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ON REVENUE AND TAXATION

CALIFORNIA'S TAX STRUCTURE: 1964

A Major Tax Study
PART I

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I. INTRODUCTION

Taxes and tax burdens have been subjects for public discussion and study since the beginning of civilization This concern is both understandable and proper, for the level of taxation is not only critical in determining quality of public services, but is a major factor in the economic life of society.

Considering these implications, it is imperative that a periodic review of the tax structure be made At the 1963 session of the California Legislature, the Assembly assigned to the Committee on Revenue and Taxation the challenging task of making a full and complete study of the state tax structure—limited only by the resources available Authorization for this study is contained in House Resolution Number 500, adopted by the Assembly on June 21, 1963.

It is logical to begin such a study by examining in some detail the existing tax structure This booklet summarizes California's tax structure as of the beginning of 1964 Each of the taxes collected by the State and the property tax are described by those individuals responsible for administering them. These statements were presented to the committee at the first interim hearing which was held at the Metropolitan Oakland International Airport on October 3 and 4, 1963

To this we have added a brief survey of the development of the tax structure. This survey is not intended to be exhaustive, but rather to cover the important developments and major trends which have culminated in the present tax system described herein

This booklet then is both a portion of a transcript of the committee's October 1963 hearing and the first in a series of reports on California's tax structure. We anticipate issuing several additional reports —some of which will discuss problems with individual taxes and some of which will discuss the impact of the tax structure as a whole and the recommendations of the committee

NICHOLAS C. PETRIS, *Chairman*

II. NEED FOR A TAX STUDY

Governor Edmund G. Brown: Mr Chairman and members of the committee· I am deeply sorry that other commitments prevent my fulfilling my wish to be with you today on your first meeting of this 1963-64 interim study period However, you know the keen interest that I have in your discussions and the findings your committee will make as a result of these hearings

I cannot think of a better time for an undertaking such as you launch today—a study of our entire tax structure from the local to the state level of government I say that because fiscal projections indicate that we have a period of two fiscal years in which state revenues will be sufficient to maintain necessary services without increases in taxes. This will permit a careful, objective study unaffected by the pressures of immediate needs The necessity for just such an unhurried study of the long-term problems becomes more pressing each year, regardless of current revenue needs Much of our present tax structure at the various levels of state and local government is archaic, based on conditions existing decades ago but no longer valid

Except for the Bradley-Burns Sales Tax Law and the recent increase in highway user levies, the present division of revenue sources between state and local governments in California dates back 30 years to a time when the budget for state government was $159 million As you Members of the Assembly know, the current fiscal budget is $3 2 billion, including $1 7 billion either given to or spent on behalf of local governments

Thirty years ago, when we operated with the $159 million budget, California's population was barely six million people It now totals over

17 million and projections tell us we will have to provide services for the needs of 20 million people in another five years It is this spectacular growth that has demolished many of the relationships in the field of taxation between the various levels of government There are many basic questions that need exploration Some of these may well be outside the dommion of your committee but nevertheless they must be explored For we need some answers Not specifically for today because we do not face a crisis, but for the future of California

We have to examine carefully the fiscal requirements that must be met to carry on the responsibilities assigned to all levels of government in California And we should study the question of which responsibilities should be shouldered by cities, by counties, and by the State. And we should be certain that we are always raising one prime question Is this program necessary or could it be eliminated in the interest of economy?

Problems which are of more immediate concern to you include: Which unit or level of government should collect the tax revenues to perform a needed task? Should the State continue to finance or collect the taxes for functions which are clearly identified as local responsibilities? Should you, the Legislators of this State, provide new tax sources for local governments?

There are signs of rising protest over our local property taxes I want you to know that I, too, believe that property taxes in some areas are too burdensome and that some relief should be provided by the State.

At the state level we should examine our tax burden on the various segments of our economy and society We should ask these questions Is the burden equitably distributed? Are some segments carrying a disproportionate share of the load?

We have taken great strides in eliminating many of our special funds But, we still earmark a considerable share of our revenues without legislative control Are we earmarking too much for specific purposes?

Should we reexamine our state tax structure to see whether it will provide adequately for our future needs? Our primary reliance now is on the sales tax With our rising personal income, this source has not shown a corresponding growth People are spending relatively more on nontaxable personal services and less proportionately on taxable commodities. If this continues, our economic experts agree, the sales tax will not meet future needs We must either broaden the base of the sales tax or place greater reliance on taxes where revenues are more responsive to income changes

Your committee during the past session helped take several notable steps forward in eliminating some of the loopholes in our sales and use tax law We should reexamine all such exemptions, deleting those that may not be justified and we must resist further attempts to further narrow the base unless a sound case can be made in both social need and tax equity

I spoke earlier of our need to provide services but five years from now for a population of 20 million Contained in that sentence is the American philosophy of taxes It is to find a just and equitable means

of raising the revenues necessary to provide the services needed from all levels of government.

I am grateful for the opportunity you have given me to give my views on some of the problems facing you as you launch this broad study of yours.

This study does not begin under a black cloud of fiscal crises. It does not because the Legislature has seen fit to enact measures to assure the State sufficient revenue for the next two years during which your careful examination of our future needs can be made.

Thank you.

III. A BRIEF HISTORY OF CALIFORNIA'S TAX STRUCTURE

California's tax history can be conveniently divided into three eras: 1850 to 1910—the era of property tax ascendency; 1911 to 1932—the era of the separation of sources and the public utilities gross receipts tax, and 1933 to 1963—the era of the diversification of the tax structure.

For 60 years after statehood, government was financed almost exclusively by taxes on property During this time, from 50 to 85 percent of the total state tax collections came from property taxes.[1] In 1850, California's first Legislature enacted a revenue measure which provided for a general statewide property tax of $0 50 per $100 of assessed valuation. Assessed values were established by county assessors, however. This measure also provided for the imposition of a $5 poll tax.[2]

Other taxes imposed by the first Legislature were a military commutation tax of $2 per annum collectible from all able-bodied men from 18 to 45 who were not in the militia,[3] a foreign miner's license tax of $240,[4] and duties on sales of property at auctions [5]

These taxes were revised periodically during the early years of statehood and new taxes devised. In 1851 a gaming license tax was en-

[1] William C. Fankhauser, *A Financial History of California*, University of California publication in Economics, 1913, pp 150, 247, 293, 344, 405-406.
[2] *Statutes of 1850*, Chapter 52.
[3] *Ibid*, Chapter 76.
[4] *Ibid*, Chapter 97
[5] *Ibid.*, Chapter 143.

acted [6] and in 1852 a variety of business and occupation license fees [7] and a passenger commutation tax were passed.[8] In 1862 a 2-percent gross premium tax on foreign insurance companies became law [9]

Other than the property tax, the taxes and fees imposed raised relatively small amounts of revenue Much of the additional state revenue in the early years came from the sale of state bonds and state lands.[10]

By 1864, the state property tax reached $1 25 per $100 of assessed valuation. It was obvious that a county assessor, by placing low values on property, could reduce the tax bills of the taxpayers within the county [11]

In 1870 a Board of Equalization was created by the Legislature to bring county assessments into line [12] However, this function of the board was declared unconstitutional in *Houghton* v *Austin*, 47 C 646

With the adoption of the Constitution of 1879, the State Board of Equalization regained the power to equalize property values in one county with that of the aggregate The delegates also wrote into the second Constitution many more details with respect to the taxation of property

Inheritance taxation became a part of the state tax picture in 1893 with the passage of a collateral inheritance tax of 5 percent on property passing outside the immediate family [13] This was expanded in 1905 to a direct inheritance tax with a sliding scale of exemptions and rates depending on relationship to the deceased and the amount of the bequests Rates ranged from 1½ to 4 percent on inheritances by members of a family to from 5 to 15 percent on inheritances by strangers [14] By 1910, the inheritance tax was raising $883,639 [15]

By 1905, there was widespread criticism and dissatisfaction with the tax structure Responding to this, the Legislature established a Tax Commission to study the problem. Reporting in 1906, the commission found the state tax system antiquated and full of inequities As an example, the plight of the farmer was cited. Farmers were paying taxes amounting to 10 percent of their income while those in industry were paying taxes amounting to only 2 percent of their income. Inadequacy of equalization was also a major problem as the State Board of Equalization had been very judicious in issuing county equalization orders.[16]

To remedy the evils found, the commission called for the adoption of the "Plehn Plan," [17] which provided for a "so-called" separation of tax sources. Under this plan, the State was to relinquish property taxes to local government and adopt a gross premiums tax on insurance companies, a franchise tax on banks and corporations, and a gross receipts tax on public utilities in lieu of a local property tax [18]

[6] *Statutes of 1851*, Chapter 8.
[7] *Statutes of 1852*, Chapter 89.
[8] *Ibid.*, Chapter 36.
[9] *Statutes of 1862*, Chapter 227.
[10] Fankhauser, *op cit.*, p 155, 356-357.
[11] *Ibid*, p 195.
[12] *Ibid*, p 187.
[13] *Statutes of 1893*, Chapter 168.
[14] *Statutes of 1905*, Chapter 314.
[15] Fankhauser, *op cit.*, p 354
[16] *Report of the Commission on Revenue and Taxation (1906)*, pp 10-12
[17] Named after Professor Carl Plehn of the University of California, a member of the Tax Commission and reported to be an expert on taxation and finance
[18] *Report of the Commission on Revenue and Taxation (1906)*, pp. 10-11.

This plan was submitted to voters in 1908 but was defeated by a vote of 87,977 yes to 114,104 against the measure [19] After several minor changes were made in the proposal, it was again submitted to the voters in 1910

According to Franklin Hichborn, support for the proposition was urged on the ground that it would relieve the burden of the property taxpayer and shift it to the utilities and general corporations and was supported by a number of large utilities, real estate boards and farm groups Opposing it were a number of "Progressives," including Senator A. E Boynton and Matt I Sullivan The Los Angeles *Express*, leading "Progressive" newspaper in Southern California, also opposed the plan The proponents of the measure carried the day, and the electorate adopted the separation of sources plan handily—141,312 in favor to 96,493 opposed.[20]

Passage occasioned a dramatic shift in the State's tax base. In 1911, 70 percent of all state tax receipts came from property taxes. In 1913 45 percent of the State's tax receipts came from the public utilities gross receipts tax and 21 percent from the taxes on banks and corporations [21]

Almost immediately, weaknesses in the Plehn Plan became evident The State Board of Equalization released a report in 1912 illustrating the inequity of the plan [22] State revenues from the plan continued to be insufficient, although rates were raised in 1913 and 1915 [23]

In 1921, rates had to be raised again—both to equalize them with property tax rates and to provide additional revenue to finance state government [24]

This touched off one of the most heated legislative struggles in modern California history

After a defeat during the first part of the then bifurcated session and a vigorous statewide campaign in opposition during the recess, the King Tax Bill secured the required two-thirds vote in each house and the tax rates on public utilities were thus raised substantially.[25]

California's tax structure reacted to the growing impact of the motor vehicle in the 1920's Demands for better roads led to the adoption of three measures in 1923:

The Motor Vehicle Act of 1923 provided for a flat $3 registration fee for privately owned motor vehicles Revenues derived from this tax were divided between the State, cities, and counties, with the proviso that none of the funds could be used for new construction.[26]

The Motor Vehicle Fuel Tax Act of 1923, popularly known as the "gas tax," imposed a 2-cent-per-gallon tax on all fuels that could

[19] Franklin Hichborn, *Story of the California Legislature of 1913*, San Francisco: The James H Barry Company, 1913, p 58

[20] *Ibid*, pp 67-69

[21] Marvel M. Stockwell, *Studies in California State Taxation, 1910-1935*, University of California Press, (1939), pp 20-24

[22] According to this report, the average rates of taxes paid on the basis of $100 of true value of their property were.

General taxpayer	$1 13
Railroads	.90
Gas and electric companies	.75
Telephone and telegraph	.90
Express companies	1 54

[23] Franklin Hichborn, *Story of the California Legislature of 1921*, San Francisco The James H Barry Company, (1921), pp 30-33

[24] *Ibid*, pp 33-42

[25] *Ibid*, pp 43-114.

[26] *Statutes of 1923*, Chapter 266.

propel a motor vehicle, except diesel oil and butane This tax was also split between State and counties, but would only be used for maintenance.[27] In 1927, a penny was added to the rate to finance construction of new roads [28]

The Motor Vehicle Transportation License Tax Act of 1923 covered common and contract carriers They were required to pay 4 percent of their gross receipts, less city or county licenses on taxes on operating property, to the Controller [29] In 1926, some carriers were removed from the provisions of this act by Constitutional Amendment and classified as public utilities subject to the public utilities gross receipts tax [30] In 1927, for the remaining contract carriers, a weight tax was imposed in lieu of the gross receipts tax.[31]

Two important changes were made in the bank and corporation franchise tax laws during the 20's As a result of a California Supreme Court decision declaring the 1915 Corporation Tax Law unconstitutional with respect to foreign corporations [*Perkins Mfg. Co.* v. *Jordan* (1927) 200 C 667], the Legislature repealed this act in 1927.[32] The concept of the bank and corporation franchise tax act was changed by the electorate in 1928 with the approval of a Constitutional Amendment which provided banks and general corporations may be taxed on the basis of net income Subsequently the Legislature enacted the bank and corporation franchise tax, carrying out the provisions of the Constitution.[33] Much of the restrictive language in the Constitution with respect to the nature of the tax, which was also adopted in 1928, has since been removed The original amendment put a 4 percent ceiling on the tax rate which could be imposed However, the requirement that "any tax imposed pursuant to this section must be under an act passed by not less than two-thirds of all the members of each house of the Legislature" has been retained in basically the same form [34]

The great depression of the 1930's caused a major upheaval in the California revenue system and, beginning in 1933, the tax structure underwent a series of far-reaching changes The first major change came with the adoption in June 1933 of a Constitutional Amendment known as the "Riley-Stewart Plan," which was designed to relieve the burden of property taxpayers The state administration, farm, manufacturing and real estate groups favored the plan, while labor and retail merchants opposed it This amendment provided for the assumption by the State of the public school costs then borne by the county by means of a countywide school tax and the abandoning of the 1910 separation of sources plan by returning public utility property back to the local tax rolls and repealing the public utilities gross receipts tax as of January 1, 1935 Limits were also placed on state and local budgets.[35]

With the passage of the Riley-Stewart Plan, the State faced a budget deficit of from $50 million to $70 million and anticipated an additional

[27] *Ibid*, Chapter 267.
[28] *Statutes of 1927*, Chapter 795.
[29] *Statutes of 1923*, Chapter 341.
[30] *Statutes of 1927*, Chapter 19.
[31] *Ibid*, Chapter 844
[32] *Ibid*, Chapter 221
[33] *Statutes of 1929*, Chapter 13.
[34] *California Constitution*, Article 13, Sec 16
[35] *California, Senate Constitutional Amendment No 30*, adopted June 3, 1933

$30 million loss in 1935 when the public utilities gross receipts tax expired.[36]

To meet this fiscal crisis, the 1933 Legislature enacted measures providing for a sales tax,[37] an income tax,[38] a license tax of 4 percent on all parimutuel wagering,[39] a 3 percent gross receipts tax on common carriers,[40] a tax on alcoholic beverages,[41] and adjustment of the deductions allowed from the bank and corporation franchise tax.[42]

The sales tax bill, which provided for a 2½ percent tax on most items including food, was signed by Governor Rolph immediately on passage The Governor vetoed the personal income tax bill, however.

In 1935 the tax base was further expanded Three new taxes were enacted and a number of others substantially revised

The most important new tax was that on personal incomes With the exception of a rate structure from 1 percent on the first $5 thousand to 15 percent on all income over $500 thousand, and personal exemptions of $1 thousand for a single person and $25 hundred for head of household, the act closely paralleled the then existing federal act Approximately $6 million was raised from this tax in 1936 and $16 million in 1937[43]

Due to problems in assessing and collecting personal property taxes on motor vehicles, a motor vehicle license fee (in-lieu tax) was enacted This legislation provided for the imposition of a tax of 1 75 percent of the market value of motor vehicles[44]

A third new tax was the use tax which extended the sales tax to personal property purchased outside California[45] The sales tax itself was also modified in 1935 Food was exempted from the tax base but the rate was increased to 3 percent[46]

Major changes were made in 1935 in the taxes collected on alcoholic beverages Although the taxes on beer and wine remained the same (at 2 cents a gallon), distilled spirits were raised to $0 80 a gallon[47]

Other changes made in 1935 included the boosting of the tax rate on corporations to 4 percent and banks to 6 percent,[48] changes in the inheritance tax,[49] and the enactment of an unemployment insurance law.[50]

Primarily as a result of the actions of the 1935 Legislature, receipts from all state taxes increased from $153,000,000 in fiscal 1934-35 to $217,942,000 in fiscal 1936-37 With the exemption of food from the sales tax and the imposition of a personal income tax, the tax base was shifted toward an ability-to-pay concept[51]

[36] California, Legislature, *Report of Assembly Committee on State and Local Taxation*, Sacramento State Printing Office, 1947, pp 77-78
[37] *Statutes of 1933*, Chapter 1020
[38] California, Legislature, *Final Calendar of Legislative Business, 50th Session (1933), AB 2429*
[39] *Statutes of 1933*, Chapter 769
[40] *Ibid*, Chapter 337
[41] *Ibid.*, Chapter 61
[42] *Ibid*, Chapter 210
[43] *Statutes of 1935*, Chapter 329
[44] *Ibid*, Chapter 362
[45] *Ibid*, Chapter 230.
[46] *Ibid*, Chapter 355
[47] *Ibid*, Chapter 330
[48] *Ibid*, Chapter 353
[49] *Ibid*, Chapter 358
[50] *Ibid*, Chapter 352
[51] California, Legislature, *Report of Assembly Committee on State and Local Taxation*, 1947, p. 85.

Four minor additional levies were imposed in the late 1930's A diesel fuel tax of 3 cents per gallon,[52] a private car tax,[53] and a corporation income tax designed to supplement the franchise tax were all passed in 1937 [54] A gift tax was added in 1939 [55]

During the war years, a sizable surplus began to pile up in the State Treasury In 1943, legislators took action to give some tax relief under these conditions The exemptions to the personal income tax were increased, the top rate lowered from 15 to 6 percent and a 15-percent war credit allowed [56] The 3-percent sale tax rate dropped to 2½ percent at this time [57] but was raised back to 3 in 1949 [58] In 1946, disability insurance sections were added to California's unemployment insurance law [59]

The postwar period can be characterized as one of more state and local sharing of revenue sources but of little fundamental change in the tax structure

Highway financing was revised by the Collier-Burns Act of 1947 This law upped the gas tax from 3 to 4½ cents per gallon, the registration fee from 3 to 6 dollars, and the in-lieu tax from 1¾ percent to 2 percent, but also, in effect, reduced the tax rates on highway carriers This act also made major changes in the distribution of highway user revenues [60] In 1953, these rates were boosted again with the gas tax going from 4½ to 6 cents a gallon, registration fees from 6 dollars to 8 dollars, and weight fees rising one-third [61]

First major step in establishing the pattern of shared revenues came in 1955 with the adoption of the Bradley-Burns Uniform Local Sales and Use Tax Law This authorized cities and counties to levy a 1-cent sales tax using the State's collection machinery [62] In other action, in 1955, the Legislature increased the tax on distilled spirits from 80 cents to $1 50 per gallon and the tax on champagnes from 24 cents to 30 cents a gallon [63]

By 1959, California faced its greatest fiscal crisis since the depression The Legislature was faced with a budget deficit of $68 million for the fiscal year 1958-59, and a prospective deficit of $200 million for 1959-60 [64]

To supply the revenue needed to meet this deficit, one new tax (a 3-cent-per-pack cigarette tax)[65] was added and a number of the existing taxes raised Income tax rates were raised from a maximum of 6 percent on income over $25 thousand to a maximum of 7 percent on income over $15 thousand [66] The franchise tax rate went from 4 percent to 5½ percent and the ceiling on the bank tax rate was raised from 8 percent to 9½ percent, however, new provisions for the rapid

[52] *Statutes of 1937*, Chapter 352.
[53] *Ibid*, Chapter 283
[54] *Ibid*, Chapter 765
[55] *Statutes of 1939*, Chapter 652
[56] *Statutes of 1943*, Chapter 364
[57] *Statutes of 1945*, Chapter 357.
[58] *Statutes of 48*, Chapter 12
[59] *Statutes of 1946, First Extraordinary Session*, Chapter 81
[60] *Statutes of 1947, First Extraordinary Session*, Chapter 11
[61] *Statutes of 1953*, Chapter 1200
[62] *Statutes of 1955*, Chapter 1311.
[63] *Ibid*, Chapter 1842
[64] California, Legislature, Report of the Legislative Analyst to the Joint Legislative Budget Committee *Analysis of the Budget Bill*, 1959-1960, Sacramento State Printing Office, February 1, 1959, p VII
[65] *Statutes of 1959*, Chapter 1040
[66] *Ibid*, Chapter 880.

writeoff for depreciation of plant and equipment were also incorporated which mitigated some of the effects of the tax increase [67]

The tax on beer was doubled—from 2 cents to 4 cents per gallon [68] —and the take from horseracing was also increased [69] An inheritance tax bill which raised rates on transfers to aunts, uncles, cousins, and strangers rounded out the tax program which was adopted by the 1959 Legislature.[70]

Very few changes in the tax structure have been made since 1959 Prescription drugs were exempted from the sales tax in 1961 [71] Payments of personal income taxes, bank and corporation franchise taxes and insurance gross premium taxes were accelerated by a special session of the 1963 Legislature—actions which evoked considerable controversy [72]

The concept of the shared revenue device was expanded in 1963 to include highway user funds Receipts from a 1-percent increase in the gas tax were earmarked for cities and counties for local road purposes [73] A pay television business license tax newly enacted in 1963 provided that the revenue derived from 2 percent of the gross receipts be divided equally between the state and local government [74]

A brief outline of California's present tax structure and the revenue produced therefrom follows:

[67] *Ibid*, Chapter 1127
[68] *Statutes of 1959*, Chapter 1125
[69] *Ibid*, Chapter 1126.
[70] *Ibid*, Chapter 1128
[71] *Statutes of 1961*, Chapter 866
[72] *Statutes of 1963*, First Extraordinary Session, Chapters 2, 9, 3 and 4
[73] *Statutes of 1963*, Chapter 1852
[74] *Statutes of 1963*, First Extraordinary Session, Chapter 5

OUTLINE OF STATE TAX SYSTEM AS OF JANUARY 1, 1964

Major taxes and fees	Reference		Base or measure	Rate	Administering agency	Fund
	Code	Sections				
Alcoholic beverage excises						
Beer	R & T[1]	32151 (a)	Gallon[2]	$0 04[3]	Equalization[4]	General
Distilled spirits	R & T	32201 (a)	Gallon	1 50[4]	Equalization	General
Wine						
Dry	R & T	32151 (b)	Gallon	01	Equalization	General
Sweet	R & T	32151 (c)	Gallon	02	Equalization	General
Sparkling	R & T	32151 (d)	Gallon	.30	Equalization	General
Sparkling hard cider	R & T	32151 (e)	Gallon	02	Equalization	General
Bank and corporation						
General corporations	R & T	23151 23501	Net income	5 5%[5]	Franchise[6]	General
Banks and financials	R & T	23181 23183	Net income	9 5% Max	Franchise	General
Cigarette	R & T	30101	Package[7]	$0 03[7]	Equalization	General
Gift	R & T	15201	Market value	2-24%	Controller	General
Horseracing license	B & P[8]	19491	Amount Wagered Breakage	5-8% 50-100%	Horse Racing Board	Fair and Exposition and General
Inheritance	R & T	13401	Market value	2-24%	Controller	General
Insurance	R & T	12101	Gross premiums[9]	2 35%[9]	Insurance Comm.	General
Liquor license fees	B & P	23320	Type of license	Various	Alcoholic Bev Control Dept	Alcoholic Bev [10] and General

Motor vehicle						
Vehicle license fees	R & T	10751	Market value	2%	Motor Vehicle Dept	Vehicle License Fee[11]
Fuel—gasoline	R & T	7351	Gallon	$0 07	Equalization	Fuel[12]
Fuel—diesel	R & T	8651	Gallon	07	Equalization	Fuel[12]
Registration fee	Vehicle	9250	Vehicle	8 00	Motor Vehicle Dept	Motor Vehicle[14]
Weight fees	Vehicle	9400	Unladen weight	Various	Motor Vehicle Dept	Motor Vehicle[14]
Transportation	R & T	9651	Gross receipts	1½%	Equalization	Transportation tax[16]
Personal income	R & T	17041	Taxable income	1-7%	Franchise	General
Private (railroad) car	R & T	11401	Valuation	[15]	Equalization	General
Retail sales and use	R & T	6051 6201	Receipts from sales of taxable items	3%	Equalization	General

[1] Revenue and Taxation Code
[2] This tax is levied at the rate of $1 24 per 31-gallon barrel
[3] State Board of Equalization
[4] Distilled spirits in excess of proof strength are taxed at double this rate
[5] Minimum tax 100 per year, not applicable to banks
[6] Franchise Tax Board
[7] This tax is levied at the rate of 1 5 mills per cigarette
[8] Business and Professions Code
[9] Insurance tax rate has been reduced to 2 33% through 1967 Ocean marine insurance is taxed at the rate of 5 percent of underwriting profit attributable to California business. A special rate also applies to annuities
[10] For return to cities and counties
[11] For payment of administrative costs, highway bond interest and redemption and apportionment to counties cities and school districts
[12] For administrative expense and apportionment to State, counties and cities for highways, airport and small craft harbors
[13] For administrative expenses and State highways
[14] For support of State Department of Motor Vehicles, California Highway Patrol, county roads and State highways
[15] Average property tax rate in the State during preceding year, which for 1962 was $6 82 per $100 of assessed valuation

Department of Finance
Budget Division

IV. CALIFORNIA'S STATE TAX SYSTEM

Ralph Currie: Mr Chairman and Committee Members As part of your review of California's state tax structure, the Department of Finance has been asked to put together the various levies discussed by the several administering agencies and to present the tax system as a whole We are pleased to have this part in your program, and in fulfilling our assignment, we have prepared a number of tables and charts which we hope you will find useful as background material for your future studies

We will cover three aspects of the state tax situation · First, the relative position of the state levies in the federal, state and local tax total of California Second, he relative importance of each major levy in the structure supporting state government Third, the trend in California collections since 1951, especially with regard to similar trends in other states

A $15 Billion Tax Bill

Tax collections by all levels of government in California in 1961-62 —federal, state, and local—totaled approximately $14.5 billion, and the sum undoubtedly passed the $15 billion mark last fiscal year.

The actual tax burden is greater than these figures indicate, since a substantial amount of the federal excise taxes on such items as cigarettes, cigars, liquor, motor vehicles, and television sets is collected elsewhere—North Carolina, Pennsylvania, Michigan, New Jersey, for example—but is passed on to Californians in the prices of products consumed here.

The $15 billion total breaks down conveniently into three packages Roughly two-thirds of the total is collected by the federal government, one-sixth by the State, and one-sixth by local governments The aggregate of local taxes exceeds the state total by about $400 million A breakdown of the total reported for 1961-62, together with the percentage increase since 1950-51, and relative parts of the total, are shown in the table below·

TAX COLLECTIONS IN CALIFORNIA

	1950-51 (in millions)	*1961-62 (in millions)*	*Percent increase since 1950-51*	*Percent of total 1961-62*
Federal	$3,730 8	$9,451 3	153 3	65 2
State	943 5	2,314 6	145 3	16 0
Local	861 7	2,727.4	216 5	18 8
Total	$5,536 0	$14,493 3	161 8	100 0

As these figures show, federal tax collections in California amounted to approximately $9 5 billion in fiscal 1962, a little more than 2½ times the sum reported for 1950-51 State taxes aggregated $2 3 billion and were up somewhat less than 2½ times, while local taxes totaled $2 7 billion and were more than triple the 1950-51 total Actually, the local tax increase may be somewhat less than the figures indicate, since early reports appear to be incomplete with respect to certain business levies

Assemblyman Carrell: What is the total personal income of the State—the gross product of the State?

Ralph Currie: In 1950, all the income of all the people was about $19 0 billion This year it will be a little over $52 0 billion So we had a 2½ times rise in the income from which to pay this aggregate taxload

This committee will have direct concern with state and local tax payments totaling more than $5 0 billion a year, a little less than half of which represents collections under state levies and more than half is local taxes Of the latter, local property taxes amounted to $2,433 million in fiscal 1962, an increase of 200 percent over the $807 million reported for 1951 Of the 1962 property tax, $634 million was collected by counties, $409 million by cities, $1 178 million by school districts and roughly $212 million by other special districts

California's State Tax System

With 9 1 percent of the nation's population last year and 11 2 percent of the total personal income, California accounted for approximately 11.5 percent of all state taxes We ranked 7th among the states in per capita state tax payments and 31st in tax payments per $100 of personal income The tax system is roughly "average" in that most of the well-known levies are employed and few of our taxes are unusual.

Assemblyman Young: May I ask a question at this point, Mr Currie You mention tax payments per capita and tax payments per one hundred dollars of personal income Which of those more clearly reflects the tax burden upon the California taxpayer—the per hundred dollars of personal income or the per capita state tax in comparison with other states?

Ralph Currie: I believe thoroughly that we should make the comparison in terms of personal income You get a much different picture by comparing your tax in relation to the income you have with which to pay taxes It's that sort of a comparison which puts Mississippi right at the top of the list They have a tremendous tax burden although their per capita taxes are very low They have income of about $1,200 per capita there We have about $2,780 per capita, so they have less than half the income I think the real measure is per hundred dollars of personal income in comparison with other states.

Relative proportions received from each tax source during the 1962-63 fiscal year are shown in the columns below The two display charts are based upon the budget computations for the current year and are slightly different from last year's actual due to the budget revenue program and changing economic conditions.

STATE REVENUE DOLLAR, 1962-63

Taxes, fees, etc	*As Percent of General Fund Revenue*	*As Percent of Total State Revenue*
Sales and use	43 7	30 5
Highway user	–	20 7
Personal income	17 3	12.0
Bank and corporation	16 7	11 6
Vehicle "in lieu"	0 1	5 5
Inheritance and gift	5 0	3 5
Insurance	4 2	2 9
Alcoholic beverage	3 3	2 7
Cigarette	3 8	2 6
Horseracing	1 8	1 7
All other	4 1	6 3
Totals	100 0	100 0

Computed from data in Table 1, attached

As these data show, almost 75 cents of the State's total revenue dollar come from the four principal sources—the sales and use tax (30 5 cents), the highway user taxes—gasoline and diesel excises, registration and weight fees and the motor transportation tax (20 7 cents), the personal income tax (12 0 cents) and the bank and corporation taxes (11 6 cents) Next is the motor vehicle license fee. This levy is collected by the State and returned to counties, cities and school districts in lieu of local taxes on this type of property

Then come five minor tax levies—if $50 to nearly $100 million a year can correctly be designated as minor inheritance and gift (3 5 cents), insurance (2 9 cents), alcoholic beverage taxes and fees (2 7 cents), cigarette (2 6 cents) and horseracing (1 7 cents)

Finally, the revenue system is completed by the miscellaneous collections which provide 6 3 cents of each revenue dollar. Those include oil and mineral royalties, interest income, the various charges for special services and the fees paid to regulatory agencies.

Comparisons With Other States

There are substantial variations between the relative contributions of the various taxes in California's system and their counterparts in the states employing a similar levy I have summarized this in the comparative tax table below:

COMPARATIVE REVENUE SYSTEMS—1962

	Percent of total revenue	
	States using this tax	*California*
General sales tax	28 1	28 3
Motor vehicles *	22 6	19 0
Personal income	17 9	11 2
Corporation income	7 8	10 9
Property	2 8	5 1
Death and gift	2 2	2 8
Insurance	2 5	2 7
Liquor *	3 5	2 6
Tobacco	4 8	2 4
Public utilities *	2 3	0 5
Parimutuels	2 0	1 4
Severance	3 8	–
Document	1 3	–
Business and professions	1 3	0 8
Hunting and fishing *	0 5	0 3
Other taxes	4.7	0 6
Nontax sources	13 2	11 3
Totals	–	100 0

* Includes license fees
Source U S Census Bureau (see Table 2 attached)

In fiscal 1962, California obtained 28 3 percent of its total revenue from the sales tax This is almost identical with the average proportion derived from this source in all sales tax states—28 1 percent. Per capita sales tax collections here were $44 50, versus an average of $35 97 in all sales tax states However, because of California's higher per capita income, sales tax collections in relation to income were slightly below the average elsewhere—$1 66 per $100 of income here compared with an average of $1 68 for all the sales tax states.

California has relied less heavily upon motor vehicle taxes than other states on the average Our highway user taxes provided 19 0 percent of all state revenue, compared with a 50-state average of 22 6 percent. Fuel taxes were slightly heavier per capita in California—$21 45, versus $19 81 all-state average—but again California's higher personal income came to the rescue and reduced the gas tax burden to 80 cents per $100 of income compared with an average of 89 cents elsewhere

The recent increase in the motor vehicle fuel tax to finance local road and street improvements will bring California nearer the national average both in relative reliance upon this revenue source and in proportion to personal income.

Assemblyman Carrell: What do you include in highway user taxes?

Ralph Currie: I am including the gas tax, the motor vehicle registration and weight fees, the motor vehicle transportation tax, and the diesel fuel tax. All of those which are dedicated to highway user taxes.

California's personal income tax is considerably lighter than the average of states employing this levy, whether measured in relative fiscal contribution, per capita tax collections or burden per $100 of personal income. This is due to the fact that the income tax is a secondary revenue source in California, supplementing the sales tax as a means of general support, whereas in about a dozen states—New York, Oregon, Delaware and Minnesota, for example—the income tax is the primary revenue source.

It should be noted, nevertheless, that the sales tax-income tax combination is by no means unusual. Of the 37 sales tax states, 23 also levy a personal income tax and 25 have a corporation income tax.

The corporation income tax is a more important revenue source in California than it is in most states Census Bureau data for 1962 show that we get about 10 9 percent of our total revenue from this source, against 7 8 percent for all states with this impost It yields $17 14 per capita here, compared with a $10 23 average in the 37 corporate income tax states The burden, as measured in yield per $100 of personal income, is 64 cents versus a 46-cent all-state average

Among the other features to be noted in comparing California's tax system with those of other states as shown in Census Bureau reports are. first, the apparent heavy reliance on a property tax This, however, is merely the motor vehicle "in lieu" tax, levied for local governments California is one of three states levying this license tax in lieu of local ad valorem taxes on motor vehicles The similar tax on privately owned railroad equipment returns approximately $2 million annually for support of state government California, of course, has no general property tax for state purposes.

Somewhat greater prominence of the death and gift tax combination is partly due to the fact that California is one of only 12 states with a gift tax and partly to the fact that many other states have an estate tax in name only. They provide merely for collection of the amount allowed state governments as a credit against the federal estate tax.

As measured against the other major industrial states, California's 2 8 percent of total revenue from death and gift taxes compares with 7 6 percent in Connecticut, 5 6 percent in New Jersey, 4.5 percent in Pennsylvania, 3.8 percent in Massachusetts, 3 5 percent in New York and 3 2 percent in Illinois during the 1962 fiscal year

We have fallen behind the parade in taxing tobacco. Since our cigarette tax was adopted in 1959 many states have increased this tax, with the result that California today is more than 2 cents below the average. This shows clearly in the $3.72 per capita ratio here, compared with $6 09 in the 47 states which tax tobacco products. The extent of California's reliance on this source—2 4 percent of total revenue—is about half the average.

A similar situation exists in the case of alcoholic beverage taxes. Excise taxes and license fees provide 2 6 percent of all state revenue in California and amount to $4 07 per capita This compares with a 3 5-percent relative fiscal contribution and per capita collections of $4.49 nationwide * Considering the circumstance that 16 states have monopoly stores and that during 1962 they obtained $236 million in contributions to general funds over and above $136.7 million in alcoholic beverage taxes and fees collected in these monopoly states, California's taxation of alcoholic beverages would appear to be substantially less than average

Other variations between the revenue systems of California and other states include the absence of a gross receipts tax on public utility services which is reported by 37 states, and a documents (stamp) tax levied

* California collects sales tax on alcoholic beverage and cigarettes, but these items are also taxed in most other sales tax states Adjustment for sales tax receipts would probably reduce somewhat the margin of tax leniency in California, but would not eliminate it

in 15 states; the smaller fiscal importance of a parimutuel tax; and the nominal role of the severance tax, which in California is used solely for support of regulatory agencies in the natural resources field

Assemblyman Carrell: This gross receipts from public utility services—how does that work?

Ralph Currie: Many states have just what amounts to a sales tax on your public utility bill Your gas and light bills are not taxed in California Many of the states do Thirty-seven states do impose a gross receipts tax.

Assemblyman Carrell: On top of whatever the bill is?

Ralph Currie: Yes.

Assemblyman Stanton: How much would that tax bring in California?

Ralph Currie: About $150 million if we taxed public utility services at 3 percent.

Nontax revenues have considerably greater prominence in other states than in California This is particularly true in the case of income from educational services, which clearly shows California's policy of tuition-free education, and in receipts from toll facilities, which reflect the policy of toll-free highways Both an aggressive investment program and attention to property management in California are evident in comparative data on interest income, where this State accounts for more than one-fourth of all-state total

Although interest income is not the direct result of any tax, it cannot be overlooked as a source of state revenue During recent years great effort has been made to keep all idle money invested, even though it may be idle for only a day The Pooled Money Investment Board, consisting of the State Treasurer as chairman, the State Controller, and the Director of Finance, has followed an investment policy which keeps all amounts in excess of $46 million fully at work In this way, receipts from interest on investments have been raised to more than $30 million annually—a sum equal to roughly half the collections from the alcoholic beverage excises.

Among other receipts arising from ownership of property are our oil and mineral royalties which, including bid bonuses for the right to drill on state-owned lands, amounted to more than $27 2 million in the 1962 fiscal year and $49 2 million in the period which closed last June 30 Of this latter sum, one-third ($16 2 million) accrued to the General Fund and two-thirds ($32 7 million) to the Water Fund

Several important revenue sources shown in Table 1 have not been outlined here—motor vehicle fees, the parimutuel tax on horse racing, business license fees and charges for special services I shall be glad to answer questions regarding these later, if you want information on these levies.

PERFORMANCE REPORT

First, however, I want to review briefly the performance of California's state tax system since 1950, and to present a series of charts which compare developments here with those in other states

The first is a graph showing the change in California's population over the last 13 years. From a total of 10 6 million people in 1950, we have grown to 17.7 million at midyear 1963—an increase of 66 per-

cent Where we had 100 people before, we now have 166. The impact of this growth upon State operations is shown by the fact that—

Enrollments have increased more than 2½ times—from 135,000 in 1950 to 351,000 this year.

Public school enrollments have increased 2¼ times—from 1 7 million in 1950 to 3 9 million this year Seventeen percent of our population was enrolled in the public education system in 1950; 24 percent is enrolled today

We have nearly 11 cars seeking driving room on our streets and highways today where we had 5 in 1950

Thanks largely to the growth in the federal old age security program and a decrease in the number of older people requiring public assistance, the social welfare load has increased only 46 percent Nearly all of this growth is in the programs of aid to needy children and to the disabled.

As a result of this growth and a two-thirds increase in the cost of goods and services purchased by the State, expenditures tripled in this period—from just over a billion dollars in 1950-51 to a projected $3 3 billion this current fiscal year, including expenditures from bond funds for building construction and the Oroville Dam Revenues from all sources have risen from just under a billion dollars in 1950-51 to an estimated $3 0 billion this year—excluding, of course, money to be received from bond sales These relationships are shown in Chart 3.

The same elements of growth and price rise have been reflected in the State's tax base The personal income of California residents has risen from less than $20 billion in 1950 to $52 billion this year. This increase of more than 2½ fold is shown in Chart 4

Assemblyman Carrell: You are taking about a third of the income, approximately 30 percent of the income?

Ralph Currie: If you are talking about nationwide, but not California, yes We are taking $15 billion out of a total of $53 billion which is a little less than 30 percent Our income has risen from a little less than $20 billion to a little over $52 billion

Assemblyman Carrell: But, of course, that doesn't reflect the excise taxes or anything like that.

Ralph Currie: It's all taxes It's total tax collections in terms of income.

Assemblyman Carrell: The federal government collects the excise tax.

Ralph Currie: It isn't quite complete, Mr Carrell, for the federal. You would have to raise the federal a little bit because of the taxes which are actually collected in say Kentucky, and passed on in the price of liquor in California, or the cigarette tax collected in North Carolina and passed on to consumers in California in the price of a package of cigarettes

Assemblyman Carrell: Is that true with automobiles?

Ralph Currie: It isn't quite true If you were to increase the federal levy by about $1 2 billion or so, you would get the total burden of federal taxes in California That is what I am trying to say. In my first table, instead of $9 5 billion collected in California the actual

burden of federal taxes we collect in California is probably about $11 billion. That isn't reflected in this

Assemblyman Carrell: It still comes back to between 30 and 33 percent.

Ralph Currie: It is about 30 percent in California. It's a little less than 30 percent in California.

Chairman Petris: How do you define personal income on Chart 4?

Ralph Currie: That's all the income of people Salaries and wages, dividends, interest, receipts from rents and royalties, and corporate income as it is passed on to the people in dividends. This is a personal income only. The income of all the people in California. There is a little bit of imputed income in it, but not a great deal. It is mostly cash income

So the burden of state taxes as measured in terms of tax payments has changed only slightly. Collections in fiscal 1951 amounted to $4.81 per $100 of personal income. The corresponding ratio last year was $5 09, an increase of 28 cents (6 percent). There was a sharp drop in the ratio of state taxes to personal income during the early 1950's when personal incomes were expanding rapidly under the impact of the Korean War upon California's economy. (See Chart 5) There was a rise in 1955-56, when a substantial expansion in the use of credit, chiefly for the purchase of cars and homes, generated a 15-percent increase in tax revenue compared with a 10-percent increase in personal income After a drop in the ratio during the 1958 recession and the 1959 adjustment in the tax base that brought income into line with outgo, the ratio of tax collections to personal income has leveled out at a point just above $5 during the last four fiscal years.

COMPARISON WITH OTHER STATES

California's rate of population growth has been three times the average of other states As Chart 6 shows. California's increase not only surpassed the all-state average by three to one, but it outstripped the average of the nine other industrial states by an even wider margin Our growth of roughly 60 percent between 1950 and 1962 compares with 19 6 percent in the 47 other states,* 18 1 percent in the other industrial states taken together, and 16 7 percent in New York, the only other state of comparable size today.

As a result of this population boom, it would be reasonable to assume a similar trend in comparative state tax burden as between California and these other states This has not been the case.

Actually, Census Bureau reports † of state tax collections show a complete reversal of this growth profile California, top on the population chart, is at the bottom of the chart showing change in tax burden (Chart 7) The Census Bureau data on tax collections are slightly different from our State Budget total because the bureau includes as taxes certain regulatory license fees which are not included in the budget tax total The amounts reported by the bureau are somewhat larger, but the trends are generally the same in each series.

* Alaska and Hawaii were not states in 1950 and have been excluded in making this comparison

† Compendium of State Government Finances.

According to Census Bureau data, the increase in California's state tax burden between fiscal 1951 and fiscal 1962 was 6 1 percent This compares with an all-state average of 26 3 percent, an industrial state average of 33 9 percent and an increase of 47 2 percent in New York, where it can be reasoned that, except for growth, the problems of state government are of a magnitude similar to those in California

Any appraisal of taxes and tax problems in California must take recognition of expenditure policies which run back to the origin of this State They must be appraised in the light of free education—kindergarten through graduate school—toll-free superhighways, liberal social traditions, the need for water conservation and development and the continuing pressure for both services and facilities at all levels of government

There are, of course, inherent differences among the states in the traditions, the service concepts, the policies and the responsibilities of state governments These are reflected in the tax systems which each state had adopted, in the relationships among agencies at the different levels of government, the extent of local assistance and the form which such subventions take A comprehensive study of the many facets of state fiscal affairs which would seek out the best features of all and apply them to the solution of California's tax problem is one of the greatest needs we have today.

California's current tax system is 30 years old this year It had its start in the Sales Tax Act of 1933 and the income tax which was vetoed in that year but enacted in 1935 The system has functioned well but in these 30 years California has changed, our economy has changed, our concepts of governmental responsibilities have changed, and our total tax burden has increased materially

Does California's tax structure still meet our needs? Should this State follow New York's example in relying heavily upon income taxes? Could we then relinquish all, or part, of the sales tax to local governments in order to redesign the property tax to the present day economic and social structures?

These are some of the basic fiscal questions that California must grapple with It is to be sincerely hoped that this committee, together with its counterpart in the Senate, will find the answers to these and other questions of basic tax policy

COMPARATIVE STATE REVENUE
1962-63 AND 1963-64
(In millions)

Source	Actual 1962-63			Estimated 1963-64			Change in totals attributable to	
	General fund	Special funds	Total	General fund	Special funds	Total	Growth, etc.	Legislation
Major taxes and fees								
Alcoholic beverages								
Beer and wine	$10 7	--	$10 7	$11 2	--	$11 2	$0 5	--
Distilled spirits	48 2	--	48 2	50 6	--	50 6	2 4	--
Liquor licenses	3 4	$10 6	13 9	2 3	$10 6	13 0	--	—$0 9*
Bank and corporation	311 3	--	311 3	400 0	--	400 0	6 1	82 6
Cigarette	70 2	--	70 2	73 0	--	73 0	2 8	--
Gift	5 6	--	5 6	5 5	--	5 5	—0 1	--
Horseracing	33 6	8 1	41 7	34 0	9 3	43 3	1 6	--
Inheritance	86 8	--	86 8	93 5	--	93 5	6 7	--
Insurance	78 0	--	78 0	105 0	--	105 0	5 0	22 0
Motor vehicles								
In lieu tax	1 1	145 9	147 0	1 1	153 9	155 0	8 0	--
Gasoline	--	362 1	362 1	--	417 0	417 0†	17 1	37 8
Diesel and LPG	--	24 1	24 1	--	25 7	25 7†	1 6	0 1
Registration and weight	--	151 4	151 4	--	161 9	161 9†	2 9	7 6
Transportation	--	14 1	14 1	--	15 3	15 3†	1 2	--
Personal income	322 0	--	322 0	396 0	--	396 0	29 2	44 8
Private car	1 8	--	1 8	2 0	--	2 0	0 1	0 1
Sales and use	813 5	--	813 5	868 1	--	868 1	46 4	8 2
Totals, major taxes and fees	$1,786 0	$716 2	$2,502 2	$2,042 3	$793 7	$2,836 0	$131 5	$202 3
Other revenue								
Interest on investments	$20 0	$10 1	$30 1	$20 6	$10 8	$31 4†	$1 3	--
Oil and gas royalties	16 8	35 0	51 8	17 0	27 0	44 0†	—7 8	--
All other	38 1	47 1	85 2	42 5	46 4	88 9†	3 7	--
Totals, other revenue	$74 9	$92 2	$167 1	$80 1	$84 2	$164 3†	—$2 8	--
Grand totals, revenue	$1,860 9	$808 4	$2,669 3	$2,122 4	$877 9	$3,000 3	$128 7	$202 3

* Decline due to effect of 1961 legislation upon 1962-63 revenue
† Revised subsequent to report on Summary of Chaptered Legislation
NOTE Detail may not add to totals due to rounding

Department of Finance
Budget Division 100163

TABLE 2

CALIFORNIA REVENUE

COMPARED WITH RECEIPTS FROM CORRESPONDING LEVIES IN OTHER STATES, 1961-62

(Collections are shown in millions)

Source	All states using this tax				California				
	Number of states using this tax	Collections from this tax	Percent of total revenue*	Tax collected per capita	Tax collected per $100 personal income	Collections from this tax	Percent of total revenue*	Tax collected per capita	Tax collected per $100 personal income
General sales	37	$5,111 4	28 1	$35 97	$1 68	$755 1	28 3	$44 50	$1.66
Special sales and gross receipts									
Motor vehicle fuel	50	3,665 0	15 5	19 81	0 89	364 0	13 6	21 42	0 80
Tobacco products	47	1,074 6	4 8	6 09	0 27	63 2	2 4	3 72	0 14
Alcoholic beverages	50	739 5	3 1	4 00	0 18	55 9	2 1	3 29	0 12
Insurance	50	591 5	2 5	3 20	0 14	73 0	2 7	4 30	0 16
Public utilities	37	419 7	2 2	2 86	0 13	13 2	0 5	0 78	0 03
Parimutuels	24	286 1	2 0	2 67	0 09	37 5	1 4	2 21	0 08
Amusement	29	29 3	0 1	0 14	0 01	0 2	--	0 01	--
Other	30	130 1	0 9	1 10	0 05	13 0	0 5	0 77	0 03
Personal income	35	2,728 0	17 9	23 77	1 08	298 9	11 2	17 61	0 66
Corporation income	37	1,308 0	7 8	10 23	0 46	290 8	10 9	17 14	0 64
Property	45	640 3	2 8	3 61	0 16	136 3	5 1	8 03	0 30
Death and gift	49	516 3	2 2	2 80	0 13	76 0	2 8	4 48	0 17
Severance	29	450 9	3 8	4 93	0 24	1 2	--	0 07	--
Poll	10	8 9	0 3	0 32	0 02	--	--	--	--
Document and stock transfer licenses	15	131 8	1 3	1 66	0 08	--	--	--	--
Motor vehicle	49	1,550 2	6 6	8 41	0 35	137 2	5 1	8 08	0 30
Motor vehicle operators	49	117 1	0 5	0 64	0 03	7 9	0 3	0 47	0 02
Corporations	50	457 2	1 9	2 47	0 11	1 4	0 1	0 08	--
Public utilities	33	22 7	0 1	0 15	0 01	0 1	--	0 01	--
Alcoholic beverages	49	91 0	0 4	0 49	0 02	13 3	0 5	0 78	0 03
Amusements	37	6 0	--	0 04	--	--	--	--	--
Occupations and businesses	50	296 7	1 3	1 60	0 07	21 4	0 8	1 26	0 05
Hunting and fishing	50	120 0	0 5	0 65	0 03	9 4	0 3	0 55	0 02
Other licenses	39	7 8	--	0 05	--	0 4	--	0 02	--
Other	10	70 5	1 6	2 05	0 10	--	--	--	--
Charges and miscellaneous general revenue	50	3,115 8	13 2	16 84	0 76	301 5	11 3	17 77	0 66
Totals	--	--	--	--	--	$2,670 9	100 0	$157 35	$5 87

* Revenue from own sources, i e excluding receipts from federal and local governments

Chart 1

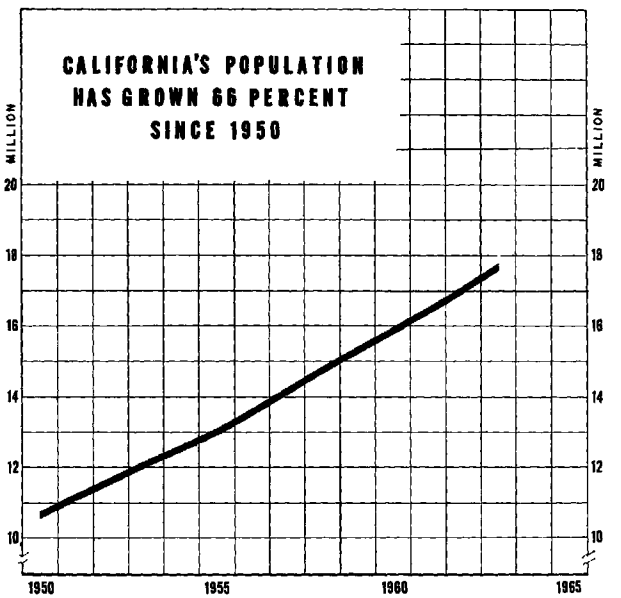
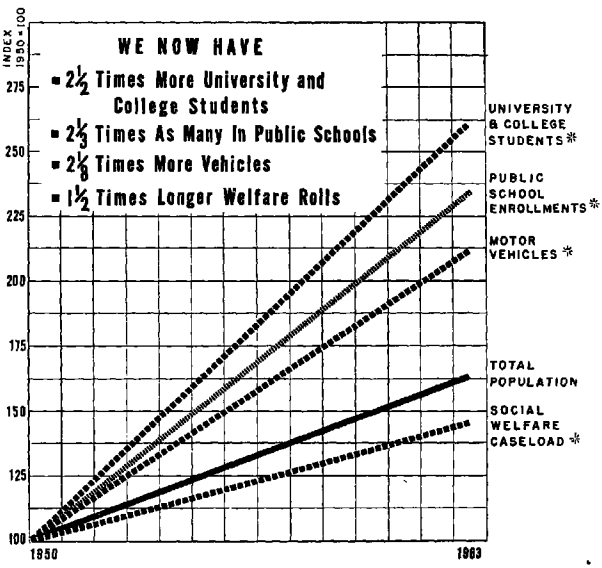

CALIFORNIA'S POPULATION
HAS GROWN 66 PERCENT
SINCE 1950
MILLION
20
18
16
14
12
10
1950
1955
1960
1965

Chart 2



* 80 % of the state budget represents expenditures for education, highways and related items, health and welfare.

Chart 3

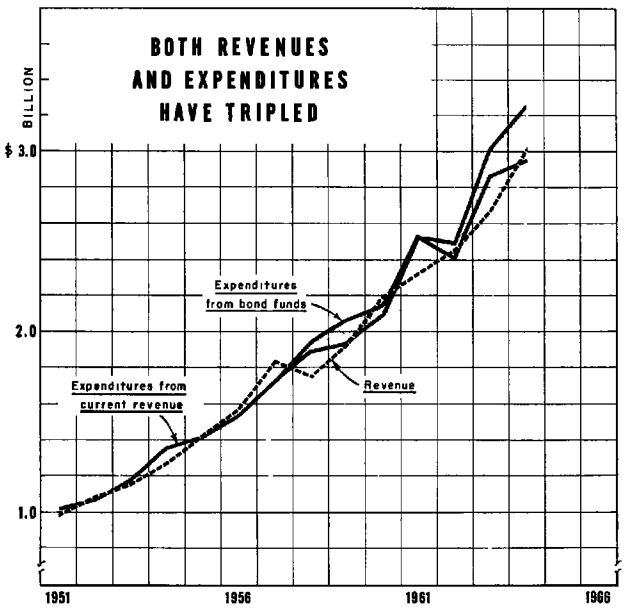

BOTH REVENUES
AND EXPENDITURES
HAVE TRIPLED
BILLION
$ 3.0
2.0
1.0
Expenditures
from bond funds
Expenditures from
current revenue
Revenue
1951
1956
1961
1966

Chart 4

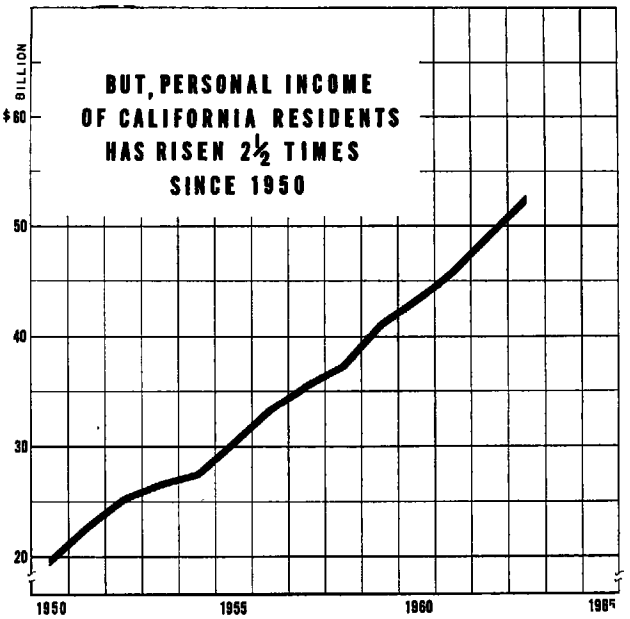

BUT, PERSONAL INCOME
OF CALIFORNIA RESIDENTS
HAS RISEN 2½ TIMES
SINCE 1950
$ BILLION
60
50
40
30
20
1950
1955
1960
1965

Chart 5

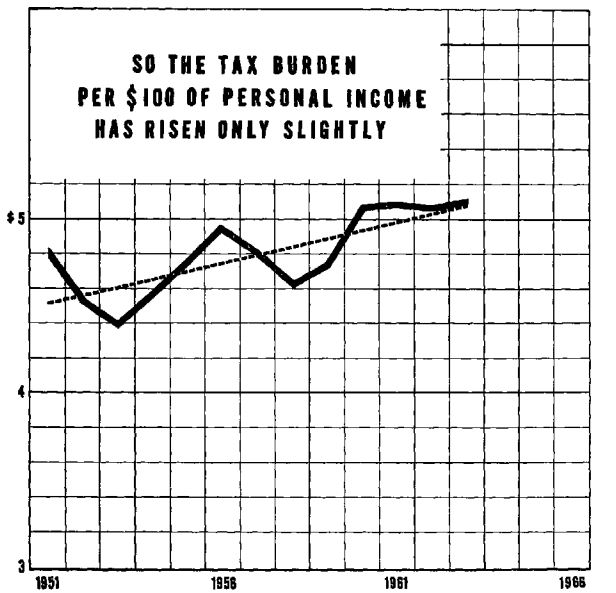

SO THE TAX BURDEN
PER $100 OF PERSONAL INCOME
HAS RISEN ONLY SLIGHTLY
$5
4
3
1951
1956
1961
1966

Chart 6

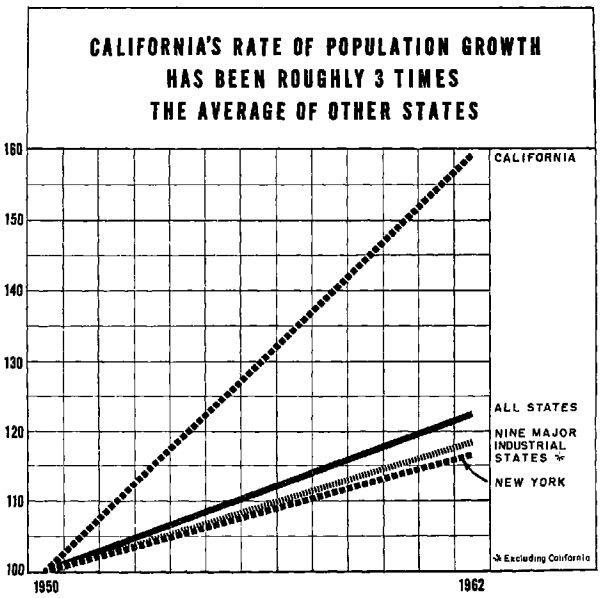
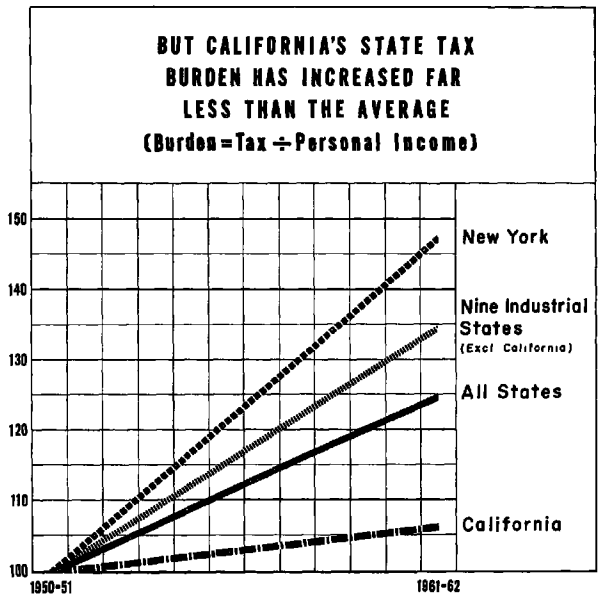

CALIFORNIA'S RATE OF POPULATION GROWTH
HAS BEEN ROUGHLY 3 TIMES
THE AVERAGE OF OTHER STATES
160
150
140
130
120
110
100
1950
1962
CALIFORNIA
ALL STATES
NINE MAJOR INDUSTRIAL STATES *
NEW YORK
* Excluding California

Chart 7


BUT CALIFORNIA'S STATE TAX
BURDEN HAS INCREASED FAR
LESS THAN THE AVERAGE
(Burden = Tax ÷ Personal Income)
150
140
130
120
110
100
1950-51
1961-62
New York
Nine Industrial
States
(Excl California)
All States
California

V. TAXES ADMINISTERED BY FRANCHISE TAX BOARD

A. SUMMARY

Martin Huff, Executive Officer, Franchise Tax Board: The Franchise Tax Board administers the Personal Income Tax Law, which is a tax on individuals, trusts, and estates and the Bank and Corporation Tax Law, which is three laws in one It taxes banks and financial corporations at a rate not to exceed 9½ percent, imposes a franchise tax on general corporations at a rate of 5 5 percent of their net income for the privilege of doing business in California and, finally, as a supplement to the franchise tax, provides for an income tax on out-of-state corporations deriving income from California operations.

An analysis of the revenue for the last fiscal year shows·

	Revenue	
	*Amount	Percent
Personal income tax	$322	50 8
Banks and financial corporations	61	9 7
Franchise tax	248	34.2
Corporation tax	2	.3
Totals	$633	100

* Millions

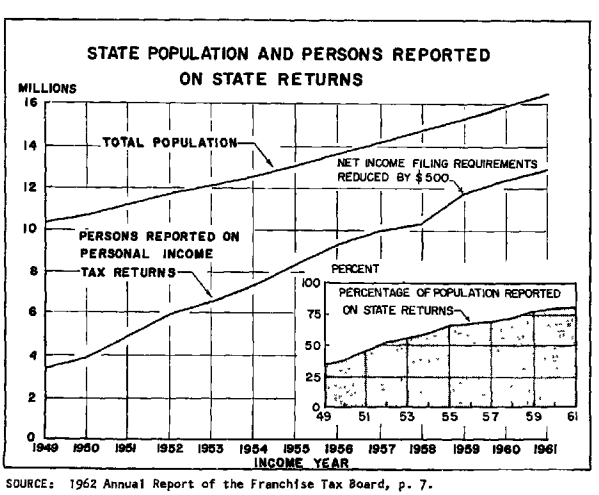
The Franchise Tax Board is an independent state agency. By administrative directive of the Governor, the board is a part of the nonstatutory Revenue and Management Agency The board and its predecessor, the Franchise Tax Commissioner, have a history dating back to 1929.

The Personal Income Tax Act was placed on the books in 1935 and its administration was delegated to the Franchise Tax Commissioner. The Corporation Income Tax Act was enacted in 1937. It is a companion measure to the Franchise Tax Act and is now actually an integral part of the Bank and Corporation Tax Law

The State Legislature transformed the office of the Franchise Tax Commissioner into the Franchise Tax Board in 1949 The board is a policymaking body and is composed of State Controller, Alan Cranston; Director of Finance, Hale Champion; and the Chairman of the Board of Equalization, John Lynch As executive officer, I am responsible for administering the agency At present we have a staff of 1,100 permanent employees During peak periods, we have several hundred temporary employees It is interesting to note that the United States Internal Revenue Service has in excess of 4,500 employees attributable to California operations

The staff is principally located in the headquarters office in Sacramento. Regional offices are maintained in San Francisco and Los Angeles In addition, we have 12 branch offices located in California and two located in the East, one in New York and one in Chicago. The eastern offices are concerned primarily with auditing the books and records of the large nationwide corporations whose headquarters are located in the East or Midwest

I am going to ask Mr Walker to distribute to the members of the committee copies of a chart that shows the relation between the total state population and the number of persons reported on state income tax returns. While the State's population has risen at an average rate



SOURCE: 1962 Annual Report of the Franchise Tax Board, p. 7.

of 4 percent from 1949 to 1961, the number of persons identified on tax returns has risen at an average annual rate of 12 percent.

This increased coverage of the State's population is due in large measure to the board's intensive enforcement program to assure the filing of timely returns. Other contributing factors are the lowered net income filing requirements in the 1959 income year and the shift of taxpayers from low incomes to higher incomes

The enforcement and audit activities of the agency are an important factor in the revenue picture of the State. For the last fiscal year these activities resulted in the assessment or collection of more than $37,000,000, at a cost of less than $6 million or in excess of $6 return for each dollar cost.

Total taxes collected amounted to 633 million dollars at a cost of 8 9 million dollars or 1 41 percent This accounted for 36 percent of the General Fund revenue.

I will now ask Mr. James Hamilton, a member of our legal staff, to give you more detailed background on the laws administered by the board

B. PERSONAL INCOME TAX

James Hamilton, Legal Counsel, Franchise Tax Board· The Personal Income Tax Law was enacted in 1935 [1] It was then known as the "Personal Income Tax Act of 1935 "

The tax came into being as a result of recommendations of a joint legislative tax committee appointed at the 1933 session This committee which was appointed to study suggested sources of new revenue in order to provide relief for real estate through the lowering of property taxes and to effect a balancing of the State Budget, recommended, among other things, the imposition of an income tax.

The California Personal Income Tax Act of 1935,[2] was applicable to income received or accrued on or after January 1, 1935 The act was patterned to a large extent after the Federal Revenue Act of 1934. Many of the federal provisions were incorporated by reference, but there were many substantial differences between the state and federal income tax law The subsequent enactment of the Federal Revenue Acts of 1935 and 1936, which changed the treatment of a number of items for federal tax purposes brought about further differences

Initially the most important differences between the state and federal law was in the treatment of an earned income credit, stock dividends, distributions of a corporation in complete liquidation, sale of oil and gas properties discovered or developed by the taxpayer, and personal holding companies [3]

The income tax law still patterned after the federal law, has been amended at each regular session of the Legislature since its enactment. Most of the changes have consisted of what are known as "conformity amendments " These are amendments based on provisions of the Federal Internal Revenue Code However, many differences have developed Also from time to time the Legislature has delayed or refused to enact certain "conformity amendments "

[1] *Stats 1935*, c 329, p 1090
[2] Enacted June 13, 1935
[3] Other differences between the original state and the federal income tax law are summarized at pages 389 to 399, inclusive, *Income Tax Management For Individuals*, McLaren and Feigenbaum, 1936 edition

Undoubtedly there has never been a time during which the state income tax law has conformed as nearly as possible to federal law This has resulted from policy decisions not to conform in certain areas or because of decisions to delay conformity as a result of revenue needs Another reason why complete conformity has not been attained is that federal tax legislation is enacted on a more or less continuous basis and is often retroactive As we know, state tax legislation is generally enacted only during regular sessions Furthermore, retroactive tax legislation is restricted by Section 31 of Article 4 of our Constitution, which prohibits the Legislature from making a gift of public money or things of value to any individual—or corporation This section, as applied to tax matters, has been construed to mean that once a right to a tax has vested it cannot be released by the Legislature [4] Therefore, this section of the Constitution prevents the State from conforming to federal provisions which retroactively release or reduce a vested tax

Because of the constitutional provision and since the law is amended only during regular sessions, there are differences in starting dates between conforming state and federal provisions which may have a continuing effect An example is the new accelerated depreciation methods Under federal law the new methods may be applied to property acquired after December 31, 1953, whereas under state law such methods may be applied to assets acquired after December 31, 1958, or five years later.

PERSONAL INCOME TAX LAW

a. Taxpayers

The tax applies to individuals, fiduciaries, estates and trusts Partnerships are not taxpayers, but must file an annual information return. The individual partners are required to include in their distributive share of the partnership income or loss

Residents are taxable on all income received by them during the taxable year, regardless of source Nonresidents are taxable on income derived from sources within this State It is important to note that the tax is imposed on residents—not domiciliaries Therefore, an individual may be a resident of this State even though domiciled in another state, or may be a nonresident even though domiciled in this State An individual under the income tax law is a resident of the state where he has his closest connections, but he becomes domiciled in a state only when physically present therein with the *intent* to become a resident thereof An individual is presumed to be a resident under our law if he spends nine months of the taxable year within this State However, this presumption may be overcome upon a sufficient showing that the presence in California is for a temporary or transitory purpose. If an individual or income is taxed in more than one state, any double tax is reduced or eliminated through the allowance of tax credits.

b. Personal Exemptions

An individual is allowed a personal exemption of $1,500. A head of a household or married couple is allowed $3,000 In the case of a married couple filing seperate returns the exemption may be taken by either or divided between them

[4] *In re Martins Estate* (1908) 153 Cal 225

An additional exemption of $600 is allowed for each dependent and for the taxpayer or his spouse if blind

An estate is allowed an exemption of $1,000. The exemption allowed a trust is $100, but if the tax due is less than $1, the exemption is increased up to its taxable income This exception is to relieve trusts from filing returns if their total tax is less than $1.

c. Rates

The tax rate is 1 percent on the first $2,500 of taxable income, increasing 1 percent on each additional $2,500 to a 7 percent maximum. The maximum applies to incomes in excess of $15,000.

Married couples filing joint returns may split their income. This means that for married couples the 1 percent rate applies to the first $5,000 of taxable income In the case of married couples filing joint returns the maximum 7 percent rate applies to incomes in excess of $30,000.

An optional tax is also provided for. The optional tax consists of a table which takes into account the taxpayer's personal exemption and standard deduction The table may be used by single persons or heads of a household whose adjusted gross income is less than $5,000 or married couples whose adjusted gross income is less than $10,000.

d. Income

Gross income includes income from any source or business whatsoever The legality of the source or activity is immaterial Some of the more common items of income consist of wages, dividends, rents, interest, royalties, pensions and gains derived from dealings in property. Some items are partially included or constitute income under certain conditions These are alimony, annuities, life insurance proceeds and prizes and awards. Taxpayers at their election may include in income in the year received or declared, income attributable to patronage dividends and loans received from the Commodity Credit Corporation If not included in income when declared or received, such amounts are taxable in later years There are also a number of provisions which defer recognition of income. Some of these are provisions which permit a tax-free sale of a personal residence, if a new home is acquired within a prescribed period of time and those which permit the reinvestment of proceeds acquired as the result of condemnation of property. Car pool receipts are not taxable, but expenses incurred are not deductible.

Some items are specifically excluded from gross income. These consist of gifts and inheritances, most amounts received under life insurance policies, up to $5,000 or employee death benefits, damages received for personal injuries or sickness, rental value of parsonages, recovery of amounts such as a bad debt if a deduction thereof for a prior year did not reduce taxes, the first $1,000 paid to members of the Armed Forces and all of their mustering out payments, certain scholarship and fellowship grants, and meals and lodging furnished for the convenience of the employer.

e. Deductions

Of most interest to taxpayers are the deductions.

Taxpayers may take a standard deduction or itemize them. In either event, the first step is to determine adjusted gross income. Adjusted

gross income is "gross income" (defined above), less deductions of a business nature These consist of:

1. Deductions attributable to a trade or business including expenses of outside salesmen;
2. Deductions for reimbursed travel and transportation expenses;
3. The net long-term capital gain deduction,
4. A deduction for losses incurred from the sale or exchange of property;
5. A deduction for expenses (including the depletion allowance) attributable to property held for the production of rents or royalties; and
6. In the case of a life tenant or income beneficiary or property held in trust or an heir, their apportionable share of any depreciation and depletion deduction

Once adjusted gross income is determined, a taxpayer then itemizes or takes a standard deduction If his adjusted gross income is less than $5,000, if single, or the head of a household, or $10,000 if married, it is advantageous to itemize deductions only if they exceed adjusted gross income by more than 10 percent

Many expenses of a business and personal nature may be deducted when itemized. The principal itemized deductions are·

An allowance for all ordinary and necessary business expenses, and for

Interest paid;
Certain taxes;
Medical expenses;
Adoption expenses;
Charitable contributions;
Political contributions;
Depreciation;
Depletion;
Alimony;
Circulation, research and trademark and trade name expenditures

Taxpayers may also deduct over a period of years:

Amortizable bond premiums; and
The cost of antismog equipment.

A taxpayer engaged in an unlawful activity such as bookmaking is prohibited from deducting any of his expenses.

All of these deductions are subject to various conditions and limitations. In addition to these, a deduction is allowed for personal exemptions and dependents. When this deduction is taken, the remaining income is the balance subject to tax, which is referred to as "taxable income."

f. Capital Assets

A capital asset consists of all property held by the taxpayer, subject to certain exceptions The most important exceptions are for stock in trade or property held for sale to customers in the ordinary course of a trade or business. If a capital asset is sold at a gain after having

been held for six months or more only one-half of the gain is subject to tax On the other hand losses may not be fully deductible.

Because of the application of this section, it is obvious that it rewards ingenuity Thus, the taxpayer who sells real estate at a gain is quick to point out that he is an investor, but if sold at a loss that he is a dealer

Special provisions are also made for the taxation of gains from an involuntary conversion or from the sale or exchange of real or depreciable property used in a trade or business This differs from the treatment of capital assets primarily in that loses are fully deductible. This special treatment over the years has been extended to various classes of property, and now includes livestock, except poultry, timber, unharvested crops, options, and certain employee termination payments

g. Accounting Period

Taxpayers may use a calendar or a fiscal year accounting period Most accounting periods must end on the last day of the month If it ends on December 31, it is a calendar year accounting period, if it ends on the last day of any other month it is called a fiscal year accounting period Except where a taxpayer first comes into existence or ceases to exist the accounting period must cover 12 months There is an exception when an accounting period ends, for example, on the last Friday of a month In this case the accounting period may vary from 52 to 53 weeks.

h. Accounting Methods

There are two common accounting methods. The first is the cash receipts and disbursements method, used by most individuals. The other is the accrual method used by many businesses

Under the cash method income is taken into account when received. However, the receipt may be actual or constructive. Constructive receipt occurs when income is unconditionally made available to a taxpayer even though not reduced to possession. For example interest earned on a savings account even though the interest has not been obtained or credited on the savings account book Deductions are allowed when actually paid, unless they should be taken for another period to clearly reflect income, such as depreciation Also prepaid expenses, like prepaid rent or insurance, must be deducted for the year to which they relate

Under the accrual method, income is reported when the right to receive it comes into being or when all events which determine the right have occurred It is the right to receive the income which controls. A deduction is allowed when the actual liability is incurred, regardless of when paid

Combinations of the above methods are also permitted, so long as they properly reflect income. Taxpayers engaged in more than one trade or business may use a different method for each.

i. Nonresidents

Nonresidents are required to include in income only gross income derived from sources within the State This includes income from a partnership or real property located in this State. Income from intangible property is taxable only if the property has acquired a business

situs in this State. Property acquires a business situs by being used in this State for business purposes, for example, if stocks or bonds are pledged to secure a loan to operate a business located in this State

If a business owned by a nonresident is conducted in this and other states, the income therefrom is required to be allocated among the states In such case taxable income is usually allocated by use of a three factor formula consisting of property, payroll and sales The ratio that the average of each of these factors attributable to this State bears to the total determines the income allocated to this State

Deductions allowed nonresidents are limited to expenses incurred in connection with income derived from this State, taxes paid to this State and contributions made to local charitable organizations. Nonresidents, however, are allowed the same personal exemptions as residents

In order to correctly reflect income, when a taxpayer's status changes from a nonresident to a resident or from a resident to a nonresident, he is required to use the accrual accounting method for the period preceding the change of status This is so that income earned or deductions incurred will be taxable in or allowed as a deduction by the State where the service was rendered or the expense incurred.

Withholding is required on payments made to nonresidents Withholding commences with payments made in excess of the taxpayer's deduction for personal exemptions It is at a rate which covers the amount of tax due on the payments made

j. Returns

Returns are required from all individuals, except married couples, whose net income is $1,500 or over Net income includes gross income, less all deductions except the deduction allowed for personal exemptions Therefore, all persons who have taxable income are required to file returns.

Married couples are required to file a return if their net income is $3,000 or over.

Estates are required to file a return if their net income is $1,000 or over and trusts if their net income is $100 or over, unless their tax is less than $1

Every individual, estate or trust is required to file a return if their gross income is $5,000 or over, regardless of their net income

Married couples at their election may file joint returns

k. Time for Filing

Returns are due from calendar year taxpayers on April 15 of the year following the close of their taxable year Returns made on the basis of a fiscal year are due on or before the 15th day of the 4th month following the close of the fiscal year.

Prior to 1964 the tax, if over $50, could be paid in three installments The entire tax must now be paid when the return is due

Up to a six-month extension for filing may be granted But even though an extension is granted, interest at the rate of 6 percent per year is payable from the time the return is due

l. Penalties

1 Civil. If a taxpayer is delinquent in filing a return the penalty is 5 percent of the tax per month up to a maximum of 25 percent This penalty may be waived if the failure is due to a reasonable cause

A 25 percent penalty may be imposed if a taxpayer fails to file a return after notice and demand, or fails to furnish information required in writing

If a deficiency results from the negligence of the taxpayer or from intentional disregard of rules and regulations a 5 percent penalty is provided for.

In the event a deficiency is due to fraud the penalty is 50 percent of the deficiency

2 Penal Provisions Any person who fails to file a return or supply information required or who makes a false or fraudulent return, with or without intent, is subject to a civil penalty up to $1,000 and is also guilty of a misdemeanor.

Any person who willfully makes and subscribes any false return verified under penalties of perjury is guilty of a felony and may be fined up to $2,000 or imprisoned for not more than five years

Any person who willfully fails to file any return with intent to evade any tax or who willfully with like intent makes a false return is punishable by imprisonment in the county jail up to one year, or in the state prison not to exceed five years, or by a fine of up to $5,000, or by both fine and imprisonment

The final penalty is against any person who has or is required to withhold tax and who willfully fails to collect or truthfully account for and pay over such tax Such willful failure is a felony. The penalty may not exceed $2,000 or imprisonment up to five years, or both.

m. Appeals

A deficiency generally may be assessed within four years after the return is filed A notice of proposed assessment may be protested within 60 days after the mailing If a written protest is not filed the proposed assessment becomes final upon the expiration of the 60-day period

The protest is not required to follow any particular form It should, however, identify the taxpayer, taxable year and amount of tax involved and generally indicate the reason for the protest. If the taxpayer so requests he is granted an oral hearing before an administrative unit which is independent from the audit staff

If the assessment is affirmed, the taxpayer may within 30 days appeal in writing to the State Board of Equalization If the board affirms the assessment the tax must then be paid before an action may be commenced in the court There is one exception to the requirement that the tax be paid before a court action may be instituted That is if the only issue is the residence of a taxpayer, then, after an adverse ruling by the Board of Equalization, a taxpayer may institute an action for a declaratory judgment

Assemblyman Carrell: I don't know if this is apropos of this personal income tax, but perhaps Mr Huff could answer this, too How much money do you collect" Do you scan any changes that are made by the federal income tax auditors? When a federal income tax auditor comes in, and he makes a report, and he raises the tax or lowers it,

do you scan these? Do you have some kind of a reciprocal agreement with the federal——

Martin Huff: We have a formal agreement with the Internal Revenue Service. We get copies of the revenue agents' report, and this is the basis for state adjustment. Any adjustments that the federal makes, we make automatically; this is a reciprocity agreement.

Assemblyman Carrell: Do you make any independent examinations yourself?

Martin Huff: Yes

Assemblyman Carrell: How much more do you collect by them?

Martin Huff: Thirty-seven million dollars

Bruce Walker: Well, there are actually many tens of thousands of standings of the files by the state-owned audit forces, and with many office adjustments made completely independent of the federal, and there are many field adjustments also made by the state staff Those are very important in the Bank and Corporation Tax, and also to some extent in the personal income tax field

Assemblyman Carrell: I am just wondering if it justifies this extra staff to make the collections I am just wondering if you could collect a little more by careful scanning of the federal audits, and probably cut down the staff

Martin Huff: This is a cooperative program, and I think you need to understand—maybe I didn't emphasize it sufficiently—that these taxes are self-assessed taxes, and the degree and the depth of the compliance program and the audit program we conduct in large part has an effect on the success of self-assessment There is a correlation here

Assemblyman Carrell: Of course, I understand you scan many of them in the office, but I think——

Martin Huff: Mr Carrell, there is another audit, as an example, and this breaks down into various segments This is done actually on returns in the lower income category These are just given a fast scan for types of errors, mechanical errors, that can be picked up at low cost, and I guess in occasional years, we have achieved 100-percent groups, but normally it ranges anywhere from 60 percent to 80 percent The higher income groups have more detailed audit programs.

Assemblyman Carrell: I am just trying to find out how necessary that is. There is a question in my mind, from a businessman's standpoint It is just an awful lot of wasted time, and waste of money for business We have agents coming in and taking a lot of our time and a lot of our employees' time, and I am just wondering how much they are collecting

Chairman Petris: I can shed some light on that, Mr Carrell I had a bill or two which related to that subject as you might remember Legislative analysts, at our request, made a study of this last year The last taxable year they were able to check was 1961, the full year, because they did the work in 1962 As I reported to the committee, subsequently, they compared the federal returns with the state returns for certain categories, and found that in one category, the federal government was getting about $3 5 million more—I mean, we were losing about $3 5 million because of the fact that there were a great number of California taxpayers who were paying their federal tax, but were not paying their state tax, not even filing their returns The total dollar

amount was about $7 4 million It could be said that, perhaps, we don't have enough people checking this area

Assemblyman Carrell: This was done within the office Outside auditors weren't going into a place of business and checking until they found——

Chairman Petris: No this was checking actual returns, both federal and state——

Assemblyman Carrell: Which could have been done in the office.

Chairman Petris: But that was done before the other system of getting the tapes from Salt Lake City was in full production, and that has cut down the gap considerably, as I understand it.

Martin Huff: Mr. Carrell, maybe there is a misunderstanding on the audit program. We don't have auditors that just go out on a fishing expedition. An office audit is conducted, but it only becomes a field audit where there is a visitation to the place of business There is some indication that more information or a more detailed audit is required before the men go out.

Assemblyman Carrell: You don't make any audits unless there is some indication——

Martin Huff: Right

Assemblyman Rumford: We are on this question and it will probably come to us again. I've discussed with other states their system of withholding. This has meant additional millions of dollars to the State of Massachusetts. Have you any comment on it? We want to know what your experience has been.

James Hamilton: Mr. Currie's studies did show, I think, that many of these states realized they were able to collect substantial amounts of taxes which before putting such a system in they just did not think would be there One of the factors in the cost of tax administration in this area involves our whole compliance program in terms of the collection procedures from people, who even though they file the return, haven't paid the tax This involves overhead and staff to follow up

Chairman Petris: It takes the board two years from the time they find out that taxpayer "A" either hasn't paid his tax, or hasn't filed a return when he should have, until the time that he gets his first letter. I shouldn't say from the time they find out It's from the time they go through the first five steps of their comparison program. For example, they get the reports all the employers send to the board, and they cull through those. Then they have certain other steps, and by the time they realize there has been a problem and the taxpayer has been notified, two whole years have gone by, and with people moving around as much as they do, in and out of State, they are very lucky to catch them the first time around If they do catch them, they find a certain percentage has left the State, and they couldn't collect them if they tried, and then they find another percentage is only taxable to the extent of about $5 or $6, and they made a ruling that if it is $6 or less, they wouldn't spend any more money trying to collect it, since they would be two years just trying to find out We could have eliminated all of that if we had enacted a withholding system for state income tax. There is a tremendous amount of detail that we could supply to the individual members on this, and I think we should have it.

Assemblyman Rumford: Republican legislators in Massachusetts said it has been working very well There will have to be a meeting of the minds so that we can get together on this

Assemblyman Young: I was just glancing over this publication I notice here, "The board mailed out 4,532,000 personal income tax returns" This was based on the information that was received from the Internal Revenue Service, I assume

Martin Huff: Right

Assemblyman Young: Then it says the board received 4,475,000 taxable and nontaxable returns which would mean it rounds out that probably sixty some odd thousand returns were not filed. How many people do we have in the State of California who are paying their federal taxes, but are not filing state tax returns?

Martin Huff: I think the two figures don't correlate The program is to use the federal tapes that have been in Ogden from the prior year's returns to address returns from subsequent years Now we all know that California taxpayers move much more rapidly than anyone else This is merely a mechanical device in which the State is saving considerable money from its prior program of having to individually address the returns to mail out to individual taxpayers This is all an automatic process and derived from the federal tapes We actually send out several million more returns by other methods of distribution The ratio of usage of blank forms to what is actually filed is considerably higher than is indicated there We distribute through the banks, and many other public agencies, and some of the other state agencies, and wholesale to public accounting firms The first chart we showed is some indication of how the gap correlation between the population itself and the number of people who are accounted for on the returns is closing and part of that gap, of course, is accounted for by people who are not required to pay taxes because of the high exemptions And this, again, is another factor where we have different and higher exemptions in the State, why we are not talking about the same population

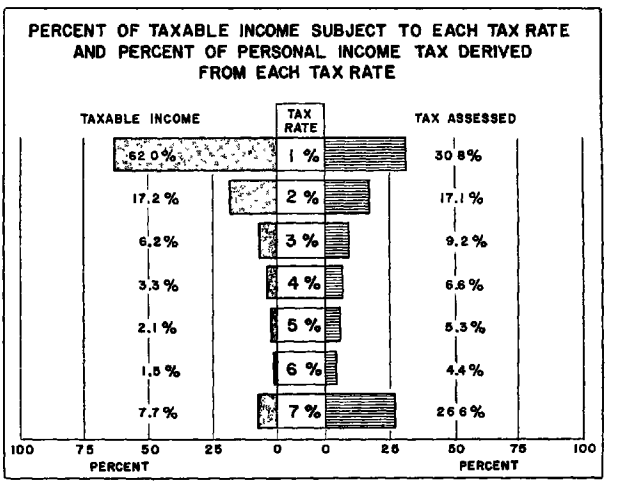
Assemblyman Young: Well, I couldn't in this brief time digest all of this material, but in other words you are stating that the argument has been made, that many people in California will file their federal income tax returns but will fail to file their state returns In other words, there is no correlation between these two figures and that particular problem.

Martin Huff: No.

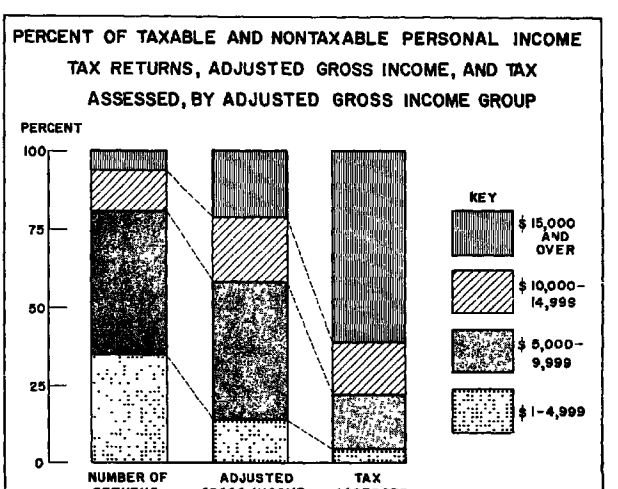
Assemblyman Young: I see

Martin Huff: Our program develops that there are many people who file state returns but do not file federal returns, too From our cooperation with the federal, we have a program that includes notification to the federal government The facts are a little more sophisticated than that because we actually mail their form out for them in their envelope

James Hamilton: Mr Chairman, I will continue with the Bank and Corporation Tax Law, which is divided into two sections

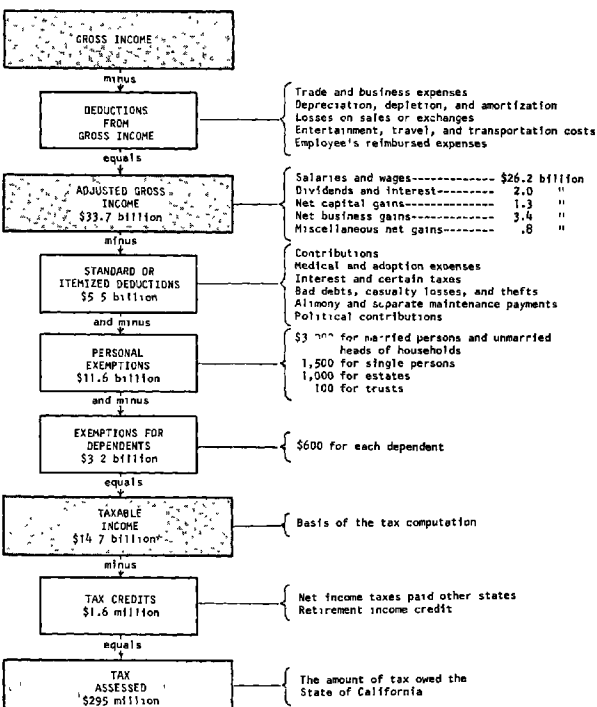


SOURCE: 1962 Annual Report of the Franchise Tax Board, p. 8.



SOURCE: 1962 Annual Report of the Franchise Tax Board, p.2.

CALIFORNIA PERSONAL INCOME TAX RETURNS 1961 INCOME YEAR



* Reported on taxable returns In the case of nontaxable returns, the sum of deductions ($.9 billion), personal exemptions ($2 8 billion), and exemptions for dependents ($1.1 billion) exceeds adjusted gross income ($3 5 billion) by $1.3 billion.

C. FRANCHISE TAX

a. History and Background

Prior to 1910, state revenues were derived mainly from a direct ad valorem property tax upon all taxable property within the State. The method was unsatisfactory and burdensome, and it came to be recognized as inequitable as well.

In 1905 a joint legislative committee was established to study the situation and suggest a remedy It submitted its report to the Legislature in 1906, which at first was rejected It was continued in existence and its program was accepted in 1910.

Its basic recommendation was a separation of tax sources This came into being in 1911 after the adoption in 1910 of Constitutional "Amendment Number One." Among other things under this amendment corporations were placed in a separate class and their franchises were taxed exclusively for state purposes

The franchise tax on banks and corporations was not measured by income Banks were taxed under what was known as the "share-tax" method and general corporations were taxed on a percentage of the "actual cash value" of their franchise

Under this method, the real estate of banks was taxed locally at the ordinary property tax rate, and the State taxed their shares of capital stock at a fluctuating rate The base, however, consisted of capital, surplus and undivided profits, minus the assessed value of real estate.

The real estate of general corporations was also taxed locally The franchise tax base consisted of the total market value of all outstanding securities, minus the assessed value of any visible or tangible property which belong to the corporation

This tax was criticized as an arbitrary tax which was impossible to anticipate and accrue There were also serious doubts as to whether or not the Bank Tax Act was constitutional As a result of these doubts, in 1927 a Tax Commission was created to investigate the systems of revenue and taxation in force, and to submit to the Governor its report and recommendations to him for submission to the Legislature at its 1929 session In 1928 the commission, in a special report, recommended the submission of a constitutional amendment so as to permit a tax to be imposed on banks and general corporations "measured by net income" A special session was called which approved the constitutional amendment, and the proposal was adopted on November 6, 1928. Following this approval the Legislature in 1929 carried out the recommendation of the commission and enacted the Bank and Corporation Franchise Tax Act That act was the predecessor of the current law

b. Franchise Tax

The franchise tax differs in many important respects from the income tax First, it is a privilege tax That is, the tax is imposed for the privilege of exercising corporate franchises within the State Second, it is a tax "measured" by income These differences are more than labels

A franchise tax is not necessarily "measured by or imposed on income" The tax may be measured by the amount of capital stock paid-up or outstanding capital stock, capital stock employed in the State, a percentage of the cash or market value of the shares of a corporation's capital, by capital and surplus or various other means Since the California tax is "measured" by income, all income may be included, even income which is otherwise exempt—such as interest received from U S obligations This is why banks and corporations are required to include in the measure of their tax income received from federal obligations owned by them

Franchise taxes also differ from income taxes in that they usually impose a minimum fee or tax In this State the minimum fee for most corporations is $100 In many other states the minimum fee is based on the value of assets owned by the corporation

Since the franchise tax is a privilege tax, it may be imposed only against corporations which have been granted the right to do business in this State, i e, incorporated or doing intrastate business in this State The franchise tax therefore, may not be imposed upon foreign corporations which are engaged exclusively in interstate commerce, regardless of the extent of their activities

c. Corporation Income Tax

The corporation income tax was enacted in 1937 to impose a tax on corporations deriving income from sources in this State The law applied principally to corporations engaged exclusively in interstate commerce

In 1933 the Massachusetts or Business Trust Act was enacted This act was repealed in 1939, when the Corporation Income Tax Act was extended to include such organizations It also applies to domestic holding companies, which are exempt from the franchise tax

The corporation income tax supplements the tax on banks and corporations just as the use tax supplements the sales tax

Since this tax is an income tax, corporations subject to it are not required to include in income interest from U S obligations, it is not a prepaid tax and no minimum tax is imposed

Corporations subject to this law have been reduced in number by the enactment of P L 86-272, effective September 14, 1959 This federal law provides that a net income tax may not be imposed on income derived from interstate commerce if the only business activity within the State is

1 The solicitation of orders for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and if approved are filled by shipment from a point outside the State; or

2 The solicitation of orders from a prospective customer, if orders by the customer are filled by shipment or delivery from a point outside the State.

The validity of this federal provision is now being litigated, with one decision upholding it and another ruling that it is unconstitutional

d. Taxpayers

The franchise tax applies to all corporations incorporated or doing intrastate business in this State Banks and financial corporations are also subject to the franchise tax; however, they are taxed at a different rate which will be outlined later.

e. Rates

The tax rate for general corporations is 5 5 percent. The rate for banks and financial corporations is determined under a formula, but may not exceed 9 5 percent.

f. Taxable Periods

The franchise tax is a prepaid tax. That is, corporations are required to pay a double tax for the first 12-month period for which they are doing business This provision may best be illustrated by this example·

Assume X corporation filed its articles of incorporation and commenced to do business on January 1, 1962, and that during the first year its net income is $10,000.

The corporation was required to prepay the minimum tax of $100 when it incorporated This amount is credited against its first year's tax. Therefore, when it files its first return on March 15, 1963, it is required to pay the following taxes·

Period	*Income*	*Tax*
Income year 1962	$10,000	$550
Taxable year 1962 (less prepay)	--	100
Adjusted tax	--	$450
Income year 1962	10,000	550
Taxable year 1962	--	--
Total	--	$1,000

Except for the first year, the period covered by the tax paid on March 15, is the year during which the tax is paid, or the year succeeding that for which the income was earned This period is referred to as the taxable year The amount of tax due is measured by the prior year's income, which is referred to as the income year Since the tax is paid in advance if the corporation in the example dissolves on June 30, it is not subject to tax on income realized during its last year, and furthermore will be entitled to a refund of one-half of the tax paid on March 15

Since the first year which a commencing corporation does business for a period of 12 months is the year that a double tax is imposed, the time as of which a corporation commences to "do business" is of considerable importance. This, of course, often results in litigation The prepay provisions create technical problems when a corporation which is on a prepaid tax basis acquires a commencing corporation in a reorganization These problems occur primarily because a dissolving corporation is entitled to a refund, while a commencing corporation is subject to the two-year liability provisions However, if the change is in form, then the transaction is considered a "reorganization" and is in effect disregarded The special reorganization provision which relates only to the computation of tax also complicates so-called tax-free corporate reorganization as the transaction must comply with the technical requirements relating to the computation of tax as well as those which specify the conditions under which gain or loss resulting from the reorganization is not recognized Thus, two separate "reorganization" provisions must be taken into account in such cases

g. Bank Tax

National banks may be taxed only as expressly permitted by Congress Section 5219 of the Revised Statutes of the United States (12 U.S.C. at 548) sets forth four methods by which banks may be taxed.

The State has adopted the fourth method, which is to tax them "according to or measured by net income." As a condition to taxing under this method, federal law requires that the rate not be higher than the rate assessed upon other financial corporations "nor higher than the highest of the rates assessed upon mercantile, manufacturing, and business corporations doing business" The purpose of the federal section is to prohibit discrimination in practical operation against national banks as a class.

Banks and financial corporations are required to pay as a franchise tax a percentage of net income, not to exceed 9 5 percent, made up of two parts. The first is a flat rate of 5 5 percent, paid by general corporations The other is an additional percentage determined on the basis of the ratio between the total personal property taxes required to be paid by nonfinancial corporations and their total net incomes; however, this additional percentage may not exceed 4 percent.

The purpose of the additional tax is to impose a tax on banks which subjects them to substantially the same burden imposed on other corporations. It has now been determined by the U S. Supreme Court after litigation involving about $180,000,000 that the burden on banks under the financial formula does not exceed the burden on general corporations.

The tax on the franchise of banks is in lieu of all other state, county, or municipal taxes or licenses except real property taxes While the personal property of banks is exempt from tax this is not true of other financial corporations

Since financial corporations, except national banks, are required to pay personal property taxes, in order to equalize their burden they are permitted to use the amount of personal property taxes paid as a credit against their additional tax. This is referred to as the financial offset

Another difference between the tax on banks and general corporations is that banks are not subject to the minimum tax. This is necessary since a minimum tax would not be "measured by income" and therefore is prohibited by federal law

h. Net Income

Net income commences with gross income Under the franchise tax law gross income includes interest received from federal, state, municipal or other bonds. There are a few items such as recoveries of amounts charged off as bad debts not resulting in a tax benefit which may be excluded from gross income. From gross income, all allowable deductions are subtracted The remainder, which is the balance included in the measure of tax, is referred to as net income.

i. Exempt Corporations

A number of corporations are exempt from tax Included are social, fraternal, civic, charitable, religious, educational, etc , organizations

Most of these organizations are subject to tax to the extent of any income derived from a source unrelated to their exempt purpose They are also subject to tax on rental income if they borrow money to acquire property They may also lose their exemption if they engage in certain

transactions with their creators or otherwise jeopardize their assets by failing to obtain adequate security.

j. Allocation

The major problem encountered with corporations engaged in business in a number of states is to determine the income properly allocable to this State The basic requirement is that such income shall be determined by a method of allocation fairly calculated to determine the net income derived from or attributable to sources within the State

When a corporation is engaged in business in more than one state, the first step is to separate the income into two classes The first class consists of business income This is usually referred to as unitary income, and is the income subject to allocation The remainder is referred to as intangible income and is apportioned by situs This means that if the corporation is a local corporation all of its intangible income is subject to tax, but if it is a foreign corporation none of its intangible income is subject to tax

If the income is subject to allocation any one of a number of methods may be used Numerous articles and textbooks have been written covering this subject The most common method, however, is to apply what is known as the "Massachusetts formula" This formula consists of three factors which are

a. Average value of real and tangible personal property owned (property)

b Wages, salaries, commissions, and other compensation of employees (wages).

c Gross sales, less returns and allowances (sales)

As to each factor, the total within and without the State and the total amount within the State are computed From these figures, the percentage of each factor within this State is determined The three percentages are then totaled and the average is computed This average percentage is then applied to the unitary income Under this or other formulas income is often allocated to this State, although separate accounting records may establish that the California operations resulted in a loss

Also related to the allocation problem is the treatment of interest and dividends

Interest income of foreign corporations is not subject to tax. This makes it possible for such corporations to borrow substantial sums and by deducting the interest expense from business income reduce or eliminate such income In order to prevent this possibility, corporations are required to charge their interest expense first against their nonbusiness or intangible income The excess, if any, may then be deducted from business income

Under federal law corporations which receive intercorporate dividends are permitted to deduct 85 percent of the dividends Under State law dividends may be deducted to the extent they are paid out of income which has been subject to state tax in the hands of the paying corporation Because of this and the limited jurisdiction of the State there is often considerable difference in the treatment of intercorporate dividends.

k. Deductions

Far fewer deductions are provided for corporations than for individuals This is because the allowance for trade or business expenses enables corporations to deduct most of their expenses

All deductions claimed by corporations must be itemized, as a standard deduction is not authorized

l. Accounting Periods and Methods

The same accounting periods and methods are permitted as are provided for under the Personal Income Tax Law However, more corporations use fiscal year accounting periods and the accrual method of accounting than individuals

m. Returns and Estimated Tax

All corporations are required to file a return and pay at least the minimum tax Returns are due from calendar year taxpayers on March 15 Returns made on the basis of a fiscal year are due within 2 months and 15 days after the close of the income year

Exempt organizations which have business income subject to tax are required to file returns within 2 months and 15 days after the close of their income year Many are also required to file information returns within 4 months and 15 days after the close of their income year if their gross income exceeds $25,000 Farmers' cooperatives are required to file returns within 8 months and 15 days after the close of their income year. These dates are the same as corresponding returns are due under federal law.

Prior to 1964 the tax could be paid in two installments Beginning in 1964, general corporations are required to pay the tax due at the time their return is filed Banks and financial corporations are required to pay as their first installment the basic tax of 5 5 percent, plus one-half of the prior year's financial rate or 2 percent The balance is due after the bank rate is determined in December.

Starting in 1965 general corporations will pay the entire tax due when the return is filed Banks and financial corporations will make a tentative payment measured by the prior year's income, based on the prior year's financial rate This payment will be adjusted after the financial rate is determined in December On June 15, calendar year taxpayers will be required to pay an estimated tax amounting to 20 percent of the tax due or $100, whichever is more. The estimate may be based on the prior year's tax On June 15, 1966, 35 percent of the estimated tax must be paid, and thereafter on each June 15, 50 percent of the estimated tax is payable

n. Penalties

1. Civil. The civil penalties are the same as provided by the Personal Income Tax Law.

2 Penal. The principal difference between the penalties under this law and the Personal Income Tax Law is that any person who attempts to exercise the powers of a bank or corporation which has been suspended may be punished by a fine of not less than $250 and not more than $1,000, or by imprisonment up to one year, or both.

o. Appeals

The manner and method which assessments are made and appeals are taken therefrom is substantialy the same as under the Personal Income Tax Law.

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VI. INHERITANCE AND GIFT TAXES

Charles Barry: Mr. Chairman, gentlemen of the committee, after a few brief words on the background of the death tax, I will attempt to follow an outline, a copy of which I have placed at the chair of each member of the committee, which outline has been brought up to date and includes the 1963 amendments to the Revenue and Taxation Code.

The inheritance tax has come down to us from antiquity. As far back as seven hundred years before the Christian era it was well established in Egypt. It followed through Rome, and down through the centuries through Europe and then into the United States It was in 1820 that Pennsylvania adopted an inheritance tax. It was the first state in our Union to do so. Other states followed suit, but it was not until about 1903 that a well planned workable inheritance tax law was enacted in the State of Wisconsin This law provided for initial exemptions to widows and children, and regressive rates of tax. By 1952 all of the states in the United States had adopted some form of this tax. With the exception of Nevada, which prior to 1925 had had an inheritance tax, all of the states in the United States adopted some form of death taxes In some states, it was purely a pickup tax taking advantage of the credit allowed under the federal law Section 2011G of the Internal Revenue Code. In some states it was an inheritance tax In other states it was purely an estate tax, and in most of the states it was an inheritance and estate tax such as California has In 1905 California copied, to a large extent, the 1903 Wisconsin law This 1905 California law served as the model for the pattern for all of the inheritance tax laws in this state from that date to the present, although it was codified in

1943, effective July 1 of 1945. Death taxes as you can see are supportable historically and traditionally. They can be justified, I suppose, as a social device for the redistribution of the wealth, but primarily it is a simple source of revenue collectible from those best able to pay, with a minimum of inconvenience——

Chairman Petris: And from that person least able to fight.

Charles Barry: No, we collect our tax from the transferee, and the transferee is strong and healthy, and ready and willing to battle. This brings us to another point, though, that death taxes are of two types. One is a tax on the privilege of transmitting a debt, and the other a tax on the privilege of receiving property on the death of another The latter is the California form and is the inheritance or succession tax, the former is the estate tax where the number and relationship of the beneficiary is wholly immaterial In the estate tax, aside from a spouse or a charity, it makes no difference who or how many beneficiaries there are in an estate, the tax is identical For example, if a man were to die with ten children, the estate tax would be exactly the same as though he left his whole estate to one stranger in blood, a friend of his Where it is under the inheritance tax, it is divided by the number of beneficiaries; each beneficiary receives his assigned exemption and the rates are calculated as the primary rates.

Assemblyman Carrell: Now, these beneficiaries pay a tax themselves, is that it?

Charles Barry: The tax is collectible from the beneficiary.

Assemblyman Carrell: Is this on top of the estate tax?

Charles Barry: Yes, sir, it is, depending upon the size of the estate. The initial exemption for the Federal Estate Tax Law is $60,000 If the estate nets less than $60,000, there is no federal estate tax, but there could be an inheritance tax because the exemptions under the inheritance tax law for each individual are lower than the $60 thousand. For an example, a minor child gets a $12 thousand exemption, an adult child or spouse or a grandchild a $5 thousand exemption If the estate goes to brothers and sisters each one gets a $2 thousand exemption The further away they get the less the exemption and the higher the tax. But with an estate tax, there is one exemption and the rates are applied to the net estate after that exemption.

Assemblyman Carrell: If you give it to one person, then he would just have a——

Charles Barry: In California, a single exemption, yes, sir

Assemblyman Carrell: He would just have a single exemption? How large would that exemption be?

Charles Barry: Depending upon his relationship If he were a class A beneficiary, it would probably be $5 thousand, a class B would be $2 thousand.

Assemblyman Carrell: If he's no relation?

Charles Barry: No relation, fifty dollars, sir

Assemblyman Carrell: Fifty dollars! How high is that percentage? What is the rate?

Charles Barry: The rate starts at 10 percent I left you a card there, sir, and it's at the bottom line of the card It shows a fifty-dollar exemption. Ten percent is the rate from zero to $25 thousand.

Assemblyman Carrell: To 24 percent, is that tops?

FORM IT-72

CALIFORNIA INHERITANCE TAX—RATES AND EXEMPTIONS

EFFECTIVE AS TO DECEDENTS DYING AFTER 12 01 A M. SEPTEMBER 15, 1961

CLASSIFICATION		EXEMPTION	Rate of Tax on amount left after deducting exemption from $25,000 00	$25,000 to $50,000	$50,000 to $100,000	$100,000 to $200,000	$200,000 to $300,000	$300,000 to $500,000	Over $500,000
HUSBAND or WIFE	Community Property	All Exempt *	2%	3%	4%	7%	9%	9%	10%
	Decedent's Separate Property	One-half of Separate Property Plus $5,000 00							
Minor Child—Including Adopted		12,000.00	2%	3%	4%	7%	9%	9%	10%
Adult Child, Grandchild (Adopted or Acknowledged) Parent—Grandparent		5,000.00	2%	3%	4%	7%	9%	9%	10%
Brother—Sister Nephew—Niece Son-In-Law Daughter-In-Law		2,000.00	6%	10%	13%	15%	15%	17%	18%
Uncle—Aunt Cousin		500.00	7%	12%	15%	15%	15%	18%	18%
Strangers In Blood—Including Brothers- and Sisters-in-Law Fathers- and Mothers-In-Law		50.00	10%	15%	18%	18%	18%	22%	24%

It is unlawful: (1) For anyone to enter a safe deposit box after the death of any person who had a right of access to that box, during lifetime, without first having it examined by a representative of the County Treasurer's Office

(2) For anyone to use a joint bank account or to transfer any personal property held in joint tenancy where one of the joint tenants is deceased without first obtaining a release from the County Treasurer's Office

* If a decedent husband gives his wife a Life Estate or Power of Appointment in his half of the community property, said half is subject to tax at the rates indicated with a $5,000 exemption allowed.

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ALAN CRANSTON, State Controller

Charles Barry: Tops is 24 percent, yes, sir. But there is an interesting feature in comparing an estate tax with an inheritance tax. If a man were left a $10 thousand bequest, he would be paying no estate tax. Since the estate itself, the whole estate is less than $60 thousand, there would be no estate tax, and there would be no portion of a tax, because there is no tax prorated to this $10 thousand beneficiary. But if the decedent were worth a million dollars, that $10 thousand bequest is dischargeable with a federal estate tax of $3,257

Assemblyman Carrell: Now what happens to this federal tax? Is this a plus tax over the federal——

Charles Barry: Yes, sir, it is now Prior to 1959, it was not Prior to 1959, under the California law, from about 1921 to 1959, we allowed a deduction—the State of California allowed a deduction—against the federal estate taxes or against the estate for federal estate taxes paid; but that was repealed in 1959, and now there is no federal estate tax deduction allowable under the California law

Assemblyman Carrell: This is a tax on a tax, really, then, isn't it?

Charles Barry: That's true, but it has been upheld by the courts of this State, *Estate of Fabris* in 1962.

Assemblyman Carrell: I don't doubt that

Charles Barry: Actually, in the beginning, there was no allowance for the federal estate tax, and until 1921, believe it or not, there was no provision in the Inheritance Tax Law at all for any deduction, even for funeral expenses They were allowed on the basis that it was a succession tax, and beneficial succession was the measure of the tax, but there was no provision in the law, and it wasn't until 1921 that any provision was put in the law to legally permit deductions to be allowed Now, let me pick up our California law. We break it down first on whose estates are taxable Then what transfers are taxable, because this is a transfer tax, not a tax on the property itself It's an excise tax—a tax on the moving of property from one person to another So we have whose estates are taxable, what property is taxable, what transfers are taxable Then what deductions are allowed. Next, what exclusions are allowed under the law; for example, community property exclusions And then the computation of the tax And, of course, we have the other features of it The payment of the tax to the county treasurer, the discounts and the refund provision. Jurisdiction to tax depends upon residence, i e, domicile of the decedent in California or the presence of real property or tangible personal property in this State We will tax all real property in the State of California It is subject to tax under the law, irrespective of the domicile of the owner It is within the borders of the State The law also taxes all tangible personal property within the borders of this State, irrespective of domicile With respect to intangible personal property—bank accounts, securities, promissory notes—these depend upon the residence or domicile of the deceased If the decedent were domiciled in another state, California would not attempt to tax a bank account that he had on deposit in a California bank, or attempt to tax stock in a California corporation belonging to a domiciliary of some other state. Other states accord a like exemption to California residents with respect to intangible personal property. Residence, incidentally, is not defined in the statute, but it is equated with domicile. I had occasion to examine the laws of

Oregon and Washington fairly recently, and they don't use the word resident or domicile They use the word inhabitant. The law is nicely vague in this area, but the courts have tied it down to domicile. We have tangible personal property, real property in California subject to tax irrespective of the domicile of the owner. Intangible personal property ties in with the domicile of the owner. In a state like California, we have quite a number of disputed domicile cases These cases could result in a double taxation; that is, taxation by two different states. We have provisions in our law to preclude this by virtue of a right to compromise a disputed domicile case, and also specific provisions of arbitration. We have never utilized the arbitration provision, but they are there, nevertheless If a decedent is a nonresident of the United States, the law says California will tax any intangible personal property in the State of California We will also tax stock in a California corporation, which the 1963 session defined precisely for us, and any other tangible personal property The law exempts bank deposits and deposits in the savings and loan associations belonging to a deceased nonresident of the United States, so long as the accounts are not used in connection with a business conducted in whole or in part in California. Then, getting into the transfers taxable, any transfer by will or the laws of succession is subject to the inheritance tax law Probate homesteads are taxable; family allowances are taxable, as are civil code homesteads, the declared homesteads If this were all, many transfers would escape tax. For example, inter vivos transfers, a deed of gift, and blanket gift from a parent to a child; this would be subject to tax so long as the transfer were made without valuable and adequate consideration equal in money or money's worth, and the courts say partial consideration in such instances is not consideration The law taxes any transfer made in contemplation of death California is one of the relatively few states that defines the term, and contemplation of death means in California with a testamentary intent or a testamentary flavor It doesn't mean a death-bed transfer as it does in some jurisdictions A transfer that would be a substitute for testamentary disposition. A transfer to take effect in possession or enjoinment, a transfer with a reserve life estate A parent deeds his home to the child, reserving to the grantor a life estate This type of a transfer is taxable under the California Inheritance Tax Law I would say, 75 percent to 80 percent of all homes in California are held in joint tenancy, and the law taxes determination of a joint tenancy by the death of one of the joint tenants on what is called a contribution theory. Code Section 13671 states that on a death of one of two joint tenants, the whole of the joint tenancy property is taxable, except that which the survivor may prove originally belonged to him, and never came from the deceased This is satisfactory in many ways but with respect to a husband and wife, difficulties arose so the Legislature in 1955 amended the law to provide that a joint tenancy held by a husband and wife which had its source in community earnings would be treated for inheritance tax purposes as community property In other words, if the home was brought with community earnings, on the death of either husband or wife, it would be treated as community property, and as you know, since 1961, all community property passing outright to the survivor

is free of inheritance tax. There are such things as three-way joint tenancies, but we don't need to go into that There was created by the Legislature in 1961 a new type of property in California called quasi community property This is property which was acquired in some state other than California which would have been community property had it been acquired in California With respect to that, it is held in joint tenancy, the statute provides that it shall be considered as though each was a contributor of one-half, as though it were a true joint tenancy, rather than a community property joint tenancy Powers of appointment is a rather dark area here. The Legislature from time to time has changed its viewpoint At one time it taxed a creation of a power of appointment to the donee of the power Subsequently, the law was changed to tax the exercise of the power by the donee. Now presently, and since 1935, we are taxing the creation of the power of appointment, but unfortunately we do not tax the exercise of the power of appointment on the death of the donee In other words, A gives to B an estate for life with a power to say how that property shall go on B, the donees' death B, the donee, exercises the power at his death, and gives it to X We do not tax that last transfer. We tax the first one but not the last, although the donee of the power has what the cases and the taxwriters say can amount to absolute ownership. He has the enjoyment of the property during his life and the right to say who shall have it after his death This, perhaps, is an area that should be explored in the future.

Assemblyman Stanton: What do you think the revenue difference might be if this——

Charles Barry: I don't have figures on that at the present time. Powers of appointment are not as popular as joint tenancies or not as popular as ordinary life estates, but they have become more important since 1954 when the Internal Revenue Code was amended. Because with the marital deduction in the Federal Estate Tax Law, if it is separate property, let's assume the husband dies first, he creates Trust A and Trust B, the so-called marital deduction trust, and he has to give the surviving spouse the power of appointment in Trust B in order to gain the advantage of the marital deduction under the federal law to exclude half of the property passing through tax, that is the property that would be in Trust B. And the use of the power of appointment has grown considerably in the last eight or nine years In large estates, because the people who have a great deal of property are able to avail themselves of the services of estate planners who will arrange their affairs so as to minimize the tax There is nothing evil in this. It is perfectly all right, but there are some loopholes that come up. In the Federal Estate Tax Law, it is provided not alone that the exercise of the power of appointment be taxed on the death of the donee, but possession of the power. If the donee had the power at the time he died, whether he exercised it or not, the transfer is subject to tax. I don't know what the revenue consquences would be We will be able, before you meet again, I think, to furnish these figures, because in the last year and one-half, we have had a statistician added to our staff. We were able to give the chairman some figures earlier this year in other areas.

Assemblyman Stanton: Do you think it might be fair to say, then, that perhaps the equity nature of the loophole is greater than say the revenue factor?

Charles Barry: Yes, sir I can point out another place with community property exclusion where perhaps we can do a favor to the taxpayers We can get this power of appointment back.

Well, to conclude then, the next type of property transfer which is subject to tax is insurance This means that it has to be genuine insurance It cannot be a single premium policy that is brought by, let's say, an elderly person in conjunction with an annuity contract. This risk-sharing feature must be present The federal law a couple of years ago eliminated the payment of premiums test We look to incidence of ownership. If the decedent has the incidence of ownership, we considered the transfer taxable. We have not in our law eliminated the payments-of-premiums test. But if the premiums were paid with community earnings and the spouse is the beneficiary of the policy of insurance, the community exclusion applies to it, and, of course, as it stands now it is not taxable There is in our law a $50 thousand insurance exemption There was up until 1942, which is 21 years ago, a $40 thousand insurance exemption in the federal law At that time, it was repealed. California did not repeal its $50 thousand insurance exemption

Assemblyman Carrell: What if their premiums are paid by some other outside source?

Charles Barry: Well, really this payment of premiums test, as I understand it, Mr Carrell, relates to the continuance of paying the premiums by the insured. The insured transfers the policy to the beneficiary, let's say, and then each continues to pay the premiums on it. Formally, if he continued to pay the premiums under the federal law, it was considered that he was still the transferrer of the insurance, and it was still subject to tax But if the policy is transferred, or, if, for example, the wife takes out the policy of insurance on her husband's life, and she pays all premiums, he is not the owner of the policy, and it is not something that is passing from him to her This was her own investment.

Assemblyman Carrell: How about a partner in business?

Charles Barry: Well, let's put it this way. If it is a partnership, a beneficiary could well be an owner of the policy, but if it were a corporation and the corporation took out the policy of insurance on the life of its president or its general manager and the corporation paid all the premiums and the proceeds were payable to the corporation as beneficiary, then it would not be subject to tax.

Assemblyman Carrell: What if it were payable to the wife of the corporation president?

Charles Barry: If the decedent were not the owner of it, then it would not be subject to tax.

Assemblyman Carrell: In other words, the corporation pays it and the wife, or the estate, is the beneficiary?

Charles Barry: Well, we have to be careful here because if it goes into the estate proper, the decedent's estate, and is subject to the terms of his will and subject to the claims of creditors, it does not qualify for the exemption, and it would be taxable. But if it goes directly to the beneficiary—if he were not the owner of the policy—it would not

be subject to tax. If he were the owner of the policy, then the $50 thousand exemption would apply.

Assemblyman Carrell: Of course, in some partnerships, one partner takes out insurance to pay off his equities in the business.

Charles Barry: Well, if it goes into the partnership as of the moment of death, his interest has been enriched by the amount of the proceeds of the policy.

Assemblyman Carrell: He would pay tax on it?

Charles Barry: Yes, sir.

Mr Chairman, I will conclude my testimony at this time and submit an outline of California Inheritance and Gift Tax Law for the record This was reproduced with the permission of University of California Extension, Continuing Education of the Bar.

CALIFORNIA INHERITANCE TAX

I Historical Background
- A The Inheritance Tax Act of 1893
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CALIFORNIA INHERITANCE TAX

I. Historical Background

California's first inheritance tax law (Stats 1853, Ch 107, p 233) was never really effective, for it was repealed the following year (Stats 1854, Ch 74, p 103)

A *The Inheritance Tax Act of 1893*
(Stats 1893, Ch 168, effective March 23, 1893)

1 The act taxed transfers by will or interstate laws of California and inter vivos transfers made in contemplation of death or intended to take effect in possession or enjoyment at or after death Transfers to father, mother, husband, wife, lawful issue, brother, sister, wife or widow of a son, husband of a daughter, adopted children, and charities were exempted The tax was payable to the treasurer of the county wherein the probate proceedings were pending

2 Amendments
(Stats 1895, Ch 28, effective March 9, 1895, Stats 1897, Ch 83, effective March 9, 1897, Stats 1899, Ch 85, effective March 14, 1899, Stats 1903, Ch 228 effective March 30, 1903 The act was repealed by Stats 1905, Ch 314, Sec 27, effective July 1, 1905)

B *The Act of 1905*
(Stats 1905, Ch 314, effective July 1, 1905) This was the predecessor of all state inheritance tax acts up to and including the Inheritance Tax Act of 1937 It was founded on the Wisconsin Act of 1903 Differences from the 1893 act included

(1) Broadening of the base to include all transferees, direct descendants as well as collaterals,
(2) Varying of exemptions and rates according to degree of blood relationship,
(3) Progressive rates

C *The Act of 1911*
(Stats 1911, Ch 395, effective July 1, 1911) This act was a complete rewriting of the 1905 Act, and all parts of the latter in conflict with the 1911 Act were repealed Important changes consisted of

(1) Limitation of lien for tax to five years as to a bona fide purchaser,
(2) Addition of penalty for unauthorized transfer, and
(3) Provision for appointment of appraisers

Contemporaneous amendment of the then Section 1440 of the Code of Civil Procedure (now Prob C Sec 605)

D *The Act of 1913*
(Stats 1913, Ch 595, effective August 15, 1913) The 1913 act was primarily a reenactment of the act of 1911, substantially increasing the rates in the upper tax brackets, but not changing the 1911 exemptions. It taxed the *creation of powers of appointment, rather than their exercise*, and provided that an inheritance tax appraiser must be appointed in every probate proceeding

The 1915 amendments (Stats 1915, Chs 189 and 198, effective August 8, 1915), provided for

(1) Taxation of joint tenancies (Sec 1(g)),
(2) Compensation of appraisers out of inheritance tax receipts,
(3) A change in classes of beneficiaries from five to four

E *The Act of 1917*
(Stats 1917, Ch 589, effective July 27, 1917) This was a reenactment with certain changes of the 1913 act It granted the surviving wife exclusion equal to one-half the community property

F *The Act of 1921*
(Stats 1921, Ch 821 effective August 2, 1921)

1 While primarily a reenactment of the act of 1917, the 1921 act
(a) Granted a deduction for federal estate tax paid, upon prescribed formula,
(b) Provided for shifting a tax lien from property sold on probate sale to proceeds of such sale,
(c) Reduced rates of the tax,
(d) Introduced the "previously taxed property" (five-year) exemption, *applicable to class A transferees*,
(e) Provided that the tenant of a safe deposit box must agree to notify depositary of the death of any other person having access to said box
2 The 1923 amendment (Stats 1923, Ch 337, effective August 17, 1923) reduced community exclusion
3 One of the 1925 amendments (Stats 1925, Ch 238, effective July 23, 1925) provided for deposit of taxes collected in the general fund
4 The other 1925 amendment (Stats 1925, Ch 284, effective July 23, 1925)
(a) Provided for treatment of the community property exclusion where the husband's will forces the wife to an election,
(b) Introduced the Prob C Sec 201.5 concept as to personal property into inheritance tax law,
(c) Taxed family allowance
5 The 1927 amendment (Stats 1927, Ch 646, effective July 29, 1927) established the intangibles exemption based on reciprocity, and introduced the additional (pickup) tax
6 The 1929 amendment (Stats 1929, Ch 844, effective August 14, 1929)
(a) Provided that transfers to take effect in possession or enjoyment at or after death would be valued as of the date of death
(b) Provided that failure by a donee to exercise power of appointment would not be a taxable transfer,
(c) Added the insurance exclusion,
(d) Changed certain exemptions and rates,
(e) Added reciprocal exemption as to foreign charities,
(f) Exempted proceeds from war risk insurance payable to the estate,
(g) Extended intangibles reciprocity to foreign states and countries,
(h) Authorized compromise of contingent interests,
(i) Revised the "previously taxed property" exemption
7 The 1933 amendment (Stats 1933, Ch 1048, effective October 25, 1933) changed the specific exemption of the wife

G *The Act of 1935*
(Stats 1935, Ch 358, effective June 25, 1935) This act was primarily a reenactment of the 1921 act as amended The 1935 act was amended three times in 1937, twice in 1941, and in 1943

H *Inheritance Tax Law Codified*
Inheritance tax law was codified in 1943 (Stats 1943, Ch 678, operative July 1, 1945) and incorporated into the Revenue and Taxation Code

II. Persons and Property Subject to the Tax

A *Where Decedent Owner Is a Resident of the State*
("Residence" is not defined in the statute *Estate of Bloom* (1931) 213 C 575, 2 P 2d 753)

1 Real property situated in California is subject to the tax Under the doctrine of equitable conversion, real property located elsewhere, subject to a contract of sale might be subject to the tax depending upon the law of the state in which the real property is located
2 Tangible personal property located in California is subject to the tax
3 Also subject to the tax is intangible personal property in California irrespective of location of evidence of ownership *Estate of Dillingham* (1925) 196 C 525

B *Where Decedent Is a Nonresident of California, but a Resident of the United States*
The tax is levied on real and tangible personal property located in California Intangible personal property is exempt under Rev & Tax C Sec 13851,* based upon reciprocity

C *Disputed Domicile Cases*
In cases of disputed domicile the Controller may compromise (Secs 14195 and 14195 4) or arbitrate (Secs 14197 and 14197 13) the question of domicile An alternative method of arbitration is provided by Secs 14190 to 14190 13 (added 1957)

D *Where Decedent Is a Nonresident of the United States*
The tax is levied on real and tangible and intangible personal property located in California (Sec 13303(b)) Included under the category "intangible personal property" is
(1) Stock in a California corporation,
(2) Stock in a federal corporation or a national bank which has its principal place of business in California,
(3) All other intangible personal property in California (Sec 13602) Bank deposits and deposits in a savings and loan association are not subject to the tax unless used in connection with a business operated in whole or in part in California (Sec 13304(b), 1956 and 1963 as amended)

III. Transfers Taxable

A *In General*
All transfers by will or the laws of succession are taxable (Secs 13601 and 13602) Also taxable are transfers of a statutory and probate homestead (Secs 13621 and 13622) and transfers of a family allowance (Sec 13623)

B *Inter Vivos Transfers*
An inter vivos transfer without valuable and adequate consideration (Sec 13641 and Stats 1959, Ch 485), *cf Estate of Stevens* (1958) 163 C A 2d 255, 329 P 2d 337, *Estate of Hyde* (1949) 92 C A 2d 6, 206 P 2d 420) is taxable if made
(1) In contemplation of death (Sec 13642), Bailey, *Taxation of Transfers in Contemplation of Death*, (1959) 10 Hastings Law Journal 370,
(2) As a substitute for a testamentary disposition (Sec 13648) *Estate of Newman* (1942) 52 C A 2d 126, 125 P 2d 908, *Estate of Adams* (1952) 39 C 2d 309, 246 P 2d 625, or
(3) To take effect in possession or enjoyment at or after death (Sec 13643), *Estate of Madison* (1945) 26 C 2d 452, 159 P 2d 630, *Estate of Hyde* (1949) 92 C A 2d 6, 206 P 2d 420

* Unless otherwise noted, all further code references are to the California Revenue and Taxation Code

Such a transfer is taxable even though the transferor retains a life income or interest (Sec 13644. *Estate of Thurston* (1950) 36 C 2d 207, 223 P 2d 12), or extracts a promise from the transferee to make payments to or care for the transferor (Sec 13645) Such a transfer by way of revocable trust (Sec 13646) Totten trust (*Estate of Goldfader* (1955) 131 C A 2d 533, 280 P 2d 799, or advancement (Sec 13647 and Prob C Sec 1050) is also taxable

C *Joint Tenancies*

1 A joint tenancy is wholly taxable to the survivor, except for that part which the survivor may prove originally belonged to him or was not received from the decedent for less than adequate and full consideration (Sec 13671), *United States* v *Jacobs* (1939) 306 U S 363, *Harvey* v *United States* (7th Cir 1950) 185 F 2d 463 See also, *Estate of Darby* (1949) 93 C A 2d 96, 208 P 2d 689

2 A husband and wife joint tenancy having its source in community earnings is treated on the death of either as community property (Sec 13671 5) For further treatment see this outline VI A

3 In the case of a three-way joint tenancy (husband, wife and third person) created with community earnings, a post 1927 community, husband or wife deceased, one half of the property is charged to each survivor The result is that the surviving husband or wife is considered as contributor to the extent of three-fourths so that on the death of the surviving husband or wife, the third person is considered to be contributor to the extent of one-fourth

4 Section 13672, added 1961, provides that if the joint tenancy had its source in quasi-community property, upon the death of either spouse, the property shall be treated as if each spouse was the contributor of one-half Quasi-community property is defined by new Sec 15300 See Gift Tax VI

D *Powers of Appointment*

(Secs 13691 to 13698) If created prior to June 25, 1935, the tax is levied upon the exercise of the power by the donee (Sec 13693) *Estate of Newton* (1950) 35 C 2d 830, 221 P 2d 952, *Estate of Baird* (1954) 126 C A 2d 219, 269 P 2d 1052, (1955) 135 C A 2d 343, 287 P 2d 372 If created on or after June 25, 1935 the tax is levied upon the creation of the power A charitable exemption is applicable in any of the following situations

(1) Where the power is limited to a charitable beneficiary (Sec 13694);
(2) Where the power is exercised in favor of a charitable beneficiary either before or after the tax is fixed, (order fixing tax subject to modification (Sec 13696)),
(3) Where a charity takes upon the nonexercise of power, (order fixing tax subject to modification)

E *Insurance*

(Secs 13721 to 13724)

1 To qualify proceeds of contract as insurance, the elements of risk sharing and risk shifting must be present *Helvering* v *LeGierse* (1941) 312 U S 531 "Incidents of ownership" is the test employed although the statute does not use the term However, payment of premiums test has not been eliminated If the premiums are paid with community earnings and husband or wife is beneficiary, the community exclusions apply *Estate of Marson* (1930) 30 C A 2d 566, 86 P 2d 922, *Estate of Compton* (1962) 198 C A 2d 766

2 Proceeds of the insurance policy or policies up to $50,000 are excluded from the tax if payable to a named beneficiary (Sec 13724(a)) If there is more than one beneficiary, the $50,000 exclusion is prorated among the beneficiaries (Sec 13724(b)) *Estate of Marson*, supra If premiums are paid with community earnings and spouse and another person are beneficiaries, that payable to spouse is excluded from tax, and the $50,000 exemption is applied to the balance of proceeds

Estate of Compton, supra Annuity contracts and supplemental contracts are not insurance, consequently the $50,000 exclusion is not applicable *Estate of Barr* (1951) 104 C A 2d 506, 231 P 2d 870, *Estate of Loewenstein* (1951) 37 C 2d 843, 236 P 2d 566

3 With respect to death benefits payable under retirement or pension plans of public (governmental) or private business systems some uncertainty as to taxability has existed *Estate of Simpson* (1954) 43 C 2d 594, 275 P 2d 467, involved a county employee, and *Estate of Richartz* (1955) 45 C 2d 292, 288 P 2d 857, involved a school teacher The Government Code exempts retirement fund contributions of public employees from taxation The Supreme Court of California held in these cases that this exemption referred to property taxes, whereas the inheritance tax is a privilege tax and decided (1) the return of employee contributions plus interest and (2) payment of the lump sum death benefit, were taxable transfers The 1955 session of the Legislature immediately added Sections 31452 and 21200 5 to the Government Code and Section 14278 to the Education Code, specifically exempting such payments from inheritance tax The 1956 session of the Legislature added Section 13880 to the Revenue and Taxation Code exempting death benefits and payments under any public retirement system from inheritance tax

The law is now clear as to payments under a California public retirement system, but the taxability of similar payments under a private governmental plan is still an unanswered question It is the Department's position that the reasoning of the *Richartz* and *Simpson* cases is sound and applicable and might well render pension payments under a private system, taxable In *Estate of Wyman* (1962) 208 C A 2d 489 it was held that death benefits payable to a beneficiary under U S civil service retirement plan were exempt under the provisions of Sec 13880

IV. Valuation (Sec 13951)

A *In General*

(Sec 13951) The market value is the price that a willing buyer would pay to a willing seller of property, neither being under any compulsion to buy or sell (Admin C, Title 18, Reg 13951(a)*) Valuation is made by an inheritance tax appraiser (Secs 14771 to 14774) appointed by the court (Prob C Secs 605, 1174, Rev & Tax C Sec 14051 and following) Valuation date is the date of the transferor's death, regardless of whether the transfer was made during life or at death (Sec 13951) *Esley* v *Zellerbach* (1942) 53 C A 2d 196, 127 P 2d 597. The federal optional or alternative valuation date is not recognized or permitted

B *Real Property*

For valuation of real property, recognized appraisal methods are used taking into consideration all relevant facts and circumstances acceptable (Reg 13951(b)) *Estate of Ross* (1915) 171 C 64, 151 P 1138 The assessed value for ad valorem taxation is not acceptable (Reg 13951(c))

C. *Securities*

1 *Listed*

The valuation of this type of securities in the mesne between high and low quotations on the principal market (Reg 13951(e)(1)) If there are no sales on date of death, the mesne is determined from quotations on the nearest date before and after death (Reg 13951 (e)(z))

2 *Unlisted, but traded over the counter*
(Same as above)

3 *Closely Owned Securities*

The appraiser must be furnished with a balance sheet as of, or near the date of, death, as well as profit and loss statements for the five years preceding the date of death If average net profits exceed a

* Unless otherwise noted all further regulation references are to Title 18 of the Administrative Code

"fair return" or net worth, there may be "good will" or "intangible value" present which is added to "net worth." The balance sheet is adjusted to reflect the true market value of underlying assets. There are three methods of arriving at a per share valuation:

(1) (Untraded securities) divide net worth by number of shares outstanding, *Estate of Felton* (1917) 176 C 663, 169 P 392,

(2) (Untraded securities) in addition to the *Felton* rule, other influencing factors must be considered, *Estate of Rowell* (1955) 132 C A 2d 421, 282 P 2d 163,

(3) (Traded securities) Sales at or near the date in question persuasive, *Estate of Goodhue* (1932) 127 C A 283, 15 P. 2d 771

4 Blockage is not recognized under Reg 13951(f), *but see* this Outline V C 5. d (7)

D *Future Interests—Life Estates and Remainders*

To determine the value of a remainder the corpus is first multiplied by 4 percent (Sec 13953) to determine the annual income, the annual income is multiplied by the factor assigned in Table A(1), Admin C, Title 18, Reg 13952-13954(1), for the age at the nearest birthday for the life tenant or annuitant. The result is the value of the life estate or annuity. For value of the remainder subtract the life estate or annuity value from the corpus. If the life tenant or annuitant should die before the tax is fixed, the value of his life estate or annuity is the sum actually paid him, and the remainder interest is correspondingly increased (Sec 13955) *Estate of Knapp* (1951) 37 C 2d 827, 236 P 2d 372. When the valuation of the future interest has been determined in accordance with the statute and rule, no further reduction may be made for a contingency which might abridge, defeat or diminish such interest (Sec 13956)

V. Deductions

A *In General*

1 Deductions are a matter of legislative grace and not a matter of right *Estate of Watkinson* (1923) 191 C 591, 217 P 1073, *aff'd sub nom Stebbins v Riley* (1925) 268 U S 137

2 The first specific provisions relating to deductions were included in the 1921 Inheritance Tax Act (Stats 1921, Ch 821, Sec 2(10)) Deductions are allowed on the theory that the inheritance tax is a succession tax upon the beneficial interest of the heir or legatee *Estate of Miller* (1921) 184 C 673, 195 P 413 See also *Estate of Rath* (1937) 10 C 2d 399, 75 P 2d 509, and *Riley v Zellerbach* (1942) 53 C A 2d 196, 198, 127 P 2d 597, 598-599 "Clear market value" is defined by Sec 13312 as the "value of any property included in any transfer, less any deductions allowable by this part"

3 A person claiming a deduction must point out the applicable statutory provision and show that the claimed deduction falls within its terms *New Colonial Ice Co v Helvering* (1934) 292 U S 435 The rule that taxing statutes are to be construed in favor of the taxpayer does not generally apply to statutory provisions dealing with exemptions or deductions *Estate of Stechler* (1927) 197 C 386, 396, 233 P 972, 977, *Estate of Bull* (1908) 153 C 715, 96 P 366

B *General Requirement*

A deduction may not be taken unless the debt, obligation, or expense actually reduces the amount of the inheritance or transfer It is not necessary that the amount to be deducted be actually physically paid at the time of deduction, but it must be finally fixed and enforceable at that time *Estate of Slack* (1948) 86 C A 2d 49, 53, 194 P 2d 61, 64 The deduction must be an obligation of the decedent or his estate, and it must be paid by the estate or the transferee (Sec 13982)

C *Particular Deductions*

1 Last illness expenses

Only those expenses paid after death are allowable since those paid before death had the effect of depleting decedent's estate in his lifetime (Sec 13986) If paid by another before death, such person should file a claim against the estate

2 Funeral Expenses

a Funeral expenses must be reasonable having regard for the station in life of the decedent and the custom of the community of which he was a resident (Sec 13986) Such expenses may include

(1) Costs for burial;
(2) Costs for burial plot, either for decedent alone, or for decedent and members of his family,
(3) Costs for tombstone, monument, or other memorial;
(4) Costs for perpetual care of burial plot,
(5) Donations to officiating clergyman,
(6) Costs for transportation of body to burial place

b Funeral and last illness expenses of a deceased wife are deductible from her estate even though she be survived by a husband financially able to pay those expenses (Sec 13986) *Riley* v *Robbins* (1934) 1 C 2d 285, 34 P 2d 715 (See also Prob C Sec 951 1)

3 Debts owed by decedent at death

a The debt should be based upon a claim timely and properly filed, allowed, and approved, but neither Sec 13983 nor the regulations use the word "claim" A claim formally presented, allowed, and approved may not be allowed as a deduction if not actually a bona fide debt of the decedent A claim upon which the statute of limitation has run is not an allowable deduction (Reg 13983(e))

b Contingent obligations of the decedent are not allowable as deductions (Reg 13983(d)) If subsequently established and paid, however, the order fixing the tax may be modified equitably and a refund obtained if petition for refund is filed within one year after the establishment or payment There is no limitation of time within which the debt must be paid after the order fixing the tax is made (Sec 13985)

c A debt secured by a mortgage may properly be deducted even though not actually paid, distribution subject to the mortgage will suffice (Reg 13983(b)) See also *Estate of Black* (1948) 86 C A 2d 49, 194 P 2d 61

4 Property taxes

Property taxes which are a lien at the date of death may be properly deducted (Sec 13986, Reg 526) Property taxes become a lien as of the first Monday in March so that if the decedent dies between that date and the date of the December payment, two installments may be deductible If death occurs between the first Monday in March and the date of the April payment, it is possible that three installments may be deductible

5 Ordinary expenses of administration
(See in general Sec 13988)

a The commission of an executor or administrator computed under Prob C Sec 901 upon the probate inventory at "date of death" values may be deducted (Sec 13988(a)) *Estate of Skinker* (1956) 47 C 2d 290, 303 P 2d 745

b The same rule applies to attorneys' fees If executor is a lawyer and elects to act as his own attorney he may claim either the executor's commission or attorney's fee, but not both But see *Estate of Thompson* (1958) 50 C 2d 613, 328 P 2d 1 Should he retain his own firm as counsel he must file an affidavit to establish that he is not to participate in or receive any benefit from the attorney's fee claimed as a deduction (Reg 13988(b)) *Estate of Parker* (1926) 200 C 132, 135, 251 P 907, 909 He may, however, employ another attorney to render the necessary legal service and the latter's fee is a proper deduction *Estate of Graham* (1921) 187 C 222, 201 P 456

c A bequest to the executor in lieu of the statutory commission is not deductible insofar as it exceeds the statutory commission (Reg 13988(a), 13601-13603(f).)

d Expenses of administration (Reg 13988(g)) ordinarily include filing fees, publication of notices, death certificates, certified copies of documents, appraiser's fees, and closing costs. Generally, these are rather modest and present no problem. The following are not allowable as ordinary expense of administration:

(1) California inheritance tax paid by or on behalf of an heir or legatee *Kelso* v. *Sargent* (1936) 11 C A 2d 170, 172, 54 P 2d 26, 26-27; *Estate of Chesney* (1905) 1 C A 30, 33, 81 P. 679, 680;

(2) Payments to compromise an actual or threatened suit by a disgruntled or disinherited heir or legatee (*compare* Sec 13409);

(3) Costs incurred defending a will contest;

(4) Costs incurred in connection with contested or litigated claims against estate; the established or compromised claim is allowable as a deduction, however;

(5) Expenses relative to carrying on decedent's business;

(6) Traveling expenses of executor or administrator or his attorney,

(7) Expenses on sale of estate property, unless the sale was directed by will, or was necessary to pay debts or taxes;

(8) If the sale is necessary, and the sale price is at or below the appraised value, the difference between the net proceeds and the appraised value is allowable as a deduction,

(9) Amounts expended for care and upkeep of estate property.

