Revenue Estimates

Projected slow but positive economic growth and recently enacted legislation significantly impact revenue estimates. California is starting to recover from the worst recession since World War II. Although this growth is projected to be slow, it does provide the grounds for a growing revenue base for the state. That growth is evident in the underlying revenue forecasts for most of California's major revenue sources.

Recently enacted legislation has changed the pattern of state General Fund revenues. This legislation has tended to increase revenue in earlier years (Fiscal Years 2007-08 through 2010-11) and reduce it in later years. For example, as part of the 2008 Budget Act, the use of business tax credits was limited to offset only 50% of the taxpayer's pre-credit tax liability for large businesses for the 2008 and 2009 years. The impact of this limitation was to increase revenue by $353 million in the 2008-09 fiscal year, by $275 million in 2009-10, and by just $8 million in 2010-11. But in 2011-12, it is expected to cause a revenue decrease of $72 million as the credits that had been limited in the previous years start to be used. Losses of a similar magnitude are expected to continue for several years. As another example, also as part of the 2008 Budget Act, corporations are allowed to share their credits with other members of their unitary group, starting in 2010. This provision had no impact until the 2009-10 fiscal year, when the expected revenue loss is $55 million. In 2010-11, this provision is expected to generate a revenue loss of $236 million, and is expected to generate a revenue loss of $341 million in

2011-12. Losses of this magnitude are also expected for subsequent years. The general pattern exhibited by these two examples—revenue gains or no impact in the early years, and revenue losses or minimal gains in the later years—is repeated for most of the tax provisions that have been enacted since 2008.

Without recently enacted policy changes, and without the impact of the Budget proposals, the underlying General Fund revenues would be expected to grow by about $8.1 billion from 2009-10 to 2010-11 and by another $2.3 billion from 2010-11 to 2011-12. However, when the impact of the recently enacted policy changes that affect the state budget are factored in, and before consideration of the impact of the Budget proposals, revenues are expected to grow by only $3.7 billion above from 2009-10 to 2010-11, and drop by $7.2 billion from 2010-11 to 2011-12.

General Fund revenues without proposed policy changes, for 2010-11 are now expected to total $90.7 billion, $3.5 billion less than the estimate at the time of the 2010 Budget Act, and 4.2 percent greater than actual 2009-10 revenues. Of the $3.5 billion decrease in the estimate relative to the 2010 Budget Act, over $1 billion can be attributed to the recently enacted federal Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. For 2011-12, revenues without proposed policy changes are expected to decrease to $83.5 billion, a 7.9-percent decrease from 2010-11. After the proposed policy changes are included, revenues are expected to be $94.2 billion in the current year and $89.7 billion in the budget year.

Figure REV-01 displays the forecast changes between the 2010 Budget Act, the 2011 budget baseline (current law) forecast, and the Governor's 2011 Budget with proposed tax changes. The Governor's Budget forecast was prepared in early December, before individuals and corporations made final withholding and estimated payments for the 2010 tax year, and before consumers completed their December purchases. These critical December and January receipts can have a large impact on state revenues. This forecast will be revised in early May when these data and April income tax receipts are available.

Figure REV-01

2011-12 Governor's Budget
General Fund Revenue Forecast
Summary Table
Reconciliation with the 2010-11 Budget Act

(Dollars in Millions)

		Governor's Budget				
Source	Budget Act	Baseline	Change From Budget Act	Proposed	Change From Budget Act	
Fiscal 09-10						
Personal Income Tax	$44,820	$44,848	$28	$44,848	$28	0.1%
Sales & Use Tax	26,618	26,741	123	26,741	123	0.5%
Corporation Tax	9,275	9,115	-160	9,115	-160	-1.7%
Insurance Tax	2,029	2,002	-27	2,002	-27	-1.3%
Vehicle License Fees	1,338	1,380	42	1,380	42	3.1%
Estate Tax	0	0	0	0	0	---
Alcoholic Beverage	324	311	-13	311	-13	-4.0%
Cigarette	98	96	-2	96	-2	-2.0%
Other revenues	1,971	2,072	101	2,072	101	5.1%
Transfers	447	476	29	476	29	6.5%
Total	**$86,920**	**$87,041**	**121**	**$87,041**	**121**	**0.1%**
Fiscal 10-11						
Personal Income Tax	$47,127	$45,470	-$1,657	$47,784	$657	1.4%
Sales & Use Tax	27,044	26,709	-335	26,709	-335	-1.2%
Corporation Tax	10,897	10,820	-77	11,509	612	5.6%
Insurance Tax	2,072	1,838	-234	1,838	-234	-11.3%
Vehicle License Fees	1,459	1,473	14	1,473	14	1.0%
Estate Tax (a)	782	0	-782	0	-782	---
Alcoholic Beverage	331	318	-13	318	-13	-3.9%
Cigarette	94	93	-1	93	-1	-1.1%
Other revenues	3,025	3,051	26	3,050	25	0.8%
Transfers	1,399	956	-443	1,420	21	1.5%
Total	**$94,230**	**$90,728**	**-$3,502**	**$94,194**	**-$36**	**0.0%**
Change from Fiscal 09-10	$7,310	$3,687		$7,153		
% Change from Fiscal 09-10	8.4%	4.2%		8.2%		
Fiscal 11-12						
Personal Income Tax	$45,281	$46,154	$873	$49,741	$4,460	9.8%
Sales & Use Tax	25,026	24,050	-976	24,050	-976	-3.9%
Corporation Tax	10,239	9,725	-514	10,966	727	7.1%
Insurance Tax	1,871	1,974	103	1,974	103	5.5%
Vehicle License Fees	167	162	-5	162	-5	-3.0%
Estate Tax (a)	1,878	0	-1,878	0	-1,878	---
Alcoholic Beverage	365	326	-39	326	-39	-10.7%
Cigarette	93	90	-3	90	-3	-3.2%
Other revenues	1,851	1,832	-19	1,933	82	4.4%
Transfers	-1,067	-767	300	454	1,521	-142.5%
Total	**$85,704**	**$83,546**	**-$2,158**	**$89,696**	**$3,992**	**4.7%**
Change from Fiscal 10-11	-$8,526	-$7,182		-$4,498		
% Change from Fiscal 10-11	-9.0%	-7.9%		-4.8%		
Three-Year Total			**-$5,539**		**$4,077**	

(a) The federal Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, which was signed by the President on December 17, 2010, did not revive the state tax credit for the estate tax. Thus, the revenue previously estimated to be received from the federal credit, "the state pick-up tax," is now $0 over the forecast horizon.

Major Revenue Proposals

To develop a budget plan that eliminates the current budget gap in a way that is both real and permanent, the Governor's Budget proposes a balanced approach: one that makes significant cuts in spending programs, and one that maintains critical revenue.

Major Revenue Proposals

General Fund

- Maintain Personal Income Tax 0.25-percent Surcharge
- Maintain Level of Dependent Exemption Credit
- Mandatory Single Sales Factor Apportionment
- Eliminate Enterprise Zones and Similar Tax Benefits
- Tax Shelter Amnesty
- Franchise Tax Board Financial Institution Record Match

Realignment – Local Revenue Fund

- Maintain Sales Tax Rate of 6 percent
- Maintain Vehicle License Fee Rate of 1.15 percent

The plan to maintain revenue consists of two parts. The first part would extend the current tax rates for five years. Tax revenue fell significantly further in the recession than did personal income. Although the economy is beginning to recover, baseline revenues are not expected to return to the 2007-08 level until 2013-14; whereas baseline expenditures have grown steadily over this time.

The second part is to eliminate two tax expenditures that are either inefficient or outside the scope of the central mission of state government, and provide the Franchise Tax Board (FTB) with two additional tools to collect taxes owed.

Extension of Current Tax Rates

There are a variety of ways in which revenue could be raised. The Governor's Budget proposes to maintain the level of current tax rates and the dependent exemption credit for five years, subject to voter approval.

- The Personal Income Tax (PIT) rate quarter-percent surcharge.
- The PIT dependent exemption credit at the same level as the personal exemption credit.

- The Vehicle License Fee (VLF) rate at 1.15 percent.
- The Sales and Use Tax (SUT) rate at 6 percent.

This package of tax extensions has several advantages.

First, because these tax rates are already in place, they are less likely to unduly interfere with the economic recovery. These policies have been in place since the spring of 2009, when the nation was still in recession. Since then, the national economy has begun a tepid recovery. Because of the relative severity of its housing crisis, California fell further than most other states during this recession. Nonetheless, California's growth out of the recession has largely mirrored that of the country. It is uncertain how other tax changes of similar magnitude would affect the economy. The prudent approach is to continue on the current path as opposed to adopting a different set of tax policies that could work their way through the economy in different—and potentially more disruptive — ways.

Second, because these tax rates are already in place, the compliance cost of the policies should be relatively low. The state agencies that administer the taxes, the employers and retailers that collect that taxes, and the households and businesses that ultimately pay the taxes have already absorbed most of these compliance costs.

