California Tax Problems and Simple Solution to Save $700 Million Yearly

California has several income tax problems such as income tax complexity, child tax credit cliff, earned income tax credit cliff, corporate tax, senior tax returns, and other tax problems (A).

California has 9 tax brackets, 216 (9×3×8) formulas, 29-page Withholding Tables, and 27 (9×3) tax rate ranges, which are very complex (B). There are two income tax systems. One is for employers to calculate withholding taxes (C). Another is for people's tax returns (D). If businesses do not need to use existing complex Withholding Tables and 216 formulas, then businesses and Department of Revenue can reduce hundred million dollars.

State tax simplification has been researched by Robert Kao and John Lee. The complex California tax system can be matched and simplified. The 9 tax brackets can be reduced to 3 (1%-6.43%-9.31%-12.3%) and the 29-page Withholding Tables and 216 formulas can be eliminated and replaced with simple two linear formulas and one existing formula by 98% (1-3/216) simplification with comparable results, which is explained by their research paper (E). Tax revenue change is almost neutral.

When 2 tax rates are set such as 1% for bottom tax rate and 6.43% for taxable income $100,000, a linear line between them to have one simple formula is the most simple, fair, and effective (E). Comparing existing 9 brackets, 29-page Withholding Tables, and 216 (9×3×8) formulas and simplified 3 simple brackets/formulas, businesses may save $481 million from 1×26×18.5 million if businesses can save $1 on each biweekly period per employee. California has about 18.5 million employees (F). The $1 covers about 8 areas (E). There are about 15 direct and non-direct benefits. Their saving values for CA government, businesses, and people may be more than $700 million/year (E: Table 6), which may need to be evaluated by CA Department of Revenue.

Another tax problem is existing young child tax credit (YCTC), which is $1,000. It is depended on CA earned income (EI) from 100% at or less than $25,000 to 0% at or more than $30,000. Form 3514 is used for YCTC with multi (50) cliffs (each $100). Smooth rates between 100% to 0 are suggested with one simple formula (1–(EI-25,000)÷5,000)×1,000 to cover EI $25,000-$30,000 to resolve the 50-cliff problem (A).

CA earned income tax credit (EITC) table has 2,960 numbers and 600 EI ranges (2021), which is complex. Simple linear formula can be used to match and simplify these numbers and ranges. Earned income (EI) tax credit can be reduced from 100% to 0 gradually for EI from 0 to $30,000 with one simple formula of (1–(EI÷30,000))×N×EI (A). Existing seniors' tax returns are complex, which cause some problems for seniors. Most seniors have simple incomes from social security benefits, 401K retirement funds, IRA, annuities, and other incomes. A simple reform is suggested to save related time and costs for many retired people and California government (G).

CA corporate income tax is at 8.84%. A flat tax rate is too simple, which can not cover different taxable incomes and small and large companies reasonably. A nice business tax plan is to have a relatively low bottom tax rate, which can encourage more people to start businesses. Small businesses hire many employees to meet social and economical needs. Then mid and large businesses are more stable and pay relatively higher tax rates. Two brackets and formulas for corporate tax calculations are suggested with two gradual tax rate ranges such as 5%-7%-9% to reduce tax rates for small businesses and to encourage for more potential businesses.

There are two political trends for income tax systems. One is to increase tax revenue with complex income tax systems. Another one is to reduce tax revenue with one or few flat tax rates, which will not resolve related problems of tax revenue, basic living cost, income tax, cliff, fairness, and others. We do need tax simplification to save significant costs and time for Department of Revenue, lawmakers, companies, and people technically. Budget balance needs to be considered at first. Proper and simple tax system can be used to resolve these tax problems with one simple linear formula as a simple and effective solution.

If you have questions and comments, please contact John Lee at johnlee@taxsimplecenter.net.

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