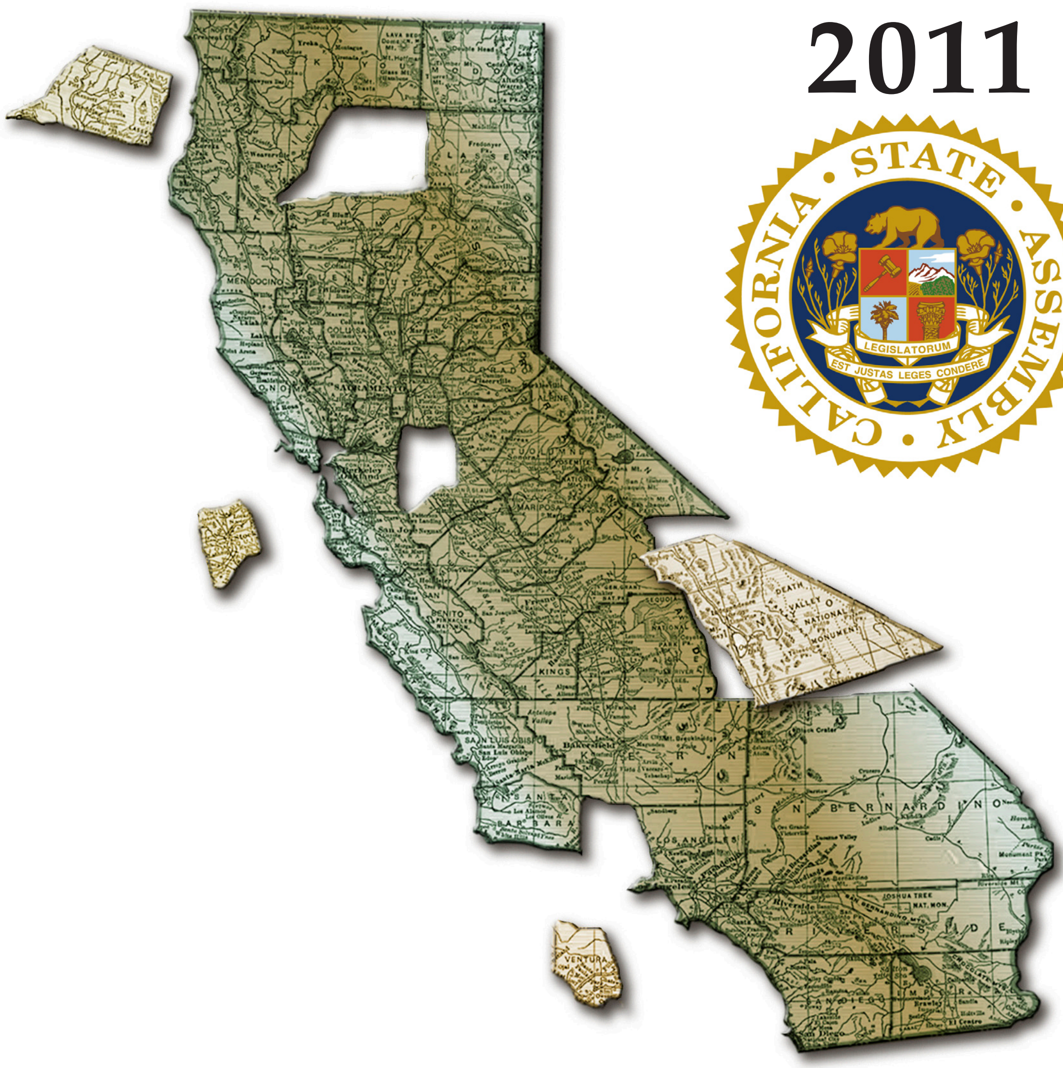
Assembly Committee on Revenue and Taxation

Revenue and Taxation

Reference Book 2011



Assemblymember Henry T. Perea, Chair

July 2012

California State Legislature

PREFACE

This Revenue and Taxation Reference Book is designed to answer some of the more commonly asked questions about California's tax structure. It is written with the general public in mind and gives a broad overview of most of California's major taxes, as well as summaries of some special features of the tax system. Many of the technical features and fine points of the law are excluded in an attempt to keep the material accessible to lay readers.

This Reference Book reflects California's tax law as of December, 2010. Generally, tax provisions that expired or were repealed prior to that date are not described.

Many features of the state tax system are described more than once in this Reference Book. For instance, certain income tax provisions affecting businesses are described both as a feature of the Personal Income Tax in Chapter 2B and in Chapter 2C, under the Corporation Tax. Readers should watch for cross-references within the text.

The Glossary in Chapter 8 provides short definitions of over 200 terms and acronyms commonly used in tax discussions.

Thanks are due to the staff members of the Franchise Tax Board, the Board of Equalization, and other executive agencies who provided information, advice, and editorial comment during the preparation of this book. Legislative Counsel also provided assistance on various issues in this book. Their collective assistance ensures that the information included is both timely and accurate.

The Revenue and Taxation Reference Book has been prepared and maintained over the years by the staff of the Assembly Committee on Revenue and Taxation.

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OVERVIEW OF CALIFORNIA'S TAX REVENUES

TABLE 1

GENERAL FUND REVENUES, FISCAL YEAR 2010-11
(In Thousands of Dollars)

Tax	Total Revenue	Percentage of General Fund Budget
Personal Income Tax	$49,491,000	53%
Retail Sales and Use Tax (General Fund portion)	$26,983,000	29%
Corporation Tax	$ 9,614,000	10.2%
Highway Users Tax	$ -0-	0.0%
Motor Vehicles Fees	$ 1,330,000	1.4%
Insurance Tax	$ 2,077,000	2.2%
Estate Tax	$ -0-	-0-
Liquor Tax	$ 334,000	0.35%
Cigarette Tax (General Fund portion)	$ 96,000	0.1%
Other	$ 2,076,000	2.2%
TOTAL	$93,489,000	100.0%*

*May not total 100% due to rounding error.

Source: Governor's 2012-13 Budget Summary, General Fund Revenue Sources, Figure SUM-03

CHAPTER 1B

BASIC FACTS ABOUT TAX LEGISLATION

HIGHLIGHTS

- Tax Levy Bills
- Legislative Vote Requirements
- Constitutional Amendments and Statutory Initiatives
- Bills with State Mandates on Local Agencies
- Fiscal Committee Hearings
- Effective Dates and Operative Dates

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1. INTRODUCTION

This chapter summarizes the most important constitutional, statutory, and legislative provisions that apply to tax legislation.

2. "TAX LEVY" BILLS

Tax Levy Bills Defined. A tax levy is a bill that imposes a state tax, repeals a state tax, or otherwise changes in any material way the rate, base, or burden of a state tax. For this reason, many bills that deal with taxes are designated as tax levy bills.

The Office of Legislative Counsel (Legislative Counsel), which is responsible for drafting all bills introduced and amended in the Legislature, determines whether a bill is a tax levy.

Legislative Counsel will classify a bill as a tax levy if its subject matter exclusively or principally imposes, repeals, or otherwise modifies the incidence or burden of a state tax. After determining that a bill is a tax levy, Legislative Counsel will include in the title of the bill a phrase indicating that the bill is a tax levy. The body of the bill will also contain a statement that the measure is a tax levy.

Bills that impose, repeal, or modify a state tax <u>and</u> that also contain unrelated provisions are not designated as tax levies, unless Legislative Counsel determines that the tax levy provisions are the principal or primary purpose of the bill.

Bills that exclusively or primarily affect the rate, base, or burden of the property tax are also designated as tax levies. However, a bill that only authorizes a local government to propose a tax to the voters is not a tax levy, because that bill does not directly affect the rate, base, or burden of an existing local tax.

Bills that deal exclusively or principally with tax administration, including the imposition of penalties and interest, are not tax levies.

How Tax Levy Bills Are Treated. The Legislature treats tax levy bills differently from other bills in the following ways:

- Tax levy bills take effect immediately [California Constitution, Article IV, Section 8(c)(3).] However, their operative dates may be different (see Section 7, below).

- Tax levy bills are not subject to referendum by the people [California Constitution, Article II, Section 9(a).]

- Tax levy bills are not subject to many of the normal legislative deadlines for the consideration of bills. Instead, they are treated like urgency bills and Constitutional Amendments. Accordingly, policy and fiscal committees may meet to hear a tax levy bill at any time other than during those periods when no committee may meet for any purpose. Similarly, either house may meet for the purpose of considering and passing a tax levy bill at any time during the legislative session.

3. LEGISLATIVE VOTE REQUIREMENTS FOR TAX BILLS

The California Constitution establishes legislative vote requirements for all tax bills, including tax levies.

Bills requiring a two-thirds vote are those that:

- Result in any taxpayer paying a higher tax (California Constitution, Article XIIIA, Section 3);

- Contain an urgency clause [California Constitution, Article IV, Section 8(d)];

- Classify personal property for differential taxation or that exempt personal property from taxation (California Constitution, Article XIII, Section 2);

- Contain a General Fund appropriation for any purpose other than public education, unless passed as part of the budget [California Constitution, Article IV, Section 12(d)];

- ° Override a Governor's veto [California Constitution, Article IV, Section 10(a).]; and

- ° Amend the provisions of the California Children and Families First Act of 1998, an initiative constitutional amendment and statute passed as Proposition 10 by the voters in November 1998 (Proposition 10, 1998, Section 8).

Bills that amend any portion of the Cigarette and Tobacco Products Tax Law enacted in November 1988 by the voters as Proposition 99 require a <u>four-fifths</u> vote.

With certain limited exceptions, all other tax bills require a <u>majority</u> vote.

4. CONSTITUTIONAL AMENDMENTS AND STATUTORY INITIATIVES

Some aspects of state tax law cannot be changed by the Legislature. These instances and the procedures relating to them are outlined below.

Tax Law Set Forth in the Constitution. A constitutional amendment is required to change any tax law contained in the California Constitution. Proposed constitutional amendments may be placed on the statewide ballot either by the Legislature or by the people through an initiative. Constitutional amendments proposed by the Legislature must be adopted by a two-thirds vote of each house and do not require the Governor's signature. An initiative, in turn, requires a majority vote of the people.

Initiative constitutional amendments must receive valid signatures equal to at least 8% of the number of voters who voted in the last gubernatorial election in order to be placed on the ballot.

Statutory Tax Law Enacted by the Voters Through a Statutory Initiative. In general, an initiative tax statute can only be changed by a vote of the people on another statewide ballot. The proposed change in the law may be placed on the ballot by another initiative or by a bill enacted by the Legislature.

Some initiative statutes, however, contain language that allows the Legislature to make changes without voter approval. These statutes typically identify the types of changes allowed and specify the legislative vote requirement to amend the statute.

Initiative statutes must receive valid signatures equal to at least 5% of the number of voters who voted in the last gubernatorial election in order to be placed on the ballot.

5. BILLS WITH STATE MANDATES ON LOCAL AGENCIES

The California Constitution (California Constitution, Article XIIIB, Section 6) requires the state to reimburse local governments for any costs incurred when the state mandates local government to provide certain new programs or higher levels of service. The Constitution provides that reimbursement is permissible but not required for mandates requested by the local agency affected, legislation defining a new crime or changing an existing definition of a crime or for mandates enacted before January 1, 1975. Reimbursement is not provided if the mandates are self-financing, have offsetting savings, require no new duties, or if the new duties result from a ballot measure approved by the voters. Government Code Sections 17500-17630 provide procedures for the constitutionally required state reimbursement of mandated local costs.

In addition, statutes require reimbursement to local agencies in the following two cases:

- Enactment of property tax exemptions or new classifications of exempt property (Revenue and Taxation Code Section 2229); or,

- Enactment of sales and use tax exemptions that cause a new loss of revenue (Revenue and Taxation Code Section 2230).

Constitutional requirements for reimbursement cannot be waived. Statutory requirements for reimbursement may be waived by statute, including the statute creating a new exemption.

6. HEARINGS BY LEGISLATIVE COMMITTEES

Bills materially changing the Revenue and Taxation Code (whether by amendment, addition or deletion) are generally referred to the Assembly Committee on Revenue and Taxation and the Senate Committee on Governance and Finance for policy review.

Under current legislative rules, tax bills, like other bills, must be referred to the Appropriations Committee of each house if they do any of the following:

- Appropriate money;

- Result in a substantial expenditure of state money by imposing new responsibilities on the state, imposing new or additional duties on state agencies, or liberalizing any state program, function, or responsibility;

- Result in a substantial gain or loss of revenue to the state; or,

- Result in a substantial reduction of expenditures by reducing, transferring, or eliminating any existing responsibilities of any state agency, program, or function.

7. EFFECTIVE DATES AND OPERATIVE DATES

In order to become law, tax bills, like all bills, must be passed by both houses of the Legislature and signed by the Governor, allowed to become law without the Governor's signature, or passed over the Governor's veto [California Constitution, Article IV, Sections 8(b) and 10(a).]

The effective date of a bill is the date it becomes law. Tax levy bills, urgency bills, bills calling for an election, and bills making appropriations for the usual current expenses of California go into effect immediately upon enactment [California Constitution, Article IV, Section 8(c)(3).] Bills that <u>do not</u> take immediate effect (i.e., bills that are not tax levies or urgency measures or that do not call for an election or make an appropriation) take effect on January 1 following enactment [California Constitution, Article IV, Section 8(c)(1).]

For most tax bills, the <u>effective date</u> of a bill that takes immediate effect is the day the statute is chaptered by the Secretary of State. However, unless specified otherwise, personal income tax and corporation tax bills apply to taxable years beginning on or after the January 1 <u>preceding</u> enactment (Revenue and Taxation Code Sections 17034, 18415, and 23058). For example, a bill enacting an income tax credit that is chaptered by the Secretary of State during 2010 will apply to taxable years beginning on and after January 1, 2010, unless otherwise specified.

Furthermore, bills may specify an <u>operative date</u> that is different from the <u>effective date</u> of a bill. For example:

- Bills amending the Sales and Use Tax Law will often specify as an operative date the first day of the first calendar quarter beginning more than 90 days after a bill's effective date;

- Personal income and corporation tax bills sometimes specify an operative date beginning in a different taxable year than the one in which the bill is enacted; or,

- Any type of bill (whether or not it is tax-related) may specify another operative date. A bill's operative date is sometimes pushed back in time in order to delay its revenue impact or to allow both taxpayers and the agency charged with administration more time to prepare.

Bills enacted in special sessions of the Legislature have different rules governing passage and effective dates.

CHAPTER 1B
BASIC FACTS ABOUT TAX LEGISLATION

CHAPTER 1C

RESTRICTIONS ON THE TAXING POWER OF THE LEGISLATURE

HIGHLIGHTS

- California Constitutional Restrictions
- U.S. Constitutional Restrictions
- State Appropriations Limit
- Initiative Statutes
- Tax Increases
- Governor's Veto
- Limits on Local Government Taxing Authority

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1. INTRODUCTION

While the Legislature has broad powers to impose taxes, there are a number of restrictions on this power. The U.S. Constitution restricts the Legislature's ability to impose taxes. Other factors also constrain the Legislature's ability to impose taxes, as described below.

2. CALIFORNIA CONSTITUTIONAL RESTRICTIONS

A number of features of California's tax law are established in the California Constitution. Modification or repeal of many of these features must be accomplished by a constitutional amendment approved by the voters of the state. The major constitutional provisions governing the power of taxation are described below.

General Taxes Not Subject to Referendum. Section 9 of Article II states that statutes providing for tax levies or appropriations for the usual current expenses of California are not subject to referendum.

Vehicle License Fees Reserved for Cities and Counties. Section 15 of Article XI requires all revenues derived from that portion of the Vehicle License Fee rate that does not exceed 0.65% of the fair market value of the vehicle to be allocated to cities and counties.

Uniform Property Taxation. Section 1 of Article XIII specifies that all property is taxable and must be assessed and taxed at full market value. This provision is modified by the restrictions upon reassessment contained in Article XIIIA.

The State May Authorize, But Not Impose, Local Taxes. Section 24 of Article XIII specifies that the state may not impose taxes for local purposes, but may authorize local governments to impose them.

Insurers Are Exempt From Most Taxes. Section 28 of Article XIII exempts insurance companies or associations from all taxes other than the state insurance gross premiums tax, local property taxes, and motor vehicles fees. Only the rate of the gross premiums tax may be changed by the Legislature. (See Chapter 3C of this Reference Book for more information on the Insurance Gross Premiums Tax.)

Local Tax Sharing Requires Voter Approval. Section 29 of Article XIII requires any agreement to share sales or use tax revenues between local jurisdictions to receive majority voter approval.

Sales Tax for Public Safety. Section 35 of Article XIII, approved by the voters in November of 1993, imposes a 1/2 cent sales and use tax statewide with the revenues allocated to cities and counties to fund public safety services.

Property Tax Rate Limited. Section 1 of Article XIIIA (Proposition 13) limits ad valorem property tax revenues to 1% of full cash value. Section 2 of Article XIIIA defines full cash value and provides that property shall only be reassessed when it changes ownership. No state transaction taxes or real estate taxes may be imposed.

Vote Requirement for State Taxes. Section 3 of Article XIIIA provides that increases in state taxes must be approved by a two-thirds vote of both houses of the Legislature and prohibits imposition of new ad valorem property taxes or state transaction taxes.

Two-Thirds Vote for Local Special Taxes. Section 4 of Article XIIIA requires cities, counties, and special districts to receive two-thirds voter approval in order to impose a "special" tax (see below). Section 2(d) of Article XIIIC provides that no local government may impose, extend, or increase any special tax unless it is approved by a two-thirds vote of the electorate.

No Gifts of Public Funds. Section 6 of Article XVI prohibits the Legislature from making gifts or loans of public moneys. The interpretation of this prohibition constrains the Legislature from providing retroactive tax relief.

Redevelopment Areas. Section 16 of Article XVI specifies that an "increment" of tax revenues generated in a redevelopment area shall be allocated to redevelopment activities.

Use of Fuel Tax Revenues. Article XIX requires revenues from fuel taxes to be used for specified transportation-related purposes. (See Chapter 3E for more information on Fuel Taxes.)

3. U.S. CONSTITUTIONAL RESTRICTIONS

Some restrictions in the U.S. Constitution, which California adopted as a condition to admittance into the Union, further limit the power of the Legislature to tax.

For example, the state may not tax the U.S. government or its instrumentalities. The state is also prohibited from taxing imports or exports and from imposing taxes that violate either the Due Process Clause or the Commerce Clause.

4. STATE APPROPRIATIONS LIMIT

The California Constitution (Article XIIIB) imposes an indirect constraint on the level of taxation in the state by way of an appropriations limit.

Under Article XIIIB, most spending by the state from tax proceeds is subject to an annual appropriations limit. The limit is expressed as the level of its **appropriations** in the base year (1986-87), with annual adjustments for changes in population and California's cost-of-living, as defined. Revenues collected that exceed this limit over a two-year period are divided between K-14 programs and rebates to taxpayers.

Proposition 111, approved by the voters in June 1990, substantially modified the provisions of the Article XIIIB appropriations limit. See Chapter 5 of this Reference Book for a detailed discussion of the existing appropriations limit.

5. INITIATIVE STATUTES

Generally, statutory tax law adopted by the voters through the initiative process may not be changed by the Legislature. Unless otherwise provided in the initiative statute, laws adopted through the initiative process may only be changed by a vote of the people. Amendments may be achieved through popular vote on one of the following two types of measures: (a) another initiative that is qualified for the ballot by the people, or (b) a bill that is passed by the Legislature and subsequently placed on the statewide ballot.

Examples of state tax laws adopted by initiative include:

- Repeal of the state inheritance tax (Proposition 6 of June 1982);
- Requirement to index personal income tax brackets (Proposition 7 of June 1982);

- Establishment of the state lottery, and provisions that sales of lottery tickets are exempt from state sales taxes and that lottery winnings are exempt from state income taxes (Proposition 37 of November 1984);

- Increase in cigarette taxes and imposition of tobacco taxes and use of surtax revenues for treatment and research of tobacco-related diseases; school and community health education programs (Proposition 99 of November 1988);

- Increase in state motor vehicle fuel taxes (Proposition 111 of June 1990);

- Increase in cigarette and tobacco taxes and use of funds for early childhood development and smoking prevention programs (Proposition 10 of November 1998);

- Requirements to use the revenues derived from sales taxes on gasoline purchases for transportation purposes instead of depositing the revenues into the General Fund (Proposition 42 of March 2002); and,

- Imposition of a 1% surtax on taxable incomes in excess of $1 million and use of funds for mental health services (Proposition 63 of November 2004).

Some initiative statutes (e.g., Proposition 99) contain language specifying the types of changes the Legislature may make by statute and the vote requirements applicable to those changes.

6. VOTE REQUIREMENTS FOR TAX INCREASES

California is one of 16 states that require super-majority votes of the Legislature on tax increases. As noted in Chapter 1B, any change in state statute that results in any taxpayer paying a higher tax must be passed by a two-thirds vote of each house of the Legislature (Article XIIIA, Section 3, as amended by Proposition 26, November 2, 2010).

7. GOVERNOR'S VETO

In order to become law, bills must be passed by both houses of the Legislature and signed by the Governor or allowed to become law without the Governor's signature. If the Governor vetoes a bill, it may become law if the veto is overridden by a two-thirds vote of each house of the Legislature.

8. LIMITS ON LOCAL GOVERNMENT TAXING AUTHORITY

Four voter-approved initiatives limit the power of local government to impose taxes for local purposes.

Proposition 13 (California Constitution, Article XIIIA approved by the voters in 1978) limits the ability of local governments to impose special taxes. Under Proposition 13, cities, counties, and schools must receive two-thirds voter approval before imposing a "special tax". Local jurisdictions are prohibited from imposing property tax rates above 1%, except for specified rates for debt service. Proposition 13 did not, however, define what constitutes a "special" tax.

Proposition 26, (California Constitution, Article XIIIA and Article XIIIC approved by the voters in 2010) broadens the definition of state and local taxes to include any change in state statute that results in any taxpayer paying a higher tax. This proposition also imposes an additional requirement for voters to approve local levies and charges with limited exceptions.

Proposition 62, a statutory initiative approved by the voters in 1986, prevents the imposition of new general taxes by local agencies without voter approval. However, because Proposition 62 was a statutory, rather than a constitutional initiative, it did not restrict charter law cities' right to impose general taxes without a vote or prevail over any contradictory constitutional provisions. Appellate courts found Proposition 62's voter approval requirements for general taxes unconstitutional. In 1995, however, the California Supreme Court reversed earlier lower court decisions and found Proposition 62 constitutional.

Proposition 218 (California Constitution, Articles XIIIC and XIIID approved by the voters in 1996) requires a majority vote of the people in order to approve the imposition or increase of a general tax. In addition, it provides that any general tax imposed, extended, or increased after January 1, 1995, and before the effective date of Proposition 218, shall continue to be imposed only if approved by a majority vote of the people.

It further provides that no local government may impose, extend, or increase any special tax unless approved by a two-thirds vote. In addition, it provides that a special tax means "any tax imposed for specific purposes, including a tax imposed for specific purposes which is placed into a general fund". Proposition 218 also provides that special purpose districts or agencies, including school districts, have no power to levy general taxes.

Proposition 218 established procedures and requirements for all assessments for special benefits. No assessment may be imposed on any parcel that exceeds the reasonable cost of the proportional special benefit conferred to that parcel. Further, the assessment may not be imposed if there is a majority protest. In general, a majority protest exists if the number of ballots submitted in opposition to the assessment exceed the number of ballots submitted in support to the assessment.

Proposition 218 requires a majority vote of property owners or a two-thirds vote of the electorate to impose or increase a property-related fee for any service other than water, sewer or refuse collection. It further specifies that no property-related fee may be:

- Levied to pay for a general governmental service, such as police or fire service;
- Imposed for a service not used by the property owner; or,
- Used to finance programs unrelated to the property-related services.

9. LIMITS ON STATE INVOLVEMENT IN LOCAL TAXATION

Proposition 1A (California Constitution, Articles XI, XIII, and XIIIB, approved by the voters in 2004) significantly reduced the state's authority over major local government revenue sources and requires the state to reimburse local governments for future revenue shifts approved at the state level. Among its many provisions, Proposition 1A prohibits the state from:

- Reducing any local sales tax rate;
- Limiting a local government's authority to levy a sales tax rate;
- Changing the allocation of local sales tax revenue;
- Shifting property tax revenues from local governments to schools or community colleges, over and above those shifts in effect prior to November 3, 2004;
- Reducing the property tax revenues provided to cities and counties as part of the so-called "triple-flip", an arrangement in which the state shifted property tax revenues for sales tax revenues and pledged the sales tax revenue to pay off deficit bonds approved by voters in March 2004.

Under Proposition 1A, any decision by the state to lower the Vehicle License Fee rate below the rate in effect on November 3, 2004, must be accompanied by a pledge to provide local governments with equal replacement revenues. Additionally, any change in how property tax revenues are shared among local governments within a county must be approved by two-thirds of both houses of the Legislature (prior law allowed such changes to be approved with a majority vote).

Proposition 1A does provide one major exception to its provisions. Beginning in 2008-09, the state may shift a limited amount of property tax revenue from local governments to schools for one fiscal year, provided that (1) the Governor declares that the shift is needed due to a severe state financial hardship, (2) the Legislature approves the shift with a two-thirds vote of both houses, and (3) the money is repaid with interest within three years. Shifts such as the one just described may not be performed more than twice during any 10 consecutive fiscal years.

Sales and Property Tax Swap – the "Triple Flip". The Legislature passed the 2003-04 Budget package with a specific feature to finance the deficit financing bonds. To facilitate repayment, sales tax revenues were swapped for property tax revenues. This three-step method, known as the "triple flip", contains the following:

1) Redirecting one-half of 1% of the local sales tax revenue to the state to repay the deficit reduction bonds. This temporary measure began in fiscal year 2004-05;

2) Offsetting the loss of local sales tax revenues by redirecting an equal amount of property taxes to cities and counties from the Educational Revenue Augmentation Fund (ERAF); and

3) Increasing state education apportionment to replace K-14 revenue losses related to redirected ERAF monies.

CHAPTER 1C
RESTRICTIONS ON THE TAXING POWER OF THE LEGISLATURE

CHAPTER 1D

WHERE TO GET INFORMATION ABOUT STATE TAXES

AGENCY	*TAX*
Board of Equalization (BOE) Check local phone directory for district office or call the toll-free statewide number of (800) 400-7115 or log on to www.boe.ca.gov Call County Assessor for inquiries regarding local property taxes.	Sales and Use Property Alcoholic Beverage Cigarette Emergency Telephone Users Surcharge Energy Resources Surcharge Hazardous Substances Insurance Motor Vehicle Fuel Diesel Fuel Use Fuel Timber Yield
Franchise Tax Board (FTB) (800) 852-5711 (800) 822-6268 (Hearing Impaired) (800) 852-2753 Or log on to: www.ftb.ca.gov For calls outside the United States: (916) 854-6500 Taxpayer Advocate (916) 845-4300	Personal Income Tax Corporation Tax
Department of Motor Vehicles (DMV) (800) 777-0133 Or log on to: www.dmv.ca.gov	Motor Vehicle Fees: License (VLF), Registration, and Weight Use Tax on Vehicles

Department of Insurance	
(800) 927-4357 Los Angeles Area (213) 897-8921	Insurance: Gross Premiums Tax
(916) 492-4300 or log on to: www.insurance.ca.gov	California Earthquake Authority
Employment Development Department (EDD) For employment tax information, log on to EDD's web site at www.edd.ca.gov or contact: Taxpayer Assistance Center (888) 745-3886	State Disability Insurance (SDI) Unemployment Insurance (UI) Withheld Personal Income Tax (PIT) Employment Training Tax (ETT)
Controller For Estate Tax: (916) 324-5961	Estate Tax
Registry of Charitable Trusts (916) 445-2021 (not a toll-free number) Office of Attorney General – Charitable Trusts **Public Inquiry Unit**: (916) 322-3360 (for copies of publications) http://caag.state.ca.us/charities	Charities Charitable Trusts Public Benefit Corporations

CHAPTER 2 - OVERVIEW OF MAJOR TAXES AND REVENUE SOURCES

CHAPTER 2A

INTRODUCTION TO THE PERSONAL INCOME TAX, CORPORATION TAX, AND SALES AND USE TAX

The personal income tax, corporation tax, and sales and use tax are the "Big Three" of California taxes for several reasons. First, they are the largest sources of revenue. Together they raised $86.088 billion in fiscal year (FY) 2010-11 (92.2% of all General Fund revenues) and $80.6 billion in FY 2009-10 (95.3% of all General Fund revenues). (Source: 2012-13 Governor's Budget Summary- REV 02 and 2009-10 Governor's – Enacted Budget Figure SUM-03)

Secondly, they are more complex than most of the other taxes. The personal income tax, for instance, has five different filing statuses, six different tax brackets in each filing status, and dozens of different tax credits and itemized deductions.

Thirdly, these three taxes have the greatest impact on California taxpayers. Nearly all Californians pay the sales tax, and the Franchise Tax Board (FTB) currently receives about 9.1 million taxable returns each year from Californians who owe income tax. Nearly all of California businesses pay some form of the corporation tax.

The following chapters, therefore, devote many pages to these three taxes. The unitary method of taxation for multistate and multinational corporations, formally known as Uniform Division of Income for Tax Purposes Act (UDITPA), is among the most complicated of all provisions of California tax law and is also discussed. The remaining chapters are devoted to the other California taxes.

Readers may obtain additional information on these taxes by calling the various administrative agencies – the FTB, the State Board of Equalization (BOE), and the Employment Development Department (EDD).

CHAPTER 2B

PERSONAL INCOME TAX

HIGHLIGHTS

• Tax Rates	1.00% - 9.30%; brackets are indexed annually for inflation.
• Number of Filers*	Over 14.1 million returns filed in 2010 (most recent year for which this information is available).
• Threshold of Taxation* (Gross income)	$15,152 for single taxpayers with no dependents. $30,305 for married taxpayers with no dependents.
• Revenue**	2010-11 $49.5 billion 2011-12 (Forecast) $51.9 billion 2012-13 (Forecast) $56 billion 53% of total General Fund revenues. (2010-11)
• Administration	Franchise Tax Board (FTB)

*Source: FTB
**From the Governor's 2012-13 Budget Summary General Fund Revenue Forecast Summary Table, Figure SUM-02

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1. WHO PAYS THE PERSONAL INCOME TAX

Individuals who are residents of California are liable for the personal income tax on income derived from all sources. Nonresidents of this state must pay income tax on income derived from sources within California. However, nonresidents are generally allowed a credit against their California tax for taxes they pay to their state of residence on the same income.

In addition to individuals, partnerships, limited liability companies, estates, and trusts are taxed under the "Personal Income Tax Law".

PERSONAL INCOME TAX COMPONENTS

Federal Income From All Sources
Minus **Exempt Income (examples)**: Nontaxable Social Security and Railroad Retirement; Insurance Proceeds; Bequests and Gifts; Public Assistance; IRA and Keogh Interest; Interest on Certain State and Municipal Government Obligations; Scholarships and Fellowships
Equals **Total Gross Income**: Salaries and Wages; Taxable Interest; Dividends; Taxable State and Local Income Tax Refunds; Alimony Received; Business Income or Loss; Capital Gain or Loss; Other Gains or Losses; Taxable IRA Distributions; Taxable Pensions and Annuities; Income or Loss from Rental Real Estate, Royalties, Partnerships, S Corporations, Estates, Trusts, REMICS, etc.; Farm Income or Loss; Unemployment Compensation; Taxable Social Security Benefits; Other Income; Gambling Winnings including Lotteries and Raffles
Minus **Adjustments to Income**: IRA Deductions; One-Half of Self-Employment Tax; Self-Employed Health Insurance Deduction: Self-employed SEP, SIMPLE, and Qualified Plans; Penalty on Early Withdrawal of Savings; Alimony Paid; Moving Expense; Student Loan Interest Deductions; MSA Deductions; HSA Deductions; Educator Expenses; Tuition and Fees Deduction; Domestic Production Activities Deduction; Certain Business Expenses of Reservists, Performing Artists, and Fee-basis Government Officials
Equals **Federal Adjusted Gross Income** (AGI)
Minus **Federal/State Differences**: State Income Tax Refund; Unemployment Compensation; Taxable Social Security Benefits; Nontaxable Federal Interest and Dividend Income; Railroad Retirement and Sick-Pay; California Lottery Winnings; Earnings and Per Capita Payments of American Indian Tribal Members Living in Indian Country Affiliated with their Tribe; Differences in Clergy Housing Allowance; IRA Distributions - Basis Recovery of IRAs, Differences in Pensions and Annuities; Differences in Passive Activities; Differences in Depreciation and Amortization; Differences in Small Business Expensing Deduction; Differences in Capital Gain or Loss; Differences in Other Gain or Loss; Differences in Net Operating Losses; Differences in Alimony Paid
Plus **Federal/State Differences**: Interest on State or Municipal Bonds From Other States; Differences in Passive Activities; Differences in Depreciation and Amortization; Differences in Small Business Expensing Deduction; Differences in IRA Deduction; Differences in Student Loan Interest Deduction; HSA Deductions; Income Exempted by U.S. Treaty; Differences in Clergy Housing Allowance; Educator Expenses; Tuition and Fees Deduction; Differences in Capital Gain or Loss; Differences in Other Gain or Loss; Differences in Net Operating Losses; Domestic Production Activities Deduction; Differences in Certain Business Expenses of Reservists, Performing Artists, and Fee-basis Government Officials; Differences in Alimony Received
Equals **California Adjusted Gross Income** (AGI)
Minus **Deductions**: California Standard Deduction or Federal Itemized Deductions; Adjusted for Federal/State Differences; State, Local and Foreign Income Taxes or General Sales Tax; Interest Paid; Contributions; Casualty and Theft Loss; Employee Business Expense; Federal Estate Tax; Generation Skipping Tax; Private Mortgage Insurance; Miscellaneous Deductions
Equals **California Taxable Income**
Multiplied by **Applicable Marginal Tax Rates**
Minus **Tax Credits** (Credits are allowable only after applicable limitations based on the tentative minimum tax): Exemption for Personal, Blind, Senior and Dependent; Senior Head of Household; Dependent Parent; Child Adoption; Prison Inmate Labor; Enterprise Zone Employee; Joint Custody Head of Household; Low-Income Housing; Enterprise Zone Hiring and Sales Tax; Research; Other States Taxes; Employer Child Care Program and Contribution: Prior year Alternative Minimum Tax; Local Area Military Base Recovery Area; Manufacturing Enhancement Area; Targeted Tax Area; Natural Heritage Preservation; Environmental Tax Credit; Nonrefundable Renters' Credit; Disabled Access for Small Business; Enhanced Oil Recovery; Transportation of Donated Agricultural Products; Community Development Qualified Deposit; Carryovers from Repealed Credits; New Jobs; Child and Dependent Care Expenses Credit; Fresh Fruits and Vegetables Credit.
Plus **Other Taxes**: Alternative Minimum Tax; Tax on Early Use of IRA, Keogh or Annuity Contract; Tax on Accumulation Distributions of Trusts; Lump-Sum Distribution; Recapture Taxes; Use Tax; Mental Health Services Tax
Equals **Total Tax Liability**
Minus **Payments and Refundable Credits**: Income Tax Withholding; Estimated Tax; Payment with Extensions; Excess SDI or VPDI; Overpayment Applied from Prior Year; Real Estate or Other Withholdings
Plus **Voluntary Contributions**
Equals **Overpayment or Balance Due**

Source: Franchise Tax Board

2. CALCULATION OF THE PERSONAL INCOME TAX

Taxpayers must compute their tax liability based on income earned during the year, usually the calendar year. Generally, taxpayers must add up all sources of nonexempt income and subtract the adjustments and deductions to which they are entitled to calculate "taxable income". They then apply the appropriate tax rate to their taxable income to arrive at a preliminary tax liability. After calculating their preliminary tax liability, taxpayers may then apply tax credits, which reduce liability (i.e., every $1 in tax credits reduces a taxpayer's tax liability by $1). In most cases, the tax liability remaining after tax credits are applied is the actual tax liability. However, a few taxpayers are liable for additional taxes under special circumstances.

The chart on the preceding page illustrates the steps involved in calculating final tax liability. As the chart shows, the income that is actually subject to tax is much smaller than a taxpayer's total income earned or received.

3. RELATIONSHIP OF STATE AND FEDERAL TAX FORMS

California's tax law largely conforms to federal income tax law. This allows substantial simplicity for state tax forms. Today, a majority of the steps in computing income subject to tax are done on federal Forms 1040, 1040A, or 1040EZ. California Forms 540 and 540A start with federal adjusted gross income (AGI). These forms then require taxpayers to make adjustments to reflect differences in state law, apply state tax credits, and compute state tax.

A third state form, without a comparable federal form, offers taxpayers a different, simplified method of calculating their taxes. Beginning with the 1999 tax year, Form 540 2EZ replaced Form 540 EZ. Form 540 2EZ begins with the taxpayer's total wages. However, the tax tables that accompany Form 540 2EZ already include the standard deduction and personal and dependent exemption credits, thereby simplifying the calculation processes required for other state forms.

In addition to the state forms available on the FTB Web site, California also offers ReadyReturn, a free service the FTB developed to make filing individual income tax returns easier. The FTB uses information from the last return filed by the taxpayer and from the taxpayers' current W-2 forms to pre-fill a California state tax return. Currently, there is no comparable federal program.

4. TAXABLE AND NONTAXABLE INCOME

For purposes of the personal income tax, income is measured or defined in four important stages: (a) Calculation of exempt income; (b) Gross income; (c) AGI; and (d) Taxable income (TI).

The major sources of income that are taken into account in computing tax liability include the following:

- Gross Income. Gross income is the starting point for calculating tax on the federal return. Gross income includes income from all sources, unless otherwise exempt. Income that must be included in gross income for both state and federal purposes includes salaries, wages, commissions, tips, alimony received, dividends, interest earnings, annuities, pensions, net gains from the sale of capital assets, net partnership and proprietorship income, net farm income, and others. Losses from capital assets, partnerships, proprietorships may be limited.

For some items, the amount of income entered on the tax return may be a negative number if the taxpayer has incurred a loss.

- Exempt Income. Certain types of income are exempt from tax. In many cases, taxpayers are not required to report this income on their tax return. Some of these items are exempt in California but are taxable for federal purposes. The most common income items that are taxable on the federal return and exempt on the state return are California lottery winnings, a portion of Social Security and Railroad Retirement benefits, unemployment compensation, and interest from U.S. Savings Bonds and Treasury Bills. Since California uses federal income as the starting figure, these items must be subtracted from federal income before calculating California tax.

- Adjusted Gross Income. After totaling all items included in gross income, certain deductions are allowed to compute AGI. These "adjustments" include payments into certain retirement plans (IRAs, Keogh plans, self-employed plans, etc.), alimony paid, penalties paid on early withdrawal of savings, and the employer portion of Social Security that is paid by the self-employed (i.e., the self-employment tax). The remaining amount is AGI.

- Taxable Income. Either the standard deduction or itemized deductions may further reduce AGI. These are described below. The remaining amount is taxable income. Tax rates are applied to this amount in order to compute tax owed before credits.

5. DEDUCTIONS FROM ADJUSTED GROSS INCOME (AGI)

All taxpayers are allowed to deduct certain amounts from AGI. Most deductions are intended to reduce the amount of income subject to tax to reflect certain living costs incurred by all taxpayers. The rationale behind deductions is that these living costs affect taxpayers' ability to pay.

The value of a deduction to a taxpayer (i.e., the amount by which the deduction reduces the taxpayer's tax liability) generally may be estimated by multiplying the deduction by the taxpayer's highest marginal tax rate (see Section 8 of this chapter for a discussion of marginal rates). For example, the approximate state tax savings to a person in the top tax bracket (9.30%) who deducts a $100 expense is $9.30 ($100 expense times the 9.30% tax rate).

A taxpayer may reduce his or her AGI by the larger of either the standard deduction or the total of his or her allowed itemized deductions.

Standard Deduction. The standard deduction is a fixed dollar amount intended to approximate deductible living expenses. For 2011, the standard deduction amounts under California law are as follows:

Single and Married/Registered Domestic Partner (RDP) Filing Separately	$3,769
Married/RDP Filing Jointly, Surviving Spouse, and Head of Household	$7,538

These amounts are indexed annually for inflation.

Standard deduction amounts under federal law are different from those in California law. In 2011, federal amounts are as follows:

Single	$ 5,800
Married/RDP Filing Jointly or Qualified Widow(er)	$11,600
Head of Household	$ 8,500
Married/RDP Filing Separately	$ 5,800

Federal law also allows taxpayers to increase their standard deductions if they have dependents, are over age 65, and/or blind.

Unlike federal law, California does not allow larger standard deductions for taxpayers that have dependents and/or are over age 65 and/or blind. Instead, state law provides exemption credits (see Section 7).

Itemized Deductions. As an alternative to the standard deduction, both state and federal law allow various specific expenses (called itemized deductions) to be deducted from AGI. The major itemized deductions permitted include the following:

- Home mortgage interest on first and second homes, subject to certain limits;

- Property taxes;

- Charitable contributions up to an annual cap. Amounts above the cap may be carried over and deducted in subsequent years;

- Unreimbursed medical expenses in excess of 7.5% of AGI;

- Unreimbursed casualty and theft losses of over $100. However, only losses in excess of 10% of AGI may be deducted; and

- Certain miscellaneous expenses in excess of 2% of AGI. Examples of deductible miscellaneous expenses include union dues, uniforms, job-related educational expenses, tax return preparation fees, safe deposit box costs, and unreimbursed business expenses.

California's rules on itemized deductions are very similar to federal rules. The major difference is that federal law allows an itemized deduction for state income taxes paid, whereas California law does not.

State limits itemized deductions for high-income filers. For 2011, the California phase-out affects single filers with AGIs in excess of $166,565, joint filers with AGIs in excess of $333,134, and heads of household with AGIs in excess of $249,852.

For federal purposes in 2011, taxpayers with AGI above a certain amount will no longer lose part of their itemized deductions.

Exemptions. In addition to allowing taxpayers a choice of claiming either the standard deduction or itemizing deductions, federal law also allows taxpayers to claim personal exemptions. The 2010 federal exemption amount equals $3,700. For 2011, taxpayers will no longer lose part of their deduction for personal exemptions, regardless of the amount of the taxpayer's AGI.

6. FILING STATUS

Taxpayers must file using one of five filing statuses: (a) Single; (b) Married Filing Separately; (c) Married Filing Jointly; (d) Head of Household; or (e) Surviving Spouse.

Filing status affects tax liability because it determines which tax rate schedules and personal exemption credits a taxpayer may claim on his or her return.

A head of household is generally a person who is not married at the end of the taxable year and who has a child or other relative living with him or her for more than half the year.

A taxpayer qualifies to file as a surviving spouse if he or she is a widow(er) who remains unmarried and maintains a dependent in the home. The taxpayer may file as a surviving spouse for the two tax years following the tax year in which the taxpayer's spouse dies. In the year the spouse dies, the taxpayer must file a joint return. The surviving spouse filing status generally permits the use of tax rates, deductions, and credits similar to those used by joint filers.

In general, California taxpayers must use the same filing status on their state returns as they use on their federal returns. In certain situations where one spouse is in the military or a nonresident, or the taxpayers are RDPs, California permits a filing status different from the filing status claimed on the taxpayer's federal return. A taxpayer might choose different filing statuses at the state and federal level if he or she could lower his or her tax liability by doing so. Effective for tax years beginning in 2007, taxpayers registered with the Secretary of State as RDPs are required to use a filing status of either married/RDP filing jointly or married/RDP filing separately for California purposes, regardless of their federal filing status. [SB 1827 (Migden), Chapter 802, Statutes of 2006; SB 105 (Migden), Chapter 426, Statutes of 2007].

7. PERSONAL, DEPENDENT, SENIOR, AND BLIND EXEMPTION CREDITS

California taxpayers are entitled to personal and dependent exemption credits in addition to their deductions. These exemption credits are intended to shelter a minimum amount of income of each person in the household from tax. The federal government offers similar tax relief through the personal exemption and increased standard deductions for certain qualifying individuals.

The personal exemption credit can be claimed by all taxpayers, except those who can be claimed as a dependent on another person's return. An example would be a college student who earns enough income to file his or her own tax return, but who is also eligible to be claimed as dependent on his or her parents' return.

A dependent exemption credit may be claimed for any relative of the taxpayer (child, stepchild, parent, stepparent, sibling, etc.) whom the taxpayer supports for over half of the calendar year. A non-relative who lives in the taxpayer's home and is supported by the taxpayer can also be claimed as a dependent.

An additional exemption credit can be claimed for any person in a household who is blind or age 65 or older on the last day of the taxable year. A person who is both blind and a senior is eligible for two additional exemption credits in addition to the personal or dependent exemption credit.

The 2011 personal, dependent, senior and blind exemption credits are as follows:

Single, Head of Household and Married/RDP Filing Separately	$ 102
Married/RDP Filing Jointly and Surviving Spouse	$ 204
Each Dependent	$ 315
Additional Credit for Person Over Age 65	$ 102
Additional Credit for Blind Person	$ 102

These credits are indexed for inflation annually.

State exemption credits are phased out for taxpayers with federal AGIs that exceed a threshold amount. The threshold amounts for 2011 are $333,134 (married/RDP filing jointly and surviving spouse), $249,852 (head of household), and $160,565(single and married/RDP filing separately). Like the exemption credits, the phase-out threshold amounts are indexed for inflation annually.

For state tax purposes, when a taxpayer reaches the phase-out threshold, he or she is required to reduce his or her credits by $6 (if a single taxpayer, head of household, or married/RDP filing separately) or $12 (if married/RDP filing jointly or surviving spouse) for each $2,500 ($1,250 if married filing separate) by which that taxpayer's AGI exceeds the threshold amount. For example, a married/RDP couple with two dependents would have their total exemption credits reduced by $24 (12 + 6 + 6) for each $2,500 by which their AGI exceeded the threshold amount.

8. TAX RATES AND BRACKETS

Proposition 63, approved by the voters in November 2004, adds a 1% surtax on that portion of a taxpayer's taxable income in excess of $1 million, effective for tax years beginning on January 1, 2005. Revenues of $1 billion are estimated for the 2010-11 fiscal year. Annual revenues of $1.2 billion for 2011-12, and $1.5 billion for 2012-13 are projected. Approximately 30,946 tax returns were liable for the surcharge for the 2009 taxable year.

Revenue generated by the Proposition 63 tax surcharge is used to expand existing county mental health programs and create new programs.

California law provides for six progressive marginal tax rates applied to taxable income: 1.00%, 2.00%, 4.00%, 6.00%, 8.00%, and 9.30%. The term "marginal tax rate" refers to the rate applied to the last (or highest) dollar of taxable income. Additionally, as noted above, for tax years beginning on or after January 1, 2005, a 1% surtax is imposed on taxable income in excess of $1 million.

Under a system of progressive marginal tax rates (or "brackets"), each additional increment of income a person earns is subject to a higher tax rate. For example, the first increment of income is taxed at a rate of 1.00%, the second (next greater) increment is taxed at a rate of 2.00%, the third increment is taxed at a rate of 4.00%, and so on. The principle behind progressive marginal tax rates is that people with more income have a greater ability to pay taxes than those with lower incomes.

The California tax rates and income brackets that apply for the 2011 year are shown in Table 2 on the next page. Note that each filing status has the same rates of tax but the amounts of income included in each respective bracket are different. Table 2 shows that in 2011, the maximum tax rate of 9.30% applied to single taxpayers with taxable incomes of $48,029 or more and to married taxpayers with taxable incomes of $96,058 or more. The income brackets are indexed annually for inflation (see Section 10 of this chapter).