D *Extraordinary Professional Fees*

Extraordinary fees, in the usual connotation of the term (e g., suits to recover property, litigated claims, etc), are not allowable as deductions (Sec 13988 1) The extraordinary fees which are allowable are limited to tax work and proceedings to fix inheritance tax, such as costs for:

(1) Proceedings under Prob C Sec 1170,

(2) Petition to determine inheritance tax,

(3) Federal estate tax return, negotiation and litigation,

(4) Income tax returns, negotiation and litigation

Such fees are allowable only for work actually performed, and if they are charged by and paid to the executor, administrator, or the executor's attorney or accountant There is no fixed fee schedule, but the fee must be fair and reasonable It may be allowed as a deduction prior to the actual fixing by the court It is not allowable if the services are minor in character and compensated in the statutory fees *Estate of George E. Tubbs* (1947) 82 C A 2d 305, 309, 186 P 2d 7, 10

E. *Federal Estate Tax as to Decedents Dying Prior to 5·05 p m, June 24, 1959*

1 Any amount due or paid to the United States as federal estate tax is allowable as a deduction Computation of the deduction is limited to property subject to the California inheritance tax, and the computation is based upon the appraiser's valuation of that property Property located outside of California may not be included in the making of this computation *Estate of Guthman* (1954) 125 C.A 2d 408, 270 P 2d 875 The marital exemption (Sec 13803) is treated as an exclusion for the purpose of this computation

2 The allowable deduction is the amount actually paid the United States as finally determined, or the appraiser's computation of the federal estate tax, whichever is the lesser amount *Estate of Slack* (1948) 86 C A 2d 49, 194 P 2d 61 The 1957 amendment gives the court continuing jurisdiction to amend the order fixing tax for this purpose only. Even though not yet actually paid, the deduction is allowable if it appears "due" in the sense that it will be paid *Estate of Slack, supra.*

3 Apportionment may be avoided by an appropriate provision in the will directing that the federal estate tax be paid out of the residue (Prob C Sec 970 and following) A similar provision in the will relating to inheritance taxes amounts to a bequest of inheritance tax, however

As to decedents dying after 5 05 p m , June 24, 1959 , Section 13989 is repealed and no deduction is allowable for Federal Estate Tax paid Constitutionality of repeal of Section 13989 was upheld in *Estate of Fabris* (1962) 200 C A 2d 408

F. *Nonresident Decedents*
If ancillary administration is had in California and the assets subject to domiciliary administration are sufficient to discharge debts and expenses, i e , the domiciliary estate is solvent, none of the debts, charges and expenses are allowable as deductions, except those directly chargeable to the California estate, i e , administrator's commissions and attorney's fees based upon the California estate, and the California expenses of administration (Reg 13981-13982(b))

G *Deductions Erroneously Allowed*
An order fixing tax may be amended to fix supplemental tax on amount of erroneous over allowance of deduction (Sec. 13984) No statute of limitations runs against the state

VI. Exclusions

A *Community Property*

1 Identification of community property to be excluded There is no presumption that any property acquired by a decedent after marriage is community property (Sec 13556) The inheritance tax presumption is the opposite of the Civil Code presumption A spouse claiming community property has the burden of proof, and must file a Community Property Affidavit, Form No 3 See *Estate of Raphael* (1949) 91 C A 2d 931, 206 P 2d 391 The definition of "separate property" in C C Secs 162 and 163 is closely followed See *Estate of Caswell* (1957) 152 C A 2d 195, 312 P 2d 703 Following is the method used for identifying community property

(a) Separate property of the decedent (and surviving spouse if inter mingled) is first identified and segregated ,

(b) Proceeds and earnings are traced and segregated ,

(c) If tracing is impossible or impracticable, separate property is capitalized at simple interest of 4 percent per annum from date of marriage or acquisition to date of death ,

(d) The balance is community property
See *Estate of Meudenhall* (1960) 182 A C A 524 and *United States* v *Stewart*, 270 F 2d 894 (cert den) re includability of wife's half cash surrender value insurance on life of husband where premiums paid with community earnings

2 Community property passing to husband on wife's death
On the death of the wife, no part of the community property passing to the husband is subject to the tax All of the community property devised or bequeathed to a person other than the husband is subject to the tax (Sec 13551(b))

3 Community property passing on husband's death
On the death of the husband none of the community property which passes outright to the wife, whether by the laws of succession, the decedent's will or by election, is subject to tax If, however, the husband's will gives the wife a life estate in his one-half of the community property, or gives her a power of appointment, the life estate or the property subject to the power is subject to tax (Secs 13551, 13552, as amended 1961) All of the community property devised or bequeathed to a person other than the wife is subject to the tax

4 Community property transferred other than by will or the laws of succession.
If one spouse transfers community property other than by will or the laws of succession outright to the other, none of the property so transferred is subject to tax If, however, the husband is the transferor, and the wife is given a life estate with remainder in another, or a power of appointment, the life estate or the property subject to the power is subject to tax. (Sec 13554) The "harsh" rule of *Kirk-*

wood v the Bank of America (1954) 43 C 2d 333, 273 P. 2d 532, which limited the community exclusion of the wife-transferee of old type community property transferred to her and a third person to one-half of what she received, rather than one-half of the total, was eliminated by amendment in 1955 There is no longer any distinction between the old type and new type community property so far as inheritance tax is concerned (Sec 13557, 1957 amendment)

B *Nonnative Son Property—Prob C 201 5 Property*

One-half of any property to which Prob C Sec 201 5 is applicable and which goes to the surviving spouse, is subject to tax (Sec 13555(a) (amended 1957)) By contrast no community property passing outright to the surviving spouse is subject to tax Sec 13551

The one-half of any Prob C Sec 201 5 property which belongs to the surviving spouse is not subject to tax (Sec 13555(b))

None of the property restored to the decedent's estate under Prob C Sec 201 8 is subject to tax (Sec 13555(b))

Any person who claims certain property in Prob C Sec 201 5 property has the burden of proving that it is such (Sec 13556 5)

See this Outline VI A 1 above

Where a married person by his will presents the surviving spouse with an election, and the surviving spouse elects to take under the will, the exclusion is the value of the property received by the surviving spouse by virtue of such election, subject, however, to a minimum exclusion of

(a) One-half of the value of Prob C Sec 201 5 property, and

(b) Full value of Prob C Sec 201 5 property (Sec 13552 5)

The same rules apply to transfers other than by will or the statutes of succession (Sec 13554 5 (1957))

See, *Rights of a Surviving Spouse in Property Acquired by a Decedent While Domiciled Outside California* by Abel, Barry, Halsted and Marsh, (1958) 47 Calif Law Rev 211

See, also, *Paley v Bank of America* (1958), 159 C A 2d 500

C *Insurance Exclusion*

Insurance proceeds payable to a named beneficiary or beneficiaries up to the amount of $50,000 are not subject to the tax See the Outline III. E 2

VII. Exemptions

A *In General*

Exemptions must be distinguished from deductions and exclusions Exemptions are a part of the tax computation and have the effect of exhausting a part at least of the lower tax brackets, thus throwing the balance of the property into higher tax brackets (Sec 13403) See *Estate of Harrison* (1952) 110 C A 2d 717, 243 P. 2d 528

B *Specific Exemptions*

There are four classes of transferees

Class A Husband, wife, lineal ancestors, lineal descendants, adopted and mutually acknowledged children and their issue, and adopted children of lineal issue of the decedent (Sec 13307), *Estate of Radovich* (1957) 48 C 2d 116, 308 P 2d 14, *Estate of Teddy* (1963) 214 A C A 126 (mutually acknowledged child),

Class B Brother or sister of the decedent, descendants of a brother or sister, wife or widow of a son, and husband or widower of a daughter (Sec 13308),

Class C Brother or sister of a father or mother of the decedent, and descendants of brother or sister of father or mother of decedent (Sec 13309);

Class D All other transferees (Sec 13310),

The specific exemption is measured in dollars and varies according to the class into which the beneficiary falls·

Class A: Minor child, $12,000; all others, $5,000 (Sec 13501),

Class B. $2,000 (Sec 13802);

Class C $500 (Sec 13803),

Class D $50 (Sec 13804)

The rates of tax are also graduated according to class, with the lowest rates to class A beneficiaries and the highest rates chargeable to class D beneficiaries The rates are also graduated according to the amount received by each beneficiary, with the lowest rate in the under $25,000 bracket and the highest in the over $500,000 bracket (Secs 13404 to 13407)

Important Chapter 1128, Stats 1959, effective 5 05 p m June 24, 1959, amends Secs 13406 and 13407, increasing the rates of tax applicable to class C and class D beneficiaries, respectively Statutes of 1961, p 4531, amended a schedule setting forth the exemptions and rates of tax as set out at page 29 hereof; Sec 13405, increasing rates of tax applicable to class B beneficiaries

C *Marital Exemption*
An exemption equal to one-half the clear market value of decedent's separate property is allowed to the spouse of the decedent (Sec 13805) There is no terminable interest rule The surviving spouse does not have to take any of the separate property for the exemption to apply It will extend to any other property devised or bequeathed to the surviving spouse The amount of the exemption is one-half the clear market value of the decedent's separate property, computed after the federal estate tax is deducted *Estate of Law* (1958) 50 A C 279, *rehearing denied* 325 P 2d 449

D *Charitable Exemption*
(Secs 13841 and 13842)

1 Transfers to the United States, the State of California, a California public corporation or a society, corporation, institution, or association exempt from taxation by California law, are exempt from inheritance tax Although the inheritance tax law exempted from taxation transfers to the United States, the Supreme Court of California held, in *Estate of Bawnson* (1948) 33 C 2d 638, 204 P 2d 330, *aff'd* 339 U S 87, that the United States could not take by will in California under Prob C Sec 27 That section has since been amended to include the United States

2 Transfers to any society, etc, operated solely for religious, charitable, scientific, literary, or educational purpose, not operated for private profit or engaged in propaganda, are exempt from taxation provided any of the requirements listed below is met
   a That the society, etc, is organized under the laws of California or of the United States (Cf *Estate of Barter* (1947) 30 C 2d 549, 184 P 2d 305,
   b That the transferred property is limited for use in California (*Estate of Fleming* (1948) 31 C 2d 514, 190 P 2d 611), or
   c That the society, etc, is organized under the laws of another state, the other sovereignty either
      (1) Did not impose a death duty, or
      (2) Had in its laws a reciprocal provision similar to California.
   See *Estate of Baxter* (1950) 100 C A 2d 397, 223 P 2d 877, *Estate of Bendheim* (1950) 100 C A 2d 398, 223 P 2d 874.

3 It is not necessary that the charitable corporation be in existence at the date of death, *se*, one may, in California, by his will create a charitable organization *Estate of Inwin* (1925) 196 Ch 360, 237, p 1074

E *Other Exemptions*

1 Although included within Chapter 5 of the inheritance tax law, the following "exemptions" are, in reality, exclusions certain intangible personal property belonging to a deceased nonresident of California; war risk insurance, the armed services exemption, and death benefit payments

2 Intangible personal property belonging to a deceased nonresident of California is not subject to tax if the other state did not impose a *death tax* with respect to *intangible personal property belonging to a* deceased resident of California, or the other state had in its laws a reciprocal provision similar to California's (Sec 13851)

3 War risk insurance, i e , National Service Life Insurance, is not subject to tax if it is payable to the estate of the deceased veteran (Sec 13861) If such insurance is payable to a named beneficiary it must be aggregated with other insurance and included therewith in applying the $50,000 insurance exclusion

4 Where the decedent was a member of the armed forces of the United States between Sept 16, 1940 "and the termination of all wars in which the United States is now engaged," and death was service connected, property transferred to persons within class A, B, or C is not subject to tax The transferee must be a dependent of decedent, and death may not be the result of wilful misconduct The "exemption" is applicable only to resident decedents or transferees. (Secs. 13871 to 13873)

5 Death benefit payments and return of employees' contributions, made under *a public* pension or retirement system to a named beneficiary or to the estate of a deceased employee are not subject to tax Section 13880 was, in effect, a legislative overruling of *Estate of Simpson* (1954) 43 C 2d 594; 275 p 2d 467, and *Estate of Richartz*, (1955) 45 C 2d 292, 288 p 2d 557. See this Outline, III. E. 3.

VIII. Computation of the Tax

A. *The Inheritance Tax Proper*

Market value (Sec 13311) or gross estate value less allowable deductions equals "clear market value" (Sec 13312)

This total is allocated among the heirs or devisees or legatees according to the statutes of succession or the will, depending upon whether the decedent died intestate or testate All transfers to a particular beneficiary are aggregated and the appropriate exemption, depending upon the beneficiary's relationship to the decedent, is deducted therefrom and the balance is multiplied, by brackets, by the appropriate rates of tax

1 All transfers to the same person (inter vivos gifts, joint tenancies, bequests, devises, etc) are aggregated, and the tax is computed on the total, as though there was but a single transfer. (Sec 13408) *Estate of Childs* (1941) 18 C 2d 237, 115 p 2d 482.

2 If a legatee or devisee under a will or an heir renounces his rights, or agrees that the estate be distributed other than under the will or the laws of succession, the tax is computed in accordance with the will or the laws of succession, depending upon whether decedent died testate or intestate, and not according to the renunciation or agreement (Sec 13409) *Cohn* v *Cohn* (1942) 20 C 2d 65, 68, 123 p 2d 833, 835; *Estate of Rossi* (1915) 169 C 148; 146 p 430, *Estate of Holt* (1923) 61 C A 464, 469, 215 p 124, 125-126; *Kelso* v *Sargent* (1936) 11 C A 2d 170, 54 p 2d 26

3 If a transfer is subject to a contingency (future interests), the tax is computed at the highest contingency A refund may be had, however, upon the happening of the contingency, where the tax was paid on high contingency (Secs 14411 to 14414) See, however, *Estate of Off* (1956) 146 C A 2d 516, 304 p. 2d 126 The Controller may compromise the tax where contingency is present (Sec 14191) In such case the court order is a final determination, and no refund is permitted upon the filling in of the interests (Sec 14192)

B *Additional Tax—"Pickup" Tax*
(Secs 13441 and 13442)

1 In a case where the credit for inheritance tax paid the state under the federal estate tax law exceeds the inheritance tax payable to the state, an additional tax is imposed equal to the difference between the

maximum federal credit and the inheritance tax (See *Estate of Good* (1963) 213 A C A 2d)

2 In a case where, due to the exclusions and exemptions, no inheritance tax would normally be owing to the state (*e g* , wife deceased, all community property in name of the husband, and wife dies intestate or leaves a will bequeathing her share of the community property to the husband), a tax is imposed equal to the maximum credit allowed under federal estate tax law (Sec 13442)

3 By the provisions of Sec. 14161 a discount equal to 5 percent of the amount of tax is available for prompt payment, *i e* , payment within six months of the date of death The discount provision does not apply where an additional tax is imposed under Secs 13441 and 13442 (Sec 14161) The reason for this rule is that under the federal estate tax law, the executor can get credit only for the exact number of dollars actually paid to the state

4 The pickup tax becomes delinquent at the expiration of two years from date of death or at the expiration of six months from the final determination, whichever is later (Sec 14103)

IX. Credits

A. *Previously Taxed Property*

1 (Sec 14071, 1957) Prior to Sept 11, 1957, there was a "previously taxed property" exemption in the law (Secs 13821 to 13824, repealed 1957) which required each item to be traced from prior estate into present estate, and identified As to the effect of the then exemption, see this Outline VII A

2 Under the present law, the decedent must have been a class A beneficiary in a prior estate, and the beneficiary in the present estate must be a class A beneficiary to the present decedent The two deaths must occur within a five year period, and an inheritance tax must have been paid in the prior estate, but no additional (pickup) tax (Secs 13441 and 13442) need have been paid The formula for computation is prescribed by Sec 14071(b) The credit so computed is deducted from the inheritance tax computed without reference to the credit

B *Gift Tax Credit*

If the same transfer is taxed both under the gift tax law and under the inheritance tax law a credit is allowed against the inheritance tax for the gift tax paid The formula for computation of gift tax credit is prescribed by the statute If the decedent had neglected to file a gift tax return and paid the tax where required prior to his death, the amount paid by the executor after death is an allowable deduction Should the same transfer also be taxable under inheritance tax law, the credit is allowable It follows, therefore, that the same payment may be used twice to reduce the inheritance tax (Secs 14051 to 14059)

X. Payment of the Tax

A *When and to Whom Payable*

The inheritance tax is due and payable as of the date of death (Sec 14102) and must be paid within two years, at which time it becomes delinquent if unpaid (Sec 14103) It is payable to the county treasurer (Sec 14104) The executor, administrator, or trustee must collect the tax, or withhold it from the transferee, and is responsible for its payment (Secs 14101 and 14121) Where a life estate with a remainder over has been created, the tax is payable out of the property itself, and is not collected from either transferee (Secs 14123 and 14124) The same rule applies to a transfer subject to a contingency (Sec 14125) The personal representative may sell estate property to pay the tax (Sec 14127) The additional (pickup) tax (Secs 13441 and 13442) is also payable to the county treasurer (Sec 14126) It becomes delinquent at the expiration of two years from date of death or six months after the final determination of the federal estate tax, whichever is later. (Sec 14103) No discount is allowable. (Sec. 14161)

B *Discount (Sec 14161)*

If the inheritance tax (no additional tax being due) is paid within six months of the date of death a discount equal to five per cent of the amount of tax is allowed No discount is allowed where the California tax is the pickup tax See *Estate of Hanke* (1948) 88 C A 2d 6, 198 P 2d 51, and the subsequent amendment to C C P Sec 12a

C *Deferment of Payment*

Where a transfer has been made subject to a contingency, payment of a portion of the tax may be deferred upon posting of a bond (Secs 14171 to 14178) Preferred practice in contingency cases is to request the appraiser to compute tax on both a normal and high (Sec 13411) contingency and then to compromise the tax by adding an agreed sum to the normal tax (Sec 14191), thus closing the matter Should the "spread" between the normal and high contingency be so large as to preclude a "fair" compromise both as to taxpayer and the state, the following two avenues are open

(1) The executor may show both computations in the report, pay the tax on the high contingency, and apply for a refund, if proper, upon the resolving of the contingency (Secs 14401 to 14403); or

(2) He may pay tax on the normal contingency, and post a bond against the difference between the normal and the high contingency

D *Interest*

If the tax is not paid prior to the date upon which it becomes delinquent (two years from the date of death) it is subject to simple interest at six per cent per annum from the delinquency date until paid (Sec 14211) All payments upon a delinquent tax are applied first to the satisfaction of interest, and the balance, if any, to the tax itself (Sec 14221)

In a proper case, the Controller may require the filing of a delinquent tax bond

E *Payment of Tax and Interest, a Prerequisite to Distribution*

1 The account of an executor, administrator or trustee cannot be approved or settled until the tax has been paid and a receipt, countersigned by the Controller is in the file (Sec 14143) A probate estate cannot be distributed (Prob C Sec 1024) nor can a decree establishing fact of death be made (Prob C Sec 1174) unless the inheritance tax and accrued interest, if any, have been paid in full *Becker* v. *Nye* (1908) 8 C A 129, 96 P 333 Payment of the tax is established by the presence in the file of the original receipt of the county treasurer, countersigned by the Controller or his deputy (Sec 14142)

2 Upon receipt of payment of inheritance tax the county treasurer executes a receipt, upon the prescribed form, in quadruplicate (Sec 14141) Distribution is as follows

(a) The fourth copy is retained by the county treasurer for his records,

(b) One copy is delivered to the person paying the tax,

(c) The original receipt and one copy is forwarded to the Controller in Sacramento

If the ledger account which was set up at the time the Report of the appraiser is balanced by the payment, the original receipt is countersigned by a deputy Controller and forwarded to the county clerk for filing in the proceeding (Sec 14142)

F *Refund*

1 Refunds are generally occasioned by payments made to secure the prompt payment discount of 5 percent, and usually arise by reason of a premature estimate of the tax without according proper weight to the many factors which might reduce the tax This accounts for perhaps 90 percent of all applications for refunds.

2 The present procedure to be followed in applying for a refund Prepare the application alleging the payment, the amount of tax found due reduced by the discount allowable, if any, show the difference, and pray that the State Controller draw his warrant upon the State Treasurer in favor of the person paying the tax Distribution

(a) Forward to the Inheritance Tax Department in Sacramento the original and one copy of the application and the form of order directing refund,

(b) If approved, the original application and original form of order directing refund will be stamped with an approval and waiver of notice of time and place of hearing, the order directing refund may then be obtained ex parte,

(c) Three "conformed" or "endorsed" copies of the order fixing tax should be served upon or delivered to the State Controller at his Sacramento office

The 1959 Legislature amended Secs 14361, 14373, 14383, 14391, 14392, 14403, 14413, 14423, and 14428, effective Sept 18, 1959, to provide that the State, rather than the County Treasurer to whom the payment on account of tax was made, shall make the refund to the person paying the tax Application for refund must still be filed, and refund may be made only upon order of the superior court having jurisdiction

3 Refunds for reasons other than as above may require a recomputation of the tax See Ch 10, Sec 14361 and following of the inheritance tax part of the Revenue and Taxation Code

Important · The 1963 Legislature by amendments to the inheritance tax law greatly simplified the refund procedures to permit the State Controller to process refund applications without the necessity of a court order Prior to the 1963 amendments Chapter 10 of Division 2, Part 8 of the Revenue and Taxation Code embraced eight different articles, all dealing with inheritance tax refunds in specified fact situations Superfluous sections (Section 14381-14383, 14401-14403, 14411-14414, 14426-14428, and 14421-14424) were repealed eliminating the specified types of direct refund The new law, by amending Sections 13956 and 13411 and adding Sections 13443 and 14371, gives the taxpayer the right to have the order fixing tax amended to reflect the correct amount of tax due

All refunds may now be obtained under the regular procedure provided in Sections 14371-14375 (overpayment in excess of correct order fixing tax) The person entitled ot the refund applies directly to the State Controller on a form provided and after audit and approval the refund is paid by the State Treasurer

The old procedure is retained in the law to afford the applicant an alternative method should dispute develop with respect to the amount or the legality of the refund

XI. Practice and Procedure

A *Appraisers*

1 The Controller must appoint at least one person in each county to act as inheritance tax appraiser for that county (Secs 14771 to 14774) Larger or more populous counties may have several inheritance tax appraisers The appraiser has no power to act except upon order of the court in a particular case

2 Court must appoint an inheritance tax appraiser in every probate proceeding (Prob C Sec 605), in every proceeding to establish the fact of death (Prob. C Sec 1174) and in every proceeding for determination of inheritance tax (Sec 14501 and following)

3 Appointment of an appraiser by the court in particular proceeding imposes the duty to ascertain and report to the court the clear market value of all transfers and the amount of tax due (Sec 14501) Upon

such appointment the appraiser becomes a referee of the court with power to issue subpoenas, require attendance of witnesses, production of records, etc. (Secs 14502 to 14505)

B *Normal Probate Procedure*

1 An original and two copies of the inventory must first be submitted When the original inventory and appraisement is returned, the following must be submitted to the appraiser.

(a) Form 22, the inheritance tax affidavit; it must be carefully and accurately filled out in detail; an incomplete or inaccurate Form 22 is the single most important cause of delay in processing the report

(b) Form 3, the community property affidavit, where required,

(c) The will and all codicils;

(d) The inventory and appraisement if not already in the hands of an appraiser;

(e) A copy of any trust instrument executed by or under which the decedent may have been a beneficiary;

(f) Any other pertinent or useful information A hearing before a department attorney may be required if the estate exceeds $200,000 gross or if problems exist

2 The appraiser drafts and submits the proposed report to the department for examination and audit It is to be noted that the appraiser is an independent officer of the court; he is not an employee of, nor is he subject to, the inheritance tax department He may file his report irrespective of department approval

3 Upon receipt of department approval of his report or at his own discretion, the appraiser files his report with the court If no objection is filed, at the expiration of 10 days from the filing of the report, the appraiser procures an order fixing tax (Sec 14509)

4 Should the executor, administrator or any of the beneficiaries, or the department be not satisfied with the report, any of them may file objections to the report following its filing and before the order fixing tax is made (Sec 14510) If objections are filed, trial is had in the Probate Court which enters its order overruling or sustaining the objections, as the case may be (Sec 14513) On the hearing of objections the objector is the "plaintiff," and the report is presumed to be correct *Of Estate of Cunningham* (1957) 148 C A 2d 8, 305 P 2d 920

C *Petition to Establish Fact of Death or Determine Inheritance Tax*
Upon filing of the petition, the executor or his attorney should procure an order appointing the inheritance tax appraiser and submit to him a copy of the petition, the Form 22 Inheritance Tax Affidavit, and the Form 3 Community Property Affidavit, if the latter is pertinent The processing is the same as indicated in this Outline XI B

D *Miscellaneous*

1 Tax Lien Imposed

a A lien is imposed upon all property subject to inheritance tax, which lien remains until the tax and interest are paid in full (Sec 14301) The statute of limitations is five years where property subject to lien is sold to bona fide purchaser, mortgagee, etc (Sec 14303) If property subject to lien is sold on probate sale, the lien on such property is extinguished and the lien attaches to proceeds of sale (Sec 14304)

b Release of the lien may be granted by the Controller, inheritance tax attorney, or the appraiser upon proof that no tax is due (Sec 14307) or by the Controller or the inheritance tax attorney if sufficient security is posted (Sec 14308) A certificate is issued as evidence of the release of the lien

2 Termination of Joint Tenancy.
Following is the procedure for termination of a joint tenancy in real property by the affidavit method·

(a) Submit to department or appraiser Form 22 affidavit and Form 3 Community Property Affidavit, if requested by department;

(b) Copy of "Affidavit—Death of Joint Tenant" (Land Title Ass'n Form) or description of property, date of deed and page of recordation and recorder's number,
(c) Appraisal of property by inheritance tax appraiser or evidence of sale price on pending sale;
(d) If it appears that no inheritance tax is due, or that it is amply secured, the certificate will issue;
(e) Recordation of "Affidavit—Death of Joint Tenant," a certified copy of death certificate, and the department certificate releasing inheritance tax lien will satisfy the title company;
(f) Generally, this simplified procedure is not available where a tax is due and there is no proceeding pending in which the tax may be determined, under such facts a proceeding under Prob C Sec 1170 should be instituted.

3 Consent to transfer and withholding by third persons
No bank, corporation, depositary, etc, may transfer any asset belonging to a decedent, or an asset in which a decedent had an interest, without retaining a sufficient portion or amount to pay any tax and interest, or without first securing consent to transfer In actual practice the withholding privilege is rarely used In the case of the contents of a safe deposit box or drawer, the contents are listed by the county treasurer and consent to transfer is then given (Sec 14344) Burial instructions or the will may be removed, however, prior to listing and consent by the county treasurer (Sec. 14344) Consent to transfer is required prior to the transfer of corporate stock (Sec. 14341) This same requirement applies to bank accounts generally However, it is relaxed in the following instances
(a) Prob C Sec 630 cases,
(b) Where a husband and wife joint tenancy accounts are up to $5,000, in this situation the bank must give notice to the Controller;
(c) Where the decedent was a California resident, and there is a California probate proceeding; the bank must give notice to the Controller

4. Informal or extra judicial determination of the tax
Where the assets transferred, or passed by survivorship consist of a bank account or shares of listed stock, and where the amount or value and the tax are relatively small, the tax may, by tradition (but *not* by statute), be fixed by "report letter" by department attorney Form 22 affidavit must be filed with department The tax is paid to the county treasurer If computation is erroneous, or overpayment made, there can be no refund, since there is no court proceeding

XII. Administration

The State Controller is vested with the responsibility for administration of inheritance tax law (Rev. & Tax C Sec 14732) The Inheritance Tax Department, set up under Sec 14731, is under the authority and direction of the State Controller. (Sec 14733) The inheritance tax attorney (chief) with offices in Sacramento (Sec 14736) is in charge of the legal work and has general supervision of the department (Sec 14738) District offices are maintained in Sacramento (five attorneys), San Francisco (six attorneys), and Los Angeles (10 attorneys) The department is not a tax-collecting agency; rather it administers and enforces inheritance tax law It advises appraisers, county treasurers, attorneys, trust officers, title examiners, taxpayers, and the general public in all matters affecting inheritance tax It issues rules and regulations; it records, compiles, and publishes statistics relating to inheritance tax

XIII. Additional References

Barnett, *California Inheritance and Gift Taxes—A Summary* 43 Calif. Law Rev. 49 (1955);
Barry, *The Inheritance Tax Affidavit of California*, 7 Hastings L. J. 237 (1956)

CALIFORNIA GIFT TAX

CALIFORNIA GIFT TAX

I. Historical Background

The original enactment of the California gift tax can be found in Stats 1939, Ch 652, effective June 21, 1939 It was codified in 1943 (Stats 1943, Ch 658, effective July 1, 1945) and can be found in Sections 15101 to 16652 of the Revenue and Taxation Code

II. Jurisdiction to Tax

A *Resident Donors*

Where the donor is a resident of the State, all real property and intangible personal property within the State, and all other personal property "the transfer of which this State may constitutionally tax," is subject to the tax

B *Nonresident Donors*

Where the donor is not a resident of the State, all real property within the State, and "all intangible and other personal property the transfer of which this State may constitutionally tax," is subject to the tax

III. Transfers Taxable

The transfer of any property, interest therein, income therefrom, in possession or enjoyment, present or future, in trust or otherwise, directly or indirectly, made with a donative intent, is taxable (Sec 15104) By contrast, under the federal gift tax which does not require "donative intent," it is sufficient to establish taxability if made without adequate and full consideration, not in the course of business A revocable transfer not normally taxable, becomes taxable upon the relinquishment of the power of revocation (Sec 15105) If the transfer is made for less than adequate and full consideration, excess value over the consideration paid is value of transfer (Sec 15106) Payment of tax by the donee is not consideration (Sec 15107) The creation of a joint tenancy between husband and wife in real property does not constitute a taxable transfer, unless the donor elects to treat it as a gift, and then it is not taxable until the joint tenancy is terminated (Note Sec 15104 5, enacted 1957, effective Sept 11, 1957, is the California version of a similar federal provision)

IV Valuation

Property transferred is valued as of the date of the gift (Sec 15551) The method of evaluating gifts of future interests is similar to that used for inheritance tax purposes (Secs 15552 and 15553) If the annuitant or the life tenant dies prior to the issuance of determination of the tax, the value of the annuity or the life interest is the amount actually paid (Sec 15554) If the donor dies before the filing of the gift tax return, his executor or administrator may elect, if the transfer is also subject to an inheritance tax, to have the transferred property valued by an inheritance tax appraiser (Secs 15571 to 15577)

V. Deductions

The actual consideration paid in money or money's worth, is deductible from the total value of the property transferred (Sec 15106) Where property is transferred subject to an encumbrance which is assumed by the donee, it is deductible from the value of the property transferred

VI. Exclusions

A *The Annual Exemption*

The annual exemption of $4,000 is subtracted from the value of the property transferred leaving as a result the "net gift" (Secs 15148 and 15401) However, the annual exemption is *not* always allowable if the gift is a future interest (Sec 15402) Gifts to minors within the "Gifts to Minors Act" qualify for the annual exemption (Sec 15402(a), 1957 as amended) In a case of conversion of separate property into community property, the second half is subject to a gift tax on the death of the spouse whose property it was without the annual exemption (Sec 15402(b))

B *Community Property Transferred*

On transfer by one spouse to the other, one-half is not subject to tax, the other one-half is taxable (Sec 15301) On transfer to a third person each spouse is donor of one-half value of the property transferred (Sec 15302) There is no distinction, for gift tax purposes in the interest that the wife acquires in community property whenever acquired (Sec 15304) It is always treated as new type community property A person claiming transferred property in community must establish that as fact (Sec 15306) Form GT4, community property affidavit, must be filed

C *Conversion of Separate Property into Community*

Where separate property of either spouse is converted into community property, one-half is subject to tax at the time of the transfer (Sec 15303(a)) The other one-half is subject to gift tax without annual exemption, on the death of the spouse whose property it was, but not to inheritance tax (Sec 13753) (Sec 15303(c)) Caveat It is unwise in the present state of the law to convert separate property into community property by intervivos transfer, for this results in 100 percent of such property being subjected to tax If the one spouse leaves separate property to the other by will, only one-half is taxed (Sec 13805)

D *Quasi-community Property*

Section 15300, enacted 1961, defines quasi-community property as property acquired by either spouse while domiciled elsewhere which would have been community property of the husband and wife had the property been acquired in California It is the same type of property as referred to in Section 201 5 Probate Code Under Sec 15301 if one spouse transfers quasi-community property to the other, one-half the property is subject to gift tax providing the same rule as for a similar transfer of community property The donor must prove the nature of the property transferred (Sec 15306) (Form GT-3) If quasi-community property is transferred to a person other than a spouse, the spouse owning the property is the donor or, if both elect, each shall be considered to be the donor of one-half (Sec 15302 5) The spouses may convert quasi-community property into community property or into property held by the spouses as joint tenants or as tenants in common with equal interests without gift tax consequences Sec 15303 5) If, however, the quasi-community property converted into community property was owned (held

in the name of) by the wife, one-half thereof would be subject to gift tax on her death.

VII. Exemptions and Rates

The specific exemptions and rates of tax are precisely the same as under the inheritance tax law. See schedule, page 29 (Secs. 15110 to 15113, 15205 to 15208, and 15421 to 15424.) Specific exemptions are not allowed where the donor is an alien nonresident of the United States. (Sec. 15425.) The specific exemption is applied as gifts are made. Application may not be deferred to later years. (Sec. 15426.) By contrast, the federal $30,000 specific exemption may be applied at the will of the donor. The charitable exemption is similar to the inheritance tax exemption. (Secs. 15441 and 15442.) The intangibles exemption is also similar to the inheritance tax exemption. (Sec. 15451.)

VIII. Returns

A. *The Donor's Return*

The donor must file a return between January 1 and April 15 following the calendar year in which the gift was made. (Sec. 15651.) The return will not be accepted until the close of the year in which the gift was made. The Controller may grant an extension of time not exceeding six months. (Sec. 15652.) The Controller may make an arbitrary determination. (Sec. 15654.)

B. *The Donee's Return*

Formerly the donee was required to file a donee's return. (Sec. 15671.) This has been obviated by the donee's signature to "Schedule D" of the current form.

C. *Penalties for Failure to File Return*

If no return is filed as required, a penalty equal to 5 percent of amount of tax is added to the tax. (Sec. 15681.) Interest is computed upon tax and penalty at 7 percent per annum beginning June 15 in the year following that in which the gift was made. (Sec. 15684.5.)

D. *Fraudulent Return*

The penalty is 25 percent of the amount of the unreported tax. (Sec. 15682.) A willful failure to file return may subject the donor to a penalty of $1,000. (Sec. 15685.)

IX. Computation of the Tax

(See Sec. 15204.) Where there are no prior gifts:

(1) the market value of the gift
(2) (less) the annual exemption
(3) (equals) the net gift
(4) (less) the specific exemption
(5) (equals) the amount subject to rates
(6) (times) the rates
(7) (equals) the gift tax due

Where the donor has made prior gifts:

(1) the new gifts for the calendar year
(2) (plus) the new gifts to same donee for all prior years
(3) (equals) the total net gifts
(4) (less) the specific exemption
(5) (equals) the amount subject to rates
(6) (times) the rates
(7) (equals) the total gift tax
(8) (less) the gift tax heretofore paid
(9) (equals) the gift tax currently due

X. Determination

A. *When Issued*

If the return is filed in time, the determination of the tax must issue within three years from the date the return is filed. (Sec. 15801.) If no return is filed or the return is false or fraudulent, a determination may be issued any time. (Sec. 15802.)

B *When the Determination Becomes Final*
The determination becomes final at the expiration of 60 days from notice of the determination (Sec 15804) and has the force and effect of judgment in a civil action (Sec 15806), unless (1) the tax is paid (Sec 15908), (2) the action is brought by donor to recover the tax so paid (Sec 15805), and (3) the action is brought within 60 days of notice of determination (Sec 15804) By 1963 amendment to Sec 16251 the requirement that the tax must be paid "under protest" was deleted as a prerequisite to action for refund

C *When Payable*
The tax must be paid within 60 days of notice of determination (Sec 15905) If not so paid, it is subject to interest at 7 percent per annum beginning 60 days after issuance of notice of determination (Secs 15905 and 15961) The tax is payable to the State Controller by remittance drawn in favor of the State Treasurer

XI. Refund

If erroneous overpayment has been made, a refund may be had by application to the State Controller within one year of the date of payment or determination of the tax (Sec 16221) Interest is not allowed if the overpayment is due to an error or mistake of the taxpayer (Sec 16271) If the overpayment is involuntary, the interest on refund is allowed at 6 percent per annum from the date of payment (Sec 16272)

INHERITANCE TAX

The 1963 legislation made the following changes in the laws effecting the work of the Inheritance and Gift Tax Division

INTANGIBLE PROPERTY IN CALIFORNIA OF DECEASED NONRESIDENTS OF THE UNITED STATES SUBJECT TO INHERITANCE TAX

Revenue and Taxation Code Section 13303(b) by specifying what shall be included in the terms "estate" or "property" sets forth the types of intangible personal property of a deceased nonresident of the United States which are subject to inheritance tax Prior to the 1963 amendment the section specifically included as subject to tax, among other intangibles, "all stock of a California corporation" and specifically excluded from tax, bank deposits not used in connection with a business operated in California.

The 1963 amendment clarifies what is meant by a California corporation by rewording the section to include stock of a corporation organized in California or which has its principal place of business here or does the major portion of its business here The amendment also extended the bank deposit exclusion to savings accounts in savings and loan associations.

The text of the section as amended·

13303 "Estate" or "property" means the real or personal property or interest therein of a decedent or transferor, and includes all of the following

(a) All intangible personal property of a resident decedent within or without the State or subject to the jurisdiction thereof

(b) All intangible personal property in California belonging to a deceased nonresident of the United States, including all stock of a corporation organized under the laws of California or which has its principal place of business or does the major part of its business in California or of a federal corporation or national bank which has its principal place of business or does the major part of its business in California, excluding, however, saving accounts in saving and loan associations operating under the authority of the Division of Savings and Loan or the Federal Home Loan Bank board and bank deposits, unless such deposits are held and used in connection with a business conducted or operated, in whole or in part, in California

REFUND PROCEDURES

Substantial changes were made in the inheritance tax refund procedures These procedures are set forth in Division 2, Part 8, Chapter 10 of the Revenue and Taxation Code Prior to the 1963 amendments, Chapter 10 embraced eight different articles of from two to seven sections each, all dealing with inheritance tax refunds As amended, Chapter 10 is now composed of a single article of five sections (Sections 14371-14375) The amendments accomplished three primary changes in the law

1 *A single method of obtaining refunds is provided* Under prior law most refunds were obtained under Sections 14371-14373 which covered cases in which the amounts paid to the county treasurer exceeded the amount fixed in the order fixing inheritance tax In five classes of cases, however, the law permitted a refund where the tax fixed and the tax paid were in balance but later events proved the tax to have been fixed in an excessive amount In these cases the law did not provide for amending the order fixing tax but permitted the taxpayer to let the erroneous order stand and apply directly for the amount of refund due The cases in which refunds were obtained in this manner are as follows

   a *Sections 14381-14383* Cases involving an additional or "pickup" tax under Sections 13441-13442 in which the credit finally allowed against federal estate tax by the Internal Revenue Service proved to be less than the total state tax which was previously fixed and paid

   b *Sections 14401-14403* Cases in which an inheritance tax was fixed and paid without making allowance for a contingency which might defeat or diminish the interest of the transferee pursuant to Section 13956 and in which the contingency happens so as to result in a lower tax

   c *Sections 14411-14414* Cases in which the tax was fixed and paid at the highest contingency pursuant to Section 13411 and in which the contingencies have resolved themselves in such manner as to produce a lower tax

   d *Sections 14426-14428.* Cases in which a transferee is entitled to an armed services exemption under Sections 13871-13873 which was not allowed when the tax was previously fixed and paid

   e *Sections 14421-14424* Cases in which a debt which was not allowed as a deduction in fixing the tax is established after distribution of the estate

   The 1963 amendments repealed the sections above enumerated, thereby eliminating this type of direct refund In lieu of the direct refund provided by the repealed sections, the new law, by amending Sections 13956 and 13411 and adding Sections 13443, and 14371, gives the taxpayer the right to have the order fixing tax amended to show the correct amount of tax due The order having been thus corrected, the refund can be obtained in the usual manner under

Sections 14371-14375 (It was not necessary to provide for amendment of the order fixing tax in cases covered by repealed Sections 14421-14424 because this is already provided for in Section 13985)

2 *Certain sections providing for refunds were repealed as being superfluous* They covered cases in which it was necessary to correct the order fixing tax before the application for refund could be made Since a correct order was required, the refund can be obtained under the regular procedure provided in Sections 14371-14375 The sections repealed as being superfluous were Sections 14361-14362 (refund after order is modified on appeal), Sections 14391-14393 (refund when power of appointment exercised in favor of charity)

3 *The basic procedure for obtaining refunds of inheritance tax was simplified* In order to obtain a refund under prior law, it was necessary for the taxpayer to file a petition in the superior court and obtain the court's order directing the State to pay the amount of refund due Notice of filing the petition had to be given the State Controller After the order was made, copies would be submitted to the Controller and the refund would be paid

This procedure is retained in the law as amended but in addition a new procedure is provided whereby the refund may be obtained by direct application to the State Controller without obtaining a court order (Revenue and Taxation Code Sections 14371-14375) The Controller will furnish forms to be used in making the application Should the Controller refuse to honor the direct application, the taxpayer may follow the old procedure and make application for a court order directing the refund

The text of the amendments which accomplish these changes is as follows:

13411 (a) In the case of a transfer made subject to a contingency or condition upon the occurrence of which the right, interest, or estate of the transferee may, in whole or in part, be created, defeated, extended, or abridged, the tax is computed as though the contingency or condition has occurred in such manner as to produce the highest rate of tax possible

(b) Upon the occurrence of the contingency or condition after an order fixing inheritance tax has been entered in which the tax was computed at the highest rate possible pursuant to this section, the court which made the order shall, upon petition after notice to the Controller, modify said order to fix the tax due in accordance with the occurrence of the contingency or condition The petition shall be filed within six months after the occurrence of the contingency or condition

13443 (a) If the amount of the maximum state death tax credit allowable pursuant to the federal estate tax law is later found to exceed the total amount of tax fixed by an order fixing inheritance tax theretofore made, the court which made said order shall, upon petition of the Controller after notice to the persons chargeable with any increased tax, modify it to fix the true amount of additional tax due under this article The Controller's petition for modification may be filed at any time within six months after he has received knowledge that the federal estate tax has been finally determined

(b) If the amount of the maximum state death tax credit allowable pursuant to the federal estate tax law is later found to be less than the total amount of tax fixed by an order fixing inheritance tax theretofore made which included an additional tax computed under this article, the court which made said order shall, upon petition by or on behalf of the persons liable for the tax fixed in said order, after notice to the Controller, modify it to fix the true amount of tax

due under this article The petition shall be filed at any time within six months after the federal estate tax has been finally determined

13874 The court which has made an order fixing inheritance tax in which the exemption provided by this article was not allowed may, upon petition after notice to the Controller, modify said order to make allowance for said exemption The petition shall be filed within one year after the entry of said order or the decree of final distribution in the estate, whichever is later

13956 (a) In determining the value of any estate or interest to the beneficial enjoyment or possession of which there is a person presently entitled, no allowance is made on account of any contingent incumbrance on the estate or interest, nor on account of any contingency upon the happening of which the estate or interest, or some part of it, might be abridged, defeated, or diminished

(b) Upon the taking effect of the incumbrance or the happening of the contingency after an order fixing inheritance tax has been entered in which no allowance was made pursuant to this section, the court which made said order shall, upon petition after notice to the Controller, modify said order to fix the amount of tax due based upon the diminution in value resulting therefrom The petition shall be filed within six months after the taking effect of the incumbrance or the happening of the condition

(Chapter 10 is repealed and Chapter 10 is added)

Chapter 10. Refunds

14371 Any person who has made a payment of tax to the county treasurer in excess of the amount specified in the order or orders fixing tax as finally amended or modified, and as said amount is adjusted pursuant to discount and interest provisions of this part, is entitled to a refund in the amount erroneously paid

14372 An application for the refund shall be made to the State Controller, or shall be filed with the superior court having jurisdiction, within one year after the date of the entry of the order fixing tax or of the decree of final distribution of the estate, whichever is later

Where application for refund is filed with the superior court, notice of the hearing together with a copy of the application shall be given to the Controller

14373 On proof satisfactory to him that the applicant is entitled to a refund, the State Controller shall draw his warrant upon the State Treasurer in favor of the person who paid the tax in the amount erroneously paid, and the State Treasurer shall refund that amount If an application to the Controller is denied in whole or in part, the applicant may file an application for a determination of the amount of the refund with the superior court having jurisdiction within one year after the date of the entry of the order fixing tax or the decree of final distribution of the estate, whichever is later On proof satisfactory to it that the applicant is entitled to a refund, the court shall by order direct the state to refund to the person who paid the tax the amount erroneously paid

Notice of the filing of such an application to the court shall be given to the Controller

14374 No person is entitled to interest upon any refund allowed by this chapter

14375 A judgment for a refund allowed by this chapter bears interest after the judgment becomes final and the refund is refused upon demand after such final judgment, but then only from the date of refusal

PROCEDURE ESTABLISHED TO INCREASE AMOUNT OF ADDITIONAL (PICKUP) TAX AFTER FEDERAL DETERMINATION

Revenue and Taxation Code Section 13443 was added to the law as one of the measures necessary to effectuate the changes in refund procedures previously described This new section also provides a procedure which permits the Controller to have the order fixing tax modified if the final federal estate tax determination results in a federal credit in excess of the tax fixed Under prior law, the taxpayer had a remedy, i.e., by obtaining a refund under Sections 14381-14383 if the credit proved to be less than the tax fixed but there was no

procedure enabling the State to pick up the excess in cases where the credit proved to be larger than the tax fixed

The text of the amended section is set forth under changes in Refund Procedures

CASUALTY LOSS DEDUCTION

A new section, 13991, was added to the Revenue and Taxation Code providing for allowance of casualty losses as a deduction in computing inheritance tax. The loss must be uncompensated for by insurance and must occur prior to the date of entry of the order fixing tax or prior to one year from the date of death, whichever is earlier Under prior law no such deduction was allowable

The text of the new section·

13991 Any net loss, not compensated for by insurance or otherwise, which shall occur as to any property included in any transfer subject to this part made by the decedent, shall be deductible from the appraised value of such property, subject to the following limitations

(a) Such loss shall have been caused by fire, earthquake, landslide or other casualty

(b) The cause of such loss, as specified in subsection (a) of this section, shall have occurred after the date of death of the decedent but prior to the date of the making of the order fixing tax, or prior to one year from the date of death, whichever is earlier.

PETITION FOR DETERMINATION OF INHERITANCE TAX— CHANGE IN PROCEDURE

Prior to the 1963 legislation when the taxpayer filed a petition under Revenue and Taxation Code Section 14551 to have the inheritance tax determined upon inter vivos transfers, the court was required to set a time and place for an inheritance tax hearing before the appraiser. The 1963 amendment to Section 14552 deletes this requirement.

The text of the section as amended.

14552 Upon the filing of the petition the court shall, by order, designate and appoint an inheritance tax appraiser to ascertain and report to the court the amount of tax, if any, due and payable on the transfer for which the petitioner is liable Upon the entry of such order, the petition and the matter to which it relates shall be deemed referred to such appraiser for all purposes

COURT COSTS IN INHERITANCE TAX PROCEEDINGS

Revenue and Taxation Code Section 14675 was amended to permit court costs to be awarded against the State in inheritance tax proceedings The amendment deleted the clause of Section 14675 which prohibited the awarding of such costs

Text of the section as amended

14675 No fee shall be charged the Controller for filing, recording, or certifying any petition, lis pendens, decree, or order, or for taking any oath or acknowledgment, in any proceeding under this part; nor shall any undertaking be required from the Controller or the State in any such proceeding

TREASURERS' COMMISSIONS

Revenue and Taxation Code Section 14797 was amended to provide increased commissions for inheritance tax collected by county treasurers (other than those of counties of the first and second class) who collect more than eight million dollars per year

Text of the section as amended

14797. The maximum commissions that may be retained by the county treasurer out of the total inheritance taxes paid to and accounted for by him in any one year are as follows

a By the county treasurer of a county of the first class, eighty-five thousand dollars ($85,000)

b By the county treasurer of a county of the second class, fifty thousand dollars ($50,000).

c By the county treasurer of a county of the third class, forty thousand dollars ($40,000), provided that where the total amount of inheritance taxes paid to and accounted for by the county treasurer in the year exceeds eight million dollars ($8,000,000) the maximum commissions that may be retained by him shall be fifty thousand dollars ($50,000)

d By the county treasurer of a county of the fourth class, twenty-five thousand dollars ($25,000); provided that where the total amount of inheritance taxes paid to and accounted for by the county treasurer in the year exceeds eight million dollars ($8,000,000) the maximum commissions that may be retained by him shall be fifty thousand dollars ($50,000)

e By the county treasurer of a county of any other class, twenty thousand dollars ($20,000), provided that where the total amount of inheritance taxes paid to and accounted for by the county treasurer in the year exceeds eight million dollars ($8,000,000) the maximum commissions that may be retained by him shall be fifty thousand dollars ($50,000)

GIFT TAX

GIFT TAX ANNUAL EXEMPTION ON TRANSFERS BETWEEN SPOUSES

Revenue and Taxation Code Section 15402(b) was amended to conform this section with the changes effected by the 1961 amendment of Section 15303(b)

Prior to the 1961 amendments, one-half of the community property passing to a wife upon the death of her husband and all of the community property passing to a husband upon the death of his wife was exempt from inheritance tax In order that separate property converted to community by inter vivos transfer of the spouses would not escape both gift and inheritance taxes by reason of such inheritance tax exemptions, the law (Revenue and Taxation Code Section 15303) provided (1) that upon a conversion of the husband's separate property to community property, one-half was subject to gift tax at the time of conversion, leaving the other half subject to inheritance tax upon the husband's death and (2) that upon a conversion of the wife's separate property to community property, one-half of the converted property was subject to gift tax at the time of conversion and the other half, if it passed to the husband, was subject to gift tax upon the wife's death In order that the full half would be subjected to gift tax (in lieu of inheritance tax) upon the wife's death, Section 15402(b) provided that the annual exemption would not be allowable

In 1961 the inheritance tax law was amended to exempt all community propery (except life estates and powers of appointment in the husband's half) passing from husband to wife, and in conformance therewith, Section 15303(c) was also amended to subject to gift tax, as of the date of a husband's death, the remaining half of his separate property which he had converted to community property during his lifetime The 1961 Legislature, however, omitted to provide, as in the case of a decedent wife, that the annual exemption would not apply

The 1963 amendment corrects this oversight by amending Section 15402(b) to disallow the annual exemption upon such transfers regardless of which spouse is the decedent-donor

The text of the section is amended

15402 Neither of the following is within the exemption allowed by this article

(a) A future interest in property, provided, that no part of a gift to an individual who has not attained the age of 21 years on the date of such transfer shall be considered a gift of a future interest in property for the purposes of this subsection if the property and the income therefrom may be expended by, or for the benefit of, the donee before his attaining the age of 21 years, and will to the extent not so expended pass to the donee on his attaining the age of 21 years, and in the event the donee dies before attaining the age of 21 years, be payable to the estate of the donee or as he may appoint under an unlimited power of appointment

(b) Property subject to tax by virtue of the operation of subdivision (c), Section 15303 of this code

AMENDMENT OF GIFT TAX DETERMINATIONS BY REASON OF PRIOR GIFTS

Revenue and Taxation Code Section 15807 was amended to provide that when a gift tax is determined for a calendar year prior to those for which determinations have already been issued, the latter determinations may be amended to show the true amount of tax which would have properly been assessed had all determinations been made in proper sequence Under the old law the prior year's gift was treated as having been made in the last year for which a determination was issued

The text of the amended section·

15807. When the Controller makes an original, amended or supplemental determination for a calendar year which is prior to calendar years for which he has theretofore made final determinations, he may concurrently therewith, notwithstanding other provisions of this part, amend the determinations for the subsequent years to show the true amount of tax which would have been determined had all determinations been issued in the sequence in which the gifts were made.

PAYMENT OF GIFT TAX UNDER PROTEST

Revenue and Taxation Code Section 16251 was amended to delete the requirement that payment of gift tax must be accompanied by a protest as a condition to filing action for recovery of the tax.

Text of the section as amended·

16251 Within 60 days after notice of the determination of the amount of tax has been given by the Controller, any person who has paid the tax may file an action against the State in the superior court having jurisdiction to recover the tax so paid

PROBATE CODE

INHERITANCE BY PERSON WHO CAUSED DECEDENT'S DEATH

Probate Code Section 258 was amended to extend the circumstances under which a person who caused the decedent's death is barred from succeeding to any portion of the estate as heir or legatee Under prior law the only circumstances which barred the person from taking was his conviction of the murder or voluntary manslaughter of the decedent.

The text of the section as amended

258 No person who has unlawfully and intentionally caused the death of a decedent, and no person who has caused the death of a decedent in the perpetua-

tion or attempt to perpetuate arson, rape, robbery, burglary, mayhem, or any act punishable under Section 288, Penal Code, shall be entitled to succeed to any portion of the estate or to take under any will of the decedent, but the portion thereof to which he would otherwise be entitled to succeed goes to the other persons entitled thereto under the provisions of this chapter or under the will of the decedent A conviction or acquittal on a charge of murder or voluntary manslaughter shall be a conclusive determination of the unlawfulness or lawfulness of a causing of death, for the purposes of this section

CONSENT TO GRANTING PETITION TO HAVE EXECUTOR OR ADMINISTRATOR COMPLY WITH OPTION

The 1963 Legislature added Section 854 to the Probate Code which provides a procedure whereby an optionee of an option given by will may obtain a court order authorizing the executor or administrator to transfer property of the estate in compliance with the option The order cannot be made unless the court finds that the inheritance tax has been paid or a consent to entry of the order is obtained from an inheritance tax attorney.

The text of the new section·

854 When any option to purchase real or personal property is given in a will duly admitted to probate the optionee may petition the court for an order authorizing the executor or the administrator with the will annexed to transfer or convey such property upon compliance with the terms and conditions stated in the will

The clerk shall set the petition for hearing by the court and give notice thereof for the period and in the manner required by Section 1200 of this code

Such order shall not be made unless the court shall find that the rights of creditors will not be impaired or shall require bond in an amount and with such surety as the court shall direct or approve The order shall not be entered unless the court shall find that all inheritance taxes payable in said proceedings have been paid or the State Controller, and inheritance tax attorney or a subordinate inheritance tax attorney has, in writing, consented to the entry of the order by the court

The petition must be filed within any time limitations stated in the will, or, in any event, within six months after the issuance of letters testamentary or letters of administration with the will annexed, provided, however, that if any time limitation in the will is measured from the death of the testator such time shall be extended by the period between such death and the issuance of such letters but in no event to more than six months after such issuance

VII. BUSINESS TAXES ADMINISTERED BY STATE BOARD OF EQUALIZATION

John W. Lynch: Mr. Chairman and members of the committee: On behalf of the Board of Equalization, I welcome this opportunity of appearing before you for the purpose of discussing the taxes we administer. I will present the major features of each of the business taxes for which we are responsible and explain the importance of each tax as a revenue source. In the aggregate these taxes and license fees produce almost three-fifths of the revenue collected by the State of California Also, I will offer some suggestions for interim committee study that could lead to more effective and equitable administration.

I will present the tax programs in the order of their relative importance revenue-wise. Let me begin with the state sales tax and the complementary use tax, which together produced $813,587,000 in the fiscal year just completed These taxes accounted for more than two-fifths of all General Fund income.

A. SALES AND USE TAXES

The California retail sales tax, originally effective August 1, 1933, is a privilege or excise tax imposed upon retailers selling tangible personal property at retail Contrary to popular impression, it is not collected from the purchaser as a tax on him The retailer is required by law to state separately the amount he charges the purchaser by way of reimbursement for the tax But, according to the California Supreme Court, "The amount added because of the tax is paid to get the goods and for nothing else. Therefore, it is a part of the price."[1]

[1] *Western Lithograph Co. v. State Board of Equalization*, 11 Cal. 2d 166.

The measure of the tax is the "gross receipts" of the retailer. The law specifically defines "gross receipts," which constitute, in essence, the total amount of the agreed sales price As the tax is measured by "gross receipts," no deductions are allowed for the usual costs of doing business or expenses, deductions which are characteristic of net income taxes One exception is the bad debt deduction first authorized by amendment in 1957.

The subject of the tax—that is, the "sale" of tangible personal property at retail—is defined generally as the transfer of title to tangible personal property for a consideration The law, however, defines "sale" more broadly than the usual concept of sale Thus, under the law's definition, a "sale" includes not only the transfer of title to tangible personal property, but the "producing, processing, fabricating, printing or imprinting of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating, processing, printing, or imprinting" For example, if a person buys a bolt of cloth and takes it to a tailor who makes a suit from the cloth, the tailor's charges are taxable, even though he furnishes no material Similarly, a printer's charges for printing are taxable even though the customer furnishes the paper stock This provision is essential to prevent the breaking down of the tax base by the device of buying raw materials from one source and having the finished product produced elsewhere, and to prevent a competitive disadvantage to those merchants who sell a finished product as against those who specialize in fabricating or processing

A "sale" also includes by definition the transfer of possession of tangible personal property when the transferor retains title to secure payment of the purchase price, and the transfer of possession of tangible personal property produced, fabricated, or printed to the special order of the customer

To be a retailer subject to the tax, one must be engaged in the business of selling tangible personal property The law specifically defines a retailer Generally, the term encompasses any person making three or more sales in any 12-month period The term "person" includes corporations, partnerships, etc., as well as individuals The application of the tax is not limited to sales in the ordinary course of a business It applies to a retailer's sales of capital assets and to sales of any tangible personal property "held or used" in a selling activity

There are, of course, a number of exemptions Commencing with four exemptions in August of 1933, the number had grown to 23 immediately prior to the 1963 amendments to the law

For the first time, the Legislature, in 1963, cut back the number of exemptions It repealed the exemption of sales of meals by employers and employee organizations to employees and the exemption of food products to the extent that they are sold by "drive-ins" It also repealed a provision, adopted two years earlier, by which certain nonprofit organizations were considered to be consumers rather than retailers of certain classes of merchandise which they sold.

The principal statutory exemptions in the law today include sales of:

Food products for human consumption, except meals and sales at drive-ins,

Motor vehicle fuel subject to the gasoline tax;

Food-producing animals, seeds and annual plants, and fertilizer,
Newspapers and periodicals,
Aircraft for air carrier use or use outside the state by nonresidents;
Interstate watercraft, deep-sea fishing vessels, and component parts of each type;
Ice for use in interstate food shipments;
Gas, electricity and water for pipe or line delivery; and
Certain medicines for treatment of humans
They also include:
"Occasional sales," consisting of sales by nonretailers, property not held or used in a selling activity and not constituting a series of sales, and sales of entire businesses between entities having substantially similar ownerships;
Sales to the United States and its wholly owned agencies and instrumentalities,
Sales by certain charitable organizations, and
Sales to certain common carriers

In addition to exempt sales, nontaxable receipts include receipts from rentals not in lieu of sales, receipts from the installing or applying of the property sold, and, in some cases, charges for delivering the property sold

There are also certain organizations exempted from a sales tax because of provisions of the California Constitution or the United States Constitution Thus, banks and insurance companies, which pay an "in lieu" tax, are exempted from the sales tax as to sales by them The use tax, however, which is imposed directly upon consumers, applies to property purchased from banks and insurance companies

Assemblyman Carrell: Do you mean on occasional sales of property?

John Lynch: No, banks are exempt from sales tax. For instance if they go into the automobile leasing business, they buy the automobiles. Now, I want to confirm this with my attorney sitting right behind you This is true, isn't it, Ed? That the banks are exempt from sales tax on the property that they purchase?

Attorney Stetson: All banks under the California Constitution are exempt from any tax imposed directly upon them, except as provided by the Constitution and this is on their net income from real property, so the sales tax or the use tax cannot be levied directly upon a bank in California The bank, however, is required to collect the use tax from the buyer, and sales to banks are subject to sales tax which is levied on the seller, not on the buyer

John Lynch: But then if they go into the leasing business they get the property at a reduced tax

Attorney Stetson: Yes, if they buy the property under circumstances that would normally subject the buyer to use tax the bank would not pay any tax with respect to the new property either upon its acquisition or upon its leasing except in the case in which the lease is virtually or should we say, for all intents and purposes a fake Then the bank would be required to collect the use tax, but if it were an ordinary rental the amount in lieu of the sale if the bank acquired the

property from other than a California vendor, would escape taxation altogether

Assemblyman Stanton: Is it fair to say then that if the banks increase their activities in the leasing field it is apt to hurt the California business climate without the imposition of a subtax to equalize between out-of-state and in-state sales?

Attorney Stetson: I would say it would result in loss of revenue and in unfair competitive situation to other retail business

Assemblyman Stanton: This could hurt the California business climate . . .

Assemblyman Carrell: I would like to get this clear. Do you mean the things like a set piece of equipment? I don't know why automobiles come to mind I suppose it might be any kind of equipment or sales like fixtures, furniture, and so forth. If the bank buys this and leases it out, there's no sales tax, is that correct?

Attorney Stetson: That is correct, except where the lease is a long-term lease that might be considered in lieu of a sale.

Assemblyman Carrell: In other words, if it becomes a lease purchase?

Attorney Stetson: Yes, then the use tax would apply against the purchaser—the bank.

John W. Lynch: But if it were a legitimate lease, Mr. Carrell, there would be no tax It would have to be a lease in lieu of a sale.

Assemblyman Young. I don't quite understand that If a bank went into the leasing business, we will take automobiles for instance, and they purchased vehicles in California from a seller of vehicles here in California, then a sales tax would be paid?

Attorney Stetson: That is right.

Assemblyman Young: But if they purchased them in Detroit, there would be no sales tax.

Attorney Stetson: That is right, because the bank would acquire title outside California, pay no sales tax, and be exempt from the use tax.

Assemblyman Young: So by the simple device of purchasing outside of the State, they would escape the tax

Attorney Stetson: That's right

Chairman Petris: If Mr Carrell did that, he would have to pay, wouldn't he? If he bought an automobile out-of-state and brought it in, he wouldn't pay a sales tax, but he would pay a use tax?

John W. Lynch: Rental transactions, already mentioned, are of two types· those "in lieu of sales" and ordinary rentals· As receipts from ordinary rentals are not subject to the sales tax, the renting of merchandise which has rapidly expanded in recent years is only partially subject to the sales tax, the sale to the lessor being the final sale to which the tax applies When the lessor is also the manufacturer, the tax base is obviously drastically reduced The significance of the expanded rental business on sales tax revenues is emphasized by the recent entry of banks into the rental business

Assemblyman Carrell: Is this quite extensive now?

John W. Lynch: It is beginning When they can see a tax advantage, business rapidly moves in, as you know, so they are beginning to expand this operation.

Chairman Petris: What kind of rentals are they going into?

Attorney Stetson: Generally, equipment on long-term leases As far as our information goes, it is pretty largely various sorts of equipment on long-term leases

John W. Lynch: The use tax was adopted one month less than two years after the sales tax went into effect It was a virtual necessity to avoid loss of business and the sales tax generated by such business, which was being diverted to tax-free states, along California's border and elsewhere For the most part, the use tax has the same exemptions as the sales tax, so that it is, in effect, a complementary tax applying to property purchased for use in California from out-of-state sellers, or from California sellers who are exempted from a tax imposed directly upon them, as in the case of banks and insurance companies

Unless their rentals are in lieu of sales, so that their purchaser must pay the use tax, no sales or use tax will be due on these transactions because the bank, as lessor and legally the consumer, is exempt from a use tax normally applicable to lessors who purchase the property outside this State or in interstate commerce Although the sales tax would apply to sales in California to the banks, much of the property to be leased would undoubtedly be purchased outside the State, with sales tax avoidance not an unlikely motive

The ownership of personal property by a bank for use in a leasing business will also create property tax problems at local levels of government. Under the in-lieu provisions of the Bank and Corporation Tax Law and Section 16 of Article XIII of the Constitution, banks are exempt from tax on personal property Accordingly, unless legal support can be found for taxation of the property to the lessee, the property will escape taxation for the support of local government

Local Sales and Use Taxes

Commencing April 1, 1956, a tax innovation came into being with the advent of the Bradley-Burns Uniform Local Sales and Use Tax Law This law authorizes counties to impose a sales and use tax to be administered by the board, and permits cities to have their sales and use tax ordinances administered by the board, provided the ordinance of the county or city conforms to the requirements of the Bradley-Burns Law This law requires that the county ordinance be at the rate of 1 percent, and that the city ordinance be at the rate of 1 percent or less The city tax constitutes an offset against the county tax so that the taxpayer always pays 1 percent If the city tax is less than 1 percent, the difference goes to the county on sales made within the city

For uniformity purposes and convenience to retailers, the place of sale for the purpose of the local tax is declared by the law to be the place of business of the retailer The local ordinances are required to provide the same exemptions contained in the State Sales and Use Tax Law with two in addition One of these relates to sales tax on sales to common carriers and waterborne vessels, and the other to use tax on purchases by public utilities subject to regulation by the Public Utilities Commission These exemptions complicate administration of the local ordinances. While there was some basis for them prior to the time

all of California's 58 counties adopted local sales and use tax ordinances, it would seem that these exemptions are now unwarranted

Effect of Exemptions on Sales Tax Revenues

Exemptions reduce state and local revenues by hundreds of millions of dollars a year No attempt will be made here to estimate losses in sales and use tax revenues resulting from exemptions or exclusions from the laws All that I wish to do at this time is to discuss (1) the effect exemptions have on administration, (2) the burden they place on the merchants who are required to collect or reimburse themselves for the tax from their consumers, and (3) inequities created by exemptions

Much of the following discussion will be pertinent to all of the taxes that I will be covering Experience demonstrates that generally broad-based taxes using lower rates tend to be more equitable than narrow-based taxes with higher rates Exemptions reduce the base Consequently, higher rates are required to produce a given amount of revenue Once an exemption is adopted, efforts are made to enlarge its scope Experience has produced the expression "exemptions beget exemptions " When individuals and businesses can choose between items subject to tax and those not subject to tax, manipulations result which invite pressures from others for a broadening of exemptions to eliminate unfair competition

In 1933, when the tax was first adopted, all food was subject to sales tax In 1935, food for home consumption was exempted from the tax on the grounds that to tax food made the sales tax excessively regressive The original food exemption covered only food In 1940, it was enlarged to include food-producing livestock and poultry This, in turn, was further expanded in 1943 to include animal life for food production Exemptions were also provided for feed for food-producing animals, and seeds, annual plants, and fertilizer for food production Two years later an exemption was provided for ice used to preserve food during interstate shipments, and nine years later this exemption was further broadened to include dry ice

Not only do exemptions reduce the amount of revenue that the state and local jurisdictions can realize from sales taxes, but they also increase the cost of administration The board is required to establish through audit the validity of exemptions claimed by taxpayers The auditing process is expensive because it involves examining records of merchants By the same token, exemptions increase the merchants' cost of doing business since they must maintain adequate records to support any exemptions that they claim This cost must necessarily be passed on to consumers

The consumers are not only required to pay for any extra records that merchants must maintain to substantiate claimed exemptions, but they also are plagued with the confusion which an excessive number of exemptions invariably creates The average consumer does not have adequate knowledge of what is and what is not taxable, so he cannot determine if he is being properly taxed At times a shopkeeper finds it virtually impossible to make a proper decision as to whether a particular item is taxable There are areas where considerable doubt exists.

To illustrate, let me call your attention to the situation with respect to the sale of fertilizer The housewife goes into a grocery store or a nursery to purchase a package of commercial fertilizer The merchant should inquire at the time of the sale whether the fertilizer is to be used for growing vegetables or flowers This information is necessary because fertilizer used for growing food is exempt from sales tax while fertilizer used for the growing of flowers is subject to sales tax This situation also applies in the case of sales to farmers If a farmer is utilizing fertilizer to produce food for human consumption, the fertilizer is exempt from tax When fertilizer is used to produce hay for race or work horses, the question of whether it is subject to tax would depend upon the use to which the hay will ultimately be put Hay grown primarily for the feeding of racing horses would be subject to tax, while that used for feeding cattle would be exempt Food for human consumption is exempt, but food supplements are subject to tax Milk products are exempt, but when chocolate is added creating a confection, the tax applies Salt for brine used to cure olives is subject to tax because it is consumed in the curing process, but olives are not subject to tax If, however, the olives were sold in the brine, neither the brine nor the olives would be subject to tax These examples may sound farfetched yet there are literally thousands of such decisions that merchants in the food business must make daily

The foregoing discussion does not represent an argument for either the elimination or retention of any exemption These examples are given to call your attention to the adverse effect of exemptions on the tax base, on the cost of administration, and on the reporting burdens of taxpayers, as well as to the confusion they create for the sellers and purchasers of tangible personal property

I have already mentioned that the 1963 Legislature was the first one to cut back the number of exemptions This action has increased the State's sales tax base by almost $450,000,000 a year This will produce $13½ million of additional sales tax revenue yearly for the State and one-third this amount for cities and counties

The elimination of the exemption of food for off-premises consumption was restricted to drive-ins This restriction may place some drive-in operators at a competitive disadvantage with respect to Chinese restaurants, pizza houses, and other establishments that can sell prepared food for off-premises consumption without having to charge a sales tax This situation points up the fact that exemptions often create an advantage for one group at the expense of another Your committee may find it profitable to review all of the present sales tax exemptions in the interest of equity and sound administration

Despite all of the exemptions and other complications inherent in sales and use tax administration, the board is able to collect these taxes at an expenditure of $1 53 for each $100 of collections

Assemblyman Carrell: I would say that business does more of the collecting than you do

John W. Lynch: That's true, but business might not collect so much unless we were watching

Assemblyman Stanton: Does business absorb the cost of this collection, or is it passed on?

John W. Lynch: The tax itself is collected by the businessman and then sent on to us But as far as recordkeeping is concerned he gets no benefit from us.

Assemblyman Stanton: What I am suggesting—the cost of the collection may well be passed on to the consumer, and if we are going to have a rebate, we might have a consumer rebate, too

John W. Lynch: I would say that the cost of collecting a sales tax is comparable to the cost of paying your income tax If a businessman doesn't have his prices high enough to pay his income taxes, he's not going to stay in business, and the same with his property taxes He's got to sell his product at a sufficient price to pay his taxes, and pay himself a profit, or else he doesn't last very long

Assemblyman Stanton: Is it fair to say then that such an attempt to compensate people for collecting the taxes would not only be inefficient but in all probability inequitable?

John W. Lynch: It would be inefficient, inequitable, and terribly costly.

Assemblyman Carrell: Why would that necessarily be so, if the State had to collect it themselves, it would certainly be more costly than it is this way.

John W. Lynch: Well, in one way we have about 400,000 licensees and permitees I will grant you that spreading the cost among them is far cheaper than it would be if we had to collect those taxes That's my private opinion In fact, Mr Carrell, there are some states where these taxes, even the gasoline taxes, are collected by the service station, the man at the pump, and the State loses a terrific amount of revenue We do it the other way We collect from the producer, and he is responsible

Assemblyman Carrell: It is on his gross business, is it not? It is not a consumer tax as such

John W. Lynch: You mean our sales tax

Assemblyman Carrell: Yes

John W. Lynch: It is a privilege tax for the right to do business; it wasn't until the 1961 Legislature we ever had an official statement of what the chart . . before that, we had no business with the charts It isn't a tax, it's a privilege fee. To continue.

B. HIGHWAY-USER TAXES

During the fiscal year just ended, the three highway-user taxes administered by the board produced gross revenues of $415,438,000 at a cost of $2,035.712, or 49 cents per hundred dollars of revenue Under the State Constitution, this revenue is earmarked for construction and maintenance of California's extensive system of highways, county roads, and city streets

Gasoline Tax

The Motor Vehicle Fuel License Tax Law is popularly known as the "gasoline tax" law This tax is for the privilege of distributing motor vehicle fuel Effective October 1, this tax was raised from 6 cents to 7 cents per gallon.

The fuel tax is collected from refiners or importers of the gasoline on practically all of the fuel they distribute in California. The tax, how-

ever, is passed on to the ultimate consumers who use the gasoline for the propulsion of motor vehicles on the highways of this State The only exemptions from the tax on the original distribution are

(a) Fuel exported from this State,

(b) Fuel sold to the United States armed forces for use in ships or aircraft or for use outside the State, and

(c) Fuel distributed to other licensed distributors under specified conditions

Otherwise, the distributor is required to report and pay tax on distributions of gasoline even though the fuel is not ultimately consumed on highways The statute provides that a person who has the right to a refund may file his claim with the State Controller For example, if you buy gasoline at a service station for use in propelling your motor boat, the amount of the gasoline tax is included in the price which you pay, but you may file a claim with the Controller for refund of this tax, less the amount due for sales tax

The gasoline tax is administered by the Board of Equalization, but the State Controller handles claims for refunds for gasoline not used on highways and is responsible for collection of tax delinquencies

In the 1962-63 fiscal year, the gross revenue from the gasoline tax was $376,981,000 The cost of administering this tax amounted to only 25 cents for each $100 collected

The apportionment of money from the Highway Users Tax Fund to local government is made by the State Controller in accordance with complex formulas as provided in the Streets and Highways Code

Diesel Fuel and LPG Taxes

The board is responsible for the entire administration of the Use Fuel Tax Law This is basically a user's tax on diesel fuel and liquefied petroleum gas (LPG) consumed in the propulsion of a motor vehicle on the highway Since almost 90 percent of these fuels are used for non-highway purposes, the tax, from its inception, has been reported and paid to the State by the person who uses the fuel

This tax is now collected from the user by the vendor at the time he pumps the fuel into the tank of a motor vehicle The vendor is required to give the user a receipt covering the transaction at the time of sale. The vendor then remits the tax to the State periodically Despite prepayment of the tax, the user must file a monthly return showing the amount of fuel which he consumed and the amount of tax paid to vendors

Prior to 1959, the highway users tax on liquefied petroleum gas consumed on the highways was collected under the gasoline tax statute. The tax on these products used for highway purposes was placed under the Use Fuel Tax Law along with diesel fuel in October 1959

Until several days ago, the rate of the tax on LPG was 6 cents a gallon Effective October 1, 1963, this tax was increased to 7 cents per gallon Liquefied petroleum gas taxed under the Use Fuel Tax Law is exempt from the state and local sales and use taxes, but diesel fuel is subject to the sales tax even though it is taxed under the Use Fuel Tax Law

This statute provides that no fuel tax is to be imposed upon diesel oil or LPG used in a motor vehicle when it is operated exclusively off

the highway However, the law states that if the distance in the operation of a vhicle which is partly off the highway and partly on the highway in a continuous trip exceeds one mile, the tax does not apply to fuel used in the operation off the highway in excess of one mile There is also a specific exemption for fuel used in the propulsion of agricultural equipment which is only incidentally moved upon a highway. Furthermore, no fuel tax is imposed on fuel used to run vehicles of a public agency operated over a highway constructed by the United States within a military reservation

The vendor collects the tax when he delivers the fuel into the fuel tank of a vehicle But a consumer whose use of fuel is exempt because his operation is exclusively off the highway may be authorized by the board to purchase fuel without the payment of the tax to the vendor. Also, certain persons who are engaged in interstate travel partly in California, and who purchase more fuel in this State than they use here, may secure authorization to purchase the fuel without paying the tax to the vendor This would be the case where the user purchases in this State quantities which would consistently result in payment of more tax than was due California Such purchasers report to the board the fuel which they use in motor vehicles while operated on California highways and pay the tax directly to us.

Of course, diesel fuel and LPG consumed by motors and equipment not operated on the highways are exempt from the use fuel tax The statute has no application to fuel used in that manner; for example, fuel consumed in railroad diesel motors or in various types of stationary motors

The tax on diesel and LPG fuels produced $24,081,000 in the past fiscal year

Motor Vehicle Transportation Tax

The board administers the Motor Vehicle Transportation License Tax Law, which imposes a tax of 1½ percent on gross receipts derived from engaging in the transportation of persons or property for hire or compensation by or upon a motor vehicle over the highway Every person who desires to become an operator and whose receipts will be subject to this tax, must apply to the board for a nonrecurring permit at a fee of $5. In addition, operators are required to obtain appropriate emblems from the Department of Motor Vehicles for display on vehicles used in operations subject to the tax Taxpayers are required to file monthly tax returns with the board along with remittances made payable to the State Controller, who has the responsibility for collecting tax delinquencies

A number of persons are excluded from the taxable classification of operator There are some exclusions from taxable gross receipts, and there are several exemptions which, added together, make this a patchwork revenue statute which has been criticized as discriminatory and inequitable

The term "operator" excludes any person who transports his own property in a motor vehicle owned or operated by him, unless he makes a specific charge for transportation This means that "not-for-hire" carriers do not pay this tax Six other exclusions are enumerated in Section 9603 3 of the Revenue and Taxation Code

The receipts of an express company derivde from the shipment of property over the lines of common carriers are excluded from the tax, but receipts derived by an express company from the transportation of property in motor vehicles operated by it are subject to the tax.

Taxable gross receipts on transportation crossing the California state line are prorated using the ratio of California mileage to total mileage

The transportation tax is not applicable to the gross receipts from the transportation of persons or property wholly within incorporated cities, between incorporated cities, between incorporated cities and private property, or wholly on private property where no portion of the highway outside the limits of the cities or private property is traversed On the other hand, if any part of the operation is over any highway outside the limits of the cities or private property, the tax is applicable to the entire gross receipts for the transportation performed both within and outside the city or private property limits

There is an exemption from the tax for passenger stage corporations whose motor vehicles are operated exclusively in urban or suburban areas, or between cities in close proximity If the one-way route mileage of any line of such a corporation exceeds 50 miles, the gross receipts from the line which exceeds 50 miles shall be subject to the tax Also, if a city imposes a tax franchise, or fee measured by gross receipts derived from the transportation of passengers, and the operator engages in the transportation of passengers partly within and partly without the city, the state transportation tax does not apply to the portion of the gross receipts attributable to operations in the city and which are included in the measure of the city tax

The transportation gross receipts tax produced $14,142,000 of gross revenue for the State during the 1962-63 fiscal year The cost of collecting this amount exceeded one million dollars, or $7 09 for each $100 of collections This cost ratio is almost 30 times as great as that involved in the administration of the gasoline and use fuel taxes

Suggestions for improving the transportation gross receipts tax have been touched upon in many of the board's annual reports Here are some of the more important areas that need study before this tax can be made an effective revenue source

(a) Certain exemptions from the transportation tax create severe problems in its administration, thereby increasing administrative costs These exemptions basically are inequitable and no longer justified in view of the State's increasing participation in providing funds for street and highway construction within cities

In 1933, when the first gross receipts tax on highway carriers was enacted, there were reasonable grounds for the exemption of operations exclusively within the cities as they did not share in the State's highway user taxes Since primary city streets and state highways within cities are now supported by these state taxes, there is no justification for continuing the exemption in the present law

(b) The exclusion from "gross receipts" of express company revenue derived from the shipment over the lines of common carriers results in preferential tax treatment of a small group of very large motor carriers operating in conjunction with affiliated express companies to which substantial portions of their transportation receipts are diverted Other carriers performing the same services but not

favored with an express company certificate are compelled to pay the tax on their total gross receipts and thus are placed under a competitive handicap

Elimination of express company and "in-city" exemptions would remove serious inequities in the tax

C. INSURANCE TAXATION

Taxes imposed upon insurers, unlike other state excise taxes, are prescribed in the California Constitution Moreover, the constitutional provision specifies that the taxes provided shall be in lieu of all other taxes and licenses, state, county and municipal, except taxes upon real estate, and in certain cases, motor vehicle license fees, and taxes applicable to the trust business of a title insurer

Ocean marine insurers are taxed at the rate of 5 percent of that portion of their underwriting profit attributable to California in accordance with a prescribed formula Insurance companies transacting general insurance are taxed on a percentage of gross premiums received minus return premiums and dividends paid Revenues derived from the taxation of ocean marine insurance are relatively minor and amounted to only $44,000 in 1962 as compared to $77 million from premium taxes

The rate of the tax imposed upon premiums has been 2 35 since 1947, with the exception of premiums received with respect to qualified pension or profit-sharing plans for employees These premiums are taxed at an annually declining rate, dropping from 2 35 in 1959 to a floor of 1 percent for the year 1965 and thereafter.

Heretofore, insurance taxes have been collected annually in the year following the base year in which the business was done As a result of legislation enacted at the 1963 Special Session, the premium tax will be collected quarterly on a "pay-as-you-go" basis Conversion to a complete quarterly installment system is to be made over a transition period up to 1967 Each year beginning in 1964, one quarterly installment, called a "prepayment," is to be added by a schedule to the regular annual payment timetable For business done in 1967 and thereafter, prepayments will be made 75 days after the close of each calendar quarter For the years 1964 through 1967, the tax rate is reduced from 2 35 to 2 33 percent, but will again return to 2 35 percent for 1968 and thereafter

Insurers, other than ocean marine, are permitted under the Constitution to deduct from their insurance taxes the amount of payments they make for real estate taxes paid on property they own upon which their home or principal office in California is located This allows for a sizeable reduction in premium taxes, which amounted to $4 8 million for the year 1962 The principal office deduction has been growing at a faster rate than the tax against which it is taken

The duty of administering the insurance tax is divided among three agencies The Constitution specifies that the tax be assessed by the Board of Equalization However, under the statutes, insurance companies make an initial assessment and file their tax returns and remittances with the Insurance Commissioner The Controller is responsible for keeping accounts of assessments and payments and instituting such collection suits as may be necessary Examinations to verify the

accuracy of reporting is done by the Insurance Commissioner, who proposes any deficiency assessments to the board The board passes on petitions for correction of amounts assessed and claims for refund

Another unique feature of the insurance tax is the socalled retaliatory tax abandoned by California in 1945 and reinstated in 1959 When a state discriminates against California companies as compared to its own companies, California retaliates by taxing companies of the other state to the same extent that California companies are taxed by that state

Several features of insurance taxation may be ripe for study and possible change by the Legislature

The principal office deduction, which has for many years been called by some a major loophole in the structure of insurance taxation, will bear serious study Possibly it should be completely eliminated or at least limited to the actual portion of the real property occupied as a principal office by an insurance company Many principal office buildings are skyscrapers, relatively small portions of which are occupied by the owning insurance companies The rest of the building space produces rental income

The administration of insurance taxes, split as it is among three agencies, complicates the taxing process and leads to misunderstanding on the part of taxpayers as to what is expected of them Some study could be made of methods to improve the overall administration of this tax

A more difficult area is the analysis of the tax burden borne by the insurance industry as compared to other business A premiums tax standing by itself fails to include investment income Furthermore, the "in lieu" feature of the tax at this date, when the activities of insurance companies are more diverse than in earlier years, might bear close scrutiny.

D. CIGARETTE TAX

In 1959, California joined an almost unanimous roll of states that impose a tax upon cigarettes The tax is levied upon distributions at the rate of 1 5 mills per cigarette or 3 cents per package of 20 A distribution of cigarettes is defined in the law as a sale or a use or consumption The net yield of this tax to the General Fund for the 1962-63 fiscal year was more than $70 million

The structure of the cigarette tax is basically that of a sales tax collected at the wholesale level A protective use tax feature is included for cigarettes coming into California as direct shipments to consumers in quantities of more than one carton at a time

Persons who engage in the sale of cigarettes as distributors are required to be licensed and must furnish bonds to the State The tax is collected through the use of stamps and printed indicia which the licensed distributors must affix to each package prior to distribution. The distributors purchase stamps or machine meter units for cash or on credit protected by bond The State Board of Equalization supplies the stamps and arranges for the machine meters to be set and sealed at over 50 banking offices strategically located throughout California. Funds received at the banks immediately go into a State Treasury account.

Distributors are allowed a 2-percent discount when they purchase tax indicia This is a compensating factor against their cost of affixing the stamps or metered impressions This operation is done by machines which open the cartons stamp the packages and reglue the cartons

Exemptions are few There are the usual ones required by the United State Constitution such as sales in export, interstate and foreign commerce sales, and sales by certain federal instrumentalities Also exempt are sales to military exchanges, commissaries, ships' stores and the Veterans Administration Manufacturers may give away tax-free sample packets of five or less cigarettes They also are not taxed on their sales to licensed distributors The California Veterans' Home may obtain federally tax-free cigarettes without the state tax applying.

California now has one of the lowest cigarette tax rates of the several states Arizona and the District of Columbia tax at 2 cents per package and Kentucky at 2½ cents Two other states have the same rate as California All other cigarette tax states now impose their taxes at from 4 to 8 cents per package with the majority in the higher brackets

Discounts allowed distributors amounted to about $1½ million in the 1962-63 fiscal year The cost of stamps consumed in the operation amounted to $338,000. The board administered this tax, including the cost of stamps and bank services but excluding discounts, for 73 cents per $100 of revenue collected

Several bills brought before the Legislature in recent sessions have raised the question of whether the cigarette tax should be collected by the stamp system or a reporting system unassisted by stamps. The committee is thoroughly familiar with these issues Another problem that the committee may desire to study—because it has been raised in several bills—is the discount rate allowed distributors if a stamp system is to continue.

California allows distributors a discount that may be equated to 36 cents per case of 60 cartons Other states allow stamping discounts ranging from 48 cents per case to $2 70 per case Some have graduated scales depending upon stamping volume In any event, before a change is made in the present discount rate, the Legislature should attempt to obtain reliable data as to actual stamping costs, administrative problems of a graduated system, and the effect of various discounts upon the competitive positions of distributors

E. ALCOHOLIC BEVERAGE EXCISE TAXES

The Alcoholic Beverage Tax Law, like the Motor Vehicle Fuel License and Use Fuel Tax Laws, uses gallonage as the measure for the taxes which it imposes The taxes on distilled spirits, wine and beer are levied on the sale of those products in California and are paid by nearly 1,100 manufacturers, wholesalers and importers In addition, there are 700 permittees and other accounts such as common carriers and warehousemen who are required to make periodic reports to the board

The beverage taxes are distinct from the fees paid for licenses to the Department of Alcoholic Beverage Control and are in lieu of all local taxes on the sale of alcoholic beverages, except the state-administered local sales tax.

The tax on distilled spirits is at the rate of $1.50 per gallon, but when the strength of the spirits exceeds 100 proof, the tax is at double that rate. The tax on beer is at the rate of 4 cents per gallon. There are several rates on wines. Table wines are taxed at 1 cent per gallon. Still wines of more than 14 percent alcohol by volume are taxed at 2 cents per wine gallon. On champagne and other sparkling wines, except sparkling hard cider, the rate is 30 cents per gallon. Sparkling hard cider is taxed at 2 cents per gallon.

Exports are exempt from the tax, as are certain sales of alcoholic beverages for industrial uses. Beer consumed by employees of a brewery upon the brewer's premises and sales of beer to certain military and naval instrumentalities are exempt.

The State excises imposed on alcoholic beverages produced a total of $58,800,000 during the 1962-63 fiscal year. Of this sum, over $48 million was generated by distilled spirits distributions. Beer sales produced almost $10 million, and the remaining $800,000 of tax came from the sale of wines.

The ratio of administrative cost to alcoholic beverage excise tax revenues is estimated at about 40 cents per $100 of collections, well below the ratio for all business taxes.

F SUBSCRIPTION TELEVISION TAX

The newest of the taxes administered by the board came into being as a result of legislation enacted in the 1963 Extra Session. A tax of 1 percent for the State and 1 percent for cities and counties was imposed upon the gross receipts of closed circuit subscription television businesses. The tax is to be collected quarterly. The local portion is "in lieu" of all other taxes or fees imposed by a local agency upon a subscription television business entity for the privilege of exercising any franchise or engaging in business.

Telephone and telegraph companies subject to regulation by the State Public Utilities Commission are exempt from the tax when they furnish transmission channels for television programs of a subscription television business. Community antenna systems and educational television systems are also exempt.

Presently there are no closed circuit subscription television systems in day-to-day operation in California. At least one company now in the process of formation and organization has announced plans for closed circuit pay television for Los Angeles and San Francisco.

The new legislation is in need of some technical clarification and additional administrative provisions. The board's staff is gathering the technical information necessary to draft proposals for amendments to the act. We expect to present these to the Legislature at the 1964 Budget Session.

One aspect of the tax which you may desire to look at as a matter of legislative policy is that the present law taxes only subscription television that is transmitted by means of closed circuits. Information that we have obtained so far indicates that there are probably three feasible methods of transmission of subscription television and these may be in competition with each other for the potential pay television market.

The first system is the one clearly taxed by the legislation, where transmission of the signal is by means of coaxial cables strung to each subscriber's television receiver This is a closed circuit transmission

A second system, not taxed under the legislation, would be transmission of the signal in a scrambled form over the regular broadcast transmitters A subscriber has an unscrambler attached to his receiver and pays for the programs for which he uses the unscrambler A nonsubscriber can receive the scrambled picture on his television receiver but cannot tune it into an intelligible picture

The third system is a hybrid where the video signal is broadcast by a regular transmitter which anyone can receive with a television receiver However, the audio portion of the signal is omitted from the broadcast A subscriber receives the audio portion through a special connection made over existing telephone wires This is partly open circuit and partly closed circuit transmission

CONCLUSION

This completes my description of the business taxes that have been assigned to the State Board of Equalization Together, they will produce over $1½ billion in taxes for the State in this fiscal year and $275,000,000 for our cities and counties We will continue to administer each tax to the best of our ability The protection of the tax base of each of the several taxes is a legislative responsibility

A proposal has been made that a small booklet be printed and supplied to each person going into business The booklet would explain the tax requirements of employers, retailers and men in other types of businesses. The booklet would also explain briefly the benefits received from tax money The proposal has been favorably received and may be acted upon

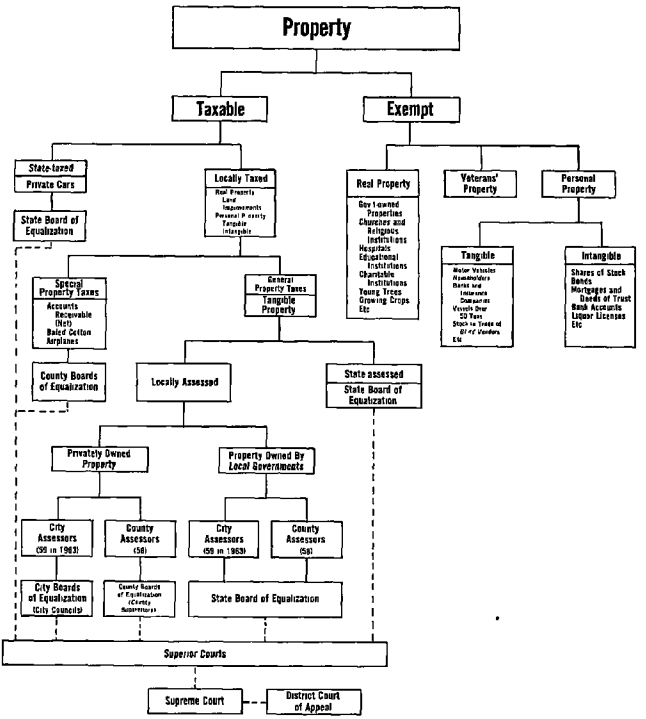
The board and its staff stand ready at all times to serve your committee in its endeavors to appraise the present tax structure and to find effective means of furnishing the revenue necessary to provide a high quality of services to California's steadily growing population To devise and maintain a revenue structure capable of efficient administration and one that will spread the tax burden in a reasonably equitable manner is a real challenge I am sure this committee is equal to that challenge Thank you.

VIII. PROPERTY TAXATION

Ronald Welch: Mr Chairman, members of the committee I was born and raised in a midwestern state that has contributed considerably to the expansion of California in recent years I am from a family of very modest means, and I suppose the modesty of our means was evidenced partly by the fact that until I went away to college, I slept in a homemade nightshirt This used to bother me a bit as I got along in years, I guess because I used to dream that I had gone to school in my nightshirt This morning I am here in my nightshirt I don't have a prepared paper I did, however, prepare a rather odd little diagram that I thought might help to organize my remarks Not having a prepared paper, I suppose it may be taken for granted that I am speaking for myself and not for the board Also, I think it goes without saying that I would welcome interruptions at any time They won't throw me off stride

Chairman Petris: Fine Will the members please take note?

Ronald Welch: In order to place myself in the proper context, I would like to say that our board has two major subdivisions for the conduct of its statutory and constitutional duties; one of which we refer to as our business tax department, the other the property tax department We have an assistant secretary in charge of each of these departments, and I am in charge of the property tax portion of the board's work Most of the property tax work of the board is performed under constitutional directives, and this distinguishes it rather sharply from the work of the other part of the board which operates mainly under statutory directives. This is a matter of some interest to govern-



ment reorganizers The property tax portions of the Constitution are found largely in Article XIII, Section 1 which begins with a rather basic concept of taxation of property in the State of California The exact words are "All property in the State except as otherwise in this Constitution provided, not exempt under the laws of the United States shall be taxed in proportion to its value " The chart I passed around begins with this basic concept of property which really means anything that is capable of private ownership, and is of value Property has two major subdivisions as indicated on the chart, looking at it from a property tax standpoint, exempt property and taxable property I would like to spend my first few moments on the exempt portion of the aggregate or property in the State

Chairman Petris: Before you go into that, would you mind giving us a little more detail on the constitutional basis for all of this. You

mentioned Article XIII and the full cash value requirement We all know that no one uses full cash value I know that there are some lawsuits pending now Would you comment on this?

Ronald Welch: Yes Section 1 of Article XIII says that property should be taxed in proportion to its value But there is another section of the Constitution, it's Section 12 of Article XI which says that all property shall be assessed for taxation at its full cash value It is obvious that the people when they adopted this Constitution expected property to be assessed at full value The statutes also provide for full value assessment, and then taxation in proportion to that full value However, over the years, the practice of assessing at a fraction of full value has developed to a point where many people, perhaps most people, don't even realize that the law seems to contemplate that the assessment shall be the full value

Assemblyman Carrell: You say full value Now what is the value of this table?

Ronald Welch: This has been defined in the statute, and it has been interpreted by the courts on numerous occasions, and speaking in a very general fashion, full value is what a property can be sold for

Assemblyman Carrell: When you come right down to it, who will buy it in the first place

Ronald Welch: I am sure it can be sold for something, Mr Carrell, and the process of finding out what it can be sold for is the job of the assessor It is a very difficult job as you are well aware

Assemblyman Carrell: How do you know full value when you are assessing? When you arrive at an assessed valuation, isn't it only 25 percent of this full value, anyway?

Ronald Welch: Well, there is a large professional group known as appraisers whose stock and trade is the ascertainment of what property can be sold for They have a pretty good body of knowledge surrounding their professional activities, and while I am sure no two people will agree precisely as to what a piece of property is worth, with possibly the exception of a few commodities that are traded actively on a commodity market or stock market, a fair degree of uniformity and agreement might be found among appraisers

Assemblyman Carrell: It's more or less the uniformity than it is an arbitrary decision When you say on full value, you don't really know if it's full value

Ronald Welch: I suppose one doesn't know anything for certain, but I think I know this with considerable degree of certainty that it is not assessed at full value, and I believe that almost anybody that would ask about it would agree that property is not assessed at full value, except in unusual circumstances Of course, some properties are, but most are not

Assemblyman Alquist: What did you think of Professor Davisson's suggestion yesterday that our tax assessors should be appointed by the State, rather than at the county level?

Ronald Welch: Well, I have never advocated this, Mr Alquist, and I have never really been very sympathetic with the idea

Assemblyman Alquist: It would produce more uniformity in assessment practices, wouldn't it?

Ronald Welch: I suppose it would There would be a price to be paid for the uniformity, and I am not at all satisfied that we are ready to pay that price The price would be a high degree of centralization of the function of property tax assessment It could be done You realize, of course, that if the State were to do this, that we would have to decentralize our operations because the subject matter of our operations would be highly decentralized When we got through, it wouldn't be terribly different than having given it to a county assessor Personally, I am kind of a small town boy, and I blanch a little bit at the idea of an agency having as much power as this would give to the state agency to which it was assigned That arises simply from the fact that property values, as Mr Carrell indicates, are exceedingly difficult things to arrive at, and there is a considerable degree of arbitrariness involved, as Mr Carrell suggests To me, it has a little different flavor than the assessment of an income tax by a state agency

Assemblyman Carrell: How about the inheritance tax appraisers? That is a statewide operation

Ronald Welch: Yes, but of course they operate on a very small amount of property in any one year as compared with the property tax. I don't know how much their appraisals might amount to in the aggregate but it is certain a minor part of the property of the state

Assemblyman Carrell: But they actually do operate locally, really they do

Ronald Welch: Yes, they really do

Assemblyman Carrell: They operate under local situations

Chairman Petris: To get back to the constitutional matter, you said that the Constitution has a full cash value requirement, and that over the years we developed this other system Just how was this developed, and why? Can you give us some idea?

Ronald Welch: I think they probably deviated in the first instance mainly by reason of the fact that the State was deriving most of its revenue in those days from the property tax, and any county which could assess at less than other counties could gain an advantage in terms of payment of the state tax Now, this at least was one of the important pressures that were placed upon assessors I think, however, there is probably another explanation of fractional assessment which is more important than that I say this without intending to reflect upon the integrity of county assessors because I have said if I were a county assessor I'd do the same Anyone assessing property has a strong impulse to play it safe which *means you don't go over the requirement* of the law, and you tend to go under it But, even if you were appointed, this would be a powerful influence on you, I believe Because the complaints are less If people think that they are supposed to be assessed at full value, and you actually assess at 80 or 90 percent of full value, those people who happen to get the 80 to 90 percent assessment are not going to complain They can only worsen their situation in their opinion But as one of the speakers yesterday pointed out, if the generality of property is assessed at something less than 80 to 90 percent for which you are assessed, you are actually being discriminated against, but you are unaware of it This is a powerful influence on assessors to reduce their assessments below the full value standards And then another influence, which I think may be even more important

than this one is the fact that over the years we have had inflationary effects, as you well know, and it is hard to raise assessments. The tendency is to keep assessments more or less stable but the values go up with inflation, and soon you find yourself at well below the full value standard This happened during the war During the 1930's, the late 1930's according to the studies that I have seen, we were assessing at something like 50 percent of full value In the postwar period we've been in the neighborhood of one-third, in the immediate postwar period in the neighborhood of one-quarter—that is in the more recent years since the inflation was generated by the Korean incident I am sure I haven't exhausted the reasons for this I think I have given you the major reasons As you suggested, Mr Petris, this matter has been in court recently, and the court has sustained fractional assessment as of the moment It's on appeal to the Supreme Court, and what will happen there, we do not know

Assemblyman Carrell: What does the Board of Equalization do on this assessment problem? Where do they assess?

Ronald Welch: The State Board of Equalization assesses several types of property as you are well aware We assess railroads, telephone and telegraph companies, gas and electric companies, and a few less important groups The state board, according to the state assessees, assesses these properties up in the area of 45 percent I would not try to place it precisely because I don't know The board itself makes the judgment as to what the full value is From this they derive an assessed value, and there is no——

Assemblyman Carrell: Well, doesn't the Constitution say something about equality of——

Ronald Welch: Yes, sir Section 14

Assemblyman Carrell: Are you then on legal grounds when you say you assess at 45 percent, and the counties are assessing at 25 percent?

Ronald Welch: No, we would not be It would have to be established in a court of law, of course, as to whether these figures are accurate

Assemblyman Carrell: You are not actually equalizing your assessments with the county, are you?

Ronald Welch: No

Chairman Petris: I think if there is any question there, Tom, the utility attorneys would have explored it thoroughly before this

Ronald Welch: To return to the outline I wanted to say just a few words about exempt properties You are going to hear more about one type of exemption later today, and I won't spend any time at all on the veterans' exemption, other than to point out that I have placed it in between real property and personal property for the simple reason that it applies to either kind of property I have listed a few of the more important types of real property which are exempt and some of the more important types of personal property It is of interest to me that real property can be exempted only by constitutional action Personal property, however, can be exempted by action of the Legislature, two-thirds of the members of both houses voting in favor of the exemption Going over to the taxable portion of the chart, we have a single type of property which is taxed by the State It is known as

private cars It refers to railroad cars owned by other than railroad companies It is a rather unimportant source of state revenue, and so I will dismiss it quickly and go to the locally taxed property Virtually *all* property in the State subject to taxation is taxed *locally* Some of it, but a very small part again, is subject to what is known as special property taxes These are solvent credits (I have labeled them on this chart as accounts receivable, because that is what they amount to now), baled cotton, and airplanes Most property, however, is subject to general property taxes which means it is supposed to be assessed at a uniform percentage of full value and taxed at a rate which is uniform within the taxing district that has jurisdiction As you are well aware, we have many, many different taxing districts in the State of California—something over 5,000 of them—and they combine themselves in a myriad of so-called code areas, areas within which a unique combination of tax rates apply We have something over 18,000 of these code areas today Actually, while we call it a general property tax, there is no uniformity in the sense that rates are uniform There is supposed to be uniformity in the proportion of full value

Chairman Petris (referring to chart) Before you leave the General Property Tax, in the box above it, under local taxes, you have real property and personal Can you give us some examples of intangibles that are taxed?

Ronald Welch: Yes, sir There is but one kind of intangible that is taxed And that's what I would call accounts receivable The statutes refer to them as solvent credits They are credits arising out of the sale of goods or services, and you may net out of this the debts of like character owed in California So it is really net accounts receivable These are the only intangibles subject to taxation in California They yield $4 million a year, so they are relatively unimportant Tangible property subject to general property taxes may be either locally assessed or state assessed We have already mentioned the state-assessed property so I will go over to the locally assessed I have subdivided this in a rather unusual manner here because I don't think many people are aware of this distinction between property owned by local governments and property that is privately owned There is a small amount in local government-owned property which is subject to taxation It is property located outside the boundaries of the local government which was taxable at the time it was acquired by the government This property is assessed by either city assessors or county assessors, and the *distinctive feature about it is that the equalization* of this property—the intracounty equalization—is performed by our board, the State Board of Equalization, rather than by the county boards of equalization This, of course, is an unimportant type of property, speaking in dollar terms It isn't worth the amount of space it takes on the chart The vast majority of the property that is locally assessed is privately owned All of it is assessed by county assessors and some of it is also assessed by city assessors duplicating the work of county assessors These properties are subject to local equalization by the county boards or the city boards of equalization I have shown dotted lines down to the superior courts to indicate that there is some relationship to the courts here but it is a very tenuous one because one can go

beyond the Board of Equalization to the courts only on questions of law and not on questions of fact, and the question as to whether the property is worth one figure or another is a question of fact rather than law Only in the event of fraud or deliberate discrimination or over valuation so gross that the court considers it constructively fraudulent can you secure relief in a superior court It might be of interest to you to know that the local boards of equalization hear about 3,000 appeals a year, and more interesting than that to me is the fact that there were 11 counties this year in which there were no protests at all before the local board If you were to look at Section 9 of Article 13 of the Constitution, you would probably think that our board has the authority to involve itself in what I refer to here as local intracounty equalization, but many, many years ago, there was a court decision saying that we could not alter the assessment of selected properties within a county Our authority in the field of equalization is confined to intercounty equalization about which I will say something in a moment So much for this chart

I want to next go into the property tax duties and activities of the State Board of Equalization, and quickly run through them We have already had occasion to speak about the assessment of state-assessed property Our second function is that of assistance to county assessors We think of this as assistance in performing the intracounty equalization function, getting uniformity in the proportion of assessed values to full values within a county Our Division of Assessment Standards is the agency within the board which assigns the duties of this character. Roughly, the duties run as follows to prescribe rules and regulations for assessors and local boards of equalization, to prescribe forms for assessment and collection of taxes, to prepare and issue instructions to assessors; to instruct, advise, and direct assessors and collectors, to make surveys of the adequacies of procedures and practices in county assessors' offices, to issue data relating to cost and other information, and to review welfare exemption applications The third function that the board has in the property tax field is that of intercounty equalization

Chairman Petris: How does the board go about giving assistance to local assessors? Do you send out directives? Do you have conferences? Do you send your representatives to the local county assessors by request when they think they have a problem? Just how do you go about helping them maintain or to do their duty, as it were, within the county and avoid a wide disparity in local assessments?

Ronald Welch: Well, you have described several of the activities very well indeed We put out voluminous instructional material We have an assessor's handbook which is probably the most complete of any state in the Union It gives the assessors assistance in almost every phase of their work For example, one of the important components of the assessor's handbook is a very detailed tabulation of costs of construction of residential, commercial, and industrial properties, farm buildings, different types of equipment within buildings, costs of mobile equipment, airplanes, boats and things of this sort

Assemblyman Chapel: Mr Chairman, may I ask a question?

Chairman Petris: Yes, Mr Chapel

Assemblyman Chapel: That handbook you mentioned I never heard of it before Is this something that the members could get a copy of?

Ronald Welch: You could, Mr Chapel I think you would be a little discouraged by the size of it It is 8½ x 11, and it stands about this high (indicating five feet)

Chairman Petris: Is this an annual publication? Is it revised to keep up with the building cost changes?

Ronald Welch: It is not prepared annually, but it is prepared at rather frequent intervals The general idea is that when costs have changed materially—I have forgotten how we define material—5, 10 percent, something on that order—we will reissue I think perhaps 5 percent change is regarded as material enough

Chairman Petris: Can this be called a state standard? Is this what you use as a standard when you are checking assessments within a county, and checking the intercounty assessments?

Ronald Welch: It is

Chairman Petris: Is it binding on them, or just suggestive?

Ronald Welch: It is only suggestive for this reason Property is not always worth what it costs to reproduce This merely indicates the reproduction cost of one type of property, that is, reproducible property, and does not go to the value of land That has to be estimated by other approaches, mainly by the sales approach What is property selling for? So when we issue a rather comprehensive section of the manual which deals with the general subject of appraising we call it the general appraisal manual, and it goes into the sales approach, the income approach, and the cost approach to value As you suggested, Mr Chairman, this division does organize conferences, and it conducts schools Last year, for example, we conducted 24 schools around the State, attended by a total of 461 people, from assessors' offices for the most part These constitute a very important part of our advisory function to the assessors Our people do circulate among the assessors' offices, mainly on request, but somewhat on our own initiative in an effort to answer their questions, and to assist them in developing the most efficient methods as indicated by what assessors elsewhere in the State have been able to accomplish We answer innumerable requests from assessors by telephone, by mail, and, as you suggested, participate in their conferences, these constitute the major types of activity We do assist them in appraisal work When they have difficult appraisal problems, we endeavor to give instructional assistance

Chairman Petris: I was going to ask you about your specialized problems—take timber for example Do you send men in at their request or do you lend them some of your deputies? How do you handle that?

Ronald Welch: We have a small core of timber appraisers, only one of whom is financed out of the General Fund It's the Assessments Standards Division Two are financed by contract arrangements with counties We do give active assistance to counties in the assessment of timber properties We also have a specialist in the field of petroleum appraisel, and give a great deal of assistance in the appraisal of this very difficult type of property We have people who specialize

in urban properties, others who specialize in rural properties, industrial properties, and personal property

Chairman Petris: How many men do you have available for helping the counties?

Ronald Welch: We have a total of 25 authorized technical positions in the division, a few of which are now vacant Approximately 20 people are employed in this type of work

Chairman Petris: Any further questions from the members on this subject? Do you want to proceed, Mr Welch?

Ronald Welch: I think our most controversial activity lies in the field of intercounty equalization We have already talked about the fact that we have practical assessment practices of long standing in the State As I see it, prior to any decision that the supreme court might make with reference to this case the chairman referred to, the law as it now stands allows the county to assess at any level it wishes By law it must assess at a uniform level within the county, but at the moment there seems to be no binding law that requires it to assess at any particular ratio of full value Consequently, some kind of intercounty equalization activities seems to be necessary The need for intercounty equalization has changed over the years Many years ago, the need arose largely from the fact that the State levied a statewide tax of uniform rate, which would, of course, bear more heavily on a county that was assessing at a high percentage of full value, than on one assessing at a lower percentage This need disappeared in 1911 when we discontinued the use of a state property tax In 1911 those properties that had been state assessed were removed from the property taxes we ordinarily know, and subjected to a gross receipts tax This was discontinued in 1935 and we began again to assess some properties at the state level, and it was necessary that they be equalized with locally assessed properties In 1945 the need for equalization arose in a different guise when a law was enacted providing for equalization aid to school districts, and this now, in our opinion, constitutes the major necessity for some kind of equalization activity on the part of the state board So far as the school aid is concerned, our only need is to measure the assessment level of a county We need to determine at what particular level a county is assessing as compared with other counties in the State, or to be more precise, as compared with the statewide average This relationship of a county to the statewide average assessment level is now used in the distribution of state school aid which runs to something on the order of $250 million a year We measure the county assessment level by appraising once in three years an average of about three hundred properties in the county by a fairly involved statistical process that I've described in several scholarly papers. We convert these appraisals into an estimate of the full cash value of property subject to local assessments This full value is then compared with the assessed value to ascertain what the assessment level is Between these surveys which are made at three-year intervals, we have a process that is quite controversial, known as trending by which we endeavor to keep pace with the changes in the full cash value of locally assessed property Then at the occasion of our new survey, we readjust our sights and project for another three years, comparing

each year's projected value with the assessed value of that year After these ratios of assessed value to our estimate of cash value have been determined, our board makes a decision as to how much tolerance it will allow about the statewide average This year, for example, the statewide average assessment level according to our estimates was 23 1 percent of full cash value The board allowed a tolerance of four percentage points on either side of this statewide average, meaning that any county whose ratio was found to be between 19 1 percent and 27 1 percent would not be subjected to an intercounty equalization order Bear in mind that this would not mean that we didn't equalize for school purposes, because for school equalization aid purposes whatever level we find is entered into the formula used to decide how much aid a school district should receive But that is the only part of the function which is based on our ratios Other functions that are intended to be performed by an equalization process are activated only in the event a county's ratio differs from the statewide ratio by a substantial amount Our board defines substantial, and defined it this year in terms of four percentage points A ratio which falls outside these limits is not tolerated by the board, and the board after holding a hearing and satisfying itself that our ratio measurement was correct or incorrect as the case may be, modifies it accordingly, and will instruct the county auditor to change all assessed values on the secured role by a uniform percentage amount in order to lift or reduce the assessment level of that county to an acceptable assessment level which means a level somewhere near the statewide average

Chairman Petris: On that point, I have a question Yesterday, there were several persons who referred to the large number of special districts we have in the State 900 in the Bay area, for example Many of these districts cross county lines As a result of the work of the board, they generally come out pretty well, don't they?

Ronald Welch: I don't know what you mean by come out pretty well Do you mean by that, that they do searching and leaving on a fairly uniform basis?

Chairman Petris: Well, yes

Ronald Welch: There are actually 225 such districts that cross boundary lines, known as joint districts, and if the assessment levels in the two counties, or more than two in some instances, were quite different, then, of course, their tax would not be uniformly distributed as the Constitution contemplates This is one of the minor necessities for intercounty equalization work

Chairman Petris: It is becoming more and more less minor, isn't it?

Ronald Welch: Yes, it is For example, in the Bay area, just this year, there was a law passed that provided for a uniform tax rate over some of the Bay area counties—I've forgotten just what the details were If assessment levels were very different within the Bay area, this tax would be distributed quite unevenly

Chairman Petris: Do you mean for a particular district?

Ronald Welch: I think it was rapid transit The tax rate of this district would be distributed very unevenly, just as the state tax would have been back in the days when the State was levying the uniform tax rate over the counties of the State

Chairman Petris: This would seem to me to have quite an effect on whether or not a new district is created If you have a substantial difference between adjoining counties, one county may elect to stay out of the new district simply because they feel that their assessment is higher, and that they are going to be paying more per capita than the neighboring people

Ronald Welch: Quite so, yes

Chairman Petris: In fact, we have had that demonstrated many times in our area

Ronald Welch: Have you? Mr Chairman, I have now very rapidly tried to cover the structure of the property tax and the functions of the State Board of Equalization within this structure I think the committee might wish to reserve the remaining time, if there is any, for questions

Chairman Petris: Any other questions of Mr Welch?

Assemblyman Alquist: I was going to ask Mr Welch whether he favors the elimination of basic aid for school districts Do you think that distribution of all state aid to schools should be on an equalization basis to provide for a more equitable system of subvention to schools?

Ronald Welch. Mr Alquist, I hope you will accept the answer of one who is not very deeply involved in school finance Yes, I would say that this would be superior, according to my concepts of good school financing I think it is not politically acceptable at the moment, but that's for you folks to judge

Chairman Petris: Any other questions, Mr Alquist? Mr Chapel?

Assemblyman Chapel: I think this is germane—it relates to the basic problem of equalization of assessments by the various counties I questioned a few county assessors, who have had many years of experience, about how their deputies are recruited and trained They said that one of the problems they had is that they can't do all the work themselves That's very obvious Therefore, they have to rely on deputies—full-time civil service employees They said that the problem of recruiting men who already had any ability, knowledge, training or experience was very difficult, and, therefore the real problem was training All too often, they had to train the men on the job—in other words they teach them to swim by throwing them in the deep water and say swim or drown They had a recruiting problem first, and secondly, when they got the man, they had so much work to do, they put him to work before they had a chance to train him They said that was the very basic thing They didn't think the Legislature could or should interfere, but this definitely, in their opinion, did reflect on the assessments that they made as county assessors I assume that this may be germane Do you have any brief answers on this?

Ronald Welch: I think you have stated it very well, Mr Chapel There isn't a great deal I can add to it except to say that one of the major functions of our Division of Assessment Standards is to provide training for the newly employed appraisers in the county assessors' offices This we endeavor to do

Assemblyman Chapel. Now on that I was also told by these very same assessors that the trouble was that you require the men to come to Sacramento

Ronald Welch: No, we do not We have had schools in Sacramento We are hoping next year to institute another school in the southern part of the State, but these are our big schools We also conduct smaller schools throughout the State We have them in Redding—we have them in Marysville You can almost name any place, and we probably had a school there We try to get a school that will accommodate about four counties, so that we don't get too large a group

Assemblyman Chapel: I don't want to belabor the point but I think there are two sides to it I think they *did mention something* about your original schools They said that only a comparatively small percentage ever were able to attend Is that correct?

Ronald Welch: Well, that is true if you put it in percentage terms I think I stated awhile ago that we had schools attended by some 460 deputies last year This is not a very large percentage of the total number in the State which runs into several thousand—I have forgotten how many it is I think I have a figure on that

Assemblyman Chapel: In other words, what they said was correct

Ronald Welch: Yes, it was

Assemblyman Chapel: Now, one final question Do you consider it within the province of the Legislature to pass any legislation or appropriate any money for this thing? In other words, where does the responsibility lie for *encouraging* and *conducting* this training that you are already doing? We are glad to know that you extend it, but in order to bring in a greater percentage of these deputies for adequate training, do you recommend or not that the Legislature be responsible for enacting any legislation or appropriating any money? My general or personal prejudice in the matter is that we pass too many laws anyhow, and we try to tell so many counties and cities how to run their business, so that's my bias, frankly Knowing my bias, please feel free to tell me what is your reaction?

Ronald Welch: Usually we do go to the Legislature with a request for small additions to our staff of the Division of Assessment *Standards* which is used mainly for this *training purpose* Actually, of course, as you can imagine, there is a limit to the number of people the county wants to send to these schools because while they are in the school, they can't go out and appraise property I suspect we could use more instructors in this field to good advantage, and if the Legislature were disposed to provide us with more funds, we certainly would not reject them

Chairman Petris: How long do these schools take?

Ronald Welch: Usually, we run a school for about a week The large school that was centered in Sacramento to which Mr Chapel referred was a two-week school, and this is what we have in mind if we should establish one next year in Southern California, as well as Northern California, which we hope to do

Chairman Petris: Do you feel they would raise the standards and also provide for perhaps greater uniformity and eliminate the intercounty differences?

Ronald Welch: Definitely We feel that these have been very valuable, and I think the assessors concur with us in this feeling

Chairman Petris: Perhaps we can ask some of the assessors who will be testifying this afternoon their opinion on the notion of perhaps making this school compulsory for all of their deputies or a substantial percentage over a period of time.

Ronald Welch: Well, you would really have to ask them to get an authoritative answer. I think they would be interested in such a proposal. Incidentally, there is an interesting law in Oregon that you might want to look into which provides for the certification of appraisers working in assessors' offices It requires that they go through certain training programs and acquire a certificate from a school

Chairman Petris: Are these from the state?

Ronald Welch: I believe that the state tax commission is the agency which issues the certificate I don't know that our county assessors would favor this program because it does have a certain degree of state control associated with it, but is an interesting experiment that one of our neighbor states has applied in an effort to raise both the number, in this instance, and the quality of the appraisal staffs They are required to have a certain minimum number of appraisers for a given amount of property I have forgotten the details

Chairman Petris: Mr Young, a question?

Assemblyman Young: I would like to ask you, Mr Welch, a question that I asked Mr Davisson yesterday concerning this bill that was introduced by Assemblyman Mills which would eliminate the assessment upon improvements in real property It had an interesting concept Do you have any comments on it or opinions of your own?

Ronald Welch: Well, it is a very controversial subject, Mr Young, and I think in common with most people who have been trained in the field of economics, I have a great deal of sympathy for what is known as land value taxation which means taxation of land at a heavier rate than is applied to a group of personal property. There is a great body of literature in this field. We have in the room an expert on it, Mr Nagy

Assemblyman Young: I think it is being used in New Zealand.

Ronald Welch: It is being used in a number of parts of the world. You had a statesman before you last spring who testified very eloquently on the virtues of this There are some problems connected with it It seems to me that the major problem is that if you were to shift the tax burden from improvements in personal property to land that you would reduce the value of land, and this would be regarded as inequitable since you would have no means of indemnifying those who had purchased land without the anticipation of this It is unfortunate, in my opinion, that we didn't do this in the days of Henry George when there weren't so many vested interests.

Chairman Petris: Would you tell us how often the board makes its determination in each county? Is this an annual procedure?

Ronald Welch: Yes, each year we define a ratio for each county. The ratios are always based on what we refer to as a trended figure. I prefer the use of the word projection Our projection may be for one year if we have just completed an appraisal survey; it will be two years if our last appraisal survey was two years back, and three years at the maximum. At that point we make a new check by appraisal

processes, establish a new benchmark, and begin a new series of projections from the benchmark But each year we compare each county's assessed value with out estimate of full cash value of the county

Chairman Petris: Did we solve the problem that was created by the timing on these things which were very unfortunate for many counties, particularly Alameda County where there was quite a change over a two- or three-year period? Did we change the date for doing this?

Ronald Welch: No, nothing has been changed that would alter that.

Chairman Petris: I am speaking of planning with respect to the budgets of the board of supervisors and school boards particularly

Ronald Welch: Yes. I see what you mean I think this was discussed in the special session There was a change in the school laws which, I think, will cure those problems Now, perhaps, time will tell us it didn't, but to the best of my knowledge, it has

Chairman Petris: You mentioned the Oregon law regarding certificated appraisers I would personally like to look into it They also have a tax deferral system of some kind Would you tell us about that?

Ronald Welch: Yes, sir. They have a provision that people over 65 years of age with income less than a certain amount need not pay taxes on the homes they occupy, but may defer that payment until death or sale of the property at which time the taxes with interest at a rate that I have forgotten become due and are liened upon the property

Chairman Petris: Do you recall at what age the people become eligible?

Ronald Welch: I believe it is 65

Chairman Petris: Is there some kind of a property limitation or value limitation?

Ronald Welch: There is an income limitation, as I recall it, and again, I am sorry I don't remember the number

Chairman Petris: I have a bill similar to that which we are going to take up in our interim study along with Mr Carrell's bills

Ronald Welch: It would interest you to know, perhaps, if you haven't already read it, that the governor of Michigan recommended such a tax deferral plan as part of the tax program that he announced about a month ago

Assemblyman Chapel: That could really be interesting, couldn't it?

Chairman Petris: Yes, a lot of his proposals are interesting, Mr Chapel I think he has got a real bipartisan support program going now back there Any other questions of Mr Welch? If not, I want to thank you very much, Mr Welch You have given us a lot of good information on your particular field

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A Major Tax Study
PART 2

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JULY 1964

PUBLISHER'S NOTE

This booklet is the second in a series of interim studies to be published this year by the Assembly Committee on Revenue and Taxation It is the first known complete compilation of financial information on California State Fees and Licenses Because of the vast amount of material it contains and the wide range of interests it affects we are making the original research document available without committee comments

Three classes of charge commonly called fees have been omitted from this report those which are really taxes (mainly the parimutuel licensing fee), education charges (tuition), and fines

The recommendations in this report are those of the researcher and should not be construed as representing the views or decisions of the committee The committee recommendations will be made in due course

ABOUT THE AUTHOR

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CALIFORNIA'S
FEE AND LICENSE STRUCTURE: 1964

by

DR ALICE JOHN VANDERMEULEN

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CHAPTER I

CALIFORNIA'S FEE AND LICENSE STRUCTURE

The Assembly Committee on Revenue and Taxation brings together in this study information on the licenses issued and the fees collected by all of the various state agencies No compilation of these charges was available, so the work began by writing to each agency to inquire whether it collected any fees A questionnaire (reproduced below) was enclosed, with a request that it be completed for each fee Many agencies sent fat replies Only a few reported that they collected no fees at all

FORM OF QUESTIONNAIRE SENT TO AGENCIES

1. Title and description of fee or license
2. Rate or scale of charges
3. How set and by whom
   a. Statute
   b. Administrative action—by whom
4. When is fee payable
5. Revenue obtained in last two fiscal years (separate figures for each year)
   a. General fund
   b. Earmarked—for what
6. Who collects fee
7. Date of last change in fee schedule and former fee schedule
8. Direct cost of collection of fee ("cost" should be defined as to content) in last fiscal year
9. Purpose of fee (more than one purpose may be indicated)
   a. To discourage waste of service by public
   b. To limit public use to capacity of facilities
   c. To cover all or part of the cost of providing service
   d To repay debt incurred for construction of facilities
   e. To assist in public regulation of private activities
   f. To raise revenue for general activities of state government
   g Other—specify
10. Suggestions welcome
    a. Aspects of present policy which merit intensive study
    b. New sources of revenue from charges for services now provided free

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When the data began to pour in, the committee decided that this study should focus on the unexplored area of "true" fees and licenses and omit three other types of payment which are nominally fees, but which differ from the traditional concept of a fee. These "pseudo" fees are (1) fees which resemble taxes (mainly the parimutuel licensing fee), (2) fees charged by educational institutions, which are essentially tuition, and (3) fees which are really fines (such as the addition to court fines for the benefit of police education or the penalties paid by sellers of alcoholic beverages in lieu of prosecution). Elaborate studies of the first two categories are available elsewhere, the third is of minor importance. It should also be noted that this study omits some of the "delegated" licensing activity of the State, such as the delegation to counties of licensing of boarding homes for children, a program for which the State reimburses the counties. The goal of this inquiry is not to survey the licensing *activities* over which the State has some measure of control, but rather to survey licensing (and other) activities from which state agencies derive revenue.

Functions for Which Fees Are Collected

From the replies to the questionnaires, it was possible to classify the fees in accord with the governmental function to which they probably apply.

GOVERNMENTAL FUNCTIONS FOR WHICH LICENSES AND FEES ARE COLLECTED BY AGENCIES OF THE STATE OF CALIFORNIA

I General government
- A Keeping public records
  - 1 Vital statistics
  - 2 Legal documents
- B Sales of public information
  - 1 Copies and lists of public records
  - 2 Governmental publications
- C Administration of justice
- D Supervision of business practices
- E Supervision of the labor market
  - 1 Private employment
  - 2 Governmental employment
- F Maintenance of standards for public health, safety, and welfare
  - 1 Housing conditions
  - 2 Working conditions
  - 3 Hazards of defective materials and equipment (boilers, elevators, trucks, etc.)
  - 4. Operators of vehicles

II Provision of social wants
- A Where benefits from use of service are shared by the public
  - 1 Health
  - 2 Education
  - 3 Welfare
- B Where use of service chiefly benefits user
  - 1 Charges for state-owned recreational facilities
  - 2 Charges for privately owned recreational equipment (boats, trailers, etc.)
  - 3 Fishing and hunting licenses
- C Where benefits to users must be weighed against costs to other users and to nonusers
  - 1 Vehicle licenses and fees

III Regulation of particular types of business
- A Where industry must comply with standards of public health, safety, and welfare
- B Where customers of industry may be subject to financial or ethical abuses
- C Where industry has aspects of a public utility
  - 1 To assure conservation of natural resources
  - 2 To protect customer with no alternative source of supply
- D Where industry is traditionally subject to control and special taxation
  - 1 Alcoholic beverages
  - 2 Horse racing

IV Provisions of services of a business nature
- A Rental of facilities (armories, Los Angeles Sports Arena, etc.)
- B Operation of ports (San Francisco)
- C Charges for state-owned natural resources (oil and gas leases, etc.)
- D Sales in potential competition with small private enterprises (lunches, etc.)

This outline is helpful in judging the equity and adequacy of the rate schedules. It also suggests fields in which there are possible additional sources of revenue.

For purposes of summarizing the factual data contained in the questionnaires, four general categories are used. Chapter II deals with occupational fees and licenses, levied mainly on *persons*. Chapter III considers fees collected from *particular types of businesses*, where the business is somewhat distinct from the persons who work there. Chapter IV deals with fees which are *general* in the sense that any person

or any business might have to pay them Chapter V is concerned with *user-type* fees which are paid for the optional use of a governmental service

Results of the Questionnaire

With the wisdom of hindsight, the questionnaire could have been revised to yield more information Question 8 on the direct cost of collection of the fees drew an almost barren response With few exceptions (notably the State Fire Marshal and the Department of Public Health), state agencies seem to gather little information concerning the direct costs of collection Sometimes the duty of collecting is viewed like the task of "picking up" after children—since it is done in odd moments, no time is spent on it! Frequently, a licensing program is merged in the budget with other activities of the agency, so that it is useless to ask whether the licensing program, including costs of enforcement, is self-supporting

Space on the questionnaire was wasted in inquiring the purpose of the fee Nearly all of the responses averred that the purpose was "To cover all or part of the cost of providing service" A few cited the additional objectives of regulating private activities and raising revenue for the general activities of state government No one, apparently, thought of the fee as a method of limiting public use to the capacity of the facilities, although there is evidence in the data that a slight rise in some user fees cuts down substantially on use

The request for suggestions did not elicit many replies, and the suggestions were generally minor Some of the ideas for new sources of revenue could, however, be generalized and applied to other fields Here are a few illustrations

1 When an agency normally gives away one copy of a publication upon request, it could charge for additional copies requested

2 When an agency supplies special services not normally supplied to the general public, a special charge could be made (The Highway Patrol, for instance, might charge for escort permits or for traffic control at commercial events)

3. Licensing programs could be separated, so that a license to operate one type of business does not confer the right to operate a subsidiary type of business either at a reduced "conjunctive" fee or at no fee at all (This is discussed in connection with employment agencies in Chapter III)

4 Special exceptions could be removed from the fee structure When this is done the rise in revenue is supplemented by a saving in the clerical time formerly required to identify special cases (The Department of Public Health, for instance, could extend its $2 charge for amending a birth record to cover cases of adoption, legitimation, and adjudication or acknowledgment of paternity)

5 Fees could be immediately imposed on new private activities as soon as it becomes evident that they require regulation (A possible case in point is the movement of oversize and overweight vehicles The Highway Transportation Agency currently requires that

operators of such vehicles file their routes, along which they may then proceed without charge In cooperation with other states, California might work out a fee for the movement of these vehicles)

In the chapters that follow, there are some suggestions for new minor sources of revenue These are far outweighed, however, by numerous recommendations for raising current fees which are either inadequate or outmoded

Although a lookout has been kept for sources of additional revenue, the focus of this study has been placed on two questions of a more enduring nature First, how could the structure and administration of California's fees and licenses be improved? And, second, what is the probable impact of California's fee and license structure upon the well-being and growth of the State's economy? It is hoped that the attempt to answer these questions will remain useful after the data have become economic history

CHAPTER II

OCCUPATIONAL FEES AND LICENSES

When replies to the questionnaire were combed for occupational fees and licenses, it was discovered that state agencies license and regulate about a million persons in more than 50 occupations The number of occupations would rise if "variations" were considered, the California Horse Racing Board for instance, lists more than 20 categories and hints that there are "other" and "miscellaneous" callings for which a license is required The number would also rise if licenses for entrepreneurial-type activities were included These licenses, such as real estate broker and funeral director, are classed with the business licenses in Chapter III Fees and licenses in this chapter pertain mainly to employees and to professional persons who may have offices but do not typically have "places of business" The distinction is hard to draw, but it seems worthwhile to attempt to separate the "worker" type of license from the "shop" type In many cases, a corresponding license for the "shop" appears in Chapter III

Within the "worker" type of license there exists some kind of spectrum of public "concern" At one end are the occupations where the layman is least able to judge performance and most dependent upon the enforcement of professional standards At the other end are the occupations where the main purpose of licensing is to deny licenses to those who have proved themselves unworthy of the privilege The exact spectrum cannot be drawn, but it seems safe to aver that surgeons fall in the upper end in comparison with, say, exercise boys for horses Licenses for occupations in the upper end would typically require a substantial fee for application and examination of qualifications, with smaller annual renewal fees In the lower end, a flat fee per year would be more appropriate

To illustrate the distinction, occupational licenses can be divided into two somewhat arbitrary groups The occupational licenses listed in Tables 1 and 2 are, on the whole, those for which the layman would have most difficulty in judging qualifications They are also occupations which closely affect public health, education, and welfare Hence it seems natural to expect finer screening and stricter enforcement in this group than in the second group, which is listed in Table 3

A large part of occupational licensing is carried out by specialized boards or commissions, 27 of which are under the aegis of the Department of Professional and Vocational Standards In most instances the revenues for each board are transferred to its "fund," and appropriations for the board's expenditures are made from the fund When licenses are renewed on a biennial basis revenues rise in alternate years, and the fund serves as a cushion

The trend of a board's fund over a period of years gives some indication as to whether the licensing program is self-supporting [1] At least,

[1] The extent to which licensing programs are self-supporting is probably generally overstated because of failure to include in costs adequate allowance for the "overhead" of general government under which the programs are operated

TABLE II—1

FEES AND LICENSES IN MEDICAL OCCUPATIONS, 1962–63

Agency and occupation	Application fee	Written examination fee	Certification fee	Initial fee	Renewal fee	Other	Collections* (in thousands)
Board of Medical Examiners							
Physician, surgeon, and podiatrist	$10						*$24
		$30					16
				$18–9			*40
					$18		*371
Reciprocity certificates			$100				106
National Board certificates			$100				93
Permits (fictitious names)				$18–9			2
					$18		*2
Registered dispensing optician	$15						*
			$35				2
				$50–25			3
					$50*		*8
Psychologist	$10						1
		$25					2
				$30–15			2
					$30*		*35
Registered physical therapist	$25						5
				$8–4			1
					$8*		*7
Licensed physical therapist	$25			$15–7 50			—
					$15*		—
							*10
Board of Dental Examiners							
Dentist	$25 (out-of-state $50)						39
				$14–7			8
					$24–6*		*77
Dental hygienist	$25						4
				$6–4			1
					$6–4*		*3
Board of Osteopathic Examiners							
Osteopath	No new licenses being issued						
					$25		17
Reinstatement						$50	1
Board of Chiropratic Examiners							
Chiropractor	$15						3
					$21		100
Board of Optometry							
Optometrist	$25 (out-of-state $35)						3
					$25[b]		118
Branch office license				$15	$15		4

TABLE II—1 (Continued)

FEES AND LICENSES IN MEDICAL OCCUPATIONS, 1962–63

Agency and occupation	Application fee	Written examination fee	Certification fee	Initial fee	Renewal fee	Other	Collections* (in thousands)
Board of Nurse Examiners							
Registered nurse	$10 (out-of-state $20)						$133
					$6		303
Temporary license						$5	22
Temporary permit						$20	22
Board of Vocational Nurse Examiners							
Vocational nurse	$10						20
Reexamination fee						$5	1
				$10*			17
					$10*		*72
Board of Pharmacy							
Pharmacist		$50					33
				$25-15			7
					$20		91
Exempt permits (Sec 4050 6)	$10						3
				$10			5
Hypodermic only				$5	$5		1
Hypnotic drug only				$20–0	$20–0		1
Board of Public Health							
Bioanalyst, clinical lab				$25	$10		5
Technologist, clinical lab				$5	$2		22
Trainee, clinical lab				$1	$1		2
Board of Veterinary Medicine							
Veterinarian		$20					3
				$5			1
					$12 50–$7 50		24

* Indicates that fee is for two-year period, collections are shown as average amount for fiscal years 1961–62 and 1962–63

[a] Amount for physicians surgeons and podiatrists includes fees paid by registered dispensing opticians

[b] Raised to $60 for the biennial period ending January 31, 1965

a dwindling fund is usually a signal to ask the Legislature for permission to raise fees Typically, the statutes specify brackets within which the board sets the exact amount of its fees When the board's fund is exhausted and fees have reached the top of statutory brackets, the licensing program must be curtailed unless appropriations are made from the General Fund

To allow free interplay of market forces among all occupations, the cost of each licensing program should be supported by the licensees.[2] This criterion is not very useful, however, since enforcement is part of the cost of the program, and the level of enforcement determines the total cost of the program Extensive study of performance and

[2] An additional argument for complete support by the licensees can be made where the board performs functions similar to those carried on by trade unions or trade associations For example, the State Board of Barber Examiners sets minimum prices for haircuts and shaves—an activity that the hairgrowing taxpayer might be reluctant to support

TABLE II–2

FEES AND LICENSES IN OTHER OCCUPATIONS AFFECTING PUBLIC HEALTH, EDUCATION, SAFETY, AND WELFARE, 1962–63

Agency and occupation	Application fee	Initial fee	Renewal fee	Other	Collections (in thousands)
Board of Social Work Examiners					
Registered social worker	$10				$1
			$11–3		33
Student	$5				—
State Board of Education					
Teacher (lifetime credential)				$8	801
Worker child care center				$8	
State Board of Public Health					
Audiometrist (lifetime license)				$3	1
Board of Guide Dogs for the Blind					
Supplier of guide dogs	$25				—
	(exam)		$5		—
Department of Motor Vehicles					
Instructor in driving school	$10		$10		*
	(exam)		(4-yr)		*
Board of Pharmacy					
Itinerant pharmaceutical vendor		$25	$25		6
Fire Marshal					
Pyrotechnic operator		$10	$10		*
Serviceman fire extinguishers		$5	$5		*
Department of Agriculture					
Pest control operator		$50	$50		27
Aircraft pest control operator and apprentice		$25	$15		6
Poultry meat inspector		$10	$5		5
Milk technician		$5	$1		—
Milk tester		$5	$1		—
Pasteurizer		$1	$1		1
Board of Structural Pest Control					
Structural pest control operator	$25				3
	(exam)	$50			4
			$50		49
Field representative	$10				7
	(exam)	$10			2
			$10		9
Board of Barber Examiners					
Barber		$10*			4
			$10*		96
Apprentice	$10				17
	(exam)	$6*			3
			$6*		18
Journeyman	$20				38
	(exam)	$6*	$6*		18
Instructor	$25				—
	(exam)	$20*	$20*		1
Board of Cosmetologists					
Cosmetologist					
Application for exam					
Cosmetologist	$21–5				134
(Reexamination)	$21–5				17
Electrologist	$21–5				1
Manicurist	$12–2				3
Instructor	$25–15				6
Cosmetologist			$10–2		447
Electrologist, manicurist, instructor			$10–2		21

TABLE II—2 (Continued)

FEES AND LICENSES IN OTHER OCCUPATIONS AFFECTING PUBLIC HEALTH, EDUCATION, SAFETY, AND WELFARE, 1962–63

Agency and occupation	Application fee	Initial fee	Renewal fee	Other	Collections (in thousands)
Board of Dry Cleaners					
Dry cleaner		$12			$8
			$12		100
Board of Funeral Directors and Embalmers					
Embalmer	$25				4
	(exam)	$25			1
			$25		48
Apprentice	$1				—
		$2			—
			$2*		1
Board of Pilot Commissioners					
Pilot for the Bays of San Francisco, San Pablo, and Suisun		3% of pilotage fees			31

* Indicates that fee is for two-year period or that collections are shown as average amount for fiscal years 1961–62 and 1962–63

[a] Not available separately

ultimately a value judgment are required to determine whether the level of enforcement is "adequate," excessive, or deficient

Without studying the quality of enforcement, it is nonetheless possible to spot fees which seem manifestly low It is also possible to discern aspects of the fee structure which may be inimical to the productivity and growth of the State The scope of this study did not permit field investigations of individual licensing programs, but an attempt has been made to discern general principles upon which to base recommendations for improvement While the principles may be sound, they may lead to erroneous conclusions where some peculiarity of the individual program has not been taken into account

Suggested Principles for Occupational Licensing

1 For medical occupations, the charges for initial accreditation (application fee, examination fee, certification fee—whatever they are called) should be adequate to cover the costs of a personal investigation and of a thorough professional examination, including both the direct costs of administering the examination and the indirect costs of periodically revising it The fee for reexamination should be equal to the original fee as a deterrent to persons who will take a shot at the first exam if the reexam is cheap The examination may be waived where a professional organization undertakes a strict program of accreditation, but a time limit should be placed on the acceptability of previously held credentials presented in lieu of examination

TABLE II—3

FEES AND LICENSES FOR OTHER OCCUPATIONS, 1962–63

Agency and occupation	Application fee	Initial fee	Renewal fee	Other	Collections (in thousands)
Department of Motor Vehicles					
Automobile vehicle salesman	----	$10	$10	----	$341
Cemetery Board					
Salesman					-
Original examination	$10	----	----	----	5
Reexamination	$5	----	----	----	—
Temporary—3 months	----	$10	----	----	b
			$10	----	5
Board of Education					
Salesman, correspondence courses	----	$5	$5	----	3
Department of Insurance					
Insurance solicitor	----	$4 a	$4*	----	*73
Bail solicitor	----	$10 b	$10	----	1
Division of Real Estate					
Real estate salesman					
Examination for original and reexam for same	$10	----	----	----	c1,600
		$10	----	----	
			$30 (4-yr)	----	
Late renewal	----	----	----	$45	
Yacht and Ship Brokers Commission					
Yacht and ship salesman	$15 (exam)	$10	----	----	2
			----	----	1
			$10	----	2
Temporary	----	----	----	$5	—
Transfer	----	----	----	$5	—
Department of Agriculture					
Weighmaster at large	----	$100	$100	----	1
Deputy public or private weighmaster	----	$2	$2	----	d
Sampler and weigher, milk and cream	----	$1	$1	----	2
Board of Architectural Examiners					
Architect	$35–0	----	----	----	48
		$15	----	----	4
			$60	----	66
Board of Landscape Architects					
Landscape architect	$20 (exam)	$10	----	----	1
			$50–10*	----	—
					*15
Contractors License Board					
Contractor	$20 (exam)	----	----	----	248
Active	----	$30 e	$30*		
Inactive	----	----	$10*	----	1,279
Delinquent penalty	----	----	----	$5	
Board of Civil and Professional Engineers					
Professional engineer	$30	----	----	----	127
		$16	----	----	11
			$12*	----	*340
Structural engineer	$40	----	----	----	6
		$16	----	----	—
			$12*	----	*11
Engineer-in-training	$15	----	----	----	41
Land surveyor	$30	----	----	----	7
		$16	----	----	—
			$12*	----	*11

TABLE II–3 (Continued)

FEES AND LICENSES FOR OTHER OCCUPATIONS, 1962–63

Agency and occupation	Application fee	Initial fee	Renewal fee	Other	Collections (in thousands)
Board of Certified Shorthand Reporters					
Certified shorthand reporter	$25				$7
		$20–5			1
			$20–5*		26
Athletic Commission					
Referee, manager, matchmaker		$25	$25		8
Second, wrestler, timekeeper, announcer		$5	$5		2
Boxer		$5	$5		2
Public Utilities Commission					
Motor transportation broker		$50	$50		*
Division of Mines and Geology					
Ore buyer, limited		$2	$2		—
Ore buyer, unlimited		$15	$15		—
Department of Conservation					
Timber operator		$15	$10		†
Late renewal penalty				$15	†
Department of Fish and Game					
Hunting and fishing guide		$10	$10		2
Trapper		$1	$1		1
Bureau of Private Investigators and Adjusters					
Private investigators and adjusters	$25				9
Investigator		$100			6
			$100*		*50
Investigator-adjuster		$100			2
			$100*		*21
Adjuster		$100			2
			$100*		*15
Repossessor		$100			1
			$100*		*5
Patrol		$50			1
			$50*		*8
Branch office				$5	1
Employee registration fee				$10	11
Collection Agency Board					
Collection agent	$75 (exam)	$20			8
			$20*		7
					*16
Employee lifetime registration				$10	8
Board of Accountancy					
Accountant					
Preliminary exam in lieu 2 years college	$10				1
C.P.A. certificate or examination	$30				30
Reexamination, minimum ($6 per subject)	$10				21
			$15*		*270
Registration, partnership				$10	2

TABLE II—3 (Continued)

FEES AND LICENSES FOR OTHER OCCUPATIONS, 1962–63

Agency and occupation	Application fee	Initial fee	Renewal fee	Other	Collections (in thousands)
Horse Racing Board					
Trainer, jockey, steward, racing secretary, starter and other major officials, jockey agent, authorized agent	----------	$10	$10		
Owner (with registration of colors) apprentice jockey, quarter horse jockey, minor officials harness horse trainer and driver quarter horse trainer	----------	$5	$5		
Parimutuel clerk, special trainer for fairs	----------	$3	$3		$50
Groom, exercise boy, miscellaneous	----------	$2	$2		
Assumed name	----------	$25	$25		

* Indicates if a fee is for two-year period or that collections are shown as average amount for fiscal years 1961–62 and 1962–63

[a] Original $5 per year effective 7/1/64

[b] Original $20 per year effective 7/1/64

[c] Estimate. Amounts for separate fees collected by Division of Real Estate were not supplied. Total for 1962–63 was $2 335 674

[d] Not separately available

[e] Fee in 1962–63 was $5 collections only $190

[f] New fee in 1964

[g] New fee 7/1/63, prorated to $15 for less than a year. No collections until 1963–64

Recommendations:

The minimum fee for initial accreditation in medical occupations (except clinical lab trainee) should be set at $25. This would affect the following occupations

Registered nurse

Vocational nurse (unchanged since originally set)

Technologist, clinical lab

Veterinarian

The fee for reexamination of vocational nurses should be raised to $10.

