

Is California A High Tax State?

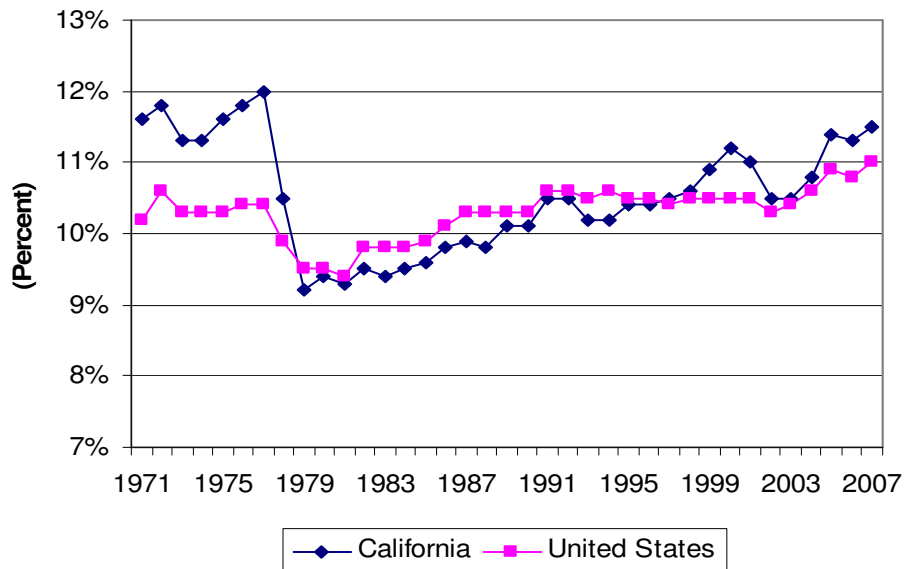
The claim is often made that California is a “high tax” state meaning that residents and businesses face higher tax rates for state and local government services compared to most other states. For example, the Tax Foundation in Washington, D.C. ranks California 47th among the 50 states (50th is the lowest rank) for what they call “business tax climate”.

What do the data show?

In 2007 state and local taxes in California amounted to approximately \$170 billion or 11.5% of personal income in the state. The national average share of income devoted to state and local taxes was 11.0%, which would have raised \$162 billion instead of \$170 billion in California.

California was a “high tax” state in the early 1970s before Proposition 13 lowered property taxes by 60%. After Proposition 13 was passed the share of income devoted to state and local taxes in California has been relatively close to the national average as shown below. The share of income devoted to state and local taxes has risen over the past 25 years in both the state and nation.

State and Local Taxes as Percent of Income



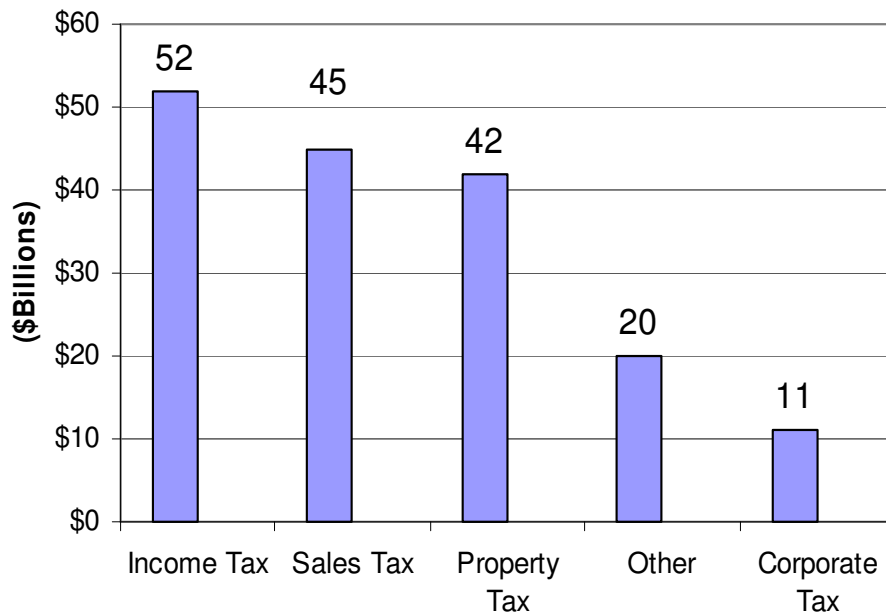
Currently the 11.5% tax share in California is higher than the 11.0% national average but that, by itself, does not make California a “high tax rate” state. For example, surges in the tax share in 1999 and 2000 and again recently were primarily the result of increases in stock option and capital gains income with the Internet boom and, more recently, with the Google stock offering.

