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Opinion



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The Sacramento Bee

Editorial: A time for great things

On Monday, Gray Davis will take the oath of office for a second term as California's governor. Here's a speech he's welcome to use:

Editorial: Little films, big box office

Here is a shred of consolation to any moviegoer who has sat through trailers for upcoming first-run blockbusters and felt a sad sort of wonder that people would pay money to see such big-budget dreck: In the year that just ended, the little films often proved the most profitable.

Letters to the editor: The only way

Re "Universal teachings," Your views, Dec. 25: Most religions teach about love. What one comes to realize when one studies the teachings of Jesus is that he did not point to the "way." He said he is the "way." In John 14:6, he specifically says, "I am the way, and the truth and the life. No one comes to the father except through me." While some may say that this is exclusive, and narrow, it is either true or not. A person can accept Jesus' sayings or turn from them. The wonder of what he taught is that he backed up his words with actions, by going to the cross. There is no greater love than Jesus laying down his life for his friends.

Daniel Weintraub: As a few rich guys go, so goes state budget

By **Daniel Weintraub** -- Bee Columnist
Published 2:15 a.m. PST Sunday, January 5, 2003

If only the rich would get richer. And stay that way.

Not exactly your ideal social policy, perhaps. But for anyone interested in balancing California's seriously out-of-whack state budget, getting the wealthy healthy again might be the quickest route to salvation.

This column's analysis of the latest tax data shows that most of the multi-billion-dollar revenue drop that has sent state government into a fiscal tailspin can be traced to fewer than 50,000 returns filed by the wealthiest people in this relatively well-off state. The total tax paid by a tiny sliver at the top of the income heap - - those making more than \$1 million a year -- declined by \$7 billion between 2000 and 2001.

These numbers, obtained from the Franchise Tax Board, demonstrate anew how California's fiscal fortunes rely to a perilous degree on the economic well-being of a relative handful of the state's 35 million residents.

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The figures also suggest that any attempt to overhaul state tax policy will have to take into account the way California's dramatically unequal distribution of income interacts with the state's somewhat progressive tax rates to create the revenue roller coaster that has befuddled state budget writers.

In short, any policy change that fails to accurately predict the behavior of the state's wealthiest citizens risks making the problem even worse than it is today.

It wasn't always this way. As recently as 1995, the personal income tax was first among equals, but it wasn't the dominant force in state finances that it is today. In 1995-96, the income tax raised about \$21 billion, or 46 percent of the state's general fund. The sales tax brought in \$17 billion and the tax on corporate profits collected almost \$6 billion.

But revisions in the tax code coupled with the Internet-driven stock market boom changed all that. By 2000, the income tax had left its sales and corporate tax mates in the dust. The personal income tax alone generated \$44 billion, or 59 percent of the state's general fund revenues. The income tax dwarfed the sales tax, which raised \$24 billion, and the corporations tax, which took in just under \$7 billion.

Not only was the income tax growing as a source of revenue for the state, but its structure was tilting. Nearly all the growth in the 1990s came from taxes on people at the upper end of the income spectrum.

Californians making \$100,000 or less, a large majority of the state's residents, paid just a little more in taxes in 2000 than they had in 1995. Revenue from that group was \$7.4 billion in 1995 and \$8.3 billion five years later.

The over-\$100,000 crowd, meanwhile, was seeing its income -- and tax bill -- explode. In 1995, people making more than \$100,000 a year accounted for 5.7 percent of California taxpayers, 32 percent of the adjusted gross income and 59 percent of the income tax paid. By 2000, that income group had grown to represent 11 percent of all those filing returns, and those returns accounted for 54 percent of the state's income and 79 percent of the income tax paid.

In raw numbers, the growth in tax revenue from this group alone was staggering. It went from \$10.7 billion in 1995 to \$12.6 billion in 1996, \$15.7 billion in 1997, \$18.3 billion in 1998, \$24.6 billion in 1999 and \$32 billion in 2000. Those taxes, in fact, accounted for almost all of the growth in the state's general fund.

And most of that growth came from taxes on stock options and capital gains. As the stock market boomed, Internet start-ups and many established companies began rewarding more and more of their employees with stock options, not just their top executives but their lawyers, computer programmers, even secretaries and janitors.

An option is the right to buy a stock at a certain price. As the share price rises above the option price, the person holding the option can buy the stock at a discount from the current price, then turn around and sell it immediately for a profit.

Those profits generate taxes in two ways. When an employee exercises an option to buy the stock, he or she records a gain -- the difference between the discounted price the employee pays for the stock and the price at which it is selling on the day of the transaction. That gain is considered income, and taxed. When the employee sells the stock, any further income is considered capital gains, or investment income, and those profits are taxed as well, usually at the top rate of 9.3 percent.

The Ombudsman: Why did the newspaper ever make that mistake?

The most irritating errors in a newspaper often are the most obvious -- at least to the reader who spotted the failures in print.

