LAO

November 2, 2017

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

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Becerra:

Pursuant to Elections Code Section 9005, we have reviewed the proposed statutory initiative related to homeowners' and renters' tax relief (A.G. File No. 17-0032).

Background

California Taxes Personal Income. California levies a personal income tax (PIT) on the income of state residents and on any income of nonresidents that is derived from California sources. The PIT is the state's largest revenue source, raising about $83 billion in 2016-17. In 2015 Californians filed over 16 million returns, including nearly 8 million single returns, nearly 6 million joint returns, and over 2 million head-of-household returns.

Renters Can Receive an Income Tax Credit. Most Californians who rent their principal residence may claim an income tax credit known as the renters' credit, which reduces their tax liability. To be eligible, a renter must have income below $39,062 for a single filer or $78,125 for a couple or head of household. The renter also must not be claimed as someone else's dependent or live in a property exempt from property taxes (such as publicly-subsidized affordable housing). The credit amount is $60 for single renters or $120 for married couples or heads of household. The renters' credit is nonrefundable meaning that the credit a filer receives cannot exceed his or her liability. For example, a single filer with liability of $50 can claim a credit for $50, not $60. The renters' credit reduces state PIT revenue by about $115 million annually.

Homeowners Can Receive PIT Deductions. Property owners may deduct the amount of their property tax payments to local governments from their taxable income, which reduces the tax liability they owe to the state. Filers may also deduct any mortgage interest they paid on their primary residence.

Homeowners Also Receive a Property Tax Exemption. The State Constitution grants a $7,000 property tax exemption for owner-occupied housing. This exemption reduces a home's assessed value by $7,000, typically reducing the homeowner's tax payment by about $80 annually. Over 5 million homeowners claim the exemption.

State General Fund Spends $125 Billion. In 2017-18, the state is expected to spend about $125 billion from its main account, the General Fund. About half of this spending is for education, mainly for K-12 schools and community colleges but also for public universities. Most of the rest is for health, social services, and criminal justice programs.

Funding Requirements for Schools and Community Colleges. Earlier propositions passed by voters generally require the state to provide a minimum amount of annual funding for schools and community colleges, known as the "minimum guarantee." The minimum guarantee tends to grow with the economy and number of students. A key input in the calculation of the minimum guarantee is state tax revenues. Reductions (increases) in state tax revenues tend to reduce (raise) funding for schools and community colleges.

Constitution Requires Minimum Annual Debt Payments and Reserve Deposits. Proposition 2 (2014) requires the state to make minimum annual debt payments and reserve deposits using a formula specified in the state constitution. Generally, this formula is based on the size of the state's General Fund and the amount of taxes paid on capital gains.

Proposal

Creates a New Income Tax Credit for Homeowners and Renters. Homeowners who are eligible for the state homeowners' property tax exemption and renters—regardless of income—who meet the non-income-related eligibility requirements for the renters' credit would be eligible for a new nonrefundable PIT credit. The amount of the credit would be $500 for a single filer, a couple, or a head of household. Unlike the renters' credit, the new credit's amount would be adjusted for inflation every year. The existing renters' credit would remain in place.

Fiscal Effect

Decreased PIT Revenues. By establishing a new credit for homeowners and renters, the measure would reduce state PIT revenue by roughly $4 billion annually beginning in 2018-19. Roughly half of all filers would benefit from the credit. Filers with no liability or who do not own a home or pay rent would not benefit. Some qualifying homeowners and renters would receive only a portion of the $500 credit because their existing tax payment is less than $500.

State Spending Impacts. The decrease in PIT revenue would affect Constitutional requirements for school funding, reserve deposits, and debt payments. The state funding requirement for schools and community colleges likely would decrease by around $2 billion in most years. In addition, the measure could increase the amount the state pays toward debts or deposits into reserves by the low hundreds of millions of dollars or decrease the amount by tens of millions. The state would also likely have less revenue available to fund other programs, services, or infrastructure.

Summary of Fiscal Effects. This measure would result in the following major fiscal impacts:

- Reduction in state revenue of roughly $4 billion per year.
- Likely a reduction in funding for schools and community colleges of roughly $2 billion in most years.

Sincerely,

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Mac Taylor
Legislative Analyst

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Michael Cohen
Director of Finance