TABLE 2

CALIFORNIA TAX RATES FOR 2011

IF TAXABLE INCOME IS:

Over:	But Not Over:	The Tax Amount is:

Single Person or Married/RDP Filing Separate – Schedule X

$ 0	$ 7,316	1.00% of the amount over $0
$ 7,316	$17,346	$73.16 plus 2.00% of the amount over $7,316
$17,346	$27,377	$273.76 plus 4.00% of the amount over $17,346
$27,377	$38,004	$675.00 plus 6.00% of the amount over $27,377
$38,004	$48,029	$1,312.62 plus 8.00% of the amount over $38,004
$48,029	No Limit	$2,114.62 plus 9.30 of the amount over $48,029

Married/RDP Filing Joint or Qualifying Widow(er) with Dependent Child – Schedule Y

$ 0	$14,632	1.00% of the amount over $0
$14,632	$34,692	$146.32 plus 2.00% of the amount over $14,632
$34,692	$54,754	$547.52 plus 4.00% of the amount over $34,692
$54,754	$76,008	$1,350 plus 6.00% of the amount over $54,754
$76,008	$96,058	$2,625.44 plus 8.00% of the amount over $76,008
$96,058	No Limit	$4,229.24 plus 9.30% of the amount over $96,058

Head of Household – Schedule Z

$ 0	$14,642	1.00% of the amount over $0
$14,642	$34,692	$146.42 plus 2.25% of the amount over $14,642
$34,692	$44,721	$547.42 plus 4.25% of the amount over $34,692
$44,721	$55,348	$948.58 plus 6.25% of the amount over $44,721
$55,348	$65,376	$1,586.20 plus 8.25% of the amount over $55,348
$65,376	No Limit	$2,388.44 plus 9.55% of the amount over $65,376

TABLE 3

FEDERAL TAX RATES FOR 2011

IF TAXABLE INCOME IS:

Over:	But Not Over:	The Tax Amount is:
Single Person - Schedule X:		
$ 0	$ 8,500	10% of the amount over $0
$ 8,500	$ 34,500	$850 plus 15% of the amount over $8,500
$ 34,500	$ 83,600	$4,750 plus 25% of the amount over $34,500
$ 83,600	$174,400	$17,025 plus 28% of the amount over $83,600
$174,400	$379,150	$42,449 plus 33% of the amount over $174,400
$379,150	No Limit	$110,016.50 plus 35% of the amount over $379,150
Married/RDP Filing Joint or Qualifying Widow(er) - Schedule Y-1:		
$ 0	$ 17,000	10% of the amount over $0
$ 17,000	$ 69,000	$1,7000 plus 15% of the amount over $17,000
$ 69,000	$139,350	$9,500 plus 25% of the amount over $69,000
$139,350	$212,300	$27,087.50 plus 28% of the amount over $139,350
$212,300	$379,150	$47,513.50 plus 33% of the amount over $212,300
$379,150	No Limit	$102,574 plus 35% of the amount over $379,150
Married/RDP Filing Separately - Schedule Y-2:		
$ 0	$ 8,500	10% of the amount over $0
$ 8,500	$ 34,500	$850 plus 15% of the amount over $8,500
$ 34,500	$ 69,675	$4,750 plus 25% of the amount over $34,500
$ 69,675	$106,150	$13,543.75 plus 28% of the amount over $69,675
$106,150	$189,575	$23,756.75 plus 33% of the amount over $106,150
$189,575	No Limit	$51,287 plus 35% of the amount over $189,575
Head of Household - Schedule Z:		
$ 0	$ 12,150	10% of the amount over $0
$ 12,150	$ 46,250	$1,215 plus 15% of the amount over $12,150
$ 46,250	$119,400	$6,330 plus 25% of the amount over $46,250
$119,400	$193,350	$24,617.50 plus 28% of the amount over $119,400
$193,350	$379,150	$45,323.50 plus 33% of the amount over $193,350
$379,150	No Limit	$106,637.50 plus 35% of the amount over $379,150

9. INDEXING

Many components of the Personal Income Tax Law used to calculate tax liability are modified annually to adjust for inflation using a method called indexing. For example, income brackets, exemption credits, the standard deduction, the joint custody head of household credit, and many of the phase-out limits in the Personal Income Tax Law are indexed annually. Indexing is intended to prevent taxpayers from being pushed into higher marginal tax brackets by increases in income that just keep pace with inflation, while the taxpayers' real buying power is not increasing.

The indexing adjustment equals the percentage difference between the California Consumer Price Index (CCPI) in June of the current year and June of the prior year. Each dollar value to be indexed is multiplied annually by this percentage change.

Indexing is illustrated below using one of the most important components of the personal income tax – brackets. As noted above, annual indexing of income within the tax brackets is intended to keep a taxpayer in the same bracket, as long as his or her income increases no faster than the CCPI. For example, the effect of indexing on two hypothetical taxpayers would be as follows:

- A taxpayer who gets a cost-of-living wage increase exactly equal to inflation will have more income in dollars but will have the same buying power as is in the previous year. Without indexing, the taxpayer's increased income might bump him or her into a higher marginal tax bracket, causing the taxpayer to owe additional income tax reflecting a higher tax rate as well as increased income. Indexing keeps the taxpayer's tax rate at the same level as the prior year, since the taxpayer's buying power remains the same.

- A taxpayer on a fixed income loses buying power in inflationary times. Without indexing, the taxpayer's tax liability would remain the same, even though the taxpayer's income was worth less in each succeeding year.

  Indexing of the tax rate brackets lowers the taxpayer's tax liability, consistent with the taxpayer's decline in buying power.

Federal law began indexing tax rate brackets in 1985 and the standard deduction in 1989. The federal indexing measure differs from California through use of the U.S. Consumer Price Index and a different 12-month period (August to August).

10. TAX CREDITS

Tax credits reduce tax liability on a dollar-for-dollar basis (i.e., $1 in tax credits reduces a taxpayer's tax liability by $1). After the taxpayer computes tax due for his or her taxable income, he or she subtracts the credits to which he or she is entitled, thereby reducing the amount of tax due. Thus, credits have a greater impact than deductions, whose value in reducing tax liability (as discussed in Section 5 of this chapter) equals the amount of the deduction times the tax rate. Most state tax credits are not refundable if they exceed total tax due. However, in some cases credits that exceed tax liability may be carried forward and claimed against a taxpayer's future years' taxes.

Credits are usually provided to give tax relief to people who incur certain non-discretionary costs, have limited ability to pay taxes, or to provide incentives to people to engage in certain activities that are socially or economically desirable. Tax reform legislation enacted in 1987 placed sunset dates (i.e., automatic repeal) on many credits in the Personal Income Tax Law in order to give the Legislature an opportunity to evaluate their impact.

The amount of the tax credits allowable in any taxable year may be limited by the taxpayer's alternative minimum tax liability or by tentative minimum tax (see Section 14 of this chapter for further information).

Some of the tax credits allowed in state law are similar to credits offered in federal law. However, in most cases the federal credits are larger.

The most significant credits allowed in state law are described below. The credits are available to both full-time and part-time California residents, as well as to nonresidents with California-source income. California residents are entitled to the full value of each credit, as long as they meet all of the eligibility criteria for the credits. Nonresidents and part-year residents are required to prorate the amount of each credit claimed using rules specified in statute.

Renters' Credit. The Legislature enacted a "renters' credit" in 1972. In the first 20 years following its inception, both the value of the credit and the income eligibility rules applied to taxpayers that claimed the credit varied, but the credit was always available. However, the renters' tax credit was suspended when California experienced severe economic pressures in the early 1990s. As part of budget agreements, the credit was not available during the five-year period corresponding to the 1993 through 1997 taxable years. The Legislature reinstated the renters' credit effective January 1, 1998.

Historically, the renters' tax credit was also refundable. However, as reinstated, the renters' credit is nonrefundable and is subject to income phase-outs. For 2011, married/RDP taxpayers filing jointly, heads of household, and surviving spouses with AGIs of $71,318 or less may claim a credit of $120. Single taxpayers and married/RDP taxpayers filing separately with AGIs of $35,659 or less may claim a credit of $60. See Chapter 6F (Renters' Credit) for more information.

There is no similar credit in federal law.

Senior Head of Household Credit. Taxpayers who are 65 years of age or older on December 31st of the current tax year, qualified as head of household during either the previous two tax years by providing a household for a qualifying individual who died during one of the previous two tax years, and whose AGI for 201 is $58,963 or less, may claim a credit equal to 2% of taxable income. For 2011, the maximum allowable credit is $1,111. The AGI cap and maximum allowable credit are indexed annually for inflation.

There is no similar credit in federal law.

Joint Custody Head of Household Credit. Taxpayers who qualify as joint custody heads of household may claim a state tax credit that offsets a portion of their tax liability. To qualify, the taxpayer must: (a) be unmarried at the end of the year; (b) have custody of a dependent under a custody agreement for between 146 and 219 days of the year; and (c) furnish over half of all household expenses. The credit is 30% of the net tax, not to exceed $374 for the 2011 tax year. The maximum available credit is indexed for inflation annually. The purpose of this credit is to allow divorced couples who share custody of a child to share the benefits of the head of household filing status. A similar credit is available to separated married persons who support a dependent parent.

There is no similar credit in federal law.

Credit for Taxes Paid to Other States. In order to avoid double taxation, California residents are generally allowed a credit for income taxes paid to another state on income that is also taxed by California. The credit may not exceed the tax California would have imposed on the income taxed by such other state. If the other state taxes this income at a lower rate than California, this credit has the effect of allowing California to tax only a portion of the income taxed by the other state.

Excess Employee's State Disability Insurance (SDI) Credit. Employees who work for more than one employer and who earned over $93,316 during the 2011 tax year may have paid more than the maximum State Disability Insurance through over-withholding. The excess may be recovered by claiming a credit against the California personal income tax on a Form 540 or 540A tax return.

Child Adoption Cost Credit. This credit is equal to 50% of the costs of adopting a minor child who is a citizen or legal resident of the United States and is in the custody of a California public agency or a political subdivision of California. The credit can be claimed in the taxable year in which the decree or order of adoption is entered, even though qualifying costs paid or incurred in prior years may qualify for the credit. Costs eligible for the credit include: (a) fees for required services of either the Department of Social Services or a licensed adoption agency; (b) travel and related expenses for the adoptive family that are directly related to the adoption process; and (c) medical fees and expenses that are not reimbursed by insurance and are directly related to the adoption process. The maximum allowable credit cannot exceed $2,500 per minor child. This credit may be carried over and is allowed for taxable years beginning on or after January 1, 1994.

Federal tax law also offers a child adoption cost credit. Taxpayers may claim a credit of up to $13,170 for the qualified adoption expenses of each eligible child. Phase-out of the federal credit begins for taxpayers with modified AGIs of more than $182,520; the federal credit is completely phased out for taxpayers with modified AGIs of $222,520 or more for the 2011 tax year. The limitation on eligible expenses and phase-out incomes are increased for inflation annually. Qualified adoption expenses include reasonable and necessary adoption fees, court costs, attorney fees, and other expenses directly related to the legal adoption of an eligible child. The federal credit is refundable for the 2010 tax year and after.

Child and Dependent Care Credit. Beginning with the 2000 taxable year, taxpayers that maintain a household within the state for a qualifying individual may claim the child and dependent care credit for employment-related expenses. The state credit supplements a similar federal household and dependent care credit.

As defined by the federal law, a qualifying individual is a dependent of the taxpayer that is under the age of 13 or a dependent or spouse who is physically or mentally unable to care for himself or herself. Employment-related expenses are defined as those incurred to enable the taxpayer to obtain or retain gainful employment.

The federal credit, which can be applied to a maximum of $3,000 in expenses for one dependent and $6,000 in expenses for two or more dependents, is equal to between 20% and 35%, depending on a taxpayer's AGI. Taxpayers with AGIs of $15,000 or less are eligible for the 35% credit. The amount of the credit decreases by one percentage point for each $2,000 by which a taxpayer's AGI exceeds $15,000. Thus, a credit of 20% may be claimed by taxpayers with AGIs over $43,000.

The state credit amount is a percentage of the federal credit, as follows:

California AGI	Credit Percentage (% of Federal Credit)
$40,000 or less	50%
$40,001 to $70,000	43%
$70,001 to $100,000	34%
Over $100,000	0%

California taxpayers may claim the state credit regardless of whether they have federal tax liability.

Credits for Businesses. A number of other credits are available for business taxpayers that file under the personal income tax law, such as sole proprietorships and partnerships. The total business credit allowed for taxpayers with net business income (PIT) greater than $500,000 is limited to 50% of the total credit available for taxable years beginning on or after January 1, 2008, and before January 1, 2010. Any credit amount in excess of the limitation is eligible for carryforward. [AB 1452 (Committee on Budget), Chapter

763, Statutes of 2008.] Refer to the Bank and Corporation Tax chapter (Chapter 2C) for a description of tax credits applicable to businesses.

New Jobs Tax Credit - Current state tax law, SBX3 15 (Calderon, Stats. 2009, Third Extraordinary Session, Ch. 17), allows a New Jobs Tax credit, for taxable years beginning on or after January 1, 2009, to a qualified employer in the amount of $3,000 for each qualified full-time employee hired in the taxable year, determined on an annual full-time equivalent basis. The credit is allocated by the FTB and has a cap of $400 million for all taxable years. The credit remains in effect until December 1 of the calendar year after the year in which the cumulative credit limit has been reached and is repealed as of that date. Any credits not used in the taxable year may be carried forward up to eight years.

There is no comparable federal credit.

Donated Fresh Fruits or Fresh Vegetables Credit. Qualified taxpayers may claim a credit equal to 10% of the costs of fresh fruits or fresh vegetables donated to a California food bank.

A “qualified taxpayer” is defined as the person responsible for planting the crop, managing the crop, and harvesting the crop from the land. The cost of donated fresh fruits or fresh vegetables is the cost of those products that would otherwise be included in inventory costs. Generally, inventory costs would include both the direct costs and the allocated indirect costs required to produce the fresh fruits or fresh vegetables. Because inventory costs are costs of doing business, the credit is available only to a business that is also a qualified taxpayer.

The recipient of a donation of fresh fruits or fresh vegetables must provide to the donor certification of the type and quantity of the products donated, the name of the donor or donors, the name and address of the donee nonprofit organization, and, as provided by the donor, the estimated value of the donated products and the location where the donated product was grown. A donor that is a qualified taxpayer must provide a copy of the certificate to the FTB upon request.

The fresh fruits and fresh vegetables credit applies to taxable years beginning on or after January 1, 2012, and before January 1, 2017. This credit may be carried forward for up to six years and may not reduce the tax below tentative minimum tax for AMT purposes.

11. CAPITAL GAINS AND LOSSES

Capital gains are profits from the sale of property and other capital assets. They are classified as a different type of income from "ordinary income," which includes wages, salaries, and interest.

Capital assets are defined as all property except the following: inventories; property held for sale in the ordinary course of business; depreciable business property; and real property used in business. Capital assets include real property (land and buildings), personal property, and intangible assets (such as stock).

Capital gains are measured as the difference between the amount realized when the asset is sold and the asset's basis. Although an asset's basis is normally that asset's original purchase price, basis can be adjusted to reflect improvements and costs of sale. Any amounts invested in improvements are added to the purchase price to increase basis; costs of sale are deducted from the sales price to reduce basis. Capital gains are generally recognized in the year an asset is sold or otherwise disposed.

Through 1986, capital gains were accorded special tax treatment in California. During that time, gains on assets held longer than one year were partially excluded from tax. However, beginning in 1987, California began including all capital gains within the measure of a taxpayer's income. California's tax treatment of capital gains is different from federal treatment, because California applies the same tax rates to capital gains as applies to ordinary income; the federal government applies lower rates to qualifying capital gains.

Under federal (but not state) law, most types of investments held more than one year are subject to capital gains tax at a top rate of 20% (10% for investors in the 15% tax bracket) if the sale takes place before May 6, 2003.

For sales on or after May 6, 2003, and before January 1, 2013, the maximum capital gain rate is 15% (5% for individuals taxed in the 10% or 15% tax bracket, or at a zero percent rate for tax years beginning after 2007).

These lower rates apply to most (but not all) types of investments. Among those ineligible are collectibles with a maximum rate of 28%. Nor do the lower rates apply to gains from the sale of investment real estate to the extent of depreciation deductions previously claimed with a maximum rate of 25%.

Special enacted state and federal laws provide an exemption for 50% of the capital gains realized from the sale of qualified small business stock (QSBS) issued after August 10, 1993, and before February 18, 2009, and be held for a least five years prior to sale. For QSBS acquired after September 27, 2010, and before 2012, and held for at least five years federal law provides an exemption for all of the gain on the disposition of the QSBS stock. For QSBS acquired after February 17, 2009, and before September 28, 2010, and held for at least five year, federal law provides an exemption of 75% of any gain realized on the disposition of QSBS stock. For state tax purposes, the company in which the investment is made must be located in California and have assets of not more than $50 million. Certain industry and other limitations apply, including industry growth in payroll, etc.

As under federal law, capital losses are fully deductible against capital gains realized in the same year. In addition, up to $3,000 of capital losses in excess of capital gains are deductible against ordinary income in any taxable year. If excess capital losses are greater than $3,000, the unused portion may be carried forward indefinitely to offset capital gains in future years and to deduct against ordinary income subject to the $3,000 annual limit. Federal law allows a three-year carryback of capital losses, but California does not.

State law also conforms to federal capital gains treatment on sale or exchange of a principal residence. Specifically, state and federal laws provide that a single taxpayer may exclude up to $250,000 and married taxpayers filing jointly may exclude up to $500,000 of gain realized on the sale or exchange of a principal residence. The exclusion is allowed each time a taxpayer selling a principal residence meets certain eligibility requirements, but generally no more frequently than once every two years. To be eligible for the exclusion, a taxpayer must have owned the residence and occupied it as a principal residence for at least two of the five years prior to the sale or exchange. Federal and state laws repealed the once-in-a-lifetime exclusion of $125,000 and the rollover of gain from the sale of a principal residence provisions that previously existed.

See Chapter 6D for a further discussion of special homeowner provisions.

12. DEPRECIATION AND AMORTIZATION

Depreciation and amortization deductions allow taxpayers to recover capital investments in certain assets over the useful lives of those assets by deducting reasonable allowances for the exhaustion, wear, and tear of property.

Depreciation and amortization are allowed for property used in a trade or business or for the production of income (investment). Depreciable property includes most kinds of tangible property and improvements to real property, farm buildings, machinery, and other physical assets. Intangible assets that may be amortized include copyrights, licenses, franchises, goodwill, and covenants not to compete. Depreciation and amortization are not allowed for property used for personal purposes, inventory and stock in trade, land, and depletable natural resources.

Under the personal income tax law, California generally conforms to the federal depreciation system for assets placed in service on and after January 1, 1987. This is called the Modified Accelerated Cost Recovery System (MACRS). Under MACRS, all depreciable assets are placed in classes. These class assignments determine the assets' useful lives (i.e., the periods over which the assets may be depreciated) and the method of depreciation that must be used. The amount to be depreciated is the property's basis or its acquisition price. In general, MACRS allows shorter useful lives and more accelerated depreciation methods than are allowed under other permissible depreciation systems, thereby allowing larger depreciation deductions.

Under federal (but not state) law, a taxpayer is allowed to elect to take a bonus first-year depreciation deduction equal to 30% of the adjusted basis of qualified property (including New York Liberty Zone property) placed in service by the taxpayer after September 10, 2001. That percentage increases to 50% for property placed in service after May 5, 2003, and before January 1, 2011. The first-year bonus depreciation allowance is increased to 100% for qualifying property placed in service after September 8, 2010, and before January 1, 2012. The 50% bonus allowance is extended to cover qualifying property placed in service after December 31, 2011, and before January 1, 2013. The additional first year depreciation deduction generally is determined without any proration based on the length of the taxable year in which the qualified property or New York Liberty Zone property is placed in service. The adjusted basis of this property generally is its cost or other basis multiplied by the percentage of business/investment use, reduced by the amount of any Section 179 expense deduction and adjusted to the extent provided by other provisions of the Internal Revenue Code. The remaining adjusted basis of this property is depreciated using the applicable depreciation provisions under the Code for the property. This depreciation deduction for the remaining adjusted basis of the qualified property or New York Liberty Zone property for which the additional first year depreciation is deductible is allowed for both regular tax and alternative minimum tax purposes.

In addition, in lieu of depreciation, existing federal and state laws (Internal Revenue Code Section 179) allow a deduction to taxpayers with a sufficiently small amount of capital expenditures for depreciable property. These taxpayers may elect to expense (i.e., to deduct immediately rather than depreciate over time) the cost of qualified property placed in service for the taxable year and purchased for use in the active conduct of a trade or business. Federal and state limits differ.

In 2010, the Small Business Jobs Act (SBJA) of 2010 was enacted. This act increases the IRC Section 179 limitations on the expensing of depreciable business assets and expands the definition of qualified property to include certain real property for the 2010 and 2011 tax years. Under the SBJA, qualifying businesses can now expense up to $500,000 of Section 179 property for tax years beginning in 2010 and 2011. Without SBJA, the expensing limit for Section 179 property would have been $250,000 for 2010 and $25,000 for 2011. The maximum Section 179 expense is $125,000 for taxable years beginning in 2012 and $25,000 for taxable years beginning after 2012.

For taxable years beginning in 2010 and 2011, the $500,000 amount provided under the new law is reduced, but not below zero, if the cost of all Section 179 property placed in service by the taxpayer during the tax year exceeds $2,000,000, the investment ceiling. For taxable years beginning after December 31, 2011, and before January 1, 2013, the investment ceiling is $560,000 and $200,000 for tax years beginning after December 31, 2012. The definition of qualified Section 179 property will include qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property for tax years beginning in 2010 and 2011. SBJA also removes cellular telephones and similar telecommunications equipment from the definition of listed property for tax years beginning in 2010.

The limit is $250,000 in 2009 under federal law but remains $25,000 for California. However, starting in 2005, California "C" Corporations are allowed to elect, in lieu of a maximum of $2,000 additional first-year depreciation, a Section 179 deduction of up to a maximum of $25,000. The allowed deduction is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $800,000 under federal law and $200,000 for California.

California permits accelerated write-off for acquisitions of personal property for exclusive use within identified incentive zones. Taxpayers doing business in certain areas such as Enterprise Zones (EZs), Local Agency Military Base Recovery Areas (LAMBRAs), and Targeted Tax Areas (TTAs) may elect to treat 40% of the cost of qualified property purchased for exclusive use within the area as a deduction in the year the property is placed in service. The maximum cost taken into account in any taxable year depends upon the length of time the area has been designated as a qualifying zone or area, but may not exceed $100,000.

The MACRS system is not permitted under the California Corporation Tax Law. However, California law permits S Corporations to compute depreciation under the rules contained in the Personal Income Tax Law. For that reason, S Corporations can use both

MACRS and the Section 179 deductions referenced above. Refer to the Corporation Tax chapter of this Reference Book (Chapter 2C) for a description of depreciation deductions allowed for other corporate taxpayers.

13. CARRYOVER OF NET OPERATING LOSSES

Net operating losses (NOLs) occur in the course of a trade or business when deductions exceed income. Under federal law, a net operating loss can be carried back for two years (five years for losses arising in 2001 and 2002, and 2008 and 2009) and carried forward for 20 years. California suspended taxpayers' abilities to claim NOL deductions during the 2008 and 2009 tax years. However, taxpayers were given two additional years in which to claim NOLs accrued prior to January 1, 2009 and one additional year in which to claim NOLs accrued during the 2009 taxable year. Beginning with the 2008 tax year the NOL carryover period is extended to 20 years for NOLs attributable to taxable years beginning on or after January 1, 2008. California allows a two-year carryback period for NOLs attributable to taxable years beginning on or after January 1, 2013. The carryback percentage is 50% for an NOL incurred in tax year 2013, 75% for an NOL incurred in tax year 2014, and 100% for NOLs incurred in tax years 2015 and later. Prior to these changes, California did not normally allow NOL deductions to be carried back. For taxable years beginning before January 1, 2000, California allowed 50% of NOLs to be carried forward for five years. For taxable years beginning in 2010 and 2011, California suspended the net operating loss (NOL) carryover deduction. Taxpayers may continue to compute and carry over NOLs during the suspension period. However, taxpayers with modified adjusted gross income of less than $300,000 or with disaster loss carryovers are not affected by the NOL suspension rules. Beginning with the 2000 tax year, the carryforward periods and carryforward amounts were increased as follows:

Tax Year	Allowed Carryforward	Length of Carryforward
1999 and earlier	50%	5 years
2000, 2001	55%	10 years
2002, 2003	60%	10 years
2004 and after	100%	10 years

In 2002, as part of the budget package, California suspended taxpayers' abilities to claim NOL deductions during the 2002 and 2003 tax years. However, taxpayers were given two additional years in which to claim NOLs accrued prior to January 1, 2002, and one additional year in which to claim NOLs accrued during the 2002 taxable year.

Prior to the changes made in 2002, special NOL carryforward rules were available to specific groups of taxpayers, including new businesses, small businesses, businesses located in EZs, LAMBRAs, and TTAs, and taxpayers involved in bankruptcies and certain bankruptcy reorganizations. Starting in 2004, virtually all businesses are treated the same way under California's NOL laws. Specific details regarding these provisions are described in Section 8 of Chapter 2C.

14. ALTERNATIVE MINIMUM TAX

Non-corporate taxpayers who take advantage of certain tax preferences must calculate and pay an alternative minimum tax (AMT) at a 7% rate if their tentative minimum tax (TMT) exceeds their regular tax due. This rate was 7.25% for tax years 2009 and 2010. The purpose of the AMT is to ensure that taxpayers who take advantage of special tax reduction provisions such as deductions and credits pay at least some minimum amount of tax on their preferentially treated income. California's AMT rules are patterned after federal law, which imposes the AMT at a graduated rate of 26% on the first $175,000 of taxable income above the exemption amount and 28% of the amount exceeding $175,000 above the exemption amount. California's AMT replaced the add-on preference tax, which was a part of California's personal income tax law until 1987.

California taxpayers that believe they may be subject to AMT must perform the following steps to determine whether they owe any tax in addition to their regular tax liability:

- Calculate regular tax liability;

- Calculate alternative minimum taxable income (AMTI) in excess of the exemption amount. Although the AMTI calculation is extremely complex, it generally requires taxpayers to forego their deductions and credits and instead allows them to subtract only a fixed-dollar AMT exemption amount;

- Multiply AMTI by the AMT rate of 7% (7.25% for tax years 2009 and 2010) to calculate TMT; and

- Compare TMT to regular tax liability. If TMT exceeds regular tax, the difference equals the taxpayer's AMT and must be added to the regular tax and paid by the taxpayer.

For 2011, the exemption amounts are $81,673 for married persons filing jointly; $61,256 for single and head of household filers; and $40,836 for married persons filing separately. These exemption amounts phase out to zero if alternative minimum taxable income exceeds $306,276 for married taxpayers filing jointly; $229,708 for single and head of household filers, and $153,137 for married taxpayers filing separately. The exemption and phase-out amounts are indexed annually for inflation.

AMT has an important interaction with tax credits. Most credits can reduce regular tax down to, but not below TMT. However, certain specific credits are not subject to this limitation. These specific credits are:

- Adoption cost credit;
- Commercial solar energy credit carryover;
- Enterprise Zone hiring credit;
- Enterprise Zone sales or use tax credit;
- LARZ hiring credit carryover;
- LARZ sales and use tax credit carryover;
- Los Angeles Revitalization Zone (LARZ) construction hiring credit carryover;
- Low-income housing credit;
- Manufacturer's investment credit carryover;
- Natural Heritage Preservation credit;
- Orphan drug credit carryover;
- Other state tax credit;
- Personal, dependent, senior, senior head of household, dependent parent, joint custody head of household, and blind exemption credits.
- Renters' credit;
- Research and development credit;
- Solar energy credit carryover;
- Targeted Tax Area hiring credit;
- Targeted Tax Area sales or use tax credit;

For a further description of the AMT, refer to Section 12 of Chapter 2C, on the Corporation Tax.

15. TREATMENT OF PENSION AND OTHER RETIREMENT SAVINGS

The tax treatment of pension and other retirement savings plans has two primary elements -- treatment of contributions and treatment of withdrawals. With almost no exceptions, California taxes pension and retirement savings (both contributions and withdrawals) in an identical manner as does the federal government.

Taxation of Contributions. California conforms to federal law with respect to contribution limitations of the various pension and retirement savings plans. Table 4 provides a quick view of the limitations on contributions for numerous programs.

TABLE 4

TYPE OF PLAN		FEDERAL CONTRIBUTION CAPS	ADDITIONAL CATCH-UP CONTRIBUTIONS FOR PERSONS OVER AGE 50
Individual Retirement Accounts (IRAs)		$3,000 in 2002-2004; $4,000 in 2005-2007; $5,000 in 2008-2012; indexed for inflation in $500 increments beginning in 2009	$500 in 2002-2005; $1,000 in 2006 and thereafter
Defined contribution plans [415(c)s]		100% of compensation or $40,000 in 2003; $41,000 in 2004; $42,000 in 2005; $44,000 in 2006; $45,000 in 2007; $46,000 in 2008; $49,000 in 2009 - 2011	
Defined benefit plans [415(b)s]		100% of compensation up to $160,000 for 2003, $165,000 for 2004; $170,000 for 2005; $175,000 for 2006; $180,000 for 2007; $185,000 in 2008; $195,000 in 2009 – 2011; and $200,000 for 2012.	
Elective deferral plans [401(k) plans, 403(b) annuities, SEPs 408(k)s]		$11,000 in 2002; $12,000 in 2003; $13,000 in 2004; $14,000 in 2005; $15,000 in 2006; $15,500 in 2007 and 2008; $16,500 in 2009 – 2011; $17,000 in 2012 ; indexed for inflation in $500 increments beginning in 2007	$1,000 in 2002; $2,000 in 2003; $3,000 in 2004; $4,000 in 2005; $5,000 in 2006 – 2008; $5,500 in 2009 and later
SIMPLE plans [408(p)]		$7,000 in 2002; $8,000 in 2003; $9,000 in 2004; $10,000 in 2005 and 2006; $10,500 in 2007; $10,500 in 2008; $11,500 in 2009 - 2012; indexed for inflation in $500 increments beginning in 2006	$500 in 2002; $1,000 in 2003; $1,500 in 2004; $2,000 in 2005; $2,500 in 2006 - 2012; catch-up contributions are indexed for inflation in $500 increments beginning in 2007
457 elective deferral plans		$11,000 in 2002; $12,000 in 2003; $13,000 in 2004; $14,000 in 2005; $15,000 in 2006; $15,500 in 2007 and 2008; $16,500 in 2009 – 2011; $17,000 in 2012; indexed for inflation in $500 increments beginning in 2007	$1,000 in 2002; $2,000 in 2003; $3,000 in 2004; $4,000 in 2005; $5,000 in 2006 – 2008; $5,500 in 2009 - 2012. Plus, the limit is twice the standard limit in a participant's last 3 years before retirement.

Source: http://www.irs.gov/retirement/participant/article/0,,id=211329,00.html

Federal law provides taxpayers with flexibility to roll one type of plan into another type of plan by allowing rollovers among governmental Section 457 plans and Section 403(b) plans, rollovers of IRAs to workplace retirement plans, and rollovers of after-tax retirement plan contributions (e.g., Roth IRAs). Those who have Section 457 plans may use their plan funds to repay contributions and earnings previously refunded to them or to purchase permissive service credits.

Taxation of Withdrawals. As mentioned above, California residents are taxed on all income, including income from sources outside California. An individual who retires in

California will pay tax on the pension income that individual receives after becoming a resident, even if that pension was earned while working in another state.

Federal laws prohibit states from taxing nonresidents on pension income received after December 31, 1995. Because California enacted legislation that conforms to the federal preemption, California does not impose a tax on specified pension income received by a nonresident after December 31, 1995, as follows:

- A qualified pension plan described in Internal Revenue Code (IRC) Section 401;
- A qualified annuity plan described in IRC Section 403(a);
- A tax-sheltered annuity described in IRC Section 403(b);
- A governmental plan described in IRC Section 414(d);
- A deferred compensation plan maintained by a state or local government or an exempt organization described in IRC Section 457;
- An individual retirement plan described in IRC Section 7701(a)(37);
- A simplified employee pension (SEP) described in IRC Section 408(k);
- A trust described in IRC Section 501(c)(18);
- Plans, programs, or arrangements described in IRC Section 3121(v)(2)(C), under certain circumstances; and
- Retired or retainer pay of a member or former member of a uniformed service computed under United States Code, Title 10, Chapter 71.

16. SPECIAL FEATURES OF THE PERSONAL INCOME TAX

Unearned Income of Dependent Children ("Kiddie Tax"). Children under age 14 who have net unearned income (i.e., investment income such as dividends, interest, or royalties) of over $1,900 for 2011 are subject to special rules. The purpose of the rules is to prevent shifting of income from parents to children to avoid tax at the parents' rate. The child's unearned income in excess of $1,900 for 2011 is subject to tax at the parents' tax rate, rather than the child's highest tax rate.

Passive Investments. California generally conforms to federal law (IRC Section 469) as that section read on January 1, 2009. Both state and federal law limit the ability of taxpayers to use passive investment losses to offset or shelter unrelated income. Passive investments are trade or business activities in which the taxpayer does not materially participate. Examples include investment in limited partnerships and other business entities; and rental activities. There is a limited exception for rental real estate activities where the taxpayer actively participates. A taxpayer may meet the requirement of active participation by participating in making management decisions or arranging for services provided by others. California has not conformed to the federal rules for "real estate professionals"; therefore, those taxpayers are still subject to the California passive loss rules.

State and federal laws require the segregation of income and deductions into "active", "passive", and "portfolio" categories. Portfolio income includes interest, dividends, royalties, and gain or loss for the disposition of assets providing portfolio income. Passive activity losses generally may not be deducted against other income, such as wages, salary or portfolio income, or business income that was not derived from passive activities. A similar rule applies to limit passive activity credits.

Current California law treats rental activities (including rental real estate activities) as passive activities, regardless of the level of taxpayer participation. Federal and California law permit the deduction of up to $25,000 of losses from rental real estate activities (even though considered passive) if the taxpayer actively participates in them and certain tests are met. This $25,000 amount is allowed for taxpayers with AGIs of $100,000 or less and is phased out for taxpayers with AGIs between $100,000 and $150,000. Deductions and credits suspended under these rules are treated as suspended losses or credits from a passive activity and can be carried forward to years in which there is passive income. Any remaining carry forwards is allowed in full when a taxpayer disposes of his or her entire interest in the passive activity to an unrelated taxpayer.

Taxpayers must adjust the amount of California passive activity losses for differences in other areas of state law (e.g., depreciation). Also, nonresidents and part-year residents must make adjustments to passive activity items in computing California source AGI.

Mandatory Electronic Payments. As of January 1, 2009, taxpayers subject to the Personal Income Tax Law are required to remit all payments electronically once an estimated tax or extension payment exceeding $20,000 is made, or upon the filing of an original return with a total tax liability over $80,000 for any taxable year that begins on or after January 1, 2009. Once the threshold is met, all subsequent payments regardless of amount, tax type, or taxable year must be remitted electronically. Individuals that do not send the payment electronically will be subject to a one percent noncompliance penalty. A taxpayer may request a waiver of the electronic payment requirement under certain circumstances. [AB 1389 (Assembly Budget Committee) Chapter 751, Statutes of 2008].

Other Special Provisions That Affect Businesses. There are other special provisions in the Personal Income Tax Law that primarily affect business taxpayers. Several of these are described in the Corporation Tax chapter (Chapter 2C).

17. MINIMUM CORPORATE FRANCHISE TAX

Most corporations taxable by California are subject to a minimum franchise tax. This is a specified dollar amount that businesses must pay even if their tax liability based on net income is lower. See Section 4 of the Corporation Tax chapter for more information on the franchise tax.

Personal income taxpayers are not subject to a minimum tax. However, certain entities taxed under the Personal Income Tax Law are subject to an annual tax equal to the minimum franchise tax. These include limited partnerships, limited liability partnerships, certain limited liability companies, and real estate mortgage investment conduits (REMICs).

18. LIMITED LIABILITY COMPANIES

A limited liability company (LLC) is a non-corporate entity, the revenue from which may be included as corporation tax revenue. An LLC provides its members with limited liability and the option to participate actively in the entity's management. An LLC is formed by filing Articles of Organization with the California Secretary of State. Although exhibiting the corporate characteristic of limited liability, an LLC with at least two members is usually treated as a partnership under the "check-the-box rules" used by both the Federal Government and California

In certain cases, an LLC may "check the box" on Federal Form 8832 (Entity Classification Election) to be taxed like a C Corporation. In addition, this C Corporation could elect S Corporation status. California applies the same tax treatment elected for federal tax purposes.

Under current state law, an LLC not classified as a corporation must pay the $800 annual LLC tax and the annual LLC fee if it is organized, doing business, or registered in California. Beginning in 2007, the annual LLC fee is based on the LLC's total income from all sources derived from or attributable to California. [AB 198 (Committee on Budget), Chapter 381, Statutes of 2007.] Total income is defined as the gross income, plus the cost of goods sold, that are paid or incurred in connection with the trade or business of the taxpayer attributed to California, determined by applying franchise and income tax sales factor rules under current law to the total income of the LLC. Prior to 2007, the annual LLC fee was based on the LLC's total income from all sources reportable to the state.[1] Total income excludes the flow-through of income from one LLC to another LLC if that income has already been subject to California's annual LLC fee. The following chart is used to compute the fee under the new law beginning 2007:

[---If Total California Annual Income Is---]

Equal To Or Over ($)	But Not Over ($)	LLC Fee
$ 250,000	$ 499,999	$ 900
500,000	999,999	2,500
1,000,000	4,999,999	6,000
5,000,000	And Over	11,790

[1] Under prior law, total income was defined as gross income from whatever sources derived plus the cost of goods sold that are paid or incurred in connection with a trade or business. The law lacked a definition for "from all sources reportable to the state", but FTB and taxpayers had defined this term to mean worldwide gross receipts without apportionment. However, this interpretation has been challenged.

19. VOLUNTARY CONTRIBUTIONS

California allows taxpayers to make voluntary contributions of their own funds to one or more organizations listed on the state tax return by checking a box on their return. These eligible activities are often called "check-offs", although they are not like the federal check-offs that allow taxpayers to direct a portion of their tax liability to the selected organization. These contributions allowable on California tax returns are deductible as charitable contributions on the following year's tax return for taxpayers that itemize deductions.

For the 2011 tax year, 18 check-offs will appear on the individual income tax form. The Legislature responded to the proliferation of check-offs on the tax form by requiring check-offs to have sunset dates and to meet minimum annual contribution amounts. The Legislature requires new check-offs to wait in line to be added to the form until old check-offs are removed (so-called 'queuing language'). The current rules regarding the standards each check-off must meet in order to remain on the form are summarized in the following chart:

VOLUNTARY CONTRIBUTION FUND INFORMATION

2011 California Personal Income Tax Return

VOLUNTARY CONTRIBUTION FUNDS	INITIAL TAX RETURN	FINAL TAX RETURN[1]	2011 MINIMUM CONTRIBUTION REQUIREMENT
ALS/Lou Gehrigs Disease	2011	2015	No minimum requirement for 2012
Alzheimer's Disease/Related Disorders Fund	1987	2014	$335,154
Arts Council Fund	2010	2014	$250,000
California Breast Cancer Research Fund	1992	2012	$364,792
California Cancer Research Fund	2008	2012	$259,061
California Firefighters' Memorial Fund	1993	2015	No minimum requirement unless the repeal date is deleted
California Fund for Senior Citizens	1983	2014	$250,000
California Peace Officer Memorial Foundation Fund	1999	2015	No minimum requirement unless the repeal date is deleted
California Police Activities League (CALPAL) Fund	2010	2014	$250,000
California Sea Otters Fund	2006	2015	$267,934
California Seniors Special Fund	1990	No Sunset	No minimum requirement
California Veterans Homes Fund	2010	2014	$250,000
Child Victims of Human Trafficking Fund	2011	2015	No minimum requirement for 2012
Emergency Food For Families Fund	1998	2013	$347,554
Rare and Endangered Species Preservation Program	1983	2017	$313,582
Safety Surrendered Baby Fund	2010	2014	$250,000
State Children's Trust for the Prevention of Child Abuse	1983	2017	$313,582
Municipal Shelter Spay-Neuter Fund	2011	2015	No minimum requirement for 2012

[1] The final tax return is subject to change if the fund has a minimum contribution threshold it fails to meet or if legislation extends the repeal date. Dates and conditions of application vary for each fund.

Source: http://www.ftb.ca.gov/individuals/vcfsr/indvolcon.shtml

20. REVENUE

The personal income tax is the largest single source of revenue for the State of California. California revenues were $49.5 billion in 2010-11 (53% of state General Fund revenues). Revenues are expected to be $54.2 billion in 2011-12.

21. ADMINISTRATION

The FTB administers the personal income tax. Returns are due annually on the 15th day of the fourth month following the close of each taxable year (typically April 15th). However for the 2011 taxable year, the due date for an individual's return is April 17th. Individuals are automatically granted an extended filing period of six months for submitting their tax returns but are not relieved of their obligation to pay the tax due by April 15. Taxpayers who do not pay 100% of their tax liability by April 15 owe interest and are assessed a late payment penalty. Similarly, taxpayers who do not file by the extended due date (typically October 15th) are assessed a penalty for failure to file. However, taxpayers who do file on or before the extended due date are not penalized for failure to file.

Salaries and wages are subject to withholding by employers. The Employment Development Department (EDD) administers withholding. If taxpayers have a significant amount of income that is not subject to withholding (such as from self-employment income or investments), they must pay estimated taxes in quarterly installments in order to ensure that they remit sufficient funds throughout the course of the year to avoid penalties for failure to timely pay. Taxpayers may be subject to penalties if amounts remitted over the course of the year through withholding and/or estimated payments are less than prescribed minimum percentages of their total tax liability.

The amount of tax due in excess of the amount withheld and/or paid as an estimated payment is due on April 15th. If a taxpayer overpays during the year through withholding and/or estimated payments, he or she can direct FTB to apply the overpayment to the next year's liability or to refund the overpayment by check.

22. CODE

California Constitution, Article III, Section 26

Revenue and Taxation Code, Division 2, Part 10, Section 17001 et. seq., and Part 10.2, Sections 18401-19802

CHAPTER 2C

CORPORATION TAX

HIGHLIGHTS

• Minimum Tax	$800 per year; except for new corporations.	
• Revenue*	2010-11 (Actual)	$9.6 billion
	2011-12 (Estimate)	$9.5 billion
	2012-13 (Estimate)	$9.3 billion
• Estimated Number of Returns Filed**	1,404,000 in 2011	
• Administration	Franchise Tax Board (FTB)	

*Source: Governor's 2012-13 Budget Summary
**Franchise Tax Board

1. WHO PAYS THE CORPORATION TAX

The **corporation tax** applies to all corporations that earn income derived from or attributable to sources in California, except insurance companies. Professional corporations, associations, certain trusts, partnerships and limited liability company(s) (LLCs) that elected to be taxed as corporations, banks, or financial institutions, such as savings and loan associations (thrifts), pay taxes under the Corporation Tax Law.

Nonprofit organizations are exempt from the corporation tax, except for income that is unrelated to their exempt purpose (see Section 13 of this chapter).

Insurance companies are exempted from the corporation tax (and most other state and local taxes) pursuant to the state Constitution. Instead, insurance companies are subject to a state gross premiums tax. (See Chapter 3C of this Reference Book for more information on the Insurance Gross Premiums Tax.)

Additional discussion about which corporations are subject to the corporation tax is provided in Section 3 below, entitled "Three Separate Taxes Comprise the Corporation Tax."

2. CALCULATION OF THE CORPORATION TAX

Taxpayers compute their tax liabilities based on income earned during the year. The year may be either a calendar year or a fiscal year commencing in any month except January, as specified by the taxpayer.

A brief summary of how tax is computed is as follows: Taxpayers must add up all sources of non-exempt income and subtract total deductions to which they are entitled, thereby arriving at "net income". They then apply the 8.84% tax rate to net income to determine the tax. Certain tax credits are allowed to reduce this tax, dollar for dollar. Also, corporate taxpayers may be liable for the alternative minimum tax.

The California corporation tax is similar, but not identical to, the federal income tax on corporations. Major differences are identified below.

When corporations do business both within and outside of California, it is necessary to determine what portion of total corporate income is taxable by California. This is done by means of formula apportionment, which is described in Chapter 2D, entitled "Determining the Income of Multistate and Multinational Corporations".

Refer to Chapter 2B on the Personal Income Tax for further information on taxes imposed on unincorporated businesses.

3. THREE SEPARATE TAXES COMPRISE THE CORPORATION TAX

There are three separate taxes levied under the umbrella of the state corporation tax:

- Corporation Franchise Tax. Every corporation doing business in California (regardless of location) is subject to the franchise tax. "Doing business" means "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit."

  The franchise tax is not a tax on income. Rather, it is a tax for the privilege of doing business in California measured by net income earned in California. Until changed by the Legislature in AB 1843 (Ackerman), Chapter 862, Statutes of 2000, a corporation paid the privilege tax for conducting business in the current year based upon (measured by) the corporation's income in the preceding year. As amended, the law requires a corporation to pay tax for the privilege of conducting business in this state for the current year based upon (measured by) the corporation's net income for the current year.

  The majority of corporations taxed by California pay the franchise tax.

- Corporation Income Tax. Corporations deriving income from California sources but not sufficiently present to be classified as "doing business" in California are subject to the corporation income tax.

This tax is nearly identical to the franchise tax. Because it is an income tax, however, interest from tax-exempt United States, California, or California municipality obligations is not included in income. Also, corporations are not subject to the minimum franchise tax.

The most common situation where the corporation income tax is applied rather than the franchise tax is where a corporation operates in California through an agent or by using traveling salespersons, so the corporation does not have an established presence in the state. Another business entity commonly subject to the corporation income tax is a "business trust", which is a trust established for the purpose of making a profit (rather than for mere conservation of assets).

Very few corporate taxpayers file under the corporation income tax.

- Bank Tax. Banks and financial institutions doing business in California are subject to an additional tax (known as the bank tax), which is levied in conjunction with the regular corporation tax. This tax is in lieu of personal property taxes and local business taxes, from which banks and financial institutions have been exempt since the enactment of the corporation tax in the 1930s.

  The bank tax rate is 2% and is designed to be equivalent to the average amount general corporations pay each year in personal property taxes and local business taxes (see below for a further discussion).

Federal law has a net income tax which applies to all corporate taxpayers, and does not have an add-on bank tax rate.

4. TAX RATES AND MINIMUM FRANCHISE TAX

The corporation franchise tax rate is the greater of 8.84% of net income, or the minimum franchise tax.

The minimum franchise tax is $800 and must be paid by any corporation subject to the franchise tax with a computed tax liability less than this amount. The $800 minimum franchise tax is not imposed for the first year a corporation is in existence. This corporation would, however, be subject to the 8.84% franchise tax rate on any net income.

The corporation income tax rate is 8.84% of net income. However, the minimum franchise tax does not apply.

The bank tax rate, which must be added to the franchise tax rate for banks and financial institutions, is statutorily set at 2%. Banks are subject to the minimum franchise tax if their computed tax from the combined corporate plus bank rate is less than $800.

Federal corporate tax rates range from a low of 15% to a high of 35%. There is no minimum tax in federal law comparable to the state's minimum franchise tax.

5. INCOME AND DEDUCTIONS

Corporations begin computing their California tax by adding all sources of income, including income from business activities, dividends, interest, rents, royalties, gains from the sale of property, income from the discharge of debt, and so on. Unlike federal tax law, interest from federal, state and municipal obligations are included in total income under California franchise tax. For corporations, there are few exclusions from income or sources of exempt income (unlike those in the personal income tax).

The corporate tax is measured not by gross income, but by net income, which is what we commonly think of as business profit. In order to determine net income, corporations are allowed to deduct specified expenses from gross income.

