Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author: Chan, et al. | Analyst: Rachel Coco | Bill Number: AB 4

Related Bills: See Legislative History | Telephone: 845-4328 | Amended Date: April 3, 2003

Attorney: Patrick Kusiak | Sponsor: ____

SUBJECT: PIT Rates/Increase Maximum Rates To 10% And 11% And Alternative Minimum Tax Rate To 8.5%

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ____________.

X 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/amended ____________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________.

____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED ____________ STILL APPLIES.

X OTHER - See comments below.

SUMMARY

This bill would increase the top personal income tax (PIT) rate from 9.3% to 10% and 11% and would increase the alternative minimum tax (AMT) rate from 7% to 8.5%.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to restore the higher tax rates to address the current budget shortfall.

EFFECTIVE/OPERATIVE DATE

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

POSITION

Pending.

Board Position:			Department Director	Date
____ S	____ NA	____ NP	Gerald H. Goldberg	4/24/03
____ SA	____ O	____ NAR		
____ N	____ OUA	X PENDING		

ANALYSIS

FEDERAL/STATE LAW

Federal law imposes five different income tax rates on individuals ranging from 15% to 38.6%. Existing state law imposes six different PIT rates ranging from 1% to 9.3%. Each tax rate applies to a different level of income known as a "tax bracket." Existing state law requires the Franchise Tax Board (FTB) to recompute the tax brackets each year based on the change in the California Consumer Price Index (CPI).

Federal law provides a personal AMT rate of 26%. Existing state law provides a personal AMT rate of 7%. A taxpayer with substantial income can use preferential tax benefits, such as exclusions, deductions, and credits, to reduce their income tax liability. AMT was established to ensure that a taxpayer who can use preferential tax benefits does not completely escape taxation.

THIS BILL

This bill would increase the AMT rate to 8.5% for individual taxpayers.

This bill also would establish a PIT rate of 10% for:

- Single filers (including married filing separate) whose taxable income is over $130,000,
- Joint filers whose taxable income is over $260,000, and
- Head of household filers whose taxable income is over $140, 000.

This bill also would establish a PIT rate of 11% for:

- Single filers (including married filing separate) whose taxable income is over $260,000,
- Joint filers whose taxable income is over $520,000, and
- Head of household filers whose taxable income is over $275,000.

For example:

2002 Tax Brackets And Rates
For Single Filers

$0	-	$5,834	1.0%
$5,834	-	$13,829	2.0%
$13,829	-	$21,826	4.0%
$21,826	-	$30,298	6.0%
$30,298	-	$38,291	8.0%
$38,291	-	And over	9.3%

2003 Tax Brackets And Rates
For Single Filers
As Proposed

$0	-	$5,834	1.0%
$5,834	-	$13,829	2.0%
$13,829	-	$21,826	4.0%
$21,826	-	$30,298	6.0%
$30,298	-	$38,291	8.0%
$38,291	-	129,999	9.3%
$130,000	-	$259,999	10%
$260,000	-	And over	11%

Note: The 2003 tax bracket amounts are not known at this time due to the annual indexing adjustment, which is based on data that is not available until the end of June 2003.

This bill also provides that the 10% and 11% brackets would be adjusted annually for inflation.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

LEGISLATIVE HISTORY

SB 169 (Alquist, Stats. 1991, Ch. 117) increased the tax rates on individuals for taxable years beginning on or after January 1, 1991, and before January 1, 1996, by adding 10% and 11% brackets and increasing the AMT rate from 7% to 8.5%.

PROGRAM BACKGROUND

In the early 1990s, California faced a severe recession, which resulted in significant shortfalls in the state budget. In response, the state acted to increase revenues and reduce expenditures. As one way of increasing revenues, the state imposed a temporary income tax rate increase in 1991, adding 10% and 11% rates for the highest income taxpayers. This temporary tax increase was in effect for four taxable years and sunset for taxable years beginning on or after January 1, 1996.

During the November 1996 general election, Proposition 217 was submitted to the voters. Proposition 217 would have extended the income tax increase for higher-income taxpayers and allocated the money from the tax increase to schools and local governments. The proposition was defeated by a margin of 50.8% to 49.2%.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida does not have a personal income tax. *Illinois* and *Michigan* impose a flat tax. *Massachusetts* has a split rate, a flat tax rate of 5.3% for most income and 12% for certain capital gains, dividends, and interest. *Minnesota* has a progressive rate with a maximum tax bracket of $61,460 and a maximum tax rate of 7.85%. *New York* has a progressive rate with a maximum tax bracket of $40,000 and a maximum tax rate of 6.85%. These amounts and rates apply to the 2002 taxable year.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue gains:

Revenue Impact ($ Billions)			
Fiscal Year	2003-04	2004-05	2005-06
Revenue Gain	+2.7	+2.1	+2.4

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

Revenue Discussion

The first fiscal year, 2003-04, has a higher revenue gain because it includes all of 2003 revenue and only a portion of 2004.

The tax brackets proposed by this bill were applied as follows:
The 10% tax rate would begin at $130,000 for single, $260,000 for joint, and $140,000 for head of household. The 11% rate would begin at $260,000 for single, $520,000 for joint, and $275,000 for head of household.

The projected 2003 CPI growth rate of 2.9% was multiplied by the current 2002 tax brackets in order to get the projected 2003 tax brackets. The projected 2003 brackets were increased by the projected CPI rate of 3.19% to calculate the brackets for 2004 and subsequent years.

Approximately 410,000 income tax returns would be subject to the 10% and 11% tax rates in the 2003 tax year.

LEGISLATIVE STAFF CONTACT

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