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Tax Reform — 1970

WILLIAM T. BAGLEY*

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And it came to pass in those days that there went out a decree from Caesar Augustus, that all the world should be taxed.

— Luke 2:1

The decree of Caesar Augustus is still in effect. No attempt has been made to repeal the decree, but major attempts have been made to shift taxation from the Christians to the lions. A reform of the tax structure in California has become a political, if not an economic, necessity. Major efforts were made during the 1970 Session of the California Legislature to achieve a meaningful reform of the state's tax structure but the vision of tax reform[1] evaporated during the final days of the legislative session with the abrupt death of Assembly Bills 1000 and 1001, the major tax reform proposal of the session. But tax reform remains one of California's most viable issues and since the need for

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1 Tax reform is a ritual widely practiced by all civilized societies. It has many meanings. Tax reform does not necessarily mean tax reduction or tax relief. Tax reform basically is an attempt to devise a more equitable tax structure. Specifically, in California tax reform has come to mean efforts to plug existing tax loopholes in the personal income and the corporate income tax, raise revenues from broader-based alternative tax sources, such as the sales and income tax, and use this money to relieve the property tax, including the personal property tax on business inventories.

fundamental reform continues to exist, there will doubtlessly be a new and growing commitment in the legislature to provide a program compatible with the political and economic exigencies of this state.

Since the need for fundamental reform continues to exist, there will be no weakening of the legislature's commitment to provide genuine tax reform. This article attempts to explain the components of the major reform proposal of the 1970 legislative session—A.B. 1000 and A.B. 1001, for very possibly this comprehensive program will be a basis for renewed efforts to construct a tax reform program during the 1971 legislative session.

Building a Program for Reform

A comprehensive tax reform package is the product of hundreds of hours of study and research. Such study on the subject of tax reform was undertaken during the fall of 1969.[2] A Joint Senate and Assembly National Tax Policy Committee was created to analyze changes in federal tax laws, and coordinate California tax policies accordingly. A Legislative-Executive Tax Study Group was formed at the request of the then Senate President Pro Tempore Howard Way and the Speaker of the Assembly, Robert Monagan. The purposes of this group were to gather data on the California revenue systems, to analyze the data and to develop various proposals for tax reform. Their work began in August of 1969 and was concluded early in 1970. A comprehensive report was issued and presented to interested legislators in December of 1969.[3] Concurrently, the Joint Committee of the Assembly and Senate Revenue

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[2] The 1969 legislative session had produced a plethora of alternatives for such a study. The report of the Advisory Commission on Tax Reform, called the Flournoy Commission, was the result of ten months of research and study by a group appointed by the Governor and contained many viable concepts for tax reform. However, shortly after this Report was presented to the public in March, 1969, the Governor rejected the consensus that had been reached by the Commission and announced the development of his own tax plan. This plan was proposed by Assemblyman Biddle (A.B. 2044 and A.B. 2052, 1969 Regular Session). In the meantime, Assemblyman John Dunlap (D-Napa) and Assemblyman Alan Sieroty (D-Beverly Hills) developed their own tax proposals (A.B. 1808, 1969 Regular Session). Other Senators and Assemblymen also introduced their own legislation. In view of all the tax measures that were being presented, Speaker of the Assembly Robert Monagan and others, both Republicans and Democrats, determined that no reform would be accomplished unless some type of bi-partisan agreement could be reached as to the components of a tax package. An informal group, consisting of three Assembly Democrats and three Assembly Republicans, plus Speaker Monagan, began to meet with the legislature unable to achieve agreement. A comprehensive interim study during the fall of 1969 was necessary to examine some of the components common to the major tax reform proposals of the 1969 session and to achieve agreement and consensus on a proposal to emerge in the 1970 session.

[3] No formal report was published. A copy of a report was submitted to interested legislators. This "Preliminary Report" of the Legislative-Executive Tax Study Group, dated November 14, 1970, is on file with the Assembly Revenue and Taxation Committee.

and Taxation Committees held hearings on the key elements of tax reform defined by the Tax Study Group.[4]

These ideas and concepts formed the basis of the major tax reform package of the session.[5] Further refinements were made during the process of achieving consensus among key legislative leaders of both parties, as well as in the process of gaining the full support of the administration. The legislative process is compromise and consensus and tax reform necessarily must be a product of compromise and consensus. As introduced on March 4, 1970, A.B. 1000 and A.B. 1001 was such a product.[6]

Legislative History

The major tax reform proposal of the session was heard in the Assembly Committee on Revenue and Taxation on April 15, 1970. In the hearing process of this policy committee, the $2.05 equalization tax for schools was stricken from the tax reform measures. This provision would have imposed a state property tax of $2.05 per $100 of assessed valuation on all taxable real property. The revenue would be placed in a fund to be distributed to all school districts, however, the larger share would go to the less wealthy school districts.[7] It was removed because

[4] Tax reform is a complex policy undertaking, with all the various public and private interest groups vying for position. Representatives from all concerned groups were invited to present their testimony to the Joint Committee. *See Joint Hearing of the Senate Committee on Revenue and Taxation and the Assembly Committee on Revenue and Taxation,* December 4, 1969; and *Joint Hearing of the Senate Committee on Revenue and Taxation and the Assembly Committee on Revenue and Taxation, I-II,* December 16-17, 1969.

[5] Proposals for tax reform during the 1970 session were as numerous as Indians on Alcatraz. As Chairman of the Assembly Revenue and Taxation Committee, Assemblyman William T. Bagley authored A.B. 1000 and A.B. 1001, which was the focus of discussion concerning tax reform during the session. It was the tax reform program which received the approval of the Administration of Governor Ronald Reagan. It received the approval of both the Senate and the Assembly Revenue and Taxation Committees, the basic policy committees of the legislature concerned with tax reform. Other proposals, such as S.B. 540 by Senator George Moscone (D-San Francisco), A.C.A. 21 by Assemblyman Joe Gonsalves (D-Norwalk), and A.B. 2137 by Assemblyman Dunlap (D-Napa), were proposed as the political alternatives of the Democratic Party; but they did not generate the necessary support to receive the approval of the Senate or Assembly Revenue and Taxation Committee. This commentary is limited to A.B. 1000 and A.B. 1001 which occupied the center stage in discussions of tax reform this past year.

[6] The Program had a broad spectrum of support. In addition to the support of Governor Ronald Reagan, the Department of Finance and both the Senate and Assembly Republican leadership, the following groups testified in support of the program or expressed a general positive reaction to the program: California Retailers' Association, California Taxpayers' Association, California Real Estate Association, California State Chamber of Commerce, California Manufacturers' Association, California Canners' League, California Teamsters' Council, League of California Cities, County of Los Angeles, County of San Diego, County of San Francisco.

[7] This concept is more adequately discussed in a separate section. The existing system of public school finance defines a "foundation program" or the guaranteed minimum level of support per pupil. The state share of the foundation program is adjusted by a district computational tax to equalize the differences in assessed value be-

of opposition from wealthy school districts, such as San Francisco, and the failure of its proponents to generate sufficient support for the concept in the Assembly Revenue and Taxation Committee.

However, an improved program for senior citizens' property tax assistance was adopted by the Committee. The existing Senior Citzens' Property Tax Assistance Program allows a 65 year-old senior citizen to apply through the State Franchise Tax Board for a rembursement of part of the property tax he pays on his home.[8]

In late April, these bills moved out of the Assembly Committee on Revenue and Taxation to the Assembly Committee on Ways and Means. The Assembly Committee on Ways and Means amended from A.B. 1001 a limitation on the oil depletion allowance[9] after objection from the oil industry on a bi-partisan vote, and substituted the recent federal decrease in the oil depletion allowance from 27½% to 22%.[10]

Amendments were also introduced to make the county expenditure limits more workable and flexible. This expenditure control provision was designed to protect property taxpayers from increased taxes with-

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tween individual districts. The State Constitution and statutory formulas insure, however, that no less than $125 will be distributed for each pupil in the state. This is known as basic aid. If the combination of the computational tax proceeds and basic aid do not provide at least the foundation program level per pupil the difference will be distributed to the district as equalization aid. The provision for a statewide property tax would shift the system of computing foundation program apportionments from a district level to a statewide system. Under this approach a statewide property tax would be instituted at a rate of $2.05 per $100 assessed valuation in every school district on all taxable real property. This provision would result in a redistribution of such property tax revenues collected in the wealthier, basic aid districts, to the less wealthy, equalization aid districts. Consequently, the disparity between the assessed values in various districts which support the educational program of the district would be decreased.

[8] The existing program is contained in sections 19521-19540 of the Revenue and Taxation Code. A program for senior citizens' tax assistance had been previously introduced by Assemblymen Petris and Unruh in the 1965 legislative session as part of a major reform package, but the program did not receive legislative approval. The existing Senior Citizen's Property Tax Assistance Program was devised by former Assemblyman John G. Veneman (R-Modesto). The existing law was included in Governor Reagan's Tax Program of 1967 in the Assembly Revenue and Taxation at Assemblyman Veneman's insistence. This program is also discussed in a separate section.

[9] The original proposed amendment to section 17686.5 of the Revenue and Taxation Code would have limited the total depletion allowance to no more than 5 times the adjusted cost of the taxpayer's interest in the property subject to recovery through depletion. The present allowance is claimable during each year of production not to exceed 50% of taxable net income.

[10] Both the personal income tax and the bank and corporate tax laws currently provide allowances for both depletion and depreciation of improvements for oil and gas wells, mines, timber and other natural deposits. In the case of oil and gas wells, the allowance for depletion is 27.5% of gross income per year, not to exceed 50% of taxable net income, and this depletion allowance can continue as long as the well is in production. Depletion allowance, in its present form, has been with us since 1926 as federal legislation, since 1929 as State of California legislation covering corporations, and since 1935 for individuals. The rationale for the depletion allowance is discussed in a separate section. It is a singular tribute to the oil industry's political power and the public's indifference that this monumental tax loophole has not been eliminated.

out taxpayer consent. It would have limited county property tax rates to a fixed maximum based on actual expenditures for 1969-70. An increase above this maximum to increase spending could be obtained with a vote of the people. At the present time, the expenditures of counties are not subject to maximum property tax rate limits. These amendments had been formulated and discussed in detail with county representatives. Although technical amendments were made during the process of hearings on these measures, A.B. 1000 and A.B. 1001 were substantially the same as when introduced. On May 21, 1970, they passed out of the Assembly by an overwhelming nonpartisan vote.

In the Senate Committee on Revenue and Taxation and the Finance Committee, A.B. 1000 came under considerable attack from educational groups. Concern was expressed with the expenditure control provisions for schools, similar to the provision for counties, which was designed to limit increases in spending and property tax rates without consent of the voters.[11] The timing of this opposition was significant. No suggestions for amendments to these provisions had been offered during the lengthy hearings in the Assembly. However, with the defeat at the polls in the June primary election of Proposition 8, school administrators and other educational groups attacked in force.[12] The

[11] The expenditure control provisions for school districts and counties are discussed in a separate section.

[12] Proposition 8 was sponsored by the California Teachers' Association and the County Supervisors' Association of California. It attempted to shift a portion of the costs of education and welfare to the state in an effort to reduce the local property tax burden. Specifically, Proposition 8 increased the homeowners' exemption from $750 to $1,000. Although this increase would make the homeowners' exemption more meaningful, it would still retain the burdensome nature of the property tax. The increase is a drop in the bucket and does not even begin to confront the problem. It also required the state to provide not less than 50% of the cost of education in the public school system. But the measure did not specify which "cost" components would be included in determination of the states' share. Proposition 8 instituted a new system of weighted average daily attendance for "educationally-disadvantaged students". Such students would be counted at 1.5 a.d.a.; and another provision would have guaranteed that 3% of the money in the state school fund shall be allocated for these students. The legislature would be allowed to define "educationally-disadvantaged," which is an interesting omission for teachers to make, assuming that teachers have had more contact with disadvantaged students than legislators. It would also mean that the legislature would have had to agree on a definition before the system could begin. Ironically, the 3% appropriation could be construed as a maximum prohibiting any increased emphasis on such programs for such students. Further, Proposition 8 specified that if the legislature required, by law, any new or expanded education program, it would have to appropriate 50% of the estimated costs of the program. This provision could have acted as a restraint to the legislature in passing new needed programs which had the support of local government. The initiative also would have required the transfer of all costs over 10% of the combined state and county costs of health care and welfare programs to the state. Although state assumption of welfare costs now borne by property taxpayers has a number of advantages, Proposition 8 would not have guaranteed that the assumption of such costs would correspondingly reduce the property tax. The state assumption of welfare could be offset, at least, in part by spending for other local purposes. The result would be a net increase in total state and local tax burden. It would have required the legislature to increase taxes by $1.13 billion for 1970-71 from sources which it did not specify.

county expenditure control limits were refined and made more workable, but continued to be strongly opposed by these groups since they posed the threat of another hurdle for the school districts when seeking increased funds.

At this time, changes were made to the bills relating to the open space land provisions. The cost reimbursement formula to local governments for open space land contracts under the Land Conservation Act of 1965 was changed from a set dollar amount per acre to 75% of the actual tax loss to local government.[13]

Finally, A.B. 1000 and A.B. 1001 moved to the Senate floor. A.B. 1000, which contained the tax increase to fund tax relief, was passed by a majority. Despite the forceful efforts of everyone concerned with its passage, A.B. 1001, which contained the tax relief provisions, failed to obtain the necessary vote required for passage, lacking one vote for the necessary two-thirds vote requirement.[14] The final tally reflected

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This proposition was defeated in the June 2, 1970, primary, although the County Supervisors' Association and the California Teachers' Association spent substantial sums to insure its passage. The vote was 1,321,092 "yes", 3,316,916 "no".

[13] The Land Conservation Act of 1965 exemplifies a recognition of the uses of the property tax, not for revenue but for purposes deemed socially desirable. The Act (beginning at CAL. GOV'T CODE section 51200) declared it the state's policy to discourage premature development of agricultural land for urban use and to encourage saving open space. The law allows local government to contract with a landowner that for 10 years the land shall be devoted to agricultural use or those uses "related to or compatible with agricultural use." Therefore, the land during this period is not assessed at the full cash or market value, but valued relative to the uses contemplated by the contract. The contract, which is automatically renewed each year binds the owner for 10 years, with penalties if cancelled. In 1966, the people approved Proposition 3 which added article XXVIII to the California Constitution. This authorized the legislature to define open space lands and provide that when such lands are restricted exclusively to recreation, enjoyment of scenic beauty, natural resources, or production of food or fiber (agricultural uses), the assessment must be based only on the restricted use. Contracts under the Land Conservation Act of 1965 were recognized as qualifying enforceable restrictions which directed the assessor to assess the land, for property tax purposes, on the basis of the open-space uses to which the land could be used under the terms of the enforceable agreement.

[14] A.B. 1000 passed the Assembly on May 21, 1970, by the necessary majority vote (47-28). A.B. 1001 was also debated and passed by the necessary two-thirds vote on May 21, 1970 (66-11). A.B. 1001 required a two-thirds vote of the membership of both houses because it increased the Bank and Corporations Tax. Although the income tax and the sales tax can be increased by a majority vote of the members of each House, Section 16(3) of article XIII of the California Constitution requires "not less than two-thirds of all the members elected to each of the two Houses of the Legislature." It also required two-thirds vote because under rules of the legislature, A.B. 1001 contained an "urgency" clause allowing the measure to take effect immediately.

On July 2, 1970, after lengthy discussion and debate, both A.B. 1000 and A.B. 1001 were referred from the Senate Committee on Revenue and Taxation with a "do pass" recommendation. On July 8, 1970, both measures received the further approval of the Senate Finance Committee and were referred to the Senate floor for debate. After prolonged debate, A.B. 1000 received the necessary majority vote of the forty-member Senate on July 28, 1970, (23-14) and was passed by the Senate and sent to the Assembly for approval of the technical changes made in the Senate. On August 20, 1970, on the day prior to the end of the legislative session, and lacking one vote, the Senate refused passage of A.B. 1001 (26-13). The measure required two-thirds or 27 votes of the membership of the Senate. When the session ended on August 21, 1970, both A.B. 1000 and A.B. 1001 "officially" died on the desks of the Senate and Assembly clerks.

the approval of the package by 93 out of 119 members of the Legislature, 60 Republicans and 33 Democrats. But, it lacked one vote.[15]

History of the Property Tax

The ad valorem property tax is one of the oldest forms of taxation known to mankind. In the Old Testament, it was decreed that the Pharaoh should have the fifth part. That form of taxation—the fifth part of production of the land—was exacted from the landowner for the privilege of holding and enjoying land.

In Great Britain, the early taxes imposed were principally taxes in kind, usually consisting of a certain portion of the produce of the land. After the Norman conquest of England, William the Conqueror revived this form of taxation and ordered a general survey of the lands. This survey was both a census and an assessment roll. The results were published in 1086 as the Domesday Book.[16] The land tax or "danegeld" was continued under the Norman kings as a regular impost at various rates which generally averaged two shillings per 100 acres.[17]

Personal property taxes were first introduced on the occasion of the Saladin tithe in 1188. King Henry ordained that all subjects were to give one-tenth of their rents and movables.[18] Assessment practices came to be fairly standardized. Movables were taxed at "full value". Exemptions were granted in counties to armour, riding horses, jewels, and clothes of knights and gentlemen and their vessels of gold, silver, and brass. In cities, a suit of clothes for every man and another for his wife, a bed for both of them, a ring and a buckle of silver or gold, a girdle of silk in ordinary use by them and a cup of silver or mages from which they drank were exempt. Everywhere, the goods of any person not amounting to five shillings in value were also exempt.

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[15] The roll-call vote by which the Senate defeated A.B. 1001, 26-13, is the following:

Republicans For: (20) Burgener, Carpenter, Cologne, Coombs, Dolwig, Cusvanovich, Deukmejian, Grunsky, Harmer, Lagomarsino, Marks, Marler, McCarthy, Nejedly, Richardson, Schrade, Sherman, Stevens, Way, and Whetmore.

Democrats For: (6) Burns, Danielson, Dills, Kennick, Song, and Walsh.

Republicans Against: (1) Bradley.

Democrats Against: (12) Alquist, Beilenson, Collier, Dymally, Mills, Moscone, Petris, Rodda, Short, Stiern, Teale, and Wedworth.

Several attempts were made to obtain a "courtesy vote" for A.B. 1001 from one of the dissenters on behalf of Senator Tom Carrell who was confined because of illness to a hospital in Los Angeles. Senator Carrell had supported both A.B. 1000 and A.B. 1001 in the Senate Revenue and Taxation Committee and the Senate Finance Committee. Even after personal appeals from Senator Carrell by telephone for a "courtesy vote," the dissenters refused to be moved. Thus, the measure failed.

[16] S. DOWELL, 1 A HISTORY OF TAXATION AND TAXES IN ENGLAND, 35 (2d ed. 1888).

[17] *Id.* at 37.

[18] *Id.* at 61.