The value of a deduction to a taxpayer, measured in terms of tax eliminated, generally may be estimated by multiplying the deduction by the tax rate. Therefore, the state tax savings to a corporation resulting from deducting a $1,000 expense is $88.40 ($1,000 expense x 8.84% state corporate tax rate).

The most important deductions available to corporations are described below. Unless noted otherwise, these are generally similar to deductions allowed to corporations in federal law.

- <u>Trade or Business Expenses</u>. Taxpayers are permitted to deduct the ordinary and necessary expenses of conducting a trade or business. Typical deductible expenses include compensation and fringe benefits for employees, the employer's portions of unemployment insurance and social security taxes, rent, utilities, advertising, and other similar current costs. Capital expenditures (that is, those that add to the value or useful life of property) cannot be deducted. Rather, they must be depreciated. (See Section 7 below.)

- <u>Taxes</u>. Corporations may deduct real and personal property taxes. Local, state, federal, and foreign income or profits taxes are not deductible. Sales taxes are also generally deductible; however, sales taxes incurred in the process of manufacturing or constructing property must be capitalized into the value of the property.

- <u>Interest</u>. In general, corporations may deduct all interest paid or accrued on business debts. While generally in conformity with federal law, California applies special rules to determine the interest expense of multistate and international corporations.

- <u>Meals, Travel, Entertainment, and Private Club Expenses</u>. Meal, travel, and entertainment costs are 50% deductible. Certain convention and cruise ship expenses are subject to special limitations. California conforms to the federal denial of club dues deductions.

- Charitable Contributions. Corporations may deduct the value of contributions to charitable or nonprofit organizations. The maximum deduction is 10% of net income; excess contributions may be carried over to the next five succeeding taxable years. Deductions for contributions of appreciated property (property that has increased in value) are generally limited to the basis (cost) of the property.

Various other (more specialized) deductions are available to corporations. Some of these deductions are described below.

6. DIVIDENDS RECEIVED DEDUCTION

Under present law, dividends received from general corporations may be eliminated if the corporation is a member of the taxpayers combined filing group.

Prior California law allowed corporate taxpayers a dividend received deduction (DRD) for dividends received from corporations that were not part of the taxpayer's filing group. The purpose of the DRD was to avoid double taxation by California on income reported at the corporate level. The payor of the dividend had to pay California tax on the income from which the dividend was paid. Without DRD relief, the corporation receiving the dividend included the dividend in income.

The DRD was computed as a percentage of the dividends received; the percentage varied depending upon the taxpayer's ownership interest in the payor corporation and whether the income of the payor corporation was subject to California income or franchise tax. The DRD was authorized for payments made by general corporations in Revenue and Taxation Code (R&TC) Section 24402; the DRD was authorized for payments made by an insurance corporation in R&TC Section 24410.

The courts declared R&TC Sections 24402 and 24410 discriminatory against non-Californian businesses and, therefore, unconstitutional. [See Farmer Bros. Co. v. Franchise Tax Board (2003) 108 Cal.App. 4th 976, cert. denied 540 U.S. 1178, and Ceridian Corp. v. Franchise Tax Board (2000) 85 Cal.App. 4th 875 (modified 86 Cal.App. 4th 483).] The FTB, with concurrence from Legislative Counsel, holds that for taxable years beginning after December 1999, neither code section provides a DRD.

In 2004, the Legislature responded to the Ceridian decision with AB 263 (Oropeza), Chapter 868, Statutes of 2004. For taxable years beginning on or after January 1, 2004, corporations are allowed an 80% DRD (85% beginning in 2009) for dividends received from 80% or greater owned insurance companies. If the insurance company is overcapitalized (stuffed), the 80% DRD is phased out based on a "premiums-received-to-total-income-earned" ratio. For years beginning before January 1, 2004, the taxpayer may elect by March 28, 2004, to have the 80% DRD and phase out ratio apply. If a proper election is made, for taxable years beginning before 2004, the taxpayer may deduct expenses associated with earning the dividend income. AB 263 also contains other provisions addressing transactions between general corporations and insurance companies.

No legislation has been enacted that amends R&TC Section 24402, which previously allowed a DRD for dividends received from general corporations.

7. DEPRECIATION AND AMORTIZATION

Depreciation and amortization deductions allow taxpayers to recover capital investments in assets over the useful lives of those assets by deducting reasonable allowances for the exhaustion or wear and tear of the property. The idea behind depreciation is that, since capital assets are used over several years, the cost of acquisition is similarly deducted over several years (rather than all at once in the year in which the asset is purchased).

Depreciation and amortization are allowed for property, other than land, used in a trade or business or for the production of income (investment), including most kinds of tangible property and improvements to real property, farm buildings, machinery and other physical assets. Intangible assets that may be amortized include copyrights, licenses, franchises, goodwill, and covenants not to compete. Depreciation is not allowed for property used for personal purposes, inventory and stock in trade, land, and depletable natural resources. (See Section 8 on Depletion below.)

For corporation tax purposes, California generally does not allow use of the federal depreciation system called the Modified Accelerated Cost Recovery System (MACRS). Instead, California uses a depreciation system generally known as the Asset Depreciation Range (ADR) system, which is similar to that used in federal law for pre-1981 assets. The ADR system generally requires the use of longer useful lives and fewer accelerated depreciation methods than would be allowed under the federal MACRS system.

Under the ADR system, assets are generally depreciated over the remaining useful life of the asset or over a designated "class life". Under this system, assets are grouped into more than 100 classes, and a guideline "life" for each class is established. For purposes of the ADR system, taxpayers may use a straight-line depreciation or certain rapid depreciation methods (such as double declining balance, 150% declining balance, sum-of-the-years-digits, or other consistent methods). The amount that is to be depreciated is the property's basis, which is typically its cost when acquired. Any depreciation that would be greater than that computed under the straight-line method is considered excess depreciation and is subject to the alternative minimum tax.

Effective for taxable years beginning on or after January 1, 2005 [AB 115 (Klehs), Chapter 691, Statutes of 2005], the Corporate Tax Law conforms to the Internal Revenue Code (IRC) Section 179 expensing provisions to the same extent under the Personal Income Tax Law. That is, a corporate taxpayer with a sufficiently small amount of annual investment is able to elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year in lieu of the current law "additional first-year depreciation" of up to $2,000. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. Prior to AB 115, only S corporations (see Section 10 of this Chapter) were permitted an IRC Section 179 deduction under the California tax law.

State law allows taxpayers doing business in certain economic incentive areas such as Enterprise Zones (EZs), Local Agency Military Base Recovery Areas (LAMBRAs), and Targeted Tax Areas (TTAs) to treat the cost of qualified property as an expense in the year the property is placed in service in the area.

8. DEPLETION

California closely conforms to federal law in the area of depletion deductions. Depletion deductions allow owners of natural resources to recover the costs of the resource as it is extracted, harvested, or otherwise diminished. Depletion is to the owner of an oil or gas well or mineral or timber property what depreciation is to the owner of a capital asset.

Depletion deductions are allowed to any taxpayer with an economic interest in a property containing depletable resources. Two alternative depletion computations are provided in both state and federal law. The taxpayer must compute the depletion amount both ways and may deduct the larger amount. The two methods are:

- Cost Depletion. Cost depletion requires the taxpayer to estimate the yield of the resource (e.g., 10 million barrels of oil). Then, the cost associated with extracting the resource is divided by the number of units. The resulting quotient is the cost depletion per unit. That amount multiplied by the number of units extracted and sold during the year determines the cost depletion that is deductible for the year. Each year, the cost basis of the property is reduced by the amount of depletion deducted for that year until the entire cost basis has been deducted. At that point, no additional cost depletion is allowed.

- Percentage Depletion. Most depletable property qualifies for this alternate computation method. However, it is not available for timber. Under percentage depletion, a flat statutorily set percentage of annual gross income from the natural resource property is taken as the depletion deduction each year. Thus, the deduction bears no relationship to the actual amount of the resource extracted during the year. However, the laws set an upper limit on the deduction of 50% of the taxable income from the property (100% for oil and gas properties).

9. CARRYOVER OF NET OPERATING LOSSES

Businesses incur "net operating losses" (NOLs) for tax purposes when allowable deductions exceed gross income. When deductions are less than gross income, the business has net income (i.e., shows a profit). A business may show a net operating loss for tax purposes without incurring actual out-of-pocket losses, due to the allowance of tax deductions for items that may not be actual out-of-pocket expenses, such as carryforward of deductions from prior years and depreciation.

In a year when a business shows a net operating loss for tax purposes, the business is not required to pay any corporation taxes beyond the minimum franchise tax.

Similar to federal law, California law generally allows businesses with NOLs to carry over these losses and deduct them against income earned in future years.

For tax years beginning on or after January 1, 2004, and before January 1, 2008, state law allows the following NOLs:

NOL TYPE	NOL % ALLOWED TO BE CARRIED OVER	CARRYOVER PERIOD
General NOL	100%	10 Years
Specified Disaster Loss	100%	15 years
Pierce's Disease	100%	9 Years
Economic Development Areas	100%	15 Years

In 2008, the following changes were made to NOLs:

- NOL deductions were suspended for taxable years beginning on or after January 1, 2008, and before January 1, 2010, for a corporation with net business income subject to tax of $500,000 or more.

- NOL deductions were suspended for taxable years beginning on or after January 1, 2010 and before January 1, 2012, for a corporation with pre-apportioned income after state adjustments of $300,000 or more.

- The NOL carryover period is extended by four years for NOLs attributable to tax years beginning before January 1, 2008, three years for NOLs incurred in taxable year 2008, two years for NOLs incurred in taxable year 2009, and one year for NOLs incurred in taxable year 2010.

- The NOL carryover period is extended to 20 years for NOLs attributable to taxable years beginning on or after January 1, 2008.

- California conforms to the federal NOL carryback rules for NOLs attributable to taxable years beginning on or after January 1, 2013, with the following modifications:

- An NOL may be carried back only two years. (Federal law has special rules that in some cases allow an NOL to be carried back for a longer period).

- The carryback amount of an NOL attributable to taxable year 2013 is limited to 50% of the net operating loss.

- The carryback amount of a NOL attributable to taxable year 2014 is limited to 75% of the net operating loss.

- California conforms to the federal carryback period for a Real Estate Investment Trust (REIT) and a corporate equity reduction interest loss, which is zero.

10. TREATMENT OF S CORPORATIONS

"S corporations" are named for a subchapter of federal income tax laws (United States Code, Title 26, Subchapter S) that grant certain corporations special tax treatment.

As defined by federal law, S corporations are domestic corporations with 100 or fewer shareholders, only one class of stock, no shareholders other than individuals, estates, trusts, and certain exempt organizations, and not a member of an affiliated group. In general, S corporations must be involved in an active trade or business and are limited with respect to the amount of passive investment income from royalties, dividends, and interest they may receive. Corporations that meet these definitions may elect to be exempt from the federal corporate tax, and instead pass through the corporation's taxable income to its individual shareholders.

A corporation's California tax status must be the same as its federal tax status is. That is, a corporation that elects to be taxed as an S corporation for federal purposes must be taxed as an S corporation for California tax purposes. Similarly, a corporation cannot be an S corporation for California tax purposes unless it has a valid federal S election in place.

Once a business elects S corporation status, its corporate income is taxed at a rate of 1.5% instead of the normal 8.84%, and credits are limited to one-third of the C corporation credit amounts. One hundred percent of the corporation's items of income, loss, deduction, and credits are passed through to the shareholders in accordance with their respective interests in the corporation.

Federal and state laws permit S corporations to own 100% of another domestic corporation and to make an election to treat the owned corporation as a Qualified Subchapter S Subsidiary (QSub). All of the activities, assets, liabilities, income, deductions, and losses of the QSub are treated as the activities, assets, liabilities, income, deductions, and losses of the parent S corporation. The parent S corporation pays tax on the entire amount of income reported and passes the full amount through to its shareholders. California law imposes a tax equal to the minimum franchise tax to the QSub.

Under California law, S corporations are permitted to use the MACRS depreciation system (described in Section 7 of this chapter) rather than the ADR system. In addition, California S corporations are not subject to the alternative minimum tax. (See Section 13 of this chapter.)

11. CAPITAL GAINS AND LOSSES

Capital gains are profits from the sale of property and other capital assets. Capital assets are defined as all property except the following: inventories, property held for sale in the ordinary course of business, depreciable business property, and real property used in business. Capital assets include real property (land and buildings), personal property, and intangible assets (such as stock).

Capital gains are measured as the difference between the amount realized when the asset is sold and the asset's basis (normally the original purchase price). Any amounts invested in improvements are added to the basis; costs of the sale are deducted from the sales price. The gain is generally recognized in the year the asset is sold or exchanged.

Capital gains classified as a different type of income from the "ordinary income" of a corporation arising from its trade or business activities. Under both federal and California law, corporate capital gains are taxed the same as ordinary income; that is, they are fully includible in income subject to tax. Under California and federal law, corporate capital losses may be fully deducted against capital gains, but excess capital losses cannot be deducted against ordinary income. Both California and federal law provide that these excess losses may be carried forward for five years and deducted against capital gains in future years. Both laws allow 100% capital loss carryforwards. Federal law permits a three-year carryback in addition to the carryover.

12. TAX CREDITS

Tax credits reduce tax liability dollar for dollar, but not below the annual minimum tax, if applicable. Thus, they operate differently from deductions, whose value in reducing tax liability equals the amount of the deduction multiplied by the highest marginal tax rate to which the taxpayer is subject. (See Section 5 of this chapter.)

Tax credits available under the corporation tax are intended to provide businesses incentives to engage in certain activities that are socially or economically desirable. Most credits are also available to businesses that file under the Personal Income Tax Law. The amount of tax credits allowable in any taxable year may be limited by the taxpayer's alternative minimum tax liability or by tentative minimum tax. (See Section 13 of this chapter for further information.)

Some of the tax credits allowed in state law are similar to credits offered in federal law. However, in most cases, the federal credit amounts are greater because the federal tax burden is approximately four times greater than California's. This can be seen by comparing the rate structures: California's corporate rate is 8.84%, while the top federal corporate rate is 35%. As a result, many state income tax credits patterned after federal credits are roughly one-fourth the size of the federal credit.

2008-2009 Credit Limitation. For taxable years beginning on or after January 1, 2008 and before January 1, 2010, business credits are limited for taxpayers with income subject to tax greater than $500,000. Total business credits are limited to 50% of tax (before the application of credits). The carryover period for any credit that is limited is increased by the number of taxable years the credit (or any portion thereof) is not allowed.

Credit Assignments. Effective for taxable years beginning on or after July 1, 2008, a member of a combined reporting group, when certain conditions are met, may make an irrevocable assignment of a credit or available credit carryover to another member of the combined reporting group. Assigned credits may be used to reduce tax in taxable years beginning on or after January 1, 2010.

Several of the major credits in California Corporation Tax Law are described below:

Donated Agricultural Product Transportation Credit. Taxpayers may claim a tax credit equal to 50% of the costs for transporting donated agricultural products to a nonprofit organization.

Upon receipt or delivery of the donated agricultural product, the nonprofit organization must provide the transporter a certificate signed and dated by an authorized representative of the organization. The certificate must state the name and address of the recipient organization, the type and quantity of the product donated, the distance the product was transported, the name of the transporter and the taxpayer donor, and that the product was donated pursuant to the Food and Agriculture Code. The taxpayer must provide a copy of the certificate to the FTB upon request.

The agricultural products transportation credit applies to taxable years beginning on or after January 1, 1996. This credit may be carried over until exhausted and may not reduce the tax below tentative minimum tax for AMT purposes.

Donated Fresh Fruits or Fresh Vegetables Credit. Qualified taxpayers may claim a credit equal to 10% of the costs of fresh fruits or fresh vegetables donated to a California food bank.

A “qualified taxpayer” is defined as the person responsible for planting the crop, managing the crop, and harvesting the crop from the land. The cost of donated fresh fruits or fresh vegetables is the cost of those products that would otherwise be included in inventory costs. Generally, inventory costs would include both the direct costs and the allocated indirect costs required to produce the fresh fruits or fresh vegetables. Because inventory costs are costs of doing business, the credit is available only to a business that is also a qualified taxpayer.

The recipient of a donation of fresh fruits or fresh vegetables must provide to the donor certification of the type and quantity of the products donated, the name of the donor or donors, the name and address of the donee nonprofit organization, and, as provided by the donor, the estimated value of the donated products and the location where the donated product was grown. A donor that is a qualified taxpayer must provide a copy of the certificate to the FTB upon request.

The fresh fruits and fresh vegetables credit applies to taxable years beginning on or after January 1, 2012, and before January 1, 2017. This credit may be carried forward for up to six years and may not reduce the tax below tentative minimum tax for AMT purposes.

Farmworker Housing Credit. Beginning January 1, 2009, the standalone Farmworkers Housing Credit (FWHC) discussed below was repealed [SB 1247 (Lowenthal), Chapter 521, Statutes of 2008], and is now incorporated within and required to be administered as part of the Low-Income Housing Credit (LIHC) program.

For both personal income and corporation taxpayers, California law allows a 50% credit for the qualified costs of construction or rehabilitation of qualified farmworker housing beginning January 1, 1997.

For banks and financial corporations, California law also allows a 50% credit on below-market rate loans used to finance the construction or rehabilitation of qualified farmworker housing. The credit equals 50% of the difference between the amount of interest income that would have been collected by a bank or financial corporation had the loan rate been one point above prime and the lesser amount of interest income actually due for the term of the loan.

The aggregate amount of both credits available for allocation cannot exceed $500,000 for any taxable year. However, any unallocated credits left over during one year may be carried forward for allocation during subsequent years.

Disabled Access Credit. For both personal income and corporation taxpayers, California law allows a 50% credit to eligible small businesses for expenses incurred up to $250 to comply with the federal Americans with Disabilities Act of 1990. The disabled access credit applies to taxable years beginning on or after January 1, 1996 and continues indefinitely. This credit may be carried over until exhausted and may not reduce the tax below tentative minimum tax for AMT purposes. There is also a comparable federal credit.

Enhanced Oil Recovery Credit. Federal law allows taxpayers an enhanced oil recovery credit that is combined with several other credits to form the general business credit.

This credit is allowed in an amount up to 15% of the taxpayer's qualified enhanced oil recovery costs. The qualified costs are defined as amounts paid or incurred for qualifying tangible property that may be depreciated or amortized and are an integral part of a qualified enhanced oil recovery project involving one or more tertiary recovery methods.

If a credit is allowed for these costs, the amount otherwise deductible or required to be depreciated or recovered through depletion must be reduced by the amount of the allowable credit.

The California enhanced oil recovery credit amount is one-third of the taxpayer's allowed federal enhanced oil recovery credit. The state credit applies only to oil recovery projects located within California.

A taxpayer's election not to take the credit for federal purposes prevents the taxpayer from claiming a state credit.

The enhanced oil recovery credit applies to taxable years beginning on or after January 1, 1996 and continues indefinitely. This credit may be carried over for up to 15 years and may not reduce the tax below tentative minimum tax for AMT purposes.

Community Development Financial Institution Deposit Credit. Under the Corporation Tax Law and the Personal Income Tax Law, a credit is allowed for 20% of the amount of each "qualified deposit" into a "community development financial institution" (CDFI). A qualified deposit is defined, as is equal to or greater than $50,000 and made for a minimum duration of 60 months. A CDFI is defined as a private financial institution located in California and certified by the California Organized Investment Network (COIN) as an entity with community development as its primary mission. CDFIs may lend in urban, rural, or reservation-based communities in California. A CDFI may include a community development bank, a community development loan fund, a community development credit union, a micro-enterprise fund, a community development corporation-based lender, and community development venture fund.

The aggregate amount of qualified deposits made by all taxpayers is limited to $10 million for each calendar year, thus limiting the value of the credit to $2 million annually.

Any previously allowed credit will be recaptured if the qualified deposit is withdrawn before the end of the 60th month and not re-deposited or reinvested in another CDFI within 60 days. However, the recapture penalty is lower if the full amount invested is not withdrawn. An amount equal to 20% of any reduction in the qualified deposit will be recaptured if the qualified deposit is reduced before the end of the 60th month, but not below $50,000.

This credit is effective for taxable years beginning on or after January 1, 1997 and before January 1, 2017. This credit may be carried over for up to four years and may not reduce the tax below tentative minimum tax for AMT purposes.

Employer-Provided Child Care. California allows credits to employers under both the personal income tax and the corporation tax for providing child care services to their employees.

Specifically: (a) a 30% credit is allowed to employers or building owners for the costs of start-up expenses related to establishing or expanding a child care program or constructing an on-site or near-site child care facility for employees' or tenants' dependents; (b) a 30% credit is allowed for employer costs to operate child care information and referral services, with a maximum dollar credit; and (c) a 30% credit is allowed for employer contributions to child care arrangements for employees' children under the age of 12, such as on-site service, center-based service, home provider care or in-home care; this credit cannot exceed $360 per year per child. Only amounts paid directly by employers to child care providers qualify for the credit. These credits sunset at the end of 2012. There are no comparable federal credits.

Low-Income Housing Construction and Rehabilitation. California allows a tax credit against the personal income tax, corporation tax, and insurance gross premiums tax for construction or rehabilitation of low-income housing in California. The credit is equal to 30% of amounts invested and is claimed over four years (9%, 9%, 9%, and 3%). Except in certain cases, it is available in addition to the comparable credit offered under federal law (9% annually for 10 years for nonsubsidized housing, 4% annually for 10 years for subsidized housing).

To qualify for the state credit, a taxpayer must receive an allocation from the Tax Credit Allocation Committee, and the rents must be maintained at low-income levels for 30 years (compared to 15 years for the federal credit). For buildings located in certain areas or census tracts, the federal credit must be reduced for the state credit to be claimed.

Corporations may elect to assign any portion of the credit to an affiliated bank or corporation. This credit can reduce regular tax below tentative minimum tax. The state credit will remain in effect as long as the federal credit remains in effect. The federal credit was made permanent by the Revenue Reconciliation Act of 1993. Federal law provides more than $50 million in credits annually to California. California offers $70 million in state credits.

Beginning January 1, 2009, and before January 1, 2016, the LIHC (other than LIHC for farmworker housing) can be allocated to the partners of a partnership owning a low-income housing project, in accordance with a partnership agreement, regardless of how the federal LIHC is allocated to the partners or whether the allocation of the credit under the terms of the agreement has substantial economic effect [SB 585 (Lowenthal), Chapter 382, Statures 2008].

Beginning January 1, 2009, the standalone FWHC discussed above was repealed [SB 1247 (Lowenthal), Chapter 521, Statutes 2008], and is now incorporated within and required to be administered as part of the LIHC program. The annual cap remains at $500,000 plus any unallocated credits under prior law. Any FWHC that is unallocated or returned is to be added to the annual credit allocation cap until exhausted.

Research Expenditures. California allows a tax credit under the personal income tax and the corporation tax for incremental research expenditures made during the year. For taxable years beginning on or after January 1, 2009, California conforms to the federal research credit as of the "specified date" of January 1, 2009, with significant modifications. California specifically does not conform to the federal research credit termination date; thus, unlike the federal credit, the California research credit is permanent. Other California modifications are discussed below.

California Credit Percentages. California modifies:

1) The federal 20% general credit to be 15% of qualified expenses; and

2) The federal 20% university "basic research" credit to be 24% of qualified expenses.

California Research. The terms "qualified research" and "basic research" include only research conducted in California. In computing gross receipts under IRC Section 41 (c)(5), only gross receipts from the sale of property held for sale in the ordinary course or business, that is delivered or shipped to a purchaser within California, will be included. Qualified research expenses are modified to exclude any amount paid or incurred for tangible personal property that is eligible for the exemption from sales or use tax under R&TC Section 6378.

University "Basic Research" Expenses. Similar to federal law, only corporations qualify for the credit for the university "basic research" credit. However, California modifies "basic research" to include any basic or applied research including scientific inquiry or original investigation for advancement of scientific or engineering knowledge or the improved effectiveness of commercial products, except the term does not include any of the following:

1) Basic research conducted outside California;

2) Basic research in social sciences, arts or humanities;

3) Basic research for purposes of improving a commercial product if the improvements relate to style, taste, cosmetic, or seasonal design factors; or,

4) Any expenditure paid or incurred to ascertain existence, location, extent, or quality of any deposit of ore or other mineral, including oil or gas.

Alternative Incremental Research Credit. For taxable years beginning on or after January 1, 2010, California conforms to the alternative incremental credit as of the "specified date" of January 1, 2009, with modifications. For California purposes, the federal credit rates of 3%, 4%, and 5% are modified to be 1.49%, 1.98%, and 2.48%, respectively, and the alternative incremental credit may no longer be elected in taxable years beginning on or after January 1, 2010.

Alternative Simplified Credit. California specifically does not conform to the alternative simplified credit.

Eligible Expenses. California generally conforms to the federal rules for eligible expenses, but does not conform to the special rules that allow qualified research expenses to include 100% of amounts paid or incurred by the taxpayer to an eligible small business, university, or federal laboratory for qualified energy research.

Enterprise Zones (EZs), Targeted Tax Areas (TTAs), Manufacturing Enhancement Areas (MEAs), and Local Agency Military Base Recovery Areas (LAMBRAs) Incentives. California provides an array of tax incentives to businesses and their employees located in designated EZs, TTAs, MEAs and LAMBRAs. These designated zones and areas are economically depressed areas of the state designated by the Department of Housing and Community Development. Special incentives include:

- For EZs. A tax credit for sales or use taxes paid on the purchase of qualified machinery and machinery parts, (which can reduce regular tax below tentative minimum tax (TMT); a tax credit to employers for wages paid to qualified employees working in the zone (which can also reduce regular tax below TMT); a tax deduction for net interest income arising from loans made to zone businesses; expensing of all or part of the cost of qualified property; and a special 15-year, 100% net operating loss carryover to offset zone income.

- For TTAs. A tax credit for sales or use taxes paid on the purchase of qualified machinery and machinery parts, a tax credit for wages paid to qualified employees working in the targeted tax area, expensing of all or part of the cost of qualified property, and a special 15-year, 100% net operating loss carryover to offset targeted tax area income. Both credits can reduce regular tax below tentative minimum tax.

- For MEAs. A credit for wages paid to qualified employees working in the MEA.

- For LAMBRA. A tax credit for sales or use taxes paid on the purchases of qualified machinery and machinery parts; a tax credit to employers for wages paid to qualified employees working in the area; expensing of all or part of the cost of qualified property; and a special 15-year, 100% net operating loss carryover to offset area income.

These tax advantages are available during the 15-year life of each designated EZ, TTA, or MEA, and during the eight-year life of each designated LAMBRA. Federal law provides limited benefits to a very small number of "Empowerment Zones" and "Enterprise Communities". Some of these federal zones partially overlap California's geographically-based economic incentive areas. Regions of overlap include Los Angeles, Santa Ana, San Diego, San Francisco, Oakland, Imperial County, Watsonville, and Fresno.

Prior-Year Alternative Minimum Tax (AMT) Credit. While the AMT ensures that a taxpayer's tax liability is not reduced to zero by tax preferences, the purpose is not to eliminate the use of the tax preferences, but to defer them. (See Section 13, following, for a discussion of the AMT.) The prior-year AMT credit is allowed for AMT paid in a prior year by taxpayers that are not liable for AMT in the current year. The amount of the allowable credit in any tax year is limited to the regular tax less the refundable credits (with no carryover provisions and the credit for taxes paid to other states). The credit may be claimed by both personal income and bank and corporation tax filers.

Prison Inmate Labor. A credit is allowed for 10% of the amount of wages paid to each prisoner employed in a joint venture pursuant to an agreement with the Director of Corrections.

New Jobs Tax Credit . Current state tax law, SBX3 15 (Calderon, Stats. 2009, Third Extraordinary Session, Ch. 17), allows a New Jobs Tax credit, for taxable years beginning on or after January 1, 2009, to a qualified employer in the amount of $3,000 for each qualified full-time employee hired in the taxable year, determined on an annual full-time equivalent basis. The credit is allocated by the FTB and has a cap of $400 million for all taxable years. The credit remains in effect until December 1 of the calendar year after the year in which the cumulative credit limit has been reached and is repealed as of that date. Any credits not used in the taxable year may be carried forward up to eight years.

13. ALTERNATIVE MINIMUM TAX (AMT)

Corporate taxpayers that take advantage of certain tax preferences (exemptions, deferrals, or deductions) must compute an AMT at a 6.65% rate and pay this if it exceeds the amount of regular tax due. The purpose of the AMT is to ensure that taxpayers who take advantage of special tax reduction provisions in the tax code pay at least some minimum amount of tax on income receiving preferential treatment. These AMT rules generally conform to federal law, which imposes the corporate AMT at a 20% rate.

Computation of the AMT is rather complex. In simplified terms, the taxpayer is required to first compute the regular tax, using the rules described in this chapter and applying the regular corporate rate of 8.84%. Then the taxpayer must compute the "tentative minimum tax," which is calculated by including more income and by adding back certain tax preferences that were claimed during the first calculation, then subtracting an exemption amount ($40,000 for corporations) and applying the AMT tax rate of 6.65% to the difference. If the "tentative minimum tax" is higher than the computed regular tax, then the difference is the AMT due, which must be paid in addition to the regular tax.

A simple example of this procedure is shown in Table 5.

These rules for corporations generally apply to personal income taxpayers as well.

AMT has an important interaction with tax credits. Most credits can reduce regular tax down to, but not below, TMT. However, specific credits are available to reduce regular tax below TMT to determine a taxpayer's regular tax liability. These credits include:

- Enterprise zone hiring credit;

- Enterprise zone sales or use tax credit;
- Los Angeles Revitalization Zone (LARZ) construction hiring credit carryover;
- LARZ hiring credit carryover;
- LARZ sales or use tax credit carryover;
- Low-income housing credit;
- Manufacturers' investment credit carryover.
- Program area hiring credit carryover;
- Program area sales or use tax credit carryover;
- Research and development credit;
- Solar energy credit carryover; and,
- Targeted Tax Area hiring credit.

In addition, the solar energy credit carryover and commercial solar energy credit carryover can reduce a taxpayer's alternative minimum tax liability.

TABLE 5

EXAMPLE: COMPUTATION OF ALTERNATIVE MINIMUM TAX (AMT)
FOR A HYPOTHETICAL CORPORATION

Regular Tax Computation:

1) Income of $500,000 less deductions of $300,000 =
Net Income of $200,000 times 8.84% rate =

Regular Tax of $17,680

2) Tentative Minimum Tax Computation:

Income of $500,000 less deductions of $300,000
plus income adjustments of $50,000 plus tax preferences added back of $100,000 =
Alternative Minimum Taxable Income of $350,000 *less* exemption of $40,000 =
$310,000 times 7.0% rate =

Tentative Minimum Tax of $21,700

3) **Difference** between Tentative Minimum Tax and Regular Tax
[$21,700 less $17,680] =

AMOUNT of . . . . $ 4,020

4) Total Tax Computation:

Regular Tax plus AMT [$17,680 plus $4,020] =

Total Tax Liability of. $21,700

Tax preference items and required adjustments are generally similar to those in federal law. Specific rules for computing each of these are provided in the law.

14. TAX EXEMPT ORGANIZATIONS

In 2010-11, approximately 121,000 organizations filed returns as exempt from the corporation tax. In general, these organizations can be described as nonprofit educational, religious, charitable, literary, scientific, civic, fraternal, and social organizations. State and federal rules for qualifying as a tax-exempt organization are nearly identical.

There are restrictions on the amount of lobbying in which such organizations may engage and retain their tax-exempt status.

Certain nonprofit business and labor organizations, chambers of commerce, real estate boards, cemeteries, certain political organizations, and various beneficiary and retirement organizations may qualify for tax exempt status.

Almost all organizations that are exempt from the corporation tax nonetheless are subject to tax on "unrelated business income" (UBI) in excess of $1,000 per year. The UBI is income from a trade or business activity that is regularly carried on and is not related to the organization's exempt purpose. The tax rate on UBI is the regular corporate rate of 8.84%. Businesses that are taxed on UBI are not subject to the minimum franchise tax.

15. REVENUE

The corporation tax is the third largest source of General Fund revenue. In fiscal year (FY) 2010-11 it generated approximately $9.6 billion.

16. ADMINISTRATION

The FTB administers the corporation tax, and also is charged with setting the bank tax rate each year.

For taxable years beginning on or after January 1, 2010, estimated payments of tax liability are due as follows:

- 1st quarter installment 30% of estimated tax
- 2nd quarter installment 40% of estimated tax
- 3rd quarter installment 0% of estimated tax
- 4th quarter installment 30% of estimated tax

Corporate taxpayers who are not required to make an estimate payment installment in the first quarter are required to make the following installment payments in subsequent quarters:

- 2nd quarter installment 60% of estimated tax
- 3rd quarter installment 0% of estimated tax
- 4th quarter installment 40% of estimated tax

Corporate taxpayers who are not required to make an estimate payment installment in the first two quarters are required to make the following installment payments in subsequent quarters:

- 3rd quarter installment — 70% of estimated tax
- 4th quarter installment — 30% of estimated tax

Corporate taxpayers who are not required to make an estimate payment installment in the first three quarters are required to pay 100% in the fourth quarter.

Returns are due on the 15th day of the third month following the close of the taxable year. Taxpayers are subject to penalties if estimated payments remitted over the course of the year are less than prescribed minimum percentages of tax liability.

Taxpayer appeals of disputed tax assessments are made first to the FTB, then to the Board of Equalization (BOE). After payment, taxpayers may appeal in the courts.

Taxpayers may post deposits with the FTB in lieu of paying disputed tax assessments. Taxpayer appeals of denied refund claims may be made either to the BOE or in state court.

The paperless automatic extension program, similar to the program for personal income taxpayers, grants a seven-month automatic extension of time to file the tax return for all corporations that are not suspended. California banks and corporations are still required to pay 100% of the current tax liability by the 15th day of the third month following the close of the taxable year. Taxpayers who owe additional tax would be required to send in their payment coupon by their original due date.

As under current law, taxpayers who do not pay 100% of the tax liability by their original due date will owe interest and will be assessed the late-payment penalty. A return filed by the extended due date, with or without 100% of the tax liability paid by the original due date, will be considered to be a timely-filed return.

Electronic Funds Transfer Requirement. Taxpayers subject to the Corporation Tax Law and that meet certain requirements must pay all tax liabilities, both estimated payments and any tax due with the return, via electronic funds transfer.

In general, taxpayers subject to Corporation Tax Law must pay via electronic funds transfer if any quarterly estimated tax payment exceeds $20,000 or their total tax liability exceeds $80,000. In addition, any taxpayer may use electronic funds transfer if the FTB grants permission to a request from the taxpayer.

17. CODE

California Constitution, Article XIII, Sections 26 and 27

CHAPTER 2C
CORPORATION TAX

Revenue and Taxation Code, Division 2, Part 10.2, Sections 18401-19802 and Part 11, Sections 23001-25141

CHAPTER 2D

DETERMINING THE INCOME OF MULTISTATE AND MULTINATIONAL CORPORATIONS

HIGHLIGHTS

- Unitary Corporations
- Combination
- Apportionment Formula
- Worldwide Combination
- Water's-Edge Combination
- Business Versus Nonbusiness Income
- Federal Treatment of Multinational Corporation

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1. INTRODUCTION

When a corporation derives income from sources both within and outside of California, it is necessary to determine what portion of total corporate income is earned in California and is subject to tax in this state.

The method used by California and many other states is called the "unitary method", sometimes erroneously referred to as the "unitary tax". It applies to both multistate and multinational corporations.

The unitary method was developed early in the history of state corporate taxation as an alternative to the so-called "source method", which attempts to identify the geographic source of each corporate income stream. The source method is inadequate because it failed to reflect that a corporation's income is earned as the result of all its activities in all locations. An attempt to identify one geographic source of the earnings does not accurately reflect the contribution of all corporate activities to the ultimate profitability of the company. In addition, the source method is inadequate because multistate and multinational firms have the ability to manipulate their internal accounts so as to shift profits earned in California or another high tax state into a state with low or no taxes on corporate income (or conversely, shift losses to high tax states).

In contrast, the unitary method combines total corporate income, then uses a formula to apportion total income to the taxing jurisdictions within which the corporation does business. This method has the advantages of reflecting the contribution of all corporate activities to overall profit, and of making the assignment of income and expenses to divisions within the corporation, or to particular geographic locations, irrelevant to the determination of tax liability.

The use of the unitary method by states has been quite controversial over the years. Most of the controversy has centered on the application of the unitary method to multinational corporations. In general, use of the unitary method to apportion income of multistate corporations operating only in the United States has received relatively little challenge. Further discussion of the controversy surrounding worldwide combination and apportionment is provided in Section 5 of this chapter.

The unitary method is a very complex area of tax law, and it has developed over the years through statutory provisions, regulations of the Franchise Tax Board (FTB), decisions on taxpayer appeals by the quasi-judicial Board of Equalization (BOE), and judicial decisions in both state and federal courts. This area of law is still evolving.

2. UNITARY CORPORATIONS

The unitary method applies to single corporations doing business both within and outside of California. It also applies to groups of affiliated corporations that, in effect, operate as one integrated business. When a group of corporations operates as a "unit" (i.e., is 'unitary'), that group is treated as if it were one corporation and is subject to the unitary method.

A single corporation or a group of affiliated corporations may conduct more than one unitary business. In those circumstances, each unitary business is accounted for separately. A corporation may also have "investment" activities that are accounted for separately from the unitary business. (See Section 7 below on Business versus Nonbusiness income.)

Whether a group of corporations comprise a unitary group is a complex determination that must be made based on the facts and circumstances of each corporate group. This is also an area where the law is still developing. Taxpayers and the FTB determine whether a group of affiliated corporations is unitary by means of three general tests that have grown out of a body of judicial opinions. These are (a) the three unities test, (b) the contributions and dependency test, and (c) the functional integration test. A unitary business exists if any of the three tests is met. In the three unities test, the relevant unities are: unity of ownership, unity of operation, and unity of use. Important facts considered for each test of unity are:

- Unity of Ownership. This exists where the same interests own, directly or indirectly, more than 50% of the voting stock of all members of the group. Unity of ownership may also exist between:

  a) A parent corporation and one or more other corporations if the parent owns stock representing more than 50% of the voting power of at least one corporation in the group and, if applicable, stock cumulatively representing more than 50% of the voting power of each of the corporations (except the parent) is owned by the parent or two or more members of the group.

  b) Any two or more corporations if stock representing more than 50% of the voting power of the corporations is owned (directly or by constructive ownership) by a single person.

  c) Any two or more corporations if stock representing more than 50% of the voting power of the corporations is owned (directly or by constructive ownership) by two or more members of the same family.

  d) Any two or more corporations that constitute stapled entities.

- Unity of Operation. Is usually shown by centralized operations or functions such as purchasing, advertising, accounting and management. In some instances, corporations that are neither in the same line of business nor vertically integrated are found to be unitary because of centralized management and central departments.

- Unity of Use. Is reflected by a centralized executive force and the operation systems in general.

3. COMBINATION

Once it is determined that a unitary business conducts unitary activities both within and outside of California, all income and deductions from the separate sites are combined. The group computes net income as if it were a single corporation. Income and expenses from intercompany transactions are disregarded (the same way transactions between a husband and wife filing a joint return in the personal income tax are disregarded). Thus, for example, dividends paid from one affiliated corporation to another are not counted as income since this is an intercompany transaction.

The portion of this total nationwide or worldwide net income that is taxable by California is then determined by formula, as described below.

4. APPORTIONMENT FORMULA

The formula is based on three "factors" -- payroll, property and sales. These three factors represent easily measurable basic corporate activities that contribute to profitability.

California generally uses the "double-weighted" sales factor apportionment method for most industries. That is, the formula uses a single payroll and property factor while including the sales factor twice (see example in Table 6). However, for certain industries, including agricultural, extractive savings and loan, banking or financial institutions, the sales factor is single-weighted, so the formula is based on the simple average of the three factors.

The formula works as follows for each tax year:

- The corporation computes the ratio of its payroll in California (stated in dollars of value) to its payroll everywhere. It computes similar ratios for its California property and sales to property and sales everywhere. Note: The payroll and sales factors compare annual expenditures while the property factor uses an average of property owned and rented by the corporation at the beginning of the year and at the end of the year.

- The arithmetic average of the three ratios is computed using a denominator of three for agricultural, extractive, savings and loan, and banking or financial activities, while double-weighting the sales factor and using a denominator of four for all other industries. This average represents the proportion of the corporation's total activity that it conducts in California.

- The average ratio computed above is applied to combined total net income to determine the share of the income of the unitary business that is apportioned to California.

- The corporate tax rate of 8.84% is applied to the net income apportioned to California.

Table 6 illustrates the application of the apportionment formula to a hypothetical corporation. The rules for apportioning income are modified for specialized industries, for example, airlines, professional sports teams, construction contractors, franchisers, trucking companies, and for certain forms of businesses, for example, partnerships and personal service corporations. The modifications, established in Regulations issued by the FTB, typically provide special rules for computing the factors used in the apportionment formula. In addition, the FTB issued Regulation 25137 that sets forth the circumstances permitting a taxpayer to use a different apportionment formula.

Because formula apportionment is intended to tax only that portion of total income that is apportioned to California, double taxation of the same income by different jurisdictions normally does not occur. Therefore, no tax credit for taxes paid to other states is provided in the corporation tax law.

New Changes To Apportionment and Sales Factor Rules:

For taxable years beginning on or after January 1, 2011, qualified apportioning trade or businesses may make an annual, irrevocable election to utilize a single factor, 100% sales, (single sales factor) apportionment formula instead of the three factor, double-weighted sales apportionment formula discussed above. Businesses that derive more than 50% of their gross receipts from agriculture, extractive business, savings and loans, or banks and financial activities would be specifically prohibited from electing a single sales factor apportionment formula.

The election must be made on a timely filed original return in the manner and form prescribed by the FTB.

Definition of Doing Business.

A bright-line test was established to provide that a taxpayer is doing business in California if any of the following conditions are satisfied:

A. The taxpayer is organized or commercially domiciled in this state.

B. Sales of the taxpayer in this state exceed the lesser of $500,000 or 25% of the taxpayer's total sales. Sales of the taxpayer include sales by an agent or independent contractor of the taxpayer.

C. The real and tangible personal property of the taxpayer in this state exceed the lesser of $50,000 or 25% of the taxpayer's total real and tangible personal property.

D. The amount paid in this state by the taxpayer for compensation exceeds the lesser of $50,000 or 25% of the total compensation paid by the taxpayer.

The amounts described in items B, C, and D above shall be updated by the FTB on an annual basis in a similar manner used to recompute the state income tax brackets.

Definition of Gross Receipts.

Gross receipts are defined as the gross amounts realized (the sum of money and the fair market value of other property or services received), but do not include the following items:

- Repayment, maturity, or redemption of the principal of a loan, bond, mutual fund, certificate of deposit, or similar marketable instrument.
- The principal amount received under a repurchase agreement or other transaction properly characterized as a loan.
- Proceeds from issuance of the taxpayer's own stock or from sale of treasury stock.
- Damages and other amounts received as the result of litigation.
- Property acquired by an agent on behalf of another.
- Tax refunds and other tax benefit recoveries.
- Pension reversions.
- Contributions to capital (except for sales of securities by securities dealers).
- Income from discharge of indebtedness.
- Amounts realized from exchanges of inventory that are not recognized under the Internal Revenue Code.
- Amounts received from transactions in intangible assets held in connection with a treasury function of the taxpayer's unitary business and the gross receipts and overall net gains from the maturity, redemption, sale, exchange or other disposition of those intangible assets.
- Amounts received from hedging transactions involving intangible assets.

Determination of Sales In California For Tangible Personal Property.

The following rules for assigning sales from tangible personal property to the sales factor were added to the Corporation Tax Law:

- Sales of tangible personal property are assigned to California if the product is delivered or shipped to a purchaser in this state, and the taxpayer (seller) or any member of the combined reporting group is taxable in this state.

- Sales of tangible personal property are assigned to California if the product is delivered or shipped to a purchaser out of state, and the taxpayer (seller) or any member of the combined reporting group is not taxable in the state of destination.

Determination of Sales In California For Other Than Tangible Personal Property.

The following rules for assigning sales of other than tangible personal property were added to the Corporation Tax Law:

- Sales from services are in this state to the extent the purchaser of the service received the benefit of the service in this state.
- Sales from intangible property are in this state to the extent the property is used in this state. In the case of marketable securities, sales are in this state if the customer is in this state.
- Sales from the sale, lease, rental or licensing of real property are in this state if the real property is located in this state.
- Sales from the rental, lease or licensing of tangible personal property are in this state if the property is located in this state.

TABLE 6

EXAMPLE: USE OF UNITARY APPORTIONMENT
FORMULA FOR A HYPOTHETICAL CORPORATION

1) **Compute ratio of corporate assets in California to assets worldwide**:

	In California	Total Everywhere	Ratio of California to Total
Sales	$1,000,000	$20,000,000	5%
Property	4,000,000	40,000,000	10%
Payroll	2,000,000	10,000,000	20%

2) **Determine the apportionment factor**:

Agricultural, extractive, savings and loan, banking or financial activities:
5% + 10% + 20% = 35% divided by 3 = 11.6666%

All other business activities: 5% + 5% + 10% + 20% = 40% divided by 4 = 10%.

Elective Single Sales Factor (Taxable Years Beginning on or after January 1, 2011) is 5%

3) **Apply apportionment factor to total corporate net income to determine income apportioned to California**:

	Qualified Business Activities*	Business Activities	Elective Single Sales Factor
Worldwide Net Income of Corporation: *times* Unitary Apportionment Factor	$5,000,000 x 11.6666%	$5,000,000 x 10%	$5,000,000 x 5%
Net Income Apportioned to California:	$ 583,330	$ 500,000	$ 250,000

4) **Apply California tax rate to determine tax**:

Income Apportioned to California: *times* Corporation Tax Rate:	$ 583,330 x 8.84%	$ 500,000 x 8.84%	$ 500,000 x 8.84%
Tax Due to California:	$ 51,566	$ 44,200	$ 22,100

*Agricultural, Extractive, Savings and Loan, and Banking or Financial Activities.

5. WORLDWIDE COMBINATION

Initially, all worldwide unitary corporations were required to combine their worldwide operations and use the unitary method, as described above, computing worldwide factors and worldwide income. The apportionment percentage was expressed as California payroll, property, and sales as a percent of worldwide payroll, property and sales.

Numerous court challenges arose regarding California's ability to require worldwide combinations of the unitary businesses of multistate corporations. In a variety of cases, the United States Supreme Court confirmed the constitutionality of California's apportionment of income on a worldwide basis.

While judicial challenges advanced, taxpayers continued their arguments against worldwide combination and encouraged the Legislature to repeal the laws requiring combination. Arguments made to the Legislature for repealing mandatory worldwide combined reports for multinational corporations included the following:

- Property, payroll, and sales do not produce equal profits in all parts of the world. For example, labor may be cheaper (and thus relatively more profitable) overseas than in the United States. Thus, the formula is distorting and results in instances of double taxation by California and foreign nations.

- Fluctuations in international exchange rates make it difficult to put economic activities around the world on a consistent and comparable basis for purposes of the formula apportionment.

- The worldwide combination and apportionment system places excessive record keeping burdens on corporations.

- The worldwide system discourages corporations from making relatively less profitable investments in California because investment in California property will increase the share of the corporation's income subject to California tax. For example, start-up of a plant is often initially less profitable.

- This system discourages investment in California by foreign firms, thereby depriving the state of the potential employment growth associated with such investment.

- Foreign governments have protested that the system is unfair to their countries' businesses that operate worldwide and have threatened retaliation on U.S. corporations operating in their countries.

- Third world countries might copy the system of worldwide combination, potentially increasing tax burdens of businesses from industrialized nations.

