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August 8, 2012

Hearing Concerning Propositions 30, 31, 38, and 39

LEGISLATIVE ANALYST'S OFFICE

Presented to:
Senate Governance and Finance Committee
Hon. Lois Wolk, Chair

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Proposition 31

☑ **Authorizes and Funds Local Government Plans**

- ***Allows Local Governments to Develop New Plans.*** Counties and local governments (cities, school districts, community college districts, and special districts) could create plans for coordinating how they provide services to the public.

- ***Allows Local Governments to Alter Administration of State-Funded Programs.*** Governments participating in a plan could create "functionally equivalent" procedures for administering state programs financed with state funds.

☑ **Restricts Legislature's Ability to Pass Certain Bills**

- ***Restricts Legislature's Ability to Increase State Costs or Decrease State Revenues.*** Requires the Legislature to show how some bills that increase state spending or decrease state revenues by more than $25 million in any fiscal year would be paid for with spending reductions, revenue increases, or a combination of both.

- ***Changes When Legislature Can Pass Certain Bills.*** Requires the Legislature to make bills and amendments to those bills available to the public for at least three days before voting to pass them.

☑ **Expands Governor's Ability to Reduce State Spending**

- ***Allows Governor to Reduce Spending in Certain Situations.*** If the Governor declares a fiscal emergency, and the Legislature does not pass legislation to address that fiscal emergency within 45 days, the Governor could reduce General Fund spending not required by the State Constitution or federal law.

☑ Changes Public Budgeting and Oversight Procedures

- ***Changes State and Local Procedures.*** Changes the state's budget process from a one-year (annual) process to a two-year (biennial) process. Requires the Legislature to reserve a part of its two-year session for oversight and review of public programs. Requires state and local governments to evaluate the effectiveness of their programs and describe how their budgets would meet various objectives.

Major Fiscal Effects of Proposition 31

	State Government	Local Government
Authorizes and Funds Local Government Plans		
Funding for plans	$200 million annual reduction in revenues.	$200 million annual increase in revenues to local governments in counties that develop plans.
Effects of the new plans	Cannot be predicted, but potentially significant.	Cannot be predicted, but potentially significant in some counties.
Restricts Legislature's Ability to Pass Certain Bills	Potentially lower spending—or higher revenues—based on future actions of the Legislature.	Potential changes in state funding for local programs based on future actions of the Legislature.
Expands Governor's Ability to Reduce State Spending	Potentially lower spending in some years.	Potentially less state funding for local programs in some years.
Changes Public Budgeting and Oversight Procedures		
Implementation costs	Potentially millions to tens of millions of dollars annually, moderating over time.	Potentially millions to tens of millions of dollars annually, moderating over time.
Effects of new requirements	Cannot be predicted.	Cannot be predicted.

Proposition 39

Background

- ***Multistate Businesses Currently Choose How Their Taxable Income Is Determined.*** State law allows most multistate businesses to pick one of two methods to determine the amount of their income associated with California and taxable by the state:
  - ***"Three-Factor Method" of Determining Taxable Income.*** This method uses the location of the company's sales, property, and employees.
  - ***"Single Sales Factor Method" of Determining Taxable Income.*** This method uses only the location of the company's sales.
- ***Energy Efficiency Programs.*** There are currently numerous state programs established to reduce energy consumption and reduce the need to build new energy infrastructure.
- ***School Funding Formula.*** Proposition 98 requires a minimum level of state and local funding each year for public schools and community colleges. The Proposition 98 guarantee can grow with increases in state General Fund revenues.

Major Provisions

- ***Eliminates Ability of Multistate Businesses to Choose How Taxable Income Is Determined.*** Under this measure, starting in 2013, multistate businesses would no longer be allowed to choose the method for determining their state taxable income and instead would have to use the single sales factor method.

- ***Provides Funding for Energy Efficiency and Alternative Energy Projects.*** This measure establishes a new state fund, the Clean Energy Job Creation Fund, to support projects intended to improve energy efficiency and expand the use of alternative energy. The Legislature would determine spending from the fund and be required to use the monies for cost-effective programs.

