

**ANALYSIS OF AMENDED BILL**

Author: DeVore Analyst: Raul Guzman Bill Number: AB 1914  
 Related Bills: See Legislative History Telephone: 845-4624 Amended Date: March 30, 2006  
 Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

<b>SUBJECT:</b>	Allow Taxpayers That Receive Capital Gains From Mutual Funds To Use Form 540 2EZ
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**SUMMARY**

This bill would require the Franchise Tax Board (FTB) to make additional types of income reportable on Form 540 2EZ.

**PURPOSE OF THE BILL**

According to the author's office, the intent of this bill is to increase the number of taxpayers who can use Form 540 2EZ to include those with certain capital gain income.

This is the department's first analysis of this bill.

**EFFECTIVE/OPERATIVE DATE**

This bill would be effective and operative January 1, 2007.

**POSITION**

Pending.

**ANALYSIS****PROGRAM BACKGROUND**

California income tax forms are created to fit general demographic categories of taxpayers based on the income and deductions they are most likely to report. The forms range from the most complex, which accommodate any combination of income and deductions, to the simplest, which accommodate income profiles made up of only wages, a small amount of interest and dividend, pension income, and minimal deductions. Each of these categories serves a large group of taxpayers, and the differences between each form are easy to communicate to taxpayers.

The Form 540 2EZ was designed and first used for the 1999 tax year. The form was a two-sided post-card income tax return with 25 lines of data. It was created to be the state's simplest tax return. Use was limited to taxpayers with the standard deduction and simple sources of income, with no more than three personal exemption credits, and with wage withholding as the only type of

Board Position:

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Department Director

S. Stanislaus

Date

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tax payments. The Form 540 2EZ uses a special tax table that incorporates the standard deduction and up to three personal exemption credits. Approximately 3 million taxpayers were eligible to use this form in 1999.

In response to a 2002 FTB study, concerns expressed by senior taxpayers, and concerns by the department, the Form 540 2EZ was expanded to an 8 ½" x 11" sheet and revised for the 2003 tax year to include the following:

- A line for nontaxable items such as U.S. social security and railroad retirement benefits.
- A line for the California Senior Special Fund voluntary contribution.
- A line to report Use Tax for purchases from out-of-state.
- Special tax tables and instructions to accommodate the additional personal exemption credit allowed for seniors.

Senate Bill 1534, enacted in 2004, requires FTB to allow taxpayers that receive certain amounts and types of income to file Form 540 2EZ.

For purposes of this requirement, "total income" consists of taxable wages, dividends, interest, and pension income. The dollar amount of the thresholds are as follows:

- For a taxpayer filing as single or as a head of household (HOH), *total income* for the taxable year must be \$100,000 or less.
- For taxpayers filing a joint return or a taxpayer filing as a qualified widow(er), *total income* for the taxable year must be \$200,000 or less.

## **STATE LAW**

Current state law requires the department to make the tax forms as simple as possible for taxpayers to prepare and allows the department the flexibility to create the simplest, most effective tax return possible. The department is required to design the forms so taxpayers can either copy figures from or attach a copy of their federal tax returns. The state income tax law for all individuals is largely patterned upon the federal income tax law.

Senate Bill 1534 (Stats. 2004, Ch. 844) enacted specific total income threshold requirements that increased the number of eligible taxpayers that could use the Form 540 2EZ.

## **THIS BILL**

For purposes of using Form 540 2EZ, this bill would amend the term "total income" to include capital gains from mutual funds along with the existing taxable wages, dividends, interest, and pension income. As a result, this bill would require the department to permit taxpayers, who have capital gains from mutual funds and who meet other existing filing requirements, to use Form 540 2EZ.

This bill would limit the capital gains that can be reported on Form 540 2EZ to:

- only those capital gains distributed from mutual funds, and
- the amounts of reportable capital gains are the same for state and federal purposes.

This bill would repeal this section on January 1, 2010.

### IMPLEMENTATION CONSIDERATIONS

This bill would only allow capital gains distributed from mutual funds to be reported on Form 540 2EZ. A new line to report those capital gains would need to be added to Form 540 2EZ. Those capital gains cannot have a state and federal adjustment because Form 540 2EZ cannot be processed if schedules are attached. If a taxpayer reports capital gains, other than from mutual funds, they would have to complete a different tax form than Form 540 2EZ.

### **LEGISLATIVE HISTORY**

SB 249 (DeVore, 2005/2006) would have required the Legislative Analyst to conduct a study regarding the 540 2EZ including the possible addition of capital gains from mutual funds to Form 540 2EZ. The bill passed both houses but was vetoed by the Governor. The veto message stated, "This bill is unnecessary and partially duplicates the already required report. I strongly recommend that the Franchise Tax Board work with the authors and their analysts office, the Legislative Analysts office, to ensure that the report includes all of the desired information, including information regarding the eligibility expansion to those with capital gains. I believe that such expansion merits review."

SB 1534 (Johnson, Stats.2004, Ch. 844) added the requirement to allow taxpayers with certain types and amounts of income to file a 540 2EZ.

SB 831 (Poochigian/Johnson, 2001/2002) would have declared the Legislature's intent to direct FTB to issue a tax form that could simplify the filing requirements of certain senior citizens. This bill was held at the Assembly Desk and then returned without Assembly action.

AB 1370 (Wiggins, Stats. 2001, Ch. 266) required FTB to conduct a study of all current tax forms that affect taxpayers who are 65 years of age or older to determine what changes are necessary and appropriate to provide the greatest benefit to those taxpayers. FTB was required to provide the results of the study to the Legislature by January 1, 2002, or as soon thereafter as practicable. The study, *California Tax Forms and Senior Taxpayers Study Report (Assembly Bill 1370)*, was completed and provided in April 2002.

## **OTHER STATES' INFORMATION**

The states surveyed include *Illinois, Massachusetts, Michigan, Minnesota, and New York.*

Review of *New York* tax forms found that individuals making more than \$100,000, or with pension or social security income, are required to file the long form.

*Illinois, Massachusetts, Michigan, and Minnesota* provide only one personal income tax form that appears to be the equivalent of a California Form 540.

These states were reviewed because their tax laws are similar to California's income tax laws.

## **FISCAL IMPACT**

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

## **ECONOMIC IMPACT**

### Revenue Estimate

This bill would not impact the state's income tax revenue.

## **LEGISLATIVE STAFF CONTACT**

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