The Five Major State and Local Tax Sources

In the 2006-2007 fiscal year the \$170 billion in state and local tax revenue in California came from five major sources: 1) personal income taxes of \$52 billion, 2) sales taxes of \$45 billion, 3) property taxes of \$42 billion, 4) corporate income taxes of \$11 billion and 5) approximately \$20 billion in other taxes.

The personal and corporate income taxes go into the state General Fund. Sales taxes are split between state government (\$28 billion) and local government and local transportation agencies. Property taxes fund schools, cities, counties and special districts. The miscellaneous taxes go primarily to local governments.

State and Local Taxes in California 2006-2007



The following sections examine personal income, sales, property and corporate income taxes in California to describe how California tax rates compares to tax rates in other states.

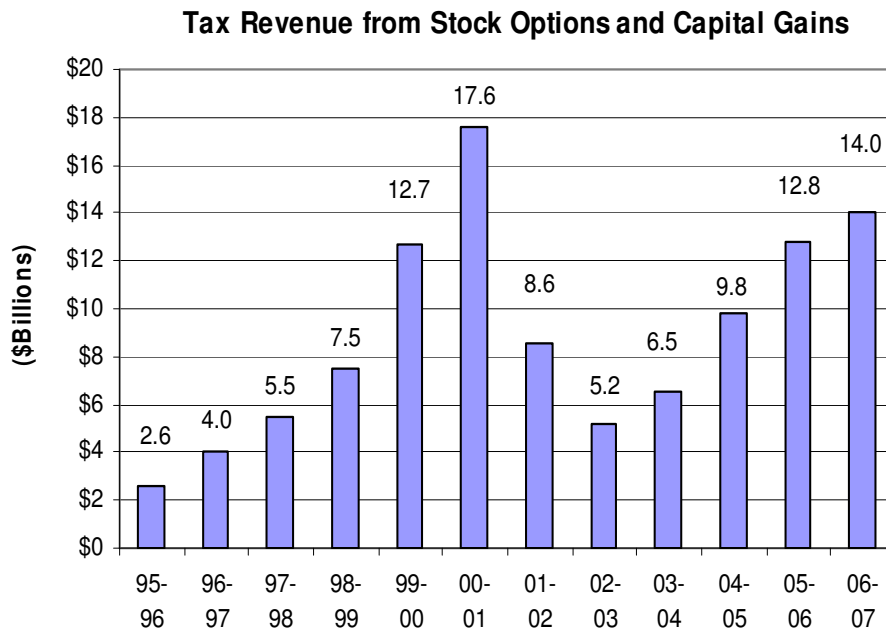
Personal Income Taxes

Are California's personal income tax rates high compared to rates in other states? The answer is yes and no.

Until 2005 California had a top income tax bracket of 9.3%. Starting in 2005 California added a 10.3% tax bracket for incomes of more than \$1 million. Only 6 states have top income tax rates above 8.5%. So California has one of the highest top-bracket income tax rates and the highest for households earning more than \$1 million.

On the other hand California's lowest income tax rate is 1% while most states have a bottom bracket of 2, 3 or 4%. So lower-income households face lower tax rates in California compared to most other states.

