Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Gaines, et al.	Analyst:	Anne Mazur	Bill Number:	ACA 3
Related Bills:	See Prior Analysis	Telephone:	845-5404	Amended Date:	June 4, 2007
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Expenditure Limits/50% Of Excess Revenue Shall Be Allocated In Equal Amounts Into Reserve Account, To Personal Income Taxpayers As Rebates & To Fund Health & Dental Care Benefits For State & University Annuitants

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

_____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended _____.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO _____.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED December 4, 2007, STILL APPLIES.

__X__ OTHER – See comments below.

SUMMARY

This measure would require a portion of revenues in excess of the expenditure limit to be rebated to personal income taxpayers.

This analysis will not address the measure's changes to other provisions of the California Constitution regarding expenditure limits, local mandates, and school funding as they do not impact the department or state income tax revenue.

SUMMARY OF AMENDMENTS

The June 4, 2007, amendments made the following changes:

- Added coauthors from both houses.
- Revised the allocation of revenues in excess of the expenditure limit.

Except for a revised This Measure section provided below, the analysis of the bill as introduced December 4, 2007, still applies. Implementation Considerations, Fiscal Impact, and Economic Impact sections of the analysis of the bill as introduced December 4, 2007, are provided below for convenience.

Board Position:			Legislative Director	Date
_____ S	_____ NA	_____ NP		
_____ SA	_____ O	_____ NAR	Brian Putler	7/10/07
_____ N	_____ OUA	__X__ PENDING		

POSITION

Pending.

ANALYSIS

THIS MEASURE

This measure would repeal and replace Article XIIIB of the California Constitution. Specifically, this measure would include, but is not limited to, the following changes.

- Total General Fund and special fund spending in a fiscal year may not increase from the prior fiscal year by more than the percentage increase in the cost of living, as defined, multiplied by the percentage increase in the state population. However, if in the previous fiscal year, total spending was less than that allowed, then the total spending for the next fiscal year could equal, but not exceed, the amount of allowable spending for the previous fiscal year. Exceptions would be made for emergencies, as defined in this measure.
- Any revenue that may not be spent in the current fiscal year due to the spending limit above would be allocated as follows:
    - 50% to the State School Fund.
    - 50% to the following, allocated in equal amounts:
        - To the Special Reserve Account within the General Fund. Money in the reserve account may be spent subject to the specifications of this measure.
        - To all personal income taxpayers as a rebate. The rebate would be proportionate to the tax liability for the tax year that encompasses the first half of the current fiscal year in which the excess exists.
        - To a trust fund established to fund health and dental care benefits for annuitants, as defined, related to employment by the State of California or the California State University System. No allocation would be required in a fiscal year if there were no unfunded actuarially accrued liabilities relating to such benefits.
- To prevent an increase in the level of allowable state spending, if the financial responsibility of providing a service is transferred, in whole or in part, from the state government to a local government, then the total amount of allowable state spending for the year of the transfer shall be reduced by an amount equal to the cost of providing the transferred services. Such a reduction would not apply for mandated programs or level of service for which reimbursement is required.

IMPLEMENTATION CONSIDERATIONS

The Revenue and Taxation Code requires the Franchise Tax Board (FTB) to administer and enforce the income and franchise tax laws. This constitutional amendment presumably would require FTB to oversee the issuance of rebates because the amount of the rebate is connected to the taxpayer's tax liability on their personal income tax return.

Department staff has identified the following implementation considerations for purposes of a high level discussion; additional concerns may be identified as the measure moves through the legislative process. In order for FTB to implement this measure, clarification is necessary for the following issues:

- Clarification of the term "proportion." Under this measure, funds must be rebated to California personal income taxpayers in proportion to their tax liability for the tax year that includes the first half of the current fiscal year in which the excess exists. It is unclear what specific criteria or measures FTB would use to determine the proportionate share of rebate for each taxpayer. The following questions should be addressed:
    - Would there be a minimum or maximum rebate amount?
    - Would the phrase "proportion to their tax liability for the tax year" mean that the taxpayer would receive a rebate in proportion to their tax liability in comparison to the total tax liability of all PIT taxpayers for that tax year?
    - Would <u>all</u> PIT taxpayers—including part year and nonresidents—with a tax liability, regardless if the liability is paid, be included in the proportional measure and potentially receive a rebate?
- Timeframe for the issuance of the rebates. This measure provides the rebate is in proportion to the taxpayer's tax liability, but does not specify when the rebates should be issued. 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 tax returns should be processed by April of the following year. In order to calculate rebates proportionate to the tax liability, FTB would need to process all tax returns for the identified tax 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 until October 15, 2007, and most of the processing completed by April of 2008. Therefore, if the state has excess revenues for the 2006/2007 fiscal year, FTB may be able to begin calculating the rebates in April 2008 based on the 2006 taxable year.
- Provisions of the Internal Revenue Code require reporting of state or local personal income tax refunds to the Internal Revenue Service (IRS). The rebate would be required to be reported to the IRS and may be subject to federal income taxes. The department would have to make computer system changes to account for and track rebates for reporting purposes because the reporting volume would increase to include all individual taxpayers that paid tax.
- Depending on the factors to be used in determining the proportionate rebate amount, certain circumstances could result in rebate revisions. These factors include the receipt of late filed returns, amended returns, audit adjustments resulting in revisions to franchise or income tax paid, and processing errors.
- Currently, FTB, IRS, and other state agencies participate in an offset process where refunds are applied to satisfy an outstanding liability owed by the taxpayer to another government entity. The rebate 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 or could be offset against a taxpayer's unpaid income tax liabilities for other years.

If these concerns, and additional concerns that may be identified, are not clarified in this measure, then the department would need future enabling legislation prior to the issuance of the rebates.

In addition, if FTB were responsible for issuing the rebates proposed by this measure, the department would need to create a new system and modify existing accounting and collection systems for issuing and processing the rebates. This measure does not include an appropriation to cover the costs of developing new and modifying existing systems for issuing and processing the rebate. Without an appropriation, the department would be required to redirect resources from revenue producing activities to implement this measure

FISCAL IMPACT

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 measure. 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 a significant number of additional phone calls and visits to field offices from taxpayers inquiring about the rebates.

The additional costs cannot be determined at this time, but are estimated to be significant. It is recommended that the bill be amended to include appropriation language that would provide funding to implement this bill. Lack of an appropriation will require the department to secure the funding through the normal budgetary process, which will delay implementation of this bill.

ECONOMIC IMPACT

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

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