1980

TAXATION. INCOME.

9 Taxation. Income—Initiative Constitutional Amendment

Official Title and Summary Prepared by the Attorney General

TAXATION. INCOME. INITIATIVE CONSTITUTIONAL AMENDMENT. Adds Section 26.5 to Article XIII of the Constitution to provide that taxes on or measured by income which are imposed under the Personal Income Tax Law or successor law shall not exceed 50 percent of those rates in effect for the 1978 taxable year. Requires the Legislature to provide a system for adjusting personal income tax brackets to reflect annual changes in the California Consumer Price Index or successor index. Adds subdivision (s) to Section 3 of Article XIII to provide that business inventories are exempt from property taxation. Fiscal impact on state or local governments: Reduction of state income tax revenues by estimated $4.9 billion in fiscal year 1980–81, $4.2 billion in 1981–82, and by unknown but increasing amounts thereafter. By operation of existing statutes, estimated reduction of $3 billion in state aid to local school districts and state payments to cities, counties or special districts commencing in 1980–81. Indeterminable but substantial reduction in other state expenditures in 1980–81 and thereafter.

Analysis by Legislative Analyst

Background:

Personal Income Tax. California's second largest source of state revenue is the personal income tax. (The largest source is the sales tax.) Proceeds from the income tax are deposited in the state's General Fund. This fund supports state departments and institutions such as the university and state colleges and helps local governments finance a wide variety of programs in areas such as education, health and welfare, and property tax relief.

Under California's income tax law, the tax rates range from 1 percent to 11 percent. As a result of recent legislation, the tax brackets are adjusted ("indexed") each year to compensate for the effect of inflation on income. Specifically, in both calendar years 1980 and 1981, the income levels at which the various tax rates apply will be raised by the percentage increase in the California Consumer Price Index. Thus, a taxpayer whose income increases at the same rate as the California Consumer Price Index would generally pay a constant proportion of his income in taxes. After 1981, the income levels at which higher tax rates apply will be raised by the percentage increase in the index which exceeds 3 percent per year.

California's income tax law provides for a number of tax credits, including the personal, dependent, renters, and solar energy credits. The personal and dependent credits are fully "indexed" under current law.

The income tax is collected throughout the year. Employers are required to withhold for payment to the state a portion of wage and salary income earned by their employees, and certain individuals are required to make quarterly payments to the state based on their estimated taxes. Final income tax payments are due in April following each tax year. The state counts revenue collections when they are *received,* rather than at the time the taxes are finally *due.*

The Governor's Budget for fiscal year 1980–81 (July 1, 1980–June 30, 1981) estimates revenues from the income tax under existing law to be $6.8 billion.

Business Inventories. Under existing law, cities, counties, special districts and school districts derive revenue from property taxes on both real property (land and buildings) and personal property. Legislation enacted in 1979 fully exempted business inventories from local property taxes. In order to replace the revenues that local governments can no longer collect through property taxes on inventories, the legislation requires the state to make reimbursement payments to local governments. In 1980–81, these reimbursements are estimated to total $459 million.

Proposal:

This proposed constitutional amendment would (1 limit personal income tax *rates* to 50 percent of those in effect during 1978, (2) require that the income tax brackets be fully "indexed" for inflation, and (3) prohibit property taxation of business inventories.

Reduction of the Income Tax Rates. The measure would amend the State Constitution to require that the rate of "taxes on or measured by income" not exceed 50 percent of the rates in effect for 1978. Under this limitation, the new basic rate structure could not exceed a range of ½ percent to 5½ percent. The tax *brackets* (that is, the income levels at which the rates apply) would not be affected by the measure initially. Thus, where income is now taxed at a maximum of 11 percent, it would be taxed at no more than 5.5 percent under the measure. The proposed amendment would not change income tax deductions, exemptions or credits, nor would it prohibit the Legislature from changing them. Because the proposal would not reduce the various tax credits by 50 percent, most taxpayers would have their final (after credit) tax liability reduced by *more* than 50 percent.

"Indexing" of Tax Brackets. The measure would amend the Constitution to require the Legislature to provide a system for fully "indexing" the income tax brackets. Because current law provides for full "indexing" during 1980 and 1981, the effect of this proposal would be to ensure that full "indexing" is continued ir 1982 and thereafter.

Business Inventory Exemption. The proposal would place an exemption for business inventories in the State

Constitution. The Legislative Counsel advises that the constitutional exemption would, as of March 1, 1981, completely replace the existing statutory exemption, and the state would not be required to continue reimbursing local governments for the resulting revenue losses. However, this measure would not discontinue these reimbursements. Therefore, adoption of this measure would have no direct effect on these payments.