Editorial: Some needed erosion

The ruling of a state appellate court is prompting a long-overdue examination of the California Coastal Commission and how the 12 commissioners get their jobs.

Editorial: Bush EPA tackles diesel

Clean air advocates were pleasantly surprised this week when the U.S. Environmental Protection Agency announced that it was preparing a tough new set of rules to reduce emissions from off-road diesel-powered vehicles and other kinds of farm and construction equipment. The announcement is being greeted with both praise and skepticism. Given the Bush administration's history on clean air issues, both responses are appropriate.

Editorial: In their own voice

Paint your face red, white and blue

Letters to the editor

Re "Victim in purse snatching dies," Dec. 26: A kind, beautiful mother died Christmas Day. This lady was a victim of a purse-snatching a week earlier in a parking lot on Florin Road, which resulted in a broken shoulder. One might say -- "just another of many such incidents."

Editorial: Yes, it's a crisis

By any rational or moral calculation, North Korea's communist regime is an international rogue. Its past record of aggression and terrorism is appalling, and its current attempt to blackmail the United States into ending a high-tension standoff on Pyongyang's terms by restarting a nuclear weapons program is outrageous.

As this happened thousands of times over during the late 1990s, the result was a tax bubble every bit as dramatic as the stock market bubble behind it. California tax revenue derived from stock options and capital gains hovered right around \$2.5 billion annually -- about 5 percent of state revenues -- from 1989 through 1994. Then it started growing. The number climbed steadily until it peaked at about \$17.5 billion in 2000 -- 20 percent of all the money collected for the general fund that year.

To get a sense of how fragile this revenue source was, consider that the employees of just two high-tech firms, Cisco and Intel, paid more than \$770 million in taxes on stock options in 1999, according to estimates by the Department of Finance.

The idea of the instant Internet millionaire was no myth. In 2000, 44,000 California taxpayers reported incomes of \$1 million or more -- about four times as many as five years earlier. Together, those people represented about one-third of 1 percent of all taxpayers, earned 21 percent of the income and paid 37 percent of the personal income tax. A group of people small enough to almost fit inside San Francisco's Pacific Bell Park earned \$172 billion and paid \$15 billion in taxes.

Then the stock market peaked, and began to slide. It took California's finances with it.

A year later the tax data told a very different story. The number of million-dollar earners dropped from 44,000 to 29,000. Their income dropped from \$172 billion to \$95 billion. And their tax bill dropped from \$15 billion to just \$8 billion. The group now accounted for about one-fourth of 1 percent of all taxpayers, about 12 percent of the income and about 25 percent of the tax paid.

What that means is that the decline in income on 15,000 tax returns -- out of 13.5 million taxpayers and 35 million Californians -- was responsible for about 80 percent of the state's historic revenue loss.

The politicians in the Capitol continue to debate whether the state's fiscal crisis was caused by too much spending or too little revenue. The answer is probably a little bit of both.

Legislators and Gov. Gray Davis spent too freely when the windfall first hit. They also cut taxes as if the new revenue stream would flow forever. But the revenue drop that occurred when the stock bubble burst was unprecedented. And it has left policymakers from Davis on down searching for a way to tame the tax system's volatility.

In a sense they may be fighting the last war. The huge run-up and then collapse of incomes in the late 1990s are not likely to be repeated soon, if ever. But even a more modest economic expansion is capable of producing a rapid increase in tax revenue as long as most of California's income is earned by relatively few people, and those people pay a relatively high rate of taxes on that income.

So can anything be done? Setting aside ideology and looking just at the math for a moment, one option would be to raise taxes on the middle class. That would broaden the tax base, making the state less reliant on the fortunes of a few. Currently, a family of four in California pays no income tax at all until they earn about \$40,000, and most people who make less than \$70,000 or \$80,000 pay relatively little in income taxes.

In 2001, people reporting incomes between \$50,000 and \$100,000 accounted for 26 percent of the income earned in the state but just 18 percent of the

income taxes paid. If that group paid income taxes commensurate with its share of the state's income, they would generate an additional \$2.5 billion a year. Such a change would probably make the tax system far more stable, because the income of the middle class does not fluctuate as wildly as the income of those at the upper end.

One problem: Doing this would require a tax increase averaging more than 40 percent on 2.8 million taxpayers at the heart of the electorate. It's a political non-starter.

Coming at the problem from a different direction, another possible fix would be to reduce or eliminate the capital gains tax, since the revenue it produces is the source of most of the volatility. Cutting the capital gains tax, it is argued, would also spur investment in California, since profits from those investments would be taxed at a lower rate, if at all.

That's a step that has been suggested by Republican Bill Simon, his party's nominee for governor in 2002, and Democrat Steve Peace, a former state senator tapped last month by Gov. Davis to be the state's new finance director. But almost all of the immediate benefit of such a reduction would go to the wealthiest 1 percent of Californians, a huge tax cut at a time when the state is short of cash and vital services already are being reduced. Another loser, politically speaking.

Instead, the most likely change in the personal income tax is something that would actually make the system even more volatile: raising tax rates on those with the highest incomes.

