

REVENUE ESTIMATES

California's economy is expected to continue its moderate improvement for the next couple of years. Although the economic outlook has not improved appreciably since the 2013 Budget Act was adopted, General Fund revenue is expected to be higher than the Budget Act forecast. The primary reason for this increase is the level of capital gains realizations for 2013 and 2014.

Figure REV-01 displays the forecast changes between the 2013 Budget Act and the Budget forecast. Revenue is expected to be \$100.1 billion in 2013-14 and \$106.1 billion in 2014-15. Over the budget window, there is an increase of \$6.3 billion. Revenue for 2012-13 has come approximately \$1.7 billion over forecast based on preliminary data. Revenue for 2013-14 is forecast to be about \$3 billion greater than the amount forecast at the time of the 2013 Budget Act. Revenue for 2014-15, before accounting for a \$1.6 billion Budget Stabilization Account transfer, is forecast to be almost \$1.6 billion greater than the amount forecast for the 2013 Budget Act. These increases are due primarily to a higher forecast for personal income tax (PIT). Sales tax revenue is projected to decrease slightly relative to the 2013 Budget Act, while corporate tax revenue is projected to drop by almost \$1.2 billion. The revenue forecast for 2014-15 is the first forecast to exceed the pre-recession revenue peak of \$102.6 billion, achieved in 2007-08.

The improved revenue forecast is attributable to the increased forecast for PIT, which is driven primarily by higher capital gains forecasts for both 2013 and 2014. The upward revision in capital gains growth is a result of the robust growth in stock prices during the second half of 2013, along with a growth in real estate values. At the time the forecast

Figure REV-01
2014-15 Governor's Budget
General Fund Revenue Forecast
Reconciliation with the 2013 Budget Act
(Dollars in Millions)

Source	Budget Act (a)	Governor's Budget	Change From Budget Act Forecast	
<u>Fiscal 12-13: Preliminary</u>				
Personal Income Tax	\$63,901	\$65,332	\$1,431	2.2%
Sales & Use Tax	20,240	20,482	\$242	1.2%
Corporation Tax	7,509	7,462	-\$47	-0.6%
Insurance Tax	2,156	2,221	\$65	3.0%
Vehicle License Fees	7	7	\$0	0.0%
Alcoholic Beverage	325	357	\$32	9.8%
Cigarette	91	90	-\$1	-1.1%
Other Revenues	2,218	2,150	-\$67	-3.0%
Transfers	<u>1,748</u>	<u>1,813</u>	<u>\$65</u>	3.7%
Total	\$98,195	\$99,915	\$1,720	1.8%
<u>Fiscal 13-14</u>				
Personal Income Tax	\$60,869	\$64,287	\$3,418	5.6%
Sales & Use Tax	22,983	22,920	-\$63	-0.3%
Corporation Tax	8,567	7,971	-\$596	-7.0%
Insurance Tax	2,200	2,143	-\$57	-2.6%
Alcoholic Beverage	332	350	\$18	5.4%
Cigarette	89	89	\$0	0.0%
Other Revenues	1,828	2,041	\$213	11.7%
Transfers	<u>331</u>	<u>346</u>	<u>\$15</u>	4.5%
Total	\$97,199	\$100,147	\$2,948	3.0%
Change from Fiscal 12-13	-\$995	\$233		
% Change from Fiscal 12-13	-1.0%	0.2%		
<u>Fiscal 14-15</u>				
Personal Income Tax	\$67,270	\$69,764	\$2,494	3.7%
Sales & Use Tax	24,216	24,071	-\$145	-0.6%
Corporation Tax	9,284	8,682	-\$602	-6.5%
Insurance Tax	2,265	2,297	\$32	1.4%
Alcoholic Beverage	339	357	\$18	5.3%
Cigarette	86	86	\$0	0.6%
Other Revenues	1,433	1,602	\$169	11.8%
Transfers	<u>-385</u>	<u>-765</u>	<u>-\$380</u>	98.8%
Subtotal	\$104,508	\$106,095	\$1,586	1.5%
Change from Fiscal 13-14	\$7,309	\$5,947		
% Change from Fiscal 13-14	7.5%	5.9%		
BSA Transfer	--	-1,591		
Total	\$104,508	\$104,503	-\$5	
Three-Year Total (without BSA transfer)			\$6,255	
Three-Year Total (including BSA transfer)			\$4,663	

(a) For comparison purposes, adjusted to reflect enactment of the Economic Development Initiative pursuant to Chapters 69 and 70, Statutes of 2013.

for the 2013 Budget Act was made, the S&P 500 index was expected to end 2013 at just over 1600. By early December of 2013, the S&P 500 index was around 1800. Besides the stock market, real estate price appreciation and permit activity was robust in 2013. For example, the value of non-residential permits in 2013 showed very large growth over the recent prior years and was not far from the peak levels of 2007.

At the 2013 Budget Act, capital gains for 2013 were expected to be \$58.4 billion, a drop of 44 percent relative to 2012. This decline reflected the expected shift of 20 percent of capital gains from 2013 into 2012 because of federal tax rate changes. The Budget forecast expects 2013 capital gains to be \$87.5 billion, a drop of only 16 percent relative to 2012. The extraordinary strength in the stock market for 2013 is expected to transition to slow and steady growth for 2014. This is expected to lead to continued above-normal capital gains in 2014, because much of the gains that individual taxpayers accrued during 2013 will be realized in later years. At the 2013 Budget Act, capital gains for 2014 were expected to be \$85.2 billion. The Budget forecasts 2014 capital gains to be \$108.3 billion. After 2014, capital gains income and associated revenue decline to more normal levels.

Figure REV-02 shows revenue from capital gains as a percentage of total General Fund revenue. As seen from this table, the amount of revenue the General Fund derives from capital gains can vary greatly from year to year. For instance, in 2007, capital gains contributed \$10.9 billion to the General Fund. By 2009, the contribution from capital gains had dropped to only \$2.3 billion.