The four following tax rates are proposed to be maintained for five years:

- **PIT Rate Surcharge:** Effective for tax years beginning on or after January 1, 2011 but before January 1, 2016, maintain the 0.25-percentage point surcharge for each PIT tax rate and the Alternative Minimum Tax (AMT) rate. This proposal is expected to generate revenues of $1,187 million in 2010-11 and $2,077 million in 2011-12.
- **PIT Dependent Exemption Credit:** Maintain the dependent exemption credit in effect in 2009 until 2015 while allowing for annual indexing. This aligns the dependent exemption credit to the amount of the personal exemption credit. Chapter 612, Statutes of 1997, and Chapter 322, Statutes of 1998, increased the dependent exemption credit to $253 for the 1998 tax year and $227 for the 1999 tax year, and indexed for inflation each year thereafter. For the 2010 tax year, the personal exemption credit is $99, as was the dependent exemption credit. This proposal is expected to generate revenues of $725 million in 2010-11 and $1,248 million in 2011-12.

- **SUT:** Effective July 1, 2011, the 6-percent State SUT rate would continue for five years. As revenues generated by 1 percent of the 6-percent tax rate are local purpose revenues (see Realignment Chapter), they are not reflected in the General Fund revenues as shown in Figure REV-01. This proposal is expected to generate revenues of $4,549 million in 2011-12.
- **VLF:** Effective July 1, 2011, the 1.15-percent VLF rate would continue for five years. Of the 1.15-percent rate, 0.5 percent would be used to fund local programs, including public safety. As these revenues are local purpose revenues (see Realignment Chapter), they are not reflected in the General Fund revenues in Figure REV-01. This proposal is expected to generate additional revenues of $1,382 million in 2011-12.

Other Revenue Proposals

Mandatory Single Sales Factor Apportionment (Corporate Income Tax — CIT):

Corporations with income derived from sources both within and outside California must use a formula that attempts to measure the amount of income that is attributable to California. In the past, for most taxpayers, California has used a four-factor apportionment formula consisting of a payroll factor, a property factor, and a sales factor that is counted twice (double-weighted). As part of the 2009 Budget Act, the Legislature adopted a single sales factor apportionment (SSF) method. The legislation provided for an election, effectively allowing corporations to choose the lower of two tax rates. This proposal would require that all corporations (except those corporations engaged in qualified agricultural, extractive, or banking activities) use SSF. This proposal is expected to generate additional revenues of $468 million in 2010-11 and $942 million in 2011-12, as well as providing several improvements to the way California taxes multi-state corporations.

The goal of moving to single sale factor was to eliminate any tax disincentives that can arise due to investment in new plant (property) and payroll in the state. There is a good argument to be made that in order for California to be competitive with other states, it should allow taxpayers to apportion income using SSF.

However, there is no reason – from an economic development perspective – to allow businesses to choose how their income will be apportioned. Requiring mostly "in-state" firms to use SSF removes a disincentive that they face, under double-weighted apportionment, from moving economic activity into California. Requiring "out-of-state" firms to use SSF accomplishes the exact same thing. It removes a disincentive that they face, under double-weighted sales apportionment, from moving economic activity into California.

Elective SSF allows the taxpayer to choose what its income is going to be and creates an inequity allowing taxpayers who operate in more than one state two different ways to calculate their income, one of which is likely to produce a much smaller tax than the other, while businesses that operate wholly inside California have no such option. This different treatment puts the wholly in-state businesses (which tend to be smaller businesses) at a competitive disadvantage to multi-state businesses (which tend to be larger businesses).

Changing to a mandatory SSF method will bring California in line with other states. Of the 23 states that have adopted SSF, only three, Missouri, Florida and Kentucky, allow an election. Of those three, only Missouri allows elective SSF for all industries.

This proposal is consistent with the Legislative Analyst's Office conclusion in their report on Single Sales Factor Apportionment which was published in May of 2010.

Along with adopting elective SSF in 2009, the state also modified some other provisions of the apportionment law. It clarified the definitions of nexus and gross receipts, broadened the definition of sales attributable to "unitary" groups of affiliated businesses, and changed the way sales of services and intangibles are assigned (cost-of-performance rule vs. market rule). These changes both protect against abuses under SSF and reduce the revenue loss from SSF.

In the 2010 Budget Act, the Legislature modified the market assignment rule for sales of services and intangibles to allow taxpayers who do not elect SSF to continue to use a cost-of-performance assignment rule. The Governor's Budget would require all taxpayers to source the sale of services and intangibles using a market approach, as opposed to a cost-of-performance approach.

Besides allowing for a consistent treatment of sales of tangibles versus intangibles and services, this provision will help to reduce the possibilities for taxpayers arranging their business transactions so as to minimize their tax. Of the three apportionment factors, taxpayers tend to have the greatest ability to manipulate their sales factor. Adopting a market approach to assigning the sales of intangibles and services will help to limit this manipulation.

The FTB estimates that adopting both of these proposals (mandatory SSF and market rule for everyone) would raise over $1 billion on an ongoing basis, relative to elective single sales factor apportionment. This increased tax liability will, generally, come from out-of-state taxpayers who will have higher tax liabilities under a mandatory single sales factor apportionment method due to their exploitation of the California market for their goods and services.

Repeal Enterprise Zone Tax Benefits (CIT and PIT):

Consistent with the new model for funding economic development (See Tax Relief and Local Government Chapter), the Budget proposes to eliminate all enterprise zone (EZ) tax incentives and similar tax incentives for specific areas for tax years beginning on or after January 1, 2011. These areas include EZs, Targeted Tax Areas, Manufacturing Enhancement Areas, and Local Agency Military Base Recovery Areas. The tax benefits provided for most of these areas include; a hiring credit, a credit for sales tax paid, a credit for employees who earn wages within the area, and a deduction for interest received from businesses in an area. This proposal would eliminate these tax benefits, both for newly earned credits and deductions and for credits that had been earned in prior years, but had not yet been used. Local agencies that want to keep any local incentives could continue to do so.

This proposal is expected to generate additional revenues of $343 million in 2010-11 and $581 million in 2011-12.

Within the context of a budget that proposes deep spending reductions across state government, all spending must be scrutinized. The EZ program is a tax expenditure —an expenditure program for local economic development run through the tax system. The Budget proposes to make significant changes in the way funding of local development efforts is handled. These changes are intended to move the responsibility and the authority for local development efforts to the local jurisdictions and their voters. Eliminating state tax benefits for EZs is a fundamental part of this change. Because the primary benefit of these zones is to shift economic activity from one geographic region within California to another geographic region within California, they are not of statewide interest.

The Legislative Analyst's Office "California's Enterprise Zone Programs" – 2005 found that EZs have little if any impact on the creation of new economic activity or employment. They also found that EZs appear to be somewhat effective in increasing economic activity within smaller geographic areas – such as within metropolitan regions. However, these increases are not generally a result of new activity, but, instead, from the shift of activity into a zone that otherwise would have occurred elsewhere.

According to a report by the W.E. Upjohn Institute for Employment Research (State Enterprise Zones: Have they Worked – 2002), "most enterprise zone incentives are too small to materially affect the investment and location behavior of most firms." The jobs created in many zones are filled by people who are not economically disadvantaged or do not live in the targeted area. They also conclude that since many of the benefits will be jobs that would have been created anyway, state and local government will see a net loss of $60,000 for every job created in a zone.

The Public Policy Institute of California found "Do California Enterprise Zones Create Jobs?" – 2009 that there was "no statistically significant effect on either employment levels or employment growth rates" within enterprise zones as compared to neighboring areas.

There is some evidence that benefits from the EZ programs go to taxpayers whose behavior has not been affected at all by the EZ program. There are firms that specialize in finding businesses that could benefit from an EZ program and offering to prepare the taxpayer's return on a percent of benefit basis. This is done for both current year and back-year tax returns. Clearly taxpayer's behavior to relocate or expand is not being driven by the existence of the EZ program if they have to be told that the program exists after they have already relocated or expanded.

Tax Shelter Amnesty (CIT and PIT):

The Budget proposes to allow the FTB to provide an amnesty for taxpayers who utilized an abusive tax-avoidance transaction. Abusive Tax Avoidance Transactions (ATATs) serve no purpose other than reducing tax. The IRS, the FTB, and the courts generally deny claimed tax benefits of an ATAT if the transaction that gives rise to those benefits lacks economic substance independent of income tax considerations. This proposal would authorize the FTB to provide a narrow tax amnesty for taxpayers that utilized an ATAT. This proposal would also provide an amnesty for the underreporting of California income resulting from offshore financial arrangements. This proposal would improve FTB enforcement tools and deter taxpayers from engaging in these activities that have no economic substance other than tax avoidance. Additionally, this proposal would reduce case backlogs at FTB. This proposal is expected to generate additional revenues of $270 million in 2010-11 and to decrease revenues by $50 million in 2011-12.