The present day property tax is a distant descendant of the feudal quitrent.[19] Under the feudal concept of property, everyone held his land of the King, and for this privilege, owed the king certain services. As this system developed, it became common to pay one's lord money instead of performing specific services.[20] The payment of quitrents existed in early colonial America. Such rents were seldom paid in New England but were an important source of revenue in middle and southern colonies such as Maryland and Virginia.[21] Property taxes similar to our present taxes ascended to importance as the quitrents diminished as a source of revenue.[22]

At a time when America was adopting English laws and traditions, England had developed a tax which resembled modern property taxation. The tax was in fact not on property, but rather on the person based upon his ability to pay.[23] At that time, the best way of determining a person's ability to pay was to look to the property he had accumulated. Unlike today, there was little chance of having a large income without at the same time having large capital. Consequently, the tax collector taxed the person on the basis of his accumulated property.

A similar system was adopted by the New England colonies where the distribution of property was relatively equal among the inhabitants.[24] When revenue was needed the logical source was a tax based upon the property owned by the individual. The theory behind such a tax was, again, to tax the person in proportion to his ability to pay.[25] Land was wealth, and therefore, the best base of determining equal tax liability. In other colonies, due to economic conditions, import and excise taxes were imposed.[26] However, during the 19th century the property tax came to be universally applied throughout the country and was the main source of revenue for state and local government. All land was taxed at so much an acre with little concern for fair market value.[27] However, with the development of industry and towns as new centers of wealth, people began to realize the inequity inherent in a per acre tax on land. This resulted in reform of the taxing system by using fair market value as the basis for taxing property, redistributing the burden

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19 J. JENSEN, PROPERTY TAXATION IN THE UNITED STATES, 18-19 (1931). [Hereinafter cited as JENSEN].
20 *Id.*
21 *Id.*
22 *Id.* at 21.
23 *Id.* at 21-22.
24 J. HELLERSTEIN, STATE AND LOCAL TAXATION, 1 (1969). [Hereinafter cited as HELLERSTEIN].
25 JENSEN at 26-27.
26 HELLERSTEIN at 1.
27 *Id.* at 37.

in relation to the worth of the land owned and not the quantity.[28] Unfortunately, the shift of the tax burden did not involve a consideration of the concept of taxing in relation to one's ability to pay and hence the reform firmly incorporated regressive taxation as a principal of property taxation.

A trend throughout the evolution of the property tax has been the increasing use of property tax revenue for nonproperty related needs. Quitrents were originally the price paid for the protected right to use the land. Most early property tax revenues in America were used for property related expenditures. These expenditures included funds for administration and enforcement of criminal laws, and the maintenance of a system for the settlement of civil disputes. In most instances, both of these programs involved property protection. Only in recent times have property tax revenues been used extensively for nonproperty related activities such as schools and welfare.

Upon entry into the union in 1850, California immediately adopted a system of property taxation to finance government services. The first legislature adopted a statewide property tax of $0.50 per $100 of assessed valuation of the property. The Revenue Act of 1850 provided for the assessment of all taxable property in each county by the county assessor.[29] For 60 years after statehood, the property tax continued to be the backbone of the state and local revenue systems.

During the last 70 years, the trend has been away from the property tax on the state level. In the United States during 1902, 52.6% of all of state revenues was from property taxation.[30] In 1967, only 2.7% derived from property taxation.[31] When the "separation of sources" plan was adopted in California in 1910, the state relinquished the general property tax to local government and the tax eventually declined as a percentage of total state revenue.

However, government dependence on the property tax really didn't change; it only shifted to the local level. Where the use of property tax by state government had declined significantly across the United States between 1902 and 1967, the funds retained importance for local government. For example, in 1902 property taxation represented 72.7% of all local government revenues in the United States. In 1965 property taxes still accounted for 57.4% of local revenues.[32] Concurrently, the dollar expenditure of property taxes has increased from 624 million

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28 *Id.* at 36-38.
29 CAL. STATS. 1850, c. 52, p. 135.
30 HELLERSTEIN at 2-7.
31 *Id.*
32 *Id.* at 8.

in 1902 to over 22 billion in 1965.[33] This increased load on the property owner is due partially to a lack of sufficient alternative methods to acquire local government revenues.[34] The burden on local government for nonproperty related programs such as schools and welfare has increased enormously.

The Need for Tax Reform

Modernly, the central target in the legislative thrust to reform the tax structure in California has been a reform of the property tax.[35] Storm clouds have been gathering over the property tax for a number of years. As the tax burden keeps rising, and as there is little or no effort to reform and modernize this tax, the trickle of criticism has grown to a torrent.[36] This torrent has been expressed in a so-called "property taxpayers' revolt." That property taxation has reached a level that evokes a taxpayer call-to-arms is beyond dispute.[37]

Yet, the property tax is the main revenue source of local government and the most prolific revenue producer in the state-local tax structure.[38] With renovation, the property tax has a proper role in the revenue

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33 *Id.*

34 *Id.* at 11-14.

35 The term property tax is a vague phrase. California does not have *a* property tax; it has many property taxes. There is a real property tax. Real property is land together with any improvements permanently attached except telephone and telegraph lines. CAL. REV. & TAX. CODE §§ 103, 105). There is a personal property tax. Personal property is all other property—basically property which is movable (CAL. REV. & TAX. CODE § 106). According to the State Board of Equalization, approximately 85% of all taxable property in California is real property. Furthermore, there are several property taxes, each with their own distinct set of economic impacts. A property tax on land differs from a property tax on buildings or residences. The supply of land is fixed. The supply of buildings and residences can be altered in response to property tax rates. Residential property taxation differs in economic impact significantly from business taxation. An increase in property taxes will burden the homeowner directly, but an increase in the burden of business property taxation does not necessarily remain with the business but can in part be shifted to the consumer.

36 Resistance to property tax increases has come mainly from the residential taxpayer. To the homeowner, the property tax is extremely visible. The property tax takes a substantial portion of his earnings usually in large lumps. Increases in the property tax are apparent as his tax bill increases. There is a strong feeling expressed in constituent letters that local spending should be held in check or reduced. It should be noted that the hate-mail to the Assembly Revenue and Taxation Committee increases substantially just after the period when local property tax bills have been mailed.

37 Although recognizing inherent faults with the residential property tax, several competent scholars have dared to suggest that the residential property tax when judged by standard economic principles of taxation, emerges with a moderately good record. Because of its fiscal flexibility, it is attractive to local governments; it is moderately sensitive to economic growth and has been said "to contribute to efficient decision-making in some economic areas." *See* George F. Break, Agenda for Local Tax Reform 5-35 (institute of Governmental Studies, University of California, Berkeley 1970). Although a few brave political souls in the legislature have been heard to whisper in the legislative halls that the residential property tax "is not that high," none have been so bold as to make this statement in public or in their districts.

38 As indicated in Table I and Table II, Appendix, local government received the astounding total of $4,686,000,000 in revenue from property taxation in 1968-69.

structure. The property tax is a tax on wealth; and although an imperfect one, it complements taxes on incomes and sales. But the situation in which the property tax has been administered has changed and the structure must change. The existing revenue system has been unable to produce a growth in revenue required for state government and local governments to meet the requirements of law and the requirements imposed by growing need or demand. (See Table I, Appendix, for a visual portrayal of this fact).

The basic problem with the existing local revenue system is that it relies much too heavily on the property tax. There is abundant evidence to support this premise. Over the past 30 years, the assessed valuation in the state has increased sevenfold—from approximately $7 billion in 1939 to approximately $49 billion in 1969. However, the revenue collected has increased more than sixteenfold, more than twice the increase in assessed value. Approximately $284 million was collected in 1939-40 compared to more than $4.6 billion in 1968-69.[39] During this 30-year period, the average statewide property tax rate jumped from $4.13 per $100 assessed value to $9.92 per $100 of assessed value.[40] Property tax rates increased by an estimated 13.3% in 1969-70 alone.[41] The average property tax payment in 1968-69 for each of California's estimated 20 million residents was approximately $228.

Of this total, Table II indicates that approximately $2,415,000,000, more than half, was spent in the support of local public schools.

[39] The following table was formulated from figures provided by the State Board of Equalization:

YIELD OF THE PROPERTY TAX IN CALIFORNIA: 1937-1969

Fiscal Year	Net Assessed Value of Tangible Property Amount ($1,000)	Annual Percentage Change	Tangible Property Tax Levies Amount($1,000)	Annual Percentage Change	Average Tangible Property Tax Rate
1958-59	$25,966,688	6.8	$1,807,932	10.6	6.96
1959-60	27,434,577	5.7	1,990,497	10.1	7.26
1960-61	29,600,932	7.9	2,195,588	10.3	7.42
1961-62	31,549,630	6.6	2,414,617	10.0	7.65
1962-63	33,326,914	5.6	2,606,131	7.9	7.82
1963-64	35,066,088	5.2	2,805,152	7.6	8.00
1964-65	36,743,364	4.8	3,057,579	9.0	8.31
1965-66	39,464,013	7.4	3,367,736	10.1	8.53
1966-67	42,522,365	7.7	3,760,608	11.7	8.84
1967-68	46,186,881	8.6	4,110,742	9.7	8.90
1968-69	48,653,400	5.3	4,569,986	11.2	9.39
1969-70	52,115,409	7.1	5,180,000	13.3	9.92

Source: BOARD OF EQUALIZATION, ANNUAL REPORTS, 1968-69. [Hereinafter cited as ANNUAL REPORTS].

[40] *See Assembly Interim Committee on Revenue and Taxation, Taxation of Property in California*, Part 5, 5-6 (December, 1964). *See also* ANNUAL REPORTS at 7. It should be noted that in the 1930's, assessed values were 50% of market value while at present they are 25% of market value.

[41] *See* Table, *supra* note 39.

This figure is estimated to exceed $250 for 1969-70.[42] The actual percentage of personal income of Californians which is used to pay property taxes dropped from 5.5% in 1939 to 2.2% in 1944 and rose to 5.4% in 1967. As indicated by Table III of the Appendix, since the end of World War II, property owners have experienced a constant increase in the percent of personal income going for property taxes. This over-reliance has unbalanced our tax system and placed an undue burden on the individual homeowner.[43]

The property tax, like all taxes, contains inherent faults. But overreliance on the property tax has magnified these faults to an intolerable level. It is clear that the property tax is the major defect in the California system; it is outmoded, discriminatory, unfair, economically destructive and regressive. It fails most accepted major standards by which economists judge the propriety of any particular form of taxation.[44]

University of California Professor Malcom Davisson told an Assembly Interim Committee on Revenue and Taxation studying the property tax in 1964 that: "The general property tax has only two faults; first, it is wrong in theory; and second, it doesn't work in practice."[45] In support of this generalization he offered the following evidence:

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[42] ANNUAL REPORTS at 7.

[43] The extent of this burden on the residential property tax and the liability of the existing $750 homeowners' exemption to mitigate the burden is demonstrated by the following figures:

LONG-TERM IMPACT OF THE HOMEOWNERS' EXEMPTION

Existing Law—$750 Exemption	1968-69	1969-70	1970-71	1971-72
Full Cash Value of Home	$20,000	$20,800	$21,630	$22,500
Assessed Value (23%)	4,600	4,784	4,975	5,175
Tax Rate	9.83	10.45	10.80	11.20
Gross Tax	$ 453	$ 500	$ 537	$ 580
Homeowners' Exemption	— 70	— 78	— 81	— 84
Net Tax	$ 383	$ 422	$ 456	$ 496

[44] Various criteria have been developed as a theoretical basis for judging the desirable characteristics of a tax. The following criteria of an acceptable tax are considered to be important:

1. Stability of source and yield;
2. Flexibility of source and yield which accommodates to rising costs and expanding services;
3. Consistency of application and predictability of amount;
4. Productivity in terms of revenue produced;
5. Adaptability to immediate and long-range needs and resources;
6. Capability of being fairly and equitably applied;
7. Geared to the ability to pay;
8. Related to the benefits or privileges received; and
9. Neutral, in the sense that taxpayers in the same circumstances receive the same treatment.

See W. SCHULTY & C. HARRIS, AMERICAN PUBLIC FINANCE 134 (1965).

[45] ASSEMBLY INTERIM COMMITTEE ON REVENUE AND TAXATION, A PROGRAM OF TAX REFORM FOR CALIFORNIA, Part 12, at 21, 22 (July, 1965).

1. The property tax is discriminatory in its application to different forms of wealth. Equal burdens should be placed on people who enjoy equal amounts of government services and own equal amounts of property. Conversely, people who have unequal amounts of property should pay unequal taxes. However, local property taxes are imposed on a base which is determined in an arbitrary and often inequitable manner; the assessment of a parcel of property is never an exact science.[46]

2. The property tax is often regressive when related to incomes of property owners. In other terms, the property tax as a percent of income rises less rapidly than income when the value of the home and income are considered. The effect of this taxing process is to allow persons with higher-value homes and incomes to pay a significantly smaller proportion of income as property tax than those whose homes and incomes are of lower value.[47]

3. The use of an ad valorem base for tax purposes places a heavy burden on persons with small current cash income. For example, a retired senior citizen on a fixed income is faced with a property tax that does not adjust to his income or his current ability to pay.[48]

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[46] In 1965 studies conducted by the Assembly Revenue and Taxation Committee found a tremendous variation of assessments within counties. One taxpayer was found to be paying two hundred times more in tax on the same value property than did another taxpayer. The owner of a $30,000 house in Berkeley had a 50% chance of having a 1966 property tax between $465 and $627, a 25% chance of owing less than $465, and a 25% chance of owing more than $627. As a result of these inequities, the California Legislature in 1966 approved the concept of percentage assessment and declared that every assessor shall assess all property subject to general property taxation from the lien date (March 1) for 1967-68 through the fiscal year 1970-71 at a publicly-announced ratio of his choosing, but that such ratio of assessment had to be between 20% to 25% of the full cash value of the property (CAL. STATS. 1966, c. 147). Beginning with the lien date for the 1971-72 fiscal year, all such property must be assessed at 25% of its full cash value (CAL. REV. & TAX. CODE § 401). Until 1966, taxable property was to be assessed at its full cash value. Since "full cash value" was defined as "the amount at which property would be taken in payment of a just debt from a solvent debtor," (section 110) that assessment should be at the full market value. The California Constitution also stated in article XI, section 12 that all property be assessed, with certain exceptions, at its full cash value. However, the common custom of assessors throughout the state had been to assess property at a percentage of actual value. Most assessors until 1966 defined full cash value as 20-50% of normal market value. The California Supreme Court in a 1967 decision upheld the legality of percentage assessment. *See* Sacramento County v. Hickman, 66 Cal. 2d 841 (1967). For a more comprehensive discussion of percentage assessment, see A. MARSHALL, II STATE AND LOCAL TAXATION, CALIFORNIA PRACTICE §§ 40-41 (1969).

[47] A regressive tax is one where the higher the income of the taxpayer, the lower the effective tax rate. A progressive tax is one where the higher the income of the taxpayer, the higher the effective tax rate. The residential property tax has been condemned in recent years for its regressive rate structure. For a summary of empirical studies on the property tax, see D. NETZER, ECONOMICS OF THE PROPERTY TAX 45-59 (1966).

[48] A recent study has indicated that as income rises approximately 12 times from $5,521 to $67,902, taxes on the same home associated with this income change rises only 3.78 times, from $423.43 to $1,603.22. Since this type of regressivity is apparent to most taxpayers, it is a source of much property tax resentment. *See* McKim, The Limits and Burdens of Taxes in California (November, 1968) prepared for the Advisory Commission on Tax Reform, Houston I. Flournoy, Chairman.

4. The property tax is a poor index of benefits received. There are, undoubtedly, certain services performed by government, particularly by local government, which do provide benefits that are pretty closely allied to the value of property, and here one can make a case for property taxation. But there are many kinds of services which are supported in large part by the property tax where this is not the case. The outstanding example is, of course, education as indicated by Table IV of the Appendix which portrays the results of a study made for the Tax Foundation[49] in 1961. The results indicated a lack of correlation between property tax burdens and benefits.[50]

5. The property tax is cumbersome and fails to adjust adequately to the changing economic conditions. It is impossible for an assessor under California's rapidly shifting economic conditions, to keep up with changes in value of property within his county on a year-to-year basis. This existence of the "time lag" in assessments and the consequent sudden increases when the property is finally assessed generates ill feeling among taxpayers while causing a revenue loss to local government. Since property tax yields tend to lag behind overall changes in economic activity, the property tax thus accentuates inflationary pressures in periods of prosperity and deflationary pressures during recessions.

There have been other objections to the property tax.[51] A major problem is the utilization of the property tax as a means of educational finance. The schools are the largest users of the property tax, and the chief cause of property tax growth.[52] Reform of the existing system

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[49] The property tax does not approach the ability to pay basis for taxation. This regressive and undesirable feature can be corrected at the middle- and low-income levels by a number of alternative devices. The homeowners' exemption and the Senior Citizens' Property Tax Assistance Program can materially reduce property tax regression at the lowest income ranges. Another alternative would be a formulation whereby the assessed value of a house could be applied as a base to an income-determined scale of rates. Other states have enacted other alternatives. *See* Yung-Ping Chen, *Present Status and Fiscal Significance of Property Tax Exemptions for the Aged* 18 NAT. TAX J. 162 (1965).

[50] This study is discussed in a recent pamphlet by G. BREAK, AGENDA FOR LOCAL TAX REFORM 14-23 (Institute of Governmental Studies, Berkeley, 1970).

[51] In a 1964 newspaper article, Robert Hutchins wrote that the property tax "encourages urban blight, urban sprawl and land speculation. It thwarts urban rehabilitation, construction, investment in building and improving homes and orderly development." *See* Hutchins, *Urban Blight, Land Speculation Gets Boost From Tax Structure*, Los Angeles Times, January 13, 1964, Part II, p. 6, col. 6. A more significant concern is the degree to which present property tax rates, or prospective high rates adversely affect economic and social conditions in California. The consideration as to whether high property taxes, in terms of their relationship to other states, contribute to unsatisfactory economic conditions is a complex analysis. No comprehensive study has been undertaken, but for an excellent discussion of property tax rates and economic climate see R. REDMOND & R. GRAVES, PROPERTY TAX LIMITATIONS IN CALIFORNIA 35-41 (University of Southern California Research Institute for Business and Economics, 1965). A comprehensive analysis of objections to the existing property tax structure is beyond the scope of this article. However, the itemization of the objections to the property tax mentioned in the test have had a significant impact on legislative policy discussions.

[52] School districts have accounted for the largest share of property tax revenues

of educational finance based on the property tax would have a significant impact. If educational finance reform can reduce the rate of growth in school property tax levies caused by tax rate increases and can reduce the inequalities in school tax rates between districts, it would bring about a significant improvement in property taxation.

A source of the demand for property tax reform has been the discontent with inequalities in school tax levies.[53] In addition, school property tax levies are not correlated to school needs.[54] For example, a school district in the City of Bakersfield has a property tax base of $5,000 per student; but a school district ten miles away near Taft, California, and near numerous oil wells, has a tax base of $200,000 per student. School district boundary lines create tremendous variations in assessed value per student. Furthermore, the expense of educating students is not uniform throughout the state, but the existing revenue system does not compensate for this factor. Compounding the problem, a recent study indicates that state apportionments to school districts do not take into account either 1) the needs of the district or 2) the wealth and income of property owners or residents within the district.[55] Taxpayers in school districts levying an average tax rate and having a substandard program have a legitimate complaint with the tax system. Reform of educational finance by the enactment of a statewide property tax as an equalization mechanism would do much to eliminate the inequalities in the existing system.