Figure REV-02
Capital Gains Revenue
As a Percent of General Fund Tax Revenues
(Dollars in Billions)

Annual Values	2004	2005	2006	2007	2008	2009	2010	2011	2012 ^P	2013 ^e	2014 ^e
Capital Gains Realizations	\$75.5	\$112.4	\$117.9	\$132.0	\$56.3	\$28.8	\$55.3	\$52.1	\$104.1	\$87.5	\$108.3
Tax Revenues from Capital Gains	\$6.1	\$9.2	\$9.6	\$10.9	\$4.6	\$2.3	\$4.7	\$4.2	\$10.6	\$8.9	\$11.1
Fiscal Year Values	04-05	05-06	06-07	07-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15
Tax Revenues from Capital Gains	\$7.0	\$9.3	\$10.0	\$9.0	\$3.9	\$3.0	\$4.5	\$6.1	\$10.1	\$9.5	\$10.5
Total General Fund Tax Revenues	\$80.4	\$91.0	\$93.8	\$95.8	\$79.5	\$84.6	\$90.1	\$83.3	\$96.3	\$98.1	\$105.5
Capital Gains Percentage	8.8%	10.3%	10.7%	9.4%	4.9%	3.5%	5.0%	7.3%	10.5%	9.7%	9.9%

^P Preliminary

^e Estimated

Figure REV-03 shows capital gains reported on California tax returns from 1970 through 2011. Although the level of capital gains has grown significantly since 1970 (along with the economy and total PIT revenue), capital gains volatility has been a constant.

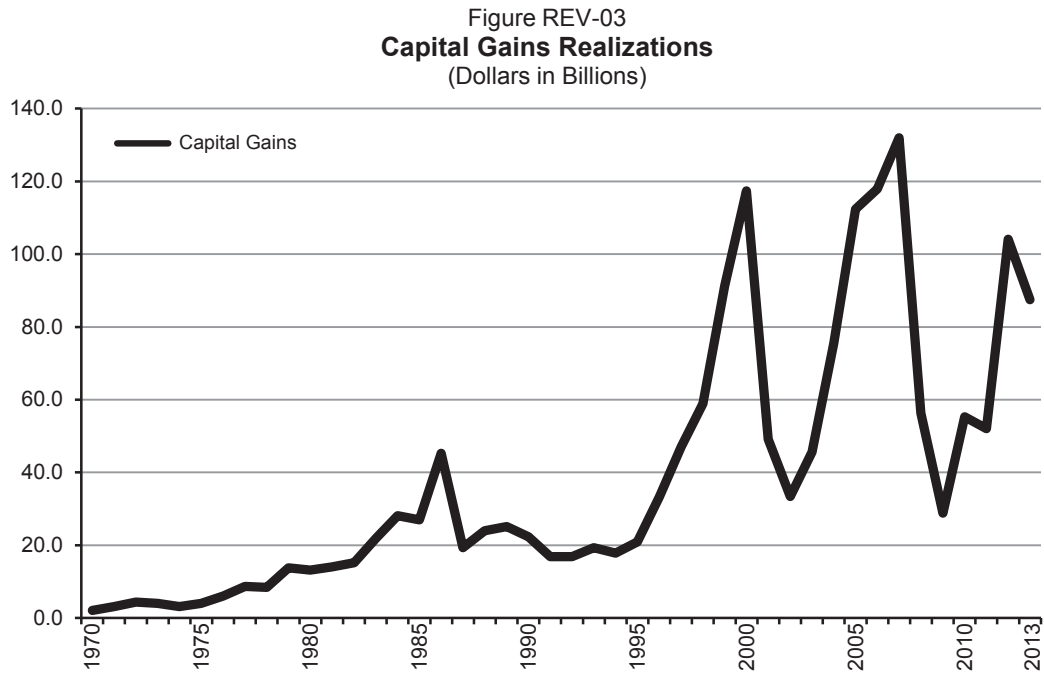
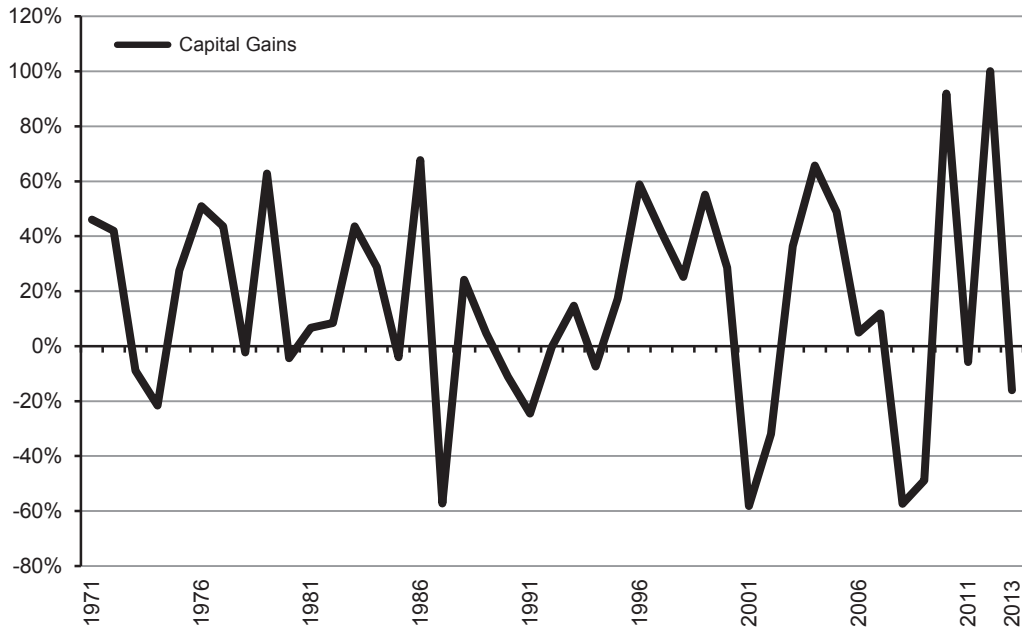


Figure REV-04 shows the year over year percentage change in capital gains since 1970. Growth exceeding 40 percent has been common. On the other hand, capital gains show an absolute year-over-year decline about one-quarter of the years, and declines exceeding 40 percent have happened four times during this period. History suggests that above-normal levels of capital gains eventually drop off.

