# ANALYSIS OF ORIGINAL BILL

**Franchise Tax Board**

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| Author: | Kuehl | Analyst: | Rachel Coco | Bill Number: | SB 1784 |
| Related Bills: | See Legislative History | Telephone: | 845-4328 | Introduced Date: | February 24, 2006 |
| | | Attorney: | Patrick Kusiak | Sponsor: | |

**SUBJECT**: Impose Additional Tax On Income Exceeding $200,000/California Health Insurance Reliability Funding Act

## SUMMARY

This bill would impose an additional tax on a taxpayer whose income exceeds certain threshold amounts in order to fund a universal healthcare plan.

## PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to provide funding for a universal healthcare program for all Californians.

## EFFECTIVE/OPERATIVE DATE

This bill would be effective immediately upon enactment. The bill specifies an operative date for taxable years beginning on and after January 1, 2007.

## POSITION

Pending.

## ANALYSIS

### STATE LAW

Residents of California are taxed on their entire taxable income (TI), regardless of source, while nonresidents are taxed only on TI from California sources. A part-year California resident's TI for the year they change residency is the sum of the entire TI during the portion of the year they were a resident and the TI from California sources during the portion of the year the taxpayer was a nonresident.

The rate of tax for the 2005 tax year ranges from 1% on TI under $6,319 for single and separate returns, under $12,638 for joint returns, and under $12,644 for heads of household to a maximum of 9.3% on TI over $41,476 for single and separate returns, over $82,952 for joint returns, and over $56,456 for heads of household. These tax brackets are indexed for inflation each year.

Once the tax is calculated, a variety of credits are allowed to reduce the tax. These credits include personal exemption credits, dependent credits, and various incentive credits.

| Board Position: | | | Department Director | Date |
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| _______ SA | _______ O | _______ NAR | S. Stanislaus | 4/28/06 |
| _______ N | _______ OUA | ___X___ PENDING | | |

Beginning with the 2005 taxable year, state tax law imposes an additional 1% tax, not subject to reduction by credits, on the portion of a taxpayer's taxable income that exceeds $1 million. The estimated revenue from the additional 1% tax is deposited into the Mental Health Services (MHS) fund on a monthly basis, subject to an annual adjustment.

## THIS BILL

For taxable years beginning on and after January 1, 2007, this bill would impose an additional tax at an unspecified rate on the portion of a taxpayer's TI that exceeds $200,000, with an additional unspecified rate on TI that exceeds $1 million.

This additional tax could not be reduced by credits.

For taxable years beginning on and after January 1, 2007, this bill also would impose an additional tax at unspecified rates on the following:

- The self-employment income of every taxpayer.
- The nonwage income of every taxpayer.

This bill would define "self-employment income" to mean the net earnings from self-employment made by an individual, excluding any amount less than $7,000 or more than $200,000.

This bill would define "nonwage income" as the amount of adjusted gross income minus net earnings from self-employment, minus the amount of any wages, received by an individual. Nonwage income excludes any amount in excess of $200,000.

This bill would provide that the additional taxes would be subject to the estimated tax payment requirements, and also the interest, penalty, and other tax administration rules, as prescribed with respect to taxes imposed under Revenue and Taxation Code section 17041.

The bill would specify that the proceeds of the additional tax are to be deposited in the Health Insurance Fund and shall be continuously appropriated to the California Health Insurance Agency for specified purposes.

The bill would also require, by November 15, 2007, FTB, in consultation with the Legislative Analyst, to establish by regulation a transfer rate and mechanism for the revenue generated as a result of the additional tax rates. The bill specifies that the transfer rate and mechanism shall be based on those set forth in the provision that created an additional 1% tax on taxable incomes over $1 million enacted by Proposition 63.

## IMPLEMENTATION CONSIDERATIONS

The bill requires the department to draft regulations based on the MHS tax to prescribe how this bill would be implemented. Based on that requirement, the department anticipates implementing this bill in the same manner, including the establishment of the transfer rate and funding mechanism, which would require changes to the computer systems, forms and instructions, and processing procedures.

## TECHNICAL CONSIDERATIONS

This bill uses incorrect nomenclature references. Amendments have been provided to address this consideration.

This bill would require the revenues collected as a result of the additional taxes to be deposited into the Health Insurance Fund for purposes of administering health care benefits under the California Health Insurance System. Since the fund and the health insurance system would be created under another bill, SB 840 (Kuehl, et al.), should this bill be enacted without the passage of SB 840 the department would be unable to deposit the revenues into the appropriate fund. The author may wish to amend both bills to include contingent enactment language or combine both bills into one.

## LEGISLATIVE HISTORY

SB 840 (Kuehl, et al., 2005/2006) would create the California Health Insurance System that would provide healthcare benefits to all people in the state. This bill is currently at the Assembly Rules desk awaiting committee assignment.

ACA 24 (Cohn, 2005/2006) would impose an additional tax at the rate of 1/40th of one percent on the taxable income of a taxpayer that exceeds $1 million with all revenues being deposited into the Domestic Violence Shelter Services Fund. This measure is currently at the Assembly Rules desk awaiting committee assignment.

The Preschool For All Act would impose an additional 1.7% tax on the portion of a taxpayer’s income that exceeds specified threshold amounts. The additional revenue would be used to provide funding for preschool programs. This initiative has qualified for the June, 2006, Primary election.

Proposition 63, enacted during the November 2, 2004, general election, imposes an additional tax of 1% of the amount of a taxpayer’s taxable income that is over $1 million and precludes any reduction in this tax by any otherwise allowable credits.

## OTHER STATES’ INFORMATION

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

*Illinois, Massachusetts,* and *Michigan* impose a flat tax of 3%, 5.3%, and 3.9%, respectively. *Minnesota* has a progressive rate with a maximum tax rate of 7.85%. These rates apply to the 2005 taxable year.

For taxable years 2003 through 2005, *New York* added two additional tax rates, which increased the maximum rate from 6.85% to 7.5% and 7.7%. For taxable years beginning after 2005, the rates revert back to a maximum of 6.85%.

Starting with the 2004 tax year, *New Jersey* imposes an additional tax of 2.6% on taxpayers earning more than $500,000. The additional tax increases the top tax rate from 6.37% to 8.97%. The revenue generated by the additional tax will be used to support property tax relief for the states lower income taxpayers and senior citizens.

**FISCAL IMPACT**

The department's costs to administer the additional taxes would be approximately $200,000 to make changes to the computer systems, forms and instructions, and processing procedures.

**ECONOMIC IMPACT**

Without specified percentages for the tax increase, the department is unable to provide a revenue estimate.

Using the AGI amounts provided in the bill, department staff determined that there are approximately 314,000 taxpayers with an AGI of between $200,000 and $1 million, 66,000 taxpayers with an AGI of over $1 million, and 1.7 million taxpayers with an AGI of $7,000 to $200,000 that paid self-employment tax in 2004. All of these taxpayers would be impacted by this bill.

**ARGUMENTS/POLICY CONCERNS**

Funding based on additional taxes imposed on high-income taxpayers creates uncertainty since the amount of income reported by high income taxpayers is volatile.

**LEGISLATIVE STAFF CONTACT**

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 1784
As Introduced February 24, 2006

AMENDMENT 1

On page 2, line 31, strikeout "part" and insert:

section

AMENDMENT 2

On page 3, line 17, strikeout "part" and insert:

section