

The logo for the California Budget Project features the word "CALIFORNIA" in a serif font above a black horizontal bar containing the words "BUDGET PROJECT" in a bold, sans-serif font. A faint outline of the state of California is visible behind the text.

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May 8, 2002

OPTIONS FOR BALANCING THE BUDGET: REINSTATING THE VEHICLE LICENSE FEE RATE

In 1998, the Legislature passed a 25 percent permanent reduction in the Vehicle License Fee (VLF) rate, which included a complex series of triggers that increased the size of the tax cut if state revenues reached certain targets. Subsequent legislation phased in the maximum tax cut in 2000. At present, the VLF rate is 0.65 percent of the depreciated value of a vehicle, down from 2 percent in 1998.¹

The VLF reduction differs from most tax cuts in that it does not reduce state General Fund revenues. Approximately three quarters (75.67 percent) of the proceeds of the VLF go to cities and counties as general-purpose revenues. The remainder goes to counties to support health, mental health, and social service programs that were transferred to counties as part of a 1991 restructuring commonly referred to as “realignment.” The legislation reducing the VLF also reimbursed cities and counties for the revenues they lost because of the tax cut. This reimbursement shows up in the state budget as a spending program. In 2002-03, the state will spend \$3.778 billion to reimburse cities and counties for their revenue losses.

What Would Be The Impact Of Restoring The VLF Rate?

If the VLF tax rate were restored, cities and counties would receive their funds directly from the proceeds of the tax and the state would not have to reimburse them for their losses. Fully restoring the VLF rate would result in a \$3.778 billion reduction in 2002-03 state spending.²

Who Pays The VLF And How Much Do They Pay?

Every California vehicle owner pays the VLF. If the rate were restored to its 1998 level, automobile owners would pay an average of \$204 per car – an increase of \$138 (Table 1).

The VLF is a modestly regressive tax, that is, low-income households pay a larger share of their income in the form of VLF than do higher income households. The progressivity of different taxes can be compared by dividing the share of a poor families’ income that goes to a particular tax by the share of income a wealthy family pays in the same tax (Table 2). Married, non-elderly families in the bottom fifth of the California income distribution spent nearly three times as much of their income on the VLF as did families at the top of the income distribution. This comparison shows that the burden of the VLF is spread similarly to that of the sales tax. The

¹ The value of a vehicle declines over time for purposes of calculating the amount of VLF that is owed.

² The VLF rate could be set at anywhere between the current rate and the former 2 percent rate, or higher. The rate could be, for example, set at 1.3 percent, approximately midway between the current and prior rates. The savings would, of course, be proportionately lower.

Table 1: What Would A VLF Increase Mean For The "Average" Car Owner?					
Car Value	Current VLF	VLF Under Pre-1998 Law	Increase if VLF restored to 1998 Level	Increase if VLF restored to 1/2 1998 Level	Increase if VLF restored to 2/3 of 1998 Level
\$5,000	\$33	\$100	\$68	\$18	\$34
\$10,154	\$66	\$203	\$138	\$36	\$69
\$15,000	\$98	\$300	\$203	\$53	\$103
\$20,000	\$130	\$400	\$270	\$70	\$137
\$25,000	\$163	\$500	\$338	\$88	\$171
<i>In 2000-01, the average car was worth \$10,153. The owner of the average car paid \$66 in VLF.</i>					
Cost to Family with Two Cars: \$5,000 & \$10,153	\$99	\$303	\$206	\$53	\$104
Cost to Family with Two Cars: \$5,000 & \$15,000	\$130	\$400	\$270	\$70	\$137
Cost to Family with Two Cars: \$10,153 & \$25,000	\$229	\$703	\$476	\$123	\$240

state's income tax, in contrast, is a progressive tax; low-income families spend a smaller share of their income on the tax than do the wealthy.

Taxpayers who itemize their deductions for federal income tax purposes can deduct the amount they pay in VLF. Approximately 40 percent of California income tax payers, primarily higher income taxpayers, itemize their deductions. Estimates suggest that approximately 15 percent of the impact of an increase in VLF would be offset by lower federal tax payments.³ In 2002-03, \$567 million in lower federal tax payments would offset the \$3.778 billion impact of restoring the VLF to 1998 levels. A taxpayer in the 27.5 percent federal income tax bracket would save \$74 in federal income taxes on the \$270 increase in VLF for a car valued at \$20,000 if the rate was restored to the 1998 level.

The VLF Over Time

California's current budget gap is largely attributable to the volatility of the personal income tax and, in particular, taxes paid on stock options and capital gains. The VLF, in contrast, is a very stable

Table 2: How Does The Burden Of The VLF Compare To That Of Other California Taxes?

	Ratio of Tax Burden For Bottom Quintile To That Of The Top Quintile
Sales & Excise Taxes	3.1
General Sales, Individuals	2.8
Excise & Gross Receipts Taxes, Individuals	5.0
Property Taxes	1.4
Property Taxes on Families	1.6
Income Taxes	0.0
Personal Income Tax	0.0
Total CA Taxes Before Federal Offset	1.3
Net CA Taxes After Federal Offset	1.5
Vehicle License Fee	2.9

Source: Institute on Taxation and Economic Policy, California Policy Research Center

³ Legislative Analyst's Office, *A Primer of the Vehicle License Fee* (June 17, 1998).

revenue source. Between 1987-88 and 1997-98, VLF collections increased by an average of 5.9 percent per year.⁴ Collections did not decline in any year during that period, and annual increases ranged from 0.5 percent in 1992-93 to 13 percent in 1987-88.

The Trade Off

The VLF rate was reduced in response to the substantial growth in state revenues, particularly revenues attributable to stock options and capital gains, of the late 1990s. Restoring the VLF rate is one option for bridging the budget gap caused by the substantial drop in these same revenues. Vehicle License Fees are a relatively stable revenue source. Restoring the VLF would improve the stability of the state's revenue base by reducing the dependence on more volatile personal and corporate income taxes and sales taxes. However, the VLF is somewhat regressive, meaning that low-income families pay a greater share of their income on VLF than do higher income households. The Legislature could mitigate the regressive nature of the VLF by enacting a refundable state Earned Income Tax Credit (EITC). An EITC puts money back in the pockets of working families at a small fraction of the amount raised by the restoration of the VLF.

Jean Ross prepared this Brief. 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 is committed to improving public policies that influence the economic and social well-being of Californians and their communities. General operating support for the California Budget Project is provided by grants from the James Irvine, Ford, Charles Stewart Mott, Friedman Family, The David and Lucile Packard, and California Wellness Foundations, the Penney Family Fund, and individual donations and subscriptions. Visit the CBP web site at www.cbp.org.

⁴ Excludes 1991-92, when the VLF rate was increased.