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California Legislators Push for More Double-Digit Income Tax Rates

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With the new Democratic push in the California legislature for higher income tax rates, it's worth taking a look back at how the top rates have changed in recent years.

California was an early adopter of double-digit income tax rates, applying rates of 10 and 11 percent to high incomes throughout the early 1990s. Hawaii applied a 10% top rate at that time, but no other state applied a double-digit rate to all taxable income. Several other states had double-digit income tax rates on their books during the 1990s but allowed federal tax payments to be deducted on the state return, reducing the effective state rate substantially. Hawaii lowered its top tax rate into the single-digit range in 1998, and the trend away from federal deductibility has reduced every other statutory rate into single digits. California's rates and brackets from that era are shown in Table 1.

Table 1
California's Personal Income Tax Rates in 1995

Singles	Couples
1% > \$ 0	1% > \$ 0
2% > \$ 4,831	2% > \$ 9,662
4% > \$ 11,449	4% > \$ 22,898
6% > \$ 18,068	6% > \$ 36,136
8% > \$ 25,083	8% > \$ 50,166
9.3% > \$ 31,700	9.3% > \$ 63,400
10% > \$ 109,936	10% > \$ 219,872
11% > \$ 219,872	11% > \$ 439,744

Source: CA Franchise Tax Board

http://www.ftb.ca.gov/forms/95_forms/95_resSch.pdf

During the late 1990s, revenue surged, and the legislature repealed the 10 and 11 percent brackets starting in tax year 1996, leaving 9.3% as the top rate.¹ See Table 2 for a tax table from that period.

There are three noticeable changes: the top two brackets are gone; the income thresholds for each bracket are no longer double for couples, creating a so-called marriage penalty; and each year's inflation adjustment has boosted the bracket thresholds slightly (because inflation was low).

Singles	Couples
1% > \$ 0	1% > \$ 0
2% > \$ 5,459	2% > \$ 9,662
4% > \$ 12,939	4% > \$ 22,898
6% > \$ 20,421	6% > \$ 36,136
8% > \$ 28,348	8% > \$ 50,166
9.3% > \$ 35,826	9.3% > \$ 63,400

Source: CA Franchise Tax Board

http://www.ftb.ca.gov/forms/00_forms/00_resSch.pdf

The next major change occurred in 2004 when a ballot initiative added a new top bracket, 10.3 percent of income above \$1,000,000. Perhaps because it was not enacted by the legislature in a normal tax-writing procedure, or perhaps because the revenue is transferred to a mental health services fund instead of the general fund, the Franchise Tax Board doesn't incorporate the new bracket into the existing rate structure on any of its forms. Instead, they still refer to 9.3% as the top rate, and the extra 1 percent over \$1 million is extracted on a separate line of the tax form. But the effect is identical, and most publishers of tax information either incorporate it into tables as we have done below in Table 3, or remark on the extra 1% in a footnote.

Another change that occurred between 2000 and 2005 is the elimination of the so-called marriage penalty. That is, for all brackets except the top one (officially not included as a bracket), the taxable income threshold for couples is exactly double what it is for singles.

Table 3
California's Personal Income Tax Rates
in 2005

Singles	Couples
1% > \$ 0	1% > \$ 0
2% > \$ 6,319	2% > \$ 12,638
4% > \$ 14,979	4% > \$ 29,958
6% > \$ 23,641	6% > \$ 47,282
8% > \$ 32,819	8% > \$ 65,638
9.3% > \$ 41,476	9.3% > \$ 82,952
10.3% > \$ 1,000,000	10.3% > \$ 1,000,000

Source: CA Franchise Tax Board

That brings us to the current debate, with Democrats in the legislature pitching the restoration of the 10 and 11 percent brackets, but this time with the extra 1% on top. Table 4 shows what the 2008 tax tables will look like if the measures are enacted.

Table 4
California's Personal Income Tax Rates
in 2008?

Singles	Couples
1% > \$ 0	1% > \$ 0
2% > \$ 6,827*	2% > \$ 13,654*
4% > \$ 16,165*	4% > \$ 32,370*
6% > \$ 25,544*	6% > \$ 51,088*
8% > \$ 35,460*	8% > \$ 70,920*
9.3% > \$ 44,814*	9.3% > \$ 89,628*
10% > \$ 160,500	10% > \$ 321,000
11% > \$ 321,000	11% > \$ 642,000
12% > \$ 1,000,000	12% > \$ 1,000,000

*2007 thresholds—they would be raised by the amount of inflation.

Source: *Sacramento Bee* for new bracket thresholds.

Economists often caution state lawmakers not to raise their rates too far above those of neighboring states so that tax competition will not siphon jobs out of state. Oregon's top rate is 9%, which the state has maintained for many years with no sales tax. Arizona's top rate is 4.54%, and Nevada has no personal income tax at all. The argument made on behalf of California's high rates—that adequate public schools and health care are impossible to maintain without such high rates—seems hard to accept when nearby states are able to do so with such dramatically lower tax rates.

Part of the package is a higher corporate income tax rate, too, bucking the worldwide trend of lower rates, but that's another story.

Notes

1. According to authoritative tax publisher CommerceClearingHouse's *State Tax Handbook*, the 10 and 11 percent rates weren't repealed until tax year 1998, but the actual tax table from the Franchise Tax Board shows those two brackets missing in both 1996 and 1997 (http://www.ftb.ca.gov/forms/96_forms/96_resSch.pdf).

Sources:

Sacramento Bee, July 8, "Democrats detail tax increase proposals" by Judy Lin and Dan Smith, <http://www.sacbee.com/111/story/1069555.html>

Legislative Analyst's Office, July 2004, "Proposition 63." http://www.lao.ca.gov/ballot/2004/63_11_2004.htm

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