

# SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Leno Analyst: LuAnna Hass Bill Number: AB 1690

Related Bills: See Prior Analysis Telephone: 845-7478 Amended Date: April 1, 2003

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Local General Income Tax/Fire Protection Finance Agency Formed By City, County, or City and County

- DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.
- AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced February 21, 2003.
- FURTHER AMENDMENTS NECESSARY.
- DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.
- REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 21, 2003, STILL APPLIES.
- OTHER - See comments below.

## SUMMARY

This bill would require the Franchise Tax Board (FTB) to administer and collect a local income tax. This bill also would add provisions regarding public safety finance agencies and property taxes. These changes do not affect the department and are not discussed.

## SUMMARY OF AMENDMENT

The April 1, 2003, amendments resolved a technical consideration by clarifying that FTB would be the state agency responsible for administering the local income tax. In addition, the amendments would make various changes to the provisions regarding public safety finance agencies and property taxes and include a provision regarding local mandates. These amendments do not impact the department and are not discussed in this analysis.

For convenience, all existing concerns and the fiscal and economic impacts are provided below. The remainder of the department's analysis of the bill as introduced February 21, 2003, still applies.

## POSITION

Pending.

Board Position:  
 S       NA       NP  
 SA       O       NAR  
 N       OUA       PENDING

Legislative Director      Date  
Brian Putler      04/10/03

## IMPLEMENTATION CONSIDERATIONS

Department staff has identified the following implementation considerations for purposes of a high-level discussion. Additional concerns may be identified as the bill moves through the legislative process. In order for FTB to implement this bill, clarification is needed for at least the following issues:

- This bill would allow a local general tax to be levied on the taxable income of any person residing in the local jurisdiction for each taxable year beginning on or after January 1, 2004. The levying of such a tax is subject to approval of a majority of the voters at an election. It is unclear whether the author intends for FTB to:
  1. process the Personal Income Tax (PIT) returns, calculate the local income tax for the appropriate taxpayers, and issue a notice of tax due to those taxpayers,
  2. include lines on the PIT return allowing the taxpayers to self-assess the local general tax while they are completing their PIT return, or
  3. amend the PIT booklets to include a separate local general tax form or schedule.

However, none of the current PIT forms have enough room to accommodate a local income tax. It is anticipated that the department would need to create a separate schedule to accompany the return.

- Under the current tax forms design schedule, the design, printing, and distribution of forms and booklets takes place in the fall of the actual taxable year. For example, the design of the 2004 PIT return would begin June 2004, printing would begin October 2004, and distribution of the returns and booklets will begin at the end of 2004. This allows taxpayers to begin reporting and paying their 2004 taxes in January 2005. Once the voters approve a local general tax, this bill requires FTB to notify the county auditor of the estimated tax to be collected in the next 12 months. Assuming the author intends for individuals to self-assess the local general tax, and assuming an ordinance were passed in November 2004, the returns and booklets for the 2004 tax year would likely have begun printing and distribution.
- The PIT automated system is developed and designed to collect and process only PIT. It currently cannot administer two different tax structures separately within one taxpayer account. In an ideal situation, taxpayers would correctly self-assess their PIT and local income tax, timely file their return and pay the total tax in full. To accommodate the ideal situation, minor programming and return processing changes would be needed within the existing PIT program. However, because taxes sometimes are not correctly self-assessed, fully paid, or timely filed, and mathematical errors are made, payments should be tracked separately and penalties and interest assessed separately. However, the existing automated system will not readily be able to separate the penalties and interest attributable to the local income tax. This would require a major redesign of the PIT system and potentially disrupt PIT revenue collection.
- This bill would require FTB to administer and collect the local income tax in the same manner as PIT. However, it is unclear if the author intends for the PIT administrative provisions regarding penalties, fees, interest, assessment, protest, and appeal to apply to the local general tax. What would happen if the taxpayer were subject to a PIT audit that results in an adjustment of taxable income? Since the local income tax is a percentage of the taxable

income for PIT purposes, would the amount of local income tax be updated and a statement sent to the taxpayer to reflect the adjustment?

Further, it is unclear if part-year residents would be required to pay any local income tax. If so, would FTB use the same rules for determining residency that are used under PIT law?

- This bill would levy a local income tax upon the taxable income of any person and the tax may not exceed an amount equal to the net tax multiplied by 8%, 2%, or 10% depending on the taxpayer's locale. For example an individual with taxable income of \$100,000 would have a PIT rate of 9.3%, or a PIT net tax of \$9,300. If the taxpayer resided in a city and county that imposed a local general tax of 10%, the local general tax amount would be \$930. However, state tax law allows taxpayers to claim certain tax credits that are used to reduce the taxpayer's tax liability dollar-for-dollar. The taxpayer described above could have credits equaling \$1,000, which would reduce their tax to \$8,300, but their local income tax would still be \$930.

Further, without a specific local income tax rate being applied to taxable income, the department would be unable to estimate the amount collected for the locality accurately. The department could only estimate the upper limits of an 8%, 2%, or 10% local income tax rate and the resulting collections for that locality.

