

WHAT WOULD BE THE IMPACT OF REINSTATING THE 10 AND 11 PERCENT PERSONAL INCOME TAX RATES?

One option for helping to bridge the state's budget gap would be to reinstate the 10 percent and 11 percent tax rates for high-income Californians. This approach was used in 1991 when the state faced a budget crisis of similar magnitude. The higher rates would add a 10 percent tax rate for single taxpayers with taxable incomes in excess of \$130,000 and married taxpayers with taxable incomes in excess of \$260,000.¹ The 11 percent rate would apply to single taxpayers with taxable incomes of more than \$260,000 and married taxpayers with taxable incomes in excess of \$520,000. The state's alternative minimum tax rate, a rate that applies to taxpayers that claim certain preference items, would also be increased proportionately to 8.5 percent. The state's current top income tax bracket of 9.3 percent applies to taxpayers with taxable incomes in excess of \$37,725 (single) and \$75,450 (married). Reinstatement of the top rates would raise \$3.1 billion in 2002-03, \$3.2 billion in 2003-04, and \$3.5 billion in 2004-05.

How Many Californians Would Be Affected?

Only 2.4 percent of California taxpayers would be affected by the proposed increase. Taxpayers with incomes in the top one percent of California households – with average incomes of \$1,341,700 – would pay more than 95 percent of the increase. The average increase for this group, after taking into account the deductibility of state income taxes for federal tax purposes, would be \$7,674. The average increase for taxpayers in the next 4 percent, with average incomes of \$253,200, would be just \$115 after adjusting for the deductibility of state income taxes.

Top Brackets Have Been Used To Bridge Prior Deficits

The state's top tax rate has exceeded the current maximum for nearly half (33 years) of the years since the state instituted the personal income tax. Former Governor Ronald Reagan signed into law two increases in the top brackets, one in 1967 and again in 1971. Governor Pete Wilson signed a measure adding 10 and 11 percent tax brackets in 1991.

Taxpayers Affected By Top Brackets Received Big Savings From The Federal Tax Package

When fully phased in, last year's federal tax package will provide substantial savings to high-income earners that far exceed the increased state taxes they would pay under the proposed top brackets. The top one percent of California taxpayers will receive a federal tax cut of \$51,717, once the federal reduction is fully phased in. In contrast, reinstating the top tax brackets would increase the average tax bill of the top one percent by \$7,674, after taking into account the deductibility of state income taxes for federal tax purposes. More than a third of the cost of Californian's higher income taxes would be paid by the federal government in the form of higher deductions.

¹ Taxable income excludes income that is not taxed in California, such as Social Security benefits, and is the amount of income remaining after taxpayers subtract the deductions to which they are entitled.

Impact of Raising the Top Income Tax Rates

All California Taxpayers, 2002

2002 Income Group	Low 20%	2nd 20%	Mid 20%	4th 20%	Next 15%	Next 4%	Top 1%	ADDENDUM: All Taxpayers
Income Range	Less Than \$18,000	\$18,000 – \$31,000	\$31,000 – \$50,000	\$50,000 – \$84,000	\$84,000 – \$179,000	\$179,000 – \$649,000	\$649,000 Or More	
Average Income in Group	\$11,600	\$24,600	\$40,000	\$65,100	\$116,800	\$253,200	\$1,341,700	
State Tax Change as a % of Income	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.9%	
Average State Tax Hike	\$ —	\$ —	\$ 0	\$ 0.36	\$ 12.00	\$ 136	\$ 12,438	
% of Total State Tax Increase	—	—	0.0%	0.0%	1.1%	3.2%	95.6%	
% of Taxpayers with State Tax Hike	—	—	—	0.1%	2.7%	20.5%	100.0%	2.4%
Federal Tax Savings as a % of Income	—	—	—	—	—	-0.0%	-0.4%	
Net Federal/State Tax Change as % of Income	—	—	+0.0%	+0.0%	+0.0%	+0.0%	0.6%	
% of State Tax Hike Paid by Feds	—	—	—	—	0.8%	15.5%	38.3%	37.1%
Average Amount of State Tax Hike Paid by Feds					\$0.00	-\$21	-\$4,764	
Average State Tax Hike Net of Fed Savings					\$12	\$115	\$7,674	

Note: The proposal modeled here would add two new top tax brackets to the California personal income tax, including a 10 percent rate on taxable income over \$130,000 for single filers (\$176,950 for heads of household, \$260,000 for joint filers) and an 11 percent rate on taxable income over \$260,000 (\$353,899 for heads of household, \$520,000 for joint filers). The proposal also increases the Alternative Minimum Tax rate to 8.5 percent. This proposal is based on the language contained in SB 1255 (Burton).

Source: *Institute on Taxation and Economic Policy, March 2002*

May 31, 2002