In 1986, legislation was enacted to respond to these concerns. Under the new system, multinational corporations were allowed to elect one of two methods of determining income subject to tax in California, either worldwide combination or water's-edge combination.

6. WATER'S-EDGE COMBINATION

Multinational affiliated corporations that operate a unitary business may elect to combine only the affiliates that are designated as being within the "water's-edge." Affiliates outside the water's-edge are disregarded, and their income plays no direct role in the computation of income subject to tax in California. The concepts of unity and combination and the operation of the formula, as described above, continue to apply. In 2001, 5,714 corporations made the water's-edge election.

The major provisions applying to corporations that elect water's-edge combination are as follows:

Definition of "Water's-Edge". The "water's-edge" includes the 50 states of the United States and specified income activity of affiliates organized overseas. Thus, affiliates organized in the United States are considered inside the water's-edge and are combined. Affiliates organized overseas are considered outside the water's-edge and are not combined, except to the extent of their United States activities. However, affiliates organized overseas which have 20% or more of their activities in the United States are inside the water's-edge. In addition, state law requires a controlled foreign corporation (CFC) with Subpart F income to include a portion of its net income and apportionment factors in the water's-edge group tax filing based on an inclusion ratio.

So-called "80-20" corporations (United States-domiciled corporations with less than 20% of their activities in the United States) are also included within the water's-edge.

Water's-Edge Election Period. Prior to January 1, 2003, corporations that elected to use the water's-edge combination method made a contract with FTB for an initial term of 84 months. On the anniversary date of the contract, the election is automatically renewed on an annual basis unless a taxpayer provides FTB with a notice of nonrenewal. For taxable years beginning on or after January 1, 2003, the contract has been replaced with a statutory election that remains in effect until terminated.

Dividend Exclusion. Corporations electing water's-edge combination may exclude from income a portion of the dividends they receive from certain affiliates. The excludable amount is equal to 75% of all qualifying dividends received. However, dividends resulting from specified construction projects are 100% deductible.

In addition, California law provides that the water's edge group must assign the interest expense that relates to the excluded dividends to those dividends, and a proportionate amount of interest expense attributable to foreign investments can be offset against the deductible dividends.

Audits. The FTB may conduct audits of corporations electing water's edge combination to ensure that income is properly accounted for, especially between members of the water's-edge group and affiliates outside of the water's-edge group, and to prevent tax avoidance.

7. BUSINESS VERSUS NONBUSINESS INCOME

Business and nonbusiness income of multistate and multinational corporations is treated differently when determining California tax liability.

Business income is all income that arises from the conduct of trade or business operations. Most corporate income is business income and is apportioned to California or elsewhere by formula, as described above.

Nonbusiness income is that which does not arise in the normal course of the taxpayer's business operations. It can include such things as dividends from other corporations, interest, royalties, gains from the sale of investment properties, and the like so long as they are not related to the normal business of the corporation. In general, nonbusiness income is allocated in full to the state where the taxpayer is commercially domiciled in the case of income from intangibles, or where the relevant property is located in the case of income from tangible personal or real property.

8. FEDERAL TREATMENT OF MULTINATIONAL CORPORATIONS

Federal law taxes corporations in a manner similar to California taxation of individuals. Corporations organized in the United States (residents) are taxed on all of their income and are allowed a credit for taxes assessed by foreign countries because they have income sources there. Corporations organized outside the United States (nonresidents) are taxed on only their United States source income.

In making determinations of income source, the federal government uses the "separate accounting method". This method requires accounting separately for income streams and expenses attributable to each member of an affiliated group of corporations and to United States versus foreign operations. Transactions between affiliates are to be accounted for on an "arm's length" basis. That is, pricing is to be adjusted to reflect what the transactions would be if they were conducted at arm's length between competitor corporations rather than between affiliated corporations.

A key feature of the federal system is an aggressive audit program to ensure that arm's length pricing is used by affiliated corporations to accurately reflect the income and goods exchanged between related businesses. These are often referred to as "Section 482 audits". Due to the complexity and controversy associated with Section 482 audits, the Internal Revenue Service (IRS) initiated an Advance Pricing Agreement (APA) program. Under this program, taxpayers and the IRS agree upon the transfer pricing methods that should be applied before the tax return is filed.

9. CODE

Revenue and Taxation Code Sections 25101-25141

CHAPTER 2E

SALES AND USE TAX

HIGHLIGHTS

• Tax Base	Total retail price of any tangible personal property unless the property is otherwise exempted; also imposed on certain state excise taxes, including those imposed on alcoholic beverages, tobacco products, and gasoline.		
• Tax Rate	Total state and local base rate of 7.25%. Generally, the rate may be 7.375% to 9.75% in those cities and counties that impose additional rates.		
• Revenue*	2010- 2011	$27.0 billion (General Fund)* $ 2.5 billion (Local Revenue Fund) $ 2.5 billion (Local Public Safety Fund) 31.6% of General Fund revenues	
	2011-12 (Estimate)	$18.8 billion (General Fund)* $ 2.7 billion (Local Revenue Fund) $ 2.6 billion (Local Public Safety Fund)	
	2012-13 (Estimate)	$20.8 billion (General Fund)* $ 2.8 billion (Local Revenue Fund) $ 2.8 billion (Local Public Safety Fund)	

*Source: Governor's Budget Summary of 2012-13

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1. OVERVIEW OF THE SALES TAX

The **sales tax** is imposed on retailers for the privilege of selling tangible personal property in California. Note, retailers are authorized to, and generally do, add sales tax to the sales price and collect reimbursement of the tax from the purchaser. The **use tax**, in contrast, is generally imposed on the use in California of tangible personal property purchased out-of-state.

Both the sales tax and the use tax are imposed on nearly identical items of tangible personal property. Tangible personal property is any physical asset, such as household goods and business equipment, which is readily movable and not permanently attached to real property. All sales of tangible personal property are taxable, unless specifically exempted by law.

However, sales of real property, such as land and buildings, are *not* subject to the sales tax. Furthermore, because the sales tax is imposed on *retail* sales, sales for resale and wholesale sales are excluded from the tax.

The measure of both the sales and the use tax are imposed on the retail price of the taxable personal property. The retail price is referred to as the "gross receipts" for sales tax purposes and the "sales price" for use tax purposes. Generally, no part of the retail price may be excluded from the tax base. If there is a manufacturers' or importers' excise tax, such as excise taxes imposed on gasoline, alcoholic beverages, and tobacco, it is included as part of the sales and use tax base. Generally, both state and federal excise taxes are included in the sales and use tax base. For example, an individual who purchases gasoline in the State of California must pay sales tax on the retail price of the gasoline, including the state and federal excise taxes.

Services are generally not subject to sales or use tax. However, when services contribute to the production or delivery of tangible personal property sold at retail, tax *does* apply to the entire sale price, with no deduction for the service component. This tax treatment follows the reasoning that acquisition of the tangible personal property is the true object of the transaction, and the service performed is deemed incidental. For example, in the sale of a custom-designed suit, the buyer's purpose is obtaining the clothing, which is tangible personal property. Although the tailor who designs and sews the suit performs a service of labor, the true object of the transaction is the sale of the suit, not the design and sewing services. Therefore, sales (or use) tax applies to the total price of the custom-tailored suit, including the design and tailoring.

Generally, leases of tangible personal property are considered "continuing" sales or uses and are subject to sales or use tax. Each payment made under the lease is subject to sales or use tax for the entire period that the leased property is located in California. Note: If a lease of tangible personal property covers property substantially in the same form as when acquired by the lessor and the lessor paid sales or use tax on the property when acquired, the rental payments are not subject to tax.

A seller's permit is a permit, furnished without charge by the State Board of Equalization (BOE), to sell tangible personal property in California. Generally, all persons or businesses that make retail or wholesale sales are required to hold a seller's permit.

In California, the retailer is liable for paying the sales tax. A retailer is described as anyone who makes more than two retail sales of tangible personal property within a 12-month period. As mentioned above, the retailer has the option of collecting a reimbursement of the tax from the consumer. However, if the retailer does not collect the sales tax reimbursement at the time of purchase, the retailer is still responsible for remitting the tax to the state.

The use tax is imposed on users of tangible personal property purchased out-of-state and brought into or delivered to California for use inside California. For example, an individual who purchases an automobile in the State of Washington and registers it in California is required to pay California use tax on his or her purchase; he or she is not subject to any

Washington sales tax. Like the sales tax, the measure of the use tax is the sales price of the tangible personal property. The purpose of the use tax is to prevent persons from avoiding the California sales tax by purchasing at retail in states where the sales tax is lower than California or where there is no sales tax.

Unlike the sales tax, which is imposed on retailers, the use tax is imposed on purchasers. In practice, the use tax is more difficult than the sales tax, because purchasers must generally self-report their California use tax liability. Although many large firms located in California are required to register with the BOE and track and report their use tax liabilities, individual consumers and many small firms who are not required to register with the BOE frequently do not report their use tax liabilities. Furthermore, although some large mail order catalog and Internet retailers located outside of California voluntarily collect use tax from California consumers and remit it to the BOE, this practice is relatively uncommon. Consequently, a significant portion of California use tax goes uncollected.

2. TAX RATES

Currently, the base state and local sales and use tax rate in California is 7.25%. This 7.25% rate is a combination of five different tax rates, as follows:

Imposed State-Wide (Total = 7.25%)

NAME	RATE (%)	2010-11 REVENUE ($ BILLIONS)	USE OF REVENUE	BASIS OF ALLOCATION
"State" rate*	3.9375 0.25 1.0625	$18.8 $1.3 $5.1	State General Fund purposes Fiscal Recovery Fund Local Revenue Fund 2011	Not applicable
Local Revenue Fund rate	0.5	$2.7	Health and welfare programs shifted to local govern-ments as part of 1991-92 state-local realignment	Allocated to counties based on population, percentage of persons below the poverty line, and changes in spending on health and welfare programs during prior years.
Local Public Safety Fund rate	0.5	$2.7	Local public safety	Allocated primarily to counties based on sales during the prior year; cities receive about 6% of Local Public Safety Fund revenues based on amounts they lost as a result of the property tax

				shifts of the early to mid-1990s.
County Transportation rate	0.25	$1.2	County transportation purposes	Allocated to counties based on the location of sale
Bradley-Burns rate*	0.75	$3.6	Local (city/county) general purpose use	Allocated to cities and counties based on the location of sale (to cities if the sale occurs in the city, to counties if the sale occurs in an unincorporated area of the county)

Also, each year a certain amount of the state sales tax revenues attributable to sales of gasoline and diesel fuel must be transferred to the Public Transportation Account (PTA) within the State Transportation Fund. The amount transferred is determined by formula. The 2006-07 transfer was $625.8 million.

Beginning in 2000-01, some of the sales tax revenue derived from sales of gasoline was also directed to the Traffic Congestion Relief Fund (TCRF). The Budget Act of 2000 appropriated $1.5 billion from the General Fund to the TCRF and required that four quarterly transfers of $125 million each be made. Beginning in fiscal year 2004-05, all sales tax revenue from sales of gasoline, net of the amount transferred to the PTA, was to be transferred to the Transportation Investment Fund. From there, $140 million was to be transferred on a quarterly basis to the TCRF, and the remainder was to be split three ways -- 20% to the PTA, 40% to the Department of Transportation, and 40% to local governments for transportation purposes. The 2001-02 budget delayed the transfer of sales tax revenue from gasoline to the Transportation Investment Fund by two years. However, one of the budget trailer bills [ACA 4 (Dutra), Chapter 87, Statutes of 2001], authorized the placement of an initiative constitutional amendment on the March 2002 ballot, which was approved by the voters through the passage of Proposition 42. Proposition 42, which was extended to become operative beginning in the 2003-04 fiscal year, would have required all sales tax revenue on gasoline except for the amount required to be transferred to the PTA be transferred to the Transportation Investment Fund for specified transportation purposes. However, Proposition 42 has been suspended by the Legislature in each of the last two fiscal years [AB 1750 (Committee on Budget, Chapter 223, Statutes of 2003, and SB 1099 (Committee on Budget and Fiscal Review, Chapter 210, Statutes of 2004].

Additional Local Rates. The Transactions and Use Tax Law authorizes cities, counties, citywide and countywide authorities, and citywide and countywide special districts to impose additional sales and use taxes (officially 'transactions and use taxes'), subject to a vote of the people. In general, the Transactions and Use Tax Law authorizes taxes to be imposed in 0.125% increments, up to a total of 2%. (However, the Los Angeles Metropolitan Transportation Commission may, upon voter approval, impose a 0.50% tax, even if it exceeds the 2% limitation).

As noted above, all transactions and use taxes are subject to voter approval. Pursuant to Proposition 218, passed by the voters in November 1996, general-purpose transactions and use taxes require majority voter approval; special-purpose transactions and use taxes require two-thirds voter approval.

As of January 1, 2012, 39 California counties, 92 cities and 1 town impose the sales tax at rates higher than 7.25% due to voter approval of imposition of additional taxes. In 2008-09 and 2009-10, these add-on taxes raised $5.0 billion and $4.7 billion, respectively, for the local governments that imposed them. See Table 7 in this chapter for the list of cities and counties with additional rates.

TABLE 7

Existing Transactions and Use Taxes (As of 01/01/12)

Jurisdiction	Rate	Purpose
Alameda County	1.5%	Transit / Hospital
Amador County	0.5%	Fire / Emergency Medical
City of Arcata	0.75%	General Fund
City of Arroyo Grande	0.5%	General Fund
City of Arvin	1.0%	General Fund
City of Avalon	0.5%	Hospital and Clinic
City of Calexico	0.5%	General Fund
City of Campbell	0.25%	Vital City Services
City of Capitola	0.25%	General Fund
City of Cathedral City	1.0%	General Fund
City of Ceres	0.5%	Public Safety
City of Clearlake	0.5%	Public Safety
City of Concord	0.5%	General Fund
City of Cotati	0.5%	General Fund
City of Davis	0.5%	General Fund
City of Delano	1.0%	General Fund
City of Del Rey Oaks	1.0%	General Fund
City of Dinuba	0.75%	Police / Fire
City of El Cajon	1.0%	Public Safety / Services
City of El Cerrito	1.0%	Street Improvement / General Fund
City of El Monte	0.5%	General Fund
City of Eureka	0.75%	General Fund
City of Farmersville	0.5%	General Fund
City of Fort Bragg	0.5%	Road Maintenance
City of Galt	0.5%	Public Safety
City of Grover Beach	0.5%	General Fund
City of Gustine	0.5%	Community Services
City of Hollister	1.0%	General Fund
City of Inglewood	0.5%	General Fund
City of La Habra	0.5%	General Fund
City of La Mesa	0.75%	General Fund
City of Lakeport	0.5%	General Fund
City of Los Banos	0.5%	Public Safety
City of Mammoth Lakes	0.5%	Parks and Recreation
City of Manteca	0.5%	Public Safety
City of Marina	1.0%	General Fund
City of Merced	0.5%	General Fund
City of Montclair	0.25%	General Fund

City of Morro Bay	0.5%	General Fund
City of Mount Shasta	0.25%	Libraries
City of National City	1.0%	General Fund
City of Nevada	0.5%	Street Improvement
City of Novato	0.5%	General Fund
City of Oxnard	0.5%	Vital Services
City of Pacific Grove	1.0%	General Fund
City of Pico Rivera	1.0%	General Fund
City of Pinole	0.5%	General Fund
City of Pismo Beach	0.5%	General Fund
City of Placerville	0.5%	Public Safety / General Fund
City of Point Arena	0.5%	General Fund
City of Port Hueneme	0.5%	General Fund
City of Porterville	0.5%	Public Safety / Police / Fire
City of Reedley	0.5%	Public Safety
City of Richmond	0.5%	General Fund
City of Rohnert Park	0.5%	General Fund
City of Salinas	0.5%	General Fund
City of San Bernardino	0.25%	General Fund
City of Sand City	0.5%	General Fund
City of Sanger	0.75%	Public Safety
City of San Juan Bautista	0.75%	General Fund
City of San Leandro	0.25%	General Fund
City of San Luis Obispo	0.5%	Essential Services
City of San Mateo	0.25%	General Fund
City of San Rafael	0.5%	General Fund
City of Santa Cruz	0.5%	General Fund
City of Santa Monica	0.5%	General Fund
City of Santa Rosa	0.5%	Public Safety / General Fund
City of Sebastopol	0.25%	General Fund
City of Seaside	1.0%	General Fund
City of Selma	0.5%	Public Safety
City of Sonora	0.5%	General Fund
City of South El Monte	0.5%	City Services Protection
City of South Gate	1.0%	General Fund
City of South Lake Tahoe	0.5%	General Fund
City of Stockton	0.25%	Public Safety
City of Tracy	0.5%	General Fund
City of Trinidad	0.75%	General Fund
City of Tulare	0.5%	General Fund
City of Ukiah	0.5%	General Fund
City of Union city	0.5%	General Fund
City of Visalia	0.25%	Public Safety
City of Vista	0.5%	General Fund

City of Watsonville	0.25%	General Fund
City of West Sacramento	0.5%	General Fund
City of Wheatland	0.5%	General Fund
City of Williams	0.5%	General Fund
City of Willits	0.5%	Road System
City of Woodland	0.75%	General Fund
Contra Costa County	1.0%	Transit
Fresno County	0.725%	Transit / Libraries / Zoo
Imperial County	0.5%	Transit
Inyo County	0.5%	General Fund
Los Angeles County	1.5%	Transit
Madera County	0.5%	Transit
Marin County	0.75%	Transit / Rail
Mariposa County	0.5%	County Healthcare
Napa County	0.5%	Flood Protection
Nevada County	0.125%	Public Libraries
Orange County	0.5%	Transit
Riverside County	0.5%	Transit
Sacramento County	0.5%	Transit
San Bernardino County	0.5%	Transit
San Diego County	0.5%	Transit
San Francisco City and County	1.25%	Transit / Public Finance
San Joaquin County	0.5%	Transit
San Mateo County	1.0%	Transit
Santa Barbara County	0.5%	Transit
Santa Clara County	1.0%	Transit
Santa Cruz County	0.75%	Transit / Public Libraries
Solano County	0.125%	Public Libraries
Sonoma County	0.75%	Agricultural Preservation / Open Space / Transit/Rail
Stanislaus County	0.125%	Public Libraries
Town of Truckee	0.5%	Road Maintenance
Tulare County	0.5%	Transit

3. EXEMPTIONS

All retail sales of tangible personal property are taxable in California unless the property is specifically exempted. Some major exemption categories are described below.

<u>Necessities</u>. The following items are granted general sales and use tax exemptions:

- Food (other than hot prepared food) for human consumption;

- Prescription medicines, wheelchairs, crutches, canes, walkers, medical oxygen delivery systems, hemodialysis products, and prosthetic devices;

- Gas, electricity, and water delivered through mains, lines, or pipes;

- Food for animals normally raised for human consumption; and,

- Fertilizer and seeds applied to land used to grow foods for human consumption.

Interstate Commerce. The Commerce Clause of the U.S. Constitution prohibits states from imposing taxes that place an undue burden on people or businesses engaged in interstate commerce. To comply with the U.S. Constitution, California has enacted laws that exempt sales of certain property involved in interstate commerce.

For example, interstate sales of vessels and aircraft, aircraft fuel used during international flights and hot prepared food sold to air carriers for passenger consumption are exempt from the sales tax.

California has also enacted laws that complement the U.S. Commerce Clause and that level the playing field for businesses that engage in interstate commerce activities in the state. For example:

- In-state sellers are allowed to deliver property for out-of-state use to common carriers in California without any sales tax being imposed.

- Businesses are not taxed on the printed sales messages they commission and have mailed to potential customers.

- Air common carriers are not taxed on the fuel used on international flights.

Without these additional laws, California businesses could be at a disadvantage vis-à-vis competitors based in other states.

Exemptions for Nonprofit and Government Organizations. Pursuant to the U.S. Constitution, all sales of tangible personal property to the federal government are exempt from tax. Museums are also exempted from sales tax on works of art they purchase for public display.

Several nonprofit organizations are allowed a partial sales tax exemption for certain items they sell under specified circumstances. The exemption is considered partial because the tax is computed based on the wholesale price of the organization's products, which presumably is lower than the retail price. For example, when the Girl Scouts make handicrafts they later resell, they remit sales tax based on the wholesale price of the materials used to make the handicrafts. Unlike most retailers, they do not have to collect or remit the sales tax based on the price for which the handicrafts are subsequently sold. Generally, the partial sales tax exemption is limited to sales of food, non-alcoholic beverages, and handcrafted items.

Groups currently eligible for partial sales tax exemptions include: Little League; Bobby Sox; Boy Scouts; Cub Scouts; Girl Scouts; Campfire Girls; YMCA; YWCA; Future Farmers of America; Future Homemakers of America; 4-H Clubs; American Youth Soccer Organization; California Youth Soccer Associations; Pop Warner Football; Special Olympics; and school-sponsored youth groups, such as high school teams. Organizations that provide vocational training services to the developmentally disabled or services to children with severe emotional disturbances are also allowed a partial exemption on the sale of handicrafts that are made by their clients and retail for $20 or less.

Other Exemptions. A few of the other major items exempted from all or a portion of the sales tax include: farm equipment, timber-harvesting equipment, racehorse breeding stock, motion picture production services, motion picture leases, returnable containers, custom computer programs, subscription periodicals, master records and tapes, property that will be used in space flights, and bulk sales of monetized and nonmonetized bullion. For a complete list of exemptions see the BOE publication titled *Sales and Use Taxes: Exemptions And Exclusions*. For additional information on these exemptions, contact the BOE.

4. SALES IN CALIFORNIA BY OUT-OF-STATE RETAILERS

California's ability to collect use tax resulting from internet, mail order and catalogue sales is significantly limited for the following two reasons: (a) U.S. Supreme Court decisions in National Bellas Hess v. Illinois Department of Revenue (1967) and Quill Corporation v. North Dakota (1992), which prohibit states from requiring mail order houses to collect and remit use taxes; and (b) the fact that consumers are legally liable for the use tax on these mail order sales. At present, however, California fails to collect approximately $1.1 billion in revenues as a result of unreported use taxes.

The Quill and National Bellas Hess Cases. Two U.S. Supreme Court decisions prohibit states from requiring mail order sellers to collect state use taxes unless the seller has physical nexus in the state. In the National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois (1967) case, the U.S. Supreme Court held that when a business does no more than communicate with customers by mail or common carrier as part of a general interstate business, requiring that business to collect and pay the use tax violates the U.S. Constitution. In Quill Corporation v. State of North Dakota (1992), the Supreme Court interpreted the Commerce Clause of the U.S. Constitution as prohibiting states from imposing use tax collection obligations on retailers whose only connection with customers in the taxing state is through mail order sales.

Both decisions leave the door open for Congress to establish a framework for uniform state taxation that does not impede interstate commerce. In an effort to simplify various states' sales and use tax systems, forty-four states, including California, and the District of Columbia, that levy a sales and use tax participated in the Streamlined Sales Tax Project (SSTP), and on October 1, 2005, the "Streamlined Sales and Use Tax Agreement" became effective. This Agreement creates a blueprint for a simplified tax collection system and attempts to alleviate the burden and cost of tax collection for sellers. The agreement addresses issues associated with tax collections, definitions of the tax base, uniformity of tax bases, electronic registration of sellers, simplification of tax rates, simplification of returns and remittances, uniform sourcing rules, as well as other issues. The Project is conducting its work through a steering committee with co-chairs, four work groups, and a number of sub-groups. Project participants are generally state revenue department administrators but there are also representatives of state legislatures and local governments. Businesses including national retailers, trade associations, manufacturers, direct marketers, telecommunications companies, leasing companies, technology companies, printers, accounting firms, and others are actively participated in the Project by offering expertise and input, reviewing proposals, suggesting language, and testifying at public hearings. Twenty-two states have been certified to be in substantial compliance with the Agreement, which means they have changed their laws so that they meet all the requirements of the Agreement.

Participation in the Project does not change any law or tax reporting/collection responsibilities of remote sellers. However, California legislators could choose to amend California's Sales and Use Tax Law to conform to the provisions of the Agreement if such conformity is desired.

Nexus and Use Tax Collection. California law requires every retailer "engaged in business in this state" to collect sales or use tax from the consumer at the time of sale. The definition of a “retailer engaged in business in the state” includes any retailer who:

- Maintains, occupies, or uses an office, place of distribution, sales or sample room, warehouse or other storage space, or other place of business in California;
- Has any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in California to sell, deliver, install, assemble, or take orders for any taxable property; and,
- Leases property in the state.

Out-of-state retailers who are deemed to be “engaged in business in this state” are required to collect and remit use tax to BOE. Some other out-of-state sellers also voluntarily collect and remit use taxes to BOE, usually when there is some question about whether their business activities in California represent nexus.

Since 1998, certain taxpayers have been allowed to obtain a use tax direct payment permit from BOE. Use tax direct payment permits allow qualifying taxpayers to self-assess and pay state and local use tax directly to BOE, thereby removing sellers of the responsibility to do so. To be eligible, an applicant must purchase or lease at least $500,000 worth of tangible personal property during the calendar year immediately preceding the application or be a county, city, city and county, or redevelopment agency. Use tax direct payment permits provide local taxing jurisdictions with a mechanism to increase the amount of local use tax revenue they receive and provide large businesses with a mechanism to minimize their chances of being audited for an outstanding use tax liability.

Legislation enacted in 2003 authorized taxpayers to report their use tax liabilities on their California income tax returns. Any use tax liability reported on a timely filed income tax return is deemed to be timely filed and paid.

The use tax also applies to foreign purchases in excess of $800 that are brought into California. California assesses the use tax due on these purchases using information from U.S. Customs Service declarations completed by returning travelers at California ports of entry.

5. SPECIAL PROVISIONS OF THE SALES TAX

Occasional Sales. Occasional sales of property are generally not subject to the sales tax. A sale is deemed "occasional" when the seller is not required to hold a seller's permit and the sale is not one of a series of sufficient duration to require a seller's permit. For example, an individual holding a garage sale over the course of a weekend would not be required to hold a seller's permit or pay sales tax on the items sold.

Swap Meets and Flea Markets. Operators of a swap meet, flea market, or special event are required to obtain evidence that each seller who leases space from the operator of the swap meet is the holder of a valid seller's permit or is not selling any item that is taxable under the sales and use tax law.

Automobiles. When a licensed automobile dealer sells a new or used vehicle, the sales tax must be collected at the time of purchase. The sales tax rate is based on the jurisdiction in which the purchaser resides. For example, if the purchaser buys a car in a jurisdiction with an 8.25% sales tax rate but registers the car in a local community with an 8.75% rate, the dealer is responsible for collecting tax at the 8.75% rate and remitting it to BOE.

When a private non-dealer sells a car, he or she is not required to collect the sales tax. Instead, use tax is collected when the owner registers the automobile with the Department of Motor Vehicles. Here again, the purchaser is required to pay tax at the rate of the local community in which the car is registered, regardless of where the car is purchased.

Mobilehomes and Factory-Built Housing and Schools. A partial sales tax exemption is allowed to mobilehome dealers on sales of new mobilehomes that are sold to customers for occupancy as a residence. In these transactions, the mobilehome dealer is the "retailer-consumer" and is required to declare and pay tax on 75% of the dealer's purchase price of the mobilehome. No tax is imposed on the sale of such new mobilehomes to customers. Section 2 of Chapter 6G contains more information on application of the sales tax to mobilehomes.

A partial exemption is also allowed on the sales price of certain factory-built housing and schools. For factory-built homes, 60% of the retail sales price is exempt from the sales tax.

6. DEDUCTING THE SALES TAX

Individuals are not allowed a state personal income tax deduction for the sales and use tax they pay during the course of each year unless the tangible personal property was purchased for use in a trade or business.

Sales taxes are generally deductible for tangible personal property purchased for use in a trade or business. However, sales taxes incurred in the process of manufacturing or constructing property must be capitalized into the value of the property rather than deducted immediately.

7. REMITTANCE OF THE SALES TAX BY RETAILERS

Reimbursement of the Sales Tax. Retailers are legally liable for remitting sales tax to the state. However, retailers are permitted to collect a "reimbursement" of the sales tax from the consumer, which is normally itemized separately as sales tax when an item is sold. The law provides for statutory reimbursement tables to be used by retailers to compute the tax on any sales transaction.

The basic rule for computing the sales tax reimbursement, since taxpayers cannot pay fractions of cents, is to round fractions equal to or larger than ½ cent up to the next cent and round fractions of less than ½ cent down to the next lower cent.

Payments and Prepayments. In general, retailers must remit sales taxes to the state on a quarterly basis. However, retailers with taxable sales of over $17,000 per month are generally required to remit sales taxes on a monthly basis. Each quarter, two prepayments and one final payment are due, with payments generally required one month following the month in which liability is incurred. Prepayment schedules are intended to help ensure a steady flow of sales and use tax revenue to the state rather than four quarterly spikes of revenue during the course of each year.

The prepayment and final payment schedules for the first, third, and fourth calendar quarters of each year are identical. The second quarter prepayment schedule was changed in order to help the state's cash flow needs during tight budget years and operates to shift more revenue to the months of May and June (the last two months of the fiscal year).

Electronic Funds Transfer. Retailers with sales tax liabilities averaging $10,000 or more per month are required to remit their tax payments via an Electronic Funds Transfer (EFT). Retailers that are not required to make sales and use tax payments through EFT may voluntarily pay by EFT after contacting BOE and completing an authorization agreement form.

8. ADMINISTRATION

The sales and use tax is administered by the BOE. The BOE drafts regulations to clarify and interpret the sales and use tax laws and handles collections and appeals. The BOE also administers all local sales (and transactions) and use taxes under contract with local taxing agencies. These contracts allow BOE to charge local jurisdictions for its costs to administer the local taxes.

9. CODE

California Constitution, Article XIII, Section 29 and Section 35

Revenue and Taxation Code Sections 6001 – 7292

CHAPTER 3A

ALCOHOLIC BEVERAGE TAX AND LIQUOR LICENSE FEES

HIGHLIGHTS

- Tax Base — Taxes and surtaxes are imposed on alcoholic beverages on a per gallon basis; license fees are levied on holders of alcoholic beverage licenses.

- Tax Rates

	Tax Per Gallon	Surtax Per Gallon	Total Taxes Per Gallon
Beer	$0.04	$0.16	$0.20
Wine (14%* or less)	$0.01	$0.19	$0.20
Wine (over 14%*)	$0.02	$0.18	$0.20
Champagne and Sparkling Wine	$0.30	none	$0.30
Distilled Spirits (100 proof or less)	$2.00	$1.30	$3.30
Distilled Spirits (over 100 proof)	$4.00	$2.60	$6.60
Sparkling hard cider	$0.02	$0.18	$0.20

- License Fees — $69 - $1,379 per year

- Tax Revenue*

2010-11	$334 million
2011-12 (Estimate)	$323 million
2012-13 (Estimate)	$329 million

- Administration — Department of Alcoholic Beverage Control (ABC) issues licenses and collects the license fees. Board of Equalization (BOE) collects the taxes.

*Alcohol content
Source: BOE/ABC

1. TAX OVERVIEW

Alcoholic beverage taxes and surtaxes are imposed on all beer and wine or distilled spirits sold within this state. The taxes and surtaxes are levied on a per gallon basis and are imposed at the highest level in the distribution chain (i.e., on manufacturers, manufacturer's agents, distillers, winegrowers, wholesalers, or rectifiers). Taxes and surtaxes on alcoholic beverages that are imported (transported) into California from out-of-state are imposed on importers.

Taxes and surtaxes are generally passed on to consumers. Although imposed in lieu of all county, municipal, or district taxes, the alcoholic beverage taxes and surtaxes are incorporated into the retail price of a product and become part of the sales tax base for that product.

Alcoholic beverage license fees are levied when licenses for the sale of alcoholic beverages are granted or renewed on a yearly basis.

In most instances, different licenses are required for manufacture, wholesale distribution, and retail sales. On-sale and off-sale retail licenses distinguish between beverages sold for on-premises consumption and those sold for consumption off the premises. Trains, boats and aircraft also require special alcoholic beverage licenses.

2. TAX RATE

There is no single tax or surtax rate on alcoholic beverages. The rate varies considerably, depending on the type of alcohol being taxed. The rates are described in the "Highlights" box at the beginning of this chapter.

3. EXEMPTIONS/CREDITS

Exemptions from the alcoholic beverage tax are provided under the following circumstances:

- Certain sales of alcohol used in trades, professions or industries other than for beverage purposes when sold by specified licensees (e.g., alcohol purchased by private businesses for business-related testing purposes) [Revenue and Taxation Code (R&TC) Section 32052];

- Ethyl alcohol used by governmental agencies or scientific universities, or alcohol or industrial alcohol in certain products when sold in containers larger than one gallon (R&TC Section 32053);

- Sales to common carriers for use on boats, trains, or airplanes when the alcoholic beverages are to be used outside the state (R&TC Section 32054);

- Continuous transportation of alcoholic beverages through the state by common carriers (R&TC Section 32051);

- Beer or wine subsequently exported outside California or destroyed (R&TC Section 32176);

- Alcoholic beverages destroyed or damaged so that they could not be sold and that the licensee has not otherwise been compensated for the loss in the amount of the tax included in the purchase price paid for the alcoholic beverages (Refund) (R&TC Section 32407);

- Distilled spirits, wine and beer sold for export and actually exported (R&TC Sections 32211, 32171, and 32173);

- Distilled spirits sold or delivered to another licensed distilled spirits manufacturer, rectifier or wholesaler (R&TC Section 32211);

- Distilled spirits sold to instrumentalities of the United States armed forces that are located on territory within the state (R&TC Section 32177.5); and,

- Wine sold or delivered in internal revenue bond to another wine grower, and beer sold or delivered in internal revenue bond to another beer manufacturer in this state (R&TC Sections 32171 and 32174).

4. FEDERAL TAXATION

The federal government also imposes excise taxes on alcoholic beverages, as follows:

Beer	$ 0.58 per gallon
Wine (14%* or less)	$ 1.07 per gallon
Wine (14% to 21%*)	$ 1.57 per gallon
Wine (21% to 24%*)	$ 3.15 per gallon
Champagne and Sparkling Wine	$ 3.40 per gallon
Distilled Spirits	$13.50 per gallon
Artificially Carbonated Wine	$ 3.30 per gallon

*Alcohol content

The federal taxes, which are considerably higher than state taxes, are imposed in addition to state taxes. Both taxes are included in the state sales tax base.

5. REVENUE

Alcoholic beverage taxes raised $334 million in 2010-11. It is estimated that they will raise $323 million in 2011-12, and $329 million in 2012-13. All alcoholic beverage tax revenues accrue to California's General Fund.

License fee revenues (currently on the order of $52.8 million annually) are directed to special funds. Most license fee revenue is deposited into the ABC Fund ($51.0 million) for use by the Department of ABC in administering the ABC Act. Much smaller amounts (approximately $1.8 million annually) are directed to the ABC Appeals Fund ($1.3 million) to support the Appeals Board and the Motor Vehicle Account ($0.5 million) to help fund the California Highway Patrol Designated Driver Program.

6. ADMINISTRATION

The Department of ABC issues licenses and collects license fees. California's BOE administers security and collects the state excise taxes. The tax is a direct obligation of the taxpayer and the BOE administers the taxes in a manner consistent with other taxes, with specified provisions for determinations of tax due, collection actions, and refund provisions. The California Taxpayer's Bill of Rights creates specific remedies and programs related to Alcoholic Beverage Taxes.

7. CODE

California Constitution, Article XX, Section 22

Revenue and Taxation Code Sections 32001-32557

Business and Professions Code Sections 23300-25762.

CHAPTER 3B

CIGARETTE AND TOBACCO PRODUCTS TAX

HIGHLIGHTS

• Tax Base	Cigarettes and other tobacco products.
• Rate	Cigarettes: $0.87 per pack. Other tobacco products: 31.73% of the wholesale cost of tobacco, effective July 1, 2011 through June 30, 2012. The other tobacco products tax rate is updated annually each July 1.
• Revenue	2010-11 (Actual) $905 million 2011-12 (Estimate) $879 million* 2012-13 (Estimate) $853 million* 1.1% of all state revenues
• Administration	Board of Equalization (BOE)

*General Fund revenue is estimated to be $93 million and $90 million

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1. TAX OVERVIEW

California levies two distinct excise taxes on tobacco products: the cigarette tax and the tobacco products tax that is imposed on items such as cigars, pipe tobacco, and chewing tobacco. Both excise taxes are imposed on distributors but ultimately passed on to consumers.

Tobacco taxes incorporated into the retail price of tobacco products become part of the sales tax base for those products.

2. TAX RATE

Prior to 1989, California levied an excise tax of five mills ($0.005) on each cigarette, or $0.10 on each pack of 20 cigarettes.

Passage of Proposition 99 in November 1988 increased the excise tax on cigarettes by $0.25 per pack (to $0.35 per pack) effective January 1, 1989 and imposed a “tobacco products tax” on cigars, chewing tobacco, pipe tobacco, and snuff. The tobacco products tax, which is stated as a percentage of the wholesale cost of tobacco, was set at a rate equivalent to the excise tax on cigarettes. Proposition 99 revenues are deposited into the Cigarette and Tobacco Products Surtax Fund to support anti-smoking education programs, tobacco-related diseases research, indigent health care and public resources.

An additional $0.02 per pack cigarette increase was added in 1994 to fund Breast Cancer Research. The proceeds from the tax are deposited in the Breast Cancer Fund, with allocations to the Breast Cancer Research Program and the Breast Cancer Control Program.

Passage of Proposition 10 in November 1998 further increased both the cigarette and tobacco products tax rates. Pursuant to Proposition 10, the cigarette tax rate increased by $0.50 per pack and the other tobacco products tax rate increased by an equivalent amount, effective January 1, 1999. Proposition 10 requires that revenues from the Proposition 10 tax increase be deposited in the California Children and Families First Trust Fund for the purpose of promoting, supporting, and improving the development of children from the prenatal stage to five years of age.

Proposition 10 also indirectly generated a second increase in the other tobacco products tax rate, beginning July 1, 1999. This additional increase resulted because Proposition 99 requires the other tobacco products tax rate to be recalculated on July 1 of each year based on the wholesale price of cigarettes in March of that year. Thus, when Proposition 10 increased the tax on a pack of cigarettes by $0.50 on January 1, it indirectly triggered an *additional* increase in the other tobacco products tax on July 1, 1999. Revenues from this additional increase were deposited in the Cigarette and Tobacco Products Surtax Fund to fund Proposition 99 programs.

3. EXEMPTIONS

Sales of cigarettes or other tobacco products to Armed Forces exchanges, commissaries, Naval or Coast Guard ships and stores, and to the Veterans Administration are exempt from the tax, as are up to 400 cigarettes transported or brought into California by any individual for his or her personal consumption. The U.S. Constitution also exempts sales by Indian smoke shops to Indians.

4. FEDERAL TAXATION (NOTE: The Children's Health Insurance Program Reauthorization Act increased the federal excise tax on tobacco products.)

The federal government imposes excise taxes on cigarettes and tobacco products at the following rates:

Small cigars (weighing 3 lbs. or less*)	$50.33 per thousand
Large cigars (weighing more than 3 lbs.*)	52.75% of wholesale price, not to exceed $402.70 per thousand
Small cigarettes (weighing 3 lbs. or less*)	$50.33 per thousand

Large cigarettes (more than 3 lbs.*)	$105.69 per thousand
Snuff	$1.51 per pound
Chewing Tobacco	$0.5033 per pound
Pipe Tobacco	$2.8311 per pound

* Per thousand

These federal excise taxes are imposed in addition to state excise taxes and are included in the state sales tax base.

5. REVENUE

Total actual tobacco tax revenues for the 2009-10 and 2010-11, and estimated tax revenues for 2011-12 and 2012-13 fiscal years are shown below:

	2009-10 ($ Millions) actual	2010-11 ($ Millions) actual	2011-12 ($ Millions) estimate	2012-13 ($ Millions) estimate
General Fund	$ 96.2	$ 96.1	$ 93.0	$ 90.0
Cigarette and Tobacco Products Surtax Fund (Proposition 99)	293.8	285.0	277.0	269.0
Breast Cancer Fund	24.1	19.2	19.0	18.0
California Children and Families First Fund (Proposition 10)	512.1	505.0	490.0	476.0

Use of Special Funds. <u>Cigarette and Tobacco Products Surtax (Proposition 99) Fund</u>: Money in the Cigarette and Tobacco Products Surtax Fund is allocated in the following ways:

- Health Education Account — 20% for education on the prevention and reduction of tobacco use
- Hospital Services Account — 35% to pay hospitals for the treatment of indigent, uninsured patients
- Physicians Services Account — 10% to pay physicians who render medical services to indigent patients

° Research Account	5% to fund research on tobacco-related diseases
° Public Resources Account	5% to be equally divided between wildlife preservation programs and improvement of state and local park and recreation facilities
° General Purposes (Unallocated Account)	25% to be used for any of the specific purposes described above

Barring any revenue offsets, Proposition 10 would be expected to result in a decrease in revenues to the Cigarette and Tobacco Products Surtax Fund. This decrease would result from an overall reduction in sales of cigarettes and other tobacco products. However, Proposition 10 requires BOE to determine the fiscal effect of the decrease in consumption on any Proposition 99 state health-related education or research programs and Breast Cancer Fund programs. To the extent these programs lose money as a result of Proposition 10, Proposition 10 requires that funds be transferred from the Children and Families First Fund to the Proposition 99 and Breast Cancer Funds to backfill the losses.

This backfill provision does not extend to Proposition 99 health care or public resources programs.

<u>Breast Cancer Fund</u>: As noted earlier, revenue in the Breast Cancer Fund is directed toward research into the cause, cure, treatment, early detection, and prevention of breast cancer. The money in the Breast Cancer Fund is divided equally between two accounts: the Breast Cancer Research Account and the Breast Cancer Control Account.

The Breast Cancer Research Account shall allocate 10% of its moneys for the collection of breast cancer-related data and 90% of its moneys to the Breast Cancer Research Program created at the University of California to award grants and contracts for research related to the cause, cure, treatment, prevention, and earlier detection of breast cancer. The Breast Cancer Control Account shall allocate its moneys to provide early breast cancer detection services for uninsured and underinsured women.

<u>California Children and Families First (Proposition 10) Fund</u>: Proposition 10 creates one state commission and authorizes the creation of 58 local commissions (one in each county) to carry out the purpose of the proposition. After the Proposition 99 and Breast Cancer Funds are backfilled to alleviate certain losses they experience as a result of Proposition 10, 20% of the remaining funds are allocated to the state commission and 80% to the local commissions. The 20% allocated to the State commission funds must be spent for the following purposes:

° Mass Medical Communications	6%/20% to a Mass Media Communications Account for television, radio, newspaper, and other mass media communications that relate to and further the goals of the act related to early childhood development.
° Education	5%/20% to an Education Account for development of educational materials, professional and parental education and training, and technical support for county commissions.
° Child Care	3%/20% to a Child Care Account for programs related to the education and training of child care providers and the development of educational materials and guidelines for child care workers.
° Research and Development	3%/20% to a Research and Development Account to fund early childhood development research and evaluation of early childhood development programs and services that are established pursuant to the proposition.
° Administration	1%/20% for administrative expenses of the state commission.
° General Purposes	2%/20% to be used by the state commission for any of the purposes of the proposition.

Each local commission is required to develop a strategic plan for supporting and improving early childhood development in its county and to spend its Proposition 10 funds in a manner consistent with its strategic plan. The formula for allocating revenues to the county commissions is based on the annual number of births in each participating county.

6. ADMINISTRATION

The BOE is the state agency responsible for collecting the cigarette and tobacco products tax. The cigarette tax is collected from distributors, who purchase stamps to affix to each pack of cigarettes.

Licensed distributors are allowed a discount of 0.85% of the value of the stamps at the time of purchase. This discount is designed to help offset the costs of affixing the stamps to each pack of cigarettes.

Criminal penalties apply to forging tax stamps or for possessing, keeping, storing or retaining for the purpose of sale or for selling or possessing for sale counterfeit cigarettes or tobacco products.

Cigars, pipe tobacco, snuff, and chewing tobacco are not stamped. The tobacco products tax is paid through the use of a return on which the distributor reports the wholesale cost of the tobacco products distributed and calculates the tax due, which is based on the wholesale cost of the tobacco products.

7. CODE

Revenue and Taxation Code Sections 30001-30481

Revenue and Taxation Code Sections 30473.5, 30474, 30474.1

CHAPTER 3C

INSURANCE GROSS PREMIUMS TAX

HIGHLIGHTS

• Purpose	In lieu of all other state and local taxes on insurers except, in part, real property taxes and vehicle license fees.
• Tax Base	For insurers other than ocean marine insurers or title insurers, imposed on gross premiums less return premiums. For title insurers, imposed on all income upon business done in California other than interest, dividends, rents from real property, income from investments, gain from disposition of investments.
• Tax Rate	2.35% on most insurers' gross premiums. 5% on ocean marine insurers on the share of underwriting profit representing gross premiums of ocean marine insurance written within California to gross premiums of ocean marine insurance written within the United States.
• Revenue	2010-11 $1.9 billion 2011-12 (estimate) $1.7 billion 2012-13 (estimate) $1.7 billion
• Administration	Board of Equalization (BOE) State Controller's Office Department of Insurance

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1. TAX OVERVIEW

Generally, insurers doing business in California are subject to a tax on the **gross premiums** written in the preceding calendar year, less return premiums. Return premiums are premiums paid in part or in full to someone who has canceled their policy before its expiration date. Most insurers pay this insurance tax based on their gross premiums. However, insurers offering certain types of insurance use a different tax base.

Title insurance companies are taxed on all income from business done in California, except interest, dividends, rents from real property, profits from sale or disposition of investments and income from investments. **Ocean marine insurers** are taxed based on their three-year average net profit. Ocean marine insurance is written on hulls, freights, sea-going vessels, and goods and wares transported on the seas.

Each out-of-state insurance company doing business in California is required to pay a retaliatory tax if its California insurance tax liability is less than the tax liability that would be imposed on a California insurance company doing the same level of business in the home state of the out-of-state insurance company.

These taxes are in lieu of all other taxes, except real property taxes.

2. CALIFORNIA EARTHQUAKE AUTHORITY

By law, insurance companies that sell regular homeowners coverage in California are also required to offer earthquake insurance. However, by the mid-1990s, large payouts for the 1989 Loma Prieta and 1994 Northridge quakes resulted in many insurance companies opting out of the California market rather than risking large future losses in the event of another major earthquake. The California Earthquake Authority (CEA) was created by the Legislature in 1996 to help resolve what was then a crisis in the availability of earthquake insurance. The CEA is a privately financed, publicly managed agency that provides limited earthquake insurance coverage for residential property owners, condominium owners, mobile homeowners, and renters. As of February 2001, the CEA has access to $7.7 billion with which to pay claims, money that was generated from policyholders, participating insurance companies and reinsurance (a form of insurance that insurers purchase to provide additional resources to pay claims).

Insurance companies that sell earthquake insurance through the CEA are not taxed on the value of their earthquake premiums, due to CEA's tax-exempt status. To date, companies that represent 66% of the earthquake insurance market sell through CEA (71% of the homeowner's insurance market). The remaining insurance companies that sell earthquake insurance (which represent 34% of the earthquake insurance market) are taxed on their earthquake insurance premiums at a rate of 2.35%.

3. TAX RATE

Premiums from some pension and profit sharing insurance contracts are taxed at 0.5%. Specialized insurers (surplus lines) and marine insurers are taxed at 3% and 5% respectively. Additionally, "non-admitted insurers" are subject to a 3% tax on gross premiums less returned premiums. Title insurers and all other insurers are taxed at a rate of 2.35%.

Proposition 103, approved by the voters in November 1988, required the BOE to adjust the rate of the insurance gross premiums tax for 1989 and 1990 to compensate for any decline in revenue resulting from the initiative's restrictions on premiums. In January of 1991, BOE set the insurance gross premiums tax rate at 2.46% of premiums collected during the 1990 calendar year.

