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Your growing tax toll

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Digging California out of a \$28 billion budget deficit is going to hurt: The major question is who will pay and how much.

Taxes on retail sales. Income. Wine. Car licenses. Even Giants baseball tickets. They're all at stake as the governor and state lawmakers confront the real possibility that they will have to take money out of people's pockets in the midst of a spiraling recession.

"The timing is off" for new taxes, said Jerry Gillespie of Hopland after paying \$250 in sales tax on a widescreen TV last week in Santa Rosa. If the sales tax were higher, Gillespie said, "we'd be even more cautious about how we would spend."

Californians haven't been hit by a major tax increase since 1991, when a mix of income, sales and other tax hikes totaled \$7 billion. The \$9.6 billion a year in new taxes proposed by Gov. Arnold Schwarzenegger that will be laid before the Legislature and recalcitrant Republicans this week is a daunting political choice.

About the only certainty is that something must give, as a steadily weakening economy continues to erode state revenues and compound the deficit. In September alone, revenue from California's "big three" taxes -- personal income tax, corporate tax and sales tax -- fell almost \$1 billion short of budget estimates.

"Right now we are on an unsustainable path," said Daniel J. B. Mitchell, professor emeritus at the UCLA Anderson School of Management. Unlike the federal government, he noted, "we can't print money or borrow from the Chinese."

For Sonoma County residents, the higher taxes would hit in various ways. Sales taxes would go up 20 percent, a bottle of wine would cost 25 cents more, families making \$325,000 a year would pay more income tax -- depending on what state lawmakers decide.

Already, state taxes take a big chunk out of the family budget. For example, a family making about \$62,000 a year pays 8.9 percent of that, about \$5,500, to the state for taxes on purchases, gasoline and alcohol and cigarettes, as well as property and income, according to the Institute on Taxation and Economic Policy.

In Sacramento, the issue is whether Republican legislators will drop their steadfast resistance to any new taxes, insisting the budget can be balanced primarily with spending cuts. Budget cuts of more than \$6 billion already are on the table.

If this were a Humphrey Bogart movie, Sacramento Republicans would be scoffing, "Taxes, we don't need to approve any stinkin' taxes."

But Republican Gov. Arnold Schwarzenegger, Democratic lawmakers and nonpartisan Legislative Analyst Mac Taylor are saying, "Yes, we do."

And quickly, they say, before the state literally runs out of money.

Bottom line: California taxpayers can brace for a multibillion-dollar assault on their wallets, coupled with another round of budget cuts, to close a deficit of \$28 billion over the next 20 months.

"It's a huge nut to crack," said Assemblywoman Norren Evans, D-Santa Rosa, who takes over as chairwoman of the Assembly Budget Committee in two weeks.

The centerpiece of the governor's special session budget proposal is a three-year, 1.5 cent sales tax increase

that would generate \$6.6 billion a year, more than two-thirds of the \$9.6 billion in new revenues Schwarzenegger has proposed.

Evans said Democrats agree with much of the governor's plan. But she is "not enthusiastic" about the sales tax, considered a regressive tax because it falls more heavily on the poor.

Jean Ross, executive director of the California Budget Project, said she would swap most of the proposed sales tax in favor of an income tax increase for couples making more than \$321,000 annually, who account for fewer than 5 percent of California taxpayers.

The income tax hike would raise \$5.6 billion a year, with the burden falling on those who can more easily afford it, Ross said. About one-fourth of the increase -- \$1.4 billion annually -- would be offset by federal income tax deductions.

Almost half of California's personal income tax revenue comes from the top 1 percent of wage earners. Overall, income taxes generate \$48.5 billion, or 53 percent of all state revenues. Sales tax ranks second, generating \$25.5 billion.

The governor's plan does not touch income taxes, but Ross noted that his two Republican predecessors, Pete Wilson and Ronald Reagan, both boosted the income tax to close budget gaps.

In 1991, Wilson and the Legislature worked out a \$7 billion tax increase, mixing top-bracket income taxes, sales and other taxes to help balance a recession-riddled budget. No major tax hikes have been enacted since then.

Now, substantial increases are under consideration.

