

THE 2005-2006 STATE BUDGET

Tax Relief, VLF, and Tax Administration

SENIOR CITIZENS' PROPERTY TAX AND RENTERS' TAX ASSISTANCE

This program provides cash payments to low-income homeowners and renters who are either senior citizens (age 62 and older), disabled, or blind. The payments are intended to partially offset property taxes paid directly by qualifying homeowners or paid indirectly (in rent) by qualifying renters. The assistance provided is inversely related to the amount of total household income. The maximum assistance payments (for households with incomes less than \$9,626) are \$472.60 for homeowners and \$347.50 for renters, and the minimum payment is \$20.40 for homeowners or \$15.00 for renters at the current household income limit of \$38,505. Households above the maximum income limit do not qualify for any assistance. The income limits are adjusted annually by the change in the California Consumer Price Index. The Franchise Tax Board (FTB) administers this program. Eligible seniors and disabled persons file claims annually with the board between July 1 and October 15.

Annual General Fund budget appropriations finance this program. For 2005-06, the Governor's budget proposes to reduce funding by \$140.6 million for the Senior Citizens' Property Tax and Renters' Tax Assistance, as shown below:

(in thousands)

	2003-04	2004-05	2005-06	Change in 2005-06
Senior Homeowners' Property Tax Assistance	\$39,062	\$40,494	—	-\$40,494
Senior Renters' Tax Assistance	143,702	142,636	42,507	-\$100,129
Totals	\$182,764	\$183,130	\$42,507	-\$140,623

Major Provisions

Elimination of Senior Homeowners' Assistance

The Governor's budget proposes legislation to terminate the Senior Homeowners' Property Tax Assistance Program for a savings of \$40.5 million in fiscal year 2005-06. This savings would be ongoing, but would be partly offset by an augmentation of \$4.7 million for the Senior Citizens' Property Tax Deferral Program, administered by the State Controller's Office. The augmentation reflects the Administration's proposal to expand income eligibility under the deferral program to the income level used by the homeowners' assistance program, so that all individuals who currently qualify for the assistance program would qualify for the deferral program. The budget states that for most individuals, the deferral program will provide more financial assistance than the property tax assistance program. This proposal implements one of the recommendations of the California Performance Review.

Expansion of Property Tax Deferral Program. Under the deferral program, qualifying senior (age 62 or older) or disabled homeowners may opt to have the state pay the property tax bill (including debt levies and special assessments) for their home. The state places a lien on the property for the deferred amounts plus interest and is repaid when the home is sold (after the owner's death, for example). To qualify for the deferral program, seniors or disabled persons must have a household income of no more than \$24,000 (\$34,000 for those who already were participants in 1983-84). Also, the homeowner must have at least 20 percent equity in the home. The budget proposal would increase the household income limit for the deferral program to the same amount currently applicable to the assistance program (\$38,505 in 2004). Under existing law, the income limit for the assistance program is adjusted annually for inflation, but the income limits for the deferral program remain fixed. The budget is not explicit as to whether this proposal includes ongoing inflation adjustments for the deferral income limit.

What's the Trade-Off? Essentially, the budget proposes to trade off ending the homeowners' assistance program for an expansion of the property tax deferral program. This raises the following issues:

- ***No trade-off for the poorest.*** Senior and disabled homeowners with incomes under \$24,000 (or \$34,000 in some cases) currently qualify for both the assistance and deferral programs (the assistance payments reduce the amount of the lien). For these homeowners, the budget proposal represents only a loss.
- ***Larger immediate benefit for some.*** The expanded deferral program may offer a larger amount of immediate financial assistance than the assistance program currently provides to recipients with incomes over \$24,000. At that income level the

assistance program provides only about \$122 (equivalent to the 1-percent property tax on \$12,200 of assessed value), and this amount declines further as income increases. For homes assessed at \$19,200 (\$12,200 plus the \$7,000 homeowners' exemption) or more, the deferral program offers a larger immediate benefit (plus it covers debt levies and special assessments).