However, BOE's authority under Proposition 103 to administratively set the gross premiums tax rate expired at the end of 1991. Accordingly, the tax rate for premiums collected in subsequent years reverted to the constitutionally specified level of 2.35%.

4. DEDUCTIONS

As stated in California Constitution, Article XIII, Section 28, the insurance tax is in lieu of all other state and local taxes and license fees, except real property taxes, motor vehicle license and registration fees, and ocean marine insurance. Insurance companies, therefore, are not subject to the corporation tax, nor do they pay property tax on personal property. Currently, there are no deductions allowed against insurance gross premiums tax.

5. FEDERAL TAXATION

Taxation of insurance companies under the federal income tax is consistent with taxation of other companies. There is no federal insurance gross premium tax.

6. REVENUE

The insurance gross premiums tax is entirely a General Fund revenue source. Insurance tax revenues for fiscal year (FY) 2010-11 were $1.9 billion. They are estimated to equal $1.7 billion in FY 2011-12, and $1.7 billion in FY 2012-13.

7. ADMINISTRATION

The insurance tax is jointly administered by three separate state agencies. The Department of Insurance issues permits for each class of insurance, processes returns, and audits taxpayers. California's BOE issues assessments, processes petitions, and hears appeals. The State Controller's Office makes refunds and collects delinquencies and penalties.

Prepayments are required to be made quarterly and returns are required to be filed annually.

8. CODE

California Constitution, Article XIII, Section 28

Revenue and Taxation Code Sections 12202-13170

CHAPTER 3C
INSURANCE GROSS PREMIUMS TAX

CHAPTER 3D

ESTATE TAX

HIGHLIGHTS

• Tax Base	The value of the adjusted taxable estate.	
• Tax Rate	Equal to the maximum allowable federal credit for which the taxpayer is eligible.	
• Revenue	2010-11 (Actual)	$5.6 million*
	2011-12 (Estimate)	$4.5 million*
	2012-13 (Estimate)	$3.1 million*
• Administration	State Controller's Office	

*Includes estimated effects of estate tax phase-out (see Section 3 of this Chapter)

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1. TAX OVERVIEW

In 1982, California voters approved an initiative to repeal the state Inheritance and Gift Tax law. The initiative, Proposition 6, provided for the imposition of the **Estate Tax**, and prohibited the imposition of inheritance taxes by the state or local governments.

Generally, estate tax is levied on the entire property holdings of an individual upon his or her death. The value of each estate is based upon the fair market value of the decedent's property and interests in property as of the decedent's date of death. The California estate tax is derivative of the federal estate tax. Under federal law, the estate tax is reduced by a credit for a portion of state inheritance or estate taxes paid, up to certain maximum levels. California's estate tax is equal to the taxpayer's maximum allowable federal credit. In effect, California "picks up" a share of the tax that would otherwise go to the federal government but does not increase the total tax liability of the estate.

2. FEDERAL REPEAL OF THE STATE PICKUP TAX CREDIT

The Economic Growth and Tax Relief Reconciliation Act of 2001 provided for elimination of the federal estate tax over a four-year period beginning in 2002.
Under federal law, an effective exclusion of $1 million exists for deaths occurring in 2002 and 2003; the effective exclusion rises to $1.5 million in 2004 and 2005; to $2 million in 2006, 2007, and 2008; and to $3.5 million in 2009. The estate tax is completely repealed in 2010, but reinstated in 2011 at the appropriate level per prior federal statute.

The 2001 federal law also phased out the state pickup tax credit over a four-year period beginning in 2002. The credit was reduced by 25% in 2002, by 50% in 2003, by 75% in 2004, and was entirely eliminated in 2005. The impact on California of the reduction in the pickup tax is significant. The pickup tax remains for the generation skipping transfer tax; however, the revenue generated is not expected to be significant. Revenue collection estimates are based primarily upon projected receipts from estates with installment payment agreements in place.

3. ADMINISTRATION

The California estate tax is a self-assessed tax, administered by the State Controller's Office. The amount to be paid is equal to the maximum federal credit allowable, as calculated according to Federal Form 706. For deaths prior to 2005, a check in this amount and a state return, along with a copy of Federal Form 706, must be sent to the Controller's Office within nine months after the death of the deceased.

4. CODE

Revenue and Taxation Code Sections 13301-14302 and Sections 16700-16950

CHAPTER 3E

FUEL TAXES

HIGHLIGHTS

• Purpose	To maintain state and local public highways and roads and to fund certain aeronautical, harbor and watercraft, and off-highway motor vehicle activities.		
• Tax Base	Fuels used to propel motor vehicles and aircraft.		
• Tax Rate	Gasoline Tax*	$0.357 per gallon	
	Aviation Gasoline Tax	$0.18 per gallon	
	Aircraft Jet Fuel Tax	$0.02 per gallon	
	Diesel Fuel Tax*	$0.13 per gallon	
	Interstate User Tax**	$0.435 per gallon	
	Use Fuel Tax	$0.06 - $0.18 per gallon	
• Revenue		Gasoline Tax***	Diesel and Use Fuel Tax****
	2010-11	$5.23 billion	$474 million
	2011-12 (Est.)	$5.23 billion	$378 million
	2012-13 (Est.)	$5.22 billion	$322 million
• Administration	Board of Equalization (BOE)		

*Rate effective July 1, 2011 to June 30, 2012. Tax rates are subject to change, as explained in Fuel Tax Swap (see below).
**Rate effective January 1, 2012 to December 31, 2012.
***Including aircraft jet fuel
****The two revenue streams are not currently tracked separately

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1. TAX OVERVIEW

California's fuel taxes fall into three distinct categories: The motor vehicle fuel tax (**gasoline tax), diesel fuel tax**, and the **use fuel tax**.

The Motor Vehicle Fuel Tax, which includes the gasoline tax and the aviation gasoline tax, is imposed on the removal of motor vehicle fuel from a terminal rack or a refinery rack into a truck, trailer, or railroad car, on the entry of the motor vehicle fuel into the state, and on certain other activities.

Motor vehicle fuels subject to the gasoline tax include gasoline, aviation gasoline, blends of gasoline and alcohol containing more than 15% gasoline, and any inflammable liquid used or usable for propelling motor vehicles operated by the explosion type of engine. Fuels not subject to the gasoline tax include diesel fuel (taxed under the Diesel Fuel Tax Law), kerosene, liquefied petroleum gas, ethanol, methanol and natural gas in liquid or gaseous form (taxed under the Use Fuel Tax Law).

The gasoline tax does not apply to inflammable liquids that do not contain gasoline or natural gasoline and that are specifically manufactured, distributed, and used for racing motor vehicles at a racetrack.

The **aircraft jet fuel tax**, which is also part of the Motor Vehicle Fuel Tax Law, is imposed on sales of aircraft jet fuel by an aircraft jet fuel dealer to an aircraft jet fuel user. Certified air common carriers, aircraft manufacturers or repairers, and the armed forces of the U.S. are not included in the definition of "aircraft jet fuel users" and are therefore not subject to this tax. In practice, the aircraft jet fuel tax is imposed primarily on nonscheduled airline carriers (private jets and private mail delivery carriers) and helicopters.

The **diesel fuel tax** is imposed under the Diesel Fuel Tax Law on the removal of diesel fuel from a terminal rack or a refinery rack into a truck, trailer, or railroad car, on the entry of the diesel fuel into the state, and on certain other activities. Diesel fuel means any liquid that is commonly or commercially known or sold as a fuel that is suitable for use in a diesel-powered highway vehicle. Dyed diesel fuel, which is intended solely for exempt off-highway use, is not subject to the tax.

Federal legislation passed in October 2005 changed the administration of the clear diesel fuel tax by requiring persons to prepay the tax on the quantity of diesel fuel used off-highway and then file a claim for refund of the diesel fuel tax based upon the number of gallons purchased that was used for off-highway purposes. California has not entirely conformed to this change in federal tax law. Under California law, exempt bus operators, train operators, and purchasers of diesel fuel for use on a farm for farming purposes may issue an exemption certificate to their vendor or supplier for their estimated exempt usage. The purchaser in these situations remains liable for the tax not used in an exempt manner and in the case of an exempt bus operator, must report their taxable and nontaxable usage and pay any resulting tax.

California has participated in the International Fuel Tax Agreement (IFTA) since January 1, 1996. Under the IFTA, interstate truckers are required to submit quarterly reports detailing the number of gallons of fuel they use in each state or Canadian province. Each trucker is required to file his or her report with a single home (base) state and is taxed based on where the trucker consumes fuel.

Interstate truckers who purchase their diesel fuel outside California for use in-state must pay an additional tax (over and above the California diesel fuel tax rate) that is equivalent to the statewide sales tax rate imposed on in-state purchases of diesel fuel. Conversely, interstate truckers are allowed a refund or credit on the equivalent sales tax rate when they purchase diesel fuel in-state but use it out-of-state. The "equivalent sales tax rate" imposed on interstate truckers is set annually by the BOE and is calculated based on the average retail price per gallon of diesel fuel in California and the combined average California state and local sales and use tax rate.

The **use fuel tax** is imposed on vendors and users of motor vehicle fuels that are not taxed under either the gasoline or diesel fuel tax, such as kerosene, liquefied petroleum gas, ethanol, methanol and natural gas (both liquid and gaseous) for use on state highways.

Both the state gasoline tax and the state aircraft jet fuel tax are part of the state sales tax base. Conversely, neither the state diesel fuel tax nor the state use fuel tax is part of the state sales tax base.

As a result of Proposition 26, approved by voters in the November 2, 2010, statewide election, the Legislature re-enacted the Fuel Tax Swap of 2010. Similar to the Fuel Tax Swap of 2010, the re-enactment reduced the sales and use tax imposed on sales of gasoline and replaced the lost revenues with an increase in the excise tax on gasoline, and on July 1, 2011, reduced the excise tax rate on diesel fuel and replaced the lost revenues with an increase in the sales and use tax rate imposed on diesel fuel sales. However, the re-enactment made the following changes related to diesel fuel:

> Effective July 1, 2011, in place of the additional 1.75% sales and use tax rate imposed by the 2010 fuel tax swap legislation on sales of diesel fuel, the re-enactment instead imposed a rate of 1.87%. In subsequent years, the re-enactment would further change this rate as follows:
>
> - Effective July 1, 2012, increase the rate of 2.17%;
> - Effective July 1, 2013, decrease the rate to 1.94%; and
> - Effective July 1, 2014, and thereafter, reinstate the 1.75% rate.
>
> Effective July 1, 2011, in place of the 2010 fuel tax swap's reduced excise tax rate on diesel fuel of 13.6 cents per gallon, the re-enactment decreased that rate further to 13 cents per gallon.

The "swap" was meant to maintain the status quo for fuels that are either fully or partially exempt from the sales and use tax, such as sales of aviation gasoline and diesel fuel used in farming activities, or fully or partially exempt from excise tax, such as diesel fuel used in farming operations, or by train operators or certain bus operators.

The fuel tax swap legislation was intended to be revenue neutral, so that the state's tax revenues would not be increased or decreased, nor would the taxpayers' tax burden be affected. To maintain revenue neutrality, the provisions of this "swap" require the BOE to each year adjust the *excise* tax rates on gasoline and diesel fuel – either upwards or downwards, beginning July 1, 2011, for gasoline, and July 1, 2012, for diesel fuel, so that the overall revenues derived from the imposition of state excise tax and sales and use taxes on sales of gasoline and diesel fuel remain the same. As required, the BOE sets the tax rate for gasoline, for the period July 1, 2011 to June 30, 2012, at $0.357, an increase of $0.004 over the previous rate of $0.353.

2. TAX RATES

The State of California taxes various fuels at the rates listed below:

Fuel	Rate (per gallon, unless otherwise specified)
Gasoline, excluding aviation gasoline*	$0.357
Aviation gasoline	$0.18
Aircraft Jet Fuel	$0.02
Diesel 100% (including biodiesel)*	$0.13
Interstate Users (IFTA members)**	$0.435
Liquefied Petroleum Gas (LPG)	$0.06
Liquefied Natural Gas (LNG)	$0.06
Compressed Natural Gas (CNG)	$0.07 per 100 cubic feet
Ethanol and Methanol	$0.09
Kerosene	$0.18

*Rate effective July 1, 2011 to June 30, 2012. Excise tax rates are subject to change, as explained in Fuel Tax Swap (see table below).

**Rate effective January 1, 2012 to December 31, 2012; however, due to the fuel tax swap, this rate may change, depending upon the July 1, 2012 setting of the diesel fuel tax rate.

Diesel fuel and fuels taxed under the Use Fuel Tax Law that are used in buses operated by transit systems, certain common carriers, public school districts, and community college districts are exempt from diesel and use fuel taxes but are, instead, taxed at a rate of $0.01 per gallon. The owner or operator of a vehicle propelled by liquefied petroleum gas, liquid natural gas, or compressed natural gas may pay an annual flat rate fuel tax based on the type or weight of the vehicle instead of the per gallon rate.

State/Federal Rate Linkage. The Federal government also imposes excise taxes on various fuels. The California gasoline, diesel, and certain use fuel tax rates are tied by statute to comparable federal taxes in order to maintain a minimum level of combined state and federal fuel tax revenue. The state/federal linked rate for gasoline taxes must be maintained at a minimum of $0.27 per gallon. Therefore, if the federal gasoline tax (which currently is $0.184 per gallon) were reduced below a rate of $0.09 per gallon and federal financial allocations to California were also reduced, the state gasoline tax would be recalculated so that the combined Federal and state excise tax on motor vehicle fuel would equal $0.27 per gallon. In addition to this combined rate, the fuel tax swap imposes an additional tax, recalculated to be effective July 1 of each year, which would increase the overall combined rate accordingly.

The same type of linkage is true for both diesel and use fuel taxes that are imposed at a state rate of $0.13 and $0.18 per gallon, respectively. Currently, the only use fuel taxed at $0.18 per gallon and subject to the state/federal linkage is kerosene fuel. If the federal diesel or kerosene fuel tax rate (which is currently $0.244 per gallon) were reduced below a rate of $0.15 per gallon and federal financial allocations to California were also reduced, the state diesel and kerosene taxes would be recalculated so that the combined Federal and state taxes would equal $0.33 per gallon for kerosene, and in the case of diesel fuel what it would have been in the absence of the federal reduction (the cap for diesel fuel was removed pursuant to the re-enactment of the fuel tax swap). However, with respect to diesel fuel, the decrease of the state excise tax rate to $0.13, pursuant to the fuel Tax Swap, in July 2011, may affect this recalculation, should a future reduction in the federal excise tax and corresponding allocation to the state occur.

Rates Applicable to Gasoline

	Through June 30, 2011	**July 1, 2011 to June 30, 2012**	**Effective July 1, 2012**
Motor Vehicle Fuel Tax – excluding aviation gasoline (cents per gallon)	$0.18	$0.353	To be determined
Motor Vehicle Fuel Tax – aviation gasoline only (cents per gallon)	$0.18	$0.18	$.018
Sales and Use Tax Rate	2.25% plus Applicable district taxes	2.25% plus Applicable district taxes	2.25% plus Applicable district taxes
Prepaid Sales Tax on Motor Vehicle Fuel (cents per Gallon)	$0.055	$0.055[1]	To be determined*

[1] This rate was effective through March 30, 2012.

Rates Applicable to Diesel Fuel

	Through June 30, 2011	**July 1, 2011 to June 30, 2012**	**Effective July 1, 2012**
Diesel Fuel Tax (cents per gallon)	$0.18	$0.13	To be determined
Sales and Use Tax	8.25%** plus Applicable district taxes	9.12% plus Applicable district taxes	9.42[2]%** plus Applicable district taxes
Prepaid Sales Tax on Diesel Fuel (cents per gallon)	$0.18	$0.25[3]	To be determined**

* The prepayment rate is set annually by the BOE by November 1, and takes effect April 1 of the following year.

**The sales and use tax rate applicable to sales of diesel fuel increased by 1.87% effective July 1, 2011. At the same time, the state-wide sales and use tax rate decreased by 1% as a result of unrelated prior legislation. Dyed diesel fuel and clear diesel fuels that are exempt from the excise tax or receive a refund of the excise tax are exempt from the sales and use tax rate increases.

3. EXEMPTIONS AND/OR REFUNDS

Excise tax exemptions are allowed for any fuel that is:

- Exported out of state;
- Sold to certain consulate officers and employees;
- Used off public roads (so-called off-highway use); and,
- Used for certain agricultural and/or construction equipment.

An exemption is also allowed for dyed diesel fuel. In this case, the fuel is dyed because it is intended for exempt use.

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[2] On July 1, 2012, the rate increased to 2.17%; on July 1, 2013, the rate will decreases to 1.94%; on July 1, 2014, and thereafter, the 1.75% rate will be reinstated.
[3] This rate is effective through March 30, 2012.

Furthermore, a partial excise tax exemption applies to certain bus operations. The following bus operations are subject to a tax of $0.01 per gallon on the diesel fuel used:

- Transit districts, transit authorities, or cities owning and operating local transit systems;

- Common carriers operating exclusively within a city limit and not subject to the jurisdiction of the Public Utilities Commission (PUC);

- Passenger stage corporations under the jurisdiction of the PUC, when used on routes of no greater than 50 miles; and,

- Public school districts, county superintendents of schools, or community college districts.

Excise tax refunds are given to anyone who pays fuel taxes and subsequently uses the tax paid fuel in an exempt manner.

4. REVENUE

Revenues from the Motor Vehicle Fuel Tax, Diesel Fuel Tax, and the Use Fuel Tax accrue to the State Transportation Fund, a special fund that provides the major source of funds for maintaining, replacing, and constructing state highway and transportation facilities. Revenues from jet fuel and aviation gasoline are transferred to the Aeronautics Account for use at certain airports.

Through various statutory allocation formulas, just over one-third of the revenue from all three taxes is shared with local governments; just under two-thirds remains with the state.

Taxes imposed under the Motor Vehicle Fuel Tax Law generated $5.2 billion in fiscal year (FY) 2010-11, the vast majority of which accrued from motor vehicle fuel taxes. Typically, only a few million dollars per year results from imposition of aircraft jet fuel taxes. Both taxes collectively are expected to raise $5.2 billion in FY 2011-12.

The diesel fuel tax and use fuel tax generated $474 million in FY 2010-11 and are expected to drop to $378 million in FY 2011-12. Diesel fuel tax and use fuel tax revenues are expected to drop to $322 million by FY 2012-13. At present, the two revenue streams are not currently tracked separately.

Together, all of these Highway User's Taxes generated roughly 3.0% of total state revenues during FY 2009-10. As reflected above and in accordance with the State Constitution, all motor vehicle fuel tax revenue is dedicated for transportation purposes. Some of this may change as a result of the enactment of the Fuel Tax Swap and passage of Proposition 22 in 2010.

5. ADMINISTRATION

The BOE administers all motor vehicle fuel taxes; however, the State Controller processes gasoline tax payments and refunds.

The aircraft jet fuel tax is imposed upon every aircraft jet fuel dealer for each gallon of such fuel sold or used. Dealers are licensed and required to pay the tax monthly to the California BOE.

The gasoline tax and diesel fuel tax are paid by suppliers at the time of removal of the fuel at the refinery rack or terminal rack. The tax is included in the selling price to the ultimate purchaser unless, under specified circumstances, the ultimate purchaser provides an exemption certificate for the number of gallons estimated to be used off-highway or for exempt bus operations. Suppliers are licensed and pay the tax monthly to BOE.

As provided in the Fuel Tax Swap, the state excise tax rate for both gasoline and diesel fuel will be adjusted annually by the BOE to maintain revenue neutrality. The rates will be set by the BOE on March 1 and will be effective July 1 each year.

Interstate truckers report and pay their diesel fuel tax liability through IFTA returns on a quarterly basis. If California is not the trucker's base state, the funds are transferred to California by the responsible IFTA member state or Canadian province.

The use fuel tax is imposed on the user but collected by the vendor who sells the fuel. A permit is required of the vendor and user. Retailers are required to collect the use fuel tax at the time they sell the fuel to persons who use the fuel. Retailers and users with use fuel permits may claim credit for the tax paid to vendors when they file their use fuel tax returns. The tax may be collected at quarterly intervals designated by BOE.

6. CODE

Revenue and Taxation Code Sections 7301-8526 [Motor Vehicle Fuel (Gasoline) Tax]

Revenue and Taxation Code Sections 7385-7398 (Aircraft Jet Fuel Tax)

Revenue and Taxation Code Sections 8601-9355 (Use Fuel Tax)

Revenue and Taxation Code Sections 8691, 9401-9433, 60130 (Fuel Tax and International Fuel Tax Agreements)

Revenue and Taxation Code Sections 60001-60708 (Diesel Fuel Tax)

California Constitution, Article XIX, Section 1

CHAPTER 3F

MOTOR VEHICLE FEES

HIGHLIGHTS

- **Tax Base** — For vehicle license fees (R&TC §§10751 - 10753), the "market value" of the vehicle. The market value of a vehicle or trailer coach is determined based on the cost of the vehicle at the time of purchase. The cost used to determine market value **does not** include any sales or use tax, local tax, or interest, finance or carrying charges. Weight fees for commercial vehicles are determined by the unladen weight, gross weight, or combined gross vehicle weight, depending on the size of the vehicle.

- **Tax Rate** — Effective July 1, 2011, vehicle license fees are 0.65% of the market value. The annual registration fee was changed to a flat $69 ($46 registration plus $23 California Highway Patrol) on July 1, 2011. From May 19, 2009 to July 1, 2011, license fees were 1.15% of the market value of the vehicle. From January 1, 2005, to May 18, 2009, the license fees were 0.65% of the market value.

- **Revenue**

	License Fees	Registration Fees	Weight Fees
2010-11 (actual)	$3.81 billion	$2.44 billion	$911 million
2011-12 (est.)	$2.14 billion	$2.95 billion	$956 million
2012-13 (est.)	$2.10 billion*	$2.89 billion**	$938 million

*Vehicle License Fee (VLF) rate of 1.15% was in placeuntil June 30, 2011. Fiscal year (FY) 2011-12 and FY 2012-13 estimates were calculated at VLF rate of 0.65%.
**Registration fee increased by $12 effective July 1, 2011.

- **Administration** — Department of Motor Vehicles (DMV)

- **Collection** — Franchise Tax Board (FTB) (delinquencies only)
  Department of Motor Vehicles (DMV)

1. TAX OVERVIEW

The Vehicle License Fee **(VLF)**, also known as the automobile in-lieu tax, is levied for the privilege of operating a vehicle on the public highways of California. The tax is imposed in-lieu of a local personal property tax on vehicles and trailer coaches. The fee is paid annually as part of the vehicle registration process.

The **motor vehicle registration fee** is levied annually on all motor vehicles, trailer coaches, and other vehicles that use public highways.

Weight fees are levied annually for the operation of certain commercial motor vehicles.

Other vehicle-related fees include driver's license fees, transfer of title fees, motor-carrier tax and others that are not discussed in this book.

2. TAX RATES

Existing law imposes a VLF for the privilege of operating a vehicle on California's public highways. Although called a fee, the VLF is a tax imposed in lieu of a local personal property tax on vehicles. The VLF is imposed at a rate of 0.65% on a vehicle's market value, which equals the manufacturer's suggested base price plus options, adjusted by a depreciation schedule specified in state law. Pursuant to the California Constitution, VLF revenue is allocated to local governments. Approximately 25% of VLF revenue is deposited into the Motor Vehicle License Fee Account in the Transportation Tax Fund and is split between cities and counties. This portion of VLF allocations is called "base VLF" and can be used by local governments for any spending purpose. The remaining 75% of local government VLF funds are restricted to funding various health, mental health, and social services programs shifted to the counties as part of the 1991 realignment. This portion of the VLF backfill is called "realignment VLF".

3. VLF HISTORY

Beginning in 1998, the state offset a portion of the VLF, which had the effect of reducing the 2% rate. In 1999, the VLF was reduced by 25% (i.e., the VLF offset equaled 25%, and the VLF rate charged to vehicle owners equaled 1.5%). The VLF offset was increased from 25% to 35% in 2000, and from 35% to 67.5% in 2001. Previous laws [Revenue and Taxation Code Section 10754(a)(3)(A) and 10754(a)(3)(B)] provided for a 67.5% offset and requires the state to transfer the amount of this offset to the Motor Vehicle License Fee Account in the Transportation Tax Fund and the Local Revenue Fund, for the benefit of local governments.

On June 19, 2003, Governor Gray Davis' administration invoked Revenue and Taxation (R&T) Code Section 10754(a)(3)(C) and declared that there were insufficient moneys to fully fund the 67.5% VLF offsets required by R&T Code Section 10754(a)(3)(A). Governor Davis' declaration triggered a repeal of the 67.5% VLF offset, effective for vehicle owners with final VLF due dates on or after October 1, 2003. Pursuant to Governor Davis' declaration, the state ceased backfilling local governments for revenue losses they experienced as a result of VLF offsets in place beginning on June 20, 2003. Consequently, local governments did not receive any VLF backfill corresponding to the period between June 20, 2003 and October 1, 2003. This "VLF backfill gap" was originally estimated by the Department of Finance to be $825 million, but was later revised upward to $1.3 billion. AB 1768 (Committee on Budget and Fiscal Review), Chapter 231, Statutes of 2003, anticipated that local governments would loan the amount of the VLF backfill gap to the General Fund and would be repaid in FY 2006-07.

On November 17, 2003, Governor Schwarzenegger issued Executive Order S-1-03, reinstating a 67.5% offset and returning the effective rate of the VLF to 0.65%. This Executive Order directed the DMV to reinstate the offset as soon as administratively feasible. In its mid-year spending proposals, the Administration indicated that fully funding the offset in excess of the $825 million loan amount would require $3.625 billion. However, because the $825 million estimate had been increased to $1.3 billion (an increase of $475 million), the Administration asked the Legislature to increase the local government loan referenced in AB 1768 to $1.3 billion and to approve an appropriation of $3.15 billion for local governments ($3.625 billion minus $475 million).

On December 18, 2003, reacting to the Legislature's decision to recess without acting upon the Governor's request to address local government reimbursement, the Governor invoked his powers under Budget Act Control Sections 27 and 28. In a letter sent from the Department of Finance to the chairs of the Senate and Assembly Budget and Appropriations Committees on behalf of the Governor, Finance Director Donna Arduin stated that the total estimated shortfall in local government reimbursement for the entire 2003-04 FY had been revised downward from the prior $3.15 billion estimate and now equaled $2.652 billion over the $1.3 billion "gap" amount. Relying upon his powers to spend at a rate that would incur a deficiency pursuant to the 2003 Budget Act, Governor Schwarzenegger approved a deficiency appropriation in the amount of $2.503 billion from the General Fund to replace revenue lost by local governments from VLF offsets. This appropriation replaced an in-lieu appropriation of $1,000 that was previously contained in the 2003-04 Budget Act.

On February 26, 2004, the Legislature sent Governor Schwarzenegger a bill revising the appropriations contained in AB 1768 [SB 1057 (Committee on Budget and Fiscal Review), Chapter 24, Statutes of 2004.] SB 1057 updated the Legislature's plans to reimburse local governments for the VLF backfill gap. SB 1057 directed the Controller to provide this reimbursement to local governments on August 15, 2006, unless an earlier transfer is authorized by the Legislature. The bill also authorized the Controller, with the approval of the Department of Finance, to advance reimbursements to local governments that could demonstrate that they would experience a hardship (defined in the bill) if they must wait until August 15, 2006 for reimbursement. Total advances allowed under the provisions of the bill were capped at $40 million.

4. VLF TAX BASE

The market value is determined based on the cost price of the vehicle. The cost price used to determine market value **does not** include any sales or use tax, local tax, or interest, finance or carrying charges and is adjusted by a depreciation schedule, as follows:

For motor vehicles, the schedule is based on an 11-year depreciation period. The base equals 100% of the purchase price in the year of sale, and is scaled down each year to 15% of purchase price in the eleventh year and thereafter. Used vehicles are placed at the top of the depreciation schedule when acquired by a new owner, with the tax based on the current purchase price of the used vehicle (there are exceptions to this rule for transfers between close family members). The following table details this depreciation schedule:

1st year value	100% of market
2nd year	90%
3rd year	80%
4th year	70%
5th year	60%
6th year	50%
7th year	40%
8th year	30%
9th year	25%
10th year	20%
11th and later years	15%

For trailer coaches or mobilehomes not on the local property tax roll, an 18-year depreciation schedule is used. Fees are based on 85% of market value in the year of sale and are scaled down to 15% of market value in the 18th and succeeding years. (See Chapter 6G of this Reference Book for more information on mobilehome taxation.)

5. REGISTRATION RELATED FEES

The annual registration fee for most vehicles is $69, which includes a $46 base registration fee and a $23 California Highway Patrol (CHP) fee. The CHP portion is subject to adjustment for increases in the California Consumer Price Index(CPI). A $2 portion of the registration fee supports the Alternative Fuel and Vehicle Technology Fund, and $1 supports the Enhanced Fleet Modernization Fund.

There is also a $20 smog abatement fee on vehicles six or less model years old that are exempt from biennial smog requirements.

In addition, counties may impose a fee up to $7 for air quality management districts for motor vehicles. Counties in the San Joaquin Unified Air Pollution Control District (Fresno, Kern, Kings, Madera, Merced, San Joaquin, Stanislaus, and Tulare) are allowed to impose a fee up to an additional $30. In December 2010, the California Air Resources Board approved the fee of $12. The fee increase was implemented on September 10, 2011. Counties may also impose a $1 or $3 fee for the Service Authority for Freeway Emergencies (SAFE) program, a $1 or $3 Vehicle Theft Deterrence Fee, a $1 or $3 Abandoned Vehicle Fee, and a $1 or $3 fee (depending on vehicle type) for law enforcement fingerprinting identification systems. Five counties (Alameda, Marin, San

Mateo, San Francisco/city, and Santa Clara) may also impose a County Transportation Projects fee of $10, which became effective six months after voters approved the measure on May 2, 2011, for local road repairs, pedestrian safety improvements, and transit reliability improvements throughout the city. San Mateo County also collects a $4 traffic/stormwater fee.

Instead of paying the annual registration fee and any supplemental fees, an owner may pay a $18 planned non-operation (PNO) fee if it is anticipated that the vehicle will not be operated during the subsequent registration year(s). This PNO fee is also subject to annual changes under the CPI.

The City and County of San Francisco has the authority to impose a local registration fee of $4 and a Vehicle License Fee surcharge of up to 15%. Proceeds of either of these levies are required to be spent on public transit. Imposition of either surcharge requires approval of two-thirds of the voters voting in an election on the issue. The fee has not been imposed to date.

The weight fee for a commercial vehicle depends on the unladen (empty) weight of the vehicle, the declared gross vehicle weight, or combined gross vehicle weight for commercial vehicles. A commercial vehicle is defined as one designed to carry property or used to transport persons for profit.

6. EXEMPTIONS

There are many exemptions to the VLF. The most common are non-resident military, government-owned vehicles, farm vehicles (used off-road), and vehicles owned and driven on federal Indian reservations and Rancherias. Vehicles owned by qualifying disabled veterans (Vehicle Code Section 9105) or a dollar amount ($20,000-$30,000) of the market value of a mobilehome or trailer coach are exempt from the VLF. (R&TC Section 10788).

7. FEDERAL TAXATION

The federal government imposes a use tax on certain highway vehicles and a "gas guzzlers" tax on manufacturers of cars with low mileage ratings. All other states have fees similar to those imposed in California.

8. REVENUE

Of the total amount of VLF revenue available to local governments, approximately 25% is deposited in the Transportation Tax Fund. This revenue is equally divided between cities and counties. The funds are then further divided among cities and among counties on a population based formula.

The remaining 75% of VLF revenues are deposited into the VLF Account of the Local Revenue Fund. These funds partially finance certain health and welfare programs, the responsibility for which the state transferred to local agencies.

Effective July 1, 2011, the rate of VLF decreased from 1.15% of the assessed value of a vehicle to 0.65% of the assessed value. For VLF collected between May 19, 2009 and June 30, 2011, the amount of VLF is distributed as follows: 0.65% is split between the Local Revenue Fund and the Motor Vehicle License Fee Account, 0.35% goes to the General Fund, and 0.15% is deposited in the Local Safety and Protection Account.

Trailer coach VLF revenues are deposited in the state General Fund. Before fiscal year (FY) 1992-93, these funds were distributed to cities, counties, and school districts on a situs basis.

The VLF on motor vehicles totaled $3.81 billion in FY 2010-11. The VLF is expected to raise $2.14 billion in FY 2011-12, and $2.10 billion in FY 2012-13.

Motor vehicle "registration" fees generated $2.44 billion in FY 2010-11 and are expected to raise $2.95 billion in FY 2011-12. Out of each $69 vehicle registration fee, $23 provides supplemental support for the California Highway Patrol. The remaining $46 supports the activities of all of the departments funded by the Motor Vehicle Account including Motor Vehicles, Highway Patrol, Justice and Air Resources Board, $2 supports the Alternative Fuel and Vehicle Technology Fund and the remaining $1 supports the Enhanced Fleet Modernization Fund.

Weight fees generated $911 million in FY 2010-11 and are expected to generate $956 million in FY 2011-12. Weight fees accrue to the State Highway Account and are used for highway construction.

9. ADMINISTRATION

Most fees are administered by DMV. Registration and license fees are paid annually at the time of registration. Authority for collecting delinquent vehicle license and registration fees was transferred to the FTB as part of the FY 1993-94 budget package. The FTB is responsible for collecting delinquent renewal fees.

10. CODE

Revenue and Taxation Code Sections 10751-11156

Motor Vehicle Code Sections 9101-9250

CHAPTER 3G

TIMBER YIELD TAX

HIGHLIGHTS

• Purpose	State-levied tax on timber when harvested, in-lieu of the property tax on standing timber. Revenues returned to local governments.
• Tax Base	"Immediate harvest value" of timber, by species and region, as established semiannually by the Board of Equalization (BOE).
• Tax Rate	Set annually, based on average property tax values in timber counties. For 2009, the rate was 2.9% of the timber's value at the time of harvest.
• Revenue*	2010-11 (Actual) $6.5 million 2011-12 (Estimate) $6.5 million 2012-13 (Estimate) $6.5 million Allocated to counties based on location of harvest.
• Administration	BOE

*Source: BOE

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1. TAX OVERVIEW

Two different taxes are imposed on timber property: The **timber yield tax** and the **property tax on timberland**. The timber yield tax is a tax on the value of harvested timber. The property tax on timberland applies to the underlying property.

While the timber yield tax is a state tax, the taxation of timberland is part of the local property tax, which is administered by the county assessor. (See Chapter 4 of this Reference Book for more information on the property tax.)

In 1977, the property tax on standing timber was replaced by a state timber yield tax. The reasons for this change included the pressure the property tax placed on timber owners to harvest prematurely, the cash flow stress caused by annual property tax liabilities on timberland owners when no income was generated by the standing timber, and county concerns that their post-harvest property tax revenues would decline sharply.

2. TAX RATE

The timber yield tax rate is set annually by BOE, based on the countywide average property tax rate in 17 timber counties. The rate in recent years has been 2.9% of the "immediate harvest value" of the cut timber. Immediate harvest values are not actual sales prices of the timber, but are amounts established semiannually by BOE, by timber species and region based on analysis of market transactions.

3. REVENUE

Timber yield tax revenues are collected by the state. After state administrative costs are deducted, remaining revenues are returned to local agencies.

The timber yield taxes generated $6.5 million in fiscal year (FY) 2010-11, and it is estimated to generate $6.5 million in FY 2011-12, and $6.5 million in FY 2012-13.

Revenues are allocated to timber-producing counties in the same proportion that revenues are generated from each county by so-called "location of harvest". Within each county, revenues are also allocated on a proportional basis. However, cities, school districts, special districts, and county governments receive those funds based upon a "minimum revenue guarantee" which was determined during a three-year base period in the mid-1970s. Because timber yield revenues have decreased since the base period, the actual dollar amounts allowed may be less, but the proportional shares remain unchanged.

4. ADMINISTRATION

The timber yield tax is administered by BOE, which sets the timber harvest values semiannually, collects the tax from timber owners, and allocates revenues to local agencies pursuant to the formula in state law. The BOE is authorized to place a lien on the assets of individuals with an outstanding timber tax liability. The California Department of Forestry has minor administrative duties as well.

5. CODE

Revenue and Taxation Code Sections 38101-38908

Government Code Section 27423, and Sections 51100-51155

CHAPTER 3H

PRIVATE RAILROAD CAR TAX

HIGHLIGHTS

• Purpose	The tax is in lieu of all other property taxes on private railroad cars.	
• Tax Base	Fair market value of the car, assessed annually, adjusted for the amount of time during the year the car is in the state.	
• Tax Rate	Prior year's statewide average property tax rate on other properties. The 2007-08 rate was 1.096%	
• Revenue	2010-11 (Actual)	$5.8 million
	2011-12 (Estimate)	$5.8 million*
	2012-13 (Estimate)	$5.8 million*
• Administration	Board of Equalization (BOE)	

*Source: Governor's Budget Summary of 2012-13

1. TAX OVERVIEW

Private railroad cars are railroad cars that are owned by companies who haul their own products, lease the cars to other shippers, or contract to carry the freight of other companies. They are not owned by the railroad companies.

The **private railroad car tax** is a property tax on privately owned railroad car fleets operating within the state. The tax is directly levied and retained by the state and is in lieu of all local ad valorem property taxes on private railroad cars. The cars are assessed and taxed by the state since it is impractical for individual counties to subject railroad cars, which can be moved frequently, to the local property tax.

The tax is based on the period of time each car is in the state and its fair market value.

Cars owned by the railroads are not subject to the private railroad car tax because they are subject to the general property tax and are included in the overall value of the railroads.

2. TAX RATE

The tax rate applied to private railroad cars is the prior year's statewide average property tax rate. The fiscal year (FY) 2010-11 rate, applicable to 2012 assessments, is 1.107%. The BOE annually determines the private railroad car tax rate.

3. REVENUE

Although the private railroad car tax is assessed and taxed by the state in lieu of local ad valorem property tax, federal law requires parity in the tax assessed against private railcars to that assessed against other business property. This federal law, the "4-R" Act, discussed more completely in Chapter 4, specifically provides that railroad cars cannot be taxed differently than other commercial and industrial property. After numerous legal challenges to the tax rate imposed in light of the required tax parity, BOE taxes private railcars using a statewide assessment ratio representing the property percentage of market value. In FY 2009-10, this ratio was 81.01% of fair market value.

The private railroad car tax is a state General Fund revenue source. In FY 2010-11 the tax generated $5.8 million. Revenues are also estimated at $5.8 million in FY 2011-12.

4. ADMINISTRATION

The BOE makes annual assessments of private cars, and levies and collects the tax.

5. CODE

Revenue and Taxation Code Sections 11201-11702

CHAPTER 3I

EMERGENCY TELEPHONE USERS' SURCHARGE

HIGHLIGHTS

• Purpose	Funds local government costs for implementation and operation of the 9-1-1 emergency telephone system.
• Tax Base	All charges for (1) intrastate telephone communication services in this state, and (2) Voice over Internet Protocol (VoIP) service that provides access to the 9-1-1 emergency system by utilizing the digits 9-1-1 by any service user in this state.
• Tax Rate	0.50% (effective through December 31, 2011).
• Revenue	2010-11 (Actual) $86.5 million 2011-12 (Estimate) $84.0 million 2012-13 (Estimate) $81.0 million
• Administration	Board of Equalization (BOE) and California Technology Agency (CTA)

1. TAX OVERVIEW

In 1972, the Legislature passed a measure calling for statewide implementation of a 9-1-1 emergency telephone system. The installation and operation of the system is funded by the Emergency Telephone Users' surcharge applied to intrastate (within California) telephone calls and Voice over Internet Protocol (VoIP) service that provides access to the 9-1-1 emergency system by utilizing the digits 9-1-1 by any service user in the state. The surcharge was established in 1976, and the system was completed in December 1985 for wireline-enhanced 9-1-1. Current revenues pay for system enhancements and operational costs.

2. TAX RATE

The surcharge rate varies, depending on funding needs; however, it has a floor of 0.5% and a cap of 0.75%. Each year, CTA determines the rate it estimates will produce sufficient revenue to fund the current fiscal year's costs for the 9-1-1 program. If warranted, CTA proposes a change in the surcharge rate for the following period.

Charges for lifeline services and for services from public coin-operated telephones are exempt from the surcharge.

3. REVENUE

Surcharge revenues accrue to a special 9-1-1 fund. The surcharge decreased to $86.5 million in fiscal year (FY) 2010-11, is estimated to decrease again to $84 million in FY 2011-12, and, again, expected to decrease to $81 million in FY 2012-13 at the rate of 0.50%.

4. ADMINISTRATION

The 9-1-1 tax is collected from consumers by the telephone companies and is remitted to BOE. Additionally, every California consumer who purchases intrastate telephone or VoIP service from a service supplier that does not collect the surcharge is required to register and pay those funds to the BOE.

The Public Safety Communications Office of CTA establishes minimum technical and operational standards for local systems and approves the funding necessary to implement and operate each system.

5. CODE

Revenue and Taxation Code Sections 41001-41176

CHAPTER 3J

UNEMPLOYMENT INSURANCE TAX

HIGHLIGHTS

• Purpose	Funds unemployment benefits for former employees who are currently unemployed.	
• Tax Base	First $7,000 of each employee's annual wage.	
• Tax Rate	The Unemployment Insurance (UI) rate schedule in effect for 2012 will be Schedule "F+". This is Schedule F plus a 15% emergency surcharge and provides for UI tax rates from 1.5% to 6.2%. In addition, employers with a positive reserve account balance as of the calculation date must pay the employment training tax of 0.1%.	
• Revenue	2008-09	$ 4.34 billion*
	2009-10	$ 4.45 billion*
	2010-11	$ 5.27 billion*
• Disbursements	2008-09	$ 9.47 billion*
	2009-10	$10.48 billion*
	2010-11	$ 7.88 billion*
• Administration	Employment Development Department (EDD)	

*Source: EDD

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1. TAX OVERVIEW

The **unemployment insurance tax** funds the cost of benefits for the UI program administered by California's EDD. It is paid by employers who have paid in excess of $100 in wages for employment during any calendar quarter. The tax is paid on the first $7,000 of wages paid by an employer to each employee during any calendar year.

All taxes paid are deposited in the UI Trust Fund maintained by the United States Treasury. The EDD draws down funds from the UI Trust Fund as needed to pay UI benefits to California workers. The UI tax revenues may be used only for payment of program benefits.

An individual account, called a reserve account, is maintained for each employer by EDD. The reserve account established for each employer has no monetary value and cannot be reimbursed to the employer. This account is used to compute the employer's tax rate, as discussed below.

The **employment training tax** (ETT) funds training programs to retain workers in targeted industries to improve competitiveness of California companies. Like the UI tax, the employment training tax is an employer-paid tax. Employers subject to ETT pay at a rate set by statute to be 0.1% (.001) on the first $7,000 of wages paid by an employer to each employee in a calendar year. Only employers with a positive reserve account balance as of the calculation date are subject to the employment training tax. However, employers found guilty of tax evasion are assessed the employment training tax, along with any penalties, interest, and other fines for the offense, regardless of the condition of their reserve account. The Employment Training Panel administers the employment training funds collected and has the discretion to allocate the funds to economic development, special employment training, and/or welfare to work.

2. TAX RATE

Unemployment Insurance Tax. New employers are assigned a UI tax rate of 3.4% for a period of two to three years. Each employer's subsequent tax rate is based on that individual employer's "experience rating" and on the tax rate schedule in effect for all employers during the year.

- Tax Rate Schedules. There are seven different UI tax rate schedules (AA, A, B, C, D, E, and F, ranging from lowest to the highest) and 38 different rates within each schedule. Depending on the schedule in place, UI tax rates can range from a low of 0.1% to a high of 5.4%.

  The tax rate schedule in effect for any given year depends on the balance in the UI Fund and total wages paid in California. Generally speaking, when the balance in the UI Fund decreases, a higher tax rate schedule is triggered. When the balance in the Fund increases, a lower tax rate schedule is triggered. A change in tax rate schedule affects the rates applied to all employers.

  The UI tax rate schedule in effect for 2012 will be Schedule "F+". This is Schedule F plus a 15% emergency surcharge, rounded to the nearest tenth. Schedule "F+" provides for UI tax rates from 1.5% to 6.2%.

- Experience Ratings. The experience rating system measures the relationship between UI taxes paid by an individual employer, benefits paid to that employer's workers, and growth in an employer's work force. Generally, employers who maintain a stable work force and timely file and pay UI taxes have a more favorable experience rate (and therefore lower UI tax rates) than employers who experience high turnover, large fluctuations in payroll, and/or are late in filing and paying their UI taxes.

An employer's experience rating is based on that employer's reserve ratio, which is the ratio of the employer's reserve account balance on July 31, to the employer's average base payroll. The reserve ratio is then compared to the applicable tax rate schedule in effect for the coming year to determine the employer's UI tax rate.

The reserve account balance is calculated as follows:

a) An employer's UI reserve account is credited with UI taxes paid by the employer.

b) The value of UI benefits paid to the employer's former employees is subtracted from the employer's reserve account.

c) Interest earned on the entire UI Fund is credited to the reserve account of each employer with a positive reserve account balance on a proportionate basis.

d) Charges and credits to reserve accounts resulting from pro-rations made on amounts that result from activity involving all employers' accounts. Under certain circumstances, law specifies that benefits not be charged against a former employer but must, instead, be charged to all employers who participate in the UI Fund. These benefits are called socialized benefits. Some socialized benefit costs relate to specific eligibility provisions. For example, benefits paid to employees who become unemployed as a result of the need to escape domestic violence. Other socialized benefit costs include the total UI benefits paid in error or because of fraud and the total annual increase of all negative reserve account balances. These factors are beyond the individual employer's control and are, therefore, shared by all employers according to the ratio of each employer's taxable wages to those of all employers. This ratio is applied to the balances of the individual items and a portion of the credits or charges goes to each employer.

e) The resulting reserve account balance is then divided by the employer's average annual taxable payroll for the preceding three years. The result equals the reserve ratio.

A high reserve ratio --- high reserves and few benefits paid --- produces a lower experience rating and thus a lower UI tax. A low reserve ratio --- low reserves and many benefits paid --- produces a higher experience rating and thus a higher UI tax.

Employers may make voluntary contributions to their reserve accounts to obtain a lower UI tax rate for a given year, although rate reductions triggered by voluntary contributions cannot lower an employer's rate by more than three rate steps (i.e., a few tenths of one percent). Furthermore, voluntary contributions are only allowed during relatively good economic times; they are not allowed during years when the two highest rate schedules (E and F) are in effect, or in calendar years in which the emergency solvency surcharge is in effect.

Each December, EDD automatically notifies all tax-rated employers of their UI tax rates and their reserve account balances. In addition, when the UI tax rate schedule is not E or F, EDD notifies eligible employers of the exact amount of voluntary payments needed to lower their UI tax rates, together with the UI tax rate reductions that would result from voluntary payments.

Employment Training Tax. All employers subject to the employment training tax, as discussed above, are assessed an additional 0.1% regardless of their UI tax rate.

3. EXEMPTIONS

There are several reasons why the wages earned by an individual may be exempt from UI taxes. Some of the more common types of exemptions include wages earned by:

- Certain family members in family employment;
- Elected officials acting in their official capacity;
- Employees performing services for a church;
- Certain students, student nurses, newspaper carriers, and golf caddies; and
- Certain domestic workers who receive less than $1,000 in cash wages during a calendar quarter.

Generally, employers who are not required to pay UI taxes for certain employees are allowed to elect such payments. The primary exception to this rule involves elected officials, whose employers may not make UI payments on their behalf.

