

# VLF Facts:

## A Primer on the Motor Vehicle In-Lieu Tax, the Car Tax Cut and Backfill

The vehicle license fee (VLF), also called the motor vehicle in-lieu tax, is a tax on the ownership of a registered vehicle in place of taxing vehicles as personal property. The VLF is paid annually upon vehicle registration in addition to other fees, such as the vehicle registration fee, air quality fees, and commercial vehicle weight fees all of which fund specific state programs. The VLF funds city and county services.

### History: The Car Tax Formerly Known as a Property Tax

Prior to 1935, motor vehicles in California were subject to the property tax, which is administered by and allocated to local governments. But the state legislature decided that a state-wide uniform system of vehicle taxation would be simpler and more efficient. The VLF is applied based on a vehicles current value as estimated by a depreciation schedule set in state law (see table 1).

Table 1  
VLF Depreciation Schedule

	Value	Trailer Coaches
1 <sup>st</sup> year value	100% of market	85%
2 <sup>nd</sup> year	90	70
3 <sup>rd</sup> year	80	55
4 <sup>th</sup> year	70	45
5 <sup>th</sup> year	60	40
6 <sup>th</sup> year	50	35
7 <sup>th</sup> year	40	30
8 <sup>th</sup> year	30	25
9 <sup>th</sup> year	25	24
10 <sup>th</sup> year	20	23
11 <sup>th</sup> year	15	22
12 <sup>th</sup> year	15	21
13 <sup>th</sup> year	15	20
14 <sup>th</sup> year	15	19
15 <sup>th</sup> year	15	18
16 <sup>th</sup> year	15	17
17 <sup>th</sup> year	15	16
18 <sup>th</sup> and later years	15	15

### Exempt Vehicles

Vehicles required to register but that are exempt from the VLF include government-owned, diplomatic, civil air patrol, farm vehicles, privately owned school buses, vehicles owned by blind or amputee veterans. Various classes of specialized vehicles are exempt from vehicle registration and the VLF but are instead subject to the property tax. These include farm trailers, privately-owned firefighting vehicles, and forklifts.

## The VLF Tax Rate

From 1948 through 2004, the VLF tax rate was 2%. In 1998, Governor Wilson signed a bill “offsetting”<sup>1</sup> the tax by 25% to 1.5% effective January 1, 1999 with deeper cuts possible in future years (35%, 46.5%, 55%, 67.5%) depending on the adequacy of state general fund revenues.<sup>2</sup> In 1999, the law was amended, accelerating the tax cut to 35% in year 2000.<sup>3</sup> In 2000, the cut was further accelerated to 67.5% commencing January 1, 2001.<sup>4</sup> For 2005, the legislature repealed the offsets and instead reduced the VLF tax rate to 0.65%. The offset revenue (also known as “backfill”) was replaced with additional property tax revenue for cities and counties.

**Table 2**  
**Vehicle License Fee (VLF) Taxpayer Offsets**

Calendar Year	1998	1999	2000	2001	2002	2003*	2004	2005**
VLF Offset	-	25%	35%	35%	67.5%	67.5%	67.5%	n/a
VLF Rebate	-	-	-	32.5%	-	-	-	n/a
Combined effective tax cut		25%	35%	67.5%	67.5%	67.5%	67.5%	n/a
Effective VLF Tax Rate (percent of valuation)	2%	1.5%	1.3%	0.65%	0.65%	0.65%	0.65%	0.65%

\*The VLF taxpayer offset ended effective October 2003 under Governor Davis, but was subsequently restored with full refunds by Governor Schwarzenegger. This created a shortage in city and county VLF backfill payments known as the “VLF Backfill Gap.” The state eventually paid these funds to local governments in late 2005.

\*\*For 2005 and since, the VLF tax rate was reduced to 0.65%. The reduced VLF funding was replaced with additional property tax share to cities and counties.

## Allocation of VLF Revenue Until July 2004

Until July 2004, 24.33%<sup>5</sup> of VLF funds were allocated to counties<sup>6</sup> to fund certain health and welfare programs under a state-local program realignment that began in 1992. Of the remaining amount, about \$280 million went to reimburse state agencies (Department of Motor Vehicles, Franchise Tax Board, and State Controller) for costs of VLF revenue collection, accounting and allocation. Of the amount remaining after realignment and administrative charges were taken out, 18.75% was allocated for special payments including supplemental funds for cities that did not levy a property tax in 1977-78, eligible low property tax cities incorporated prior to 1987, and supplemental funds for counties. The 81.25% was allocated half to cities and half counties on a population basis.

<sup>1</sup> The program is generally referred to as an “offset” rather than a tax cut or tax credit, because the total amount of VLF legally due from the taxpayer was not changed. Instead, the state pays or “offsets” a portion of the amount due, and taxpayers pay the remaining balance.

<sup>2</sup> AB2797 (Cardoza) Chapter 322, Statutes of 1998

<sup>3</sup> AB1121 (Nakano) Chapter 74, Statutes of 1999

<sup>4</sup> Chapters 106 and 107 Statutes of 2000. This includes a 35% offset and a 32.5% rebate. In 2001, legislation replaced the rebate program with a direct offset commencing year 2002.

