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December 3, 2019

Hon. Xavier Becerra  
Attorney General  
1300 I Street, 17<sup>th</sup> Floor  
Sacramento, California 95814

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INITIATIVE COORDINATOR  
ATTORNEY GENERAL'S OFFICE

Attention: Ms. Anabel Renteria  
Initiative Coordinator

Dear Attorney General Becerra:

Pursuant to Elections Code Section 9005, we have reviewed the proposed constitutional initiative (A.G. File No. 19-0023) related to taxation of personal and corporate income.

## Background

***Education Is the Largest Category of State Spending.*** The state collects taxes and fees from people and businesses and uses these funds to pay for public services. This year, the state plans to spend around \$140 billion from its main operating account, the “General Fund.” The State Constitution requires that about 40 percent of this spending (\$55 billion) go to schools and community colleges. About one-quarter of the spending goes to health and human services programs. The rest is spent mostly on public universities, prisons, parole programs, and courts.

***Schools and Community Colleges Also Receive Property Taxes.*** Schools and community colleges also receive about \$25 billion per year from local property taxes. Altogether, schools and community colleges receive around \$80 billion per year from state funds and local property taxes.

***Personal Income Tax Is the State's Largest Funding Source.*** The state's largest source of funding is the personal income tax (PIT). The PIT is a tax on most types of income, such as wages, salaries, and earnings from investments. A taxpayer's PIT payment is equal to a certain share of their income. The share of income paid in taxes—or tax rate—increases as a taxpayer's income increases. For nearly all income above \$1 million, the tax rate is 13.3 percent.

***Tax on Corporate Profits Is Also a Major Funding Source.*** Another major source of state funding is the corporation tax, which is a tax on the profits of corporations. The amount a corporation owes in corporation taxes is equal to its profits multiplied by its tax rate. A corporation's tax rate depends on its business structure. Regular corporations pay a tax rate of 8.84 percent. Some businesses with fewer than 100 owners and no foreign ownership are “S corporations” and pay a tax rate of 1.5 percent. In addition to paying general corporation taxes, banks and financial institutions pay an additional 2 percent tax rate.

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## Proposal

***Increase Income Taxes on High-Income Taxpayers.*** The measure increases the PIT for those earning more than \$1 million. Taxpayers would pay an additional 2 percent tax on their income above \$1 million but below \$2 million. Taxpayers also would pay an additional 3 percent tax on their income above \$2 million. (The language of the measure is somewhat unclear about the tax rate applied to income above \$2 million. Another possible interpretation is that the measure applies a 5 percent tax rate on income above \$2 million. Our analysis assumes a 3 percent tax rate based on our understanding of the proponent's intent.)

***Increase Taxes on Corporations.*** The measure also increases taxes on corporations with profits above \$1 million. Regular corporations would pay an additional 5 percent tax on their profits above \$1 million. S corporations would pay an additional 3 percent tax on their profits above \$1 million.

***New Funding Dedicated to Schools.*** The funds raised from these new taxes would be placed in a special account to be spent on schools and community colleges. Most of the funding would be distributed in a way that is similar to how the state distributes most other funding for schools and community colleges. The funding would be in addition to the funds schools and community colleges already receive under the state's constitutional education funding requirement.

## Fiscal Effects

***Increase in Funding for Schools and Community Colleges.*** The measure's new taxes on high-income earners and corporations would provide new funding to schools and community colleges. At the same time, the measure could reduce existing funding to schools and community colleges from existing taxes, as we discuss below. The amount of the new funding to schools and community colleges would be more than the losses of existing funding. Overall, funding to schools and community colleges likely would increase by \$9 billion to \$15 billion per year.

***Reduced Revenue to the State General Fund.*** In response to the measure's tax increase, some taxpayers probably would reduce their income in California to avoid paying more taxes. Taxpayers could do this in a variety of ways. Small business owners could try to find additional business costs to count against their income. Corporations could try to shift more of their sales to other states, reducing how much of their profits come from California. Some taxpayers could move out of the state. These actions would reduce existing PIT and corporation tax revenue for the state General Fund by as much as a few billion dollars per year.


***Reduced Spending on Noneducational Public Services.*** A reduction in taxes paid to the state General Fund would lead to a similar reduction in spending from the General Fund. General Fund spending on schools and community colleges could go down by a couple hundred million dollars to a couple billion dollars per year. Likewise, General Fund spending on other public services, like health and human services programs and public universities, could go down by a couple hundred million dollars to a couple billion dollars per year.

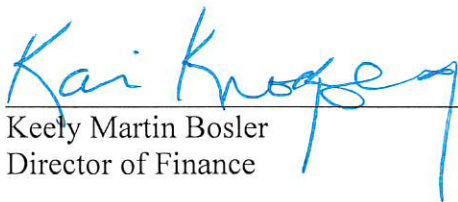
### ***Summary of Fiscal Effects.***

- Increase in taxes paid by high-income earners and corporations of \$10 billion to \$15 billion, assuming taxpayers do not act to reduce their tax bills.

- If taxpayers do change their behavior, these new tax collections could be a few hundred million to a few billion dollars lower.
- Overall, funding for schools and community colleges likely would increase by \$9 billion to \$15 billion.
- There also could be a decrease in funding for other public services of a couple hundred million dollars to a couple billion dollars per year.

Sincerely,

*for*   
Gabriel Petek  
Legislative Analyst

*for*   
Keely Martin Bosler  
Director of Finance