Fiscal Impact:

Impact on State Revenues. The adoption of this initiative would reduce state personal income tax revenues by $4.9 billion in fiscal year 1980–81 (July 1, 1980–June 30, 1981), by $4.2 billion in fiscal year 1981–82 (July 1, 1981–June 30, 1982), and by unknown but increasing amounts thereafter.

The estimated revenue reduction in 1980–81 is larger than the reduction estimated for the following year because it reflects the impact of lower tax rates for an 18-month period (January 1, 1980–June 30, 1981). Under existing law, final tax liabilities for any income year are determined by the tax law in effect when the taxes are due. Because this measure, if approved by the voters, would become effective in June 1980, it would apply to income earned during all of calendar year 1980 if existing statutes remain unchanged—even the five-month period preceding the June 3 election. As a result, tax collections during the 1980–81 fiscal year would be reduced by the amount of reduced tax liability for all of calendar year 1980. In addition, because of reduced income tax withholdings and quarterly income tax payments during the first six months of calendar year 1981, the state would experience a further reduction in state tax collections during the 1980–81 fiscal year. Thus, the $4.9 billion revenue loss estimated in 1980–81 is due to reduced tax liabilities for twelve months in 1980 and six months of 1981.

Effect on State and Local Governments. Any significant reduction in revenues will ultimately require a reduction in expenditures below what expenditures would have been otherwise. A $4.9 billion reduction in income tax revenues is equivalent to a 25-percent loss in total state General Fund revenues in fiscal year 1980–81. The General Fund finances 86 percent of all state expenditures, including those for activities conducted directly by the state government as well as those expenditures that support activities at the local government level.

Because the measure would reduce revenues by 25 percent, there would have to be major reductions in total state expenditures from existing levels. Under existing state law, a portion of these reductions would be made according to the formula specified in Assembly Bill 8 (Chapter 282, Statutes of 1979), which enacted a long-term local government fiscal assistance program. We estimate that, as a result of this formula, state aid to local school districts would be reduced by $2.2 billion, and state payments to cities, counties and special districts would be reduced by up to $800 million in 1980–81. These formula reductions total $3.0 billion. Because the revenue loss is estimated to be $4.9 billion, reductions in other state expenditures would have to be made as well.

Existing law allows the Legislature to prevent the specific formula reductions specified in AB 8 from taking effect. However, if that happened, other reductions of equal magnitude would have to be made in total state expenditures.

Currently, over half of total General Fund expenditures is devoted to elementary, secondary, and higher education, about a third is devoted to health and welfare, and the remaining amount supports property tax relief and general state activities. The major reduction in revenues from this initiative could affect all of these programs.The Governor's Budget estimates that the General Fund surplus will be $1.8 billion on June 30, 1980. If the expenditures proposed in this budget are approved, including the continuation of those programs enacted in prior years, the state surplus (including federal revenue-sharing funds) would decline to $0.7 billion by June 30, 1981. These surplus funds could be used on a one-time basis to support expenditures during 1980–81 that otherwise would be supported by revenues from the personal income tax. If surplus funds were used in 1980–81, these funds would not be available in 1981–82, when the measure would reduce income tax revenues by an additional $4.2 billion.

Text of Proposed Law

This initiative measure expressly amends the Constitution by amending a section thereof and adding a section thereto; therefore, new provisions proposed to be inserted or added are printed in *italic type* to indicate that they are new.

PROPOSED AMENDMENTS TO ARTICLE XIII

First—Section 26.5 is added to Article XIII thereof, to read:

26.5 (a) Taxes on or measured by income which are imposed under the Personal Income Tax Law or any successor thereto shall be at rates not to exceed 50 percent of those rates in effect for the 1978 taxable year.

(b) The Legislature shall provide for a system of adjusting the personal income tax brackets under the Personal Income Tax Law or any successor thereto to reflect annual changes in the California Consumer Price Index or any successor thereto.

Second—Subdivision (s) is added to Section 3 of Article XIII thereof, to read:

(a) Business inventories.

Third. If any provision of this measure or the application thereof to any person or circumstances is held invalid, such invalidity shall not affect other provisions or applications of the measure which can be given effect without the invalid provision or application, and to this end the provisions of this measure are severable.

9 Taxation. Income—Initiative Constitutional Amendment

Argument in Favor of Proposition 9

VOTE YES ON PROPOSITION 9!

Proposition 9 will cut your state income taxes 49 percent or more.

Your tax cut is necessary because state income taxes have been rising even faster than property taxes were before Proposition 13!