The highest income Californians pay a large share of the state’s PIT taxes. For the 2011 tax year, the top 1 percent of income earners paid 41.1 percent of PIT taxes, down from the recent high of 48.1 percent in 2007. The share of total adjusted gross income for this group has increased from 13.8 percent in 1993, to 20.9 percent in 2011. Consequently, changes in the income of a relatively small group of taxpayers can have a significant impact on state revenues.

Figure REV-04
Capital Gains are Extremely Volatile



These two related phenomena—significant reliance of General Fund on capital gains and on taxes paid by a small portion of the population—underscore the difficulty of forecasting PIT revenue, particularly in the long term, and the importance of budgeting in a way that does not build long-term commitments on windfall revenue. While there is a high level of confidence that 2013 capital gains will be well above normal levels and a reasonable level of confidence that 2014 capital gains will be above normal levels, it is very difficult to predict 2015 capital gains with any degree of confidence. As such, the Budget forecast for capital gains returns to normal levels as a percentage of personal income in 2015.

LONG-TERM FORECAST

Figure REV-05 shows the forecast for the three largest General Fund revenues from 2012-13 through 2017-18. Total General Fund revenue from these sources is expected to grow from \$93.3 billion in 2012-13 to \$118 billion in 2017-18. The average year-over-year growth rate for this period is 6.8 percent.

Figure REV-05

Long-Term Revenue Forecast - Three Largest Sources
(General Fund Revenue - Dollars in Billions)

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	Average Year-Over-Year Growth
Personal Income Tax	\$65.3	\$64.3	\$69.8	\$73.5	\$77.4	\$81.3	7.2%
Sales and Use Tax	20.5	22.9	24.1	25.8	26.3	26.8	6.3%
Corporation Tax	7.5	8.0	8.7	9.3	9.7	9.8	5.3%
Total	\$93.3	\$95.2	\$102.5	\$108.6	\$113.4	\$118.0	6.8%
Growth	16.4%	2.0%	7.7%	5.9%	4.4%	4.1%	

Note: Numbers may not add due to rounding

The economic forecast reflects modest but steady growth over the next five years. The projected average growth rate in Gross Domestic Product over this period is 3 percent, a slightly slower rate than normal for an economic expansion. Most of the key drivers of the revenue forecast, such as total personal income, unemployment rate, and wages, are projected to grow at slightly slower rates than was projected for the 2013 Budget Act forecast. The long-term forecast reflects the sunset of the Proposition 30 sales tax rate increase halfway through 2016-17 and the elimination of the top three income tax brackets at the end of 2018.

ECONOMIC DEVELOPMENT INITIATIVE

Shortly after the 2013 Budget was adopted, the Legislature enacted the Governor’s proposal to reform California’s economic development programs. The state’s Enterprise Zone tax credit program, which was developed over 25 years ago, was failing to encourage the creation of new jobs and was, instead, rewarding employers for simply moving jobs from one place to another within the state. Additionally, the New Jobs Hiring Credit created in 2009 had not been effective at stimulating job growth.

In place of those two programs, three tax incentive programs were created. A new hiring credit is focused on specific areas that have high unemployment and poverty rates. This credit will be available for the hiring of long-term unemployed workers, unemployed veterans, ex-offenders previously convicted of a felony, recipients of the federal Earned Income Tax Credit, and people receiving public assistance. The new program also includes an upfront sales tax exemption for manufacturing or biotech research and development equipment purchases valued at up to \$200 million per business. Finally,

the California Competes tax credit will be administered by the Governor's Office of Business and Economic Development, which will negotiate agreements to provide businesses tax credits in exchange for investments and employment expansion in California.

This legislation is revenue neutral over five years and focuses on improving the performance of tax credits. It allows California to be more effective at stimulating economic growth and creating new jobs. The program is designed to allow small businesses to easily obtain the manufacturing sales tax exemption, and dedicates a portion of the hiring credit and the incentive fund solely to small businesses.

Figure REV-06 shows the revenue impact of the various components of the economic development initiative for the budget window.

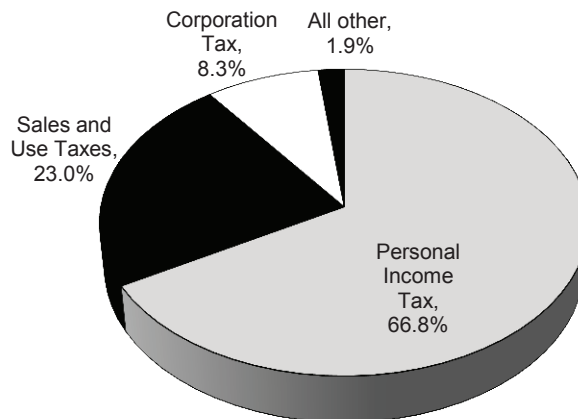
Figure REV-06
Economic Development Initiative
(Dollars in Millions)

	2012-13 Preliminary	2013-14 Forecast	2014-15 Forecast
Repeal Enterprise Zones	\$0	\$95	\$375
Repeal Hiring Credit	0	14	21
New Hiring Credit	0	-8	-37
Sales Tax Exemption for Manufacturing Equipment	0	0	-486
California Competes	0	0	-32
Total	\$0	\$101	-\$159

GENERAL FUND REVENUE

In 2014-15, General Fund revenues and transfers represent 69.7 percent of total revenues reported in the Budget. Figure REV-07 shows the breakdown of General Fund revenues by taxation type. The remaining 30.3 percent consists of special fund revenues dedicated to specific programs.

Figure REV-07
2014-15 General Fund Revenues and Transfers = \$104.5 Billion



PERSONAL INCOME TAX

The personal income tax (PIT) is the state’s largest single revenue source, accounting for 66.8 percent of all General Fund revenues and transfers in 2014-15.

Proposition 30 created three new income tax brackets for families with rates of 10.3 percent for taxable income above \$500,000, 11.3 percent for taxable income above \$600,000, and 12.3 percent for taxable income above \$1,000,000. These new tax brackets are in effect for seven years—tax years 2012 to 2018. Modeled closely on the federal income tax law, California’s PIT is imposed on net taxable income—gross income less exclusions and deductions. The tax rate structure is progressive over much of the income spectrum. For the 2012 tax year, the marginal rates ranged from 1 percent to 12.3 percent.