Financial Institution Record Match (FIRM) (CIT and PIT):

The Budget proposes to require financial institutions to participate in a record match process between financial institution customer records and FTB debtor records. FTB would use the match information to collect delinquent state income tax debts using existing laws and collection methods. Currently, FTB receives Form 1099 data on interest income earned by taxpayers. This information can be used by FTB to find bank accounts owned by delinquent taxpayers. However, this information is deficient in two ways. First, FTB only has access to information on interest-bearing accounts. Second, the information FTB receives is for interest that was earned in the prior year. By the time FTB issues an order-to-withhold on the account, the taxpayer may have closed or moved the account.

FIRM would provide FTB with current information on all bank accounts – interest-bearing and otherwise – that delinquent taxpayers may have. This approach has been used successfully by the Department of Child Support Services to collect money from delinquent child support payers. This proposal would help close the tax gap and collect additional revenue from taxpayers who have not paid their legally required share of taxes. Additionally, the use of timely financial data will reduce current collection process inefficiencies due to levies being issued based on outdated account information. This proposal is expected to generate additional revenues of $10 million in 2010-11 and $30 million in 2011-12.

Figure REV-02 shows the total impact of the tax solutions and associated spending on the Governor's Budget.

Figure REV-02

Net Benefit Of Tax Solutions

(Benefit to General Fund - Dollars in Millions)

	2010-11	2011-12
Direct General Fund Impact		
Personal income tax surcharge: Maintain the 0.25-percent PIT surcharge for five years.	$1,187	$2,077
Personal income tax dependent exemption credit: Maintain the current dependent exemption credit, which is aligned to equal the personal exemption credit amount for five years.	725	1,248
Mandatory Single Sales Factor: Modify current law to make this multi-state/national corporate income apportionment method mandatory instead of elective. Under current law, the opportunity to elect begins with the 2011 tax year.	468	942
Repeal Enterprise Zones: Eliminate the income tax incentives currently available for certain types of expenditures made in the designated zones.	343	581
Amnesty: Allow tax shelter cases in audit and protest to settle without penalties.	270	-50
Financial Institutions Records Match (FIRM): Allow the Franchise Tax Board access to bank records of debtors, similarly to what is currently done to collect child support.	10	30
Franchise Tax Board Costs of Amnesty and FIRM		-2
Revenue Driven Increase in Propostion 98 Expenditures		-1,990
Realignment Revenues - Local Revenue Fund 2011		
Maintain 6-percent state sales tax, with 1 percent dedicated to realignment.	0	4,549
Maintain 1.15 percent (VLF) rate, with 0.5 percent dedicated to realignment.	0	1,382
Other Special Fund Revenues That Offset General Fund Costs		
Extend the Hospital Fee for Medi-Cal to June 30, 2011	160	
Continue Managed Care Organization Taxes for Medi-Cal and Healthy Families		97
Total Net Benefit Of Revenue Solutions	$3,163	$8,864

General Fund Revenue

Percent of General Fund Revenues and Transfers

Personal income tax	55.5 percent
Sales and use taxes	26.8 percent
Corporation tax	12.2 percent
All other	5.5 percent

General Fund 2011-12 revenues and transfers represent 73 percent of total revenues reported in the Governor's Budget. The remaining 27 percent consists of special fund revenues dedicated to specific programs. The revenue estimates noted in the following discussion include the impact of the various proposals noted above under "Major Revenue Proposals" as well an estimated $6.5 million in 2010-11 and $13 million in 2011-12 from a proposal that will allow for increased efforts to collect PIT and Corporation Taxes under existing law.

Personal Income Tax (PIT)

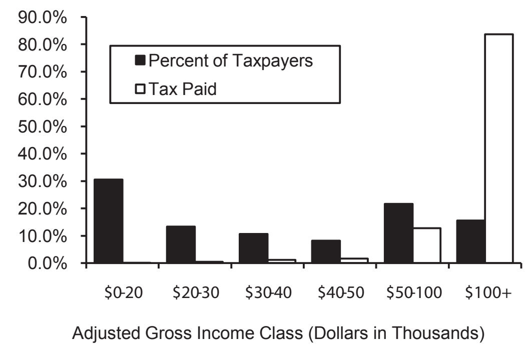
Personal Income Tax Revenue (In Billions)

2009-10	$44.848
2010-11 (Forecast)	$47.784
2011-12 (Forecast)	$49.741

The PIT is the state's largest single revenue source, accounting for 55.5 percent of all General Fund revenues and transfers in 2011-12. After a 3.4-percent increase in the prior fiscal year, income tax revenues are expected to increase another 6.5 percent in 2010-11 followed by an increase of 4.1 percent in 2011-12. These revenue estimates include $2.31 billion in 2010-11 and $3.59 billion in 2011-12 from the proposed: (1) extension of the 0.25-percent surcharge and maintaining the dependent exemption credit amount, (2) elimination of the enterprise zone and similar tax benefit zones, (3) amnesty from penalty charges for the settlement of tax shelter cases in audit and protest, and (4) establishment of a financial institutions record match (FIRM) process between financial institution customer records and FTB debtor records.

Modeled closely on the federal income tax law, California's personal income tax is imposed on net taxable income—gross income less exclusions and deductions. The tax rate structure is steeply progressive over much of the income spectrum, with rates ranging from 1 percent to 9.3 percent. Since the 2009 tax year, the marginal rates ranged from 1.25 percent to 9.55 percent. The Administration is proposing to maintain these tax rates for five years beginning in 2011. Figure REV-03, which shows the percent of total returns and tax paid by adjusted gross income class, illustrates the shares of the tax paid by various income classes. In 2008, the top 15.6 percent of state taxpayers, those with adjusted gross incomes (AGI) over $100,000, paid 83.6 percent of the personal income tax. The top 1 percent of state taxpayers paid 43 percent of the personal income tax. As a result of the tax bracket structure and distributions of tax liability, changes in the income of a relatively small group of taxpayers can have a significant impact on state revenues.

Figure REV-03
Percent of Taxpayers and Percent of Tax Paid by Adjusted Gross Income Class
2008 State Tax Data



Income ranges for all tax rates are adjusted annually by the change in the California Consumer Price Index. This prevents taxpayers from moving into higher tax brackets because of inflation without an increase in real income. For the 2010 tax year, this adjustment increased 0.9 percent, reflecting rising prices during 2010 after declines in 2009. For the 2011 tax year, the adjustment is projected to be an increase of 1.4 percent. The personal income tax rate applies to total taxable income from all sources, after which taxpayers can reduce their gross tax liability by claiming various credits.

An Alternative Minimum Tax (AMT), imposed at a rate of 7 percent, limits the amount of benefits that taxpayers realize from the use of deductions and exemptions, and thus ensures that all taxpayers pay a minimum level of tax. Since the 2009 tax year, the AMT rate is 7.25 percent. The Administration is proposing to maintain the 7.25-percent rate for another five years.

The largest income source for the personal income tax is wages and salaries. In 2008, taxes attributable to wages and salaries accounted for over 60 percent of personal income tax revenues. Based on the economic forecast, wages and salaries are expected to rise 0.8 percent in 2010, followed by 4.3 percent growth in 2011, and 4.7 percent in 2012. Capital gains are also a significant contributor to personal income tax revenues. In 2008, this component accounted for over 11 percent of the personal income tax.

Capital gains are highly volatile. Gains reported by taxpayers plunged 57.3 percent in 2008 and are estimated to have declined a further 38 percent in 2009. Capital gains are expected to bounce back with 34 percent growth in 2010, followed by 29 percent growth in 2011.

The Governor's Budget revenue estimates incorporate the potential behavioral impacts of federal tax law changes. The federal Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) enacted tax reductions for dividend income, capital gains and other income. These tax reductions were set to expire after 2010 before recent steps were taken by the President and Congress to extend the reductions through 2012. The estimates assume that some taxpayers during 2010 had responded to the potential rate change by accelerating 2 percent of 2011 capital gains to 2010. Also, it is estimated that 2 percent of 2011 dividends and 1.1 percent of wages were accelerated to 2010. These changes are projected to increase 2010-11 revenues by $200 million and to reduce 2011-12 revenues by the same amount.

Figure REV-04 shows the portion of General Fund revenues from capital gains. In addition to wages and salaries and capital gains, other major components of AGI include net business and proprietor income, which together constitute about 11 percent of the total.