Estimated Effects of Proposition 39 on State Revenues and Spending

	2012-13	2013-14 Through 2017-18	2018-19 And Beyond
Annual Revenues	$500 million	$1 billion, growing over period	Over $1 billion
Annual Spending			
Amount dedicated to energy projects	None	$500 million to $550 million	None
Increase in school funding guarantee	$200 million to $500 million	$200 million to $500 million, growing over period	$500 million to over $1 billion

Fiscal Impact

- ***Increase in State Revenues.*** This measure would increase state revenues by around $500 million in 2012-13 and by around $1 billion annually starting in 2013-14.

- ***Some Revenues Used for Energy Projects.*** For a five-year period (2013-14 through 2017-18), about half of the additional revenues—$500 million to $550 million annually—would be transferred to the Clean Energy Job Creation Fund to support energy efficiency and alternative energy projects.

- ***School Funding Likely to Rise Due to Additional Revenues.*** Generally, the revenue raised by the measure would be considered in calculating the state's annual Proposition 98 minimum guarantee. The higher revenues likely would increase the minimum guarantee by at least $200 million for the 2012-13 through 2017-18 period. In some years during this period, however, the effect could be significantly greater.

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Proposition 30

Temporary Tax Increases

- ***Sales Tax.*** Increases sales tax by one-quarter cent from January 1, 2013 through the end of 2016.
- ***Personal Income Tax (PIT).*** Increases marginal PIT rates on higher incomes as shown in the figure. These tax rates would be in effect for seven years—from the 2012 tax year through the end of the 2018 tax year.

Current and Proposed Personal Income Tax Rates Under Proposition 30

Single Filer's Taxable Income[a]	Joint Filers' Taxable Income[a]	Head-of-Household Filer's Taxable Income[a]	Current Marginal Tax Rate[b]	Proposed Additional Marginal Tax Rate[b]
$0-$7,316	$0-$14,632	$0-$14,642	1.0%	—
7,316-17,346	14,632-34,692	14,642-34,692	2.0	—
17,346-27,377	34,692-54,754	34,692-44,721	4.0	—
27,377-38,004	54,754-76,008	44,721-55,348	6.0	—
38,004-48,029	76,008-96,058	55,348-65,376	8.0	—
48,029-250,000	96,058-500,000	65,376-340,000	9.3	—
250,000-300,000	500,000-600,000	340,000-408,000	9.3	1.0%
300,000-500,000	600,000-1,000,000	408,000-680,000	9.3	2.0
Over 500,000	Over 1,000,000	Over 680,000	9.3	3.0

[a] Income brackets shown were in effect for 2011 and will be adjusted for inflation in future years. Single filers also include married individuals and registered domestic partners (RDPs) who file taxes separately. Joint filers include married and RDP couples who file jointly, as well as qualified widows or widowers with a dependent child.

[b] Marginal tax rates apply to taxable income in each tax bracket listed. The proposed additional tax rates would take effect beginning in 2012 and end in 2018. Current tax rates listed exclude the mental health tax rate of 1 percent for taxable income in excess of $1 million.

Proposition 30 *(Continued)*

☑ New State Revenues From Tax Increases

- ***Additional State Tax Revenues Through 2018-19.*** Over the five fiscal years in which both tax increases would be in effect (2012-13 through 2016-17), the average annual state revenue gain from this measure is estimated at around $6 billion. As shown in the figure, smaller revenue gains are likely in 2011-12, 2017-18, and 2018-19.

- ***Revenues Could Change Significantly From Year to Year.*** The revenues raised by this measure could be subject to multibillion-dollar swings—either above or below the revenues projected above. This is because the vast majority of the additional revenue is from the PIT rate increase on higher incomes, which is volatile and difficult to predict.

Proposition 30 Revenue Estimates

(In Millions)

	Personal Income Tax	Sales and Use Tax	Total
2011-12[a]	$2,816	—	$2,816
2012-13	4,265	$607	4,872
2013-14	4,358	1,313	5,671
2014-15	4,697	1,401	6,098
2015-16	4,917	1,485	6,402
2016-17	5,173	804	5,977
2017-18	5,434	—	5,434
2018-19	2,216	—	2,216

[a] Reflects Governor's proposal to accrue a portion of personal income tax revenues collected during 2012-13 back to the 2011-12 fiscal year.