Adding two new tax brackets of 10 percent and 11 percent, a move backed by many Democrats in the Legislature, would generate an estimated \$3 billion a year. Almost all of that would be paid by the top 1 percent, or about 135,000 taxpayers.

The new 10 percent bracket would kick in at incomes of \$130,000 for individuals and \$260,000 for couples. The 11 percent rate would apply to incomes greater than \$260,000 for singles and \$520,000 for couples. The average tax increase for that elite group would be about \$12,000 a year, according to the California Budget Project, a non-partisan group that advocates for the poor.

Nobody knows how those wealthy taxpayers would react to such an increase. If they stayed in California, and didn't change their behavior, the state treasury and those who rely on it for services would be better off. And certainly a tax increase of a few thousand dollars on someone making a half-million a year would seem unlikely to drive them from the state.

But if the increase prompted just a few thousand of the wealthiest taxpayers to flee California, then the revenue decline it would cause could make the past year's drop seem mild. The truth is you could put thousands of laborers to work at good wages and probably not compensate for the lost income tax from one departed millionaire.

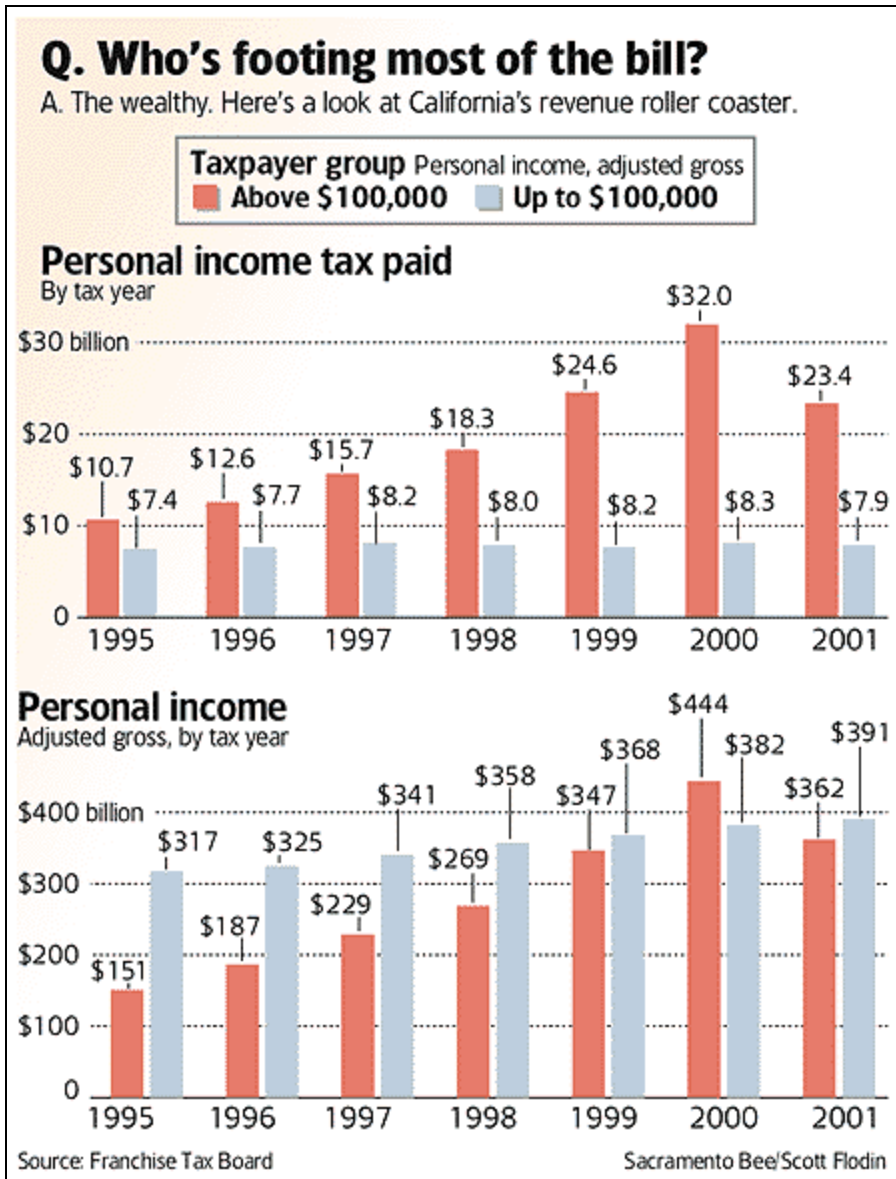
Even if it worked as intended, raising taxes on the wealthy would push California out on a fiscal limb that everyone already knows is weak. Had the higher rates been law during the late 1990s, the revenue growth the state experienced would have been even greater. And the decline, when it came, would have been even steeper.

Going further in that direction would make the state's masses even more reliant on the good fortune of a few than they are today. And as the last few years

have shown, in the long term that can be a very risky proposition.

About the Writer

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