<sup>5</sup> Revenue and Taxation Code Section 11001.5, for the FY 2003-04 year only, this percentage was increased in order to fully fund county realignment from VLF revenues irrespective of the “VLF backfill gap.” The effect of this change was that the base MVLF allocation to cities and counties bore the full impact of the VLF backfill gap.

<sup>6</sup> In addition to the 58 counties that provide these services, VLF realignment funds are also allocated to the Cities of Berkeley, Long-Beach, Pasadena and a Tri-City JPA.

Proposition 47 of 1986 (Article XI, Section 15 of the California State Constitution) requires that the VLF be allocated to cities and counties. However, the legislature may alter the tax rate and the allocation among cities and counties.

## **June 2003: The “Trigger” is Pulled**

Since its inception in 1998, the MVLF reduction was structured as a local tax reduction, made possible by a state general fund subsidy to local governments. Under the law, local governments are “backfilled” by the state general fund for any loss of revenue due to VLF reductions. In 2004-05, this backfill will amount to \$3.9 billion.<sup>7</sup> The law has always contained provisions that if state general fund revenues are insufficient to fund this taxpayer subsidy, then the offset would be removed and the effective taxpayer rate would return to its 1998 level. On June 19, 2003, the California State Controller and Director of Finance made findings of insufficient revenues and the effective MVLF rate went from 0.65% to 2%. Due to administrative changes and notifications of taxpayers by the Department of Motor Vehicles, the new rate went into effect for taxpayers with October 2003 registrations.

## **The FY03-04 “Backfill Gap”**

The FY03-04 budget deleted all funding for the VLF backfill effective with the pulling of the trigger. Consequently, during the period June 20 through October 1, 2003, the reduced rate remained, but the backfill to local governments for the reduction was not funded.<sup>8</sup> The “MVLF Backfill Gap” totaled \$1.25 million and was paid by the state in the FY05-06 budget year.

## **November 2003: The “Trigger” is Unpulled**

Governor Gray Davis was recalled in a special election on October 7, the results of which were certified on November 14, 2003. Following his inauguration in November 2003, Governor Schwarzenegger repealed the “VLF trigger,” restoring the reduction of the VLF from 2% to 0.65% and instructing that refunds be paid to anyone who had paid the higher rate. On December 17, 2003, Governor Schwarzenegger issued an executive order appropriating \$2.625 billion to provide backfill funding for City and County VLF. The \$2.625 billion covered the lost revenues to cities and counties for FY03-04, except the “backfill gap.”

## **The VLF for Property Tax Swap of 2004<sup>8</sup>**

In May 2004, Governor Schwarzenegger proposed a VLF for property tax swap as a part of a state-local budget agreement. The Legislature included its version of the swap in the 2004 budget package. Under the swap, over 90% of city VLF revenue was exchanged for property tax.

In a change from the Governor’s agreement with local governments, the Legislature, in AB2115 of 2004, provided for no property tax in lieu of VLF to replace the lost VLF areas annexed to cities after

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<sup>7</sup> In FY 2003-04, the VLF backfill gap reduced revenues by \$1.3 billion. The entire impact of this revenue shortfall comes out of the base MVLF allocations other than fixed expenses including administrative charges.

<sup>8</sup> More detail on the history and mechanics of the VLF for Property Tax Swap of 2004 is available at <http://www.californiacityfinance.com/VLFswapNtakeFAQ.pdf>

2004. This seriously impacts the fiscal viability of some annexations and needs to be resolved with new legislation. The Legislature also made no provision in the law for property tax in lieu of VLF for city incorporations after 2004. These changes have caused major fiscal difficulties for many communities that are in the process of incorporating and cities that are in the process of annexing inhabited areas. Cities in the midst of plans to annex inhabited islands and communities in the midst of plans to incorporate immediately faced the loss of over 90% of VLF revenues that they had been counting on under previous law. The League of California Cities is working to remedy this situation.

