

Budget Conference Committee Tax Reform Package

- The proposed tax reform alternative would raise federally deductible taxes (Personal Income Tax and Vehicle License Fee) and reduce the State Sales Tax that is not deductible on federal personal income tax forms. Under this tax reform proposal all income groups would, after deductibility, experience an overall net tax reduction.
- The total revenues raised by this tax reform would be approximately \$1.8 billion. This is slightly less than what is estimated to be returned to the taxpayers through reduced federal tax liability. The revenue is projected to grow slightly to approximately \$3 billion in future budget years.
- The additional revenues raised by this tax reform proposal will reduce the size of the cuts required to education and core health safety net programs for the poorest Californians in closing the State’s current \$19 billion budget gap. Furthermore, the ongoing nature of this tax reform will help to stabilize California’s fiscal situation going forward.
- **Personal Income Tax.** Under this proposal, the Personal Income Tax rate for each bracket, except the top bracket would be increased by 1 percent. This proposal would flatten the tax structure and, on the margin, would reduce personal income tax volatility by shifting reliance away from the top income tax bracket. The current 0.25 percent surcharge would also be extended for all brackets. The Current and proposed rates are below:

current law		proposal	
2010	2011	2010	2011
1.25%	1.00%	2.25%	2.25%
2.25%	2.00%	3.25%	3.25%
4.25%	4.00%	5.25%	5.25%
6.25%	6.00%	7.25%	7.25%
8.25%	8.00%	9.25%	9.25%
9.55%	9.30%	9.55%	9.55%

Approximately \$8.7 billion in additional Personal Income Tax would be raised under this proposal in the budget year.

- **Vehicle License Fee.** Under this proposal, the Vehicle License Fee (VLF) would be increased from 1.15% to 1.65%. A portion of this increase would be dedicated to restructuring public safety programs that are currently funded at the state level and will now be shifted to the counties. The amount dedicated to restructuring public safety programs in 2011-12 would be approximately 0.5% of the VLF. A smaller portion of the increase will be dedicated to the counties in the budget year given the need to phase in the restructuring of the public safety programs.

current law		proposal	
2010	2011	2010	2011
1.15%	0.65%	1.65%	1.65%

Approximately \$1.5 billion in additional Vehicle License Fee would be raised under this proposal in the budget year.

- State Sales Tax.** Under this proposal, the State Sales Tax would be reduced by 1.75% in the budget year and an additional 0.75 percent in 2011-12. In total, the sales tax would be reduced a full 2.5 percent in 2011-12 when compared with the current rate. This reduction would only impact the state sales tax and would have no impact on the local sales tax. Also, the proposal would hold harmless transit funding provided in the February 2010 Fuel Tax Swap. This sales tax reduction is independent of the state sales tax reduction under the “single flip”. The reduction to the state sales tax under the “single flip” would be in addition to the sales tax reduction described below.

current law		proposal	
2010-11	2011-12	2010-11	2011-12
6.00%	5.00%	4.25%	3.50%

The State Sales Tax would be cut by approximately \$8.4 billion in the budget year.

- Impact to Taxpayers.** Under this tax reform proposal, taxpayers across income groups could see a reduction in the overall state and federal taxes paid because the proposal would swap out taxes that are not deductible (sales tax) for taxes that are deductible when determining federal income tax owed. An average taxpayer in each tax bracket could see a tax cut that ranges from \$10 to over \$1,000 depending on their tax bracket and the percentage of their household budget spent on taxable goods.

Furthermore, the reduction in sales tax may spur additional consumer purchases and business investment in economic activity since approximately one-third of the sales tax is paid by businesses.