Figure REV-04

Capital Gains
As a Percent of General Fund Revenues

(Dollars in Billions)

	2001	2002	2003	2004	2005	2006	2007	2008	2009 [p]	2010 [e]	2011 [e]
Capital Gains Income	$49.1	$33.4	$45.6	$75.5	$112.4	$117.9	$132.0	$56.3	$34.9	$46.8	$60.4
Tax at 9%	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Capital Gains Tax	$4.4	$3.0	$4.1	$6.8	$10.1	$10.6	$11.9	$5.1	$3.1	$4.2	$5.4
	01-02	02-03	03-04	04-05	05-06	06-07	07-08	08-09	09-10	10-11	11-12
Total General Fund Revenues and Transfers	$72.3	$71.3	$74.9	$82.2	$93.5	$95.5	$99.2	$82.8	$87.0	$94.2	$89.7
	01-02	02-03	03-04	04-05	05-06	06-07	07-08	08-09	09-10	10-11	11-12
Capital Gains Tax as Percent of General Fund Revenues & Transfers	6.1%	4.2%	5.5%	8.3%	10.8%	11.1%	12.0%	6.2%	3.6%	4.5%	6.1%

[p] Preliminary

[e] Estimated

Beginning with the 2011-12 Governor's Budget forecast, the Capital Gains series = (Net Positive Capital Gains + Capital Gains Losses used against ordinary income.) The prior data series was only Net Positive Capital Gains.

Note: Totals may not add due to rounding
2002-03 revenues do not include $9.242 billion in economic recovery bonds.
2003-04 revenues do not include $2.012 billion in economic recovery bonds.
2007-08 revenues do not include $3.313 billion in economic recovery bonds.

Additional Information

The FTB, which administers the personal income tax and corporation tax, prepares an annual report which streamlines much of the information previously included in the Operations Report, Annual Report and Performance Report. Its website, www.ftb.ca.gov, includes these reports as well as detailed tables and statistics. Information on personal income tax and corporation tax exclusions, deductions, and credits is also available in the Department of Finance's Tax Expenditure Report, published annually on the Internet at www.dof.ca.gov in "Reports and Periodicals."

A portion of personal income tax revenue is for dedicated purposes and deposited into a special fund instead of the General Fund. Proposition 63, passed in November 2004, imposes a surcharge of 1 percent on taxable income over $1 million in addition to the 9.3-percent General Fund rate (9.55 percent for tax years 2009 and 2010, and proposed to be extended). Revenue from the surcharge is transferred to the Mental Health Services Fund and used to fund mental health service programs. Revenues of $739 million are estimated for the 2009-10 fiscal year. Annual revenues of $891 million for 2010-11, and $924 million for 2011-12 are projected, reflecting modest income increases of higher-income taxpayers. Substantial portions of these revenues are received in the Mental Health Services Fund as settle-up transfers the second year following the year for which they are paid. (See the Department of Mental Health Services budget for information on transfers to and expenditures from the Mental Health Services Fund.)

The General Fund and the Mental Health Services Fund shares of personal income tax revenues for 2009-10 through 2011-12 are shown in Figure REV-05.

Figure REV-05

Personal Income Tax Revenue

(Dollars in Thousands)

	2009-10 Preliminary	2010-11 Forecast	2011-12 Forecast
General Fund	$44,847,866	$47,784,000	$49,741,000
Mental Health Services Fund	798,570	891,000	924,000
Total	**$45,646,436**	**$48,675,000**	**$50,665,000**

Sales and Use Tax

Receipts from sales and use taxes, the state's second largest revenue source, are expected to contribute 26.8 percent of all General Fund revenues and transfers in 2011-12. Figure REV-06 displays sales and use tax revenues for the General Fund, as well as special funds, for 2009-10 through 2011-12. General Fund revenues in 2010-11 and 2011-12 do not include any sales taxes collected from the sale of gasoline because of the fuel tax swap implemented in July 1, 2010, which exempted fuel sales from the General Fund portion of the sales tax (see the section on the Motor Vehicles Fuel Tax). In 2010-11 and 2011-12, taxable gasoline sales are expected to be around 8 to 9 percent of the entire taxable sales base. The sales tax is expected to generate General Fund revenues of $26.709 billion in 2010-11 and $24.05 billion in 2011-12.

Figure REV-06

Sales Tax Revenue

(Dollars in Thousands)

	2009-10 Preliminary	2010-11 Forecast	2011-12 Forecast
General Fund	$26,740,781	$26,709,000	$24,050,000
Sales and Use Tax-Realignment	2,355,670	2,431,917	2,661,391
Sales and Use Tax- Administration's Proposed Realignment	0	0	4,549,010
Public Transportation Account	928,374	306,894	408,783
Economic Recovery Fund	1,172,329	1,201,000	1,301,000
Total	**$31,197,154**	**$30,648,811**	**$32,970,184**

The Budget proposes to maintain the 6-percent sales tax rate, of which 1 percent will fund state-local realignment (see Realignment Chapter). Receipts from this 1-percent sales tax will be local-purpose revenues deposited into a special fund.

The sales tax applies to sales of tangible personal property in California; the companion use tax applies to property purchased outside the state for use within California. Most retail sales and leases are subject to the tax. Exemptions from the tax for necessities such as food for home consumption, prescription drugs, and electricity make the tax less regressive than it otherwise would be. Other exemptions provide tax relief for purchasers of particular products — e.g., farm equipment, custom computer programs, or materials used in space flights. These exemptions are generally enacted to encourage certain types of economic activity.

Through the first three quarters of calendar year 2009, the largest contributors to the sales tax base were wholesale trade at 11.3 percent, food services and establishments serving alcoholic beverages at 11.2 percent, and motor vehicle and parts dealers at 10.1 percent. Other significant contributors to the sales tax base include sales by general merchandise stores at 9.1 percent and gasoline stations at 8.5 percent.

Taxable sales, including gas, decreased by 12.4 percent in 2008-09. Based on preliminary data, it is estimated that taxable sales will decrease by an additional 4.5 percent for 2009-10. Growth is expected to resume in 2010-11 at 5.2 percent, followed by a further pick-up in 2011-12 at 8.9 percent growth.

Sales and Use Tax Revenue – General Fund (In billions)

2009-10	$26.741
2010-11 (Forecast)	$26.709
2011-12 (Forecast)	$24.050

Approximately two-thirds of the sales tax is related to consumer spending and paid by households. Such purchases are strongly influenced by such macro-economic factors as employment trends and interest rates. Given that much of the sales tax base is comprised of non-essential purchases that can be postponed or cancelled, consumer confidence can have a significant impact on sales tax revenues. The remaining approximately one-third of the sales tax is paid on purchases by businesses. This component, too, is governed by businesses' perceptions of economic conditions and the need for additional equipment acquisitions and other capital purchases. Sales and use tax revenues are forecast by relating taxable sales to economic factors such as income, employment, housing starts, new vehicle sales, and inflation.

Additional Information

The Board of Equalization, which administers the sales and use tax, tobacco tax, alcoholic beverage taxes, and fuel taxes, provides additional information in its annual report, which is available on its website, www.boe.ca.gov. Information on sales tax exemptions is included in the Department of Finance's Tax Expenditure Report, published annually on the Internet at www.dof.ca.gov in "Reports and Periodicals."

Figure REV-07 displays the individual elements of the state and local sales tax rates. Figure REV-08 shows combined state and local tax rates for each county.

Figure REV-07

2010-11 State and Local Sales and Use Tax Rates

State Rates		
General Fund	5.00%	Pursuant to Sections 6051.3 and 6051.4 of the Revenue and Taxation Code, this rate is 5%, but may be temporarily reduced by 0.25% if General Fund reserves exceed specified levels. During 2001, the rate was 4.75%, and during 2002 and thereafter, this rate is 5.00%.
General Fund	1.00%	Pursuant to Sections 6051.7 and 6201.7 of the Revenue and Taxation Code, beginning on April 1, 2009, an additional temporary 1.00% General Fund sales tax was imposed. This tax is scheduled to expire on July 1, 2011. (See note below)
Local Revenue Fund	0.50%	Dedicated to local governments to fund health and social services programs transferred to counties as part of 1991 state-local realignment.
Economic Recovery Fund	0.25%	Beginning on July 1, 2004, a new temporary 0.25% state sales tax rate was imposed, with a corresponding decrease in the Bradley-Burns rate. These revenues are dedicated to repayment of Economic Recovery Bonds. Once these bonds are repaid, this tax will sunset and the Bradley-Burns rate will return to 1%.
Local Uniform Rates[1]		
Bradley-Burns	0.75%[2]	Imposed by city and county ordinance for general purpose use.[3]
Transportation Rate	0.25%	Dedicated for county transportation purposes.
Local Public Safety Fund	0.50%	Dedicated to cities and counties for public safety purposes. This rate was imposed temporarily by statute in 1993 and made permanent by the voters later that year through passage of Proposition 172.
Local Add-on Rates[4]		
Transactions and Use Taxes	up to 2.00%	May be levied in 0.125% or 0.25% increments[5] up to a combined maximum of 2.00% in any county.[6] Any ordinance authorizing a transactions and use tax requires approval by the local governing board and local voters.

[1] These locally-imposed taxes are collected by the State for each city and county and are not included in the State's revenue totals.

[2] The 1 percent rate was temporarily decreased by 0.25 percent on July 1, 2004, and a new temporary 0.25 percent tax imposed to repay Economic Recovery Bonds. Cities and counties will receive additional property tax revenues equal to the 0.25 percent local sales tax reduction.