2. The growth and welfare of the State are favored by the spill-in of persons who have been specially trained or educated elsewhere. Hence, discrimination against out-of-state applicants for professional licenses seems undesirable.

Recommendation:

The out-of-state penalty should be eliminated for applicants in the following occupations

Dentist

Optometrist

Registered nurse (In 1962-63, out-of-state applications outnumbered in-state in the ratio of more than 4 to 1. Hence the differential does not serve as a premium for handling unusual cases.)

3 An occupational licensing program makes little sense unless it is accompanied by a minimum level of enforcement of standards Fees which are largely consumed in clerical expense should be raised, or the licensing program should be dropped

Recommendation:

All initial or renewal fees should be raised to a minimum of $5 per year or $10 on the biennial basis This would affect the following occupations

Registered physical therapist
Dental hygienist
Technologist, clinical lab
Trainee, clinical lab (In a 1962 study of its fee structure the Board of Public Health itself stated that the $1 fee was too low)
Audiometrist
Driving school instructor
Milk technician
Milk tester
Pasteurizer
Barbers apprentices and journeymen
Embalmers, apprentice
Insurance solicitors
Deputy public or private weighmaster
Sampler and weigher, milk and cream
Ore buyer, limited
Trapper (last changed in 1917)
In horseracing Parimutuel clerk, special trainer, groom, exercise boy

4 The overall field of occupational licensing should be periodically searched for simplifications and economies of scale that would reduce costs The present study suggests five methods of cost reduction

a Isolated licensing functions should be consolidated, and procedures should be standardized This would permit the use of such cost-saving devices as stenographic pools and quantity purchases of acknowledgment postcards and window envelopes

Recommendation and example:

The Division of Mines and Geology issues two kinds of ore buyers' licenses under Section 2251 of the Public Resources Code The division reports that only 60 to 70 licenses are issued annually—the purpose of the licensing being to control "highgrading" (*i.e.* theft) of gold at the mine by (presumably, unlicensed) employees The licensing operation is mainly a clerical job, and the Division of Mines and Geology has questioned the feasibility of transferring the function to some other agency This suggests that the Department of Professional and Vocational Standards might establish a "miscellaneous" branch in which "by-product" licensing could be consolidated

b Where licenses are issued biennially, an attempt should be made to eliminate the annual swings in revenues and workloads There are two approaches to the solution (1) stagger the licensees' renewal dates —say, by having them fall on the licensee's birthday (as the Department of Motor Vehicles does with drivers' licenses) or (2) plan the work of the licensing boards in such a way that a "floating" staff could migrate from board to board for the renewal periods.[4]

Recommendations:

Isolated boards could make some progress toward staggering the workload The Board of Medical Examiners, for instance, could spread out the renewal dates for its various types of licenses, now *all* due the last day of February in even-numbered years Major improvements would hinge, however, on the construction of a two-year master calendar over which renewal dates could be scattered

c Fee schedules should be simplified and anachronistic provisions should be removed

Recommendations and examples:

The California Horse Racing Board might reduce its fee schedule to two steps ($15 and $5) from its present five-step schedule ($25 $10, $5, $3, and $2)

"Dead" fees (from which there are rarely any collections) should be standardized with "live" fees For instance, the $40 Certificate fee for Army and Navy physicians and surgeons could be merged with the standard $100 fee for other physicians and surgeons

d Provisions that applied to an earlier, more rural area should be eliminated A case in point is the $25 fee required of optometrists for restoration of their certificate if the certificate is suspended because the optometrist has failed to register with the clerk of the county where his place of practice is maintained A representative of the Board of Optometry comments

> Entire requirement might be questioned from standpoint whether it now serves any worthwhile purpose—perhaps it is anachronistic Determining whether an optometrist has had his certificate of registration registered as required in the office of the county clerk of the county in which he practices often necessitates considerable searching of records, which is time consuming

No revenue was collected from this fee in 1961–62 or 1962–63

e The issuance of licenses should be tailored to minimize the cost of enforcement

Recommendation and example:

Enforcement frequently involves unannounced onsite inspection, and inspectors attempt to determine whether the license displayed belongs to the person doing the work A cosmetologist, for instance, may be asked to leave her dripping customer and rummage for her driver's license Since a photograph can now be reproduced on a license at

[4] The possibility of sharing a floating staff is supported by the fact that certain functions are presently combined for what seems like an unlikely coalition of boards Landscape Architects, Shorthand Reporters, Veterinary Medicine, and Yacht and Ship Brokers

nominal cost, the widespread adoption of this feature should be examined in light of possible saving in time and tempers

5 As an aid to intelligent governmental budgeting, the direct costs of issuing licenses should be covered by fees, even when the group of licensees is comprised mainly of governmental employees This requirement is necessary to clarify intergovernmental relations and to eliminate hidden subsidies to particular governmental functions

Recommendation and example:

The Board of Education issues lifetime credentials for teachers, a function which was carried on with a deficit for nine out of the years 1951–63 In 1960–61, the deficit had grown to $207,333 In October 1961, the fee was raised from $4 to $8 A maximum fee of $10 per credential is presently authorized under Education Code 13182, history suggests that the credentialing function will face another period of deficits during the next decade There are two solutions to this type of problem

(1) Change the pattern of legislation in such a way that licensing fees are removed from statutory maxima This is the solution that doubtless would be favored by the licensing agencies [4]

(2) Set a minimum statutory fee for original accreditation in specified occupations, the minimum to be reviewed, say, once every five years

Solution (2) possesses the advantage that the Legislature could thereby encourage careful scrutiny of persons entering occupations of great public concern The list of these occupations would change from time to time Perusal of Table 2 suggests that, in addition to the teaching credential, initial fees are too low for pyrotechnic operators, servicemen for fire extinguishers, poultry meat inspectors, and aircraft pest control operators

6 Fees which rise with the income of the licensee should be limited to occupations where the cost of enforcement rises in a like manner This principle is considered more fully in connection with the licensing of businesses Two questionable cases crop up in vocational licenses the branch office license for optometrists and the pilotage fees collected by the Board of Pilot Commissioners In the case of optometrists, one might wonder whether the convenience of the patient and the efficiency of medical care is served by deterring decentralization and large-scale operation In the case of pilots, one might question the wisdom of levying the stiffest fees on the men who pile up the most experience

[4] "Thus, a representative of the Certification Office recommends, 'The maximum fee of $10 per credential should be changed to permit State Board of Education to change the fee if need arises'"

CHAPTER III

LICENSES AND FEES LEVIED ON PARTICULAR TYPES OF BUSINESS

What seems like infinite variety in the *bases* for assessing business fees can be reduced to about two dozen general formulas As an aid in following the data, the chart below indicates the general nature of the multiform bases to be encountered To dispel doubt concerning the reality of some of the bases, one example is given for each

The data contained in the responses to the questionnaire have been separated into seven categories, according to the type of fee being collected Despite difficulties of classification, the use of categories brings out significant facets of the data

Table III—1 fits with Table II—1 to show all types of licenses in the medical field This area is segregated partly because it is the one where the layman is most dependent upon the enforcement of professional standards, partly because collections therefrom are a factor in determining the cost of medical care To the extent that the state is concerned with minimizing or shouldering private medical costs, fees and licenses in the medical field deserve close scrutiny

Table III—2 segregates licenses and fees in the area of food and agriculture, most of which are collected by three departments Health, Agriculture, and Fish and Game To show a clearer picture of total fees paid by the industry Table III—3 is added It lists the charges made by the Department of Agriculture for services such as inspecting crops, testing seed, and certifying plants These fees are paid in the main by farmers who are not formally "licensed " In a sense, however, the charges resemble business licenses because they are a necessary cost of doing business. In 1962-63, collections from licenses proper and from charges for services totaled $8 4 million

The enormity of this figure must give pause To the extent that costs of production are shifted to the ultimate buyers of agricultural products, the California farmer is handicapped in competing with out-of-state farmers, and the California consumer has a higher food bill. Insofar as fees and licenses unduly burden the industry, the common problem of farmers is intensified food prices climb, but the farmer's share of the consumer's food dollar continues to decline [1]

Table III—4 lists fees and licenses in miscellaneous fields closely connected with public health, education, safety, and welfare The licensing program in each field is administered by a specialized board or agency Some of the fee schedules suggest that they serve two ancillary goals customarily accomplished through taxation rather than licensing

1 The collection of larger amounts from establishments with larger gross income ("Student enrollment fee and revenue stamp" paid by cosmetology schools; "interment fees" paid by cemeteries)

[1] For the United States as a whole, the farmer's share steadily declined in the last decade from 44 percent in 1953 to 38 percent in 1963 (Julius Duscha, *Los Angeles Times* (February 16 1964), p 8

EXAMPLES IN 1962–63 FEE AND LICENSE STRUCTURE

(A) Sale of nursery stock
(B) Producer of economic poisons
(C) Milk products plant
(D) Cemeteries
(E) Athletic club
(F) Onsale general licenses for alcoholic beverages
(G) Corporate security broker
(H) Hospitals and nursing homes
(I) Radioactive materials
(J) Credit unions
(K) Temporary onsale beer and wine
(L) Wine grower
(M) Frozen milk products plant
(N) California Dairy Council fee
(O) Butter cutting and wrapping permit
(P) Market milk inspection
(Q) Horse, mule, burro slaughterer

TABLE III–1

BUSINESS FEES AND LICENSES IN MEDICAL FIELDS, 1962–63

Agency and type of business	Original fee	Renewal fee	Other	Collections (in thousands)
Board of Osteopathic Examiners				
Clinic permit fee	$25			$1
Board of Pharmacy				
Pharmacy	$50–0			26
		$25–0		105
General dealer, prophylactic	$5–0			—
		$5–0		—
Wholesale and manufacturing, prophylactic	$50–0	$50–0		4
General dealer permit (no prescriptions)	$5–0	$5–0		4
Wholesale drug	$50–0	$50–0		16
Manufacturing drug	$50–0			18
Board of Public Health				
	No beds		Charge	
Hospital and nursing home	1– 49		$20	35
	50– 99		$30	
	100–199		$40	
	200–		$50	
Establishment for handicapped	1– 29		$20	1
	30– 49		$30	
	50– 74		$40	
	75–		$50	
Certification of hospital for nonprofit (minimum $15)	25 cents/active no beds			
Clinic	$20	$20		1
Clinical laboratory	$10	$10		14
Biologics producer or distributor	$30	$10		—
	No of animals		Charge	
Keeping and using laboratory animals certificate	1– 500		$ 5	6
	501–2499		$ 25	
	2500–		$200	
Radiation machine registration	$5*	$5*		177
Radioactive materials	$500 to $20, depending on strength			31
Bird banding		3	cents/band	24

* Biennial fee

TABLE III—2

BUSINESS FEES AND LICENSES IN FOOD AND AGRICULTURAL FIELDS, 1962–63

Agency and type of business	Original fee	Renewal fee	Other	Collections (in thousands)
Department of Public Health				
Cannery	$50	$50		$7
Inspection and laboratory control			60%–06⅔% of cost	251
Cold storage	$50	$50		15
Frozen food locker	$25	$25		6
Egg processing	$100	$100		4
Walnut shelling	$25	$25		1
Horsemeat processing	$50	$50		1
Department of Agriculture				
Farm products handler, broker, cash buyer, commission merchant, dealer				
Primary	$80	$80		
Conjunctive	$25	$25		[a]280
Farm products agent (primary)	$10	$10		
Farm products processor	$90	$90		[a]41
Agent	$10	$10		
Bonded warehouse, agricultural				
Grain and hay	1 cent/ton	(min $25,	max $100)	
Cannery	50¢/M cases	(min $50,	max $200)	—
Dried fruit	2¢/ton	(min $50,	max $200)	
Miscellaneous	$25	$25		
Grain warehouse registration				
Each warehouse (annual)	$10	$10		2
Each warehouseman (annual, maximum)	$150	$150		
Commercial fertilizer				
Producer, manufacturer, importer, dealer	$50	$50		[b]23
Jobber	$25	$25		
Tonnage tax			14¢/ton	[b]260
Agricultural minerals				
Producer, manufacturer, importer, dealer	$50	$50		10
Jobber	$25	$25		
Tonnage tax			5¢/ton	[b]76
Economic poisons				
General	$100	$100		
Plus payment for each product in excess of 10	$10	$10		[c]105
Limited use	$25	$25		
Plus payment for each product in excess of 2	$10	$10		
Livestock remedy registration	$25	$15		16
Hazardous livestock remedy	$15	$15		8
Feeding stuffs				
Commercial tonnage tax			4¢/ton	280
Milk products plant	$10	$10		
Plus $1 for each 100,000 lbs over the first 100,000 lbs received during the preceding year				13
Milk distributor	$3	$3		6
Market milk inspection fee (Maximum 3 mills/gal graded milk and cream, 2 mills/gal ungraded milk and cream sold)			Cost	85
Fluid milk and cream assessment 6 mills/lb milk fat, 3 mills from producers, 3 mills from distributors				[d]916
California Dairy Council Fee May and October 10 mills/lb milk fat, other months 6 mills per lb milk fat shared equally by producers and handlers				[e]508

TABLE III—2 (Continued)

BUSINESS FEES AND LICENSES IN FOOD AND AGRICULTURAL FIELDS, 1962–63

Agency and type of business	Original fee	Renewal fee	Other	Collections (in thousands)
Department of Agriculture—Continued				
Milk distributor—Continued				
Sales stimulation and consumer education program				
Sacramento area 4 mills/lb milk fat, producers only				$38
Alameda area 3 mills/lb milk fat, producers and handlers				70
San Diego area 5 mills/lb milk fat producers and handlers				55
Butter cutting and wrapping permit (minimum $1)			20¢/1,000 lbs	18
Modified milk products	$100	$100		1
Frozen milk products plant	$35	$35		
Plus $3 for each 10,000 gallons over 20,000 manufactured during preceding year				151
Dietetic or dietetic frozen milk products	$25	$25		1
Ice cream or ice milk mix manufacturer			4¢/gal	2
Oleomargarine or margarine				
Manufacturer	$100	$100		54
Bakery and restaurant	$2	$2		
Imitation milk				
Manufacturer	$100	$100		54
Bakery and restaurant	$2	$2		
Imitation ice cream or ice milk				
Manufacturer	$100	$100		11
Bakery and restaurant	$2	$2		
Imitation cream				
Manufacturer	$100	$100		
Wholesaler	$50	$50		—
Retailer	$5	$5		
Bakery and restaurant	$2	$2		
Poultry plant	$40	$40		12
Cattle slaughterer	$100–20	$100–20		12
Horse, mule, burro slaughterer	Based on	quantity		
Foreign cold storage meat				
Importer and wholesaler	$25	$25		1
Inspection fee			Cost	20
License to feed garbage to swine	$20	$20		4
Permit to hold or import nutria	$10	$10		1
License to sell nursery stock ($15 plus 50¢/acre over first acre)			$30 (max.)	121
Department of Fish and Game				
License to feed migratory birds	$25	$25		1
Game breeder No. 1 (limited)	$5	$5		6
Game breeder No. 2 (unlimited)	$25	$25		3
Game tags			3¢ each	2
Shellfish cultivator	$25	$25		—
Fish breeder	$15	$15		4
Commercial fishing	$15	$15		123
Live fresh water fish for bait	$10	$10		2
Commercial fishing boat registration	$10	$10		38
Wholesale fish dealer	$25	$25		8
Fish canner and processor	$75	$75		3
Fish importer and broker	$25	$25		2
Fish importer	$5	$5		—

TABLE III—2 (Continued)

BUSINESS FEES AND LICENSES IN FOOD AND AGRICULTURAL FIELDS, 1962–63

Agency and type of business	Original fee	Renewal fee	Other	Collections (in thousands)
Department of Fish and Game—Continued				
Fish tax paid by processors brokers, etc on fish other than salmon purchased, received, or taken			5¢/cwt	$294
Salmon tax paid by processors, brokers etc on salmon received, purchased, or taken			½¢/lb	42
Special privilege tax paid by brokers, importers, or wholesalers of sardines, mackerel, squid, herring, and anchovy			5¢/cwt	85
Tags				
Bass, legally imported			1¢ each	—
Catfish, legally imported			1¢ each	6
Trout			1¢ each	5
Perch			1¢ each	—
Salmon, legally imported			1¢ each	—
Oyster bed				
Application fee for allotment of area	$50			—
Rental of oyster beds			$1/acre	6
Tax on removal from state reserves (maximum)			$10/ton	2

[a] Collections based mainly on former fees of $55 (agent, $5) for primary license and no charge for conjunctive. Higher fees effective 6/1/63
[b] Collections based mainly on former fee of 18 cents for fertilizer and 6 cents for minerals
[c] Collections based mainly on former fees of $75 up to 10 products ($3 for each additional) and $15 up to 2 products ($3 for each additional)
[d] Collections based on former fee of 4 mills shared by producers and distributors
[e] Collections based on May and October only, fee for other months added in 1963
[f] Same rate is paid for butter received in package form for distribution in California
[g] No figure for collections supplied
[h] Collections may include some wholesale licenses at $50/year, requirement deleted in 1963
[i] In addition the California Poultry Improvement Commission collected $10,500 from Entry (participation) fees, at the rate of $250 for California entrants and $350 for out-of-state entrants
[j] Less estimated $4 127 commission to agents
[k] Less $1,901 commission to agents

2 The setting of fees to limit the number of establishments and hence reduce public consumption of the product Although the sumptuary license is more evident in the area of alcoholic beverages, one wonders whether it is also exemplified in the $1,000 annual license for wholesalers of fireworks This is double the fee for manufacturers (whose products may be shipped out of State) and 10 times the fee for importers and exporters It is also about 10 times the average fee for all other types of licensed business

Table III—5 shows fees and licenses for a variety of miscellaneous types of business Some of these fees have elements of a gross income tax, the clearest example being the "fee" for owners or operators of motor vehicles transporting property for hire For large express companies, one can guess that the traditional flat part of the fee ($4 per quarter) is swamped by the modern addendum of one-third of 1 percent of gross operating revenue

Two "industries"—alcoholic beverages and insurance—were singled out for individual tables, partly because their fee schedules were unique

TABLE III–3

FEES COLLECTED FOR SERVICES BY THE DEPARTMENT OF AGRICULTURE, 1962–63

Name of fee	Basis for charges	Collections (in thousands)
Shipping point inspection fee	For each crop, the size and number of containers or carloads, plus extraordinary travel and other expenses of the inspector	$1,820
Field crops inspection fee	For each crop, the quantity tested, the extent of the testing (e g "complete inspection," "partial inspection," "submitted sample"), the number of tests performed, plus extraordinary travel and other expenses of the inspector Frequently a minimum specified	388
Canning tomato inspection fee	34 cents per ton maximum Money not used for program is returned to canners and producers on a prorata basis	1,124
Seed testing fee	For each crop, the type and number of tests made plus additional charges for "sampling by request," including travel expense of the inspector	24
Strawberry plant certification fee	Acreage fee $50 per acre or fraction Testing fee $250 for first 30 plants plus $7 for each additional plant	a3
Seed garlic certification fee	Application fee of $25 for each block to be planted, $30 per acre or portion thereof for each increase block, $20 per acre or portion thereof for each certified block	b
Seed potato certification fee Seed potato test plot fee	$4 per acre for first field inspection, for second field inspection, and for tagging and grading, $1 50 per acre for seed entered for foundation stock	56
Avocado nursery stock certification	$25 for each lot of seed to be treated plus $25 for each additional 10,000 seed or portion thereof, $25 for certification of avocado nursery plus $20 for each additional 1,000 seed or portion thereof, $25 for each trip requested beyond two	b
Grape vine registration and certification	$10 per hundred mother block vines or portion thereof, $35 per acre or portion increase block plus $20 for each additional acre or portion, $25 application fee for nursery stock certification plus $10 per 1,000 feet of single nursery row or portion	4
Deciduous fruit and nut tree registration and certification	$5 per mother block tree (minimum $75), $3 per scion orchard tree (minimum $120), $75 for each ¼ acre or portion of nursery stock, $3 per seed source tree ($5 per tree for fewer than 8 trees)	3
Citrus registration and certification	$10 per mother block tree (minimum $200), $10 per year for each tree registered, $100 per ¼ acre or portion of candidate trees, $50 per ¼ acre or portion of increase block or certified block	b
Psorosis registry fee	$10 per tree	14
Container brand registration	$5 original, $1 renewal	1
Cattle brand recording	$5 original or transfer, $3 renewal, $6 reinstatement, $2 duplicate certificate	101
Hide and brand inspection fee	Charge per head 13 cents basic inspection, 20 cents point of origin inspection, 10 cents pasture inspection, 8 cents sales yard to sales yard inspection	733

TABLE III—3 (Continued)

FEES COLLECTED FOR SERVICES BY THE DEPARTMENT OF AGRICULTURE, 1962–63

Name of fee	Basis for charges	Collections (in thousands)
Apiary identification number registration	$1 original, no renewal required	—
Apiary serial brand registration or transfer	$2 original, no renewal required	—
Weighing and measuring device inspection fee	Contracted with counties at uniform rates based on cost	[c]$21

[a] Collections are based on former fee of $30 per acre, same testing fee
[b] Collections for 1962–63 not supplied
[c] Collections include $9 000 fees from Livestock and Vehicle Scales earmarked for Department of Agriculture Fund Other fees paid to General Fund

jungles that could not be squeezed into the format of the other tables In addition, each presented an interesting problem

Fees in the alcoholic beverage industry, as shown in Table III—6, frequently are based on the hypothesis that it matters *where* the business is done—in a little town or a big city (This basis is used in only one other type of licensing schedule, that for employment agencies) Are there really more potential clients *per establishment* in big cities? Or is it that the costs of enforcement *per establishment* are greater in big cities? If so, why stop the rise in the schedule at 40,000 population? Since collections from licenses for the sale of alcoholic beverages total more than $12 million per year, the nature of the schedule is important

Fees in the insurance field (Table III—7) illustrate the difficulty of revising rates to bring in more revenue The solution looks like that adopted by some restaurants under wartime price controls, unable to charge more for established items, restaurateurs began to add charges for items such as bread and butter, formerly free Thus, many of the old fees, dating back as far as 1933, are supplemented by shiny new ones (such as the fee for service of process upon commissioner) never before charged It should be added that the insurance field is particularly thorny because increases in fees may subject California insurance companies to retaliatory assessments by other states

Without field investigations of individual licensing programs, serious errors may be made in specific recommendations An attempt has been made, however, to set forth general rules and to suggest how they might be applied Comments made on the questionnaires confirm some of the conclusions

Suggested Principles for Business Licensing

1 In fields where the fee is not a flat amount, care should be taken to avoid placing unintentional penalties upon the efficiency of private

TABLE III–4

BUSINESS FEES AND LICENSES IN OTHER FIELDS AFFECTING PUBLIC HEALTH, EDUCATION, SAFETY, AND WELFARE, 1962–63

Agency and type of business	Original fee	Renewal fee	Other	Collections (in thousands)
Department of Motor Vehicles				
Driving school operator	$25	$25	$100	*$10
For three examinations				
State Fire Marshal				
Firm that services, recharges, or inspects fire extinguishers	$35	$35		
Firm that tests water of dry chemical extinguishers	$35	$35		
Firm that tests carbon dioxide fire extinguishers	$35	$35		13
Certificate of registration of employees for above firms			$5	
Firm applying flame-retardant chemicals, fabrics, or materials				
Listing of firm	$50	$50		
Listing of one product (annual)			$150	21
Listing of each additional product (annual)			$30	
Firm manufacturing or supplying or installing equipment approved by the Fire Marshal				
Listing of one material, piece of equipment, or method of construction (annual)			$50	
Next four additional			$25 each	
More than five			$10 each	
Listing one series of fire alarm control units (annual)			$25	b7
More than one			$10 each	
Listing one fire alarm warning device (annual)			$10	
More than one			$5 each	
Fireworks				
Wholesaler	$1,000	$1,000		
Manufacturer	$500	$500		
Importer or exporter	$100	$100		c26
Retailer, per outlet	$10	$10		
Public display	$25	$25		
Board of Barber Examiners				
Barbershop				
Inspection and issuance fee	$28*			21
		$6*		27
Transfer			$6*	5
Barber college	$100	$100		2
Board of Cosmetologists				
Establishment application			$10–2	4
Establishment license	$4			21
		$10–2		99
School application fee			$60–30	2
School inspection fee			$60–30	2
School license	$150–100			4
		$150–100		21
School student enrollment fee and revenue stamp		$5–2		41
Board of Dry Cleaners				
Shop Examination			$20	18
	$30*			*27
		$30*		*139
Plant Examination			$20	42
	$120*			*62
		$120*		*208
School	$250	$250		1

TABLE III—4 (Continued)

BUSINESS FEES AND LICENSES IN OTHER FIELDS AFFECTING PUBLIC HEALTH, EDUCATION, SAFETY, AND WELFARE, 1962–63

Agency and type of business	Original fee	Renewal fee	Other	Collections (in thousands)
Board of Funeral Directors and Embalmers				
Funeral director				
Original fee	$35			$1
Initial license	$100*			*1
		$100*		*104
Transfer			$15	1
Board of Cemeteries				
Certificate of authority				
Original filing fee			$200	2
Additional filing fee			$300–0	1
	$100			1
		$100		8
Interment fee			15¢–0	13
Auditing fees for examiner of endowment funds (max /day)			$50	3
Broker				
Original examination	$100			2
Reexamination	$25			—
First renewal (individual, corporation, or partnership)		$75		8
Second renewal (additional officers of corporation or partners)		$25		—
Branch office			$25	1
Board of Structural Pest Control				
Principal office	$40			2
		$40		27
Branch office	$20			2
		$20		5
Revenue stamps			50¢	147
Inspection report certificate			$1	31
Board of Furniture and Bedding Inspectors				
Manufacturer, wholesale supply dealer		$120–10*		*38
Pro rata		$60		*12
Repairer, renovator, sterilizer		$80–20*		*99
Pro rata		$40		*8
Retail combination		$40–8*		*173
Pro rata		$10		*5
Retail furniture or bedding		$20–4		*84
Department of Veterans Affairs				
Plan check and inspection of houses financed by the Department			$50	37
Department of Industrial Relations				
Plan checking and construction permit fees				
State Housing Law (apartments, hotels, dwellings)	On value	of construction		61
Earthquake Protection Law	On value	of construction		2
Mobilehome Park Law				
Plan checking and construction permit fee	On value	of construction		69
Annual or supplemental permit to operate		Number of lots		53
Prefabricated structures				
Construction plan check	$10 min			
Electrical plan check	$5 min			
Plumbing plan check	$5 min			
Resubmission fee	$5			2
Awnings, approved models	$11			
Cabanas and ramadas	$15			
Travel fee, out-of-state applicant, per model	$40			

TABLE III—4 (Continued)

BUSINESS FEES AND LICENSES IN OTHER FIELDS AFFECTING PUBLIC HEALTH, EDUCATION, SAFETY, AND WELFARE, 1962-63

Agency and type of business	Original fee	Renewal fee	Other	Collections (in thousands)
Department of Industrial Relations—Continued				
Motel Act				
Construction permit fee	On value	of construction		$9
Permits to operate for additional units or change of status	$10			2
Trailer Coach Regulations				
Plan approval	On equipment to be installed ($5 min.)			
Approval insignia fee				
Independent	$4			162
Dependent	$2			
Inspection fee for requested inspection		$6/coach or $6/hour		23
Travel fee, out-of-state applicant	$40			

* Star indicates that fee is for two-year period or that collections are shown as average amount for fiscal years 1961-62 and 1962-63

[a] Includes collections from instructors' licenses ($10—4/year)

[b] Includes collections from pyrotechnic operators' licenses ($10/year).

[c] Fee schedule was revised in 1963

business Without knowledge of enforcement costs, it is dangerous to cite specific instances Three examples are suggested by the data

Importers and wholesalers of foreign cold storage meat are burdened by an inspection fee based on the cost of inspection An official of the Department of Agriculture comments

> The entire Article 2, Chapter 1, Division 3, should be deleted, since it is a duplication of inspection performed by the United States Department of Agriculture, Meat Inspection Division

Motel owners are similarly burdened An official of the Division of Housing writes·

> The Motel Act, and related permit provisions, should be incorporated in the State Housing Law, with statutory designation of local primary enforcement agencies under present law There are areas of duplication or overlapping, as the local enforcement agency does not assume complete enforcement jurisdiction and the division is therefore required to process some overlapping permits and fees

Kelp harvesters pay a flat license of $10 and a lease fee of 10 cents per ton for a specific area A penalty fee of 50 cents per ton is assessed on the amount taken above the amount specified in the lease Penalty collections in 1962–63 were much larger than regular lease fees This suggests that small operators enjoy an advantage over large operators and that the regular lease fee should be raised, as it would tend to be in a free market.

TABLE III—5

BUSINESS FEES AND LICENSES IN MISCELLANEOUS OTHER FIELDS, 1962–63

Agency and type of business	Original fee	Renewal fee	Other	Collections (in thousands)
Division of Corporations				
Corporate Securities Law				
Brokers certificate				
First office		$100		
Additional office		$50		$137
Change partnership		$10		
Investment counsel certificate		$50		11
Agent's certificate		$25		369
Hearings, audits, examinations			Cost	3
Industrial Loan Law				
Administration fee ($250 minimum)			Cost	72
Examination			Cost	53
Credit Union Law				
Application fee	$5			—
Administration fee (based on assets)	$8–450			
Plus 25 cents per $1 000 for assets over $500,000				335
Personal Property Broker Law				
Investigation fee	$100			20
Examination fee (annual)			Cost	111
Small Loan Broker Law				
Investigation fee	$100			1
License	$200	$200		288
Examination fee (annual)			Cost	4
Escrow Law				
Investigation fee	$100			4
Main office	$100	$100		44
Branch office	$35	$35		
Examination and hearing fee			Cost	73
Penalty for late renewal or reinstatement			½ license	1
Check sellers and Cashiers Law				
Investigation fee	$50			—
Principal office	$100	$100		
Branch office	$20	$20		20
Agency	$3	$3		
Examination fee			Cost	18
Security Owners Protective Law				
Application fee	$25			—
Retirement Systems Law				
Declaration of intention to form	$50			6
Examination fee			Cost	9
Trading Stamp Law				
License (application and annually)	1% of required bond			12
Department of Agriculture				
Public Weighmaster	$25	$25		*107
Additional location	$5	$5		
Private weighmaster	$25	$25		*9
Additional location	$10	$10		
Automotive products dealer				
Motor fuel license per pump	$2	$2		224
Brake fluid registration and permit	$100	$50		7
Automatic transmission fluid registration	$100	$50		2
Antifreeze registration and permit	$50	$50		5

TABLE III—5 (Continued)

BUSINESS FEES AND LICENSES IN MISCELLANEOUS OTHER FIELDS, 1962–63

Agency and type of business	Original fee	Renewal fee	Other	Collections (in thousands)
Department of Fish and Game				
Kelp harvester	$10	$10		—
Lease fee for specific area			10¢/ton	$4
Fee for amount taken above amount specified in lease			50¢/ton	6
Yacht and Ship Brokers Commission				
Yacht and ship broker Examination			$15	—
	$100			3
		$50		12
Branch office	$10	$10		—
Transfer			$5	—
Division of Real Estate				
Broker				
Original examination and reexamination			$25	
	$25			
		$50/ 4 yrs		
Late renewal			$75	
Branch office, change of address, salesman transfer, duplicate license, fictitious name, etc			$4	[b]1,336
Endorsement to deal in real property securities			$50	
Permit to handle mineral oil, and gas transaction			$1	
Mineral, oil, and gas subdivision filing fee			$150	
Subdivision filing fee minimum			$50	
Plus $1/lot up to $250 maximum				
Board of Collection Agencies				
Collection agency	$400 [c]			18
		$300–200		146
Duplicate license			$20	2
Highway Transportation Agency				
Outdoor advertising firm	$65	$65		
Each advertising sign (annual)			50¢	118
Each advertising structure (annual)			$2	
Athletic Commission				
Athletic club	$100–25	$100–25		5
Show tax, 1 cent on each 20 cents or fraction, minimum			$25	142
Radio and TV tax, 1 cent on each 20 cents or fraction, minimum			$25	9
Public Utilities Commission				
Certificate of public convenience and necessity				
Passenger stage corporation	$50			—
Highway common carrier, petroleum irregular route carrier, cement carrier	$150 [d]			12
Street railroads, gas corporations, electric corporations, telegraph corporations, water corporations, common carrier vessels, express corporations, freight forwarders, warehousemen	$50 [d]			10
Highway carrier registration of authority from Interstate Commerce Commission	$25			*

TABLE III—5 (Continued)

BUSINESS FEES AND LICENSES IN MISCELLANEOUS OTHER FIELDS, 1962–63

Agency and type of business	Original fee	Renewal fee	Other	Collections (in thousands)
Public Utilities Commission—Continued				
Permits to operate				
Highway contract carrier, radial highway common carrier, petroleum contract carrier, city carrier, cement contract carrier	$150 [1]			$562
Household goods carrier	$100			10
Transfer fee	$50 [2]			
Charter-party carrier (annual)	$25			3
Certificate authorizing indebtedness				
For first million			$1/$1,000	
For next 9 million			50¢/$1,000	102
Above 10 million			25¢/$1,000	
Person or corporation owning or operating motor vehicles in the transportation of property for hire, express corporation, freight forwarder, motor transportation broker, vessel operator, railroad corporation. Flat fee of $4/quarter plus ½ of 1% of gross operating revenue				3,339
Department of Motor Vehicles				
Hauler of property or persons for hire, BE permit per vehicle			$1	33
Automobile dealer, manufacturer, transporter, dismantler				
First set of plates with investigation			$58	
First set of plates, no investigation			$8	
Each additional set of plates			$8	501
Automobile dismantler, investigation for failure to send in documents and plates			$5	
Automobile dealer, misuse report of sale			$3	624
Board of Equalization				
Motor vehicle broker or producer	$10	$10		17
Motor vehicle transportation license tax (truck tax)				
Initial permit (no renewal)			$5	
Reinstatement			$10	36
Division of Industrial Welfare				
Industrial homework	$50	$50		5

TABLE III—5 (Continued)

BUSINESS FEES AND LICENSES IN MISCELLANEOUS OTHER FIELDS, 1962-63

Agency and type of business	Original fee	Renewal fee	Other	Collections (in thousands)
Division of Labor Law Enforcement				
Private employment agencies, theatrical and motion picture agencies, labor contractors				
Main office				
Application fee			$25	
License, cities over 100,000	$100	$100		
License, cities over 25,000	$50	$50		
License, other places	$25	$25		
Application for transfer			$25	
Branch office			$25	
Managers handling artists				
Main office				
Application fee			$25	
License	$50	$50		
Application for transfer			$25	
Branch office			$25	$171
Farm labor contractors				
Application fee			$10[i]	
License	$25[j]	$25[j]		
Private nurses registries				
Main office				
Application fee			$25	
License, cities over 100,000	$100	$100		
License, cities over 25,000	$50	$50		
License other places	$25	$25		
Branch office			$25	

[a] Includes collections from deputies' licenses ($2/year) shown in Table II-3
[b] Estimate reached by subtracting from total $1,000,000 for collections from real estate salesmen shown in Table II-3
[c] In 1963–64 the original license fee was raised to $500, the renewal to $450–$350
[d] Also for each application to transfer, lease mortgage, assign, sell, or otherwise encumber any certificate
[e] No revenue because enacted by 1963 Legislature
[f] Also for each application to sell, mortgage, lease, assign, transfer, or otherwise encumber a permit except transfer subsequent to death of a permittee when fee is $25
[g] Except transfer subsequent to death of a permittee, when fee is $25
[h] Minimum $25
[i] Effective July 1, 1964, railroad corporations and vessel operators excluded
[j] Licenses for labor contractors eliminated September 20, 1963

Recommendation:

Only a neutral *Representative of the Public Interest* can investigate and, more important, *ferret out*, possible instances where the burden of state fees handicaps the efficiency of private business Such a representative must be independent of the licensing agencies but must have access to their data Although this representative would be dealing with the problems of business, he might appropriately be attached to the Office of Consumer Counsel, from which he could make recommendations to the Governor In addition to his duties in connection with principle (1), now under consideration, he could also implement principles (2) through (5) below, which do impinge directly on consumer welfare

TABLE III—6

FEES AND LICENSES ADMINISTERED BY THE DEPARTMENT OF ALCOHOLIC BEVERAGES, 1962–63

	Original	Annual	Duplicate	Transfer	Collections (in thousands)
Onsale general	$6,000				$858
Cities over 40,000 population		$580		$406	
			$496	$347	
Cities over 20,000 population		$412		$288	
			$328	$230	
Other localities		$360		$252	
			$276	$193	
Trains and sleeping cars		$128			
			$32		
Boats		$332			5,630
Vessels of more than 1,000 tons burden		$128			
			$24		
Airplanes		$128			
			$10		
Club					
Cities over 40,000 population		$330			
Cities over 20,000 population		$248			
Other localities		$220			
Seasonal business	$2,000				26
Cities over 40,000 population		$145		$102	
			$124	$87	
Cities over 20,000 population		$103		$72	119
			$82	$57	
Other localities		$90		$63	
			$69	$48	
Veterans' club, other club					
Cities over 40,000 population		$330		$165	
Cities over 20,000 population		$248		$124	[b]165
Other localities		$220		$110	
Caterer's permit					
On sale general			$100		
Clubs					
Cities over 40,000 population			$580		115
Cities over 20,000 population			$412		
Other localities			$360		
Onsale beer and wine	$150				3b
		$84		$59	
Boats		$56			
Trains		$16			363
Airplanes		$16			
Temporary, per day		$5 50			28
Onsale beer	$100				
		$84		$59	133
Fishing party boats		$32		$16	1,010
Offsale general	$6,000				1,041
Gross annual retail sales of distilled spirits under $20,000		$200 [a]		$140	
Plus for sales in excess of $20,000		$200			4,703
Offsale beer and wine	$25				
		$12		$12	
Temporary		$25			164
Distilled spirits wholesaler		$276 [d]		$193	50
Beer and wine wholesaler		$56		$39	52
Wine broker		$50		$39	—
Customs broker		$12		$12	—
Brandy manufacturer		$168		$118	5
Distilled spirits manufacturer		$276 [d]		$193	4
Distilled spirits manufacturer's agent		$276 [d]		$193	20
Rectifier		$276 [d]		$193	6
Each still		$12		$12	3

TABLE III—6 (Continued)

FEES AND LICENSES ADMINISTERED BY THE DEPARTMENT OF ALCOHOLIC BEVERAGES, 1962–63

	Original	Annual	Duplicate	Transfer	Collections (in thousands
Distilled spirits importer		$276[d]		$193	$3
Beer manufacturer		$828		$580	
			$56	$39	11
Beer and wine importer		$56		$39	1
Wine grower					
5,000 gallons or less		$32			
5 000–20,000 gallons		$44			
20,000–100,000 gallons		$52 50			31
100,000–200,000 gallons		$110			
200,000–1,000,000 gallons		$105			
Each additional million gallons		$110	$56	$39	
Public warehouse		$12		$12	1
Industrial alcohol dealer		$56		$39	1

[a] Collections from most of the licenses in this table include an unknown component from duplicate (replacement) licenses at $5 50 each and transfers by surviving partner, spouse fiduciary, etc at $27 50 each
[b] Of which $61 577 was from Veterans' Clubs
[c] Fee raised by $24 effective 7/1/64
[d] Fee raised by $62 effective 7/1/63

2 Like taxation for revenue, simple licensing should strive to be "neutral"—that is, it should cause minimum interference with the interplay of market forces, the means by which a free economy expresses its choice of the preferred output More specifically, this means that licenses should not be used as a conscious device for

(a) Altering consumer preferences, including the choice between leisure and work,

(b) Attracting resources into an industry,

(c) Discouraging resources from flowing into an industry,

(d) Protecting industry or labor within the State from out-of-state competition, and

(e) Altering the normal geographical distribution of firms within the State

Probable examples of each type of interference can be cited from the tables in this chapter

(a) The millage fee paid by producers and handlers of milk fat for the "sales stimulation and consumer education program" seems clearly designed to alter consumer preferences

(b) The fact that canneries pay only 60–66⅔ percent of the cost of inspection and laboratory control attracts resources to the canning industry as against, say, the frozen food industry or the fresh food products industry

(c) Resources are seemingly discouraged from flowing into the "imitation" milk, cream, and ice cream industry by license fees on bakeries, restaurants, and wholesalers using or selling one or more of these prod-

TABLE III–7

BUSINESS FEES AND LICENSES ADMINISTERED BY THE DEPARTMENT OF INSURANCE, 1962–63

Name of fee	Unchanged	Changed on 9/26/63		Changed on 9/30/64		Collections (in thousands)
		Before	After	Before	After	
Application for admission (Original Certificate of Authority)		$85	$255			$5
Application for approval of underwriter's name		0	$10/2 yrs			—
Filing amended admission documents	$10					1
Annual renewal certificate of authority	$10					7
Annual renewal certificate of authority, reciprocals	$10					—
Application for amended certificate of authority	$10					1
Application for change in membership of copartnership						
Insurance agent				$4	$5	—
Insurance broker				$10	$12 50	—
Life agent	$4					—
Application for endorsement removing name of natural person from organizational license	$1					12
Motor club						
Application for certificate of authority	$25					none
Amended documents certificate of authority	$10					none
Annual license fee	$10					—
County mutuals						
Declaration of intention to incorporate		0	$250			—
Annual renewal certificate of authority		0	$10			—
Certificate of surplus		0	$25			—
Certificate of merger, original		0	$100			—
Fraternal benefit societies						
Application for certificate of authority		$20	$250			—
Annual renewal certificate of authority	$20					1
Filing merger documents		0	$25			—
Filing annual statements	$20					1
Declaration of intention to incorporate as a reinsurer		0	$250			—
License for rating organization				$25 (lifetime)	$100 (initial) $50 (annual)	—
Escrow department, underwritten title companies						
Approval of auditor						
Initial	$10					—
Renewal every 5 years	$10					—
Approval of annual audit		$10/ quarterly audit	$25/ audit			5

TABLE III—7 (Continued)

BUSINESS FEES AND LICENSES ADMINISTERED BY THE DEPARTMENT OF INSURANCE, 1962–63

Name of fee	Unchanged	Changed on 9/20/63		Changed on 9/30/64		Collections (in thousands)
		Before	After	Before	After	
Application for permit to issue securities		Prior to 9/20/63: Plus First $20,000 $10; Next $30,000 5%; Next $50,000 4%; Next $100,000 2%; Above $500,000 1%			After 9/20/63: First $1,000 $50; Next $49,000 .5%; Next $50,000 1%; Next $400,000 .05%; Next $4,500,000 .02%; Next $5,000,000 .01%; Above $10,000,000 .002%	$5
Application for permit to issue securities evidencing any change in rights, privileges or restrictions on outstanding securities		$25	$50			
Filing application to issue rights, warrants having no value		0	$50			—
Issuing certificate of deposit of securities	$5					6
Receiving, withdrawing or substituting securities on deposit or deposit of securities in lieu of workmen's compensation bond		0	$25 (initial)			—
		0	$5 (each change)			—
Filing of tax bond or receiving securities in lieu thereof, change in deposit or endorsing bond	$5					—
For alien insurers						
Issuing certificate of deposit of securities		$5	$24 (initial) $5 (each change)			—
Filing certificate of deposit of securities	$5					—
Filing certificate of trustees for trusted assets	$5					—
Stock or bond appraisal	Cost					—
Certification of surplus by commissioner—reciprocals		0	$25			—
Service of process upon commissioner						
Appointment of agent after one initial appointment	$5					—
For reciprocals and alien insurers		0	$10			—
For foreign insurers		0	$5			—
Others		0	$2			—
Filing annual statements	$25					19
First amendment to license application	$1					10
Certifying copies of documents	$1					—
Attaching commissioner's seal of office	$1					1

TABLE III—7 (Continued)

BUSINESS FEES AND LICENSES ADMINISTERED BY THE DEPARTMENT OF INSURANCE, 1962–63

Name of fee	Unchanged	Changed on 9/26/63		Changed on 9/30/64		Collections (in thousands)
		Before	After	Before	After	
Issuing certificates, prepared form	$2[b]					[a]$8
Vocational licenses and certificates						
Security broker certificate		$25	$100			
Each additional office		0	$50			—
Security agent certificate		$5	$25			—
Insurance broker license				$10[d]	$12 50[d]	6224
Insurance solicitor license				$8	$10[d]	73
Surplus line broker license				$50	$62 50	12
Life and disability agent						
Examination, first		$3	$6			[a]47
Examination, repeat		$3	$10			
License		$4[d]	$8[f]	$8[d]	$10[d]	[a]38
Fire and casualty agent						
Examination, first		$5	$6			[a]46
Examination, repeat		$5	$10			
License				$8[f]	$10[d]	[a]166
Travel insurance agent	$4					1
Bail						
Permittee, new license				$60	$100	3
Permittee, renewal	$50					
Solicitor, new license				$10	$20	1
Solicitor, renewal	$10					
Agent, new license				$10	$20	8
Agent, renewal	$10					

[a] Copy of original $5
[b] When form is not prepared fee is reasonable cost not to exceed $10
[c] The Department of Insurance also collects small fees for making copies of documents and comparing copies of papers
[d] Fee is for two years collections are shown as average of 1961–62 and 1962–63
[e] Changed 12/31/64
[f] Change to $8 was effective 6/30/63

ucts There are no comparable fees for bakeries, restaurants, and retailers who handle "the real thing"

(d) The California butter industry must be protected to some degree from out-of-state competition by the necessity to pay the butter cutting and wrapping fee on butter received in package form for distribution in California

(e) License fees based on population in the location of the business (for example, nurses' registries and various other types of employment agencies) tend to pull the establishments away from heavily populated areas In these fields, there would seem to be no obvious reason for interfering with normal locational patterns as determined by the market

The examples above are suggested by the fee schedules Other methods of limiting competition, such as the setting of unduly difficult examinations, would require investigation by a representative of the public interest, as recommended under Principle (1) above As a first step, the representative of the public interest could act as a watchdog against the imposition of new infractions of the principle of neutrality

3 There is a presumption in favor of fee schedules which reflect actual costs of enforcement of standards.[2] Such a schedule facilitates the working of natural market forces and encourages the allocation of resources in accordance with consumer preferences. Where the cost of enforcement does not differ greatly as between licensees the great advantages of simplicity dictate a single flat fee per establishment. Where the cost of enforcement rises with capacity or with the amount of production, a sliding schedule of fees may be more equitable than a flat amount. In no case, however, should the schedule contain more than a few brackets, since the costs of compliance rise more rapidly than the gains in equity.

Lacking detailed information concerning procedures and costs, it is impossible to make specific recommendations. It may be helpful, however, to illustrate the way in which fee schedules might be examined for violations of the "cost principle."

The page reproduced below is taken from a pamphlet entitled *Inspection Fees and Charges*, issued by the Federal-State Inspection Service, U.S. Department of Agriculture, State of California Department of Agriculture, Bureau of Shipping Point Inspection, revised and effective July 11, 1959. Three questions might be investigated.

Is the carload cost of inspection the same for all kinds of crops? This page shows only peas, peppers, and potatoes, but the same charge is made in all other schedules—alphabetically, all the way from apples to watermelons.

Are there no economies of scale in inspecting large lots? Although the schedules look complicated, the rate is proportional to the base at the upper end of each bracket. "Other potatoes," for instance, cost 3.3 cents per hundredweight. If the shipper falls below the top of his bracket, he is subject to a fortuitous rise in inspection cost per hundredweight. At the top of the scale an extra sack raises costs by 0.2 cent per hundredweight for the whole shipment; at the breaking point of the scale, an extra sack could raise costs by 1.1 cents per hundredweight for the whole shipment. Hence the present schedule falls between two stools. It misses both the equity and simplicity of a flat charge per unit of inspection and the possibility of reflecting economies of scale for large lots.

Is the *cost of inspection* affected by the *geographical area* where it is done? If not, it is difficult to explain to growers on the south side of Township M 2 North in Los Angeles County why they should pay at least 10 percent more for inspection than growers on the north side.

4 There is a strong presumption in favor of simplicity in fee schedules, especially for fields where

(a) larger establishments are less subject to a deterioration of standards (because they have reputations to protect, or greater know-how, or more professional employees, etc.), and

(b) the fee serves the ancillary purpose of acting as a sumptuary levy, and slight inequities further this aim.

[2] Exceptions to this rule would occur, of course, if accessory goals were being pursued. To obtain maximum revenue for the general fund, for example, the State should behave like a discriminating monopolist, charging each establishment all that it is willing to pay.

PEAS		PEPPERS				
Tubs	Hampers	Lettuce crates	Florin crates	In bulk	Car	Fee
175 or less	163 or less	80 or less	120 or less	6000 or less	¼	$3 00
176/350	164/325	81/160	121/240	6001/12000	½	6 00
351/525	326/488	161/240	241/360	12001/18000	¾	9 00
526/700	489/651	241/320	361/480	18001/24000	1 0	12 00
701/770	652/716	321/352	481/528	24001/26400	1 1	13 20
771/840	717/781	353/384	529/576	26401/28800	1 2	14 40
841/910	782/846	385/416	577/624	28801/31200	1 3	15 60
911/980	847/911	417/448	625/672	31201/33600	1 4	16 80
981/1050	912/976	449/480	673/720	33601/36000	1 5	18 00
1051/1120	977/1041	481/512	721/768	36001/38400	1 6	19 20
1121/1190	1042/1107	513/544	769/816	38401/40800	1 7	20 40
1191/1260	1108/1172	545/576	817/864	40801/43200	1 8	21 60
1261/1330	1173/1237	577/608	865/912	43201/45600	1 9	22 80
1331/1400	1238/1302	609/640	913/960	45601/48000	2 0	24 00

POTATOES

in Madera, Fresno, Kings, Tulare, Inyo Kern, Riverside San Bernardino Counties and that part of Los Angeles County North of Township M 2 North—3 cents per hundredweight with a minimum of $3 per certificate 3½ cents per hundredweight after 7 p m

OTHER POTATOES		SWEET POTATOES		
50-pound sacks	100-pound sacks	Bushel baskets	Car	Fee
180 or less	90 or less	140 or less	¼	$3 00
181/360	91/180	141/280	½	6 00
361/540	181/270	281/420	¾	9 00
541/720	271/360	421/560	1 0	12 00
721/900	361/400	561/616	1 1	13 20
901/864	401/432	617/672	1 2	14 40
865/936	433/468	673/728	1 3	15 60
937/1008	469/504	729/784	1 4	16 80
1009/1080	505/540	785/840	1 5	18 00
1081/1152	541/576	841/896	1 6	19 20
1153/1224	577/612	897/952	1 7	20 40
1225/1296	613/648	953/1008	1 8	21 60
1297/1368	649/684	1009/1064	1 9	22 80
1369/1440	685/720	1065/1120	2 0	24 00

Recommendations and examples:

Schedules which might be simplified on grounds set forth under (a) include license fees for hospitals, nursing homes, establishments for the handicapped, and sellers of nursery stock

Schedules which might be simplified on grounds set forth under (b) fall mainly in the field of alcoholic beverages The table reproduced below[3] illustrates the complexity of fees in this field and also points to what may be a widespread flaw in California's business licensing. the willingness to prorate fees according to elapsed time without allowance for fixed overhead, a tendency that is also carried over into fees for "transfers" In the table exhibited, for instance, no great financial

[3] From *Alcoholic Beverage Control Manual*, May 15, 1964

FISCAL YEAR LICENSE FEES

Type		July-September	October-December	January-June	Transfers
20 B	Retail package offsale beer and wine	$12 00	$8 00	$8 00	same
21 C	Retail package offsale general for under $20 000 gross retail sales of distilled spirits per year	224 00	168 00	112 00	
C	In addition for $20,000 or more gross retail sales of distilled spirits per year	200 00			
	21 C Transfer	164 00	158 00	152 00	
19 D	Industrial alcohol dealer's	56 00	42 00	28 00	$39 00
14 E	Public warehouse	12 00	9 00	6 00	same
14 E	Copy of public warehouse	1 00	1 00	1 00	
5 F	Distilled spirits manufacturer's agent's	328 00	246 00	164 00	
	5 F Transfer	215 00	242 00	219 00	
18 G	Distilled spirits wholesaler's	328 00	246 00	164 00	
	18 G Transfer	245 00	232 00	219 00	
17 H	Beer and wine wholesaler's	56 00	42 00	28 00	39 00
2 I	Wine grower's				
	5 000 gallons or less	22 00			
	Over 5,000 to 20,000 gallons	44 00	At any time of year		
	Over 20,000 to 100,000 gallons	82 50			
	Over 100 000 to 200,000 gallons	110 00			
	Over 200,000 to 1,000,000 gallons	165 00			
	Each 1 000,000 gallons over 1,000,000	110 00			
2 I	Duplicate of wine grower's	56 00	42 00	28 00	39 00
1 J	Beer manufacturer's	828 00	621 00	414 00	580 00
1 J	Duplicate beer manufacturer's	56 00	42 00	28 00	39 00
4 K	Distilled spirits manufacturer's	328 00	246 00	164 00	
	4 K Transfer	245 00	232 00	219 00	
12 L	Distilled spirits importer's	none	none	none	none
8 N	Wine rectifier's	276 00	207 00	138 00	193 00
16 Q	Wine broker's	56 00	42 00	28 00	39 00
15 R	Customs broker's	12 00	9 00	6 00	same
11 S	Brandy importer's	none	none	none	none
6 T	Still (per still)	12 00	9 00	6 00	same
7 U	Rectifier's	328 00	246 00	164 00	
	7 U Transfer	245 00	232 00	219 00	
9 W	Beer and wine importer's	none	none	none	none
10 WH	Beer and wine importer's general	56 00	42 00	28 00	39 00
13 X	Distilled spirits importer's general	328 00	246 00	164 00	
	13 X Transfer	245 00	232 00	219 00	
3 X	Brandy manufacturer's	168 00	126 00	84 00	118 00
30 TBW	Temporary offsale beer and wine	25 00			
	Duplicate license (replacement)	5 50	At any time of year		
	Transfers Premises, by surviving partner, spouse, fiduciary, etc.				
	21 C Transfers	51 50	45 50	39 50	
	5 F, 18 G, 4 K, 7 U, 13 X Transfers	79 50	66 50	53 50	
	All other transfers	27 50			

harm would be done to any licensee if the transfer column read "same" (as the regular fee) all the way down Collections would require less clerical time, and the State would derive some additional revenue The same results would obtain if the two "pro rate" columns were reduced to one, perhaps an average of the two to be applicable after November first

5 Licensing programs should be searched periodically to eliminate anachronisms and costly procedures A possible example is the sale at 1 cent each of tags for certain kinds of fish When one sees the elab-

orately printed metal tag on a trout at the fish counter, one wonders whether most of the penny was used up in manufacturing, selling, and attaching the tag. Some cheaper method (such as a purple ink stamp like that used on meat, combined with stiff penalties for its illegal use) would benefit fish dealer and consumer alike.

6. As with occupational licensing, the licensing of business makes little sense unless it is accompanied by a program for enforcement of standards. Fees that are largely consumed in clerical expense should either be raised or eliminated.

Recommendations:

The following fees should be raised to cover clerical costs plus some margin for enforcement:

- Milk distributor
- Barber shop renewals [4]
- Apiary identification number registration
- Apiary serial brand registration or transfer
- Credit union application fee
- Real estate permit to handle mineral, oil, and gas transactions
- Industrial homework [5]
- Examinations for insurance agents (life and disability, fire and casualty)
- Travel insurance agent license

7. When an agency regulates several closely related industries, fee schedules should be closely tied to costs so that industry subsidizes its closest competitor.

Recommendation and example:

The Division of Housing of the Department of Industrial Relations makes a careful analysis of the cost of each of its "fee-connected activities." Unlike many agencies, it correctly includes in cost peripheral items like time spent on related legal actions and on report writing, plus "overhead" for the administrative and operating costs of the division and the department. Thus a meaningful comparison can be made between collections and costs. It appears not only that the housing field is being slightly subsidized as a whole but also that some of the components are heavily subsidized by others. In 1962–63 collections as a percentage of cost were:

State Housing Law	84%
Mobilehome Park Law	74%
Trailer Coach Regulations	130%
Motel Act	91%
Earthquake Protection Law	102%

The Division of Housing is aware of this apparent inequity and suggests that an attempt should be made to "pinpoint direct costs of services as related to the designated fees."

[4] Comment of an official of the State Board of Barber Examiners: "This fee does not pay for the cost of issuance and proportionate cost of administration of the act."

[5] In 1962–63 collections did not cover even the direct cost of processing 105 homework licenses and 805 permits. This field is a good example of one where a margin is needed for enforcement.

8 Equity as between establishments, as well as higher levels of service by the regulatory agency, would be promoted by charging a separate fee for each type of business conducted

Example:

Under the present Labor Code, a licensee need pay only a single fee to operate as a nurses' registry and a general employment agency, or to operate as an artists' manager and a general employment agency

Serious Questions of Policy

The data presented in this chapter raise three issues concerning the overall policy of the state in its regulation of economic activity While the economist can draw attention to these issues and outline the probable consequences of various alternatives, the choice of alternatives is a policy decision

1 Many business licenses bear fees which resemble gross income taxes Sometimes the fee is levied directly upon receipts, more often it is removed one step and levied upon an indirect measure of receipts (amount produced, quantity inspected, capacity, and so on) Sometimes the fee is proportional, sometimes the rate declines as receipts (or the measure of receipts) rises

This type of fee structure raises questions of equity as between (a) big and little firms within a licensed industry, and (b) industries which pay a kind of hidden income tax and industries which do not If the fee were an outright tax for general revenue, it would be safe to conclude that the taxed industries are burdened *vis-à-vis* the untaxed In this case, however, the fees are frequently placed in special funds which are used in part for activities similar to those performed by (or desired by but forbidden to) trade unions or trade associations So it is possible that the industries which pay the fees are benefitted *vis-à-vis* those which do not

If fees assessed on receipts were spent in the same way as general state revenues, it would be possible to weigh their probable effect upon the State's economic growth Fees of this sort resemble sales taxes, although they may raise prices to the consumer more than an equal amount of sales taxation because of pyramiding [6] It is widely believed that taxes upon consumption, such as sales taxes, provide a more favorable climate for economic growth than progressive income taxes gauged to produce the same amount of revenue [7] The significant comparison in this case, however, is not between hypothetical progressive income taxes and fees which are like proportional gross income taxes What should be compared is proportional gross income taxes and lump sum fees yielding an equivalent amount of revenue This choice is rarely discussed in the modern theory of economic growth, since "capitation" taxes on business violate current concepts of ability to pay The gist of the theory, with its emphasis on the stimulation of investment, points to a conclusion that flat license fees would be more conducive to economic growth than fees which are proportional to gross income

[6] Six mills, for example, collected from producers and distributors of fluid milk may, after markups, raise the price of the product at the retail outlet by 1 cent

[7] For the rationale leading to this conclusion, see, for example, John F Due, *Government Finance*, 3d ed (Homewood Richard D Irwin, Inc, 1963), pp 586–588

The offsale general license for distilled spirits offers an example of what might happen if a flat-fee policy were adopted The basic fee in 1962–63 was $200, plus an additional $200 for establishments whose gross retail sales exceeded $20,000 The number of establishments was about 10,000 and collections were about $4,703,000, or roughly $470 per establishment Unfortunately, collections include transfers at $140 each and prorated fees at $150 and $100 So it is impossible to calculate what the flat fee would have to be, but it seems safe to guess that it would have to be at least $300 Small retailers would pay about $100 more, large retailers about $100 less [8] Such a change would presumably widen by $200 the normal discrepancy between the net profits of the small retailer and the large retailer The theory is that this would augment the supply of funds for investment On a graphic, overpersonal level, the example would be complete if the small retailer reduced his personal consumption of goods and services, thereby freeing productive resources which could be used for the construction of plant and equipment, financed by the increased venture capital of the large retailer

2 Most of the fees collected for business licensing go into special funds This practice has long been criticized on the ground that it leads to added administrative costs and lack of control over expenditures Usually, it is thought that expenditures are greater than they would have been if the activity had been supported out of regular appropriations The opposite error—spending too little—can also occur when support is limited to collections from dedicated sources Although it would seem that underspending could be corrected by raising fees, this may lead to an unwanted restriction of licenses An example of this impasse may occur in the licensing of radioactive materials No one can argue against a level of expenditures adequate to control radiation, yet the fees necessary to support this level may represent an undesirable deterrent to the beneficial uses of the materials [9]

The general argument against special funds has been summarized by the Assembly Committee on Ways and Means

> There is no sound reason for special funds for regulating agencies It implies that regulation is for the regulated group alone, whereas it must be assumed to be in the public interest as well If it is not in the public interest, it should not be a state function If it is in the public interest, there is no reason why license fees and related assessments should not be in the General Fund [10]

The present study reveals an additional argument against dedicated funds when they are of a "mixed" nature The most flagrant example is the Fish and Game Preservation Fund which is fed by two sources of a very different nature business fees and licenses as shown in Table III—2 and user fees collected from sportsmen (Table V—1) In

[8] The Department of Alcoholic Beverage Control would endorse such a change and has made three attempts at general sessions of the Legislature to effect it on the ground that costs of administration and collection would be reduced

[9] This view is held by the Department of Public Health The department believes that the radioactive material regulatory program is "truly a public health program" which should be financed "principally from general support funds"

[10] California Legislature, Assembly Interim Committee on Ways and Means, *Report on Dedicated Funds* (February 15 1961), p 28 In 1959 the Legislature attempted to consolidate separate Professional and Vocational Standard funds into a single Professions and Vocations *Fund* The *Controller* and Attorney General believed that the measure was defective, and the new fund received no money *Ibid*, p 34

a combination like this, the budgetmaker cannot tell who may be subsidizing whom To the extent that the commercial fishing business is subsidizing public recreation, the fish-purchasing public probably subsidizes the sportsman Even the sit-at-home beeteater may be paying a higher price for beef because the fish dealer's contribution to the sportsman raises the price for fish and switches the demand toward beef[1] The problem is further confused by the general conservation activities performed by the Department of Fish and Game, a program to which the general taxpayer should presumably contribute

For the pessimist who doubts that dedicated funds, especially of the user type, can be abolished, the chief hope for improvement probably lies in greater use of performance budgeting This would force a regulatory agency to break down its work first into programs, then into units of performance, and finally into activities carried out Where a regulatory agency served other functions, as with the Department of Fish and Game, the separate breakdown for each function could be weighed against its sources of support [11]

3 A question arises as to whether a business license, once issued, should become the "property" of the licensee—an asset of his business which he can sell along with the equipment and the goodwill The problem is most acute in the case of licenses to sell alcoholic beverages, where the number and location of licenses is strictly limited, but it occurs also in other businesses such as funeral homes and employment agencies The importance of transfers can be judged by comparing the number issued with the number of renewals For barbershops, for example, the number of shop transfers in 1962–63 was more than 10 percent of the number of renewals [12] On the ground that the acceptability of the premises can change with its management, it would seem logical to raise transfer fees at least to the cost of renewing the license

This would not meet the problem in the alcoholic beverage field where transfers for desirable sites command prices far in excess of their original cost It has long been suggested that the State should recapture the appreciation in value created through the monopolistic privileges conferred by a license As the Assembly Interim Committee on Government Organization put the question

> By the issuance of a state privilege for $6,000 under the present setup whereby this privilege can be sold to another, a value of $15,000 is created overnight Is it right for the State to issue a privilege which immediately doubles or triples in value the day that privilege is issued? Should the State create and allow this windfall to the licenseholder—a person who has done no work to create this value? [13]

One obvious solution was opposed on the ground that it would work a hardship on licensees

> To have all licenses revert to the State, as some have suggested, also raises a number of problems Licensees who have paid large

[11] Techniques of performance budgeting for an agency with a variety of programs are described in Jesse Burkhead, *Government Budgeting* (New York John Wiley & Sons, Inc, 1959), pp 148–162

[12] Department of Professional and Vocational Standards, *Activity Report to Governor Edmund G Brown*, January 1, 1963–June 30, 1963, p 33, and July 1, 1963–December 31, 1963, p 33

[13] California Legislature, Assembly Interim Committee on Government Organization, *The Alcoholic Beverage Control Act* (January 1963), p 22

prices for these transferred licenses can only recover their investments through further transfer Particularly hard hit would be those who have obtained their licenses recently In addition, if a licensee wished to sell his business, there is no guarantee that he can sell his stock, his store, and his "goodwill" if the buyer is not assured of getting a license [14]

The Assembly committee that studied this problem rejected another obvious solution, the removal of monopoly elements by issuing licenses without limit Instead, it recommended two indirect attacks The first was an attempt to increase the supply of licenses in certain counties by continuing the provisions for intercounty transfers The effectiveness of such a method is limited because counties into which licenses can be transferred tend to be those where the asking price is low, and "it is just as economical for a prospective purchaser to acquire a license within the same county rather than to buy one in another county and pay the $3,000 transfer fee to transfer in" [15] The second recommendation was a limitation on the number of liquor licenses of the same type which might be acquired by any one person, partnership or corporation [16] Although large chain stores held only 10 percent of the outstanding licenses, they were alleged to be a strong force in driving up the price for licenses in choice locations The large chains could afford to pay a high price partly because the cost of the license was a small factor in the overall cost of large shopping facilities and partly because a liquor department substantially increased the volume of overall sales in other departments

The Alcoholic Beverage Control Act effective September 20, 1963, shows a valiant attempt to meet the problem headon "The purchase price or consideration that may be paid by a transferee or received by a transferor of an onsale general license or offsale general license originally issued on or after June 1, 1961, shall not exceed six thousand dollars ($6,000)" [17] Like any price control law that contravenes the law of supply and demand, this statute must be difficult to enforce It must lead to some grandiose payments for fixtures and inventory Furthermore, it does not recapture for the State the monopoly value created by issuing a limited number of licenses in a limited number of locations

The basic difficulty is that the value of a license depends not only upon the wall upon which it hangs but also upon ever-changing economic developments in the neighborhood While this is true of all business licenses, the limitation of the number of liquor licenses makes most of them worth more than the fee charged by the State, frequently several multiples of this fee The direct solution would be for the State to charge market prices for nontransferrable licenses A partial approach to this solution would be to auction new licenses to the highest bidder, rather than holding a drawing when the number of applicants exceeds the number of licenses available

[14] *Ibid*, p 23 Actually, the license *does* revert to the State, and the buyer, if not disqualified, is issued a new one
[15] *Ibid*, p 25
[16] *Ibid*, p 27
[17] Article 4, § 24079.

A further approach could be taken by inserting in the formula for *renewal* fees some factor that indirectly measures the value of the license Precedent for this has already been established in the additional fee required for an offsale general license when gross retail sales of distilled spirits exceed $20,000 per year Someone familiar with the industry could doubtless pick over the great assortment of variables shown in the chart at the beginning of this chapter and select a variable that would be a fairly good measure of the worth of a license The recapture of monopoly values through sliding renewal fees has the advantage of treating alike all establishments, whether or not they change hands frequently, and of recapturing gains that might go untouched for a generation

CHAPTER IV

GENERAL FEES AND LICENSES

This chapter is concerned with licenses and fees that any person or any business might have to pay Many of the fees are technically voluntary—one need not drive a car or incorporate a business, but most of them are a necessary expense of "normal" living Taken one at a time, each affects only one segment of the population As a group, however, they come out of almost every pocket

The data compiled from the questionnaires have been separated into three parts Table IV—1 shows miscellaneous fees paid by the general public, including, of course, businesses which act as separate corporate entities in bringing suit, redeeming tax deeded land, and so on Table IV—2 shows general fees paid by all kinds of businesses in the "operating" sense—that is, fees which are part of the usual cost of doing business Table IV—3 shows general fees collected by the Department of Motor Vehicles [1] It mixes elements from both of the preceding classifications, since payments which the payors regard as business expenses cannot be separately identified Partly for this reason and partly because collections are such a large source of revenue, charges made by the Department of Motor Vehicles are treated in a separate section at the end of the chapter

The data in the tables understate the scope and variety of general fees collected by various state agencies Most agencies collect small sums for clerical services The Division of Corporations, for example, charges 30 cents per page for copywork and $2 for certification The Public Utilities Commission charges 20 cents per folio for plain copying, 25 cents per folio for copy to be certified plus $1 for certification These clerical fees have not been assembled into a table, to do so would give a false impression of completeness Many agencies did not report clerical fees as part of their fee schedules, and omissions would add to a substantial amount

Recommendation With Regard to Unlisted Minor Fees:

Although it would not necessarily increase revenues, the efficiency of state government would be improved if overall minima were set for such services as photocopying, certification, issuing duplicates for lost licenses, endorsing corrections on licenses etc The rationale behind this recommendation is that this type of work is a distraction from the main job of the agencies and the public should be motivated to make minimal requests As a trifling example, the State Personnel Board in 1962–63 issued 41 duplicate typing or shorthand certificates at a direct cost of $21 for collection of the fee and $35 for recording and depositing The charge of 50 cents each did not even cover the cost of collection, and it would have been cheaper to throw the collec-

[1] Fees levied on particular types of businesses, such as driving schools and automobile dealerships, are shown in Chapter III

tions out of the window than to record and deposit them It is hoped that a substantial minimum charge would reduce this type of activity

Miscellaneous Fees Paid by the Public

There is a presumption in favor of setting miscellaneous fees high enough to cover costs, except where the government is performing a function traditionally associated with public welfare Fees collected by the Department of Mental Hygiene illustrate such an exception The maximum charge for the board of mentally ill pay patients is fixed at the statewide average per capita cost of maintaining patients in all state hospitals, although the actual average cost may vary by about $100 per month at different hospitals The maximum charge bears no relation to the cost of treating a particular patient, since care in receiving and intensive treatment wards costs much more than care in continued treatment wards [2] Section 6651 of the Welfare and Institutions Code provides that

> The Director of Mental Hygiene may reduce, cancel or remit the amount to be paid on satisfactory proof that the estate or relatives, as the case may be, are unable to pay the cost of such care, support, and maintenance or that the amount is uncollectable

This arrangement exemplifies the fundamental dilemmas of mixing a public welfare function with a charge based on ability to pay To the extent that the forgiveness of fees is administered equitably, the unproductive public cost of investigating individual ability to pay rises To the extent that the forgiveness of fees is administered inequitably, the productivity of public expenditures falls Finally, it is impossible to evaluate the fees actually being charged except by a thorough investigation of a sample of actual cases

Apart from collections by the Department of Mental Hygiene, the dominant characteristic of miscellaneous fees paid by the public is that they are sales of "pieces of paper " The cost of producing the physical product may or may not be covered For the largest item in this category—sale by the Department of Motor Vehicles of duplicates of dealers' reports of sale—one would guess that the $3 charge is adequate to cover physical costs and clerical expenses, particularly since the volume of sales exceeds 200,000 per year The sale of copies of the Motor Vehicle Code at $1 each probably covers physical cost, but may fail to cover the overhead cost of depositing and bookkeeping

Four difficulties arise in assessing the second largest item, the sale of documents by the State Printer (1) Like all public enterprises which are tinged with an educational function, the sale of governmental publications cannot be run like a similar private enterprise, the price of bestsellers cannot be raised to cover losses on unpopular items (2) The Documents Section is not solely a merchandising operation, since the section also distributes material required under the Library Distribution Act (3) The Documents Section obtains its merchandise from its parent organization, the Office of State Printing, which also produces the printing for state agencies and the Legislature, manufactures

[2] The Legislative Analyst has recommended that patients be divided into two groups, with patients under continued (generally, more prolonged) treatment charged less than those requiring more intensive care *Report of the Legislative Analyst for the Fiscal Year July 1, 1963, to June 30, 1964*, pp 443–444

TABLE IV—1

MISCELLANEOUS FEES PAID BY THE PUBLIC, 1962–63

Agency and description of fee	Schedule of charges	Collections (in thousands)
State Printer Sale of documents		$316
State Controller		
Redemption and sales fee for tax sold or tax deeded land	$1 50 per separately valued parcel	246
Service charge for claims against the Abandoned Property Account	1% of value of property ($10 maximum)	46
Supreme Court		
Filing transcript on appeal, civil case, for each notice of appeal	$50	[a]9
Filing original proceedings	$50	
Filing petition for hearing	$25	
District Courts of Appeal	Same as Supreme Court	[b]17
Department of Public Health		
Vital statistics		
Certified copy or search of records	$2	132
Delayed registrations	$4	15
Amending birth record, change in surname	$2	—
State Personnel Board		
Oral panel transcript	$37 50	[c]1
Board hearing transcript		
Per folio original	35 cents	
Per folio carbon	10 cents	
Photocopying service record card	$1	
Duplicate typing or shorthand certificates	50 cents	
Unemployment Insurance Appeals Board		
Transcript of hearing, first copy, per page	$1	3
Each additional copy, or where appeal filed, per page	30 cents	
State Employees Retirement System		
Filing abstract or transcript of judgement	$2 50	[d]
Industrial Accident Commission		
Transcript of hearing, per page	$1	28
Sale of disability rating schedule	$2	1
Copies and certified copies of records, per page	75 cents	7
Department of Motor Vehicles		
Sale of Vehicle Code, per copy	$1	15
Duplicate of dealers' report of sale, each	$3	634
Department of Highway Patrol		
Sale of accident reports and photographs, each	$2	200
Department of Mental Hygiene		
Outpatient clinic and day treatment fee, maximum per visit	$10	74
Neuropsychiatric institutes, pay patients board charges, maximum per day	$35	964
Mentally ill pay patients board charges, maximum per month	$278	15,010
Guardianship fees	As allowed by Courts	67

[a] Includes other minor charges such as $1 for issuing various kinds of certificates, 5 cents per folio for comparing a document, and 1 cent per folio for comparing carbon copies or duplicate prints Schedule of charges shown became effective September 20, 1963 Former fees $7 50 for original proceedings, $10 for filing transcripts from lower court

[b] Includes estimate of $1,780 for Third District

[c] Excludes collections of $218,407 for services rendered at cost to other state agencies and units of local government

[d] Excludes collections of about $500 000 for costs of administering retirement systems for public agencies

textbooks for public schools, and operates the Legislative Bill Room The production of so many "joint products" requires excellent cost accounting to correctly portray the cost of merchandise sold by the "subsidiary," the Documents Section (4) The Office of State Printing itself is only one of the complex of services operated by the Department of General Services through the Service Revolving Fund Other services include such diverse activities as the operation of an automotive pool, purchasing and distribution of supplies and the maintenance and repair

of communication equipment, office machines and automotive equipment

In this vast complex, the budget of the Documents Section is like the budget of the sales department for can openers in the empire of General Electric Viewed in this light, however, the budget of the Documents Section presents figures which would certainly arouse the curiosity of an ambitious vice president [3]

	Actual 1961–62	*Estimated 1962–63*	*Proposed 1963–64*
Sales	$330,251	$250,000 *	$350,000
Cost of documents	62 %	60 %	60 %
Distribution costs			
Salaries	19 %	25 %	30 %
Operating expenses	15 %	20 %	15 %
Depreciation	0.4%	0.3%	0.3%
Total distribution costs (after deducting reimbursements)	62 %	60 %	60 %

*Actuals proved to be $318,435

The typical sales manager would be asked why the cost of goods purchased and the net cost of distribution rise as volume increases For the net cost of distribution, the answer lies in increased salary cost—not only higher salaries in later years, but also more positions per dollar of sales Despite more efficient printing equipment, this factor may also affect the cost of the parent supplier of documents A typical business, faced with such a situation, would raise the price of those publications for which the demand was least elastic This move would tend both to raise revenue directly and to reduce operations to a scale where they are, apparently, more efficient A public monopoly should not behave with the cupidity appropriate to private enterprise, however, and the more desirable public policy would be to attempt to discover why the Documents Section seems to operate with diseconomies of scale

Recommendations:

The earlier recommendation that overall minima be set for clerical charges would serve to prevent "losses" on most of the minor miscellaneous fees shown in Table IV—1 As a matter of efficiency, it would seem wise to adopt the uniform charge (described in Chapter I) for amendments to a birth record by the Department of Public Health Major new sources of revenue in this classification appear to hinge on charges for special service in time of need As an extreme example, the Highway Patrol might impose a fee for blood relays and escort service So long as the use of such services is confined to emergencies, it would seem more humane to support them by general taxation

General Fees Paid by Business

Fees paid by business fall into three classifications fees collected for the privilege of issuing securities and making other transactions related to the Corporate Securities Law, fees for permission to collect taxes (chiefly the sales tax) administered by the Board of Equalization, and fees for inspecting industrial hazards

[3] Source of figures *State of California Budget for the Fiscal Year July 1, 1963, to June 30, 1964*, p 1049

The charges made by the Division of Corporations under the Corporate Securities Law have a slight aura of taxation, in 1962–63 they resulted in a net contribution of something like a million dollars to the general fund There are two sound arguments for the excess of collections over expenditures The first is that a tax system is likely to be more equitable if it is comprised of taxes with a variety of bases rather than a single base such as net income Thus collections from permits to issue securities would force corporations with no taxable income to make some contribution to the cost of government The second argument is explained by the Commissioner of Corporations as follows·

> Furthermore, the cost of administering the Division of Corporations is expressed in part by costs of the Legislature, the Governor, and other state activities For this reason, it seems appropriate that, for every agency, fees should be designed to cover not only the out-of-pocket expense of the agency but to make some contribution towards general expense of unallocated expenses of state government [4]

This argument has some of the beauty of the golden rule, but also some of the vulnerability To the extent that other states do not follow it, the cost of issuing securities will tend to be lower elsewhere, and corporations might be attracted away from California Second to the extent that California's other fee-collecting agencies do not make a similar contribution to the cost of general government, corporations may be "handicapped," with effects similar to those of raising the rates of the franchise tax Neither of these qualifications appears to be serious The amounts collected are not large enough to be a noticeable deterrent to incorporation in California, and, to corporations on the borderline, the strictness of regulation is probably a dominant consideration in determining the locus of operations The second qualification assumes that the burden of collections remains on the payors of the fees Since the fees are essentially a business expense, it is likely that the incidence is shifted for the most part in the form of higher prices to the customers of the corporation [5]

If the philosophy of the fee schedule of the Division of Corporations were to be carried over to the schedule of the Division of Industrial Safety, sharp increases would doubtless be in order All of the charges are at least six years old and the schedule for elevators was last revised in 1954 Basic legislation concerning maximum fees has not been changed since the Labor Code of 1949 and this legislation is permissive "The division *may* fix and collect such fees " The interpretation given by the division to this legislation is that the purpose of the fees is mainly to discourage waste of the service by the public The division does not have data on the cost of collection, but in certain cases

> when the Accounting Section advises us that the fee is delinquent and we have to send a safety engineer to the location to attempt to force payment, the cost of collection is greater than the fee [6]

[4] Letter of John G Sobieski to Honorable Nicholas C Petris, Chairman Assembly Committee on Revenue and Taxation, December 10, 1963

[5] There appears to be greater likelihood of shifting of fees than of income taxes, and substantial evidence indicates that the corporate income tax tends to be shifted forward

[6] From reply to questionnaire

TABLE IV–2

GENERAL FEES PAID BY BUSINESS, 1962–63

Agency and description of fee	Schedule of charges	Collections (in thousands)
Division of Corporations		
Corporate Securities Law		
Permit to issue securities	$50 minimum	
Plus percentage of value of securities		
Over $1 000 to $50,000	2%	
Over $50,000 to $100,000	1	
Over $100 000 to $500 000	05	
Over $500 000 to $5 000 000	02	
Over $5,000,000 to $10 000 000	01	
Over $10,000,000	002	$2,187
Amending permit to issue securities	$25	
Permit to negotiate for sale	$25	
Permit to issue certificates of deposit	$50	
Permit to issue guarantee of a security	$50	
Permit to change rights preferences privileges or restrictions on outstanding securities	$50	
Fee for requesting consent of commission to change	$25	
Escrow fees		
Acting as escrow holder	$50	
Order consenting to transfer in escrow	$10	103
Depositing with commissioner documents from escrow	$2 50	
State Board of Equalization		
Sales and use tax permits		
Original or change of address	0	
Reinstatements	$1 (but $25 for every third time)	120
Use fuel (diesel) tax permits		
Original	0	
Reinstatement	$10	0
Vendor's use fuel tax permits		
Original	0	
Reinstatements	$10	—
State Fire Marshal		
Inspection fee, tank trucks carrying flammable liquids		
120–500-gallon capacity	$2	
500–1,500-gallon capacity		
single compartment	$5	*44
multiple compartment	$10	
Over 1,500-gallon capacity	$10	
Department of Water Resources		
Building or enlarging dam		
For cost up to $1 333	$20	
For cost $1 333 to $100,000	015 of cost	
Plus		355
For the next $100 000	075 of cost	
For the next $500 000	005 of cost	
For all over $1 000,000	002 of cost	
Division of Industrial Safety		
Elevator inspection fees		
Hand-powered dumbwaiters	$2	
Freight platform hoists hand powered man platforms	$3	
Power dumbwaiters, hand powered elevators power sidewalk elevators	$4	32
Manlifts	$5	
Escalators, power passenger or freight elevators	$7	

TABLE IV—2 (Continued)

GENERAL FEES PAID BY BUSINESS, 1962–63

Agency and description of fee	Schedule of charges	Collections (in thousands)
Division of Industrial Safety—Continued		
Shop inspection for tanks		
Capacity less than 1200 gallons	$4/hour or 35 cents per tank, whichever is greater	
Capacity more than 1200 gallons	$4/hour, minimum $4/tank	$45
Boilers and fire pressure vessels		
Fabricator's shop	$4/hour or $1 each, whichever is greater	
Jobsite	$4/hour or $20 each, whichever is greater	
Resale inspection, all tanks and boilers	$4/hour or $4 each, whichever is greater	
External field inspections		
Fire tube boilers up to 30 inches diameter	$3	
All other boilers	$4	
Internal field inspections		
Fire tube boilers up to 30 inches diameter	$4	
30–48 inches diameter	$7	
over 48 inches diameter	$11	80
Water tube boilers up to 150 square feet heating surface	$5	
150–500 square feet	$8	
500–2,500 square feet	$11	
over 2,500 square feet	$20	
Field inspection, tanks		
1,200-gallon or less capacity	$4	
more than 1,200-gallon capacity	$4/hour or $4 each, whichever is greater	

[a] Collections based on former fee schedule of $3 for capacity less than 1,500 gallons

Recommendations:

1 The fee schedule of the Division of Industrial Safety should be revised to cover the costs of its inspection program, including enforcement To accomplish this, the maximum charges permitted in the Labor Code may have to be raised The maximum charge for elevators, for instance, might have to be double the present figure of $7 50 Delinquent penalties should be imposed as a means of reducing the use of personnel for collection safaris

2 Fees charged by the Department of Water Resources for building or enlarging a dam should be raised The schedule, set by Section 6300 of the Water Code, was last changed in 1933 Certainly the minimum is obsolete, and the percentages of cost appear inadequate to support the program Only 62 percent of the cost of the program was covered in 1962–63

3 The tank truck fees administered by the State Fire Marshal may need upward revision The marshal reports

> The tank truck and bulletins and listing programs will require a very close control if they are to be maintained on a self-supporting basis The fees of both programs were adjusted this year, but there is still concern that there may not be adequate support [7]

[7] Letter from Glenn B Vance to Assemblyman Petris, December 9, 1963

In the meantime consideration should be given to a suggestion by the marshal concerning the due date for fees He believes that costs would be reduced if all fees were payable on a specific date instead of a year from the date of last inspection

4 The Board of Equalization issues permits to retailers of tangible personal property and to vendors of motor vehicle fuel, diesel fuel, and liquefied petroleum gas These permits are essentially a control device for collecting taxes on sales, and the privilege conferred on the permittee is really an obligation to remit taxes Hence, no charge is made for the original permit The charges for reinstatement of permit are in the nature of penalties For the sales and use tax permit, the reinstatement fee is a capricious penalty which rises from $1 to $25 every third time it is levied Surely it is a waste of clerical personnel to count the number of reinstatements for a particular retailer and ascertain whether the number is divisible by 3 It is recommended that the reinstatement fee for sales and use tax permits be altered to a uniform charge of $10

Fees Administered by the Department of Motor Vehicles

To the questionnaire concerning its fees, the Department of Motor Vehicles submitted a disappointing reply No mention was made, for instance, of the sale of information from department files, although the director has said

> It can thus be seen that information from departmental files is big business and represents a sizable part of the department's operation [8]

Where information was furnished it was sometimes so aggregated that little analysis of specific fees was possible As Table IV—3 shows, 23 fees are lumped together in one collection totaling nearly 93 million dollars

Within the scope of this study, there seemed no hope of tracing this great flow back to its sources Mr Tom Bright, the director of the department, states, "This is all the detail available in the department regarding revenue collected by type of fee, according to our present procedures" [9]

Cost data for the collection of specific fees are likewise unknown As Mr Bright explains

> Much of the information requested in your communication is unavailable in the department records Basically, this is because all our fees are collected at one transaction by the same personnel and no breakdown is available as to the cost for each of the fees
>
> The amount of time each fee requires of our personnel is unknown It would be extremely costly to collect such data, and as a result of conferences between the staff of our department and the Department of Finance and General Services over many years, it has been decided that the information would not be worth the cost of obtaining it [10]

[8] California Legislature Assembly Interim Committee on Transportation and Commerce, "*Keeping Pace With Needs of Motor Vehicle Ownership and Use* (January 1961), p 43 More than $1 077 000 was collected from this source in the 1959–60 fiscal year

[9] Letter to Assemblyman Petris, December 6, 1963

[10] *Ibid*

TABLE IV—3

GENERAL FEES AND LICENSES ADMINISTERED BY THE DEPARTMENT OF MOTOR VEHICLES, 1962–63

Type of fee	Amount	Collections (in thousands)
Registration		
Basic California	$8	[a]$78,000
Proportionate basic, VC 8153 and VC 8163		[a]2,800
Station wagon	$1 additional	a
Electric passenger vehicles	$10 additional	a
Additional weight fee for commercial vehicles	Scale according to type of vehicle and unladen weight	44,963
Vehicles registered outside State		
First registration fee	$6	a
Reregistration in same year	$1	a
Permit, limited term or reciprocity		
VC 9260	1/10 annual fee	a
VC 8008 and VC 4004	$5	a
One-trip permit	$5	a
Horseless carriage registration	$25	a
Certificate of ownership without registration	$5	a
Identification plates		
Amateur radio station	$3	a
Press photographer	$3	a
Fleet vehicle device	$2	a
Cotton or farm trailer	$5	a
Special construction or mobile equipment	$5	62
Special services		
Return of nonresident plate	$1	a
Transfer of registration	$2	a
Filing chattel mortgage	$2	a
Recording of installation of engine or motor	$2	a
Duplicate of registration	$2	a
Quarterly registration fee for privilege of paying weight fees quarterly when vehicle is in use	$2	a
Credit for fees paid	$2	a
Seizure and sale	Cost	a
Vehicle license (in lieu) fees		
Annual	2% of assessed value	145,622
Proportionate	10% of annual, $1 min	1,231
Driver's license	$3	9,205

[a] Estimated Collections from this fee plus all others bearing the same footnote were $93,722,870

Recommendations and examples:

Like other giant clerical operations, the work of the Department of Motor Vehicles is undergoing transition to data processing equipment For this reason it would be unwise to base recommendations upon existing data [11]

The general impression gathered from various sources is that the fee structure of the department needs "modernization," but that this should be undertaken only as an integral part of the overall modernization of departmental methods It would be strange, for instance, to automate the physical process of collecting the vehicle license (in lieu)

[11] For example, a study made in August 1962 by the management analysis section of the Division of Administration of the department lists as an element of cost in issuing an amateur radio plate 12 47 cents for proofreader's time (Report No 10 *A Study of Fees and Charges for Specific Services*) In view of the low cost of photocopying, this element would be expected to disappear

fee without reconsidering the formula for charging the cities and counties for this service [12]

There is evidence that the California fee structure for drivers and vehicles has not kept pace with the economic development of the State The $3 fee for an operator's license, good for a five-year period, ranks eighth from the bottom among the 50 states On an *annual* basis, California's charge is 60 cents The comparison with other states is as follows [13]

Operator's license fee per year	*Number of states*
0–$0 59	7
$0 60– 1 24	17
1 25– 1 99	12
2 00– 2 99	13
3 00– 4 00	3

The states where it is "cheaper" to drive are Hawaii (license good until revoked), Ohio, Missouri, Utah, South Carolina, South Dakota, and Nevada—in general, states where the driver is likely to have a few more seconds to make decisions

It is difficult to make a similar comparison for automobile registrations because many states compute their basic registration fees as a fixed amount plus some multiple of a variable factor—most commonly weight, but also age, horsepower, factory price, and other measures of worth Among the 17 states that charge a flat registration fee, California's $8 fee ranks eighth from the bottom The "cheaper" states are Alaska, Arizona, Massachusetts, Louisiana, Nevada, Washington, and Wyoming [14] Among the states that charge a flat fee plus an amount based on some other variable, 16 states *start with* a flat fee that is greater than California's *total* fee [15]

From one point of view, the fee schedule of the Department of Motor Vehicles should be set high enough not only to cover the department's costs but also to make a contribution to the General Fund Thus the private cost of placing another vehicle on the road would more nearly approach the social cost, including the various wastes caused by congestion on the highways (damage from smog, loss of man-hours, etc) From another point of view, however, the use of motor vehicles resembles going to school members of the public who do not participate nonetheless benefit from the activities of those who do Thus the welfare of the stay-at-homes is increased by those who brave the highways, and the private benefit from placing another vehicle on the road is supplemented by benefit to those who depend on public transportation On the hypothesis that the social cost of placing a vehicle on the highways in California is at least as great as the social benefit, it would seem desirable to raise the fees collected by the Department of Motor Vehicles to a point where the activities of the department would be self-supporting [16]

[12] Mr Bright states, "A formula developed years ago regarding the cost for the administration of this law is still being used and said cost is subtracted from the revenue collected and used for the administration of the Vehicle License Fee Law" *Op Cit* (Bright letter)

[13] Compiled from License Department, Automobile Club of Southern California, *Summary of Motor Vehicle Acts*, 1964

[14] *Ibid*

[15] *Ibid*

[16] This problem is similar to that of allocating the costs of highways to nonusers For a discussion of the issues, see Milton Z Kafoglis, "Highway Policy and External Economies," *National Tax Journal*, XVI, No 1 (March 1963), 89–101

An interesting question arises as to the proper relationship of the four basic levies on use of the highways

The operator's license fee,
The vehicle registration fee,
The fee based on weight (for commercial vehicles), and
The taxes on fuel

Each of these levies is a blunt tool for limiting congestion, each could be sharpened at some administrative cost The "pleasure" vehicle registration fee, for example, could embrace the weight variable frequently charged by other states This would encourage the use of smaller cars The fee for vehicles registered outside the State could be raised to the basic California rate on the ground that their bewildered drivers *frequently* cause congestion—and consternation—*on* the freeways during rush hours An attempt could be made to encourage the "one-car family" In this connection, the recent adoption of a $1 additional registration fee for station wagons would seem to be a nudge, albeit trifling, in the wrong direction What is needed is not a penalty on the all-purpose car, but rather a penalty on the additional car that appears in heavy traffic during peak-load hours Such a penalty would serve the usual function of price in limiting use [17]

It is tempting to recommend that certain fees be raised immediately The most important of these would be the fee for an operator's license, which, according to a departmental study, is issued at a loss [18] Other candidates would be the $1 fees, including the "BE permits" for more than 30 000 commercial vehicles (shown in Table III—5) But this would be a piecemeal solution to an important problem Rather, the need is for an integrated plan of the various fees and taxes paid by the highway user This plan should take into account the additional detail and the revised cost figures which surely will be forthcoming from the greater use of electronic equipment by the Department of Motor Vehicles It should also take into account the recent accumulation of data on highway usage in California, as well as the many solutions that specialists all over the country have proposed for similar problems Finally, the plan should not be bound by the connotation of fees as a clerical charge for enforcing certain minimum standards Where the private cost of an activity differs from the social cost, a single type of tax (such as the fuel tax) is frequently not sufficient to produce the socially optimal solution [19] Thus it may be necessary to use the fee structure as a supplement to the fuel tax in order to promote the optimum development of the State

[17] The absence of such a penalty may explain why the supply of highways never seems to catch up with the need As soon as highways are expanded, the cost of congestion to drivers falls, and new traffic is stimulated This explanation is developed in Charles O Meiburg "An Economic Analysis of Highway Services," *Quarterly Journal of Economics* LXXVII No 4 (November 1963), 646–656

[18] Department of Motor Vehicles, *A Study of Fees and Charges for Specific Services*, op cit

[19] For example, the fuel tax could not be so effective in removing decrepit vehicles from the roads as a combination of the fuel tax and a substantial basic registration fee

CHAPTER V

USER-TYPE FEES

Many of the fees in this chapter are of "modern" origin, stemming from an increased demand for "organized" recreation This demand grows out of four institutional changes in our society the concentration of population, the mobility afforded by fast transportation, rising real income, and the problem of using increased leisure California derives three broad categories of revenues from the leisure-time activities of its citizens (1) licenses and permits related to fishing, hunting, and boating, (2) charges for admission and parking at publicly owned recreational and educational facilities, and, (3) rentals and concession fees paid by private enterprise operating in publicly owned facilities

All of these fees—even those in the third category—are difficult to assess because they are fused with considerations of public welfare California has followed the widespread procedure of making only nominal charges for most of its recreational and semieducational facilities The rationale of this policy must be that the general public, and hence the nonusing taxpayer, derives an indirect benefit from use of the facilities by others This conclusion can be based on any of the following arguments

1 Recreation, like education, improves the individual and hence the society of which the individual is a member

2 Expenditures for recreational facilities, like expenditures for street lighting, reduce the incidence of undesirable activities, such as crime

3 Some of the appropriations for public recreation, such as the cost of water projects and water pollution programs, are directly beneficial to the general public because they conserve natural resources [1]

How then can one arrive at the proportion of support which the user should be expected to contribute? One approach is to find out what the user would be willing to pay Another approach is to compare the fee with the charge made by private enterprises offering comparable facilities [2] A third and somewhat circular approach is to find out what other states are charging [3]

None of these approaches resolves the fundamental difficulty that any increase in fees is likely to deprive that segment of the population

[1] With regard to this type of program, a representative of the Department of Fish and Game believes "The work being done is necessary to the preservation of fish and wildlife The results however are beneficial to all persons Thus, costs of these programs should not be the entire responsibility of the individual license buyer The license buyer does not cause the problem and there is usually no enhancement of the resources to benefit him"

[2] The Legislative Analyst used both of these approaches in assessing fees charged for overnight camping facilities On both grounds he recommended an increase in fees *Analysis of the Budget Bill, Fiscal Year July 1, 1963, to June 30, 1964*, pp 730–731

[3] Efforts are currently being made to measure the final incidence and costs of recreation This problem was discussed by Omer L Carey in "Recent Developments in Evaluating Recreational Benefits," a paper given at the 38th annual conference of the Western Economic Association

most in need of and most benefited by public recreational facilities A partial solution lies in "discriminatory" pricing—setting prices in such a way that consumers who can afford higher prices pay more In the present fee schedules, there are instances of indirect attempts to achieve this end charges which increase with the age of the payor, charges which decrease for persons traveling in groups, and so on If the State dropped its uniform pricing policy for outdoor facilities, even more reliance could be placed on discriminatory practices Extra charges (say, for reserved space or for more convenient locations) could be paid by users for whom time is worth more than money

Still, the fundamental problem remains What portion of public recreational expenditures should be supported by user fees? Some of the recommendations that follow are based on an implied half-answer they assume as a minimum that user fees should advance with the cost of government, so that leisure is not the beneficiary of inflation [4]

Licenses and Fees Related to Fishing and Hunting

Table V—1 shows fees collected by the Department of Fish and Game Nearly half of the fees have not been revised for a decade, and the most important fee, sport fishing licenses for residents over 16, has not been revised since 1948 In accordance with principles set forth earlier, a major revision of the fee schedule is suggested [5]

Recommendations and examples

1 That a minimum of $2 be set for all fees and licenses issued to persons Many of the $1 fees are old the junior hunting license, for instance, has not been revised since 1933 With the rise in clerical costs, a $1 fee is likely to be consumed in paperwork, with nothing left for enforcement

2 That all fees set more than a decade ago be raised to take account of the rising costs of the department For fees under $10, the increase should be at least $1 Larger fees should be adjusted by convenient round amounts

3. That the commission paid to voluntary licensing agents be eliminated The Legislative Analyst has found that the agents are generally merchants who would be willing to sell licenses at cost in order to attract foot traffic to their stores [6] The feasibility of obtaining licensing agents without commission has already been tested by the Division of Small Craft Harbors, and the system is working successfully

4 That special charges for veterans' wives and exemptions for certain aged, blind, wards of the State, disabled veterans, and servicemen be eliminated The department estimates that the value of free licenses issued in 1962–63 was about $100,000 The Senate Factfinding Committee on Natural Resources has recommended "reimbursements" of

[4] This view contrasts with the argument that public subsidy of recreational activity induces consumer expenditures (presumably at the expense of saving) and thereby stimulates the California economy An example of this reasoning was reported by Walt Radke "It has been estimated that anglers alone plunk out $50,000,000 annually for the gas, vittles, beer and lodging contingent to the chase Fish and Game officials contend this gives them a legitimate call on state monies" *San Francisco Examiner*, December 25, 1963

[5] For a general discussion of fees collected by the Department of Fish and Game, see Chapter III

[6] For a detailed discussion, see *Report of the Legislative Analyst to the Joint Legislative Budget Committee*, California Legislature 1963 Regular Session, pp 717–718

TABLE V—1

USER-TYPE FEES AND LICENSES ADMINISTERED BY THE DEPARTMENT OF FISH AND GAME, 1962–63

Type of fee	Amount	Collections (in thousands)
Sport fishing licenses		
Resident over 16	$3	[a]$4,428
Nonresident over 16	$10	[b]83
Nonresident over 16 for 10 days	$3	[c]49
Citizen of U S , Pacific Ocean for 3 days	$1	[d]130
Angling, inland waters except trout	$1	2,181
Angling, inland waters and trout	$2	
Hunting licenses		
Resident over 16	$4	[e]2,342
Junior under 16	$1	[f]59
Nonresident	$25	[g]23
Nonresident, special for licensed club	$5	—
Veterans' wives	$4	none
Napa Marshes, over 16	$3	1
Napa Marshes, under 16	$1	—
Duplicate sport fishing or hunting licenses	$1	[h]1
Deer tags for holders of hunting licenses	$2	[i]809
Deer tags for holders of nonresident hunting licenses	$10	[j]4
Bear tags for holders of hunting licenses	$1	[k]27
Pheasant tags for holders of hunting licenses	$2	[l]847
Bird net tags for permitted bird nets	25¢	—
Colorado River Stamp	$2	[m]12
Expired license stamps for collectors		
California	20¢	—
Arizona	50¢	—
Fishing party boat license	$3	2
Pheasant club license		
Under 500 acres	$75	4
Over 500 acres	$100	11
Commercial hunting club	$25	1
Permits		
Controlled hunting area	$2	92
Seasonal stamp for hunting, specific area	$5	1
Pheasant and coot	$2	6
Deer, specific areas	$5	58
Military, for servicemen on reservations	$2	1
Elk, special hunt	$25	2
Game meat storage	$1	15
Deer, to prevent agricultural depredation	$2	none
Use of domestic pheasants to train dogs	$1	—
Use of domestic birds for field trials	$5	—
Seismic, permitting exploration by explosives (administration observer, etc)	Cost	
Scientific collector, senior	$5	2
Scientific collector, student	$1	—
Bird net for scientific purposes	$10	—
Falconry license	$15	2

Less the following amounts of commission to license agents

[a] $222 181 [c] $2 437 [e] $88 233 [g] $138 [i] $20 728 [k] $1,363 [m] $581
[b] $1 242 [d] $6 501 [f] $2,963 [h] $180 [j] $20 [l] $8 784

the department from the General Fund to offset free license "revenue loss."[7] The department comments

> We concur with the factfinding committee that the free licenses are actually a welfare program and as such should be supported from the General Fund rather than by the license buyers.[8]

Recommendation (4) above is based not on a denial that free licenses are actually a welfare program, but rather on a denial of the desirability of such a program. In general, the recipient's welfare will be maximized if he has freedom in the choice of his activities, and the "loss" to the Department of Fish and Game may not be matched by the pleasure of the exempt recipient. Thus, appropriations from the General Fund for welfare should take the form of financial aid—that is, generalized purchasing power—rather than "gift certificates" which can be used in only one way.

Licenses and Fees Related to Small Craft

The licenses and fees administered by the Division of Small Craft Harbors are shown in Table V—2. The $977,099 of revenue compares favorably with $180,671 as the cost of collection.

Recommendations:

1. As a matter of efficiency, it is suggested that the original registration fee be raised to $6 for the first year and be lowered to $3 for the second year, thereby eliminating the distinction between the second and third years.

2. To keep pace with clerical costs, the $1 fee for duplicates and certified copies should be raised to $2.

Fees Administered by the Division of Beaches and Parks

In response to the questionnaire concerning its fees, the Department of Parks and Recreation indicated that it operates under several constraints. Section 5010 of the Public Resources Code merely states, "The department shall collect fees the amounts to be determined by the department." The Legislative Analyst has suggested that the State should recover from the user a greater share of the cost involved in providing park service and facilities, and has stated that the ratio of recovery should be at least 50 percent. The State Park Commission has expressed the hope that "special" facilities, such as boat ramps, ski lifts, and utility hookups for trailers, would pay for themselves. For such facilities, the commission has suggested that charges be comparable with commercial rates in areas located nearby. Against these upward pressures, the department feels

> there is an even more important consideration to observe, that of public acceptance.[9]

What is called "public acceptance" in public undertakings may be equivalent to what is called "price elasticity of demand" in private enterprise. It would be helpful to know how the usage of park and

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[7] *Second Progress Report of Senate Factfinding Committee*, 1963 Session, p. 214.
[8] Letter of W. T. Shannon, Director of Department of Fish and Game, to Hon. Nicholas C. Petris, December 5, 1963.
[9] Memo from Charles A. DeTurk, Director, Department of Parks and Recreation, to Honorable Hugo Fisher, Administrator, the Resources Agency, December 4, 1963.

TABLE V–2

FEES AND LICENSES ADMINISTERED BY THE DIVISION OF SMALL CRAFT HARBORS, 1962–63

Type of fee	Amount	Collections (in thousands)
Registration, undocumented vessel		
Original		
First year	$5	
Second year	$4	
Third year	$3	
Renewal (for three-year period)	$3	
Transfer of ownership	$2	$977
Duplicate of certificate of ownership or certificate of number	$1	
Certified copy of registration documents	$1	
Sale of registration lists by counties		
Registration lists, per thousand names	$3 25	
IBM cards, per thousand names	$4	

recreational facilities responds to changes in fees Unfortunately, the collections reported by the department are so aggregated that it is impossible to trace the effect of any particular change in the fee schedules Nor is it possible to compare collections with costs, since park personnel collect fees in conjunction with other duties Because much of the cost of operating recreational and educational sites is fixed costs, the cost *per visitor* probably falls sharply with increases in attendance This would explain the Legislative Analyst's finding that

> The net cost of operating the state historical monuments per visitor ranged from the profit of 56 cents at Hearst San Simeon to a maximum cost of $5 25 per visitor at the Fort Humboldt State Historical Monument Where all of the monuments are considered, the average cost for each visitor is approximately 33 cents [10]

With these considerations in mind, the following general policies are suggested

Recommendations and examples:

1 The negotiation of contracts for concessions and rentals of state-owned facilities should include state participation in the gross receipts of the private enterprise This would recoup for the State part of the expenditures of visitors who can afford more than the basic admission fee

2 Ten-cent turnstiles should be installed wherever it is feasible to charge for admission now provided free Such a minimum charge would recover some cost and would discourage few visitors with genuine interest

3 Consideration should be given to closing, for part of the year or part of the week, state historical monuments that show a comparatively high cost per visitor Economy should also be practiced in the maintenance of these monuments, especially with regard to temporary displays in flower beds, etc

[10] *Analysis of the Budget Bill, Fiscal Year July 1, 1963, to June 30, 1964*, p 731

TABLE V–3

FEES ADMINISTERED BY THE DIVISION OF BEACHES AND PARKS, 1962–63

Type of fee	Amount	Collections (in thousands)
Day-use facilities fee		
Automotive vehicle, per day	50 cents	
Bus, per day	$2	
Effective January 1, 1964		
Adult group, per person (minimum $2 50)	*25 cents*	
Youth group with adult leader (minimum $1 00)	*10 cents*	
Person entering on foot and using facilities	*25 cents*	
Special charges		
Bothe-Napa swimming pool, admission		
Adult over 15	75 cents	$609
Child between 6 and 15	35 cents	
Angel Island State Park, admission for adult over 12 (no group fee)	25 cents	
Riding and hiking trail camps		
Automotive vehicle and two horses	$1	
Each additional horse	25 cents	
Parks with group horsemen's facilities		
Persons in organized groups	10 cents	
Each horse	25 cents	
Campsite fee		
Improved trailer sites, per night per trailer and vehicle	$1 50	
Effective January 1, 1964	*$2 00*	
Established campsites, per night per vehicle	$1	
Effective January 1, 1964		
Type A Campground	*$2*	636
Type B Campground	*$1 50*	
Type C Campground	*$1*	
Group overnight camping, per day per person	10 cents	
Effective January 1, 1964		
Adult group, per person (minimum $2 50)	*25 cents*	
Youth group with adult leader (minimum $1 00)	*10 cents*	
Person entering on foot	*25 cents*	
Boat launching fee		
Use of launching facilities and trailer parking areas, per boat	50 cents	43
Angel Island mooring space, per space per day	$1	
Concession agreements, including grazing agreements in one state park and dwelling rentals in two state parks (on bid or negotiated)	Various	286
Water and sewage charges, Squaw Valley and Columbia (variable charges depending on tap size, quantity, etc)	Various	9
Tours		
Charman London House, per adult	10 cents	
Effective August 14, 1963	*25 cents*	
Hyde Street Pier	0	
Effective August 7, 1963		
Adult	*$1*	
Youth, 6–18 years	*50 cents*	
Museum at Morro Bay State Park		
Adult	25 cents	
Children under 12 or persons in educational groups	10 cents	736
Educational groups in buses, per bus	$2	
Hearst San Simeon State Historical Monument		
Admission per adult including bus trip	$2	
Admission, youth 6–12 years	$1	
Additional charge for reserved ticket	$1	
Will Rogers State Park		
Admission per person to home	25 cents	
San Juan Bautista State Historic Park		
Admission per person over 6 years	25 cents	

4 Wherever possible, special charges should be made for special conveniences The rationale of this policy, as explained earlier, is to discriminate among users in such a way as to encourage widespread enjoyment of the facilities at minimum expense to the State This might involve increased use of vending machines, rental of beach and camping equipment, sale of firewood, and similar miscellaneous services

5 As a corollary to recommendation (4) and to implement the suggestion of the State Park Commission that fees for special facilities be comparable to commercial rates, care should be taken to provide service comparable to commercial service This means that the premises should be well-kept and that visitors should be treated like patrons

Fees Administered by the California Museum of Science and Industry

Fees collected by the California Museum of Science and Industry, shown in Table V—4, are similar in nature to those levied by the Department of Parks and Recreation The same general policy recommendations apply Recommendation (1) applies with special force to the rental of the Coliseum and the Sports Arena These facilities are sublet by commercial enterprises—professional athletic teams, circuses, ice shows, and the like—whose fortunes are subject to wide variations from season to season It is hoped that the museum, by sharing and spreading some of the risk, could derive greater revenues from these facilities Instead of the strangely rounded figures of $50,000 and $10,000, the museum might accept a lower flat fee plus a percentage of the gross In this way the museum could offer terms comparable to those frequently accepted by landlords of private stadiums and auditoriums

TABLE V—4

FEES ADMINISTERED BY THE CALIFORNIA MUSEUM OF SCIENCE AND INDUSTRY, 1962–63

Type of fee	Amount	Collections (in thousands)
Parking		
Cars in lot		
Sporting events other than high school	$1	
High school sporting events	50 cents	
Trade shows	75 cents	
Religious events	50 cents	
Los Angeles County Museum	25 cents	
Buses in lot		
Sporting events	$4	$404
Trade shows	$3	
Religious and eleemosynary events (where collection taken up)	$2	
Flat charges		
Religious events free to public	$25	
Monthly rental, daytime Monday-Friday, one lot to University of Southern California	$150	
Museum automatic gate lot, per two hours	10 cents	5
Street two-hour parking meters, per hour	10 cents	12
Admission to model train exhibit	10 cents	15
Rentals per year		
Coliseum	$50,000	50
Sports Arena	$10,000	10
Miscellaneous		1

Armory Rentals

The 129 armories of the State are used by schools, churches, PTA organizations, citizens interested in youth problems, the U S Post Office, state fire fighters, local fire and police departments, election committees, census takers, and so on For some of these meetings, such as civil defense and disaster training classes, no rental is charged For other groups, such as children from the public schools during inclement weather, the rental is reduced below the basic minimum

In 1962–63 the basic hourly charge for drill floor, kitchen, latrines and offstreet parking was $2 50 [11] For larger armories, the charge ran as high as $20 The basic *daily* charge for smaller armories was $25, for larger armories $50 [12] Higher charges were made for the bigger armories, the highest being $250 for Mission Armory at San Francisco

Rentals collected in 1962–63 were $59,864, of which about one-tenth was required for salaries of personnel making collections At a very rough guess, the average rental time per armory is about 100 hours per year It would be desirable to increase this average, partly to increase revenue, but also to utilize the facilities more fully

The rental of armories is limited by the nature of their clientele, mainly governmental organizations and volunteer private organizations, both with scanty budgets If armories attempted to attract more affluent customers, such as trade shows, they would be critized for using tax-exempt buildings in competition with privately owned meeting places Nor would the attempt necessarily succeed, the facilities offered by a large hotel cannot be provided on an on-again-off-again basis in a barren barrack The longrun solution to greater utilization of armory facilities probably hinges on the locations selected About 17 percent of present armories are currently leased or rented This suggests that an armory need not be a single-purpose building if it is located where it can serve other governmental functions

Fees for the State Fair

Fees collected by the Department of General Services for the State Fairs are a potpourri of the types considered earlier in this chapter with two added ingredients

Admission fees at the outside gate Admission fees to "particularly attractive" events	($628,767)
Rental of facilities for commercial use and public service activities Collections from concessionaires	($476,155)
Entry fees for exhibitors	($19,094)
Parimutuel fee	
9% plus ½ of the breakage to the State Fair	($542,674)
7% plus ½ of the breakage to the Horse Racing Board	($318,937)

The amounts in parentheses are collections in 1962–63 from the fall fair Collections of $37,340 were made from the spring fair, which was presented under the joint auspices of the 52d District Agricultural Association The expectation is that the 1964 spring fair (not to be

[11] For each additional square foot of space, an extra charge of ¼ cent was made for each four hours of use A separate charge was made for overtime payment of armory personnel required to supervise every licensed activity

[12] As a matter of convenience, the U S Post Office was charged a flat fee of $25 per day regardless of the size of the armory

staged in conjunction with the 52d District) will show substantially higher collections because of the addition of parimutuel fees from 21 days of quarter horse racing

The State Fair is subject to the typical vicissitudes of show business, accentuated perhaps by vagaries of the weather The Comptroller explains the problem as follows:

> While the revenues reported here are divided into five categories for planning purposes, virtually the entire revenue structure is directly correlated with attendance The State Fair budget is predicated each year on the ability to "earn" in revenues over 80% of the appropriations for expenditures and is projected to balance the State Fair Fund at zero at the close of each fiscal year The precariousness of this system of budgeting becomes apparent when it is realized that the majority of authorized expenditures is committed before the revenues begin to flow in As the Fair is budgeted with no fund reserve the slightest error in revenue estimates can cause a funding problem in the payment of authorized programs [14]

In the last decade the State Fair has earned between 65 and 78 percent of its expenditures. The paid attendance has been about half a million, and the deficit per paid admission has varied between $1 09 and $1 64 The lowest loss occurred when attendance was very high (519 000) and the highest occurred at the nadir of attendance (373 - 000) in 1955–56 [14]

Because "The State Fair has been continuously encouraged to become as self-supporting as possible ," the Comptroller reports that "fee schedules are constantly reviewed and frequently revised to provide the optimum income " [15] It is hoped that the attempt to increase revenue will not put the Fair beyond the means of "first-time" visitors for whom it may be a unique experience Any revisions in fees should certainly not discriminate against the young exhibitor for whom the winning of a ribbon may provide the memory of a lifetime

[13] Letter from W. David Kelts, Comptroller, California State Fair and Exposition, to Mr Nicholas C Petris, Chairman, Assembly Committee on Revenue and Taxation, December 31, 1963

[14] Figures from Legislative Analyst, *op cit*, pp 364–365

[15] W David Kelts, *op cit*

CHAPTER VI

SUMMARY

When statistical data are amassed for the first time, the temptation to add them is almost irresistible Yielding, one discovers that the 1962–63 collections shown in the foregoing chapters were

Occupational fees and licenses	$8,131,000
Business fees and licenses	32,983,000
General fees	302,630,000
User-type fees	16,532,000
California's revenue from fees	$360,276,000

The total is impressive [1] It represents 0 73 percent of California's 1962 personal income and is equal to almost 20 percent of California's 1962–63 general fund revenues

Effect of the Fee Structure Upon California's Economy

In assessing the effect of the collection of fees upon the State's economy, it would be a mistake to interpret this total as a homogeneous flow The total is comprised of elements that course through the economy in differing ways Among the fees paid by what might be called "households," some partake of the nature of consumer expenditures (a day at the beach!), while others resemble personal taxes (recording vital statistics) Among the fees paid by businesses, some resemble current business expenses (seed testing), some are like the cost of investment (application to issue securities), and some are really income taxes (especially when they are based on gross revenues)

These distinctions are important when revisions of the fee structure are contemplated An increase in fees on consumer-type activities may not increase state revenues; it may merely cause households to substitute other types of consumption (both privately and publicly "produced") or to increase the rate of personal saving Thus the analysis of the probable effects of changes in the fee structure depends on the nature of the fees being changed

As if this were not enough, the results of changes in the fee structure depend also on the concomitant change in the use of funds If a rise in collections is accompanied by a rise in expenditures for enforcement of standards, the effects might be analagous to those of a balanced-budget increase in governmental expenditures If, in contrast, the increased collections are held in a dedicated fund and invested in earning assets, the public "saving" would be expected to have effects comparable to private saving This might also be the result if fees were used as a means of raising revenue to retire public debt.

[1] Actual collections were undoubtedly higher Many fees result in collections of less than $500, and these amounts were lost in rounding the figures for the tables In addition, many agencies did not report miscellaneous collections However, the total includes motor vehicle "in lieu" fees, which are more correctly classed as property taxes

In the analysis of income flows, it has been customary among economists to lump the payment of fees with tax collections, and to assume that the payor will respond to the payment of a dollar in fees as he would to the payment of a dollar in taxes. Perhaps the broadest implication of this intensive study of California's fee structure is the realization that this method would result in error. At least half of California's fees should be more accurately viewed as similar to consumer expenditures, current business expenses, or expenditures for acquiring plant and equipment. Thus the reaction of payors could be more correctly predicted from their behavior as consumers or businessmen than from their behavior as taxpayers. For any proposed revision of the fee structure this realization could be put together with recent research concerning the response of California's economy to change.[2] Although the outcome could not be forecast with certainty, the prediction should be much more reliable than it could have been a decade ago.

The Gist of the Recommendations

Looking back over the recommendations made in this study, it appears that the suggested changes in fees are almost invariably upward. The chief explanation for this bias is that many of the charges have become obsolete in light of the rising cost of government. License fees which once were adequate to cover the cost of collection and provide for some enforcement of standards may now fail to cover the cost of issuance. User-type charges which once equaled the cost of providing services now equal only part of the cost. From the point of view of increasing state revenues, the greatest flow would come from a small rise in widespread, almost inescapable, fees such as those collected by the Department of Motor Vehicles and the Department of Alcoholic Beverages. But to confine the increases to a few sweeping changes would be bad government, since it would emphasize a host of small inequities now existing.

"Equity" in a fee structure often seems to imply "neutrality," which in turn means not interfering with "normal" market choice. In the licensing of business, the implication is that the fee structure should not favor one type of business over another. In the setting of recreational charges, the fee structure should not favor one pursuit of happiness over another, and so on. Although the target of neutrality is utopian, it provides a shield against the suasion of special interests.

Many of the recommendations in this study are aimed at neutrality, but this goal has not been pursued where it seems wise to make conscious use of the fee structure as an adjunct to other public policies. Fees for undesirable activities may appropriately be as stiff as sumptuary taxes, while fees for desirable activities have to dip into the realm of the possible for citizens with slight ability to pay.

Except for functions with a welfare aspect, it has generally been assumed that the services for which fees are charged should be self-supporting. One way to reach this goal is to raise fees. An alternative, more desirable path, is to effect reductions in the cost of service. Many methods have been suggested: the simplification of fee structures, the

[2] See, for example, W. Lee Hansen and Charles M. Tiebout, "An Intersectoral Flows Analysis of the California Economy," *The Review of Economics and Statistics*, XLV, No. 4 (November 1963), pp. 409–418.

consolidation of licensing programs, the elimination of duplications in inspections, and so forth

Concomitant with an attempt to reduce costs, it would seem imperative to make greater efforts to discover what the costs of particular fee-connected activities really are This information is blurred whenever an agency collects several types of fees or performs several functions The use of performance budgeting has been suggested, especially when an agency serves diverse groups Without such budgeting, an agency like the Department of Fish and Game, the servant of three distinct groups (the general public, the business community, and the sportsman) can hardly hope to set equitable fees

The problem of setting fees is not so simple as choosing a flat amount The business licenses in Chapter III, alone, exhibit over two dozen types of sliding scales Such a structure remakes fees into taxlike payments, resembling sales and income taxation Hence the use of these sliding scales has implications for the stability and growth of California's economy

Whenever a fee schedule departs from flat amounts, it becomes a sharpened instrument of policy This study has made recommendations in both directions sometimes the sharpened instrument seemed to be cutting the wrong way (impeding the efficiency of private enterprise, for instance) and should be blunted, other times the instrument was achieving a useful purpose but needed to be honed

An alternative to sharpening the instrument by elaborating the fee schedule is the addition of supplemental fees This method has frequently been adopted as an expedient where alteration of the basic fee has met with some obstacle, such as a statutory limitation or fear of retaliation from other states This report recommends the addition of supplemental fees in another situation, as a device for making recreational programs more nearly self-supporting without depriving anyone of the enjoyment of the basic facilities

The prospect of discovering brand new types of fees as a source of revenue for the State is like the chance of discovering new kinds of taxes New fees could be imposed The Highway Transportation Agency, for instance, is studying "the economic feasibility of charging fees for the execution of encroachment permit agreements," now granted free on public property[3] A difficulty foreseen by the Division of Highways is that fees for encroachment permits might evoke "retaliatory charges by utility companies who now provide areas to us on their easements without cost"[4] A broader consideration is the ultimate incidence of the proposed fees To the extent that the utility companies did not succeed in "getting even" with the State, would the cost of the fees merely be passed on to the customers of the companies in the form of higher utility rates? If so, the imposition of the fees is a costly skirmish, and the revenue could be obtained more efficiently by raising the rates of existing taxes

[3] Many cities derive substantial revenues from encroachment fees, which are justified by the possibility that the municipality may be liable for injuries resulting from accidents For a discussion of such fees, see Harold M Somers, *Public Finance and National Income* (Philadelphia The Blakiston Co., 1948), p 440

[4] Letter to the author from Thomas A Carroll, Attorney, Department of Public Works, Division of Highways, January 21, 1954

The best avenue for increasing state revenues through the collection of fees appears to lie in improving present levies, making them at the same time more lucrative and more equitable Recommendations directed to these two aims are scattered throughout this study Some of these recommendations involve changes in method, as with the proposal for auctioning new alcoholic beverage licenses Others involve higher charges for special services or special cost The most fundamental reform that could be made in the fee structure would be to hitch it to an index of the cost of government A first step toward such a link would be an annual review of fees that have remained unchanged for five years The first review would be a horrendous task, but the yield would be correspondingly large

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CONFORMITY OF STATE PERSONAL INCOME TAX LAWS TO FEDERAL PERSONAL INCOME TAX LAWS

A Report for
The California Legislature Assembly
Interim Committee
on Revenue and Taxation

September 1964

BY

DR. CORINNE LATHROP GILB

PUBLISHER'S NOTE

This booklet is the third in a series of interim studies to be published this year by the Assembly Committee on Revenue and Taxation It is a complete and comprehensive study of the question of conformity between state and federal income taxes Because of the vast amount of material it contains and the wide range of interests it affects, we are making the original research document available without committee comments

It was not possible to go into exhaustive detail on each and every item Therefore, emphasis has been given to the major questions—those of automatic conformity and those relating to specific conformity issues of major substance

The recommendations in this report are those of the researcher and should not be construed as representing the views or decisions of the committee The committee recommendations will be made in due course

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QUOTATIONS

"To tax and to please, no more than to love and be wise, is not given to men."—Edmund Burke, in English debate on taxing the Americans, 1774.

"Taxes are as complex as life The moralist calls for just taxes, but taxes cannot be just The administrator asks for simple taxes; but experience shows that they cannot simply be simple Some politicians would mould taxes wholly in accordance with political expediency; but statesmen realize that in the long run this would be impolitic The businessman demands practical taxes; but financial history proves that it is impracticable to make them merely practical The legalist wants taxes administered strictly according to law, but the record of the income tax and the property tax makes it clear that such taxes cannot be successfully administered by methods meticulously legal "—T S Adams, Yale economics professor, speech in 1928

"Few legacies we shall pass to our children will influence their lives more than the tax system—federal, state, and local "—C Lowell Harris, economics professor, Columbia University, 1964.

SUMMARY

The Issue: In what manner, to what degree, on what specific points, should state personal income tax law be conformed to the federal law?

Scope of the Problem: Considerations to be kept in mind are:

(1) Convenience and economy of administration for taxpayers, tax practitioners, and public government;
(2) Predictability and control of revenue,
(3) Considerations of equity and socioeconomic impact;
(4) Effect on the distribution of power
   (a) Between federal, state, and local governments;
   (b) Between public government and private enterprise;
   (c) Between different agencies and their related "clientele" at any level of government;
(5) Effect on the State's competitive position vis à vis other states, and the nation's competitive international position.

Alternative Policies Available:

(1) Total abandonment of the state personal income tax in favor of other taxes;
(2) The enactment of state personal income tax laws on bases so substantially different from those of the federal tax that there is no issue of conformity,
(3) Continuation of the State's past policy, which has been to adopt substantial portions of the federal tax law and to conform on a piecemeal basis to subsequent changes in that law;
(4) Major or partial "automatic" conformity to present and prospective federal tax law by
   (a) Adopting federal adjusted gross income, with minor adjustments, as the state tax base;
   (b) Directing through state statutes that federal income tax laws be applied in lieu of state action either on specific points or on all applicable points not covered by state law; and/or providing in state administrative tax regulations that federal regulations be applied either in lieu of or as a supplement to the state regulations;
(5) Total or major conformity, either
   (a) By making state personal income tax a flat percentage of federal income tax, as has been done in Alaska; or
   (b) Using the percentage method, but with modifications reflecting and retaining differences between federal and state graduations (the Bibbero plan or something similar);

(6) Federal collection and subvention to the State

Where state withholding is a percentage of federal withholding (e g , in Idaho), the basic state law, to which adjustments are made at the end of the tax year, may follow any of the conformity methods outlined above.

Policy Recommendation:

The method should be adopted which provides the maximum conformity for the convenience of the taxpayer consistent with needs for predictability and control over revenue by the state government. More facts are needed about how the state government does or could predict and control revenue before a particular conformity method can be singled out. There should be a presumption in favor of the Bibbero plan first, and the New York system, second, until and unless administrative factors rule them out

Whatever policy is adopted, it should be accompanied by a *major alteration in the State's role in federal tax policymaking* Whether there is piecemeal or automatic conformity, the federal government is calling the tune No minor tinkering with individual tax laws is going to alter the fact of the federal government's preponderant influence and impact on the State's economy, as a result of federal income taxes. Federal policy is not made with California's special needs or problems as a primary consideration If the State is to protect its own interests, it must do so at the federal level where the power really lies, not simply through the State's Congressmen, but through new methods of joint decision-making between federal and state administrators and legislators

A DESCRIPTION OF CONFORMITY POLICY CHOICES: SUMMARY OF ARGUMENTS

(1) *Abandonment of state income tax* Only 14 states, as of 1963, did not have a state income tax (Connecticut, Florida, Illinois, Maine, Michigan, Nebraska, Nevada, Ohio, Pennsylvania, Rhode Island, South Dakota, Texas, Washington, and Wyoming) In some of these states, the legislatures have passed income tax laws which have been invalidated as unconstitutional by the courts (Illinois, Washington, Pennsylvania). A policy of no income tax is advocated by those who advocate abandonment of the "ability to pay" principle of taxation. It is also advocated by those who think federal, state, and local tax sources should be clearly separated, with a minimum of overlapping California's revenue needs are such that this approach is not practical

(2) *State laws substantially different from federal.* Although some of the early state income tax laws were markedly different from the federal, and the states of New Hampshire and Tennessee still limit their personal income tax to income from dividends and interest, the tendency has been for all states to come closer to the federal model. As of 1961, more than one-third of the income tax states tied state income taxes explicitly to federal law Although major deviations might give the state a lever to counteract rather than reinforce some federal tax policies, such deviations would also make the taxpayer's task of computing his tax much more difficult than it is already

(3) *Piecemeal conformity.* A number of states have based state tax law defining taxable income on federal law, by reference to federal law already in existence in a particular year, with a minimum necessary number of express variations The constitutionality of this practice has been approved in state courts (see Santee Mills v Query, 122 S C 158, 115 S E 202 (1922), or Featherstone v Norman, 153 S E 58) The past policy of California's State Legislature has been to conform state income tax law to federal income tax law as much as possible, considering state conditions and revenue needs There has been a presumption in favor of conformity Also, the State follows federal tax regulations wherever possible, and there is a conclusive presumption that the State has adopted federal administrative and court interpretations of federal tax laws wherever state law has exactly conformed to the federal

The primary argument in favor of this approach is that it permits maximum predictability and state control over revenue Accepting the arguments of the administrative branch, in 1961 the California Senate Fact Finding Committee on Revenue and Taxation concluded that this method was "the most satisfactory," because "the Legislature will retain such a degree of control over the revenue program as will enable it to best serve state needs," and at the same time, "policy will be to provide conformity wherever practicable."

The arguments against this approach are as follows· The Department of Finance has not made clear the precise reasons why predictability and control over revenue could not also be had if the State used the Bibbero plan (see p 14 below) or something equivalent, since the State could retain control over brackets and rates. However, it is true that the 1964 federal tax cut did create revenue difficulties for states in which state withholding is a percentage of federal withholding (Idaho, New Mexico, Oklahoma, Utah), and for West Virginia and Alaska, where the state tax was a percentage of the federal As a result, West Virginia and Alaska abandoned their percentage of the federal tax system Due note should be taken, during 1964, of how well the other states were able to make an appropriate adjustment

The main arguments against this approach are from the standpoint of the taxpayer, whose case has not been thoroughly presented to the Legislature in the past Under the piecemeal conformity system, amendments in the federal code are presumably enacted into state law in the first legislative session after the federal amendments have been made. Therefore, there is always a time lag, the law requires constant updating, and the taxpayer is still faced with disparities between the state and federal law in any given tax year Also, this approach leaves many detailed provisions unconformed There are more than one hundred items out of conformity at the present time Even when state conformity laws are passed in the same year as a new federal law, as they were in California in 1964, conformity is not complete. California's 1964 conformity bill did not include approximately 25 items contained in the federal 1964 Revenue Act, though several of the omitted items were applicable to state tax Therefore—or nevertheless—the taxpayer is left with a difficult task of double computation of his income tax, particularly the 50 percent of California taxpayers who are not entitled to use the short IBM form The tax lawyers and accountants who serve such taxpayers are in the forefront of those urging greater conformity.

Also, often federal omnibus bills are carefully balanced to offset an economic impact in one direction with a concession in another State conformity which selects only a portion of a balanced federal revenue act may be imposing a penalty without its corresponding concession or vice versa.

One of the main arguments for piecemeal conformity is that it is a way of retaining state power, rather than blindly following federal policies made without the State's interests primarily in mind. However, although the arguments for buttressing state power are sound, it is extremely doubtful that piecemeal conformity gives anything more than the illusion of power in terms of socio-economic impact on California. (See analysis on page 20). Even where state tax law does deviate to give a special tax concession to a particular group of people, the question is whether all taxpayers should be greatly inconvenienced so that a special dispensation can be made to a few Quite possibly, the special assistance might be more advantageously given in some other way than through income tax concessions

(4) *"Automatic" conformity by state statutory reference to federal existing and prospective tax law* To avoid time lag problems, some states have adopted laws, together with appropriate constitutional

amendments, conforming state definitions of taxable income not only to existing, but also to future, federal law. There are various ways of doing this. One is by adopting federal adjusted gross income, with minor adjustments, as the state tax base. Another is by directing through state statutes that federal income tax laws be applied in lieu of state action either on specific points or on all applicable points not covered by state law. State administrative tax regulations may also provide that federal regulations be applied either in lieu of or as a supplement to the state regulations The most notable example of the "automatic conformity" approach is in the State of New York, where a constitutional amendment permitting automatic conformity was approved by the voters in November, 1959 In New York, the federal tax law becomes automatically applicable unless specifically contravened by state law The New York Tax Commission reported for 1960-61 that conformity had resulted in great simplification of the preparation of tax returns.

It should be pointed out that New York has some circumstances which are different from the circumstances in California. It relies to a considerably greater extent on personal income tax for state revenues. For the 1962 fiscal year, New York's income tax yielded 55 3 percent of all the state's tax collections, whereas the figure for California was only 24 9 percent * Personal income tax yielded slightly more than 42 percent of New York's tax collections; whereas for California it accounted for only approximately 11 to 12 percent of total state tax revenues Also, New York has many more nonresident taxpayers (a total of 200,000 in 1959), including the great numbers who work in New York City but live in other states In 1962, California's nonresident taxpayers totalled only 50,592, whereas the total number of tax returns was 4,582,448 Also, more than is the case in California, the economy of New York is not self-sufficient, but is closely integrated with the economies of the other states.

The adoption by reference of future changes in the federal law has been questioned as an unconstitutional delegation of state legislative authority to the federal government State cases have gone both ways (i e., have held that it is constitutional, and that it is unconstitutional). (See 79 Law Edition 474, 133 A L R 401, 166 A L R 516, 177 A.L R. 467.) New York obviated this question by adopting a constitutional amendment, such as that proposed for California by Assemblyman Marks in 1963 (ACA 43 in the general session, ACA 4 in the special session). See also his AB 2548, in 1963.

Automatic conformity by reference to present and prospective federal tax laws has been recommended by California State Bar committees The main arguments for this approach are "simplicity, ease of enforcement and flexibility to accommodate changes in the federal tax law."

The main arguments against it are as follows:

Conformity, under this system, is still far from complete. Since 1960, New York has found it necessary to pass more than 30 new statutes deviating New York law in detail from the federal law. California, too, would find some deviations necessary A representative of the

* Tax Foundation, *Facts and Figures on Government Finance*, 1962-63, page 183.

California State Bar Committee on Taxation made the following presentation* concerning necessary deviations before the Senate Committee on Revenue and Taxation 1960-61:

"Since every adjustment which is made to federal taxable income (or federal tax) represents a measure of departure from conformity, they should be held to a minimum They should be limited to those which are compelled for constitutional reasons and to those necessary to protect against a provable revenue loss which would outweigh the cost of the added complexity.

Among the adjustments to be considered are the following · †

1 Exclusion of income which the United States can tax but the State cannot, viz, interest on federal securities.

2 Inclusion of income which the State can tax but the United States either cannot tax or has not chosen to tax, viz, interest on securities of other states and their subdivisions

3 Disallowance of expenses of earning income in the first category above and allowance of expenses of earning income in the second category.

4 Disallowance of deduction for state income tax Although it might seem incongruous for the State to allow a deduction for its own tax, the revenue loss could easily be recouped by adjusting the rates Therefore, this adjustment to the tax base is not really necessary One proviso must be made, however The occasional practice of a few taxpayers to pay their state tax prior to the end of the taxable year would have to be ruled out, for it would introduce interdependent variables into the computation of the tax

5 Increase in personal exemptions

If it is desired to leave the state personal exemption at a higher level than the federal, it need not be done by an adjustment to the tax base It would be simpler to do it by allowing a credit against the tax, as several states now do (Note: there are some objections to this.)

6 Determination of the tax on nonresidents

Inasmuch as nonresidents can be taxed only on their income derived from sources within the State, they should be allowed only such deductions as are related to that income and perhaps an aliquot portion of those deductions which are not related to any income. This means that some rather detailed provisions in the state law relating to nonresidents are unavoidable However, references to the Internal Revenue Code could still be utilized, e g, in specifying the type of receipts includible in gross income and the deductions allowable in computing net income from California sources With regard to taxpayers engaged in a unitary business both within and without the State, their net income from all sources could then be determined by the existing allocation methods.

* Reported in California State Bar *Journal*, v 35 (July-August, 1960), p 453
† If the reader wishes to proceed with the thread of the main argument, he should turn to page 13

7. Allowance of deductions or credits for taxes paid to other states or countries

[*Special Problems:*] Conforming the Bank and Corporation Tax Law to the Internal Revenue Code presents more serious problems than conforming the Personal Income Tax Law. The chief difficulty is that incorporating some of the Internal Revenue Code provisions into the state law would obfuscate, if not invalidate, the present method of taxing banks.

However, even with all these necessary deviations, automatic conformity would make the taxpayer's task much simpler than it has been up to now. A half-cure may be better than none

There may be some difficulties in altering state rates quickly enough to adjust to changes in the federal law. If a change were made in the federal tax law which drastically affected state revenue, and that change came late in the year, the state rate would have to be changed by the legislature quickly enough so that new forms could be printed quickly enough to get them into the hands of the taxpayers sufficiently in advance of the filing deadline. New York's system of private printing may be more flexible than California's state printing system. If the California Legislature failed to approve a rate change in time, the federal tax change might create havoc for state tax revenues However, New York does manage to cope with all these problems A more thorough study of New York's methods is needed.

In 1961 the California Senate Fact Finding Committee on Revenue and Taxation decided against automatic conformity (see *Report*, p. 12) on the grounds that the advantages were outweighed by the fact that adoption of the plan "would cause the Legislature to abdicate from its historic function of levying taxes in the manner required by state conditions and in a way best calculated to fill state needs . " The Legislature has budgetary control of only slightly over 30 percent of total state expenditures (because of earmarked funds), the committee said, and adoption by referral of federal tax laws would "tend to render the State Legislature a useless anachronism in a major portion of its legislative function." This is not really true, since the Legislature would still be free to enact laws specifically nonconforming from the federal and would still approve the rates.

Another argument is that automatic conformity would mean wholesale adoption of the social and economic policies implicit in the federal tax law. However, compared with the impact of federal tax law on the State, the California Legislature has relatively little control over the socioeconomic effects of the personal income tax, no matter which conformity policy is adopted. See the discussion in a later section of this report on "Power."

(5) *State tax as a flat percentage of federal tax* A more thorough method of conformity was that adopted by Alaska (first as a territory and then as a state), in which state tax was a flat percentage (10 percent, 14 percent, and then 16 percent in 1963) of federal income tax. The constitutionality of this was approved in Alaska Steamship Company v. Mullaney (180 P2d 805 (1950)), but the issue of delegation of state power to make future law was not raised in that case South

Carolina in 1922 and Georgia in 1929 enacted a flat percentage tax, but these laws were soon repealed because of administrative difficulties: limited and delayed access to federal income tax data, unsolved problems of interstate apportionment of income, budgetary uncertainties, and loss of state initiative However, the science of tax administration has improved considerably since that time Utah in 1951 and New Mexico in 1953 offered the percentage basis as an option for taxpayers in low income brackets, but later dropped this approach, which left only Alaska until West Virginia adopted a percentage plan in 1961. Alaska is different from California both in the greater degree to which it relies on income tax for state revenues (38.4 percent of all the state's tax collections, as compared with California's 24 9 percent for fiscal 1962) and more importantly in the percentage of taxpayers who are nonresidents In any case, both Alaska and West Virginia abandoned this method as a result of the 1964 federal tax cut, which leaves no state now following this practice.

In California, adoption of the Alaska method, with some adjustments, has been recommended by committees of the State Bar.

This method has the advantage of simplicity in administration, both for government and for the taxpayer. In 1961, the California Senate Fact Finding Committee on Revenue and Taxation decided against this method because "the State would surrender a considerable amount of fiscal independence in that drastic changes in federal revenues could have a dramatic effect on state revenues without any sort of fiscal review available to the Legislature . . ." "state revenues could not be predicted with any degree of accuracy until the federal revenue figure for any one year was ascertained" "puts the State in the position of approving *sub silentio* all the various policy changes made by Congress." (pp 12-13)

The method also automatically adopts federal graduations, which would be a major shift of the incidence of the tax burden for California taxpayers The issue has been raised repeatedly in the State Legislature See AB 3070 (Burton) and AB 3018 (Meyers), ACA 43 (Marks et al), and ACA 64 (Meyers) introduced in the 1963 General Session, which would adopt the flat percentage approach and related constitutional amendments. AB 2956 (Bagley) also introduced in the 1963 General Session was identical to AB 3070.

(6) *State income tax as a percentage of the relationship between total federal and state taxes for each tax bracket.* This is the approach proposed by Richard Bibbero, President of Medical Management Control, a San Francisco firm of management consultants to physicians and dentists. Bills on the basis of this plan were introduced by Assemblymen Meyers and Marks in the 1963 and 1964 sessions of the Legislature. Tax would be based on the individual's personal income tax paid to the federal government the prior year The rate of state tax would be established for each bracket of tax paid to the federal government at a fixed percentage based on the current interrelationship of taxes paid to the state as a percent of taxes paid the federal government. This would permit retention of differences between state graduations and federal graduations. It would also permit change of the rates from year to year, as state revenues would dictate.

In his statement presented to the Assembly Interim Committee on Revenue and Taxation, on December 17, 1963, Mr. Bibbero gave the following example:

"A married couple with $20,000 of taxable income last year would have paid the federal government $4,124 of tax. The interrelationship of tax paid as per [a table presuming two dependent children] would be 7.4 percent We recommend . . . that this year's State's rate [for this income group] be 7 percent of the tax paid or $280.09. As recommended, a married person with $5,000 federal taxable income would pay 1 percent to the State and with $40,000 would pay 10 percent.

The citizen should be required to certify that last year he paid the federal government so much. His percentage as per the state tables was so much, and his check for this amount would be sent to the State Franchise Tax Board."

There are very strong arguments in favor of this plan, and it deserves the State Legislature's most serious consideration In the first place, it would eliminate altogether the present problems for taxpayers and tax practitioners resulting from state nonconformity to federal income tax This simplification of tax computation would put savings of both cost and time into the hands of the taxpayers. The simplification might be a positive incentive to attract new industry or people with high incomes and exceptional talents into the State.

In the second place, it would make possible a major reduction of state personnel required to administer the present complicated separate state tax law, with a corresponding reduction of administrative costs Key personnel could probably be reassigned to other positions within the state government, where their special training and experience would be needed.

The conclusions of past interim committees about "automatic" conformity do not apply to this plan, since it was not under consideration and offers substantial improvements over plans previously considered

The plan does permit state retention of graduations different from the federal graduations.

One of the major arguments against the plan is that it would result in loss of the state government's ability to predict and control state revenue This would be a conclusive argument if the state tax were to be a percentage of current federal tax owed. However, it is proposed that state tax be a percentage of the previous year's federal tax At the time state tax is paid the taxpayer does or can be required to report what his current tax payment is to the federal government, or to give to the state administration a complete copy of his federal return. Therefore, the State would be in a position to know, a year in advance, what the base for the following year's state tax would be for most taxpayers To be sure, every year new taxpayers arrive and old ones leave the tax rolls. The current net increase of taxpayers is 200,000 each year But the burden of proof should be on the administration to demonstrate that it could not predict the revenue yield from new taxpayers under the Bibbero plan.