The largest income source for the PIT is wages and salaries. Although the year-over-year growth rates for wages tend to be less volatile than other income sources, wages and salaries includes some volatile types of compensation such as the vesting of restricted stock and restricted stock units, the exercise of most stock options, and bonus payments. In 2011, taxes attributable to wages and salaries accounted for over 63 percent of PIT revenues. Based on the economic forecast, wages and salaries are expected to rise by an average of 3.1 percent in 2013, followed by 5-percent growth in 2014, and 6 percent in 2015.

As noted previously, capital gains are expected to be above normal levels for 2013 and 2014. Forecasting capital gains beyond 2014 is difficult, since capital gains growth rates can fluctuate wildly. As such, the forecast assumes capital gains will return to historically normal levels beginning in 2015.

Pension income is a growing income source for PIT and accounted for 6 percent of PIT revenues in 2011. Pension income is increasing due to a growing 65 and over population and a strong stock market. Pension income is forecast to rise by 10.5 percent in 2013, 6.3 percent in 2014, and 6.3 percent in 2015. A significant reversal in the stock market could reduce these forecasted growth rates.

A portion of PIT revenue is for dedicated purposes and deposited into a special fund instead of the General Fund. Proposition 63, passed in November 2004, imposes a surcharge of 1 percent on taxable income over \$1 million. Revenue from the surcharge is transferred to the Mental Health Services Fund and used to fund mental health service programs. Revenues of \$1.5 billion are estimated for the 2012-13 fiscal year. Annual revenues of \$1.4 billion for 2013-14, and \$1.6 billion for 2014-15 are projected. The General Fund and the Mental Health Services Fund shares of PIT revenues for 2012-13 through 2014-15 are shown in Figure REV-08.

Figure REV-08
Personal Income Tax Revenue
(Dollars in Thousands)

	2012-13 Preliminary	2013-14 Forecast	2014-15 Forecast
General Fund	\$65,332,000	\$64,287,000	\$69,764,000
Mental Health Services Fund	1,477,000	1,375,000	1,587,000
Total	\$66,809,000	\$65,662,000	\$71,351,000

SALES AND USE TAX

The sales and use tax (sales tax) is generally applied to the sale of merchandise, including vehicles, in the state. Sales and Use Tax revenues are forecast by relating taxable sales to economic factors such as income, employment, housing starts, new vehicle sales, and inflation. The sales tax is expected to generate General Fund revenues of \$22.9 billion in 2013-14 and \$24.1 billion in 2014-15. Revenue growth from 2013-14 to 2014-15 is muted due to a \$486 million reduction in 2014-15 revenues as a result of the start of the manufacturing equipment sales tax exemption on July 1, 2014. Receipts

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from the sales tax, the state's second largest revenue source, are expected to contribute 23 percent of all General Fund revenues and transfers in 2014-15.

Figure REV-09 displays total sales tax revenues for the General Fund, and various special funds, for 2012-13 through 2014-15. Beginning on July 1, 2004, a temporary 0.25 percent state sales tax rate was imposed with revenues dedicated to the repayment of Economic Recovery Bonds. The total sales tax rate did not increase, however, as there was a concurrent drop in the Bradley-Burns rate for local governments. Once these bonds are repaid, which the Budget currently estimates to be in late 2014-15, this rate adjustment will sunset.

Figure REV-09
Sales Tax Revenue
(Dollars in Thousands)

	2012-13 Preliminary	2013-14 Forecast	2014-15 Forecast
General Fund	\$20,482,000	\$22,920,000	\$24,071,000
Sales and Use Tax-1991 Realignment	2,925,184	3,042,335	3,246,609
Sales and Use Tax-2011 Realignment	5,516,614	5,880,519	6,311,174
Economic Recovery Fund (a)	1,443,386	1,514,000	1,616,000
Other (b)	640,106	1,755,761	1,845,852
Total	\$31,007,290	\$35,112,615	\$37,090,635

(a) Economic Recovery Bonds are expected to be repaid by the end of 2014-15.

(b) Includes (1) Public Transportation Account: \$640.1 million in 2012-13, \$609.9 million in 2013-14, and \$593.2 million in 2014-15, and (2) Managed Care Organization Tax: \$1.2 billion in 2013-14, and \$1.3 billion in 2014-15.

Figure REV-10 displays the individual elements of the state and local sales tax rates.

Taxable sales, including sales of gasoline, increased by 8.3 percent in 2011-12. Based on preliminary data, it is estimated that taxable sales have increased by 5.9 percent in 2012-13. Growth is expected to continue at 5.5 percent in 2013-14, followed by 6.7 percent in 2014-15.

Over the last few years, wholesale trade has been the largest contributor to the sales tax base. Motor vehicle and parts dealer taxable sales realized the largest year-over-year growth of all sectors. Other significant contributors to the sales tax base include sales from gasoline stations and food services, which primarily include full-service restaurants, as well as food contractors and caterers.

Figure REV-10

2014-15 State and Local Sales and Use Tax Rates (as of January 1, 2014)

State Rates		
General Fund	4.19%	The permanent rate of 3.94% may be temporarily reduced by 0.25% if General Fund reserves exceed specified levels. As of January 1, 2013, Proposition 30 temporarily adds 0.25 percent to the General Fund rate.
Local Revenue Fund 2011	1.06%	Revenues attributable to a rate of 1.0625 percent is dedicated to the Local Revenue Fund 2011.
Local Revenue Fund	0.50%	Dedicated to local governments to fund health and social services programs transferred to counties as part of 1991 state-local realignment.
Economic Recovery Fund	0.25%	Beginning on July 1, 2004, a temporary 0.25% state sales tax rate was imposed, with a corresponding decrease in the Bradley-Burns rate. These revenues are dedicated to repayment of Economic Recovery Bonds. Once these bonds are repaid (currently estimated to be April 2015), this tax will sunset and the Bradley-Burns rate will return to 1%.
Local Uniform Rates¹		
Bradley-Burns	0.75% ²	Imposed by city and county ordinance for general purpose use. ³
Transportation Rate	0.25%	Dedicated for county transportation purposes.
Local Public Safety Fund	0.50%	Dedicated to cities and counties for public safety purposes. This rate was imposed temporarily by statute in 1993 and made permanent by the voters later that year through passage of Proposition 172.
Local Add-on Rates		
Transactions and Use Taxes	up to 2.00%	May be levied in 0.125% or 0.25% increments ⁴ up to a combined maximum of 2.00% in any county. ⁵ Any ordinance authorizing a transactions and use tax requires approval by the local governing board and local voters.