[3] The city tax constitutes a credit against the county tax. The combined rate is never more than 1 percent in any area (or 0.75 percent during the period when Economic Recovery Bonds are being repaid).

[4] These taxes may be imposed by voters in cities, counties, or special districts. The revenues are collected by the State for each jurisdiction and are not included in the State's revenue totals.

[5] Increments imposed at 0.125 percent are only allowed when revenues are dedicated for library purposes.

[6] An exception to the 2 percent maximum is Los Angeles County, which may impose up to 2.5 percent.

Note: The Administration is proposing to maintain the current 6 percent rate of which 1 percent will be deposited in the Local Revenue Fund of 2011.

Figure REV-08

Combined State and Local Sales and Use Tax Rates by County

(Rates in Effect on October 1, 2010) [32/]

County	Tax Rate	County	Tax Rate	County	Tax Rate
Alameda	9.75%	Madera	8.75%	San Joaquin [21/]	8.75%
Alpine	8.25%	Marin [10/]	9.00%	San Luis Obispo [22/]	8.25%
Amador	8.75%	Mariposa	8.75%	San Mateo [23/]	9.25%
Butte	8.25%	Mendocino [11/]	8.25%	Santa Barbara	8.75%
Calaveras	8.25%	Merced [12/]	8.25%	Santa Clara [24/]	9.25%
Colusa [1/]	8.25%	Modoc	8.25%	Santa Cruz [25/]	9.00%
Contra Costa [2/]	9.25%	Mono [13/]	8.25%	Shasta	8.25%
Del Norte	8.25%	Monterey [14/]	8.25%	Sierra	8.25%
El Dorado [3/]	8.25%	Napa	8.75%	Siskiyou	8.25%
Fresno [4/]	8.975%	Nevada [15/]	8.375%	Solano	8.375%
Glenn	8.25%	Orange [16/]	8.75%	Sonoma [26/]	9.00%
Humboldt [5/]	8.25%	Placer	8.25%	Stanislaus [27/]	8.375%
Imperial [6/]	8.75%	Plumas	8.25%	Sutter	8.25%
Inyo	8.75%	Riverside	8.75%	Tehama	8.25%
Kern [7/]	8.25%	Sacramento [17/]	8.75%	Trinity	8.25%
Kings	8.25%	San Benito [18/]	8.25%	Tulare [28/]	8.75%
Lake [8/]	8.25%	San Bernardino [19/]	8.75%	Tuolumne [29/]	8.25%
Lassen	8.25%	San Diego [20/]	8.75%	Ventura [30/]	8.25%
Los Angeles [9/]	9.75%	San Francisco	9.50%	Yolo [31/]	8.25%
				Yuba	8.25%

[1/] 8.75% for sales in the City of Williams.
[2/] 9.75% for sales in the Cities of Richmond, Pinole, and El Cerrito.
[3/] 8.50% for sales in the City of Placerville and 8.75% for sales in the City of South Lake Tahoe.
[4/] 9.475% for sales in the Cities of Reedley and Selma and 9.725% for sales in the City of Sanger.
[5/] 8.50% for sales in the City of Eureka and 9.00% for sales in the Cities of Arcata and Trinidad.
[6/] 9.25% for sales in the City of Calexico.
[7/] 9.25% for sales in the Cities of Arvin and Delano.
[8/] 8.75% for sales in the City of Clearlake and the City of Lakeport.
[9/] 10.25% for sales in the Cities of Avalon, El Monte, and Inglewood and 10.75% for sales in Pico Rivera and South Gate.
[10/] 9.50% for sales in the City of San Rafael.
[11/] 8.75% for sales in the Cities of Fort Bragg, Point Arena, Ukiah, and Willits.
[12/] 8.75% for sales in the Cities of Merced, Los Banos, and Gustine.
[13/] 8.75% for sales in the City of Mammoth Lakes.
[14/] 8.75% for sales in the Cities of Salinas and Sand City and 9.25% in the Cities of Del Rey Oaks, Pacific Grove, and Seaside.
[15/] 8.875% for sales in the Cities of Truckee and Nevada City.
[16/] 9.25% for sales in the City of La Habra.
[17/] 9.25% for sales in the City of Galt.
[18/] 9.00% for sales in the City of San Juan Bautista and 9.25% for sales in the City of Hollister.
[19/] 9.00% for sales in the City of Montclair and the City of San Bernardino.
[20/] 9.25% for sales in the City of Vista, 9.5% for the City of La Mesa, and 9.75% for sales in the Cities of El Cajon and National City.
[21/] 9.00% for sales in the City of Stockton and 9.25% for sales in the City of Manteca.
[22/] 8.75% for sales in the Cities of Arroyo Grande, Morro Bay, Grover Beach, San Luis Obispo, and Pismo Beach.
[23/] 9.50% for sales in the Cities of Hillsdale and San Mateo.
[24/] 9.25% for sales in the City of Campbell.
[25/] 9.25% for sales in the Cities of Watsonville, Capitola, and Scotts Valley and 9.50% for sales in the City of Santa Cruz.
[26/] 9.25% for sales in the Cities of Sebastopol and Santa Rosa and 9.50% for Cotati and Rohnert Park.
[27/] 8.875% for sales in the City of Ceres.
[28/] 9.00% for sales in the City of Visalia. 9.25% for sales in the Cities of Farmersville, Porterville, and Tulare. 9.50% for sales in the City of Dinuba.
[29/] 8.75% for sales in the City of Sonora.
[30/] 8.75% for sales in the Cities of Oxnard and Port Huer
[31/] 8.75% for sales in the Cities of Woodland, West Sacramento, and Davis.
[32/] Reflects state sales tax rate of 6 percent. The Budget proposes to maintain this rate for another five years. Revenue from this extension will be deposited into the Local Revenue Fund of 2011.

Corporation Tax

Corporation Tax Revenue (In Billions)	
2009-10	$ 9.115
2010-11 (Forecast)	$ 11.509
2011-12 (Forecast)	$ 10.966

Corporation tax revenues are expected to contribute 12.2 percent of all General Fund revenues and transfers in 2011-12. Corporation tax revenues are expected to increase by 26.3 percent from 2009-10 to 2010-11 but then decline by 4.7 percent by 2011-12. This is in part a function of recent policy changes discussed below. These revenue estimates include $689 million in 2010-11, and $1.24 billion in 2011-12, for the proposals to (1) require mandatory single sales factor allocation of income; (2) eliminate EZs and similar tax benefit areas; and (3) provide amnesty from penalty charges for the settlement of tax shelter cases in audit and protest.

Corporation tax revenues are driven by corporate profits, which generally track the overall business cycle. Corporation tax revenue over the next several years will be diminished by the recent legislative actions taken in prior budget acts. In particular, the following provisions will tend to weaken the growth of corporation tax revenue:

- The expiration of the temporary limitation of credits to offset no more than 50 percent of pre-credit tax liability, which were operative for tax years beginning after January 1, 2008, but before January 1, 2010.
- The ability of unitary taxpayers to share tax credits among members of the unitary group, which is operative for tax years beginning on or after January 1, 2010.
- The ability of taxpayers to elect single sales factor apportionment, which is operative for tax years beginning on or after January 1, 2011.
- The end of the temporary suspension of net operating losses, which is operative for tax years beginning on or after January 1, 2008, but before January 1, 2012.
- The ability for taxpayers to carry back net operating losses to prior years, which is operative for tax years beginning on or after January 1, 2012.

Corporation tax revenues are derived from the following sources:

- The franchise tax and the corporate income tax are levied at a rate of 8.84 percent on net profits. The former is imposed on corporations that conduct business in California, while the latter is imposed on corporations that derive income from California sources without conducting business in the state. For example, a corporation that maintains a stock of goods in California to fill orders taken by independent dealers would be subject to the corporate income tax.

- Corporations that have a limited number of shareholders and meet other requirements to qualify for state Subchapter S status are taxed at a 1.5-percent rate rather than the 8.84 percent imposed on other corporations.
- Banks and other financial corporations pay the franchise tax plus an additional 2-percent tax on net income. This "bank tax" is in lieu of local personal property and business license taxes.
- The AMT is similar to that imposed under federal law. Levied at a rate of 6.65 percent, the AMT ensures that corporate taxpayers do not make excessive use of deductions and exemptions to avoid paying a minimum level of tax.
- A minimum franchise tax of $800 is imposed on corporations subject to the franchise tax, but not on those subject to the corporate income tax. An $800 minimum tax is also imposed on Limited Liability Companies (LLCs), Limited Partnerships and Limited Liability Partnerships.
- In addition to an annual tax of $800, a fee is imposed on LLCs based on total income. The fee ranges from $900 for LLCs with income between $250,000 and $499,000, to $11,790 for LLCs with income of $5 million or more. LLCs with total income of less than $250,000 do not pay this fee.
- The corporation tax forecast is based on an analysis of California taxable profits, employment rates, personal income, and actual cash receipts.