There is, of course, the problem of possibly necessary yearly adjustment of rates to take into account changes in the federal tax law The fact that Alaska has abandoned its percentage plan is a persuasive argument against the Bibbero plan

Another argument (pro or con, depending on one's point of view) is that adoption of the Bibbero plan would mean automatic adoption of the social and economic policies implicit in the federal income tax However, the state law deviates so little from the federal law in any case, and its relative socio-economic impact is so minor, that it is questionable whether the State Legislature would voluntarily be giving up much real power or independence The state tax law *is* used to give special benefits to some classes of taxpayers not so benefited by the federal tax law. The question is whether the merits of giving these special benefits to a few outweigh the costs and inconvenience of nonconformity for the many. On the other hand, the argument is made that only approximately 400,000 state taxpayers encounter any real complexities in making out their tax returns, and that more than half of all taxpayers are entitled to use the short card form return, on whose simplicity the Bibbero plan would not be much improvement The persuasiveness of these arguments depends on where the weight of one's sympathies lie. There is no easy scientific way of measuring relative taxpayer inconvenience, or of weighing this inconvenience against the special benefits a nonconforming provision might give a particular group.

(7) *Federal collection and subvention of state income tax.* The most simple (for the taxpayer) and economical administrative arrangement of all would be for California to permit the federal government to collect the state tax along with its own and rebate it to the State There are various ways of doing this, representing various degrees of centralization or decentralization of control

One approach would follow the precedent of the state-local sales tax supplements, a precedent which has been found to be quite workable With this approach, the State could retain independent control over the state tax rates. The objections to this plan are similar to the objections to the Alaska and Bibbero plans.

Another method is that of tax sharing, in which the federal government would set the rates and do the collecting, but would remit a share to the states on the basis of prior agreement. A precedent for this approach is the system of federal income tax administration used in Canada since 1941 * The Canadian system has been successful in securing tax uniformity among the provinces and simplifying tax administration and compliance However, the provincial governments have complained that they were deprived of flexibility of decision and that they have not been given a big enough share. Yet, all but Quebec do voluntarily participate in the plan, their participation is optional, not mandatory.

Adoption of federal collection might make possible the elimination of most of the personnel of the Franchise Tax Board, a saving of $4 to

* A description of that system may be found in James A Maxwell's *Tax Credits and Intergovernmental Fiscal Relations* (Washington, D C, The Brookings Institution, 1962), pp 135-141

$7 million a year. On the other hand, it is contended that the State's audit system brings in $5 revenue for every $1 spent (See attached Tables I and II from the board's 1963 annual report) Also, the federal government would exact a charge for its services

The main argument against the federal collection plan are the complicated problems of determining the proper basis for sharing If the federal government remitted an equal percentage to all the states, wealthy states would be subsidizing the poor states. If the percentages were weighted, the question is on what basis If the basis is on origin or domicile, there are complicated problems of defining residence, allocating interstate business income, and taxing nonresident income, but these are problems the state must solve in any case Also, of course, unless something like the Bibbero approach were used to retain the effect of state graduations, there would be major changes in tax incidence.

The plan would mean greater federal control in a narrow sense, but in a broader sense it might mean less federal control than the present system under which the federal government returns much of the revenue it collects in the form of grants-in-aid for specified purposes A tax subvention plan leaves the states free to spend the revenue as they choose.

TABLE I

NET REVENUE AND COSTS ARISING FROM PERSONAL INCOME TAX ENFORCEMENT ACTIVITIES, BY SOURCE
1963 CALENDAR YEAR

Source	Net revenue	Costs	Net revenue per dollar cost
Audit			
Drawer audit	$2,713,222	$719,484	$3 77
Field audit	3,448,784	938,604	3 67
RAR audit*	2,278,906	236,040	9 65
Specialist Section	252,370	128,991	1 96
Residence and withholding	1,189,889	50,943	23 36
Subtotals	$9,883,141	$2,074,071	$4 77
Compliance (other than audit)			
Employers' and payors' information returns†	$3,716,661	$959,960	$3 87
Federal comparison program (FCP)‡	3,544,331	959,893	3 69
Preliminary examination	1,511,775	366,748	4 12
Subtotals	$8,772,767	$2,286,601	$3 84
Grand totals	$18,655,908	$4,360,672	$4 28

* Copies of Revenue Agents' Reports (RAR's) of the Internal Revenue Service are forwarded to the Board

† Employers are required to file wage earner information returns (copy of Form W-2 or Form 599) and payors' of dividends interest, rents and royalties, etc, are required to file information returns (Form 599) where such payments exceed certain limits

‡ The Board contracts with the Internal Revenue Service for the name address, and selected income data of all persons filing U S individual income tax returns in California These data are compared with the corresponding items appearing on State income tax returns

Source 1963 Report of the California State Franchise Tax Board

TABLE II

NET REVENUE ARISING FROM PERSONAL INCOME TAX ENFORCEMENT ACTIVITIES BY LOCATION 1963 CALENDAR YEAR

Location	Audit		Nonaudit (compliance)		Percent of total
	Office	Field	599-FCF*	Preliminary examination	
Headquarters	$5,244,498	$306,715	$640,655	$1,511,775	41 3
Los Angeles		2,096,496	4,732,343		36 6
San Francisco		2,235,462	1,887,994		22 1
Totals	$5,244,498	$4,638,643	$7,260,992	$1,511,775	100 0

* See second and third footnotes to Table I

Source 1963 Report of the California State Franchise Tax Board

Whatever the Legislature's decision is about conformity policy for the coming few years, a committee or commission of state legislators and tax administrators and perhaps others should be appointed to explore more thoroughly the possibility of federal collection in the context of a thorough re-examination of the whole spectrum of present state-federal fiscal relationships (See the analysis of "Power" in this report.)

* * * *

A Note on Withholding: A system of state withholding is possible under any of the conformity policies except the first one listed It is true that many states which have withholding also have adopted federal definitions of taxable income. Probably it is inconvenient but not impossible to administer withholding unless this is done However, those states which make state withholding a percentage of federal withholding do run into revenue difficulties when there is a sudden cut in the federal rates, as there was in the Revenue Act of 1964.

ANALYSIS OF CRITERIA

I. CONVENIENCE AND ECONOMY OF ADMINISTRATION, FOR TAXPAYERS, TAX PRACTITIONERS, AND PUBLIC GOVERNMENT

If convenience and economy for taxpayers and tax practitioners were the only criterion, there is no doubt that the best policy would be to have the federal government collect the state tax The next best solution would be to adopt the Bibbero plan. Third would come some form of automatic conformity, possibly the New York plan.

It is probable that this is also the order of merit in terms of improving taxpayer compliance and in facilitating controls on evasion Much more reliance would be placed on federal enforcement procedures. State auditing could still be retained where desirable.

No solution, however, is a cure-all Federal collection might operate simply and smoothly once all the terms were agreed to, but coming to appropriate terms would be a very knotty problem If the New York approach is adopted, there will still, necessarily, be many exceptions and departures from the federal law in the state tax law.

All of the "automatic" methods create some problems of state prediction and control over revenue

The present system of piecemeal conformity does create difficulties for taxpayers There is usually at least a one year time lag and sometimes several years before state law is conformed to changes in the federal law. This means that in the interim the taxpayer must figure his return on the basis of differences in the law However, state administrators argue that the taxpayers' difficulties are exaggerated In 1962, 1 million out of 4,585,000 of California's state income taxpayer's used the short IBM card from 540A for their returns, and 2½ million could use this form of return if they chose There are fewer than 400,000 taxpayers in the higher income brackets where most of the difficulties arising out of nonconformity occur *

II. PREDICTABILITY AND CONTROL OVER REVENUE

Prediction difficulties arise if a state follows a conformity policy so that changes in the federal tax law automatically affect taxpayers' liabilities for state taxes. Adjustments can be made by adjusting the rates, but this has to have legislative approval, and there might be a problem of getting that approval in sufficient time or even of not getting it at all. On some occasions, when the legislature did not act or did not act quickly enough, the state might get more revenue than it had anticipated. On others, it would be faced with an unexpected deficit.

Also, state tax policy needs to be flexible, to make rapid adjustments in times of unexpected drastic economic change The income tax is inherently less predictable in its revenue yield than many other taxes. It responds more sensitively to business cycles In an inflationary

* Franchise Tax Board

economy, it tends to increase revenue (as a result of more people moving into higher tax brackets) without an increase in rates On the other hand, it may lead to a sudden drop in revenue in a deflationary economy. Although the method of federal collection may be satisfactory from the standpoint of the state's ability to predict its revenue (depending on the nature of the agreement with the federal government), it is comparatively inflexible Even though a formula might be provided in advance for automatic adjustments to changes in the business cycle, it is possible that not all of the needs for future adjustments would be anticipated in the state-federal agreement In such case, the state might not be able to make sudden necessary changes in its tax policies in times of crisis

III. POWER DISTRIBUTION

The central issue in the problem of conformity is the issue of distribution of power between the state and federal governments. In considering this question, care must be taken to distinguish between mere authority and real power States have the legal authority to impose an income tax; they have the authority to conform or not conform to federal income tax When they do not conform, they may have the illusion that they are exercising real power

Power, however, is a relative thing. Insofar as the income tax is used as a device to motivate or deter certain kinds of socioeconomic behavior, when the federal income tax impact is much higher on the individual taxpayer than is state income tax impact, that taxpayer will base his decisions on the federal, rather than the state, tax A decision not to conform the state tax on such an item will probably have negligible socioeconomic impact (Example the laws concerning deductibility of business expenses)

The monetary, as distinguished from motivational, impact of state conformity or nonconformity must be measured against the monetary impact of the federal tax on the same items It is always a relative, never an absolute, thing. State nonconformity may have more effect where the impact is concentrated rather than dispersed—that is, where a large tax benefit or penalty is thereby given to a relatively few people

It is only when the state offers a direct tax benefit (such as making political contributions deductible up to $100, or the exclusion of up to $1,000 received for services in the armed forces), not allowed under the federal income tax, that state nonconformity may amount to an exercise of real power at the state level, in the sense that the tax law may have a noticeable effect on taxpayer's decisions in the spheres affected.

As the situation now stands, although each of the conformity approaches offers a different degree of abdication of state power to the more over-riding federal power, none of the methods—even major nonconformity—could restore the state to a paramount position in affecting its own economy through the income tax. The issue, then, is *how can* the state improve its power in order to protect and advance its own interests, vis-à-vis federal policy which may not take those interests sufficiently into account.

The power question related to income tax should not be examined in isolation, but should be seen as part of the larger picture of state-federal fiscal relationships.

At one time, tax thinking was that each level of government would have its own functions and revenue sources, with a minimum of overlapping. Thus, the federal government would have its income tax, the state governments their sales taxes, and the local governments the property tax—with a minimum of overlapping either of taxation or of governmental activities. Each in its own sphere could then make policy independently of the others. That day is passed.

We now live in an era both of overlapping functions and taxes. There is a problem of coordination. If the federal government is not to overshadow the other levels of government, there is also a problem of how the latter can reassert their power.

It is a fact that, whatever the state does, the federal government has a huge direct tax impact on the state. For the fiscal year 1962, Californians bore 11 16 percent of the total federal tax burden For the fiscal year 1961 they paid to the federal government $8,486,217,000 in taxes. In 1961, $633,000,000 of that money was given back to California state and local governments in the form of grants-in-aid and shared revenues, and an additional $196,200,000 was given to individuals and institutions in California.* This form of federal-state fiscal relationship, however, inevitably implies a high degree of federal control Very often federal grant-in-aid programs are designed with eastern, rather than special California, problems in mind.

One way for the State to remedy this situation is to raise its own taxes and finance its own programs as much as possible. By making state and local income, property, and sales taxes deductible from the federal income tax, the federal government long ago left the door open for states to do this Deductibility has been described as an indirect way the federal government may subsidize state and local governments, without any federal control over how the revenue is spent. Because of deductibility, state and local tax burdens are not nearly so high as they seem. Furthermore, when a state has a progressive income tax, as California does, the higher the tax bracket, the lower the cost of state income tax as an addition to federal tax. Citing the precedent of the estate tax credit, some tax reformers urge that a federal income tax credit be given for specific state taxes paid, as a substitute for the present system of deductibility The credit would amount to a reduction of federal tax so that the states could have that revenue source. A federal tax credit might be designed so that there was a minimum of federal control over state tax policy; or Congress might exercise a high degree of control over state taxes by detailed specifications of the conditions under which a credit might be granted. (See Maxwell, *op. cit.*, chapters two to four, for an up-to-date discussion of tax credit proposals.) If the federal government does adopt a policy of specified tax credits, nonconformity of state tax laws may result in loss of a federal tax credit for California taxpayers Independence would cost the State money.

* Tax Foundation, *op cit*, pp 112,86

To return, now, to the main line of analysis:

If state income tax is a flat percentage of federal income tax, federal power is then absolute The state may control its own rates, but has abdicated any other power role.

If a Bibbero-type scheme is used, the state tax may alter or offset somewhat the degree of total impact of tax on individual tax brackets, but it will not affect behavior or decisions related to specific tax items.

The relative impact of other degrees of nonconformity (other than the granting of certain specific tax exemptions, deductions, or credits to special groups not so benefited under federal tax) will depend on how large the percentage of state tax is in comparison with the federal income tax. In California, as Table III shows, the overall percentage is quite low. Compared with many states, California derives a relatively small percentage of its total tax revenues from the income tax. Although since World War II states have tended to turn to sales rather than income taxes for new sources of revenue,* by 1962, income taxes were producing 19.6 percent of the total tax revenues of the states, with personal income tax producing 13 3 Oregon and New York depended upon individual and corporate income taxes for over 50 percent of their state tax revenues Nearly half of the income tax states relied on the income tax to a greater extent than did California

TABLE III

CALIFORNIA STATE INCOME TAX AS A PERCENT OF FEDERAL INCOME TAX

Adjusted gross income class	U S individual income tax (after credits) paid on returns filed in California (millions)	*Estimated* California personal income tax computed as a percent of U S individual income tax		*Actual* California personal income tax assessed	
		Amount (col 2 × 5 748%) (millions)	Percent of total	Amount (millions)	Percent of total
(1)	(2)	(3)	(4)	(5)	(6)
Less than $5,000	$527 4	$30 3	11 7%	$9 9	3.8%
$5,000-9,999	1,664 9	95 7	36 9	53 8	20 7
10,000-14,999	902 3	51 9	20 0	42 6	16 4
15,000-19,999	316 1	18 2	7 0	21 8	8 4
20,000-24,999	174 4	10 0	3 9	15 6	6 0
25,000-49,999	440 1	25 3	9 7	48 7	18 8
50,000-99,999	271 2	15 6	6 0	34 3	13 2
100,000-149,999	78 0	4 5	1 7	11 3	4 4
150,000-199,999	37 5	2 2	8	5 6	2 2
200,000 and over	104 6	6 0	2 3	16 0	6 1
	$4,516 6	$259 7	100 0	$259 7	100 0

SOURCE Column 2, *Statistics of Income—1960 Individual Income Tax Returns*, U S Treasury Department, p 79, column 5, *1961 Annual Report of the Franchise Tax Board*, p A-3

* Tax Foundation, "The Financial Challenge to the States" (1946-57) (New York, March, 1958), page 16.

California not only has obtained a relatively small percentage of its total revenues from income tax, but has also remained quite static in this respect while the policy of other states has been altering. As of 1939, California's state income taxes produced only 18 6 percent of total state tax revenues; by 1957, combined personal and corporate taxes still produced only 19 0 percent As of 1962, the percentage was 24.9. On the other hand, the percentage of income tax has been steadily rising in most states. In 1939, only five income tax states obtained more than 15 percent of their state tax revenues from income taxes By 1957, 19 states raised more than 15 percent and 12 states raised more than one-fourth of their total revenues from this source For most years since 1939, New York, Oregon, and Wisconsin have obtained more than 40 percent of their total state revenue from this source Whereas in 1939, 21 percent of the states obtained less than 10 percent of their total revenues from income tax; by 1957, only six were in this category. (In 1962, there were eight)

The lowness of California's percentage has a direct bearing upon the conformity question, and upon the degree of power really exercised by the State through the device of nonconformity One way to give the State more of a weapon to counteract federal policy, where that seems called for, would be to raise the state income tax (while lowering taxes from certain other sources) to something approximating the level of New York, Wisconsin, or Oregon.

There are sound arguments for doing this, which should appeal to intelligent taxpayers on all points of the political spectrum from radical right to radical left Whereas the sales and property taxes single out and penalize certain kinds of spending or use of private income, and the main weight of their burden necessarily falls more heavily (percentage-wise) on modest or middle incomes than on high incomes even when the taxes are graduated in some fashion—the income tax *can be* (though it has not been in the past) more neutral An income tax could be levied as a flat percentage on all incomes, without any progressivity at all; it could be steeply progressive, or it could compromise somewhere in between It can also be, as amply demonstrated by the federal income tax, a more flexible instrument for economic policy, whether that policy be dictated by the value-system of the right or of the left or of some other combine of forces Some tax experts contend that it is also more flexible as a revenue producer, responds more sensitively to business cycles than do the other taxes, and yields more revenue, without the necessity of raising rates, in an inflationary economy, where there is also a rise in per capita real income. Others say that a sales tax, properly conceived, could also have such virtues In addition, the income tax has the advantage of being an unhidden tax. The taxpayers know what they are contributing to government, paying taxes becomes a conscious act of citizenship. (This, of course, is why the tax is politically less expedient)

If California's income tax were a much higher percentage of the federal tax, it would be used as a real lever to offset federal tax policies, where the interests of the State might dictate Also, the cost to the taxpayer would not be the face amount of the tax because he can deduct state income taxes from his federal income tax

The argument against this policy is, of course, that state taxes would have to be close to the level of federal taxes before they could override

federal tax considerations in influencing taxpayers' decisions Short of this, the state income tax is comparatively impotent as an instrument of socioeconomic policy.

Whatever unilateral policy the State follows, whatever conformity method it employs, the fact is that federal power through the income tax will continue and probably increase If the State is to be an independent seat of power, as this writer thinks it should, then it will have to pursue the old goals by new means. Namely, it will have to have more of a voice in federal policymaking.

One approach would be for a continuing state committee composed of legislators and state officials to ascertain state attitudes and needs in relation to income tax policy and to make these facts known to the Californian Congressional delegation as a bloc.

Since most of the federal tax program is first formulated at the administrative level, a more effective approach would be through participation in some kind of permanent and official agency or commission set up specifically to provide a channel of communication between state government representatives and federal tax policymakers.

State-federal cooperation in *administering* taxes has already come a long way. There has been far less cooperation in the *making* of tax policy.

In the early 1930's, various groups began to talk about the need for a tax system in which overlapping taxes were kept to a minimum, or were justified on logical grounds, and in which use of particular taxes was allocated to the various levels of government on the basis of sound and reasoned criteria A variety of efforts have been made to achieve this goal, none very effective

The Council of State Governments has been concerned with the problem since it appointed a Committee on Conflicting Taxation in 1933. In 1942, at the council's request, the President of the United States asked the Director of the Bureau of the Budget and the Secretary of the Treasury to participate in the work of the council's taxation committee. The combined group was called Joint Federal-State-Local Committee on Fiscal Policies and Practices, and met several times during the war The council's reports on taxes have been useful, but have not affected policy very much

The Governors' Conference has had a continuing interest in overlapping taxes In 1947 and 1948, the members of its Special Committee on Tax and Fiscal Policy met with members of Congress in a Joint Conference on Federal-State Tax Relations This was the first time top-level federal and state officials had met together in an attempt to solve common fiscal problems, but little came of it As a result of President Eisenhower's proposal to the 1957 Governors' Conference, 7 federal officials and 10 state governors met as a Joint Federal-State Action Committee and issued a report making recommendations for specific changes in the tax law, but these were not well received

Various private groups have studied the problem. In 1947, a Joint Committee of the American Bar Association, the National Tax Association, and the National Association of Tax Administrators issued a report on the separation of state, federal, and local sources of revenue In 1953, the Tax Policy League held a symposium on tax coordination The Brookings Institution has sponsored studies of the problem.

The federal government has made some gestures toward solution In 1941, by authority of a Senate resolution, the Treasury Department appointed a Special Committee on Intergovernmental Fiscal Relations, whose report recommended the establishment of a Federal-State Fiscal Authority to promote close collaboration among state and federal administrations aiming toward more joint administration of selected overlapping taxes, to facilitate interstate cooperation, to conduct research, to disseminate information and educate the public, and to perform other useful services. This proposal was widely praised, but not adopted, mainly because the advent of the war directed attention to other problems The Hoover Commission, too, recommended the creation of a continuing agency on federal-state relations

As a result of a mandate in the Legislative Reorganization Act of 1946, the Senate and House Committees now called Committees on Government Operations created subcommittees on fiscal relations In 1948, the Senate Committee issued a report on "Coordination of Federal and State Taxes," recommending that the Joint Committee on the Legislative Budget as a regular procedure hold conferences with representatives of state and local governments to give them an opportunity to explain their needs. In 1957, the House's subcommittee on intergovernmental relations of the Governmental Operations Committee held regional hearings to assess the attitudes of state and local officials on the problem of tax coordination In 1953, a Commission on Intergovernmental Relations was appointed by Congress, mainly to study grants-in-aid Since then it has issued several useful annual reports, but it has barely scratched the surface of the problem Many of its recommendations have been ignored.

In summary, it can accurately be said that effective mechanisms for coordination do not yet exist, although there is widespread agreement that such mechanisms are badly needed. Also, most of the activity just described has been designed to try to separate tax sources as much as possible Since income taxes are now firmly entrenched both at the federal and state levels, and state conformity to federal tax laws is increasing, more cooperative efforts are needed in the making of *federal* tax law.

It is hereby strongly recommended that the California Legislature and state administration appoint a committee or commission to explore this problem further, and to prepare a plan whereby California state officials can have a much more formal, continuing, institutionalized voice in the federal policymaking process

The state-federal balance is not the only power issue at stake Also involved is the relative balance between federal, state, and *local* governments The issue arises with respect to deductibility of local taxes from state income tax Since deductibility is primarily a device for tax coordination, the state income tax *should not necessarily conform to the federal tax laws in allowing or not allowing deductibility* The arguments for making a given tax deductible at the federal level may not apply when deductibility from state tax is being considered

If the state income tax is raised—either as a way to help offset federal power or for other reasons—and there is to be a corresponding reduction in other taxes, the most likely tax for reduction is the property tax However, since this is primarily a source for local revenue,

the question then arises as to what substitute sources of revenue might be provided for local governments One possible substitute is the local income tax. Beginning in Philadelphia in 1940, a number of cities and taxing districts in at least five states have adopted the income tax, usually only on wages and salaries, taxed at a flat rate so that the tax is regressive. A local income tax poses many administrative difficulties. One way to circumvent many of these difficulties would be to adopt the tax supplement technique used successfully in Scandinavian countries and discussed earlier in this report in connection with federal-state relationships By this method, the local income tax supplement would be collected at the state level and then distributed to the local government.

Alterations in the tax mix would also, of course, alter the relative power and roles of state administrative agencies. This topic goes beyond the bounds of conformity problems, which are the subject matter of this report.

One other topic worthy of note is the possible effect of alternative conformity policies upon California's competitive position in relation to other states. Since state income tax is deductible from federal income tax in any state, there no strong reason why state income tax rates should affect California's competitive position A federal tax credit (which is different from a tax deduction) would minimize adverse interstate competitive effects even more. On the other hand, since the taxpayers who have the most difficulties with nonconformity are those in the upper income brackets, a policy of maximum or total conformity in California might be a positive attraction to people in this category.

IV. EQUITY

When state income tax is conformed to federal income tax, it automatically adopts the federal tax's inequities. Since this is so, and since the criterion of equity is applied to individual conformity issues, some general discussion of equity principles is relevant here.

Different people mean different things by equity in income taxation. Some mean a tax which is the same on all taxpayers Others mean a tax according to ability to pay, which in turn could mean either a proportional tax (a flat percentage) or a graduated tax. Refinements of the ability-to-pay principle include the concept of gross income, deductions for dependents, special dispensations for the aged or handicapped, special dispensation for extraordinary expenses (sickness or casualty losses), and other provisions Others think that equity requires that those who benefit from government spending should pay taxes in proportion to their benefit (the philosophy behind user taxes, such as the gasoline tax which goes to build highways in most states) Some think "undeserved" wealth should be more heavily taxed. More universally agreed-upon is the principle that all in a like situation should be taxed equally

The income tax, both state and federal, has certain built-in inequities. It generally does not tax unrealized gain or self-consumed production According to Jerome R Hellerstein, there is more unrealized gain not taxed than realized gain that is A net worth tax has been proposed from time to time, but not adopted because of the administrative diffi-

culties it would entail. Also, income tax tends to fall upon—and thus penalize—the kind of activity which is most easily recorded or traced In fact, it penalizes activity as such

Roughly speaking, the federal income tax to which California's state tax conforms is premised on the ability-to-pay principle, though not so consistently or thoroughly as many people suppose

Since the federal income tax originally fell primarily upon the wealthy, and the statutory rates are still steeply graduated, there is a widespread belief that total tax impact in the United States falls rather heavily on those with high incomes.

This is not true when the *combined impact* of all taxes is computed Property taxes, then sales taxes were enacted and increased originally on the premise that the income tax would be on upper incomes and the property and sales taxes would be garnered from a broader base. However, the base of the income tax has been lowered, and property and sales taxes have increased, so that the net effect has been to diminish the total progressivity of American taxes. A study by Professor Richard Musgrave in 1955 indicated that the overall tax system in the United States, including all taxes, was only barely progressive for incomes up to $10,000, which included about 90 percent of family units The total effective rate ranged from 26 9 percent on the first $2,000 of income to 33 percent on incomes between $7,500 and $10,000. For all incomes over $10,000, the combined effective impact was about 40 percent. He concluded that the burden was essentially proportional on incomes up to $10,000 and only mildly progressive on incomes beyond *

Statistics on the total tax impact on Californians are being prepared by another consultant for the Assembly Committee's Tax Study, to show combined effect of federal, state, and local taxes on taxpayers at different income levels in the state

Even when the income tax alone is considered, historically the federal income tax has moved from a class tax to a mass tax—from a tax on the rich, at first affecting only one percent of the population, to a broad-based tax deriving a high percentage of revenue from the lower income brackets. In most years before 1940, income tax was paid by fewer than 6 percent of all gainfully employed persons in the United States. In 1940, there were 7½ million federal income tax returns reporting taxable income, out of a population of 132 million By 1957, taxable returns accounted for about 86 percent of the total amount of adjusted gross income estimated to have been received by all individuals in the United States † In 1960, there were 48 million returns reporting taxable income out of a population of 180 million

A personal income tax has been in effect in California since 1935. In that year, there were only 372,836 returns; by 1961, the number of returns was 4,475,122, an increase of over 4,100,000. In 1949, there were returns for 32 9 percent of the State's population; by 1953, the percentage was 54.6 percent; by 1958, 69 7 percent; and by 1961, 79 percent. In 1949, state adjusted gross income was 44.2 percent of personal income in the state; by 1957, the percentage was 68.5 percent.‡

* "The Incidence of the Tax Structure and Its Effects on Consumption," in *Federal Tax Policy for Economic Growth and Stability*, Papers submitted to Joint Committee on the Economic Report, 84th Congress, First Session, Washington, D C, 1955, page 98

† Kahn, *Personal Deductions in the Federal Income Tax*, page x

‡ Annual Reports of Franchise Tax Board, 1959 and 1962

Partially, this broadening of the tax base has been due to deliberate extension of the tax downward, for the federal government since the close of World War II. Personal exemptions in the federal income tax declined from $3,000 for single individuals and $4,000 for married couples, in 1913; to $1,000 and $2,500, with an additional $400 per dependent, by 1939; down to their present level.

The pattern for state personal exemptions is as follows:

	1935-42	*1943-4*	*1945-8*	*1949-52*	*1953-8*	*1959*
Joint-married	$2500	$3500	$4500	$3500	$3500	$3000
Separate-married	1250	1750	2250	1750	1750	1500
Single	1000	2000	3000	2000	2000	1500
Head of household	2500	3500	4500	3500	3500	3000

It should be noted that California's exemptions are high compared with those in many other states.

However, for both the federal and state governments, exemptions have not been raised to take into account the effects of inflation Also, a rise in real income plus inflation have pushed millions of Americans into higher tax brackets Using the average of the first nine months of 1962 as equalling 100, the purchasing power of the consumer dollar in the United States has declined as follows:*

1929	176.1	1944	171 7
1934	225 7	1954	107.4
1939	217.4	1962	100 0

Since 1913, when the federal income tax amendment was adopted, the cost of living has risen at least 200 percent As a result, exemptions which once were designed to cover the basic cost of living for those in modest circumstances no longer have this effect

Still another factor are the loopholes available to those with high incomes or which are more beneficial to them than to others: As United States Senator Barry Goldwater has said, the "whole tax structure is filled with loopholes" Senator Paul Douglas has said that the "loopholes have become 'truck holes'," and Chairman Wilbur Mills of the House Ways and Means Committee has described the tax system as a "house of horrors." † The loopholes not only substantially modify the ability-to-pay results of the tax but also violate the "like tax to those like situated" principle.

On the basis of these criteria, some of the major loopholes in the federal tax law reinforced to a major extent or in toto by various methods of state tax conformity are as follows:

Capital gains special treatment —benefits increase as income increases, because of progressive rate

—discriminate between gain from property as against income from services, to the disadvantage of professional men and others who sell services

—discriminates in favor of subdivider who holds large piece of real property for a single sale as against an ordinary realtor or developer whose transactions are taxed as ordinary income

* Tax Foundation, *Reconstructing the Federal Tax System · A Guide to the Issues*, January, 1963, page 11.

† Quoted by Louis Eisenstein, *The Ideologies of Taxation*, (New York, Ronald Press. 1961), page 181.

Capital gains treatment (continued)	
	—permits special favors to corporation executives through stock options and lump-sum distributions of pension funds
Unrealized appreciation	—in December, 1960, the New York Stock Exchange estimated that 40 percent of the value of some $250 billion dollars of stock held by individuals was unrealized appreciation, not as such subject to income tax.
Special corporations, family trusts and partnerships, private foundations, special trusts	
Income splitting (NOTE: California as a community property state had income splitting prior to addition of any tax provisions on this subject in federal law.)	—benefits the middle incomes more than the low or high "When authorized by Congress in 1948, 97 percent of the benefits went to 5 percent of those benefited." "As a result of income splitting, husbands with incomes between $10,000 and $50,000 are now paying less than they paid in 1941." *
Accelerated depreciation when applied to real property	—see analysis under special conformity issues
Business expense deductions	—see analysis under special conformity issues
Percentage depletion	—the larger the profit, the larger the deduction
	—the deduction continues as long as production continues, though the investors may have recovered their investment many times over "There is a case on record in which one individual oil operator had total net income of $14 million over a five-year period, but paid a total of only $80,000 in income taxes, his effective rate of tax because of percentage depletion (and the related intangible drilling costs allowed) was six-tenths of 1 percent." †
Special exemptions for interest on state and local bonds	—a major source of tax avoidance in upper income brackets
Other special exemptions	

As a result of these various factors, the progressivity of statutory rates is not matched by equivalent progressivity in real impact. In 1956, the average federal income tax paid by all individuals with incomes of $100,000 or more was approximately 36 percent of their income, though the effective rate was supposed to be 67 percent at $100,000, 78 percent at $200,000, and 80 percent at $500,000.‡ As of 1957, about 21 percent of the total revenue yield of the federal tax was supplied by taxpayers with adjusted gross incomes under $5,000 and 60 percent by those with adjusted gross incomes under $10,000. For the fiscal year 1960, about 86 percent of all federal revenues from income tax came from taxes on income in the first bracket. Only 14

* Eisenstein, page 45 There are, of course, arguments on other grounds *in favor of* income-splitting
† Hellerstein, *Taxes, Loopholes and Morals* (New York, McGraw Hill, 1963), page 24
‡ Hellerstein, page 16

percent came from taxes on income subject to progressive rates.* The 1964 changes will introduce more progressivity into the lower income levels, but will not alter much the overall pattern.

California's income tax is in one sense more progressive, because of higher exemptions and wider brackets, but the progressivity stops at $15,000. If the California personal income tax were to be more consistently based on the ability-to-pay principle, graduated rates beyond the $15,000 level would have to be introduced.

Note should also be taken of the effects of special deductions in diminishing such progressivity as there is If a state had a 15 percent rate on income in a federal 90 percent bracket, the state rate would reduce the federal rate to 76 5 percent ($15 state taxes per $100 income leaves $85 federal taxable income, of which 90 percent is $76 50 or 76 5 percent of $100) so that the actual additional cost to the taxpayer for the state tax would be only 1 5 percent ($76 50 + $15 state tax = $91.50, or $1 50 more than the $90 federal tax). The higher the federal tax bracket, the less the real cost to the taxpayer of a progressive state tax For some taxpayers, combined federal-state income taxes may actually be *less* than what the federal tax would be without a state tax.† Deductibility from federal income tax, therefore, may reduce or in some cases even turn into regressivity the progressivity of the state income tax For taxpayers in the higher brackets who believe in state's rights, the most logical policy is to encourage a high and steeply progressive state income tax Deductibility from federal income tax also accentuates whatever regressivity there may be in other state and local taxes.

Apart from gross monetary-level discriminations, the federal income tax has incorporated in it *patterns of favoritism*, some of which were intentional, some of which have been inadvertent. Some of these, suggested by the analyses of specific conformity issues and by the writers cited in the bibliography, are as follows·

Favors	*As Compared With*
corporations	noncorporations
large business	small business
homeowners	renters
borrowers	nonborrowers
married	unmarried
inactivity of all kinds	activity-exchange
special lobbying	average person lobbying
old people	other age groups
veterans	non-veterans
receivers of gifts	workers
corporation employees	self-employed
exploiters of mineral resources	other businesses

* Eisenstein, page 56.
† See Emanuel Melichar's discussion of this in *State Individual Income Taxes*, page 98 *et seq*

By conforming, the state personal income tax also embraces these patterns of favoritism

V. SOCIAL AND ECONOMIC POLICY

Some of the departures from strict equity are, of course, deliberate, since the federal income tax has been increasingly used as a conscious instrument to carry out economic and social policy. A conforming state income tax automatically reinforces the policies inherent in the federal income tax, and for that reason some general policy discussion is appropriate here, though space does not permit a thorough elaboration upon this subject.

For both economic and social policy, one of the central issues is what the appropriate balance of power should be between public government and private control.

Economic Policy

In the economic sphere, this power issue is mingled with issues about how the American economy does or should work. One issue is whether the economy needs stabilization or stimulation toward growth, or how can it have both at the same time One school of thought is that income taxes are a stabilizing factor, since cyclical contractions and expansions in the private economy are moderated by opposing movements of income tax payments High income taxes may be a curb upon inflation.

Others stress the need for a stimulation of the economy, but disagree about methods of stimulation Those who feel that the economy is best stimulated through increases of consumer purchasing power advocate high personal exemptions and other devices to free money at the lower economic levels Here the private-public power issue arises if specific tax laws are enacted to direct consumer buying into special channels.

For those who subscribe to the "trickle-down" theory of economic stimulation, there is the additional issue of whether the economy should be stimulated by selective special incentives for corporation executives and so forth (all of which imply a major role for public government in determining where the stimulations should be focused); or whether the stimulation should come through a repeal of any tax at all on capital gains, a drastic diminishment of progressive rates, an absence of any tax on "rollover" investments where the money gained from one transaction is immediately invested in another, and other devices which leave a maximum amount of independent decision-making and economic power in private hands and make public government's role as neutral as possible.

Still another, but related, issue is how to balance incentives to work (rewards in relation to effort) with income redistribution (through progressive rates, etc.) as a mode of creating equality of opportunity In other words, if the capitalist system is to operate in a way which leaves open opportunity for new enterprisers and small business, then perhaps tax laws should not permit the permanent formation of huge aggregates of capital in the hands of only a few people.

Many of the tax controls on consumer spending are not in the income tax but rather in selective sales and excise taxes which are beyond the scope of this report.

Many of the details of federal law bearing on the other economic issues are more important in corporation tax laws (which are outside the scope of this report) than they are on personal income tax laws. However, many of the relevant laws pertain both to personal as well as to corporation income tax

On selective tax incentives toward capital formation and financing through equity capital, rather than borrowing, recent economic studies indicate that this is a problem for small and new risky business, rather than for the large corporations, though the tax law is not tailored to assist the former rather than the latter. A news release on May 12, 1964, stated the following. "One of the things most institutional lending groups have learned to live with recently is the realization that many corporations that ordinarily might be seeking to borrow from them have stored up substantial amounts of cash for their own use Estimates of the cash flow of non-financial corporations at the end of 1963—their after-tax profits plus depreciation and less dividends—vary from $40 billion to $43 billion. "This has lessened the demand for funds from lending concerns But it also has created new duties for the fiscal officers of companies with ample, or more than ample, supplies of cash on hand."* John W Gilbert in "Use of Corporate-Generated Funds for Expansion," *Taxes* v. 42 (January 1964), page 50, concludes that United States corporations are currently generating their own funds at an astonishing rate.

Where companies do need outside capital, their tendency is to borrow money rather than to sell stock, because interest rates are low compared with earnings, and interest is deductible, whereas dividends are not Shareholders are inclined to favor loans over a new issue of stock; a new issue to new investors is frowned upon because it will dilute equity in the business.

The need for capital seems to be concentrated primarily in small business and in new risky ventures. However, most investors have little interest in new equities, regardless of taxes, so that special tax provisions such as the dividend credit and exclusion do not necessarily lead to more risk investment Adolf Berle has estimated that from 1919 to 1947, gross capital formation in the U S. was about $770 billion. Of this total, merely 2 percent, or $15 billion, was derived from individual savings invested in new issues of common stock Of this 2 percent, only a portion was exposed to the hazards of new ventures.† The research of Professor J Keith Butters of Harvard indicates that investors are either security-minded or risk-minded, and that when tax considerations operate, the security-minded are induced to become more conservative and the risk-minded more venturesome. Of the small group interested in new issues, only a minority are affected by taxes and only some of these are stimulated by taxes, rather than deterred.‡ Therefore, it can well be argued that current tax policies

* Reported by UPI in the Oakland *Tribune*, from a book newly issued by Morgan Guaranty Trust Company of New York
† Quoted in Eisenstein, page 80
‡ Butters, Thompson, Bollinger, *Effects of Taxation · Investments by Individuals*, 1953

either are directed toward a need which is not there, or do not accomplish the purpose they are supposed to accomplish

If the approach of special incentives is desired, much more could be done through the income tax to encourage risk capital and to stimulate small business In California, this would require new tax provisions not conforming to present federal tax law

Tax laws are also used to create special incentives for corporation executives, through special tax treatment of tax options, profit-sharing, and corporate pension plans, and through the deductibility of business expenses A Securities Exchange Commission report for February 1961, showed that 350 large companies gave their executives stock-option benefits totalling $200 million in 1959 and $164 million in 1960. A study of these companies shows that 215 top executives received stock-option benefits averaging almost 30 percent of their salaries in 1960; one-fourth received benefits equal to half or more of their salaries.*

Those who disapprove of this tax policy argue that businessmen would work hard even without such incentives. If anything, higher taxes would make them work even harder, it is said It is also said that businessmen primarily work for motives other than money: a desire for power and prestige, the need for security, a sense of duty or loyalty, a sense of achievement, or even because of "conditioned response." Also, it is said that stock options tend to go to the men at the top who would stay with the company and work hard anyway; they are not primarily used as incentives for bright young executives Also, it is asked why business executives should have special incentives while those in service trades or the professions are not given these tax advantages It is argued that in an economy with a rising per capita income, there is more and more demand for services so that there are acute and chronic shortages of professional and technical workers The need is, according to this argument, for more incentives to encourage people into these fields, particularly in California where the shortages in some professional and skilled vocations are especially acute

To counter the arguments of those who contend that high taxes generally, and progressive taxes in particular, are a deterrent to the economy and that capital formation would best be achieved by tax cuts and repeal of capital gains taxes, there is the argument that personal savings have been steadily rising despite higher taxes Total gross individual savings were $24 4 billion in the United States in 1941; by 1961, they were $78 8 billion, a more than threefold increase † Also, it is pointed out that low taxes did not prevent the 1929 crash, and that high taxes have not prevented prosperity during the past 20 years. Furthermore, despite progressivity, these savings are concentrated in the upper brackets. One percent of all families (those with incomes over $15,000) has about 35 percent of all the savings. Each year, at least half of those in the top 1 percent save 20 percent or more of their income before taxes.‡ Also, real income per capita has been steadily rising (by 1961 disposable income per capita was about 34 percent more than in 1929),[1] despite the parallel rapid rise in taxes.

* Hellerstein, p 38.
† Tax Foundation, *op cit*, page 73.
‡ Eisenstein, page 82.
[1] Tax Foundation, *op. cit*, page 60.

There are also those who argue that the economy does not need to be stimulated to produce more consumer goods, but rather what are needed are such things as schools, parks, public buildings, and other improvements which require higher taxes and more flow of money through public government.

In addition to these general actual effects (or intended effects) on the economy through the income tax, there are also specific actual effects (or intended effects) Specific tax measures are designed to encourage or discourage real estate investment as compared with other investment, to encourage borrowing and the maintenance of a fixed debt on real estate, to encourage rapid replacement of equipment in business and rapid turnover of real estate, to encourage or discourage job mobility, to affect the competitive position of American business in the world economy, to stimulate or control inflation or deflation Tax laws also affect relationships between management and stockholders in business, encourage homeowning rather then renting and the use of one's own automobile rather than public transit To alter these patterns, state tax law would have to be different from the federal law

Social Policy

There are three main ways certain kinds of social policies can be carried out, representing three different gradations of public-private control· (1) through direct provision of governmental services, government welfare aid, and government scholarships or direct statutory or administrative mandates; (2) through income tax exemptions, deductions, and credits; and (3) through private agencies and institutions, with or without the indirect governmental subsidization resulting from the tax deductibility of private philanthropic contributions.

Often, the income tax device is used when it is politically difficult to get direct governmental action, or as a way of forestalling direct governmental action. At the present time, in the federal personal income tax law, to which state law conforms, are provisions designed to give outright subsidies to veterans, old people, and the handicapped; to encourage private saving for old age; to give special help to victims of disaster or major illness; and so forth In California, the tax law has been used for crime deterrence, by making nondeductible the business expenses for certain illegal activities. There is increasing pressure for special tax credits in the federal income tax, to assist people who send their children to college, to encourage employers to create new jobs, to encourage political contributions, and for a variety of other purposes In the 82d Congress there were two tax credit bills; in the 85th, there were 35, in the 86th, there were 52; and in the 87th, 89

Aside from arguments on the merits of each specific proposal, there are general arguments for and against using the income tax as an instrument of social policy. Sometimes it is a question of doing it through the income tax, or not being able to do it at all Sometimes this is a way of giving indirect governmental help without detailed governmental control. However, the benefits of tax subsidies are seldom, if ever, distributed in a fashion most consistent with the purpose of the subsidy, since the benefit is often in proportion to income. The higher the income and the higher the income tax otherwise payable, the higher

the benefit, in many cases. Even when the credit is for a flat amount, no benefit is received unless the person is a taxpayer who would otherwise owe a tax.

A third way of carrying out social policy is through private action through private agencies and institutions. By permitting private tax exempt foundations and charitable trusts, and by making charitable contributions deductible from income tax, the government is in effect encouraging private rather than public efforts to solve social problems. This amounts to a deliberate policy to decentralize power. A detailed analysis of this question will be given in relation to the specific conformity issue of whether to raise the ceiling on charitable deductions in California to the level permitted under the federal income tax. As background, it might be pertinent to note that as of 1952, there were 12,000 private charitable foundations in the United States; by 1961, there were more than 45,000. As of 1960 their combined net worth was more than $9.8 billion, 23 percent more than the total capital funds of the nation's largest commercial banks Their aggregate annual receipts were approximately $1 34 billion. The Foundation Library Center in New York estimated that all foundations had total assets of $13 billion and made annual grants of approximately $700 million *

* "Tax Exempt Foundations and Charitable Trusts Their Impact on our Economy," Chairman's Report to the Select Committee on Small Business, House of Representatives, 87th Congress

SPECIFIC CONFORMITY ISSUES

Since the California Legislature may, if it chooses, decide deliberately to alter or abolish any of the state tax laws now in conformity with federal law, theoretically this analysis of individual issues should include an analysis of all the major elements of the federal tax law. California, for example, could confine the special deduction for capital gains to gains on new ventures; it could cut off the depletion allowance after the original costs are recovered, close off other loopholes, and eliminate social subsidy provisions from the income tax. Within the time limits allowed, however, a total analysis was not possible. With a few exceptions, this analysis is confined to federal laws with which the state law is not now in conformity Nor was it possible to analyze *all* the laws now out of conformity, for they run into more than a hundred So a selection had to be made, and the criterion of selection was primarily—though not entirely—on the basis of major revenue impact This selective process reflects both the state's past piecemeal conformity policy and the bias of state administrative officials toward primary concern with revenue and administrative problems Note should be taken of these biases in selection If a new conformity policy is adopted, then perhaps study will need to be made of other individual tax laws not included here.

Of all the provisions of the federal income tax which have been criticized on grounds of equity or lack of neutrality or of their implicit policy (and to which the State Legislature may decide to *unconform* the state law), one problem stands out as particularly pertinent to California and that is the tax shelters available to income real estate property through both the state and federal law. This law is singled out not only because of the special importance of land use in California, which is host to so many constant new in-migrants, but also because it is vitally connected with finance and lending practices. So this report will begin with an analysis of some elements of the present law affecting income from real estate and then will proceed to an analysis of laws with which state law is not now in conformity

REAL ESTATE DEPRECIATION

Question: Should California limit depreciation on income-producing real property to the straight-line method and close other tax loopholes affecting such property?

The Broader Context

The answer to this question cannot be given solely in terms of the conformity issue, nor solely in terms of the income tax What is needed is a thorough study of the combined and interrelated impact of property taxes, income tax provisions, and assessment practices upon real estate and real estate finance in California, including effects upon land

use and urban renewal There is no doubt that tax laws have greatly distorted the normal operations of supply and demand in these fields The nature of these distortions, their extent, and their damaging effects have yet to be explored.

Tax laws are biased in favor of home owners, since interest payments on home mortgages are deductible, whereas renters pay such interest indirectly but cannot take an equivalent deduction. Also, the rental value (equivalent to a landlord's profit, after interest payments and taxes) of a home in which the owner lives is not included as taxable income One real estate expert has said that the total influence of property taxes has been to limit the amount and type of real estate investment, and to increase its peculiar characteristics so that property is "milked" in its early years and then neglected Tax laws in general tend to encourage mortgage financing rather than equity financing, and to encourage nonamortization of mortgage payments and either the maintenance of a high fixed debt or sale of the property, which is then taken back under long-term lease, with rental payments which are deductible if the property is used for business purposes. Other tax-avoidance practices lead to gross overevaluation of properties and to the formation of highly complex and unstable financial structures. Tax laws have led to the overbuilding of apartments and the underbuilding of inexpensive homes, and have injected artificial criteria for building, so that there may be no incentive to improve the product Financial and tax considerations weigh much more heavily than consumer needs. Large land developers, holding land and selling to an operating company to make a capital gain instead of ordinary income, may be more interested in raising the value of their unused land than in rapid sale of the homes they build, they are interested in creating a kind of shortage, which in turn could lead to a kind of land monopoly around the center cities and greatly increase present cleavages between central cities and their suburbs Much more study is needed of all this of the relationships between the assessed value of slum property and of the value taken as a basis for depreciation; of pressures toward disproportionately high assessed valuations on improvements as compared with the land on which they stand, or vice versa; and of the combined effect of tax laws on slum clearance and urban renewal

The Depreciation Issue

Present California law for the depreciation of income-producing real property conforms to the federal law, which means that such property may be depreciated rapidly in the early years of its holding according to formulae also applied to the depreciation of tangible personal property and realty When Congress originally adopted faster depreciation methods in 1954, its primary concern was with machinery and equipment, though it made no distinction between tangible personal property and realty. Although the 150 percent declining balance method of depreciation was permitted for income-producing real estate under the 1939 code, by a ruling issued in 1946 its use was very limited, so that the 1954 change was a major one Between 1954 and 1964, real estate depreciation could be deducted from ordinary income, whereas the gain was taxed at capital gains rates. Where allowances for depreciation ex-

ceeded the actual decline in economic value of the property, the taxpayer was permitted in effect to convert ordinary income into capital gain Acquisition of real estate was usually financed by a mortgage on the property, and depreciation deductions were allowed on amounts equivalent to the indebtedness as well as the taxpayer's equity investment, so that the large depreciation deductions permitted the tax-free amortization of the mortgage, a substantial tax-free cash return on the investment, and frequently enabled the taxpayer to show a loss from year to year to offset other ordinary income

Such advantages led to a boom in real estate investment. In 1959, 1960, and 1961 there were 25 offerings registered with the Securities Exchange Commission by so-called cash flow real estate investment companies involving over $300 million In New York alone, over $1 billion of real estate securities was offered in 1961 Many of these companies specialized in acquiring existing properties to be used as depreciation tax shelters. Property was often held by a managing broker, who held similar property for others and periodically arranged a rotation so that his clients could get a new depreciation basis (See Pretzer v. U S, 61-1 USTC, paragraph 9477 (D C, Ariz)) "Tax sheltering was often accentuated by use of a phantom mortgage."*

California tax law was not conformed to the new federal law concerning depreciation until 1959 Thereafter, such tax advantages were available in the state tax as well as the federal tax, although California continued to tax real estate investment trusts as ordinary corporations rather than giving them the special tax treatment given them by the federal law

Numerous books and pamphlets have guided investors into the great benefits of real estate tax loopholes, ranging all the way from "Tax Saving Opportunities in Real Estate Transactions," Number 16 (March 1, 1961) of CCH's Standard Federal Tax Reports, to William Nickerson's, *How I Turned $1,000 into a Million in Real Estate in My Spare Time* (New York, Simon and Schuster, 1959)

In 1962 for depreciable machinery and other personal property, and in 1964 for income-producing real estate, the federal tax law was changed to limit conversion from ordinary income to capital gains where accelerated depreciation had been used In 1964, California income tax law was conformed to the new 1964 federal provision. Many tax experts claim, however, that opportunities for tax avoidance still abound in the real estate field

One Federal administration proposal, which did not pass in 1962, was to limit real property to straight-line depreciation, depriving it of the declining balance method, including those determined on a 200 percent and 150 percent base The Treasury cited as evidence of unrealism in accelerated depreciation of real estate the fact that (a) there is normally a great disparity between the rate of depreciation under the accelerated method and the rate of amortization of real estate mortgages typically required by lenders of money, and (b) hundreds of millions are annually invested in real estate securities on the basis of projections showing negligible or extremely small net income for tax purposes. (See article by Colean in April, 1955 *Architectural Forum*) De-

* Mervyn L Hecht, "Rollover Basis Can Solve Depreciation Shelter Problem," *Taxes*, volume 42 (February, 1964), pages 114, 116

preciation on buildings is much slower than it is on equipment, can be offset by repair, and technological obsolescence may be remedied There is no rapid falloff of value in early years In fact, some say depreciation should be low in the early years and accelerated later to follow the real obsolescing patterns of real property as compared with machinery, which loses much of its value in the early stages Also, real estate is readily transferable without excessive cost, as factory equipment is not, and real estate has a broader market than most specialized equipment.

The arguments of the National Association of Home Builders against the Administration's proposal were that it would greatly restrict new rental housing construction, which is 30 percent of new housing Furthermore, the NAHB claimed, "excessive depreciation benefits are purely temporary in nature; real estate is comparatively nonliquid and therefore investors require a higher return " It was argued that income producing property is a hazardous risk, and that maximum rental flow is tied more to the value of the location than to methods of operation Real estate salvage value is difficult to predict, and the depreciation allowance is the only protection against a wide range of contingencies which may affect the value of property The NAHB said, however, that it did not defend the cash-flow or depreciation-shelter type corporation which specialized in acquiring property, making tax-free distributions to shareholders, and disposing of property when depreciation deductions failed to wipe out rental income It said the law should be changed to correct existing abuses, providing all pertinent factors were taken into consideration.

Note should be taken of the fact that each new buyer of a slum property may depreciate the property all over again, which makes it profitable not to raze slums When government does pay for slum property for urban renewal, very often it pays a high price for buildings which it has already in effect subsidized several times over, each time a new owner has deducted depreciation for the buildings from his income tax.

This is an example of one out of many California tax provisions, currently in conformity with the federal law, which bear further study and analysis The sources on which the foregoing comments were based are listed in the Bibliography.

DIVIDEND EXCLUSION

Question: Should California conform its tax law to Section 116 of the Internal Revenue Code which allows exclusion of $100 per taxpayer of income from dividends from taxable domestic corporations, estates, or trusts?

This analysis will be in three parts· (1) legislative background; (2) the arguments pro and con, and (3) tables on federal dividend tax liability, by year and income bracket.

Legislative Background

Between 1913 and 1936, under the federal income tax, dividends were free of income tax, though they were subject to a surtax. In 1936,

an undistributed profits tax law was passed, though modified in 1938 and repealed in 1939, and between 1936 and 1954 dividends were treated as other income At the request of a Republican administration, a law was passed in 1954 (following in modified form a Canadian law adopted in 1949) providing for a $50 exclusion and a four percent dividend credit. (The Canadian credit was 20 percent. Altogether, 28 countries have some relief provision on dividend income) At one point, the 1954 bill provided for an ultimate $100 exclusion and an ultimate credit of 15 percent The Administration compromised on four percent with the thought that this would soften immediate revenue impact and the figure could be gradually raised to 15 percent Even the more modified version which was passed was strongly opposed by labor organizations In 1961 and 1962 President Kennedy recommended that the dividend exclusion and credit be repealed, and in 1959 and 1960 the Senate voted to repeal the 4 percent credit, but this was not adopted by the conference committees Business interests urged their retention and the AFL-CIO strongly urged their repeal in the Congressional hearings of 1962. The 1964 Revenue Act included a much fought-over provision to reduce the 4 percent credit to 2 percent for 1964 and to repeal it for subsequent years At the same time the $50 exclusion was increased to $100. The House Ways and Means Report argued that a reduction of the corporate rate by 4 percent, as provided in HR 8363, probably would do as much to remove any double taxation as would continuance of the 4 percent credit, and combined with the 7 percent investment credit would have more direct impact on making funds available for corporate investment

Many of the states have exempted dividend income to some extent, usually confining the exemption to income from corporations already paying income tax to the state A survey in 1942 showed that the majority of states with broad income tax exempted dividend income to some extent six rural states exempted dividends paid out of income which had been used as a measure of a corporate income tax, to the extent corporate income was taxed by the state, four rural states exempted dividends paid by domestic corporations and other corporations which earned 50 percent of their income within the state; and 12 states made dividends fully taxable, treated as other income Other states have had varying special provisions Maryland at one time taxed investment income at different rates from other income

Conformity of California law to the federal law was considered by the Senate Fact Finding Committee in 1959-60, which concluded that it should not be conformed because of severe revenue losses which would result. The law at that time, however, included both the exclusion and the credit The Treasury Department stated in 1962 that the $50 exclusion produced only one-third the amount of loss derived from the 4 percent credit

THE ARGUMENTS PRO AND CON

(1) *Revenue Impact.* The California Department of Finance estimated in 1963 that a $50 exclusion would result in a revenue loss of $1,125,000. Presumably, then, a $100 exclusion would result in a greater

revenue loss (but not twice as much, since fewer people would have $100 to exclude) On the other hand, it is argued that the exclusion would stimulate business growth which would produce more long-run revenue yield.

(2) *The Issue of Double Taxation* The rationale for the 1954 changes in the federal law was that dividends represent the distributions of previously taxed income and therefore should not be taxed twice. Some states tax dividends because the stock on which the dividends are paid escapes property taxation. In California, the double taxation issue is different from the federal because the state income tax on general corporations is only 5½ percent. This reduces the double taxation to an almost negligible level. Also, where income from California corporations is received by out-of-state stockholders in a state where dividends are not taxed, there is no double taxation at all. (To get at income in the form of dividends paid to non-resident stockholders, Wisconsin imposed a tax on the privilege of declaring dividends out of income earned in Wisconsin, to be deducted by the corporation. This was validated by the United States Supreme Court as a corporation net income tax.)

Those who refuse to accept the argument of double taxation do so on the following grounds (a) It may not be double taxation at all, since business may shift the burden of corporate income tax to consumers in the form of higher prices, or to workers in the form of lower wages, and because of the low state corporation income tax and other factors mentioned above. (b) The corporate and individual income taxes rest on different concepts, with the corporate tax being the price paid for the privilege of operating (part of the costs of operating), and the personal tax being based on personal capacity and obligation to help bear the costs of government. (c) Double taxation is rampant throughout our tax system, as when a consumer tax is paid for purchases made from income on which an income tax has already been paid, or when federal, state, and local jurisdictions impose taxes on the same income (d) There is not double taxation to the full amount of the corporate income tax because if that income had gone directly to the stockholders, instead of to the government in the form of taxes, a fraction of that income would have been paid out anyway in the form of personal taxes.

(3) *Effect on Capital Formation and Dispersal of Stock Ownership.* One of the original purposes of the 1954 provisions was to encourage investment, for it was felt that the United States was lagging behind other countries in capital formation. The $50 exclusion in the 1954 Revenue Act and the $100 exclusion in 1964 were designed to encourage broader stock ownership among those with relatively low income, the idea being to give more Americans a stake in American corporate enterprise.

Those who oppose the exclusion (and opposed even more than the four percent credit) argue that the American investment rate cannot be compared with that of other countries whose economies are in different stages Investment rate has to be in balance with demand.

Others say that these provisions do not accomplish what they are intended to accomplish, though there is disagreement about this. The

Treasury Department testified to the Senate Finance Committee in 1962 that in the eight years since 1955, the proportion of total corporate public long-term financing accounted for by stock issues had not been significantly higher than in the eight years before 1955 On the other hand, the National Association of Manufacturers pointed to the Treasury's tables showing an increase in annual equity financing from $1 9 billion in 1946-53 to $3 3 billion in 1954-61, an average increase of $1 4 billion or 75 percent, approximately three times the estimated revenue effect of the credit and exclusion The NAM argued that this increase would have been substantially less, had it not been for the dividend exclusion. Also, when dividends are taxable, investors may prefer that corporations retain the earnings for greater growth rather than distribute them, thus reducing the incentive for equity financing

Louis Eisenstein has pointed out the inconsistency of giving special treatment on capital gains in order to stimulate investors to sell securities for a profit, and at the same time giving the dividend exclusion in order to stimulate investors to hold securities for dividends, and arguing in both cases that this will lead to an increase in equity capital

In any case, there is no assurance that the benefits of a dividend exclusion from the California personal income tax would accrue to California

There is some question, too, about whether the exclusion really leads to more widespread ownership of stock The New York Stock Exchange has estimated that the number of shareholders in the United States rose from 6 5 million in 1952 to 17 million in 1962. On the other hand, a study sponsored by the University of Michigan Survey Research Center showed that as of late 1959, only 14 percent of American families held any stock in publicly held corporations (including only 8 percent by families headed by craftsmen, and 2 percent by laborers or service workers) (cited page 638 of Senate Finance Committee hearings) When focus is upon the amount of stock held, it becomes clear, as Daniel Holland has said, that "no other type of income is distributed in such a concentrated fashion "* In 1950, only 6 percent of all dividend recipients reported $5,000 or more of dividends, but they received 65 percent of all dividends reported by individuals on tax returns Two years after the 1954 $50 exclusion (and 4 percent credit) had been in effect, it was still reported that taxpayers in income classes of $50,000 and over comprised 2 5 percent of all taxable dividend returns, but they received 36 percent of the dividends reported on such return * Eisenstein *(op cit* page 112) has quoted the following figures· that only about one family out of ten own stock in public corporations; that less than one percent of all families (those with a net worth beyond $250,000) holds about 70 percent of the total value of the shares; more than 50 percent of the shareholders own only one percent of the stock; the families of wage earners hold three-tenths of one percent; and the number of individuals reporting dividends rises from 2 percent in the lowest income groups to 90 percent and over in the highest income groups.

* See Daniel M Holland, *Dividends Under The Income Tax* (Princeton University Press, 1962).

SELECTED DATA ON DIVIDENDS AND DIVIDEND TAX LIABILITY, 1918-1957

Year	Tax liability on dividends (million dollars)	Effective rate of tax on dividends (%)	Tax liability on dividends as a % of total personal tax liability (%)	Dividends as a % of adjusted gross income (taxable returns) (%)	Column 4 + Column 5	Dividends on taxable returns as a % of personal dividend receipts (%)
1918	290	12 5	25 7	14 8	1 7	66
1919	279	12 1	21 9	11 4	1 9	79
1920	240	9 4	22 3	10 9	2 0	78
1921	177	8 6	21 6	13 4	1 8	70
1922	206	9 0	23 9	13 3	1 8	77
1923	164	6 1	24 8	13 3	1 9	71
1924	207	7 3	29 3	12 6	2 3	74
1925	170	5 5	23 2	15 5	1 5	70
1926	208	5 9	28 5	17 7	1 6	74
1927	229	6 0	27 5	18 7	1 5	76
1928	261	6 4	22 1	17 3	1 3	75
1929	262	6 1	26 2	18 6	1 4	74
1930	203	5 3	42 6	24 4	1 7	71
1931	126	4 8	51 2	24 8	2 1	63
1932	140	8 5	42 4	18 4	2 3	62
1933	120	9 3	32 1	16 0	2 0	62
1934	202	12 1	30 5	17 7	2 2	65
1935	245	12 9	37 3	16 7	3 2	66
1936	536	15 4	44 2	21 9	2 0	78
1937	543	14 3	47 8	21 8	2 2	81
1938	280	11 3	36 6	17 2	2 1	78
1939	384	12 8	41 3	16 8	2 5	79
1940	557	16 0	37 2	13 4	2 8	88
1941	847	21 4	21 7	8 0	2 7	89
1942	999	28 3	11 2	4 8	2 3	81
1943	1,133	32 0	7 8	3 3	2 3	78
1944	1,107	31 8	7 2	3 2	2 3	79
1945	1,182	31 7	6 9	3 1	2 2	79
1946	1,333	29 2	8 2	3 9	2 2	79
1947	1,594	30 1	8 7	3 9	2 2	81
1948	1,339	21 2	9 1	4 1	2 2	82
1949	1,510	24 0	10 3	4 5	2 3	84
1950	2,031	27 1	10 9	4 7	2 3	81
1951	2,120	28 6	8 7	4 0	3 2	82
1952	2,109	28 9	7 5	3 7	2 1	82
1953	1,995	27 7	6 7	3 4	2 0	78
EXCLUDING FIDUCIARIES						
1954	1,672	24 2	6 2	3 3	1 9	71
1955	1,765	23 0	5 9	3 3	1 8	69
1956	1,937	22 9	5 8	3 4	1 7	70
1957	1,992	22 4	5 8	3 4	1 7	71

Table 29, page 112 in Daniel M. Holland, *Dividends Under the Income Tax* (Princeton University Press, 1962)

SHARE OF DIVIDEND TAX LIABILITY BY INCOME CLASSES 1918-1957

(Per Cent)

Year	Under $5,000	$5,000 to $50,000	$50,000 and over
1918	0 0	13 3	86 8
1919	0 0	13 9	86 2
1920	0 0	18 6	81 4
1921	0 0	20 4	79 6
1922	0 0	14 8	85 2
1923	0 0	16 1	83 9
1924	0 0	11 4	88 7
1925	0 0	14 0	86 0
1926	0 0	12 5	87 6
1927	0 0	11 8	88 2
1928	0 0	10 5	89 5
1929	0 0	11 2	88 8
1930	0 0	13 1	86 8
1931	0 0	13 5	86 5
1932	0 0	13 3	86 7
1933	0 0	12 8	87 2
1934	0 0	20 2	79 8
1935	0 0	18 9	81 1
1936	1 1	24 2	74 9
1937	1 2	25 3	73 6
1938	2 0	30 5	67 5
1939	1 8	27 4	70 9
1940	1 9	30 8	67 3
1941	5 1	39 9	55 0
1942	8 3	44 1	47 6
1943	7 7	45 9	46 4
1944	7 4	45 6	47 0
1945	6 7	47 2	46 3
1946	5 7	44 6	49 7
1947	5 0	43 3	51 7
1948	3 2	35 2	61 7
1949	4 1	36 4	59 4
1950	2 9	34 0	63 2
1951	3 1	37 2	59 6
1952	3 4	40 9	55 8
1953	3 7	43 5	52 7
EXCLUDING FIDUCIARIES			
1954	2 1	38 5	59 4
1955	1 6	35 5	62 9
1956	1 5	36 1	62 4
1957	1 6	36 6	61 8

Income refers to net income from all sources

Table 36, p 128 in Daniel M Holland, *Dividends Under the Income Tax* (Princeton University Press, 1962)

DIVIDEND TAX LIABILITY
AS A PERCENTAGE OF TOTAL PERSONAL INCOME TAX LIABILITY 1918-1957

Year	Under $5,000	$5,000 to $50,000	$50,000 and over
1918	0 0	10 5	40 8
1919	0 0	9 3	32 9
1920	0 0	10 5	40 3
1921	0 0	11 7	44 3
1922	0 0	9 5	39 4
1923	0 0	10 1	43 0
1924	0 0	10 9	41 6
1925	0 0	11 2	28 9
1926	0 0	12 7	35 8
1927	0 0	12 6	33 3
1928	0 0	11 3	25 7
1929	0 0	16 0	28 6
1930	0 0	19 0	53 9
1931	0 0	20 1	70 4
1932	0 0	14 5	77 2
1933	0 0	10 7	53 5
1934	0 0	19 3	61 0
1935	0 0	17 9	55 6
1936	9 2	39 0	56 7
1937	9 2	31 3	63 3
1938	8 9	26 2	50 4
1939	7 5	27 1	60 8
1940	5 4	26 6	56 5
1941	3 6	20 3	41 2
1942	2 0	14 3	29 6
1943	1 1	11 3	25 4
1944	1 0	9 7	25 4
1945	0 9	8 9	23 9
1946	1 1	9 0	26 5
1947	0 9	9 7	33 3
1948	0 7	7 0	28 7
1949	1 1	8 4	37 1
1950	0 9	8 1	34 9
1951	0 8	6 4	32 0
1952	0 8	5 6	31 9
1953	0 9	5 0	32 0
EXCLUDING FIDUCIARIES			
1953	0 8	4 6	30 3
1954	0 5	4 1	29 1
1955	0 4	3 4	28 8
1956	0.4	3 3	28 8
1957	0 4	3 2	29 6

Table 37, p 131 in Daniel M Holland, *Dividends Under the Income Tax* (Princeton University Press, 1962)

EXPENSE ACCOUNT DEDUCTIONS

Question: Should California adopt tax laws conforming to the sections on expense account deductions in the Revenue Act of 1962 (Public Law 87-834), amendment to Section 274(c) in the 1964 Revenue Act (Public Law 88-272)?

This analysis is in four parts. (1) the policy issues; (2) the background and debate of the 1962 and 1964 Revenue Acts; (3) post-1962 experience, and (4) Revenue Act of 1962 provisions

The Policy Issues

On the deduction of entertainment and travel expenses for business purposes, business gifts, and the costs of business meals, the 1962 Revenue Act and a 1964 change did not add or subtract permissible deductions but rather codified some existing rules and regulations and revised some rules for determining deductibility

The major changes were as follows·

Before	*After*
expenses must be ordinary and necessary business expenses	must be *directly related* to business
	Senate Finance Committee Report also said they must have a direct relation to probable income ("more than a general expectation of deriving some income at some indefinite future time")
	an exception, with *qualifications*, is made for entertainment directly preceding or following a business discussion
where use of an entertainment facility is mixed between personal and business, the percent which is business may be deducted	the *primary purpose* of the facility, use of club, etc must be business (over 50%) or the expense is not deductible at all
the primary purpose of a trip must be business or the expense is not deductible at all	where a trip is partially for business and partially personal, with some exceptions travel expenses are to be allocated and the business percentage of the expenses are deductible (1964 added. except, for travel outside the U S, travel not exceeding one week or where the non-business activity is less than 25 percent of total time)
the ordinary and necessary test applies to business gifts and business meals	dollar limitations on business gifts
	business meals must be in an "atmosphere conducive to business discussion"
where the business purpose of the expense was established, the exact amounts could be estimated	detailed documentation is required as to place, time, amounts, purpose, donee, etc.

The provisions of the California state income tax law at present fall into the "before" category SB 268 (Cobey) introduced in the 1963 General Session at the request of the Franchise Tax Board, contained a section, which did not pass, which would have put California's law into the "after" column

Background of 1962 and 1964 Revenue Act Changes

Pressure for change in the federal law came from two major sources First, there was growing *public discontent* (perhaps envy) over the extremes of "expense account living" Dramatizing the situation were a series of tax court decisions allowing the deduction of expenses for hunting lodges, yachts, and an African safari to publicize an American dairy business Second, the Internal Revenue Service had *problems in applying and enforcing the existing law.* Despite a series of admin-

istrative efforts to prevent abuses, a survey of the returns of 1,005 business taxpayers claiming entertainment and travel deductions for 1959 and 1960 showed that 80 percent were erroneous in 1959 and 79 percent in 1960, and over half the individual taxpayers studied did not complete the expense account schedules or answer the questions about deductions in the 1960 returns

In 1959 and again in 1961, Senator Clark introduced a bill, which passed the Senate in June, 1961, as an amendment to the Public Debt Limit and Rate Extension Bill of 1960 It disallowed entertainment expenses other than for food and beverages, limited business gifts to $10 per recipient per year, and prohibited deduction of dues or initiation fees in social, athletic, or sporting clubs or organizations The House and Senate conferees dropped this amendment and asked that the matter be studied by a joint committee The President's recommendation to the Congress in 1962 included the above and a recommendation that deductions for food and lodging on business trips be limited to twice the maximum for federal employees (which would then amount to twice $16 or $32 a day). The Revenue Act of 1962, passed after extensive public hearings, was considerably more lenient In late 1962, new IRS regulations on expense record-keeping were issued The 1964 change was a relatively minor one regarding foreign travel

In the public hearings, the following arguments were presented for and against the 1962 bill as it was finally passed:

Arguments Presented for the Bill:

(1) The existing law lent itself to abuse and helped to foster a kind of immorality
   (a) Taxpayers were deducting expenses which were really personal as if they were business expense;
   (b) Some lavish or extravagant business expenses put business sales on the level of "payola"
(2) It was difficult for the IRS to ascertain facts and enforce the law:
   (a) Documentation for the deduction was often vague;
   (b) Interpretation was often subjective;
   (c) This led to conflicts between tax examiners and taxpayers
(3) The all or nothing approach of the primary purpose rule on travel led to inequities
(4) Inequalities in enforcement led to resentment on the part of taxpayers who did not benefit
(5) Since the whole income tax system relies on voluntary compliance and self-assessment, the whole state of affairs might lead to a breakdown of the system and of honest compliance
(6) The new law will yield considerably more tax revenue

Arguments Presented Against the Bill:

(1) The new provisions do not eliminate subjective judgment (e g, on what is directly related to business or what surroundings are conducive to business discussion) and therefore uneven application is still likely.

(2) The new act substitutes government administrative judgment for business judgment on what are necessary business expenses Businessmen are better judges than government as to what is necessary to promote sales.

(3) Imposes excessive bookkeeping burdens on taxpayers (In a survey conducted by *Dun's Review and Modern Industry*, reported in the New York *Times*, November 6, 1963, page 16, this was listed as a major complaint of the 120 companies surveyed—whose annual sales ranged from $100,000,000 to $600,000,000—but 68 percent said the additional recordkeeping would not pose unusual problems. However, recordkeeping might be a major problem for smaller businesses and self-employed taxpayers)

(4) Introduces many new tests, which will require a whole new series of individual interpretations before application of the law will be clear

(5) Might have an adverse effect on the hotel, airline, restaurant, and entertainment industries (At Senate Finance Committee hearings, the Washington counsel for the National Restaurant Association testified that over $2 billion a year was reported as business expenses for food and beverage entertainment, and he claimed the new bill's proposals would produce, if enacted, a sales loss of over $1 billion a year and over 200,000 jobs lost George J Stigler, *Trends in Employment in the Service Industries* (Princeton, 1956) stated that employment per dollar of receipts is almost three times as high in restaurants as in food stores, so that the amount of dining out can have a significant effect on employment. However, in the survey referred to above, it was found that only one-third of the companies found it necessary to tighten up their entertaining as a result of the new law.)

(6) The new provisions discriminate against certain kinds of businesses and professions which rely on entertainment more than others do·

(a) For professional men, goodwill entertaining is often the only discreet and ethical way open for getting new business The connection between such entertaining and business is sometimes necessarily indirect and long-range

(b) Hurts small businesses which cannot afford to keep entertainment facilities on their premises and must rely on use of clubs and other facilities, where personal use is mixed with business

(c) Hurts wholesalers more than retailers, wholesalers with many customers more than those with a few, those with highly competitive products more than those selling patent-protected products

(7) Insofar as deductions for actual business costs are allowed, this amounts to taxation on something in excess of true income and is a move in the direction of gross receipts tax rather than net income tax.

(8) Although this was not brought out in the hearings, it should be mentioned that the new law discriminates against *wives*, by making their accompanying husbands on business trips and conventions clearly non-deductible Is it good social policy to do this? One of the men who has set up the California State Bar convention for many years claims that much more business is done if wives are along and that the State Bar does all it can to encourage their presence

Post-1962 Experience

Since the 1962 bill was passed, and since issuance of the new IRS regulations, discontent over these measures has continued. In debate over the 1964 Revenue Act, Senator Long (Democrat, Louisiana) proposed to repeal the 1962 requirement that substantial business discussions must precede or follow any deducted entertaining of business clients This proposal narrowly lost in the Senate Finance Committee. Some say the 1962 changes actually liberalized expense account deductions in some details, that they were not stringent enough, and that their main impact was on small businessmen. It is said that the 1962 revisions encourage taxpayers to cheat by making dishonest diary entries, and that the standards are still vague and uncertain On the other hand, representatives of the hotel and restaurant industries claim these industries have been badly hurt by the 1962 changes

As a result of all this discontent, the House and Senate committees have agreed to hold new public hearings on the subject

* * * * * * *

Generally speaking, California businessmen are likely to base their expense-account habits and recordkeeping on federal tax law, and they are not likely to keep a second set of records for the more liberal California law Therefore, it probably will not make much major difference in socioeconomic terms whether or not California law is conformed to the federal on this point For the sake of convenience, there is a presumption in favor of conforming

Revenue Act of 1962 Provisions

Entertainment: Section 274(a)(1)(A) No deduction for activity of a type generally considered to be entertainment, amusement, or recreation unless the taxpayer "establishes that the item was directly related to, or, in the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that such item was associated with, the active conduct of the taxpayer's trade or business."

Comments: No deduction allowed for any expense which is against public policy or violates the public conscience (e g , the use of call girls to promote business) The Senate Finance Committee Report says no deduction for lavish or extravagant expenses, though this is not in the act itself. The business expense does not have to produce income directly, but the House Ways and Means Report says something more is required than "a general expectation of deriving some income at some indefinite future time from the making of the entertainment-type expenditure."

Entertainment Facility: Section 274(a)(1)(B). No deduction for a facility used in connection with entertainment "unless the taxpayer establishes that the facility was used *primarily* for the furtherance of the taxpayer's trade or business and that the item was *directly related* to the active conduct of such trade or business, and such deduction shall in no event exceed the portion of such item directly related to, or, in case of activity referred to in subparagraph (A), directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), the portion of such item associated with the active conduct of the taxpayer's trade or business."

(2)(A) Dues or fees to any social, athletic, or sporting club or organization shall be treated as items with respect to facilities.

Comment: A social, athletic, or sporting club does not include civic organizations or professional organizations. Only the proportion allotted to business use of a club will be allowed.

Exceptions: Section 274(e) subsec (a) shall not apply to

(1) Business meals "Expenses for food and beverages furnished to any individual under circumstances which (taking into account the surroundings in which furnished, the taxpayer's trade, business or income-producing activity and the relationship to such trade, business, or activity of the persons to whom the food and beverages are furnished) are of a type generally considered to be conducive to a business discussion."

(2) Expenses for food and beverages (and facilities used in connection therewith) furnished on the business premises of the taxpayer primarily for his employees.

(3) Expenses for goods, services, and facilities, to the extent that the expenses are treated by the taxpayer, with respect to the recipient of the entertainment, amusement, or recreation, as compensation to an employee on the taxpayer's return of tax under this chapter and as wages to such employee for purposes of Chapter 24 (relating to withholding of income tax at source on wages)

(4) Expenses paid or incurred by the taxpayer, in connection with the performance by him of services for another person (whether or not such person is his employer), under a reimbursement or other expense allowance arrangement with such other person, except (A) where services are performed for an employer, only if the employer has not treated such expenses in the manner provided in paragraph (3), or (B) where the services are performed for a person other than an employer, only if the taxpayer accounts (to the extent provided by subsection (d)) to such person

(5) Expenses for recreational, social, or similar activities (including facilities therefor) primarily for the benefit of employees (other than employees who are officers, shareholders or other owners, or highly compensated employees). An individual owning less than 10 percent interest in taxpayer's trade or business shall not be considered a shareholder or other owner and for such purposes shall be treated as owning any interest owned by a member of his family (within the meaning of Section 267(c)(4)).

(6) Expenses incurred by a taxpayer which are directly related to business meetings of his employees, stockholders, agents, or directors

(7) Expenses directly related and necessary to attendance at a business meeting or convention of any organization described in Section 501(c)(6) (relating to business leagues, chambers of commerce, real estate boards, and boards of trade) and exempt from taxation under Section 501(a).

(8) Expense for goods, services, and facilities made available by the taxpayer to the general public

(9) Expenses for goods or services (including the use of facilities) which are sold by the taxpayer in a bona fide transaction for an adequate and full consideration in money or money's worth. For purposes of this subsection, any item referred to in subsection (a) shall be treated as an expense

Business Gifts: Section 274(b)(1) No deduction for business gifts to exceed $25 per recipient per taxable year "Gift" means any item excludable from gross income of the recipient under Section 102 which is not excludable from his gross income under any other provision of this chapter." A gift does not include·

(A) An item costing taxpayer up to $4 on which the name of taxpayer is clearly and permanently imprinted and which is one of a number of identical items distributed generally by the taxpayer;

(B) A sign, display rack or other promotional material to be used on the business premises of recipient,

(C) An item of tangible personal property having a cost to the taxpayer not in excess of $100 which is awarded to an employee by reason of length of service or for safety achievement

Comments: For purposes of this section, husband and wife shall be treated as one taxpayer The limit does not include wrapping, insurance, mailing, etc Gift does not include death benefits, scholarships, fellowships, prizes, or awards The limit is on a partnership as well as on each member thereof.

Travel: Section 274(c). No deduction allowed "which is not allocable to such trade or business or to such activity described in Section 212 "shall not apply . . . to . . . travel which does not exceed one week or where the portion of the time away from home which is not attributable to the pursuit of the taxpayer's trade or business is less than 25 percent of the total time away from home . . ." Section 162 (a) (2) amended by striking out "including the entire amount expended for meals and lodging" and inserting "including amounts expended for meals and lodging other than amounts which are lavish and extravagant under the circumstances."

Substantiation: Section 274(d). No deduction for travel, entertainment, facilities, gifts unless taxpayer substantiates evidence corroborating his own statement This would cover amount of item, time, place, date and description of gift. business purpose, and business relationship to the taxpayer of the persons involved.

Comments: In general, a clear contemporaneously kept diary or account book is adequate, but may need receipt, cancelled check, paid bill, etc , to verify amount. Expressly departs from *Cohan* rule.

Also bearing on Section 274 are Section 162, Section 167, Section 1791, Section 262, Section 1221, Section 1231, Section 6001.

BUSINESS LOBBYING EXPENSES

Question: Should California permit deductions from personal income tax for business lobbying expenses to conform with IRS Code Section 162(e)?

Legislative Background

Prior to 1954, the U.S Treasury regulations disallowed expenditures for making appearances, submitting material, or communicating with respect to legislation (Regul. 118, section 39 23 (o)-1 (f) and 39.23 (q)-1 (a). However, these regulations were not uniformly enforced In 1959, the IRS disallowed the deductions of two business concerns—one, a state of Washington wholesale beer distributor who had tried to deduct the cost of fighting a local option measure on the ballot which would have made beer distribution a state monopoly; the other, a liquor wholesaler in Arkansas who had opposed a statewide prohibition law Both cases were appealed to the courts (Cammarano v U.S. and F Straus and Sons, Inc v U.S, 358 U S 498 (1959)), and the Supreme Court held that the IRS regulations had the force of law, since they were implicitly sanctioned by Congress when Congress re-enacted the statute to which they pertained In November 1959, the IRS held a public hearing on its proposed new rules, and in December 1959, issued 1 162-15 (e) expressing more firmly its prior policy. As a result of pressures from special groups, about twenty members of Congress introduced bills to make business lobbying expenses deductible One bill was approved by the House Ways and Means Committee in 1960, but the session ended before it was brought to a vote In 1962, HR1065 was passed allowing *deductions of costs for appearances before or communications to individual legislators or legislative bodies; for the portion of the dues paid to an organization which is used to lobby for the business interests of its members; and for the expense of communications between the member and the organization with respect to legislation No deduction was allowed for attempts to influence the general public, by advertising or otherwise, or for expenses connected with political campaigns.*

Arguments for and against:

(1) It was argued that this was an extension of the right of petition and freedom of speech, though the Cammarano decision had held that a decision in Speiser v. Randall, 357 U.S 513 (1958) citing Grosjean v. American Press Company, 297 U.S. 233 (where the court said denial of a tax exemption for engaging in speech is a limit on free speech) was not applicable because the petitioners in the Cammarano case were not denied free speech, but simply had to pay for it out of their own pocket "Censorship by taxation" was the slogan used.

(2) Business argued that it was at a disadvantage in opposing lobbying by tax-supported representatives of government, where the issue was one of government in competition with business For that reason, the U S Chamber of Commerce wanted advertising also to be deductible, arguing that the public side gets free publicity, but businesses

have to advertise to present their side. It was contended that nondeductibility of advertising of costs penalizes small business as compared with large business, since the former was not able to pay for advertising out of profits. Big companies already bury their lobbying expenses.

(3) It was also argued that business expenses for appearing before administrative bodies and the courts were deductible, and that there was no reason to discriminate against legislative appearances.

(4) Also, it was said that the new law would diminish enforcement problems.

(5) And that it would prevent interference with business judgment as to what expenses are ordinary and necessary.

(6) On the other hand, Senator Proxmire of Wisconsin disapproved because the new law "gave no break to organizations that fight for ideals," since it applied only to special interests He also argued that lobbying expense is not an ordinary and necessary business expense.

In general, the argument against this law is that it reinforces the already large advantage special interests (producer and individual economic interests) have as compared with those concerned with a broader, general interest. A large percentage of the bills which come before legislative bodies may be divided into two categories. producer issues and consumer issues. Generally speaking, producer issues are raised by those most narrowly and immediately concerned; groups involved in the debate are those most closely related to the process or area of work at issue; and the public pays scant attention. Also, generally speaking, the producer bills enacted into law tend to reinforce the status quo, to consolidate the advantage of those who already have considerable status and power in the private economic spheres. Unlike producer issues, which are raised by a few people and resolved within narrow circles, consumer issues often require the mobilization of large numbers of people, and therefore the techniques of mobilization and of lobbying must be different. (In a comparable way, decisions among those already in power in a corporation are arrived at differently from decisions on issues raised through a major proxy fight instigated by minority stockholders.)

To mobilize scattered dispersed consumers and relatively powerless people requires the apparati of politics, requires slogans and even demagoguery—these are techniques of dealing with masses. Therefore, when a tax advantage is given to those already having private power, there is a considerable augmentation of the advantage they already have When no tax advantage is given to those who employ mass persuasion techniques, they are at a corresponding disadvantage. The same holds true not only between consumer and producer issues, and between the powerful and powerless, but also between different kinds of issues raised by the same group (e g, the lobbying methods of medical men on technical medical problems as compared with their techniques on Medicare)

SELF-EMPLOYED RETIREMENT

Question: Should California conform state tax law to the provisions of the Keogh Act, the Self-Employed Individuals Tax Retirement Act of 1962 (Public Law 87-792), which goes into effect for tax years starting after December 31, 1962?

To be kept in mind in assessing the Keogh Act are *revenue problems* (since passage of the act means considerable immediate loss of revenue, partially recovered at the time the retirement funds are distributed), and *socioeconomic problems* The latter fall into four main categories· (1) In general, federal income tax law—by giving special advantages to corporations and to large corporations—furthers *prevailing trends toward large organization* and the decline (relatively speaking) of individual self-employment in the professions, on small farms, and in small business. The Keogh Act is a *counter-move*, to help encourage self-employment (2) The Keogh Act may have some effect on job *mobility* It might encourage small farmers, self-employed businessmen, and professional men to fire their lesser employees before they have served four years, to avoid having to include them in a retirement plan, though this effect is not likely. On the other hand, it might inhibit partnership and other changes among professional men, although immediate vesting permits more mobility than is possible under many corporate plans where vesting is delayed for 10 years or more (I e , in the one case, the contributor to the retirement fund has a right to his contribution from the beginning, in the other, he has such a right only after attaining a certain age or only after a certain number of years of employment) (3) The act creates incentives for *capital formation* and *channels investment* in certain directions, to the exclusion of others The effect of this upon the economy should be assessed And, (4) this is one way of dealing with the *economic problems of old age* and should be assessed in those terms

In addition to the general policy problems, there are many technical provisions which should be assessed in terms of administration and enforcement

This report is in five parts. (1) the policy issues; (2) the tax advantages of corporate structure, (3) some methods of providing income for old age, (4) debate over the Keogh Act; and (5) California considerations.

The Policy Issues

The key points of the Keogh Act are as follows (as summarized in the California State Bar *Journal*, v. 37 (September-October, 1962) page 797:

1 *Basic Concept*—For pension purposes, the act treats self-employed persons as employees, making them eligible for coverage in qualified plans For purposes of the act, all of their separate businesses are treated as one.

2. *Employees of the self-employed*—Covered self-employed persons must also cover all full-time employees with more than three years of service, not counting seasonal, part-time, and temporary workers

3 *Annual deductions by the self-employed*—Such a person may put up to 10 percent of his earned income or $2,500, whichever is less, into a retirement plan. Whatever he contributes he can take a tax deduction of half that amount He won't have to pay taxes on the fund until after retirement when he begins drawing money out, presumably in most cases when he is in a lower income tax bracket

4. *Base for deduction*—Earned income means professional fees and other compensation received for personal services Where both capital

and personal services are material income-producing factors, earned income means *not* more than 30 percent of income from the business, but not less than $2,500 where the self-employed works full-time

5 *Vesting*—In plans under the act, contributions for employees vest immediately in them.

6. *Coordination with social security*—In some cases, the act allows coordination for plans covering self-employed persons The plan would get credit only for employer's actual social security contributions

7. *Lump sum distribution*—If participant chooses he may take a lump sum distribution A special averaging device provides for taxing such distributions after age 59½, or received before age 59½ due to participant's disability or death

8. *Custodial account*—One may have a custodial bank account instead of a trust, if investments are solely in regulated investment company stock or life insurance policies Included in the term "bank" are various institutions regulated by state banking authorities A retirement plan funded entirely through life insurance, endowment, or annuity contracts purchases from a life insurance company requires no bank trustee if the insurance company furnishes appropriate information to the Internal Revenue Service

At present, contributions to plans set up under the Keogh Act are not deductible under state income tax law. Assemblyman Cologne introduced A B. 1972 in the 1963 General Session, which would have made some contributions deductible from state income tax The bill did not pass.

The Tax Advantages of Corporate Structure

Tax laws give numerous advantages to corporations which are not shared by the self-employed. (See CCH, "Tax Patterns of Employees' Fringe Benefits," issued in 1963.) This relative lack of advantage effects small farmers and small businessmen, too, but it has been of special concern to fee-basis professional men because their professional associations and codes of ethics, in the past, have taken a strong position against corporate practice on the grounds that it substituted a profit motive for the service concept which is the basis of professionalism, and because it placed a third-party intermediary between the professional and his patient or client, which might lead to a breakdown of the fiduciary relationship.

However, fee-basis professionals have become increasingly aware of their tax disadvantages Other kinds of pressures (the spread of prepayment plans in medicine, the design of numerous large projects by some architects, the need for specialization and for some coordination of specialists, the need for more auxiliary personnel) have led to a rapid increase in group practice and in the number of large professional firms.

So, in the past decade, until squelched by recent IRS regulations, the professions were reconsidering the merits of incorporation or of establishing Kintner-type associations with corporate characteristics, for tax purposes At the present time, 27 states provide for professional corporations, and 6 more to a limited extent (C C H. Federal Tax Reporter, Vol 6, paragraph 5943 0973). Some professionals (e g , archi-

tects and engineers) may incorporate in California A bill has been under consideration by the legislature to permit other professions to practice in corporate form.

The tax advantages given to corporations were seen by the professions as follows:

"The dentist now has none of the tax deductions that manufacturers and other businessmen value so highly. The dentist cannot take depreciation on the wearing down of his bodily condition from years of work; he cannot get a depletion allowance . . . for the energy time depletes and which can never be restored; he is not part of a growing enterprise whose capital stock is becoming so valuable that he gets a stock option, which is clearly worth money, but whose value is never taxed to him Nor is he entitled to tax saving devices permissible to corporations A corporation can be a tax-saving device in two different ways. First, it can offer a shelter from progressive tax rates Second, it offers fringe benefits that can be used as a tax-saving device The major fringe benefits are: group insurance, *pension plans* and profit-sharing plans "* (Emphasis added)

Lawyers have seen the tax advantages of treatment as corporations in the following light· "In such a case, all the attorneys, including the owners, are employees Salaries paid by the association to the attorneys and other employees are allowable as a deduction. Income can be accumulated, with limitations, after paying corporate taxes. The corporate tax rate applicable may be lower than the personal brackets of the attorneys Current income can be used to provide generous retirement benefits for the attorneys and other employees under a qualified profit sharing plan or pension plan or both As employees the attorneys can enjoy the tax benefits of group insurance They can also continue to enjoy the benefits of Social Security and in addition benefit by coverage under workmen's compensation and state disability compensation Premium payments made under a plan for hospitalization, major medical or disability income insurance are deductible . . and are not taxable to the attorney even though he is the beneficiary of the policy If the attorney is unable to work because of sickness or injury, the first $100 per week received under his disability income (except for the first week of non-hospitalized sickness) will be received income tax exempt if he is under a wage continuation plan Also, all amounts received by an attorney under a plan as reimbursement for hospitalization and other medical expenses are exempt from income taxation, without limitation."

However, treatment as a corporation would not be without its disadvantages ". . . income accumulated will be subject to corporate tax and when later distributed will be subject to additional personal income tax The initial corporate tax rate may be higher than the individual tax rate would have been Profits after taxes may be accumulated to $100,000 . . . without penalty If retained profits exceed this figure, a reasonable need and business purpose must be shown or (there may be) . . . a penalty tax." . . "the Internal Revenue Service might disallow deductions for a portion of the salaries paid to the attorney-owners as

* Anthony J Kennedy, "Incorporation by Dentists," *Journal of the California State Dental Association*, volume 37 (December 1961), pages 443-444

being excessive and unreasonable, and in reality disguised dividends. This determination would result in double taxation ''*

In any case, the issue was rendered moot by new proposed IRS regulations, to be retroactive until 1961, denying to professional corporations or Kintner-type associations the advantages of corporate tax treatment unless they had the characteristics of a business corporation. This would be impossible to reconcile with entrenched concepts of professional practice, which means that professionals cannot get the tax advantages of corporate employees unless they give up self-employment in any form

Some Methods of Providing Income for Old Age

Corporate Pension Plans: For various reasons, old people in our society are not cared for automatically within the family circle Since this is the case, new methods have had to be devised to provide them with income after their years of productive work. One method was through the establishment of Social Security. Another has been through private tax-deductible corporate pension plans. Before World War II, corporation executives set up such plans primarily for the benefit of themselves and used them as methods of rather large-scale tax avoidance The 1942 Revenue Act plugged many of the loopholes by requiring (1) there must be a definite plan having determinable benefits and intended to be permanent; (2) funds contributed to the support of the plan must be beyond the control of the plan and not subject to recapture; (3) the plan must not discriminate in favor of the highly-paid, but must include a broad class of employees, and (4) to be currently deductible, contributions in any one year may not fund liabilities too rapidly, the limit being payment in any one year of the normal cost (which is the cost attributable to the current year of service) plus no more than 10 percent of the liability for past service.

The new requirements, plus wartime profit conditions, plus the fact that wage stabilization precluded collective bargaining over wages and hours but permitted bargaining on fringe benefits all led to a great broadening and extension of corporate pension plans during World War II and even more so after the war so that by the end of 1962, almost 36 million people in the United States were covered by private or public retirement plans other than social security (one half of all workers in commerce and industry and three-fourths of all government personnel) † In San Francisco-Oakland for 1957-1958, 80 percent of office workers were covered and 67 percent of plant workers of the major industries studied.‡

Old Age Security for the Self-Employed· For many years, the self-employed were not included under Social Security and they had no tax deductions for pension plans There were approximately 9 million people in the United States in the latter category in 1962, and an estimated

* Byron F White and Paul A Peterson, "Corporate Tax Advantages for Attorneys," California State Bar *Journal*, volume 35 (March-April, 1960), pages 175-177.
† Figures from Institute of Life Insurance
‡ U S Bureau of Labor Statistics, *Wages and Related Benefits, Nineteen Labor Markets, 1957-8*, Bulletin, (Washington, D C., Government Printing Office, 1959) See also, Report of the California Governor's Commission on "Employment and Retirement of Older Workers," 1960, Chapter V on "Pension Funds in California," and California State Personnel Board, "Employee Benefits in Private Industry in California," August, 1962

664,900 self-employed in California in 1963 Inclusion of the self-employed under Social Security was one step to remedy this situation, by giving them opportunity for subsistence income in old age. (At their own request, medical practitioners were not included under Social Security) The Keogh Act was another step, making it possible for them to save, with tax advantages, for income beyond the subsistence level in old age.

The Keogh Act took 11 years to pass Initial agitation came from the American Bar Association and the Association of the Bar of the City of New York (in short, from higher-income lawyers), and ABA representatives led the pressure groups which saw the bill through to passage At first it was hoped that tax benefits for retirement funds for the self-employed could be obtained by amending Section 165 of the 1939 Internal Revenue Code to permit self-employed persons to be treated as their own employees for purposes of any pension plans they might set up, but it was found that they could not qualify under a Treasury Department ruling So New York Congressmen Reed and Keogh, on a bipartisan basis, sponsored a bill drafted by the bar associations on July 7, 1951, inthe First Session of the 82nd Congress. The Keogh bill, H R 10, was based on the Senate Committee bill with some changes. The Treasury Department opposed the Keogh bill vehemently, not on principle, but because of the losses in revenue it would bring As a result the bill was greatly watered down The professions felt they had been given less than half a loaf It was passed, one commentator said, "in such attenuated form as to be almost useless " Even so, it barely escaped pocket veto At present, counsel for the professional associations are urging professional men to go along with the Keogh Act in the hope that they can get more favorable amendments. Keogh-type laws were passed in England in 1956, and Canada and New Zealand in 1957.

Rep. Keel introduced H R 8711 on October 10, 1963, to liberalize the Keogh law It was reported on October 8, 1963, that Congressman Keogh had stated in a speech before the American Academy of General Practitioners in Kansas City that he would introduce legislation to repeal the 50 percent deferment, the percent and dollar limitation, and to substitute a rule of nondiscriminatory and reasonable contribution for the self-employed and his employees. He said the dollar limit was designed to reduce the fiscal effects of the law and to reduce opposition.* Pressures are also strong to make the distribution taxable as capital gains

The tax benefits available to the self-employed are still substantially less than those available to corporate employees:

Corporate Plan	*Under Keogh Act*
Maximum deduction 15 percent of compensation out of profits. By adding pension plan, corporation can contribute & deduct another 10 percent	Deduction maximum of $1,250.

* Reported in the *Bulletin* of the Kern County Medical Society, volume X (November 1963), page 337

Corporate Plan	*Under Keogh Act*
May be carryover provisions, even for shareholder-employee under certain conditions	No provision for carrying over unused contributions to next year for self-employed, though may for his employees
Lump sum distribution ordinarily given capital gain treatment Maximum tax of 25 percent on the distribution.	No capital gains treatment of distribution—through some benefits on lump-sum distribution
Amount exempt from estate tax under certain circumstances	Amount of plan included in estate of deceased self-employed person for estate tax
Vesting can be conditional	Immediate vesting
If excess contribution, deduction of excess disallowed; if termination without good reason, lose benefits but no penalty.	Penalty for premature distribution or excess contribution
Employees earning less than $4,800 may not be covered, and only portion of income earned by employee over $4,800 may be put into plan for him.	If owner-employee's own contribution not more than ¼ of total contributions for all covered employees, then owner-employee can exclude from what he would ordinarily have put in for himself and employees the amount of social security tax he pays for self and employees
Deductible accident and health plans and sick pay Deductible group insurance plans $5,000 employee death benefit	Not under Keogh Act
85 percent dividends received credit	Not under Keogh Act
Choice of fiscal year	

The Debate Over the Keogh Bill

Arguments Presented for the Bill:

1. Partial rebalancing of the inequities between self-employed and corporate employees
2. Encourages thrift, individual initiative, and self-reliance in solving the economic problems of old age
3. Participation in the plan is wholly voluntary
4. May encourage continued self-employment and halt the drift toward corporate salaried practice
5. Provides new business for banks and insurance companies, though many banks regard the task as a service rather than as a source of profit
6. The effect of the law is anti-inflationary.

Arguments Presented against the Bill:

1. Does not go far enough; stops far short of parity with corporate employees

2. Does not include corporate employees who have no pensions (originally did, but this was dropped because of Treasury Department opposition). Also, does not include persons covered by public employee systems (about 8 million as of January 1, 1963),* who do not have the tax advantages given corporate employees.
3. Will produce a substantial loss of tax revenue.
4. It may encourage employers to fire employees after three years to avoid having to include them in pension plans, though this is not likely.
5. It may tie employees or partners to the firm and prevent their making advantageous changes (though this is minimized by the provision for immediate vesting)
6. Extends tax benefits to those who least need relief. The individual who may not be able to make contributions to the trust fund receives no tax deduction Tax relief for those who can afford to contribute is a departure from the ability to pay principle
7. Some centralization of control over investments; the employee loses control over his own money.
8. Depending upon the tax bracket of the individual contributor, the tax savings resulting from contributions to the trust, and the earnings of the trust fund if conservatively invested, would not produce benefits equivalent to the benefits which might be enjoyed if the individual set aside amounts equivalent to the permitted contributions and invested the same for his own account
9. There are some personal hazards—e g , death of the self-employed individual's spouse prior to the distribution year would result in a loss of the right to split the income, and correspondingly disastrous tax results might follow

Other Considerations:

1. The act gives special advantages to those having 10 percent or less interest, and thus might motivate the formation of large law or medical firms
2. Investment funds are being set up under professional association auspices If their control over investment of these funds is ever centralized, will this give them new economic power?
3. The act will result in the channeling of new capital into investment What will be the economic effects of this channeling?
4. Certain kinds of investments are permissible or encouraged; others are not What will be the effect of this?

California Considerations

To date, physicians have been the chief group in California to implement the Keogh Act A group plan was worked out in 1963 by the California Medical Association and mailed to all members in December Almost immediately, 240 signed up and there were over 4,000 requests for copies of the material California lawyers have been studying the plan. The Los Angeles Bar Association has set up a group plan, but not the State Bar, as yet The California Society of CPA's has voted not to bother with a group plan.

* *Newsletter* from Martin E Segal Company, Consultants and Actuaries, on "Public Employee Retirement Systems," v 8, number 1, (January 1964)

Immediate benefits to California's self-employed would be slight, if California law were conformed to the Keogh Act. However, this might be an opening wedge for later liberalizations, which would benefit professionals but might produce substantial revenue loss for the state government The benefits of the Keogh Act, of course, accrue more to higher-income self-employed than to low-income ones.

ANNUITIES

Question: Should California conform its law to tax annuities so that the portion excludable from income is determined by dividing the cost of the annuity by the number of years payments are to run or in the case of a life annuity, by the life expectancy, rather than simply make, as it now does, three percent of the annuity taxable and the remainder applied as a return of cost until the full cost is recovered, after which the entire proceeds are taxable?

Recommendation: This is one of the items not now in conformity most needing to be conformed There appear to be no arguments for nonconformity.

Legislative Background

Taxation of annuities has varied over the years In 1926 the law was changed so that the income was exempt until all the amount originally paid in had been received back and then taxes were applied California law follows the rule in effect in the federal law between 1934 and 1954 Three percent represented the usual rate of return on the cost of the annuity as of 1934 Each payment is treated as in part a return of principal, in part income In 1954, the federal code abandoned the 3 percent rule (see Section 72, Regs S S 1 72-1-1 72-9) In 1961, SB 98 (MacBride) was introduced in the California legislature to conform to the 1954 change, and was approved by the Senate Fact Finding Committee on Revenue and Taxation, 1959-1961 It was also recommended by the Assembly Interim Committee on Revenue and Taxation, 1961-1963 However, the bill was not passed

There has been no uniform method of treating annuities among the states Some tax them generally as income, or under separate categories, others exempt them entirely However, as of 1961 only a handful of states had followed the 1954 rule, most were still following the 3 percent rule In California, since 1961, certain employee's annuities (where the employer is an exempt organization) have been given special treatment.

Arguments

In 1954, the United States Treasury Department argued that the effects of the 3 percent rule varied widely and erratically with the type of annuity contract and the circumstances of the taxpayer. In some cases, the taxpayer could not possibly recover his full cost tax-free; in others he became fully taxable on annuity payments after a short period of retirement Many annuitants died before they had recovered their cost tax-free. For purpose of applying 3 percent, the total original cost continued to be used each year regardless of the fact that the reserve decreased and therefore interest on it decreased Also, the 3 percent

was the amount presumed to have been earned upon the individual's contributions, including interest earned, but it was a 1934 figure, and it has not been an accurate reflection of later facts Interest rates may be as low as 1 percent (not 3 percent). The 1954 change was proposed as a more accurate method for annuitants to recover their cost tax-free All of these arguments apply to the present state law Also, it should be pointed out that annuitants suffer a hardship, having adjusted to one standard of living, when their income is suddenly cut at the point the entire proceeds become taxable. Nonconformity makes two separate tax computations necessary, which is a burden on the taxpayer. This is particularly significant in California, which is a state to which annuitants migrate There appears to be no reason whatsoever why California should not conform with the federal law

OLD AGE EXEMPTION

Question: Should California conform to federal law which allows an extra $600 exemption to taxpayers over 65?

Recommendation: No

Discussion

There is no doubt that, as one expert has said, "poverty among the aged remains one of our most persistent and difficult economic and social problems." * However, an indiscriminate exemption for persons over 65 is not a solution for that problem In California, since exemptions are already much higher than the federal exemptions, a person over 65 would have to have a good income in order to be liable for income tax at all. Other than for medical expenses, which are taken care of in the tax laws another way, old people do not ordinarily have extraordinary expenses to which other age groups are not also subject. If anything, their personal expenses are less, since presumably they are no longer supporting a family The revenue loss from this exemption would be large Considering this question in 1959-1961, the Senate Fact-Finding Committee on Revenue and Taxation decided that California law should not be conformed to the federal law on this point

SURVIVING SPOUSE JOINT RETURN

Question: Should California conform its tax law to IRC 2(b) to permit a surviving spouse to file a joint return for two years following the year of death, providing the survivor maintains for the entire taxable year a household which is the principal place of abode of a son, stepson, daughter, or stepdaughter who is a member of the household and for whom the taxpayer is entitled to the exemption for a dependent (providing also that the survivor was entitled to file a joint return with the deceased spouse during the latter's lifetime)?

The federal surviving spouse and head of household rules were put into effect after married couples were given the right to split income for tax reporting purposes, as a way of balancing equities Since 1953, California has permitted a surviving spouse to file a joint return in the same year, but not for two additional years, as the federal law provides

* See Margaret S Gordon, "Aging and Income Security," in *Aging and Society*, edited by Clark Tibbitts (Chicago, Univ of Chicago Press, 1960), page 208).

However, in California this nonconformity is substantially offset by the state's special personal exemption for head of household status (It should be noted, however, that California allows no deduction for the dependent required to qualify a taxpayer for head of household status, whereas the federal law does allow a deduction, so that the apparent advantage of the California head of household exemption is reduced by $600) There are also differences in effect due to the fact that state brackets are wider than the federal brackets Up to a certain income level, the head of a household receives more favorable treatment under present state law than under the federal law, but as the level of income rises, the situation is reversed. The state's head of household rule benefits lower income people, the federal surviving spouse rule is of primary benefit to high income people It gives such people time to make appropriate readjustments in their finances and manner of living, after the sudden death of a spouse A bill (SB 96) to conform California law to the federal surviving spouse rule was introduced by Senator MacBride in 1961, but went to interim study The Senate Fact-Finding Committee on Revenue and Taxation for 1959-1961 recommended conformity, so did the Assembly Interim Committee on Revenue and Taxation for 1961-1963.

Further study needs to be given California's present treatment of heads of households

MEDICAL DEDUCTION CEILING

Question: Should California law be changed to raise the ceiling on medical deductions to conform to the ceiling permitted under federal law? (For a single taxpayer or a married taxpayer filing a separate return, the present state maximum medical deduction is $1,250, whereas the federal maximum is $10,000

For a married taxpayer or head of a household, the state maximum is $2,500 and the federal, $20,000 For a disabled taxpayer over 65, the state maximum is $15,000 and the federal, $20,000. For a taxpayer and spouse who are both over 65, are both disabled, and file a joint return, the state maximum is $30,000 and the federal, $40,000)

A special deduction for medical expenses has been permitted under the federal tax law since 1942, with numerous modifications, the most recent in 1964. Partially, this has been a refinement of the ability-to-pay principle, based on the theory that a taxpayer's ability to pay is reduced in years in which he has extraordinary medical expenses Also, for taxpayers not coming within the needs test necessary to make them eligible for medical aid under the Kerr-Mills bill, the medical exemption has been described as an alternative to Medicare In tax theory, the medical exemption is comparable to the casualty loss allowance To be theoretically consistent, there should be no ceiling on either kind of extraordinary expense, though the floors are justifiable as ways of distinguishing between ordinary and extraordinary personal expenses Also, theoretically, there should be carry forward and carry back of extraordinary medical expenses as there is in federal law for casualty losses The absence of such comparable provisions for medical expenses is due to fear of excessive revenue loss for government rather than due to any logically justifiable tax premise California's lower ceiling has been primarily motivated by revenue considerations AB2007

(Cologne) has been considered by this interim committee; it proposes to bring state ceilings into conformity with the federal.

Raised ceilings on medical deductions are not a real alternative to Medicare, in that the benefits are distributed according to income and tax liability rather than according to need. Raising the ceiling would be of most benefit to high income groups.

One special effect of medical deductions is that taxpayers with health insurance tend to get relatively less benefit than those without, because their medical expenses are less erratic. The medical deduction has been described as an insurance plan with a subsidy element. "Those who do not purchase private insurance may benefit at the expense of those who do." *

EXTRA 10 PERCENT FOR CHARITABLE CONTRIBUTIONS

Question: Should California permit an additional deduction of 10 percent of gross income for charitable contributions to specified types of recipients (such as hospitals, schools, and churches), in conformity with the federal law, instead of limiting the deduction to 20 percent as the state law now does? (See IRC Section 170 (b) (1) (A))

Background

Deductions for philanthrophy in federal income tax date from 1917 and are justified as a way of deliberately decentralizing decision making in welfare and culture matters, and to some extent as a way of providing tax incentives for the private subsidization of activities which might otherwise have to be carried out at public expense. The limit on charitable contribution deductions was raised in 1952 from 15 to 20 percent. The additional 10 percent was included in 1954. Further liberalizations were included in the 1964 Revenue Act, but the California 1964 conformity measure did not conform to these because California had not previously conformed to allow an additional 10 percent for donations to specified kinds of recipients A bill (SB 94) to conform California law to the 1954 change was introduced by Senator McBride in 1961 and went to interim. Conformity was recommended by the 1959-1961 Senate interim committee, and the Assembly interim committee for 1961-1963.

Discussion

In 1954, it was estimated that two-thirds of the gifts of living donors went to religious organizations There is no clear evidence that this and other philanthropic giving in the aggregate depends appreciably on tax incentives (Kahn, *op cit*, page 178) The raise in ceiling is of primary benefit to taxpayers in the upper income brackets, particularly those with incomes over $50,000. Few persons with incomes below $50,000 have been affected by the federal ceiling increases, though persons in the below $50,000 income range have originated well over nine-tenths of the total contributions (Kahn, page 181). Because of higher

* For a thorough analysis of the effects of medical deductions, see Harry C Kahn, *Personal Deductions in the Federal Income Tax* (Princeton University Press, 1960), particularly Chapter 7, "Medical Expenses and Casualty Losses," which has tables on comparative impact.

state personal exemptions, an increase in state charitable deductions might have more effect on state income tax revenues than a corresponding change has had upon federal revenues On the other hand, since California does not have progressive rates beyond $15,000 income, there would not be the same incentive as there is under the steeply progressive federal tax rates for those in upper income brackets to give more to charity as the result of an additional ten percent deduction Under a strict conformity measure, there would be no assurance that the contributions deducted from state income tax would go to California recipients; they might very well be sent out of the State

Kahn makes a strong argument for a tax credit, rather than a deduction, as used in Great Britain since 1946 Through the tax credit, the British government's participation in a taxpayer's charitable gifts becomes equal to the standard rate of tax on an equivalent amount of his income. Therefore, it is relatively much more simple to procure a desired level of government participation consistent with revenue requirements by varying the rate at which taxpayers may credit their contributions against tax liability The tax credit gives public government the freedom to review periodically its own position in underwriting private philanthropy A credit would permit Congress to vary the rate of benefit to different types of philanthropy The objection to this is that it might lead to greater public government interference in activities heretofore under private control

OTHER CONFORMITY ISSUES

Military pay exclusions: Since military pay is federal, there seems to be a strong argument in favor of conforming California tax treatment to the federal treatment wherever possible There is some justification, on the merits, for limiting the military pay exclusion to pay for active duty and not including reservists whose military duty amounts to a second job.

Farmers' land clearing deductions: There appears to be no reason why California should not give a limited deduction for land clearing, as the federal law has done since 1962.

Illegal activities: There is some objection to California's special provision making business expenses for illegal activities nondeductible, since it uses the income tax as a tool for crime enforcement, in violation of strict principles of tax neutrality On the other hand, the tool has been effective, has helped put the pinball operators out of existence in California, and operates as a deterrent to bookmakers

Net operating loss deductions: Theoretically, all of the sound arguments for carryover and carryback of operating losses permitted in the federal law also should apply to state income tax California law has not been conformed because there has been a fear that to apply the federal rule to state personal income tax might lead to pressure for application to the state franchise tax, with disastrous revenue results It has been noted that the federal government usually repeals its relief, anyway, in serious depression situations.

Dependents allowed: Minor differences between state and federal law on deductions for dependents ought to be conformed, unless there are

technical differences between the state and federal tax law which make nonconformity necessary

Personal exemptions: The personal exemptions in California are much higher than the federal exemptions and higher than the exemptions in most states Conformity policy on this depends on basic philosophy about where the tax burden should lie See the discussion in this report, under "Equity." Since the impact of the sales tax (even if "graduated" by use of exemptions) falls more heavily proportionately on persons in low and middle income brackets, the high exemptions are needed as an offset if tax laws are to be based on ability to pay

Standard deduction: Tax administrators are generally in favor of the standard deduction in preference to itemized deductions, not only on grounds of simplicity of administration but also because of unequal distribution of benefits from itemized deductions (See Kahn, previously cited) There is some thought that the deduction for single persons should be more than half of that for married couples, since a married couple can presumably live somewhat more cheaply than two single persons living separately.

Tax brackets: According to Emanuel Melichar's *State Individual Income Taxes,* published by University of Connecticut Storrs Agricultural Experiment Station, 1961, California's brackets are more progressive than those of most other states Nevertheless, progressivity does halt abruptly for those beyond $15,000 income level Progressive rates for income brackets beyond that level would be more consistent with the ability-to-pay principle, and since state taxes are deductible from federal income tax, the State would be getting additional revenues at relatively small cost to the taxpayer The higher the tax bracket of the taxpayer, the relatively less the cost would be

Most other items now out of conformity with the federal tax law are of a technical nature and should be conformed whenever this is possible

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APPENDIX 1

Provisions of the Federal Internal Revenue Law Not in the California Personal Income Tax Law AND Provisions of the California Personal Income Tax Law But Not in the Federal Revenue Law

EXHIBIT A. PRINCIPAL PROVISIONS *IN THE FEDERAL* INTERNAL REVENUE LAW *BUT NOT IN THE CALIFORNIA* PERSONAL INCOME TAX LAW

IRC Sections	Principal federal provisions not included in State Personal Income Tax Law	Comparison of specific provisions of State Personal Income Tax Law and Internal Revenue Code	Source documents used to prepare estimates of revenue change shown in cols. 5 and 7	Estimated revenue effect of conforming state to federal law		
				Fiscal year as specified	Annual growth factor	1985-86 fiscal year
(1)	(2)	(3)	(4)	(5)	(6)	(7)
		TAX RATES AND TABLES				
1 (c) and 1(b) (1)	Federal law contains two rate schedules, one for head of household and one for all other taxpayers State law has only one rate schedule	Not measurable inasmuch as the tax rate brackets of the second tax rate schedule could be wider or narrower and the maximum rate could be different.	--	--	--	Not measurable
1(b) (2)	Federal law provides that "head of household" cannot qualify for "surviving spouse" tax benefit "surviving spouse" provisions are meaningless unless survivor is treated as "head of household "	Federal law makes special provision for certain surviving spouses To qualify for the "surviving spouse" provision, all of the state requirements for "head of household" are met The federal "surviving spouse" joint return income splitting benefit is substantially offset by the State's special personal exemption of $3,000 for "head of household" status	--	--	--	Not measurable
1(b) (4)	Federal law does not permit an individual to qualify as head of household if he is a nonresident alien Nonresident may qualify as head of household for state tax purposes	Under federal law, special provisions apply to nonresident aliens One of these provisions is that a nonresident alien cannot qualify as "head of household " Residency and citizenship are not a requirement for "head of household" status under state law	--	--	--	Nominal gain
2(b)	Federal law permits a surviving spouse to file a joint return for two years following year of death	State and federal permit surviving spouse to file joint return where the husband or wife dies during the year Federal permits surviving spouse to claim benefits of income-splitting for 2 additional years in certain limited circumstances (Bock ¶114)	"Summary of the Act to Revise the Internal Revenue Laws of the U S., 1954," Joint Committee on Internal Revenue Taxation, 1954	-$200,000 (1960-61)	5%	-$255,000

EXHIBIT A. PRINCIPAL PROVISIONS *IN THE FEDERAL* INTERNAL REVENUE LAW *BUT NOT IN THE CALIFORNIA* PERSONAL INCOME TAX LAW—Continued

IRC Sections	Principal federal provisions not included in State Personal Income Tax Law	Comparison of specific provisions of State Personal Income Tax Law and Internal Revenue Code	Source documents used to prepare estimates of revenue change shown in cols. 5 and 7	Estimated revenue effect of conforming state to federal law		
				Fiscal year as specified	Annual growth factor	1965-66 fiscal year
(1)	(2)	(3)	(4)	(5)	(6)	(7)
		TAX RATES AND TABLES—Continued				
3	Federal optional tax table contains separate brackets for taxpayers with up to 3 dependents State optional tax table contains one bracket, but allowance for dependents is taken into account before the optional tax table is applied	The state "optional tax table" provides for a standard deduction of 10% of adjusted gross income less exemptions for dependents The minimum standard deduction for a single person is $500 The maximum standard deduction for a head of a household or married couple is $1,000 The minimum deduction commences with the taxable year 1964 The federal "optional tax table" provides for a standard deduction of 10% of adjusted gross income State law provides for deducting exemptions for dependents from adjusted gross income as the step immediately prior to using the optional tax table, this eliminates the need for separate exemption brackets as in the federal tables	1961 and 1962 Annual Reports of the Franchise Tax Board (Table 1F)	--	--	See Sec 141
4(d)	Federal law prohibits nonresident from using optional tax table State law permits nonresident to use the tax table	Under federal law, another special provision relating to nonresident aliens is that they are not allowed a standard deduction and thereby may not use the optional tax table State law allows all taxpayers a standard deduction and use of the optional tax table	--	--	--	Nominal gain
21	In case of change of law or rate for federal tax purposes change of rate in case of fiscal year taxpayer is prorated on a daily basis Under state law new rate or change is applied on a yearly basis, unless statute provides otherwise Also contains special provisions relating to 1964 Act	Most personal income taxpayers file on a calendar year rather than a fiscal year basis Conforming to the federal law would result in a revenue gain in a year in which there was a state rate increase and a revenue loss in a year in which there is a state rate reduction	--	--	--	Nominal gain or loss (see col 3)

TAX CREDITS

31(a)	This relates to credit for tax withheld on wages Under state law only withholding is from nonresidents	Not applicable to state inasmuch as withholding applies only to a limited number of nonresidents	--	--	--	Not applicable
31(b)	This allows a credit for special refunds of social security Under state law comparable taxes are collected by different agencies and used for different purposes	Not applicable to state law. (See column 2)	--	--	--	Not applicable
32	Applies to nonresident aliens, foreign corporations and tax-free covenant bonds.	Comparable provisions of state law credits for taxes withheld from nonresidents and foreign corporations but not on tax-free covenant bonds	--	--	--	Not applicable
33	Allows a credit for taxes paid foreign countries State law limits credit to taxes paid other states	Tax credit for taxes paid foreign countries deleted from state law in April 1957, effective with 1957 income year returns	1957 and 1958 Annual Reports of Franchise Tax Board (Table 1)	-$80,000	--	-$80,000
34	Allows a 4 percent dividend credit Similar credit could exceed state tax (Reduced to 2 percent for 1964, repealed for dividends received after December 31, 1964)	The federal 4 percent or 2 percent "dividends received" credit would not be feasible under state law inasmuch as it would reduce or eliminate tax liability of many taxpayers in higher income brackets	Analysis prepared by State Department of Finance	--	--	Not applicable (See col 2)
35	Relates to partially tax exempt interest Under state law interest is either taxable or exempt	Federal law allows a tax credit on certain U S obligations State law exempts all interest income from bonds and other obligations of the U S as per the U S Constitution	--	--	--	Not applicable
36	Disallows certain credits if tax table is used for determining tax Disallowed credits are not provided for under state tax law	Federal law credits are for (1) overwithholding on taxes withheld at source on nonresident aliens, (2) foreign tax credits, and (3) partially tax-exempt interest. These credits are disallowed individuals claiming a standard deduction and use of the optional tax table without regard to tax credits	-	--	--	Nominal gain
38	Allows a tax credit as provided by Section 46, 47 and 48	See 46, 47 and 48 below	--	--	--	See 46, 47 and 48 below
46, 47 and 48	Allows a tax credit up to 7 percent for investments in certain depreciable property Credit in many instances would exceed state tax Federal Act of 1964 provides that basis of depreciable property will not be reduced by amount of the credit Also allows prior reductions to be restored Elevators and escalators now qualify for credit.	Federal provides for 7 percent credit for investment in certain types of depreciable assets with useful life of four years or more State regulations allow options to maintain the same depreciable basis and depreciate amount equivalent to the investment credit Also will permit adjustments for restored bases	"Summary of Provisions of the Revenue Act of 1962 and 1964," Office of Budget Review, Treasury Department, November 1962	--	6%[1]	-$3,360,000

[1] Approximately 92% is for corporations

Compiled by the Franchise Tax Board November 22, 1963 (revised July 1, 1964).

EXHIBIT A. PRINCIPAL PROVISIONS *IN THE FEDERAL* INTERNAL REVENUE LAW *BUT NOT IN THE CALIFORNIA* PERSONAL INCOME TAX LAW—*Continued*

IRC Sections	Principal federal provisions not included in State Personal Income Tax Law	Comparison of specific provisions of State Personal Income Tax Law and Internal Revenue Code	Source documents used to prepare estimates of revenue change shown in cols. 5 and 7	Estimated revenue effect of conforming state to federal law		
				Fiscal year as specified	Annual growth factor	1965–66 fiscal year
(1)	(2)	(3)	(4)	(5)	(6)	(7)
		ADJUSTED GROSS INCOME DEFINED				
62(7)	Permits a deduction from adjusted gross income for contributions made under a self-employed pension plan	Federal permits self-employed individuals a limited deduction for contributions to retirement plans No comparable state provision	October 31, 1962 memo to Executive Officer entitled "Estimated Fiscal Effects of Proposed Legislation"	—$1,500,000 (1963–64)	5%	—$1,650,000
62(8)	Permits a deduction from adjusted gross income for moving expenses	Comparable provision limited to in-state moves	--	--	--	--
		ITEMS INCLUDED IN GROSS INCOME				
72	Taxes annuities under the life expectancy rule Under state law taxed under the 3 percent rule	State law provides that 3 percent of the cost of the annuity is taxable and the remainder is applied as a return of cost until the full cost is recovered, thereafter, the entire proceeds are taxable The 1954 IRC introduced "life expectancy rule" whereby portion excludable from income is determined by dividing cost of annuity by number of years payments are to run or in the case of a life annuity, by the life expectancy	"Summary of the Act to Revise the Internal Revenue Laws of the U S, 1954" Joint Committee on Revenue Taxation, 1954	—$200,000 (1961 income year)	5%	—$255,000
73	Federal law provides income of a child from personal services is income of the child	Taxable to the parent unless the child has been "emancipated" Child is considered "emancipated" if allowed to keep and spend his earnings (Bock ¶204)	--	--	--	Nominal loss
78	Taxes income derived from certain mortgages made by a joint-stock land bank Same tax treatment is now reached under general law	Under state law, interest on mortgages or obligations issued by joint-stock land banks organizated under the Federal Farm Loan Act is exempt These mortgages are obligations of an instrumentality of the U S government	--	--	--	Not applicable

ITEMS EXCLUDED FROM GROSS INCOME

101(b)(2)(B)(ii) and (3)	Provides $5,000 death benefit exclusion for payments to employees under a self-employed pension plan, but not for the self-employed individual	Federal law specifically denies the $5,000 death benefit exclusion for self employed individuals For state purposes self-employed individuals are entitled to death benefit exclusion	--	--	--	Nominal gain
103	Relates to treatment of governmental obligations Governed for state tax purposes by general law.	U S Constitution prohibits states from taxing U S obligations On the other hand, state law provides for taxing interest income on non-California government obligations	--	--	--	Not measurable
112	Relates to certain exclusion for military pay received while in a combat zone Sections 17146 and 17147 grant certain exclusions regardless of area in which members of armed forces are serving	Federal law includes an exemption for mustering-out pay and another for compensation received for active service in a combat zone after June 24, 1950 or while hospitalized as a result of such service State law exempts compensation received for services in the armed forces up to $1,000 a year and mustering-out pay, terminal leave and unused leave pay and bonds, and educational benefits received under federal or state law The state exclusion also applies to military retirement pay (Hoek ¶218)	Analysis of 1962 income year Forms 540 and 540A returns.	+$1,000,000 (1963–64)	5%	+$1,100,000
115	Excludes income accruing to any governmental public utility or subdivision	Accomplished under state law by complete omission of any reference to taxing governmental public utilities or subdivisions	--	--	--	Not applicable
116	Permits first $100 of dividends to be excluded from tax It should be noted that federal law limits exclusion to dividends received from domestic corporations Similar restriction for state tax purposes would severely restrict dividends qualifying for the exclusion.	Federal law provides for exclusion from gross income of the first $100 of dividends ($200 in case of married couples) received from qualifying domestic corporations No comparable state provision	Analysis of 1961 income year Forms 540 and 540A returns, and Revenue bill of 1964.	--	--	−$2,335,000

STANDARD DEDUCTION FOR INDIVIDUALS

141	Federal law allows single person a maximum standard deduction of $1,000 Federal law allows a single person a minimum standard deduction of $300 Minimum allowed a married couple is $400	See column 2 for further explanation State law allows a single person a maximum standard deduction of $500, and a married couple or head of a household, $1,000.	1963 Annual Report of Franchise Tax Board.	+$2,125,000 (1962–63)	3%	+$2,335,000

Compiled by the Franchise Tax Board November 22, 1963 (revised July 1, 1964).

EXHIBIT A. PRINCIPAL PROVISIONS *IN THE FEDERAL* INTERNAL REVENUE LAW *BUT NOT IN THE CALIFORNIA* PERSONAL INCOME TAX LAW—Continued

IRC Sections	Principal federal provisions not included in State Personal Income Tax Law	Comparison of specific provisions of State Personal Income Tax Law and Internal Revenue Code	Source documents used to prepare estimates of revenue change shown in cols. 5 and 7	Estimated revenue effect of conforming state to federal law		
				Fiscal year as specified	Annual growth factor	1965-66 fiscal year
(1)	(2)	(3)	(4)	(5)	(6)	(7)
142	Federal law does not allow standard deduction to nonresident aliens Nonresidents are allowed standard deduction for state tax purposes	Refer to IRC Section 4(d)	--	--	--	Nominal gain
144	Under federal law maximum standard deduction for married couple or head of a household using tax table is $2,000. Maximum under state law is $10,000	Between $5,000–$10,000 adjusted gross income, federal law allows a 10 percent standard deduction State law allows a married couple or head of a household a *minimum* standard deduction of $1,000	--	--	--	No revenue effect
		PERSONAL EXEMPTIONS				
151(a) and (b)	Federal law allows taxpayer a $600 personal exemption and the same for his spouse State law allows $3,000, which may be taken by either or divided as they elect	Federal law allows married couple under 65 years of age $1,200 exemption ($600 each), state law allows $3,000 or $1,800 more	1962 Annual Report of Franchise Tax Board (Table 1C)	+$101,700,000 (1961 income year)	5%	+$13 0,000,000
151(c)	Federal law allows an extra exemption for taxpayers over 65 State law does not	Federal law allows an additional $600 exemption for taxpayers 65 years of age or over The exemption for a married couple both of whom are over 65, neither of whom are blind, is $2,400 State law allows $3,000—or $600 more	Statistics of Income, 1960 —U S Individual Income Tax Returns, 1962 Annual Report of Franchise Tax Board	—$3,200,000 (1961 income year)	5%	—$3,460,000
151(e)	Federal law provides that unless a dependent is a student his gross income may not exceed $600 State law contains no limitation	Age and educational status of children are not considered in qualifying for dependency under state law.	--	--	--	Nominal gain
152(a)(9) and (10)	Federal law considers any individual supported in the home a dependent Also persons receiving institutional care if one-half of support furnished by taxpayer.	Federal law allows a deduction for unrelated individuals, such as foster children and also for a disabled person under certain *limited* circumstances State law contains no such provision.	"Summary of the Act to Revise Internal Revenue Laws of the U S , 1954," Joint Committee on Internal Revenue Taxation, 1954	—$175,000 (1960-61)	5%	—$225,000
152(b)(3)(A)	Children born and living in the Philippines may be treated as dependents under federal law	No application in state law.	--	--	--	Not applicable

ITEMIZED DEDUCTIONS FOR INDIVIDUALS

162(e)	Expenses incurred with respect to appearances with legislation are deductible Such expenses generally not deductible under state law	Federal law allows expenses paid or incurred in connection with appearances before legislative bodies where the legislation is of direct interest to the taxpayer (Bock ¶301).	--	--	--	Nominal revenue loss
165(i)	Allows a casualty loss for property confiscated by Cuba	No comparable state provision Federal law was retroactive when enacted.	--	--	--	--
170(a) and (b)	Permits up to 30 percent of adjusted gross income to be contributed to charitable organizations.	Federal law allows charitable contributions of up to 30 percent of adjusted gross income, provided that the amount over 20 percent is contributed to a hospital, school, church or governmental unit and "charities" which receive a substantial part of their support from the general public or from government, e g , Red Cross Revenue Act of 1964 allows excess contributions to be carried over for 5 years Carryover however is limited to 30 percent type contributions Unlimited contribution provisions have been revised and no deduction is allowed for a future interest in tangible personal property until all intervening rights of donor or his relatives have expired State law limits the charitable contribution deduction to 20 percent of adjusted gross income	Statistics of Income, 1960 —U S Individual Tax Returns (Table M)	—$720,000 (1960-61)	6%	—$960,000
170(d)	Permits up to $50 monthly charitable deduction for support of full time foreign student in grade 12 or lower	No comparable state provision.	--	--	--	Nominal revenue loss
171(c)	Contains a special rule for bonds which are partially taxable Under state law bonds are either taxable or exempt	State law allows a deduction for the amortization of bond premium on bonds the income of which is taxable Under state law, bond premiums on nontaxable bonds must be amortized but a deduction is not allowed	--	--	--	Not applicable
17..	Provides for a net operating loss deduction State law does not provide for this deduction	Federal law allows net operating losses to be carried back three years and carried forward up to five years Conforming to Federal law could result in substantial revenue loss in a depression, For the 1960 income year, net operating losses of $22,401,000 were reported on 4,352 taxable U S individual income tax returns and $143,173,000 on 9,560 nontaxable returns in the U S Thus is out of 61,027,937 returns and $315 billion adjusted gross income	Statistics of Income, 1960 —U S Individual Income Tax Returns (Table 4)	--	--	Nominal revenue loss (see col 3)
175	Under federal law expenses incurred for soil and water conservation can be deducted	Under state law, there is no limitation on the amount deductible (Bock ¶301(a))	--	--	--	Nominal revenue gain

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EXHIBIT A. PRINCIPAL PROVISIONS *IN THE FEDERAL* INTERNAL REVENUE LAW *BUT NOT IN THE CALIFORNIA* PERSONAL INCOME TAX LAW—Continued

IRC Sections	Principal federal provisions not included in State Personal Income Tax Law	Comparison of specific provisions of State Personal Income Tax Law and Internal Revenue Code	Source documents used to prepare estimates of revenue change shown in cols 5 and 7	Estimated revenue effect of conforming state to federal law		
				Fiscal year as specified	Annual growth factor	1965-66 fiscal year
(1)	(2)	(3)	(4)	(5)	(6)	(7)
	up to 25 percent of the gross income derived from farming State law does not limit percentage deductible					
182	Permits farmers to deduct up to $5,000 per year spent for clearing land Under state law such expenses are capitalized, i e, added to the cost of the land	Federal law allows farmers to treat as a deductible expense, rather than as capital charge, expenditures for clearing land, if such expenditures are for the purpose of making the land suitable for farming No comparable state provision	--	--	--	Nominal revenue loss
213	Federal law permits a maximum medical deduction of $20,000 for taxpayers who are over 65 and disabled State limitation is $15,000 Federal ceiling is $10,000 and $20,000 State ceiling is $1,250 and $2,500 Bills to conform to federal law have not been approved	Maximum medical deductions for other than disabled Federal: Joint returns $10,000; Separate returns 5,000 State: Joint returns $2,500; Separate returns 1,250 Maximum deductions for disabled 65 years or over Federal: One taxpayer $20,000; Two taxpayers 40,000 State: One taxpayer $15,000; Two taxpayers 30,000	Statistics of Income, 1960 —U S Individual Income Tax Returns (Table 9)	—$290,000 (1960-61)	10%	—$470,000
217	Federal law permits a deduction for moving expenses	State law conforms, except that deduction is limited to in state moves	Revenue Bill of 1964	--	--	—$430,000
		ITEMS NOT DEDUCTIBLE				
269	Permits disallowance of deductions, etc, if a corporation is acquired to evade or avoid income tax Section 17615 of state law contains similar provisions (IRC 482 = PITL 17615)	Through practical application of the Federal law this section was difficult to administer Federal Section 482 is much wider in application and under state law Section 17615 is the exact equivalent	--	--	--	Not applicable
272	Denies a deduction for expense of certain contracts relating to disposition of coal or iron ore Has been omitted because of limited coal mining in this State	See column 2 for explanation Coal and iron ore mining is a minor extraction industry in California Applies for the most part to corporations	--	--	--	None
274	Disallows certain entertainment, gift and travel expenses Section 17296 disallows travel or entertainment expenses unless substantiated	A 1962 federal amendment restricted the allowable deductions for entertainment, travel and business gift expenses Under state law there are no limitations providing the expenses can be substantiated as ordinary and necessary business	"Summary of Provisions of the Revenue Act of 1962," Office of Budget Review, Treasury Department November 1962	+$500,000 (1963-64)	5%	+$550,000

333	Revenue Act of 1964 tightened up the definition of personal holding companies This section permits companies which will be classified as personal holding companies to be liquidated on favorable terms	No comparable state provision				
368	Permits stock to be acquired by a subsidiary corporation in exchange for its parent's stock.	No comparable state provisions Applies to corporations, but affects individuals since the acquisitions will not qualify as tax-free acquisitions	--	-	--	--
		EFFECTIVE DATE OF SECTIONS				
391–395	All related to effective dates of provisions regarding application of 1939 and 1954 IRC	Under federal law governing corporate distributions and adjustments sections are provided to specify the effective dates of each portion of this general subject State law provides the effective date of each section as specified in the Revenue Act and by Section 17024 (operative date)	--	--	--	Not applicable
		DEFERRED COMPENSATION				
401(a)(5)(c), (d), (e), (f), (g), 402(a), 403(a), 404(a), and 405	Provides for self-employed pension plans Relates to self-employed pension plans	No comparable state provisions See also Section 62(7).	--	--	--	--
		ACCOUNTING METHODS				
401(h)	Permits pension plans to provide for payment of medical, etc , benefits for retired employees and their spouses and dependents	No comparable state provisions	--	--	--	--
401(i)	Provides that union-negotiated multi-employer pension trusts may be treated as qualified from its creation	No comparable state provisions	--	--	--	--
P L 86–459	Dealer Reserve Income Adjustments Act of 1960 This act was for the most part retroactive, and therefore could not be made applicable for the same periods for state tax purposes	No comparable state provision Conformity at this time would not accomplish the desired tax relief results for state purposes Since in complying with P L 86–459 in 1960, the entire state tax was paid for the 1960 tax year, any change now would have to be retroactive	--	--	--	Not applicable
454(c)	Relates to United States savings bonds, which are not subject to state tax	See column 2 for explanation.	--	--	--	--
		FOREIGN TAX CREDITS				
515	Allows a credit for taxes paid foreign countries State credit is limited to taxes paid other states	Refer to IRC Section 32.	--	--	--	--

EXHIBIT A. PRINCIPAL PROVISIONS *IN THE FEDERAL* INTERNAL REVENUE LAW *BUT NOT IN THE CALIFORNIA* PERSONAL INCOME TAX LAW—Continued

IRC Sections	Principal federal provisions not included in State Personal Income Tax Law	Comparison of specific provisions of State Personal Income Tax Law and Internal Revenue Code	Source documents used to prepare estimates of revenue change shown in cols. 5 and 7	Estimated revenue effect of conforming state to federal law		
				Fiscal year as specified	Annual growth factor	1965-66 fiscal year
(1)	(2)	(3)	(4)	(5)	(6)	(7)
		NATURAL RESOURCES DEDUCTIONS				
613(b)	Relates to percentage depletion rates Federal rates are higher on certain minerals than state	Federal law permits 23 percent depletion allowance on such metals as chromite, lead, manganese ore and concentrates, mercury, zinc, and platinum, corresponding State allowance is 15 percent Federal law permits 15 percent depletion allowance on calcium carbonate and magnesium compounds, corresponding state allowance is 10 percent	Mineral Information Service, January 1 1959, California State Division of Mines p 6	—$300,000 (1959 and 1960 income years)	--	—$380,000 [2]
613(d)	This section relates to the method of computing and prorating the depletion deduction The provisions to which this relates have not been adopted for state tax purposes	Under federal law specific provision for proration of percentage depletion allowance was made for fiscal years ending in 1954 No comparable state provisions	--	--	--	--
614	Permits property subject to the depletion deduction operated under certain unitized or pooled arrangements to be aggregated or grouped	Under federal law, the term "property" under certain circumstances may be an aggregation of two or more interests into one property, thus losses may be offset against gains Under state law, each well must be depleted separately	--	--	--	Nominal loss to personal income tax but substantial loss to corporation tax
615	Permits up to $100,000 of ore or mineral exploration expenses to be deducted State limit is $75,000.	Another difference is that under state law the $75,000 limitations may be claimed in only 4 taxable years whereas federal allows the $100,000 limitation to be deducted in an indefinite number of years.	--	--	--	Nominal loss to personal income tax but substantial loss to corporation tax
		NATURAL RESOURCES EXCLUSIONS FROM GROSS INCOME				
621	Permits payments made by the United States government to encourage exploration, development, and mining for defense purposes to be excluded Section was omitted from prior law Relates primarily to corporations.	No comparable state provision.	--	--	--	Nominal revenue loss

NATURAL RESOURCES SALES AND EXCHANGES

631	Permits gain upon disposal of coal or iron ore with a retained economic interest to be treated as a long-term capital gain Was enacted from prior law Little coal in this State and probably relates primarily to corporations	See explanation in column 2 Coal mining is a minor extraction industry in California	--	--	-	--
632	Limits federal income tax rate to a maximum of 30 percent upon sale of oil or gas properties Unnecessary in view of state rates	Not applicable	--	--	--	Not applicable

ESTATES, TRUSTS, BENEFICIARIES AND DECEDENTS

642(d) and (h)	Relates to net operating loss deduction	Refer to Section 172	--	-	--	--
643(a)(6) and (d)	Relates to "foreign trusts" for federal tax purposes	Under state law, "foreign trusts" include those in other states as well as in foreign countries State law provides detailed rules for establishing the effect of residency upon trusts	--	--	--	Not applicable
663(b)	Relates to distributions during first 65 days Was a special rule under 1939 Code not adopted under state law	See explanation in column 2	--	--	--	Not applicable
665(c), (d) and (e)	Special rules relating to foreign trusts for federal tax purposes	Refer to IRC Section 643(a)(6) and (d)	--	--	--	Not applicable
669	Special rules relating to foreign trusts for Federal tax purposes	Refer to IRC Section 643(a)(6) and (d)	--	--	--	Not applicable
691(d)	Special annuity provision	Under federal law, special treatment is provided as to amounts received by surviving annuitant under a joint and survivor annuity contract, using the annuity life expectancy tables Under state law, the life expectancy tables are not used No comparable state provision is necessary	--	--	--	Nominal loss

REGULATED INVESTMENT COMPANIES

851–855	Provides for special tax treatment of regulated investment companies and their shareholders Under federal law regulated investment companies are taxed only on amounts distributed, but the distributions retain the same character that they had in the hands of the company. Most regulated investment companies are exempt from	Under federal law certain dividends received from "regulated investment companies" (commonly known as "mutual funds") may be treated as capital gains There is no comparable section in state law so such dividends must be treated as ordinary income In cases where the federal tax has been paid on retained capital gains by a regulated investment company and a federal tax credit al-	--	--	--	Substantial loss

[2] Estimate includes corporations, only a small part of the $380,000 revenue loss would be attributable to individuals

EXHIBIT A. PRINCIPAL PROVISIONS *IN THE FEDERAL* INTERNAL REVENUE LAW *BUT NOT IN THE CALIFORNIA* PERSONAL INCOME TAX LAW—Continued

IRC Sections	Principal federal provisions *not* included in State Personal Income Tax Law	Comparison of specific provisions of State Personal Income Tax Law and Internal Revenue Code	Source documents used to prepare estimates of revenue change shown in cols. 5 and 7	Estimated revenue effect of conforming state to federal law		
				Fiscal year as specified	Annual growth factor	1965-66 fiscal year
(1)	(2)	(3)	(4)	(5)	(6)	(7)
	state franchise tax, but their shareholders are taxed on the same basis as are shareholders of other corporations. For more complete explanation, see the bill adding Section 23701o to the Bank and Corporation Tax Law	lowed to the shareholders, the undistributed capital gain is included in income for federal purposes. Under state law, there is no recognition of income until the dividends are actually received by the shareholders, either in cash or additional shares. (Bock ¶220).				
		REAL ESTATE INVESTMENT TRUSTS				
856-858	Treats real estate investment trusts substantially the same as regulated investment companies. Bills to provide substantially the same treatment for state tax purposes have not been approved.	See explanation in Column 2	--	--	--	Nominal loss
		INCOME FROM SOURCES WITHIN AND WITHOUT THE UNITED STATES				
861-894	Contains provisions relating to nonresidents, foreign corporations, etc.	Although in some respects the state rules relating to residency are similar to the federal provisions regarding resident aliens, the two laws deal with quite different situations (Bock ¶103). State law provides detailed rules regarding residency and the taxing of nonresidents	--	--	--	Not applicable
901-905	Relates to income from sources without the United States	Refer to IRS Section 32	--	--	--	Not applicable
911-912	Relates to earned income from sources without the United States	Under federal law, a citizen who establishes a bona fide foreign residence for an uninterrupted period for at least 510 "full days" during 18 consecutive months is entitled to a tax exemption for specified amounts of compensation earned for services performed abroad. No comparable state provision, detailed rules regarding residency apply to taxpayers who are abroad	--	--	--	Nominal loss
931-934	Relates to income from United States possessions.	Under federal law, special provisions are made regarding possessions of the United States. Under state law, no distinction is made as to the source of income for California residents and nonresidents are only taxed on income derived from California	--	--	--	Not applicable

GAIN OR LOSS ON DISPOSITION OF PROPERTY—BASIS RULES

1014(a)	Permits basis of property acquired from a decedent to be valued at date of death or one year later Under state law, is valued as of the date of its acquisition. This is because inheritance tax law does not permit optional valuation	See column 2 for explanation (Book ¶1610)	--	--	-	--
1014(b)(3)	Provides that basis of foreign personal holding company stock is not increased when acquired by inheritance	Personal holding company provisions have not been adopted or followed for state purposes	--	--	--	--
1016(a)(12) and (13)	Relates to consent dividends and holding companies	No comparable state provision (Book ¶220)	--	--	--	--
1016(a)(15)	Relates to basis of certain contracts providing for disposition of coal or iron with a retained economic interest	Refer to IRC Section 631.	--	--	--	--
1016(a)(19)	Investment credit property	No comparable state provision See IRC Sections 46, 47, and 48	--	--	--	Not applicable
1016(a)(2)	Permits basis of foreign personal holding company stock to be increased to federal estate tax attributable thereto	(See Sec 1022)	--	--	--	--
1020	Permits taxpayers to increase the basis of property for excess depreciation allowed prior to 1952 which did not result in a tax benefit Not considered applicable under state law because it is retroactive	See column 2 for explanation	--	--	--	Nominal loss
1021	Provides that in case of a sale the basis of an annuity contract cannot be less than zero Not necessary under existing state law	Under federal law without this provision use of the exclusion rates with the annuity life expectancy tables a taxpayer could have a minus basis for the annuity. Use of the 3 percent rule under state law does not require a special provision since proper computation of the 3 percent rule makes a minus basis an impossibility	--	--	--	Not applicable
1022	Permits basis of foreign personal holding company stock to be increased by federal estate tax attributable thereto	Personal holding company provisions have not been adopted for state tax purposes	--	--	--	--

COMMON NONTAXABLE EXCHANGES

1037	Relates to exchanges of certain United States obligations issued under the Second Liberty Bond Act	Under federal law, no gain or loss is recognized on the surrender to the United States of obligations issued under the Second Liberty Bond Act. Under state law, gain or loss would be recognized.	--	--	--	Nominal gain or loss

EXHIBIT A. PRINCIPAL PROVISIONS *IN THE FEDERAL* INTERNAL REVENUE LAW *BUT NOT IN THE CALIFORNIA* PERSONAL INCOME TAX LAW—*Continued*

IRC Sections	Principal federal provisions not included in State Personal Income Tax Law	Comparison of specific provisions of State Personal Income Tax Law and Internal Revenue Code	Source documents used to prepare estimates of revenue change shown in cols. 5 and 7	Estimated revenue effect of conforming state to federal law		
				Fiscal year as specified	Annual growth factor	1965-66 fiscal year
(1)	(2)	(3)	(4)	(5)	(6)	(7)
		EXCHANGES IN OBEDIENCE TO S E C. ORDERS				
1032(a)(1)	Carryover of basis on S E C exchanges	Generally the same but much less detailed than federal (Bock ¶532)	--	--	--	Nominal loss
1032	Definition of S E C provisions	Generally the same but much less detailed than federal (Bock ¶532)	--	--	--	Nominal loss
		DISTRIBUTIONS REQUIRED BY ANTITRUST LAWS				
1111	DuPont Divestiture Provisions A bill adding this provision was vetoed in 1963	Under federal law, a provision was enacted in 1962 providing special tax relief for the distribution of 63 million shares of General Motors Company stock by the DuPont Corporation resulting from antitrust litigation (Bock ¶220) As noted in column 2, a bill incorporating this relief provision was not enacted 23 million shares were distributed in July, 1962, and in November, 1962 The remaining 23 million shares must be distributed by February, 1965 In August, 1962, the Department of Finance estimated the revenue loss on the total distribution of 63 million shares in the next 3-4 years at $4,000,000 At that time, General Motors stock was listed on the NYSE at $47 per share If another bill was introduced and enacted at the 1964 or 1965 Legislative Session and applied to the second, third, etc , distributions, the revenue loss would be in the millions of dollars	--	--	--	Substantial revenue loss (see column 3)
		CAPITAL GAINS AND LOSSES				
1201(b)	Relates to an alternative tax on capital gains. Maximum of 25 percent is in excess of state rate	Not applicable in view of the State's lower tax rate schedule	--	--	--	Not measurable
1201(b)(2)	Alternative capital gains tax of 25 percent Not applicable in view of state rates.	See IRC Section 1201(b) above	--	--	--	Not measurable
1221(5)	Provides that certain United States obligations are not capital assets (savings bonds) such obligations are exempt from state tax.	Under state law the treatment of obligations of the United States issued at a discount and payable without interest at a fixed maturity date not exceeding one year as other than capital assets is not necessary The discount is in effect interest on the United States obligations which is exempt for state purposes	--	--	--	Not applicable

1231(b)(2)	Permits coal and iron ore to qualify for capital gain treatment	Little coal mined Probably applies primarily to corporations.	--	--	--	--
1237(d)	Effective date of federal law	Relates to the sale of subdivided real property The 1954 federal provisions were not enacted into state law until 1955	--	--	--	Not applicable
1246 and 1247	Taxes certain amounts of gain on the sale of foreign investment company stock as ordinary income No special state provisions relating to investment companies and of limited application	State law has not been conformed to a federal amendment adopted in 1962 which taxes a United States shareholder owning 10 percent or more of the stock of certain corporations as though his pro rata share of the undistributed earnings of the foreign corporation were actually distributed to him (Book ¶220)	--	--	--	Nominal gain
1248	Taxes certain amounts of gain on sales or exchanges of certain foreign corporations as ordinary income Would have only limited application for state tax purposes	See IRC Sections 1246 and 1247 above	--	--	--	--
1249	Taxes as ordinary income gain from certain sales of patents to foreign corporations	Under federal law, gain from the sale or exchange of patents and certain other intangible property rights to controlled foreign corporations is treated as ordinary income rather than capital gain No comparable state provision (Book ¶5164)	--	--	--	Nominal gain
		MITIGATION OF EFFECTS OF STATUTE OF LIMITATIONS				
1311–15	Provisions for certain adjustments, notwithstanding the expiration of the statute of limitations Section 1905 3 9 permits somewhat similar adjustments	Federal law mitigates the effect of the statute of limitations in certain circumstances where an inconsistent position is maintained (Book ¶708) No comparable state provision	--	--	--	Nominal loss
		INVOLUNTARY LIQUIDATION AND REPLACEMENT OF LIFO INVENTORIES				
1321	Permitted tax-free replacement of certain LIFO inventories involuntarily liquidated prior to January 1, 1955 (i e , during the Korean War) Was not applicable for state tax purposes because of its retroactive effect.	See explanation in column 2.	--	--	--	Not applicable
		CLAIM OF RIGHT				
1341–42	Permits a taxpayer to adjust for amounts erroneously included in income under a claim of right.	Under federal law, the "claim of right" doctrine may be exercised at the option of the taxpayer to recompute his tax liability for the year in which an item of income was reported and repayment of which was made in a later year This option would be used only in the case in which the tax benefit of the deduction would be less in the year of repayment No comparable state provision, taxpayer would be required to claim a deduction in the year of repayment but could not recompute prior year tax and apply to current year	--	--	--	Nominal loss

Compiled by the Franchise Tax Board November 22, 1963 (revised July 1, 1964).

