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CAL-TAX CRITICIZES PLAN TO SWAP CAR TAX HIKE FOR HIGHER INCOME AND TOBACCO TAXES

“This is a tax scheme that will only compound California’s financial problems. The scheme will damage schools, taxpayers, cities and counties, and small business. It is counterproductive for the California Legislature to spend time hatching such ill-advised tax schemes.” – Larry McCarthy, president, California Taxpayers’ Association (Cal-Tax).

Leading Assembly Democrats are apparently planning to roll back the car tax increase triggered this year by the Davis administration and replace it with a massive increase in the personal income tax, cigarette tax and potentially others.

The scheme, initially reported in newspapers on August 11, would be a swap intended to be revenue neutral. Although legally suspect, they would use this back-door legislative maneuver in an effort to circumvent the Constitution’s two-thirds vote requirement for increasing taxes.

The four weeks left this year in the 2003-04 legislative session, beginning August 18 and ending September 12, clearly are high-risk times for taxpayers, businesses and consumers.

Assembly Appropriations Committee Chair Darrell Steinberg, who said he wants to author such a bill, told reporters he believes by raising new taxes by \$4.2 billion (the annual amount estimated to be at stake with the car tax increase), Democrats could approve the plan by simple majorities. He intends to circulate the plan among fellow Democrats before putting it into legislative form for formal introduction, possibly by early September.

The California Taxpayers’ Association is concerned even as the proposal is in the discussion stage, yet to be fully cooked, according to a legislative source. Taxpayers cannot afford to sit back and wait for a formal bill introduction, because by that time supporters of such a scheme will be pushing it in the waning days or hours of the session. Last year, without public hearings or debate late in the session, the Legislature passed a \$2.4 billion tax bill.

Cal-Tax, among others, has long held that two-thirds votes are needed to increase state taxes and this rule should apply even in a so-called revenue-neutral measure because the bill would be increasing taxes on some class of taxpayer.

Furthermore, the income tax is so volatile that estimates of revenue from this source should be considered guesstimates.

Violating Constitutional Protections. Californians should be alarmed by the flagrant disregard for constitutional protections inherent in this scheme. Voter approved constitutional protections for schools and taxpayers are being run over.

- Proposition 98. Intended to assure minimum funding for children in K-12 public schools, this constitutional amendment, approved by voters in 1988, sets aside 40 cents of every general fund tax dollar.
- Proposition 13. Intending to protect taxpayers from unnecessary taxation, voters in 1978 approved this initiative not only to limit increases in property taxes but to require two-thirds votes of the Legislature to enact new or increased taxes. The tax increase proposal would exchange a recent tax increase that did not receive the appropriate approval by the Legislature with more taxes that also would not be approved within constitutional protections.

Massive Income Tax Increase. The proposed increase in income tax is massive. It would raise taxes on those with adjusted gross incomes of \$125,000 or more (single filers) and \$250,000 (joint filers).

Raising income taxes will also impact small, unincorporated businesses that account for 15 percent of personal income tax payments, and will chase away jobs because Nevada, Texas and other non-income tax states become more attractive for investment. More upper-income Californians will be encouraged to take up residence elsewhere. History clearly shows that income tax increases reduce revenue from that source. See the attached Fact Sheet on increasing the California Income Tax: <http://www.caltax.org/Fact%20Sheet.pdf>.

Tobacco Taxes are Regressive and Spawn Criminal Activity. The proposal would increase the tax on cigarettes from 87 cents a pack to \$1.10 a pack (with corresponding increases in excise taxes on other tobacco products).

A substantial percentage of any cigarette tax increase will be paid by low-income Californians. Raising the cigarette tax violates every tenant of good tax policy. The cigarette tax is revenue source that will decline as rates are increased. The tax is inequitable because it isolates a group of consumers for discriminatory and punitive taxation.

The tax is extremely regressive and more of the tax burden falls on lower income households. Administrative costs for collecting this tax will increase because of

illegal sales, cross-border smuggling, and counterfeit tax stamps and products. Illegal sales grow with every increase in the tax.

There are other problems:

Unnecessary and Costly Litigation. Unfortunately, passage of such a tax shift scheme will produce only litigation. Lawsuits can be expected from taxpayers who believe this scheme violates the constitutional two-thirds vote requirement for raising taxes and/or teachers who believe that Proposition 98 guarantees schools a portion of the tax increases. Either way, taxpayers will be paying for the court costs and attorney fees. The additional revenue becomes illusory and ultimately the budget will have that much of a bigger hole to fill.

It could get worse. The Davis administration argued that the car tax “trigger” required them to increase the car tax because the state had “insufficient revenues” to pay local governments for the revenue owed them by the state. This proposed tax swap then could become a tool for regularly ratcheting up taxes by a majority vote. This year it is a “tax swap” by majority vote. Next year, when faced with this Legislature’s insatiable spending appetite and the resulting \$8 billion to \$10 billion budget deficit, is the car tax increase once again triggered without a vote? Is it then swapped out again before the November 2004 election for yet another round of tax increases? Will there ever be an end? This is a game that once engaged could be replicated under pressure from the spending lobby.

Even assuming the Legislature is not so bold as to engage in such shenanigans as the yo-yoing of the car tax, there are detrimental effects to taxpayers and the economy from increasing the taxes potentially targeted by this proposal.

A tax increase is not needed to reduce the car tax. The Legislature has left untouched numerous opportunities to reduce spending by eliminating fraud, waste, mismanagement, and low-priority activities that are consuming taxpayer dollars. (See Fraud and Waste at Cal-Tax Online.)

Without commenting on the merits or demerits of the car tax increase, which is subject to existing litigation and possible repeal initiatives for the November 2004 ballot, Cal-Tax believes the alternative taxes targeted by Mr. Steinberg and others represent bad tax policy.