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in recent years. In the 1961-62 fiscal year, their revenues from property taxes amounted to $1.7 billion, or 48.3% of property taxes for all local government which amounted to $2.44 billion. In the 1968-69 fiscal year, their revenues from property taxes amounted to approximately $2.8 billion, or approximately 60% of property taxes for all local governments which amounted to $4.6 billion. The increase in utilization of property taxes for cities was $323 million in 1958-59. This increased for cities to $635 for 1968-69, or slightly less than doubled. However, school district property tax utilization more than tripled from $845 million in 1958-59 to $2.8 billion in 1968-69. These figures emphasize the important degree to which school districts have placed increasing demands on property taxes with consequent increases in the school district property tax rates. *See* ANNUAL REPORT. *See also* Table I and Table II.

[53] Tax rates for all school purposes in 1968-69 varied from $1.23 to $9.36 per $100 of assessed valuation. Fifty-seven districts levied a property tax rate of $3.25 or less. Four hundred fifty-nine districts levied a tax of more than $5.00 per $100 of assessed value. The remaining 543 districts levied tax rates from $3.26 to $5.00. Some of these variations can be attributed to environmental factors and the preferences of the electorate, but the structure of school finance based upon the property tax is the major case of variations in school property tax levies.

[54] There is a tremendous variation in educational expenditures per student among school districts. Educational expenditures vary in elementary districts from $354 to $951 per student. The variation in high school districts is from $552 to $1,851; in unified districts the variation is from $454 to $1,739. Taxpayers in high tax rate districts tend to spend less per student and have mediocre or poor educational programs. Taxpayers in low tax rate districts have the highest expenditure per student and have the best schools.

[55] *See* Legislative-Executive Tax Study Group, Preliminary Report 23, 24 (November 14, 1969), on file with the Assembly Revenue and Taxation Committee, Room 4016, State Capitol Building, Sacramento, California.

A rehabilitation of the property tax structure is also necessitated by the problems of local government finance. As Table V of the Appendix will show, revenues of our cities, counties, school and special districts almost equal state revenues. But more than one-half of the state budget is devoted to assisting thousands of independent local governmental units. Despite the financial effort being made to solve urban problems, including education, these problems have become increasingly serious. Present indications are that population will continue to grow, that the factors influencing increased expenditures will persist.[56] Local governments will continue to be faced with the problem of obtaining revenue to pay for the costs of increasing needs.[57]

Although a moderation of past rapid rates of growth is possible by the decline in the rate of growth of the school-age population in most areas, projections of total state-local expenditures indicate a rate of growth more rapid than that of the economy as a whole.[58] Since local revenues are not likely to rise with equal rapidity recurring fiscal crises can be expected to continue for local government.

The prospects of doom and gloom and severe theoretical criticism to which the property tax is subjected does not prophesize its abolition. The central issue is the extent to which the property tax should be employed rather than whether it should be abolished. The property tax has an acceptable role in a system of state and local taxes. But a rehabilitation of that structure is necessary. Alternative sources of revenue to local government including schools must be found. Such a rehabilitation is necessary to restore local confidence in the property tax, to protect the residential property taxpayer, and to preserve the stability and independence of local government.

The Legislative Response to Tax Reform

The legislature has made progress in past legislative sessions toward property tax reform. A $750 assessed-value exemption for owner-occupied homes was enacted for 1969-70 and future years.[59] The previously discussed Senior Citizens Property Tax Assistance Program to

[56] As mentioned previously, educational expenditures accounted for the greatest increase in the costs of local government. Other reasons for increased costs of local government are the trends toward urbanization and, within major metropolitan areas, toward suburbanization and the corresponding increased demands of local government.

[57] The dimension of the increasing expenditures on local government is exemplified by the following figures: between 1940 and 1962, local government expenditures in California increased 828%, compared with a population increase of 143%. *See* REDMOND & GRAVES, *supra* note 51, at 8-15.

[58] TAX FOUNDATION, INC., FISCAL OUTLOOK FOR STATE AND LOCAL GOVERNMENT TO 1975, at 91 (1966).

[59] *See* CAL. CONST. art. XIII, § 1(d); CAL. REV. & TAX. CODE § 218.

provide assistance for low-income, senior citizens was enacted in 1968.[60] Fifteen percent of the property tax on business inventories was exempted for 1969-70.[61] This exemption was increased to 30% for 1970-71 and 1971-72. To provide property tax relief for renters, a standard deduction in the personal income tax was increased.[62] A provision was enacted to distribute 30% of the revenue from the cigarette tax to cities and counties which has become a significant revenue source for local government.[63]

The legislature has enacted property tax assessment reforms, including a statewide 25% uniform assessment ratio beginning in 1971.[64] The California Constitution was amended to provide for special assessment of open space lands in scenic, recreational, and agricultural uses.[65] A statute was enacted requiring assessors to assess land, restricted by a government contract to agricultural uses, on the basis of use rather than on the basis of comparable sales.[66]

The 1970 Legislative Response

The basic purpose of A.B. 1000 and A.B. 1001 was to respond to what still must be done. The major thrust of this tax reform package was: 1) to close major existing tax loopholes in the tax structure, such as the oil depletion allowance; 2) to provide a substantial amount of property tax relief to the homeowner; 3) to give relief to the business community, and thus the consumer, in the form of an expanded busi-

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60 CAL. REV. & TAX. CODE §§ 19521-19540.

61 CAL. REV. & TAX. CODE § 219.

62 CAL. REV. & TAX. CODE § 17171. Although non-renters may make use of this deduction, this section was intended to help property renters indirectly through a state income tax deduction. The provision allows individuals who do not itemize their deductions on their state income tax forms to take a standard deduction of $1000 for a single person or $2000 standard deduction for a married couple.

63 An excise tax of $.10 per pack is levied on the distribution of cigarettes. Seven cents of this tax is for the state's General Fund and $.03 is collected by the state for local government and remitted to cities and counties on a formula based on population and where the sale took place. Since this tax was increased in 1967 from $.03 to $.10, total cigarette consumption has been decreasing. The continuing decline was no doubt caused by the tax increase, as well as publicity given to the health hazards of smoking. However, Department of Finance estimates that the cigarette tax will produce $159.9 million in revenue for the state and $68.1 million in revenue for local cities and counties for 1970-71. *See* CAL. REV. & TAX. CODE § 30101.

64 CAL. REV. & TAX. CODE § 401. *See* discussion note 46 *supra*.

65 *See* CAL. CONST. art. XXVIII and the discussion in note 13 *supra*. *See also* CAL. REV. & TAX. CODE §§ 421-424, 1815.7.

66 The Land Conservation Act of 1965 is contained in CAL. GOV'T CODE §§ 51200-51295. It should be noted that a series of measures introduced in 1969 by Assemblyman John Knox (D-Richmond) extended the coverage of the Open Space Amendment of the state constitution to scenic and to recreational lands (CAL. GOV'T CODE § 51205). The major change made by these measures was to require land to be assessed on the basis of use, rather than on the basis of comparable sales if it is restricted by law or contract to agricultural, scenic, or recreational uses. (*See* CAL. REV. & TAX. CODE §§ 421, 426). One measure extended open space provisions to salt ponds, mud flats, and wildlife preserves (CAL. GOV'T CODE § 51201).

ness inventory exemption; 4) to equalize the burden and costs of welfare to counties throughout the state; and 5) to place some legitimate limitation on local government expenditures.

The basic objection was to shift at least 20% of the local property tax burden to broader-based state taxes such as the sales and income tax. As proposed, the tax reform package would have reduced homeowners' property taxes by at least 20% for moderate-valued homes and by 100% for very low-valued homes.[67] It would have provided an additional $200 million to county government, including a major shift of welfare costs to the state and away from the county property taxpayer.[68] For the first time, strict expenditure control limits would have been imposed on local government and school districts. This proposal would have created a 50% business inventory property tax exemption, thus allowing California to compete with neighboring states which have no business inventory tax. It would have doubled the scope and benefit of the existing Senior Citizens' Property Tax Assistance Program. For the first time, it would have provided state funds for local revenue lost because of the Land Conservation Act. And finally, for the first time it would have provided a program of comprehensive renter tax relief.

There follows in greater detail a discussion of the major components of a tax reform program. All these elements were contained in A.B. 1000 and A.B. 1001 and should be a basis for constructing tax reform for 1971.

A. *The Homeowners' Exemption*

Since the cause of the pressure for tax reform is the level of the property tax on homes, increasing the existing $750 homeowners' exemption of assessed value should be a major element in a tax reform proposal. Proposition 1A adopted by the voters in November, 1968, established a precedent by granting direct homeowner relief through an exemption of $750 of assessed value.[69] The legislature used sales tax proceeds to

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[67] The tax program would have completely eliminated the property tax on homes with a market value of $4,000 or less.

[68] The tax program would have provided $196 million in property tax relief to local government in 1970-71. This sum was over and above the $377 million that the state would provide for homeowner property tax relief. For example, Stanislaus County would have received $3.8 million in direct assistance under the provisions of the tax program. The Department of Finance has estimated that this sum would have reduced the county property tax rate by $0.93 for 1970-71. In addition, residential property taxpayers would have received an exemption of $1,000 of assessed value plus 20% of the remaining assessed value. According to the State Department of Finance, this is the equivalent of a $2.50 average rate reduction in the property tax of a homeowner above the present $750 assessed value exemption.

[69] The homeowners' exemption was authorized by the addition of Section 1(d) to Article XIII of the State Constitution by Proposition 1A on the ballot for the General

reimburse local government for revenue losses created by the exemption.[70] The $750 exemption was granted to all homeowners, regardless of income or wealth, but it had its greatest impact on homes with modest values. For example, the $750 exemption was equivalent to a 30% property tax reduction for a house with a full cash value of $10,000 (such a home would have an assessed value of $2,500 at the 25% assessment ratio; the $750 exemption is 30% of that assessed value); but the exemption would be only a 10% reduction for a home with a full cash value of $30,000 ($7,500 assessed value at the 25% ratio; the $750 exemption is 10% of this assessed value). As a result of the $750 homeowners' exemption, the regressive nature of the residential tax was reduced.[71]

Election held on November 5, 1968. Section 1(d) provides, in part:

> Sec. 1d. The homeowners' property tax exemption shall apply to each dwelling, as defined by the Legislature, occupied by an owner thereof on the lien date as his principal place of residence. . . .

Section 1(d) empowered the legislature to define "dwelling" and to increase or decrease the exemption. It required the legislature to provide from state taxes funds to reimburse local government for revenue losses by reason of the exemption.

[70] The cost in state funds of the $750 exemption in 1969-70 for reimbursements to local government was $183 million. REPORT OF THE LEGISLATIVE ANALYST, ANALYSIS OF THE BUDGET, 1970-71, at 1029.

[71] The following figures indicate the impact of the $750 exemption on the residential property tax. The Legislative Analyst maintains that even after the enactment of the $750 exemption the property tax continues to be regressive at low incomes, but roughly proportional at middle incomes. *See* REPORT OF THE LEGISLATIVE ANALYST, ANALYSIS OF THE BUDGET BILL, 1969-70, at A-53-54.

THE EFFECT OF THE HOMEOWNERS' EXEMPTION ON THE REGRESSIVE NATURE OF THE CALIFORNIA PROPERTY TAX

		Before Proposition 1A Property Taxes[a]		After Proposition 1A Property Taxes[b]	
Adjusted Gross Income Class	Average AGI	Amount	Percent of AGI	Amount	Percent of AGI
$ 0-$ 2,000	$ 1,589	$185	11.6	$115	7.2
2,000- 3,000	2,562	200	7.8	130	5.1
3,000- 4,000	3,523	220	6.2	150	4.3
4,000- 5,000	4,643	234	5.0	164	3.5
5,000- 6,000	5,574	244	4.4	174	3.1
6,000- 7,000	6,540	267	4.1	197	3.0
7,000- 8,000	7,520	279	3.7	209	2.8
8,000- 9,000	8,500	316	3.7	246	2.9
9,000- 10,000	9,495	334	3.5	264	2.8
10,000- 11,000	10,490	365	3.5	295	2.8
11,000- 12,000	11,491	376	3.3	306	2.7
12,000- 13,000	12,484	431	3.4	361	2.9
13,000- 14,000	13,465	429	3.2	359	2.7
14,000- 15,000	14,470	464	3.2	394	2.7
15,000- 20,000	16,969	528	3.1	458	2.7
20,000- 25,000	22,143	707	3.2	637	2.9

[a] Based upon a special study by the Franchise Tax Board of itemized property tax deductions on 1965 California personal income tax returns filed by married couples. This study was released in December 1967. Property taxes for income groups below $5,000 were estimated by extrapolating 1966 federal income tax data.

[b] Obtained by subtracting $70 from the before Proposition 1A data. This infor-

A.B. 1001 would have increased the existing homeowners' exemption for single-family homes on a parcel of property of three acres or less from $750 to $1,000, plus 20% of the remaining assessed value.[72] For duplexes and single-family homes on parcels in excess of three acres the exemption would have increased from $750 to $1,500. The homeowners' exemption of $1,500 would have extended for the first time to the owners of cooperative apartments and those owning multiple-family dwellings in excess of two units if they live in one of the units.[73]

By increasing the homeowners' exemption, the regressiveness of the property tax would be decreased at the low and moderate income levels.[74] As Table VI of the Appendix indicates, the amount of tax relief given in the form of the homeowners' exemption would be visible to property taxpayers.[75] The homeowners' exemption of 20% of the

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mation does not show the effect of eliminating the property tax on household personal effects.
Source: LEGISLATIVE ANALYST, ANALYSIS OF THE BUDGET BILL, 1969-70, at A-54.

[72] The $1,000 plus 20% exemption would operate as follows: Assume a house with a market value of $20,000. Since the house is assessed at a ratio of 25% of its market value, the assessed value of the home would be $5,000. With the existing $750 exemption of assessed value, the result would be $4,250 in assessed value. If the county has a tax rate of $10 per $100 of assessed value, his tax bill would be, under current law, $425. Under the tax program as proposed the $1,000 assessed value exemption would be deducted from the assessed value ($5,000 assessed value — $1,000 exemption = $4,000). Twenty percent of the remaining assessed value would also be exempt (20% of $4,000 assessed value = $800). The total exemption would therefore be $1,000 plus $800, or $1,800. The resulting assessed value would be $3,200 which if applied to a tax rate of $10 per $100 of assessed value, would result in a tax bill of $320.

[73] Existing law, CAL. REV. & TAX. § 218, has set the following requirements to qualify for the homeowners' exemption:
1. The dwelling must be occupied as the principal place of residence (vacation or secondary homes are excluded, as are vacant or rented homes).
2. The individual must be the owner of the dwelling.
3. He must file a claim between the lien date (March 1) and April 15.
4. There must not be a veterans' exemption on the property for the year in which the homeowners' exemption is applied.
5. No more than one exemption per dwelling can be allowed.
6. The owner of a dwelling must not have received an allowance for taxes, except for the Senior Citizens' Property Tax Assistance Program. (This requirement excludes approximately 100,000 taxpayers on public assistance).

"Dwelling" is defined in section 218 to include:
1. Single-family dwelling occupied by an owner.
2. A multiple-dwelling unit occupied by an owner, but multiple-dwelling unit does not include any unit containing more than two separate dwelling units (i.e., anything other than a duplex).
3. A condominium occupied by an owner. It should be noted that this definition excludes an apartment owner living in the apartment house. Cooperatives are also excluded. The tax reform program would have extended the homeowners' exemption to cooperatives, such as Rossmor in Orange County, and owners living in an apartment house.

[74] The basic problem is that in 1970, the statewide average property tax rate will be approximately $11 per $100 assessed valuation. If the ratio of assessed to market value of the property on which taxes are paid is 25%, then the average statewide rate will be approximately 2.75% of market value regardless of the accompanying income. The rationale for increasing the homeowners' exemption is that the property tax is made more proportional to the income involved in home ownership and the ability-to-pay basis for taxation.

[75] Since the homeowners' exemption decreases taxes on residences rather than

remaining assessed value, after the $1,000 exemption, limits the ability of the assessor to reduce the significance of the homeowners' exemption in future years by increasing the assessment on a home.[76] The existing $750 exemption has been rendered useless by the assessors' increase in assessments or by increased tax rates. The 20% would guarantee continuing and on-going tax relief even if property tax rates and assessments continue to increase.

B. *Senior Citizens*

A.B. 1001 also proposed an increase in the scope of the Senior Citizens' Property Tax Relief Program by providing for a higher and more realistic schedule of reimbursement or refund of property taxes to senior citizens. This program finances property tax assistance for senior citizens with limited incomes. Claimants must be homeowners, at least 65 years of age, and have a household income from all sources of less than $3,350 during the year. The amount of state assistance varies inversely with income. Those with an income of less than $1,000 would have 95% of their property taxes reimbursed by the State Franchise Tax Board, while those with incomes between $3,325 and $3,350 would receive 1% reimbursement. The percentage reimbursement for the property tax is limited to the tax on the first $5,000 of assessed value of the home.

A.B. 1001 would have changed the reimbursement schedule to allow recovery by senior citizen homeowners with up to $4,600 annual income.[77] The percentages are also changed so that at lower incomes there will be a 97% reimbursement and at the higher incomes a 4% reimbursement.[78]

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all taxable real property, greater tax reductions can be achieved for homeowners through this exemption than through general property tax reduction programs that apply to the total real property tax base. This is a significant consideration in favor of utilizing the homeowners' exemption as a method of tax relief.

[76] The ineffectiveness of a static $750 exemption is illustrated by the following table:

LONG-TERM IMPACT OF THE HOMEOWNERS' EXEMPTION

Existing Law—$750 Exemption	1968-69	1969-70	1970-71	1971-72
Full Cash Value of Home	$20,000	$20,800	$21,630	$22,500
Assessed Value (23%)	4,600	4,784	4,975	5,175
Tax rate	9.83	10.45	10.80	11.20
Gross Tax	$ 453	$ 500	$ 537	$ 580
Homeowners' Exemption	— 70	— 78	— 81	— 84
Net Tax	$ 383	$ 422	$ 456	$ 496

[77] In 1968-69 state reimbursements totaling $7.8 million were paid to 57,345 claimants. About 5% of the total number of senior citizens in California participated in this program. The provisions of A.B. 1001 would add $6 million in additional relief for 1971-72 to a greater number of senior citizen applicants.

[78] The increase in the benefits of the senior citizens' property tax relief program

The assistance for a senior citizen under this program would be in addition to the homeowners' exemption. For example, a senior citizen with a home worth $18,000 would pay in 1969-70 approximately $400 in property taxes. With the increased homeowner exemption as proposed in A.B. 1000, his tax bill would decrease to $300. If his income was $3,200 annually, he could apply for assistance under the program. He would be entitled to a further reduction of approximately $183. His total property tax bill would be $118.[79]

The reduction of a senior citizens' tax bill from $341 to $117 is the type of relief necessary to prevent the senior citizen from being driven from his home. Senior citizens are generally on a fixed income that does not keep pace with the cost-of-living increases and merit consideration in a major tax reform package.