4. BENEFITS

Unemployment insurance (UI) benefits are payable to employees who become unemployed through no fault of their own, are able and available to work, are actively seeking work, and have earned sufficient wages in the "base period".

The base period of a claim is a 12-month period. Each base period has four quarters (each quarter is three months). The base period is established when the claim is filed.

There are two types of base periods -- the standard base period and, beginning April 1, 2012, an alternate base period. When there are not enough wages in the standard base period to establish a valid UI claim, wages in the alternate base period may be used to establish a claim.

Standard Base Period. The **standard base period** is the FIRST FOUR of the last five completed calendar quarters prior to the beginning date of the claim.

If the claim begins in:	The Base Period is:
January, February, March	October 1 through September 30
April, May, June	January 1 through December 31
July, August, September	April 1 through March 31
October, November, December	July 1 through June 30

Alternate Base Period (Effective Beginning April 2012). The **alternate base period** is the LAST FOUR completed calendar quarters prior to the beginning date of the claim.

If the claim begins in:	The Base Period is:
January, February, March	January 1 through December 31
April, May, June	April 1 through March 31
July, August, September	July 1 through June 30
October, November, December	October 1 through September 30

An employee who leaves a job voluntarily may also claim UI benefits if he or she had good cause (e.g., the working conditions were dangerous).

The employer's reserve account is credited with the tax contributions and, in most cases, charged with benefits paid to former employees. An employer who receives a notice of claims made by former employees may file a protest with EDD if he or she believes that the employee is not entitled to the benefits claimed.

The weekly benefit amount is based on the quarter within the base period in which the employee's wages were the highest. Currently, benefit amounts range from $40 to a maximum of $450 per week. The employee may draw up to 26 weeks of regular UI benefits during a one-year period.

However, EDD can extend the benefit period during periods of severe unemployment based on criteria specified in law. For example, when at least 6% of California's work force that is covered by UI becomes unemployed, up to 13 additional weeks of UI benefits are available to those who have exhausted their regular UI benefits.

Responsibility for funding the additional UI payments is shared equally between the state UI Fund and the federal government.

5. FEDERAL TAXATION

The federal government imposes a federal unemployment tax (FUTA) on employers equal to 6.2% of the first $7,000 in wages they pay each qualifying employee. However, the federal government gives employers in states with approved unemployment insurance programs a credit of 5.4% against the federal tax. Thus, California employers are subject to a net federal tax of 0.8%.

Effective July 1, 2011, the federal government imposes a federal unemployment tax (FUTA) on employers equal to 6.0% of the first $7,000 in wages they pay each qualifying employee. Since the federal government gives employers in states with approved unemployment insurance programs a credit of 5.4% against the federal tax, California employers are subject to a net federal tax of 0.6%. Starting January 2012, the credit will be reduced to 5.1% because the state has been borrowing from the federal government to pay UI benefits for more than two straight years. The additional FUTA revenue will be used to help repay the state's federal loan. Additional credit reductions will continue every year if nothing is done to revise the state's UI funding structure to regain solvency in the UI Trust Fund.

6. REVENUE

Unemployment insurance tax revenues totaled $4.34 billion in FY 2008-09, $4.45 billion in FY 2009-10, and $5.27 billion in FY 2010-11.

7. ADMINISTRATION

Any employer who pays in excess of $100 in total wages during any calendar quarter is required to register with EDD. Employers are required to make quarterly UI payments on the last day of the month following the close of each calendar quarter. Quarterly returns in which employers must reconcile their quarterly payments with the amounts of tax actually due for the quarter must be filed by the last calendar day of the month following the end of the quarter. Penalties and interest are imposed on delinquent amounts.

8. CODE

Unemployment Insurance Code Sections 100-2129

CHAPTER 3K

STATE DISABILITY INSURANCE TAX

HIGHLIGHTS

• Purpose	Funds payments for employees who are unable to work due to non-occupational injury or illness and pregnancy. Funds payments for employees who need to take time off work to care for a seriously ill child, spouse, parent, or domestic partner, or to bond with a new child.
• Tax Base	In 2010, first $93,316 of each employee's annual wages. In 2011, first $93,316 of each employee's annual wages. In 2012, first $95,585 of each employee's annual wages.
• Tax Rate	The rate increased from 1.10% in 2010 to 1.20% for 2011. The rate decreased from 1.20% in 2011 to 1.00% for 2012.
• Revenue	2008-09 $4.68 billion* 2009-10 $5.33 billion* 2010-11 $5.59 billion*
• Disbursements	2008-09 $4.90 billion* 2009-10 $5.12 billion* 2010-11 $5.11 billion*
• Administration	Employment Development Department (EDD)

*Source: EDD

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1. TAX OVERVIEW

The state **disability insurance tax** is collected from employees and funds the State Disability Insurance (SDI) program. This program is administered by California's EDD. The program provides Disability Insurance (DI) and Paid Family Leave (PFL) benefits. The tax is withheld from employees of establishments that employ one or more persons and have paid more than $100 in wages in a calendar quarter. Tax collection is performed through mandatory payroll deductions. Revenues are deposited in the Unemployment Compensation Disability Fund. There is no comparable federal tax.

Disability insurance provides partial compensation for wages lost due to non work-related illnesses, injuries, or pregnancy. The PFL insurance extends disability compensation to cover individuals who take time off of work to care for a seriously ill child, spouse, parent, or domestic partner, or to bond with a new child. The programs cover approximately 13 million California workers.

2. TAX RATE

The SDI tax rate is adjusted annually, based on the balance in the Disability Fund. The taxable wage limit is set by statute and changes when the maximum weekly benefit changes. For 2009, the tax was 1.10% on the first $90,669 of wages earned by each employee. Recent changes in the tax rate and taxable wage limit are as follows:

- For 2010, the maximum wage limit was $93,316, and the tax rate was 1.10%.
- For 2011, the maximum wage limit was $93,316 and the tax rate was 1.20%.
- For 2012, the maximum wage limit is $95,585 and the tax rate is 1.00%.

3. EXEMPTIONS

Certain groups of employees are exempt from paying (and therefore receiving) SDI. They are as follows:

- Some public agency employees;
- Public school employees;
- Federal government employees;
- Self-employed individuals or employers;
- Employees of churches and certain other religious organizations;
- Individuals in certain types of family employment (e.g., children employed by their parents, spouses employed by their spouse, son, or daughter);
- Individuals who file religious exemption certificates stating that they rely upon prayer in the practice of religious healing; and

- Certain domestic workers who receive less than $750 in cash wages during a calendar quarter.

Although exempt from the requirement to pay SDI taxes, public school and public agency employees may elect coverage as an entire entity, by bargaining unit, or for management and confidential employees. Individuals in family employment may also elect coverage. The tax rate for these employees is the same as for non-exempt employees.

Self-employed individuals may also elect coverage, but the tax rate for self-employed individuals may be different than for non-exempt employees. The self-employed tax rate is based on the net profit of the business that elects the coverage during the year prior to election.

4. BENEFITS

Benefits for DI and PFL vary depending on the employee's wages. In 2000, the legislation was enacted that linked the SDI maximum weekly benefit amount to the maximum amount set for Worker's Compensation Temporary Disability. DI benefits for 2008 and 2009 ranged from $50 to $959 per week. The maximum weekly benefit amount increased to $987 for 2010, remained at $987 for 2011, and increased to $1,011 for 2012. The total SDI benefits paid to each employee equal 52 times that employee's weekly benefit; however, a claimant's benefits cannot exceed 100% of the wages paid to that claimant during his or her qualifying base period. The total PFL benefits paid to each employee cannot exceed six times that employee's weekly amount within a 12-month period. The "base period" consists of the first four of the last five or six completed calendar quarters, depending upon the month in which the claim for benefits is filed, as shown below:

MONTH CLAIM IS FILED	BASE PERIOD
January, February, or March	October 1 through September 30
April, May, or June	January 1 through December 31
July, August, or September	April 1 through March 31
October, November, or December	July 1 through June 30

5. REVENUE

Revenues from the SDI tax are held in the Unemployment Compensation Disability Fund, a special fund in the State Treasury. Revenues are maintained separately from the unemployment insurance tax revenues collected from employers. The Fund collected $4.68 billion in fiscal year (FY) 2008-09, $5.33 billion in FY 2009-10, and $5.59 billion in FY 2010-11.

Disability benefit payments totaled $4.90 billion in FY 2008-09, $5.12 billion in FY 2009-2010, and $5.11 billion in FY 2010-11.

6. REFUNDS

An employee who works for multiple employers during a given year and cumulatively earns wages in excess of the taxable wage limit may file for a refund of the excess tax paid when filing his or her California personal income tax return.

7. VOLUNTARY PLANS

An employer, with majority consent of his or her employees, may substitute a voluntary plan for the SDI plan. The voluntary plan must provide equal or greater benefits than the state plan, including both DI and PFL benefits, and be approved by EDD.

SDI contributions withheld by a voluntary plan (which are optional on the part of the employer and cannot exceed the state plan rate) are not remitted to EDD.
Instead, in the voluntary plan, the employer retains these moneys in trust to pay benefits and administrative costs of the plan. As of January 2012, there were approximately 2,542 voluntary plans. As of January 2011, voluntary plans covered almost 500,057 workers (out of a total of approximately 18.2 million workers in California). All voluntary plans are self-insured.

8. ADMINISTRATION

Any employer who pays in excess of $100 in total wages during any calendar quarter is required to register with EDD. Employers are required to file quarterly returns with EDD in which they remit the SDI contributions they withhold from their employees, as well as reconcile the amounts withheld during the quarter with amounts actually due. Generally, SDI withholding must be remitted by employers to EDD at the same time as other required employee withholding, such as state personal income taxes.

9. CODE

Unemployment Insurance Code Sections 2601-3306

`CHAPTER 4

LOCAL PROPERTY TAX

HIGHLIGHTS

• Tax Base	Assessed value of real property (land, improvements, and fixtures) and tangible personal property (equipment, machinery, office furniture, etc.).	
• Tax Rate	Maximum 1% countywide rate on assessed value of property, proceeds of which are distributed to all local agencies within the county pursuant to statutory formula. Individual agencies may levy rates above the 1% maximum to service voter approved debt.	
• Revenue	2009-10	$49.2 billion*
	2010-11 (Estimate)	$48.0 billion*
	2011-12 (Estimate)	$48.4 billion*
• Administration	County Assessors and Board of Equalization (BOE)	

Includes basic 1% rate; excludes reimbursement by the state to local governments.

*Source: BOE

1. TAX OVERVIEW

The **property tax** is the major general revenue source for local governments in California. It is imposed on the property owners and is based on the value of the property (thus it is often referred to as an ad valorem tax). However, since the adoption of Proposition 13 in 1978, real property has generally been taxed based on its value at the time of its acquisition, with increases for inflation limited to 2% per year. Liability is for a fiscal year (July 1 to June 30) or a portion thereof. Payments are made in one or two annual installments.

The property tax applies to all classes of property -- residential, commercial, industrial, agricultural, open space, timberland, and vacant land. Special rules apply to some kinds of property, such as certain agricultural land and timberland. Public land is generally exempt. Property taxes are collected by the county and distributed to local agencies within the county based on a statutory formula.

2. FOUNDATIONS OF PROPERTY TAX LAW

Much of the law pertaining to taxation of property is prescribed in the California Constitution -- in Article XIII, which was part of the original California Constitution, and in Article XIIIA, which was adopted by the voters of the state as Proposition 13 in 1978.

Most fundamental modifications to property tax law must be made by constitutional amendment approved by the voters of California. The Legislature is authorized to implement and modify various aspects of property tax law and is authorized by the Constitution to exempt personal property by a two-thirds vote.

Judicial decisions play an important part in the evolution of property tax law, as lawsuits are brought to resolve disputes over the meaning of various constitutional and statutory provisions. The U.S. Supreme Court upheld the constitutionality of Proposition 13 in 1992, finding that it does not violate the U.S. Constitution's equal protection or right to travel provisions.

3. WHO MUST PAY THE PROPERTY TAX

In most cases, the owner of the property is assessed for the property tax. In cases where the owner leases the property to someone else, the assessor may assess either the owner, the lessee, or may make a joint assessment on both the lessor and lessees. However, the owner is ultimately liable for payment of the tax.

In one special circumstance, a non-owner of property is assessed for the property tax. This occurs when an individual or business has the right to use tax-exempt land. The most common example is the case of government-owned property that is leased to a private party. The lessee holds what is called a "possessory interest" in the property, and is assessed for property taxes on the property. Examples of taxpayers who have possessory interests are owners of cabins on national forest land, ranchers with grazing rights on federal lands, aircraft operators using government-owned airports, cable television companies laying cable in publicly owned streets, and shipping companies renting berths in county-owned ports.

4. TYPES OF PROPERTY SUBJECT TO TAX

The Property Tax Base. The property tax base is composed of two major categories of property: Real property and tangible personal property.

Real property includes land, permanently attached improvements (such as buildings, swimming pools, and other structures), fixtures (items that are permanently affixed to structures, such as air conditioning units, lighting fixtures, permanently installed machinery, etc.), and mineral rights.

Tangible personal property includes movable property such as equipment, portable machinery, office furniture, vessels, and aircraft. Some of the major types of property that are not part of the property tax base include property owned by government or certain charitable organizations, intangible property (e.g., stocks and bonds), household personal property, automobiles and trucks, and business inventories. These are described more fully in the exemption section below (Section 12).

State-Assessed Versus Locally-Assessed Property. Assessment of property involves placing a value on that property for purposes of property taxation. All real and personal property is classified as either locally-assessed property or state-assessed property, depending on which level of government is responsible for assessment.

The assessor of each county is responsible for valuation of locally-assessed property. Most property is locally-assessed.

The BOE is responsible for valuation of state-assessed properties. State-assessed properties include utility and railroad property, private railroad cars, inter-county pipelines, flumes, canals, ditches, and aqueducts. Generally, state-assessed properties operate as an integrated unit and often cross county boundaries. These properties are sometimes called "unitary" properties.

Unitary property is assessed as an operating unit because the separate parcels in each county have little independent value. For example, it makes little sense to value one section of railroad track; its value depends on being a part of an integrated system. Therefore, the BOE values all of the state-assessed property holdings as a single unit and allocates the value among the counties.

Secured and Unsecured Property Tax Assessment Rolls. All property is accounted for on property tax assessment rolls maintained by each county assessor. The property tax assessment rolls contain an entry for each parcel of land, including the parcel number, owner's name, and assessed value. This information may also be stored electronically, rather than on a physical document. There are two kinds of property tax rolls. Property is entered on one or the other, based on how certain the county is of being able to collect taxes if they become delinquent, as described below.

Most property is on the secured roll. The secured roll consists of property for which the payment of tax is "secured" by a lien on real property owned by the taxpayer in that county. This means that the county could seize and sell the real property to satisfy the liability if the taxes become delinquent.

Generally, all real property for which the owner or possessor holds title is on the secured roll. Personal property can also appear on the secured roll if its owner also owns real property in the same county that can secure the personal property. All state-assessed property is also entered on the local secured roll. This portion of the secured assessment roll is sometimes referred to as the "Board roll".

The unsecured roll consists of personal property of taxpayers that do not own real property in the county on which a lien can be placed to secure eventual payment if the property tax becomes delinquent.

Thus, the unsecured roll consists primarily of personal property and machinery and equipment owned by businesses that lease, rather than own, the real property they occupy. Generally, possessory interests in real property will be placed on the unsecured roll if the holder of the interest does not own other real property in the same county on which a lien can be imposed. Airplanes and boats are also on the unsecured roll.

The main difference in the treatment of property on these two rolls is that secured property taxes are payable in two installments, no later than December 10 and April 10, while unsecured property taxes are payable in one installment due no later than August 31. This earlier due date for unsecured roll tax payments is intended to assure collection of taxes on property that is more mobile.

5. TAX RATE

The provisions of Proposition 13, California Constitution, Article XIIIA, limit property tax rates. Local property tax rates are composed of two parts:

- The basic countywide rate is limited to a maximum of 1%. Local agencies are permitted to adopt lower rates that can result in a countywide rate of less than 1%. The proceeds of the basic countywide 1% tax rate are general revenues allocated to local agencies within the county by statutory formula; and,

- Local agencies within each county are permitted to levy additional tax rates for debt. The vote requirements were simple majority prior to Proposition 13 and generally two-thirds after approval by voters in June of 1978. However, pursuant to Proposition 39 passed by the voters in November 2000, bonded indebtedness incurred by a school district, community college district, or county office of education for the construction, reconstruction, rehabilitation, or replacement of school facilities may be approved by 55% vote after November 7, 2000. The proceeds of each additional debt rate are allocated to the local agency that received voter approval to incur the debt, and are earmarked for payment of principal and interest on that debt.

The California Supreme Court ruled that additional tax rates imposed to fund employee pension systems approved by the voters prior to July 1, 1978, are valid debt rates under Proposition 13 [Carman v. Alvord (1982)]. The Legislature codified permissible purposes for which additional rates may be levied as qualified indebtedness and placed limits on increases in additional rates for certain types of pension system debt.

As a result of the levy of additional rates for voter-approved debt, tax rates may vary from area to area within any county, depending on the number and amount of debt rates levied by the local agencies. For example, a resident of one area may pay a 1.1% rate (composed of the 1% countywide rate, a 0.05% rate for school district debt and a 0.05% rate for park district debt), while a resident of another area of the county may pay a 1.2% rate (composed of the 1% countywide rate, a 0.10% rate for a different school district's debt and a 0.10% rate for a water district debt).

The California Constitution provides that the tax rate applicable to the unsecured roll is the prior year's secured roll tax rate. This is because the unsecured roll bills are sent out early in the fiscal year, often before local agencies set the tax rate for the current year. Although counties have the authority under Proposition 13 to set the basic countywide tax rate below the maximum rate of 1%, in most cases the basic tax rate generally does not change. However, the additional debt rates change annually, based on revenue needs to meet principal and interest obligations. Normally the variation in debt rates from year to year is not great, so the impact on an individual tax bill is not pronounced.

6. PROPERTY VALUATION UNDER PROPOSITION 13

Valuation of property is a key factor in property taxation, since the tax rate is applied to the taxable value of the property (formally referred to as the 'assessed value' or 'full value') to determine taxes due. For example, a property with an assessed value of $115,000 in an area where the total rate is 1.1% will have a property tax liability of $1,265, computed as follows:

$115,000 assessed value x 0.011 tax rate = $1,265 tax

Proposition 13 sets forth rules controlling the valuation of property for property tax purposes. The Supreme Court has ruled that these provisions apply to the valuation of locally-assessed real property only, and does not apply to state-assessed property.

Value Standards: Fair Market Value and Acquisition Value. Under pre-Proposition 13 law, locally-assessed real property was assessed each year using a current market standard. Fair market value, which was determined annually by the county assessor, is the value for which the property would sell if offered on the open market.

Proposition 13 subjected locally-assessed real property to a new set of valuation rules, often referred to as the "acquisition value" standard. This system has several components as provided by Proposition 13 and implemented by statute, as described below:

- For purposes of moving from the old to the new system, Proposition 13 first required property values to be rolled back to the 1975-76 fiscal year (FY) fair market value level for the FY 1978-79. Properties that have not sold or undergone new construction since FY 1975-76 have a FY 1975-76 "base year value".

- A property's base year value is adjusted upwards each assessment year to reflect inflation as measured by the California Consumer Price Index, but not in excess of 2% annually. This process continues as long as the property is not subject to an ownership change or new construction. This value is known as the "factored base year value". This system is sometimes described as an "acquisition value" based system. The term "acquisition value" refers to basing future assessed values on the value of the property at the time it was originally acquired. The constitutional validity of this feature of Proposition 13, which often results in different tax burdens for similar properties, has been upheld by the U.S. Supreme Court.

- When a property is sold, transferred, or subjected to any other change in ownership, the property is reassessed to current fair market value as of the date ownership changed. Newly constructed property is also assessed at current fair market value as of the date of completion.

- The fair market value assessment at the time of new construction or change in ownership becomes the property's new "base year value", which is thereafter adjusted upwards by no more than 2% annually, until such time as another change in ownership occurs.

- If new construction occurs on only a portion of a property (for example, a room addition), the newly constructed portion is given a new base year value, and the pre-existing portion retains its old factored base year value. A property can have multiple base year values due to new construction until the whole property changes ownership, when it will be assigned a new base year value based on its total fair market value at the time of sale.

- If on any lien date (January 1) the market value of a property declines below its (base year value) factored base year value, it may be reassessed to reflect the lower value for that upcoming fiscal year. However, if the market value of the property recovers each following lien date after it is reassessed downward, the county assessor may increase the value of the property to its current market value for the next fiscal year. However, any property that is reassessed in this way may not be given a value that is greater than its factored base year value.

Three types of locally assessed real property are not subject to this valuation system. These are agricultural and open space land, timberland, and historical properties. Special valuation rules, described in Section 10, Preferential Assessment of Certain Properties, cover these properties.

Purchase Price Assumed to Represent Fair Market Value. Current law provides that when establishing value upon a change in ownership, the assessor should trust the purchase price represents fair market value, unless there is evidence that the property would not have transferred for that price in an open market transaction. If the assessor believes the property's fair market value is different from the purchase price and the property owner appeals the valuation, the assessor must demonstrate why he or she used another value, generally by presenting comparable sales. The requirement to use the actual purchase price paid as the fair market value is sometimes referred to as "Rule 2", because the concept was originally adopted as a rule by the BOE. It has since been codified in statute.

Exemptions From Reassessment Upon Change in Ownership or New Construction. Constitutional amendments adopted after Proposition 13 and statutory interpretations have permitted several exclusions from fair market value reassessment at the time of change in ownership or new construction. Six of the most significant include:

- Intrafamily Transfers. Under Proposition 58 of 1986, transfers of property between spouses are not considered changes in ownership. This proposition codified previously enacted legislation. In addition, Proposition 58 provided that transfers of principal residences plus transfers of up to $1 million of other property between parents and children are not subject to reassessment upon change in ownership. Proposition 194 of 1996 extended the provisions of Proposition 58 to transfers between grandparents and grandchildren if the parents of those grandchildren are deceased.

- Replacement Residences of Senior Citizens. Under Proposition 60 of 1986, senior citizens may transfer the factored base year value of their original residence to a replacement principal residence, if the replacement is of equal or lesser value and located in the same county. Under Proposition 90 of 1988, the same relief is available for moves between counties if the county board of supervisors where the replacement home is located has adopted an ordinance permitting the transfer of value.

- Replacement Residences of Disabled Persons. Under Proposition 110 of 1990, severely and permanently disabled persons meeting specified requirements may transfer the base year value of an original dwelling to a replacement dwelling of equal or lesser value without triggering reassessment.

- Seismic Safety Improvements. Under Proposition 13 of 2010, specified seismic retrofitting and earthquake hazard mitigation technologies applied to existing buildings are not subject to reassessment as new construction.

- Environmental Contaminations. Under Proposition 1 of 1998, property acquired or reconstructed as a replacement for property destroyed as a result of environmental contamination cleanup activities may be excluded from fair market value reassessment.

- Transfers by and between Registered Domestic Partners (RDPs). Under SB 565 (Migden), Chapter 416, Statutes of 2005, transfers of real property between RDPs or former RDPs are excluded from changes of ownership. In addition, transfers to trusts at death and in connection with property settlement upon the dissolution of a RDP are not considered changes of ownership that subject the real property to reassessment.

Other allowable exclusions from reassessment include:

- Property reconstructed after a disaster;
- Property acquired to replace comparable property destroyed in a disaster;
- Property acquired to replace property taken by eminent domain;
- Additions of solar energy systems and fire sprinkler systems; and,
- Modifications to make an existing residence more accessible to a severely and permanently disabled person.

The Appendix to this chapter lists all of the amendments to California Constitution, Article XIIIA, adopted by the voters since enactment of Proposition 13 in 1978.

The Legislature has also clarified application of the provisions related to change in ownership and new construction, providing that fair market value reassessments are not required for specified transactions, including:

- Transfer of the bare legal title (e.g., when a homeowner pays off the mortgage held by a bank or other financing entity);
- Creations of leases with a term of the creation of less than 35 years (a lease with a term of more than 35 years is considered a 'change in ownership');
- Creations of joint tenancies, when the prior owner is one of the joint tenants in the new joint tenancy;
- Transfers of property between commonly-owned legal entities where the percentage of ownership shares does not change, and transfers of property between individuals and legal entities where the percentage of ownership does not change;
- Transfers of ownership interests in legal entities, and transfers of corporate stock so long as no one individual, corporation, partnership or other legal entity acquires more than 50% of the stock;
- Transfers of properties to revocable trusts;
- Alterations or improvements to property that are not considered major rehabilitations; and

- Sales of mobilehome parks to the tenants of the parks, either as a whole or transfer of individual rental spaces.

Assessment of Property That is Damaged or Declines in Value. The rules that apply to cases of damage or general decline in value that are not associated with disasters declared by the Governor are as follows:

- Ordinary Circumstances When Value Declines. If property experiences a decline in value for any reason other than a misfortune or calamity, such as a general drop in real estate values, special rules apply regarding that property's assessment value. To the extent that its fair market value is less than its value on the property tax roll, the assessor will reassess the property downward on the next January 1 lien date to reflect its value in its present condition.

  However, if the property experiences a decline in value but the market value still is greater than the adjusted base year value on the roll, the factored base year value cannot be reduced.

  If the market value later goes up or repairs are made that cause the value to increase, the value on the tax roll will revert at the next lien date to the factored base year value that would have applied if the decline had not occurred.

  If restoration construction on the property is significant enough to be classified under Proposition 13 rules as "new construction", the newly constructed portion will be reassessed to fair market value.

- Damage Due to "Misfortune or Calamity". If property has been damaged or destroyed by a misfortune or calamity, the owner may request that the property be reassessed downward immediately to reflect its current value in the damaged condition. This downward reassessment procedure is available only in counties that have adopted authorizing ordinances. It is not necessary for the damage to have occurred as a result of a disaster declared by the Governor. The downward reassessment is accomplished by reducing the factored base year value by the same proportion by which the full market value of the property declined due to the damage.

  The downward assessment results in a reduction of property taxes for the assessment year, prorated to reflect the number of months remaining in the year after the damage occurred. The reduced taxes are refunded to the property owner.

  In addition, property owners may apply to defer payment of the next property tax installment due following the disaster. The deferral is permitted until the corrected property tax bill, reflecting the reduced value, is issued.

When the damaged property is restored, it will be reassessed upward. That value will not exceed its prior factored base year value, even though the fair market value may be higher. As in the above situation, if restoration of the property is significant enough to be classified under Proposition 13 rules as "new construction", the newly constructed portion will be reassessed to fair market value.

Two additional relief provisions also are available to owners of property damaged or destroyed by a disaster declared by the Governor. These are described below:

- Exemption from New Construction Reassessment. If real property is substantially damaged or destroyed by a misfortune or calamity, any timely new construction that makes the property substantially equivalent to its state prior to damage or destruction will not result in a reassessment of the new construction. That is, the property can retain its tax value even though new construction has occurred and the new fair market value exceeds the value on the property tax roll. Any portion of the new construction that goes beyond "substantial equivalence" to the state of the property prior to the disaster is reassessed to full market value.

- Transfer of Old Tax Value upon Relocation. If property is substantially damaged or destroyed by a disaster as declared by the Governor, the base year value may be transferred if the owner constructs or acquires comparable property within the same county within five years after the disaster. The base year value transfer is available to comparable property located in another county only if the county in which the replacement property is located has adopted an ordinance permitting the transfer of value and the time frame is limited to three years. This opportunity to retain the assessed value of the original property is available only if the property sustains physical damage amounting to more than 50% of its full cash value immediately before the disaster. The replacement property must be comparable to the damaged property in size, utility and function. If the market value of the replacement property is more than 120% of the original property, the amount in excess of 120% is added to the transferred factored base year value.

Assessment of Oil and Gas Property. Oil, gas, geothermal or other mineral rights are assessed under Proposition 13 rules. New mineral reserves are added to the roll at their fair market value at the time they are proven to be economic. Thereafter, the value is increased annually by no more than 2% and is adjusted downward in proportion to the depletion of the mineral resource.

7. SUPPLEMENTAL ASSESSMENT ROLL FOR CHANGES IN OWNERSHIP AND NEW CONSTRUCTION

During the first five years after implementation of Proposition 13, some property owners were able to temporarily escape the added tax liability arising from changes in ownership or new construction. This occurred as a result of the continuation of pre-Proposition 13 rules establishing tax liability for a fiscal year (July 1 to June 30) based on the value of property as of the preceding lien date.

Prior to July 1, 1983, the law provided that when property was reassessed due to change in ownership or new construction, the additional value was not subject to tax until the fiscal year beginning after the next lien date, which was at that time March 1. Thus, new value could escape taxation for a period of from 4 to 16 months. For example:

- An ownership change in February 1980 was not reflected in higher taxes until the 1980-81 fiscal year, beginning in July 1980, 4 months later.

- An ownership change on March 2, 1980 was not reflected in higher taxes until the 1981-82 fiscal year, beginning in July 1981, 16 months later.

- An ownership change in October 1980 was not reflected in higher taxes until the 1981-82 fiscal year, beginning in July 1981, 10 months later.

However, under legislation that took effect on July 1, 1983, property reassessed upon change of ownership or new construction is now subject to tax immediately, by being placed on a "supplemental assessment roll". The supplemental assessment roll applies only to locally assessed real property subject to Proposition 13 assessment rules and manufactured homes.

The supplemental roll works as follows:

- The added value created by the new construction or ownership change is placed on a separate property tax roll (the supplemental roll) on the date the ownership change occurs or the new construction is complete.

- A tax bill is issued based only on the added value and is prorated for the remaining portion of the fiscal year.

- In the next fiscal year, the entire new assessed value of the property is placed on the regular roll, and there is no supplemental roll liability for that property.

For example, consider a home assessed at $100,000 in an area where the tax rate is 1.1%. The home is on the regular roll, and the tax for the entire year is $1,100. On December 31 a room addition is completed that has a fair market value of $30,000. The supplemental roll tax bill for that year is $165, computed as follows:

$30,000 x 0.011 tax rate = $330 tax x 0.50 (prorating for half of year) = $165

The $165 supplemental tax bill is paid in addition to the $1,100 regular roll bill. The next year, the original value is increased by 2% and combined with the new value of the room addition, and a single regular roll tax bill is issued of $1,452:

$100,000 x 1.02 = $102,000 + $30,000 = $132,000 x 0.011 tax rate = $1,452 tax

Pursuant to AB 459 (Oropeza), Chapter 392, Statutes of 2005, sellers of residential real property are required to provide to the purchaser a notice about supplemental property tax assessments.

8. VALUATION OF OTHER PROPERTY

Annual Reassessment to Fair Market Value. Property other than locally-assessed real property is subject to the valuation rules that were in effect for all property prior to Proposition 13. The pre-Proposition 13 rules now apply only to locally-assessed personal property and state-assessed property. These two classes of property are assessed to current fair market value each year, as of the lien date. For locally-assessed personal property, the county assessor has the responsibility for determining fair market value. For state-assessed property, the BOE determines fair market value. In both cases, the tax rate is the same as for all other property: The basic 1% rate, plus any additional rates for debt.

If damage or other factors cause fair market value to decline for these properties, the decline will be reflected in the next annual reassessment. In addition, owners of locally-assessed personal property may apply for immediate downward reappraisal during the tax year after a "misfortune or calamity", if local county ordinances permit. This is the same procedure described in Section 6 above for locally-assessed real property.

Determination of Fair Market Value. Fair market value is defined as the price the property would bring at a sale in the open market by a willing buyer and willing seller, neither of whom is under any compulsion to buy or to sell, and with full knowledge of the uses to which the property can be put.

Determination of fair market value is a question of judgment, and the law recognizes that there is no single acceptable appraisal method that assessors should employ to determine fair market value. Some of the most commonly used methods include using the purchase price, looking at sales of comparable properties, capitalizing the income stream (rent) produced by the property, and determining the cost to replace the property.

Recall that for purposes of establishing the fair market value of a property that has been purchased, current law requires that the purchase price be presumed to be the fair market value, unless there is evidence the property would not have sold for that in an open market transaction.

As pointed out earlier in this chapter, the property tax applies only to tangible property. Intangible property is not taxable. Examples of intangibles that are not subject to the property tax include general franchises, patents, and goodwill. However, the courts have recognized that in some instances the presence of intangibles contributes to or enhances the value of real property, in which case they may be reflected in the assessment of property for tax purposes.

Impact of the "4-R" Act on Railroad Valuation. Federal legislation enacted in 1976, the Railroad Revitalization and Regulatory Reform Act (the "4-R Act"), has affected the valuation of state assessed railroad property. The 4-R Act prohibits states from taxing railroad property more highly than other commercial and industrial property in the state. Since California assesses most commercial and industrial property under the "acquisition value" rules of Proposition 13, and railroad property is reassessed to fair market value annually as state assessed property, California must modify its assessment of railroad property to comply with the requirements of the 4-R Act.

BOE has concluded that the effective assessment level of state-assessed railroad property in California is 65.14% of fair market value for the FY 2008-09.

9. LIEN DATE AND "ESCAPED" ASSESSMENTS

All locally-assessed taxable property is assessed annually as of 12:01 a.m. on January 1. This is called the lien date, because on that date the taxes due become a lien against the property until paid. The lien date was changed from March 1 to January 1 commencing January 1, 1997.

All state-assessed property is assessed each year as of 12:01 a.m. on January 1.

An escape assessment is a retroactive, corrective assessment. This assessment rectifies an omission or error that caused taxable property to be under-assessed, or not assessed at all. In most cases, once such an omission or error occurs, the property escapes proper assessment each year thereafter until the underassessment is discovered and corrected. Upon discovery that a property escaped assessment, the assessor is required to appropriately value the property as of the valuation date, record the appropriate value on the roll being prepared, and process any necessary corrections to the current roll. In addition, the assessor is required to process escape assessments for earlier years for which the time to make assessments still is open.

In general, the time period during which assessments may be made remains open for four years beginning on July 1 of each assessment year. To determine the open period for escape assessments, the period is counted back in time from the assessment year of discovery and correction.

For example, a new barn was completed in April 1997 but was not assessed until the assessor discovered it in January 2002. Upon discovery, the assessor should:

- Record (enroll) the appropriate value on the roll being prepared (FY 2002-03). The role for this assessment year closes on July 1, 2002, so this correction would not be an "escape assessment".

- Correct the current roll (FY 2001-02); this is year one of the limitations period.

- Process escape assessments for all prior years within the statute of limitations (FYs 2000-01, 1999-2000, and 1998-1999 represent years two, three, and four of the limitations period).

As revealed by this example, the assessor is not always able to make a corrective assessment for every year that the property escaped assessment.

10. PREFERENTIAL ASSESSMENT OF CERTAIN PROPERTIES

California Constitution, Article XIII, Sections 3(j) and 8, provides special assessment rules for three categories of property in order to preserve them in their current form and reduce pressure for development. The special assessment rules allow the property to be assessed at the lower of (a) fair market value, (b) the Proposition 13 assessment value, or (c) historical value. The categories of property covered by the special rule are:

- Open space land and agricultural land, the use of which is restricted under Land Conservation Act (Williamson Act) contracts. Examples of open space contracts include scenic highway corridors, wildlife habitats, saltponds, managed wetlands, submerged areas, and recreational areas. The state reimburses local governments for part of the revenue loss resulting from preferential assessments under the Williamson Act. (The Williamson Act is described more fully in Chapter 6G.)

- Timberland.

- Qualifying historical property.

11. TAXPAYER APPEALS OF PROPERTY VALUATION

Taxpayers who disagree with the values placed on locally assessed property by the county assessor may appeal to the county equalization body between July 2 and September 15 of the fiscal year for which the taxes are due. In some counties, the appeals date is extended to November 30.

Under current law, the elected county board of supervisors may sit as the county BOE or may create one or more assessment appeals boards (AABs) to provide that function. According to BOE, there are 19 counties in California in which the board of supervisors also sits as the county BOE. In the remaining 39 counties, AAB members are appointed by a majority vote of the board of supervisors. Each AAB member's term is three years long, and there is no limit on the number of terms an AAB member may serve. Individual terms are staggered to ensure that a board will not be comprised of members with no prior AAB experience.

Eligibility requirements for appointment to an AAB vary depending on the size of the county. In counties of less than 200,000 people, the board of supervisors may appoint any person who is believed to possess "competent knowledge of property appraisal and taxation". In all other counties, an appointee must have a minimum of five years' professional experience in California in one of the following roles: Certified public accountant or public accountant, licensed real estate broker, attorney, property appraiser accredited by a nationally recognized professional organization, or property appraiser certified by the California Office of Real Estate Appraisers or state BOE.

The roles and duties of the county equalization bodies have been litigated repeatedly. Among the courts' findings: County BOEs are quasi-judicial agencies that function as the fact-finding bodies designated by law to remedy excessive assessments. These boards have the duty to determine the value of locally assessed property and the fairness of the assessment. In discharging this duty, a board's determination regarding the merits of a valuation case are conclusive. Thus, the decision of a county BOE is equivalent to the determination of a trial court and may be reviewed only for arbitrariness, abuse of discretion, or failure to follow the standards prescribed by law.

Rulings of the county equalization body can be appealed to Superior Court, but any Superior Court asked to review a question of fact, which generally is a valuation decision, is limited to inquiry into whether the county board's findings are supported by substantial evidence (i.e., whether the findings are supported by some credible evidence in the administrative record). Thus, the Superior Court sits as an appellate tribunal that reviews the AAB record for reversible error, and taxpayers do not have a right to trial de novo. Over time, three types of reversible errors have been identified: (a) denial of procedural due process to a party by an AAB; (b) utilization of an unlawful appraisal methodology by an AAB; and (c) issuance of findings and/or decisions by an AAB that are not supported by substantial evidence.

Local assessees are provided greater appeal rights on refund actions arising from questions of law than actions arising from questions of fact. In general, questions of fact involve the circumstances surrounding a property's fair market value. Questions of law often involve the determination whether the transfer of a property meets the definition of a change in ownership. Other examples of issues eligible for trial de novo include: (a) whether a property qualifies for a specific property tax exemption; (b) whether a particular item is real or personal property; (c) whether a particular statute is constitutional; and (d) whether the proper method of valuation has been used.

Taxpayers who disagree with the values placed on state-assessed property by the BOE may appeal to the Board itself, with further appeal rights to the Superior Court. State assessees are provided trial de novo if they appeal to the Superior Court. Unlike the restrictions placed on courts asked to review questions of fact on locally-assessed real property, the court may make an independent determination of the fair market value of a state-assessed property.

12. PROPERTY TAX EXEMPTIONS

Various categories of property are partly or fully exempt from the property tax. The major exemptions are summarized below.

Property totally exempted from local property tax includes:

- Most government-owned property.

- Nonprofit religious, charitable, charitable education, and hospital property. This is generally known as the "welfare exemption".

- Household furnishings and personal effects.

- Business inventories, including livestock, held for sale.

- Growing crops. Also, orchards for the first four years after they were planted and vineyards for the first three years after planting.

- Low-value property (generating a tax of less than $100). The county board of supervisors must authorize this exemption before it is allowed for the county.

- Freight and passenger vessels over a certain size.

- Private railroad cars that are subject to the state private railroad car tax in lieu of the local property tax.

Property partially exempted from local property tax includes:

- The first $7,000 of full value of an owner-occupied principal residence. This is known as the Homeowners' Exemption. The state reimburses local governments for the loss of revenue attributable to this exemption. (Refer to Chapter 6E, Homeowners' Exemption, for a more detailed discussion.)

- The first $100,000 or $150,000 as adjusted for inflation of property owned by disabled veterans and their spouses, with the exempt amount depending on the annual income of the veteran. Beginning in 2006, the exemption amount is adjusted for inflation each year.

- Autos and trucks, which are subject to the vehicle license fee (VLF). Mobilehomes sold new prior to July 1, 1980 are also subject to the VLF in lieu of the property tax; mobilehomes installed after that date are placed on the local property roll and assessed as real or personal property, depending upon the method of attachment to land.

- Standing timber, which is subject to the Timber Yield Tax. Note, however, that the land underlying the timber remains subject to the property tax. Timber land is usually subject to preferential assessment.

- Racehorses are subject to a special annual Racehorse Tax. This tax is a fixed amount varying by type of racehorse and the age of the horse.

- Personal property of insurance companies is subject to the insurance gross premiums tax in lieu of all other taxes except real property taxes.

- Personal property of banks and financial institutions is subject to a Bank Tax rate in addition to the normal bank and corporation tax. The personal property of banks is not subject to personal property taxes.

- Business records, which are valued based on the value of the paper, rather than the value of the information contained.

13. PROPERTY TAX RELIEF PROGRAMS

The state pays for a variety of property tax relief programs through income tax credits, cash payments made directly to taxpayers, and subventions to local governments as reimbursement for the loss of revenues resulting from property tax exemptions and preferential assessments.

Table 8 illustrates the cost to the state of the major property tax relief programs for FY 2009-10 (the most recent FY for which actual expenditures are known). Most of these programs are described in more detail in Chapter 6, Special Features of the California Tax System.

In 2011, a county-optional senior citizens and disabled property tax deferral program was created to replace the suspended state program. [AB 1090 (Blumenfield), Chapter 369, Statutes of 2011] .

TABLE 8

Estimated State Expenditures on Property Tax Relief Programs, 2010-11

Homeowners' Exemption (subvention to local governments)	$438.0 million
Senior Citizens, Blind & Disabled Homeowner and Renter Property Tax Assistance (direct cash payments to taxpayers)	$ -0- million
Senior Citizens and Disabled Property Tax Deferral (subvention to local governments)	$ -0- million
Williamson Act Open Space and Agricultural Land Contracts (subvention to local	$ -0- million

governments)

*Source: 2011-12 Governor's Budget

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14. ALLOCATION OF PROPERTY TAX REVENUES TO LOCAL AGENCIES

In 1979, after the passage of Proposition 13, the Legislature enacted a method of allocating the proceeds of the countywide 1% property tax rate to various local entities in each county. The legislation enacting this method was AB 8 of 1979, and the system came to be known as the AB 8 system.

In brief, the AB 8 system ensured that local entities would receive revenues equal to the amount they received in the prior year (the 'base') plus that entity's share of any growth in revenues deriving from assessed valuation in that jurisdiction (the 'increment'). Property tax proceeds from growth, whether due to new construction, changes in ownership, or the 2% inflation factor, accrue only to jurisdictions where the growth occurs.

AB 8 generally allowed local agencies to receive the same share of property tax revenues after Proposition 13 that they received prior to Proposition 13. However, AB 8 also shifted a portion of the property taxes received by schools to cities, counties, and special districts and the state assumed a greater share of education funding. This shift is known as the AB 8 shift or bailout. In effect, California subsidized local governments by passing money through school districts and inflating local governments' property tax revenues.

As part of the package of efforts closing the FYs 1992-93 and 1993-94 budget deficits, the AB 8 shift was partially reduced. Legislation reallocated property tax revenues from cities, counties, and special districts to schools. This shift was accomplished through an Education Revenue Augmentation Fund (ERAF) in each county.

In years following the ERAF property tax shifts, local agencies receive their new base amount plus their share of any growth within the jurisdiction during the past year.

15. ADMINISTRATION

The BOE is charged with developing standards for local assessment practices and also has responsibility for assessing certain utility properties, as described above.

Prior to the enactment of Proposition 13, the BOE had "equalization" powers. That is, the power to require a county to increase assessed values to bring them in line with state standards and assessed values elsewhere in the state. Since the enactment of Proposition 13, BOE no longer has that function. However, BOE is required by statute to monitor local assessment practices and assessed values and report on its findings. If, in its monitoring function, the Board determines that the level of assessment in any county is less than 95% of the assessment level required by law, the county can lose a portion of annual supplemental property tax roll revenues that are earmarked for county administrative costs.

Local county assessors value all property except the utility and railroad property, private railroad cars, inter-county pipelines, flumes, canals, ditches, and aqueducts assessed by the BOE. The county tax collector collects the property taxes, and the county auditor determines the appropriate allocation of revenues to local entities within each county.

Secured roll taxes are paid to the county tax collector in two installments, which are delinquent if not paid by December 10 and April 10 annually. Unsecured roll taxes are paid in one installment due no later than August 31 annually.

16. CODE

California Constitution, Article XIII and XIIIA

Revenue and Taxation Code Sections 1-6000 and Sections 11201-11273

Various sections in Education Code, Government Code, and other Codes.

CHAPTER 4
LOCAL PROPERTY TAX

APPENDIX

History of Proposition 13 and Subsequent Amendments

Statewide Ballot	Proposition Number	Summary of Change Adopted
June 1978	13	Enactment of Article XIIIA. Added Article XIIIA to State Constitution, limiting property tax rate, rolling assessments back to 1975-76 level, limiting increases in assessed value, providing for reassessment upon change in ownership or new construction, prohibiting imposition of new property or other kinds of taxes on real property, authorizing the imposition of local special taxes by 2/3 vote, and making other changes. Most provisions took effect for 1978-79 fiscal year.
November 1978	8	Disasters and Declines in Value. Amended Section 2 of Article XIIIA, providing that real property reconstructed after a disaster will not be considered new construction if the new market value is comparable to the market value prior to the disaster, and authorizing reduction in assessment of a property in order to reflect substantial damages, destruction or other factors causing a decline in value.
November 1980	7	Solar Energy Systems. Amended Section 2 of Article XIIIA, authorizing the Legislature to provide that the construction or addition of any active solar energy system will not be considered new construction.
June 1982	3	Eminent Domain and Inverse Condemnation Amended Section 2 of Article XIIIA, providing that a change in ownership will not include acquisition of property as a replacement for comparable property from which the owner was displaced by eminent domain, acquisition by a public entity, or inverse condemnation. Applied to property acquired after March 1, 1975, for assessments made after June 8, 1982.

June 1984	23	Seismic Safety Reconstruction. Amended Section 2 of Article XIIIA, providing that reconstruction or improvement to property constructed of unreinforced masonry bearing wall construction in compliance with local seismic safety ordinances will not be considered new construction during the first 15 years after the reconstruction.
November 1984	31	Fire Safety Systems. Amended Section 2 of Article XIIIA, authorizing the Legislature to provide that the construction or installation of a fire sprinkler, extinguishing, detection or related system will not be considered new construction. Applies to systems constructed or installed after November 6, 1984.
November 1984	34	Historic Structures Rehabilitation. Amended Section 2 of Article XIIIA, providing that the addition to, or alteration or rehabilitation of, certified historic structures will not be considered new construction, so long as the structure is the owner's principal residence.
June 1986	46	Excess Tax Rates for Bonded Debt. Amended Section 1 of Article XIIIA, allowing the levy of a property tax rate in excess of the 1% maximum to pay interest and redemption charges on bonded debt approved by a two-thirds vote of the voters on and after July 1, 1978, for acquisition or improvement of real property.
June 1986	50	Replacement Property After Disaster. Amended Section 2 of Article XIIIA, allowing the transfer of assessed value from a property substantially damaged or destroyed by a disaster to a comparable replacement property in the same county. Also set forth definitions of "substantially damaged or destroyed" and "comparable." Applies to property acquired or newly constructed on or after July 1, 1985.

November 1986	58	Transfers of Property Within Families. Amended Section 2 of Article XIIIA, providing that change in ownership will not include: (1) the transfer of real property between spouses since March 1, 1975; and (2) the transfer of a principal residence and first $1 million of other real property between parents and children. Also provided that unless specified otherwise, amendments to Section 2 will apply to changes of ownership which occur, and new construction which is completed, after the effective date of the amendment.
November 1986	60	Replacement Residences of Senior Citizens, Moves Within Counties. Amended Section 2 of Article XIIIA, permitting the Legislature to allow persons over age 55, who sell their residence and buy or build another of equal or lesser value in the same county within two years, to transfer the old residence's assessed value to the new residence.
November 1988	90	Replacement Residences of Senior Citizens, Moves Between Counties. Amended Section 2 of Article XIIIA, permitting the Legislature to extend the relief allowed by Proposition 60 of November 1986 to replacement residences located in a different county from the original residence, if the county of the replacement dwelling has adopted an ordinance participating in the program. Applied to replacement dwellings acquired on or after a county ordinance is adopted, but not before November 9, 1988. Amended the language adopted in Proposition 58 of 1986 to provide that unless provided otherwise, amendments to Section 2 adopted after November 1, 1988, will apply to changes in ownership that occur and new construction that is completed on or after the effective date of the amendment.