The governor's 1.5 cent increase would push the state's share of the sales tax from 7.25 percent to 8.75 percent. Cities, counties and other government agencies take additional tax bites as well, and the total tax could exceed 9 percent for many Californians.

In Santa Rosa, for example, if the state sales tax increase were imposed on top of the voter-approved quarter-cent increase for a commute rail line that takes effect in April, the current 8 percent rate would jump to 9.75 percent.

As an alternative, the Legislative Analyst has proposed a 5 percent across-the-board income tax surcharge so that the sales tax increase could be less.

"I don't know anyone who really wants more taxes," said Gillespie, the TV buyer. But he's also dismayed that California roads and schools are deteriorating. "Our infrastructure is falling apart," he said.

The Budget Project applauded two elements of Schwarzenegger's plan: Expanding the sales tax to apply to a host of services, including auto and furniture repairs, veterinary bills and sporting events, and a 9.9 percent oil severance tax -- each reaping \$1.2 billion a year.

California is the only jurisdiction in the world, Ross said, that does not tax companies for taking oil out of the ground. The state produces too little of the world's oil for the tax to affect gasoline prices at the pump, she said.

Drinkers also will pay more if the governor's proposed alcohol excise increase wins approval. Adding 30 cents to a six-pack of beer, about 25 cents to a bottle of wine and about \$1.07 to a quart of liquor would generate \$585 million a year.

"There is no golden bullet," said Fred Silva, fiscal adviser to Beacon Economics of San Rafael, a research firm. The "perfect tax," he said, would be a broad-based tax at a low rate: "We don't have one."

Sales tax is a "popular target" for politicians, Silva said, but it's not deductible against federal income tax.

Boosting the vehicle license fee, essentially a property tax on vehicles, is politically charged. The legislative analyst proposed increasing the fee from 0.65 percent to 1 percent, generating an additional \$1.6 billion a year.

But Schwarzenegger, who slashed the fee as one of his first post-recall acts in office in 2003, would "have to swallow a lot of political pride" to take that step, UCLA's Mitchell said.

The decision by former Gov. Gray Davis to reinstate the higher vehicle fee is considered one of the reasons for his recall.

Schwarzenegger told lawmakers last week that they will have failed if they do not deal with the deficit by month's end.

Taylor urged lawmakers to attack the problem "quickly and aggressively," noting that budget deficits of about \$22 billion are looming for the next five years.

"The magnitude of the budget shortfall is too great to close on only one side of the ledger," Taylor's report said. "Revenue must be increased and expenditures must be decreased."

But Evans said the political landscape hasn't shifted since GOP lawmakers balked at new taxes, forcing a record 85-day delay in adopting a budget in September that used accounting gimmicks to help cover a nearly \$17 billion deficit.

Schwarzenegger called the special session as the deficit grew first to \$11 billion for the current fiscal year that ends July 1, then to \$28 billion for the rest of this year plus 2009-10, according to Taylor's accounting last week.

The Assembly's first floor session is scheduled for Wednesday.

Republicans remain committed to a no-tax budget; Democrats have said that a cuts-only plan is unacceptable, and a bipartisan agreement is needed to secure the required two-thirds majority vote.

"Raising taxes is the worst thing we could do right now. It will devastate an economy that is hanging on by a thread, threaten jobs and hurt working families," said Senate Republican Leader Dave Cogdill of Modesto and Assembly Republican Leader Mike Villines of Fresno in a joint statement.

"Nothing's changed," Evans said. The governor proposed a new budget, but apparently has not rounded up any GOP votes to back it. Assuming all Democrats support it, the budget needs two Republican state senators and seven Assembly members to become law.

The current session ends Nov. 30, and new members will be sworn in Dec. 1.

California could get financial help from Congress through an economic stimulus program, but the state would first have to make progress shoring up its finances, officials said.

If nothing gets done this month, the state likely will run out of cash in February or March, unable to pay bills or salaries, said Paul Warren of the Legislative Analyst's Office.

Income tax payments will relieve the crunch in April, he said, but meanwhile the state's credit rating would be harmed and economic pain spread widely.

"I honestly don't know what to tell you to expect," Evans said.