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were as follows:

REFUND OF TAXES PAID IN FIRST $5,000 OF ASSESSED VALUATION

Income	Proposed	Present Law
$1,000	97	95
1,500	92	75
2,000	87	55
2,500	76	35
3,000	61	15
3,300	52	3
3,500	46	—
4,000	28	—
4,500	8	—
4,600	4	—

[79] The following table indicates that the average payment to a claimant under the program for 1970-71 will be $141, which is slightly less than 50% of the net property taxes on these homes after deducting the $750 homeowners' exemption. This table also illustrates the growth in tax rates and assessed values on these homes.

SENIOR CITIZENS ASSISTANCE

(All numbers are average figures)

	1967-68	1968-69	1969-70
Assessed valuation	$2,919	$3,128	$3,353
Property tax rate	9.25	9.72	10.32
Gross property tax	$ 270	$ 304	$ 346
Homeowners' exemption	0	54[a]	60[b]
Net property tax	270	250	286
Percent of assistance	50.4	49.2	49.3
Senior citizen assistance	136	123	141

[a] A sample of 1,200 returns showed that only 77% of senior citizens claimed the $70 rebate (77% × $70 = $54).

[b] Assumes that only 77% also claimed the homeowners' exemption because the filing coincided with the rebate.

Source: Report of the Legislative Analyst, Analysis of the Budget Bill, 1970-71, at 1029.

Illustration of the Change
in Senior Citizens' Property Tax Assistance
1970-71 Data

	Existing Law	Proposed (AB 1001)
Assessed value of home	$4,500.00	$4,500.00
Property tax rate	10.70	10.70
Gross Property tax	$ 481.00	$ 481.00
Homeowners' exemption	80.00	181.00
	401.00	300.00
Senior Citizens' Relief (Present: 15%. Proposed: 61%)*	401.00 (15%)60.00	183.00(61%)
Net Property Tax	$ 341.00	$ 117.00

* Assume a household income of $3,200.

C. *Renter Relief*

As was mentioned, a 1968 tax reform program enacted a $750 assessed value exemption for homeowners; at the same time, the personal income tax standard deduction in the income tax law was increased to $1,000 ($500 prior to 1968) for single taxpayers and to $2,000 ($1,000 prior to 1968) for married couples.[80] The purpose of increasing the standard deduction was to provide to renters a tax reduction roughly equivalent to the relief granted homeowners.[81] This was

[80] CAL. REV. & TAX. CODE §§ 17171-17177. A taxpayer can take the standard deduction, in lieu of itemizing his nonbusiness deductions. In such cases, no other deductions from gross income are allowed except the deductions allowable in computing the adjusted gross income. The standard deduction is a fixed amount regardless of income. The election to take the standard deduction is made at the time of filing the return by the taxpayer. Under federal law, the standard deduction is 10% of adjusted gross income, with a minimum and a maximum provided. The federal minimum is $200 plus $100 for each exemption allowable. The maximum is $500 for a married person filing separately, and $1,000 for a single person or a married couple filing jointly. Sections 141-145 of the Internal Revenue Code.

[81] The adoption of the standard deduction to grant the equivalent of property tax relief to renters is one of the wonders and mysteries of the legislative process. This method of granting relief slaughters the renter who must itemize his deductions and the poor renter who has minimal income. Any individual including a non-renter, can elect to take the standard deduction. This mechanism provides no relief to middle income renters who have itemized deductions in the excess of the standard deduction limits. The magnitude of relief would also vary with income, a facet not comparable to the flat $750 homeowners' exemption. For example, the homeowners' exemption for 1970-71 will be worth approximately $80 in property tax savings to each claimant; renters will receive income tax savings ranging from $15 to $50 depending upon their marital status and income level:

INCOME TAX SAVINGS FROM PROPOSITION 1A
TO RENTERS BY DOUBLING THE STANDARD DEDUCTION

Adjusted Gross Income	Single Taxpayer	Married Couple
$ 4,500	$15	No tax

done on the theory that most renters are forced to use the standard deduction because they cannot itemize property taxes or interest costs on their dwellings.

In legislative discussions to increase the homeowners' exemption, the question of whether a renters' relief program should also be enacted was reviewed. Franchise Tax Board statistics indicate that the proportion of renters in California is approximately 40% of the population. Table VII of the Appendix will show that lower-income groups have the highest proportion of renters, and almost 80% of single taxpayers are renters. About 34% of the joint returns of married couples are from renters. Homeowners are able to deduct interest and taxes from adjusted gross income to arrive at taxable income for personal income tax purposes;[82] but renters can claim no part of rent as an income tax deduction. In legislative discussions, the tax reform program recommended by the Advisory Commission on Tax Reform (Flournoy Commission) was criticized for the absence of a proposal to grant the equivalent of property tax relief to renters. It can be argued that this flaw is compounded when these programs advocate using higher sales taxes to finance homeowners' relief. The result would be a tax shift that would increase the regressiveness of our tax structure. Low-income renters, in effect, would be paying a large portion of the increased sales taxes that would be used to finance property tax relief for middle- and higher-income homeowners.[83]

If property taxes on homeowners are onerous and deserve reduction, then do renters deserve a rebate for the property tax portion of their rent? Few studies have been made on the subject, but some authorities feel that renters do pay some portion of the owner-landlord's property tax liability. Figures presented in discussions with members of the Legislative-Executive Tax Study Group indicated that property taxes can constitute 13% to 25% of the renter's annual payment to the land-

7,500	25	$20
10,000	30	30
12,500	40	40
15,000	50	50

82 CAL. REV. & TAX. CODE §§ 17203, 17204.

83 It must be understood that the topic of renter relief is subject to sharp debate. The premise that if you do something for the homeowner you must also do something for renters can be attacked. There is no necessary relation between the homeowners' exemption and renter assistance. If the homeowners' exemption was adopted because a policy decision was made that real estate taxes were too high as compared with other taxes, the question that everyone bearing an addition tax to finance relief must somehow be relieved of that burden leads nowhere. Unless a burden is shifted (*i.e.*, to somewhere else), a reform is ineffectual. If a policy decision is made that homeowners should have tax relief, then the question is what is a suitable tax source? It can be argued that the fact that a small portion of this tax source falls on renters is not relevant. Some of it falls on business and other segments. Should business also be relieved of its burden?

lord.[84] However, the evidence is speculative;[85] it is even more ambiguous in terms of the amount of property tax increases that are reflected in increased rental charges. It can be argued that for the most part rents are set by the free play of economic forces, or in other words, supply and demand. Factors other than taxes can be more important in the setting of rents. For example, if there is a vacancy factor of 20% for a particular area, a tax or other increases probably will not be passed on to the renter nor will a tax decrease make any difference in the rent.[86]

A.B. 1000 did adopt a concept of renter relief.[87] An income tax credit was proposed for renters. Each taxpayer who is a renter of a dwelling place which is not exempt from property taxes was allowed to deduct up to $50 from his state income tax payment. If the income tax liability is less than $50, the tax liability would be eliminated; but no

[84] As part of the analysis of renter relief by the Legislative-Executive Tax Study Group, the following table was formulated. The table illustrates eleven returns of corporations whose business activity is apartment renting. Note that property taxes as a median percent of gross rent derived from property tax deductions by landlords constitutes 13.5% of rent.

PROPERTY TAX DEDUCTIONS BY LANDLORDS ON CORPORATION FRANCHISE TAX RETURNS
1968 INCOME YEAR

Gross Rents	Property Taxes	Property Taxes as a Percent of Rent
$ 90,556	$ 8,903	9.8%
20,769	1,535	7.4
28,360	4,520	15.9
68,929	6,457	9.4
35,432	4,085	11.5
20,687	4,071	19.7
40,644	5,086	14.3
190,185	31,886	16.8
46,167	6,254	13.5
21,661	2,848	13.1
10,081	1,968	19.5
$573,471	$78,333	13.7 (median = 13.5%)

[85] The California Real Estate Association has stated in discussions of renter relief that percent of rent attributed to the property tax is 24%. Different percentages have also appeared. No case has been convincingly made of the portion of property taxes represented in rent.

[86] However, it should be true that over the long run, costs of all kinds affect housing supply and this includes taxes. Thus, over the long haul, the level of taxes does have an influence on supply and price. The problem is how much of an influence? Governor Reagan's tax reform legislation in 1969 introduced by Assembly Republican Floor Leader Biddle was greeted with skepticism. The proposals neglected renter relief. The response of the Governor was that if property taxes were lowered, the landlords would quite promptly pass savings on to tenants. But factors other than taxes affect rent lands and whether a landlord shares the wealth.

[87] A renter relief program was adopted because the major consensus of legislators and staff members of the Tax Study Group was that such a program was necessary. The basic feeling was that renters should not bear the costs of homeowners' relief without some type of relief. The question then became how would renter relief be granted. It was decided that a renter relief program which would rebate $50 directly to every renter in the state would be an administrative nightmare. An income tax credit administered by the Franchise Tax Board would be the most inexpensive and simplest to administer; thus, the income tax credit approach was taken.

refund would be allowed on the unused credit. This provision, according to the Legislative Analyst's office would cancel any tax owed by a single renter earning up to $5,300 and by a married renter earning up to $9,000. No renter credit would be claimed by single persons with less than $3,250 income, or couples with less than $6,500 income because they do not have income tax liability.

D. *Business Inventory Exemption*[88]

The inequities and economic liabilities inherent in the inventory tax have long been recognized in California. Various studies by the Assembly Committee on Revenue and Taxation,[89] the National Tax Association,[90] and the Advisory Committee on Intergovernmental Relations[91] have all condemned this tax.

In 1968, California enacted a 15% property tax exemption for business inventories, effective for 1969-70 property taxes.[92] The exemption was financed by making 1/14th of the bank and corporation tax (approximately $39 million) available to replace revenue lost to local government by reason of the reduction of the property tax on business inventories. In 1969, the exemption was increased to 30%

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[88] It may be inaccurate to speak of business inventory tax exemption. There is no special tax on inventories in California. However, business inventories are part of the property tax base. The property tax applies to business inventories just as it applies to real property, machinery, equipment, etc. Business inventories are subject to taxation and are assessed at 25% of their full valuation, on the first monday in March of each year. The issue is whether inventories should be excluded from the property tax base. A 15% business inventory exemption would exclude 15% of the assessed value of business inventories from the tax base. In 1969, the business inventory exemption amounted to $475.4 million of assessed value and $46 million in taxes. Business inventories are defined in CAL. REV. & TAX. CODE § 129 as:

> "Business inventories" shall include goods intended for sale or lease in the ordinary course of business and shall include raw materials and work in process with respect to such goods. "Business inventories" shall also include animals and crops held primarily for sale or lease, or animals used in the production of food or fiber and feed for such animals.
> "Business inventories" shall not include any goods actually leased or rented on the lien date nor shall "business inventories" include business machinery or equipment or office furniture, machines or equipment, except when such property is held for sale or lease in the ordinary course of business. "Business inventories" shall not include any item held for lease which has been or is intended to be used by the lessor prior to or subsequent to the lease.

[89] *See* ASSEMBLY INTERIM COMMITTEE ON REVENUE AND TAXATION, 4 TAXATION OF PROPERTY IN CALIFORNIA, No. 12, at 142-157 (1964).

[90] Buehler, Report of the Committee on Intergovernmental Fiscal Relations, Proceedings of the Fifty-Eighth Annual Conference on Taxation (National Tax Association, 1966).

[91] ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, STATE-LOCAL TAXATION AND INDUSTRIAL LOCATION (Washington: Report A-30, 1967). The Advisory Commission stated at 83:

> De-emphasizing the personal property tax, especially on business inventories, is perhaps the most significant step States can take to improve both their business tax climate and their business tax structure.

[92] CAL. REV. & TAX. CODE § 219. The 15% exemption was ratified by the voters with the approval of Proposition 1A in the 1968 general election.

for the 1970-71 and 1971-72 fiscal years. Unless the life of the 30% exemption is extended at a future session of the legislature, the exemption reverts to 15% in the 1972-73 property tax year.[93]

Current state policy has been to appropriate state funds for local governments to partially make up the loss of property tax revenue caused by the exemption.[94] For the 1969-70 fiscal year, state appropriations for local government as replacement revenue for the exemption fell short of actual loss by $1.06 million according to figures submitted to the Committee by the State Board of Equalization. During the 1971 session, the counties can again be expected to ask the legislature to appropriate funds to make up expected shortages.

A.B. 1001 for 1970-71 and each year thereafter would have proposed to reimburse to local governments for the business inventory exemption on an actual cost basis, rather than on a fixed schedule as required by present law.[95] It would have increased the exemption from the personal property tax for business inventories to 50% for 1971; and 45% for 1972 and each year thereafter. The revenue producing provisions of A.B. 1001 would have provided $105 million in 1971-72 and $148 million in 1972-73 to finance the exemption.

Proponents for the exemption advance several persuasive arguments.[96] It is argued that economic inventory taxation places California at a definite disadvantage in competing with other states for new industries and jobs. California needs both. Inventory taxation also causes an annual slow-down in business activity prior to the lien date,

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[93] CAL. REV. & TAX. CODE § 219, as amended CAL. STATS. 1969, c. 152b, p. 3118, § 3, expanded the exemption to 30%.

[94] Proposition 1A in 1968 provided that the state would reimburse local governments for the total revenue loss occasioned by the homeowners' exemption and for *most* of the loss from the inventory exemption. Existing law provides that 1/14 of the bank and corporation tax revenues shall be transferred to the Property Tax Relief Fund to make payment to the counties for the inventory exemption (CAL. GOV'T CODE § 16100). The magnitude of these payments by county are specified (CAL. GOV'T CODE § 16107), but adjustments are made depending upon the future level of the bank and corporation tax revenues compared to the level in 1969-70. If the franchise tax revenues in 1971-72 are 10% higher than the existing level, then each county would have its statutory reimbursement schedule increased by 10%. Unfortunately, for local governments, the franchise tax has not increased at the same rate as business inventories. Increased revenues have not offset the increase in business inventories. A.B. 1001 would have abolished the present method of reimbursement to the counties. Instead, the state would fully reimburse the counties for the tax losses experienced by all levels of local government from the exemption. This has been a position which is strongly favored by local government.

[95] Unless replacement revenue is provided, a portion of the costs of local government would be shifted from business inventory taxpayers to homeowners and other local taxpayers. Many local agencies having statutory rate ceilings would have no means of making up the loss in revenue caused by the exemptions reduction in assessed value except by undermining their existing services or programs.

[96] Most of the economic arguments for exempting inventories are based on the premise that other states give a special tax treatment to inventories or are moving in the direction of such treatment.

March 1. This causes a loss in warehouse occupancy in California, fewer goods being available to consumers, losses in business income and jobs and consequential losses in tax revenue to state and local government. The inclusion of inventories in the tax base discourages manufacturers and certain wholesalers from locating in California. It is suggested that exempting inventories from taxation will encourage manufacturers to locate new facilities in California, increase California manufacturers' sales and increase tax revenues.[97]

A tax on business inventories is also inequitable. A 1968 study[98] by the staff of the Senate Committee on Revenue and Taxation identified the following asserted inequities in inventory taxation:

(1) Inventories and other business personal property are appraised annually while real property is appraised less frequently. Thus the effective tax rate on inventories may be slightly higher than the effective tax rate on other property on the same roll.

(2) Businessmen engaged in goods-producing or selling operations are required to maintain inventories and to pay a tax on this type of property. By contrast, businessmen engaged in service operations generally do not pay such a tax. For example, manufacturers, wholesalers, and retailers are taxed; doctors, lawyers, accountants, and businesses primarily engaged in rendering services pay a small amount of tax or no tax at all.

(3) On the lien date, some businesses require high levels of inventory; others may require more modest levels. Building material dealers, canners, nurserymen, and winemakers, for example, must have high levels of inventories on the lien date. Retailers of toys, by contrast, may have considerably less inventory in March than in November. Some businesses can, for tax reduction purposes, deplete their inventory stocks while others cannot.

(4) Inventory taxes must be paid whether or not a business makes a profit. Indeed, a business may have higher inventories, and higher taxes, during an unprofitable period than during a profitable period.

(5) The tax resulting from the inclusion of inventories in the tax base is loosely related to gross sales. This creates a hardship for certain businesses. For example, a jewelry store may have gross sales of $100,000 and may turn its inventory over once during the year. The

[97] *See* ADVISORY COMMISSION, *supra* note 91, at 59-61.

[98] Arguments relating to inequities in inventory taxation are mentioned in a Senate staff study which examined the advantages and disadvantages of inventory taxation. Most of the inequity arguments mentioned are taken from this study. *See* CALIFORNIA LEGISLATURE, SENATE, AN ANALYSIS AND EVALUATION OF PROPOSALS RELATING TO THE AD VALOREM TAXATION OF BUSINESS INVENTORIES IN CALIFORNIA 12-15 (1968).

assessed value of the average inventory (or the inventory on the lien date) of the jewelry store is $12,500 (one-quarter of the $50,000 wholesale price of the goods). A $10 tax rate results in a tax of $1,250.

An appliance store, on the other hand, may also have gross sales of $100,000 but the amount of inventory required at any one time is approximately one-fifth the value of the jeweler. Hence the assessed value of the average inventory (or the inventory on the lien date) of the appliance store is $3,500. (The $70,000 wholesale price divided by 5 is $14,000. One-quarter of $14,000 is $3,500.) A $10 tax rate results in a tax of $350. Both stores had gross sales of $100,000 during the year; the jewelry store's tax is $1,250; the appliance store's tax is $350.

Other states have eliminated this form of taxation by outright repeal, gradual phaseouts, major reduction, and "Free-Port" laws[99] to the extent that by 1975 few states will have any significant form of inventory taxation.[100] If by that time California has failed to move beyond the 15% exemption, its tax treatment of inventories will be completely out of line with other states. To omit inclusion of further inventory tax reduction in any major reform proposal reflects a lack of concern for the need to improve California's business tax climate and business tax structure.

E. *Open Space Program*

The Land Conservation Act of 1965 authorized the establishment of "agricultural preserves"[101] by "contract" or by "agreement." The act

[99] Freeport laws are laws which exempt goods that come into a state from out of state and which are destined for export to another state or to a foreign country, or laws which exempt goods produced or manufactured in a state and which are destined for export to another state or a foreign country. The effect of freeport laws is partially to exempt inventories from taxation. Inventories of manufacturing concerns would be exempted by freeport laws, but retailers would still have their inventories taxed. It should also be noted that California is probably a major termination situs for goods rather than a state through which goods pass. Therefore, a freeport law would not have a substantial impact in California.

[100] *See* CALIFORNIA LEGISLATURE, SENATE, *supra* note 98, at 29-31. The Appendix contains an excellent summary of the tax treatment for business inventories in other states.

