

State of California

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Legislative Change No.

04-41

Bill Number: Proposition 63 Proponent: Steinberg

Laws Affecting Franchise Tax Board: Revenue and Taxation Code Sections 17043, 19602, and 19602.5

Enacted at the November 2, 2004, General Election

SUBJECT: Proposition 63/Mental Health Services Expansion and Funding/Tax on Taxable Income Over \$1 Million

Proposition 63 (Initiative Statute), made the following changes to California law:

Section 17043 is added to the Revenue and Taxation Code.

For taxable years beginning on and after January 1, 2005, this initiative statute imposes an additional tax of 1% of the amount of the taxpayer's taxable income (TI) that is over \$1 million. The TI subject to the additional tax is the TI upon which the regular tax is imposed. Thus, in the case of a nonresident, the California source TI must exceed \$1 million for this additional tax to apply.

This additional tax is not subject to reduction by credits, the TI threshold of \$1 million is not indexed, the tax is imposed on the TI required to be shown on the return without regard to filing status, and the income splitting provisions of Section 17045 do not apply.

This section provides that for purposes of applying Part 10.2 this additional tax is treated as if it were imposed under Section 17041. Thus, this additional tax is subject to the estimated tax payment requirements, interest, penalty, and other tax administration rules.

Section 19602 of the Revenue and Taxation Code is amended.

Adds to the list of exceptions the amounts required to be credited to the Personal Income Tax Fund to reflect the revenues deposited in the Mental Health Services (MHS) Fund under Section 19602.5.

Section 19602.5 is added to the Revenue and Taxation Code.

The estimated revenue from the additional tax imposed under Section 17043 is required to be deposited on a monthly basis in the MHS Fund, subject to an annual adjustment based on actual cash flow deposits and actual tax returns filed.

Bureau Director

Jana Howard for Brian Putler

Date

11/19/04

The annual adjustment amount for the following fiscal year would be determined by the Department of Finance, in consultation with the FTB, on March 1 after the tax returns are filed. The Department of Finance is required to notify the Legislature and the Controller of the annual adjustment amount within 10 business days after the determination is final.

If the annual adjustment amount is a positive number, the Controller is required to transfer that amount from the General Fund to the MHS Fund on July 1 of the following fiscal year. If the annual adjustment amount is a negative number, the Controller is required to suspend monthly transfers to the MHS Fund for the following fiscal year, until the total amount of suspended deposits for the following fiscal year equals the amount of the negative annual adjustment amount.

See Attachment 1 for a graphic of the funding mechanism of Proposition 63, Attachment 2 for a time line of the funding mechanism of Proposition 63, and Attachment 3 for examples showing the calculation of the annual adjustment amount.

This act is effective November 3, 2004. The 1% tax is operative for taxable years beginning on or after January 1, 2005.

This act will not require any reports by the department to the Legislature.

63000
10000

Estimated Increase In Tax Liability and Fiscal Year Revenue

Impose 1% additional tax on TI in excess of \$1 million

<u>Tax Year</u>	<u>Est. Tax Liability Increase</u>
2005	\$ 634 million
2006	\$ 672 million
2007	\$ 713 million
2008	\$ 758 million
2009 and later	annual growth of 7% of preceding tax year

<u>Applicable Fiscal Year</u>	<u>Est. Revenue From Additional Tax</u>
2004-05	\$ 254 million
2005-06	\$ 683 million
2006-07	\$ 690 million
2007-08	\$ 733 million
2008-09 and later	annual growth of 7% of preceding fiscal year

63000
10000

Cash Flow Deposits In Mental Health Services (MHS) Fund

Net Personal Income Tax Receipts (102 Report)
Amounts Received By FTB and EDD Under PIT Law

x

<u>Fiscal Year</u>	<u>Monthly %</u>
2004-05	.70%
2005-06 and later	1.76%

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Monthly Cash Deposited In MHS Fund

63000
10000

Annual Adjustment Of Cash Flow Deposits In MHS Fund Starting FY 2006-07 Based On Actual Cash Flow Deposits And Actual Tax Return Data

Tax Liability Adjustment Amount (TLAA)
Actual tax increase based on tax return data minus TY estimate under Step 1

