**Franchise Tax Board**

# ANALYSIS OF ORIGINAL BILL

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| Author: | McClintock | Analyst: | Anne Mazur | Bill Number: | SCA 2 |
| Related Bills: | See Legislative History | Telephone: | 845-5404 | Introduced Date: | December 6, 2004 |
| | | Attorney: | Patrick Kusiak | Sponsor: | |

**SUBJECT**: Budget Process/Revenues Collected In Excess Of Appropriations Limit Shall Be Returned Within Next Fiscal Year By Rebate To PIT Return Filers In Proportion To Social Security Taxes Paid

## SUMMARY

This measure would require revenues in excess of the amount appropriated by the Legislature be rebated in the following fiscal year to personal income tax return filers in proportion to social security taxes paid.

This analysis will not address the measure's changes to other provisions of the California Constitution regarding budget enactment processes, Budget Stabilization Account, appropriations limits, and school funding as they do not impact the department or state income tax revenue.

## PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to limit state spending and borrowing, guarantee on time, balanced budgets, restore the 2/3 vote requirement for all tax increases, and return excess revenue to individual taxpayers.

## EFFECTIVE/OPERATIVE DATE

This measure would become effective the day following approval by the voters in the general election following approval of the measure by the Legislature. The measure would apply to the 2006-07 fiscal year and each subsequent fiscal year.

## POSITION

Pending.

## ANALYSIS

FEDERAL/STATE LAW

Under the California Constitution, the voters of the state have the authority to approve or reject any amendments to the State Constitution. Private citizens or groups can initiate amendments or the Legislature may place an amendment on the ballot if the proposal passes each House by a two-thirds vote. The Legislature proposes amendments to the California Constitution by passing a Senate Constitutional Amendment (SCA) or an Assembly Constitutional Amendment (ACA). Neither an SCA nor an ACA require the approval of the Governor. After the Legislature approves an SCA or ACA by two-thirds vote in the Senate and the Assembly, it is assigned a proposition number and placed on a statewide ballot for the voters to approve or reject the proposed change. Any amendment to the Constitution proposed by the Legislature and adopted by a majority vote of the people takes effect the day after its adoption.

| Board Position: | | | Department Director | Date |
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| _____ SA | _____ O | _____ NAR | Gerald H. Goldberg | 2/7/05 |
| _____ N | _____ OUA | X PENDING | | |

Currently, specific provisions of Article XIIIB of the California Constitution:

- Prohibit a government entity's annual appropriation from exceeding its annual limit, which is adjusted annually for the cost of living and population changes.
- Provide that:
  - 50% of the revenues received by the state in a fiscal year and the next fiscal year that are in excess of the amount that may be appropriated by the state for the same fiscal years, are transferred to the State School Fund.
  - The remaining 50% of the excess revenues must be returned by the state by revising tax rates or fee schedules within the next two subsequent fiscal years.

For federal purposes, refunded state income taxes previously claimed as a deduction must be reported as income on the federal return.

## THIS BILL

This measure would repeal and replace Article XIIIB of the California Constitution with the provisions of the measure. This measure would provide that revenues collected in a fiscal year that exceed the amount that may be appropriated by the state for that fiscal year must be rebated within the next fiscal year to California personal income tax filers in proportion to the total amount of social security taxes paid by every filer, spouse, or dependent covered in that tax return filing for the most recent taxable year. Until the first year in which aggregate excess revenues exceed $100 million, excess revenues may be carried forward to the next fiscal year.

## IMPLEMENTATION CONSIDERATIONS

In its current version, the measure does not address administration of the rebate program. However, presumably, Franchise Tax Board (FTB) would be responsible for this function. Unless specified in this measure, the following items, and any later identified concerns, would need to be addressed in future enabling legislation prior to the issuance of the rebates.

- Identification of the state agency responsible for administering, calculating, and issuing the rebates.

- Identification of the state agency and time frames for measuring/determining existence and amount of excess revenue.

- Authority and methodology for determining social security tax paid by the taxpayer, spouse, and dependents included on the applicable tax return filing. FTB does not collect social security tax contribution data in the course of its current tax administration activities, nor is this data readily available through other state agencies. Attempts to acquire this data from the Social Security Administration have been unsuccessful because SSA maintains the position that it is prohibited from sharing this information.

