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Other Possible Revenue Sources for Medi-Cal and Developmental Services

LEGISLATIVE ANALYST'S OFFICE

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Second Extraordinary Session

Hon. Rob Bonta, Chair

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Selected Other Tax Increase Options

The LAO has been asked by the committee to discuss possible revenue increases if certain taxes (other than the Managed Care Organization [MCO] tax) are raised. The state's total taxation in these areas theoretically could be set at a level to cover public health and certain other social costs arising from use of these products, but those costs often cannot be established with precision. Possible tax options include:

- ☑ ***Tobacco Taxes.*** A $1 per pack cigarette tax increase and an equivalent increase for other tobacco products likely would raise $600 million to $700 million per year, net of backfilling for losses to special funds that rely on cigarette and other tobacco taxes.

- ☑ ***Alcoholic Beverage Tax.*** Updating alcohol excise tax rates to reflect inflation since 1991, when they were last changed, would raise around $200 million of annual revenue. Such an increase generally would involve an over 50 percent rise in existing per-gallon tax rates. Currently, beer and most wine is taxed at 20 cents per gallon, distilled spirits of 100 proof or less are taxed at $3.30 per gallon, and distilled spirits over 100 proof are taxed at $6.60 per gallon.

- ☑ ***Taxes on High-Calorie Products.*** A 2013 state legislative proposal to impose a 1-cent tax per fluid ounce of specified sweetened beverages would have generated about $1.7 billion annually (including $1.2 billion from carbonated soft drinks alone), according to a Board of Equalization estimate. While the Constitution generally prohibits sales taxes on food, the Legislature could explore other taxes for high-calorie foods.

- ☑ ***These Taxes Would Affect Consumption.*** These revenue estimates could prove to be too high or too low as they reflect assumptions about decreases in consumption of the taxed products. Changes in consumption due to higher tobacco taxes are fairly well understood. California, however, has less experience concerning changes in consumption due to increased beverage taxes.

Changes to Tax Credits and Other Tax Expenditures

☑ ***Tax Expenditures Equal About Half of Current General Fund Revenue.*** Tax credits, exclusions, exemptions, and deductions currently reduce state General Fund revenues by an estimated $55 billion each year. Our office long has advised the Legislature to aim for a broad-based tax system with as few tax expenditures as possible. Reducing or eliminating tax expenditures could provide funds to (1) lower tax rates or (2) raise funds for public programs, including health-related programs.

☑ ***Many Tax Provisions Will be Difficult to Reduce.*** Earlier this year we released an online post about the state's major tax expenditures (see our website here: http://bit.ly/1S6FfL7). The largest tax expenditures—exemptions or deductions like those concerning food purchases, health insurance, mortgage interest payments, and Social Security benefits—are deeply entrenched, benefiting millions of Californians. Yet, our office has long urged the Legislature to evaluate tax credits and deductions frequently and critically. In 2007, for example, we suggested significant changes to the mortgage interest deduction.

☑ ***Credits Aimed at Specific Firms or Industries Problematic.*** Recently, there has been a trend of the state considering new tax reductions targeted at specific industries or even specific firms. We view such policies with significant concern. Such targeted tax reductions move the state away from a broad-based tax system applied evenly to everyone. These reductions benefit specific firms or industries, but benefits for California as a whole often are difficult to discern.