
IS CALIFORNIA A HIGH TAX STATE?

Are California's tax rates uncompetively high? Is the tax burden on households and businesses in California out-of-line with similar states? In his State of the State Address, Governor Pete Wilson asserted that "California's taxes are the fifth highest in the nation and the second highest of any industrial state." Is California really a high tax state? What are the facts?

CALIFORNIA IS AN AVERAGE TAX STATE

According to the Statistical Abstract, published by the Governor's Department of Finance, California ranked 27th among the states in total tax revenue per \$1,000 of personal income in 1992-93 and 24th in total state and local tax revenue in 1991-92.¹ Using the broadest measure of tax burden -- combined state and local taxes, fees and assessments -- California ranked 22nd among the states in 1992-93.² California does rank 4th in corporate income tax collections, however, the state's relatively high corporate tax burden is offset by a lower than average property tax burden.

WHAT STATES HAVE A HIGHER TAX BURDEN THAN CALIFORNIA?

States with a higher state tax burden include those often cited as competitors with California in the battle for jobs and economic development. New Mexico, North Carolina, Arizona, Utah and Nevada all have a higher tax burden than California. Similarly, a number of major industrial states impose a higher state tax burden including Minnesota, Wisconsin, Washington, Connecticut and Massachusetts.

States with a higher combined state and local tax, fee, and assessment burden include both traditional industrial states such as Minnesota, New York, Wisconsin, Washington, and Michigan and those often cited as California's competitors for jobs including New Mexico, Utah, Arizona, Oregon, and Idaho.

HOW DOES CALIFORNIA'S TAX BURDEN COMPARE TO THAT OF OTHER STATES?

States vary greatly in the mix of taxes, fees, and assessments used to fund public services. States also differ in the relative burden of state taxes as compared to those levied by local government. While California's ranking for individual taxes varies, in any comprehensive measure of taxation, California typically ranks

¹ *California Statistical Abstract*, Department of Finance. 1992-93 is the most recent year for which information is available. California's ranking in 1991-92 and 1992-93 does not reflect the business tax relief granted in 1993 or the expiration of the top rates on the personal income tax at the end of 1995.

² *Cal-Tax Research* (California Taxpayers Association, March 1996).

near the middle of all states. The figures cited in the chart below include the impact of the tax increases enacted in 1991, but not the corporate tax reductions enacted in 1993 or the expiration of the top rates on high income individuals at the end of 1995.

HOW HAS CALIFORNIA'S TAX BURDEN CHANGED OVER TIME?

Prior to the passage of Proposition 13 in 1978, California was a

	California		U.S.
	Rank	Amount	Average
State and local taxes, fees & assessments (1992-93)	22	\$142.52	\$140.07
Total state taxes (1992-93)	27	\$73.04	\$69.03
Total state and local taxes (1991-92)	24	\$113.80	\$115.57
Property tax revenues (1992-93)	30	\$31.36	\$36.03
Personal income tax revenues (1992-93)	21	\$25.77	\$21.99
State and local sales tax revenues (1991-92)	18	\$29.57	\$27.22
Corporate income tax revenues (1991-92)	4	\$7.13	\$4.49

Source: California Statistical Abstract, California Taxpayers Association, US Census Bureau.

high tax state. In 1976-77, California ranked 3rd highest among the states in total state and local tax revenues per \$1,000 of personal income. California fell to 24th in 1978-79 as a result of Proposition 13 where it remains today. Moreover, total California state and local taxes per \$1,000 of personal income declined 26.5% between 1976-77 and 1991-92. The national average declined 9.7% during the same period. *In other words, California's state and local tax burden has dropped two and a half times more than the national average.*

The \$815 million reduction in 1996-97 revenues attributable to the expiration of the top tax rates on high income personal income taxpayers equals 1.8% of projected General Fund revenues. If the top rates are not restored, California's 1996 tax cut as a percentage of General Fund revenues will rank among the largest in the nation. This revenue loss, along with the reduction in revenues attributable to the Manufacturing Investment Tax Credit and other tax relief granted in 1993 should result in a further drop in California's ranking.