[101] *See* CAL. GOV'T CODE §§ 51200-51295. The legislation is also known as the "Williamson Act." "Agricultural preserves" are defined in section 51201(d). As mentioned in note 13 *supra*, prior to the passage of the Act, all property was required to be assessed on the basis of its full cash value. One effect of this assessment standard was to impute speculative values to land, particularly in the vicinity of urban development. As property taxes approached or exceeded net profits, agricultural landowners were compelled to discontinue farming. The resulting pattern was one of premature land conversion, discontiguous development and urban sprawl. CALIFORNIA LEGISLATURE, JOINT COMMITTEE ON OPEN SPACE LAND, PRELIMINARY REPORT 27-45 (1969) [hereinafter cited as OPEN SPACE LAND REPORT].

The Land Conservation Act is made up of two programs. Section 51240 authorizes any city or county to contract to limit the *use of prime agricultural land* as defined in section 51242. Section 51255 authorizes any county by agreement to limit the use of *any land* within an agricultural preserve. The length, terms, conditions and restrictions of an "agreement" are not governed by the Act, but are left to negotiation between county and landowner (section 51256). There is no provision for the cancella-

allowed farmers to contractually restrict the use of their land to agriculture for ten years.[102] The contracts provided for automatic one-year extensions at the annual anniversary date, unless either the landowner or the county gave written notice of non-renewal.[103] In 1966, the people ratified article XXVIII of the California Constitution, thus granting to the legislature the authority to depart from market-value assessment on open space land.[104] In 1967, the legislature used its authority to give a new dimension to the Land Conservation Act. The legislature decided that land which is restricted to agriculture or compatible uses pursuant to the Act should be assessed on the basis of its income generating value in agriculture; accordingly, the legislature denied the assessor the use of comparable sales data in the valuation process.[105]

Under present law, there are no state funds provided to local governments for open-space lands brought under enforceable restriction pursuant to the Act.[106] The need to save prime agricultural lands and other open-space lands is one of statewide concern. This pro-

tion of an "agreement," and it is not restricted to prime agricultural land. The state is also not a direct or indirect party to an "agreement." Contracts are virtually non-existent. The agreement procedure has accounted for 98% of the total restricted land. The contract procedure has been avoided because farmers demanded the greater flexibility of the agreement procedure, or because the counties want to avoid state control inherent in the requirement that state approve both the execution and cancellation of contract restrictions. *See* Alden and Shockre, *Preferential Assessment of Agricultural Lands: Preservation or Discrimination,* 42 S. CAL. L. REV. 59, 64-67 (1969).

[102] CAL. GOV'T CODE § 51244.

[103] CAL. GOV'T CODE § 51245. The contracts provide for automatic one-year extensions at the annual anniversary date of the contract. Thus, rolling contracts are created potentially in perpetuity, but are in no case shorter than ten years. Either the landowner or the county may begin a ten-year termination period by filing a notice of non-renewal in any year. Once the notice has been filed, the contract is treated as expiring restriction with a fixed termination date and is assessed accordingly. This method of termination does not involve any penalty or payback of deferred taxes. The grounds for cancellation of a contract are prescribed in the Act (sections 51281-283). Mutual assent is not sufficient grounds for cancellation. The opportunity for a more profitable use is not grounds for cancellation. The contract may be cancelled if cancellation would be consistent with the purposes of the Act and would be in the public interest. Once cancellation is approved, the landowner must pay a cancellation fee amounting to 50% of the new unrestricted assessed value.

[104] Under the provisions of article XXVIII the legislature was authorized to: (1) define open space, (2) specify an enforceable restriction of open-space land to food and fiber production (agriculture) and other open space uses, and (3) provide for a method of valuing such open-space land consistent with the use and restriction to use.

[105] CAL. REV. & TAX. CODE § 423. The success of the contractual restriction of the Land Conservation Act in reducing the assessed value of the land was dependent upon its effect on the market value of the restricted land. Even under the Act, the assessor could use comparable sales data of land similarly situated under restrictive use.

[106] Prior to 1969, the Land Conservation Act provided that the state was obligated to pay participating counties $1 for each acre of prime land as defined in section 51242 within the county which is subject to contract. However, as mentioned in note 101, *supra,* landowners prefer the agreement procedure and the $1 per acre was not sufficiently attractive to counties to cause them to offer only contracts on prime land. This provision was repealed during the 1969 session at the recommendation of the the Joint Committee on Open Space Land. OPEN SPACE LAND REPORT 14, 15.

gram cannot be effective if a number of important counties refuse to implement the program.[107] Appropriate incentives should be provided to counties for implementation of this program. A serious problem of implementation has been the adverse impact on the county property tax base as the result of land coming under the jurisdiction of the Act. Local taxing districts, such as a school district, within an agricultural preserve can suffer significant decrease in property tax receipts because of the reduced assessed valuation as a result of the implementation of the Act. Local taxing agencies, which rely on the property tax, must increase the tax rate if they are to receive the same amount of revenue.[108]

A.B. 1000 would have provided an incentive to counties to enter into Land Conservation Act contracts. Losses in ad valorem property tax revenues to local taxing districts and the county would be lessened. The program provided for payments to local governments for land under open-space restrictions. All local governments would have received a payment computed by determining the difference between the assessed value for the year prior to the year the land became subject to the Land Conservation Act and the current assessed value as restricted, applying the current year's tax rate to 75% of the difference in the assessed value figures. Depending on how much additional land would have been placed under agreement as a result of the reimbursement provisions in the program, it was estimated that the state would have provided $8 million in 1970-71 and $10 million in 1971-72.

F. *Withholding*

A withholding system is a procedure for collecting state income taxes when income is earned by witholding the tax from wages. It consists of requiring employers to deduct and remit to the government an amount from employees' salaries and wages approximating the probable tax on such income.[109] This method of collection must be considered as a necessary component of tax reform.[110]

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[107] For example, according to 1968 figures most property restricted under the Act was not the prime agricultural land that the Act was designed to protect. According to the Joint Committee on Open Space Lands, by March, 1968, only 23 counties had executed contracts or agreements. Of this land, 131,273 was reported to be prime agricultural land and 1,930,695 was non-prime. OPEN SPACE LAND REPORT 50-52.

[108] OPEN SPACE LAND REPORT 65-70. The joint Committee on Open Space Lands indicated the total difference in assessed value for the counties resulting from having land under the Act was $42 million in assessed value for 1968-69.

[109] CAL. REV. & TAX. CODE § 18805 authorizes the Franchise Tax Board to withhold payments of compensation for personal services, payments for professional services, patent royalties, prizes, etc. This form of limited withholding has been applied to nonresidents. The Franchise Tax Board has not used this section to extend a withholding system to include resident, as well as nonresident taxpayers. *See* CCH CAL. TAX REP. ¶¶ 18-151, 18-154 (1967).

[110] Of the 36 states having a personal income tax, only California and North

The strongest argument in favor of withholding is improved compliance. A witholding system would catch many who now evade payment of California's personal income tax.[111] Of primary concern are taxpayers who do not file returns and leave the state after earning income in California. Also, under the present method of collection, there is a substantial lag between the time income is earned and the time when the tax is due and paid.[112] With withholding the magnitude of these problems would be decreased. In addition to persons who don't file, another serious problem is encountered with individuals who file their income tax returns but do not pay, or do not pay the correct amount. Delinquent taxes are pursued by the Franchise Tax Board, and part of these taxes are collected after a period of time.[113] But as can be seen from Table IX of the Appendix, the percentage of income tax accounts payable (over 3 years old) has increased substantially.

Withholding will not solve the personal income tax evasion or delinquency problem entirely, but it should materially reduce this problem. The Franchise Tax Board estimated additional revenue through improved compliance at $22 million in the 1969-70 fiscal year, had withholding been enacted in 1968.[114]

There would be other major benefits in the enactment of a system of withholding. First, such a system would result in proceeds from the state's personal income tax coming into the treasury more evenly instead of coming in mainly in November, April, and May as they do now. The state is currently faced with a serious cash-flow problem which would be substantially eliminated with withholding.[115] Second, it is more con-

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Dakota have no system of withholding. In the 1967 ranking on the basis of the amount of individual income taxes collected per capita, California was twentieth among the states. Thus, California can be classified as a state with a comprehensive income tax. *See* U.S. DEP'T OF COMMERCE, BUREAU OF THE CENSUS, COMPENDIUM OF STATE GOVERNMENT FINANCES 1967, at 12 (1968).

111 California's personal income tax law is codified as Part 10 of the Revenue and Taxation Code, commencing at section 17001. A personal income tax is imposed upon all of the taxable net income of both residents and nonresidents derived from sources within the state. The amount of the tax due is determined either by the use of an optional tax table as applied to adjusted gross income by taxpayers with an adjusted gross income of less than $10,000, or by the use of a graduated rate applicable to all taxpayers, excluding heads of households. CAL. REV. & TAX. CODE § 17041.

112 A PROGRAM OF TAX REFORM, *supra* note 45, at 40.

113 The scope of this problem is demonstrated by Table VIII of the Appendix.

114 The Franchise Tax Board has estimated that "improved compliance" would have produced $25 million in additional revenue in 1970-71 had withholding been enacted. These figures are estimates, but both the Department of Finance and the Legislative Analyst have concurred in these estimates. Based upon the experience of other states, it is estimated other sources not precisely identifiable would produce another $20 million in 1970-71. *See* Table X.

115 The following Table demonstrates this problem:

venient for taxpayers to have taxes withheld than to pay them in one lump sum. Those who do not accumulate the money to pay taxes would have to borrow. The return or advantage that might have been derived from the use of money in the intervening period may not outweigh the interest on borrowed funds or interest or penalties to the state.[116] Third, the state would also receive substantial benefits from receiving income tax revenue sooner. The state would receive approximately $115 million in additional revenue because it would tax and collect economic growth in the income year rather than in the subsequent year.[117]

GENERAL FUND CASH FLOW
1970-71

1970-71	Receipts	Disbursements	Current Deficiency or Excess	Net Borrowing	Total Borrowing
July	$329	$398	—$ 69	$ 69	$111
August	343	470	— 127	127	238
September	234	377	— 143	143	381
October	372	383	— 11	11	392
November	595	400	194	—194	198
December	234	385	— 151	151	349
January, '71	265	391	— 126	126	475
February	389	450	— 61	61	536
March	410	594	— 184	184	720
April	1,071	375	697	—697	23
May	364	345	19	— 19	4
June, '71	374	390	— 16	16	20

Source: LEGISLATIVE ANALYST, ANALYSIS OF THE BUDGET, 1970-71, at 919.

A major change to the Personal Income Tax Law, enacted in 1967 was the declaration of estimated tax provision. This measure was aimed at solving the cash-flow problem; but the prepayment or estimated tax has not solved the cash-flow problem. The change required higher-income taxpayers to make semi-annual payments beginning in October, 1967. For 1968 and subsequent years, taxpayers with an estimated tax of $200 or more or a tax liability of that amount for the preceding year were required to file estimates and pay 50% of the estimated tax on or before the last day of October of the tax year. Approximately 273 million was paid in 1969, which constituted one-fourth of the total personal income tax yield. FRANCHISE TAX BOARD, ANNUAL REPORT 10 (1969).

[116] A majority of people in California favor the enactment of a system of withholding. A Field Poll taken in May, 1968, produced the following count for the citizen's pulse:

Preference, May, 1968	
Pay-as-you-go (*i.e.*, withholding)	58%
Lump-sum payments	34%
Don't know	5%
Qualified	2%

Source: Field Research Corporation California Poll, Release # 605, May 30, 1968, at 1.

Other states which have adopted withholding indicate little, if any, taxpayer opposition. Many states, in fact, report taxpayer satisfaction, something that no other collection method has been able to accomplish. *See* A PROGRAM OF TAX REFORM, *supra* note 45, at 42.

[117] This is not an easy concept to illustrate. The following Table is an attempt. The figures used are hypothetical to illustrate the concept; they are not a representation of actual amounts.

A problem that had caused a great deal of debate is the so-called "windfall" in additional revenue produced in the first year of the implementation of a system of withholding. This windfall or one-time revenue results from the fact that the inauguration of withholding requires the collection of portions of two years of taxes in one year. For example, in the same fiscal year the state under withholding will collect: 1) on April 15, the full tax owed for the prior year and, 2) five months of withholding collections for the current year.[118] Many argue that this earlier payment of taxes required by withholding is in itself an increased tax burden and that the taxpayer therefore deserves special consideration.[119]

This argument leads to the introduction of the concept of forgiveness. Basically, forgiveness is a proposal to eliminate the effect of this "double collection" by reducing the tax liability of personal income taxpay-

HOW WITHHOLDING PRODUCES ON-GOING REVENUE BY GROWTH IN THE TAX BASE REALIZED IN THE INCOME YEAR
(Figures are hypothetical to illustrate the point, rather than actual)

Year	Assumed Taxable Income	Revenue Produced With Average 3% Tax Rate: w/withholding	Revenue Produced With Average 3% Tax Rate: collected following year	Increase Each Year Due to Withholding
1965	21.2 bil.	$ 636 mil.	$ 585 mil.	$51 mil.
1966	23.5 bil.	705 mil.	636 mil.	69 mil.
1967	26.0 bil.	780 mil.	705 mil.	75 mil.
1968	29.0 bil.	870 mil.	780 mil.	90 mil.
		$2,991 mil.	$2,706 mil.	

[118] The amount of this "windfall" in 1970-71 was estimated to be in excess of $500 million. This sum does not appear by magic; but it is a necessary product of withholding.

If withholding begins on January 1, 1971, the money collected through withholding from January 1, 1971, to June 30, 1971, is money that ordinarily would be collected on April 15, 1972. The amount of money so collected can be used in the fiscal year ending June 30, 1971, instead of in the fiscal year ending June 30, 1972.

In addition, the state will collect, on April 15, 1971, income taxes due for the calendar year 1970. This money is also available for expenditure in the fiscal year ending June 30, 1971.

Thus, the state receives the money it would ordinarily receive for operating in fiscal year 1971-71; and, in addition, receives money, through withholding, in fiscal year 1970-71 that it would ordinarily not receive until the next fiscal year.

This additional amount of money received in the fiscal year ending 1971 is the windfall.

[119] But the windfall has *not*, as some have argued become a tax increase. This revenue consists of money owed to the state under law. The dollar tax burden to individual taxpayers does not increase. The advantage to the state is that taxes collected during the first six months the system is in effect can be spent by the state in the fiscal year 1970-71 instead of in the fiscal year 1971-72. Earlier collection can be construed to be a "burden," but it is not a tax increase. Nor is withholding "double taxation." Withholding does require the payment in 12 months of a tax liability accruing over 27½ months, January 1, 1969, to April 15, 1971. But this is "double taxation" only if this can be understood to mean that the taxpayer has to pay taxes sooner than he would if withholding did not exist.

(Assuming a withholding system goes into effect on January 1, 1971, in a 12-month period, April 15, 1970, to April 15, 1971, the taxpayer has paid taxes accruing over 27½ months, January 1, 1969, to April 15, 1971.)

ers.[120] To lessen the taxpayer's burden of paying tax on the immediately past year's income and the current year's income at one time, it is argued that a percentage of the tax due on the previous year's income liability should be forgiven during the first year of withholding.

The tax program proposed a system of withholding. It would have instituted the withholding of state personal income taxes beginning January 1, 1971, and would have required quarterly estimates if a person had $1,000 or more in income subject to tax from other than wages and salaries. If the amount withheld by an employer was more than $50 per month, the employer would remit to the state on a monthly basis; if the amount withheld is less than $50 per month, remittance would be required on a quarterly basis. It also did provide for a 35% credit for 1970 income taxes to eliminate the "windfall" or one-time revenue impact.

G. *Educational Equalization Tax*

California has an obligation to see that all children have an equal opportunity to have an adequate education. But the existing system of public support is not being utilized in the most effective manner.[121] This stems basically from the fact that schools are completely dependent upon the property tax to produce local revenue, which is also utilized as an important source of revenue for other local entities.[122] An analysis of property tax during the past several years, leads to two clear conclusions: 1) that the public schools have had to depend upon the local property tax for an increasing portion of school revenues, and 2) that property tax levies have increased largely as the result of the increase

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[120] The purpose of forgiveness is to reduce or eliminate the one-time revenue that accrues to the state. This is equal to taxes collected through withholding in the months of January, February, March, April, May, and June of 1971, assuming the state begins withholding on January 1, 1971.

[121] *See* LEGISLATIVE ANALYST, ANALYSIS OF THE BUDGET BILL, 1970-71, at 191-222, for a discussion of state expenditures for education and recommendations for improvement of this structure.

[122] An analysis of property tax levies during the past several years, leads to two clear conclusions: 1) that the public schools have had to depend upon the local property tax for a major and increasing portion of school revenues, and 2) that property tax levies have increased largely as the result of the increase in school levies. The following figures compare school district property tax revenues to other major segments of local government:

PROPERTY TAX REVENUES FOR LOCAL GOVERNMENT
1968-69

Purpose	Revenues (in Millions)	Percent of Total
School Districts	$2,449	53.6%
Counties	1,317	28.8
Cities	522	11.4
Special Districts	282	6.2
Total	$4,750	100.0%

Source: Legislative Analyst

in school levies.[123] If property taxes are too high, and have grown too fast, it is largely as the result of the growth of school levies.

This reliance on the property tax has caused problems. Under present conditions, district expenditures differ markedly from district to district. (See Table XI of the Appendix). This is created by the fragmentation of the tax base by the existence of large numbers of school districts with widely differing property values within the districts. As a result, there is a wide variation in the local ability of a school district to support an adequate education program.[124] This variety of combinations of expenditures per pupil and tax base produces a significant variation in the tax rate which property owners are required to bear.[125]

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[123] Testimony relating to school districts and property tax levies presented to a Joint Hearing of the Senate Committee on Revenue and Taxation and the Assembly Committee on Revenue and Taxation in December, 1969, made the following points to support this conclusion:

1) In the period 1953-54 through 1967-68, local property tax support to the general fund of school districts increased from 49.1% to 55.5% while state support decreased from 47.5% to 37.5%.

2) In the period 1955-56 through 1967-68, total school general fund revenues increased 281%. Local property tax revenues increased 321%, while revenues from the state increased 199%.

3) In the same period, the percent of increase in assessed valuation and in total property tax levies were as follows:

a. Percent of increase in assessed valuation, 132
b. Percent of increase in total property tax levies, 232
c. Percent of increase in levies for schools, 312
d. Percent of increase in levies for other purposes—cities, counties, and special districts, 170

4) In the same period, property tax levies for schools increased from 43.4% to 54% of total property tax levies, while other levies declined from 56.6% to 46%.

5) During the same period, tax rates on property for all purposes increased 43%; tax rates for school purposes increased 78%; while tax rates for other purposes increased 16%.

6) During the same period, increases in school levies totaled $1.701 million, which is 312%, and 40% of which growth was due to tax rate increases. And other levies for other purposes increased by $1.204 million, or 19.9% due to tax rate increases.

Joint Hearing, December 16, 17, *supra* note 4, vol. 1, at 35-38.

