ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	McClintock	Analyst:	LuAnna Hass	Bill Number:	SCA 3
Related Bills:	See Legislative History	Telephone:	845-7478	Introduced Date:	February 6, 2003
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Expenditures Limit/Issuance Of Rebates

SUMMARY

This measure would require the Franchise Tax Board (FTB) and the State Controller to issue rebates of a portion of the revenues received by the state in excess of the amount appropriated by the State during the fiscal year.

This analysis will not address the measure's changes to the other provisions of the California Constitution regarding various appropriations and the State School Fund, as they do not impact the department or state income tax revenue.

PURPOSE OF THE BILL

According to the author's staff the purpose of this measure is to create a new process to return excess revenue to taxpayers via the income tax system.

EFFECTIVE/OPERATIVE DATE

This measure would become effective and operative the day following approval by the voters in the next general election, which would be in November 2004, if such approval occurs.

POSITION

Pending.

ANALYSIS

STATE LAW

Under the California Constitution, the voters of the State have the authority to approve or reject any amendments to the State Constitution. Private citizens or groups can initiate amendments or the Legislature may place an amendment on the ballot if the proposal passes each House by a two-thirds vote. The Legislature proposes amendments to the California Constitution by passing a Senate Constitutional Amendment (SCA) or an Assembly Constitutional Amendment (ACA). Neither an SCA nor an ACA require the approval of the Governor. After the Legislature approves an SCA or ACA by two-thirds vote in the Senate and the Assembly, it is assigned a proposition number and placed on a statewide ballot for the voters to approve or reject the proposed change. Any amendment to the Constitution proposed by the Legislature and adopted by a majority vote of the people takes effect the day after its adoption.

Board Position:			Department Director	Date
_______ S	_______ NA	_______ NP	Gerald H. Goldberg	02/21/03
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_______ N	_______ OUA	_______ PENDING		

Currently, specific provisions of Article XIIIB of the California Constitution:

- Prohibit a government entity's annual appropriation from exceeding its annual limit, which is adjusted annually for the cost of living and population changes.
- Provide that:
  - 50% of the excess revenues that are received by the State in a fiscal year, which is in excess of the amount that may be appropriated by the State for that same fiscal year, are transferred to the State School Fund.
  - The remaining 50% of the excess revenues must be returned by the State by revising tax rates or fee schedules within the next two subsequent fiscal years.

THIS BILL

This measure would create the Emergency Reserve Account, Revenue Stabilization Account, and Rebate Account within the General Fund of the State. In any fiscal year that the Controller determines that the total revenues received by the State exceeds the amount that may be appropriated by the state for that fiscal year, the following would occur:

- The Controller would transfer an amount equal to the excess revenue in the General Fund into the Emergency Reserve Account, so long as the total amount in the reserve account does not exceed 3% of the total General Fund revenues for that fiscal year.
- If total excess revenues for any fiscal year exceed the amount that may be transferred above, the Controller would transfer an amount equal to that excess to the Revenue Stabilization Account, so long as the total amount in the stabilization account does not exceed 7% of the total General Fund revenues for that fiscal year.
- If excess revenues remain after both allocations above, then 50% of the remaining excess would be transferred to the State School Fund and 50% transferred to the Rebate Account.

At the end of each fiscal year, the funds in the Rebate Account would be rebated to certain California taxpayers on a pro rata basis. The rebates would be issued to persons, corporations, or other entities that paid taxes on, or measured by, income for taxable years that began during the prior calendar year. FTB and the Controller would be authorized to jointly take any necessary actions that would facilitate the issuance of the rebates. This measure would be self-executing, meaning the rebate process would begin once the State has realized the appropriate excess revenues. Enabling legislation would not be required, but legislation may be enacted to facilitate the operation of the rebate process, so long as the legislation does not conflict with this measure.

IMPLEMENTATION CONSIDERATIONS

The Revenue and Taxation Code requires FTB to administer and enforce the income tax laws. This constitutional amendment generally would require FTB and the Controller to oversee the issuance of rebates. Additional enabling legislation would not be needed for the issuance of rebates if the voters pass the proposed constitutional amendment and the State receives excess funds subject to rebate under this measure.

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

- Clarification of the phrase "pro rata basis." Under this measure, funds must be rebated to California taxpayers on a pro rata basis to persons, corporations, or other entities that paid taxes on, or measured by income. It is unclear what specific criteria or measures FTB would use to determine the pro rata share of rebate for each taxpayer. The following are a few of the questions that should be addressed:
  - Would the rebate amount be based on factors such as total income or total tax?
  - Would there be a minimum or maximum rebate amount?
  - Would the rebate amount for taxpayers who are married and filing a joint tax return be twice the amount of a rebate for an individual taxpayer?