EXHIBIT A. PRINCIPAL PROVISIONS *IN THE FEDERAL* INTERNAL REVENUE LAW *BUT NOT IN THE CALIFORNIA* PERSONAL INCOME TAX LAW—Continued

IRC Sections	Principal federal provisions not included in State Personal Income Tax Law	Comparison of specific provisions of State Personal Income Tax Law and Internal Revenue Code	Source documents used to prepare estimates of revenue change shown in cols. 5 and 7	Estimated revenue effect of conforming state to federal law		
				Fiscal year as specified	Annual growth factor	1965-66 fiscal year
(1)	(2)	(3)	(4)	(5)	(6)	(7)
		OTHER LIMITATIONS				
1346	Permits the tax to be recomputed if resulting from the recovery of an unconstitutional federal tax	Under federal law the recovery of unconstitutional federal taxes claimed as a deduction in a prior year may at the election of the taxpayer be handled in two ways The first option would be to add the tax recovery to his current year's income This section allows a second option to recompute the tax for the year in which the deduction had been claimed No comparable state provision Under state law, if the deduction resulted in a tax benefit, that amount would be taken into current year's income	--	--	--	Nominal loss
1347	Provides for a maximum federal tax of 30 percent in case of payment by the United States involving certain acquisitions of property by it	No comparable state provision.	--	--	--	Not measurable
		PARTNERSHIPS AND PROPRIETORSHIPS TO BE TAXED AS CORPORATIONS				
1361	Permits a partnership to be taxed as a corporation	Policy and practical problems regarding administration of similar sections under state law are formidable	--	--	--	Not measurable
		CORPORATIONS TO BE TAXED AS PARTNERSHIPS				
1371–1377	Permits certain corporations to in effect be taxed as partnerships	Policy and practical problems regarding administration of similar sections under state law are formidable	--	--	--	Not measurable

1385 and 1388	Provides for tax treatment by patrons of patronage dividends Section 17117 5 of state law provides for the taxation of such dividends	Under federal law, cooperatives are not allowed a deduction for patronage dividends unless the patrons include such amounts in taxable income, whether the dividends are merely received or allocated Under state law, cooperatives are allowed a deduction for all patronage dividends, the patron has the election of reporting such dividends on an accrual or cash basis providing he is consistent in the method used	--	--	--	--
Cross	Cross reference 5, 121, 145, 154, 165(i), 170(f) and (g), 218, 302(e), 307(c), 318(b), 356(f), 443(d), 472(f), 501(e), 682(e), 1016(c), 1023, 1033(h), 1034(k), 1035, 1055, and 1232(a)					
	End of Internal Revenue Code Income Tax Provisions					

Compiled by the Franchise Tax Board November 22, 1963 (revised July 1, 1964)

EXHIBIT B. PRINCIPAL PROVISIONS *IN THE CALIFORNIA* PERSONAL INCOME TAX LAW BUT *NOT IN THE FEDERAL* REVENUE LAW

PITL Sections	Principal state provisions not included in the Federal Income Tax Law	Comparison of specific provisions of State Personal Income Tax Law and Internal Revenue Code	Source documents used to prepare estimates of revenue change shown in cols 5 and 7	Estimated revenue effect of conforming state to federal law		
				1960-61 fiscal year (or as specified)	Annual growth factor	1963-64 fiscal year
(1)	(2)	(3)	(4)	(5)	(6)	(7)
		RESIDENCY				
17014	Defines residents of California as individuals in this state for other than temporary or transitory purposes and individuals domiciled in this state who are outside California for a temporary or transitory purpose	Although in some respects the California rules relating to residence are similar to the federal provisions regarding resident aliens, the two laws deal with quite different situations (Bock ¶103)	--	--	--	Not applicable
17015	Defines nonresidents as all individuals other than residents	See FITL Section 17014 above	--	--	--	Not applicable
17016	Establishes a presumption of residence where an individual spends in the aggregate more than nine months of a taxable year in California	See FITL Section 17014 above	--	--	--	Not applicable
		PATRONAGE DIVIDENDS				
17117.5	Provides that taxpayers may elect to consider noncash patronage allocations received from farmers' cooperatives and mutual associations as income in the taxable year in which they were advised the allocation was made, or in the year such dividend is redeemed or realized upon	The federal law was changed effective in 1963 to provide a complete set of new rules for taxing cooperatives and their patrons. Generally, these rules provide that cooperatives will not be allowed a deduction for patronage dividends unless the patrons include such amounts in taxable income, whether the dividends are actually received or merely allocated (Bock ¶225)	--	--	--	Nominal gain

PRESUMPTION OF TAXABILITY

17119	Establishes a presumption of taxability when property is acquired in a transaction purporting to be a sale or exchange where the value of the property is substantially in excess of the value of the consideration surrendered The excess value shall be considered ordinary income unless it is shown that (a) The sole consideration was the money or property surrendered, (b) The excess value was a gift, or (c) For some other reason the excess value does not constitute income, or the gain is not to be otherwise recognized	The federal law treats this subject by regulation and case law under the general title of bargain purchases While a specific section is not contained in the federal code the same treatment is covered by regulation and actual practice.	--	--	--	Not applicable

ITEMS EXCLUDED FROM GROSS INCOME

17137	Provides that gross income does not include amounts which California is prohibited from taxing under constitutions or laws of the United States or California	No application in federal law	--	--	--	Not applicable
17146	Provides that compensation received from the armed forces of the United States to the extent of $1,000 does not constitute gross income.	The federal law contains no such provision but does include an exemption for mustering-out pay and another for compensation received for active service in a "combat zone" after June 24, 1950, or while hospitalized as a result of such service Federal exemption extends to terminal leave and unused leave pay and G I educational benefits (Book ¶218)	Analysis of 1962 income year Forms 540 and 540A returns	See column 4	--	+$1,000,000

ITEMIZED DEDUCTIONS

17210	Permits a deduction for political contributions made during any primary or general election to the extent of $100 for each individual filing a return	Allowable only in "even-numbered" years, that is, when there is a general election	Analysis of 1960 income year Forms 540 and 540A returns	+$50,000	5%	+$80,000
17220	Permits the cost of antismog machinery, meaning any device or equipment for collection as source of atmospheric pollutants and contaminants, to be amortized and deducted over a period of 60 months in lieu of the accepted method of depreciating the adjusted basis	See column 2 for explanation	--	--	----	Nominal gain

Compiled by the Franchise Tax Board November 29, 1963

EXHIBIT B. PRINCIPAL PROVISIONS *IN THE CALIFORNIA* PERSONAL INCOME TAX LAW BUT *NOT IN THE FEDERAL* REVENUE LAW—*Continued*

PITL Sections	Principal state provisions not included in the Federal Income Tax Law	Comparison of specific provisions of State Personal Income Tax Law and Internal Revenue Code	Source documents used to prepare estimates of revenue change shown in cols. 5 and 7	Estimated revenue effect of conforming state to federal law		
				1960-61 fiscal year (or as specified)	Annual growth factor	1963-64 fiscal year
(1)	(2)	(3)	(4)	(5)	(6)	(7)
17234	Permits political contribution up to $100	Refer to PITL section 17210	--	--	--	See 17210 above
17259	Permits a deduction for expenses paid or incurred in connection with the adoption of a child These expenses include any medical and hospital expenses of the mother, and any welfare agency, legal or other fees relating to the adoption	The state law was amended in 1963 so as to allow a deduction for adoption expenses This includes medical expenses of the mother and legal fees and other costs relating to adoption There is no provision for adoption expenses in the federal law, however, under a 1960 revenue ruling certain medical expenses of an adopted child are deductible by the adopting parent, provided the child qualifies as a dependent when the medical bills are incurred or paid (Bock ¶315)	--	--	--	Nominal gain
17260	Limits the combined medical and adoption expenses allowable to $2,500 in the case of a joint return of husband and wife and $1,250 in the case of a single person or a married person filing a separate return	The federal law permits a maximum medical deduction for other than disabled of $10,000 on joint returns and $5,000 on separate returns and for disabled 65 years of age or over of $20,000 for one taxpayer and $10,000 for two taxpayers The state law permits a maximum medical deduction for other than disabled of $2,500 on joint returns and $1,250 on separate returns and for disabled 65 years or over of $15,000 for one taxpayer and $30,000 for two taxpayers	Statistics of Income, 1960 --U S Individual Income Tax Returns (Table 9)	−$290,000	10%	−$400,000
		ILLEGAL ACTIVITIES				
17297	Provides that where a taxpayer has income derived from illegal activities as defined in Chapters 9, 10, or 10 5 of Title 9 of Part 1 of the Penal Code of California, no deductions from gross income are allowable Also, no deductions are allowed from gross income derived from activities which tend to promote or further, or are connected with such illegal activities	See column 2 for explanation.	--	--	--	Gain not measurable

		DEDUCTIONS OF NONRESIDENTS				
17301	Allows nonresidents of California deductions only to the extent connected with income arising from sources within this State and taxable to the nonresident.	The state law is similar in principle to the federal law relating to deductions of nonresident aliens, the general rule being that deductions are allowable only to the extent they are connected with income from sources within California and the United States, respectively Since the two laws deal with basically different situations, no attempt is made here to analyze the differences in detail (Bock ¶324)	--	--	--	Not applicable
17302	Permits nonresidents to deduct taxes paid to California even though not connected with income from California sources	Refer to PITL Section 17301	--	--	--	Not applicable
17303	Permits to nonresidents a deduction for contributions and gifts, but only if made to (1) A corporation or association organized under the laws of California, (2) The Vocational Rehabilitation Fund, or (3) California or its political subdivisions for exclusively public purposes	Refer to PITL Section 17301	--	--	--	Not applicable
17304	Provides that alimony and separate maintenance payments are not deductible by a nonresident	Under state law specific provision has been made not to allow alimony as a deduction for nonresidents Alimony is a personal expense	--	--	--	Not applicable
		CHANGE OF RESIDENCY				
17596	Provides that when a taxpayer changes his residence, either from or to the status of a resident of California during a taxable period, his income is taxable when or where it accrued regardless of his method of accounting This contemplates taxation of income earned in California even though when received the taxpayer may have become a nonresident	No application in federal law	--	--	--	Not applicable
		ESTATES AND TRUSTS				
17733	Allows a trust $100 exemption, but provides exemption is increased to amount of tax if tax is less than $1.	Federal law allows a simple trust (one which distributed all of its income currently) an exemption of $300. All other trusts can deduct a $100 exemption (U S Master Tax Guide ¶227).	--	--	--	Nominal gain

Compiled by the Franchise Tax Board November 29, 1963.

EXHIBIT B. PRINCIPAL PROVISIONS IN THE CALIFORNIA PERSONAL INCOME TAX LAW BUT NOT IN THE FEDERAL REVENUE LAW—Continued

PITL Sections	Principal state provisions not included in the federal Income Tax Law	Comparison of specific provisions of State Personal Income Tax Law and Internal Revenue Code	Source documents used to prepare estimates of revenue change shown in cols. 5 and 7	Estimated revenue effect of conforming state to federal law		
				1960-61 fiscal year (or as specified)	Annual growth factor	1963-64 fiscal year
(1)	(2)	(3)	(4)	(5)	(6)	(7)
17742	Estates of decedents are taxed as follows (a) On their entire net income if the decedent was a resident of California at the date of his death, or (b) On the income received from California sources if the decedent was a nonresident at the date of his death Trusts are taxable on their entire net income if the fiduciary or beneficiary is a California resident regardless of the residence of the trustor	Under state law specific provisions must be made for trusts having mixed resident fiduciaries and beneficiaries These provisions are necessary for state law to provide an equitable means of apportioning trust income on the basis of state residency Under federal law similar but not identical provisions are made for nonresident aliens	--	--	--	Not applicable
17743	Provides that when the taxability of a trust is dependent on the residence of the fiduciaries, and there are two or more fiduciaries, the income taxable is apportioned according to the number of fiduciaries who are residents of California as against the number who are nonresidents	See PITL Section 17742	--	--	--	Not applicable
17744	Provides that when the taxability of a trust depends on the residence of the beneficiaries, and there are two or more beneficiaries, the income taxable is apportioned according to the number of beneficiaries who are residents of California as against the number who are nonresidents	See PITL Section 17742	--	--	--	Not applicable
17745(a)	Provides that if the taxes imposed on a trust are not paid at the time the income is distributed to the beneficiary (except a contingent beneficiary of a nonresident trust), the income is taxable to the beneficiary	See PITL Section 17742.	--	--	--	Not applicable

17745(b)–(d)	Provides that a contingent beneficiary of a nonresident trust is taxed when income or corpus is distributed or distributable Income is taxed over a six-year period	See PITL Section 17742.	--	--	-	Not applicable
		GROSS INCOME OF NONRESIDENTS				
17951–54	Specifies extent to which a nonresident is taxable.	No application in federal law.	--	--	-	Not applicable
		TAX CREDITS				
18001–11	Where California and some other state of the United States both impose a net income tax on the same income, the law provides for the allowance of a credit against the tax due California for taxes paid to the other state The credit is allowable to resident and nonresident individuals, estates and trusts, and their beneficiaries Whether or not the credit is allowed by California is dependent on the income tax laws of the other state	There are many differences between the California credits for taxes paid to other states and the foreign tax credit in the federal law The federal credit is allowed for income taxes generally, the California credit is allowed only for taxes based on net income Federal credit is allowed only where the taxpayer elects to take the credit instead of using the foreign tax as a deduction, California requires no election since it allows no deduction for income taxes under any circumstances (Bock ¶115)	--	--	--	Not applicable
	End of California Personal Income Tax Law Sections					

Compiled by the Franchise Tax Board November 29, 1963

APPENDIX 2

Letter From Franchise Tax Board With Respect To Automatic Income Tax Conformity

To : Assembly Revenue and Taxation Committee

From: Franchise Tax Board

Subj : Observations Regarding Statements Submitted to Committee on December 17, 1963.

At the committee hearing in San Francisco on December 17, 1963, three statements were submitted recommending that the state personal income tax be based on a percentage of the federal income tax. Following is a summary of the problems we have noted in such proposals·

1. Shift in the tax burden;
2. Possible effect of future federal changes;
3. Modifications or adjustments which would be required;
4. Technical problems not covered;
5. Revenue loss, . .

A discussion of these problems is submitted for your consideration.

1 *Shift in the tax burden* If all other considerations were put aside, it would be simpler to determine the amount of State tax due if the state rate was fixed as a percentage of the Federal income tax However, this "simplified" approach results in a downward shift in the existing tax burden

It has been suggested that the shift in the burden could be avoided if the State imposed its tax at a point which matched its existing personal exemptions and then adopted various brackets so as to maintain the existing tax burdens

If the state tax is based on a percentage of the federal tax, future federal changes will result in an additional shifting of the burden. The nature of future changes cannot be predicted, but the effect may be illustrated as follows:

Assume that the federal law is revised insofar as it relates to the taxation of gains from the sale of capital assets.

That as a result of the revisions the taxable income of X, a single man, is reduced from $20,000 to $18,000 In such case his federal tax, based on existing rates would drop from $7,260 to $6,200.

X will be required to pay less state tax after the revision if the state tax is based on a percentage of the federal tax. The tax burden as to X could be compensated for by increasing the state rates for all taxpayers in X's tax bracket but such adjustment would penalize taxpayers in the same bracket not benefiting from the federal tax revision.

If the deductions and credits allowed under federal law applied equally to all taxpayers it would be simple to compensate for the difference in tax bases by adjusting the state rate upwards This simple solution is not possible without altering existing burdens because the more liberal federal deductions and credits do not apply uniformly. Therefore, it is impossible to avoid a shift in the tax burden to the extent of the difference between the state and federal tax bases The Department of Finance in a memorandum submitted at the hearing estimated that the adoption of the more liberal Federal provisions would result annually in a loss of more than $25,000,000 of General Fund revenue. An example of the difference between the state and federal tax bases and the resultant shift is as follows

In the examples it is assumed that the taxpayers are married, file joint returns and have two dependent children In example A, all income is from wages. In example B all income is from dividends. In example C all income is derived from the sale of manufactured products, that machinery costing $200,000 was purchased during the year which qualifies for the federal investment credit, that the machinery has a useful life of 10 years and that the straight line depreciation method is used.

	A (Wages)		B (Dividends)		C (Self-employed)	
	State	Federal	State	Federal	State	Federal
Gross income	$20,000	$20,000	$20,000	$20,000	$300,000	$300,000
less wages, rent, interest, etc					256,400	256,400
Depreciation *					23,600 *	23,600 *
Net income	20,000	20,000	20,000	20,000	20,000	20,000
less dividend exclusion				100		
Standard deduction	1,000	1,000	1,000	1,000	1,000	1,000
Personal exemptions	4,200	2,400	4,200	2,400	4,200	2,400
Taxable income	14,800	16,600	14,800	16,500	14,800	16,600
Tax	294	4,124	294	4,090	294	4,124
less. dividend credit				660		
investment credit						14,000
Tax payable	294	4,124	294	3,430	294	0†

* Includes first year depreciation (200,000 — 4,000 = 196,000 — 10)
† $9,876 tax credit carryback or carryover

The same amount of state income tax is paid by each of the taxpayers, however, the federal tax payable fluctuates between $0 and $4,124 In addition, the taxpayers in example C, have a $9,876 tax credit which may be carried over to reduce their federal tax in future years

It was suggested that the shift in tax burden could be avoided or minimized if the state rates were based on the prior year's federal tax. By basing the rates on a known tax base it was said that a predictable amount of state income tax could be ascertained This method, however, presents two major obstacles

The first is that if the tax base is the prior year's federal tax, the State must either forego one year's income tax or subject one year's

income to a double tax. While there may be no legal objection to a double tax, in many instances such tax would be highly inequitable. This would be particularly true if a taxpayer retired in the year of change. An additional problem would be presented if a taxpayer died in such year. Such method would mean a new taxpayer would not be subject to tax until a year after the income is earned. Difficult problems would also be encountered in connection with taxpayers entering and leaving the State.

The next obstacle is that the amount of federal tax paid in this State cannot be determined in time for current rates to be based thereon. For example, October 21, 1963, was the earliest date that the Internal Revenue Service could furnish any information for the taxable year 1961. This was preliminary information, which did not disclose the tax collected by income groups, i.e., single taxpayers, heads of households, and married couples. This latter information is never compiled by the Internal Revenue Service, and may be obtained, if at all, only by contracting with the Internal Revenue Service. Without this information it is doubtful if the amount of state tax paid by marital status can be equitably apportioned.

Since information regarding the amount of federal tax paid for 1961 cannot be obtained until October, 1963, or later, the Legislature could not base state rates thereon until the budget session convened in February 1964 At least 60 days would be required in order to print and address the returns This means that during the budget session returns could not be furnished taxpayers until sometime in April If for any reason the rates were not fixed at the earliest possible date, it is possible that the returns could not be furnished, completed, and returned in time for the income tax to be received in the fiscal year for which the rates were determined

Even if there were no other problems, taxpayers would be required to recompute their last year's federal tax if they are unable to locate their prior year's federal return Such recomputation would be as difficult, if not more so, than the computation now required to determine current year's tax.

2 *Possible effect of future federal changes.* The Senate Fact Finding Committee on Revenue and Taxation in its report published in 1961, discussed at some length many of the reasons why the state income tax law should not be irrevocably based on federal tax laws. In addition to the reasons mentioned in the Senate report, if the state rates were a percentage of the federal tax, the State may be placed in the anomalous position of raising its tax rates whenever the federal government lowers its rates and lowering its tax rates whenever the federal government increases its rates During the war years when the federal government sharply increased its income tax rates, the State lowered its tax rates At the present time state tax rate increases are a possibility, yet the federal government proposes to substantially lower its tax rates State and federal revenue requirements have and do conflict and the divergent needs might in the future create major revenue problems It should be noted for example, that when the federal government adopted a withholding system that it forgave 75 percent of the 1942 or 1943 tax, whichever was less. A similar federal change

could be devastating if the state tax was irrevocably based upon a percentage of the federal tax.

3. *Modifications or adjustments which would be required.* Certain modifications or adjustments are required if the state income tax is fixed as a percentage of the federal tax This was recognized by the bills considered by the committee. States for example, are precluded from taxing interest paid on federal obligations. Therefore, an adjustment must be provided so that the federal tax could be reduced by the amounts attributable to income derived from federal obligations. Interest paid on obligations of a State and its subdivisions are exempted from taxation under Section 103 of the Internal Revenue Code of 1954. Therefore, in order to prevent tax avoidance, interest on obligations issued by other states should be subjected to tax. These necessary adjustments would require some type of handling if the state income tax was a percentage of the federal tax. It also appears that adjustments would be provided for personal exemptions if the tax burden is not to be shifted down.

It has been suggested that no law should be enacted with regard to exemptions or deductions which would modify the federal tax base. As mentioned above, modification is required for interest paid on state and federal obligations. Furthermore, in the absence of a constitutional prohibition one legislative body, as a general rule, cannot limit either its own powers or those of a subsequent legislature, and the act of one legislature is not binding on its successors. *In re Collie,* 38 Cal 2d 397

It has also been stated that unless the percentage of federal tax method was adopted, the Legislature would have the impossible job of making the state income tax law conform to United States executive, legislative and judicial law. Such, however, is not the case because of the rule of construction applicable to the state income tax law. This rule as established in the case of *Meanley* v. *McColgan* (1942) 49 Cal. App. 2d 313, is:

> "The provisions of our statute . . . were copied from the Federal statute. Under such circumstances the federal decisions constitute not only argumentative authority, *but are conclusive on the proper interpretation of our statute.* (*Holmes* v. *McColgan,* 17 Cal. 2d. 427; *Union Oil Associates* v. *Johnson,* 2 Cal 2d 727)."

Major adjustments would be required if a percentage of the federal tax is applied to nonresidents. This is because such taxpayers derive only part of their income from sources within this State; therefore, if the state tax is to be equitable it must be limited to income derived from sources within this State. Unless deductions allowed non-residents are restricted, they may reduce their state tax by claiming personal deductions (such as alimony), which are not connected with the income derived from sources within this State.

The bills submitted to the committee (A B 2548 and 3018) fail to permit adjustments if a taxpayer is a resident of the State for only part of the year This means a taxpayer who becomes a resident in December is subject to state tax on all of his income, even though all of such income for the taxable year may have been earned in his former state of residence. Under existing law (Section 17596), such taxpayer would be subject to tax only on income attributable to this State after the

change of residence The harshness of such tax however, may to some extent be alleviated by allowable tax credits

4 *Technical problems not covered* If the State based its tax on a percentage of the federal tax some provisions should be made for overlapping deductions or items of income Neither of the bills contain such provisions

Adjustments should also be allowed for the difference in basis property may have for state and federal tax purposes These differences may arise if the gain on a reorganization or liquidation was not recognized for federal tax purposes, but was recognized for State tax purposes Also the basis of property will be different where Subchapter S (Section 1371 et seq) is applicable under federal law This is because retained earnings are taxed under federal law, but not under state law Differences will also occur because prior to the enactment of the Federal Revenue Act of 1964 the basis of depreciable property was required to be reduced by the amount of the federal investment credit This adjustment was not required under state law

Adjustments would be required for example, if a taxpayer used the installment method for reporting the gain on the sale of property for federal tax purposes, but used the cash method for state tax purposes. Adjustments should also be allowed for taxpayers using different accounting methods, otherwise some deductions may be allowed twice or items of income may be subjected to double taxation

The above items are not exclusive, but are mentioned so as to point out that if inequities are to be avoided adjustments should be provided for.

5. *Revenue loss* Each of the bills submitted to the committee contemplate that taxpayers will file a simplified return The return will consist of little more than the amount of federal tax paid and the state tax due With such limited information the State would be unable to audit returns If the audit program is abandoned the State would be deprived of an estimated $10,500,000 in general fund revenue (Approximately $1,450,000 of this revenue is attributable to federal adjustments which might be recoverable in any event).

Insofar as we can determine none of the states which have adopted a federal tax base have abandoned their audit programs Alaska for example, requires a return to be filed which, excepting for permitting adjustments required by their law, is a duplicate of the federal return

It was suggested at the hearing that the committee review House Report No 2519, published January 3, 1953, a Report to the Committee on Ways and Means, House of Representatives, Regarding Coordination of Federal, State and Local Taxes The report discusses at length various means whereby cordination is possible Some of the conclusions of the committee are·

> Page 37 "The ultimate solution of these difficulties may lie in several directions States could allow their taxpayers to pay a fixed percentage of their federal income-tax liabilities as an alternative to computing their taxes under state law As already indicated, this method is being used in Utah and Alaska *The reason for the limited use of this method may well be the close tie-in which it implies for state revenues with changes in the federal law* "

Page 42· "Coordination prospects —State governments are well established in income taxation A program for intergovernmental coordination in this area needs, therefore, to proceed on the assumption that both federal and state governments will continue in the field. The use of the income tax at the local level does not necessarily aggravate the coordination problem because these taxes are at a low rate, generally do not overlap state taxes, and do not appreciably affect the combined tax burden of the income recipient

"The fact that the area of federal-state conflict is not as broad as appears at first sight holds promise for further improvement in coordination The deductibility of state taxes for federal income tax purposes precludes the imposition of confiscatory levies. It also narrows interstate differentials at middle and high income levels even though state income tax rates and exemptions vary greatly Mutual deductibility of taxes paid at both the federal and state level further narrows these differentials.

"Improvements have already been realized as a result of recent revisions in state tax laws incorporating some provisions of federal law In this connection, the use of the standard deduction and of the simplified tax table is especially important If the trend toward uniformity continues, unified administration may ultimately be possible.

"Such conflicts as exist in the individual income tax field can be resolved in large part without a revolutionary change in the relationship between the federal government and the states Measures which are already tested and proved to be effective are adequate to enable the federal and state governments to follow an integrated program involving a minimum of administrative expense to the governments and a minimum of compliance costs to the taxpayers

"The passage of time will not of itself resolve the remaining problems of federal-state income tax coordination *It should be possible, however, to provide a basis for increasing cooperation and administrative coordination either by federal-state agreements which do not necessarily include all states or, preferably, by a more inclusive type of agreement in which most states could join quickly."*

According to Announcement 64-1, Internal Revenue Bulletin 1964-1, an agreement for cooperation in tax administration between the Internal Revenue Service and the State of Massachusetts recently concluded was the 27th agreement now in effect Thus, the majority of the states, including this State, have now entered into agreements whereby reciprocal arrangements are provided for assistance and enforcement of the various types of federal and state tax laws Therefore, as anticipated by the report, a majority of the states have entered into agreements which largely avoid federal-state conflict

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THE SALES TAX

A Major Tax Study

PART 4

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DECEMBER 1964

THE SALES TAX

by

Dr. Harold M. Somers
assisted by Joseph J Launie

DECEMBER 1964

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PUBLISHER'S NOTE

This booklet is the fourth in a series of studies on California's tax structure to be published this year by the Assembly Committee on Revenue and Taxation It is a comprehensive examination of the sales tax.

As the sales tax is the major revenue producer for the State of California, accounting for over 30 percent of the revenue collected by the state, a study in depth of this method of taxation is of the utmost importance Because of the significant new data developed in this work and because of the wide range of interests it affects, we are making the author's original research document available for public distribution.

The findings, conclusions, and recommendations in this report are those of the researcher and should not be construed as representing the views or decisions of the committee The committee recommendations will be made in due course

ABOUT THE AUTHOR

This report on the sales tax was prepared by Dr. Harold M. Somers, chairman of the Department of Economics at U C L A Dr Somers received his Ph D in economics from the University of California at Berkeley and his LL B from the University of Buffalo Law School

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Dr Somers has published widely in the areas of economics and taxation He is the author of a book, *Public Finance and National Income,* and a contributor to volumes on *Growth of the American Economy* and *Taxation and Business Concentration.*

Among his contributions to professional publications are·

"What Generally Happens During Business Cycles—and Why," *Journal of Economic History*, summer 1952 (Review article)

"The Place of the Corporation Income Tax in the Tax Structure," *National Tax Journal*, September 1952 (Review article)

"'Cost of Money' as the Determinant of Public Utility Rates," *Buffalo Law Review*, spring 1955 (Article)

"Estate Taxes and Business Mergers," *Journal of Finance*, May 1958 (Paper presented to American Finance Association, Philadelphia, December 1957) (Article)

"Reconsideration of the Capital Gains Tax," *National Tax Journal*, December 1960 (Article)

"Theoretical Framework of Sales and Use Taxation," *Proceedings of the Fifty-fourth National Tax Conference 1961* (National Tax Association) (Article)

"Capital Gains Tax· Significance of Changes in Holding Period and Long-term Rate," *Vanderbilt Law Review*, June 1963 (Article)

Dr Somers was assisted in the preparation of this report by Joseph J Launie, who is a teaching assistant and graduate student at U C L A Mr Launie was previously a member of the research staff of the Bureau of Business and Economic Research at the University of Nevada

I

INTRODUCTORY

This is a study of the sales tax, with special reference to California We begin with a detailed description of California's sales and use taxes (II) based on the presentation of the Honorable John W Lynch, member of the Board of Equalization, and comments made by members of the board's staff. This is followed (III) by a broad survey of existing sales taxes in the United States and a technical economic analysis of the implications of sales taxation We then plunge into three major questions. the *regressivity* of the sales tax (IV); the taxation of *services,* in other states (V and VI), and the probable revenue effects (VII) and regressivity effects (VIII) of taxing services in California; and the nature and cost of sales tax *exemptions* in California (IX) and the crucial role they play in tax policy (X).

II

CALIFORNIA SALES AND USE TAXES[1]

The state sales tax and the complementary use tax, together produced $813,587,000 in the fiscal year 1962-63 These taxes accounted for more than two-fifths of all General Fund income

Nature of the Tax

The California retail sales tax, originally effective August 1, 1933, is a privilege or excise tax imposed upon retailers selling tangible personal property at retail Contrary to popular impression, it is not collected from the purchaser as a tax on him The retailer is required by law to state separately the amount he charges the purchaser by way of reimbursement for the tax But, according to the California Supreme Court, "The amount added because of the tax is paid to get the goods and for nothing else Therefore, it is a part of the price "[2]

The measure of the tax is the "gross receipts" of the retailer The law specifically defines "gross receipts," which constitute, in essence, the total amount of the agreed sales price As the tax is measured by "gross receipts," no deductions are allowed for the usual costs of doing business or expenses, deductions which are characteristic of net income taxes One exception is the bad debt deduction first authorized by amendment in 1957.

The subject of the tax—that is, the "sale" of tangible personal property at retail—is defined generally as the transfer of title to tangible personal property for a consideration The law, however, defines "sale" more broadly than the usual concept of sale. Thus, under the law's definition, a "sale" includes not only the transfer of title to tangible personal property, but the "producing, processing, fabricating, printing or imprinting of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating, processing, printing, or imprinting " For example, if a person buys a bolt of cloth and takes it to a tailor who makes a suit from the cloth the tailor's charges are taxable, even though he furnishes no material Similarly, a printer's charges for printing are taxable even though the customer furnishes the paper stock. This provision is essential to prevent the breaking down of the tax base by the device of buying raw materials from one source and having the finished product produced elsewhere, and to prevent a competitive disadvantage to those merchants who sell a finished product as against those who specialize in fabricating or processing

[1] Derived from statement and discussion by the Honorable John W Lynch, Member of the Board of Equalization in *California's Tax Structure 1964*, Part I, pp 93–100. (Sacramento Assembly Interim Committee on Revenue and Taxation, Hon. Nicholas A Petris, Chairman, January 1964.)

[2] *Western Lithograph Co. v. State Board of Equalization*, 11 Cal 2d 156.

A "sale" also includes by definition the transfer of possession of tangible personal property when the transferor retains title to secure payment of the purchase price, and the transfer of possession of tangible personal property produced, fabricated, or printed to the special order of the customer

To be a retailer subject to the tax, one must be engaged in the business of selling tangible personal property The law specifically defines a retailer Generally, the term encompasses any person making three or more sales in any 12-month period The term "person" includes corporations, partnerships, etc , as well as individuals The application of the tax is not limited to sales in the ordinary course of a business It applies to a retailer's sales of capital assets and to sales of any tangible personal property "held or used" in a selling activity.

Exemptions

There are, of course, a number of exemptions Commencing with 4 exemptions in August of 1933, the number had grown to 23 immediately prior to the 1963 amendments to the law.

For the first time, the Legislature, in 1963, cut back the number of exemptions. It repealed the exemption of sales of meals by employers and employee organizations to employees and the exemption of food products to the extent that they are sold by "drive-ins" It also repealed a provision adopted two years earlier, by which certain nonprofit organizations were considered to be consumers rather than retailers of certain classes of merchandise which they sold

The principal statutory exemptions in the law today include sales of

Food products for human consumption, except meals and sales at drive-ins,
Motor vehicle fuel subject to the gasoline tax,
Food-producing animals, seeds and annual plants, and fertilizer,
Newspapers and periodicals,
Aircraft for air carrier use or use outside the state by nonresidents,
Interstate watercraft, deep sea fishing vessels, and component parts of each type,
Ice for use in interstate food shipments,
Gas, electricity and water for pipe or line delivery, and
Certain medicines for treatment of humans

They also include

"Occasional sales," consisting of sales by nonretailers, property not held or used in a selling activity and not constituting a series of sales, and sales of entire businesses between entities having substantially similar ownerships,
Sales to the United States and its wholly owned agencies and instrumentalities,
Sales by certain charitable organizations; and
Sales to certain common carriers

In addition to exempt sales, nontaxable receipts include receipts from rentals not in lieu of sales, receipts from the installing or applying of the property sold, and, in some cases, charges for delivering the property sold.

Leases of Equipment by Banks

There are also certain organizations exempted from a sales tax because of provisions of the California Constitution or the United States Constitution Thus, banks and insurance companies, which pay an "in lieu" tax, are exempted from the sales tax as to sales by them The use tax, however, which is imposed directly upon consumers, applies

to property purchased from banks and insurance companies All banks under the California Constitution are exempt from any tax imposed directly upon them, except as provided by the Constitution and this is on their net income and real property, so the sales tax or the use tax cannot be levied directly upon a bank in California. The bank, however, is required to collect the use tax from the buyer, and sales to banks are subject to sales tax which is levied on the seller, not on the buyer If they buy property under circumstances that would normally subject the buyer to use tax the bank would not pay any tax with respect to the new property either upon its acquisition or upon its leasing except in the case "in which the lease is virtually or should we say, for all intents and purposes a fake " Then the bank would be required to collect the use tax, but if it were an ordinary rental the amount in lieu of the sale if the bank acquired the property from other than a California vendor, would escape taxation altogether [1]

If the banks increase their activities in the leasing field it would result in loss of revenue and in unfair competition relative to other retail business If the bank buys any kind of equipment and leases it out, there is no sales tax except where the lease is a long-term lease that might be considered in lieu of a sale, in which case it becomes a lease purchase and then the use tax would apply against the purchaser from the bank But if it were a legitimate lease there would be no tax It would have to be a lease in lieu of a sale If a bank went into the leasing business, automobiles for instance, and they purchased vehicles in California from a seller of vehicles here in California, then a sales tax would be paid But if they purchased them in Detroit, there would be no sales tax, because the bank would acquire title outside California, pay no sales tax, and be exempt from the use tax So by the simple device of purchasing outside of the state, they would escape the tax

Rental transactions are of two types those "in lieu of sales" and ordinary rentals As receipts from ordinary rentals are not subject to the sales tax, the renting of merchandise, which has rapidly expanded in recent years, is only partially subject to the sales tax, the sale to the lessor being the final sale to which the tax applies When the lessor is also the manufacturer, the tax base is obviously drastically reduced. The significance of the expanded rental business on sales tax revenues is emphasized by the recent entry of banks into the rental business [2]

The use tax was adopted one month less than two years after the sales tax went into effect It was a virtual necessity to avoid loss of business and the sales tax generated by such business, which was being diverted to taxfree states, along California's border and elsewhere. For the most part, the use tax has the same exemptions as the sales tax, so that it is, in effect, a complementary tax applying to property purchased for use in California from out-of-state sellers, or from California sellers who are exempted from a tax imposed directly upon them, as in the case of banks and insurance companies

The ownership of personal property by a bank for use in a leasing business will also create property tax problems at local levels of gov-

[1] Attorney Stetson of the board in response to a question by Assemblyman Tom Carrell, *op cit*, pp 95–96

[2] Ibid, including discussion of Assemblymen William Stanton, Tom Carrell and Pierce Young

ernment Under the in-lieu provisions of the Bank and Corporation Tax Law and Section 16 of Article XIII of the Constitution, banks are exempt from tax on personal property Accordingly, unless legal support can be found for taxation of the property to the lessee, the property will escape taxation for the support of local government.[1]

Local Sales and Use Taxes

Commencing April 1, 1956, a tax innovation came into being with the advent of the Bradley-Burns Uniform Local Sales and Use Tax Law This law authorizes counties to impose a sales and use tax to be administered by the board, and permits cities to have their sales and use tax ordinances administered by the board, provided the ordinance of the county or city conforms to the requirements of the Bradley-Burns Law This law requires that the county ordinance be at the rate of 1 percent, and that the city ordinance be at the rate of 1 percent or less The city tax constitutes an offset against the county tax so that the taxpayer always pays 1 percent If the city tax is less than 1 percent, the difference goes to the county on sales made within the city

For uniformity purposes and convenience to retailers, the place of sale for the purpose of the local tax is declared by the law to be the place of business of the retailer The local ordinances are required to provide the same exemptions contained in the State Sales and Use Tax Law with two in addition One of these relates to sales tax on sales to common carriers and waterborne vessels, and the other to use tax on purchases by public utilities subject to regulation by the Public Utilities Commission These exemptions complicate administration of the local ordinances While there was some basis for them prior to the time all of California's 58 counties adopted local sales and use tax ordinances, it would seem that these exemptions are now unwarranted.[2]

Effect of Exemptions on Sales Tax Revenues

Exemptions reduce state and local revenues by hundreds of millions of dollars a year This review is concerned with (1) the effect exemptions have on administration, (2) the burden they place on the merchants who are required to collect or reimburse themselves for the tax from their consumers, and (3) inequities created by exemptions

Some of the favorable aspects of exemptions are examined in Chapter X.

Experience demonstrates that generally broad-based taxes using lower rates tend to be more equitable than narrow-based taxes with higher rates. Exemptions reduce the base Consequently, higher rates are required to produce a given amount of revenue Once an exemption is adopted, efforts are made to enlarge its scope Experience has produced the expression "exemptions beget exemptions" When individuals and businesses can choose between items subject to tax and those not subject to tax, manipulations result which invite pressures from others for a broadening of exemptions to eliminate unfair competition

In 1933, when the tax was first adopted, all food was subject to sales tax In 1935, food for home consumption was exempted from the tax on the grounds that to tax food made the sales tax excessively regres-

[1] Lynch, *op cit*, p 97
[2] Lynch, *op cit*, pp 97–98

sive. The original food exemption covered only food In 1940, it was enlarged to include food-producing livestock and poultry. This, in turn, was further expanded in 1943 to include animal life for food production Exemptions were also provided for feed for food-producing animals, and seeds, annual plants, and fertilizer for food production Two years later an exemption was provided for ice used to preserve food during interstate shipments, and nine years later this exemption was further broadened to include dry ice.

Not only do exemptions reduce the amount of revenue that the state and local jurisdictions can realize from sales taxes, but they also increase the cost of administration. The board is required to establish through audit the validity of exemptions claimed by taxpayers. The auditing process is expensive because it involves examining records of merchants By the same token, exemptions increase the merchants' cost of doing business since they must maintain adequate records to support any exemptions that they claim This cost must necessarily be passed on to consumers at least in part

The consumers are not only required to pay for any extra records that merchants must maintain to substantiate claimed exemptions, but they also are plagued with the confusion which an excessive number of exemptions invariably creates The average consumer does not have adequate knowledge of what is and what is not taxable, so he cannot determine if he is being properly taxed At times a shopkeeper finds it virtually impossible to make a proper decision as to whether a particular item is taxable There are areas where considerable doubt exists

To illustrate, note the situation with respect to the sale of fertilizer The housewife goes into a grocery store or a nursery to purchase a package of commercial fertilizer The merchant should inquire at the time of the sale whether the fertilizer is to be used for growing vegetables or flowers This information is necessary because fertilizer used for growing food is exempt from sales tax while fertilizer used for the growing of flowers is subject to sales tax This situation also applies in the case of sales to farmers If a farmer is utilizing fertilizer to produce food for human consumption, the fertilizer is exempt from tax When fertilizer is used to produce hay for race- or workhorses, the question whether it is subject to tax would depend upon the use to which the hay will ultimately be put Hay grown primarily for the feeding of racing horses would be subject to tax, while that used for feeding cattle would be exempt Food for human consumption is exempt, but food supplements are subject to tax Milk products are exempt, but when chocolate is added creating a confection, the tax applies Salt for brine used to cure olives is subject to tax because it is consumed in the curing process, but olives are not subject to tax If, however, the olives were sold in the brine, neither the brine nor the olives would be subject to tax These examples may sound farfetched yet there are literally thousands of such decisions that merchants in the food business must make daily [1]

The foregoing discussion does not represent an argument for either the elimination or retention of any exemption These examples are given to call attention to the adverse effect of exemptions on the tax base, on the cost of administration, and on the reporting burdens of

[1] Lynch, *op cit*, p 99

taxpayers, as well as to the confusion they create for the sellers and purchasers of tangible personal property.[1]

It was noted above that the 1963 Legislature was the first one to cut back the number of exemptions This will produce $13½ millions of additional sales tax revenue yearly for the state and one-third this amount for cities and counties.[1]

The elimination of the exemption of food for off-premises consumption was restricted to drive-ins This restriction may place some drive-in operators at a competitive disadvantage with respect to Chinese restaurants, pizza houses, and other establishments that can sell prepared food for off-premises consumption without having to charge a sales tax This situation points up the fact that exemptions often create an advantage for one group at the expense of another [1]

Despite all of the exemptions and other complications inherent in sales and use tax administration, the board is able to collect these taxes at an expenditure of $1 53 for each $100 of collections [2] The tax itself is collected by the businessman and then sent on to the board. But as far as recordkeeping is concerned he gets no benefit from the board [2] The cost of collecting a sales tax is comparable to the cost of paying your income tax "If a businessman doesn't have his prices high enough to pay his income taxes, he's not going to stay in business, and the same with his property taxes He's got to sell his product at a sufficient price to pay his taxes, and pay himself a profit, or else he doesn't last very long " [2] An attempt to compensate people for collecting the taxes would be inefficient, inequitable, and terribly costly [3] The sales tax is a privilege tax for the right to do business, it was not until the 1961 Legislature that the board ever had an official statement of the tax chart. Before that, the board had no business with the charts [4] "It isn't a tax, it's a privilege fee " [5]

[1] Lynch, *op cit*, p 99
[2] Lynch, *op cit*, p 100
[3] *Ibid* (in response to a question by Assemblyman William Stanton)
[4] *Ibid* (in response to a question by Assemblyman Tom Carrell).
[5] *Ibid*

III

THE SALES TAX AND ITS ECONOMIC IMPLICATIONS

The sales tax is one of the most controversial taxes in the United States It is widely used by state and local governments and is highly productive of revenue There is much opposition to it however, on the claim that it is "regressive" It is generally regarded as being far inferior to the income tax by almost every acceptable criterion

This study is not intended to make a positive case for or against the sales tax so much as to clear away some of the false issues that still hound it in respectable circles The sales tax can then be considered on its merits, rather than on unfounded rumors or outmoded misconceptions Theoretical and statistical research of recent years has cast doubt on the assumptions and presumptions of the past

VARIATIONS AMONG STATE SALES TAXES

As is the case with most state and local legislation, state laws vary widely in their scope and tax rates The various rates and types are shown in Table 1 In most of the states that employ the retail sales tax, revenue from this source far exceeds the revenue from state personal income taxes The broad tax base provided by the retail sales tax generates a great deal of revenue with relatively low rates

There are extremely wide variations among the state laws with regard to the items subject to a state sales tax Food consumed off the premises is subject to tax in some states and not in others The tax status of many commodities varies widely from one jurisdiction to the next Table 2 indicates the coverage in the various sales tax states in a recent year

SIGNIFICANCE OF EXEMPTIONS

There are three basic reasons for exemptions in a sales tax law These are.

(1) Inclusion of the commodity or service would make the tax too regressive

(2) The commodity or service is of such a nature that there would be an excessive administrative burden involved in collecting the tax

(3) The commodity in question is not a final good If a producer must pay a sales tax on machinery, component parts or raw materials, this will increase his costs and result in tax pyramiding

We may consider each of these briefly (1) One of the basic precepts governing taxation is that a given tax should be assessed according to the taxpayer's ability to pay. A regressive tax, in which the tax burden decreases as the ability to pay increases, violates this precept A regres-

sive tax is therefore considered to be inequitable Food purchased for consumption at home is an example of a commodity which has been made tax exempt because of its effect on regressivity This subject will be discussed in much greater detail in a later chapter of this study

(2) The administrative difficulties involved in the collection of a sales tax imposed on certain services has been a reason frequently advanced for the exclusion of most services from general sales taxes While these arguments may have been quite valid during the 1930s when many sales tax laws were first enacted, the detailed records required of business by various laws, and modern data processing techniques, may well make it possible to overcome this hurdle of excessive administrative expense

(3) Retail sales taxes are generally intended to be borne by the final consumer. It is the intention of most general sales tax laws to cover only final or consumer goods For this reason, many state laws exclude machinery, raw materials and component parts from their general sales tax This is certainly desirable for otherwise there will be double taxation If a business firm must pay retail sales taxes on intermediate goods which it purchases, the costs to the firm are increased by the amount of the tax If the firm then passes the tax forward, it must increase the price of its final goods The consumer then pays the retail sales tax on the higher final price If the good passes through many stages of production, as is highly likely in modern industry, there is an opportunity for multiple tax pyramiding This will serve to magnify the distorting effect of the tax on relative prices

If these three reasons for exemptions were independent, then the exemption of any particular good or service could be evaluated on the basis of how it relates to each particular facet, such as regressivity Unfortunately, however, the exclusion of goods or services from taxation because of administrative difficulties affects the regressivity of the tax The taxation of services is a good case in point If upper income families spend a larger percentage of their income on services than lower income families, the exclusion of services from taxation makes the tax more regressive or less progressive than it might be

The specific exemptions in the sales tax are undoubtedly granted for good reason There are some economic consequences, however, that cannot be ignored One of the problems of an indirect type of tax such as the sales tax is that by changing the prices of various commodities it affects consumer choice If the original relative price structure was economically efficient, as is usually assumed, then any distortion caused by the tax must lead to an inefficient and less desirable result It may be assumed that the distortion of relative prices will be smaller the wider the tax base and the fewer the exemptions If all goods and services are subject to a sales tax at the same rate, then relative prices will change relatively little and the primary effect of the tax will be a decrease in overall purchasing power Conversely, the more exemptions and exclusions that a law contains, the greater the change in relative prices This is particularly true if this law is compared with a completely general sales tax which yields the same amount of revenue but with a lower rate made possible by its broader base

TABLE 1

Type of Sales Tax and Rates Levied, by State and by Type of Transaction, August 1964

State	Type of tax	Rates levied					
		Retail	Wholesale	Extractive	Manufacturing	Personal and professional services	Wages, interest, rent, dividends
Alabama	Gross receipts	4 000% [a]		1 500%	1 500%		
Alaska	Gross receipts	$20,000 to $100,000 at 500%, over $100,000 at 250%					None
Arizona	Gross income	3 000%		1 500%			
Arkansas	Gross receipts	3 000%					
California	Gross receipts	3 000%					
Colorado	Retail sales	2 000%					
Connecticut	Retail sales	3 500%					
	Unincorporated gross income	13% 1st $60,000, 20% over	035% 1st $60,000, 065% over		13% 1st $60,000, 20% over		
Delaware	Gross receipts license	$5 plus 1/7 of 1%	$5 plus 1/7 of 1%		$5 plus 025%		
District of Columbia	Gross receipts	3 000%					
Florida	Retail sales	3 000% [b]					
Georgia	Retail sales	3 000%					
Hawaii	General excise	3 500%	500%	500%	500%	3 500%	
Illinois	Retail sales	3 500%					
Indiana	Retail sales	2 000%					
	Gross income	500%	500%	2 000%	2 000%	2 000%	2 000%
Iowa	Retail sales	2 000%					
Kansas	Retail sales	2 500%					
Kentucky	Retail sales	3 000%					
Louisiana	Retail sales	2 000%				2 000% [c]	
Maine	Retail sales	4 000%					
Maryland	Retail sales	3 000%					
Michigan	Retail sales	4 000%					
	Business receipts	775%	775% 125%	775%	775%	.775%	
Mississippi	Retail sales	3 500% [b]					
Missouri	Retail sales	3 000%					
Nevada	Retail sales	2 000%					

New Mexico	Gross income	3 000% [a]	500% [d]	3 000%		3 000%
North Carolina	Retail sales	2 000%	050%			
North Dakota	Retail sales	2 250%				
Ohio	Retail sales	3 000%				
Oklahoma	Retail sales	2 000%				
Pennsylvania	Retail sales	5 000%				
Rhode Island	Retail sales	3 500%				
	Unincorporated business [e]	200%	100%	200%	200%	200%
South Carolina	Retail sales	3 000%				
South Dakota	Retail sales	2 000%				
Tennessee	Retail sales	3 000%				
Texas	Retail sales	2 000%				
Utah	Retail sales	2 500%				
Vermont	Meals and rooms	3 000% [f]				
Virginia	Merchants license	200%	$50 1st $10,000 gross purchases plus 13% over $10,000			
Washington	Retail sales	4 000%				4 000% [e]
	Business and occupation	0044%	0044%	0044%	0044%	0044%
West Virginia	Retail sales	2 000%				
	Occ gross income	500%	250%	Varies from 1 35% to 7 87%	4000%	1 0500%
Wisconsin	Selective retail sales	3 000%				3 0000% [c]
Wyoming	Retail sales	2 000%				

Source *State Sales Tax Reporter* (Chicago Commerce Clearing House, Inc), Vols. I–IV.

[a] Except automobile and truck sales at 1½%
[b] Except automobile and truck sales at 2%
[c] Personal services only
[d] Alcoholic beverages only.
[e] An exemption of $5,000 granted to all taxpayers
[f] Meals including alcoholic beverages and transient rentals of less than 30 days' consecutive occupancy only

(Note Format derived from Ohio Department of Taxation, *Retail Sales Tax Comparative Tables*, pp 3-4 Columbus, 1956)

TABLE 2

Taxable Status of Selected Commodities, Services, and Sales to Institutions Under State Sales and Use Tax Laws—March 1962

	Retail sales tax																		
	Ala	Ark	Calif	Colo	Conn	D C	Fla	Ga	Ill	Iowa	Kan	Ky	La	Me	Md	Mich	Mo	Nev	N D	Ohio
Food																				
Used in home	A	A	B	A	B	A[1]	B	A	A	A	A	A	A	B	B	A	A	A	A	A
Restaurant meals	A	A	A	A	B[2]	A	A	A	A	A	A	A	A	A	B[2]	A	A	A	A	A
School lunches	B	B	B	B[3]	B	—	B	B	B	B	B	B	B[3]	B	B	B	B	B	B[3]	B
Free meals to employees	B	B	B	B[3]	B	—	A	—	B	B	B	—	B[3]	B[6]	B	A[7]	B	B[6]	A	A
Meals served by churches, etc	—	B	B	B[3]	B	—	A	—	B	B	B	B[3, 97]	B[3]	B	B[3]	B[3]	B[10]	A	B[3]	B
Industrial production—goods used in																				
Component part or raw material	B	B	B	B	B	B	B	B	B	B[12]	B	B	B	B	B	B	B	B	B	B
Fuel, electricity[14]	B	A	*	B	B	B	B	A	A	B	B	B[93]	A	A	B	B	A	A	A	B
Machinery and equipment[15]	B[16]	A[112]	A	A	B	A	A[15]	A	A	A[99]	A	A[99]	A	A	A	A	B	A	A[91]	B
Office equipment and supplies	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A[21]	A	A	A[23]	A
Nonreturnable containers, labels, etc	B	A	B	B	B[22]	B	B	B[22]	B	B	B	B	B	B	B[22]	B	B	B	B	B
Agricultural production—goods used in																				
Feed, seed, fertilizer	B	A[24]	B[25]	B	B	B	B	B	B	B	B	B	B[27]	B	B	B	B	B	B	B
Machinery	A[29]	A	A	A	A	A	B	A	A	A	A	A	A	A	A[29]	B	A	A	A	B
Other commodities																				
Alcoholic beverages	A	A	A	B	A	A	A	A	A	A	B	B	A	B[34]	A	A	A	A	B	A[35]
Automobiles	A[37]	A	A	A	A	B	A[38]	A	A	B[115]	A[109]	A[103]	A	4,39 100	B[40]	A[36]	A	A	A	A
Cigarettes	A	B	A	B	B	B	A	A	A	A	B	A	A	B	A	A	A	A	B	B
Clothing	A	A	A	A	B[42]	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A
Farm products (retail)	B	B	B[46]	A[46]	B	B	B	A	A[46]	A	A	A[101]	B	B	B	A	A	A[45]	A	B[47]
Ice	B	A	A[49]	—	A[49]	B	B	A	A	A	A	A[102]	A	A	B	A	A	A	A	B
Medicine	A	A	B[50]	A	B[50]	B	B	A	B[50 69]	A	A	A	A	B[50]	B	B[51]	A	A	B[50]	B[52]
Motor fuels	B	B	B	B	B	B	B	A	A	B	B	B	B	B	B	A	B	B	B	B
School textbooks	A	—	A	A	—	—	B	A	—	B[53]	—	A[103]	A	—	A	B[53]	A	A	B[53]	B[53]
Occasional sales	B	B	B	A	B	B	B	B	B	B	A	B	B	B	B	B	B	B	B	B
Occasional sales—automobiles	B	B	B	A	A	A[55]	A	B	B	B	A	B	B	B	A	A[55]	A	A	B	A
Utility services																				
Gas (domestic use)	B	A	B[57]	A	B	A	B	A	B[61]	A	A[62]	A	B	B	A	A	A	B	A	B
Electricity (domestic use)	B	A	B	A	B	A	B	A	B[61]	A	A[63]	A	B	A	A	A	A	B	A	B
Water (domestic use)	B	A	B[67]	B	B	A	B	A[59]	B[61]	A	A	A	B	A	B	B[67]	A	B	B	B
Communications	B	A	B	A	B	B	B	A	B	A[62]	A	A	B	A	B	B	B	B	A	B
Transportation	B	B	B[68]	B	B	B	B	A[60]	B	B	B	B	B	B	B	B	A	B	B	B
Other services																				
Admissions	A	A[76]	B	B	B	B	B	A[96]	A	B	A[75, 77]	A[75]	A	A	B	B[78]	B	A	B	A[75]	B
Newspapers[80]	A	B	B	B	B	B	B	A	B	B	B	B	A	B	B	B	B	B	B	B
Transient lodgings[82]	A[82]	A	B	A	A	A	A	A[82]	A[82]	B	A	A[82]	A	A[83]	B	A	A	A	B	B
Leases and rentals of tangible personal property	B[5]	A	B	A	B	A	A	A[86]	A	B	A	B[98]	A	B	A	A[90]	A	B	A	A
Institutions—sales to																				
Charitable and religious	B	B[93]	A	B	B	B	B	B	B	B	B	A[104]	A	A	B	B	B	B	B	B
State and subdivisions	B	A[91]	A	B	B	B	B	B	A	B	B	A	A	B	B	B	B	B	B	B

Taxable Status of Selected Commodities, Services, and Sales to Institutions Under State Sales and Use Tax Laws—March 1962

	Retail sales tax										Gen sales N C	Gross receipts						Totals		
	Okla	Pa	R I	S C	S D	Tenn	Tex	Utah	Wis	Wyo		Ariz	Hawaii	Miss	N M	Wash	W Va	A	B	—
Food																				
Used in home	A	B	B	A	A	A	B	A	B	A	B	A	A	A	A	A	A	27	10	
Restaurant meals	A	B[3]	A	A	A	A	A	A	A	A	A	A[4]	A	A	A	A	A	34	3	
School lunches	B	A[5]	B	B	B[3]	B	B	B	B	—	B	A	A	B	—	B	B	3	31	3
Free meals to employees	A	—	B	B	B[6]	B[6]	—	A	B	A	—	B	—	—	B	A	B	9	20	8
Meals served by churches, etc	B	B[6]	—	—	B[6]	A	A	B	B	—	—	A	B	B	—	B[6]	—	5	22	10
Industrial production—goods used in																				
Component part or raw material	B	B	B	B	B	B	B	B	B	B	B[15]	B[6]	B[13]	B[12]	B[13]	B	B	----	37	
Fuel, electricity[14]	B	B	B	B	A[16]	A[16]	B[108]	A	B	A	A[70]	A	A	A	A	A	A	20	17	
Machinery and equipment[19]	B	B	A	B	A	A	A	A	B	A[20]	A[71]	A	A	A	A	A	B	27	10	
Office equipment and supplies	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A[23]	37		
Nonreturnable containers, labels, etc	B	B	B	B	B[23]	B	B	B	B	B	B	B	B	B	A	B	B	2	35	
Agricultural production—goods used in																				
Feed, seed, fertilizer	A[23]	B	B	B	A[75]	B	B	B	B	B	B	A[76]	A	B	B	B	B	5	32	
Machinery	A	B	A	B	A[23]	A	B	A	B	A	B[13]	A	A	A[21]	B[22]	A	B	27	10	
Other commodities																				
Alcoholic beverages	A[25]	A	A	A	B	A	B[107]	A[113]	A	B	B[26]	A	A	A	A	A	A	28	9	
Automobiles	B[63]	A	A[29]	A	B	A	B[60]	A[82]	A[72]	A	A[41]	A	A	A[42]	B[29]	A[30]	B[40]	29	8	
Cigarettes	B	B	B	A	B	B	B	A	A	B	A	A	A	A	A	A	A	22	15	
Clothing	A	B[44]	A	A	A	A	B[105]	A	B	A	A	A	A	A	A	A	A	33	4	
Farm products (retail)	B	B	A	B[17]	B	A	B[109]	A[42]	B	A	B	B	A	B	B	B[48]	A	16	21	
Ice	A	A	A	A	A	A	A[110]	A	B	A	B	A	A	A	A	A	A	29	7	1
Medicine	A	B[50]	B	A	A	B	A	B	A	B[30]	A	A	A	A	A	A	22	15		
Motor fuels	B	B	B	B	B	B	B	B	B	B	B	B	A	A	B	B	B	5	32	
School textbooks	A	A	—	B	—	B	A	B[34]	B	—	B	B	A	B	B	A	B	14	14	9
Occasional sales	A	B	B	A	B	B	B	B	B	A	B	B	A	B	B	B	B	5	33	
Occasional sales—Automobiles	A	A	B	B	B	B	B	A	A	A	A[36]	B	A	B	A[36]	A	A	20	17	
Utility services																				
Gas (domestic use)	A	A	A	A	A	B[64]	A	A	B	A	B	A[37]	B[114]	A[39]	A	B[13]	B[111]	22	15	
Electricity (domestic use)	A	B	A	A	A	B	A	A[65]	B	A	B	A[37]	B[114]	A[39]	A	B[13]	B[111]	22	15	
Water (domestic use)	B	B	A	B	A[39]	B	B	B	B	B[37]	B	A[37]	B[114]	A[39]	B	B[13]	B[111]	13	24	
Communications	A	A	A	A[62]	A	B	B	B	A	A[73]	A	B	A[37]	B[114]	A	A[62]	B[13]	B[111]	19	18	
Transportation	A[115]	B	B	B	B[62]	B	B	A[119]	B	A[35]	B	A[37]	B[114]	A[62]	A	B[111]	B[112]	8	29	
Other services																				
Admissions	A	B	B	B[105]	A[75 77]	B[78]	B	A	A[74]	A	B[78]	A	A	A	A	B	A	20	17	
Newspapers[33]	B	A	B	B	B	A	B	B	B	B	B	A	A	A	B	B	A	9	28	
Transient lodgings[31]	A	A	A	A[83]	B	A[63]	B	A[83]	A	A	A[82]	B	A	A	A	A	A	29	8	
Leases and rentals of tangible personal property	A	A	A	B	B	A[87]	A	A	B[75]	A	A[85]	A	A	A	A	B[33]	A[39]	26	11	
Institutions—sales to																				
Charitable and religious	B[92]	B	B	A	B	B	B	B	B	B	B	B[94]	A	B	A	A	B	7	30	
State and subdivisions	B	B	B	A	B	B[93]	B	B	B	B	B	B	A	B[95]	A	A[5]	B	9	28	

A Taxable B Nontaxable — No provision *Gas and electricity exempt in California, other fuels taxable (revised from Indiana report)

Sources State statutes, regulations, and CCH *State Tax Reporters*
Reproduced from Indiana Commission *Final Report*, 1962, "The Retail Sales Tax," pp 36–41.

FOOTNOTES

1 Taxed at 1 percent rate
2 Meals over $1 are taxed
3 Exemption applies only to meals below $0 50
4 Taxed at 1½-percent rate
5 Food purchased for such purposes is taxable
6 No specific provision, probable status shown
7 Taxable on basis of 25 cents per meal
8 If meals are served only occasionally
9 If proceeds are used for religious purposes
10 Not open to general public
11 Charitable organizations not exempt
12 Sales of building materials and supplies to owners, contractors, and builders are taxable
13 Subject to wholesale tax rate
14 Fuel and electricity, if exempt, are exempt only if used directly in industrial processing
15 Exempt from use tax
16 Exemption if fuel comes in direct contact with and consumed rapidly in the processing of manufactured supplies
17 Machinery and equipment, if exempt, are exempt only if used directly in industrial processing
18 Exempt from use tax if used for replacement or expansion of existing facilities
19 Taxed only if machinery sale is over $1,000
20 Equipment and industrial materials not readily obtainable in the state are exempt
21 Except for offices directly related to industrial processing
22 Except where used directly in making retail sales.
23 Includes returnable containers
24 Livestock feed and seed cotton are exempt
25 If used to produce goods for human consumption
26 Commercial feeds taxed at wholesale rate of ¾ percent
27 Feed is taxed
28 Feed is exempt
29 Tractors taxable at 1½ percent
30 Taxable at 2 percent
31 Tractors taxable at 1 percent.
32 Tractors are taxed
33 Used farm machinery is exempt
34 Exempt if sold in state liquor stores
35 Beer and malt beverages exempt
36 Beer and wine are taxable, liquor not
37 Taxed at 1½ percent.
38 Taxed at 1 percent
39 Except vehicles sold to nonresidents
40 Taxed at same rate under another law.
41 Taxable at 1 percent with maximum tax of $80 To be 1½ percent, July, 1962
42 Taxed at 2 percent
43 Children's clothing only
44 Formal apparel, furs, and jewelry not exempt
45 Exemption applies only to animals used for food
46 Sales of breeding stock are exempt
47 Direct sales of food items only are exempt
48 Farmers may procure free certificates up to $1,200 of sales
49 Exempt if used in packing food and shipped in interstate commerce.
50 Prescription sales only are exempt
51 One-half the price of prescriptions is exempt
52 Prescriptions, artificial limbs, and prescribed support devices are exempt
53 Exempt if sold by school board
54 Only when sold to schools
55 Taxed under separate 2-percent titling law
56 Taxed at 1-percent rate
57 If delivered through pipes or mains
58 If billed separately after sale is made
59 Municipal utilities exempt
60 Only local telephone service is taxed
61 Taxed at same rate under service occupational tax law
62 Includes radio
63 Gas and electricity used in farming are exempt
64 Natural gas is exempt
65 REA cooperatives are exempt
66 Bus and cab fares of less than 25 cents and receipts from transportation of farm products are exempt
67 Taxed at 1½-percent rate
68 Includes pipelines
69 Purchases of drugs by pharmacists for filling prescriptions are taxable
70 Fuel is taxed at only 1 percent
71 Machinery and parts are taxed at only 1 percent with a maximum tax of $80 on a single article
72 Motor vehicles are taxable except buses and trucks and semitrailers sold to common or contract carriers
73 Tax applies only to intrastate telegraph services to business, industrial, professional, and commercial users and local basic rate telephone services to the same users
74 Exempt are movie admissions of 75 cents or less and admissions to activities of schools and religious or charitable groups
75 Except state, county, or local fairs
76 Exempt if the sale of the property to the lessor was subject to sales or use tax
77 Admissions for charitable or educational purposes are exempt
78 Taxed under separate admissions tax at ½-percent rate
79 Admissions to theaters are taxed at 1 percent under separate law
80 In many or most states, sales of magazines and other periodicals also are exempt
81 Taxes normally apply to lodgings of less than a month
82 Taxed at same rate under separate law
83 If for less than 90 days
84 Taxable where rental is in lieu of sale or property is substantially consumed during lease
85 Except lease of motion picture films
86 Leases or rentals of less than seven days are exempt
87 Rentals from films, recordings, and transcriptions are exempt

[89] Lease with option to buy is taxable
[90] Except rentals of motor vehicles which have paid motor vehicle registration tax
[91] Exemption applies to nonprofit hospitals and children's homes but materials for construction and repair are taxable
[92] Except on foodstuffs used for free distribution to poor or to public, penal, and eleemosynary institutions. School buses sold to school districts are exempt
[93] Religious organizations are exempt except when engaged in business for profit
[94] Includes scientific and educational institutions
[95] Taxable when competing with private business
[96] Exemption applies only to hospitals
[97] Racing admissions are exempt
[98] Exemption applies only to religious societies
[99] Exemption applies to all coal for the manufacture of electricity and fuels used in manufacturing, mining, or refining to the extent that the cost of the fuel exceeds 3 percent of the cost of production
Exempt are sales of machinery for new and expanded industry and industrial tools with a useful life of less than one year
[100] The value allowed for a motor vehicle traded in for another is not taxable
[101] Sales of livestock for breeding, poultry for egg production, and livestock for use in farming are exempt

[102] Exempt if sold for use in ice drinks
[103] All sales by educational institutions to own students are exempt.
[104] Hospitals are exempt from use tax on out-of-state purchases
[105] Taxed under separate admissions tax law at 10 percent
[106] Only gas and electricity used in industrial processing are exempt, other fuels taxable
[107] Taxable if served with meals
[108] Work clothing and any outer apparel are exempt if not exceeding $10
[109] Exempt if food for human consumption
[110] Exempt if used in packaging
[111] Gross receipts are taxable at various rates under other laws
[112] Manufacturing machinery is subject to the Arkansas sales tax but exempt under the use tax if the machinery is not available within the state
[113] Sales of raw materials to manufacturers are subject to the general excise on wholesaling of ½ percent
[114] Taxed under separate statute at rates from 5 percent up
[115] Exemption applies only to new motor vehicles
[116] Exempt are fares of 15 cents or less and of school children
[117] Exempt only when sold by the producer
[118] Draught beer consumed on the premises is exempt.
[119] Street railways exempt

The granting of sweeping exclusions and important exemptions destroys the feature of a universal levy and the resulting retail sales tax resembles a system of selective excise taxes, with the adverse features of such taxation.

WHO REALLY PAYS THE SALES TAX? [1]

It is popularly taken for granted that the consumer pays the sales tax. Even if he does so in a literal sense, does the tax finally rest on him? [2] This involves us in a study of shifting and incidence.

An analysis of tax shifting can easily become discouraging. We are all aware of the various possibilities that have been explored in the overwhelming number of articles and treatises dealing with the economic theory of taxation. Depending on the conditions assumed, it is possible to reach conclusions that the imposition of a sales tax results in an increased, decreased or unchanged price and that some or all of the burden of the tax is borne by the consumer. Under various conditions, some or all of the burden may be borne by factors of production. Depending on the responsiveness of productive effort to tax burden, the result may be an increase, a decrease, or no change in output. What happens to prices in general and to output in general will also depend on the monetary and fiscal policy that is pursued. There are many empty boxes to be filled.

Empirical research has not reached the point where it is possible to state which empty boxes are filled. It is still necessary to rely on general observation, experience and possibly even intuition. This may be superior, however, to giving each of the empty boxes an equal probability, concluding that anything is possible, and then tossing a coin to decide which policy to follow.

The theoretical analysis of tax shifting has usually been approached in terms of the maximization of profit. If we assume that the businessman had been maximizing profit before the tax was imposed and continues to do so, certain results follow logically. More recently, alternative assumptions have been used, such as maximization of gross receipts subject to a profit constraint, retention of a share of the market under oligopoly conditions, or maximization of net worth. Without minimizing these other maximizing assumptions, there is still reason to believe that maximization of profit is a good working basis on which to build an analysis of tax shifting.[3] Modifications can readily be made where it appears that other behavioral assumptions are more realistic.

If the businessman does not follow any consistent behavior pattern, his reactions to a general sales tax cannot be predicted. If he follows the principle of profit maximization, he will generally bear some of the tax and pass some of it on to the consumer under the imperfectly competitive conditions that are widely prevalent. A "separate charg-

[1] The following sections are largely derived from Harold M. Somers, "Theoretical Framework of Sales and Use Taxation," *Proceedings of the Fifty-fourth National Tax Conference 1961* (National Tax Association), pp. 607–618, and "Some Implications of Sales and Excise Taxation," *Excise Tax Compendium—Papers Submitted to the Committee on Ways and Means*, June 15 and 16, 1964 (U.S. Government Printing Office, 1964), Part 1, pp. 24–31.

[2] Every recent study of sales tax burden assumes that the sales tax is borne completely by the consumer. See Irving Jay Goffman, *The Burden of Canadian Taxation*, p. 41 (Toronto: The Tax Foundation, July 1962).

[3] See William C. Pardridge, "Sales or Profit Maximization in Management Capitalism," *Western Economic Journal*, II (2), 134–141 (Spring, 1964).

ing'' provision does not materially affect this result. The ''separate charging'' provision merely requires that the sales tax be shown separately on the bill. It does not say that the retailer must not alter the base price He may lower the price on which the tax is figured The total amount per unit paid by the consumer (base price plus tax) will generally be more than the base price alone before the tax was imposed The seller will absorb some of the tax if the addition of the tax to the old base price will cut sales so badly that he will be worse off than if he shaved the base price somewhat. In this sense he absorbs part of the tax

If the seller tries to maximize gross sales subject to a profit constraint, it is likely that he will absorb an even larger proportion of the tax In order to see this, let us first consider the sales maximization itself and then see what effects the profit constraint will have The aim is presumably to keep sales receipts as large as possible net of the sales tax. We assume that the demand curve (based on total amount paid per unit) is the same as it was before and that the sales tax is a certain percentage of gross sales It is conceivable, but highly unlikely, that consumers will treat the sales tax as something apart from the transaction completely In that remote case, the effective demand curve will shift upward by the amount of the tax and the entire tax could be shifted to the consumer

Some price led to maximum gross sales before the tax was imposed. If the consumer continues to pay this amount per unit, the total amount received from him will continue to be the maximum This conclusion is unchanged if a certain fixed percentage is taken from the gross amount received and designated ''sales tax'' Thus gross receipts (either before or after tax) will continue to be maximized if the seller cuts the base price per unit by the full amount of the tax, i e absorbs the tax completely himself In other words, if the business man were simply interested in maximizing gross sales (whether gross or net of tax) he would absorb the tax completely

This might sharply cut into profits, however, or might cause losses, hence a profit constraint must be imposed The profit constraint (perhaps imposed by shareholders or directors, or merely by fear) requires the seller to try to make a certain minimum profit, at least If he was previously operating well within the profit constraint, the conclusion just reached would not be upset no new gross price (base price plus tax) would have to be charged and the seller would continue to bear the full burden of the tax. If the seller had been operating at or near the limits of the profit constraint, he would have to give up somewhat the objective of maximizing gross sales The result would be some increase in the gross price, i e in the total amount paid per unit by the consumer. The seller would then absorb some of the tax and shift some of it to the consumer Only in the most unusual circumstances would he shift all of it to the consumer.

The general conclusion is that the seller will absorb some or all of the sales tax under conditions of gross sales maximization subject to a profit constraint The introduction of the assumption of maximization of gross sales has the effect of increasing the number of situations in which the seller will absorb the sales tax It is not correct to say that the consumer alone bears the burden of the sales tax.

OTHER PRICE EFFECTS

The initial effects on the taxed commodities are considered above Even a general sales tax may have many exemptions—such as food for off-premise consumption Since any rise in the price of taxed commodities implies a reduced amount of such commodities demanded and produced, resources are available for transfer to nontaxed areas. This may reduce prices in those areas [1] It has even been suggested that both the taxed and untaxed commodities may fall in price in certain special instances [2]

So much for the initial burden of a general sales tax. What effect does the tax have on consumer welfare, productive effort, and economic growth?

In this discussion we try to isolate the effects of sales taxes, when no monetary or fiscal policies are taken to offset them Our analysis may then be regarded as indicating the magnitude of the task facing the monetary and fiscal authorities should they wish to offset the tax effects. For the purpose of the tax analysis alone, we will assume that monetary policy is permissive in that it allows such monetary expansion or contraction as may be induced by the tax, no more and no less. Similarly, we assume that other aspects of state or federal fiscal policy do not offset or accentuate the effects of the particular tax under review, the general sales tax We shall also assume that the sales tax is imposed primarily on consumer items Prevailing sales taxes do hit some investment goods and could be extended to cover all of them

EFFECT OF SALES TAXES ON CONSUMER WELFARE

Much has been written about the "excess burden" of indirect taxation, including sales taxation The argument is that specific sales taxes distort consumer choice, thereby leaving the consumer worse off than he would be if the same revenue were extracted from him through an income tax. Special excises penalize the particular commodities involved, thus reducing the consumer's welfare more than if the same revenue were derived from him by way of an income tax, and he were left free to dispose of his disposable income as he saw fit Even a general sales tax distorts the choice between taxable and exempt goods and services If there were no exemptions whatever, the consumer's choice between spending and saving would still be distorted

This allegation against the sales tax relative to the income tax has been disputed. The income tax distorts a choice too, the producer's choice between work (taxable) and leisure (nontaxable, to date) Moreover, the consumer cannot forever avoid but can only postpone the sales tax by working and saving · he must pay the tax when and if he does spend If the sales tax is general, and the tax burden ultimately falls on the factors of production rather than on the consumers as such, the effect is much like that of the income tax

One argument that tends to favor a sales tax over an income tax is that attributed to "money illusion" [3] People like the feel of money

[1] See J A Stockfisch, "On the Obsolescence of Incidence," *Public Finance*, XIV, 2, 1959, 125–148 at 135 and the literature reviewed there

[2] See H Hotelling, "Edgeworth's Taxation Paradox and the Nature of Demand and Supply Functions," *Journal of Political Economy*, XL (5), 577–616 (October 1932)

[3] See John F. Due, *Sales Taxation*, p 32 (Urbana, Illinois, 1957).

passing through their fingers Even if their real income is the same under both taxes, more money is temporarily under their dominion and control for purposes of discretionary expenditure in the case of the sales tax than in the case of the income tax (especially under an income tax withholding system) All considered, however, there is little to choose between a general sales tax and an income tax regarding their net impact on the welfare of the consumer who has to pay the same amount in the form of either tax.

EFFECT OF GENERAL SALES TAX ON PRODUCTIVE EFFORT

In determining the effect of any tax that rests on the productive factors, in whole or in part, we must take into account one important theoretical concept that has much practical relevance This is the backward-rising supply curve It is usually applied to labor but is applicable to other factors as well. The basic idea is that in some ranges a higher rate of pay will result in a smaller amount of effort supplied; and conversely, a lower rate of pay will result in a greater amount of effort supplied. This response is likely to prevail where a certain desired level of disposable income is a governing consideration. It shows up in the working family where the wife and the children go to work when the main breadwinner's rate of pay is cut [1] It also shows up in the physician who cuts his office hours and eliminates house calls when his stature and fees have reached a level where he can increase his hours on the golf course It also shows up in the widow or retired person who wants to derive a certain disposable income from investments and will increase the riskier and higher income investments (at the expense of cash or low-interest equivalent) in response to higher income taxes which reduce the take-home return

The significance of the backward-rising supply curve of productive factors is that a higher tax may increase rather than decrease the total amount of productive effort. Where the primary consideration is the maintenance of a certain standard of living, a higher tax may result in a larger number of labor hours or investment dollars offered. To the extent that this is true, higher taxes of all sorts will increase productive effort.

The crucial question, of course, is· "What proportion of productive factors has a backward-rising supply curve?" Unfortunately, empirical research cannot yet give us a comprehensive answer, although a few isolated studies exist Observation suggests a considerable preoccupation with standard of living On the other hand, there are still many persons, perhaps most, who will respond to a reduction in their rate of pay with a reduction in the number of units of the factor offered. Taking the total population, higher taxes of any kind imposed on, or resting on, the productive factors may result in no decline whatever in productive effort within a reasonable range This would be true of both income and general sales taxation.

[1] But see W Lee Hansen, "The Cyclical Sensitivity of the Labor Supply," *American Economic Review*, LI (3), 299–309 (June 1961).

SIGNIFICANCE OF GENERAL SALES TAX FOR ECONOMIC GROWTH

If it turns out that people are willing to let their standard of living decline under the impact of a general sales tax, the tax may nevertheless make a contribution to economic growth. A general sales tax at the retail level will then have the effect of reducing the demand for consumer goods and services. There will be a reduction in the use of labor and materials for production of consumption goods. Since some of the burden of the tax is borne by investors, this tax will discourage investment in the production of consumption goods relative to other forms of investment and will release some capital from the consumer goods field. The net effect is to make more resources available outside the consumer goods field. Whether the potential will actually be realized will depend on conditions in the rest of the economy, including, of course, governmental policies.[1]

OTHER EFFECTS OF A GENERAL SALES TAX

Burden on Business Firms

The major disadvantage of the sales tax compared with the income tax is that it is imposed on the business firm regardless of profits. If the firm could shift the tax forward completely without any reduction of business, there would be no problem on this score. In fact, however, there is generally some reduction in business and some absorption of the tax by the seller. This means that profits are cut or losses appear. Even if the firm were making losses, the desire to minimize losses might dictate the absorption of some of the tax, hence there would be an aggravation of the loss (although not so great an aggravation as would occur if an attempt were made to raise prices by the full amount of the tax). This effect is mitigated by the loss carryover provisions of the federal income tax, but these do not always provide relief since profits have to be made at some time for the carryover provisions to be useful.

Revenue Flexibility

There is a great deal of leverage in a sales tax that has large basic exemptions.[2] As income rises, the revenue from the sales tax may rise more than proportionately. Contrariwise, when income falls, revenue may fall more than proportionately. A sales tax can be just as volatile and just as responsive to cyclical variations—if that is desired—as the income tax. This means that it can be just as stabilizing—diverting proportionately larger amounts of revenue to the treasury in boom times and proportionately smaller amounts in depression.

It is clear that a general sales tax can be anything we want to make it in terms of its stabilizing or destabilizing effect. By altering the exemptions it is possible to make the sales tax behave much like the

[1] The shift from consumption to investment as a result of an excise tax can be demonstrated rigorously under hypothetical conditions. See J. A. Stockfisch, "The Capitalization of Investment Aspects of Excise Taxes under Competition," *American Economic Review*, XLIV (3), 287–300 at 296–298 (June 1954).

[2] See David G. Davies, "Sales Taxes and the Stable Growth of Income," *National Tax Association, Proceedings of the Fifty-third Annual Conference 1960*, 529–534, and H. M. Groves and C. H. Kahn, "The Stability of State and Local Tax Yields," *American Economic Review*, XLII (1), 87–102 (March 1952).

income tax. By exempting nothing, we can make the tax a destabilizer, maintaining large revenues even in time of depression

Sales tax revenues in California have fluctuated widely with variations in business activity. This is in contradiction to the widely held notion that a sales tax is inflexible The recession troughs of the fiscal years 1949–1950, 1953–1954 and 1957–1958 show up clearly in any table of California sales tax yields, as in Table 3 The strong growth trend shows up to insure positive percentage changes in 1953–54 and 1957–58 despite fluctuations in their magnitude

Regressivity

One of the major charges leveled against the sales tax is that it is regressive. If the term "sales tax" is used without specification as to rates and exemptions and the term "regressive" is used without definition, it is impossible to evaluate the truth of the charge It is so important, however, that we have undertaken a detailed study of regressivity, which appears in the next part. For the present, we may say that by manipulation of rates and exemptions, it is possible to make the sales tax regressive, proportional or even progressive in certain ranges on any of the generally accepted definitions [1] Likewise, the income tax, even with "progressive" rates, may not, in fact, be progressive throughout the entire range of incomes, what with numerous deductions and tax shelters which provide opportunities for conversion of income to capital gains at the higher income levels [2]

SIGNIFICANCE OF A SALES TAX AS A SUPPLEMENT TO AN INCOME TAX

Although sales and income taxes are similar in some respects, there is a fundamental distinction between the two for our purposes The sales tax can be an instrument for growth promotion by discouraging consumption The income tax may be employed to stimulate investment through special depreciation provisions or investment credits The two could work hand in hand: The sales tax would help release resources whose utilization would be encouraged by the special income tax provisions.

A general sales tax may also be regarded as a necessary supplement to an income tax from another point of view The income tax has many general deductions and exemptions. it also has many special provisions. Some of these are economically desirable and may be called "growth loopholes" Others serve no desirable economic purpose except to relieve the taxpayer of tax These may be called "giveaway loopholes." It is quite possible for a person to maintain a high standard of living and yet pay no income tax he may be living off capital or tax-free income, he may be using legitimate deductions or exemptions, he may be availing himself of some "growth loophole" or "giveaway loophole"; or he may be evading the tax by simple failure to declare in-

[1] See David G Davies, "An Empirical Test of Sales-tax Regressivity," *Journal of Political Economy*, LXVII (1), 72–78 (February 1959), and more recent articles by the same author, including "A Further Reappraisal of Sales Taxation," *National Tax Journal*, XVI (4), 410–415 (December 1963), and William H Hickman, *Distribution of the Burden of California Sales and Other Excise Taxes* (State Board of Equalization, Division of Research and Statistics, Sacramento, California, October 1958) These authors assume that the buyers bear the full burden of the tax

[2] See, for instance, Robert Eisner in *Income Tax Differentials*, esp. pp 166–168. (Tax Institute Symposium, 1957)

TABLE 3

Percentage Changes in Yields of the California Sales Taxes Relative to the Previous Year

Fiscal year	Percentage change	Fiscal year	Percentage change
1943–44	20*	1953–54	1
1944–45	11	1954–55	6
1945–46	19	1955–56	14
1946–47	35	1956–57	6
1947–48	14	1957–58	1
1948–49	7	1958–59	4
1949–50	–9	1959–60	12
1950–51	26	1960–61	0.16
1951–52	5	1961–62	5 4
1952–53	10	1962–63	8 5

* 1943–49 adjusted to conform with a 3-percent tax rate

Source 1943–51 in California Legislature, Senate Interim Committee on State and Local Taxation, Part Two, *State and Local Sales and Use Taxes in California, 1955*, 1952–60 from revenue figures in California State Board of Equalization, Annual Report, 1959-63 (Derived from Robert N Schoeplein "Sales Taxation of Services" (1962), unpublished M A thesis presented at the University of California, Berkeley)

come or by claiming excessive deductions or exemptions Unreported income at the federal level alone has been estimated at $25 billion a year [1] It is possible to have "yachts without income" on a more sophisticated level than in the thirties A sales tax would force these persons to make some contribution to the support of governmental services. Doubtless the sales tax, too, can be avoided or evaded Avoidance is made possible by not spending on taxable items; evasion would be difficult for any one person, however, no matter how strategically he may be placed, for more than a few of the large number of items covered by the tax.

The sales tax provides a means of taxing those who somehow manage to have a low net taxable income despite a high inflow of disposable resources. In short, one argument for a sales tax is that it draws upon those who maintain a high standard of living and yet avoid paying their fair share of the cost of governmental services

The view of the sales tax as a necessary supplement to the income tax is especially important in California because of (1) the presence of many retired individuals with a large ability to pay, consisting of resources greater than their taxable income under the income tax; and (2) the rapid rate of in-migration of families who do not immediately pay income tax although they immediately avail themselves of facilities provided by governmental bodies The sales tax ensures an immediate contribution to government. It acts even more quickly than income tax withholding, which is contingent on the earning of a taxable income There are also many retired individuals and in-migrants with a low ability to pay any tax, including the sales tax. methods of reimbursing them for sales tax paid could be devised If we avoid a legitimate source of revenue because of the excessive burden on some (a burden which could easily be relieved) we are favoring the many in an effort to exempt a few.

[1] Internal Revenue Commissioner Mortimer M Caplin, in testimony before the Senate Investigations Subcommittee, Washington, D C , August 23, 1961.

IV

REGRESSIVITY OF SALES TAXATION

Critics of sales taxation have long argued that sales taxes are less desirable than income taxes because they are more regressive The ability-to-pay principle is largely the basis for this contention. It is felt that equity considerations demand that a tax should be related to a person's ability to pay Since the sales tax is a tax on consumption, and lower income families generally consume a larger percentage of their income than higher income families, the argument has held that sales taxes are regressive and therefore objectionable on equity grounds. Recent studies have shown, however, that this regressivity may be more apparent than real in the case of California's type of sales tax. In evaluating the regessivity of the California 4 percent sales tax, the first major consideration is the exclusion of food consumed off the premises [1] This single exclusion makes the California sales tax much more progressive than it otherwise would be

Before proceeding any further, it is necessary to define the term "regressivity." A regressive tax may be defined as one in which the effective tax burden declines as the ability to pay increases. A regressive sales tax would be one in which the amount of sales tax paid is a declining percentage of the ability-to-pay measure. If the ability-to-pay measure is income, we take the amount the family actually pays in sales taxes during a year divided by its income during that year. If the individual spends much more on consumption than he earns, it is quite conceivable that his effective tax rate could be higher than the legal or 4 percent rate even though there are exemptions.

As Davies and others have indicated, the most important consideration in determining the effective tax rate is the proper definition of income [2]

In many early discussions of this problem, net income or gross income were used as the income definition. Since income is used to determine the effective tax rate, it is clear that the proper definition is crucial While current gross or net income has the advantage of familiarity and easy availability, it does not allow for transitory variations in income When we consider the individuals in the lowest income class we find in most studies that these people consume more than their gross income Not many people manage to consume more than their income over their entire lifetime For most people, low income is of a relatively temporary nature There are a great many young people in this group.

[1] Details of the California tax are available in *California Sales and Use Tax Law* (Sacramento State Board of Equalization, 1963) A summary is available in *California's Tax Structure 1964*, Part I (Sacramento Assembly Interim Committee on Revenue and Taxation, January 1964), pp 93–100 (substantially reproduced in Part II, above)

[2] David G Davies, "An Empirical Test of Sales Tax Regressivity," *Journal of Political Economy* (February 1959), "Progressiveness of a Sales Tax in Relation to Various Income Bases," *American Economic Review*, 50(5) December 1960, pp 987–995

These people have a great deal of future earning power and can generally borrow on their expected future earnings There are also a great many retired people in this group These people have generally earned much more in the past and are now living on the income from their assets or they are consuming past savings. There are also people in this category who are "between jobs" and temporarily have a much smaller income than their normal income Any income contains both normal and transitory elements When considering current gross or net income alone, year by year, it is not possible to take account of the transitory elements Normal income, by eliminating transitory variations shows a person's ability to pay much more clearly.

SIGNIFICANCE OF THE FOOD EXEMPTION

Table 4 shows the results of a recent study of the incidence of the 3 percent District of Columbia sales tax on families at different current income levels.

The powerful effect of the exemption of food for home consumption is quite evident in this table Sales tax with food taxable ranges from 4.16 percent of disposable income for the lowest income group to 1 28 percent for the highest income group. With the exclusion of food for home consumption, the effective tax rate for the lowest income group drops to 2.44 percent while the effective tax rate of the highest income group falls only to 0 92 percent. The sales taxes considered, both with and without the food exemption, are almost completely regressive. With only one exception, the effective tax rate falls as the income class rises Figure 1 brings out this relationship quite clearly. It should be noted however that this effective tax rate is related to current disposable or net income Since this income concept does not allow for transitory variations in income or reflect the differences in the net worth of individuals, it is questionable whether this is truly the appropriate measure of ability to pay. A different measure might indicate markedly dissimilar results.

Even using this current income definition, the present California retail sales tax law is much less regressive in the lower income ranges than the District of Columbia sales tax considered above This is shown in Figure 2. The tax is substantially neither regressive nor progressive to about $7,000 of family income.

An interesting comparison of the incidence of retail sales tax and the Indiana gross income tax has been made by the Indiana Tax Commission. The Indiana gross income tax is more than a gross receipts tax. It is applied to personal gross incomes as well as business gross receipts As applied to individuals it is essentially a flat rate income tax without personal deductions The Indiana commission, using the income definition of disposable income, finds the gross income tax to be less regressive than a sales tax without food exemption. The contrast is evident in Figure 3.

TABLE 4

Incidence of District of Columbia Sales Tax on Families of Various Incomes

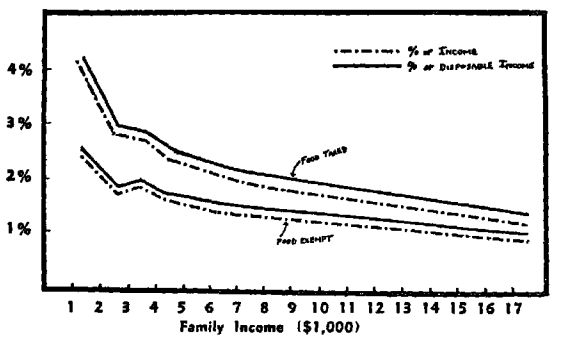
Income class	$0–2,000	$2,000–3,000	$3,000–4,000	$4,000–5,000	$5,000–7,000	$7,000–10,000	$10,000 up
Average income (before taxes)	1,132	2,513	3,518	4,506	5,838	8,241	17,520
Federal, state, and local taxes	25	116	189	279	457	751	2,810
After tax income (disposable)	1,107	2,397	3,329	4,227	5,371	7,490	14,710
Consumption expenditures	1,933	2,924	3,539	4,363	5,016	6,036	7,946
Expenditures not subject to sales tax	401	634	769	925	1,049	1,239	1,646
Taxed expenditures	1,533	2,290	3,070	3,138	3,957	4,824	6,300
Food	623	872	1,050	1,139	1,272	1,419	1,761
Other	910	1,418	2,020	2,299	2,685	3,375	4,539
Sales tax at 3 percent rate	46	69	92	103	119	145	189
Sales tax at 3 percent rate—food exempt	27	43	61	69	81	101	136
Percent sales tax of average income	4 06	2 74	2 62	2 29	2 04	1 76	1 08
Percent sales tax of average income—food exempt	2 39	1 71	1 73	1 53	1 39	1 23	78
Percent sales tax of disposable income	4 16	2 88	2 76	2 44	2 22	1 94	1 28
Percent sales tax of disposable income—food exempt	2 44	1 79	1 83	1 63	1 51	1 35	92

Adapted from Table 1, "District of Columbia Sales Tax Act," *Hearings*, The Committee on the District of Columbia, Senate (April 24, 25, 1961)

Reproduced from Indiana Commission *Final Report*, 1962, "The Retail Sales Tax," p 22

FIGURE 1

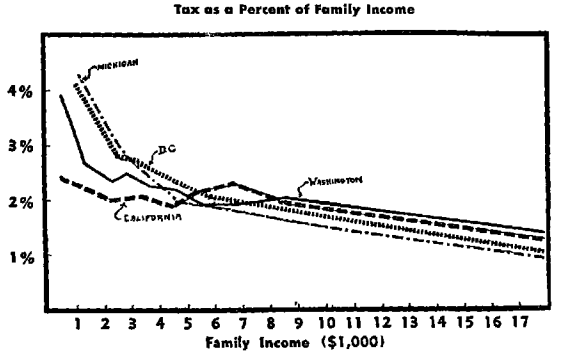
Incidence of District of Columbia Sales Tax—
Percent Tax at 3 Percent Rate of Family Income



Reproduced from *The Retail Sales Tax*, Indiana Commission, Final Report, 1962, p 23
Source: Table 4, above.

FIGURE 2

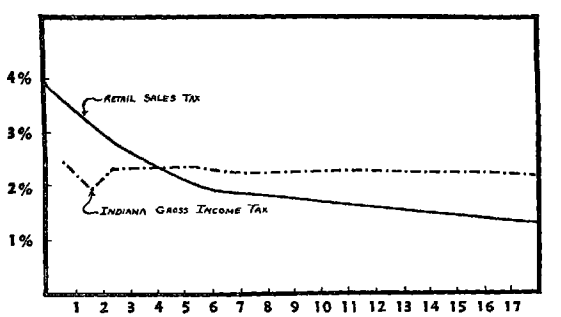
Incidence of Sales Tax Laws—
Tax as a Percent of Family Income



Source: Table 4, above, and also: *Distribution of the Burden of California Sales and Other Excise Taxes*, p 13; *Michigan Tax Study Staff Papers*, p 139; Philip Cartwright, "Public Attitudes Toward Sources of State Revenues," *National Tax Journal*, December 1949, p 370
Reproduced from *The Retail Sales Tax*, Indiana Commission, Final Report, 1962, p 24.

FIGURE 3

Comparison of Incidence of Sales Tax and Indiana Gross Income Tax



Source *Staff Reports*, Indiana Commission on State Tax and Financing Policy, 1957–59, pp 43–47
Reproduced from Indiana Commission *Final Report*, 1962, p 25

It should be noted, however, that this result implicitly assumes that businesses will not be able to shift forward to the consumer any of the burden of the gross income tax levied on their business income. This is consistent with the traditional view of *net* income but not with the accepted views of the shifting of a gross income tax.[1] To the extent that any of the business gross receipts tax is shifted forward to the consumer, it becomes difficult to demonstrate that a gross receipts tax would be much less regressive than a retail sales tax.

A statistical analysis has been made by Davies of California data to determine the regressivity of the California sales tax.[2] Davies uses "disposable receipts" in order to provide some measure of income averaging He defines "disposable receipts" as follows:

DR = Net income + (assets sold + liabilities added) —
(assets acquired + liabilities disposed of)

This income concept has the advantage of averaging out many of the transitory fluctuations but it tends to understate the ability to pay of people with large amounts of wealth in relation to their income.

In this study, 1950 data were used Three geographical regions were considered, Los Angeles, San Francisco-Oakland and San Jose. In 1950 about 5 8 million residents or 56 percent of the total California population resided in these districts This information is shown in Tables 5A, 5B and 5C.

[1] But see Marian Kryzaniak and Richard A Musgrave, *The Shifting of the Corporation Income Tax* (Baltimore The Johns Hopkins Press, 1963)
[2] David G Davies, "The Relative Burden of Sales Taxation A Statistical Analysis of California Data," *American Journal of Economics and Sociology*, 19(3), April 1960, pp 289–296

Davies uses the device of rank correlation to determine whether or not the tax is regressive Davies concludes·

"The California retail sales tax has elements of progressivity regardless of the income or receipts concept used to determine the effective rate of taxation For the whole range of observable gross or net income, however, the sales tax is regressive With respect to disposable receipts the California sales tax is progressive [1]

In using the device of rank correlation to determine tax progressivity certain problems are encountered Rank correlation of 1 0 between effective tax rate and income denotes a clearly progressive tax

TABLE 5A

Gross Income and Effective Tax Rate

Income class[a]	Gross income	Consumption	Taxable consumption	TxC−C[b] percent	APC[c]	APCT ×C[d]	Effective[e] rate percent
Under 1	$614	$1,706	$617	36 17	2 79	1 005	4 018
1–2	1,628	2,083	875 5	42 03	1 28	538	2 151
2–3	2,646	2,731	1,146	41 96	1 03	433	1 733
3–4	3,788	3,664	1,662	43 88	967	439	1 756
4–5	4,801	4,279	1,922	44 92	891	400	1 602
5–6	5 942	5,289	2,704	51 12	800	455	1 820
6–7 5	7,348	6,608	3 455	52 28	899	470	1 881
7 5–10	9,357	7,261	3 578	49 25	776	382	1 523
Over 10	17,510	10,298	6 256	60 75	588	357	1 429

[a] Net income class, thousands of dollars
[b] Taxable consumption divided by consumption
[c] The average propensity to consume
[d] The average propensity to consume taxable commodities
[e] Amount of tax divided by gross income
[f] Amount of tax divided by net income
[g] Amount of tax divided by disposable receipts

Source Based on *Study of Consumer Expenditures*, Vols I, II, III, XIII, and XVI, University of Pennsylvania, 1953
Reproduced from David G Davies, "The Relative Burden of Sales Taxation", *American Journal of Economics and Sociology*, XIX(3), April 1960, p 290

TABLE 5B

Net Income and Effective Tax Rate

Income class[a]	Net income	Consumption	Taxable consumption	TxC−C[b] percent	APC[c]	APCT ×C[d]	Effective[f] rate percent
Under 1	$601	$1,706	$617	36 17	2 84	1 027	4 105
1–2	1,551	2,083	875 5	42 03	1 34	565	2 258
2–3	2 512	2,731	1,146	41 96	1 09	546	1 825
3–4	3,541	3 664	1,662	43 88	1 03	469	1 879
4–5	4,473	4,279	1 922	44 92	957	430	1 719
5–6	5,470	5,289	2 704	51 12	967	494	1 977
6–7 5	6,633	6,608	3 455	52 28	996	521	2 083
7 5–10	8,408	7,261	3 578	19 25	864	425	1 701
Over 10	14,885	10,298	6,256	60 75	622	420	1 681

[a] For table notes a, b, c, d and f, see notes to Table 5A Source See Table 5A
Reproduced from Davies, *op cit*, p 292

[1] Davies, *op cit*

TABLE 5C

Disposable Receipts and Effective Tax Rate

Income class [a]	Disposable receipts	Consumption	Taxable consumption	TxC − C[b] percent	APC [c]	APCT XC [d]	Effective [a] rate percent
Under 1	$1,736	$1,706	$617	36 17	983	355	1 421
1–2	2,171	2 083	875 5	42 03	958	402.7	1 6108
2–3	2,845	2 731	1,146	41 96	900	402.8	1 6112
3–4	3,760	3,564	1,662	46 88	974	442	1 769
4–5	4,592	4,279	1,922	44 92	933	418	1 674
5–6	5,552	5 289	2,704	51 12	958	487	1 948
6–7 5	6,991	6,608	3,455	52 28	945	494	1 977
7 5–10	7,836	7,261	3,576	49 25	927	456	1 826
Over 10	11,317	10,298	6,25o	60 75	910	553	2 211

[a] For table notes a, b, c, d and g see notes to Table 5A Source See Table 5A
Reproduced from Davies, *op cit*, p 293

while rank correlation of −1 0 denotes a clearly regressive tax Most taxes, however, fall somewhere in between It would appear that rank correlation is a poor measure for the determination of tax progressivity for three reasons First, a very small difference in tax rates from one class to another will cause a large change in the coefficient of rank correlation This is shown in Table 6A below [1]

TABLE 6A

Rank Correlation and Effective Tax Rate (Hypothetical)

Net income	Effective tax rate (percent)	Rank
$1,000	460	1
2,000	480	3
3,000	479	2
4,000	482	4
5,000	490	5

Rank correlation = 0 9

The second reason is that rank correlation, when used to compare two different taxes cannot indicate the magnitude of their progressivity or regressivity Let us consider two progressive taxes both of which have a rank correlation of 1 0 These are shown in Table 6B

Rank correlation does not provide us with a means of determining which of these two taxes is the more progressive

The third problem, which Davies has pointed out, is that when you do not have either 1 0 or −1 0 rank correlation, it is difficult to weigh the different income classes to determine whether a given tax is progressive or regressive in its effects on the largest number of people

Laumie has devised a sales tax progressivity-regressivity measure to avoid the problems involved in the use of rank correlation [2] This measure is the progressivity-regressivity index (PRI) The PRI is

[1] Based on J J Laumie, "Sales Tax Progressivity" (June 1964), an unpublished paper prepared for a graduate seminar in public finance conducted by the author at U C L A

[2] In the unpublished paper, cited above.

TABLE 6B

Comparison of Two Taxes with 1.0 Rank Correlation (Hypothetical)

Net income	Tax No. 1		Tax No. 2	
	Effective tax rate (percent)	Rank	Effective tax rate (percent)	Rank
$1,000	4997	1	20	1
2,000	4998	2	2 00	2
3,000	.4999	3	4 00	3
4,000	.5000	4	10 00	4
5,000	.5001	5	15 00	5

defined as the mean effective tax rate of individuals above the median income divided by the mean effective tax rate of individuals below the median income.

That is: PRI $= T_a \div T_b$, where $T_b =$ effective tax rate below median net income and $T_a =$ effective tax rate above median net income.

Then PRI > 1 denotes a progressive tax, PRI $= 1$ denotes a proportional tax and PRI < 1 denotes a regressive tax The greater the divergence from 1, the more the progressivity or regressivity With this measure, the progressivity of given taxes can be compared. To some extent, at least, this measure also shows whether a given tax is progressive or regressive in its effects on the largest number of people.

In his study, Launie has also devised an alternative measure. Since the size of a person's asset position has a great deal to do with his ability to pay, he uses a person's wealth as the relevant ability-to-pay measure. He defines "wealth" as the individual's net worth at the beginning of the period plus his net income. We will refer to it as "net resources."

Launie's study includes data from cities in the western states for the year 1950. It is based on the same *Study of Consumer Expenditures,* undertaken by the Bureau of Labor Statistics and the Wharton School of Finance, used by Davies in the study cited above

It is assumed for the present analysis that the entire tax is passed forward to the consumer The significance of a more realistic assumption as to tax incidence is considered at a later point With the use of the PRI described above, we compare Nevada's 2-percent general sales tax including food with California's 4-percent general sales tax where food is excluded. The *Study of Consumer Expenditures* of the Wharton School of Finance was used to obtain the empirical data For purposes of comparison, the "Large Cities in the West" classification was used for both taxes with the food component simply being dropped out of taxable consumption when considering the 4-percent tax excluding food While this prevents the analysis of any consumption shifts that might occur due to the taxation of food it is assumed that in the aggregate this is of little importance. The PRI is computed below for the three kinds of ability-to-pay measures. "net income," "disposable receipts" and "net resources."[1]

[1] The following application of the PRI index is derived with some modification from the unpublished study cited above.

Table 7, using net income, shows the average propensity to consume, the average propensity to consume taxable commodities, amount paid in taxes and effective tax rate with a *2-percent sales tax, including food* where net income is used to determine the effective tax rate Since taxable consumption is larger than net income for the lowest income class, the effective tax rate for this class is higher than the 2-percent prescribed rate It is to be noted that this holds even though the ratio of taxable consumption to total consumption is lowest for this income

TABLE 7

Net Income and Effective Tax Rate, 2 Percent, Food Taxable

1 Disposable net income class* (000)	2 Net income	3 Consumption (C)	4 Taxable consumption (TC)	5 TC − C	6 APC	7 APCT	8 Tax amount	9 Effective tax rate (8) − (2) (percent)
Under 1	619	1,279	811	63	2 07	1 31	$16 22	2 62
1–2	1,534	1,889	1,277	68	1 23	83	25 54	1 66
2–3	2,527	2,665	1,932	72	1 05	76	38 64	1 53
3–4	3,523	3,699	2,714	75	1 02	77	54 28	1 54
4–5	4,459	4,374	3,321	76	98	74	66 42	1 49
5–6	5,468	5,108	3,975	78	93	73	79 50	1 45
6–7 5	6,664	6,239	4,908	79	94	74	98 16	1 47
7 5–10	8,613	7,134	5,630	79	83	.65	112 60	1 31
10 and over	15,040	10,573	8,313	79	70	55	166 26	1 10

APC = (3) ÷ (2)
APCT = (4) ÷ (2)
Median income = $3,566, PRI = 1 38 − 1 87 = 738

* *Disposable net income* refers to money income after deduction of personal taxes and occupational expenses and includes wages and salaries including tips and bonuses, income from unincorporated businesses and professions, net receipts from rented properties, net receipts from roomers and boarders, interest, dividends, receipts based on military service, unemployment insurance and social security benefits, other public and private pensions and retirement benefits, cash received as public and private relief, payments from private insurance annuities and trust funds, profits from the sale of stocks and bonds bought in 1950 and profits from businesses owned but not operated, contributions from persons not in the family, and such items as alimony, prizes and gambling gains

Occupational expenses, such as union dues and purchase of special tools, were subtracted from wage and salary earnings and were not included in gross or net income Federal, state and local income tax, poll tax and personal property taxes were deducted from gross income to arrive at the netted figure Two nonmoney items—the value of food and housing received as pay—were included as income

Source *Study of Consumer Expenditures*, Vol II, p xxvii Wharton School of Finance and Commerce, University of Pennsylvania (Washington, D C 1956)

class Although the effective tax rate does not decline continuously as income increases, the PRI of 0 738 indicates that this is a regressive tax. See Figure 4

Table 8 shows the same data with a *4-percent sales tax exempting food* where net income is again used to determine the effective tax rate When the effective tax rate is plotted against income (Figure 5 below), a curve with several peaks is shown The PRI of 0 931 denotes that, while this tax is regressive, it is much less regressive than the 2-percent sales tax including food.

In Tables 9 and 10, disposable receipts is used as the ability-to-pay measure to consider the same 2-percent and 4-percent sales taxes, respectively. The PRI of 0 971 indicates that the 2-percent tax including food, while slightly regressive, is almost proportional This is borne out in Figures 6 and 7. With a 4-percent sales tax, food exempt, and disposable receipts as our income measure, the PRI of 1.202 indicates that this is a progressive tax.

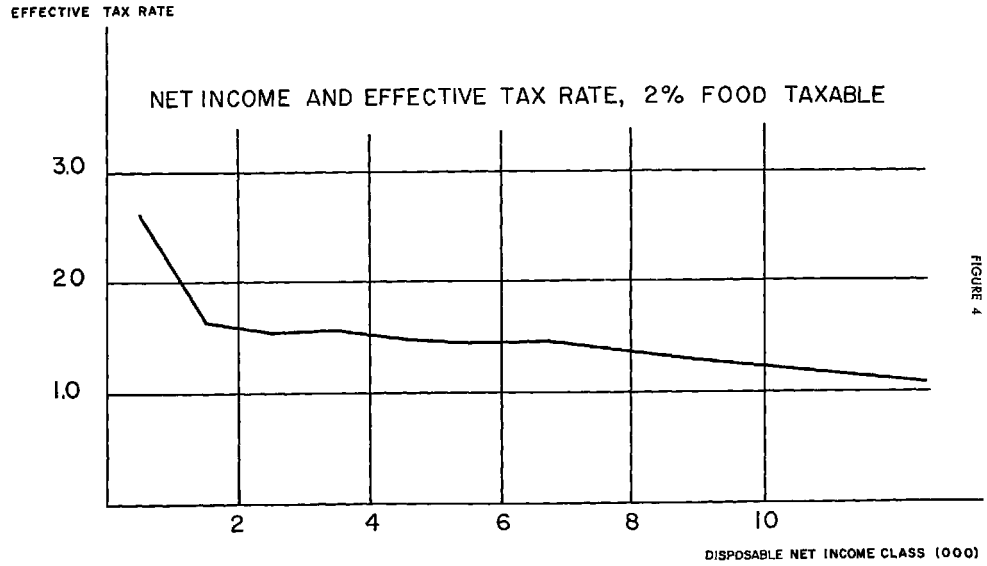

EFFECTIVE TAX RATE
NET INCOME AND EFFECTIVE TAX RATE, 2% FOOD TAXABLE
3.0
2.0
1.0
2
4
6
8
10
DISPOSABLE NET INCOME CLASS (000)

FIGURE 4

It is clear from the above tables that both taxes are more progressive when disposable receipts are used as the ability-to-pay measure The reason for this is that disposable receipts, representing more of an average income measure, greatly increases the base for the lowest income classes while raising the upper end of the scale much less

When we use net resources as our ability-to-pay measure to determine the effective tax rate as in Tables 11 and 12, we find our base of comparison increasing quite markedly in the lower income classes. In Table 11, considering the 2-percent tax rate including food, the PRI of 1 110 indicates that this is a progressive tax The PRI of 1 359 of Table 12 where the 4-percent tax rate excluding food is considered, indicates that this tax measure is more progressive than the 2-percent tax See Figures 8 and 9.

TABLE 8

Net Income and Effective Tax Rate, 4 Percent, Food Exempt

1 Disposable net income class* (000)	2 Net income	3 Consumption (C)	4 Taxable consumption (TC)	5 TC − C	6 APC	7 APCT	8 Tax amount	9 Effective tax rate (8) ÷ (2) (percent)
Under 1	619	1,279	368	29	2 07	59	$14 72	2 38
1–2	1,534	1,889	631	33	1 23	41	25 24	1 64
2–3	2,527	2,665	1,074	40	1 05	42	42 96	1 70
3–4	3,523	3,009	1,603	44	1 02	46	64 12	1 82
4–5	4,459	4,374	2,007	46	98	45	80 28	1 80
5–6	5,468	5,108	2,479	19	93	45	99 16	1 81
6–7 5	6,664	6,239	3,178	51	94	.48	127 12	1 91
7 5–10	8,613	7,134	3,662	51	83	42	146 48	1 70
10 and over	15,010	10,573	5,893	56	70	39	235 72	1 57

APC = (3) ÷ (2)
APCT = (4) ÷ (2)
Median income = $5,566, PRI = 1 76 − 1 89 = 931

* *Disposable net income* refers to money income *after* deduction of personal taxes and occupational expenses and includes wages and salaries including tips and bonuses, income from unincorporated businesses and professions, net receipts from rented properties, net receipts from roomers and boarders, interest, dividends, receipts based on military service, unemployment insurance and social security benefits, other public and private pensions and retirement benefits, cash received as public and private relief payments from private insurance annuities and trust funds, profits from the sale of stocks and bonds bought in 1950 and profits from businesses owned but not operated, contributions from persons not in the family, and such items as alimony, prizes and gambling gains

Occupational expenses, such as union dues and purchase of special tools, were subtracted from wage and salary earnings and were not included in gross or net income Federal, state and local income tax, poll tax and personal property taxes were deducted from gross income to arrive at the nested figure Two nonmoney items—the value of food and housing received as pay—were included as income

Source *Study of Consumer Expenditures* Vol II p xxvii Wharton School of Finance and Commerce, University of Pennsylvania (Washington, D C 1956)

It is believed that when "net resources" is used as the base of comparison to determine the effective tax rate as in Tables 11 and 12, we have a measure that quite accurately indicates a person's ability to pay. The relatively large ratio of net worth to income of the lowest income class reflects the fact that this is a heterogeneous group There are a great many retired people, for instance, with low current net income but relatively large asset holdings The transitory element is also important here many people temporarily have a low income for a myriad of reasons, while their net worth is large relative to their income. The lowest income group also includes some persons who have

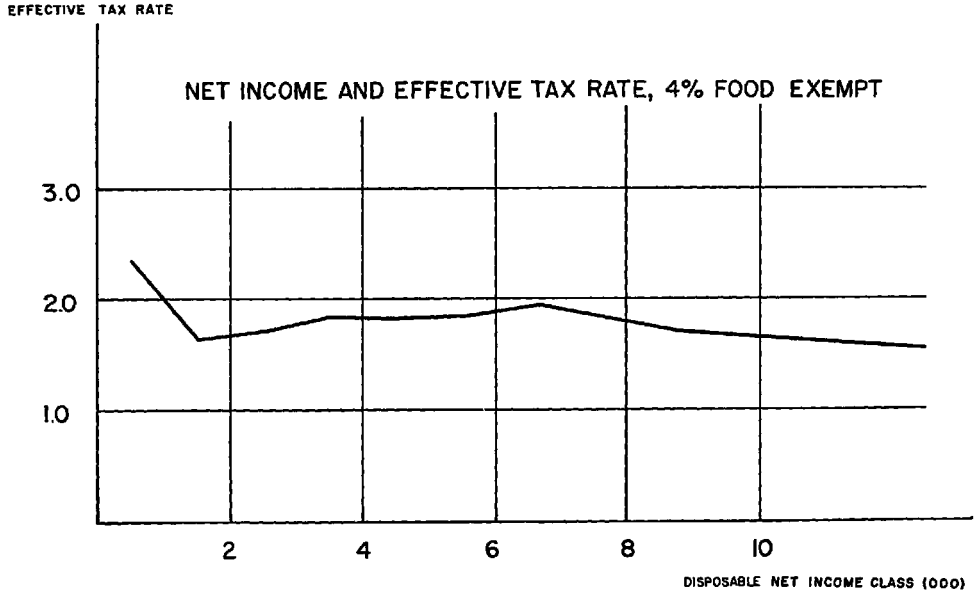

EFFECTIVE TAX RATE
NET INCOME AND EFFECTIVE TAX RATE, 4% FOOD EXEMPT
3.0
2.0
1.0
2
4
6
8
10
DISPOSABLE NET INCOME CLASS (000)

FIGURE 5

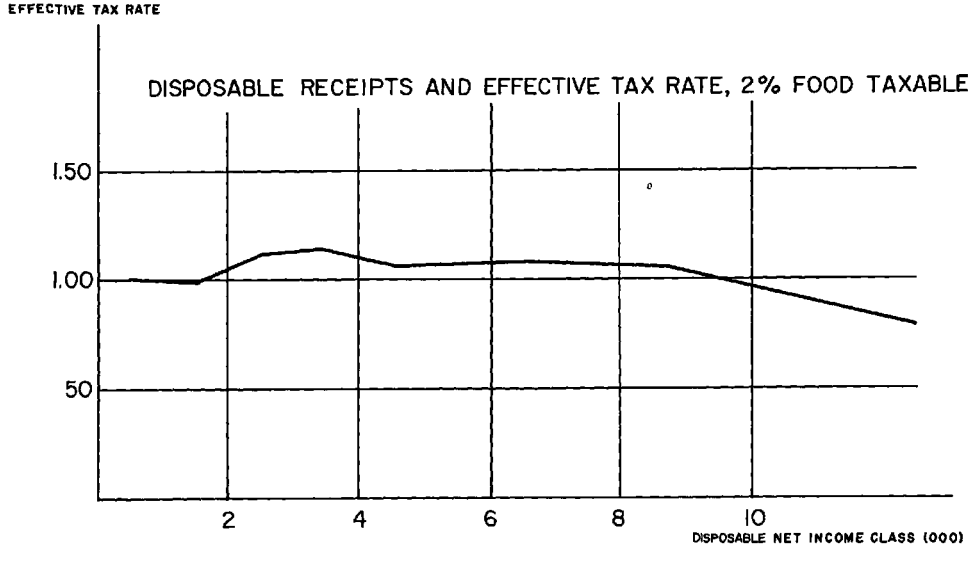

EFFECTIVE TAX RATE
DISPOSABLE RECEIPTS AND EFFECTIVE TAX RATE, 2% FOOD TAXABLE
1.50
1.00
50
2
4
6
8
10
DISPOSABLE NET INCOME CLASS (000)

FIGURE 6

TABLE 9

Disposable Receipts and Effective Tax Rate, 2 Percent, Food Taxable

1 Disposable net income class* (000)	2 Disposable receipts	3 Consumption (C)	4 Taxable consumption (TC)	5 TC − C	6 APC	7 APCT	8 Tax amount	9 Effective tax rate (8) − (2) (percent)
Under 1	1,613	1,279	811	63	79	50	$16 22	1 01
1–2	2,597	1,889	1,277	68	73	49	25 54	98
2–3	3,442	2,665	1,932	72	77	56	38 64	1 12
3–4	4,749	3,609	2,714	75	76	57	54 28	1 14
4–5	6,289	4,374	3,321	76	70	53	66 42	1 06
5–6	7,413	5,108	3,975	78	69	54	79 50	1 07
6–7 5	9,125	6,239	4,908	79	68	54	98 16	1 08
7 5–10	10,750	7,134	5,630	79	66	52	112 60	1 05
10 and over	20,757	10,573	8,313	79	51	40	166 26	80

APC = (3) − (2)
APCT = (4) − (2)
Median income = $3,56b, PRI = 1 02 − 1 05 = 971

* *Disposable net income* refers to money income after deduction of personal taxes and occupational expenses and includes wages and salaries including tips and bonuses income from unincorporated businesses and professions net receipts from rented properties, net receipts from roomers and boarders, interest, dividends, receipts based on military service, unemployment insurance and social security benefits, other public and private pensions and retirement benefits, cash received as public and private relief, payments from private insurance annuities and trust funds, profits from the sale of stocks and bonds bought in 1950 and profits from business es owned but not operated, contributions from persons not in the family, and such items as alimony, prizes and gambling gains

Occupational expenses, such as union dues and purchase of special tools, were subtracted from wage and salary earnings and were not included in gross or net income Federal, state and local income tax poll tax and personal property taxes were deducted from gross income to arrive at the netted figure Two nonmoney items—the value of food and housing received as pay—were included as income

Source *Study of Consumer Expenditures*, Vol II, p xxvn Wharton School of Finance and Commerce, University of Pennsylvania (Washington, D C 1956)

TABLE 10

Disposable Receipts and Effective Tax Rate, 4 Percent, Food Exempt

1 Disposable net income class* (000)	2 Disposable receipts	3 Consumption (C)	4 Taxable consumption (TC)	5 TC − C	6 APC	7 APCT	8 Tax amount	9 Effective tax rate (8) − (2) (percent)
Under 1	1,613	1,279	368	29	79	23	$14 72	91
1–2	2,597	1,889	631	33	73	24	25 24	97
2–3	3,442	2,665	1,074	40	77	31	42 96	1 25
3–4	4,749	3,609	1,603	44	76	34	64 12	1 35
4–5	6,289	4,374	2,007	46	70	32	80 28	1 28
5–6	7,413	5,108	2,479	49	69	33	99 16	1 34
6–7 5	9,125	6,239	3,178	51	68	35	127 12	1 39
7 5–10	10,750	7,134	3,662	51	66	34	146 48	1 36
10 and over	20,757	10,573	5,893	56	51	28	235 72	1 14

APC = (3) − (2)
APCT = (4) − (2)
Median income = $3,56b, PRI = 1 31 − 1 09 = 1 202

* *Disposable net income* refers to money income after deduction of personal taxes and occupational expenses and includes wages and salaries including tips and bonuses, income from unincorporated businesses and professions, net receipts from rented properties, net receipts from roomers and boarders, interest, dividends, receipts based on military service unemployment insurance and social security benefits, other public and private pensions and retirement benefits, cash received as public and private relief, payments from private insurance annuities and trust funds, profits from the sale of stocks and bonds bought in 1950 and profits from businesses owned but not operated, contributions from persons not in the family, and such items as alimony, prizes and gambling gains

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Source *Study of Consumer Expenditures*, Vol II, p xxvn Wharton School of Finance and Commerce, University of Pennsylvania (Washington, D C 1956)

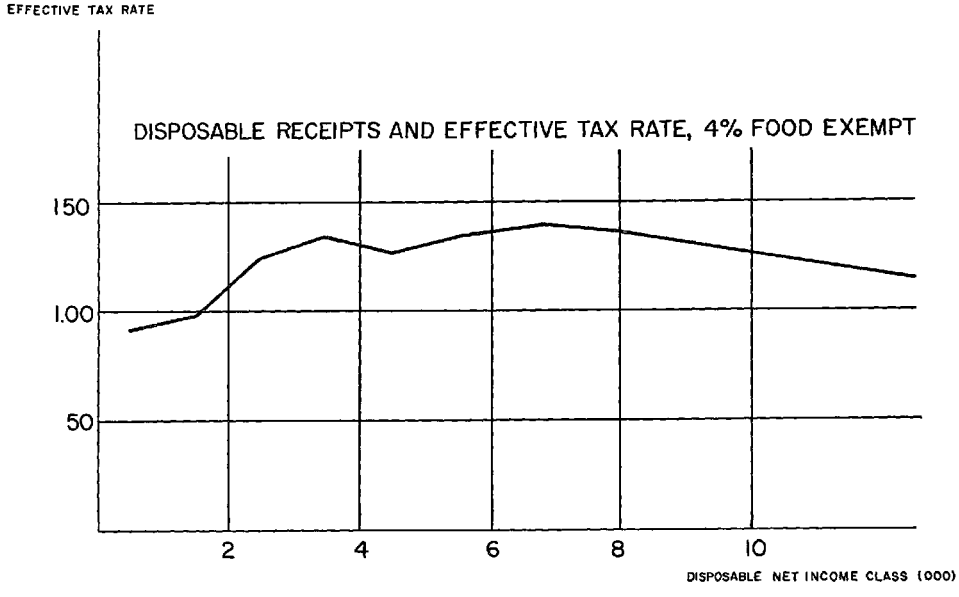
EFFECTIVE TAX RATE
DISPOSABLE RECEIPTS AND EFFECTIVE TAX RATE, 4% FOOD EXEMPT
150
1.00
50
2
4
6
8
10
DISPOSABLE NET INCOME CLASS (000)

FIGURE 7

TABLE 11

Net Resources and Effective Tax Rate, 2 Percent, Food Taxable

1 Disposable net income class* (000)	2 Net income	3 Net worth[a]	4 Net resources (2) + (3)	5 Consumption (C)	6 Taxable consumption (TC)	7 TC — C	8 Tax amount	9 Effective tax rate (8) ÷ (4)
Under 1	619	5,065	5,684	1,279	811	63	$16 22	29
1–2	1,534	4,610	6,144	1,889	1,277	68	25 54	42
2–3	2,527	5,750	8,277	2,665	1,932	72	38 64	.47
3–4	3,523	7,480	11,003	3,609	2,714	75	54 28	49
4–5	4,459	8,480	12,939	4,374	3,321	76	66 42	51
5–6	5,468	10,164	15,632	5,108	3,975	78	79 50	51
6–7 5	6,664	11,750	18,414	6,239	4,908	79	98 16	53
7 5–10	8,613	19,155	27,768	7,134	5,630	79	112 60	41
10 and over	15,040	40,000	55,040	10,573	8,313	79	166 26	30

Median income = $3,566, PRI = 454 — 409 = 1 110

[a] Estimated from "Survey of Financial Characteristics of Consumers," *Federal Reserve Bulletin* (December 1950)

* *Disposable net income* refers to money income after deduction of personal taxes and occupational expenses and includes wages and salaries including tips and bonuses, income from unincorporated businesses and professions, net receipts from rented properties, net receipts from roomers and boarders, interest, dividends, receipts based on military service, unemployment insurance and social security benefits, other public and private pensions and retirement benefits, cash received as public and private relief, payments from private insurance annuities and trust funds, profits from the sale of stocks and bonds bought in 1950 and profits from businesses owned but not operated, contributions from persons not in the family, and such items as alimony, prizes and gambling gains

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Source *Study of Consumer Expenditures*, Vol II, p xxvii Wharton School of Finance and Commerce, University of Pennsylvania (Washington, D C 1956)

TABLE 12

Net Resources and Effective Tax Rate, 4 Percent, Food Exempt

1 Disposable net income class* (000)	2 Net income	3 Net worth[a]	4 Net resources (2) + (3)	5 Consumption (C)	6 Taxable consumption (TC)	7 TC — C	8 Tax amount	9 Effective tax rate (8) ÷ (4)
Under 1	619	5,065	5,684	1,279	368	29	$14 72	26
1–2	1,534	4,610	6,144	1,889	631	33	25 24	41
2–3	2,527	5,750	8,277	2,665	1,074	40	42 96	52
3–4	3,523	7,480	11,003	3,609	1,603	44	64 12	58
4–5	4,459	8,480	12,939	4,374	2,007	46	80 28	62
5–6	5,468	10,165	15,632	5,108	2,479	49	99 16	63
6–7 5	6,664	11,750	18,414	6,239	3,178	51	127 12	69
7 5–10	8,613	19,155	27,768	7,134	3,662	51	146 48	53
10 and over	15,040	40,000	55,040	10,573	5,393	56	235 72	43

Median income = $3,566, PRI = 579 — 426 = 1 369

[a] Estimated from "Survey of Financial Characteristics of Consumers," *Federal Reserve Bulletin* (December 1950)

* *Disposable net income* refers to money income after deduction of personal taxes and occupational expenses and includes wages and salaries including tips and bonuses, income from unincorporated businesses and professions, net receipts from rented properties, net receipts from roomers and boarders, interest, dividends, receipts based on military service, unemployment insurance and social security benefits, other public and private pensions and retirement benefits, cash received as public and private relief, payments from private insurance annuities and trust funds, profits from the sale of stocks and bonds bought in 1950 and profits from businesses owned but not operated, contributions from persons not in the family, and such items as alimony, prizes and gambling gains

Occupational expenses, such as union dues and purchase of special tools, were subtracted from wage and salary earnings and were not included in gross or net income Federal, state and local income tax, poll tax and personal property taxes were deducted from gross income to arrive at the netted figure Two nonmoney items—the value of food and housing received as pay—were included as income

Source *Study of Consumer Expenditures*, Vol II, p xxvii Wharton School of Finance and Commerce, University of Pennsylvania (Washington, D C 1956)

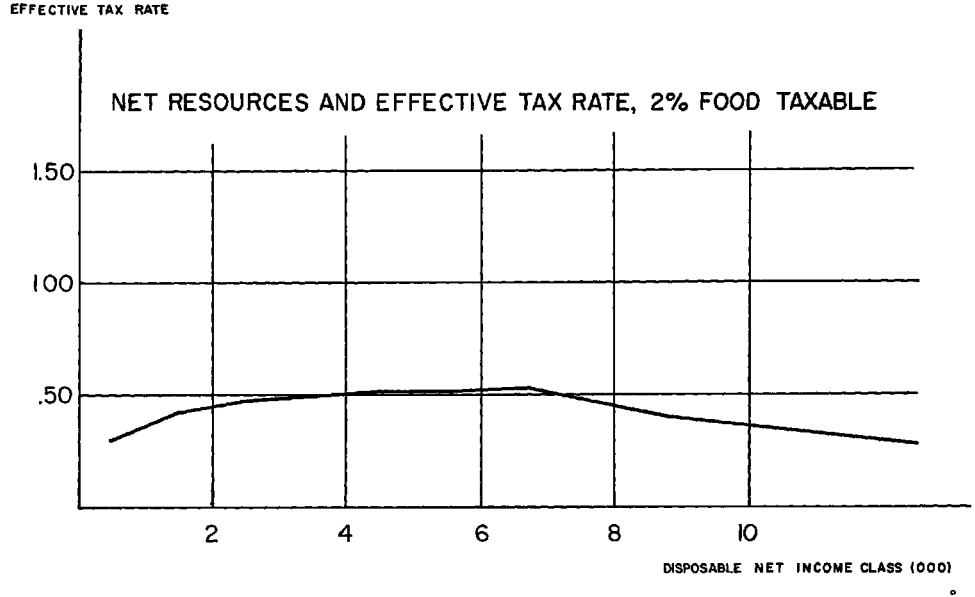

EFFECTIVE TAX RATE
NET RESOURCES AND EFFECTIVE TAX RATE, 2% FOOD TAXABLE
1.50
1.00
.50
2
4
6
8
10
DISPOSABLE NET INCOME CLASS (000)

FIGURE 8

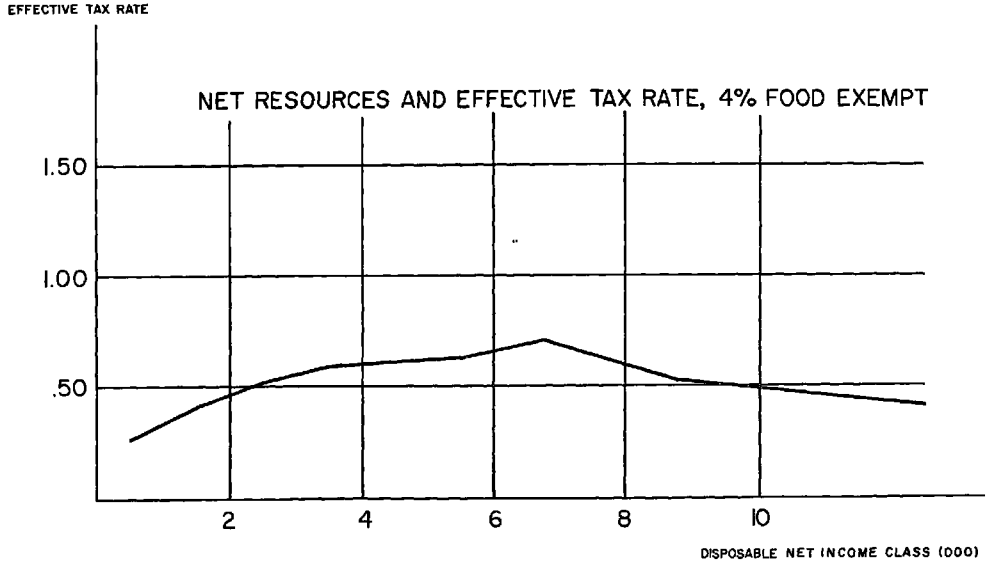

EFFECTIVE TAX RATE
NET RESOURCES AND EFFECTIVE TAX RATE, 4% FOOD EXEMPT
1.50
1.00
.50
2
4
6
8
10
DISPOSABLE NET INCOME CLASS (000)

FIGURE 9

little or no net worth As we will show at a later point, this last group is not predominant

The progressivity-regressivity index shows that regardless of which measure of ability to pay is used, a 2 percent sales tax including food is more regressive or less progressive than a 4 percent sales tax excluding food When "net resources" is used as the base of comparison, however, both tax measures are seen to be progressive, even under the extreme assumption (evaluated later in this study) that 100 percent of the tax is passed on to the consumer in both cases "Net resources" is taken as the measure that indicates most fully the ability to pay.

HETEROGENEITY OF THE LOW-INCOME GROUP

The ability-to-pay concept used in Tables 11 and 12 above includes both net income and net worth Since equity considerations are the basic reason for considering the subject of progressivity and regressivity, an appropriate measure of the taxpayer's ability to pay a certain tax is of the greatest importance Although a retail sales tax is levied on current consumption, the ability to pay a tax does not depend upon disposable income alone The net worth of an individual is also relevant. This could only be ignored if it could be shown that disposable income and net worth were perfectly positively correlated If this were true, the addition of net worth to disposable income would not change the regressivity of the resulting effective tax rates As the above tables show, however, the addition of net worth does cause a considerable change in regressivity This results, in part, from the fact that the lowest income class is a heterogeneous group This can be seen in Tables 13 to 18

It can be seen that the ability to pay cannot be ascertained from consideration of current money income alone The lowest income group is—as a group—not without resources It is particularly important to note the final column of Table 17 entitled "assets-income ratio " The assumption that the ability to pay can be deduced from current gross income alone implicitly assumes that the ratio of assets to income is constant for all income classes This clearly is not the case In fact the lowest income class has an assets-income ratio almost double that of the highest income class For this reason, it is important to consider an individual's net resources, that is, his net income plus his net worth, when considering equity problems such as tax regressivity

REGRESSIVITY CONSEQUENCES OF VARIOUS EXEMPTIONS

The preceding discussion has centered around the regressivity of retail sales taxes which are levied on tangible personal property without specifically considering the effect of exemptions other than the food consumed off premises exemption It should be noted, however, that as one moves up the income scale, individuals not only consume a different proportion of their disposable income or wealth, but the consumption mix also changes It follows therefore that the exemption of various commodities can affect the regressivity of a retail sales tax Tables 19 to 25 and Figures 10 to 15 show the effect on regressivity of several alternative retail sales tax laws

It should be noted that the effective tax rates shown in these tables relate to money receipts and disposable income and not to "net resources." Using the "net resources" definition the effective tax rate curves would all be more progressive than those depicted above. No matter which ability-to-pay definition is used, however, it would appear from these data that the exemption of food consumed off premises makes a tax much more progressive.

The subject of the extension of the retail sales tax to services will be considered in much more detail in the later parts of this study.

EFFECTS OF FAILURE TO SHIFT THE SALES TAX

The above analysis used the assumption that all of the sales tax was shifted to the consumer If, as seems most likely to be the case (see Part III, above), some of the tax is actually borne by the seller or other business firms, the results have to be modified accordingly. We must first make an appropriate assumption as to the ability to pay of owners of business firms compared with consumers as a whole It may surely be taken for granted that the owners of business firms have a greater ability to pay than consumers as a whole In that case, the results derived above would be reinforced the sales tax has a less regressive or a more progressive effect than we have shown. The conclusion remains that a sales tax with food exemption is progressive where "net resources" is used as the ability-to-pay measure

A GRADUATED SALES TAX?