- ***Loan versus grant.*** The downside to the deferral program to the participants, of course, is that it is a loan rather than a grant. Deferrals reduce the amount that the homeowner can borrow with a mortgage and they reduce the value of the property to heirs. Furthermore, individuals who have less than 20 percent equity in their home can not participate in the deferral program.

Scale-Back of Senior Renters' Assistance Program

The Governor's budget proposes \$100.1 million of savings by reducing the benefit and eligibility levels to near what they were in 1998, when the income limit was \$13,200 and the maximum amount of benefit was \$240 (versus \$347.50 in 2004). Unlike the homeowners' proposal, the budget does not include any other program expansion to offset any portion of this reduction. However, senior and disabled renters who have enough income to have a state income tax liability would continue to be eligible to claim the Renters' Credit on their income tax return. The Renters' Credit is \$60 (single) or \$120 (married) and is available to renters with incomes up to about \$30,000 (single) or \$60,000 (married). However, many low-income seniors and disabled persons have no state income tax liability or too little liability to obtain the full benefit of the Renters' Credit.

Additional Hit to SSI/SSP Recipients. SSI/SSP beneficiaries generally qualify for the current senior renters' or homeowners' assistance payments. The budget proposes to eliminate both the state and federal cost-of-living adjustments (COLAs)to SSI/SSP grants. Consequently, the proposed reductions in homeowners and renters assistance will result in an overall reduction in total income to SSI/SSP beneficiaries who have no other sources of support.

VEHICLE LICENSE FEE BACKFILL

Major Provisions

Property Tax Swap

Proposition 1A, approved by the voters in the 2004 November general election, and 2004-05 budget trailer legislation (SB 1067 and AB 2115) permanently reduced the annual Vehicle License Fee (VLF) paid by vehicle owners by 67.5 percent. The VLF is collected by the state, but the revenue goes to cities and counties for general purposes and to fund health and social services costs for

Realignment programs. In order to keep local governments whole, the state "backfilled" local governments with General Fund payments equivalent to their reduction in actual VLF revenue (except during a "gap" period from July through September of 2003 for which cities and counties will be paid in August 2006). Proposition 1A and the related trailer legislation also eliminated the VLF backfill starting in fiscal year 2004-05 and replaced it with property tax revenue shifted to cities and counties from schools (less \$700 million in fiscal years 2004-05 and 2005-06). The state continues to bear the cost of the backfill, however, through an equivalent amount of increased General Fund support of schools, as required by Proposition 98. After the initial shift in 2004-05, the VLF-replacement property tax will grow with assessed value in each city and county. This replacement property tax revenue is constitutionally protected for local governments under Proposition 1A.

Annual Cost Has Grown By About \$600 Million. The 2004-05 budget estimated that the state amount of property tax shifted to cities and counties would be \$4.1 billion in fiscal year 2004-05. The Governor's proposed budget for 2005-06, however, now estimates that VLF revenues are growing much more rapidly and that the amount of replacement revenue required in fiscal year 2004-05 will be significantly higher—almost \$4.7 billion, or an increase of about \$600 million above the 2004-05 Budget estimate. This additional amount will be built into the ongoing property tax base of cities and counties and into the state's ongoing Proposition 98 funding obligation.

FRANCHISE TAX BOARD

The Franchise Tax Board (FTB) consists of the State Controller, the Chair of the State Board of Equalization (BOE), and the Director of Finance. The FTB administers the Personal Income Tax and the Corporation Tax. FTB also assists other departments and programs in the collection of delinquent debts, including delinquent child support payments. The budget proposes total spending of \$699 million (\$512 million from the General Fund) and 5,285 personnel-years of staff for support of the FTB in fiscal year 2005-06. Total proposed spending increases by 13.2 percent from the current year, but General Fund spending increases by a much lower 5.4 percent. Staffing declines slightly by 0.8 percent—primarily due to the expiration of limited-term positions for the tax amnesty program. The overall spending increase primarily reflects increased funding for development and initial implementation of the Child Support Enforcement System.