[124] The following figures show the wide difference in the tax base that exist among school districts:

ASSESSED VALUATION PER ADA
1968-69

	Elementary Level	High School Level	Junior College Level
Low	$ 125	$ 10,350	$ 48,761
Median	12,835	35,347	141,990
High	1,156,872	339,362	377,737

Source: Legislative Analyst

[125] The following was the range of tax rate in 1968-69:

RANGE OF TOTAL TAX RATES
FOR PUBLIC SCHOOL DISTRICTS 1968-69

District Level	Low	High	Average
Elementary	$0.32	$6.75	$2.15
High School	0.92	3.13	1.99
Unified	1.23	6.77	4.12
Junior College	0.35	0.94	0.61

Source: Legislative Analyst

The state attempts to reduce these inequities by means of equalization aid payments, but the difference in educational opportunities and property tax burden remains.[126] The tax reform program attempted to respond to this problem by creating a statewide equalization property tax.[127] It was felt that educational opportunities could be raised to a more acceptable minimum level and school tax burdens could be made much more equal with the enactment of such a tax.[128]

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[126] A discussion of the structure of public school finance is beyond the scope of this article. A brief explanation of school finance is found in note 7, *supra.*

Basically, the state supports local education through the allocation of funds from the State School Fund. The State School Fund is derived from formulas authorizing the annual automatic transfer of money from the General Fund, which is the depository for state revenues, to the State School Fund. The formulas are based on certain statutory and constitutional amounts per pupil in average daily attendance in the preceding year (*e.g.,* CAL. EDUC. CODE § 17301). After the State School Fund is derived, it is distributed into various categories for educational programs and activities specified by statute as eligible for state support. Such programs would include basic and equalization aid which make up the foundation program. Basic to the distribution of funds to local districts is the concept of the foundation program. The Legislative Analyst estimates that in excess of $1.4 billion will be distributed to local districts from the State School Fund for 1970-71: $1.2 billion will be distributed as basic, equalization or supplemental support aid. In essence, the foundation program is a guaranteed minimum level of support identified by the state per pupil, adjusted by a computational tax or a state minimum school district tax rate. The state's role is viewed as that of providing each school district with sufficient support to guarantee adequate education to every student. Individual districts can spend more than the level the state identifies as a minimum financial foundation for education; but the state provides financial support for those districts unable to attain the minimum financial foundation through local taxation. Existing law provides that every school district, including a wealthy district, will receive no less than $125 for each pupil. This amount is known as basic aid. If the combination of the computational tax and basic aid do not provide at least the foundation program level as defined by the state per pupil. The difference will be distributed by the state to the district as equalization aid.

[127] Another approach to equalization is school district reorganization, the merger of many small units into a few large ones. The creation of larger districts would help reduce disparities in the property tax base by combining areas of high and low assessments. In 1964, the state attempted to provide incentives for unification. The total number of districts has been reduced from approximately 1,500 in 1965 to 1,100 in 1969, but efforts for unification are strongly opposed in certain areas. Indeed, a movement for the decentralization of large city school districts in Los Angeles was attempted during the 1970 session.

There are also other options to slowing the growth of property tax levies. For example:

1) The state could automatically provide additional funds to meet its share of inflationary costs.

2) The state could maintain its level of support by adding the amounts of slippage to equalization aid.

3) The state could assume a larger portion of school costs by increases in the foundation program, and through an increase in the homeowners' exemption. More than half of all the money replaced by the state under the homeowners' exemption turns up as school revenues in school budgets.

But most of these alternatives are beyond the jurisdiction of the Assembly Revenue and Taxation Committee and should be considered as part of a much needed educational reform proposal initiated by the Education or Finance Committees in the Legislature. The statewide property tax is an equalization alternative relevant to a tax reform proposal. For this reason, it should be incorporated in a tax reform measure. But no attempt should be made to reform the entire structure of education finance, or to provide a system for increased school support in a tax reform measure. This is a task for another reform proposal.

[128] The financial structure of public education and the gross variations in per pupil expenditures from school district to school district have brought a constitutional attack on the entire structure in Michigan. For an excellent article of this subject and

A statewide property tax for schools means pooling a portion of present property tax levies for schools and utilizing this revenue to equalize school support. Under the tax program, each county would have been required to levy a $2.05 tax, which is the same as the existing computational tax rate on all the assessed valuation in the county, collect the tax and deposit this revenue in the State School Fund. This revenue would then be redistributed as equalization aid. Whereas under the present system the state minimum tax or the computation tax proceeds only have an impact on equalization aid districts, the proposal would have resulted in a distribution of property tax revenues collected in wealthier, basic-aid districts, to less wealthy, equalization-aid districts.[129] The Legislative Analyst estimated that a $2.05 statewide property tax would produce an additional $60 million during 1970-71 in equalization aid. This would have significantly decreased the disparity between high-wealth and low-wealth districts.[130]

A statewide property tax should be instituted in connection with a major tax reform program. If the homeowners' exemption is increased at the same time that a statewide property tax is enacted, the adverse impact of the statewide property tax on homeowners in high-wealth dis-

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proposed solutions, see Coons, Clune, and Sugarman, *Educational Opportunity: A Workable Constitutional Test for State Financial Structures*, 57 CAL. L. REV. 305 (1969).

[129] Approximately 375 districts in which about 10% of the pupils are enrolled, which have a high property tax base, would be required to increase tax rates to maintain the same level of school services. The statewide tax will require such districts to contribute more to the equalization fund than is returned to the district. How this operates in a rich district is shown as follows:

Assume

Foundation Program	$ 355
Statewide Tax	1
AV/ADA of District	30,000
State Average AV/ADA	14,000

Apportionment of:	At Present	Under Statewide Tax
Basic Aid ($125)	$125	$125
Equalization Aid ($125 +140 —355 = 90)	—	90
Property Tax Equalization (× $14,000)	—	140
District Tax Levy	300	—
TOTALS	$425	$355
Difference	—$ 70	
Tax Rate Difference	—$ .23	

[130] The Legislative-Executive Tax Study Group estimated that a $2.05 statewide property tax would reduce the disparity in expenditures as follows:

Present Law	Cost Per ADA	Ratio
Baldwin Park (Low-Wealth)	$ 533	1
Beverly Hills (High-Wealth)	1,794	3.4
Statewide Tax at $2.05		
Baldwin Park	$ 545	1
Beverly Hills	1,200	2.2

tricts would be diminished. Property tax rate decreases stemming from the state assuming much of the county welfare burden as part of tax reform would also lessen the impact on "adversely-affected" school districts. This would reduce the political opposition from school districts adversely affected.

H. *Expenditure Control Limits for School Districts and Local Government*

A mechanism must be created which would guarantee that state funds provided for property tax reduction in a tax program will not be consumed by higher local spending. There must be a device which would insure that state funds for tax relief does end up as relief to the taxpayer. We have all been presented with ample evidence of the high growth rate of school expenses and local property taxes as well as the general need for some rational means of limiting this rampant increase.[131] It has also been demonstrated many times that the existing tax rate limits on schools are not a rational or effective way of limiting expenditures.[132] There can be no tax relief through a major tax reform package or any other tax relief measure if the legislature does not limit the growth of the property

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[131] *See* notes 122 and 123 *supra.*

[132] The following statement was included in A.B. 606 during the 1969 Legislative Session:

> The Legislature hereby declares that the concept of school property tax control by means of tax rate limits has failed to control either school expenditures or school tax rates. It is the intent and purpose of the Legislature to develop methods of limiting school property taxes while insuring continued voter participation in determining limitations. Expenditure control, as well as other methods of limitations shall be examined in the furtherance of this legislative intent. CAL. STATS. 1969, c. 784.

A system of maximum tax rates to control school property taxes has been in effect since 1931 (CAL. EDUC. CODE § 20751). It has not been proven effective for a number of reasons.

1) Tax rates higher than statutory minimum rates exist in about 93% of California's school districts.

PERCENT OF DISTRICTS ABOVE STATUTORY MAXIMUM RATES 1967-68

Elementary	96.9%
High School	98.3%
Unified	95.3%
Junior College	21.7%
Total	92.8%

2) The legislature has authorized at least 33 "permissive override taxes" that may be levied for particular purposes over and above any existing statutory maximum (CAL. EDUC. CODE § 20751) or voted maximum taxes rates (CAL. EDUC. CODE § 20803).

3) The maximum tax rates established were not equitable among districts because of the wide variation in AV/ADA existing. A $1 tax rate in a district with $5,000 in assessed valuation per ADA will provide $50 per pupil while the same rate in a district with $20,000 in AV/ADA will provide $200 per pupil.

4) The variations in AV/ADA required the low-wealth districts to seek higher rate increases than moderate- or high-wealth districts.

tax at the local level. Therefore, A.B. 1000 proposed a provision to limit the expenditures of schools, counties, and cities.

a) *Schools*—Effective 1971-72 with a base year of 1969-70, expenditures for current expenses[133] per average daily attendance (ADA) for each school district would have been limited to the amount spent in the prior year per ADA, plus a factor for growth (the factor is the percentage increase of the consumer price index). The limits could be exceeded by one percent for unexpected emergencies if approved by the county board of supervisors. The limit could also be increased by a vote of the people. Excluded from current expenses are funds received by the federal government and from private sources, funds for pre-kindergarten education and those funds produced by permissive overrides which are still authorized by A.B. 1000.

For other than current expense, a district could have levied either:

1) a maximum rate of $.13 per $100 of assessed valuation for elementary, $.08 for high school, $.21 for unified, or,

2) the rate presently voted or levied by the district. Increases in these limits would be permitted if approved by a vote of the people.

Districts are allowed to continue levying a tax rate to retire bonds and repay school building loans, to hold elections and to match federal or nongovernmental funds.[134] Existing tax rate limits and *most* authorized permissive overrides were repealed.[135] Permissive overrides are allowed to continue for certain essential programs such as community services, child care centers, mentally retarded programs, educationally-handicapped programs, development centers for the handicapped, adult education, retirement costs of classified employees, Personnel Commission, earthquake safety, regional occupational centers and certain build-

[133] The term "current expenses of education" is an accounting term which has been used for several years by the Department of Education. The current expenses of education are the current operating expenditures of a school district, including those expenditures charged to Classes 100 through 800 of the California School Accounting Manual. Specifically, such expenditures would include teachers' salaries, pupil transportation, operation of the physical plant, health services, and certain fixed charges such as employees' insurance. *See* STATE DEPARTMENT OF EDUCATION, CALIFORNIA SCHOOL ACCOUNTING MANUAL 24-28 (1968). The manual is officially approved by the Board of Education (CAL. EDUC. CODE § 17199).

[134] Federal funds or federal grants would not be included within the expenditure control limit. A district was empowered to levy a property tax rate to generate local matching funds.

[135] Several permissive overrides slipped back into A.B. 1000 because of political pressure from educational groups hell-bent on preserving their particular special program. Several of these permissive overrides contained maximum limits. For example, adult education (CAL. EDUC. CODE § 20802.8) has a $.10 per $100 of assessed valuation limit. It can be argued adult education would have been in a more advantageous situation under an expenditure control limit which would assure these programs of a cost of inflation growth even above their maximum limits.

ing repairs.[136]

If a district had voted an override but not levied the full amount of the tax authorized, the bill allowed the district to get credit for the balance of an unused override. A provision also required the state to increase state apportionments per ADA to school districts by the same percentage that the consumer price index has increased.[137] This would have created a guaranteed obligation of increased state support for schools for inflation.

> b) *Counties*—Effective 1971-72, current expenses for countywide services (excluding public assistance, libraries, public protection, services in the unincorporated areas, elections, contract services and services required by law) per capita by each county are limited to the prior year's current expenditures per capita plus a factor for growth (the factor is the percentage increase in the consumer price index). The limit may be exceeded by 2% for unexpected emergencies by a 4/5th vote of the supervisors. The limit could also be increased by a vote of the people.

A separate limit was created for public assistance. Expenditures by counties for public assistance were limited to the prior year's expenditures plus a factor for growth (the factor is the average percentage increase in public assistance expenditures for the prior three years). This limit may be exceeded by 1% for unexpected emergencies by a unanimous vote of the supervisors. If the supervisors believe that this limit will endanger the peace, health or safety of the county's residents or prohibits expenditures required by law, they could request from the State Director of Social Welfare an increase in the limit.

These provisions would have more effectively limited the extent to which counties, cities, and schools districts could levy property tax rates. Under present law, counties are not subject to expenditure or tax rate limits. As mentioned previously, schools are subject to crude tax rate

[136] There was a basis for continuing certain permissive overrides. Regional occupational centers (CAL. EDUC. CODE § 7456), and child care centers (CAL. EDUC. CODE § 16633) are programs which are basically welfare programs rather than an educational program; earthquake safety (CAL. EDUC. CODE § 15518) is mandated under state law to conform with specific requirements and local district should retain flexibility to conform to mandated safety requirements.

[137] BUREAU OF LABOR STATISTICS, CONSUMER PRICE INDEX FOR URBAN WAGE EARNERS AND CLERICAL WORKERS, commonly known as the CPI, measures the changes in prices and goods and services. It is generally regarded as the principal indicator of changes in the cost of living. Initially, the CPI was based upon a survey of expenditures by wage earners and clerical workers in 1917-19. The weighting factors, the list of items and the cities in which price data were collected for the index have been updated several times since that period to keep pace with changing buying habits. The CPI measures price changes from a designated reference period. Since 1962, the base period has been the average of the three years of 1957, 1958 and 1959 as equal to 100. By dividing a dollar by the U.S. CPI of 127.7, the purchasing power of the dollar becomes $.78. This means that the dollar of the base period of 1957-59 is equal to $.78 today.

limits, with a number of exceptions.

School districts strongly opposed the creation of these limitations in the tax program;[138] but there are some obvious advantages of this concept to school districts:

a) An expenditure limit is far more flexible than existing maximum tax rates, and the currently inadequate permissive override method of financing is almost totally repealed. School districts would no longer have to be forced to spend available funds in special categories authorized by permissive overrides, but could allocate their resources to best meet the district's priorities or needs.

b) Districts would no longer be at the mercy of radical changes in assessed value, and therefore radical tax rate changes.[139]

c) Low wealth districts would be guaranteed cost-of-living growth. Their growth would no longer be limited by the lower assessed value growth that they experience.[140]

d) Expenditure limits provide a more orderly pattern for school financing than the existing tax rate limits. Districts would be dependent on assessed value changes; they would have a known and predetermined expenditure amount that they can budget as they wish and at an earlier date.

A principal criticism of the education lobby in regard to A.B. 1000 and A.B. 1001 was that it did not solve the problems of school finance and that, in fact, the expenditure control limits only enhanced the problem. This criticism is erroneous on both premises. Tax reform is not intended to finance schools. The criticism of tax reform was based on the desire for more state money on the part of school officials. A tax program should not purport to meet this problem. But this tax reform program did help schools.

a) The bill would have required the state to annually increase its school apportionments by the cost of living.

b) Replacement funds to school districts for reduction in assessed value due to the Land Conservation Act of 1965 were provided

138 Genuine mechanical problems with certain portions of the expenditure limit provisions existed. However, school officials did not bring these defects to the Assembly Revenue and Taxation Committee, but waited for the Senate Revenue and Taxation Committee to launch their attack.

139 This one feature of existing law is probably more responsible for the school crisis than any other. Schools get a big one-shot increase in assessed value in one year due to cyclical reassessments by the county assessor (16% for example). They spend this and the next year when there is a small increase (1%), they are in financial difficulties and possibly near bankruptcy. In other words, the existing system encourages districts to use one-time windfalls in assessed value and then get into trouble in the following year.

140 Low-wealth districts must depend on growth in assessed value to finance increasing costs without tax rate increases. But low-wealth districts traditionally experience lower rates of growth in assessed valuation than wealthy districts. A.B. 1000 would have allowed poor districts to grow at the same rate as wealthier districts.

in A.B. 1001; school districts get nothing under present law.

c) Schools would have received $25 million in new revenue because the homeowners' exemption becomes larger than the veterans' exemption, many claimants will shift from the latter to the former.[141] The homeowners' exemption is fully funded by reimbursement from the state while the veterans' exemption has never been funded by the state.

d) According to the Senate Office of Research, the increase in the homeowners' exemption would increase the state share of the educational support. If this package had passed, the state share of the educational support would be 41.3%. This is in line with pleas of school officials that the state assume a larger portion of the cost of education.

I. *The Minimum Income Tax*

In 1969, the United States Congress enacted the most comprehensive tax reform measure in modern history.[142] It started through Congress with the goal of ending or minimizing many specialized tax shelters, tax breaks and tax preferences. But the final law ended up a combination of tax relief, tax reform and new tax preferences.[143] The principal goal of the Federal Tax Reform Act of 1969 was to eliminate or limit many of the advantages in the income tax law which permitted taxpayers with substantial incomes to escape the income tax.[144]

141 CAL. CONST. art. XIII, § 1¼, provides that every legal resident of California who has served in the Armed Forces during time of war and who has received an honorable discharge, or who after war-time service has continued in the Armed Services, or who has been released from active duty because of a disability resulting from such service in time of peace, is entitled to an exemption of assessed value of $1,000, or lacking this amount of property in his name, as much of the property of his wife as is necessary to equal this amount. Widows, widowed mothers, are entitled to the same exemption. No exemption can apply if the claimant or his wife owns taxable or non-taxable property of the value of $5,000 or more, or $10,000 in community property. In determining this limitation the assessed value of taxable property and actual market value of non-taxable property is used.

A veteran has the alternative of filing for the $1,000 veterans' exemption or the $750 homeowners' exemption. Obviously, most veterans choose the $1,000 veterans' exemption. With the increase of the homeowners' exemption to $1,000 assessed value, plus 20% of the remaining assessed value, many veterans would have shifted to the state-funded homeowners' exemption. The Department of Finance estimated that this "shift" would have resulted in a $40.2 million "windfall" to the counties.

142 For the provisions of the Federal Tax Reform Act of 1969, see CCH, TAX REFORM ACT OF 1969 (1969); CCH, EXPLANATION OF THE TAX REFORM ACT OF 1969 (1969).

143 Few tax advantages were completely eliminated, but several were substantially limited. For example, the use of accelerated depreciation of real property was curtailed (IRC § 521). But other tax advantages such as tax-exempt interest for state and local bonds and the deduction for intangible drilling costs of oil wells were not touched. Several new tax advantages were added. Investors in low- and middle-income housing can defer their tax on the capital gain from the sale of such housing if they reinvest the proceeds in similar housing (section 167(k)). A provision providing for a rapid write-off or amortization of pollution control facilities were added (section 704).