June 1990	110	Replacement Residences of Disabled Persons. Amended Section 2 of Article XIIIA permitting severely and permanently disabled persons to transfer the base year value of an original residence to a replacement residence of equal or lesser value under certain circumstances. Also exempts modifications to improve accessibility for the disabled from "new construction" reassessment. This measure's provisions parallel those of Propositions 60/90 with respect to qualifying replacement properties.
November 1990	127	Seismic Retrofitting of Existing Buildings. Added a paragraph to Subdivision (c) of Section 2 of Article XIIIA allowing seismic retrofitting improvements or improvements utilizing earthquake hazard mitigation technologies to be constructed or installed in existing buildings without being subject to reassessment as new construction.
November 1992	160	Spouses of Persons Who Died on Active Duty in the Military. Allows the Legislature to exempt from property taxation, in whole or in part, the home of the spouse of a person who died as the result of a service-connected injury or disease while on active duty in military service unless the home is receiving another real property exemption.
November 1993	171	Replacement Property After Disaster. Amended Section 2 of Article XIIIA, allowing the transfer of assessed value from a property substantially damaged or destroyed by a disaster to a comparable replacement property located in another county if the county where the replacement property is located has adopted an ordinance permitting the transfer of value. Applies to property damaged on or after October 20, 1991.

June 1994	177	New Construction Exclusion for Disabled Accessibility Improvements. Amended Section 2 of Article XIIIA exempting modifications to improve accessibility for the disabled from "new construction" reassessment. This measure's provisions apply to property that is not the principal place of residence of a disabled person.
March 1996	193	Grandparent – Grandchild Transfers of Property. Amended Section 2 of Article XIIIA excluding transfers of property between grandparents and grandchildren from change in ownership if the parents of those grandchildren are deceased as of the date of the transfer.
November 1998	1	Environmental Contaminations. Amended Section 2 of Article XIIIA to exclude property acquired or reconstructed as a replacement for property destroyed as a result of environmental contamination cleanup activities from fair market value reassessments.
November 2000	39	School Facilities Bonded Indebtedness, 55% Voter Approval. Amended Section 1 of Article XIIIA to reduce the voter approval threshold from two-thirds to 55% for school facilities.
June 2010	13	Seismic Safety Reconstruction. Amended Section 2 of Article XIII A to remove the 15-year time limit for unreinforced masonry Buildings. (See Prop. 23 of June 1984)

CHAPTER 4
LOCAL PROPERTY TAX

CHAPTER 5 - GOVERNMENT APPROPRIATIONS LIMIT: ARTICLE XIIIB OF THE CONSTITUTION

CHAPTER 5

GOVERNMENT APPROPRIATIONS LIMIT: ARTICLE XIIIB OF THE CALIFORNIA CONSTITUTION

HIGHLIGHTS

- What is the Appropriations Limit?
- Expenditures Versus Appropriations
- How the Appropriations Limit Works
- History of the State's Limit
- Relationship Between State and Local Limits

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1. IN BRIEF: WHAT IS THE APPROPRIATIONS LIMIT?

Proposition 4, approved by the voters in November 1979, added Article XIIIB to the California Constitution. Article XIIIB limits the level of most appropriations from tax sources that the state and most local government entities are permitted to make in any given year. The limit for each year is equal to the limit for the prior year, adjusted for changes in the cost-of-living and population. Various other adjustments are also required. The first year in which appropriation limits applied to state and local governments in California was fiscal year (FY) 1980-81.

Article XIIIB also requires state and local governments to return to taxpayers (or in certain cases, K-14 education programs) any tax revenues in excess of the amount that can be appropriated in any given FY.

This constitutional provision also requires the state to reimburse local governments and school districts for the costs of complying with state mandates, and requires the Legislature to establish a prudent state reserve fund.

Article XIIIB was significantly modified by two initiative constitutional amendments approved by the state's voters in November 1988, Propositions 98 and 99. Proposition 111, approved by the voters in June 1990, made several additional significant revisions to the appropriations limit. Changes made by these propositions are noted in the following sections.

2. EXPENDITURES VERSUS APPROPRIATIONS

The terms "appropriations limit" and "spending limit" or "expenditure limit" are often used interchangeably, and there is some confusion about the difference between appropriations and expenditures.

An appropriation is an action by the Legislature to set aside an amount of money for a specified purpose. In short, an appropriation authorizes money to be spent. Appropriations are made in the annual Budget Bill, or in individual bills providing for specific governmental programs.

The actual expenditure of money occurs later, and is implemented by the State Controller. Writing checks is a ministerial function of the Controller. The Controller has no authority to expend money that has not been appropriated by the Legislature.

The amount of an expenditure on a program may not equal the appropriation for that program. For example, if the number of clients for a particular government service is actually less than anticipated, the appropriation may be larger than the amount actually spent.

Article XIIIB sets forth a limit on the amounts that may be appropriated from government tax proceeds. In the remainder of this chapter, Article XIIIB will be referred to as an appropriations limit, although in casual conversation and the popular press it is often called a spending limit.

3. HOW THE APPROPRIATIONS LIMIT WORKS

Most of the operative provisions of Article XIIIB are provided in the Constitution. Some features required statutory implementation, which was accomplished by legislation enacted in 1980, and again in 1990 for changes made by Proposition 111.

The paragraphs below describe how the appropriations limit works, based on both constitutional and statutory provisions. Opinions provided by the Legislative Counsel and the Attorney General have contributed to our interpretation of the provisions of Article XIIIB.

Which Governmental Agencies Have Limits? Article XIIIB applies to the state and to most units of local government -- cities, counties, K-12 school districts, community college districts, and special districts. Each governmental entity has its own appropriations limit. The few local governmental entities that are not subject to an appropriations limit are:

- Special districts in existence on January 1, 1987 that did not levy a property tax rate in excess of 12.5% in FY 1977-78; and,

- New special districts formed since that time by a vote of the people that are not funded from tax proceeds.

Which Revenues Are Subject to a Limit? Article XIIIB places a limit on appropriations from most, but not all, government revenue sources. The limit applies to appropriations from proceeds of taxes from both the general fund and special funds of government entities. Tax proceeds include tax revenues, interest earnings on invested tax revenues, and any revenues collected through a regulatory license fee or user charge in excess of the amount needed to cover the cost of providing the regulation, product, or service.

Appropriations from non-tax revenues are excluded from the limit. Examples of non-tax proceeds include lottery proceeds, tidelands oil revenues, federal funds, proceeds from the sale of government property, revenues from regulatory license fees or user charges equal to the amount needed to cover the cost of providing the function, gifts, and borrowed funds.

In addition, proposition 111 excluded appropriations from the following revenue sources from the limit:

- Gas and diesel tax revenues above nine cents per gallon;

- Sales and use taxes collected on gas and diesel taxes above nine cents per gallon; and

- Truck weight fees that exceed those in effect on January 1, 1990.

Which Appropriations Are Subject to Limit? Appropriations for almost all government functions are subject to limitation under Article XIIIB. However, there are some important exceptions.

The original Proposition 4 provided that the following appropriations are not limited, even if made from proceeds of taxes:

- Subventions from the state to local governments and schools, the use of which is unrestricted (these subventions are not subject to the state's limit, but instead are counted as subject to the local entity's limit);

- Appropriations to pay for costs of complying with federal laws and court mandates;

- Payments for interest and redemption charges on pre-existing (i.e., pre-Proposition 4) or voter-approved bonded indebtedness;

- Withdrawals from previously appropriated reserve funds; and,

- Refunds of taxes.

Proposition 99, adopted by the voters in November 1988, created another major category of appropriations not subject to the limit. These are appropriations of new tax moneys from cigarette and tobacco products resulting from tax increases imposed by Proposition 99. Under that statutory initiative, beginning in FY 1988-89, state revenues from those new or increased cigarette and tobacco taxes are set aside in special accounts for expenditure on treatment or research of tobacco-related diseases, tobacco health education programs, and wildlife preservation and related programs. All such appropriations are exempt from limitation under Article XIIIB.

Proposition 111 excluded capital outlay from the appropriations limit. This change reflects the fact that while capital outlay appropriations are made during a single budget year, they reflect long-term investments that are utilized over a number of years.

Appropriations directly related to an emergency, such as a fire, earthquake, or other natural disaster, were also excluded from the limit by Proposition 111. No reduction in future limits is required for appropriations made for these emergency purposes.

The "Base Year" Limit. The first year that limits were in effect was FY 1980-81. The base year for determining the appropriations limit in FY 1980-81 was FY 1978-79. Actual appropriations in the 1978-79 FY that had been financed by the proceeds of taxes were the starting point. Appropriations not subject to limitation (see above) were subtracted from that figure and this became the "base year" level of appropriations for computing all subsequent years' limits.

Proposition 111 updated the base year for calculating the limit for each government entity to FY 1986-87. For fiscal years beginning with FY 1990-91, the limit for each entity is the FY 1986-87 limit adjusted annually as specified by Article XIIIB as amended by Proposition 111.

Base year appropriations limits for new local government entities incorporated after the enactment of Article XIIIB are to be established by local agency formation commissions or county formation review commissions, and approved by the voters of the incorporation or formation elections.

Annual Adjustments to the Limit. The appropriations limit for each year since FY 1980-81 is calculated by adjusting the base year limit for changes in the cost-of-living and population. Proposition 111, passed by the voters in June 1990, revised each of the adjustment factors. Specifically, annual adjustments to limits, either upward or downward, are made as follows:

- Cost-of-Living.

  State and schools. Governments' limits are adjusted by the change in California per capita personal income.

  Local agencies (except schools). Limits are adjusted by the change in California per capita personal income or the change in the local property tax roll due to the addition of new nonresidential construction.

- Population.

  State. The population factor is calculated by adding: (a) the change in the state's total population weighted by the percent of the budget spent on non-educational programs, and (b) the change in average daily attendance (ADA) for K-14 education weighted by the percentage of the budget spent on K-14 education.

  Local agencies. The population factor is the percentage change in the jurisdiction or in the county in which the jurisdiction is located. Special districts located in two or more counties may use the change in the county in which the district has the highest assessed valuation.

  Counties. The population change for counties can be calculated by using one of three methods: (a) the percentage change in population within the county; (b) the percentage change in population for both the county itself and contiguous counties; or (c) the percentage change in population within the incorporated portion of the county.

  K-14 Schools. The change in population is the percentage change in average daily attendance.

- Program Transfers. Limits of governmental entities are modified to reflect transfers of financial responsibility from one level of government to another. The limit of the new service provider is increased by the amount the former service provider's limit is reduced.

- Funding Transfers. Adjustments either upward or downward are made to account for transfers of program funding sources, for example from tax revenues (subject to limit) to fees (not subject to limit).

The level of appropriations actually made by a government entity in any year does not have any bearing on the calculation of the appropriations limit for the subsequent years. Each year's limit is computed based on the prior year's limit, not the prior year's appropriations.

If the governing body actually appropriates less money than what would be permitted by the limit, it has "room" under its limit, and the limit will be further adjusted the following year for cost-of-living and population changes. A government entity does not "lose" room under its limit for the future by appropriating less than the maximum permitted in any year.

Appropriations Permitted in Excess of the Limit. Article XIIIB sets forth two circumstances under which governments may make appropriations in excess of their limits:

- Emergency. Appropriations for declared emergencies do not count towards and may be made in excess of the limit. Proposition 111 removed the requirement that the limits for future years must be reduced over a three-year period so that there would be no total increase in allowable appropriations.

- Voter Approval. Article XIIIB permits voters of a jurisdiction to authorize an increase in the appropriations limit. However, no voter-approved increase may be in effect for more than four years. At the end of the four-year period, either the voters must approve another increase or the limit must return to the level it would otherwise have been.

When Revenues Exceed the Appropriations Limit. A government entity may receive revenues during a fiscal year that exceed its appropriations limit. Proposition 111 allows governments to average appropriations over a two year period before becoming subject to the excess revenue provisions of Article XIIIB. In other words, a government entity can offset appropriations that exceeds its appropriations limit in one year of a two-year period by appropriating less than the limit in the other year. If revenues exceed the appropriations limit after taking this two-year averaging into account and authority to appropriate is not provided by either an emergency declaration or voter approval, Article XIIIB as amended by Propositions 98 and 111 sets forth a process for disposing of the excess state revenues:

- Education Programs. After the two-year averaging period, 50% of any excess revenues are transferred to the State School Fund for elementary, secondary and community college education. A portion of this excess revenue (25%) may effectively be built into the base used to calculate future funding required by Proposition 98 if the excess funds are used for a specified purpose. The transfer to education is not required if the state's average expenditure per student and average class size is equal to or exceeds that of the ten states with the best performance in these areas.

° Return of Excess. The 50% of excess revenues remaining after the transfer to education must be returned to taxpayers within the following two years. The return can be made through a reduction in the tax rate or as a fee reduction.

4. HISTORY OF THE STATE'S LIMIT, FYs 1980-81 TO 2010-11

How the Limit is Administered. Under statute, the Governor must submit to the Legislature along with the budget an estimate of the state's appropriations limit for the budget year. The estimate is subject to the budget process, and the official limit is established in the annual Budget Bill. The Department of Finance and the Legislative Analyst's Office have developed the methodologies necessary to compute the limit annually.

Effect of the State's Limit FYs 1980-81 to 1986-87. For the first five years that Article XIIIB was operative, it essentially had no constraining effect on state budgets. Changes in population and CPI outpaced the growth in state revenue in the early 1980s, so that actual revenues received were the constraint on the level of state spending until FY 1986-87.

During this period unused "room" under the state's appropriations limit peaked in FY 1982-83 at $3.4 billion, and declined steadily after that. A decline in the rate of inflation after that time reduced the rate at which the limit was raised annually, while at the same time a robust economy brought steady growth in state revenues. In late 1986, analysts were predicting that by FY 1987-88, the Article XIIIB appropriations limit would begin to function as a significant constraint on state spending.

However, an unanticipated surge in tax revenues in the spring of 1987 caught most observers by surprise. That revenue surge, caused primarily by taxpayer reaction to the federal Tax Reform Act of 1986, pushed the state substantially over its appropriations limit for the first time during the 1986-87 fiscal year. The state ended that fiscal year with $1.1 billion in excess revenues.

FY 1986-87 Rebate of Excess Revenues. During FY 1986-87 Article XIIIB required excess revenues to be returned by means of a tax rate reduction or fee reduction. The method selected to deal with the $1.1 billion in excess state revenues for the 1986-87 FY was to send rebate checks to 11.1 million personal income taxpayers.

The Limit Today. Revisions to the limit calculation implemented by Proposition 111 have continued to result in room under the appropriations limit in recent years. For example, California expected to be almost approximately $17 billion under the appropriations cap in FY 2011-12.

5. RELATIONSHIP BETWEEN THE STATE'S AND LOCAL GOVERNMENTS' LIMITS

Subventions. As noted above, subventions from the state to local governments that are unrestricted as to the purposes for which they may be spent are not counted as state expenditures subject to limit, but rather are counted against the local limit.

With respect to K-12 school districts, a portion of a district's revenue limit apportionment from the state constitutes a subvention for purposes of Article XIIIB. Subventions are defined as amounts necessary to fund the "foundation program," after taking into account local tax revenues. The "foundation program" represents a computed value that generally is less than the revenue limit amount. The balance of the regular apportionment, as well as apportionments for categorical programs, are not considered to be subventions. State subventions for community college districts are determined similarly.

Reporting Requirements. Legislation enacted in 1987 requires local entities to include information in their annual budget documents relating to their appropriations limits and their appropriations subject to the limit. Proposition 111 requires that the annual calculation of a local government entity's appropriations limit shall be part of that entity's annual financial audit.

6. CODE

California Constitution, Article XIIIB

Government Code Sections 7900-7914

Education Code Sections 41203-41206

CHAPTER 6A

OVERVIEW OF SPECIAL STATE TAX PROVISIONS AFFECTING SENIOR CITIZENS

HIGHLIGHTS

- Social Security Income Not Taxable
- Additional Personal Credits for Elderly and Blind
- Senior Head of Household
- Property Tax Reappraisal Relief for Senior Citizens
- No State Inheritance Tax

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1. OVERVIEW

California has several tax programs benefiting the elderly. While many of the provisions are not directed specifically at seniors and may, in fact, be aimed at other groups of citizens, persons over age 55 are frequently the beneficiaries. Below is a list of state tax provisions for which many senior citizens qualify.

2. PERSONAL INCOME TAX BENEFITS

Social Security Income Not Taxable. Under California income tax law, Social Security and Tier 1 Railroad Retirement benefits are not taxable. In contrast, federal tax law requires 50% of Social Security benefits to be taxed if: (a) so-called "provisional income" exceeds $32,000 for married filers filing joint returns; or (b) provisional income exceeds $25,000 for any other filing status; and 85% of benefits received to be taxed if: (a) provisional income exceeds $34,000 for single taxpayers; or (b) provisional income exceeds $44,000 for any other filing status. Married taxpayers that file separately are taxed on the total amount of benefits received. "Provisional income" equals a taxpayer's adjusted gross income plus any tax-exempt interest plus and any untaxed income from a foreign country plus one-half of a taxpayer's Social Security or Tier 1 Railroad Retirement benefits.

Additional Personal Credit for the Elderly and Blind. Every California taxpayer is entitled to personal exemption or dependent credits for all the members of the household.

An additional credit can be claimed for any person in a household who is (a) age 65 or older on the last day of the tax year; or (b) blind. A person who is both elderly and blind is eligible for two additional credits on top of the personal or dependent credit.

The additional personal credit for either an elderly person or a blind person is $102 ($204 if both elderly and blind) in the 2011 tax year and may be claimed on the taxpayer's personal income tax return.

Renters' Credit. The amount of credit allowed varies based on the taxpayer's adjusted gross income (AGI) and filing status. AGI amounts are indexed annually for inflation. In 2011, a credit of $120 is allowed for married/registered domestic partners (RDPs) filing joint returns, heads of household and surviving spouses if AGI is $71,318 or less, and $60 for other individuals (single or married/RDP filing separately) if AGI is $35,659 or less. The renters' credit is nonrefundable. See Chapter 6F (Renters' Credit) for more information.

Senior Head of Household. A California senior may claim a tax credit as a senior head of household in the amount of 2% of taxable income, up to a maximum of $1,228 for 2011, if certain conditions are met. The taxpayer must be 65 years of age or older by the end of the taxable year and must have qualified as head of household during one of the two preceding taxable years by providing a household for an individual who died during one of those years. In 2011, the taxpayer's adjusted gross income may not exceed $65,153. The maximum credit amount is indexed annually for inflation.

Tax Relief on Sale of Home. Like federal law, state law allows taxpayers to exclude up to $250,000 ($500,000 if married filing jointly) of gain realized on the sale or exchange of a principal residence. The exclusion is allowed each time a taxpayer selling a principal residence meets certain eligibility requirements, but generally no more frequently than once every two years. To be eligible for the exclusion, a taxpayer must have owned the residence and occupied it as a principal residence for at least two of the five years prior to the sale or exchange.

3. PROPERTY TAX BENEFITS

Property Tax Reappraisal Relief for Senior Citizens. Proposition 60, which was approved by voters in 1986, allows senior citizens over 55 years of age to maintain their property tax base year value for intra-county (within a county) replacements of principal residences. In order to carry over the base year value of the property sold, the replacement property value must be equal to or lower than the value of the senior's original residence. Seniors purchasing new homes in 2011, for example, may carry over their property tax base year value from their original home (for example, a home purchased in 1953) to their replacement home.

Proposition 90, approved by the voters in 1988, allows counties to extend Proposition 60 relief to inter-county (between counties) replacements of principal residences by seniors. However, this program is optional on the part of counties receiving the base year transfer (i.e., the new residence of the senior). Currently, only eight counties (Alameda, El Dorado, Los Angeles, Orange, San Diego, San Mateo, Santa Clara, and Ventura) accept inter-county base year transfers.

Taxpayers must claim the property tax reappraisal relief through the local county assessor. See Section 6 of Chapter 4 in this Reference Book for more information.

4. NO STATE INHERITANCE TAX

California's inheritance tax was repealed by Proposition 6 in 1982.

California now levies a "pickup" estate tax up to the maximum amount of the inheritance tax credit allowed against the federal estate tax. This "pickup" tax does not increase the overall tax liability of the estate. See Chapter 3D on Estate Tax for additional information.

5. CODES

California Constitution, Article XIIIA

Revenue and Taxation Code Sections 69.5, 17037, 17054, 17054.7, and 17087

CHAPTER 6A
OVERVIEW OF SPECIAL STATE TAX PROVISIONS AFFECTING SENIOR CITIZENS

CHAPTER 6B

SENIOR CITIZENS AND DISABLED PROPERTY TAX POSTPONEMENT PROGRAM

HIGHLIGHTS

• Type of Relief	Deferral of property taxes.	
• Eligibility	Age or disability, occupancy, income, and home equity criteria must be met (see below).	
• When to Claim	Annually.	
• Participants	2010-11	-0-
• Cost	2010-11	-0- *

*Chapter 4, Statutes of 2009, indefinitely suspended the program
Chapter 369, Statutes of 2011 enacted the county deferred property tax program and allows each county to participate in a local program.

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1. DESCRIPTION OF PROGRAM

The Property Tax Postponement program formerly available to qualifying senior, blind or disabled homeowners was indefinitely suspended by the Legislature on February 20, 2009. The Legislature also prohibited the State Controller from accepting applications from claimants.

Generally, the Property Tax Postponement program for senior citizens and blind or disabled persons allowed eligible homeowners to defer payment of all or a portion of the property taxes on their residences. Qualified applicants were issued two Certificates of Eligibility that may be submitted to the County Tax Collector as payment for their property taxes. The state then paid the county the amount of the deferred taxes on behalf of the homeowner.

The program acted as a loan from the state to eligible property owners. Interest rates were set each year based on the annual yield received by the state on its Pooled Money Investment Account. The loan is repaid when the taxpayer dies, sells the home, moves, or allows a "senior lien" to become delinquent. There was no maximum amount of postponed property taxes that could accumulate under the program.

For the purpose of the postponement program, "property taxes" include everything on the claimants' secured property tax bill, including special assessments, charges, and user fees, in addition to ad valorem taxes. Special assessments levied independently of the county tax bill are not eligible for postponement.

The tax postponement law was first passed in 1977 and was expanded several times. Originally designed for persons over 62 years of age, the program was available to eligible blind and disabled persons regardless of age. In many cases, delinquent property taxes were eligible for postponement if the person was eligible for the program when those taxes became delinquent.

The applicable simple interest rate and all interest charges are computed monthly and are added to the individual's postponement account, which is administered by the State Controller's Office. The interest rate for one year's balance of a postponement account does not carry over to the following year. For example, if the interest rate is 3% in 2003 and 2% in 2004, the taxpayer pays 3% interest on the balance of the 2003 account and 2% on the balance of the 2004 account, regardless of when the loan is repaid.

2. REPAYMENT OF POSTPONED PROPERTY TAXES

Repayment of postponed property taxes is required only under the following circumstances:

- The claimant dies or sells, conveys or disposes of the property, permanently ceases to occupy the premises, or allows any tax or assessment to become delinquent. Repayment is also required if he or she vacates the dwelling due to condemnation.

- The claimant allows foreclosure of liens to occur which have higher priority than that of the state (e.g., bank loans, mechanic's liens). In such cases, a notice of sale must be sent to the Controller by the foreclosing party.

3. COST

During FYs 2009-10 and 2010-11, no property taxes were postponed.

4. CODE

Health and Safety Code Section 18079

Government Code Sections 16180-16214

Revenue and Taxation Code Sections 20581-20646

CHAPTER 6C

OVERVIEW OF SPECIAL STATE TAX PROVISIONS FOR HOMEOWNERS

HIGHLIGHTS

- Sales of a Principal Residence
- Deductibility of Home Mortgage Interest
- Deductibility of Real Estate Taxes
- Property Tax Benefits
- Homeowners' Exemption
- Property Tax Reappraisal Relief

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1. OVERVIEW

California tax law contains a number of provisions for tax relief to homeowners. Tax relief is available for both property and personal income taxes, under certain circumstances.

2. PERSONAL INCOME TAX BENEFITS

Sale of a Principal Residence. Under Federal law, for sales or exchanges occurring after December 31, 2008, the gain attributable to any period of time after 2008 that the property was not used as the principal residence of the taxpayer, taxpayer's spouse, or former spouse, may not be excluded from federal taxable income. [Internal Revenue Code (IRC) Section 121(b)(4)(A) [sic IRC Section 121 (b)(5)(a)] as enacted by PL 110-289]. California has not conformed to this change.

Deductibility of Home Mortgage Interest. Under both state and federal tax law, individuals may deduct the interest on a home loan for their principal or secondary residence, subject to certain limitations. Interest is deductible on loans of up to $1 million used to purchase a home and on home equity loans of up to $100,000. However, the home equity loan may not exceed the difference between the fair market value of the home less the debt incurred to acquire the loan.

Deductibility of Real Estate Taxes Paid. Under both state and federal tax law, individuals who itemize deductions can claim deductions for real estate tax on Schedule A of their federal individual income tax return. Taxpayers are allowed to deduct only the amount of real estate tax paid during the year that is based on the assessed value of the property and not that portion that is assessed for a local benefit that tends to increase the value of the property. Amounts shown on the property tax bill that are not deductible include: special assessments, special taxes, fees, or other charges that are not computed based on the assessed value of the property, regardless of their purpose, with limited exceptions. Beginning with the 2012 California income tax return, the reporting requirements for real estate tax deductions will require taxpayers to include the property parcel number and deductible and nondeductible amounts

3. PROPERTY TAX BENEFITS

Homeowners' Exemption. Under the California Constitution, homeowners are eligible for a partial property tax exemption for their principal residence. The first $7,000 of the full value of the property is not taxed. So, if a principal residence has a base year value of $150,000, the amount on which property tax is assessed is $143,000. If the property tax rate is 1%, then the homeowners' exemption reduces the total tax from $1,500 to $1,430.

New owners must file with the county assessor by February 15 preceding the fiscal year for which the exemption is sought. If an eligible homeowner fails to file by February 15, he or she will receive 80% of the exemption, if a filing is made by December 10. (See Chapter 6D for more information on the homeowners' exemption.)

Property Tax Reappraisal Relief. Proposition 13 requires that property be reassessed at fair market value when there is a change of ownership or when it is newly constructed. Three significant exemptions from the change in ownership reassessment rule are:

- <u>Intra-family Transfers</u>. Under Proposition 58 of 1986, transfers of property between spouses are not considered changes in ownership (this codified implementing law previously enacted by the Legislature). In addition, Proposition 58 provided that transfers of principal residences plus transfers of up to $1 million of other property between parents and children are not subject to change in ownership reassessment.

  Proposition 193 of 1996 provided that transfers between grandparents and grandchildren are not subject to reassessment if the parents of those grandchildren are deceased as of the day of the transfer.

- <u>Replacement Residences of Senior Citizens</u>. Under Proposition 60 of 1986 and Proposition 90 of 1988, senior citizens may transfer the adjusted base year value of the principal residence to a replacement principal residence, if the replacement is of equal or lesser value and located in the same county. The same relief is available for moves between counties if the county where the replacement home is located has adopted an ordinance permitting the valuation transfer. (See Chapter 6A)

- Replacement Residences of Severely and Permanently Disabled Persons. Under Proposition 110 of 1990, severely and permanently disabled persons, as defined, may transfer the adjusted base year value of the principal residence to a replacement principal residence. To qualify, the person must obtain a doctor's certificate as to the disability and must certify that the cause of the move is the disability itself or its financial consequences. The replacement residence must meet the same value tests established under Propositions 60 and 90.

Several exemptions from reappraisal due to new construction are also available. Among these exemptions are construction to improve seismic safety in an existing building, construction to modify an existing residence or other structure to improve accessibility for the disabled, and construction on a residence severely damaged in certain types of disasters. Property acquired or reconstructed as a replacement for property destroyed as a result of environmental contamination cleanup activities may also be excluded from fair market value reassessment.

4. CODES

Revenue and Taxation Code Sections 63, 63.1, 69.5, 70, 218, and Section 17152

CHAPTER 6C
OVERVIEW OF SPECIAL STATE TAX PROVISIONS FOR HOMEOWNERS

CHAPTER 6D

HOMEOWNERS' EXEMPTION

HIGHLIGHTS

• Type of Relief	Property Tax	
• Eligibility	Anyone who, as of the January 1 lien date, owns and occupies a dwelling used as a principal residence.	
• When to Claim	Purchasers of residences are mailed a claim form that must be filed by February 15. A claim need only be filed once. For the supplemental assessment roll, the exemption must be claimed within 30 days following the date of notice of supplemental assessment.	
• Participants	5.5 million in 2010-11	
• Cost	2010-11 (Actual)	$438.1 million
	2011-12 (Estimate)	$434.5 million
	2012-13 (Estimate)	$438.8 million

Source: Governor's Budget Summary of 2012-13

1. DESCRIPTION OF EXEMPTION

The California Constitution [Article XIII, Section 3(k)] exempts the first $7,000 of the full value of a dwelling occupied as the owner's principal residence on the January 1 lien date from property taxation. For instance, if a principal dwelling has an adjusted base year value of $150,000, it will be assessed at $143,000 after deduction of the homeowners' exemption. The Legislature must reimburse local governments for property tax revenue lost due to this exemption pursuant to Article XIII, Section 25 of the California Constitution.

2. ELIGIBILITY

To be eligible for the homeowners' exemption, a person must occupy, as a principal place of residence, a dwelling that he or she owns. This includes mobilehomes assessed for property tax purposes. Owners of condominiums, cooperatives, and multiple residence dwellings are eligible for the exemption on the assessed value attributable to the portion they occupy.

The exemption does not extend to property that is rented, vacant, or under construction on January 1, nor does it apply to vacation or secondary homes of the owner, or to a dwelling on which an owner receives the veterans' or disabled veterans' exemption.

The exemption relates to a specific parcel of real property owned by a qualified individual. When a property with a homeowners' exemption in effect is sold, the property retains the exemption so the benefit of the homeowners' exemption transfers to the purchaser for a limited time.

If the previous owner claimed the homeowners' exemption on the property, the property sold retains its exemption for the remainder of the fiscal year and that exemption will be automatically applied to the tax bill. However, the new owner must apply for the homeowners' exemption for the subsequent fiscal year.

If the previous owner failed to file or did not qualify for the exemption, the new owner may apply for the exemption on the supplemental roll after the change of ownership. (See Chapter 4 of this Reference Book for more information on the supplemental roll). In addition to filing the application on a timely basis, the owner must meet the requirement for the exemption no later than 90 days after the date of the change of ownership.

3. APPLICATION PROCEDURE

Eligible homeowners filing for the exemption for the first time must file with the county assessor by February 15 preceding the fiscal year for which the exemption is sought. If an eligible homeowner fails to file by February 15, he or she will receive 80% of the exemption, if a filing is made by December 10. If the owner misses the December 10 filing date, no exemption is allowed for that year.

Once an eligible homeowner files for the exemption, that owner will be automatically granted the exemption for that property in future years. The homeowner is responsible for notifying the assessor only when he or she is no longer eligible. Penalties are assessed for failure to do so.

For assessments on the supplemental roll, the eligible homeowner must file for the exemption with the county assessor on or before the 30th day following the date of notice of the supplemental assessment and must meet the exemption requirements no later than 90 days after the date of the change of ownership or date of completion of new construction. If an eligible homeowner fails to file on a timely basis, he or she will receive 80% of the total exemption if filing is made on or before the date on which the first installment of supplemental taxes becomes delinquent.

4. LIMITATIONS ON EXEMPTION INCREASES

The Constitution allows the Legislature to increase the size of the homeowners' exemption, but if it does so, two other actions are required:

- The Legislature must increase the rate of state taxes in an amount sufficient to pay for the increased cost of state subventions to local governments; and

- The Legislature must provide a comparable increase in benefits to qualified renters.

5. COST

The state cost of the homeowners' exemption was $438.1 million in fiscal year (FY) 2010-11, and is estimated to be $434.5 million in FY 2011-12, and $438.9 million in FY 2012-13. These amounts are subvened to local governments to compensate for the loss in property tax revenue.

Over 5 million homeowners receive this exemption.

6. CODE

California Constitution, Article XIII, Section 3(k)

Revenue and Taxation Code Section 218

Government Code Sections 16120-16123

CHAPTER 6D
HOMEOWNERS' EXEMPTION

CHAPTER 6E

RENTERS' CREDIT

HIGHLIGHTS

• Type of Relief	The renters' credit is a nonrefundable personal income tax credit intended to provide partial relief from the property tax.	
• Eligibility	Any person who rented and occupied a California premises as a principal residence for at least 50% of the taxable year.	
• Amount of Credit	$60 (single and married filing separately), $120 (married filing jointly, head of household, and surviving spouse).*	
• Cost to the General** Fund	2009-10	$160 million
	2010-11	$150 million
	2011-12	$140 million

*The credit is phased out above specified adjusted gross incomes
**Costs to the General Fund are initially estimated and revised as data becomes available
Source: Franchise Tax Board

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1. DESCRIPTION OF CREDIT

Under California law, qualified renters are allowed a nonrefundable personal income tax credit. The credit is a flat amount and is unrelated to the amount of rent paid. In 2011, a $120 credit is available to married taxpayers filing jointly, heads of households, and surviving spouses with adjusted gross incomes of $71,318 or less. A $60 credit is available to single taxpayers and married taxpayers filing separately with adjusted gross incomes of $35,659 or less. These phase-out amounts are indexed annually for inflation. The rate of inflation in California, for the period from July 1, 2010 through June 30, 2011, was 2.6%. The 2011 phase-out amounts are indexed by this amount.

2. ELIGIBILITY

- A "qualified renter" is an individual who:
- Is a California resident; and

- Rented and occupied California premises constituting his or her principal place of residence for at least 50% of the taxable year. Persons residing in mobilehomes qualify if the land on which their mobilehome sits is rented.

Any otherwise qualified renter who is a nonresident for a portion of the taxable year is allowed 1/12 of the renters' credit for each full month that the individual resides in the state during the taxable year.

A "qualified renter" does not include individuals:

- Who for more than 50% of the taxable year rented and occupied premises that were exempt from property taxes;

- Whose principal place of residence for more than 50% of the taxable year was with any other person who claimed that individual as a dependent for income tax purposes; or

- Who has been allowed or whose spouse has been allowed the homeowners' property tax exemption during the taxable year.

The Revenue and Taxation Code defines a resident as:

- Every individual who is in this state for other than a temporary or transitory purpose; and

- Every individual domiciled in this state who is outside the state for a temporary or transitory purpose.

3. APPLICATION PROCEDURE

All California personal income tax booklets include a Nonrefundable Renter's Credit Qualification record. By answering the questions on the qualification record, taxpayers can determine if they qualify to claim the nonrefundable renter's credit.

A separate application is not required. Those who qualify may claim the credit on their tax returns.

4. COST TO GENERAL FUND

The state cost of the renters' credit was $150 million in fiscal year (FY) 2010-11, and is estimated to be $140 million in FY 2011-12.

5. CODE

Revenue and Taxation Code Section 17053.5

CHAPTER 6F

OPEN SPACE AND AGRICULTURAL LAND CONTRACTS (WILLIAMSON ACT)

HIGHLIGHTS

• Type of Relief	Partial relief from the property tax.	
• Eligibility	Must own agricultural, open space, or recreational land.	
• When to Claim	Contracts may be signed with local governments any time, depending on county or city rules.	
• Number of Acres Under Contract	16.6 million	
• Cost to State	2010-11	$1,000.00
	2011-12	$1,000.00
	2012-13	$1,000.00

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1. DESCRIPTION OF PROGRAM

The California Land Conservation Act of 1965 (the Williamson Act), enables cities and counties to enter into contracts with landowners to restrict land for agricultural use. Participating landowners receive a tax reduction, because the land is valued according to the income it generates from agriculture (use value) rather than fair market value. State subvention payments are made to local governmental agencies as partial reimbursement for the tax revenue lost due to the preferential assessment of land under contract.

Beginning in 1999, SB 1182 (Costa), Chapter 353, Statutes of 1998, established the Farmland Security Zone (FSZ) provisions of the Williamson Act. These FSZ provisions permit landowners to rescind their Williamson Act contracts and create FSZ contracts. These latter contracts give landowners a greater property tax reduction but restrict the land for agricultural purposes for a longer period of time. Land subject to a FSZ contract is valued at 65% of the value assigned under the Williamson Act. The FSZ contracts were further defined by SB 649 (Costa), Chapter 1019, Statutes of 1999. (See Chapter 4 of this Reference Book for more information on standard property tax valuation procedures.)

The purpose of the Williamson Act is to preserve the limited supply of agricultural land, especially prime agricultural land, and to discourage the premature and unnecessary conversion of agricultural land to urban usage. In addition to agricultural land, open space land categories allowed as compatible uses in agricultural contracts or under Williamson Act open space contracts are scenic highway corridors, wildlife habitat, salt ponds, managed wetlands, submerged areas, recreational lands and lands enrolled in either the United States Department of Agriculture conservation reserve program or conservation reserve enhancement program. The FSZs are intended to strengthen the Williamson Act by expanding the options available to landowners and local governments, including providing landowners with a guaranteed reduction in property taxes. In return for the increased tax benefits paid to local landowners, FSZ contracts are twice as long, and contract cancellation more difficult and twice as expensive.

2. ELIGIBILITY

Any city or county with a general plan may elect to establish agricultural preserves. An agricultural preserve must be at least 100 acres, unless a city or county determines that a smaller preserve is justified by the unique characteristics of the agricultural enterprises in the area, and if the size is consistent with the general plan.

A city or county may impose restrictions, terms and conditions, including payments and fees, in addition to those allowed under the Williamson Act. They may also establish the compatible uses allowed in preserves relative to agricultural uses or production.

3. METHOD OF ASSESSMENT

Both Williamson Act and FSZ property is subject to the assessment by one of three methods:

- Capitalization of Income. Contracted property is assessed on the basis of current capitalized income, which reflects its income producing or "use" value.

- Unrestricted Value. The property is valued at its unrestricted, factored, base year value. This is the method used for most all other property pursuant to Proposition 13 (Article XIIIA of the California Constitution).

- Current Market Value. Market value assessment is based on the current, comparable sales approach.

The lesser of the capitalization of income, factored base year value, or current market valuation is used to determine the amount of property taxes owed on land enrolled in Williamson Act contracts.

An alternate method of assessment (Revenue and Taxation Code Section 423.3), which is voluntary on the part of cities and counties, enables a lower Williamson Act value to be established than under either acquisition value or current market value. Currently, only San Joaquin, Ventura, Imperial, and Sonoma counties use this method.

The assessment approach used in a given year will vary depending on whether farm income is high or low in comparison with property valuation factors. The state, through a subvention program, partially reimburses local governments for the tax revenue loss resulting from participating in the Williamson Act program and for the costs to administer the local program. The subvention is based on the type of land under contract (prime or nonprime), rather than on the actual tax revenue loss. Subvention payments are $5.00 per acre for prime land and $1.00 per acre for nonprime land. However, subvention payments of $8.00 per acre are paid for FSZ land that is located within an incorporated city or within three miles of the sphere of influence of that city. In fiscal year (FY) 2008-09, AB 1389 reduced subvention payments by 10%. In FY 2009-10, subventions were reduced to $1,000 in the budget. In FY 2010-11, subventions were reduced to zero.

4. THE CONTRACTS

Each Williamson Act contract runs for a minimum of 10 years (Sacramento, Mariposa, and Monterey counties have allowed 20-year contracts) and is automatically renewed each year, unless either the landowner or local government files for nonrenewal. FSZ contracts have an initial 20 year term and automatically renew each year. If a contract is not renewed, contractual restrictions remain for nine more years for Williamson Act contracts and 19 more years for FSZ contracts. During that period, taxes on the property gradually return to the level of taxes on unrestricted property according to a schedule specified in statute.

A landowner who wishes more immediate cancellation of an existing contract may petition the local government to cancel the contract but must pay a fee equal to 12.5% of the fair market value of the property for Williamson Act property or 25% of the fair market value of the property for FSZ property. Cancellation may only be granted after a board of supervisors or city council has made specified findings. The Department of Conservation's approval is also requested for cancellation of an FSZ contract. Recent court cases have emphasized that nonrenewal is the preferred method of terminating a Williamson Act contract.

AB 1265 (Nielson), Chapter 90, Statutes of 2011, authorized local jurisdictions until January 1, 2016, to revise the terms of Williamson Act contracts and allowed for a reassessment of the property in any fiscal year if, in the previous fiscal year, the local jurisdiction received less than one-half of the foregone property tax revenues in subventions from the state.

5. CONTRACT APPLICATION PROCEDURE

Application to place land under contract must be submitted by landowners to the city or county planning department.

6. CODE

California Constitution, Article 13, Section 8

California Administrative Code Title 14, Chapter 2

Government Code Sections 16140-16154, and Sections 51200-51297.4

Revenue and Taxation Code Sections 421-430.5

CHAPTER 6G

MOBILEHOME TAXATION

HIGHLIGHTS

• Mobilehomes Taxes	Sales or use tax when sold. Property Tax or Vehicle License Fee (VLF), depending on date of mobilehome purchase.
• Tax Exemptions	Partial sales or use tax exemption for some mobilehomes.
• Administration	Sales and Use Tax: Board of Equalization (BOE) Property Tax: County Assessor Vehicle License Fee: Department of Housing and Community Development (HCD)

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1. OVERVIEW OF MOBILEHOME TAXATION

The taxation of mobilehomes is somewhat complex. Since the late 1970s, the law has been modified many times to reflect the changing role of mobilehomes in our society from primarily vehicles to primarily stationary housing. Mobilehomes are generally subject to two major kinds of taxes: (a) sales or use taxes at the time of sale or resale, and (b) either the property tax or the VLF annually. When applied to mobilehomes, the VLF is commonly called the "in-lieu tax (ILT)", as it is seen as a tax in lieu of the property tax. The specifics of these taxes are summarized below.

2. SALES TAXES ON MOBILEHOMES

The following guidelines are used when applying the sales tax to mobilehomes.

For New Mobilehomes:

- A new mobilehome sold after July 1, 1980, to a customer for occupancy as a residence is subject to use tax on 75% of the dealer's cost, regardless of whether or not the mobilehome is installed on a permanent foundation. This represents a partial exemption, since the sales tax is normally applied to 100% of the retail price of an item.

- A new mobilehome sold for any nonresidential use is subject to sales tax on 100% of the sales price of the mobilehome.

<u>For Used Mobilehomes</u>:

- A used mobilehome that is subject to the local property tax (see below) is exempt from the sales tax.

- A used mobilehome that is subject to VLF (see below) is subject to sales tax based on its current value, as determined by a recognized value guide, if the sale is:

  a) Through a person licensed as a dealer and not on the dealer's own account;

  b) Through a licensed real estate broker; or

  c) A private party transaction.

  However, if the value guide does not include the age, model, and manufacturer of the particular mobilehome, or if the actual sales price is less than the value specified in the value guide, the sales tax is based on the actual sales price of the mobilehome.

- A used mobilehome subject to VLF is subject to sales tax based on the sales price of the mobilehome if it is sold by a dealer acting on his or her own account and not as a broker.

  The sales price includes charges for awnings, skirting, and other property sold with the used mobilehome that is not directly affixed to real property. Separately stated charges for existing real property improvements (such as concrete, landscaping, or in-place location value) are not subject to the sales tax.

3. DETERMINING WHETHER A MOBILEHOME IS SUBJECT TO THE PROPERTY TAX OR VEHICLE LICENSE FEE

- New mobilehomes installed on a permanent foundation system are considered a fixture improvement to the underlying real property and are taxed in the same manner as conventional housing (See Chapter 4 of this Reference Book for a description of the Local Property Tax.)

- New mobilehomes sold prior to July 1, 1980 and installed on a nonpermanent foundation system are subject to VLF. (See Chapter 3F of this Reference Book for a description of the VLF.)

- New mobilehomes sold on or after July 1, 1980 and installed on a nonpermanent foundation system are classified as personal property, but special provisions in the law essentially treat mobilehomes the same as real property.

- ° Used mobilehomes that are sold are taxed under the tax system that applied to the home before the sale.

- ° Owners of pre-July 1, 1980, mobilehomes subject to VLF continue to be taxed that way, unless the owner chooses to transfer the mobilehome to the property tax roll.

- ° Owners of pre-July 1, 1980, mobilehomes subject to VLF that are located in a mobilehome park converted or proposed to be converted to a resident-owned subdivision, cooperative, condominium, or nonprofit corporation may choose to transfer the mobilehome to the property tax roll.

- ° Mobilehomes subject to VLF on which the registration lapsed for 120 days or more between July 1, 1980, and October 1, 1984, and on which reinstatement to the VLF system was not applied for by December 31, 1986, were automatically placed on the property tax rolls, with delinquent taxes and fees included in the property tax bill.

- ° Mobilehome accessories (e.g., skirting, awnings, etc.) are also subject either to the property tax or the vehicle license fee.

- ° Accessories purchased as part of the mobilehome package prior to 1977 are subject to VLF. Generally, accessories purchased after July 1, 1980, are subject to the property tax when they are affixed to a mobilehome placed on a permanent foundation or affixed directly to real property. Accessories purchased between 1970 and 1980 are subject to one or the other of those two taxes, but not both.

4. HOW THE PROPERTY TAX APPLIES TO MOBILEHOMES

Mobilehomes subject to property tax are entered on the secured roll by the county assessor and are eligible for the homeowners' exemption. Where the resident owns both the mobilehome and the underlying land, a single property tax bill for land and improvements is issued. The mobilehome owner is also eligible for property tax relief available to other homeowners, such as Property Tax Assistance or Property Tax Postponement. (See Chapter 4 of this Reference Book for a description of the secured roll, Chapter 6E for a discussion of the Homeowners' Exemption, Chapter 6B for a description of the Senior Citizens Property Tax Assistance Program, and Chapter 6C for a description of the Senior Citizens Property Tax Postponement Program.)

Often, an occupant of a mobilehome will own the mobilehome but lease or rent the underlying land. In that case, the land is separately assessed to the mobilehome park owner. The homeowner may claim the homeowners' exemption in this situation.

The general rules established by Proposition 13 regarding property tax rates and valuation apply to mobilehomes subject to property tax (see Chapter 4). If the fair market value of the mobilehome declines below the adjusted base year value, the assessor will reassess the mobilehome downward under the decline in value provisions, as described in Chapter 4. Special rules also apply to disaster damage to mobilehomes.

5. HISTORY OF MOBILEHOME TAXATION

Prior to 1979, it was illegal to place a mobilehome on a permanent foundation, and mobilehomes were treated as vehicles for tax purposes. Thus, mobilehome owners paid an annual vehicle license fee set at 2% of market value that was depreciated each year according to a statutory schedule. Most of the VLF revenue at that time was allocated to cities, counties and schools by formula on the basis of population. Mobilehome owners renting space in mobilehome parks were eligible for the Renters' Credit and Senior Citizens Renter Assistance, but were not eligible for the homeowners' exemption or the Senior Citizens Property Tax Assistance and Postponement Programs.

After major mobilehome taxation legislation passed in 1979 and 1980, most existing mobilehomes continued to be taxed basically as they had been. These homes remained subject to VLF, which has provided them with considerable reductions in their tax liabilities as the state has enacted several VLF rate reductions.