A sales tax could be set up on a graduated basis, just like the income tax The tax could be, say, 4 percent on the first $100 of any particular purchase and, say, 6 percent on any amounts above that For instance, in the case of a purchase of $200, the tax would be $4 on the first $100 and $6 on the second $200, making a total of $10 There would undoubtedly be an attempt to segment purchases so as to keep each separate purchase below $100 If there are actually multiple and separable units in a purchase, the segmentation could be accomplished and the government would be in the same position as if there were no graduation—no better and no worse But some items could not very well be segmented, e g an automobile or a yacht or an outboard motor The graduated tax could readily be applied to these and would be in keeping with the spirit of a graduated tax—to tax according to ability to pay The existing progressive income tax, incidentally, is also vulnerable to segmentation—splitting income among members of a family or among multiple corporations or trusts Much of the work of income tax authorities is directed toward reducing or removing such opportunities for tax avoidance.

SUMMARY

Whether or not the sales tax is found to be "regressive" depends on our definition of "regressive" At the basis of all concern with regressivity is "ability to pay" A tax is regarded as being "regressive" if the amount paid falls relatively as ability to pay rises The basic question is, then, what is the appropriate "ability-to-pay" measure? Traditionally, current income has been taken as the measure of ability to pay In that case, the sales tax is found to be "regressive" even with

TABLE 13

Net Worth of Consumers Within Specified Groups, December 31, 1962

Group characteristic	All families	Percentage distribution of families, by net worth											Mean (dollars)	Median (dollars)
		Negative	$0–999	$1,000–4,999	$5,000–9,999	$10,000–24,999	$25,000–49,999	$50,000–99,999	$100,000–199,999	$200,000–499,999	$500,000–999,999	$1,000,000 and over		
All families	100	8	17	17	14	24	11	5	1	1	(1)	(1)	22,568	7,550
1962 income														
$0–2,999	100	12	31	16	15	17	7	1	(1)	(1)	(1)	(1)	8,675	2,760
$3,000–4,999	100	13	22	22	12	17	8	3	(1)	1	(1)	(1)	10,914	3,320
$5,000–7,499	100	7	14	21	17	28	8	4	1	(1)	(1)	(1)	15,113	7,450
$7,500–9,999	100	3	5	19	16	37	14	5	2	(1)	(1)	(1)	21,243	13,450
$10,000–14,999	100	1	3	9	13	34	24	11	4	1	(1)	(1)	30,389	20,500
$15,000–24,999	100	(1)	(1)	2	8	18	30	26	7	7	1	(1)	74,229	43,750
$25,000–49,999	100	1	(1)	(1)	1	2	7	20	31	30	5	3	267,996	160,000
$50,000–99,999	100	(1)	(1)	(1)	(1)	(1)	1	3	13	37	27	20	780,582	470,000
$100,000 and over	100	(1)	(1)	(1)	(1)	(1)	(1)	1	4	61	35	1,554,162	875,000	
Age of family head														
Under 25	100	33	48	14	5	(1)	(1)	(1)	(1)	(1)	(1)	(1)	762	270
25–34	100	18	26	25	15	13	3	1	(1)	(1)	(1)	(1)	7,081	2,080
35–44	100	8	13	18	18	28	8	5	1	1	(1)	(1)	19,442	8,000
45–54	100	7	10	19	10	29	16	6	2	1	(1)	(1)	25,459	11,950
55–64	100	2	14	10	14	29	16	9	4	2	(1)	(1)	34,781	14,950
65 and over	100	2	17	13	17	25	16	6	1	2	1	(1)	20,718	10,450
Employment-housing status														
Nonfarm homeowner	100	1	2	15	19	36	16	7	2	1	(1)	(1)	31,478	15,100
Self-employed	100	(1)	(1)	4	8	26	23	21	9	6	2	1	96,386	38,250
Employed by others	100	2	3	17	20	37	14	5	1	1	(1)	(1)	22,026	13,150
Retired	100	(1)	2	11	24	33	22	5	1	2	(1)	(1)	29,752	16,150
Nonfarm renter	100	19	39	21	8	7	3	1	1	(1)	(1)	(1)	8,092	720
Self-employed	100	7	13	10	4	23	27	7	2	2	4	1	73,691	20,500
Employed by others	100	22	35	24	9	6	2	1	(1)	(1)	(1)	(1)	5,266	760
Retired	100	5	54	11	14	11	1	2	(1)	1	(1)	(1)	10,827	660
Farm operator	100	(1)	5	6	12	26	29	16	3	3	(1)	(1)	43,973	26,250
Region														
Northeast	100	9	16	15	14	28	10	5	2	1	(1)	(1)	23,980	8 600
North Central	100	6	14	14	15	29	13	5	1	2	(1)	(1)	23,632	10,150
South	100	10	20	22	15	18	9	4	1	1	(1)	(1)	18,318	4,640
West	100	7	13	18	12	21	14	6	2	1	(1)	(1)	26,192	7,650

[1] No cases reported or less than ½ of 1 percent

Note: All data are preliminary and are subject to revision Details may not add to totals because of rounding.

Reproduced from "Survey of Financial Characteristics of Consumers," *Federal Reserve Bulletin*, March 1964, p 391

TABLE 14

Composition of Net Worth, December 31, 1962

A. Percentage of group having specified assets or debt—families grouped by size of net worth, income, etc

Group characteristic	Tangible assets			Business, profession (farm and nonfarm)	Life insurance, annuities, retirement plans	Liquid and investment assets						Miscellaneous assets	Personal debt (excludes auto)
								Investment assets					
	All	Own home	Automobile			All	Liquid assets	All	Stocks	Marketable bonds	Other		
All families	83	59	73	17	58	79	78	29	18	2	15	12	50
Size of net worth													
Negative	61	8	59	3	30	48	48	5	3	(1)	1	1	97
$0-999	50	10	47	3	34	45	44	2	1	1	1	4	42
$1 000-4,999	87	50	74	6	53	78	77	11	6	(1)	4	10	59
$5 000-9,999	93	77	76	14	64	87	86	23	13	1	11	14	56
$10 000-24,999	96	87	83	21	72	95	94	37	20	2	20	16	49
$25,000-49,999	97	87	90	36	76	99	98	62	39	5	32	18	24
$50,000-99,999	99	83	89	56	71	97	97	84	53	9	53	20	23
$100,000-199,999	94	38	91	57	74	100	100	93	79	19	43	26	28
$200,000-499,999	88	35	87	53	58	99	97	95	77	21	62	32	11
$500,000 and over	99	83	81	69	73	100	99	99	82	48	56	66	29
1962 income													
$0-2,999	62	44	39	14	31	58	56	15	9	2	7	6	34
$3,000-4 999	82	47	76	12	53	73	73	19	10	1	13	8	56
$5,000-7 499	95	62	89	17	67	87	86	27	16	1	13	12	58
$7,500-9,999	95	74	92	19	77	96	96	39	21	2	22	18	64
$10 000-14,999	97	82	95	23	82	97	96	53	36	5	24	18	50
$15,000-24,999	93	84	91	29	82	100	97	71	52	7	37	25	41
$25,000-49,999	98	92	96	70	84	100	100	89	78	20	47	28	29
$50 000-99 999	97	93	83	70	84	100	99	94	87	36	62	39	16
$100,000 and over	99	97	85	81	92	100	99	99	98	68	81	42	17
Age of family head													
Under 25	75	12	75	1	43	75	74	5	3	(1)	2	8	72
25–34	87	42	86	12	53	77	76	21	15	1	7	10	72
35–44	87	60	83	20	66	81	81	28	16	2	15	16	63
45–54	88	71	81	30	68	80	80	33	22	2	19	14	54
55–64	82	69	70	23	62	79	77	38	21	4	20	12	32
65 and over	74	64	46	14	38	79	78	29	18	3	17	9	19

Employment-housing status													
Nonfarm homeowner	100	100	83	19	65	89	87	37	23	3	21	15	50
Self-employed	100	100	93	99	74	97	95	60	32	7	43	17	34
Employed by others	100	99	91	10	74	91	89	36	21	2	19	16	59
Retired	100	100	47	8	38	80	78	30	21	2	15	13	24
Nonfarm renter	58	1	58	7	48	66	65	16	11	1	7	8	51
Self-employed	72	5	72	100	56	85	85	47	43	6	9	23	38
Employed by others	66	1	68	4	52	79	79	15	10	1	5	9	61
Retired	20	1	19	5	20	59	57	13	7	(1)	10	1	8
Farm operator	97	54	94	100	48	84	83	42	31	7	17	15	30
Region													
Northeast	74	55	63	13	67	80	79	27	22	3	10	11	47
North Central	87	64	78	20	61	85	83	31	18	2	16	13	45
South	86	60	75	19	53	71	69	26	12	2	17	12	54
West	85	55	80	18	48	84	84	33	21	3	18	15	54

1 No cases reported or less than $\frac{1}{2}$ of 1 percent
NOTE All data are preliminary and are subject to revision.

Source Board of Governors, Federal Reserve System, "Survey of Financial Characteristics of Consumers," *Federal Reserve Bulletin*, March 1964, p 292

TABLE 15

Composition of Net Worth, December 31, 1962

B. Mean amount of specified assets or debt held by all families in group—families grouped by size of net worth, income, etc

(In dollars)

Group characteristic	Total net worth	Tangible assets					Liquid and investment assets							Less Personal debt (excludes auto)
		All	Own home	Auto-mobile	Business, profession (farm and nonfarm)	Life insurance, annuities, retirement plans	All	Liquid assets	Investment assets				Miscel laneous assets	
									All	Stocks	Market-able bonds	Other		
All families	22,588	6,612	5,975	637	3,913	1,376	9,643	2,579	7,063	4,972	456	2,535	1,528	483
Size of net worth														
Negative	−538	121	37	84	92	67	82	64	18	7	1	10	3	903
$0–999	302	214	72	141	30	124	108	98	11	1	2	8	13	186
$1,000–4,999	2,809	1,706	1,284	422	127	563	731	631	100	46	4	50	76	394
$5,000–9,999	7,295	4,536	3,996	540	404	927	1,885	1,268	397	150	8	240	197	374
$10,000–24,999	16,281	9,422	8,634	789	1,656	1,511	3,980	2,266	1,715	567	8	1,140	241	529
$25,000–49,999	35,306	14,956	13,721	1,236	5,283	2,625	11,874	5,961	5,914	2,132	272	3,510	795	225
$50,000–99,999	67,042	15,748	14,429	1,319	15,701	4,342	30,560	9,512	21,048	9,659	461	10,928	1,181	490
$100,000–199,999	129,958	26,960	25,215	1,745	22 484	6,312	74,068	14,454	58,614	35,301	2,202	18,111	2,795	1,662
$200,000–499,999	283,855	27,209	24,891	2,319	65,833	8,803	182,006	19,151	162,855	105,180	4,249	53,445	11,464	1,659
$500,000 and over	1,176,281	54,006	51,452	2,554	245,811	18,677	890,160	40,073	849,187	363,208	79,023	106,956	273,272	5,848
1962 income														
$0–2,999	8,875	3,901	3,752	149	1,418	190	3,458	1,330	2,128	1,480	201	448	113	205
$3,000–4,999	10,914	3,956	3,544	412	1,902	635	4,663	1,738	2,925	818	19	2,088	137	378
$5,000–7,499	15,112	5,815	4,673	643	2,050	1,133	5,426	1,716	3,710	2,385	18	1,326	1,339	453
$7,500–9,999	21,243	8,387	7,499	888	2,577	1,579	7,900	2,722	4,779	1,476	44	3,258	1,532	712
$10,000–14,999	30,389	10,873	9,527	1,346	5,174	2,975	11,202	4,233	6,969	3,761	318	2,893	749	584
$15,000–24,999	74,329	17,004	15,188	1,816	9,088	5,198	39,880	9,241	30,638	18,733	1,445	10,460	3,964	502
$25,000–49,999	267,956	35,090	32,215	2,875	66,144	10,819	111,761	19,068	92,693	58,111	4,742	29,810	48,736	4,653
$50,000–99,999	789,382	48,764	45,961	2,803	231,977	19,559	387,573	41,845	345,728	204,685	71,971	69,092	86 313	4,804
$100,000 and over	1,554,152	89,645	85,534	4,011	288,915	32,309	1,058,672	64,426	1,004,246	758,253	121,985	124,008	96,379	12,268
Age of family head														
Under 25	762	544	248	297	36	125	381	256	125	44	(1)	81	169	493
25–34	7,661	2,798	2,300	498	1,014	678	1,566	647	919	515	29	375	2,098	492
35–44	19,442	5,952	5,244	708	3,939	1,496	6,961	1,566	4,505	2,356	105	1,953	2,541	546
45–54	25,469	8,557	7,845	912	5,776	2,241	8,144	2,563	5,581	2,834	272	2,475	1,472	730
55–64	34,781	9,206	8,465	741	6,275	1,789	16,647	4,117	12,530	7,542	695	4,293	1,220	356
65 and over	30,718	7,846	7,474	372	3,267	873	18,452	4,670	13,782	8,349	1,234	4,198	535	256

Employment-housing status														
Nonfarm homeowner	31,478	10,996	10,148	848	4,441	1,837	12,778	3,301	9,477	5,453	565	3,459	2,013	576
Self-employed	96,385	17,695	16,403	1,292	34,367	3,883	37,148	6,710	30,438	14,353	2,642	13,406	4,646	1,355
Employed by others	22,026	9,903	8,974	928	702	1,884	8,667	2,288	5,678	3,956	195	1,897	2,010	539
Retired	29,752	11,257	10,952	335	748	603	16,991	5,023	11,969	7,361	678	3,930	421	299
Nonfarm renter	8,092	383	48	335	1,187	753	5,239	1,588	3,654	2,411	303	940	903	354
Self-employed	73,691	1,297	415	882	25,815	2,298	23,890	4,754	19,136	11,370	5,885	2,001	23,819	3,428
Employed by others	5,268	395	28	367	420	803	3,813	1,244	2,569	1,960	90	579	150	312
Retired	10,827	161	75	85	73	212	10,153	3,212	6,970	5,312	82	1,576	212	13
Farm operator	43,973	6,182	5,501	681	25,767	1,278	10,138	2,309	7,829	1,354	535	5,940	1,095	486
Region														
Northeast	23,980	7,141	6,611	530	3,026	1,708	10,813	3,400	7,434	5,581	683	1,171	1,783	512
North Central	23,632	7,454	6,728	726	4,954	1,312	9,153	2,626	6,527	3,006	335	3,186	1,245	486
South	18 318	5,168	4,571	597	3,409	1,128	8,112	1,915	6,197	3,358	513	2,426	929	429
West	26,192	6,941	6,219	723	4,423	1,498	11,300	2,415	8 885	4,949	212	3,725	2,647	529

[1] No cases reported

Note All data are preliminary and are subject to revision Details may not add to totals because of rounding

Source Board of Governors, Federal Reserve System, "Survey of Financial Characteristics of Consumers," *Federal Reserve Bulletin*, March 1964, p 293

TABLE 16

Distribution by Owners' Income of Selected Balance Sheet Items—Early 1950

Percent

Money income (1949) before taxes	Liquid assets	Car	House	Farm	Live-stock and crops	Life insur-ance	Other real estate	Stock	Busi-ness[1]	Retire-ment fund	Total assets	Debt	Net worth	1949 income
	1	2	3	4	5	6	7	8	9	10	11	12	13	14
Under $1,000	6	3	6	22	19	4	5	1	1	(2)	6	7	6	2
$1,000–1,999	9	9	9	13	15	6	9	1	2	2	8	6	8	9
$2,000–2,999	15	15	14	14	14	13	12	4	4	9	12	16	11	16
$3,000–3,999	15	18	19	10	12	16	14	7	5	26	14	20	13	19
$4,000–4,999	11	15	16	3	8	14	8	5	6	24	11	15	11	15
$5,000–7,499	18	22	19	18	13	21	19	6	15	23	17	20	17	19
$7,500 and over	26	16	16	19	18	25	30	75	65	16	31	14	33	20
Not ascertained	(2)	2	1	1	1	1	3	1	2	(2)	1	2	1	(2)
All cases														
In percent	100	100	100	100	100	100	100	100	100	100	100	100	100	100
In $ billion	91	30	175	57	16	43	70	42	79	10	613	64	549	170

[1] Includes closely held corporations
[2] No cases reported or less than 0 5 percent

Reproduced from R W Goldsmith et al , "*A Study of Saving in the United States*," Vol III, p 126 (Princeton, Princeton University Press, 1956)

TABLE 17

Asset-income Ratios, by Income of Spending Units, 1950

Money income (1949) before taxes	Total income		Total assets		Assets-income ratio
	Percent	Billion dollars	Percent	Billion dollars	
Under $1,000	2	3 4	6	36 8	10 8
$1,000–2,000	9	15 7	8	49 0	3 1
$2,000–3,000	16	27 2	12	73 6	2 7
$3,000–4 000	19	32 3	14	85 8	2 7
$4,000–5,000	15	25 5	11	67 4	2 6
$5,000–7 500	19	32 3	17	104 2	3 2
$7,500 and over	20	34 0	31	190 0	5 5
Not ascertained	[a]	----	1	6 1	
All cases	100	170 0	100	613 0	3 6

[a] No cases reported or less than 0 5 percent

Derived from Goldsmith, *Saving in U S*, III, Table W-50, p 126
Source Robert J Lampman, *The Share of Top Wealth-holders in National Wealth 1922–56*, p 133 NBER, Princeton University Press (Princeton, 1962)

TABLE 18

Distribution of Spending Units by Income Within Asset Groups—Early 1950

Percent

Money income (1949) before taxes	Total assets							
	Under $100[1]	$500–900	$1,000–1,900	$2,000–4,900	$5,000–9,900	$10,000–24,900	$25,000–59,900	$60,000–and over
	1	2	3	4	5	6	7	8
Under $1,000	32	16	13	11	11	7	6	3
$1,000–1,999	30	26	19	16	14	12	6	2
$2 000–2 999	18	32	33	26	22	15	12	5
$3,000–3,999	7	18	22	25	23	22	12	4
$4,000–4,999	2	5	9	12	12	18	12	6
$5,000–7,499	1	3	4	7	12	20	24	17
$7,500 and over	(2)	(2)	(2)	1	2	5	24	62
Not ascertained	1	(2)	(2)	2	1	1	4	1
All cases	100	100	100	100	100	100	100	100

[1] Includes zero assets
[2] Includes negative and zero net worth

Source R W Goldsmith et al, *A Study of Saving in the United States*, p 130, Vol III, Princeton University Press (Princeton, 1956)

TABLE 19

Distribution of Consumer Expenditures, 1950—Average Annual Expenditures on Selected Items by Philadelphia and Pittsburgh Families

Summary of Expenditures Subject to or Exempt From a Hypothetical 2 Percent Retail Sales Tax

	Expenditure items*	Consumer expenditures	Percentage of total consumer expenditures (percent)	Assumptions regarding tax status†					
				Case A	Case B	Case C	Case D	Case E	Case F
1	Housing[1]	$511 00	11 5	E	E	E	E	E	E
2	Light, refrigeration and water	62 68	1 4	E	E	E	E	E	E
3	Fuel	113 12	2 5	E	E	E	T	T	T
4	Household operation[2]	206 79	4 7	E	E	E	E	T	E
5	House furnishings and equipment	276.16	6 2	T	T	T	T	T	T
6	Food								
	a For home consumption	1,184 53	26 8	E	E	E	E	E	T
	b. All other[3]	198 51	4 5	E	T	T	T	T	T
7	Alcoholic beverages	94 59	2 1	E	E	E	E	E	E
8	Tobacco								
	a Cigarettes	75 42	1 7	E	E	E	E	E	E
	b Other	13 58	0 3	T	T	T	T	T	T
9	Personal care articles[4]	53 67	1 2	T	T	T	T	T	T
10	Clothing	481 28	10 8	T	T	E	T	T	T
11	Clothing materials and services[5]	66 69	1 5	E	E	E	E	E	E
12	Medical care	217 93	4 9	E	E	E	E	E	E
13	Recreation								
	a Admissions	59 61	1 3	E	E	E	E	E	E
	b Other[6]	147 26	3 3	T	T	T	T	T	T
14	Automobile transportation								
	a Gasoline	71 49	1 6	E	E	E	E	E	E
	b Other[7]	354 62	8 0	T	T	T	T	T	T
15	Other transportation[8]	101 36	2 3	E	E	E	E	E	E
16	Personal services[9]	48 17	1 1	E	E	E	E	E	E
17	Newspapers and magazines	31 87	0 7	E	E	E	E	E	T
18	Books	5 28	0 1	T	T	T	T	T	E
19	All other[10]	68 28	1.5	E	E	E	E	E	
	Total	$4,443 89	100 0						

Source Based on unpublished data from the Bureau of Labor Statistics, "Survey of Consumer Expenditures in 1950"

Reproduced from *The Tax Problem*, Commonwealth of Pennsylvania, *Report of the Tax Study Committee*, Harrisburg, May 1953, pp 205-209

* Excluding personal taxes.
† E—Tax exempt T—Taxable
[1] Includes rent paid for homes (including vacation homes) and, in the case of home owners, taxes, insurance, interest on mortgage, and the cost of repairs and improvements.
[2] Includes expenses of laundry and cleaning sent out, wages of maids, gardeners, etc., the expense of servicing, insuring and repairing furnishings and equipment, and moving expenses Also includes expenditures on stationery, candles, matches and other household articles, laundry soap, cleaning supplies. Service and commodity items cannot be separated
[3] Includes expenditures on food eaten away from home, whether at work or at school, in lunchrooms or restaurants. Also includes expenditures, ice cream, soft drinks, and candy consumed away from home
[4] Includes toilet supplies such as soap, cleansing tissue, combs, razors, etc
[5] Includes expenditures for pressing, cleaning, dyeing, shoe repairing, shoeshines, and watch and jewelry repairs Also includes yard goods bought, yarn, pins and needles, thread, etc Service and commodity items cannot be separated
[6] Includes expenditures on toys, sporting goods, athletic equipment, phonograph records, cameras, hobby equipment, dues paid to social clubs, and pets
[7] Includes expenditures on cars and automobile equipment and supplies, also the cost of repairs, insurance, license fees, parking and garage rent Service and commodity items cannot be separated
[8] Includes expenses of local transportation, travel expense, and the expense involved in the purchase and upkeep of boats, bicycles, and motorcycles Service and commodity items cannot be separated
[9] Includes the expense of haircuts, permanent waves, manicures and similar items
[10] Includes education and other miscellaneous expenditures

TABLE 20

Case A—Percentage of Disposable Income Spent on Taxable Goods and Services and Estimated 2-percent Retail Sales Tax Burden for Selected Income Classes

Tax Applies Only to Sales of Tangible Personal Property, Exempting Food, Alcohol, Cigarettes, Gasoline, Fuel, and Periodicals

Disposable income classes*	Percentage of disposable income spent on taxable goods and services (percent)	Average sales tax burden as a percentage of average disposable income (percent)	Average sales tax burden as a percentage of money receipts† (percent)
Under $2 000	17 89	0 36	0 35
$2,000~2,999	23 31	0 46	0 44
3,000~3,999	28 40	0 57	0 53
4,000~4,999	29 79	0 60	0 56
5,000~5,999	32 58	0 65	0 60
6,000~7,499	29 36	0 59	0 54
7,500~9,999	29 81	0 60	0 53
10,000 and over	26 60	0 53	0 48

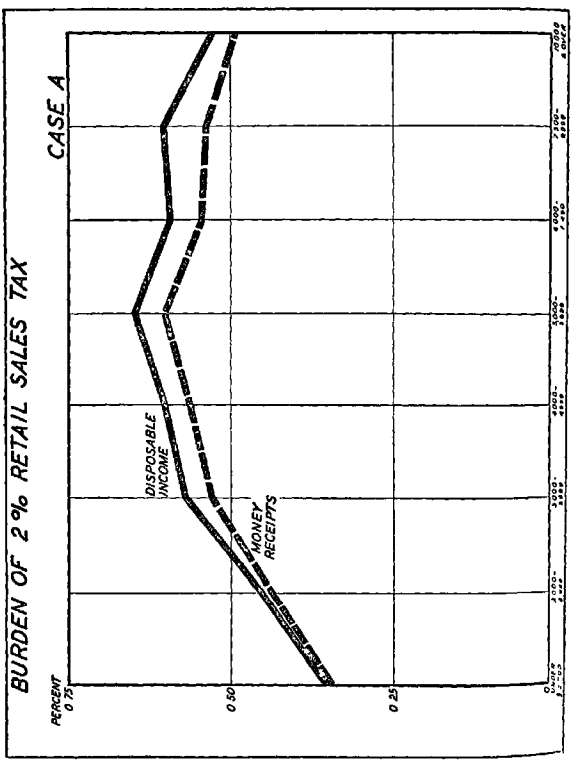
Source Based on unpublished data from the Bureau of Labor Statistics, "Survey of Consumer Expenditures in 1950"

* Disposable income is money income after personal income taxes Money income includes wages, salaries, dividends, interest, other income public and private assistance, social security payments, periodic insurance, annuity, and other payments, receipts from military service, alimony, etc

† Money receipts include money income, receipts from the lump-sum settlement or surrender of life insurance and annuity policies, the lump-sum settlement of property and other insurance policies, inheritance, bequests, etc

Reproduced from *Tax Problem*, p 211

FIGURE 10



Reproduced from *Tax Problem*, p 210.

TABLE 21

Case B—Percentage of Disposable Income Spent on Taxable Goods and Services and Estimated 2-percent Retail Sales Tax Burden for Selected Income Classes

Tax Applies Only to Sales of Tangible Personal Property, Exempting Food Consumed off Vendor's Premises, Alcohol, Cigarettes, Gasoline, Fuel, and Periodicals

Disposable income classes*	Percentage of disposable income spent on taxable goods and services (percent)	Average sales tax burden as a percentage of average disposable income (percent)	Average sales tax burden as a percentage of money receipts† (percent)
Under $2,000	20 56	0 41	0 40
$2,000–2,999	27 96	0 56	0 53
3,000–3,999	33 11	0 66	0 62
4,000–4,999	34 73	0 69	0 65
5,000–5,999	37 64	0 75	0 69
6,000–7,499	34 08	0 68	0 62
7,500–9,999	34 81	0 70	0 62
10,000 and over	32 27	0 65	0 58

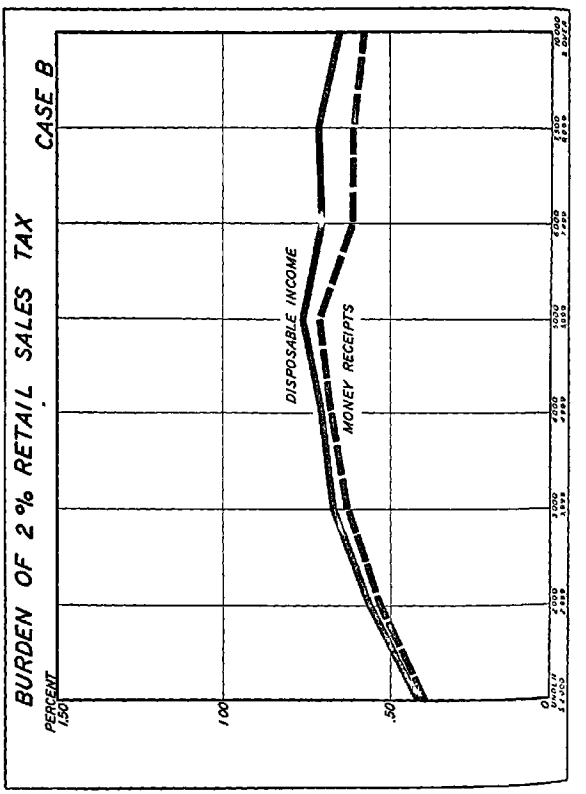
Source See Table 20—Case A

* Disposable income is money income after personal income taxes (See Table 20—Case A)

† Money receipts include money income and other money receipts. (See Table 20—Case A)

Reproduced from *Tax Problem*, p 213

FIGURE 11



Reproduced from *Tax Problem*, p. 212.

TABLE 22

Case C—Percentage of Disposable Income Spent on Taxable Goods and Services and Estimated 2-percent Retail Sales Tax Burden for Selected Income Classes

Tax Applies Only to Sales of Tangible Personal Property, Exempting Clothing, Food Consumed off the Vendor's Premises, Alcohol, Cigarettes, Gasoline, Fuel, and Periodicals

*Disposable income classes**	Percentage of disposable income spent on taxable goods and services (percent)	Average sales tax burden as a percentage of average disposable income (percent)	Average sales tax burden as a percentage of money receipts† (percent)
Under $2,000	12 96	0 26	0 26
$2,000–2,999	18 79	0 38	0 36
3,000–3,999	22 66	0 45	0 43
4,000–4,999	24 69	0 49	0 46
5,000–5,999	26 31	0 53	0 48
6,000–7,499	24 03	0 48	0 44
7,500–9,999	24 21	0 48	0 43
10,000 and over	20 49	0 41	0 37

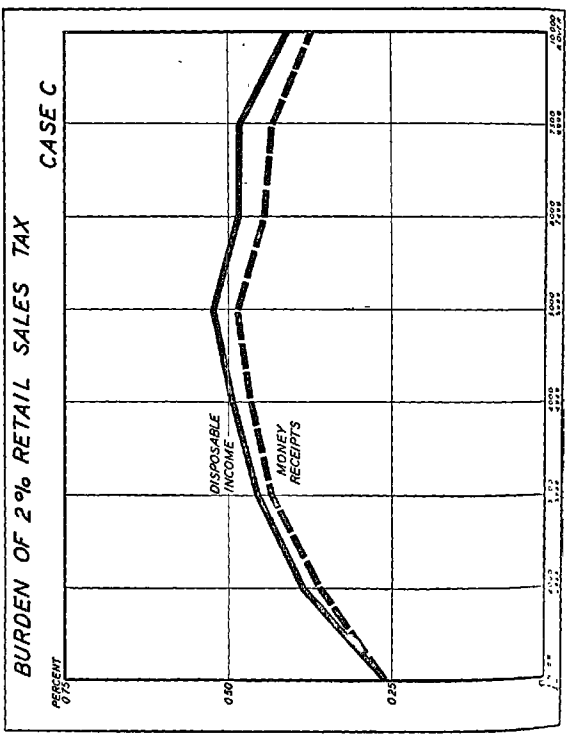
Source See Table 20—Case A

* Disposable income is money income after personal income taxes (See Table 20—Case A)

† Money receipts include money income and other money receipts (See Table 20—Case A)

Reproduced from *Tax Problem*, p 215

FIGURE 12



Reproduced from *Tax Problem*, p 214

TABLE 23

Case D—Percentage of Disposable Income Spent on Taxable Goods and Services and Estimated 2-percent Retail Sales Tax Burden for Selected Income Classes

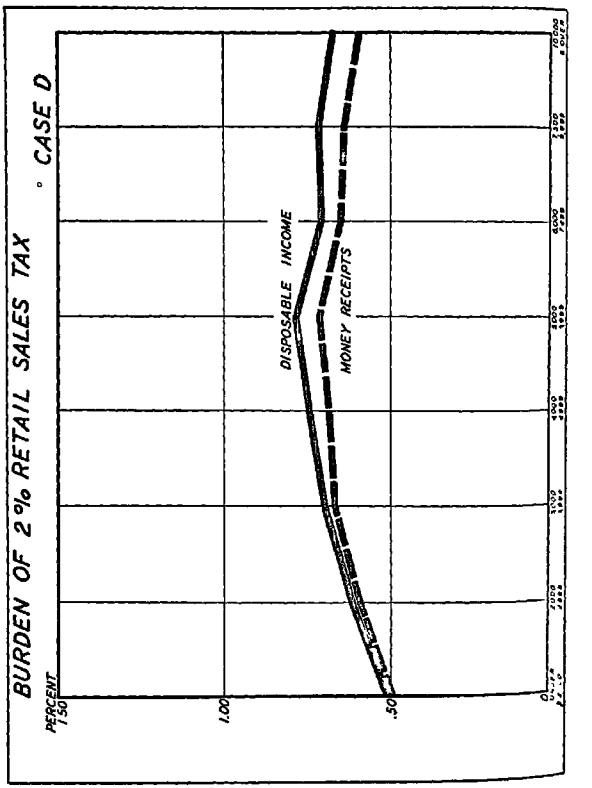
Tax Applies Only to Sales of Tangible Personal Property, Exempting Food Consumed off Vendor's Premises, Alcohol, Cigarettes, Gasoline, and Periodicals

Disposable income classes*	Percentage of disposable income spent on taxable goods and services (percent)	Average sales tax burden as a percentage of average disposable income (percent)	Average sales tax burden as a percentage of money receipts† (percent)
Under $2,000	24 94	0 50	0 49
$2,000–2,999	31 47	0 63	0 60
3,000–3,999	35 96	0 72	0 68
4,000–4,999	37 59	0 75	0 70
5,000–5,999	39 96	0 80	0 73
6,000–7,499	36 19	0 72	0 66
7,500–9,999	36 65	0 73	0 65
10,000 and over	33 29	0 67	0 60

Source See Table 20—Case A

* Disposable income is money income after personal income taxes (See Table 20—Case A)
† Money receipts include money income and other money receipts (See Table 20—Case A)
Reproduced from *Tax Problem*, p 217

FIGURE 13



Reproduced from *Tax Problem*, p 216

TABLE 24

Case E—Percentage of Disposable Income Spent on Taxable Goods and Services and Estimated 2-percent Retail Sales Tax Burden for Selected Income Classes

Tax Applies Only to Sales of Tangible Personal Property, Services for Household Operation, Laundry and Other Clothing Services, and Personal Services Exemptions Include Food Consumed off Vendor's Premises, Alcohol, Gasoline, Tobacco, and Periodicals

Disposable income classes*	Percentage of disposable income spent on taxable goods and services (percent)	Average sales tax burden as a percentage of average disposable income (percent)	Average sales tax burden as a percentage of money receipts† (percent)
Under $2,000	32 30	0 65	0 61
$2,000–2,999	38 64	0 77	0 74
3,000–3,999	42 34	0 85	0 80
4,000–4,999	44 36	0 89	0 83
5,000–5,999	46 97	0 94	0 86
6,000–7,499	42 65	0 85	0 78
7,500–9,999	45 83	0 92	0 82
10,000 and over	40 87	0 82	0 73

Source See Table 20—Case A

* Disposable income is money income after personal income taxes (See Table 20—Case A)
† Money receipts include money income and other money receipts (See Table 20—Case A)
Reproduced from *Tax Problem*, p 219

TABLE 25

Case F—Percentage of Disposable Income Spent on Taxable Goods and Services and Estimated 2-percent Retail Sales Tax Burden for Selected Income Classes

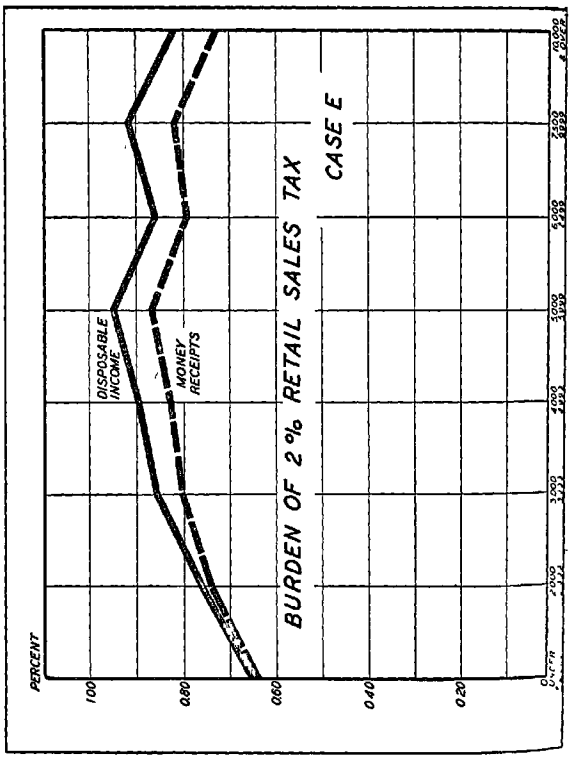
Tax Applies to Sales of Tangible Personal Property, Including Food Sales, but Excluding Alcohol, Cigarettes, Gasoline, and Periodicals

Disposable income classes*	Percentage of disposable income spent on taxable goods and services (percent)	Average sales tax burden as a percentage of average disposable income (percent)	Average sales tax burden as a percentage of money receipts† (percent)
Under $2,000	68 93	1 38	1 36
$2,000–2,999	65 90	1 32	1 26
3,000–3,999	65 86	1 32	1 24
4,000–4,999	64 91	1 30	1 21
5,000–5,999	63 98	1 28	1 17
6,000–7,499	57 00	1 14	1 04
7,500–9,999	55 14	1 10	0 98
10,000 and over	46 08	0 92	0 82

Source See Table 20—Case A

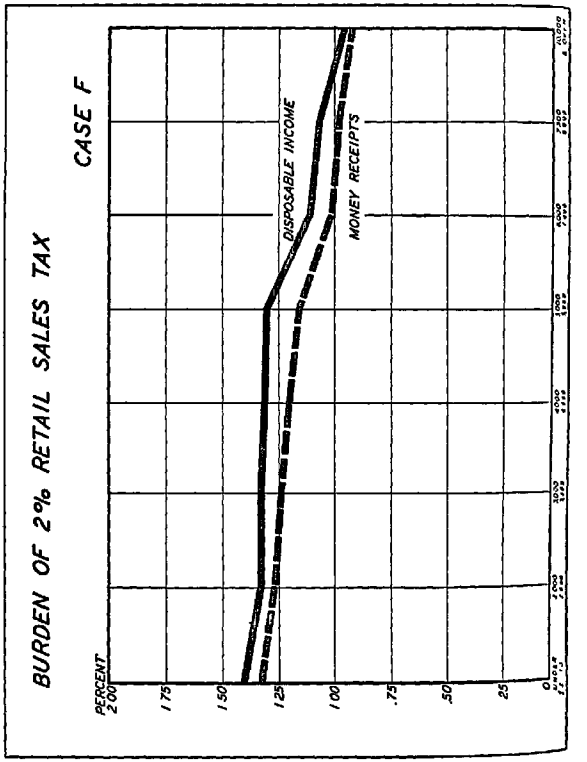
* Disposable income is money income after personal income taxes (See Table 20—Case A)
† Money receipts include money income and other money receipts (See Table 20—Case A)
Reproduced from *Tax Problem*, p 221

FIGURE 14



Reproduced from *Tax Problem*, p 218

FIGURE 15



Reproduced from *Tax Problem*, p 220

a food exemption If we follow Davies and add net capital liquidations to income in measuring ability to pay, we find that the sales tax is much less regressive and even becomes progressive with a food exemption If we follow Lamne and include all net resources, i e net worth plus income, in our ability-to-pay measure, we find that the sales tax with or without a food exemption is actually progressive sales tax paid relative to ability to pay rises as we move up the income scale to a point past the median

The reason for the results obtained is found in a little-known aspect of the lowest income group That group is actually very mixed in terms of economic resources Some have little or no net worth while others have a high net worth in relation to their current income The group with relatively high net worth is actually dominant statistically. Any tax policy which is concerned with the low income group must distinguish between the two components if such policy is predicated on ability to pay.

Some observers may consider the sales tax to be too regressive or insufficiently progressive even with food exemption and even with total economic resources as our ability-to-pay measure A desire to increase progressivity could be satisfied by having a graduated sales tax, e g 4 percent on the first $100 of any purchase and 6 percent on amounts over $100 This would involve problems of enforcement comparable to those encountered in the splintering of income for income tax purposes

V

RETAIL SALES TAXATION OF SERVICES IN OTHER STATES

Widening the tax base to include services has often been proposed as an alternative to a general rate increase. The arguments in favor of inclusion of services in the retail sales tax base may be summarized as follows:

1. It would be consistent with the general concept of the sales tax as a comprehensive levy on personal consumption expenditures.
2. It would eliminate the present tax advantage of services over commodities, thus more fully achieving the standard of economic neutrality.
3. It would simplify administration and compliance for the numerous services which mix personal service with the sale of some tangible personal property, such as repair shops which must bill service and commodities separately and segregate the receipts.
4. It might produce substantial revenue.

The arguments against the inclusion of these services are:

1. Services are inconsistent with the statutory base of tangible personal property.
2. Any comprehensive taxation of services would involve taxation of myriad firms and persons—down to the last bootblack and parlor maid—and be administratively impossible.
3. There would be tremendous political opposition.

Discussion of the extension of the sales tax base to include services usually considers the following classifications of services:

a. Utilities.
b. Repair services to tangible personal property.
c. Personal services.
d. Rentals and leases of tangible personal property.
e. Transient lodging accommodations rentals.
f. Amusements.
g. Business services.
h. Professional services.
i. Repair services to real property.

The extent to which certain of these services are covered in various states is shown in Table 26. The following sections of this study consider first the present tax status of the above services in the other states in the country.[1] Next an estimate is made of the approximate revenue gain to be realized from the extension of the sales tax base to include the above services in California. Finally the effects of changes in the tax base are compared with changes in the legal tax rate.

[1] Derived from Robert N. Schoeplein, "Sales Taxation of Services" (1962), unpublished M.A. thesis presented at the University of California, Berkeley, and Commerce Clearing House, *All-State Sales Tax Reports*.

EASTERN RETAIL SALES TAX STATES

Maine

Effective 1963, the legal tax rate was increased to 4 percent. Maine's state retail sales tax dates from 1951. This sales tax is restricted to the sale of tangible personal property, but the tax is extended to include transient rentals and utilities. The sale and distribution of gas, water or electricity is taxed. In areas of controversy between sales of tangible personal property and services, the Maine statute has specifically included the total selling price of the following: portrait photographers,

TABLE 26

Application of State Retail and General Sales Taxes to Selected Services: 1960

State	Gas and electric, domestic	Water domestic	Communications	Transportation	Admissions	Repair and installation	Motel and hotel
Alabama	E	E	E	E	T	E	T
Arizona	T	T	T	T	T	E	T
Arkansas	T	T	T	E	T	E	T
California	E	E	E	E	E	E	E
Colorado	T	E	T	E	E	E	T
Connecticut	E	E	E	E	E	E	T
Florida	E	E	E	E	T[a]	E	T
Georgia	T	E[b]	T[a]	T	T	E	T
Hawaii	E	E	E	T	T	T	T
Illinois	E	E	E	E	E	E	E
Indiana	T	T	T	T	T[a]	T	T
Iowa	T	T	T	E	T	E	E
Kansas	T	T	T	E	T	E	T
Kentucky	E	E[c]	T	E	T	E	T
Louisiana	E	E	E	T	T	T	T
Maine	T	T	E	E	E	E	T
Maryland	T	E	E	E	E	E	T
Michigan	T	E	T	E	E	E	T
Mississippi	T[d]	T[d]	T	T	E	T[a]	T
Missouri	T	T	T	T	T	E	T
Nevada	E	E	E	E	E	E	E
New Mexico	T	E	T	T	T	T	T
North Carolina	E	E	E	E	T	E	T
North Dakota	T	T	T	E	T	E	E
Ohio	E	E	E	E	T	E	T
Oklahoma	T	E	T	T	T	E	T
Pennsylvania	T	T	T	E	E	T[a]	E[a]
Rhode Island	T	T	T	E	E	E	E
South Carolina	T[a]	E	E	E	E	E	T
South Dakota	T	T	T	E	T[a]	E	E
Tennessee	E	E	E	E	E	E[a]	T
Utah	T	E	T	T[a]	T	T	T
Washington	E	b	E	E	T	T	T
West Virginia	E	E	E	E	T	E	E
Wyoming	T	E	T	T	T	E	E
Number that tax	21	12	10	11	21	8	25
Number that exempt	14	23	16	24	14	27	10

T Taxable
E Exempt
[a] With certain exceptions
[b] Municipal corporations only
[c] Water sewer services taxable
[d] Except municipally owned
[e] Has special tax of 4 percent on lodging

Source: *All-State Sales Tax Reporter* (Chicago: Commerce Clearing House, Inc.), Current Loose-Leaf Service Review of the individual state statutes, Vols. I, II, and III
Reproduced from Schoeplein, *op. cit.*, pp. 76–77

photoprinting, engraving plates, all printed and otherwise reproduced material, bookbinders, stonecutters, florists, and 50 percent of the total tire recapping price

Certain business establishments are recognized as final consumers of the parts and materials utilized in rendering a service These businesses must pay sales tax on materials purchased, the total value of their work for subsequent customers is tax exempt. Specifically listed businesses are auto paint shops, shoe repairmen, watch and jewelry repairmen, optometrists, barber and beauty shop operators On other repair of tangible personal property, labor and material is to be itemized separately with sales tax applying only to the material

Hotels and similar establishments with less than four sleeping rooms available for rental are exempt from the sales tax as is continual rental from the 91st day onward.

Pennsylvania

The present Pennsylvania sales tax rate is 5 percent The statute and companion regulations are quite complex In detailed regulations a lengthy list of commodities and services is ruled on In 1959, the statute was amended to include repair services and installation charges; other services however are restricted or exempted Rental or lease of tangible personal property is taxed at a rate of 3 percent.

The amended statute defines the scope of the sales and use tax as a levy upon the sale at retail of [1]

> 1. Any transfer for a consideration of the ownership, custody, or possession of tangible personal property. . . .
>
> 2. The rendering of a service of printing or imprinting of tangible personal property. . . .
>
> 3. The rendering for a consideration of washing, cleaning, waxing, polishing or lubricating of motor vehicles, whether or not any tangible personal property is transferred in conjunction therewith; and the mandatory inspection of motor vehicles
>
> 4. The rendition for a consideration of the service of repairing, altering, or cleaning tangible personal property or applying or installing tangible personal property as a repair or replacement part of other personal property, except real property . This shall not be deemed to impose a tax upon such services in the preparation for sale of new wearing apparel or upon diaper service
>
> 5. Any license to use or consume, pursuant to a rental contract or other lease arrangement

The tax status of repair services is further clarified in the regulations which state, "Persons engaged in the business of repairing, cleaning, altering, replacing, or inspecting tangible (taxable) personal property are required to collect and remit tax upon the entire charge which they make for their work, including charges for parts, time, labor, or service" [2]

[1] CCH, *ibid*, Sec 63-003
[2] CCH, *ibid*, Sec 63-581

Persons rendering certain specified services are considered consumers and must pay tax upon tangible personal property used incidental to rendering their service Examples given in the statute are professional men, barbers, beauty parlor operators, pest and insect exterminators, shoe repairmen, bootblacks, laundries, dry cleaners, funeral directors.[1]

Services listed as exempt from sales taxation are "services rendered by the learned professions, barber beautician services; pest and insect extermination services; funeral director services; janitorial and cleaning services upon real estate; shoeshine services, boarding, care and maintenance of animals, stenographic services "[2]

Maryland

The legal sales tax rate in Maryland is 3 percent. The statute restricts the scope of the tax to tangible personal property plus gas and electricity, and transient lodging The present statute states that an exemption will be granted for labor or services, when stated separately in a bill.

Some persons engaged primarily in the rendering of services are considered to be consumers of material used as an incidental element in performing the service Specifically listed are physicians and dentists, insect or pest exterminators, barber shops and beauty shops, storage warehousemen, dry cleaners and laundries

Table 27 indicates the percentage yield of certain service category industries in the Maryland sales tax collections in a recent year.

SOUTHERN RETAIL SALES TAX STATES

South Carolina

South Carolina's tax statute was generally revised in 1951 While essentially a "tangible personal property" state, South Carolina extended the tax base to include cleaning and laundry services in 1959 The legal rate is 3 percent.

The South Carolina tax includes:[3]

1 Every person engaged in the business of selling tangible personal property

2 Every person engaged in the business of furnishing lodgings, or accommodations to transients for a consideration, except establishments with less than six sleeping rooms.

3. Renting or leasing of tangible personal property.

4 Electric power and communications.

5 Every person engaged in the business of operating a laundry, launderette, cleaning, dying, or pressing establishment for a consideration (Amusements are exempt from the sales tax)

[1] CCH, *Ibid*, Sec 63-579
[2] CCH, *Ibid*, Sec 63-580.
[3] CCH, *Ibid*.

The entire sales revenue of the following service oriented businesses is subject to tax florists, photographers, photofinishers, printers, tire recapping, fabrications, monuments (less segregated labor for placement), and outdoor advertising Service businesses considered as consumers of material used in the performance of their services are listed in the statute as jewelry repairmen, shoe repairmen, optometrists and oculists, barber and beauty shops, motion picture theaters, auto painters, contractors and builders, painters, and professional services Lodging accommodations are tax-free after 90 continuous days' occupancy

TABLE 27

Maryland: Sales Tax Yields From Selected Services

Selected categories	Collections 1960 (percent)
Utilities and transportation	10 30
Hotels, motels, tourist courts	1 00
Laundry, linen, cleaning service	0 25

Source State of Maryland, *Statistical Report of the Retail Sales Tax and Tobacco Tax Division* (fiscal 1960), pp 12–13 Reproduced from Schoeplein, *op cit*, p 87

Georgia

Georgia is basically a "tangible personal property" state with a legal rate of 3 percent The Georgia statute specifically grants exemptions to professional, insurance or personal service transactions which involve inconsequential sales of tangible personal property, and services rendered by repairmen for which a separate charge is made However, the following are included within the scope of the tax base transportation service, local telephone service, admissions to entertainment, athletic, amusement and similar events services on fabricating materials furnished by the consumer, and lodging accommodations which are regularly furnished to transients and occupied 90 days or less Utilities such as oil, gas and electricity are included in the tax base

Florida

Florida has a 3 percent legal tax rate as do the neighboring states of Alabama, Georgia and South Carolina Only a few specified services are subject to the tax in Florida Effective 1963, admissions are taxed

Taxable transactions are defined in the statute as sales of: [1]

1 Tangible personal property

2 Rentals of specified living quarters

3 Custom fabricating or printing

4 The furnishing of tangible personal property consumed on the premises

The Florida statute and regulations exempt professional, insurance or personal service transactions involving sales as inconsequential elements for which no separate charge is made wired music service, credit reports, information service, furniture and storage warehouse-

[1] CCH, *Ibid*, Sec 30-024

men, garage space by a hotel if billed separately, and hotel auditoriums

Included in the tax base are interior decorating fees, restorations to tangible personal property, printing, and recapped tires

Alabama

Alabama has a sales and use tax with a 4 percent legal rate In practice, the Alabama tax is restricted to tangible personal property although the wording of the statute is rather vague Rulings have excluded repair services if separately billed Major service exclusions include utility services on which excise taxes are paid, other utilities—gas, water and electricity, and transient rentals

Service-oriented industries included are amusement admissions and parking at places of amusement; tire recapping at the selling price of the tire, made-to-order and custom sales, such as awnings, seat covers, convertible tops, slip covers, printing, shoe repair and jewelry, which are taxed at the selling price when tangible personal property is exchanged unless separate billing is performed for the repair service, newspapers and outdoor advertising signs

Kentucky

Kentucky has a 3-percent legal sales tax rate Kentucky bases its tax mainly on tangible personal property, including, however, lodging accommodations for less than 90 days, the furnishing of sewer services and intrastate telephone and telegraph services and the sale of admissions except those subject to special state tax Specifically included are sales of newspapers and magazines at fixed locations (newsboys and newsstands exempt), sales by pharmacists; the sales price of producing, fabricating, and processing property furnished by consumers, printing and engraving services, and services not separately itemized for repair work

Final sales of the following group are exempt but they are considered to be consumers of the materials utilized incidental to rendering the service banks, advertising agencies, commercial artists, laundries, cleaners, barbers, beauty shop operators, tire repairmen, taxidermists, shoe repairmen, bootblacks, medical services, lawyers, engineers, accountants, morticians, and similar businesses and professions

Tennessee

Tennessee has a sales and use tax of 3 percent The scope of the Tennessee tax is described as follows [1]

> "the transfer of title or possession or both exchange, barter, lease or rental, conditional or otherwise, of tangible personal property and includes fabrication and shall include the following services sale, rental, or charges for lodgings or accommodations, but not to include occupancy by the same person for 90 days or more; charges for services rendered by persons operating or conducting a garage, parking lot, or other place of business for the purpose of parking or storing motor vehicles "

Repair services are not subject to the tax, nor are laundry and dry cleaning

[1] CCH, *ibid*, Secs 69-024 and 69-028

Specifically included in the tax base are the following service oriented businesses artists and art dealers, florists and nurserymen, leases and rentals of tangible personal property, made-to-order sales, prescription drugs and medicines, photographs, photostats and blue prints, and printing Considered to be consumers of the materials used in providing their services are barber and beauty shops Newspapers and utilities are excluded from the tax Table 28 shows the percentage contribution to total tax revenue of the "miscellaneous service group" in a recent year

TABLE 28

Tennessee: Sales and Use Tax Yields From Selected Services

Miscellaneous service group category	Sales tax (percent)	Use tax (percent)
Hotels, rooming houses, tourist courts	1 16	0 00
Leasing or renting tangible personal property	1 05	1 67
Bowling alleys, billiard halls	0 03	0 00
Laundries, cleaning, dyeing	0 02	0 34
Newspapers, job printers	0 02	4 94
Warehouses and storage plants	0 03	0 08
Shoe repair and shoeshine shops	0 03	0 00
Machine shops and foundries	0 25	0 41
Miscellaneous	0 41	3 83
Total	3 60	11 27

Source Tennessee Taxpayers Association, *Sales Tax Collections, Fiscal 1960*
Reproduced from Schoeplein, *op cit*, p 97 (with adjustment of total, col 2)

Installation services are presently taxed while storage warehousemen are exempt There is a 1 percent tax on utilities sold to manufacturers and also on industrial machinery instead of the regular retail tax rate.

Louisiana

Louisiana sales and use tax law provides for a legal rate of 2 percent. A number of services are included in the tax base An individual liable for collection of the sales tax is defined as any person who [1]

"sells, leases, rents or stores tangible personal property or the following services

a. The furnishing of rooms by hotels, and tourist camps;

b The sale of admissions to places of amusement and to athletic entertainment other than that of schools, colleges and universities, and recreational events, and the furnishing for dues, fees, or other consideration of the privilege of access to clubs or the privilege of having access to or the use of amusement, entertainment, athletic, or recreational facilities;

c The furnishing of storage or parking privileges by auto hotels and parking lots;

d The furnishing of printing or overprinting or similar services of reproducing written or graphic matter;

e. The furnishing of laundry, cleaning, pressing, or dying services including renovation and storage;

f The furnishing of cold storage space;

[1] CCH, *ibid*, Secs 39-027/044

g The furnishing of repairs to tangible personal property, including by way of illustration and not of limitation, the repair and servicing of automobiles and other vehicles, electrical and mechanical appliances and equipment, watches, jewelry, refrigerators, radios, shoes, and office equipment and appliances."

Included in the Louisiana tax base then are repair services, transient rentals, admissions, laundry and cleaning services, printing services and storage The following businesses or transactions are specifically included in the tax base· auto refinishers, tangible personal property made to order, florists, ice sales, pharmacists, blueprinting, magazines and periodicals, advertising signs, auto rentals and leases, and the first $50 of funeral expenses

Many other service businesses are considered as consumers of incidental materials consumed in the performance of the service Specific examples given are barber and beauty shop operators, physicians and surgeons, and undertakers

Specifically exempt transactions are transportation charges, financial service charges, installation charges if billed separately, photodeveloping, newspapers, furniture storage, hotel fees paid by the month rather than the day, and taxicabs Water and electricity are also excluded from the tax base.

Arkansas

Arkansas has a "gross receipts" tax and a companion "compensating tax," both with a legal rate of 3 percent. Services are generally excluded However, the following service sector transactions are included admissions, dues and fees, materials used in furnishing advertising, rentals or leases of tangible personal property, property consumed in the furnishing of professional services, and public utilities

There is a unique provision which applies to automobiles and appliances which excludes "secondhand" trade-in sales from further taxation

Oklahoma

Oklahoma has a 2 percent sales and use tax law Generally services are not taxed but there are few exemptions of tangible personal property Utilities are taxed with the exception of water Transportation services, admissions, auto parking and storage, printing, and lodging accommodations are also included in the tax base

Regulations include transactions by florists, nurserymen, made-to-order merchandise, photofinishers, photostat and blueprint producers, taxicabs, renters and leasers of tangible personal property, and not less than 60 percent of lump sum funeral charges in the sales tax base People engaged in providing personal or professional services, hospitals, sanatoriums, oculists, optometrists, contractors, and service stations are specifically named as consumers of the incidental material utilized in performing their services

Installation charges which are billed separately are not subject to the sales tax It is interesting to note that total gross receipts of firms providing lodging accommodations are subject to the tax even if the facilities are rented on a permanent basis Table 29 shows a detailed

analysis of the "service group" in the Oklahoma retail sales tax collections in a recent fiscal year.

Texas

Texas has a motor vehicle sales and use tax of 2 percent and also a sales tax of 2 percent on the sales of tangible personal property at retail These taxes were effective July 1, 1963

Specifically exempt from the sales tax are telephone and telegraph sales, tangible personal property used in manufacturing, food for off-premises consumption, gas and electricity Virtually all services are excluded by the tangible personal property nature of the law

MIDWEST RETAIL SALES TAX STATES

Michigan

The Michigan retail sales and use tax presently has a legal rate of 4 percent Generally the Michigan tax is limited to tangible personal property but recently it has been extended to cover transient rentals with no exemptions because of the length of occupancy, as well as intrastate telephone and telegraph service

Service-type businesses taxed include linen and laundry suppliers, sales and multigraphers and mimeographers, a use tax on communication services, painters and lithographers, public utilities such as gas, steam and electricity, sign painting, and custom tailors and dressmakers

TABLE 29

Oklahoma: Sales and Use Tax Collections by Classes of Business, July 1, 1959, to June 30, 1960

Business classification	Sales tax (percent)	Use tax (percent)
Service group		
Hotels and lodging	1 25	0 53
Theaters and tent shows	0 49	0 02
Other amusements, athletic	1 03	0 16
Printing and advertising	0 82	2 57
Barber and beauty	0 06	0 04
Physicians, optometrists, dentists	0 10	2 37
Undertakers	0 34	0 02
Photographers	0 35	0 12
Shoe repair	----	0 02
Other	0 02	0 62
Total service group	4 44	6 47
Food group	24 51	2 64
Apparel group	4 11	1 20
General merchandise	21 07	9 15
Furniture and equipment	4 52	0 48
Motor vehicle*	8 90	1 16
Lumber and materials	10 66	7 85
Public utility and transportation	8 62	26 08
Contracting	----	13 57
Miscellaneous	13 08	31 40

* Does not include vehicle sales which are subject to motor vehicle tax

Source Oklahoma Tax Commission, *Sales and Use Tax*, 1960
Reproduced from Schoeplein *op cit*, p 103

TABLE 30

Michigan: Estimate of Probable Yield From Inclusion of Selected Services, 1956

Services	Increase to tax yield (percent)
Shoe cleaning and repair, cleaning, dyeing, pressing, alteration storage, and repair of garments, laundering in establishments, barber shops and beauty parlors water, auto repair, greasing, washing, parking, storage, purchased local transportation, radio and television repair, admissions to amusements	6 94
Telephone other than business and pay	1 62
Transient hotel and motel	0 64
Total	9 20

Source Michigan Tax Study, *Staff Papers 1956* pp 429–30
Reproduced from Schoeplein, *op cit*, p 107

Considered as consumers of materials consumed incidental to performing their services are barber and beauty shops, bookbinders, contractors, optometrists, theaters, and motion picture houses If the services of blacksmiths, repairers, and auto, electric, machinery or plumbing repairmen are billed separately, they are exempt from the tax

To eliminate the administrative burden of small tax returns, Michigan exempts the first $50 per month of gross sales by each taxpayer (retailer) Michigan has studied the possibilities of widening the sales tax base to include more services The study concluded in part that "broadening the base to include services sold to ultimate consumers not only would increase revenue but would tend to make the tax more equitable" [1]

Table 30 shows their estimates of the increase in revenue from this source in a recent year.

Illinois

Illinois presently has a sales and use tax law with a legal rate of 3 5 percent. The Illinois law is concise and is largely confined to sales of tangible personal property Services, transportation, utilities, admissions and transient rentals are all excluded from the Illinois law

Installation, alteration and special service charges are subject to sales tax if included in the selling price but excluded if billed separately

Ohio

The Ohio sales and use tax law has a legal rate of 3 percent While essentially a "tangible personal property" state, Ohio recently extended the law to apply to the furnishing of lodging accommodations to transients

Service industry exemptions include utility sales subject to excise tax, transportation public utilities, professional services and installation sales Specifically included in the Ohio sales tax base are the following service sector businesses florists, photographers, and producers of photostats and blueprints.

[1] Michigan Tax Study, *Staff Papers, 1956*, p 428

Missouri

The Missouri sales and use tax has a present legal rate of 3 percent While the sales tax base is quite broad, repair services, professional services or personal services are not taxed

The tax base includes the sale of tangible personal property, admissions, electricity, water and gas, telephone and telegraph services, intrastate transportation, and transient rentals.

Major service sector exemptions include sales made by physicians, dentists, and veterinarians of property used in their professions, hotel and tourist camp residents who are deemed "permanent guests," sales by warehousemen, bookbinders, laundries and dry cleaners

The statute specifically exempts all general services not designated as taxable in the law. Semiservices which are within the scope of the sales tax base include rentals, leases or similar transactions, 50 percent of tire retreading if the customer furnishes the tire and 100 percent if the vendor furnishes the tire, florists; prescription drugs, photographers, photofinishers and photoengravers, printers; books, magazines and newspapers; linen and uniform rental; 50 percent of a lump sum funeral service.

Deemed to be consumers of material used in performing their services are contractors, auto refinishers and painters, painters and paperhangers, professional services, barbers and beauty shops, and repair shops of such a nature that the material consumed is incidental to the service General repair shops are required to segregate labor and parts and charge sales tax on the parts

Iowa

The legal rate of the Iowa sales and use tax law is 2 percent The tax base includes sales of tangible personal property, admissions other than state or county fairs, and gas, electricity, water and communication services for retail users

Repairmen who repair the tangible personal property of others are defined as rendering a service and their gross receipts are not subject to the sales tax, however they are considered as consumers of materials utilized in performing their service

Important service sector exemptions include the furnishing or service of transportation, electricity or steam used in the processing of tangible personal property for ultimate sale at retail, advertising and newspapers and magazines The semiservice inclusions are quite limited applying only to pharmacists, florists and nurserymen

Kansas

Kansas has a sales and use tax law with a legal rate of 2¼ percent. In addition to the sales of tangible personal property, the Kansas law includes telephone and telegraph service, utilities, and admissions within the scope of the tax base The furnishing of lodging accommodations for less than 28 consecutive days by an establishment that has four or more sleeping rooms is also taxable

Major service sector exemptions include utility and petroleum sales for use in taxable services, newspapers, and record and tape service In general repair, services must be billed separately to be exempt The following services are specifically exempt from taxation: physicians, surgeons, oculists, optometrists, dentists, veterinarians, barbers, abstrac-

tors, lawyers, architects, painters, sign painters, refinishers, and services performed by beauty shops, hospitals, infirmaries, sanitoriums, schools and colleges, laundries, dry cleaners and other similar services

North Dakota

The legal rate of the North Dakota sales and use tax law is 2½ percent The tax base includes the sales of tangible personal property, steam, gas, electricity, and communications service, admissions, jukebox sales and repair and cleaning services, leasing and rental of tangible personal property, and transient rentals

The inclusions of semiservice businesses are printers and reproducers, photofinishing in excess of the first proof, florists and nurserymen, and hospitals at one-half of gross billings to patients. The statute has detailed provisions concerning the tax status of amusements Dancing and most spectator sports are taxable, while participant sports such as golf and bowling are tax exempt

South Dakota

South Dakota has a retail sales and use tax law with a legal rate of 2 percent The tax base includes sales of tangible personal property, admissions, all utilities, prescriptions and communications, and transient rentals.

Service sector exemptions include transportation services; admissions to state, county or local fairs; advertising charges in newspapers or magazines; and rentals of real or tangible personal property.

Considered as consumers of the materials incidental to performing their services are professional people, barbers and beauty parlors, bootblacks, cleaners, dyers, laundries, painters, and hospitals

Segregation of material from services is specified for blacksmiths, memorial dealers and auto chassis lubricators It is implied that separate billing also extends to general repairmen

A South Dakota civic group conducted a survey in 1959 on the effects of extending the sales tax to include services [1] The proposal was to extend the base of the sales tax to include repair services, transient rentals, professional services, personal services, and business services Recently transient rentals were added to the tax base.

Estimates of the percentage increases in sales and use tax yields in a recent year the shown in the Tables 31 and 32

Wisconsin

Wisconsin imposed a sales and use tax on February 1, 1962, with a legal rate of 3 percent The tax applies first to certain specified items of tangible personal property It applies also to laundry and dry cleaning, transient rentals, admissions, intrastate telephone and telegraph services, photographic service and the repair and maintenance of taxable tangible personal property

The Wisconsin law is an extremely interesting one since it applies to many services but only a specified list of tangible personal property items It would appear from the nature of the items included in the tax base that the Wisconsin law would be a relatively highly progressive one.

[1] South Dakota Citizens Tax Study Committee, *Report, 1959.*

The principal tangible personal property items concerned are liquor and beer; tobacco; motor vehicles, aircraft, radios, television sets and musical instruments, food consumed on the premises, sports equipment excluding toys and games, household furnishings, jewelry, furs, miscellaneous leather goods, perfume, and soft drinks

TABLE 31

South Dakota: Estimated Tax Receipts From Extension of 2 Percent Sales Tax to Selected Services, 1959

Type of service	Increase as percent of tax yield
Personal services	1 717
Business services	0 534
Automobile repair	0 925
Miscellaneous repair	0 517
Hotels, motels, etc	1 273
Total	4 966

Source South Dakota Citizens Tax Study Committee, *Report*, 1959 Adapted from dollar estimates, p 81–82 Reproduced from Schoeplein, *op cit*, p 119

TABLE 32

South Dakota: Estimated Tax Receipts From Extension of 2 Percent Sales Tax to Professional Services, 1959

Profession	Increase as percent of tax yield
Doctors	1 183
Dentists	0 470
Lawyers	0 821
Others	0 365
Total	2 839

Source South Dakota Citizens Tax Study Committee, *Report*, 1959 Adapted from dollar estimates, pp 81–82 Reproduced from Schoeplein, *op cit*, p 119

FAR WEST RETAIL SALES TAX STATES

Wyoming

The legal rate of the Wyoming sales and use tax law is 2 percent The tax base includes the sale of tangible personal property, admissions, transportation, telephone and telegraph service, electricity, gas, and the leasing and rental of tangible personal property. Transient rentals are not taxed. Major service sector exemptions include city cab and bus fares of less than 24 cents and gas, electricity and water furnished through mains

It is implied that materials and service charges should be separated and a sales tax charged on the materials General services are also omitted from the tax base It is specified in the statute however that jewelry repairers, optometrists, physicians and surgeons are to be considered as consumers of incidental materials utilized in the performance of their services. Specifically included semiservices are florists, magazine

agencies, prescription drugs and photofinishing when only a single charge is made.

Colorado

The Colorado sales and use tax laws have a legal rate of 2 percent The tax base consists mainly of the sale of tangible personal property but it also includes gas, electricity and communications, and transient rentals Service sector exemptions include newspapers and lodging accommodations after 30 consecutive days of rental

The law provides that in the semiservice sector the sales tax must be paid on the purchase price of articles made to order for the customer Listed under this heading are custom tailors, custom furriers, drug prescriptions, drapes, curtains, eyeglasses, cabinetmakers, photographers, printers and picture framers A table is provided within the statute for determining the sales taxation of morticians when one charge is made without separation of property and services Separate invoicing is provided for materials and services in repair services with the sales tax applying to the materials only

Sales to manufacturers of component parts are tax exempt

Utah

The legal rate of the Utah sales and use tax laws is 2 percent Utah is one of the few states extending its sales tax base to include a large number of services From July 1, 1963, to July 1, 1969, a temporary additional tax of one-half percent is levied, making the legal rate 2½ percent

The Utah Sales Tax Law, effective July 1, 1961, now reads.[1]

"There is levied and shall be collected and paid

1 A tax upon every retail sale of tangible personal property,
2 Transportation and telephone and telegraph service intrastate,
3. Utilities and fuel other than rural electrification,
4. All meals furnished by commercial establishments;
5 Admission to any place of amusement, entertainment, or recreation,
6 All services for repairs or renovations of tangible personal property, or for installation of tangible personal property rendered in connection with other tangible personal property,
7. Charges for transient living accommodations except where residency is maintained continuously under terms of a lease or similar agreement for 30 days or more,
8 Charges for laundry and dry cleaning services"

The new statute extends the sales tax base to all repair services and provides a long list of examples Semiservice establishments listed as also included in the sales tax base are florists, 50 percent of grown floral and nursery items, magazines, prescription drugs, recapping and repairing of tires, photographers and photofinishers, polishing and printing Certain businesses which provide personal services are listed

[1] CCH *op cit*, Secs 71-034/040.

as consumers of the materials incidental to the performance of their service These businesses include barbers and beauty operators, optometrists and oculists, and the professional services Separation of property and services is required of morticians with the tax applying only to the property sold.

Nevada

The legal tax rate of the Nevada retail sales tax is 2 percent The Nevada tax was enacted in 1955 after long consideration of the experience of other states The tax is imposed on the gross receipts of any retailer from the sale of all tangible personal property sold at retail in the state Admissions, transient rentals, utilities and services are excluded because the tax base is primarily tangible personal property.

Major service sector exemptions include gas, electricity and water delivered through mains, lines or pipes, material for domestic heat, and newspapers and periodicals The law holds that businesses providing professional or personal services are consumers of materials utilized in the provision of the service The segregation of service and material charges on the invoices of repairer and reconditioners is also required When only an insignificant amount of materials is involved, the repairer is then deemed to be the consumer and there is no sales tax on the customer's invoice

Semiservices included in the scope of the law include the finished work of commercial artists, prescription drugs, photofinishers, printing and engraving, and florists Also included in the tax base is 50 percent of tire recapping and electric motor or transformer rewinding charges

In their 1948 report on the sales tax, the Nevada Legislative Counsel Bureau considered the expansion of the tax base to include services and they noted:[1]

> " . . a sales tax should not be applied to blanket fashion to all services. An examination of the various types of services, however, reveals several whose inclusion within the scope of the tax would not only be feasible but would actually facilitate efficient administration as well as further the attainment of the other objectives of the tax
>
> "The groups of services which might be included within the scope of the tax consists of consumers' services ordinarily rendered by established commercial enterprises conducting business in a manner substantially the same as that of consumers selling tangible personal property. The group includes
>
> 1 Repair and fabrication of taxable articles, such as shoe repair, tailoring, and household appliance repair
> 2 Laundry service and dryecleaning
> 3 Barber shop and beauty parlor services
> 4 Rental or tangible personal property "

The Nevada Legislature chose to enact a tangible personal property law rather than include services in the tax base. However, in 1960 a

[1] Nevada Legislative Counsel Bureau *Survey of Sales Tax Applicable to Nevada,* pp 29-30 (Carson City. 1948).

survey placed strong emphasis on widening the base of the Nevada sales tax law [1] This report made an estimation of the probable yield from the widening of the sales tax base to include certain services.

Table 33 shows these estimated yields for the services considered in the report

The report stressed the advantages of including transient rentals and amusements in the tax base since the major part of the burden would fall on nonresidents and chiefly people of medium and high income groups This argument has particular significance in Nevada because of the extremely large tourist industry there relative to the rest of its industrial base.

TABLE 33

Nevada: Estimated Effect of Changes in Tax Base Data for 1958

Inclusion of services	Estimated yield (thousands)	Percentage increase to yield
Hotels, motels, camps	$2,059	17 846
Public utilities	553	4 793
Personal services	344	2 983
Amusements (other than gambling)	60	0 520
Auto repair, garages	187	1 621
Other repair	78	0 676
Total	$3,281	28 438
Total collections, fiscal 1958		$11,537,000

Source Nevada Legislative Tax Study Group, *Financing State and Local Government in Nevada*, 1960, p 423
Reproduced from Schoeplein, *op cit*, p 128

TABLE 34

North Carolina: Revenue Collections and Possible Revenue Collections by Business Type, Fiscal 1960

Business group	Actual tax collections 1960	Possible tax collections no exemptions	Increase in tax receipts
Apparel group	$5,576,715	$5,919,181	$342,466
Automotive group	15,325,836	44,352,404	29,026,568
Food group	12,485,002	34,239,483	21,754,481
Furniture group	7,499,113	9,745,321	2,246,208
General merchandise	21,657,747	29,199,968	7,542,221
Lumber and building	10,915,757	17,255,369	6,339,612
Beauty and barber	148,361	174,254	25,893
Florists and nurseries	389,565	470,706	81,141
Rental of rooms	947,027	1,006,060	59,033
Undertakers	498,327	663,711	165,384
Totals	$76,443,450	$143,026,457	$67,583,007
Net increase if food group were totally exempt			$33,343,524

Source Constructed from information on business groups furnished by State of North Carolina, *Statistics of Taxation*, December 31, 1960, pp 212-13, 239-40
Reproduced from Schoeplein, *op cit*, p 136

[1] Nevada Legislative Tax Study Group, *Financing State and Local Government in Nevada* (Carson City 1960)

VI

TAXATION OF SERVICES: MULTI-STAGE SALES TAX STATES

The states in this section impose sales-type taxes at various stages of distribution, not merely the retail level [1]

Arizona

Arizona is a general sales tax state There is a tax levied on the gross income of about 17 different types of businesses. Manufacturing, wholesaling, farming and motor transportation are excluded from the tax base For sales at retail, the legal tax rate is 3 percent Professional or personal services with inconsequential transfer of tangible personal property are exempt While repair service is excluded as long as it is separately billed, many services are covered The tax base includes publishing, including subscriptions and job printing; advertising; income from hotels, dude ranches, resorts, tourist camps, apartment house and office buildings, auto rentals, contracting sales to residents, including engineering and architectural fees, pharmaceutical sales; and utility services

North Carolina

Basically the North Carolina tax is a 3-percent levy on retail sales of tangible personal property, transient rentals, laundry, cleaning and dyeing and rentals or leases of tangible personal property with in addition a 0 05-percent levy on wholesalers and a 1-percent levy on specific businesses

Repairmen are required to segregate materials and labor and charge sales tax on only the materials Services are not included in the tax base to any great extent Table 34, however, indicates possible increases in sales tax revenue if all exemptions were removed

Mississippi

Mississippi has a series of different tax rates for various categories of manufacturers, wholesalers and retailers ranging from 0 125 percent to 3½ percent The tax rate on gross receipts of retailers and from transient rentals is 3½ percent

The tax base includes utilities, contracting, most repair businesses, recreational facilities, and lodging accommodations Most services except professional services are taxed

New Mexico

The New Mexico tax system is a broad-based gross receipts tax that includes all services such as repair service, personal and professional service and real property sales and service The retail tax rate is 3 percent

[1] Sources Schoeplein and CCH volumes cited previously

There is a large variety of rates applied to other businesses Contributions to total tax yield in a recent year by various businesses is shown in Table 35

Washington

Washington has a retail sales and use tax together with a business and occupation tax Their coverage is quite broad and business, personal professional and repair services are covered with few exceptions Rates range from 0 44 percent to 4 0 percent Transient rentals are taxed See Tables 36 and 37

Hawaii

Hawaii has a "general excise tax" together with a use tax Virtually all businesses operated for a profit are covered by the tax, and there is a variety of tax rates for the different levels of production Rates range from 0 75 percent to 3½ percent The few major exemptions include hospitals, banks, public utilities and insurance companies subject to separate legislation This tax is extremely broad in its coverage

TABLE 35

New Mexico: Tax Collections by Business Category, 1957

Class	Rate (percent)	Tax collection as percent of total yield
Apparel	2	2 2
Auto accessories	2	5 2
Subsistence	2	15 6
Furniture	2	2 7
Building material	2	5 0
Other retail stores	2	19 8
Public utilities	2	4 7
Contracting group	2	11 7
Professional and personal	2	6 6
Amusement	2	0
Agents and brokers	2	5
Wholesale jobbing	0 125	1 1
Natural resources	2	15 4
Manufacturing processing	0 25	2 6
Automotive sales	1	3 1
Miscellaneous revenue	----	2 9
Total		100 0

Source Adapted from information presented in New Mexico State Bureau of Revenue, *Biennial Report 1956–1958*, p 31 Reproduced from Schoeplein, *op cit*, p 143

TABLE 36

Washington: Business and Occupation Tax by Kind of Business, 1960

Category	Tax rate (percent)	Percent of yield
Extracting	0 44	0 5
Manufacturing	0 44	18 2
Wholesaling	0 44	25 8
Retailing	0 44	42 0
Service and miscellaneous	0 44	13 5

Source Washington State Tax Commission, *18th Biennial Report, 1960*, p A-15 Reproduced from Schoeplein, *op cit*, p 147

TABLE 37

Washington: Service Category of Business Occupation Tax, 1960

Activity	Percent of total business occupation tax
Amusements	0 7
Engineers, architects	0 5
General contractors	0 1
Stock brokers, loan companies	0 8
Real estate, insurance	2 1
Collection, advertising	0 7
Attorneys	0 7
Rental of realty	0 3
Water service	0 2
Barber shops, beauty	0 3
Physicians, dentists, hospitals	2 6
Other services	4 5

Source Washington State Tax Commission, *18th Biennial Report, 1960,* p 4–15
Reproduced from Schoeplem, *op cit*, p 147

and leads to a large amount of tax pyramiding since it is levied at every stage of production, not on the value added but on the gross income of the firm The importance of this tax in the island's tax structure can be seen in Table 38

West Virginia

The present West Virginia tax code includes the "occupational gross income tax" together with retail sales and use taxes The basic rate for retail sales has been 2 percent, but there has recently been added a temporary 1-percent additional sales and use tax to make the legal rate 3 percent.

The taxes in this state involve some tax pyramiding since they are levied on gross income at several stages of production. Professional and personal services are excluded from all the tax codes The taxation of services is quite extensive It is interesting to note that they tax stock and bond brokers and schools. Utilities sold through mains are exempt from the tax while food is not. The West Virginia occupational gross income tax includes the receipts from certain real and personal property, making it an extremely broad based tax. The tax approaches the definition of a gross income tax

Indiana

Indiana is a gross income tax state with a levy on the gross income of all business and professions, including receipts from other than commercial selling transactions There is a variety of rates under this statute and services are taxed at from 0 375 percent to 1 5 percent Services taxed at 0 375 percent include dry cleaning, laundering, repair businesses and undertakers Florists, job printers, barber and beauty shops, and utility services are among thos taxed at 1 5 percent, as are professional services and many personal services

Recently a "gross retail tax" or sales tax has been added to the Indiana tax structure. The tax base of the retail sales tax includes sales of tangible personal property; transient rentals; water, electricity,

TABLE 38

Hawaii: Source of the Tax Dollar, 1960

Source	Percent
1. General excise (gross income) tax, compensating tax, consumption tax	43
2 Income category	23
3. Property taxes	13
4. All others	21
Total	100

Source Hawaii (State) Director of Taxation, *Annual Report, 1960.*
Reproduced from Schoeplein, *op cit*, p 150

gas or steam for domestic consumption; and intrastate telephone and telegraph service Service stations are deemed consumers of items incidental to providing their service Service and labor charges are tax exempt in repair work when separately billed.

Alaska

The state of Alaska has a business license tax which amounts to a tax on gross receipts This tax is quite broad in its coverage, exempting only nonprofit organizations and production receipts subject to the state's production tax The tax therefore is levied at several stages in the production process which implies a certain amount of tax pyramiding. All services are covered by this tax. The rate is a basic charge of $25 plus ½ percent of gross receipts up to $100,000 with the first $20,000 tax exempt. The rate of ½ percent applies to all gross receipts over $100,000.

Delaware

The state of Delaware imposes a license tax on manufacturers and on retail and wholesale merchants The manufacturing rate is $5 plus 1/40 percent on gross receipts, while merchants must pay $5 plus ¼ percent of the aggregate cost value of goods sold with the first $5,000 of sales tax exempt.

Connecticut

Connecticut's sales and use tax law, initiated in 1947, has a legal rate of 3½ percent The statute covers sales of tangible personal property and also transient rentals Transient rental is defined as occupancy for a period of 30 consecutive days or less

If repair parts are insignificant to a repair service, no sales tax is levied, but the repairman is the consumer of such parts Specific examples given are jewelers, shoe and hat repairmen. Also tax is levied on material used in advertising, personal service publications, racing forms, paintings or portraits, paint sold to painters, and material in auto repairing

The statute also requires that separate tallies be kept on repairs and materials where parts and material are a significant part of total cost and sales tax is applied to the parts and materials.

Production materials are excluded from the tax but machinery is taxable.

In addition to the retail sales tax, Connecticut has a gross income tax on the proceeds of unincorporated businesses The tax rate is 0 13 percent on the first $60,000 of gross sales and 0 26 percent over that This tax applies to unincorporated businesses involved in retail sales, motor transportation, amusements or manufacturing

The rate on wholesale sales is 0 035 percent on the first $60,000 and 0 065 percent over $60,000 The regulations state specifically that since the law applies chiefly to the sale of tangible personal property, professional people such as architects are exempt

Rhode Island

First enacted in 1947, the present legal sales tax rate in Rhode Island is 3¼ percent Although Rhode Island is a "tangible personal property state," the section of the statute defining the scope of the sales tax is quite complex It reads that the scope of the retail sales tax is to include [1]

1 Any transfer of title, or possession, exchange, barter, lease, or rental, conditional or otherwise, in any manner or by any means of tangible personal property for a consideration,
2 The producing, fabricating, processing, printing, or imprinting of tangible personal property for a consideration;
3. The furnishing, preparing, or serving for a consideration of food, meals, or drinks, including any cover, minimum, entertainment, or other charge in connection therewith,
4 The furnishing and distribution of electricity, natural gas, artificial gas, steam, refrigeration, and water,
5 The furnishing of service to telephone subscribers or furnishing of telegraph, cable, or radio messages

Segregation of materials and services is required of repairers and reconditioners with sales tax to be charged on materials The statute specifically includes entire charges made by caterers, printers, photographers and photostat producers, X-ray laboratories, material consumed by a contractor in the course of construction, florists

Rhode Island has recently enacted a gross income tax on the proceeds of unincorporated businesses The tax rate is 0 20 percent on the first $30,000 of gross sales and 0 10 percent of gross sales over $30,000 The first $5,000 of income is exempt

Virginia

Virginia now has a merchant's license tax based on gross income The wholesale rate is $50 on the first $10,000 and 0 1 percent over that The retail rate is $20 on the first $2,000 gross sales and 0 2 percent above that Retail merchants are defined so as to exclude the provision of lodging accommodations or the sale of services from the tax base Since the tax is both on the wholesale and retail level, it is a multiple stage tax

[1] CCH, *Ibid*. Sec 66-026

VII

ESTIMATES OF TAX YIELD FROM SELECTED SERVICES IN CALIFORNIA

This part of the study is concerned with estimates of the increase in sales tax revenue likely to result from the extension of the sales tax base to include certain selected services The basic estimates are those made by Schoeplein in 1962 [1] The estimates recognize that a considerable portion of the gross revenues listed in *The Census of Business* is already taxed under the California Sales and Use Tax Law The amounts already taxed were estimated for each of the services individually and followed consultations with statisticians in the State Board of Equalization and the Department of Finance Current estimates by the board are primarily a projection of Schoeplein's original study to reflect anticipated increase in personal income with allowances for gross receipts which would be uncollectible for various reasons [2]

An alternative approach used by the Stanford Research Institute uses a "lump sum" approach and is a sample extrapolation of the Bureau of the Census data with a reduction factor of 25 percent to compensate for taxes which are now being collected [3]

There are certain service areas where a sales tax has serious disadvantages The taxation of services rendered to business, for instance, would lead to imperfect shifting and tax pyramiding Business services are clearly intermediate goods and do not fall into the category of final sales

1. *Utilities*

Tables 39, 40 and 41 show the estimates made of the revenues to be gained by the extension of retail sales taxes to utilities

As can be seen, the extension of the retail sales tax to utilities would provide an extremely large source of revenue Administrative costs would be quite low An important consideration, however, is that of equity It is important to determine the effect of the inclusion of utilities on tax regressivity This will be considered in some detail later in this study

2. *Repair Services to Tangible Personal Property*

Table 42 shows the estimate of tax yields from repair services to tangible personal property [4]

As can be seen, the revenue to be gained from this category is not particularly large, however the administrative cost would appear to be relatively small since most of these establishments currently pay sales

[1] In the work cited previously

[2] Letter to Mr David Doerr, committee consultant, Assembly Interim Committee on Revenue and Taxation, from John B Marshall, senior statistician, Research and Statistics, State Board of Equalization, June 8, 1964

[3] *Ibid*

[4] See the Schoeplein study cited above for details on the method utilized to derive these figures

taxes on materials and parts The inclusion of repair services would also eliminate a great deal of bookkeeping for the business firms since they would now pay retail sales tax on their gross receipts rather than segregating parts and materials charges as at present This could greatly diminish their collection costs An estimate of the incidence of this extension with regard to net income is given in Table 43

3. *Personal Services*

Estimated tax yields from the extension of sales tax to personal services are given in Table 44

The probable increase in sales tax income is about 2 9 percent There are however formidable administrative problems to be considered here In the 1958 *Census of Business* California survey there were 40,134 such firms Only about 6,500 of these firms filed reports with the State Board of Equalization Therefore extension of the sales tax to this category would have required about 34,000 new permits Due to the nature of the firms in this industry, most of whom are quite small, auditing costs could be quite high

4. *Rentals and Leases of Tangible Personal Property*

The estimate of the additional yield from the extension of the retail sales tax base to include rentals and leases of tangible personal property is given in Table 45 A preliminary estimate for the fiscal year

TABLE 39-A

Gas, Electricity and Telephone

Utilities	1958 estimated tax yields
State, at 3 percent	$57,464,000
Local, at 1 percent	19,155,000
Total	$76,619,000

Reproduced from Schoeplein, *op cit*, p 212

TABLE 39-B

Gas, Electricity, Telephone and Water

Utilities	1962 estimated tax yields	
	State—3 percent	Local—1 percent
Gas and electricity	$59,595,594	$19,865,198
Telephone	29,399,707	9,799,902
Water	6,545,000	2,181,667
Totals	$95,540,301	$31,846,767

Source Data developed from California Public Utilities Commission records by Ralph Kelly, research analyst for Assembly Committee on Revenue and Taxation

TABLE 40

Estimated 3 Percent State Sales Tax Yields From Gas and Electricity Sales, 1962

	Taxable sales	Estimated tax yield—3 percent	Cumulative estimated tax yield—3 percent
Electric utilities			
Private utilities			
Residential	$186,341,713		
Commercial and industrial	504,129,321		
Public streets and highways	17,823,888		
Sales to public authorities	24 717,007		
Sales to railroads	420,165		
Other	12,136		
Total sales to final customer	$903,444,230	$ 27,803,326	
Publicly owned utilities			
Irrigation districts	$19,014,931		
Municipal*	217,060,773		
Sacramento Municipal Utility District	25,958,595		
Total sales to final customer	$262,034,299	7,861,028	
Total tax yield—electricity			$37,664,354
Gas utilities			
Private gas utilities			
Residential	$462 018,563		
Commercial and industrial	248,290,006		
Sales to public authorities	1,215,454		
Total sales to final customer	$711,524,023	21,345,720	
Public gas utilities			
Municipal*	$19,517,340	585,520	
Total tax yield—gas			$21,931,240
Total tax yield—3 percent on sales of electricity and gas			$59,595,594

* For fiscal year 1962–63

Source Data developed from California Public Utility Commission records by Ralph Kelb, research analyst for Assembly Committee on Revenue and Taxation

1965–66 suggests that sales tax revenue from this source could go as high as $20,000,000 [1]

In this area there is the familiar problem of tax pyramiding since there is a great deal of rental, particularly auto and truck rental that is undertaken by business firms It would appear, however, that at least a consistent policy in this area could be followed If purchases of business machinery and equipment are subject to a retail sales tax, rental or lease of the same equipment could also be subject to the retail sales tax Otherwise the tax acts to affect the "buy or lease" decision Conversely, of course, if the sale of the equipment is tax exempt, the lease could also be tax exempt Therefore the decision to extend the tax base to this category should depend mainly on the tax status of related intermediate goods

[1] Letter to the Honorable Nicholas C Petris, chairman, Assembly Interim Committee on Revenue and Taxation, from John B Marshall, senior statistician, Research and Statistics, California Board of Equalization, June 8, 1964

TABLE 41-A

Estimated 3 Percent State Sales Tax Yields From Telephone Services, 1962

Private telephone companies	1962 revenues	Tax yield at 3 percent
Local		
Subscribers	$711,432,687	
Public telephone services	28,758,999	
Local private lines	18,904,773	
	$759,096,459	$22,772,893
Toll*		
Message tolls	$391,779,749	
Undersea tolls	3,929,513	
Private line tolls	46,078,687	
	$441,787,949	$13,253,638
Tax revenue on intrastate calls using Schoeplem's 50 percent intrastate assumption		$6,626,814
Total estimated revenue yield at 3 percent intrastate telephone service		$29,399,707

* Intrastate and interstate

Source Same as Table 40

TABLE 41-B

Estimated 3 Percent State Sales Tax From Sales of Water Delivered Through Mains, 1962–63

Sales in areas with population of 4,083,688	$61,515,161
Estimated sales statewide 1962–63	$218,162,525
Estimated revenue at 3 percent	$6,545,000

Source See table above

TABLE 42

Repair Services to Tangible Personal Property

1958 estimated tax yields

State, at 3 percent	$17,763,000
Local, at 1 percent	5,921,000
Total	$23,684,000

Reproduced from Schoeplem, *op cit*, p 219

TABLE 43

Incidence of a 3 Percent Sales Tax on Repair Services to Tangible Personal Property

Item	Household income	Dollars tax per $1,000 income	Difference per $1,000 vs $2,500 income	Tax rate as percent of $2,500 income rate
Auto repair and auto insurance	$2,500	$0 68	----	----
	4,500	0 74	$0 06	108 82
	6,000	0 78	0 10	114 71
	8,000	0 75	0 07	110 29
Miscellaneous	2,500	1 72	----	----
Repair services and professional services	4,500	1 87	0 15	108 72
	6,000	1 53	(0 19)	88 95
	8,000	1 85	0 13	107 56
Jewelry, watch care	2,500	0 12	----	----
	4,500	0 13	0 01	108 33
	6,000	0 12	0 00	100 00
	8,000	0 15	0 03	125 00

Reproduced from Schoeplein, *op cit*, p 188

TABLE 44

Personal Services

1958 estimated tax yields	
State, at 3 percent	$17,504,000
Local, at 1 percent	5,833,000
	$23,337,000

Reproduced from Schoeplein, *op cit*, p 228

TABLE 45

Rentals and Leases of Tangible Personal Property

1958 estimated tax yields	
State, at 3 percent	$3,700,000
Local, at 1 percent	1,230,000
	$4,930,000

Reproduced from Schoeplein, *op cit*, p 232

5. Transient Rentals

The estimate of the tax yield from the extension of the retail sales tax to transient rentals is given in Table 46

TABLE 46

Transient Rentals

	1958 estimated tax yields
State, at 3 percent	$6,252,000
Local, at 1 percent	2,084,000
Total	$8,336,000

Reproduced from Schoeplein, *op cit*, p 244

TABLE 47

Sales Tax Yields of Seven States From Transient Rentals

State	1958 total receipts hotels, motels, etc	1958 total sales tax collections	Percent increase to total sales tax	State tax rate (percent)	Dollar yield from transient rentals	Tax base as percent of total hotel, etc receipts
		(Dollars in thousands)				
Maryland	$31,786	$44,219	1 00	3	$442	46 35
Michigan	109,927	317,342	0 04*	3	2,031	61 59
Nevada	108,806	10,304	17 85*	2	1,839	84 51
North Carolina	48,573	73,296	1 29	3	947	64 99
South Dakota	13,259	13,783	1 27*	2	175	65 99
Tennessee	43,245	91,563	1 16	3	1,062	81 86
California	409,619	597,086	1 05*	3	6,250	50 88

* Estimated

Reproduced from Schoeplein, *op cit*, p 248

A large number of other jurisdictions now tax such rentals as shown in Table 47. Transient room renters are generally either businessmen or tourists There is a great deal of evidence that the incidence on tourists of a tax on transient room rentals is progressive because overnight tourism is generally undertaken by middle and upper income consumers This can be seen in Table 48

A large part of the burden of a tax on transient rentals would fall on out-of-state residents Since these tourists obtain the benefits of many government services while in California, it may be argued that the transient room rental is a method whereby they contribute to the support of the government services whose benefits they enjoy Similarly, a "transient" who decides to stay and rent or buy an apartment or house starts contributing immediately rather than after some delay.

Administratively, this extension would add quite a few new accounts to the sales tax rolls The administrative costs of handling extremely small lodging units make an exclusion of lodging establishments with less than four or six rooms appear quite attractive As can be seen

above, this provision is frequently made in those jurisdictions taxing transient rentals Another important provision is the definition of the term "transient rental " Many jurisdictions provide that lodging rental is exempt from taxation after the 30th day of consecutive occupancy Perhaps a better differentiation can be made on the basis of whether the rental is paid by the day or by the month with rentals paid by the month being tax exempt.

A special problem arises from the fact that some communities have already adopted motel and hotel occupancy taxes Could the state impose an occupancy tax effective only in cities and counties which do not have hotel occupancy taxes? Legal opinion is to the effect that the

TABLE 48

Family Vacation Trips by Income Class

Category	Family income			
	Under $3,000 (percent)	$3,000–4,999 (percent)	$5,000–7,499 (percent)	$7,500–over (percent)
Vacation trip of 100 or more miles adults				
Has taken vacation trips	60	74	88	93
Never has taken such trips	40	25	12	7
Not ascertained	--	1	--	--
Total	100	100	100	100
Plans to take vacation trip in next 12 months adults				
Definitely	12	23	36	49
Probably	5	11	10	16
Undecided	6	4	4	5
Will not take trip	76	61	49	29
Not ascertained	1	1	1	1
Total	100	100	100	100

Source *American Motel Magazine* (January 1959), pp 28-29 From Report by University of Michigan Survey Research Center, *1958 National Travel Market Survey*
Reproduced from Schoeplein, *op cit*, p 196

state could impose a privilege tax which would be applicable only in those areas of the state where a similar local tax is not imposed [1]

6. *Amusements*

The estimated increase in sales tax yield from the extension of the tax base to include amusements is given in Table 49

This is a field relatively heavily taxed by the federal government There is fairly good evidence however that a tax on amusements would be highly progressive Part of the burden would also be borne by out-of-state residents Provisions should presumably be made to exclude amusements sponsored by nonprofit organizations such as schools and colleges as well as state, county and local fairs These provisions can

[1] Letter to the Honorable Nicholas Petris, chairman, Assembly Interim Committee on Revenue and Taxation, from A C Morrison, Legislative Counsel, by Don Vickers, Deputy Legislative Counsel, June 3, 1964 The following cases are cited in support of the opinion in point *Roth Drug, Inc* v *Johnson* (1936), 13 Cal App 2d 720, 732, and *Charles C Steward Machine Co* v *Davis* (1937) 301 U S 548, 589, 81 L Ed 1279, 1292, and on related issues, *State of Florida* v *Mellon* (1927) 273 U S 12, 71 L Ed 511, *Gilhem* v *Johnson* (1936) 7 Cal 2d 744, and Sec 7202, R & T C.

be found in the statutes of most jurisdictions currently taxing admissions. The equity consideration of progressivity might outweigh the fact that the federal government is already taxing this area.

7. *Professional Services*

Professional services, which include mainly the services of physicians, surgeons, dentists, lawyers, accountants, architects, and management consultants present special difficulties. Equity considerations may be important in the taxation of medical services since such taxation might be highly regressive. Since many lawyer's services are provided to business firms, their taxation would lead to tax pyramiding There is also an administrative problem. Taxation of professional services would require initiation of many thousands of new accounts and auditing costs might be relatively high.

It is difficult to make revenue estimates in this area because of the dearth of available data even indirectly related to the problem A range of $50 to $60 million appears reasonable for the 1965–66 fiscal year [1]

TABLE 49

Amusements

1958 estimated tax yields

State, at 3 percent	$12,784,000
Local, at 1 percent	4,261,000
Total	$17,045,000

Reproduced from Schoeplein, *op cit*, p 239.

TABLE 50

Estimates of California Sales Tax Yields From Selected Services

State Legal Sales Tax Rate 3 Percent

Service category	California, 1958*		California, 1962*	
	Estimated tax yield (000)	Addition to yield (percent)	Estimated tax yield (000)	Addition to yield (percent)
Utilities	$57,464	9 62	$76,900	10 00
Repair services	17,763	2 98	23,839	3 10
Personal services	17,504	2 93	22,301	2 90
Equipment rentals	3,700	0 62	6,921	0 90
Transient room rent	6,252	1 05	9,228	1 20
Amusements	12,784	2 14	16,918	2 20
Totals	$115,467	19 34	$156,107	20 30
Base sales tax yield without services†.				
Calendar 1958				$597,086,000
Calendar 1962				769,000,000

* Calendar years
† Source 1958 only State Board of Equalization, *Annual Report* Fiscal 1957–1958 and fiscal 1958–1959, quarterly data Reproduced from Schoeplein, *op. cit*, p 242.

[1] Letter to Mr David Doerr, committee consultant, Assembly Interim Committee on Revenue and Taxation, by John B Marshall, senior statistician, Research and Statistics, State Board of Equalization, June 8, 1964

Summary

Table 50 summarizes the additional tax yield to be gained from the extension of the sales tax base to include the above services, except professional services. It is evident that there is much revenue to be derived from this source. Tables 51 and 52 tabulate the estimated revenues for the 1965–66 fiscal year. The 3-percent state tax alone is estimated to yield over $87 million on services (excluding utilities)

TABLE 51

Estimated Sales Tax Revenues That Could Be Derived in the 1965–66 Fiscal Year by Extending the Tax to Include Services

Class number	Taxable service	Estimated taxable transactions	State tax at 3 percent
1	Auto and truck repairs	$690,000,000	$20,700,000
2	Other transportation equipment and farm implement repairs	34,000,000	1,020,000
3	Personal service repairs	340,000,000	10,200,000
4	Personal services	895,000,000	26,850,000
5	Transient accommodation rentals	325,000,000	9,750,000
6	Amusements	620,000,000	18,600,000
	Totals	$2,904,000,000	$87,120,000

Source California State Board of Equalization (Letter from John B Marshall, senior statistician, Research and Statistics, to the Honorable Nicholas C Petris, chairman, Assembly Interim Committee on Revenue and Taxation, April 2, 1964)

TABLE 52

Detailed Description of Selected Services to Which Sales Tax Could Be Extended, With Estimated Revenues in the 1965–66 Fiscal Year

Class 1 Auto and Truck Repairs Includes the repair of automobiles and trucks, and the gross receipts of all auto parking facilities and such nonrepair services as automotive washing, waxing, and towing
Revenue estimate $20,700,000

Class 2 Other Transportation Equipment and Farm Implement Repairs Includes repairs made on aircraft (both private and commercial), watercraft, motorcycles, bicycles and farm implements
Revenue estimate $1,020,000

Class 3 Personal Services Repairs Includes the repair of watches radios and TV sets household, commercial, and industrial appliances and machinery and all types of furniture and equipment not covered under items 1 and 2
Revenue estimate $10,200,000

Class 4 Personal Services. Includes all service charges made by beauticians, barbers, launderers, cleaners, dyers, shoe repairmen, funeral parlors, and other types of personal services other than professional services and services rendered insurance companies, real estate agencies, financial institutions, and stock exchanges
Revenue estimate $26,850,000

Class 5 Transient Accommodation Rentals Includes the rental receipts of hotels, motels, tourist courts, and trailer parks from transients
Revenue estimate $9,750,000

Class 6 Amusements Includes admission charges to theatres, dance halls, sporting and racing events, and any charges for the use of sporting facilities State and county fairs and school and church events would not be subject to the tax
Revenue estimate $18,600,000

Source Same as Table 51

VIII

THE EFFECT OF CHANGES IN THE SALES TAX BASE AND SALES TAX RATE ON REGRESSIVITY

Growth of the California economy will automatically ensure some rise in sales tax revenues without change in rate or coverage If the state is to realize even more revenue than this from its retail sales and use tax either the tax rate must be raised, or the tax base must be broadened to include some services, or a combination of these means must be employed Previous chapters have considered the amount of extra revenue to be derived from extending the scope of the sales tax base to include various services We will now consider the incidence of a broadened sales tax base and compare it with the incidence of a higher tax rate.

RATE VS. COVERAGE

Table 53, below, shows the effective tax rates for various income classes for the present tax base with both a 4-percent tax rate and a 5-percent tax rate The effective tax rate for each income class is derived by dividing the amount of taxes paid by the "net resources" (income and net worth) for that particular class It should be recalled from previous discussion of this method of determining the regressivity of a tax that the reason "net resources" is used as the "ability-to-pay" measure for equity purposes is that "net resources" represents the actual ability to pay of a family Neither net nor gross income concepts take into account the net worth of the individual They also do not allow for transitory variations in income In calculating the progressivity-regressivity index (developed by Laumie), a weighted arithmetic mean is used for the categories above and below the median The index then is the ratio of the weighted arithmetic mean effective tax rate of the above-the-median households divided by the weighted arithmetic mean effective tax rate of the below-the-median households The PRI for the present tax base is 1.267, which indicates that the tax is broadly progressive A ratio of 1 000 would indicate proportionality, with less than unity indicating regressivity Higher ratio numbers indicate greater progressivity

It is interesting to note that changes in the legal tax rate, when the tax base remains unchanged, do not change the progressivity-regressivity index There is some likelihood, however, that an equal-revenue change from property tax to sales tax might result in a shift in tax burden from farm to nonfarm population [1]

Table 54, below, indicates the effect of widening the scope of the tax base to include the following services· utilities, repair of tangible personal property, personal services, amusements, transient room rentals and rentals of tangible personal property

[1] This was the conclusion reached in Nebraska See E G Schmidt, *Estimated Impact of Retail Sales Tax in Nebraska* (University of Nebraska, Business Research Bulletin No 62, 1956), p 22

TABLE 53

Net Resources and Effective Tax Rate (ETR) Present Tax Base, 4 Percent and 5 Percent Legal Tax Rates—Los Angeles, 1960-61

1 Disposable net income class[a] (000)	2 Mean gross income	3 Weight (number of families)	4 Net income	5 Net worth[b]	6 Net resources (4) + (5)	7 Consumption	8 Taxable consumption	9 Tax amount (4 percent)	10 Tax amount (5 percent)	11 ETR (4 percent) (9) ÷ (6)	12 ETR (5 percent) (10) ÷ (6)	13 Weighted ETR (4 percent) (3) × (11)	14 Weighted ETR (5 percent) (3) × (12)
Under 999	$505	5	$582	$6,286	$6,868	$2,024	$560	$22 40	$28 00	326	408	1 630	2 040
1-1 999	1,808	33	1,589	8,875	10,464	1,927	481	19 24	24 05	184	230	6 072	7 590
2-2 999	2,809	29	2,515	10,098	12,613	2,679	832	33 46	41 80	265	330	7 685	9 570
3-3 999	3,894	33	3,553	10,506	14,059	4,210	1,986	79 44	99 30	565	706	18 645	23 298
4-4 999	4,964	40	4,521	11,677	16 198	4,262	1,754	70 16	87 70	433	541	17 320	21 640
5-5 999	5,916	55[c]	5,463	13,204	18,672	4,992	2,038	81 52	101 90	436	546	23 544	29 484
											Σ_b =	74 896	93 622
6-7 499	7,495	86	6,752	16,325	23,077	6,832	3,211	128 44	160 55	556	696	47 816	59 856
7 5-9 999	9,649	55	8,616	21 243	29,859	7,915	3,613	144 52	180 65	484	605	27 104	33 880
10-14 999	12,114	40	11,363	30,389	41,952	9 481	4,477	179 08	223 85	427	534	17 080	21 360
15 and over	27,308	11	19,577	107,674	127,251	16,224	6,981	279 24	349 05	219	274	2 409	3 014
											Σ_a =	94 845[d]	118 656[e]
											PRI =	1 267	1 267

Md = $5,975 median ETR = effective tax rate Σ_a = sum above median. Σ_b = sum below PRI = progressivity-regressivity index

[a] Disposable net income money income after deduction of personal taxes (federal, state and local income taxes, poll taxes and personal property taxes)

[b] Estimated from "Survey of Financial Characteristics of Consumers," op cit Chapter II, Table 16 above and Lampman, op cit , Chapter II, Table 16-D above

[c] The class listed as $5-5 999 actually contains only 54 families below the median of $5 975 The number of 54 is used for all subsequent computations in this line

[d] Includes 0 435 representing the one family above the median in the $5-5 999 class

[e] Includes 0 546 representing the one family above the median in the $5-5 999 class

Source Columns 2, 3, 4, 7 and 8, U S Dept of Labor, Bureau of Labor Statistics, *Survey of Consumer Expenditures*, 1960-1961, "Consumer Expenditures and Income," BLS Report No 237-72, p 9, Table 1A (Washington 1964)

TABLE 54

Net Resources and Effective Tax Rate, Tax Base Extended to Services, 4 Percent and 5 Percent Legal Tax Rates—Los Angeles, 1960-61

1 Disposable net income class[a] (000)	2 Mean gross income	3 Weight (number of families)	4 Net income	5 Net worth[b]	6 Net resources (4) + (5)	7 Consumption	8 Taxable consumption	9 Tax amount (4 percent)	10 Tax amount (5 percent)	11 ETR (4 percent) (9) ÷ (6)	12 ETR (5 percent) (10) ÷ (6)	13 Weighted ETR (4 percent) (3) × (11)	14 Weighted ETR (5 percent) (3) × (12)
Under 999	$595	5	$582	$6,286	$6,868	$3,024	$751	$30 04	$37 55	437	547	2 185	2 735
1–1 999	1,603	33	1,589	8,876	10,464	1,927	651	26 44	33 05	253	316	8 349	10 428
2–2 999	2,609	28	2,515	10 098	12,613	2,678	1 139	45 52	56 90	361	451	10 ab9	13 079
3–3 999	3,894	33	3,553	10,506	14,059	4,210	2,128	97 12	121 40	691	864	22 803	28 512
4–4 999	4,964	40	4,521	11,677	16,198	4,262	2,207	88 28	110 35	545	681	21 800	27 249
5–5 999	5,916	55[c]	5,468	13,204	18,672	4,992	2,627	105 08	131 45	563	703	30 402	37 962
											Σ_b =	96 009	119 956
6–7 499	7,495	86	6,762	16,325	23,077	5,833	3,945	157 80	197 25	684	855	58 824	73 530
7 5–9 999	9,649	56	8,616	21 243	29,859	7,915	4,447	177 88	222 35	596	745	33 376	41 720
10–14 999	15,114	40	11,563	30 389	41,952	9,481	5,476	219 04	273 80	522	653	20 880	26 120
15 and over	27,308	11	19,677	107,574	127,251	18,224	8,700	348 00	435 00	273	342	3 003	3 762
											Σ_a =	116 646[d]	145 835[e]
											PRI =	1 215	1 215

Md = $5,975 median ETR = effective tax rate Σ_a = sum above median Σ_b = sum below PRI = progressivity-regressivity index

[a] Disposable net income money income after deduction of personal taxes (federal, state and local income taxes, poll taxes and personal property taxes)

[b] Estimated from "Survey of Financial Characteristics of Consumers," op cit, Chapter II, Table 16 above and Lampman, op cit, Chapter II, Table 16-D above

[c] The class listed as $5–5 999 actually contains only 54 families below the median of $5 975 The number of 54 is used for all subsequent computations in this line

[d] Includes 0 563 representing the one family above the median in the $5–5 999 class

[e] Includes 0 703 representing the one family above the median in the $5–5 999 class

Source Columns 2, 3, 4, 7 and 8, U S Dept of Labor, Bureau of Labor Statistics, *Survey of Consumer Expenditures*, 1960-1961, "Consumer Expenditures and Income," BLS Report No 237-72, p 9, Table 1A (Washington 1964)

The progressivity regressivity index of 1 215 indicates that the effect of this tax base widening is to reduce the progressivity slightly. The change from 1 267 to 1 215, however, is not of great significance It is interesting to compare the effective tax rates of Table 53 showing the present tax base and a 5-percent legal rate with those of Table 54 showing the tax base extended to include selected services with a 4-percent legal rate The effective rate for the broadened base is higher for the three lowest income classes, in fact for the lowest six income classes with the exception of the $3,000–$4,000 income class It is slightly lower for the upper four income classes

Table 55 considers a tax base widened to include the above list of services with the exception of utilities The progressivity-regressivity index of 1 244 indicates that the exclusion of utilities from the tax base has made it slightly more progressive than inclusion of all services Comparison of the effective tax rates of Table 53 showing the present tax base with a 5 percent legal rate with those of Table 55 shows that the effective rates of Table 53 are lower for all income classes The difference in the indices for the two tables, that of 1 267 and 1 244 is extremely small Equity considerations then would not appear to be too important a factor in considering which plan to employ However it should be noted that the extension of the tax base to selected services will have the effect of returning higher revenue for a given legal tax rate and also the important effect of providing fewer resource allocation distortions As has been previously noted, the broader the base of the sales tax, the less adverse are its economic effects.[1] The present tax base, which is essentially tangible personal property, has the effect of making the prices of goods higher relative to those of services, thus shifting resources from the goods sector into the service sector The broader tax base will correct this to some degree In this sense it would represent a rationalization of the tax structure

EXTENSION TO INTERMEDIATE GOODS

The regressivity effect of extending the sale tax to more intermediate goods and services purchased by business firms may also be considered Hickman, in his study, *Distribution of the Burden of California Sales and Other Excise Taxes*,[2] attempts to measure the "indirect" effect of sales taxes on incidences He noted that since businesses in California must pay retail sales tax on office supplies, materials and capital goods, the resultant increase in price of their final goods represents an indirect sales tax burden to the consumer

This business taxation results in a great deal of tax pyramiding and imperfect shifting which is certain to result in some additional burden on the consumer The additional burden can be represented as the difference between the total amount that a given tax costs the consumers and the total amount of tax revenue received When taxes are pyramided, being levied at many stages in the productive process, the resulting increase in costs to the business firm raises the final price

[1] But see James M Buchanan and Francesco Forte, "Fiscal Choice Through Time A Case for Indirect Taxation," *National Tax Journal*, XVII (2), June 1964, 144–157, and D A Worchester, Jr, "A Graphic General Equilibrium Analysis of the Burden of Taxes," *Western Economic Journal*, II (3), summer 1964, pp 267–285

[2] State Board of Equalization, Division of Research and Statistics, Sacramento, 1958.

TABLE 55

Net Resources and Effective Tax Rate, Tax Base Extended to Services, Utilities Excluded, 4 Percent and 5 Percent Legal Tax Rates—Los Angeles, 1960–61

1 Disposable net income class[a] (000)	2 Mean gross income	3 Weight (number of families)	4 Net income	5 Net worth[b]	6 Net resources (4) + (5)	7 Consumption	8 Taxable consumption	9 Tax amount (4 percent)	10 Tax amount (5 percent)	11 ETR (4 percent) (9) ÷ (6)	12 ETR (5 percent) (10) ÷ (6)	13 Weighted ETR (4 percent) (3) × (11)	14 Weighted ETR (5 percent) (3) × (12)
Under 999	$505	5	$552	$6,286	$6,868	$2,024	$681	$27 24	$34 05	397	496	1 985	2 480
1–1 999	1,608	33	1,589	8,875	10 464	1,927	566	22 64	28 30	216	270	7 128	8 910
2–2 999	2,609	29	2,515	10,098	12,613	2,679	1,017	40 68	50 85	323	403	9 367	11 687
3–3 999	3,394	33	3,553	10,506	14,059	4,210	2,301	92 04	115 05	655	818	21 615	26 994
4–4 999	4,964	40	4,521	11,677	16,198	4,262	2,067	82 68	103 35	510	638	20 400	25 520
5–5 999	5,916	55[c]	5,488	13,204	18,672	4,992	2,463	98 48	123 10	527	659	28 458	35 586
											Σ_b =	88 953	111 177
6–7 499	7,495	86	6,732	16,825	23,077	6,832	3,733	149 32	186 80	648	810	55 728	69 680
7 5–9 999	9,640	56	8,818	21,243	29,859	7,915	4,217	168 68	210 85	565	706	31 640	39 536
10–14 999	13,114	40	11,583	30,389	41,052	9,481	5,226	209 04	261 30	508	623	19 920	24 920
15 and over	27,308	11	19,577	107,674	127,251	16,224	8,277	331 08	413 85	260	325	2 860	3 575
											Σ_a =	110 675[d]	138 350[e]
											PRI =	1 244	1 244

Md = $5,975 ETR = effective tax rate Σ_a = sum above median. Σ_b = sum below median. *PRI* = progressivity-regressivity index

[a] Disposable net income money income after deduction of personal taxes (federal, state and local income taxes, poll taxes and personal property taxes).

[b] Estimated from "Survey of Financial Characteristics of Consumers," op cit., Chapter II, Table 16 above and Lampman, op cit., Chapter II, Table 15-D above

[c] The class listed as $5–5 999 actually contains only 54 families below the median of $5 975 The number of 54 is used for all subsequent computations in this line

[d] Includes 0 527 representing the one family above the median in the $5–5 999 class

[e] Includes 0 659 representing the one family above the median in the $5–5 999 class

Source Columns 2 3, 4, 7 and 8, U S Dept of Labor, Bureau of Labor Statistics, *Survey of Consumer Expenditures*, 1960–1961, "Consumer Expenditures and Income," BLS Report No 237–72, p 9, Table 1A (Washington 1964)

to the consumer by more than the amount of the tax. In a tax system where not all commodities are taxed and where some goods go through many more stages of production than others, this business taxation can greatly increase the undesirable effects of the sales tax on resource allocation

Hickman, when considering the equity of the sales tax used the gross and net income concepts. He maintained that the sales tax was regressive not because of the direct effects but because of the indirect effects. It should be noted that his assumption that all consumer goods prices were increased by this business taxation, which was the basis for his regressivity assumption, is open to question

The nature of the prevailing limited tax base assures that costs of some firms will be increased much more than others by the retail sales tax It quite simply depends on how many taxable capital goods must be purchased by the firm and also how many stages of production are involved. It a good passes through a great many stages and is sold as an intermediate good from one firm to another at the end of each stage, then the amount of tax pyramiding could be quite considerable.

The taxation of capital goods and materials purchased by business firms has another undesirable effect. By giving a tax advantage to vertically integrated firms, it puts small firms at a competitive disadvantage and leads to more vertical integration Whether or not this is economically desirable is not the question, the point is that this is a side effect of the tax, which while not a purpose of the legislation is certainly a very real outcome of it.

Rationalization of the tax structure would therefore appear to call for the exemption of business firms from retail sales taxes on goods and services purchased by them as far as it is administratively feasible.

BURDEN ON LOW INCOMES

While the wealth and net worth studies clearly show that many of the families with extremely low incomes have large holdings of assets and large net worth, it cannot be denied that the average figures mask the low net worth figures of some of the families in these classes. There may be some families living on $1,200 social security income with zero or even negative net worth It may be possible to remove any regressive effects of present sales taxation by simply exempting these individuals It would appear to be administratively feasible to set up income criteria, such as all families on social security plus all families with less than $2,000 net income. It would be desirable not to exempt those families with large net worth, therefore some restriction would have to be set on the maximum allowable amount of property income. The procedure would then be for these individuals to submit a state income tax form in spite of the fact that they would have no state income tax liability They would be required to list by type of item the total amount spent on state sales tax during the year. The amount spent on sales taxes could then be refunded [1]

[1] These possibilities are developed more fully in testimony of Harold M Somers before the House Ways and Means Committee, June 16, 1964 See *Federal Excise Tax Structure*, Part 2, pp 95–122 (Washington. U.S Government Printing Office, 1964)

TABLE 56

Summary of Family Expenditures, Income, and Savings, by Income Class—All Urban Families and Single Consumers—Los Angeles, 1960–61

	Total	Money income after taxes									
		Under $1 000	$1,000–$1,999	$2,000–$2,999	$3,000–$3,999	$4,000–$4,999	$5 000–$5,999	$6,000–$7,499	$7,500–$9,999	$10,000–$14,999	$15,000 and over
Number of families in sample	389	5	33	29	33	49	55	88	50	40	11
Percent of families	100 0	1 3	8 5	7 5	8 6	10 3	14 2	22 2	14 4	10 3	2 8
Average											
Family size	3 0	1 8	1 3	2 1	1 9	2 7	3 3	3 4	3 9	4 1	4 2
Money income before taxes	$7 202	$695	$1,608	$2,609	$3,504	$4,469	$5,316	$7,495	$9,549	$13,114	$27,308
Net change in assets and liabilities	$107	−$1,675	−$317	−$128	−$586	−$142	$504	−$164	$561	$823	$2,004
Number of full-time earners	1 7	2	1	2	1 5	1 8	1 7	1 9	1 1	1 1	1 3
Age of head	55	58	67	57	47	45	43	40	40	46	47
Education of head	12	8	8	9	11	12	12	12	12	14	13
Number of children under 18 years	1 2	4	1	5	5	1 1	1 5	1 5	1 6	1 3	1 5
Percent											
Homeowners, all year	48		27	24	30	40	33	58	64	80	91
Auto owners, end of year	84	40	21	52	85	85	93	97	98	100	100
Nonwhite	10		18	17	6	13	13	8	0		0
Reporting savings increase	55	20	30	34	36	50	60	56	73	65	73
decrease	42	80	42	55	64	40	40	43	27	35	27
no change	4		18	10		10		1			
With children under 18 years	52	20	9	24	48	55	65	70	70	70	73
With persons 65 years and over	21	20	67	38	21	20	11	7	9	28	27
Average income, expenditures, and savings											
Total receipts	$6,287	$2,471	$2 938	$3,902	$5,482	$6,740	$8,881	$9 318	$12,694	$19,505	$27 313
Money income after taxes	6,361	582	1,589	2,515	3 553	4,521	5,468	6,733	8 610	11,553	19,877
Other money receipts	70		30	80	135		12	139	100	52	4
Decrease in assets	1,552	1,921	1,132	1,099	1,394	1,905	374	879	1,665	4,338	5 069
Increase in liabilities	1,324	27	87	328	400	915	1,027	1,548	2,313	2,572	2,684
Account balancing difference	−276	98	−142	−151	−223	−3	−290	−518	−474	164	−930
Total disbursements	9 563	2,323	2,980	4,143	5,705	6 743	7,171	9,836	13,168	18,351	28,243
Increase in assets	2,363	146	799	1,224	995	1,598	1,223	1,505	3,589	6,588	8 737
Decrease in liabilities	600	27	103	46	210	490	483	758	950	1,146	1,000
Personal insurance	315	45	15	70	135	190	254	341	447	629	1,299
Gifts and contributions	296	90	136	125	152	207	220	399	567	516	1,013
Expenditures for current consumption	5,989	2,024	1,927	2,679	4,210	4,262	4,992	6,832	7,915	9,481	16,234
Food, total	1,379	426	564	740	845	1,026	1 216	1,495	1,902	2,151	3,207
Food prepared at home	1,049	344	478	619	575	796	1,010	1,150	1,399	1,610	2,129
Food away from home	331	82	84	121	270	230	206	325	503	540	1,078
Tobacco	90	60	33	39	66	71	85	125	140	65	133
Alcoholic beverages	111	32	12	49	36	51	115	153	193	236	151

Housing, total	1,700	691	757	933	1,219	1,403	1,527	1,992	2,126	2 341	4,409
Shelter	876	502	473	606	676	813	815	937	1,030	1,094	1,711
Rented dwelling	391	502	342	480	542	507	522	570	513	198	23
Owned dwelling	459		126	113	125	289	306	544	738	828	1,540
Other shelter	26		4	0	9	16	7	23	29	78	149
Fuel, light, refrigeration water	184	70	95	121	127	140	165	207	230	259	423
Household operations	303	103	127	182	242	288	287	398	404	611	1,298
Housefurnishings and equipment	267	16	80	93	174	163	248	349	404	356	760
Clothing, clothing materials, services	551	104	88	211	378	333	462	626	456	894	1,402
Personal care	156	41	41	95	112	130	145	188	202	207	308
Medical care	446	55	240	250	346	287	340	510	593	737	812
Recreation	270	130	53	83	126	181	207	323	403	489	721
Reading	47	16	13	20	28	34	39	57	57	59	115
Education	52	120		8	20	24	52	34	77	125	251
Transportation	1,040	324	160	233	941	643	711	1,271	1,222	1,501	4,148
Automobile	910	48	50	188	875	594	671	1,205	1,134	1,737	1,806
Other travel and transportation	130	276	43	43	66	49	40	67	97	164	2,342
Other expenditures	137	24	28	13	62	69	61	167	203	259	566
Value of items received without expense	261	347	197	159	183	176	481	307	191	224	212
Food	15	113	31	24	25	9	11	13	9	7	14
Shelter	16	168	38	43	10	1	26			26	
Other	229	66	126	93	160	167	444	294	182	192	198
Percent distribution											
Expenditures for current consumption	100 0	100 0	100 0	100 0	100 0	100 0	100 0	100 0	100 0	100 0	100 0
Food, total	33 0	21 0	29 1	27 6	26 1	24 1	25 0	21 7	24 0	22 7	19 8
Food prepared at home	17 5	16 5	24 8	23 1	13 7	13 7	22 2	16 8	17 7	17 0	13 1
Food away from home	5 5	4 5	4 4	4 5	6 4	5 4	4 7	4 9	6 4	5 7	6 6
Tobacco	1 6	3 0	1 7	1 5	1 6	1 7	1 7	1 8	1 8	1 7	8
Alcoholic beverages	1 9	1 6	6	1 8	9	1 2	2 3	2 2	1 7	2 5	9
Housing, total	28 4	34 1	30 3	34 8	29 0	32 9	30 6	27 7	26 9	24 7	27 2
Shelter	14 6	24 8	24 5	22 4	16 1	19 1	16 7	13 7	13 6	11 5	10 5
Rented dwelling	6 5	24 8	17 7	17 9	12 9	11 9	10 5	5 4	4 0	2 0	1
Owned dwelling	7 7	0	6 5	4 2	3 0	6 8	5 1	8 0	9 3	8 7	9 5
Other shelter	4	0	2	2	2	4	1	3	4	8	0
Fuel, light, refrigeration, water	3 1	3 5	4 9	4 5	3 0	3 3	3 3	3 0	2 9	2 6	2 6
Household operations	5 1	5 1	6 6	6 8	5 7	6 8	5 7	5 8	5 1	6 4	8 0
Housefurnishings and equipment	4 5	8	3 1	1 6	4 1	3 8	4 8	5 1	5 1	3 8	4 7
Clothing, clothing materials, services	9 2	5 1	4 6	7 9	9 0	7 6	9 3	9 3	10 8	9 4	8 6
Personal care	2 6	2,0	2 1	3 5	2 7	3 0	2 9	2 8	2 6	2 2	1 9
Medical care	7 4	2 7	12 5	9 3	8 2	7 6	6 8	7 5	7 5	7 8	5 0
Recreation	4 5	6 4	2 8	3 2	3 0	4 3	4 1	4 7	5 1	4 9	4 4
Reading	8	8	7	7	7	8	8	8	7	6	7
Education	9	5 9	0	3	5	6	1 0	5	1 0	1 3	1 5
Transportation	17 5	16 0	5 2	8 7	22 3	15 1	14 2	18 6	15 4	20 0	25 6
Automobile	15 2	2 4	2 9	7 0	20 8	13 9	13 4	17 6	14 2	18 3	11 1
Other travel and transportation	2 3	13 6	2 2	1 6	1 6	1 1	8	1 0	1 2	1 7	14 4
Other expenditures	2 3	1 2	1 5	5	2 2	1 6	1 2	2 4	2 6	2 8	3 5

Source U S Dept of Labor, Bureau of Labor Statistics, *Survey of Consumer Expenditures, 1960–1961*, "Consumer Expenditures and Income," BLS Report No 237–72, p 9 (Washington, 1964)

TECHNICAL APPENDIX TO PART VIII

The data from which the income and consumption expenditures for Tables 53 through 55 was taken is given in Table 56.

Estimation of taxable consumption was made as follows For Table 53, where the tax base is that of the present California law, the following categories were included:

a Food away from home
b. Tobacco.
c. Alcoholic beverages
d. Household operations
e Housefurnishings and equipment
f. 80 percent of clothing, clothing materials and services.
g. 80 percent of recreation
h. 90 percent of automobile transportation
i. 10 percent of other travel and transportation

For Table 54, which considered the expansion of the sales and use tax base to include utilities, repair of tangible personal property, personal services, amusements, transient room rentals and rentals of tangible personal property, the following categories were included·

a Food away from home.
b. Tobacco.
c Alcoholic beverages
d Other shelter.
e. Fuel, light, refrigeration, water
f. Household operations.
g Housefurnishings and equipment.
h. Clothing, clothing materials and services
i Personal care.
j Recreation.
k Automobile transportation.
l 20 percent of other travel and transportation.

For Table 55, which considers the expansion of the sales tax base to include the above listed services with the exception of utilities, the following categories were included

a Food away from home.
b Tobacco
c. Alcoholic beverages.
d Other shelter.
e Household operations
f Housefurnishings and equipment
g Clothing, clothing materials and services
h. Personal care.
i Recreation
j. Automobile transportation
k. 20 percent of other transportation

IX

EXEMPTIONS UNDER THE CALIFORNIA SALES TAX: DETAILED ANALYSIS

There are two types of transactions that are not covered by the California sales and use tax The first of these arises from the fact that the tax is imposed only on sales of "tangible personal property," hence services are automatically excluded without the need for specific reference or "exemption" to that effect The other type of nontaxable transaction results from the explicit exemption of certain transactions that do involve the sale of tangible personal property The present chapter is concerned only with the explicit exemptions Another part of this study deals fully with the exclusion of services.

The revenue estimates given in Table 57 are for the fiscal year 1965–66.

Before going into the details of the exemptions, we may mention that there is a general exemption of property the sale or use of which the state is prohibited from taxing under the Constitution or laws of the United States or the Constitution of this state (Revenue and Taxation Code, Section 6352) Most of the constitutional limitations come from the commerce clause and the due process clause and most of them prevent a tax that places an undue burden on interstate commerce. In most cases these apply to producer goods which should be excluded from any retail sales tax in order to avoid the distortions of imperfect shifting and tax pyramiding (There is of course no possibility that this exemption can be removed in any event.) As for economic effects, the exemption tends to reduce tax pyramiding and imperfect shifting since this applies chiefly to producer goods

Gas, Electricity and Water

There are exempted from the taxes imposed by this part the gross receipts from the sales, furnishing, or service of and the storage, use, or other consumption in this State of gas, electricity, and water when delivered to consumers through mains, lines, or pipes (R. & T C , Sec 6353.)

Background [1]

When the Retail Sales Tax Act was first adopted in 1933, public utilities were subject to the "in lieu" tax provisions of Section 14, of Article 13, of the California Constitution, and would not have been subject to the sales tax in any event. Accordingly, the Retail Sales Tax Act incorporated a specific exemption of sales of gas, electricity, and water, through mains, lines or pipes, in order that there would be no conflict between the Retail Sales Tax Act and the Constitution

[1] Provided by State Board of Equalization (Letter from John B Marshall, senior statistician, Research and Statistics, to the Honorable Nicholas C Petris, chairman, Assembly Interim Committee on Revenue and Taxation, April 2, 1964)

TABLE 57

Estimated Sales Tax Revenues That Could Be Derived in the 1965–66 Fiscal Year by the Elimination of Existing Exemptions

Revenue and Tax Code section	Year adopted	Nature of exemption	Estimated taxable sales	State tax at 3 percent
6353	1933	Gas, electricity and water delivered through mains	[a]$2,536,000 000	[a]$76,100,000
6354	1939	Gold	3,850,000	115,000
6356	1937	Vessels of more than 1,000 tons	Negligible	Negligible
6357	1933	Motor vehicle fuel	2,293,500,000	68,800,000
6358(a)	1941	Animal life for human consumption	486,000,000	14,580,000
6358(b)	1943	Feed for animals which provide food for humans	567 000,000	17,010,000
6358(c)	1943	Seeds which produce food for humans	28,500,000	855,000
6358(d)	1943	Fertilizer used to produce food for humans	99,750,000	2,995,000
6359	1935	Food products	5,954,000,000	178,600,000
6359 5	1945[b]	Ice used in interstate shipment of food	15,000,000	450,000
6362	1941	Newspapers	134,000 000	4,000,000
6362	1941	Periodicals	45,000,000	1,350,000
6363	1943	Meals served to students or teachers by school district, P T A , or blind person	130,000,000	3,900,000
6363 5	1961	Meals served by religious organizations	2,170,000	65,000
6364	1943	Containers	916,000,000	27,480,000
6366	1945	Aircraft sold to interstate carriers, foreign governments or nonresidents	Negligible	Negligible
6367 6006 5	1947	Occasional sales	Large but indeterminate	Large but indeterminate
6368	1949	Watercraft	Negligible	Negligible
6368 5	1963	Rail freight cars for use in interstate or foreign commerce	Negligible	Negligible
6369	1961	Prescription medicines	316,700,000	9,500,000
6375	1959	Sales by charitable organizations	17,900,000	537,000
6381	1939	Sales to any instrumentality of the United States including the American National Red Cross	Very large but indeterminate	Very large but indeterminate
6383	1939	Silver bullion	133,000	4,000
6385	1943	Sales to a common carrier for shipment to a point outside the state		
	1943	(a) Steamship lines	[c]5,000,000	None
	1963	(b) Tramp steamers	7,000,000	210,000
6386	1955	Sales to out-of-state contractors for use outside state	Small	Small
6387	1955	Sales for use solely outside this state when delivered to a forwarding agent	None	None

TABLE 57—Continued

Estimated Sales Tax Revenues That Could Be Derived in the 1965–66 Fiscal Year by the Elimination of Existing Exemptions

Revenue and Tax Code section	Year adopted	Nature of exemption	Estimated taxable sales	State tax at 3 percent
6388	1963	New trucks, tractors, and trailers purchased from out-of-state dealer for out-of-state use	Negligible	Negligible
6402	1945	Property purchased from United States	544 000	16,300
6404	1956	Vehicles loaned for driver training	150,000	4,500
6405	1963	Credit for replacement purchase of automobile demolished in an out-of-state accident	100,000	3.000
4750 5[d]	1963	First sale each year of automobile by any person not licensed as a dealer	300,000,000	9,000,000
		Totals	[c]$11,322,267,000	[c]$339,476,000

SOURCE California State Board of Equalization (Letter from John B Marshall senior statistician, Research and Statistics to the Honorable Nicholas C Petris, chairman Assembly Interim Committee on Revenue and Taxation, April 2, 1964)

[a] This data compiled by a staff member of the Assembly Interim Committee on Revenue and Taxation, is not included in total

[b] Dry ice added to exemption in 1954

[c] Does not include estimated amounts for indeterminate items or amounts for utilities

[d] Vehicle Code

Although public utilities are no longer subject to the "in lieu" provisions, these having been changed by constitutional amendment in 1933, the exemption for which provision is made in Section 6353 remains in the Sales and Use Tax Law

Revenue estimate (for gas and electricity only)_____ $70,000,000

Comment

This exemption may be considered to be in two parts first, utilities consumed at the retail level, and second, utility services consumed by business firms

Budget studies indicate that utility services constitute a larger percentage of the budget of lower income families than higher income families, therefore this exemption on the retail level probably increases the progressivity of the sales tax to some extent However the effect of this exemption on progressivity is not too great The slight degree of additional progressivity obtained by means of this exemption must be weighed against the narrowing of the tax base

The blanket exclusion of all utility services narrows the tax base and increases the effects of the sales tax in favoring utility purchases over other purchases Taxation of utilities purchased by business would lead to imperfect shifting and tax pyramiding One economic effect of this exclusion at the retail level comes from its effect in reducing the price of gas and electricity relative to competing goods such as fuel oil for use in home heating Fuel oil used for home heating is subject to the sales tax but if the home is heated by gas or electricity there is no sales tax This institutes a tax-induced market effect favoring the use of gas or electricity for this purpose

Gold

There are exempted from the taxes imposed by this part the gross receipts from the sale of gold bullion, gold concentrates, or gold precipitates by the producer or refiner and the storage, use, or other consumption in this State of gold bullion, gold concentrates, or gold precipitates when sold by the producer or refiner for storage, use, or other consumption in this State (R & T C, Sec 6354.)

Background [1]

This exemption was adopted to aid the gold mining and refining industries.

Revenue estimate [1] _____ $115,000

Comment

There would be no possibility of shifting the tax to the purchaser where the U.S. government is the purchaser of gold bullion and the purchase is at a set price

Silver Bullion

There are exempted from the computation of the amount of the sales tax the gross receipts from the sales of silver bullion by the producer or refiner (R & T C, Sec 6383)

Background [1]

As in the case of gold (see item No 2) this exemption was probably intended to aid the silver producing and refining industries

Revenue estimate [1] _____ $4,000

Comment

Any silver bullion that is purchased by private individuals would be classified as an intermediate good which should not be subject to a retail sales tax for the reasons previously mentioned

Vessels

There are exempted from the taxes imposed by this part the gross receipts from sales of vessels of more than 1,000 tons burden by the builders thereof and the storage, use, or other consumption in this State of any ship of more than 1,000 tons burden which is purchased in this State from the builders and with respect to which the use tax would, if the ship had been purchased outside this State or in interstate commerce, be inoperative because prohibited under the Constitution or the laws of the United States or the Constitution of this state. (R & T C, Sec. 6356.)

Background [1]

When this section was first enacted in 1937, it was not known whether a vessel purchased outside this state or in interstate commerce, would be constitutionally exempt from use tax Anticipating that the vessel might be exempt, the Legislature apparently desired to place California builders on an equal basis with out-of-state builders who were not subject to the sales tax The subsequent upholding by the courts of the validity of the use tax makes this section for practical purposes inoperative, because the use tax applies whether the ship is purchased from a California builder or not See *In re Los Angeles Lumber Products Co , Ltd.*, 45 Fed Supp. 77.

Revenue estimate _____ negligible

[1] *Ibid.*

Comment

Apart from the effect of the use tax (noted above), this exemption provides that a buyer should not have to pay a sales tax on an intrastate transaction involving a vessel if he would not have had to pay a sales tax on a similar interstate transaction This simply provides that a California builder will not be at a competitive disadvantage by the amount of the sales tax on a sale to a California buyer vis-à-vis a builder in another state.

Given the existing constitutional prohibition, this exemption is useful in that it provides for uniform treatment of both interstate and intrastate transactions with reference to these vessels This consideration aside, the exemption applies to producer goods that are not, strictly speaking, part of a retail sales tax.

Motor Vehicle Fuel

There are exempted from the taxes imposed by this part the gross receipts from the distributions of and the storage, use, or other consumption in this State of motor vehicle fuel the distributions of which in this State are subject to the tax imposed by Part 2 (commencing at Section 7801) of this division and liquefied petroleum gas the use of which is subject to the tax imposed by Part 3 of this division, and not subject to refund

The Controller shall collect the sales tax upon sales of motor vehicle fuel which are subject to tax and refund under Part 2 of this division and the use tax when applicable to the storage, use or other consumption of such fuel by way of deduction from refunds otherwise allowable under that part He shall transfer the amount of the deductions from the Motor Vehicle Fuel Fund to the Retail Sales Tax Fund (R & T C, Sec. 6357)

Background [1]

This exemption very likely was enacted because the distributions of gasoline for highway use were taxable under the fuel license (gallonage) tax This policy is not followed with respect to cigarettes, alcoholic beverages, and diesel fuel.

Revenue estimate [1] $68,800,000

Comment

This exemption provides that motor vehicle fuel the distributions of which in this state are subject to the motor vehicle fuel excise tax and not subject to refund. If subject to refund, the sales tax is collected by deduction from the refund.

This is simply the exclusion from the tax of an item that bears a specific excise tax in order to avoid undue tax pyramiding

Animal Life; Feed; Seeds; Plants; Fertilizer

There are exempted from the taxes imposed by this part the gross receipts from sales of and the storage, use, or other consumption of

(a) Any form of animal life of a kind the products of which ordinarily constitute food for human consumption

(b) Feed for any form of animal life of a kind the products of which ordinarily constitute food for human consumption, or are to be sold in the regular course of business

(c) Seeds and annual plants the products of which ordinarily constitute food for human consumption or are to be sold in the regular course of business

(d) Fertilizer to be applied to land the products of which are to be used as food for human consumption or sold in the regular course of business (R & T.C, Sec. 6358)

[1] *Ibid*

Background [1]

This section was added in 1941 and enlarged in 1943 to clarify, extend, and consolidate prior rulings of the Board of Equalization stemming from the food exemption adopted in 1935 The exemption now applies to sales of livestock, baby chicks and other poultry, feed, seed, certain plants, and fertilizer used to produce food for human consumption

Revenue estimate [1] $35,440,000

Comment

Animal life and feed therefor, seeds, annual plants, and fertilizer, the products of which are to be used as food for human consumption or sold are exempted by this section

This exclusion applies to intermediate goods in the food sector Since food products consumed off premises are excluded from taxation, there is even more reason than the usual factors named above for excluding these intermediate goods from taxation The economic effects of this exclusion are to eliminate imperfect shifting and tax pyramiding in this area This exclusion helps to make the sales tax more progressive by forestalling any tax-induced price increases in the area of food products The importance of the food products exclusion itself is discussed below.

Food Products

There are exempted from the taxes imposed by this part the gross receipts from the sale of and the storage, use, or other consumption in this state of food products for human consumption

"Food products" include cereals and cereal products, oleomargarine, meat and meat products, fish and fish products, eggs and egg products, vegetables and vegetable products, fruit and fruit products, spices and salt, sugar and sugar products other than candy and confectionery, coffee and coffee substitutes, tea, cocoa and cocoa products other than candy or confectionery

"Food products" include milk and milk products, milkshakes, malted milks and any other similar type beverages which are composed at least in part of milk or a milk product and which require the use of milk or a milk product in their preparation

"Food products" do not include spirituous, malt or vinous liquors, soft drinks, sodas, or beverages such as are ordinarily dispensed at bars and soda fountains or in connection therewith, medicines, tonics, and preparations in liquid, powdered, granular, tablet, capsule, lozenge, and pill form sold as dietary supplements or adjuncts

None of the exemptions provided for in this section shall apply: (a) when the food products are served as meals on or off the premises of the retailer, or (b) when the food products are furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware provided by the retailer, or (c) when the food products are ordinarily sold for immediate consumption on or near a location at which parking facilities are provided primarily for the use of patrons in consuming the products purchased at the location, even though such products are sold on a "takeout" or "to go" order and are actually packaged or wrapped and taken from the premises of the retailer (R & T C, Sec 6359)

Background [1]

This section, enacted July 1, 1935, exempted sales of food for human consumption other than meals and food consumed on the premises At the same time, the tax rate was increased from 2½ to 3 percent

[1] *Ibid*

This exemption, of course, reflects policy considerations probably still present.

Revenue estimate[1] $178,600,000

Comment

This is a major provision, which exempts food products for human consumption. The term "food products" does not include candy, confectionery, spirituous, malt or vinous liquors, soft drinks, sodas, or beverages (other than beverages containing milk or a milk product) such as are ordinarily dispensed at bars or soda fountains or in connection therewith, medicines, tonics, and preparations in liquid, powdered, granular, tablet, capsule, lozenge, and pill form sold as dietary supplements or adjuncts, or meals served on or off the premises of the retailer, or drinks or foods furnished, prepared or served for consumption at tables, chairs or counters or from trays, glasses, dishes or other tableware provided by the retailer, or when food products are ordinarily sold for immediate consumption on or near a location at which parking facilities are provided for use by patrons consuming food

From an equity standpoint, this exemption is the most important in assuring the progressivity of the sales tax Food consumed at home is a much larger percentage of the budget of the lower income families than it is of the higher income families

The economic effects of this exemption work through the narrowing of the tax base that results from the tax-free status of food consumed at home The prices of other goods are increased relative to food products so that there is a certain amount of resource reallocation away from other goods and into the food sector

Ice

As incidental to the exemption provided for in Section 6359, there are exempted from the taxes imposed by this part, the gross receipts from the sale of and the storage, use, or other consumption in this State of ice or dry ice used or employed in packing and shipping or transporting food products for human consumption between a point or points within and a point or points without this State (R & T C, Sec 6359 5)

Background[1]

This exemption was aimed at promoting sales of California fruits and vegetables to out-of-state purchasers by relieving California shippers of the alleged competitive handicap of the tax on their ice purchases With the steady growth of mechanical cooling equipment this exemption is becoming increasingly less significant from a revenue standpoint.