State Spending

- ***New Tax Revenues Available to Fund Schools and Help Balance the Budget.*** The revenue generated by the measure's temporary tax increases would be included in the calculations of the Proposition 98 minimum guarantee—raising the guarantee by billions of dollars each year. A portion of the new revenues therefore would be used to support higher school funding, with the remainder helping to balance the state budget.
- ***Backup Budget Plan Reduces Spending if Voters Reject This Measure.*** The 2012-13 budget plan requires that its spending be reduced by $6 billion if this measure fails. These trigger cuts, as currently scheduled in state law, are shown in the figure.

2012-13 Spending Reductions if Voters Reject Proposition 30

(In Millions)

Schools and community colleges	$5,354
University of California	250
California State University	250
Department of Developmental Services	50
City police department grants	20
CalFire	10
DWR flood control programs	7
Local water safety patrol grants	5
Department of Fish and Game	4
Department of Parks and Recreation	2
DOJ law enforcement programs	1
Total	**$5,951**

DWR = Department of Water Resources; DOJ = Department of Justice.

Proposition 30 *(Continued)*

☑ **Realignment Provisions**

- ***Guarantees Ongoing Revenues to Local Governments.*** The measure requires the state to continue providing the tax revenues redirected in 2011 (or equivalent funds) to local governments to pay for the programs transferred in the 2011 realignment.

- ***Eliminates Potential Mandate Funding Liability.*** The measure specifies that the state would not be required to provide mandate reimbursements for any of the program responsibilities transferred to local governments in the 2011 realignment.

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Proposition 38

☑ **Personal Income Tax Increases**

- ***Increases Tax Rates for 12 Years.*** Increases marginal PIT rates as shown in the figure. These tax rates would be in effect for 12 years—from the 2013 tax year through the 2024 tax year.

Current and Proposed Personal Income Tax Rates Under Proposition 38

Single Filer's Taxable Income[a]	Joint Filers' Taxable Income[a]	Head-of-Household Filer's Taxable Income[a]	Current Marginal Tax Rate[b]	Proposed Additional Marginal Tax Rate[b]
$0-$7,316	$0-$14,632	$0-$14,642	1.0%	—
7,316-17,346	14,632-34,692	14,642-34,692	2.0	0.4%
17,346-27,377	34,692-54,754	34,692-44,721	4.0	0.7
27,377-38,004	54,754-76,008	44,721-55,348	6.0	1.1
38,004-48,029	76,008-96,058	55,348-65,376	8.0	1.4
48,029-100,000	96,058-200,000	65,376-136,118	9.3	1.6
100,000-250,000	200,000-500,000	136,118-340,294	9.3	1.8
250,000-500,000	500,000-1,000,000	340,294-680,589	9.3	1.9
500,000-1,000,000	1,000,000-2,000,000	680,589-1,361,178	9.3	2.0
1,000,000-2,500,000	2,000,000-5,000,000	1,361,178-3,402,944	9.3	2.1
Over 2,500,000	Over 5,000,000	Over 3,402,944	9.3	2.2

[a] Income brackets shown were in effect for 2011 and will be adjusted for inflation in future years. Single filers also include married individuals and registered domestic partners (RDPs) who file taxes separately. Joint filers include married and RDP couples who file jointly, as well as qualified widows or widowers with a dependent child.

[b] Marginal tax rates apply to taxable income in each tax bracket listed. For example, a single tax filer with taxable income of $15,000 could have had a 2011 tax liability under current tax rates of $227: the sum of $73 (which equals 1 percent of the filer's first $7,316 of income) and $154 (2 percent of the filer's income over $7,316). This tax liability would be reduced—and potentially eliminated—by personal, dependent, senior, and other tax credits, among other factors. The proposed additional tax rates would take effect beginning in 2013 and end in 2024. Current tax rates listed exclude the mental health tax rate of 1 percent for taxable income in excess of $1 million.