¹ These locally-imposed taxes are collected by the state for each county and city and are not included in the state's revenue totals.

² The 1 percent rate was temporarily decreased by 0.25 percent on July 1, 2004, and a new temporary 0.25 percent tax imposed to repay Economic Recovery Bonds. Cities and counties will receive additional property tax revenues equal to the 0.25 percent local sales tax reduction.

³ The city tax is a credit against the county tax. The combined rate is never more than 1 percent (or 0.75 percent during the period when Economic Recovery Bonds are being repaid).

⁴ Increments imposed at 0.125 percent are only allowed when revenues are dedicated for library purposes.

⁵ An exception to the 2 percent maximum is Los Angeles County, which may impose up to 2.5 percent.

The managed care organization tax is a tax on Medi-Cal managed care plan premiums through 2015-16, with the rate being equal to the state sales tax rate. Medi-Cal managed care plans are assessed the tax and proceeds are matched with federal funds to provide supplemental payments to plans. Remaining proceeds are used for the provision of health services to children and seniors and persons with disabilities in the Medi-Cal program.

Figure REV-11 shows combined state and local tax rates for each county including special rates for certain cities within those counties.

Figure REV-11
Combined State and Local Sales and Use Tax Rates by County
(city rate provided if different from the county rate)

Rates in Effect on January 1, 2014

County	Tax Rate	County	Tax Rate	County	Tax Rate
Alameda	9.00%	Mendocino	7.625%	San Mateo	9.00%
Alpine	7.50%	Point Arena, Ukiah, and Willits	8.125%	San Mateo	9.25%
Amador	8.00%	Fort Bragg	8.625%	Half Moon Bay	9.25%
.....	7.50%	Merced	7.50%	Santa Barbara	8.00%
Calaveras	7.50%	Atwater, Gustine,	8.00%	Santa Maria	8.25%
Colusa	7.50%	Los Banos, and Merced	8.00%	Santa Clara	8.75%
Williams	8.00%	Modoc	7.50%	Campbell	9.00%
Contra Costa	8.50%	Mono	7.50%	Santa Cruz	8.25%
Concord, Hercules, Orinda,	9.00%	Mammoth Lakes	8.00%	Watsonville	8.50%
Pinole, Pittsburg, and San Pablo	9.50%	Monterey	7.50%	Santa Cruz and Capitola	8.75%
El Cerrito and Moraga	9.50%	Salinas and Sand City	8.00%	Shasta	7.50%
Del Norte	7.50%	Carmel, Del Rey Oaks, Greenfield,	8.50%	Sierra	7.50%
El Dorado	7.50%	Marina, Pacific Grove,	8.50%	Siskiyou	7.50%
Placerville and South Lake Tahoe	8.00%	Seaside, and Soledad	8.00%	Mt. Shasta	7.75%
Fresno	8.225%	Napa	8.00%	Solano	7.625%
Reedley and Selma	8.725%	Nevada	7.625%	Vacaville	7.88%
Sanger	8.975%	Truckee and Grass Valley	8.125%	Rio Vista	8.38%
Glenn	7.50%	Nevada City	8.50%	Vallejo and Fairfield	8.63%
Humboldt	7.50%	Orange	8.00%	Sonoma	8.25%
Arcata, Eureka, and Trinidad	8.25%	La Habra	8.50%	Cotati, Rohnert Park, Santa Rosa,	8.75%
Imperial	8.00%	Placer	7.50%	Sonoma, and Healdsburg	9.00%
Calexico	8.50%	Plumas	7.50%	Sebastopol	9.00%
Inyo	8.00%	Riverside	8.00%	Stanislaus	7.625%
Kern	7.50%	Cathedral City and Palm Springs	9.00%	Ceres and Oakdale	8.125%
Ridgecrest	8.25%	Sacramento	8.00%	Sutter	7.50%
Arvin and Delano	8.50%	Galt and Sacramento	8.50%	Tehama	7.50%
Kings	7.50%	San Benito	7.50%	Trinity	7.50%
Lake	7.50%	San Juan Bautista	8.250%	Tulare	8.00%
Clearlake and Lakeport	8.00%	Hollister	8.50%	Visalia	8.25%
Lassen	7.50%	San Bernardino	8.00%	Tulare	8.50%
Los Angeles	9.00%	Montclair and San Bernardino	8.25%	Dinuba	8.75%
Avalon, Culver City,	9.50%	San Diego	8.00%	Tuolumne	7.50%
Commerce, El Monte, Inglewood,	10.00%	Vista	8.50%	Sonora	8.00%
Santa Monica, South El Monte,	10.00%	La Mesa	8.75%	Ventura	7.50%
and San Fernando	10.00%	El Cajon and National City	9.00%	Oxnard and Port Hueneme	8.00%
Pico Rivera, South Gate,	10.00%	San Francisco	8.75%	Yolo	7.50%
and La Mirada	10.00%	San Joaquin	8.00%	West Sacramento and Davis	8.00%
Madera	8.00%	San Luis Obispo	7.50%	Woodland	8.25%
Marin	8.50%	Arroyo Grande, Grover Beach,	8.00%	Yuba	7.50%
Fairfax, Novato, and San Rafael	9.00%	Morro Bay, Pismo Beach,	8.00%	Wheatland	8.00%
Mariposa	8.00%	San Luis Obispo, and Paso Robles			

CORPORATION TAX

Corporation tax revenues are expected to contribute 8.3 percent of all General Fund revenues and transfers in 2014-15. Corporation tax revenues were \$7.5 billion in 2012-13 and are expected to increase by 6.8 percent to \$8.0 billion in 2013-14. In 2014-15, they are expected to increase by 8.9 percent to \$8.7 billion. The 2013-14 revenues show more growth, in part, because of the passage of Proposition 39 (discussed below). Despite the projected year-over-year growth in corporation tax, receipts continue to be sluggish and are significantly affected by various tax law changes—primarily tax credits and income apportionment rules—that have been adopted in the last 25 years.