However, mobilehomes purchased new after July 1980 and occupied as residences are now treated very much like conventional homes with respect to property tax liability. Over time, most mobilehomes occupied as residences will be subject to local property taxation rather than VLF.

6. COMPARISON OF TAXATION OF CONVENTIONAL HOUSING AND MOBILEHOMES

The purchaser of a conventional home does not pay sales tax on the purchase price of the home. Instead, the sales tax has been imposed during the construction of the home through building materials sold to the builder. The purchaser of a new mobilehome pays the sales tax on a portion of the retail price of the home, since the tax is based on 75% of the dealer's price (presumably less than the retail price). The purchaser of a used mobilehome subject to the property tax does not pay sales tax on the purchase.

For factory-built housing, only 40% of the cost to the buyer is subject to sales tax, which is intended to represent the portion attributable to materials.

Owners of both conventional homes and mobilehomes are eligible for various types of tax relief, including income tax deductions of home mortgage interest, the homeowner's property tax exemption, property tax assistance and postponement, etc.

Transfers of mobilehomes installed on non-permanent foundation systems are processed by the HCD and are not subject to any local government-imposed documentary transfer taxes. Transfers of mobilehomes installed on permanent foundations, which are considered to be an improvement to the real property to which they are attached, are handled at the local government level through the county recorder's offices. There may be fees assessed by local governments on these transfers.

7. ADMINISTRATION

The BOE administers the sales and use tax on mobilehomes, the local county assessor administers property taxation of mobilehomes, and HCD administers the VLF. Although most VLF on mobilehomes is collected by HCD, the Department of Motor Vehicles (DMV) still registers and collects VLF on occasional mobilehomes. Generally speaking, HCD is authorized to collect delinquent VLF, while local county assessors are authorized to collect delinquent property taxes. In a very small number of instances (i.e., VLF collected by DMV on occasional mobilehomes), Franchise Tax Board is authorized to collect delinquencies.

8. CODE

Health and Safety Code Sections 18000-18700

Revenue and Taxation Code Sections 5800 et. seq., 6012.2, 6012.7, 6012.8, 6012.9, 6276.1, 6379, and 10701 et seq.

For property tax purposes, both mobilehomes and conventional homes are subject to the same Proposition 13 valuation rules, as described above and in Chapter 4 of this Reference Book.

CHAPTER 6G
MOBILEHOME TAXATION

CHAPTER 7

OVERVIEW OF CALIFORNIA TAX ADMINISTRATION

HIGHLIGHTS

- Franchise Tax Board (FTB)
- Board of Equalization (BOE)
- Employment Development Department (EDD)
- Local Property Taxes

California's tax system is administered by a number of different state agencies, as well as by county assessors (Table 12). These agencies are charged with implementing tax law, enforcing tax statutes, collecting tax liabilities, and remitting moneys collected to the state's General and special funds and local jurisdictions. Two agencies share responsibility for the "big three" state taxes - personal income, corporation, and sales and use taxes. The FTB administers the personal income and corporation taxes. The BOE administers the sales and use tax. The BOE also serves as an appeals panel for taxpayer disputes with FTB.

This chapter outlines the responsibilities of the various administrative agencies. For additional information or answers to specific questions, please refer to sections of this Reference Book dealing with specific taxes or contact the administering agency.

1. FRANCHISE TAX BOARD

The FTB administers the Personal Income and Corporation Tax Laws. Together these taxes raised 63.2% of the state's General Fund revenues during the fiscal year 2010-11. The FTB is charged with developing and maintaining compliance, reporting, and payment systems for these two taxes. In addition, the FTB performs Political Reform Act audits and collects delinquent Vehicle License Fees and court-imposed payments. The FTB also collects delinquent fees, wages, and penalties for the Department of Industrial Relations.

A three-member board consisting of the State Controller, the Chair of the BOE, and the Director of the Department of Finance governs the FTB.

Personal Income Tax. The personal income tax is a self-assessed tax. Returns are due from individual taxpayers on April 15th for the preceding year for most individuals.

Personal income taxes are withheld from taxpayers' wage and salary income throughout the year. Quarterly estimated tax payments are required on income that is not subject to withholding. The tax liability that exceeds the tax withheld is due together with the tax return on April 15[1]. Amounts withheld in excess of taxes due can be claimed as a refund or applied to the next year's tax liability on the taxpayer's return.

Corporation Tax. Corporation taxes are also self-assessed. Corporation tax returns are due on the 15th day of the third month following the close of the taxable year. Corporations are required to pay estimated taxes in quarterly increments.

Appeals Process. After examining a taxpayer's return or conducting an audit, the FTB may issue a Notice of Proposed Assessment (NPA) indicating that additional taxes are owed (i.e., that a deficiency exists) for taxes administered by the FTB. Taxpayers, whether personal income or corporation tax filers, that dispute a deficiency assessment proposed by the FTB can protest and appeal using the following procedures:

- Within 60 days after the NPA (deficiency) is issued, a taxpayer must file a written notice of protest with the FTB. The taxpayer is not required to pay any amount under dispute at this time. However, if the proposed deficiency assessment is eventually determined to be owed, interest will accrue from the initial due date.

- The FTB reviews the protest, reviews documentation or holds a hearing as required, and notifies the taxpayer of the disposition with a Notice of Action (NOA).

- Taxpayers who dispute a NOA may appeal to the BOE in writing within 30 days after the date the FTB mails the NOA to the taxpayer. The BOE will then consider the appeal and, where appropriate, hold a hearing on the appeal. It is not necessary for the taxpayer to pay the tax prior to filing an appeal with the BOE. The BOE will affirm, reduce, or eliminate the deficiency assessment.

- Taxpayers who disagree with the BOE's final determination may file suit in Superior Court. However, in all cases other than those involving a determination of residency, the taxpayer must pay the amount in dispute and file a claim for refund with the FTB before filing the suit.

The FTB or BOE may abate interest relating to a deficiency assessment to the extent the interest is attributable to an unreasonable error or delay by the FTB in performing a ministerial or managerial act. If the BOE determines that the FTB's action was unreasonable, the taxpayer also may be eligible for reimbursement of reasonable fees and expenses incurred in pursuing the appeal.

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[1] Due on April 17^{th} for 2011 Taxable Year

When the BOE's determination on the NOA is final and if the amount due remains unpaid, the FTB may pursue collection activities. The collection activities may include filing a public tax lien, levying on wages and/or bank accounts, and seizing and selling property. Applicable interest rates on amounts due and on the imposition of penalties are specified in statute.

Income Tax Settlement Authority. The FTB also has authority to settle civil tax matters in dispute without using the normal appeals process. Settlement authority applies to both personal income and corporation tax disputes. The FTB settlement authority is patterned on federal settlement authority and is intended to provide an alternative to the cost and risks inherent in litigation.

In situations where the proposed reduction of tax and/or penalties exceeds $8,800, any recommended settlement must be reviewed by the Attorney General for reasonableness from an overall perspective. The recommended settlement is then presented to the FTB (Board) in closed session. The Board must approve or disapprove the settlement recommendation within 45 days or it will be deemed approved. Disapproval must be by majority vote of the Board. Cases that involve reductions of tax and/or penalties of $8,800 or less are reviewed and approved by the Executive Officer and Chief Counsel, jointly.

All settlements involving reductions of taxes or penalties in excess of $500 become matters of public record.

2. BOARD OF EQUALIZATION

The BOE administers the Sales and Use Tax Law, a number of business taxes and environmental fees, property taxation of public utilities, and has oversight responsibility for local property tax administration. The Board itself consists of four elected members and the State Controller. The Board also adopts regulations necessary to implement the taxes and fees it oversees.

Sales and Use Tax. The BOE collects sales and use taxes from retailers and distributes revenues due to the state and to local jurisdictions. The BOE also administers transactions and use taxes for local jurisdictions on a contract basis, retaining a small portion of the revenues as an administrative fee.

The BOE routinely audits taxpayers to determine whether sales and use taxes are accurately reported. If BOE determines that there is a deficiency, it must provide the taxpayer with written notice of the determination. The taxpayer may file for redetermination within 30 days. After a petition for redetermination is made, a hearing before the BOE is held.

State-Assessed Property. The BOE assesses property owned by public utilities operating in multiple counties. The BOE assigns a value to the property in each county and allocates that value to individual county assessors, who are responsible for levying and collecting any property taxes due. Disputes over values assigned to state-assessed properties may be taken to the Board members for a formal hearing.

Other Taxes. The BOE is also responsible for administering and collecting a number of other taxes and fees, which are collectively known as BOE's "Special Taxes and Fees". These taxes and fees include the Motor Vehicle Fuel Tax, Diesel Fuel Tax, Use Fuel Tax, Alcoholic Beverage Tax; Cigarette and Tobacco Products Tax; Energy Resources and Emergency Telephone Users Surcharges, Hazardous Waste Taxes and Integrated Waste Management Fees, Tire Recycling Fees, Lead Poisoning Prevention Fees, Oil Spill Fees, the Timber Yield Tax, and the Private Railroad Car Tax. Payers of these taxes and fees are subject to the same appeals process outlined for the sales and use taxes.

Settlement Authority. The BOE has been granted settlement authority to help resolve disputes involving sales and use taxes and the various special taxes noted above. The BOE's settlement authority is similar to that described above for FTB. However, for settlements in which the reduction of tax or fee exceeds $500, the law requires that a public record statement, available for public review, be placed in the Office of the Board's Executive Director.

3. EMPLOYMENT DEVELOPMENT DEPARTMENT

The EDD administers the Unemployment Insurance (UI), Employment Training Tax (ETT), and State Disability Insurance (SDI) tax programs. In addition, EDD is responsible for ensuring that personal income taxes are withheld from the wage and salary income of workers.

Unemployment Insurance. Unemployment Insurance taxes are levied on the first $7,000 of income for covered employees each year. The tax is paid by the employer and collected by EDD. If EDD assesses a deficiency against an employer, the taxpayer has 30 days to petition for reassessment. This petition is reviewable by an Administrative Law Judge and may be appealed to the Unemployment Insurance Appeals Board.

Employment Training Tax. Regardless of their UI tax rate, all employers are assessed an additional 0.1% as an employment training tax, except for those employers with a negative reserve account balance.

State Disability Insurance. State disability insurance (SDI) is paid by employees and covers approximately 13 million California workers. Employees who work for multiple employers and earn income in excess of the wage base may file for a refund of excess contributions on the taxpayer's personal income tax return.

Paid Family Leave. Paid Family Leave insurance is a component of SDI and extends disability compensation to cover individuals who take time off from work to care for a seriously ill child, spouse, parent, or domestic partner, or to bond with a new child. Employers are required to deduct the Paid Family Leave contributions from the wages of employees who are covered by the SDI program.

Personal Income Tax Withholding. The EDD's tax branch administers the reporting, collection, and enforcement of personal income tax withholding. "Withholding" represents the money that employers are required to hold back from employees' wages. Amounts withheld are based on each employee's W-4 or DE-4, forms that are on file with each employer and that contain information regarding the tax status of the employee.

Settlement Authority. The EDD has the authority to settle certain civil employment tax disputes. The Settlement Program provides employers and the EDD an opportunity to avoid the cost of prolonged litigation associated with resolving disputed payroll tax issues (i.e., protests, appeals, or refund claims). When reviewing a settlement offer, the EDD considers the risks and costs to the State associated with litigating the issues, balanced against the benefit of reaching a settlement agreement. Final tax liabilities, cases still in process, cases involving fraud or criminal violations, and issues solely involving fairness or financial hardship are generally not eligible. Depending on the reduction of tax and penalties, settlement agreements are subject to approval by an Administrative Law Judge, the California Unemployment Insurance Appeals Board, and the Attorney General before they can be finalized.

4. INSURANCE GROSS PREMIUMS TAX

Three agencies share responsibility for administering the Insurance Gross Premiums Tax - the Department of Insurance, BOE, and State Controller. The Department of Insurance issues permits for each class of insurance, processes returns, and audits taxpayers. The BOE issues assessments, processes petitions, and hears appeals. The State Controller makes refunds and collects delinquencies and penalties.

5. LOCAL PROPERTY TAXES

Property taxes are assessed and collected at the local level for all property except that held by public utilities. Property held by public utilities is assessed by the BOE.

Property is assessed annually as of 12:01 A.M. each January 1. On this date, any taxes due become a lien on the property. Property owners can appeal the value of their property by filing an application for change in assessment with the Board of Supervisors or assessment appeals board between July 2 and September 15 each year (in some counties until November 30) for properties on the regular roll. Supplemental and escape assessments must be appealed within 60 days of the date the notice of change in assessment is mailed.

The Board of Supervisors of each county serves as a BOE for locally-assessed property to assure comparable valuation of property. Assessment appeals go before the Board or the assessment appeals board, if one exists in that county. Decisions of the county may only be appealed to court in certain limited circumstances: arbitrariness, lack of due process, abuse of discretion, failure to follow standards established by law, or for other specified reasons. Legal actions must be filed in Superior Court within six months after a claim for refund is denied by the county board.

The BOE oversees local assessment practices and develops standards for local assessment. In addition, the BOE periodically evaluates the performance of individual county assessors.

6. MOTOR VEHICLE TAXES

The Department of Motor Vehicles (DMV) administers the vehicle license, registration, and weight fees. The FTB is responsible for collecting delinquent vehicle license and registration fees. These fees are paid annually at the time of vehicle registration. The trailer coach (mobilehome) fee is administered by the Department of Housing and Community Development and is also paid annually. The Motor Carrier tax is levied by the Public Utilities Commission (PUC) and is paid quarterly. Motor Carrier tax appeals are filed with and heard before the PUC.

7. STATE CONTROLLER

The State Controller administers and collects the Estate Tax. This tax is levied as a portion of the federal tax. The tax is due on the date of death and becomes delinquent after nine months.

8. TAXPAYERS' BILL OF RIGHTS

In 1988, the Taxpayers' Bill of Rights was enacted in California to set certain standards for tax administering agencies and provide taxpayers with protection against unreasonable action. Specific provisions of the Bill of Rights include:

- Establishment of Taxpayers' Rights Advocates in the FTB and the BOE;
- Requiring state agencies to respect the confidentiality of taxpayer information;
- Setting standards for hearing and appeals procedures;
- Defining conditions under which taxpayers can receive reimbursement for fees and expenses incurred while pursuing an appeal; and,

- Restricting the types of property and the conditions under which property may be sold to satisfy a tax levy.

In 1997, the California Taxpayers' Bill of Rights 2 was enacted to conform California's income and franchise tax laws to the federal Taxpayers' Bill of Rights 2 and in so doing to expand the protection afforded to taxpayers. The California Taxpayers' Bill of Rights 2 was extended to California's Sales and Use Tax Law in 1998 and to California's special taxes and fees in 1999. Some of the many provisions of the Taxpayers' Bill of Rights 2 include the following:

- The burden of proving correctness of information provided on third-party information returns (e.g., W-2s or 1099s) may shift to the FTB once the taxpayer complies with certain conditions;

- Interest attributable to unreasonable errors or delays caused by the FTB or the BOE staff performing a ministerial or managerial act may be abated;

- Taxpayers have an additional five days to pay deficiency assessments after receiving a notice and demand;

- A levy must be released if made in violation of the FTB or the BOE administrative procedures or if it is in the state's best interest to do so;

- Taxpayers' litigation costs and appeal expenses may be reimbursed;

- Taxpayers may sue the state for damages if the FTB or the BOE staff intentionally entice a taxpayer's representative to provide information about the taxpayer by offering to settle the representative's tax liability;

- Taxpayers qualifying to file a joint return may file such a return even though prior separate liabilities of the taxpayer's spouse may be unpaid;

- Payers of interest, dividends, or wages must include their telephone number in the information report they file;

- Delinquent taxpayers must be given annual notice of their delinquency;

- Notice of termination of an installment payment agreement as well as the basis thereof must be mailed to the taxpayer 30 days prior to termination;

- The FTB must make a reasonable attempt to contact a taxpayer if it cannot locate a taxpayer's account within 60 days of receiving payment;

- Enrolled agents are deemed as third-party recordkeepers for purposes of relating to issuance of subpoenas;

- The FTB regulations may apply retroactively only in specified circumstances; and,

- Mail sent through the IRS-designated private delivery services are considered as if sent via the U.S. Postal Service.

In 1999, California conformed its personal income and corporation taxes to many of the provisions of the federal Taxpayer Bill of Rights 3, enacted by Congress in 1998 as part of the Internal Revenue Service Restricting and Reform Act. A few examples of California's conformity to the federal Taxpayer Bill of Rights 3 include:

- Innocent spouse relief;

- Suspension of interests and penalties if the FTB does not notify a taxpayer about amounts owed;

- Prohibition against the FTB using financial status to determine unreported income;

- Requirement that the FTB notify taxpayers before notifying third parties regarding the determination or collection of the taxpayer's liability;

- Requirement that the FTB release a wage levy if tax is uncollectible;

- Limitation on the FTB selling principal residences to satisfy unpaid liabilities; and,

- Waiver of early withdrawal penalties when retirement plans are levied.

TABLE 9

TAX ADMINISTRATION RESPONSIBILITIES

Tax	Responsible Agency
Alcoholic Beverage Tax	
Tax Collection	Board of Equalization
Licensing & License Fee Collection	Department of Alcoholic Beverage Control
Corporation Tax	Franchise Tax Board
Cigarette and Tobacco-Related Products Tax	Board of Equalization
Emergency Telephone User's Surcharge	
Rate Setting	Department of General Services
Tax Collection	Board of Equalization
Estate Tax	State Controller
Gasoline, Diesel, Use Fuel Taxes	Board of Equalization
Insurance Gross Premiums Tax	
Permit Issuance	Department of Insurance
Tax Assessment	Board of Equalization
Refunds & Penalty Collection	State Controller
Motor Vehicle License Fee	
Administration	Department of Motor Vehicles
Collection (delinquencies only)	Franchise Tax Board
Motor Vehicle Registration Fee	Department of Motor Vehicles
Motor Carrier Tax	Public Utilities Commission
Paid Family Leave	Employment Development Department

TABLE 9

(Continued)

Tax	**Responsible Agency**
Personal Income Tax (PIT)	Franchise Tax Board
PIT Withholding	Employment Development Department
Private Railroad Car Tax	Board of Equalization
Property Tax	
Assessment	County Assessors Office
Standards Development	Board of Equalization
Public Utility Property Tax	Board of Equalization
Sales and Use Tax	Board of Equalization
State Disability Insurance	Employment Development Department
Timber Yield Tax	Board of Equalization
Unemployment Insurance Tax	Employment Development Department
Weight Fees	Department of Motor Vehicles

CHAPTER 8

GLOSSARY OF TAX TERMINOLOGY

The terminology of taxation can be overwhelming. The purpose of this glossary is to promote familiarity with this terminology for those who do not work with tax issues every day. We have attempted to include the major terms and abbreviations used when discussing taxation issues.

The definitions provided in this glossary are brief. Please refer to the appropriate chapters of this Reference Book for a more thorough explanation of the terms and concepts.

COMMON ABBREVIATIONS

AGI	Adjusted Gross Income
AMT	Alternative Minimum Tax
AV	Assessed Valuation
CT	Corporation Tax
BIE	Business Inventory Exemption
BOE	Board of Equalization
CPI	Consumer Price Index (the U.S. Index)
CCPI	California Consumer Price Index
DOF	Department of Finance
DMV	Department of Motor Vehicles
EDD	Employment Development Department
FTB	Franchise Tax Board
HOE	Homeowners' Exemption
IRA	Individual Retirement Account
IRC	Internal Revenue Code

IRS	Internal Revenue Service
MIC	Manufacturer's Investment Credit
NOL	Net Operating Loss
OAL	Office of Administrative Law
PIT	Personal Income Tax
R&D	Research and Development Credit
R&TC	Revenue and Taxation Code
SDI	State Disability Insurance
TI	Taxable Income
TPZ	Timberland Production Zone
UBI	Unrelated Business Income
UI	Unemployment Insurance
VLF	Vehicle License Fee

GLOSSARY OF TAX TERMINOLOGY

A

ABILITY TO PAY	Tax principle that ties the burden of taxation to the taxpayer's economic circumstances. Taxation based on "ability to pay" is an alternative to taxation based on benefits or services received.
ACCELERATED WRITE-OFF	Computation of an income tax deduction that reduces taxable income by allowing the deduction to be taken earlier than the rules would ordinarily permit. For example, accelerated depreciation allows deductions for the wear and tear of property to be taken over a shorter period than the accepted useful life of the asset.
ACQUISITION VALUE	Property tax concept referring to the value of property when acquired. Acquisition value is embodied in Proposition 13. This is an alternative to the "ad valorem" concept. This term was used by the California Supreme Court in its Amador Valley decision and does not appear in Proposition 13 or related statutes.
ADJUSTED GROSS INCOME (AGI)	Total gross income reported for income tax purposes, less certain specified deductions if applicable. Typically, California AGI equals federal AGI adjusted for differences in tax treatment of certain types of income (e.g., state income tax refunds, social security income, interest on state and municipal bonds from other states, etc). (See Chapter 2B for complete list of the components of AGI.)
AD VALOREM	According to value. Before Proposition 13, the property tax was considered an ad valorem tax, as it was based on current value of the property instead of its acquisition value. Currently, personal property tax is ad valorem, or based on current value.
AD VALOREM ASSESSMENT	Special assessment levied for operating purposes by many special districts, particularly water districts.

	The assessment is usually levied only on the value of land or land and improvements (not personal property).
ALTERNATIVE MINIMUM TAX (AMT)	An additional tax which must be computed by personal income and corporate taxpayers that take advantage of certain tax preferences. If AMT liability exceeds regular tax liability, the excess must be paid in addition to the taxpayer's regular tax liability. The purpose is to ensure that taxpayers that take advantage of special tax preferences pay minimum tax on income receiving preferential treatment. Patterned after the AMT in federal law.
AMORTIZATION	An accounting procedure used to reduce the value of an intangible asset by periodic charge-offs against income. For tax purposes, amortization is similar to depreciation. Also refers to the principal reduction of an outstanding debt through regular payments of interest and principal.
APPORTIONMENT	Method by which California determines how much of a multi-state or multi-national corporation's total net profits are subject to California income taxes. (See Chapter 2D.)
APPROPRIATION	An authorization of money from a specific fund to a specific agency or program for expenditures or to incur obligations for a specified purpose and period of time. The amount expended may be less than the amount appropriated.
APPROPRIATIONS LIMIT	Maximum amount of tax proceeds that may be appropriated in a fiscal year by state or local government under Article XIIIB of the California Constitution (Proposition 4 of 1979). (See Chapter 5.)
ARTICLE XIIIA	The article of the California Constitution added by Proposition 13 of 1978.
ARTICLE XIIIB	The article of the California Constitution added by Proposition 4 of 1979 (Appropriations Limit).
ARTICLES XIIIC AND XIIID	The articles of the California Constitution added by

	Proposition 218 of 1996.
ASSESSED VALUE	The measure against which the property tax rate is applied to compute the tax. Generally it is market value, unless a standard other than market value has been established by the Constitution for real property or by statute for personal property.
ASSESSMENT ROLL	A countywide list of all taxable property. It identifies each property, its owner, and its value for assessment purposes.
ASSESSMENT YEAR	For property tax law, the period beginning with a lien date and ending immediately prior to the succeeding lien date. Under current law, the assessment year begins on January 1 and is coterminous with the calendar year.
AVERAGE DAILY ATTENDANCE (ADA)	A formula for measuring the full time equivalent number of students attending school. Most state aid to schools is based on ADA. An example of an ADA calculation for a regular full-time elementary school is the number of student-days of attendance divided by the number of actual school days.
B	
BASE	For property tax allocation purposes, the amount of property tax revenues received in the prior year (See also 'Increment'.) (For a different usage, see 'Tax Base'.)
BASE YEAR VALUE	The full cash value of real property in 1975-76, or in any subsequent year upon a purchase, change in ownership, or new construction. Under Proposition 13, assessed value for property tax purposes may increase by no more than 2% per year.
BASIS	For purposes of income taxes, basis generally means the cost of an asset to the taxpayer acquiring the property. It is used for calculating depreciation and capital gains and losses when the property is ultimately disposed of. Most inherited property is given a basis of its fair market value on the date of inheritance. Property acquired by gift generally has

	a basis equal to that of the donor.
BENEFITS RECEIVED	Tax principle that those who receive the benefit of government services should pay for them. Alternative to "ability-to-pay".
BOARD OF EQUALIZATION (BOE)	State revenue agency, responsible for administration of the sales and use tax and other special taxes. The BOE also oversees local administration of the property tax. The Board is directed by five members: The State Controller and four members elected by the voters. The BOE is a quasi-judicial body and serves as the appellate body for income and franchise tax disputes filed with the Franchise Tax Board.
BONDING POWER	The right of state or local government to borrow money by issuing bonds.
BRADLEY-BURNS	The 1955 act that allows a uniform 1.25% sales tax to be imposed by cities and counties. This tax is collected by the BOE and returned to local jurisdictions based on the location of the taxed transaction.
BROAD-BASED TAX	A tax levied upon a large tax base. Often such a tax is paid by the vast majority of the population. An example is the sales and use tax.
BUSINESS INVENTORIES	Personal property of business that is held for sale or lease. Exempted by the Legislature from property taxation beginning in 1980-81.

C

CALIFORNIA CONSUMER PRICE INDEX (CCPI)	Measures inflation in California and is calculated by the California Department of Industrial Relations.
CAPITAL ASSET	Real property, personal property, stocks and bonds and other property held by a taxpayer. Examples of property that are not considered capital assets include copyrights and inventory held for sale.
CAPITAL EXPENDITURES	Expenditures for capital assets such as buildings,

roads, airports, land, etc.

CAPITAL GAINS — Income or profit from the sale of capital assets.

CAPITAL OUTLAY — Represents an appropriation for any acquisition of land or other real property, major construction, improvements, equipment, designs, plans and specifications, lease purchase agreement, and the request for and exercise of a purchase option.

CARRYOVER — In cases where a tax benefit from a credit, deduction or other write-off exceeds the allowable amount for a particular year, carryover permits the excess amounts to be preserved and applied against income or tax liability in subsequent tax years.

CARRYBACK — Allowed for net operating losses and certain credits. Permits net losses in excess of income or credits in excess of tax liability to be "carried back" to earlier tax years, so that tax for those years may be recomputed and refunds may be claimed.

CHANGE OF OWNERSHIP — Term used in Proposition 13. Refers to a transfer of real property. Upon a change in ownership, real property is reassessed to its full cash value as of the date of transfer.

Several exceptions apply including inter-spousal transfer of a principal residence to a surviving spouse, or certain transfers between parents and children, grandparents and grandchildren, and registered domestic partners.

CHECK-OFF CONTRIBUTIONS — Donations to specified nonprofit organizations or activities that taxpayers are permitted to make on their state tax returns. Taxpayers remit the amount of voluntary contributions in addition to amount of tax due or as an application of a refund due on the return. Often called "check-offs".

CLEAN-UP BILL — Technical follow-up bill that often follows a major piece of legislation. Usually deals with erroneous cross-references, chaptering problems, legislative clarification of misinterpretations of the original bill, and other corrections.

CONSUMER PRICE INDEX	A measure of inflation. Can either refer to the United States Consumer Price Index calculated by the United States Department of Commerce or the California Consumer Price Index (CCPI) calculated by the Department of Industrial Relations.
CONSUMPTION TAX	Generic term for a tax on commodities and transactions where the burden falls on the consumer in the price paid for goods and services, such as a sales tax.
CORPORATE FRANCHISE TAX	A tax imposed upon a corporation's right to do business in California. It is measured by a corporation's net earnings, but not imposed based on income.
CREDIT	Amount that can be subtracted from the actual amount of tax owed, usually in the income tax. Credits represent tax expenditures aimed at benefiting specific groups (e.g., senior credit) or inducing certain behavior (e.g., an investment tax credit).

D

DEDUCTIONS (AGI)	Amounts subtracted from adjusted gross income to yield the taxable income upon which income tax liability is based.
DEFERRAL	Postponement of paying taxes because of specific provisions in the tax law. For example, the Senior Citizens Property Tax Postponement Program allows low and moderate income senior citizens to defer payment of property taxes until they sell their home, die, or move.
DEPENDENT	In income tax law, a relative of the taxpayer (child, stepchild, parent, stepparent, sibling, etc.) for whom the taxpayer provided over half of his or her support during a calendar year. Can also include a non-relative who meets the support rule and who lives in the taxpayer's home.

DEPLETION	Deductions permitted to owners or certain lessees of natural resources (such as oil or gas wells or timber property) to recover the costs of the resource as it is extracted, harvested or otherwise wasted or diminished. Comparable to depreciation for real or personal property or amortization of intangibles.
DEPRECIATION	A decrease in the value of a capital asset due to wear, use, action of the elements, inadequacy, accident, or obsolescence. An income tax deduction for depreciation allows a write-off for a capital expenditure that roughly coincides with the decrease in value of the asset over time.
DIRECT TAX	Generic term for a tax that is not easily shifted or passed on to some other entity by the entity on whom it is levied; for example, the personal income tax.
DEPARTMENT OF FINANCE (DOF)	The DOF serves as the financial branch of the Governor's administration. The DOF prepares the Governor's proposed budget and publishes other budget documents, provides formal revenue estimates, and expresses the Governor's position on fiscal matters before the Legislature.

E

EARMARKED FUNDS	Revenue designated by statute or the Constitution for a specific and restricted purpose.
EARNED INCOME	Includes wages, salaries, and fees for services rendered. In most cases, does not include distribution of profits, such as dividends, or earnings on an investment, such as interest.
EDUCATIONAL REVENUE AUGMENTATION FUND (ERAF)	The funds created to receive property tax revenues redirected from cities, counties, and special districts to schools and community college districts. The permanent redirection of property taxes reduces the state's Proposition 98 funding obligation to K-14 school districts. The revenue loss to local governments is mitigated by receipt of a half-cent sales tax for public safety purposes.

EFFECTIVE TAX RATE	Percentage of market value, income, or other tax base that the tax liability represents. Often differs from the nominal tax rate due to progressive tax rates.
ELASTICITY	As applied to taxes, the degree to which growth in revenue from a tax corresponds to changes in income.
EMPLOYMENT DEVELOPMENT DEPARTMENT (EDD)	State agency that administers unemployment insurance and disability taxes and personal income tax withholding.
EQUITY	Fairness or justice. It also refers to the value of property minus the liens and other claims against the property that offset its value. If the claims against a property exceeds its value, this is described as "negative equity".
ESTATE TAX	Generic term for a levy on the right to transfer property upon the death of the owner. Once the value of the estate is determined, a tax rate is applied to this base.
EXCISE TAX	Generic term for a levy on the manufacture, sale, or use of a particular commodity or service, for example, liquor, cigarettes, or telephone services. Excise taxes are levied on a per-unit basis (e.g., per gallon, per pack, per minute).
EXCLUSION	The part of a tax base that is excluded by law when computing the tax. For example, Social Security income is an exclusion for state income tax purposes.
EXEMPTIONS	Status of specified people, property, institutions, or sources of income or wealth not subject to taxation.

F

FEDERAL CONFORMITY	Degree to which a state's income tax base and computation corresponds to federal income tax laws. California utilizes a process of selective federal conformity.

FISCAL COMMITTEE	Designated committee in each house of the California Legislature that hears any bill with a fiscal impact on the state. In both the Assembly and the Senate, this committee is the Appropriations Committee.
FISCAL YEAR	Twelve-month period for budgeting, accounting or tax collection purposes. May differ from calendar year. The state and local governments' fiscal year is July 1 to June 30. The federal fiscal year is October 1 to September 30.
FRANCHISE	A special privilege extended by the government to a private enterprise. The corporate franchise tax is levied on the franchise for the privilege of doing business in California and is measured by net income.
FRANCHISE TAX BOARD (FTB)	State agency responsible for administering the personal income and corporation tax laws. The three Board members include the State Controller, the Chair of the Board of Equalization, and the Director of the Department of Finance.
FULL CASH VALUE	The highest amount a willing and knowledgeable seller of a property could obtain from a willing and knowledgeable buyer, neither being under any compulsion to buy or sell. Same as "market value" or "fair market value".

G

GROSS INCOME	All sources of income except exempt income. Gross Income is the starting point for computing taxable income prior to adjustments and deductions.
GROSS PREMIUMS	All insurance premiums received by an insurer. Used to compute the insurance tax after return premiums are subtracted.

H

HEAD OF HOUSEHOLD	An unmarried individual whose home is the principal place of abode of a son, stepson, daughter, stepdaughter, father, mother or any other dependent

	person for whom a dependent credit may be claimed. A head of household may also be someone who maintains any household as the principal place of abode for a father or mother provided that such parent qualifies a the taxpayer's dependent.
HIDDEN TAX	Generic term for an indirect tax that is incorporated into the price of goods and services and is therefore not apparent when paid. An example is the fuel tax which is included in the price of gas at the pump.
HOMEOWNERS' EXEMPTION	A constitutionally provided property tax exemption for homeowners. The exemption reduces the assessed value of a principal residence by $7,000 and in doing so reduces the property tax liabilities of most homeowners by approximately $70 per year.
IMPACT	The individual or business firm with the legal liability to initially pay a tax, whether or not it actually bears the final burden. (See also 'Incidence'.)
INCIDENCE	Individuals or groups that bear the actual burden of a tax.
INCOME	Money or other consideration received during a given period by an individual, corporation, or other entity for labor or services or from property, investments, or other form of compensation.
INCOME TAX	A tax levied on the income of individuals and/or corporations; may be applied to gross (total) income or net income (gross income less deductions for certain expenses).
INCREMENT	For local property tax allocation purposes, the amount of property tax revenue generated by growth in assessed valuation from one year to the next. (See also 'Base' for another usage, see 'Tax Increment Financing'.)
INDEXING	Method by which tax rates, brackets, exemptions or benefits are automatically adjusted for inflation.

INFLATION	An increase in the price level or, conversely, a decline in the purchasing power of money.
INHERITANCE TAX	Generic term for a tax levied upon the value of property that individual beneficiaries receive from an estate of a deceased person. The voters of California repealed the State Inheritance Tax in June 1982. (See also 'Pickup Tax' and 'Estate Tax'.)
IN-LIEU TAX	Tax levied in place of another tax or group of taxes. May refer to provisions sheltering a class of taxpayers from other taxes. For example, the Constitution provides that the California on insurers tax is imposed in-lieu of other state taxes on insurers and their property.
INTANGIBLE PROPERTY	Assets that cannot be perceived by the senses, such as the goodwill of a business, customer base, or the workforce of a business.
INTERACTION	Changes in the liability associated with one tax that affect the liability associated with another tax (e.g., a reduction in property taxes will likely increase income taxes, because itemized deductions for property taxes will be reduced).

J

JOINT RETURN	One personal income tax return filed by both members of a married couple.
JURISDICTIONAL CHANGE	Procedure by which a city, county or special district transfers functions or changes boundaries; by which a new local agency forms; or by which two or more local agencies consolidate. Jurisdictional changes may result in changes in the allocation of property tax revenues.

L

LEVY	The imposition or collection of a tax. Also may refer to the amount of tax imposed.
LICENSE TAX	A tax on the right to do something, such as the sale

of liquor, hunting, marriage license, or the right to operate a business.

LIEN	A claim on property to satisfy a debt. Some taxes result in a lien against property.
LIEN DATE	The time when the taxes become a lien on property and the date on which property is valued for tax purposes. Property taxes become a lien at 12:01 a.m. on January 1 preceding the fiscal year for which taxes are collected for both locally-assessed real property and state-assessed property.
LOCAL ASSISTANCE	Portion of the state budget devoted to inter-governmental expenditures and shared taxes. State operations and capital outlay comprise the remainder of the state budget.
LUXURY TAX	Generic term for a tax imposed upon articles not considered essential to a normal standard of living. Currently there are no luxury taxes in California law, although the federal government periodically adopts various luxury taxes.

M

MARGINAL TAX RATE	Income tax rate to which the taxpayer's highest dollar of income is subject.
MARKET VALUE	Full, fair market value of an asset. Equals "full cash value" for Proposition 13 purposes in the property's "base year".
MARRIAGE PENALTY	Feature of the federal income tax structure that cause the combined tax on two single people with equal incomes to be less than the tax on a married couple composed of the same two people. The California personal income tax does not impose a marriage penalty.
MINIMUM FRANCHISE TAX	Minimum amount of tax imposed annually on any corporation under the California bank and corporation franchise tax. The minimum franchise tax is currently $800. There is no minimum franchise tax imposed on corporations their first

year of incorporation. Limited partnerships and limited liability companies also pay an annual tax in an amount equal to the minimum franchise tax.

N

NET INCOME	Income remaining from earnings gains profits after all allowable costs, expenses, losses, and allowances for depreciation have been deducted.
NET OPERATING LOSS (NOL)	Occurs when allowable deductions exceed gross income computed under the law in effect for the loss year. Both state and federal income tax law provide for the carryover of NOLs, although specific provisions vary.
NEW CONSTRUCTION	Term used in Proposition 13. New construction is reappraised at its full cash value on the date it is complete and available for use.

O

ORDINARY INCOME	All income other than capital gain.

P

PAYROLL TAX	Generic term for a tax based on the payroll of a business. California's unemployment insurance tax is an example.
PER CAPITA	Amount per individual.
PERSONAL PROPERTY	Movable property and equipment, as opposed to immovable property such as land and buildings.
PICKUP ESTATE TAX	A California estate tax enacted after the elimination of the inheritance tax in 1982. It is imposed up to the level of the maximum state inheritance tax credit allowed against the federal estate tax. It does not change the taxpayer's combined state and federal estate tax liability but collected a portion of the federal state tax, in effect, to California. Commencing in 2005, the federal credit for state death taxes was fully repealed. Therefore, the California estate tax is inapplicable.

PIGGYBACK	Generic term for a tax levied as a percentage of the liability imposed by another tax. There are no California piggyback taxes.
POSSESSORY INTEREST	Interest of a lessee in government-owned property. Lessees pay property taxes related to possessory interests.
PROGRESSIVE	Tax structure or policy in which either persons with high incomes pay a larger percentage of their income in tax than persons with lower incomes or where persons with high incomes receive a smaller share of tax relief than persons with lower incomes.
PROPERTY TAX	A tax on all real and tangible property located in the state and not specifically exempt.
PROPOSITION 4	Initiative constitutional amendment approved on the November 1979 ballot. Imposed limits on allowable appropriation of tax revenues by state and local governments. Added Article XIIIB to the California Constitution.
PROPOSITION 13	Initiative constitutional amendment approved on the June 1978 ballot. Limited property tax rates to 1% of assessed value, limited the growth in assessed valuation to a maximum of 2% annually, placed restrictions on the imposition of new taxes. Added Article XIIIA to the Constitution.
PROPOSITION 62	Initiative statute approved on the November 1986 ballot. The measure was intended to require a popular vote for any new locally-imposed tax or any increase in an existing locally-imposed tax. It was embroiled in a legal controversy until December 1995, when the California Supreme Court upheld its constitutionality.
PROPOSITION 98	Initiative statute and constitutional amendment approved on the November 1988 ballot. Established minimum funding guarantee for schools and community colleges, allocated a portion of state revenues in excess of the appropriations limit to education.

PROPOSITION 111 — Legislative initiative that substantially modified the provisions of Propositions 4 and 98. (See Chapter 5 for details.)

PROPOSITION 218 — Initiative constitutional amendment approved on the November 1996 ballot. Sets forth voter approval requirements for the imposition of special and general taxes by local governments.

(FOR OTHER PROPOSITIONS, SEE APPENDIX TO CHAPTER 4 - LOCAL PROPERTY TAX.)

R

REAL PROPERTY — The ownership of, claim to, possession of or right to the possession of land and permanently attached improvements, such as buildings. Does not include "personal property" such as furniture and equipment.

REGRESSIVE TAX — A tax that imposes a higher burden on lower-income taxpayers than it does on higher-income taxpayers. Opposite of "progressive".

RETURN PREMIUMS — Insurance premiums paid in part or in full by persons who have canceled their policy before its expiration date.

REVENUE LIMIT — A limit on the increase in the aggregate amount of revenue that can be raised from one year to the next. For school finance, this is a school district's income from state and local sources, exclusive of categorical aid.

S

SALES TAX — A tax levied on the gross receipts from the retail sale of tangible personal property unless otherwise exempted.

SECURED ROLL — That part of the local property tax assessment roll that contains real property where the taxes are adequately secured by a lien.

SEVERANCE TAX — Generic term for a tax imposed on the extraction of

	natural resources, usually based on volume or value of a resource extracted or harvested. SIMILAR TO YIELD TAX.
SITUS	Site or place. Applies to the location of property for the purpose of determining which government agency may impose taxes on it and which government agency receives tax revenue from it.
SPECIAL ASSESSMENT	A tax for local improvements imposed only on the properties benefited.
SPECIAL TAX	Term used in Proposition 13 and further defined in Proposition 218. Special taxes are those imposed and restricted for specific, rather than general, governmental purposes. Local agencies may impose special taxes upon approval of two-thirds of those voting on the measure.
SPILLOVER BENEFITS	Benefits enjoyed by those not directly paying for them.
SPLIT ROLL	In the context of property taxes, means assessment or taxation of a certain class of property in a manner different than other property. Could refer to a split assessment ratio, a split tax rate, or a split exemption level. Does not currently apply in California.
STANDARD DEDUCTION	A flat amount that all income taxpayers are allowed to deduct in lieu of claiming itemized deductions. Intended to approximate expenses that reduce the taxpayer's ability to pay. A feature of federal income tax law; California uses a personal credit.
STATE ASSESSED PROPERTY	Property that crosses jurisdictional boundaries and is assessed by the Board of Equalization, rather than local county assessors. State assessees are primarily utilities and railroads.
STATE MANDATED COSTS	Costs incurred by local agencies or schools resulting from a new program, or higher level of service for an existing program, mandated by state legislation or an executive order. Under Proposition 4 (Article XIIIB), the state is required to reimburse

	local agencies for these costs, with specified exceptions.
S CORPORATIONS	Closely held corporations (i.e., they have a limited number of shareholders) that receive special tax treatment under both federal and state law. They are named after a specific section of federal tax law (Subchapter S of Subtitle A of the Internal Revenue Code).
SUBVENTION	Money transferred from the state to local government.
SUPPLEMENTAL ROLL	An additional assessment roll that contains property that changes ownership or is newly constructed after the regular January 1 lien date. Enacted in 1982.
SURPLUS	Commonly refers to the carryover balance in the state's General Fund at the start of a new fiscal year, or to reserves held by the state for unforeseen contingencies. Also known as the Special Fund for Economic Uncertainties.
SURTAX	An additional tax rate added onto the rate of an existing tax.
T	
TANGIBLE PERSONAL PROPERTY	Material assets such as household goods or business equipment that are readily movable and are not permanently attached to real property.
TAX	A compulsory payment required by a government.
TAX BASE	The part of the economy or the portion of the population against which a tax is levied or measured.
TAX BURDEN	The impact of a tax, usually expressed in tax dollars per capita or dollars per amount of personal income. For an individual taxpayer, tax dollars per measure of income (household, AGI, other).

TAX DEEDED PROPERTY	Property on which property taxes are delinquent and which has been deeded to the state until the time it is sold for back taxes or redeemed by the owner.
TAX EXPENDITURE	A component of the tax law that deviates from the basic structure of the tax (e.g., an exemption, exclusion, deduction, credit, and/or deferral). The term "tax expenditure" is intended to reflect foregone revenues resulting from the preferential treatment.
TAX INCREMENT FINANCING	A method used by redevelopment agencies to secure bonds, whereby property tax revenue from an increase in value in property over a base amount is used to pay off the bonds.
TAX LEVY	A bill in the California Legislature that imposes a state tax, repeals a state tax, or otherwise changes in any material way the rate, base, or burden of a state tax. The Legislative Counsel determines whether a bill is a tax levy. Special rules regarding legislative deadlines and effective dates apply to tax levies.
TAX RATE	The ratio of the tax to the tax base. For property tax purposes, the rate is applied to assessed value to determine the amount of the tax. For income and franchise tax purposes, the rate is applied to taxable income to determine the amount of the tax.
TAX RATE AREA	Geographic area that is served by the same combination of governmental units and has the same property tax allocation factors.
TIDELANDS REVENUE	Revenues earned by the state from sale of oil extracted from state tidelands (between shoreline and three miles out into the Pacific Ocean). Primarily located adjacent to the city of Long Beach.
TIMBER YIELD TAX	A tax imposed in California in lieu of the property tax on standing timber. Tax applies when timber is harvested and is based on the value of the timber when cut.

TIMBERLAND PRODUCTION ZONE (TPZ)	Ten-year land use restriction on growing and harvesting timber in exchange for preferential property tax assessments for timberland.

U

UNITARY APPORTIONMENT	Formula by which the share of a corporation's net income subject to tax in California is determined. California's share of the reportable income of a unitary corporation is apportioned to California using factors of property, payroll and sales. Often erroneously referred to as "unitary tax" -- it is not a separate tax, but a method of apportioning income.
UNRELATED BUSINESS INCOME (UBI)	Income earned by tax-exempt nonprofit organizations that is not related to the organization's exempt purpose but is derived from a trade or business activity that is regularly carried on by the organization. UBI is subject to income tax, even though the organization's exempt-purpose income is not.
UNSECURED ROLL	That part of the assessment roll, consisting largely of business personal property, on which the taxes are not secured by a lien on real property.
UNSECURED TAX RATE	Prior year's secured roll tax rate, which is levied against current year's unsecured roll.
USE TAX	A tax on goods purchased outside the state and delivered to California for use in the state. A use tax is designed to remove inequities between purchases made within and those made outside the state. Companion to the sales tax, the burden for payment is with the purchaser.
USER CHARGE	A charge levied for use of a government-provided commodity or service. For example, day-use fees at a marina or park.
VALUE ADDED TAX (VAT)	Generic term for a tax levied on a product at each stage of its manufacture or processing based on the increase in value attributable to the particular process. It is similar to a sales tax, but is paid at each stage of production and marketing and is

	incorporated into the final purchase price rather than added on at the time of sale. Used in many other countries, but not in the United States
VEHICLE LICENSE FEE	The vehicle license fee (VLF) is an annual fee on all vehicles registered in California.
W	
WAIVER (DISCLAIMER)	Refers to a boilerplate statement, commonly at the end of a bill, that "waives" another statutory requirement, such as an automatic sunset or reimbursement of any state mandated costs created by that bill. If their rights to reimbursement are not waived, local governments may file claims for reimbursement of state-mandated costs and/or state-initiated revenue losses via Board of Control.
WATER'S-EDGE COMBINATION	Method of combining the income of multinational corporations to determine the amount of net income taxable by California. The "water's-edge" is defined as the 50 states of the United States and specified "tax havens". This method is an alternative to worldwide combination.
WELFARE EXEMPTION	Property tax exemption available for property owned by nonprofit charitable, educational, religious, and scientific organizations and that meets other tests.
WILLIAMSON ACT	Statutory provision for reduced property tax assessments on agricultural and other open space property in return for a contractual agreement that the property must be maintained in agricultural use for at least 10 years.
WORLDWIDE COMBINATION	Method of combining the income of multinational corporations to determine the amount of net income taxable by California. Corporations must use worldwide combination if they do not elect water's-edge combination.
Y	
YIELD TAX	Generic term for a tax levied on the value of a

	resource at the time of its extraction or harvest. California's timber yield tax is an example. SIMILAR TO SEVERENCE TAX

Z

ZERO BRACKET AMOUNT (ZBA)	A previous feature of state and federal income taxes. A flat deduction given to all taxpayers, the amount of which varied by tax filing status. The ZBA replaced the standard deduction and was incorporated in the tax tables, but was repealed and the standard deduction reinstated in 1987.
ZERO SUM	With a fixed pool of money, if one party receives an increased share, other parties must lose a commensurate amount.