From 1943 through 1985, corporation tax liability as a percentage of profits closely tracked the corporation tax rate. Since 1986, tax liability as a percentage of profits has dropped below the statutory level of 8.84 percent. Increasing S-corporation activity and use of credits have been the primary factors contributing to a divergence between profit and tax liability growth. Businesses that elect to form as S-corporations pay a reduced corporate rate, with the income and tax liability on that income passed through to owners and thus shifted to the personal income tax.

Insurance Tax

Most insurance written in California is subject to a 2.35-percent gross premiums tax. This premium tax takes the place of all other state and local taxes except those on real property and motor vehicles. In general, the basis of the tax is the amount of "gross premiums" received, less return premiums.

Insurance Tax Revenue (General Fund) (In Billions)

2009-10	$2.002
2010-11 (Forecast)	$1.838
2011-12 (Forecast)	$1.974

To provide interim funding for the Healthy Families and Medi-Cal programs, Chapter 157, Statutes of 2009 extended the 2.35-percent gross premiums tax to the Medi-Cal managed care plans in 2009 and 2010. The Governor's Budget proposes to extend the tax to provide continued funding for Healthy Families. Figure REV-09 displays the distribution of total insurance tax revenues from 2009-10 through 2011-12.

Figure REV-09

Insurance Tax Revenue

(Dollars in Millions)

	2009-10 Preliminary	2010-11 Forecast	2011-12 Forecast
General Fund	$2,002.0	$1,838.0	$1,974.0
Children's Health and Human Services Special Fund	178.7	192.3	194.5
Total	**$2,180.8**	**$2,030.3**	**$2,168.5**

Totals may not add due to rounding.

The Department of Finance conducts an annual survey to project insurance premium growth. Responses were received this year from a sample representing about 35 percent of the dollar value of premiums written in California.

In 2009, $114.5 billion in taxable premiums were reported, representing a decrease of 7.2 percent from 2008. The most recent survey indicates that total premiums will increase by 2.5 percent and 3.1 percent in 2010 and 2011, respectively. As reforms in workers' compensation insurance continue to take hold, taxable premiums from workers' compensation insurance continue to decrease. Survey respondents predicted declines of 1.1 percent and 0.7 percent in 2010 and 2011, respectively, in this line of insurance. The primary reason for the decline in the Insurance Tax revenue estimate from 2009-10 to 2010-11, and the weak growth to 2011-12 is refunds that are expected to be paid pursuant to a Board of Equalization decision in the *California Automobile Insurance Company* case. The California Department of Insurance is expected to pay refunds related to this decision of $230 million in 2010-11 and $149 million in 2011-12.

Alcoholic Beverage Taxes

In addition to the sales tax paid by retail purchasers, California levies an excise tax on distributors of beer, wine, and distilled spirits.

Alcoholic beverage revenue estimates are based on projections of total and per capita consumption for each type of beverage. Consumption of alcoholic beverages is expected to grow over the forecast period, increasing by 2.3 percent for both 2010-11 and 2011-12.

Alcoholic Beverage Tax Rates Per Gallon (January 1, 2011)

$0.20 for beer, dry wine, and sweet wine

$0.30 for sparkling wine

$3.30 for distilled spirits

Collections in 2009-10 and forecasted revenues for 2010-11 and 2011-12 are shown in Figure REV-10.

Figure REV-10
Beer, Wine, and Distilled Spirits Revenue
(Dollars in Millions)

	2009-10 Preliminary	2010-11 Forecast	2011-12 Forecast
Beer and Wine	$150.2	$152.7	$155.3
Distilled Spirits	161.1	165.6	170.2
Total	**$311.2**	**$318.3**	**$325.5**

Totals may not add due to rounding.

Cigarette Tax

The state imposes an excise tax of 87 cents per pack of 20 cigarettes on distributors selling cigarettes in California. An excise tax is also imposed on the distribution of other tobacco products such as cigars, chewing tobacco, pipe tobacco, and snuff. The rate on other tobacco products is calculated annually by the Board of Equalization based on the wholesale price of cigarettes and the excise tax on cigarettes.

Revenues from the tax on cigarettes and other tobacco products are distributed as follows:

- Ten cents of the per-pack tax is allocated to the General Fund.
- Fifty cents of the per-pack tax, and an equivalent rate levied on non-cigarette tobacco products, goes to the California Children and Families First Trust Fund for distribution according to the provisions of Proposition 10 of 1998.
- Twenty-five cents of the per-pack tax, and an equivalent rate levied on non-cigarette tobacco products, is allocated to the Cigarette and Tobacco Products Surtax Fund for distribution as determined by Proposition 99 of 1988.
- Two cents of the per-pack tax is deposited into the Breast Cancer Fund.

Projections of cigarette tax revenues are based on total and per capita consumption of cigarettes while revenue estimates for other tobacco products rely on wholesale price data. The cumulative effect of product price increases, the increasingly restrictive environments for smokers, state anti-smoking campaigns funded by Proposition 99 Tobacco Tax and Health Protection Act revenues and revenues from the Master Tobacco Settlement, and the 2009 federal cigarette tax rate increase have considerably reduced cigarette consumption.

Annual per capita consumption (based on population ages 18-64) declined from 123 packs in 1989-90 to 84 packs in 1997-98 and 40 packs in 2009-10, the latest year of actual data available. The long-term downward trend in consumption should continue to reduce cigarette tax revenues and this forecast assumes an annual decline in total consumption of approximately 3 percent.

Figure REV-11 shows the distribution of tax revenues for the General Fund and various special funds for 2009-10 through 2011-12.

Figure REV-11

Tobacco Tax Revenue

(Dollars in Millions)

	2009-10 Preliminary	2010-11 Forecast	2011-12 Forecast
General Fund	$96.2	$93.0	$90.0
Cigarette and Tobacco Products Surtax Fund	293.7	285.0	277.0
Breast Cancer Fund	19.3	19.0	18.0
California Children and Families First Trust Fund	512.1	497.0	482.0
Cigarette and Tobacco Products Compliance Fund	1.8	1.7	1.7
Total	**$923.0**	**$895.7**	**$868.7**

Totals may not add due to rounding.

Property Taxes

Article XIIIA of the State Constitution (Proposition 13) provides that property is assessed at its 1975 fair market value until it changes ownership. When ownership changes, the assessed value is redetermined based on the property's current market value. New construction is assessed at fair market value when construction is completed. A property's base year value may be increased by an inflation factor, not to exceed 2 percent annually.

Although the property tax is a local revenue source, the amount of property tax generated each year has a substantial impact on the state budget because local property tax revenues allocated to K-14 schools offset General Fund expenditures. Assessed value growth is estimated based on twice-yearly surveys of county assessors and evaluation of real estate trends. Continued declines in sales volumes and prices, coupled with declines in property values and failures to remit property tax payments as a result of mortgage defaults and foreclosures, continue to negatively impact assessed values and property tax levies. Property tax collections are estimated to decrease 5 percent from 2009-10 to 2010-11. As the process of foreclosing on properties with delinquent mortgages accelerates in 2011-12, and those properties are resold, the decline in property tax revenues is expected to end. However, no positive growth in revenues is anticipated, leading to a forecast of zero percent growth for 2011-12.

Property taxes received by school districts and reflected in the Department of Education and Community Colleges budgets are significantly below projections used for the 2010-11 Governor's Budget.

Estate/Inheritance/Gift Taxes

Proposition 6, adopted in June 1982, repealed the inheritance and gift taxes and imposed a tax known as "the pick-up tax," because it was designed to pick up the maximum state credit allowed against the federal estate tax without increasing total taxes paid by the estate. The pick-up tax is computed based on the federal "taxable estate," with tax rates ranging from 0.8 percent to 16 percent.

The federal EGTRRA phased out the federal estate tax by 2010. This 2001 Act reduced the state pick-up tax by 25 percent in 2002, 50 percent in 2003, 75 percent in 2004, and eliminated it beginning in 2005. However, the recently-enacted Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 made changes to the federal estate tax for 2011 and 2012. One of those changes was an extension of the elimination of the state estate tax credit, which had been in effect since 2005, for 2011 and 2012. This extension effectively eliminates the California estate tax through 2012. Accordingly, the amount of revenue estimated to be received from this source, under current federal law, is now $0 in both the current and budget years.

Some revenues from this tax continue to be collected from estates established prior to 2005. For instance, about $8 million in tax receipts were received in 2009-10 from this source.

Other Revenues

Vehicle License Fee (VLF)

Since 2009, the VLF rate has been 1.15 percent. Of this amount, 0.65 percent goes to local governments, 0.35 percent goes to the General Fund, and the remainder to local public safety programs (see below). Revenues from this source to the General Fund will be $1.473 billion in 2010-11 and $162 million in 2011-12.

Under the Administration's revenue proposal, the 1.15-percent VLF rate would be maintained for five years. 0.5 percent would be dedicated for local purposes, and will fund specified services, including the local public safety programs (see Realignment Chapter).