- Time frame for issuance of the rebates. This measure provides that the rebate would be in proportion to the total amount of social security taxes paid by every filer, spouse, or dependent covered in the tax return filing for the most recent taxable year. The measure also provides that, unless the aggregate excess is less than $100 million, the excess must be rebated in the fiscal year following the end of the fiscal year with excess revenue. However, personal income tax returns may be filed, with extension, until October 15. The department generally processes returns within six months of receipt, which means a majority of the returns should be processed by April of the following year. In order to calculate rebates proportionate to the social security paid, FTB would need to process all tax returns for the taxable year prior to calculating the rebate amount to ensure all eligible taxpayers are accounted for. For example, tax returns for the 2006 taxable year may be filed through October 15, 2007, and most of the processing would be complete by April of 2008. If the state has excess revenue for the 2006/2007 fiscal year, the excess may be required to be rebated by June 2008, the end of the 2007/2008 fiscal year. However, FTB could not begin calculating the rebates based on the 2006 taxable year until April 2008, resulting in a very short time frame to issue the rebates.

- Provisions of the Internal Revenue Code require reporting of state or local income tax refunds to the IRS. Although the rebate would be based on funds available from excess state revenues, and not solely derived from excess income taxes paid, it is possible that the refund would be required to be reported to the IRS and subject to federal income taxes.

- Depending on the factors determining the proportionate rebate amount, certain circumstances could result in rebate revisions. These factors include the receipt of amended returns with corrected W-2 information, IRS audit adjustments resulting in revisions to social security tax paid by wage earners and self-employed individuals, or processing errors.

- Currently, FTB, IRS, and other state agencies participate in an offset process where refunds are offset to satisfy an outstanding liability owed by the taxpayer to another government entity. Without clarification, this could be construed as either a payment of excess state revenues or a refund of taxes paid. As such, clarification would be needed on whether these payments would be subject to the agency-offset process.

**LEGISLATIVE HISTORY**

SCA 3 (McClintock, et al., 2003/2004) would have required the FTB and the State Controller to issue rebates to taxpayers, on a pro rata basis, of a portion of the revenues received by the state in excess of the amount appropriated by the state during the fiscal year. This measure failed passage with the Senate Committee on Revenue and Taxation.

SCA 16 (McClintock, 2003/2004) would have required all excess state revenues to be returned via revision of the tax rates or fee schedules. This measure failed passage with the Senate Committee on Education.

ACA 6 (Campbell, 2003/2004) and SCA 16 (McClintock, et al., 2001/2002) would have required FTB and the State Controller to issue rebates of excess revenues. These bills failed to pass out of committee.

AB 2609 (Stats. 1987, Ch. 915) and SB 47 (Stats. 1987, Ch. 908) authorized a tax rebate of excess funds for the 1986 taxable year. Qualified taxpayers were allowed a tax rebate of 15% of the tax imposed by the income tax law, as defined, with specified minimum dollar limits and maximum dollar limits. The rebate was calculated and administered by FTB. The Controller was required to send rebate checks to taxpayers by January 15, 1988.

## OTHER STATES' INFORMATION

A review of the state laws and constitutions of *Florida*, *Massachusetts*, *Michigan*, and *Minnesota* revealed the following:

- *Florida*, which has no personal income tax, requires excess revenues to be refunded to taxpayers.
- *Minnesota* requires excess revenues to be refunded to the taxpayers in the form of sales tax rebates.
- *Massachusetts* allows a credit, called the "excess revenue credit," toward taxpayers' personal income tax liabilities.
- *Michigan* requires excess revenue to be refunded on a pro rata basis that is based on the liability reported on the Michigan income tax and single business tax returns.

A review of *New York* and *Illinois* state laws and constitutions did not produce any information regarding procedure for excess revenues. The laws of these states were reviewed because of similarities to California income tax laws.

## FISCAL IMPACT

As written, this measure would not impact the department's programs and operations. However, depending on the level of responsibility given to the department, costs could be significant. At a minimum, the department would need to implement a system to calculate, issue, and track the rebates proposed in this bill. In addition, the department could have to reissue rebates returned as undeliverable or deposited into escheat, comply with additional revenue reporting requirements for rebates, and report on rebates within the offset program. It is likely that the department would receive additional phone calls and visits to field offices from taxpayers inquiring about the random selection of taxpayers receiving rebates.

## ECONOMIC IMPACT

This measure would not impact personal income tax or corporate tax revenues.

## LEGISLATIVE STAFF CONTACT

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