

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: June 2, 2003

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Local General Income Tax/Public Safety Finance Agency

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 amended April 23, 2003.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED April 23, 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 in this analysis.

SUMMARY OF AMENDMENTS

The June 2, 2003, amendments resolved several, but not all, of the implementation and technical concerns as discussed in the department's analysis of the bill as amended April 23, 2003. Specifically, these amendments would create Part 10.1 of the Revenue and Taxation Code and the provisions of that part would:

- Require FTB to revise the personal income tax (PIT) forms to allow individuals to report a local income tax and require the city and county of their residence to be designated on the return;
- Require the city or county to notify FTB by June 1st of any calendar year of the passage of a measure to impose a local income tax, which would allow FTB sufficient time to revise the PIT forms and booklets;
- Clarify that FTB would administer and collect the local income tax in the same manner as PIT, which would include, but not be limited to, the assessment of penalties, interest, fees, and deficiency assessments;

Board Position:

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Legislative Director

Date

Brian Putler

06/30/03

- Define “resident” by reference to current state income tax law, modified to reflect residency in a city or county or city and county, which would allow FTB to use the same rules for determining residency that are used under PIT law;
- Specify that FTB would transmit the local income tax revenue, less any refunds and FTB’s costs to implement and administer the tax, to the appropriate city or county; and
- Specify that a local income tax delinquency would fall after child support and other taxes collected by FTB in the order of payment priority as specified under current law.

As a result of the amendments, the department has revised or identified additional implementation, technical, and policy considerations. For convenience, all new and existing concerns are provided below. The remainder of the department’s analysis of the bill as amended April 23, 2003, still applies.

POSITION

Pending.

ANALYSIS

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

- 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 be readily 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. The department costs outlined in “Fiscal Impact” below includes the costs to separate the penalties and interest attributable to the local income tax. Amendment 4 is provided to require FTB to transmit the appropriate penalties and interest attributable to the local income tax to the city or county.
- This bill would authorize the imposition of a local income tax upon the taxable income of any person who is a resident of that locality 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 and one personal exemption would have a PIT net tax of \$7,342. If the taxpayer resided in a city and county that imposed a local general tax of 10%, the local general tax amount would be \$734. 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 \$6,342, but their local income tax would still be \$734.

- 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. Generally, estimating revenue projections is done by a state agency other than FTB, which may have the appropriate information and systems to make such projections. Currently FTB uses zip codes to identify counties for statistical purposes. Zip codes that overlap county boundaries are rare. 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. The costs described under “Fiscal Impact” below do reflect the cost to create or modify a system to sort tax statistics to the appropriate jurisdictions and estimate the amount of local income tax that could be collected. However, even with a system in place to estimate the local income tax that could be collected, the methodology would be imprecise and could result in substantial errors for specific localities.
- This bill requires FTB to transmit the local income taxes collected within 60 days after collecting the tax. 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 15th or, with an extension, October 15th. In order to ease administration for FTB, the department would likely remit the funds weekly or monthly, which would have a minor impact on current fiscal operations.

The time required to process PIT returns depends on the volume received, complexity of the returns, and whether the returns result in a refund or balance due. Department staff recommends amending the bill to provide that FTB would transmit the local income tax within 60 days of when the PIT return is *processed* or FTB *collects* any unpaid local income tax. Amendment 6 is provided to clarify this timeframe.

- Although this bill would define “resident” by reference to current state income tax law, modified to reflect residency in a city or county or city and county, which would allow FTB to use the same rules for determining residency that are used under PIT law, this definition is likely to be burdensome for purposes of a taxpayer that lives in a city or county, or city and county, for part of a year. Amendment 2 is provided to specify that a taxpayer would be considered a resident of a city or county, or city and county, for purposes of a local income tax so long as he or she is a resident of the city or county, or city and county, for at least six months during the taxable year.
- This bill would require FTB to transmit the local income tax amounts, less FTB’s costs to administer the tax, to the appropriate city and county. Current laws regarding non-tax debts administered by FTB provide for a reimbursement to FTB of costs to administer the programs. Generally, the laws are usually specific to the amount of reimbursement available to FTB and require an agreement between agencies outlining the reimbursement. The language in this bill should be clarified to reflect something similar to existing statutes, which would require FTB to enter into a contractual agreement with the city or county that would outline the reimbursement procedure instead of FTB being reimbursed through the amounts collected. Amendments 5 and 6 are provided.

- This bill would require an individual to include his or her city and county of residence on the PIT return, which would allow an individual that resides in a city or county with a local income tax to self-assess the tax on the PIT return. In the event the individual includes the city and county of residence but fails to calculate and include a tax amount, FTB could treat the failure to self-assess any tax due as a math-error, as defined under current income tax law, and subsequently calculate the local income tax amount and send a notice to the taxpayer. However, in the event the taxpayer fails to include the city and county of residence, Amendment 3 would allow FTB to use the individual's mailing address included on the tax return to determine the city and county of residence. If the individual's mailing address were in a city or county with a local income tax, Amendment 3 also would allow the department to treat the omission of local income tax as a math-error, calculate the local income tax, and send a notice of tax due to the taxpayer.

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." Amendment 1 is provided to correct the reference to "income tax."

