

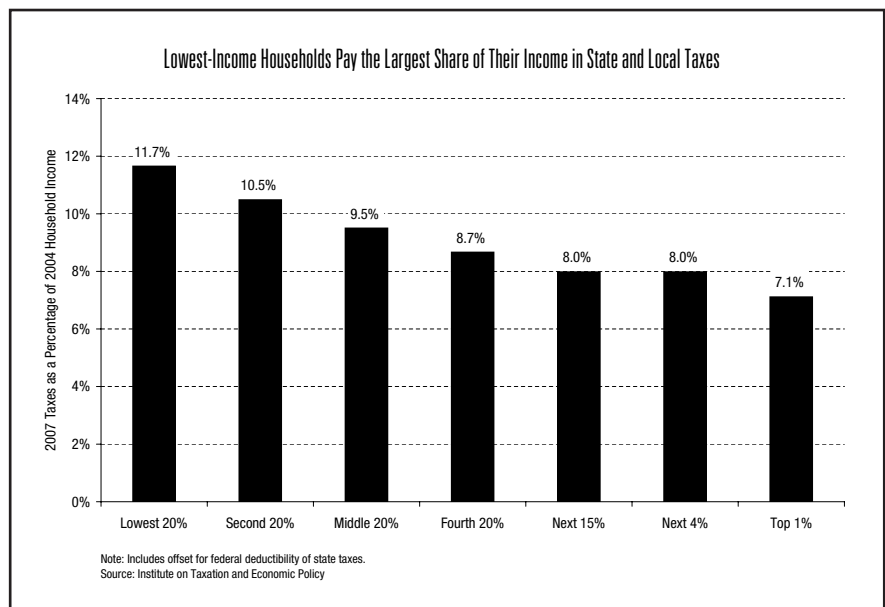
WHO PAYS TAXES IN CALIFORNIA?

Former Supreme Court Justice Oliver Wendell Holmes once noted that, “(t)axes are what we pay for civilized society.” State and local taxes support our public schools, streets and highways, public hospitals that form the backbone of the state’s trauma care system, parks and beaches, the public health infrastructure that ensures that our food is safe to eat and our water is safe to drink (and that delivers water to homes across California), as well as a range of other services. While the primary purpose of a tax system is to raise the money needed to support public services, tax policy can also serve as an end in itself, providing incentives for taxpayers to engage in desired activity or providing cash assistance to certain individuals. Tax day – the day Californians are required to file their income tax returns – provides an opportunity to look at who pays taxes in California, who doesn’t, and how California’s tax systems compare to those of other states.

K E Y F A C T S

■ How much do Californians pay in state and local taxes?

Measured as a share of family income, California’s poorest families pay the most in taxes. The poorest fifth of the state’s households, with an average income of \$11,100, spend 11.7 percent of their income on state and local taxes.¹ In comparison, the wealthiest 1 percent, with an average income of \$1.6 million, spend 7.1 percent of their income on state and local taxes.



The share of income California's families spend on state and local taxes is a function of the state's highly progressive personal income tax and regressive sales and excise taxes. Higher income households pay more in income taxes. Lower income households pay a greater share of their income in sales and property taxes. Households also bear a share of the burden of taxes imposed on business through higher prices and reduced corporate earnings. Higher income households pay a relatively greater share of the corporate income tax, while lower income households pay a greater share of businesses' sales and excise tax burden.

■ **Who pays income taxes in California?**

A single mother with one child will have no 2006 income tax liability unless she earns over \$38,271. A family of four with two children will have no 2006 state income tax liability unless their income exceeds \$47,671.² California's high income tax threshold is attributable to the increases in the dependent credit enacted in 1997 and 1998. The state's high tax threshold – the income level at which an individual or family begins to pay income taxes – also means that low- to moderate-income families receive minimal or no benefits from the state's various credits, deductions, and other tax benefits, since they have little or no tax liability to offset.

California's Personal Income Tax Thresholds Are High			
	2006 Tax Threshold	2006 Federal Poverty Line	Tax Threshold as a Percentage of the Federal Poverty Line
Single, no children	\$14,261	\$10,488	136%
Married, no children	\$28,571	\$13,500	212%
Head of household, one child	\$38,271	\$13,896	275%
Head of household, two children	\$45,371	\$16,242	279%
Married, one child	\$40,471	\$16,227	249%
Married, two children	\$47,671	\$20,444	233%

Note: Assumes families claim the standard deduction and the renter's tax credit. 2006 federal poverty line assumes non-elderly householders.