For 2011 and 2012, multi-state businesses could determine California taxable income based on one of two methods that they deemed most advantageous to them: (1) an apportioning formula which factors in their sales, property, and employees in this state, or (2) one based only on sales in California—frequently referred to as the single sales factor formula. The ability of corporations to use this election had a significant negative impact on corporation tax revenue.

Proposition 39, The California Clean Energy Jobs Act, passed by voters in November of 2012, requires most multi-state businesses to apportion their multi-state business income to California using single-sales-factor apportionment. Beginning in January 2013, Proposition 39 also removed the ability of some corporations to source their sales of services and intangibles to the state in which the majority of the work to produce that service or intangible was performed. Under Proposition 39, almost all taxpayers are required to source their sales of services and intangibles to the state into which the service or intangible is sold.

The Proposition 39 revenue estimate has decreased since the 2013 Budget Act was adopted. In May 2013, the Franchise Tax Board had estimated, using data from 2010 tax year returns, a revenue gain from Proposition 39 of \$928 million for 2013-14 and \$1 billion for 2014-15. A more recent estimate, using data from 2011 tax year returns, forecasts revenue gains of \$675 million for 2013-14 and \$726 million for 2014-15.

Also reducing corporation tax revenue is the continuing trend toward large refunds related to the resolution of taxpayer disputes from prior years. It is estimated that \$600 million in prior year refunds could be paid by the end of 2013-14, and our forecast assumes that this trend of refunds will continue.

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The net impact of the Economic Development Initiative on the corporation tax is expected to be an increase of \$59 million in 2013-14 and \$189 million in 2014-15.

From 1943 through 1985, corporation tax liability as a percentage of profits closely tracked the corporation tax rate. Since 1986, increasing S-corporation activity and use of credits have been contributing to a divergence between profits and tax liability growth. Businesses that elect to form as S-corporations pay a reduced corporate rate, with the income and tax liability on that income passed through to owners and thus shifted to the personal income tax.

INSURANCE TAX

Most insurance policies written in California are subject to a 2.35 percent gross premiums tax. This premium tax takes the place of all other state and local taxes except those on real property and motor vehicles. In general, the basis of the tax is the amount of "gross premiums" received, less return premiums. The insurance tax is expected to generate General Fund revenues of \$2.1 billion in 2013-14 and \$2.3 billion in 2014-15.

The Department of Finance conducts an annual survey to project insurance premium growth. Responses were received this year from a sample representing about 39 percent of the dollar value of premiums written in California.

In 2012, \$120.2 billion in taxable premiums were reported, representing a decrease of 0.02 percent from 2011. The most recent survey indicates that total premiums will increase by 2.5 percent and 3.4 percent in 2013 and 2014, respectively. Survey respondents also reported 16.7 percent and 9.4 percent growth for taxable premiums from workers' compensation insurance in 2013 and 2014, respectively.

The primary reason for the decline in the insurance tax revenue estimate from 2012-13 to 2013-14 is refunds that are expected to be paid pursuant to a Board of Equalization decision in the *California Automobile Insurance Company* case. These refunds are also expected to dampen 2014-15 revenue. The California Department of Insurance estimates that the refunds resulting from this decision will equal \$223 million in 2013-14 and \$149 million in 2014-15.

ALCOHOLIC BEVERAGE TAXES

In addition to the sales tax paid by retail purchasers, California levies an excise tax on distributors of beer, wine, and distilled spirits. The tax rates per gallon are applied

as follows: (1) \$0.20 for beer, dry wine, and sweet wine, (2) \$0.30 for sparkling wine, and (3) \$3.30 for distilled spirits.

Alcoholic beverage revenue estimates are based on projections of total and per capita consumption for each type of beverage. Consumption of alcoholic beverages is expected to decline by about 2 percent in 2013-14 before returning to an almost 2-percent increase in 2014-15. Revenues from this tax were \$357 million in 2012-13 and are forecast to be \$350 million in 2013-14 and \$357 million in 2014-15.

CIGARETTE TAX

The state imposes an excise tax of 87 cents per pack of 20 cigarettes on distributors selling cigarettes in California. An excise tax is also imposed on the distribution of other tobacco products such as cigars, chewing tobacco, pipe tobacco, and snuff. The rate on other tobacco products is calculated annually by the Board of Equalization based on the wholesale price of cigarettes and the excise tax on cigarettes.

Revenues from the tax on cigarettes and other tobacco products are distributed as follows:

- Ten cents of the per-pack tax is allocated to the General Fund.
- Fifty cents of the per-pack tax, and an equivalent rate levied on non-cigarette tobacco products, goes to the California Children and Families First Trust Fund for distribution according to the provisions of Proposition 10 of 1998.
- Twenty-five cents of the per-pack tax, and an equivalent rate levied on non-cigarette tobacco products, is allocated to the Cigarette and Tobacco Products Surtax Fund for distribution as determined by Proposition 99 of 1988.
- Two cents of the per-pack tax is deposited into the Breast Cancer Fund.

Projections of cigarette tax revenues are based on projected per capita consumption of cigarettes and population growth, while revenue estimates for other tobacco products also rely on wholesale price data. The cumulative effect of product price increases, the increasingly restrictive environments for smokers, state anti-smoking campaigns funded by Proposition 99 Tobacco Tax and Health Protection Act revenues and revenues from the Master Tobacco Settlement, and the 2009 federal cigarette tax rate increase have reduced cigarette consumption considerably. This declining trend is expected to continue. Annual per capita consumption (based on population ages 18-64) declined

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from 123 packs in 1989-90 to 84 packs in 1997-98 and 40 packs in 2011-12. This forecast assumes an annual decline in total consumption of approximately 3.6 percent.

Figure REV-12 shows the distribution of tobacco tax revenues for the General Fund and various special funds for 2012-13 through 2014-15.

Figure REV-12
Tobacco Tax Revenue
(Dollars in Millions)

	2012-13 Preliminary	2013-14 Forecast	2014-15 Forecast
General Fund	\$90.0	\$89.0	\$86.0
Cigarette and Tobacco Products Surtax Fund	277.8	264.0	256.0
Breast Cancer Fund	18.0	18.0	17.0
California Children and Families First Trust Fund	481.2	466.0	451.0
Cigarette and Tobacco Products Compliance Fund	1.7	1.5	1.5
Total	\$868.7	\$838.5	\$811.5

PROPERTY TAXES

Although the property tax is a local revenue source, the amount of property tax generated each year has a substantial impact on the state budget because local property tax revenues allocated to K-14 schools generally offset General Fund expenditures.