If your household income is $15,000, *you will save 70.1 percent. That's $275.07, or $22.92 each month.*

At $20,000 income your saving is 56.8 percent; *that's $364.88, or $30.41 monthly.*

At $30,000 your saving is 53.6 percent; *that's $795.96, or $63.33 monthly.*

At $40,000 your saving is 53.6 percent; *that's $1,371.09, or $114.26 monthly.*

At $50,000 your saving is 49.4 percent; *that's $1,807.45, or $150.62 monthly.*

The business inventory tax is permanently eliminated.

Everyone with income will receive this tax cut. Lower income people receive larger percentage decreases because they are primarily renters. Renters received less Prop. 13 benefit than homeowners.

Proposition 9 indexes state personal income taxes permanently, so inflation will never again push you into higher tax brackets.

820,000 Californians signed petitions putting Proposition 9 on the ballot.

But politicians, big government employee unions, welfare workers and recipients, labor union bosses and tax-spending special interests are using *scare tactics* that make their NO on Proposition 13 campaign look like *child's play!*

They are committing millions to convince voters California will virtually *fall into the sea* if we cut state income taxes.

During the Proposition 13 campaign, THEY said sales taxes would be increased to 12 percent, unemployment would be tremendous and all vital services severely cut.

What really happened?

The economic boom created by Prop. 13 yielded more revenue supporting essential services the year after 13 than the year before!

The Department of Commerce reports one-half million new, productive jobs in private industry were created while fewer than *19,000 government employees were laid off (out of 1½ million).*

As a result, California's economy led the nation. Inflation *was lower* here than nationally by 10–20 percent. Unemployment was reduced dramatically, especially among minority groups, young people and older persons, who suffer the highest unemployment levels.

Tax cuts are good for the economy. They cut inflation (tax increases, along with deficit government spending, create inflation). Tax reductions make our state more appealing for new plants and offices—hence *new jobs are created.* Welfare and unemployment payments are lowered.

Can California afford a tax cut?

The Governor says no new general taxes or general tax increases will be required.

A better question is: *Can we afford not to cut state income taxes?*

The *real income* of American taxpayers decreased 8.3 percent during the past two years. At that rate your real income, the goods and services you can purchase after inflation and taxes, will *decline to one-half* your current standard of living in the 1980's!

That's why a broad cross-section of citizens, including Democratic Senators Alan Robbins and Paul Carpenter, Republican Senate Leader William Campbell, Assembly Republican Leader Carol Hallett, Former Treasury Secretary William Simon, Ronald Reagan's Chief Adviser on tax matters—Congressman Jack Kemp, women's groups, minority group members, city councilmen, and small business owners, urge you to vote YES on Proposition 9!

HOWARD JARVIS
Chairman, California Tax Reduction Movement

DR. ARTHUR LAFFER
Professor of Economics, U.S.C.

BOB WILSON
Democratic State Senator, 39th District

Rebuttal to Argument in Favor of Proposition 9

Proposition 9 is not tax reform—it is an irresponsible scheme which will give huge tax breaks to wealthy individuals at our expense.

Not everyone will receive this tax cut. Less than 20 percent of taxpayers will get more than 60 percent of the tax reductions. *Millions of working people, senior citizens and renters will receive nothing.* All of us will have to pay even *more in taxes and fees* to support Proposition 9's windfall tax breaks for the rich.

Proposition 9 will not create jobs or stimulate the economy. It will simply transfer $1,100,000,000 from state tax returns to federal tax returns (because of reduced deductions) and increase the assets of a select few.

Proposition 9 is poorly designed and already outdated. It fails to take into account recent legislative action to keep state taxpayers from being pushed by inflation into higher brackets and to eliminate the business inventory tax. By Howard Jarvis' own admission, a drafting error in Proposition 9 will inadvertently wipe out $1,400,000,000 in state revenues.

Since 1978, California has taken two major steps in the area of fiscal reform—passage of Proposition 13 to give massive property tax relief and the Gann Initiative to limit government spending. Now, we need to make those programs work—not rush headlong into a tax gimmick designed to benefit only the rich.

Proposition 9 deserves a NO vote.

EVERETT V. O'ROURKE
Chairman, California Legislative Committee
American Association of Retired Persons
National Retired Teachers Association

ANTHONY RAMOS
Executive Secretary, California State Council of Carpenters

FREDA THORLAKSSON
President, California State PTA

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Argument Against Proposition 9

Proposition 13 cut property taxes on our homes and the sky didn't fall.

Why?