ARE CALIFORNIA'S TAX RATES ON THE WEALTHY TOO HIGH?

California's personal income tax system is widely heralded as one of the most progressive in the country. That is, high income households pay more in taxes as a share of their income, while lower income households pay less. Recently, the progressivity of California's income tax system has come under attack. Critics argue that California's tax burden on the wealthy harms the state's economic competitiveness. A closer look at the data suggests that California is a moderate tax state for all but the very wealthiest. Even then, California is not the highest tax state in the country.

Survey	Income of \$50,000	Income of \$75,000	Income of \$100,000	Income of \$200,000
Money Magazine (1994)	41	34	21	n/a
Minnesota Department of Revenue (1991)	16	26	17	9
District of Columbia/KPMG (1993)	40	35	26	n/a
Citizens for Tax Justice (1991)	36 (\$54,000)	18 (\$82,200)	n/a	5 (\$184,440)

Source: Center for the Study of the States.³

³ Rankings vary based on the year chosen and the amount and type of deductions assumed. These studies are based on the amount of tax a representative taxpayer would pay on the same amount of income and with the same deductions in various states. In 1992, only 20% of California personal income taxpayers reported incomes in excess of \$50,000, 10.4% reported incomes in excess of \$70,000, 4.2% reported incomes in excess of \$100,000, and 1.0% reported incomes in excess of \$200,000. Citizens for Tax Justice reports tax burden by income group. The rankings shown above reflect California's position at the income levels shown in parenthesis.

ARE CALIFORNIA'S CORPORATE TAX RATES OUT OF LINE WITH OTHER STATES?

While California's corporate income tax rate is among the ten highest in the country, the total burden of state and local taxes as a percentage of income and on individual firms is lower and falling. In 1995, California's statutory corporate income tax *rate* ranked 9th in the country. The same study by the ranked California 17th in combined corporate income and property taxes paid.⁴ The difference results from California's narrow tax *base*. California's tax collections are lower due to the number of tax credits, deductions, and exemptions which reduce the amount businesses actually pay in tax. Moreover, California's corporate income tax collections as a percentage of personal income declined 30.4% between 1976-77 and 1991-92.⁵

One typical method of comparing business tax burdens between states is the use of representative taxpayers. Representative taxpayer studies look at the amount of taxes a hypothetical firm would pay in different states. Typically, firms are constructed using data representative average investment, income and other characteristics for a given firm and industry. A recent study prepared by KPMG for the Governor of North Carolina ranked California 17th out 21 states in overall tax burden, 18th in property tax burden, 11th in income and franchise tax burden and 10th in sales and utility tax burden.⁶ These studies are consistent with the results found in a range of similar studies. Among the reasons for California's favorable rankings are the property tax exemption for business inventories, the state's permanent Research and Development Tax Credit, and low property tax rates resulting from Proposition 13.

IS ECONOMIC GROWTH STRONGER IN STATES THAT ENACTED TAX CUTS?

Proponents of tax cuts also maintain that lower taxes will spur employment and income growth and that this increased economic activity will result in tax cuts paying for themselves in higher revenues. Some point to specific states as examples of tax cuts resulting in improved economies, lower unemployment, and improved standards of living.

	1994 Tax Cut as % of 1993 Revenues	Percentage Change in Employment 10/94-12/95	Change in Employment (Rank)	Change in Unemployment Rate 1/95 - 1/96
Arizona	1.0%	3.4%	7	-0.6%
Georgia	1.4%	3.5%	6	0.3%
Maryland	1.0%	0.0	45	0.2%
New Jersey	5.1%	1.2%	33	-0.3%
New Mexico	2.2%	4.7%	3	0.4%
New York	1.6%	0.8%	38	0.1%
Pennsylvania	1.0%	-0.1%	47	0.2%
Utah	1.0%	5.2%	2	-0.5%
US Average		1.7%		
California		1.4%	29	-0.3%

Source: Center for the Study of the States, Bureau of Labor Statistics.

