businesses. These include law firms and hedge funds.

• The average taxpayer in the bottom 60% will initially see a relatively small tax cut, but will later experience a tax increase due to the expiration of most of the bill’s provisions in 2025, according to the Institute on Taxation and Economic Policy (ITEP).
In California, the share of corporate income paid in state taxes has been falling for decades.

Corporate net income rose from $24 billion in 1981 to $203 billion in 2015. Yet, over this same period, the share of this income paid in state corporation taxes fell from nearly 10% to 4.4%.
The Share of Corporate Income Paid in State Taxes Fell By More Than Half Between 1980 and 2015

Corporate Taxes as a Percentage of Income for Corporations Reporting Net Income

Source: Franchise Tax Board
What are the goals that we seek to achieve with our tax system and what does California’s tax system look like today?
What Should a Good Tax System Do?

- **Adequacy**: Provide an adequate level of revenues on a timely basis.
- **Fairness**: Distribute the cost of paying for public services fairly.
- **Growth**: Promote economic growth and efficiency and keep pace with sources of economic growth.
- **Administrative ease**: Be easily administered; and,
- **Accountability**: Ensure accountability and transparency.
The Personal Income Tax Is Projected to Account for Two-Thirds of California’s General Fund Revenues

Projected 2018-19 General Fund Revenues = $134.8 Billion

Note: Reflects total projected General Fund revenues before a $5.1 billion transfer to the state’s rainy day fund, $1.5 billion of which is required by Proposition 2 (2014).

* Includes Highway Users Taxes, Insurance Tax, Alcoholic Beverage Taxes and Fees, Cigarette Tax, Motor Vehicle Fees, and other various additional sources of revenue.

Source: Department of Finance
Property taxes are an important source of local revenues.

For example, property taxes comprise roughly 20% of total revenues received by counties.
Property Taxes Comprise Roughly One-Fifth of Total County Revenues, 2015-16

- Federal Funds: 15.7%
- State Funds: 31.4%
- Property Taxes: 19.5%
- Enterprise Revenues*: 14.8%
- Charges for Current Services: 8.8%
- Other**: 9.7%

* Reflects revenues associated with business-type activities, such as airports and hospitals.
** Reflects a range of smaller revenue sources, including other taxes, fines, licenses, and permits.
Note: Excludes the City and County of San Francisco. Percentages do not sum to 100 due to rounding.
Source: California State Controller’s Office
Local governments’ ability to boost revenues is severely constrained by state rules. As a result, it’s difficult for local jurisdictions to raise taxes in order to enhance or expand services.
Locals Can Increase the Property Tax Rate Only to Fund Voter-Approved Debt

- Proposition 13 (1978) limits the countywide property tax rate to 1% of a property’s assessed value. Revenues raised by this rate are allocated to jurisdictions within the county.

- Local governments can boost the property tax rate only to pay for voter-approved debt (generally infrastructure bonds).
  - The property tax rate cannot be increased to raise revenues for local services.

- Property tax rate increases for certain school facility bonds need approval by 55% of local voters. Increases for other types of infrastructure bonds need approval by two-thirds of local voters.
Moreover, when local tax increases are approved, they often are regressive, meaning they affect lower-income households more than others.

Examples of regressive taxes include the sales tax and taxes on parcels of property.
How is California faring, economically and fiscally?
California’s Low- and Midwage Workers Have Seen Only Modest Gains Since 1979
Percent Change in Inflation-Adjusted Hourly Wages for Workers Ages 18-64

Note: Figures reflect 2017 dollars.
Due to Higher Revenues, 2018-19 Spending Per Student Would Be More Than $3,400 Above 2011-12
K-12 Proposition 98 Spending Per Pupil, Inflation-Adjusted

* 2017-18 estimated and 2018-19 proposed.
Note: Figures reflect 2018-19 dollars and exclude spending for adult education, preschool, and child care. Prop. 98 spending reflects both state General Fund and local property tax dollars.
Source: Legislative Analyst’s Office
California Ranks Low on Several Measures of Support for K-12 Education

• In 2015-16, California ranked:

  — **51st nationally in the number of K-12 students per teacher** (about 22-to-1).

  — **41st in K-12 spending per student**, after adjusting for differences in the cost of living in each state.

  — **37th in K-12 spending as a share of the state economy**, as measured by personal income.
State Spending Per Student at CSU and UC Remains Well Below Pre-Recession Levels, Despite Recent Increases

Direct General Fund Expenditures Per Full-Time Student, Inflation-Adjusted

*Estimated.

Note: Figures are in 2016-17 dollars and reflect “full-time equivalent” enrollment, which accounts for credits taken by each student relative to a full-time course load. Data exclude indirect state funding for CSU and UC attributable to Cal Grant tuition and fee payments.

Source: Department of Finance, California State University, and University of California
Enrollment in Subsidized Child Care and Preschool Has Not Recovered From Recession-Era Cuts

Average Monthly Number of Children Enrolled

Note: Figures are rounded to the nearest thousand. California Community Colleges CalWORKs Stage 2 data for 2016-17 reflect estimates, not actuals.

Source: California Community Colleges Chancellor’s Office, California Department of Education, and Department of Social Services
Without an Increase in 2018-19, CalWORKs Grants Will Be Below the Deep-Poverty Line for the Eleventh Straight Year

Annualized Maximum Grant for a Family of Three as a Percentage of the Federal Poverty Line

Note: Grants are for high-cost counties. The proposed 2018-19 budget does not increase grant levels.

Source: Budget Center analysis of Department of Social Services, US Department of Health and Human Services, and US Social Security Administration data
Due to Budget Cuts, State Spending for SSI/SSP Grants Is About 40% Below the 2007-08 Level

General Fund Expenditures in Billions, Inflation-Adjusted

Note: Figures are in 2018-19 dollars. All figures are estimates except for 2018-19, which reflects the Governor’s proposed expenditure level.
Source: Department of Social Services