This bill references the "board" as the agency to transmit the local income tax revenues to the cities and counties. Board is defined within the R&TC as the Board of Equalization (BOE). Amendment 4 is provided to reference FTB instead of BOE.

FISCAL IMPACT

In order to administer a local income tax program, FTB would incur significant system programming hours. The department would need to create codes and program the systems to identify and calculate the tax for each city, county, and city and county. The calculation of the local income tax would be adjusted in those instances where a mathematical correction is made to a return during processing that would change a taxpayer's PIT liability. The taxpayer would either get a reduced refund or be billed for the additional local income tax. The department also would need to extensively modify the billing system specifically for those taxpayers who do not report or pay the local income tax. All of the information relating to the local income tax would need to be captured and retained in the department's systems. In addition, although a worksheet and instructions would be provided in the PIT booklet, the department anticipates an increase in taxpayer contacts to the department for assistance in calculating the local income tax. Further, there could be an increase in the department's collection activities for those taxpayers who fail or refuse to report or pay a local income tax.

As a result, the department has identified a preliminary implementation cost estimate of \$3.5 - \$3.7 million. Total costs include changes to the tax forms, instructions and booklets, programming, testing, and maintaining departmental systems, processing hours, remittance of the local income tax to the appropriate city, county, or city and county, and the development and negotiation of agreements to ensure taxpayer privacy and non-disclosure of taxpayer information. For purposes of this estimate, the department used the San Diego County population that filed approximately 1.1 million PIT returns. Of the \$3.6 - \$3.8 million estimated above, approximately \$2.4 million is for systems updates and the printing of PIT booklets to include a new worksheet and the various codes. The \$2.4 million cost is not based on the population of a specific city, county, or city and county and would be consistent regardless of the number of cities, counties, or cities and counties that may enact a local income tax. Any cost in excess of the \$2.4 million would be based on the population of a specific city, county, or city and county. Therefore, the department's cost could increase significantly depending on the number and population of cities, counties, or cities and counties that may enact a local income tax.

This bill does not include a provision to cover FTB's start-up costs. To ensure the department has the funding to implement this bill, the department would suggest the author add appropriation language to this bill that would cover the start-up costs of implementation. At a minimum, department staff suggests appropriation language that would provide FTB \$100,000 for the 2003/2004 fiscal year to create or modify a system to estimate the local income tax that could be collected and \$2.3 million for the 2004/2005 fiscal year due to the significant tax forms changes and the programming and testing effort required. The department is currently working on Budget Change Proposals (BCPs) for the 2004/2005 fiscal year and deficiency requests for the 2003/2004 fiscal year. However, absent an appropriation or Department of Finance approval of a BCP for the 2004/2005 fiscal year or a deficiency request for the 2003/2004 fiscal year, the department would be required to redirect staff from other revenue generating activities of the department, such as collections administration or audit, to administer this bill.

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 local income 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.

Since this bill does not currently contain a provision to require employers to increase withholding from an employee's (taxpayer's) wages, it is possible that a taxpayer that resides in a city or county that enacts a local income tax would not have sufficient withholding to cover both his or her PIT liability and the local income tax liability for a taxable year. As a result, the taxpayer may be subject to underpayment penalties.

The majority of tax returns are filed on a calendar-year basis. The local income tax would be self-assessed on tax returns filed after the close of that calendar year. For fiscal purposes, ideally, the estimate of local income tax and the collection of the tax would be made for the same taxable year as the tax is assessed on the return. However, the timeliness of the transfer of money to the local jurisdiction may be an issue. Local jurisdictions generally operate on a fiscal year basis. For those returns filed and processed by April 15th the local jurisdiction would likely receive the transfer of tax before the end of one fiscal year. For tax returns filed by the extended due date in October, the local income tax amounts would be transferred to the local jurisdiction in the next fiscal year.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1690
As Amended June 2, 2003

AMENDMENT 1

On page 5, lines 19, 22, and 24, strikeout "tax" and insert:

income tax

AMENDMENT 2

On page 7, line 18, strikeout "has the" and strikeout lines 19 through 21, inclusive, and insert:

means an individual who resides in the city, the county, or the city and county, for more than six months during the taxable year.

AMENDMENT 3

On page 7, line 22, after "(a)" insert:

(1)

On page 7, between line 27 and line 28, insert:

(2) If a taxpayer fails to include the taxpayer's city and county of residence on the return, the city and county of residence will be presumed to be the city and county determined on the basis of the mailing address on the return.

(3) If a taxpayer fails to include a city or county of residence on the return as required by paragraph (1), then any adjustment required to make the local income tax assessment on the return shall be treated as arising out of a mathematical error and assessed and collected under Section 19051.

AMENDMENT 4

On page 7, modify line 33 as follows:

18205. The ~~board~~Franchise Tax Board shall transmit local income tax and applicable penalties and interest

AMENDMENT 5

On page 7, line 34, strikeout "and net of an amount" and strikeout lines 35 through 37, inclusive.

AMENDMENT 6

On page 7, line 39, strikeout "collecting the tax" and insert:

the personal income tax return is processed or the tax is collected, whichever is later.

18206. A city or county that enacts a local income tax in accordance with this part shall enter into an agreement with the Franchise Tax Board to provide for reimbursement to the Franchise Tax Board of expenses incurred by the Franchise Tax Board to implement and administer this part.