Key Provisions

- **Abusive Tax Shelters.** The Governor's budget is proposes \$1.8 million and 17.1 positions to increase staffing for the Abusive Tax Shelter Taskforce. The additional funding to combat abusive tax shelters is expected to generate \$43 million in General Fund revenue in fiscal year 2005-06 and \$60 million in fiscal year 2006-07.
- **Child Support Enforcement.** The Governor's proposed budget for the Franchise Tax Board includes an augmentation of \$26.1 million General Fund, \$52.9 million reimbursements from the Department of Child Support Services (DCSS), and 15.5 positions to continue the federally mandated development of a single, statewide child support enforcement system in fiscal year 2005-06. It also includes an augmentation of \$170,000 General Fund and \$330,000 reimbursements for activities related to the State disbursement unit. The FTB is responsible for development and operation of these systems in cooperation with the DCSS. The first phase of this large project should be completed by September 2006. Successful completion will end federal penalties of \$200 million annually.
- **Senior Citizens' Tax Assistance Program Changes.** The Governor's budget proposes to replace the current Senior Citizens' Property Tax Assistance Program with an expansion in the Senior Citizens' Property Tax Deferral Program. In addition, the benefits and eligibility for the Senior Citizen Renters' Tax Assistance are being scaled back (see the Tax Relief section for more detail). The changes in these programs will result in administrative savings of \$575,000 and 12 positions in the FTB's budget for fiscal year 2005-06.
- **Tax Gap Enforcement.** The Governor's budget proposes a package of five measures to reduce the tax gap (the shortfall between what is owed and what is paid) at a cost of \$8.6 million and 99.2 positions. The effort will target preparers of fraudulent returns, increase audit staff, use more information sources to identify nonfilers, expand underground economy criminal investigations, and provides informant rewards. These measures will generate an estimated \$34 million of General Fund revenue in fiscal year 2005-06, increasing to nearly \$44 million in fiscal year 2006-07.
- **Unallocated reduction.** The FTB has been instructed by the Administration to reduce its budget by \$7.84 million with the flexibility to implement through layoffs, hiring freeze, procurement reductions, or other administrative means as it may choose. The budget does not assume any revenue loss due to this reduction.

- **Privacy Protection.** The Governor's proposed budget includes \$698,000 (\$513,000 General Fund) to implement privacy protections for social security numbers as required by SB 25.

STATE BOARD OF EQUALIZATION

The State Board of Equalization (BOE) is comprised of four members elected specifically to the board from districts and the State Controller. The BOE administers the sales and use tax (including all state and local components), oversees the administration of the property tax, and collects a variety of excise and special taxes (including the gasoline tax, insurance tax, and cigarette and tobacco products taxes). The BOE also hears taxpayer appeals of FTB decisions.

The budget proposes \$365 million (\$209 million from the General Fund) and 3,628 personnel-years of staff for the BOE in fiscal year 2005-06. Total funding increases by \$6.3 million (1.8 percent), and General Fund support increases by \$1.6 million (0.8 percent), compared with spending estimates for the current year. Proposed staffing declines slightly—by 20.2 personnel-years (0.6 percent) from the current-year estimate.

Key Provisions

- **California Tire Fee Increase.** The Governor's budget proposes an increase of \$224,000 in reimbursements and 5.6 personnel years in the budget year to administer the increase of California Tire Fee on behalf of the California Integrated Waste Management Board and the California Air Resources Board.
- **Covered Electronic Waste Recycling Fee.** The Governor's budget proposes \$4.6 million in reimbursements and 32.8 personnel years in the current year and \$5.7 million in special funds and 76.8 personnel years in the budget year to collect fees for the Covered Electronic Waste Recycling Act on behalf of the California Integrated Waste Management Board.
- **Ongoing Cigarette and Tobacco Products Taxes Increase.** The Governor's budget proposes to add \$850,000 special funds and 9.6 personnel years to continue the ongoing administrative workload associated with Proposition 10, the California Children and Families First Act of 1998.

- **Underground Storage Tank Maintenance Fee Increase.** The Governor's budget proposes to add \$79,000 and 1 personnel year special funds to administer the increase in the California Underground Storage Tank Maintenance Fee.
- **No Unallocated Reduction.** Unlike with most other state departments (including the Franchise Tax Board—the state's other main tax administration agency), the budget proposes no unallocated reduction for the BOE.