144 HOUSE COMM. ON WAYS AND MEANS, TAX REPORT OF 1969, H. REP. No. 413, 91st Cong., 1st Sess., Part 1, 1-4 (1969).

Such a host of concepts were contained in the Act that the legislature in 1969 created the Joint Committee on National Tax Policy to study and examine its provisions. As a result of the Joint Committee's study, the tax reform program incorporated many of the specific provisions of the federal act, including the minimum income tax concept.[145] The purposes in adopting the minimum income tax provision for California were similar to those of the federal Congress: to reduce the capacity of wealthy individuals and corporations to escape the income tax law and to make sure that taxpayers who overindulge in so-called tax preferences pay a fair share of the tax burden.[146]

The provisions for a minimum income tax incorporated into A.B. 1000-1001 were similar to the federal provisions.[147] A 1.5% state minimum income tax would have been imposed on certain tax preference items such as accelerated depreciation on real property, bad debt deductions of financial institutions, the excess of percentage depletion over cost depletion, and tax benefits from stock options. The tax would have been computed on the gross amount of exempt income, less: 1) $30,000; 2) the income taxes paid for the taxable year; and 3) any net losses. As proposed, this minimum income tax provision would produce approximately $14 million in revenue for California. For example, if an individual received $200,000 of income from preferential sources such as percentage depletion and pays $20,000 of regular state income tax, he would subtract $30,000 from his preferential income, leaving $170,000. He then would subtract the $20,000 leaving $150,000 taxable under the 1.5% state minimum tax. Thus, he would pay $2,250 in addition to his regular income tax. The minimum income tax is a means of remedying the progressiveness of our state income tax system and is a concept which should be incorporated into a tax reform program.[148]

[145] A.B. 1000-1001 contained over 20 provisions conforming California tax laws to the Federal Tax Reform Act. California has followed a policy of piecemeal conformity in regard to the personal income tax, since its adoption, with legislative changes to accord with the federal law being made based on particular conditions and revenue needs. Federal regulations are followed as closely as possible and federal administrative and court interpretations of federal law have been adopted whenever state and federal law do conform. Conformity between state and federal income tax law eases the administrative burden and the complexity of the law. The selected provisions incorporated into the tax reform program from the federal act would have added $16 million in revenue for property tax relief. These provisions would have also significantly closed certain loopholes in the state income tax law as well as achieved conformity. These were the reasons for the inclusion of the conformity income tax provisions in a tax reform program whose main goal was property tax relief.

[146] The term "tax preference" usually refers to amounts of income not subject to taxation or deductions which save regular income tax or capital gains tax for the taxpayer who takes them. Specifically, items of tax preferences subject to the minimum income tax are listed in IRC § 57.

[147] There are minor differences. The federal minimum income tax provision applied a 10% rate to preference income. IRC Section 56(a).

[148] The Advisory Commission on Tax Reform considered the minimum income

J. *Oil Depletion*

Sections 24832 and 17686 of the Revenue and Taxation Code provide that in the case of oil and gas wells, the allowance for depletion shall be 27½% of the gross income from the property during the income year, excluding an amount equal to any rents or royalties paid by the taxpayer. This allowance cannot exceed 50% of the net income of the taxpayer from the property.[149] As a normal procedure in taxation, a taxpayer is entitled to depreciate his initial investment in plant and equipment over a period of years by treating a percentage of such investment as an annual expense until the original investment is returned. This process is called depreciation. Percentage depletion is a departure from the usual rule that only the cost of an asset may be recovered tax free. A taxpayer is allowed to deduct a fixed percentage of his gross income as a deduction without regard to the cost of the asset being dedepleted. He deducts 27½% of the gross income from his producing property, but not more than 50% of the net income from that property.

There are several rationales offered for the depletion allowance. It is suggested that the depletion allowance is necessary to encourage exploration and development of oil reserves. Existing law does not require the money retained by the taxpayer as a consequence of the depletion allowance to be invested in extractive enterprises. Economic research has not indicated that the depletion allowance has resulted in a large increase in reserves.[150] It has also been pointed out that

> in the long-run percentage depletion does not significantly encour-

tax as a method of rectifying the situation. The Commission cited the following figures from a United States Treasury Department study: almost 50% of individuals with incomes from taxable sources of between $500,000 and $1 million and over 50% of the individuals with adjusted gross incomes of $1 million or more will pay tax at an effective rate of less than 30% of their true income. But about 65% of the individuals with adjusted gross income between $50,000 and $100,000 will pay tax at an effective rate of more than 30%. In other words, a larger percentage of the taxpayers in the $50,000 to $100,000 group will pay tax of over 30% than in the over $500,000 income group. The minimum tax would receive most of its revenue from taxpayers with $500,000 or more of exempt income each year (60%). A substantial portion would also come from individuals with between $100,000 and $500,000 of exempt income (25%). ADVISORY COMMISSION ON TAX REFORM, TAX REFORM REPORT 14, 15 (March, 1969).

149 The depletion allowance, in its present form, has been with us since 1926 as Federal legislation, since 1929 as state legislation covering corporations and since 1935 for individuals. Until 1969, federal and state provisions provided that 27½% of the gross value of oil and gas production is free of income taxation, up to a limit of 50% of net income from the property. The Federal Tax Reform Act of 1969 decreased the depletion allowance for oil and gas from 27½% to 22% (IRC, § 613(b)). Under federal law, there are approximately 103 different minerals which have depletion allowances. California law also recognizes a depletion allowance for a variety of minerals. (*See* CAL. REV. & TAX. CODE §§ 24833, 17687).

150 Walter J. Mead, The Economics of the Depletion Allowance, at 5, presented before the Assembly Revenue and Taxation Committee, June 10, 1969, on file with the Assembly Revenue and Taxation Committee, Room 4016, State Capitol, Sacramento, California.

> age the allocation of additional real resources to exploring presently unproductive oil lands. The depletion allowance is primarily an ad valorem subsidy to mineral rights owners.[151]

Depletion subsidizes existing mineral rights owners and does not necessarily encourage allocation of real resources to unproductive lands. Another rationale for depletion is that extractive enterprises such as oil and gas are vital to our national defense. This justification is of doubtful merit, but regardless of its merit budgetary support for national defense is a function of the federal government, not the State of California. A justification for depletion also mentioned is that the development of mineral resources is a high-risk endeavor. This risk should have a sweetner, preferrably green in color. However, it is unlikely that the high-risk of loss in discovering and exploiting oil and mineral resources is related to depletion. Most of the depletion allowance goes to individuals who take no risks at all, or can afford the risk.[152] National figures indicate that oil companies have a very low rate of business failures which would seem to undermine the glamour of the risk.[153]

The argument is frequently heard that the elimination of percentage depletion will cause the shut-down of thousands of marginal producers. However, the "mom and pop oil well" or the small marginal producer gains little or nothing from percentage depletion and its elimination would not affect him to any considerable extent. A marginal producer

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151 Davidson, *Policy Problems of the Crude Oil Industry*, AMERICAN ECON. REV. 107 (1963).

152 Most of the money spent for drilling wells is not in high-risk areas, but in fields where production already exists. It should be mentioned that CAL. REV. & TAX CODE §§ 24423, 17283 allow an oil operator to deduct as expenses intangible drilling and development costs. Intangible drilling costs include such items as labor, material, supplies, fuel, power, tool and truck rentals, and repairs of drilling equipment. The operator is permitted to deduct that part of his investment in oil production facilities classified as intangible drilling expenses by: 1) deducting his expenses in the year incurred, or by 2) annual depreciation. This advantage gives the oil operator a 100% accelerated depreciation. The operator deducts drilling expenses and any production on the property is subject to percentage depletion. This type of tax treatment can do much to dry the tears of an operator who comes up with a dry hole. In fact, the interplay between the depletion allowance and the intangible drilling expense deduction creates certain tax problems for an operator. The intangible drilling expense deduction can cause a company to "lose" its depletion allowance. For example, support "A" has a gross from an oil property of $10,000,000 but he also expends this for intangible drilling expenses and other current charges. He, therefore, has no net and is allowed no percentage depletion. He has in effect lost a deduction of $2,750,000 irrevocably.

In order to avoid this "A" may choose to sell a "carved-out oil payment." These may be in various forms but essentially involve the sale of future production. In the instant case we will assume "A" sells a production payment for $10,000,000 the amount to be paid the purchaser over a period being $10,000,000 plus an interest and profit factor.

In such circumstances, "A's" depletable gross for the year will be $20,000,000 on which depletion of $5,500,000 will be allowable. "O" has saved the $2,750,000 deduction he would otherwise have "lost."

153 Bruce Walker, before the Joint Hearing of the Senate Committee on Revenue and Taxation and the Assembly Committee on Revenue and Taxation, MAJOR TAX REFORM, vol. II, at 274-280, (December 17, 1969).

does not have the outside income to offset against depletion. The elimination of depletion in California, it is argued, would hurt the California producer. But at the state level, the value and advantage of the depletion allowance is limited by the relatively low-income tax rate and the fact that state taxes can be deducted from federal taxes.[154] A second response to this argument is that major oil companies doing business in California also do business in other states or other areas of the world. Their entire nationwide or worldwide net income is considered as a unitary whole under California law, the portion taxed by California law being determined by formula. In such cases, depletion gives such corporations a benefit on income and property located in other states and foreign countries. The depletion allowance said to be so helpful to California oil industry, actually in part, is an allowance against Arabian oil income and of dubious benefit to California.[155]

When the clouds of debate rise from the subject of oil depletion, the fundamental issue remains: Are extractive enterprises of such overriding importance to our economy that they should be encouraged and rewarded with large amounts of tax free income? A "yes" answer has the following implications: 1) other taxpayers must carry a heavier burden in order that these extractive enterprises may enjoy a tax advantage; 2) equity between individuals or businesses having similar net incomes is abandoned; 3) extractive enterprises are accorded a higher value than such other essential pursuits as providing food, medical care, education or other necessary goods and services.

The legislature should seriously consider limiting or eliminating the oil depletion allowance. This is a special tax deduction not enjoyed by other businesses who also have assets which are losing value or being depleted due to obsolescense and use. The tax reform program limited the deduction to five times the original investment cost. The taxpayer could continue to deduct 27½% of gross income, up to 50% of net income until the point that the depletion allowance taken amounted to five times cost. A study by the Franchise Tax Board of the depletion allowance for 1967-68 revealed that on the average percentage depletion results in a deduction equal to 15.6 times the original investment cost.[156] The tax program would have significantly limited the depletion concept, as well as providing $15 million in revenue for property tax relief.

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[154] For example, a special deduction for state purposes of $1,000 is worth $70 at the present corporate rate less the federal tax on the $70 or a net savings to the corporation of about $35. Corporations, particularly oil corporations, do not base their actions on insignificant tax incentives.

[155] *See* note 153 *supra*, at 246, 47, 62, 63.

[156] *Id.* at 256-59.

K. *Welfare Costs*

If pressure from tax reform arises partly from a feeling that the California revenue system relies on the property tax for too large a percent of the costs of government, then the state should consider a takeover of all or a portion of the county costs of social welfare.[157] The assumption of a portion or all of the costs of county social welfare would also equalize the welfare burden among the counties and partially reduce the heavy load from counties with high-welfare costs. The Legislative-Executive Tax Study Group identified several tax advantages of a proposal to assume local welfare costs:[158]

1) Because tax levies for the support of social welfare vary from county to county, a shift of this cost to the state would bring greater equality to such levies. As Appendix A shows, the tax rate in some counties for social welfare is more than five times the tax rate in other counties. In general, metropolitan and valley counties have high-welfare costs. Orange County, Ventura County, and several mountain counties have relatively low-welfare costs.

2) Shifting the county cost of social welfare to the state would reduce county property tax levies on all kinds of taxable property. According to the Tax Study Group, approximately 35% of the reduction would go to the homeowners; the remaining 65% would go to business property.[159]

3) Since social welfare expenditures are an important cause of county property tax growth, the removal of such costs from the county tax base would slow the rate of county property tax growth. The county cost of social welfare is growing at an average rate of 16% per year;[160] eliminating this factor would reduce the percentage growth of county taxes by one-sixth.

4) It can be argued that the income maintenance portion of social welfare costs should be paid entirely by state and federal taxpayers. This argument is based on the supposition that the social benefits of income maintenance programs extend beyond the county-of-residence of the recipient. People holding this point of view argue that these costs should be paid by taxpayers having the greatest ability to pay taxes. Assuming that state taxes measure ability-to-pay better than property

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[157] The Legislative-Executive Tax Study Group informed the Legislature that presently the counties pay, through property taxation, 36% of the non-federal cost of social welfare. A comprehensive explanation of the social welfare system in California is a complex undertaking beyond the scope of this article.

[158] *See* Legislative-Executive Tax Study Group, Preliminary Report, 59-62 November 14, 1969. This unpublished report is on file with the Assembly Revenue and Taxation Committee.

[159] *Id.* at 60.

[160] *Id.*

taxes, it is arguable that shifting from property taxes to state taxes for the support of the income maintenance portion of social welfare increases the equity of the tax structure.

5) Removing social welfare costs from the county budget might improve taxpayer understanding of local expenditures, improve the responsibility of local government, and may lessen taxpayer dissatisfaction with welfare expenditures. Some people suggest that welfare has been used to divert taxpayer attention from other portions of the county budget. If that is so, such a proposal might increase taxpayer understanding of county taxes and expenditures and lower the political tensions associated with welfare expenditures.

A.B. 1001 proposed to assume a greater share of local welfare costs. It provided for a uniform state-county sharing ratio on the nonfederal portion of all categorical aid programs. Under existing law, these programs have the following sharing ratios:

	Nonfederal Cost	
Program	State	County
Old-Age Security	85.7%	14.3%
Aid to Needy Disabled	85.7	14.3
Aid to Blind	75.0	25.0
Aid to Families with Dependent Children	67.5	32.5

The tax program changed the ratios so that they would all be 75% state and 25% county. According to the Legislative Analyst, this change would increase state costs by about $5 million in 1970-71.

Second, A.B. 1001 proposed an equalization formula whereby the state would absorb 60% of the mandatory county categorical aid costs which exceeded the equivalent of a 25¢ county property tax rate.[161] Third, the state would have absorbed all of the existing county costs for Medi-Cal which are about $106; but the state would discontinue the $35 million grant it makes to the counties under the medically-indigent "option" program.[162] The net effect of these two changes is an in-

[161] This feature resulted in equalization between counties for the costs of welfare categorical aid programs because counties making higher taxing efforts to fund such programs received additional funding from the state while counties making low taxing efforts in this area were subject to the strict 75% state/25% local sharing ratio. This feature operated as follows. If the 25% local share in a county exceeded the amount produced by a 25¢ tax rate, the state would assume an additional 60% of the difference between the 25% share and the 25¢ tax rate equivalent. The equalization results were dramatic. For example, Orange county's tax rate for welfare programs would have increased by 11.6¢ because of their presently low taxing effort for such programs, while San Francisco's tax rate for these programs would have decreased 31.8¢ because of their high level of taxing effort. This result occurs because San Francisco would have been eligible for the additional state aid while Orange County would not.

[162] The California Medical Assistance Program (Medi-Cal) was initiated on

crease of $71 million in state costs and a corresponding reduction in county costs.

The total impact of the provisions of A.B. 1001 was estimated by the Legislative Analyst to be an assumption by the state of $162 million of local welfare costs for 1971-72. The impact of these provisions on the tax rate in each individual county is summarized in Appendix B.

Financing Tax Reform

To provide the necessary revenue to finance property tax reduction, a number of adjustments in the tax structure were to have been made. Several of the reform provisions previously discussed, such as the minimum income tax and withholding would have provided a significant amount of revenue to finance the relief aspects of the program.[163] A tax reform program must provide sufficient revenue to finance the proposed relief. Expenditures for relief must be balanced by equal amounts of revenue so that tax increases will not be required in future years to finance the program. This means that the growth rates of revenues must approximate the growth rates in the relief. The major sources of revenue to finance the relief provisions of the tax program were the following:

1) *The Sales Tax*—A.B. 1000 would have increased the sales and

March 1, 1966, as the result of legislation enacted in 1965. *See* CAL. WELF. & INST. CODE § 14000 *et seq.* Along with the categorical aid program, it constitutes a major component in California's welfare structure. The estimated total cost of Medi-Cal for the 1969-70 fiscal year was $1,059,587,377.

The program provides medical assistance to families with dependent children, to the aged, blind, and permanently and totally disabled individuals whose income and resources are either insufficient to meet the cost of necessary medical services or are so limited that their application toward the cost of such care would jeopardize the person's or family's future minimum self-maintenance and security.

The total Medi-Cal cost has three component parts: 1) cost of care, 2) the county option, and 3) program administration. Cost of care includes the payment for medical care provided by physicians, dentists, hospitals, nursing homes, etc., to recipients of public assistance and the medically indigent. The county option cost is that which is paid by both the state and the county for provision of medical care to county indigent patients in county hospitals. Administration is the cost of administering the program which is carried out by the state, the counties and the fiscal intermediaries. The fiscal intermediaries, Blue Cross North, Blue Cross South, and Blue Shield, process and pay all the claims for payment submitted by providers of care.

Funding is provided by the federal government in the amount of approximately 50% of the total cost of care. The state and county governments share the remainder in the amounts computed under various provisions of the Welfare and Institutions Code.

The county option program guarantees state participation in the cost of hospital care for county indigents who are not otherwise covered by state medical assistance programs including the Medi-Cal program. It is a joint county-state program not matched by federal funds. Persons eligible for care under the option program are persons without the ability to pay who are neither eligible for public assistance nor covered by insurance. Thirty counties covering 82% of the cost of all county hospital services have chosen the option method of paying for the cost of care for those county indigent patients.

[163] For example, withholding would have provided an estimated $222 million in revenue for tax relief in 1971-72. *See* Table XII of the Appendix.

use tax rate from 5% to 6%.[164] Present law taxes sales transactions at 5%, allocating 4% to state government and 1% to cities and counties.[165]

Although several objections were voiced to an increase in the sales tax on the grounds that it is a regressive tax, the sales tax in California exempts food, housing and prescription drugs from taxation. In doing so, the sales tax in California becomes nearly a proportional tax. Recent studies indicate that the California sales tax has an index falling between .81 and .98 (1.00 indicates a proportional tax and less than 1.00 indicates a regressive tax).[166] In terms of the tax program, the sales tax increase partially offsets both the benefit of the renter credit and the homeowners' exemption.

2) *The Income Tax*—Two new rates were proposed at the top of the existing income tax structure in California.[167] An 11% bracket was proposed for incomes above $16,000 ($32,000 for joint returns) for the 1972 income year. In 1973, a 12% bracket would be added for joint returns above $36,000. There would have been no increase in personal income tax rates for joint returns below $32,000 and single returns below $16,000. Under present law, 10% is the highest income tax rate, applicable to taxable incomes over $28,000.

Increasing the tax rate for higher income taxpayers compensates for

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164 The sales tax provisions begin at section 6001 of the Revenue and Taxation Code. The state imposes a sales tax of 4% on all sellers at retail for the privilege of selling certain kinds of tangible personal property. (section 6051 of the Revenue and Taxation Code). Another 1% is collected on behalf of cities and counties (sections 7200-7207). A use tax is also imposed on the use, storage or consumption in California of tangible personal property purchases from any retailer for storage use or consumption in the state (section 6201 of the Revenue and Taxation Code).

165 Opponents of the tax program charged that the 1% increase in the sales tax would have given California the highest sales tax in the United States. This is simply not true. It must be noted that the 1% increase would not be utilized to finance the cost of government, but for property tax relief to California taxpayers. New York, Pennsylvania, and Alabama all impose a 6% sales tax to finance local and state government without tax relief. Alaska, Colorado, Connecticut, Illinois, Kentucky, Maine, Mississippi, and Rhode Island impose a 5% sales tax to finance the expenditures of government.