Because state government stepped in after Proposition 13 passed and helped local communities make sure the basic services we want like schools, roads, police and fire protection were maintained without major cutbacks. Overall, the state replaced about 70 percent of property tax revenues cut from local budgets.

Proposition 9 is a very different story.

Proposition 9 proposes to cut STATE income tax rates in half. But who's going to replace the thousands of millions of dollars Proposition 9 takes from the state budget? The federal government? The other states won't stand for that.

What if no one steps in? Will these thousands of millions be made up by reducing waste in government? No! One thing we learned from Proposition 13 is that just cutting taxes doesn't make government more efficient. The politicians are just as likely to cut the services we want instead of trimming the fat.

So, what will happen? We all know from experience that we can't get something for nothing. Someone must pay for Proposition 9. A few Californians reading this statement will win. Most of us will lose.

We lose because Proposition 9 takes away state funding we need—especially after Proposition 13—to keep our communities livable and our economy healthy.

Most of all, we lose because Proposition 9 is a tax redistribution scheme that shifts more of the cost of government onto average taxpayers.

Consider these facts:

- Proposition 9 doesn't close a single tax loophole. Every tax shelter and tax avoidance device allowing a few wealthy Californians to escape paying their share remains unchanged.
- Forty percent (40%) of the money Proposition 9 cuts from the state budget this year goes to the richest five percent (5/100ths) of all taxpayers. This privileged elite will get a two-thousand-million-dollar ($2,000,000,000) tax break.
- Proposition 9 only changes state income tax laws. It does *not* cut federal income taxes *OR* social security taxes. IT DOES *NOT* LIMIT *regressive* taxes like the SALES TAX or the GAS TAX which hit average working people, retirees and others on fixed incomes the hardest. When the time comes to raise taxes, GUESS WHOSE TAXES WILL BE RAISED?
- Proposition 9 means higher state and local fees. Think what will happen to the cost of things like vehicle registration and weight fees, college tuition, garbage collection and other charges if state income tax rates are cut in half. WHOM WILL THESE INCREASES HURT? The handful of superrich with their $2,000,000,000 tax break? Or the rest of us?

Proposition 9 is unfair and misdirected. IF IT WINS, WE LOSE. VOTE NO ON 9.

ATTENTION, SENIOR CITIZENS:

You worked hard and paid taxes all your lives. Now your income is lower and so are your income taxes. Over 2,800,000 California seniors pay *NO* income tax and get no relief from Proposition 9.

Proposition 9 means MORE TAXES for seniors and less from government in return. VOTE NO ON 9.

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Rebuttal to Argument Against Proposition 9

PROPOSITION 9—YES!

I. *PROPOSITION 9 HELPS EVERY CALIFORNIAN FIGHT INFLATION.* Californians need tax reductions to combat the harm caused by the rising living costs—which increased 25 percent in two years!
PROPOSITION 9'S OPPONENTS DON'T BELIEVE YOU NEED INFLATION RELIEF.

II. *PROPOSITION 9 WILL ONLY REDUCE STATE INCOME TAXES TO 1978 LEVELS.* State income taxes are actually going up faster than property taxes prior to Proposition 13. State income taxes have nearly tripled in just three years!
We believe you paid enough income taxes three years ago.
PROPOSITION 9'S OPPONENTS SAY YOU DIDN'T PAY ENOUGH.

III. *PROPOSITION 9 WILL REDUCE STATE INCOME TAXES MOST FOR THOSE WITH THE LOWEST INCOMES.*
That's especially important for senior citizens paying income taxes on their small interest earnings, pensions, and part-time employment. And it's important for renters, many with lower incomes, who gained less than property owners from Proposition 13.
Under $10,000 income, Proposition 9 cuts state income taxes 74 percent, 70 percent at $15,000. At $50,000, tax cuts are one-third less. Corporations get no tax reductions.
PROPOSITION 9'S OPPONENTS SAY NO REDUCTIONS ARE POSSIBLE.

IV. *TEXAS AND FLORIDA HAVE 4 PERCENT SALES TAX. NO INCOME TAX. PROPERTY TAXES ARE LESS THAN CALIFORNIA'S. EACH HAS LOWER CRIME RATES THAN CALIFORNIA.*
After Proposition 9, California's per capita taxes will be about average nationally. Obviously, government can provide essential services with these revenues.
OUR OPPONENTS SAY, "CUTTING TAXES DOESN'T MAKE GOVERNMENT MORE EFFICIENT."
WE SAY, IT MUST BE MADE MORE EFFICIENT BEFORE IT BANKRUPTS US!

PROPOSITION 9—YES!

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