

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Campbell Analyst: John Pavalasky Bill Number: AB 612
Related Bills: See Legislative History Telephone: 845-4335 Introduced Date: February 19, 2003
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Alimony Deduction for Nonresidents

SUMMARY

This bill would allow a nonresident or part-year resident taxpayer of California a prorated alimony deduction, thus making California law consistent with case law from the U.S. Supreme Court and resolving a federal constitutional issue.

PURPOSE OF THE BILL

According to the author's office the purpose of the bill is to resolve a federal constitutional issue.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately and apply to taxable years beginning on or after January 1, 2003.

POSITION

Pending.

ANALYSIS

FEDERAL LAW

Payments of alimony or separate maintenance made under a divorce or separation instrument are deductible by the payor spouse under Internal Revenue Code (IRC) Section 215 and taxable to the payee spouse under IRC Section 71.

STATE LAW

In determining California-source income, current law does not allow a deduction for alimony payments made by either a nonresident or a part-year resident during the time they are a nonresident, even if paid to a California resident. This provision denying a deduction was first introduced in 1957.

The justification for this rule appears to have been that because California does not tax nonresident taxpayers on alimony income, nonresidents should not be allowed an alimony deduction. However, because alimony cannot be deducted while a nonresident, it would appear that this constitutes, under *Lunding* (see below), an impermissible categorical denial of deductions to nonresidents.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director
Gerald H. Goldberg

Date
03/14/03

The California Constitution, however, prohibits an administrative agency from refusing to enforce a California statute on the grounds that it is unconstitutional, unless an appellate court has determined that such statute is unconstitutional. Unless the statute is amended, the department will be required to continue to enforce it unless an appellate court rules otherwise.

THIS BILL

This bill would provide that the deduction for alimony payments is **allowed** to a nonresident or part-year resident. This deduction would be allowed in the same ratio (not to exceed 1.00) that "California adjusted gross income (AGI)" for the entire year, computed without regard to the alimony deduction, bears to "total AGI" for the entire year, computed without regard to the alimony deduction. This ratio is consistent with the treatment of adjustments to income for nonresidents under current law as amended by AB 1115 (Stats. 2001, Ch. 920).

IMPLEMENTATION CONSIDERATIONS

This bill would improve the department's administration of state tax law by eliminating a federal constitutional issue.

LEGISLATIVE HISTORY

A substantially similar provision was included in legislation (AB 1115) in 2001, but was removed from that bill during Senate Appropriation Committee hearings based on the proposal's estimated \$5 million revenue loss. In 2002 the revenue impact of the proposal was reexamined and was revised to reflect an insignificant revenue loss by examining actual tax returns claiming this deduction. This proposal was inserted into an Assembly Revenue and Taxation Committee bill but was subsequently removed in a later amendment to that bill.

PROGRAM BACKGROUND

The United States Constitution, under what is known as the Privileges and Immunities Clause, provides that the citizens of each state are entitled to all the privileges and immunities of the citizens of all the states.

In 1998 the United States Supreme Court considered the application of this clause to a New York statute denying nonresidents an alimony deduction in computing New York adjusted gross income.

In *Lunding Et Ux. v. New York Appeals Tribunal et al.* (1998) 118 S.Ct. 766, the court struck down the New York statute holding that New York's categorical denial of the deduction to nonresidents violated the Privilege and Immunities clause of the Federal Constitution, stating that New York had not substantially justified its discriminatory treatment of nonresidents. Although New York's nonresident alimony statute, New York Tax Law Section 631(b)(6), is worded differently than California's Revenue and Taxation Code Section 17302, the effect is identical.

OTHER STATES' INFORMATION

Florida has no comparable method of taxation of nonresidents of that state since it has no personal income tax.

Illinois and *Michigan* allow the alimony paid by a nonresident to be deducted in arriving at adjusted gross income.

Under *Massachusetts* law, if a nonresident pays alimony to a Massachusetts resident, the nonresident may deduct the alimony paid.

New York allows a nonresident a deduction for alimony paid using the same ratio that their business income is apportioned to New York.

Those states were examined due to similarities to California of those states' population and business activity.

FISCAL IMPACT

This bill would ease the administration of California's laws and potentially improve compliance by nonresident taxpayers.

ECONOMIC IMPACT

Revenue Estimate

This proposal is estimated to impact the PIT revenue as follows:

Estimated Revenue Impact of AB 612 Effective January 1, 2003 [\$ In Millions]			
	2003-04	2004-05	2005-06
Nonresident Alimony Deduction	Negligible Loss	Negligible Loss	Negligible Loss

Negligible loss is less than \$250,000 annually.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

These estimates reflect various factors including the amount of alimony paid by and average apportionment factor of California nonresidents and part-year residents based on the department's PIT samples. It is projected that the majority of the estimated revenue loss would begin in 2006-7 based on a projected \$2 million of revenue loss associated with foregone compliance enforcement of this issue.

ARGUMENTS/POLICY CONCERNS

Some taxpayers and their representatives will support this bill because it would resolve a federal constitutional issue. It would also reflect a fair tax policy by providing the same tax benefit to both residents and nonresidents of California.

LEGISLATIVE STAFF CONTACT

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