Assessed value growth is estimated based on statistical modeling and evaluations of real estate trends. The median sales price of new and existing homes rose by over 12 percent in 2012 and 24 percent in 2013 (with activity in the 2013 calendar year driving fiscal year 2014-15 assessed valuations for property tax purposes). While sales volumes declined by approximately 3 percent in 2013, the impact on 2014-15 property tax revenues will be moderated by the significant increase in 2013 median prices, combined with the reassessment to current market value of homes whose assessed values were significantly reduced during the market downturn. This increase in property valuations, coupled with continuing declines in the number of foreclosures, indicates the state's real estate market is in a period of rebound. Despite this overall increase, however, there are still areas where sales volumes and property values continue to stagnate.

Statewide property tax revenues are estimated to increase 4.2 percent in 2013-14 and 6.3 percent in 2014-15, of which roughly 40 percent (\$22.3 billion) will go to K-14 schools. While this amount includes \$785 million that schools are expected to receive in 2014-15 pursuant to the dissolution of the RDAs, it does not include the \$1.6 billion shifted to cities and counties to replace sales and use tax revenues redirected from those entities to repay the Economic Recovery Bonds, nor does it include the \$6.8 billion shifted to cities and counties to replace Vehicle License Fee (VLF) revenue losses stemming from the reduced VLF rate of 0.65 percent.

OTHER REVENUES

UNCLAIMED PROPERTY

The Budget reflects receipts of \$473 million in 2012-13, \$421 million in 2013-14, and \$446 million in 2014-15. These numbers reflect increases in receipts from life insurance companies.

INDIAN GAMING

The Budget reflects General Fund revenues from tribal gaming of \$335 million in 2012-13 and \$332 million in 2013-14 and 2014-15. This revenue includes approximately \$95 million that is transferred annually from a special deposit fund to the General Fund for certain transportation programs that would otherwise be funded with revenues from a bond sale yet to occur. Absent a bond sale, the Administration proposes to continue this funding arrangement through 2015-16.

LOAN REPAYMENTS TO SPECIAL FUNDS

The Budget reflects the repayment of loans to special funds based on the operational needs of the programs requiring these repayments. In addition, the Budget proposes early loan repayments for transportation and Cap and Trade to accelerate programmatic benefits, such as the maintenance of existing state highways. Total repayments are projected to be \$720.9 million and \$927 million in 2013-14 and 2014-15, respectively.

SPECIAL FUND REVENUE

The California Constitution and state statutes specify into which funds certain revenues must be deposited and how they are to be spent.

Total special fund revenues are estimated to be \$43.1 billion in 2014-15. Taxes and fees related to motor vehicles are expected to comprise about 27 percent of all special fund revenue in 2014-15. The principal sources are motor vehicle fees (registration, weight, and vehicle license fees) and motor vehicle fuel taxes. During 2014-15, it is expected that about \$12 billion in revenues will be derived from the ownership or operation of motor vehicles. About 38 percent of all motor vehicle taxes and fees will be allocated to local governments, and the remaining portion will be used for state transportation programs.

MOTOR VEHICLE FEES

Motor vehicle fees and taxes consist of vehicle license, registration, weight, driver’s license, and other charges related to vehicle operation. Figure REV-13 displays revenue from these sources from 2012-13 through 2014-15.

The Vehicle License Fee (VLF) is imposed on vehicles that travel on public highways in California. The current VLF tax rate is 0.65 percent. This tax is imposed in lieu of a local personal property tax on automobiles and is administered by the Department of

Motor Vehicles. The number of vehicles in the state, the ages of those vehicles, and their most recent sales price affect the amount of VLF collected. The total number of vehicles in California—autos, trucks, trailers, and motorcycles including vehicles registered in multiple states—is estimated to be 29,910,283 in 2013-14 and is expected to increase to 30,413,022 in 2014-15. Consistent with expected increases in national new vehicle sales due to the availability of consumer credit, an improving employment picture, and projected increases to after-tax income, the forecast projects that there will be 2,027,262 new vehicles registered in 2013-14, increasing to 2,132,968 in 2014-15.

In addition to the VLF, truck owners pay a fee based on vehicle weight. Due partly to the expected increase in truck sales reflecting an improving business climate, weight fee revenues are expected to be \$945 million in 2013-14 and to increase by 1.3 percent to \$957.5 million in 2014-15.

Figure REV-13
Motor Vehicle Fees Special Fund Revenue
 (Dollars in Thousands)

	2012-13 Preliminary	2013-14 Forecast	2014-15 Forecast
Vehicle License Fees	\$1,945,822	\$2,048,591	\$2,093,171
Registration, Weight, and Other Fees	<u>3,890,492</u>	<u>3,981,718</u>	<u>4,115,531</u>
Total	\$5,836,314	\$6,030,309	\$6,208,702

MOTOR VEHICLE FUEL TAXES

The motor vehicle fuel tax, diesel fuel tax, and use fuel tax are the major sources of funds for maintaining, replacing, and constructing state highway and transportation facilities. Over one-third of these revenues are apportioned to local jurisdictions for a broad range of local road projects, including both maintenance of existing roads and construction of new roads. In addition, some jurisdictions choose to spend a portion of their allocation on improvements to the state highway system in their region to decrease traffic congestion. Motor vehicle fuel tax collections are shown in Figure REV-14.

Figure REV-14

Motor Vehicle Fuel Tax Revenue

(Dollars in Thousands)

	2012-13	2013-14	2014-15
	Preliminary	Forecast	Forecast
Gasoline ¹	\$5,170,066	\$5,684,733	\$5,208,178
Diesel	320,576	327,082	333,721
Total	\$5,490,642	\$6,011,815	\$5,541,899

¹ Does not include jet fuel.