Source: Franchise Tax Board and US Census Bureau

■ **How much does the "average" California family earn?**

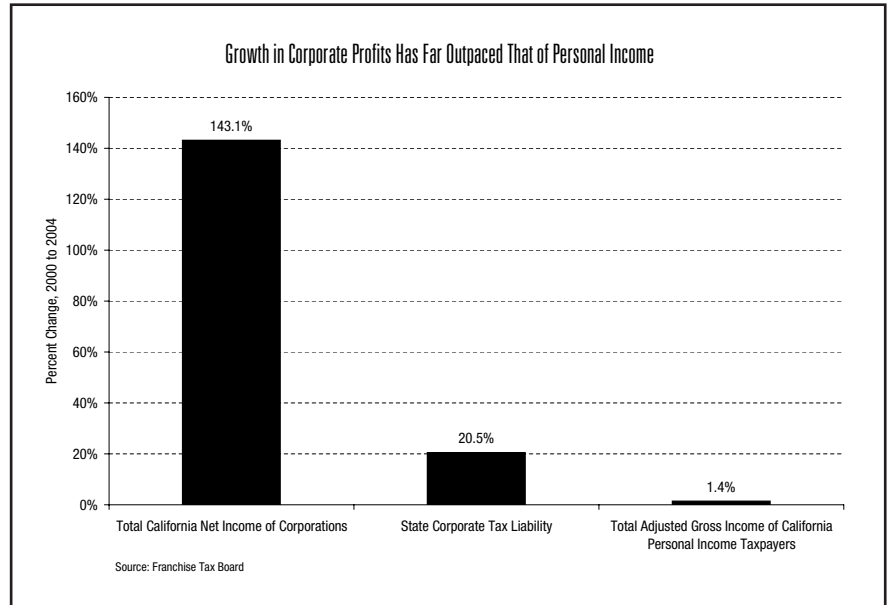
California's 2005 median household income, the income where half of all households earned more and half earned less, was \$51,755.³ The median income for all California personal income taxpayers was \$34,128 in 2005, the most recent year for which data are available.⁴ The 2005 median income of taxpayers filing joint returns was \$63,587.

■ **Who pays the corporate income tax in California?**

Small businesses pay a very small share of the corporate income tax. While 616,805 corporations filed tax returns in 2004, the 1.7 percent with taxable incomes of \$1 million or more paid 84.1 percent of the 2004 tax.⁵ The most costly corporate tax credit is the Research and Development (R&D) Credit. In 2004, 1,766 corporations claimed \$613.0 million in R&D credits, averaging \$347,127 per firm.⁶ Overall, relatively few corporations claim the state's various tax credits. In 2004, fewer than 1.5 percent of the state's corporations claimed any of the state's tax credits.

A number of recent research reports have documented the rise in corporate profits and decline in the share of national income accounted for by wages and salaries.⁷ While comparable data are not available for California, similar data show that the recent growth in corporate profits reported for California tax purposes far exceeds that in income reported by individual taxpayers. Between 2000 and 2004, the most recent year for which data

are available, the total adjusted gross income of California's personal income taxpayers increased by 1.4 percent. In contrast, the net profits reported by corporations for California tax purposes more than doubled, rising by 143.1 percent.



■ **Is California a high tax state?**

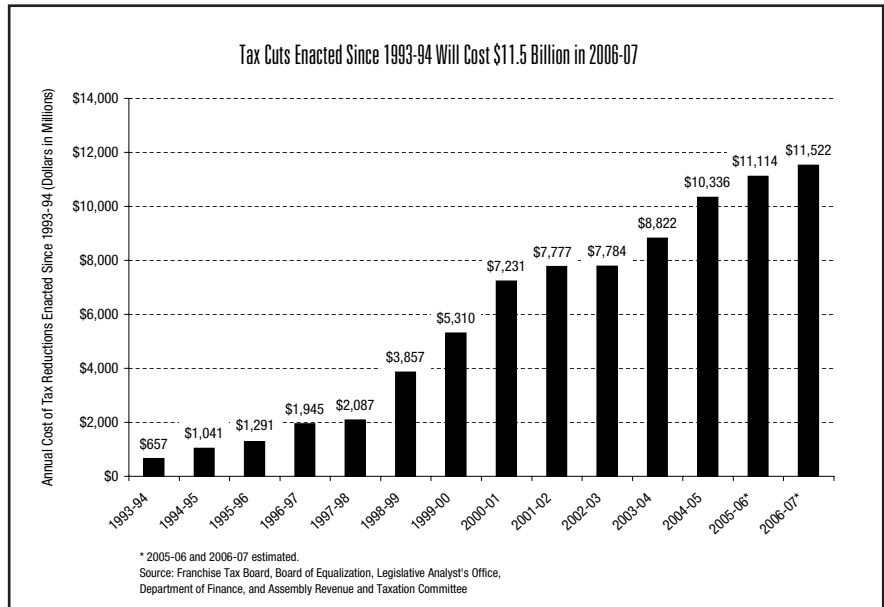
California is a moderate tax state. In 2004-05, California ranked 13th among the 50 states with respect to state taxes as a percentage of personal income. The state ranked 19th with respect to total “own source” revenues – the broadest measure of state and local revenues – raised by state and local governments in 2003-04, the most recent year for which data are available. California ranks relatively high with respect to personal and corporate income tax collections, and relatively low with respect to property, vehicle fuel, and alcoholic beverage taxes.