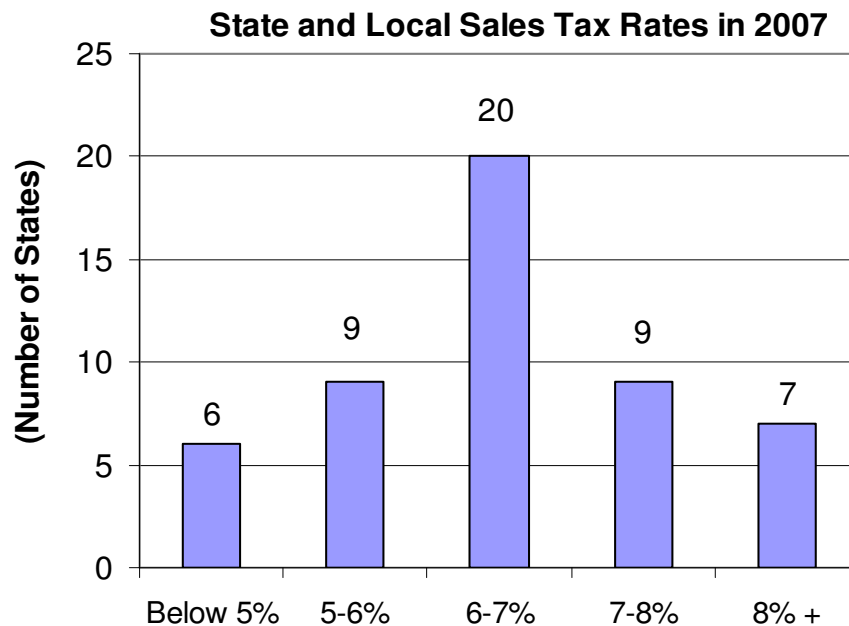
The state income tax structure is very progressive and a high share of personal income tax revenues come from households earning more than \$100,000. Moreover, a large share of revenue growth has come from stock option and capital gains income. Most of the revenue growth and the increase in California's ratio of taxes to income came **without any change** in tax rates. Approximately \$1 billion of current income tax revenue is the result of the 10.3% bracket being added in 2005.



Sales Tax Rates

The state collects a sales tax rate of 7.25% of which 2% is allocated to local governments and 5.25% to the state General Fund. In addition 28 counties have passed local sales taxes for transportation and county services and more than 50 cities and counties have additional sales taxes for local services. Local sales tax rates vary from 0% to 1.5%. The average sales tax rate in California including the state and local portions is 7.95%.

Seven states have combined state and local sales tax rates higher than California's, which is tied with Texas and just slightly higher than Arizona.



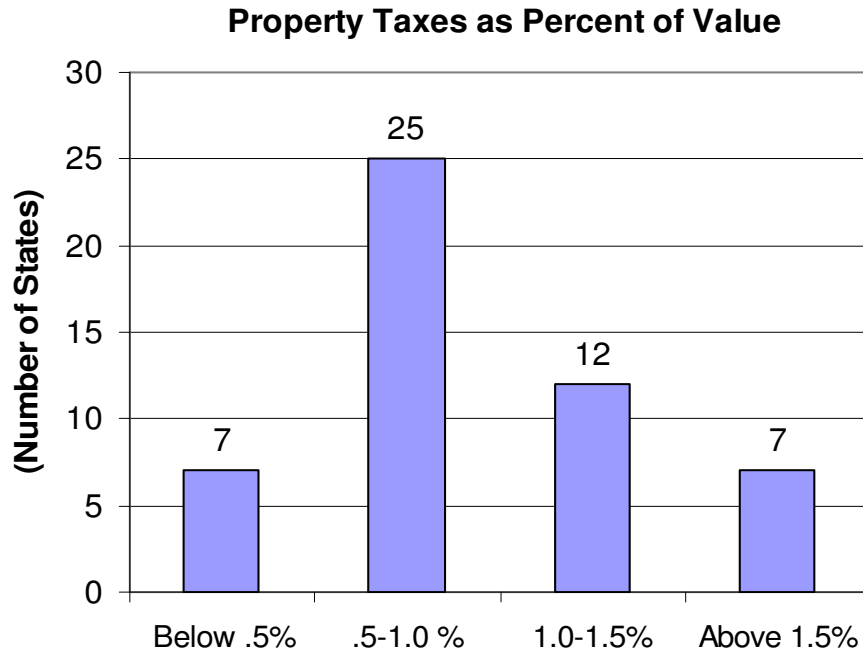
So California does have a relatively high sales tax rate. A portion of the sales tax rate (1%) was added in the early 1990s to replace local property tax revenue that was redirected from local governments to fund education.