  In addition, the department receives annually approximately 2,000 Corporation Franchise Tax returns from corporations that have income of at least $10 million, which accounts for 70% of the franchise tax payments. If "pro rata basis" were based on tax paid and corporations were eligible for the rebate under this bill, then these corporations would receive a bulk of the rebate funds.
- A timeframe for the issuance of the rebates. This measure provides the rebate is in proportion to the taxpayer's tax liability and all funds in the Rebate Account must be rebated at the end of each fiscal year. However, personal income tax returns may be filed, with extension, until October 15. The department generally processes returns within six months of receipt, which means a majority of the tax returns should be processed by April of the following year. In order to calculate rebates proportionate to the tax liability, FTB would need to process all tax returns for the identified tax year prior to calculating the rebate amount to ensure all eligible taxpayers are accounted for. For example, tax returns for the 2002 taxable year may be filed until October 15, 2003, and most of the processing completed by April of 2004. Therefore, if the state has excess revenues for the 2002/2003 fiscal year, FTB may be able to begin calculating the rebates in April 2004 based on the 2002 taxable year.
- Provisions of the Internal Revenue Code require reporting of state or local income tax refunds to the IRS. Although the rebate payments are based on funds available from excess state revenues, and not solely derived from excess income taxes paid, it is likely that the rebate would be required to be reported to the IRS as additional income. However, if the rebate were considered a refund of income taxes paid, it also would be required to be reported to the IRS. However, the reporting requirements for the department differ for income and refunds.
- Could rebate payments be revised after issuance? Depending on the factors determining the pro rata rebate amount, certain circumstances could result in rebate revisions. These factors include the receipt of amended returns, audit adjustments, or processing errors.
- How will offsets to FTB, the Internal Revenue Service, and other State agencies be handled? Currently, these agencies participate in an agency-offset process where refunds are offset to satisfy an outstanding liability owed by the taxpayer to another government entity. Without clarification this could be construed as either a payment of excess state revenues or a refund of taxes paid. As such, clarification would be needed on whether these payments would be subject to the agency-offset process.

If these concerns and any additional concerns that may be identified are not clarified in this measure, then the department would need future enabling legislation prior to the issuance of the rebates.

In addition, if FTB were responsible for issuing the rebates as proposed by this measure, the department would need to create a new system for issuing and processing the rebates. This measure does not include an appropriation to cover the costs of developing a system for issuing and processing the rebate. Without an appropriation the department would be required to redirect resources from revenue producing activities to implement this measure.

LEGISLATIVE HISTORY

ACA 6 (Campbell, 2003/2004) would require the Franchise Tax Board (FTB) to issue rebates of excess revenues to personal income taxpayers. This bill is at the Assembly Desk.

ACA 22 (Campbell, 2001/2002) would have required FTB and the State Controller to issue rebates of a portion of the revenues received by the state in excess of the amount appropriated by the State during the fiscal year. This bill was held at the Assembly Desk.

SCA 16 (McClintock, et al., 2001/2002) would have required FTB and the State Controller to issue rebates of any revenues received by the state in excess of the amount appropriated by the State during the fiscal year. This bill failed passage with the Senate Revenue and Taxation Committee.

A version of AB 2869 (Machado, Stats. 2000, Ch. 977) prior to enactment would have authorized a sales and use tax rebate to qualified taxpayers of $50 or a variable amount based on the taxpayer's filing status and federal adjusted gross income. This provision was removed from the bill.

AB 2609 (Stats. 1987, Ch. 915) and SB 47 (Stats. 1987, Ch. 908) authorized a tax rebate of excess funds for the 1986 taxable year. Qualified taxpayers were allowed a tax rebate of 15% of the tax imposed by the income tax law, as defined, with specified minimum dollar limits and maximum dollar limits. The rebate was calculated and administered by FTB. The Controller was required to send rebate checks to taxpayers by January 15, 1988.

OTHER STATES' INFORMATION

A review of the state laws and Constitutions of *Florida, Massachusetts, Michigan,* and *Minnesota,* found the following:

- *Florida* and *Minnesota* require excess revenues to be refunded to the taxpayers.
- *Massachusetts* allows a credit, called the "excess revenue credit," toward taxpayers' personal income tax liabilities.
- *Michigan* requires excess revenue to be refunded on a pro rata basis that is based on the liability reported on the Michigan income tax and single business tax returns.

A review of *New York* and *Illinois* state laws and Constitutions did not produce any information regarding procedures for excess revenues. The laws of these states were reviewed because of similarities to California income tax laws.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved but are anticipated to be significant. At a minimum, the department would need to implement a system to calculate and issue the rebates proposed in this bill.

ECONOMIC IMPACT

This measure would not impact personal income tax and corporate tax revenues.

ARGUMENTS/POLICY CONCERNS

Other methods are available to rebate excess State revenue that may be accomplished more efficiently, such as a change in 1) tax rates, 2) taxable income brackets, or 3) the standard deduction.

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