The gallons of gasoline consumed were down 0.74 percent in 2012-13 when compared to the prior fiscal year. Gasoline consumption is expected to decrease 0.67 percent in both 2013-14 and 2014-15. Because most diesel fuel is consumed by the commercial trucking industry, the gallons consumed are affected most significantly by general economic conditions. A recovering economy is expected to contribute to growth of 2 percent in diesel consumption per year in 2013-14 and 2014-15.

The motor vehicle fuel tax (gas tax) is collected from distributors when fuel is loaded into ground transportation for transport to retail stations. This fuel is taxed at a rate of 39.5 cents per gallon under current law. The excise rate is adjusted annually so that the total amount of tax revenue generated is equal to what it would have been when gasoline was subject to the state sales tax rate. The Budget forecasts that the excise tax on gasoline will be 36.4 cents per gallon in 2014-15. Fuels subject to the gas tax include gasoline, natural gas, and blends of gasoline and alcohol sold for use on public streets and highways.

Distributors pay the diesel fuel tax, which applies to both pure diesel fuel and blends, at the fuel terminal. Diesel fuel for highway use is taxed at a rate of 10 cents per gallon in 2013-14. The excise rate is adjusted annually so that the total amount of tax revenue generated is neutral given the changes to the sales add-on for diesel fuel. Under current law, the sales tax rate add-on will decrease to 1.75 percent in 2014-15, and the Budget forecasts that the excise tax on diesel fuel will be adjusted to 11 cents per gallon

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in 2014-15. Dyed diesel fuel, which is used for off-highway purposes such as farm equipment, is not taxed.

SUMMARY OF STATE TAX SYSTEM

The state's tax system is outlined at the end of this section in Figure REV-15. Tax collections per capita and per \$100 of personal income are displayed in Schedule 2 in the Appendix. The revenue generated from each state tax from 1970-71 through 2014-15 is displayed in Schedule 3 in the Appendix.

Figure REV-15
**Outline of State Tax System
as of January 1, 2014**

Major Taxes and Fees	Base or Measure	Rate	Administering Agency	Fund
Alcoholic Beverage Excise Taxes:				
Beer	Gallon	\$0.20	Equalization	General
Distilled Spirits	Gallon	\$3.30	Equalization	General
Dry Wine/Sweet Wine	Gallon	\$0.20	Equalization	General
Sparkling Wine	Gallon	\$0.30	Equalization	General
Hard Cider	Gallon	\$0.20	Equalization	General
Corporation:				
General Corporation	Net income	8.84% [1]	Franchise	General
Bank and Financial Corp.	Net income	10.84%	Franchise	General
Alternative Minimum Tax	Alt. Taxable Income	6.65%	Franchise	General
Tobacco:				
Cigarette	Package	\$0.87 [2]	Equalization	See below [2]
Other Tobacco Products	Wholesale cost	29.82% [3]	Equalization	See below [3]
Insurance				
Insurers	Gross Premiums	2.35% [4]	Insurance Dept.	General
Liquor License Fees	Type of license	Various	Alc. Bev. Control	General
Motor Vehicle:				
Vehicle License Fees (VLF)	Market value	0.65%	DMV	Motor VLF, Local Revenue [5]
Fuel—Gasoline	Gallon	\$0.360 [6]	Equalization	Motor Vehicle Fuel [7]
Fuel—Diesel	Gallon	\$0.10 [8]	Equalization	Motor Vehicle Fuel
Registration Fees	Vehicle	\$69.00	DMV	Motor Vehicle [9]
Weight Fees	Gross Vehicle Wt.	Various	DMV	State Highway
Personal Income	Taxable income	1.0-12.3% [10]	Franchise	General
Proposition 63 Surcharge	Taxable income > \$1 million	1.0%	Franchise	Mental Health Services
Alternative Minimum Tax	Alt. Taxable Income	7.0%	Franchise	General
Retail Sales and Use	Sales or lease of taxable items	7.50% [11]	Equalization	See below [11]
Medi-Cal managed care plans	Sales Tax on Gross Premiums	3.93%	Equalization	See below [12]

[1] Minimum Tax is \$800 per year for existing corporations. New corporations are exempt for the first two years.

[2] This tax is levied at the combined rate of 10 cents/pack of 20 cigarettes for the General Fund, 25 cents/pack for the Cigarette and Tobacco Products Surtax Fund, 2 cents/pack for the Breast Cancer Fund, and 50 cents/pack for the California Children and Families First Trust Fund.

[3] The surtax rate is determined annually by the BOE and is equivalent to the combined rate of tax applied to cigarettes, with funding for the Cigarette and Tobacco Products Surtax Fund and California Children and Families First Trust Fund. Effective July 1, 2013, through June 30, 2014, the rate is 29.82 percent of the wholesale cost.

[4] Ocean marine insurance is taxed at the rate of 5 percent of underwriting profit attributable to California business. Special rates also apply to certain pension and profit sharing plans, surplus lines, and nonadmitted insurance.

[5] For return to cities and counties. Trailer coach license fees are deposited in the General Fund.

[6] As part of the fuel tax swap implemented beginning July 1, 2010, this rate was increased from 18 cents and will be adjusted each year to maintain revenue neutrality with the elimination of the General Fund portion of the sales tax on gasoline.

[7] For administrative expenses and apportionment to State, counties and cities for highways, airports, and small craft harbors.

[8] As part of the fuel tax swap, this rate was decreased by 3 cents on July 1, 2012, and will be adjusted each year thereafter to maintain revenue neutrality to offset the increased sales tax on diesel.

[9] For support of State Department of Motor Vehicles, California Highway Patrol, other agencies, and motor vehicle related programs.

[10] Proposition 30 (The Schools and Local Public Safety Protection Act of 2012) was passed by the California voters in November 2012. Proposition 30, for tax years 2012 through 2018, created three new income tax brackets with rates of 10.3 percent for taxable income over \$250,000, 11.3 percent for taxable income over \$300,000, and 12.3 percent for taxable income over \$500,000.

[11] The 7.50 percent rate includes the rates for General Fund, Special Funds, and uniform local rates. Additionally, cities and counties may generally assess up to an additional 2.00 percent to the statewide rate. This rate includes the passage of Proposition 30 (The Schools and Local Public Safety Protection Act of 2012), effective beginning January 1, 2013.

[12] Tax on Medi-Cal managed care plan premiums through 2015-16, with the rate being equal to the state sales tax rate.

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