Property Tax Rates

In 1978 California voters approved Proposition 13, which lowered property tax rates by approximately 60%. Proposition 13 established a ceiling of 1% of assessed value for local property tax rates **and** limited the increase in assessed valuation to 2% per year unless the property was sold.

As a result of the limitation of 2% on annual increases in assessed valuation many properties are assessed at much less than market value and the **“effective property tax rate”** in California is not 1% but slightly below .5% or half as much.

Five states (Alabama, Delaware, Hawaii, Louisiana and West Virginia) and the District of Columbia have lower effective property tax rates than California and 45 states have higher effective tax rates. Twenty-five states have effective rates between .5% and 1.0%, 12 states have effective rates between 1.0% and 1.5% and 7 states have tax rates that are equal to more than 1.5% of market value compared to California's .477% rate.



Corporate Income Tax Rates

California's corporate income tax rate is 8.84% with a minimum tax of \$800 per year. California's tax is a flat rate on all taxable income. Several states (15) have corporate tax rates that vary with income like California's personal income tax.

Eleven states and the District of Columbia have a top corporate income tax rate higher than California's. States with higher top brackets include Alaska (9.4%), Iowa (12.0%), Maine (8.93%), Massachusetts (9.5%), Minnesota (9.8%), New Hampshire (9.25%), New Jersey (9.0%), Pennsylvania (9.99%), Rhode Island (9.0%), Vermont (8.9%), West Virginia (9.0%) and the District of Columbia (9.975%). Four additional states have top brackets above 8%.

Thirty-four states have lower corporate tax rates compared to California. Including 12 with top rates between 6% and 7%, 11 with top rates between 7% and 8% and 11 with lower top rates or with no corporate income tax.

Conclusion

California has comparatively high tax rates for corporate income and sales taxes, comparatively high **and** low personal income tax rates depending on your income and comparatively low property tax rates. The structure of tax rates in California is significantly affected by Proposition 13, which switched the primary responsibility for school funding from local property taxes to state revenue sources. Without Proposition 13, California's tax structure would be more similar to that in other states with higher property tax rates and lower income tax rates.

California's state and local tax "share" of 11.5% of income is slightly above the national average of 11.0%. The gap is partly the result of slightly higher overall tax rates and partly because California has an above-average share of residents who receive stock option and capital gains income.

This analysis does not address two important public policy questions facing the state:

- How should we respond to the ongoing budget shortfalls and large future infrastructure spending?
- What is the best policy for promoting economic prosperity—a) lower tax rates and less spending on public services or b) higher tax rates and more spending on public services?

Sources

The state budget data is from the Legislative Analyst's Office for the 2006-2007 budget (www.lao.ca.gov). Comparisons of personal and corporate income tax rates are from the Tax Foundation (www.taxfoundation.org). Comparisons of property tax rates are from the American Community Survey as analyzed by the National Association of Home Builders <http://www.nahb.org/generic.aspx?sectionID=734&genericContentID=76984&channelID=311>.

Sales tax rate comparisons are from <http://www.thestc.com/STRates.stm> the website of the State Tax Clearinghouse, a private sales tax services firm.