Revenue estimate[1] $450,000

Comment

Ice used in shipping food products in interstate commerce is exempted by this section The ice excluded from taxation by this exemption is an intermediate good This exemption is useful because it excludes an intermediate good from taxation Sales taxation of ice would increase to a slight extent the cost of food and would also represent somewhat of a burden on interstate commerce.

[1] *Ibid*

There are two important considerations here First, since ice is an intermediate good, it raises the question whether this exemption should be extended to include ice used in shipping food products in intrastate commerce Most of the ice referred to in this exemption is used to refrigerate railroad freight cars There is an alternative method of refrigerating railroad freight cars, that is mechanical or diesel refrigerated cars For consistency, and to avoid favoring the use of ice over mechanical refrigeration an argument could be made that diesel fuel used for operating refrigerated railroad cars used for the shipment of food should also be exempt In economic terms they are competing goods and there can be no reason for exempting one from taxation and not the other. To do so is to violate the principle of tax neutrality.

Newspapers and Periodicals

There are exempted from the taxes imposed by this part, the gross receipts from the sale of, and the storage, use, or other consumption in this State, of *tangible personal property which becomes an ingredient or component part of* any newspaper or periodical regularly issued at average intervals not exceeding three months and any such newspaper or periodical (R & T C, Sec 6362)

Background [1]

The purpose of this exemption was, apparently, to remove the tax burden from sales in such amounts (5 or 10 cents) and by such vendors (e g newsboys) that the cost of compliance would be prohibitive In the case of magazines, many are sent by mail to subscribers from outside the state by publishers not engaged in business here, who could not be required to collect the use tax, which could not as a practical matter, be collected from subscribers. The exemption also constituted a legislative determination of the predominance of the service (as distinguished from the sale) element in these transactions

Revenue estimate [1] $5,350,000

Comment

This is another important provision, which exempts newspapers and periodicals regularly issued at average intervals not exceeding three months and tangible personal property which becomes an ingredient or component part of any such publication.

Publications of this type generally constitute an extremely small portion of the budget of most consumers, therefore the equity considerations here are quite small Aside from the difficulty of tax collection from the myriad of retail outlets, the reason for this exemption must lie in public policy. There are certain practical problems to be considered in taxing a 10-cent item The component parts of these publications are properly not a subject for retail sales taxation since they are intermediate goods. The exemption of these publications at the retail level, however, raises questions of competition These are communications media and the competing media are subject to sales taxation in a sense One must pay a sales tax on a television receiver and also on radio equipment The economic effect of this exemption then is to favor, however slightly, the allocation of resources to newspapers and periodicals at the expense of radio and television, the chief substitute goods involved.

[1] *Ibid*

Meals

There are exempted from the taxes imposed by this part the gross receipts from the sale of, and the storage, use, or other consumption in this State of, meals and food products for human consumption served to the students or teachers of a school by public or private schools, school districts, student organizations, parent-teacher associations, and any blind person (as defined in Section 6005 of the Government Code) operating a restaurant or vending stand in an educational institution under Chapter 11 of Division 7 of Title 1 of the Government Code The term "food products" as used in this section has the meaning ascribed to it in Section 6359 except that the term includes foods furnished, prepared, or served for consumption at tables, chairs, or counters, or from trays, glasses, dishes, or other tableware provided by the retailer (R & T C, Sec 6363)

Background [1]

This exemption was, in part, a legislative ratification of the board's earlier rule that a school, student body, etc, serving meals exclusively to students and teachers was not a retailer Probably, it also reflected legislative policy to aid school children

Revenue estimate [1] $3,900,000

Comment

This provision—a large revenue loser—exempts meals and food products sold by schools, student organizations, etc to the students or teachers of a school

The equity impact of this exemption is difficult to assess Students (and teachers) come from all income classes In any event, the percentage of any individual's budget spent on these tax-free meals is apt to be quite small, making the impact of this exemption on equity of correspondingly little magnitude

The exemption does have the economic effect of giving these food establishments a tax-induced price differential over similar private concerns In California, a great majority of these meals are served in State or city owned cafeterias located in schools, colleges and universities It may be that the additional custom that these facilities receive as a result of their tax exempt status saves the State money by making these facilities more profitable and relieves State and local governments of additional need for support Most of these facilities are operated for the convenience of the students and teachers involved and therefore the tax-induced price differential may not be of much importance It may be that this tax exempt status is not diverting any business from private concerns because the convenience of the facility is the overriding consideration in its use There is a strong presumption, however, that this exemption places the facilities benefited at a competitive advantage over business enterprises in those areas where such enterprises are, or could be, within convenient range

Religious Organization Meals

There are exempted from the taxes imposed by this part the gross receipts from the sale of, and the storage, use or other consumption in this State of, meals for human consumption served by any religious organization at a social or other gathering conducted by it or under its auspices, if the purpose in serving the meals is to obtain revenue for the functions and activities of the organization and the revenue obtained from serving the meals is actually used in carrying on such functions and activities

[1] *Ibid.*

For the purposes of this section, "religious organization" means any organization the property of which is exempt from taxation pursuant to Section 1½ of Article XIII of the State Constitution (R & T C, Sec 6363 5)

Background [1]

This exemption was designed partly to remove the administrative problems incident to the collection of insignificant amounts of tax and to relieve religious organizations from the burdens of record keeping and filing sales tax returns with respect to meals served for fund raising purposes, such as church supper

Revenue estimate [1] ---------- $65,000

Comment

This exemption is consistent with general public policy of using the tax exemption device as a form of subsidy to religious organizations The economic consequences of this particular exemption are negligible since there is very little likelihood of competition with commercial organization

Containers

There are exempted from the taxes imposed by this part, the gross receipts from sales of and the storage, use, or other consumption in this State

(a) Nonreturnable containers when sold without the contents to persons who place the contents in the container and sell the contents together with the container

(b) Containers when sold with the contents if the sales price of the contents is not required to be included in the measure of the taxes imposed by this part

(c) Returnable containers when sold with the contents in connection with a retail sale of the contents or when resold for refilling

As used herein the term "returnable containers" means containers of a kind customarily returned by the buyer of the contents for reuse All other containers are "nonreturnable containers" (R & T C, Sec 6364)

Background [1]

This exemption expressed the legislative policy that prior court decisions should not upset the effect of board rulings regarding containers See *Coca-Cola Co v State Board of Equalization*, 25 Cal 2d 918 The basis for this exemption appears to be that containers sold to a person who uses them in selling his own product are in effect being purchased for resale

Revenue estimate [1] ---------- $27,480,000

Comment

These containers are producers' goods and therefore are properly exempted from retail sales taxation for the reasons enumerated above

Aircraft Sold To Interstate Carriers, Foreign Governments and Nonresidents

There are exempted from the taxes imposed by this part the gross receipts from the sale of and the storage, use, or other consumption of aircraft sold to persons using such aircraft as certificated or licensed carriers of persons or property in interstate or foreign commerce under authority of the laws of the United States or any foreign government, or sold to any foreign government for use by such government outside of this State, or sold to persons who are not residents of this State and who will not use such aircraft in this State otherwise than in the removal of such aircraft from this State (R. & T C, Sec 6366)

[1] *Ibid*

Background [1]

This exemption was added in 1945 as a sales tax exemption In 1947 it was amended to add a use tax exemption The purpose of the exemption was to foster the California aircraft manufacturing industry by placing it in a favorable competitive position with similar industry out of state Since aircraft are mobile, they could be delivered in interstate commerce without sales tax applying and could re-enter the state in interstate commerce without use tax applying Initial delivery out of state to avoid the tax required additional delivery cost to the manufacturer The exemption caused little if any loss of revenue because manufacturers avoided the tax, even with some additional delivery expense

Revenue estimate [1] _____ negligible

Comment

This exemption applies only to aircraft sold to certificated or licensed carriers of interstate or foreign commerce, or to foreign governments for use outside state, or to nonresidents who will not use the aircraft in this State other than to remove it from this state

These aircraft are largely producers' goods which are properly exempted from a retail sales tax However, it would appear that this exclusion was not introduced for that reason since it does not apply to aircraft to be used for intrastate transportation. The interstate aspect of this exemption would indicate that it is aimed at the avoidance of an undue burden on California manufacturers engaged in interstate commerce Since aircraft used by all licensed carriers are producers' goods, the exclusion could be broadened to include all licensed carriers, intrastate as well as interstate On the other hand, if the exemption is completely eliminated, it would certainly affect unfavorably the competitive position of California airframe manufacturers or provoke the pointless shipments mentioned above

Occasional Sales

There are exempted from the taxes imposed by this part the gross receipts from occasional sales of tangible personal property and the storage, use, or other consumption in this State of tangible personal property, the transfer of which to the purchaser is an occasional sale (R & T C, Sec 6006 5 and 6367)

Background [1]

This exemption sought to clarify the area of exempt occasional sales after several court decisions had ruled under particular factual situations, leaving the area of exempt sales somewhat indefinite

Revenue estimate [1] _____ Large but indeterminate [2]

Comment

An "occasional sale" is a sale of property not held or used in an activity requiring a seller's permit, and is also a transfer of all or substantially all of the property used in such an activity resulting in no substantial change in the real or ultimate ownership of the property (Sec 6006 5)

[1] *Ibid*

[2] The exemption of occasional sales provides an opportunity for a unique form of evasion Title could be left in the original occasional seller until the middleman finds a buyer

This exclusion is primarily for administrative convenience because of the difficulty involved in handling sales of this type from a standpoint of collection and compliance The revenue and the economic and equity effects of this exclusion are difficult to determine.

Watercraft

There are exempted from the taxes imposed by this part the gross receipts from the sale of and the storage, use, or other consumption in this State of watercraft for use in interstate or foreign commerce involving the transportation of property or persons for hire or for use in commercial deep sea fishing operations outside the territorial waters of this State, and any sales of tangible personal property becoming a component part of such watercraft in the course of constructing, repairing, cleaning, altering, or improving the same, and charges made for labor and services rendered in respect to such constructing, repairing, cleaning, altering, or improving (R & T C, Sec 6368)

Background [1]

This exemption was intended to aid California shipbuilders, shipyards, and ship chandlers by removing the sales tax as a competitive factor in competition with out-of-state firms.

Revenue estimate [1] _____ negligible

Comment

Watercraft, and property becoming a component part thereof, used in interstate or foreign commerce or deep sea fishing are exempted by this section. The goods excluded from sales taxation under this provision are producers' goods This exclusion, like the others mentioned above, is defensible on the grounds that these are producers' goods, but unless such taxation would be unconstitutional under the commerce clause, one could argue that it should either be broadened to include watercraft used in intrastate transportation or that these exclusions should be eliminated altogether

Rail Freight Cars

There are exempted from the taxes imposed by this part the gross receipts from the sale of and the storage, use, or other consumption in this State of rail freight cars for use in interstate or foreign commerce (R & T. C, Sec. 6368 5)

Background [1]

This exemption was represented to the Legislature as being necessary to foster a new freight car building industry in California and placing the manufacturer in a favorable competitive position with manufacturers outside the state. The tax could be avoided without the exemption if the manufacturer delivered the freight cars outside the state, but this would cause additional delivery expense This exemption is similar to that for aircraft.

Revenue estimate [1] _____ negligible

Comment

This exemption is identical to the one above except that it applies to freight cars rather than watercraft

[1] *Ibid*

Prescription Medicines

(a) There are exempted from the taxes imposed by this part the gross receipts from the sale, and the storage, use, or other consumption, in this State of medicines

(1) Prescribed for the treatment of a human being by a person authorized to prescribe the medicines, and dispensed on prescription filled by a registered pharmacist in accordance with law, or

(2) Furnished by a licensed physician and surgeon or podiatrist to his own patient for treatment of the patient, or

(3) Furnished by a hospital for treatment of any person pursuant to the order of a licensed physician and surgeon or podiatrist, or

(4) Sold to a licensed physician and surgeon, podiatrist or hospital for the treatment of a human being

(5) Sold to this State or any political subdivision or municipal corporation thereof, for use in the treatment of a human being, or furnished for the treatment of a human being by a medical facility or clinic maintained by this State or any political subdivision or municipal corporation thereof

(b) "Medicines" as used in this section mean and include any substance or preparation intended for use by external or internal application to the human body in the diagnosis, cure, mitigation, treatment or prevention of disease and which is commonly recognized as such a substance or preparation intended for such use; provided that "medicines" do not include (1) any auditory, prosthetic, ophthalmic or ocular device or appliance, (2) articles which are in the nature of splints, bandages, pads, compresses, supports, dressings, instruments, apparatus, contrivances, appliances, devices, or other mechanical, electronic, optical or physical equipment or article or the component parts and accessories thereof, (3) any alcoholic beverage the manufacture, sale, purchase, possession or transportation of which is licensed and regulated by the Alcoholic Beverage Control Act (Division 9, commencing with Section 23000, of the Business and Professions Code).

(c) "Hospital" as used in this section has the meaning ascribed to it in Section 1401 of the Health and Safety Code

(d) Insulin furnished by a registered pharmacist to a person for treatment of diabetes as directed by a physician shall be deemed to be dispensed on prescription within the meaning of this section (R & T C, Sec 6369)

Background [1]

This exemption was proposed by the Governor in his address to the joint convention of the Senate and Assembly at the beginning of the 1961 session. The tax on prescription drugs was said to weigh "most heavily on the aged and afflicted" (page 80, Assembly Journal, January 3, 1961)

Revenue estimate [1] ---------- $9,500,000

Comment

This is a very costly exemption of prescription medicines for human use. The most important connotation of this exemption is an equity one. While it is impossible to define any commodity as a "necessity" in economic terms, prescription medicines often bulk fairly large in the budgets of older people many of whom have low incomes From this standpoint, this exemption increases the progressivity of the tax and thereby increases its equity The economic effects of this exemption are difficult to discern because this is a good that makes up a small portion of the budget of most households.

Sales by Charitable Organizations

There are exempted from the taxes imposed by this part the gross receipts from the sale of and the storage, use, or other consumption in this State of, tangible personal property made, prepared, assembled or manufactured by

[1] *Ibid*

organizations formed and operated for charitable purposes qualifying for the exemption provided by Section 214 of the Revenue and Taxation Code known as the "welfare exemption" which are engaged in the relief of poverty and distress, and make the sales as a matter of assistance to the purchasers (R & T C, Sec 6375)

Background [1]

This exemption is aimed at relieving persons in financial distress from paying sales tax reimbursement on certain necessities purchased from charitable organizations that supply consumer articles at low cost to the needy.

Revenue estimate [1] $537,000

Comment

This is similar to other tax exemptions used as a form of subsidy to charitable groups In this case, the effect is largely to relieve the impoverished purchaser of the burden of the tax As implied by the substantial revenue estimate, there is considerable benefit at the expense of commercial organizations that would be competing for the same sales

United States

There are exempted from the computation of the amount of the sales tax the gross receipts from the sale of any tangible personal property to

(a) The United States, its unincorporated agencies and instrumentalities,

(b) Any incorporated agency or instrumentality of the United States wholly owned by the United States or by a corporation wholly owned by the United States,

(c) The American National Red Cross, its chapters and branches (R & T C, Sec 6381)

Background [1]

This exemption resulted from court decisions upholding the validity of imposing a tax on a retailer to the United States even though the financial burden of the tax is shifted to the United States. It represents legislative policy to relieve the United States from the burden of the tax This policy is probably directed primarily to national defense production, and placing California suppliers of the United States on an equal footing with competitors in other states In the case of the Red Cross, it is directed to the humanitarian work of this organization

Revenue estimate [1] ..... Very large but indeterminate

Comment

This is a very important provision which exempts property sold to the United States (except by corporations which, although instrumentalities of the United States, are not wholly owned by the United States) and to the American National Red Cross

Since this is not required for constitutional reasons, the reason for an exemption such as this must lie elsewhere The economic effect of this exemption is to permit the federal government to purchase an item at a lower price than a private concern would be able to purchase the same item The ultimate effect of this exemption is to allocate more

[1] *Ibid*

resources to the government sector than would be the case without such an exemption The only other justification for this exemption would be that these items are chiefly producers' goods and therefore should not be subject to a retail sales tax in any case The question of competition with other states is difficult to evaluate—especially if every state encounters the same argument

Common Carriers

There are exempted from the computation of the amount of the sales tax the gross receipts from sales of tangible personal property to a common carrier, shipped by the seller via the purchasing carrier under a bill of lading whether the freight is paid in advance, or the shipment is made freight charges collect, to a point outside this State and the property is actually transported to the out-of-state destination for use by the carrier in the conduct of its business as a common carrier The term "common carrier," as used in this section, with respect to water transportation, shall be deemed to include any vessel engaged, for compensation, in transporting persons or property in interstate or foreign commerce (R. & T C , Sec 6385)

Background [1]

This exemption was proposed by common carriers so that they could buy supplies and take delivery in the state, and ship them outside the state by their own facilities without imposition of tax They claimed that other purchasers could secure this advantage by having the goods shipped by carrier and, thus, a purchaser who was also a carrier was handicapped by its dual capacity The section was passed before the Supreme Court had decided the case of *Standard Oil Company* v. *Johnson*, 24 Cal 2d 40, possibly, in anticipation of an adverse decision The decision, however, held that the tax did not apply.

In 1963, because of the question whether tramp steamers qualified as common carriers, the section was amended to settle this issue, to the effect that such tramp steamers were for purposes of the section to be regarded as common carriers

Revenue estimate [1] ---------- $210,000

Comment

This provision exempts property sold to common carriers, shipped via the purchasing carrier to a point outside this state under a bill of lading

These items are producers' goods and therefore are properly exempt under a retail sales tax Once again, the interstate character of this exemption is noteworthy For consistency and minimum economic distortion of the market, it might be argued that this exemption should be applied also to intrastate common carriers Otherwise all this exemption does is to provide an inducement for interstate buyers to purchase goods of this type in California

Out-of-State Contractors

There are exempted from the computation of the amount of the sales tax the gross receipts from the sale in this State of tangible personal property to a holder of a valid seller's permit issued under Section 6068 when the property is used by the purchaser outside of this State in his performance of a contract to improve real property and, as a result of such use is incorporated into and

[1] *Ibid*

becomes a part of real property located outside of this State. This exemption shall apply only if the purchaser certifies in writing to the seller, in such form as the board may prescribe, that the property will be used in a manner and for a purpose herein specified (R & T C, Sec 6386)

Background [1]

This section originated out of the controversy that arose over the application of sales tax to persons who would take delivery of raw materials in California, fabricate them, transport the fabricated article outside the state to be incorporated into real property outside the state in fulfillment of a construction contract It had previously been held in *Levine* v *State Board of Equalization*, 142 Cal App. 2d 760, that the tax applied to sales to the purchaser even though the purchaser had given a resale certificate The section, therefore, exempts such purchasers from the tax, but only if they hold a California seller's permit.

Revenue estimate [1] ---------- Small

Comment

Property sold to the holder of a seller's permit for use in performing a contract to improve real property located outside this state and which is incorporated into and becomes a part of such real property is exempted under this provision Out-of-state contractors are permitted to purchase building materials in California without payment of the sales tax It encourages the purchase of building materials in California and permits the alteration or repair of real property outside of California at a lower cost than otherwise would be the case Once again, a justification for such an exemption, other than as a subsidy to encourage the out-of-state sale of building materials, is on the grounds that these may be intermediate goods Actually, this would depend on whether the structure were a private dwelling or a business establishment

Delivery to Export Packers

There are exempted from the computation of the amount of the sales tax the gross receipts from sales of tangible personal property purchased for use solely outside this State and delivered to a forwarding agent, export packer, or other person engaged in the business of preparing goods for export or arranging for their exportation, and actually delivered to a port outside the continental limits of the United States prior to making any use thereof (R & T C, Sec 6387.)

Background [1]

This section, in effect, writes into the law the rule of the case of *Gough Industries* v *State Board of Equalization*, 51 Cal. 2d 746, holding that if goods are destined for export their sale is not rendered taxable because the seller delivers them to an export packer, engaged by the buyer, who is in the business of preparing goods for export

Revenue estimate [1] ---------- None

Comment

Property purchased solely for use outside this state and delivered to a forwarding agent or export packer and actually delivered to a

[1] *Ibid*

port outside the United States prior to making any use thereof is exempted.

New Vehicles Purchased From Out of State

Where a new truck, new truck tractor, new semi-trailer, or new trailer, any of which has an unladen weight of 6,000 pounds or more, or new trailer coach or new auxiliary dolly, is purchased from a dealer located outside this State for use without this State and is delivered by the manufacturer to the purchaser within this State, and such purchaser drives or moves such vehicle from the manufacturer's place of business in this State to any point outside this State within 30 days from and after the date of the delivery, there are exempted from the taxes imposed by this part the gross receipts from the sale of and the storage, use or other consumption of such vehicle within the State, provided that the purchaser furnishes the following to the manufacturer

(a) Written evidence of an out-of-state registration for such vehicle

(b) The purchaser's affidavit attesting that he is not a resident of California and that he purchased such vehicle from a dealer at a specified location without the State for use outside this State

(c) The purchaser's affidavit that such vehicle has been moved or driven to a point outside this State within 30 days of the date of the delivery of the vehicle to him (R & T C, Sec 6388)

Background [1]

This exemption began in 1959 as an aid to California housetrailer manufacturers. It allowed them to make tax free delivery in California of trailers ordered in other states but delivered in California and taken out of the state for registration The exemption was expanded in 1963 to include heavy commercial trucks, truck tractors, trailers and semi-trailers. No significant revenue effect has been identified with this exemption because manufacturers could in any event avoid tax by delivery in interstate commerce. The rationale of the exemption is similar to that for aircraft.

Revenue estimate [1] _____ negligible

Comment

This exemption makes the California truck and trailer manufacturing plants competitive with plants in non-sales-tax states for out-of-state purchasers. For the California economy this amounts to a subsidization of the export of trucks to other areas Perhaps the sales tax would place these manufacturers at a competitive disadvantage but it should be noted that there are many other goods manufactured in California and taken elsewhere which do not enjoy this tax-free status There would also seem to be some discrimination against California dealers selling to out-of-state buyers.

Property Purchased From United States

The storage, use or other consumption in this State of property purchased from any unincorporated agency or instrumentality of the United States, except (a) any property reported to the Surplus Property Board of the United States, or to any agency succeeding to the functions of that board, as surplus property by any owning agency and (b) any property included in any contractor inventory, is exempted from the use tax

"Surplus property," "owning agency," and "contractor inventory" as used in this section have the meanings ascribed to them in that act of the Congress of the United States known as the "Surplus Property Act of 1944" (R & T.C, Sec. 6402.)

[1] *Ibid.*

Background [1]

The intent of this section was really to impose the use tax with respect to purchases of surplus property from the United States At the same time, it was definitely the intention to continue the exemption from use tax of other property purchased from unincorporated instrumentalities of the United States Since it is impractical, if not beyond the power of the state, to require collection by the United States of the tax from the purchaser, it becomes a practical impossibility in most cases to collect the tax from the buyer of many small items, such as government publications

Revenue estimate [1] $16,600

Comment

The administrative difficulties in collecting the use tax on purchases from the United States are formidable but the exemption of such property is indefensible on economic grounds It provides a competitive advantage for government agencies when selling property if they are in competition with private sellers and as such constitutes an allocation of more resources to the government sector than would otherwise be the case Even in the matter of government publications, there is considerable competition with privately produced and published books

Vehicles Loaned for Driver Training

The loan by an automobile dealer of a motor vehicle to any school district for a driver training educational program conducted by the district is exempt from the use tax If the dealer makes any other use of the vehicle except retention, demonstration or display while holding it for sale in the regular course of business, the use is taxable to the dealer under Chapter 3 of this part as of the time the property is first so used, and the sales price of the vehicle to the dealer is the measure of the tax (R & T C, Sec 6404)

Background [1]

This exemption was to encourage the availability of "loaner" automobiles to schools for student driver training Without the exemption an automobile dealer would be subject to use tax on cars loaned from his inventory to a school for driver training

Revenue estimate [1] $4,500

Comment

This exemption provides special treatment for goods used in a program which the State wishes to promote The economic effects of this are minimal. The saving of lives is great

Credit for Replacement Purchase

When a passenger automobile or other motor vehicle being used to transport persons without compensation is damaged as a result of a casualty while outside this State to such an extent that it becomes reasonably necessary to replace it, the amount of any sales or use tax with respect to the purchase of the replacement, paid by the purchaser to another state or to his vendor, shall constitute a credit against the use tax applicable to the vehicle purchased (R & T C, Sec 6405)

Background [1]

This provision relieves the consumer from the double burden of consumption-type taxes of two states under the very limited circum-

[1] *Ibid.*

stances where the consumer purchases a new automobile as a result of a severe accident while outside the state rather than solely by choice.

Revenue estimate [1] $3,000

Comment

The exemption provides that if a passenger automobile is so damaged while outside of this state that it must be replaced, the sales tax paid to the other state is a credit against the amount of use tax that is due. The result is that the taxpayer is not subject to double taxation as a result of a casualty loss This is certainly desirable on equity grounds and its economic effect is insignificant

Auto Use Tax

The department shall withhold the registration or the transfer of registration of any motor vehicle sold at retail to any applicant by any person other than a dealer certificated under Section 11714 of this code or a wrecker licensed under Sections 11500, 11501, 11502, and 11503 of this code, holding a valid seller's permit under Section 6068 of the Revenue and Taxation Code, until the applicant pays to the department the use tax measured by the Sales price of the motor vehicle as required by the Sales and Use Tax Law, together with penalty, if any, unless the State Board of Equalization finds that no use tax is due, or unless the applicant files with the department a certification of the person selling the motor vehicle to the applicant stating that the person had not made any other retail sale of a motor vehicle of a type subject to registration under the Vehicle Code during the preceding 12 months. If the applicant so desires, he may pay the use tax and penalty, if any, to the department so as to secure immediate action upon his application for registration or transfer of registration, and thereafter he may apply through the Department of Motor Vehicles to the State Board of Equalization under the provisions of the Sales and Use Tax Law for a refund of the amount so paid (Vehicle Code, Sec 4750 5)

Background [1]

This section is more restrictive than the occasional sale exemption allowed for other tangible personal property where a person may make two sales during any 12-month period without becoming a retailer The exemption is primarily designed to allow private citizens not engaged in automobile selling to make one retail sale of a personal automobile each year without sales or use tax attaching

Revenue estimate [1] $9,000,000

Comment

This exemption of one automobile sale a year by persons not engaged in the car business is defensible, if at all, on administrative grounds Even these grounds are weak in view of the possibility of enforcement by way of the registration process The revenue loss is not negligible

Summary and Recommendations

The tax base of the California sales tax law is eroded severely by its exemptions The tax base should be equitable and afford the maximum degree of tax neutrality possible Generally speaking, a broad tax base reduces competitive inequities and economic distortions This is not to say that there should be no exemptions since other considerations may override the desire for a broad tax base, as in the very costly but very

[1] *Ibid*

necessary food exemption. It would appear that a reconsideration of the California retail sales tax may lead to extensive revision of many of the other exemptions considered above. (The taxation of services which would require redefinition of the "tangible personal property" nature of the present statute is considered in great detail elsewhere and therefore will not be considered here.)

The exemptions dictated by requirements of the U.S. Constitution must be maintained of course. Certainly it would be futile to attempt to extend the sales tax to areas where this tax would be unconstitutional.

The exemption of motor vehicle fuel is reasonable since this is subject to a special excise tax which can always be set at the full rate desired by the Legislature.

The exemptions referring to food for off-premises consumption, school meals and prescription drugs are explained on equity grounds. Their effect is important in making the sales tax more progressive. Justification exists for the exemption of driver-training loaners and casualty-loss replacements.

The remainder of the exemptions may be evaluated against a new exemption of all intermediate goods and all producer goods including office supplies. This exemption would avoid the imperfect shifting and tax pyramiding that occurs. A retail sales tax is designed to impose a tax not at any stage in the productive process but at the final sale to the consumer. Otherwise there is a great deal of tax pyramiding and imperfect shifting with the resultant uncertain incidence. It is actually deceptive to maintain a certain legal tax rate when the actual effective rate is much higher as a result of indirect taxation resulting from tax pyramiding and imperfect shifting.

If it is truly desired to impose a tax at more than one stage in the productive process, then a value-added tax is the logical substitute for the present retail sales tax.[1] In this manner, the excess burden could also be eliminated since the value-added tax is designed to be imposed at the various stages of the productive process while the retail sales tax is designed to be imposed only at the final stage of the productive process, the final sale to the consumer. It would be much easier, however, to improve the existing California sales tax than to go to an entirely different kind of tax like the value-added tax.

It is important to note that massive consumption exemptions like food, fuel and housing, are progressively distributed in themselves. Proportionality and regressivity are found only when intermediate goods are also taxed and the assumption is made that the tax on them is shifted completely to all output (whether taxable or not) by way of total expenditures.[2] Since total consumption expenditures (without regard to exemptions) are distributed regressively, the statistical result is to mask the progressive nature of the exemptions. An inference from this is that the California sales tax would be progressive into the higher levels of income if existing consumer exemptions were retained and intermediate goods were not subject to taxation.

[1] The main proponent of this type of tax is Dan Throop Smith. See his "Value Added Taxation in Relation to Income, Excise and Sales Taxation" in *Excise Tax Compendium. Papers Submitted to House Ways and Means Committee, June 15 and 16, 1964*, pp. 89–98.

[2] This was demonstrated in Irving Jay Goffman, *The Burden of Canadian Taxation*, p. 20. (Toronto. The Tax Foundation, July 1962.)

X

CONCLUSIONS: THE CRUCIAL ROLE OF EXEMPTIONS

It is evident from the foregoing study that exemptions are crucial to an equitable and economically defensible sales tax Sales tax administrators understandably defend the tax base and resist exemptions which erode the revenue, complicate administration and prevent equitable enforcement From a legislative point of view, however, some exemptions are essential to achieve equity and desirable economic effects

Even what is equitable and what is economically desirable depends partly on one's value judgments and point of view. Some will question the desirability of a "progressive" tax structure based on "ability to pay," however defined. All will agree that the sales tax should be "fair" for all classes of income, that the tax should treat all in similar situations equally and not create a competitive advantage for one over another. On the economic side, sales tax exemptions can be justified, if judiciously used, where they have a salutary effect on the state's economy They may also be used to promote activities of worthy nonprofit organizations which might otherwise have to be financed by government

We have seen that the California sales tax is "progressive" by reasonably acceptable standards, up to a certain level of income. This is accomplished by the use of exemptions, of which the most important are:

Food not consumed on the premises
Prescription drugs
Public utility services
Agricultural food products

Of these, the food exemption is overwhelmingly the most important. California is one of 10 sales tax states to have greatly reduced regressivity through exemptions. There is a corresponding loss of tax revenue, of course, to the tune of $178 million a year in California.

Some exemptions are used deliberately for welfare purposes, as a substitute for, or supplement to, more direct forms of aid A number of states exempt sales to nonprofit religious, charitable and educational institutions California has not made significant moves in this direction as yet An argument in favor of these exemptions is that these organizations carry out activities that would otherwise necessitate the use of public funds. Only a few limited concessions have been made here in this direction—e g in a bill (Quimby) to put the tax on the wholesale rather than the retail price in the case of Girl Scout cookies.

Exemptions provide a powerful weapon for the stimulation of the California economy or for the avoidance of an adverse economic effect Three bills passed by the 1963 Legislature illustrate this In one case (Petris) trucks sold to out-of-state buyers were made exempt Here, the sales tax could make or break a sale in competition with other states

In another case (Nisbet) the sale of railroad cars was exempted in order to encourage the establishment of a railroad car factory in California This is an example of the encouragement of economic development with no loss in revenue California had no railroad car sales prior to the passage of the bill and would not otherwise have any A third example (Thomas) is the bill to exempt the sale of fuel to tramp steamers This encourages tramp steamers to call at California ports instead of going to competing ports

California also exempts sales to the United States government although sales to state and local governments are taxed The exemption arises from a fear that a tax on sales might jeopardize the large volume of aerospace contracts going to California

Further extensions in the direction of equity might be to exempt all medicines, whether or not sold by prescription Another extension under current consideration is the exemption of prosthetic devices Here again, equity dictates extension to similar situations The bill currently under consideration would exempt as prosthetic devices, an artificial substitute for a missing part of the body, as a hand, leg, eye, denture, etc , in other words, a mechanical appliance used to restore a function A logical extension is to include ophthalmic, orthopedic, auditory, and dental appliances It is estimated that this exemption, broadly conceived, would cost the state $6 million in fiscal 1965–66 [1]

Another possibility worthy of serious consideration is the exemption of restaurant meals sold to low-income persons who cannot eat at home This may require a blanket exemption of restaurant meals below a certain level

Some exemptions appear to have no social or economic purpose but exist for administrative convenience only This includes occasional sales of automobiles and certain types of meals

As we have seen above, many states tax services and derive considerable revenue therefrom California could certainly obtain a large amount of revenue from this source, even if it is confined to services with respect to personal property Whether extension to services would make the sales tax more or less progressive depends on the scope of the extension

A closely related area is the taxation of rentals and leases, particularly of personal property Just as in property taxation, where a mere possessory interest in the property may be as valuable as the actual ownership, the rental of tangible personal property may provide the possessor with as much satisfaction as the actual purchase Yet the purchase invokes the sales tax while the rental does not Rentals and leases of personal property are on the increase and there is a growing competitive advantage against those who offer the same products for sale

In short, an exemption is as powerful an instrument as the sales tax itself It must and should be used judiciously to achieve equity and promote the development of the California economy

[1] Letter to Honorable Nicholas C Petris chairman, Assembly Interim Committee on Revenue and Taxation, from John B Marshall, senior statistician, Research and Statistics, State Board of Equalization, June 8, 1964

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ASSEMBLY INTERIM COMMITTEE REPORTS

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STUDY OF WATER DISTRICT LAWS

(1963 Revision)

A REPORT OF THE ASSEMBLY INTERIM COMMITTEE ON WATER TO THE CALIFORNIA LEGISLATURE

(House Resolution 505, 1963)

January 1964

Published by the

ASSEMBLY
OF THE STATE OF CALIFORNIA

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* Resigned December 20, 1963

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January 7, 1964

CALIFORNIA LEGISLATURE
ASSEMBLY INTERIM COMMITTEE ON WATER

HONORABLE JESSE M. UNRUH
Speaker of the Assembly
MEMBERS OF THE ASSEMBLY
State Capitol, Sacramento 14, California

GENTLEMEN Pursuant to House Resolution No 505 of the 1963 General Session, the Assembly Interim Committee on Water herewith submits a report, *Study of Water District Laws* (1963 Revision).

This report is a revised abridgement of the committee's report to the 1963 Legislature on water district laws The text and tables have been brought up to date to reflect changes made in water district laws at the 1963 General Session.

This report represents a comprehensive summary of selected provisions of major water district laws Although the report is primarily intended to serve as a background reference source for use of Members of the Legislature, it is hoped it will also be of value to the many water districts and water organizations in the State

Respectfully submitted,

CARLEY V. PORTER, Chairman

By Assemblyman Porter

HOUSE RESOLUTION NO. 505

Relating to a revision of the *Study of Water District Laws* prepared by the Assembly Interim Committee on Water

WHEREAS, The Rules Committee of the California State Assembly referred to the Assembly Interim Committee on Water, House Resolution No 434 of the 1961 General Session, which authorized a study of the laws relating to the organization, powers and duties of water districts; and

WHEREAS, The Assembly Interim Committee on Water submitted a report, *Study of Water District Laws,* to the 1963 Legislature, pursuant to said resolution; and

WHEREAS, This report includes a summary of selected provisions of the Water Code and special district acts pertaining to water districts; and

WHEREAS, This report has proved to be a valuable reference document for both the Members of the Legislature and other persons in the State concerned with water district organization; and

WHEREAS, Many general district acts and special district acts relating to water districts are receiving substantial amendment in the 1963 Session of the Legislature; now, therefore, be it

Resolved by the Assembly of the State of California, That the Assembly Interim Committee on Water is authorized to revise its report to the 1963 Session of the Legislature, *Study of Water District Laws*; and, be it further

Resolved, That said committee is authorized to publish a revised edition of said report incorporating the changes made in water district laws by the 1963 Session of the Legislature

(Adopted by the Assembly June 19, 1963)

PREFACE

This report is a revised edition of the *Study of Water District Laws* published by the committee in November 1962 This new edition, including only the historical and analytical material on water districts (including the results of the committee questionnaire), has been brought up to date to reflect the many changes made in water district acts by the Legislature at the 1963 General Session

In its 1962 report the committee made a number of recommendations regarding water district legislation, most of which were enacted during the 1963 session These changes are reflected in the text and tables of this report Further findings and recommendations of the committee will be made to the Legislature in a later report to the 1965 General Session.

The complete list of districts which was included in the 1962 report has been omitted since such a list will be available from the Secretary of State sometime in 1964 as a result of the Government Code requirements enacted by Chapter 457, Statutes of 1963.*

* 12171 The Secretary of State shall compile and maintain a complete list of all districts for which certificates or copies of orders, ordinances or resolutions declaring districts formed or organized have been filed This list shall contain the name of each district, the date of formation, and the county or counties in which the district is located

The list of districts, and all certificates, maps, or copies of orders, ordinances or resolutions filed with the Secretary of State in connection with the formation, change of boundaries, merger, consolidation, or dissolution of districts, shall be open to inspection by the public

INTRODUCTION

The material in this report does not provide a complete analysis of all water district acts The tables and accompanying text cover only those portions of district acts which the committee felt were most likely to be the immediate concern of the Legislature

In approaching this study, the committee found several prior studies and background publications available for its use, but all proved to be incomplete for its purposes It was then determined that an entirely new analysis of district acts be made, organized to meet the specific requirements of this study

PRIOR STUDIES

Of the prior studies of districts, the most complete source document is the 1954 report for the Assembly Interim Committee on Municipal and County Government, *Analysis of California District Laws,*[1] which was prepared by the Legislative Counsel It provides tabular information on all general act and special act water districts in addition to most of the other general act and special act districts in the State, including street and highway districts, harbor districts, etc. Biennial supplements to this report, showing only new districts formed and not including amendments to existing districts acts, have been issued regularly since its original publication; however, no complete revision in it has ever been made and it is somewhat cumbersome to use with its four supplements

The water district sections of the above report were published separately in 1955 by the Assembly Interim Committee on Conservation, Planning, and Public Works under the title, *Water District Laws of California, an Analysis, Section 2* [2] No revisions for this report have been issued A companion report by the same committee, *Irrigation District Movement in California, A Summary, Section 1,* prepared by the University of California, Bureau of Public Administration, provides a detailed history and excellent background on one of the earliest of California's general water district laws [3]

The 1957 Regular Session of the Legislature saw the creation of the Senate Interim Committee on Study of Districts,[4] which began its study during the 1957-59 interim and issued a preliminary report in June 1959 Although a number of suggestions for district legislation resulted from this study, it concerned itself primarily with financial aspects of districts Its work has only limited application to our current study To this date no further study of districts has been made by the Senate

Over the years the Department of Water Resources and its predecessors have issued *Irrigation and Water Storage Districts in California, Bulletin No 21,* which describes new districts formed under the

[1] California Legislative Counsel, *Analysis of California District Laws,* 1954, 392 pps
[2] Assembly Interim Committee Reports, 1953-1955, Vol 13, No 5A, Jan 1955, 191 pps
[3] Assembly Interim Committee Reports, 1953-1955, Vol 13, No 5, 62 pps
[4] Senate Resolution 166, 1957, *Senate Journal,* p 4132

two acts and gives limited general information in tabular form on all districts formed under these acts This bulletin was issued annually from 1929 to 1944 Since 1944 it has been issued irregularly.[5]

In July 1958 the Department of Water Resources issued the fifth edition of its publication, *General Comparison of California Water District Acts,*[6] which was first published in 1950 and revised in 1951, 1952 and 1953 This report included both general act and special act water districts Each general district act or special district act was treated separately by the report and comparison of features from act to act was somewhat difficult At this date, this 1958 report has not been revised

Two years later, in December 1960, the Department of Water Resources released a list of *California Districts Formed Under General and Special Water District Acts.*[7] This is a rather complete list which, in addition to the name of the district, also lists the county in which each is located, but does not include district addresses.

One of the reasons for the paucity of historical information on water districts is the fact that no central records facility existed for water districts prior to 1949 In that year the Legislature added Section 12463 1 to the Government Code,[8] which created an advisory committee composed of seven local governmental officers to assist the State Controller in developing complete and adequate records of districts other than school districts The Controller and the advisory committee were authorized to require financial reports from public districts whenever they felt it in the public interest to do so As a result, the Controller has issued an *Annual Report of Financial Transactions Concerning Special Districts of California* each fiscal year since 1950-51 This is an extremely complete and valuable document and contains a great deal of helpful information. Each year additional district acts have been included in the report and the most recent edition included 171 general and special district acts involving 3,237 individual districts

The Controller issues a similar report, *Annual Report of Financial Transactions Concerning Irrigation Districts of California,* on a calendar year basis, pursuant to the same Government Code requirements

The Department of Water Resources has recently published *Bulletin 114, Directory of Water Service Agencies in California,*[9] which is a revision of a 1955 report This directory includes the name, location, irrigated area and number of domestic service connections of commercial water companies, mutual water companies and public water districts in California

[5] *Bulletin 21,* covering the years 1916 to 1928 and published in 1929, is an exceptionally complete document including early history and detailed information on each district This was followed annually by issues designed by letter from *Bulletin 21-A,* covering the year 1929 and published in 1930, through *Bulletin 21-O,* covering the year 1943 and issued in 1944 *Bulletin 21-P* covers the years 1944-1950 The *Bulletin 21* issued in 1958 covered the years 1951 to 1955, the March 1960 issue covered the years 1956 to 1958, the December 1960 issue covered 1959 *Bulletin 21-60* was issued in 1962 and covers 1960 The period prior to 1916 is covered in the following publication State Department of Engineering, *Bulletin 2, Irrigation Districts in California,* 1887-1915 dated 1916

[6] Department of Water Resources, Sacramento, 1958, 77 pps (mimeo)

[7] Department of Water Resources, Sacramento, December 1960, 32 pps (mimeo)

[8] Statutes of 1949, Chapter 1521

[9] Department of Water Resources, Sacramento, June 1962

The publications discussed above comprise the basic current reference materials on water districts now available A number of studies of individual district problems have been published and they are included in the bibliography which appears as an appendix to this report

Of historical interest, prior to codification of the Water Code in 1943, biennial reports were issued by the Department of Public Works, Division of Water Resources, and its predecessors on irrigation districts, California water districts, water storage districts and other agricultural general act districts These reports, which varied somewhat in content from publication to publication, were titled *California Irrigation District Laws*, and included the complete statutes of these three general acts as well as other statutory material and general data on these districts They were issued from 1919 to 1948 [10] This series was published separately from the *Bulletin No 21* series

As a result of legislative action, the Division of Water Resources issued a comprehensive summary report in 1930 entitled *Bulletin No 37, Financial and General Data Pertaining to Irrigation, Reclamation and Other Public Districts in California* This document was prepared under the direction of the California Irrigation and Reclamation Financing and Refinancing Commission, which was created in 1929.

The biennial reports listed above, *Bulletin No 37* and the *Bulletin No 21* series, are the only available public documents covering this long early history of these districts There has been little attention paid to the history and development of water districts in California

DEFINITIONS

For the purposes of this study it has been necessary to clarify some confusion which has centered around the term "special district" As used by laymen, a "special district" is any public district, other than a school district, with specialized and limited purposes For example, cemetery districts, park districts, transit districts, sanitation districts, library districts, fire protection districts, parking districts, mosquito abatement districts and water districts are types of districts which are commonly referred to as "special districts" One of these "special districts" may be formed either under a general enabling act with actual formation procedures handled on the county level or it may be formed by special act of the Legislature In 1962 there were 3,237 of these "special districts" [11]

There is a legislative distinction, however, between districts formed under general enabling acts and those created by special legislative act Therefore, as used in this report a *general district act* is an enabling statute which does not create any specific local district but sets forth the organization and procedures by which districts can be formed locally Any legislative amendment of a *general district act* affects all districts formed under it.

[10] These were issued as follows Department of Engineering, *Bulletin 6*, 1919, Department of Public Works, Division of Engineering and Irrigation, *Bulletin 1*, 1921, *Bulletin 7*, 1923, *Bulletin 10*, 1925 and *Bulletin 18*, 1927 The Department of Public Works, Division of Water Resources, issued the report biennially from *Bulletin 18-A*, 1929 through *Bulletin 18-H*, 1943 A final issue *Bulletin 18-I*, was released in 1948 Publication of the Water Code made this series unnecessary

[11] Alan Cranston, State Controller, *Annual Report of Financial Transactions Concerning Special Districts of California, 1961-62*, p IX

As used in this report a *special district act* is a statute enacted by the Legislature establishing a specific district. For example, in 1961 Assembly Bill 2455,[12] a *special district act,* created the Kern County Water Agency. Any amendment to this *special district act* affects only the Kern County Water Agency

In this report "assessments" has been used in general to indicate both taxes and assessments

SCOPE OF STUDY

At the outset the committee felt that if a selected list of districts was studied in detail it would be possible to provide a more useful document for the use of the committee Since the study was to serve as a source document for the Legislature, with particular application during general sessions, when a large number of new special districts and amendments to existing special and general district acts are proposed, an attempt was made to center the study on those districts with which the Legislature has been most concerned in recent years First, the study was limited by including only general district acts found in the Water Code and those uncodified general and special district acts generally classified in legal publications as water acts This was done because the resolution creating this committee assigned it "the subject matter of the Water Code, uncodified laws relating thereto, and other matters relating to water, water resources, flood control and irrigation" [13]

Second, the study was further limited by omitting a number of general district acts under which only one district had organized In actual practice the districts are, in effect, special districts The Metropolitan Water District Act (under which only the Metropolitan Water District of Southern California is formed), the County Water Authority Act (under which only the San Diego County Water Authority is formed), and the Municipal Water District Act of 1935 (also with only one district formed under it) were omitted from the study for this reason

An obvious exception to this limitation is the inclusion of the Water Replenishment District Act (the Central and West Basin Water Replenishment District is the only district formed under this act) In its concurrent study of the State's ground water problems, the committee found that certain provisions in this recent (1955) act may become increasingly important as the need for ground water replenishment grows in many areas of the State.

Third, a number of district acts were omitted from this study due to their limited use as water distribution entities Among the general act districts omitted for this reason are drainage districts, levee districts, protection districts, reclamation districts, storm drain maintenance districts and storm water districts

In summary, the districts which the committee has studied include the most widely used distribution entities providing wholesale or retail

[12] Statutes of 1961, Chapter 1003
[13] House Resolution 500, 1963, *Assembly Journal,* p 6078.

water service in addition to certain other districts Ten general district acts were included in the committee's study

California Water Districts (Water Code, Div 13)
California Water Storage Districts (Water Code, Div 14)
County Water Districts (Water Code, Div 12)
County Waterworks Districts (Water Code, Div 16)
Flood Control and Flood Water Conservation Districts (Deering Act 9178).
Irrigation Districts (Water Code, Div 11)
Municipal Water Districts of 1911 (Water Code, Div 20) [13a]
Water Conservation Districts of 1927 (Deering Act 9127a).
Water Conservation Districts of 1931 (Deering Act 9127c).
Water Replenishment Districts (Water Code, Div 18)

A complete list of districts formed under these general acts, as well as special act districts, is attached to this report as Appendix A

A total of 55 special act districts were included in the study In recent years these districts have been formed in ever-increasing numbers For purposes of this study all but 3 of those 55 districts comparable to the general district acts above have been grouped together in the following three categories·

(1) County Flood Control and Water Conservation Districts
(2) Flood Control Districts
(3) Water Agencies

COMMITTEE QUESTIONNAIRE

The resolution directing this study, in addition to an analysis of district laws, requests "the reasons for their variations" In order to best assess the difficult-to-establish "reasons" for differences both among and within districts, and to obtain information not included in the statutes, the committee sent a questionnaire to all districts included in the study A total of 608 districts received the questionnaire The districts' response was most gratifying as 441 districts replied for a 73 percent return A copy of the questionnaire is included in this report as Appendix B

TABLE I. RESPONSE TO COMMITTEE QUESTIONNAIRE

	Number sent	*Number returned*	*Percent returned*
California water	98	59	60
California water storage	7	6	85
County water	177	132	75
County waterworks	96	64	67
Flood control and flood water conservation	4	3	75
Irrigation	110	83	75
Municipal water (1911)	48	33	69
Water conservation (1927)	5	3	60
Water conservation (1931)	11	9	81
Water replenishment	1	1	100
Special act districts	51	48	94
All Districts	608	441	73

[13a] Codified by Chapter 156, Statutes of 1963 (S B 15)

FORMAT OF REPORT

This report was organized to provide a quick reference to selected provisions of both the general district acts and special district acts and to permit comparison between these districts Five major tables, each giving detailed provisions of each act, accompany chapters two through six of the report These major tables are as follows: *Voting Basis and Formation Provisions* (Table V, Chapter II); *Governing Body Provisions* (Table VIII, Chapter III); *Powers* (Table X, Chapter IV); *Financing Provisions* (Table XII, Chapter V), and *Boundaries Provisions* (Table XXI, Chapter VI) Provisions of the 10 general district acts and 55 special district acts are included in each table

A number of smaller tables supplement the major tables and provide (1) summaries of the major tables, (2) summaries of data from the committee questionnaire, and (3) summaries of other provisions in the acts The text of the chapters accompanying the major tables discusses in greater detail matters related to the tables

Appendixes to the report include a bibliography of district materials, and a discussion of the Special Assessment, Investigation, Limitation and Majority Protest Act of 1931,[14] the District Investigation Law of 1933,[15] local agency formation and annexation commissions, and the county boundary commissions

The major tables in this report were based on uniform terminology—unlike previous reports of this type which utilized the actual language of each act—which greatly facilitates quick comparison of various districts, a principal objective of this report Many of the tables in this report have been revised and several have been added

ACKNOWLEDGMENTS

The committee wishes to express its appreciation to the many persons who assisted it in this study, particularly the districts who responded to the committee questionnaire, as well as the office of Alan Cranston, State Controller, the Districts Securities Commission, the Department of Water Resources, and the Irrigation Districts Association

The committee also wishes to express its appreciation to Legislative Counsel A C Morrison and his staff and Legislative Analyst A Alan Post and his staff for their invaluable assistance in the preparation of this report

[14] The complex provisions of this act determine whether or not a water district in any specific circumstance is subject to this act

[15] At the present time no water districts included in this study are subject to the provisions of this law, however, the law may be expanded to cover water districts at any future date

CHAPTER I

WATER DISTRICT ORGANIZATION IN CALIFORNIA

Historically the distribution of water in California has been primarily for irrigation purposes. Even with the great urban development in recent years, 90 percent of the water used in the State today is for irrigation and only 10 percent is for municipal, industrial and miscellaneous purposes The Department of Water Resources has estimated that with the ultimate development of the State, 80 percent of the water used annually will be for irrigation purposes [1]

In a very general way, the evolution of public water distribution entities in California paralleled the growth of the State

The creation of districts by the Legislature began during the 19th century when the State was predominantly agricultural and was accomplished primarily by a few general district acts However, as the urban areas of the State grew rapidly during the early 20th century and as industrial development became an increasingly important segment of the economy, new general district acts were needed The unprecedented growth of California in recent years, which came while the State maintained the largest agricultural economy in the nation, made the water problems of districts more complex This was accompanied by an increased tendency to create special act districts, at the same time as the increasing demand for water accelerated the creation of districts under general district acts

The entry of the State into water project construction resulted from passage in 1959 of the Burns-Porter Act and the subsequent ratification by the voters in 1960 of the $1,750,000,000 bond issue to finance the State Water Facilities The effects of rapid urbanization of the fastest-growing areas of the State, particularly in Southern California, are reflected in the proposed allocation of the 4,000,000-acre-foot [2] yield of the project Nearly half of the project water is expected to be used for municipal and industrial purposes and 45 percent of the total yield will be delivered south of the Tehachapi Mountains where water use will be predominantly domestic and industrial The need for more entities to distribute project water has arisen

It was estimated in 1962 that there were more than 3,700 public and private water entities serving local areas in California These may be broken down into four major categories of water distribution entities (1) private water agencies (public utilities companies, which are private enterprises operating under public regulation, and mutual water companies, which are nonprofit, co-operative enterprises under private ownership formed for the purpose of serving their own members or stockholders), (2) general act districts, (3) special act districts; and (4) municipal water departments

[1] S T Harding, *Water in California*, 1960, p 30
[2] One acre-foot is equivalent to covering one acre with water one foot deep One acre-foot equals 325,828 gallons of water

In 1962 some 1,400 (or 38 percent) of the State's water distribution entities were mutual companies, about 500 (or 14 percent) were public utility companies, 900 (or 24 percent) were public districts and approximately 200 (or 5 percent) were municipal entities [3]

Mutual water companies are any corporation or association organized to deliver water solely to its stockholders or members or to the State or any of its agencies or departments on a nonprofit basis Since they are privately owned they do not have taxing powers. Nor are they permitted to exercise the power of eminent domain

Public utilities companies (or commercial water companies) are also privately owned but are usually operated for profit These companies are normally permitted to serve only those located within their franchised service area There are a number of large public utilities companies in California The largest currently serves water to an estimated 235,000 customers in 35 cities

The State Public Utilities Commission has regulatory authority over the public utilities companies However, it does not exercise this authority over mutual water companies, municipally owned utilities, or public districts

Although they are not the most numerous of water distributing entities, public districts nonetheless directly serve approximately 74 percent of the State's irrigated acreage They directly serve only 15 percent of the State's domestic water, but indirectly serve as wholesale distributors for a much larger percentage than this [4]

EVOLUTION OF PUBLIC DISTRICTS

It is helpful to an understanding of the current status of water district acts to briefly trace the development of these districts, particularly those treated in detail in this report This is not an exhaustive history but is based upon the limited materials available

General District Acts, 1866-1963

The first general district act enacted by the Legislature came in 1866 and provided for reclamation districts [5] The principal function of these districts was to reclaim swamps, marshes or tidelands—an important problem in that early period of the State's development More than 125 of these districts still exist today and are located primarily in the Sacramento and San Joaquin Valleys

In 1872, the Legislature authorized the formation of irrigation districts.[6] This early law, under which no districts were formed, permitted landowners to petition the county board of supervisors for the formation of a district In 1874, the Legislature enacted an Irrigation District Act applicable only to Los Angeles County which permitted the board of supervisors, following a feasibility study of an irrigation system, to call an election on the construction of the project and formation

[3] California Department of Water Resources, *Directory of Water Service Agencies in California, Bulletin No 114*, June 1962, p 1
[4] Stanford Research Institute, *Economic Considerations in the Formulation and Repayment of California Water Plan Projects*, March 1958 p 114
[5] Albert T Henley, "The Evolution of Forms of Water Users Organizations in California," *California Law Review*, Vol 45, No 5, December 1957, p 667
[6] Statutes of 1871-72, Chapter 634 (repealed by Statutes of 1943, Chapter 372)

of a district. As with the 1872 act, no districts were formed under this law.[7]

One of the first special act water districts came into being in 1876 with passage by the Legislature of an act creating the West Side Irrigation District,[8] in a seven-county area extending from Suisun Bay to Tulare Lake The district never became operative Two years later the Modesto Irrigation District was created by special act[9] This district never became operative Instead the Modesto Irrigation District of today was the second district organized under the Wright Act in 1887.

In 1880 the Legislature enacted two general district acts creating protection districts and drainage districts for purposes similar to those of the earlier reclamation districts Additional drainage district acts were passed in 1885, 1897, 1903, 1919 and 1923[10] Today there are no 1880 or 1897 act drainage districts and only one remaining 1923 district All three acts have been repealed[11] There are six active districts formed under the 1885 act, 16 formed under the 1903 act, and three formed under the 1919 act

Additional protection district acts were passed in 1895 and 1907[12] Seven protection districts remain formed under the 1880 act, one formed under the 1895 act and two formed under the 1907 act.

A related type of district—the levee district—was authorized in 1905 with passage of the Levee District Act, with a second act of this type passed in 1959[13] Seven of these 1905 districts—the purpose of which is to construct and maintain levees—exist today. No districts have been formed to date under the 1959 act, however

The Storm Water District Act of 1909 also authorized districts to protect lands from damage by soil erosion or storm waters Districts formed under this act were empowered to construct dams, ditches, dikes, etc There are nine of these districts in existence today General acts providing for storm drain maintenance districts were passed in 1937 and 1939 There now are 26 districts remaining under the 1937 act and only one remaining under the 1939 act (which has been repealed)[14]

Following the establishment in 1878 of the office of State Engineer, the engineer issued a report in which a proposed general act for irrigation districts was outlined It was not until 1887, however, when under the sponsorship of Assemblyman C C. Wright, an attorney from Stanislaus County, a comprehensive enabling act for irrigation districts was finally passed by the Legislature[15]

The Wright Act formed the basis for most of the irrigation district legislation passed to the present time Ten years later, in 1897, the Wright Act was repealed and re-enacted by the so-called Bridgeford Act, authored by Assemblyman E A Bridgeford of Colusa, Glenn and

[7] University of California Bureau of Public Administration, *The Irrigation District Movement in California, A Summary*, January 1955, p 11

[8] Statutes of 1875-76, Chapter 491, which was re-enacted by Statutes of 1877-78, Chapter 345 (repealed by Statutes of 1943, Chapter 372)

[9] Statutes of 1877-78, Chapter 526 (repealed by Statutes of 1943, Chapter 372)

[10] Statutes of 1880, Chapter 117, Statutes of 1885, Chapter 158, Statutes of 1897, Chapter 228, Statutes of 1903, Chapter 238, Statutes of 1919, Chapter 354, Statutes of 1923, Chapter 102

[11] Statutes of 1953, Chapter 1021, Statutes of 1953, Chapter 1020

[12] Statutes of 1880, Chapter 63, Statutes of 1895, Chapter 201, Statutes of 1907, Chapter 25

[13] Statutes of 1905, Chapter 310 Statutes of 1959, Chapter 370

[14] Statutes of 1909, Chapter 222, Statutes of 1937, Chapter 265; Statutes of 1939, Chapter 1100 (repealed by Statutes of 1953, Chapter 1001)

[15] Statutes of 1887, Chapter 34

Lake Counties [16] The 1897 act was substantially the same as the 1887 act, with the exception of basic changes in procedures for organization and incurring indebtedness As an early Department of Public Works bulletin explained, "The original Wright Act was plainly defective, among other particulars, in not providing for sufficient state supervision to prevent the organization of wholly speculative districts and districts for other reasons not justified or feasible, also, in failing to give the State any control of irrigation district finances" [17] Today there are 113 irrigation districts organized under this act, which was officially named the "California Irrigation District Act" in 1917 The largest concentration of these districts is in the Central Valley; however, they are found in 32 of the 58 counties of the State, including metropolitan areas.

Through the years irrigation districts have gradually broadened their scope In 1919 the generation of electricity was added to the powers of irrigation districts This was a significant action and greatly influenced the development of certain districts The Division of Water Resources noted as early as 1929, "Without incidental income from power, some of the most important irrigation developments in California during the past decade either would not have been possible or would have been delayed for many years" [18] Other powers include drainage and flood protection

These districts also serve domestic water users Today approximately 1 6 percent of the water delivered by irrigation districts is for domestic and industrial purposes Total water deliveries by irrigation districts in 1960 amounted to 7,519,000 acre-feet [19] and total land area included in 1960 was 4,557,656 acres [20]

At the 1913 and 1915 sessions of the Legislature amendments were made to the Irrigation District Act giving the State Irrigation Commission (now the Districts Securities Commission) wide supervisory powers over the issuance of securities by districts Although amended additionally since that time, this supervision continues today

In response to the urban growth of the State in the early years of this century and accompanying the progressive movement in state politics, the Legislature passed another major general district act—the Municipal Water District Act of 1911 [21] The primary purpose of these districts was to provide a domestic water supply. A second Municipal Water District Act was enacted in 1935 [22] but has been little used and only one district remains formed under this act There are now 49 districts formed under the 1911 act

In 1913 three more general district acts were passed by the Legislature—the County Water District Act,[23] the California Water District Act,[24] and the County Waterworks District Act.[25]

[16] Statutes of 1897, Chapter 189
[17] California Department of Engineering, *California Irrigation District Laws, Bulletin No 6*, 1919 p 7
[18] California Department of Public Works, Division of Water Resources, *Irrigation Districts in California, Bulletin No 21*, 1929, p 35
[19] California Department of Water Resources, *Irrigation and Water Storage Districts in California, 1960, Bulletin No 21-60*, p 1
[20] Alan Cranston, State Controller, *Annual Report of Financial Transactions Concerning Irrigation Districts of California*, 1960, p 1
[21] Statutes of 1911, Chapter 671 See also Ch 156, Statutes of 1963
[22] Statutes of 1935, Chapter 78
[23] Statutes of 1913, Chapter 592.
[24] Statutes of 1913, Chapter 387.
[25] Statutes of 1913, Chapter 370

County water districts today are the most numerous of all general act districts with 186 districts formed under this act. In its original form the County Water District Act was closely patterned on the original Municipal Water District Act of 1911, except that it applied to unincorporated territory The districts organized under the County Water District Act have been used mainly for domestic water supply and only incidentally for irrigation [26]

A number of factors influenced the passage of the California Water District Act Its original sponsors planned to organize districts in *entered government land* in the Chuckawalla Valley and the Palo Verde mesa in Riverside County [27] Also, provisions in the Irrigation District Act which prohibited overlapping districts resulted in the provision in the California Water District Act which permits the organization of California water districts within the boundaries of an irrigation district, subject to certain restrictions In effect, however, these restrictions limit these districts generally to areas not actually served by an irrigation district [28]

One of the major differences between this act and the Irrigation District Act is the voting basis California water districts provide for voting on the basis of land ownership, with one vote for each $1.00 of assessed land value In irrigation districts, on the other hand, each resident, registered voter has one vote (See Table V on pages 42-46)

Rather surprisingly, no districts were created in this Riverside County area and the first California water district (Nieland Water District) was formed in 1921 in northern Imperial County, within the Imperial Irrigation District but in an area not served with a distribution system from the irrigation district [29] In effect, this California water district served as a local zone for the irrigation district

Development of districts under the California Water District Act began slowly Since its passage, its provisions have been greatly broadened and it has received its greatest use in the last few years. There are now 109 California water districts, making it the third most-used general district act.

The original County Waterworks District Act was passed to provide a means by which the City of Los Angeles could organize the then-unincorporated area of the San Fernando Valley to receive water from the Los Angeles Aqueduct The aqueduct was almost complete and it was desired to make the Owens Valley water available to the area, which it proposed to later annex to the city Originally these districts were known as county irrigation districts [30]

According to an early report, "At that time irrigation district bonds were not in a favorable position in the investment markets In an amendment to the act in 1915, therefore, the name of the districts formed under the act was changed to county waterworks districts." [31]

[26] California Department of Public Works, Division of Water Resources, *California Irrigation District Laws, Bulletin No 18-B*, 1932, p 7 (hereafter referred to as Bulletin No 18-B) and *Bulletin No 21, Op Cit*, p 17

[27] California Department of Public Works, Division of Water Resources, *California Irrigation District Laws, Bulletin No 18-A*, 1929, p 6 (hereafter referred to as *Bulletin No 18-A*).

[28] *Ibid*, p 222

[29] *Bulletin No 21, Op. Cit.*, p 18.

[30] *Ibid*, p 20

[31] *Loc Cit*

Ninety-three of these districts, which are limited primarily to unincorporated areas, now exist, many having been formed in recent years The districts, however, are concentrated in great numbers in a few counties. For example, there are 33 such districts in Fresno County and 14 in Los Angeles County The influence of county government is great in the operation of these districts

County water districts and California water districts include powers of drainage and reclamation in addition to those of distributing water for domestic and irrigation purposes The more limited county waterworks districts are principally domestic water supply entities, although they may supply irrigation water

In 1915, the Legislature passed the California Irrigation Act [32] (to be distinguished from the earlier California Irrigation District Act), which was desired by the Iron Canyon Association as a step toward the construction of the Iron Canyon Project on the Sacramento River near Red Bluff.[33] No districts in this area were ever formed under this act, which permitted the formation of conservation districts and a new type of irrigation district—only one of which was formed during the life of the act.

The California Irrigation Act was then amended in 1917 and reenacted in 1919 as the California Irrigation Act of 1919 in an attempt to accomplish another objective—the formation of a large district on the Kings River for the purpose of constructing storage at the Pine Flat site. This action was the beginning of a long series of attempts to organize a district on the Kings River.[34]

As a result of litigation over several proposed districts in the San Joaquin Valley, the California Irrigation Act of 1919 was declared unconstitutional in 1920.[35]

The Legislature in 1921 then repealed the unconstitutional act and at the same time enacted the California Water Storage District Act [36] to meet objections to the unconstitutional act and to serve slightly different purposes The purposes of this new act, the districts of which have the power to store and distribute water for irrigation, were to provide a general act under which (1) overlap with irrigation districts was permitted; (2) districts with large areas and large landholdings but small resident populations could be formed with voting based upon land ownership; (3) benefits which are not directly proportional to the value of the land could be assessed equitably [37] Voting and assessments are the principal areas of difference between this act and the Irrigation District Act.

The first four districts formed under the act each fit one or more of these unusual situations The Tulare Lake Basin Water Storage District had practically no residents In the San Joaquin River Water Storage District the principal interests were those of the Madera Irrigation District and Miller and Lux The latter also organized the Buena Vista Water Storage District and owned practically all the land in that

[32] Statutes of 1915, Chapter 621
[33] *Bulletin No 21, Op Cit*, p 22
[34] *Ibid*, pp 22-23
[35] *Modesta* v *Board of Supervisors of Madera County* (1920), 183 Cal 434
[36] Statutes of 1921, Chapter 914
[37] *Bulletin No 21, Op Cit*, p 23, *Bulletin No 18-A, Op Cit.*, p 135, and California Department of Public Works, Division of Water Resources, *California Irrigation District Laws, Bulletin No 18-F*, 1939, p 5

district. In the Kern River Water Storage District the principal interests were centered on the Kern County Land Company and a number of separate canal companies, all more or less controlled by the Kern County Land Company [38]

Today there are nine of these districts, all located in the southern San Joaquin Valley, two having been formed in 1962. An unusual aspect of these districts has been the large degree of control exercised over them by the Department of Water Resources Major changes in this act were made in 1963, however, with most of the department's general supervision transferred to the Districts Securities Commission and most of the department's authority over elections was transferred to the district boards (effective July 1, 1965) [38a]

During the 1920's there were a number of other actions in local areas which resulted in the passage of closely related general and special district acts

In 1923, the Legislature created the only irrigation district formed by special district act, the Palo Verde Irrigation District [39] This district act consolidated an existing levee district and a drainage district. Features of the act follow very closely the procedures of the California Irrigation District Act.

Special acts were passed by both the 1921 and 1923 Legislatures creating a water district in Santa Clara County [40] However, local elections to make the district operative failed to pass [41] Senator Herbert Jones of Santa Clara County then sponsored the Water Conservation Act of 1929 [42] for the conserving, storing, spreading and sinking of waters for underground replenishment. A district was then successfully formed in Santa Clara County under this general act and it began a pioneer ground water replenishment program.[43]

This 1929 act was repealed two years later and re-enacted as the Water Conservation Act of 1931 [44] Today there are 10 of these 1931 districts operating, including districts in Santa Clara County and Ventura County engaged in extensive ground water replenishment. The powers of these districts are broad, however, and include the general storage and distribution of water as well as recharge (and the replenishment assessment or "pump tax").

Following the nullification of the California Irrigation Act of 1919, the Kings River interests succeeded in getting the Legislature to enact the California Water Conservation District Act of 1923 [45] as their next attempt to form a district in that area. The unusual local circumstances of the Kings River area were reflected in this act, which authorized creation of conservation districts composed of "three or more units, all or any of which shall be irrigation, water storage, or reclamation, or drainage districts; or any other political subdivisions of the State organized to promote irrigation or reclamation or drainage or flood con-

[38] *Bulletin No 21, Op Cit*, p 22. *Bulletin No. 18-B, Op. Cit.*, p. 162.
[38a] Statutes of 1963, Chapter 1607 (A B 2963).
[39] Statutes of 1923, Chapter 452
[40] Statutes of 1921, Chapter 822, and Statutes of 1923, Chapter 479
[41] *Bulletin No 21, Op Cit*, pps 29-30
[42] Statutes of 1929, Chapter 166
[43] Interesting accounts of the history of the formation of this district are found in Henley, *Op Cit*, and Stephen Smith, *The Public District in Integrating Ground and Surface Water Management. A Case Study in Santa Clara County*, April 1962, 135 pps
[44] Statutes of 1931, Chapter 1020
[45] Statutes of 1923, Chapter 426

trol . . '' The act also created the State Irrigation Board to effect the consolidation of these various districts into conservation districts Shortly after the enactment of this act a formation petition was filed by the Kings River Conservation District and remained pending for many, many years. The California Water Conservation District Act was repealed in 1953 [46] without having a district formed under it A special act district, the Kings River Conservation District, was finally enacted by the Legislature in 1951,[47] following construction of Pine Flat Dam by the U S. Army Corps of Engineers, ending more than 30 years of effort

In 1927, the Legislature enacted the Water Conservation Act of 1927, a general district act creating districts with powers of financing and constructing water conservation works The 1927 act was drawn primarily in the interests of landowners along the Santa Clara River in Ventura County who desired to conserve water by spreading.[48] Only six districts formed under this act remain today The Ventura district which sponsored this act later reorganized under the 1931 act as the United Water Conservation District.

It was during the period from 1915 to 1930 that the irrigation district became a successful and accepted institution The double impact of World War I and increased western migration brought about substantial new growth in these districts during this period In the delivery of agricultural water, irrigation districts dominated the field In 1929, only seven county water districts were serving agricultural areas and districts formed under the other four general district acts (California Water, County Waterworks, California Water Storage, and Water Conservation of 1927) had accomplished little with regard to the serving of agricultural water [49] Unfortunately, there are no records available of the activities of these districts in the area of domestic and industrial water supplies

This growth of districts in local communities also coincided with the emergence of an integrated program for water development of the Sacramento and San Joaquin Valleys, which culminated with submission of the State Water Plan (Division of Water Resources, *Bulletin No. 25*) to the Legislature of 1931 and the enactment in 1933 of the Central Valley Project Act. The failure of the State to finance the project during this depression period resulted in congressional authorization in 1935 for federal construction of the project The construction of the project stimulated the creation of districts to provide entities to contract for federal project water, and at least 12 irrigation districts are known to have been formed for this purpose.[50]

In 1931 still another general district act, creating flood control and flood water conservation districts,[51] was enacted Five districts formed under this statute exist today and are all located in Sonoma, Modoc, and Mendocino Counties. This general act was intended specifically for flood control and conservation of floodwaters. Districts formed under it do not have the power to distribute water A great many similar countywide flood control districts were desired in the years following

[46] Statutes of 1953, Chapter 998
[47] Statutes of 1951, Chapter 931
[48] *Bulletin No 21, Op Cit*, p. 27.
[49] University of California Bureau of Public Administration, *Op Cit*, p. 25.
[50] *Ibid*, p 29
[51] Statutes of 1931, Chapter 641.

this act and the other general district conservation acts, but almost all of these countywide districts followed the pattern of Los Angeles County and were formed as special act districts.

The next general district acts passed by the Legislature were the Municipal Water District Law of 1935, the California Water Storage and Conservation District Act (1941) and the County Water Authority Act (1943).

No further general district acts of statewide application were passed until 1951 when the Legislature enacted the Community Services District Act (Sections 60000-61891, Government Code) [52] These multipurpose districts are authorized to supply water for domestic, irrigation, sanitation, industrial, fire protection and recreation purposes, as well as to collect, treat, or dispose of sewage, waste and storm water, and to collect or dispose of garbage or refuse. These districts may also provide fire protection, public recreation, street lighting, mosquito abatement, and police protection

In 1955 the Legislature enacted a general district act applicable only to seven Southern California counties which provided for water replenishment districts.[53] The main feature of these basinwide districts is the provision for a "replenishment assessment" or "pump tax" to finance the purchase of water for ground water replenishment. The act was sponsored by the Southern California Water Coordinating Conference and was based upon the successful replenishment operations of the Orange County Water District. The original sponsors of the bill saw its immediate application in Los Angeles County, and in 1959 the Central and West Basin Water Replenishment District was organized under this act to replenish the overdrawn central and west basins of Los Angeles County This is the only replenishment district formed to date. It was expected that replenishment district boundaries would be based upon ground water basins and these districts would overlap a number of other water districts organized on other bases

Mention should also be made of another general district act—the Public Utility District Act (Sections 15501-18004, Public Utilities Code)[54]—which, although not appearing in the Water Code, includes certain powers of water districts, including the storage and distribution of water Since its enactment it has been used in many areas of the State and 68 districts formed under this act, many of them providing water services, now exist.

Not all general district acts have been successfully used, however. There are at least three general district acts under which no local districts ever were formed The earliest of these was the County Power Pumping District Act of 1915,[55] which authorized districts to construct and equip wells to serve district lands This act was finally repealed in 1953, having remained on the statute books for almost 40 years

A second general district act—the Conservancy Act of California, enacted in 1919 [56]—provided for the formation of districts for the spreading of floodwaters for storage and other purposes, including

[52] Statutes of 1951, Chapter 1711
[53] Statutes of 1955, Chapter 1514
[54] Statutes of 1921, Chapter 560
[55] Statutes of 1915, Chapter 746 (repealed by Statutes of 1953, Chapter 1023).
[56] Statutes of 1919, Chapter 332 (repealed by Statutes of 1953, Chapter 1023).

irrigation.[57] There is no record of any districts being formed under this act for irrigation purposes and it was also repealed in 1953.

The third act which was never used was the lengthy (191 sections) California Water Storage and Conservation District Act of 1941.[57a] Districts formed under this act have broad powers, including the general functions of several other general act districts (irrigation districts, reclamation districts and water storage districts) and are specifically permitted to store water underground and to use surplus waters. This act was repealed in 1963 by legislation sponsored by this committee.[57b]

Special District Acts, 1915-1963

The first major special act district created by the Legislature was the Los Angeles County Flood Control District, enacted in 1915. Most of the county is included in this district, which was formed principally to conserve and control flood and storm waters. The district was formed by special act since none of the general acts in existence at that time were adequate.[58]

Through the years since the earliest days of statehood the Legislature created a number of miscellaneous types of districts (reclamation, storm drain, levee, etc.) by special district act. This has continued until the present day but these district acts are not treated individually in this report. Those enacted since 1915, however, are included in Table II on page 35 under the category, "Other."

With this Los Angeles district a pattern of formation of flood control districts began. Since this first flood control district nine more special district acts, based upon but not identical to the Los Angeles district, have been enacted. In 1927, 12 years after formation of the Los Angeles district, the American River Flood Control District in Sacramento County and the Orange County Flood Control District, were created. It was another 12 years later, in 1939, that the San Bernardino County Flood Control District was formed by special act. During the period from 1940 to 1950, similar districts were formed in Ventura County (1944) and Humboldt County (1945). In the mid-1950's, additional flood control districts were enacted, including Morrison Creek (1953) in Sacramento County, Fresno Metropolitan (1955), and Del Norte County (1955). The most recent district of this type was the San Mateo County Flood Control District, which was enacted in 1959.

Most of these flood control districts are limited to the control and conservation of flood and storm waters and are not empowered to distribute or sell water. These districts were created by special act and no general act district along similar lines was ever enacted.

In 1945 the San Diego County Flood Control District Act was enacted by the Legislature. When the bill was first introduced the district was substantially similar to the flood control districts noted above. In the bill's final form which became law, however, the district was reduced in scope to that of a planning body charged only with making

[57] California Department of Public Works, Division of Water Resources, *Irrigation District Laws, Bulletin No. 18-C*, 1933, p. 7.
[57a] Statutes of 1941, Chapter 1253.
[57b] Statutes of 1963, Chapter 109 (A.B. 111).
[58] Committee questionnaire.

studies. This district in its present form, therefore, is not comparable to the above-described flood control districts. It has, however, been included in the study and the tables under the category of special district act flood control districts

The development of a similar type of district by special act began with the enactment in 1945 of county flood control and water conservation districts for Riverside and San Luis Obispo Counties. Twenty-one of these districts exist today and were formed principally to conserve flood and storm waters and to construct flood control works However, generally they have broader powers than the flood control districts, including water distribution in some cases.

The third county flood control and water conservation district was authorized for Monterey County in 1947 and three more were authorized in 1949 (Sonoma County, Alameda County and Mendocino County). In 1951, creation of these special districts by the Legislature reached a peak when six new districts were approved by the Legislature during that general session (Solano County, Santa Clara County,[58a] Napa County, Lake County, Contra Costa County, and Yolo County). Two of these districts were created at each of the next two general legislative sessions (Marin County and San Benito County in 1953 and Santa Cruz County and Santa Barbara County in 1955).

At the special session of 1956 a county flood control and water conservation district was enacted for San Joaquin County, and in 1957 for Tehama County. At the 1959 session of the Legislature four county flood control and water conservation districts, all located in Northern California, were created by special act (Siskiyou County, Sierra County, Plumas County and Lassen-Modoc County). No additional districts of this type have been enacted since 1959 In many cases these districts closely resemble each other and, in fact, often were copied from earlier acts in the series.

In recent years another large group of countywide special act districts have been formed under the general title—Water Agencies As with the above special act districts, several of these water agencies are patterned after other districts of this type and are virtually identical

The first county water agency was enacted in 1945 for Santa Barbara County. The second district of this group was the Sacramento County Water Agency Act, which was patterned after the Santa Barbara act and was enacted in 1952. In 1957, creation of a series of these districts in Northern California counties began with the enactment of County Water Agencies for Contra Costa, Placer and Shasta Counties

In 1959, eight of these agencies were created—five of these were countywide—covering the Counties of Yuba, Sutter, Nevada, El Dorado and Amador. A sixth—Mariposa—covered the entire county except Yosemite Park. These Northern California water agency acts were quite similar in most respects, although several varied in minor ways to meet local conditions The two remaining districts enacted in 1959—the Mojave Water Agency and the Antelope Valley-East Kern Water Agency—were both included in the same bill Neither were countywide and both, as drafted, were nearly identical to the Municipal Water

[58a] Name changed (effective July 1, 1964) to Santa Clara County Flood Control and Water District to avoid confusion with a water conservation district formed under a general district act (Statutes of 1963, Chapter 1941).

District Act of 1911, a general district act The principal purpose of their enactment was to contract with the State for water from the State Water Facilities.

The 1961 Legislature approved one remaining countywide district in Northern California—the Alpine County Water Agency which was based upon the El Dorado County Water Agency Act of 1959—and enacted three others for areas in Southern California (also to provide contracting agencies for water from the State Water Facilities) Two of these agencies—Desert and San Gorgonio Pass—were nearly identical to the Municipal Water District Act of 1911 The third, the Kern County Water Agency, was unlike any existing water district These differences in the Kern Agency resulted principally from unusual circumstances existing in Kern County.

At the First Extraordinary Session of 1962, the Legislature created two more special act water agencies (Upper Santa Clara Valley in Los Angeles County and Crestline-Lake Arrowhead in San Bernardino County), also for the express purpose of contracting with the State for water from the State Water Facilities Passage of these acts brings the total number of these agencies to 19 The Crestline-Lake Arrowhead agency was copied from the Antelope Valley-East Kern agency of 1959 which, in turn, was copied from the Municipal Water District Act of 1911. The Upper Santa Clara agency was based upon several previous special act agencies. All of these water agencies have broad powers to conserve and distribute water.

No special act districts were created at the 1963 General Session

In the last 20 years it has been the objective of most of the counties of the State to establish countywide districts to co-ordinate water development activities in the county (in almost every case with the board of supervisors serving as governing body). In some instances this coordination may take the form of providing service as a countywide wholesaler of water from State or federal projects, or it may take the form of constructing flood control projects

As has been outlined in this discussion of special act districts, each of the three types—water agencies, flood control districts, and county flood control and water conservation districts—has been utilized in a number of counties, the water agencies becoming the most popular type in the last few years. Interestingly enough, in the formation of these three categories of special act districts which are countywide, there is only one county (Santa Barbara) in which there is more than one of these *countywide* special act districts (a water agency and a county flood control and water conservation district)

In 1950 the Brisbane County Water District in San Mateo County was created by special act.[59] This district is governed by all the provisions of the County Water District Act except for special bonding provisions which are included in the special act This special act was used as a method of creating a general act district slightly different from other districts formed under the general district act for the specific purpose of meeting local needs.

In 1959 a special act was utilized to consolidate two irrigation districts and two county water districts into a new district—the Costa

[59] Statutes of 1st Ex 1950, Chapter 18

Mesa County Water District—in all respects operated virtually in the same manner as districts formed under the County Water District Act, a general district act.

The same session of the Legislature passed the Limited Water District Law of 1959,[60] which authorized the formation of municipal water districts in a small area of northern Santa Clara County (The act was to be effective only for two years) The Legislature declared in the act that unique problems of municipal growth and peculiar water storage and supply problems necessitated the use of this "special act" rather than formation under a general district act Yet the Limited Water District Law is not actually a special district act since it doesn't create a specific district by name but, as a general act, sets up procedures whereby districts may be formed. This act was another unusual attempt by the Legislature to meet specific local needs

In an action similar to the Costa Mesa merger, in 1961 a special act was used to merge the Hollister Irrigation District into the San Benito County Flood Control and Water Conservation District, a special district act.[61]

Over the years three other important special district acts which do not fit into any of the above three categories have been enacted by the Legislature. These are the Orange County Water District Act (1933),[62] the Santa Clara-Alameda-San Benito Water Authority Act (1955),[63] and the Yuba-Bear River Basin Authority Act (1959).[64] Only the Orange County Water District (as a result of its pioneering efforts at ground water replenishment) has been included in this study (found in the tables under the category, "Other").

The two other districts, the Santa Clara-Alameda-San Benito Water Authority and the Yuba-Bear River Basin Authority, are both districts with broad general powers including the provision of water for any beneficial use. The Yuba-Bear River Basin Authority has the additional power to control flood and storm waters

Water Development by Metropolitan Areas

The greatest development of domestic and industrial water supplies for the State's burgeoning metropolitan areas has been accomplished by the State's largest cities.[65] The State's metropolitan areas have a long history of pioneering water development projects involving a number of different approaches.

The first major municipal water importation project began in 1905 with the approval by the voters of the City of Los Angeles of a bond issue to begin a 240-mile-long aqueduct project to bring water to the city from the Owens Valley in Mono County. The project was completed in 1913 An expansion of the aqueduct was completed in 1940 and the aqueduct still provides most of the water used by the city each

[60] Statutes of 1959, Chapter 2136
[61] Statutes of 1961, Chapter 203.
[62] Statutes of 1933, Chapter 924
[63] Statutes of 1955, Chapter 1289
[64] Statutes of 1959, Chapter 2131
[65] These are colorfully described in Michael Brewer and Stephen Smith, *California's Man-Made Rivers*, University of California, Division of Agricultural Sciences, Berkeley, June 1961, 28 pps

year; the remainder comes from wells and the Metropolitan Water District.[66] Additional expansion of the project was announced in 1963.

The second major project by a city was by San Francisco, which completed its O'Shaughnessy Dam on the Tuolumne River in Yosemite National Park in 1923 The first pipeline to San Francisco was completed in 1925 and it has since been expanded twice. The city also sells water to many communities in the eastern half of the peninsula, part of northern Santa Clara County, and southwestern Alameda County.

On the eastern shore of San Francisco Bay, nine cities joined in the sponsorship and formation of a regional water district The major problem facing this group was to find a general act which would permit a district to exist in more than one county and include both incorporated and unincorporated areas. As a result of these efforts a new general district act—the Municipal Utility District Act—rather than a special district act, was passed by the Legislature in 1921.[67] This act also authorized these districts to supply light, water, power, heat, transportation, telephone service, garbage and sewerage facilities.

The East Bay Municipal Utility District was formed under this act in 1923, including areas in Alameda and Contra Costa Counties. The district's major project was Pardee Dam on the Mokelumne River and a 94-mile aqueduct to the East Bay area. Additional dams and aqueducts are now being added to the system.[68] Unlike the Metropolitan Water District of Southern California and the San Diego County Water Authority, which are wholesale agencies, the East Bay Municipal Utility District is also a retail water entity.

In the years since its passage, the Municipal Utility District Act has been used for the formation of several other districts, differing widely in purpose. For example, one such district—the Sacramento Municipal Utility District—provides electric power only

In 1927 an unusual general district act—the Metropolitan Water District Act[69]—was enacted by the Legislature primarily to meet the additional water needs of the City of Los Angeles and Southern California, which were experiencing tremendous growth in population. A year later, in 1928, the only district formed under this act—the Metropolitan Water District of Southern California—came into existence This district has proved to be, in effect, a special act district A Metropolitan Water District is composed of "member units," which include cities and public water districts The six-county Metropolitan Water District of Southern California now has a population of 8,000,000 (almost half the State) and an assessed valuation of $17,261,412,395. Its member units include the 13 original cities, 11 municipal water districts, and a county water authority. However, within the area of the

[66] Metropolitan Water District of Southern California, *23d Annual Report*, 1961, p 50 Detailed history of the Los Angeles development and also the development of the Metropolitan Water District of Southern California are included in Vincent Ostrom, *Water and Politics*, The Haynes Foundation, 1953, 297 pps

[67] Statutes of 1921, Chapter 218.

[68] Interesting accounts of the early development of a water supply for the East Bay as well as the San Francisco area are found in the following reports of the Commonwealth Club of California *A Bay Cities Water District*, Vol XI, No 3, 77 pps . *The Bay Cities Water Problem*, 1915, Vol X, No 6, 36 pps , *The Bay Cities Water Supply*, 1914, Vol IX, No 1, 96 pps

[69] Statutes of 1927, Chapter 429 The early history of the district is told in detail in the Metropolitan Water District of Southern California's *History and First Annual Report*, published in 1939.

district there are a total of 96 incorporated cities.[70] In recent years areas annexing to the district have been required to do so by first organizing as municipal water districts This policy has stimulated the formation of these districts in Southern California

The water supplies for this district come from the Colorado River. Shortly after its formation the district began planning for a 242-mile-long aqueduct to bring this water from Parker Dam on the Colorado River to the Los Angeles area The aqueduct began operation in 1941 and recently it was enlarged to its full capacity of 1,212,000 acre-feet a year, or one billion gallons daily. The aqueduct project represents an investment by the district of nearly one-half billion dollars.

A fourth metropolitan area—San Diego—also utilized a general district act to form a district to approach its water supply problems on a countywide basis. The San Diego County Water Authority, formed in 1944, is the only district formed under the County Water Authority Act,[71] which was enacted by the Legislature the previous year The main function of the San Diego County Water Authority was to construct an aqueduct connecting San Diego with the lines of the Metropolitan Water District. The original aqueduct, constructed in two stages, was supplemented by a second aqueduct, completed in 1960.[72] County water authorities may be formed by two or more public agencies (including cities and selected water districts) with the governing body consisting of at least one representative from each public agency.

These impressive projects in the State's four largest metropolitan areas—Los Angeles, San Francisco, San Diego and the East Bay—are in addition to many other municipal water systems.

RECENT TRENDS IN DISTRICT FORMATION

Special District Acts

As can be seen from Table II below, most of the special act districts have been created in the last 10 years—the high point coming at the 1959 Legislative session when 15 special district acts were approved As has been described above, the first special act districts were flood control districts, most of which were formed between 1915 and 1947, and are generally countywide in area.

Beginning in 1945 and continuing through the 1959 session, the second type, flood control and water conservation districts were formed in large numbers. Most of these districts are also countywide and have broader powers than the flood control districts.

The third type of special act district which evolved was the water agency, also countywide for the most part. With the exception of one agency formed in 1945 and another in 1952, all the rest of the 19 water agencies have come in the past seven years. These districts are concentrated in Northern California. Table VII on page 52 shows the locations and area of each of these three categories of special act districts.

[70] Metropolitan Water District of Southern California, *Water for People*, July 1962, pp. 18-19.
[71] Statutes of 1943, Chapter 545.
[72] Brewer and Smith, *Op. Cit.*, p. 9.

TABLE II. NUMBER OF SPECIAL ACT WATER DISTRICTS ENACTED BY THE LEGISLATURE, 1915-1963

*Year**	*Water agencies*	*Flood control districts*	*Flood control and water conservation districts*	*Other*	*Total*
1915	0	1	0	2	3
1917	0	0	0	1	1
1919	0	0	0	1	1
1921	0	0	0	1	1
1923	0	0	0	1	1
1927	0	2	0	0	2
1933	0	0	0	1	1
1939	0	1	0	0	1
1944 †	0	1	0	0	1
1945	1	2	2	0	5
1947	0	0	1	0	1
1949	0	0	3	0	3
1951	0	0	6	1	7
1952 †	1	0	0	1	2
1953	0	1	2	1	4
1955	0	2	2	4	8
1956 †	0	0	1	0	1
1957	3	0	1	0	4
1959	8	1	4	2	15
1961	4	0	0	0	4
1962 †	2	0	0	0	2
TOTAL	19	11	22	16	68

* No districts were formed in years not listed.
† Extraordinary Session.

General District Acts

Although the number of special act districts has about doubled in the past five years, a number of general district acts have shown a similar rate of growth. Table III on page 33 shows the total number of districts formed under each general act for the years 1951-52 to 1961-62.

At present it is too early to estimate the effect the local agency formation commissions will have on the number of new districts formed.

A number of new general act districts have been formed in recent years in Kern County to provide local districts to distribute state project water.

It can be seen that the number of county water districts has more than doubled in the eight-year period from 1953-54 to 1961-62, with 95 districts having been formed in that period for a total of 186 today. During the same eight years the number of municipal water districts more than doubled, increasing from 22 to 49 In the six-year period from 1955-56 to 1961-62 the number of California water districts rose from 67 to 109, an increase of more than 50 percent

Although not increasing at such a rapid rate, county waterworks districts nonetheless have shown a substantial increase in the last 10 years, from 1951-52 to 1961-62. During this period the number of these districts increased from 54 to 93. These general district acts have also been amended often during the past decade or so.

On the other hand, the long-established and predominantly agricultural irrigation districts have remained static in number for several decades. In fact, in the 10-year period from 1951-52 to 1961-62 the

TABLE III. TOTAL NUMBER OF GENERAL ACT DISTRICTS 1951-52—1961-62

	1951-52	*1952-53*	*1953-54*	*1954-55*	*1955-56*	*1956-57*	*1957-58*	*1958-59*	*1959-60*	*1960-61*	*1961-62*
California water	n a.	n.a.	n.a.	n a.	67	77	87	88	92	100	109
California water storage	4	4	4	4	4	4	4	6	7	7	9
County water	n a.	n.a.	91	116	125	141	152	160	168	177	186
County waterworks	54	64	66	69	75	79	82	86	90	90	93
Flood control and flood water conservation	4	4	4	4	4	4	4	4	4	4	5
Irrigation *	107	116	117	113	114	113	115	115	115	113	113
Municipal water (1911)	n.a	n.a.	22	24	28	28	29	35	45	48	49
Water conservation (1927)	5	5	5	5	6	6	6	6	5	5	6
Water conservation (1931)	10	10	10	10	10	10	10	11	10	10	10
Water replenishment	--	--	--	--	0	0	0	1	1	1	1

* Calendar year basis
n a —not available.
SOURCE Alan Cranston, State Controller.

net increase in these districts was only six—the total having risen from 107 to 113. The number of water conservation districts formed under the 1927 and 1931 acts and flood control and flood water conservation districts has also remained almost static in recent years.

Since few general district acts required notice of formation of districts to be filed with any state agency prior to enactment of legislation at the 1963 session, there is no information available concerning California water districts prior to 1955-56 and county waterworks districts prior to 1950-51—the years when the State Controller began including these districts in his annual report on special districts.

It is expected that the number of *countywide* special district acts will not increase appreciably in the future (none were formed at the 1963 General Session) since 36 of the 58 counties, including Alpine, the State's smallest, now have at least one countywide district and many others have what are essentially countywide districts. A number of districts were created during the 1959, 1961 and 1962 legislative sessions as a result of the Department of Water Resources' policy of contracting with water districts covering as large an area as possible. In many cases it is not possible to easily consolidate several local districts for contracting purposes so a special act district is superimposed over the area, eliminating any problems of overlap, conflicting jurisdiction, etc The Department has now completed such contracting, however.

On the other hand, the number of general act districts is expected to continue to increase as the State continues to grow, and the need for additional amendments to general district acts will continue.

TABLE IV. CHRONOLOGICAL LIST OF GENERAL DISTRICT ACTS

Year	*Title*
1866	Reclamation Districts Act
1872	Irrigation Act of 1871-72
1880	Drainage District Act (repealed)
	Protection District Act of 1880
1885	Drainage Law of 1885
1887	"Wright Act" (irrigation districts)
1895	Protection District Act of 1895
1897	California Irrigation District Act (repeal and re-enactment of "Wright Act")
	Drainage District Act (repealed)
1903	Drainage District Act of 1903
1905	Levee District Act
1907	Protection District Act of 1907
1909	Storm Water District Act of 1909
1911	Municipal Water District Act of 1911
1913	County Water District Act
	County Waterworks District Act
	California Water District Act
1915	California Irrigation Act (repealed)
	County Power Pumping District Act (repealed)
1919	California Irrigation Act of 1919 (1915 act re-enacted—unconstitutional)
	Conservancy Act of California (repealed)
	Drainage District Act
1921	California Water Storage District Act
	Public Utility District Act
	Municipal Utility District Act
1923	California Water Conservation District Act (repealed)
	Drainage District Act of 1923 (repealed)

TABLE IV. CHRONOLOGICAL LIST OF GENERAL DISTRICT ACTS—Continued

Year	*Title*
1927	Metropolitan Water District Act
	Water Conservation Act of 1927
1929	Water Conservation Act of 1929 (repealed)
1931	Water Conservation Act of 1931
	Flood Control and Flood Water Conservation District Act
1935	Municipal Water District Law of 1935
1941	California Water Storage and Conservation District Act (repealed)
1943	County Water Authority Act
1951	Community Services District Act
1955	Water Replenishment District Act
1959	Levee District Law of 1959

CHAPTER II

FORMATION AND AREA

The formation procedures for general act districts and special act districts differ greatly since the former are organized at the local level while the latter are, for the most part, created by the Legislature with very little or no local action necessary to activate them.

GENERAL ACT DISTRICTS

Formation

The formation procedures for general act districts can be divided into five basic steps First, legislation enacted in 1963 created a five-member local agency formation commission in each of the counties of the State composed of city, county and public representatives with the responsibility of approving the formation of special districts (including water districts) and cities [1] As a result of this legislation, the first step in the formation of a general act district is the filing of a notice of intention of forming the district with the commission The notice must include a description of the boundaries of the proposed district

Second, those in the local area wishing to organize the district are required to file a petition with the county board of supervisors of the principal county in which the proposed district is located (The sole exception is water storage districts, which file with the Department of Water Resources) The number of signatures required varies from district to district as is shown in Table V on pages 37-41. If the petition is insufficient, in most cases, the proceedings may be terminated. After the petition has been deemed sufficient, and necessary submission to the county boundary commission has been made, the local agency formation commission must be notified No further action can be taken on the proposed formation until the commission has approved of the formation The commission must hold a hearing on the proposed district In considering the proposal the commission review must include consideration of a number of factors including population, organized community services, the effect of the formation, and others.[2]

If the commission disapproves of the formation of the proposed district, all proceedings of formation are terminated and no district composed of "the same or substantially the same territory" can be proposed for one year. If the commission approves the formation of a district, the normal procedures called for in the general district act are then followed.

Third, for all general act districts except municipal water districts, the normal public hearing required by the general district act must be held. The board of supervisors of the principal county (or the Department of Water Resources in the case of water storage districts and

[1] Sections 54775-54791, Government Code (Statutes of 1963, Chapter 1303). For a complete summary of the commission procedures, see Appendix B
[2] Section 54786, Government Code

TABLE V. VOTING BASIS AND FORMATION PROVISIONS

A GENERAL ACT DISTRICTS

	District voting basis	Formation[1]		
		Petition	Hearing	Election[2]
California water	Landowner (one vote for each $1 of assessed land value)	Owners of majority of land area (if noncontiguous areas, owners of majority of assessed value of land in each area)	Yes	Yes
California water storage	Landowner (one vote for each $100 of assessed land value)	Majority of landowners (including majority of assessed land value) or 500 landowners (including 10 percent of assessed land value) to Department of Water Resources	Yes (by Department of Water Resources)	Yes (by Department of Water Resources)
County water	Voter	10 percent of voters (if cities, 10 percent in each)	Yes	Yes (if cities, majority in each)
County waterworks	Voter	25 percent of resident landowners or 25 percent of resident and non-resident landowners (including 15 percent of resident landowners)	Yes	Yes, if any protest (may omit election if petition signed by all owners of real property in district)
Flood control and flood water conservation	No provision for voting	10 landowners (including 25 percent of assessed land value)	Yes	No, action by board of supervisors
Irrigation	Voter	Majority of landowners (including majority of assessed land value), or 500 petitioners (electors or landholders) including owners of 20 percent of assessed land value	Yes (also investigation by Department of Water Resources)	Yes

[1] Unless otherwise indicated, board of supervisors of principal county receives petition and conducts hearing and election

[2] Majority unless otherwise indicated.

TABLE V. VOTING BASIS AND FORMATION PROVISIONS—Continued

A. GENERAL ACT DISTRICTS—Continued

	District voting basis	Formation[1]		
		Petition	Hearing	Election[2]
Municipal water (1911)	Voter	10 percent of voters (if cities, 10 percent in each) (other provisions, declaration of intention and inclusion of portion of a city partly incorporated in an existing district)	No	Yes
Water conservation (1927)	Landowner (one vote for each acre)	50 landowners or owners of majority of land area	Yes	Yes
Water conservation (1931)	Voter	500 voters or 20 percent of voters	Yes	Yes
Water replenishment	Voter	10 percent of voters (if more than one county, 10 percent in each county) to County Clerk	Yes (by Department of Water Resources)	Yes (by board of supervisors)

B. SPECIAL ACT DISTRICTS

1. County Flood Control and Water Conservation Districts

Alameda	Voter	No provision	----	----
Contra Costa	Voter	No provision	----	----
Lake	Voter	No provision	----	----
Lassen-Modoc	Voter, bonds landowner (one vote for each $1000 of assessed value of all property)	10 percent of voters of Lassen County (board may activate without petition[3])	No	At discretion of board of supervisors[3]
Marin	Voter	No provision	----	----
Mendocino	Voter	No provision	----	----
Monterey	Voter	No provision	----	----
Napa	Voter	No provision	----	----
Plumas	Voter, bonds landowner (one vote for each $1000 of assessed value of all property)	No provision	----	----
Riverside	Voter	No provision	----	----

[1] Unless otherwise indicated, board of supervisors of principal county receives petition and conducts hearing and election
[2] Majority unless otherwise indicated.
[3] Lassen County Board of Supervisors

TABLE V. VOTING BASIS AND FORMATION PROVISIONS—Continued

B. SPECIAL ACT DISTRICTS—Continued

1. County Flood Control and Water Conservation Districts—Continued

	District voting basis	Formation		
		Petition	Hearing	Election[1]
San Benito	Landowner (one vote in each zone in which own land)	----	----	Yes
San Joaquin	Voter	No provision	----	----
San Luis Obispo	Voter	No provision	----	----
Santa Barbara	Voter	No provision	----	----
Santa Clara	Voter	No provision	----	----
Santa Cruz	Voter	No provision	----	----
Sierra	Voter, bonds landowner (one vote for each $1000 of assessed value of all property)	No provision	----	----
Siskiyou	Voter, bonds landowner (one vote for each $1000 of assessed value of all property)	10 percent of voters (board may call election without petition)	No	At discretion of board of supervisors
Solano	Voter	No provision	----	----
Sonoma	Voter	No provision	----	----
Tehama	Voter, bonds landowner (one vote for each $1000 of assessed value of all property)	No provision	----	----
Yolo	Voter	No provision	----	----

2. Flood Control Districts

American River	Voter	No provision	----	----
Del Norte County	Voter	No provision	----	----
Fresno Metropolitan	Voter	----	----	Yes
Humboldt County	Voter	No provision	----	----
Los Angeles County	Voter	No provision	----	----
Morrison Creek	Voter	No provision	----	----
Orange County	Voter	No provision	----	----
San Bernardino County	Voter	No provision	----	----

[1] Majority unless otherwise indicated.

TABLE V. VOTING BASIS AND FORMATION PROVISIONS—Continued

B SPECIAL ACT DISTRICTS—Continued

2 Flood Control Districts—Continued

	District voting basis	Formation		
		Petition	Hearing	Election[2]
San Diego County	No provision for voting	No provision	----	----
San Mateo County	Voter	No provision	----	----
Ventura County	Voter	No provision	----	----

3. Water Agencies

Alpine County	Voter	No provision	----	----
Amador County	Voter	No provision	----	----
Antelope Valley-East Kern	Voter	No provision	----	----
Contra Costa County	Voter	No provision	----	----
Crestline-Lake Arrowhead	Voter	----	----	Yes
Desert	Voter	No provision	----	----
El Dorado County	Voter	No provision	----	----
Kern County	Voter	----	----	Yes
Mariposa County	Voter	No provision	----	----
Mojave	Voter	25 voters (to Board of Supervisors of San Bernardino County)	Yes (by Department of Water Resources)	Yes (by Board of Supervisors of San Bernardino County)
Nevada County	Voter	No provision	----	----
Placer County	Voter	No provision	----	----
Sacramento County	Voter	No provision	----	----
San Gorgonio Pass	Voter	No provision	----	----
Santa Barbara County	Voter	No provision	----	----
Shasta County	Voter	No provision	----	----
Sutter County	Voter	No provision	----	----
Upper Santa Clara Valley	Voter	No provision	----	----
Yuba County	Voter	No provision	----	----

[2] Majority unless otherwise indicated.

TABLE V. VOTING BASIS AND FORMATION PROVISIONS—Continued

4. Other

	District voting basis	Formation		
		Petition	Hearing	Election[a]
Kings River Conservation District	Voter	No provision	----	----
Orange County Water District	Landowner or owner of improvements or other assessable rights (one vote per $100 of assessed value in each division), voter, for bond elections only	No provision	----	----
Palo Verde Irrigation District	Landowner (one vote per $100 assessed value of land and improvements)	No provision	----	----

[a] Majority unless otherwise indicated

water replenishment districts) conducts the hearing The board generally has the authority to change proposed boundaries, excluding areas found not to be benefitted by the district and including areas which can show benefit

In the case of water replenishment districts, water storage districts and irrigation districts, the Department of Water Resources must make an investigation of the proposed project of the district under consideration If the department's evaluation is adverse, changes in boundaries, etc, can be made to meet the department's objections. The formation procedure must be terminated if the objections are not met. With respect to irrigation districts, the department's objections can be overruled by a petition of three-fourths of the landowners of the proposed district

During the formation process, before an election is held, a determination is usually made on a number of organizational options which may be available. These permit variations between districts formed under one general district act. For example, the number of irrigation district directors may be either three or five, and a choice must be made in the petition (The only exception is the El Dorado Irrigation District which may have seven directors) California water storage districts may have 5, 7, 9 or 11 directors—a determination being made at the final hearing. The Water Conservation Acts of 1927 and 1931 have options of three, five or seven directors—the choice being specified in the petition.

With reference to water replenishment districts, the maximum ad valorem assessment to be permitted (up to 20 cents per $100 assessed value) is included in the petition at the time of formation and becomes one of the factors presented to the voters at the election. Under the 1931 Water Conservation Act the petition similarly may include a

request that taxes for bonded indebtedness be levied on all property rather than land only, which is the normal basis for assessment in these districts.

In the formation of districts under the Water Conservation Acts of 1927 and 1931, the proceedings are automatically terminated upon petition (objecting to the formation) by owners of more than one-half of the assessed value of the proposed district.

In 1961 the Legislature added slightly different provisions to the County Water District Act and the California Water District Act which specifically permit the board of supervisors to terminate formation proceedings before the election if, in their opinion, the district is "not in the public interest" (county water districts, Section 30264 1, Water Code) or if there is "good cause" (California water districts, Section 34302.5, Water Code) for it *not* to be formed. This explicit authority gives the local boards of supervisors a firmer control over formation of these districts and was enacted to reduce the number of uneconomic or otherwise impractical districts being formed

In the formation of flood control and flood water conservation districts the board of supervisors itself creates the district after the hearing, as there is no provision in the act for an election In the formation of county waterworks districts, the election can be dispensed with if the formation petition is signed by all owners of real property in the district.

In all the remaining general act districts in this study an election is the fourth step in the formation procedure The election is called by the body which received the petition.

A simple districtwide majority is required to approve formation of all districts except county water districts, where majorities must also be recorded in each city included in the proposed district as well as in the unincorporated area.

Recognizing the fact that general act districts have evolved separately over a long period of time, it is understandable that there would be a lack of uniformity in a number of these procedural items related to formation. For example, formation elections for county water districts must be held between 60 and 70 days after the hearing. A number of other district acts set no time period but the Water Conservation Act of 1931 provides a maximum period of 120 days The requirements for publication of notice of election provide another example of a lack of uniformity between general district acts.

The County Waterworks District Act is unique in that it permits the formation of improvement districts and the approval of a bond issue to be consolidated with the formation election

The final step in the formation process is the filing of notice of formation with the Secretary of State (and in the case of certain districts with other state and local officials). This filing requirement was enacted in 1963 upon the recommendation of this committee [2a] Each district must file a certificate listing the name of the district, the date of formation, the county or counties in which the district is located and either a description of the boundaries of the district, or reference to a map showing the boundaries, or reference to the county recorder's

[2a] Statutes of 1963, Chapter 457 (Assembly Bill 112).

office where a description of the boundaries has been recorded. If sufficient the formation ordinance may be submitted

The 1963 legislation also required that the Secretary of State "shall compile and maintain a complete list of all districts for which certificates or copies of orders, ordinances or resolutions declaring districts formed have been filed." [2b] This includes all of the general act districts included in this study.

In order to maintain this complete list, the 1963 legislation required all districts formed prior to September 21, 1963 (the effective date of the 1963 legislation), to file formation information with the Secretary of State by January 1, 1964.

Area

Table VI on pages 44-45 briefly outlines territorial requirements of general act districts in this study and the restrictions imposed upon their formation It can be seen that a number of districts prohibit overlap or superimposition of either the same type of district, other types of districts, or both. With irrigation districts, for example, overlap is permitted only with the approval of the existing district.

The example of a small water district in San Diego County which serves 1,300 acres of land has often been cited with reference to superimposition of districts. This district is within a municipal water district which is within a county water district which is a member of the county water authority, which is a member agency of the Metropolitan Water District Similar cases of the superimposition of several districts over one area exist in other areas of the State At least two general district acts and many special district acts were in part passed to permit overlap with other districts

It can also be seen from this table that in most cases, proposed districts need not be composed of contiguous areas. As explained above, all proposed district boundaries are subject to adjustment before the election so that only areas benefiting from the district are included Additional restrictions in the case of irrigation districts, water storage districts and California water districts require that all areas included in the district must be susceptible to irrigation from common sources proposed by the district as its supply Formation of water replenishment districts is limited to seven Southern California counties (Santa Barbara, Ventura, Los Angeles, San Diego, Riverside, San Bernardino and Orange)

All 10 general district acts included in this study can include both incorporated and unincorporated area

A related problem—the growth of municipalities and creation of new municipalities including the areas of existing districts—was the subject of a lengthy court action, which concluded in April 1962. On December 6, 1957, the Downey County Water District, as a result of annexation by the city, was contained completely within the corporate boundaries of the City of Downey, in Los Angeles County. The city then passed a resolution declaring the district merged with the city. (The County Water District Act is silent on the matter of overlap with municipalities) A court test was made of the merger and the superior court ruled against the city. On appeal, the district court of appeals

[2b] Section 12171, Government Code.

TABLE VI. AREA OF GENERAL ACT DISTRICTS

General district act	*Area*
California water districts	Land which is capable of using water beneficially for irrigation, domestic, industrial or municipal purposes and which can be serviced from common sources of supply and by the same system of works; must be contiguous unless not more than two miles apart or separated by state hospital land Lands in a California water district in existence not less than five years and not delivering water may be included in an irrigation district; under water service contracts with United States, state agency or district, lands may become part of any irrigation, drainage or reclamation project.
California water storage districts	Lands irrigated or susceptible of irrigation from a common source and by the same system of works, need not be contiguous May include land in other agencies including other water storage districts having different plans, purposes, and objectives
County water districts	County or two or more contiguous counties or a portion of such county or counties; may include unincorporated territory Lands in a county water district in existence not less than five years and not furnishing water may be included in irrigation districts A county water district which includes part or all of the land in an irrigation district may take over properties of the irrigation district. A district may be annexed to or included within a municipal utility district without impairing legal existence
County waterworks districts	Any unincorporated portion of a county, or the whole or any portion of one or more incorporated cities and contiguous unincorporated territory, and not included in a county irrigation or county waterworks district, may include noncontiguous territory of not less than 10 privately-owned acres which may be supplied through same distribution system Any overlap is prohibited
Flood control and flood water conservation districts	Any area within one county requiring control of floods and conservation of floodwaters Shall not include lands within any other flood control district "heretofore created or organized"
Irrigation districts	Land irrigable from common source and by same system; need not be contiguous; includes residential and business New districts may not include land in another irrigation district without consent of board of existing district.
Municipal water districts (1911)	Any county or portion of a county or lands in more than one county, may consist of either incorporated or unincorporated territory alone or both; if city included, its entire corporate area must be included, with certain exceptions; land need not be contiguous. Identity or legal existence of any public corporation or agency is not impaired by inclusion in district.

TABLE VI. AREA OF GENERAL ACT DISTRICTS—Continued

General district act	*Area*
Water conservation districts (1927)	Lands in watershed of any stream of water or unnavigable river, or adjacent thereto or deriving a water supply therefrom; may be entirely within unincorporated territory or partly within incorporated territory; may be within one or more counties; need not be contiguous.
Water conservation districts (1931)	The whole or a part or parts of one or more watersheds of any stream or streams of water or unnavigable river or rivers, or territory adjacent thereto or deriving a water supply therefrom; may be entirely within unincorporated territory or partly within incorporated territory; may be within one or more counties; need not be contiguous.
Water replenishment districts	Incorporated or unincorporated territory or both within one or more of the Counties of Santa Barbara, Ventura, Los Angeles, San Diego, Riverside, San Bernardino and Orange, except area now in Orange County Water District. Overlap with existing agency which replenishes ground water supplies prohibited

then reversed the trial court decision A hearing was denied by the State Supreme Court.

In its decision the district court of appeals relied upon a 1910 rule of merger and declared:

> ". . . the general rule in connection with other special districts is that when the territory of a public corporation of limited powers is annexed to and entirely contained within the boundaries of a municipal corporation which has power to exercise the same functions as well as others essential to municipal government, the public corporation of limited powers, in the absence of special legislative enactment revealing it should continue its existence, of necessity automatically merges with the municipal corporation and ceases to exist . . . This doctrine of merger by operation of law is predicated on the theory of duplication of functions—otherwise two distinct local governmental bodies claiming to exercise the same authority, powers and franchises simultaneously over the same territory would 'produce intolerable confusion, if not constant conflict.' "[3]

It is not known how many districts are subject to dissolution as a result of this decision At the 1963 session several bills were introduced modifying or reversing this decision; none was passed.

SPECIAL ACT DISTRICTS

Formation

The passage by the Legislature of a special act district generally replaces at least the first two steps of formation and most often the third step as well. As is shown on Table V, only 5 of the 55 special act districts included in this study (one county flood control and water

[3] *People ex rel City of Downey* v. *Downey County Water District (1962)*, 202 A.C.A. 870, 875

conservation district, one flood control district, and three water agencies) required an election within the district itself to render the district operative; and only one district—the Mojave Water Agency—required the filing of a petition and the conducting of a hearing by the board of supervisors in a manner similar to that of general act districts.

Unusual circumstances in the area of the Mojave agency also resulted in a requirement in the act that following the filing of the petition, the Department of Water Resources make a study of the need for the district

In the majority of the special act districts covered by this study (see Table VIII) the governing body is the board of supervisors. In these cases it has been customary for the board to pass a resolution declaring the district operative and duly organized. In at least two special act districts (Sutter County Water Agency and Nevada County Water Agency) this action has not been taken and the districts, for all practical purposes, are inactive Two other districts (Siskiyou County Flood Control and Water Conservation District and Sierra County Flood Control and Water Conservation District) have been officially recognized by board resolution but are inoperative There is no requirement that districts created by special act be activated within any specific time period (except for those requiring an election to be held within a specific period following the passage of the act)

Area

In each of the 55 special district acts in this study the area included in the districts is specifically set forth and is described in Table VII on page 47 The Legislature itself defines the original boundaries of special act districts.

None of the general district acts can prohibit the Legislature from superimposing a special act district over an existing general act district. This fact seems to be one of the major reasons for creation of a number of these districts by means of special acts That is, a special district act may be, in practical terms, the only way to create a countywide district without raising conflicts with numerous existing general act districts, each with different overlap provisions.

One special act district, in its response to the committee questionnaire, stated that a general act district had announced it would withhold approval of formation of the water district under a general district act and, therefore, a special district act was the simplest means of overcoming this opposition

Another major reason for formation by special district act is (rather than replacing existing districts) to specifically provide larger entities for the purpose, for example, of contracting with the federal or state government. Most of these special district acts have express provisions providing that they *do not* impair the existence of general act districts within the special act districts.

TABLE VII. AREA INCLUDED IN SPECIAL ACT DISTRICTS *

Special act districts	Number of districts	Countywide	Part of one county	More than one county
County Flood Control and Water Conservation Districts	22	Alameda, Contra Costa, Lake, Marin, Mendocino, Monterey, Napa, San Joaquin, San Luis Obispo†, San Benito, Santa Barbara, Santa Clara, Santa Cruz, Sierra, Sonoma, Tehama (16)	Plumas, Riverside, Siskiyou, Yolo (4)	Lassen-Modoc, Solano (Solano, Yolo Counties) (2)
Flood Control Districts	11	Del Norte County†, Humboldt County†, Orange County, San Bernardino County, San Diego County†, San Mateo County, Ventura County† (7)	American River (Sacramento County), Fresno Metropolitan, Los Angeles County, Morrison Creek (Sacramento County) (4)	None
Water Agencies	19	Alpine County, Amador County, El Dorado County Kern County, Nevada County, Placer County, Sacramento County, Santa Barbara County, Shasta County, Sutter County (10)	Contra Costa County, Crestline-Lake Arrowhead (San Bernardino County), Desert (Riverside County), Mariposa County, Mojave (San Bernardino County), San Gorgonio Pass (Riverside County), Upper Santa Clara Valley (Los Angeles County) (7)	Antelope Valley-East Kern (Los Angeles, Kern Counties), Yuba County‡ (2)
Other	3	None	Orange County Water District, Palo Verde Irrigation District (Riverside County) (2)	Kings River Conservation District (Kings, Tulare, Fresno Counties) (1)

* Based upon district act as last amended by Legislature Some districts may annex and exclude area without action of Legislature (See Chapter VI)
† Excluding only offshore islands
‡ Annexation of areas in other counties permitted by act

CHAPTER III

GOVERNING BODIES

The provisions for governing bodies of the water districts included in this study are somewhat more uniform than other aspects of these districts.

SELECTION

General Act Districts

With the exception of flood control and flood water conservation districts and county waterworks districts, members of the governing bodies of the 10 general district acts in this study are elected. Directors of county waterworks districts may be either the board of supervisors or a separate body appointed by the supervisors. The board of supervisors always serves as the governing body of flood control and flood water conservation districts.

All eight general district acts with elected directors provide for election by division. Four require election by division and three others require it if divisions are established. Only the Irrigation District Act provides for election by division on an optional basis.

Special Act Districts

With regard to special district acts, all of the county flood control and water conservation districts except three have the board of supervisors serving as ex officio directors of the district The Tehama County and Yolo County Flood Control and Water Conservation Districts each provide for appointment of directors by the board of supervisors and the San Benito district board consists of two directors appointed by the board of supervisors and three elected at large Three of these district acts—Contra Costa, Lake and San Joaquin—provide that the board of supervisors may delegate all of its authority to an appointed commission to serve in place of the board itself (only Contra Costa has exercised this option to date)

All of the flood control districts formed by special act, except American River and Fresno Metropolitan, also utilize the county board of supervisors as governing body Fresno Metropolitan provides a board composed of appointed city and county officials, a city council member, a board of supervisors member, and district residents appointed by these two bodies (see Table VIII) The American River District provides for election of directors at-large

Ten of the 19 special act water agencies have the county board of supervisors serving ex officio as directors of the agency Five of the agencies utilize election by division, two utilize a combination of some elected at large and some elected by division, and one includes a combination of election at large, election by division and appointment One agency act (Amador County) permits either elected directors or the board of supervisors serving ex officio.

TABLE VIII. GOVERNING BODY PROVISIONS

A GENERAL ACT DISTRICTS

	Size	Qualifications	Selection	Maximum remuneration
California water	5*	District landowner	Elected (by division if established)	$10/day and expenses (can be changed by by-laws)
California water storage	5, 7, 9 or 11†	Not specified	Elected by division	$25/day and 10¢/mile between residence and office, expenses
County water	5	Voter of district (of division if elected by division)	Elected (by division if established)	$50/meeting (monthly limit of 2), other business, $20/day and expenses
County waterworks	5	Board of supervisors	Ex officio	None
		Landowner and voter‡	Appointed by board of supervisors	$10/month
Flood control and flood water conservation	5	Landowner and resident of district	Appointed (by board of supervisors)	Expenses only
Irrigation	3 or 5 (3, 5, or 7 El Dorado Irrigation District only)†	Landowner and voter of district and division resident if elected by division	Elected by division at large	$35/day, or $500 monthly salary if district produces power, 10¢/mile between residence and office, expenses
Municipal water (1911)	5	Division resident	Elected by division	$50/meeting (monthly limit of 2)
Water conservation (1927)	3, 5, or 7†	County resident and district voter	Elected (by division if established)	Meetings, $10/day, other business, $10 per diem, expenses
Water conservation (1931)	3, 5, or 7†	County resident and district voter	Elected by division	Meetings, $25/day, other business, $25 per diem, expenses
Water replenishment	5	Division resident	Elected by division	$50/meeting (monthly limit of 2)

B. SPECIAL ACT DISTRICTS

1 County Flood Control and Water Conservation Districts

Alameda	(District)	5	Board of supervisors	Ex officio	$24/month and expenses
	(Zones in Pleasanton and Murray Townships)	7	District resident, landowner	Elected at large	$25/meeting (monthly limit of 2), expenses

Contra Costa	5	Board of supervisors (may delegate all authority to commission of 7)	Ex officio	$24/month and expenses
Lake	5	Board of supervisors (may delegate all authority to commission of 9)	Ex officio	$150/month and expenses
Lassen-Modoc	10	All county supervisors in district	Ex officio	Expenses only
Marin	5	Board of supervisors	Ex officio	No provision
Mendocino	5	Board of supervisors	Ex officio	Expenses only
Monterey	5	Board of supervisors	Ex officio	No provision
Napa	5	Board of supervisors	Ex officio	$100/month and expenses
Plumas	5	Board of supervisors	Ex officio	Expenses only
Riverside	5	Board of supervisors	Ex officio	No provision
San Benito	5	District resident and landowner	2 appointed by board of supervisors, 3 elected at large	$25/meeting (yearly maximum of $500) and expenses
San Joaquin	5	Board of supervisors (may delegate all authority to commission of 7)	Ex officio	$24/month and expenses
San Luis Obispo	5	Board of supervisors	Ex officio	No provision
Santa Barbara	5	Board of supervisors	Ex officio	Expenses only
Santa Clara	5	Board of supervisors	Ex officio	No provision
Santa Cruz	5	Board of supervisors	Ex officio	Expenses only
Sierra	5	Board of supervisors	Ex officio	Expenses only
Siskiyou	5	Board of supervisors	Ex officio	Expenses only
Solano	5	Board of supervisors	Ex officio	Expenses only
Sonoma	5	Board of supervisors	Ex officio	$1900 per year and expenses
Tehama	5	Landowner, resident and voter of district	Appointed by board of supervisors	Expenses only
Yolo	5	District resident	Appointed by board of supervisors	Expenses only

* May be increased to 7, 9 or 11 members by board resolution at any time after four years from the formation of a district.
† Depends on number of divisions
‡ Board of supervisors may appoint independent board upon petition of 10 percent (or 25) of district water users

TABLE VIII. GOVERNING BODY PROVISIONS—Continued

B SPECIAL ACT DISTRICTS—Continued

2 Flood Control Districts

	Size	Qualifications	Selection	Maximum remuneration
American River	5	Resident (for one year) and voter of district	Elected at large	$40/meeting (monthly limit of 1), expenses
Del Norte County	5	Board of supervisors	Ex officio	No provision
Fresno Metropolitan	9	(2) Directors of public works, city and county	Ex officio	Meeting, $10/day$, other business, $10 per diem$, expenses
		(4) All district residents, one a member of city council	Appointed by city council	
		(3) Two district residents, other one, member of board of supervisors	Appointed by board of supervisors	
Humboldt County	5	Board of supervisors	Ex officio	No provision
Los Angeles County	5	Board of supervisors	Ex officio	No provision
Morrison Creek	5	Board of supervisors (Sacramento County)	Ex officio	Expenses only
Orange County	5	Board of supervisors	Ex officio	No provision
San Bernardino County	5	Board of supervisors	Ex officio	No provision
San Diego County	5	Board of supervisors	Ex officio	No provision
San Mateo County	5	Board of supervisors	Ex officio	Expenses only
Ventura County	5	Board of supervisors	Ex officio	$50/month

3. Water Agencies

Alpine County	5	Board of supervisors	Ex officio	$20/meeting (monthly limit of 3), other business, $20/day and expenses

Amador County	5	Division voter, or	Elected by division	$20/meeting (monthly limit of 3) and expenses
		Board of Supervisors	Ex officio	None
Antelope Valley-East Kern	7	Division resident	Elected by division	$20/meeting (monthly limit of 3)
Contra Costa County	5	Board of supervisors	Ex officio	No provision
Crestline-Lake Arrowhead	5	Division resident	Elected by division	$20/meeting (monthly limit of 3)
Desert	5	Division resident	Elected by division	$20/meeting (monthly limit of 3)
El Dorado County	5	Board of supervisors	Ex officio	Expenses only
Kern County	7	Division voter	Elected by division	$25/meeting and expenses
Mariposa County	5	Board of supervisors	Ex officio	$20/meeting and expenses (can be changed by ⅘ vote of board)
Mojave	11	Voter of agency (of division if elected by division)	8—Elected (7 by division, 1 at large), 3—appointed by various agencies	$20/meeting (monthly limit of 3)
Nevada County	5	Board of supervisors	Ex officio	$20/meeting (monthly limit of 3), other business, $20/day and expenses
Placer County	5	Board of supervisors	Ex officio	Expenses only
Sacramento County	5	Board of supervisors	Ex officio	Expenses only
San Gorgonio Pass	7	Elector of division (elector or landowner of agency if elected at large)	Elected, 5 by division and 2 at large	$20/meeting (monthly limit of 3)
Santa Barbara County	5	Board of supervisors	Ex officio	Expenses only
Shasta County	5	Board of supervisors	Ex officio	Expenses only
Sutter County	5	Board of supervisors	Ex officio	$20/meeting and expenses (can be changed by ⅘ vote of board and majority of advisory council)

‡ Except city or county officials.

TABLE VIII. GOVERNING BODY PROVISIONS—Continued

B SPECIAL ACT DISTRICTS—Continued

3. Water Agencies—Continued

	Size	Qualifications	Selection	Maximum remuneration
Upper Santa Clara Valley	7	Los Angeles County resident and elector or landowner of agency (of division if elected by division)	Elected, 6 by division, 1 at large	$20/meeting (monthly limit of 3)
Yuba County	5	Board of supervisors	Ex officio	$20/meeting and expenses (can be changed by ⅔ vote of board and majority of advisory council)

4. Other

Kings River Conservation District	7	Landowner, elector and resident of district (of division if elected by division)	Elected, 6 by division, 1 at large	$20/meeting (monthly maximum of 5), expenses, and other compensation as fixed by board
Orange County Water District	10	District resident and division landowner	Appointed, 3 1 each by City Councils of Anaheim, Fullerton and Santa Ana, elected, 7—by division	$20/meeting and mileage, other business, $30/day and expenses
Palo Verde Irrigation District	7	District landowner (majority must also be district residents)	Elected at large	$20 per diem

Of the other special act districts, the Palo Verde Irrigation District elects directors at large, the Kings River Conservation District uses a combination of election at large and election by district, and the Orange County Water District uses a combination of election by district and appointment by city councils The Orange County Water District situation came about when the original district, including all seven directors elected by division, was enlarged to take in three cities To provide representation to these new areas each city was permitted to appoint a director and the board was enlarged to accommodate the additional directors

The American River Flood Control District Act (1927) and the two water agencies created by a single act of the 1959 Legislature—the Mojave Water Agency and the Antelope Valley-East Kern Water Agency—provide that the first district governing board be appointed by the Governor with subsequent members elected

SIZE

General Act Districts

Four of the general district acts in this study provide that the size of the governing body may vary from district to district Irrigation districts may have three or five directors (except that El Dorado Irrigation District may have seven); water conservation districts of both 1927 and 1931 each have an option of three, five or seven directors; and water storage districts have an option of 5, 7, 9 or 11 directors. The six remaining general district acts each have governing bodies consisting of five members A unique provision permitting the enlargement of the Board of California Water Districts to 7, 9 or 11 members at any time four years after formation was enacted in 1961 [1]

Special Act Districts

Of the special act flood control and water conservation districts, all except the Lassen-Modoc District have governing bodies of five members. The Lassen-Modoc District has a board of 10 members as it encompasses two counties With the exception of the Fresno Metropolitan Flood Control District, which has a nine-member board, all special act flood control districts have five-member boards

With regard to the special act water agencies, 14 have five-member governing bodies, four have seven-member bodies, and one has an 11-member body. Of the other special act districts, the Kings River Conservation District and the Palo Verde Irrigation District each have seven-member governing bodies and the Orange County Water District has a board of 10 members

Although the vast majority of districts have five-member governing bodies, there seems to be no real agreement as to the most ideal size Those with larger boards, the Orange County Water District and the Mojave Water Agency, for example, required these larger boards to meet organization requirements of the local districts

A number of districts, however, informed the committee that procedural problems often arose with the operation of three-member boards when one member was absent As a result of this problem, the commit-

[1] Section 34708, Water Code (Statutes 1961, Chapter 1328).

tee questionnaire included a question as to the actual number of directors utilized by those districts given a choice. The answers to this question are as follows:

TABLE IX. SIZE OF GOVERNING BODY OF DISTRICTS WITH OPTIONAL PROVISIONS

Type of district	*Number of dists.*	*Number of responses*	*Size of board* 3	5	7	9	11
Irrigation	110	76	24	52	0	n a	n a
Water conservation (1927)	5	2	0	0	2	n a.	n a
Water conservation (1931)	11	8	0	2	6	n a.	n a
Water storage	7	6	n.a.	3	1	1	1
Totals	133	90	24	57	11	1	1

n a —not applicable

Thus it can be seen that irrigation districts are the only general act districts utilizing three-member boards, with approximately one-third of the responding districts using this size board From the table it can also be seen that a majority of those districts formed under general district acts with optional board sizes chose the five-member board.

TERM OF OFFICE

Section 25000 of the Government Code provides four-year terms for members of all county boards of supervisors Therefore, all districts using the board of supervisors as ex officio boards of directors are subject to four-year terms. With very few exceptions, all of the other districts in this study provide four-year terms for directors

The exceptions include the Palo Verde Irrigation District, which provides three-year terms, and the Fresno Metropolitan Flood Control District, which provides both two- and four-year terms, depending upon the method of selection of members Also of interest is the Metropolitan Water District Act, which is a general district act not providing fixed terms of office for directors, as directors serve at the pleasure of the appointing entity

QUALIFICATIONS

General Act Districts

As is indicated in Table VIII, all general act districts except water storage districts establish some qualifications for membership on the governing board of the district All general district acts providing for election by division, except water storage districts, require that the director be a voter or resident of the division from which he is elected. Two general district acts — irrigation districts and California water districts—require that directors be landowners. A similar requirement is made by the Flood Control and Flood Water Conservation District Act, which has no provisions for voting.

Special Act Districts

The Tehama and San Benito County Flood Control and Water Conservation Districts require directors to be both landowners and residents and the Yolo County Flood Control and Water Conservation District requires directors to be district residents. The remaining spe-

cial act districts in this category are governed by the board of supervisors.

Of the special act flood control districts, the American River district and the Fresno Metropolitan district require that a director be a resident of the district. All other districts in this category are governed by the board of supervisors.

Of the special act water agencies, only the Upper Santa Clara Valley Water Agency and the San Gorgonio Pass Water Agency require that directors be landowners (here it is required if the residence requirement is not met). All other districts require residence in the district or division if elected by division.

All three of the other special act districts—Kings River Conservation District, Orange County Water District and Palo Verde Irrigation District—require land ownership as a condition of membership on the district's governing body. All three also have residence requirements.

REMUNERATION

General Act Districts

The compensation for directors of general act districts varies from district to district (see Table VIII). Generally, however, compensation is based either upon a per-day or per-meeting basis, often with a monthly limit Some districts also provide for expenses, including travel, etc.

Special Act Districts

The special act districts with elected boards generally follow a similar pattern wtih various combinations of rates per-day and per-meeting and with various expense allowances.

There is a great deal of variation among those special act districts governed by the county board of supervisors, whose pay as supervisors is set by statute. There are three general patterns of compensation of the boards in this situation. Some districts governed by the board set a nominal additional salary ($24 per month, for example) and provide for expenses The Sonoma County Flood Control and Water Conservation District provides the greatest compensation of all the special act districts—$1,900 per year plus expenses.

On the other hand, some of the special act districts governed by the board of supervisors make no provision for additional compensation above the regular salary of supervisors.

Other special act districts provide only expenses for the board.

Of course, the basic pay of supervisors varies greatly from county to county. For example, Los Angeles County supervisors receive $21,000 a year while Sierra County supervisors receive only $2,400 a year. Both of these boards have at least one water district for which they serve as governing body.

Some of the special act districts have provisions for the appointment of citizens' advisory bodies to assist the governing bodies. The number of members of these advisory groups varies a great deal, as do their responsibilities and compensation.

CHAPTER IV

FUNCTIONS AND POWERS

STORAGE AND DISTRIBUTION OF WATER

General Act Districts

All but one (Flood Control and Flood Water Conservation District Act) of the general district acts in this study give the districts the power to store and distribute water and act as wholesale and/or retail water distribution entities.

Special Act Districts

All of the special act county flood control and water conservation districts have the authority to store and distribute water (Mendocino, which is limited to flood and storm waters is the only district limited in this regard), but one of the special act flood control districts (San Diego County) does not have this power and six of these districts (American River, Fresno Metropolitan, Morrison Creek, Los Angeles County, San Mateo County, and Ventura County) have only limited power to store and distribute water The Fresno Metropolitan and Los Angeles County Flood Control Districts are permitted only to store water and this storage is limited to storm and other waste waters. An amendment to the Los Angeles district act permits the district to store imported and reclaimed waters for ground water replenishment, however, when such waters are provided to the district without charge. Special zones have been established for this purpose and the district has engaged in replenishment, in co-operation with local districts, for several years The Morrison Creek Flood Control District is permitted both storage and distribution but this, too, is limited to flood and storm waters The American River, San Mateo County and Ventura County Flood Control Districts are limited to storage only without any other restrictions.

Districts not permitted to distribute water, or those which are limited to distribution or storage of storm, flood and waste water, as a result are not capable of serving as wholesale or retail water entities and, for example, would not be able in their present form to serve as a "master agency" for water from the State Water Facilities.

All 19 of the special act water agencies and the three other special act districts included in this study have the power to store and distribute water Six of the water agencies (Alpine County, Amador County, Kern County, Mariposa County, Nevada County and Placer County) are limited in that they can distribute water outside the agency only if such water is in excess of the agency's needs.

TABLE X. POWERS

A. GENERAL ACT DISTRICTS

	Eminent domain*	Storage and distribution of water	Ground water replenishment	Hydroelectric power
California water	Yes (CCP) but outside county requires board of supervisors' consent	Yes	Not specified	May contract with agencies for construction and operation of hydroelectric works
California water storage	Yes (CCP and Const), except property of another public agency, outside of county requires board of supervisors' consent	Yes	Not specified	Yes, but limited to incidental development
County water	Yes (CCP), may not condemn solely for recreation purposes	Yes	Not specified	Yes, but limited to incidental development (wholesale only)
County waterworks	Power not specifically granted	Yes	Not specified	No
Flood control and flood water conservation	Yes	No	Not specified	No
Irrigation	Yes (CCP)	Yes	Yes	Yes
Municipal water (1911)	Yes, but outside district requires board of supervisors' consent under certain circumstances	Yes	Yes	No
Water conservation (1927)	Yes (CCP)	Yes, but certain limitations on ground water acquisition	Yes	No
Water conservation (1931)	Yes, except cemeteries (CCP)	Yes	Yes, and also has related assessment power ("pump tax")	No
Water replenishment	Yes, except water rights already put to beneficial use or property owned by an agency having replenishment power But outside county requires board of supervisors' consent	Yes, but limited to replenishment	Yes, and also has related assessment power ("pump tax")	No

* Unless otherwise stated, the provision is general in scope
CCP Expressly incorporates Code of Civil Procedure, Part 3, Title 7 (Sections 1237 to 1268 2).
Const Expressly incorporates California Constitution, Article I, Section 14

TABLE X. POWERS—Continued

B. SPECIAL ACT DISTRICTS

1. County Flood Control and Water Conservation Districts

	Eminent domain*	Storage and distribution of water	Ground water replenishment	Hydroelectric power
Alameda	Yes, but outside county requires board of supervisors' consent	Yes	Yes	No
Contra Costa	Yes, except property of city and county or municipal utility district	Yes	Yes	No
Lake	Yes, but outside county requires board of supervisors' consent	Yes	Not specified	No
Lassen-Modoc	Yes, except water rights and water facilities, but limited to district (CCP)	Yes	Yes	Yes (wholesale only)
Marin	Yes, except city and county or public district	Yes	Yes	No
Mendocino	Yes (CCP)	Yes, but limited to flood and storm waters	Yes	No
Monterey	Yes, but outside county for recreation requires board of supervisors' consent	Yes	Yes	No
Napa	Yes	Yes	Yes	No
Plumas	Yes, except water rights and water facilities, but outside agency requires board of supervisors' consent (CCP)	Yes	Yes	Yes (wholesale only)

Riverside	Yes, but subject to certain specific limitations	Yes	Yes	No
San Benito	Yes, except Pacheco Pass Water District property	Yes	Yes	No
San Joaquin	Yes, except property of city and county or municipal utility district, but limited to district	Yes	Yes	No
San Luis Obispo	Yes	Yes	Yes	No
Santa Barbara	Yes, except property of city and county or municipal water district	Yes	Yes	No
Santa Clara	Yes, except in other water conservation districts within county	Yes	Yes, and also has related assessment power ("pump tax")	No
Santa Cruz	Yes (CCP)	Yes	Yes	No
Sierra	Yes, but outside county requires board of supervisors' consent (CCP)	Yes	Yes	Yes (wholesale only)
Siskiyou	Yes, except water rights and water facilities, but limited to county (CCP)	Yes	Yes	Yes (wholesale only)
Solano	Yes, except public water development projects, but limited to district (CCP and Const.)	Yes	Yes	No
Sonoma	Yes (CCP)	Yes	Yes	Yes
Tehama	Yes, except water rights and water facilities, but limited to county (CCP)	Yes	Yes	Yes
Yolo	Yes, but outside county requires board of supervisors' consent	Yes	Yes, and also has related assessment power ("pump tax")	No

* Unless otherwise stated, the provision is general in scope.
CCP. Expressly incorporates Code of Civil Procedure, Part 3, Title 7 (Sections 1237 to 1286.2).
Const. Expressly incorporates California Constitution, Article I, Section 14.

TABLE X. POWERS—Continued

B. SPECIAL ACT DISTRICTS—Continued

2 Flood Control Districts

	Eminent domain*	Storage and distribution of water	Ground water replenishment	Hydroelectric power
American River	Yes	Only storage	Not specified	Yes
Del Norte County	Yes	Yes	Yes	No
Fresno Metropolitan	Yes	Only storage of flood, storm and other waste waters	Yes, but limited to flood, storm and other waste waters	No
Humboldt County	Yes	Yes	Yes	Yes (wholesale only)
Los Angeles County	Yes (CCP)	Only storage of flood, storm and other waste waters (and imported and reclaimed water when furnished without cost to district)	Yes, but limited to flood, storm and other waste waters (and imported and reclaimed water when furnished without cost to district)	No
Morrison Creek	Yes (CCP)	Yes, but limited to flood and storm waters	Yes, but limited to flood and storm waters	No
Orange County	Yes (not beyond 15 miles outside district) (CCP)	Yes	Yes	No
San Bernardino County	Yes	Yes	Yes	No
San Diego County	No	No	No	No
San Mateo County	Yes, but outside county requires board of supervisors, and city council consent	Yes	Yes	No
Ventura County	Yes	Only storage	Yes	No

3. Water Agencies

Alpine County	Yes, except public water use property, but outside county requires board of supervisors' consent (CCP and Const)	Yes	Yes	Yes (wholesale only), also can sell rights to use falling water
Amador County	Yes, but outside county requires board of supervisors' consent (CCP and Const)	Yes	Yes	Yes (wholesale only), also can sell rights to use falling water
Antelope Valley-East Kern	Yes, but limited to agency	Yes	Yes	No
Contra Costa County	Yes, except public water use property, but limited to agency (CCP and Const)	Yes	Yes	No
Crestline-Lake Arrowhead	Yes, but outside agency requires board of supervisors' consent	Yes	Yes	Yes (wholesale only), also can sell rights to use falling water
Desert	Yes, but limited to agency	Yes	Yes	Yes (wholesale only), also can sell rights to use falling water
El Dorado County	Yes, except public water use property, but limited to agency (CCP and Const)	Yes	Yes	Yes (wholesale only), also can sell rights to use falling water
Kern County	Yes, but outside county requires board of supervisors' consent (CCP and Const)	Yes	Yes	Yes (wholesale only), also can sell rights to use falling water
Mariposa County	Yes, except public water use property, (CCP and Const)	Yes	Yes	Yes, also can sell rights to use falling water
Mojave	Yes, except public water use property, but limited to agency (CCP and Const)	Yes	Yes, and also has related assessment power ("pump tax")	Yes (wholesale only)
Nevada County	Yes, except public water use property, outside agency requires board of supervisors' consent (CCP and Const)	Yes	Yes	Yes (wholesale only), also can sell rights to use falling water

* Unless otherwise stated, the provision is general in scope.
CCP Expressly incorporates Code of Civil Procedure, Part 3, Title 7 (Sections 1237 to 1266 2).
Const Expressly incorporates California Constitution, Article I, Section 14.