Indian Gaming

The Governor's Budget reflects General Fund Revenues from tribal gaming of $364 million in 2009-10, $364 million in 2010-11, and $364 million in 2011-12.

For 2009-10 and 2010-11, about $100 million in revenue was transferred from a special deposit fund to the General Fund, absent the sale of bonds to fund certain transportation programs to which this revenue had been allocated. Ongoing litigation has dimmed the prospects for a bond sale. Absent a bond sale, the Administration proposes to continue transferring this revenue to the General Fund for another five years starting in 2011-12. That proposal is reflected in the above revenue estimates.

Unclaimed Property

The Governor's Budget reflects receipts of $337 million in 2009-10, $220 million in 2010-11, and $221 million in 2011-12 from unclaimed property. The 2009-10 amount includes a one-time unclaimed property receipt increase of $90.5 million from FDIC-seized banks and an increase in overall holder reporting of about $13 million.

Sale Leaseback of 11 State Facilities

One of the budget solutions for the 2010 budget was the sale and leaseback of 11 state facilities. The sale of the 11 state facilities is expected to generate one-time General Fund revenues of $1.2 billion in the 2010-11 fiscal year. However, a lawsuit has been filed challenging the sale; at this time, the completion of the transaction is uncertain.

Loans and Transfers from Special Funds

The Governor's Budget proposes to transfer the following amounts of surplus balances in special funds to the General Fund:

- $12.0 million in 2010-11
- $83.6 million in 2011-12

New loans from special funds to the General Fund are also proposed as follows:

- $493.9 million in 2010-11
- $516.3 million in 2011-12

In addition, repayments for certain loans previously made from various special funds to the General Fund have been deferred to the 2012-13 fiscal year, resulting in temporary savings to the General in 2011-12 for $291 million.

These proposals will provide short-term relief to the General Fund as other long-term budget solutions are implemented, and will not harm the essential functions of those special funds' programs.

Special Fund Revenue

The California Constitution and state statutes specify into which funds certain revenues must be deposited and how they are to be spent. Special fund revenues consist of:

- Receipts from tax levies allocated to specified functions, such as motor vehicle taxes and fees.
- Charges such as business and professional license fees.
- Rental royalties and other receipts designated for particular purposes, such as oil and gas royalties.

Total special fund revenues are estimated to be $32.2 billion in 2011-12. Taxes and fees related to motor vehicles are expected to comprise about 37 percent of all special fund revenue in 2011-12. The principal sources are motor vehicle fees (registration, weight, and vehicle license fees) and motor vehicle fuel taxes. During 2011-12, it is expected that about $12 billion in revenues will be derived from the ownership or operation of motor vehicles. About 44 percent of all motor vehicle taxes and fees will be allocated to local governments, and the remaining portion will be used for state transportation programs.

Motor Vehicle Fees

Motor vehicle fees and taxes consist of vehicle license, registration, weight, driver's license, and other charges related to vehicle operation. Figure REV-12 displays revenue from these sources from 2009-10 through 2011-12.

Figure REV-12

Motor Vehicle Fees Special Fund Revenue

(Dollars in Thousands)

	2009-10 Preliminary	2010-11 Forecast	2011-12 Forecast
Vehicle License Fees	$481,581	$490,398	$514,923
Realignment	1,445,422	1,474,852	1,548,041
Administration's Proposed Realignment	0	0	1,382,000
Registration, Weight, and Other Fees	3,381,688	3,384,122	3,396,723
Total	**$5.308.691**	**$5.349.372**	**$6.841.687**

The VLF is imposed on vehicles that travel on public highways in California. This tax is imposed in lieu of a local personal property tax on automobiles and is administered by the Department of Motor Vehicles. Revenues from the 0.65-percent base VLF rate, other than administrative costs and fees on trailer coaches and mobile homes, are constitutionally dedicated to local governments.

The number of vehicles in the state, the ages of those vehicles, and their most recent sales price affect the amount of VLF collected. The total number of vehicles in California —autos, trucks, trailers, and motorcycles including vehicles registered in multiple states —is estimated to be 30,476,000 in 2010-11 and 30,686,000 in 2011-12. The forecast assumes that there will be 1,352,000 new vehicles registered in 2010-11, and 1,590,000 new vehicles in 2011-12.

The VLF is calculated on the vehicle's "market value," adjusted for depreciation. The motor vehicle schedule is based on an 11-year depreciation period; for trailer coaches, it is an 18-year period. A 0.65-percent rate is applied to the depreciated value to determine the fee.

Chapter 87, Statutes of 1991 revised the VLF depreciation schedule and required the Department of Motor Vehicles to reclassify used vehicles based on their actual purchase price each time ownership is transferred. Revenue from this base change is transferred to the Local Revenue Fund for state-local program realignment.

Chapter 322, Statutes of 1998 established a program to offset a portion of the VLF paid by vehicle owners at the 2-percent rate. The state paid or "offset" a portion of the amount due and taxpayers paid the balance. This General Fund offset gave taxpayers significant tax relief and compensated local governments. A permanent offset of 25 percent of the amount of the VLF owed became operative in 1999. Chapter 74, Statutes of 1999 increased the offset to 35 percent on a one-time basis for the 2000 calendar year. Chapters 106 and 107, Statutes of 2000, and Chapter 5, Statutes of 2001, extended the 35-percent offset through June 30, 2001, and provided an additional 32.5-percent VLF reduction, which was returned to taxpayers in the form of a rebate. Beginning July 1, 2001, the VLF was reduced by 67.5 percent. As the amount paid by taxpayers decreased, the amount backfilled by the General Fund increased.

The VLF reduction was suspended for a 141-day period beginning July 1, 2003. Executive Order S-1-03, issued November 17, 2003, rescinded the offset suspension and directed the Department of Motor Vehicles to reinstate the offset as soon as administratively feasible.

Chapter 211, Statutes of 2004 eliminated the VLF offset and reduced the VLF tax rate to 0.65 percent. Local governments now receive property tax revenues to compensate them for the loss of VLF revenue. In 2004-05 and 2005-06, that replacement revenue was reduced by $1.3 billion to assist the state. The estimated value of the VLF backfill to local governments is $5.7 billion in 2011-12. The value of the tax reduction from

2 percent to 0.65 percent is $4.3 billion. In February 2009, the VLF rate was increased to 1.15 percent for five years. Out of the 0.5-percent increase, 0.15 percent goes for funding local law enforcement and the remaining 0.35 percent goes to the General Fund. As a result of this increase, revenues from this source to local public safety programs will be $442 million in 2010-11 and $49 million in 2011-12. The Governor's Budget maintains the VLF at the 1.15-percent rate, with 0.5 percent becoming local purpose revenue. The value of the tax reduction that remains in effect is $2.7 billion.

The Department of Motor Vehicles administers the VLF for trailer coaches that are not installed on permanent foundations. Those that are installed on permanent foundations (mobile homes) are subject to either local property taxes or the VLF. Generally, mobile homes purchased new prior to July 1, 1980, are subject to the VLF. All trailer coach license fees are deposited in the General Fund.

In addition to the VLF, commercial truck owners pay a fee based on vehicle weight. Chapter 861, Statutes of 2000, and Chapter 719, Statutes of 2003, revised the fee schedules to conform to the federal International Registration Plan.

Motor Vehicle Fuel Taxes

The motor vehicle fuel tax, diesel fuel tax, and the use fuel tax are the major sources of funds for maintaining, replacing, and constructing state highway and transportation facilities. Just over one-third of these revenues is apportioned to local jurisdictions for street and highway use.

Gasoline consumption was flat in 2009-10 when compared to the prior fiscal year. Gasoline consumption is expected to decrease 0.2 percent in 2010-11 and then increase 1.4 percent in 2011-12.

Because most diesel fuel is consumed by the commercial trucking industry, consumption is affected most significantly by general economic conditions. Diesel fuel consumption fell 4.2 percent in 2009-10. However, a recovering economy is expected to contribute to growth of 3 percent in diesel consumption in 2010-11 followed by 4.4-percent growth in 2011-12.

Motor vehicle fuel tax collections are shown in Figure REV-13.

The motor vehicle fuel tax (gas tax) is collected from distributors when fuel is loaded into ground transportation for transport to retail stations. This fuel is taxed at a rate of

35.3 cents per gallon under current law. Fuels subject to the gas tax include gasoline, natural gas, and blends of gasoline and alcohol sold for use on public streets and highways.

Figure REV-13

Motor Vehicle Fuel Tax Revenue

(Dollars in Thousands)

	2009-10 Preliminary	2010-11 Forecast	2011-12 Forecast
Gasoline [1]	$2,665,421	$5,220,441	$5,089,447
Diesel	496,174	511,567	402,885
Total	**$3,161,595**	**$5,732,008**	**$5,492,332**

[1] Does not include jet fuel.

Distributors pay the diesel fuel tax, which applies to both pure diesel fuel and blends, at the fuel terminal. Diesel fuel for highway use is taxed at a rate of 18 cents per gallon. Dyed diesel fuel, which is destined for off-highway uses such as farm equipment, is not taxed.