There is little evidence to suggest that tax cuts produce higher revenues. In the short-term, tax cuts may actually reduce economic activity. The Legislative Analyst notes that, "after taking into account reduced government spending (which would likely need to occur to maintain a balanced budget), the near-term gains in net new jobs and related economic activity would be *minimal*. The increases in after tax incomes of

⁴ Robert Tannenwald, "State Business Tax Climate: How Should It Be Measured and How Important Is It?" *New England Economic Review* (January/February 1996).

⁵ U.S. Department of Commerce, Bureau of the Census, *Government Finances* (various years).

⁶ "Comparative Analysis of the Relationship of North Carolina's Tax Structure to Economic Development," (Policy Economics Group, KPMG Peat Marwick, November 30, 1994).

taxpayers would boost income and employment in some private sector industries. However, these gains would be offset by the direct and indirect negative impacts on the economy of less government expenditures.”

In fact, states that enacted tax cuts in 1994 had mixed economic performance in 1995. California’s employment growth fell well within the range of that in states enacting significant tax cuts. As illustrated above, whether or not a state adopted a tax cut had little relationship to change in employment over the past year. Employment levels depend on overall levels of economic activity, of which state tax levels are a very small part. Studies typically estimate state and local taxes at 1 - 2% of businesses’ operating costs. California outperformed a majority of the states that enacted tax reductions based on the strength of the state’s recovery and the size of the state’s economy.

CALIFORNIA HAS ENACTED SIGNIFICANT TAX RELIEF IN THE 1990S

Proponents of additional tax reductions note that a number of states have recently enacted tax cuts, while ignoring the significant tax relief granted by the Legislature, even during the depths of the state’s recession. Tax cuts enacted since 1990 cost the General Fund approximately \$1.985 billion in 1995-96. This figure does not include the ongoing loss attributable to Proposition 13, unitary reform for corporate taxpayers, repeal of the inheritance tax, business inventory property tax exemptions and other measures.

Table 4: Significant Tax Relief Enacted 1991-1996 (annual revenue loss in excess of \$5 million)	
	1995-96 Revenue Loss
Subcorporation S tax rate reduction	\$632 million
Extension of Net Operating Loss carryforwards	\$599 million
Manufacturing investment tax credit	\$444 million
Expiration of the top rates on the personal income tax	\$325 million*
Extension & expansion of the Research & Development tax credit	\$158 million
Los Angeles Revitalization Zone	\$49 million
Sales tax exemption for free newspapers & magazines	\$30 million
Bunker fuel tax exemption	\$21 million
Expansion of the Enterprise Zone program	\$18 million
Expansion of credit union income exemption	\$13 million
Limited partnership income source rules	\$10 million
Employer Child Care Expenses tax credit	\$6 million
Local Area Military Base Recovery Areas	\$5 million
Total	\$1.985 billion

* Increases to \$815 million in 1996-97
 Source: Franchise Tax Board 1995-96 Tax Expenditure Report, Department of Finance 1995-96 Tax Expenditure Report

CONCLUSION

While California compares favorably to other states with respect to tax burden, the state lags far behind in terms of critical investments in education and infrastructure. California ranked 49th in elementary and secondary school spending as percentage of personal income, 35th in higher education spending, and 49th in highway spending.⁷ California is at far greater risk for deficits in public investment ranging from education to infrastructure than from an excessively high tax burden.

There are many methods of comparing state tax burdens. Each has strengths and weaknesses. California ranks as a moderate tax state in both comparisons based on the level of tax collections or studies analyzing the amount that a representative taxpayer would pay. California’s higher than average corporate tax rate is balanced by a low property tax burden and moderate sales and income tax burdens.

⁷ Transportation spending is for 1992, higher education for 1993-94, and elementary and secondary education for 1992-93.

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