**Table 3**  
**Vehicle License Fee (VLF) Revenues and Allocations**  
(in billions)

	<u>1997-98</u>	<u>1998-99</u>	<u>1999-00</u>	<u>2000-01</u>	<u>2001-02</u>	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>	<u>2007-08</u>	
<b>REVENUE</b>												
VLF Net Taxpayer Reve	3.8	3.700	3.282	3.275	1.913	1.871	2.052	2.134	2.219	2.330	2.446	
Offset & Rebate - State	-	0.482	1.324	1.842	3.559	3.797	3.012		<sup>a</sup>			
Backfill Gap paid 8/2005							1.249					
Property Tax in-lieu of VLF									(see below) <sup>b</sup>			
Total	<u>3.8</u>	<u>4.2</u>	<u>4.606</u>	<u>5.117</u>	<u>5.472</u>	<u>5.669</u>	<u>6.313</u>	<u>2.134</u>	<u>2.219</u>	<u>2.330</u>	<u>2.446</u>	
<b>ALLOCATION</b>												
Realignment (Local Rev	0.9	1.0	1.123	1.232	1.339	1.353	1.507	1.605	<sup>c</sup>	1.666	1.730	1.832
Motor Veh Lic Fee Acco	2.9	3.2	3.483	3.885	4.133	4.316	4.806	0.529	0.553	0.575	0.614	
Total	<u>3.8</u>	<u>4.2</u>	<u>4.606</u>	<u>5.117</u>	<u>5.472</u>	<u>5.669</u>	<u>6.313</u>	<u>2.134</u>	<u>2.219</u>	<u>2.330</u>	<u>2.446</u>	
<b>Allocation of MVLF</b>												
Admin&SpecialPayment	0.250	0.250	0.325	0.262	0.275	0.286	0.286	0.289	0.304	0.324	0.340	
R&T11005.7 Payment	0.050	0.050	0.050	0.050	0.050	0.050	0.050	-	<sup>d</sup>			
Special Allocations												
to cities&counties	0.489	0.537	0.583	0.670	0.714	0.746	0.838	-	<sup>d</sup>	-	-	
Orange County								0.054	<sup>e</sup>	0.056	0.059	0.062
Recently Incorporated Cities								0.010	<sup>e</sup>	0.010	0.008	0.003
Cities per capita	1.059	1.164	1.263	1.451	1.547	1.617	1.816	0.176	0.183	0.184	0.209	
Counties per capita	1.059	1.164	1.263	1.451	1.547	1.617	1.816	-				
Total	<u>2.9</u>	<u>3.2</u>	<u>3.483</u>	<u>3.885</u>	<u>4.133</u>	<u>4.316</u>	<u>4.806</u>	<u>0.529</u>	<u>0.553</u>	<u>0.575</u>	<u>0.614</u>	
<b>Property Tax in-lieu of VLF</b>								4.393	<sup>b</sup>	4.891	5.282	5.704
... to counties								2.691	<sup>b</sup>	2.995	3.234	3.493
... to cities								1.701	<sup>b</sup>	1.896	2.048	2.211

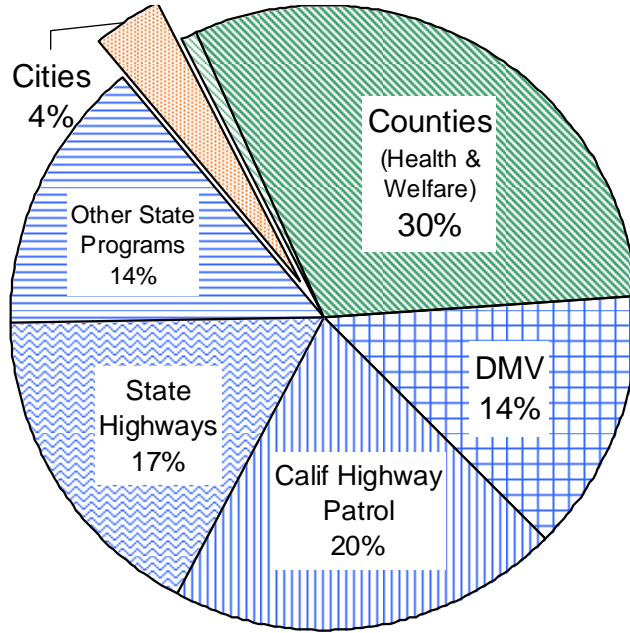
**Notes**

- a) The VLF backfill was eliminated in the Budget Act of 2004.
- b) In FY04-05 cities and counties received additional share of property tax to compensate for the elimination of the VLF backfill and change in allocation formulas (VLF Adjustment Amount). In subsequent years, this property tax grows for each agency in proportion to the growth in assessed valuation in that jurisdiction.
- c) The share of VLF revenues allocated to the Local Revenue Fund was increased beginning in FY04-05 to 74.9% to maintain the level of VLF revenues supporting to county realignment programs.
- d) Various MVLF allocations were eliminated. Cities and counties that previously received these allocations now receive property tax in lieu of VLF (VLF Adjustment Amount) instead. These special allocations included: about \$8 million to eighty specified no or low property tax cities and \$50 million to various cities in proportion to losses from the ERAF property tax shift. The Budget Act of 2004 included one special payment: \$54 million (grown annually) for the County of Orange to maintain the VLF revenues which are pledged to the county's deficit reduction plan.

## The Taxpayer's Perspective: Where My Vehicle License & Registration Fees Go

With the reduction in the VLF, fees going to state programs now constitute over 60% of the vehicle license and registration fees paid.

	millions		
Cities	\$ 193	4%	VLF
Counties (Health & Welfare)	\$ 1,666	30%	
DeptMotorVeh	\$ 751	14%	Fees
Calif Highway Patrol	\$ 1,117	20%	
State Highways	\$ 926	17%	
Other State Programs	\$ 781	14%	
<b>Total</b>	<b>\$ 5,491</b>		



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**Sources:**

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