- Under current law, taxpayers are not precluded from using an address other than their residence on their tax return. Taxpayers may use a post office box, their business address, the address of their tax preparer, or address of a friend or relative. In order to administer the tax program outlined in this bill effectively, all taxpayers would need to provide their correct residence address on their tax return.
- This bill would require FTB to estimate, based on historical data, the amount of local general tax to be collected in the first 12 months in which the tax is imposed. Currently FTB uses zip codes to identify counties for statistical purposes. Zip codes that overlap county boundaries are rare. However, for purposes of estimating and imposing the city tax in this bill, the use of zip codes would be insufficient because zip codes that overlap jurisdictions are much more common. To appropriately sort tax statistics to incorporated jurisdictions would require complete street address to city cross-reference coding that is not currently in place. Such a system could be costly for the department.
- This bill requires FTB to remit the taxes collected, but does not specify to whom FTB should remit the funds. Department staff recommends amending the bill to provide that the Controller would be responsible for the disbursements of the local income tax collections to the counties. FTB could be responsible for determining the amount of the tax assessed, the amount collected, depositing the tax collected into one of various income tax funds that filter into the General Fund, and for notifying the Controller. If using the General Fund is not the intent, then FTB would be required to create a separate account, which would require additional programming and reporting requirements.

In addition, this bill requires FTB to remit the taxes within 60 days of the revenues being reported and collected. Assuming the taxpayer were to self-assess the local income tax on the PIT return, FTB receives PIT returns and payments daily from January through April 15<sup>th</sup> or with an extension, October 15<sup>th</sup>. It is suggested that the author clarify the remittance language

to specify how often FTB should remit the taxes and whether FTB would be required to remit the funds on a daily basis.

- Current law provides that debts must be paid in a specific order when an individual has more than one debt being collected by FTB. This bill does not specify where a local income tax delinquency would fall in the order of payment priority, which could create uncertainty about where the department should apply payments that are received.
- Current laws regarding the non-tax debts administered by FTB provide for a reimbursement to FTB of costs to administer the programs. The laws are usually specific to the amount of reimbursement available to FTB or require an agreement between agencies outlining reimbursement. The reimbursement language in this bill should be clarified to reflect something similar to existing statutes.

### TECHNICAL CONSIDERATIONS

The provision of the bill that adds Section 99.3 to the Revenue & Taxation Code (R&TC) uses the phrases "income tax" and "tax" interchangeably to reference the local income tax that could be imposed as a result of this bill. Department staff recommends using the phrase "income tax."

In addition, the R&TC provision would allow a local income tax on the taxable income of any "person residing" in the city or county where the local income tax was approved. Existing state tax law defines "person" broadly to include, but is not limited to, individuals, partnerships, and corporations. However, the term "residing" would apply only to individuals since entities such as corporations and partnerships are technically unable to "reside" in a specific location. Depending on the intent of the author, the bill should be amended to clarify the phrase "person residing."

### **FISCAL IMPACT**

It is anticipated that significant implementation costs would be incurred to develop, test, and implement the changes that would be required to accommodate this bill, regardless of whether one or several ordinances were passed. These start-up costs are not yet known and will be determined as the bill is further developed, as implementation concerns are resolved, and as a department implementation strategy can be identified. These start-up costs would include, but not be limited to, system programming, creation of a billing system, and the creation of a schedule, form, or billing notices for the general tax.

The costs to administer this program are also not known. Total ongoing costs would depend upon the number of cities, counties, or cities and counties that would participate, the number of residents subject to the tax, the level of self-assessment and compliance achieved, and the extent of the enforcement activities needed. Costs would include additional storage space, data entry, system programming and maintenance, reports, collections activities, and customer service personnel.

According to the bill, FTB's administrative costs would be deducted from the amounts collected prior to the taxes collected being remitted. However, no provision is made to cover FTB's start-up costs. Depending on when voters approved such a tax and how many cities, counties, or cities and counties approve such a tax, the costs could be more than one or two such areas could be expected to pay.

**ECONOMIC IMPACT**

This bill would not impact the state's income tax revenue.

## **ARGUMENTS/POLICY CONCERNS**

This bill would provide inequitable treatment for certain classes of taxpayers. For example, the local income tax under this bill would not be levied against individual taxpayers who do not have a PIT filing requirement or businesses and corporations that reside or do business within the area of the general tax, even though everyone within the area would realize the benefits of the public safety finance agency.

Historically, concern has arisen when the department contracts for a percentage of collection to cover costs because the possibility exists that the percentage may not cover the costs of the program in any given year and monies from the General Fund may be needed to cover any difference.

## **LEGISLATIVE STAFF CONTACT**

LuAnna Hass  
Franchise Tax Board  
845-7478  
[LuAnna.Hass@ftb.ca.gov](mailto:LuAnna.Hass@ftb.ca.gov)

Brian Putler  
Franchise Tax Board  
845-6333  
[Brian.Putler@ftb.ca.gov](mailto:Brian.Putler@ftb.ca.gov)