TABLE X. POWERS—Continued

B. SPECIAL ACT DISTRICTS—Continued

3. Water Agencies—Continued

	Eminent domain*	Storage and distribution of water	Ground water replenishment	Hydroelectric power
Placer County	Yes, except public water use property, outside agency requires board of supervisors' consent (CCP and Const)	Yes	Yes	Yes (wholesale only); also can sell rights to use falling water
Sacramento County	Yes, except public water use property (CCP and Const)	Yes	Yes	No
San Gorgonio Pass	Yes, but limited to agency	Yes	Yes	Yes (wholesale only), also can sell rights to use falling water
Santa Barbara County	Yes, except public water use property, (CCP and Const)	Yes	Yes	Yes, but limited to incidental development and use of agency
Shasta County	Yes, except public water or power use property, but outside county requires board of supervisors' consent (CCP and Const)	Yes	Yes	Yes, but limited to incidental development (wholesale only); also can sell rights to use falling water
Sutter County	Yes, but limited to agency (CCP and Const.)	Yes	Yes	No
Upper Santa Clara Valley	Yes, but outside agency requires board of supervisors' consent	Yes	Not specified	Yes (wholesale only); also can sell rights to use falling water
Yuba County	Yes, but outside county requires board of supervisors' consent, (CCP and Const)	Yes	Yes	Yes, but limited to incidental development; also can sell rights to use falling water

4 Others

Kings River Conservation District	Yes, except public water use property (CCP)	Yes	Yes	Yes
Orange County Water District	Yes, except property used for water, power, within Santa Ana River watershed (or study of plantlife)	Yes	Yes, and also has related assessment power ("pump tax")	No
Palo Verde Irrigation District	Yes	Yes	Yes	Yes

* Unless otherwise stated, the provision is general in scope.
CCP Expressly incorporates Code of Civil Procedure, Part 3, Title 7 (Sections 1237 to 1286.2).
Const Expressly incorporates California Constitution, Article I, Section 14

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GROUND WATER REPLENISHMENT

A second power which is closely related to the storage and distribution of water is ground water replenishment. Until recently, in most districts there has been no need for specific replenishment programs of the type authorized by the Water Replenishment District Act or undertaken by certain districts in the San Francisco Bay area and Southern California. As a result, in a number of cases the power of ground water replenishment may be implied from the term "storage" as used in the acts These acts generally authorize storage of water "for any useful purpose" or similar language In the case of districts with the expressed power of replenishment, specific reference to underground storage or the sinking and spreading of water is usually included

There are five general district acts (California Water, California Water Storage, County Water, County Waterworks, and Flood Control and Flood Water Conservation District Acts) that do not expressly authorize replenishment Twenty-one of the 22 special act county flood control and water conservation districts (Lake is the only exception), 9 of the 11 flood control districts (American River and San Diego County are the exceptions), 18 of the 19 water agencies (Upper Santa Clara Valley is the exception), and the 3 other special act districts have the power of ground water replenishment

Two general act districts (Water Replenishment District Act and Water Conservation Act of 1931) and four special district acts (Santa Clara County Flood Control and Water District, Orange County Water District, Yolo County Flood Control and Water Conservation District and Mojave Water Agency) have specific authorization to conduct replenishment programs utilizing the special "replenishment assessment" (discussed in detail in Chapter V, Financing of Districts). In addition, a district formed under a general act (Alameda County Water District) has similar replenishment powers which were added by special act of the Legislature in 1961 It should be noted that the Water Conservation Act of 1931, which came into being as a result of the need for replenishment programs, was amended in 1963 to provide for a "replenishment assessment." The United Water Conservation District in Ventura County, the Santa Clara Valley Water Conservation District in Santa Clara County, both formed under this act, have engaged in replenishment programs for many years Additional 1963 action gave specific replenishment powers to the Stockton and East San Joaquin Water Conservation District (1931) A number of districts have recently expressed the view that the "replenishment assessment" is necessary to provide a complete replenishment program. The Legislature may well be faced with requests to grant this additional power to both general district acts and special district acts in the future.

EMINENT DOMAIN

The power of eminent domain has received a great deal of attention from the Legislature in recent years. A general lack of uniformity exists among district acts with regard to this power.

All general act districts and all but one special act district (San Diego County Flood Control District) in this study have the basic

power of eminent domain. A wide variety of restrictions have been placed upon individual acts, however.

As shown in Table X, some district acts expressly incorporate Article I, Section 14 of the *California Constitution;* some expressly incorporate Part 3, Title 7 (Sections 1237-1266 2) of the *Code of Civil Procedure;* and some do not include specific reference to either.

General Act Districts

Six of the nine general district acts with this power place restrictions upon the exercise of eminent domain. Municipal water districts are limited to the extent that condemnation outside the district requires the consent of the board of supervisors of the county involved California water districts and water storage districts may not condemn outside the county in which they are located without board of supervisors' consent Water storage districts may not condemn the property of another public agency Other district limitations include water conservation districts (1931) which are not permitted to condemn cemeteries; water replenishment districts, which are prohibited against condemning water rights already put to beneficial use or property owned by an agency having replenishment power, and county water districts which may not condemn solely for recreation purposes

Six of the 10 general district acts incorporate the provisions of the Code of Civil Procedure.

Special Act Districts

Most of the special act districts are limited in this power. The most frequent restrictions on exercise of eminent domain by special act districts are summarized below·

TABLE XI. SUMMARY OF RESTRICTIONS ON EMINENT DOMAIN POWER OF SPECIAL ACT DISTRICTS

	Number of districts	Limited to district	Outside district—requires board of supervisors consent	Outside of county—requires board of supervisors consent§
County flood control and water conservation	22	Solano, Lassen-Modoc, San Joaquin, Tehama* (4)	Plumas† (1)	Alameda, Lake, Monterey‡, Sierra, Yolo (5)
Flood control	11	None	None	San Mateo County (1)
Water agencies	19	Antelope Valley-East Kern, Contra Costa County, Desert, El Dorado County, Mojave, San Gorgonio Pass, Sutter County (7)	Crestline-Lake Arrowhead, Placer County†, Upper Santa Clara Valley, Nevada County, Sacramento County† (5)	Alpine County, Amador County, Kern County, Shasta County, Yuba County (5)
Other	3	None	None	None

* County-wide district with actual wording of act limiting to county
† Countywide districts, therefore, limitation effective only in counties other than those in which district is located
‡ Limitation applies only to condemnation for recreation purposes
§ Supervisors of affected county in which condemned property is located

There are several restrictions in special district acts not shown in Table XI. For example, an unusual provision in the San Benito County Flood Control and Water Conservation District Act prohibits the condemnation of property of the Pacheco Pass Water District; the Orange County Flood Control District is prohibited from exercising eminent domain more than 15 miles from the district; and several other special act flood control and water conservation districts and flood control districts are prohibited from condemning one or more of the following: property of a city and county, municipal utility district, public district, or water development project; water rights; or property within certain other districts

Ten of the water agencies (Alpine County, Contra Costa County, El Dorado County, Mariposa County, Mojave, Nevada County, Placer County, Santa Barbara County, Shasta County, and Sacramento County) are prohibited from condemning property devoted to public water use. A similar restriction applies to the Kings River Conservation District and, in somewhat different terms, to the Orange County Water District. Twenty-five of the 55 special act districts incorporate the Code of Civil Procedure provisions

It can be seen that there are many variations in the manner in which the eminent domain power granted to districts is described and in the restrictions on this power. There seems to be no specific pattern of selection of restrictions except that a great many of the more recently enacted acts provide for approval by the board of supervisors of the county affected of any condemnation outside the district or county in which the district is located.

The power of eminent domain seems to be one district power in which greater uniformity would be advantageous.

HYDROELECTRIC POWER

General Act Districts

The authority to develop hydroelectric power has been granted to only 4 of the 10 general district acts in this study (California water, California water storage, county water and irrigation). The water storage district and county water district provisions are limited to incidental development, while the County Water District Act also requires that power developed be sold at wholesale only.

Special Act Districts

Four of the special act county flood control and water conservation districts (Lassen-Modoc, Plumas, Sierra and Siskiyou) authorize the development of hydroelectric power and are limited to wholesale marketing of this power. A fifth, Sonoma, authorizes hydroelectric development without this limitation.

Only two of the special act flood control districts (American River and Humboldt County) are authorized to develop hydroelectric power (wholesale only in the case of the Humboldt district). Fifteen of the 19 special act water agencies (Antelope Valley-East Kern, Contra Costa County, Sacramento County and Sutter County are the four exceptions) are authorized to develop hydroelectric power. All but 3 of these 15 agencies (Mariposa County, Santa Barbara County and Yuba County)

are also limited to wholesale marketing of such power. The Santa Barbara County, Shasta County and Yuba County Water Agencies are further limited to incidental development of hydroelectric power. Thirteen of these special act water agencies also have the authority to sell rights to use falling water from their projects. (Mojave and Santa Barbara County Water Agencies are the only exceptions)

It can be seen that special district water agencies, the most recently formed districts, have a greater percentage of districts with the authority to develop hydroelectric power. It should be pointed out, however, that many of these water agencies are physically located where it is impossible to use this authority

CONTRACTS WITH THE FEDERAL GOVERNMENT

The power of districts to contract with the federal government for water from federal projects governed by the Reclamation Act of June 17, 1902 [1] and subsequent federal reclamation acts [2] is a power that has been under intense discussion and litigation for many years In addition to contracting for water supplies, districts may contract with the United States for the construction of distribution systems for federal projects Federal loans to districts are discussed in Chapter V (Financing).

General Act Districts

In 1917 the Legislature passed the Irrigation District Federal Cooperation Law (now codified as Sections 23175-23302, Water Code) which authorizes districts to "co-operate and contract with the United States" under Reclamation Law. These provisions call for an election within the district to approve such a contract and authorize districts to levy assessments to meet these contractual obligations if the contract calls for repayment of construction money, repayment of the cost of acquiring any property or issuance of bonds Under this law, irrigation districts are also authorized to borrow money from the federal government A 1935 amendment to this co-operation law provided that county water districts be considered irrigation districts and be empowered to act as an irrigation district in co-operation and contracting with the federal government

In 1941 the County Water District Law itself was amended to specifically authorize "co-operation under irrigation district Federal Cooperation Law." In 1953 a similar section was added to the California Water District Law empowering California water districts to contract and co-operate with the United States under the provisions of the Irrigation District Federal Cooperation Law.

Provisions were also added to the Water Storage District Law in 1941 authorizing co-operation and contracting with the United States These provisions were similar to those of the Irrigation District Federal Cooperation Law except that no election is required to approve a contract between the United States and a water storage district Provisions sim-

[1] See c 1093, 32 *Stat* 388

[2] These laws are codified in various sections of 43 USC from Section 372 through Section 498 See also Leland Graham, *Some Aspects of Federal-State Relationships in California Water Resource Development,* Sacramento, 1961, 280 pps (process), for an excellent discussion of many aspects of Reclamation Law, including the California contracts.

ilar to those of the Water Storage District Law (but not including an election) were added in 1949 to the Water Conservation Act of 1931 More limited power to contract with the federal government is granted to districts formed under the Water Conservation Act of 1927

The Municipal Water District Act (1911) includes a provision authorizing these districts to contract with a number of public agencies (including the United States) "to carry out any of the powers of such district" Approval of a contract under these provisions requires a two-thirds majority vote if the contract calls for the incurring of an indebtedness or liability exceeding in any year the income and revenue for such year. This applies either to the district itself or an improvement district.

When enacted in 1955, the Water Replenishment District Act included a provision authorizing such districts to "act jointly with or co-operate with the United States . . . to the end that the purposes and activities of this district may be fully and economically performed."

The Flood Control and Flood Water Conservation District Law of 1931 includes a provision authorizing districts formed under this act to "negotiate and contract with the government of the United States . . . for the construction or maintenance of the works of the district." This provision is more limited than the other general district acts Thus, of the general district acts, only the County Waterworks District Act makes no provision for co-operation and contracting with the federal government.

Following the completion of early phases of the Central Valley Project, a large number of districts contracted with the federal government for a water supply and construction of distribution facilities The standard contracts with the Secretary of the Interior delegated substantial control over the districts to the Secretary of the Interior Extensive litigation over the validation of these contracts ensued and the famous *Ivanhoe Irrigation District* case lasted eight years before finally being decided by the U.S Supreme Court in 1958 In this 8-0 decision the court reversed the California Supreme Court and upheld the Ivanhoe contract and three similar contracts The Ivanhoe contract was a combination contract (9-e and 9-d) calling for both a water supply and federal construction of a distribution system The validity of the 160-acre limitation and other important aspects of reclamation law were also decided in this case.[8]

Special Act Districts

Although the special district acts included in this study were enacted over a period of several decades, within the three types of these dis-

[8] *Ivanhoe Irrigation District* v *McCracken* (1958) 357 U S 275 This decision consolidated three other appeals from similar California Supreme Court decisions in addition to the *Ivanhoe* case Two of the other three, *Madera Irrigation District* v *All Persons* (1957), 47 Cal 2d 681 and *Alhonico* v *Madera Irrigation District* (1957), 47 Cal 2d 695, concerned general act districts and Central Valley Project Contracts The other, *Santa Barbara County Water Agency* v *All Persons* (1957), 47 Cal 2d 599, involved a special act district and a contract for the Cachuma Project For text of U S Supreme Court opinion see Engle, *Central Valley Project Documents, Part II*, House Doc #246, 85th Cong, 1st Sess, 1957, pps 741-756, also see California Legislature Joint Committee on Water Problems, *Eleventh Partial Report*, 1957, pps 14-102 for the four earlier State Supreme Court decisions A final action before the California Supreme Court culminated in 1960 when the court upheld all four contracts

tricts there is a great deal of uniformity of provisions for contracting with the federal government.

Seven of the special act county flood control and water conservation districts (Mendocino, Sierra, Siskyou, Solano, Sonoma, Yolo and Tehama) contain language expressly authorizing these districts to co-operate and contract with the federal government under Reclamation Law and also apply the provisions of the Irrigation District Federal Cooperation Law to these districts One other district, the San Joaquin County Flood Control and Water Conservation District, expressly authorizes co-operation and contracting under Reclamation Law but does not incorporate Irrigation District Federal Cooperation Law The remaining 13 districts in this category authorize contracts with the federal government (and in most cases with other governmental bodies as well) for the acquisition of property rights or the construction, maintenance and operation of any or all works and improvements authorized by the district act The language varies from act to act but these provisions generally pertain to flood control and related projects Ten of the 11 special act flood control districts (San Diego County Flood Control District has no authority to contract) include this same general provision with authority granted to contract for projects authorized by the acts.

On the other hand, all 19 of the special act water agencies contain provisions expressly authorizing the districts to contract with the federal government under Reclamation Law. Twelve of these agencies (Alpine County, Amador County, El Dorado County, Kern County, Mariposa County, Nevada County, Placer County, Sacramento County, Santa Barbara County, Shasta County, Sutter County and Yuba County) have substantially identical provisions and all 12 districts are also authorized to contract under the provisions of the Irrigation District Federal Cooperation Law. The five agencies copied from the Municipal Water District Act (Antelope Valley-East Kern, Crestline-Lake Arrowhead, Desert, Mojave and San Gorgonio Pass) and the Upper Santa Clara Valley and Contra Costa County Water Agencies all include specific provisions for elections on contracts and do not incorporate Irrigation District Federal Cooperation Law provisions

These contracting provisions of water district acts provide an interesting example of what seems to be unintentional uniformity The provisions of the Irrigation District Federal Cooperation Law are actually used by county water districts, California water districts, and 19 special district acts, in addition to irrigation districts By simply authorizing a new special act district to utilize the provisions of Irrigation District Federal Cooperation Law, the Legislature has created a desirable uniformity.

OTHER POWERS

Sewage Disposal

Five general district acts (Irrigation District Act,[4] California Water District Act, County Water District Act, Municipal Water District Act of 1911 and Water Conservation Act of 1931) also have power to acquire, construct and operate facilities for the collection, treatment

[4] 1962 legislation set out rather specific powers in this regard for the El Dorado Irrigation District and districts of less than 4,500 acres serving 75 percent domestic water (See Statutes of 1963, Chapters 420 and 492)

and disposal of sewage. None of the special act districts have this additional power.

Fire Protection

The County Water District Act and the Municipal Water District Act are the only acts in this study which authorize the acquisition, construction and operation of fire protection facilities.

Recreational Facilities

Three general district acts (County Water District Act, Municipal Water District Act and Water Conservation Act of 1927) and six special district acts (Alameda County, and Marin County Flood Control and Water Conservation Districts, Orange County and San Mateo County Flood Control Districts and the Antelope Valley-East Kern and Crestline-Lake Arrowhead Water Agencies) specifically authorize the operation of recreation facilities incidental to district facilities The San Mateo County Flood Control District Act specifically permits the operation of public parks, playgrounds, beaches, golf courses, tennis courts, and other "amusement or recreational facilities" by the district.

Drainage and Reclamation

Four general district acts (California Water, California Water Storage, County Water, and Irrigation) and nine special district acts (Alameda, Mendocino, San Benito, and Sonoma County Flood Control and Water Conservation Districts, San Bernardino County and San Mateo County Flood Control Districts, Sacramento County Water Agency, Kings River Conservation District, and Palo Verde Irrigation District) include certain drainage and reclamation powers as authorized powers. These powers have not been granted to any of the more recent water agencies.

Miscellaneous

The Contra Costa County Water Agency and the Mojave Water Agency each are specifically granted the power to prevent salinity intrusion, a responsibility of particular importance to the Contra Costa agency.

CHAPTER V

FINANCING

The financing of water districts has been given the greatest consideration through the years by both the Legislature and others concerned with districts. Table XII on page 74 and the discussion in this chapter are an attempt to examine only the most important areas of financing of water districts.

AD VALOREM ASSESSMENTS

Basis

As can be seen from Table XII, all general act districts except California water storage districts and flood control and flood water conservation districts, and all special act districts except the San Diego County Flood Control District, have provision for ad valorem assessments to finance district operations. Two of the major general act districts—irrigation districts and California water districts—base all ad valorem taxes on land only, the traditional emphasis of these agricultural districts. As was indicated above, these districts also base voting rights on land ownership All other general act districts permit assessment of land and improvements or of all property (which includes land, improvements and personal property). The basis for all eight general act districts is the same for both the district and zones (where the district is authorized to create zones) Recent amendments to the County Water District Act provide different bases under certain circumstances for specific districts.

With regard to special act districts there is a similar variation as to taxable property, and in many cases the basis for districtwide assessments is not the same as for zone assessments. Table XIII summarizes these assessment provisions, which are detailed in Table XII. In a few special act districts the basis for assessment for bond repayment is different than it is for other purposes

When a general district act leaves the method of assessment up to the local district, the determination is usually made at the time of formation of the local district and the choices available are carefully spelled out. For example, districts formed under the Water Conservation Act of 1931 may assess land and improvements for bond purposes rather than land only. This option must be made in the petition at the time of formation of the district and is effective during the life of the district.

As is shown in Table XIII, general district acts divide almost evenly between use of land only, land and improvements, or all property as a basis for both district and zone assessment (only six of these acts permit the creation of zones, however)

When considering special act districts there are a number of discernible patterns which are different for each category of special district act. With regard to county flood control and water conserva-

TABLE XII. FINANCING PROVISIONS

A. GENERAL ACT DISTRICTS

	Power to create zones[1]	Annual ad valorem assessments[2]			Indebtedness			
			Maximum limit					
		Basis[4]	District	Zone	Type	Vote required[3]	Maturity period (Maximum years)	Maximum
California water	Yes	Land	None	None	General obligation bonds	2/3	40	None
					Revenue bonds	Majority	40	None
					Warrants	1/6 of board	5	None
California water Storage	No	No ad valorem tax Assessments on land based on project benefits	--	--	General obligation Bonds	Majority	40 (50 for additional bonds)	None
					Direct assessment warrants	None	5	75% of income from supporting assessments
					Warrants	None	None	None
County water	Yes	All property (except Sierra Lakes, Marianas Ranchos, Circle Oaks (for bonds) and Kings County Water Districts (for improvement district) which may base these assessments on land only	None	None ($ 75 under alternate procedure)	General obligation bonds	2/3	None	None
					Revenue bonds	Majority[3]	40[3]	None
						2/3	50	
					Refunding bonds	Majority	None	None
					Formation warrants	None	None	None
					Notes	None	5	2 percent of assessed value ($500,000 for all purposes other than flood control)

County waterworks	Yes	Land or all property	None	None	General obligation bonds (dist.)	Majority	40	None
					General obligation bonds (zone)	60 percent	40	None
					Revenue bonds	Majority[2]	40[2]	None
					Refunding bonds	Majority	30	None
					Loans (from county)	Board majority	5	85 percent of anticipated annual revenue ($10,000 for districts with less than $100,000 assessed value)
Flood control and flood water conservation	No	No ad valorem tax	--	--	No provisions	--	--	--
Irrigation	Yes	Land	4 percent of assessed value for operation and maintenance 4 percent of assessed value for certain other purposes 1 percent of assessed value for fund to purchase district bonds	None	General obligation bonds	Majority or ⅔	50	None
					Revenue bonds	Majority[2]	40[2]	None
						⅔	50	
					Refunding bonds	Majority	None	None
					Warrants	Board action or majority election	5 (more by voter approval)	$ 25/$100 of assessed value
Municipal water (1911)	Yes	All property	None	None	General obligation bonds	⅔	40	None
					Revenue bonds	Majority[2]	40[2]	None
					Notes	None	3	Lesser of $1,000,000 or 2 percent of assessed value

[1] Benefit zones, improvement districts, etc., except those formed under improvement acts.
[2] Per $100 assessed value, exclusive of bond assessments
[3] Revenue Bond Act of 1941, Government Code Sections 54300-54700
[4] "Land and improvements" indicates statutory references to either "land and improvements" or "real property"
[5] When listed, "by zone," must obtain required majority in each zone if more than one zone participating

TABLE XII. FINANCING PROVISIONS—Continued

A GENERAL ACT DISTRICTS—Continued

	Power to create zones[1]	Annual ad valorem assessments[2]			Indebtedness			
		Basis[4]	Maximum limit		Type	Vote required[5]	Maturity period (Maximum years)	Maximum
			District	Zone				
Municipal water (1911)—Continued					Notes (for specified purposes)	None	10	Lesser of $500,000 or 1 percent of assessed value
					Formation warrants	None	None	None
					Refunding bonds, notes	Same as original authorization	Same as original authorization	None
Water Conservation (1927)	No	Land and improvements	$ 25 (additional $ 30 by majority election)	--	Formation warrants	None	None	$ 25/acre of land
					Revenue bonds	Majority[3]	40[3]	None
Water conservation 1931	Yes	Land and improvements, or land	$ 25 (additional $ 10 under specified circumstances)	None	General obligation	⅔	40 (25 for zones)	None None
					Revenue certificates	None	None	Revenue from reclaimed water
					Warrants	None	None	None
					Formation warrants	None	None	$ 25/acre of land
Water replenishment	No	Land and improvements	$ 20 (more by voter approval)	--	General obligation bonds	⅔	40	None
					Formation warrants	None	None	None

B. SPECIAL ACT DISTRICTS

1. County Flood Control and Water Conservation Districts

Alameda	Yes	All property (zone or land and improvements)	$ 015	None ($ 15 for zones in Pleasanton and Murray townships May be more by ⅔ vote)	General obligation bonds (by zones)	⅔ (by zone)	40	None (zones in Pleasanton and Murray townships, 5% of assessed value)
Contra Costa	Yes	All property (zone or land and improvements)	$ 02	$ 20	General obligation bonds (by zones)	⅔ (by zone)	40	None
					Refunding bonds	Board majority	--	None
Lake	Yes	Land and improvements	$ 50	$1 50	General obligation bonds (by zones)	⅔ (by zone)	40	None
					Revenue bonds	Majority[2]	40[3]	None
					Refunding bonds	Board majority	40	None
Lassen-Modoc	Yes	All property	$ 10	$ 05	General obligation bonds	⅔	50	15 percent of assessed value
					Warrants	None	None	None
Marin	Yes	All property	$ 05	$1 00	General obligation bonds (by zones)	⅔ (by zone)	None	None
Mendocino	Yes	All property (zone land and improvements)	$ 02 ($ 05 after bonds are issued)	$ 02	General obligation bonds	⅔	40	None
					Refunding bonds	Board majority	--	None
					Warrants	None	None	None
Monterey	Yes	All property (zone or land and improvements)	None	None	General obligation bonds (by zones)	Majority	40	None

[1] Benefit zones, improvement districts etc , except those formed under improvement acts
[2] Per $100 assessed value, exclusive of bond assessments
[3] Revenue Bond Act of 1941, Government Code Sections 54300-54700
[4] "Land and improvements" indicates statutory references to either "land and improvements" or "real property "
[5] When listed, "by zone," must obtain required majority in each zone if more than one zone participating

TABLE XII. FINANCING PROVISIONS—Continued

B. SPECIAL ACT DISTRICTS—Continued

1 *County Flood Control and Water Conservation Districts—Continued*

		Annual ad valorem assessments[2]			Indebtedness			
	Power to create zones[1]	Basis[4]	Maximum limit		Type	Vote required[5]	Maturity period (Maximum years)	Maximum
			District	Zone				
Napa	Yes	All property (zone or land and improvements)	$ 15	None	General obligation bonds (by zones)	$^2/_3$ (by zone)	40	None
Plumas	Yes	All property	$ 10	$ 05	General obligation bonds	$^3/_5$	50	None
					Warrants	None	None	None
Riverside	No (zones created by act itself)	All property	$ 025	$ 40	General obligation bonds (by zones)	$^2/_3$	40	None
San Benito	Yes	Zones only land (land and improvements for flood control)	Zone taxes only	$ 25	General obligation bonds (by zones)	$^2/_3$	40	None
			Also 'Administrative Assessment Zone (includes all zones) $ 10					
San Joaquin	Yes	All property (zone or land and improvements)	$ 02 ($ 04 if water conservation or distribution)	$ 20 (flood control)	General obligation bonds (by zones)	$^2/_3$ (by zone)	40	None
				$ 20 (water conservation)	Refunding bonds	Board majority	--	None
San Luis Obispo	Yes	All property	None	None	General obligation bonds (by zones)	$^2/_3$ (by zone)	40	None
					Revenue bonds	Majority[3]	40[3]	None
Santa Barbara	Yes	All property	$ 02	$ 20	General obligation bonds (by zones)	$^3/_5$	40	5 percent of assessed value

					Refunding bonds	Board majority	--	None
Santa Clara	Yes	All property or land and improvements	None	None	General obligation bonds (by zones)	⅔	40	None
Santa Cruz	Yes	All property (zone land and improvements)	$ 02	$ 25 (can be more by majority election)	General obligation bonds (by zones)	⅔ (by zone)	40	None
					Refunding bonds	Board majority	40	None
					Refunding bonds	⅔	None	None
					Revenue bonds	Majority[2]	40[3]	None
Sierra	Yes	All property	$ 10	$ 05	General obligation bonds	⅔	50	15 percent of assessed value
					Warrants	None	None	None
Siskiyou	Yes	All property	$ 10	$ 05	General obligation bonds	⅔	50	15 percent of assessed value
					Warrants	None	None	None
Solano	Yes	All property (zone or land and improvements)	$ 15	$ 10	General obligation bonds	⅔	40	Amount repayable by annual tax of $ 15
						½ of board	40	
					Refunding bonds	Majority	None	Amount repayable by annual tax of $ 15
						½ of board	None	
Sonoma	Yes	All property	$ 09 ($ 06 additional for flood control and drainage projects)	$ 25 (can be more by majority election)	General obligation bonds	⅔	40	None
					Refunding bonds	Board majority	--	None
					Revenue bonds	⅔ of board	40[3]	None
					Warrants	None	None	None

[1] Benefit zones, improvement districts, etc., except those formed under improvement acts
[2] Per $100 assessed value, exclusive of bond assessments
[3] Revenue Bond Act of 1941, Government Code Sections 54300-54700
[4] "Land and improvements" indicates statutory references to either "land and improvements" or "real property"
[5] When listed, "by zone," must obtain required majority in each zone if more than one zone participating

TABLE XII. FINANCING PROVISIONS—Continued

B. SPECIAL ACT DISTRICTS—Continued

1 County Flood Control and Water Conservation Districts—Continued

	Power to create zones[2]	Annual ad valorem assessments[3]			Indebtedness			
		Basis[4]	Maximum limit		Type	Vote required[4]	Maturity period (Maximum years)	Maximum
			District	Zone				
Tehama	Yes	All property	$ 03 ($ 05 with consent of board of supervisors)	$ 05 ($ 15 with unanimous consent of advisory committee, $ 50 with majority election)	General obligation bonds (by zones)	2/3	50	15 percent of assessed value
					Warrants	None	None	None
Yolo	Yes	All property	$ 05	None	General obligation bonds (by zones)	2/3	50	None
					Revenue bonds	Majority[5]	50	None
					Refunding bonds	2/3	50	None
					Notes	None	4	2 percent of assessed value
					Warrants	None	None	None
2 Flood Control Districts								
American River	Yes	Land	$ 10	None	General obligation bonds	Majority	40	None
					Refunding bonds	Board majority	--	None
					Warrants	None	None	None
Del Norte County	Yes	All property (zone or land and improvements)	None	None	General obligation bonds (by zones)	2/3	40	None

Fresno Metropolitan	Yes	Land and improvements	$ 20	None	General obligation bonds	Majority	40	None
					Refunding bonds	Board majority	--	None
					Notes	Board majority	None	$ 10 tax
Humboldt County	Yes	All property or land and improvements (zone all property)	None	None	General obligation bonds	⅔	40	None
Los Angeles County	Yes	Land and improvements	$ 15	$ 05	General obligation bonds	Majority	40	None
Morrison Creek	No	Land and improvements	$ 05 ($ 10 after bonds are issued)	--	General obligation bonds	⅔	40	None
					Refunding bonds	Board majority	--	None
					Warrants	None	None	None
Orange County	No	All property	$ 20 ($.10 for other than purchase and distribution of water)	--	General obligation bonds	⅔	40	None
San Bernardino County	Yes	All property	Aggregate limit of $ 30		General obligation bonds	⅔	40	None
					Loan (by zones)	Majority	20	Per loan 2 percent of assessed value of zone
San Diego County	No	--	Donations only	--	--	--	--	--
San Mateo County	Yes	Zones only all property or land and improvements	No tax	$ 40 (may be increased by majority vote)	General obligation bonds (by zones)	⅔ (by zone)	40	None

[1] Benefit zones, improvement districts, etc., except those formed under Improvement acts
[2] Per $100 assessed value, exclusive of bond assessments
[3] Revenue Bond Act of 1941, Government Code Sections 54300-54700
[4] "Land and improvements" indicates statutory references to either "land and improvements" or "real property"
[5] When listed, "by zone," must obtain required majority in each zone if more than one zone participating

TABLE XII. FINANCING PROVISIONS—Continued

B SPECIAL ACT DISTRICTS—Continued

1 County Flood Control and Water Conservation Districts—Continued

		Annual ad valorem assessments[2]			Indebtedness			
			Maximum limit					
	Power to create zones[1]	Basis[4]	District	Zone	Type	Vote required[5]	Maturity period (Maximum years)	Maximum
Ventura County	No (zones created by act itself)	All property	Aggregate limit—Zone 1 $ 20		General obligation bonds (by zones)	2/3 (by zone)	40	None
				Zones 2-4 $ 40	General obligation bonds (by district only for importation of water)	2/3	40	None
				"Special zone" $1 00	Loans (by zone) for flood control or conservation	2/3	10	Zone 1, 1% of assessed value, Zones 2-4, 2% of assessed value. "Special zones," 5% of assessed value
3 Water Agencies								
Alpine County	Yes	All property (zone land)	$ 05	None	Revenue bonds	Majority[3]	50	None
Amador County	No	All property	$ 10 (may be increased by county wide election)	--	General obligation bonds (by member unit)	2/3 (by member unit)	40	None
					Revenue bonds	Majority[3]	40[3]	None
Antelope Valley-East Kern	Yes	All property	Aggregate limit of $ 10 (administrative purposes only)		General obligation bonds	2/3	40	None
					Revenue bonds	Majority[3]	40[3]	None

					Refunding bonds	--	--	None
					Notes	None	3	Lesser of $500,000 or 2 percent of assessed value
					Formation warrants	None	None	None
Contra Costa County	Yes	All property (zone land)	$ 03	None	General obligation bonds	⅔	None	None
					Refunding bonds	Majority	None	None
					Revenue bonds	Majority[2]	40[3]	None
						⅔	50	
					Warrants	None	None	Anticipated annual revenue
Crestline-Lake Arrowhead	Yes	All property	Aggregate limit of $1, including bond assessments (may be more by majority election)		General obligation bonds	⅔	40	None
					Revenue bonds	Majority[2]	40[3]	None
					Refunding bonds	--	--	None
					Notes	None	3	Lesser of $500,000 or 2 percent of assessed value
					Formation warrants	None	None	None
Desert	Yes	All property	None	None	General obligation bonds	⅔	40	None
					Revenue bonds	Majority[2]	40[3]	None
					Refunding bonds	⅔	40	None
					Notes	None	3	Lesser of $1 million or 2 percent of assessed value

[1] Benefit zones, improvement districts etc., except those formed under improvement acts
[2] Per $100 assessed value, exclusive of bond assessments
[3] Revenue Bond Act of 1941, Government Code Sections 54300-54700
[4] "Land and improvements" indicates statutory references to either "land and improvements" or "real property"
[5] When listed, "by zone," must obtain required majority in each zone if more than one zone participating

TABLE XII. FINANCING PROVISIONS—Continued

B SPECIAL ACT DISTRICTS—Continued

3 Water Agencies—Continued

		Annual ad valorem assessments[2]			Indebtedness			
			Maximum limit					
	Power to create zones[1]	Basis[4]	District	Zone	Type	Vote required[5]	Maturity period (Maximum years)	Maximum
Desert—Continued					Formation warrants	None	None	None
El Dorado County	No	All property	$ 10	--	General obligation bonds (by member unit)	⅔ by member unit)	40	Sum of capital obligations and water payments to be paid by member units
					Revenue bonds	Majority	50	None
Kern County	Yes (for federal or state contracts only)	All property	$ 05	None	General obligation bonds (by member unit)	⅔ (by member unit)	40	None
					Revenue bonds	Majority[3]	40[3]	None
Mariposa County	Yes	All property	$ 10	$ 50	General obligation bonds (by zones)	⅔) by zone)	40	None
					Revenue bonds	Majority[3]	40[3]	None
Mojave	Yes	Land	$ 45 (for certain State contract costs)	None	General obligation bonds	⅔	None	None
		Land and improvements	$ 10 (administrative costs only)		Revenue bonds	Majority[3]	40[3]	None
						⅔	50	None
		Land and improvements	None (for certain state contract costs only)		Refunding bonds	Majority	--	None

					Notes	⅔ of board	5	Annual issue limited to $ 025 per acre
Nevada County	Yes	All property (zone land)	$ 05	None	Revenue bonds	Majority[3]	40[2]	None
Placer County	Yes	All property	$ 10	$ 50	General obligation bonds (by zones)	⅔ (by zone)	40	None
					Revenue bonds	Majority[3]	50	None
Sacramento County	Yes	All property	$.15	$.25 (can be more by election)	Special assessment	⅔	40	Amount repayable by tax of $ 15/$100 of assessed value exclusive of member units' debt (flood control and drainage exempt from limit)
					General obligation bonds (by agency)	⅔ election or ⅔ of board	None	
					Refunding bonds	Majority election or ⅔ of board	--	
					General obligation bonds (by zones)	Majority	None	None
					Revenue bonds	Majority[4]	40[2]	None
San Gorgonio Pass	Yes	All property	Aggregate limit of by election)	$ 40 (can be more	General obligation bonds	⅔	40	None
					Refunding bonds	--	--	None
					Revenue bonds	Majority[3]	40[2]	None
					Notes	None	8	Lesser of $1 million or 2 percent of assessed value
					Formation warrants	None	None	None

[1] Benefit zones, improvement districts, etc , except those formed under improvement acts
[2] Per $100 assessed value, exclusive of bond assessments
[3] Revenue Bond Act of 1941, Government Code Sections 54300-54700
[4] "Land and improvements" indicates statutory references to either "land and improvements" or "real property"
[5] When listed, "by zone," must obtain required majority in each zone if more than one zone participating

TABLE XII. FINANCING PROVISIONS—Continued

B. SPECIAL ACT DISTRICTS—Continued

3 Water Agencies—Continued

	Power to create zones[1]	Annual ad valorem assessments[2]			Indebtedness			
		Basis[4]	Maximum limit		Type	Vote required[5]	Maturity period (Maximum years)	Maximum
			District	Zone				
Santa Barbara County	No	All property	$ 15	--	Special assessment	2/3	40	Amount repayable by tax of $ 15/$100 of assessed value exclusive of member units' debt
					General obligation bonds	2/3 election or 4/5 of board	None	
					Refunding bonds	Majority election or 4/5 of board	--	
Shasta County	Yes	All property	$ 05	Set by majority vote	General obligation bonds (by zones)	2/3 (by zone)	40	10 percent of assessed value
					Revenue bonds	Majority[3]	40[3]	None
					Refunding bonds	Majority	--	None
					Warrants	Board majority	None	Anticipated annual revenue
Sutter County	No	All property	$ 10	--	Revenue bonds	Majority[3]	40[3]	None
Upper Santa Clara Valley	Yes	All property	None	None	General obligation bonds	2/3	40	None
					Refunding bonds	--	--	None
					Notes	None	3	Lesser of $1 million or 2 percent of assessed value
					Formation warrants	None	None	None
Yuba County	No	All property	$ 10	--	Revenue bonds	Majority[3]	50	None

Kings River Conservation District	Yes	Land	$ 25	No provision for zone tax	General obligation bonds	⅔	40	None
					Refunding bonds	Majority	None	None
					Revenue bonds	⅔	None	None
Orange County Water District	No	Land and improvements	1961-65, $ 20, 1965-71, $ 15, from 1971, $ 08[6]	--	Warrants	None	None	None
					General obligation bonds	⅔	40	5% of assessed value
Palo Verde Irrigation District	Yes	Land or land and improvements	None	None	Notes	None	1	$100,000
					General obligation bonds (district)	Majority	40	None
					General obligation bonds (zone)	⅔ (or consent in writing by owners of ⅔ of assessed value of lands)	40	None
					Revenue bonds	Majority	40	None
					Refunding bonds	Majority	40	None
					Warrants	None	None	None

[1] Benefit zones, improvement districts etc., except those formed under Improvement acts
[2] Per $100 assessed value, exclusive of bond assessments
[4] "Land and improvements" indicates statutory references to either "land and improvements" or "real property"
[5] When listed, "by zone," must obtain required majority in each zone if more than one zone participating
[6] Levy over $ 08 requires four-fifths consent of board can be used only for purchase of replenishment water, and must exclude separate mineral rights

tion districts, little use is made of land only as an assessment basis All but two of the districts base district assessments on all property. Almost as many also use all property as the zone basis. Five of these districts permit zones the option to assess land and improvements instead of all property Two of these districts, which assess all property districtwide, require zones to assess land and improvements. Still another possibility utilized by one district is assessment for either the district or the zone by either of the two methods.

The special act flood control districts split almost evenly between assessment of land and improvements or of all property However, with the special act water agencies almost all districts (18 out of 19) provide for district assessment based upon all property Ten of the 14 water agencies which have the power to create zones also assess these zones on the basis of all property four make zone assessments on the basis of land only, and one (Mojave) uses a combination of bases.

Thus it can be seen that there are a great many different combinations of assessment bases At the same time each category of special act districts tends to utilize one general approach It is obvious that in the creation of a new special act district the possible choices of assessment bases are many and varied

TABLE XIII. SUMMARY OF BASIS OF AD VALOREM ASSESSMENTS OF WATER DISTRICTS

	Number of districts	Land		Land and improvements		All property	
		District	Zone	District	Zone	District	Zone
General act districts	10	5	4	3	1	3	3
Special act districts County flood control and water conservation districts	22	0	1	2	10	20	18
Flood control districts	11	1	1	4	4	5	5
Water agencies	19	1	4	1	0	18	10
Other	3	2	2	2	1	0	0
All Districts	*65	8	11	13	19	46	36

* Columns do not add up since some districts do not have assessments and others have more than one basis

Limits

In all cases the tax limits discussed in this chapter and included in Table XII are exclusive of taxes levied for payment of bonded indebtedness An election to authorize the selling of bonds is considered an authorization to levy sufficient taxes to pay back the principal and interest on the bonds (if these are general obligation bonds) However, certain limits are imposed by several district acts upon the total amount of bonds that can be sold or the total indebtedness that can be incurred These restrictions are discussed in the section of this chapter on bonding

Only three of the eight general district acts in this study that authorize ad valorem assessments place limitations on the tax rate which may be levied. These are the Water Conservation Acts of 1927 and 1931 and the Water Replenishment District Act Each of these district acts, however, as can be seen from Table XII, provides for levies in excess of the limit under certain circumstances For example, the tax rate of water replenishment districts and water conservation districts formed under the 1927 act may exceed the limit by majority vote of the district's voters and the voters of water conservation districts formed under the 1931 act may authorize special assessments by majority vote.

Water replenishment districts have a statutory limit of $0 20 per $100 of assessed value but the actual limit is established at the time of formation of the district The limit to be used, up to $0 20, is included in the petition of formation After the district is formed the limit established at formation may be increased even beyond the $0 20 by majority vote of the district's voters; however, the original limit cannot exceed the $0 20 limit.

The Irrigation District Act, while not limiting the tax rate which may be levied, does limit the amount which may be raised by an annual assessment for maintenance and operation to 4 percent of the assessed value of land, the amount which may be raised for certain other district purposes to 4 percent of the assessed value of land, and the amount which may be raised for the purchase of district bonds to 1 percent of the assessed value of land

None of the 10 general district acts in this study have any statutory restrictions or limits on zone tax rates

With regard to special act districts, however, a large percentage of these district acts include limitations on both the district tax rate and the zone tax rate, and in most cases these limits are different for the district and zones

Table XIV summarizes the tax limits of general and special act districts and briefly indicates the range of these limitations As is in-

TABLE XIV. SUMMARY OF AD VALOREM TAX LIMITS OF WATER DISTRICTS

		District				Zone			
	Number of districts	Number with limits	$ 00-$ 10*	$ 11-$ 30*	Over $ 30*	Number with limits	$ 00-$ 10*	$ 11-$ 30*	Over $ 30*
General act districts	10	3	0	3	0	0	--	--	--
Special act districts County flood control and water conservation districts	22	18	14	3	1	15	5	6	4
Flood control districts	11	6	2	3	1	4	1	0	3
Water agencies	19	17	13	2	2	6	1	1	4
Other	3	2	0	2	0	0	--	--	--
All Districts	65	46	29	13	4	25	7	7	11

* Per $100 assessed value.

dicated, general act districts are much less restricted than special act districts as far as the maximum tax rate is concerned

In the case of all three categories of special act districts, more restrictions are placed upon the district tax limit than are placed upon the zone tax limit Also, for special act districts a majority of the district tax limits are less than $0 10 per $100 of assessed value On the other hand a majority of the zone limits are in excess of $0 10, and 11 out of the 25 zone limits are in excess of $0 30 per $100 of assessed value

Of those special act districts with district tax limits, the lowest limit is the 1½-cent per $100 assessed value limit placed upon the Alameda County Flood Control and Water Conservation District This district, it should be noted, does not have a zone limit A number of other special act districts have limits almost this low The highest district limit among special act districts is the $0 50 limit placed upon the Lake County Flood Control and Water Conservation District

The lowest zone limit among special act districts is the $0 02 limit placed upon the Mendocino County Flood Control and Water Conservation District The highest limit on a special act district for zone taxes is the $1 50 limit placed upon the Lake County Flood Control and Water Conservation District

A number of special act districts do not specify a district or zone limit but establish an overall limit which cannot be exceeded by the combined district and zone tax rates

Actual Tax Rates

The tax limits discussed above are the maximum permitted by the general and special district acts The actual tax rates utilized by the operating districts are often far below the statutory maximum. On the other hand, special act districts often find it necessary to ask the Legislature to raise their tax rate maximum as conditions in the local district change A number of factors, including the necessity of obtaining local support for formation of a special act district, enter into the determination of the limit included in the original special district act legislation

Tables XV and XVI summarize the actual tax rates being levied by general and special act districts It can be seen from these tables that not all districts authorized to do so actually levied taxes in 1961-62 (1962 for irrigation districts)

Use of County Officials for Taxation

Five of the eight general district acts in this study which authorize the levy of ad valorem assessments provide for the collection of all district taxes by county officials based upon the county assessment rolls These are the County Waterworks, Municipal Water (1911), Water Conservation (1927 and 1931) and Water Replenishment Acts

The remaining three general district acts offer both use of county officials and use of a district's own assessor and collector These provisions of the three acts vary, however

The Irrigation District Act provides as the normal procedure assessment by the district's own assessor and collection by the district's own tax collector. This act, however, provides that "If a board neglects or

refuses in any year to levy assessments pursuant to this part, the board of supervisors of the office county shall, as provided in this article, perform the duties of the board of the district in respect to levying assessments in the same manner and with the same effect as if they were performed by the board " (Section 26500, Water Code) Thus, under these circumstances irrigation districts use the county assessment rolls and utilize county officials for collection

A further provision of the Irrigation District Act provides that the governing body of any irrigation district of less than 3,000 acres may, by resolution, dispense with the offices of district assessor and tax collector and in so doing utilize county assessment rolls and collection by county officials

The California Water District Act also provides as a normal procedure the assessment by the district assessor and collection by the district tax collector

A number of variations are possible with these districts, however The governing body of a California water district may direct its assessor to utilize the county assessment rolls rather than making a separate district assessment. Under these circumstances the district retains the two district officials—assessor and tax collector—however

The California Water District Act also provides alternate provisions under which the governing body of a district, by resolution, may elect

TABLE XV. RANGE, AVERAGE, AND MEDIAN OF ACTUAL DISTRICTWIDE TAX RATES OF WATER DISTRICTS 1961-1962

	Number of districts	Number levying taxes	Highest tax rate levied*	Lowest tax rate levied*	Average tax rate levied*	Median tax rate levied*
General Act Districts						
California water	109	28	$10 000	$0 150	$2 215	$1 184
California water storage	No ad valorem taxes Assessments on per acre basis					
County water	186	91	$5 087	$0 010	$0 672	$0 376
County waterworks	93	30	$26 100	$0 001	$1 516	$0 269
Flood control and flood water conservation	No ad valorem taxes Assesments based on benefits					
Irrigation†	113	84	$13 000	$0 200	$3 404	$2 700
Municipal water	49	36	$3 000	$0 005	$0 544	$0 420
Water conservation (1927)	6	3	$0 250	$0 010	$0 097	$0 130
Water conservation (1931)	10	9	$0 259	$0 040	$0 159	$0 205
Water replenishment	1	1	--	--	$0 002	--
Special Act Districts						
County flood control and water conservation	22	12	$0 200	$0 015	$0 051	$0 041
Flood control	11	8	$0 200	$0 014	$0 095	$0 086
Water agencies	19	7	$0 200	$0 030	$0 069	$0 068

* Shown to the closest mill per $100 assessed value
† Calendar year 1962
SOURCE Alan Cranston, State Controller

TABLE XVI. RANGE, AVERAGE, AND MEDIAN OF ACTUAL DISTRICTWIDE TAX RATES FOR LONG TERM INDEBTEDNESS OF WATER DISTRICTS 1961-1962

	Number of districts	Number levying taxes	Highest tax rate levied*	Lowest tax rate levied*	Average tax rate levied*	Median tax rate levied*
General Act Districts						
California water	109	5	$3 019	$1 410	$2 000	$1 880
California water storage	No ad valorem taxes Assessments on per acre basis					
County water	186	47	$3 878	$0 020	$0 823	$0 600
County waterworks	93	48	$23 408	$0 051	$4 298	$2 697
Flood control and flood water conservation	No ad valorem taxes Assessments based on benefits					
Irrigation†	113	28	$3 601	$0 050	$1 231	$1 112
Municipal water	49	8	$0 740	$0 300	$0 455	$0 515
Water conservation (1927)	6	0	--	--	--	--
Water conservation (1931)	10	4	$2 042	$0 097	$0 632	$0 195
Water replenishment	1	0	--	--	--	--
Special Act Districts						
County flood control and water conservation	22	2	$0 185	$0 143	$0 164	$0 164
Flood control	11	0	--	--	--	--
Water agencies	19	0	--	--	--	--

* Shown to the closest mill per $100 assessed value
† Calendar year 1962
SOURCE Alan Cranston, State Controller

to have all its taxes levied and collected by the counties in which the district is located and to base these taxes upon the county assessment rolls.

The County Water District Act provides two specific procedures—the "main tax procedure" and the "alternative tax procedure"—for the levy and collection of district taxes

The "main tax procedure" calls for use of the county assessment rolls and collection of taxes by county officials The "alternative tax procedure" provides that the governing body of a county water district may, be resolution, dispense with the "main tax procedure" and utilize its own district assessor and district tax collector

The "alternative tax procedure" further authorizes, upon resolution of the governing body, the simultaneous use of both procedures with each procedure being used for different taxes levied by a single district

The Water Storage District Act includes provisions authorizing the use of county officials to collect district assessments.

Forty-three of the 45 special district acts in this study utilize county officials for collection of district taxes and base these taxes on the county assessment rolls The two exceptions are the Palo Verde Irrigation District, which has its own assessor and tax collector (only if the district fails to levy taxes to meet bonded indebtedness are county officials authorized to perform these functions), and the San Diego

County Flood Control District, which does not have the power to levy ad valorem assessments.

As is discussed elsewhere in this report, the fact that a district utilizes county officials and the county assessment rolls for levy and collection of taxes makes that district subject to the provisions of several other acts, including the "alternative method for dissolution of districts" provisions of the Government Code (see Chapter V) and the requirements for reporting boundary changes found in Sections 54900-54903 of the Government Code.

BONDS

All but two of the general district acts (flood control and flood water conservation districts and water conservation districts of 1927) and all but one of the special district acts (San Diego County Flood Control District—which permits donations only) authorize the financing of district projects by the sale of one or more types of bonds

The most common type of long-term issue are general obligation bonds, which are secured by the taxing resources of the district and offer the greatest degree of security to the bond purchaser. Revenue bonds, which are secured only by designated revenues, are the second most-used type of bonds Districts that have assured revenues from certain water tolls, power sales or other regular revenues, often use revenue bond financing

Certain bonding trends can be seen among special district acts. For example, all 22 county flood control and water conservation districts are authorized to issue general obligation bonds while only four of these districts have the authority to issue revenue bonds. The same situation is true with flood control districts where 10 of the 11 special act districts of this type are authorized to issue general obligation bonds while none are authorized to issue revenue bonds Generally speaking, these two types of districts construct primarily projects which do not produce revenue Flood control projects, particularly, do not generally produce revenue and must be financed by taxation, and thus, general obligation bonds

A somewhat different situation exists with regard to special district water agencies, however These districts generally have the authority to issue both general obligation and revenue bonds These districts are more likely to construct projects with revenue from, for example, power generation.

A third type of bonds authorized by many districts are refunding bonds, which are used to refinance previous bond issues In most cases there are no set vote or maturity requirements for these bonds and refunding bonds generally must be sold under the same conditions, and be approved by the same majority, as the original bonds Some districts, however, do establish specific requirements for refunding bonds and these are set out in Table XII.

Bond Elections

Nearly all bond issues must be authorized by the voters of the district or zone. In a few cases, bonds may be issued by large majorities of the governing body (four-fifths, for example) and without a vote of the people.

There is much variation among districts as to the method of issuing bonds Several districts construct projects only by zone and, therefore, issue bonds by zones. Other districts issue bonds districtwide but require the necessary majority in each zone of the district A great many combinations are available to districts, including issuance by two or more zones.

Article XI, Section 18, of the California Constitution provides·

> "No county, city, town, township, board of education, or school district, shall incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year, without the assent of two-thirds of the qualified electors thereof, voting at an election to be held for that purpose . . ."

Because of this provision, local municipal and school general obligation bond issues require a two-thirds majority for approval (The courts have ruled that this section does not apply to revenue bonds which are repaid from revenues, not taxes [1]) Court decisions have also established that the two-thirds requirement does not apply to water districts [2]

Nevertheless, as a result of the pattern set by the constitutional provision, most water districts require two-thirds votes for general obligation bonds, although not required by the Constitution. (A number of districts do require only a simple majority) The bond vote requirements of districts included in this study are as follows:

TABLE XVII. SUMMARY OF VOTE REQUIRED FOR WATER DISTRICT BOND ISSUES

	Number of districts	General obligation bonds		Revenue bonds	
		Majority	Two-thirds	Majority	Two-thirds
General act districts	10	3*	6	6	2
Special act districts County flood control and water conservation districts	22	1	23	4	0
Flood control districts	11	3	7	0	0
Water agencies	19	0	15	18	2
Other	3	1	3	1	1
All districts	65	8	53	29	5

* County waterworks districts require 60 percent for zone bonds

[1] See *Oxnard* v *Dale* (1955), 45 Cal 2d 729,290 P 2d 859, and *Redondo Beach* v *Taxpayers, Property Owners, Citizens and Electors* (1960), 54 Cal 2d 126,352 P 2d 170 An excellent discussion of local bond elections is contained in Stanley Scott and Frank Mormil "Local Bond Elections in California The Two-Thirds Requirement." *Public Affairs Report*, University of California, Bureau of Public Administration, June 1962

[2] See *In re Madera Irrigation District* (1891), 92 Cal 296, 28 Pac 675 (Irrigation districts), and *Joint Highway District No 13* v *Hinman* (1934), 220 Cal 578, 32 P 2d 144

It must be noted that some districts permit different vote requirements under certain conditions, in which case, these districts are included more than once in the above table In addition, not all districts permit both types of bonding, and some have no bonding provisions whatsoever.

Table XVI indicates that the predominant requirement for general obligation bonds is a two-thirds vote and the predominate requirement for revenue bonds is a simple majority vote.

Five of the 10 general district acts in this study and 25 special district acts incorporate part or all of the revenue bond procedures set forth in the Revenue Bond Law of 1941 (Sections 54300-54700, Government Code). Acts not utilizing these procedures include detailed revenue bond provisions in the individual acts.

In recent years at least one exception to the provisions of the Revenue Bond Law has been made in four special district acts by an extension of the maximum bond maturity period from 40 to 50 years These districts utilize all the Revenue Bond Act procedures except the maturity period. One general district act, the County Water District Act (which authorizes the sale of bonds pursuant to the Revenue Bond Act) permits a 50-year maturity period if a two-thirds vote is used for these revenue bonds This is an alternative procedure included in the County Water District Act. Some special act districts have adopted this same procedure as well.

The procedures for issuing general obligation bonds are spelled out in each general district act and each special district act as there is no act comparable to the Revenue Bond Act dealing with general obligation bonds.

Bond Limitations

None of the general district acts establishes a limit on the amount of bonds a district may issue Several general act districts apply some limits to other forms of financing, including warrants, notes, etc , but not to bonds

Eleven special act districts have maximum bonding limits In these districts using the assessed value limitation, the maximum bonding varies from 5 percent of the district's assessed value to 15 percent of this value Another form of limit restricts bonding to that amount that can be repaid from a specific tax rate These rates vary from a maximum annual tax of $0 10 per $100 assessed value to $0 15 per $100 assessed value

Another form of limitation on bonding is the establishment in the district acts of maximum interest rates at which bonds may be sold. The maximum rate per annum is usually 5 percent, although certain district acts permit higher interest rates

Interest Rates

As was noted above, the more recently enacted special act water agencies generally authorize the use of revenue bonds while only a few of the earlier categories of districts authorize this use According to the Districts Securities Commission, "revenue bonds of districts appear to be becoming more acceptable on the market in recent years, and in

many instances, the interest rates were as low as would be expected if sold as a general obligation of the district."[8]

As an indication of this trend, Table XVIII represents nationwide bond interest data.

It can be seen that during 2 of the 12 months the interest rate for revenue bonds was less than that of general obligation bonds and one month the rate was the same. At the same time, however, the interest rates of revenue bonds fluctuated more widely than those of the more stable general obligation bonds.

XVIII. MONTHLY WATER BOND INTEREST RATES

(Nationwide)

Month	1962-63 net interest cost (percent)	
	General obligation bonds	Revenue bonds
April	3 03	3.36
May	3 31	3 23
June	3 39	3 89
July	3 45	3 65
August	3 25	3 67
September	3 12	3 36
October	3 14	3 47
November	3 04	3 04
December	3 33	3 24
January	3 14	3 20
February	3 36	3 61
March	2 93	3 18

SOURCE Chief, Basic Data Branch, Division of Water Supply and Pollution Control, U S Public Health Service, as reprinted in "Journal of the American Waterworks Association," July 1963

Districts Securities Commission

Prompted by the widespread default of many irrigation and water districts in payment of principal and interest due on outstanding bonds during the late 1920's, the Legislature in 1929 created the California Irrigation and Reclamation Financing and Refinancing Commission In a report to the Governor dated December 1, 1930, the commission recommended legislation to restore the credit standing of districts, to obtain necessary financing, to establish the confidence of the investing public, to strengthen the individual buying power of landowners in these districts, and to provide continuing checks and curbs on the creation of new indebtedness.

[8] "Functions and Operations of California Districts Securities Commission," T. P Stivers, executive secretary, before Governor's Council, May 23, 1962

As a result of this study and report the 1931 Legislature created the Districts Securities Commission. The commission membership now consists of the State Superintendent of Banks, the Attorney General, the Director of Water Resources, and two members at large appointed by the Governor. The Districts Securities Commission assumed all of the duties of the earlier California Bond Certification Commission, which was created in 1911 for the purpose of establishing a better market for irrigation district securities but had much less authority over districts than the new Districts Securities Commission [4]

The 1930 report of the Financing and Refinancing Commission concluded that most of the water districts in default at that time should not have been organized in the first place. The principal reasons for default in bond payments, the commission concluded, were (1) overcapitalization; (2) an impossible amortization program; (3) inclusion of marginal lands incapable of bearing their proportion of district debt; (4) lack of adequate, dependable and feasible water supply; and (5) failure of lands to develop as planned.

Following the creation of the Districts Securities Commission, 59 districts were refinanced and investor confidence in the State's water districts was restored.

The commission now passes upon the economic feasibility and financial soundness of some districts' proposals to incur long-term indebtedness by issuance of bonds, warrants, or by contracts

The commission's investigation includes a review of project plans and estimates, the financial condition of the district and analysis of repayment capacity, a confirmation of the valuations of property that provide security for the bonds, a review of the proposed maturity schedule, provisions for reserve funds, and other conditions of sale of the bonds

The commission's record is impressive and there has never been a default in payment of principal and interest on bonds or warrants approved by the commission since its organization in 1931.[5]

At the present time irrigation districts and California water districts are required by law to be subject to the broad financial supervision of the commission and must submit to the commission for approval all proposals for incurrence of long-term indebtedness by issuance of bonds and warrants (except revenue bonds of California water districts) or by contracts Certain special act districts as well are required to submit securities to the commission for approval, and the revenue bonds of county water districts must also be approved by the commission. In addition, any contracts entered into under the Irrigation District Federal Cooperation Law providing for repayment of construction money, repayment of the cost of acquiring any property, or issuance of bonds, must be submitted to the commission.[5a]

[4] California Department of Public Works, Division of Water Resources, *Financial and General Data Pertaining to Irrigation, Reclamation and Other Public Districts in California, Bulletin No 37*, Sacramento, 1930, pps 15-22; California Department of Public Works, Division of Water Resources, *California Irrigation District Laws, Bulletin 18-B*, Sacramento, 1931, p 31

[5] T P Stivers, "Water District Activities in California," statement of September 28, 1960

[5a] Contracts with the State for Davis-Grunsky loans are not required to be submitted to the commission for approval See 40 Ops Cal Atty Gen 198

In addition to the general act districts listed above, many other public agencies may utilize the services of the commission Section 20003 of the Water Code provides as follows·

> "20003 Whenever the governing board of any water storage district, water conservation district, county water district, county water works district, public utility district, reclamation district, drainage district, or any district other than an irrigation district, the primary function of which is the irrigation, reclamation, or drainage of land, or the development of water for domestic use or the distribution thereof, or the generation of power or the generation thereof, which district exists under the law of this State, declares by resolution that it deems it desirable that the bonds of the district should be certified pursuant to this chapter, the governing board of the district shall file a certified copy of the resolution with the Commission Then, and in that event, all of the provisions of this chapter apply to the district . "

About 500 additional districts, including nearly all of the general district acts concerned primarily with the conservation or distribution of water, are eligible to submit securities to the commission under this provision At the present time, however, very few have done so In 1962, 109 irrigation districts and 47 California water districts had sold securities and automatically were subject to commission supervision In addition, 11 county water districts, 2 drainage districts, 4 cities, 1 community services district, 1 public utility district, 1 water storage district, 1 water conservation district (1931), and 2 special act districts have submitted to commission supervision

It is important to note that whenever a district requests commission approval of a bond issue, commission control and supervision continues during the entire period these bonds are outstanding and during this period no additional bonds can be issued without commission approval

All districts so supervised must also file annual financial reports with the commission. These requirements may in part explain why so few districts having an option to use the commission's services have actually done so In addition, the California Water Storage District Law adds to these requirements and provides that whenever the commission has passed upon one district bond issue, all subsequent issues must be submitted to the commission After July 1, 1965, *all* bond issues of water storage districts must be submited to the commission.

Commission approval and certification of a bond issue results in the bonds becoming legal investments for all trust funds, the funds of all insurance companies, banks (both commercial and savings), trust companies, the state school funds, and any funds which may be invested in county, municipal or school district bonds, and they may be deposited as security for the performance of any act whenever the bonds of any county, city and county, or school district may be so deposited, including deposit as security for public money. This certification normally results in a broader market for the district's securities and a lower interest rate to the district.

Bonds issued by certain general act districts, however, by wording in the general district acts themselves automatically become legal investments for similar types of funds as bonds examined and approved

by the commission. In addition bonds issued under the Revenue Bond Law of 1941 are not subject to commission approval.

The County Waterworks District Act and the County Water District Act contain language which gives bonds issued under these acts the same force, value and use as bonds of any municipality and a number of special district acts also have this same provision It should be noted, however, that despite these statutory declarations, these bonds do not have the same status as commission-approved securities

The commission has often expressed the view that this lack of uniformity of procedures relating to the issuance of bonds results in bonds of the various types of districts varying greatly as to their degree of soundness The executive secretary of the commission has said that "the commission is of the opinion that bonds issued by all agricultural water districts, irrespective of the type of act under which they are organized, should meet uniform minimum standards in the issuance of bonds, and it is believed that this can best be accomplished by placing all agricultural type water districts under the financial supervision of this commission in the same manner as irrigation districts and California water districts."[6] Legislation expanding commission authority was introduced but not approved at the 1963 Session of the Legislature

Chapter 1607 of the Statutes of 1963 transferred to the commission many of the responsibilities of the Department of Water Resources relating to financial supervision of California water storage districts (effective July 1, 1965)

OTHER FINANCING METHODS

In addition to ad valorem assessments and bonds, districts may finance operations and projects by (1) issuance of warrants, (2) issuance of notes; (3) loans and (4) water charges, and other assessments

Warrants

District short-term financing is often accomplished by issuance of warrants which are normally payable over a period of 5 to 10 years These warrants are often sold at quite reasonable interest rates and most water district acts establish a maximum interest rate at which warrants may be sold.

As with bonds, all income from warrants issued by water districts organized under state law are exempt from federal income tax, which is a substantial assistance in marketing at low rates of interest.

Many of the district acts in this study authorize the issuance of warrants. The conditions of issuance vary from district to district Some district acts require a vote of the people to issue warrants, while others permit authorization by board action alone Also, the maturity period and amount of warrants is limited by some district acts and not limited by others

Some of the district acts in the study authorize a particular type of warrant—the formation warrant These are usually very short-term issues and are used to meet the formation costs of districts

Notes

A number of district acts in this study authorize the issuance of promissory notes. As with warrants, some district acts limit the maturity period, interest rate, and amount of the note which is permitted.

[6] Letter to Assemblyman Carley V. Porter, dated July 5, 1962

Loans

In recent years loans from the state and federal governments have become major forms of financing of local water development projects, after many years of federal activity in flood control projects The federal government took first action in this area in 1955 and 1956 with the passage of Public Laws 130 and 984 by the 84th Congress. Under Public Law 130, federal non-interest-bearing loans are made to local agencies for the purpose of constructing distribution systems on authorized federal reclamation projects Under Public Law 984, the Small Projects Act, non-interest-bearing loans or grants up to a maximum of $5,000,000 are made to local agencies for construction of irrigation facilities

In 1957 the California Legislature first enacted a program of state assistance to local projects, which in 1959 became the Davis-Grunsky Act This program provides low-interest[7] loans up to a maximum of $4,000,000 to public agencies for the construction of local projects "in which there is a statewide interest," and which the agencies are unable to finance on reasonable terms from other sources Larger loans may be made with approval of the Legislature The act also provides loans of up to $50,000 for the preparation of project feasibility reports. Grants of up to $400,000 for recreation and fish and wildlife functions of such projects are also permitted under this act Larger grants may also be made with approval of the Legislature At the 1963 Session 10 bills authorizing total grants of $28,025,000 were passed and approved by the Governor.

1961 amendments specified that every public agency empowered by law to construct a project eligible for a Davis-Grunsky loan or grant is granted the power to borrow money or receive a grant under the program, execute a contract with the state, and levy ad valorem taxes or assessments to repay the loan By this action, and without specific authorization in the individual district act, most of the districts included in this study are, therefore, automatically permitted to use this method of financing

The act requires an election in the local district (except in the case of a proposed grant, where the district has a governing body which is elected or is the board of supervisors) to approve a grant or loan.

At the 1963 session extensive changes were made in the act and its purposes were "liberalized" and broadened (See Chapter 2023, Statutes of 1963) Grants may now be made for initial water supply and sanitary facilities up to $100,000

Two of the district acts included in this study provide for district financing by means of loans under specific circumstances County waterworks districts may accept loans from the county in which they are located. Provisions of the act limit these loans to 85 percent of the district's anticipated annual revenue or $10,000 if the district has less than $100,000 assessed value The loans are also limited to five years

Upon majority vote of the electorate, loans may be accepted for zones of the San Bernardino County Flood Control District. Such loans may be made for up to 20 years and in an amount per loan not exceeding 2 percent of the assessed value of the zone. Upon a two-thirds vote,

[7] Interest rates are determined from a formula which is based upon the sale of general obligation bonds by the State over a five-year period (See Chapter 1075, Statutes of 1963)

zones of the Ventura County Flood Control District may authorize 10-year loans.

Water Charges and Other Assessments

Most of the districts included in this study are authorized to charge for water delivered Certain districts also are permitted to levy standby charges for water availability which do not depend on actual water delivered

In 1953, the Orange County Water District Act was amended to provide for a novel "replenishment assessment" which is assessed on each acre-foot of ground water extracted This assessment, commonly called a "pump tax," is levied to finance the replenishment of both accumulated and annual overdraft of the underground basins of the district

A slightly modified replenishment assessment is the key feature of the Water Replenishment District Act, a general district act In 1961, authority to levy a replenishment assessment was granted by special legislative act to the Alameda County Water District, which is a district formed under the County Water District Act In 1962 the Legislature amended the Santa Clara County Flood Control and Water Conservation District, a special district act, to authorize the levy of a replenishment assessment by that district At the 1963 session, replenishment assessment powers were added to the Water Conservation Act of 1931, a general district act, the Stockton and East San Joaquin Water Conservation District (formed under a general district act), the Yolo County Flood Control and Water Conservation District Act and The Mojave Water Agency Act, special district acts All of these provisions for replenishment assessments are based upon the Orange County Water District Act and its experience

In all cases described above the replenishment assessment complements an ad valorem tax program by the district

Several other district acts provide for the levy of special assessments, including those based on benefits from district projects. Water storage districts, particularly, utilize a number of forms of financing not used by other districts, including direct assessment warrants, warrants payable at future times, and several other types of special assessment The unusual forms of financing used by these districts are in part a result of the nature and character of these districts, which were created for specific purposes and to meet specific needs (See Chapter I)

BENEFIT ZONES AND IMPROVEMENT DISTRICTS

A number of different terms are used to describe zones or subdistricts within general or special act districts. These zones are basically a financing entity within a district, created for the purpose of limiting the assessment of costs to the property benefited by the project

Table XII includes a column, "power to create zones " This refers to the power of the district's governing body to create special zones for the financing of projects of common benefit to the areas of these zones. These zones are variously referred to as "zones," "benefit zones," "improvement districts," or "distribution districts " They are merely geographic areas which have various powers to levy ad valorem assessments, issue one or more types of bonds, and construct works Zones

utilize the same methods of financing, in most cases, as the district itself. In some districts, bonds, for example, are issued only by zones There is, however, no limit on the size of zones The word "zones" was used in this study to differentiate these zones from the three improvement acts discussed below

The term "zones," as used in this study, does not include: (1) "*member units*;" (2) "zones" which are created by the district act itself as electoral boundaries (which are often referred to as "divisions"); or, (3) districts formed under the Improvement Act of 1911 (Sections 5000-6794, Streets and Highways Code), the Municipal Improvement Act of 1913 (Sections 10000-10609, Streets and Highways Code) The latter are special assessment district acts and were originally created for use by counties and municipalities However, a number of general and special district water acts specifically authorize their use These improvement acts differ greatly from the types of zones included in Table XII above Under the improvement acts, there is an assessment of individual property for the entire cost of the project and such assessments can be paid at once or by the issuance of bonds—the security of the bonds being specific individual parcels of property.

Zones

Six of the 10 general district acts in this study authorize the formation of zones within the districts Of the special district acts, 21 of the 22 county flood control and water conservation districts, 7 of the 11 flood control districts, 14 of the 19 water agencies, and 2 of the 3 other special district acts are authorized to create such zones

Table XIX, compiled from the committee questionnaire, indicates the extent to which districts authorized to create zones have actually done so

It can be seen from Table XIX that less than half of the districts actually have created zones Municipal water districts, county water districts, and irrigation districts have made the most extensive use of zones

In 1927 the Legislature passed an act providing "for the organization and creation of improvement districts under the 'California Irrigation District Act'; to provide for the acquisition, construction, operation, maintenance and repair of improvements therein, and for the levy of assessments on the lands of such improvement districts" [8] This act has subsequently been amended substantially and after codification now appears as Part 7 of Division 11 (Sections 23600-24103) of the Water Code as part of the Irrigation District Act

These provisions have been carefully worked out and have been used quite successfully In 1949, county water districts were authorized to create improvement districts pursuant to the provisions of the Irrigation District Act, and in 1953 California water districts were authorized to do the same Therefore, the three most used general district acts are today authorized to utilize the same basic procedures for the formation of zones or improvement districts

In 1949 special provisions were added to the Irrigation District Act providing for the creation of distribution districts "for the purpose of contracting with the United States pursuant to the federal reclama-

[8] Statutes of 1927, Chapter 1415

tion laws for the construction of a distribution system separate from or supplemental to the works of the district " These provisions (Sections 23500-23583, Water Code) were prompted by the completion of portions of the Central Valley Project The Irrigation District Act also provides for "revenue improvement districts," in which assessments are prohibited and all obligations of the improvement district must be met by revenues (Water Code, Sections 23800-23811, added in 1947)

In 1957, Part 6 5 (Sections 36460-36543, Water Code) was added to the California Water District Act, providing for the creation of distribution districts along the same lines as those of the Irrigation District Act These provisions in the California Water District Act also permit the formation of distribution districts for distribution systems not associated with federal projects as well

In addition to authorizing use of the Irrigation District Act provisions for formation of improvement districts, the County Water District Act includes an alternate procedure for the formation of improvement districts (Sections 31585-31618, Water Code), enacted in 1959

Each of the other three general district acts which provide for the creation of improvement districts or zones do so by means of specific provisions in the individual act The provisions in the Municipal Water District Act of 1911 were added in 1951.

The same year provisions (Sections 55650-55679, Water Code) were added to the County Waterworks District Act authorizing the creation of "zones " A unique provision in this act (Section 55200-55203, Water

TABLE XIX. NUMBER OF DISTRICTS WHICH HAVE CREATED ZONES

	Questionnaire		Number creating zones		
	Number of districts	Total returned	Yes	No	No response
General District Acts*					
California water	98	59	2	44	14
County water	176	132	24	79	29
County waterworks	96	71	1	8	49
Irrigation	109	82	16	52	14
Municipal water (1911)	48	33	13	18	2
Water conservation (1931)	11	9	2	5	2
Special District Acts					
County flood control and water conservation	22	21	14	5	2
Flood control	11	8	4	4	0
Water agencies	19	13	1	8	4
Other	3	2	1	1	0
All Districts	593	430	78	224	116

* Districts not listed are not authorized to establish zones

Code) permits these zones to be created at the time of formation of the district.

In 1933, improvement district provisions were added to the Water Conservation Act of 1931 Later, in 1958, additional provisions permitting the formation of "special improvement districts" for specific purposes were added to this act.

It can be seen that provisions for improvement districts or zones in the case of all general district acts came sometime after the original enactment of the acts, beginning with the Irrigation District Act in 1927.

The most common use of zones is for the construction of distribution systems, including canals, pipelines, etc One irrigation district reported it created 258 separate zones for the lining of open ditches. Zones are also used for assessment of maintenance and operations costs of projects

A number of county water districts have utilized zones to finance sewerage systems, one of the functions of these districts. Municipal water districts have used zones to repay federal loans and for ground water replenishment programs One municipal water district created zones to purchase private water companies that were included within the district General act districts have used zones for a wide variety of projects and purposes.

With regard to special act districts, the older flood control and water conservation districts and flood control districts have used zones a great deal Responses to the questionnaire indicated these zones had been used for construction of dams and levees, operation and maintenance of flood control projects, channel clearance and many other related purposes

The Kern County Water Agency Act, enacted in 1961, included provisions for zones of benefit for the specific purpose of contracting for water from the State Water Facilities Considerable attention was given in this act to including in zones only lands specifically benefitting from the projected import of water The definition of "benefit" in this act was quite limited compared to the provisions of most other general and special district acts Since enactment of the Kern County Water Agency Act many persons have referred to the new type of zone authorized by it as "benefit zones." A number of special act districts have indicated to the committee that they were anxious to provide zones similar to those in the Kern County act for their district in order to similarly limit the inclusion of land in zones.

Special Assessment Districts

Four general district acts authorize the use of one or more of the special assessment district acts to finance improvements County water districts and water conservation districts (1931) may use all three acts —the Improvement Act of 1911, the Municipal Improvement Act of 1913, and the Improvement Bond Act of 1915. Municipal water districts (1911) and county waterworks districts are authorized to use only the Improvement Act of 1911. In addition, county water districts and water conservation districts (1931) are permitted to use the Street Opening Act of 1903 (Sections 4000-4443, Streets and Highways Code).

Special act districts are authorized to use these acts as follows:

TABLE XX. SPECIAL ACT DISTRICTS AUTHORIZED TO USE SPECIAL ASSESSMENT DISTRICT ACTS

	Number of districts	Improvement Act of 1911	Municipal Improvement Act of 1913	Improvement Bond Act of 1915
County flood control and water conservation	22	Contra Costa, Marin, San Luis Obispo, Santa Cruz, Sonoma, Yolo (6)	Contra Costa, Marin, San Luis Obispo, Santa Cruz, Sonoma, Yolo (6)	Contra Costa, Marin, San Luis Obispo, Santa Cruz, Sonoma, Yolo (6)
Flood control	11	Fresno Metropolitan, Orange County, San Mateo County (3)	San Mateo County (1)	Fresno Metropolitan, Orange County, San Mateo County (3)
Water agencies	19	Amador County, Antelope Valley-East Kern, Contra Costa County, Cresthne-Lake Arrowhead, Desert, Kern County, Mojave, San Gorgonio Pass (8)	Amador County, Contra Costa County, Kern County, Mojave (4)	Contra Costa County, Mojave (2)
Other	3	None	None	None

A total of 17 special act districts are authorized to use the 1911 act, and 11 districts are authorized to use the 1913 and 1915 acts Both general act and special act districts, however, have made very little use of these special assessment district acts Table XXI below indicates their actual use by genral act districts, based upon responses to the committee questionnaire.

Of the 17 special act districts authorized to use one or more of the three special assessment district acts only one district—the Sonoma County Flood Control and Water Conservation District—reported to the committee that it had actually used one of the acts The district added that it found the procedures of the 1911 act "too complex and costly."

TABLE XXI. ACTUAL USE OF SPECIAL ASSESSMENT DISTRICT ACTS BY GENERAL ACT DISTRICTS

	Number of districts	Number of responses	Improvement Act of 1911	Municipal Improvement Act of 1913	Improvement Bond Act of 1915
County water	176	132	11	10	7
County waterworks	96	71	4	*	*
Municipal water (1911)	48	33	3	*	*
Water conservation (1931)	11	9	0	0	1

* Not authorized

These special assessment district acts, therefore, are only a minor factor in the financing programs of water districts, but, if desired, could be used by nearly half of the State's water districts.

In 1963 the Legislature added powers to the Irrigation District Act permitting the El Dorado Irrigation District to form improvement districts for certain purposes in much the same manner as county service areas are formed by counties.[9]

[9] See Statutes of 1963, Chapter 492

CHAPTER VI

BOUNDARIES

This chapter discusses the manner in which districts, after formation, are increased in size by *annexation* of additional territory, are decreased in size by the *withdrawal* of territory, are consolidated with one another by *merger* or *consolidation*, or cease to exist by *dissolution*.

In 1933 the Legislature enacted the District Organization Law (now Sections 58000-58309, Government Code) to provide a uniform procedure for formation, annexation, withdrawal, consolidation and dissolution of "tax or assessment districts" The provisions of this law are applicable to general and special act districts only if the District Organization Law specifically includes the district act (no water districts, special act or general act, are now so included) or if a special or general district act specifically incorporates provisions of the District Organization Law Although none of the 10 general district acts authorize the use of any of the provisions of the District Organization Law, a number of the special act districts in this study utilize one or more of its procedures.

As a result of the differences between formation of general act districts and special act districts, provisions for changes in boundaries of the two types of districts are quite different

Only a small number of the special district acts have provision for these boundary changes

For general district acts the basic steps involved in voluntary annexation are in most cases similar to those of formation and include: (1) submission of proposal to local agency formation commission for approval, (2) filing of a petition[1]; (3) public hearing, and (4) an election[2] (or in some cases, board action only) The steps for voluntary withdrawal and dissolution are basically the same as those for annexation except that proposals for withdrawal or dissolution are not subject to the jurisdiction of the local agency formation commissions.

ANNEXATION (Inclusion)

General Act Districts

As can be seen from Table XXII, all general act districts except flood control and flood water conservation districts provide for the annexation (termed "inclusion" in some district acts) of additional territory to districts

The first step in annexation is submission of the proposal to the local agency formation commission This filing must include the specific boundaries of the proposed annexation If the proposed annexation is one requiring submission to the county boundary commission[2a] this

[1] In the case of annexation and withdrawal unless otherwise indicated the petition requirements apply only to the area to be annexed or withdrawn

[2] In the case of annexation and withdrawal unless otherwise indicated the election is held only in the area to be annexed or withdrawn

[2a] A full discussion of county boundary commissions is included in the appendix of this report

TABLE XXII. BOUNDARIES PROVISIONS

A GENERAL ACT DISTRICTS

	Annexation[1]			Withdrawal[1]			Dissolution[1,2]		
	Petition[2]	Hearing	Election[3,4]	Petition[3]	Hearing	Election[3,4]	Petition[3]	Hearing	Election[4]
California water	Majority of landowners (including 50 percent of land)	Yes	Yes (districtwide) if board deems the annexation is not in the district's best interest, or if protest by 3 percent of district landowners or owners of 3 percent of assessed land value	Owners of all land	Yes	No, board action	Owners of ⅓ of land	No	Yes, ⅔ vote
							Involuntary Action by Attorney General for nonuse of powers[5]		
California water storage	Owners of 50 percent of land (to Department of Water Resources until July 1, 1965, to board thereafter	Yes (by Dept of Water Resources until July 1, 1965 by board thereafter)	Yes (districtwide) if protest by board or by 3 percent of district landowners (conducted by Department of Water Resources until July 1, 1965, by board thereafter)	Owners of all land (to Department of Water Resources until July 1, 1965, to board thereafter)	Yes (by Dept of Water Resources until July 1, 1965, by board thereafter)	No, action by Department of Water Resources until July 1 1965 by board thereafter	Majority of landowners (including majority of assessed land value) If inactive ⅔ of voters and owners of 50 percent of land and assessed land value	No	Yes, ⅔ vote
							Involuntary Action by Attorney General for nonuse of powers or by Department of Water Resources for failure to report on project within 10-25 years from formation date, abandonment of project, or failure of voters to approve project		
County water	Majority of voters or majority of landowners, (including 50 percent of land)	Yes	No, board action	Board resolution or owners of majority of assessed value of land and improvements	Yes	No, board action	40 percent of electors, or owners of 40 percent of assessed value of land and improvements (must be latter if debt exceeds 10 percent of assessed value of all property)[6]	Yes	Yes, 60 percent vote
	Uninhabited area[6] board resolution or owners of 25 percent of land and assessed land value	Yes	No, board action				Unanimous board action	Yes	No, action by board of supervisors

County water-works	Owners of 50 percent of land, or	Yes	Yes (districtwide and annex area)	Part of district may withdraw when included within a municipal corporation (prior to issuance of bonds and construction of works) Effective upon action of city and filing with county assessor, State Board of Equalization, and district board			50 residents	Yes	No, board resolution
	Owners of all land	Yes	No				Involuntary Whenever all of district is annexed to municipal corporations providing water service or whenever a city not providing water service upon incorporation includes all of district Effective when action dissolving district is filed with State Board of Equalization Also action by Attorney General for nonuse of powers.[5]		
	Uninhabited area 1 Owners of all land	Yes	Yes (districtwide and annex area)	Owners of 50 percent of land or by governing body of city to which area annexed	Yes	No, board action			
	2 Unincorporated contiguous land only owners of all real property	Yes	No						
Flood control and flood water conservation	No provision	--	--	No provision	--	--	(Government Code Sections 58950-58965 applicable—action by county officials for nonuse of powers)		
Irrigation	Majority of landowners (including 50 percent of land)	Yes	Yes (districtwide) if protest by 3 percent of district landowners (including 3 percent of district assessed land value)	Owners of 50 percent of land, or by governing body of city to which area annexed	Yes	No, board action	Majority of landowners (including majority of assessed land value) If inactive ⅔ of voters and owners of 50 percent of land and assessed land value	No	Yes, ⅔ vote
							Involuntary Action by Attorney General for nonuse of powers		
Municipal water (1911)	Voters equal to 10 percent of voters in last gubernatorial election (if cities, 10 percent in each)	No	Yes	Board resolution or voters equal to 10 percent of voters in last gubernatorial election (if cities, 10 percent in each)	Yes, if withdrawal initiated by board	Yes	25 percent of voters if bonded indebtedness paid (to county clerk)	Yes (by board of supervisors)	Yes (conducted by board of supervisors)
	Uninhabited area [3] board resolution or owners of 25 percent of land and assessed land value	Yes	No, board action	Uninhabited area [4] board resolution or owners of 25 percent of land and assessed land value	Yes	No, board action			

[1] Unless otherwise indicated district's governing body receives petition and conducts hearing and election
[2] Under appropriate circumstances districts may be dissolved for nonuse of powers under Government Code Section 58980
[3] Unless otherwise indicated petition and election only in area to be annexed or withdrawn
[4] Majority unless otherwise indicated In certain districts final board action on annexation or withdrawal is subject to referendum election
[5] If the district's taxes or assessments are both computed and collected by county officials, Government Code Sections 58950-58965 are applicable—action by county officials for nonuse of powers
[6] Less than 12 voters in residence

TABLE XXII. BOUNDARIES PROVISIONS—Continued

A. GENERAL ACT DISTRICTS—Continued

	Annexation[1]			Withdrawal[1]			Dissolution[1,2]		
	Petition[3]	Hearing	Election[3,4]	Petition[3]	Hearing	Election[3,4]	Petition	Hearing	Election[4]
Water conservation (1927)	Owners of all land (to board of supervisors)	Yes (by board of supervisors)	No, action by board of supervisors	Owners of all land (to board of supervisors)	Yes (by board of supervisors)	No, action by board of supervisors	50 landowners or owners of 50 percent of land (to board of supervisors)	Yes (by board of supervisors)	Yes 60 percent of total number of acres in district (conducted by board of supervisors)
							(Alternative method in Government Code Sections 58950-58965 also applicable—action by county officials for nonuse of powers)		
Water conservation (1931)	Majority of landowners (including 50 percent of the land)	Yes	Yes (districtwide) if board deems annexation is not in district's best interest, or if protest by 3 percent of district landowners (including 3 percent of assessed value of land in district)	Landowners (must be contiguous to exterior boundaries of district)	Yes	No, unanimous vote of board	10 percent of electors or owners of 50 percent of land (to board of supervisors)	Yes (by board of supervisors)	Yes, 60 percent (conducted by board of supervisors)
							(Alternative method in Government Code Sections 58950-58965 also applicable—action by county officials for nonuse of powers)		
Water replenishment	10 percent of voters	No	Yes	Board resolution or voters equal to 10 percent of voters in last gubernatorial election	Yes, if withdrawal initiated by board	Yes	25 percent of voters if bonded indebtedness paid (to county clerk)	No	Yes (conducted by board of supervisors)
B. SPECIAL ACT DISTRICTS									
1. County Flood Control and Water Conservation Districts									
Alameda	No provision	--	--	Cities only may withdraw	No	Yes (conducted by city council)	No provision	--	--
Contra Costa	No provision	--	--	Cities only may withdraw	No	Yes (conducted by city council)	No provision	--	--
Lake	No provision	--	--	Cities only may withdraw	No	Yes (conducted by city council)	No provision	--	--
Lassen-Modoc	No provision	--	--	No provision	--	--	200 voters[7]	No	Yes, ⅔ vote

Marin	No provision	--	--	Cities only may withdraw	No	Yes (conducted by city council)	No provision	--	--
Mendocino	No provision	--	--	No provision	--	--	No provision	--	--
Monterey	No provision	--	--	No provision	--	--	No provision	--	--
Napa	No provision	--	--	No provision	--	--	No provision	--	--
Plumas	No provision	--	--	No provision	--	--	200 voters[7]	No	Yes, ⅔ vote
Riverside	No provision	--	--	No provision	--	--	No provision	--	--
San Benito	(Limited to the county) 50 landowners (50 percent if less than 100 in area)	Yes	Yes, if in discretion of board	50 landowners (50 percent if less than 100 in area)	Yes	Yes, if in discretion of board	(Alternative method in Government Code Sections 58950-58965 also applicable—action by county officials for nonuse of powers)	--	--
San Joaquin	No provision	--	--	Cities only may withdraw	No	Yes (conducted by city council)	No provision	--	--
San Luis Obispo	No provision	--	--	No provision	--	--	No provision	--	--
Santa Barbara	No provision	--	--	No provision	--	--	No provision	--	--
Santa Clara	No provision	--	--	No provision	--	--	No provision	--	--
Santa Cruz	No provision	--	--	No provision	--	--	No provision	--	--
Sierra	No provision	--	--	No provision	--	--	200 voters[7]	No	Yes, ⅔ vote
Siskiyou	10 percent of voters[8]	Yes	Yes, if protest by 30 percent of voters	No provision	--	--	200 voters[7]	No	Yes, ⅔ vote
Solano	No provision	--	--	No provision	--	--	20 voters[9]	No	Yes, ⅔ vote
Sonoma	No provision	--	--	No provision	--	--	No provision	--	--
Tehama	No provision	--	--	No provision	--	--	200 voters[7]	No	Yes, ⅔ vote
Yolo	No provision	--	--	Owners of majority of assessed land value	Yes (also investigation by Department of Water Resources)	No, board action	No provision	--	--

[1] Unless otherwise indicated, district's governing body receives petition and conducts hearing and election
[2] Under appropriate circumstances, districts may be dissolved for nonuse of powers under Government Code Section 58980
[3] Unless otherwise indicated petition and election only in area to be annexed or withdrawn
[4] Majority unless otherwise indicated In certain districts final board action on annexation or withdrawal is subject to referendum election
[7] Incorporates the article on dissolution in the District Organization Law Government Code Sections 58300-58309, except for petition by 20 voters
[8] Incorporates the article on annexation in the District Organization Law, Government Code Sections 58230-58248, which requires the district act to set the number of petitioners for petition and protest
[9] Incorporates the article on dissolution in the District Organization Law, Government Code Sections 58300-58309

TABLE XXII. BOUNDARIES PROVISIONS—Continued

B SPECIAL ACT DISTRICTS—Continued

2 Flood Control Districts

	Annexation[1]			Withdrawal[1]			Dissolution[1 2]		
	Petition[2]	Hearing	Election[3 4]	Petition[2]	Hearing	Election[3 4]	Petition	Hearing	Election[4]
American River	25 percent of voters	Yes	Yes (districtwide in certain circumstances)	No provision	--	--	No provision	--	--
Del Norte County	No provision	--	--	No provision	--	--	No provision	--	--
Fresno Metropolitan	Board resolution or 25 percent of landowners (including 25 percent of land)	Yes	Yes, if protest by over 25 percent of landowners	Board resolution or 25 percent of landowners (including 25 percent of land)	Yes	Yes, if protest by over 25 percent of landowners	No provision	--	--
Humboldt County	No provision	--	--	No provision	--	--	No provision	--	--
Los Angeles County	No provision	--	--	No provision	--	--	No provision	--	--
Morrison Creek	No provision	--	--	No provision	--	--	No provision	--	--
Orange County	No provision	--	--	No provision	--	--	No provision	--	--
San Bernardino County	No provision	--	--	No provision	--	--	No provision	--	--
San Diego County	No provision	--	--	No provision	--	--	No provision	--	--
San Mateo County	No provision	--	--	No provision	--	--	No provision	--	--
Ventura County	No provision	--	--	No provision	--	--	No provision	--	--
3 Water Agencies									
Alpine County	Majority of landowners (including 50 percent of land)	Yes	Yes (districtwide) if protest by 3 percent of district landowners (including 3 percent of district assessed land value)	No provision	--	--	Incorporates Government Code Sections 58950-58980, providing for dissolution for nonuse of powers by county officials by court action and by board of supervisors by resolution		

Amador County	No provision	--	--	No provision	--	--	Incorporates Government Code Sections 58950-58980, providing for dissolution for nonuse of powers by county officials by court action and by board of supervisors by resolution.		
Antelope Valley-East Kern	Voters equal to 10 percent of voters in last gubernatorial election (if cities, 10 percent in each)	No	Yes	Board resolution or 25 percent of landowners and 51 percent of voters (if cities, 51 percent of voters in each)	Yes	Yes, agencywide	25 percent of voters, if bonded indebtedness paid (to county clerk of principal county)	No	Yes (conducted by board of supervisors of principal county)
	Uninhabited area [3] Board resolution or owners of 25 percent of land and assessed land value	Yes	No, board action	Uninhabited area [3] Board resolution or owners of 25 percent of land and assessed land value	Yes	No, board action			
Contra Costa County	No provision	--	--	No provision	--	--	20 voters[5]	No	Yes, ⅔ vote
Crestline-Lake Arrowhead	Voters equal to 10 percent of voters in last gubernatorial election (if cities, 10 percent in each)	No	Yes	Board resolution or voters equal to 10 percent of voters in last gubernatorial election (if cities, 10 percent in each)	Yes	Yes	25 percent of voters, if bonded indebtedness paid (to county clerk of principal county)	No	Yes (conducted by board of supervisors of principal county)
	Uninhabited area [3] Board resolution or owners of 25 percent of land and assessed land value	Yes	No, board action	Uninhabited area [3] Board resolution or owners of 25 percent of land and assessed land value	Yes	No, board action			
Desert	Voters equal to 10 percent of voters in last gubernatorial election	No	Yes	Board resolution or voters equal to 10 percent of voters in last gubernatorial election (if cities, 10 percent in each)	Yes	Yes	Voters equal to 25 percent of voters in last gubernatorial election (to county clerk of principal county)	No	Yes (conducted by board of supervisors of principal county)
	Uninhabited area [3] Board resolution or owners of 25 percent of land and assessed land value	Yes	No, board action	Uninhabited area [3] Board resolution or owners of 25 percent of land and assessed land value	Yes	No, board action			

[1] Unless otherwise indicated district's governing body receives petition and conducts hearing and election
[2] Under appropriate circumstances districts may be dissolved for nonuse of powers under Government Code Section 58980
[3] Unless otherwise indicated petition and election only in area to be annexed or withdrawn
[4] Majority unless otherwise indicated. In certain districts final board action on annexation or withdrawal is subject to referendum election
[5] Less than 12 voters in residence
[6] Incorporates the article on dissolution in the District Organization Law, Government Code Sections 58300-58308.

TABLE XXII. BOUNDARIES PROVISIONS—Continued

B. SPECIAL ACT DISTRICTS—Continued

3. Water Agencies—Continued

	Annexation[1]			Withdrawal[1]			Dissolution[1,2]		
	Petition[3]	Hearing	Election[3,4]	Petition[3]	Hearing	Election[3,4]	Petition	Hearing	Election[4]
El Dorado County	No provision	--	--	No provision	--	--	Incorporates Government Code Sections 58950-58980, providing for dissolution for nonuse of powers by county officials by court action and by board of supervisors by resolution		
Kern County	No provision	--	--	No provision	--	--	Incorporates Government Code Sections 58950-58980, providing for dissolution for nonuse of powers by county officials by court action and by board of supervisors by resolution		
Mariposa County	No provision	--	--	No provision	--	--	Incorporates Government Code Sections 58950-58980, providing for dissolution for nonuse of powers by county officials by court action and by board of supervisors by resolution		
Mojave	Voters equal to 10 percent of voters in last gubernatoral election (if cities, 10 percent in each)	No	Yes	Board resolution or owners of majority of assessed value of land and improvements	Yes	No, action by board	20 voters[5]	No	Yes, ⅔ vote
	or owners of 75 percent of assessed land value	Yes	No, order of board of Supervisors of San Bernardino County						
Nevada County	Majority of landowners (including 50 percent of land)	Yes	Yes, (districtwide) if protest by 3 percent of district landowners (including 3 percent of district assessed land value)	No provision	--	--	Incorporates Government Code Sections 58950-58980, providing for dissolution for nonuse of powers by county officials by court action and by board of supervisors by resolution		
Placer County	No provision	--	--	No provision	--	--	Incorporates Government Code Sections 58950-58980, providing for dissolution for nonuse of powers by county officials by court action and by board of supervisors by resolution		
Sacramento County	No provision	--	--	No provision	--	--	20 voters[5]	No	Yes, ⅔ vote

San Gorgonio Pass	Voters equal to 10 percent of voters in last gubernatorial election	No	Yes	Board resolution or voters equal to 10 percent of voters in last gubernatorial election (if cities 10 percent in each)	Yes	Yes	Voters equal to 25 percent of voters in last gubernatorial election (to county clerk in principal county)	No	Yes (conducted by board of supervisors in principal county)
	Uninhabited area [5] Board resolution or 25 percent of owners of land and assessed land value	Yes	No, board action	Uninhabited area [5] Board resolution or 25 percent of owners of land and assessed land value	Yes	No, board action			
Santa Barbara County	No provision	--	--	No provision	--	--	20 voters[9]	No	Yes, ⅔ vote
Shasta County	No provision	--	--	No provision	--	--	No provision	--	--
Sutter County	No provision	--	--	No provision	--	--	Incorporates Government Code Sections 53950-53980, providing for dissolution for nonuse of powers by county officials by court action and by board of supervisors by resolution		
Upper Santa Clara Valley	Voters equal to 10 percent of voters in last gubernatorial election	No	Yes	Board resolution or voters equal to 10 percent of voters in last gubernatorial election (if cities 10 percent in each)	Yes	Yes	Voters equal to 25 percent of voters in agency in last gubernatorial election, if bonded indebtedness paid (to county clerk of principal county)	Yes (by board of supervisors of principal county)	Yes (conducted by board of supervisors of principal county)
	Uninhabited area [5] Board resolution or 25 percent of owners of land and assessed land value	Yes	No, board action	Uninhabited area [5] Board resolution or 25 percent of owners of land and assessed land value	Yes	No, board action			
Yuba County	No provision	--	--	No provision	--	--	Incorporates Government Code Sections 53950-53980, providing for dissolution for nonuse of powers by county officials by court action and by board of supervisors by resolution		

[3] Unless otherwise indicated, district's governing body receives petition and conducts hearing and election
[5] Under appropriate circumstances districts may be dissolved for nonuse of powers under Government Code Section 58889
[8] Unless otherwise indicated, petition and election only in area to be annexed or withdrawn
[4] Majority unless otherwise indicated In certain districts final board action on annexation or withdrawal is subject to referendum election.
[9] Less than 12 voters in residence
[6] Incorporates the article on dissolution in the District Organization Law, Government Code Sections 58300-58309.

TABLE XXII. BOUNDARIES PROVISIONS—Continued

B. SPECIAL ACT DISTRICTS—Continued

4 Other

	Annexation[1]			Withdrawal[1]			Dissolution[1 2]		
	Petition[3]	Hearing	Election[3 4]	Petition[3]	Hearing	Election[3 4]	Petition	Hearing	Election[4]
Kings River Conservation District	Voters equal to 10 percent of voters in last gubernatorial election	Yes	Yes	In city Owners of majority of land	Yes	No, board action	No provision	--	--
				Other Owners of majority of assessed land value	Yes	No, board action			
Orange County Water District	Majority of landowners, and 50 percent of land	Yes	Yes, if protest by 3 percent of landowners of district (also owning 3 percent of land value), or if board deems annexation is not in district's best interest (districtwide)	All landowners	Yes	No, board action	No provision	--	--
Palo Verde Irrigation District	Owners of 50 percent of land	Yes	Yes, (districtwide) if protest or if board deems annexation is not in district's best interest	Same as Irrigation District Law, as amended, on January 1, 1923			Majority of landowners (including majority of assessed land value) If inactive 2/3 of voters and owners of 50 percent of land and assessed land value	No	Yes, 3/4 vote
							Involuntary Action by Attorney General for nonuse of powers		

[1] Unless otherwise indicated, district's governing body receives petition and conducts hearing and election
[2] Under appropriate circumstances districts may be dissolved for nonuse of powers under Government Code Section 58950
[3] Unless otherwise indicated petition and election only in area to be annexed or withdrawn
[4] Majority unless otherwise indicated In certain districts final board action on annexation or withdrawal is subject to referendum election

action must be taken following the filing with the formation commission A copy of the boundary commission report is then submitted to the formation commission

As with formation proceedings, the formation commission then holds a public hearing on the proposed annexation A number of factors are required to be taken into consideration by the commission when reviewing the proposal. If the formation commission disapproves the annexation, all further proceedings are terminated and no notice of intention to annex "the same or substantially the same territory" may be filed with the commission for one year after disapproval [25] If the commission approves the annexation proposal, the regular procedures in the general district act are then followed

The various requirements include: a majority of landowners, holding a majority of the land (California water, irrigation, and water conservation (1931)); owners of a majority of the land (California water storage and county waterworks); owners of all land (water conservation (1927)); and either a majority of landowners, who also are owners of a majority of land, or a majority of voters (county water)

The County Waterworks District Act, the County Water District Act, and the Municipal Water District Act of 1911 each provide different petition, hearing and election requirements for uninhabited area (defined as area with less than 12 voters in residence). Generally no elections are held in these cases

All district acts except the Municipal Water District Act (with respect to annexation of inhabited area) and the Water Replenishment District Act (and County Waterworks District Act when owners of *all* land sign petition) expressly require a public hearing on the annexation petition. Hearings for water storage districts are conducted by the Department of Water Resources (until July 1, 1965—by the district board thereafter) and for water conservation districts (1927) by the county board of supervisors. The governing bodies of all other districts conduct these hearings

Only the County Waterworks District Act, the Municipal Water District Act of 1911 and the Water Replenishment District Act require that an election always be held on the proposed annexation Municipal water district and water replenishment district elections are in the area to be annexed only and county waterworks district elections are held in the existing district and the area to be annexed

The California Water District Act requires an election if owners of 3 percent of the district's assessed value or 3 percent of the district landowners protest The Irrigation District Act, and the Water Conservation Act of 1931 require an election only if protests to the annexation are filed by 3 percent of the district landowners (including 3 percent of the assessed land value in the district) All these elections are district wide. The California Water District Act and Water Conservation Act of 1931 also permit the board to order an election if it deems the proposal not in the best interests of the district. The California Water Storage District Act requires an election if the board protests or if 3 percent of the district landowners protest The County Water District Act requires only board action (this action is subject to a normal referendum election procedure, however).

[25] Section 54767, Government Code.

Special Act Districts

As was explained in the discussion of formation of special act districts, the area and boundaries of these districts are always specified in the original special district act which is enacted by the Legislature In many cases these are countywide districts. As a result only 13 of the 55 special district acts in this study include provisions for annexation of additional territory at the local level (additional territory can be added to the district, of course, by legislative amendment of the special district act).

The San Benito and Siskiyou County Flood Control and Water Conservation District Acts each provide for annexation. The San Benito District Act requires a petition signed by 50 landowners or 50 percent of the landowners (if less than 100 in area). A hearing is required but an election is at the discretion of the board (The San Benito district act may not annex outside of the county.) The Siskiyou district act incorporates the annexation provisions of the District Organization Law

Of the special act flood control districts, only the Fresno Metropolitan District Act and the American River District Act include annexation provisions In the case of the Fresno district, the governing body of the district may initiate the proceedings (which also may be initiated by a petition signed by 25 percent of the landowners including 25 percent of the land) Provision is made for a hearing and an election is held if there is a protest by more than 25 percent of the landowners in the area to be annexed The American River District requires a petition of 25 percent of the district voters and requires both a hearing and an election.

Eight of the special water agency acts have annexation procedures (Alpine County, Antelope Valley-East Kern, Crestline-Lake Arrowhead, Desert, Nevada County, Mojave, San Gorgonio Pass and Upper Santa Clara Valley) All require a petition signed by voters equal to 10 percent of the voters in the last gubernatorial election except the Alpine Act, which requires a majority of landowners (including a majority of land) and the Nevada Act in which the provisions are identical to those of the Irrigation District Act. The Alpine County Water Agency Act expressly requires a public hearing with an election required only if a protest is filed by 3 percent of the district landowners, including 3 percent of the land All six other agencies do not require a hearing but do require an election in the area to be annexed Five of these agency acts also establish special procedures for annexation of uninhabited area However, the Mojave Water Agency Act contains an alternative procedure for annexation under which owners of 75 percent of the assessed value may petition A hearing is held and annexation is ordered by the board of supervisors

Of the other special water district acts, the Kings River Conservation District, the Orange County Water District and the Palo Verde Irrigation District Acts all permit annexation.

The extent to which special districts may annex additional territory is exemplified by the Antelope Valley-East Kern Water Agency, which annexed 68,000 acres in the first eight months of 1962 alone [8]

[8] Feather River Project Association, *Newsletter*, August 30, 1962, p 4

WITHDRAWAL (Exclusion)

The provisions for withdrawal (termed "exclusion" in some acts) differ between districts as greatly as those of annexation.

When the governing body is charged with making the decision whether or not to permit a proposed withdrawal, it is usually required to use two principal criteria regarding the withdrawal: (1) Is it in the best interest of the district to permit the withdrawal? and (2) Will the area proposed to be withdrawn be substantially and directly benefited by continued inclusion in the district?

General Act Districts

As with annexation, 9 of the 10 general district acts (again excluding Flood Control and Flood Water Conservation District Act) provide for the withdrawal of territory from a district. (See Table XXII.)

The petition requirements for withdrawal are even greater than those for annexation Three general district acts (California water, California water storage and water conservation of 1927) require that owners of *all* the land in the area to be withdrawn sign withdrawal petitions and no election is required. The Irrigation District Act and County Water District Act require petitions to be signed by the owners of a majority of land and land and improvements respectively Two district acts (municipal water of 1911 and water replenishment) require petitions to be signed only by voters equal to 10 percent of the voters at the last gubernatorial election The Water Conservation Act of 1931 sets no minimum number of signatures for withdrawal petitions The County Waterworks District Act includes special provisions for the involuntary withdrawal of part of a district only when it is included within an incorporated city as county waterworks districts are primarily for unincorporated areas 1963 amendments to this act permit exclusion pursuant to the provisions of the Irrigation District Act

Three district acts (county water, municipal water of 1911 and water replenishment) permit withdrawal proceedings to be initiated by the governing body of the district Hearings are required in municipal water district and water replenishment district withdrawal proceedings if the proceedings were initiated by the board, and hearings are required in county water district withdrawal proceedings whether the proceedings were initiated by a petition or by the board Elections are required in municipal water district and water replenishment district withdrawal proceedings

In the remaining district acts permitting withdrawal, hearings are required and final action is taken without an election

As with formation and annexation, the Department of Water Resources receives petitions, conducts hearings and makes final decisions on withdrawal for water storage districts The county board of supervisors performs these functions for water conservation districts of 1927.

The Irrigation District Act also authorizes a city to which part of an irrigation district has annexed to begin withdrawal action.

The Municipal Water District Act of 1911 is the only general district act to establish separate petition, hearing and election requirements for withdrawal of uninhabited area.

Special Act Districts

Of the special county flood control and water conservation district acts, five (Alameda, Contra Costa, Lake, Marin and San Joaquin) include provisions that only cities may withdraw from the district, with no hearing required and the election conducted by the city council. The San Benito District Act provides for a petition, hearing and election and its withdrawal provisions are identical to its provisions for annexation. The Yolo County District Act is somewhat unusual. The petition must be signed by owners of a majority of the assessed land value. A hearing is required as well as an investigation by the Department of Water Resources Board action, rather than an election, is necessary to complete the withdrawal.

As with annexation, the Fresno Metropolitan Flood Control District Act is the only special flood control district act with withdrawal procedures, which in this case are also identical to provisions for annexation.

Six of the water agency acts have withdrawal provisions. Four of these agency acts (Crestline-Lake Arrowhead, Desert, San Gorgonio Pass and Upper Santa Clara Valley) require a petition signed by voters equal to 10 percent of the votes at the last gubernatorial election, or withdrawal may be instituted by the agency board. (If cities are included in the area to be withdrawn the petition must include 10 percent in each city.) These four district acts all require a public hearing and an election.

The Mojave Water Agency Act provides for withdrawal by board action following a public hearing. Either the board or petitions signed by owners of a majority of assessed value of land and improvements may commence such action.

Similar provisions in the Antelope Valley-East Kern Water Agency Act were amended by the Legislature in 1961 and withdrawal was made much more difficult. This agency act now requires a petition of 25 percent of the landowners and 51 percent of the voters (with 51 percent of voters in each city involved) or board action to commence withdrawal proceedings. A hearing is required as well as an agencywide election. The Antelope Valley-East Kern, Crestline-Lake Arrowhead, Desert, San Gorgonio Pass and Upper Santa Clara Valley Water Agency Acts all provide identical additional procedures for withdrawal of uninhabited area.

Of the other special water district acts, the Kings River Conservation District Act provides two types of petitions for withdrawal, both requiring a hearing, with the board making the final decision. In cities, petitions must be signed by owners of a majority of land and in unincorporated areas, the owners of a majority of the assessed value of the area to be withdrawn. The Orange County Water District Act requires a petition signed by all landowners. A hearing is required and final action is taken by the board. The Palo Verde Irrigation District is governed by provisions of the Irrigation District Act as they existed on January 1, 1923.

DISSOLUTION

The dissolution of districts (termed "disincorporation" or "disorganization" by some district acts) can be accomplished in a number of ways These provisions for all districts are included in Table XXII

Involuntary

There are several involuntary methods of dissolution. First, general and special act districts may be subject to the "automatic dissolution" provisions of the Government Code (Section 58980) which provides:

> "58980. When any tax, assessment, or any other district has no outstanding obligations, owns no property, and for five years has not collected taxes or other revenues or disbursed any district funds or otherwise exercised district powers it shall be dissolved by resolution of the board of supervisors of the county in which the office of such district is located Not less than 30 days prior to the adoption of the dissolution resolution the clerk of the board of supervisors shall send notice to the last known principal place of business of the district that under the provisions of this article will on a specified date consider a dissolution resolution concerning the district. Such district shall be deemed to be dissolved upon the filing of a certified copy of the resolution of dissolution with the Secretary of State, the State Board of Equalization and with the county clerk and assessor of each county in which any portion of such district is located."

Another article of the Government Code, "alternative method of dissolution of districts" (Sections 58950-58965) applies only to districts "whose taxes or assessments are computed and collected by county officers" and results in involuntary dissolution The district must not be in debt and it must not have exercised its powers for three years Other requirements must also be met by districts to be dissolved under these provisions Under these provisions, the county official required by law to compute or collect the district's taxes may file a request with the board of supervisors asking that the district be dissolved The board must hold a hearing on the request and if it is granted, the district attorney brings a court action to dissolve the district

A third method of involuntary dissolution for nonuse of powers is by the Attorney General This is provided for by specific provisions in the California Water District, County Waterworks District and Irrigation District Acts A hearing is required. The provisions of these three different acts vary somewhat in detail

As discussed elsewhere in this report, the District Organization Law (Sections 58000-58309, Government Code) establishes procedures for dissolution as well as formation, annexation, withdrawal and merger Some district acts expressly incorporate one or more procedures from this law

At least four special act districts have never been organized on the local level following their enactment by the Legislature and are now inactive It is obvious that if proceedings under any of these involuntary provisions succeed in dissolving these districts, new special enactments of the Legislature would be necessary to create the districts again.

Voluntary

In 1961 the Legislature added a new article to the Government Code (Sections 58990-58997) providing for "dissolution by supervisors." This provision is in addition to all other procedures for dissolution This provision for dissolution is commenced by resolution of the district board (passed unanimously) The resolution is presented to the board of supervisors

To be eligible for dissolution in this manner, a district (1) must have no indebtedness; (2) must not be serving customers or rendering services; (3) must have no property works or assets except unexpended cash reserves; (4) the board has determined that no useful purpose would be served by continued existence of the district, (5) the district has not or will not submit a budget for the tax year in which the dissolution is requested The supervisors must then hold a public hearing The district may not be dissolved under this article if a written protest of 10 percent of the registered voters of the district is filed Following the dissolution, notice of this action is filed with the Secretary of State and the county assessor

General Act Districts

In addition to these voluntary and involuntary provisions in the Government Code, 9 of the 10 general district acts (The only exception is the Flood Control and Flood Water Conservation District Act) also contain specific procedures for dissolution In most cases these follow the general pattern of petition, hearing and election (or board action)

The Irrigation District and the California Water Storage District Acts require petitions signed by a majority of landowners including a majority of assessed land value (The California Water Storage District Act incorporates the irrigation district provisions) No hearing is required but a two-thirds majority is required to dissolve the district For inactive irrigation districts and water storage districts the petition must include two-thirds of the voters and owners of a majority of the land and the assessed land value of the district

The California Water District Act requires a petition signed by owners of one-third of the land in the district, no hearing, and a two-thirds majority at an election to dissolve a district

The County Water District Act requires petitions signed by 40 percent of the voters or owners of 40 percent of the assessed value of the land and improvements of the district If the district indebtedness exceeds 10 percent of the assessed value of land and improvements of the district, the petition must be signed by owners of 40 percent of the assessed value A hearing and a 60 percent majority vote are required to approve the dissolution The County Water District Act also provides an alternative procedure for dissolution by the county board of supervisors The board of the district may, in a unanimous action, request the supervisors to dissolve the district. The district must be inactive and meet certain conditions very similar to those in the "dissolution by supervisors" provisions of the Government Code A hearing is required and final action is taken by the supervisors The district may not be dissolved under this alternative procedure if written protest of 10 percent of the registered voters of the district is filed

The Municipal Water District and Water Replenishment District Acts require a petition signed by 25 percent of the district voters and the bonded indebtedness of the district must be paid in order to be dissolved A hearing is required only for municipal water districts and for both districts a simple majority election is necessary for approval of dissolution The county clerk receives this petition and the hearing and election are conducted by the board of supervisors

The Water Conservation Acts of 1927 and 1931 have slightly different dissolution provisions, although the board of supervisors directs the procedures The 1927 act requires a petition by 50 landowners or owners of 50 percent of the district land The 1931 act requires 10 percent of the district electors or owners of 50 percent of the land to petition. A hearing and election is required by both acts. The 1927 act requires approval by voters representing 60 percent of the total number of acres in the district, while the 1931 act requires a 60 percent majority of the votes cast

The County Waterworks District Act provides for both voluntary and involuntary dissolution Voluntary dissolution requires a petition by 50 residents A hearing is required and then final dissolution action is taken by the governing body

The involuntary dissolution occurs under two conditions. First, whenever a district is annexed to, or included within, a municipality providing water service the city council may dissolve the waterworks district Second, whenever a city, at the time of incorporation, does not have facilities for serving its residents with water and when a county waterworks district serving the city is completely within the boundaries of the city, the city council may dissolve the district

Special Act Districts

An involuntary form of dissolution of special act districts, of course, is legislative repeal of the special district act

A number of special district acts, however, do have regular provisions for dissolution and many expressly incorporate several of the Government Code provisions for dissolution

Six special County Flood Control and Water Conservation District Acts (Lassen-Modoc, Plumas, Sierra, Siskiyou, Solano and Tehama) incorporate the District Organization Law dissolution procedures (several increase the required number of petition signatures from 20 to 200). Under these provisions no hearing is held and a two-thirds majority is required at an election The San Benito district incorporates the "alternative method of dissolution of districts". The other 12 district acts of this type have no such provisions, and none of the special act Flood Control District Acts has provisions for dissolution.

Eighteen of the 19 special act Water Agency Acts include dissolution procedures Nine of these agency acts (Alpine County, Amador County, El Dorado County, Kern County, Mariposa County, Nevada County, Placer County, Sutter County and Yuba County) expressly incorporate both the "automatic dissolution" provisions (Section 58980, Government Code) and the "alternative method of dissolution of districts" (Sections 58950-58965, Government Code) which were treated above in the discussion of involuntary dissolution.

Four agency acts modeled on the Municipal Water District Act of 1911 (Antelope Valley-East Kern, Crestline-Lake Arrowhead, Desert and San Gorgonio Pass) utilize the petition and election provisions of the act (discussed above under general district acts) but differ slightly in that they do not require a hearing The Upper Santa Clara Valley Water Agency Act incorporates the Municipal Water District Act provisions without change.

Four water agency acts (Contra Costa County, Mojave, Sacramento County and Santa Barbara County) also incorporate the dissolution provisions of the District Organization Law.

Of the other special district acts, the Kings River Conservation District and the Orange County Water District Acts have no dissolution provisions and the Palo Verde Irrigation District Act incorporates the provisions of Irrigation District Law.

CONSOLIDATION AND MERGER

In the various water district acts in this study there is some confusion of the terms consolidation and merger, which are often used interchangeably In this study both shall be considered to mean the same. That is, the combining of two or more districts into one district.

Part of the District Organization Law (Sections 58260-58269, Government Code) provides the only general consolidation provisions applicable to water districts At the present time no water district acts authorize use of these provisions, which apply only to districts formed under the same general district act There are no provisions in the law for the consolidation of districts formed under different general acts and this must be accomplished by special act of the Legislature. The Costa Mesa County Water District and the Coachella County Water District were both formed by special act and were the result of the consolidation of several districts formed under different general district acts

General Act Districts

Nine of the 10 general district acts (flood control and flood water conservation districts are the only exception) include provisions for consolidation or merger of two or more districts formed under the same general district act[4] Prior to 1963, only three (county water, county waterworks and irrigation districts) districts had these powers. At the request of this committee the other six district acts were amended to permit consolidation pursuant to the County Water District Act (Statutes of 1963, Chapter 163, Assembly Bill 344, and also Chapter 2132, Assembly Bill 2232). In a further confusion of these terms, the Irrigation District Act and the Water Conservation Act of 1931 include provisions for "annexation" of a complete district by another district. (This is really a "merger" with one district losing its identity into the other) The Legislative Counsel has ruled a consolidation or merger must be approved by the local agency formation commission[5]

The procedures for consolidation or merger in the Irrigation and County Water District Acts are substantially similar. The first step is a resolution by the boards of all affected districts indicating the de-

[4] The irrigation district provisions were first enacted in 1921.
[5] Opinion No. 710 (September 4, 1963).

sirability of merger. Both acts provide that this action may be taken by the board on its own motion or if requested by a petition meeting the same requirements as a petition for formation of a district. The boards involved must then agree upon a name for the new district and the elective offices to be utilized by the new district, and this must be included in the board resolution (a copy of this resolution must be forwarded to the Department of Water Resources).

The Department of Water Resources is authorized then to "make or cause to be made any investigation that it deems necessary "[6] Within 90 days the department must submit a report to each board recommending boundaries for the consolidated or merged district and apportionment of the outstanding indebtedness of the districts Under the Irrigation District Act, the affected boards meet jointly to hear protests and set boundaries, etc An election is then held with a majority required in each district to be consolidated or merged.

The County Waterworks District Act provides for initiation of consolidation or merger proceedings by the county board of supervisors (which is normally the governing body). The supervisors can consolidate or merge only those districts for which it is the governing body. A public hearing is required and if 50 percent of the registered voters in any one of the districts to be consolidated file a written protest, consolidation or merger of that district must be terminated but consolidation or merger of other districts may continue.

The actual consolidation or merger is voted by the board of supervisors and an election is not required The County Waterworks District Act also includes an interesting provision whereby "Two or more waterworks districts governed by their own governing boards may enter into agreements wherein and whereby such districts may be consolidated for all operational purposes upon such terms as such governing boards shall agree upon. . . ."[7]

The provisions of the Irrigation District Act providing for the annexation of one irrigation district to another irrigation district are substantially similar to the provisions for consolidation or merger of the same act.

The nine general district acts providing for consolidation or merger include procedures to provide for distribution of the outstanding indebtedness of districts involved in consolidation or merger Table XXIII below summarizes the various consolidation provisions

Special Act Districts

None of the special district acts in this study provide for consolidation or merger with other districts Such actions have been accomplished in the past only through enactment of another special act.

JOINT EXERCISE OF POWERS

In 1921 the Legislature enacted the Joint Exercise of Powers Act.[8] Under this act, two or more public agencies, if authorized by their governing bodies, by agreement may jointly exercise any power common to the contracting parties, even though one or more of the contracting agencies is located outside this State.

[6] Sections 27175 and 32670, Water Code
[7] Sections 55971, Water Code.
[8] Sections 6500-6578, Government Code.

TABLE XXIII. CONSOLIDATION PROVISIONS OF GENERAL DISTRICT ACTS

	Petition	Report	Hearing	Election*
California Water	Owners of majority of land area (if noncontiguous areas, owners of majority of assessed value of land in each area) or board action alone (of all consolidating districts)	Yes, by Department of Water Resources or board of supervisors (if districts located in one county)	No	Yes
California Water Storage	Majority of landowners (including majority of assessed land value) or 500 landowners (including 10 percent of assessed land value) or board action alone (of all consolidating districts)	Yes, by Department of Water Resources or board of supervisors (if districts located in one county)	No	Yes
County Water	10 percent of voters or board action alone (of all consolidating districts)	Yes, by Department of Water Resources or board of supervisors (if districts located in one county)	No	Yes
County Waterworks	25 percent of resident landowners or 25 percent of resident and nonresident landowners (including 15 percent of resident landowners) or board action alone (of all consolidating districts)	Yes, by Department of Water Resources or board of supervisors (if districts located in one county)	No	Yes
Flood Control and Flood Water Conservation	No provision	--	--	--
Irrigation	Majority of landowners (including majority of assessed land value), or 500 petitioners (electors or landholders) including owners of 20 percent of assessed land value or board action alone (of all consolidating districts)	Yes, by Department of Water Resources	Yes	Yes
	Annexation of one district by another No, action by board of annexing district	Yes, by Department of Water Resources	Yes (combined boards must, at this time, by majority vote of each board approve annexation)	Yes
Municipal Water (1911)	10 percent of voters (if cities, 10 percent in each) or board action alone (of all consolidating districts)	Yes, by Department of Water Resources or by board of supervisors (if districts located in one county)	No	Yes

TABLE XXIII. CONSOLIDATION PROVISIONS OF GENERAL DISTRICT ACTS—Continued

	Petition	Report	Hearing	Election*
Water Conservation (1927)	50 landowners or owners of majority of land area or board action alone (of all consolidating districts)	Yes, by Department of Water Resources or by board of supervisors (if districts located in one county)	No	Yes
Water Conservation (1931)	500 voters or 20 percent of voters or board action alone (of all consolidating districts)	Yes, by Department of Water Resources or by board of supervisors (if districts located in one county)	No	Yes
	Annexation of one district by another 500 voters or 5 percent of voters, or board action	No	No	Yes, in district to be annexed Final action is by board of district annexing Election optional in district annexing, except that if protest by 3 percent or 1 000 voters of district annexing election is required
Water Replenishment	10 percent of voters (if more than one county, 10 percent in each county) or board action alone (of all consolidating districts)	Yes, by Department of Water Resources or board of supervisors (if districts located in one county)	No	Yes

* Unless otherwise indicated, requires a majority vote in each consolidating district

"Public agency," as defined in the act, includes the federal government, any federal department or agency, the State, an adjoining state, any state department or agency, a county, city, public corporation or public district of California or an adjoining state The act specifies in detail what must be included in an agreement and the agency or entity provided by the agreement to execute the agreement need not be one of the parties to the agreement

There are a number of examples of use of this act by water districts Recently it has been suggested that this act could be used to effect basinwide ground water management where a number of public agencies are involved

In one case, the Joint Exercise of Powers Act was used by a county waterworks district and an irrigation district The water plant of the waterworks district was operated by the irrigation district In another case, a county and an irrigation district jointly acquired and provided a water supply

It would seem that a great many possibilities for joint action by different types of districts are possible under this act It would also seem that much more use of this act could be made than has been in the past

APPENDIXES

APPENDIX A

CALIFORNIA LEGISLATURE
ASSEMBLY INTERIM COMMITTEE ON WATER

WATER DISTRICT LAWS STUDY QUESTIONNAIRE

Instructions

Please return in the accompanying post-paid, self-addressed envelope by Friday, May 25, 1962

Please answer directly on the questionnaire Attach additional sheets if necessary

In this questionnaire the terms "general district act" and "special district act" are used as follows A "*general district act*" is an enabling statute which does not create any district in particular but rather sets forth the organization and procedure under which a district may be created locally (an example is the Irrigation District Law of 1897) A "*special district act*" is that type of act by which the Legislature specifically creates a particular district (an example of this type is the Kern County Water Agency Act of 1961)

Please answer all questions as completely as possible; all replies will be kept confidential

QUESTIONS TO BE ANSWERED BY ALL DISTRICTS

1 How many directors does your district have?_____

2. Have your district's eminent domain provisions proved satisfactory?

If not, why, and what changes would be desirable?_____

3. What are your district's maximum assessment limitations (cents per $100 assessed valuation)?_____
What rate are you presently using?_____

4 (a) What are your district's methods of financing (for example, general obligation bonds, revenue bonds, warrants, notes, etc)?

And for what purposes?_____

WATER DISTRICT LAWS STUDY QUESTIONNAIRE—Continued

(b) What maturity periods does your district use for each method?
_____
_____
_____

(c) Which methods do you find most satisfactory?_____
_____
_____

(d) What electorate majority is required for your district's bonds? (for example, two-thirds or a simple majority)_____
_____

5. Does your district have the authority to create improvement districts or benefit zones?_____
Has your district actually created such improvement districts or benefit zones?_____If so, for what purposes?_____
_____
_____
_____

6. What is your district's water pricing policy?_____
_____
_____
_____
_____
_____
_____

7 Has your district used any of the following acts?

	Please check *Yes*	*No*
(a) Street Opening Act of 1903 (Streets and Highways Code, Secs 4000-4443)	____	____
(b) Improvement Act of 1911 (Streets and Highways Code, Secs 5000-6794)	____	____
(c) Municipal Improvement Act of 1913 (Streets and Highways Code, Secs 10000-10609)	____	____
(d) Improvement Bond Act of 1915 (Streets and Highways Code, Secs. 8500-8851)	____	____
(e) Other improvement act(s):_____	____	____

Comments: _____
_____
_____

8 Is your district confronted with ground water management or replenishment problems which may lead it to ask for new legislation?
_____
_____
What are those problems?_____
_____
_____

WATER DISTRICT LAWS STUDY QUESTIONNAIRE—Continued

9. Does your district feel that a uniform election procedure should be established for all water district acts?_____

Comments: _____

10. Is your district satisfied with its present procedures for the following:

(a) annexation:_____

(b) consolidation:_____

(c) exclusion (withdrawal):_____

(d) dissolution:_____

Comments:_____

11 Are there any terms or provisions in any of the water district laws which are too complex, too vague, or not readily understandable (do not include those mentioned above)?_____

If so, which ones?_____

12. (a) What services or supervision does your district receive from State agencies?_____

(b) Of what value to your district are these services or supervision?_____

(c) Does your district desire any services or supervision that is not available?_____

WATER DISTRICT LAWS STUDY QUESTIONNAIRE—Continued

QUESTIONS TO BE ANSWERED ONLY BY GENERAL LAW DISTRICTS

13. (a) Under what general enabling act was your district formed?

(b) In what year was your district formed?

(c) If you know, why did your district form under that act?

QUESTIONS TO BE ANSWERED ONLY BY SPECIAL ACT DISTRICTS

14 (a) If you know, why was your district formed by special district act rather than under a general district act?

(b) If you know, was your district's act modeled after any particular act(s)?_____If so, which one(s), and why?

(c) Does your district feel that it is related to any particular group of water district acts?

15. If your district act does not contain the 1961 uniform validation procedure in Sections 860-870 of the Code of Civil Procedure, do you believe it would be desirable for your district to adopt this procedure?

Comments:

THANK YOU VERY MUCH FOR YOUR ASSISTANCE.

Name and title of person answering questionnaire

Name of district

Mailing address of district

APPENDIX B

OTHER LAWS AFFECTING DISTRICTS

I Local Agency Formation and Annexation

II County Boundary Commission

III The Special Assessment Investigation, Limitation and Majority Protest Act of 1931

IV District Investigation Law of 1933

I. LOCAL AGENCY FORMATION AND ANNEXATION
(Sections 54750-54771, 54775-54791, Government Code)

At the 1963 Regular Session of the Legislature two laws were enacted relating to the review and approval or disapproval by local agency formation commissions of proposals for the formation of, and annexation to, territory of cities and special districts within a county and the adoption by such commissions of standards and procedures for the evaluation of such proposals These laws were Chapter 1808 (A B 1662) and Chapter 1810 (S B 861) of the Statutes of 1963 Chapter 1808 added Sections 54775 to 54791, inclusive, to the Government Code and Chapter 1810 added Sections 54750 to 54771, inclusive, to that code.

1. Local Agency Formation

Chapter 1808, relating to proposals for formation of cities and special districts, provides for the creation in each county of a local agency formation commission consisting of the following five members selected as follows:

a Two representing the county, each being a county officer, appointed by the board of supervisors; two representing the cities in the county, each being a city officer, appointed by a city selection committee, and one representing the general public, appointed by the other four members (Sec. 54776)

b In any county in which there is no city; three representing the county, each a county officer, appointed by the board of supervisors, and two representing the general public, appointed by the other three members (Sec 54776 1).

c. In any county in which there is but one city, two representing the county, each a county officer, appointed by the board of supervisors; one representing the city, who must be a city officer, appointed by the legislative body of the city; and two representing the general public, appointed by the other three members (Sec 54776 2)

The term of office of each member is generally four years Each serves without compensation, but is reimbursed for reasonable and necessary expenses (Sec. 54777)

A city selection committee is also established for each county, consisting of the mayor of each city within the county or, if there is no

mayor, the president of the city council for the purpose of making first appointments to the commission (Sec 54778).

The local agency formation commission is empowered to review and approve or disapprove, with or without amendment, wholly, partially or conditionally (a) proposals for the incorporation of cities, and (b) proposals for the creation of special districts; and is required to adopt standards and procedures for the evaluation of proposals for the creation of cities or special districts (Sec 54780).

"Special district" means an agency of the State for the local performance of governmental or proprietary functions within limited boundaries. "Special district" does not include the State, a city, a county, a school district, a special assessment district formed under the Improvement Act of 1911, the Municipal Improvement Act of 1913, the Street Opening Act of 1903, the Vehicle Parking District Law of 1943, the Parking District Law of 1951, the Pedestrian Mall Law of 1960, any similar assessment law, or any similar procedural ordinance adopted by a chartered city. Also, "special district" does not include an improvement district or zone formed for the sole purpose of designating an area which is to bear a special tax or assessment for an improvement benefiting that area (Sec 54775).

Before a notice of intention to circulate a petition seeking the incorporation of a new city may be filed, the proponents are required to file a notice of intention to form the new city with the commission (Sec. 54781, subd. (a)).

Before proceedings are initiated to form a special district the proponents are required to file a notice of intention to form the special district with the commission (Sec 54782, subd. (a)). "Proceedings to initiate the formation of a special district" mean (1) the circulation of a petition to form a special district or the filing of notice to circulate such a petition, if such notice is required; or (2) the adoption of a resolution or ordinance by the board of supervisors initiating the formation of a special district (Sec 54782, subd. (a)).

A notice of intention to form a new city must contain the specific boundaries of the proposed city (Sec 54781, subd (a)), and a notice of intention to create a special district must contain both the specific boundaries and a description of the kind of district (Sec 54782, subd. (a)).

To the extent applicable, the matter is submitted to the county boundary commission for its review (Sec. 54781, subd. (b); Sec. 54782, subd (b)).

In the case of a proposed city, upon completion of the review by the county boundary commission, and within 10 days after the clerk of the board of supervisors certifies that a petition is properly signed and correctly describes the boundaries of the proposed city, the clerk notifies the local agency formation commission. No further action can then be taken concerning the proposed incorporation until that commission has rendered its decision (Sec 54781 (b))

In the case of a proposed special district, the law provides that after the review by the county boundary commission, and within 10 days after the determination by the appropriate officer or body as to the sufficiency of the petition, or if proceedings have not been initiated by petition, within 10 days after the boundaries of the proposed district

have been finally determined by the agency having the power to make such determination, the officer, body, or agency making such determination must notify the commission of such action. No further action can then be taken concerning the proposed formation until the commission has rendered its decision (Sec 57482, subd (b))

Following receipt of the notice of the sufficiency of the petition to form a city or district, the commission sets the date, time, and place for a public hearing on the matter not more than 60 days after such receipt. The commission must, at least 15 days prior to the date of the hearing, notify the governing body of each city or special district having jurisdiction within the boundaries of the proposed city or district, or within three miles of the proposed exterior boundaries, any interested party who requests such notice and the proponents of the formation petition of the date, time and place of the hearing. In addition a notice of the hearing must be given in a newspaper of general circulation at least 15 days before (Sec 54784).

At the hearing, the commission must hear any interested person who has made a formal request to appear and be heard, and the report of the commission's staff (Sec 54785)

Factors to be considered by the commission in the review of a proposal for the creation of a city or district must include (1) population, population density, land area and land uses, per capita assessed valuation, topography, natural boundaries, and drainage basins, proximity to other populated areas, the likelihood of significant growth in the area and in adjacent incorporated and unincorporated areas during the next 10 years; (2) need for organized community services, the present cost and adequacy of governmental services and controls in the area, probable future needs for such services and controls, probable effect of the proposed formation and of alternative courses of action on the cost and adequacy of services and controls in the adjacent areas; and (3) the effect of the proposed formation, and of alternative actions, on adjacent areas, on mutual social and economic interests, and on the local governmental structure of the county (Sec 54786)

The commission must present its determination within 30 days following the conclusion of the hearing If the commission approves the formation of the proposed city or district, formation proceedings may be continued as otherwise provided by law. If it approves the proposed formation with modifications or conditions, further proceedings for the formation may be continued only in compliance with such modifications or conditions. If it disapproves the proposed formation, further proceedings to form the city or district must terminate (Sec. 54787).

If the formation of a proposed city is disapproved, no notice of intention to form a new city composed of the same or substantially the same territory may be filed with the commission for at least one year after the date of disapproval If the formation of a proposed special district is disapproved, no notice of intention to form a special district, under the same provisions of law providing for the formation of the special district which was disapproved, which is composed of the same or substantially the same territory, may be filed with the commission for at least one year after the date of disapproval (Sec 54789).

The local agency formation provisions of Chapter 1808 (A B 1662) do not apply to proceedings to form a city or special district which are initiated prior to the time when the first members of a commission created by the chapter are selected in the county in which lies the territory to be included in the proposed city or special district. In the case of a proposed city, proceedings are considered initiated by the filing of a notice of intention to circulate a petition seeking the incorporation of a new city (Ch 1808, Sec. 3)

2. *Local Agency Annexation*

The local agency formation commission created pursuant to Chapter 1808 (A B 1662) of the Statutes of 1963 is empowered (1) to review and approve or disapprove, with or without amendment, wholly, partially or conditionally, proposals for the annexation of territory to local agencies (defined as cities or special districts—Sec 54750) within the county, and (2) to adopt standards and procedures for the evaluation of proposals for the annexation of territory to local agencies within the county (Sec 54760, and see Secs 2 of Chapters 1808 (A B 1662) and 1810 (S B 861))

"Special district" means an agency of the State for the local performance of governmental or proprietary functions within limited boundaries. "Special district" does not include the State, a city, a county, or a school district (Sec 54750)

No petition seeking the annexation of territory to a local agency can be circulated or filed, nor can any public officer accept any such petition for filing, nor can any governing body initiate proceedings to annex territory on its own motion until there is filed with the commission a notice of intention to annex The notice must contain the specific boundaries of the territory proposed to be annexed (Sec 54761).

If the territory of a special district lies in more than one county, the notice of intention to annex must be filed with the commission of the county in which the territory to be annexed lies (Sec 54768).

To the extent applicable, the matter is submitted to the county boundary commission for its review and report A copy of the report must be given the local formation commission Otherwise, no further action can be taken concerning the proposed annexation until the commission has made its determination in the matter (Sec 54762).

The provisions in Chapter 1810 with respect to a hearing and the factors to be considered in a review of an annexation proposal are similar to those in Chapter 1808 relating to proposals for the formation of a city or special district (Secs 54763-54766).

If the commission approves the annexation, proceedings therefor may be continued as otherwise provided by law If it approves the proposed annexation with modifications or conditions, further proceedings for the annexation may be continued only in compliance with such modifications or conditions If it disapproves the proposed annexation, further proceedings to annex the territory to the city or special district must terminate (Secs 54766, 54767)

If the proposed annexation to a city is disapproved, no notice of intention to annex the same or substantially the same territory to that city may be filed with the commission for at least one year after the date of disapproval If the proposed annexation to a special district is

disapproved, no notice of intention to annex the same or substantially the same territory to that special district may be filed with the commission for at least one year after the date of disapproval (Sec 54767).

The local agency annexation provisions of Chapter 1810 (S B 861) do not apply to proceedings to annex territory to a local agency if the annexation petition has been circulated or filed, or if a governing body has initiated proceedings to annex on its own motion prior to the time when the first members of the local agency formation commission are selected in the county or counties in which lie the annexing local agency and the territory to be annexed (Ch 1810, Sec 3).

II. COUNTY BOUNDARY COMMISSION

(Sections 58850-58862, Government Code)

In general, the law provides for the submission to a county boundary commission of every proposal for the formation of a new district or changes in the boundaries of an existing district that may be or that is supported by taxes or special assessments levied and collected with county taxes, with certain exceptions, and for the filing of a report by the commission with the board of supervisors containing its recommendations respecting the proposal.

Each county has a county boundary commission composed of the chairman of the board of supervisors or a supervisor designated by him, who is chairman of the commission, the county assessor, auditor, surveyor or engineer if no surveyor, planning engineer or director of planning if no engineer, and clerk or registrar of voters in counties which have a registrar of voters (Sec. 58850) A member of the commission may designate one of his deputies to act in his place (Sec. 58850.1).

The clerk of the board of supervisors is the secretary of the commission (Sec. 58851).

The commission members and secretary serve ex officio without additional compensation (Sec 58852)

The commission meets at the call of the chairman, and notice of a meeting must be given by the secretary at least five days prior to the meeting (Sec. 58852 1).

The law applies to any proposal for the formation of a new, or change in the boundaries of an existing, district, exercising fuctions that are or may be supported by taxes or special assessment taxes levied on property within the district and collected with county taxes The law does not apply to proposals concerning special assessment districts formed for the purpose of providing various municipal and county improvements, a municipal utility district, or a transit district organized under the Transit District Law (Div 10 (commencing with Sec. 24501), P U C) whose boundaries include all or portions of two or more counties (Sec. 58853)

Prior to circulation, if circulation is required, or filing with the board of supervisors, for the formation of a new district, or with the governing body of an existing district for a change of boundaries,

the proposal must be submitted to the commission of the county in which all or a part of the district is or may be located (Sec 58854).

Upon submission of the proposal, the commission must consider it If requested, and if in the discretion of the chairman or majority of the commission it is in the public interest, a public hearing is required (Sec. 58855).

In considering the proposal, the commission must compare the proposed boundaries of the district with those of other districts within the county; (b) ascertain the extent to which overlapping in conflicting boundaries may result from the proposal; and (c) ascertain other factors that the commission regards inimical to the public interest (Sec 58856).

Within 30 days after submission of the proposal, the commission must prepare and adopt a report and recommendation of the proposal The report must be filed with the board of supervisors if the proposal concerns the formation of a new district, or with the governing body of an existing district if it would provide for a change in boundaries A copy must be furnished the proponents of the proposal (Sec 58857)

If the adoption of the proposal would result in two or more districts possessing in any common territory the authority to perform the same or similar functions, the report must contain a statement describing such facts and such area, and also include a statement of the provisions of Section 53064 of the Government Code (Sec 58856) This section provides, generally, for resolving the question of which district shall function in the same or common territory where two or more districts possess the authority to perform the same or similar functions in the territory, the territory comprises only a portion of each of the districts and a district requests such resolution.

Before acting upon any proposal, the board of supervisors or the governing body of the district must consider the recommendations and report of the commission and give them such weight as in its judgment the public interest requires (Sec. 58860)

The proponents must also consider the commission's recommendations, and must modify the proposal accordingly if they consider it proper (Sec 58858) If they do not accept the commission's recommendations, they must file a statement of their reasons for doing so with the board of supervisors, where the proposal is for the formation of a new district, or with the governing body of an existing district where it is for a change of boundaries, and must furnish a copy of the statement to the commission. The proposal may be circulated or filed with the board of supervisors or the governing body of the district only after such filing and furnishing (Sec 58859).

If a proposal for a change of boundaries or formation of a new district has been submitted to, and a report made by, the commission, and no further action has been taken by the proponents for one year after the submission of the proposal, the proposal must be resubmitted to the commission before further proceedings may be conducted, in the same manner as if no prior submission to the commission has been made (Sec. 58862).

III. THE SPECIAL ASSESSMENT INVESTIGATION, LIMITATION AND MAJORITY PROTEST ACT OF 1931
(Sections 2800-3012, Streets and Highways Code)

This act provides that before any ordinance or resolution may be adopted by the legislative body of any city, county, district or other public corporation ordering the construction of any public improvement or the acquisition of any property for public use where the cost of such construction or acquisition is to be paid in whole or in part by special assessments or through special assessment taxes upon land, the proceedings required by the act shall be taken

The act requires a determination by the legislative body initiating the assessment or project of the boundaries of the area subject to repay the cost and a definition of the project. The legislative body shall cause a report to be made showing the estimated cost and its relation to the assessed value of the land in the district, and then the legislative body shall hold a hearing on the report and after meeting stated requirements may proceed with the improvement The act contains provisions that a protest made by the owners of more than one-half of the area of the property to be assessed, or more than one-half of the frontage if the assessment is based on frontage, shall terminate the proceedings. It also contains provisions limiting debt which may be incurred and provisions covering notice of the proposed assessment, cost of the proceedings under this act, and the method to be used to determine objections (other than majority protests) made to the improvement

The act specifically exempts from its coverage irrigation districts, irrigation district improvement districts, fire districts, fire protection districts, or public cemetery districts and any proceedings which would otherwise be subject to the act when· (1) the proceedings are undertaken by a district or public corporation within one year of its incorporation and the proposed improvements are substantially described in an investigation proceeding had under the District Investigation Act of 1933, (2) the proceedings are by a chartered city or a chartered county and said city or county has complied with the provisions of Section 17 of Article XIII of the Constitution, or (3) all of the owners of more than 60 percent in area of the property subject to assessment for the proposed improvement have signed and filed with the clerk or secretary of the legislative body a written petition for the improvements and a waiver of the investigation proceedings

Also, this act specifically exempts from its provisions bonds issued or to be issued to provide money with which to acquire, construct or complete any public improvement, work, or public utility.

Bonds which have been voted by a majority or two-thirds vote, as may be required by the law under which the bonds are issued, are also specifically exempted from the provisions of this act.

The act does not apply to any maintenance district proceedings or to any assessment levied for the maintenance of any improvements.

The act does not apply to proceedings for the construction of sanitary sewers, sewage disposal works, and storm water drains, where such proceedings have been recommended by the health officer of the city

or county in which such proceedings are instituted as a necessary health measure, if such recommendation is given in writing and spread upon the minutes of the legislative body conducting the proceedings and such necessity is found to exist by a resolution adopted by a four-fifths vote of the members of the legislative body.

IV. DISTRICT INVESTIGATION LAW OF 1933

(Sections 58500-58732, Government Code)

The District Investigation Law of 1933 prescribes certain proceedings which must be taken in organizing districts which are subject to its provisions It contains requirements for reports, notice and hearing, tax and assessment limitations, and termination of proceedings upon majority protest.

The District Investigation Law of 1933 is not now applicable to any water districts (see Section 58501).