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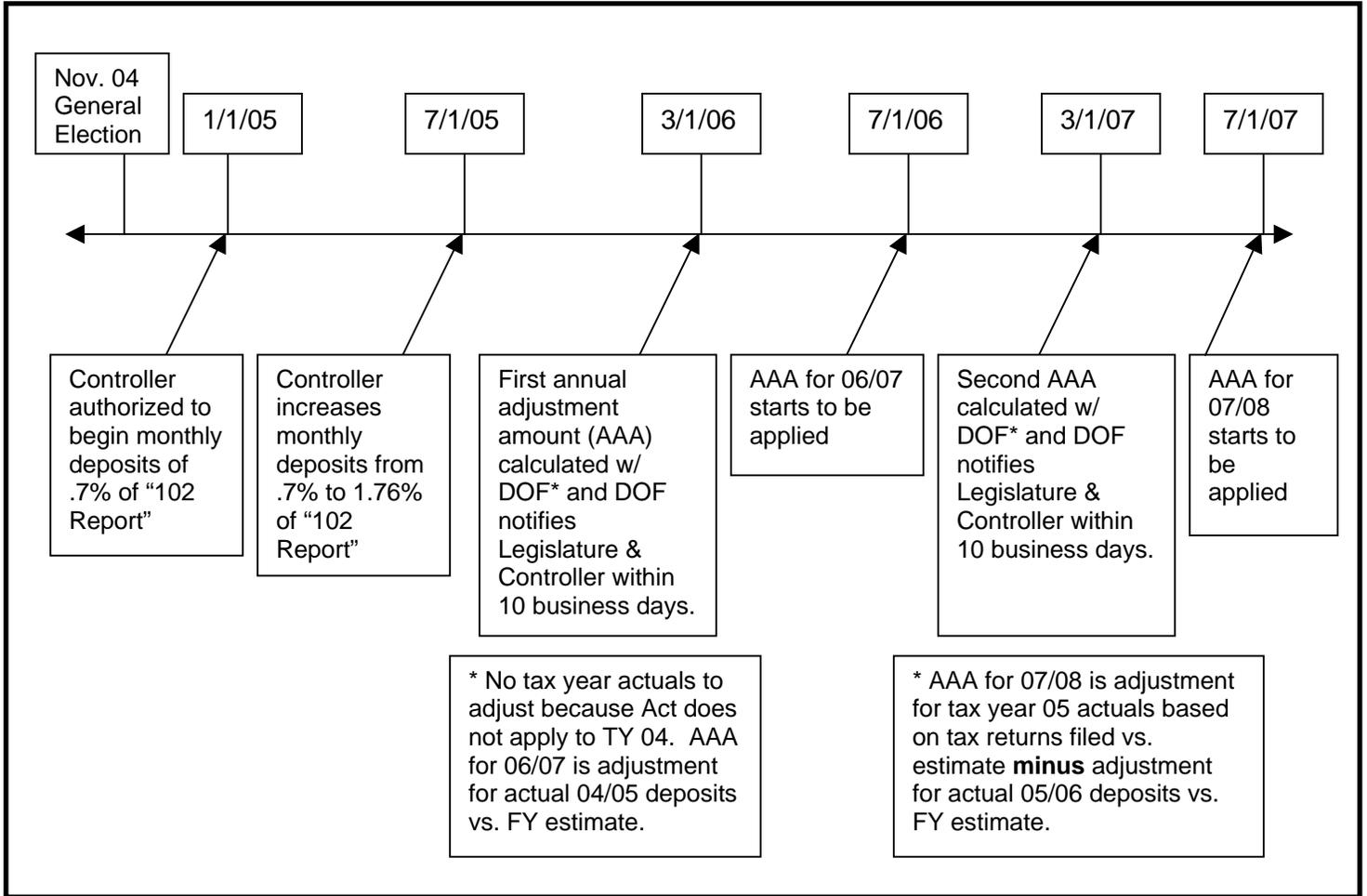
Revenue Adjustment Amount (RAA)
Deposits under Step 2 minus FY estimate under Step 1

=

Annual Adjustment Amount (AAA)*

* If annual adjustment amount is a positive number, the Controller transfers that additional amount from the General Fund to the MHS Fund at the beginning of the next fiscal year.
* If annual adjustment amount is a negative number, the Controller suspends monthly deposits under Step 2 until total amounts suspended equal that amount.

Attachment 2
Time Line Of The Funding Mechanism Of Proposition 63



Attachment 3
Calculation of Annual Adjustment Amount - Examples

Tax Liability Adjustment Amount (TLAA) = Actual tax liability increase for tax year based on tax return data minus Estimated Tax Liability Increase for tax year (Table in Prop 63)

Revenue Adjustment Amount (RAA) = Actual deposits for applicable FY minus Revenue Estimate for applicable FY (Table in Prop 63)

Annual Adjustment Amount (AAA) for FY Y = TLAA for TY beginning 2 years before FY Y minus RAA for FY 2 years before FY Y

EXAMPLES

1. March 1, 2006 AAA Fiscal Year 2006-07 Calculation

A. MHS Fund Overfunded

TLAA = \$0 (Proposition 63 does not apply to Tax Year 2004)

- RAA = \$46 million (**Assume** actual deposits \$300 million (.7% of "102 Report" Cash Flow) minus \$254 million revenue estimate for 2004-05
Applicable Fiscal Year per Table)

2006-07 AAA = -\$46 million [Monthly deposits suspended until suspended deposits equal the negative amount.]

B. MHS Fund Underfunded

TLAA = \$0 (Proposition 63 does not apply to Tax Year 2004)

- RAA = -\$34 million (**Assume** actual deposits \$220 million (.7% of "102 Report" Cash Flow) minus \$254 million revenue estimate for 2004-05
Applicable Fiscal Year per Table)

2006-07 AAA = + \$34 million [One-time supplemental payment on July 1, 2006.]

2. March 1, 2007 AAA Fiscal Year 2007-08 Calculation

A. MHS Fund Overfunded

TLAA = \$10 million (**Assume** actual tax liability increase based on TY 2005 returns of \$644 million minus estimated tax liability increase of \$634 million for 2005 Tax Year per Table)

- RAA = \$17 million (**Assume** actual deposits \$700 million (1.76% of "102 Report" Cash Flow) minus \$683 million revenue estimate for 2005-06
Applicable Fiscal Year per Table)

2007-08 AAA = -\$7 million [Monthly deposits suspended until suspended deposits equal the negative amount.]

B. MHS Fund Underfunded

TLAA = \$66 million (**Assume** actual tax liability increase based on TY 2005 returns of \$700 million minus estimated tax liability increase of \$634 million for 2005 Tax Year per Table)

- RAA = \$17 million (**Assume** actual deposits \$700 million (1.76% of "102 Report" Cash Flow) minus \$683 million revenue estimate for 2005-06
Applicable Fiscal Year per Table)

2007-08 AAA = + \$49 million [One-time supplemental payment on July 1, 2007.]