Proposition 38 *(Continued)*

☑ New State Revenues From Tax Increases

- ***Raises $10 Billion in Annual Revenue.*** Beginning in 2013-14, the annual amount raised would be around $10 billion. (In 2012-13, the measure would raise roughly half this amount.) Revenues likely would vary from year to year largely due to the swings in the income of upper-income taxpayers.

LAO Forecast of Proposition 38 Revenues

(In Millions)	
2012-13	$5,596
2013-14	9,903
2014-15	10,663
2015-16	11,256
2016-17	11,817
2017-18	12,414

Proposition 38 *(Continued)*

☑ Schools

- ***Provides Additional Funding for Schools.*** Through 2016-17, schools would receive roughly 60 percent of revenues raised by this measure (roughly $6 billion annually in the initial years). Beginning in 2017-18, schools would receive roughly 85 percent of revenues.

- ***Distributes School Funds Through Three Grant Programs.*** Requires school funds be allocated as follows:

  – ***Educational Program Grants (70 Percent).*** Allocated based on number of students enrolled in each school. Can be spent on broad range of activities, including instruction, school support staff, and parent engagement.

  – ***Low-Income Student Grants (18 Percent).*** Allocated based on number of low-income students enrolled in each school. Same spending restrictions as with educational program grants.

  – ***Training, Technology, and Teaching Materials Grants (12 Percent).*** Allocated based on number of students enrolled in each school. Can be used for training school staff and purchasing up-to-date technology and teaching materials.

- ***Requires Funds to Be Spent at Corresponding School Sites.*** Funds must be spent at the specific school whose students generated the funds.

Proposition 38 *(Continued)*

☑ **Early Care and Education (ECE)**

- ***Provides Additional Funding for Preschool and Child Care Programs.*** Through 2016-17, ECE programs would receive roughly 10 percent of revenues raised by this measure (roughly $1 billion annually in initial years). Beginning in 2017-18, ECE programs would receive roughly 15 percent of revenues.

- ***Provides Preschool to More Children From Low-Income Families (52 Percent).*** Expands number of preschool slots available in targeted neighborhoods (generally those with more low-income families).

- ***Establishes New Program for Infants and Toddlers From Low-Income Families (17 Percent).*** Establishes California Early Head Start Program to provide child care and family support services to low-income families with children ages birth to three.

- ***Establishes Quality Rating System and Provides Higher Payments to Higher Quality Providers (12 Percent).*** Requires the state to implement an Early Learning Quality Rating and Improvement System to assess effectiveness of individual ECE programs. All ECE programs could choose to be rated on this scale. Child care and preschool programs with higher quality scores would receive supplemental payments.

- ***Partially Restores Prior Program Reductions (19 Percent).*** Partially restores recent state budget reductions to child care slots, provider payment rates, and certain statewide activities that support the ECE system.

Proposition 38 *(Continued)*

☑ **State Debt Payments**

- ***At Least 30 Percent of Revenues for Debt-Service Relief Through 2016-17.*** State savings of roughly $3 billion annually.
- ***Limits Growth of School and ECE Allocations Beginning 2015-16, Uses Excess Funds for Debt-Service Payments.*** Beginning 2015-16, allocations to schools and ECE programs could not increase at a rate greater than average growth in California per capita personal income over the previous five years. State savings would vary from year to year but could be several hundred million dollars annually.

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Comparing Propositions 30 and 38

	Proposition 30	Proposition 38
Tax increases	Personal income tax and sales tax	Personal income tax
Revenue raised in 2012-13	$7.7 billion[a]	$5.6 billion[b]
Revenue raised in 2013-14	$5.7 billion	$9.9 billion
Revenue used for:	Public education and state budget	Public schools, early childhood education, and state budget (debt service on bonds)
2012-13 trigger cuts if measure takes effect?	No	Yes
Guarantees funding for 2011 Realignment?	Yes	Not addressed
Operative time period	7 years (2012-2018)	12 years (2013-2024)

[a] Includes revenue collected in 2012-13 that accrues to 2011-12. LAO estimate differs from estimate included in 2012-13 budget ($8.5 billion).
[b] Expenditure of these revenues likely would not occur until 2013-14.