How Does California Compare? Revenues as a Percentage of Personal Income			
	California Rank	California	US
Total State and Local Own Source (2003-04)	19	16.17%	15.55%
Total State and Local Taxes (2003-04)	17	10.96%	10.72%
State Taxes (2004-05)	13	7.58%	6.50%
Local Taxes (2003-04)	30	3.94%	4.43%
State and Local General Sales Taxes (2003-04)	19	2.81%	2.60%
State and Local Property Tax (2003-04)	34	2.82%	3.38%
State General Sales Tax (2004-05)	20	2.31%	2.13%
State Motor Fuels Taxes (2004-05)	45	0.26%	0.35%
State Tobacco Tax (2004-05)	40	0.08%	0.13%
State Alcoholic Beverage Sales Taxes (2004-05)	41	0.02%	0.05%
State Individual Income Tax (2004-05)	5	3.31%	2.21%
State Corporate Income Tax (2004-05)	5	0.67%	0.39%

Source: US Census Bureau and US Bureau of Economic Analysis

■ **How have California's tax policies changed over time?**

Over the past two decades, the cost of funding state services has shifted from corporate to personal income taxpayers. Forecasters estimate that personal income tax will provide 54.7 percent of General Fund revenues in 2007-08, up from 35.4 percent in 1980-81. Corporate tax receipts are expected to provide 10.6 percent of General Fund revenues in 2007-08, down from 14.6 percent in 1980-81. New, increased, and expanded corporate tax breaks and the 1996 corporate rate reduction are responsible for the decline in the share of state revenues provided by the corporate income tax. Tax cuts have limited growth in state revenues as a whole, with tax cuts enacted between 1993 and 2005 reducing estimated 2006-07 state General Fund revenues by an estimated \$11.5 billion.



■ **Who doesn't pay taxes in California?**

In 2004, the most recent year for which data are available, 449,277 taxpayers reported incomes of \$200,000 or more. However, 1,343 of these households paid no California personal income tax.⁸ How did they do it? The largest tax breaks claimed by “no tax” households include enterprise zone tax breaks, miscellaneous deductions, and the R&D Credit. The number of high income “no tax” returns more than doubled between 1996 and 2004, rising from 510 to 1,343.

Jean Ross prepared this Policy Points. 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 engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, individual donations, and subscriptions. Please visit the CBP's website at www.cbp.org.

ENDNOTES

- ¹ Institute on Taxation and Economic Policy (April 2007). Reflects 2007 tax laws, 2004 income levels, and offset for federal deductibility.
- ² California Franchise Tax Board. Assumes taxpayers claim the renter's tax credit and do not itemize their deductions.
- ³ US Census Bureau.
- ⁴ California Franchise Tax Board, *Personal Income Tax Statistics Comparison by County 2005 Taxable Year*, downloaded from http://www.ftb.ca.gov/aboutFTB/press/2007/07_17attach.pdf on April 10, 2007. Income reported for tax purposes excludes that of low-income households who are not required to file tax returns, and includes income from capital gains, which are not included in household income by the Census Bureau.
- ⁵ California Franchise Tax Board, *Annual Report 2005*, pp. 147 and 160.
- ⁶ California Franchise Tax Board, *Annual Report 2005*, p. 158.
- ⁷ See, for example, Aviva Aron-Dine and Isaac Shapiro, *Share of National Income Going to Wages and Salaries A Record Low in 2006: Share of Income Going to Corporate Profits at Record High* (Center on Budget and Policy Priorities: March 29, 2007) downloaded from <http://www.cbpp.org/8-31-06inc.htm> on April 2, 2007.
- ⁸ California Franchise Tax Board, *Annual Report 2005*, pp. 18-19.