Beginning in 2010-11, the fuel tax swap eliminated the General Fund portion of the sales tax on gasoline and replaced it with an excise tax of 17.3 cents per gallon, increasing the total excise tax to 35.3 cents per gallon. To maintain revenue neutrality, this excise tax will be adjusted each year. The 2011-12 Governor's Budget forecasts that the excise tax on gasoline will be 33.5 cents per gallon in 2011-12. The Budget proposes that the tax swap be reenacted by two-thirds vote, in accordance with the provisions of Proposition 26.

Beginning in 2011-12, the fuel tax swap increased the sales tax on diesel fuel by 1.75 percent, while decreasing the excise tax to maintain revenue neutrality. The Governor's Budget forecasts that the excise tax on diesel fuel will be reduced by 4.8 cents to 13.2 cents from the current level of 18 cents per gallon. The budget proposes that this element of the gas tax swap also be re-enacted by a two-thirds vote.

The use fuel tax is levied on sales of kerosene, liquefied petroleum gas (LPG), liquid natural gas (LNG), compressed natural gas (CNG), and alcohol fuel (ethanol and methanol containing 15 percent or less gasoline and diesel fuel). These fuels are taxed only when they are dispensed into motor vehicles used on the highways. Current use fuel tax rates are 18 cents per gallon for kerosene, 6 cents per gallon for LPG and LNG, 7 cents per 100 cubic feet for CNG, and 9 cents per gallon for alcohol fuel. Users of LPG, LNG, or CNG may elect to pay a flat rate of tax based on vehicle weight instead of the per-gallon tax.

An excise tax of 2 cents per gallon is levied on aircraft jet fuel sold at the retail level. This tax does not apply to commercial air carriers, aircraft manufacturers and repairers, and the U.S. armed forces.

Local transit systems, school and community college districts, and certain common carriers pay 1 cent per gallon on the fuel they use instead of the tax rates described above.

Summary of State Tax System

The state's tax system is outlined at the end of this section in Figure REV-14 and Figure REV-15. Tax collections per capita and per $100 of personal income are displayed in Schedule 2 in the Appendix. The revenue generated from each state tax from 1970-71 through 2011-12 is displayed in Schedule 3 in the Appendix.

Figure REV-14
Outline of State Tax System
as of January 1, 2011

Major Taxes and Fees	Base or Measure	Rate	Administering Agency	Fund
Alcoholic Beverage Excise Taxes:				
Beer	Gallon	$0.20	Equalization	General
Distilled Spirits	Gallon	$3.30	Equalization	General
Dry Wine/Sweet Wine	Gallon	$0.20	Equalization	General
Sparkling Wine	Gallon	$0.30	Equalization	General
Hard Cider	Gallon	$0.20	Equalization	General
Corporation:				
General Corporation	Net income	8.84% [1]	Franchise	General
Bank and Financial Corp.	Net income	10.84%	Franchise	General
Alternative Minimum Tax	Alt. Taxable Income	6.65% [1]	Franchise	General
Tobacco:				
Cigarette	Package	$0.87 [2]	Equalization	See below [2]
Other Tobacco Products	Wholesale cost	33.02% [3]	Equalization	See below [3]
Estate	Taxable Fed. Estate	0% [6]	Controller	General
Insurance				
Insurers	Gross Premiums	2.35% [7]	Insurance Dept.	General
Medi-Cal managed care plans	Operating Revenues	2.35%	Health Care Services	See below [5]
Liquor License Fees	Type of license	Various	Alc. Bev. Control	General
Motor Vehicle:				
Vehicle License Fees (VLF)	Market value	1.15% [8]	DMV	[9]
Fuel—Gasoline	Gallon	$0.353 [10]	Equalization	Motor Vehicle Fuel [11]
Fuel—Diesel	Gallon	$0.18 [12]	Equalization	Motor Vehicle Fuel
Registration Fees	Vehicle	$56.00	DMV	Motor Vehicle [13]
Weight Fees	Gross Vehicle Wt.	Various	DMV	State Highway [14]
Personal Income	Taxable income	1.0-9.3% [15]	Franchise	General
Proposition 63 Surcharge	million	1.0%	Franchise	Mental Health Services
Alternative Minimum Tax	Alt. Taxable Income	7.0% [15]	Franchise	General
Retail Sales and Use	taxable items	6.75% [17]	Equalization	See below [17]

Figure-REV-15
Notes to Figure REV-14

[1] Min. tax $800 per year for existing corporations. New corporations are exempt from the min. tax for the first two years.

[2] This tax is levied at the combined rate of 10 cents/pack of 20 cigarettes for the General Fund, 25 cents/pack for the Cigarette and Tobacco Products Surtax Fund, 2 cents/pack for the Breast Cancer Fund, and 50 cents/pack for the California Children and Families First Trust Fund.

[3] A tax equivalent to the tax on cigarettes. The rate reflects the 50 cents/pack established by the California Children and Families First Initiative, with funding for Cigarette and Tobacco Products Surtax Fund and California Children and Families First Trust Fund.

[4] The Fair and Exposition Fund supports county fairs and other activities, the Satellite Wagering Account funds construction of Satellite Wagering Facilities and health and safety repairs at fair sites. Wildlife Restoration Fund and General Fund also receive monies.

[5] Insurance tax on Medi-Cal managed care plans in 2009 and 2010, pursuant to Chapter 157, Statutes of 2009 (AB 1422), to provide interim funding for the Healthy Families and Medi-Cal programs. Tax receipts collected pursuant to Chapter 157 are available for a specific purpose and are required to be deposited into the Children's Health and Human Services Special Fund. The Administration s proposing to extend the tax to provide continued funding for Healthy Families.

[6] The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 phases out the federal estate tax by 2010. As part of this, EGTRRA eliminates the State pick-up tax beginning in 2005. The EGTRRA sunsets after 2010; at that time, the federal estate tax will be reinstated along with the State's estate tax. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, however, made changes to the estate tax for 2011 and 2012. One of those changes was an extension of the elimination of the state estate tax credit, which had been in effect since 2005, for 2011 and 2012.

[7] Ocean marine insurance is taxed at the rate of 5 percent of underwriting profit attributable to California business. Special rates also apply to certain pension and profit sharing plans, surplus lines, and nonadmitted insurance.

[8] Department of Motor Vehicles. Beginning January 1, 1999, vehicle owners paid only 75 percent of the calculated tax, and the remaining 25 percent (offset percentage) was paid by the General Fund. Chapter 74, Statutes of 1999, increased the offset to 35 percent on a one-time basis for the 2000 calendar year. Chapters 106 and 107, Statutes of 2000, and Chapter 5, Statutes of 2001, extended the 35-percent offset through June 30, 2001, and provided for an additional 32.5-percent reduction, which was returned to taxpayers in the form of a rebate. Beginning July 1, 2001, the VLF offset was set at 67.5 percent. From June 30, 2003, through November 18, 2003, the VLF reduction was suspended. On November 17, 2003, Governor Schwarzenegger rescinded the suspension, thereby reinstating the offset. Effective January 1, 2005, the VLF rate is 0.65 percent. In February 2009 the VLF rate increased to 1.15 percent with 0.35 percent of the 0.5 percent increase going to the General Fund and the remaining 0.15 percent oing to local law enforcement. The Budget proposes to maintain the VLF rate of 1.15 percent for five years.

[9] For return to cities and counties. Trailer coach license fees are deposited in the General Fund.

[10] As part of the fuel tax swap implemented beginning July 1, 2010, this rate was increased from 18 cents and will be adjusted each year to maintain revenue neutrality with the elimination of the General Fund portion of the sales tax on gasoline.

[11] For administrative expenses and apportionment to State, counties and cities for highways, airports, and small craft harbors.

[12] As part of the fuel tax swap, this rate will be decreased by an estimated 4.8 cents on July 1, 2011, and will be adjusted each year thereafter to maintain revenue neutrality with the 1.75% increase in sales tax on diesel beginning July 1, 2011.

[13] For support of State Department of Motor Vehicles, California Highway Patrol, other agencies, and motor vehicle related programs.

[14] For state highways and State Department of Motor Vehicles administrative expense. Chapter 861,Statutes of 2000, replaced the fee schedule for trucks, based on the unladen weight of commercial trucks and trailers, with a new schedule based on the gross weight capacity of trucks alone, in order to comply with the International Registration Plan standards. Chapter 719, Statutes of 2003, increased weight fees to achieve revenue neutrality as specified in Chapter 861.

[15] Average property tax rate in the state during preceding year.

[16] Includes a 6 percent rate for the state General Fund, a 0.25 percent rate for the Economic Recovery Fund, and a 0.50 percent rate for the Local Revenue Fund. The Budget proposes to maintain the sales tax rate of 6 percent.

[17] Since 2009 the marginal rates ranged from 1.25 percent to 9.55 percent and the alternative minimum tax has been 7.25 percent. The Budget proposes to maintain these rates for five years.

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