166 Critics of sales taxation have argued that sales taxes are less desirable because they are regressive. The ability-to-pay principle is largely the basis for this contention. Since the sales tax is a tax on consumption, and lower income families generally consume a larger percentage of their income than high income families, the argument is that sales taxes are regressive and should be rejected on equity grounds. But the regressivity of the sales tax in California is mitigated because the exclusion of food from sales taxation. This exclusion makes the California sales tax much less regressive than it otherwise would be. For an excellent analysis of the incidence of the sales tax burden in California, see ASSEMBLY INTERIM COMMITTEE ON REVENUE AND TAXATION, THE SALES TAX, Part 4, vol. 4, no. 11, at 31-71 (December, 1964).

167 The Personal Income Tax Law (CAL. REV. & TAX. CODE §§ 17001-19452) imposes a tax on the taxable income of individuals (other than heads of households), estates, and trusts at progressive rates ranging from 1% on taxable income of not more than $2000 to 10% on any portion of taxable income in excess of $14,000. Heads of households are taxed at graduated rates varying from 1% on taxable income of not over $3,000 to 10% on income over $15,000. *See* CAL. REV. & TAX. CODE §§ 17041, 17042, 17731.

the higher property tax relief that they would receive in the form of the proposed $1,000 plus 20% of the remaining assessed value homeowners' exemption.[168] The flat 20% percentage reduction would give more property tax relief to taxpayers with higher value homes. As Table XII of the Appendix indicates, the 11% and 12% brackets would provide approximately $92 million in revenue.

3) *Bank and Corporation Tax*—The tax program would have increased, effective July 1, 1972, the bank and corporation franchise tax from 7% to 7½%. For banks and financial institutions, the maximum tax rate was also increased ½% from 11% to 11½%.[169] In the first full year of the effectiveness of these provisions, this increase would have provided $50 million per year in revenue.

It is equitable that the business community share in the costs of a program of property tax relief as the benefits of such a program will be widely distributed among all segments of the state's economy. The business community would have received general property tax relief through the welfare provisions of the package as well as more specific relief in the form of the business inventory exemption. The timing of the increase was set to correspond to the increase in the cost of the inventory tax for the 1972-73 fiscal year.[170]

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[168] *See* note 72 *supra* for an explanation of the $1000 plus 20% of remaining assessed value homeowners' exemption.

[169] A franchise tax was first imposed in 1929; the corporation income tax followed in 1937. In 1949 the franchise tax law, together with the corporation income tax law, was incorporated into the Revenue and Taxation Code, as Part II of Division 2 of the Code. These provisions are known as the Bank and Corporation Tax Law. The franchise tax is imposed for the privilege of exercising the corporate franchise in California. It is imposed upon corporations organized in California and upon foreign corporations doing business in the State (Section 23151). The rate of 7% is imposed on the net income from California sources. A corporation income tax is imposed upon net income, at the basic rate of the franchise tax. It is applied only to corporations that are not subject to the franchise tax (Section 23501). The "bank and financial corporation" tax is levied on banks and other financial corporations doing business in California for the privilege of exercising their franchises in the State. In effect, the tax on banks and financial corporations consists of 7% plus a tax rate that is a percentage equal to the average percentage of the total amount of net income, allocable to California, of all general corporations for the next preceeding year payable as franchise taxes and personal property taxes by all such general corporations. The total tax, however, is limited to 11% of net income (sections 23186, 23186a, 23181, 23183).

[170] It was alleged by Senate Democrats that the tax program, when fully effective in 1972-73, provided tax reductions to business in an amount of $78 million greater than the amount of tax increase imposed on business; it was also alleged that consumers would have paid $79 million more in taxes than they would have received in benefit. These allegations are totally inaccurate. A more realistic estimate of the total impact of the tax program on business would show that business would get $303 million in relief and pay $314 million in additional taxes. The Democratic figures incorrectly assumed that all sales taxes not paid by business are paid by California individuals. Actually, a significant portion is paid by neither, but by state and local government and tourists and visitors. The $78 million figure does not adequately consider that businesses pay a significant portion of the sales tax, pay approximately 15% of the personal income tax, would have paid a significant portion of the minimum income tax and other federal conformity features of the tax program, and would have been subjected to increased personal income and franchise taxes.

Using this procedure to analyze the burden of the tax program, the impact of the

The Future of Tax Reform

Since most political pulse-takers indicate that California taxpayers still have blood in their eyes, tax reform can be expected to be a major issue during the 1971 Legislative Session. Several favorable factors will exist next session. First, the 1971 session of the Legislature will be a non-election year. The "political grandstanding" by the opposition of responsible and reasonable tax reform measures and the rapidly constructed political alternative offering a laudable but unattainable millenium will dramatically decrease.[171]

What will the 1971 tax reform package contain? This article has attempted to outline what the major elements of a tax package should contain. The 1971 tax program of the Assembly Revenue and Taxation Committee will contain these elements.

Relief will include, in addition to the substantial homeowner and business inventory tax exemption:

— Tight school expenditure controls to keep property taxes down, rather than the loose and useless rate limits that now exist;

— State assumption and equalization of approximately $200 million of welfare burden now born by counties;

—An increase in the Senior Citizens' Tax Exemption Program;

— Payment to local governments to fund the Open Space Exemption Program;

— Exemption from property taxes of open spaces held by certain non-profit groups such as Nature Conservancy;

— Conformity to recent federal reform, including a minimum

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program on married couples with two children is as follows:

Income	Tax Reduction	Tax Reduction As A Percent of Income
$ 5,000	$ 54	1.10%
7,500	59	.99
10,000	68	.68
15,000	90	.60
20,000	117	.59
25,000	151	.60
50,000	81	.16

The married taxpayers who gain the most from the program are those in the $5,000 to $7,500 income range.

[171] A recent responsible and intelligent candidate for public office proposed a 25% reduction in the residential property tax over a period of four years. At current property tax rates, this would require $1.5 billion of offsetting state money. His proposed sources of this amount were: 1) total repeal of the oil depletion allowance, 2) repeal of the capital gains exemption, 3) elimination of the home office deduction for insurance companies, 4) institute withholding, 5) institute a minimum income tax, and 6) eliminate travel and entertainment deductions. But the total estimated revenue from these sources was $408. This left $1.1 billion to be raised to balance the proposed package, which would have required a substantial increase in the sales or income tax.

income tax on wealthy individuals who pay no tax and a reduction of the oil depletion allowance.

Several factors may dramatically affect the configurations of a tax package enacted in 1971. First, the composition of the Legislature will be important. The basic question is whether the electorate will return as their representatives, individuals dedicated to enacting a tax reform package. Second, with a Democratic majority returned in November, 1970, it can be expected that a power struggle will ensue for the position of Democratic leadership in the House. This instability could have a fundamental impact on a tax reform package. Third, because of state fiscal problems, there is going to be a tax package during the 1971 session to raise revenue; hopefully, this measure will include the reform aspects mentioned. The Legislative Analyst estimated that the 1970-71 state budget had a current operating deficit of $234 million and was balanced by using the last of the surpluses from Governor Reagan's 1967 Tax Program, and by using $98 million in essentially one-time transfers. During the 1971-72 fiscal year, the Legislative Analyst expects that the state will face a $300 million deficit, and that this deficit could be higher, depending upon the rate of inflation, the level of unemployment, the legal requirement of a cost-of-living factor for aid to families with dependent children program, and whether new school funds are appropriated.[172] It is evident that revenue for tax reform will have serious competitors. Whether the state's financial position will undermine efforts for a comprehensive tax reform package remains to be seen.

Fourth, another consideration which could have an impact on a tax reform package is the fiscal crisis or revenue gap faced by local government. The Legislature has become keenly aware of the plight of the cities and the counties, their growing expenditures and their lagging revenues; but the state is suffering from the same problems. Local government will be one of the competitors along with property tax relief, local school districts, and the state operations budget for new sources of funding. An anonymous individual once stated that the art of taxation consists in plucking the goose so as to obtain the most feathers with the least hissing. Whether the California taxpayer will be in any mood to reach into his pocket to solve the financial problems of local and state government without tax reform remains to be seen. There is a motto that one should not pluck the goose that lays the golden egg. Governor Reagan, the Department of Finance, and the Legislature have long

[172] Statement of A. Alan Post, Legislative Analyst, to the League of California Cities Annual Conference, held in San Diego, California, October 27, 1970, at 13-14.

looked for that fabled goose. In view of the state and local governments' financial situation, if that golden goose should show her head in 1971, she certainly will get plucked.

APPENDIX

TABLE I

MAJOR TAXES IN CALIFORNIA STATE AND LOCAL TAX STRUCTURE (In millions)

Type	1966-67 Revenue	% of Total	1967-68 Revenue	% of Total	1968-69 Revenue	% of Total
Personal Income and Payroll:						
Federal	$ 9,690		$10,577		$13,080	
State	1,442		1,786		1,943	
Total	$11,132	46.0	$12,363	47.7	$15,023	49.7
Property:						
State	$ 195		$ 203		$ 221	
Local	3,839		4,224		4,686	
Total	$ 4,034	16.7	$ 4,427	17.1	$ 4,907	16.2
Corporation Income:						
Federal	$ 3,648		$ 3,084		$ 3,956	
State	453		577		592	
Total	$ 4,101	16.9	$ 3,661	14.1	$ 4,548	15.0
General Sales:						
State	$ 1,191		$ 1,465		$ 1,652	
Local	339		372		394	
Total	$ 1,530	6.3	$ 1,837	7.1	$ 2,046	6.8
Selective Sales:						
Federal	$ 1,598		$ 1,706		$ 1,614	
State	1,002		1,087		1,170	
Total	$ 2,600	10.7	$ 2,798	10.7	$ 2,784	9.2
All Other:						
Federal	$ 385		$ 381		$ 391	
State	370		392		433	
Local	67		82		113	
Total	$ 822	3.4	$ 855	3.3	$ 937	3.1
Grand Total:	$24,219		$25,936		$30,245	100.0

Source: From figures submitted by the State Department of Finance.

TABLE II
ESTIMATED LOCAL TAX REVENUE
1968-69 Fiscal Year
(In millions)

	Total	City*	County	School District	School District
Property Tax	$4,686	$ 635	$1,165	$2,415	$ 385[3]
Sales & Use Tax 1%)	384	334[2]	50		
Other Non-property Taxes					
Business License	66	63	3		
Franchise Tax	25	20	5		
Service Tax (4% for gas, electricity, telephone)	20	20**			
Hotel-Motel Tax	20	17	3		
Realty Transfer Tax	18	6	12		
Total Other	$ 149	$ 126	$ 23		
Total Local Tax Revenue	$5,133	$1,072	$1,261	$2,415	$ 385
Plus: State Revenue to Local[1]	3,000				
Grand Total	$8,133				

* San Francisco included as a city.
** In city of Los Angeles only.
1 Approximate amount of state revenue subvened or spent by state on behalf of local government. ($3 billion)
2 Approximately 20 million was added to the amount for Los Angeles as a result of a 1% locally-imposed and locally-collected sales tax for a six-month period from 9/1/68 to 2/28/69.
3 Includes $125 million of special assessments.
Source: Advisory Commission on Tax Reform, Houston I. Flournoy, State Controller and Chairman.

TABLE III
PROPERTY TAX AS A
PERCENTAGE OF PERSONAL INCOME
IN CALIFORNIA (1940-67)
(In millions)

Year	Personal Income	Property Tax Levies	Percent
1940	$ 5,839	$ 298	5.1%
1945	15,194	367	2.4%
1950	19,527	791	4.0%
1955	30,224	1,253	4.1%
1960	43,183	2,195	5.0%
1965	60,000	3,057	5.0%
1966	65,000	3,367	5.2%
1967	69,600	3,760	5.4%

Source: Computed from UNITED STATES DEPARTMENT OF COMMERCE, OFFICE OF BUSINESS ECONOMICS, ANNUAL REPORTS and STATE BOARD OF EQUALIZATION, ANNUAL REPORTS, 1954-55, 1967-68.

TABLE IV

PROPERTY TAXES AND LOCAL SCHOOL BENEFITS AS A PERCENTAGE OF INCOME[a] FOR ALL FAMILIES BY INCOME CLASS, 1961

Income Class	Gross Property Tax Burden[b]	Elementary and Secondary Education Benefits[c]	Net Property Tax Burdens (1)-(2)
	(1)	(2)	(3)
Under $2,000	6.6	6.0	0.6
$ 2,000 - $ 2,999	4.8	6.1	—1.3
$ 3,000 - $ 3,999	4.3	5.2	—0.9
$ 4,000 - $ 4,999	3.8	5.0	—1.2
$ 5,000 - $ 5,999	3.6	4.4	—0.8
$ 6,000 - $ 7,499	3.4	3.8	—0.4
$ 7,500 - $ 9,999	3.0	2.8	0.2
$10,000 - $14,999	2.7	1.8	0.9
$15,000 and over	2.1	0.7	1.4
Total	3.4	3.4	0.0

[a] Income is measured net of personal income and property taxes, but it is broadly defined to include such frequently omitted items as imputed income in kind, government transfer payments, and realized gains and losses. It therefore gives a truer picture of actual tax burdens.

[b] In order to simulate a completely property-tax-financed school program, residential property tax burdens, which were only 1.9 percent of total family income in 1961, have been raised proportionately to equal total school benefits by multiplying the Tax Foundation burden estimates for each income class by 1.79.

[c] These benefits were allocated to the different income groups on the basis of the number of children under 18 years of age in each.

Source: TAX FOUNDATION, INC., TAX BURDENS AND BENEFITS OF GOVERNMENT EXPENDITURES BY INCOME CLASS, 1961 AND 1965, at 25, 31 (1967).

TABLE V

ESTIMATED STATE AND LOCAL TAX REVENUE 1968-69 Fiscal Year (In millions)

Revenue			
State Taxes			
General Taxes	$4,121		
Highway User Taxes	865		
Payroll Taxes	879		
Total State Taxes		$5,865*	
Local Taxes			
Property Tax	$4,600		
Sales and Use Tax	384		
Other Non-Property Taxes	149		
Total Local Taxes		5,133*	
Total Estimated Revenue			10,998

* Approximately $3 billion of state revenue is subvened or spent on behalf of local government resulting in state revenue of $2,865 and local revenue of $8,133.

Source: Advisory Commission on Tax Reform, Houston I. Flournoy, State Chancellor and Chairman.

TABLE VI

COMPARISON OF ESTIMATED TAX SAVINGS UNDER $750 EXEMPTION AND $1,000 PLUS 20 PERCENT EXEMPTION, 1970-71

Full Cash Value of Home	Homeowners' Exemption		Total Tax Savings[a]	
	Existing	Proposed	Existing	Proposed
$ 15,000	$750	$1,490	$80	$158
20,000	750	1,720	80	182
25,000	750	1,950	80	207
30,000	750	2,180	80	231
40,000	750	2,640	80	280
50,000	750	3,100	80	329
75,000[b]	750	4,250	80	451
100,000[b]	750	5,400	80	572

[a] Rounded to nearest dollar.
[b] Individuals with homes of this value can expect to pay an increased income tax to finance property tax relief. For example, the Department of Finance estimates that an individual with a $100,000 home would pay $671 more in income tax under the provisions of the tax program.

Source: Legislative Analyst

TABLE VII

ESTIMATED DISTRIBUTION OF RENTERS WHO FILED TAXABLE INCOME TAX RETURNS 1965 DATA

Adjusted Gross Income Class	Single Returns[a]		Joint Returns[a]	
	Renters	Percent of Total	Renters	Percent of Total
$ 0 - $ 5,000	$436,062	88.4%	$ 44,907	72.5%
5,000 - 10,000	349,855	76.5	619,281	44.7
10,000 - 15,000	32,574	53.5	220,547	24.7
15,000 - 20,000	5,385	43.4	37,884	15.9
20,000 - 25,000	2,298	42.5	9,663	12.4
25,000 - 50,000	2,456	32.1	9,770	10.5
50,000 - 100,000	310	17.6	1,103	5.9
$100,000 and over	63	8.8	146	3.0
Total	$829,003	79.8%	$943,301	34.0%

[a] Computed by using unpublished data on the number of taxable returns with itemized real and personal property tax deductions and subtracting these returns from the total taxable returns in FRANCHISING TAX BOARD, 1966 ANNUAL REPORT.

TABLE VIII

PERSONAL INCOME TAX DATA

Tax Year	No. of No Pay. Part-Pay Returns[c] (000)	% of Total Returns	Estimated Tax[a] (Millions)	Accounts Receivable at 6/30 No. (Thousand)	Accounts Receivable at 6/30 Amount (Millions)	Amounts Written off Amount (Millions)	Amounts Written off Year Ended
1964	221	6.0%	$20.0	203	$18.5	$2.1	6/30/64
1965	266	7.1%	27.2	398	31.2	3.6	6/30/65
1966	259	6.7%	28.3	372	28.5	4.9	6/30/66
1967	315	7.7%	36.7	380	31.9	1.2	6/30/67
1968	379	10.0%	80.5	407	56.8[b]	0.3	6/30/68

[a] Based on average tax per fully paid return.
[b] Adjusted for unposted partly paid estimated returns.
[c] No-pay returns averaged 92% and part-pay, 8% of total payment delinquencies.
Source: DEPARTMENT OF FINANCE, REPORT OF DEPARTMENT OF FINANCE TO THE CALIFORNIA LEGISLATURE, 1969 SESSION (Supp.).

TABLE IX

PERSONAL INCOME TAX COLLECTION LEDGER
AGE OF ACCOUNTS

6/30	Under 1 Year	Over 1 Yr. Under 3 Yrs.	Over 3 Yrs.	Total Accounts (000)
1966	47%	33%	20%	106
1967	36%	46%	18%	97
1968	29%	39%	32%	112

Source: State Controller

TABLE X

FISCAL IMPACT OF WITHHOLDING BY REVENUE SOURCE
(If effective January 1, 1970)

	Fiscal Effect (In Millions) 1969-70	1970-71	1971-72
1. *ONE TIME REVENUE*			
A. *Accelerated collection of tax:* Includes amounts received through withholding and declaration of estimated tax which, under the current law, would be received in succeeding years.			
1. Withholding	$250	$ 50	$ 10
2. Declarations of estimated tax	175	10	—
B. *Overwithholding:* Estimated amount of overwithholding of 1970 income year taxes that will be refunded in calendar year 1971	$ 55	$ 15	—
One Time Revenue	$480	$ 75	$ 10

2. *ONGOING EFFECTS OF WITHHOLDING*			
A. *Improved compliance and other:*			
From those emigrants and mobile persons within the state who currently fail to file returns and other sources that are not precisely identifiable, based on experience of other states	$ 15	$ 45	$ 55
B. *Growth:*			
This is the result of an expanding economy. The benefit of economic growth is realized during the income year rather than the subsequent year.			
1. From withholding	$ 15	$ 45	$ 55
2. From declarations of estimated tax	10	25	30
Ongoing Effects of Withholding	$ 40	$115	$140
Total Withholding Effect	$520	$190	$150

TABLE XI

RANGE OF SCHOOL DISTRICT EXPENDITURES PER PUPIL 1967-68

District Level	Low	High	Average
Elementary	$364	$ 951	$536
High School	552	1,851	766
Unified	454	1,739	631
Junior College	568	1,220	727

Source: LEGISLATIVE ANALYST, ANALYSIS OF THE BUDGET, at 191.